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Takaful Insurance: A Critical Evaluation of Takaful Business in the UAE and its Prospects for Growth

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Abstract

In 1979, the first Takaful insurance was established in Sudan as an alternative option of conventional insurance which is impermissible by Sharia Compliance. The business witnessed a dramatic prosperity during the mid-years of operation in terms of a double-digit growth and increased number of operators. However, this optimistic trend has significantly declined during the last 5 years, mainly in the GCC region which is the home market of Takaful. For rigorous comparability with conventional insurance companies, the UAE market has been chosen as a subject study in this research.

Unlike conventional finance, business ethics in Islamic Finance is a case of mandatory religious duty. Using this premise, the case study investigates challenges, constraints and prospects experienced by Takaful business in UAE, as an Islamic financial product. Insights have been drawn from Theory of Constraints (TOC) and Principal Agent Theory for critical analysis of data that was collected from primary and secondary sources.

Qualitative-driven mixed research method is used and interviews were held with two business leaders in the UAE along with regulator, Sharia scholar, independent lawyer and two academic researchers. Necessary statistics about Takaful were obtained from secondary sources such as Alpen Capital, Milliman, A.M. Best, Earnest & Young, Badri and the UAE Insurance Authority' Annual Reports.

It has been found that the current structure of Takaful model brings complicated challenges. The concept of conditional donation and imposing Qard Hasan have converted the model into conventional, ineffective corporate governance mechanism, failure of regulatory system to capture the specificities of Takaful and incapability of Sharia scholars to innovate and promote Takaful products of which all work opposite to upward direction of the business. Many recommendations have been proposed to a) convert the hybrid commercial model into Mutual Takaful; otherwise, b) crucial changes are required from business leaders at all organizational levels in terms of operational, regulatory and Sharia Scholarity reforms. Regardless of crucial constraints the business face in its origin markets, taking into account the number of Muslims, the attractive regulatory system which support mutuality and the current call for ethical business, Takaful business could have its way to be established and flourished in western countries.

This research provided a comprehensive study about Takaful from its social historical roots to its modern commercial application. This research has made a contribution to the discipline of insurance finance by investigating takaful system and highlighting challenges that are facing the business in the UAE market as a case study. Further areas of researches have also been outlined in this research.

List of Abbreviation

AT	Agency Theory
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
BOD	Board of Directors
CAGR	Compound Annual Growth Rate
CG	Corporate Governance
FAS	Financial Accounting Standards
FEA	Far East Asia
GCC	Gulf Cooperation Council
GOE	Gross Operational Expenses
GST	Goods and Services Tax
GWC	Gross Written Contribution
GWP	Gross Written Premium
IA	Insurance Authority
IFI	Islamic Financial Institutions
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
IFSI	Islamic Financial Services Industry
MENA	Middle East and North Africa
MESA	Middle East and South Asia
PF	Policyholders' Fund
PRF	Participants' Risk Fund
ROE	Return on Equity
RTO	Re-Takaful Operator
SEA	South East Asia
SF	Shareholders' Fund
SSB	Sharia Supervisory Board
SO	Sharia Officer
TO	Takaful Operator
TOC	Theory of Constraints

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CHAPTER I

Introduction

1.1- Overview of Takaful as an Insurance Model

The concept of risk mitigation has its roots in a history when people had experimentally realized that they were living side by side with risks which affected all aspects of their life. However, it has been gradually discovered that these risks could be managed to an expected level out of their adverse effects. The first provision of providing mitigation tools was the concept of risk sharing which means the burden of carrying the loss on individuals has being distributed among a group of people. For instance, a trade community was formed by Phoenician merchants, more than 3,000 years back, that each community member accepted to share the loss with another member who had lost cargo during the sea voyage by contributing a portion of profit to a common pool allocated for that purpose (Fisher, 2013).

Pietro Masci (2011) as well as Khorshid (2004) found that the Babylonian commercial traders, in 2250 BC, agreed to secure a loan and pay the lender a fixed amount (premium) in an exchange for safe arrival. The lender could then cancel the loan should an unfortunate incident occurred and compensate those traders who suffered losses during the trip from the collected premium. This practice was enforced legally by the Code of Hammurabi (the King of Babylon) in 2100 BC (Masci, 2011) (Khorshid, page 45). This is evidence of another provision of insurance through risk transfer form. Pietro also confirmed that social insurance was commonly practiced during the ancient Romans Era by organized burial societies to provide funeral service upon the death of any member of society.

In Peninsula, Fisher (2013) examined the concept of insurance in the Middle East region and found that Arab traders, prior to the Islam era, had established a risk sharing mechanism, called (Daman Khatar Al Tareeq), to compensate other fellow traders for any financial loss they may have sustained during road trips from a pool made by an individual’s contribution (Fisher, 2013). Ostensibly, the concept of mutual, cooperative, risk sharing and risk transfer was practiced and developed gradually over years to undertake recent modern form of risk mitigation provisions.

Indeed, the risk mitigation mechanism has been experienced in various communities across the ages and the concept of insurance, as the final stage of risk management process, became familiar to people as an effective mechanism for mitigating the impact of any probable risks. The first formal insurance policy was written and signed in Genoa in 1347 CE where each party wrote their names and the sums that needed to be insured under the insurance proposal slip and since that the term of Underwriting has become a part of practical life. However, the fundamental need of insurance is apparently not disputable between societies but the way of providing it has varied over the time.

Dickson (1960) and Buckham al et (2011) disclosed the fact that the concept of insurance was converted to a commercial business in 1666 when the Great Fire of London had destroyed thousands of houses and the need for an insurance instrument was consequently indispensable. A year after, in 1667, the Sun Fire office as a result was established (Dickson, 1960) (Buckham al et, 2011). The office is currently known as the Royal & Sun Alliance which is one of the largest insurance companies in the UK.

By the end of the 17^{th} century, London became a trading centre and the demand for marine insurance was increased. Edward Lloyd opened a coffee shop which became a popular place where ship-owners and merchants met and discussed marine business. Insuring their ships and cargos was the core concern of discussion. This had attracted underwriters who commenced preparing insurance slips to insure hull and cargo in exchange for an agreed amount paid by merchants and ship owners. Afterwards, coffee became the Insurance Market of Lloyd's of London (Raynes, 1948).

In the Islamic world, Sharia jurists have unofficially announced that the conventional models are forbidden (Haram) due to the existence of prohibited elements in conventional contracts such as Gharar (Uncertainty), Maysir (Gambling) and Riba (Interest) (Motuza 2006, Nico 2010, Sarwar 2016). However, Muslim's jurists had a prolonged dialogue over years, afterward, for permissibility or impermissibility of conventional insurance until a new Fatwa from the Fqih Academy in Jeddah in 1985 (the most reliable Academy in Islam) confirmed that all conventional insurance contracts are prohibited (Haram) and forbidden for Muslims (Islamic Fqih Academy, 1985). Consequently, an alternative model has been introduced to Muslims, offering insurance products which are in line with Sharia-compliance, known as "Takaful Insurance".

Having established the differences of risk approach, the provision of providing insurance nowadays could be categorized into the following three principal modes:

- Mutual or Cooperative Model (Risk Sharing)
- Proprietary / Commercial Stock Model (Risk Transfer)
- Takaful Model (Risk Sharing based on Shariah Compliant)

The former two models have had a long historical period of experience while the latter has newly emerged in the market, particularly in the second half of the last century, and the first Takaful insurance company was established, in its modern form, in 1979 in Sudan (Hussain, 2011), (Saeed, 2019). The original meaning of Takaful is derived from the Arabic ward "Kafal" which literally refers to bearing responsibilities or carrying out duties on behalf of others. Sarwar (2016) and others such as Motuza (2006), (Pasha and Hussain, 2013) and Nico (2010) provided a brief description of Takaful as a means of mutual guarantee between the society's members to achieve social solidarity and financial protection. In term of business, Takaful is a scheme where participants agree to donate to a pool for providing mutual financial aid to those members who might sustain a loss (Motuza, 2006). Then, a commercial company shall be appointed by participants in order to manage the fund and carry out insurance and investment activities on their behalf. Takaful is conceptually a hybrid model incorporating the same concept of mutuality and some management features of proprietary.

Unlike Mutual / Cooperative and Proprietary Models, Takaful is a newly established business and constructed on the basis of Shariah principles (Hussain, 2011). As Shariah is a complete way of life for Muslims, the business was perceived to be created for providing protection means for Muslim's communities only. Theoretically, this assumption is seemingly sound but practically Takaful is fit for all people regardless of their thoughts, beliefs and religions (Khorshid, 2001). Joseph and Shreih (2009) addressed the concept that Takaful is exclusively designed for Muslims is absolutely misconceived as the majority of participants of the Takaful scheme in Malaysia, for instance, are not Muslims.

As a relatively new business form, as compared to conventional models, some researchers and business reporters believe that regardless of the fact that Takaful is confronting a number of challenges and obstacles which prevent the business to grow in local and global markets, it is still growing faster than conventional insurance (double digits growth in the last decade) and has potential opportunities to grow in both markets based on the dynamic approach of operation and the ethical principles associated with Takaful products (Ernst & Young, 2010; Alpen Capital, 2017). However, some other researchers, (Mei-Hwen, 2015; Saeed, 2019; Deloitte, 2015) have a pessimistic view of the business; based on the statistical fact that the current gross contribution of Takaful insurance is only minor, accounting for less than 1% of the total global insurance industry' revenues. On the other hand, if Takaful is really designed to fit Muslims' requirements only, the current total contribution is ultimately disappointing. Even in its original market, for instance, there are 12 Takaful operators out of 62 insurance companies registered in the UAE market, the gross Takaful contribution still forms less than 10% of total insurance gross written premiums GWP (Insurance Authority of UAE, 2017); regardless of the fact that the majority of the population are Muslims (more than 76%).

Regardless of the argumentative issue, both views confirmed that the Takaful operation is confronting significant strategic and operational challenges such as the lack of Takaful awareness among the public and workforces, lack of standardization, ineffective corporate governance arrangements, shortage of rateable Retakaful and restricted investment policy of which all are preventing the industry to grow and develop as expected (PWC, 2008), (Abu Hussin, Mohd & Hussin, 2014), (Al-Amri & Hossain, 2015), (Hassan, 2019).

Takaful business has experienced a steady uptake and growth momentum in the Middle Eastern markets, particularly in GCC countries, in the last decade irrespective of the significant adverse impact of the international financial crisis of 2008 on the local and global economies (Earnest & Young, 2014; Alpen Capital, 2017). Following the said Fatwa, indeed, Takaful has become firmly established in markets where Muslims form the majority of the population such as the MENA and South East Asia regions. The concept of Takaful as a Shariah-Compliant entity has encouraged Muslims to enter the scheme, especially given the perception that conventional insurance is forbidden (Haram) in Islam and, therefore, Muslims should require another means of insurance protection, subject to the Shariah principles (Halal).

Takaful has more recently emerged and developed in new markets such as Europe, Asia and America. The flexible models of operation, the ethical principle behind the business, and the transparent financial transactions of Takaful business have seemingly provided the industry with an advantage to compete with the conventional insurance counterparts. The fundamental growth of Takaful has been picked up by the international insurance companies who have consequently established windows to specifically sell Takaful products in the Middle East and some of them have undertaken audacious steps to operate Takaful in their home countries (Khan, 2008).

The unique model of Takaful provides the industry with a real means for expansion into non-Muslim communities, which traditionally adopt the conventional insurance forms, through the attractive principles of owning the portfolio, distributed returns, and the ethical prospects of Takaful (Hasan, 2019). These principles will be explained in detail in this report with constructive comparisons to the conventional models.

Having said that, it has been intended to conduct a critical evaluation for Takaful business in different markets, but mainly in the UAE as a Case Study, from three pivotal perspectives:

- To determine the impact of Sharia Standards and guidelines on business performance and whether the business is a commercially profitable insurance model
- To examine challenges and constraints the business face from practical aspects and outline the impact of these constraints on business performance
- To expose the potential opportunities of expansion toward global markets and ultimately recommend strategic inspiration for policy makers to make Takaful as the mainstream of business whether for Muslim or non-Muslim communities since the world is claiming for ethical products and transparent financial transactions, subsequent to the financial crisis of 2008.

1.2- Aims and Objectives of Research

From the above perspectives, the subject research is aimed to determine the impact of Islamic principles of Takaful on business performance and whether the current model of Takaful business is practically and commercially viable as an insurance model compared with conventional models in local and global markets by addressing the following objectives.

1- **Critical evaluation of the business model of Takaful as practiced in the UAE market through examining the principles aspects in practice and conducting a comparative analysis of performance between takaful and the conventional insurance industry in the UAE and global markets.**
   This objective has been achieved by providing answers to the following questions:
   - As a part of Islamic Finance, what are the impact of Islamic principles on Takaful performance?
   - Is the current regulatory system in support of Takaful business?
   - Could Takaful model be an alternative option of Conventional models?

2- **Examining the strategic and practical challenges / constraints that are preventing the development and growth of Takaful business in original markets as well as submarkets.**
   In the aim of achieving this objective, the following questions have been answered.
   - What are the key challenges / constraints Takaful business face in main markets?
   - What is the impact of these constraints on the business and how to overcome?

3- **Exploring what the business needs to expand into global markets**
This objective has been achieved by answering the following question.
Does Takaful business have an opportunity to flourish in western markets?

In conclusion, to achieve the research objectives and address all relevant aspects, this research is constructed into 6 chapters, Introduction, Literature Review, Research Methodology, Data Analysis, Findings and Discussion and the last one is Conclusion and Recommendations. The qualitative driven research methodology is conducted then the data has been analysed and presented utilizing the insights of Theory of Constraints and the Agency Theory.

Nevertheless, it has been claimed by Alshammari & Alhabshi (2017) that the Takaful sector in GCC countries has sustained a lacuna for academia. It has also been confirmed that there is no research at this time addressing the historical profile of Takaful comparing it with the current market practice (Alshammari and Alhabshi, 2017). In fact, this research is aimed to address the same with more critical insights.

CHAPTER II

Literature Review

2- Introduction

Unlike Islamic Finance, business ethics in a conventional financial system are advisable and preferable for implementation, while in Islam they are mandatory in each and every business' dealing. The Sharia objective, mainly financial transactions (Muamalaat), is the governance body that ensures all business transactions are free from any prohibited elements; otherwise, they are forbidden.

As Takaful insurance is an Islamic business, Sharia principles of which the business has been established are introduced in order to understand how the Takaful model was founded and developed during many years of operation compared with other conventional insurance provisions in terms of business ethics, principles, operational models, contractual relationships and performance. Also addressed in this chapter are the challenges / constraints that Takaful business faces which have become a preventative stick in its growth wheel whether in the main markets as well as submarkets.

To address these points in a structural way, this chapter comprises of three sections that cover a) the Islamic aspects of Takaful business in terms of principles, ethics, contractual structure, operational models, corporate governance issue and business challenges, b) Takaful performance globally, regionally and in the local market of the UAE as a business case study and a comparable between Takaful and conventional insurance in terms of performance and c) the conceptual framework of how these aspects have been analysed and presented.

A) Theoretical Foundations of Islamic Finance & Takaful

2.1- Business Ethics

Many researchers outline the premise that there is no specific universal definition of ethics; but they are broadly defined as moral principles that determine what is commonly right or wrong and applied in all aspects of human life including businesses (Singh & Mishra, 2018), (Beekun, 1996), (Velasquez, 2014). In that sense, several ethical theories have been gradually developed to determine the ethical framework that everyone, either individuals or groups, should apply (Al-Aidaros, Shamsudin & Idris, 2013). While the relativism theory argues that ethical values are relative and differ according to a particular community, place and environment, the Deontology theory (supported by Immanuel Kant) claims that the universal should be governed by common ethical values that everyone should accept (Velasquez, 2014).

Even though these theories focus on the moral act itself, others have been developed on the basis of the consequence of that act such as Utilitarian and Egoism theories. Whereas the former theory considers that any action is morally accepted when the consequences of such action brings the most good to the greatest number, the egoism theory focuses on the consequences that bring the greatest good to the person itself, not to others (Lavan & Martin 2008).

Another theory was created, based on religion called Divine Theory which argues that all ethical values are being brought about by religions to serve the people's interest. While all ethics are commanded in the holly books, Muslims are following an additional source which is the speech and action of the Prophet Mohammed "Sunna" (Mohammed 2005).

Having reviewed these theories, Velasquez (2014) concluded that secular ethical theories are limited and incomprehensive as each theory provides a single viewpoint regarding ethical standards. Also, there is no theory can offer a universal ethical standard of what is right or wrong other than divine theories, particularly Islamic theory.

In 1960, the concept of business ethics became a matter of discussion among corporations when it discovered the importance of building a trust relationship between customers and corporations in order to grow and flourish (Kumar, 2020). Arnold et al (2019) outlined that business ethics, in 1979, was primarily discussed from a philosophical perspective prior to becoming an essential part of decision making and social responsibility. Velasquez (2014) defined business ethics as a specialized study that is concerned with moral standards and its application to a social and organizational system, including the personal activities of people within organizations.

Consequently, and based on these theories, organizations have implemented a "Code of Ethics" for each transaction carried out by everyone in the organization shall be compatible with that code and such action becomes a part of the organizational corporate governance (Beekun, 1996).

2.2- Business Ethics in Islam

However, Muslims believe that the source of Qur'an and Sunnah have provided a comprehensive ethical framework, as it is a command of God, which is applicable at any time and for all societies. Islam has also developed ethical standards not merely applicable in various but in all aspects of human life (Al-Qaradawi 1994).

According to Velasquez (2014), all ethical theories which were primarily developed in western countries are insufficient and have been therefore rejected by Islam. Dabiri (2021) confirmed that the Islamic ethical framework is multidimensional and comprehensive as it covers all aspects including business dealings. According to the Islamic ethical code, Muslims must practice truthfulness and trustworthiness in each business transaction, honour contractual commitments and avoid any un-halal activities such as fraud, cheating, exploitations and deceit (Dabiri, 2021).

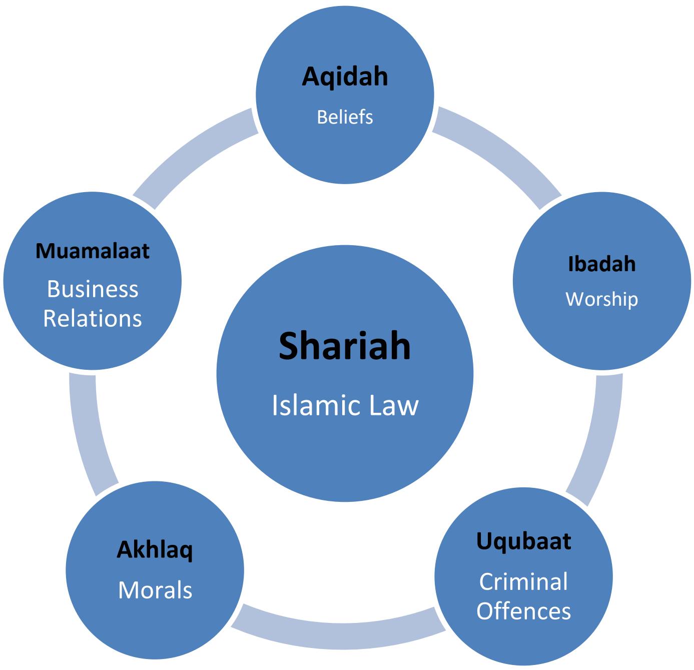
In respect of business, generating money out of money (Riba), unjustifiable enrichment, concentrating the wealth in few hands and uncertainty of business dealings become the main concern of Sharia objectives as they shall cause harm to individuals and societies and ultimately are considered void (Uddin, 2015). However, organizations who are engaged in Halal business could enhance ethical behaviour among all stakeholders through developing an Islamic code of ethics (Beekun, 1996).

In the early years of operation, Islamic finance struggled to achieve a balance between the generation of wealth and the way of redistributing the wealth subject to maintaining an equitable share to all stakeholders (Farook, 2007). In order to overcome this problematic formula, IFIs have developed a code of Islamic Ethics which are applicable to all organizations, including Islamic insurance, with the aim of achieving social responsibilities through putting the Islamic commercial principles before profits (Olorogun, 2015).

2.3- Brief Introduction to Sharia

While Islam is a complete way of life for Muslims, Sharia is the path to the watering place (IFSB, 2006). Shariah is the Islamic Law that governs all aspects of life for Muslims including social, ethical and commercial affairs. Technically, Sharia is defined as “Commands, prohibitions, guidance, principles and rules derived from the primary sources of Islam, the Quran and supplementary teaching of the Prophet Muhammad (PBUH)”. The objectives of Sharia are to promote the level of welfare and justice amongst mankind through protecting their faith, self, intellect, posterity and wealth and any action or speech made against these five objectives (Maqasid) is forbidden (Abdul Aziz & Mohd Noh, 2014), (Vejzagiec & Smolo, 2011) and (CII Text Book, 590 Principles of Takaful, 2017).

Shariah governance is divided into five categories: Beliefs, Worship, Morals, Criminal Offences and Business Transactions, as illustrated below.



Source: (El-Wereny, 2017)

While others are relating to a great deal with governing the sociality and morality of human relationships among themselves as well as with their religious beliefs, the Business relationships had been codified under Muamalaat section by underlining the rules derived from Sharia's resources to organize and determine Islamic commercial transactions and contracts.

However, it is not surprising to recognize that the worship (Ibadah) principle is separated from Muamalaat and therefore there is no religious, preconditioned entry to the scheme of Islamic Finance which is opened for all irrespective of their religion (Zainal Abidin, 2013).

2.3.1- Islamic Finance, Objectives, Principles and Prohibitions

Islamic Finance refers to the financial services provided according to Islamic jurisprudence (Sharia Law). All financial services must be free of interest (Riba), excessive uncertainty (Gharar), gambling (Maysir) and from any activity that causes harm to society (Kammer, 2015), (Franzoni & Allali, 2018). The main objectives of Islamic finance is to achieve economic and social fairness and justice and to ensure equitable distribution of wealth to the community as a whole.

Business and trading activities are encouraged by Islam for the purpose of building an active and organized society and achieving prosperities and economic developments. Abuse of power for those who are rich, exploitation of those who are at the disadvantage and treating others immorally is unarguably impermissible by Sharia (El-Wereny, 2017).

2.3.2 - Objectives of Islamic Finance

For equitable distribution of wealth, Sharia is much concerned by concentrating wealth in a few hands. The common feature of capitalist economies is that the relationship between the lender and borrower is influenced and motivated by interest rates. The main concern of the wealthy lender is not only on generating profit from the money which has been borrowed but on the possessions that can be exchanged if the loan is not paid in the event of the borrower's default. The ultimate result is that the "rich are becoming richer and the poor are getting poorer". Therefore, making money merely out of money without making any effort / bearing any responsibility from the lender is forbidden by Sharia (Najeeb, 2014). Instead, capital providers are encouraged to invest their money with the borrower and they are entitled, conversely to gain any profit generated and bear any loss resulting from running the business. This practice leads to achieving fairness and justice among involved parties.

2.3.3 - Principles of Muamalaat

To achieve these objectives, Shariah has established principles for Muamalaat (business relationships) relating to fairness transactions, ethical investments, transparency, risk participation and asset backed (Saiti & Abdullah, 2016) and (Ismail, Mahat & Mazlan, 2020).

1. Fairness of contract is the main principle of Islamic finance that which parties are free to agree terms and conditions of the contract provided so that any term shall not be in conflict with Sharia's prohibitions
2. As the ultimate goal of Shariah is the wellbeing of mankind, ethical standards form a fundamental pillar of Islamic jurisprudences. Muslims are enforced to apply ethical standards to investments, for instance, Muslims are not allowed to invest in weapons and alcohol or activities that cause harm to humanitarian affairs
3. The core principle of Islamic finance is the transparency throughout all financial dealings. This principle imposes on contracted parties a duty to declare all material facts around the subject matter of the contract and all terms and conditions must be clear to all parties before the contract becomes valid. The seller for example must disclose all information relating to the product and must not misrepresent intentionally or negligently any fact around the subject matter. For simple comparison, this principle is conversely meeting the utmost good faith principle in conventional insurance whereas the duty of disclosure and misrepresentation are forming the essential component in any conventional insurance contract
4. Furthermore, the Prophet Mohammed (PBUH) stated that "profit comes with liability" and this was interpreted by Sharia that the money provider must participate in business as a partner and any resultant profit or loss from the business must be shared proportionally based on a pre-agreed percentage (Qaradawi, 1997). Ultimately, generating money out of money is forbidden unless incurring liability or risk participation of loss
5. The last financial principle which forms an important characteristic of Islamic Financial transactions is the tangible assets. All financial transactions must involve tangible assets and any profit can only be generated from exchanging money with something having an intrinsic value. The seller must have a legal ownership or actual possession of the subject matter before making an offer for sale. This principle, again, supports the current principle of insurable interest which is also an essential element in any conventional insurance contract

2.3.4 - Prohibitions in Financial Contracts

The general rule in Sharia is that anything contradicting or contravening any of the higher objectives of Sharia and Muamalaat is prohibited or restricted, regardless of whether parties to the contract are, Muslims or Non-Muslims (Uddin, 2015). Sharia scholars had identified a long list of prohibitions relating to all aspects of life for Muslims including but not limited to business relationships. This study will focus on prohibitions and restrictions which mark the conventional insurance contracts unacceptable and which Takaful companies must be refrained from.

1- **Gharar (Uncertainty)**

Gharar is an Arabic word having broad meanings but all include a variety of negative implications such as risk, fraud, hazard and uncertainty. The common interpretation of the term in Islam is generally referred to as uncertainty and the prominent Islamic scholar and jurist "Ibn Abidin Al Shami" had defined the Gharar in respect of financial transactions as "*Uncertainty over the existence of the subject matter of sale*" (Al-Saati, 2003). Any contract of exchange contains some doubt or uncertainty about the existence or description of the subject matter such as the nature, quality, pricing and delivery of the underlying assets as a result of shortage of information is an invalid contract in Islam due to Gharar. For example, the Prophet Muhammad (PBUH) has forbidden the purchase of the embryo of any animal, which was a common practice before Islam, until it is born.

As transparency is the main principle of Islamic Finance, parties to a contract must disclose all material facts and necessary information about the subject matter in order to avoid exploitations and injustice to any of the contracted parties. Therefore, both parties must be fully aware of the item or service that is being sold / provided, terms and conditions must be clear and certain and the mutual consideration must be determined prior to announcing a valid contract according to Shariah Compliance.

2- **Maysir (Gambling)**

Shariah has strictly prohibited any transaction involving any gambling activities, as declared by the primary source "The Quran", which includes an effortless benefit for one party over the detriment of others (Quran, 5:90) (Quran, 2:219). Making a profit / loss by taking a risk deliberately is causing harm to individuals and the society as a whole and the places that facilitate these games such as casinos, lotteries and such is absolutely forbidden to deal with.

Islamic scholars confirmed that Gharar and Maysir are closely related and whenever an element of Gharar exists in any transaction, Maysir is usually exposed as a part or as a result of this transaction (IIBI Website, Islamic Insurance "Takaful").

3- **Riba (interest)**

Riba is an Arabic word translated as an interest or excess which literately means an increase of wealth without a justifiable consideration for the increase (Uddin, 2015). Making profit is encouraged by Islam but earning money out of money is impermissible unless it is used on trade activities or exchange in something equivalent in value or service. The reason behind that Riba is producing injustice among society as the lender is benefiting from the weak position of borrower who is having no other option rather than accepting to pay interest over the loan which is in contradictory to the main principles of Islamic finance (Muamalaat) and ultimately forbidden by Sharia compliance.

Having said that, it must be noted and affirmed that the Sharia prohibitions for conventionality relate to the principles and the way of conducting and running the business but not, in anyway, are applicable to participants. Therefore, the business is open for all people regardless of whether they are Muslims or not if the product being insured is Halal (Serap el at, 2013)

2.4- Takaful Insurance

The literature foundation of this research has been derived from articles published in international journals, academic research, books and statistical reports conducted by international actuaries and rating agencies. As the business is still in its infancy stage, the available information regarding the subject business has only been traced during the last decade, mainly between 2010 and 2020, and found few published articles and academic thesis. For instance, from Sciencedirect.com, UK Online Library and Amazon.com, there are 11 journal articles, 9 Thesis and 5 books published about Takaful Insurance, respectively. While the majority of these disclose the Takaful business in Far East Asia, few articles provide comparison between GCC and Malaysia markets; none of them reveal the business in the UAE Market, specifically. The most important book which is more relevant to the subject research is “Takaful Islamic Insurance – Concept and Regulatory Issues” written by Simon Archer, Rifaat Ahmed Abdel Karim and Volker Nienhaus and published in 2009. Furthermore, as the business is religious in nature, the majority of articles were published in International Islamic Journals such as the International Journal of Islamic Finance, the International Journal of Islamic Thought, International Journal of Islamic and Middle Eastern Finance and Management, Journal of Islamic Accounting and Business Research, Journal of Islamic Marketing, etc.

2.4.1- Background of Takaful

Although Takaful is a relatively modern concept, the notion of this goes back to pre-Islamic times. Alhabshi (2009) and others (e.g., Omer Fisher, 2013; Abdou et al., 2014) provides a good historical context regarding the pre-Islamic era, i.e., prior to 1500 AD, which is briefly outlined here. At that time, the community in the Arabian Peninsula was in the form of tribal gatherings with each tribe having its own values but sharing common customs and traditions. Alhabshi also outlined that the harsh desert conditions had imposed on members the necessity to be united for confronting the common dangers of desert life. As members were closely related, each tribe had developed a strict system of loyalty in exchange for providing protection, in terms of property and life, for its members. In order to achieve that purpose, a pool was created to settle the tribal disputes (Alhabshi, 2009). Fisher (2013) has described further how the tribal fund was collected by means of donation, whether cash or kind, which has been made by each member to the pool and once collected no refund, was allowable. This system was known as Al Aqila, which broadly defines as a joint guarantee by a group of individuals to help each other when a misfortunate event had occurred and this is clearly similar to the meaning of modern-day insurance. For instance, if a member has committed murder, the consequence was one of two: retaliation for intentional murder or amicable settlement for inadvertent crime. Bin Awang (2012) has highlighted that the tribes had agreed to share responsibility when a person was accidently killed by someone from the same or another tribe in order to reduce bloodshed and achieve social security. As a pooled liability, the entire tribe had to pay Diya (blood money), as a compensation to the victim's heirs (Bin Awang, 2012), (Habib, 2018). In this practice, the tribe was obliged to cover the loss and liability collectively by assisting the offender who was financially incapable to cover the loss alone and compensating, to some extent, the victim's family by means of cash or kind. This communal principle was seen to be social in nature; however, it was also economic in consequence and reflected the spirit of mutuality amongst the society. Interestingly, however, moral rules still prevailed in that the tribe allowed revenge for intentional murder and in this case no compensation was payable to the victim's family from the tribal pool. For simple comparison, this practice could be considered nowadays as a type of third-party insurance policy with some coverage and exclusions.

Looking at this from a business perspective, Fisher (2013) found that the Merchants of Makkah had established a fund called Hilf to compensate members who sustained losses as a result of any natural disasters, what might now be seen as a form of social insurance. Similarly, another fund was placed on traders called Daman Khatar Al Tariq (surety for hazards on the highway) to protect the convoy of goods against robbery or piracy during trade journeys (Fisher, 2013).

It becomes apparent from the literature above that the people at that time had realized the fact that the burden of facing risks by a group is undoubtedly much lighter than when borne by individuals; the bigger the size of the group the lighter is the harm on individuals.

At the time of Islam, the Arabs had begun trading among the Arabian Peninsula and expanded into the Levant and Yemen. Lian (2006) traced these principles after the era of Islam and found that the system of Al Aqilah, Hilf and Daman Khatar Al Tariq were subsequently reaffirmed, wherein the whole members of tribe contributed to share any loss and ultimately distributed the burden of liability among the entire tribe (Lian, 2006). This prospective could be seen as an early foundation of social insurance within the tribal society. However, Fisher (2009) also outlined that when Muslims expanded trading business in the second century of Islam into Asia and the Far East, the principle of cooperation (Ta-awun) was extended as well. The traders had mutually agreed to compensate each other when an unfortunate event occurred by contributing to a pool made for that purpose (Fisher, 2009). The practice conducted by merchants to collect a sum of money prior to setting sail to compensate any loss sustained by any one of them due to the perils of the sea had led to the birth of what is called today as a Marine Insurance. However, this step is considered as a transitional leap from the tribal into commercial system where the donation was collected only from the merchants, not from all members of the tribe. Refreshing and re-energizing these practices in the Islamic financial sphere has led to establishing the foundation of Islamic banks and, afterwards, Takaful companies in different parts of the Islamic worlds (Htay, 2014).

2.4.2- Modern Application of Takaful

Indeed, the notion of insurance in the Muslim world is complex. As argued previously, conceptually, Muslims believe that pecuniary and other types of loss have been brought upon people by God either as a punishment of wrong activities or as a test of faith and loyalty (Khorshid, 2001; Mushtaq, 2011). Following this belief, and of particular note here is the fact that any means of preventing or mitigating the loss is neither preferable nor acceptable; modern day or 'Western' type of insurance would, therefore, become invalid as a business practice. In fact, neither the Holy Quran nor the Sunnah referred to commercial insurance contracts and the whole matter therefore was left to Muslims' jurists / scholars (Tolefat and Asutay, 2013). Syed Ahmed (2015) and others noticed that insurance as a business had never even been discussed in Islam until the 19th century when Ibn Abidin, Hanafi jurist, (1784 –1836) raised the issue by announcing that marine insurance, which was practiced widely in Europe and other parts of the 'Western' world was not permissible under Sharia Law (Syed 2015; Anwar 1994, Khorshid 2004; Renat 2007). Nonetheless, whilst this view appears to be generally accepted, the concept of insurance became an issue of debate afterwards. Renat (2007) highlighted that Sheikh Mohamed Abdu, Abd-arahman ʿIsa and Abd Al-Wahab Khallaf (Muslim Jurists) have made what was viewed as being an ambiguous statement, that life insurance is a Modaraba (profit sharing) contract and therefore it is permissible by Sharia. This statement was, however, disputed by other jurists and the matter in respect of life insurance was not settled until 1972 when the National Fatwa Committee had announced that "*life insurance as presently practiced by insurance companies is a void (fasid) transaction as it is contrary to the Shariah's principles of contract*" (Rental, 2007).

It is important to recognize that the discourse surrounding insurance has long protracted dialogue between jurists for over 100 years. The debate surrounding the concept of insurance was intensified during the Fqih Conference held in Damascus, in 1951, when the Syrian scholar and jurist Mustafa Al Zarqa had affirmed that conventional insurance is Sharia compliant as the insurance contract is a modern form of the traditional compensatory system adopted in Islam like Diya or Aqilah and should be ultimately permissible (IFSB & IAIS, 2006). The National Fatwa Committee of Malaysia, which was carried out in 1972, as well as the official fatwa in Sudan confirmed impermissibility of conventional insurance and the Sharia Board of the Faisal bank of Sudan proposed establishing a Takaful company to insure all risks of operation in compliance with Sharia Law. Consequently, the first Takaful Company was founded in 1979 (BIBF, 2014).

Having said that, the matter was still disputable in the Islamic Umma (World) and Muslim jurists had a prolonged dialogue over years, for permissibility or impermissibility of conventional insurance until a new Fatwa from the Fqih Academy in Makkah in 1985 confirmed that all conventional insurance types are prohibited (Haram) and forbidden for Muslims. Resolution No. 9 (9/2) concerning Insurance and Reinsurance stated:

First: *The commercial insurance contract with a fixed periodical premium, which is commonly used by commercial insurance companies, is a contract which contains major elements of deceit, which void the contract and, therefore is prohibited (haram) according to Shari'a.*

***Second:** The alternative contract, which conforms, to the principles of Islamic dealings is the contract of cooperative insurance, which is founded on the basis of charity and cooperation. Similarly, is the case of reinsurance based on the principle of cooperative insurance* (Islamic Fqih Academy, 1985).

It can be seen from the above that the concept of insurance itself was not a point of dispute between Muslim jurists rather than the way of operating the business (Qaradawi, 2001). The element of uncertainty “Gharar”, gambling “Maysir” and interest (Riba) are prohibited by Sharia as confirmed in the Holy Quran and Sunnah. Ayub (2003), Renat (2007) and all others, particularly after 1985, have affirmed that these elements are existing in conventional insurance contracts (Renat, 2007). Uncertainty and gambling are closely related; while the former is viewed from an Insurer’s practice the later was considered from the Insured perspective. El-Qalqili (2017) confirmed that the uncertainty “Gharar” arises in conventional insurance as a result of the uncertainty of whether any loss will occur and how much it will cost Insurers (El-Qalqili, 2017). Zainal Abidin (2013) also outlined that gambling “Maysir” is practiced reciprocally by: a) The Insurer who may pay a huge amount in case of loss incurred compared with a small paid premium or pay nothing and keep the premium, which has been paid up front, as a pure profit and b) The Insured who is prepared to lose a small amount (the premium) if no loss has materialized but a huge amount might be received on contrary. That means the Insured might get much more than what was paid for, as a premium, on a chance which is akin to gambling that is prohibited by Sharia. The third element of interest (Riba) is existed in conventional insurance as a result of operation through investing the collected premiums in the exchange markets as well as from the adopted interest-bearing investment policy.

Takaful Act 312 for the year of 1984, Under the Laws of Malaysia, has defined Takaful as “*a scheme based on brotherhood, solidarity and mutual assistance, which provides forms of mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose”.* In terms of business, the Act has provided a specific definition to a Takaful Business as “*business of Takaful whose aims and operations do not involve any element which is not approved by the Shariah*” (Takaful Act 1984). Conceptually, Takaful is defined as a joint guarantee scheme in providing possible indemnity or contingency but conventional insurance is based on compensation of loss in exchange for premium which is paid by the insured (Hussain, 2011).

Having said that, the Takaful insurance was classified as a risk sharing provision subject to be in line with Sharia principles. As mutuality is not recognized by many jurisdictions in Islamic countries, Sharia scholars allowed the appointment of a commercial firm that could be domestically licensed as an agent (Wakeel) to manage the insurance pool in exchange of agency fee (Wakala fee) subject to each Takaful operator who shall appoint a Sharia Supervisory Board (SSB) from inception to ensure that all Sharia principles and rules are complied with. The SSB consists of 3-7 members, but at least one advisor who has a thorough educational background in Islamic Sharia and commercial activities and shall meet quarterly to supervise Takaful operation in terms of policies, products and treaty arrangements. Further, the SSB shall monitor all financial transactions including fulfilment of Zakat and advise on distribution of any surplus generated from

Takaful operation. Takaful operators are, also, required to employ an in-house Sharia Officer (SO) as a connection link between the company and the SSB. The SO shall monitor, internally, day to day operations and report any transaction that might be suspected / found to not be in compliance with Sharia principles. However, further models of operation have been introduced after which have been examined subsequently within the context of this research.

2.4.3- Comparison between conventional (Stock and Mutual) and Takaful insurance

Unlike Mutual and Takaful provisions, Naveed (2009) highlighted that the proprietary conventional insurance could be seen as a commercial project aiming to generate the maximum profit for shareholders (capital providers) (Naveed, 2009). All resources, experiences, actuarial sciences and IT technologies shall be therefore used for evaluating, assessing, promoting and pricing the risk in order to achieve the most economic interests for shareholders. In that sense, the door of exploitation might be practiced by conventional operators in many ways such as rejecting a payable claim, offering unfair adjustment or applying unrelated exclusions benefiting from the lack of knowledge by the Insured regarding the insurance contract. By contrast, Fisher (2013) confirmed that the main driver of Takaful is not promoting business for profit rather than applying the principle of “bear ye one another’s burden”.

However, in consideration of insurance principles, the three provisions share the following similar principles (CII Text Book, PO5 Insurance Law, 2013; OIC Fqih Academy, Resolution 200, 2016):

1) Principle of Insurable Interest: which is a legal condition that constitutes the existing of a financial relationship between the Insured (Participant) and the subject matter of insurance
2) Principle of Utmost Good Faith: the duty of the Insured to disclose all material facts of the subject matter and not to misrepresent them; whether these facts are requested or not.
3) Principle of Proximate Cause: which refers to the dominant cause whether solely or within a chain of causes leads to trigger the peril insured against.
4) Principle of Indemnity: which is the commitment to compensate the Insured (Participant) when the insurance peril is triggered.
5) Principle of Contribution: which prevents the Insured of having double compensation through sharing the loss among other Insurers who are insuring the same subject matter.
6) Principle of Subrogation: which allow Insurers to recover the compensated amount from any third party who cause damage to the Insured.

Nevertheless, Takaful insurance is distinguished from others by the following principles:

1) Comply with Sharia rules in all dealings and contracts
2) Non-insurable subject does not meet Sharia Compliance
3) Avoidance of any transaction that involve Riba (interest)

A) Mutual / cooperative mode

Historically, Mutual mode was the first provision of providing risk mitigation, as outlined in Chapter I, through affinity groups, living in a districted geographical area, to serve some particular needs. In its modern form, Lawrence (2017) in his article published in NAMIC confirmed that the first mutual fire insurer in the UK was established in 1696 and the first insurers in the US were Mutual, created by farmers and property owners, and the first operation of Mutual, known as Friendly Society for Mutual Insurance of Houses Against Fire, was in 1736 in South Carolina (Lawrence, 2017). Friendly Society was defined by Green (1993) as a self-governing entity established in the UK in the eighteenth century by workers to provide mutual financial benefits when hard time arises. Each member will contribute a portion of their wages to a common pool which shall be used to compensate members against sickness, incapability of work, accidental death and to support widows and orphans. The concept was extended to provide some types of insurance and ultimately attracting more and more contributors. In the later part of the nineteenth century, there were almost 27,000 Friendly Societies in the UK registered under the Friendly Society Act 1896 (Green, 1993). The mutual scheme was expanded into Europe and other western countries. For instance, the Mutual French Company MACIF was originally established in 1960 to provide insurance protection to shopkeepers and industrialists (Gönülal, 2013). According to the same resource, mutual pools are owned and controlled by their members and operated based on risk sharing arrangements. The purpose behind forming the contribution pool is to indemnify members against damages arising from specified perils and all claims and expenses are settled from this pool.

