

This special article highlights
the conceptual aspects of
general takaful and presents
an insight into the operation
of general takaful
business in Malaysia.

GENERAL TAKAFUL: A CONCEPTUAL FRAMEWORK

I. Takaful & Takaful Business – An Introduction

Takaful is derived from an Arabic word which means mutual guarantee, whereby a group of participants agree to mutually guarantee among themselves against a defined loss. This simple concept of takaful is the foundation of the takaful business, which is the present Shariah-compliant insurance.

Takaful business as currently practiced can be categorised as follows:

i. By management structure of takaful operator	<ul style="list-style-type: none"> • Cooperative or mutual takaful whereby the participants themselves manage and accountable for the takaful scheme; or • Takaful Tijari or commercial takaful whereby management of takaful scheme is undertaken by separate entity specifically appointed for this purpose known as takaful operator.
ii. By type of business	<ul style="list-style-type: none"> • Family takaful that provides a combination of long-term savings and protection for participants and their dependents arising from death, disability or survival. • General takaful focuses on a short-term protection of properties and liabilities against any loss or damage.

II. General Takaful – Underlying Concepts

A general takaful scheme essentially involves the relationship of two parties; the takaful operator and a group of participants. Their relationship is governed by the following underlying concepts:

i. Among participants	<ul style="list-style-type: none"> • Governed by the contracts of takaful and tabarru'. • Tabarru' in general takaful is the agreement by a participant to relinquish, as a donation, a sum of contribution that he agrees to pay into a takaful fund, to fulfill his obligation of mutual help and joint guarantee should any of his fellow participants suffer a defined loss. • The concept of tabarru' is the pillar in takaful system that makes the Gharar (uncertainty) element allowable under the takaful contract.
ii. Between participants and takaful operator	<ul style="list-style-type: none"> • Governed either by the contract of mudharabah (profit-sharing) or wakalah (agency), whereby the takaful operator is appointed to manage the scheme. Other Islamic contracts may also be used such as combination of mudharabah or wakalah, waqf or trust. • Based on the underlying contract, takaful operator will receive fee or share the operating profit as a reward for managing the takaful scheme.

III. Comparison Between General Insurance and General Takaful

Apart from the distinctive features of takaful contract, there are other distinguishing factors between general takaful and general insurance as practised in Malaysia as follows:

	General Insurance	General Takaful
Operating expenses	<ul style="list-style-type: none"> Insurers will charge the actual operating expenses to the general insurance fund. 	<ul style="list-style-type: none"> Operating expenses can either be borne by the shareholders' fund (under mudharabah model) or be charged to the participants as fixed upfront charges (under wakalah model).
Investment of fund	<ul style="list-style-type: none"> There is no restriction apart from those imposed for prudential reasons. 	<ul style="list-style-type: none"> Assets of the takaful funds are invested in Shariah-compliant instruments.
Operating profit	<ul style="list-style-type: none"> All the operating profit will be credited into the shareholders' fund. 	<ul style="list-style-type: none"> Operating profit at the end of the year will be distributed to the takaful operator and eligible participants based on the pre-agreed profit-sharing ratio as stipulated in the contract.

IV. Principles of General Takaful Contract

Based on the established legal maxim of *fiqh* concept of *al-asl fi al-ashya' al-ibahah* (all things are permissible unless prescribed otherwise), general takaful contract assimilates four main general insurance principles below in its practices that embody **the concept of fairness** in dealings as encouraged by Shariah. Other general insurance principles are also applied in the general takaful contract and practices so long as they do not conflict with Shariah.

Permissible Takaful Interest (Insurable Interest)

- Permissible takaful interest exists when there is a relationship between participants and the subject matter, normally arising from several situations as follows:
 - **Ownership of property.** The owners of property will lose financially if their property is damaged or destroyed.
 - **Potential legal liability.** Permissible takaful interest can also exist when there is a financial loss arising from legal liability. For example, employers have legal liability to pay compensation to their employees if accidents occurred during employment.
 - **Contractual right.** 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. It also prevents moral hazard among the participants.

Utmost Good Faith

- All parties in a takaful contract are obliged to disclose all material information, at the inception of the contract and upon the claim settlement.
- Failure to disclose and/or misrepresentation of any material facts could lead to contract being voided.
- Misrepresentation on the part of takaful operators could also lead to criminal sanction under the law.
- This is fundamental 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.

Principle of Indemnity

- The takaful scheme provides financial compensation in order to place the affected participant in the same pecuniary position as he enjoyed immediately before the loss.
- It ensures the participant does not get more than his actual amount of loss to prevent the participant from making profit from the claim.
- 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.

Principle of Subrogation

- The takaful scheme in indemnifying the participant, is entitled to recover from third party whose liable for the loss.
- In this case, participants receive compensation from the third party through the takaful operator: It reinforces the principle of indemnity by preventing the participant from collecting twice for the same loss and profiting from the loss.

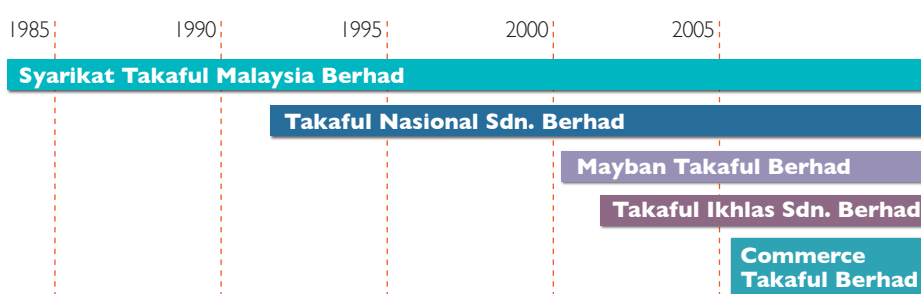
GENERAL TAKAFUL IN MALAYSIA: AT A GLANCE

The general takaful industry in Malaysia has experienced a remarkable growth since its inception more than 20 years ago. This is evident by the increasing number of players, the viable and progressive industry performance, comprehensive market structure and wide range of products provided by the takaful operators.

I. Rapidly Growing Industry

Currently there are five takaful operators conducting general takaful business. The size and scale of takaful industry today represents the growing recognition of tremendous potential it offers in contemporary Islamic finance business. The takaful operators are supported by a comprehensive infrastructure that has improved over the last 20 years as illustrated below:

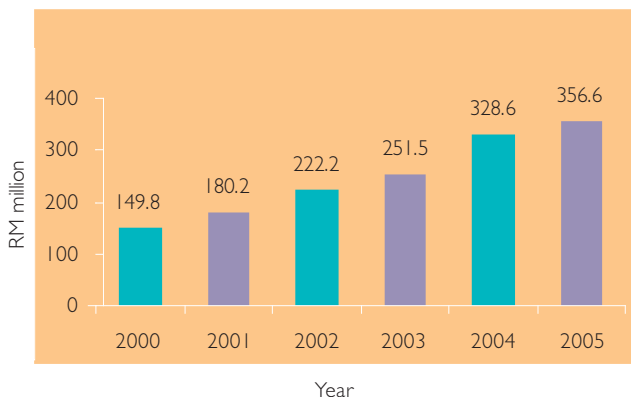
Stages of Institutional Set-up



	1985	1990	1995	2000	2005
Number of branches	-	31	42	124	147
Number of agents	-	-	39	694	2,278
Number of brokers	-	-	-	-	25
Number of bancatakaful	1	1	12	16	39
Number of adjusters	-	-	-	-	32

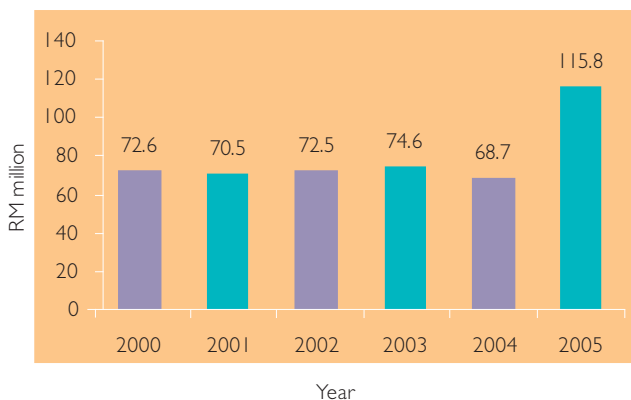
II. Viable & Progressive Industry Performance

