TAKAFUL BASIC EXAMINATION (TBE) TEXTBOOK

Part A: Basic Takaful and Medical & Health Takaful

MALAYSIAN TAKAFUL ASSOCIATION

TAKAFUL BASIC EXAMINATION (TBE)TEXTBOOK

Part A: Basic Takaful and Medical & Health Takaful

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CHAPTER 1: FUNDAMENTALS OF SHARI'AH AND *MU'ĀMALĀT*

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Understand the concept of *Sharī'ah* and its application to Takaful.
- Understand 'how' the concept of contract in ***Mu'āmalāt*** explains the creation of the Takaful contract.

1.0 INTRODUCTION

The Arabic word '*Islām*' simply means 'submission'. In a religious context, it means complete submission to the will of *Allāh SWT. Islām* is not a mere religion but "*ad-dīn*", meaning 'the way of life'. It touches upon the material as well as spiritual dimensions of human existence. *Allāh SWT* emphasized the completeness of *Islām* in the following *Quranic* verse;

> ***Allāh SWT* says:**
>
> *"This day I have perfected for you your religion and completed My favor upon you and have approved for you Islām as religion"*
>
> *(al-Maidah: 3)*
>
> *Sahih International*

1.1 THE CONCEPT OF *ISLĀM*

The key elements of *Islām* comprise of *'Aqīdah* (a set of beliefs), *Sharī'ah* (a set of laws) and *Akhlāq* (a code of moralities). These are further elaborated below:

1.1.1 *'Aqīdah*

'Aqīdah literally means a knot. *'Aqīdah* generally refers to a firm belief in the fundamentals of *Islām* which is primarily centered on the pillars of *Imān*. It is a belief system that requires the highest degree of faith and acceptance without any doubt whatsoever. This faith (*'Aqīdah*) is founded on the belief in the Oneness of *Allāh SWT*, His Angels, His Messengers, His Books, the Hereafter and His Divine decree. From this foundation stems the entire concept of *Islām*, its rules and regulations as expounded in the *Qur'ān* and Prophetic traditions.

1.1.2 *Akhlāq*

It refers to the practice of virtue, morality, and manners in Islamic theology and philosophy. It consists of relationship between man and *Allāh SWT*, man and man, and, man and other creatures.

1.1.3 *Sharī'ah*

Sharī'ah is a set of rules derived from both the *Qur'ān* and the traditions (*Sunnah*) of the Prophet Muhammad (peace be upon him) and the scholarly opinions (*Ijtihād*) which are based on the *Qur'ān* and *Sunnah*. The concept of *Sharī'ah* is to govern man in the conduct of his life in order to realize the Divine will, and it covers behavior, spiritual, mental and physical aspects of life. Thus, the principles of *Sharī'ah* covers the total way of life that includes faith, practices, individual's behaviour, legal and social transactions.

Sharī'ah covers the subject of Islamic law called *Fiqh. Fiqh* is often described as the human understanding of the divine Islamic law and practices of the *Sharī'ah* which comprises of the following:

- *Fiqh 'Ibādat*: It governs the relationship between man and Allah (glorified and exalted is He). It includes praying (*ṣalāh*), fasting (*saum*), almsgiving (*zakāh*), and performing the pilgrimage (*hajj*).

- *Fiqh Munākahāt*: This relates to family law. This area deals with marriage, divorce, inheritance, guardianship and other related matters.

- *Fiqh Jināyat*: This relates to criminal law. This area deals with major offences like, theft (*sarīqah*), murder (qatl), unlawful sexual intercourse (zina) etc.

- *Fiqh Mu'āmalāt*: This covers the rules governing commercial transactions between the parties in the said transaction.

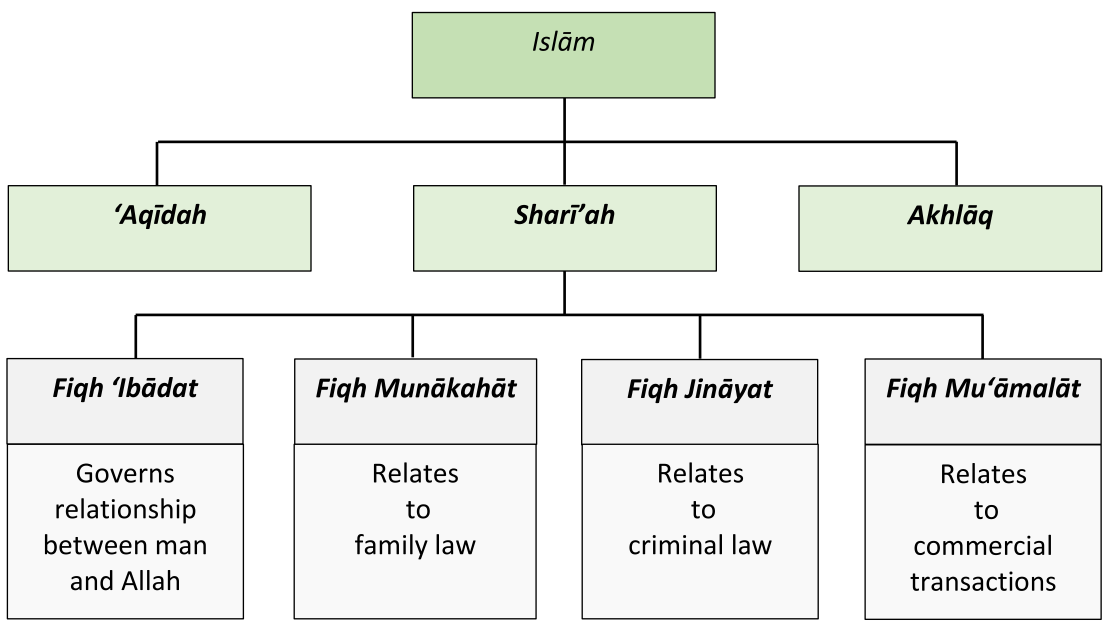

Figure 1.1: *Main Components of Islām*

1.2 THE SOURCES OF *SHARĪ'AH*

There are four sources of law under *Sharī'ah*. These are:

- The *Qur'ān* which comprises of the words of Allah that were revealed to the Prophet Muhammad (peace be upon him).

- The *Sunnah* which refers to all that is narrated from the Prophet Muhammad (peace be upon him) including his actions, sayings and whatever he has tacitly approved.

- *Ijmā'* which is a source of Islamic law and has a binding effect on the entire Muslim community. It arises from the agreement of the *mujtahidūn* (jurists) from among the community of Prophet Muhammad (peace be upon him) after his death.

- *Qiyās* is the extension of *Sharī'ah* rulings from an original case to a new case, because the latter has the same effective cause as the former but different circumstances. It may be loosely translated as analogy.

1.3 THE OBJECTIVES OF *SHARĪ'AH* (*Maqāṣid al Sharī'ah*)

Maqāṣid is the Arabic word for goals or purposes. In the Islamic context, it refers to the purposes of Islamic faith.

According to a prominent Muslim scholar Imam al-Ghazali, "the objective of the *Sharī'ah* is to promote the well-being of all mankind, which is safeguarding faith (*ad-dīn*), life (*nafs*), intellect (*'aql*), lineage (*nasl*) and their wealth (*māl*)". Whatever that ensures the sanctity of these five principles, will serve public interest, and is therefore desirable.

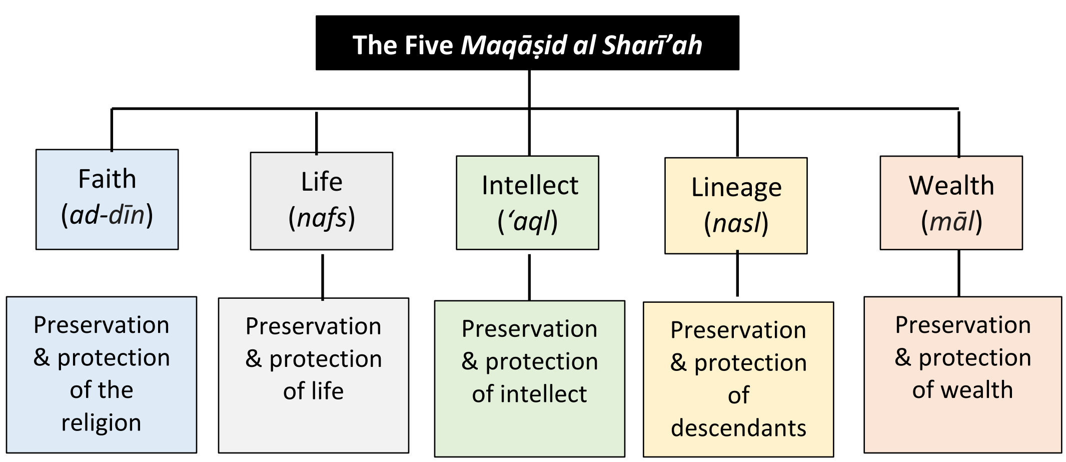

Figure 1.2: The five components of *Maqāṣid Shariah*

The five components mentioned above are described in Table 1.1 below.

Table 1.1: Description of the five *Maqāṣid al Sharī'ah*	
Religion	The preservation and protection of faith or religion *(ad-dīn)* under all circumstances. **Example:** Defending the Islamic faith particularly if it desecrated by enemies of *Islām*.
Life	The preservation and protection of life under all circumstances. **Example:** Prohibition of putting one's life in a detrimental situation.
Intellect	The preservation and protection of intellect and mind under all circumstances. Protection of mind requires safeguarding it from anything that might harm the ability and functions of the brain. **Example:** Drinking alcohol or taking drugs can be detrimental to one's mental capabilities.
Lineage	The preservation and protection of descendants and honor under all circumstances. **Example**: *Islām* prohibits adultery or other immoral behaviors.
Wealth	The preservation and protection of wealth i.e. property, non-property, cash, stock etc. through legitimate process under all circumstances. **Example:** The pro-active initiatives and planning in safeguarding one's property against misfortunes or disasters.

1.4 BASIC PRINCIPLES OF *MU'ĀMALĀT*

The source of *Sharī'ah* that is relevant to the operations of takaful is *Fiqh Mu'āmalāt.* The term "*mu'āmalāt* " (plural of *mu'āmalah*) means 'transactions'. It covers any form of mutual dealings held between men to solve their everyday needs, relating to trade and commerce. That is, socio-economic activities.

The major Islamic *Sharī'ah* schools of thought (*Ḥanafī, Mālikī, Shāfi'ī* and *Ḥanbalī*) are of the opinion that all economic activities are legally permissible as long as these activities do not transgress any of the tenets of *Sharī'ah*.

For *Sharī'ah* compliance, the basic principles that must be followed under *mu'āmalāt* are shown in Table 1.2 below.

TABLE 1.2: The Principles of *Mu'āmalāt*	
Principle	**Explanation**
General Rule of Permissibility	All matters other than rituals are permissible until evidence is given that a certain matter is prohibited.
Mutual Consent	A contract must be mutually agreed upon and the parties involved shall be free from any elements of coercion (force), fraud, misrepresentation or other illegal means.
Wide Circulation of Wealth	Wealth and property should be actively transferred from one hand to another and contribute to the circulation of wealth among the general public. Hoarding is prohibited.
Transparency in Commercial Dealing	All parties to a contract must be clear as to the terms and conditions of their dealings as specified in the agreement.
Justice and Fair Dealing	Contract must be just and fair to all parties in the agreement.
Custom is of Force	Contract terms that are in accordance with customs are permissible.
Freedom to Contract	People are free to insert conditions in their agreements. However, they are not allowed to prohibit something that is permissible or permit something that is prohibited in the contract.

1.5 CONCEPT OF CONTRACT IN *MU'ĀMALĀT*

Commercial law in *Islām*, *fiqh al-mu'amalat*, is regulated by Islamic jurisprudence with the principles of natural justice being at its foundation. The basis of all commercial activity is through the formation of contracts (also referred to as '*aqad*).

The *Islāmic* scholar, Barbati, defined "'*aqad*" (in his book "*Inayah 'ala Fath al-Qadri*") as:

"A legal relationship created by the conjunction of two declarations, from which flow legal consequences with regard to the subject matter".

To enter into a valid contract there are three (3) elements which need to be fulfilled:

1. Offeror and offeree (contracting parties)

It is a condition of a valid contract that one party (the offeror) makes an offer to another party (the offeree). Both parties must have the capacity to contract. Capacity is a quality which makes a person qualified for acquiring rights and undertaking duties and responsibilities as per the contract. To be legally competent to enter into a contract, the parties must have sound mental capacity and be at the age of puberty.

2. Offer and acceptance

For a contract to be formalized, there must be an offer (*Ijab)* by one party (the offeror) and acceptance (*Qabūl)* of that specific offer by another party (the offeree). Contracts can be entered into orally, in writing or by the conduct of the parties.

3. Subject matter and consideration.

A contract must have a specific subject matter which normally refers to the goods or services under the contract. The consideration is something of value that is exchanged for the goods or services. In most cases, the consideration is price that is paid for the good or services.

Subject matter of a contract must be:

- lawful,
- in existence, with the exception of both a deferred delivery sale (*bay' al-salam*) and contract of manufacture or projects (*istisna'*),
- not fabricated,
- deliverable,
- clearly determined in the contract, and
- the price must be pre-determined so as to not lead to uncertainty.

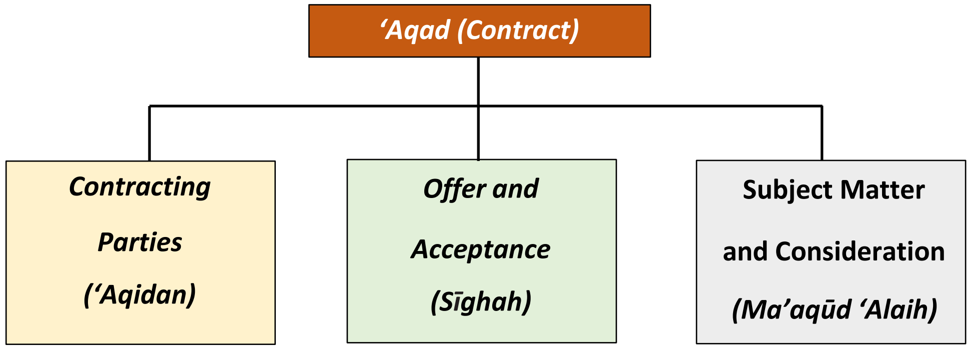

Figure 1.3: Essential elements of 'Aqad

What distinguishes Islamic contracts from the Western concept, is that, both the offer and acceptance must take place simultaneously at the same time and place ('*majlis al-'aqd*'). This is to avoid any ambiguity and disagreements taking place at a later date.

Contracts in Islam are prohibited by three salient injunctions which eliminate exploitation in transactions and prevent unjustified enrichment. These are the prohibition imposed by the presence of *Ribā (interest)*, *Gharār (uncertainty)* and *Maysir (speculation or gambling)* which will be discussed in Chapter 2.

CHAPTER 1	ASSESSMENT QUESTIONS

1. ‘*Aqīdah* generally refers to a firm belief in the fundamentals of *Islām* which are centered on

A. *Imān*
B. *Akhlāq*
C. *Jināyat*
D. none of the above is true

2. Select ONE of the following statements which is NOT TRUE.

A. *Fiqh ‘Ibādat* deals with the relationship between man and *Allāh* SWT.
B. *Fiqh Munākahāt* deals with the rulings related to family law.
C. *‘Aqīdah* deals with commercial behaviour and morality.
D. *Fiqh Jināyat* deals with rulings related to criminal law.

3. *Maqāṣid* is the Arabic word for goals or purposes and it covers all of the following EXCEPT

A. Faith
B. Lineage
C. Rationale
D. Wealth

4. The four (4) sources of *Sharī’ah* are

A. *Qur’ān, Sunnah, Ijmā’, Qiyās.*
B. *Qur’ān, Sunnah, Ijmā’, ‘Aqīdah.*
C. Qur’ān, Sunnah, Ijmā’, ‘Ibādat.
D. *Qur’ān, Sunnah, Ijmā’, Munākahāt*.

5. The term *“mu‘āmalāt ”* refers to

A. matters relating to morality.
B. matters relating to trade and commerce.
C. matters relating to personal behavior.
D. matters relating to conflicts.

CHAPTER 2: INTRODUCTION TO TAKAFUL AND INSURANCE

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Understand the difference between takaful and insurance.
- Understand how the elements of *Gharār, Ribā, Maysir* prohibits life insurance for Muslims.

2.0 INTRODUCTION

The Takaful Act, 1984 was legislated to pave the way for the introduction and regulation of takaful business in Malaysia. Since its inception, the Malaysian takaful industry has seen a rapid growth over the years and is now regarded as an important component of the Islamic financial system.

Prior to 1984, the life insurance industry was operated by conventional life insurance companies. The introduction of insurance in Malaysia dated back to the 18th and 19th century, where trading firms and agency houses acted as agents for insurance companies from the United Kingdom. When Malaya achieved its independence, there was an effort to establish domestic insurance companies. The early 1960's saw the growth of many life and general insurance companies. The Government introduced the Insurance Act, 1963, through which the general conduct and supervision of the insurance industry was vested in the Director General of Insurance under the Ministry of Finance.

At present, the regulation and supervision of both the Takaful and insurance business is governed by Bank Negara Malaysia under the Islamic Financial Services Act, 2013 (refer to 8.1.2 in Chapter 8 for further information) and Financial Services Act, 2013 respectively.

2.1 DEFINITION OF TAKAFUL

The word "Takaful" is derived from the Arabic verb *"Kafālah"* which means to jointly guarantee. According to the Islamic Financial Services Act 2013, Takaful is defined as:

"An arrangement based on mutual assistance, under which, takaful participants agree to contribute to a common fund providing for mutual financial benefits, payable to the takaful participants or their beneficiaries, on the occurrence of pre-agreed events".

The contributions by individuals to the Takaful fund is referred to as *tabarru'* or donation. Takaful is based on *Sharī'ah* or Islamic law, which explains how individuals can cooperate and protect each another from calamities. Its underlying thought promotes:

- Mutual responsibility
- Brotherhood, and
- Solidarity of society

Ta'awun is the willingness to help other individuals without being asked and expecting rewards from Allah (SWT). That is, voluntary mutual assistance. It is the foundation of the risk sharing mechanism in Takaful. It encourages piety (*taqwa*) and cooperation towards good causes.