Theoretically, members of the scheme manage the mutual pool but practically they appoint professional managers to run the business on their behalf. The share of each member is not transferable or sellable to another party but the member can simply leave the scheme at any time.

Any surplus generated from running the pool will be distributed among members, as owners, proportionality according to their share or it might be accumulated to meet future contingencies. If the pool sustains deficit, members are called to cover the deficit by injecting additional contribution or it might be paid by the robust reserve maintained for this purpose. Practically, the Mutual is a limited liability company and a call for additional contribution is not practicable, therefore a subordinated debt is usually requested to supplement the pool.

The key feature of the Mutual is the need for a long gestation period to build up an adequate reserve to maintain sustainability; otherwise, it may face the possibility of winding up or taken over by another mutual company. In other words, if the Mutual is sustaining a continuous deficit during the first years of operation, it will fail to meet claims, operational expenses, and capital requirement and pay back the subordinated debts. This will result in dissolution or be taken over by another company with more capital, which could be either a mutual or a proprietary insurance company.

The conflict of interest may arise between members and managers regarding the distribution of bonuses from any generated surplus. The members may wish to share any surplus or reduce their participation for future contribution while the management wants to build up more reserve to meet any unexpected disastrous deficit or to expand through writing new classes of business. The constitution and regulatory authorities had, to some extent, resolved this conflict by requesting an adequate reserve to be maintained by mutual insurance which could mitigate the effect of adverse impact, but expansion is still a challenge. In respect of investment, there are no restrictions on investment and the generated returns belong to the participants (IFSB, 2006).

Nowadays, mutual and cooperative models are witnessing challenges of stability and sustainability but are still forming 50% of insurance market share in some European countries and one third in USA, as illustrated in the table (1) below according to the Global Mutual Market Share Report of 2014.

Table (1) - Mutual / cooperative Market Share in Major Global Insurance Markets

Country	**Market Share %**
Netherlands	51
France	47.4
Germany	44.4
Japan	40.8
USA	37.1
UK	7.7
China	0.3

Source. http://www.icmif.org/publications/global-mutual-market-share/global-mutual-market-share-2014

B) The proprietary Insurance Provision Model

The proprietary insurance is a risk transfer arrangement owned by its shareholders who appoint managers to run the business on their behalf. Unlike the Mutual, the ownership can be transferable to third parties and the policyholders have no share or control on how the collected premiums are used (Bonner, 2019). Policyholders are transferring their probable risks to insurers who shall indemnify the insured against any valid claim in exchange by paying a premium which becomes a part of the company’s fund. All claims, expenses and liabilities are settled from this fund.

Any surplus gained from operation of the business (technical profit and investment returns) solely belongs to shareholders but any deficit; conversely, arising from operation shall be their own liability. However, the company is responsible to meet all regulatory requirements in respect of capital adequacy and stability of solvency. In terms of financial reporting, the Proprietary is using one single set of accounts to present the financial status of the company and therefore there is no segregation of funds between the collected premiums from policyholders and shareholder’s fund. As mutual, proprietary Insurers have no restriction on investment but any returns solely belong to shareholders (IFSB, 2006).

Nowadays, the Proprietary is a prevailing model of insurance provision all around the world and forming, for instance, 90% of all Insurance in the UK and two thirds in the USA (CII Text Book, Principles of Takaful, 2017).

C) Takaful Insurance model

Similar to the mutual / cooperative model, Takaful is an alternative provision of insurance based on a risk sharing principle. In order to overcome challenges faced by Mutual in terms of viability and sustainability, Takaful has adopted a method of segregation between the risk-sharing pool and Takaful operator's pool who are managing the participant's pool in exchange of an agreed fee (Ali, 2016).

The concept of Takaful has emerged as a result of arguable dialogue of Islamic scholars whether the previous provisions of insurance are admissible per Sharia compliance. This argument was settled recently in favour of Takaful as an alternative option of impermissible conventional insurance, as addressed above. The two key adaptations made by Takaful compared to conventional are, firstly, changing the type of contract and mode of operation in order to remove or mitigate the Sharia objections to conventional and secondly, developing a viable and sustainable model of Mutual by inviting commercially motivated professional operators to manage the operation. However, these changes are discussed thoroughly hereunder.

The participants contribute to a pool by means of contribution / donation with the aim of mutual indemnification to each other in case any member sustains a loss. The participants' fund is formed in a risk-sharing principle and completely segregated from the shareholder's fund. Shareholders are appointed by the participants to manage their fund for a pre-agreed remuneration fee (Pasha and Hussain, 2013; Khan and Alam, 2011).

The surplus generated will be distributed to participants only as owners of the fund but, unlike Mutual, any deficit shall be paid by shareholders by means of Qard Al Hasan which is a free-interest loan made by a shareholder to cover the deficit subject that the loan will be given a priority to recoup from any future surplus generated.

However, the table (2) below provides the key differences between the three models.

Table (2) - Key features of the three Insurance Provisions

Basis	**Conventional Insurance**	**Mutual / cooperative**	**Takaful – Islamic Insurance**
Contract Basis	Risk Transfer Bilateral in nature	Risk Sharing Bilateral in nature	Risk Sharing (loss or profit) Unilateral in nature
Capital	Provided by shareholders	Provided by participants	Two separate funds, policyholders fund and shareholders fund
Purpose	Security and Profit	Security & Co-Operation (help one another)	Security & Co-Operation (help one another)
Activity	Buying and Selling as Product	Co – Operation	Co – Operation
Payment	Premium (Cost of buying insurance / security)	Contribution	Donation / Contribution

Ownership of Fund	- With Insurance Company/ Shareholders - Transferable	- With the Participants / Members. - Not transferable	- With the Participants / Members. - Not transferable
Role	Seller of Insurance Products	Manage participants fund	Manage participants fund
Investment	Any financial product	Any financial product	Only Shariah compliant products
Sharing of surplus	No sharing with insured / policyholders	Surplus money is shared among the members / participants	Surplus money is shared among the members / participants
Dissolution / Winding up	all assets in excess of liabilities will be transferred to the shareholders only	all assets in excess of liabilities will be transferred to participants only as the shareholders	**Policyholders Fund:** all assets in excess of liability will be used for charities and general public welfare **Shareholders Fund:** all assets in excess of liabilities will be transferred to the shareholders according to their individual share

Source: http://cob.rb.kau.edu.sa/Files/849/Researches/56402_26701.doc

2.5- The Law of Contract

The English law defined the contract as "any agreement, enforceable by law, between two or more persons to do, or abstain from, some act or acts, their intention being to create legal relations and not merely to exchange mutual promises". Offer, Acceptance and Consideration are the key components of any contract to become legally valid in addition to other elements such as the intention to create a legal relationship, capacity to contract and certainty of terms (CII Text Book, PO5 Insurance Law, 2013), (Felgentrager, 2004).

Consideration was defined as "some right, interest, profit or benefit occurring to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other" (Allen & Overy, 2016). Once the offer is unconditionally accepted, the law will not generally enforce the contract unless it is supported by consideration. In a contract of sale, for instance, the buyer of property must pay or provide the seller something of value in exchange to validate the contract and once doing so it becomes a bargain that is enforced by law. However, exchanging promises is permissible and recognized by law as well and the buyer or the seller in this case needs only to exchange promises to each other that an amount will be paid or the subject property will be delivered in a certain time of future. If money or property has not been paid / delivered at the agreed time, no binding contract is in place and the law will consider the contract void. It is essentially recognized that the aim of law is to bind both contracted parties to implement their obligation to each other; otherwise the contract can be void or voidable.

John Calamari (1998) in his book "the Law of Contract" confirmed that for every contract, a legally sufficient consideration must be exchanged and each party must receive consideration (mutual consideration). In other words, the consideration must be delivered in both directions between parties otherwise neither party will be legally bound to the contract. He also stated that the consideration must have some value, but not necessarily equal, and it could be money, a promise to perform / not perform acts or a tangible property. Any one of these considerations could be exchanged by others – for instance, money may be exchanged for property or vice versa (Calamari, 1998).

By definition, the consideration must be a detriment to one party or a benefit to the other party where neither detriment nor benefit was legally recognized prior to contract. Because there must be a mutual and reciprocal consideration, each party to the contract shall incur a detriment and receive a benefit in order to be legally valid.

2.5.1- Types of contracts

A bilateral contract is formed between two or more parties by exchanging mutual and reciprocal promises for performing or not performing some acts. The promise made by one party must be supported by sufficient consideration to the other party in order to be recognized by law. Conversely, unilateral contract is a promise made only by one party in exchange of performing or not performing an act by the other party. In both types of contract, the evidence of understanding by each party to the purpose of contract must be clear in order to be enforceable by the court (CII Text Book 590, 2017). The table (3) below illustrates the key differences between both contracts.

Table (3) – Bilateral and Unilateral contract (key difference)

Features	Bilateral contracts	Unilateral contracts
Involvement to a contract	Two or more parties	Single party
Promise	Reciprocal to each other	Made only by one party
Actions	All parties are obligated	One party is obligated
Form of contract	Unconditional acceptance to offer supported by sufficient mutual consideration	Does not need acceptance to be communicated to the offer and performance / non-performance by offeree is a consideration
Terms of contract	Terms must be clear to all parties	Terms are the offeror's discretion

Source: CII Textbook 590 (2017)

2.5.2- Contract of Insurance

An insurance contract is subject to the same components, outlined above, in order to be enforceable by law along with some elements which apply only to insurance contracts such as the Utmost good faith and Insurable Interest (CII Text Book, PO5 Insurance Law, 2013). The Insurance contract therefore is an agreement between the Insured who agrees to pay some amount (premium) as a price of the promise to the Insurer in exchange that the Insurer will provide indemnity to the Insured on the operation of a specified peril.

The contract of uncertainty is void in Islam and any allowable contract must be certain and free of ambiguity. Buying a tangible product, for instance, allows the buyer to examine and inspect the product before deciding to buy, and offering a consideration in return is subject to the seller's acceptance. Once unconditional acceptance has been agreed by both parties, the contract is then approved in terms of legal points of view as well as Sharia compliance. An insurance product is an intangible and the Insured (buyer) is paying a premium without having an opportunity to inspect the product rather than a promise of payment being made by the Insurer for compensation once an insured peril occurs. The Insured herein is buying a promise of indemnity when an insured peril is triggered.

The Takaful contract is not in the form of buying / selling (Bilateral Contract) rather than a contract of donation / tabarru (Unilateral Contract) and the Takaful operator is an agent operating policyholders' fund on behalf of participants. Therefore, no element of Gharar and Maysir are exercised whereas the participants are sharing the loss or profit as the Insured and Insurer at the same time. Furthermore, investing the pooled funds will only be according to Sharia compliance; hence ensuring no element of Riba or Maysir is practiced (Whitney, 2012).

Regardless of religious prohibitions, the Insured and Insurers enter the conventional contract by exchanging promises that the former shall pay a sum of amount up front (premium) to the Insurers in exchange of receiving a protection / compensation from the later when any insured peril operates during the policy period. The controversial question is what consideration the Insured shall receive in the case where no loss has been sustained during the same period. Certainly, the contract will be valid when mutual consideration is reciprocated, and this may open the door to an arguable discussion as to whether a conventional insurance contract is lacking in the most important element of a valid contract.

Seemingly, the conservative concern for Sharia Scholars in an intangible insurance contract is the consideration. The consideration in a conventional contract is uncertain and ambiguous, for the same reasons as stated above, that make the whole contract voidable. The solution was to change the contract from Bilateral where consideration is a must to validate the contract to Unilateral in order to avoid the doctrine of consideration.

However, consideration has been recently criticized by many scholars and judges whether consideration is an indispensable requirement for a valid legal contract. Some have argued to remove the doctrine of consideration while others recommended implementing legislative reforms that allow an enforceable contract without consideration. For instance, the German legal system requires only an offer and unconditional acceptance to validate any contractual agreement (Boardman, 2011), (Chappuis, 2008).

Having said that, the question which may arise to whether the current form of Takaful business will be entirely changed if consideration is removed as a conditional requirement? However, this issue is out of the research's scope but has been discussed briefly herein. Nevertheless, highlighting this issue might open the door for more research in the future.

2.5.3- Conventional Insurance Contract and Sharia Compliance

Conventional insurance contract is a bilateral contract of exchange where Insurers provide an offer in the form of an insurance slip including scope of cover, exclusions, terms and conditions for the other party to accept. Once the offer is accepted, a consideration of a fixed amount shall be paid in the form of a premium to the Insurers who, in turn, receive the money, issue the policy and run the risk on behalf of the Insured. The premium is paid in an exchange of a promise given by the Insurer to indemnify the Insured in case of any loss which might be occurred during the policy period. Assuming both parties have practiced the utmost good faith during negotiating the contract, it is a valid and enforceable contract as all elements of a valid contract: offer, acceptance and consideration is contained.

In this contract, the Insurer may pay nothing at the end of policy if no insured peril is operated and keep the premium as a pure profit or pay a huge amount for compensating the Insured in case a claim is arise. The Insured, as well, may lose what was paid upfront in case no loss is sustained during policy period or receive big amount for compensation. Therefore, under the conventional contract the outcome is uncertain and parties entered the contract with ambiguous and uncertain exchange of consideration. According to Sharia, a promise to pay if and when a particular event might occur is invalid contract due to Gharar as a consideration following from one party to another is uncertain. Furthermore, the Insurer has taken the risk in a chance no loss will occur during the policy period and keep the premium as a net profit while the Insured is willing to lose the small money paid upfront if a huge amount might be received in case of loss. This also another reason of invalidating the contract due to Maysir as an element of gambling is practiced under the conventional contract.

Riba (usury) has existed as a consequence of conventional insurance operation through investing part of the collected premiums in interest bearing institutions or activities which are impermissible under Sharia Law. Some Sharia scholars believe that the Insured should not get more than what was paid as premium in case of a loss otherwise the Insured is generating money out of money without putting any effort to do so and this is what considered as Riba which is forbidden by Sharia. However, exchanging money for money is permissible in Islam as far as there is no difference in the exchanged amounts and must be carried out at the same time. Conventional contract is a contract of monetary exchanges, both parties are exchanging premiums for claims but the matter becomes an issue in Islam because the difference of paid-in (premium) and paid-out amounts (claims) are considerably different in terms of values and time of exchange. This type of exchange is prohibited due to usury (Akoob, 2013).

2.6- Takaful Contractual Elements

Sharia has imposed strict restrictions on the bilateral contract of exchange in order to meet the principles, rules and conditions of Islamic financial transactions (Muamalaat); otherwise, the contract will be rendered void or voidable. In order to avoid / eliminate any breach of these principles, the bilateral contract of exchange has been replaced by a unilateral, which is a one-sided contract, based on the principle of donation (Tabarru).

1. Tabarru: is the foundation of Takaful contract whereas participants have mutually agreed to contribute into a pool some of their money in the purpose of protecting and mitigating probable losses incurred by others. It is a joint guarantee of financial aids to enhance charitable affairs amongst individuals, groups and society as a whole. The contract of charity is a unilateral contract which is permissible by Sharia jurisdictions where donators are not expecting a counter-value in exchange of their donation. This concept has been criticized by some scholars to say that if the donator is not expecting any benefit from his donation; why is it that he claims benefit from the Takaful fund? Professor Al Sideeq Al Dareer, the prominent Sharia Scholar in Sudan, has established a concept of conditional and irrevocable donation which was later confirmed by Sheikh Yusuf Al Qaradawi, the famous Muslim Jurist, who stated in his book The Lawful and the Prohibited in Islam that Islam allows "*Contract of donation with a condition of compensation*" (Qaradawi, 1997, P 273), (COMCEC, 2019). It means that the participant preserves, prior to entering the pool, his right of compensation in exchange for donation. Technically speaking, the concept of Tabarru has transformed the insurance contract from the bilateral contract of exchange to unilateral conditional donation contract and ultimately, the element of excessive Gharar does not exist in such arrangement that renders the contract void or voidable.

2. Wa'ad: it is a promise made by one party to another party to perform or carry out actions in their favour and to their own benefit. Participants have made a Wa'ad / promise to each other in Takaful scheme that they will be indemnified against any specified loss arising from a particular peril. This is a unilateral contract which is legally binding in Sharia commercial law (Muamalaat). The contract in the proprietary provision, as similar as Takaful, is a contract of promise but the difference is that the promise here is made by the Insurers towards the Insured, provided that the premium has been paid up front.

3. Takaful Contract: once participants have made their donation and agreed to indemnify each other against probable losses that might be suffered by any member of the scheme, the form of Takaful is established. As the participants have no proper expertise and due diligent skills to manage the fund and run the business in a professional manner, they appoint individuals or a company to manage the fund on their behalf. In an Islamic commercial business, there are different models of operation that define the contractual relationship between the participants as the owners of the fund and the appointed company as the manager to that fund. These models will be, theoretically and practically discussed in more details in the coming chapters.

Dissimilar to the conventional, the Takaful arrangement has two types of contractual relationship: one contract among the group of participants and a second contract between the said group and Takaful Operators. So, from corporate structural perspectives, it seems a firm within a firm, i.e., it is a mutual operation established within a proprietary body corporate (Archer, 2013). However, the domestic law of each country will determine the legal personality of takaful company; whether mutual or proprietorship. For instance, the UAE Law is not designed to allow mutual and therefore takaful companies were registered under commercial law.

Furthermore, a Takaful contract is not merely required to be Sharia compliant but it must also comply with domestic law. Therefore, a potential conflict of law, particularly in non-Muslim countries, exists between two laws (Sharia and domestic), specifically for those matters relating to interpretation of some clauses in a Takaful contract (Colon, 2011). This conflict is minimal in Muslim countries where the source of law, to the most extent, has been derived from Sharia jurisdictions.

As far as the ultimate goal of insurance business it provides financial protection in exchange to paying / contributing some amount to a common pool, the key differences between the three provisions of insurance are the ownership of the fund, the type of contract between involved parties and how the fund is being managed.

2.6.1-Sharia Supervisory Board SSB

Prior to commencement of operation, Sharia have imposed an obligation on Takaful / Retakaful operators to appoint a religious board to ensure that Sharia principles are adhered to in each and every aspect of operation. The SSB is ordinarily appointed by Takaful management and consists of a few members of Sharia scholars who are competent on Islamic commercial jurisprudences (Fqih Al Muamalaat) with adequate knowledge of insurance business and commercial activities.

The roles of SSB members are to review, supervise and audit all Takaful contracts and Retakaful treaties to ensure that they are in line with Sharia compliance and national and international Islamic standards. Also they are supervising the overall operational processes including the adopted investment policy, marketing strategy, innovation of new products and issuing ultimately their Sharia Compliance Report addressing whether the company complies or semi-complied with Sharia jurisprudences and imposing correction duty in case of the later that must be implemented within a specific period; otherwise the company will face temporary suspension of activities until observations are adhered to(Ahmed, 2013).

The shortage of skilled scholars who are eligible to be a member of SSB is a practical challenge to Takaful companies. Tarek Seif (2014) affirmed that Takaful companies might witness a conflict between the Sharia Scholars and technical senior managers as a result of lacking a technical knowledge by the former and religious backgrounds by the later. This will affect adversely on the process of innovating new products that meet both requirements in terms of technicality and Sharia Compliance (BIBF, 2014).

In respect of day-to-day operation, Takaful operators must appoint a Shariah Compliance Officer, approved by SSB, to ensure that Sharia internal control is secured by supervising the business activities on a daily basis. The Sharia officer is the connected link between the SSB and the company and he/she must conduct an on-going supervision of business transactions and observe and report any breach of Sharia standards set up by the SSB.

2.6.2- Operational Models of Takaful

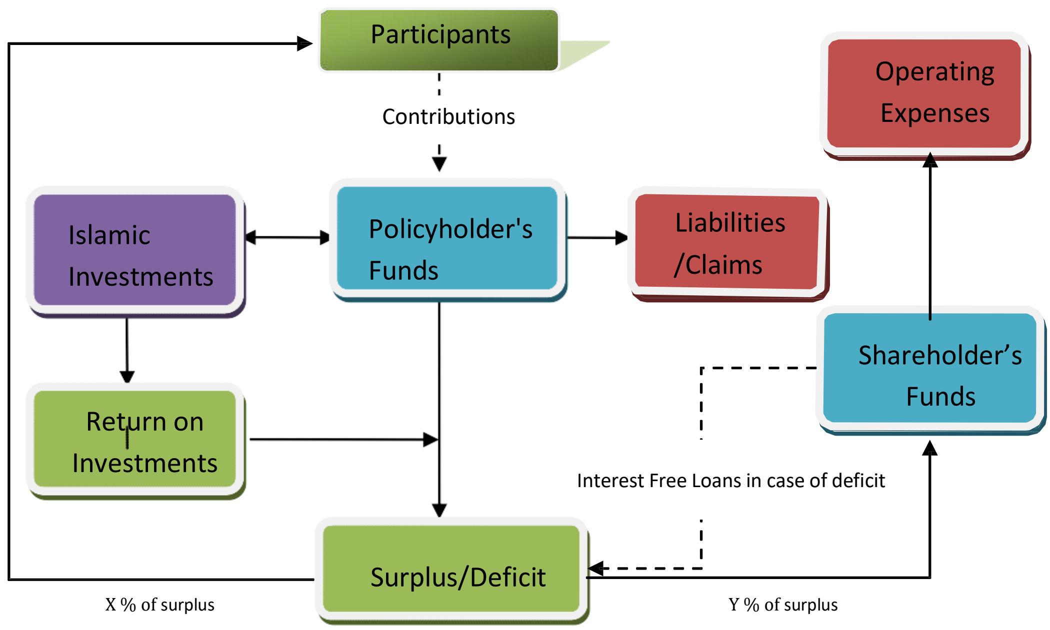
Sharia scholars have developed many models of operation that a Takaful operator could adopt, based on the Sharia Finance Principle (Muamalaat).

1- **Modaraba Model (Profit Sharing)**

Shareholders are acting as an entrepreneur / Modarib while the participants act as capital providers / Rab Al Mal. Shareholders are investing the policyholder's fund (PF), in line with Shariah Compliance, in exchange of sharing a pre-agreed proportion of any investment returns, the chart (1) below refers. The basis of Modaraba Model was commercially challenged, particularly during the early years of operation, as the capital invested is not sufficient to generate an adequate remuneration to a Takaful Operator (TO). Consequently, Malaysian operators adopted a modified Modaraba Model, as illustrated below, which allows shareholders to share, in addition to investment returns, any surplus generated from underwriting side (CII Text Book, Principles of Takaful, 2017). However, this movement was questioned by Shariah Scholars in the GCC as the underwriting surplus is purely belonging and attributable only to participants.

In case the PF sustains deficit, an interest-free loan will be provided by the shareholders but shall be recouped from any future surplus (Hussain, 2011).

Chart (1) – Profit Sharing Model



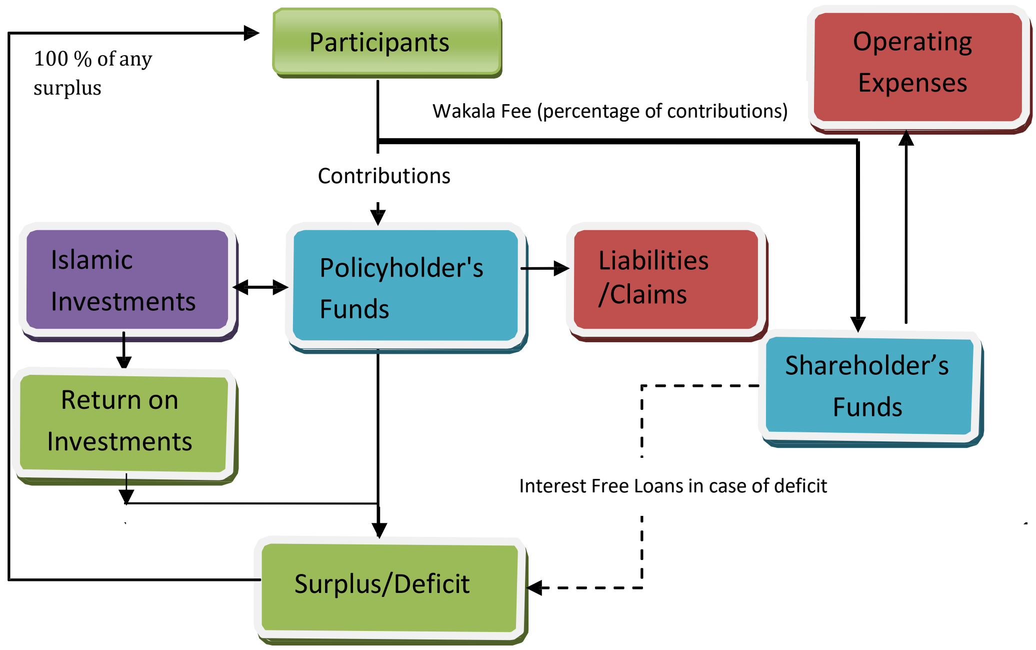
Source: PricewaterhouseCoopers, Takaful: Growth opportunities in a dynamic market Insurance

2- Wakala Model (Risk Sharing)

Shareholders are managing the policyholder's fund as Wakeel / Agent. Accordingly, shareholders are paid upfront a pre-agreed proportion of gross policyholder's contributions for managing insurance operation on behalf of policyholders. The fee is pre-assessed to cover the operational expenses as well as margin of profit for shareholders. The Basic Wakala Model, as illustrated in the below chart (2), has also been commercially challenged as the TO require charging a high Wakala fee, during the early years of operation, to cover operational costs. This might, too, lead them to accept poor risks in the aim of increasing the gross contribution and ultimately receive more income. Therefore, a modified Wakala model was introduced and adopted in different Islamic countries.

At the end of the financial year, any surplus generated from operation and investment returns will be distributed between participants and shareholders according to the pre-agreed percentage. The policyholders may enjoy cash returns or allow a reduction on future contribution. In case of probable deficiency of policyholders' fund, the same scenario for injecting an interest-free loan as in the Modaraba Model is applicable.

Chart (2) – Risk Sharing Model



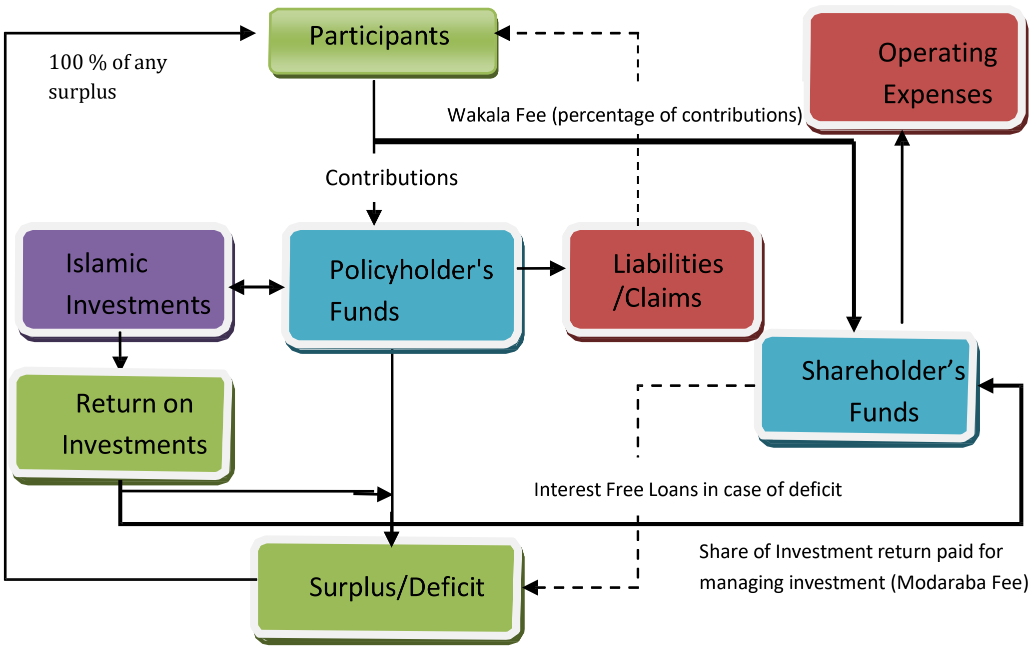
Source: PricewaterhouseCoopers, Takaful: Growth opportunities in a dynamic market Insurance

3- Modaraba and Wakala Model (Hybrid Model)

It is the most preferable model for TOs as Shareholders are entitled to receive upfront a Wakala fee for managing the portfolio and a Modaraba fee for investing the PF. Under the basic hybrid model, any surplus generated from the underwriting / technical results will be shared amongst policyholders only.

However, the modified model allows shareholders to receive an incentive fee from underwriting surplus as an appreciation of good management and operation. The duty of providing Qard Hasan by shareholders remains unchanged. This model is commonly used by Takaful operators in the Middle East and South East Asia in the recent years, but it is obligatory in Bahrain and Malaysia (Wahab, 2007). The chart (3) below refers.

Chart (3) – Hybrid Model



Source: PricewaterhouseCoopers, Takaful: Growth opportunities in a dynamic market Insurance

4- **Waqf Model (Trust-Fund)**

Under this model, the Shareholders provide minimal capital to establish the trust fund or Waqf fund. The purpose behind that is to give the participants fund a legal personality under the Waqf Deed (Archer, 2009). The participants contribute to this fund which will be then operated and invested by a Takaful operator under the hybrid model. The right of participants' ownership is transferred to the Waqf fund and all claims shall be made against this fund.

Underwriting surplus will remain within the Waqf Fund and be distributed at the full discretion of Takaful Operators. Having said that, the obligation of participants, conceptually, to call back when the fund sustains shortfall is waived. Practically, the Takaful Operators are obliged to provide Qard Hasan in case of deficit.

However, a portion of any surplus generated must be utilized in charitable purposes and the common well. This model has been commonly used in Pakistan irrespective of the tendency in rejecting this model by the majority of Sharia Scholars (Wahab, 2006) (Archer, 2009).

Table (4) below shows the key features of Takaful operational models.

Table (4) – key features of the main models

Features	Wakala Model	Modaraba Model	Hybrid Wakala – Modaraba Model
Remuneration to Shareholders	Pre-agreed percentage of gross contribution	Pre-agreed percentage of investment returns	Fixed fee as Wakeel and share of investment profit
Relationship with Shareholders	Agency contract / Agent to manage the PF (Wakeel)	Entrepreneur for investing the PF (Modarib)	Wakeel and Modarib
Profitability to Shareholders	Suitable for General and Family Takaful	More suitable for Family Takaful	Suitable for both long and short-term contracts
Surplus	Might be shared as an incentive fee	Not allowed to share surplus particularly for Family Takaful. Some companies allow for General Takaful	Incentive fee is allowed in General Takaful but not in Family Takaful

Source. (Simon, 2009, page 44)

At this time, Takaful operators in each market are adopting different operational models. The optimal model is unsettled yet and this has created a pressure on Takaful operators by a) shareholders who are expecting maximum profitability and b) policyholders who are looking for a unique product based on mutual support whatever the adopted model is (Blake, 2015). Therefore, it has been discussed and ultimately addressed, in this research, advantages, disadvantages and recommendation for the model that meets stakeholders' satisfaction from the point of Sharia and a practitioner's view.

2.6.3-Treatment of Deficit (Qard Hasan)

Particularly in the early years of operation, the Takaful fund may fall into deficit when liabilities, due to the unexpected losses incurred, are exceeding the contributions and maintained reserves of Participants Fund. In principle, any deficit or surplus resulting from the operation of PF shall be shared proportionally among participants as the owners of that fund. Therefore, participants have called for more contribution to cover the deficit. In practice, this call is impractical as the number of participants could be thousands and are living in different parts of the world. However, the International Islamic Fqih Academy IIFA in resolution number 200, Clause (9) had provided four options to overcome this problematic matter. The Takaful Operator, at the time of deficiency, might carry out one of the following actions (IIFA, 2013):

a) Borrow from a third party
b) Claim for calls from participants
c) Agree with claimant to either reduce the compensated amount or pay instalments or

d) Provide a free-interest loan or benevolent loan as it is a preferable name by some Shariah jurists

Borrowing a loan will increase the PF liability and could complicate the process of repayment if the PF sustained another deficit in the coming years. Calls for more contribution or to reduce the claimable amount is impractical and, most probably, constrained by national regulations. The only option the TOs have been left with is to provide an interest-free loan to the participant's fund where it shall be recouped from any future surplus. This option is also supported by regulations as the TO are having a legal entity and shall comply with the solvency requirement and capital adequacy. For instance, the UAE Insurance Authority has imposed an obligation on Takaful Operators to provide an interest-free loan (Qard Al Hasan) to the participants fund, up to a maximum equal to the total equity of Shareholders (Insurance Authority Resolution (4), 2010). It is to be noted that the loan will be debited to PF and does not, practically, remove the deficit other than providing liquidity to the fund in order to meet its obligation and keep the business floats. Imposing a loan on TO as a conditional agreement between participants and Takaful Operators was criticized by some scholars as the loan is being paid to the PF on a goodwill basis and should not be an obligatory requirement; so, they prefer to name it as a “benevolent loan”.

The Takaful Operator may choose an option to increase the Wakala Fee from gross future contributions for recovering the Qard Hasan. However, this practice is confronting a strong reluctance from scholars on the basis that this will give TO an advantage over the deficit and shall be entirely impermissible (Bakar, 2009). Technically speaking, this practice may increase the possibility for future deficits as the Takaful Fund will receive less net contribution after deducting the Wakala Fee from the gross amount.

Unlike Proprietary and Mutual insurance provisions, the concept of Qard Al Hasan in the Takaful model is a unique feature as it is:

a) An attractive point for participants of Takaful scheme as they are having an ownership share in the PF, protected through an insurance contract (policy), benefiting from any surplus generated but not responsible for any deficiency that the PF might sustain at the end of operational financial year. Therefore, if the concept has been introduced properly and appropriately to the market, providing Qard Al Hasan will be one of the most Unique Selling Points for Takaful business and
b) The participants are the owners of the Takaful Fund and they are, conceptually, sharing any sustained losses or gained surpluses at the end of the financial year. As this is unpractised, particularly in terms of sharing the loss, the mutual concept of sharing the risk is converted into risk transfer (conventional insurance)

These points have been addressed thoroughly in this report in the coming chapter.

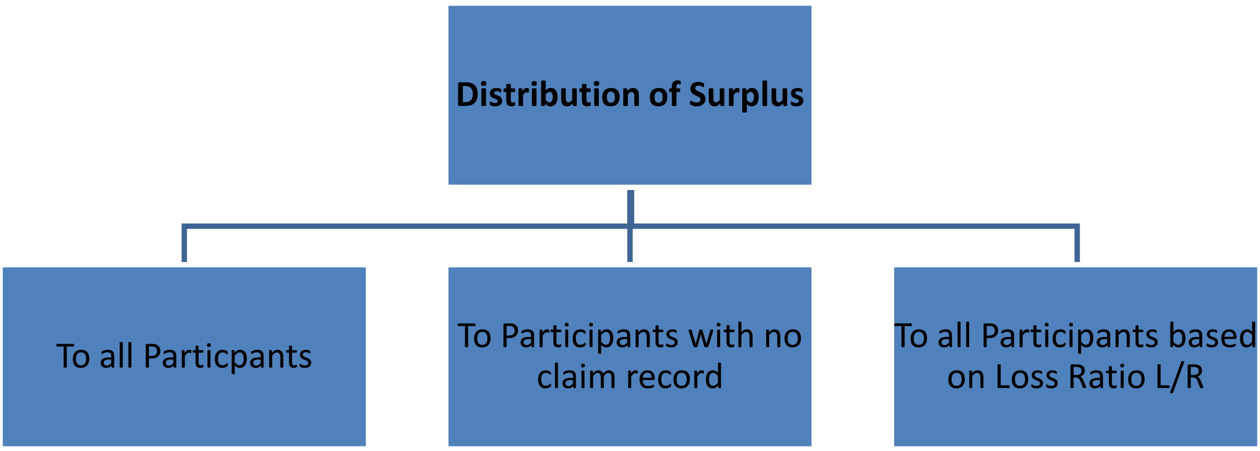
2.6.4-Treatment of Surplus

Surplus is a good indicator measuring the level of performance in terms of underwriting results, claims management, assessment of risks, cost effective strategy, investment policy and the model of operation that is adopted by TO. According to “Guidelines on Takaful Operational Framework” issued by Bank Negara Malaysia the Takaful Operator must establish a formal policy on the way of managing surplus which shall be reviewed and approved by the Sharia Supervisory Board. The policy shall underline the level of surplus to be distributed to participants and surplus carrying forward to meet future contingences, Sharia requirements of distributing surplus and TO obligations to meet surplus management policy (Mokhtar, Abdul Aziz & Md. Hilal, 2015).

Prior to distributing back any surplus, TO shall consider the adequacy of capital requirements by maintaining a proper reserve from any generated surplus, settling of any due outstanding amount to recoup Qard Al Hasan, if any, paid in previous deficit years and accumulate further reserves to maintain long term viability and sustainability of Participants Fund.

However, management policy of surplus distribution differs from one market to another and among Takaful operators within the same market. The lack of unified standards is a challenge in terms of accounting and how Takaful operators shall allocate surplus in their financial reporting (Al-Amri & Hossain, 2015). According to AAOIFI (2015) in its standard No. 26, Islamic Insurance, Article 12 (Insurance Surplus), the surplus could be distributed in three ways as illustrated in the chart (4) below.

Chart (4) – Surplus Distribution



Source: [(PDF) Takaful surplus distribution: A different perspective (researchgate.net)]

While some of Sharia scholars believe that all participants are entitled to share any generated surplus regardless of whether they have had a claim during the particular financial year; others would allow surplus to be shared only with those who have made no claim during the same financial year. The later method is similar to that practiced by conventional insurance under a scheme of No-Claim Bonus where the Insured is entitled to benefit discount in the future premium from his clean loss record (Hidayat, 2012). However, no claim bonus is established on a case-by-case basis. Some practitioners have criticized this method that the participants through exercising their contractual rights to claim compensation from the PF, are punished by preventing them to benefit from surplus which is against the spirit of solidarity and ethical values that the fund is established for. However, the mid-way method allows all participants to share surplus proportionately based on their net underwriting result (L/R) but the practical controversial point in this method arises when the net result for a particular participant is negative.

Furthermore, AAOIFI have also allowed Sharia Supervisory Board to distribute surplus in any other method (AAOIFI, 2015). Seemingly, this will keep the door open for creating different methods of surplus distribution standardization.

2.6.5-Takaful Financial Structure

Transparency in financial reporting is becoming more insistent for stakeholders in particular and for the market and the public as a whole in general. Therefore, voluntarily disclosing information of the company's financial position beyond what is compulsory required by legal and regulatory requirements will enhance the trust and credibility of that company in front of stakeholders and attract the market attention if it is a public stock company. As far as conventional insurers are properly regulated in terms of financial reporting frameworks, Takaful operation still require more efforts to address the proper framework of reporting financial statements due to the essential differences of structure between Takaful and conventional insurance companies.

Unlike conventional, contribution received from participants, Takaful is deposited into a separate fund. The segregation between the shareholders' fund and participants' fund is imposed by regulators to achieve high level of transparency but, at the same time; it will create difficulties in terms of financial reporting. In the proprietary model, as a single set of accounts, the International Financial Reporting Standards (IFRS) is adopted as a framework for preparation and presentation of financial statements. The IFRS is an international application for reporting to stakeholders but it has been argued by some scholars that it is not aligned with the requirements of Islamic financial reporting as no consideration for segregation, distributing surplus and the injection of Qard Al Hasan has been taken into account.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), based in Bahrain, is attempting to provide a comprehensive alternative accounting framework for Takaful companies in order to overcome all conservative arguments raised by scholars in respect of the financial reporting standardization. Nevertheless, the absence of Takaful standardization in respect of financial accounting for the time being has left Takaful operators with no option other than using IFRS as similar as conventional Insurers (CII Textbook, Takaful Principles, 2017). AAOIFI have made some progress by issuing financial Accounting Standards (FAS 12 & FAS 13) for Islamic financial institutions of which are the same along with practical comparison with conventional financial reporting have been conducted / discussed in more details in this research.

2.6.6-Investment in Takaful

Investment feature is an extremely important factor to determine the overall operation of insurance industry. Since the premium is paid upfront, the insurance company can invest part of the collected fund until the cash is required to pay claims and operational expenses (Perpetua, 2017). However, the law of investment is “the higher return shall come at the price of increased risk” (CII Text Book, PO5, 2017). Investment managers, therefore, have to make a balance between liquidity, investment return and risk in order to meet a company’s objectives as well as regulatory requirements.

Typically, insurance companies have many investment instruments such as short-term debt and money market instruments, bonds, equity and alternative assets (private equity, commodity funds, derivatives etc.). While the money market and bonds are representing short-term, low risk, fixed income but lower returns, the equity, real estate and alternative assets are long-term, exposed to high risk, variable income but higher returns. However, the majority of these instruments are interest-bearing and ineligible for Takaful operators as per Sharia Compliance. The Astana International Financial Centre prohibited Takaful Operators to invest in a) Trading assets on unregulated financial market b) foreign exchange transactions and c) Derivatives instruments for speculation (AIFC, Rule No. FR00031, 2018)**.**

In the last decade, the Islamic Financial Institutions have developed many Sharia Complaint’s money market instruments and Islamic bonds (Sukuk) which could provide adequate asset classes for investment. However, these instruments are still much less than what is available for conventional insurance.

According to IFSB, the investment activities should be carried out in line with Sharia Compliance and regardless of whether they have been managed by in-house or outsource managers, the TOs remain responsible to meet ethical requirements and fiduciary. Therefore, the TOs are requested to document investment policy placing investment strategy for each line of Takaful business and setting out objectives to match business liability. For instance, the strategy and objective for Family Takaful will be definitely different for general Takaful as the duration to meet liability for the former is longer than the later (IFSB-8, 2009).

As the majority of contribution in Malaysia, for example, is derived from Family Takaful (life insurance), the Takaful Operators therefore have the ability to invest in long-term instruments and hold a significant portion of fixed-income and Sukuk for a long time that could match their long-term liabilities. In contrast, the general business is dominant in the MENA region which requires quick liquidity that restricts the ability of TOs to hold long-term investment.

