POTENTIAL OF TAKĀFUL IN PAKISTAN: OPERATIONAL AND TRANSFORMATIONAL PARADIGM

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ABSTRACT

Potential of *Takāful* in Pakistan: Operational and Transformational Paradigm

Takāful is an Islamic way of doing insurance. It proved its viability after several *Fatwās* were issued by *Ulama* and *Fiqh* academies in its favour. Presently, over 100 *Takāful* and *Re-takāful* companies as well as *Takāful* windows under conventional insurance are operating across the world. Enhanced financial performance of selected *Takāful* companies has shown the growing interest in *Takāful* business across the world. Insurance comparison in Muslim and advanced countries as well as in the South Asian region has identified low literacy, low GDP per capita and low GDI value as the probable causes of low insurance penetration in Pakistan. Geographical spread of *Takāful* business and estimated future potential together with the increasing trend of insurance business indicated that potential for *Takāful* business exists in the country. It urges the policy makers to pay attention to global indicators that might become potential contributors to *Takāful* business. The study emphasizes that strengthened regulatory standards, with *S̲harī'ah* compliance mechanism playing a central role, are essential to transform conventional insurance system and exploit the existing business potential.

To further analyze which of the *Takāful* standards are significantly affecting *Takāful* practices, a survey of *Takāful* operators in the country indicated that reporting standards and internal controls have low level of observance in Pakistan. The survey of 150 life insurance customers revealed that majority of the respondents is unaware of *Takāful* concept. Level of *Takāful* awareness was found to be significantly associated with the education of the customers, their perceptions about *Takāful* and their intentions to shift to *Takāful* Company. Education was found to be the single important factor affecting monthly income of the respondents, their state of mind and hence their awareness about *Takāful*. The study identifies effective regulatory framework a critical factor for the success of *Takāful* business in Pakistan. A greater focus on promotion of *Takāful* and governance issues along with strengthened role of SECP as a regulatory authority is likely to contribute for further growth of *Takāful* industry in Pakistan.

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LIST OF ABBREVIATIONS

AAOIFI – Accounting and Auditing Organization for Islamic Financial Institutions

ASEAN – Association of South East Asian Nations

BMA – Bahrain Monetary Authority

BNM – Bank Negara Malaysia

IAIS – International Association of Insurance Supervisors

ICDPS - Islamic Corporation for the Development of Private Sector

ICMIF – International Cooperative and Mutual Insurance Federation

GDI – Gender Development Index

GDP – Gross Domestic Product

IDB – Islamic Development Bank

IFSB – Islamic Financial Services Board

IIRA – International Islamic Rating Agency

MOU – Memorandum of Understanding

NIC – National Insurance Company

NTUC - National Trades Union Congress

OECD - Organization for Economic Co-operation and Development

OIC - Organization of the Islamic Conference

PA – Personal Accident, Participant's Account

PSA – Participant's Special Account

PTF – Participants' *Takāful* Fund

PKTCL – Pak-Kuwait *Takāful* Company Limited

PRCL – Pakistan Reinsurance Company Limited

SBP – State Bank of Pakistan

SECP – Securities and Exchange Commission of Pakistan

SLIC - State Life Insurance Corporation

STMB – Syarikat *Takāful* Malaysia Bhd.

UNDP – United Nations Development Program

WB – World Bank

CHAPTER 1

INTRODUCTION

1.1 SIGNIFICANCE OF THE STUDY

Over the last few years insurance is increasingly recognized as an important component in poverty alleviation strategies. Poor households face difficulty in generating regular and substantial income to save for future and are extremely vulnerable to economic, political, and physical downturns. A little drop in income or increase in expense can have a disastrous effect on their already low standard of living. They have limited access to health care facilities; have low literacy rate and poor living conditions. Death, sickness, or accident may force them to dispose their property or some of the productive assets, which in turn further decreases future income and current livelihood. The frequency of losses is also greater for the poor; many are regularly exposed to natural disasters (like flood), fire, and theft with limited means of recovery (Patel, 2004; pp.3-4).

Given the dominance of western culture and values as well as plight and vulnerability of today's Islamic world, there has always been an incessant conflict between the two civilizations. Muslims have always been struggling for decades at almost every walk of real life to retain their values and culture. The philosophy behind such struggle is underpinned in powerful expression of collective identity that is multiple and highly diversified following the contours of each culture and historical formation of each identity. The feeling of this collective identity has urged Muslim scholars to find solutions of current economic problems to make their lives compatible with *Sharī'ah* and to safeguard the Muslim *Ummah* against the perils of the western culture. (Yusuf, 2006; pp.56-63)

As a manifestation of this philosophy behind the theory of collective identity, Islamic finance has emerged as a full fledged discipline in the last two decades. There is urgent need to produce experts in this field to meet the ultimate desires of Muslims as they do not want to live in a state of contradiction between the demands of their faith and realities of life. *Takāful*, a significant element of Islamic finance is a need of today's Muslim world for their sustainable development and to liberate them from the vicious circle of poverty trap and exploitive tools of conventional system.

An attempt has been made in this thesis to identify *Takāful* as an important financial instrument and its crucial role in the development of the country. It is an effort to create awareness of *Takāful* concept among general public and to eliminate misconceptions related to prevalent concept of conventional insurance.

1.2 REVIEW OF LITERATURE

From the beginning, the concept of insurance has been misunderstood and misinterpreted by Islamic scholars as well as the Muslim community. Conventional insurance has been widely criticized by Islamic jurists and *Ulama* because of its detrimental and illegal elements such as uncertainty, gambling and interest that are repugnant to *Sharī'ah* (Musleh-ud-Din, 1982; p.143). There have been conflicting views among *Ulama* regarding the validity of insurance and some of them have considered it haram, illegal and unislamic without providing any alternative to the general public. These misperceptions together with the issues such as low literacy, low per capita income etc. are the key factors for low penetration of insurance in many Muslim countries including Pakistan (Sigma, 2006).

1.2.1 VIEWS OF ISLAMIC SCHOLARS

According to Billah (2003a; pp.26-27), views of the Muslims scholars about insurance can be divided into three classes:

First group of scholars and Islamic jurists has a moderate view about insurance. It accepts all forms of insurance (including life and general insurance) provided that income from investment of funds does not contain element of interest. This group of scholars maintains that insurance has remained present in one form or the other in early Islamic life and it should be considered an essential part of planning in life.

The second group of scholars partially accepts the insurance practices. It is of the view that life can not be insured as the event is uncertain and it also involves gambling so we are placing a small amount (life policy premium) in return for a huge amount (maturity value of life policy). Another reason for which life insurance is objectionable to this group is that it contravenes the law of *Mirath* and *Wasiyah* which states that benefits of insurance policy should be passed on to the legal heirs of the deceased and not the absolute beneficiary as usually in case of life insurance. However, this group has no objection on general insurance practices to cover any material loss until and unless it does not involve element of interest.

The third group of Islamic jurists entirely rejects the insurance practices in all its forms. It is of the view that insurance business is illegal and repugnant to *Sharī'ah* as it contains the elements of *riba, maisir* and *gharār* which are strictly prohibited by the *Shari'ah*.

1.2.2 OBJECTIONS ON CONVENTIONAL INSURANCE

According to Ghifari (2003; p.3), the Islamic Jurists and the Muslims economists, e.g. Prof. Muhammad Abu Zahra, Dr. Isa Abdoho, Muhammad Ali al-Bulaqi (from Egypt), Mufti Muhammad Shafi, Mufti Wali Hasan, etc., from Pakistan, Mahdi Hasan, Muzhari, Muhammad Zafiruddin, Syed Uruj Ahmad Qadri etc., from India have criticized and reproved modern capitalistic insurance for certain reasons, from *Sharī'ah* view point. Here is a summary of their worthy opinions:

- That this system is born and nourished by *riba* which is not only unlawful from religious point of view but also it is the greatest hurdle in the circulation of wealth and a most effective tool for the concentration of wealth into a few hands.
- That it is of an uncertain nature.
- That it is game of chances.
- That it involves some unjust conditions, which are unlawful in Islam.

According to Yusof (1990; pp.40-41), generally, the accepted view of the jurists is that the present day insurance does not; in its present form conform to the rules and requirements of *Sharī'ah* due to following exploitive tools that are detrimental for the society.

a. Al-gharār:

There is the element of *al-gharār* (uncertain or unknown factors in the operation of a contract) in both the life and general insurance contracts. Nature of such contracts is uncertain as neither of the two parties exactly knows the amount of compensation as well as exact time of occurrence of event. According to *Sharī'ah* scholars, the sale in which no physical commodity exists at the time of contract is void under *Sharī'ah* and hence prohibited. In case of insurance, both the physical existence and time of occurrence of an event is unknown so sale of insurance contract is prohibited in the eyes of *Shari'ah.*

b. Al-maisir:

There is the element of *al-maisir* (or gambling) which arises as a consequence of the presence of al-gharār, in particular in the case of life insurance. When a life policy holder dies before the end of the period of his insurance policy after paying only part of the premium, for example, his dependents will receive certain sum money which the policy holder in the first place is not informed of how and from where it is to be derived.

c. Al-riba:

Sharī'ah scholars object that there is an element of *al-riba* (interest) in the investment activities of conventional insurance companies. *Sharī'ah* prohibits all the guaranteed and risk-free returns on investment, Rather it emphasizes on real production of goods which involve risk and return.

1.2.3 IDEA OF *TAKĀFUL*

Takāful is an Islamic way of doing insurance. It is an alternative to conventional insurance and also called Islamic insurance. Basically, the word *Takāful* is derived from the Arabic word *'kafl'* which means guarantee or responsibility (Billah, 2003b; p.19). *Takāful* literally means mutually guarantee and solidarity. *Takāful* act 1984 of Malaysia defines *Takāful* as "*a scheme based on mutual assistance, which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for the purpose*". Thus it is a financial transaction of a mutual co-operation between two parties to protect one of them from unexpected future material risk.

From management point of view, *Takāful* is a system whereby a group of people called participants who agree to pay a certain amount to a fund called *Takāful* fund. The fund is managed by a trustee called *Takāful* Company (also called a *Takāful* Operator) who invests the fund in *Sharī'ah* based instruments. Participants are compensated out of this fund in case a loss or catastrophe occurs to any of them.

Takāful has emerged as a way of doing insurance in Islamic way which is free from exploitive tools of conventional insurance (i.e. *al-gharār, al-maisir,* and *al-riba*). It has grown at an accelerating rate for the past two decades though the roots of *Takāful* could be found since the period of Holy Prophet (SAW) by the practices of *`al - 'Āqilah* among Arab tribes (Billah, 2003b; pp.5-7).

1.2.4 EMERGENCE FROM HISTORICAL PERSPECTIVE

Emergence of *Takāful* practices can be traced fourteen centuries back from the practices of *al-aqilah* among the ancient Arab tribes before the period of the Holy Prophet Muhammad (SAW) (Billah, 2003b, p.3). The central idea of the doctrine of '*aqilah'* was that everybody among the Arab tribes was bound to pay a fixed amount of money to a fund that was ursed to pay to the heirs of the victim as a blood money. The purpose behind was to provide financial protection to the heirs and to mitigate their miseries.

This practice of 'aqila' or blood money as practised by the ancient Arab tribes was supported and recommended by Holy Prophet (SAW) (Billah, 2003b; pp.5-7). It is evident from the following hadith:

> "*Narrated by Abu Hurairah (R), he said that once two women from Huzail clashed when one of them hit the other with a stone which killed her and the baby in the victim's womb. The heirs of the victim brought an action to the court of the Holy Prophet (SAW) who gave a verdict that the compensation for the foetus to be a male or female slave while the compensation for the killed woman is a blood money (dyat) to be paid by the 'Aqilah' (the relatives of the father's side) of the killer." (Sahih Al-Bukhari, Vol. 9, No. 45, p. 34).*

Takāful related practices such as 'aqila' or blood money were also supported by second Caliph, Hazrat Umar (RA). He has ordered that a mutual fund should be established in every district to compensate the heirs of deceased person as well as martyrs (Gibb, 1979; p.29). The practices of the Holy Prophet and his companions reflect that concept of insurance as a protection tool was there in the doctrine of *'al-aqilah'* practiced during that period.

1.2.5 EFFORTS FOR THE VALIDITY

During the period of the nineteenth century *Ibn Abidin* (1784-1836), a Hanafi lawyer was the first person to discuss about the idea of insurance and its legal entity (Anwar, 1994; p.1315). He was also the first person to discover insurance in the context of a legal constitution, being no longer a customary practice.

Several attempts were made in the 20th century to provide evidence for the validity of *Takāful* business (Vardit, 1985; p.32).

In 1965, the second conference of the Islamic Research Academy discussed the subject matter of insurance. It concluded that cooperative insurance is acceptable but in order to ensure the development of a viable and practical *Takāful* model, it decided to continue further study of the matter through a committee of Islamic jurists, economists (including insurance experts) lawyers, and sociologists. In 1972, a number of Islamic jurists participated in a symposium organized by the Libyan university. They discussed among other subjects "the validity of insurance contracts". They conditionally but temporarily accepted that validity of insurance contracts other than life insurance which they ruled out as illegal and agreed to continue, discuss and examine the matter further at some appropriate forum. In 1976, the first international conference on Islamic Economics was held in Makkah-Al-Mokarama which was attended by more than two hundred Islamic jurists and economists. The insurance contract was one of the subjects discussed and they reached the following decision:

> *"The commercial insurance which is practiced by the commercial insurance companies in this era does not conform to the Sharī'ah principle of cooperation and solidarity because it does not fulfill the Sharī'ah conditions which would make it valid and acceptable"*(Sadiq, 2003; p.6).

This conference also suggested that a committee comprising of *Sharī'ah* experts and Muslim economists should be constituted in order to suggest a system of insurance that will be free from *"riba"* (interest) and *gharār* (uncertainty) and which will realize the cooperation and solidarity intended by the *Sharī'ah* in place of the conventional insurance. In 1976, Higher Council of Saudi Arabia issued a *fatwā* in favor of Islamic model. In 1977, another *fatwā* was issued by the *Fiqh* Council of Muslim World League in favor of Islamic insurance. In 1984, *Fiqh* Council of the Organization of the Islamic Conference issued a *fatwā* in favor of insurance under Islamic model. In the same year, *Takāful* Act of 1984 was promulgated by the Ulama and Government of Malaysia to initiate *Takāful* business in the country parallel with conventional system. In 1985, Maja Al-*Fiqh*, the Grand Counsel of Islamic Scholars in Mekkah, approved the *Takāful* system as the correct alternative to conventional insurance in full compliance with *Sharī'ah* (Fisher and Taylor, 2000). In 1992, Council of Islamic Ideology of Pakistan (CIIP) submitted its report on Islamisation of insurance system in Pakistan and proposed a suitable *Takāful* model for Pakistan after reviewing the operations of existing *Takāful* models across the world (CIIP Report, 1992).

Shaikh Muhammad al-Madni, the principal of the college, Al-Azhar University was of the view that problems related to contemporary issues of banking and insurance should not be left to individuals, rather Muslim jurists, thinkers and researchers should work together to reach at a unanimous opinion about these issues. He further warned that in the absence of such consensus, people would remain divided into two classes; one claiming it unlawful while other following its own desires would treat it legitimate (Musleh-ud-Din, 1982; p.151).

Muhammad Shafi, a renowned Islamic scholar of Dar al-Ulum Karachi (Pakistan), has given some suggestions to make the conventional insurance *Sharī'ah* compliant. He suggests that the amount paid towards insurance policy should be invested, on the principle of *Mudhārabah* (where lender shares equally in profit and loss), instead of pre-determined interest. Investment should be not be concentrated on any one sector rather it should made in different sectors with prudent management to minimize the chances of loss. The profit obtained can be distributed according to agreed terms between the two parties. A *Waqf* fund should be created by mutual contribution of the participants. In case of material loss, catastrophe or any unforeseen event, affected participants should be compensated out of *Waqf* fund. This concept of mutual cooperation and *Waqf* fund is in line with the spirit of *Sharī'ah* and the concept of *Waqf ala'l-awalad* where it is permissible for legal heirs to be benefited from the endowment of their father. He further suggested that rules should be devised to provide financial assistance to the participants in case of loss or accident. A method should be used to standardize the personal information of the participant related to his age, health and past claim performance. There should be no forfeiture of installment in case participant fails to pay any further installment for any reason. Such forfeiture is illegal from *Sharī'ah* point of view (Musleh-ud-Din, pp.159-162).

1.2.6 *TAKĀFUL* PRACTICES IN THE 20TH CENTURY

The world's pioneer *Takāful* operator, the Islamic Insurance Company Ltd, was established in Sudan in 1979 (Billah, 2004c; pp.4-6). However, Bank Negara of Malaysia took the initiative to formulate legal procedures to introduce *Takāful* business in Malaysia parallel to conventional insurance system. This led to the establishment of Syarikat *Takāful* Malaysia Bhd. in 1984. After the success of first *Takāful* Company in Malaysia, *Takāful* Nasional Sdn, Bhd., the second *Takāful* company and subsidiary of Malaysian Nasional Insurance (MNI) Bhd., started its operations in 1993. With the success of Islamic insurance in Malaysia, new *Takāful* operators emerged in Brunei, Indonesia, Singapore and other Muslim and non-Muslim countries of the world.

Billah (2003b; p.10) argues that *Takāful* has grown steadily in the 20th century and performance of *Takāful* and *Re-takāful* companies in Arab countries as well as across the world is quite impressive. Yet, there are some Muslim scholars who raise objections on prevalent insurance practices without discussing the alternate solution in Islam. Thus they tend to create misconceptions in the minds of general public keeping them away from insurance and becoming ignorant of *Takāful.* He emphasizes the *Sharī'ah* scholars to play their role to eliminate the misconceptions from the minds of *Muslim Ummah* related to insurance (especially life insurance) and making them aware of islamically accepted solution of insurance in the form of *Takāful.*

TABLE 1.1: *TAKĀFUL* COMPANIES ACROSS THE WORLD

Company(s)	Year(s)	Country(s)
Takāful Australia	n.d	Australia
Islamic *Takāful* and Re-*Takāful* Co. (Bahamas)	1983	Bahamas
Islamic *Takāful* & Re-*Takāful*	n.d	Bahamas
Al-Salam Islamic *Takāful* Co.	*1992*	Bahrain
Bahrain Islamic insurance co.	*n.d**	Bahrain
Islamic insurance and Re-insurance Co.	*1985*	Bahrain
Sarikat *Takāful* al-Islamiyah	*1983*	Bahrain
Takāful international	*1989*	Bahrain
Life *Takāful* (pte)	1999	Bangladesh
General *Takāful* (pte)	1999	Bangladesh
Insurance Islam TAIB sendirian Berhad (IITSB)	1993	Brunei
Tabung Amanah Islam	n.d	Brunei
Takāful and Re-*Takāful* Co.	n.d	Brunei
Takāful Ab birhad	n.d	Brunei
Metropolitan insurance Co.Ltd.	n.d	Ghana
Syarikat *Takāful* Indonesia	n.d	Indonesia
PT Asuransi *Takāful* keluarga	1994	Indonesia
PT Asuransi *Takāful* Umum	n.d	Indonesia
Pt Syarikat *Takāful*	n.d	Indonesia
Takāful asuransi	n.d	Indonesia
Islamic insurance Co. Plc.	*n.d*	Jordan
International company for cooperative insurance	*n.d*	Kuwait
International *Takāful* Co.	n.d	Luxembourg
Takāful S.A (formerly Islamic *Takāful* co.)	1982	Luxembourg
Asean Re-*Takāful* international (L) Ltd. (ARIL)	1997	Malaysia
Asean *Takāful* group (ATG)	1996	Malaysia
Syarikat *Takāful* Malaysia Bhd.	1984	Malaysia
Takāful National Bhd	1993	Malaysia
Takāful Ikhlas Sdn Bhd.	2003	Malaysia
Qatar Islamic insurance Co.	*1994*	Qatar
Al-Aman Cooperative Insurance (al-Rajihi)	*1985*	S.Arabia
Islamic Arab Insurance Co. (Dallah al-Baraka group)	1979	S.Arabia
Islamic Corporation for Insurance of Investment and Export Credit	1995	S.Arabia
National Cooperative Ins Co. (NCCI)	1986	S.Arabia
Islamic *Takāful* and Re-*Takāful* Co.	1986	S.Arabia/Bahamas
Global Islamic Insurance Co.	*n.d*	S.Arabia/Bahrain
Islamic Insurance and Reinsurance Co.(IIRCO)	1985	S.Arabia/Bahrain
Islamic Universal Insurance	n.d	S.Arabia/Bahrain

Takāful Islamic Insurance Co. Bahrain	n.d	S.Arabia/Bahrain
International Islamic Insurance Co.	*n.d*	S.Arabia/UAE
Islamic Arab Insurance Co. (IAIC)	n.d	S.Arabia/UAE
Islamic International Insurance Co. (salamat)	1985	S.Arabia/UAE
Sosar Al Amane (al Baraka group)	n.d	Senegal
Ampro Holding Singapore Pte Ltd.	n.d	Singapore
Keppel Insurance	n.d	Singapore
Syarikat *Takāful* Singapore	1995	Singapore
Amana *Takāful* Srilanka(Pte)	1999	Srilanka
Al Baraka Insurance Co.	1984	Sudan
Islamic Insurance Co.	1979	Sudan
Sheikan Insurance Co.	n.d	Sudan
The National Re-insurance Company (Sudan) Ltd.	n.d	Sudan
The United Insurance Company (Sudan) Ltd.	1968	Sudan
Watania co-operative insurance Co.	1989	Sudan
Takāful T&T	n.d.*	Trinidad
Takaaful T & T Friendly Society	1999	Trinidad & Tobago
BEIT ladat Ettamine Tounsi Saudi (Best Re)	1985	Tunisia
Ihlas sigorta As	n.d	Turkey
Alliance insurance	n.d	UAE
Oman Insurance Co.	n.d	UAE
The Islamic Arab insurance Co.	1980	UAE
Takāful UK Ltd.	1982	UK
UBK @ IIBU Manzil programmes	1998	UK
Takāful USA Management Services, LLC	1996	USA
Failaka investments, Inc.	1996	USA(Chicago)

Source: Billah (2003b), "List of Takāful companies", pp.10-12

The Table 1.1 shows a list of both *Takāful* companies as well as companies practicing under cooperative insurance system in different countries of the world. It can be inferred from the above table that *Takāful* business is not only growing in Arab and Muslim countries but also in advanced and non-Muslim countries of the world. It shows a huge potential of *Takāful* in the countries with large Muslim population like Pakistan where *Takāful* had no existence till the beginning of 21st century.

1.2.7 DEVELOPMENTS IN THE 21ST CENTURY

The *Takāful* business has proved its viability in the early years of 21st century (Ayub, 2003; p.3). It has been growing at the rate of 10-20% p.a. compared to the global average growth of insurance 5% p.a. A large number of *Takāful* companies exist in the Middle East, Far East, Iran, Turkey, and Sudan and even in some non-Islamic countries. Now there are over 80 companies offering *Takāful* services and 200 conventional companies are operating under *Takāful* windows in more than 23 countries around the world and 10-12 *Re-takāful* companies worldwide (*Takāful* and *Re-takāful* companies, 2006). Malaysia has developed *Re-Takāful* business as well. *Takāful* products are available to meet the needs of all sectors of the economy, both at individual as well as corporate levels to cater for short and long term financial needs of various groups of the society.

In the international arena, Malaysia is a member of the Developing Eight Group (D-8), an arrangement for development cooperation among eight developing countries, namely, Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey, where *Takāful* was endorsed as a D-8 project to be spearheaded by Malaysia. To this effect, Malaysia was entrusted with the task to educate and market the concept and application of *Takāful* among the members of the Organization of Islamic Countries (OIC), and ultimately to assist in the establishment of *Takāful* companies worldwide (BNM report, 2004b; p.418).

A number of international conferences and seminars were organized during 21st century to create awareness of Islamic financial services among Muslim *Ummah* and to share ideas to boost up the growth of *Takāful* industry worldwide. Dr Zeti Akhtar Aziz, Governor of Bank Negara, Central Bank of Malaysia delivered a keynote address at an international conference in 2003. Here is the summary of her speech:

> *The Takāful industry represents an important component in the overall Islamic financial system of a country. It plays its role in the mobilization of long-term funds and acts as an important institutional investor hence supporting the overall economic growth and development of a country. The challenge is thus to evolve a dynamic and vibrant Takāful industry within the Islamic financial system that is dynamic, responsive and sustainable. In the absence of a viable Islamic capital*

market, there would not be an adequate supply of quality financial instruments for which the Takāful funds could be invested. With the acceleration of its global integration, Takāful will provide synergies and opportunities for the Islamic financial industry to evolve into an important component of the international financial system that can contribute to enhance prospects for balanced global growth and an enhanced shared prosperity (IIBI Report, 2003).

In 2005, Bank Negara undertook several policy initiatives to approve consortiums and joint ventures to attract foreign financial institutions to promote *Takāful* business in Malaysia and to position the country as an international hub for *Takāful* and *Re-takāful* practices. In the same year, Bank Negara participated in the joint working group of IFSB and IAIS to develop international prudential standards for the regulation and supervision of *Takāful* companies and initiated its efforts with Islamic Development Bank (IDB) to establish 12-member committee to promote *Takāful* in OIC member countries. Other key developments include equity participation of a Malaysian *Takāful* operator in PKTCL, the first *Takāful* company of Pakistan and the participation of IDB in the equity of ASEAN *Re-takāful* through its subsidiary, ICDPS (BNM press statement, 2006).

Seeing these key initiatives for the development of *Takāful*, it can be inferred that there are vast opportunities for its growth in Muslim countries with large population like Pakistan, where decades of ignorance of and misperceptions about insurance as well as unavailability of *Sharī'ah* based insurance have kept the Muslim *Ummah* far away from managing and overcoming unexpected risks and enjoying decent standard of living.

1.2.8 EVOLUTION IN PAKISTAN

The period of early 1980s could be regarded as the resurgence of Islamic finance when Muslim countries like Pakistan, Sudan and Malaysia and some Arab countries mobilized their efforts to transform their financial systems on Islamic lines (Chapra & Ahmed, 2002; p.17). Yet Malaysia took the lead by establishing first *Takāful* Company in 1984 and is the only country with separate legislation in *Takāful*.

Pakistan started its efforts in 1980s to Islamize its financial system. Federal *Sharī'at* Court gave its historical judgment on prohibition of interest from existing financial system. Moreover, to Islamize the insurance system, CIIP undertook an extensive review of existing insurance system and finally submitted its comprehensive report in 1992 proposing a suitable model of Islamic insurance for Pakistan. Yet it was an unfortunate country as all the efforts to Islamize the economy got entangled in the bureaucratic control and complex political system of the country and no substantial progress was made in this regard till the beginning of 21st century (Abdel Karim & Archer, 2002; p.39).

The real impetus to these efforts gained momentum after the promulgation of insurance ordinance 2000 followed by Takāful Rules 2005 issued by ministry of commerce (MOC) to regulate *Takāful* business in Pakistan. It is interesting to note that when Ministry of Commerce (MOC) was issuing *Takāful* Rules for Pakistan in 2005, Malaysia was celebrating its 20 years of *Takāful* experience. Malaysia got independence in 1957, ten years later than Pakistan, yet it was 20 years ahead of Pakistan in the field of *Takāful*. Malaysia became the leading Islamic country by effective implementation of its policies set to overhaul the whole financial system.

The thesis emphasizes that sound state policies together with effective regulatory framework play a critical role for the success of Islamic financial services of a country. It identifies key areas of concern for regulatory authority and *Takāful* players and gives recommendations for future course of action for the formation of a competitive and dynamic *Takāful* industry in Pakistan.

1.3 OBJECTIVES OF THE STUDY

This research thesis aims to achieve the following research objectives:

- To provide an understanding of the concept and operations of *Takāful* business among general public as well as in business community in Pakistan.
- To identify key standards that are of prime consideration in strengthening regulatory framework for *Takāful* industry.
- To identify the factors that could play a primary role in shaping the perceptions of general public about *Takāful* in future.
- To enable *Takāful* operators to achieve operational efficiency and devise strategies to promote *Takāful*.
- To motivate other researchers to recognize *Takāful* as an emerging field of Islamic finance and to identify different areas of interest to be explored in future.

1.4 RESEARCH QUESTIONS

This research thesis attempts to address the following research questions:

i. How could *Takāful* be helpful in managing risk and uncertainties in business without violating *Shari'ah?*

ii. What factors determine the potential of *Takāful* business across the world and how much potential exists in Pakistan?

iii. How far the regulatory frameworks are adequate for *Takāful* and which *Takāful* standards are essential to strengthen regulatory framework?

iv. How far the general public is aware of the concept of *Takāful* and which factors determine their level of awareness?

1.5 BENEFICIARIES OF THE RESEARCH

This research will be greatly beneficial to *Takāful* operators as well as regulatory authority (SECP) of Pakistan in particular and students as well as researchers in the field of Islamic finance in general. *Takāful* operators will be benefited from this research by understanding the risks associated with *Takāful* as well as *Sharī'ah* based risk management practices. They will also be able to gain comprehension of different standards relevant to *Takāful* industry. This research will be beneficial for SECP by providing information on key *Takāful* standards that are pertinent to effectively regulate *Takāful* operators in Pakistan. Finally, students and researchers related to Islamic finance and *Takāful* will grasp in depth understanding of operational mechanism of *Takāful* business, financial performance of *Takāful* companies and empirical methodology for *Takāful.* Researchers in the field of management sciences will be able to identify key areas of *Takāful* that still need to be explored and to use this thesis as a reference to embark on the area of their own interest.

1.6 RESEARCH METHODOLOGIES

Research has been conducted using the following methodologies.

- Secondary data collection through exploratory research (to explore the field of *Takāful*)
- Primary data collection through qualitative research (Personal observations, interviews, surveys)

First, an attempt is made to explore the world of *Takāful*. How it has developed from its history to present state. Relevant literature related to *Takāful*, work done by other researchers and scholars in the field of *Takāful*, international journals, annual reports of different companies and websites related to *Takāful* have been analyzed to draw a comprehensive understanding of concept of *Takāful* and its distinctive features and its financial performance in the recent years. Secondly, interviews and personal meetings have been conducted with the senior managers of *Takāful* companies in Malaysia to grasp better understanding of operations of *Takāful* business. Operations of these companies have been deeply observed and discussions have been made with senior Managers about their successful strategies and difficulties in their implementation. Issues and future challenges related to *Takāful* have also been discussed with concerned Managers and strategies to cope with those challenges. Lastly, an empirical study with reference to Pakistan was conducted to make the thesis more realistic and authenticated. The study seeks to know the level of observance of different *Takāful* standards affecting *Takāful* practices in Pakistan. The study also takes into account the customers' perceptions about *Takāful* and the factors that affect their level of awareness. Descriptive statistics was applied to judge the observance of *Takāful* standards while chi-square test was used to assess the factors that significantly affect the level of *Takāful* awareness.

1.7 A NOTE ON REFERENCES

References have been given at the end of the thesis. APA style has been adopted throughout the research. Reference section contains citations of books, journals, annual reports and internet sources. However, there are some alterations that should be keep in mind while reading the reference section.

In case of publications of organizations, banks, insurance companies etc. where no author is identified, organization name has been taken instead of author's name e.g. IAIS, BNM, etc. In the event, the year of publication is not known, it is denoted by n.d. means no date of publication.

In case, an article is taken from internet, full internet source is given at the end of each reference of an article starting with last name of author, year and so on. Day and date at which article was cited is also given after each internet source to make the research more authentic.

Effort is made to provide full detail of each reference to enable readers to reach the cited source and find out relevant details if they deem it necessary or if in their view, given information is not sufficient. However, in some of the references, there is lack of necessary detail e.g. author's name, publisher's name or year of publication is missing in some cases.

1.8 SCOPE AND LIMITATIONS OF THE STUDY

The research is conducted to gain comprehensive understanding of operational mechanism of *Takāful*, different models practiced across the world and transformational paradigm for *Takāful*. Financial performance of Pakistan insurance industry has been analyzed to gauge current level of insurance penetration in Pakistan. Conventional insurance practices are beyond the scope of this thesis and therefore have not been discussed except for comparative purpose. The research is limited to highlight conceptual differences between *Takāful* and conventional insurance. *Takāful* industry across the world has been studied to develop a comprehensive picture for the potential and growth of *Takāful* industry in Pakistan. A survey of *Takāful* operators and insurance customers in the country has been conducted to judge the level of observance of *Takāful* standards and perceptions of general public about *Takāful*. Only three *Takāful* operators were operating in the country at the time of survey. Survey of insurance customers is restricted to Rawalpindi region due to time and cost constraints. Sample consists of insurance customers due to non-availability of sufficient numbers of *Takāful* customers. The limitation of the survey is that its results have been generalized for the entire country; however actual results might differ when a sufficiently large sample is taken from all the main cities of the country.

CHAPTER SUMMARY

Potential of insurance as risk management instrument has not been sufficiently tapped. Vulnerability of the poor to unexpected losses calls for a greater need of insurance which has been neglected by a large majority of Muslims in the past. It was perceived as unislamic by most of the *Sharī'ah* scholars as it contains elements of uncertainty, gambling and interest that are repugnant to *Shari'ah*. *Takāful* came as an alternative to conventional insurance as it was free from prohibited elements. Several *fatwās* in the 20th century were issued by *fiqh* academies and *Ulama* in favor of *Takāful*. As result of these efforts, *Takāful* companies started operating in different parts of the world including Muslim, non-Muslim and some Arab countries. Pakistan also initiated its efforts in 1980s to Islamize its insurance system yet these efforts could not bring fruitful results due to complex political system of the country. At last, Ministry of Commerce (MOC) issued *Takāful* Rules 2005 to regulate *Takāful* business in the country. Since then, international players are taking keen interest to initiate *Takāful* business in Pakistan. This research thesis aims to explore *Takāful* potential that exists in the large population of the country while strengthening regulatory standards for *Takāful*. The empirical study further supports to strengthen regulatory framework and may help in determining the factors that can positively contribute to reap the benefits of untapped potential market for *Takāful*. The limitation of this thesis is that it does not discuss conventional insurance practices. It mainly focuses on operational functioning of *Takāful* business and *Takāful* practices across the world. The scope of empirical study is limited to *Takāful* practices in Pakistan as *Takāful* industry of Pakistan is the main focus of the study.

CHAPTER 2

CORPORATE UNDERSTANDING OF *TAKĀFUL*

INTRODUCTION

"Many Muslims misunderstand the concept of fate. For some Muslims believe that the future is in the hand of Allah, where they are facing with fatalistic mentality by putting themselves in the doctrine, whether one is rich or poor, happy or sad, it is fated by Allah. It is a good dealing with luck. In fact, efforts and prayers should precede this kind of belief" (Iqtisad Al-islamy, 2003). For a long time, same misconceptions have been associated with insurance. Muslim scholars and Islamic jurists have treated insurance illegal, haram and repugnant to *Sharī'ah* without providing an alternative solution to Muslim *Ummah*. As a result of these prevalent misconceptions, any effort or risk management strategy to insure the assets or life has been considered against the fate and will of *Allah*.

For the past two decades, *Takāful* has emerged as one of the important Islamic financial instruments and a powerful tool to manage individual risks and business downturns. Risk is prevalent everywhere in our daily lives as well as in the business and effective risk management plays an important role to deal with uncertainties and unexpected situations. Islamic teachings emphasize on the best use of all available material and financial resources and prudent planning to achieve well being of individuals as well as of society. *Takāful* has proved its validity to combat individual as well as business risks and to the economic activities of a country. It is based on the principles of *tabarru* (donation), good faith and mutual cooperation to achieve welfare of public at large.

It is the need of the hour that financial experts and business professionals could understand the operational mechanism of *Takāful*. While *Takāful* is an important part of

Islamic financial system, the concept itself and the nature of operations of *Takāful* companies is a topic that has been relatively neglected compared with Islamic banking (Lewis, 2003). This chapter attempts to provide an in-depth understanding of *Takāful* business from an organizational perspective. It highlights intricacies of operational mechanism of *Takāful* while providing conceptual understanding of *Takāful* through flow chart diagrams. Conceptual understanding includes operational functioning of family and general *Takāful* business as well as sources of income and expenses for participants and *Takāful* operators. Applicable principles and justifications for *Takāful* provide philosophy and spirit behind *Takāful* contracts. The focus of this chapter is to identify various types of risks associated with *Takāful* business and devise criteria for managing risks and enhancing risk management culture in the organizations. It also discusses challenges to risk management in *Takāful*.

2.1 CONCEPTUAL UNDERSTANDING

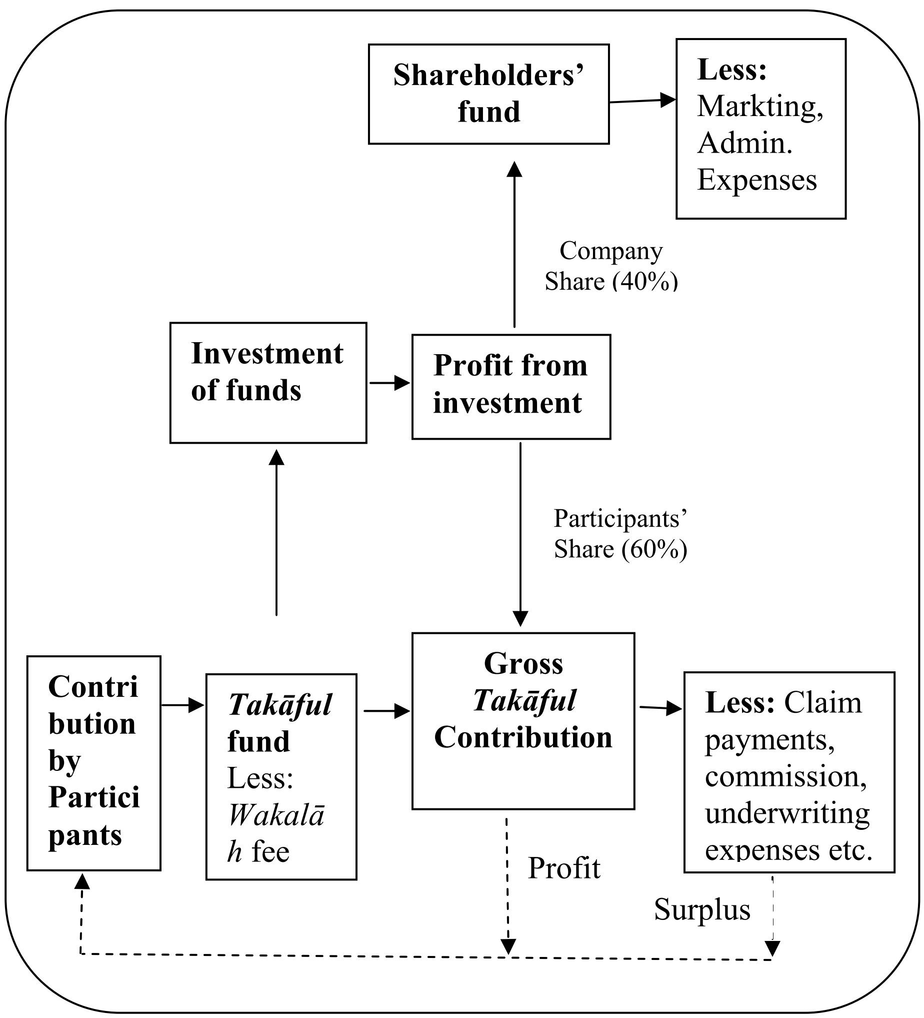
According to Bank Negara, the Central Bank of Malaysia, *"Takāful is a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aids and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpos*e" (*Takāful* Act 1984, Section 2).

It can be inferred from the above concept that purpose behind the *Takāful* contract is to achieve the welfare of all members who are in need of help. That is the reason the members give a major portion of their contribution as *tabarru* (donation) which could be used to cover a loss or catastrophe that may occur to any participant.

Instead of treating *Takāful* a buying or selling contract, Obaidullah (2005a; pp.124-126) observes it as an arrangement by a group of people with common interests to guarantee or protect each other from a certain defined misfortune or mishap through the creation of a defined pool contributed out of their common resources. In this arrangement, each participant donates a fixed amount in a fund with the intention that if any of the participants incurs a loss or catastrophe, he will be compensated out of that fund. At the end of the year, *Takāful* operator has no right on the surplus that remains in the *Takāful* fund after paying all the claims to the affected participants. The surplus is distributed back to the participants that have no claim during the policy period. This kind of arrangement is known as *Takāful* and is acceptable under *Shari'ah.*

In the Figure 2.1 shown below, contribution paid by participants first goes to a fund called *Takāful* fund (TF). *Takāful* operator (the company) merely acts as a manager and trustee of these funds and charges a fee for making an arrangement for collection of contribution and payment of claims. *Takāful* fund is invested in *Sharī'ah* approved instruments.

FIGURE 2.1: CONCEPTUAL UNDERSTANDING OF TAKĀFUL BUSINESS[1]



[1] This framework was developed after having discussion with senior management of *Takāful* Ikhlas Sdn. Bhd.

Profit obtained from those investments is shared between *Takāful* operator and participants according to pre-determined agreed ratios. Participants' profit is added to *Takāful* fund to get gross contribution fund that is then paid to participants. After paying claims, deducting agency fees and underwriting expenses whatever is left is called surplus that is then paid back to those participants who have no claim during a specified period. However, *Takāful* Company may hold a portion of surplus as a contingency reserve (*Takāful* Rules 2005, section 14(5)). Under Mudarbah model, management expenses are deducted from shareholders' fund. In case, claim payments and agency fees exceed gross *Takāful* contribution, shareholders can provide interest free loan (*Qard-e-Hasana*) to cover the loss (*Takāful* Rules 2005, section 15). Contingency reserve may also be established by *Takāful* Company with mutual decision of board of directors to protect the rights of participants and to account for expected future losses.

2.1.1 CLASSES OF *TAKĀFUL* BUSINESS

Takāful business could be classified into two major groups of businesses depending upon the maturity period and risk involved.

i. Family *Takāful* business
ii. General *Takāful* business

i. *Family Takāful business*[2]*:*

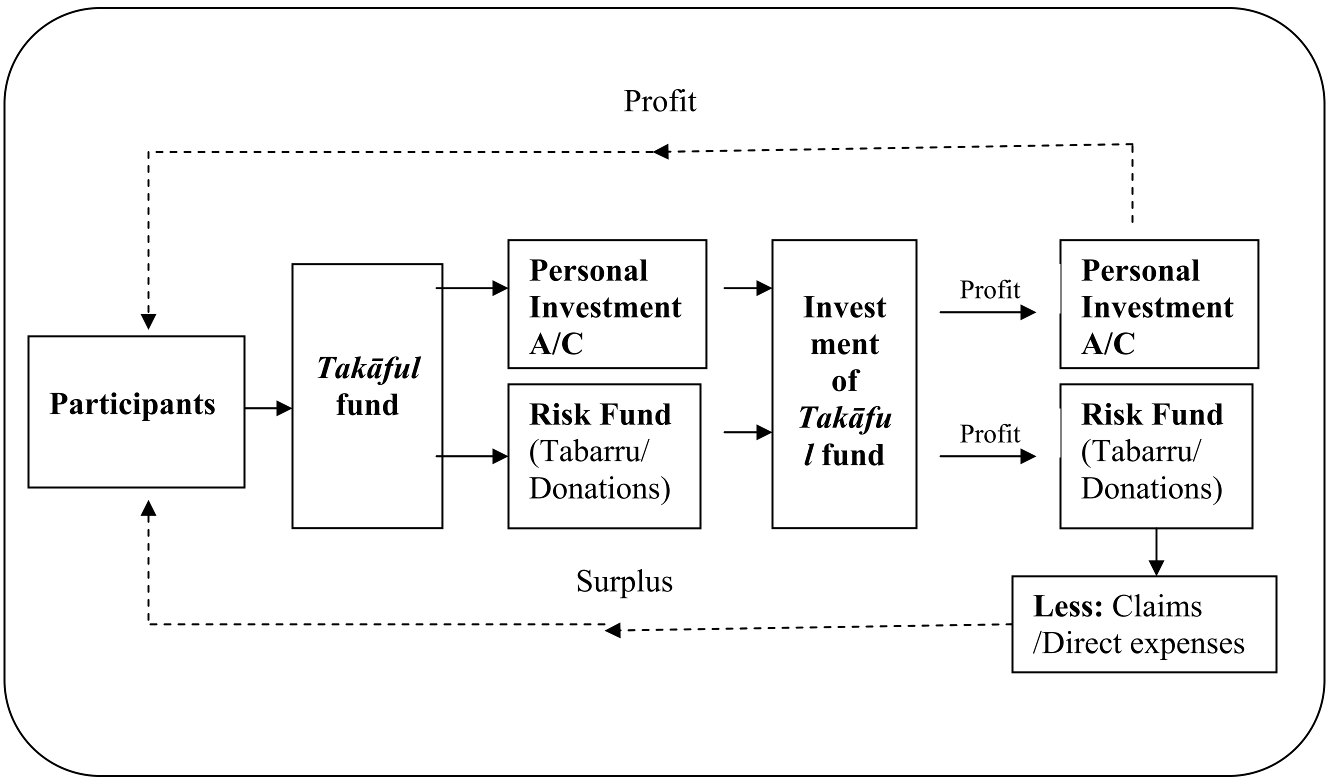
Family *Takāful* business includes long term *Takāful* products whose maturity period is more than one year. It could be up to 5 years, 10 years or 20 years. For example Pension *Takāful* plan, Children Education *Takāful* plan, Mortgage *Takāful* plan etc.

Family *Takāful* contracts aims at providing long term saving and investment plans to the participants to meet their specific needs in the long run. So contribution paid by participants is divided into two portions. A large part goes to personal investment account and the other small portion is treated as *tabarru* (donation) that goes to Risk Fund and is used to pay for claims and direct expenses (agency fees, management expenses). Both funds are invested together in *Sharī'ah* compliant instruments and profit is allocated to

[2] This section is based on operational mechanism of family *Takāful* business of Syarikat *Takāful* Malaysia, Berhad.

both accounts according to their share of investments. Entire profit from personal investment account is added to participants' accounts according to their share of contribution. Risk fund together with the profit obtained from investment is used to pay for claims and company direct expenses (agents' fees, operating expenses). Any amount left is treated as surplus and is paid back to the participants.

FIGURE 2.2: FLOW OF FUNDS IN FAMILY TAKĀFUL BUSINESS[3]



ii. ***General Takāful business:***

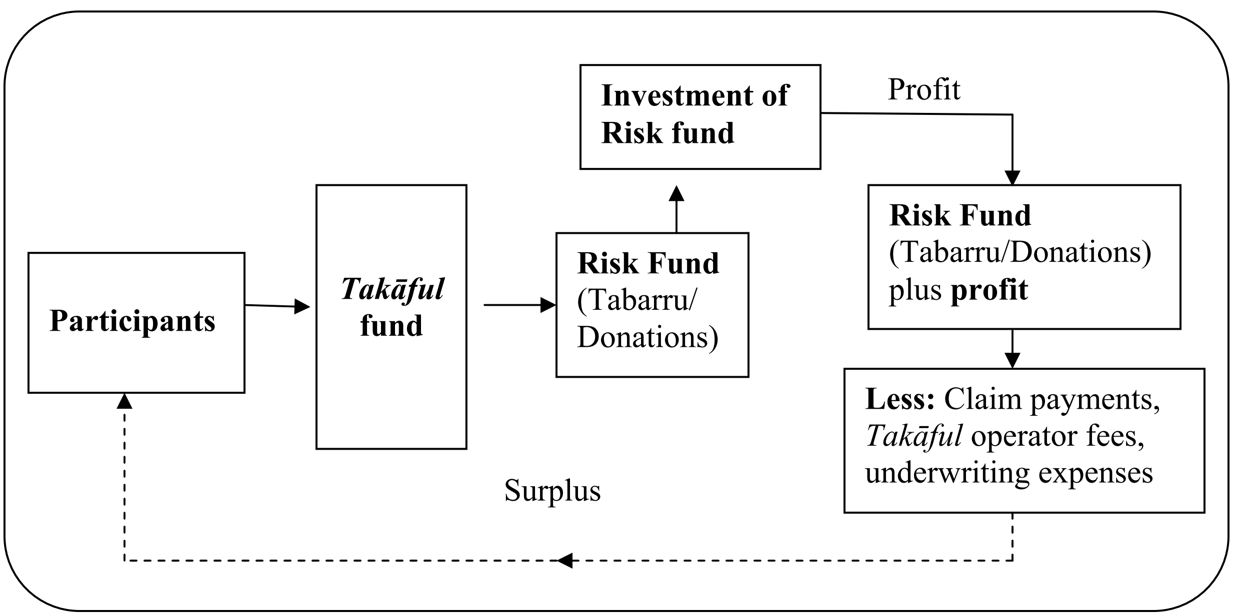
General *Takāful* Products includes short term *Takāful* plans whose maturity period is one year or less. General *Takāful* business is mainly divided into Motor and non-Motor *Takāful* insurance.

[3] This flow chart was developed after discussing family *Takāful* business of *Takāful* Ikhlas Sdn. Bhd. Malaysia with its senior management. It does not include company's account to simplify the processing of funds.

In Motor *Takāful* insurance contract, participants pay a fixed amount (contribution) to safeguard themselves against any sudden accident or damage to their private car or motor cycle. The amount is paid for a period specified in the contract (usually a year). Non-Motor *Takāful* business encompasses a wide range of products i.e. fire *Takāful* scheme, marine cargo *Takāful* scheme, personal accident *Takāful* scheme, burglary *Takāful* scheme, machinery break down *Takāful* scheme etc.

In general *Takāful* business, all the contribution is treated as *tabarru* (donation) and goes to Risk Fund to cover the loss or damage that may occur to any participant during the specified period. This risk fund is invested on short term basis in *Sharī'ah* compliant instruments and profit is added to Risk fund. Any surplus left after paying claims and deducting direct expenses (*Takāful* agents' fees, underwriting expenses) is paid back to the participants. In case claims payments and direct expenses exceed risk fund, an interest free loan (qard-e-hasana) may be obtained from shareholders' fund to cover the loss. This loss is repaid from the risk fund in future.

FIGURE 2.3: FLOW OF FUNDS IN GENERAL TAKĀFUL BUSINESS[4]



[4] This flow chart was developed after discussing general *Takāful* business of *Takāful* Ikhlas Sdn. Bhd. Malaysia with its senior management. It does not include company's account to simplify the processing of funds.

2.1.2 SOURCES OF INCOME AND EXPENSES

It is mandatory for *Takāful* operator to keep separate records of accounts for participants as well as for shareholders (*Takāful* Rules, 2005). That's why *Takāful* operators maintain participants' *Takāful* account (PTF) for participants and shareholders' account (SHF) for shareholders. First, we examine sources of income and costs incurred by PTF.

Sources of income to PTF (For Participants):

i. Share in surplus
ii. Share in profit from investment
iii. Claims received from re-*Takāful*

Expenses incurred from PTF:

Following expenses are charged to participants' *Takāful* fund (*Takāful* Rules, 2005, Section 9 (4)):

i. *Takāful* operator fees
ii. *Mudhārabah* share of profit from participants' *Takāful* fund (PTF)/ *Wakalāh* fees for investment management of funds
iii. Re-*Takāful* expenses
iv. Claims costs (surveyors' fees, investigation expenses etc.)

Sources of income (For Takāful Operator):

Takāful Operator usually has three sources of income (*Takāful* Rules, 2005, Section 10 (1)):

i. *Takāful* Operators' fees
ii. 100% profit from Share Holders' Fund (SHF)
iii. *Mudhārabah* share of profit from Participants' *Takāful* Fund (PTF)/ *Wakalāh* fees for investment management of funds

Costs incurred by Takāful operator:

i. Marketing expenses
ii. Operational and investment expenses
iii. Management expenses

Initially, *Takāful* operator has to incur all the costs related to registration and licensing and initial setup to start company's operations.

2.1.3 APPLICABLE PRINCIPLES

In the light of findings of Billah (2003b; pp.51-57, 297) and BNM Report (2005), following principles are applicable to *Takāful* contract:

i). Principle of tabarru (donation):

Part of the contribution paid in a *Takāful* policy is regarded as *al-Tabarru* (donation or charity). The participant in a general policy has the right to make a claim in consideration of paid-contribution only if there is any risk to subject matter of the policy within the maturity period, but if there is no risk, the participant has no right to make a claim for any benefit over the paid contribution.

ii). Principle of uberrimae fide (good faith):

The parties involved in a *Takāful* contract should have a good faith with each other and should work to cooperate with each other to mitigate risk and to protect themselves against any unexpected future loss or catastrophe. Hence, it is obligatory for each party to disclose all the material information and to avoid hiding any fact without any intention of deception. *Allah* (SWT) says to the effect:

"….. Do not misappropriate your property among yourselves in vanities but let there be amongst you traffic and trade by mutual good will……" (*Al-Quran*, 4:29)

Hence, Quran emphasizes on dealings and business contracts with mutual consent of both parties so that both can be benefited from the business dealing.

iii). Principle of' al-mudharabah:

Under *al-Mudharabah* contract, one person provides capital is called *Rabb-al-maal* while the other party (*mudarib*) provides business skills and management expertise to run the business successfully. Both parties share the profit according to pre-determined agreed ratios. In case of *Takāful* business, participants are the providers of capital *(Rabb-al-maal)* as they pay the contribution amount to *Takāful* fund. *Takāful* operator manages the funds and provides essential expertise to invest the funds in *Sharī'ah* approved way and hence acts as *mudarib*. In *Mudhārabah* contract, *mudarib* (*Takāful* operator) shares in the profit according to pre-determined agreed ratios.

iv). Principles of" mirath" and "wasiyah":

In a conventional insurance insurance, the policyholder nominates a person who might not be an absolute beneficiary in case of unexpected and sudden death of the insured. In *Takāful* business, compensation and benefits of a *Takāful* policy are distributed to true heirs of deceased and according to *mirath* and *wasiyah* (laws of inheritance). In fact, a nominee in a *Takāful* contract is a mere trustee who receives benefits of the contract and distributes them among the legal heirs of the deceased, in accordance with the principles of *"Mirath"* and *"Wasiyah"*.

v). Principle of rights and obligations:

A *Takāful* contract is based on the principle of rights and obligations where each person has some rights and at the same time has certain obligations towards others. For instance, it is the right of every person to have one's life, property and other assets protected against unexpected perils and dangers of life. Similarly it is obligatory to every person to look after his family, neighbors, helpless, widow, children against an unexpected perils or catastrophe. It is evident from the following hadith:

"...Narrated by Safwan bin Salim (R), the Holy Prophet (SAW) said: The one who looks after, works for a widow and for a poor person, is like a warrior fighting for Allah's cause or like a person who fasts during the day and prays over the night ...." (Sahih alBukhari, Vol. 8, No. 35, p.23)

It can be inferred from the above *hadith* that rights of fellow human beings are even more important than fighting for the cause of *Allah* and praying and fasting day and night.

vi). Principle of ta'awun (mutual co-operation):

A *Takāful* business contract is based on the concept of *ta'awun* or mutual cooperation. This sense of cooperation could be seen in two ways. One between the participants (who are the providers of capital) and the *Takāful* operator (who is the manager of funds) and the other is among participants themselves in which they mutually agree to help each other from a joint fund in case of loss or unexpected peril.

Such mutual co-operation among the parties in the *Takāful* contract has been clearly emphasized in the Holy *Quran*. *Allah* says to the effect:

"...Cooperate with each other in virtue and piety ,and do not cooperate in sin and transgression…" (*Al-Quran*, 5:2)

vii). Principle of indemnity:

The aim of this principle is to keep the affected participant on the same pecuniary position as he was enjoying before the occurrence of loss. This principle also ensures that participant should not get more than the amount of loss so that he could not derive any profit from the claim. This principle is not applicable to life *Takāful* or personal accident *Takāful* (Death *Takāful* Cover) as no monetary reward can indemnify for the loss of life.

viii). Principle of subrogation:

This principle states that if loss to the participant is due to negligence of a third party then it should be recovered from the third party who is responsible for the loss. In this case, *Takāful* operator makes payment to the participant through third party. This is done to prevent participant from receiving compensation from both sides for the same loss.

2.1.4 JUSTIFICATIONS FOR THE VALIDITY

According to Billah (2003b; pp.69-79), following justifications could be made for the validity of *Takāful* contract.

i. Free from element of riba:

Takāful contract does not involve element of *'riba'* as it is based on the principle of *Mudhārabah* or *Wakalāh*. Investments are made neither in interest-based instruments nor in illegal business that is prohibited in *Sharī'ah* e.g. liquor, casino etc. Rather *Takāful* funds are invested in *Sharī'ah* compliant instruments with the approval of *Sharī'ah* supervisory board of the company. Profit is distributed to participants according to agreed ratios.

Hence, in *Takāful* contract, transactions are based on the mutual agreement between the parties on profit sharing basis free from element of riba. Such business is justified by the Divine principle of mutual transaction as *Allah (SWT)* says to the effect:

… "O ye who believe! Do not misappropriate your property among yourselves in vanities, but let there be a trading among you by mutual good will"*.... (Al-Quran, 4:29)*

ii. Free from gambling:

A *Takāful* contract does not involve the element of gambling or betting. In the contract of gambling, one is benefited at the loss of others. In conventional insurance, if a person does not incur a loss during a specified period for which he pays a premium, his entire premium is forfeited. On the other hand, a *Takāful* contract, participants who have no prior claims are entitled to surplus in addition to their share of profit from investment.

iii. Free from gharar (uncertainty):

A *Takāful* contract does not involve element of*' Gharar'* or uncertainty. In conventional insurance, there is uncertainty as insured pays a small premium against a huge loss and he is not sure how and from where his loss is going to be compensated in future in case all persons have claims. In *Takāful* contract, participants mutually agree to contribute a certain amount in a fund (called *Takāful* fund) and each one knows that he will be paid out of this fund in the event of loss and in case the amount of loss exceeds the amount of *Takāful* fund, *qard-e-hasana* (interest free loan) is taken from shareholders' fund to cover the loss.

iv. Takāful is not against the will of Allah:

A *Takāful* contract does not supersede the will of *Allah (SWT)*. In family *Takāful* contract, the aim is not to ensure and determine one's life or death nor does a person or an institution have ability to determine the future material luck of one's dependents. Rather family *Takāful* contract is a kind of pension plan to save for the old age when one is sick and might be unable to earn livelihood. The use of family *Takāful* as a pension scheme has been approved by prominent Muslim scholars like Mustafa Al-Zarqa, Adil Salahi and others. Such planning is in line with Islamic principles whereby Islam emphasizes the need for a risk management strategy to overcome difficulties in life.

v. Takāful is not against 'tawakkul':

A *Takāful* contract is not against the Islamic principle of *'tawakkul'* (putting trust on *Allah* (SWT)), a prevalent misconception mainly associated with the contract of insurance. The fact is that many Muslims misunderstand the concept of '*tawakkul'* and think that nothing could be done without the will of *Allah* as He has all the power to do whatever He wants so one should put one's trust on *Allah* in all circumstances. This practice kept the Muslims for a long time away from being innovative to overcome difficulties and solve contemporary problems. In fact, a Muslim should put trust on *Allah* after employing all the available resources and the best use of his wisdom that *Allah* has granted a man. It is clear from the following tradition of the *Holy Prophet (SAW):*

"*The Holy Prophet (SAW) told a Beduin Arab who left his camel untied, trusting to the will of Allah (SWT) , tie the camel first then leave it to the will of Allah (SWT)….." (Sunan al -Tirmizi, vol.4, No. 2517, p. 668)*

Hence a plan to mitigate risk in future against unexpected tragedy is not against the principle of *'tawakkul'*, rather it is in line with the Islamic risk management strategy.

vi. Highest ethical and moral standards:

A *Takāful* contract is based on highest standards of ethics and morality to care for the fellow beings (whether they are Muslims or non-Muslims) in their miseries and distress. This is justified by the principle of mutual cooperation in the *Shari'ah*. *Allah* (SWT) says to the effect:

......" *Maintain a mutual co-operation among yourselves in righteousness and piety* "... *(Al-Quran, 5:2)*

The following *Ahadiths* also express the reward from *Allah* to care for His creatures and showing kindness and mercy.