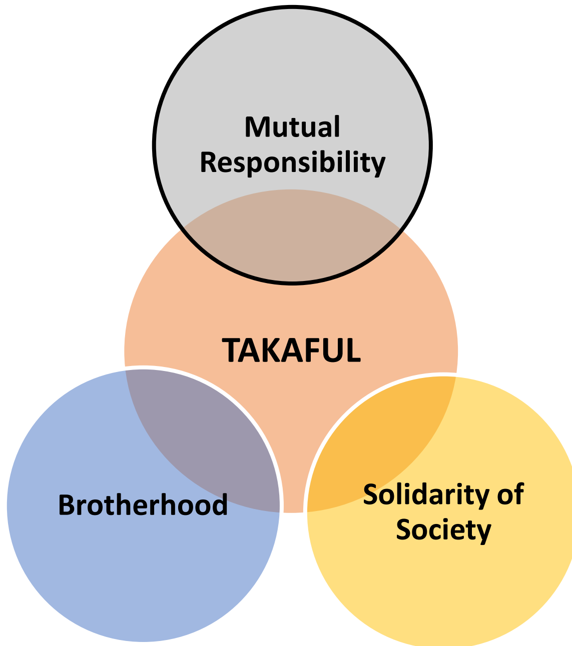

Figure 2.1: Takaful Philosophy and Concept

2.2 BENEFITS OF TAKAFUL

From the physical and financial perspectives, the following are the benefits of Takaful: -

- It provides financial protection and security for a family against financial loss caused by the death of a breadwinner. It provides an avenue of ensuring the maintenance of the life-style of beneficiaries.
- It provides property owners financial protection and security against financial loss caused by damage to their properties.
- It helps the participants to prepare sufficient income for themselves and their dependents to maintain their standard of living if permanent disability strikes.
- It helps prevent the dilution of current assets, such as residential properties and investments, due to hospital and medical expenses.

- It allows the participants to fulfill their social obligation towards the community and family.
- It provides financial assistance for the unfortunate and needy through the concept of *tabarru'* where a part of the contribution will be apportioned to the risk fund.

- *Zakāt* (tithe) and corporate tax paid by takaful operators can be used for the purpose of community development and nation building.

From the spiritual perspective, the benefits of takaful include: -

- The element of *tabarru'* or donation which provides an opportunity to the participants to gain the pleasure, blessings and rewards from *Allāh*. Donating part of their wealth for the purpose of helping others in need will be counted as good deeds on the Day of Judgment.

- Promotes moral values and ethical dealings in all its business activities and operations as it is free from the elements that are prohibited by *Sharī'ah* such as *Ribā*, *Gharār* and *Maysir*. It helps the participants to have clarity and peace of mind.

2.3 CONCEPT OF INSURANCE

On the other hand, the concept of insurance essentially states that a group of individuals exposed to similar risk come together and pays premiums to the insurer towards the formation of an insurance fund. Thus, insurance is a sale contract between two parties, where the insurer sells protection while the insured pays the premium. It is a medium through which the financial burden of a misfortune is transferred from the insured to the insurer. There is no mutuality or agreement among the insureds. In case an individual person suffers a loss on the occurrence of the covered risk, he is compensated by the insurer out of monies from the fund.

According to Financial Services Act 2013, insurance business shall be divided into two classes:

- Life business, which shall include any type of insurance business carried on as incidental only to the life insurer's business; and

- General business, which means all insurance business which is not life business.

A contract of general insurance is a contract of indemnity and this principle aims to put the insured in the same financial position as he was in before the misfortune occurred. The sum insured is fixed at a level, which will provide an adequate compensation at the time of loss. A contract of indemnity does not cover life insurance and personal accident insurance.

For the purposes of the Act, reinsurance of liabilities under a policy is treated as insurance business of the class and description to which the policy would have belonged if it had been issued by the reinsurer (so it is classified as either life or general insurance business).

2.4 BENEFITS OF INSURANCE

From the physical and financial perspective, the following are the benefits of insurance: -

- It provides financial protection and security for the family against financial loss caused by the death of a breadwinner.

- It provides financial protection and security for the property owners against financial loss caused by the damage of their properties.

- It helps the participants to prepare sufficient income for themselves and their dependents to maintain their standard of living if permanent disability occurs to the person covered.

- It helps prevent the current assets like residential properties and investments from being diluted to fund hospital and medical expenses.

- Corporate tax paid by the insurance companies can be used for the purpose of community development and nation building.

From the personal and spiritual perspective, insurance helps create peace of mind. This comes from the realization that the policies the insured owns, will help the family to maintain a reasonably comfortable lifestyle and protect them from financial loss should pre-mature death, illness, disability or damage to properties occurs.

2.5 *SHARĪ'AH* RESOLUTION ON INSURANCE

The concept of insurance (as practiced currently) has not received consensus from Islamic scholars as to its permissibility. As such '*Ijtihād*' has been used to determine whether it is permissible (*ḥalāl*) or prohibited (*harām*).

2.5.1 Fatwas on Prohibition of Insurance

1. The National Fatwa Committee

The Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia, during its' meeting on 15 June 1972, discussed and deliberated on the issue of permissibility of life insurance.

It was resolved that:

"Life insurance provided by life insurance companies is a business transaction which is voidable because it contradicts Islamic business principles as it contains the elements of *gharār, maysir* and *ribā*. As such from the *Sharī'ah view*point, insurance is *harām*".

2. The Islamic *Fiqh* Academy of OIC

The Islamic *Fiqh* Academy, emanating from the Organization of Islamic Conference, met for its Second Session in Jeddah, Kingdom of Saudi Arabia, from 10 to 16 *Rabiulawal*, 1406 H (corresponding to 22 - 28 December 1985). A review of the presentations made by the participating scholars during the Session on the subject of `Insurance and re-insurance' was undertaken. By closely examining all types and forms of insurance, the basic principles upon which they are founded, their goal and objectives, and what has been issued by the *Fiqh* Academies and other edifying institutions in that regard;

It was resolved that:

"The Commercial Insurance Contract, with a fixed periodical premium, which is commonly used by commercial insurance companies, is a contract which contains major element of risks, which voids the contract and therefore, is prohibited (*harām*) according to *Sharī'ah."*

The alternative contract which conforms to the principles of Islamic dealings is the contract of co-operative insurance, which is founded on the basis of charity and co-operation.

2.6 PROHIBITED ELEMENTS IN INSURANCE

The three elements, namely, *gharār, maysir* and *ribā* are prohibited elements present in an insurance contract which renders the contract as *harām*.

2.6.1 *Gharār*

The Arabic word *Gharār* is a fairly broad concept that means deceit, risk, fraud, uncertainty or hazard that might lead to destruction or loss. *Gharār* in Islam refers to any transaction of probable objects whose existence or description is not certain, due to the lack of information and knowledge of the outcome of the contract or the nature and quality of the subject matter of the contract.

A contract is presumed to have elements of *gharār* when:

- The parties are unsure as to the certainty of the event, that is, whether such an event will or will not occur.
- The subject matter is not within the knowledge of the parties.
- There is no certainty as to the existence of the subject matter.
- Its acquisition is in doubt.
- Its quantum is unknown.

It should be noted that uncertainty cannot be removed from the business transactions totally. Thus, *Sharī'ah* scholars have differentiated between major and minor *gharār*.

The minor *gharār (Gharār Yāsir)* which is not avoidable in financial transactions is permissible and would not affect the validity of contract. For example, it is not possible to know whether each nut in a sack of nuts offered for sale is of edible quality, yet this is a minor *gharār* (the buyer can of course test a few of the nuts before buying) and so the sale of nuts in a sack is generally permitted.

However, the major *gharār* (*Gharār Fāhish*) is so vague that there is no means of quantifying it. As such it is not permissible. An example will be the when two parties undertake a transaction for a future sale - meaning undertaking the transaction now but the item(s) of sale and the price will both be determined at a future time.

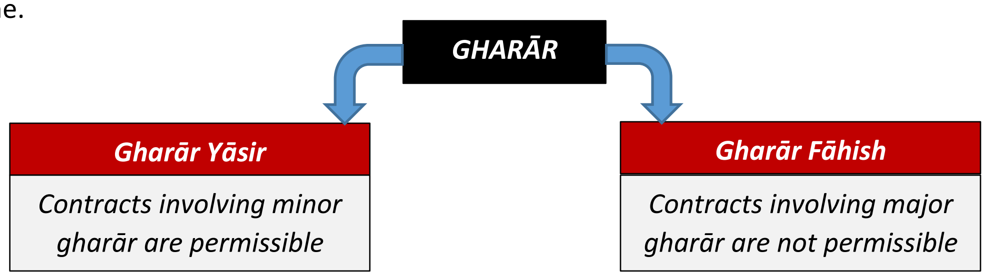

Figure 2.2: Types of *Gharār*

2.6.1.1 *Gharār* in insurance

In the case of insurance, *Gharār* is said to exist because:

- Neither the insurer nor the insured knows outcome of the contract. Result of the exchange is uncertain at the point of contract is made,

- In the case of general insurance, the insured does not know the amount of compensation he is likely to get in the case of an accident or a peril.

- The insurer nor the insured know when peril will occur.

- There is no equity in insurance. The insured is required to pay the premiums, but if the peril insured against does not happen, the insured will not be paid anything at all. So, the insurance company, may or may not have to pay any compensation. On the other hand, if the insured event occurs, the insurer may end up paying more than the premiums that were collected from the insured.

2.6.2 *Maysir*

The term '*Maysir*' means gambling. Islam prohibits all forms of gambling. *Maysir* refers to the easy acquisition of wealth by chance, whether or not it deprives the other's right. For example, the uncertainty of the timing of benefits of a life insurance contract creates an element of *Maysir*. In insurance, *Maysir* is said to exist because:

- The insured could receive huge amount of money, without an equivalent input of premiums.

- There is the possibility of paying premiums without getting any amount in return.

- The insurer loses if there are too many claims where the premium amount collected is insufficient.

- When the premium collected exceeds the claims, the insurers could make huge profits.

2.6.3 *Ribā*

Ribā in Arabic literally means an increase, expansion or growth. In *Islāmic* jurisprudence, it refers to unjustified increase in the eyes of *Sharī'ah.*

Ribā refers to any benefits that arise out of a loan contract or transaction that involves usurious (r*ibāwi*) items

In a hadith, **Prophet *Muhammad SAW*** declared**:**

'Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, and salt by salt - like for like, equal for equal, payment being made on the spot. If the species differ, sell as you wish provided that payment is made on the spot'.

Following the above hadith, ribawi items can be classified into two main categories as follows:

(a) As a measure of value (al-thaman). This refers to gold and silver which are used as currency to measure value of items valuable for sale and purchase. The modern currency (in the form of paper money) is classified as a *ribā*wi item because it acts as a measure of value and medium of exchange.

(b) Staple and storable food. This is represented by wheat, barley, dates and salt which are used as staple and storable food. In the Malaysian context, rice would be included as a *ribā*wi item as it is the main staple food in the country.

Direct Quranic references on *ribā* are also found in four surahs (Al-Rum, 30:39; Al-Nisa, 4:161; Ali-Imran, 3:130 and Al-Baqarah, 2:275-9).

For the purposes of this text, reference is made to the debt based *ribā* and the sales based *ribā*.

2.6.3.1 Debt-Based *Ribā (Ribā Duyūn)*

In general, *ribā al-duyun* is any excess or additional benefit charged or paid as consideration in a lending or borrowing transaction above the principal amount. The types of *Ribā Duyūn* are described in the figure below.

Ribā Duyūn	*Ribā Qard*	Refers to any benefit imposed upfront by virtue of lending money regardless of whether the borrower will default in the future or not.
	Ribā Jāhiliyyah	An additional benefit imposed on the borrower attributed to the borrower's default in repaying the sum borrowed within the stipulated time.

Figure 2.2: Types of *Ribā Duyūn*

2.6.3.2 Sale-Based *Ribā* (*Ribā Buyū'*)

It occurs in trading and exchange transactions, in which unequal exchange of r*ibāwi* items is made and comprises of the following:

a. *Ribā Fadhl which is the* exchange of ribāwi items of different measurement

b. Ribā Nasī'ah where the payment for the *ribāwi* items traded is not made on an immediate basis.

The following rules of exchange apply in deciding whether transactions will fall under *Ribā Fadhl* or *Ribā Nasī'ah*.

Rule 1:

Exchange between *ribāwi* items of the same kind (and of the same basis) must be made with equal weight, measurement, number or payment and the delivery must be made at the same time.

- If payment and delivery are made at the same time but the weights, measurements or numbers of the materials exchanged are not equal, then *Ribā Fadhl applies*.
- If payment and delivery are not made at the same time but the weights, measurements or numbers of the materials exchanged are equal, then Ribā Nasī'ah *applies*.

Rule 2:

Payment and delivery between *Ribāwi* materials of different kinds and of the same basis must be made at the same time, though they may be made at different prices. Equal weights, measurements or numbers of the materials exchanged are not required to be observed here.

- If payment and delivery are not made at the same time (simultaneous), then Ribā Nasī'ah occurs.

Table 2.1: Description of *Ribā Buyū'*

Type	Description
Ribā Fadhl	Due to unequal amount or quantity
Ribā Nasī'ah	Due to deferment in time of counter values (ribawi item) that belong to: 1. The same basis/genus *(jins)* and same kind *(nau')* **Example**: gold and gold; or 2. The same basis/genus *(jins)* and different kind *(nau')* **Example**: gold and silver

A summary of the types of *Ribā* is shown in Figure 2.3 below.

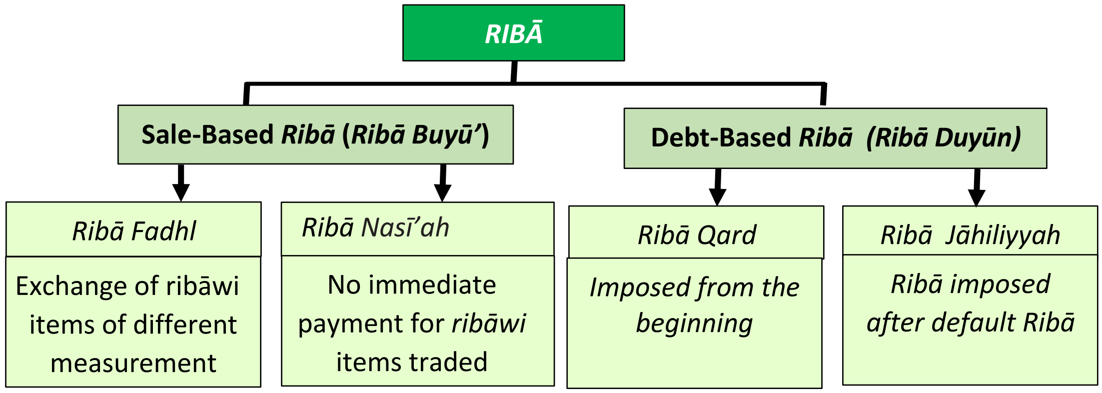

Figure 2.3: Types of *Ribā*

2.6.3.3 *Ribā* Elements in Insurance

1. Ribā Fadhl

- Exchange of two *ribāwi* items (monetary compensation and insurance premium) at different values.

2. Ribā Nasī'ah

- Exchange of the insurance premium and monetary compensation at different times.

3. Ribā Duyūn

- Interest charged on late payment of premium;
- Interest charged on policy loans;
- The insurance company invests the premium in interest bearing investments;
- The insurance company pays interest on their life insurance product; and
- The insurance company considers future interest when calculating the premium.

2.7 COMPARISON OF TAKAFUL AND INSURANCE

A summary of the main points of comparison between takaful and insurance is shown in Table 2.2.

Table 2.2: Comparison of Takaful and Insurance

Element	Takaful	Insurance
Essence of Intention	Intention is to create both spiritual and legal relationships.	Intention is to create legal relations only.
Subject Matter	Subject matter must be *Sharī'ah* compliant.	Subject matter must be Common Law compliant.
Guarantee	The Takaful Operator is only the Fund Manager. The Participant mutually guarantees each other.	Insurance company provides the guarantee.
Fund	The fund belongs to the participants and managed by the Takaful Operator for an agreed fee for the services rendered.	The fund belongs to and is managed by the Company. The fund is kept separate from the shareholder's fund.
Payment of contribution/ premium	Part of the contribution becomes a *tabarru'*.	Paid premium creates an obligation on the insurer through a 'sale and purchase' contract.
Forbidden Elements	Takaful is based on Islamic principles and free from any of the forbidden elements.	Insurance policy contains the element of *Gharār, Ribā and Maysir.*
Profits	The profit and/or surplus is shared among the participants.	The profit is distributed at the discretion of the company.

CHAPTER 2 | ASSESSMENT QUESTIONS

1. The word "Takaful" is derived from the Arabic verb

A. *"Kafālah"*
B. *"Ad-dīn"*
C. *"Akhlāq"*
D. *"'Aqīdah"*

2. Some of the benefits of Takaful are listed below. Select the option that is FALSE

A. It allows the participant to fulfil his social obligation towards the community and family.
B. It provides financial assistance for the unfortunate and needy through the concept of tabarru' .
C. It provides protection and security for the family and the group against any misfortune.
D. Not all of the above are TRUE.

3. *Tabarru'* is an Arabic word that means

A. sharing
B. mutual help
C. donation
D. consent

4. The elements prohibited by *Sharī'ah* in *Mu'āmalāt* are ____. One of the following options is <u>FALSE</u>

A. *Ribā* (Usury)
B. Gharār (Uncertainty)
C. Fiqh (Commercial controls)
D. Maysir (Gambling)

5. *Ribā Buyū'* refers to

A. trading and exchange transactions in which unequal exchange of *Ribāwi* items of same kind and same basis.
B. unjustified increment in money lent whether in kind or cash over and above the principal amount.
C. an additional amount imposed on the borrower attributed to borrower's default in repaying the sum borrowed with the stipulated time.
D. any benefit imposed upfront by virtue of lending money regardless whether the borrower will default in the future or not.

CHAPTER 3: CONCEPT OF RISK IN TAKAFUL

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Understand the relationship between risk and takaful
- Understand the concept of risk management under *Shari'ah*
- Describe the relevance of risk management in meeting risk mitigation objectives

3.0 INTRODUCTION

Risk is the outcome of uncertainty which causes a loss. Facing a risk is an everyday phenomenon, from cutting oneself during shaving in the morning, or slipping and falling in the bathroom, being involved in a road accident, or dying prematurely due to a sudden heart attack. In evaluating the impact and consequences of a risk, there are two (2) factors that have to be taken into account, namely:

- The probability of the risk occurring (loss frequency); and

- The consequences of the occurrence of the risk (loss severity).

The key is to understand the relationship between these two factors. High frequency and low severity risks are not significant, but a low frequency and high severity risk can be disastrous as shown in Table 3.1 below.

Table 3.1: Examples of the relationship between the risk factors

A minor cut on a finger while cutting vegetables	Plane crash
High frequency	Low frequency
Low severity	High severity

For a risk to be covered by Takaful, the focus is on risks that have a loss severity sufficient to cause a financial burden on an individual or business (see Section 3.3 below). Examples of risk factors in takaful are weight, health condition, lifestyle, type of occupation, type of hobbies, frequency of travel etc.

While risk is mostly viewed from a negative perspective, the ability to recognize risk and manage it can lead to a positive outcome. For example, while the risk of smoking is an established fact, a smoker who recognizes the risk and quits smoking will have a positive outcome.

3.1 CLASSIFICATION OF RISKS

Generally, risks are classified into distinct categories as shown in Table 3.2 below.