Indeed, it has been addressed by many business researchers that Takaful investment assets are restricted as the available investment assets, widely practiced, in the global markets are bearing elements that are prohibited by Islamic jurisprudences (Swartz and Coetzer, 2010), (Fisher, 2013), (Serap, 2013). Certainty, this has a negative impact on Takaful performance and the same has been investigated in this research.

2.6.7- Re-insurance / Re-Takaful Arrangement

Similar to conventional Reinsurance, Re-Takaful is an agreement between the Takaful operator and Re-Takaful Company in the aim of protecting the Policyholders Fund from huge and/or unexpected catastrophic claims (Khan, 2009).

In its standard No 41, Article 8 of Islamic Reinsurance, AAOIFI have confirmed that the participants in this case are the insurance companies (TOs). In fact, the Takaful Risk Pool under this agreement is the ceding entity of Re-Takaful Operators (RTO), not the Takaful Operator and many researchers have overlooked this fact et al (Zainal Abdin, 2013). The TO(s) contribute from the Policyholders Fund into a pool by means of tabarru in the purpose of forming a fund and then appoint the RTO as the manager (Agent) to run the business on their behalf (IFSB-18, 2016). The main objective of Re-takaful can be said to be of widening the principle of solidarity and brotherhood among other participants from different pools. In another word, a participant from one takaful fund will essentially contribute to help or is being helped by other participants from other takaful funds. This is a unique aspect of the Re-takaful arrangement which differs from conventional reinsurance.

Indeed, the purpose of using Re-Takaful Operators RTO is to protect the Participants' Risk Fund PRF(s) through spreading the risks over different Takaful pools as well as to a wide geographical area and increasing the capacity to underwrite more risks. Furthermore, some type of risks requires more technicalities which could be provided by RTO underwriters. Similar to TOs, all principles of Sharia are the regulatory path governing the relationship between the two entities. From TO perspective, Re-takaful is enhancing capital particularly when the pool sustains a deficit and the Qard Hasan becomes inevitable. However, the way of providing Qard Hasan to Takaful Funds in case of deficit is, in practice, unclear and requires further studies and research.

The Re-Takaful agreement might use any agreed model of operation whether Modaraba, Wakala or hybrid model. The remuneration methods for managing the Takaful Participant's Fund are pre-agreed under the Re-Takaful treaty and any surplus or deficit will be treated in the same way as Takaful operators. Dissimilar to conventional Reinsurance, Re-Takaful commissions are payable to the Takaful Risk Funds and the shareholders have no right to share or receive any benefit from the said commissions.

From Sharia point of view, a conventional Reinsurance contract is impermissible due to the existence of prohibited elements in terms of uncertainty, gambling and usury. The essential challenge facing a Takaful business is the shortage of rateable Re-Takaful operators. This challenge has brought regulators and scholars' attention to find out alternative options through allowing, by the principle of necessities, temporarily using of conventional reinsurance with some regulatory and Sharia restrictions. Such restrictions have been imposed by AAOIFI (AAOIFI 2015, Sharia Standard No. (41): Islamic Reinsurance), when dealing with conventional reinsurance such as:

> *7/2) It is impermissible for an Islamic insurance company to receive reinsurance commission from a traditional reinsurance company. Nevertheless, the Islamic insurance company has the right to seek premium discounts from the traditional reinsurance company.*

7/3) Islamic insurance companies should not accept any redistributions of insurance surplus forwarded by traditional reinsurance companies. Nonetheless, Islamic insurance companies can request premium discounts from traditional reinsurance companies.

In the time being, Takaful operators seemingly have no alternative option rather than placing the business with conventional Reinsurers which this practice is temporarily accepted by Sharia Scholars (Whitney, 2012). However, Sharia is more concerned about Re-Takaful particularly when the TO use the conventional Reinsurers. The key issues can be summarized hereunder (CII Text Book, 590 Principles of Takaful, 2017).

- **Claims recovery**

When any claim is paid by TO, the right of reinsurance recovery will be commenced. The recovered amount shall be placed in the PRF as the claim is paid from this particular fund. This is a common practice in conventional reinsurance as well as Takaful business insofar as the latter is using Retakaful backup. The matter becomes an issue when the business is placed in conventional reinsurance. The scholars argued that the source of money recovered from conventional reinsurers is most probably not Shariah compliant and the PRF will be contaminated with impure money that requires purification. Taking into account the lack of credible Retakaful operators, scholars have allowed the takaful fund to receive recovered money as it is sourced from a Re-takaful operator. This point has been discussed in detail during the interview with a Sharia scholar.

- **Retakaful Commission**

Ceding commission whether received from conventional Reinsurers or Retakaful(s) is not permissible for the TO, according to AAOIFI Sharia Standard 41. The reinsurers or RTOs must quote on the net contribution basis not on gross contribution. However, the gross contribution shall include the ceding commission and if it is received by TO, then it must be returned to PRF (AAOIFI, 2017).

- **Profit Sharing**

Profit sharing is a common practice in conventional reinsurance. The aim of profit sharing is to provide the ceding Insurers with an incentive to manage the pool effectively. However, this is not permissible in Retakaful arrangements but the RTO shall distribute any surplus generated from the contract to TOs based on the method of surplus distribution determined by Shareholders and SSB of RTO. The TOs must then deposit the received surplus into the PRF.

According to Sharia, TO is not permissible to receive profit sharing from conventional reinsurers but if this is received by one way or another, the Sharia Scholars determine two options to deal with profit sharing either by using the profit commission to renew the reinsurance contract or to leave it with reinsurers and seek a discount for renewal.

In fact, none of Retakaful Operators worldwide have rated “A” and the highest rate given by A.M. Best is B++ to Emirate Retakaful and ACR Retakaful and BBB to Takaful Re

(Baydoun et al, 2016). Nevertheless, it has been recorded that the number of Retakaful operators has been globally reduced to 21 RTOs in 2017 from 35 in 2015. This is a substantial indicator which could reveal what has been missed or overlooked in the streamline of Takaful business (HBMSU, 2016).

These aspects have been examined in this research through interviews carried out with Sharia Scholars, Regulators, Retakaful managers as well as business practitioners.

2.6.8- Takaful between Theory and Practice

Theoretically, a group of participants have mutually agreed to indemnify each other through contributing a sum of money by means of Tabarru (donation) to a pool whereby any probable loss sustained by any scheme's member shall be compensated from the collective fund. After formation of the fund, participants appoint an operator to manage the fund on their behalf and to their own benefit. The relationship between participants and managers is predetermined through a number of operational models, more commonly Modaraba, Wakala or hybrid model of Modaraba and Wakala. Managers then receive a remuneration fee or a percentage of investment returns depending on the model that was agreed between parties. Participants also determine the level of Wakala fee and Modaraba share, lines of undertaken business (products), surplus distribution and investment policy. It is undoubtedly this provision which is exactly the same as mutual insurance but the main difference here is that the managers are a commercial corporation owned by shareholders. Managers are required to stand on the same foot distance between policyholders and shareholders and maintain a high level of integrity and transparency to protect the interest of both alike.

The main issue in Takaful fund was whether the fund shall be emerged within the shareholders fund, thereby having a separate legal entity or is completely segregated. While the first was not allowed by Sharia, the second is most likely restricted by local regulations. The remaining option of having an independent and segregated fund was supported by the Islamic Financial Services Board IFSB in its standard IFSB-8 through confirming that the underwriting fund belongs to the Takaful participant and will not be in any case owned by shareholders (IFSB-8, Page 5).

Practically, the participants do not arrange for contribution, establish the Takaful fund and appoint the manager. Instead, the shareholders set up the TO in order to manage the business as managers who are, in turn, creating the product, inviting participants to contribute and establishing the Takaful Fund after obtaining approval from relevant authorities to do so. The level of remuneration, the way of distributing surplus, the investment policy and type of undertaking risks are determined and managed by shareholders along with SSB and local regulatory authority. The Participants Fund will be then held on trust, by Takaful Operator and managed to meet the participants' claims. As far as this arrangement is practicable, it brings many of the constraints, challenges and corporate governance issues relating to the right of shareholders, managers and participants. All these aspects have been examined in the following chapter.

2.7- Corporate Governance of Insurance Industry

Corporate Governance (CG) is defined as a *set of organizational arrangements* that the management of any organization shall carry out in order to protect, as appropriate as possible, the interest of stakeholders (Archer, 2009, page 48). According to the same resource, any party who has a stake in the corporation is defined as a stakeholder and the key challenge confronting the system of CG is the capability of the corporation's management to address the interest of the different stakeholders within a practicable framework. Stakeholders may have certain rights such as rights of property, information and control. The right of property means that the stakeholder has the right to sell and transfer shares or receive cash flows (cash settlement in respect of insurance) and they shall be informed (rights of information) of all aspects of the corporation activities that relate to their interest such as receiving the company's annual financial reports. As far as the first two rights do not protect the stakeholders' interests from any decisions made by the management, the right of control has been given to stakeholders by having the right of attending the company's general meetings and to practice the right of voice.

In respect of the proprietary insurance, the policyholders are having no share of the company's equity and therefore are considered as customers. As the contract of stock companies is in the form of buying and selling, the customers are having, by law, the full right of property and information but they do not have any control on management activities and the only option that policyholders can practice is the exit option by leaving the scheme for another company if they are dissatisfied with the service provided. In other words, the policyholders are relying upon the market competition to ensure that their interests are protected.

Principally, for Islamic insurance undertaking, participants are the owners of the insurance fund and should not be, in anyway, considered as customers other than the stakeholders. Conversely, the contribution of participants is not a part of shareholder's fund, which is the only fund recognized by law, and therefore it has been given no consideration to be part of the company's equity. This has caused a potential conflict of interests which requires close oversight at corporate governance level. Zainal Abidin et al (2013) has raised a very important question regarding who is managing the conflict of interest between the shareholders and policyholders taking into account that the TO managers have been assigned by shareholders to manage the PF. This question is still unanswered at this time (Zainal Abidin, 2013). It is understandable that the Takaful Operators will look after the interest of shareholders as they are the party who bears the business expenses but, at the same time, it is assumed that the SSB shall carry out regular investigation to make sure that the interest of policyholders are preserved, as equal as, the shareholders interest.

In respect of Qard Hasan, it is a mandatory obligation for shareholders to provide the Qard at the time of underwriting deficit which shall be paid back from any future surplus. Archer el at (2009) highlighted an issue that the participants must be informed of how much the deficit is? What is the method of recouping and how much the future contribution will be charged? This information is essential for participants in order to decide whether they will continue in the current scheme or find out another scheme to join. This point, conceptually, seems very arguable as contributors who have incurred big losses / claims to the pool that led to deficiency will be the first party to leave the scheme and the new contributors for the next year will be penalised by re-paying part of the outstanding Qard, regardless whether their contributions generate surplus. Practically, this information is not required by regulators to be disclosed and the difference between Proprietary and Takaful becomes indistinguishable.

Conceptually, the participants as the owner of the policyholders' fund have the right to agree collectively to (Serap, 2013):

a) Award the TO a portion of the underwriting surplus as an incentive fee for their good performance
b) Decide to retain the surplus as precautionary reserves
c) Donate some or all of underwriting surplus to charitable organizations or
d) Distribute the surplus to all these options in a pre-agreed proportion

Practically, shareholders as a capital provider and owner of TO have the full control on the operation such as appointing the BOD, assigning external auditors / actuaries and choosing the Sharia Supervisory Board. The Board of Directors, on the other hand, appoints the executive management and both make decisive decisions with respect to the technical operation and business strategy, including Takaful underwriting, contribution level and investment policy. Also, they have the right to decide of how much of the surplus shall be distributed among policyholders at the end of the particular financial year subject to obtaining approval from the SSB. Out of the three methods of surplus distribution stated overhead, AAOIFI have made allowance for SSB to find out another method they believe it is more appropriate for distributing surplus. Having remembered that the SSB members are appointed and remunerated by BOD, this will be another aspect of conflict of interest which has been addressed in this study.

However, as shareholders are remunerated from Wakala fee and Modaraba sharing, they are exposed to business risk as well as fiduciary risks when the executive management fails to a) attract more participants and ultimately more contributions that cover, at least, the operational expenses and / or b) achieve negligible investment returns. In the worst scenario, the shareholders are exposed to credit risks when the policyholders' fund sustains deficit at the end of financial year. The shareholder shall consequently provide, by law, a free interest loan to cover the deficit and they may fail to recoup the loan due to further deficits (Archer, Abdel Karim and Nienhaus, 2009). Having considered those risks together with market forces, the shareholders have a significant consideration to protect the policyholders' interest, irrespective of no regulations in place to force this direction, as a means to protect their interests. In the UAE, for instance, all shareholders' funds are exposed fully to the risk of Qard Hasan; Article 4: Solvency Margin, clause 3) "*The entire Shareholders' Funds shall be made available to provide Qard Hasan in case of a deficit in the Participants' Risk Funds*" (Insurance Authority UAE, 2014).

Regardless of their equity as the owners of the underwriting fund, policyholders in the Takaful undertaking, dissimilar to mutual insurance, have no control rights to protect their interest. The only option they have is "free to exit" by choosing another insurance provider if they are treated unfairly and unreasonably by the TO.

In the UAE, the Insurance Authority in article 26, dated 2010, stated that "*The aforesaid participants (policyholders) shall have the right to attend and discuss without having voting (control) rights in the general meeting assembly / meetings*". However, AAOIFI have made preference afterwards, to policyholders of Takaful scheme to participate in managing insurance operations through "*appropriate legal arrangements that enable them to exercise their control rights and protect their interests by means of representing them in the BOD*" (AAOIFI, Sharia Standard# 26, 2015). This article has not been given, up to date, power of implementation in the UAE market.

In order to fulfil regulatory requirements, Takaful operators shall appoint external auditor and independent actuary. According to the Insurance Authority, Board of Directors' Decision Number (26) of 2014, Article (4) – Actuarial Requirements for Technical Provisions, particularly provisions 1 & 5, the following provisions apply to the actuarial requirements for technical provision:

1. *The Board of Directors shall appoint an Actuary who is registered by the Authority.*
5. *The Actuary shall provide the Insurance Authority with an annual report that presents the immediate or future risks facing the Company.*

In respect of external auditors, Article (4) – Auditing of Accounting Books of the same direction states:

- *The Company shall appoint one or more qualified and experienced External Auditors for its accounts for every financial year*
- *The Company shall submit to the Authority the management letter issued by the External Auditor, on an annual basis, before publication of the financial statements.*

However, Shareholders of Takaful operators shall establish two mandatory committees from BOD's members, Article (1) – General Requirements for Investments:

a) *The Company's Board of Directors shall form an Audit Committee consisting of at least three members from non-executive managers (a Chairman and two other members), of whom a member shall be an expert in financial and accounting affairs. The Audit Committee shall meet at least once every three months, or whenever necessary.*
b) *An active Investment Committee should be in place to ensure there is adequate segregation of duties between execution, recording, authorization, reconciliation and related assurance.*

The auditing committee (Auditing & Risk Management Committee ARM) shall discuss, arrange meetings and provide supporting documents to external auditors and actuary. In a competitive market where numbers of international auditing and actuarial firms are working, and knowing that their works have been remunerated by shareholders, this shall give rise to a potential conflict of interest between shareholders and policyholders.

In respect of Corporate Governance, the same issue regarding Takaful undertaking is applicable, to most extent, to Retakaful arrangement. However, unlike of TO's participants, it is assumed that the participants of RTO are professionals and can understand and manage the RT requirements; that is, the issue of conflict of interest here is, to a large extent, manageable (IFSB 18, 2016).

2.7.1- Accountabilities in Takaful Insurance

As outlined above, the relationship between shareholders and managers in a proprietary insurance company is properly regulated and the corporate governance has been efficiently determined in order to protect their interests as well as other stakeholders alike (Akinboade, 2003). In addition to a number of regulations that address the issue of conflict with customers, particularly Insurance Conduct of Business Sourcebook (ICOBS) framework which require customers to be treated fairly and reasonably in every daily transaction (FAC, 2008), the market forces such as competition and customer services form a regulatory body to protect customers' interest (Mayston, 1993).

(Muhamat, 2019) outlined that the business under question is different from any other business and has a complex relationship between stakeholders due to the presence of two principals; shareholders and policyholders. Conceptually, participants appoint Takaful Operator as an agent to manage the pool and protect their interest. Therefore, the TO is accountable to participants for carrying out the business as trustee and the relationship between both parties are managed appropriately under the contract of Tabarr'u. However, in practice, shareholders established a commercial entity / Takaful Operator and appoint managers to manage the participants' fund as well as the shareholders' fund and protect their interests alike.

Shareholders in Takaful provide business capital to establish the TO, as required by regulations, and appoint all members of governance such as BODs, SSB, external auditors and actuaries. The BOD along with executive management have full control of and responsibility for managing the operation on behalf of shareholders. Hence, they have the right to make crucial decisions in terms of business strategy, underwriting rates, the level of remuneration fees, surplus distribution and investment policy for policyholders' fund. However, shareholders are exposed to fiduciary and credit risks when the policyholders' fund sustains deficit and the obligatory Qard Hasan is inevitable and the inability to recoup it from future technical results (Archer, Karim and Nienhaus, 2009).

Policyholders in the Takaful scheme, as the owners of their fund, have the right to be compensated against any loss sustained during the insurance period and a cash return or reduction of future contributions when the financial year brings surplus to their fund. Nevertheless, and unlike mutual insurance, they have no corresponding control right in the current operational model to protect their interest. Obviously, the hybrid model of Takaful produces two main stakeholders, shareholders and policyholders, and the relationship between involved parties seems to be more sophisticated and requires a comprehensive framework of corporate governance in order to manage the subject issue (Zainal Abidin, 2013).

Having said that, the business managers are in a disadvantageous position as they have two principals; from one side the participants who are the owner of the Policyholders' Fund and from another side the shareholders who have assigned the managers to act on their behalf for managing the business to, at least, the best of their, as well as the Participants' interest (Serap, 2013). Nevertheless, the business is acquiring another layer of governance as an Islamic business and must be subject to Islamic Financial Transactions (Muamalaat). The SSB is appointed by shareholders to find out whether the business has been conducted in line with Sharia ethical principles (AAOIFI, 2015).

According to Mayston (1993) the question which must be answered in Principal-Agent theory is who is the principal? Muhamat (2021) has outlined that the policyholders in the Takaful scheme should be examined at the level of "principal's principal" and should be therefore given a priority over shareholders. Contribution from participants is the first point to form a fund that shareholders can get a license to manage it and run the business. Initially, the insurance business is the core activity in the Takaful scheme, which was evolved over the time to include investment. From corporate governance perspectives, the policyholders have not been involved in any decision carried out by management neither in insurance activities nor investment policy and the only option available to present their dissatisfaction of services provided is "voting with their feet" (Archer, Karim and Nienhaus, 2009). Like the procedures practiced in Sudan, it has been suggested that in order to enhance corporate governance policyholders should establish an annual general meeting to appoint their representative in the BODs (Muhamat, 2021).

IFSB (2009) in its guiding principles regarding Corporate Governance of Takaful undertaking have recommended that:

- *Reinforcement of relevant good governance practices as prescribed in other relevant internationally recognised governance standards for insurance companies, while addressing the specificities of Takāful undertakings*
- *TOs shall adopt an appropriate code of ethics and conduct to be complied with by their officials at all levels*

Islamic principles of business transactions (Muamalaat) become part of IFIs governance standards and any Islamic firm is required to implement these standards in each and every business activity. Nevertheless, they are not sufficient to establish a standalone corporate governance framework for IFIs. Therefore, following the conventional governance standards (Anglo-Saxon / Continental European) in different jurisdictions becomes inevitable. Having said that, the IFIs shall be therefore exposed to dual layers of governance standards (conventional and Sharia) which, indeed, become a significant challenge (Karbhari, Muye, Hassan & Elnahass, 2018).

2.8- Key challenges of Takaful Industry

It is understandable that each industry has its own challenges and opportunities where some of these are common among different markets while others are more specific to a particular market. Having traced challenges confronting Takaful business in different markets, it has been noticed that many of these challenges are shared among main markets for Takaful business such as Middle East and Far East Asia.

Ahmad (2007) has addressed the key challenges the Takaful business faces in South East Asia as a) misconception that Takaful is exclusively designed for Muslims b) lack of awareness which is a significant constraint that prevents development and growth of Takaful in national and global markets and c) absence of innovative products compared with conventional (Ahmad, 2007). After 3 years of operation, the same challenges had been highlighted by Swartz and Coetzer for the same market (Swartz & Coetzer, 2010). According to the Milliman Report issued in 2010, there are six key challenges facing the business worldwide such as 1) lack of awareness 2) shortage of experienced human resources and Sharia scholars 3) lack of standardization 4) scarcity of centralized regulations 5) Corporate governance and 6) shortage of assets for investment (Milliman Research Report, 2010). While Mohamed Omer (2011) reconfirmed these challenges, Alhabshi and Sheik Abdul Razak (2011) had predicted, in addition to the previous set, future challenges of Takaful business such as the small size and capacity of Takaful operators, the low penetration rate and the shortage of Retakaful support and capacity. From actuarial perspective, actuaries are always concerned about risk capacity and how primary Takaful could place large risks with the absence of insufficient Retakaful financial security (Jaffer and Unwin, 2011).

In 2013, Abu-Hussin has outlined that irrespective of a double-digit growth of Takaful since 2010, the industry is still having common challenges in two different markets; Malaysia and GCC. There is a low level of awareness among people about the nature and spirit of Takaful business, shortage of qualified workforces, innovative products and regulatory support, ineffective Corporate Governance and restricted investment policy. Again, Abu-Hussin and Hussin in 2014 have readdressed the same challenges (Abu-Hussin & Hussin, 2014). A.M. Best in their report of 2013 outlined an important factor that non-rated Retakaful companies are considered to be a major issue facing Takaful operators from financial perspective. Unlike conventional reinsurers, the absence of rated Retakaful is an ongoing concern for the Takaful operator to place, with them, the primary risks are a consequence of inadequate financial capacity and security (A.M. Best Report, 2013).

According to the Milliman Research Report of 2017, it was surprisingly noticed that the key challenge in a country such as Indonesia which contains the largest number of Muslims, more than 207 million, is the lack of public awareness in respect of Takaful as a means of financial protection. The report also highlighted other challenges that the business is not supported enough by government; there is a remarkable lack of distribution channels and product innovation, in addition to the lack of skilled human resources. Sarwar (2016) also highlighted the challenges that Islamic Finance and Takaful is facing in Bangladesh such as lack of regulatory support, public awareness and human resources and restricted investment channels. El-Qalqili (2017) confirmed that the main challenges facing Takaful business worldwide are the lack of standardization and regulatory harmonization.

In the GGC countries, Alpen Capital, in their report of 2017, have outlined the main challenges that Takaful business faces in the region such as intense competition, slowdown of economy, shortage of experienced manpower in the field, lack of standardized regulation and insufficient investment opportunities (Alpen Capital Report, 217).

The key challenges that prevent Takaful business from moving forwards, as was conceptually expected, in the global market, particularly in the GGC region and more specifically in the UAE, could be classified as:

1. Lack of public awareness of Takaful business
2. Ineffective Corporate Governance arrangements
3. Lack of regulatory support
4. Lack of standardization in terms of regulatory, Sharia and financial reporting
5. Restricted investment policy
6. Shortage of rateable Retakaful
7. Competition

The lack of Takaful awareness in home countries, such as the UAE where 76% of the population are Muslims, becomes undoubtedly a crucial constraint toward growth and development and shows the failure of Takaful business' chain, from structuring the contract, creating products and carrying out insurance activities, to build clear knowledge of the nature of the business among community. The lack of Corporate Governance, regulations and standardization are interconnected factors that a) increase the gab of public awareness and b) impact adversely on business performance.

The corporate governance of Takaful becomes a critical issue confronting the business, as addressed above, but it has been noted by the author that the majority of resources highlighted this issue from a broad view without examining the relationship between stakeholders from practical, regulatory and Sharia perspectives. However, these constraints have been discussed in this research and addressed to which extent they could affect the business in terms of growth and development.

Nevertheless, as some of Takaful markets, such as Malaysia, have already overcome the lack of investment assets which are available to Takaful business and the matter of Retakaful arrangements, these issues shall not be discussed as challenges, in this research, other than relevant factors that affect the business performance in the UAE market.

B) Global Landscape of Takaful

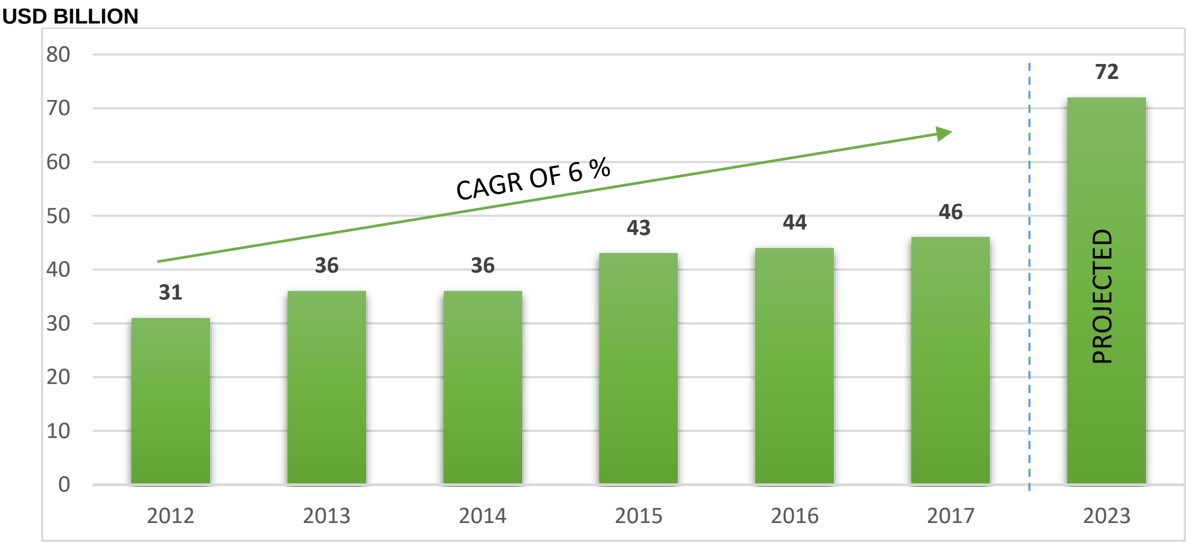
2.9- Takaful Performance

The first Takaful operator was established in 1979 in Sudan and the concept spread steadily among MENA and FEA regions, particularly in GCC and Malaysia respectively. The business has also moved out of its border to USA, UK and other western countries, as outlined below.

2.9.1-International Market of Takaful

According to Islamic Finance Development Report (2018) and Islamic Financial Service Industry Stability Report (2019), Takaful industry witnessed a sustainable growth of CAGR 6% between 2012 and 2017, as shown in the Graph (1) below, at the total asset of USD 46 billion accounting less of 2% from the total Islamic Financial Industry (Islamic Banking, Capital Markets and Takaful).

Graph (1) - CAGR of Takaful between 2012 - 2017



Source. Islamic Finance Development Report 2018

Regardless of the smallest global contribution, Takaful is progressing its continuous growth as new countries have jointed the Islamic market such as Nigeria, the UK, USA and other western states. With five Takaful operators, the first fully-fledged Takaful company in Nigeria was launched in 2017 following the initiative guidelines issued by the government in 2013 to increase insurance penetration rate in the county. The Takaful sector in the UK is also expected to evolve rapidly as the government is seeking new business opportunities post Brexit. The Islamic Insurance Association of London (IIAL), along with regulatory framework provided by the FCA and PRA, have introduced in 2018 its Sharia and legal landscape for Islamic insurance (Takaful and Retakaful) with the aim of rolling out the business by 2019 (COMCEC, 2019).

Having perceived Takaful as an Islamic Insurance, Muslims in Europe are expected to place their insurance business with a Takaful Company in line with their commitment to Sharia Compliance. The European Muslims form 6 % of total population (almost 53 million Muslims) and the majority of them are highly educated with a sufficient personal income that encourages them to protect their assets / possessions by arranging insurance protection (Jaffer, 2013).

From 2003, the number of Takaful operators has been increasing impressively worldwide, as illustrated in the table (5) below, with an annual combined growth rate of 13.4% up to 2015. Subsequently, more Retakaful operators have been established to serve the need for Islamic reinsurance capacity in the global markets.

Table (5) – Number of Takaful and Retakaful operators up to 2017

	2003	2012	2015	2017
Number of Takaful Institutions	58	238	258	324
Number of Retakaful Providers	3	22	35	21

Source: COMCEC (2019)

The International conventional Insurance and Reinsurance companies in the world have noticed the essential opportunity to invest in Takaful business. AIG for instance, the biggest insurance company in the world opened a Takaful window in Bahrain at the beginning of 2006. This movement has encouraged other European international insurance and Reinsurance companies such as Allianz, Hannover Re and Swiss Re to penetrate Takaful business in the Gulf market and the opportunity to conduct the business in their home origin (Zuriah, 2009).

Many reforms in Europe in terms of regulations and legislations have been implemented to meet Islamic finance requirements. For example, the government of the UK has exempted Islamic Finance from taxation in order to attract Islamic investment. The first Sharia Syndicate was established in London by Lloyd's, the leaders of the insurance market in the world, in 2006 with a capacity of USD 72 million. In 2008, Halal insurance products were sold by the first Islamic insurers in the UK, established by M/s. Principle Insurance Holding Limited, to serve more than two million Muslims (Jaffer, 2010).

However, Malaysia is the largest market for Takaful in the Far East Asia and recording upward achievement in terms of growth and penetration rate (Hassan, 2019). The industry witnessed continued success through opening a new distribution channel, particularly digital technology, and adopted strategic approach of model of operation and distribution of surplus.

2.9.2-Takaful Market in the Middle East /GCC Countries

In the Middle East, Takaful business has witnessed prosperity and an increase of annual growth rate during the last few years. According to the Alpen Capital Report published in 2010 Saudi Arabia remains the core market of Islamic insurance business and accounting 48% of the global Takaful contribution, particularly when Medical and Motor insurance became mandatory since 2006 (Alpen Capital, 2010). The industry has been supported by a large number of Islamic Financial Institutions which have been established in the GCC region since 2006. According to the same report, half of global Islamic Institutions are operating in the GCC with an annual growth estimated between 15 to 20% over the last decade. In their report "Global Takaful Insight 2014", Earnest & Young estimated the gross contribution of Takaful in the GCC region around USD 8.9 billion in 2014 from an estimated USD 7.9 billion in

2013. It has been forecasted to maintain a double-digit growth momentum up to 2016 with an estimated rate of 14% to reach USD 20 billion by 2017. Within the Gulf region, Saudi Arabia is still the leading Takaful industry and forms 77% of gross contribution followed by the UAE with 15% of Takaful market share. All other GCC countries are accounting for just 8 % of gross Takaful contribution (Earnest & Young, 2014). The optimistic approach of Takaful growth was confirmed during the Global Islamic Economic Summit carried out in Dubai in 2015. The Dubai Centre for Islamic Banking and Finance (DCIBF) released a report after the Summit revealed that “Based on the rapid growth of Takaful business, the volume of global contribution could reach USD 52.5 billion by 2020”. However, the report also highlighted challenges facing this industry in terms of Takaful sales due to the shortage of distribution channels, particularly in several emerging markets, which shall be overcome on an urgent basis in order to maintain the predicted movement upwards.

Nevertheless, one of the insurance reporters Wong Mei- Hwen has claimed in her report “Global Takaful Market: In need of a rejig” published in the Middle East Insurance Review | Jun 2015 that Takaful’s rapid growth seems to be decelerating from 16% in 2012 to 7.6% in 2013 and the descending trend is expected for the coming years. Moreover, Takaful products, even in countries where Muslims are the majorities, have failed to meet expectation in terms of diversification and competition (Wong, 2015).

Regardless of the smallest number of Muslim populations comparing with Southeast Asia and Africa, GCC region remains, globally, the home of large numbers of Takaful operators and the volume of gross contribution. The dramatic increase of Takaful operators in number could be an indicator that the growth of the business is attracting more investors as a good opportunity to generate profit from conducting Sharia compliant business. Nevertheless, the market from the supply side could be overly saturated and adding new Takaful service could cause a fear of competition between similar offerings, as shown in the table (6) below. This may raise a question whether the demand side in the GCC region, for instance, require 88 Takaful operators taking into account the number of Muslims compared with other markets (HBMSU, 2016).

Table (6) – Number of Takaful Operator serving Muslim Population

	GCC	Southeast Asia	North Africa and Levant
Muslim Population	49.5 M	357 M	314 M
Number of Takaful Operators	88	66	68

Source: HBMSU (2016)

Having said that, the GCC market is, in fact, the original home of the Takaful business representing 77.2% of the global Gross Takaful Contribution / Premium GWP in the year of 2015. The business accounts for 44% of the insurance sector in GCC. However, it would be surprising to know that the penetration rate of Takaful in GCC countries, where the majority are Muslims, it forms only 0.5% which is much lower than conventional insurance rate of 1.3% (Alpen Capital, 2017). It is in fact critical evidence that Takaful business in its origin home is not delivered to the community, whether Muslims or Non-Muslims, as an alternative option of conventional insurance.

Furthermore, the statistical international reports for the insurance industry show that total contribution of Takaful industry is still accounting for less than 1% of the total gross written premium of the global insurance industry. In 2017, for example, the GWP generated globally estimated at USD 4,892 billion while the Takaful business has recorded an amount of USD 27.7 billion which represent only 0.6%. knowing that the penetration rate of Takaful in the original market is still far away from conventional insurance counterparts operating in the same market and taking into account that the business has been designed for Muslims, as an alternative option of impermissible conventional insurance, which are forming the majority of GCC countries, these unexpected outcomes lead this research to conduct a critical evaluation of the business in terms of operation, regulations and Sharia concerns. Nevertheless, this study will focus on Takaful business in the GCC countries, the biggest market of Takaful. Furthermore, a comparable analysis between Takaful and conventional in respect of business performance during the last years is inevitable in order to achieve a practical evaluation. As the whole market in Saudi Arabia is 100% fully fledged Sharia Compliance, the study shall be restricted to the second largest Takaful market in the GCC, the UAE market, where both conventional and Takaful insurance is practiced.

2.9.3-UAE Takaful Market

According to the World Population Review, the estimated population of the UAE in 2020 is 9.89 million where Muslims are 7.5 million, representing 76% of total population. The local population is only 10% of total population.

Before the 7 Emirates were united in 1971, the insurance business had been established in 1959 by Indian companies, the Oriental Insurance and The New India Assurance.10 years after, other foreign insurance companies joined the trend while the first national insurance companies were established in 1970 by Sharjah Insurance Company and Dubai Insurance Company. In respect of the regulatory regime, the federal Law No. 9 of 1984 introduced the Higher Committee for Insurance to govern the business and it was replaced by the Insurance Authority through the Federal Law No. 6 of 2007 (Alrazni and Uluyol, 2018).

In the UAE, the insurance penetration rate is the highest in the GCC and accounts for 2.9% which is marginally below the penetration level of 3.2% in the emerging markets. The market is witnessing a fiery competition with 62 insurance providers comprising of 35 local and 27 foreign insurance companies. Out of the 35 local players, there are 12 national Takaful Operators. The five biggest national conventional insurance companies are generating a premium accounting of 53.2% of the GWP in 2016 (Alpen Capital, 2017). However, insurance sector witnessed a growth of 12% during 2017 with a gross written premium amounting of AED 44.8 billion comparing to AED 40 billion in 2016. The gross written contribution GWC of all Takaful Operators amounted to a total of AED 4.2 billion representing 9.3% of the total GWP. The business accounted an increase of 13.5% comparing with previous year of 2016 (UAE Insurance Authority Report, 2017).

Out of 62 insurance companies operating in the market, there are 31 listed public providers which are split into 21 conventional and 9 Takaful operators (including the newly joined operator “Orient UNB Takaful”. According to the Milliman Report of 2018, all listed insurance companies in Abu Dhabi Stock Exchange and Dubai Financial Market have witnessed a slight growth of 0.5% to AED 21.9 billion during 2018 of which the Takaful sector contributed AED 3.7 billion. However, the decline of 0.5% in the GWP was sustained by conventional players in the same year and has been offset by the growth rate of 5.8% in GWC of Takaful segment (A.M. Best, 2019).

It can be noticed that the market is overcrowded by insurance providers who are serving a small population and fighting therefore for a small pie. This has led insurance providers to adopt aggressive pricing policies with a significant allowance of policy coverage in the aim of attracting more customers. However, this has drawn the margin of profitability down and caused huge accumulated losses with a high Combined Ratio (Alramz, 2017).

The regulatory landscape of Takaful in the UAE is newly established and the first Resolution issued specifically for Takaful by Insurance Authority was in 2010. The main issues which have been emerged in this resolution are briefly introduced as under:

- Forming the Supreme Sharia Committee SSC in order to supervise compliance with Sharia for all Takaful operators in the UAE. The members of the SSC ranging between 3 to 5 and are not allowed to be a member of SSB in any Takaful Operator operating in the UAE.
- Dissimilar to some Muslim counties, Takaful windows in the UAE are not permitted and conventional insurance therefore is not allowed to open a Takaful window to sell Islamic products (Article 3).
- A combination between General Takaful and Personal Takaful is not allowable anymore (Article 7)
- The existing composite of Takaful operators must rectify their status within a limited timeframe of one year from the date of this resolutions coming into force (Article 35). Up to that date, the Personal Takaful Fund must be segregated from a General Fund.
- Any breach of Sharia Compliance from Takaful operators, the General Director will notify the company after soliciting the SSC and give 30 days to rectify the status in line with Sharia provisions. If the company fails to do so, the matter shall be escalated to the Authority' BOD to suspend its activity until the breach is rectified (Article 31).
- The Qard Hasan is mandatory when the PRF is insufficient to meet its liability and the shareholders are exposed to provide a loan up to the total of the company's equity. The Qard could be recouped from any future surplus in one payment or several instalments. Failing to provide the same, the same discipline is applicable as above but the notification period is 15 days instead of 30 days (Article 28).
- The Takaful operators have the right to use conventional reinsurance if the ceded risks require certain capacity or to be distributed to a proper number of companies subject to the same requirements if they are not available in Retakaful or Takaful operators (Article 29).

In November 2016, the UAE Insurance Authority capped the Wakala and Modaraba fee on annual renewable policies at 35% of GWP and investment income. Such new regulations aim to achieve standardizing processes, developing corporate governance, strengthening technical provisions and protecting the interest of policyholders.

Knowing that the penetration rate of Takaful sector in the UAE accounted only 0.23% (Alpen Capital, 2017) and the market share is still less than 10%, Takaful performance in the UAE is a matter of question that critically triggers the researcher's approach. However, professional experts of Takaful business together with many practical and academic researchers have addressed the challenges facing the Takaful business for more than 10 years but none of these challenges have been overcome yet. The major challenge is the lack of Takaful awareness and differentiation whereas the majority of people still believe the concept that Takaful is very similar to conventional.

Having said that, as far as Takaful operators manage the business in the conventional way, the regulators adopt no new reforms to regulate the business and Sharia Scholars undertake no proper supervision, the future of Takaful is unpredictable and is holding ambiguous results.

C) Conceptual Framework

2.10- Theoretical Insight

The conceptual framework of this research has drawn insights from two theories, Theory of Constraints (TOC) and Agency Theory (AT), as the subject research addresses two main themes, constraints which form a bottleneck for development as outlined above and corporate governance which is warned as an ineffective mechanism that Takaful business sustains. Having answered the questions for each theory, analysing the outcomes and combining the results in one framework shall enhance findings and open the door for appropriate recommendations.

As outlined in section one, the business confronts key challenges that prevent a Takaful industry from growing and flourishing, more specifically in the GCC region. While some of these challenges have been observed since early years of operation and become constraints against the chain of performance, others seem to be a consequence of operation. However, having maximized the utilisation of constraint shall maximize the output of the process other than relying on a non-constraint resource (Aryanezhad et al., 2010). Therefore, this research is designed to focus on these constraints, particularly the lack of business awareness along with relevant factors and ineffective corporate governance mechanism, benefiting from Theory of Constraints' techniques.

Furthermore, the complexity of relationships between stakeholders in the Takaful business has led to misalign parties' interests as the principal of current Takaful model is not accurately identified. To answer the question "who is the principal" in the Takaful scheme and align conflict of interest among parties, the framework of Agency Theory has been utilized.

2.10.1- Theory of Constraints (TOC)

TOC is a technical method used for improving business processes and maximising operational efficiency (Pacheco et al., 2019). This method was developed by Goldratt in 1980 and discussed in his book "the Goal" published in 1984. The theory assumes that any complex system is simply a combination of linked processes where, at least, one of these processes acts as a constraint which prevent the system to achieve a high level of performance. TOC focuses on five steps; identifying the most significant constraints, exploiting the system constraint, aligning and managing the system around the constraint, elevating performance of the constraint to optimum level and repeating the process afterwards. It also includes a Thinking Process which is a problem-solving technique by finding out the main cause of undesirable effects and then eliminating those effects without causing a new one (Al Ami, Saha & Mohona, 2018). This technique is designed to answer three fundamental questions; what needs to be changed? What should it be changed to? And what actions could lead to the change? (Al Amin, Rahman & Shahriar, 2020). Regardless its application in almost all kinds of business, it has been criticized that it does not provide a complete management paradigm (Pacheco, Antunes Junior & Matos, 2021).

2.10.2- Agency Theory (AT)

Stakeholders of any business are different based on the type of business. It is crucial for any business to determine the relationship between stakeholders, the interest of each and how their interests are managed and protected. Notably, this issue has been highlighted by Berle & Means (1932) and Coase (1937) who addressed the problem that could arise from the separation between the ownership of an operational fund (shareholder) and the control of that fund (the managers).