Net Contributions of General Takaful



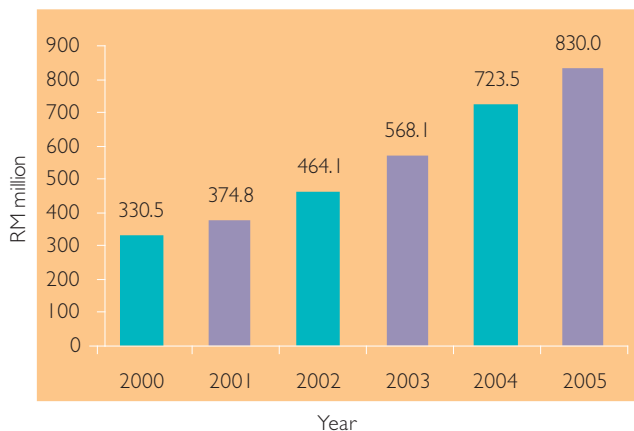
General takaful industry in Malaysia recorded progressive growth, particularly over the last six years. Public demand for general takaful products has continuously risen, evident by the improvement in net contributions of general takaful. Total net contributions for general takaful expanded by double-digit growth rate at an average of 19.2% annually, to register RM356.6 million in 2005.

Underwriting Profit for General Takaful



In terms of profitability, the underwriting profit was sustained at an average of RM71.8 million for the period from 2000 to 2004. In 2005, the underwriting surplus increased nearly two-fold to RM115.8 million.

Total Assets of General Takaful



Total assets grew stronger over the years, with an increase of more than two-fold of its assets from RM330.5 million in 2000 to reach RM830 million in 2005. In 2005, the assets of general takaful accounted for 4.41% of the general insurance industry.

III. Comprehensive Market and Regulatory Infrastructure

Since the last two decades of its inception, the takaful sector has been operating in a structured and competitive market and well supported by a conducive regulatory infrastructure. The takaful industry has been able to function effectively with the existence of a comprehensive market structure. Collaborative efforts and continuous support from each party has been the critical factors in enhancing the resilience and robustness of the industry.

Legal and Regulatory Framework	
Bank Negara Malaysia	<ul style="list-style-type: none"> Formulate regulations and prudential policies as well as supervise the industry to ensure that the takaful business is managed prudently. Govern the conduct of the takaful operators through the enactment of Takaful Act 1984.
Shariah Advisory Council	<ul style="list-style-type: none"> Determine the Shariah rulings on Islamic banking, finance and takaful transactions conducted by financial institutions under the purview of Bank Negara Malaysia. Serve as the reference point for the court or arbitrator in dispute resolution that involves Shariah issues in Islamic banking and finance cases.
Dedicated High Court in the commercial division of High Court Kuala Lumpur for muamalat cases	<ul style="list-style-type: none"> Adjudicate all cases relating to Islamic banking and finance.

Market Players	
Takaful operators	<ul style="list-style-type: none"> Underwrite the takaful business and act as the administrator of the fund on behalf of the participants.
Retakaful companies	<ul style="list-style-type: none"> Underwrite takaful business from the takaful operators.
<p>Takaful intermediaries and adjusters</p> <p>Provide supporting roles to the industry by complementing the takaful operators in serving the public.</p>	<p>Agents</p> <p>Represent takaful operators in marketing and servicing their products in return for commissions received from takaful operators.</p> <p>Brokers</p> <p>Act on behalf of consumers to place the application for coverage with an appropriate takaful operator and receive brokerage fee in return for the services rendered.</p> <p>Bancatakaful</p> <p>Marketing of takaful products through a bank's established distribution channel.</p> <p>Adjusters</p> <p>Investigate claims, evaluate losses incurred and make recommendations on claim settlement.</p>

Industry Associations

Malaysian Takaful Association (MTA)	<ul style="list-style-type: none"> Improve industry self-regulation through uniformity in market practices and promoting a higher level of cooperation among the players in developing the industry.
Persatuan Insurans Am Malaysia (PIAM)	<ul style="list-style-type: none"> Collaborate with takaful association to promote the establishment of sound insurance and takaful industry.
Insurance Brokers Association of Malaysia (IBAM)	<ul style="list-style-type: none"> Elevate status, safeguard and advance the interest of brokers as well as procure their general efficiency and proper professional conduct.
Association of Malaysia Loss Adjuster (AMLA)	<ul style="list-style-type: none"> Promote, develop and establish a sound loss adjusting profession in Malaysia.

Training

International Centre for Education in Islamic Finance (INCEIF)	<ul style="list-style-type: none"> Provide the educational needs of the different levels of Islamic finance practitioners through certification programmes, specialising in developing professionals and specialists in Islamic finance as well as a talent development solution for the global Islamic financial services industry.
Islamic Banking and Finance Institute Malaysia (IBFIM)	<ul style="list-style-type: none"> Provide training and education, advisory and consultancy, and research and development in Islamic finance to meet the industry needs at the technical level.
International Centre for Leadership in Finance (ICLIF)	<ul style="list-style-type: none"> Provide leadership programmes to top management to spearhead the development of world class leaders in Islamic banking and finance.

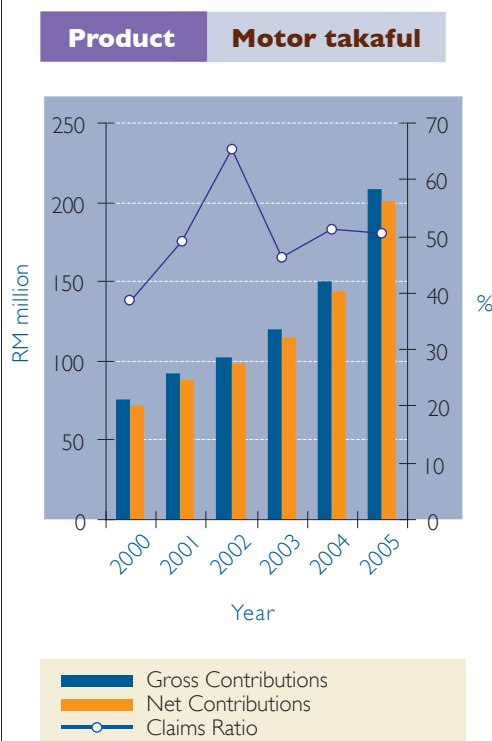
Consumer Education Programmes

Laman Informasi Nasihat dan Khidmat (LINK) Bank Negara Malaysia	<ul style="list-style-type: none"> 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. Provide consumer services on general enquiries and complaints as well as financial education.
InsuranceInfo	<ul style="list-style-type: none"> Provide information on insurance and takaful products and services, and educate the consumers on their rights and responsibilities in a clear and simple manner.

Supporting Institutions or Agencies	
Insurance Services Malaysia (ISM)	<ul style="list-style-type: none"> Provide infrastructure of databases to build competencies in prudent pricing and reserving and increase efficiencies in operation by info-sharing, fraud detection and information technology (IT) usage.
Motor Research Consortium (MRC)	<ul style="list-style-type: none"> Provide a centralised database on motor parts and labour costs as used for reference by insurers, takaful operators, adjusters and motor repairers.
Financial Mediation Bureau (FMB)	<ul style="list-style-type: none"> Provide consumers with a fast, convenient and efficient avenue to channel their complaints, disputes or claims for resolution as an alternative to the courts.

IV. Availability of Wide Range of Products

The types of general takaful products provided by Malaysian takaful operators constantly increase in variety and sophistication, which is consistent with the demands and expectation of the consumers.