Table 3.2: Classification of risks		
Type of risk	**Description of risk**	**Examples**
Pure risk	**A risk where there is a loss or no loss**	**Fire, Accident, Illness.**
Speculative risk	**A risk where there is a loss, no loss or gain**	**Investments**
Fundamental risk	**A risk that affects the whole community or a large number of people within the community.**	**Flood, Earthquake, Pandemic**
Particular risk	**A risk that affects an individual**	**Fire, Accident, Theft**

3.2 CONCEPT OF RISK IN TAKAFUL

In takaful, when the term 'risk' is used, it generally refers to the likelihood of an event happening and the consequent possibility of a financial loss arising from that event. A financial loss may be defined as a decline in or disappearance of value suffered as a result of the contingent event.

As stated in Section 3.0 above, risk and its consequence are an everyday phenomenon. It is pertinent to note that not all risks are covered by takaful. The characteristics of the risks that can be covered by takaful are described below:

- **Pure risk**

Only pure risks, where there is a loss or no loss, are covered under takaful. For example, a person can be covered for a medical contingency under a takaful medical plan. If the person is suffering from a minor ailment and is cured at home, there is no loss. However, if the ailment is serious, and the person needs to be admitted in hospital for treatment, then there is a financial loss to the person concerned.

- **Pecuniary**

The risk must involve a potential loss that can be financially measured (e.g., fire damage to homes, or payment of hospital charges, or the payment of a lump sum upon the pre-mature death of an individual).

• **Particular risk**

The risk must be a risk that affects individuals or an entity. Takaful is related to covering the financial loss suffered by an individual or a business.

• **Homogenous risk**

Takaful Operators will look for homogeneous or similar exposures based on the law of large numbers in order to forecast the probability and expected extent of the associated loss arising from the exposures. The law of large numbers states that as the number of loss exposures increases, the predicted loss tends to approach the actual loss. However, the law of large numbers will apply if the following conditions are met:

- the loss exposures must be independent, and
- there is a random or chance occurrence of the loss.

• **Fortuitous**

The happening of the event must be entirely by unforeseen circumstances and random in nature. The frequency and severity of any such risk must be beyond the control of the insured (for example, the demise of an individual, or the occurrence of an accident).

• **Public policy**

An act against public policy (an act which the public opines to be right and good in the interest of the public at large) or one which contravenes the law cannot be covered under takaful. For example, a drug dealer who loses his drugs in a fire cannot claim for the loss, or a person who was fined for drunk driving cannot be covered for the payment fines and penalties for breaking the law.

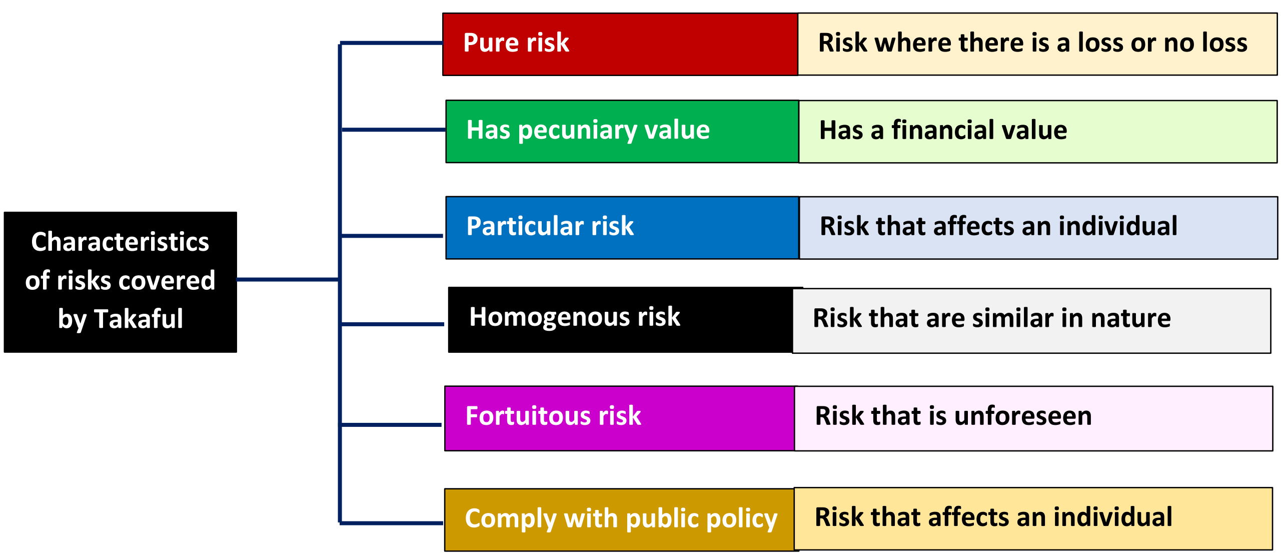

Figure 3.1: Characteristics of risks that can be covered by Takaful

3.3 TYPES OF PURE RISK

In takaful coverage, we are primarily concerned with pure risks faced by individuals. For this purpose, pure risks are generally categorized into **three** (3) types as follows:

3.3.1 Personal Risks

A personal risk is defined as a risk that directly affects individuals. The personal risks falling within the scope of takaful are:

- Pre-mature death

The pre-mature death of breadwinner can have a disastrous effect on the beneficiaries and can leave them in a position of destitute with extreme financial stress.

- Poor health

Poor health can result in excessive demand for money to pay for medical bills. This can be compounded by the fact that a debilitating illness can cause an individual to be unable to work, thus, resulting in the loss of income.

- Unemployment

A major risk to personal financial security is unemployment. Lack of savings can cause extreme financial and emotional stress as there is no financial resource during the period of unemployment.

Prolonged illness leading to unemployment can be more burdensome and add to financial and emotional stress.

3.3.2 Property Risks

Property risks refer to the possibility of loss due to damage to property from various causes or perils such as fire, flood, earthquakes, and other natural disasters.
There are **two** (2) types of risk related to property:

- Direct Loss

Financial loss that results from the physical damage, destruction, or theft of the property. For example, a factory damaged by fire, or the theft of goods stored in a warehouse.

- Indirect Loss

This is also sometimes referred to as consequential loss. This is a financial loss that indirectly results from the occurrence of a direct physical damage or theft of property. For example, when a factory is damaged in a fire, the owner loses income due to a loss of goods, delays in production caused by machine downtime, or time taken for the repair of the damaged premises.

3.3.3 Liability Risks

A liability risk is a vulnerability that can cause a party to be held responsible or liable for certain types of losses. Putting it in another way, it is the risk that an individual or business incurs when its actions result in bodily injury, death, property damage, or financial loss to third parties. When this happens, the affected third party will have the option to sue the party allegedly responsible for the action that caused the loss. Many businesses and individuals face various types of liability risk on a daily basis, the losses for which can be quite substantial. Examples of liability risk include a doctor performing a wrong diagnosis and undertaking surgery that is detrimental to the patient, a manufacturing factory polluting the environment that causes a certain disease (e.g., lung infections from smoke emissions) among residents living in the vicinity of the factory.

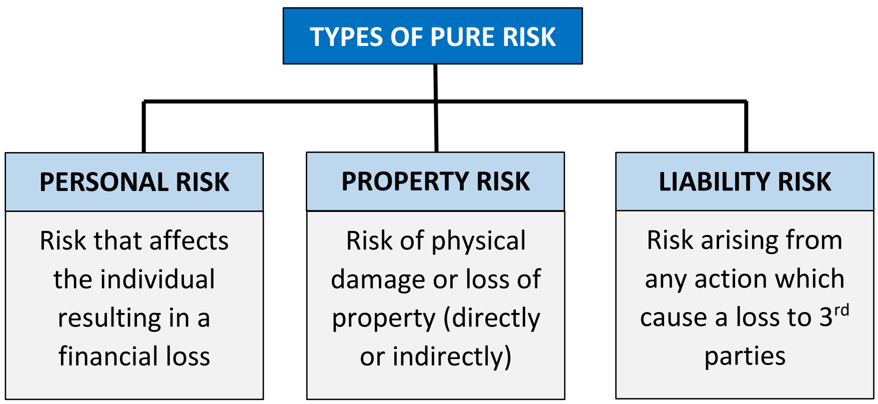

Figure 3.2: Types of pure risks

3.4 PERIL AND HAZARD

Apart from concept and implications of risk discussed above, it is necessary to understand two further terms related to the concept of loss, that is, “peril” and “hazard”.

3.4.1 Peril

Peril is defined as the cause of a loss and there are several sub-categories of perils.

3.4.1.1 Natural Perils

This category includes perils caused by natural elements such as rain, ice, snow, typhoon, hurricane, volcano, wave action, wind, earthquake, or flood.

3.4.1.2 Man-Made Perils

Man-made perils include causes of loss that are within an individuals’ control, such as suicide, terrorism, war, theft, defective products, environmental contamination, destruction of complex infrastructure and electronic security breaches.

3.4.1.3 Economic Perils

The third category of perils is economic in nature, such as recession, inflation, local fluctuations, and the instability of industrial firms.

3.4.2 Hazards

While perils are the direct causes of a loss, a hazard is one that increases the probability of occurrence of a loss. Some conditions are more hazardous than others. For example, driving on a sunny day is less hazardous compared to driving through a heavy thunderstorm, or working on an oil rig is a more hazardous occupation than working at a desk job.

From the perspective of takaful, we must be aware of several types of hazards as discussed below.

3.4.2.1 Physical hazard

It is a physical condition of the subject matter that increases the chance of a loss. For example, driving on the highway with bald tyres, or storing inflammable material in a warehouse constructed of wood.

3.4.2.2 Moral hazard

This relates to the attitude of an individual that increases the chance of a loss. For example, a person who is careless and does not stub out a cigarette in an environment containing easily inflammable material or an obese person who does not consistently exercise or manage the diet.

3.4.2.3 Morale hazard

A lack of concern about the outcome of his actions due to the existing coverage provided by takaful. For example, a person who does not lock his vehicle as the vehicle is covered for theft under a takaful plan or a person who indulges in dangerous sports after procuring a medical and health takaful plan (which he did not indulge in before the plan for the fear of incurring hospital costs due to injuries).

3.5 RISK MANAGEMENT UNDER SHARI'AH

Risk is an element of life which can manifests itself if we are ignorant of the future. Muslims are asked to work hard in order to be able to change their conditions as narrated in the verse of the *Holy Qur'an* "... Verily never will Allah change the condition of a people until they change it themselves (with their own souls)..." (*Qur'an 13:11*).

Prophet Muhammad (peace be upon him) once asked a Bedouin who had left his camel untied, "Why do you 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 Muslims should consider their fate, it also indicates how Muslims must try to reduce the risk of loss and calamities.

The Qur'an has also presented stories of previous prophets so that Muslims can take the necessary lessons from their experiences. The story of the prophet Yusof (peace be upon him), for instance, tells us about risk planning. The story of Prophet Ya'qub (peace be upon him), Yusof's father, tells us about the management of risks as Ya'qub commanded his sons to enter Egypt from different gates.

"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 (SAW) migration to Madinah gives us other lessons on how the Prophet (SAW) managed risk. The Prophet (SAW) reduced the risk of getting killed by asking 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 (SAW) 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 the above examples depict that risk management is in the roots of Islam. Muslims should put their trust onto *Allah* only after meticulous planning and efficiently utilizing all the available resources.

3.6 RISK MANAGEMENT PROCESS

Takaful is a tool to manage both personal and business risks. While personal risks are specific to the individual (death, accident, illness, and savings), business risk relates to business losses arising from property damage, liability to third parties, consequential loss, theft, loss of a key-employee etc.

Risk management is key to ensuring that both the individual and business are able to withstand the financial strain caused by a peril. It is pertinent to note that while risk management is a broad topic, the discussion in this section shall focus on risk that can be covered by takaful. The main steps in the risk management process are:

- Risk identification
- Risk evaluation
- Develop a risk management plan
- Implementation of the risk management plan
- Monitoring and review the risk management plan.

Figure 3.3: Steps in Risk Management

3.6.1 Risk Identification

Risk identification refers to the process of identifying, analyzing, reviewing and anticipating possible risks. The objective of this step is to identify and categorize risks that could affect the client and to document these risks.

The key in this process is to engage the client in a discussion and obtain relevant and sufficient information about the client's current risks, the risk management initiatives that have been taken, and 'what' other concerns the client may not have factored into the current risk management plan. The outcome of risk identification is a list of potential risks faced by the client.

For example, in the case of an individual, the client may have a medical plan and some death coverage. The risk identification will list what other risks are contingent and relevant to the client. For example, the client may not have addressed the retirement risk (not having a retirement plan in place).

Similarly in a business, the client may have substantial plans in place, but there may be an opportunity to explore other potential risks, such as, the impact arising from the loss of a key-man.

3.6.2. Risk Evaluation

Risk evaluation is the process of determining the risk's impact or potential losses. In order to evaluate or determine the impact of the risk, the followings have to be considered:

- Risk Frequency

  Risk frequency refers to the number of times a loss producing event will occur during a given time period (probability of its occurrence).

• Risk Severity

Risk severity refers to the cost or amount of losses, in monetary terms, arising from a loss-producing event.

This is important in prioritizing the risk faced by the client and in defining the appropriate action that can be taken by considering the resources that are available. One group of resources are the current assets while the other resource is the surplus generated from current personal income. Both of these can be used to fund the risk management plan.

3.6.3. Development of the risk management plan.

Once the risks have been evaluated and prioritized, it is time to develop a risk management plan by selecting the appropriate risk control measure. This is an important step. The end result is to determine which of the prioritized risk will be selected, the quantum of coverage needed for each selected risk, and the control measure(s) that should be adopted (in the case of takaful, which plan will be used). This is then matched with the resources available for the solution (affordability). Table 3.3 outlines the risk control measures that can be adopted.

Table 3.3: RISK CONTROL MEASURES	
Risk Avoidance	A technique that seeks to eliminate or prevent the risk through discontinuation of activities or businesses that presents such a risk. An example is: A smoker stops smoking to avoid the risk of lung cancer.
Risk Control	A technique to improve the risk to achieve an acceptable and fair standard. It involves methods that reduce the severity of the loss or the likelihood of the loss from occurring. An example is: Installation of water sprinklers to put out a fire to reduce the severity of the loss.
Risk Retention	This involves accepting the risk if the current level of the risk is already at an acceptable level. Risk retention is a viable strategy for small risks where the cost of covering against the risk would be greater over time than the total losses sustained. An example is: A company may want to retain the risk of damage to a small machine by setting aside funds for such an eventuality.
Risk Transfer	A process of transferring risks to an organization or individual. When a risk is transferred, losses will be paid by the organization or individual to whom the risk is transferred. An example is: A house owner can transfer the risk of loss incurred if his house is destroyed by fire by entering into a fire takaful contract or transfer the cost of hospitalization by taking a medical takaful plan.
Risk Sharing	A process of sharing risks with others who have similar nature of risk. An example is: A motor vehicle owner can share the risk of loss incurred when his motor vehicle is involved in accident by entering into a motor takaful contract, or a takaful plan covering pre-mature death.

3.6.4. Implementation of the Risk Management Plan

Once the selection of a suitable method is made, the plan is ready for implementation. In performing this step, the risk is prioritized and matched with the actions to be taken.

3.6.5. Monitoring and Reviewing the Risk Management Plan

These activities involve periodical reviews, monitoring the implementation process, and the progressive revision of the plan to incorporate any changes in the personal, business and economic environments.

Periodical reviews can help to:

- identify any deficiencies or adjustments that have to be made to the plan,
- ensure the objectives of the plan are met, and
- identify any new unfolding needs.

Reviews should be done at least once a year or when there is a change in the financial and risk circumstances of the client.

CHAPTER 3 ASSESSMENT QUESTIONS

1. A risk has two elements. Select the combination that is CORRECT.

A. Likelihood of an event happening and the severity of the negative consequences.
B. The predictability of an event and the estimation of a loss.
C. The certainty of loss and severity of loss.
D. None of the above options are CORRECT.

2. In evaluating a risk, the following are taken into account. Select the MOST APPROPRIATE answer.

A. Loss frequency only
B. Loss severity only
C. Both Loss frequency and Loss severity
D. None of the above

3. Identify the statement below that best describes a pure risk.

A. It has an element of loss, breakeven and gain.
B. It only has the element of loss and breakeven.
C. It only has the element of loss.
D. It only has the element of gain.

4. A Peril is defined as

A. the cause of danger.
B. the immediate cause of loss.
C. the cause for concern.
D. the ultimate concern of all losses suffered.

5. The installation of water sprinklers to put out a fire to reduce the severity of the loss in a factory is an example of

A. Risk Retention
B. Risk Avoidance
C. Risk Evaluation
D. Risk Control

CHAPTER 4: BASIC PRINCIPLES RELATED TO THE TAKAFUL CONTRACT

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Understand the basic principles applicable to the takaful contract

4.0 INTRODUCTION

Takaful contracts are not only subject to the general principles of the law of contract but also certain special *Sharī'ah* legal principles that are applicable to takaful contracts. The general underlying principle is that 'all things are permissible unless prescribed otherwise'. The takaful contract embraces the normal insurance principles in practice (as far as these are *Sharī'ah* compliant).

Under section 2, Part 1 of IFSA, 2013, a takaful certificate is defined as

"A takaful certificate includes a takaful cover note or any contract of takaful for family takaful business or general takaful business whether or not evidenced in the form of a takaful certificate. It signifies the takaful operator is under any liability indicated in the contract, whether the takaful certificate was issued by the takaful operator or the liability was transferred to the takaful operator from another takaful operator."

It is a broad definition that covers the certificate for both family and general takaful. The key point is that the certificate signifies the takaful operator is under a liability that is indicated (agreed upon) in the contract. For such a liability to exist, the contract must be valid.

It is therefore important for the agent to know and understand some of the basic principles that relate to and impact the interpretation of the takaful contract.

4.1 THE BASIC PRINCIPLES AFFECTING THE TAKAFUL CONTRACT

The basic principles applied to a takaful contract are discussed below:

4.1.1 Permissible Takaful Interest (PTI)

The SAC, in its 52nd meeting dated 2 August 2005 and 76th meeting on 9 June 2008, has resolved the following:

i. The concept of insurable interest does not contradict the *Sharī'ah* and it may be applied in takaful (in takaful, terminologically it is referred to as "permissible takaful interest");

ii. In general takaful, a person with legal and financial interests in a particular subject is deemed to have permissible takaful interest.

The basis of the ruling by the SAC was that while insurable interest was introduced in conventional insurance to avoid elements of wagering and gambling, this concept is also consistent with fundamental features of takaful. Under the concept of *tabarru`*, takaful participants mutually agree to guarantee each other from any form of risks acceptable in *Sharī'ah* by contributing to a common fund.

The flexibility of contribution and mutual guarantee may lead to moral hazard or manipulation of the takaful contract for non- *Sharī'ah* compliant purpose (taking a takaful plan on the life of an unrelated person as a form of a wager). In line with the *Sharī'ah* principle known as *sadd zarai`* (blocking the means that may lead to harmful result), the concept of permissible takaful interest is viewed as a mechanism to avoid such moral hazard or manipulation in takaful.