During business development, particularly in UK and Europe, many theories were introduced to establish standards on corporate governance, mainly Agency Theory (AT) or Principal-Agent Theory and stakeholders Theory. Stakeholders' theory provides a broader view of agency theory where it determines the relationship between the parties inside and the parties outside the organization. Donaldson & Davis (1991) defined a stakeholder as any party influences / has been influenced by achievement of organization's objectives. However, this theory has been criticized as it fails to explain how stakeholders have been equally treated without having a conflict of interest (Freeman, 1994). The main difference with Agency Theory is that the social responsibility, in this theory, is recognized as the community is one of the main stakeholders in any organization (Muhamat, 2021).

In his book The Wealth of Nations, Adam Smith (1776) is the first author who suspected the existence of agency problem when an organization is managed by a person who is not the owner of the business, then a chance to work for his own benefit is a probable end (Panda & Leepsa, 2017). The relationship between the owners of the business and the managers had been examined by AT from the view of conflict which arise between the two parties due to the misalliance of expectation whereas each party is self-motivated to maximize its interest, specifically from the agent side (Jensen & Meckling, 1976). Forming the board of directors along with auditing mechanism and an attractive remuneration scheme to the agent, has been established as a governance tool to mitigate the conflict of interest among parties (Fama, 1980).

To conclude this chapter, Takaful business has been investigated from strategic as well as operational aspects in the aim of answering research questions through:

- Addressing whether the business is conducted in line with Sharia standards and determining the influence of the unique nature of business operation on profitability in the UAE market
- Tracing Takaful performance and determining the impact of the above factors on business growth and development
- Examining the challenges that are confronting the business and establishing the subsequent effect on business' growth and
- Finding out what the business needs to expand out of its borders

This shall ultimately serve the aim of this research of determining whether Takaful business is practically and commercially a viable option compared with conventional counterparts in the UAE market and whether it has an opportunity to move into globalizing.

From the above, it has been noticed that there is inconsistency between some of Sharia principles regarding business conduction and local regulations in terms of treatment of deficiency, surplus distribution, operational models and financial accounting reporting. It is also found that the business sustains same challenges faced since decades of operation which become constraints toward growth such as lack of business awareness and ineffective corporate governance mechanism. Business practitioners claimed that the shortage of investment assets which are available for Takaful and the rateable of Retakaful operators are factors tightening Takaful operators' hands to uphill and put the business in a competitive track comparing with conventional counterparts.

In respect of Takaful performance, statistics show that the share of Takaful revenue worldwide forms less than 1% of global insurance gross written premium regardless the number of Muslims which form almost 25% of global population. Locally, in the UAE market for instance, Takaful business is still having a 10% of insurance market share with 0.23% penetration rate. As a part of Islamic Financial Industry, the share of Takaful business in 2019 accounted 1.1% only from the total of IFSI revenue which reached in the same year USD 2.4 Trillion.

The impact of inconsistencies between Islamic principles and domestic regulations on Takaful performance along with existing challenges / constraints have been examined in this research utilizing a combination of theories, mainly the Theory of Agency and Theory of Constraints, to analyse collected data and present them in an academic manner.

CHAPTER III

Research Methodology

3. Introduction

The key indicator that determines research methodology is the type and nature of the conducted research. Traditionally, there are two broad methods of reasoning; referred to as an inductive and deductive approach. While the inductive reasoning starts from a particular observation and moves toward generalization (bottom up) in the aim of creating a theory, the deductive approach works in an opposite way (top down) that starts from more general to more specific in purpose of testing the theory / starting point (Burney, 2008), (Atieno, 2009). However, qualitative and quantitative methods have been commonly used, instead, for conducting research study representing inductive and deductive reasoning respectively.

The qualitative method is subjective in nature and usually used to describe the subject phenomenon, particularly when little information is available about the topic, and to generate, ultimately, a new theory. However, the quantitative method is primarily used to test theory through examining the relationship among variables in an objective and scientific approach. Researchers in qualitative research are personally involved and will be influenced, in one way or another, by discussion carried out with participants while in the case of quantitative, researchers are absolutely remote and neutral and attempting to study the topic of interest from a distance (Antwi and Kasim, 2015). Cohen et al. (2000) emphasized that no one method has an advantage over another as both are useful for most of the research endeavours.

Nevertheless, the qualitative method has been described as a time-consuming method because it generates a huge amount of data that needs classification, codification, reporting, examination and extensive analysis. Dörnyei (2007) has signposted that for a one-hour interview, it may need six to seven hours for transcription and almost 50 pages of transcript. On the other hand, quantitative is more complex, particularly for non-mathematicians, and requires an extensive statistical analysis and extra resources for testing the end results (Chetty, 2016). Unlike quantitative, the findings of the qualitative approach cannot be perceived by population with the same degree because these findings in this method are not tested (Atieno, 2009).

In the last few decades, a new method has been employed by many researches whereas a combination of qualitative and quantitative data is inescapable. In the Mixed Method, qualitative and quantitative data is combined for the purpose of broadening the breadth and depth of understanding and authenticating the research's conclusion, and offsetting any weakness which may arise by either method alone (Johnson et al 2007, Blake 1989), (Creswell, 2013), (Schoonenboom and Johnson, 2017). Further, Almalki (2016) has emphasized that the mixed method approach is extremely practical and offers an opportunity to address the subject issue by employing numerical statistics that support the critical issue of the research. Corner (1991) has addressed the close interconnection between the qualitative and quantitative methods where one is supporting another to eliminate inadequacies in each method separately (Corner, 1991). A distinguish has been made by Fossey who confirmed that the qualitative methods are subjective and explorative in nature rather than quantitative ones which are objective (Fossey, 2002). Therefore, the best method to test the scientific rigor and credibility of theoretical collected data is to provide statistics and numerical data (a combination of textual and numeric). The key issue of using mixed method is how and when the qualitative and quantitative dimensions are integrated and embedded, whether concurrently or sequentially, in the subject study (Tashakkori and Creswell, 2007).

3.1- Qualitative Driven and Research Theory

Considering the above and taking into account the type of questions, the nature of study and the importance of including quantitative data, it is intended to use one of the mixed methods in this research, specifically qualitative dominant method. This method has been defined as a type of mixed research whereas the qualitative data is relying on critical, constructive and structural view of the research process while the quantitative data is an additional supportive data where both are concurrently enhancing the rigor and credibility of the end conclusion (Johnson, Onwuegbuzie and Turner, 2007). Morse and Cheek (2014) confirmed that the main characteristic of qualitative driven mixed method is that both components serve the same aim of the research; but the core is qualitative supplemented by quantitative component. The two components are kept separate until the point the research require combination between them and are usually integrated into a new section.

The secondary qualitative resources for this study are not, practically, sufficient to address its research objectives and therefore, interviews have been used as a primary data to fill the gap and ultimately to serve this purpose. Having collected required data from secondary and primary resources, intensive analysis has been undertaken thereafter and the quantitative data is integrated into qualitative data sequentially and embedded in a separate chapter of this report for appropriate discussion and proper conclusion.

The analysis is carried out with the help of insights drawn from Theory of constraints TOC which focus on the weakest points of the business chain that prevent the business from growing, determine the relationship of these points and find out the way to reduce the impact or even eliminate such constraints (Simsita et al, 2014). But in this research, the analysis also focuses on multiple accountabilities between stakeholders (Gailmard, 2012), particularly the conflicting accountability between Shareholders / Managers and Policyholders / Managers from one side and between profitability and Sharia Compliance from the other side. Therefore, it is intended to carry out a combined analysis between two theories, TOC and Agent / Principal, in order to achieve the ultimate goal of this research.

3.2- Justification for Qualitative Dominant Mixed Research Methodology

- According to the fact that Takaful business is relatively new, there is consequently a very limited number of credible resources, whether academic or professional, and collecting the data through qualitative interview is ostensibly inevitable.

- Takaful business is still in its infancy stage in comparison with conventional insurance and it would be impractical to evaluate the business between theory and practice, to address the key challenges and highlight the possible opportunity to move out of its borders by relying merely on qualitative or quantitative data as standalone research.

- The concept of Takaful is initially having historical roots and has been developed gradually to its modern commercial business. Therefore, the theoretical data is available but it is inadequately addressed due to the unique nature of the business. Also, the graphical line of numerical statistics showing the movement of the business does not have a long tail record and it could not consequently determine an accurate picture of development. For the latter reason, the quantitative data will be consulted on as a complementary that supports the core qualitative data (Doyle, Brady and Byrne, 2009).

- The logistical and operational challenges confronting Takaful business are not naturally quantifiable and the most probable way to outline these challenges is essentially relying on conducting qualitative research which becomes a dominant in this study. However, examining and evaluating these challenges practically does not have a great value without finding out the impact of these challenges on the business' growth and development. Therefore, statistical data obtained from international insurance reports have been consulted and then a combination of gathered data in terms of textual and numeric has been integrated to achieve the aim and purpose of this research.

- As research of business, many of the stakeholders shall supposedly benefit from the end results. While the main purpose of this study is to find possibilities for improving and developing the Takaful business in the local market, the final aim is to figure out probabilities to encourage policy makers (one of stakeholder of this research) to adopt this business as a streamline or recommend an alternative model of operation. Greene (2005) has clearly identified that mixed method approach responds, other than the single method, to decision makers' policy as well as other legitimate stakeholders' interests and needs.

For all reasons outlined above, the qualitatively driven method is seemingly indispensable to achieve the final goals for conducting the subject study.

3.3- Questions for a Qualitatively Driven Interview

The qualitative interview is based on semi-standardized and open-ended questions that allow the interviewees to answer questions freely and comfortably and to encourage them to be more involved in highlighting hidden facts around the business. Moreover, senior knowledgeable interviewees may probe far beyond answers and raise further questions which serve the purpose of this research (Berg, 2009), Dörnyei (2007). On the contrary, this method is intended to be more complex than closed-ended questions (where answers can be "Yes" or "No") and the end results might be generalized, imprecise and less credible.

The semi-structured questions of the qualitative interview are open-ended and imperatively constructed to be likely able to generate sufficient data about the phenomenon in question with much focus on the research's objectives. Maxwell (2013) emphasized that good interview questions require inspiration and extensive understanding of the matter of interest, rather than a mechanical exchange of information. Taking into account the seniority level of participants, the semi-structured questions have been constructed in a way that elicits the longest answer from participants followed by probing questions on the aim of having a full picture of the matter under question (Harvard Guideline of Developing Interview Questions).

3.4- Data Collection

3.4.1-Secondary Resources

In fact, the secondary data that currently exists forms a strong foundation of primary data, the baseline for comparison and helps to design the type of research methodology and research questions. Finding the applicable secondary resources that fits the topic of interest could be problematic and quite time consuming, particularly when the information about the subject study is very limited (Sloboda, 2016).

Regardless its advantages of providing access to a huge number of researches and shaping the framework of conducting the research, it could distort the end results if the data has been collected, thoughtlessly, from unreliable resources and uncontrollably analysed (Herron, 1989)

In respect of this research, there are very few books available regarding Takaful business worldwide and therefore the main resources for secondary data has been / is being gathered from a good number of articles, downloaded from the internet, public journals, professional expert reports, technical reports, official statistics, industry associations and so like. In addition, there are few Arabic books and articles regarding Shariah jurisprudence and regulations which require careful translation and interpretation. Searching in scopus.com, UK Online Library, Sciencedirect.com, Researchgate.com, books.google.com, Abebooks.com, Amazon.com. and others, there are a lot of English books relating to Islamic Finance and Islamic Banking but few books for Takaful business. Even so, some of these books are outdated while others are related to the different aspects of this research. Conversely, there are a lot of articles addressing various aspects of Takaful business in different markets, mainly in Far East

Asia and the MENA regions. In the UAE libraries, a few Arabic books are available regarding Islamic Finance in general with some references to the business in question.

Nevertheless, the huge number of articles available through the internet is more or less providing the same typical information regarding Takaful principles and operation which, to some extent, seems to be “copy-paste” (Al-Amri and Hossain, 2015), (Hassan, 2019). In one way or another, the collected data from the above resources is supposedly updated and it will help tracing the historical roots of the Takaful, transformational leap from social to commercial business and the new developments in terms of Sharia and regulatory concerns.

In respect of quantitative data, the international insurance reports along with local market official report will form an important resource to gather statistical data which shall be compared with participants’ interpretation for evaluating the business from a practitioners’ point of view. Statistical data shall trace the development of Takaful business whether in the main, merging or western markets, highlight areas of weaknesses and outline the strength points. Quantitative data shall be mainly collected from statistical reports carried out by international firms such as Milliman, Alpen Capital, A.M. Best and Earnest & Young to show Takaful development during the last decade in different markets as well as from UAE Insurance Authority for the local market.

Combining the quantitative with gathered qualitative data, analysing the findings, shall enhance the scientific rigor, reliability and validity, as practical as possible, of the end results (Hesse, 2010). The gathered data through secondary resources, theoretically and statistically, shall be examined and evaluated to shape the framework for primary data which undoubtedly serve the ultimate purposes of this research (Dunn et al, 2015).

3.4.2-Primary Resources

The primary data has been collected through direct interviews with senior people, listed below, who have massive experience, knowledge and a high qualification portfolio in terms of Takaful industry, business operation, regulations and Sharia.

1. Interview with two CEOs of Takaful Operators in the UAE market, the CEO of Abu Dhabi National Takaful (the best Takaful performance in the UAE) Mr. (OA) and the CEO of Islamic Insurance Company SALAMA (the oldest Takaful Operator in the UAE) Mr. (PS)
2. Interview with Sharia Scholar, Sheikh (NY), who is a member of Sharia Supervisory Board SSB for a huge number of Islamic Institutions worldwide, including Abu Dhabi National Takaful
3. Interview with the Manager of international Reinsurance / Retakaful, Mr. (MAS)
4. Interview with Professional Lawyer who is specifically involved in Takaful regulation, particularly in UK and UAE, Mr. (PH)
5. Interview with one of regulators of the UAE Insurance Authority (Senior Researcher), Mr. (AM)

6. Interview with Professor (SA) who is the visitor professor in Reading University UK and a consultant in the IFSB) who has a book regarding Takaful Principles and Regulatory Issues
7. Interview with Professor (OF) who established three Takaful Operators in the MENA region and a writer of many professional and academic article about Takaful business

Achieving the aim of this research "*determine whether Takaful business is practically and commercially a viable insurance model compared with conventional counterparts in the local and global markets*", it is imperative to provide answers to the following questions:

- ✓ As an Islamic business, is the landscaping of Takaful appropriately constructed?
- ✓ Has the business been regulated in line with Sharia standards and guideline?
- ✓ Is the business commercially, in terms of profitability, a viable insurance model in the UAE market?
- ✓ Why Takaful business is not flourishing and prospering in origin markets as expected?
- ✓ Does the business have an opportunity to move into globalization?

It is therefore envisioned to scrutinize the overall Takaful operation, from logistical, operational and organizational perspectives, in the local market through addressing the following objectives.

3.5- Research Objective

1- Critical evaluation of Takaful Principles' aspects as practiced in the UAE market

This objective is split into two sections:

A) Examining the impact of Sharia principles and regulatory system on Takaful model in the UAE

The operational side of any business could not be separated from conceptual principles, particularly when it is constructed on religious beliefs. In respect of the business in question, the Sharia principles are the foundation and the first starting point of operation. Regulations then comes to govern the business cycle based on domestic regulatory regime. Therefore, it is intended to examine the following particulars:

- ✓ The effect of regulatory environment on Takaful business in the UAE and whether the current regulations are in consistency with Sharia Standards
- ✓ Implication of Takaful Contract, policy wordings, Qard Hasan, surplus distribution in terms of practical perspectives
- ✓ Remuneration implication on Takaful model
- ✓ Aspects of conventional Reinsurance / Retakaful

In order to achieve progress, the standards established by Accounting and Auditing Organization of Islamic Financial Institutions AAOIFI, the guideline addressed by Islamic Financial Services Board IFSB and the UAE Insurance Authority' regulations in respect of Takaful business has been reviewed. In the purpose of investigating whether the business has been, in practice, conducted in line with Sharia standards and guideline, Sharia Scholars and a member of the IFSB have been interviewed. Also, the same has been deeply discussed with the senior researcher from the UAE Insurance Authority. Also, investigating the impact of a regulatory regime and contractual principles on Takaful in practice, business leaders, Sharia Scholars, IA regulator, independent professional lawyer and academic researchers have been interviewed.

Comparing and analysing the collected data from both resources, a critical evaluation has been carried out in order to determine:

a. The impact of any observed inconsistencies on market perception and public awareness and ultimately, on Takaful business' growth and development in the UAE market
b. Whether Sharia principles, regulations and operation are forming a streamline that make the business viable
c. Whether the current operational model of Takaful is, principally, capable of driving the business upwards

B) Carrying out a practical analysis of Takaful performance compared with conventional insurance industry in the UAE and global markets (Practical Section)

It is intended to carry out a comparative analysis in terms of Takaful performance compared with conventional in the main markets in general and in the UAE in particular.

Having examined the conceptual aspects of Takaful business, it is imperative to investigate the impact of these principles on Takaful performance. For this purpose, the World Takaful and Conventional Insurance Reports, actuarial statistics and the Annual Reports regarding the insurance sector, issued by the UAE Insurance Authority, have been examined. It is intended to trace Takaful performance during the last 5 years in the main markets, sub-markets and, in particular, the UAE local market. The collected primary data shall be used, where it is required, to serve the comparative analysis.

In order to provide scientific rigor for this research, the key performance measures such as market share, annual combined growth rate, penetration rate, return on employed capital, combined ratio of the business during the last 5 years, mainly between 2014 and 2018, has been traced. Quantitative data is mainly collected from statistical reports carried out by a) international firms such as Milliman, A.M. Best, Alpen Capital and Earnest & Young as well as annual reports issued by IFSB and b) local actuarial reports such as Al Ramz, Badri and the annual reports from the UAE Insurance Authority for the insurance sector in the local market whereas all resources have been traced to show Takaful development during the last 5 years in different markets, more specifically in the UAE. These reports include a deep analysis of Takaful results (technical results and investment returns), factors affect the business profitability and recommendations for improvements. From a practical review, two CEOs of Takaful Operators in the UAE market have been interviewed.

The collected data has been brought to the attention of interviewees in order to combine the qualitative answers with real statistic figures in the purpose of evaluating the business performance, compared with conventional competitors' performance and ultimately address the accurate position of Takaful business in the current local and global business map.

Analysing the gathered data, compared with the existing secondary resources and combining the findings with the author's experience in the insurance field, in general, and in Takaful, in particular, it would help in achieving a critical evaluation of Takaful business in the UAE market in terms of:

a. The influence of operational models (for instance, the Wakala Fee) on underwriting results and the restricted investment policy on overall profitability
b. The impact of current Sharia Standards and regulation on Takaful performance in the UAE market and
c. The impact of management strategy for conducting Takaful business

Having said that, the final goal of the first objective is to find out what are the crucial factors influencing or having a direct impact on Takaful growth and developments and whether the business, in terms of profitability, is a viable and alternative option of conventional insurance.

2- Investigate practical challenges / constraint the business face in origin markets

Essentially, this objective can be achieved through carrying out a crucial investigation of the following core operational aspects of Takaful business in the UAE.

a) Business Operation

It has been addressed from secondary data that the business is sustaining considerable operational challenges such as the lack of knowledgeable staff, lack of public awareness of Takaful, extensive shortage of reliable Islamic Reinsurance (Retakaful), shortage of skilled Sharia scholars, low retention rate as operators are still small sized, restriction of investment policy and low penetration rate of takaful compared with conventional (Abouzaid, 2007; Milliman, 2010; Bhatty, 2010).

Furthermore, the way of introducing the business to the public is misconceived. It has been noted that "Faith is becoming a marketing tool for Takaful rather than the sole reason for attractiveness". This is another issue which shall be determined whether Takaful business in its original home is delivered to the community, whether Muslims or Non-Muslims, on the basis of religious beliefs or as an alternative viable option of conventional insurance.

The end results of Takaful performance are a consequence of the business chain starting from Sharia principles, regulations, operations and organizational flow. In other words, this chain could be categorized into logistical support to start operational activities within an organizational umbrella. Each stage has brought its own challenges and these have been classified and discussed in this research, based on their practical impact on Takaful performance. Two Chief Executive Officers of Takaful operators operating in the UAE market have been therefore interviewed. The participants have been chosen prudently in terms of Takaful knowledge, conventional background and business achievement.

b) Current regulations

Takaful business has sustained insufficient regulatory approach in all markets, but more specifically in the UAE market (Hodgins, 2015). The unique nature of Takaful operation such as the mandatory of Qard Hasan, the segregation of Shareholders and Policyholders' funds, the method of distributing generated surplus, Financial standards reporting, operational models and investment policy are attracting a high level of consideration for regulators.

From secondary data, it has been observed that there are few numbers of current regulations that have a perilous impact on Takaful performance (Wakerley and Barlow, 2019). These regulations have been discussed with the UAE Insurance Authority regulator. Furthermore, the impact of these regulatory challenges on business operation has been also discussed during the interviews carried out with the CEOs.

c) Retakaful / Reinsurance

As the primary business of Takaful is new, the arrangement of reinsurance backup is still unclear and sustains a lack of regulatory support. Furthermore, it has been claimed that the main challenge preventing Takaful business from growing and expanding worldwide is the shortage of rateable Retakaful (Htay et al, 2014). This challenge has brought to regulators and scholars' attention to find out alternative options by allowing temporarily using conventional reinsurance with some regulatory and Shariah restrictions (AAOIFI 2015, Sharia Standard No. (41): Islamic Reinsurance).

However, the above challenges are interconnected and having essential influence on all levels of the business in terms of operational, regulatory and Sharia aspects. For further understanding of how these challenges are affecting business performance in the real market, an interview with the CEO of conventional Reinsurer, based in Lebanon, has been carried out to clear the uncertainties around the Reinsurance operation regarding treaties and facultative arrangements, key challenges of Retakaful from a practical point of view and the relationship between the cendant and Retakaful Operator in terms of regulatory, Shariah and corporate governance issues. These issues have also been examined during the interviews with CEOs of Takaful operators and the Authority regulator.

d) Corporate Governance

The business under question is different from any other business and has a complex relationship between stakeholders. Theoretically, participants appoint a Takaful Operator as an agent to manage the pool to their best ability. However, in practice, shareholders established a commercial entity / Takaful Operator to manage the participants' fund as well as shareholders' fund in their best interests. The business also has another layer of governance as an Islamic business and must be subject to Islamic ethical standard and Financial Transactions (Muamalaat). The SSB is appointed by shareholders to find out whether the business has been conducted in line with Sharia jurisprudences.

From literature, Zainal Abidin et al (2013) has raised a valid question of how the conflict of interest between the shareholders and policyholders has been managed and who is responsible to do so. However, this question is still unanswered. Having remembered that the SSB members are appointed by BOD, this will add another aspect of conflict of interest.

Having said that, the relationship between shareholders and policyholders is complex and requires an intensive involvement of regulatory bodies in the aim of managing the subject issue. Practically, it is crucial to realize how and to what extent the conflict of interest has been managed. Therefore, it is intended to carry out assessment a) practically, through interviewing the CEOs of two Takaful Operators and b) conceptually, through interviewing the local regulator and Sharia scholar.

e) Relevant Factors

While the research objectives will be addressed through secondary and primary data, other factors relating to the business environment are indispensable. The dramatic growth of Islamic banking and the upward trend of using wider investment tools for Takaful business and others, either in the international markets as well as the UAE market, shall be taken into consideration, particularly for outlining the third objective of this research.

Having addressed the operational, regulatory, Retakaful and corporate governance challenges, which confront Takaful business in the UAE market, from secondary and primary resources, these challenges shall be classified into two categories:

- ✓ Core challenges that have a direct impact on Takaful business compared with conventional insurance. Those which are mainly preventing Takaful business to be sufficiently regulated, properly distinguished and appropriately performed. The lack of public awareness and unified regulatory body in line with Sharia standards and ineffective corporate governance are an example.

- ✓ Common challenges that have an impact on Takaful business in general, but more effect on Takaful industry in the UAE market such as innovative products and competition

Then each category has been analysed to explore the impact on Takaful performance and determine to what extent these challenges shall affect the growth and development of Takaful business in the UAE market.

3- Establish what the business needs to move out of origin borders

In order to achieve the last objective of this study, secondary data has revealed that the Takaful concept is already existing in western markets in the form of mutual and friendly societies (Swartz and Coetzer, 2010). From a practical perspective, two western academic professors who wrote, are writing, substantial articles around Islamic finance and Takaful business in the UK and USA in terms of regulatory, principles and operation have been interviewed in order to provide a comprehensive view of the business either in or out of original markets.

From regulatory aspects, one independent lawyer from an international litigation firm (Clyde & CO) who has an extensive knowledge in Takaful law in international markets as well as the UAE market has been also interviewed.

Combining and analysing the collected data from both resources, it could then be determined whether Takaful business, in its current form, is capable to operate in global markets and establish the foundation of the business needs in terms of regulatory and operational issues, compared with conventional counterparts, to grow and expand out of original markets.

3.6- Limitations of Study

1. The objectives of this research are much more concerned about Takaful business from supply / operational and regulatory side. Customers' perception and services have not been considered from the demand side / policyholders' point of view due to time constraint. This is an interesting topic which most probably requires standalone research.
2. Some methodological constraints:
    a. Lack of knowledgeable people about Takaful: it has been noticed that there is a significant lack of awareness of insurance in general and Takaful in particular in the UAE market either among customers or Takaful operators. Due to this reason, the number of interviewees has been restricted to a few people who have knowledge and experience of Takaful and can add value to the study in terms of reliability and credibility.
    b. Restriction of time for interviews: as the chosen interviewees are seniors at the executive managerial level, there is less opportunity for having much more time for further interviews or even long interviews. This restriction has led to an extension of the study by depending on quantitative data to enhance research credibility

c. Location of gathering data: it must be noted that the interviewees have been extremely selective and are living in different geographical areas such as UK, Bahrain and UAE. However, the majority of interviews have been carried out in the UAE; otherwise, the cost associated with this study becomes unbearable

3. Shortage of reliable resources: as the business is in its childhood stage, few academic and professional resources are available which significantly constrained in finding a trend and the accurate relationship between variables. This is an uncontrollable restriction, but the qualitatively driven method may play a reliable role in overcoming it

4. Shortage of practical research on the topic of Takaful: there are a huge number of articles but merely a few academic research papers which conduct a comparison study on Takaful between theory and practice

However, some of the above limitations are uncontrollable and that might lead to a possible bias of collected information and affect, to some extent, the credibility and reliability of this study. Nevertheless, it is essential to confirm that the conducted methodology has been selected to enhance research credibility, as much as is practicable, through carrying out statistical analysis to support the outcome of qualitative analysis. Further studies are essentially required in order to participate in developing the business and bridging the gap in all aspects of operation.

To conclude**,** the collected data of this research is assembled through conducting a combination of primary research as well as secondary literature research. While the primary data has been collected mainly from qualitative interviews, the secondary data is being gathered from Takaful world reports, academic research, books, articles, journals and international conference reports. This chapter addresses the reason behind using the qualitative driven mixed methodology, the method of collecting primary data and how it serves research objectives, and finally the limitation and recommendation for further studies.

CHAPTER IV

Primary and Secondary Data Analysis

4- Introduction

This chapter is divided into two sections. The first section has been allocated to examine how Takaful principles are practiced / adjusted in the business environment and what the impact of local regulatory disciplines, in the region in general and in the UAE in particular, on each aspect of the business in contrast with the existing foundation and guidelines established by AAOIFI and IFSB, respectively. The findings of this section shall be lacking in meaningful without consulting statistical performance of Takaful. Therefore, the second section is designed to trace performance of Takaful during the last decade, examining the impact of essential factors, addressed in section one, on business results and exposing the influence of the specific nature on movement direction. At the end, an analytical discussion of combined findings in both sections is conducted.

4.1- Section (1): Aspects of Takaful Principles

4.1.1-Regulatory Overview of Takaful Business in the UAE / GCC

It is intended in this chapter to examine the impact of existing regulations on Takaful business in terms of performance and practical perspectives. From the literature review, it has been noticed that the Takaful industry, in general, requires an intensive regulatory approach whether from domestic or international regulators / institutions. In the UAE, particularly, the existing regulation of Takaful is still insufficient comparing with conventional business.

The responding lawyer (PH) has initially pointed out the current regulatory landscape of Takaful in the GCC / UAE which can be split into the following three categories:

- Those jurisdictions into which currently have takaful specific regulation in place (i.e. UAE, the Dubai International Financial Centre (DIFC), Bahrain, Qatar and the Qatar Financial Centre (QFC) and Oman
- Those which have general insurance legislation which is noted to be applicable to both takaful and conventional insurance companies (i.e. the Kingdom of Saudi Arabia which applies to the 'co-operative' model to all insurers); and
- Those jurisdictions which currently make little provision for or recognize takaful as a separate type of insurance in their regulatory regime (i.e. Kuwait)

There is then also an issue as to whether a particular regulator will seek to regulate Sharia compliance and, if so, the extent to which that regulator imposes mandatory rules in relation to the structure of a takaful operator. This is typically the case in those jurisdictions with takaful specific regulation; albeit, the DIFC has specifically indicated that it will not attempt to regulate issues of Sharia.

It has been also noted that:

- Even where there is takaful specific regulation, the majority of the regulations applicable to conventional insurance will also apply to takaful (for example, in relation to conduct of business).
- Many of the regulatory requirements imposed in relation to the structure of takaful operators are designed to create a level of comparability to conventional insurers. This enables regulators to apply substantially the same prudential requirements for these entities as they do for conventional insurers.

However, and to the high extent, he confirmed, that the regulations managing conventional insurance business are more or less the same for Takaful with very few regulations designed to capture the segregation of funds, Qard Hasan and surplus distributions. Nevertheless, the financial reporting for Takaful operators is still on a conventional basis.

From practical terms, the responding manager (PS) highlighted that

> ***"the regulators in the UAE have brought an effective regulatory regime of insurance from international insurance markets / regulatory bodies and requested insurance companies to implement them without taking into consideration whether the local market is mature enough for applying these regulations in practice"*. (PS)**

He also stated that the regulators are required to be engaged very aggressively with Takaful companies and escalate which part of the regulations are preventing the growth of Takaful in the UAE and which part of the regulations can be brought at certain stages.

The second responding manager (OA) has also confirmed that

> ***"in the UAE, they have come a long way in establishing regulations for Takaful companies which is very positive"*. (OA)**

However, other countries, particularly in the GCC, have already started implementing regulations for Takaful operations. It is a fact that the most important role of regulators, more certainly for financial institutions, is to create regulations regarding supervision & surveillance and implement remedial action afterwards. In respect of surveillance, the regulators in the UAE have put in place electronic means to monitor the solvency of the insurance industry as a whole, Takaful and conventional insurance. So now they can monitor the result of any insurance company to ensure that they are able to honour their contractual agreement with the policyholder. Thus, the adequacy and the solvency margin are the main topic for regulators to protect the interest of policyholders. The e-form template and other electronic tools have been created by the Insurance Authority to monitor closely the capital adequacy, assets and liabilities. He pointed out that

> ***"any insurance company in the UAE now is required to submit all financial transactions and statements to the Insurance Authority each quarter in order to ensure that the solvency margin for any company is adequately maintained and if any company reaches the critical stage of solvency margin, they implement close monitoring immediately".* (OA)**

In respect of Takaful business, he has criticized the newly imposed regulation regarding the commission paid to distribution channels and said

> "***the regulators may evolve around to create more fairness in the competition between Takaful and non-Takaful companies and this point dwells around the acquisition cost which was imposed by regulators to be borne by Shareholders"***. **(OA)**

This undoubtedly creates a sort of imbalance in terms of competition with conventional counterparts. It should be noted that Takaful company is a model to make money and should be supported to do so in order to strengthen its assets while the rights of policyholders are preserved. In case of deficit in the policyholders' fund, it is a mandatory requirement on the shareholders to provide Qard Hasan without interest in order to cover that deficit. So, there is a mutual benefit between policyholders and shareholders. Shareholders will work hard to make money, but not to run into deficit because this will impact adversely on their net profit. However, this could work better if regulators allowed this dynamic balance without imposing strict extra expenses on the shareholders.

The responding Reinsurance manager (MAS), in this aspect, pointed out that

> *"**the regulators around the world, in particular GCC region, did not standardize the common and best practice for Takaful to do business. So, the perception of the end users / policyholders of a difference between takaful and non-takaful offer is not distinguishable".*** **(MAS)**

Takaful business, from a technical aspect, should be more expensive than conventional business because of surplus distribution which plays a major role in the pricing of Takaful products. The end users are not buying Takaful because they believe in the product or that the product is different and fulfils their needs but rather, they are buying Takaful because it might be commercially viable for their company, alongside of its ethical investment. So, the main driving decision of policyholders remains the price. However, shareholders will insist on charging a high Wakala fee to maximize their profit which reflects adversely on technical results and leads ultimately into deficiency of policyholders' fund. He then concluded that

> *"**in the absence of specific regulations to manage this issue, the growth of Takaful will not be commensurate with the original vibes and it remains shy of expectations".*** **(MAS)**

Nevertheless, in the UAE and Saudi Arabia, he confirmed, the regulators are working hard to make sure that all practices, mechanisms of control and solvency requirements are put in place. However, it is still a lack of long-term approach from regulatory perspective which prevents a Takaful segment from growing as originally predicted.

Though, the responding insurance regulator (AM) is having a different view. Insurance Authority IA in the UAE has made an extensive effort for developing the insurance industry in general, and the Takaful sector, in particular. He established that

> **"the IA, for instance, has recently published many regulations in respect of general and family Takaful in the aim of increasing the potential growth for this segment in the market". (AM)**

Needless to confirm that the UAE was the first market in the region who has issued, in 2010, specific regulations for managing Takaful business, which has had an extensive impact on the growth rates of Takaful insurance compared to conventional insurance. Moreover, he continued, the UAE has preserved a leading position in Takaful insurance business that made many markets follow this model such as Morocco, for example. Developing a number of legislative and legal regulations for the insurance sector in the market has certainly enhanced the leadership role through a combination between conventional and Takaful regulations which reflected on the growth of global Takaful sector.

(AM) has also addressed an important factor that, on the other hand, the current regulations outlined by the Accounting and Auditing Organization for Islamic Financial Institutions AAOIFI could not be applicable in all markets, particularly in the UAE market. For instance, AAOIFI standard does not allow Takaful Operator (TO) ceding the risk 100% to reinsurers, which was a practice in the UAE market before 2016, and a considerable share shall be retained in-house. He has strongly argued that

> "***this could not be applicable in the UAE market as Takaful Operators are small sized and applying the same could lead them running off or even winding up"*. **(AM)**

Therefore, the regulators allow Takaful Operators to retain a minimum share, at least 1%, for each undertaken risk. This has been shown in the A.M. Best analysis who stated that the performance of UAE insurance market in 2017 was remarkable as a result of adopting a standard regulatory framework during the last three years.

From the above, the existing regulatory landscape, could be classified into:

- One fit all approach is not practically workable
- Imposing acquisition cost on shareholders has had a negative impact on growth and competency
- Lack of standardization and standard regulations restrict the growth of business
- The regulatory framework of Takaful business in the UAE is the best among other jurisdictions
- AAOIFI standards are not applicable in all markets
- Incapability of regulators to capture the specificities of Takaful

These points have been thoroughly examined in the coming chapter.

4.1.2-Takaful Insurance Contract

AAOIFI in its standard 26, para 2, stated that “As for Conventional Insurance, it is a *Mu’awadah* (mutual compensation) contract that seeks to make a profit out of the insurance operation itself, and, hence, is subject to Shari‘a rulings on financial dealings that involve *gharar* (uncertainty). Consequently, conventional insurance is banned by Sharia”.

Having reviewed the Sharia concerns regarding the conventional insurance contract, it has been noted by the author that the doctrine of consideration is the main concern for Sharia Scholars that allow uncertainty in an insurance contract. From literature, this doctrine has been criticized as a conditional requirement for a valid contract. The German Law, for instance, requires only offer and acceptance for enforceable contract. If this has been adopted, shall the current form of Takaful business be changed?

The implication of consideration on a Takaful contract and whether the principle of Tabarru is legally recognizable has been discussed with a professional lawyer who commented as below.

There are a number of difficulties with this approach, namely:

- In many jurisdictions there is a concept of consideration as the basis for a legally binding contract and, therefore, a removal of this requirement would have far-reaching effects across many areas of business.
- Consideration is only one aspect of the reasoning behind the Tabarru concept. Whilst removing the need for consideration may address the issue of Gharar, it would not necessarily deal with the issue of Maysir.

Therefore, the critical issue is considering the need for the application of the Tabarru concept in the first place. In this regard, Islamic scholars consider that conventional insurance is incompatible with Sharia due to the existence of both elements; Gharar and Maysir.

In respect of Gharar, conventional insurance is based on a contract that requires the insurer, in return for the premium paid by the insured, to either pay a specified sum or to indemnify the insured in the event of a loss. Such contracts necessarily give rise to uncertainty. Moreover, such contracts are inevitably uncertain insofar as it is unclear whether a loss will be incurred. There may also be uncertainty as to how much will be recoverable by the insured in the event of loss. Furthermore, conventional insurers, as commercial enterprises seeking to make a profit, are necessarily concerned with whether the premiums they receive will exceed the amount of the losses suffered by their Insured. Whilst premium rebates or no claims discounts are commonplace, it is unarguable that an insured may receive no tangible benefit from purchasing an insurance policy should risk covered by the insurance not eventuate. Such an argument applies only in respect of indemnity insurance.

From a Sharia perspective, there is therefore an element of unjust enrichment for the conventional insurer who may provide no service to the insured. The resulting imbalance between the insurer and the insured is inconsistent with the ethical norms of the Sharia. This perceived flaw of conventional insurance is resolved in the Takaful model by returning to the participant a share of the profit generated by the Takaful operator in the form of the distribution of surplus.

Regarding Maysir, conventional insurance is considered by Sharia scholars to be a form of gambling insofar as the outcome of any insurance contract is uncertain and, particularly, because the insured may recover far more than the premium paid or the Insurer may pay nothing shall the Insured peril does not occur.

The above issues have been resolved in Takaful through the application doctrine of Tabarru whereby the relationship between the participant and the Takaful fund are deemed to be parallel contracts of donation. The donation concept does deal with the idea that, from a Sharia perspective, there may be no consideration provided by the insurer in circumstances where the insured does not suffer a loss in the policy period as a donation is not dependent upon consideration being present.

However, the use of the Tabarru concept is problematic and needs to be fundamentally reconsidered. This is on the basis that:

- It does not reflect the commercial realities of the relationship whereby participants do make contributions in the expectation that they will receive claims payments in the event of a covered loss and, indeed, it is highly unlikely that a court would not enforce the terms of a takaful policy; and
- Applied strictly, it would also give rise to a conceptual difficulty for the reinsurance / retakaful arrangements of a takaful operator (which are typically based on the concept that the takaful operator has a liability to the participants).

It is of note in this regard, that the cooperative model used in Saudi Arabia is not dependent upon the Tabarru concept and instead focuses primarily on the distribution of surplus as the mechanism for creating mutuality avoiding Gharar.

For the sake of completeness, (PH) concluded, the analysis of conventional insurance as involving Maysir is fundamentally distinct from the approach taken in common law systems. From an English law perspective, whilst there are similarities between gambling and insurance, a distinction is made based upon the concept of insurable interest. The use of the concept of insurable interest to distinguish insurance contracts from gambling contracts would therefore allow the issue of Maysir to be resolved.

4.1.3-Takaful Policy Wordings

Having reviewed Takaful policy wordings, terms and conditions, issued by Takaful operators, it has been observed by the author that Takaful Operators in the UAE are applying the same terms and conditions in their insurance contracts as a copy-paste of conventional wordings, except for the preamble as required by Sharia ang regulators. For example, deductible and depreciation is widely applied by conventional Insurers. The reasoning behind applying deductible is to avoid dealing with small claims and encourage policyholders to carry out due care of the subject matter of insurance while depreciation is to prevent the Insured getting benefit from the loss. Ultimately, the final claim amount payable to the policyholders is reduced. As a scheme of solidarity and cooperation, it has been questioned whether Takaful business is a conventional in nature but in line with Sharia Compliant. This issue was discussed with a professional lawyer, Sharia Scholar and an IA Regulator.

(PH) has specified the requirements imposed by the UAE regulators and Sharia scholars in respect of policy contract, as below.

- Interestingly, in the UAE the takaful model is to be recorded in a separate takaful subscription agreement to the "takaful insurance policy" and signed by both the operator and the participant. It is to address "the bases and rules which govern the cooperative relation between the [participant] and the [operator] including the legal aspect of such relationship" and should refer to the fact that the payments by a participant are by way of donation. The takaful subscription agreement must include:
    - Details of the remuneration payable to the operator, including the calculation methodology and the share of the operator in revenue generated by investments
    - Information regarding the investment policy in respect of contributions (including confirmation that such policy complies with Sharia)

- It is submitted that, in accordance with the conduct principles applicable to takaful operators, the disclosure of these details reflects good practice for all takaful operators in the region. This information, he confirmed, "is declared in the preamble of a Takaful contract; but all other terms and conditions are similar to that conventional contract and there is no regulatory requirement to have a specific Takaful terms and conditions".

The responding Sharia scholar (NY) has admitted that Takaful contract should be entirely designed to meet Sharia principles as well as market requirements. However, he has addressed two reasons behind that

a) "***Takaful business is still lagging behind the Islamic banking industry as a new business and undoubtedly there is a lack of unified takaful statistics and actuarial studies, for the time being".*** Therefore, the market is using the practice available in conventional wordings which have been developed during a long historical period of existence
b) ***"The second reason is relating to insurance regulators who are familiar with conventional concepts more than the new principles"*** which have been recently introduced and are not available anywhere in the world and in the insurance industry, in particular

In contrary to this, the Insurance regulator (AM) ascribed the matter into the Sharia Committee. He commented "the Sharia Supervisory Board SSB in any Takaful companies must review all the company's transactions, products, contracts, and documents which the company deals with in order to ensure compatibility with the Islamic Sharia provisions and provide a comprehensive set of recommendations including specific Takaful policy wordings. That shall enable the regulators to approve the same, if it is found practically appropriate and in line with the existing rules, before placing new sets of regulations into practical use.