Coverage

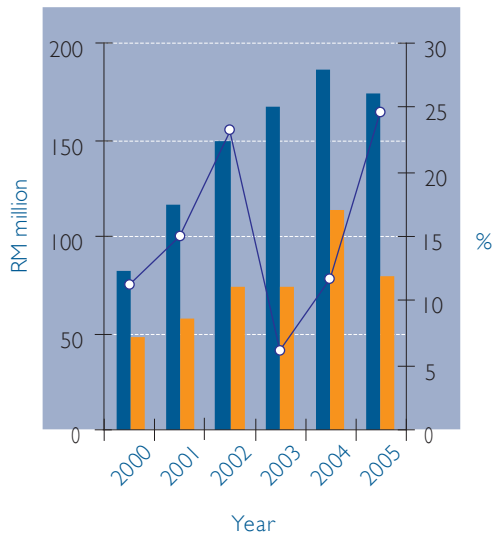
- Motor takaful provides coverage against loss or damage to the participant's own vehicle or to third party bodily injury or death, third party property loss or damage due to accidental fire, theft or accident.

Performance

- Motor takaful business has registered strong growth since 2000 with an average growth rate of 22.9% in terms of net contributions.
- In 2005, motor takaful emerged as the largest component of general takaful in terms of gross contributions, with 37.6% share of the total gross contributions after being the second largest to fire takaful from 2000 to 2004.
- Motor takaful typically has high retention ratio averaging at 97.8% owing to the less complex nature of its scheme coverage.
- Motor takaful business experienced better claims ratio than that of its conventional insurance counterpart over the period which allowed better prospect of sharing operating profit with participants. In 2005, motor takaful recorded claims ratio of 50.4% (insurance: 66.3%).

Product

Fire takaful



■ Gross Contributions
■ Net Contributions
—○— Claims Ratio

Coverage

- Basic fire takaful provides coverage on property against loss or damage caused by fire, lightning or explosion.
- Houseowner takaful provides coverage on residential property against loss or damage by fire or other perils such as flood, burst of pipe or earthquake.
- Householder takaful covers loss or damage to the content of residential property and fatal injury to participants arising from fire and other perils.

Performance

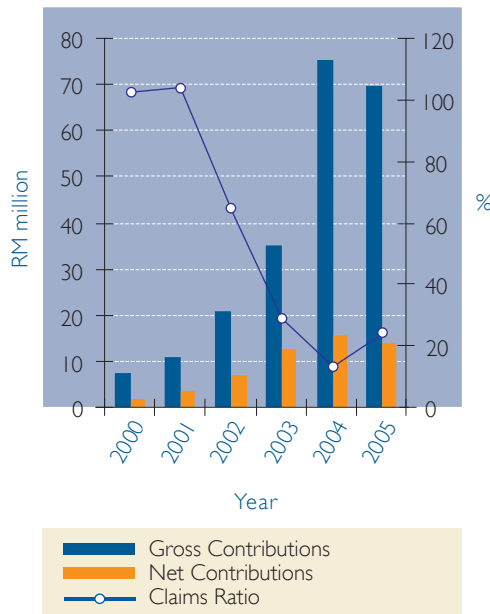
- In terms of net contributions, fire takaful remained as the second most dominant business in the general takaful industry. It has recorded annual growth rate of 14% since 2000.
- In 2005, fire takaful registered a retention ratio of 69.7% and recorded the largest retakaful outflow abroad of RM134.4 million.
- The claims ratio increased to 24.6% in 2005 compared to 11.8% in 2004. The increase is due to large claims recorded during the year.

Product

Marine, Aviation and Transit (MAT) takaful

Coverage

- Marine takaful provides cover for the hull, the cargo transported by sea, air or land and the liabilities that may devolve upon ships and ship operators against loss or damage.
- Aviation takaful provides coverage for aircraft, goods transported and legal liability to third parties in respect of any perils of aerial transportation or navigation.



Performance

- In 2005, the gross contributions for MAT comprise mainly marine hull takaful business with 45.7% share, followed by aviation and cargo takaful business with 40.1% and 12.5% respectively.
- MAT takaful business consistently registered low retention ratio reflecting the heavy reliance on retakaful arrangements. In 2005, the retention ratio registered was 32.6%.
- MAT takaful business sustained a favourable trend in claims experience over the period, with claims ratio of 23.1% in 2005.

Product

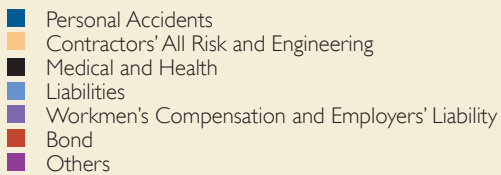
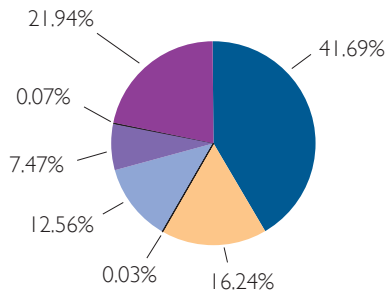
Other classes of takaful (Miscellaneous takaful)



Coverage

- The classes of general takaful business are continually expanding to provide cover for a wide range of new risks and contingencies.
- The main categories include the following:
 - Personal accident takaful**
Provides compensation in the event of death, disablement or injuries that may arise from an accident.
 - Engineering takaful**
Comprises the coverage for machinery breakdown, loss or damage due to machinery breakdown, boiler and pressure vessel, as well as plant and machinery being erected.
 - Contractors' all risk takaful**
Covers any loss or damage during construction and maintenance period including third party liability.
 - Employers' liability takaful**
Indemnifies damages and/or injury borne by employees during employment.
 - Public liability takaful**
Provides compensation against any legal liability incurred for bodily injury to third parties or damage to their property.

Distribution of Net Contributions
for Miscellaneous Takaful



Performance

- Miscellaneous takaful business has sustained a favourable trend in the annual growth of gross and net contributions of 22.4% and 19% respectively since the year 2000.
- In 2005, personal accident takaful emerged as the dominant business in miscellaneous general takaful, with 41.7% share in the total net contributions.

THE OPERATION OF GENERAL TAKAFUL BUSINESS IN MALAYSIA

The main objectives of general takaful scheme are to achieve twin aims of providing takaful benefits as expected by the participants and securing optimum return for the shareholders of takaful operators. Towards this end, the conduct of the general takaful business are governed by the Shariah and prudential rules and practices aimed to balance the interest of relevant stakeholders, particularly the participants, as well as the management and shareholders of takaful operators. The operation of general takaful business and its governing rules are illustrated below, through the three stages of business operation.

Pre-operational Prerequisites

▶ **Pre-takaful Contract**
Product development, marketing and underwriting

▶ **Post-takaful Contract**
Management of takaful fund
– Collection of contributions, investment, retakaful, claims management and distribution of operating profit

A. Pre-operational Prerequisites

There are certain rules and regulations provided under the legislation or imposed by Bank Negara Malaysia to ensure that the takaful business is managed by qualified persons and owned by strong shareholders, has financial capacity to operate as well as has in place sound corporate governance and good operating infrastructure. These rules are applicable from the initial stage of operation and should be adhered to by takaful operators at all times. Among the major rules are:

I. Financial Requirements

The financial requirements are aimed at strengthening the capacity of takaful operators to support their business expansion and safeguarding the takaful fund. Specific requirements are as follows:

- To provide the nominal amount, subscribed and paid-up share capital and the amount paid-up preceding the application of conducting takaful business. The current minimum paid-up capital requirement is RM100 million;
- To place a statutory deposit with the Accountant General of a value of not less than RM300,000;
- To ensure that the surplus of assets over liabilities of a takaful operator shall not be less than RM15 million for the general takaful business; and
- To pay for annual registration fees of RM2,500.

II. Corporate Governance

Corporate governance is key in general takaful business to ensure all stakeholders are treated fairly. It is important due to high reliance by the participants (as certificate holders or contributors) on the takaful operator in ensuring that the takaful business is being properly managed. Among the major requirements are:

Shareholders

- Shareholders of a takaful operator shall consist of strong corporate entity to provide the overall support for the takaful operator. Foreign equity participation of up to 49% is allowed in takaful operators.

Board of Directors, Chief Executive Officer and management

- Takaful operators are required to set up a Board of Directors, who is responsible in safeguarding the integrity and credibility of the takaful operator and ensuring that the daily operations of the takaful operator are handled by a team of qualified and competent management. The Board shall also be responsible in setting up the various Board committees to enhance the corporate governance of takaful operations. These committees are the audit, nominating, remuneration and risk management committees.
- A Chief Executive Officer (CEO) shall be appointed as the principal officer in charge of the overall affairs of the takaful operator, with the support from a team of skilled management. The appointment of a CEO is subject to the approval of Bank Negara Malaysia.
- Greater emphasis is directed at the fitness and propriety of directors and CEO given the high degree of commitment required from board members and senior management.