....."Narrated by Abu Huraira (R) the Holy Prophet (SAW) said: Whosoever removes a worldly grief from a mu'min, Allah (SWT) will take away from him one of the grieves of the hereafter. Whosoever alleviates a hardship from a needy person, Allah (SWT) will alleviate a hardship from him in both this world and the hereafter..." (Sahih Muslim, 1990; p.114)

"Narrated by Safwan bin Salim (R) , the Holy Prophet (SAW) said: The one who looks after and works for a widow and for a poor person is like a warrior fighting for the cause of Allah (SWT) or like a person who fasts during the day and prays over night....." (*Sahih Bukhari*, Vol. 8, No. 35, p. 23).

vii. Takāful is based on the principle of 'Masalih al-Mursalah':

A *Takāful* contract is based on the principle of *'Masalih al-Mursalah'* (unrestricted pubic interest) for the purpose of eliminating hardships from one's life and strive for achieving welfare of oneself and one's family.

In Quran, *Allah* (SWT) says to the effect:

....."*Allah (s.w.t.) intends easy life for you while He does not want to put you to difficulties...." (Al-Quran, 2:185)*

In an occasion, The Holy Prophet (SAW) said: (Narrated by Saad bin Abi Waqqas (R)), "... It is better for you to leave your offspring wealthy than to leave them poor asking others for help..." (Sahih Bukhari, Vol. 8, No. 725, p. 477).

It means *Allah* wants His people to work hard to explore the universe to achieve decent standard of living themselves, for their families and for societies where they live. It can be inferred from the above arguments that *Takāful* contract is based on a transparent and fair system where each party is clearly aware of its rights and obligations. One of the prominent features of *Takāful* contract that distinguishes it from conventional insurance is its *Sharī'ah* compliance feature and transparent contract that is free from exploitive tools that are detrimental to society and are repugnant to *Shari'ah*. There is no harm in accepting and entering into *Takāful* contract due to its *Sharī'ah* compliance mechanism that makes it acceptable to every one irrespective of one's faith and belief i.e. whether one is Muslim or non-Muslim.

2.1.5 OPERATIONAL MECHANISM

Takāful business requires prudent marketing and managerial skills and expertise to provide *Takāful* benefits to participants as well as to secure optimum return for shareholders. Following steps are essentials for effective implementation of *Takāful* business (BNM Report, 2005).

i). Marketing:

Marketing is also important in order to attract a large number of participants to the scheme thereby strengthening the *Takāful* fund to pay the future claims. *Takāful* operators market *Takāful* products either directly to participants or through independent brokers, agents and banca*Takāful*.

Though direct marketing remains the dominant distribution channel in Malaysia in 2005 with 44.3% of total *Takāful* contribution, yet strong performance of *Takāful* brokers and active agency force have continued to generate higher contributions and account for 34.1% of *Takāful* market. Banca*Takāful* has emerged as a major distribution channel in Malaysia and accounts for 20.4% of total *Takāful* contribution in 2005 albeit from a very low base (BNM report, 2006).

ii). Underwriting:

Underwriting refers to the process of selecting and classifying applicants for *Takāful* through clearly established standards consistent with the company's objectives (Rejda, 2006; p.607). Upon successful marketing; the attention is then focused on the *Takāful* operator to conduct underwriting process for the benefit of the whole *Takāful* scheme. *Takāful* operators will assess the risks involved in an application for *Takāful* coverage. Based on the assessment, the *Takāful* operator will then decide on the appropriate contribution rate to be charged to the participants. The purpose of underwriting is to control adverse selection and ensure the solvency of the *Takāful* fund for claim payments. A proper underwriting practice would lead to the *Takāful* fund earning a higher underwriting profit.

To arrive at an appropriate contribution rate, *Takāful* operators undergo the following three stages of underwriting process:

a) ***Information gathering:***

Adequate and relevant information is collected concerning the physical features of the property and personal characteristics of the applicant.

b) ***Risk assessment:***

Upon completion of information gathering, *Takāful* operator will assess and classify the risk as standard (average), rated (above average) or preferred risk (better claim experience).

c) ***Determination of contribution rate:***

Once applications are accepted, *Takāful* operator determines the contribution rate based on the classification of risks. Standard contribution rates are applicable on average risks. Extra charge is imposed on rated risks while a discount is given on standard rate to participants with good claims experience. In motor *Takāful*, No Claim Bonus (discount on contributions) is offered for participants with good claims experience.

iii). Collection of contributions:

Upon completion of the underwriting process, both the *Takāful* operator and participant will reach a mutual agreement on the terms of *Takāful* coverage. The *Takāful* operator will then collect contributions from the participant as agreed in the *Takāful* contract. Under the Wakalah model, a portion of the contributions will be allocated to the *Takāful* operator, as fee for managing the *Takāful* fund. The portion is based on the ratio agreed upon by the participant and *Takāful* operator as specified in the contract and it varies depending on the type of products.

In Malaysia, there are certain requirements imposed on intermediaries of *Takāful* business in terms of collection of contributions. Agents of motor *Takāful* business are required to submit the contributions to *Takāful* operators within a maximum period of seven days from the date on which the contributions are received. As for brokers, contributions received from participants within the "contribution warranty" period shall be submitted to *Takāful* operators within 15 days from the date on which the contributions are received.

iv). Investment of funds:

The contributions received from the participants will also be used for investment activities that comply with the *Shari'ah*. The investment function is essential in the overall operations of *Takāful* operators in maintaining the solvency of the *Takāful* fund as well as in enhancing the operating profit for the benefit of participants and *Takāful* operator.

In Malaysia, investments of a *Takāful* operator are made mainly in the following categories:

- IPDS (Islamic Private Debt Securities);
- *Shari'ah*-approved equities;
- Deposit placements;
- Government Islamic papers;
- Properties; and
- Extension of financing.

Investment in IPDS maintained an increasing trend over the period. In 2005, it emerged as the highest component of investment for general *Takāful* fund with a value of RM326.6 million.

v). Claims management:

The ultimate objective of claims management is to ensure prompt and fair settlement of claims, in order to protect the interest of participants and promote positive image of the general *Takāful* industry. Effective claims management demands adoption of clear work processes that is supported by adequate skilled manpower to handle the claims.

The claim process generally involves the following three stages:

a). Notification of claim by the participant

b). Investigation of claim by *Takāful* operator

c). Claim assessment

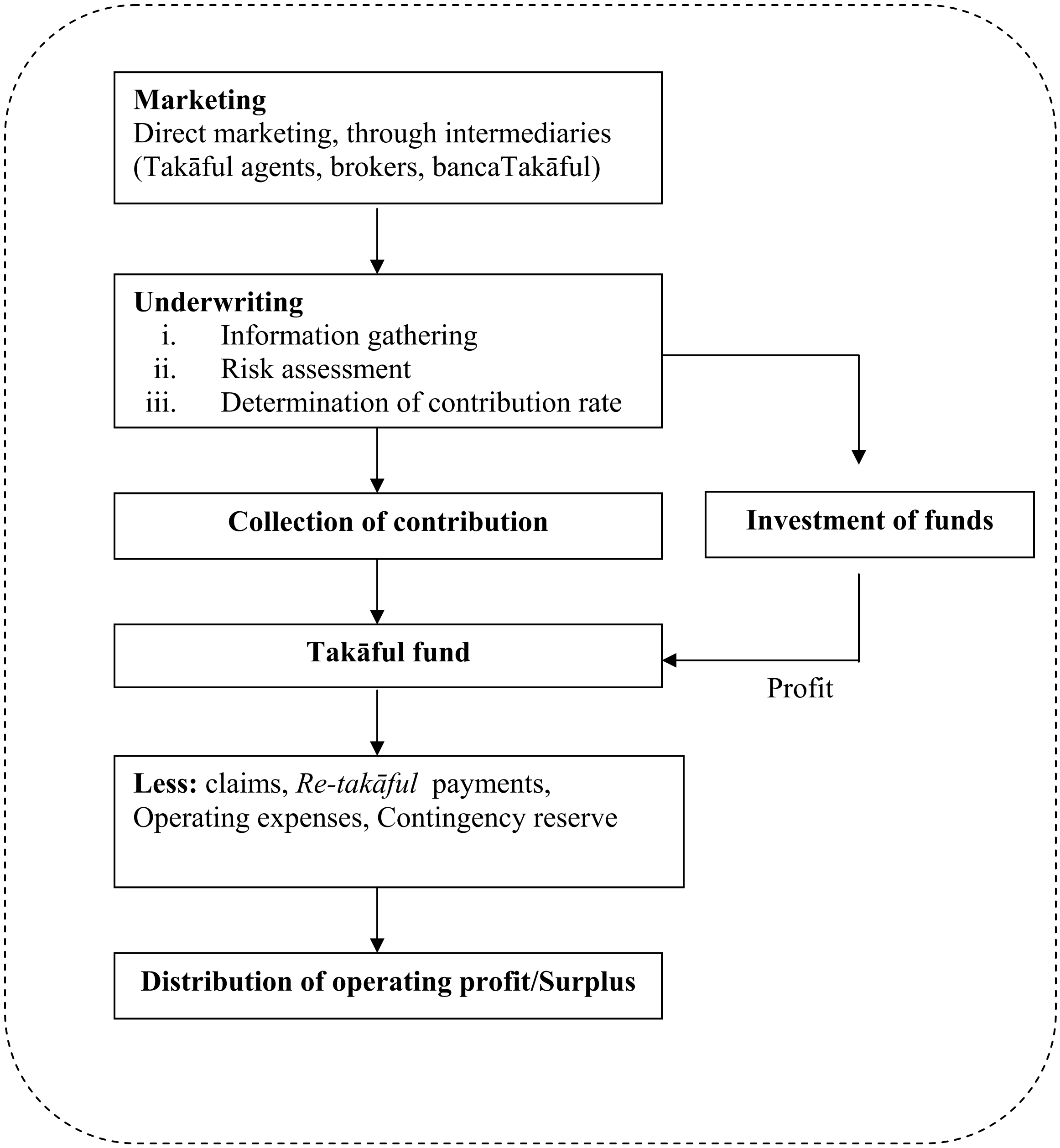
Other major initiatives to further improve the claim handling and management emphasize on improving efficiency in claim handling via the use of information technology, minimizing threats posed by fraud and enhancing the consumer protection with comprehensive channels of complaint resolution mechanism.

vi). Distribution of operating profit and underwriting surplus:

After taking into account the investment returns, provisions for *Re-takāful*, claims and reserves; the balance of the *Takāful* fund is distributed to the eligible participants and shareholders according to the pre-agreed ratio as stipulated in the contract. The distribution of operating profit is an essential element in *Takāful* as it forms the basis of *Takāful* operations relating to the rights of the participants to share the profit of the *Takāful* fund.

Underwriting surplus is the amount of contribution that is left after paying claims and *Takāful* operating expenses (upfront charges, agency fees etc.). It is paid back to participants as *Takāful* operator has no right on it. In the event of deficit in the *Takāful* fund, when claims payment and operating expenses exceed the amount of contribution, the *Takāful* operators provide benevolent loan from the shareholders' fund in order to rectify the deficit which will be repaid from the future profit. The *Takāful* operators may also be required to make direct contributions to the *Takāful* fund in the form of *tabarru'* from the shareholders' fund if the deficit continues to deteriorate.

FIGURE 2.4: FLOW CHART OF OPERATIONAL MECHANISM OF TAKĀFUL



2.1.6 *RE-TAKĀFUL* ARRANGEMENTS

After collecting the contributions, the efforts are then focused on ensuring prudent management of the *Takāful* fund, including the use of *Re-takāful* . *Re-takāful* is basically *Takāful* for *Takāful* operator (Annual Report of Asean Re-*Takāful*, 2006). It is an agreement between *Takāful* operator and Re-*Takāful* Company where original policyholders (participants) of *Takāful* fund are not involved in any way. It is one of the risk management tool used by *Takāful* operators to transfer part of the risk under the *Takāful* fund to another *Takāful* operator or *Re-takāful* company. The amount of risk retained by the *Takāful* operator for its own account is called the retention limit. Re-*Takāful* Operator collects re-*Takāful* contribution from several *Takāful* operators in the region and takes the responsibility to hedge the risks of *Takāful* operators in case the amount of loss exceeds the retention limit. It invests the fund on *modarbah* basis and shares the profit with ceding companies according to pre-determined ratio.

With respect to selection of *Re-takāful* operators, *Takāful* operators should ensure *Re-takāful* coverage is ceded to a financially sound *Re-takāful* operator or a reinsurer. In the current practice, *Re-takāful* arrangements with the reinsurance companies are allowed (*Takāful* Rules 2005) under the circumstances of *"hajah"* (necessity) as lack of *Re-takāful* capacity is still prevalent. In terms of inwards *Re-takāful* arrangements, *Takāful* operators must ensure that acceptance of risks shall comply with the *Shari'ah*.

2.2 ROLE AND FUNCTIONS OF INTERMEDIARIES

In the light of Bank Negara Malaysia *Takāful* Report (2005), *Takāful* intermediaries have specific roles and functions to play in the development and growth of *Takāful* business industry and are described as follow:

i). *Takāful* Agents:

They are representatives of *Takāful* companies, market their business, provide essential information to prospective *Takāful* customers on *Takāful* products, scope of cover, contribution rate etc. They, in return, receive commission from *Takāful* operators for rendering services related to marketing of *Takāful* products to attract and retain prospective *Takāful* customers.

ii). Takāful Brokers:

Takāful broker is a person, firm or a company that acts as an independent contractor on behalf of consumers and sometimes has controversial role as compared with *Takāful* agents. *Takāful* brokers facilitate consumers in placing their application for a *Takāful* certificate, selection of suitable *Takāful* operator, renewal of *Takāful* contract etc. In return, they receive a brokerage fee from consumers for the services rendered.

In Malaysia, it is mandatory for a *Takāful* broker to have a licence from regulatory authority and he must be a member of association of *Takāful* brokers approved by the minister. Failing which may result either eight thousands ringgit fine or imprisonment for six months or both (*Takāful* Act 1984, Section 37(1)).

iii). BancaTakāful:

Banca*Takāful* is a new and emerging concept in the field of *Takāful* industry. It is an arrangement of *Takāful* operator with a bank to act on its behalf to market *Takāful* products. The bank uses its existing network as a distribution channel to expand company's business at a wider scale. The bank could be either a commercial bank or an Islamic bank, yet *Sharī'ah* scholars prefer to use Islamic bank being *Sharī'ah* compliance as an important feature of *Takāful* business.

It would help Takāful operators to create synergies with the banking system and can not only be an effective distribution channel but also serve to drive down operating costs (IIBI, 2003). In Malaysia, there is a significant increase in *Takāful* business through banca*Takāful* distribution channel in 2005 as it accounts for 20.4% of total *Takāful* business as compared to 6.5% in 2004 (BNM Report, 2006).

iv). Takāful Adjusters

Takāful adjusters' main function is concerned with claims assessment and management. They investigate claims, evaluate and calculate losses and make recommendations for claim settlement. They act either on behalf of *Takāful* operator or participants for a specified fee, commission or salary.

In Malaysia, a person illegally acting as an adjuster without having a license may be fined up to twenty thousands Malaysian Ringgit increased by four thousands ringgit for each day on which he was found to be a guilty of the offense or a twelve months imprisonment or both (Takāful Act 1984, Section 38(1)).

2.3 RISK MANAGEMENT

In Islamic financial planning, *Takāful* is a way to reduce the financial risk of loss due to accident and misfortunes (Iqtisad Al-islamy, 2003). As a matter of fact, *Takāful* plan is an alternative to the insurance in the conventional financial planning. In *Takāful* plan, the participant would pay particular amount of money as contribution (known as the premium) partly to risk fund (the participants' special account) using the concept of *tabbaru'* (donation) and partly to another party (known as *Takāful* company) with a mutual agreement that, the *kafiil* (*Takāful* company) is under a legal responsibility to provide for the participant a financial protection against unexpected loss, should it happen within the agreed period.

2.3.1 CONCEPT

"Risk is the chance of happening of something that will have an impact upon our objectives. It is measured in terms of likelihood and consequences" (GOWA, 2002). Traditionally, concept of risk has been associated with uncertainty of events in future. Higher the uncertainty of events, higher is the risk. In insurance, risk is the amount of loss associated with property or life. Risk to property can be a loss or damage to car, building, house, etc. Risk to life can be described as poor health, premature death, bodily injuries as a result of accident etc. (Rejda, 2006; p.23).

Risk management is *a process that identifies loss exposures faced by an organization and selects the most appropriate techniques for treating such exposures* (Rejda, 2006; p. 63). According to New Zealand standard of Risk Management, "*It is the culture, processes and structures that are directed towards the effective management of potential opportunities and adverse effects"*. In fact, risk management is an ongoing process that encompasses all aspects of our life.

2.3.1 RISK MANAGEMENT UNDER *SHARI'AH*

Risk traditionally means possibility of meeting danger or suffering, harm or loss (Iqtisad Al-islamy, 2003). Risk is an element of life in this world for being ignorant of the future. It is also factor of investing that one should take time to understand prior to selecting any specific investment instruments or any new adventures. Muslims are asked to work hard in order to be able to change their conditions as obvious in the verse of Holy Quran, "*... Verily never will Allah change the condition of a people until they change it themselves (with their own souls)...*" (Qur'an 3:11). However, it is true that only *Allah* knows one's future and fate, Muslims should strive to achieve the goodness in this world and the hereafter. Submission to *Allah*, of course, has a positive effect on human behavior. For it will lead to peace and contentment. Undoubtedly, one has to submit every single thing to *Allah*, but it supposes to be after his hands stretch out to do the best effort as he can, to change himself, so that he would be able to manage and to cope with unforeseen calamities or misfortune.

Prophet Muhammad peace be upon him once asked a Bedouin who had left his camel untied, "Why do not tie your camel?" the Bedouin answered, " I put my trust in *Allah*" the prophet then said, "tie up your camel first then put your trust in *Allah*"*(Sunan al -Tirmizi,* vol.4, No. 2517, p. 668). This conversation depicts not only how should Muslims accept their fate but it also indicates how do Muslims reduce the risk of loss and calamities.

Qur'an has presented stories of the previous prophets so that Muslims can take the lessons from their experiences. The story of the prophet Joseph, for instance, tells us about financial planning. The story of Prophet Ya'qub, Joseph's father, tells us about the management of risks as Ya'qub commanded his sons to enter Egypt from different gates. Qur'an states, "*Further he said: "O my sons! Enter not all by one gate: enter ye by different gates. Not that I can profit you aught against Allah (with my advice): None can command except Allah: On Him do I put my trust: and let all that trust put their trust on Him*" (Qur'an 12:67).

The history of the prophet's migration to Madinah gives us other lessons on how the Prophet (SAW) managed the risk. The Prophet reduced the risk of getting killed by asking Hazrat Ali (R.A.) to sleep in his bed during the night of emigration. It was reported that as night advanced, the Quraish posted assassins around the Prophet's house. Thus they kept vigil all night long, waiting to kill him the moment he left his house early in the morning, peeping now and then through a hole in the door to make sure that he was still lying in his bed.

All these above examples depict that risk management is in the roots of Islam. We, as a Muslims, should put our trust onto *Allah* only after meticulous planning and best utilization of all the available resources.

2.3.2 NORMS OF ETHICS

Obaidullah (2002, pp.2-4) has identified norms of efficiency and ethics for *Sharī'ah* based risk management in a business contract. These norms are also applicable to *Takāful* contract and are briefly described as follow:

i. Each party in *Takāful* contract should be free to accept the terms and conditions of the contract and no coercion is imposed on any party.

ii. *Takāful* contract should be free from element of *'riba'* (interest) that is prohibited by *Shari'ah.* One of the major objections on the contract of conventional insurance by *Sharī'ah* scholars is element of *'riba'* in its investments for which it is considered illegal and unIslamic.

iii. There should be no uncertainty or ambiguity about the nature of contract. Excessive uncertainty is not permissible in *Shari'ah*. For example, *Sharī'ah* scholars disallow conventional insurance contract where no party clearly knows how and from where the insured amount is to going to be paid in case a loss or catastrophe occurs to the insured.

iv. There should not be any element of gambling in *Takāful* contract. It means that *Takāful* contract should not be aimed at getting a huge advantage at the cost of others. Rather, participants should have sincere intention of helping each other in case of loss or catastrophe from a joint fund.

v. Contribution amount for participants should be adequate and fair and should be determined by actuaries and approved by *Sharī'ah* scholars.

vi. *Takāful* customers (participants) should have equal access to adequate, accurate and timely market information related to *Takāful* products and company's performance where they want to contribute their money.

vii. Rights of any third party should not be adversely affected by *Takāful* contract between two parties. It means *Takāful* contract should not be detrimental to any third party.

viii. There should be unrestricted public interest in *Takāful* products and its business contract which should work for the benefit of people at large.

2.3.3 TYPES OF RISKS IN *TAKĀFUL*

Business industry is prone to a number of risks. Five types of risks in business (Basel, 2006; IAIS, 2004) have been identified that are relevant to *Takāful* business. First two types of risks (underwriting and operational risks) are directly related to operations of *Takāful* company while remaining three (credit, liquidity and market risks) are associated with the investment activities of the company.

i. Underwriting Risk:

Underwriting risk is pertinent to insurance and *Takāful*. It occurs due to adverse selection of applicants or due to re-*Takāful* risk as a result of inability of re-*Takāful* operator to meet the obligation towards ceded company under re-*Takāful* agreement (IAIS, 2003; pp.32-33). Adverse selection refers to the tendency of selecting applicants that result in higher than average chance of loss (Rejda, 2006; p. 45). The risk of adverse selection arises when applicants with higher than average chance of loss succeed in obtaining *Takāful* coverage at standard rates e.g. high risk drivers or persons with serious health problems. It results in higher claim ratio and put the firm on high liquidity constraints. Re-*Takāful* risk occurs as the ceded company remains liable for a portion of outstanding claim to the extent re-*Takāful* operator fails to provide financial protection to *Takāful* operator in accordance with agreed terms. Both adverse selection and re-*Takāful* risk hamper the firm's underwriting capacity; disturb the cash flow pattern and hence affect the stability of the profits of the company.

ii. Operational Risk:

Operational risk is not a well defined concept , yet Basel Report (2006, p.144) defines it as a loss that occurs as a result of inadequate or failed internal processes, people, technology or from external events.

Internal processes failure occurs (Ahmed & Khan, 2001; pp.29-30) as a result of inaccurate processing of transactions, inefficient record keeping, violating operational control limits, non-compliance of regulations etc. people risk may occur due to incompetence of employees, fraud and failure to perform the duties. Technology risk may arise as a result of telecommunication system or computer network breakdown. Risks from external events include unenforceability of regulatory policies, legislation and regulations that affect the fulfillment of contracts and transactions in the organizations. These risks are also called legal risks and are considered a part of operational risks.

iii. Credit Risk:

Credit risk occurs a result of default of counterparty when it fails to meet its obligations in time and in accordance with agreed terms (IAIS, 2004; p.14).

In case of insurance, credit risk may be treated as default risk, migration risk, spread risk or concentration risk. Default risk occurs when *Takāful* operator does not receive or partially receive cash flows or assets to which it is entitled because the other party fails to meet the obligations of the contract. Migration risk occurs when probability of a future default of an obligator adversely affect the contract today. Spread risk occurs due to market perception of increased risk on either macro or micro basis. Concentration risk is the result of increased exposure to losses due to concentration of investments in a particular geographical area or economic or industrial sector. *Takāful* industry is also exposed to these risks.

iv. Liquidity Risk:

Liquidity risk is the risk resulting from *Takāful* company's inability to meet its obligations (i.e. claims payments and maturity price of policy) when they fall due. This risk occurs because the company has insufficient liquid assets or high level of liabilities (IAIS, 2004; p.18). Liquidity risk includes liquidation risk, affiliation investment risk and capital funding risk.

Liquidation value risk is the risk under circumstance when assets are liquidated below their real (market) value. Affiliated investment risk is the risk that investment in an affiliated or member company might result in drain of financial or operating resources. Capital fund risk is the risk that insurance company will not be able to outsource funds in case of large claims. *Takāful* industry, just like conventional insurance company, faces similar types of liquidity risks.

v. Market Risk:

Market risk is the volatility of prices in instruments and assets of *Takāful* company in the market. It can be classified as equity price risk, interest rate risk, currency risk and commodity price risk (IAIS, 2004, p.12). Equity price risk is the risk of loss resulting from changes in market price of equities or other assets. Interest rate risk is the risk of loss resulting from changes in interest rates that adversely affect the cash flows of the insurance company. Currency risk is the risk of los resulting from volatility of exchange rates that adversely affect the operations of insurance company.

For a *Takāful* company, it does not include interest rate risk, however *Takāful* operators are exposed to mark up price risk as avoidance of interest based transactions is distinctive feature of *Sharī'ah* compliance.

2.3.4 MANAGING RISKS

All types of risks in *Takāful* require specific risk management strategy and need to be managed on individual basis.

i. Underwriting Risk Management:

Underwriting risk can be managed by establishing standard selection procedure consistent with the company's objectives. Most of the *Takāful* operators require physical inspection or medical reports of the applicants that have serious health problems or prone to higher than average risk. Some have introduced computerized underwriting system to standardized underwriting procedure and minimizing the chance of adverse selection. For example, *Takāful* Ikhlas Sdn. Bhd. of Malaysia uses computerized underwriting procedure for motor *Takāful* where applicants who meet standard requirements are automatically selected for *Takāful*. Others are rejected or alternatively are offered higher contribution rates for the extra risk. To minimize re-*Takāful* risk, *Takāful* operator can evaluate the financial strength of re-*Takāful* operators in the region and diversify the risk geographically by making arrangements with more than one re-*Takāful* operator.

ii. Operational Risk Management:

Management of this risk is more complex as it arises from failure of internal processes, people, information system breakdown and non-compliance with regulatory standards (Ahmed & Khan, 2001; pp. 38-39). Senior management and board of directors of *Takāful* company should devise policies and develop strategies to manage and reduce operational risks. Sources of operational risk (i.e. people, processes and technology) should be handled carefully. This raises the importance of corporate governance culture in the organization. Given the newness of *Takāful* industry, computer software available for conventional insurance might not be appropriate for *Takāful* industry. This calls for recruiting talented professionals in the field of informational technology so that they could develop software to meet peculiar needs of *Takāful* industry. Independent external auditors can also play an important role in mitigating operational risk as they point out flaws in internal processes of the organization. This calls for proper disclosure of activities and independent and secure reporting system.

iii. Credit Risk Management:

Credit exposure limits should be established within *Takāful* company's investment policies to mitigate and manage default risk, migration risk, spread risk and concentration risk as discussed under credit risk. Following credit exposure limits can be established for *Takāful* company investment and credit activities (IAIS, 2004; pp.16-18).

- Internal and external rating of counterparties
- Limit on maturity of credit facility (prefer short term credit over long term credit)
- Limit on maximum investment amount or a certain percentage of investment exposure to a single issuer, industry, geographical region or some other risk classification.

Prohibition of interest does not allow *Takāful* companies to investment in interest-based instruments (Chapra and Khan, 2000). Moreover, *Takāful* companies do not have access to credit derivatives that are considered effective instruments for credit risk mitigation. Yet Al-Suwailem (2006; pp.67-68) argues that futures and Option contracts result in losses for more than 70% of the time and hence such instruments are considered as factors of loss, not of gain. The non-availability of Islamic derivatives raises the importance of internal control mechanism for *Takāful* operators which ensures that credit risk exposures are maintained within limits of prudential standards defined by internal controls.

iv. Liquidity Risk Management:

IAIS Report (2004, p.20) identifies two approaches in order to hedge liquidity risk that are also applicable to *Takāful* industry. These are:

i. Cash flow modeling
ii. Liquidity ratios

Cash flow modeling is done in order to assess the amount of deficit, surpluses or liquidation value risk in order to meet the needs of *Takāful* industry. *Takāful* operator should make sure that it has sufficient liquid assets in order to meet liquidity risk and unexpected liquidity requirements.

Use of liquidity ratios will help *Takāful* operator to set the amount of liquid assets required to meet demands of liability portfolio, desired level of liquidity ratio will also help in determining *Takāful* operator's investment policies.

Capital funding risk could be mitigated by setting contingency plans and drawing cash from re-*Takāful* policies. This form of liquidity hedging could be recognized by knowing current level of liquid assets in hand to meet *Takāful* operator's investment policies. In order to identify and evaluate liquidity risks, Ahmed and Khan (2001, p.38) emphasize the need of adequate internal control and proper disclosure of information in the organization. Towards this end, it is essential to have regular independent reports and internal audit function should periodically review the liquidity risk management process.

v. Market Risk Management:

Management of market risk includes devising strategies to manage interest rate risk, exchange rate, and commodity price risk as well as equity price fluctuations. *Takāful* operators are not involved in interest based transactions so they do not face this risk. However, KIBOR (Karachi Inter Bank Offered Rate) can be used as bench mark for markup in Islamic financial institutions in their financing activities.

Conventional institutions manage the market risk using financial derivatives such as futures, forward, option or swap contracts (Chapra & Khan, 2000; p.55). *Takāful* operators face difficulty in managing market risk as these financial derivatives are not compatible with *Sharī'ah* in the eyes of Islamic scholars. However, according to Al-Suwailem (2006; pp.118-126), cooperative hedging and bi-lateral mutual adjustment are acceptable instruments under *Sharī'ah* to mitigate currency risk and interest rate risk respectively. Additionally, *Takāful* operators could apply stress tests and Value at Risk (VaR) techniques to mitigate commodity price risk and equity risk. Stress testing is one of the risk management tools that can be employed to assess the vulnerability of portfolios to abnormal shocks and market conditions. Value at Risk is the probability of portfolio losses exceeding some specified proportion.[5]

2.3.5 ENHANCING RISK MANAGEMENT CULTURE

Cultivation of risk management culture is extremely important to form a robust and resilient *Takāful* industry in Pakistan. This objective, however, could not be achieved without active participation and collaboration of regulatory authorities, senior management of *Takāful* companies and members of *Sharī'ah* Supervisory Board (SSB). Towards this end, regularities authorities should make sure that stress testing and Value at Risk (VaR) reports as identified above are regularly produced and obtained from senior management of *Takāful* operators in addition to reports of *Takāful* risks. Regular review of these reports will greatly facilitate the regulatory authorities as well as *Takāful* operators to enhance risk management practices in *Takāful* industry.[6]

Moreover, effective implementation of internal control and corporate governance system could prove to be of vital importance to *Takāful* operator as well as to concerned regulatory authority. It will help the authorities in effective monitoring of *Takāful* activities and managing different types of risks hence enhancing the functioning of *Takāful* operators in the industry.

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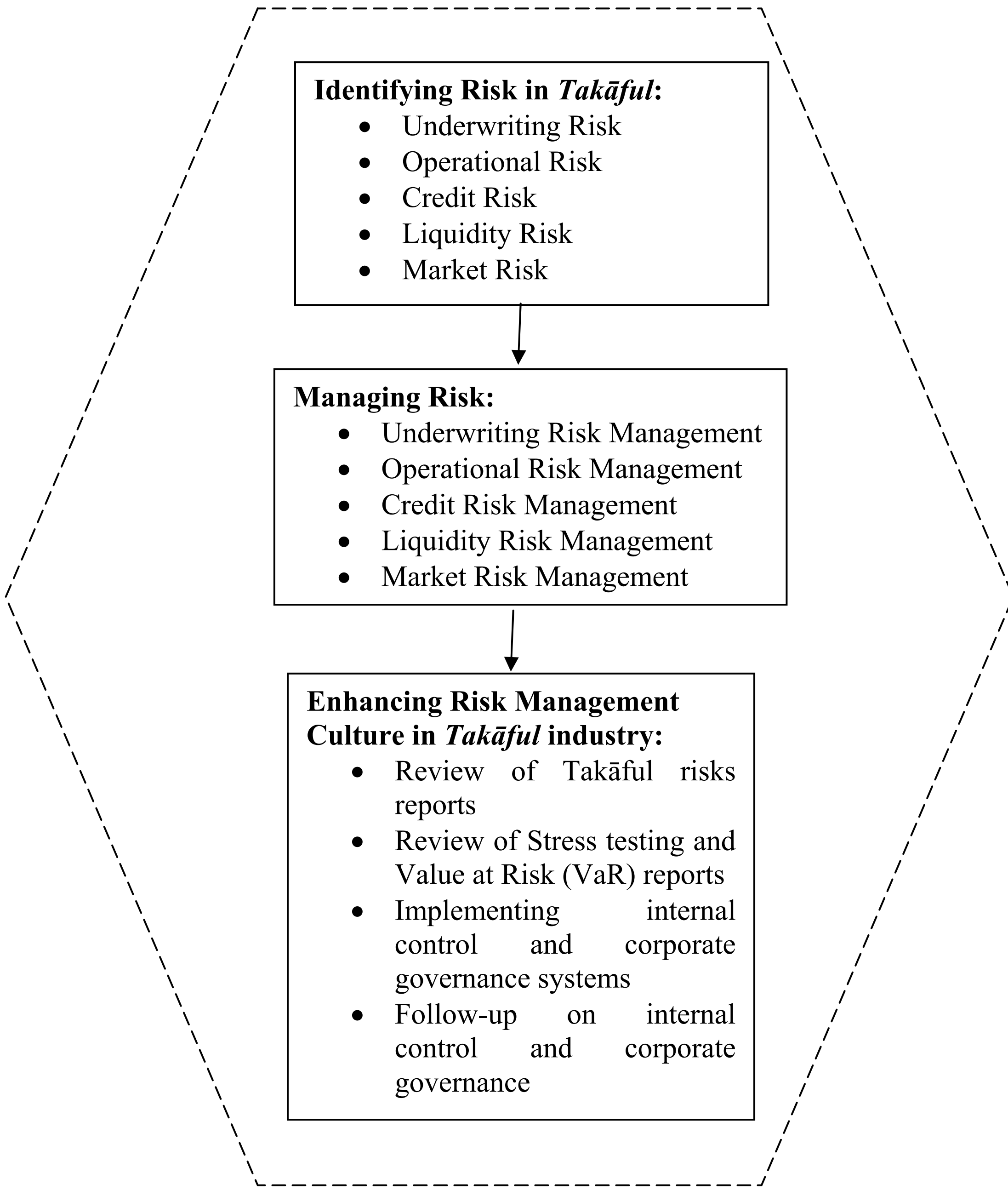
[5] For details of stress tests and Value at Risk (VAR) techniques, see BIS (2000). *"Stress testing by large financial institutions: Current practice and aggregation issues*" and Blaschke et al. (2001). *"Stress testing for financial systems: An overview of issues, methodologies and FSAP experiences"*

[6] See Chapra, U. & Khan, T. (2000). *"Regulation and Supervision of Islamic Banks",* Occasional paper No. 3, Islamic Research Training Institute, Islamic Development Bank, Jeddah, pp. 56-57

FIGURE 2.5: FLOW CHART OF RISK MANAGEMENT IN *TAKĀFUL*



2.4 CHALLENGES TO RISK MANAGEMENT

In spite of effective risk management techniques discussed above, there are certain challenges in the way of risk management for *Takāful.*

i. Internal Controls:

Internal controls are indispensable for recognizing and assessing risks faced by financial institutions including *Takāful* companies. Basel Committee (2005) and IAIS (2006a) reports have focused on the importance of internal controls for banking institutions as well as for conventional insurance companies respectively. Chapra and Ahmad (2002) found that existence of effective internal control have prevented the financial institutions from systemic crisis and enabled them to have early detection of problems and associated risks they might face in future. These experiences highlight the importance and need of internal controls for *Takāful* companies. Unique nature of these companies from conventional insurance demands the fulfillment of *Sharī'ah* aspects. IFSB and IAIS joint working group (2006) maintains that to have effective internal control mechanism, *Takāful* companies must ensure *Sharī'ah* controls in addition to all statutory regulations. It urges the need of a regular *Sharī'ah* audit as a part of an on-going internal control system.

ii. Corporate Governance:

The corporate governance structure specifies the distribution of rights and responsibilities of the Board, manager, shareholders and other stakeholders (OECD Report, 1999) yet effective corporate governance ensures the independence of board of directors (BOD) who in turn devise polices and implement strategies for risk management and hold the management accountable to shareholders (Psaros and Seamer, 2002; p.7). Lack of an effective corporate governance framework hampers the independence of board of directors (BOD) and hence poses a challenge to risk management. It in turn increases the operational risk which might result in failure of operations due to inability of BOD to implement unbiased and independent decisions for the best interest of all stakeholders. *Takāful* companies are confronted with an additional challenge related to corporate governance of *Sharī'ah* Supervisory Board (SSB). Grais and Pellegrini (2006b) identify corporate governance issues that affect their role and functioning in the organizations. It calls for a greater need to incorporate corporate governance culture to overcome related issues of *Takāful* industry.

iii. *Sharī'ah Based Challenges:*

According to Ahmed & Khan (2001), most of the risk management techniques are not applicable to Islamic financial institutions due to the requirements of *Sharī'ah* compliance. It creates *Sharī'ah* based challenges to risk management for *Takāful* companies as well. These challenges arise as *Sharī'ah* restricts the use certain instruments that are considered useful in conventional risk management e.g. derivatives (futures, options, swaps etc.) and sale of debts. Al-Suwailem (2006, pp.89-90) argues that *Sharī'ah* constraints to human behavior do not hinder creativity, rather these constraints are the major driving force behind the creation of innovative financial instruments. He suggests several Islamic financial instruments for risk management and concludes that *Sharī'ah* is abundant with real solutions to the present problems of gambling and speculation. It provides directions to *Sharī'ah* scholars and experts of Islamic finance to explore the dimensions of *Sharī'ah* in order to integrate risk management practices with value creation.

iv. *Financial Engineering:*

Financial engineering aims at designing new and innovative *Sharī'ah* compliant Islamic financial instruments for IFIs including *Takāful* companies. Chapra and Ahmad (2002) maintain that financial engineering has emerged as the greatest challenge faced by *Sharī'ah* scholars of present time as it poses major threat to IFIs to become competitive in the contemporary business environment. Process of giving *fatwās* by *Sharī'ah* scholars regarding the permissibility of a financial instrument is quite slow and over-conservative (Iqbal et al, 1998; pp.47-48) as *Sharī'ah* scholars and experts of modern finance have different academic backgrounds. They use technical terms related to their own field that are most of the time not easily understandable to other party. The need is to produce scholars with *Sharī'ah* background that also have working knowledge of modern finance to meet the acute challenge of financial engineering.

v. *Islamic Financial Market:*

Islamic financial market provides a secondary market for trading of Islamic financial instruments. In the absence of this market, it will be extremely difficult for *Takāful* companies to maintain its liquidity position to make prompt claim payments when they become due. Retaining a large portion of *Takāful* fund to maintain high liquidity ratio will affect the efficiency of the firm and its competitiveness as compared to conventional insurance companies that have ready access to liquid bonds and t-bills. Islamic Financial Market will greatly facilitate the *Takāful* companies to invest large portion of their fund in Islamic financial instruments and increasing their efficiency and competitiveness while maintaining low liquidity ratio. It will also help *Takāful* companies in hedging market risk by providing alternative instruments to financial derivatives that are not acceptable under *Shari'ah*.

vi. *Need of Private Credit Rating Agencies:*

Although International Islamic Rating Agency (IIRA) has been set up in Bahrain to judge the *Sharī'ah* compliance and financial strength of Islamic financial institutions (IFIs) including *Takāful* companies, it is not be possible for IIRA to rate thousands of counterparties with whom *Takāful* companies deal. Consequently, it calls for the need of private credit rating agencies in each Muslim country that could provide information related to financial strengthen, fiduciary risk and credit worthiness of thousands of counterparties that privately issue financial instruments (Chapra & Ahmed, 2002; pp.80-81). This information could provide great help to IIRA in rating these companies and make it readily available to *Takāful* companies and other interested parties.

CHAPTER SUMMARY

Takāful scheme is based on brotherhood, solidarity and mutual assistance to the members in case of need where each participant contributes a fixed amount to *Takāful* fund. There are two classes of *Takāful* business. Family *Takāful* business includes long term *Takāful* products whose maturity period is more than one year. General *Takāful* products includes short term *Takāful* plans whose maturity period is one year or less. Income for *Takāful* operator includes *Takāful* operator's fees, profit from shareholder fund and *modarbah* share from PTF. Participants pay contribution as donation with good faith. *Takāful* operator acts on behalf of participants and benefits of *Takāful* policy are distributed according to the Islamic laws of inheritance. *Takāful* is acceptable in Islam as it is free from uncertainty, gambling and interest. It is neither against the will of *Allah* nor against *tawakkul*. Operations of *Takāful* company start with marketing of *Takāful* products through *Takāful* intermediaries. *Takāful* operator underwrites the applicants for risk assessment. Contribution is collected from the qualified applicants. Amount in *Takāful* fund is then invested in *Sharī'ah* approved instruments. Profit is added to *Takāful* fund and claims are paid to the loss affected members out of the fund. Remaining profit and surplus is distributed back to participants with no prior claims. Re-*Takāful* arrangements are also considered essential to transfer a part of *Takāful* risk to re-*Takāful* operator.

Takāful intermediaries play a major role in reaching far-off markets for the expansion of *Takāful* business. *Takāful* agents are commission based representatives of *Takāful* companies who provide essential information to prospective *Takāful* customers on *Takāful* products. *Takāful* broker acts as an independent contractor and assists consumers in placing their fresh applications or renewal of *Takāful* contract for a brokerage fee for the services rendered. In banca*Takāful*, the bank offers its existing network as a distribution channel to expand *Takāful* company's business at a wider scale. *Takāful* adjusters' main function is concerned with claims assessment and management. They investigate claims, evaluate and calculate losses and make recommendations for claim settlement.

Risk management is of vital importance in Islam and *Takāful* provides a way to manage risks in business according to *Sharī'ah* principles. Five types of risks have been identified in *Takāful* business that affect operational and investment functions of *Takāful* operator. Underwriting risk occurs due to adverse selection of applicants or due to re-*Takāful* risk. Operational risk occurs as a result of inadequate or failed internal processes, people, and technology or from external events. Credit risk occurs as a result of default of counterparty when it fails to meet its obligations in accordance with agreed terms. Liquidity risk is the risk resulting from insurance company's inability to meet its obligations (e.g. claims payments). Finally, market risk is volatility in the prices of instruments and assets of the *Takāful* company in the market. Operational risk can be managed by enhancing corporate governance culture in the organizations. Cash flow modeling and use of liquidity ratios is quite helpful to identify liquidity constraints. *Takāful* operators might face difficulty in managing market and credit risks as *Sharī'ah* compliant nature of *Takāful* contract does not allow *Takāful* companies to deal with interest rate and financial derivatives due to their speculative nature by which they tend to benefit one party at the loss of other. On the other hand, Islamic financial instruments like cooperative hedging and bi-lateral mutual adjustment aim at providing mutual gains to both parties by the way of risk sharing.

Risks associated to *Takāful* have raised several challenges that need to be encountered to enhance risk management practices. Regular *Sharī'ah* audit is found to be an integral part of effective internal controls that prevent the companies from systemic crisis. Corporate governance calls for independence of BOD to devise policies for effective risk management, make unbiased decisions and solve issues related to functioning of SSB. *Sharī'ah* based challenges call for devising innovative Islamic financial instruments as *Sharī'ah* is abundant with real solutions to present business dilemma and does not hinder creativity. Exploring those solutions will help to meet the challenge of financial engineering. Islamic financial market will greatly facilitate the task of *Takāful* companies to invest large portion of their fund in Islamic financial instruments and increase their efficiency and competitiveness. There is need to establish private credit rating agencies that could assist IIRA to rate thousands of counterparties for the benefit of *Takāful* operators.

CHAPTER 3

TAKĀFUL MODELS AND GLOBAL PRACTICES

INTRODUCTION

There is a global interest in Islamic finance in general and *Takāful* in particular. The main feature that differentiates *Takāful* services from conventional ones is *Sharī'ah* compliance nature of these services. Investors are taking keen interest in this potential market as Muslims constitute about one fourth of the world population (Muslim population, 2006). To streamline operations of a *Takāful* company, management and *Sharī'ah* experts have developed different operational models for *Takāful* business. *Takāful* model is the basis of the company operational activities. It provides conceptual framework for the operations of *Takāful* Company and sets a path for the flow of funds in the organization. All the transactions of the company business are carried out in the light of conceptual framework of *Takāful* model adopted by the company. A number of *Takāful* companies are successfully operating in Muslim and Arab countries and they are growing each year. Many conventional insurance companies, showing their interest in *Takāful*, have opened *Takāful* windows to compete with *Takāful* companies.

This chapter discusses different *Takāful* models being practised by *Takāful* operators across the world. The chapter is mainly divided into three sections. First section discusses functioning and conceptual mechanism of *Takāful* models practised by *Takāful* operators across the world. It gives practical examples to explain functioning of each *Takāful* model in detail. Second section raises some *fiqh* related issues faced by *Takāful* operators practicing different *Takāful* models in different countries. Third section gives a description of financial performance of selected *Takāful* companies in different countries. Financial performance of the companies has been analyzed on the basis of net profit, growth of insurance premium of family and general *Takāful*, growth in total assets. Return on Assets (ROA) gives an overall measure of financial performance. An attempt has been made to analyze the financial performance of *Takāful* companies during past 5-year period. Yet due to lack of availability of the data related to *Takāful* companies, the analysis for some companies is based on two or three years of financial performance.

3.1 *TAKĀFUL* MODELS IN PRACTICE

Theoretically, *Takāful i*s perceived as *cooperative insurance* (*Takāful* models in practice, 2006), where members contribute towards a common pool yet the commercialization of *Takāful* has produced several models of Islamic insurance, each reflecting a different experience, environment and perhaps a different school of thought. Currently following models are being practised in *Takāful* companies across the world.

3.1.1 *TAKĀFUL TA'AWUNI* (NON-PROFIT MODEL)

Ta'awuni model (Billah, 2004c; pp.5-8) is based on the concept of brotherhood, solidarity and mutual cooperation among participants to achieve well-being of those who are in great need of help due to a sudden calamity, misfortune or disaster. This model seeks to achieve welfare of *Takāful* participants and community at large. *Takāful* operator acts as a trustee on behalf of participants with no intention of making profit. That's why this model is also called non-profit model. The profit and underwriting surplus are distributed entirely to the participants.

Let's consider the following example to illustrate how the concept of ta'awuni model is applied. A (first party) lends his money to B (second party) and B manages the fund sincerely with no intention for profit making or benefit. Here A is the participant where B is *Takāful* operator who manages the fund. It is important to acknowledge that the contribution paid is actually based on the principles of *Tabar'ru`.* A *tabar'ru`* concept is rather a one-way transaction in which once the contribution is made, the contributor has no right to take any benefits out of it. The fund is used for any participant who faces difficulties within the time period as agreed on insurance policy. When the participant contributes to the fund, he is indirectly applying the golden principle of 'bear ye one another's burden'.

Qardawi (n.d., p. 75) has clearly mentioned that this concept of mutual cooperation is absent in prevalent system of insurance. He says: *"As far as insurance* *companies-especially life insurance are concerned, they do not satisfy these conditions in any respect because the insured individuals do not pay the premium as donations; such a thought never occurs to them…"*

Rahman (n.d., p. 24) has described that it is incorrect to imply that the principles of 'mutuality' in all insurances. He asks: *"How can all forms of insurance be mutual when this mutual character is actually unknown to the insurer and insured? What is the value of an economic interdependence among all the insured and between the insured and the insurer, of which neither of them is aware?"*

These findings of research scholars urge us to seriously think on the issue of mutual cooperation in *Takāful* system and to inculcate true Islamic spirit of cooperation among members of society so that benefits of implementing an Islamic insurance system could be achieved in reality.

Global Practices

The concept of *ta'awuni* (Billah, 2004c; pp.5-8) was originated in Sudan in 1979 when first *Takāful* company started its operations in Sudan. After that, insurance companies are bound to follow ta'awuni model and adopt *Takāful* business by law. *Ta'awuni* model was also adopted and being practised by Bank al-jazira Saudi Arabia when the scholars realized that there is a need for cooperation in insurance under the umbrella of *Shari'ah*. Thus came the idea that members should donate their contribution to a fund (*Takāful* fund) to compensate the members in case of distress. Both the participants and *Takāful* operators should acknowledge their rights and obligations to the fund. The profit and underwriting surplus solely belongs to the participants.

3.1.2 *MUDHĀRABAH* MODEL (*TIJARI*)

In *Takāful*, *Mudhārabah* model is a profit sharing contract (Billah, 2004c; pp.4-6) where participants provide capital in the form of contribution and *Takāful* operator acts as a mudarib who provides his management expertise to efficiently utilize the *Takāful* fund. It is also called *tijari* model as it works on commercial business basis. *Takāful* operator shares the profit from investment of *Takāful* fund and is responsible for all management expenses.

In family *Takāful* plan, Participant's contribution is divided into two parts. The major portion of the fund goes into Participants' Account (PA) that belongs to participant whereas smaller portion is contained in Participants' Special Account (PSA) that is used to pay claims and underwriting costs. Entire amount of PA and PSA is invested in *Sharī'ah* approved instruments. Profit from PA is shared between participants and *Takāful* operator according to agreed ratios. Profit and the amount in PSA are used to pay for claims and underwriting costs. In case, claims payments and underwriting costs exceed the amount prescribed in PSA, the loss is compensated from PA or shareholders may provide interest free loan (qard-e-hasana). In case, claims and underwriting costs are less than the amount available in PSA, the amount left is treated as underwriting surplus and shared between *Takāful* operator and the participants. In *Mudhārabah* model, *Takāful* operator claims to share in underwriting surplus as an incentive for efficiently managing *Takāful* funds.

In general *Takāful* plan, there is no PA A/C and participants' contribution goes directly to PSA that may be invested and is used to pay for underwriting costs and claims. A portion of PSA fund after taking into account profit from investment can be retained as contingency reserve for future. Any amount left is treated as underwriting surplus and is shared among participants and *Takāful* operator according to agreed ratios.

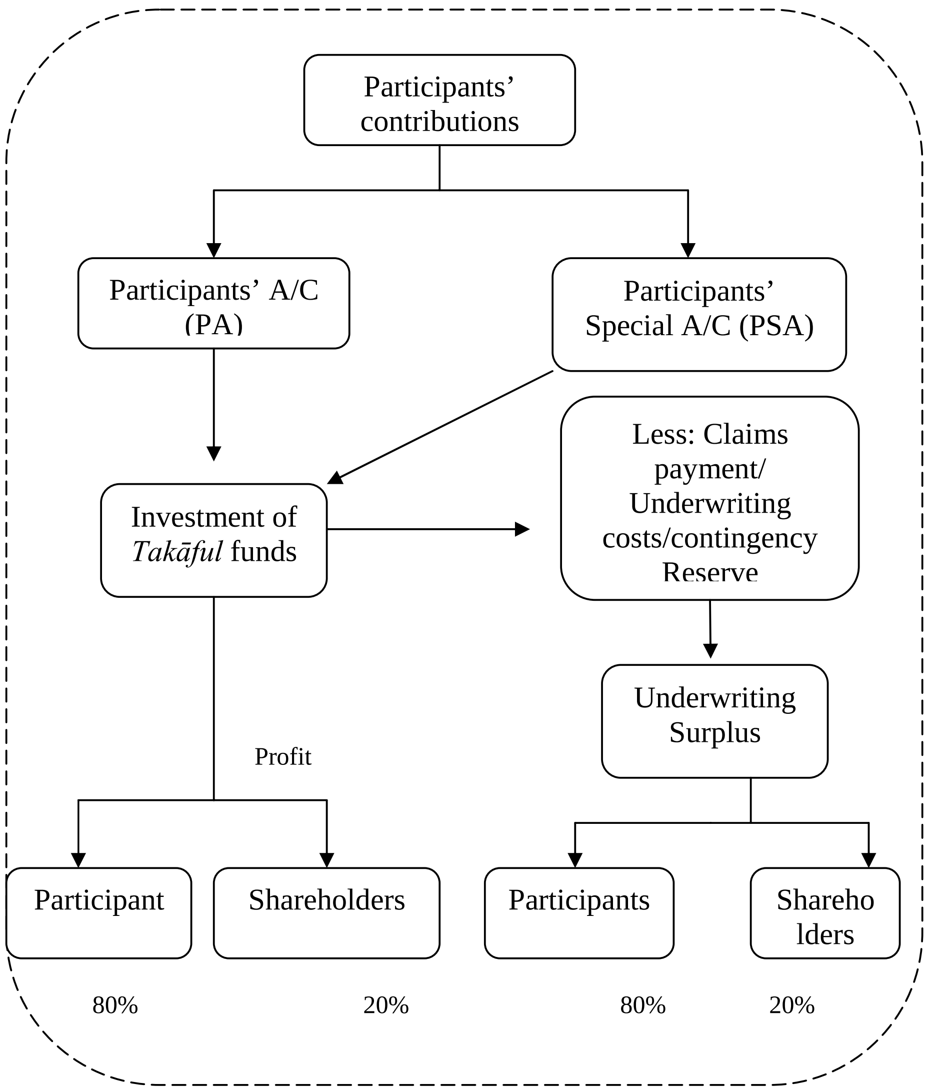
a. Global Practices

Mudhārabah model has been in operation in Malaysia for almost 20 years since the incorporation of Syarikat *Takāful* Malaysia in 1985, the first and the largest *Takāful* company in Malaysia. With its foundation firmly established, the *Mudhārabah* model in Malaysia has proven to be both viable business venture as well as profitable to consumers and investors alike. Besides Malaysia, *Mudhārabah* model is also being practiced in Brunei. It is reported that *Takāful* operators in Brunei have been paying almost 36% profit to their participants (*Takāful* Malaysia News bulletin, 2001).

b. The Model

The Figure 3.1 below shows a flow chart of modarbah model for family *Takāful* practiced by Syarikat *Takāful* Malaysia. Here, Participants' contribution is distributed in two accounts i.e. Participants' Account (PA) and Participants' Special Account (PSA). PSA is risk management account which is used to pay for the loss (claims payment) where as PA belongs to participant. Greater portion of contribution is allocated to PA as compared to PSA (e.g. 80% of the contribution goes to PA whereas 20% goes to PSA). Amount in both accounts is invested together in *Sharī'ah* based instruments and profit is allocated proportionally to both accounts. After deducting Claims payment, Underwriting costs and contingency expenses from PSA, surplus is shared between participants and shareholders according to pre-determined ratios. The whole amount in PA together with profit is delivered to the participant after the maturity period.

FIGURE 3.1: MUDARBAH MODEL



Source: Sharikat Takāful Malaysia Berhad. www.Takāful-malaysia.com

HOW DOES *MUDHĀRABAH* MODEL WORK?

FIGURE 3.2: FAMILY *TAKĀFUL* PLAN (FIRST YEAR)

Total contribution Rs. 100,000
Return on investment 10%

Allocation to PA = Rs. 80,000 (80%)		Allocation of PSA = Rs. 20,000 (20%)	
Profit (10%)	= Rs. 8,000	Profit (10%)	= Rs. 2,000
Total fund	= Rs. 88,000	Total fund	= Rs. 22,000
		Less:	
		Claim payments (10%)	= Rs. (10,000)
		Underwriting costs	= Rs. (5,000)
		Surplus	= Rs. 7,000
		Participants' share (80%)	= Rs. 5,600
	Rs. 5,600 ←		
Accumulation to PA	=Rs. 93,600		

The Figure 3.2 shows a practical example for the flow chart of *modarbah* model for first year after receiving *Takāful* contribution. Here, it is assumed that company has initial contribution of Rs.100, 000 that is distributed into two accounts i.e. a greater portion (Rs.80,000) goes to Participants' Account (PA) whereas smaller portion (Rs.20,000) is kept for Participants' Special Account (PSA) to cover the loss (claims payment) as it occurs to any of the participants. Amount in both accounts is invested together in *Sharī'ah* based instruments and profit is allocated proportionally to both accounts. Assuming a profit of 10% from the investment of *Takāful* fund, Rs.8000 goes to PA whereas Rs.2000 goes to PSA. Adding the profit, amount in PA reaches toRs.88,000 and amount in PSA becomes Rs.22,000. Claim ratio is assumed to be 10% while underwriting cost is estimated as 5% of the total contribution for the first year. After deducting Claims payment and underwriting costs from PSA, surplus of Rs.7000 is obtained that is shared between participants and shareholders according to pre-determined ratios. 80% of the surplus (Rs.5600) goes to PA while 20% (Rs.1400) goes to PSA. After adding participant's share, amount in PA becomes Rs.93,600. It is used as an opening account for the second year.

FIGURE 3.3: FAMILY *TAKĀFUL* PLAN (SECOND YEAR)

Total contribution Rs. 100,000
Return on investment 10%

Allocation to PA = Rs. 80,000 (80%)	Allocation of PSA = Rs. 20,000 (20%)
Profit (10%) = Rs. 8,000	Profit (10%) = Rs. 2,000
Total fund = Rs. 88,000	Total fund = Rs. 22,000
	Less:
	Claim payments (10%) = Rs. (10,000)
	Underwriting costs = Rs. (5,000)
	Surplus = Rs. 7,000
	Participants' share (80%) = Rs. 5,600

Rs. 5,600

2^{nd} year PA fund = Rs. 93,600
Balance in PA = Rs. 93,600
Profit earned in 2^{nd} year (10%) = Rs. 9,360

Accumulation to PA = Rs.196, 560

The Figure 3.3 shows a practical example for the flow chart of *modarbah* model for second year. The procedure for the flow of *Takāful* contribution is the same as that of first year. The only difference is that balance of first year (Rs.93,600) together with the profit earned in second year is also added to PA fund. Hence total accumulation to PA fund becomes Rs.196, 560 by the end of second year.

FIGURE 3.4: FAMILY *TAKĀFUL* PLAN (THIRD YEAR)

Total contribution Rs. 100,000
Return on investment 10%

Allocation to PA = Rs. 80,000
(80%)

Profit (10%) = Rs. 8,000

Total fund = Rs. 88,000

Allocation of PSA = Rs. 20,000
(20%)

Profit (10%) = Rs. 2,000

Total fund = Rs. 22,000

Less:
Claim payments = Rs. (10,000)
(10%)
Underwriting costs = Rs. (5,000)

Surplus = Rs. 7,000

Participants' share = Rs. 5,600
(80%)

Rs. 5,600

3rd year PA fund = Rs. 93,600
Balance in PA = Rs. 196, 560
Profit earned in
3rd year (10%) = Rs. 19,656

Accumulation to PA = Rs.309, 816

The Figure 3.4 shows a practical example for the flow chart of *modarbah* model for third year. The procedure for the flow of *Takāful* contribution is the same as that of first year. The only difference is that balance of second year (Rs.196, 560) together with the profit earned in third year is also added to PA fund. Hence total accumulation to PA fund becomes Rs.309, 816 by the end of second year.

