

**Penulis Jemputan / Guest Commentary**  
**Takaful – Development and Challenges**  
**Over 20 Years of Its Existence in Malaysia**

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**ABSTRACT**

*Even though the fundamentals of takaful were laid centuries ago, its modern form only appeared in the last twenty five years. Its growth had been remarkable especially in Malaysia. Despite of the impressive growth rate, its penetration rate compared to that of insurance is still minimal. Being a relatively recent phenomenon, takaful operators need to provide a credible, effective, efficient and significant alternative against conventional insurers. In order to be more relevant in the marketplace, they need to increase the awareness of the masses, relook at their present distribution channels, keep abreast with the latest technologies, introduce new appropriate products and reposition themselves more as a risk management advocator and these need to be done in earnest and immediately.*

**ABSTRAK**

*Walaupun asas-asas yang mendasari takaful telah pun digarap berkurun yang lalu, kemunculannya dalam bentuk kini wujud hanya dalam dua puluh lima tahun yang lepas. Kadar pertumbuhannya, lebih-lebih lagi di Malaysia, amatlah menggalakkan. Namun demikian, sekiranya dibandingkan dengan insurans, kadar penembusan takaful di pasaran masih lagi kecil. Sebagai satu fenomena yang baru secara relatifnya, pengendali-pengendali takaful perlu menyediakan satu alternatif yang meyakinkan, efektif, efisien dan signifikan setanding dengan insurer-insurer yang sedia ada. Untuk menjadikan mereka lebih relevan di pasaran, pengendali-pengendali ini perlu meningkatkan kesedaran masyarakat mengenai takaful, mengkaji balik saluran-saluran pengeluaran yang sedia ada, sejajar dengan insurer-insurer lain dalam penggunaan teknologi terkini, menyediakan produk-produk baru yang sesuai serta memposisikan diri mereka sebagai pengamal pengurusan risiko dan perkara-perkara ini perlu ditangani secara serius dan segera.*

## INTRODUCTION

Up until 25 years ago, both the Muslims and Non-Muslims had only one means of insurance protection that is, via the conventional insurers. Today, the world had witnessed the emergence and development of *takaful* which is often viewed and perceived myopically synonymous to Islamic Insurance. The formation of the first *takaful* company in 1979 in Sudan is a culmination of a historical legacy dated way back as early as the 6<sup>th</sup> century when the system of *Al-Aqila*, as practised by the pagan Arabs, was approved and used by the Prophet (S.A.W) in his judgement in solving a dispute between two women from the Huzail tribe (Khan 1979). Documents enunciating the *Aqila* principle were also found in the Constitution of Medina written in 622 A.D. The *Al-Aqilah* scheme is based on an annual contribution into a fund from which disbursement will be made to victims of accidental murder to those who lost their belongings, etc. Besides the *Al-Aqilah* scheme, there were the *Al-Qasamah* scheme and the *Al-Muwalah* scheme. These schemes work on the principal of communal mutual cooperativeness which is also known as *takaful Al-Ijtima'i*. In fact, as narrated by historians, this form of Islamic insurance had existed in the early part of the 2<sup>nd</sup> century Hijrah. It was then adopted by the traders plying between Arab countries to India and the rest of Asia. Later these concepts were adopted by the Europeans and named marine insurance. In business, this concept of mutual cooperation against losses and calamities is known as *takaful Al-Tijari*.

Gradually, the developments were further enhanced during the beginning of the 19<sup>th</sup> century when a Hanafi lawyer, Ibn Abidin (1784-1836) became the first Islamic scholar who came up with the meaning, concept and legal entity of an insurance contract (Klingmuller 1969).

However, due to the conflicting views amongst the Muslim Scholars, this concept was not developed into a financial institutional framework. Views among the Muslim Scholars about insurance differ sharply such as:

- Insurance is totally 'haram' because of its uncertainty and aleatory nature;
- Insurance can be accepted in its current form because of its necessity in nature as there are no 'nas' against conventional insurance; and
- Commercial insurance contain elements of *Al-Gharar*, *Al-Maisir* and *Al-Riba* and if these elements can be avoided, then Muslims can accept insurance.