Guidelines on Directorship for Takaful Operators

It specifies the requirements relating to the appointment and re-appointment of directors, as well as major duties and responsibilities of directors and chief executives. It aims to ensure the competence, independence and integrity of the directors and CEO in managing the affairs of takaful business.

Shariah Committee

- Takaful operators are also required to establish a Shariah Committee as part of its internal governance in order to ensure compliance with the Shariah. The appointment of the committee members are subject to approval by Bank Negara Malaysia.

Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions

It sets out rules, regulations and procedures in the establishment of a Shariah Committee, as well as its roles, scope of duties and responsibilities. It also specifies the relationship and working arrangements between a Shariah Committee and the Shariah Advisory Council of Bank Negara Malaysia.

Auditor

- Takaful operators shall employ the services of a qualified auditor, for the purpose of ensuring professional conduct in auditing. Bank Negara Malaysia issued a set of qualifying criteria for the appointment of audit firm as auditor of a takaful operator; in which the onus is placed on the takaful operator to ensure that the audit firm complies with all the criteria set by the Bank. Takaful operators are required to submit their application for the appointment of auditors at least two months prior to the date of their annual general meeting each year.

Actuary

- Takaful operators need to have the technical expertise of an actuary to ensure the effectiveness and soundness of financial management of the business particularly in the areas of assets and liabilities management, product pricing, determination of reserves and assessment of the overall risks.

Takaful operators are also required to provide adequate disclosure and ensure transparency in takaful practice as part of the measures to enhance the corporate governance and protect the interest of all relevant stakeholders. Among the major disclosure requirements are:

i. For shareholders, participants and investors

Takaful operators are required to observe the requirements as set out in the Guidelines on Financial Statements for Takaful Operators in the preparation of their reports and financial statements. The guidelines provide the basis and guidance for presentation and disclosure of the following reports and financial statements of the takaful operators:

- Directors' and auditors' reports;
- Statement by director;
- Statutory declaration;
- Report of the Shariah Committee;
- Balance sheet;
- Income statement;
- Statement of changes in equity;
- Revenue account;
- Cash flow statement; and
- Notes to the financial statements.

Guidelines on Financial Statements for Takaful Operators

The guidelines set out the minimum disclosure requirements of financial statements of takaful operators aim at improving the comparability and usefulness of the reports, particularly in facilitating assessment of the performance of takaful operators by various stakeholders.

ii. For regulator

Takaful operators are required to submit statistical information regarding their financial condition to Bank Negara Malaysia through online Takaful Operators Statistical System. The data submissions will allow Bank Negara Malaysia to conduct timely analysis of the financial condition of takaful operators.

III. Operating Infrastructure

Prior to conducting the general takaful business, the takaful operator should be equipped with a widespread of skills and expertise, as well as an efficient management and information system. Among the critical areas are:

- **Technical areas.** Expertise in technical areas such as actuarial, underwriting, product development, investment and claims are crucial as they perform the core functions in the takaful business. The takaful operator should have adequate number of persons conversant in these areas with proper training programmes to nurture development of expertise.
- **Shariah.** The appointment of a Shariah coordinator is also vital, in order to ensure the operation of the takaful business is in compliance with Shariah requirements as advised by the Shariah Committee.
- **Information and communication technology.** Takaful operators are also expected to have an efficient system of information and communication technology. This is important to support the overall operations and enhance the efficiency of the distribution channel as well as improve the accuracy and timeliness of financial reporting and monitoring system of takaful operators.

B. Pre-takaful Contract – Conduct and Operations

The conduct of takaful business prior to participants entering the takaful contract can be broadly categorised into product development, marketing and underwriting activities.

I. Product Development

Product development is one of the core processes, whereby takaful operator designs the appropriate products to cater to the consumers' demands and needs. The product development process for general takaful can be summarised into the following five stages:

STAGE I – Product Design

Information Gathering

Takaful operators conduct market research or surveys to identify the consumers' demands and expectations, for personal and commercial products.



Data Analysis

Takaful operators analyse information gathered and carry out sales projection based on the target market.



Design Product Coverage

Takaful operators design a new product in terms of its coverage and benefits.

STAGE II – Product Pricing

- The pricing of takaful product takes into account several key factors such as market considerations, current and historical prices, wakalah fees (for wakalah model) or profit-sharing ratio (for mudharabah model), retakaful risk contribution rate, takaful operator's past loss experience and forecast costs (expected claims costs and costs of takaful-related services). Relevant industry statistics such as statistics on fire, diseases, crime rates and traffic accidents are also carefully analysed.
- Takaful operators are subject to common tariff structure in their pricing policy for motor and fire takaful products. This arrangement will be governed under the Inter-Takaful Operators Agreement on Takaful Intermediaries.

Basic Principles of Pricing

- **Adequacy** – sufficient to pay losses and reasonable operating expenses of the takaful operator.
- **Not excessive** – should not be too high that participants are paying more than the risks covered in the contract.
- **Responsiveness** – should be responsive over time to changing loss exposure and changing economic condition.

STAGE III – Product Documentation

- Greater emphasis is placed upon the disclosure and transparency in certificate documents in view of the complex nature of takaful business and the variations in takaful models adopted by takaful operators.
- Takaful operators will prepare relevant documentations, such as the marketing brochures, application procedure and the certificate documents with clear clauses of rights and obligations of the parties, so as to ensure that both the participants and takaful operators have a clear understanding of the takaful contract. Some of the main clauses are:
 - Aqad (contract) between takaful operator and participants;
 - Contribution payments;
 - Cancellation conditions;
 - Claim conditions;
 - Distribution of operating profit and fees; and
 - Renewal notice and instructions.
- Takaful operators are responsible to ensure proper disclosure of the certificate details and the use of clear certificate wordings.

STAGE IV – Development of Operating Infrastructure

- Readiness of information technology and support system

- Takaful operators shall enhance their information technology and support system to monitor and manage the new product.

STAGE V – Assessment by Relevant Parties

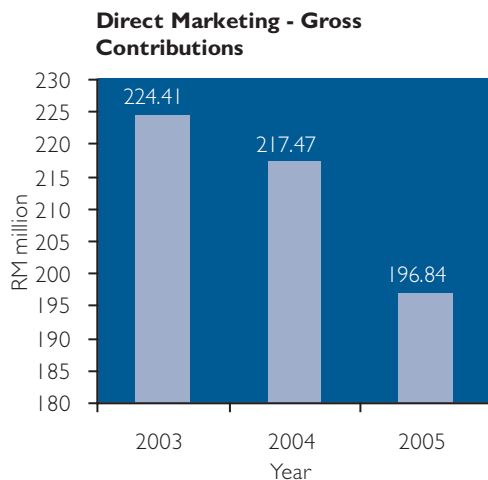
- **Shariah Committee.** Takaful operators shall seek views and approval from the Shariah Committee on the concept, structure, terms and conditions of the new product.
- **Various internal departments.** Takaful operators will require the assessment from the relevant units or departments, such as Risk Management, Internal Audit, Compliance, Finance and Legal departments to ensure that all aspects of risk relating to the new product are carefully analysed and managed.
- **Submission to Bank Negara Malaysia.** Takaful operators are then required to submit the certification or endorsements from Shariah and the relevant committees to Bank Negara Malaysia for approval.

II. Marketing

Owing in part to the complexity of product features or terms used in the contract, insurance products generally are sold, rather than bought. This axiom similarly applies to takaful and explains the importance of marketing. Marketing is also important in order to attract a large number of participants to the scheme thereby strengthening the takaful fund to pay the future claims.

Takaful operators market general takaful schemes either directly to participants or through independent brokers, agents and bancatakaful.