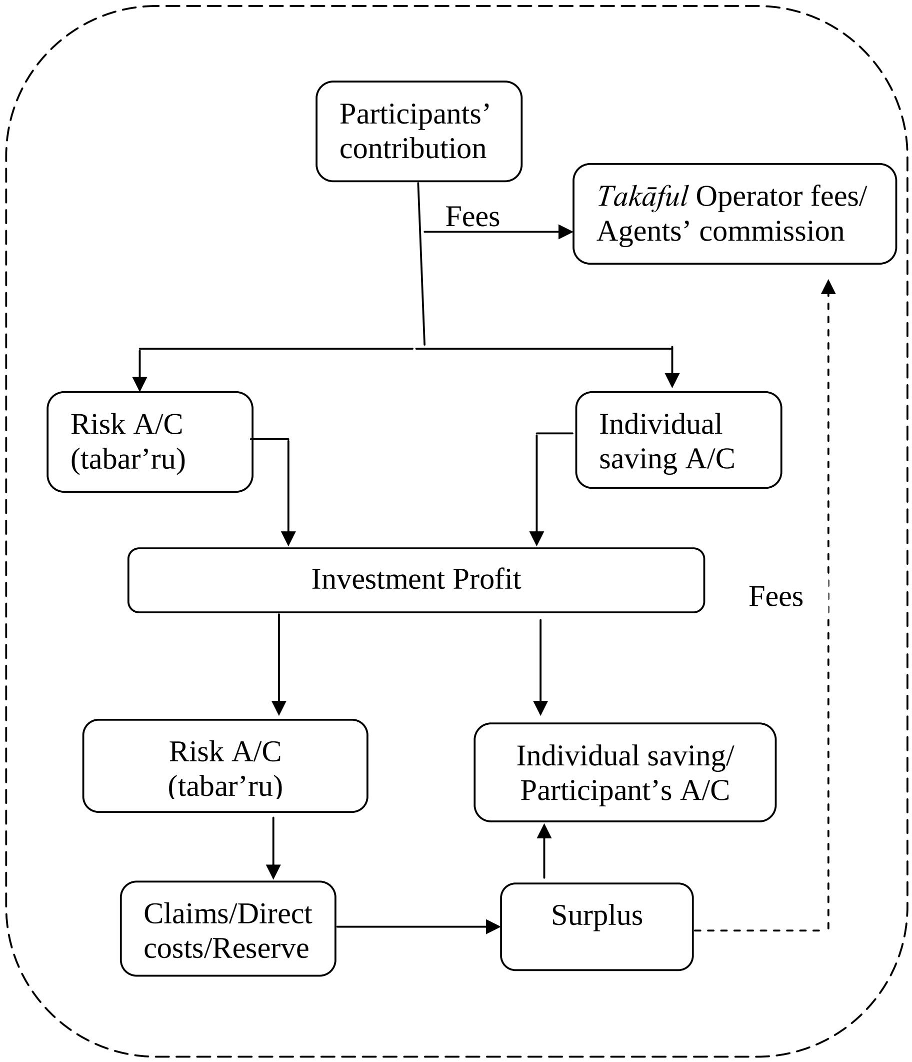
It could be seen from the above example that any surplus left in PSA after accounting for all the risks goes to PA fund that is participants' personal account. Hence the amount in PA goes on increasing each year. At the end of maturity period, the entire amount in PA account belongs to participant. Before the maturity period, if participant incurs any loss, he is compensated from PSA account in addition to his balance in PA account.

3.1.3 *WAKALĀH* MODEL

Wakalāh model is a fee driven Islamic contract in which one party provides capital whereas other party manages the funds. Here, other party charges a fixed fee instead of profit sharing as in *Mudhārabah* contract for providing its managerial services to prudently invest and manage the funds. In *Takāful* contract, participants provide capital in the form of contribution and *Takāful* operator manages the funds and charges a fixed fee (called a *Wakalāh* fee) for providing its services (Whear & Western, 2006). The *Wakalāh* fee should be fair and appropriate and should be determined and approved by *Sharī'ah* Supervisory Board (SSB). *Wakalāh* model is considered more transparent than *Mudhārabah* model as charges are fixed and predetermined by the both parties. There are no hidden charges. Some *Takāful* operators charge an additional fee on surplus as an incentive to efficiently manage the funds.

When *Takāful* contribution is paid by the participants, *Wakalāh* fee is deducted as upfront charge. The Figure 3.5 shows a flow chart of *Wakalāh* model for family *Takāful* practiced by Bank Al-Jazira of Saudi Arabia. Here, agents' commission is directly drawn from Participants' contribution as upfront charge. The remaining amount is distributed in two accounts i.e. Individual saving account and Risk account to cover the loss of affected participants. Individual saving account is each participant's personal account that is used for future savings. Risk account is also known as *tabar'ru* account as participants agree to donate a portion of their contribution to this fund which is used to pay for claims, underwriting costs and *Re-takāful* expenses. Amount in both accounts is invested under *Sharī'ah* guidelines and profit obtained from investment is appropriated to both accounts according to their original ratio. Any surplus left from risk account goes to individual saving account. Sometimes, *Takāful* company charges a compensation fee on the amount of surplus as a return for its efficiency and prudent underwriting skills.

FIGURE 3.5: *WAKALĀH* MODEL



Source: Bank Al-Jazira, Saudi Arabia. www.baj.com.sa

HOW DOES *WAKALĀH* MODEL WORK?

FIGURE 3.6: GENERAL *TAKĀFUL* PLAN

Takāful contribution	=	Rs. 100,000
Agents' commission (35%)	=	Rs. (35,000)
Amount available for Risk fund (tabarru)	=	Rs. 65,000
Profit from investment (10%)	=	Rs. 6,500
Risk fund	=	Rs. 71,500
Claims payment/direct Expenses (40%)	=	Rs. (40,000)
Underwriting Surplus	=	Rs. 31,500
Wakalāh fee on surplus (10%)	=	Rs. (3,150)
Contingency Reserve (10%)	=	Rs. (3,150)
Participants' share in surplus	=	Rs. 25,200 or
		25.20%

The Figure 3.6 shows a practical example for the flow chart of *Wakalāh* model for general *Takāful* after receiving *Takāful* contribution. Here, it is assumed that company has initial contribution of Rs.100,000 from which 35% agents' commission is deducted as upfront charge. The remaining amount of Rs.65,000 goes to risk fund and is invested in *Sharī'ah* based instruments. 10% profit is assumed from investment of risk fund. After adding the investment profit, risk fund moves to Rs.71,500. Claim payment and direct expenses including underwriting are assumed to be 40%. After deducting Claims payment and direct expenses from risk fund, underwriting surplus of Rs.31,500 is obtained. 10% of underwriting surplus is deducted as *Wakalāh* fee while another 10% is kept as contingency reserve. Remaining amount of surplus i.e. Rs.25,200 is distributed among participants who have no prior claims. It indicates that participants of general *Takāful* can be compensated with surplus share of more than 25% by the use of prudent underwriting mechanism. Sometimes, surplus share is used to pay for the contribution of next year in which case, participants have to pay less contribution to the extent of their share in underwriting surplus.

FIGURE 3.7: FAMILY *TAKĀFUL* PLAN (FIRST YEAR)

Takāful contribution = Rs. 100,000
Agents' commission (35%) = Rs. (35,000)

Takāful contribution left = Rs. 65,000

Risk A/C (tabar'ru)	Individual saving A/C
(20%)	(80%)
Rs.13, 000	Rs. 52,000

Profit from investment (10%) = Rs. 1,300 | Rs. 5, 200

Risk A/C = Rs.14, 300 | Rs. 57, 200
Claims payment/direct Expenses (10%) = Rs (10,000)

Underwriting Surplus = Rs. 4,300

Wakalāh fee on surplus (10%) = Rs. (430)

Participants' share in Underwriting surplus = Rs. 3,870

The Figure 3.7 shows a practical example for the flow chart of *Wakalāh* model for family *Takāful* after receiving *Takāful* contribution in the first year. Here, it is assumed that company has initial contribution of Rs.100,000 from which 35% agents' commission is deducted as upfront charge. 20% (Rs.13,000) of the remaining amount of Rs.65,000 goes to risk fund while 80%(Rs.52,000) goes to individual saving account. Fund in the both accounts is invested in *Sharī'ah* based instruments and10%

profit is assumed from investment of fund. Hence profit of Rs.1,300 is added to risk fund while Rs.5,200 is added to individual saving account. After adding the investment profit, risk fund increases to Rs.14,300 while individual saving account rises to Rs.57,200. Claim payment and direct expenses are assumed to be 10%. After deducting Claims payment and direct expenses from risk fund, underwriting surplus of Rs.4,300 is obtained. 10% of underwriting surplus is deducted as *Wakalāh* fee. Remaining amount of surplus i.e. Rs.3,870 is carried forward and added to the second year *Takāful* fund.

FIGURE 3.8: FAMILY *TAKĀFUL* PLAN (SECOND YEAR)

Takāful contribution amount	= Rs. 100,000 + 3,870 (first year surplus)	
	= Rs. 103,870	
Agents' commission (35%)	= Rs. (35,000)	
Takāful contribution left	= Rs. 68,870	
	Risk A/C (tabar'ru) (20%)	Individual saving A/C (80%)
	Rs.13, 774.0	Rs. 55,096.0
Profit from investment (10%)	= Rs. 1,377.4	Rs. 5,509.6
Risk A/C	= Rs.15, 151.4	Rs. 60,605.6
Claims payment/direct Expenses (10%)	= Rs (10,000)	
Underwriting Surplus	= Rs. 5,151.4	
Wakalāh fee on surplus (10%)	= Rs. (515.1)	
Participants' share in Underwriting surplus	= Rs. 4,636.3	

The Figure 3.8 shows a practical example for the flow chart of *Wakalāh* model for family *Takāful* after receiving *Takāful* contribution in the second year where underwriting surplus of the first year is carried forward and is invested again with the *Takāful* fund. Here again initial contribution of Rs.100,000 is assumed in addition to first year surplus. The rest of the procedure is the same as discussed for the first year. 35% agents' commission is deducted as upfront charge. 20% of the remaining amount of Rs.65,000 goes to risk fund while 80% goes to individual saving account. Fund in the both accounts together with the first year surplus is invested in *Sharī'ah* based instruments and10% profit is assumed from investment of fund. Hence profit of Rs.1,377.4 is added to risk fund while Rs.5,509.6 is added to individual saving account. After adding the investment profit, risk fund increases to Rs.15,151 while individual saving account rises to Rs. 60,606. Claim payment and direct expenses are assumed to be 10%. After deducting Claims payment and direct expenses from risk fund, underwriting surplus of Rs. 5,151.4 is obtained. 10% of underwriting surplus is deducted as *Wakalāh* fee. Remaining amount of surplus i.e. Rs. 4,636.3 is carried forward and added to third year *Takāful* fund.

Hence, underwriting surplus and individual saving account go on increasing each year as discussed in the example above. At the end of maturity period, the entire amount in the individual saving account belongs to participant besides his share in underwriting surplus.

Global Practices

Wakalāh model has been practiced by Bank Al-Jazira, Saudi Arabia. It is also being practiced by Commerce *Takāful* Berhad and *Takāful* Ikhlas Sdn. Berhad in Malaysia. Government of Bahrain has also taken the initiative to make compulsory for *Takāful* and *Re-takāful* companies to adopt *Wakalāh* model in their business (Al Sadah, 2005). This model is gaining popularity across the world due to its transparency and fixed nature of charges irrespective of the amount of *Takāful* contribution received as it provides leverage for the company to act in the best interests of participants and enhance their returns. Moreover, there are less *Sharī'ah* related issues associated to this model that might create conflicts of interests among *Sharī'ah* scholars of different schools of thoughts.

3.1.4 MIXED MODEL (*MUDHĀRABAH + WAKALĀH*)

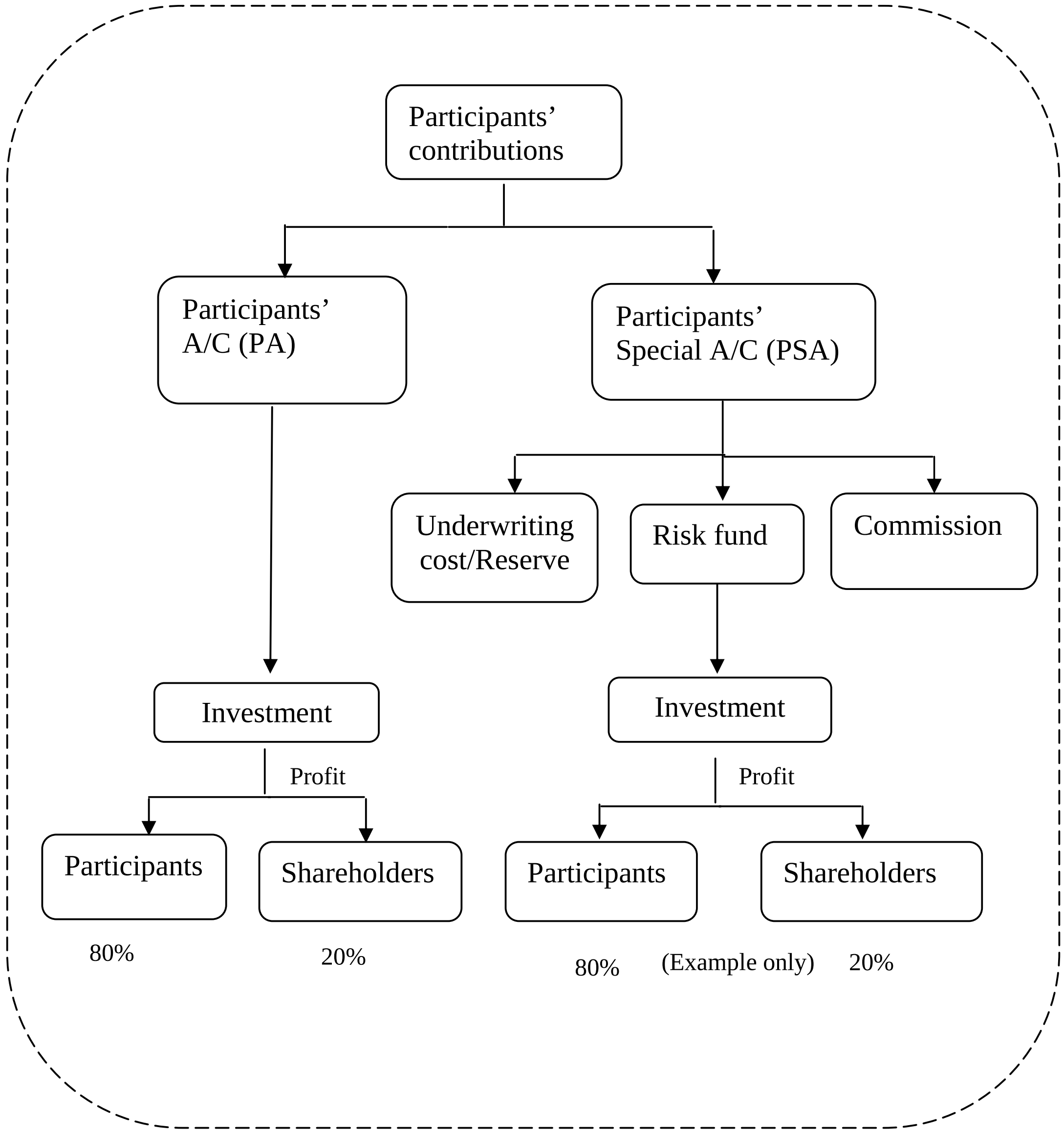
Mixed model is a combination of *al-Mudhārabah* and *al-Wakalāh* model where *al-Wakalāh* contract is used for underwriting activities while *al-Mudhārabah* contract is adopted for investment activities (Tolefat, 2006). With regard to underwriting activities, the shareholders act as the *wakeel* (agent) on behalf of participants to manage their funds whereby the *Takāful* company (shareholders) receives contribution, pay claims, arrange *Re-takāful* and all other necessary actions related to *Takāful* business. In exchange for performing these tasks, the company charges each participant a fee known as a *Wakalāh* fee, which is usually a percentage of the contribution paid by each participant. On the investment side, the company invests the surplus contributions in *Sharī'ah* based instruments based on *Al-Mudhārabah* contract, whereby the company acts as *mudarib* on behalf of participants *(Rab-al-maal* or capital providers). However, in order to satisfy the *Sharī'ah* requirement for *Al-Mudhārabah* contract, the ratio of profit is fixed and agreed upon between the two parties, at the inception of the contract.

Proponents of this model argue that a *Mudhārabah* arrangement is better suited for management and investment of *Takāful* fund (Obaidullah, 2005a; p.148) and provides incentive to *Takāful* operator to optimize its return by sharing profit. The *Wakalāh* model is perhaps better suited than the *Mudhārabah* for managing the *Takāful* business for the agency fee (cost of insurance). It is more transparent and is free from the controversial charging of expenses (including marketing commissions) to the *Takāful* fund. These arrangements need to be considered as a part of efforts to search for an optimal model of *Takāful* as well as to create harmony among existing *Takāful* models.

Global Practices

The mixed model of Al-wakalah/Al-mudaraba (Tolefat, 2006), is the dominant model in the Middle East market and it is widely practiced by *Takāful* companies worldwide. In Malaysia, it is being practiced by *Takāful* Nasional Berhad and Mayban *Takāful* Berhad (MTB). Proponents of this model argue (Obaidullah, 2005a) that as this model combines the benefits of *mudaraba* as well as *Wakalāh* model so it could facilitate the search for a unified approach to standardize *Takāful* practices across the world.

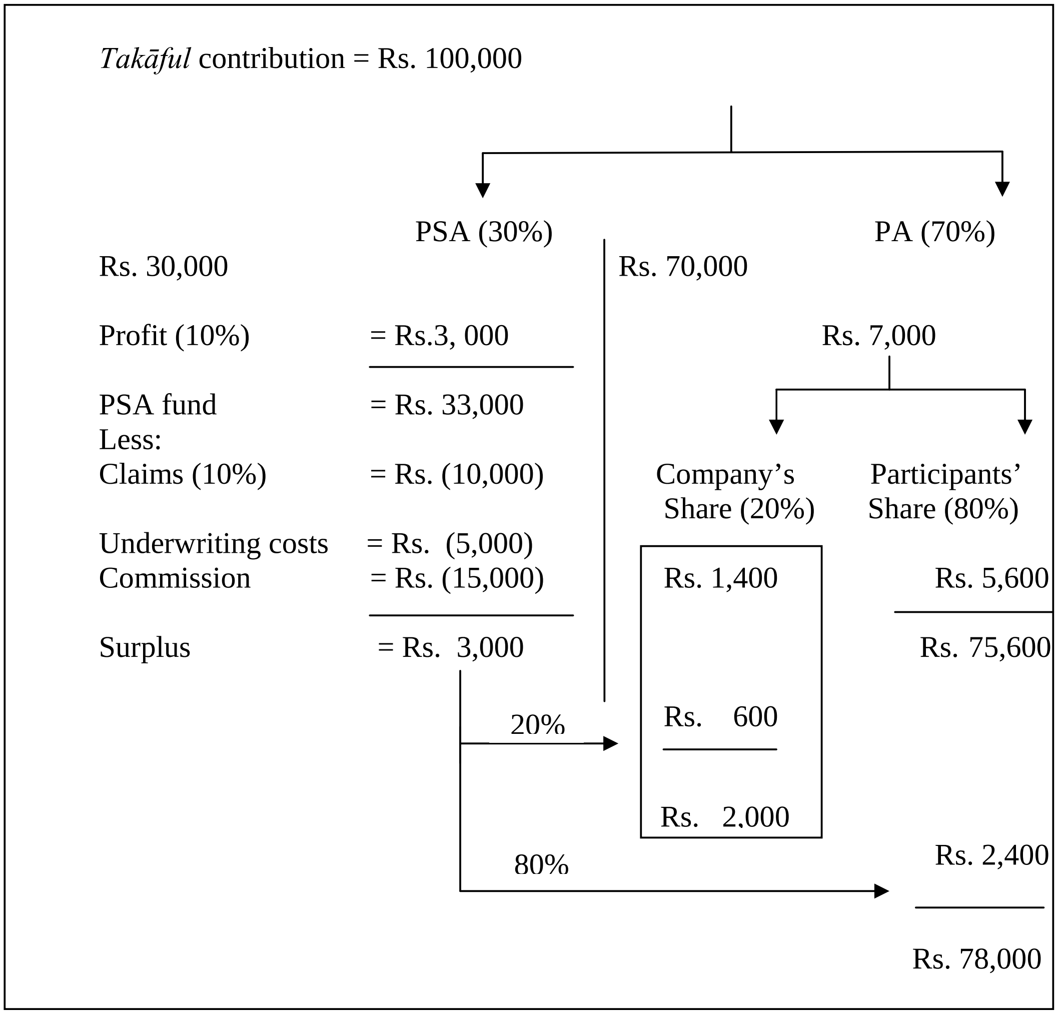
FIGURE 3.9: MIXED MODEL (MUDARBAH + WAKALAH)



Source: <u>Takāful Nasional Bhd. Malaysia.</u> <u>www.*Takāful*nasional.com.my</u>

HOW DOES MIXED MODEL WORK?

FIGURE 3.10: FAMILY *TAKĀFUL* PLAN



In the Figure 3.10, it could be seen that *Takāful* company applies a mixed approach for the management of *Takāful* fund. It uses *Wakalāh* concept for PSA account when it charges commission as a fee. It uses *Mudhārabah* concept when it invests the amount of PA account and shares in the profit from the investment and underwriting surplus according to agreed ratios. Participants' share of surplus together with their share of profit from investment is added to their PA account.

3.1.5 *WAKALĀH* MODEL WITH *WAQF* FUND

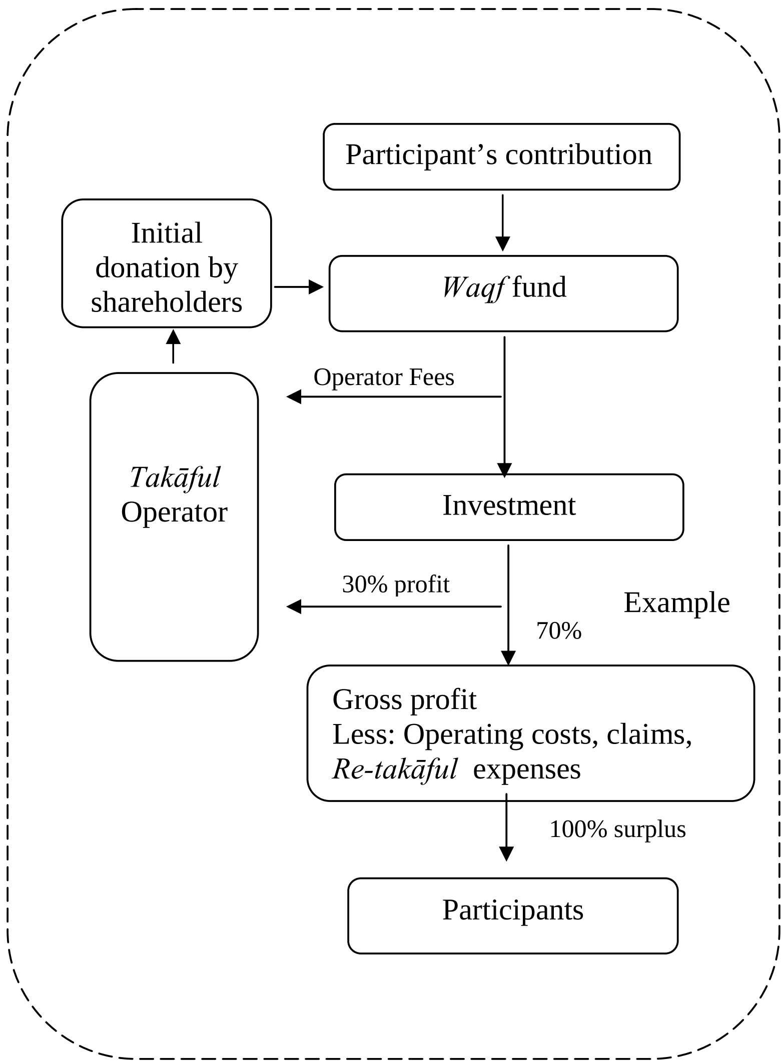
After several objections were raised regarding the issue of surplus sharing in *Mudhārabah* model and modified *modarbah* model and their legal status. A need was felt to develop a model that could work towards building the creditability of *Takāful* operator as a welfare institution rather than a profit oriented entity. This lead to the formation of *Wakalāh* Model with *Waqf* fund that was approved by *Sharī'ah* scholars of *Darul Uloom* Karachi, the most famous and credible Islamic institution in Pakistan. The model is a modified form of *Wakalāh* model where a *Waqf* fund is created by initial donation of shareholders. Participants' contribution goes directly to *Waqf* fund. *Takāful* operator deducts its fees from *Waqf* fund. The remaining amount is invested in *Sharī'ah* based instruments. The profit from investment is shared between *Takāful* operator and participants according to agreed ratios. After deducting claims, *Re-takāful* expenses and underwriting costs, 100% net surplus belongs to participants who have no prior claims and distributed to them according to their proportion of contribution.

Global Practices

Wakalāh Model with *Waqf* fund is being practiced by *Takāful* operators of Pakistan. This model has also been adopted by *Takāful* operators of South Africa (Tolefat, 2006). This model is a modified form of *Wakalāh* model. In this modified *Wakalāh* model with *Waqf* fund, the relationship of the participants and of the operator is directly with the *Waqf* fund. The operator is the wakeel of the *Waqf* fund and the participants pay one sided donation to the *Waqf* fund (not conditional) The *Waqf* fund rules (Abdul Wahab, 2006) may define the sharing of surplus and other rules under which it would operate but without having any obligation to distribute surplus.

The Figure 3.11 shows a flow chart diagram of *Wakalāh* model with *Waqf* fund for general *Takāful* after receiving *Takāful* contribution. According to this model, first a *Waqf* fund is created by the joint efforts of participants as well as shareholders who initially donate their contribution to this fund. Here, *Takāful* operator fees (also called *Wakalāh* fee) are directly drawn from *Waqf* fund. The remaining amount is invested on the basis of modarbah under *Sharī'ah* guidelines and profit obtained from investment is shared between participants and *Takāful* operator according to their mutual terms of agreement. *Takāful* operator is responsible for all the management expenses from shareholders' fund. Operating costs, *Re-takāful* expenses and claim payments are made from participants' fund. Any surplus left after deducting all the related expenses belongs to participants. Sometimes, *Takāful* company retains a portion of underwriting surplus as a contingency reserve to meet any sudden and unexpected future cost.

FIGURE 3.11: WAKALAH MODEL WITH *WAQF* FUND



Source: Takāful Pakistan Limited, www.Takāful.com.pk

HOW DOES *WAQF* MODEL WORK?

FIGURE 3.12: GENERAL *TAKĀFUL* PLAN

Takāful contribution	=	Rs. 100,000
Takāful operator's fees (35%)	=	Rs. (35,000)
Amount available to *Waqf* fund	=	Rs. 65,000
Profit from investment (10%)	=	Rs. 6,500
Waqf fund	=	Rs. 71,500
Claims payment (30%)	=	Rs. (30,000)
Operational costs (10%)	=	Rs. (10,000)
Contingency Reserve (10%)	=	Rs. (10,000)
Underwriting Surplus (100% participants' share)	=	Rs. 21,500 or **21.5%**

The Figure 3.12 shows the flow of funds for a general *Takāful* business of a *Takāful* company following *Wakalāh* model with *Waqf* fund. First of all, *Takāful* contribution of Rs. 100,000 has been assumed for the year that goes to *Waqf* fund. *Wakalāh* fee (35%) is deducted from *Takāful* contribution as upfront charge. The remaining amount (Rs. 65,000) goes to *Waqf* fund and is invested in *Sharī'ah* approved instruments (Islamic bonds and stocks). Profit from investment is assumed to be 10% that builds up the *Waqf* fund to Rs. 71,500. After paying claims and deducting operational costs, 10% contingency reserve is maintained for account for unexpected future risks and losses. Entire amount of underwriting surplus i.e. Rs. 21,500 belongs to participants. Hence they obtain 21.5% return in the form of underwriting surplus on their initial contribution. The company might give this surplus in the form of cash or readjust the contribution for the next year.

3.2 ISSUES IN *TAKĀFUL* MODELS

Sharī'ah scholars who belong to different schools of thoughts have different point of views on *Sharī'ah* matters. This has created certain fiqh related issues in *Takāful* models being practised by *Takāful* operators across the world. Abdel Karim and Archer (2002) have identified corporate governance, regulatory and accounting issues that affect the functioning of Islamic financial institutions including insurance companies. Ismail (2004) discussed the issues in modified *Mudhārabah* model at a workshop at Bank Negara, Central Bank of Malaysia. Billah (2004c) gives gross root reasons for having diversified *Takāful* models and also discusses their possible solutions. Khanzada (2007) also highlights issues in *Takāful* industry in Pakistan under *Waqf* model. Based on the views of above researchers, key issues that have been found in different *Takāful* models are summarized as follow:

i. Sharī'ah issues:

Sharī'ah issues arise as different *Takāful* models are being practised in different countries. *Sharī'ah* scholars who provide *Sharī'ah* supervisory services to *Takāful* operators belong to different schools of thoughts (e.g. *Hanafi*, *Shaafi*, *Humbali*, *Maaliki* etc.) propagate different opinion on *Sharī'ah* matters according to their belief in particular school of thought. Grais and Pellegrini (2006a, pp.17-21) identify issues of independence, confidentiality, competence, consistency and disclosure of responsibilities that affect functioning of SSB in the organization. Due to lack of competent *Sharī'ah* scholars in the field of Islamic finance, most of the scholars hold positions in *Sharī'ah* Supervisory Boards (SSBs) of several companies. This may jeopardize the confidentiality of the company secret information and company may restrict SSB to access certain information and hence affect its independence in the organization. SSB decisions on *Sharī'ah* matters might not be consistent as the company might not properly disclose the responsibilities of SSB and restrict their authority in certain areas.

Sharī'ah supervisory board (SSB) strictly ensures *Sharī'ah* compliance of *Takāful* fund and only approves those investment avenues that are compatible with

Shari'ah. For example, investment in alcohol production or liquor business is not allowed in *Shari'ah*. Though investment of *Takāful* fund is made in consultation with the members of SSB, yet there are chances that some part of income from investment might be considered as illegal from *Sharī'ah* point of view e.g. company invests in an airline or hotel business that apparently seems to be permissible under *Sharī'ah* but it has debt financing in its capital structure or it has derived a part of its income from sale of alcohol or liquor (Abdel Karim & Archer, 2002; p.71).

ii. Profit sharing:

Critics on the issue of profit sharing argue that it is illegal for participants as well as for *Takāful* operators to share in profits as is the case in *Mudhārabah* model. For participants, the issue arises as a result of *tabarru* nature of contribution. A group of *Sharī'ah* scholar is of the view that as participants pay the contribution as donation so from *Sharī'ah* point of view, they cannot receive any profit from donated amount. Similarly, since *Takāful* operators acts as a trustee and manger of funds and its responsibility is to act in the best interests of shareholders. Also the remuneration and salaries of managers are fixed and approved by board of directors, so *Takāful* operator should not be allowed to share the profit but only entitled to fixed charges. The same issues arise for modified *Mudhārabah* model.

iii. Underwriting surplus sharing:

Issue of underwriting surplus sharing is similar to that of profit sharing. *Sharī'ah* scholars argue that Participants are not allowed to share in the surplus of the amount (*Takāful* contribution) which they have already donated to tabar'ru fund. Similarly *Takāful* operators have no right to share the surplus amount as they have already received *Wakalāh* fee or their share of profit. Now the question arises if neither participants nor *Takāful* operator has legal right on the underwriting surplus, where this amount should go. A group of *Sharī'ah* scholars is of the view that this amount should go to a *Waqf* fund for charitable purpose and should be used for the welfare of poor and needy people of the society who are not real members of *Takāful* company. Another group of scholars propose that underwriting surplus could be returned to the participants as *'hibah'* (gift).

iv. Unearned Wakalāh fee:

Wakalāh fee (agents' commission) is usually charged in advance as upfront charge when participant pays contribution amount. According to accrual principle of accounting, *Wakalāh* fee will be earned at the end of *Takāful* period for a particular year. *Takāful* operators claim that participant's contribution will be refunded whenever he wants to withdraw the contract. Only *Wakalāh* fee is deducted from the contribution amount. The question arises if any participant withdraws his contract at the mid of *Takāful* period, has *Takāful* operator any right on unearned *Wakalāh* fee? If not then how should unearned *Wakalāh* fee be returned to the participant when *Takāful* operator deducts it in advance and pays to *Takāful* agents as commission.

v. Legal status of Waqf fund:

Waqf fund is created by initial donations from shareholders' fund. Then *Takāful* contribution, income from investment, underwriting surplus is added to *Waqf* fund. Yet *Waqf* model raises questions about its legal status. Should this fund fall under the purview of trust act or any other act? Is *Takāful* operator bound to comply with provisions of trust act or any other act in addition to *Takāful* regulations? What are the tax implications of treating *Waqf* fund as separate entity or not a separate entity from *Takāful* Company? These questions require clarification from legal and *Sharī'ah* experts related to *Takāful* business.

vi. Corporate Governance issues:

Adoption of a *Takāful* model raises issues of corporate governance regarding the rights of participants who are the provider of funds for the *Takāful* Company. Although *Takāful* operators act as a trustee and manager of funds and get their share of profit in the form of *Mudhārabah* or *Wakalāh* fee, yet they have been criticized for maximizing the shareholders' profits while ignoring the rights of participants that are major stakeholders of the company. In the absence of proper corporate governance practices, company and its board of directors are not held accountable for their decisions that are not favorable to participants or community at large. Moreover, participants are not given positions in the board of directors so they have no right to question any decision of the board and feel themselves insecure (Abdel Karim & Archer, 2002; p.72). Strengthening the regulatory framework is essential to regulate the activities of *Takāful* operators and to protect the rights of participants.

3.3 *TAKĀFUL* PRACTICES ACROSS THE WORLD (SELECTED *TAKĀFUL* COMPANIES)

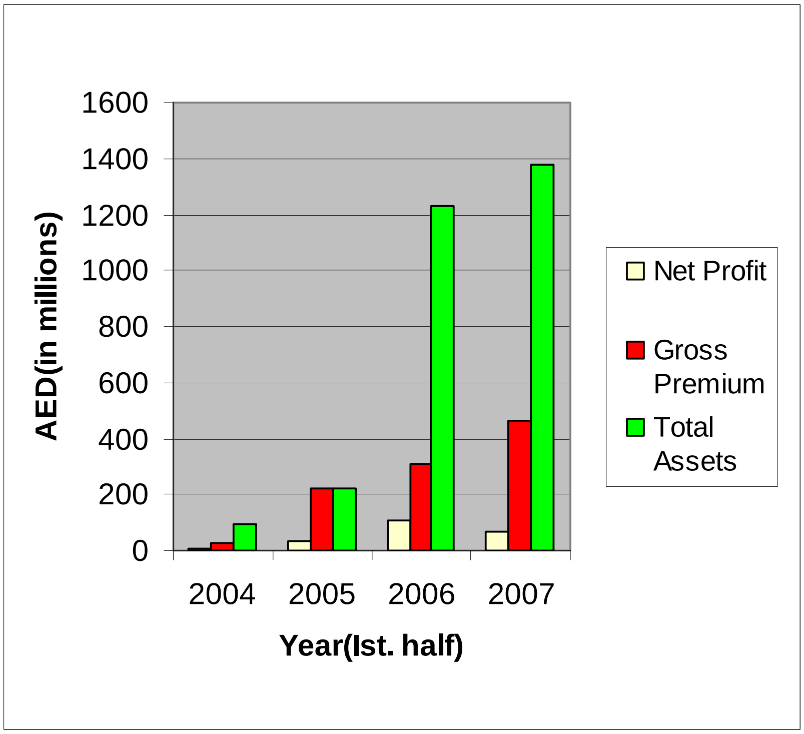
Takāful has not only established its strong foothold in many Muslim and Arab countries but also in advanced and some non-Muslim countries of the world. Here we examine *Takāful* practices of five *Takāful* companies that are operating in United Arab Emirates, Bahrain, Malaysia and Sri Lanka. The financial performance of these companies has been analyzed on the basis of growth of net profit, *Takāful* premium, total assets and return on assets (ROA).

3.3.1 SALAMA ISLAMIC ARAB INSURANCE COMPANY (UAE)

SALAMA Islamic Arab Insurance Company of UAE is the world's largest *Takāful* and Re-*Takāful* provider, (UAE Press release on *Takāful*, 2006). It was incorporated in 1979 to provide *Sharī'ah* compliant solutions to the customers across the world. SALAMA has paid up capital of AED (Arab Emirates Dirham) 1 billion and has been rated as 'BBB' by Standard & Poor's. It has been a pioneer company in UAE in promoting *Takāful* and re-*Takāful* services to the general public. For 28 years, it has committed to its values and principles by providing Shariah compliant solutions to its customers.

SALAMA has investments in a number of its subsidiaries that include *Takāful* and Re-*Takāful* International Investment Corporation; Bahrain, BEST RE; Tunisia and Saudi IAIC Insurance. BEST RE Tunisia is the world largest re-*Takāful* company that is operating in more than 60 countries across the world. SALAMA offers a wide range of *Takāful* products in family *Takāful*, general *Takāful* and health *Takāful* to individual and corporate customers. It is UAE's specialized company due to its highly trained and skilled staff that provide high standards of quality service. It has expanded the range of its customers by providing innovative products and *Sharī'ah* compliant *Takāful* solutions that meet the needs of individuals, families and corporations (SALAMA Semi Annual Report, 2007).

FIGURE 3.13: SALAMA PERFORMANCE AT A GLANCE



Source: Semi-Annual Reports 2004- 2007, SALAMA Insurance, www.salama.ae

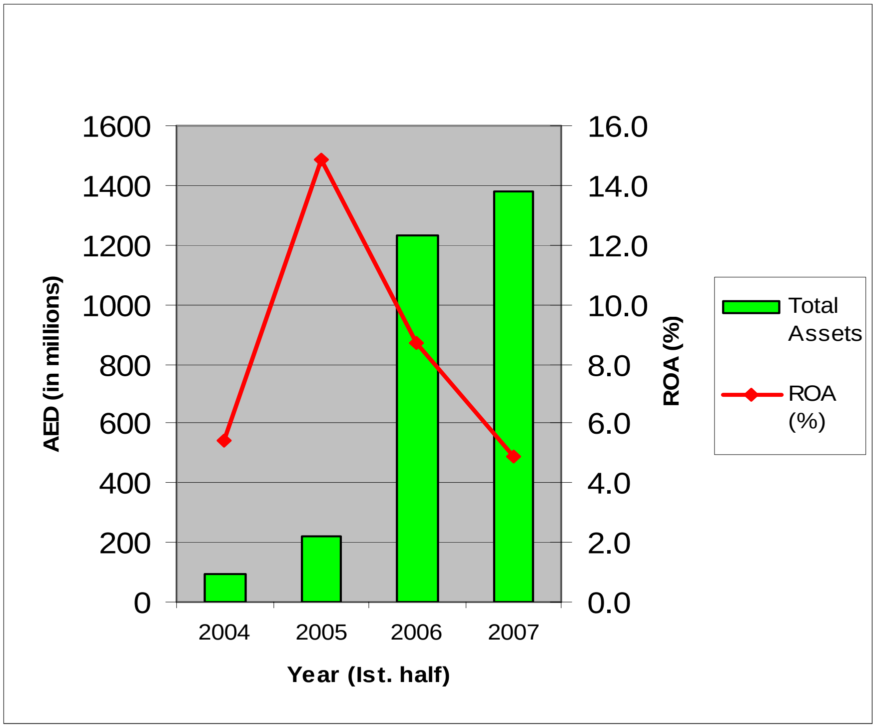
The Figure 3.13 shows the financial performance of SALAMA Islamic Arab Insurance Company indicating the growth of net profit, gross *Takāful* premium and total assets during the first half year of the period 2004-2007.

Net profit during this period has been increased from AED 5.103 million in 2004 to AED32.521million in 2005 (6.4 times increase). After this, net profit has been sharply increased to AED 107.142 million in 2006 (3.3 times increase in net profit). It was then decreased to AED67.775 million in 2007. The graph indicates that total net profit has been increased about 14 times during the first half year period 2004-2007. There has been an average increase of 5 times in each half year in the net profit during the said period.

Gross *Takāful* premium during this period has been increased from AED 26.634 million in first half of 2004 to AED 220.647 million in first half of 2005 (8.5 times, the highest increase in the period). After achieving this higher premium base, there was 40% increase in gross insurance Premium and it increased to AED 310.918 million in first half of 2006. During first half of 2007, growth rate rose to 49% that further increased the gross insurance premium to AED 462.179 million. There has been 3 times increase in *Takāful* premium on the average in each half year period. It indicates that SALAMA Insurance is increasingly becoming popular among the general public. It further indicates that it has increased its customer base by positioning its corporate image and credibility in the minds of the general public.

Total Assets during this period have been increased from AED 94.643 million in 2004 to AED219.064 million in 2005 (2.3 times increase). After this, total assets have been sharply increased to AED 1229.721 million in 2006 (5.6 times, the highest increase in the period). They were further increased to AED1378.614 million in 2007. The graph indicates that total assets have been increased about 15 times during the first half year period 2004-2007. There has been an average increase of 5 times in each half year in the total assets during the said period.

FIGURE 3.14: ASSET PERFORMANCE OF SALAMA INSURANCE



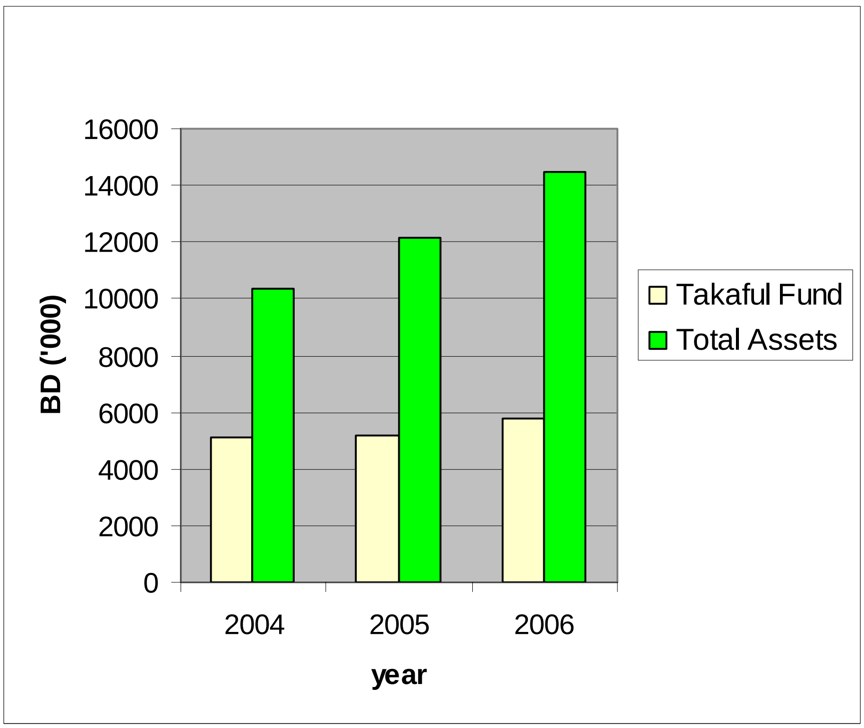
Source: Semi-Annual Reports 2004- 2007, SALAMA Insurance, www.salama.ae

Figure 3.14 shows the Asset performance of SALAMA Insurance Company during first half year of the period 2004-2007. Total Assets during this period have been increased from AED 94.643 million in 2004 to AED219.064 million in 2005 (2.3 times increase). After this, total assets have been increased to AED 1229.721 million in 2006 (5.6 times, the highest increase in the period). They were further increased to AED1378.614 million in 2007. Return on Assets (ROA) was 5.4% in 2004 that was jumped to 14.8% in 2005. It was then decreased to8.7% in 2006 and further decreased to 4.9% in 2007. The decrease in later two years was much enough to offset the impact of increase in the first year. It indicates that total assets have grown faster than net profit in the last three years hence hampering ROA. On the average ROA was estimated to be 8.4% for the given period. Overall net profit growth was comparable with total Assets as both have grown 14 to 15 times during first half year of the period 2004-2007.

3.3.2 *TAKĀFUL* INTERNATIONAL (BAHRAIN)

Takāful International formerly known as Bahrain Islamic Insurance Company (BIIC) was incorporated in 1979 to provide Islamic financial services to cater the needs of a large Muslim community. BIIC was renamed as *Takāful* International in 1998 to reflect the company image in complete harmony with Muslim cultural and social values. In 2000, the company restructured its units and expanded its operations to the selected markets outside of Bahrain where *Takāful* products were in high demand by potential customers due to its unique and fair system (*Takāful* International Report, 2006).

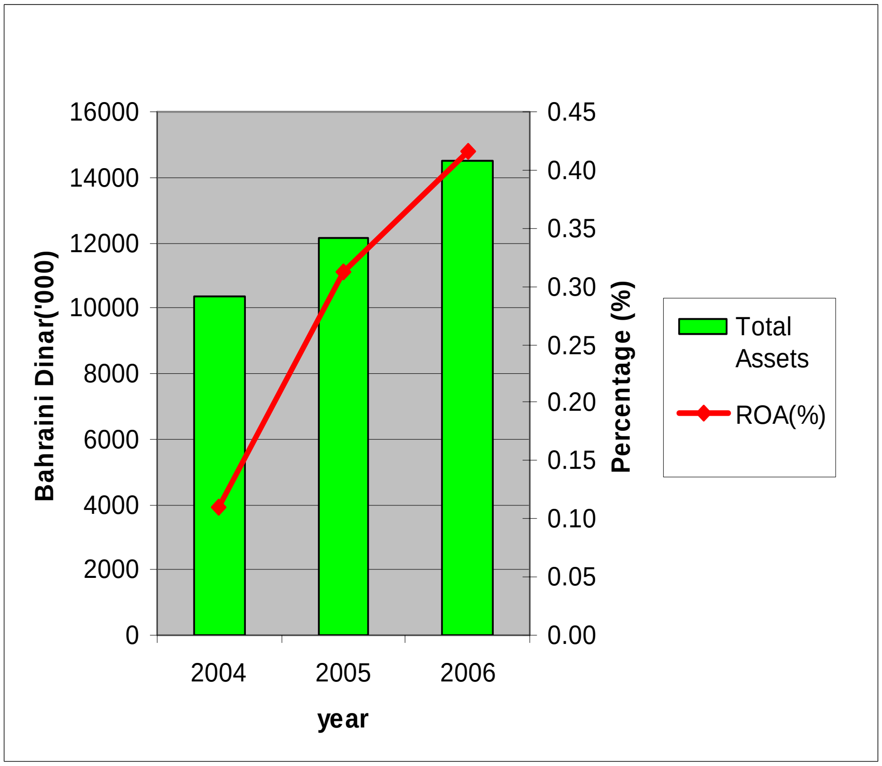
FIGURE 3.15: TAKĀFUL INTERNATIONAL AT A GLANCE



Source: Annual Reports 2004-2006, Takāful International, www.Takāfulweb.com

The Figure 3.15 shows growth of total assets as well as *Takāful* fund at *Takāful* International during the period 2004-2006. *Takāful* business has shown growth of 12.6% during 3-year period by gaining BD5.107 million business in 2004 to BD5.749 million in 2006. It indicates overall business growth of about 6.3% per anum. Total assets of the company have been increased with an average growth rate of 20% per anum from 10.339 million to 14.477 million Bahraini Dinars during this period (almost 40% increase in total assets during 2004-2006).

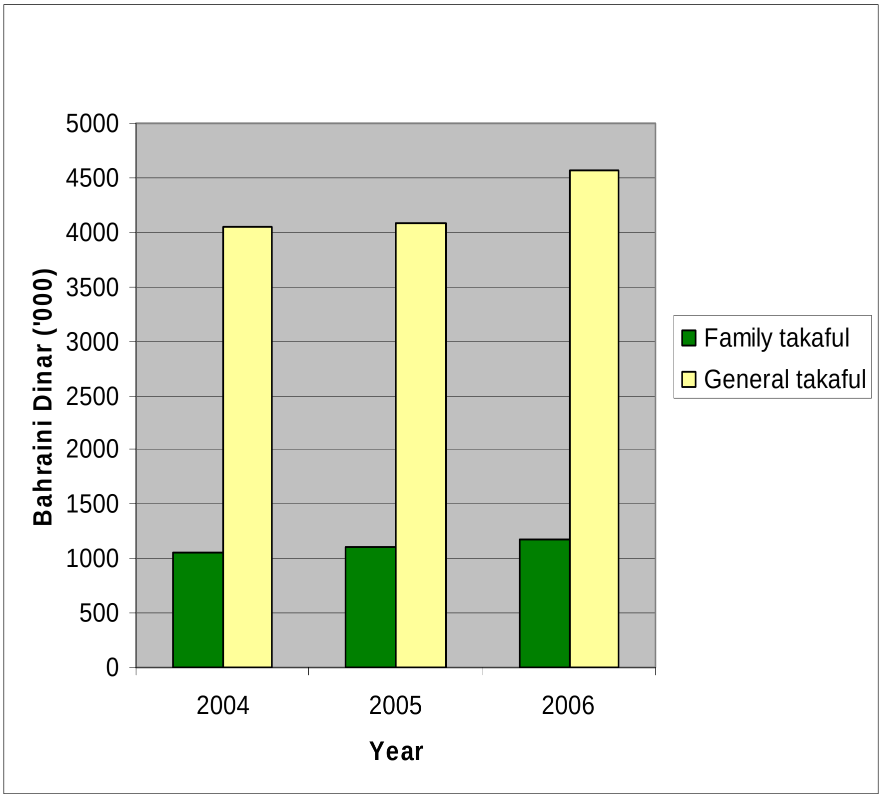
FIGURE 3.16: ASSET PERFORMANCE OF TAKĀFUL INTERNATIONAL



Source: Annual Reports 2004-2006, Takāful International, www.Takāfulweb.com

After restructuring its operational units in 2000, *Takāful* International has shown remarkable performance shown in the Figure 3.16 from the year 2004 to 2006. Its assets have been increased from 10 million to 14.5 million Bahraini Dinars during this period (almost 45% increase in total assets). Return on assets (ROA) has increased from 0.10% to 0.40%. Average ROA was estimated to be 0.28% for the given period. This percentage increase seems to be quite small. Yet in absolute terms, net profit has been increased from 11,325 to 60,321 Bahraini Dinars during this period. It indicates 2.5 times increase in net profit in a year on the average.

FIGURE 3.17: TAKĀFUL GROWTH AT TAKĀFUL INTERNATIONAL



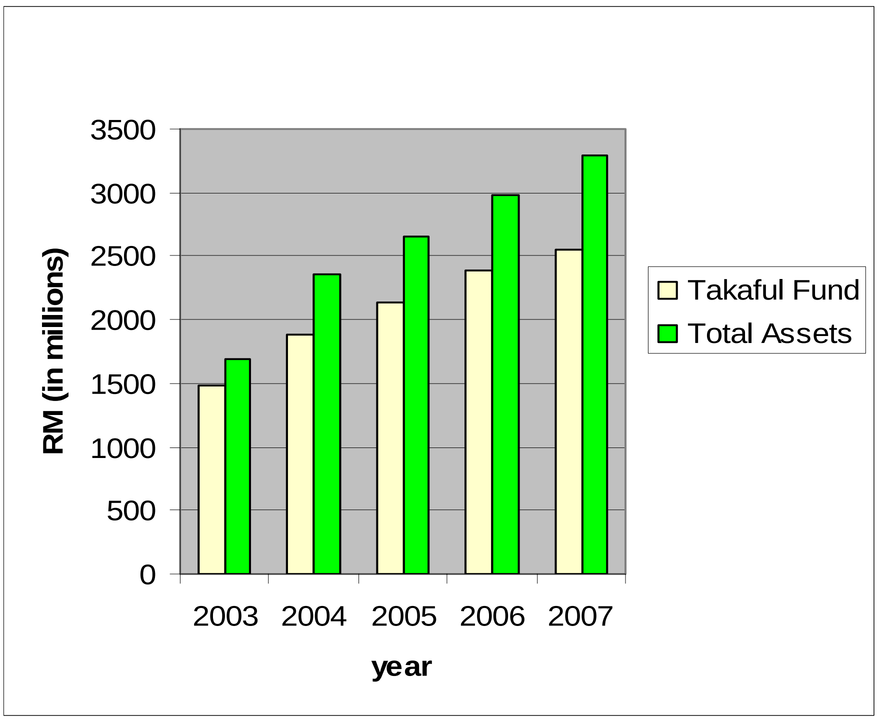
Source: Annual Reports 2004-2006, Takāful International, www.Takāfulweb.com

The Figure 3.17 shows growth of family and general *Takāful* at *Takāful* International during the period 2004-2006. General *Takāful* business has attracted greater *Takāful* business than family *Takāful* whereas growth in *Takāful* business has almost been steady for both categories. Family *Takāful* business has shown growth of 13% during 3-year period by gaining BD1.05 million business in 2004 to BD1.18 million in 2006. General *Takāful* business has shown growth of 14% during 3-year period by reaping BD 4.1 million business in 2004 to BD 4.6 million in 2006.

3.3.3 SYARIKAT *TAKĀFUL* MALAYSIA

Syarikat *Takāful* Malaysia (or *Takāful* Malaysia), a subsidiary of Bank Islam Malaysia, was the first *Takāful* company to start *Takāful* operations in Malaysia in 1985 with an authorized capital of RM. 500 million and paid up capital of RM 10 million. The company was converted into a public limited company in 1996 raising the capital to RM. 55 million. Capital structure of the company was further enhanced as a result of restructuring in 2003. Currently, the company maintains paid up capital of RM.152.643 million. The company offers a wide range of products in personal *Takāful*, health care and education. The company is following mudarabah *Takāful* model that is based on profit sharing with the participants (*Takāful* Malaysia Report, 2007).

FIGURE 3.18: TAKĀFUL MALAYSIA AT A GLANCE

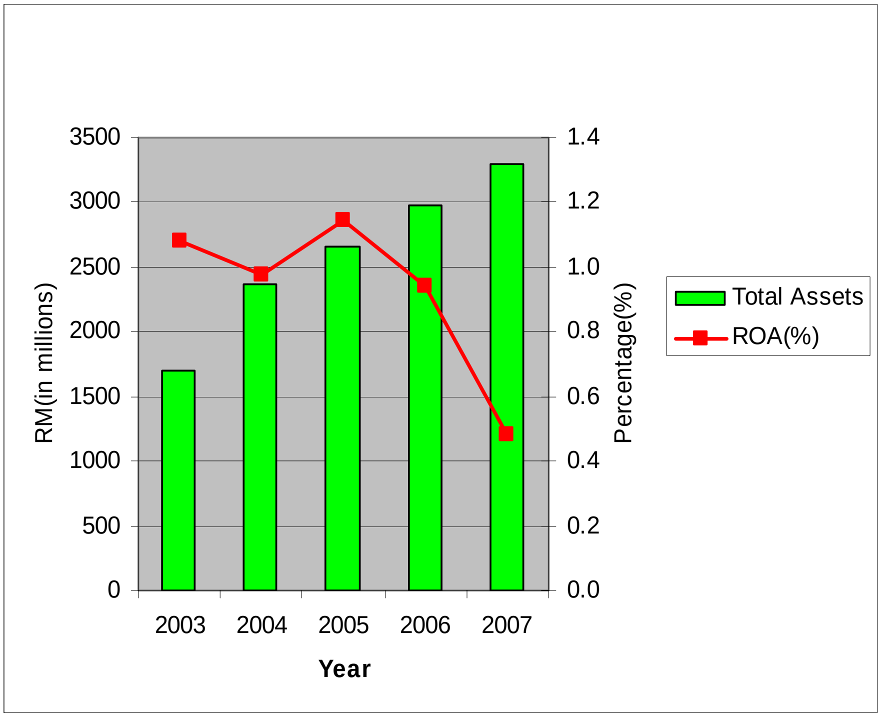


Source: Annual Reports 2003-2007, Takāful Malaysia, www.Takāful-malaysia.com

The Figure 3.18 shows growth of total assets as well as *Takāful* fund at Syarikat *Takāful* Malaysia during the period 2003-2007. Total assets for the year 2003 were estimated to be RM 1697 million that have increased to RM 2360 million in 2004. They have further increased to RM 2661 million in 2005 and RM 2983 million in 2006 and finally increased to RM 3291 million in 2007. The data indicate that total assets of *Takāful* Malaysia have an average growth rate of 25% per anum during the period 2003-2007 growing from RM 1697 million in 2003 to RM 3291 million in 2007.

Total *Takāful* business was estimated to be RM 1488 million in 2003 that increased to RM 1879 million in 2004. It further increased to RM 2134 million in 2005 and RM 2384 million in 2006 and finally increased to RM 2558 million in 2007. The data indicate that total *Takāful* business has grown with an average increase of 14% per anum during 5-year period i.e. 2003-2007.

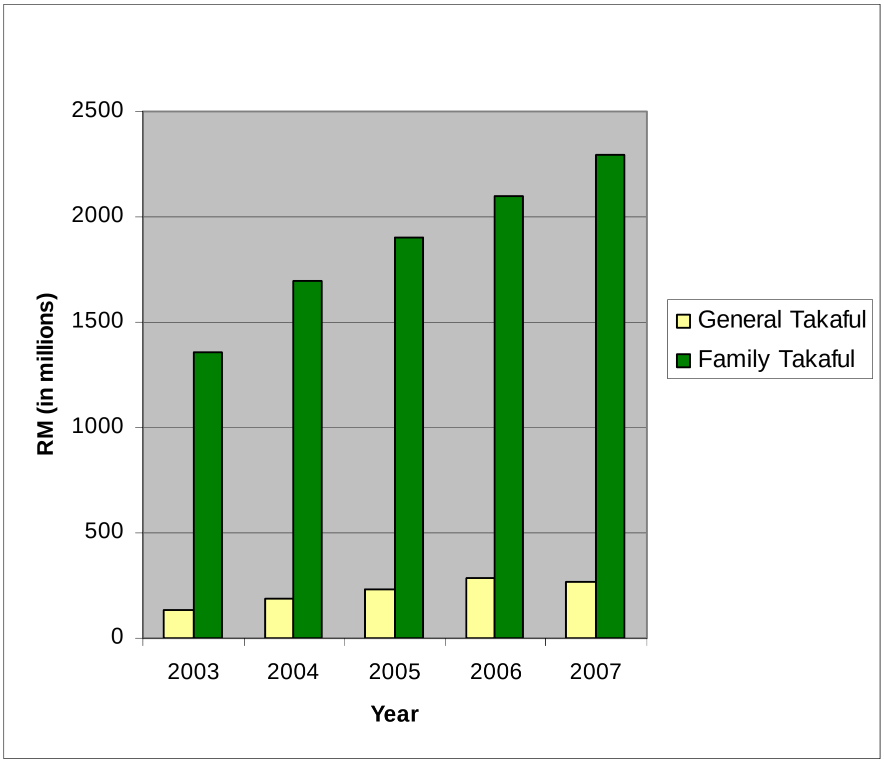
FIGURE 3.19: ASSET PERFORMANCE OF TAKĀFUL MALAYSIA



Source: Annual Reports 2003-2007, Takāful Malaysia, www.Takāful-malaysia.com

The Figure 3.19 shows the asset performance of the company during the 5-year period 2003-2007. It shows that assets of *Takāful* Malaysia have an average growth rate of 25% during the period 2003-2007 growing from RM1697 million in 2003 to RM3291 million in 2007. Return on Assets (ROA) has a declining trend from 1.1% return in 2003 to 0.5% in 2007. There was slight decline in ROA from 2003 to 2006 due to higher asset growth yet in absolute terms net profit has been increased by 53% during this period from RM18.354 million in 2003 to RM28.024 million in 2006. During 2007, there is sharp decline of 44% in net profit to RM15.818 million that further decreased ROA. This decline in net profitability was due to 40% decrease in surplus transfer from general *Takāful* revenue account. Net profit was further decreased due to 32% increase in management expenses and other operating expenses (*Takāful* Malaysia Annual Report 2007, p.62). However, company maintained its average ROA at 0.9% per anum during 5-year period.

FIGURE 3.20: TAKĀFUL GROWTH AT TAKĀFUL MALAYSIA



Source: Annual Reports 2003-2007, Takāful Malaysia, www.Takāful-malaysia.com

Takāful Malaysia has been very fortunate in attracting a large community of customers to family *Takāful* business and hence setting a solid base to flourish. In the Figure 3.20, Family *Takāful* business was estimated to be RM1355 million in 2003 that increased to RM2291million in 2007 with an average increase of 14% during 5-year period. General *Takāful* business, though seems to have smaller share in total *Takāful* business as compared to family *Takāful*, was RM133 million in 2003 that increased to RM267million in 2007. It has grown at an average rate of 20% during 5-year period. The above data indicate that family *Takāful* has a major contribution in the growth of *Takāful* Malaysia that constitutes 90% of the total *Takāful* business of the company.