Even though majority of the muslim scholars are of the opinion that the conventional insurance practised today is not syariah compliant, however, on closer look many do not object to the concept of insurance where 'the fortunate many supports the unfortunate few', but rather they questioned the contract or the practice. For instance, according to Yusuf Qardawi (1995: 276), a prominent muslim scholar:

Our observation that the modern form of insurance companies and their current practices are objectionable Islamically does not mean that Islam is against the concept of insurance itself; not in the least, it only opposes the means and methods. If other insurance practices are employed which do not conflict with Islamic forms of business transactions, Islam will welcome them.

From the excerpt it is quite evident that respected scholars such as Yusuf Qardawi do agree that the concept of insurance is permissible, however modifications need to be in place to take care of the issues that are found in the contract and practice of insurance.

### DEVELOPMENT IN MALAYSIA

In Malaysia, on June 15 1982, the Majlis Fatwa Kebangsaan (National Fatwa Council) deliberated on the question of life insurance. Consensually, the members of the Council decided that life insurance as practised by insurance companies is a 'fasid' (defective) transaction as it is contrary to the Syariah principles of contract. Subsequently in 1982, the working committee (Badan Petugas Khas) to set up the Islamic Consultative body to study the formation of an Islamic insurance company in Malaysia recommended the formation of Islamic Insurance institutions which are now known as takaful companies. The decision of the jurists to formulate the takaful program as in agreement with the Syariah legal maxim: "all things originally are permissible unless there is evidence to prove their prohibition." This principle as agreed by all Muslim Scholars, is that the financial instruments that exist in the current economy and the benefits derived from them are essentially from man's use and as such are permissible. Accordingly, the Quran states (verse 31.20):

Do not see that Allah has subjected to you whether is in the heavens and what is on earth, and has showered upon you His favours, both apparent and unseen? Allah has given man control over their use and it is not logical that (may He be glorified) their use is forbidden as He has bestowed man with his "favours" In fact He has prohibited only a few things for specific reasons because they are harmful for man, the true negative repercussion of which is in the hands of Allah. Allah knows what man does not.

To legislate the activities of takaful, the government of Malaysia introduced the Takaful Act 1984 which formally regulates and oversees the development and transactions of the takaful business so as to run in parallel to the long existing insurance industry.

The development of Islamic insurance in Malaysia has thus far evolved a three-phase cycle. In the first evolutionary phase back in the 60s and 70s saw a surge of Islamic fervour and calls for the establishment of an Islamic

financial system. Scholars and Muslims jurists in many parts of the world discussed and put forth the idea of introducing an Islamic financial system which is interest-free and uncertainty-free that is, Syariah compliant.

Then came the second phase, the nurturing phase, which took place during the 80s. It is during this phase that some of the fundamental infrastructure namely the Islamic Banking Act of 1983 and the Takaful Act of 1984 (the only one of its kind in the world) were formulated. Subsequently then, came the first prototype model of Bank Islam in 1984 and Syarikat Takaful Malaysia in 1985. Their existence remain unperturbed for many years perhaps due to the fact that the government wants to ensure that the Islamic system rudiments were given a fairly even chance to grow and be on a sound footing.

The 90s and the early years of the 21<sup>st</sup> century witnessed another phase in the development of the Islamic financial system in Malaysia. In this so-called consolidation phase saw the emergence of competitive elements within both Islamic Banking and insurance sector. Conventional banks were allowed to introduce 'interest-free banking' windows and Bank Negara Malaysia also issued three more new Islamic bank licences. Three new takaful licences were also issued to MNI Takaful Sdn. Bhd (later known as Takaful Nasional Sdn. Bhd), Mayban Takaful Berhad, and Takaful Ikhlas Sdn. Berhad. The presence of these new players had somewhat introduced competitive forces in the respective marketing environment which in turn had influenced both marketing and consumers decisions and activities. The competition spurred more vigorous marketing activities in the form of more varied products, more promotions and competitive prices.