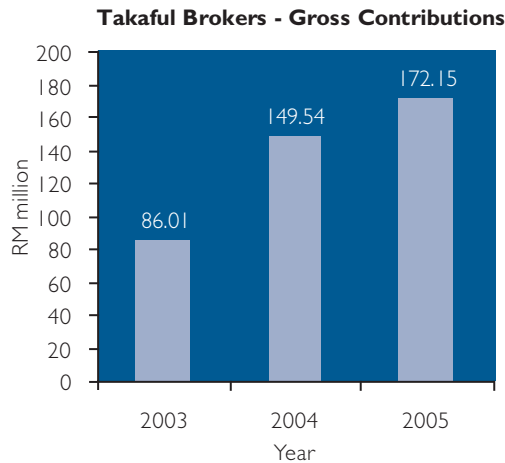
Direct Marketing



Direct marketing remained as the most dominant distribution channel in 2005 with 35.7% of general takaful contributions. However, there was gradual reduction in percentage of shares in gross contributions due to increased popularity of other distribution channels.

- Direct marketing by takaful operators are carried out via internet, media advertisement, telemarketing, direct mailing and marketing personnel at their head office and branches.
- The use of internet by takaful operator has been on an increasing trend. Some of the takaful operators have offered renewal services for motor takaful through the internet.
- The takaful operator is subject to regulatory requirements stipulated under the Guidelines on Provision of Internet Takaful by Takaful Operators. The guidelines are aimed at promoting the orderly development of takaful business conducted through internet. The guidelines highlight the risks faced by takaful operators in using the internet as a distribution channel and the minimal risk management measures that should be instituted to ensure the proper functioning of the system and protection of certificate owners' interests.

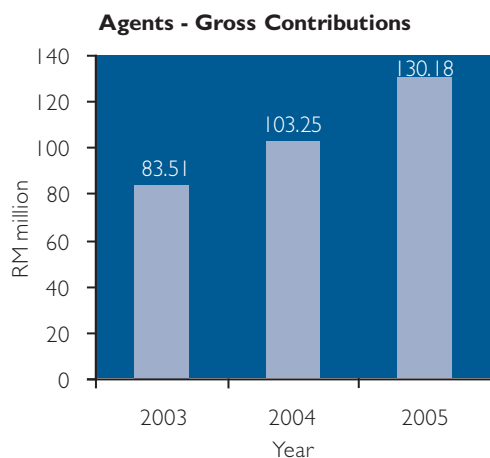
Takaful Brokers



Takaful brokers are the second most dominant takaful distribution channel over the last three years with the distribution share increased from 21.4% (2003) to 32.1% (2005). Takaful brokers generated the most commercial lines business for the general takaful sector:

- Takaful brokers are independent from takaful operators as they are usually appointed by, and act for consumers.
- Therefore, takaful brokers legally do not have the authority to bind the takaful operator. Instead, the takaful brokers can accept applications for takaful coverage and then attempt to place the coverage with an appropriate takaful operator. In return, takaful brokers will receive brokerage fee from the participants.
- The services of takaful brokers are usually solicited by commercial clients in sourcing for the best takaful plan for their complex business risks.
- Due to the role and nature of takaful broking business, the law requires takaful brokers to be licensed and set up as a body corporate which are subject to a certain amount of minimum unimpaired paid-up capital requirement of RM500,000 for brokers licensed under Takaful Act 1984 and RM600,000 for brokers licensed under both Takaful Act 1984 and Insurance Act 1996. Takaful brokers licensed under Takaful Act 1984 are also required to have professional indemnity insurance or takaful coverage of not less than RM500,000 against any legal liability arising from misconduct or negligence in the course of advising customers. The minimum professional indemnity coverage for brokers licensed under both Takaful Act 1984 and Insurance Act 1996 is RM1 million.

Agency System

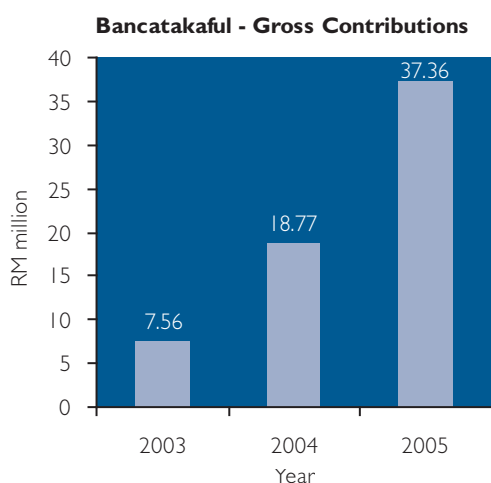


- Takaful operator builds its own agency force by recruiting, financing, training and supervising the agents.
- The agent is legally representing the takaful operator and has the authority to bind the company in which he represents, subject to certain underwriting authority limit as may be stipulated in the agency contract.
- The agent will receive a portion of the contribution as remuneration from takaful operators for the services rendered.

The takaful operators' marketing strategy relies strongly on agency system to penetrate the dispersed customer base. This is reflected by the increasing trend in market share of gross contributions generated by agents of 20.8% (2003), 21% (2004) and 23.6% (2005).

- The agent is subject to the Code of Ethics of takaful intermediaries in order to ensure the services rendered and ethics observed are of the highest standard. Under this framework, the minimum standards of conduct and the minimum training requirement to be completed by the takaful intermediaries must be set out so as to ensure that the takaful intermediaries uphold proper and ethical practice.

Bancatakaful



- Bancatakaful is the distribution of takaful products through a bank's established distribution channel.
- Takaful operators in Malaysia are required to observe the regulatory requirements relating to bancatakaful as set out in Circular on Bancatakaful so as to ensure that the consumers benefit from the efficient cost structures of bancatakaful arrangements.

Bancatakaful made noticeable headway albeit from a very low base, to account for 7% of general takaful distribution share in 2005. The trend of increasing bancatakaful penetration is set to continue, owing to the ability of takaful operators to leverage on existing group structure and closer strategic affiliations with other financial institutions.

In marketing general takaful products, takaful operators and their intermediaries have a general duty of care particularly towards individual participants to ensure that they make a well informed decision in participating in the takaful scheme. The communication materials must be clear, fair and not misleading. The information provided to prospective participants must be accurate, relevant, complete and presented in simple language. Key information pertaining to takaful products that must be disclosed to a prospective participant include the following:

- Name of the takaful operator;
- Full details of types of cover and benefits;
- Full details of the contributions payable by the prospective participants;

- Restrictions and exclusions;
- Any significant conditions, warranties or obligations which the prospective participants must meet, failing which the takaful operator may repudiate the liability or cancel the cover;
- Period of coverage; and
- Reminder of duty of the prospective participant to disclose all information material to the takaful operator and the consequences of failure to disclose or wrongful disclosure by the prospective participants.

In addition, the takaful operators are required to observe the Guidelines on Prohibitions Against Unfair Practices in Takaful Business to further promote proper disclosure and greater transparency to consumers. The guidelines also promote sound business practices and fair treatment by ensuring equitable contractual terms and conditions as well as positive disclosure practices.

Ultimately, the customer is the central focus of the marketing process. Therefore, the marketing activities undertaken by the takaful operator should be designed to deliver the following specific outcomes:

- Consumers should understand the key features of a certificate, including scope of coverage and significant exclusions before participating in a takaful contract; and
- Consumers are sufficiently and properly advised as to assist them in making decision to choose suitable products that meet their needs.

III. Underwriting

Upon successful marketing, the attention is then focused on the takaful operator to conduct underwriting process for the benefit of the whole takaful scheme. Takaful operators will assess the risks involved in an application for takaful coverage. Based on the assessment, the takaful operator will then decide on the appropriate contribution rate to be charged to the participants.

In underwriting process, the takaful operators are guided by an underwriting policy which states in detail the type of risks to be accepted, the contribution rating plan and the appropriate loading to be imposed on contributions, amounts of takaful to be written and other underwriting details. The underwriting policy will also be dependent on the retakaful arrangement of the takaful operator:

The purpose of underwriting is to control adverse selection and ensure the solvency of the takaful fund for claim payments. A proper underwriting practice would lead to the takaful fund earning a higher underwriting profit.

Basic Principles of Underwriting

- Selection of participants according to the company's underwriting standards.
- Equity among participants
 - exposures that are similar with respect to losses and expenses should not be charged substantially different rates.

