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## The Future of Takaful (Islamic Insurance) Business in Malaysia under the Islamic Financial Services Act (IFSA) 2013

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### ABSTRACT

Very recently, a new takaful legislation, i.e. IFSA 2013, has been enforced to repeal the old Takaful Act 1984 (TA). Generally, the 2013 Act strengthens the requirements made under the 1984 Act as well as provides additional requirements including licensing of takaful operator, limiting to one class of takaful business per takaful operator and establishment of permissible takaful interest. The new Act also incorporates requirements that are provided by guidelines related to takaful business especially Shariah-compliant and Shariah governance requirements. This study aims to examine these statutory requirements and analyse their implications on the business of takaful in Malaysia. The traditional legal research method is used to analyse provisions relating to takaful in IFSA. This study finds that the Malaysian takaful law has been substantially improvised by the promulgation of the new Act and many changes need to be done by takaful operators to ensure their compliance with the law. This recent legal development could be a promising initiative for better future of takaful industry in Malaysia.

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## INTRODUCTION

The takaful industry has been developed in Malaysia since 1980s and it is legislated by the federal law (IBFIM, 2007; Seyed Ibrahim, 2008; Thanasegaran, 2008; Laldin, 2008). In 1984, the Parliament passed the TA to regulate the business of takaful. However, the Act did not provide adequate rules for the implementation of takaful (Mahmood, 1991; Thanasegaran, 2008). To close the loopholes in the Act, IFSA is enacted recently. Compared to the former, the latter contains more provisions and substantive law of takaful. IFSA came into force on the 30<sup>th</sup> June 2013 except for most paragraphs in Schedule (Sch.) 9. It repeals the TA and the Islamic Banking Act (IBA) 1983 (S. 282, IFSA 2013), thus becoming a single legislation governing both takaful business and Islamic banking business. But any rule, regulation, order, notification or other subsidiary legislation made by the Ministry of Finance (MOF) under the TA and in force before the enforcement of IFSA, is deemed to have been made under a corresponding provision in the latter and continues to remain in full force and effect until amended or revoked, except the subsidiary legislation set out in Schedule [Sch.] 16 which are deemed to have been revoked (S. 283(a) & Sch. 16, IFSA 2013). Similarly, every guideline, direction, circular or notice issued by *Bank Negara Malaysia (BNM)* under the TA in relation to any matter which corresponds with any provision of IFSA and in force before its enforcement, is deemed to be standards which have been lawfully specified under such provision of the latter and shall continue to remain in full force and effect until amended or revoked (S. 283(b), IFSA 2013). This article attempts to discuss some new rules and requirements for the operation of takaful provided by the new Act and analyses its impact on the business of takaful in Malaysia.

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## MATERIALS AND METHODS

This study is a qualitative legal research which is based on the doctrinal (traditional) legal research methodology (McConville & Chui, 2007; Hutchinson, 2013). The method is used to analyse the provisions of IFSA relating to takaful.

## RESULTS AND DISCUSSION

### 1.0 Significance of IFSA:

The main objectives of IFSA are to promote financial stability and compliance with Shariah through the regulation and supervision of Islamic financial institutions (preamble of IFSA). The Act strengthens legal framework of takaful by improvising takaful law in Malaysia. The Act provides a clearer definition of takaful compared to that of the TA and differentiates between takaful and its business. Takaful is statutorily 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” whereas takaful business means “the business relating to the administration, management and operation of a takaful fund for its takaful participant which may involve elements of investment and savings and includes retakaful business...” (S. 2(1), IFSA 2013). The first definition focuses on the relationship among takaful participants for the purpose of providing takaful funds and mutual indemnity whereas the second definition concerns the relationship between the participants and the takaful operator for the management and investment of the funds (Arbouna, 2008; Engku Ali & Odierno, 2008). These new definitions are consistent with nature of takaful because the takaful participants are simultaneously the insurer and the insured whilst the takaful operator is the fund manager. In addition, the Act also adds more substantive law of takaful such as permissible interest, separation between the takaful fund from the shareholders’ fund, assumption of risk by the takaful fund, duty of disclosure and the payment of takaful benefits. Furthermore, the Act enhances Shari‘ah compliance and Shari‘ah governance in the operation of takaful and it also strengthens consumer protection in order to increase confidence of the public in the takaful industry (Papp, 2013).