4.1.1.1 Family takaful

Under paragraph 3, Schedule 8 (Section 140) of IFSA, 2013, a takaful participant entering into a contract of family takaful shall have a permissible takaful interest in the person covered at the time such contract of takaful is entered into and at the time the takaful benefits are payable.

The term 'entered or entering' into a contract of family takaful on the person covered means participating in the payment of takaful benefits on that person's death or on the happening of any contingency dependent upon his death or survival.

There are two situations to be noted here:

a. PTI at the time of application, and

b. PTI at the time the takaful benefits are payable.

It is necessary to look at each of these to understand their respective implications on the takaful contract.

a. PTI at the time of application.

In the case where a takaful participant does not have a PTI in the person covered at the time such contract is entered into, the contract shall be void.

A person shall have a permissible takaful interest in the person covered if that other person is:

- his spouse.

It is pertinent to note that a family takaful certificate issued to a person where the person covered is his spouse, the contract shall not be void only on the ground of dissolution of marriage between the person and his spouse.

- his child or his ward who is not yet an adult at the time the person entered into the contract of takaful.

The term child will include a step-child and adopted child.

- his employee; or

An example will be the case of an employer suffering a loss upon the demise of his key-employee.

- a person on whom he is wholly or partly dependent for maintenance or education at the time he entered into the contract of takaful.

A person entering into a contract of family takaful on a person covered shall obtain the prior written consent of that person, unless the person covered is a minor. The person covered may revoke his consent by informing the licensed family takaful operator in writing. Where the person covered revokes his consent the person entering into the contract of takaful no longer has a permissible takaful interest on that person covered.

With regard to a minor, it is important to look at Paragraph 4, Schedule 8 (Section 140) of IFSA, 2013, which relates to the capacity of a minor to enter into a contract of takaful. There are two situations that are dealt with under this paragraph.

(i) A minor between the age of ten years and sixteen years

Paragraph 4 states that notwithstanding any law to the contrary, a minor who has attained the age of ten years but has not attained the age of sixteen years, with the consent in writing of his parent or guardian may:

(a) participate in a family takaful certificate upon his life or upon the life of another person in which he has a permissible takaful interest; or

(b) may assign the family takaful certificate on his life or take an assignment of a family takaful certificate.

(ii) A minor who has attained the age of sixteen years

However, a minor who has attained the age of sixteen years:

(a) may participate in a family takaful arrangement in respect of a family takaful certificate upon his life or upon the life of another person in which he has a permissible takaful interest; or

(b) may assign the family takaful certificate on his life or take an assignment of a family takaful certificate, and is as competent in all respects to have and exercise the powers and privileges of a takaful participant in relation to the family takaful certificate of which he is the takaful participant as he would be if he had attained the age of majority.

A minor who has attained the age of sixteen years shall obtain the consent in writing of his parent or guardian to assign a family takaful certificate on his life.

b. PTI at the time the takaful benefits are payable.

Where a takaful participant does not have a PTI in the person covered at the time the benefits are payable, such contract shall not be void by reason only that the takaful participant did not have such PTI. However if there are other conditions that exist, for example, fraud or misrepresentation of a material fact, the Takaful Operator can still void the contract.

So, once the permissible takaful interest exist at the beginning of the contract, and if at any time after the contract has been formalized, the takaful operator becomes aware that a takaful participant no longer has a permissible takaful interest in the person covered, the following shall apply:

- where there is no claim made or there is a claim made or on the maturity of such takaful certificate, as the case maybe, the licensed family takaful operator shall

    (a) pay to the takaful participant such moneys payable under the contract of family takaful as may be specified by the Bank Negara Malaysia; and

    (b) upon such payment to the takaful participant, the contract of family takaful shall be deemed to be terminated.

4.1.1.2 Group Takaful

In the case of a group takaful certificate, it shall not be void if the group takaful participant does not have PTI, at the time when the contract was entered into and at the time the takaful benefits are payable.

A family takaful operator shall obtain a declaration from the takaful participant to ensure that the takaful participant has permissible takaful interest in the person covered in the manner as may be specified by the Bank (BNM). The takaful operator shall be liable to a person even if the takaful operator is yet to receive the contribution.

4.1.1.3 General Takaful

Permissible takaful interest can be established if there is a provision in the contract that one party is responsible for any loss or damage to the property and third-party liability. This principle is the main element to ensure validity of a takaful contract. Permissible takaful interest exists when there is a relationship between participants and the subject matter, normally arising from several situations as shown in Table

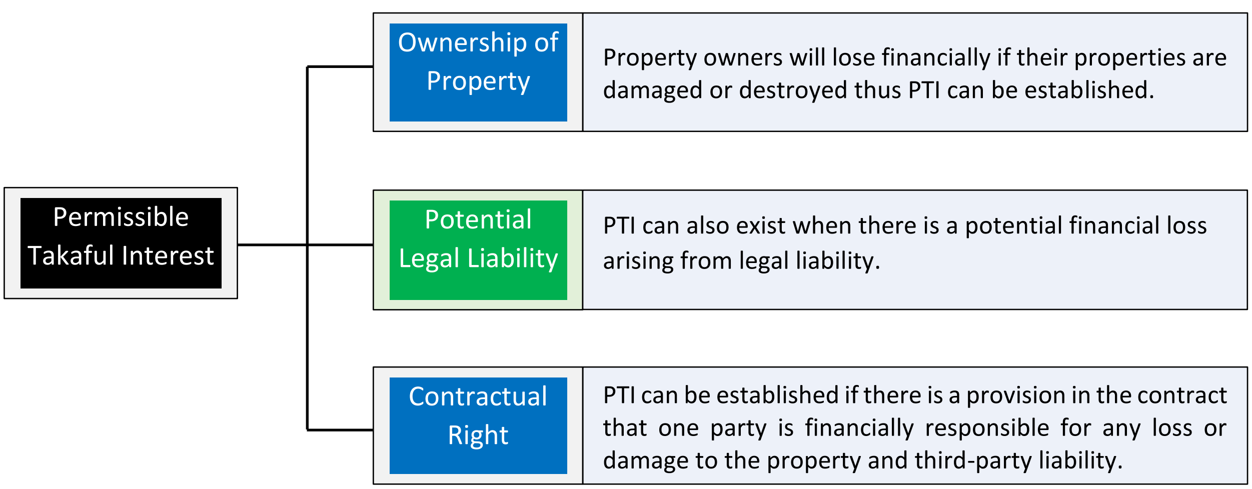

Figure 4.1: Types of Situations where Permissible Takaful Interest Exists

4.1.2 Duty of Utmost Good Faith

The duty of utmost good faith is a positive duty to voluntarily, accurately and fully disclose all facts material to the risks being proposed, whether requested or not. Failure to do so may give the aggrieved party the right to regard the contract as void. Both parties, i.e., the participants and the takaful operator must fully and truthfully disclose all the material facts related to the proposal.

Section 141 (4) of IFSA 2013 states that before a contract of Takaful other than a consumer takaful contract is entered into, varied or renewed, a proposer shall disclose to the licensed takaful operator a matter that;

1. he knows to be relevant to the decision of the licensed takaful operator on whether to accept the risk or not and the rates and terms to be applied; or

2. a reasonable person in the circumstances could be expected to know to be relevant.

The duty of disclosure placed on the participant is not a duty to disclose all information but only information that has a bearing on the risk to be undertaken by the takaful operator. This is more pertinent in general takaful business as the nature and variations arising from the underlying contracts used by the takaful operators require greater disclosure and transparency from all contractual parties.

According to Part 2 (Schedule 9) Paragraph 4 of the Act, the duty of disclosure shall not require the disclosure of a matter that:

1. diminishes the risk to the takaful operator;

2. is of common knowledge;

3. the takaful operator knows or in the ordinary course of his business ought to know; and

4. in respect of which the takaful operator has waived any requirement for disclosure.

This duty shall continue throughout the period of takaful wherein the participant is required to inform and disclose to the takaful operator of any changes which might materially increase the risk of the coverage. For example, a change in the occupation of a building from a sundry shop to a fireworks storage facility, or the change in occupation of an individual from a desk job (engineer doing design work in an office environment) to a high-risk job (the engineer is assigned duties that require a permanent assignment on an offshore oil rig). The duty also applies from the time the proposal is made to the takaful operator to the time the proposal is accepted and approved by the operator.

If a proposer fails to answer or gives an incomplete or irrelevant answer to a question contained in the proposal form or when such question was asked by the takaful operator and the matter was not pursued further by the takaful operator, compliance with the proposer's duty of disclosure in respect of the matter shall be deemed to have been waived by the licensed takaful operator.

4.1.2.1 Material Fact

A material fact is defined as any fact that would reasonably influence a takaful operator's underwriting decision on a certificate, i.e., after identifying and evaluating the hazards associated with the risk, underwriter will decide on whether to accept, accept with condition(s), decline, or defer the proposal.

4.1.2.2 Breach of Utmost Good Faith

In a case of breach of utmost good faith, the Takaful contract becomes void irrespective of whether the breach has been committed innocently or fraudulently.

Innocent misrepresentation occurs when a misrepresentation is made by the participant who had reasonable grounds for believing that his false statement was true. For example, an applicant may know his/her diagnosis but may not necessarily know that it belongs to a category of the diseases as outlined in the application.

If there is any evidence to indicate fraud on part of the takaful participant, for example if the participant has chronic diabetes or pursues a dangerous hobby but does not reveal that to the Takaful Operator.

If a material misrepresentation is proven, the takaful operator is not required to refund the contribution in the participants' risk fund *(tabarru`* fund) to the takaful participant. However, the amount in the participants' investment fund shall be returned to the takaful participant as the participant has an ownership right to the PIF.

4.1.3 Principle of proximate cause

Proximate cause is defined as the active or efficient cause that sets in motion a train of events which brings about a result, without intervention of any force, initiated and working actively from a new and independent source.

A loss may be attributed to more than a single event. There may be concurrent causes or a chain of causes which may occur in sequence or in broken chain. Thus, the cause of a loss must be established because only risks specifically covered (not excluded risks as mentioned in the Takaful certificate) can be compensated.

<u>Example 4.1</u>

A takaful operator has rejected a participant claim on the damage of his laptop. The laptop was stolen and found by the police, but the thief had crushed and completely damaged it. The participant has an all-risk coverage for the laptop, but it does not include theft coverage. The Takaful Operator rejected the claim on the ground that theft is the proximate cause of the loss which is an excluded peril.

<u>Example 4.2</u>

A man falls from a ladder at a low height and scratches his leg a little. He is taken to a hospital, and in the hospital, he contacts cholera from the next bed patient and dies. The proximate cause of his death is cholera and not falling from the ladder,

4.1.4 Principle of Indemnity

Indemnity can be defined as a mechanism used by the Takaful Operator to provide compensation in an attempt to place the participant in the same pecuniary position after the loss as enjoyed (by the participant) immediately before the loss. This principle is applied to prevent the participant from making a profit out of his loss. Only the contracts of property and liability takaful are subjected to this principle. Health takaful and personal accident takaful certificates are not contracts of indemnity as no money payment can actually indemnify for loss of life.

This is discussed further in Chapter 1 of Part B of the Takaful Basic Examination textbook.

4.1.5 Principle of Subrogation

Subrogation, in a legal sense, means one party has the right to "step into the shoes" of another party for the purpose of bringing a claim for damages. It ensures that the participant does not profit from his actual loss. In cases where the participant had been partly indemnified by a third party, the Takaful Operator will only pay the balance, up to the amount of payment made to the participant.

This is discussed further in Chapter 1 of Part B of the Takaful Basic Examination textbook.

4.1.6 Principle of Contribution

The principle holding that two or more Takaful Operators each liable for a covered loss should participate in the payment of that loss. Having paid its share of a loss, a Takaful Operator may be entitled to equitable contribution - a legal right to recover part of the payment from another Takaful Operator whose certificate was also applicable.

This is discussed further in Chapter 1 of Part B of the Takaful Basic Examination textbook.

CHAPTER 4	ASSESSMENT QUESTIONS

1. Select the statement that is TRUE about Permissible Takaful Interest.

A. It is only applicable to individual family takaful policies.
B. General takaful proposals are not subjected to permissible takaful interest
C. Group takaful is exempted from permissible takaful interest if there are more than 50 participants.
D. none of the above options are TRUE.

2. The duty of disclosure shall not require the disclosure of a matter that ________. Select the statement below which is FALSE.

A. diminishes the risk to the Takaful Operator;
B. is not of common knowledge;
C. the Takaful Operator knows or in the ordinary course of his business ought to know; and
D. in respect of which the Takaful Operator has waived any requirement for disclosure.

3. The duty of disclosure placed on the participant is a duty _________.

A. to disclose all information about oneself to the takaful operator.
B. to disclose only information that has a bearing on the risk to be undertaken by the takaful operator.
C. to disclose only information that will ensure a financial loss to the takaful operator.
D. none of the above are TRUE.

4. A minor who has attained the age of sixteen years ________. Select the statement which is NOT TRUE.

A. may participate in a family takaful arrangement in respect of a family takaful certificate upon his life
B. may participate in a family takaful arrangement in respect of a family takaful certificate upon the life of another person in which he has a permissible takaful interest; or
C. may assign the family takaful certificate on his life
D. may not take an assignment of a family takaful certificate unless he has the prior written consent of his parents.

5. The *Sharī'ah* principle known as *sadd zarai`* practice refers to ________.

A. blocking the means that may lead to harmful result
B. allowing all that is permissible
C. qualifying all that is permissible
D. blocking that which is disadvantageous to the takaful operator.

CHAPTER 5: COMMERCIAL CONTRACTS AND THE TAKAFUL BUSINESS MODELS

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Understand the various types of commercial contracts applicable to takaful
- Describe the *muḍārabah* and *wakālah* business models used in takaful

5.0 INTRODUCTION

In practice, Takaful combines several *Shari'ah* compliant contracts such as *tabarru'* (donation), *wakālah* (agency) and *muḍārabah* (profit-sharing). The combination of these may differ according to the different business models adopted by Takaful Operators. The business models are discussed later in this chapter.

5.1 COMMERCIAL CONTRACTS IN TAKAFUL

Each of the contracts mentioned above are described below.

5.1.1 *Tabarru'* (Donation)

The term *Tabarru'* is an Arabic word which means donations or gifts. In a takaful contract, the participant agrees to relinquish all or certain portion of his contribution as a donation to a pool. The *tabarru'* portion will be credited into the Participant Risk Fund to enable the participant to fulfil his obligation of mutual help and joint guarantee in the event any of the fellow participants suffers a defined loss. The *tabarru'* concept is applied in a Takaful contract eliminates the element of *gharār* (uncertainty).

5.1.2 *Muḍārabah*

Muḍārabah is a contract between a capital provider and an entrepreneur, under which the capital provider provides capital to be managed by the entrepreneur.

Under the takaful system, the takaful participants enter into a *muḍārabah* contract with the takaful operator where the operator, as the entrepreneur, is entrusted with managing the takaful business and the participant(s), as the capital providers, are obliged to pay the takaful contribution. The contract will define the ratio of the profit to be shared between the two parties.

5.1.3 *Wakālah*

Wakālah refers to a contract of agency, which means doing any work or providing any service on behalf of any other person. Under the takaful arrangement, the takaful operator will act as the agent or "*wakil*" of the participant. In return, the takaful operator is allowed to charge a fee for the services rendered. The agent has fiduciary duties (*amanah)* towards the principal within what he has been authorized to do.

The *wakālah* contract may take the following forms:

(a) unrestricted agency (*wakālah* mutlaqah): an agency contract in which the principal appoints someone as agent to perform a particular task without any specific restriction or condition; or

(b) restricted agency (*wakālah* muqayyadah): an agency contract in which the principal appoints someone as agent to perform a particular task with specific restriction or condition.

5.2 TYPES OF TAKAFUL OPERATIONAL MODELS AND THEIR APPLICATIONS

There are two main models for takaful operators i.e. the *muḍārabah* model (profit sharing) and the *wakālah* model (agency).

During the initial years of the takaful industry, the pure *muḍārabah* model was used in Malaysia by Syarikat Takaful Malaysia. The pure *muḍārabah* model only allows sharing of investment return. This model was later modified to allow sharing of the investment return on the contribution pool and also in any underwriting surplus generated by the takaful operator.

However, in recent years, the majority of takaful operators have either adopted the *wakālah* or modified *wakālah* model. These models have also become more popular globally.

5.2.1 The *Wakālah* Model

Under the takaful system, this model describes an agency agreement between the operators acting as the agent or "*wakil*" and the participant as the principal. As a *wakil*, the takaful operator will perform the following:

- Manage the participation of the participants in a variety of takaful products provided by the operator;
- Undertake the management of the takaful fund; and
- Manage the operations of the takaful company, etc.

In return for rendering the agency services, the takaful operator is permitted to charge a fee. The fee is derived from the takaful contributions paid by the participant. Under this model, the takaful operator will earn its revenue from the:

- Wakālah fee described in the aforementioned; and
- Return on the investment of its shareholders' fund

Some takaful operators may also charge a performance fee for its roles and services in managing the investment of the takaful fund.

- ***Wakālah* Model for General Takaful**

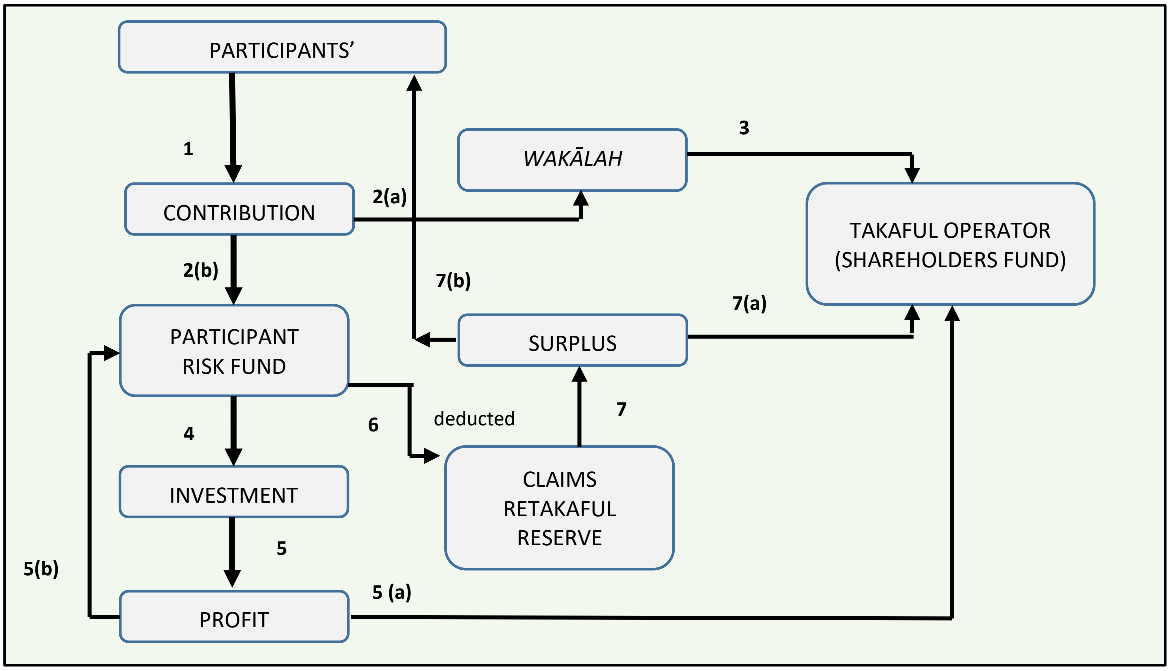

Figure 5.1: *Wakālah* Model for General Takaful

Explanation of the *Wakālah* Model for General Takaful**:**

1. Participants' pay takaful contributions.

2. (a). *Wakālah* fee will be deducted from the contribution.

