

CHAPTER 1

INTRODUCTION

1.1 Introduction

It is quite natural or *fitrah* in any society that everybody is exposed to all sorts of unexpected risks in his daily life. These risks may occur to one's life, property or even business ventures. Often these risks affect the lives of many individuals in a society in a way, which is sometimes so devastating and shattering, they may leave these unfortunate people vulnerable and helpless. The question is, how we are going to help such unfortunate people? One of the ways of doing so would be through the application of insurance. The primary objective of insurance is to uphold, among the parties involved, shared responsibilities on the basis of mutual co-operation in protecting an individual against unexpected risks.

From the economic perspective, insurance helps industrialists and other entrepreneurs to avoid the necessity of freezing capital to guard against various contingencies because they can pay a fixed contribution by way of premium and obtain financial security against the risks insured. Insurance has also enabled commercial, industrial and vast of other business organizations to operate on a large scale which otherwise would have been impossible. Huge insurance funds are also invested in Government securities and industrial shares which indirectly provide financial assistance to the government, local authorities and industry.

In Islam, the principle of mutual co-operation and solidarity are always encouraged in the life of Muslims.¹ In fact, Islam calls for the protection of certain basic rights, i.e. religion, life, dignity, property and mind. Thus, the concept of insurance taken as a means of precautionary measures against life and property should fit happily within the framework of the religion of *fitrah* that is Islam. The idea that Islam does not object to insurance per se is

¹ Allah The Almighty has said: "...and co-operate you one another in righteousness and piety". Al-Quran, Surah al-Maidah 5:2

concurred by the contemporary Islamic scholar, Dr. Yusuf Qaradawi when he says that:

"Our observation that the modern form of insurance companies and their current practices are objectionable Islamically does not mean that Islam is against the concept of Insurance itself; not in the least – it only opposes the means and methods. If other insurance practices are employed which do not conflict with Islamic forms of business transactions, Islam will welcome them."²

1.2 Insurance Industry in Malaysia

The introduction of insurance in Malaysia dates back to the 18th 19th centuries where trading firms and agency houses acted as agents for insurance companies from the United Kingdom. Upon the achievement of independence, there was an effort to establish domestic insurance companies. Some of these companies operated on an unsound basis with improper underwriting guideline.

The Government subsequently intervened and the Insurance Act, 1963 was introduced. Later on, the Act was replaced by the Insurance Act 1996. Under the Act, general conduct and supervision of the insurance industry was vested in the Director General of Insurance under the Ministry of Finance.³ At the moment there are 58 insurance companies in Malaysia offering various kinds of insurance product which fall under two main domain, i.e. life and general insurance.

However, for many years, Malaysia has practiced a conventional insurance system. Conventional means general, usually unspoken, agreement about how people should act or behave in certain circumstances. As for insurance, conventional insurance means ordinary insurance system that has come into

² Yusuf al-Qaradawi (Dr), The Lawful and The Prohibited in Islam, p.276

³ Tang Kin Wah et.al., **Pre Contract Examination Guide Book**, Kuala Lumpur : Life Insurance Association of Malaysia, p.1

existence in a community of a country. Conventional insurance companies in the West have become examples of any insurance company established in other countries.

In general, all operations in conventional insurance companies have been influenced by the force of capitalism and regulated by the Common Law. As a consequence, some practices of the conventional insurance companies are unlawful from the perspective of Islamic law. This phenomenon has continued for a long time until the idea of Islamic insurance system or *takaful* has come into picture by the creation of Syarikat *Takaful* Malaysia Berhad (STMB) in 1984.

1.2 Islamic Insurance (*Takaful*) System in Malaysia

The history of Islamic insurance or *takaful* in Malaysia can be traced back in the early 1970's whereby National *Fatwa* Council issued a verdict that insurance, especially life insurance, was a corrupt practice as it contained elements of uncertainty (*gharar*), gambling (*maysir*) and interest (*riba*). Consequently, a special steering committee named Badan Petugas Khas (BPK), chaired by Prof. Dato' Ahmad Ibrahim was set up by Badan Perunding Islam (BPI) in 1982 with its main objective to prepare a complete framework regarding the prospect of establishing an Islamic insurance in Malaysia.

The committee visited countries such as Saudi Arabia, Egypt and Switzerland to study the operation and management of related companies there. The findings and recommendations of BPK were submitted to BPI on April 1984. Among other things, the task force has proposed for the legislation of special act to regulate and supervise the *takaful* business. In 1984, the government has approved the *Takaful* Act, which provides the legal framework for the introduction of *takaful* products along Islamic principles. The Act is modeled on the Insurance Act 1963 with necessary modifications and revisions in line with the Islamic principles.

Syarikat *Takaful* Malaysia Sendirian Berhad (STMB) was the first Islamic insurance company operating under the *Takaful* Act 1984. The company was incorporated in November 1984 and commenced its operations a few months later with the operation of the first branch in Kuala Lumpur. In the year 2000, STMB operated a total of 24 branches with staff strength of 872 people. The shares of the company were listed on the Kuala Lumpur Stock Exchange (Main Board) in 1996.

The company's policy is to strive for excellence in providing the best service to all its participants irrespective of race and creed. It offers a comprehensive range of *takaful* products designed specially to meet the public insurance needs. The products, as in conventional insurance, have been classified into two main categories i.e. Family *Takaful* Plan and General *Takaful* Schemes.