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

STAGE 1 Gathering Information

- Involves gathering adequate and relevant information concerning the exposure.
- The basic method of gathering information is through the proposal form.
- Both the physical features of the property and personal characteristics of the applicant should be considered.
- In terms of renewal of takaful contracts, past claims experience shall also be considered.

STAGE 2 Risk Classification

Upon completion of information gathering, takaful operators will assess and classify the risks involved into the following categories:

- **Standard** – if particular risk is considered a typical risk.
- **Rated** – if particular risk is considered as higher-than-average risk.
- **Preferred** – if particular risk is considered as better-than-average risk.

STAGE 3 Determination of Contribution Rate

Once applications are accepted, takaful operator will determine the contribution rate based on the classification of risks, as follows:

- **Standard risk** – standard contribution rates will be applicable.
- **Rated risk** – takaful operator shall impose the following:
 - ▶ Loading – extra charge imposed in addition to the standard contribution rate; or
 - ▶ Excess – takaful operator shall only provide coverage of loss exceeding a certain amount.
- **Preferred risk** – discount on the standard rate will be applicable. In motor takaful, No Claim Bonus (discount on contributions) are offered for participants with good claims experience.

Certain key underwriting factors are also considered in determining the contribution rates. Among the key factors are:

General Takaful Product	Key Underwriting Factors
Motor	<ul style="list-style-type: none"> • Model and cubic capacity of the vehicle • Age of drivers • Age of vehicle • No claim bonus entitlement (if any)
Fire	<ul style="list-style-type: none"> • Construction class of the building • Use of the building of risk • Sum covered
Marine	<ul style="list-style-type: none"> • Type of cargo • Voyage details • Carriers • Nature of packing
Personal Accidents	<ul style="list-style-type: none"> • Age of participant • Occupation class (level of hazard risks) • Sum covered
All Risks	<ul style="list-style-type: none"> • Business occupation • Location of risk • Construction of building • Interest to be covered

C. Post-takaful Contract – Conduct and Operations

Post-takaful contract operations involve the collection of contributions as well as a series of activities in managing the takaful fund, namely retakaful, investment and claims management.

I. Collection of Contributions

Upon completion of the underwriting process, both the takaful operator and participant will reach a mutual agreement on the terms of takaful coverage. The takaful operator will then collect contributions from the participant as agreed in the takaful contract.

Under the wakalah model, a portion of the contributions will be allocated to the takaful operator, as fee for managing the takaful fund. The portion is based on the ratio agreed upon by the participant and takaful operator as specified in the contract and it varies depending on the type of products.

For certain classes of general takaful business such as motor takaful, the takaful operators are required to comply with the statutory requirement of the Cash-Before-Cover to engender greater market discipline in the management of contributions. The Cash-Before-Cover requirement stipulates that a takaful fund is not permitted to assume any risk unless the contributions payable is received by the takaful operator.

For non-motor business, takaful operators also apply the concept of “contribution warranty”, whereby participants are allowed up to sixty days from the date of inception of the takaful certificate to remit contributions to the takaful operator. Takaful coverage shall commence from the inception of the takaful certificate, and is in force during this period.

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

II. Retakaful

After collecting the contributions, the efforts are then focused on ensuring prudent management of the takaful fund, including the use of retakaful. Retakaful is one of the risk management tools used by takaful operators to transfer part of the risk under the takaful fund to another takaful operator or retakaful company. The amount of risk retained by the takaful fund for its own account is called the retention limit.

There are two types of retakaful arrangement available for takaful operators, namely, the treaty and facultative retakaful.

- i. Treaty retakaful**
 - Retakaful is placed under a standing agreement which is usually on annual basis. All risks that fall within the scope of the agreement are automatically accepted by retakaful companies.
- ii. Facultative retakaful**
 - Retakaful is offered and accepted on a case-by-case basis. The arrangement is optional whereby there is no obligation for both the takaful operator and the retakaful companies to enter into the arrangement.

Retakaful is important for two reasons:

- i. Increase underwriting capacity.** The transfer of risk through retakaful allows takaful fund to accept business in excess of its underwriting capacity.
- ii. Claim costs stabilization.** Retakaful helps to protect takaful fund against fluctuations of aggregate claim costs due to the frequency and/or severity of losses, as the cost of claim to the takaful fund will be capped up to its retention limit.

There are two important considerations in managing retakaful:

i. To set an optimum retention limit to ensure that risks borne by the takaful fund are within its financial capacity

- The primary considerations in setting retention limit include protection of the takaful fund, stabilization of financial results and financial capacity to meet claims.
- A clear retention limit should be set for each class of business and for categories of risks within each class of business.
- A takaful operator's retention strategy must take into account not only single risk claims but also multi-risk event.

ii. To enter into retakaful arrangement with strong retakaful operators or reinsurers

- With respect to selection of retakaful operators, takaful operators should ensure retakaful coverage are ceded to a financially sound retakaful operator or a reinsurer. In the current practice, retakaful arrangements with the reinsurance companies are allowed under the circumstances of "*hajah*" (necessity) as lack of retakaful capacity is still prevalent. Priorities are accorded to Malaysian takaful or retakaful operators to optimise the national retention capacity before securing retakaful support or reinsurance from abroad.
- In terms of inwards retakaful arrangements, takaful operators must ensure that acceptance of risks shall comply with the Shariah.

III. Investment

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

The main investment strategy for general takaful fund is to invest in liquid assets in order to maintain the liquidity of the fund. This is due to the short-term nature of the liabilities of the general takaful fund, whereby the protection period in most contracts is usually one year or less, and the claims are usually settled quickly. Also, in contrast to family takaful claims, which generally involved a fixed amount, general takaful claim payments can vary widely depending on various factors such as medical costs, auto repair costs or construction costs.

The takaful operators must comply with the following investment requirements with the objective of ensuring security and quality of the assets of the takaful fund:

- i. The takaful fund must consist of Malaysian assets, which shall not be less than eighty per cent of the total value of assets of the fund.

Malaysian Assets

- Securities issued under the Government Funding Act 1983;
- Shariah-approved shares or securities listed by any stock exchange approved under the Securities Industry Act 1983;
- Shares in, or securities of, a society registered under the Co-operative Societies Act 1993;
- Estates or interests in land in Malaysia;
- Malaysian currency held on current account or any deposit account in Malaysia with a bank licensed under the Banking and Financial Institutions Act 1989, the Islamic Banking Act 1983 or the Development Financial Institutions Act 2002; and
- Loans or investments in or connected with Malaysia as may be prescribed under the Takaful Act 1984.

- ii. The value of investments in securities of the Federal or State Government issued in Malaysia shall not be less than fifteen per cent of the total value of the assets of the fund.

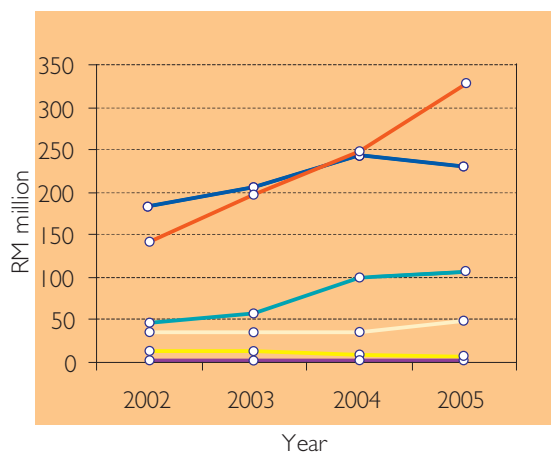
- iii. In terms of investment in Islamic private dept securities (IPDS) or Islamic Financing Facilities (IFF) for the purpose of authorised Malaysian assets, takaful operators are required to observe the Specification under Regulations 3(b) and (c) of the Takaful (Prescribed Financial Institution, Loan and Investment) Regulations 2003, which specify the manner in which an IPDS or IFF is qualified as authorised assets as well as the investment limit permissible.

Investments of a takaful operator are made mainly in the following categories:

- IPDS;
- Shariah-approved equities;
- Deposit placements;
- Government Islamic papers;
- Properties; and
- Extension of financing.