### 2.0 Impact of IFSA on Takaful Business in Malaysia:

#### 2.1 Licensing Requirements:

Under IFSA, takaful business becomes a licensed business (S. 2(1)). No person is allowed to carry on the business unless he is licensed by the MOF based on the recommendation of *BNM* (S. 8(1) (a), IFSA 2013). Conducting the business without having a valid licence is an offence; upon conviction, an offender is liable to the maximum penalties provided under the law, i.e. imprisonment for a term not exceeding ten years or a fine up to fifty million ringgit or both (S. 8(3), IFSA 2013). Application for the licence must be submitted in writing to *BNM* together with all documents or information as specified by the Bank (S. 9, IFSA 2013). If the Bank is satisfied with the application, it shall make a recommendation to the Minister to grant the licence (S. 10(2), IFSA 2013). When the licence is granted, the licensed takaful operator shall commence its business within a period as may be specified by the Minister based on the recommendation of the Bank (S. 10(6), IFSA 2013). Failure to commence the business within the specified period may cause the licence to be revoked (S. 18(1) (c), IFSA 2013). The takaful operator may also be required to pay a licensing fee or an annual fee as may be prescribed by a regulation which may be made under section 271 (S. 23(1), IFSA 2013). These licensing requirements are applicable to new takaful operators to be established after the enforcement of the Act. As for the existing takaful operators registered under section 8 of TA, they shall be deemed to have been licensed under section 10 of IFSA (S. 284(1) (b), IFSA 2013).

IFSA requires that a licensed takaful operator must be a public company (S. 21(1), IFSA 2013). This new requirement has closed the door for a private company or a cooperative society to carry on the business of takaful as was approved under the TA (s. 4(1)(a) & (b), TA). Pursuant to this new requirement, an existing takaful operator which is a private company and is deemed to be a licensed takaful operator under paragraph 284(1) (b) shall be converted into a public company within twelve months from the enforcement date. The company must apply for the conversion before the expiry of the twelve months period (S. 287, IFSA 2013). Conversion of a private company into a public company will enable the company to strengthen its capital because it will then have wider powers to raise capital, but the company will be subject to more onerous regulation (Mohd Sulaiman *et al.*, 2008). The takaful company shall not be granted the licence if its capital funds are less than the minimum amount as may be prescribed by the Minister (S. 12(1), IFSA 2013). In case of a company incorporated in Malaysia, the minimum capital fund for a licensed takaful operator is RM100 million and RM10 million for a licensed international takaful operator. For an international takaful operator which is a branch established in Malaysia by a foreign company, the minimum amount of its assets over liabilities is RM10 million (Schedule 1 & 2, Islamic Financial Services (Minimum Amount of Capital Funds or Surplus of Assets over Liabilities) (Licensed Person) Order 2013). In line with the principal regulatory objectives of IFSA (S. 6(a)

& (b)), these requirements would ensure that all takaful operators will be more financially capable to run the business of takaful, thus will be able to give more protection to the rights and interests of takaful participants.

In addition to the above limitation, the Act only allows a licensed takaful operator to carry on one class of takaful business only – either Family Takaful Business (FTB) or General Takaful Business (GTB) (s. 16(1), IFSA). However, a licensed family takaful operator may carry on GTB relating to medical schemes, subject to conditions specified by *BNM* (S. 16(2), IFSA 2013). Contravention of subsection (1) is an offence which, upon conviction, makes the offender be liable to be imprisoned for a term not exceeding eight years or to be fined up to twenty-five million ringgit or to both (S. 16(3), IFSA 2013). Consequently, an existing takaful operator registered for both classes of takaful business under the TA is given five years period to comply with this requirement (S. 286, IFSA 2013). This new requirement may disadvantage the composite takaful operator because it may lose some of its business. The takaful operator may retain both businesses by establishing a subsidiary company then transfers one of the businesses to the new company. But the establishment of the subsidiary company requires substantial amount of financial capital and additional human resources to run the new company (Shan, 2013). This may cause an increase in the cost of operating takaful business and may lead to the increase of takaful contribution rates. Ultimately, takaful consumers will have to bear all these additional costs. In addition, this limitation may raise the possibility of imbalance in the offering of takaful coverage between the general and family takaful operators.