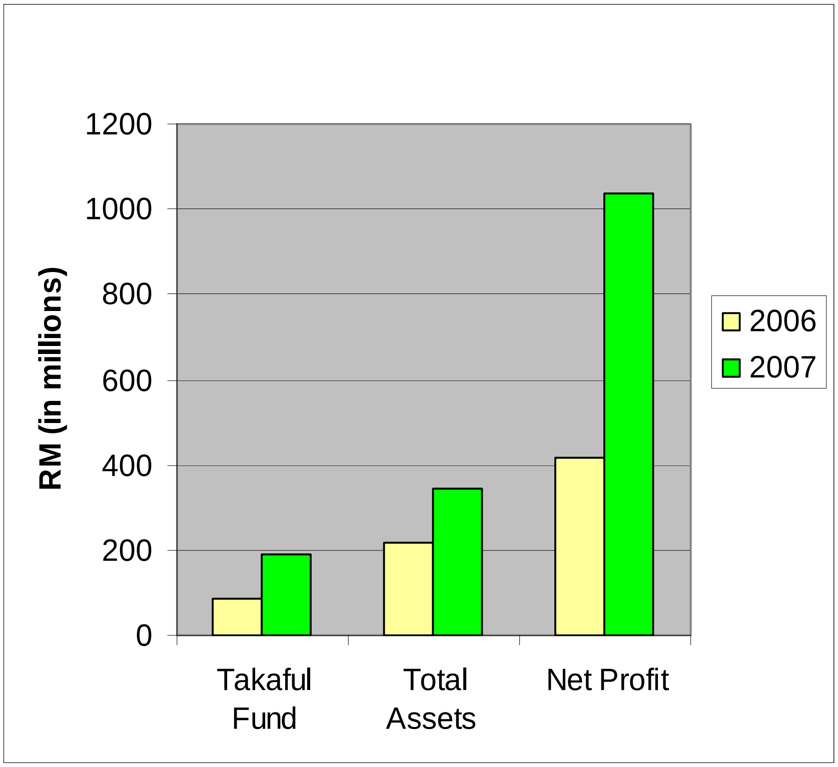
3.3.4 *TAKĀFUL* IKHLAS (MALAYSIA)

Takāful Ikhlas, relatively a new player as compared to *Takāful* Malaysia, was established in 2003 to promote *Takāful* services in Malaysia. It is a subsidiary of Malaysian National Reinsurance Berhad (MNRB) that is an investment holding company with subsidiaries involved in the re-insurance and insurance business. The company, within three years of its inception, has established sound credibility among more than 400,000 individual customers and corporations for its Islamic financial protection services. It offers a comprehensive range of family and general *Takāful* products as well as group *Takāful* plans and Riders for individuals and commercial enterprises (*Takāful* Ikhlas Report, 2007).

Based on *Wakalāh* concept, it has developed an agency network that consists of 4,000 personnel (*Takāful* Ikhlas Report) that are well-trained and highly knowledgeable in providing *Takāful* services to the target customers. *Takāful* agents are employed on commission basis and company charges a fixed fee called *Wakalāh* fee to the participants to cover its management and operational expenses. The concept of agency network in promoting *Takāful* business has been quite successful for the company and it has achieved its business targets in a very short span of time with higher expected growth.

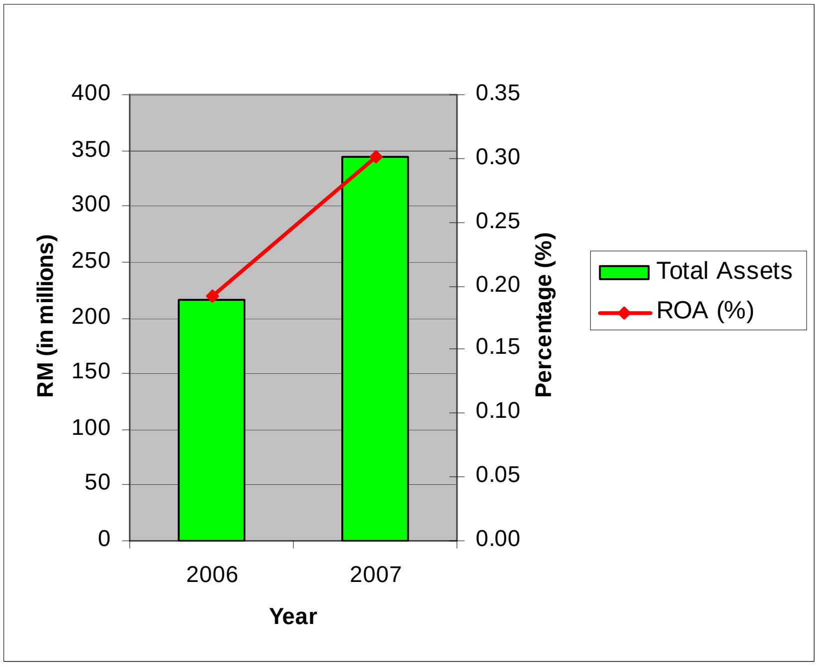
The Figure 3.21 below shows the financial performance of *Takāful* Ikhlas indicating the growth of *Takāful* fund, total assets and net profit during the period 2006-2007. *Takāful* fund during this period was estimated to be RM 85.088 million in the year 2006 that increased to RM 189.673 million in 2007 (123% increase per anum in the period 2006-2007). Total Assets during this period were estimated to be RM 216.695 million in the year 2006 that increased to RM 344.289 million in 2007 (59% increase per anum in the period 2006-2007). Net profit during this period was estimated to be RM 416,615 in the year 2006 that increased to RM 1035,128 in 2007 (149% increase per anum in the period 2006-2007).

FIGURE 3.21: TAKĀFUL IKHLAS AT A GLANCE



Source: *Annual Report 2007, Takāful Ikhlas, www.Takāful.ikhlas.com.my*

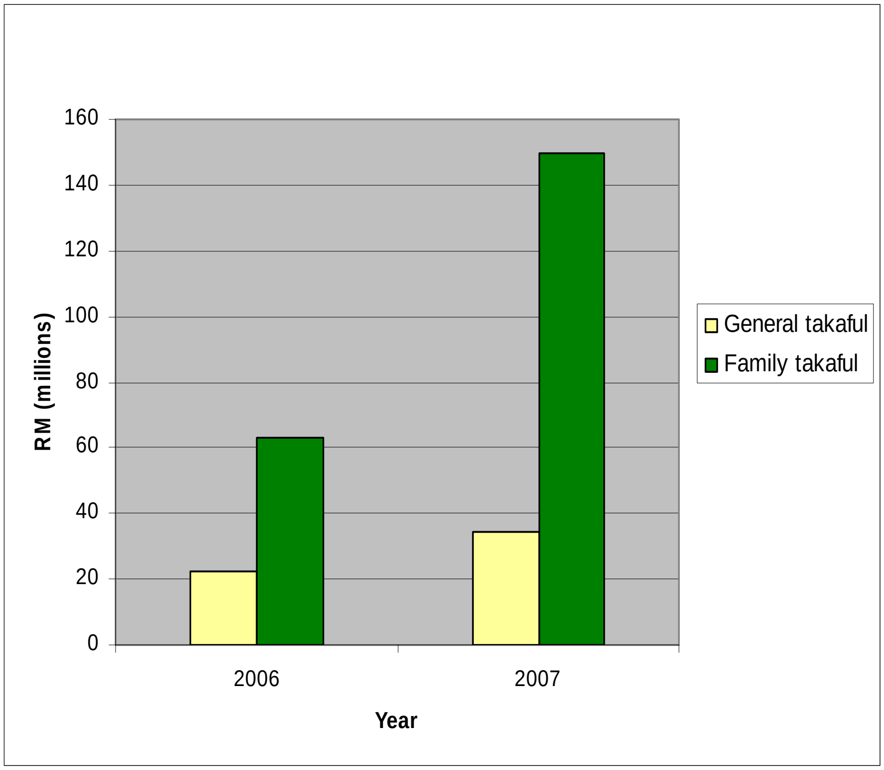
FIGURE 3.22: ASSET PERFORMANCE AT TAKĀFUL IKHLAS



Source: *Annual Report 2007, Takāful Ikhlas, www.Takāful.ikhlas.com.my*

The Figure 3.22 shows remarkable profitability of *Takāful* Ikhlas during 2006-2007. Total assets of the company have grown from RM.217 million in 2006 to RM.344 million in 2007 with an increase of 54%. ROA of total assets has been quite straight as shown in the chart above. It has increased from 0.19% in 2006 to 0.30% in 2007 in spite of higher growth in total assets. It shows higher profitability of the company during one year period. It is due to higher increase in net profit i.e.RM416 thousand in 2006 to RM1035 thousand in 2007 (more than 2 times increase during a single year). Average ROA (return on assets) was estimated to be 0.25% for the 2-year period.

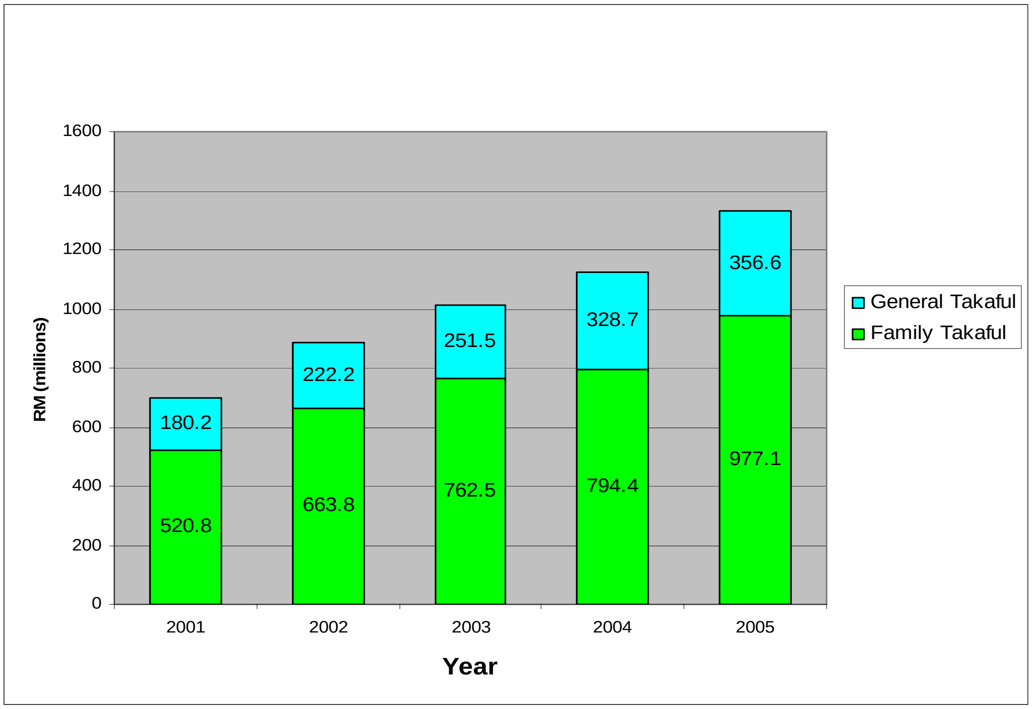
FIGURE 3.23: TAKAUFL GROWTH AT TAKĀFUL IKHLAS



Source: *Annual Report 2007, Takāful Ikhlas,* *www.Takāful.ikhlas.com.my*

In the Figure 3.23, both family and general *Takāful* have shown higher growth during 2006-2007. Yet family *Takāful* has attracted greater *Takāful* business and higher business growth. General *Takāful* has increased from RM.22 million in 2006 to RM.34 million in 2007 showing increase of 55% during 2006-2007. Family *Takāful* has increased from RM.63 million in 2006 to RM.150 million in 2007 showing138% increase during 2006-2007. Similar to *Takāful* Malaysia, *Takāful* Ikhlas has also attracted a large population of customer for family *Takāful* business. The success of *Takāful* Ikhlas in *Takāful* business in a very short period is due to its competent and skillful work force. *Takāful* agents have played a vital role in the promotion of *Takāful* business by creating its awareness among general public and eliminating certain misconception associated with prohibition of insurance business in Malaysia.

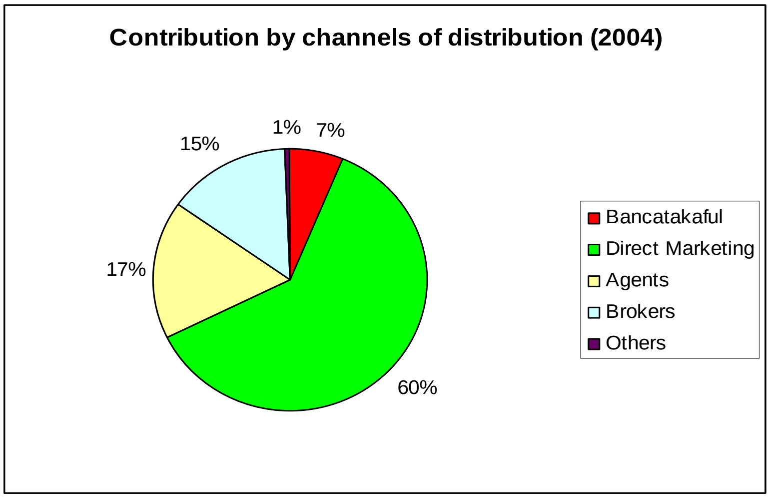
FIGURE 3.24: PERFORMANCE OF MALAYSIAN TAKĀFUL INDUSTRY

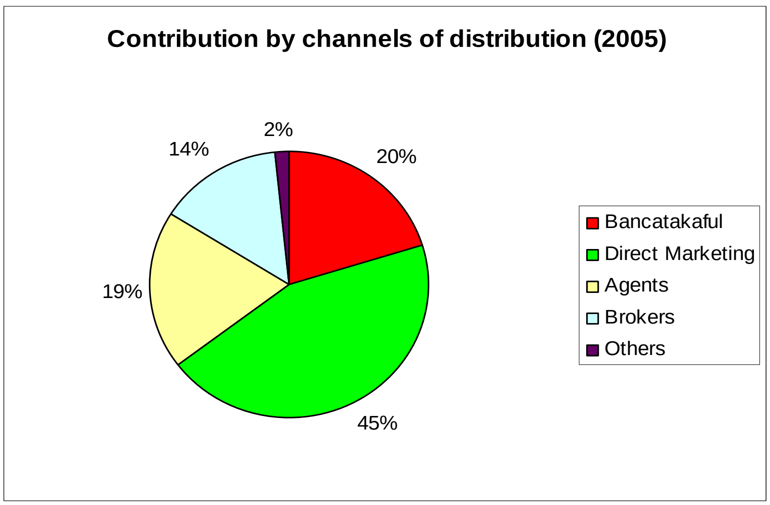


Source: *BNM Report 2005, Takāful industry performance, www.bnm.gov.my*

The Figure 3.24 shows performance of Malaysian *Takāful* industry as a whole. Family *Takāful* has gained greater *Takāful* market share as compared to general *Takāful* during the period 2001-2005. General *Takāful* business was estimated to be RM.180.2 million in 2001 that increased to RM.356.6 million in 2005 showing an average increase of 20% per anum. Family *Takāful* business was estimated to be RM.520.8 million in 2001 that increased to RM.977.1 million in 2005 showing an average increase of 18% per anum. Average contribution of General *Takāful* business to the total *Takāful* market was estimated to be 24% per anum. On the other hand, average contribution of family *Takāful* business to the total *Takāful* market was estimated to be 76% per anum. Hence in Malaysian *Takāful* industry, family *Takāful* business constitutes almost 3 times the general *Takāful* business.

FIGURE 3.25: CHANNELS OF DISTRIBUTION IN MALAYSIA





Source: BNM Report 2004-2005, Takāful industry performance, www.bnm.gov.my

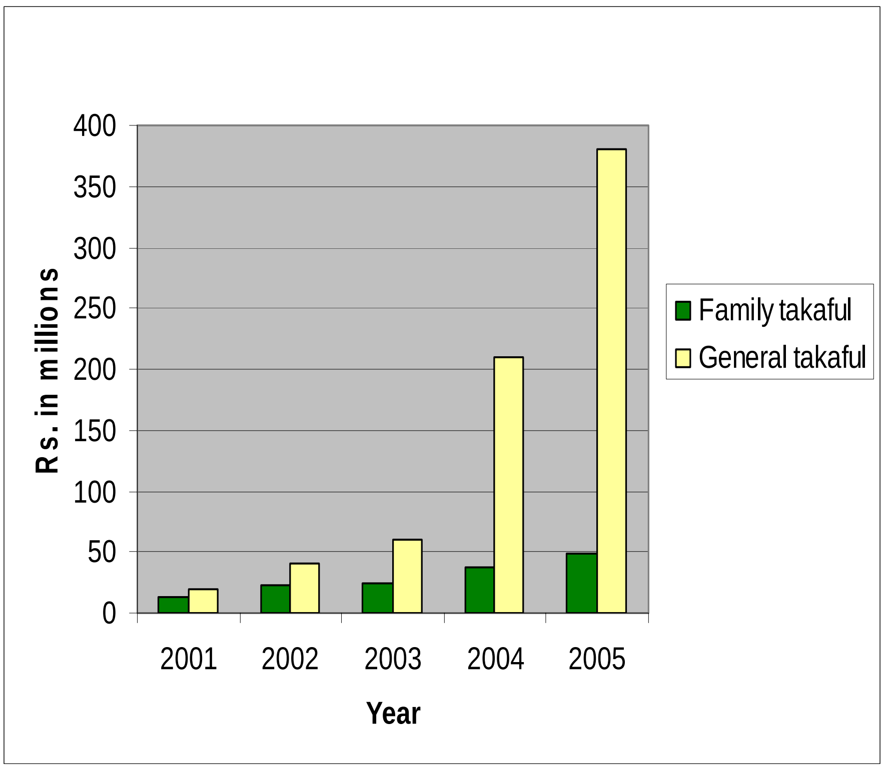
Pie-charts in the Figure 3.25 show the share of different channels of distribution of Malaysian *Takāful* industry promoting *Takāful* business in the country. In 2004, direct marketing constituted the highest share of *Takāful* business that was 60% of the total *Takāful* market. In 2005, share of direct marketing was decreased to 45% yet it was still highest share in the *Takāful* market.

In 2004, *Takāful* agents constituted 17% of the total *Takāful* market that was the second highest share in the market. In 2005, share of *Takāful* agents was increased to 19%. Share of *Takāful* brokers was 15% in 2004 that was decreased to 14% in 2005. Share of banca*Takāful* was 7% in 2004 that increased significantly in 2005 and constituted 20% of the total market share. Banca*Takāful* emerged as a major distribution channel in 2005 which shows the involvement and participation of banks in promoting *Takāful* business.

3.3.5 AMANA *TAKĀFUL* INSURANCE (SRI LANKA)

Amana *Takāful* Limited, a subsidiary of Syarikat *Takāful* Malaysia, was setup in 1999 as first *Takāful* company in Sri Lanka (Amana *Takāful* Report, 2005). From its inception, the company has catered for both family and general *Takāful* business in the country. Amana *Takāful* has expanded its operations to establish 12 branches island wide including the South and East of Sri Lanka and has extended overseas with the setting up of a branch office in the Maldives (Salieh, 2006).

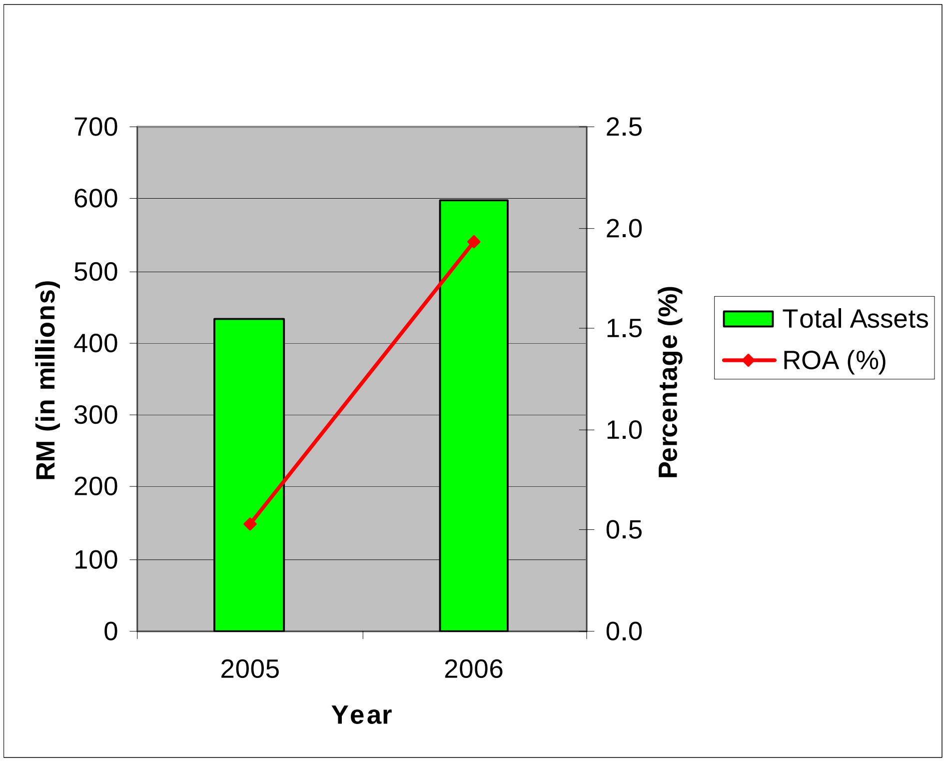
FIGURE 3.26: TAKĀFUL GROWTH AT AMANA TAKĀFUL



Source: *Annual Reports 2001-2005, Amana Takāful,*
http://www.Takāful.lk:8080/goAmanaInsurance.do

Takāful growth at Amana *Takāful* has been quite impressive. The Figure 3.26 shows 5-year period of *Takāful* growth at Amana *Takāful* from 2001to 2005. General *Takāful* has grown much faster than family *Takāful* in the last two years. It has shown 19 times growth in general *Takāful* business in 5-year period. This shows the gaining popularity of general *Takāful* business among general public. Family *Takāful*, though seems to have slow growth, has grown favorably from Rs.13 millions in 2001 to Rs.48 million in 2005 (about 3.7 times). Hence growth in family *Takāful* has been steady yet general *Takāful* business has surpassed it.

FIGURE 3.27: ASSET PERFORMANCE AT AMANA TAKĀFUL



Source: *Annual Reports 2005-2006, Amana Takāful,*
http://www.Takāful.lk:8080/goAmanaInsurance.do

The Figure 3.27 shows overall profitability of Amana *Takāful* during 2005-2006. Total assets of the company were estimated to be RM.433 million in 2005 that were increased to RM.597 million in 2006. This shows an increase of 38% in total assets in one year period. Return on assets (ROA) was estimated to be 0.5% in 2005 that was increased to 1.9% in 2006. This increase in ROA together with increase in total assets shows greater profitability of the company. Net profit of the company was RM.2.3 million in 2005 that significantly increased to RM.11.52 million in 2006 (almost 5 times increase in net profit in one year).

CHAPTER SUMMARY

Five types of *Takāful* models, as identified in this chapter, are being practised across the world. *Ta'awuni* model is a non-profit model based on the concept of brotherhood, solidarity and mutual cooperation among participants to achieve well-being of all. *Takāful* operator acts as a trustee on behalf of participants with no intention of making profit. *Mudhārabah* model (also called *tijari* model) is a profit sharing contract whereby participants provide capital in the form of contribution and *Takāful* operator acts as a mudarib who provides his management expertise to efficiently utilize the *Takāful* fund. *Wakalāh* model is a fee driven Islamic contract whereby participants provide capital whereas *Takāful* operator manages the funds for a fixed fee. Mixed model is combination of *al-Mudhārabah* and *al-Wakalāh* model where *Al-Wakalāh* contract is used for underwriting activities while *Al-Mudhārabah* contract is adopted for investment activities. *Wakalāh* model with *Waqf* fund is a modified form of *Wakalāh* model where a *Waqf* fund is created by initial donation of shareholders. Participants' contribution goes directly to *Waqf* fund. *Takāful* operator deducts its fees from *Waqf* fund. The remaining amount is invested in *Sharī'ah* based instruments. The profit from investment is shared between *Takāful* operator and participants according to agreed ratios. Net surplus belongs to participants who have no prior claims.

Fiqh related issues arise in *Takāful* models as *Sharī'ah* scholars belonging to different schools of thoughts have different point of views on *Sharī'ah* matters. *Sharī'ah* issues are concerned with the independence, confidentiality, competence, consistency and disclosure of responsibilities that affect functioning of SSB in the organizations. Critics on the issue of profit sharing argue that it is illegal for participants as well as for *Takāful* operators to share in profits due to *tabarru* nature (donation) of contribution. Issue of underwriting surplus sharing prevents *Takāful* operators to share the surplus amount and restricts their earning to *Wakalāh* fee or their share of profit. Issue of unearned *Wakalāh* fee arises when a participant withdraws his contract at the mid of *Takāful* period, as fee is usually charged in advance as upfront charge when participant pays contribution amount. *Waqf* model raises questions about its legal status, treating *Waqf* fund as separate entity and its tax implications. Corporate governance issues raise the voice for accountability of company board of directors as they have been criticized for maximizing the shareholders' profits while ignoring the rights of participants.

Five *Takāful* companies were selected and their financial performance was analyzed to gauge future trend and potential for *Takāful*. SALAMA Islamic Arab Insurance Company of UAE, incorporated in 1979, has shown growth of 5 times in net profit, 3 times increase in *Takāful* premium and 5 times increase in the total assets in each half year during the period 2004-2007. Average ROA (return on assets) was estimated to be 8.4% for the given period. *Takāful* International formerly known as Bahrain Islamic Insurance Company (BIIC) was incorporated in 1979. It has shown growth of 2.5 times in net profit, growth of about 6.3% in *Takāful* premium and 20% per anum growth in the total assets during the period 2004-2006. Average ROA (return on assets) was estimated to be 0.28% for the given period. Syarikat *Takāful* Malaysia, incorporated in 1985 as the first *Takāful* Company of Malaysia, has shown growth of about 14% in *Takāful* business and 25% per anum growth in the total assets during the period 2003-2007. Average ROA (return on assets) was estimated to be 0.9% for the given period. Net profit was increased by 53% in first three years till 2005 while there was 44% decline in 2007 due to decrease in surplus and increase in management expenses. *Takāful* Ikhlas, established in 2003 in Malaysia, has shown growth of 149% in net profit, 123% in *Takāful* fund and 59% per anum growth in the total assets during the period 2006-2007. Average ROA (return on assets) was estimated to be 0.25% for the 2-year period. Amana *Takāful* Limited, setup in 1999 as the first *Takāful* company in Sri Lanka, has shown 19 times growth in general *Takāful* while 3.7 times in family *Takāful* during the period 2001-2005. There was 5-times growth in net profit and 38% per anum growth in the total assets in 2005-2006. ROA (return on assets) increased from 0.5% in 2005 to 1.9% in 2006.

Seeing the increasing trend of *Takāful* practices across the globe and financial performance of *Takāful* companies in different countries, it can be inferred that *Takāful* has significant growth opportunities in Muslim countries in future and new players trying to enter this market can take great benefit from its untapped potential.

CHAPTER 4

PAKISTAN INSURANCE INDUSTRY AND POTENTIAL FOR *TAKĀFUL*

INTRODUCTION

Insurance industry plays an important role in the overall development of the economy by managing and indemnifying financial risk and by serving as a major institutional investor for the capital and money market instruments. The concentration of insurance in the overall financial system depends on the demand and supply of insurance services. The demand for insurance mainly depends on the real disposable income, individual preference for financial security and insurance premium rates. Moreover, economic environment of a country, interest rates, inflation, cultural and religious beliefs, level of awareness about insurance and individual ability to plan for future also play a crucial role in creating demand for insurance. On the other side, supply of insurance mainly depends on the availability of insurance services (SBP Report 2003, p.95).

Though Pakistan Insurance industry has shown satisfactory performance for the last few years yet the misconceptions associated with conventional insurance and lack of awareness about alternative system are big hurdles in the way of future growth and potential of insurance. This chapter attempts to provide an overview of Pakistan insurance industry while estimating potential of *Takāful* business in the country. The chapter seeks to assess the potential of *Takāful* from four broad perspectives. In the first place, insurance growth in Pakistan indicates that potential for growth does exist for *Takāful* as well. Insurance comparison among Muslim countries as well as share to world insurance market signify existing low level of insurance and potential for future growth. Comparison with advanced countries indicates Pakistan abysmal low insurance penetration. Regional comparison shows insurance density and penetration of Asian countries. Growth of *Takāful* across the world and geographical spread of *Takāful* business specifically indicate that potential for *Takāful* exists in the Asian region. The chapter identifies global indicators that might serve as potential contributors to *Takāful* business in Pakistan. It also discusses key features of *Takāful* products as well as role of micro-*Takāful* schemes in providing insurance to the poor.

4.1 PAKISTAN INSURANCE INDUSTRY: AN OVERVIEW

Pakistan is one of the largest countries with total population of 165 million people out of which 97% are Muslims. Due to stringent religious beliefs, people have been reluctant to accept insurance as a way to improve their living condition. About 67.5% of population lives in rural areas (World Fact book, 2006) and 73.6% are living below poverty line i.e. earning less than $2 per day (UNDP, 2006). As a result of low disposable income, low literacy rate together with stringent religious beliefs, insurance industry in this country could not progress well as compared to other countries in the region e.g. India and Srilanka.

Historically, insurance industry in Pakistan has been characterized by inadequate and ineffective supervision, inadequate financial and prudential regulations, lack of innovative insurance products and monopoly of state owned insurance companies. The asset structure has been highly skewed towards state owned insurance companies. In 2001, State Life Insurance Corporation (SLIC) and National Insurance Company Limited (NICL) constituted 80.5 % of the total assets of the whole insurance industry. Till 2005, this share remains 74% of the total insurance market (SBP Report 2005; p.107).

While the insurance reforms initiated by Government of Pakistan started in 1990s for the formation of a robust insurance industry yet the actual impetus to the development drive came with the promulgation of the Insurance Ordinance 2000. This was followed by the introduction of new insurance regulations by SECP in the form of Insurance Rules 2002 and the Code of Conduct for Surveyors and Loss adjusters (SBP Report 2004, p.136)

Though share of state owned companies has been decreased in the last few years and share of private domestic and foreign companies has been increased (SBP Report

2005), still insurance industry in Pakistan could not grow as compared to international market. Being an Islamic ideological state, where Islamic way of life is rooted in the lives of people of Pakistan, religious beliefs of the people regarding validity of insurance are big hurdles in the promotion of insurance business in the country. There is urgent need on the part of government and concerned authorities to take effective measures to boost up insurance business according to true needs of people.

The total number of companies operating in the market has decreased from 63 in the year 2000 to 54 in the financial year 2003. Till now there are 50 insurance companies involved in general insurance business out of them 49 are private companies while one is state owned i.e. National insurance company Limited. Out of 49 private companies, 44 are local insurers while two are foreign insurers. Three companies have been registered as *Takāful* operators (SECP, 2007).

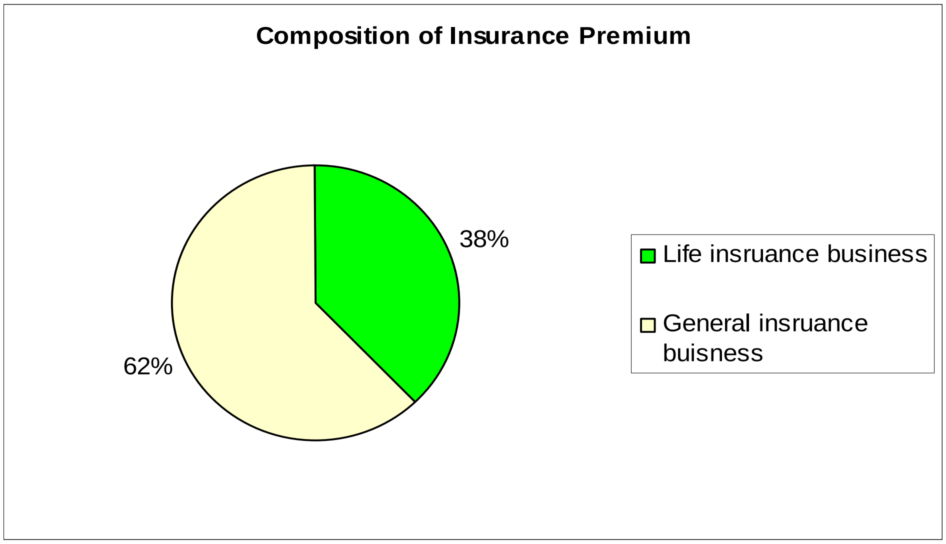
On the other hand, 5 insurance companies are involved in life insurance business in the country out of which 4 are private and one is state owned i.e. State Life Insurance Corporation Limited. Out of four private life insurance companies two are local and two are operating as foreign insurers. Pakistan Reinsurance Company is only Reinsurance Company in the country providing reinsurance services to general insurance companies (SECP, 2007).

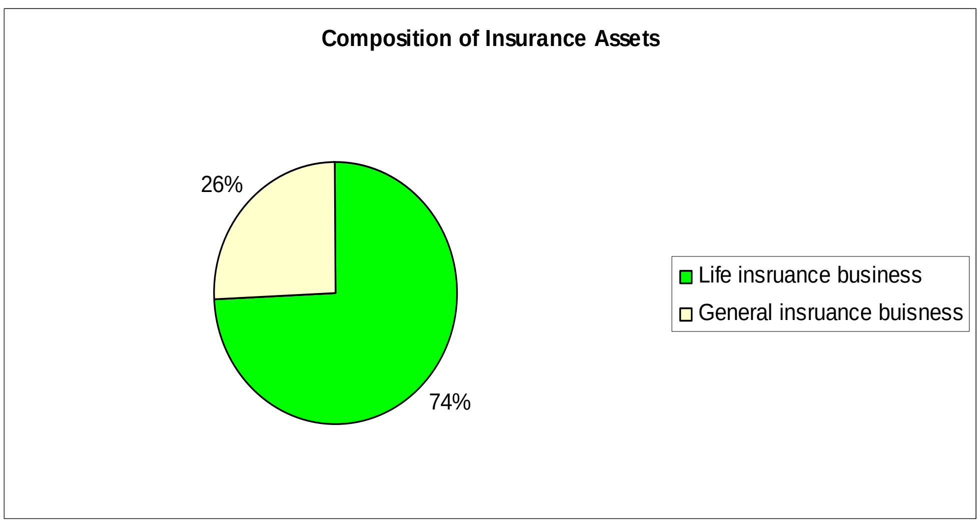
In Pakistan, till 2005, 62% of the total premium received from policyholders constitutes general insurance business while 38% comes from life insurance as indicated in the pie charts of the Figure 4.1 below.

Life insurance business requires more capital adequacy and solvency margins and more capital requirements[1], so assets of life insurance companies are usually greater than general insurance companies. Pakistan insurance industry contains 74% assets of life insurance business while general insurance companies have 26% share in total insurance assets of the industry.

[1] In Pakistan, general insurance companies require minimum paid up capital of 80 million rupees while life insurance companies require 150 million rupees as capital requirement (SECP, 2007).

FIGURE 4.1: COMPOSITION OF INSURANCE BUSINESS





Source: *SBP Report, 2005; www.sbp.gov.pk,*

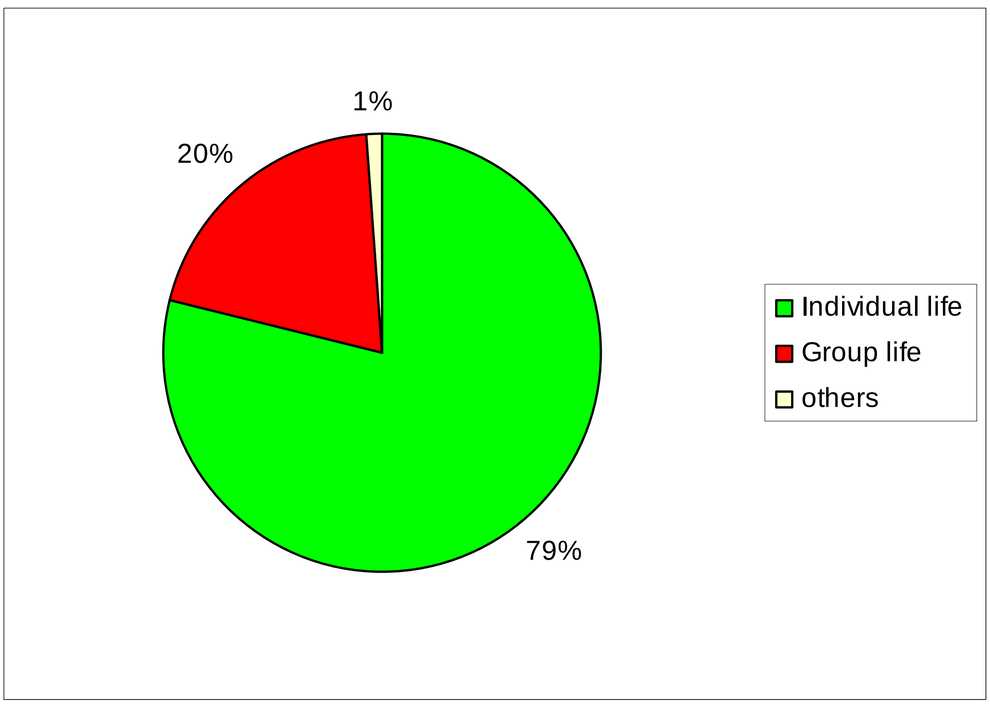
Insurance Association of Pakistan (2005); www.iap.com.pk

4.1.1 LIFE INSURANCE BUSINESS

Life insurance business in Pakistan is concentrated in two major areas: individual and group life insurance. Individual life insurance has greatest share in the life insurance business (79% share as shown in Figure 4.2 below). Both individual and group life insurance constitutes about 99% of total life insurance business in the country. Other types of life insurance products like annuity plan, pension plan, children education plan and accident & health insurance are not much popular and have negligible share of about 1% share in total life insurance business.

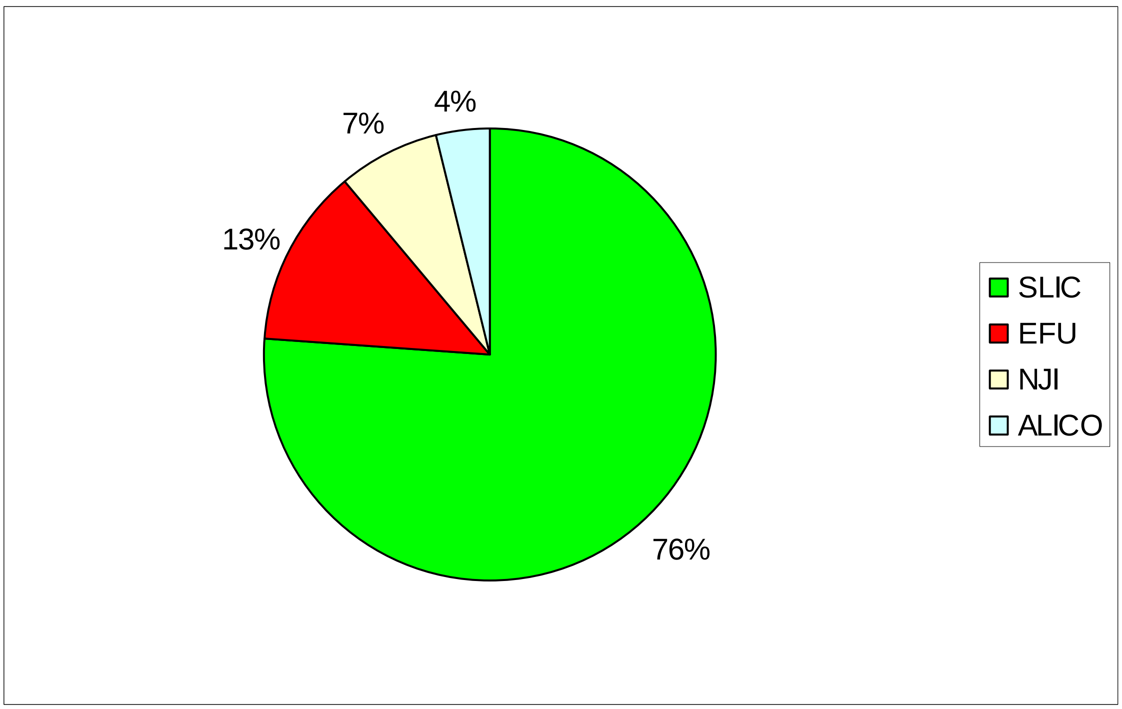
There is ample growth potential in life insurance business of these products in Pakistan as they meet the true needs of the people and provide them protection from economic downturns.

FIGURE 4.2 COMPOSITION OF LIFE INSURANCE BUSINESS



Source: *SBP Report, 2005; www.sbp.gov.pk,* Historically, life insurance business is dominant by state owned company in Pakistan. State Life Insurance Corporation (SLIC) of Pakistan is the only state owned company in the country that was created from the consolidation of 41 insurance companies during the process of nationalization in the early 1970s (SBP FSA Report 2005). Since then, SLIC has continued to remain a dominant insurance company in the country and contains 76% of the total life insurance business in 2005 as shown in the Figure 4.3.

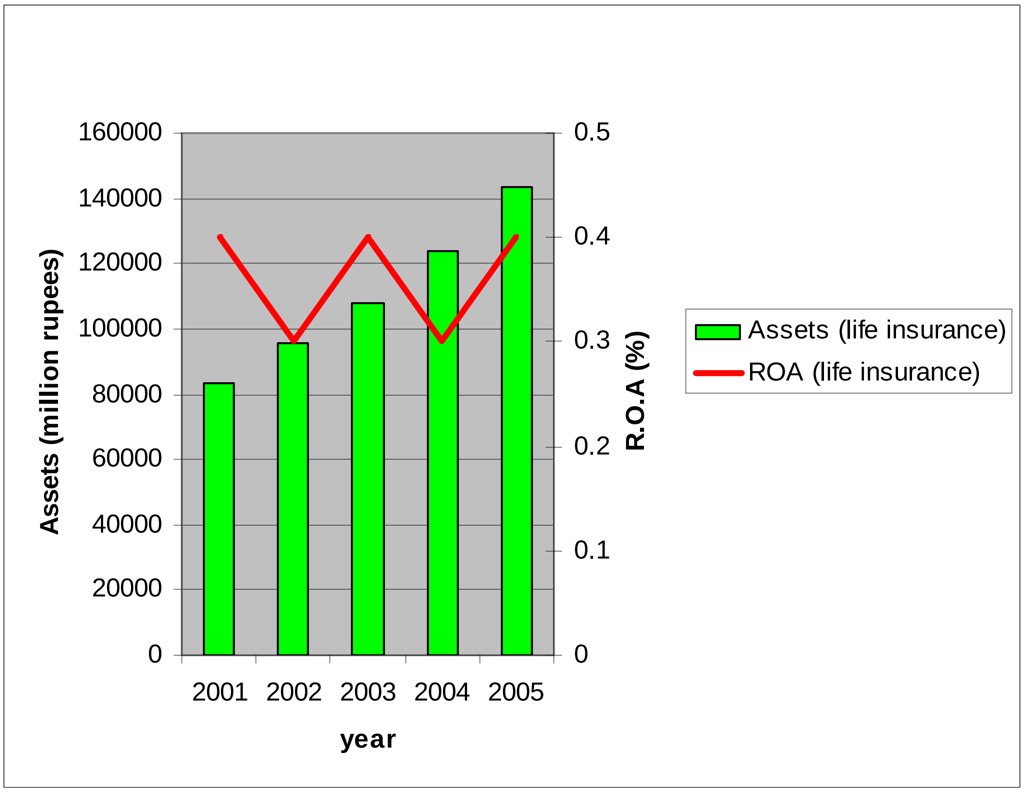
FIGURE 4.3 SHARE OF LIFE INSURANCE COMPANIES



Source: *SBP Report, 2005; www.sbp.gov.pk,*

Though share of state owned companies SLIC and NICL has been decreased in the year 2005 and share of private domestic and foreign companies has been increased as compared to 2004, still insurance industry in Pakistan could not grow as compared to international market. Being an Islamic ideological state, where Islamic way of life is rooted in the lives of people of Pakistan, religious beliefs of the people regarding validity of insurance is a big hurdle in the promotion of insurance business in the country. There is urgent need on the part of government and concerned authorities to take effective measures to boost up insurance business according to true needs of people.

FIGURE 4.4 PERFORMANCE OF LIFE INSURANCE



Source: *Annual Reports of Life Insurance Companies (year 2001-2005)*

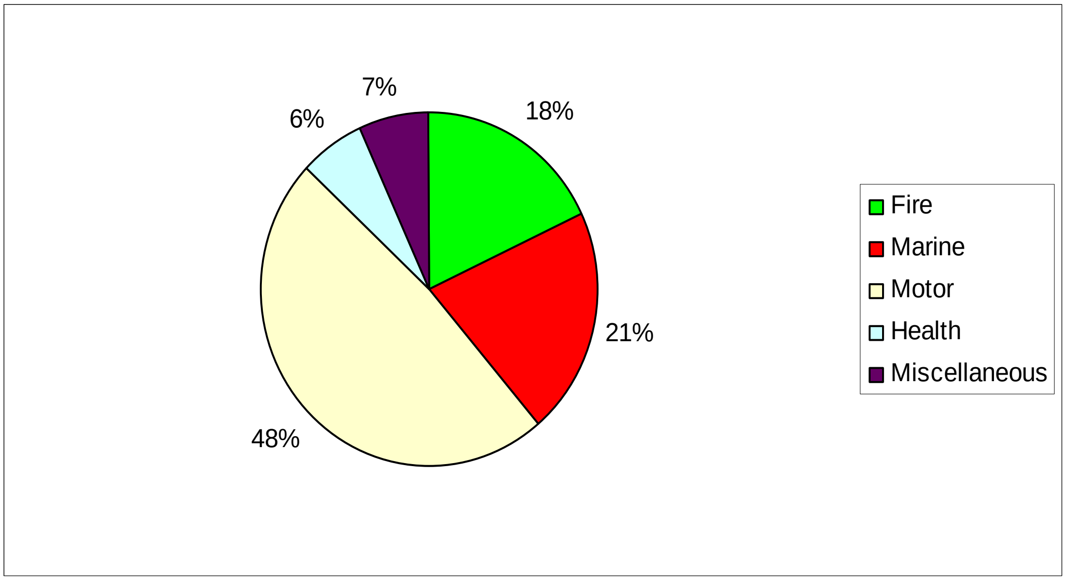
The Figure 4.4 shows overall profitability of life insurance business that is measured by Return on Assets[2] (ROA). Net profit for the year 2001 was estimated to be Rs.302 million that increased to Rs.510 million in 2005. It has shown an average increase of about 14% per anum. ROA for life insurance during 5-year period has fluctuated up and down. In 2001, it was estimated to be 0.4% that was decreased to 0.3% in 2002. It increased to 0.4% in 2003 and further decreased to 0.3% in 2004. It again increased to 0.4% in 2005. In spite of its fluctuation, it shows consistent performance of insurance industry as there is steady increase in total assets during 5-year period. Average ROA ratio for life insurance for the 5-year period was estimated as 0.4%.

[2] ROA is defined as total net profit divided by total assets during a specified period. It expresses net profit as a percentage of total assets.

4.1.2 GENERAL INSURANCE BUSINESS

National Insurance Company Limited (NICL) is the only state owned company involved in general insurance business in the country. Beside this, there are 48 private insurance companies involved in general insurance business in Pakistan (SECP, 2007).

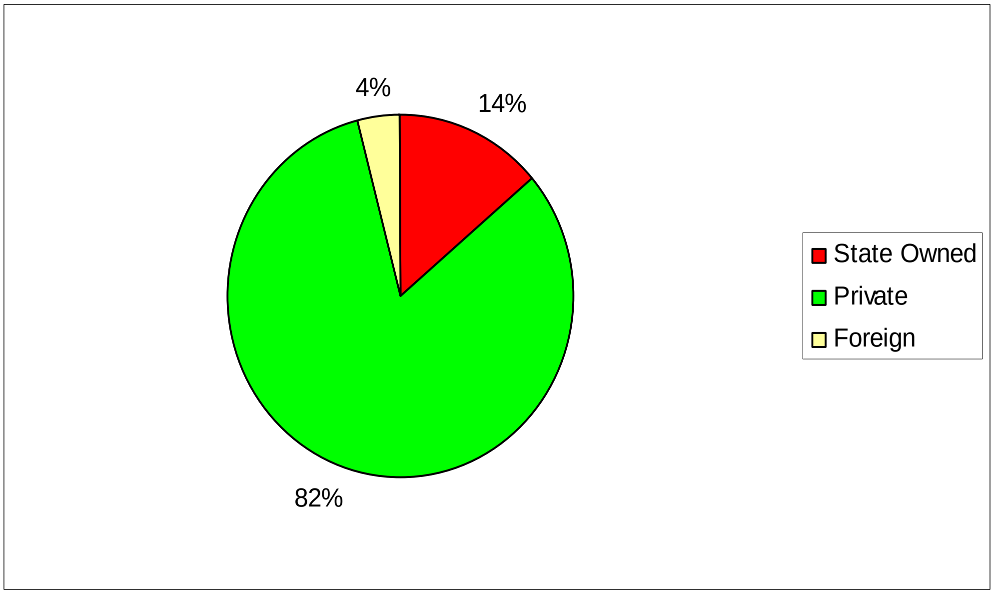
FIGURE 4.5: COMPOSITION OF GENERAL INSURANCE



Source: *Insurance Association of Pakistan (2006), www.iap.com.pk*

There are five categories of general insurance as shown in the Figure 4.5 above. Motor insurance has the largest share and constitutes of 48% of the total general insurance business. Increase in motor insurance is mainly characterized by rapid increase in number of cars in recent past as a result of increased loans and car financing schemes in the country. Marine insurance accounts for 21% share of total general insurance business. It is associated with international trade and increases with imports and exports of goods and services. Fire insurance is the third largest category and accounts for 18% of general insurance. It is associated with growth of construction and industrial sector. Health insurance accounts for 6% of general insurance. Miscellaneous category includes aviation insurance, travel related insurance and cash insurance etc. It accounts for 7% of general insurance business in Pakistan (IAP, 2006).

FIGURE 4.6: PARTICIPANTION IN GENERAL INSURANCE

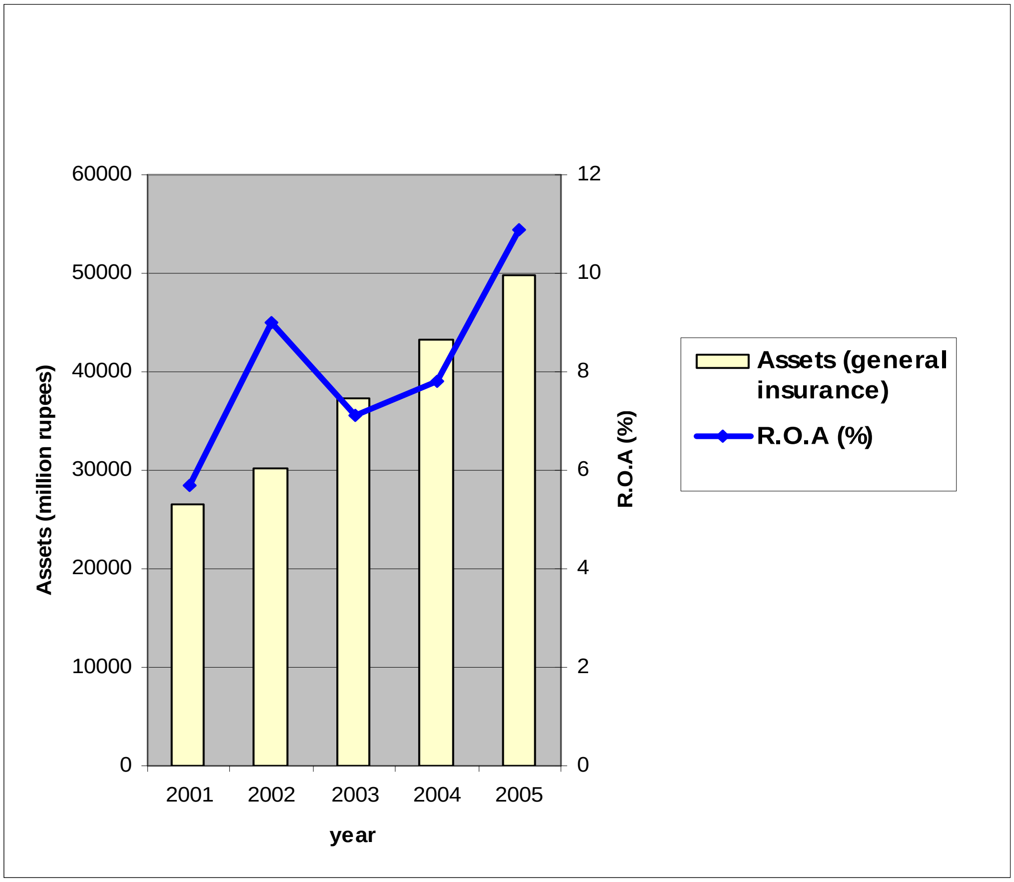


Source: *Insurance Association of Pakistan (2006), www.iap.com.pk*

Contrary to life insurance sector, general insurance sector is largely dominated by private companies as shown in the Figure 4.6. National Insurance Corporation Limited (NICL) constitutes 14% share of total general insurance. The business is highly skewed towards few private companies that account for 82% share of general insurance as seen in the chart above. Among these private companies, there are top ten companies that account for about 80% share of total private business (SECP, 2007). Among these ten companies, two companies i.e. EFU General Insurance Ltd. and Adamjee Insurance Company constitute about 67% share of total private business (IAP, 2006).

In the past few years, the share of state owned company, NICL, has been decreased and two *Takāful* operators have participated in general insurance business in the country. In the coming section we will examine the underwriting performance and profitability of general insurance business.

FIGURE 4.7: PERFORMANCE OF GENERAL INSURANCE



Source: *Annual Reports of General Insurance Companies (year 2001-2005)*

The Figure 4.7 shows overall profitability of general insurance business that is measured by Return on Assets (ROA). Net profit for the year 2001 was estimated to be Rs.1514 million that increased to Rs.5454 million in 2005. It has shown an average increase of about 52% per anum. ROA for general insurance was estimated to be 5.7% in 2001 that was increased to 9.0% in 2002. It decreased to 7.1% in 2003 and again increased to 7.8% in 2004. It further increased to 10.9% in 2005.

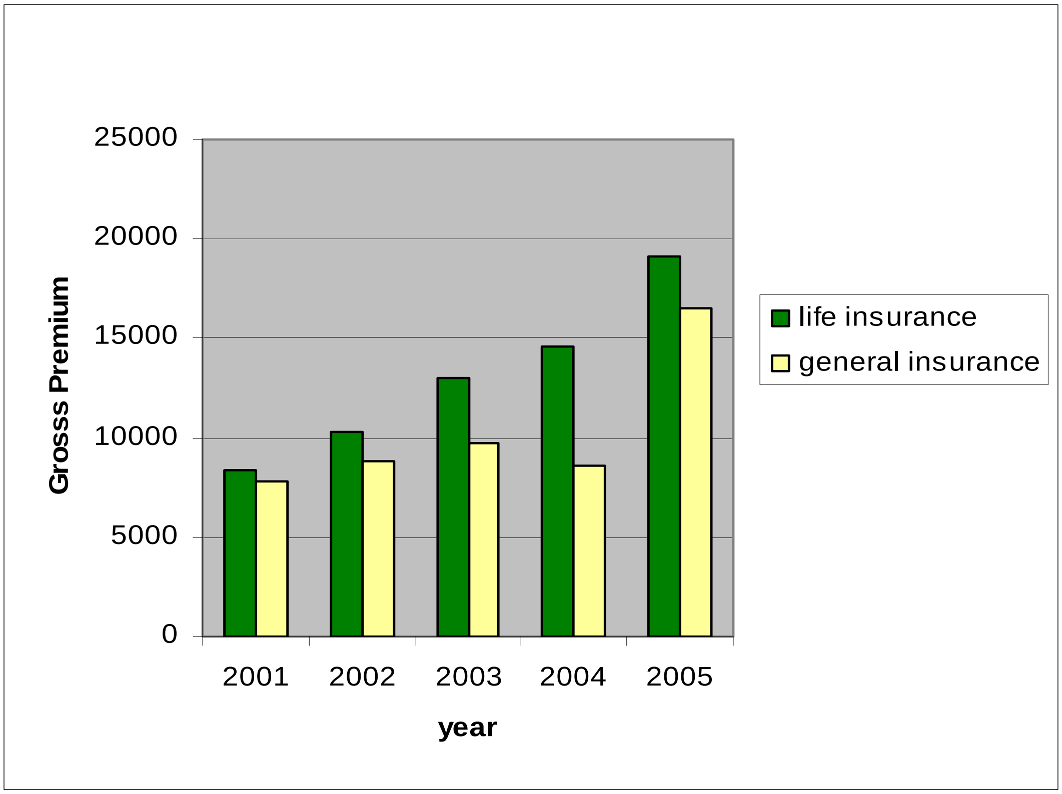
In spite of some fluctuation, it shows consistent performance of insurance industry as there is steady increase in total assets during 5-year period. Average ROA for general insurance for the 5-year period was estimated as 8.1%.

4.1.3 OVERALL PERFORMANCE

Previous sections have shown the individual performance of life as well as general insurance business. This section attempts to combine and compare both the life and the general insurance and show an overall picture of insurance industry of Pakistan. It shows growth of insurance premium, net profit growth and asset growth for life and general insurance business besides giving a combined view of asset growth and return on assets (ROA).

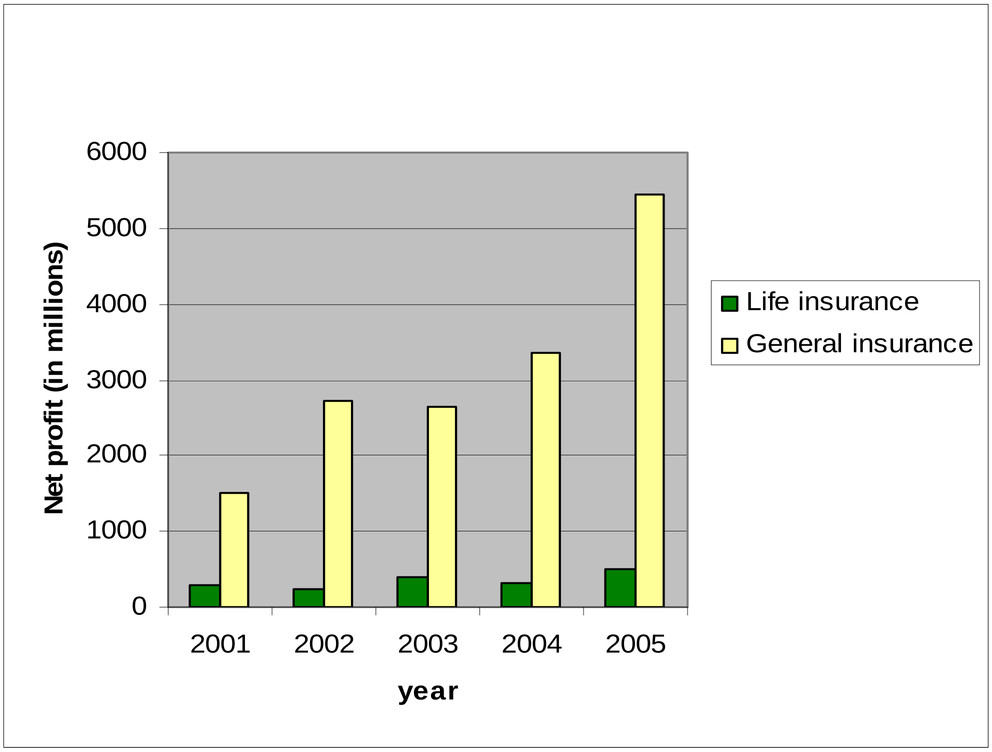
Figure 4.8 below gives a comparison of life and general insurance premiums for the 5-year period 2001-2005. Life insurance gross premium, as estimated in 2001, was Rs.8,028 millions that has grown to about Rs.19,100 million in 2005 (a total of 140% growth in 5 year period). The average growth rate for life insurance business has been 28% per anum. General insurance gross premium, as estimated in 2001, was Rs.7,835 millions that has grown to about Rs.16,500 millions in 2005 (a total of 110% growth in 5 year period). The average growth rate for general insurance business has been 22 % per anum. It shows that life insurance business is growing faster than general insurance business. It could also been seen in the year 2005 in the figure 4.8 on the next page.