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

Investment Distribution



- IPDS and Equities
- Deposit Placements
- Government Islamic Papers
- Properties
- Extension of Financing
- Foreign Assets

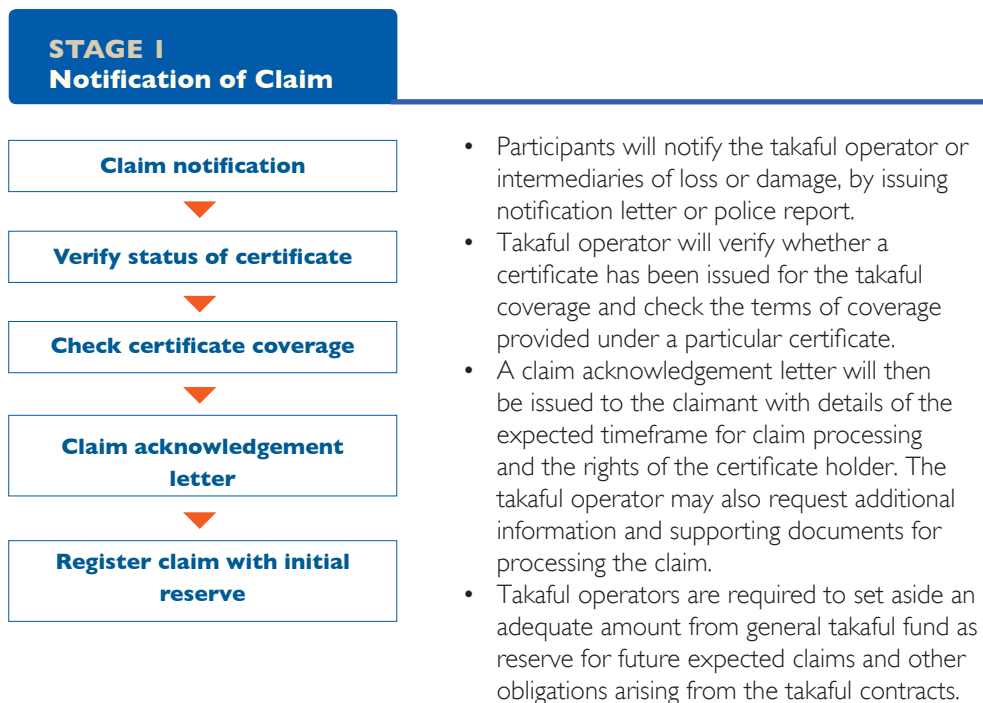
IV. Claims Management

The ultimate objective of claims management is to ensure prompt and fair settlement of claims, in order to protect the interest of participants and promote positive image of the general takaful industry. Effective claims management demands adoption of clear work processes that is supported by adequate skilled manpower to handle the claims. Bank Negara Malaysia has issued the Guidelines on Claims Settlement Practices to promote the best practices in claims management by the takaful operator.

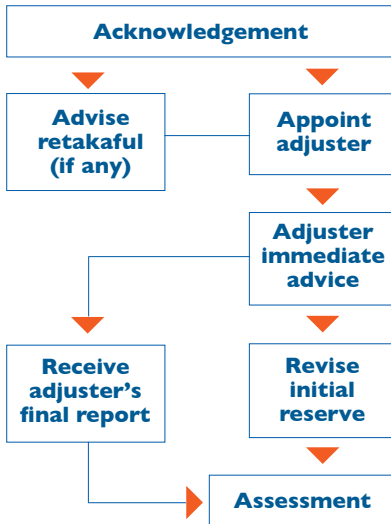
Guidelines on Claims Settlement Practices

- It specifies the minimum standards for prompt and fair payment of claims and ensures that payment of claims is made on a timely manner.
- It requires takaful operators to set-up a claims servicing counter at their head office in order to provide efficient and effective claim services to claimants.
- The guidelines must be observed by the takaful operators in handling general takaful claims and serve to complement the efforts of the takaful operators with regard to the fraud control and risk management.

The claim process generally involves the following:

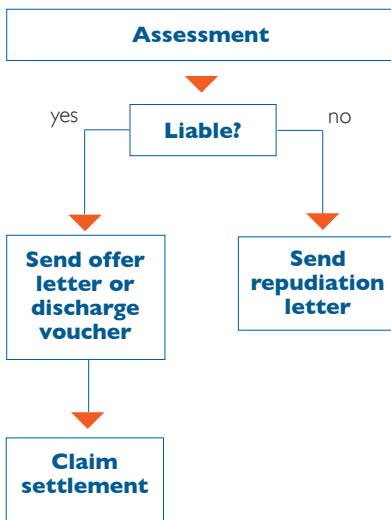


STAGE II Investigation of Claim



- Takaful operators will advise retakaful companies for certificates involving retakaful and also appoint a loss adjuster to examine the details of the claim.
- The loss adjuster will examine the causes of loss or damage, assess the amount of loss and determine whether the participant has fulfilled the obligations under the takaful contract. A final report of the investigation will be presented to the takaful operator for assessment.

STAGE III Claim Settlement



- Takaful operators will conduct an assessment based on the report by the loss adjuster. A decision will be made on the liability of the claim.
- If the claimant's certificate covers the loss and the participant has fulfilled the obligations under the contract, the takaful operator will issue an offer letter on claim settlement. Takaful operator may also apply the principle of contribution, which is the right of the takaful operator to call upon other takaful operators liable to the same participant to share the cost of an indemnity payment.
- In the case when the claimant's certificate does not cover the loss and/or that the claim is fraudulent, then the takaful operator will issue a repudiation letter to advise the claimant on the rejection of his or her claim, stating the reasons for the repudiation in a clear and simple manner.

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

▶ **Use of IT in claim handling**

In handling the claims settlement for own damage motor takaful, takaful operators' adjusters and repairers are required to utilise the centralised database on motor parts and labour costs of Motor Research Consortium Sdn. Bhd. for motor repairs estimation to reduce subjectivity in claims estimation.

▶ **Takaful fraud prevention measures**

Four main initiatives currently pursued to minimise takaful fraud:

i. Joint Steering Committee and Joint Working Committee on Anti-fraud Initiatives

- This joint project between Bank Negara Malaysia and the associations representing takaful and insurance industries focuses on developing and recommending anti-fraud measures as well as assisting the regulator, law enforcement agencies and industry players in their effort to combat takaful and insurance fraud.

ii. Electronic Fraud Information Database

- A database established by Bank Negara Malaysia to record all fraud and defalcation cases and breaches of Code of Ethics reported by insurers and takaful operators.
- The database enables Bank Negara Malaysia to identify new modus operandi of frauds and alert the insurance and takaful industries so as to prevent further occurrences of frauds.

iii. Cooperation among the relevant authorities

- There are continuous collaborative efforts between Bank Negara Malaysia, Polis DiRaja Malaysia and the associations representing takaful and insurance industries, in expediting investigation and resolving the fraud cases.

iv. Introduction of JPJ eINSURANS

- The introduction of online submission of motor cover notes by takaful operators in January 2005 helps to eliminate problems relating to forged motor cover notes.

► **Dispute resolution measures**

There are three levels of complaint resolution channels before going to the court process, as follows:

- 1 Each takaful operator has its own complaint unit, dedicated to cater for any arguments or complaints from the participants.
- 2 Bank Negara Malaysia has established Laman Informasi Nasihat dan Khidmat (LINK) as a second level complaint resolution.
- 3 Financial Mediation Bureau (FMB) has also been launched by Bank Negara Malaysia, as an effort to assist consumers in the event of dispute with takaful operators. It provides consumers with fast, convenient and efficient avenue to refer their complaints or disputes for resolution. In terms of claims, complaints referred to the FMB are limited to the following:
 - RM200,000 for motor and fire takaful plans;
 - RM5,000 for third party property damage; and
 - RM1 00,000 for other types of takaful plans.

V. Distribution of Operating Profit

After taking into account the investment returns, provisions for retakaful, claims and reserves, the balance of the takaful fund will be distributed to the eligible participants and shareholders according to the pre-agreed ratio as stipulated in the contract. The operating profit for the year is determined at the end of each financial year and will be distributed in line with the terms of the contract. The distribution of operating profit is an essential element in takaful as it forms the basis of takaful operations relating to the rights of the participants to share the profit of the takaful fund.