From the author's experience in the UAE market, in practical terms, it could be confirmed that Takaful operators have added to their insurance policies a preamble, as required by Sharia standards and regulations, to define the contracted parties, models of operation (Wakala / Modaraba), Qard Hasan and surplus distribution. The main coverage, terms and conditions are usually copy-paste of any conventional insurance policy in respect of each line of business. the preamble of Takaful contract refers to Sharia Terms such as donation, participants, contributions, Takaful Operators, surplus, the Wakala and Modaraba fee while these terms have disappeared in the whole wordings, schedule, clauses, warranties and conditions; but instead, it has been referred to in conventional terms such as the Insured, premium and insurers. Also, any insurance proposal form submitted either by the Insured direct or through a broker does not have any reference to Sharia terms. The same has been practiced by the loss adjusters and other service outsourcers who submit their reports based on conventional terms. However, they are not to be blamed for doing so as neither Takaful operators nor regulators and Sharia Supervisory Board have imposed requirements on all of the parties involved in dealing with Takaful activities (underwriting, claims, actuaries, auditors, etc.) to strictly use Sharia terms.

As outlined in the primary data, the Sharia scholar and insurance regulator have reciprocally blamed each other for developing Takaful own wordings to serve the concept and principle of the business. From the author's own view of the party who should be blamed more is the Takaful operators. It could be an excuse that all Takaful staff is coming from a conventional background and their attitude toward Takaful business is simply as similar to any other conventional insurance company and they were seemingly reluctant to provide any effort to change or amend the wordings to differentiate Takaful contracts from those used by conventional counterparts. This excuse could be justifiable before 20 years ago, where the business started up in the market, but it is not acceptable anymore after all of these years of experience. The Takaful operator could be a link between SSB and regulators to enhance Takaful contract and make it popular as Sharia Compliant in respect of all wordings used in the contract. So, the main, crucial finding, is that there is a significant miscommunication among business leaders of how the Takaful contract could be introduced into the market as a Sharia Compliant. The missing link between these parties has a negative influence on all aspects of Takaful business and is considered as an adverse factor toward its business development.

Another aspect of differentiation is the policy terms and conditions. The main purpose of the scheme is to enhance solidarity among members and mitigate any financial loss that might be sustained following the operation of the unfortunate event. For instance, applying deductibles and depreciations to claims, similar to conventional insurance policy, shall weaken the differentiation between the two models and reduce the spiritual cooperation among members. Reviewing conventional insurance policies, it has been noticed that conventional insurance companies have widely applied nil deductibles for their customers and extended the cover to include a new reinstatement clause (new for old) in order to compete, retain and attract more customers. Having extended the "New for Old" clause to the policy, means that the Insurer has waived the right of depreciation. Unsurprisingly, Takaful operators have started following the same terms, as the conventional. It is undoubtedly the case that the Reinsurance cost will be increased as the risk which is being brought to the Reinsurance pool will be amplified when these terms are waived. As far as Takaful operators are using conventional reinsurance, this will be applicable also to them. Therefore, Takaful operators could adopt a pragmatic approach to the market by introducing their products free of these terms as a matter of solidarity other than a matter of market practice.

In respect of the conventional reinsurance contract, the shareholders, as the owners of the fund, are responsible to arrange and choose the type of reinsurance treaty in which reinsurers and their business shall be ceded. On the contrary, the participants in the Takaful model are the owners of the reinsured fund and therefore they must be informed, during signing the Takaful contract, that Takaful operators will donate a portion of their fund to Retakaful / Reinsurers in order to protect their fund from any unexpected events / losses. For the time being, this issue is not currently practiced in the market place and should be addressed in the preamble of Takaful contract.

4.1.4-Takaful Operational Models

Remuneration for the Takaful operation is based mainly on four models – Modaraba, Wakala, Hybrid and Waqf models. The argument around the most attractive or practical model in terms of operational aspects as well as Sharia perspectives is not settled for the time being, as outlined in the literature review. Before examining this issue with the Sharia Scholar, it is intended to highlight the regulations practiced in the GCC regarding the operational models of Takaful through consulting the professional lawyer (PH) who pointed out the followings.

- The principle *takaful* structures used by operators in the GCC are the Wakala model and the combined Wakala / Modaraba model. Some regulators have introduced regulations requiring the use of one or both of these specific models. For example, UAE Takaful Regulations expressly provide that *takaful* operators in the UAE shall use a pure Wakala model or the combined *Modaraba* / *Wakala* structure. By Article 8:

  "*The process of risk management and investment related to the subscriptions by the company shall be undertaken on the basis of agency or agency and Modaraba together.*"

- In Bahrain the CBB Rulebook TA module provides that *takaful* operators may only use a combined *Wakala / Modaraba* model:

  "*All takaful firms licensed in Bahrain must organize and operate their business according to the al Wakala model. Specifically, in exchange for the provision of management services to takaful fund(s), the shareholders of the takaful firm will receive a specific consideration (Wakala fee). For the insurance assets invested on behalf of takaful funds, the takaful operator will use the al Mudarabah model,* *and will receive a set percentage of the profits generated from the investment portfolio.*"

- In contrast neither the DFSA nor the QFCRA specify the *(re)takaful* model to be used by operators. The DFSA Rulebook module IFR notes that:

  "… *structures of Takaful Insurers (including reinsurers) vary, as to the Islamic contracts governing their business. As the DFSA has not yet thought it appropriate to limit the permissible structures and contracts, the DFSA is willing to consider modifications to its Rules to apply the most appropriate prudential regime to a Takaful entity*."

He confirmed that "under the Sharia it is required that the takaful operator maintains two separate accounts: one for its own rights and liabilities and one for the rights and liabilities of the policyholders". There can be no commingling of the takaful fund with the assets of the takaful operator. In commercial takaful operations, the takaful operator is responsible for the day-to-day operations of the takaful fund, including the underwriting, investment, and claims administration. This role is usually undertaken in accordance with the principles of Wakala (agency) and/or Modaraba (partnership between an entrepreneur and a capital provider). The takaful fund, as opposed to the takaful operator, bears the liability in respect of loss of the assets.

The takaful fund must, at all times, belong to the participants. It is therefore essential that documentation underpinning the takaful operation satisfactorily segregates the assets in the takaful fund from those of the takaful operator. The success (or otherwise) of this structuring will depend upon the laws and regulations of the jurisdiction in which the takaful fund is established and will likely only be tested upon the insolvency of the takaful operator. (PH) has raised also an important issue that

> ***"The primary difficulty is that the Wakala and Modaraba models are typically contractual in nature and the takaful fund does not have a separate legal personality from the takaful operator".*** **(PH)**

These potential difficulties have led to takaful operations in some jurisdictions, primarily in Pakistan, to utilize Waqf structures whereby the takaful fund is a form of charitable trust which has a separate legal personality. The legal efficacy of such structures will depend upon the laws of the individual jurisdiction. In common law systems such Waqf is structured in this way and would likely be interpreted as a trust under the applicable trusts laws. An alternative would be to establish the takaful fund as a mutual in jurisdictions which have laws that provide for such entities.

From a Sharia point of view, the Sharia Scholar (NY) commented that all these models, if they are technically designed well, are workable. There are certain Sharia scholars, like the opinion of Sheikh Mustafa Zarqa, Sheikh Abdulla Bin Mana'e and other scholars, who believed that the contract of modern insurance itself, conventional insurance, is acceptable. Having contributions and returns on security of the risk, which is the way of carrying out conventional insurance, is permissible from the Sharia point of view. However, their concern with regards to any conventional insurance company is the investment part. So, any investment activities and any financial transactions must be Halal (permissible). He settled that

> *"these opinions have been criticized by other scholars who confirmed that all conventional insurance activities including the contract itself is impermissible due to the existence of excessive Gharar (uncertainty) and Maysir (gambling) and ultimately an alternative option came to light which was Takaful insurance".* **(NY)**

The Sharia scholars have designed many operational models of Takaful where Takaful operators may use either one or a combination of all which are permissible and in line with Islamic financial transactions. However, it has been given a choice for local regulatory entities and Takaful operators to use whatever model they believe is good for their business.

In Malaysia, for instance, they used to have the Modaraba model while in the Middle East and most Arab countries, particularly the GCC countries, are adopting the Wakala and Modaraba (Hybrid Model); Wakala model for running takaful activities and Modaraba for investing the collected funds / contributions. In respect of the Waqf model, it has recently been adopted in Pakistan based on the opinion of Sheikh Mohammad Taqi Osmani and other rulings who believe that the fund of Waqf is not Waqf in itself. For example, if somebody donates a carpet to the masjid (Mosque); unless he says that this carpet is Waqf, this donation in itself is not Waqf. On another word, this carpet could be sold and replaced by a new one; unless it is declared Waqf, then nobody can sell or replace it. So, the donation for the Waqf which must be utilized by the Waqf fund is not Waqf in technical sense because, in perpetuity, it could be utilized. However, the participants and shareholders in Takaful companies based on Waqf model donate to the pool with conditional issues in order to establish a Waqf fund. This model is mostly found in Pakistan and not all Pakistani Takaful companies are working on Waqf.

The Sharia scholar has come to the conclusion that

> *"the most preferable model which complied with Sharia principles is the hybrid model, Wakala model in running insurance activities and Modaraba model for investment".* **(NY)**

In simple terms, using Modaraba model alone for running the Takaful Risk Fund and Investment Fund is impossible because Modaraba means the distribution of profit only after recoupment of invested funds / assets which is clearly referring to investment activities not insurance activities. So, this model alone is not preferable from the Sharia point of view. Nowadays, the majority of Malaysian Takaful companies converted their model into a hybrid model.

These points outlined by the Sharia Scholar and Professional lawyer have been discussed from practical point of view, based on secondary data (CII Text Book, Takaful Principles, 2017).

- Using a pure Modaraba model has proven to be a commercial challenge to shareholders. The only remuneration received by shareholders is a pre-agreed percentage of any investment returns. In order to be commercially viable, the invested fund must be large enough to generate high investment income. The main challenges Takaful managers face in this model is that a) they need many years to generate a sufficient fund to be invested, b) due to Sharia restrictions, the investment assets are very limited to Takaful operators and c) the obligation of injecting Qard Hasan remains. However, some Sharia scholars have modified this model and allowed Takaful managers to share a percentage of the underwriting surplus; but others have rejected this allowance as the surplus is belonging only to participants.

- In respect of the pure Wakala model, Takaful managers are benefiting from a pre-agreed fee as a percentage from any contribution received. To maximize their remuneration, Takaful managers may accept bad risks to increase the level of gross contribution and ultimately increase the volume of their fee as the more contributions are generated the bigger Wakala Fee is received. Further, Takaful managers are not encouraged to concentrate on investment part as they are not entitled to receive any remuneration from investment returns. The key challenges confronted by using this model are a) huge operational expenses at the start up compared with small contributions received, b) no intensive to focus on underwriting efficiency and c) the obligation of injecting Qard Hasan remains. As similar to the modified Modaraba model, the modified Wakala model is reluctantly accepted.

- The Waqf model has been adopted, mainly in Pakistan, to legalize the participants fund by converting this fund into a trust that can be legally recognized and to mitigate the conditionality of donation. The shareholders initially establish the Waqf fund by donation, then supplemented by further contribution from participants. The Takaful manager shall receive a Wakala fee for management and share any profit generated from the investment income with Waqf fund. However, shareholders have no right to share any surplus generated as it is considered a Waqf deed. The main challenge of this model is funding Qard Hasan which is unclear and the concept is objected to by the majority of Sharia scholars.

4.1.5-Wakala Fee

AAOIFI standard 26, article (3/2) states that "The Participant fund bears all direct expenses pertaining to management of insurance operations" and more specifically article 10/9 "*the Insurance Account shall bear all the expenses and fees that relate to insurance activities*". However, IFSB-8 stated "*For the Takaful Operators TOs, the Wakala fee is expected to cover the total sum of: (a) management expenses; (b) distribution costs, including intermediaries' remuneration; and (c) a margin of operational profit to the TO*". In the UAE, insurance regulation has recently imposed a regulation on the TOs that the intermediaries' remuneration is borne by shareholders, as abstracted below (Financial Regulations for Takaful Insurance Companies, Section 7, Article 3, Wakala & Modaraba Fee, 2014).

a) *A percentage not exceeding (35%) of gross written contributions and participants' investment revenues accrued during the financial year. The shareholders account should bear all operational, administrative and general expenses for Takaful insurance* *business. The participants account should not bear any expenses other than the percentage mentioned in this paragraph.*

It seems there is inconsistency between standards and guideline issued by AAOIFI and IFSB respectively. It must be noted that AAOIFI is established to standardize regulations, including but not limited to Takaful, while IFSB is introduced as an adviser who provides guidelines and recommendations. Conceptually, AAOIFI standards shall be followed; but instead, the IA in the UAE has surprisingly preferred to follow IFSB guidelines.

(PS) as well as (OA) share the same view on this aspect. They have commented that, in November 2016, the Insurance Authority has triggered the new regulation regarding the Wakala fee and commission which was determined in a percentage of a max 35% from gross contribution whereas there is no restriction on conventional companies. (PS) has highlighted that

> ***"the conventional company, for example, can have an expense loading of 15% and pay commission of 35% to the broker for acquiring the business. A takaful company cannot do that because they have a restriction of 35%".*** **(PS)**

So suddenly the takaful sector becomes at a disadvantage in relation to conventional sectors. Such restrictions will hamper the growth of Takaful business and prevent takaful companies to compete effectively with the conventional rates whereas the conventional Insurers are already having a lot of market share while Takaful hands are tied in terms of these things.

The regulator (AM) has argued that the percentage of Wakala fee had been determined after studying the average of the Wakala and Modaraba fees in the market comparing to the best practice in the International Takaful markets, and after discussions within the Takaful companies in the UAE. He outlined that

> *"**Statistically, the max percentage of 35% was calculated on the basis that the actual average of Wakala fees in the Takaful market for 5 years was 15%, the rest to cover the other operational, administrative and general expenses**".* (**AM)**

It may be worth to mention that the Insurance Authority is working on New regulation which will divide that ratio, between Wakala fees and Commissions provided that the total Operating Expenses that are charged to the participants account must not be exceeding than (35%) of GWC.

The Sharia scholar (NY) has a diplomatic view and confirmed that the two options can be practically applied as

> *"**The principle behind these options is the application of justice and fairness among stakeholders and to ensure that the policyholders, particularly, are not overcharged with expenses"**.* **(NY)**

While some scholars believe that increasing the participants fund by involving brokers is benefiting shareholders as their Wakala fee will be increased, others have the opposite view, that this increase is benefiting policyholders as the capacity of compensation will be adequate and then the acquisition cost shall be borne by policyholders. Recently, another pragmatic approach has been discussed among scholars that the increase of participants fund will benefit both parties and the costs should be shared proportionally. He concluded his point in this issue as

> ***"However, as far as the Wakala fee is declared in the contract and the distribution of costs between shareholders and policyholders is transparently implemented, there is no issue from the Sharia point of view"*.**
> **(NY)**

One rule of SSB is to ensure that the contract has been adequately executed.

The implication of this regulation imposed by IA could be discussed from a practical perspective as under.

It is a common understanding that the method of pricing insurance products is basically constructed based on the followings.

- Determining the market rate
- Loading a percentage to cover GOE
- Loading a percentage to cover the acquisition cost (commissions paid) and
- Loading a percentage for a margin of profit

According to the Insurance Authority Report of 2019, the commission ratio for the 35 national insurance providers stands at 9.7% for Property & Liability insurance and 4.4% for Health insurance while the expense ratio stands at 10.6% and 9.3% for the same lines of business respectively. The commission ratio for Takaful operators accounts for 4% much more than conventional national companies at 13.1% for property insurance and 2% more for health insurance at 6.1%, while the expense ratio is almost 2% more for Property (accounting 12%) and 4% more (accounting 12.4%) for health insurance, as clearly illustrated in the table (7) below.

Table (7) - Gross Commission and Expenses Ratio by line of Business (Traditional & Takaful National Companies) for 2019 (IA Annual Report for Insurance Sector, 2019)

	Commission Ratio		**Expense Ratio**	
	P& L	Health insurance	P& L	Health insurance
National insurance companies	9.7%	4.4%	10.6%	9.3%
National Conventional Insurance companies	9.1%	4.2%	10.3%	8.8%
Takaful Insurance operators	13.1%	6.1%	12%	12.4%

Author's Analysis

From the table above, it could be noticed that the commission and expense ratios for the national conventional insurance in respect of property insurance, for instance, is accounting for 19.4% while for national Takaful it is 25.1%.and conventional insurers can load to the burning rate whatever percentage, after loading the Commission and Expenses, for unexpected losses / catastrophes and a margin for profit, Takaful operators are unable to load more than 10% in order to maintain the level of 35%

restricted Wakala fee. Ultimately, it can be observed that the price for any property insurance product for Takaful is approx. 6% more than conventional; assuming the burning rate and margin of profit is the same for both providers.

In order therefore, to compete with other conventional counterparts and increase the profit margin for shareholders, Takaful operators might be forced to reduce the burning cost which will cause a loss as the product has technically become under-priced. Alternatively, Takaful operators might aggressively attempt to reduce the GOE, such as Methaq Takaful, and increase the margin of profit without reducing the standard technical rate of pricing. However, this approach could be workable for companies who have a long stay and have already built a contingent reserve but it will affect negatively on new companies where the GOE in the start-up is extensively high, like the OUTFL Company, who started business in 2017, where the GOE touched the level of 44% (Badri Report, 2018).

Conversely, if the policyholders fund bears the acquisition costs, the shareholders then are allowed to load 23% as a profit margin and unexpected losses which is tremendously high. From the other side, the policyholders' fund shall bear 35% as a Wakala fee and almost 13% for acquisition cost. This undoubtedly leads to deficit as the price of the product becomes technically insufficient to meet the fund's liability and the shareholders therefore have no other option, by law, rather than providing Qard Hasan to cover such deficit.

The higher commission and expense ratio for Takaful companies could be attributable to the following factors.

- Small size leads Takaful management to pay more commission for acquiring more business growth. As the life age of the majority of Takaful operators is less than 20 years, the operational expenses are still high, particularly, they are unable to allocate a budget for investing in technology which enables them to reduce GOE
- Small capital restricts their ability to underwrite huge risks and generate ultimately big contributions. The brokers for huge accounts most probably accept receiving discounted commissions in order to retain their clients as the commission is eventually paid from their accounts.
- For both reasons, Reinsurers shall also not be in a preferable position to offer more treaty facilities in terms of wider cover and better terms and conditions with a discounted rate.

Limiting the Wakala fee means that IA have determined 65% as the minimum technical rate of any Takaful insurance product and the remaining 35% shall cover the operational expenses, brokerage commission and a profit for shareholders.

Therefore, Takaful managers are facing a potential dilemma. Increasing brokerage commission to acquire more business, within a limit of 35% Wakala fee, shall lead to under-rated GOE and margin of profit where shareholders, most probably, find themselves at a loss, while reducing the same the capability to compete other conventional counterparts, who have no limit to pay brokerage commission, becomes far away and ultimately less acquiring of business.

In contractual terms, the broker as an agent will be approached by customers to place their business with any insurance providers that meet their requirements in terms of policy coverage as well as competitive price. Consequently, an appointment letter, signed by the customer, shall be given to the broker including specific duties and obligations. It is therefore a contractual agreement between the broker and the customer and the brokerage fee shall obviously be borne by customers. Instead, the IA regulators have surprisingly enforced Takaful management to bear such costs in the aim, assumingly, of protecting policyholders.

On the other hand, the insurance business in the UAE market is, indeed, brokerage oriented. However, the regulators have not limited the brokerage fee and kept the market open for tremendous greed of brokers who place the business with whoever pays more. This has reflected negatively on Takaful business, particularly for general lines. For instance, the brokerage fee for engineering and motor is ranging between 20% and 25%. Having limited the Wakala fee, Takaful operators suddenly become unable to compete with conventional and a significant reduction of contribution has been witnessed after this regulation. According to IA report of 2019, the share of Takaful sector in respect of Property and Liability insurance in the UAE market has been reduced from 12.6% in 2016 to 11.1% in 2019 while the share of the national conventional player for the same line of business has witnessed an increase from 87.4% to 88.9% for the same period (IA Annual Report for Insurance Sector, 2019). This shows clearly the impact of such regulation on the Takaful sector. The same scenario, of course, happens to other lines of business but to a slightly lower extent.

Having addressed that, from the author's point of view, there are many possible solutions the regulators could adopt, either by:

1. Limiting the Wakala fee to a percentage which reflects the actual G&A expenses according to actuarial studies along with a margin of profit and leave the acquisition costs to be balanced by market forces
2. Determining reasonably fixed brokerage fees for each line of business which is applicable to all insurance players whether Takaful or conventional OR
3. Allowing the Sharia Supervisory Board SSB and Takaful management to determine the level of Wakala fee which represent their commitment to policyholders and shareholders alike as the shareholder, at the end, shall provide Qard Hasan in case the policyholders' fund sustains deficiency.

4.1.6-Management Incentive Fee

As outlined above, limiting the max Wakala fee in the UAE market has been criticized by Takaful operators. Conversely, many Takaful operators nowadays are benefiting from the underwriting results by means of a Management Incentive Fee in addition to a Wakala fee and Modaraba profit sharing. The question which has been discussed with the managers of Takaful Operator as well as the insurance regulator is whether takaful shareholders are entitled to share underwriting profit and whether the current remuneration (Wakala and Modaraba) is unreasonable for shareholders as well as policyholders?"

(PS) has commented that

> *"the question of fair remuneration is basically very simple. Though the regulation will specify maximum Wakala fee and Modaraba percentage, but the remuneration should be very clearly calculated".* **(PS)**

The methodology for calculating the remuneration is quite straightforward. Initially, shareholders should look at all the expenses the takaful operator is going to incur purely for managing the business. Then, they should look at it in the cost of the capital, which shareholders are providing in terms of contingent liability or possibility of providing Qard Hasan, calculate the return on that capital, add to the expenses and calculate the Wakala fee based on the gross premium. That's the simplest method to arrive at a fair compensation.

So, determining the cost of capital and the operational expenses, the Wakala fee should be determined easily on the basis of recovering these costs. He simplified his statement by giving an example

> *"if the takaful company can look at their financial statement for a completed year, say 2018, then based on 2018, the expenses incurred, and deployment of capital are determined. Based on these, they can calculate what Wakala fee should be charged for 2019. Then they could agree with the Sharia Supervisory Board at the beginning of the year".* **(PS)**

Then the question is whether shareholders should participate in underwriting profit or not. Now, once they have been compensated fairly, then there is no need for them to participate in underwriting profit because they have been compensated for their capital and recovered all of the expenses they have incurred. So, the remuneration of shareholder is a function of what cost the shareholder is going to incur to manage the business and what compensation they should get for recovery. However, he said

> *"The only problem will arise when starting a new Takaful company. Because the start-up expenses are very high; the revenue would be very low".* **(PS)**

So, if the shareholders start to charge very high Wakala to cover these costs, the new takaful company cannot sustain. For that, a slightly different methodology can be used which means the shareholder can only charge part of these expenses and will not recoup entirely the cost of capital, but it could be re-compensated through the subsequent profitable years. In that case, he concluded

> **"For the initial year, it can be agreed that they have gained some benefit from the underwriting income to allow them to receive some compensation". (PS)**

(OS) has an opposite view that

> *"As far as the acquisition costs are borne by shareholders, by law, the shareholders should participate in any positive results achieved by prudent underwriting strategy in order to balance the additional incurred costs".* **(OA)**

Practically, the technical results of Takaful operators sustain losses as the majorities are new and they do not have sufficient reserve to withstand incurred liabilities. So, this issue could be discussed in the coming years when the Takaful market becomes stable and sustainable.

From regulatory perspectives, the insurance regulator (AM) confirmed that "Insurance Authority is very keen to protect the rights of the participants and beneficiaries of the Takaful Insurance operation as well as conventional insurance. Therefore, according to the Board of Directors' Decision Number (26) of 2014 Pertinent to the Financial Regulations for Takaful Insurance Companies, Article 3, "*The Company may use up to 10% of the annual Insurance or Underwriting Surplus for participants' funds after approval of the Shari'a Committee and the Authority. In exceptional circumstances, the Company may use up to 20% of the annual Insurance or Underwriting Surplus for participants' funds if there is actuarial justification for a percentage higher than 10%, as noted in paragraph (4), and after approval of the Shari'a Committee and the Authority*". This percentage is consistent with the best practice in Takaful sector and it is reasonable for shareholders as well as policyholders.

In its financial accounting standards FAS 13, issued in 2000 with an effective date in 2002, AAOIFI allowed shareholders to share the surplus with participants. However, this was revised in 2006 by the Sharia standard (26) of Islamic Insurance, article 5/5 which stated that the shareholders / management company are not entitled to any share of the surplus. The regulation which has been made by IA regulators is in contradiction with Sharia standards.

As discussed above, the acquisition cost which must be incorporated within the limited Wakala Fee is strongly criticized by business leaders. Allowing shareholders to benefit from the small percentage of surplus could reflect on a) balancing the paid commission and b) encouraging Takaful management to carry out a prudent underwriting practice. From a practical point of view, the incentive fee seems to be an advantage to the business but, in principle, it is inconsistent with Sharia compliance as shareholders are assumed to be fairly compensated through charging Wakala and Modaraba fees.

Having said that, and in case the policyholders' fund sustains loss / deficiency, Takaful operators shall not be in a position to balance the acquisition costs which disappoint their incentive enthusiasm to invest in Takaful business. Therefore, and from the author's point of view, that IA is encouraged to changeround and drop 1) the acquisition cost from Wakala fee and, if this is happened, 2) the allowable percentage of underwriting surplus. This will serve the business in terms of practice and Sharia Principle.

4.1.7-Application of Deficit

The provision of the free interest loan "Qard Hasan" is almost mandatory in all jurisdictions, such as the UAE, when the participants' fund sustains a deficit.

In accordance with the AAOIFI, FAS 13, there are many ways to cover the deficit:

The deficit might be settled from the reserve of participants, if any;

- Borrowing from the shareholders' funds with the possibility that the deficit could be paid back from future surpluses, if any;

- Calling back the participants to meet the deficit pro rata; and
- Increasing the future contributions of participants on a pro rata basis

However, it has been noted that there are many issues around the principle of Qard Hasan and these have been classified into the followings.

- **Takaful Risk Model**

Like mutual, Takaful is based on a risk sharing concept which means that the participants shall share the loss and surplus of a Takaful Fund. As far as Takaful Operators are obliged to provide Qard Hasan to cover any deficit that might be sustained, it seems that the concept of risk sharing is practically converted into a risk transfer model as in conventional insurance.

The Sharia Scholar (NY) confirmed that

> *"in the sense that the Qard is recoverable by the Shareholder, and then the principle of risk sharing is maintained as the recovered amount shall be borne by participants and deducted from any future surplus generated in the Participant account as the owner of the fund. If the Participant Risk Fund sustains continuous deficits and the loan is irrecoverable, then this model becomes very close to conventional one.* **(NY)**

The same view has been confirmed by (PS) who stated that

> ***"The concept of Qard Hasan is established in the purpose of: a) overcoming the main challenge Mutual faces in the hard times where the policyholders' fund is insufficient to cover its commitments / liabilities and b) encouraging shareholders / managers to carry out due diligence skills for managing the pool effectively in order to avoid any probability of deficiency".* (PS)**

However, Takaful stands in a mid-point between Mutual and Proprietary Models. If it is recoverable, then it is a risk sharing and if it is not, it is a risk transfer.

Conversely, (OA) confirmed

> ***"That Takaful participants are not requested to a premium call like mutual and therefore any liability is only borne by the shareholder, similar to conventional. For that reason, Takaful is undoubtedly becoming a risk transfer not a risk sharing one".*** **(OA)**

It is indeed a controversial point where Takaful is conceptually defined as risk sharing as mutual, providing a mandatory Qard Hasan is converting the model, in practice, to proprietary where the shareholders in the later is responsible to make good for any deficit sustained from the company's operation. Conversely, when the policyholders' fund generates surplus, they are entitled to receive a proportional part of that surplus on a pro rata basis. While the former case contradicts with the principle of risk sharing, the latter is supporting that principle. From the author's view, as it is obviously not a pure risk sharing model; it is undoubtedly not a risk transfer model. Instead, this practice is indeed converting Takaful business into a **Profit-Sharing Model** which could be introduced as a main feature / USP of Takaful operation to compete conventional counterparts.

- **Qard Hasan and Capital Solvency Requirement**

The question which must be addressed is, whether providing Qard Hasan shall affect the shareholders' capital solvency and whether participants are informed about that deficit?

(PS) highlighted a crucial issue that the value of the Qard is an artificial asset which is created in the books of the takaful company and it is helping the solvency. If the Qard is recoverable, the Capital is not touched as the Qard will appear in the shareholder book as receivable from policyholders and as payable in the policyholder's statement to shareholders without having a real asset against that loan in the financial statement. He has supported his statement by giving an example

> ***"For instance, if the company goes into liquidation, the value of the Qard shall be zero as no asset has been marked in the financial statement against this Qard. But undoubtedly, if the Qard is irrecoverable, then the minimum capital requirement is breached and the shareholders must inject the same value of the Qard in the capital".*** **(PS)**

However, if the solvency capital requirement is breached, then a plan must be addressed by Takaful management of how to correct such a breach. There is no regulation imposed on Takaful operators to inform policyholders of any deficit their fund sustains.

(OA) has raised an interesting issue regarding the way of booking Qard Hasan. He commented that

> ***"The solvency margin could be affected depending on the mathematical way of booking the provision of Qard Hasan. Some Takaful operators divided the loan into many years to be recouped while few of them are booking the full loan as a loss".*** **(OA)**

For example, if the company has a deficit in policyholders' fund of AED 50 million in 2019, the first group of companies will take a discounted provision of 20% this year assuming the loan will be recouped in a period of 5 years. What that means is; there is still a hidden liability of AED 40 million really truly unaccounted for. If the second year the same company have sustained another deficit of AED 50 million, that means the total liability on the shareholders becomes AED 90 million and this could affect adversely on the solvency margin and the company should be then monitored by regulators. For the second group which ADNTC is one of them, before accounting for any profit or loss at the end of 2019, the amount of AED 50 million will be allocated in full as a liability on shareholders' financial statement. If there is another AED 50 million deficit in the second year, it could be accounted for because there were no loans unaccounted from previous years. In this way, the solvency margin will not be affected. In other words, if the shareholders are requested to cover the full deficit in any moment during the second year, they are able to do so as the loan was already booked in their financial statement.

Anyway, he answered

> *"**All participants are informed about any deficit their account sustains. In fact, all stakeholders are informed quarterly through public financial results of Takaful companies which are required by the Insurance Authority"**.* **(OA)**

The regulator (AM) has responded that according to the Financial Regulations for Takaful Insurance Companies, Section 1, Article (2), item (11)

a) *"The Company shall document its Contingency Funding Plan, including the Qard Hasan facility submitted by the shareholders, to address how it will meet its current and future insurance liabilities in case it does not have adequate assets or liquidity of assets to honour its current and future insurance liabilities.*
b) *The Company shall address the events or circumstances identified in the Contingency Funding Plan.*
c) *The Contingency Funding Plan is an internal document that should be made available to the Authority upon request*".

Further, Section 4, Addendum, 7.d, Page (63) from the same resolution stated "*Qard Hasan shall be treated as receivable and considered as an unsecured and uncovered loan. It should be written off completely if it is not recouped within three (3) years. Each year's Qard Hasan should be considered separately*".

Seemingly, there are many methods, practiced in the UAE market, of booking the Qard Hasan in Takaful Company's financial statement. However, it is surprisingly noted that there is no specific regulation from the Insurance Authority other than the above general regulations regarding booking Qard Hasan. Obviously, there is a lack of a regulatory approach for unifying the method of booking the Qard Hasan. Further, the regulators have not made it compulsory for Takaful operators to inform participants about the status of their fund rather than what has been publicly announced in the financial statement of public companies.

- **The method of recouping Qard Hasan**

The manager (PS) has outlined that there are many categories of recouping Qard Hasan:

- ***"The first one is raising the price of the product"***. For example, if the Motor policy price is AED 120 for a specific model of car and it could be added AED 2 for recovering the Qard Hasan. The collected amount from all policies should be used to recoup the Qard. In this way, the factor of competition might be considered before doing so.
- ***"The second category is much broader and beyond product level, it is the total portfolio at the end of financial year"***. If there is any surplus, the management gives priority to recover the Qard and the remaining may be

distributed to policyholders or maintained as a contingency reserve. In SALAMA, for example, the BOD insists on distributing a percentage of surpluses into policyholders, not recouping the Qard in full, in order to attract more customers and ultimately underwrite more business.

However, the manager (OA) commented that

> "***There are different regulations worldwide of recouping Qard Hasan. Some of them state that it should be recouped for a certain period and should be written off if it is not recouped within that period, while others allow maintaining the Qard for as long as it remains unpaid".*** **(OA)**

In the UAE, for instance, the Qard should be written off within three years and that imposes a pressure on Takaful operators to adopt a prudent underwriting strategy and conservative investment policy.

The lawyer (PH) addressed that where a Takaful operator has provided Qard Hasan it may be recouped in a single year (assuming that the surplus in the following year is sufficient) or it may be spread over several years. If the period for repayment of Qard Hasan is specified in the Takaful documentation, then the Takaful operator may not demand repayment from the takaful fund prior to the expiration of the period. In the absence of such specification, Qard Hasan will be deemed to be recoverable upon demand.

In this aspect also, another issue has been discussed; particularly when some voices recently raised that the current method of recouping Qard Hasan seems to be unfair. Contributors who have incurred big losses or claims to the pool that led to deficiency will be the first party to leave the scheme and the new contributors for the next year will be penalised by repaying part of the outstanding Qard regardless of whether their contributions have generated surplus.

The manager (PS) pointed out that

> ***"The policyholders who brought claims which led to deficiency this year; they will probably bring profitable business to the pool in the next year and vice versa. So, it is not the matter of who brings the loss rather than how the underwriting policy is constructed".*** **(PS)**

For example, to mitigate losses, any insurance company will reinsure the risks and retain a portion according to what percentage their capacity allows. If the company insures many buildings with the different sum insured ranging from AED 10 M to AED 200 M, then it could be said that the first 10 M the company can retain and any loss above that should be reinsured. Therefore, if the building of AED 200 M is destroyed, the net loss of the company is only AED 10 M. The deficiency comes as a consequence of wrong estimation of probabilities. If two buildings are destroyed within the same financial year, then the company will be in a deficit of AED 10 M, because the expectation of losses as planned in the underwriting strategy was one loss of AED 10 M only. However, increasing the premium for the specific Insured who admitted the claim is the second mistake the company makes. Instead, the company may apply more restrictions to the policy and provide recommendations to improve the risk. Therefore, the policyholder will not leave and the persistency rate shall be maintained. In this case, the old and new policyholders will receive fair treatment.

The manager (OA) agreed that

> *"It should be allowed to reward those policyholders who contributed positively to the pool. Some form of returns or cash backs could be an encouraging advantage to keep their preventative measures of risks to a good level and they should not be penalized as a consequence of losses or deficiencies incurred by the management of bringing other bad business to the pool".* **(OA)**

However, Qard Hasan is a collective approach representing the total performance of the pool. It is not an ignorable fact that there is no obligation on Takaful Operator to offer individual rewards, but it is fair to do so. Another issue should be mentioned here that

> *"Qard Hasan is announced in financial statements which are available to the public and the participants know that they are not getting any surplus because the policyholders' fund was in deficit".* **(OA)**

In any case, as far as the shareholders are responsible to make good for that deficit, the participants have the full right to join or exit the pool without any liability upon their decision.

The lawyer (PH) highlighted an important fact, practiced in the market, as where the Takaful operator manages multiple Takaful funds, the Takaful documentation may provide that surplus from such Takaful funds will be applied to offset any deficit prior to Qard Hasan being provided. Such a provision can be controversial as it creates exposure for participants of one Takaful fund to the risks accruing of another Takaful fund, irrespective of whether such risks are comparable to those facing the participants.

From the Sharia point of view, the Sharia Scholar (NY) stated that

> *"The method of recovering the Qard is a technical matter. Once the fund is capable for recovering the loan in part or full, it is the management decision which defines the method".* **(NY)**

However, the regulators have already put in place some requirements / priorities to recoup the Qard and Takaful operators have to follow them.

Theoretically, and from the author's point of view, the concept of Qard Hasan has been found to be a mechanism of counterbalance to mitigate the conflict of interests between policyholders and shareholders. From regulatory perspectives, imposing Qard Hasan shall drive the management policy toward reducing the Wakala fee to a minimum reasonable percentage in order to achieve underwriting profitability and ultimately to avoid providing Qard Hasan to policyholders' fund. Practically, the Qard Hasan is appeared in the company's financial statement as merely accounting transaction without having any actual asset value. Therefore, the impact of deficit / Qard Hasan on shareholders account is negligible.

However, according to A.M. Best Market Review of 2018, this has been changed recently in some Middle East countries. In Bahrain, for instance, the regulators have imposed a regulatory requirement on Takaful operators to transfer assets to a policyholders' fund as a provision of Qard Hasan. The UAE Insurance Authority also requires Takaful operators to write off the Qard every three years if they fail to recoup it. These regulations have led to a positive achievement of Takaful business in these countries (A.M. Best Market Review, 2018).

4.1.8-Application of Surplus

Another critical issue has been discussed with a Sharia scholar regarding surplus distribution. AAOIFI (Item 5/5), IFSB (Guidance 70) and under IA Articles (25), the Takaful Operator may maintain a portion of surplus to form a contingency reserve to cover any future contingent circumstances. Having said that, the participants who generate surplus have no right to decide how this surplus should be distributed and shall ultimately bear the losses which might be brought to the pool by other new participants. As the main objective of Sharia is to achieve justice among participants, these standards and regulations become a matter of criticism. Before discussing this issue with the Sharia Scholar, it has been intended to consult the professional lawyer of how the existing regulations are dealing with such an issue.

(PH) stated that in the event that the takaful fund is successful and a surplus is generated, this surplus is shared between the participants. This creates a mutually beneficial arrangement for all participants. Historically, some takaful operators have sought to share in the surplus. This is not permitted. However, he stated that

> ***"There is relatively limited guidance available as to the detail of the arrangements for the distribution of surplus and the methodologies used vary between takaful operators and between different regions".*** **(PH)**

There are therefore variations as to which participants are deemed to be eligible to receive surplus. AAOIFI FAS 13 provides that there are a number of ways to allocate a surplus. The surplus may be paid to all participants who have paid their contributions to the takaful fund in a given period. Alternatively, surplus may be paid only to those participants who have not made a claim or, possibly, whose claim does not exceed the amount of the surplus to be returned. Typically, surplus is calculated once per financial year of operations and it may be distributed at such time. However, it is more common for the distribution of surplus to be undertaken on the anniversary of a policy. For long-tail business, it may be that surplus is paid into a separate account for distribution following the run-off of the policy liabilities. Over and above, the three board authorities have allowed the Takaful operator to retain part of the generated surplus as a contingent reserve to withstand any future uncertainties.

He also highlighted that "in the UAE and Bahrain, Takaful operators are to establish a policy governing the return of surplus. Similar requirements exist in relation to the QFC, where an operator is required to have a written policy for determining the surplus or deficit arising from its operations and the basis of distributing or transferring such surplus to shareholders or participants. Such policies should be approved by the operator's SSB".

The Sharia Scholar (NY) has commented on the above statement and brought the concept of mixed funds to justify the intention of these standards.

> *"Similar to Islamic banks, people reciprocally change, one person leaves the scheme and another person joins it. Every day and every moment, people are opening new accounts and others withdrawing their accounts. So, it is difficult to know the exact or precise account for every Tom, Dick and Harry".* **(NY)**

Building a reserve from surplus generated from investment, in Islamic banks, is based on mixed funds (Mukhalata) and waiver of rights (Mubara'a) which are a concept of Sharia principles. Mubara'a means that every participant accepts that whatever fund is deducted from his account for building a risk reserve, the next customer will benefit from it as he has already benefited from previous customers. He confirmed that

> *"For separate investment, it is easy to determine exactly what are the costs, loss and profit for each account but for a big pool, it will be impractical to determine those factors; otherwise, it is inevitable to establish rules of how entering or exiting the pool and what is the right for joining or exiting the scheme".* **(NY)**

The same principle is applicable to Takaful business as a mixed pool and participants have waived their rights, by a contract, toward other participants. However, it is true that the existing participant may suffer indirectly for building a reserve and not receiving a surplus, but on a long-term basis, it levels out.

From the author's point of view that the intention of these standards and insurance authority regulations is to protect the participants from any financial difficulties that Takaful Operators face; if the pool sustained huge losses in the future years which disabled the pool to cover liabilities incurred by participants and their claims might not be paid. In fact, these standards are helping shareholders more than policyholders. All other standards and regulations regarding Takaful business impose a strict obligation on shareholders to cover any deficit the policyholders' fund sustains. Therefore, instead of distributing surplus to policyholders whose funds generate surplus, these standards allow shareholders to maintain the surplus ahead for the next year. This will help them to avoid providing Qard Hasan in case of deficiency. One of the most advantages of Takaful over conventional insurance is the element of surplus distribution and if this surplus is distributed in the same year of generating it, many new participants will join the scheme in the next year and more contributions will be received. Furthermore, this will reflect positively on spreading the concept of Takaful among people through the simple marketing tool of "word of mouth". Ultimately the probability of deficiency becomes less, and the shareholders will receive a bigger Wakala fee. This is what happened for Takaful Malaysia STMB which has moved from a struggling position to one of the most successful operators through adopting new operational and strategic policy, i.e. branding the company as a Takaful operator for all Malaysians, whether Muslims or Non-Muslims and distributing a 15% surplus consistently to participants (CII Text Book, 590 Principles of Takaful, 2017).