#### GROWTH

Today there are more than 30 registered takaful companies worldwide, operating either writing directly or placing it through Islamic windows or marketing agencies. The size of the global takaful business was estimated at approximately US\$500 million for both the life and non-life business. Of this, 56% of the business was written in the Middle East, 7% from Africa, 36% from Asia and 1% from Europe and the United States. According to the forecast made by the Arab Insurance Group (ARIG) based in Bahrain, the takaful market will be worth US\$2.1 billion by the year 2010 (Beatty, 1997: 16).

In Malaysia (over the period 1986-2000), the total takaful contribution recorded an average growth rate of 47%. On the family takaful business (life), the total participation in force increased from RM16.7 million in 1986 to RM25.6 billion in 2000. The takaful fund assets of both family and general takaful have registered an average rate of 68% over the same period (Bank Negara Malaysia 2001: 148).

Table 1 indicates the number of new family takaful business acquired over the last 5 years. A further indication of the growth is shown in Table 2 and Table 3 which indicated the amounts of premiums collected and the assets of the takaful funds respectively.

TABLE 1. Number of new policies and amount of premium, 1999-2003

Year	No. Of New Policies (Unit)	Amount Of Premium (RM, Million)
1999	100,511	154.6
2000	209,256	297.3
2001	229,199	368.8
2002	237,037	452.2
2003	265,035	511.0

Source: *Takaful Annual Report*, Bank Negara Malaysia

TABLE 2. Amount of premium by type of takaful products, 1999-2003

Year	Amount of premium (RM, Million)		
	Family Takaful	General Takaful	Total
1999	238.0	107.8	340.8
2000	373.0	149.7	522.7
2001	520.8	180.2	701.0
2002	667.5	222.2	889.7
2003	762.5	251.5	1,014.0

Source: *Takaful Annual Report*, Bank Negara Malaysia

TABLE 3. Asset size by type of takaful products, 1999-2003

Year	Asset size (RM, Million)		
	Family Takaful	General Takaful	Total
1999	607.4	227.0	834.4
2000	1,542.4	330.5	1,872.9
2001	2,644.7	374.8	3,019.5
2002	3,162.8	464.1	3,626.9
2003	3,861.0	568.1	4,429.1

Source: *Takaful Annual Report*, Bank Negara Malaysia

## CHALLENGES

Despite the thriving rate of growth as witnessed in Malaysia over recent times, the level of market penetration in terms of takaful certificates over the total population is only about 5% compared with a market penetration of over 30% for the conventional insurance business. The question now is, will the takaful industry in Malaysia be able to achieve the daunting target of capturing 20% of the insurance market share by 2010 as set by Bank Negara Malaysia (Bank Negara Malaysia 2001. 150). Is the domestic takaful industry strategically positioned and robust enough to face the ever challenging financial environment?

## AWARENESS

Even after a presence of almost twenty years in Malaysia, the concept of takaful is still alien to some and vague to many. There are still many in Malaysia asking the basic question, "what is the difference between takaful and insurance,?" Why is this so? Is the target segmentation of takaful products skewed towards a certain sector of the market, or being Islamic, is takaful should only be accepted by the Muslims? Are the marketing strategies adopted presently open enough to the general public? Are there constraints that prohibited Non-Muslims to participate?

Takaful is a knowledge-based product and as a relatively new concept ought to be appropriately positioned and widely promoted so as to create the awareness to the public before products are introduced. The information disseminated thus far through the various channels of the media is neither regular, sufficient nor impactful.

As a service-oriented product, takaful inherits unique characteristics such as intangibility, inseparability, heterogeneity and perishability that could greatly affect its marketing process especially the type of distribution channel to be utilized. Takaful operators should be fully aware that as an intangible-dominant product, takaful services are not easily promoted. The intangibility aspect of the product makes it difficult to depict in advertising, whether the medium is print, television or radio. Takaful advertising should thus emphasized tangible cues that will help consumers understand and evaluate the service. The cues may be physical facilities in which the service is performed or some relevant tangible object that symbolizes the service itself. Personal selling and contact with the customer are very important parts of the promotional program for service operators.