FIGURE 4.8: GROWTH IN INSURANCE PREMIUM



Source: *Annual Reports of Insurance Companies (2001-2005)*

FIGURE 4.9: NET PROFIT GROWTH OF INSURANCE



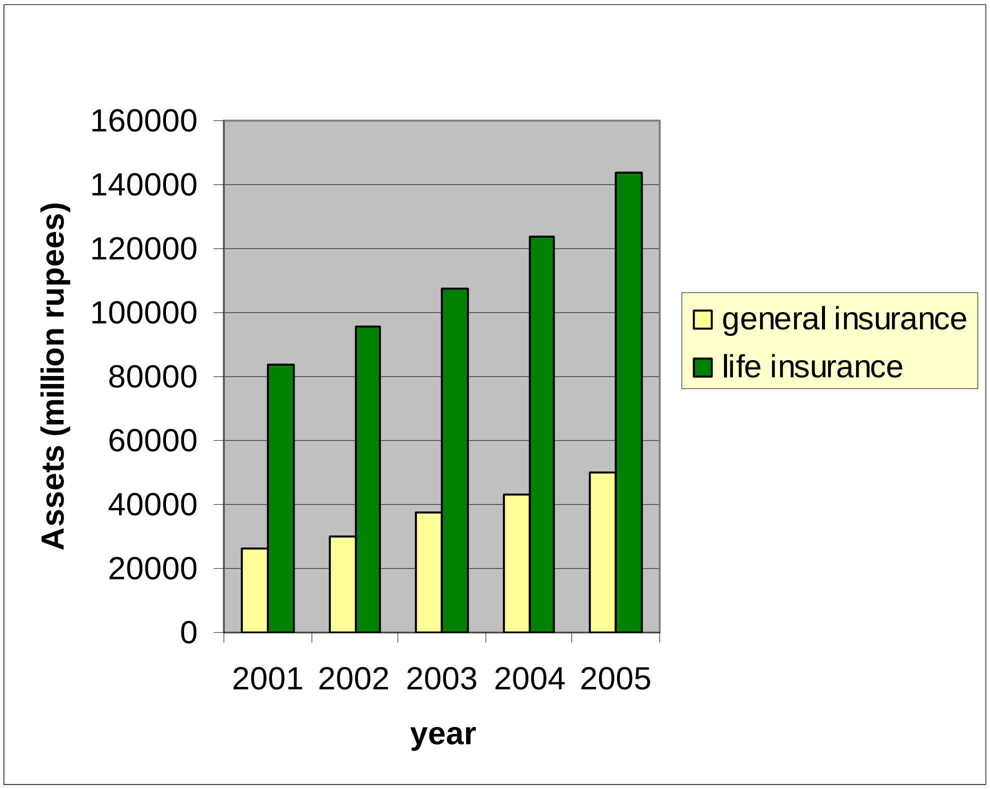
Source: *Annual Reports of Insurance Companies (2001-2005)*

The Figure 4.9 gives a comparison of net profitability of life and general insurance for the 5-year period 2001-2005. Life insurance profit, as estimated in 2001, was Rs.302 millions that has grown to about Rs.510 millions in 2005 (approximately 68% growth in 5 year period). The average growth rate for life insurance business has been about 14% per anum.

General insurance profit, as estimated in 2001, was Rs. 1,514millions that has grown to about Rs. 5,454 millions in 2005 (a total of 260% growth in 5 year period). The average growth rate for general insurance business has been 52 % per anum.

It indicates that net profit for general insurance has grown faster than that of life insurance.

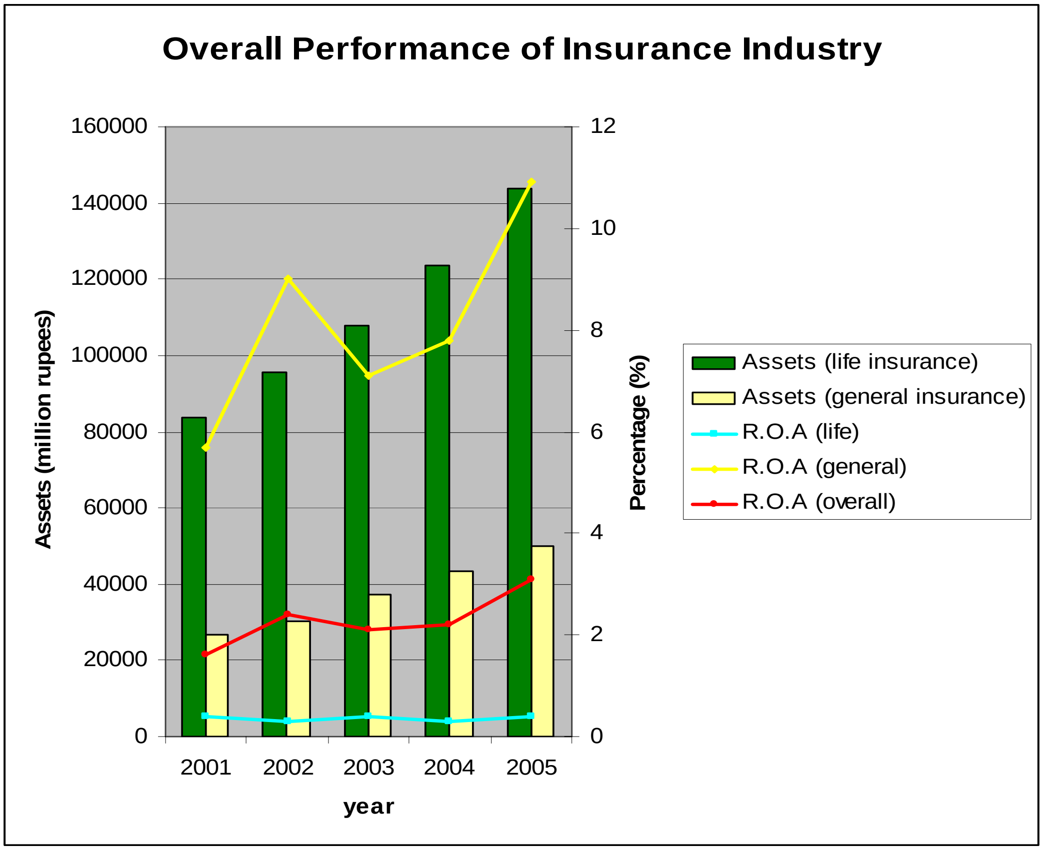
FIGURE 4.10: ASSET GROWTH OF INSURANCE



Source: *Annual Reports of Insurance Companies (2001-2005)*

The Figure 4.10 gives a comparison of life and general insurance assets for the 5-year period 2001-2005. Life insurance assets, as estimated in 2001, were Rs. 83,543 millions that has grown to about Rs. 143,729 millions in 2005 (approximately 80 % growth in 5 year period). The average growth rate for life insurance business has been16% per anum. General insurance assets, as estimated in 2001, were Rs. 26,534millions that has grown to about Rs. 49,800 millions in 2005 (a total of 90 % growth in 5 year period). The average growth rate for general insurance business has been 18 % per anum. General insurance assets have grown faster than life insurance assets due to heavy investment by insurance companies in equity and paid up capital to maintain capital adequacy margins

FIGURE 4.11 OVERALL PERFORMANCE



Source: *Annual Reports of Insurance Companies (year 2001-2005)*

The Figure 4.11 compares the asset performance (return on assets) of both life and general insurance business and also shows overall asset performance of insurance industry in 5-year period (2001-2005). It is obvious from the above chart that ROA (Return on Assets) ratio for life insurance is quite low as compared to general insurance. Moreover, ROA ratio for life insurance has been steady trend while for general insurance it has decreased in the year 2003 but overall has increasing trend. Overall ROA ratio was estimated to be 1.6 % in 2001 which increased to 2.4 % in 2002. It decreased to 2.1% in the following year but slightly rose to 2.2 % in 2004 and further increased to 3.1% in 2005. Hence overall asset performance of insurance industry has increasing trend in 5-year period.

4.2 GLOBAL COMPARISON

This section provides a global view of insurance in three scenarios and compares Pakistan's insurance business with the world market. First, it compares insurance penetration in Muslim countries. Then it provides insurance comparison among low and high HDI countries. Finally, it makes an assessment of spread of insurance business in South Asian Region.

4.2.1 INSURANCE IN MUSLIM COUNTRIES

In a global study of 46 Muslim countries (Patel, 2004), insurance penetration was found to be quite low as compared to the world insurance market particularly in highly populated Muslim countries like Pakistan, Indonesia and Turkey.

TABLE 4.1: INSURANCE PENETRATION IN MUSLIM COUNTRIES

HD rank 2006	Country	Muslim population (%) 2004	HDI* value 2004	Adult literacy rate (%) 2004	GDP per capita (PPP US$) 2004	Insurance penetration: Premiums as a share of GDP 2005 (%)	Total population 2004 (millions)	Share of World insurance market 2005 (%)
33	Kuwait	100	0.871	93.3	19,384	0.79	2.6	0.01
34	Brunei	67	0.871	92.7	19,210	-	0.4	-
39	Bahrain	100	0.859	86.5	20,758	1.95	0.7	0.01
46	Qatar	95	0.844	89	19,844	1.09	0.8	0.01
49	**UAE**	**96**	**0.839**	**77**	**24.056**	**1.53**	**4.3**	**0.05**
56	Oman	99	0.810	81.4	15,259	1.14	2.5	0.01
61	**Malaysia**	**59**	**0.805**	**88.7**	**10,276**	**5.42**	**24.9**	**0.21**
64	Libya	97	0.798	82.0	7,570	0.23	5.7	0.01
73	Albania	70	0.784	98.7	4,978	-	3.1	-
76	Saudi Arabia	100	0.777	79.4	13,825	0.46	24.0	0.04
78	Lebanon	70	0.774	86.0	5,837	3.15	3.5	0.02
86	Jordan	94	0.760	89.9	4,788	2.59	5.6	0.01
87	Tunisia	98	0.760	74.3	7,768	2.07	10.0	0.02
92	**Turkey**	**99.8**	**0.757**	**87.4**	**7,753**	**1.55**	**72.2**	**0.17**
96	Iran	99	0.746	77.0	7,525	1.23	68.8	0.07
98	Maldives	100	0.739	96.3	4,798	-	0.3	-
99	Azerbaijan	93.4	0.736	98.8	4,153	-	8.4	-
102	Algeria	99	0.728	69.9	6,603	0.56	32.4	0.02
105	Turkmenistan	89	0.724	98.8	4,584	-	4.8	-
107	Syria	91	0.716	79.6	3,610	0.52	18.6	0.02
108	Indonesia	88	0.711	90.4	3,609	1.52	220.1	0.12
110	Kyrgyzstan	75	0.705	98.7	1,935	-	5.2	-

111	Egypt	94	0.702	71.4	4,211	0.85	72.6	0.02
113	Uzbekistan	88	0.696	99.0	1,869	-	26.2	-
122	Tajikistan	85	0.652	99.5	1,202	-	6.4	-
123	**Morocco**	**99**	**0.640**	**52.3**	**4,309**	**2.87**	**31.0**	**0.04**
132	Comoros	98	0.556	63.7	1,943	-	0.8	-
134	**Pakistan**	**97**	**0.539**	**49.9**	**2,225**	**0.67**	**154.8**	**0.02**
137	Bangladesh	88.3	0.530	41.0	1,870	0.61	139.2	0.01
141	Sudan	73	0.516	60.9	1,949	-	35.5	-
148	Djibouti	94	0.494	65.0	1,993	-	0.8	-
150	Yemen	99.9	0.492	49.0	879	-	20.3	-
153	Mauritania	100	0.486	51.2	1,940	-	3.0	-
155	Gambia	90	0.479	38.0	1,991	-	1.5	-
156	Senegal	94	0.460	39.3	1,713	-	11.4	-
157	Eritrea	50	0.454	57.0	977	-	4.2	-
159	Nigeria	50	0.448	67.0	1,154	0.70	128.7	0.02
160	Guinea	85	0.445	29.5	2,180	-	9.2	-
162	Tanzania	50	0.430	69.4	674	-	37.6	-
164	Côte d'Ivoire	60	0.421	48.7	1,551	1.53	17.9	0.01
170	Ethiopia	50	0.371	42.0	756	-	75.6	-
171	Chad	50	0.368	25.7	2,090	-	9.4	-
174	Burkina Faso	50	0.342	21.8	1,169	-	12.8	-
175	Mali	90	0.338	19.0	998	-	13.1	-
176	Sierra Leone	60	0.335	35.1	561	-	5.3	-
177	Niger	97	0.311	28.7	779	-	13.5	-

***** HDI (Human development index) – composite index based on life expectancy, educational attainment and standard of living. A HDI below 0.500 reflects low human development and well being.

Sources: *UNDP (2006), Sigma (2006), World Bank (2006).*

Comparison of insurance in Muslim countries in the Table 4.1 shows that Pakistan's position is quite pathetic in the world market in general and in international Muslim community in particular. It has 134th number in HDI ranking, has large population most of which is illiterate and has no access to basic necessities of life, has low GDP per capita and low insurance penetration as compared to Indonesia, Malaysia, Turkey and some other Arab and non-Arab Muslim countries.

In the Table 4.1, it could be seen that Malaysia is on the top in Muslim countries regarding insurance coverage but only constitutes 0.21% share of the world insurance market with the total population of about 25 million of which 59% are Muslims. All other Muslim countries have insurance penetration less than Malaysia. Most of the Muslim countries have negligible share of insurance in the world market except Turkey and

Indonesia with insurance share of 0.17% and 0.12% respectively. Pakistan, with a total population of more than 150 million people of which 97% are Muslims, has only 0.02% share in the world insurance market. Low purchasing power along with low HDI value could be a major factor for low insurance penetration in Pakistan as expressed by GDP per capita (in US dollars) in the table above. Another factor that could be responsible for the low insurance penetration is lack of awareness among general public about insurance as indicated by adult literacy rate that is quite low for Pakistan (49.9%) as compared to other Muslim countries.

4.2.2 COMPARISON WITH ADVANCED COUNTRIES

After analyzing the position of Pakistan among Muslim countries, share of insurance in the world market was compared among low HDI as well as high HDI countries to further analyze the position of Pakistan with that of advanced countries. Seven countries were selected in the comparison of high and low human developed countries including as shown in Table 4.2 below. In 2006, the three largest insurance markets (USA, Japan, and UK) covered almost 55 per cent of the total world insurance market, but only 8 per cent of the world population (Muslim population world wide, 2007). Pakistan, though better than Kenya and Nigeria, has quite low GDP per capita, low literacy rate and low women participation and empowerment in society as expressed by low GDI value (0.513). Low GDP indicates low purchasing power. As a result of this low purchasing power, 73.6% of total population is living below poverty line (earning less than $2 per day). All these factors have contributed towards low share of Pakistan insurance industry in the world market as compared to advanced countries like UK, USA and Japan (in the table below, it is only better than Kenya and Nigeria).

TABLE 4.2: INSURANCE IN LOW AND HIGH HDI COUNTRIES

HDI♣ rank (from 177) 2006	Country	GDP per capita (PPP US$) 2004	Total population (millions) 2006	Adult literacy (% age 15 and above) 2004	Population below poverty line ($2 per day) (%)	GDI♦ value 2006	Share of world insurance 2006 (%)
7	Japan	29,541	127.8	99%	0%	0.942	12.36
8	USA	39,676	299.1	99%	0%	0.946	31.43
18	U.K.	30,821	60.1	99%	0%	0.938	11.24
61	Malaysia	10,276	26.1	88.7%	9.3%	0.795	0.20
134	**Pakistan**	**2,225**	**165.8**	**49.9%**	**73.6%**	**0.513**	**0.03**
152	Kenya	1,140	33.5	73.6%	58.3%	0.487	0.02
159	Nigeria	1,154	128.7	67%	92.4%	0.443	0.02

♣HDI (Human development index) – composite index based on life expectancy, educational attainment and standard of living. A HDI value equal to or more than 0.800 has high human development, 0.500-0.799 HDI has medium human development and a HDI below 0.500 reflects low human development and well being.

♦GDI (Gender-related development index) – composite index using same variables as HDI but adjusted in accordance with the disparity in achievement between women and men. A GDI value of less than 0.500 indicates that women suffer the double deprivation of low overall achievement in human development than men.

Sources: UNDP (2006), Sigma (2006), Sigma (2007), www.islamicpopulation.com

Patel (2004; pp.10-11) concluded that insurance is not as widespread in developing countries as compared to the developed world and in the poorest of countries it is virtually non-existent. All developing countries, even those with large populations, have a very low proportion of the world insurance market. In developed countries, insurance has become a legal necessity and is compulsory by law. On the other hand, in developing countries (most of which have large Muslim populations), insurance is not being made available compulsory where it is needed the most, where human well-being is at the lowest and vulnerability is at its highest.

4.2.3 REGIONAL COMPARISON

In the regional comparison as shown in Table 4.3 below, five countries of Asian region were selected and position of Pakistan was compared based on insurance rank by volume, GDP per capita (in $US), insurance premium, insurance density, insurance penetration and share in the world market.

TABLE 4.3: INSURANCE IN ASIAN REGION (SELECTED COUNTRIES)

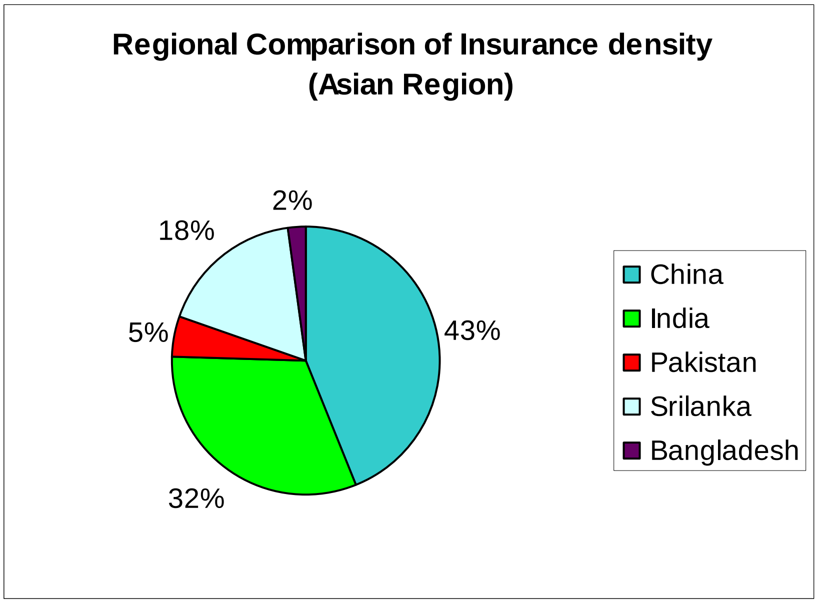
Insurance rank by volume 2006	**Country**	**GDP per capita (PPP US$) 2004**	**Insurance Premium ($US million) 2006**	**Insurance* density 2006** $ per capita	**Insurance* penetration 2006 (%)**	**% share of world market 2006**
9	China	5,896	70, 805	53.5	2.7	1.90
15	India	3,139	43, 032	38.4	4.8	1.16
58	Pakistan	**2,225**	**949**	**5.9**	**0.8**	**0.03**
79	Srilanka	4,390	444	21.3	1.6	0.01
84	Bangladesh	1,870	375	2.6	0.6	0.01

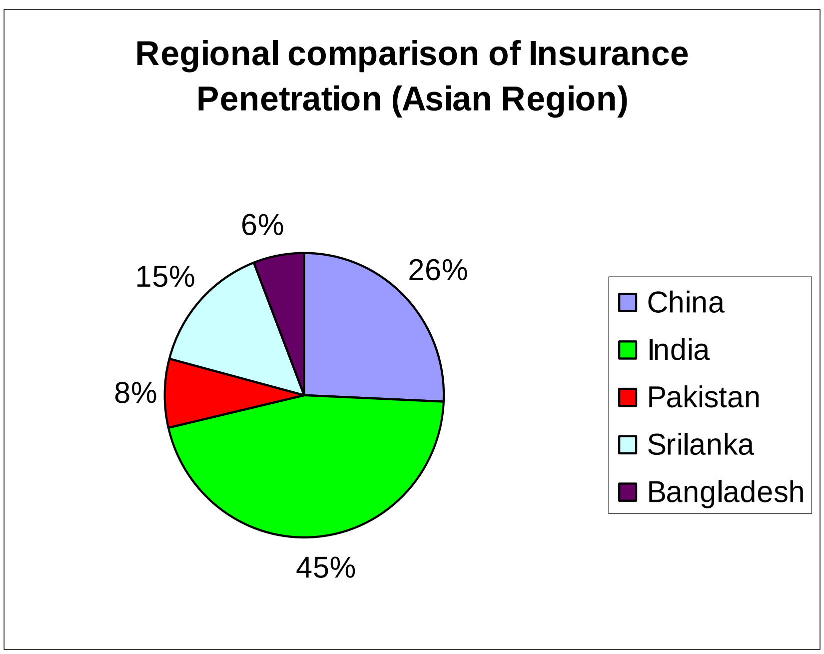
*Insurance density is defined as gross premium per capita and insurance penetration is showing gross premium as a percentage of GDP i.e.
Insurance density = gross premium/total population
Insurance penetration = (gross premium/GDP) $\times$100

Source: UNDP (2006), Sigma (2007)

Pakistan was ranked at 58th position in the world insurance market by volume as compared to 9th position of China and 15th of India. GDP per capita for Pakistan is lower than China, India and Srilanka and only slightly better than Bangladesh which has 84th insurance rank by volume in the world market. Insurance Premium for Pakistan is also lower than China and India. It could be argued that Pakistan has lower premium than the two countries due to their large population. Yet, Pakistan position is also low in insurance density and penetration comparisons which give another angle of the measure of level of insurance in the country. It is shown in the following charts.

FIGURE 4.12: REGIONAL COMPARISON OF INSURANCE BUSINESS





Source: Sigma (2007), World insurance in 2006

The pie-charts in the Figure 4.12 show the share of Pakistan in regional comparison of insurance at South Asian region. In the comparison of insurance density, share of insurance density for Pakistan is 5% as compared to 18% of Sri Lanka, 32% of

China and 43% of India. It is only better than Bangladesh that has 2% share of insurance density. In the comparison of insurance penetration, share of insurance penetration for Pakistan is 8% as compared to 15% of Sri Lanka, 26% of China and 45% of India. It is only better than Bangladesh that has 2% share of insurance density. In both cases, India has the highest share while Pakistan has quite low position in the South Asian region.

4.3 ASSESSING *TAKĀFUL* POTENTIAL FOR PAKISTAN

This section specifically attempts to assess potential of *Takāful* business in Pakistan from three dimensions. First it gives geographical spread of *Takāful* business to assess *Takāful* market in different regions. Then it comes to light global indicators that might determine the level of insurance penetration. Finally, it projects future estimate of *Takāful* market.

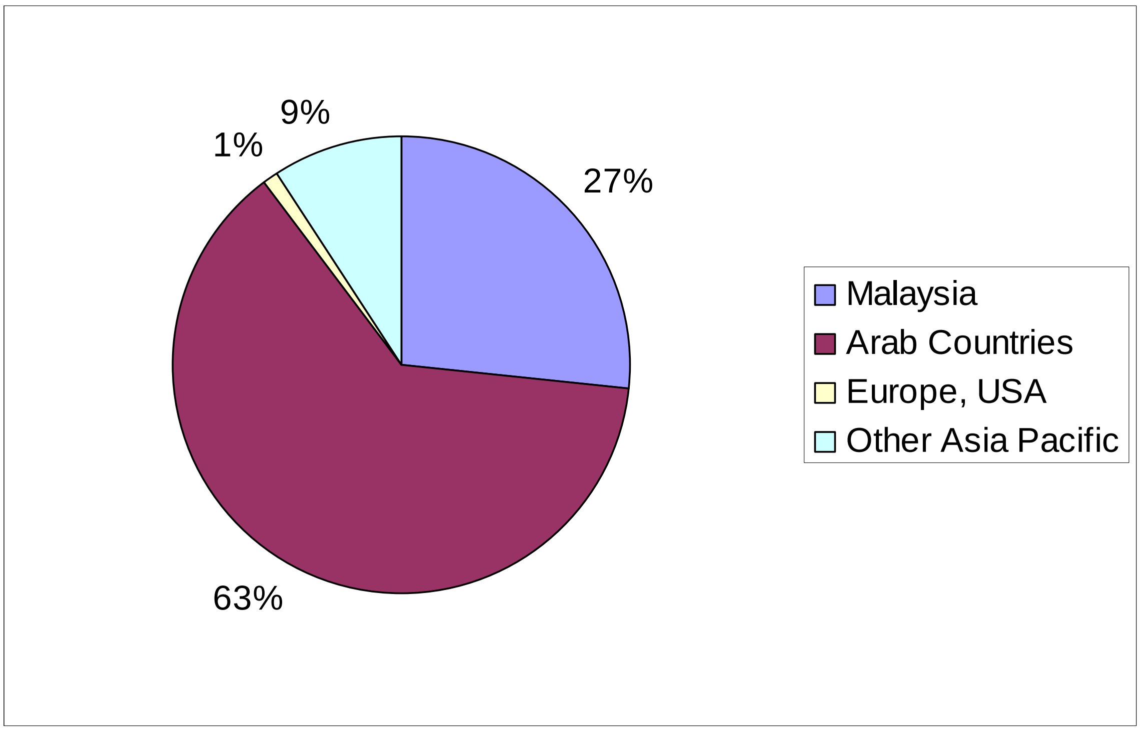
4.3.1 GEOGRAPHICAL SPREAD OF *TAKĀFUL*

The historical data on *Takāful* reveal that in 1996, there were 30 institutions transacting *Takāful* business – 6 countries in the Middle East and Asian centers such as Malaysia, Indonesia and Brunei. There are now about 80 *Takāful* companies, 200 conventional companies operating under *Takāful* windows in more than 23 countries and 10-12 *Re-takāful companies* worldwide. Overall Gross Premium Written for Islamic insurers is estimated at USD 500,000 million with average 10% annual growth (*Takāful* and *Re-takāful* companies, 2006).

The above figures indicate that global interest in Islamic financial services especially in *Takāful* is growing at an increasing rate and expected to capture higher market growth in future. The reason is that Islam, the world's fastest growing religion, is estimated to grow at around 235% in the last 50 years reaching 1.5 billion people. There are large minority Islamic populations in key Islamic countries and there are large Islamic communities in the US and Europe. It is expected that total number of *Takāful* operators may reach 105 worldwide in 2007 (Middle East insurance review, 2006).

All insurance companies in Sudan are deemed to operate in accordance with Islamic *Sharia* principles. It is worth noting that *Takāful* grew and matured even faster in Saudi Arabia, Bahrain and other Arab countries. In addition, new *Takāful* companies have been established in Sri Lanka and Tunisia. At least four more *Takāful* companies are under formation in the Middle East (viz. Kuwait, UAE and Egypt). Several other *Takāful* companies are being contemplated in various countries such as Pakistan, Australia and Lebanon. It is also understood that interest is shown in *Takāful* in South Africa, Nigeria, and some of the former states of the Soviet Union. The more successful companies in the Middle East have grown at 10% p.a. whereas in Malaysia the rate of growth has been 60% p.a. (Bhatty, 2001; p.10).

FIGURE 4.13 GEOGRAPHIC SPREAD OF TAKĀFUL BUSINESS



Source: https://www.reorient.co.uk/pdfs , Takāful & Re-takāful companies (2006)

The Figure 4.13 shows geographical spread of *Takāful* business in 2006 across the world. Total *Takāful* market was estimated to have total contribution of US$640 millions. Arab countries having the greatest share constituted approximately 63% of *Takāful* market. Malaysia, the single country, contributed for 27% of total *Takāful* premium. *Takāful* penetration, although quite low, can also be seen in Non-Muslim countries of Europe and USA that indicates a future potential in those countries. Other Asia pacific countries where majority of the population is Muslim constituted 9 % of the total *Takāful* market which shows a great *Takāful* potential in those countries including Pakistan.

Takāful insurance has become increasingly available in many countries of the world especially those with significant Muslim population. The growth of Islamic insurance is expected to be on the rise over the next decade in line with the fastest development in Islamic investment and banking systems (First international *Takāful* symposium, 2005).

It is estimated that on average *Takāful* business will grow at around 15% per annum over the next 10 to 15 years. The growth in family *Takāful* will be greater at 21% p.a. whilst general *Takāful* is expected to grow at 8% p.a. Consequently, the global *Takāful* premium is projected to be US$12.5 billion by 2015, 75% of this coming from family *Takāful* business. This is not an unachievable task when we have Malaysian *Takāful* business growing at 60% pa and the Middle East at 10%. With concerted effort on part of the *Takāful* operators worldwide, a growth of 20% p.a. should be very much possible (Bhatty, 2001; p.10).

4.3.2 GLOBAL INDICATORS

Following global indicators have been identified through the previous research that signify potential for *Takāful* in Pakistan.

- Analysis of Pakistan insurance industry shows that overall financial performance of the industry has increased in the last few years. Moreover, Pakistan share in the world insurance market was 0.02% in 2004 that has grown to 0.03% in 2006. It indicates that insurance industry in the country is growing and potential exists for future growth of *Takāful* as well (See insurance share in Table 4.1 and Table 4.2).
- In the global comparison of 46 Muslim countries, Pakistan was found to be the second largest country in the Muslim world having population of more than 150 million, yet it has low share of insurance in the world market. Other Muslim countries like Malaysia, UAE, Turkey and Morocco that have lesser population than Pakistan have higher share of insurance in the world market (Table 4.1).
- Adult literacy rate was found to be 49.9% in 2004 that is quite low as compared to other developed Muslim countries. Even some underdeveloped Muslim countries

like Nigeria and Tanzania were found to have higher literacy rate (67% and 69.4% respectively) than Pakistan (Table 4.1).

- In the insurance comparison of low and high HDI countries, Pakistan was found to have GDP of US$2,224 per capita that is quite low as compared to Malaysia and some other advanced counties. It is a measure of purchasing power of the people of the country (Table 4.2).
- 73.6% of the people were estimated to live below poverty line i.e. earning less than $2 per day (UNDP, 2006). It means only 26.4% are earning more than $2 per day. It affirms the low purchasing power of the people as reflected in low GDP per capita (Table 4.2).
- GDI value (Gender-related Development Index) was found to be 0.513 in case of Pakistan that is quite low as compared to other advanced countries. It indicates that women empowerment and their participation in economic activities of the country is quite low and they suffer greater deprivation as a result of low overall achievement in human development than men (Table 4.2).
- In the insurance comparison in the Asian region, GDP per capita for Pakistan was found to be lower than India and China. It was even lower than Sri Lanka that has low HDI value and lower insurance volume rank than Pakistan (Table 4.2).
- Population of India and China is about 8 and 9 times greater than Pakistan, yet insurance premium (in $US millions) for India and china was estimated to be 45 times and 75 times higher than that of Pakistan. It indicates a relatively lower value of insurance premium for Pakistan with respect to its population as compared with India and China (Table 4.3).
- Insurance density was estimated to be $5.9 per capita for Pakistan as compared to $38.4 for India, $53.5 for China and $21.3 for Sri Lanka. It compares total gross insurance premium with total population of the country (Figure 4.12).
- Insurance penetration was estimated to be 0.8% for Pakistan as compared to 2.7% for India, 4.8% for China and 1.6% for Sri Lanka. It represents total gross insurance premium as a percentage of GDP of the country (Figure 4.12).
- Geographical spread of *Takāful* business shows that most of the current *Takāful* market is captured by Malaysia and some Arab countries. Asian countries

constitute a small portion of total *Takāful* market. It indicates that potential exist in those Asian countries where majority of the population is Muslim (Figure 4.13).

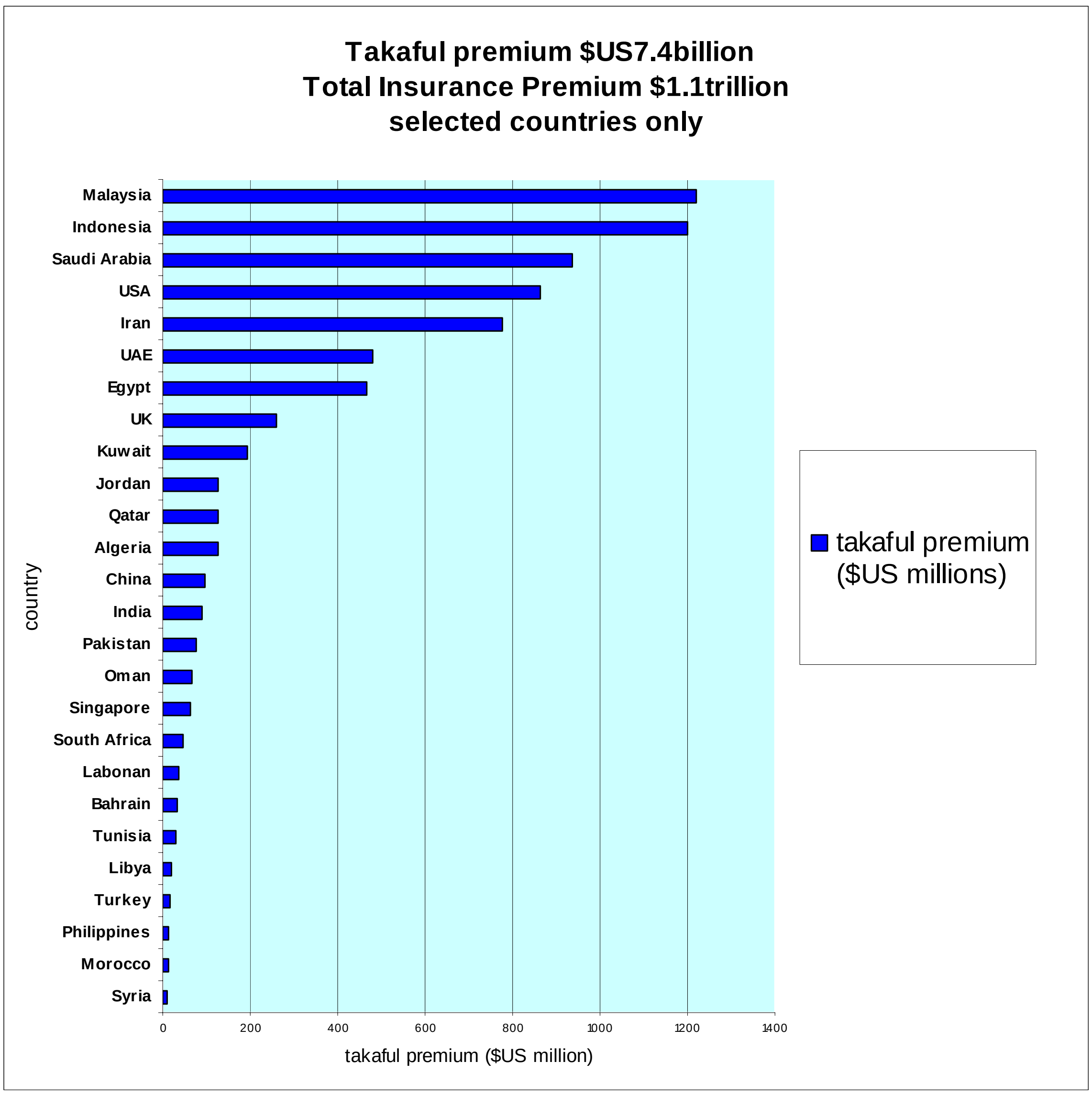
The above figures point out some key indicators that require attention of policy makers to raise the standard of education to increase literacy rate, make policies to uplift GDP of the country to raise GDP per capita and devise strategies for women participation in the economic activities to raise GDI value so that the benefits of un-tapped *Takāful* market could be realized to its fullest. Growth and potential of *Takāful* can play a significant role in the growth of insurance industry while enhancing its share in the world insurance market.

4.3.3 FUTURE ESTIMATE

In a global study of twenty-seven countries (Bhatty, 2001), Pakistan's share of *Takāful* for the year 2015 was projected to be US$75 million which is about 1% of the total *Takāful* premium as shown in the Figure 4.14. This proportion is quite small as compared to other countries (e.g., Malaysia, Indonesia, USA, and UK). This calls for a greater need of Islamic insurance in the country. Government of Pakistan should realize its responsibility to create awareness and stress importance of *Takāful* business among general public being Pakistan an Islamic democratic state so that growth of *Takāful* business in Pakistan could be comparable with other countries where growth rate is much higher than Pakistan.

Future *Takāful* potential for Pakistan was estimated to be about $US 75 million in 2015. It is quite low as compared to other countries like Malaysia, Saudi Arabia and UAE that have smaller population than Pakistan. Moreover, this estimate is based on existing insurance business that is already low as discussed in global and regional comparison. However, *Takāful* business has gained momentum in Pakistan after 2005 since the promulgation of *Takāful* Rules 2005 by SECP. Pak-Kuwait Investment Company (PKIC), a joint venture between Pakistan and Kuwait, started its efforts in 2002 to introduce *Takāful* in the country. Its major shareholders include *Takāful* National of Malaysia (25%), PKIC (30%), Meezan Bank (10%) and others (35%). In 2007, a second *Takāful* company, *Takāful* Pakistan Limited, started its operations in the country. In Aug 2007, Pak-Qatar *Takāful* Group obtained two separate licenses from SECP to start operations in family as well as in general *Takāful* business in the country. Applications of certain other local and international sponsors for launching *Takāful* companies are in the pipeline. In fact, Pakistan has become the focus of international investors and they are keen to explore this emerging potential market for *Takāful* (SECP, 2007).

FIGURE 4.14 TAKĀFUL POTENTIAL, YEAR 2015



Source: Bhatty (2001), www.islamic-banking.com

Seeing the vast population of Pakistan and recent *Takāful* growth in the country, potential for *Takāful* could be much higher than estimated for the year 2015 in the the Figure 4.14 above.

4.4 *TAKĀFUL* PRODUCTS AND THEIR KEY FEATURES

This section is based on the study of Syarikat *Takāful* Malaysia, the first and the largest *Takāful* Company in Malaysia. *Takāful* Malaysia is expected to be a major contributor to the Malaysian sector and insurance industry in general, in its efforts to accomplish the objective of the Financial Sector Master Plan under which the *Takāful* sector is set to control 20% market share of the insurance industry by 2010 (*Takāful* Malaysia annual report, 2005; p.72) .

Basically, *Takāful* business is divided into two broad categories[3]:

- Long term basis (Family *Takāful*)
- Short term basis (General *Takāful*)

4.4.1 LONG TERM BASIS

Long term basis of *Takāful* business is further divided into individual sector and group sector business. It is concerned with family *Takāful* business whose duration is extended beyond one year. It could be for 3 years, 5years, 10 years or 20 years depending upon the type of the family *Takāful* product. Individual sector business includes family *Takāful* plan , family *Takāful* plan for education and *Takāful* mortgage plan. Individual sector business aims at providing *Takāful* coverage to general public (individuals) and enables them to plan for unexpected future misfortunes. For example, family *Takāful* plan inculcates regular saving habits among individuals to better plan for old age and sudden accidents. Family *Takāful* plan for education enables parents to plan for future education of their children. *Takāful* mortgage plan enables the participants to take loan from a bank or a cooperative society to purchase house, property, car etc. and provides financing facility to the financial institution in case of untimely death or permanent total disability

[3]See Appendix B for detailed guidelines and procedures for selected *Takāful* products.

of the participant (borrower). Group sector business includes group family *Takāful* plan, group family *Takāful* plan for credit facility and group medical *Takāful*

Group sector business provides cover to a group of persons under a common single master *Takāful* certificate. Usually group sector business plans are purchased by employer of an organization for his employees. For example, employer purchases group family *Takāful* plan to cover a group of employees in case of their untimely death, provides them credit facility from a financial institution or provides medical facility to its employees and their limited dependents.

Key features:

i). ***Supplementary Benefits:***

These benefits include Permanent Total Disability (PTD) resulting from accident, Hospital Benefits (HB) in the event of sickness and Family Rider (FR). The objective of FR is to extend the *Takāful* benefits to immediate spouse and children of the participant. These supplementary benefits are often considered for individual Family *Takāful* plan. Under group family *Takāful* plan, Proposer may apply to include supplementary benefits such as Permanent Total Disablement (PTD), Funeral Expenses, Accidental Death and Permanent Partial Disability, and Hospitalization Benefit in consideration for additional payment of *Takāful* contributions.

ii). ***Declaration of Hibah:***

Participants of the family *Takāful* Plan are required to complete and sign the '*Declaration of Hibah'* form. By completing the form, the participant agrees to transfer as gift the proceeds of the plan to the child (ren) named in the form in accordance with the Islamic principle of *hibah* ('gift'). In the event of untimely death of the participant, the benefits payable under the Certificate are paid to the named child (ren) as beneficiary.

iii). ***Group Hospitalization and Surgical Benefits (GHS):***

Group medical *Takāful* plan provides cover for medical and hospitalization expenses incurred by a person covered arising from medical care or hospitalization due to injury or disease. The plan offers facility for reimbursement of medical and hospitalization expenses payable by an employer for the benefits of its employees.

iv). ***Underwriting Considerations:***

In underwriting consideration, physical characteristics of participants such as age, sex, height, weight and health are given due importance. Family history of prospective participant is also considered for any possibility of hereditary illness such as heart problem, diabetic or hypertension.

Evidence of health of the person covered usually is not required for group family *Takāful* plan. While, in case of group family *Takāful* for credit facility, it would not be required within the Free Cover Limit (FCL). However it must be assured that no possibility of selection against a potential person to be covered is made. Acceptance of cover for sums exceeding the FCL is subject to the company's underwriting guidelines.

4.4.2 SHORT TERM BASIS

Short term business is related to general *Takāful* business whose maturity period is up to maximum one year. There is a large variety of *Takāful* products for general *Takāful* business. They mainly range from motor *Takāful* scheme, fire *Takāful* scheme, marine cargo *Takāful* scheme to personal accident *Takāful* scheme, fidelity guarantee *Takāful* scheme, plate glass *Takāful* scheme and burglary *Takāful* scheme. In addition, machinery breakdown *Takāful* scheme, electronic equipment *Takāful* scheme and workmen's compensation *Takāful* scheme are also popular in Malaysia.

Key features:

i). ***Scope of Cover:***

General *Takāful* schemes cover sudden and unforeseen damages to motor or non-motor policies and losses due to machinery breakdown, fire, theft or dishonesty etc.

ii). ***Principal Exclusions:***

Principal exclusions include losses or damages arising from war or civil commotion are generally not covered by *Takāful* operator.

iii). *Treaty Exclusions:*

Sometimes, *Takāful* operator does not undertake certain types of businesses. For example, infidelity guarantee *Takāful* scheme, jewelers, supermarkets, banks and travel agents are not paid for dishonesty of their employees.

iv). *Declined Risks:*

These are avoidable risks which *Takāful* operator refuses to accept during contract period. It is clearly mentioned in the agreement what risks will be covered under particular General *Takāful* scheme and what risks should be ignored.

v). *Referred Risks:*

Under certain circumstances, *Takāful* operator is unable to accept certain types of risks that are beyond its capacity. So they are referred to some other *Takāful* or *Re-takāful* company with which *Takāful* operator has prior arrangement.

vi). *Underwriting Consideration:*

All the proposals for general *Takāful* schemes should be carefully scrutinized to avoid anti-selection. Underwriting decision should be made after taking into account all the possible risks.

4.5 MICRO-*TAKĀFUL*

This section provides an understanding of the concept of micro-*Takāful*, its schemes in practice, the challenges in the way and its scope in under-developed counties with large population.

4.5.1 CONCEPT

Micro-*Takāful* concept is based on providing *Takāful* cover to poor and low income people of the country who cannot save enough money to protect their family and children against unexpected losses of wealth and property as a result of natural disaster or an accident etc.

4.5.2 SCHEMES IN PRACTICE

Micro-*Takāful* schemes gained importance as a result of unexpected and catastrophic events that have worsened the already condition of poor. Currently following micro-*Takāful* schemes are in practice in different countries (Prosper, 2007; pp. 15-17):

Takāful Trinidad and Tobago (*Takāful* T & T) was the first company to offer micro-*Takāful* scheme for the general welfare of its people. In January 2007, Bontrager Task Force submitted a report to the Board of Management of *Takāful* T & T in which it presented its recommendations for the launch of micro-*Takāful* scheme in the country. Adoption of Islamic values and *Sharī'ah* compliance were the key feature of the presentations. After considering these recommendations, *Takāful* T & T decided to offer micro-*Takāful* and mutual aid products and services to poverty stricken families of Muslims and non-Muslims alike.

In April 2007, *Takāful* Ikhlas of Malaysia launched a micro-*Takāful* scheme in collaboration with Farmers Welfare Federation of Malaysia to support poor and destitute farmers of the country. It provides immediate death coverage up to RM. 500 in return for contribution of RM. 1.8 per anum to 100,000 poor families. Such *Takāful* schemes are increasingly becoming popular in Malaysia for poverty stricken families who want to protect themselves upon sudden death of their bread-winner.

Amana *Takāful*, Sri Lanka's first and largest *Takāful* company, plans to launch a revolutionary micro-*Takāful* scheme that will provide *Takāful* coverage to low income population of the country. The rate of contribution will be quite affordable to attract a large segment of poor population. In case of low claim ratio at the end of the year, surplus will be distributed back to the participants.

4.5.3 CHALLENGES

Takāful operators usually face the following challenges while providing micro-*Takāful* products to the poor of rural areas (Patel, 2004; Prosper, 2007).

i. Pricing of micro-*Takāful* products
ii. Efficiency gains (as a result of large scale distribution)
iii. Poor families are un-comfortable with the idea of sharing or pooling resources
iv. Misconceptions and superstitions
v. Relevance of micro-*Takāful* with the needs of the poor
vi. Inefficient documentation and claiming mechanism
vii. Limited risk and financial management capabilities
viii. Lack of resources for re-insurance or re-*Takāful* arrangements

4.5.4 SCOPE

Micro*Takāful* schemes could play a major role in reducing calamities of the poor people. The need is to overcome challenges that are big hurdles in the promotion of micro-*Takāful* schemes in the rural areas. The success of these schemes could not be assured without Government support. It is evident from the case study of Agricultural Mutual Fund of Lebanon. It provides health insurance coverage for about 800,000 people of the country who are economically weak and constitute about 80% of the total population. The fund covers 5,000 families and provides for 23,000 beneficiaries, it is open to all sects and all religions. The government covers 85 per cent of hospital fees. The fund has preferential agreements with healthcare providers which give discounts of up to 50 per cent. The Mutual fund is operating in 80 villages in southern Lebanon and is under the Health Mutual Law (Patel, 2004; pp. 17-19).

Successful experiences of micro-*Takāful* schemes in Trinidad and Tobago, Malaysia and Sri Lanka as well as success of agricultural Mutual Fund in the rural area of Lebanon indicate that these schemes could be successfully launched in any other country and could be used as a poverty alleviation strategy to protect the low income people from unexpected losses and catastrophes. Seeing the lower purchasing power as reflected in low GDP per capita and vast population of the rural areas of Pakistan, there is huge scope for micro-*Takāful* schemes. With the support from Government, these schemes could be successfully implemented and tailored to the needs of low income group of the country.

CHAPTER SUMMARY

Historically, structure of insurance industry in Pakistan has been highly skewed towards state owned insurance companies. Till 2005, State Life Insurance Corporation (SLIC) and National Insurance Company Limited (NICL) constituted 74% of the total insurance market. There are 5 life insurance companies and 50 general insurance companies in the country in life and general insurance sector respectively. Most of the companies are private, local and foreign insurers. The financial analysis of Pakistan insurance industry during 2001-2005 indicates that average premium growth rate for life insurance business has been 28% per anum as compared to 22% for general insurance. The average net profit growth rate for life insurance business has been about 14% per anum as compared to 52% for general insurance. The average asset growth rate for life insurance business has been 16% per anum as compared to 18% for general insurance. The average ROA for life insurance business has been 0.36% per anum as compared to 8.1% for general insurance. Hence overall performance of general insurance has been better than life insurance sector.

Global comparison highlights the position of Pakistan insurance industry in the world scenario. In a global survey of 46 Muslim countries, Pakistan was found to have 134th position in HDI ranking. It has large population most of which is illiterate and has no access to basic necessities of life, has low GDP per capita and low insurance penetration as compared to Indonesia, Malaysia, Turkey and some other Arab and non-Arab Muslim countries. In the insurance comparison of low and high HDI countries, Pakistan was estimated to have low share of insurance in the world market as compared to advanced countries like UK, USA and Japan. In the regional comparison, Pakistan was ranked at 58th position in the world insurance market by volume as compared to 9th position of China and 15th of India. Insurance density, Insurance penetration and GDP per capita for Pakistan were found to be lower than China, India and Srilanka and only slightly better than Bangladesh which has 84th insurance rank by volume in the world market. It was found that majority of the people of the country (73.6%) is living below poverty line i.e. earning less than $2 per day that reflects low purchasing power of people.

Takāful potential has been specifically perceived in three dimensions: 1) Geographical spread of *Takāful* business indicates that most of the current *Takāful* market is captured by Malaysia and some Arab countries. Asian countries constitute a small portion of total *Takāful* market. It indicates that potential exists in those Asian countries including Pakistan where majority of the population is Muslim. 2) Global indicators were found to be low adult literacy rate, low GDP per capita, low GDI value that result in low purchasing power of people and are considered major causes for low insurance penetration in the country. 3) Estimating future potential in a study of twenty-seven countries, Pakistan's share of *Takāful* for the year 2015 was projected to be US$75 million which is about 1% of the total *Takāful* premium. This proportion seems to be quite small as compared to other countries (e.g., Malaysia, Indonesia, USA, and UK) when one family *Takāful* and three general *Takāful* companies have already been set up in the country and licenses for some other companies are in pipe line. Recent growth of *Takāful* in the country indicates that potential exists for *Takāful* in Pakistan that has more than 150 million Muslim population. It urges the policy makers and concerned authorities to devise strategies to pay attention to global indicators that might become potential contributors to achieving growth in *Takāful* business.

Takāful products are broadly categorized as family and general *Takāful* business. Family *Takāful* products are further divided into individual sector and group sector business. Their duration extends beyond one year e.g. family *Takāful* plan for education for individuals and group family *Takāful* plan to cover a group of employees. General *Takāful* is a short term business whose maturity period is one year or less e.g. motor *Takāful* scheme, fire *Takāful* scheme etc. *Takāful* products provide supplementary benefits that include Permanent Total Disablement (PTD) and Family Rider. As a part of underwriting process, *Takāful* operator might not undertake certain types of businesses (treaty exclusion) or certain types of risks (declined risks) or transfer a part of risk to some other *Takāful* or *Re-takāful* company (referred risks).

Micro-*Takāful* concept is based on providing *Takāful* cover to poor and low income people of the country. Currently *Takāful* T & T, *Takāful* Ikhlas of Malaysia and Amana *Takāful* of Sri Lanka have micro-*Takāful* schemes in practice that are playing a major role in reducing calamities of the poor people. Agricultural Mutual Fund of

Lebanon provides health insurance coverage for about 800,000 people of the country who are economically weak and constitute about 80% of the total population. The need is to overcome challenges like pricing of micro-*Takāful* products, efficiency gains and misconceptions in poor families related to pooling of resources that are big hurdles in the promotion of micro-*Takāful* schemes in the rural areas.

CHAPTER 5

TAKĀFUL VS. INSURANCE: TRANSFORMATIONAL PARADIGM

INTRODUCTION

For a long time, the idea of insurance has been misunderstood and misinterpreted among religious scholars and Islamic jurists. Static religious beliefs and misconceptions about validity of insurance kept Islamic scholars far away from being innovative and to come up with an alternative to conventional insurance. There have been conflicting views of *Ulama* regarding validity of insurance. A group of Islamic scholars has rejected the entire idea of insurance and treated it illegal, *haram* and repugnant to *Sharī'ah*.

However, efforts initiated in twentieth century by Islamic researchers and *Fiqh* academies provided their opinions and *fatwā*s in favour of *Takāful* to make it a viable insurance alternative compatible with the teachings of *Sharī'ah*. Though Council of Islamic Ideology Pakistan (CIIP) also submitted its report in 1992 to Islamize insurance system in Pakistan yet these efforts entangled in the vested interests and political crisis of the country and *Takāful* industry is yet to flourish in Pakistan as compared to Malaysia and other Muslim countries.

This chapter discusses the differences between conventional insurance and *Takāful* and provides a theoretical framework to transform the prevalent conventional insurance system in the country. It also highlights the importance of regulatory frameworks to effectively monitor *Takāful* operators. Regulatory standards discussed in this chapter are of prime importance to the concerned authorities of Islamic countries particularly of Pakistan to form a robust regulatory framework for *Takāful* industry. The chapter is mainly divided into four sections. First section compares *Takāful* with conventional insurance and points out exploitive tools of conventional insurance. Second section is a very comprehensive section and encompasses four major areas for transformation paradigm. First it reviews the efforts undertaken by Government for islamisation of financial system in Pakistan. Secondly, it discusses the steps that can be taken to transform the existing conventional insurance system, transformation process and benefits that can be achieved through such transformation. Then, it discusses regulatory standards for the formation of robust regulatory framework that will support such transformation to sustain successfully. In the last section, challenges in the way of transformation have been discussed.

5.1 TAKĀFUL VS. INSURANCE

This section elaborates the main differences that exist between conventional insurance and *Takāful* and also explains the prohibitive elements of conventional insurance that exploit the society as they provide benefits to some members at the cost of others.

5.1.1 DIFFERENCES BETWEEN INSURANCE AND *TAKĀFUL*

The major points of difference (Obaidullah, 2005a; Billah, 2003a) between conventional insurance and *Takāful* may be enumerated in brief as under:

i. Nature of business:

Conventional Insurance business is based on profit-motive and aims to maximize returns to shareholders. *Takāful*, on the other hand, is based on the motive of community welfare and protection. The business of *Takāful* itself is non-profit where *Takāful* operator only charges a fee for the services rendered and aims at increasing benefits to the participants.

ii. Nature of contact:

In conventional insurance, customers are the policyholders who pay premium to the insurance company in return for the coverage of risk that may be inflicted upon them. It is a buy-sale contract where insurer guarantees to cover the risk for the paid premiums.

Takāful contact, on the other hand, is a risk sharing agreement among members (participants) to pay a fixed amount in a joint fund to help each other in case of loss or risk. Here, *Takāful* operator merely acts as a manager of funds.

iii. Disclosure and transparency:

In conventional insurance, there is uncertainty about the subject matter of the contract. The insurer guarantees to cover a certain loss but neither the insurer nor the insured exactly knows from where and how the loss is to be recovered in future if it occurs to many or all of policyholders. So there is a lack of disclosure and transparency in conventional insurance. In *Takāful* contract, on the other hand, participants agree to contribute in a joint fund (*Takāful* fund) and agree to help each other from that fund if a loss occurs to any or all of them. Here, Shareholders provide interest free loan if amount of claim payments exceed the amount of contribution. This makes the *Takāful* contract more transparent as all the relevant information is fully disclosed to participants. This is the system that is based on Islamic principles of mutual cooperation and brotherhood and compatible with *Sharī'ah* guidelines.

iv. Treatment of funds:

Conventional insurance company has separate account for each policy. Premiums received from policyholders for general insurance policy go to general insurance account. Whereas premium received for life insurance policy goes to life insurance account.

In general *Takāful* contract, entire contribution received from participants is treated as *tabarru* and goes to risk fund account. In family *Takāful* contract, a portion of contribution is treated as tabarru that goes to risk fund account whereas remaining major portion is kept in a separate account called participant's account (PA) that belongs to the participant.

v. Investment of funds:

In conventional insurance, funds from general and life insurance accounts are invested in interest based instruments involving fixed returns. Moreover, some funds may be invested in *Sharī'ah* prohibited schemes or projects like casino, liquor or some other illegal business. In *Takāful* business, all the funds from risk account and participants' accounts are invested in *Sharī'ah* compliant instruments on the basis of *Mudhārabah* where profit is shared according to agreed ratios. Moreover, in *Takāful* business, funds cannot be invested in *Sharī'ah* prohibited or illegal business.

vi. Claims and benefits:

In conventional insurance, policyholders have the right to claim the whole amount (or maturity value) stated in the policy in case of risk. But in case of no loss, policyholder is entitled to the policy value at the end of maturity period together with interest if any.
In family *Takāful* contract, participants have right to claim the amount of loss from risk fund besides the entire amount from PA together with the share of profit earned till that period. But if participant survives till the maturity period without any loss or claim, he will get the amount only accumulated in PA together with the share of profit earned.

vii. Surrender value:

In conventional insurance, if policyholder wants to withdraw his policy before the maturity period, he will get some compensation known as surrender value. Usually, surrender value is less than total amount paid as premium till that period. Insurance company deducts his management and operating expenses and also bonus, interest payments or any other benefits received by policyholder during that period. In *Takāful* contract, if participant wants to withdraw a *Takāful* plan, he will receive his entire amount accumulated in PA together with his share of profit from investment till that period. *Takāful* operator, however, may charge a small fee for drawing funds.

viii. Extra risk premiums:

In conventional insurance, extra risk premium is charged to the policyholder if he is prone to exceptional risk owing to his poor health or strenuous job. In *Takāful* contract, usually, contribution amount is fixed and no one is discriminated by extra foreseeable future risk. However, if underwriter thinks that a participant is expected to pose a higher risk to the company in future based on initial underwriting screening process, he may increase his share of *tabarru* in his contribution with his due consent. This will definitely decrease his share in PA than generally his share would be.

ix. Limit of damages covered:

In *Takāful* contract, participant is entitled to cover a limited number of damages and risks as specified in the contract. Underwriter clearly explains and discloses to the participant what damages will be cover under this contract. In conventional insurance, there is no limit on the number of damages cover under certain policy and Court of justice, in some cases, may be authorized to charge unlimited losses to the insurer based on the claim and insurance guarantee provided to the insured.

x. Nominee/beneficiary in insurance:

Nominee is a person who is designated to collect policy benefits in case of sudden accident or death of policyholder. In conventional life insurance, nominee is absolute beneficiary who is expected to receive benefits of policy and no other person (even the legal heir) has right to claim the all or part of benefits disbursed to the nominee. In *Takāful* contract, nominee is not the absolute beneficiary rather he acts as a trustee who main responsibility is to receive *Takāful* benefits from operator and distribute them to the legal heirs of the deceased according to the Islamic principles of inheritance (*al-mirath and al-wasiyah)*.

xi. Distribution of profit and surplus:

In general insurance, policyholders have no share in surplus and any surplus left goes to shareholders' fund. In life insurance, policyholders are entitled to the interest payments received from investments that add toward the policy value of the insurance contract. In life insurance, distribution of profits or surplus is a managerial decision taken by the management of the insurer. As a result there is a conflict of interest between shareholders and the policyholders.