For practical comparison, conventional insurance companies nowadays are practicing what is called “No Claim Bonus”. This allows cash return to policyholders or reduction in premium during renewal stage as a bonus if any policyholder does not incur loss / submit a claim during the insurance period. Further, they have adopted another attractive point for big accounts or important customers to return back a percentage of premiums if the loss ratio is less than an agreed percentage. So, the shareholders will bear claim losses of policyholders and reward those who have admitted no claim during insurance periods. This practice is definitely becoming more advantageous to conventional over Takaful business. Similarly, Takaful operators have adopted these attraction points exactly, as conventional insurance which is reflected on perceiving Takaful as similar to conventional.

4.1.9-Conventional Reinsurance’ Perspective

Practically, the majority of reinsurance contracts of Takaful business are placed with conventional reinsurers due to insufficient capacity / lack of rated Retakaful. Also, there are several implications raised by many researches of using conventional reinsurance (Rahman, Ahmad and BUANG, 2011), (Rahman, 2009), (CII Text Book, 590, 2017), (Serap, 2013) and others. However, it is intended to examine whether the shortage of Retakaful capacity is a material fact for using conventional reinsurance. Therefore, this issue along with its implications has been discussed with a Sharia Scholar and business managers, as outlined below.

- **Shortage of Rateable Retakaful**

The shortage of rated Re-Takaful operators has seemingly brought to regulators and scholars’ attention to find out alternative options by allowing temporarily using conventional reinsurance with some regulatory and Shariah restrictions.

The professional lawyer (PH) is skeptical about this statement given that two specialist Retakaful carriers in the UAE (DIFC) have closed recently plus there is very heavy dependence on conventional reinsurance which will only change if Islamic scholars insist on the use of specialist Retakaful support.

Contrariwise, the manager (PS) admitted that the conventional reinsurance support is enough to satisfy business requirements and the best reinsurers worldwide such as Munich Re and Swiss Re are providing Retakaful support through their Takaful windows. Looking from this point, the business has not been affected. However, “having a shortage of rateable Retakaful in the world will prevent marketing Takaful business as 100% Sharia Compliant insurance which shall affect adversely on customers’ perception particularly when huge corporate entities require disclosure of the reinsurance panel”. So that becomes quite a challenge.

It has been commented by (OA) that the main concern for Takaful operations is to protect the policyholders as well as shareholders. In fact, there is insufficient reinsurance market for Takaful to cater for full takaful needs. However, it still gives preference to Retakaful companies provided that they are strong and rated. The most important factor for any insurance company, rather than rating, is the financial strength and capital adequacy of the Reinsurance company whether Takaful or Non-Takaful. If the business is placed with Retakaful company which is neither rated nor financially strong and many claims have been admitted by a Takaful operator, then it is a huge risk if the Retakaful is unable to honour its commitment and pay back its share of claims. The question which shall come to the front is how the policyholders are compensated and/or What the benefit Takaful operator brings to the industry by using Retakaful operators? So, having a shortage of rated Retakaful, forces Takaful operators to place the majority of business with conventional Reinsurers.

From a Reinsurance point of view, the manager of international Reinsurer (MAS) has addressed the point that the Internationally rated Reinsurers have attempted to provide capacity to Takaful business through initially opening windows, for example in Labuan, Bahrain, UK and other parts of the world, want to find out whether Takaful business is profitable and satisfying customers' needs prior to establishing a Retakaful Operator. Apparently, due to regulatory issue, Sharia requirements, providing Qard Hasan and distributing surplus make Retakaful costly and less competitive than conventional and as the Sharia and regulators allow takaful operators to use conventional, for necessities, this has had an adverse effect on the flourishing and prosperity of Retakaful business.

The Shariah scholar (NY) has argued the last point that allowing Takaful operators to use conventional reinsurance is coming from the principle of "dire needs" which is preferable to use rather than "necessities".

> ***"Historically, reinsurance companies had been established after many years of existing insurance companies due to the need of a larger capacity and a spreading out of the risk into different geographical areas. Building a rated reinsurance company has taken decades to be recognized. The same scenario is applicable to Retakaful in our approach".*** **(NY)**

Further, the Sharia scholars have made certain restrictions on the contract used with conventional reinsurance in order to avoid any prohibited element that might arise during technical operation. However, the scholar agreed that the unique features of Takaful business require, as soon as practicable, establishing a strong and rated Retakaful to satisfy the requirement of Takaful business chain.

Further aspects have been discussed with a Sharia Scholar regarding the Retakaful issue. Under AAOIFI shariah standard 41, *Islamic insurance companies should stick to the minimum size of reinsurance with traditional reinsurance companies, and Sharia Boards should undertake follow-up in this connection*. It could be claimed that this tolerance has an adverse impact on the keenness of establishing Retakaful Operators. If this tolerance is not allowable, what are the consequences on takaful business?

(NY) has addressed that allowing conventional reinsurance as a restricted alternative option was a pragmatic decision or salutation to the fact that there are no strong Retakaful companies existing in the market. Sharia scholars have allowed this option temporarily, based on the principle of "dire need", until the time that Retakaful companies are strong enough and have a capacity to support Takaful business all over the world. On the other hand, the regulators in the UAE market, and maybe in almost all countries, require insurance companies to deal with rated reinsurance companies in order to maintain a stable local market. Following the same, Takaful operators will be left without reinsurance support as there is no rated Retakaful company to meet these requirements. Establishing a strong Retakaful requires a huge capital and seemingly there is no one who is encouraged to invest in Retakaful business. Therefore, it was recommendable to establish a joint venture with the existing strong reinsurance companies, like Lloyds for instance, and try to reach a Sharia solution for that arrangement. Alternatively, the existing Takaful operators can cooperate with each other and establish among themselves a strong Retakaful company. Conversely, Takaful operators are competing with each other, similar to their traditional rivals. This is the main reason that the world does not have a rated Retakaful company or companies in different places in the world. So, Sharia scholars are always trying to find practical solutions for business operation, but the lack of practical research on this aspect needs to be reinventing the wheel.

- **Reinsurance Recovered Money**

As noticed from the literature, AAOIFI standards allowed the recovered money of claims from the conventional reinsurer to be deposited into the Participants' account. It has been claimed that the money which is coming from conventional reinsurers is most probably impure as the source of this money is not Sharia compliant.

The Sharia scholar (NY) pointed out that

> *"**As far as the conventional reinsurance has been allowed by Sharia for the reason of "dire needs", the money which comes from reinsurers to cover their shares of paid claims incurred by Takaful operator is permissible".*** **(NY)**

For example, if somebody is buying a car or leasing a house, as far as the contract of sale or lease is halal and legally recognized, the buyer is not breaching the Sharia law if the owner has bought the car from impermissible resources, unless he is aware of this issue before buying it. In the same scenario, a conventional reinsurance contract has been modified to meet Islamic Financial transactions and it is assumed that their sources of money are Halal.

- **Reinsurance Commission**

Surprisingly, and under AAOIFI Sharia Standards also, it is permissible to deposit the recovered money for paid claims from traditional reinsurers, but it is impermissible to do so for reinsurance commission and profit distribution, into policyholders' account. The author has observed a crucial contradiction between these standards.

The Sharia scholar (NY) has commented that, technically, Reinsurers are giving insurance companies / Takaful operators a commission as an incentive to encourage them while placing their business with these Reinsurers and the insurance companies / Takaful operators in this case become an agent / broker for the Reinsurers.

> *"**As far as there is no "dire needs" for this commission, the Sharia scholars decided that this money should not be deposited into the policyholders Fund and instead the Takaful operators must cede only the net contribution to Reinsurers"*** (Gross contribution – Reinsurance commission). **(NY)**

- **Reinsurance Profit Sharing**

According to IFSB 18 “the Reinsurance profit commission is an incentive award given to a Takaful Operator for the good management performance of the business that is ceded”. AAOIFI confirmed that this commission must be deposited into the policyholders’ account if received from a Retakaful operator. It is arguable that as participants are not involved with risk management practice, then this profit sharing, technically, should be deposited into the shareholders’ account.

The Sharia scholar pointed out that

> *“The regulators in different jurisdictions have adopted this guideline, but from the Sharia point of view there is no harm to share with shareholders or even deposit the full profit sharing into their account”.* **(NY)**

Therefore, this is not based on sharia principle but rather preferable practice.

Having noticed that, the same issue has been discussed with operational managers of Takaful business.

The manager of Reinsurance (MAS) has confirmed that

> *“Profit sharing should be shared with shareholders and could be constructed on a layer basis. For instance, the profit coming from the first layer shall not be shared with the shareholders, but from the second layer the shareholders could share 10% of profit, the third layer 50% and so on”.* **(MAS)**

This profit is a crucial incentive to Takaful operators for managing the risk effectively and efficiently and encouraging them to select good risks through adopting a conservative and prudential underwriting policy.

In contrast, the manager (PS) has surprisingly pointed out that

> *“As far as the shareholders are already remunerated for managing the pool through charging a Wakala fee, they are principally not entitled to share profit commission”.* **(PS)**

However, regardless of the fact that the regulators in the UAE have imposed on the shareholders to bear the acquisition costs within the restricted Wakala fee, this money, by principle, belongs to the policyholders as a return on their fund which was placed with a particular reinsurer and should be deposited in their account.

In a different practical approach, the manager (OA) highlighted a very important factor which has not been earlier addressed. He stated that the Reinsurance profit sharing in Retakaful is entirely different in conventional reinsurance which is called surplus distribution. This is sometimes working against the good operating company. He continued

> *“For example, if many Takaful operators are insuring risks with the same Retakaful company, regardless of whether some of them brought a good business to the pool, and others brought loss-making businesses which make the pool collectively in deficit, the Retakaful will not distribute any surplus to all of the Takaful operators. This will frustrate the good company who works very hard to provide a Retakaful pool with quality*

> ***business and look to some surplus in return; instead, the company will be judged on the performance of the pool collectively. While in the conventional Reinsurance, the profit sharing applies on a one-to-one basis".*** **(OA)**

For instance, the Reinsurer A is insuring companies B, C, D and E. If B brought profitable business to reinsurer A, they will be entitled on their own merit to get a form of profit sharing or any type of incentives regardless of whether C, D and E brought losing business to that reinsurance. So, there is no collective approach of the pool like Retakaful. Conventional Reinsurers deal with each Cedant on its merits and the value they bring to the reinsurance pool. Therefore, good Takaful companies will be at a disadvantage by generating profit sharing or overriding commission by giving good performing accounts to reinsurer because they go on a single pool side rather than a client's side. (OA) concluded that

> ***"In addition to the shortage of rated Retakaful, this may lead Takaful operators preferring to deal with conventional Reinsurers other than Retakaful operators".*** **(OA)**

However, by regulations, all reinsurance commission or profit sharing received goes to the policyholders' fund; but unexpectedly all commissions paid out are being imposed on shareholders while it should go to the same place. This has created an imbalance between commissions paid and commissions received.

In fact, there is a shortage of rated Retakaful in the world and "A" rated Retakaful companies are rare or even non-existent. The highest rating Retakaful companies by A.M. Best are Emirate Retakaful and ACR Re Takaful with B++ (Good) and Takaful Re with BBB.

The report of HBMSU (2016), which has been conducted by academic and business practitioners, highlighted that the total Takaful premium ceded to Retakaful was estimated between USD 0.6 to USD 1 billion which represents 7% only of global Takaful written premium in 2014. Typically, 30% to 50% of General primary insurance would be ceded into reinsurers depending, of course, on the type and appetite of risk. Having established a considerable number of new Retakaful during the last 10 years, the global Retakaful capacity has increased to reach roughly USD 2.5 billion. This allows 33% of primary Takaful premium to be ceded to Retakaful, assuming that 50% of general Takaful premium of USD 15.1 billion (USD 7.5 billion) will be ceded into Retakaful. It is clearly demonstrated that primary Takaful failed to utilize the available capacity of Retakaful (HBMSU, 2016). Therefore, the statement announced by Takaful managers that there is a shortage of Retakaful capacity is seemingly an insufficient excuse.

The report concluded that the primary Takaful operators have plausibly preferred to conclude reinsurance treaties with conventional reinsurers; probably due to the large capital, actuarial and underwriting skills, financial stability, branding recognitions, diversification of risks and geographical widespread they have and also, historically they have been existing much longer than Retakaful.

This conclusion is in line with other statistical reports who addressed the same issue about Retakaful. Indeed, these factors are important for Takaful managers to decide where the business shall be placed / reinsured; but the most important one, addressed by the manager (OA), is advertently ignored. This point is crucial, as none of the secondary resources have been outlined before and it explains the reason behind the reduced numbers of Retakaful operators worldwide, as addressed above. According to Badri Report of 2018, 4 out of 8 listed Takaful operators in the UAE market sustained a deficit. If all of these companies have placed their business in one Retakaful, the other successful companies who have generated a profit will receive no profit sharing as the pool collectively sustained a loss. Profit sharing is an essential income to policyholders' pool which helps in having a sufficient fund to cover part of the liabilities and commitment of the pool. This may ultimately avoid deficiency and the shareholder therefore will escape from providing a compulsory Qard Hasan. So, from a financial point of view, it is more beneficial for Takaful operator to use conventional reinsurance.

Having addressed that, the collective surplus distribution of Retakaful should be revisited by Sharia scholars, regulators as well as business leaders to find out a solution similar to the way of profit sharing of conventional reinsurance that each Takaful operator should be considered by its own merits and whether its ceded business is profitable or bringing losses. However, the method of distributing surplus available for Takaful operators are the same as those applicable to Retakaful operators. For instance, instead of distributing surplus to all participants (cedants) or based on their loss ratio, the surplus should be distributed to cedants that have generated profits.

To conclude, it has been noted from literature that Sharia scholars have adopted what is called "conditional donation" in order to overcome challenges relating to the concept of Tabarru. However, this shall, in reality, create a consideration between the participant and the pool that is the participant will contribute to the pool by means of donation subject to receiving financial aid once he sustains a loss. Again, the subject pool has no legal personality and therefore the consideration is transferred, by agency contract, to a Takaful operator who manages this relationship in exchange of a fixed Wakala fee.

Also, using the same policy wording similar to the conventional has supported the lack of differentiation between conventional and Takaful insurance in the market in general and among the public in particular.

In respect of Takaful operational models, it can be established that the most practicable and commercial intensive model to be adopted by Takaful operators is the hybrid model of Wakala / Modaraba which has been supported by Sharia Scholars as well as regulators alike.

Regardless of the current regulation in respect of acquisition cost, which is inconsistent with AAOIFI standards, this regulation has a crucial negative impact on the Takaful industry in the UAE market. Furthermore, implications of such regulation have been addressed in the coming Performance Section of this chapter.

What has been raised by the lawyer is very critical as Takaful operators may use the surplus of Fire insurance class to cover the deficit from an engineering one which is unfair for policyholders of fire insurance. While the segregation funds of life and general insurance is adequately regulated, there is no single regulation to manage this issue within the same fund.

Furthermore, allowing Takaful operators to utilize conventional reinsurance capacity along with relevant Sharia standards regarding the above issues should be re-reviewed by Sharia scholars and the involvement of regulators as well as Retakaful managers is inevitable.

4.2- Section (2): Takaful Performance in the UAE (Facts and Figures)

This section is designed to determine whether Takaful business is statistically performing as a viable and practicable option compared with conventional insurance in the global as well as local markets. In order to achieve the benefit behind this objective, the following areas have been examined thoroughly and systematically.

- For critical analysis, it is imperatively important to trace the performance of Takaful business as a part of the global Islamic Financial service industry (IFSI) in its original markets as well as different submarkets around the globe
- Examining the global overall results of Takaful business
- Reviewing the overall insurance business in the GCC in general and Takaful business in particular
- Reviewing the annual performance of the insurance industry in the UAE and focusing on the Takaful sector

Then, a critical analysis has been carried out based on primary and secondary gathered data as well as the author’s experience in the UAE insurance market, particularly in Takaful business.

4.2.1-Islamic Financial Services Industry IFSI

In 2019, the Islamic Financial Services (banking, capital markets and Takaful) has recorded a growth of 11.4% on a y-o-y basis and achieved an amount of USD 2.44 trillion comparing with USD 2.19 trillion in 2018 as shown in the table (8) below.

Table (8) – Performance of Islamic Financial Service Industry in 2019 among regions

USD Billion

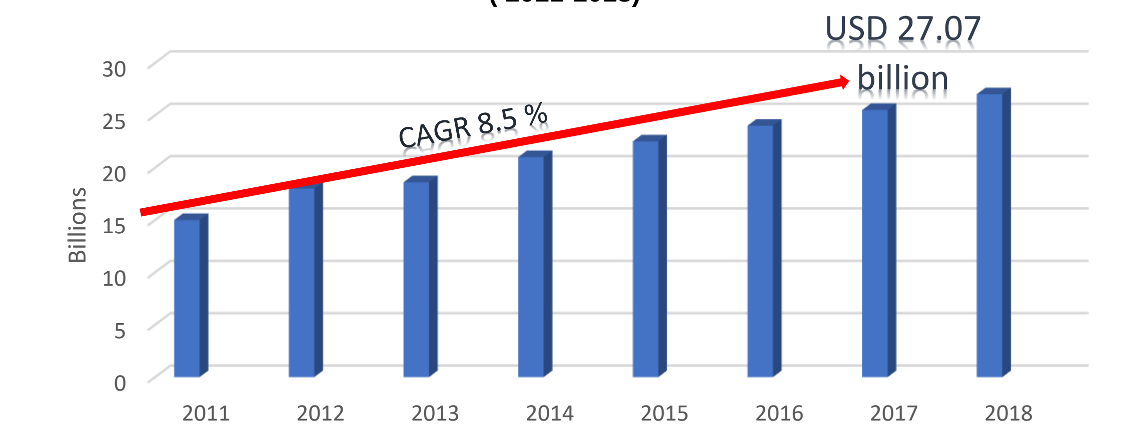
Region	Banking Assets	Sukuk Outstanding	Islamic Funds Assets	Takaful Contribution	Total	Share
GCC	854	204.5	36.4	11.70	1,106.6	**45.4%**
South-East Asia	240.5	303.3	26.7	3.02	573.5	**23.5%**
MESA	584.3	19.1	16.5	11.36	631.3	**25.9%**
Africa	33.9	1.8	1.6	0.55	37.9	**1.6%**
Others	53.1	14.7	21.1	0.44	89.3	**3.7%**
Total	1,765.8	543.4	102.3	27.07	2,438.6	**100%**
Share	**72.4%**	**22.3%**	**4.2%**	**1.1%**	**100%**	

Source: ISLAMIC FINANCIAL SERVICES INDUSTRY STABILITY REPORT 2020

Regardless that the global Islamic banking sector is the largest segment of IFSI, it has reported a continuous decline in its global share for the last three years which recorded 72.4% comparing with 76% in 2018. Equally, Takaful industry is forming the lowest global share of IFSI and it has also been confronted with the same decline scenario by recording 1.1% at the end of 2018, decreasing from 1.3% reported in 2017.

Nevertheless, Takaful business has witnessed a CAGR of 8.5% over the period of 2011 and 2018 but is still facing potential obstacles with a significant concentration of the business in few regions, particularly in the general line of business. The graph 2 below refers.

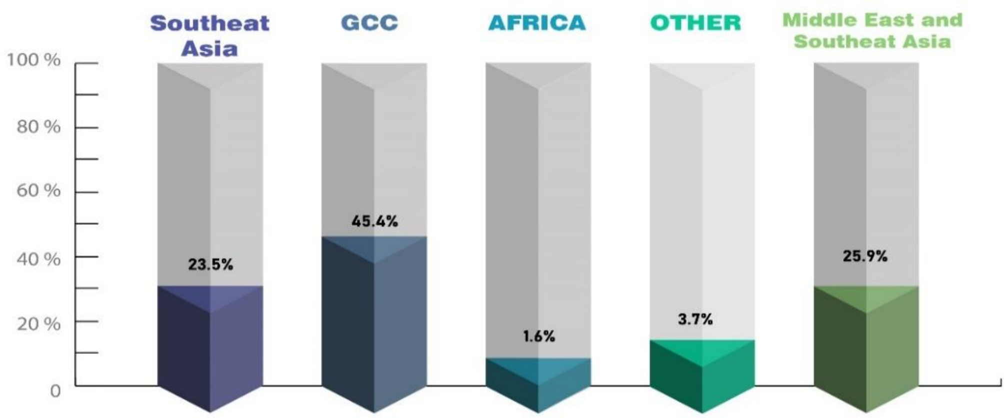
Graph 2 -Trend of Global Takaful Contributions (2011-2018)



Source: IFSB 2019

Regionally, GCC is still the largest market for the Islamic Financial Industry with a global Islamic banking asset of 45.4% in 2019 followed by MESA and South-East Asian regions with 25.9% and 23.5% respectively. Africa is ranking the least with 1.6% share of global IFSI assets, as shown in the graph 3 below (IFSI Report, 2019).

Graph (3) - Breakdown of IFSI by Region (2019)



4.2.2- Global Takaful Business

Despite the fact that Takaful business has witnessed a remarkable global growth; it has accounted USD 21.2 billion in 2014 which forming 0.4% of global Gross Written Premium (USD 4.77 trillion) of insurance industry (1.23% of IFSI). The revenue growth in MENA and GCC region is influenced by general business while Family Takaful forms a small share. Motor, Property and General Accident products account for 30% to 50% of gross contribution compared with less than 15% for engineering, Marine and aviation lines. This is understandable because these products require sophisticated underwriting skills and huge capital capacity to afford for where Takaful operators are having a shortage of both. However, Medical insurance becomes a dominant line from the beginning of 2011 in the GCC as it becomes mandatory, particularly in Saudi Arabia and UAE where both countries estimated a double consecutive growth during the last 6 years in these countries (HBRSU, 2016).

According to the Milliman Report of 2017, the global Takaful contribution in 2015 was estimated at USD 14.9 billion with a double-digit growth rate of 14% whereas General Takaful representing 83% of generated contribution and 17% only for Family Takaful. It has been affirmed by the report that this data was collected for the main Takaful markets (GCC, FEA, Africa and other countries) and by published statistical information. For instance, the Iranian market which is one of the largest markets for Takaful is excluded from this report. The Table (9) below refers.

Table (9) - The Performance of the General and Family Takaful business in 2015

USD Billion

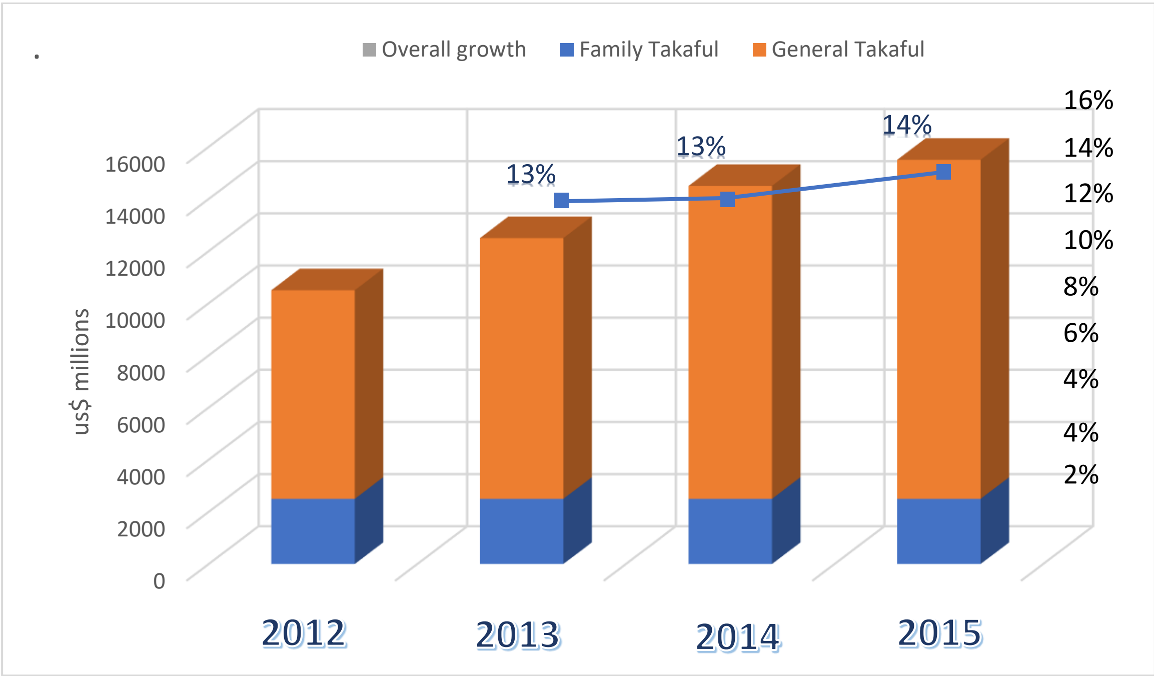
Sector	Market Share	Estimated Revenues	Growth Rate
General Takaful	83%	12.3	17%
Family Takaful	17%	2.6	(1) %
Total Takaful	100%	14.9	14%

Source: Milliman Report of 2017

The GCC markets maintained a compound annual growth rate of 18% between 2012 and 2015 while the South East Asia markets witnessed a 4% decrease of CAGR due to a significant depreciation of local currencies relative to USD during the current years. In the local markets, the SEA has demonstrated a positive growth in local currency terms. However, Africa has recorded the highest growth rate with 19% of CAGR during the same period. Taking into account the large uninsured population in Africa, Takaful may find a potential opportunity to grow and expand.

The graph 4 below indicates a considerable overall growth in the global Takaful market with 13% of CAGR between 2012 and 2015. General Takaful is still prevailing forming a potential growth of 17% while Family Takaful recording 1% from total contribution in 2015 (Milliman Report, 2017).

Graph (4) – Overall Growth of global Takaful Market (2012 – 2015)



GWC: 10,363 11,578 13,083 14,879

Source: Milliman Report (2017)

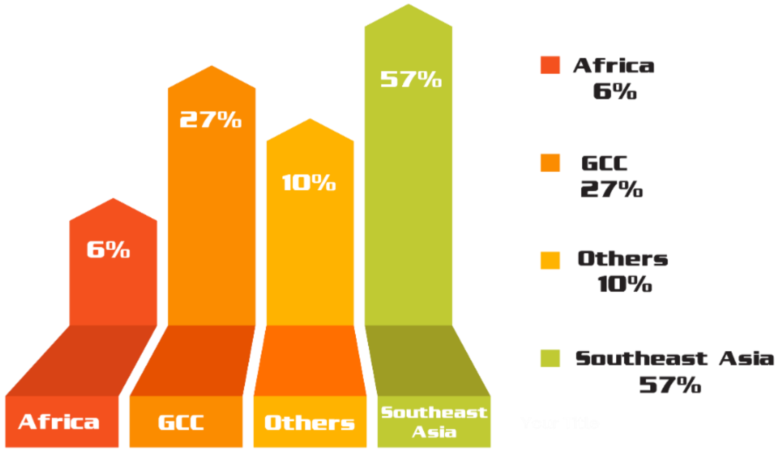
Regionally, GCC Takaful market is showing the highest CAGR compared to other markets in 2012-2015 and its growth is largely driven by General Takaful. Also, it demonstrates the highest global market share with 77% followed by South East Asia, Africa and other remaining countries at 15%, 5% and 3% respectively. Saudi Arabia is the largest market of Sharia Compliance worldwide while the UAE exhibited a strongest growth of 32% in 2015 in terms of General and Family Takaful.

In 2015, the Gross Written Contribution in the South East Asia reached USD 2.2 billion recording a 12% growth rate. Malaysia is the largest market for Takaful in the region forming 62% of the market share followed by Indonesia at 33% for the same year. Regardless the depreciation in the currency relative to USD, Malaysia and Indonesia are still achieved a positive growth of 5% and 3% respectively in the year of 2015.

1) <u>Family Takaful</u>

As shown in the chart (5) below, South East Asia has achieved 57% of the global Family Takaful market share with Gross Written Contribution of USD 1.5 billion in 2015 while the GCC region recorded a 27% only with USD 0.7 billion in the same year. However, despite the fact that the South East Asia recorded a CAGR of 4%, the GCC region demonstrated a higher CAGR of 13% for Family Takaful in the same period. In Africa, the Takaful industry was recently introduced but the highest CAGR of 22% has been recorded in this market with GWC of USD 0.2 billion in 2015. The underpenetrated market of Africa opens the door for significant opportunity to develop Family Takaful as well as General business in these countries. The remaining countries such as Turkey, Pakistan and Bangladesh recorded an aggregate GWC of USD 0.3 billion with 11% CAGR for the year of 2012-2015.

Chart 5 – GWC of Family Takaful by Key Regions in 2015



Source: Milliman Report (2017)

Country wide, Malaysia is still the largest market for family Takaful worldwide which has alone a share of 33% of the market with a GWC of USD 0.8 billion in 2015. Indonesia is the second market in the South East Asia with an estimated GWC of USD 0.6 billion in the same year.

In the GCC, Saudi Arabia is the largest market of Family Takaful with a GWC of USD 0.28 billion followed by the UAE with a GWC of USD 0.27 billion in 2015. It has been recorded that the UAE demonstrates the strongest growth in the market as a result of introducing a compulsory health insurance in Dubai.

The low market share of Family Takaful in the GCC comparing with SEA is a matter that attracted the researcher's attention who has attempted to understand the reasons behind that through a critical discussion with business leaders in the market.

The manager (PS) pointed out that

> ***"One of these reasons is the majority of population in the Far East Asia is locals who are indigenous to their countries. That means they are looking to save money, secure their elders and children and invest for future returns. While the majority of population in the GCC are expats, So, their propensity to invest and save money through long-term security is not a matter of attraction due to the simple fact that their residency in these countries is unstable and they may easily move out or return back to their homes".*** **(PS)**

Further, the regulations impose restrictions on older people who are over 60 years old and wish to stay in these countries. Therefore, pension / retirement life insurance product does not even exist for them in the market.

On the other hand, he continued

> "***Distribution channels of life products in Far East Asia do not cost the insurance companies other than paid commission. Any one individual can be an agent for life insurance and selling life products in a commission basis. This somehow, could cover their expenditure which is considered enough for the majority of local people. Conversely, distribution channels in the GCC are costly because the commission plan does not cover life expenses for life agents who need to pay for rent which represent a considerable percentage of their income".*** **(PS)**

So, a minimum salary in addition to commission will be workable but that makes life products expensive and not cost attractive. Nowadays, part-time working is allowed in the UAE and this will encourage individuals to be life agents, in addition to their main jobs, on a commission basis which shall reflect on the price and increase selling life products.

Also, in the GCC, initiatives are made for the expatriate population to remain in the country where they are currently living. For example, the UAE have taken a lot of initiatives to attract people, particularly businessmen and experts, by given long-term residency visas. Therefore, this will increase the tendency to buy life insurance. Another aspect is relating to the local population.

> ***"For instance, the local population in the UAE has a lot of safety nets. So, their health insurance is free and the retirement benefits are endless and therefore they do not need even looking to life products which have been designed for those purposes. But in the Far East, people are self-employed, self-working, private sector employees who basically save for their old ages and for their benefits"*. (PS)**

There are quite different dynamics of the population between these two samples which make, in fact, a big difference for life insurance.

The manager (OA) confirmed the fact that

> "***Family takaful in the market of South East Asia, particularly in Malaysia, is performing very well due to many factors. First, the majority of the population are locals and secondly the insurance penetration rate in SEA is much more than in the Middle East in general and in the GCC in particular where both factors are playing crucial roles in life insurance".*** **(OA)**

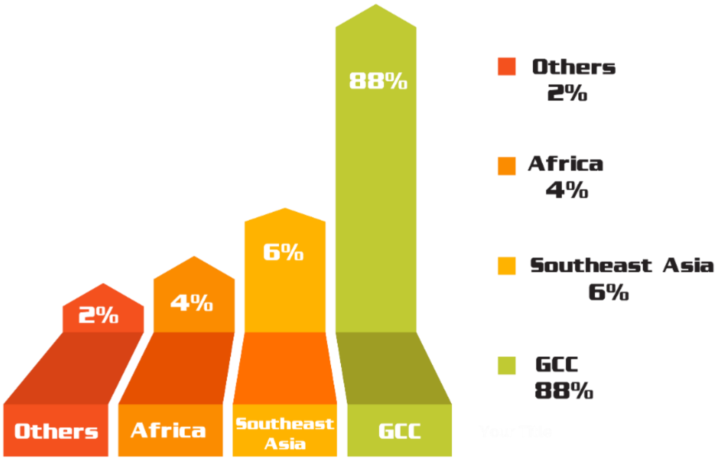
2) <u>General Takaful</u>

In respect of a General Takaful, the chart (6) below is clearly demonstrating that GCC is leading the global market with 88% of GWC in 2015 and is demonstrating the highest CAGR of 19% between 2012 and 2015. While South East Asia and the remaining countries have recorded a growth of 3% and 2% respectively in terms of CAGR for the same period. Surprisingly, Africa achieved a double-digit growth in respect of General Takaful with a CAGR of 18% over the period 2012 to 2015 (Milliman Report, 2017). With a significant number of uninsured populations, particularly Muslims, Africa is again representing a potential market with a remarkable opportunity for general Takaful to grow and expand.

In the GCC region, Saudi Arabia remains the largest market for general Takaful and representing 88% of overall market, followed by UAE at 6% in 2015. Both markets have demonstrated the strongest growth estimated at 20% and 19% of GWC, respectively.

Within South East Asia, Malaysia has the largest general Takaful market share at 70% with a growth of 6%, while Indonesia has exhibited a higher positive growth of 22% in 2015, in local currency terms.

Chart 6 - GWC of General Takaful by Key Regions in 2015 (US$)



Source: Milliman Report (2017)

As per the Ernest & Young report for 2017, general Takaful is dominating in GCC countries while Far East Asia continues to dominate life Takaful. This is an important factor that affects the growth of the business in the region and the reasons behind that have been discussed with business leaders of Takaful operators in the UAE. The table (10) below shows the percentage of general and family Takaful in the Middle East and Malaysia.

Table (10) - Portfolio Composition (2016)

	General Takaful	**Family Takaful**
Middle East	76	24
Malaysia	31	69

A.M. Best. Market Review, 14 May 2018

Global Number of Takaful Operators and Windows

Since 1980, the number of Takaful players has been increased from a few players to 58 by 2003. A significant increase, afterwards, witnessed a reach of 269 players in 44 countries around the world as of 2015 (HBMSU, 2015). Conversely, 11 players were closed / merged during the same period. Table (11) below illustrates the Global Takaful Growth in Numbers by Type of Institution between 2012 and 2015.

Table (11) - Number of Takaful Operators

	2012	2015
Total Active Takaful	238	258
Pure Takaful	129	139
Cooperatives	62	64
Takaful Windows	25	20
Re-Takaful and Windows	22	35

Source: HBMSU, (2015)

However, when tracing the number of Takaful operators in the different markets, it has been noted that the number dramatically increased, particularly in the MENA region, as shown in the table (12) below.

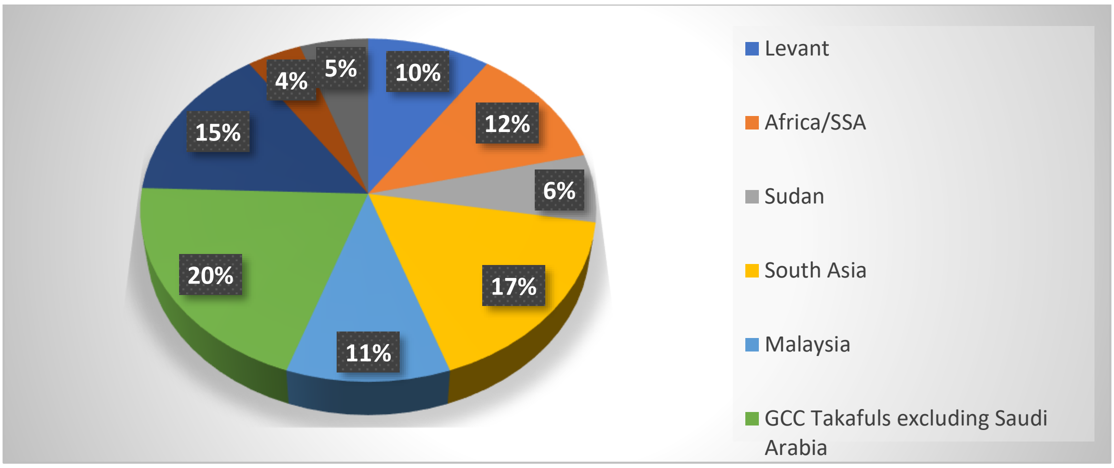
Table (12) - Takaful Expansion - Geographically

Region	2003	2015	Change
Indian Sub-Continent and Near Asia	1	15	14
North Africa and Levant	13	68	55
Asian and Pacific	13	66	53
GCC	17	88	71
Iran	11	14	3
Others- EU / Trinidad /Turkey / Kazakhstan / Yemen / USA	3	9	6
Total	58	260	202

Source: HBMSU, (2015)

As addressed in the literature, the cooperative model, which differs from the Takaful model, is mainly adopted by Saudi Arabia and the number of cooperatives was segregated, as illustrated in the below pie-chart (7).

Chart 7 – Number of Takaful and cooperative operators in 2015



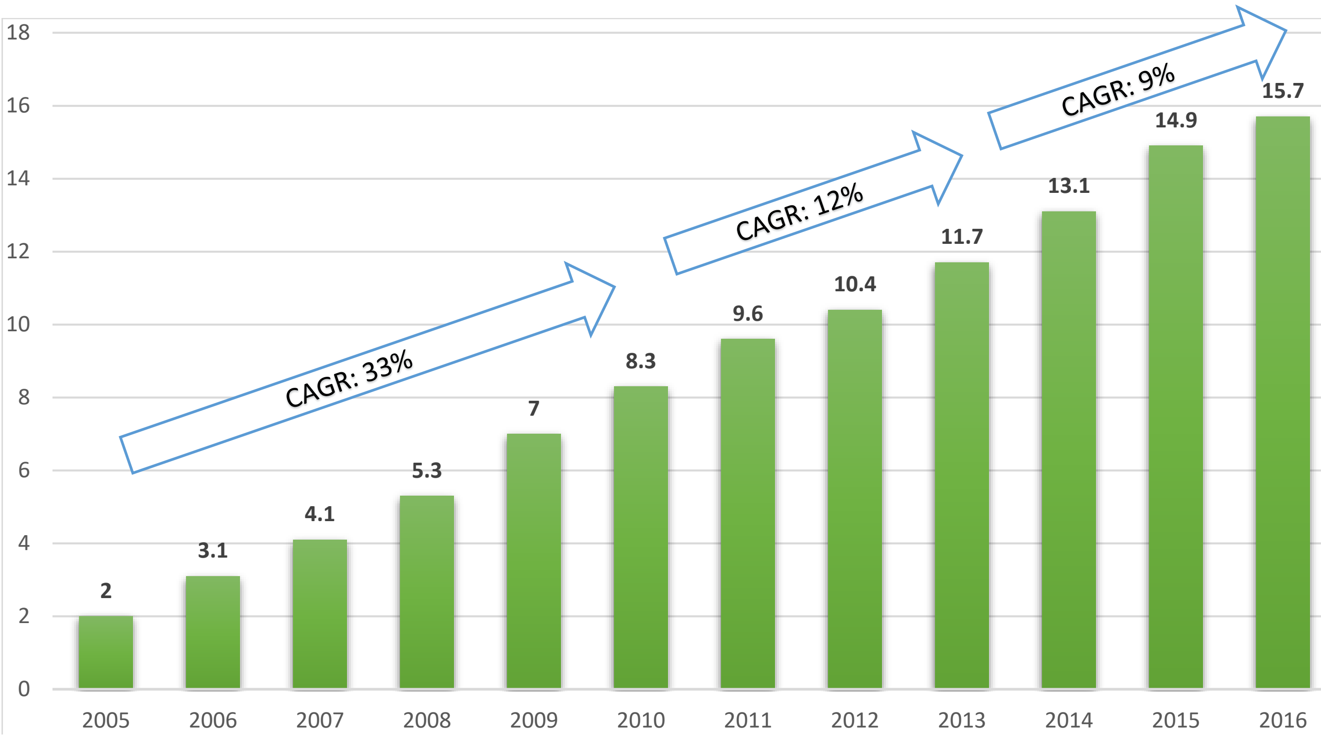
SOURCE HBMSU-2015

It can be noticed that in the first two decades of operation since 1983, there were 58 Takaful operators set up in 21 countries, while the next 12 years witnessed an increase of more than 200 new Takaful companies formed in 23 countries. The global average time of operation for a sample of 259 Takaful players is estimated at almost 11 years. This illustrated that the whole takaful industry is quite youthful comparing it with conventional players who have been existing for more than 300 years (HBMSU, 2015).

According to the IFSB survey conducted in 2019 and to the Global Takaful Directory of 2019, the number of Takaful entities, including Takaful windows within conventional and Re-Takaful, reached 353 operating in almost 33 countries worldwide, particularly in the GCC, MESA and SEA regions. MESA contains 114, which is the largest number of Takaful institutions, followed by SEA and GCC with 106 and 79, respectively. The number of fully-fledged Takaful operators is 222 with 88 windows, while the number of Re-Takaful Operators is 15 along with 28 windows.

The increased number of Takaful insurance operators is an indication that the business is spreading and finding its way into other markets, most particularly Africa. However, the trend was slowed down in 2019 when comparing it with the period between 2003 and 2015. As shown above, the business is seemingly having some difficulties with entering the EU and USA, Non-Muslim countries, and the reasons behind that have been discussed in the next chapter. In addition to that, Milliman's Global Takaful Report of 2017 traced the Compound Annual Growth Rate between 2005 and 2017 and noticed that the CAGR dropped significantly from 33% to 9% respectively, as shown in the below chart (8) (Milliman Report, 2019).

Chart 8 – CAGR between 2005 and 2017



Source: Milliman Report (2019)

4.2.3-Overview of GCC Insurance Business

According to Alpen Capital Report of 2017, the GWP achieved in the GCC markets reached USD 26.2 billion in 2016 where USD 22.9 billion of the total written premiums was generated from general insurance business (Non-Life Insurance), forming 87.6% of the market share. The CAGR recorded 12.4% from 2011 driven by the expansion of Motor and Medical insurance which form more than 70% of the general insurance premium. The life insurance is a small piece of total generated premium in the GCC due to many factors; the social welfare scheme provided by the states for nationals and low cultural awareness of life insurance in the region. Life insurance therefore is restricted, mainly, amongst expatriates who are familiar with the concept from their original countries. Increasing the number of expatriates in the GCC has led the business to grow at a CAGR of 10.4% between 2011 and 2016 and reached a GWP of USD 3.2 billion. However, UAE is leading the life insurance market with 75.6% of GWP for life insurance in the GCC and achieving a CAGR of 13.9% for the same period.