2.(b). The participant contributions will be apportioned into the Participants' Risk Fund (PRF) which is based on the *tabarru'* concept.

3. *Wakālah* fees which consists of agency commissions and administration expenses will be channeled to takaful operator

4. The fund will be invested in *Sharī'ah*-Compliant investments such as Government Islamic Instruments (GII), *sukuk*, equities, fixed assets and General Investment Account (GIA).

5. Investment profit (if any) will be treated as follows:

5(a). Payment of performance fee to the takaful operator.

5(b). Net profit after deducting performance fee will be distributed to PRF.

6. The Participants' Risk Fund will be used for claims, Retakaful and reserve.

7. At year end, the surplus (if any) will be treated as follows:

7(a). Payment of performance fee to the takaful operator.

7(b). Net surplus after deducting performance fee will be distributed to the participants.

However, in the case of a deficit, the shareholders of the takaful operator will provide a loan without charging any interest (*qarḍ)*.

- ***Wakālah* Model for Family Takaful**

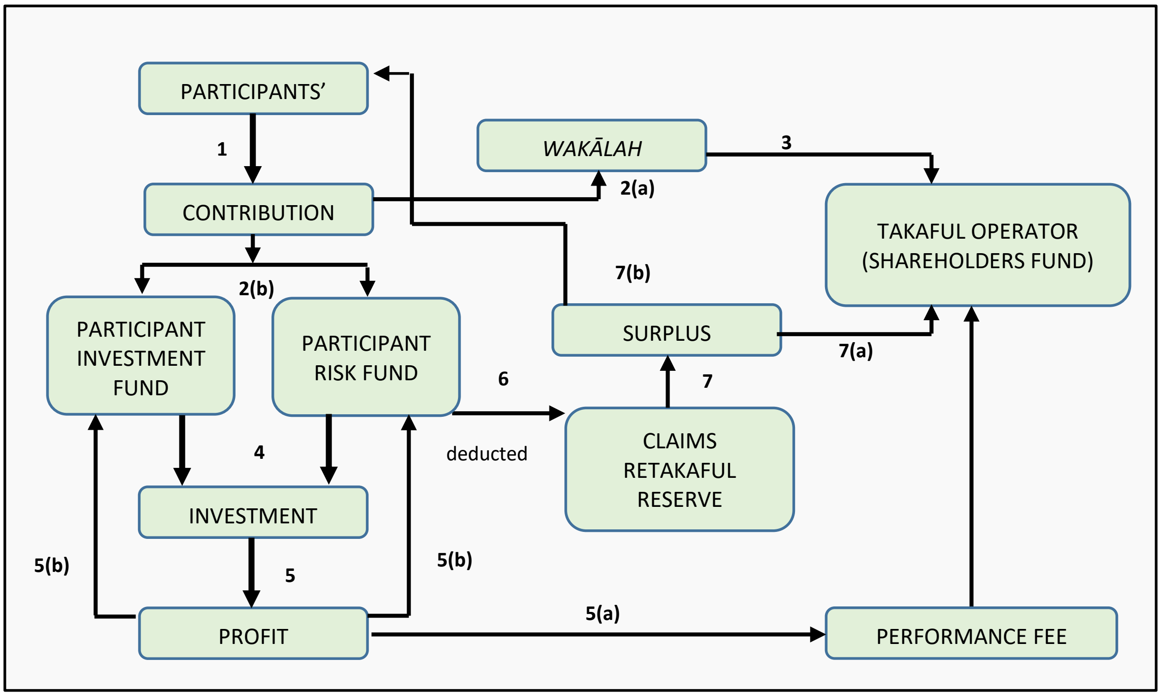

Figure 5.2: *Wakālah* Model for Family Takaful

Explanation of the *Wakālah* Model for Family Takaful**:**

1. Participants' pay takaful contributions.

2. (a). *Wakālah* fee will be deducted from the contribution.

2.(b). The participants' contributions will be apportioned into participants' Investment Fund (PIF) which is meant for saving, and the Participants' Risk Fund (PRF) which is based on the *tabarru'* concept.

3. *Wakālah* fees which consists of agency commissions and administration expenses will be channeled to the takaful operator

4. The fund will be invested in *Sharī'ah* -Compliant investments such as Government Islamic Instruments (GII), *sukuk*, equities, fixed assets and General Investment Account (GIA).

5. Investment profit (if any) will be treated as follows:

5(a) Payment of performance fee to the takaful operator.

5(b).Net profit after deducting performance fee will be distributed to the PIF and PRF respectively.

6. The Participants' Risk Fund will be used for claims, Retakaful and reserve.

7. At year's end, the surplus (if any) will be treated as follows:

7(a). Payment of performance fee to the takaful operator.

7(b). Net surplus after deducting performance fee will be distributed to the participants.

However, in the case of a deficit, the shareholders of the Takaful Operator will provide a loan without charging interest (*qarḍ)*.

- ***Muḍārabah* Model for General Takaful**

Explanation of the *Muḍārabah* Model for General Takaful (refer to Figure 5.3 below)**:**

1. Participants' pay takaful contributions to Participants Risk Fund.

2. The fund will be invested in *Sharī'ah*-Compliant investments such as Government Islamic Instruments (GII), *sukuk*, equities, fixed assets and General Investment Account (GIA).

3. Investment profit, if any, will be shared among the participants and takaful operator based on the pre-agreed ratio.

4. At year's end, the surplus will be distributed to the participants and takaful operator based on the pre-agreed ratio.

However, in the case of a deficit, the shareholders of the takaful operator will provide loan without charging interest (*qarḍ)*.

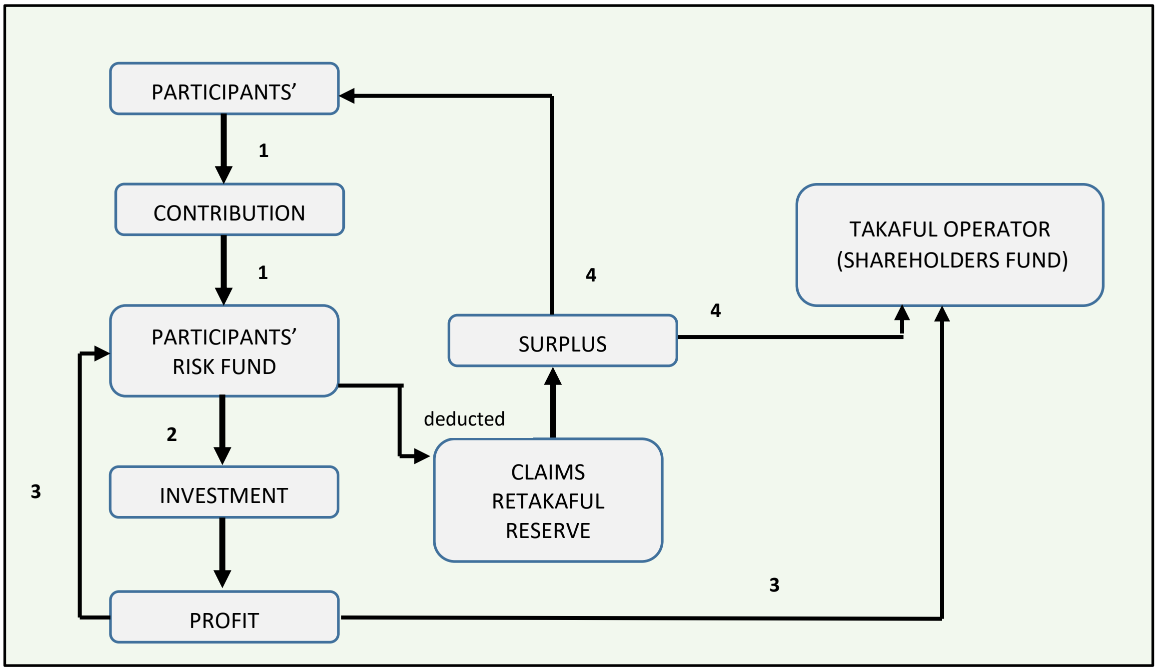

Figure 5.3: *Muḍārabah* Model for General Takaful

5.2.2 *Muḍārabah* Model for Family Takaful

Explanation of the Muḍārabah Model for Family Takaful (refer to Figure 5.4 below):

1. Participants' pay takaful contributions.

2. The participants' contributions will be apportioned into:

2(a). Participants' Investment Fund (PIF), which is meant for saving; and

2(b). Participants' Risk Fund (PRF), which is based on the *tabarru'* concept.

3. The fund will be invested in *Sharīʿah*-Compliant investments such as Government Islamic Instruments (GII), *sukuk*, equities, fixed assets and General Investment Account (GIA).

4. Investment profit, if any, will be shared among participants (to the PIF and PRF) and the payment of performance fee to the takaful operator based on the pre-agreed ratio

5. The Participants' Risk Fund will be used for claims, Retakaful and reserve.

6. At year's end, the surplus will be distributed to the participants and takaful operator based on the pre-agreed ratio.

However, in the case of a deficit, the shareholders of the takaful operator will provide a loan without charging interest (*qarḍ)*.

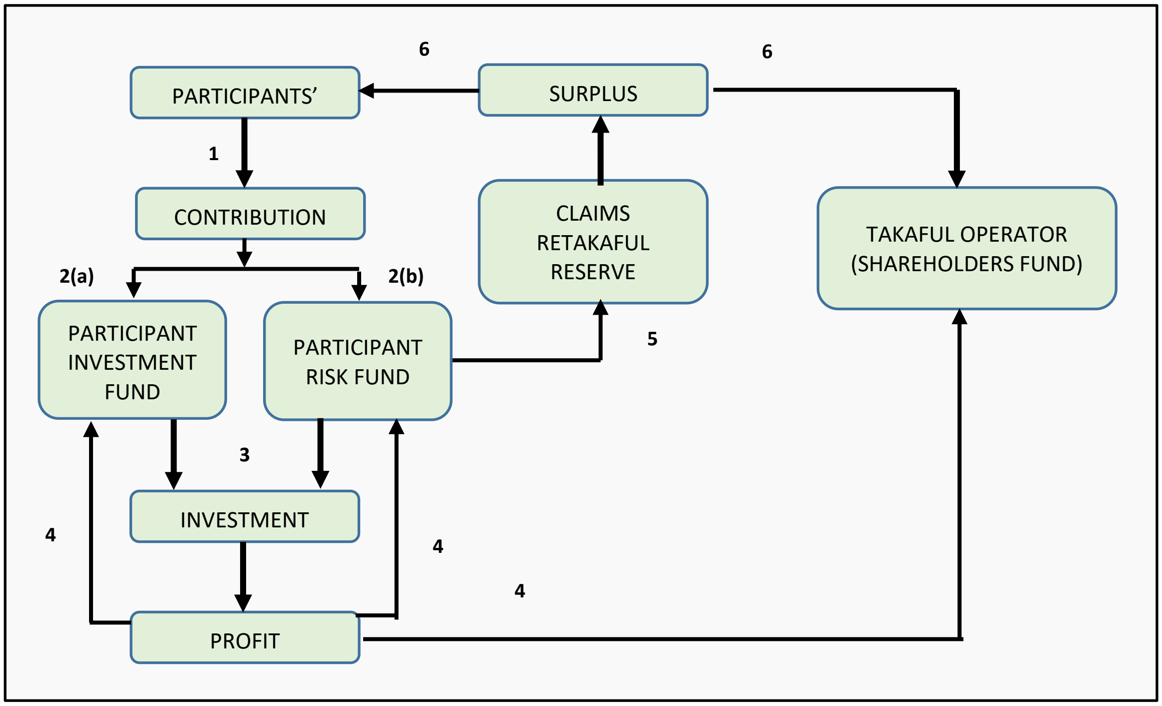

Figure 5.4: *Muḍārabah* Model for Family Takaful

5.2.3 Muḍārabah + Wakālah Model (Hybrid Model)

The Takaful hybrid model is a combination of *muḍārabah* and *wakālah* models. Under this model, the takaful operator assumes the role of entrepreneur (*muḍārib)* as well as the agent (*wakil)* of the participant. The participants, act as both provider of capital and principal to the agent.

By this arrangement, on the part of the operator, an agency fee can be remunerated as an upfront charge from the takaful fund, whilst at the same time, the operator will have the right to profit-sharing on the returns on the investment of the Takaful fund in accordance with the *muḍārabah* contract.

In this regard, the *muḍārabah* contract is applied on the investment activity only. Profit from the fund in this instance will comprise of the surplus from underwriting as well as returns on the investment as a whole. In addition to the *wakālah* fee, the model provides discretion to the operator to charge, on the surplus of the takaful fund, a performance fee in consideration for managing the takaful business as a whole.

Therefore, the operator has three sources of income: the *wakālah* fee, profit sharing from the investment return of the takaful fund and returns on the investment of its shareholders fund. As for the participants, they will have the right to share the net underwriting surplus as well as profit sharing on the investment of the takaful fund.

CHAPTER 5	ASSESSMENT QUESTIONS

1. The term *Wakālah* refers to

A. A contract of agency.
B. A contract of representation.
C. A contract of mutual consent.
D. A contract cooperation.

2. One of the following is FALSE about the *Wakālah* system.

A. the Takaful Operator will manage the participation in a variety of Takaful products.
B. the Takaful Operator will manage the fund of the company.
C. the Takaful Operator will manage the company operations.
D. the Takaful Operator will take all the profits of the business.

3. Under the *Wakālah* model, the Takaful Operator will earn its revenue from

I. *wakālah* fee
II. returns on the investment of its shareholders' fund
III. returns on the investment of its participant risk fund
IV. returns on investment from the participants investment fund

A. I and II
B. I, II and III
C. I, II and IV
D. All of the above are TRUE

4. Under the *Muḍārabah* Model, profits will comprise of

A. returns on the investment and surplus from the underwriting in respect of the Takaful funds only.
B. profit from the Shareholders' Fund only.
C. surplus from the underwriting in respect of the Takaful funds and Shareholder's fund
D. returns on the investment of the Takaful fund and the Shareholder's fund.

5. In the event there is a deficit in the takaful fund during its operations, the following will take place

A. the shareholders of the Takaful Operator will provide *qard*.
B. the company will seek a loan from Bank Negara
C. the participants will provide *qard* at a fixed return rate
D. the shareholders will provide *qard* at a fixed return rate

CHAPTER 6: TAKAFUL INTERMEDIARIES

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Describe the types of intermediaries found in the takaful market
- Understand the rights of the principal and intermediaries in the principal-agent contract.
- Describe the prohibited conduct of agents

6.0 INTRODUCTION

A Takaful intermediary is an individual who solicits Takaful business or invites potential customers to enter into Takaful contracts with Takaful Operators. These intermediaries comprise of Takaful agents, Takaful brokers and Financial Advisers.

Intermediaries are paid commissions (or brokerage fees for brokers) for each plan that is approved by the Takaful Operator. The commission is based on a pre-agreed percentage of the contributions made by customers.

6.1 TYPES OF TAKAFUL INTERMEDIARIES

The various types of intermediaries mentioned above are described below.

6.1.1 Takaful agent

A takaful agent represents a takaful operator and primarily promotes takaful plans developed and marketed by the takaful operator.

According to the IFSA 2013, the term 'takaful agent' means a person who does all or any of the following:

a) solicits or obtains a proposal for takaful certificate on behalf of a Takaful Operator;

b) offers or assumes to act on behalf of a takaful operator in negotiating a Takaful certificate; and

c) does any other act on behalf of a takaful operator in relation to the issuance, renewal or continuance of a takaful certificate.

Apart from having takaful agents who market the products of the takaful operator, the operator may also have a bancatakaful partner. A bancatakaful operator is a banking institution or development financial institution that has a distribution or marketing arrangement with the takaful operator. In this partnership, the bank staff will market the takaful products directly to the customers of the bank.

6.1.2 Takaful broker

According to IFSA Act 2013, a 'takaful broker' is defined as a person who, as an independent contractor, carries out Takaful and/or Retakaful broking marketing. The broker represents the interests of a potential participant who desires to have a takaful plan. Some of the main duties of a takaful broker are:

a) assist the customer in obtaining and renewing a takaful cover from a takaful operator.
b) advice the customer on the most appropriate takaful plan, its coverage and terms which are being offered by takaful operators.

6.1.3 Financial advisor

A financial advisor is an independent party that provides financial advisory business. A financial advisory business is defined as one that undertakes the following tasks:

a) analyzing the financial planning needs of a person relating to a takaful product;

b) recommending an appropriate takaful product to a person;

c) sourcing a Takaful product from a licensed takaful operator for a person;

d) arranging a contract in respect of a takaful product for a person; or

e) such other business, service or activity in relation to a financial service.

A comparison between the above-mentioned intermediaries is illustrated in Table 6.1.

Table 6.1: Comparison of Takaful Intermediaries

Intermediary	Function	Represents	Licensed/Registered by
Takaful agent	Solicits or obtains a proposal for a takaful certificate	Takaful Operator	Malaysian Takaful Association
Takaful broker	Independent contractor who carries out Takaful and/or Retakaful broking business	Customer	Bank Negara Malaysia
Financial advisor	An independent party that provides financial advisory business	Customer	Bank Negara Malaysia

6.2 AGENT BEHAVIOUR

The IFSA 2013 states the following with regard to the behavior of the agents in the marketplace.

1. Disclosure Requirement

Section 140 (Para 10) of IFSA 2013 requires all agents who market takaful products for a takaful operator to inform potential customers that he is an agent and acting on behalf of a particular takaful operator.

2. Takaful Agent to Represent Licensed Takaful Operator

As stated under Section 26 of IFSA 2013, no person shall market or promote takaful products or business as an agent or broker for a person or operator other than a licensed takaful operator. Any person found guilty of this provision, can be fined not exceeding RM50 million or imprisonment not exceeding 10 years, or both.

3. Non-Compliant of IFSA 2013

Section 136 (4) of IFSA 2013 states that if any agent is found to be non-compliant with the provisions of the Act and if found guilty, can be fined not exceeding RM10 million or imprisonment for a period not exceeding five years or both.

6.3 THE DUTIES OF AN AGENT

The contract of agency between the takaful operator and agent is in writing. It contains the terms and conditions relating to the conduct of the agency and the remuneration payable to the agent.