## 2.2 Shari'ah Requirements:

IFSA Shari'ah requirements consist of three major areas, i.e. Shari'ah compliance, Shari'ah governance and Shari'ah audit (Part IV, IFSA 2013). Section 28(1) requires the takaful operator to ensure that its aims, operation, business, affairs and activities comply with Shari'ah at all times. In this regard, a compliance with Shari'ah means that the takaful operator must comply with the ruling of the Shari'ah Advisory Council [SAC] of *BNM* in respect of any particular aim and operation, business, affair or activity (S. 28(2), IFSA 2013). To ensure that all the business, affairs and activity of the takaful operator are in compliance with Shari'ah, it must establish a Shari'ah Committee [SC] for the purposes of advising it on Shari'ah matters (S. 30(1), IFSA 2013). According to section 28(3), if the takaful operator becomes aware that it is carrying on its business in a manner which is not in compliance with Shari'ah or the advice of its SC or the ruling of the SAC, the company is required to immediately notify *BNM* and its SC of the fact, immediately stop from carrying on such activity and submit to the Bank a plan on the rectification of the non-compliance within thirty days of becoming aware of such non-compliance or such further period as may be specified by the Bank (S. 28(3) (a) – (c), IFSA 2013). IFSA further strengthens the Shari'ah compliance and Shari'ah governance requirements by imposing heavy penalties on any person who contravenes subsection (1) or (3). Upon conviction of such an offence, the person is liable to imprisonment for a term not more than eight years or to a fine not exceeding twenty-five million ringgit or to both (S. 25(5), IFSA 2013).

The Act also confers power to *BNM* to specify standards on Shari'ah matters relating to the carrying on of takaful business in accordance with the advice or ruling of SAC, and to give effect to the advice or rulings (S. 29(1) (a) & (b), IFSA 2013). Therefore, the takaful operator, its director, chief executive officer, senior officer or its SC member shall at all times comply with the standards (S. 29(3), IFSA 2013). Failure to comply with any of the standards is also an offence which, upon conviction, makes the offender be liable to the same punishment as mentioned earlier (S. 29(6), IFSA 2013). Apart from that, IFSA also empowers *BNM* to appoint or require a takaful operator to appoint a Shari'ah auditor who will carry on an audit on Shari'ah compliance by the institution (S. 37-38, IFSA 2013). Codification of these Shari'ah requirements could strengthen the takaful industry; thus, it is expected that the industry would be able to gain and secure bigger and stronger public confidence.

## 2.3 Permissible Takaful Interest:

IFSA requires a takaful participant who enters into a family takaful contract on a person covered other than the participant himself to have a 'permissible takaful interest' in the person covered at the time of making the contract and the payment of takaful benefit (Para 3(1) & (2) of Sch. 8, IFSA 2013). The requirement of permissible takaful interest in family takaful contracts corresponds to the rule of insurable interest in life insurance policies (Para 3 of Sch. 8, Financial Services Act [FSA] 2013). The application of this rule in the contract of family takaful is essential to avoid invalidation of the contract due to the element of wagering because a wager contract is void (S. 31(1), Contract Act [CA] 1950). Nevertheless, it should be noted that permissible takaful interest is not necessary for a group takaful contract (Para 3(12) of Sch. 8, IFSA 2013).

If a takaful participant enters into a family takaful contract without having a permissible takaful interest in the person covered at the time of the contract, the contract shall be void (Para 3(3) of Sch. 8, IFSA 2013). However, the contract shall not be void if the participant who has entered into the contract ceases to have the permissible takaful interest at the time of the payment of takaful benefit or at any time after it is concluded. In such cases, if the takaful operator becomes aware that the participant no longer has the permissible takaful

interest in the person covered, it shall pay to the takaful participant the money payable under the family takaful certificate and the contract shall be deemed to be terminated upon such payment (Para 3(4) & (5) of Sch. 8, IFSA 2013). A person is deemed to have a permissible takaful interest in the life of his spouse, children, ward under the age of majority at the time of making the contract, employee or a person on whom he is totally or partially dependent for maintenance or education at the time he entered into the contract (Para 3(6) of Sch. 8, IFSA 2013). A person who enters into a contract of takaful on a person covered mentioned earlier must obtain the prior written consent of the latter unless that person covered is a minor (Para 3(8) of Sch. 8, IFSA 2013). To ensure that the takaful participant has permissible takaful interest in the person covered, the takaful operator shall obtain a declaration from the takaful participant in the manner as may be prescribed by the Bank (Para 3(13) of Sch. 8, IFSA 2013). This new statutory requirement adds more substance to the takaful law as it was not mentioned in the repealed TA (Thanasegaran, 2008).