Chart 9 - Segment-wise GCC Insurance Market Size

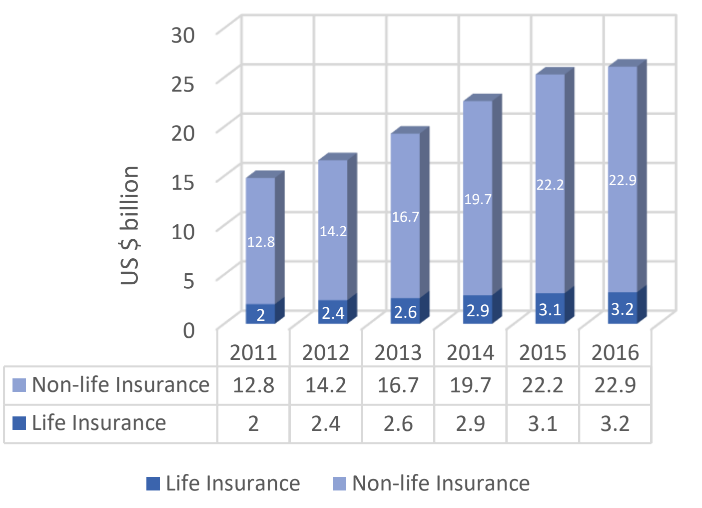
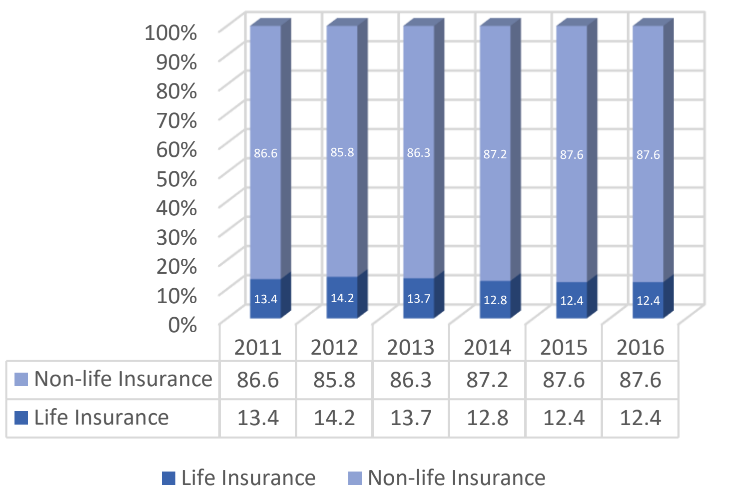


Chart 10 - Proportion of th GCC Insurance Segments



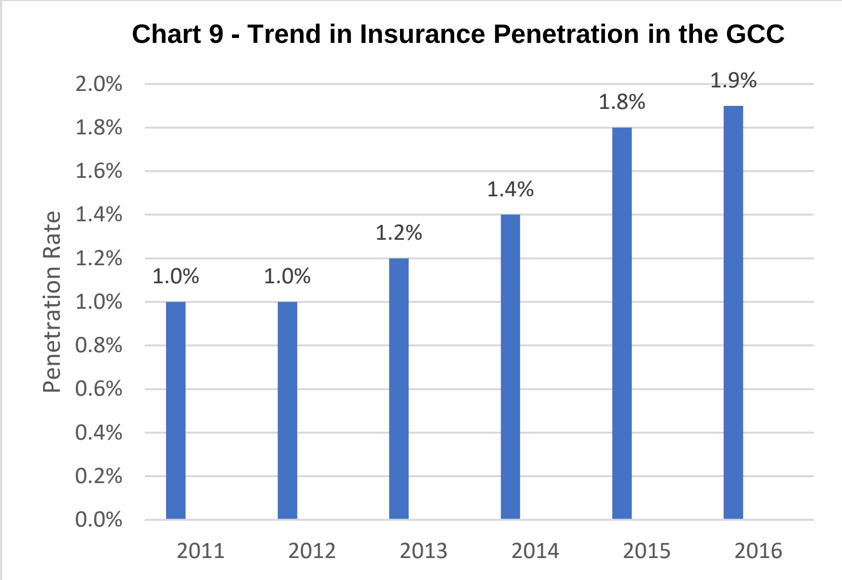
The insurance industry in the region has witnessed a continuous growth in terms of GWP and reached USD 28.2 billion in 2018 with a CAGR of 8.9%. The slight decrease of CAGR between 2016 and 2018 is explainable due to the economic and political challenges the region witnesses (Alpen Capital Report, 2019).

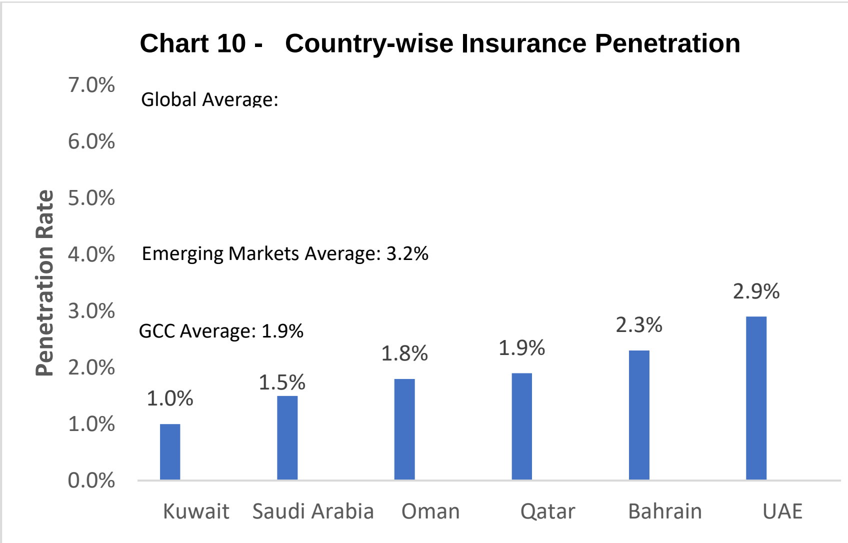
Within the region, according to the same report, UAE retained its position as the largest insurance market accounting for 44.3% of the overall GWP in 2018, followed by Saudi Arabia which accounted for 33.6%. However, Qatar has recorded the fastest GWP growth with a CAGR of 16%, particularly due to hosting the FIFA World Cup 2022 which is receiving a huge amount of investment for infrastructure developments and an inflow of expatriates.

Insurance Penetration Rate

The Insurance penetration rate in the GCC is estimated at an average of 1.9% for the year of 2016 and it is still below the average rate of 3.2% in the emerging markets. Country-wise, the UAE is having the highest penetration rate at 2.9% followed by Bahrain at 2.3%, as illustrated in the below charts (9) and (10). The reason behind that is a) the majority of the population in these countries are expatriates and b) the economy has structurally diversified well which creates a demand for general and life insurance products.

Regardless, of the strong growth of GWP in the region, the average of insurance penetration has slightly decreased to 1.7% in 2018 compared with 2016 record (Alpen Capital Report, 2019).





Source: Alpen Capital Report (2019)

4.2.4-Overview of Takaful Sector in the GCC

The demand for Islamic financial solutions has been increased as the majority of people in the GCC are Muslims. The table (13) below shows the percentage of Muslim population in the GCC countries according to World Population Review (2021). The region is accommodating more than 70 Islamic Insurance operators and considered the largest market for Takaful insurance with a combined contribution of USD 11.5 billion in 2015, representing 77.2% of the world Takaful Contribution with a growth of CAGR at 18% from 2012.

Table 13 – Muslim Population in GCC region

Country	Muslim Population	Percentage of Muslim Population
Saudi Arabia	31,878,000	97.10%
Oman	2,427,000	85.90%
UAE	4,615,081	76.2%
Kuwait	2,175,684	74.60%
Bahrain	1,063,239	73.70%
Qatar	1,566,786	77.5%

Source. Muslim Population By Country 2021 (worldpopulationreview.com)

Considering the large number of insurance companies, it seems that the market is overcrowded with Takaful operators and conventional insurers who are competing aggressively to gain more shares from a small pie.

The market witnessed a decline of GWC to USD 10.6 billion in 2018 compared with USD 10.9 billion in 2016. In fact, all Takaful operators in the region are small and struggling to gain profitability over their conventional rivals. The profitability of Takaful operators declined between 2016 and 2018 due to the fear of competition and burning prices and the volatility of investment returns as the real estate market has suffered from a downward movement. The net profit of the Takaful sector in GCC has sharply declined from USD 674 million in 2016 to USD 281 million in 2018 (S&P Global, 2018).

Family Takaful has, indeed, a substantial opportunity to grow benefiting from the increased demand of life insurance from Islamic banks that have become the largest distribution channels for offering the subject sub-segment as a part of financial planning solutions. The life products are being offered under Bancatakaful where the banks play a brokerage role between their customers and Takaful operators. However, both institutions are benefiting from such demand and tailored life products to meet the augmented needs of their customers. In the GCC region, the Family Takaful has witnessed prosperity and the CAGR has increased to reach 13% between 2012 and 2015.

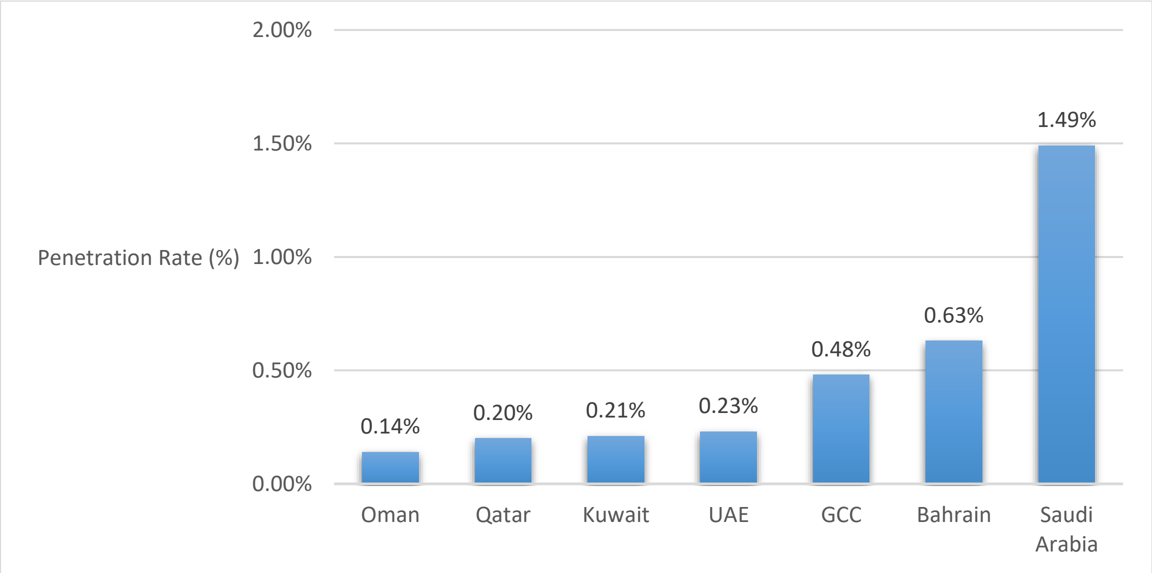
According to Islamic Financial Services Industry Stability Report of 2020, Takaful industry maintains an upward trend with a CAGR of 8.5% between 2011 and 2018. However, the total Takaful contribution growth in 2018 has globally declined from 4.3% reported in 2017 to 3.2% with an estimated contribution of USD 27.07 billion. Also, the general Takaful business is still prevailing over Family Takaful and recording USD 22.4 billion (82.6% of global GWC) compared to USD 4.7 billion (17.4%) for Family Takaful.

By region, the largest market of Takaful business was reported in the GCC with a contribution of USD 11.7 billion which formed a 43.2% of global Takaful contribution. MESA is the next largest market with a total contribution which reached USD 11.36 billion (42%), followed by SEA with USD 3.02 (11.2%) billion and Africa USD 0.55 billion (2.03%).

Takaful Penetration Rate

According to Alpen Capital Report of 2017, Takaful penetration rate in GCC countries is still accounting for 0.5% as of 2015, as illustrated in the below chart (11), which is 1.3% far from the conventional insurance rate for the same year (Milliman Report, 2017). As the majority of the population is Muslims, this rate is, in fact, an unexpected outcome. Conversely, this presents a substantial opportunity for Islamic insurers in the region to grow and expand.

Chart 11 - GCC Takaful Penetration Rates (2015)



Source: Alpen Capital Report (2017)

Having discussed the reasons behind the low penetration rate of Takaful with business leaders, the manager (PS) highlighted that "the insurance penetration rate, in general, in the region is still less than other parts of the worlds, particularly for Takaful insurance which is not expected". The insurance industry in the GCC countries was dominated by conventional insurance, for more than 60 years, while Takaful business has recently emerged in the market. The majority of Takaful operators are aged between 10 to 15 years, and even less, except SALAMA which has been established since 1979. However, statistics shows that Takaful has started gaining more shares from conventional slowly but increasingly.

Another important aspect has been outlined by the manager (OA) who stated that *"**Business leaders should not be targeting a specific religion to sell their products but it is an advantage to target the ethics out of it**"*. **(OA)**

For instance, bringing transparent products and ethical investments, distributing surplus when the business is successfully operated is a means of enhancing the concept and increasing penetration. The crisis of 2008 is one of the examples which show how much unprincipled business operation brought losses to humanity. Six million of American people lost their homes and the insurance industry lost USD 5 trillion in the USA alone because of that crisis, while the impact on Islamic Financial Institutions, particularly the conservative Takaful undertaking, was mostly untouched. So, targeting these principles, which are the core values for people, regardless of whether they are Muslims or Non-Muslims, shall make success to any business.

However, he confirmed that

> ***"Takaful operators therefore should never look to Takaful business from a religious perspective other than to its concept driven by successful and ethical operation. In this case the concept will attract more customers and start gradually to compete with its conventional counterparts".*** **(OA)**

In order to increase the penetration rate of Takaful in the market, (OA) has also addressed that

> ***"The distribution channels of Takaful should not be ignored; the more the banking sector in Sharia compliant products becomes stronger, Takaful will go along with it. It has been witnessed that when the Islamic banks in the region achieve constant growth, the gross written contribution of the Takaful industry is increased".*** **(OA)**

So, Islamic banks and financial institutions are playing a major role by increasing the penetration rate of Takaful over conventional players.

It should be emphasized that competing by introducing Takaful as an Islamic product to attract more Muslims is the wrong approach. The ethical point behind Takaful is what benefits the customers gain, by offering Takaful products. He concluded from this aspect that

> "**Takaful operators can compete with conventional through enhancing their rating, services, commitment and competitive price, not merely by offering Halal products. Takaful is a business model and designed to fit insurance requirements to whole communities whether Muslims or Non-Muslims". (OA)**

Looking to the business from this angle, the Takaful penetration rate shall be increased. If there is a big portion of the economy now being Islamic funds, then this would reflect in a significant way by the penetration rate of Takaful.

4.2.5-Insurance overview of UAE Market

In the UAE, there are 62 insurance providers including 35 national companies and 27 foreign companies where some of them are composite (providing all lines of business) while others are either providing general or personal and fund accumulations. Out of 35 national companies, there are 12 Takaful operators practicing insurance business based on Shariah Compliant. During the last 5 years (2014 – 2018), the insurance sector in the UAE has grown steadily as shown in the table (14) below.

Table 14: Performance of Insurance Sector in the UAE (2014-2018)

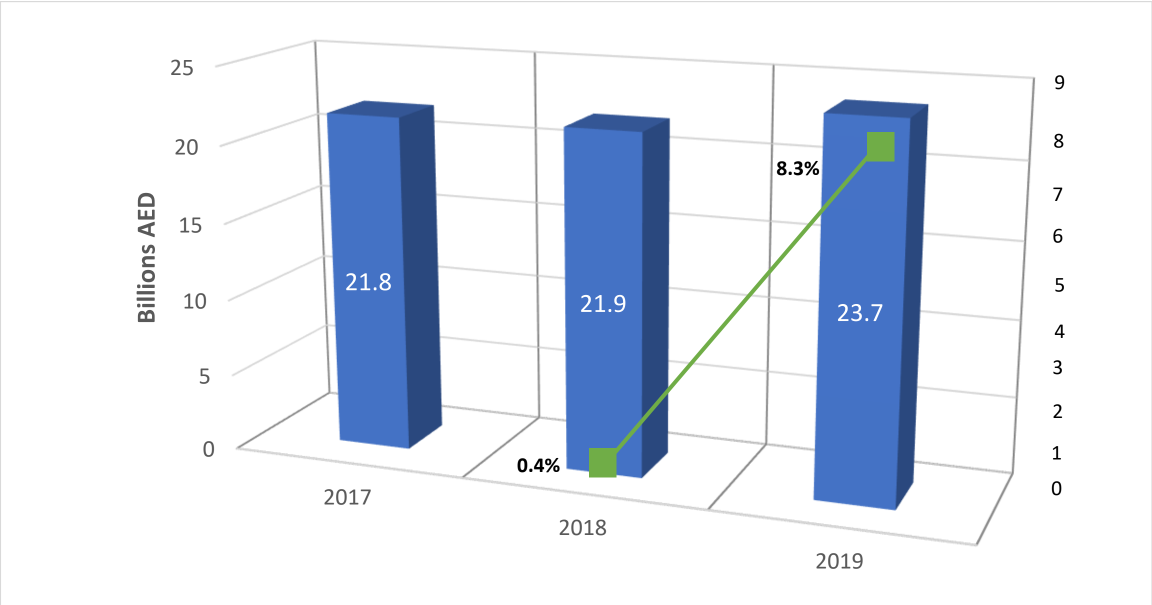
USD Billion

	2014	**2015**	**2016**	**2017**	**2018**
Gross Written Premium	9.18	10.12	10.95	12.28	11.97
National Companies including Takaful	5.54	6.11	6.82	7.71	7.58
Foreign Companies	3.64	4.01	4.14	4.57	4.39
Takaful contribution	0.71	0.93	1.02	1.16	1.21

Source. UAE Insurance Authority Report for Insurance Activity 2018

According to Milliman Report of 2019, the insurance market in the UAE has witnessed a continuous upward trend for the third consecutive year with 8.3% growth of Gross Written Premium which is estimated at AED 23.7 billion in 2019, compared with AED 21.9 in 2018, as shown in the chart (12) below. The data in the said report is recorded for all insurance listed companies (30 companies out of 62 registered companies in the market) in the Abu Dhabi Securities Exchange ADX and Dubai Financial Market DFM.

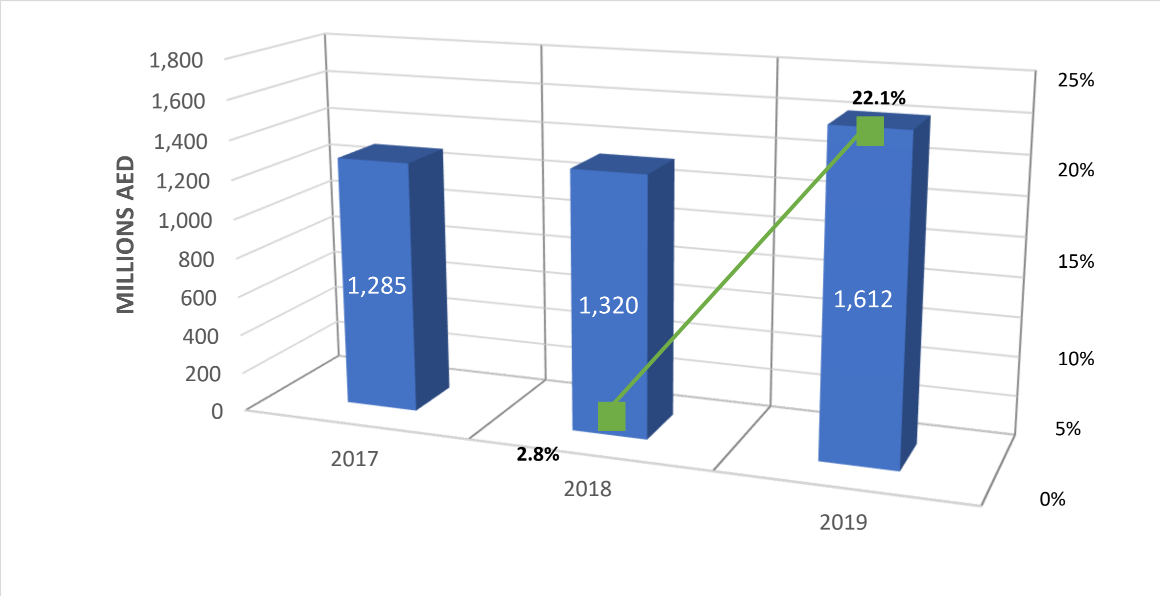
Chart 12 - UAE Gross Written Premium (GWP) - 3Year Trend



Source: Alpen Capital Report (2019)

In terms of Net Profit, the chart (13) below shows that the market has achieved an increase of 22.1% net profit from AED 1.3 billion in 2018 (2.8%) to AED 1.6 in 2019 (Milliman Report, 2019). This increase is mainly due to a positive investment return yielding from high risk investments assets. Nevertheless, this increase of profitability is not sustainable as it could carry a significant decrease in the future investment for the same high-risk assets.

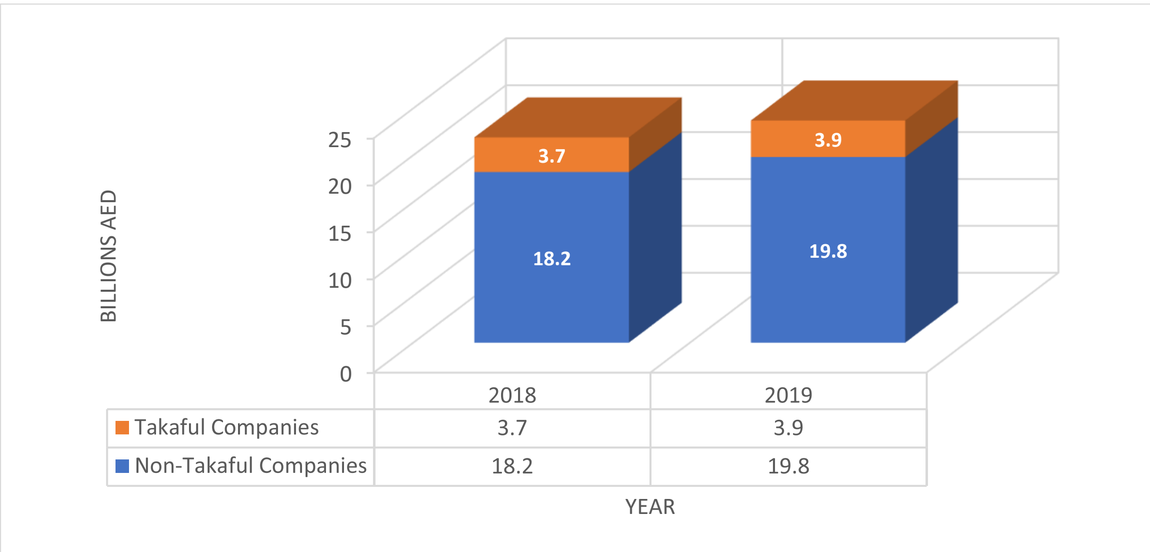
Chart 13 -UAE Net Profit- 3Year Trend



Source: Milliman Report (2019)

Takaful business has shown, in 2019, a growth of 5.8% compared with an 8.8% increase for its conventional counterparts with a total gross contribution of AED 3.9 billion compared to AED 19.8 billion for conventional, as illustrated in the chart (14) below. It is to be confirmed that these figures have been recorded from 30 insurance listed companies in the UAE.

Chart 14 – Takaful and conventional performance



Source: Milliman Report (2019)

According to the Badri Management Consultancy Report of 2020, the GWP for the insurance industry in the UAE is estimated at AED 40 billion in 2019 with a growth of 1% from the previous year. The analysis has been conducted for 30 listed companies and 22 foreign insurance branches. The GWP for listed companies and branches is estimated to be AED 34.5 billion. While the Gross Written Premium for the listed companies alone is valued AED 23.7 billion, representing 59% of the total gross premium of the industry volume, the branches have achieved an amount of AED 10.7 billion with an estimated growth of 8% and a decline of 3% for the listed companies and branches respectively, compared to 2018. However, the CAGR of the industry during the last five years is computed at 8%. In terms of profit, the total profit achieved for listed companies and branches is estimated at AED 2.2 billion in 2019 compared to AED 1.8 billion in 2018 with a significant growth of 20%.

The report also concluded that insurance companies that recorded losses from their underwriting business were able to minimize the impact from their investment income. This shows that there is room for improvement in underwriting strategies in the market because the primary source for generating profits for insurance companies is expected to be from insurance activates. Like the technical profit for the largest Takaful provider (SALAMA), the underwriting performance was the one and only driver of profits in 2019, for all insurance providers except a few companies (Badri, 2020).

4.2.5.1- Takaful Insurance Sector in the UAE

It has been reported that the UAE Takaful market is the second largest market in the GCC with a 10.3% market share in 2018. With a contribution estimated at USD 1.2 billion, the UAE market has grown by 5.8% which is lesser than the double-digit growth of 13.2% recorded in the previous years. The Takaful market is mainly driven by the general Takaful which forms 95% of gross contributions. Medical and Motor insurance were still the largest lines of business, forming over 40% and 30% of a total Takaful contribution, respectively.

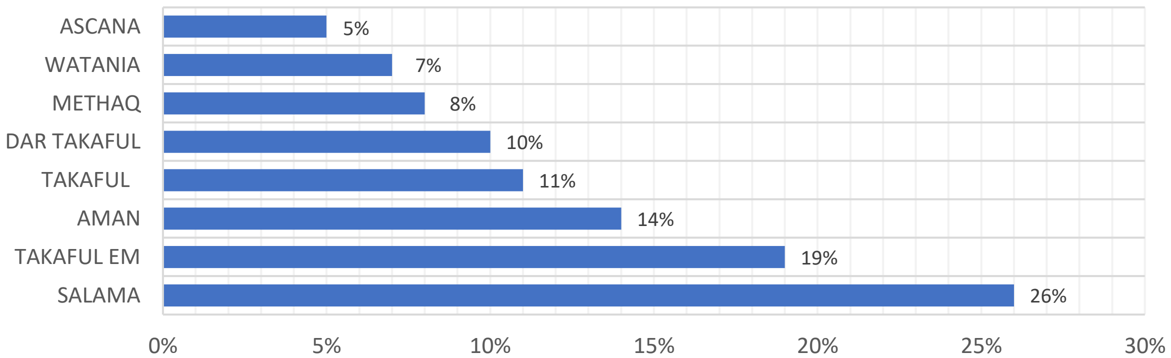
Family Takaful in the GCC is still accounting for 6% only of the overall Takaful contribution in 2018 with a penetration rate is much lower than the 0.3% of the life insurance segment recorded in the region. However, Family Takaful in the UAE market remains the highest compared with other GCC countries with a growth of 6% in 2018, which is lower than the growth rate of the 13% achieved in 2017. There are many factors driving Family Takaful such as the increase demand for life insurance among expatriates, the existing of progressive regulatory system and adopting operational digitization which places the UAE as the leading market in the region (IFSI Report, 2019).

4.2.5.2- Market Share among Takaful Operators

With one Takaful operator, established in 1979, SALAMA remained the only company operating the Takaful scheme for 16 years in the UAE market. Since 1995, 9 Takaful operators joined where the most recent company was established in June 2017. Regardless of being an attractive option compared with conventional insurance, the Takaful market is struggling to sustain profits. For instance, 6 out of 8 companies counted accumulated losses while 5 of these companies exceeded 38% of their share of capital in the year of 2016.

The size of a Takaful operator seems to be uncorrelated with performance. For example, the largest Takaful operator SALAMA, which dominates a 26% share of Gross Takaful Contribution, sustained accumulated losses of AED 465 million representing a loss of 38% of its capital (AED 1.2 billion) with a Combined Ratio stands at 137%. Conversely, the smallest one Watania Takaful has achieved a significant movement in its performance with a Combined Ratio of 78% in the year of 2016. However, Abu Dhabi National Takaful recorded the best performance among other peers with a market share of 11% of the gross Takaful contribution in 2016 and the combined ratio has been improved to 89% (ALRAMZ, 2017). The chart (15) below illustrates the market share of the listed Takaful operators in the UAE market, based on Gross Written Contribution.

Chart 15 - Takaful Market Share
"Market share by Gross Contribution, excluding Orient UNB Takaful"



	SALAMA	TAKAFUL EM	AMAN	TAKAFUL	DAR TAKAFUL	METHAQ	WATANIA	ASCANA
Takaful Market Share	26%	19%	14%	11%	10%	8%	7%	5%

Source: Al Ramz (2017)

The annual report for the insurance sector issued by the UAE Insurance Authority in 2018 shows that the gross written contribution for Takaful companies have almost doubled during the last 5 years, as illustrated in the table (15) below, from AED 2.58 billion in 2014 to AED 4.42 billion in 2018. Also, the market share of the Takaful sector reached 10% of the total gross written premium in the UAE insurance market in 2018.

Table 15: Performance of Takaful Sector in the UAE (2014-2018)

(AED Billion)

	2014	**2015**	**2016**	**2017**	**2018**
Gross Written Premium	33.53	36.95	40	44.82	43.72
National Companies including Takaful	20.22	22.3	24.89	28.14	27.68
Foreign Companies	13.31	14.65	15.11	16.68	16.04
Takaful contribution	2.58	3.41	3.74	4.25	4.42
Market Share of Takaful	7.7%	9.2%	9.35%	9.48	10.1%
Market Share of Takaful out of National Insurance	12.76%	15.3%	15%	15.1%	16%

Source. UAE Insurance Authority Report for Insurance Activity 2018

From primary data, it has been questioned whether 10% market share is a satisfactorily result after almost 4 decades of operation, the manager (PS) pointed out that

> *"Takaful business is growing up in the UAE. In 2018 for instance, the whole market grew only 0.5% (less than 1%) whereas Takaful is the only business that grew more than 10%. Slowly, Takaful companies were able to improve their business proposition and attract customers away from the conventional players".* **(PS)**

However, the share of Takaful in the market can be increased dramatically and he recommended four solutions which could help the Takaful sector to achieve substantial growth.

a) **Merging / Acquisition:** Instead of 12 companies in the UAE, it could be half or less in numbers by merging or acquisition. Then all Takaful companies will benefit because the size of the company becomes bigger in terms of capital and capacity and then they will be able to compete with larger conventional companies. In this case, the annual growth might be troubled.

b) **Mandatory Takaful:** However, the regulators can play major rules by improving the regulations relating to Islamic products. For example, if Takaful is becoming mandatory for all Islamic banks' products, by law, this will achieve a dramatic growth for Takaful business**.**

c) **Islamic Market:** In the Middle East, there are two large markets for Takaful, one is the UAE, and one is Saudi Arabia. While the market in the later is 100% Takaful, it is only 10% in the UAE. So, if the UAE starts to move toward Islamic Takaful, then the growth will undoubtedly be increased.

d) **Takaful Service:** The last issue is to be relied upon by Takaful operators, who should bring benefits to customers in a different manner of conventional

While the manager (OA) has confirmed the first and last solutions, he has highlighted some other factors around the business which have played a major role of Takaful performance, particularly for the market share, summarized under.

- Takaful Operators were newly established compared with its conventional counterparts. *"**When Takaful comes to life, the conventional insurance companies were adequately reserved and built much more clientele"***
- Second, ***"Takaful companies were born where the market was highly competitive and fierce competition between companies was at the top".*** So, they were struggling to gain some market shares.
- Thirdly, ***"the public awareness for Takaful is less as the concept was not accurately introduced".***
- Fourthly, the reflection of market landscapes. *"**The number and size of conventional banks compared with Sharia compliant banks were multiple whether at the local or international level. In the UAE market, for instance, there are few Islamic banks and tens of conventional banks and this is applicable to all Islamic financial institutions".***

However, Takaful performance results in the last decade show that there is a double-digit growth and an increase in the market share.

(OF) has argued that the insurance industry is a conglomerate of different categories and types of risk exposure. So, looking into a single market and surprisingly saying that the Takaful market share is only forming 10% of gross written premium in the UAE is the wrong approach. Looking at 20 years back, it could be noticed that the share has been doubled or even tripled. However, he also outlined many important factors driving the insurance sector in the GCC relating to the social and educational culture, regulatory regime and operational strategy, which is summarized below.

- The cultural orientation around the whole notion of risk for people in the Middle East and particularly in the GCC region was practically experienced not educationally learnt. *"**Muslims believe in Kadar (will of God) and whatever the risks they are facing they have to accept the outcome as a part of their beliefs. So, this will reflect in the misunderstanding of the insurance concept as a risk management means".*** This factor along with the lack of educational or academic knowledge about risks is a contributable reason of a low penetration rate of insurance in this part of the world. ***"For instance, unlike Business Corporations in the GCC, a risk culture in a company in France, UK or USA and is a part of the way the corporation runs itself".***
- The other reason is related to regulations which has made motor and medical insurance mandatory since 2006 in Saudi Arabia and later on in other GCC countries.
- The third reason is that Takaful managers and staff are increasingly becoming familiar with the concept and more professional means of implementing a Takaful business into operation.
- The last reason is the heavily competition. The market is crowded with insurance providers who are serving a small population. *"**So, the customers nowadays, who are presumably looking for Islamic insurance only, can get 12 quotations for their car insurance, for instance, from 12 Takaful operators in a minute, particularly due***

to a technological advantage". This will lead Takaful providers to quote even less than the burning rate in order to get more volume of business.

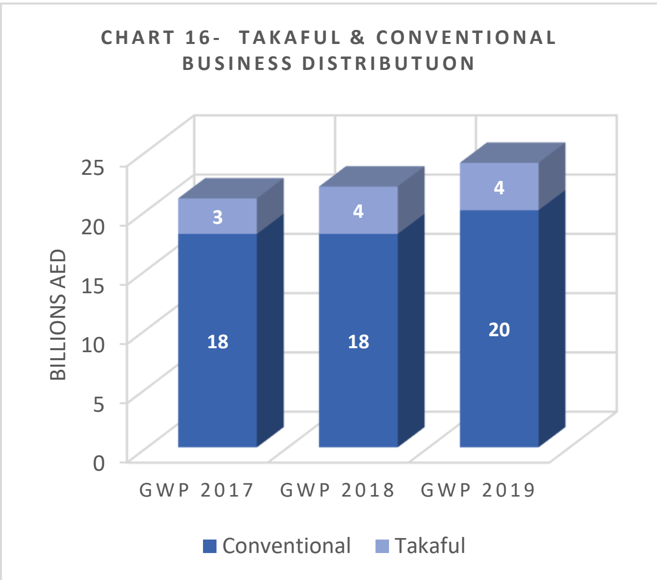
In Saudi Arabia, in 2006, there were more than 80 insurance brokers and 70 companies where they have restructured and recapitalized for the whole industry and required that all insurance companies be publicly listed and traded. So, regulation has been evolving in Saudi Arabia and that is also true in the UAE. However, more to the point is that the recognition by the regulators of the special features of Takaful as compared to conventional insurance or risk management using a stock company was not very evolved and was not very favourable toward Takaful. Though, he concluded that

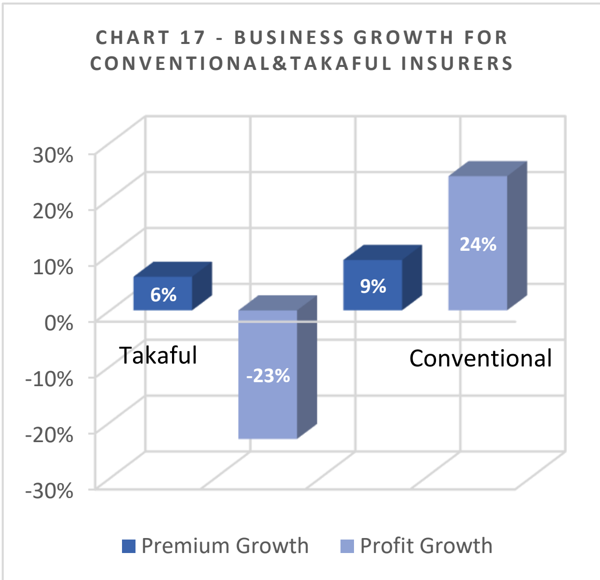
> ***"The idea is that there was no special legislation recognizing the difference between Takaful companies and conventional stock companies and hence Takaful companies needed to compete head-to-head with stock companies which is actually putting them at a competitive disadvantage from day one".*** **(OF)**

- **Net Profit**

According to the insurance industry analysis conducted by Badri (2020) includes 9 Takaful operators, out of 30 listed insurance companies operating in the UAE market, the Gross Written Contribution of these operators represents a 16% of the total written business for the listed companies in 2019 compared to 17% in 2018. While the growth rate of the business remains stable at 6%, the profit of shareholders has sustained a decline of 23% compared with the previous year of 2018, which was a decline of 4% in comparison with 2017.

The bar chart (16) and (17) below shows the significant growth of conventional in terms of GWP and profit compared with their Takaful counterparts (Badri Report, 2020).





Source: Badri Report (2020)

In the GCC region, the home of Takaful, the net income dropped 27% y-o-y from USD 383 million in 2017 to USD 281 million in 2018. The main decline has been recorded in the Saudi market with 45.8% down in aggregate earning term of 31 cooperative Operators, while 21 operators have posted net losses between 29.2% and 2,784.9% which drew down the overall profitability of the Takaful sector.

Regardless of such a drop in the region, the UAE Takaful market, in 2018, has maintained its upward growth in terms of net income driven by regulatory changes over the last two years through introducing a mandatory health insurance among Emirates and setting a minimum tariff for motor insurance. The net profit during the said year, for Takaful sector, has recorded a growth rate of 8.3% y-o-y, estimated at USD 35.7 million. While Methaq Takaful and Ascana-Takaful have generated the highest net income, SALAMA (the largest Takaful Operator) sustained a dramatic drop in net profit from USD 10.2 million in 2017 to USD 0.13 million in 2018 (IFSI Report, 2020).

- **Return on Equity**

It could be seen from the table (16) below, that the ROE metric for Takaful business, between 2012 and 2016 in the MENA region, is considerably less than conventional as Takaful operators are struggling to achieve comparable underwriting profitability.

Table 16 - Return on Equity Takaful V Conventional for MENA Region
(ROE= net income / shareholders' equity)

	2012	2013	2014	2015	2016
Conventional	10%	19%	11%	9%	8%
Takaful	-4%	3%	7%	2%	2%

Source: A. M. Best Market Review 2018

The reason is obviously due to the new presence of Takaful business, small sized companies, and high cost to start-up. In a competitive market, Takaful Operators have initially focused on top line scale over performance, but this has subsequently changed when a new management at several Takaful companies has taken over recently and the bottom-line profitability becomes dominant (A. M. Best Market Review, 2018).

However, the UAE market presented the highest ROE rate of 14% compared with other regional countries in 2018, with a significant upward trend from an average of 0.8% documented in the last three years. For the same period, listed Takaful companies have achieved an overall net income of USD 381 million reflecting a significant improvement of underwriting results and operational expenses control, particularly in motor and medical lines, benefiting from a favourable regulatory reform (IFSI, 2020).

However, in their Report for 2017 and 2018, A.M. Best highlighted that Takaful operators in the UAE have significantly narrowed the gap and the ROE becomes very close to conventional peers due to the noticeable increase in underwriting profitability (A. M. Best Financial Review, 2019). This increase in profitability has been achieved as a result of:

1) Determining actuarial prices for Motor and Medical products and setting a minimum tariff of Motors' third-party liability and
2) Determining the maximum charged by shareholders as Wakala fee

- **Combined Ratio**

The combined ratio is a tool to measure the sufficiency of contribution income comparing with operational expenses (CR = Incurred losses + general expenses / Net Earned Premium). Therefore, if the ratio is less than 100% the company achieves a profit and vice versa.

According to Islamic Financial Service Industry Stability Report (2019), the combined ratio for general and Family Takaful in 2018 compared with the last three years (2015-2017) shows a positive movement toward profitability. It could be noticed that the combined ratio for most selected markets is below 100% (profitability achievement) except for four markets such as Pakistan, Iran, Saudi Arabia and Kuwait. Further, the combined ratio has been relatively improved comparing with the past three years due to the positive change in loss ratio and good management expenses control. Also, Takaful operators have taken a step forward by selecting risks carefully, changing pricing strategy and paying attention to claim administration. However, Retakaful / Reinsurance commission and investment returns are factors to offset the increase of combined ratio in 2018.

Table 17 - Combined Ratio for MENA Takaful and Conventional Insurers

Combined Ratio	2012	2013	2014	2015	2016
Conventional	92	93	97	96	90
Takaful	120	108	106	108	110

Source: A. M. Best Market Review 2018

As illustrated above, the combined ratio for Takaful business is more than 100% during the years of 2012 – 2016. That means the incurred losses and general expenses are more than the net earned contribution and the business ultimately sustained a loss compared with conventional counterparts.

4.2.5.3- Restricted Investment Policy

Takaful managers must pay considerable attention to invest in the fund of participants in order to secure liquidity requirements and carry out efficient Asset-Liability Matching (ALM). Islamic investment must not include any interest-bearing assets or forbidden (Haram) activities. Having limited investment assets compared with conventional, the returns of a Takaful investment will be undoubtedly lower than their conventional peers and their competitive position is becoming more challengeable (CII Text Book, Principles of Takaful, 2017). Practically, the limited asset for Takaful investment is a barrier of growth and limitation on developing long-term products due to the issue of

ALM. The requirement of capital adequacy is therefore larger than its conventional peers (A.M. Best Report, 2013).