Some of the general duties of an agent are as follows:

- Promotion of takaful products and services.
- Giving advisory services (related to takaful products) and customer support to the clients.
- To submit proposals to the principal as required.
- To create awareness about takaful products and services.
- Maintain good rapport with existing and prospective clients.
- Being aware of market developments and conditions to guide their customers accordingly.

However specifically, the duties of an agent to the principal (takaful operator) are:

- To obey the principal's directions.
- To exercise due care and skills in undertaking all obligations arising from the contact with the principal.

- To personally perform the duties required under the contract and not delegate any duties to another individual.
- To act in good faith in all dealings with the principal
- To account for all monies received by the agent on behalf of the principal. Insurance brokers are required by their professional the principal code of practice to keep their clients' money separate from their own.

6.4 RIGHTS OF AN AGENT

The rights of the agent are as follows:

- The agent's most important right is the right to receive payment for his services, usually in the form of a commission or a fee.
- The agent is also entitled to reimbursement of moneys which he has expended with the express authority of his principal within the acceptable limits.
- The agent has the right to perform his duties in the manner which he considers to be appropriate. He may reject any attempt by his principal to control the manner in which he works.

6.5 OBLIGATIONS OF THE PRINCIPAL

The principal has the following obligations towards his agents:

- To pay remuneration and expenses as agreed; or, to pay what is customarily reasonable.
- Indemnify the agent against the consequences of any lawful act performed on the principal's behalf or with the authority of the agent.

6.6 REMEDIES OF THE PRINCIPAL

If an agent does not perform the duties as required, the principal may:

- Sue the agent for damages for specific performance or for breach of contract
- Terminate the agent without notice or compensation in cases of a serious and blatant breach of duties
- Rescind any contract made through the agent and refuse commissions where there is a fraud or the agent has acted in mala fide (bad faith).

6.7 TERMINATION OF AGENTS

The relationship of principal and agent may be terminated by the following:

- By notice of revocation given by the principal to the agent.
- By notice of renunciation given to the principal by the agent.
- By the completion of the transaction where the authority was given for that transaction only.
- By expiration of the period stipulated in the contract of agency.
- By mutual agreement.
- Generally, by death, lunacy or bankruptcy of the principal or agent.
- By operation of any law which renders the agent contract as illegal.

6.8 PROHIBITED CONDUCT OF AGENTS

Schedule 7 of the Islamic Financial Services Act (IFSA) 2013 details the list of prohibited business conduct that would apply equally to takaful operators and takaful intermediaries. These are reproduced as follows:

- Engaging in conduct that is misleading or deceptive, or is likely to mislead or deceive in relation to the nature, features, terms or price of any financial service or product.
- Inducing or attempting to induce a financial consumer to do an act or omit to do an act in relation to any financial service or product by:

    i. Making a statement, illustration, promise, forecast or comparison which is misleading, false or deceptive;

    ii. Dishonestly concealing, omitting or providing material facts in a manner which is ambiguous; or

    iii. Recklessly making any statement, illustration, promise, forecast or comparison which is misleading, false or deceptive.

- Exerting undue pressure, influence or using or threatening to use harassment, coercion, or physical force in relation to the provision of any financial service or product to a financial consumer, or the payment for any financial service or product by a financial consumer.
- Demanding payments from a financial consumer in any manner for unsolicited financial services or products including threatening to bring legal proceedings unless the financial consumer has communicated his acceptance of the offer for such financial services or products either orally or in writing.

- Exerting undue pressure on, or coercing a financial consumer to acquire any financial service or product as a condition for acquiring another financial service or product.

- Colluding with any other person to fix or control the features or terms of any financial service or product to the detriment of any financial consumer except for any tariff or premium rates or policy terms which have been approved by the Bank Negara Malaysia.

CHAPTER 6 | ASSESSMENT QUESTIONS

1. According to IFSA 2013, a Takaful agent is defined as a person who does all or any of the following. One of the following is FALSE

A. Solicits or obtains a proposal for Takaful certificate on behalf of a Takaful Operator.
B. Offers or assumes to act on behalf of a Takaful Operator in negotiating a Takaful certificate.
C. Does any other act on behalf of a Takaful Operator in relation to the issuance, renewal, or continuance of a Takaful certificate.
D. Ensures a takaful certificate is kept in force by whatever means possible.

2. The main duties of a Takaful broker are as follows. Select the CORRECT combination below.

I. Assists the customer in obtaining and renewing a Takaful cover from a Takaful Operator
II Recommends and advises the customer on the most appropriate Takaful plan offered by Takaful Operators.
III. Takes the initiative to design and create a plan for the customer and seek approval from Takaful Operators
IV. Ensures the customer will sign a commitment contract with the client to stay with the selected Takaful Operator for at least 10 years.

A. I & II
B. I, II & III
C. II, III & IV
D. All of the above are TRUE

3. A financial advisor provides financial advisory services that includes the following. Select the one option that is FALSE.

A. Analysing the financial planning needs of a person relating to a Takaful product.
B. Packaging a plan for a person to earn maximum income from the sale.
C. Recommending an appropriate Takaful product to a person.
D. Sourcing a Takaful product from a licensed Takaful Operator for a person.

4. Section 140 (Para 10) of IFSA 2013 requires__________.

A. all agents to inform potential customers that he is an agent of and acting on behalf of a particular Takaful Operator.
B. all agents to adhere to the principle of utmost good faith.
C. all agents to advise their customers to adhere to the principle of utmost good faith.
D. all agents to remind their customers of the negative effects of replacing a takaful policy.

5. The principal will have the following duty towards the agents. Select the CORRECT option below.

A. To pay the agent all remuneration and expenses as agreed.
B. Indemnify the agent against consequences of any act lawfully or unlawfully done.
C. Indemnify the agent against consequences of acting within and outside his authority.
D. Ratify all sales actions, presentations and commitments made by the agent to the client.

CHAPTER 7: MEDICAL AND HEALTH TAKAFUL

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Describe the concept and characteristics of Medical and Health Takaful to the customer.
- Identify the features and benefits of Medical and Health Takaful plans and how the plans cater to the customers' needs

7.0 INTRODUCTION

Today, Malaysians are living longer and have access to better and more advanced medical care. This is a positive development and a sign of progress in the country's health management and outcomes. However, Malaysia, like all developing countries, is in an epidemiological transition (experiencing a change in disease patterns).

Major health issues and challenges have changed from acute infectious diseases to chronic lifestyle related disorders like cardiovascular diseases, diabetes mellitus, cancers, and age-related disorders. Rates of obesity and diabetes are on the rise as people consume more unhealthy food and adopt unhealthy lifestyle practices. The need for expensive long term medical care and treatment, has led to a greater demand for Medical and Health Takaful (MHT) to finance the cost of potential future medical costs.

7.1 CATEGORIES OF MEDICAL AND HEALTH TAKAFUL (MHT)

An MHT plan is a takaful plan that covers the medical expenses arising from disease, sickness, or accident.

There are **two** categories of Medical and Health Takaful, namely the:

1. Indemnity Certificate

It is a type of medical plan that reimburses the participants for relevant medical expenses incurred. An example of an indemnity certificate is Hospitalization and Surgical Takaful where a participant will be reimbursed for the costs of medical treatments and services which he has incurred upon hospitalization.

2. Benefit Certificate

A benefit certificate pays a pre-determined sum of money if a covered event occurs during the certificate period, or the payment of an allowance or income stream at regular intervals for the period that the certificate owner is incapacitated and/or hospitalized. Examples of benefit certificates are a Hospitalization Cash Benefit plan and a Critical Illness Takaful.

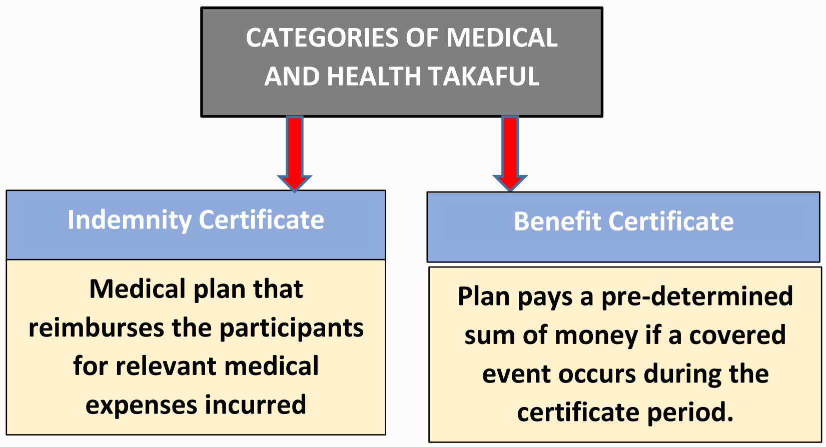

Figure 7.1: Categories of Medical and Health Takaful

7.2 TYPES OF COVERAGE

The various types of cover under medical and health takaful are discussed below.

7.2.1 Hospitalization and surgical takaful plan

A hospital and surgical takaful (HSI) plan provide reimbursement of medical expenses incurred by the certificate owner for medical treatment due to illness, sickness, disease or injury. This plan covers the expenses incurred due to hospitalization and surgical procedures.

Generally, benefits provided by a Hospitalization and Surgical Takaful plan include the following:

- Hospital Room and Board.
- Intensive Care Unit.
- Hospital Supplies and Services.
- Anesthetist's Fees.
- Surgeon's Fees.
- Operating Theatre Fees.
- In-hospital Physician's Visits.
- Pre-Hospitalization Diagnostic Tests.
- Pre-Hospitalization Specialist Consultation.
- Post-Hospitalization Treatment.
- Emergency Accidental Outpatient Treatment.
- Ambulance Fees.

Each of the benefits stated above will have an 'inner limit' that may vary from one plan to another and also from one operator to another.

Some plans may be extended to cover the following:

1. Hospital Cash Allowance.
2. Overseas travel
3. Outpatient Cancer Treatment.
4. Outpatient Kidney Dialysis.
5. Organ Transplant
6. Accidental death benefit
7. Outpatient day care surgery and consultation
8. Daily cash allowance at government hospitals

7.2.2 Hospitalization income benefits

It can be offered as stand-alone certificate or as rider to Family Takaful or Medical and Health Takaful plan. This plan provides participants with daily cash benefit, should the participant be hospitalized due to illness, sickness, or injury, subject to the terms and conditions of the certificate or rider. The plan pays a pre-agreed amount of allowance for each day the insured person is hospitalized.

7.2.3 Critical illnesses

Critical Illnesses is a takaful plan which provides a lump sum benefit if the person covered is diagnosed with one of the specific illnesses in the certificate (usually 36 critical illnesses but some Takaful Operators may cover more). Some products are designed exclusively for certain segments of the population such as females in the case of female-related illnesses such as breast or ovarian cancer. Others include juvenile cancer riders to provide protection against critical illnesses common among children.

Table 7.1: Examples of Illnesses covered under Critical Illnesses Takaful

Alzheimer's Disease/Irreversible Organic Degenerative Brain disorder	HIV Due To Blood Transfusion
Bacterial Meningitis	Loss of Independent Existence
Benign Brain Tumor	Loss of Speech
Blindness/Total Loss of Sight	Major Burns
Brain Surgery	Major Head Trauma
Cancer	Major Organ/Bone Marrow Transplant
Chronic Aplastic Anemia	Medullary Cystic Disease
Coma	Motor Neuron Disease
Coronary Artery By-Pass Surgery	Multiple Sclerosis
Deafness/Total Loss of Hearings	Muscular Dystrophy
Encephalitis	Other Serious Coronary Artery Disease
End Stage Kidney Failure	Paralysis/Paraplegia
End Stage Liver Failure	Parkinson's Disease
End Stage Lung Failure	Primary Pulmonary Arterial Hypertension
Full Blown AIDS	Severe Cardiomyopathy
Fulminant Viral Hepatitis	Stroke
Heart Attack	Surgery to Aorta
Heart Valve Surgery	Systemic Lupus Erythematous with Lupus Nephritis

7.2.4 Disability income takaful

The disability income plan aims to provide an income stream to substitute the workplace income lost as the result of a disabling accident or sickness. Generally, the maximum amount of disability income that can be replaced is about 60% to 70% of the workplace income.

7.3 CHARACTERISTICS OF MEDICAL AND HEALTH TAKAFUL

Main characteristics of Medical and Health Takaful are as follows:

7.3.1 Non-termination of coverage with claims payment

A Medical and Health Takaful Plan usually provides payment of claims up to the limits stipulated in the takaful certificate. Such limits could be one or a combination of the following:

- Per disability limit
- Overall annual limit
- Lifetime limit

These are elaborated in Table 7.2 below.

Table 7.2: Limit for Medical and Health Takaful Plan	
LIMIT	DESCRIPTION
Per disability limit	The maximum amount of benefits available to a participant per disability
Overall annual limit	The maximum amount of benefits available to a participant in any particular certificate year
Lifetime limit	The maximum amount of benefits available to a participant during his lifetime.

A point to note is that the payment of a claim does not result in a termination of the certificate except in the event of a death claim. So, if a participant makes multiple claims disability claims during the year, future claims will still be payable as long as the annual limit is not breached.

7.3.2 Increase of risk with time for medical and health takaful

Medical and Health Takaful contributions also factors in the morbidity risk of the participants. The risk increases with age and consequently the contributions payable will increase with age. It is pertinent that the agent discusses this with the prospect as a delay in acquiring a medical plan can cause:

- the prospect to pay higher contribution in the future corresponding to the future age, or
- expose the prospect to medical risk which may require a loading or render the prospect uninsurable in the future

7.3.3 General exclusions

Medical and Health Takaful usually excludes the following:

- Pre-existing illness at the time of application.
- Specified illnesses will not be covered for these illnesses if the illnesses have been treated or occurred during the first 12 months of the takaful cover period (for e.g., tumors and gastritis) and their related conditions
- Claims for illness or injury caused through illegal or unlawful acts.
- Pregnancy or childbirth.
- Venereal disease, infection or parasites.
- Murder or physical assault.
- Cosmetic or plastic surgery.

7.3.4 Termination of a medical and health takaful

A medical and health takaful certificate will be terminated at the happening of the following events:

- Complete use of the annual limit or lifetime limit stipulated in the certificate
- On the certificate anniversary date following the participant's maximum eligibility age
- On the death of the participant

7.4 COST CONTAINMENT MEASURES

Healthcare costs in Malaysia, are continuously on the rise, causing the Medical and Health Takaful business to become less profitable. Various methods have been introduced by Takaful Operators to contain costs and prevent abuses which directly or indirectly give rise to inflated claims.

These measures are discussed below:

- **Inner Limits**

An inner limit is a 'limit within a limit'. For example, if the participant's *inner limit* for surgery is RM 20,000 that is the maximum that he can claim per surgical procedure although his annual limit may be higher.

- **Schedule of Surgical Procedures**

This outlines the list of surgical procedures specifically covered by the certificate. It narrows the risk exposure of the Takaful Operator.

- **Maximum Period of Compensation**

The maximum period that the certificate will cover the participant for any medical services or treatment. For example, the certificate will cover room and board for a maximum of 30 days for an admission.

- **Co-Takaful**

Co-takaful is the amount that the participant must pay out-of-pocket before the Takaful Operator pays the remaining sum for a particular hospital admission, visit or service. It is a fixed percentage of the incurred amount or a fixed quantum as stated in the certificate. The co-Takaful sum must be paid each time a claim is made by a covered person.

The percentage of co-Takaful may vary from one operator to another but Bank Negara Malaysia also places a cap on the co-Takaful percentage chargeable by operators.

Example:

En. Ahmad was admitted in the hospital for 12 days and the total claim was RM 12,000. Let's assume, the Takaful Operator has fixed the co-Takaful payment at 10% of the overall claim.

During discharge from the hospital, En. Ahmad had to pay RM 1,200 (which is the 10% of the co-takaful value) and the balance of RM 10,800 will be settled by the Takaful Operator.

- **Co-Payment**

A co-payment is a fixed amount that a participant pays for covered medical services. The remaining balance is covered by the participant's Takaful Operator.

Suppose a participant has a medical plan with a RM 50 co-payment to visit a primary care physician, a RM 150 co-payment to see a specialist, and a RM80 co-pay for generic drugs. The participant will pay these fixed amounts for those services regardless of what the services actually cost. The Takaful Operator pays the remaining balance (the "covered amount").

Therefore, if a visit to the patient's endocrinologist (a specialist) costs RM 550, the patient pays RM150 and the Takaful Operator pays the remaining RM400.

- **Deductible**

A deductible is a fixed amount that the participant must first pay regardless of the total cost of an eligible benefit. For example, if a deductible of RM 1,000 is stated in the plan selected, the participant will have to pay the first RM 1,000 of the total cost of an eligible benefit (excluding cost of daily room and board) and the remaining balance will be paid by the Takaful Operator up to the annual limit.

- **Panel of Hospitals**

The Takaful Operator will have a list of hospitals allowed under the certificate. The Operator may identify and work with several hospitals that may provide the desired healthcare.

7.5 "CASHLESS" HOSPITAL ADMISSIONS

In the case of 'Cashless' hospital admissions, the admission of a participant to a panel hospital is usually facilitated by the issuance of a letter of guarantee. This will dispense with the need to pay the hospital deposit prior to admission. Upon discharge from the hospital, the participant does not have to settle the bill with the hospital. All the eligible benefits will be paid by the Takaful Operator. The Takaful Operator is generally represented by a third-party administrator, which co-ordinates the discharge issues with the hospital and settles the bill. The claimant only needs to pay for non-reimbursable charges upon the discharge.

It is important to note that "cashless" hospital admission arrangements are usually non-contractual unless specifically mentioned in the Takaful contract. Usually, they are merely a value-added service provided by the Takaful Operator to certain eligible certificate owner.

7.5.1 Third party administrator

Third Party Administrators are appointed representatives of the Takaful Operator who are responsible for settling both reimbursement claims as well as cashless claims. The Third-Party Administrators are also responsible for processing the claimants' request for cashless service. The functions of third-party administrators are shown in Table 7.3.

Table 7.3: Functions of third-party administrators	
FUNCTION	**SERVICE**
CASHLESS SERVICE	Cashless Service ensures that if the participant is admitted in a hospital listed by the Takaful operator, the bill is paid directly by the Takaful operator and the participant does not have to make advance payment
CLAIM SETTLEMENT	Third party administrators will manage the claims – from the point of claim intimation to advising customers on network hospitals, approving cashless and reimbursement claims, and finally disbursing the claims to the customer.
MAINTAINING DATABASE	Once the certificate has been issued, all the records are passed on to the third-party administrators. All further communications of the participant will be managed by the third-party administrators and not by the Takaful operator. It is the responsibility of the third-party administrator to maintain the database of the participants and medical cards for management purposes.

7.6 MINIMUM STANDARDS ON PRODUCT DISCLOSURE AND TRANSPARENCY IN THE MARKETING OF MEDICAL AND HEALTH TAKAFUL PLAN

In addressing some of the key challenges, the regulators have issued the Guidelines on Medical and Health Business, and the Guidelines on Product Transparency and Disclosure in the marketing of medical and health products to reduce mis-selling and misrepresentation to consumers. The Guidelines must be read together with Schedule 8 of the Financial Services Act 2013 (FSA) on 'Disclosure Requirements'

The minimum standard stipulates the disclosure requirements that all Takaful Operators must comply with and the key features of the standard are as follows:

1. The Standard is applicable to all types of individual Medical and Health Takaful plans including riders attached to individual family plans.