In 1993, second *takaful* license has been granted to MNI *Takaful* Sendirian Berhad in order to fulfill the ever-increasing demand for *takaful* products and services. The company's operation was officially commenced in 1994. Few years later (in 1998), the company changed its name into *Takaful* Nasional Sendirian Berhad (TNSB).

Both companies have proved to be viable despite intense competition from the conventional practitioners. This indicates that more and more people especially Muslims are more conscious about the importance of *takaful*. Lately, the Government has been planning to issue ten more licenses to *takaful* operators including Maybank *Takaful*.⁴ If this comes into reality, Malaysia will have a sophisticated Islamic insurance system running on a parallel basis with the conventional insurance system just like its banking industry.

⁴ Interview with Encik Mohamad Zaidi Abd.Rahman, Branch Officer of Syarikat *Takaful* Malaysia Berhad

1.3 Objectives of The Study

Islamic insurance or *takaful* has become an alternative to conventional insurance in Malaysia. The reason behind the emergence of *takaful* during the 1980's in Malaysia was due to the realization of the country's leader about the importance of having an insurance system that follows the *Shari'ah*.⁵ As it is commonly known, conventional insurance deals with interest, gambling and uncertainty. These objectionable elements together with comments from Muslim jurists will be described in detail later.

With regards to the emerging needs for Islamic insurance, the writer is trying to observe and analyze the scenario in Malaysia and unveil any significant findings in it, especially in the context of *takaful* pricing. Some people have said that *takaful* contributions are higher than premium under conventional insurance system for similar types of policy.⁶ Since most people are inclined to make decision based on rationality (to get highest benefit for the least cost), they would choose insurance instead of *takaful*. The writer will try to seek answers for the statement by making comparison between the two systems. The title has been chosen by the writer with the objectives as shown below:

1. To clarify the concepts of interest (*riba*), uncertainty (*gharar*), as well as gambling (*maysir*). The existence of these elements in the conventional insurance system will be explained. Arguments from jurists that support and against the illegality of conventional insurance due to these elements will also be highlighted;

⁵ The word *Shari'ah* is originally meant the path leading to the water and in religious usage it means the way which direct a person's life along the right path. The *Shari'ah* governs all aspects of human life. Its principles include not only faith or spiritual aspects of human life but also personal behavior, legal and social transactions.

⁶ A survey conducted by Mohd. Tarmidzi Ahmad Nordin, an associate lecturer at Malaysian Insurance Institute found that 43.5% out of 156 respondents agreed that *takaful* contribution is more expensive than conventional insurance. Whereas 32.1% labeled *takaful* contribution as indifferent from conventional insurance and the other 24.3% labeled it as cheaper.

2. To understand the basic concepts and principles of both conventional and Islamic insurance;
3. To comprehend the method of calculating insurance premium for both life and general policies as well as the pricing objectives;
4. To elucidate the differences in terms of contribution or premium pricing between Islamic insurance (*takaful*) and conventional insurance as well as other operational aspects, including their performance.

1.4 Scope of The Study

The scope of the research will be the analysis of conventional contract of insurance from the perspective of *Shari'ah*. Several views from Muslim jurists will be highlighted regarding the three main elements i.e. *riba*, *maysir* and *gharar* and their connection with the modern contract of insurance.

The writer will proceed to explain the basic principles and concepts of insurance as well as *takaful*. In doing so, a brief history of both insurance and *takaful* will be explained. After knowing them then the writer will continue to elaborate the fields of insurance and *takaful* in the context of Malaysia.

The method of premium pricing will then be highlighted and several key products of both insurance and *takaful* will be compared in terms of their pricing to the insured and participants. The comparative study will reveal similarities and differences in the two different insurance systems practicing different concepts and principles.

The writer will then analyze descriptively the overall performance of *takaful* industry against conventional insurance industry in terms of four different aspects, namely growth of assets, growth of combined contribution income, underwriting experience as well as market penetration.

1.5 Limitations of The Study

Since the study of premium pricing is limited to the three (3) companies only, the result of this study cannot be used as a generalization of the premium or contribution pricing of other insurance and *takaful* companies.

Another limitation of the study is that some elements of the research require confidential materials such as premium rates of the companies. Hence, the officers are not willing to respond in details so as not to reveal any confidential information to third parties.

1.6 Organization of The Study

The study comprises of five chapters with an abstract attached at the beginning of the study and followed by appendices at the end of the study.

Chapter 1 is the introduction of the study explaining about the insurance environment, and the two types of insurance systems which exist in Malaysia

Chapter 2 is the literature review, which highlights some past studies, opinions and descriptions of *riba*, *gharar* and *maysir* and their relation with conventional contract of insurance. Secondly, it elaborates the concepts and principles of both conventional and Islamic insurance systems. Lastly it discusses about the fields of insurance from the Malaysian context. This chapter shall fulfill the first and second objective of the study.

Chapter 3 discusses about the hypothesis of the study, the research methodology and the method of premium pricing. This chapter describes a sample selection, data collection techniques and data analysis techniques in the study. This chapter shall fulfill the third objective of the research.

Chapter 4 is the interpretation of the findings of *takaful* contribution under the Islamic insurance system and premium payment under the conventional insurance system. Comparative analysis as well the overall performance of both systems will also be highlighted in the chapter. This chapter shall fulfill the fourth and final objective of the study.

Chapter 5 concludes the study and proposes some recommendations based on the findings and related discussions. The findings and recommendations might be useful for future research, especially for studies in the similar area.