#### **2.4 Statutory Age for Entering into the Contract of Takaful:**

To ensure the validity of the contract of takaful, the person who makes the contract must be a person who is of the age of majority, of sound mind and is not disqualified from contracting by any law to which he is subject (S. 11, CA 1950). Previously, a person under eighteen years old was not eligible to enter into the contract of takaful (S 64, TA 1984). But, under IFSA, the statutory age for participating in a family takaful scheme has been reduced to sixteen years old (Para 4(2) (a) of Sch 8, IFSA 2013). The Act also allows a minor who has attained the age of ten years, with the written consent from his parent or guardian, to 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 (Para 4(1) (a) of Sch 8, IFSA 2013).

#### **2.5 Duty of Utmost Good Faith:**

IFSA explicitly requires the participant and takaful operator to exercise the duty of utmost good faith in their dealings with each other starting from pre-contractual arrangements until the making and paying of claims, after the contract of takaful has been entered into, varied or renewed (Para 5(9) of Sch 9). Schedule 9 of the Act explains the pre-contractual duty of disclosure and representations for contracts of takaful and remedies for misrepresentations relating to the contracts (S. 141(1), IFSA 2013). The application of the provisions of the Schedule is essential to determine whether the takaful operator may avoid a contract of takaful for misrepresentation (Para 1(3) of Sch. 9, IFSA 2013). However, paragraphs relating to pre-contractual duty of disclosure by the participant are not in force yet.

With regard to this duty, takaful contracts are divided into consumer takaful contract and non-consumer takaful contracts. The Act imposes different scope of duty of disclosure on the participant for consumer contracts and non-consumer contracts. Before entering into or varying a consumer takaful contract, a proposer who is a consumer must answer any specific question requested by the takaful operator that is relevant to its decision in accepting the risk and determining the rates and terms to be applied (Para 5(1) of Sch. 9, IFSA 2013). For renewal, the takaful operator may either request the consumer to answer specific questions, or give the consumer a copy of particulars that he has disclosed previously and request the consumer to confirm or amend the particulars (Para 5(3) of Sch. 9, IFSA 2013). In both cases, the consumer is obliged to take reasonable care not to make a misrepresentation to the takaful operator when answering the questions or confirming or amending the requested information (Para 5(2) and 5(4) of Sch. 9, IFSA 2013). In addition, the consumer must also disclose to the takaful operator other relevant information that is not requested by the takaful operator (Para 5(8) of Sch. 9, IFSA 2013). With regard to a non-consumer contact, a proposer must disclose any relevant information that he knows or could reasonably know that affect the decision of the takaful operator in accepting the risk and determining the rates and terms to be applied. Such duty must be discharged by the proposer before entering into, varying or renewing the contract (Para 4(1) of Sch. 9, IFSA 2013). This statutory duty will ensure that the participant will be more transparent when entering into the contract of takaful. The law could also reduce cases of fraud and forgery by participants.

As for the takaful operator, before entering into, varying or renewing any takaful contract, it must clearly inform the proposer or consumer in writing of his pre-contractual duty of disclosure and that the duty shall continue until the time the contract is entered into, varied or renewed (Para 4(4) & 5(7) of Sch. 9, IFSA 2013). When attracting the participant to enter into, vary or renew the contract, the takaful operator shall not, whether fraudulently or not, make a misleading, false or deceptive statement or fraudulently conceal a material fact (Para 11(1) of Sch. 9, IFSA 2013). Any person who induces the participant to make the contract by these means commits an offence and shall, on conviction, be liable to imprisonment for a term not more than five years or to a fine not exceeding ten million ringgit or to both (S. 141(2), IFSA 2013). These punishments could reduce fraudulent activities by the takaful operator, takaful agent or broker in the selling of takaful products to the consumers.

#### **Conclusion:**

Comparing IFSA with the repealed TA, it is obvious that this new Act is more comprehensive than its former as it strengthens regulatory framework and deliberates existing requirements of takaful business. It also provides additional requirements for the operation of this business to ensure soundness and integrity of takaful industry in Malaysia. However, on the other hand, this Act seems to be quite stringent because it only allows a public company to operate takaful business and limits a takaful operator to one class of takaful business only. Such strictness may hamper the still developing takaful industry as it forbids a bigger number of participation of potential financially capable private institutions in the industry.

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