In the event of deficit in the takaful fund, the takaful operators will provide benevolent loan from the shareholders' fund in order to rectify the deficit which will be repaid from the future profit. The takaful operators may also be required to make direct contributions to the takaful fund in the form of tabarru' from the shareholders' fund if the deficit continues to deteriorate.

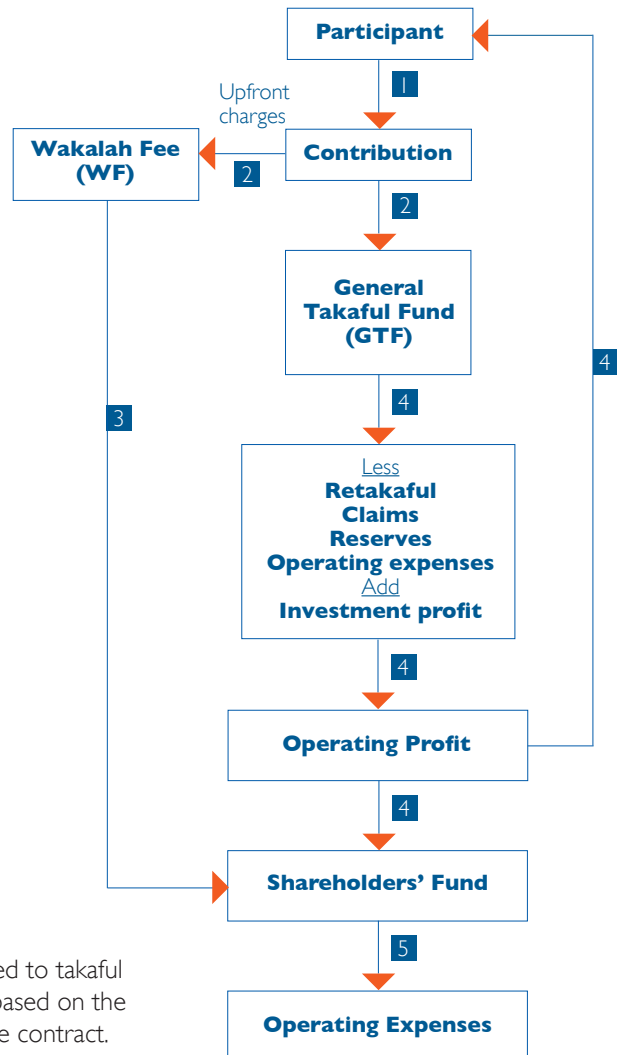
Operational Flow of General Takaful

The operational framework of a general takaful fund can be summarised as follows:

Operational Flow of General Takaful

1. Participant pays contribution.
2. Contribution will be divided into:
 - Wakalah Fee (WF) under wakalah model; and
 - General Takaful Fund (GTF).

The allocation between WF and GTF is based on the pre-agreed ratio between participant and takaful operator as specified in the contract and depending on the type of products.
3. WF that consists of commission and management expenses will be paid to shareholders' fund.
4. Excess in GTF after deducting operating expenses (under mudharabah model) will be invested and investment income will be ploughed back to the fund. Operating profit at the end of the year (after deducting claims, retakaful, reserves and operating expenses as well as adding investment profit) will be distributed to takaful operator and eligible participants based on the pre-agreed ratio as stipulated in the contract.
5. Shareholders will use the WF to pay for operating expenses and in the case of takaful operators operating under mudharabah model, the profit from investment will be used to pay for the expenses incurred.



FUTURE OUTLOOK

The general takaful industry is set for a major boost over the forthcoming years, with the emergence of new players to enhance the competitiveness of the industry and buoyed by the continuing increase in public awareness of the Islamic financial products. The rapid pace of development of retakaful business will reinforced the enabling environment for further expansion of general takaful business, particularly in the commercial lines.

The sound and conducive regulatory, supervisory and Shariah framework that govern the industry will continue to be the pillars towards sustainable development of the general takaful industry. Towards this end, strong corporate governance and risk management practices, particularly in underwriting, investment and claims management, will remain as the main thrust to maintain long-term growth prospect of the general takaful business.

For the regulators, the harmonisation of the general takaful practice across differing international economies and the development of international regulatory and supervisory framework and best practices in takaful will be among the major initiatives to be undertaken in promoting further progress of the takaful industry.

Moving forward, product innovation will continue to be the key factor in attaining a promising growth for the industry. A great demand for insurance coverage calls for a well-diversified takaful products to cater for the changing needs and various risks in the industry. For instance, catastrophic risks management has managed to capture greater worldwide attention, with the recent unprecedented numbers of natural disasters and terrorism attacks. Takaful weather cover that provides financial protection for farmers may be useful particularly in our efforts to develop further agriculture and related industries. The challenge now lies in takaful players embarking on mitigation of these new risks, such as catastrophic risks as well as large and specialised risks, liability risks, and other risks catered by the conventional counterparts, as an effort to attain a greater share in the insurance sector and promote rapid growth of the general takaful industry.

List of General Takaful Products Provided by Malaysian Takaful Operators

Products	Syarikat Takaful Malaysia Berhad	Takaful Nasional Sdn. Berhad	Takaful Ikhlas Sdn. Berhad	Mayban Takaful Berhad
Motor takaful scheme	■	■	■	■
Fire takaful scheme				
▶ Basic fire	■	■	■	■
▶ Fire and allied perils	■	■	■	■
▶ Houseowner	■	■	■	■
▶ Householder	■	■	■	-
▶ Industrial all risks	■	■	■	-
▶ Consequential loss	■	■	■	-
▶ Growing trees	■	■	■	-
▶ Long-term fire	-	■	■	-
▶ Sprinkler leakage	■	-	-	-
▶ Strata care	■	-	-	-
Marine, aviation and transit takaful scheme				
▶ Marine cargo	■	■	■	-
▶ Marine hull	■	■	-	-
Miscellaneous takaful scheme				
▶ Personal accident takaful scheme				
• Personal accident	■	■	■	■
• Haji or umrah	■	■ ¹	■	-
▶ Engineering takaful scheme				
• Machinery breakdown	■	■	■	-
• Loss of profits (machinery)	■	■	-	-
• Boiler and pressure vessel	■	■	■	-
• Erection all risks	■	■	■	-
• Civil engineering completed all risks	■	-	-	-
• Stock deterioration	■	-	-	-
▶ Contractors' all risks takaful scheme	■	■	■	-
▶ Liability takaful scheme				
• Employers' liability	■	■	■	-
• Public liability	■	■	■	-
• Professional indemnity	■	-	-	-

Note : ■ Products currently being offered by takaful operators.

¹ Umrah only.

² Immigration bond only.

The above list is not intended to be exhaustive. The extent of products and coverage offered differs among takaful operators.

Products	Syarikat Takaful Malaysia Berhad	Takaful Nasional Sdn. Berhad	Takaful Ikhlas Sdn. Berhad	Mayban Takaful Berhad
• Directors and officers liability	■	-	-	-
• Bailee or warehousemen	■	-	-	-
• Malpractice practitioners	■	-	-	-
• Product liability	■	-	-	-
▶ Workmen's compensation scheme				
• Workmen compensation	■	■	■	-
• Foreign worker compensation	■	■	■	-
▶ Bond takaful scheme	■	■	■ ²	-
▶ Plate glass takaful scheme	■	■	■	-
▶ Money takaful scheme	■	■	■	-
▶ Burglary takaful scheme	■	■	■	■
▶ Fidelity guarantee takaful scheme	■	■	■	-
▶ All risks takaful scheme	■	■	■	-
▶ Storage tanks takaful scheme	■	■	■	-
▶ Equipment all risks takaful scheme	■	■	■	-
▶ Electronic equipment takaful scheme	■	■	■	-
▶ Livestock takaful scheme	■	■	■	-
▶ Domestic maid takaful scheme	-	■	-	-
▶ Package takaful scheme (combination of several coverage provided under one scheme)	■	■	■	-

Note : ■ Products currently being offered by takaful operators.

¹ Umrah only.

² Immigration bond only.

The above list is not intended to be exhaustive. The extent of products and coverage offered differs among takaful operators.