In *Takāful* contract, participants have not only their share in the surplus but also in the profit from investments according to their proportion in the investment. However, *Takāful* company may retain a portion of profit or surplus in a contingency reserve for future risks. Further, it is the *Takāful* contract, not the management of the operator company that specifies in advance how and when profit will be distributed.

xii. Accounting and Auditing treatment:

In conventional insurance, accounting and auditing procedure is based on international accounting standards and principles. Auditing is done by independent external auditor on yearly basis. In *Takāful* business, accounting and auditing mechanism generally follows AAOIFI[1] guidelines where *Sharī'ah* Review and Internal *Sharī'ah* Audit are considered essential part of auditing process.

xiii. Payment of Zakāt:

In conventional insurance, there is no concept of payment of *Zakāt* from operating income of the company. On the other hand, in case of *Takāful* business, payment of *Zakāt* is considered an integral part of Islamic financial system. That's why *Takāful* company has an additional obligation of *Zakāt* as compared to conventional insurance system.

xiv. Sources of Regulations:

Conventional insurance laws and regulations are man-made that are based on business experience, human thoughts and legal literature as well as statutes and culture of the country. *Takāful* regulations, on the other hand, are based on Islamic principles (*Quran and Sunnah*) and decisions and *fatwā*s of *Sharī'ah* supervisory board. Regulatory authorities may seek guidance from the experience of conventional insurance and certain regulations might be adopted or modified for *Takāful* system that are justified and compatible with *Sharī'ah.*

[1] AAOIFI is Accounting and Auditing Organization for Islamic Financial Institutions established in 1991, based on Manama, Bahrain to cater the needs of Islamic Financial Institutions (IFIs) including *Takāful* companies.

5.1.2 EXPLOITIVE TOOLS OF CONVENTIONAL INSURANCE

According to Ghifari (2003; p.3), the Islamic jurists and the Muslim economists, e.g. Prof. Muhammad Abu Zahra, Dr. Isa Abdoho, Muhammad Ali al-Bulaqi (from Egypt), Mufti Muhammad Shafi, Mufti Wali Hasan, etc., from Pakistan, Mahdi Hasan, Muzhari, Muhammad Zafiruddin, Syed Uruj Ahmad Qadri etc., from India have criticized and reproved modern capitalistic insurance for many certain reasons, from *Sharī'ah* view point. Here is a summary of their worthy opinions:

- That this system is born and nourished by riba which is not only unlawful from religious point of view but also it is the greatest hurdle for the circulation wealth.
- That it is of an uncertain nature.
- That it is game of chances.
- That it involves some unjust conditions, which are unlawful in Islam.

According to Yusuf (1990; pp.40-41), generally, the accepted view of the jurists is that the present day insurance does not; in its present form conform to the rules and requirements of *Sharī'ah* due to the presence of the following three elements:

i. Al-gharar:

Al-gharar is Arabic term which means uncertainty about the contract. *Gharar* is prohibited in Islam due to its two illegal aspects (Obaidullah, 2005a; pp.29-33), first is uncertainty and second is deceit which leads to injustice, fraud and exploitation of other party by taking unfair advantage of ignorance of other party. Under insurance contract, uncertainty exists due to inadequate and inaccurate information about the contract, non-existence of subject matter of the contract i.e. how the amount of the compensation that the company will pay is to be derived in the event of a catastrophe or disaster and complex nature of the contract where no party is fully aware of its obligations towards the contract. Quran has forbidden such transactions that involve gharar and deceit to any party by hiding some facts or providing inaccurate information:

"Woe to those who deal in fraud, who when they take their measure from others take it fully, and when they measure or weigh for them give less than what is due."
Al-Quran (83:1-3)

Shuayb (R.A.) said to his nation "And O my people! Give just measure and weight, nor withhold from the people the things that are their due. Commit not evil in the land with intent to do mischief that which is left for you by Allah is best for you if you are believers." Al-Quran (11: 85-86)

The teachings of our Prophet (SAW)

The Prophet (SAW) passed by a man who was selling grain. He asked him "How are you selling it?" The man then informed him. The Prophet (SAW) then put his hand in the heap of grain and found it was wet inside. Then he said, "He who deceives other people is not one of us."

The Prophet (SAW) said, "When you enter into a transaction, there should be no attempt to deceive."

Hence uncertainty in transactions may lead to deceit, fraud or undue advantage to one party due to lack of disclosure and transparency about the terms of contract. It can be inferred that any business transaction in which either party has an intention to deceive is clearly forbidden by *Quran* and *Sunnah*.

ii. Al-Maisir:

Gambling (*qimar* and *maisir*), though not synonymous, but to some extent is related to *gharar* in which outcome of a transaction is not exactly known. The insured pays a small amount of premium in the hope that in case of loss or damage, he will obtain full benefit much higher than the premium paid. In case no loss or injury occurs to the insured, his premium is forfeited (Obaidullah, 2005a; p.34).

There is the element of *al-maisir* (or gambling) which arises as a consequence of the presence of *al-gharar*, in particular in the case of life insurance. When a life policy holder dies before the end of the period of his insurance policy after paying only part of the premium, for example, his dependents will receive certain sum money which the policy holder in the first place is not informed of how and from where it is to be derived.

Quran has warned against all such transactions which involves gambling and called it akin to Devil's job and great sin.

"Ye who believe! Intoxicants and gambling, sacrificing to stones and divination by arrows, are an abomination, - of Satan's handiwork: eschew such (abomination), that ye may prosper." Al-Quran (3:90)

"Satan's plan is (but) to excite enmity and hatred between you, with intoxicants and gambling, and hinder you from the remembrance of Allah, and from prayer: will ye not then abstain?" Al-Quran (3:91)

"They ask thee concerning wine and gambling. Say: `In them is great sin and some profit, for men; but the sin is greater than the profit.' They ask thee how much they are to spend; say: `what is beyond your needs. Thus doth Allah make clear to you His signs: in that ye may consider." Al-Quran (4:219)

iii. Al-riba:

There is the practice of *al-riba* (interest) and other related practices in the investment activities of the conventional insurance companies which contravene the rules of the Shariah**.** All kinds of riba (interest i.e. addition or increase in principal amount), is prohibited in Islam as depicted in the following verses of the Holy Quran (Obaidullah, 2005a; p.22)

Riba (interest) is any increase in principal amount that is due within specified period. In conventional insurance contract, usually funds are invested in interest based avenues where return is fixed and guaranteed no matter how much profit investor reaps from the investment (Obaidullah, 2005a; p.124). The *Quran* has clearly forbidden all business transactions that involve riba and cause injustice in any form to any of the parties. It is clearly mentioned in the following verses:

"O' Muslims, Do not devour riba, doubling and redoubling it and fear (the punishment of) Allah that you may be successful." Al-Quran (3:130)

"O' believers, fear Allah and forgo the interest that is owing, if you really believe. If you do not, beware of war on the part of Allah and His Apostle. But if you repent, you shall keep your principal. Oppress none and no one will oppress you." Al-Quran (2:278-279)

"What you provide with the prospect of an increase through the property of (other) people, will have no increase with Allah; yet what you give in alms and charity,

seeking the countenance of Allah, (will increase): it is these who will get a recompense multiplied." Al-Quran (30:39)

These verses clearly indicate that all the business transactions involving uncertainty, gambling and interest are unlawful under *Sharī'ah*. A Muslim should abstain from involving oneself in such transactions as such business has no increase with Allah. Most of the Islamic scholars and economists agree on the fact that these prohibited elements of *Sharī'ah* implicitly exploit the society and cause to keep the wealth of the nation concentrated in few hands. Moreover, these are the major causes of inflation in the country and increase the unemployment rate.

5.2 TRANSFORMATIONAL PARADIGM

This section takes a review of efforts taken for Islamisation of financial system in Pakistan. Then it discusses steps that are essential to transform the prevalent insurance system. It also discusses process of transformation and benefits that might be reaped by society by the way of transformation.

5.2.1 REVIEW OF EFFORTS FOR ISLAMISATION OF FINANCIAL SYSTEM

The efforts for the islamisation of financial system in Pakistan were started in 1969 (Mehmood, 2002) when Ministry of Finance filed a reference before Islamic ideological council to express its opinion on existing financial system of the country. The Council gave following opinion in December 1969 to the Government for the islamisation of economy in the country:

"The Council is unanimously of the view that Riba is forbidden in all its forms and any increase or decrease in rate of interest does not affect its prohibitive character".

It further elaborated its recommendation in the following manner.

"The Advisory Council of Islamic Ideology recommends that the Government of Pakistan may appoint a Committee of accredited leaders of juristic thought, experts and specialists in modern finance, banking and law in the country in order to assist and advise the advisory council of Islamic Ideology in determining the steps to be taken for the reformation of the existing system in the light of the teachings of Islam. The Council is hopeful that with concerted efforts such reformation is possible" CIIP Report (1991; p.136).

Efforts for Islamisation of banking and financial system of Pakistan were put in practice in 1977-78. At that time, Pakistan was among the three countries in the world that were trying to implement comprehensive interest free banking at national level[2]. In January 1981, separate Interest-free counters were set up at all the nationalized commercial banks of the country. Bank of Oman, a foreign bank, also offered the depositors to open their accounts on profit and loss sharing basis. In March 1981, State Bank of Pakistan introduced new Islamic financial instruments in the form of

[2] The other two countries were Iran and Sudan, for details see, IDB & IFSB Report (2007). *"Islamic financial Services Industry Development: Ten year Framework",* Islamic Development Bank and Islamic Financial Services Board, Islamic Research and Training Institute, Jeddah.

Participation Term Certificates (PTC) and *Mudhārabah* Certificates. From July 1985, all the commercial banks were strictly required to offer Islamic banking services to general public. Existing customers were given opportunity to maintain their accounts on profit and loss sharing basis. However, foreign currency accounts and outstanding foreign loans were exempted from this compulsion till their maturity (SBP Annual Report, 2002, p.189).

However, this non-interest based banking was declared un-Islamic by Islamic Ideological Council and Federal *Shari'at* Court in 1991. Consequently, most of the general public stayed away from the existing interest-based banking system and the efforts to Islamize the system could not produce desired results. Real impetus to Islamisation, however, came in December 1999 after the establishment of the Commission for Transformation of Financial System (CTFS) along with two task forces to plan and implement the process of transformation in compliance with the directives given by the Supreme Court of Pakistan. This was succeeded by the formulation of separate rules and regulations for Islamic banking parallel to commercial banking activities (SBP Report, 2005; p.93).

As a result of concerted efforts of CTFS, an Islamic Banking Division was established in the Banking Policy Department at SBP in 2001 which was expanded to a full-fledged Islamic Banking Department (IBD) in 2003 to implement the transformation process (SBP Report, 2004; pp. 65-66).

The efforts for the Islamisation of insurance can be traced since 1983 when Council of Islamic Ideology analyzed eleven laws of existing insurance system and declared in its report that current insurance system contains illegal elements like uncertainty, gambling and interest that contradict with the injunction of Islam (CIIP Report, 1992). In 1986, as a result of council recommendations, a working group was constituted to prepare a sketch of insurance system that is based on Islamic values of collective responsibility and cooperation. The group comprised of *Ulama* members of council, chairmen of existing insurance corporations, and controller of insurance of Government of Pakistan. These efforts were further enhanced by promulgation of *Shari'at* Ordinance 1988 and enforcement of *S̲h̲arī'ah* Act 1991(Mehmood, 2002; p.686).

Towards Islamisation of insurance in Pakistan, following decision was taken by Federal *Shari' at* Court regarding element of interest factor in insurance Act 1938:

"Provisions of Ss. 3-BB(1)(b), 27(3), 29(8)(b), c(iii), 47-B & 81(2)(d), Insurance Act, 1938 providing for a range of rates of interest, guarantee as to the principal amount and interest thereon, payment of interest on installments of capital, besides other conditions as to interest and time allowed for its payment as may be prescribed are repugnant to Injunctions of Islam and will cease to have effect as on and from Ist July, 1992" (FSC Report, 1992; p. 7).

Council of Islamic Ideology finally submitted its comprehensive report on insurance in 1992 and pointed out some elements of existing insurance system that were repugnant to *Sharī'ah*. To Islamize the insurance system of Pakistan, Council proposed establishment of some feasible institutions like Dar-ul-Kifalat, Idara Waqf-alal-aulad, Waqf-alal-Aqarib and institution of Mutual Insurance for Islamic insurance practices in the country.

In spite of all these efforts to transform the existing insurance system, the implementation of recommendations got entangled in the complex political system and corrupt elements of bureaucracy of the country. Though most of the researchers and scholars in the field of Islamic finance belong to Pakistan and it is one of those Muslim countries who started taking initiatives for more than two decades ago to transform the entire financial system, yet it is sad to say that this is an unfortunate country that could not proceed well in this emerging field due to the element of corruption, a big rooted evil endemic among politicians and bureaucrats (Abdel Karim & Archer, 2002; p. 39).

As a result of this poor performance and lack of commitment from Government, no substantial progress was made to transform the existing insurance system till the beginning of 21st century. The real impetus to the development drive for insurance came with the issuance of *Takāful* Rules 2005 by Ministry of Commerce. Now, there are four *Takāful* companies (one family *Takāful* company and three general *Takāful* companies) operating in the country. More *Takāful* players are expected to enter in this lucrative market in the coming years (SECP, 2007).

5.2.2 STEPS IN TRANSFORMATION

Following steps are essential for transformation of conventional insurance system into *Sharī'ah* based insurance (Anwar, 1994; Abdul Wahab, 2006).

i. Segregation of shareholders' and participants' fund:

Segregation of shareholders and participants' funds is the distinctive feature of *Takāful* business that differentiates its operations from conventional insurance. Amount received from participants is called contribution and treated as tabarru (donation) to pay for the loss or catastrophe that may occur to any of the participants. For General *Takāful*, there is only Participants *Takāful* Fund (PTF) from which risk related benefits are paid out. All the funds in General *Takāful* belong to PTF. Family *Takāful* is split into Participants Investment Account (PIA) and Participants *Takāful* Fund (PTF). Funds in PIA belong to participants and are invested in *Sharī'ah* approved financial instruments. Funds in PTF are treated as tabarru and are used to pay for claims. Any surplus left after paying claims belongs to participants. It can be distributed to participants or could be kept in PTF to pay for future claims. *Takāful* operator has no claim on surplus and only charges a fee to pay for administrative expenses and for managing the participants' funds prudently.

ii. Elimination of exploitive tools from the prevalent system:

As we have seen in our previous discussion that conventional insurance is prohibited under *Sharī'ah* due to its exploitive elements (uncertainty, gambling and interest) and also because of investment in haram business (*Sharī'ah* illegal activities like casinos and liquor business). So *Takāful* should be adopted as an alternative way as it provides an Islamic way of doing insurance business that is free from exploitive elements and investment is only undertaken in halal business.

Contract of *Takāful* agreement between insured (participant) and insurer (*Takāful* operator) should be clear and transparent so that each party could exactly know what risks should be covered under a certain contract. Otherwise, there will be a conflict of interests (due to *gharar*) between the two parties as each party would try to put the cause of perils on the other party. Provision of transparency would eliminate the factor of *Al-*

gharar from the contract. Spirit of mutual cooperation and shared responsibility often claimed, is not fully practised by *Takāful* companies in its true spirit. It must be well inculcated and enhanced among the participants so that if any of them incurs a loss, he should be compensated from *tabarru* fund. This spirit of mutual cooperation will eliminate the element of gambling from the contract. To eliminate the element of *riba* (interest), investment should be made in halal business under *Sharī'ah* guidelines. Moreover, indemnity should not be given in terms of fixed monetary units (i.e. cash) but to the extent of actual loss to the participant. In the case of fixed monetary units, participants may not be fully indemnified because of erosion of monetary value as a result of inflation.

iii. Undertaking of new agreement:

Beside the exploitive elements of conventional insurance, there exist conceptual differences that require customers of conventional insurance to undertake new agreement for *Takāful* contract. In the conventional insurance, the contract is between the customers and the insurer whereby insurer takes the responsibility to accept the risk of policyholders. On the other hand, in case of *Takāful*, the contract is among the participants on the basis of pooling the resources and sharing the risk as it occurs to any of participant. *Takāful* operator merely acts as a manager of funds and charges a fee for its services. So undertaking of new agreement is essential keeping in mind the distinct nature of *Takāful* contract.

iv. Transforming insurance policies:

There are two main policies offered by conventional insurance companies:

1. General insurance policies
2. Life insurance policies

Duration of contract in general insurance policies is one year or less. Life insurance policies are longer than one year. They might be up to 5 years, 10 years or 20 years duration depending upon the type and nature of contract. These policies are difficult to change because of their longer duration as well as their interest-based investments as they have elements of fixed returns.

General insurance policies can easily be converted into general *Takāful* in one year after expiration of contract. However, in case of life insurance policies, new policies can be started under family *Takāful* contract, while existing polices could be continued under conventional insurance till their maturity.

v. Training of staff:

Building human capital for the *Takāful* business in *Sharī'ah* and actuarial science is the key to the growth of *Takāful* industry (IDB & IFSB, 2007; p.30). In transformation process, training of existing staff is essential to acquaint them with *Sharī'ah* compliance mechanism as well as accounting and auditing treatment of *Takāful* funds transactions.

vi. Encourage to set up separate Takāful companies:

There is need to set regulations to encourage the establishment of separate *Takāful* companies instead of allowing window operations which may simply try to crush a *Takāful* operator before it can establish itself for pure commercial interests as any business entity would do to protect it.

It needs to be ensured that regulatory limitations which may be set-out are not penalizing for the *Takāful* operator on account of two sets of rules being applied to it in terms of compliance etc – one from the regulators and the other from *Sharī'ah* perspective. Regulation needs to ensure that there is at least a level playing field for *Takāful* operators so that they are able to operate and establish themselves and the compliance and other costs do not unduly disadvantage them but perhaps some incentives are offered to encourage companies to setup separate *Takāful* operations.

v. Regulatory Changes:

It is worth mentioning that *Takāful* regulations are framed keeping in view the protection for the consumer in terms of controls in operational practices and penalizing operators not adhering to strict guidelines. On the other hand, *Takāful* operator should be provided adequate freedom to be able to compete with conventional operators on at least equal footing. Additionally, *Takāful* Regulations need to ensure that proper and adequate measures are implemented and there is a strict monitoring system in place to control malpractices with strict penalties for any violation.

vi. Re-takāful arrangements:

A complete transformation or incentives to *Takāful* would mean more and more security can be available on a *Takāful* basis. *Takāful* operators need to collaborate with each other to build a re-*Takāful* pool on a shared basis. In the absence of a re-*Takāful* company, a larger *Re-takāful* pool can be better negotiable with international reinsurers and with expansion increase its capacity to retain risks within the pool. This would reduce reliance on foreign reinsurance which is difficult to obtain for a single *Takāful* operator. The ultimate objective should be to have large enough pools to eliminate/minimize the need for foreign reinsurers. In Malaysia, Asean *Re-takāful* International (L) has been setup to forge cooperation among *Takāful* operators of South East Asian region i.e. Malaysia, Indonesia, Brunei, and Singapore. However it needs to be ensured that funds are managed on a professional basis and able to attract *Takāful* operators within Pakistan and possibly from other regional *Takāful* operators as well.

5.2.3 TRANSFORMATION PROCESS

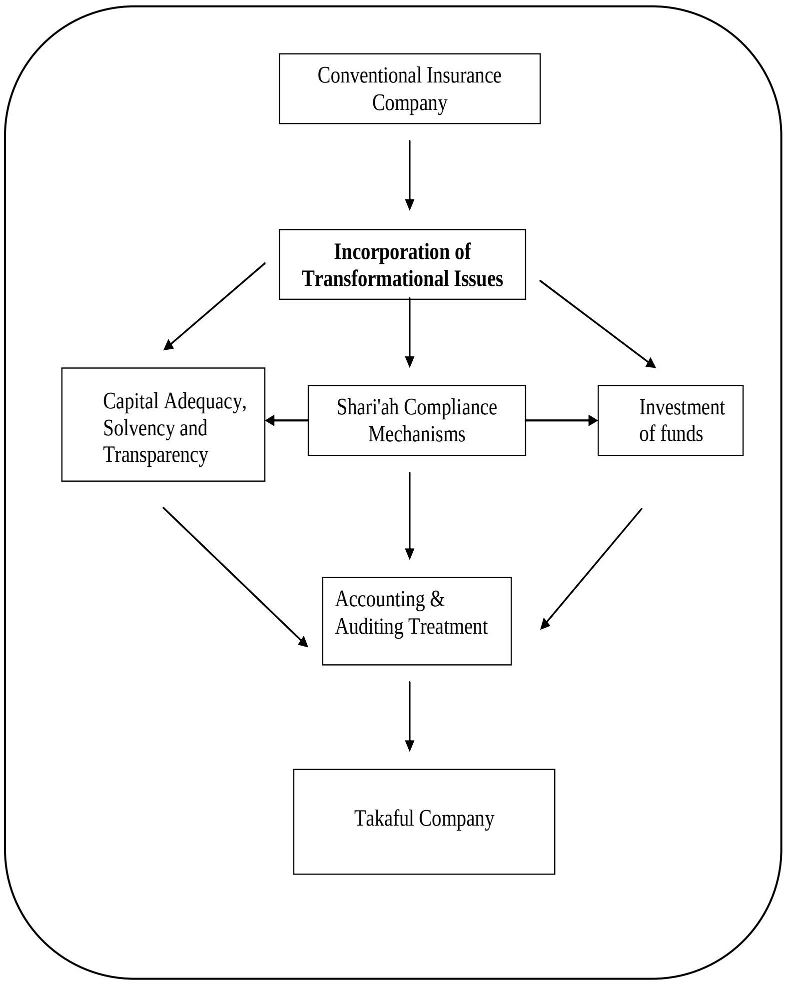
Akhter (2007) maintains that *Sharī'ah* compliance mechanism should encompass some key issues for the transformation of existing insurance system to *Takāful* based system as shown in the Figure 5.1 below. He identifies key transformational issues that would facilitate the transformation as follow:

- Capital adequacy, solvency and transparency
- Investment of funds
- Accounting and auditing treatment

Unique nature of *Takāful* business and the risks associated with it demand higher level of capital adequacy standards for *Takāful* as compared to conventional insurance. *Takāful* contract needs to be transparent without any element of uncertainty and speculation. *Takāful* fund can be invested in *Sharī'ah* based instruments such as *modaraba, musharaka* or ordinary shares of companies involved in *halal* business

(Obaidullah, 2005b; p.12). Accounting and auditing of accounts should follow AAOIFI guidelines. Obaidullah gives the idea of Islamic Value Accounting (IVA) to identify shared core values that give a measure of how well the institution has lived up to Islamic values (p.38).

FIGURE 5.1: TRANSFORMATION PROCESS



Source:________________

5.2.4 BENEFITS

The transformation of conventional insurance system is expected to bring the following benefits.

a. *Freedom of society from exploitive elements:*

Transformation from conventional to *Takāful* will free the society from interest based system and inherent evils associated with it. It will help the needy people to keep up their activities and will reduce income gap between the rich and the poor. Such transformation will free the society from uncertainty and gambling as the contracts will be more transparent. Each party (participant and *Takāful* Company) will know exactly what the contract all about is and what the obligations of each party are.

b. *Sense of Islamic brotherhood among participants*:

In *Takāful* contract, there is an agreement between participant and *Takāful* operator and among participants themselves. Each participant agrees to help others in case any loss or catastrophe occurs to them. It creates a sense of Islamic brotherhood among participants as they know that they are pooling the fund to help each other. This results in greater respect for humanity.

c. *Poverty alleviation:*

As opposed to conventional insurance, formation of *Takāful* system will be an important step in reducing income gap in society by helping poor. Hence it will contribute towards poverty alleviation and will assist the economy to grow faster as a result of increased purchasing power and increase in aggregate demand.

d. *Spiritual relief:*

A complete transformation could rid the insurance industry of a lot of evils which are unlikely to go away with a parallel system. In case of conventional insurance, the risk of underwriting losses would be passed on to the policyholders. A *Sharī'ah* compliant *Takāful* system will provide spiritual relief to participants by eliminating the evils of conventional insurance. Though risk management techniques would try to ensure that deficits do not arise in a *Takāful* fund by the way of *Re-takāful* or reinsurance (as may be permissible) still, shareholders might provide *qard-e-hasana* in case of loss.

Sound policies and regulations play a key role in devising the shape of the economy of a country. Effective implementation and monitoring of those regulations has ensured success of growing economies of the world. On the other hand, ineffective implementation and failure to follow up has caused most the underdeveloped economies lagging behind their targets (Akhter, 2007). Specifically, regulatory standards monitor and facilitate the functions of businesses and industry and protect the rights of investors and general public. Keeping in view the emergence of *Takāful* business in Pakistan, this section discusses regulatory standards that are essential to strengthen regulatory framework for *Takāful*.

The purpose of high level controls is to establish high level regulatory standards for *Takāful* operator and ensure corporate governance practices within the organization (CBB, 2006). Following elements were found to be essentially associated with high level controls.

i. Authorized entities for Takāful business:

Pubic limited companies as well as any corporate body incorporated under the laws of Pakistan are eligible to conduct *Takāful* business in Pakistan (Insurance Ordinance 2000, Section 5). It is also mentioned in the ordinance that no private company or subsidiary of a private company is allowed to start *Takāful* operations in the country.

ii. Capital requirements:

Takāful operators are allowed to conduct *Takāful* business subject to the following minimum capital requirements (Insurance Ordinance 2000, Section 28(2)).

Family *Takāful* Business Rs. 150 million

General *Takāful* Business Rs. 80 million

Foreign companies are required to have 51% shares in *Takāful* business with a foreign exchange of US $ 2 Million and the same equivalent amount is to be raised from the local market.

iii. Statutory deposits requirements:

Takāful operator is required to deposit Rs. 10 million or 10% of paid up capital, whichever is higher, as statutory deposit with state bank of Pakistan (Insurance Ordinance 2000, Section 29(2)). This requirement is specific to family *Takāful* business only. Regulatory authority (SECP) may reduce this amount to zero to achieve solvency level in *Takāful* industry as required by the commission.

iv. Board Committees:

To achieve high level controls, *Takāful* companies are required to establish board committees which can enhance the functioning and effectiveness of Board members and can help them in the assessment of risks in *Takāful* business. In addition to that board committees also prove helpful in resolving any possible conflicts of interests that may arise among board members (CBB, 2006).

v. Executive management Committee:

Executive management committee consists of Chief Executive Officer, General Manager and heads of finance, operations and other business departments (CBB, 2006). It provides support and assistance to CEO and ensures proper corporate governance practices with in the organization. Its responsibilities include monitoring of day to day operations and performance of departments and coordinate their activities to achieve set targets.

vi. Sharī'ah Supervisory Board (SBB):

Selection and recruitment of members of SSB should be according to AAOIFI governance standards for Islamic Financial Institutions (*Takāful* Rules, 2005). The function of SSB is to review the operations of *TakŬful* company and ensure their compliance with *Sharῑ'ah*. Generally, members of SSB give their advice and guidance to the Board members and senior management on product design, handling of claims, investments avenues, income sources, distribution of surpluses and profit and allocation of *TakŬful* operators' costs.

vii. Mapping of risks and responsibilities:

Chief Executive Officer must maintain clear mapping of risks faced by *TakŬful* company in collaboration with the board and should devise effective strategies to cope with these risks. To achieve this, CEO should delegate appropriate authority and responsibility to senior management. It should be done proportionally so that each manager should clearly know what his duties are and what he is supposed to do. There should also be a mechanism for effective monitoring of management performance .

viii. Remuneration policies:

Regulatory authority should require *TakŬful* operators to devise appropriate remuneration policies for its employees, managers and directors. Remuneration policy should be long term basis as short term policy might encourage reckless behavior on the part of directors and managers to achieve short-term benefits. Level of remuneration should be set in such a way to attract, retained motivate employees, managers and directors in the organization by creating job loyalty (CBB, 2006).

ix. Internal Audit:

Each *TakŬful* operator should establish an internal auditor to efficiently evaluate and monitor the performance of *TakŬful* company. Internal auditors should have unrestricted access to company's accounts and they should have open access to approach senior management even CEO for any clarification related to business transactions. Internal auditors should have appropriate knowledge, skills and abilities to perform their duties efficiently and independently free from any outside pressure. They should not be involved in other affairs of the company so as to affect their performance and independence (Akhter, 2007; p. 84).

First, the regime needs to take account of the conceptual separation between participants' and shareholders' funds. The location of charges/fees and of the corresponding costs and risks varies between operators, and sometimes within each operator by product type or fund. In particular, the extent to which shareholders are committed to supporting any deficit in participants' funds through an interest free loan may vary, and this will affect the extent and manner in which shareholders' funds are treated in the solvency regime. The asset profile of a *Takāful* operator, whether general or family *Takāful* is likely to be very different from its conventional counterparts, and the capital regime needs to take this into account, particularly where the risks are not fully transferred to policyholders (as they are in some investment products).

In a Family *Takāful* plan there are generally no guarantees (i.e. they operate on a 'defined contribution' rather than a 'defined benefit' basis). This implies that the risk profile is different from the standard insurance product, where guarantees are normally given in terms of maturity benefits, surrender benefits and death benefits. This has implications both for capital adequacy and for disclosure to participants.

5.3.2.2 BUSINESS CONDUCT STANDARDS

Following rules have been devised for proper code of conduct of *Takāful* practices in the country (Insurance Ordinance, 2000; CBB, 2006).

i. Utmost good faith:

Takāful contract requires each party to respect the interests and rights of other party and should act with the intention of utmost good faith towards the other party.

ii. Avoiding deceptive code of conduct:

Takāful operator should not try to deceive or mislead the participants during the course of business by providing wrong or misleading information related to *Takāful* product, service, price or claim etc.

iii. Cancellation of contract for fraudulent claims:

If any participant was found to have fraudulent claim during the process of investigation about estimation of loss, *Tak ful* operator has the right to cancel the *Tak ful* plan. Yet it will pay the participant only the amount he has actually paid to the company.

iv. Identification of customer requirements:

Tak ful operator must identify and seek specific customer requirements related to the type of *Tak ful* product, amount of contribution, maturity period and quality of services they require to deliver *Tak ful* product at a place convenient to them.

v. Handling of complaints:

Tak ful operator should respond to its customers if they complain (either oral or written) at any time in the course of contract. Prompt action should be taken to resolve the problems of customers. *Tak ful* operator should keep proper record of all the complaints reported by customers and action taken to settle the problem.

vi. Claim handling:

In case a claim is submitted by the participants, *Tak ful* operator should take prompt action to settle the claim and inform the participant with an explanation about how the claim will be handled. It should provide the customer necessary guidance about the claims process and keep him informed about the progress towards claims handling till the claim is completely settled. *Tak ful* operator should inform the customer in writing if it cannot handle all or any part of claim.

vii. Fair treatment and conflicts of interest:

Tak ful operator should treat all of its customers equally and fairly and should always put the rights of their customers above their duties. They should avoid conflicts of interest with the customers. In case any conflict arise, it should be managed promptly and fairly to avoid prejudice to any party.

iii. Operational risk:

Operational risk related to efficiency of operations of *TakṺful* operator. Operations of company are handled by people, processes, systems and outsourced activities. Failure or inefficiency of any of these elements affect the operations of the company and hence poses operational risk for it. Effective strategies to cope with operational risk are business continuity planning, contingency plans and crisis management.

5.3.2.4 FRAUD DETECTION AND MANAGEMENT STANDARDS

"The supervisory authority requires that insurers and intermediaries to take necessary measures to prevent, detect and remedy insurance fraud" (IAIS, 2006a).

TakṺful industry is exposed to similar types of fraud as compared to conventional insurance industry. Following types of frauds are possible in *TakṺful* business to encounter (IAIS, 2006b):

i. Internal fraud:

Internal fraud is the fraud against the *TakṺful* company by its internal member. It can be a director of the board, a manager or member of staff on his/her own or in collusion with others who are either internally or externally related to the company.

ii. Participants' fraud and claims fraud:

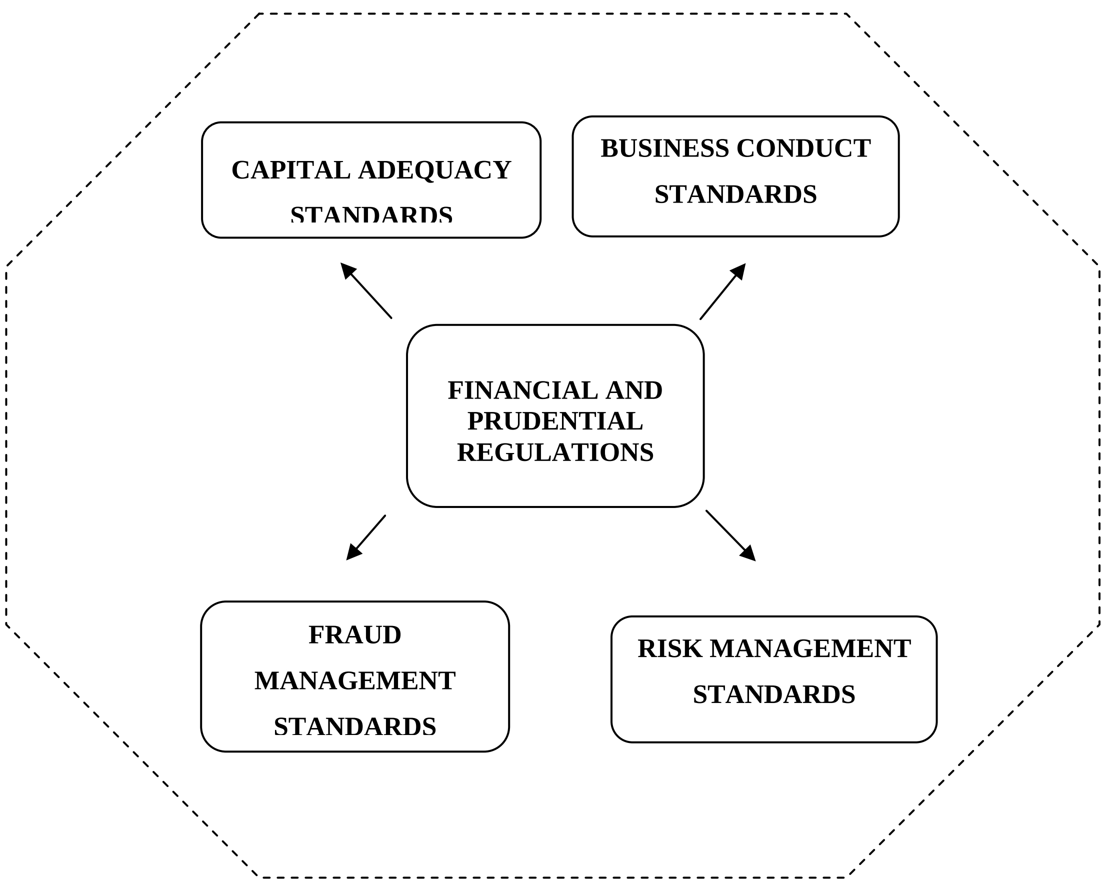
This type of fraud is usually perpetrated by the customer of the company e.g. fraud against *TakṺful* company in the purchase and/or execution of a *TakṺful* product (either family or general) by one person or people in collusion by obtaining wrongful coverage or payment.

iii. Intermediary fraud:

This type of fraud is perpetrated by intermediaries (*TakṺful* brokers, agents) against participants or *TakṺful* Company.

There is dire need to take effective measures to detect and prevent these three types of fraud that may affect the competitiveness of the *TakṺful* industry. Internal audit and internal controls are found to be the most effective measures to detect the prevalent frauds in the organizations (IAIS, 2007). Specific measures taken to detect and prevent fraud are anti-fraud policy and fraud awareness among *Takāful* operators, intermediaries and customers. Moreover, some precautionary measures should be taken by *Takāful* operator in advance to detect and prevent fraud e.g. elimination of potential conflicts of interests among employees, managers and directors is effective tool to prevent internal fraud. To prevent claims fraud, prudential underwriting skills and claims assessment are essential. To prevent intermediary fraud, *Takāful* operators should have direct communication with the intermediaries.

FIGURE 5.2: A FLOW CHART SHOWING DIFFERENT COMPONENTS OF FINANCIAL AND PRUDENTIAL REGULATIONS



5.3.3 REPORTING STANDARDS

Reporting standards provide guidelines for Reporting to regulatory authority. They also emphasize the need for public disclosure of financial transactions.

5.3.3.1 REPORTING TO REGULATORY AUTHORITY

"The supervisory authority sets the requirements for the submission of regular and systematic financial and statistical information, actuarial reports and other information from all insurers licensed in the jurisdiction" (IAIS, 2006a; essential criteria

Failure to resolve the matter through discussion will lead to a formal warning. Failure to adequately respond to formal warning by *Takāful* operator will result in more server enforcement measures by regulatory authority.

iv. Future Directives:

Regulatory authority may issue directions to a *Takāful* operator if it considers these will serve to achieve regulatory objectives. Usually, regulatory authority issues directives in the following conditions:

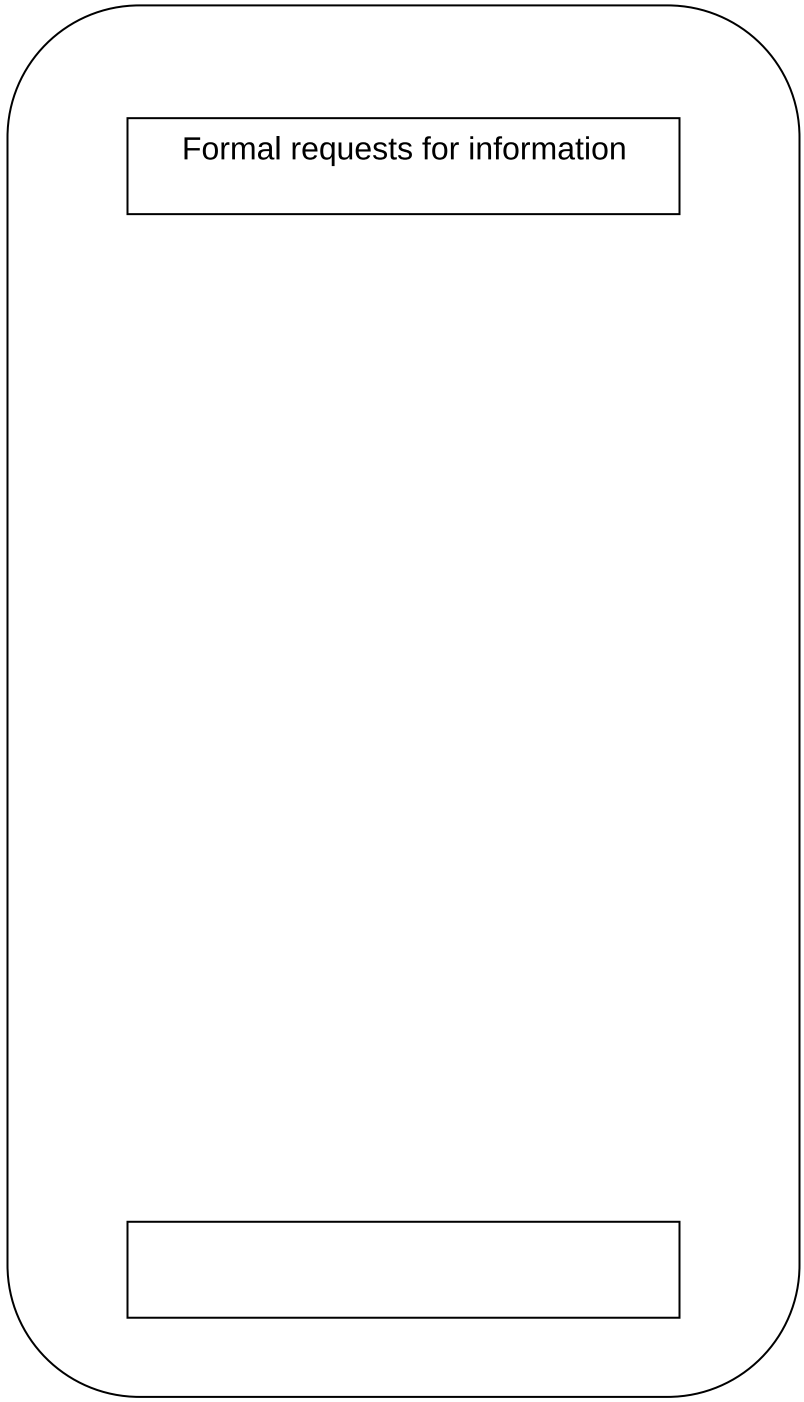
a) If the breach of supervisory requirement is significant and serious enough to pose potential risk to customers.
b) If the duration or frequency of contravention shows widespread incompetence of management and is the result of its reckless behavior.
c) If regulatory objectives are served better through the issue of direction rather than any other enforcement action.

v. Financial penalties:

Regulatory authority may impose limited financial penalties on *Takāful* operator if it has breached a major requirement or failed to adequately respond to the warnings or directions of regulatory authority. Though the amount of financial penalty is determined by the nature of violation of *Takāful* operator and extent of supervisory resources used for that purpose, yet the financial penalty becomes evident in the following circumstances:

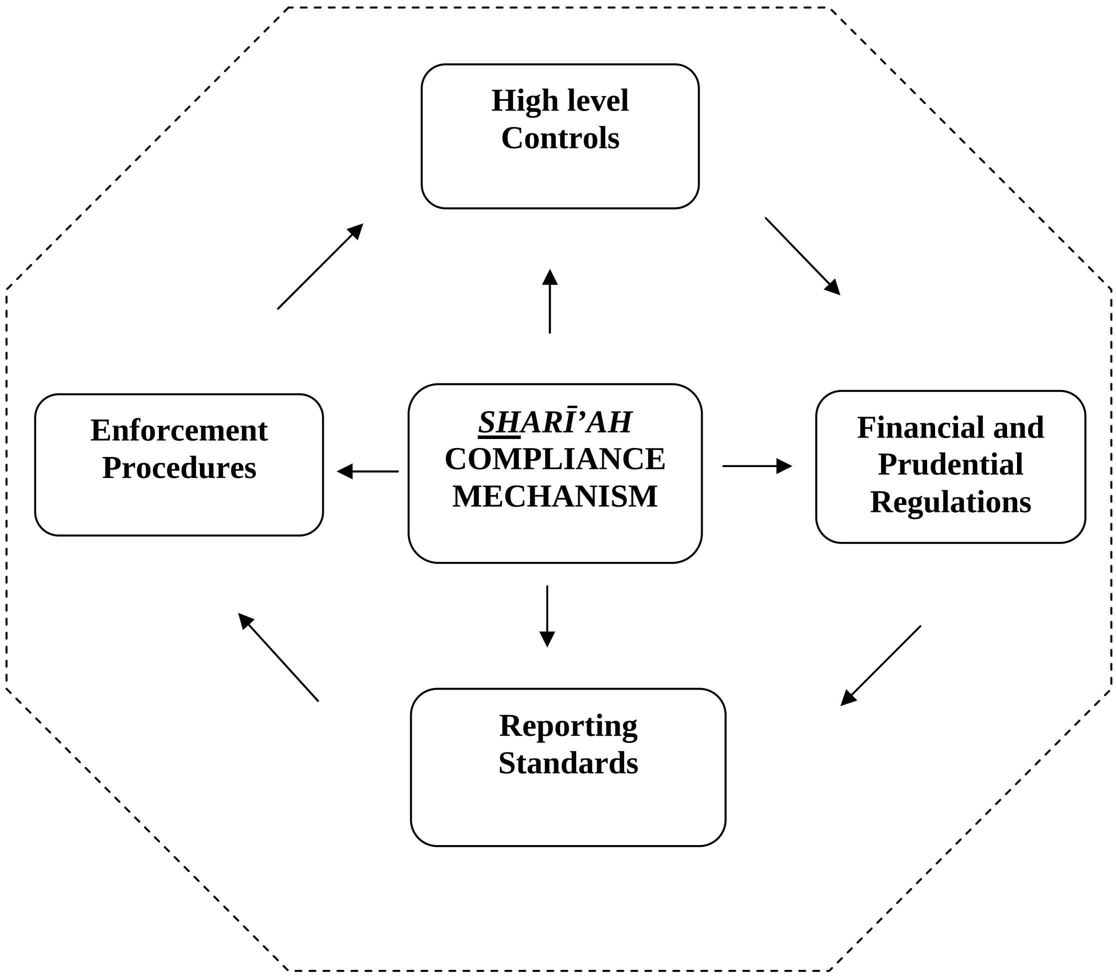
a). If *Takāful* operator fails to address significant inaccuracies in its reporting
b). If it repeatedly disobeys the formal requests of regulatory authority within prescribed deadlines.
c). If it reports false or misleading information to regulatory authority
d). If it fails to maintain adequate system and proper controls which may result in significant financial loss to customers.

FIGURE 5.3: STEPS IN ENFORCEMENT PROCEDURES



Source: *Central Bank of Bahrain (CBB, 2006), www.cbb.gov.bh*

FIGURE 5.5: A SCHEMATIC DIAGRAM OF REGULATORY STANDARDS FOR *TAKĀFUL*



The Figure 5.5 shows a schematic diagram of regulatory standards for *Takāful* indicating that *Sharī'ah* compliance mechanism plays a central part and is considered at the core of all regulatory activities. The process starts with setting high level controls and ends at enforcement procedures. Arrows in circle shows that standards are inter-related and each standard affects the functioning of other. Regulatory standards could be improved by detecting loopholes in enforcement procedures and re-setting high level controls.

5.4 CHALLENGES TO TRANSFORAMTION

In spite of steps discussed to facilitate the task of transformation, there are challenges that might create hindrance in the way of transformation.

i. S[illegible] [illegible]y

Strengthening regulatory framework is a key to the development of a robust *Tak ful* industry in Pakistan. SECP should take steps to protect the interests of *Tak ful* operators. Till now, Malaysian is the only country that has separate legislation for *Tak ful* business. Such legislation is essential to effectively regulate *Tak ful* operators to operate competitively and to ensure transparency in *Tak ful* operations.

i. A[illegible]

Low literacy, misconceptions about insurance and lack of awareness are the major causes of low insurance penetration in Muslim countries in general and Pakistan in particular. It is need of the hour to change the mindset of general public and create awareness about importance of insurance given its key role in economic and business activities and daily lives of individuals.

i. Pr[illegible]

Fair pricing and innovation in *Tak ful* products is of vital importance to both participants and *Tak ful* operators and has a crucial role in enhancing *Tak ful* business. Given the agency fees and other administrative expenses, and risks associated with new playing field of *Tak ful* industry, *Tak ful* operator has to charge a little bit high premium as compared to conventional insurer to maintain flow of its operations. Although pricing of *Tak ful* products is done in consultation with actuaries and *Shar ah* scholars, the issue here is to provide financial protection at a reasonably fair price to all who wish to protect themselves from unforeseen events. Customers will be ready to accept those products that are fairly priced and at the same time address their unique needs and expectations.

operators and intermediaries to take necessary measures to prevent, detect and remedy internal fraud, participants' fraud and intermediary fraud. Reporting standards entail *Takāful* operator to submit and disclose information related to financial performance indicating profit and losses overtime, breakdown of assets, liabilities and shareholder's funds, quantitative and qualitative information on risk exposures, valuation of tangible and intangible assets, methods of calculation of *zakāt* and income taxes and basic business management and corporate governance information. To ensure enforcement and compliance of all regulations, supervisory authority might demand some additional information as a part of its on-going supervision process. Formal written warnings are considered regulatory authority's first level of formal enforcement. After issuing future directions, regulatory authority may impose limited financial penalties on *Takāful* operator if it has breached a major requirement. *Sharī'ah* compliance mechanism is the centre of all the business activities of a *Takāful* Company. It starts with selecting members of SSB of high caliber, allocating them corporate responsibilities, ensuring company reliance on their reporting and evaluating *Sharī'ah* performance of the company through *Sharī'ah* audit.

In spite of comprehensive framework available for transformation of conventional insurance, there exist challenges like separate legislation for *Takāful* business, low literacy and lack of education, high pricing, lack of innovative *Takāful* products as well as absence of *Sharī'ah* compliant corporate governance that might pose a major threat to the process of transformation. There is also dire need to devise strategies to overcome challenges and create awareness of *Takāful* so that its benefits could reach at gross root level of the economy.

CHAPTER 6

TAKĀFUL STANDARDS AND CUSTOMER PERCEPTIONS AFFECTING *TAKĀFUL* PRACTICES IN PAKISTAN: A SURVEY

INTRODUCTION

International Association of Insurance Supervisors (IAIS) has issued insurance core principles (ICPs) that provide prudential standards and a basis for effective regulation and supervision of insurance and reinsurance companies across the globe. Most of those ICPs are also applicable to *Takāful* business, yet *Sharī'ah* compliance feature of *Takāful* business restricts the applicability of certain principles that are only applicable to conventional insurance. In a self assessment exercise of different countries across the globe, many core principles were not fully observed by the concerned regulatory bodies (IAIS, 2006a). Lack of effective implementation practices of insurance principles has raised different regulatory issues. To judge the effective implementation and applicability of these principles to *Takāful*, Islamic Financial Services Board (IFSB)[1] and Insurance Commission of Jordan co-organized an inaugural seminar on the regulations of *Takāful* (Islamic Insurance) in Jordan on January 2005.

Takāful industry is faced with numerous operational and transformational issues that can affect its functioning in one way or the other. For example, Chapra and Khan (2000) have found that failure to have adequate internal control systems and lack of effective risk management practices are the major causes of financial crisis in the organizations. Given the newness of *Takāful* industry in Pakistan and intense

[1] IFSB is an international standard-setting organization that issues global prudential standards and guiding principles for the Islamic financial services industry. It enhances the soundness and stability of these established standards for Islamic banks and *Takāful* companies. As a part of its concerted effort with Insurance commission of Jordon, IFSB took an initial step, to establish a joint working group with the IAIS to produce an issue paper to judge the applicability of the existing IAIS core principles to the regulatory and supervisory standards for *Takāful*.

competition from conventional insurance, Pakistan *Takāful* industry is expected to face serious challenges in the observance of operational and transformational standards that might affect its functioning in future. This study attempts to see the effectiveness of operational and transformational standards raised by joint working group of IFSB and IAIS that also complement the research of previous chapter. The study also encompasses public perceptions about *Takāful* and the factors that affect their level of awareness about *Takāful*.

Maysami and Williams (2006) conducted a survey of 84 respondents in Singapore to judge the perceptions of Muslim community about *Takāful*. They concluded that there is a distinct association between *Takāful* awareness and religious perceptions of the respondents about nature of *Takāful* business. Extending this concept, present study is more comprehensive in the sense that it not only seeks to find out the factors that are affecting *Takāful* awareness in Pakistan but also sees the impact of *Takāful* awareness on customer loyalty.

The present survey aims to point out operational and transformational standards that are of prime importance to regulatory authority to regulate *Takāful* industry so as to provide a level playing field for new *Takāful* players who are interested to enter into *Takāful* business. This study might assist SECP (regulatory authority of Pakistan) in devising sound policies for *Takāful* industry and setting standards that will not only enhance the functioning of *Takāful* operators but also safeguard the interests of all stakeholders. Finally, it might contribute towards restoring the confidence of local and foreign investors. This study will provide great help to *Takāful* operators in understanding public perceptions about *Takāful* and devising strategies to promote *Takāful* business to the vast population of the country.

6.2 ANALYSIS AND INTERPRETATIONS

This section analyses the data obtained from the survey of Tak–ful operators and insurance customers. Interpretations are made to describe the trend of responses according to scale used for their measurement. Key findings given after interpretation of data help to further substantiate the research questions raised in the first chapter and tend to draw necessary recommendations for the final chapter.

6.2.1 SURVEY RESULTS OF TAK–FUL OPERATORS

Survey results of Tak–ful operators include descriptive statistics of Tak–ful standards as well as their comparison among Tak–ful operators.

6.2.1.1 DESCRIPTIVE STATISTICS

The following tables show survey results of three Tak–ful companies included in the study. These are Pak-Kuwait Tak–ful Company Limited, Tak–ful Pakistan Limited and Pak-Qatar Tak–ful Limited. Survey encompasses a total of seven standards including five operational and two transformational standards. These standards were assessed using pre-determined essential criteria set to measure each standard. Results are summarized below:

TABLE 6.1: MEASUREMENTS OF TAK–FUL STANDARDS

Operational Standards	N	Mean	Std. Deviation	C.V.
1.Risk assessment and management standards	3	3.38	.33	9.8%
2.Corporate governance standards	3	3.41	.26	7.6%
3.Reporting standards	3	2.67	.80	30%
4.Internal controls	3	3.17	.76	24%
5.Fraud detection and preventic standards	3	3.06	.42	13.7%
Transformational Standards				
6.Capital adequacy and solvency standards	3	3.62	.55	15.1%
7.Shari'ahcompliance standards	3	3.27	.31	9.5%
Valid N (list wise)	3			

Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

TABLE 6.2: RISK ASSESSMENT AND MANAGEMENT STANDARDS

Descriptive Statistics

	N	[illegible]	[illegible]	[illegible]	[illegible]
1. [illegible]	3	3.00	4.00	3.3333	.5[illegible]5
2. [illegible]	3	3.00	3.00	3.0000	.00000
3. [illegible]	3	3.00	4.00	3.6[illegible]	.5[illegible]5
4. [illegible]	3	3.00	4.00	3.3333	.5[illegible]5
5. [illegible]	3	3.00	4.00	3.6[illegible]	.5[illegible]5
6. [illegible]	3	3.00	4.00	3.3333	.5[illegible]5
7. [illegible]	3	3.00	3.00	3.0000	.00000
8. [illegible]	3	3.00	4.00	3.6[illegible]	.5[illegible]5
[illegible]	3				

[illegible]

[illegible] 1, [illegible] 2, [illegible] 3, [illegible] 4

[illegible] 6.2 [illegible] Tak-ful [illegible] 3.00. [illegible] 0's [illegible] 3.33. [illegible] 3.6[illegible] [illegible] 0.58 [illegible]

TABLE 6.3: CORPORATE GOVERNANCE STANDARDS

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
1. Rights of Shareholders	3	3.00	4.00	3.33	.58
2. Other Stakeholders	3	3.00	3.00	3.00	.00
3. Disclosure and transparency	3	3.00	4.00	3.67	.58
4. Responsibilities of the Board	3	3.00	4.00	3.67	.58
Valid N (list wise)	3				

Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Table 6.3 shows the essential criteria for the observance of Corporate Governance Standards at *TakŪful* industry. Four standards have contributed towards assessment of Corporate Governance in the organization. These standards are Rights of Shareholders, Other Stakeholders, Disclosure and transparency and Responsibilities of the Board. It could be seen that out of 4 essential components set to measure this standard, component 2 (Other Stakeholders) was found to be largely observed (mean value ‘3.00’) and it does not deviate from the mean (standard deviation ‘.00’). Component 1 (Rights of Shareholders) was little more than largely observed (mean value ‘3.33’) and it deviated ‘.58’ units from the mean (standard deviation ‘.58’). Criteria 3and 4 were found to be nearly fully observed (mean value ‘3.67’) and they deviated ‘.58’ units from the mean (standard deviation ‘.58’). It indicates that Disclosure and transparency and Responsibilities of the Board have greater impact on corporate governance practices in the organization.

TABLE 6.4: RIGHTS OF SHAREHOLDERS

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
1. Secure Methods of ownership registration	3	1.00	4.00	3.0000	1.73205
2. Ease of Transferring Shares	3	1.00	4.00	3.0000	1.73205
3. Access to Information by Shareholders	3	4.00	4.00	4.0000	.00000
4. Participation and voting at Annual General Meetings	3	3.00	4.00	3.6667	.57735
5. Election of Board	3	4.00	4.00	4.0000	.00000
6. Share in Profit	3	1.00	4.00	3.0000	1.73205
7. Amendments to the Statutes	3	3.00	4.00	3.6667	.57735
8. Authorization of Additional Shares	3	3.00	4.00	3.6667	.57735
9. Extraordinary transactions	3	3.00	4.00	3.6667	.57735
10. Sufficient and Timely information about AGM	3	4.00	4.00	4.0000	.00000
11. Opportunity to ask questions and place items on agenda	3	3.00	4.00	3.6667	.57735
12. Vote in person or in absentia	3	3.00	4.00	3.6667	.57735
13. Clearly articulated and disclosed rules	3	3.00	4.00	3.6667	.57735
14. No use of anti-takeover devices	3	3.00	4.00	3.6667	.57735
15. Vote by Custodians	3	3.00	4.00	3.6667	.57735
Valid N (listwise)	3				

Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Table 6.4 shows the essential criteria for the observance of Shareholders' Rights at *Takāful* industry. It could be seen that out of 15 essential criteria set to measure this standard, criteria 1, 2, and 6 were largely observed as they had mean value of 3.00. Their standard deviation was '1.73' which indicates that they deviated '1.73' units from the mean. Nine criteria (4, 7 to 9 and 11 to 15) were found to be nearly fully observed as they had mean value of 3.67. Their standard deviation is '0.58' which indicates that they deviated 0.58 units from the mean. Three criteria (3, 5 and 10) were fully observed as they had mean value of 4.00. Their '0'standard deviation indicates that they did not deviate from the mean.

TABLE 6.5: OTHER STAKEHOLDERS

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
1. Rights of Participants	3	3.00	4.00	3.6667	.57735
2. Redress for violation of rights	3	3.00	4.00	3.3333	.57735
3. Availability of Information about financial performance	3	3.00	4.00	3.3333	.57735
4. Participants representation on board meetings	3	1.00	3.00	1.6667	1.15470
5. Rights of employees	3	1.00	3.00	2.3333	1.15470
6. Performance bonuses for employees	3	1.00	4.00	2.6667	1.52753
7. Interest-free loans	3	1.00	4.00	2.6667	1.52753
8. Code of business practices	3	3.00	4.00	3.6667	.57735
9. Representation of Shariah Board in board meetings	3	1.00	3.00	1.6667	1.15470
10. Shari'ah Board review and approves takaful products and instruments	3	4.00	4.00	4.0000	.00000
11. Shari'ah Board review and supervision	3	4.00	4.00	4.0000	.00000
12. Harmony of operations	3	4.00	4.00	4.0000	.00000
13. Collection and distribution of zakat	3	1.00	3.00	1.6667	1.15470
14. Social development activities	3	1.00	4.00	2.6667	1.52753
Valid N (listwise)	3				

Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Table 6.5 shows the essential criteria for the observance of Other Stakeholders' rights at *Takāful* industry. It could be seen that out of 14 essential criteria set to measure this standard, criteria 4, 9, and 13 were less than partly observed (mean value '1.67') and they deviated '1.15' units from the mean (standard deviation '1.15'). Criterion 5 was little more than partly observed (mean value '2.33') and it deviated '1.15' units from the mean (standard deviation '1.15). Three criteria (6, 7, and 14) were less than largely observed (mean value '2.67') and they deviated '1.53' units from the mean (standard deviation '1.53'). Criteria 2 and 3 were little more than largely observed (mean value '3.33') and they deviated '.58' units from the mean (standard deviation '.58'). Criteria 1 and 8 were nearly fully observed (mean value '3.67') and they deviated '.58' units from the mean (standard deviation

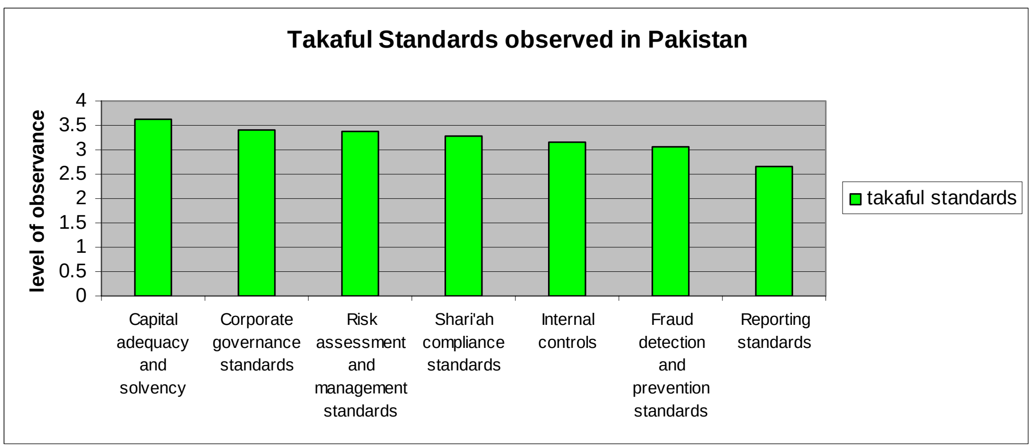
TABLE 6.12: SHARI'AH COMPLIANCE STANDARDS

Descriptive Statistics

1. Identity and Corporate Image	3	3.00	4.00	3.6667	.57735
2. Level of authority given to SSB	3	3.00	4.00	3.6667	.57735
3. New takaful is offered only after fatwa	3	3.00	4.00	3.6667	.57735
4. Company Reliance on SSB Reporting	3	3.00	4.00	3.6667	.57735
5. Importance given to SSB approved documents	3	3.00	4.00	3.6667	.57735
6. Actuaries determine contribution amount in consultation with SSB	3	1.00	3.00	1.6667	1.15470
7. Fair Contribution Amount	3	3.00	4.00	3.3333	.57735
8. Shariah approved instruments	3	3.00	4.00	3.6667	.57735
9. Distribution of profit and surplus	3	1.00	4.00	2.6667	1.52753
10. Mechanism for dealing non-Shariah compliant income	3	3.00	4.00	3.6667	.57735
	3	3.00	4.00	3.6667	.57735
	3	2.00	4.00	3.0000	1.00000
	3	3.00	4.00	3.6667	.57735
	3	3.00	4.00	3.6667	.57735
	3	1.00	3.00	1.6667	1.15470
	3				

(mean value '1.67') and they deviated '1.15' units from the mean (standard deviation '1.15'). Criterion 9 was less than largely observed (mean value '2.67') and it deviated '1.53' units from the mean (standard deviation '1.53'). Criterion 12 was largely observed (mean value '3.00') and it deviated '1.00' unit from the mean (standard deviation '1.00'). Criterion 7 was little more than largely observed (mean value '3.33') and it deviated '.58' units from the mean (standard deviation '.58'). Remaining ten criteria (1-5, 8, 10, 11, 13 and14) were found to be nearly fully observed (mean value '3.67'). They have standard deviation of .58 units that indicates that on the average responses on these standards deviated .58 units from the mean.