2. For group Medical and Health Takaful plans, Takaful Operators should ensure that the disclosures are made to the master certificate owners.

3. The Standard shall apply to all channels through which Medical and Health Takaful plans are distributed.

4. Specific Disclosure Requirements

Takaful Operators and their intermediaries should provide sufficient details of the essential features of the Medical and Health Takaful plan to prospective participants.

a) Information on the Takaful Operator including the name and address.

b) Product description to describe the plan and its main objectives and purposes.

c) The specific information that should be disclosed regarding the benefits of a particular Medical and Health Takaful plan includes: -

- The form and amount of the benefits payable under the certificate;
- Details of the events, circumstances or contingencies upon which benefits are payable;
- Exclusions and limitations of benefits, pre-existing conditions, specified illnesses and qualifying period; and
- Contributions rates.

5. Other important disclosures regarding the Medical and Health Takaful plan are as follows:-

- Participants are given a "free-look period/cooling-off period" of 15 days from the delivery date of the certificate to review the suitability of the newly participated Medical and Health Takaful plan. It should be highlighted that participants can return the certificate and deduction of expenses incurred for the medical examination wouldbe made to the contributions if the certificate is returned to the Takaful operator during the period;
- As an example, the cost-sharing provisions shall not be mandatory and where applicable, shall be limited to the lower of 20% (excluding deductibles) or RM3,000 (inclusive of deductibles) on every claim, and shall not be mandatory.

- The possible implications of switching from one type of Medical and Health Takaful plan to another or from one provider to another; and
- Checklist indicating confirmation that the intermediary has clearly highlighted important aspects of the product to the proposer.

7.7 GROUP MEDICAL AND HEALTH TAKAFUL

A Group Medical and Health Takaful plan is similar in coverage to individual medical and health plans. The benefits, rights and obligations of the participants are contained in the master policy. It is normally an employer-sponsored coverage for business owners, employees and their dependents, as part of an employee's remuneration package. All eligible employees or members (of an association or club) can be covered and the contribution is based on:

- the group size,
- characteristics such as occupation class, average age band, claims experience and overall profitability of the account, and
- whether the services of a third-party administrator is used, in which case, a loading will be imposed.

A group medical and health takaful plan may be on a contributory or non-contributory basis. A non-contributory plan covers all eligible employees or members where the contribution is paid by the group certificate owner or employer. A contributory plan requires the participation of at least seventy-five percent (75%) of eligible group members, where the contribution may be partly subsidized or contributed in full by the member or employee.

A Takaful Operator is liable to the participant under a group certificate even if the group certificate owner has no permissible takaful interest in the life of that participant and if that participant has paid the contribution to the group policy owner regardless of whether the Takaful Operator has not received the contribution from the group certificate owner.

GROUP MEDICAL AND HEALTH TAKAFUL PLAN

Covers a group of participants (for e.g. employees or members of a club or association) under one master certificate

Contributions depends on group size, group characteristics, and inclusion of a third party administrator

Contributions payment:

- **Contributory: contribution is paid by the group certificate owner or employer**
- **Non-contributory: contribution is subsidized or contributed in full by the member or employee**

Figure 7.2: Summary of key points of a Group Medical and Health Takaful

7.8 RENEWAL OF MEDICAL AND HEALTH TAKAFUL

Renewal conditions may vary from one Takaful plan to another.

Generally, there are four (4) renewability options that may be practiced in Medical and Health Takaful plan. These options are described in Table 7.4 below.

Table 7.4 : Types of Renewability Options for Medical and Health Takaful Plan

Renewability Options	Description
Non-Cancellable and Guaranteed Renewable	Medical and Health Takaful plan with non-cancellable and guaranteed renewable means that the certificate cannot be cancelled, and the contract provisions cannot be changed without the participant's consent. In addition, the contributions cannot be changed as long as the participants continue pay the contributions.
Guaranteed Renewable	As long as the contributions are paid on the certificate, the Takaful Operator is obliged to renew the certificate (if the lifetime limit is not exceeded). However, the Takaful Operator can raise contributions as long as the change affects an entire class of participants and does not single out any individual. In the long run, guaranteed renewable certificate although more expensive are a safer option.
Conditionally Renewable	A contract which states that the certificate is renewable under certain conditions as defined in the contract.
Optionally Renewable	The fourth and final type of renewability provision offers the least security for the participants and has little application in modern medical and health coverage. It is known as an optionally renewable coverage. Under an optionally renewable provision, contribution may be increased, and benefits modified on a class basis. The Takaful Operator may renew or not renew the certificate at its discretion on the certificate's anniversary date; mid-term cancellation is not permissible under this type of certificate.

7.9 PAYMENT OF CONTRIBUTION

The payment of contribution will depend on the type of the certificate. Some certificates are issued on "cash-before-cover" basis, whereas other certificate may be subject to the 60 days contribution warranty.

A grace period may be allowed in the case of guaranteed renewable certificates, conditional renewal certificates and non-cancellable certificates, to provide the convenience to the certificate owner to make the payment. However, any claim occurring during the grace period is not payable although the Takaful Operator will not consider the certificate as lapsed. The certificate will only be considered lapsed if contribution is made before the end of the grace period.

CHAPTER 7	ASSESSMENT QUESTIONS

1. An Indemnity Certificate (under the Medical and Health Takaful) is one that

A. Reimburses the participants for relevant medical expenses incurred.
B. Reimburses the participants for critical illness only.
C. Reimburses the participant for death under the education plan.
D. Reimburses the participant for the TPD caused by accidents only.

2. Select the one statement below which is FALSE about the Benefit Certificate (under the Medical and Health Takaful)

A. It pays a pre-determined sum of money if a covered event occurs during the certificate period.
B. An example of a Benefit plan is a Hospitalisation Cash Benefit plan and Critical Illness Takaful.
C. An example of a Benefit plan is a Critical Illness Takaful.
D. None of the above is FALSE.

3. A Medical and Health Takaful Plan usually provides payment of claims up to the limits stipulated in the Takaful certificate. Select the combination below which is TRUE.

I. Per disability limit
II. Overall annual limit
III. Lifetime limit
IV. Unlimited limit

A. I & II
B. I, II & III
C. II, III & IV
D. All of the above are TRUE

4. The payment of a claim under a Medical and Health Takaful Plan does not result in a termination of the certificate except

A. in the event of a death claim.
B. in the event the Operator does not pay the claim.
C. the hospital providing the services does not accept the guarantee letter.
D. the participant does not pay the hospital for uncovered expenses.

5. To contain costs and abuses arising from inflated claims in Medical and Health Takaful, various methods are used by Takaful Operators to manage costs which include

I. Inner Limits
II. Schedule of Surgical Procedures
III. Maximum Period of Compensation
IV. Co-Takaful

A. I & II
B. I, II & III
C. II, III & IV.
D. All of the above are TRUE.

CHAPTER 8: DEVELOPMENT AND SUPERVISION OF THE TAKAFUL INDUSTRY IN MALAYSIA

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Describe the role of Bank Negara Malaysia in regulating and shaping the takaful industry
- Understand the role of the *Sharī'ah* Committee (SC) of the Takaful Operator
- Understand the relevance of the Personal Data Protection Act (PDPA) 2010 to the takaful business.
- Describe the role of the Ombudsman for Financial Services in resolving complaints/disputes arising from products and services provided by the Financial Service Providers (FSPs)

8.0 INTRODUCTION

Since the late 1990's, Bank Negara Malaysia has played a key role in transforming the life insurance and takaful industries through systematic and challenging regulations aimed at creating a level playing field among license holders, and driving initiatives aimed at creating a fair and just treatment of customers.

8.1 MALAYSIAN LEGISLATION, REGULATORY FRAMEWORK AND CONSUMER PROTECTION

8.1.1 Role of Central Bank of Malaysia (Bank Negara Malaysia)

Bank Negara Malaysia (BNM) was established on 26 January 1959 under the Central Bank of Malaysia Act, 1958. Its main purpose is to issue currency, act as a banker and adviser to the Government of Malaysia and regulate the country's financial institutions, credit system and monetary policy.

The Islamic financial system in Malaysia is given due recognition by the Central Bank of Malaysia Act 2009 via provision of the legal foundation for its development in the overall Malaysian financial system. Under this ambit, BNM will supervise takaful operators, Retakaful operators as well as international takaful operators.

BNM's supervisory role in relation to the takaful industry is to:

1. Preserve the stability of the takaful Industry;
2. Instill public confidence in the takaful Industry;
3. Promote strong governance standards in the management of takaful operators;
4. Ensure that consumers are well informed for their decision making;
5. Integrate supervision across all economic sectors.

8.1.2 Islamic Financial Services Act (IFSA) 2013

Malaysia has further strengthened the *Sharīʿah* governance and *Sharīʿah* compliance in the Islamic financial services industry by legislating the Islamic Financial Services Act (IFSA) 2013. This Act was passed by Parliament on June 30 2013, replacing the Takaful Act, 1984 and the Islamic Banking Act, 1983.

IFSA 2013 emphasizes a total *Sharīʿah* compliance effort of the Islamic finance industry through four key dimensions, namely:

1. *Sharīʿah* governance framework;

2. *Sharīʿah* standards for each contract used in Islamic financial transactions;

3. Pre-emptive measures to address issues of concern within the Islamic Financial Institutions' (IFIs) that may affect the interests of depositors and certificate owners; and

4. The effective and efficient functioning of Islamic financial intermediation.

8.1.3 Policy Document on *Sharī'ah* Governance

BNM issued the policy document on *Sharī'ah* Governance for Islamic financial institutions which came into effect on April 1, 2020. This policy document aims to further strengthen the effectiveness of *Sharī'ah* governance implementation and reinforce a closer integration of *Sharī'ah* considerations in the business and risk strategies of the Islamic financial institutions (IFIs). This supersedes the *Sharī'ah* Governance Framework for Islamic Financial Institutions issued on 22 October 2010.

Accordingly, IFIs are required to demonstrate that their *Sharī'ah* governance arrangements are operating effectively and appropriate to their size, nature of business, complexity of activities and structure. The Bank also expects to see evidence of better alignment in promoting a strong *Sharī'ah* compliance risk culture within Islamic financial institutions. This is in line with the more active roles expected of the Board, *Sharī'ah* Committee and senior management of IFIs'.

8.1.4 Takaful Operational Framework (TOF)

The Takaful Operational Framework (TOF) was issued by BNM on December 2010 and made effective from January 1, 2012. It outlines the parameters that govern the operational requirements relating to the management of takaful funds and shareholders fund. The TOF aims to achieve operational efficiency of takaful business and sustainability of takaful funds, thereby safeguarding the best interest of the takaful participants. The requirements in this policy document are developed in accordance with the IFSA 2013.

The issuance of TOF is part of the government's initiatives to promote orderly growth of takaful business. It also outlines the various rules and requirements for takaful operators without limiting the takaful operators from applying any particular contracts for their operations.

Among the objectives of the TOF are to:

- Enhance operational efficiency of takaful business;
- Build healthy takaful funds which are sustainable;
- Safeguard the interests of participants; and
- Promote uniformity in takaful business practices.

8.1.5 Life Insurance and Family Takaful Framework

Bank Negara Malaysia has issued the Life Insurance and Family Takaful Framework on 23 November 2015 that aims to promote innovation and a more competitive market supported by higher levels of professionalism and transparency in the provision of insurance and takaful products and services.

8.1.6 Operating Cost Controls for Life Insurance and Family Takaful Business

Bank Negara's Operating Cost Controls for Life Insurance and Family Takaful Business introduced in December 2019, aims to:

a. Deregulate the operating cost control limits on Life Insurers and Takaful Operators

b. Provide life insurers and takaful operators greater flexibility to manage operating expenses which commensurate with their business strategies

c. Encourage greater innovation and competition.

d. Set standards to strengthen the professionalism of insurance and takaful intermediaries.

The Operating Cost Controls by Bank Negara also introduced the Balanced Score Card (BSC) Framework for the life insurance and takaful intermediaries to further strengthen the fair treatment of consumers.

A licensed insurer and takaful operator shall reflect the following KPIs in the design of the BSC Framework:

(a) Completion rate of Customer Fact Find (CFF) form.

(b) Persistency rate for year 1 and year 2.

(c) Number of substantiated complaints.

(d) CPD hours.

8.1.7 Anti-Money Laundering Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLATFPUAA 2001)

The Anti-Money Laundering, Anti-Terrorism and Proceeds of Unlawful Activities Act, 2001 came into force on 15 January 2001 with the aim of preventing and combating money laundering, terrorism financing and the use of illegal proceeds.

8.1.7.1 Money Laundering

Money laundering is where cash proceeds originating from an unlawful activity are received and converted for the purpose of disguising the illegal gains as cash proceeds deriving from a legitimate activity and/or business. The act of money laundering is conducted to conceal the original source of the unlawful cash proceeds.

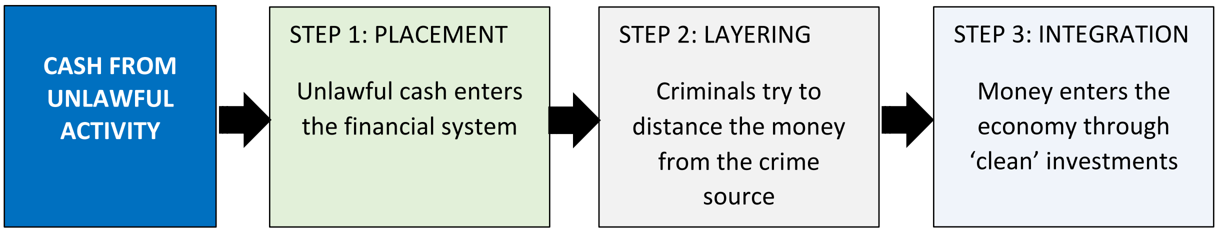

Figure 8.1: The Money Laundering Process

8.1.7.2 Terrorism Financing

Terrorism financing is where a person provides financial support and/or any other form of support to fund terrorists or terrorist organizations for the purpose of assisting and/or benefitting such terrorists or terrorist organizations to carry out acts of terrorism.

8.1.7.3 Proceeds of an Unlawful Activity

Under Section 3 of the Act, the term "proceeds of an unlawful activity" is defined as "any property derived or obtained, whether directly or indirectly, by any person as a result of any unlawful activity". The term "unlawful activity" is further defined as any activity which constitutes any serious offence or foreign serious offence, regardless of whether such activity, in whole or in part, takes place within or outside Malaysia.

It is pertinent that the takaful agents are vigilant when dealing with customers and should make it a point to know the source of the contributions, the occupation of the customer and the intent of taking a takaful plan.

8.2 FINANCIAL CONSUMER PROTECTION, COMPLAINTS AND DISPUTES

In line with ensuring that customers of financial products are granted protection and a fair and equitable treatment, there are several legislative and regulatory interventions which have been introduced over the years. These are elaborated below.

8.2.1 Malaysia Deposit Insurance Corporation (Amendment) Act 2021.

Perbadanan Insurans Deposit Malaysia (PIDM) is a statutory body established under the Malaysia Deposit Insurance Corporation Act (MDIC), 2005 to administer the national deposit insurance system aimed at protecting depositors in commercial and Islamic banks.

8.2.2 Takaful and Insurance Benefits Protection System (TIPS)

The MDIC, 2005 was later expanded by Parliament to administer the Takaful and Insurance Benefits Protection System (TIPS) effective 31 December 2010. TIPS is a system established by the Government to protect owners of takaful certificates and insurance policies from the loss of their eligible takaful or insurance benefits in the event that an insurer member or takaful operators fails and is unable to honor the takaful or insurance benefits. TIPS came into effect on 31 December 2010 and is administered by PIDM.

8.2.3 Ombudsman for Financial Services (OFS)

OFS (formerly known as Financial Mediation Bureau) has been appointed by Bank Negara Malaysia as the operator of the Financial Ombudsman Scheme (FOS) in April 2016 pursuant to the Financial Services Act 2013 (FSA) and the Islamic Financial Services Act 2013 (IFSA). OFS is an independent body set up as an alternative complaint/dispute resolution body to assist financial consumers to resolve their complaints/disputes with the Financial Service Providers (FSPs) who are its Members.

The recommendation of the Case Manager is not binding on both parties. If either claimant or the Member does not accept the Case Manager's recommendation, the complaint/dispute may be referred to the Ombudsman for Adjudication within 30 days from the date of recommendation or by the date stipulated in the recommendation (whichever is later).

The decision of the Ombudsman is final and is only binding on the Member if the complainant accepts that decision. However, if complainant chooses not to accept the Ombudsman's final decision, complainant is free to pursue the claim through any other means, including initiating a legal proceeding or arbitration.

8.2.4 BNM LINK

BNMLINK represents one of Bank Negara Malaysia's important points of contact with the general public. It acts as a centralised point of contact to facilitate a rapid and effective response for members of the public and small and medium enterprises (SMEs) in matters related to the financial sector.

BNMLINK through its exhibitions, self-service kiosks and booklets also provide consumer financial education as well as awareness on the role of Bank Negara Malaysia in nation building to the public.

Personnel of BNMLINK are available to assist and effectively address and attend to matters in the areas of banking, insurance, Takaful, SMEs financing, currency as well as other areas under the purview of Bank Negara Malaysia.

8.2.5 Motor Insurance Bureau (MIB)

MIB was incorporated on 24 October 1967 as a company limited by guarantee under the Company's Act 1965.

The objectives of the MIB are:

- To ensure as far as possible that Part IV of the RTO 1958 or any amendments shall be just and equitable and the objective be achieved to the fullest possible extent;

- To administer jointly with the government, the Insurance Guarantee Scheme Fund in respect of insolvent insurers;

- To make compassionate payments or allowances to persons injured or to dependents of persons killed through the use of motor vehicles; and

- To make calls or impose levies upon its members to enable the bureau to discharge its obligations.

8.2.6 Personal Data Protection Act (PDPA) 2010

The Personal Data Protection Act 2010 (PDPA) came into force in November 2013 to regulate the processing of personal data in a commercial transaction. PDPA applies to any person who processes or authorizes the processing of any personal data in respect of commercial transactions Personal data processed in Malaysia;

The purpose of the PDPA is to:

1. Protect personal data belonging to the public from being misused through commercial transactions;
2. Protect sensitive data from being misused;
3. Facilitate international trade;
4. Protect consumer rights.

8.3 *SHARĪ'AH* DEVELOPMENT AND COMPLIANCE

8.3.1 *Sharī'ah* Advisory Council (SAC) of Bank Negara Malaysia

The *Sharī'ah* Advisory Council of Bank Negara Malaysia (SAC) was established in May 1997 as the highest *Sharī'ah* authority in Islamic finance in Malaysia. The SAC has been given the authority for the ascertainment of Islamic law for the purposes of Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business, which is based on *Sharī'ah* principles and is supervised and regulated by Bank Negara Malaysia.