## DISTRIBUTION

Distribution is a major factor in developing service-marketing strategy because of the inseparability of services from the producer. In view of the low exposure of takaful to the public, the role and the number of the

different channels that is to be made available is vital. The dissemination of information can make use of the various distribution networks; be it through the agents, brokers, banks, government agencies, cooperatives and others. The agency system, for instance, is central in the insurance marketing process especially in the life insurance sector. For years, it had been proven that the agency system have been effective and successful in marketing insurance products globally. However, despite this fact, there are operators in the Malaysian takaful industry who do not subscribe to the agency concept.

In an effort to enhance this basic marketing approach other means of channelling are also presently employed such as:

1. Through bancassurance – the selling of takaful products at bank counters. The products could either be a direct takaful product or a product designed jointly by the bank and the takaful operator. Besides the banks, in Malaysia, the post office is also involved in out-letting takaful products;
2. Through database marketing/telemarketing – an operator would be able to cross sell products. However, using this approach, the product to be recommended ought to be simple and easy to administer; and
3. Through the use of internet – with the advent of e-commerce the use of internet to market takaful products becomes inevitable and necessary.

#### POSITIONING

Another important aspect a takaful operator has to develop in facing the insurance market that is congested with the various insurance companies is the art of positioning. Positioning starts with a product. The process of positioning involves the process of shaping the way customers perceive the product.

The religious compatibility that is directly linked to takaful products is dear to the heart of many Muslims. Coupled with a quality service and competitive price a takaful operation should not face any resistance from the Muslim Ummah. In this form of niche marketing, Islamic values can positively be used to position takaful products in facing the Muslim markets. On the other hand, the excellent service, comparatively good product and competitive price plus some other extra features such as profit sharing (*mudharabah*) can attract non-Muslims to participate in the takaful ventures. In positioning the business, one has to be mindful of many questions and situations. For example, what position do we own and what position do you want to own? Whom must you outgun? Do you have the resources to do it? In positioning, one must understand the role of words (especially in advertising); how words affect people and subsequently create change. To uphold positioning we need vision, courage, objectivity, simplicity, subtlety, patience and willingness to sacrifice. Finally in this day and age we also need a global outlook.

#### NEW PRODUCTS

As the years progressed the world faced a whole range of new risks that were unknown before. Some risks accompanied advancing technology and some have arisen from changes in the legal environment and include potential liability that existed due to environmental change, discrimination in employment, violence in the workplace, interruptions of business resulting from computer failures, privacy issues, computer fraud, electronic larceny, nuclear hazards, malpractice and others. Their risks, most of which are insurable, invite the insurance fraternity to develop appropriate insurance coverage to protect the victims from financial losses. Likewise, takaful operators also have to be wary of such risks and their takaful implications.

As for family takaful or life insurance, the community at large are in need of coverage pertaining to the issues of education of children particularly to institutions of higher learning; the problem of hospitalization; the emergence of coverage against dreaded diseases; and the question of superannuation and pension funds.

To handle the proliferation of new risks, the research and development of new risks, the research and development (R&D) department of takaful operators should be watchful to the requirements of new products, so as to meet the demand of customers. These products can be presented on an individual basis or as a package consisting of several general takaful risks or as a package that combined general and family takaful risks. Often, takaful operators also have to mold a customized product that is tailor-made for a particular customer. In short, to meet the current customers' needs, the takaful operators have to be alert so as to remain competitive in the marketplace.

#### IMPACT OF INFORMATION TECHNOLOGY

The impacts of Information Technology (IT) on the takaful industry are several. Firstly, as mentioned above, the impending impact of IT; namely, computers to the business environment have pushed insurance and takaful operators alike to offer coverage for potential financial losses that can occur due to business interruption caused by computer failures, computer fraud and the like.

Secondly, computers, being an important and essential tool that could provide new sources of information on potential loss problems for loss managers. They are a means by which a much improved risk management information system can be developed to assist decision making and a supplement to quantitative tools that can make risk and loss measurement feasible and practical.