FIGURE 6.1: TAKǔFUL STANDARDS OBSERVED

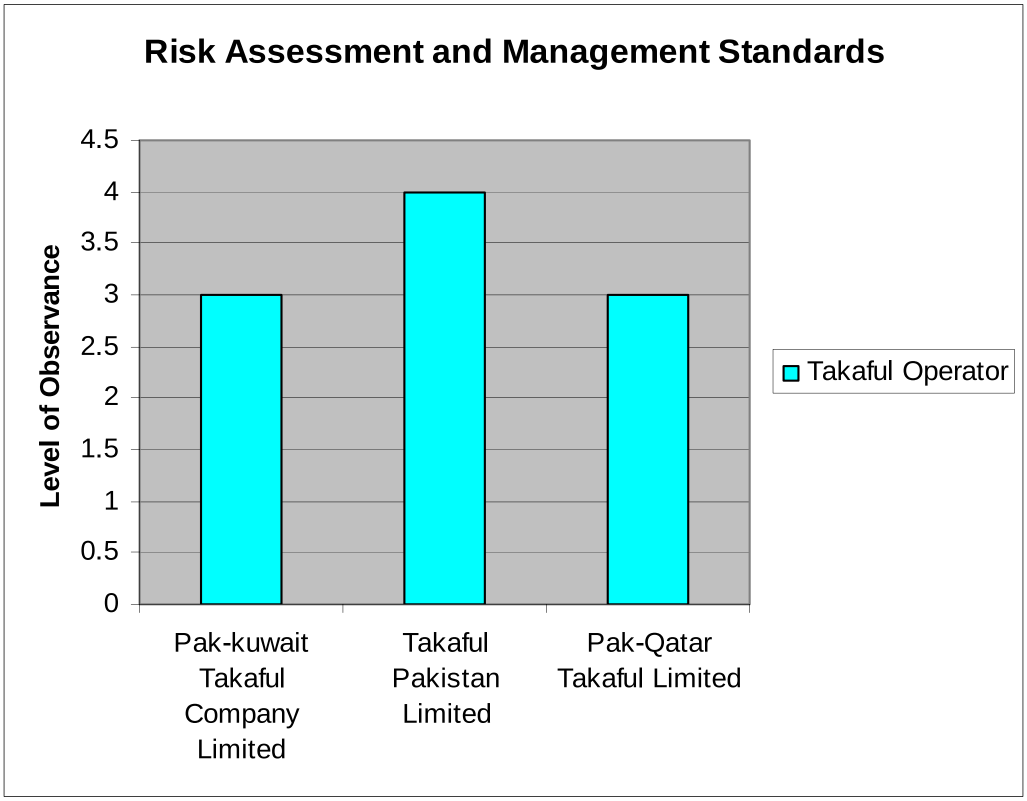


The Figure 6.1 shows the level of observance of *Tak–ful* Standards at *Tak–ful* industry. The standards were arranged in descending order with first standard having highest level of observance and last standard having lowest level of observance. It could be seen that out of 7 standards, Capital adequacy and solvency standards were found to have maximum observance value i.e. 3.62 while Reporting standards were found to have least observance value i.e. 2.67.

6.2.1.2 OBSERVANCE OF STANDARDS AMONG *TAKĀFUL* OPERATORS

The following standards compare the observance of *Takāful* standards among the three *Takāful* operators. Level of observance for each standard has been calculated from the responses received from each *Takāful* operator. It is based on mean value of essential criteria for each standard as described above.

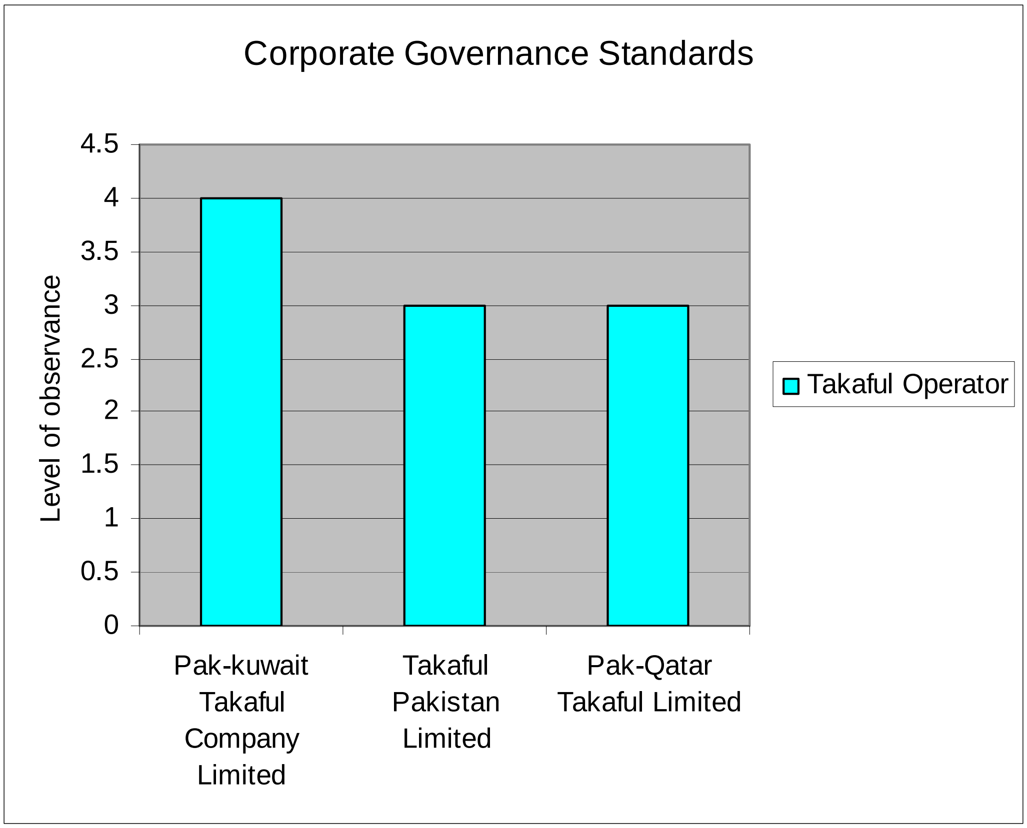
FIGURE 6.3: RISK ASSESSMENT AND MANAGEMENT



Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Figure 6.3 shows the level of observance of Risk Assessment and Management Standards among three *Takāful* operators surveyed in Pakistan. Level of observance of this standard for each company is based on eight elements that represent essential criteria for Risk Assessment and Management Standards as shown in the early table. It could be seen that level of observance for *Takāful* Pakistan Limited is '4' that is higher than other two *Takāful* operators. It indicates that *Takāful* Pakistan has fully incorporated risk assessment and management practices in its operations. Level of observance for other two Takāful operators is '3'. It indicates that these standards are not fully but rather largely observed in both Takāful companies.

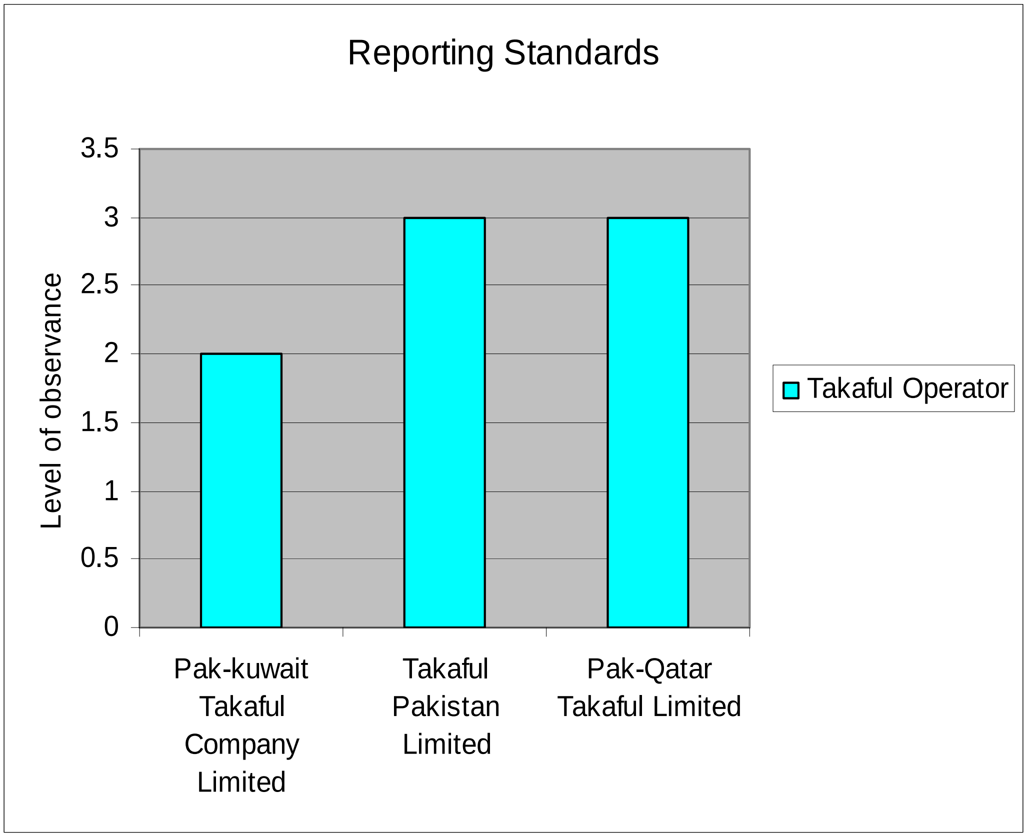
FIGURE 6.4: CORPORATE GOVERNANCE



Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Figure 6.4 shows the level of observance of Corporate Governance Standards among three Takāful operators surveyed in Pakistan. Level of observance of this standard for each company encompasses four areas namely shareholders' rights, stakeholders' rights, disclosure and transparency as well as on responsibilities of the board. For each aspect, essential criteria have been laid down as shown in the early tables. Here, it could be seen that level of observance for Pak-Kuwait Takāful Company Limited is '4' that is higher than other two Takāful operators. It indicates that Pak-Kuwait Takāful has fully incorporated Corporate Governance practices in its operations. Level of observance for other two Takāful operators is '3'. It indicates that these standards are not fully but rather largely observed in both Takāful companies.

FIGURE 6.5: REPORTING STANDARDS



[illegible]

[illegible] Tak-ful [illegible]

[illegible] Tak-ful [illegible] Tak-ful

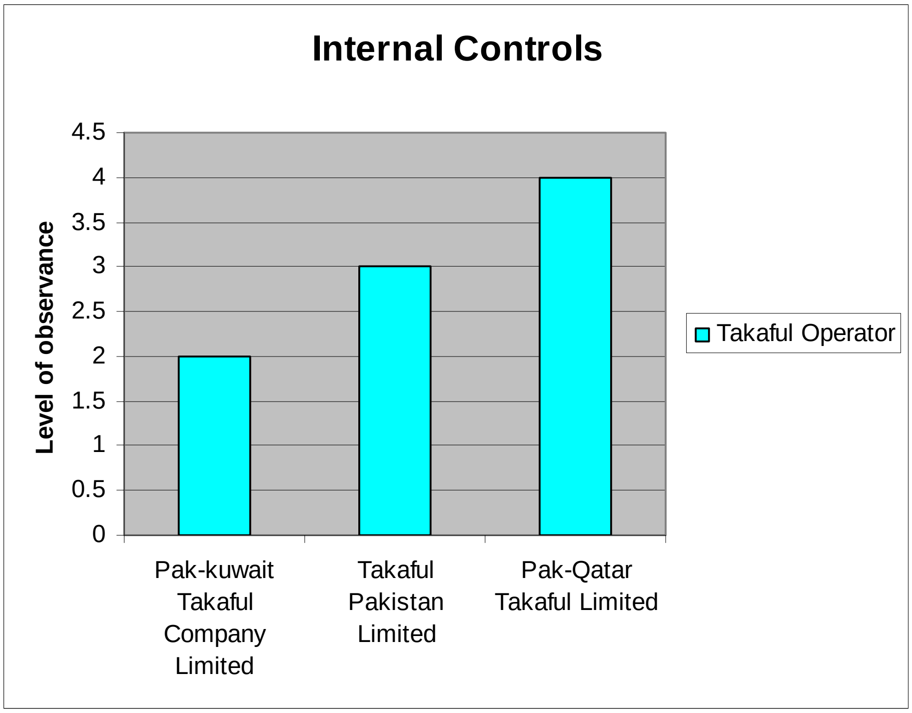
[illegible] Tak-ful [illegible]

[illegible] Tak-ful [illegible]

[illegible] Tak-ful [illegible]

[illegible] Tak-ful.

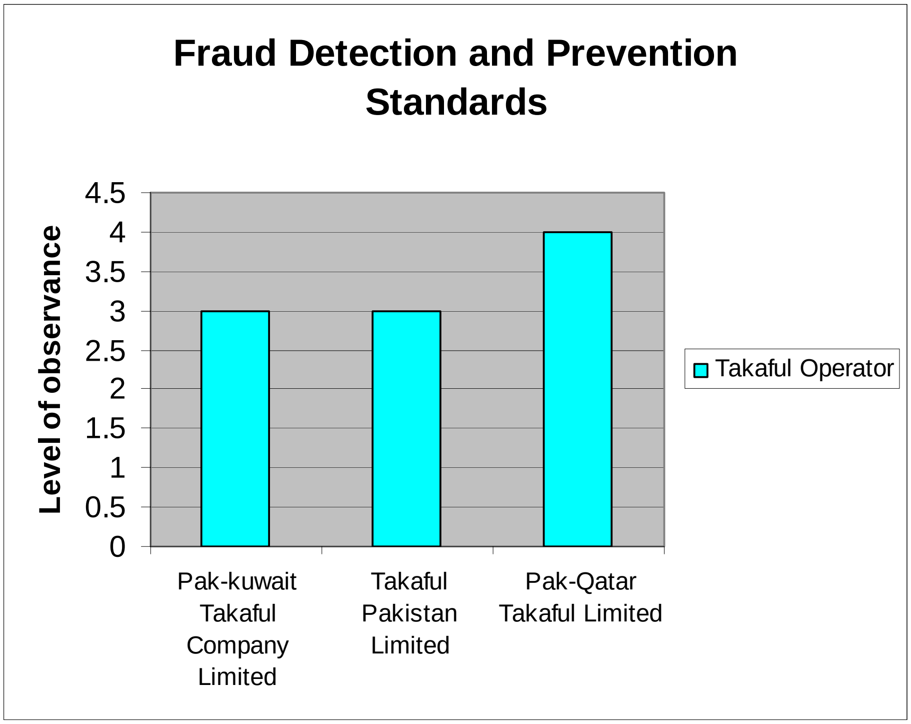
FIGURE 6.6: INTERNAL CONTROLS



Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Figure 6.6 shows the level of observance of Internal Controls among three *TakŪful* operators surveyed in Pakistan. Level of observance of this standard for each company is based on sixteen elements that represent essential criteria for Internal Control as shown in the early table. It could be seen that level of observance for Pak-Qatar *TakŪful* Limited is '4'. It indicates that the company has fully observed and implemented internal control mechanism in its business operations. Level of observance for *TakŪful* Pakistan Limited is '3'. It indicates that the company has largely (not fully) observed and implemented internal control mechanism in its business operations. Level of observance for Pak-Kuwait *TakŪful* Company Limited is '2' that is lower than other two *TakŪful* operators. It indicates that Pak-Kuwait *TakŪful* has only partly implemented internal control mechanism in its business operations.

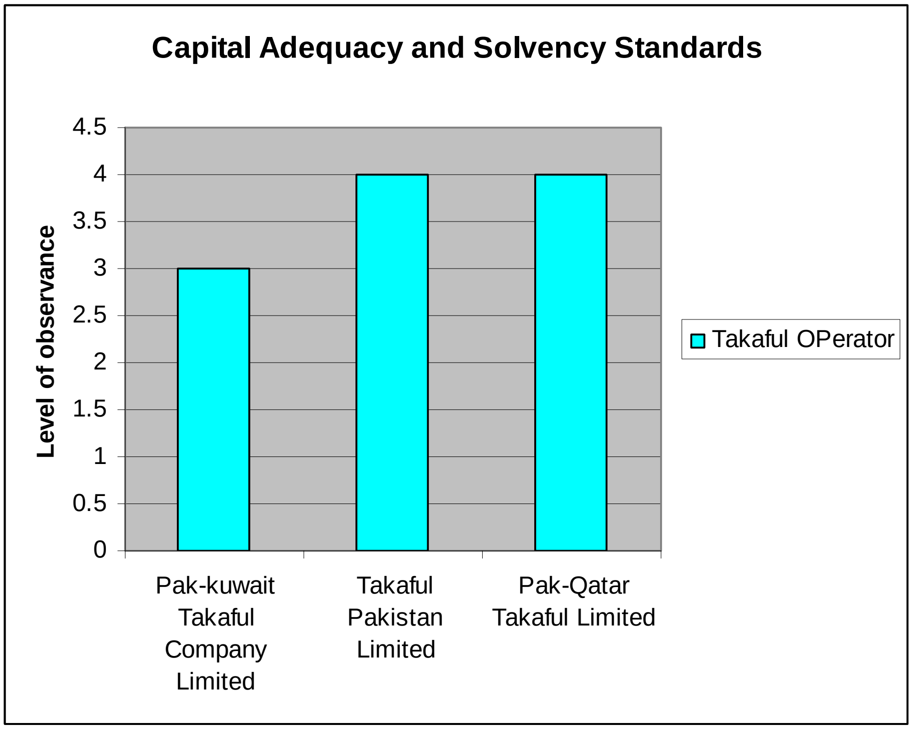
FIGURE 6.7: FRAUD DETECTION AND PREVENTION



Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Figure 6.7 shows the level of observance of Fraud Detection and Prevention Standards among three *TakŪ̄ful* operators surveyed in Pakistan. Level of observance of this standard for each company is based on six elements that represent essential criteria for Fraud Detection and Prevention Standards as shown in the early table. It could be seen that level of observance for Pak-Qatar *TakŪ̄ful* Limited is '4' that is higher than other two *TakŪ̄ful* operators. It indicates that *TakŪ̄ful* Pakistan has fully incorporated and implemented Fraud Detection and Prevention measures in its operations. Level of observance for other two *TakŪ̄ful* operators is '3'. It indicates that these standards are not fully but rather largely observed in both *TakŪ̄ful* companies.

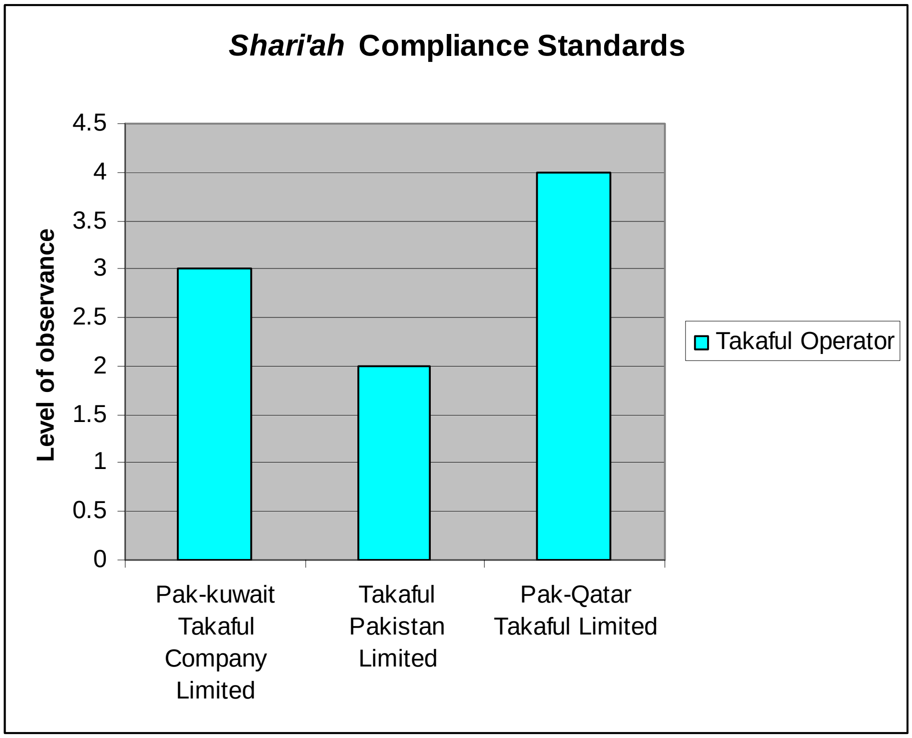
FIGURE 6.8: CAPITAL ADEQUACY AND SOLVENCY



Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Figure 6.8 shows the level of observance of Capital Adequacy and Solvency Standards among three *Takāful* operators surveyed in Pakistan. Level of observance of this standard for each company is based on seven elements that represent essential criteria for Capital Adequacy and Solvency Standards as shown in the early table. It could be seen that level of observance for Pak-Kuwait *Takāful* Company Limited is '3' that is lower than other two *Takāful* operators. It indicates that though Pak-Kuwait *Takāful* largely observed Capital Adequacy and Solvency requirements, it has not fully observed the Capital Adequacy and Solvency standards set by the regulator. Level of observance for other two *Takāful* operators is '4'. It indicates that these standards are fully observed in both *Takāful* companies. It can be inferred that the two companies have adequate Capital Adequacy and Solvency level to cope with unexpected risk than Pak-Kuwait *Takāful* Company.

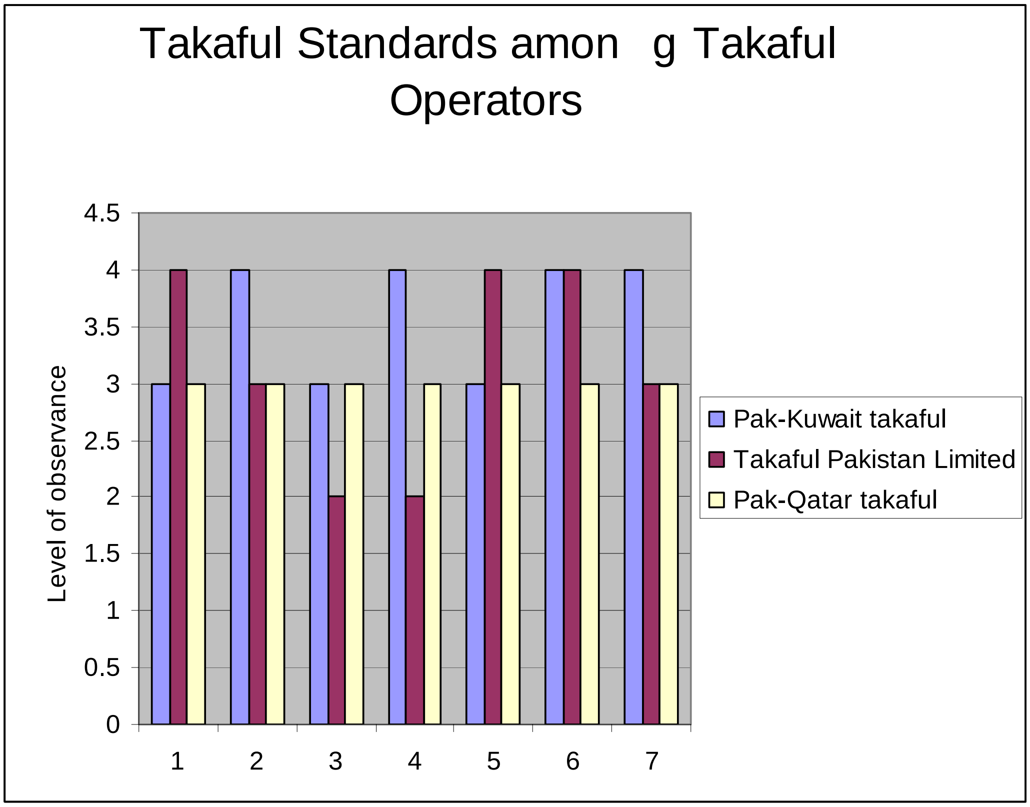
FIGURE 6.9: *<u>SH</u>ARĪ'AH* COMPLIANCE STANDARDS



Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

The Figure 6.9 shows the level of observance of *<u>Sh</u>arī'ah* Compliance Standards among three *Takāful* operators surveyed in Pakistan. Level of observance of this standard for each company is based on fifteen elements that represent essential criteria for *<u>Sh</u>arī'ah* Compliance Standards as shown in the early table. It could be seen that level of observance *<u>Sh</u>arī'ah* Compliance Standards for Pak-Qatar *Takāful* Limited is '4'. It indicates that the company has fully observed and implemented *<u>Sh</u>arī'ah* Compliance mechanism in its business operations. Level of observance for Pak-Kuwait *Takāful* Company Limited is '3'. It indicates that the company has largely (not fully) observed and implemented *<u>Sh</u>arī'ah* Compliance mechanism in its business operations. Level of observance for *Takāful* Pakistan Limited is '2' that is lower than other two *Takāful* operators. It indicates that *Takāful* Pakistan has not only partly implemented *<u>Sh</u>arī'ah* Compliance mechanism in its business operations.

FIGURE 6.10: TAKĀFUL STANDARDS AMONG OPERATORS



Coding of data:
Not observed = 1, partly observed = 2, largely observed = 3, fully observed = 4

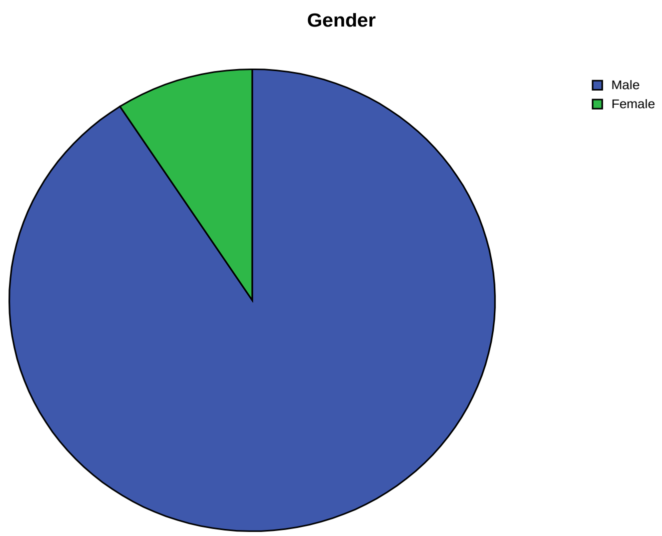
The Figure 6.10 shows the level of observance of Takāful Standards among three Takāful operators surveyed in Pakistan, namely Pak-Kuwait Takāful Company Limited, Takāful Pakistan Limited and Pak-Qatar Takāful Limited.

At Takāful Pakistan Limited, standards 3 and 4 (Reporting Standards and Internal Control) were found to have low level of observance as compared to other Takāful operators. It indicates that reporting standards and internal controls are partly observed at Takāful Pakistan Limited.

At Pak-Kuwait Takāful Company Limited, standards 3 and 5 were found to have largely observed while all other standards were full level of observance. It indicates that reporting standards and Fraud detection and prevention standards were largely observed at Pak-Kuwait Takāful Company Limited.

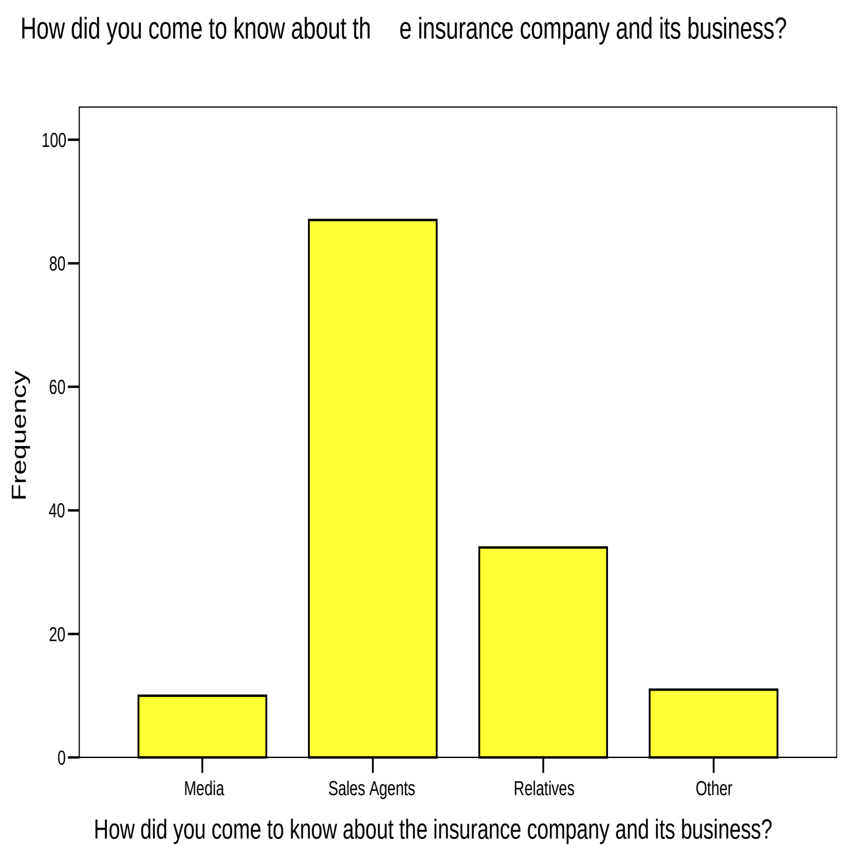
At Pak-Qatar Takāful Limited, all the standards were largely observed and not a single standard was fully observed or less than largely observed.

FIGURE 6.14: FREQUENCY DISTRIBUTION OF GENDER



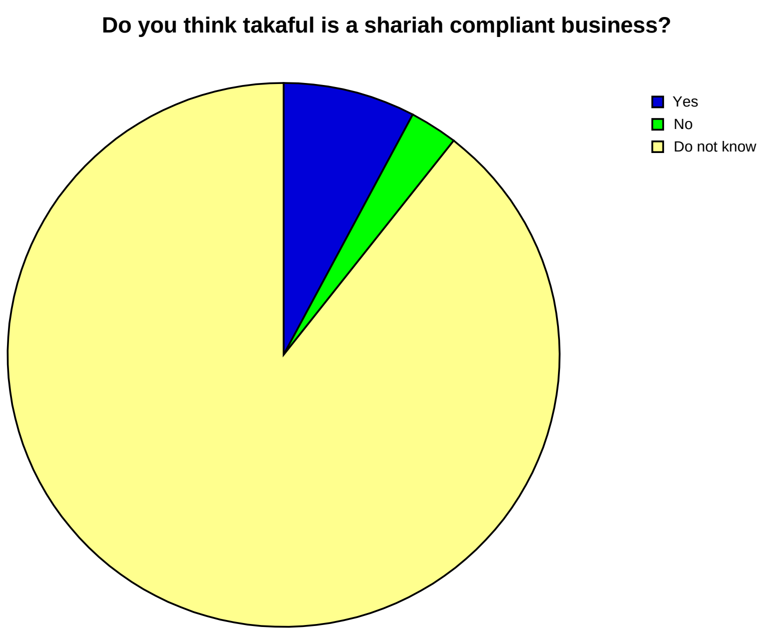
The Figure 6.14 shows the gender distribution of the participants in the survey. Male participants constitute a major portion of the sample and account for 91% of the participants surveyed. 9% of participants were females who participated in the survey. It indicates a high disparity ratio between male and female insurance customers. The main reason for this high level of gender inequality is that usually male participants are bread-winners and play the role of the head of the family so their insurance is more important as the whole family has to depend on them. It also indicates low women participation in the employment sector.

FIGURE 6.17: CHANNELS OF DISTRIBUTION



The Figure 6.17 shows the effectiveness of distribution channels used to reach the target customers. For this purpose, customers were asked how they came to know about insurance. The data collected through survey revealed that 61.3% of the customers were introduced to insurance business through sales agents that were found

FIGURE 6.19: PIE CHART OF *SHARI'AH* COMPLIANT PERCEPTION



The Figure 6.19 shows the views of customers (policy holders) about *Takāful* business. The data was summarized in three responses as shown above. About 7.7% of the participants viewed *Takāful* as a complete *Sharī'ah* compliant business. The 2.8% of the participants did not consider it *Sharī'ah* compliant business. While 89.4%

the view to pay the premium on monthly basis while 1.4% of the participants were paying the premium on quarterly and semi-annually basis. About 93% of the participants showed their preference to pay premium on annual basis. It indicates that majority of the respondents want to pay premium once in a year.

FIGURE 6.24: INTENTION TO SHIFT THE COMPANY

The Figure 6.24 shows the responses of the customers (policy holders) with respect to their loyalty with State Life Insurance Corporation (SLIC). The data was summarized in three responses as shown above. About 68% of the customers were of the opinion that they will stay with State Life while 12% of the participants gave the opinion that they may shift to any insurance company. 20.4% of the customers told that they will shift to a *TakǕful* company if such company exists in the country.

6.2.2.2 FACTORS ASSOCIATED WITH *TAKǔFUL* AWARENESS

The following data show the relationship of *TakǕful* awareness with other variables of the study. In this way, it attempts to show the factors that are affecting *TakǕful* awareness of the respondents.

TABLE 6.13: ASSOCIATION OF AGE WITH *TAKǔFUL* AWARENESS

Do you know about takaful business? * Age (years) Crosstabulation

			Age (years)					
			Below 20	20-30	30-40	40-50	above 50	Total
Do you know abo takaful business?	Yes	Count	0	3	4	4	2	13
		% within Age (ye	.0%	11.1%	8.9%	9.8%	7.4%	9.2%
	No	Count	2	24	41	37	25	129
		% within Age (ye	100.0%	88.9%	91.1%	90.2%	92.6%	90.8%
Total		Count	2	27	45	41	27	142
		% within Age (ye	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	.447[a]	4	.978
N of Valid Cases	142		

a. 6 cells (60.0%) have expected count less than 5. The minimum expected count is .18.

The cross tabulation of the Table 6.13 shows a relationship between age of the customers surveyed and their awareness about Tak–ful. It indicates that customers who have their age below 20 years do not know about Tak–ful business. For the age group 20-30, 11.1% of the total customers are aware of Tak–ful. This ratio has decreased to 8.9% for the age group 30-40. Then it increases to 9.8% for the age group 40-50 and decreases again to 7.4% for the customers above 50 years of age. It indicates that Tak–ful awareness has been fluctuated with the rise of age level and there is no continuous connection between Tak–ful awareness and age of the respondents.

Chi-Square tests of the Table 6.13 also verify the fact that there is no significant association between age of the respondents and Tak–ful awareness. It indicates that Tak–ful awareness is not affected by age and respondents belonging to different age groups have almost same level of Tak–ful awareness.

TABLE 6.14: EDUCATION AND TAK–FUL AWARENESS

Do you know about takaful business? * Education Crosstabulation

1	0	10	2	13
1.6%	.0%	21.3%	50.0%	9.2%
61	29			

conventional insurance business and *Takāful* awareness. It means that *Takāful* awareness is not affected by the source through which customers came to know about insurance business. It further clarifies the fact that respondents who came to know about insurance business through different sources have almost same level of *Takāful* awareness.

TABLE 6.19: *SHARĪ'AH* COMLIANT PERCEPTION AND *TAKĀFUL* AWARENESS

u know about takaful business? * Do you think takaful is a shariah compliant business? Crosstabu

			o you think takaful is a shariah complia business?			
			Yes	No	Do not know	Total
Do you know about takaful business?	Yes	Count	11	2	0	13
		% within Do you think takaful is a shariah compliant business?	100.0%	50.0%	.0%	9.2%
	No	Count	0	2	127	129
		% within Do you think takaful is a shariah compliant business?	.0%	50.0%	100.0%	90.8%
Total		Count	11	4	127	142
		% within Do you think takaful is a shariah compliant business?	100.0%	100.0%	100.0%	100.0%

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	129.976[a]	2	.000
N of Valid Cases	142		

a. 3 cells (50.0%) have expected count less than 5. The minimum expected count is .37.

The cross tabulation of the Table 6.19 shows a relationship between *Takāful* awareness among customers and their perception about *Takāful* as a *Shari'ah* compliant business. It indicates that the customers who think *Takāful* as a *Shari'ah* compliant business have 100% *Takāful* awareness. The customers who do not view *Takāful* a *Shari'ah* compliant business have 50% *Takāful* awareness. Finally, the customers who do not know about *TakǕful* as a *Shari'ah* compliant business have no *TakǕful* awareness.

Chi-Square tests of the Table 6.19 indicate the fact that there is a significant association between *TakǕful* awareness among customers and their perception about *TakǕful* as a *Shari'ah* compliant business ($p<1\%$). It means that *TakǕful* awareness is strongly linked with their views about *TakǕful* business. It can be further inferred that misconceptions exist among general public about *TakǕful* as some of the respondents who are aware of *TakǕful* consider it a non-*Shari'ah* compliant business.

TABLE 6.20: RISK MANAGEMENT PERCEPTION AND *TAKĀFUL* AWARENESS

you know about takaful business? * Do you think takaful is helpful in managing risk and uncertaintie daily life? Crosstabulation

			o you think takaful is helpful in managir risk and uncertainties in daily life?			
			Yes	No	Do not know	Total
Do you know about takaful business?	Yes	Count	12	0	1	13
		% within Do you think takaful is helpful in managing risk and uncertainties in daily life	100.0%	.0%	.8%	9.2%
	No	Count	0	3	126	129
		% within Do you think takaful is helpful in managing risk and uncertainties in daily life	.0%	100.0%	99.2%	90.8%
Total		Count	12	3	127	142
		% within Do you think takaful is helpful in managing risk and uncertainties in daily life	100.0%	100.0%	100.0%	100.0%

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	130.071[a]	2	.000
N of Valid Cases	142		

a. 3 cells (50.0%) have expected count less than 5. The minimum expected count is .27.

The cross tabulation of the Table 6.20 shows a relationship between *Takāful* awareness among customers and their perception of *Takāful* as a risk management tool in daily life. It indicates that the customers who perceive *Takāful* as a risk management tool in daily life have 100% *Takāful* awareness. The customers who do not perceive *Takāful* as a risk management tool in daily life have no *Takāful* awareness. Finally, the customers who do not know about *Takāful* as a risk management tool have 0.8% *Takāful* awareness.

Chi-Square tests of the Table 6.20 indicate the fact that there is a significant association between *Takāful* awareness among customers and their perception about *Takāful* as a risk management tool in daily life (p<1%). It means that *Takāful* awareness is strongly linked with their perception about Tak-ful business. It further indicates that presenting Tak-ful as a risk management tool will increase the level of awareness among general public.

TABLE 6.21: SHARĪAH SCHOLARS' VIEWS AND TAK-FUL AWARENESS

Do you know about takaful business? * Do you think Shari'ah scholars have contradictory views on takaful? Crosstabulation

			Do you think Shari'ah scholars have contradictory views on takaful?			
			Yes	No	Do not know	Total
Do you know about takaful business?	Yes	Count	12	0	1	13
		% within Do you think Shari'ah scholars have contradictory views on takaful?	9.9%	.0%	5.9%	9.2%
	No	Count	109	4	16	129
		% within Do you think Shari'ah scholars have contradictory views on takaful?	90.1%	100.0%	94.1%	90.8%
Total		Count	121	4	17	142
		% within Do you think Shari'ah scholars have contradictory views on takaful?	100.0%	100.0%	100.0%	100.0%

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	.707[a]	2	.702
N of Valid Cases	142		

a. 3 cells (50.0%) have expected count less than 5. The minimum expected count is .37.

The cross tabulation of the Table 6.21 shows a relationship between Tak-ful awareness among customers and their views about Shari'ah scholars' contradictions. It indicates that the 9.9% of the customers who think that Shari'ah scholars have contradictory views on Tak-ful are also aware of Tak-ful. None of the customers who are aware of Tak-ful think that Shari'ah scholars have no contradictions on Tak-ful. 5.9% of the customers who do not know about Shari'ah scholars' views are aware of Tak-ful.

Chi-Square tests of the Table 6.21 indicate the fact that there is no significant association between Tak-ful awareness among customers and their views about

6.2.2.3 FACTORS ASSOCIATED WITH EDUCATION

[illegible] 6.26 [illegible] [illegible] R10,000 [illegible] Tak-ful [illegible] R20,000. [illegible]

TABLE 6.26: ASSOCIATION OF EDUCATION WITH PURCHASING POWER

Crosstab

[illegible]

		[illegible]				
		[illegible]0,000	10,000-20,000	20,000-50,000	[illegible]50,000	[illegible]
[illegible]	[illegible]	36	19	3	4	62
	[illegible]	7	17	4	1	29
	[illegible]	6	27	10	4	47
	[illegible]	0	0	2	2	4
[illegible]		49	63	19	11	142

Chi-Square Tests

	[illegible]	[illegible]	[illegible] (2-[illegible])
[illegible]	54.598[a]	12	.000
[illegible]	142		

a. 12 [illegible] (60.0%) [illegible] 5. [illegible] .11.

[illegible] 6.26 [illegible] (p<1%). [illegible]

TABLE 6.27: ASSOCIATION OF EDUCATION WITH PUBLIC MINDSET

Crosstab

Count

		What will you do if you are given an option to shift the company?			
		stay with the State Life Insurance	shift to a conventional insurance company	shift to a takaful company	Total
Education	Matric or below	45	7	10	62
	Intermediate	20	6	3	29
	Graduate	29	4	14	47
	Postgraduate	2	0	2	4
Total		96	17	29	142

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	9.208[a]	6	.162
Linear-by-Linear Association	3.377	1	.066
N of Valid Cases	142		

a. 4 cells (33.3%) have expected count less than 5. The minimum expected count is .48.

The cross tabulation of the Table 6.27 shows a relationship between education of customers and their intention to shift the company. It indicates that the 73% of the customers having matric education want to stay with State Life (their parent company) while 17% want to shift to *Takāful*. On the other hand, 50% of the pos-graduates want to stay with State Life while 50% want to shift to *Takāful*. It indicates that increase in the level of education has increased the intention of the respondents to shift from traditional insurance. Hence, it supports the evidence that education plays a major role in changing mindset of the general public.

Chi-Square test of the Table 6.27 results for the above tabulation, however, does not support the evidence that significant association exists between education of the customers and their intention to shift the company ($p<10\%$). Yet linear association was found to be significant between education and intention to shift the company ($p<10\%$). It can be concluded that evidence found in cross tabulation was due linear by linear association that was found to be significant at 10% level.

CHAPTER SUMMARY

Takāful industry is faced with numerous operational and transformational issues that can affect its functioning in one way or the other. This chapter attempts to see the effectiveness of operational and transformational standards raised by joint working group of IFSB and IAIS that also complement the research of previous chapter. The study also encompasses respondents' perceptions about *Takāful* and the factors that affect their level of awareness about *Takāful*. The survey aims to assist SECP in setting standards that not only help to enhance the functioning of *Takāful* industry but also safeguard the interests of all stakeholders. It will provide great help to *Takāful* operators in understanding respondents' perceptions about *Takāful* and devising strategies to promote *Takāful* business to the vast population of the country.

Two questionnaires were designed for this purpose: one for *Takāful* operators and other for general public. First questionnaire was used to assess the operational and transformational standards from *Takāful* operators' point of view while the second questionnaire was used to assess customers' perceptions and their level of awareness about *Takāful*. To assess *Takāful* standards, three *Takāful* operators were selected that constituted the entire *Takāful* industry in Pakistan. For public perception survey, 150 customers (policy holders) of State Life Insurance were surveyed at Rawalpindi under convenient sampling procedure and 142 valid responses were received. Cronbach's alpha for *Takāful* standards questionnaire was found to 0.92 whereas its value for standardized items of customer survey questionnaire was found to be 0.76 that ensured the reliability of responses.

Descriptive statistics was used to analyze the results of data obtained from *Takāful* operators while cross-tabulation and chi-square tests were applied to analyze the data of insurance customers. Survey results of *Takāful* operators reveal that reporting standards were found to have low level of overall observance among *Takāful* operators while reporting standards and internal control were found to have higher level of variation among *Takāful* operators in Pakistan. Among the three *Takāful* operators surveyed, Pak-Qatar *Takāful* was found to have lower level of average observance of *Takāful* standards. Survey results of insurance customers reveal that a large population of the country is unaware of *Takāful* business. Education was found to have significant association with the monthly income of

- A significant association was found between education of the respondents and their level of *Takāful* awareness ($p<1\%$).
- A significant association was found between perceptions of the customers about *Takāful* as a *Shari'ah* compliant business and their level of *Takāful* awareness ($p<1\%$).
- A significant association was found between perceptions of the customers about *Takāful* as a useful risk management tool in daily life and their level of *Takāful* awareness ($p<1\%$).
- *Takāful* awareness was found to be unaffected by age, gender, monthly income, marital status and previous knowledge of insurance business. It was also found that *Takāful* awareness has no significant relationship with respondents' views about *Shari'ah* scholars and their payment pattern of insurance premium.
- A significant association was found between customers' intention to shift to a *Takāful* company and their level of *Takāful* awareness ($p<5\%$).

7.1.3 IMPACT OF EDUCATION

- A significant association was found between education of the respondents and their monthly income ($p<1\%$) Table 6.25.
- A significant linear by linear association was found between education of the respondents and their intention to shift to a *Takāful* company ($p<10\%$) Table 6.26.

In the survey of *Takāful* operators, observance of *Takāful* standards can be associated with newness of *Takāful* operator in the industry as Pak-Qatar was found to have low level of observance than other two *Takāful* operators. In customer insurance survey, education was found to be an important factor shaping perceptions of the respondents, affecting their income level as well as their level of *Takāful* awareness. These findings are further explored in the discussion section coming next.

7.2 DISCUSSION

Two questionnaires were designed for the survey: one for *Takāful* operators and other for general public. First questionnaire was used to assess the operational and transformational standards from *Takāful* operators' point of view while the second questionnaire was used to assess customers' perceptions and their level of awareness about *Takāful*. To assess *Takāful* standards, three *Takāful* operators were selected that constituted the entire *Takāful* industry in Pakistan. For public perception survey, 150 customers (policy holders) of State Life Insurance were surveyed at Rawalpindi under convenient sampling procedure and 142 valid responses were received. Cronbach's alpha for *Takāful* standards questionnaire was found to 0.92 whereas its value for standardized items of customer survey questionnaire was found to be 0.76 that ensured the reliability of responses.

Descriptive statistics was used to analyze the results of data obtained from *Takāful* operators while cross-tabulation and chi-square tests were applied to analyze the data of insurance customers. Survey results of *Takāful* operators reveal that reporting standards were found to have low level of overall observance among *Takāful* operators while reporting standards and internal control were found to have higher level of variation among *Takāful* operators in Pakistan. Among the three *Takāful* operators surveyed, Pak-Qatar *Takāful* was found to have lower level of average observance of *Takāful* standards. Survey results of insurance customers reveal that a large population of the country is unaware of *Takāful* business. Education was found to have significant association with the monthly income of respondents and their level of *Takāful* awareness. It was found to have linear by linear association with respondents' intention to shift to a *Takāful* company. Level of *Takāful* awareness was found have significant association with the perceptions of the customers and their intention to shift to a *Takāful* company.

Basically, two-prong strategy has been adopted in this study to strengthen *Takāful* business in the country. One aspect focuses on the regulatory level to strengthen regulatory framework for *Takāful* operators while the other aspect aims at public level to gauge their perceptions about *Takāful* business.

To strengthen regulatory framework for *Takāful* industry, observance of *Takāful* standards is essential among *Takāful* operators. A survey of *Takāful* operators in the country was conducted to judge the level of observance of *Takāful* standards. Survey results reveal that reporting standards and internal controls have lower level of observance and higher level of variation so they require immediate attention of the regulatory authority. By analyzing the essential criteria set for reporting standards in the Table 6.8 on page 198, it could be seen that criterion 5 is less than partly observed. It indicates that adherence of accounting and auditing procedure with AAOIFI guidelines is lacking among *Takāful* operators. AAOIFI is a standard setting accounting and auditing organization for Islamic financial institutions that issues standards under *Shari'ah* guidelines to meet the specific needs of Islamic financial services industry including *Takāful*. Criteria 4 and 6 are partly observed and they also need attention of regulatory authority. Criterion 4 is related to submission of financial information of the subsidiary on request while criterion 6 is concerned with off-balance sheet exposures.

By analyzing essential criteria for internal controls in the Table 6.9 on page 199, it could be seen that criteria 9 to 16 have low level of observance and high level of dispersion. Criterion 9 ensures that company has on-going internal audit function. Survey results indicate that usually *Takāful* operators do not have their audit on continuous basis; rather they are accustomed to a formal audit that is done once a year. Criterion 10 ensures that company internal audit function has unfettered access to its business lines and supporting departments. Survey results indicate that since *Takāful* operators do not have their audit on continuous basis; so there is no direct access to company’s other departments. Criteria 11 to 15 have low level of observance for similar reasons in the absence of an internal audit function of the company. Criterion 16 indicates that actuarial reports are not made available to BOD all the time for their appointments.

In the comparison of observance of *Takāful* standards among *Takāful* operators in the Figures 6.10 and 6.11 on page 212 and 213 respectively, Pak-Kuwait *Takāful* Company was found to have higher level of observance than other two *Takāful* operators i.e. *Takāful* Pakistan Limited and Pak-Qatar *Takāful*. It is because of the fact that Pak-Kuwait *Takāful* Company is the first *Takāful* operator in the country established in 2005. *Takāful* Pakistan Limited and Pak-Qatar *Takāful* are relatively new players in the market so they definitely require some time to incorporate new innovations and to overcome their shortcomings. Yet the standards pointed out in this discussion need careful attention

6.13, 6.15, 6.16, 6.17 and 6.18 respectively. It indicates that Takāful awareness scheme can be targeted to all the respondents including males and females, singles and married, rich and poor without any age discrimination and without any compulsion of their previous knowledge of insurance.

Survey results of the Tables 6.19 and 6.20 reveal that Takāful awareness has no significant relationship with respondents' views about Shari'ah scholars. It indicates that both respondents who are aware and not aware of Takāful think that Shari'ah scholars have contradictory views on Takāful and are not fully aware of Takāful concept. Moreover, Takāful awareness was found to have no association with the payment pattern of insurance premium of the customers. It was found through survey results that about 93% of the total customers prefer to pay their insurance premium annually irrespective of their Takāful awareness.

A significant association was found between customers' intention to shift to a Takāful company and their level of Takāful awareness as mentioned in the Table 6.24. Survey results reveal that about 18% of the customers who are not aware of Takāful want to shift to Takāful company. On the other hand, 46% of the customers who are aware of Takāful want to shift to Takāful. More over, all of the customers who want to shift to any other company are unaware of Takāful. It indicates that Takāful awareness has profound impact on customers' intention to shift to a Takāful company.

To further analyze the impact of education on purchasing power of the respondents and their state of mind, it was found in the Table 6.26 that education has significant association with the monthly income of the respondents. As discussed in the global indicators under section 4.3.2 of chapter 4, low purchasing power expressed in low monthly income per capita was found to be a probable cause of low insurance penetration in developing Muslim countries like Pakistan. All the efforts to raise the purchasing power of a common man and alleviate poverty have not produced desired results. Pakistan having large population has quite low literacy rate in the comity of nations.

7.3 OVERALL RESULTS

This thesis was guided by four research questions mentioned on page 14 of the first chapter. These are:

i. How could *Takāful* be helpful in managing risk and uncertainties in business without violating *Shari'ah?*
ii. What factors determine the potential of *Takāful* business across the world and how much potential exists in Pakistan?
iii. How far the regulatory frameworks are adequate for *Takāful* and which *Takāful* standards are essential to strengthen regulatory framework?
iv. How far the general public is aware of the concept of *Takāful* and which factors determine their level of awareness?

The thesis justifies the first question by providing a comprehensive understanding of operational mechanism of *Takāful* business. It identifies five types of risks in *Takāful* business and gives strategies to effectively manage the risks according to *Sharī'ah* principles. It maintains that *Takāful* operators might face difficulty in managing market and credit risks as *Sharī'ah* compliant nature of *Takāful* contract does not allow *Takāful* companies to deal with interest rate and financial derivatives due to their speculative nature by which they tend to benefit one party at the cost of other. It recommends cooperative hedging and bi-lateral mutual adjustment as acceptable instruments under *Sharī'ah* to mitigate currency and interest rate risk respectively. It emphasizes that *Sharī'ah* is abundant with real solutions to the present business problems and does not hinder creativity. It further recommends stress tests and Value at Risk (VaR) techniques to mitigate commodity price and equity risk.

The second question has two parts; first part is related to the factors that determine the potential of *Takāful* business across the world while second part is related to potential of *Takāful* in Pakistan. In response to the first part, this research analyses the financial performance of selected *Takāful* companies of different countries on the basis of growth of insurance premium of family and general *Takāful*, growth in total assets and return on assets (ROA). Net profit of *Takāful* companies under study increased on the average from 50% (minimum) to 5-times (maximum). *Takāful* premium increased on the average from 4% (minimum) to 3-times (maximum). There was on the average 20% (minimum) to 5-times (maximum) increase in total assets. ROA for the selected companies was found to be 0.28% (minimum) to 8.4% (maximum). It concludes that financial performance of *Takāful* companies has been quite impressive across the world and potential exist for future growth as well. The analysis of Pakistan insurance industry during the period 2001-2005 indicates that life insurance business is growing at an average rate of 28% while general insurance is growing at 22% per anum. The average net profit growth rate for life insurance business was found to be about 14% per anum while that of for general insurance business was 52%. Potential for *Takāful* business in Pakistan has been assessed from four perspectives. 1) Through growth of Pakistan insurance industry indicating that potential exists for *Takāful* as well. 2) Insurance comparison among Muslim countries and comparing Pakistan's share to world insurance market. 3) Regional comparison showing insurance density and penetration in Asian countries. 4) Growth of *Takāful* across the world and geographical spread of *Takāful* business give specific dimensions indicating that potential exists for *Takāful* in the Asian region including Pakistan. It also figures out the global indicators such as low adult literacy rate, low GDP per capita, low GDI value that probably determine the potential of insurance business and might become potential contributors to *Takāful* business in Pakistan.

In response to the third research question, this research identifies regulatory standards that monitor and facilitate *Takāful* business and are essential to strengthen regulatory framework. *Sharī'ah* compliance mechanism was found to be the centre of all the business activities of a *Takāful* Company. It starts with selecting members of SSB of high caliber, allocating them corporate responsibilities, ensuring company reliance on their reporting and evaluating *Sharī'ah* performance of the company through *Sharī'ah* audit. To judge the observance of regulatory standards among *Takāful* operators in Pakistan, a survey was conducted and responses of three *Takāful* operators in the country were collected. Survey results revealed that reporting standards and internal control were found to have low level of overall observance and higher level of variation among *Takāful* operators in Pakistan.

CHAPTER 8

CONCLUSION AND RECOMMENDATIONS

8.1 CONCLUSION

Takāful has emerged as an alternative solution to present insurance dilemma. The success of Takāful business lies in its very nature of being Sharīʿah compliant. This system is based on eternal Sharīʿah laws where no one gets undue advantage at the cost of others. Rather, it is a fair and transparent system free from exploitation and injustice. Recent growth of Takāful across the world clearly indicates its promising future for Pakistan. Transformation of existing system is truly compatible with the needs and beliefs of the people of Pakistan who constitute more than 150 million population of Muslim community. Such transformation does not mean abolishing the existing system all at once. Yet it means providing sound footing to Takāful system on one hand and preparing the people to get ready for a change on the other hand. Such gradual transformation is strongly supported and highly lauded in Islam. Takāful awareness program will greatly facilitate the transformation process as significant association was found between Takāful awareness among general public and their intention to shift to Takāful.

Challenges in the area of risk management, corporate governance and financial engineering are quite important and should be tackled on priority basis. Particular focus is required to corporate governance issues related to use of different Takāful models and Sharīʿah matters. A central Sharīʿah board having scholars of different schools of thoughts may resolve fiqh related issues and other Sharīʿah issues to a great extent. There is need to explore innovative Islamic financial instruments to facilitate risk management practices and provide avenues for investment of Takāful funds. Islamic secondary financial market is also essential for the trading of Islamic financial instruments. Conventional framework does not meet the needs of Takāful industry, so separate institutional framework is desired to support and facilitate *Takāful* industry. In spite of comprehensive framework available for transformation of conventional insurance, there are certain elements that might create hindrance and directly or indirectly affect the process of transformation. Activities should be harmonized and instead of completely abolishing the conventional insurance system, concerted efforts and multi-facet approach is required for gradual transformation.

Policy makers need to focus on global indicators that determine the factors for creating demand for insurance and affect the level of awareness of people. Sound state policies followed by effective regulatory framework are critical factors for the success of *Takāful* industry in the country. Reporting standards and internal controls should be the focus of Regulatory authority to strengthen regulatory standards for *Takāful*. Significant results of education with its impact on people perceptions and their level of *Takāful* awareness urge the policymakers to devise strategies to raise the level of education of general public of the country. Education can be used as a tool to raise earning capability of people, uplifting their standard of living and at the same time providing them spiritual relief by making *Takāful* available at their doorstep. It will fulfill their ultimate desire of having *Sharī'ah* compliant financial protection in the form of *Takāful* for which they have aspired for a long time.