As the reference body and advisor to Bank Negara Malaysia on *Sharī'ah* matters, the SAC is also responsible for validating all Islamic banking and takaful products to ensure their compatibility with the *Sharī'ah* principles. In addition, it advises Bank Negara Malaysia on any *Sharī'ah* issue relating to Islamic financial business or transactions of Bank Negara Malaysia as well as other related entities.

8.3.2 *Sharī'ah* Committee (SC) of the Takaful Operator

Under IFSA 2013, it is a statutory requirement that a *Sharī'ah* Committee be set up in each institution licensed under the said legislation. The Committee is established for purposes of advising the licensed institution in ensuring its business, affairs and activities comply with *Sharī'ah*. The *Sharī'ah* Committee, and the company management are the key players responsible for the *Sharī'ah* governance of the IFIs. Although the Board is ultimately accountable and responsible for the overall *Sharī'ah* governance framework and *Sharī'ah* compliance of the IFIs.

SHARĪ'AH DEVELOPMENT AND COMPLIANCE

SAC of Bank Negara Malaysia

- the sole authoritative body on *Sharī'ah* matters pertaining to Islamic banking, takaful and Islamic finance.
- responsible for validating all Islamic banking and takaful products to ensure their compatibility with the *Sharī'ah* principles

SC of the Takaful Operator

- advise the licensed institution in ensuring its business, affairs and activities comply with *Sharī'ah*
- oversight of the *Sharī'ah* compliance of business operations, *Sharī'ah* Research and *Sharī'ah* Audit function

Figure 8.2: Role of SAC and SC in *Sharī'ah* development and compliance.

CHAPTER 8	ASSESSMENT QUESTIONS

1. The main purpose of Bank Negara Malaysia (BNM) is_____. Select the option that is FALSE

A. to issue currency, act as banker and adviser
B. undertake all economic activity for the government and country
C. act as banker and adviser to the government
D. regulate the country's financial institutions

2. BNM role as supervisor for the Takaful industry is to achieve the following objectives. Select the COMBINATION THAT IS TRUE.

I. Preserve the stability of Takaful Industry
II. Promote strong governance standards in the management of Takaful Operators
III. Create powers to integrate all economic activity under its supervision
IV. Approve all investment of Takaful Operators to maximize participant returns

A. I & II
B. I, II & III
C. II, III & IV.
D. All of the above are TRUE.

3. The main objectives of IFSA 2013 are to___. Select the option below which is FALSE.

A. Promote financial stability
B. Strengthen compliance with *Sharī'ah*
C. Strengthen regulatory framework for Islamic financial institutions
D. to promote monetary and financial stability, and to exercise oversight over payment systems.

4. *Sharī'ah* Governance Framework (SGF) has the following objectives EXCEPT____.

A. to set out the expectations on an Islamic financial institution's *Sharī'ah* governance structures
B. ensuring that all operations and business activities are consistent with *Sharī'ah* principles
C. to ensure proper and effective *Sharī'ah* audit functions
D. to ensure all insurance and takaful companies are *Sharī'ah* compliant

5. The Takaful Operational Framework (TOF) objectives include all of the following EXCEPT

A. to enhance operational efficiency of Takaful business
B. safeguard the interests of Takaful participants
C. promote uniformity with the standard practices of the life insurance business
D. promote uniformity in Takaful business practices

CHAPTER 9: INDUSTRY SELF- REGULATION

LEARNING OUTCOMES

After reading this chapter you will be able to:

- Understand 'why' self-regulation is needed in the takaful industry
- Describe the relevance of other organizations in supporting the self-regulation efforts and in the development and provision of services.

9.0 INTRODUCTION

"Self-Regulation" is granted by government to the industry associations to permit them to regulate the activities of their members within certain parameters and guidelines. These associations are vested with powers to enforce the rules and regulations formulated (through Intercompany agreements) to ensure professional conduct of their respective businesses. The main purpose of the industry association is to facilitate "self-regulation" among members of the particular industry.

The associations also act as a platform for consultation and mediation between the industry and Bank Negara Malaysia and other bodies, where required.

9.1 INDUSTRY ASSOCIATIONS

The membership of Takaful Operators and Insurance Companies in their respective industry associations is mandatory and is prescribed by law. Examples of these are the Malaysian Takaful Association, the Life Insurance Association of Malaysia, Persatuan Insurans Am Malaysia etc.

However, there are instance when trade associations are also formed in the insurance and takaful industry to protect and advance the common interest of its members. Examples include the National Association of Malaysian Life Insurance and Family Takaful Advisers (NAMLIFA) and the Malaysian Financial Planning Council.

The industry also has professional organizations that have been established to promote educational and professional development such as the Malaysian Insurance Institute, Islamic financial Services Board, IBFIM etc.

9.1.1 Malaysian Takaful Association (MTA)

Malaysian Takaful Association (MTA) was incorporated in 2002 with the objective of promoting the establishment of a sound Takaful structure in Malaysia in cooperation and consultation with the Director-General of Takaful. MTA is dedicated in promoting the interest of its members and to supervising the self-regulation within the industry.

It also undertakes to:

1. Promote and represent the interests of the member companies and the Takaful industry.

2. Render where possible, to member companies, such advice and assistance as may be required.

3. Circulate information likely to be of interest to member companies, and to collect, collate and publish statistics and other information relating to Takaful.

4. Cooperate with other associations, both domestic and global for common interest.

The Vision and Mission of the MTA are shown in Table 9.1 below.

Table 9.1: Vision and Mission of The Malaysian Takaful Association

Vision for the industry and MTA	Mission of MTA
To achieve the desired future takaful landscape by creating value for the industry, society and country in every aspect of our conduct, in line with the Maqasid Shariah	**To support the achievement of our vision, we are committed to build and strengthen our foundation through MTA Reform Plan 2022-2023 (Islah23) focusing on the following key strategic objectives:** **•establishing Visibility for MTA;** **•adopting Best Governance practice;** **•achieving Operational Efficiency; and** **•attaining organizational Sustainability.**

9.1.2 Life Insurance Association of Malaysia (LIAM)

Formed in 1974, the Life Insurance Association of Malaysia (LIAM) is a trade association registered under the Societies Act 1966. LIAM has a total of 16 members, of which 14 are life insurance companies and 2 life reinsurance companies.

The objectives of LIAM are as follow:

- To promote public understanding and appreciation for life insurance.
- To strengthen the market practices of the life insurance industry through self-regulation.
- To support the regulatory authorities in developing a strong and healthy industry.
- To enhance the professionalism of staff and agents through continuous training and education.
- To liaise and work with local and foreign insurance organizations towards achieving common objectives and benefits.

9.1.3 Persatuan Insurans Am Malaysia (PIAM)

PIAM is the national trade association of all licensed direct and reinsurance companies for general insurance in Malaysia. Currently, PIAM has 23 member companies comprising 19 direct general insurance and 4 reinsurance companies operating in Malaysia.

The corporate objectives of PIAM are to:

- Articulate one unified voice for and on behalf of the industry.
- Create favourable business environment for member companies.
- Promote image of the industry and its role in the Economy.
- Educate consumers on general insurance products.
- Foster public confidence by protecting the interests of consumers.
- Establish a sound and efficient insurance infrastructure with best practices.
- Raise professionalism and ensure standards in distribution.
- Harmonize approaches and solutions to industry issues.

9.1.4 Malaysian Insurance and Takaful Brokers Association (MITBA)

MITBA, established in 1974, is the only national body of insurance and takaful brokers and is the collective voice of the industry – advising members, the regulator, consumers, trade associations and other stakeholders on key insurance issues. MITBA provides training, technical advice, guidance on regulation and business support. Its role is to elevate the status of insurance and takaful brokers through professional development and by establishing improved standards of qualification and ethical practice.

9.2 KEY ORGANISATIONS SUPPORTING THE TAKAFUL INDUSTRY

9.2.1 Organizations involved in Setting Operational Standards for the Industry

9.2.1.1. Islamic Financial Services Board (IFSB)

The Islamic Financial Services Board (IFSB), which is based in Kuala Lumpur, was officially inaugurated on 3rd November 2002 and started operations on 10th March 2003.

It serves as an international standard-setting body of regulatory and supervisory agencies that have vested interest in ensuring the soundness and stability of the Islamic financial services industry, which is defined broadly to include banking, capital market and insurance.

9.2.1.2 Malaysian Accounting Standards Board (MASB)

The Malaysian Accounting Standards Board (MASB) was established under the Financial Reporting Act 1997 (Act) as the standard-setting body of the Financial Reporting Foundation (FRF) whose functions shall be the determination and issuance of accounting standards for the preparation of financial statements, which are required to be prepared or lodged under any law administered by the Securities Commission Malaysia, Bank Negara Malaysia or the Registrar of Companies.

9.3. LEARNING AND DEVELOPMENT INSTITUTIONS

9.3.1 IBFIM

IBFIM is an industry-owned institute whose objective is to serve the needs of the Islamic finance industry stakeholders in talent and business development. Since 2001, IBFIM has been conducting training programs as well as extending business and *Sharī'ah* advisory services.

9.3.2 Malaysian Insurance Institute (MII)

The Malaysian Insurance Institute (MII) is the leading professional body and education institution for the Malaysian insurance industry. It provides internationally recognised qualifications in insurance, risk management and financial planning. It is highly respected as a regional centre that offers an extensive range of quality education programs and training courses for professionals in the insurance and financial services industry.

9.4 OTHER ASSOCIATIONS SUPPORTING THE INDUSTRY

9.4.1 Association of Malaysian Loss Adjusters

The Association of Malaysian Loss Adjusters established in 1981 is the association of loss adjusters approved by the Minister and is registered as a society under the new Section II of the Societies Act 1966. Section 20C (1) of the Insurance Act 1963 requires that no person shall act or hold himself out as an adjuster unless he is the holder of a license granted by the DGI and is a member of an association of adjusters approved by the Minister of Finance.

9.4.2 Association of Financial Advisers (AFA)

The AFA is a representative body for financial advisers in the country.

9.4.3 Malaysian Financial Planning Council (MFPC)

MFPC is a self-regulatory body to promote financial literacy and enhance the profession of Financial Planners through education and training.

The Registered Financial Planner (RFP) programme introduced by MFPC was launched by Bank Negara Malaysia (BNM) in November 2002. The RFP and the *Sharī'ah* RFP programmes are recognised by BNM and the Securities Commission as pre-requisite for the Financial Adviser's License and the Capital Market Services Representative License respectively.

In addition, MFPC has also established Best Practice Standards and the Code of Ethics for Financial Planners, which are continually reviewed and updated in line with changes in the legal and regulatory framework.

CHAPTER 9 | ASSESSMENT QUESTIONS

1. The main objectives of Malaysian Takaful Association (MTA) includes the following. Select the CORRECT combination below.

I. To promote and represent the interests of the member companies and the Takaful industry
II. To render where possible, to member companies such advice and assistance as may be required
III. To advise Bank Negara on all matters related to the takaful industry
IV. Cooperate with other associations, both domestic and global for common interest

A. I & II
B. I, II & IV
C. II, III & IV.
D. All of the above are TRUE.

2. The key objectives of Malaysian Insurance and Takaful Brokers Association (MITBA) are ____. Select the option below which is FALSE

A. To advise and prepare reports on broking for Bank Negara on all matters related to the takaful broking business in Malaysia.
B. To ensure that employees of members are professionally qualified, conversant with insurance and takaful laws and practices
C. To provide a platform for the promotion of discipline, professional conduct and etiquette.
D. To promote the healthy growth of the insurance industry in line with National objectives.

3. Select the statement below which is FALSE.

A. IBFIM is an industry-owned institute whose objective is to serve the needs of the Islamic finance industry stakeholders in talent and business development
B. The Islamic Financial Services Board (IFSB) is an international body of regulatory and supervisory agencies ensuring the soundness and stability of the Islamic financial services industry
C. One of the objectives of the Life Insurance of Malaysia (LIAM) is to strengthen the market practices of the life insurance and takaful industry through self-regulation.
D. PIAM constitutes the statutory association recognized by the Government of Malaysia for all registered insurers who transact general insurance business in this country.

4. The key objectives of Malaysian Financial Planning Council (MFPC) include all of the following EXCEPT

A. To certify financial planners and uplift their professionalism
B. To enhance the image of the financial planning profession
C. To set all rules and enforce all practice standards in the financial planning industry
D. To provide self-regulation in the financial planning industry.

5. “Self-Regulation” is granted by government to the industry associations to

A. enable them to pass laws and rules to govern their members.
B. empower the association to discipline and sack any member who contravenes the law.
C. the permit them to investigate and check the operational efficiency of its members to ensure fair and equitable services to the members of the public.
D. formulate rules and regulations through intercompany agreements to ensure professional conduct of their respective businesses.

GLOSSARY OF FAMILY TAKAFUL TERMS

Bancatakaful
Promotion and marketing of Takaful products by the banking institutions.

Basic Sum Covered
This is the minimum amount to be received upon death or when the Person Covered becomes disabled.

Contributions
Monetary contribution provided once or periodically by a participant to a takaful operator for the purpose of investment and *tabarru*'.

Co-Takaful
When the person covered agrees to pay a certain percentage of the costs charged for any medical treatment.

Co-payment
A provision in a medical and health certificate which requires the certificate holder to bear the difference in room charges as well as other eligible benefits (usually 10%-20%) described in the certificate contract if the rate charged by the hospital is higher than the certificate holder's eligibility.

Deductible
Amount of expenses that must be paid out of pocket before a takaful operator pays for any expenses.

Fatwa
Religious decree or an authoritative legal opinion based on Islamic law (*Sharī'ah*).

Fundamental Risk
A risk that affects the whole community or a large number of people within the community.

Gharār
Refers to any element of absolute or excessive uncertainty in any business or about the subject of a contract or its price, or mere speculative risk. It has potential to lead to undue loss to one part of a contract and unjustified enrichment of another, which is prohibited.

Gharār Fāhish
Major uncertainties.

Gharār Yāsir
Minor uncertainties.

Group Family Takaful
Family takaful (usually without medical examination) on a group of people under a master Certificate. It is typically issued to an employer for the benefit of employees, or to members of an association.

Hazard
A circumstance that increases the likelihood or probable severity of a loss.

IFSA 2013
Islamic Financial Services Act 2013 released by BNM.

Maqasid Sharī'ah

Objectives of the *Sharī'ah*. *Sharī'ah* aims to promote benefits and remove harm in the life of mankind.

Material fact
A material fact is defined as any fact that would reasonably influence a takaful operator's underwriting decision.

Maysir
Gambling.

Medical and Health Takaful
A contract that provides specified medical treatment benefits such as the cost of hospitalisation, surgical and physician consultation fees against risks of a person being diagnosed with certain illnesses or having injury arising from an accident.

Medical Benefit Certificate
A benefit certificate pays a pre-determined sum of money if a covered event occurs during the certificate period, or the payment of an allowance or income stream at regular intervals for the period that the certificate owner is incapacitated and/or hospitalized

Medical Indemnity Certificate
It is a type of medical plan that reimburses the participants for relevant medical expenses incurred.

Moral Hazard
In Takaful, moral hazard refers to the change in behavior of a participant in a way that raises costs for the Takaful Risk Fund. For example, a person with motor Takaful may drive with less caution or a participant may take up skydiving as a new hobby.

Muḍārabah
An agreement between the entrepreneur and the capital provider in a business venture to share profit based on an agreed profit-sharing ratio. Losses are borne by the capital provider.

Particular risk
The risk must be a risk that affects individuals or an entity.

Permissible Takaful Interest
A participant's financial interest in the subject matter covered under the Takaful.

Person Covered
A takaful participant or other person in respect of whom the takaful participant enters the contract of takaful and in respect of whom takaful benefits are payable to the takaful participant or his beneficiaries on the occurrence of pre-agreed events under the contract of takaful (Section 2, Islamic Financial Services Act 2013).

Pre-Existing Condition
A coverage limitation included in many health takaful certificates which states that certain physical or mental conditions, either previously diagnosed or which would normally be expected to require treatment prior to issue, will not be covered under the new certificate for a specified period of time.

Pure Risk
A risk where there is a loss or no loss.

Qard al-Hasan
Lending without interest or benevolent loan

Ribā
Interest. An increase, addition, unjust return or advantage obtained by the lender as a condition of a loan. Any risk-free or "guaranteed" rate of return on a loan or investment is Riba. Riba in all its forms is prohibited in Islam.

Ribā Buyū'
Usury of trade.

Ribā Duyūn
Usury of debt.

Rider
An attachment to a certificate that modifies its conditions by expanding benefits.

Risk Avoidance
A technique that seeks to eliminate or prevent the risk through avoiding the activity contributing to the risk.

Risk Control
A technique to improve the risk to achieve an acceptable and fair standard.

Risk Retention
Self-managing the risk if the current level of the risk is already at an acceptable level.

Risk Sharing
A process of sharing risks with others who have similar nature of risk.

Risk Transfer
A process of transferring risks to an organization or individual.

Sharī'ah
Islamic law derived from three sources: the Quran, the Sunnah and Ijma (agreed upon by majority of independent scholars). A "Shariah compliant" product meets the requirements of Islamic law.

Speculative Risk
A risk that affects the whole community or a large number of people within the community.

Sum Covered
The amount of money that a Takaful Operator is obligated to cover in the event of a covered loss. It is dependent upon the contribution price that is being paid for the takaful coverage.

Sunnah
It refers to whatever was reported that Prophet Muhammad (peace be upon him) said, did or gave his tacit approval.

Surplus
The excess of the participants' fund carried forward less actuarial liabilities.

Tabarru'
A portion of participant's contribution for the purpose of mutual assistance and used to pay claims submitted by eligible claimants. Takaful participants mutually guarantees each other against a defined risk or catastrophe befalling one's life, property or any form of valuable things.

Takaful Fund
A common fund contributed by takaful participants and maintained by a licensed takaful operator, which is separate from takaful operator's shareholders' fund.

Underwriting
Selection of takaful participants according to the takaful operator's risk standards.

Utmost Good Faith
The principle of utmost good faith requires anyone seeking Takaful participation to disclose all relevant facts. These are facts that would influence the judgment of a prudent underwriter in fixing the contribution or determining whether they will take on the risk. Where material non-disclosure can be proven, a contract can be voided.

Wakālah
Agent-principal relationship, where a person nominates another to act on his behalf.

The above glossary and explanation do not necessarily bear their legal meanings as they are prepared strictly for the information of readers who are unfamiliar with certain terms and expressions used.

ANSWERS TO SELF-ASSESSMENT QUESTIONS

	1	2	3	4	5
CHAPTER 1	A	C	C	A	B
CHAPTER 2	A	D	C	C	A
CHAPTER 3	A	C	C	B	D
CHAPTER 4	D	B	B	D	A
CHAPTER 5	A	D	A	A	A
CHAPTER 6	D	A	B	A	A
CHAPTER 7	A	D	B	A	D
CHAPTER 8	B	A	D	D	C
CHAPTER 9	B	A	C	C	D