Thirdly, IT provides an efficient back-end support system that a takaful operator could not afford to go without. All processes pertaining to an efficient takaful operation are automated; even to the extent that it can be handled by a computerized intelligence system.



Lastly, IT can also assist the takaful industry in the area of marketing. Internet is the gateway to the future electronic transactions of the takaful business. The volume of business through this channel will be expected to increase exponentially as the years go by.

However, IT, when viewed from a security and safety standpoint, can bring us a new set of problems to a takaful organization. Disaster recovery systems have to be installed to safeguard the extremely valuable equipment and records vital to the organization. Sophisticated fire extinguishing systems need to be installed, sabotage and vandalism must be prevented, employee fraud and espionage by competitors checked and in the event of loss of electric power, back-up alternative power sources ought to be in hand.

#### RISK MANAGEMENT

Risk management can be defined as a comprehensive, integrated and a systematic process of treating risks. Under risk management, there are two sets of tools; namely, risk control and risk financing measures of which insurance/takaful is one of them. In other words, insurance or in this case takaful, is a subset of risk management.

In an advanced economy like the United States, risks are increasingly handled through the process of risk management. In so doing, a client is exposed not only to risk financing tools such as takaful coverage but also to other risk control measures which include risk avoidance, combination, segregation, diversification as well as loss prevention and loss reduction. This means that when a risk management package is offered to a client, a combination of risk control and risk financing tools are being utilized. As such, takaful operators should position themselves as risk management providers that are more comprehensive and integrative in nature.

#### RETAKAFUL

Any discussions about takaful would inevitably involved the activity of retakaful or reinsurance because the underwriting process is closely related to reinsurance and the underwriter's ability to accept risks especially large ones will depend on the availability of reinsurance or retakaful.

Currently, the presence of retakaful in the global marketplace can be considered negligible. The present takaful operators are largely supported by the conventional reinsurers. Therefore, it is of utmost urgency that this missing link problem be addressed either by the present takaful operators or other interested parties to venture into this important lifeline of the takaful industry.

#### INVESTMENT ISSUES

One of the prerequisites for a takaful operator to develop better and more viable product is a successful development of Islamic investments. Currently,

the range of investment instruments is still limited. The growth of takaful could provide good opportunity for Islamic banks and funds managers to invest their funds on a long term basis. These institutions, together with their takaful counterparts, need to nurture this close symbiosis in order to find the way forward in developing long-term investment instruments. In order to provide effective fund management services, the banks and fund managers should understand the long-term asset-liability matching requirements of takaful companies. This partnership is most essential and vital in order to sustain a more durable and sustainable takaful industry.

#### STRATEGIC ALLIANCES

With the Islamic resurgence seen worldwide, many countries especially those with a substantial Muslim population have come to grips with the reality of instituting an Islamic financial system within their economy. Such a system will take time to develop and without trying to reinvent the wheel, one possible short-cut approach would be to foster strategic alliances with countries or organizations that are already involved in the business. With the expansion of takaful industry worldwide the spread of risk through reciprocity and exchanges would be better served. This would also perhaps spur the formation of more and bigger retakaful companies to ensure better management of the takaful fund.

#### CONCLUSION

As we proceed further into the millenium, takaful operators will face many more challenges with liberalization going into full steam. The bigger, more efficient conventional insurers will be expanding their market share at the expense of takaful operators. Takaful operators must shift their paradigm by constantly reforming and reengineering their business in order to face the increased competition within and outside the industry; to face the inevitable trend of the convergence of financial products; to meet the ever demanding customer for better quality services; and to accept and adopt the sophistication of the cyber world.

Takaful, being a relatively recent phenomenon in Malaysia, needs to be known, broadcasted and campaigned so as to increase the awareness of the masses. Such awareness will increase the desire to opt for an Islamic based financial product. Better and efficient distribution channels to retail such products are essential and in this era of advanced information technology, IT is paramount as a vehicle to make all this happen. More retakaful operators should come into the scene to stimulate the industry. More Islamic investment instruments are necessary from the various financial institutions so as to ensure takaful move forward with a more dynamic and progressive outlook.

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