It is hoped that this research work will be regarded as a starting point for further enhancement of research in *Takāful* in Pakistan to complete the cycle of Islamic finance. It is a step towards creating awareness among general public of the need and importance of *Takāful* in present day environment and to come out of vicious circle of poverty trap and wide income gap. The findings of this study, if implemented properly will definitely contribute towards the formation of a robust, competitive and dynamic *Takāful* industry in Pakistan. The opportunity to offer an alternative to conventional insurance system to the population at large is a great opportunity which should be utilized in its true spirit.

xii. Proper disclosure of financial information:

Takāful operators should disclose their financial information to general public on timely basis. Financial statements showing the past financial performance of the company should be readily available to general public. It will establish the credibility of the company and build public confidence. Moreover, proper disclosure will provide an opportunity to local investors to immediately make their investment decisions.

xiii. Sharī'ah Compliant Corporate Governance Framework:

Two areas of corporate governance should be given due importance: a) Participants should be given the right to vote to elect their representatives who could represent them in board meetings to discuss their problems and other matters of interest. b) *Sharī'ah* scholars should be given appropriate representation on the board meetings. All the major decisions should be made under the supervision of BOD and with the consultation of members of SSB.

xiv. Re-takāful arrangements:

To diversify the risk to a broader level and to ensure more protection and stability to *Takāful* Operators, establishment of a *Re-takāful* pool in South Asian region i.e. Pakistan, Bangladesh, Srilanka and India is in the spirit of a *Takāful* industry. Such a pool is highly desirable for the *Takāful* industry to grow not just in Pakistan but also internationally *Takāful* operators have a need for risk sharing pools.

xv. Adherence to AAOIFI guidelines:

Insurance companies under conventional insurance system are bound to follow international accounting standards (IAS) in their accounting and auditing system. Since these standards have been developed on conventional lines, they fail to address the *Sharī'ah* compliance feature of *Takāful* companies and Islamic financial institutions (IFIs). Moreover, *Takāful* companies need to maintain separate accounts for participants as well as for shareholders. To address these issues, AAOIFI has devised accounting and auditing standards to meet the unique needs of Islamic financial institutions including *Takāful* companies.

xvi. Introducing micro-Takāful schemes:

Micro-*Takāful* schemes should be introduced by *Takāful* operators to low income people especially of remote areas of the country who have no direct access to *Takāful*. These schemes will greatly facilitate the low income people to save and plan for their future life according to their resources. These schemes could be arranged with the cooperation of micro-finance institutions, SMEs, or other development institutions that provide financing to low income groups.

xvii. Introducing new investment instruments:

New Islamic investment avenues should be opened so that *Takāful* fund could be invested in a variety of instruments, e.g. Islamic bonds (*Sukuk)* or *Islamic* papers could be issued by the government to create new investment avenues for *Takāful* business.

xviii. Islamic financial markets:

Islamic secondary market is essential for mobilizing of *Takāful* funds and trading of Islamic financial instruments. It will serve the need of *Takāful* operators by providing them a secondary market for trading long term securities. Islamic money market will serve the need to trade short term securities and overcome liquidity constraints.

8.3 DIRECTIONS FOR FUTURE RESEARCH

This research identifies following areas of research to be further explored in future.

i. Scope of micro-takāful and poverty alleviation

Micro-*takāful* schemes provide insurance cover to low income people of the community. The main objective of these schemes is to raise the standard of living of poor class by providing protection to poverty stricken people of the society. Most of the poor families are unprepared to face unexpected perils and catastrophes of life. There is urgent need to find out mechanism to make the micro-*takāful* schemes successful so that they can contribute towards providing relief to the poor. There is also need to find out issues and hurdles that might hamper the role of these schemes as most of the people might be reluctant to accept these scheme due to their illiteracy, ignorance etc.

ii. Developing efficiency criteria for Takāful operators to serve as a community welfare centers

In the absence of a robust regulatory framework, most of the *Takāful* operators, just like their conventional counterparts, might act to maximize the profit for shareholders hence ignoring the rights of participants who are the major stakeholders of the company. There is a possibility that *Takāful* operators and their respective actuaries overestimate the risks associated with particular *Takāful* products and might charge a higher premium to their customers. There is also a possibility that members of *Sharī'ah* Supervisory Board might not be well-informed about the real situation and might approve certain decisions that might work against the interests of participants. To prevent any possibility of malpractices, there is need to develop efficiency criteria for *Takāful* operators to serve as a community welfare centers.

iii. Role of bancaTakāful to reach untapped Takāful market in remote areas

Banca*Takāful* has emerged as a major distribution channel to make *Takāful* products available to a large majority of population even in the remote areas. Since most of the people even in the rural areas have their bank accounts in the banks or have interaction with the bank when they pay their utility bills, or deposit money in their accounts. There is need to work how this network could be effective for *Takāful* operators and how banks can be benefited from this opportunity by offering an additional service to their customers.

iv. Accounting and auditing system for Takāful companies

Conventional insurance is based on accrual accounting where as in *Takāful*, cash accounting is acceptable. The need is to develop an Islamic accounting system for Islamic financial institutions in general and for *Takāful* industry in particular. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has already been set up. Moreover *Sharī'ah* audit is essential for a *Takāful* Company to ensure implementation of *Sharī'ah* ruling in all of its operations. Unfortunately, there are numerous issues related to functioning of members of SSB (*Sharī'ah* Supervisory Board) as *Sharī'ah* scholars have different schools of thoughts (e.g. *Hanafi, Shafie, Hanbali, Maliki* etc.) The need is to achieve consensus among different *Sharī'ah* scholars on *Takāful* business operational and investment options.

v. Scope for e-Takāful:

With the advancement in technology, most of the users are shifting to internet shopping. Banks are also offering their services through internet as it is easy and 24 hours service. For customers, it is also cheap and more convenient as it saves their time and money. Seeing the recent trend in e-banking and internet shopping, opportunity also exists for e-*Takāful* (*Takāful* through internet) growth in future. There is need to work on the issues and challenges that must be encountered to achieve growth for e-*Takāful* such as awareness and confidence in *Takāful* products, quality of service etc.

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GLOSSARY

al ʻAqd - Contract

In *Takāful* practice the parties involved herein are mainly the participants and the operator, who bind themselves with a mutual consent to encounter a defined risk. Parties bind themselves relying on the principles of *al-'Aqd* (contract) through that of *al-Ijab* (offer) and a *Qabul* (acceptance).

al `Amānah **–** Trust

al `Amānah means 'trust' which is also a kind of contract whereby a person offers something valuable to someone else for safe keeping as a trust. It could sometimes be by express contract or by an implied contract, in which the trustee is unilaterally bound to keep the trust according to the terms and conditions agreed upon by the owner and also the trustee.

`al - ʻĀqilah **–** Paternal relatives

The paternal relatives who pay the blood money. The doctrine of al-Aqilah has been practiced among the ancient Arab tribes in which it was an implied mutual agreement among the tribes that, if anyone is killed unintentionally by a person of different tribe, the slayer's paternal relative used to take the responsibility to make a mutual contribution for the purpose of paying the blood money on behalf of the slayer, to the victim's relatives.

al-Wala' - Clientage

al-Wala' means a contract of clientage between a stranger whose descent is unknown and another person, in which the stranger offers the other that, you are my guardian and will be liable to pay any form of compensation in case I commit any wrongful act, in consideration of which, you will be entitled to inherit my property upon my death.[11] If however the later agrees to the offer made by the stranger the contract will be binding upon both of them.

Bai bitha-man al-`ājil - Sale by Deferred Payment

Practical scenario of the doctrine of Bay' Bithaman Ajil (BBA) is that, it is a sale of deferred payment in which one party buys an asset or property and sell it to the costumer at an agreed cost, plus mark up price to be paid in the future, either in lump sum or by installments.

Ceding Company – Takāful operator who initially writes the business and later transfers part or all of coverage to a re-Takāful operator in the region.

Cover note – A temporary document or certificate issued by the agent on behalf of the insurer to the insured, which gives an effect of an interim cover.

Diwān – The finance department of the early Muslim stage.

Diyyat – Blood wit, blood money, a monetary compensation against unjustified manslaughter.

Ex-ante Sharī'ah audit - certification of permissible financial instruments through fatwas (based on forecasts)

Ex-post Sharī'ah audit - verification of transactions' compliance with issued fatwas (based on actual results)

Fatwā — Juristic opinion, juridical decision.

Fiqh – Knowledge of Sh

***'Urf* –** Custom, usage, common practice.

***Wadī'ah* - Deposit**

Wadi'ah is a kind of contract whereby a person leaves his valuable in the custody of others as a trust for safe keeping.

***Wakālah* –** Agency

Wakalāh is a contract of agency, in which a person delegates his business to another and substitutes the other in his place.

***Waqf* –** Charity, religious endorsement testamentary bequest of real estate.

***Zakāt* –** Compulsory tax imposed on certain categories of wealthy people.

6. There is a computerized support system for estimating the variability of earnings and risk management.				
7. The risk management system monitors and controls all material risks.				
8. The Company regularly reviews the market environment in which it operates, draws appropriate conclusions as to the risks posed and takes appropriate actions to manage adverse impacts of the environment on Takāful business.				

CORPORATE GOVERNANCE STANDARDS:

I. **The Rights of Shareholders:**
Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.
Please tick the appropriate box.

	FO	LO	PO	NO
A. Basic shareholders' rights:				
9. Secure methods of ownership registration				
10. Ease of transferring shares				
11. Access to information by shareholders.				
12. Participation and voting at Annual General Meetings.				
13. Election of board.				
14. Share in profit.				
B. Right to participate in fundamental corporate changes.				
15. Amendments to the statutes.				
16. Authorization of additional shares.				
17. Extraordinary transactions (e.g. sale of the institution).				
C. Right to be adequately informed about, participate and vote in general shareholders meetings (AGM):				
18. Sufficient and timely information about AGM.				
19. Opportunity to ask questions and place items on agenda.				
20. Vote in person or in absentia.				
D. Efficient and transparent functioning of market for corporate control.				

21. Clearly articulated and disclosed rules and procedures, transparent prices and fair conditions.				
22. No use of anti-takeover devices to shield management from accountability.				
23. Vote by custodians or nominees in agreement with beneficial owner.				

II. Other Stakeholders:
Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.
Please tick the appropriate box.

	FO	LO	PO	NO
24. Rights of participants (withdrawal of Takaful policy and profit share)				
25. Means to redress for violation of rights of stakeholders.				
26. Availability of information about financial performance of the company to the participants.				
27. Participants representation in board meetings or shareholder meetings.				
28. Existence of some organ that represents the interests/rights of employees (e.g. trade union)				
29. Performance bonuses for employees (other than bonuses to Takaful agents).				
30. Interest –free loans for employees				
31. A code of business practices or code of ethics known to all employees of the organization.				
32. Representation of Shari'ah board members in board meetings.				
33. Shari'ah board reviews and approves new Takaful products and instruments introduced by the company.				
34. Shari'ah board reviews and supervises the operations of the company.				
35. Shari'ah board ensures that operations of the company are in harmony with Shari'ah.				
36. Arrangement for the collection and distribution of zakat of shareholders and participants.				
37. The Company is involved in social development activities.				

III. Disclosure and Transparency:
Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.
Please tick the appropriate box.

	FO	LO	PO	NO
A. Disclosure of material information given on:				
38. Financial and operating results				
39. Company objectives				
40. Major share ownership and voting rights.				
41. Board members, key executives and their remuneration.				
42. Material foreseeable risk factors.				
43. Material issues regarding employees and other stakeholders.				
44. Governance structures and policies.				
45 B. Preparation of information, audit and disclosure in accordance with high standards of accounting, disclosure and audit.				
46 C. Annual audit by independent auditors.				
47 D. Channels of disseminating information allow for fair, timely and cost effective access to information by users.				

IV. Responsibilities of the Board:
Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.
Please tick the appropriate box.

	FO	LO	PO	NO
48 A. Act on informed basis, in good faith, with diligence and care and in the best interests of company and shareholders.				
49 B. Protect and oversees the rights of participants.				
50 C. Compliance with law and taking into account stakeholders interests.				
51 D. Fair treatment of each class of shareholders.				
E. Key functions of the Board:				
52. Corporate strategy, risk policy, budgets, business plans, performance objectives, implementation and performance surveillance, major capital expenditure, acquisitions, divestures.				
53. Selection, monitoring, replacement of key management.				
54. Key executive and board remuneration, board nomination.				
55. Monitoring of conflict of interest of management, board members and shareholders, participants including misuse of corporate assets and abuse in related party transactions.				

56. Ensuring integrity of accounting and financial reporting systems, including independent audit, systems of control, compliance with law.				
57. Monitoring management practices and making necessary changes.				
58. Overseeing disclosure and communication.				
59. Fiduciary responsibility that the operations of company conform to *Sharī'ah.*				
F. Objective judgment on corporate affairs:				
60. Assignment of non-executive board members to tasks of potential conflict of interest (e.g. financial reporting, remuneration).				
61. Devote sufficient time to their responsibilities.				
62 G. Access to accurate, relevant and timely information.				

REPORTING STANDARDS:
Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.
Please tick the appropriate box.

Essential Criteria:	**FO**	**LO**	**PO**	**NO**
63. The Company submits regular and systematic financial and statistical information, actuarial reports and other information to SECP.				
64. The Company, as a minimum, provides an audit opinion to SECP annually.				
65. The Company provides more detailed and additional information whenever there is a need.				
66. The Company submits information about its financial condition and performance on both a solo and a group-wide basis. It also submits financial information of any subsidiary on request of supervisory authority.				
67. The Company accounting and auditing methods adhere to AAOIFI guidelines. The valuation of assets and liabilities should be consistent, realistic, and prudent				
68. requires insurers to report any off-balance sheet exposures.				
69. The Company provides report on its outsourced functions.				
70. The Company provides accurate information and has the authority to impose penalty for deliberate misreporting.				

INTERNAL CONTROLS

Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.

Essential Criteria:	FO	LO	PO	NO
71. The board of directors is ultimately responsible for establishing and maintaining an effective internal control system.				
72. The internal controls address checks and balances; e.g. cross-checking, dual control of assets, double signatures.				
73. The internal and external audit, actuarial and compliance functions are part of the framework for internal control, and must test adherence to the internal controls as well as to applicable laws and regulations.				
74. The risk management systems, strategies and policies are approved and periodically reviewed by the board of directors.				
75. The board of directors provides suitable oversight of market conduct activities.				
76. The board of directors receives regular reporting on the effectiveness of the internal controls. Internal control deficiencies, either identified by management, staff, internal audit or other control personnel, are reported in a timely manner and addressed promptly.				
77. Internal controls address accounting procedures, reconciliation of accounts, control lists and information for management.				

78. Oversight and clear accountability for all outsourced functions is required as if these functions were performed internally and subject to the normal standards of internal controls.

92. Takāful company takes effective measures to prevent fraud, including providing counter-fraud training to management and staff.				

Transformational Standards:

CAPITAL ADEQUACY AND SOLVENCY STANDARDS

Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.

Please tick the appropriate box.

Essential Criteria:	**FO**	**LO**	**PO**	**NO**
93. The solvency regime addresses in a consistent manner: a. valuation of liabilities, including technical provisions and the margins contained therein b. quality, liquidity and valuation of assets c. matching of assets and liabilities d suitable forms of capital e. Capital adequacy requirements.				
94. Any allowance for risk mitigation or transfer considers both its effectiveness and the security of any counterparty.				
95. Suitable forms of capital are defined.				
96. Capital adequacy requirements are sensitive to the size, Complexity and risks of the company's operations, as well as the accounting requirements that apply to Takāful business.				
97. The minimum capital adequacy requirements should be set at a sufficiently prudent level to give reasonable assurance that participants' interests will be protected.				
98. Capital adequacy requirements are established at a level such that the company having assets equal to the total of liabilities and required capital will be able to absorb significant unforeseen losses.				
99. Solvency control levels are established. Where the solvency position reaches or falls below one or more control levels, a corrective action can be taken in a timely manner				

SHARI'AH **COMPLIANCE STANDARDS:**

Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed.
Please tick the appropriate box.

Essential Criteria:	**FO**	**LO**	**PO**	**NO**
100. Identity and corporate image of SSB (Shari'ah Supervisory Board) is maintained in the organization.				
101. Level of authority given to members of SSB to observe high standard of code of ethics among all employees and management in the company.				
102. A new Tak~~ful~~ Product is offered only after fatwa is issued by members of SSB its favor.				
103. Company reliance on SSB reporting.				
104. Importance given to SSB approved documents.				
105. Actuaries determine contribution amount in consultation with Shari'ah scholars.				
106. Contribution amount is fair and is approved by Shari'ah scholars of the company.				
107. The extent to which company's investments are made in Shari'ah compliant instruments.				
108. Distribution of profit and surplus to participants is determined by members of SSB.				
109. There is mechanism for dealing with non-Shari'ah compliance income sources within the company.				
110. SSB guidance is sought regarding calculation and distribution of zakat.				
111. Claims are handled in consultation with Shari'ah scholars.				
112. There is mechanism for internal Shari'ah audit in the company.				
113. The company regularly conducts its Shari'ah audit from an external auditor together with its account audit.				
114. There is a rating committee for Shari'ah Quality Rating (SQR) to assess Shari'ah compliance of company's operations.				

8. How would you like to pay contribution?

[. Monthly
[. Quarterly
[. Semi-annually
[. Annually

Please tick the appropriate box	**Yes**	**No**	**Do not know**
9.Do you think Tak-ful is a Shar 'ah compliant business?			
10. Do you think Tak–ful is helpful in managing risk and uncertainties in daily life?			
11. Do you think Shari'ahscholars have contradictory views on Tak–ful?			
12. Do you think Shari'ahscholars are fully aware about concept of Tak–ful?			

13. What would you do if you are given an option to shift the company?

[. Stay with the State Life
[. Shift to any company
[. Shift to Tak–ful company

APPENDIX B

SELECTED TAKĀFUL PRODUCTS: GUIDELINES AND PROCEDURES*

1. LONG TERM BASIS

INDIVIDUAL SECTOR BUSINESS:

i) Family Takāful Plan

ii) Family Takāful Plan for Education

GROUP SECTOR BUSINESS:

iii) Group Family Takāful Plan

iv) Group Medical Takāful

i. FAMILY TAKĀFUL PLAN:

1. INTRODUCTION:

The Family Takāful Plan is a long term al-Mudharabah contract which provides saving and mutual cover among participants. The plan provides mutual financial aid and assistance in the event of misfortunes covered. Essentially the main objectives of the plan are as follows:-

i. Establishing a fund through discipline and regular savings

ii. Providing financial benefit to dependents arising from untimely death of the participants

iii. Creating a superannuation fund upon maturity

iv. Providing supplementary benefits in the event of PTD (permanent total disability) including personal accident

* These *Takāful* products are being offered by *Sharikat Takāful* Malaysia, Berhad. As retrieved from company's intranet http://Takāful-malaysia.com/html.php?file=./intranet/manual/ on Monday, 25th September, 2006

the FR must be affected separately. If adopted children are to be covered, their names must be declared.

The period of Takāful for FR shall be similar to the term of the basic certificate or upon the spouse attaining the age 65 years whichever is earlier.

The amount of additional contribution for FR will be credited into the PSA of the Family Takāful Fund.

4. UNDERWRITING & ASSESSMENT OF PROPOSAL:

In assessing the Proposal opinions expressed by the doctor who conducts the medical examination on the Proposer must be given due consideration. In some cases, a follow-up with the doctor is necessary to obtain clarifications. In the event of doubt, a second opinion from another doctor may be sought. Before the Proposal is accepted it is essential that the following features be examined:-

4.1. AGE OF PROPOSER

The age next birthday of the Proposer must not be less than 19 years old but not exceeding 55 years old. In addition, on maturity of the Plan the Proposer age must not exceed 65 years old.

4.2 PHYSICAL CONDITIONS

Special attention must be given to particulars such as the Proposer age, sex, height and weight as they will give a rough idea of the Proposer physical condition and often a clue to his state of health. A person who is overweight (obesity) must be treated with caution as he is most likely to suffer from heart disease, hypertension, diabetes, etc. Similarly, records pertaining to medical treatment, if any, undergone by the Proposer must be checked especially if he had been recently undergone operation. A Proposal may have to be rejected or postponed if the Proposer had just undergone an operation. Likewise, a Proposal may have to be declined or its acceptance postponed if the Proposer is suffering from serious physical deformities or impairments.

4.3 OCCUPATION

The Proposer occupation provides the vital information on the duties and tasks that he is required to perform. Occupation by itself may not necessarily depict the actual work done. The job description can be used as a means to gauge the degree of exposure as certain types of occupation are known to have a high rate of accident. At the same time certain types of occupation are easily prone to certain sicknesses or diseases. The occupational hazards are set out in the specific section on Occupational Rating Classification attached to this manual.

4.4 AVOCATIONAL:

A Proposer engaged in hazardous activities and pursuits must be treated with great caution as such Proposer is often more exposed to accidents. Dangerous hobbies such as flying, gliding, parachuting, mountaineering, racing of all types, etc. are classified as high degree hazards.

A Proposer engaged in activities and pursuits contrary to the Syariah such as horse racing (jockey), drinking, etc. cannot be accepted.

4.5 FINANCIAL CAPACITY:

The Proposer must have the financial capacity to pay the Takāful installment at the agreed intervals. As the Family Takāful Plan is a long-term contract, the validity of the contract is subject to the ability of the Proposer to meet his obligation to pay the Takāful installment when it is due. If the Takāful installment that the Proposer elects to pay is high in proportion to his income it is likely that he may encounter financial difficulties and may not be able to continue paying the installment.

4.6 MORAL HAZARDS

A Proposer arranging to participate in the Family Takāful Plan with intent to defraud claims should be meticulously examined. The evaluation is usually made with reference to the financial capacity of the Proposer. This may be ascertained from the level of Takāful installment chosen by the Proposer and whether the amount is a reasonable proportion to his income.

A person of bad moral hazard is easily proned to commit serious crimes such as robbery, suicide, etc.

4.7 FAMILY HISTORY

It is also important to consider the family medical history of the proposer as certain types of illnesses may be hereditary as heart problem, diabetic, and hypertension.

5. UNDERWRITING DECISION:

Having thoroughly assessed the Proposal, the following underwriting decisions may be made;

7. DEFERMENT OF TAKĀFUL INSTALLMENT:

7.1 A Participant of Family Takāful Plan and Family Takāful Plan for Education with the consent of the Company may defer the payment of his regular Takāful installments by submitting his application in a standard form provided by the Company.

7.2 The above deferment may only be granted in the following circumstances:-

i. participant in pursuit of further studies

ii. participant accompanying his/her spouse for (i) above

iii. participant becoming unemployed

7.3 The participant shall only be eligible to apply for the deferment subject to his participation in the respective plan is not less than 12 months or has fully paid the Takāful installment for a similar period. The maximum period of deferment shall be 3 years and any further period shall be subject to the discretion of the Company.

7.4 The participant is required to pay in lump sum the equivalent amount of tabarru' for the PSA in respect of the deferment period including the additional Takāful contribution for the corresponding supplementary benefits. However, the participant may elect to terminate the supplementary cover during the deferment period.

7.5 The Letter of Approval shall be issued to the participant upon acceptance for the deferment. Share of profits for the participant shall be duly credited into the PA during the deferment period. Statement of profits and income tax shall be issued annually as normal. However, no renewal notice shall be issued during the deferment period.

7.6 One month prior to the expiry of the deferment period, Renewal Notice shall be issued to the participant to notify him of the date he is required to continue the payment of his Takāful installments.

8. SURRENDER:

8.1 Surrender is a status whereby a Participant ceases his participation in the Family Takāful Plan. Upon surrender, a Participant shall receive a refund of all Takāful installments paid and credited into his Participant's Account together with the total profit generated there from. No refund shall be made from the Participants Special Account.

8.2 The contract of Takāful is deemed to be surrendered (i.e. terminated) if a Participant;

8.2.1 applies in writing to the Company to discontinue or terminate his participation;

8.2.2 fails to pay the Takāful installment on the expiry of the grace period.

8.3 On surrender no further payment of the Takāful installment is to be made and intermediaries such as the Participant's bank or his employer should be notified forthwith to stop the remittance of his Takāful installment through such an intermediary. If after the surrender the Takāful installment is received, it must be refunded to the Participant immediately.

8.4 A Participant who surrenders shall be required to sign a `Surrender Discharge Form'. This form is an instrument declaring that the Company shall be cleared of its obligations and liabilities under the terms and conditions of the contract. A Participant shall also be required to surrender the Original Takāful Certificate. In the event that the Certificate is lost, the Participant shall be required to furnish a Loss Declaration duly stamped.

8.5 Certificate surrendered within a period less than 2 years will be rendered with a service fee that is different for non-medical and medical cases. Usually lower for non-medical cases, and higher for medical cases.

9. MATURITY:

9.1 The Family Takāful Plan shall attain its maturity on completion of the term of participation.

9.2 A notification of maturity shall be given to the Participant two months prior to date of maturity of the Certificate.

9.3 SURRENDER OF ORIGINAL CERTIFICATE

The Participant shall be requested to surrender to the Company the Original Certificate issued to him. If the Certificate has been assigned, the assignee who shall be entitled to the proceeds of the benefits under the assignment shall be requested to show proof of the assignment by furnishing the Deed of Assignment or its copy which must be duly certified. The Deed will indicate the extent of interest of the assignee under the Certificate assigned.

9.4 PROOF OF IDENTITY OF PARTICIPANT

A Participant claiming the payment of Takāful benefits on maturity must show proof of his identity. A copy of his identity card or his employment record would be sufficient proof for this purpose.

9.5 MATURITY CLAIM DISCHARGE FORM

Having decided to admit the maturity claim a request must be made to the participant to sign the Maturity Claim Discharge Form. The Discharge Form is the basis of settlement of the Takāful benefits at maturity.

9.6 SETTLEMENT OF TAKĀFUL BENEFITS

The payment of Takāful benefits at maturity shall be made from the following Accounts:-

i. PARTICIPANT'S ACCOUNT (PA):

The total amount of Takāful installments paid by the Participant from the date of entry to the last due date as specified in the Certificate;

The amount of profits generated from the investment of installments as in (i) above due to the Participant at the latest closing date prior to the date of maturity of the Family Takāful Plan that he had participated.

ii. PARTICIPANTS' SPECIAL ACCOUNT (PSA):

The total amount of surplus allocated based on the actuarial valuation of the Participants' Special Accounts.

ii. FAMILY TAKĀFUL PLAN FOR EDUCATION

1. INTRODUCTION:

Family Takāful Plan for Education is a long-term saving and investment program with an objective of creating a kind of endowment or a family scholarship fund to finance the children's future education. The Plan would enable an individual to participate in the Takāful business with the following objectives:-

i. To save regularly for a fixed period with a view of establishing a family educational fund for the benefit of the children;

ii. To invest with a view of earning profits in a manner acceptable to Syariah which in turn would lead to further accumulation of the saving;

iii. To provide financial benefit to the children in the event of untimely death of the participant. The benefits payable in the event of death of the participant shall be paid to the named children according to the Islamic principle of `hibah' (gift).

2. DECLARATION OF HIBAH:

2.1 Participant to the Family Takāful Plan for Education is required to complete and sign the '*Declaration of Hibah*' form. By completing the form, the participant agrees to transfer as gift the proceeds of the Plan to the child(ren) named in the form in according to the Islamic principle of Hibah ('gift'). In the event of untimely death of the participant, the benefits payable under the Certificate shall be paid to the named child(ren) as beneficiary.

Therefore such proceeds shall not be subject to the Islamic Principle of the Distribution of heritance according to the faraid law.

2.2 The participant should be advised to name any one child in the certificate. In the event of two or more children to be named, the participant should be further advised to effect separate certificate for each child.

2.3 The minimum age of the child at the time the hibah is to be payable shall be not less than 18 years old. In the event death of the participant prior to the child attaining the age of 18 years or such other age when the hibah shall become payable, the proceeds paid under the plan shall be managed by the Company under a special '*Trust Account*'.

In all other aspects, the operational system and procedure for the Family Takāful Plan for Education are similar to the Family Takāful Plan.

iii. GROUP FAMILY TAKĀFUL PLAN

1. INTRODUCTION:

1.1 The Group Family Takāful Plan provides cover to a group of persons under a common single master Takāful Certificate. The proceeds of the plan shall be payable to a proper claimant or person covered resulting from death or bodily injury either due to disease or accident.

The plan may be considered as a comprehensive type of Takāful product since it covers death as well as bodily injury due to any cause subject to certain general exclusions as shown in the Certificate.

1.2 However, it must be noted that the Group Family Takāful Plan is not a contract of indemnity as it would be impossible to determine the value of a person's life or loss of limb, sight, etc. Nevertheless, in assessing the proposal of

In this respect, certain factors should be observed before considering to accept the proposal.

3.1 Number of Persons & Evidence of Health

In order to avoid anti-selection, a minimum percentage of the persons to be covered must be imposed as follows:-

Potential Membership	Percentage Participation
Up to 50	100%
51 to 99	90%
100 to 250	75%
above 250	50%

Proposal with lower percentage of participation may be considered but subject to evidence of good health of the person covered.

A group must constitute at least 20 persons. However, in a compulsory scheme whereby all members/employees shall be covered such minimum number of person shall be waived, but subject to all persons to be covered are required to submit personal health declaration.

For a large scheme where the possibility of anti-selection is minimum, the proposal may be accepted without requiring evidence of health even though the percentage of participation would be less than 50%.

However, such acceptance must be made after a careful study and approval of the CEO or the GM Family Takāful Division.

3.2 Fixed Formula Sum Covered

The sum covered should be based on factors outside the control of members/employees. For this reason, it is proper to offer the same amount of cover known as `level cover' for each and every person in the group. However, where required e.g. for employment benefit, it is possible to vary the amount according to salary grade, category or level of position provided that there is no opportunity for any members/employees to choose the benefit level. Benefit in excess of the formula may be granted, but only subject to evidence of good health.

3.3 Actively at Work Condition

Acceptance without evidence of health shall be applicable for employees who are actively at work only. Coverage for employees who are not actively at work may need to be postponed or otherwise full health evidence shall be required.

If any member/employee who did not join the Plan at the inception or when first eligible, subsequently wishes to join, he/she should only be accepted subject to satisfactory evidence of good health.

If a member/employee is absent from work due to ill health on the date he is first eligible to join the Plan, cover should only commence after he/she has been continuously at work for a period of 15 days. In addition, subsequent increases in cover should only be granted under similar actively at work condition.

When taking over an existing group plan from Takāful operator/insurer, the actively at work condition may be waived as such condition is considered to be effected by the previous plan. Notwithstanding the above, great care must be taken before considering accommodating such request, and it should only be confined to a satisfactory claim experience.

4. SHARE OF SURPLUS:

4.1 At the end of the Period of Takāful, the participant will be entitled to the share of surplus, if any, from the Group Family Takāful Plan, provided that the participant has not incurred any claim during the period of cover.

4.2 For large group, profit sharing may be considered even in the event of claims incurred only with the approval of the CEO or GM Family Takāful Division. The sharing of such profit shall be based on the net balance of the Takāful contribution paid for the year after deducting the total claims admitted.

iv. GROUP MEDICAL TAKĀFUL

1. INTRODUCTION:

The Group Family Takāful for Medical Takāful provides cover for medical and hospitalization expenses incurred by a person covered arising from medical care or hospitalization due to injury or disease.

The Plan offers facility for reimbursement of medical and hospitalization expenses payable by an employer for the benefits of its employees.

This would help to stabilize the medical

2.1.2 Intensive Care Unit

Reimbursement of the daily charges by the hospital, during confinement as in patient in the Intensive Care Unit of the hospital. The maximum period and amount payable shall not exceed the maximum amount and no. of days stated in the similar Benefits Schedule.

3. EXCLUSIONS:

GHS shall not pay or reimbursed medical and hospital expenses incurred during any period unless the hospitalization and special services given have been recommended approved and performed by a Registered Medical Practitioner and in accordance with the diagnosis and treatment of the condition for which such hospitalization is required.

In addition, benefits shall not be payable in the following circumstances:-

a. Dental examination, filling, extraction including removal of impacted tooth and general dental care except dental operation resulting from an injury sustained by the Person Covered in an accident;

b. Outpatient physiotherapy treatment, procurement or use of special braces;

c. For eye glasses, contact lens, acquisition of prosthetic such as artificial limbs, hearing aids and others or the examination for the purpose prescribing them or cost of fitting them;

d. Injuries due to insanity or self-infliction;

e. Treatment for obesity, weight reduction or weight improvement;

f. Injury or sickness arising from racing of any kind (except on foot), sky diving, scuba diving, mountaineering or any hazardous sports;

g. Cosmetic surgery for purpose of beautification or plastic surgery; non-medical personal services such as telephone, television and the like;

h. Hospitalization or medical treatment relating to birth control or infertility; pregnancy including childbirth, miscarriage, or any complications from pregnancy;

i. Acquired Immune Deficiency Syndrome (AIDS) or AIDS related complex (ARC);

j. Any other causes prohibited by Shariah.

4. UNDERWRITING CONSIDERATION:

In view of the fact that Group Hospitalization and Surgical Benefit cover could be susceptible to large claims either by size or frequency, careful and meticulous assessment at the underwriting stage is imperative.

In this respect, the following factors should be observed before considering to accept the proposal.

4.1 Number of Persons & Evidence of Health

Evidence of health of the persons to be covered usually would not be required if the Plan is on compulsory basis. However, the persons must be actively at work on the date they are enrolled into the Plan. It is imperative to ensure that no possibility of selection against a potential person to be covered is made.

Acceptance for age above 60 years old shall be subject to evidence of good health.

A group must constitute at least 10 persons excluding dependents. Consideration for a proposal with a group less than 10 persons shall be subject to individual underwriting. Where the Plan is on a voluntary basis, the number of persons covered excluding dependents must be at least 50% of the total group size before acceptance without individual health declaration may be considered.

4.2 Cover for Dependent

In cases where dependents are to be included the following condition should be followed:-

i. Spouse can always be included, but care should be taken as it is possible to have more than one. The maximum age limit is 65 years old;
ii. Children's coverage can only commence on the 15th day from birth until age 19 years. Coverage for children in full-time tertiary institution may be extended to age 25 years;
iii. For adopted child, only those notified to the Company would be covered and the obligation to notify is rest with the participant;
iv. There shall be no coverage for children age below 14 days old. Coverage below this age may post difficulties as :-

i. FIRE TAKĀFUL SCHEME:

1. INTRODUCTION:

The purpose of this scheme is to protect individuals from loss or damage arising from fire, lightning or domestic gas explosion.

2. SCOPE OF COVER:

The basic cover provided under terms and conditions of the contract as detailed in the Fire Takāful Certificate, is loss or damage due to or arising from fire, lightning or domestic gas explosion.

Indemnity under an ordinary Fire Takāful Certificate is limited to the actual value at the time of the occurrence of fire, i.e. depreciation will be taken into consideration and factor generally the amount of claims payable will be as per prevailing market value.

Therefore, it is always advisable cover be affected on 'Reinstatement Value' basis. Under this basis, the actual reconstruction and/or replacement value of the subject matter covered such as building and/or its contents (except for stock) be made. Should under-coverage exist i.e. when the sum covered is less than the actual reconstruction cost/value or replacement value, the Participant will have to bear a proportionate share of the loss, and this means the "Average Clause" will be applied. Such under-coverage is also applicable under 'Indemnity' basis.

3. PRINCIPAL CERTIFICATE EXCLUSIONS:

This certificate does not cover loss and/or damage arising from:

i. Loss by theft during and after occurrence of fire.

ii. War and Civil Commotion.

iii. Radioactive contamination.

iv. Arson by Participant himself.

v. Collapse of building.

vi. The building covered and/or containing the properties covered unoccupied and remains so for a period of more than 30 days consecutively.

4. UNDERWRITING CONSIDERATION:

a. Under-coverage should be avoided as the Certificate is subject to "Average Clause". No members of staff shall be allowed to commit the Company's acceptance on the adequacy of sum covered. However, staff may advise Participants on the matter, if requested.

b. Warranties to be imposed by FTM must be strictly complied with and stated on the Cover Note. Clauses (extended Perils or otherwise) required must also be stated on the Cover Note. If space is inadequate, Appendix should be used with a note of "Subject to Appendix" noted on Cover Note.
c. Description of cover must be precise and clear with sums covered stated specifically.
d. Due consideration must be given to the standard of housekeeping and management of the proposer.
e. National and International trends of the business, e.g. rubber, timber, palm-oil, mining etc. should be closely monitored to ascertain whether its trend is declining so that the probability of exposure to moral can be minimized.
f. Flood cover should not be loosely granted to risks location in low lying areas and known to have incurred flood claim. Likewise, subsidence and landslip should not be extended on ex-mining area (for more than 2 stories building) and hilly slope. “Risk Survey Report" must be submitted through the Underwriting department for approval before accepting such cover.
g. Long Term Agreement (LTA) Discounts.
   All LTA discounts should cease as from April 1, 1996.
h. Long Term Cover.
   Long Term Cover cannot be given other than annual period unless authorized by the Managers of Underwriting Departments.

ii. MARINE CARGO TAKĀFUL SCHEME

1. INTRODUCTION:

Marine Takāful may be affected by either the buyer or seller of goods depending on the terms of the contract of sale. The types of contract concluded between the buyer and seller may either be FOB, C & F or CIF basis.

1.1 Types of Contract:

1.1.1 FOB (Free On Board)

The Seller delivers the goods sold onto the vessel and his interest ceases upon delivery of the goods. The Buyer is responsible for the Takāful / insurance of the goods the moment they are on board the vessel. He is also liable for the payment of freight charges to the Shipping Company.

1.1.2 C & F (Cost and Freight)

The Seller is responsible for freight charges until the goods are delivered at the destination. The Buyer would have to affect Takāful / insurance for the transit of these goods.

1.1.3 CIF (Cost Insurance and Freight)

The Seller is responsible for all charges, including Takāful / insurance premium and freight charges, until the goods are delivered at the destination, whereupon his contract with the Buyer ceases. The price charged by the Seller includes Takāful / insurance and freight charges.

This Takāful Scheme should be written cautiously as its profitability largely depends on the claims experience of the Proposer from his previous shipments.

2. SCOPE OF COVER:

2.1 Institute Cargo Clause (A)

Cover: All Risks of loss or damage to the cargo.

2.2 Institute Cargo Clause (B)

Cover:

i. Fire or explosion
ii. Stranded, grounded sunk or capsized of vessel
iii. Overturning or derailment of land conveyance
iv. Collision or contact of vessel with any external object other than water
v. Discharge of cargo at port of distress
vi. Earthquake, volcanic eruption or lightning Jettison or washing overboard
vii. Entry of sea, lake or river water into vessel, craft, hold, conveyance container lift van or place of storage
viii. General average sacrifice

ix. Total Loss of any package lost overboard or dropped whist loading onto, or unloading from vessel or craft.

2.3 Institute Cargo Clause (C)

Cover:

i. Fire or explosion

ii. Stranded, grounded sunk or capsized of vessel

iii. Overturning or derailment of land conveyance

iv. Collision or contact of vessel with any external object other than water

v. Discharge of cargo at port of distress

vi. Jettison

vii. General Average sacrifice

2.4 Institute War Clause (Cargo)

Marine Certificate may be extended to cover War Risks subject to payment of an additional Takāful Contribution at the current rate prescribed by Institute of London Underwriters. It must be noted that War Risks attached only when the goods are loaded on vessel and terminates on discharge from the vessel at the final port or place of discharge or on expiry of 15 days from midnight of the day of arrival of the vessel at the final port of discharge, whichever shall first occur.

2.5 Institute Strikes Clause (Cargo)

This extension is also available to cover loss or damage caused by:

a. Strikes, locked-out workmen or persons taking part in labor disturbances, riots or civil commotion.
b. Any terrorist or any person acting from a political motive.

3. EXCLUSION FOR ALL CLAUSES:

i. willful misconduct of participant

ii. ordinary leakage, loss in weight or volume

iii. insufficient or unsuitable packing

iv. inherent vice of cargo

v. loss caused by delay

vi. insolvency or of financial default of owners

vii. unseaworthiness of vessel

viii. War & SRCC risks unless the Certificate is extended to include these perils (Special Exclusion Applicable to Clauses B & C).

ix. Deliberate damage or destruction by malicious act.

4. UNDERWRITING CONSIDERATION:

a. Client/Shipper - Moral Hazard: A Proposer who does not employ dependable forwarding agents to clear his goods usually referred to be an example of bad moral hazard.

b. Nature of Goods: A full description of the goods to be covered must be given. Incorrect information will render a claim inadmissible. Some goods are susceptible to certain types of loss or damage.

Examples are:

i. Asbestos sheets - Breakage

ii. Canned goods - Rusting, Denting, Damage to Label etc.

iii. Oil - Leakage, Shortage, Evaporation

iv. Flour - Tearing of Bags

v. Hides and Skins - Heating & Sweating

vi. Timber - Warping/staining

vii. Cement - Hardening due to exposure

c. Method of packing: The cargo clauses exclude loss or damage due to insufficient or unsuitable packing. As such it is only advisable for the Proposer to protect himself by ensuring proper packing.

d. Value: The value cannot be exaggerated and since the Certificate is issued on an agreed value basis it is not permissible for the Proposer to cover more than 110% of the cost of goods excluding any duties payable.

e. Voyage: Knowledge of the voyage is a crucial factor which may result in the underwriter either imposing stringent terms or even declining the risk. Examples of such cases are:

i. Sailing through war zones

ii. Sailing through typhoon affected areas e.g. Philippines, Bangladesh.

f. Detail of Steamer/Vessel: Where the vessel is above 15 years of age an "over aged vessel" surcharge amounting to about 20% - 25% of the rate should apply. Other details like the occupation/use or types of vessel and the construction of the vessel are essential data.

The Classification of vessels as per Institute Classification Clause must be revealed.

g. Coverage required/Any Transsshipment: The rates depend very much on the cover required. Sometimes there is a tendency for the Proposer to request the best suitable cover for goods which are very susceptible to damage by marine perils.

   For example, cement is very vulnerable to damage by water. As such the Proposer just needs cover for water damage and will request for cover under Clause B. It is therefore the underwriter's duty to decide whether to grant such cover and the rate to be charged or to offer cover say for Total Loss only or Clause C only.

   Very often where the property is the subject of a Bank's Letter of Credit cover is mostly required for Clause A and it is for the underwriter to adjust other terms e.g. imposing a higher rate or an excess.

h. Volume of Business: Information will also reveal whether the business is seasonal or regular and the approximate number of shipments per year.

i. Port of Loading and Unloading: Consideration has to be given to the hazards which may be present in certain ports in the world. Example, port conditions at Karachi might have "bad handling" problems resulting in damage to goods. But port facilities and services are being upgraded from time to time. In assessing the proposal this factor must be taken into account.

j. On Deck/Under Deck: Where the underwriter is not advised and it is not customary, it is to be presumed that the cargo is always shipped under deck. If it found that it is shipped on deck, should there be a loss, the claim shall not be payable.

5. DECLINED RISKS:

Irrespective of terms and conditions, the following risks are to be avoided:

- Marine Hull Business
- Shipments by under - and unclassified vessels

- EAR, CAR, Machinery Breakdown of Hulls
- Liability risks
- Political risks
- Stock transit risks which include manufacturing and processing risks
- Coverage of inherent vice or nature of goods whatsoever
- Influence of temperature and humidity
- Storage risks (without voyage risks)
- Jewelers' Block Policies, precious stones and the like
- Living plants
- Explosives, war materials
- Antiques and curious works of Arts
- Timber, wood (sawn, logs or boards)
- Fishmeal
- Valuables (Jewellery, Gold Bullion & the like)
- Interior transit cover - where the imported consignment in respect of the ocean voyage is not covered with the Company.

6. TREATY EXCLUSION:

- Business Interruption and Consequential Loss
- Livestock
- Rejection risks
- Storage Risks written as such
- Vegetables & Fresh Fruits
- Bulk cargo like oil, sulphur, coke, coal, fertilizers, ores, pig iron scrap etc.

iii. PERSONAL ACCIDENT TAKĀFUL SCHEME

1. INTRODUCTION:

The Company presently transacts seven types of Personal Accident Takāful Scheme essentially to cater for the different needs and demands of the market. The types of Personal Accident Takāful offered by the Company are:

a. Personal Accident Takāful
b. Group Personal Accident Takāful

c. Group Personal Accident (Short Period) Takāful
d. School Children Personal Accident (TPSM)
e. Religious School Children Personal Accident (TPSA)
f. UMRAH Takāful Scheme
g. Mass Mailing

2. SCOPE OF COVER:

The Scheme compensates the Person covered should be suffer '*bodily injury'* caused by *Violent, Accidental, External and Visible Means*. If the injury results in 'death or disablement' then the Company will compensate according to the Table of Benefits as outlined in the certificate.

2.1 *Definition*

I. "Bodily injury" - injury to the body and excludes injury to feelings/emotions.
II. "Violent" - not implying actual violence but includes any external impersonal
III. Cause e.g. drowning or inhalation of gas or even undue exertion.
IV. "Accidental" - an untoward event or unlooked-for mishap which is not planned expected or designed. This excludes disease or any form of intentional act by the person covered by it would cover negligence.
V. "External and Visible Means" any cause which is not internal and for this purpose of this Takāful any external cause would be or deemed to be visible for purposes of the Certificate.
VI. "Intoxication" means where a man's conduct is being influenced by liquor or drugs that he has consumed resulting in the disturbance to the balance of his mind or intelligent exercise of his faculties.

2.2 Territorial Limits - world-wide.

3. EXCLUSIONS:

I. Hazardous sports - water ski jumping, polo, hunting, mountaineering necessitating ropes, or guides, parachuting, racing of any kind other than on foot, wrestling, boxing, motor.
II. Use of wood-working machinery driven by mechanical/electrical power
III. Pre-existing physical or mental defects
IV. Suicide/self injury

V. Disease and sickness
VI. Intoxication by alcohol or drugs
VII. Pregnancy or miscarriage or childbirth
VIII. War and kindred perils
IX. Whilst committing any unlawful act
X. Nuclear related risks

4. CLASSIFICATION OF OCCUPATION AND BENEFIT:

The profession, occupation or business of the Person Covered is a major factor in determining his risk and probability of accident. For all Personal Accident except Travel Personal Accident Takāful occupations are classified under the headings set out below. Different rates are charged for each of these classifications, reflecting the degree of exposure, via:-

Class I - All persons engaged in Professional and/or Administrative, or any personnel occupation but who are neither supervising nor engaged in manual labor. Examples: doctors, lawyers, accountants, clerks, shop owners, dentists, nurses, surgeons, architects, teachers.

Class II - Persons supervising but not actually engaging in manual labor. Examples: mine managers, foremen, planters' contractors (not working themselves) clerks-of-work, industrial clerks, printers, storekeepers, tailors, and waiters.

Class Ill - Persons who are either generally or at any time engaged in manual labor. Examples: bus conductors, drivers, carpenters, electricians, farmers, fishmongers, hawkers, mechanics, plumbers, rubber estate workers and shop assistants.

N. B. To ensure that an appropriate and correct Takāful Contribution is obtained for each risk, it is necessary for the Participant's Occupation and Nature of Business to be described as fully as possible on the Proposal Form.

Should there be is any doubt on the classification comes; reference must be made to the Underwriting Department before a quotation is made.

5. REFERRED RISK

- Foreigners/Expatriates

6. DECLINED RISKS:

The list hereunder covers all types of declined risks of Personal Accident Takāful Scheme, via:-

6.1 People or Persons suffering from Diseases/Disabilities as follows:

- Acute Rheumatism Hydrocephalies
- Apoplexy Locomotor Ataxia
- Blindness (in both eyes) Meningitis
- Cerebo Spinal Meningitis Myxedema
- Diplopia (double sight) Neurasthenia
- Deafness (in both ears) Paralysis
- Epilepsy Phthisis (consumption)
- Heart Complaints
- Pneumonia (unless free for one year since complete recovery Infections of the Kidney, Urinary Organs or Stomach).
- Persons with any physical defects or abnormalities.

6.2 Declined Occupation

1. Acrobat/Actor
2. Animal Trainer or Attendant
3. Automobile Racing Driver and race-track employees
4. Airline Personnel other than Ground Crew
5. Army Personnel
6. Construction workers (engaged on breakwaters, bridges, dams, docks, gasometers, harbors, jetties, locks, moles, pier, reservoirs, retaining walls, shafts, steeples, subways, towers and tunnels)
7. Law Enforcement Officials
8. Demolition Workers
9. Detectives
10. Divers/Frogmen
11. Explosive Workers (including explosives chemists, handlers or custodians)
12. Firemen
13. Foresters engaged in felling, sawing or carting trees

14. Mine employees (underground) or persons engaged in pit or mine
15. Mountaineers
16. Musicians/Entertainer
17. Police or Prison Warders or similar occupations
18. Quarry workers
19. Professional Sportsmen
20. Seamen
21. Security Guards
22. Stevedores
23. Underground Workers
24. Window Cleaners
25. Woodworking Machinists
26. Betting Shop Operators
27. Workers on oil rigs/platform
28. Travel Agency business
29. Travel card, charge card & credit card business

7. UNDERWRITING CONSIDERATION:

I. Diseases/Physical Disabilities:

Persons who suffer from certain physical disabilities or who have a history of certain illnesses are considered as poor risks. Great care must be exercised when dealing with proposals which disclosed any physical infirmity especially when the proposal reveals that the proposer suffers or has suffered from any disease infirmity or deformity which may be of a recurrent nature or is likely to affect agility or to protract disability in the event of an accident.

II. Ambiguous Occupation:

Where occupations are stated ambiguously eg. Director or Merchant, the staff must ascertain from the prospective Participant. The actual and exact description of duties to enable correct rates to be charged and to avoid any Lakewood of repudiating claims due to misrepresentation.

III. Abnormal Risk:

The following abnormal risks may be acceptable subject
To special terms. In all cases the proposal must be submitted to the Corporate and Broking Department together with a copy of Medical Report detailing the extent of the disability.

a. Blindness of One Eye

if condition is long standing and sight of the other eye is sound, risk can be accepted subject to a loading of 25% with an endorsement that in the event of loss of the remaining eye, compensation will be payable on the basis of loss of sight of one eye only or 50% of the benefit available.

b. Loss of One Arm

Rate should be loaded by 25% and with endorsement providing that loss of the other limb will constitute compensation on the basis of loss of one arm only for 50% only.

c. Rupture or Hernia

Accept with care. Cover to be endorsed excluding liability for any condition or complication arising out of or connected with Hernia.

d. Deafness of One Ear

Provided that the other ear is sound acceptance normally at normal terms subject as usual that loss of the other ear will be payable on the basis of loss of one ear.

IV. Before the participation is accepted, the proposal must be fully completed and duly signed and there should not be any compromise even if the proposal is presented at the last minute.

V. Every participation must be specifically stated on certificates/cover notes as assumptions are totally not acceptable.

iv. FIDELITY GUARANTEE TAKĀFUL SCHEME

1. INTRODUCTION:

1.1 This Takāful Scheme is to protect an employer against the infidelity i.e. dishonesty of his employee. In the normal course of business transaction an employer invariably has to entrust money, securities, goods etc. to his employee or delegate monetary responsibility to the employee. In the event that the employee is dishonest, the employer would most certainly suffer financial loss.

1.2 Examples of Indemnity

Theft, misappropriation of funds, false conversion of money or stock or forgery.

2. SCOPE OF COVER:

The Scheme indemnifies the employer, who is the Takāful participant for direct pecuniary loss due to all acts of fraud or dishonesty or forgery or embezzlement committed by any of his employees,

a. during the Period of Takāful;
b. during the uninterrupted continuance of employment of the said employee;
c. In connection with the occupation and duties of the said employee.

<u>2.1 Important Note:</u>

The Scheme pays only one claim per person. The sum covered stands reduced in correspond to the amount of claims paid.

<u>2.2 Discovery Period:</u>

The act of fraud or dishonesty must be discovered either during

a. Period of Takāful ;
b. Within three months from its expiry ; or
c. Within three months after the death, dismissal or retirement of the employee whichever event shall first happen.

<u>2.3 Types of Cover:</u>

a. Named Basis:

   The Scheme covers the dishonesty of individual persons named in the Certificate e.g. Halim or Halimah.

b. Positions or Designation Basis:

   It is the position of the employee that is covered e.g. Cashier, Accountant, Storekeeper etc. The advantage of this basis is that when one employee leaves and another takes over there is no necessity to amend the Certificate or notify the Company as the new employee will be automatically cover under the same Certificate.

c. Blanket Basis:

The Scheme covers all employees irrespective of a position or occupation against dishonesty. The Takāful contribution is usually adjustable upon expiry based on the number of employees to be covered.

2.4 Sum Covered:

There are two ways to fix this limit which is always on per incident and per aggregate basis and they are:

a. Limit per Person Basis:

This is commonly used for Named Basis wherein the Participant can identify the areas where he may suffer pecuniary loss.

b. Limit on Blanket Basis:

This is usually for Certificate issued on a Position Basis or Blanket Basis.

3. PRINCIPAL EXCLUSION:

a. If the nature of the employer's business or if the duties and conditions of employment have changed;
b. Any consequential loss;
c. Shortage due to error or omission and/or accounting error;
d. Unexplained or unaccountable losses or disappearances;
e. If the remuneration of the employee has reduced without the sanction of the Company;
f. If the precautions and checks for securing accuracy of accounts are not observed.

4. REFERRED RISKS:

Banks/Financial Institutions

5. DECLINED RISKS:

a. Proposals must be declined if there is reason to suspect the existence of the following among employees to be covered or the nature of the participant's business comprising the activities listed hereunder: -
    - Excessive drinking.
    - Dissipation or undesirable associates.
    - Gambling or speculation.

- Outstanding debts.
- Living beyond means.
- Insufficient or uncertain income (remuneration by commission etc.)
- Relatively heavy financial responsibilities including sureties for loans.
- Betting shops/Lotteries
- Jewelers
- Money changers lenders
- Security Companies
- Employers acting in dual capacity

b. Proposal must be declined if the employee to be covered is suspected to be:

- A collector for a hire purchase firm, money lenders etc.
- A new or used-car salesman.
- A commercial traveler, canvasser or collector.
- Remunerated by commission, part of profit etc.
- A minor unless counter securities can be obtained.

c. Turf Club employees.

d. Pubs & Bars.

e. Gambling premises

f. Share & Stock market traders.

g. Security Guard firms.

h. Proposals from sources not having other business with the Company.

i. Finance Companies.

6. TREATY EXCLUSION:

a. Jewelers, Furriers, Pawnbrokers, Watchmakers

b. Supermarkets, Banks, Travel Agents

c. Goods in Transit in respect of Wines, Spirits and Tobacco

7. UNDERWRITING CONSIDERATION:

Acceptance of a proposal shall depend upon the following consideration:-

a. the system of check in force is adequate

b. the moral hazard of the employee

c. if possible the underwriter should make discreet enquiries as to the integrity of the employee and submit a confidential report to the Underwriting Department. The underwriter should also report on the credibility standing and reputation of the Employer.

d. The Underwriting Department will examine the system of checks as disclosed in the Proposal Form and where necessary make further enquiries about the employee. If the system of check in force is inadequate, or if there are grounds for suspecting ambiguity or evasion, the Proposal will be declined.

e. The points giving rise to concern should be discussed with the employer and if he is willing to amend the system of checks a new form incorporating details of the revised system should be obtained.

f. This Takāful Scheme must be extended on accommodation basis only i.e. should be part of overall package.

v. PLATE GLASS TAKĀFUL SCHEME

1. INTRODUCTION:

The Plate Glass Takāful Scheme covers breakage of fixed glass in commercial and industrial premises, public buildings business complexes etc. This Takāful Scheme has become more popular now as more buildings / premises are largely fitted with glass panels.

2. SCOPE OF COVER:

The Company will pay or make good to the Participant on the glass covered against breakage subject to limit as specified in the Schedule of the Takāful Certificate.

3. PRINCIPAL EXCLUSIONS:

- Fire, lightning, earthquake and explosion
- War and kindred risks
- Riot and civil commotion
- During transit to or while being affixed to or removed from or during the course of alteration on the premises.

4. REFERRED RISKS:

a. When the building is largely constructed of glass.

b. Where the premises adjoining vacant building land, or in an area facing abnormal exposure to wind.

5. DECLINED RISKS:

a. Area noted or publicly known for acts of vandalism, malicious damage or crime.
b. Premises which are empty or not in normal occupation.

6. UNDERWRITING CONSIDERATION:

Only risks in good class area, and having no undesirable features should be accepted.

vi. MOTOR TAKĀFUL SCHEME

1. INTRODUCTION:

1.1 At present, Motor Takāful Scheme represents a sizeable portfolio of the General Takāful Business of the Company. Though generally, experience of the conventional insurance shows adverse underwriting results of this portfolio Motor Takāful has been profitable to the Company. It will continue so provided underwriting procedure and discipline is strictly adhered to.

1.2 As a cardinal rule, the Company only accepts vehicles for private and social use only. This falls under two major types of cover, via :-

a. Private Car
b. Private Motorcycle

1.3 However, commercial vehicles may be accepted for selected corporate clients on accommodation basis only. The acceptance must be based on the following criteria:

a. Main or core activity of the participant is not transportation activity.
b. All other Takāful requirements of the participant at the Scheme are placed with the Company of which its total Takāful contribution exceeds the Motor contribution.
c. Good claims experience for past 3 years
d. Good and sound housekeeping particularly in relation to the maintenance and management of vehicles.

1.4 Cover for both private and commercial vehicles must strictly be rated in accordance with the Company's rating guide.

2. CASH BEFORE COVER (CBC):

Section 25 of the Takāful Act 1984 Malaysia, and regulation on "Assumption of Risks and Collection of Contribution" provide that contribution for Motor Takāful Scheme, must be fully paid and settled before acceptance. Therefore, all staff must strictly follow this regulation as non-compliance may render the staff guilty of the offence and shall, on conviction, be liable to a fine depending upon the policy of the company.

3. TYPES OF COVER:

3.1 Private Third Party:

The cover given to this class is:

a. Indemnity to participant or his authorized driver against any liability which may attach to him in consequence of any third party being injured/death by the use of his vehicle.
b. Indemnity for liability in respect of damage to properties belonging to a third party in consequence of the use of the vehicle covered.

3.2 Private Comprehensive:

3.2.1 Similar to 3.1 (a) and (b) above.

3.2.2 Indemnity to participant for the loss or damage to his the vehicle or its spare parts arising out of following events:-

i. accidental collision or overturning,
ii. collision or overturning caused by mechanical breakdown,
iii. collision or overturning caused by wear and tear,
iv. impact damage caused by falling objects provided not resulted from flood, typhoon, hurricane, storm, tempest, volcanic eruption, earthquake, landslide, landslip or other convulsion of nature is involved,
v. fire explosion or lightning,
vi. burglary, housebreaking or theft,
vii. malicious act,
viii. whilst in transit (including its loading and unloading) by :

a.Road rail inland waterway

b.Direct sea route across the straits between the island of Penang and the mainland.

4. PERIOD OF COVER:

4.1 For new business or first-time participations the period of cover must be for one year period.

4.2 A six-month period of cover may be accepted for renewal but should not be encouraged. The contribution should be calculated on pro-rata basis.

5. COMMON EXCLUSION:

I. Consequential loss, depreciation, wear and tear, mechanical or electrical breakdown, failures or breakages.
II. Damage to tyre unless vehicle is damaged at the same time.
III. Any loss or damage outside Geographical Area.
IV. Flood, typhoon hurricane or convulsion of nature.
V. Strike, Riot, civil commotion.
VI. Compensation awarded in respect of judgments delivered outside Malaysia, Singapore or Brunei.
VII. Legal liability to passengers.

6. TREATY EXCLUSION:

I. Tramways, trolley buses or motor vehicles of any kind running on rails or cables, waterborne vessels, aircraft, hovercraft and other vehicles not designed to run solely on terra firm.
II. Vehicles specially designed or adapted for military use.
III. Vehicles which are used at airports and air fields not only in exceptional cases (e.g. Tank vehicles, lift trucks, traction vehicles, supply vehicles of all kinds).
IV. Any racing, rally or speed trials or professional races of any kind with motor propelled vehicles and Personal Accident in respect of such vehicles.
V. Manufacturers' and/or dealers' stock at automobile factories and/or showrooms.
VI. Loss, damage or liability for goods conveyed in connection with any business on any vehicle covered by the Company.
VII. Taxis, self-drive hire vehicles and any other vehicles which are used for the carriage of passengers for hire or reward or for public transport except Private

Vehicles/buses owned by Institutions and used by own staff/clientele on trip basis are covered.

VIII. Contractors' plant and equipment not on a public highway.

IX. The ownership, operation, maintenance or use of any vehicle the principal use of which is the transportation of high explosives such as nitroglycerine or dynamite or any other similar explosive or chemicals or gases in liquid or compressed or gaseous form and the bulk transportation of liquefied petroleum or gasoline (use of a tank truck for the transportation of fuel oil not being excluded).

7. REFERRED RISKS:

a. Entertainers/Show persons/artists
b. Contractors
c. Hawkers

8. DECLINED RISKS:

Physically disabled Proposer.

a. Minors.
b. Provisional or no valid license holder (unless husband/wife where the spouse is main driver and hold valid driving license).
c. Proposer with endorsed driving license by court for road traffic offence.
d. Unfavorable claims experience.
e. Proposal rejected by other insurers.

High-performance or sports car.