In fact, most investment assets available in the market for investment are by nature of interest-bearing which is prohibited by Sharia. Regardless of the development carried out by many Islamic financial institutions to create Sharia-Compliant investment instruments, considering the segregation of Funds, type of business and the nature of available investment assets, the investment portfolio of Takaful business is still lagging behind the conventional counterparts.

In the UAE, the Insurance Authority, like the IFSB guidelines, have issued financial regulations for Takaful investment and limited the investment assets into a percentage for each class (Insurance Authority, Decision No. 26. 2014).

The professional lawyer (PH) has addressed many restrictions on Takaful' investment assets:

- Takaful operators are required to undertake all investment activities in a Sharia-compliant manner. The investments are usually undertaken by the takaful operator or delegated to a specialist investment manager who is required to prudently manage investments of the takaful fund. Because of the Sharia requirements the asset risk of a takaful fund will differ from that of conventional insurance. For example, a takaful operator cannot invest in conventional bonds and there are limitations on the use of derivatives (which are commonly used by conventional insurers to hedge against currency risk). Historically, these constraints have led to the over-dependence of takaful operators on cash deposits, equities, and illiquid real estate assets.
- It is not always possible for takaful operators to avoid receiving income that is haram. For example, a takaful operator may elect to invest in the shares of a company, the activities of which were permissible at the time of investment, but which become impermissible due to the changing nature of its activities. In these circumstances, the takaful operator is obliged to purify its investment income by donating an amount to charity equivalent to the investment income that is so tainted. It is therefore essential that appropriate processes are in place to identify such haram income and to ensure that it is purified in accordance with the direction of the Sharia Board.

The impact of restricted investment assets on Takaful performance, in terms of Sharia and regulatory perspectives, has been discussed in many articles and professional insurance reports; but it is intended in this research to investigate practical difficulties faced by Takaful operators in dealing with investment assets.

The manager (PS) pointed out that the Takaful Operators have two responsibilities, one for policyholders' investment Fund and one for Shareholders' investment Fund. On top of that, regulators have restricted investment to a specific percentage for asset classes. Also, there is a restriction of how much money should be deposited in a particular bank due to risk exposure of that bank. However, these regulations are applicable to both policyholders and shareholders' investment.

Shareholders can decide in which asset they wish to invest more, long-term, short-term, and high risk with higher returns, as the invested money belongs to them while the issue is rising when it comes to policyholder money. This money is deployed on a day-to-day basis, and it is impractical to invest it in a long-term investment because whenever the claim has been made, the payment must be available in the company's cash portfolio. Furthermore, the invested money is belonging to participants and it is not advisable to invest in a high-risk asset because if there is any loss in the investment part it may lead to deficiency of the policyholders' fund which will affect the shareholders assets through providing Qard Hasan. Therefore, a very conservative strategy has been deployed for policyholders' investment. Again, the investment policy depends on the class of business. For general Takaful, the investment is most probably short-term for 3 to 6 months while for Family Takaful, it is a long-term for 5, 10 or sometimes up to 15 years investment period. Anyway, the investment portfolio is monitored quarterly to ensure that it is in line with regulatory limits.

The manager (OA) has remarked that

"***The conventional investment channels are more open than other Takaful channels. So, it could be found that 7 Islamic banks where Takaful operators can invest in them without any restrictions and 28 conventional banks in the UAE and this is applicable to all entities operating in the Middle East, particularly in the GCC region".*** **(OA)**

However, it is a misconception that Sharia compliant investment is designed for Muslims or to be invested in by Islamic entities which is a common mistake. There are a lot of conventional entities where Takaful operators can invest their funds with them. For example, many of the Takaful operators have bought shares in Etisalat (Telecommunication company) which is a non-Islamic entity; but once they are receiving returns, the balance sheet of Etisalat will be monitored and checked whether or not the revenue is derived purely from the actual operation of the company and no element of interest is exists, then the revenue will be deposited into the policyholders funds; otherwise the un-halal money shall be purified by depositing the interest-related return into a separate account, out of shareholders or policyholders' accounts, made for that purpose. The collected money in this account will be distributed to charities under supervision of SSB. Therefore, the money could be invested in any of the local or international equities subject to maintain Sharia Principles in all investment processes.

So, it is a fact that there is restriction on investment, but the key success is having a diversification investment portfolio. For instance, Takaful operators can deposit funds with Sharia Compliant banks, buy equities, real estate investments, Ejara investment and so many kinds of investments. Regardless of the fact that a very conservative investment policy has been implemented, Abu Dhabi National Takaful, for instance, is making a good level of returns and the investment portfolio represents 20% to 25% of the company's net profit.

"One important aspect which many people have missed out is that the investment portfolio will be increased, in line, by achieving profitable growth". **(OA)**

For example, the investment portfolios for the same company in 2010 was 180 million and it is close to 900 million in 2019 and that was derived from profitable growth which was achieved during the last 10 years. So, it is a fact that the more performance growth the company achieves the more immunity and more assets to invest in. This could be a pillar to protect the balance sheet of the company.

Furthermore, it could be noticed that there are essential factors that affect the Takaful investment portfolio in the UAE. These have been summarized as follows.

- Due to the shortage of workforces who are capable of dealing with Sharia-Compliant investment, the common practice adopted by Takaful operators in the UAE is to outsource investment into a professional investment company subject to comply with Sharia and regulations' requirements (Milliman, 2010). This will increase the cost of investment and lead to lack of control
- The investment committee in the BOD with collaboration with SSB shall oversee the financial sheet of investment income to ensure that the source of money is purely Sharia compliant. In case the source is doubtful, purification is a means by which to comply with. The income from a non-Halal source shall be deposited in a separate account designed for this purpose and distributed to charities with close supervision by SSB. This course requires professional practitioners for auditing the financial statement of investment where the SSB members are most unlikely to have auditing skills
- **Asset Liability Matching ALM:** It is a challenge for a Takaful Operator to maintain a balance between Sharia Compliant investment assets and availability of cash to cover liability when it becomes due. Takaful operators shall not invest in interest bearing bonds or equity of companies carrying out non-halal activities (Financial Regulation of Takaful, 2014).
- **Investment Diversification:** As outlined in the literature, the family Takaful is dominant in SEA and the investment strategy is focused on long-term investment such as Sukuk (Islamic Bonds), while this matter is opposite in GCC markets where general Takaful is prevailing and a short-term investment such as deposits is the major component of investment's income.

Having reviewed the investment portfolio of the insurance sector in the UAE market, the total investment income generated in 2017 was AED 3 billion which is a dramatical increase from AED 1.4 Billion comparing with 2016 results. While the share of national insurance companies amounted to 25%, the foreign companies were having the lion's investment share of 75% (Annual Report of the Activity of Insurance Sector in the UAE, 2017).

In respect of national insurance companies, it can be noticed that there is no segregation of investment portfolio between policyholders and shareholders. However, the table (18) below shows that the incurred investment expenses for Takaful sector is much more their national conventional rivals. Regardless of the huge difference of invested assets between national conventional and Takaful companies, the net income over investment assets is almost the same.

Table 18 – Investment Statement for National Insurance Companies AED ,000

Investment income	National Insurance companies		Takaful Operators		Traditional Companies	
	2017	2016	2017	2016	2017	2016
Total Invested Assets	30,112,220	27,591,748	5,857,243	4,659,310	24,254,976	22,932,438
Gross Investment Income	986,314	1,136,893	238,548	233,919	747,767	902,974
Investment Expenses	213,666	159,917	88,733	49,401	124,932	110,516
Net Investment Income	772,649	976,976	149,815	184,518	622,834	792,458
Percentage of expenses	22%	14%	37%	22%	16.7%	12%
Percentage of net income over investment assets	3%	3.6%	3%	4%	3%	3.5%

Author's analysis

For a more understandable view of a Takaful investment portfolio in the market, it has been intended to examine the financial statements published by 4 Takaful operators in the UAE market, as shown in the table ((19) below, by picking up those elements that are relating to the subject in question.

Table 19 - Selected Balance Sheet Figures

AED('000s)

	ADNTC		SALAMA		AMAN		TAKAFUL EMARAT	
	2015	2018	2015	2018	2015	2018	2015	2018
Gross Contribution	264,060	383,296	933,346	1,062,960	427,060	375,824	402,822	599,068
Shareholders Profit (Loss)	35,610	58,517	(29,420)	70,444	38,514	939	24,455	7,570
Policyholders Profit (Loss)	5,980	26,294	(133,420)	(69,967)	(36,332)	11,372	(14,240)	6,475
Investment Income for shareholders	4,700	12,997	18,598	17,750	(2,473)	1,631	(10,363)	34,164
Investment Expenses	n/a	n/a	(992)	(1,397)	n/a	n/a	(833)	(599)

Shareholders Profit (Loss) - After Qard	41,590	68,346	(162,840)	477	2,183	939	10,215	14,045
Policyholders Profit (Loss) - After Qard	-	17,577	-	-	-	11,372	-	-

Investment Income for policyholders	1,737	10,834	316	421	(2,490)	338	n/a	(2,285)
Modaraba share	521	4,903	34	50	-	84	n/a	n/a
Wakala Fee	66,285	116,024	105,361	144,319	75,066	67,809	56,326	77,923
Consolidated Net Profit / Loss - After Qard (PHF + SHF)	41,590	85,923	(162,840)	477	2,183	12,311	10,215	14,045

Total Participants' Assets	439,740	621,128	1,039,917	1,885,944	1,147,522 (Breakdown into PHF and SHF missing in FS)	509,873	188,510	711,669
Total Shareholders' Assets	257,375	394,089	2,319,272	2,121,090		853,017	255,763	326,748

Author's Analysis

- It has been noticed that the investment expense is not allocated in the financial statement in many of the Takaful operators and tracing whether it is paid from policyholder's or Shareholders' fund is not identifiable. Many of the business managers, including (OA), believe that it does not matter where these expenses are allocated as the shareholders at the end of the annual operation shall make good for any deficit that the policyholders' fund sustains. This argument is obsoletely invalid as the mean feature of Takaful business is surplus distribution. Favouring shareholders' portfolio over policyholders' fund should be monitored carefully by regulators to maintain transparency and enhance distinction of Takaful business among public awareness.

- It is not understandable on which basis Takaful operators have calculated the Wakala Fee and there are no clear instructions from regulators of the same, as shown in the table (20) below. Furthermore, it is not clear which line of business has been charged more of a percentage. it is clearly remarkable that Takaful management has been given a room, not seen by regulators, to calculate Wakala fee regardless of the volume of generated gross contributions.

Table 20: Financial Statement for the top 4 Takaful Operators in the UAE

AED ('000s)

	ADNTC		**SALAMA**		**AMAN**		**TAKAFUL EMARAT**	
	2015	2018	2015	2018	2015	2018	2015	2018
Gross Contribution	264,060	383,296	933,346	1,062,960	427,060	375,824	402,822	599,068
Wakala Fee	66,285	116,024	105,361	144,319	75,066	67,809	56,326	77,923
Wakala Fee as a percentage of GC %	25 %	30 %	11 %	14%	18 %	18 %	14 %	13%

Author's analysis

- The investment income of policyholders comparing with assets available for investment is much less or even negligible in comparison with investment returns of shareholders.
-
- Except ADNTC, the policyholders fund for others, sustained losses or very minimal surplus compared with shareholder's profit. Furthermore, it has been noticed that a huge difference between the shareholders' profit (AED 68 million) and policyholders' surplus (AED 17 million) in ADNTC which is the best performing Takaful operator while the oldest and largest Takaful operator in the market (SALAMA) sustained continuous losses.

4.2.6-Discussion

Having noticed the huge amount generated by the Islamic Financial Services Industry worldwide, the Takaful share is very minimal and accounted for only 1.1%. There are many reasons behind that which could be summarized as follows.

- The business is still in its infancy stage compared with conventional insurance where it takes a long time to build trust relationship with customers
- No regulation enforces Islamic banks to insure their customers' financial assets with Takaful companies
- Takaful products are much like conventional and all terms and conditions are copy-paste from conventional insurance policies
- As small sized operators, the restricted reinsurance facilities and the high operational costs, make Takaful products uncompetitive in terms of price and insurance coverage
- Shortage of Sharia scholars who have experience in insurance business and shortage of insurance practitioners who have knowledge of Sharia principles. This is an important factor that affects both abilities to innovate insurance products that are different from conventional but in line with Islamic needs and requirements and / or approve new products as a result of misunderstanding

- Restricted investment policy and increase of investment' incurred costs

Islamic banks are playing a source of bancassurance business for Takaful operators such as life insurance, home finance, Motor insurance and loans. However, this source of business is not provided free of charge. Islamic banks are charging a considerable commission to insurance players in the market. There is no regulation which enforces Islamic banks to deal with Takaful operators only; but the matter has been left to the sole decision of Islamic banks. As they are small players in the market, Takaful operators are not in a favourable competitive position over conventional in terms of offered products and rates and this keeps the door for conventional products open.

However, the graphic performance curve of Takaful industry is, indeed, moving in line with the Islamic banking sector. The global share of Takaful business has subsequently declined when Islamic banking was sustaining a consecutive decrease of its global share during the last three years. Nevertheless, all respondents were in agreement with the tremendous effect of Islamic banking on Takaful business. Knowing that GCC countries are housing the most Islamic financial institutions in the world and forming almost 45% of the global performance share, Takaful business in these countries is open for a huge opportunity to grow and expand.

4.2.6.1- Global Share of Takaful Business

It has been recorded that the global share of Takaful business compared with total gross insurance premium has been increased during the last 5 years from 0.44% in 2014 to 0.52% in 2018, the below table (21) refers. This shows that the business during these years has grown 27% and 17% in terms of global contribution and share, respectively.

Table 21: Global Gross Written Premium (2014-2018)

USD Billion

	2014	**2018**
Global insurance	4,770	5,200
Takaful	21.2	27.07
Takaful global Share	0.44%	0.52%

Author's Analysis

The responding professor (OF) addressed some important points which give an explanation to the reason that Takaful business is still accounting for less than 1% of global gross premium. Firstly, the industry is still very young compared with conventional counterparts who have been in the insurance business for 400 years. Another reason is where the Muslims are living.

> *"**In Ethiopia for example, they have 55 million Muslims with one Takaful company which was getting off the ground in 2018. Nigeria also**, which is housing 90 million Muslims (Pew research, 2015), **there is 65% of the labour force that is living in rural areas where insurance companies do not like to operate in these areas as it is too costly for commercial business to operate in an***

environment where insurance products, to the majority, are unaffordable". (OF)

Also, another important factor is that Takaful, as a risk sharing mechanism, failed to be closed to community as mutual insurance companies and the model of operation is confusing. "**The mutual companies on a conventional basis are well understood, managed, capitalized and typically regional at best".** There are almost 3,000 mutuals around the world who are underwriting 22% of insurance business. However, as their inherent strength in staying close to community roots, it is a misplaced expectation that they should aspire to be huge and international.

From statistical reports, the growth of the global Takaful industry decreased from double digit growth from 2012 - 2015 to 3.2% in 2018 which is a slower rate than 4.3% accounted in 2017. However, a compound average growth rate over the period of eight years from 2011 to 2018 is 8.5%.

General Takaful is still dominant over Family Takaful and maintained almost the same percentage during the last 4 years as shown below. However, Family Takaful shows a little increase of 0.4%. The table (22) below refers.

Table 22: Gross Contribution of Family and General Takaful for the year of 2015 and 2018

USD Billion

	2015	% of GWC	2018	% of GWC
General Takaful	12.3	83%	22.4	82.6%
Family Takaful	2.6	17%	4.7	17.4%

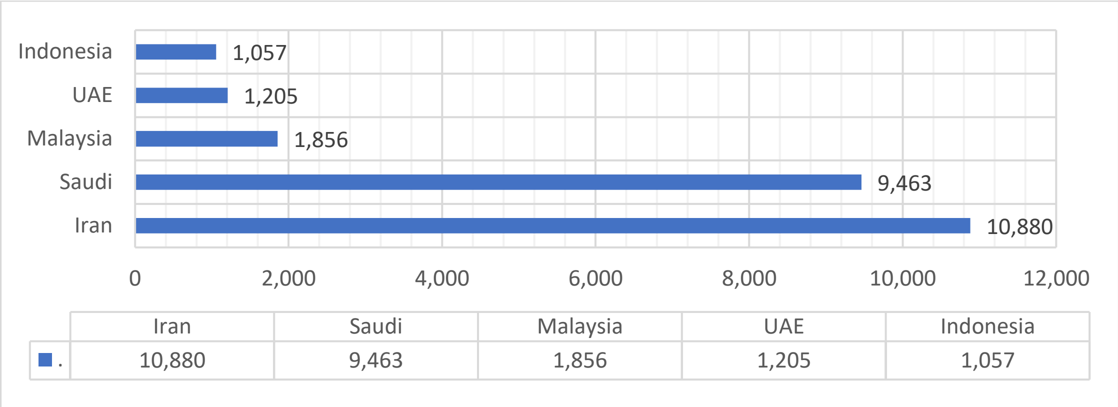
Author's Analysis

The dramatic increase of Takaful operators in terms of numbers, between 2003 and 2015, shows the appetite trend of investors to establish a Takaful business in different places in the world, particularly in MENA, FEA and GCC regions, where the majority of people are Muslims. However, this trend sustained a decline of new operators between 2015 and 2019, as addressed above.

Statistically, motor, medical and personal accident of General Takaful formed more than 80% of gross contributions in 2018. Retention Ratio for these lines recorded 80%, and varied between different jurisdictions in the selected markets. While the retention ratio for medical and motor classes ranged from 88% to 97%, the same is lower for commercial lines (Property, Engineering and Marine risks) ranging from 30% to 36%. As Takaful operators have insufficient capacity to retain large and complex risks, the retention ratio for energy and aviation lines is maintained at 2.8% and 6.5% respectively (IFSI Report, 2020). Having said that, Takaful operators are seemingly showing incapability to underwrite huge risks and merely acting as brokers for international insurance companies.

Unsurprisingly, 91% of Takaful global contribution is generated from 5 main markets, Iran, Saudi Arabia, Malaysia, the UAE and Indonesia. The total Takaful contributions in these countries form at least 0.47% of the total global insurance premiums. The chart (18) below shows the contribution of the top five Takaful markets in 2018 (USD million).

Chart 18 – GWC in the top 5 Takaful Markets (2018)



Source: IFSI Report (2020)

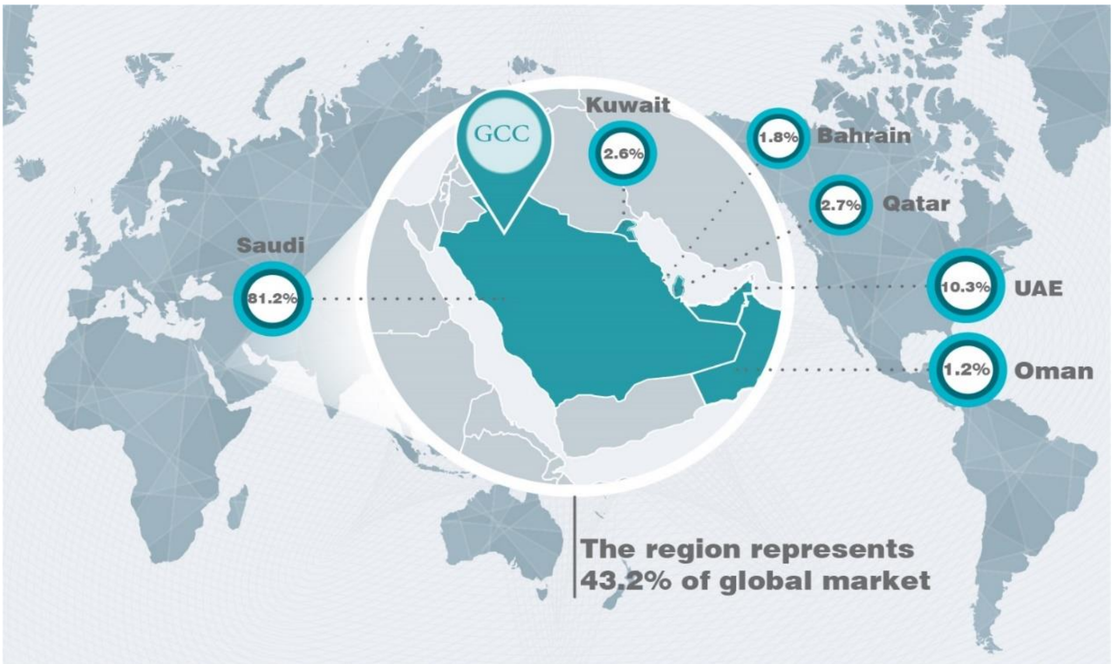
It is, astonishing to note that a country such as Indonesia with the largest number of Muslims in the world (more than 200 M) is generating a contribution of less than a small country like UAE where the total population is less than 10 m (Muslims form 76%). This is, in fact, an essential indicator that the number of Muslims is not a material factor to allow a flourishing of Takaful business.

4.2.6.2-Takaful in GCC Markets

In Saudi Arabia, the Takaful business accounts for 43.2% of global Takaful Contribution (81.2% of the total GCC Takaful market) and achieved continuous growth at a CAGR of 8.3% between 2013 and 2018 respectively. The GWC in Saudi Arabia alone reached an amount of USD 9.7 billion while all other countries in the region generated an amount in circa of USD 2 billion. As all insurance companies are Sharia Compliant and operated through a Cooperative model, the Saudi Arabia market does not therefore give any indication of how the Takaful industry could grow and expand among other conventional counterparts. This result may abuse the research outcome and it has been considered wherever comparison is beneficially required.

In the second largest market of Takaful, the GWC of Takaful industry in the UAE has reached USD 1.01 billion in 2018 with a CAGR of 11.1% from 2016. With 12 Takaful operators, out of 62 insurance providers, the Takaful business accounted for nearly 17% of the market share of the overall insurance industry in 2018, for 30 listed companies, which forms a significant increase from 9.5% recorded in 2015 (Alpen Capital Report, 2019). This result is higher than what has been recorded by the UAE Insurance Authority for the whole insurance sector in the year of 2018. The chart (19) below shows the market share of Takaful business amongst GCC countries.

Chart 19– Takaful share in GCC Countries



Source: Alpen Capital Report (2019)

Unlike SEA region, General Takaful in the GCC is still prevailing over Family Takaful and accounting for 83% of the total written contribution. As outlined, the key reasons behind that could be summarized as follows.

- The majority of the population is expats who are resident on a limited residence visa which could be renewed according to the demand of the workforce. This instability of lifestyle reflects on the behavioural attitude toward long term investment in GCC countries
- Life insurance products are too expensive compared with SEA due to high paid commission
- The welfare benefits for locals are very generous and replaces the need for life insurance
- Insurance penetration rate is much less in GCC compared with SEA

Over and above, there is a very important factor that relates to religious culture for Muslims, who believe that the human soul belongs to God and birth and death is a matter of his will. Therefore, insuring human lives is against the will of God and it is not preferable. Technically and from practical perspectives, the Insured must have an insurable interest of the subject matter to be eligible for any insurance cover. It means that it must be a financial relationship between the Insured and the subject matter of insurance. This relationship could be triggered through ownership (car, house, caravan etc.), contractual agreement (such as Tenancy Contract) or by law (negligence / liability). As human life is not belonging to anyone, either by ownership and contract nor by law, life insurance is lacking, technically, one of the most important pillars of any insurance contract “insurable interest”. This issue has been resolved by implementing a concept of assigned a beneficiary who is having insurable interest in the Insured’s life, such as family or children.

Nevertheless, In Islam, posterity is one of the fifth Islamic objectives that requires protection, and the concept of Family Takaful has come to light. This concept was practiced by Arab tribes in the Peninsula by means of Diya (blood money) where a sum of cash or kind paid to victim’s family as a financial aid in the purpose of protecting his family. For comparison, this principle could be considered nowadays as a simple policy of life insurance / Family Takaful.

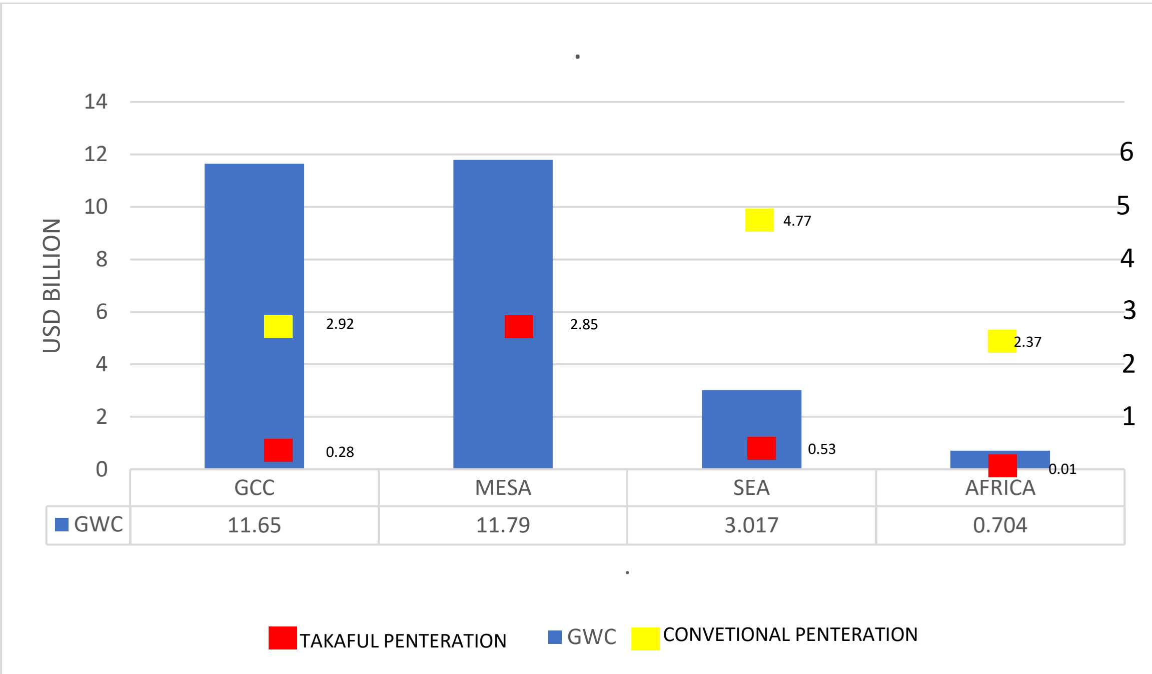
There is one important issue which has not yet been settled between Sharia principles and the law. In common law, the Insured can assign benefit of the policy to anyone who shall sustain a financial loss when the Insured passes away and the law will enforce the contract so that no one is allowed to claim benefit other than the assigned party. In Islam, the inheritance shall be divided into legal heirs according to Sharia principles (Fara’id). If the Insured dies, the heirs can claim benefits of any amount the Insured has or be having at the time of death. Therefore, when the court enforces the contract to the assigned beneficiary, the legal heirs could claim against that and request dividing the amount based on Sharia (Noor & Bin Abdullah, 2008). Some of the Sharia scholars have considered the benefit of the policy as a gift “Hibah” and then no one can claim for a given gift. However, it is argued that the Insured shall not be in a position whether by law or Sharia to offer a gift of something that is not owned / possessed at the time of signing the contract (Abdullah and Abdul Aziz, 2010). Therefore, the regulators must look into this matter carefully and issue a clear regulation to avoid any possible argument.

- **Penetration Rate**

In general terms, the density and penetration of life insurance in the GCC is very low compared with other western countries. For example, the expenditure of life insurance in Saudi Arabia and UAE is USD 1 and USD 68 per head, while it is USD 2,503 in the UK and USD 1,447 in the USA with a penetration rate of 10.30% and 4.23%, respectively (Ahmad, Masood and Khan, 2010). Comparing it with the high GDP in these countries, the penetration of life insurance is not commensurate. This will clearly show the substantial difference of attitude toward risks between these countries.

The chart (20) below shows Takaful penetration rate in GCC which is significantly much lower than conventional insurance at 0.28% out of 2.92% comparing it with the total insurance penetration rate. The unexpected result in the GCC is not much different from the Takaful penetration rate compared with conventional at SEA region.

Chart 20 – Penetration Rate of conventional and Takaful Insurance among regions



Source: Milliman Report (2019)

As highlighted overhead, the responding managers have confirmed the fact that Takaful business in the world is still in its infancy stage and requires more time to prevail. However, they have come with some recommendations to increase the penetration rate through.

- Targeting customers regardless of religious perspectives by practicing ethical and successful operation
- Islamic banks and financial institutions can play a major role of increasing Takaful market share
- Innovating products that meet customers' insurance requirements

All of these practical factors could bring customers' attention to Takaful business; the more customers brought in the more the penetration rate is achieved.

However, and in addition to the above, there are interrelated logistical factors, from the author's point of view, that affect the penetration rate of Takaful business such as:

- Lack of public awareness about Takaful business as an alternative option of conventional
- Absence of acknowledgeable Takaful brokers who could play a major role of spreading the right concept of Takaful
- Insufficient educational campaigns / programs to enhance the concept among Takaful workforce as well as public

All these points have been discussed, deeply, in the coming section.

4.2.6.3-Takaful business in the UAE

Tracing Takaful performance in the UAE market for the last 5 years shows that the business is growing substantially in terms of gross annual contribution and market share comparing it with conventional insurance sector, as illustrated in the table (23) below.

Table 23: Performance of Takaful sector in the UAE 2014-2018

AED Billion

	2014	2015	2016	2017	2018
Gross Written Premium	33.53	36.95	40	44.82	43.72
Takaful contribution	2.58	3.41	3.74	4.25	4.42
Market Share of Takaful	7.7%	9.2%	9.35%	9.48	10.1%

Author's Analysis

Comparing the business with national insurance companies, it has been observed that the net earned contribution of the Takaful sector, unlike conventional, is decreased regardless of the substantial increase of gross written contribution, the table (24) below refers. This is because the significant loss sustained by the largest Takaful provider SALAMA, in 2018, which dropped the overall net profit of this sector down.

Table 24: Performance of Takaful Sector comparing with Conventional National Insurance in UAE

AED Billion

	2016	2017	2018
Total Gross Premium for National Companies including Takaful	24.89	28.14	27.68
Gross Premium of National (Conventional)	21.15	23.89	23.26
Gross Takaful Contribution	3.74	4.25	4.42
Net Earned Premium of National Companies	12.454	13.9	14.45
Net Earned Premium of National Companies (conventional)	10.12 48%	11.41 48%	11.8 50%
Net Earned Contribution of National Takaful	2.33 62%	2.49 58%	2.65 60%

Author's Analysis

The penetration rate of insurance in the UAE is the highest amongst GCC countries. In 2017, the penetration rate in the UAE was recorded at approximately 2.9% and it was still below the average for emerging markets (3.2%) and significantly below the global average (6.3%). The responding lawyer (PH) highlighted that "There is relatively limited appetite for insurance / Takaful products in the UAE and the majority of premium is coming from mandatory lines. The position is also exacerbated by leakage from the market, particularly in the life insurance sector, whereby expatriates purchase products from their home jurisdictions". Furthermore, penetration of the life insurance / family Takaful sector is particularly limited. This is due in part to the leakage issue referred to above and to the small scale of Takaful capacity and localized operation of the business.

Family Takaful in the UAE

The responding manager (OA) has outlined that

> *"**Regardless of the limited number of life Takaful operators in the UAE, family Takaful is growing and gaining momentum during the last years. For example, Family Takaful in the ADNTC was formed by 5% of the company's portfolio in 2010 and has increased yearly to form 35% in the year of 2019".***
> **(OA)**

The reason behind that is the increase of awareness among expats of the need of life insurance as a part of a saving instrument for their families. The Tables (25) and (26) below show the gross written contribution of family Takaful in the UAE market comparing with GWP of conventional life insurance for the year of 2016 and 2017.

Table 25: Performance of Family Takaful comparing with Life Insurance in the UAE

AED Billion

Gross Written Premium	**2016**	**2017**	**Line of business**	**Total**	
				2016	**2017**
National companies including Takaful	22.88	26.07	General	24.89	28.14
	2.01	2.07	Life		
Foreign Companies	8.54	8.99	General	15.1	16.67
	6.56	7.68	Life		
Takaful Operators	3	3.41	General	3.74	4.25
	0.74	0.84	Family Takaful		

Source. Author's Analysis

Table 26: Market Share of Family Takaful in the UAE

	2016	2017
Family Takaful comparing with Notional Companies	36.8%	40.5%
Family Takaful comparing with Foreign Companies	11%	10.9%
Family Takaful from total Gross Written Premium	8.6%	8.6%

Source. Author's Analysis

From the tables above, it can be noted that the life sector in the UAE is dominated by foreign companies where they are forming 81% of total gross written premium for life insurance. It is clearly explainable as these companies, such as Munich, MetLife and AXA who have a long experience in this segment and multi-innovative life products that meet the needs of a huge number of people. Another important reason is that the majority of expats prefer dealing with international companies that have a presence in their home countries which enable them to benefit from life insurance wherever they are living. This factor is not an option for local companies who are unable to create international products that cover expats in their homes.

Further to those factors addressed above in the GCC market, which are applicable to the most extent in the UAE, there is one factor which is relating merely to the local jurisdiction. The UAE Insurance Authority had issued a regulation in 2007 preventing composite companies to operate both types of insurance. Therefore, all new companies registered after that date were allowed into either practicing General insurance or life insurance. Afterwards, many of Takaful operators were established in the UAE market to carry out general insurance activities as the market for Family Takaful is, not yet, matured. Therefore, there are 5 out of 12 Takaful operators are practicing both types and offering Family Takaful. This undoubtedly reflects negatively on the share size of Family Takaful in the market as a whole.

Another important point raised by the responding lawyer (PH) relates to the investment. In principle, life insurance is a mean of investment for mutual benefit to the Insurer as well as the Insured. The critical factor that affects the growth of Family Takaful is the lack of investment assets which are available. He stated

> ***"There also appears to be fundamentally less appetite for life insurance solutions, as a form of investment, than is the case in other markets. Possibly this is due to the absence of income tax (and therefore there is no comparable efficiency to be gained) and/or greater sophistication of investors who purchase financial products directly".*** **(PH)**

However, these issues are applicable to both the conventional and Takaful industry. For the Takaful business, many Takaful operators in the UAE lack scale and are inadequately rated. This limits the lines of business which they can access and also precludes certain operational efficiencies. He also acknowledged that

> ***"In part, this is due to the comparative youth of these entities and the impact of initial start-up costs".*** **(PH)**

It is also noticed that most of the contribution generated from Family Takaful is derived from Group and Credit life which are short-term policies based on annual contribution. Nevertheless, an individual life product which requires long-term investment is still limited.

Other new regulations, in the UAE, for life insurance / Family Takaful were brought into practice from 2019. These are relating to commission paid to intermediaries, investment-linked products and disclosure obligations on all stakeholders including operators, brokers and other distribution channels and how the financial data shall be reported to the insurance authority. These regulations shall enhance transparency and credibility of life products and support the principle of customer's protection (IFSI, 2020).

4.2.6.4-Takaful Share Vs. Conventional in the UAE

It has been claimed from the literature review that the market of GCC is much saturated by insurance providers, particularly Takaful operators. In a small market such as the UAE, there are 62 insurance providers serving a population of 10 million. Out of these providers, there are 12 Takaful operators. Considering the following factors:

- Muslims in the UAE are forming 76% of total population
- Takaful share is almost 10% of the total insurance market
- The Penetration rate of Takaful is far from its conventional counterparts

Logically, as Muslims are prohibited to place their insurance needs with conventional providers, the market share of Takaful should reflect, at least, the number of Muslim populations by the same percentage. On the contrary, conventional culture is still prevailing among people and this highlights a warning to Takaful operators and regulators, that there is a significant lack of awareness about the Takaful business. This has been discussed in the next chapter.

The responding managers have outlined many factors that affect Takaful business in the UAE from logistics and operational aspects, as noted underneath.

- ➢ The market is crowded by insurance providers, particularly Takaful operators. Merging and acquisition is a practical solution to increase capacity and reduce competition
- ➢ Islamic financial institutions, particularly Islamic banks, are not appropriately supportive. Regulators may play a major role by making Takaful products mandatory for Islamic financial institutions.
- ➢ Shortage of innovative Takaful products to meet customers' requirement as well as Sharia compliance
- ➢ New entry in a competitive marketplace
- ➢ Marketing Takaful products is similar to conventional

As confirmed by (OF), 12 Takaful operators in a small market like UAE is undoubtedly a disadvantage, there is an important factor relating to risk background in terms of religious beliefs and social culture. Also, the lack of specific legislation for a Takaful business is another factor that enhances the perception of the business as similar as to conventional.

Unlike developed countries, most of the population in the UAE comes from developing countries, where the risk orientation does not form a part of their educational culture. In addition to Muslims' reaction about unfortunate incidents, both reasons have had a significant impact on the insurance business in the UAE market. As recorded, 90% of population in the UAE is expats and ultimately, they are tenants. It is rarely found, for instance, that individuals who are looking to insure their contents and buying a household insurance policy which such type of insurance is forming a considerable portion of the insurance industry in the developed countries. Unsurprisingly, the foreign insurance companies in the market are providing household insurance to their customers who are originally coming from those countries. Hence, other individual insurance, out of mandatory motor and medical, such as Personal Accident, life insurance and the like are not demanded in the market due to the same reasons which reflects adversely on the overall penetration of insurance.

Reducing the number of Takaful players in the UAE market, by either merging or acquisition, could undoubtedly benefit all stakeholders of the Takaful industry through:

- Increasing capital which allows Takaful operators to underwrite huge risks and ultimately increase the income of contribution; this shall enhance Takaful operators' capability to retain in-house higher percentage of contribution
- Encouraging Reinsurers to provide more coverage facilities with the best discounted prices as the volume of business being offered by Takaful operators is increased; this will enhance the competitive position of Takaful operators among its conventional counterparts

As outlined in the previous section, Reinsurance commission is principally paid to the Reinsured as a means of sharing a percentage of operational expenses that have been incurred to manage the ceded risk. Also, Reinsurance profit sharing is an incentive amount, commonly paid by Reinsurers, to cedant for proper management of the risk. Both are participating of reducing the incurred expenses and ultimately reflect positively on the combined ratio. Knowing that these commissions for Takaful are deposited into the participants fund and therefore not participating to offset the increase cost of general expenses, the gross and net combined ratio of Takaful companies in the UAE are still above 100%, as shown by the table (27) below. which means a loss (IA Annual Report, 2019).

Table 27 - Combined Ratio for Property and Liability Insurance

	2017	2018
Gross combined ratio for National conventional	116.5%	77.4%
Gross combined ratio for National Takaful	93.8%	116.8%
Net combined ratio for national conventional	84%	79.5%
Net combined ratio for national Takaful	110%	113.3%

Author's analysis

Furthermore, limiting the Wakala Fee to 35% including general expenses and acquisition cost leads Takaful managers to decide on reducing the expenses by paying off some employees, reducing the salaries of key personnel and restricting their capability to invest in Technology and marketing campaigns. This puts tremendous pressure on existing employees to work, anxiously, extra hours to compensate the shortage of employees and to maintain their job which, undoubtedly, reflects adversely on the efficiency and quality of their outputs.

Having said that, the operational costs of Takaful insurance is much more than its conventional counterparts due to the following.

- Imbalance of commission paid in and paid out arising out of a) Sharia restrictions regarding Reinsurance commission and profit sharing and b) maximizing the Wakala fee up to 35% including brokerage commissions
- Incurred costs to maintain the compatibility of Takaful operation with Sharia principles
- Restricted Islamic investment assets and incurred costs to comply with Sharia which reduce investment income and ultimately reduce the Modaraba profit sharing which would be utilized to offset part of the operational expenses

Therefore, Takaful operators, in addition to surplus distribution, have no other option than to increase the price of Takaful products in order to recoup back some of the operational expenses and keep a margin of surplus.

From all resources, it has been noticed that the main challenge that affect the business of the Takaful sector is its small size, being unbranded and having a limited access to international markets. Opening Takaful windows by international Insurers and Reinsurers might solve this issue and shall increase the market share of Takaful business worldwide. IFSB have issued many guidelines and recommendations to be followed to manage Takaful windows based on Sharia Compliance. The following are the key issues addressed by IFSB.

- Assets of Takaful windows are absolutely segregated from conventional
- When Takaful window's asset is supported by those of a conventional company in terms of solvency or liquidity, this asset must be identified and as being Sharia Compliant
- The Takaful contracts issued by windows must be in line with Sharia Compliant

Two forms are recommended to international Reinsurers, either to open Takaful window or establish subsidiaries wherever they are in or out of borders (IFSB-18, 2016). In each case, Takaful business will be opened to a huge financial capacity and globally branded companies and in addition benefit from a high profile of technical expertise.

However, while this is an option in many jurisdictions, it is not allowed in the UAE. As shown above, statistically, life insurance in the market is dominated by foreign companies (27 providers) generating an annual premium in circa of AED 7 billion while the life insurance for all national companies (35 providers) is accounting for AED 2 billion only (Takaful contribution is less than AED 1 billion). On the other side, and in practical terms, many international companies who are operating in the market and looking for a branded Takaful insurance provider, have no option other than insuring their business (mostly marine, aviation, oil and huge engineering projects) in international branded company through fronting arrangement with local Takaful provider. **Therefore, allowing Takaful or Retakaful windows into the UAE is a potential opportunity to increase the market share of Takaful either for General or Family Takaful alike.**

The current operational strategy of Takaful operators is how to compete with their conventional counterparts in price and service. This is a fundamental misunderstanding of what Takaful business is. The ownership of the policyholders' Fund, flexible models of operation, distribution of surplus and ethical values behind the Takaful operation are the key feature of a Takaful business and the unique selling points USPs or Unique Value Propositions UVPs of Takaful industry. Failure to introduce the business using the UVPs / USPs and branding the business as value-driven, the public awareness about Takaful and conventional is misconceived and the appropriate location of Takaful remains displaced on the world business map.

It could be concluded that the regulators have played no roles to support Takaful business and, instead they have limited the Wakala / Modaraba share and prohibited the option of establishing Takaful windows in the UAE market. Complying with Sharia principles in terms of production and investment and in addition to the above factors have made Takaful operational expenses more other conventional counterparts. Regardless of the fact that statistical results show that the Takaful business has grown in a very short period compared with conventional and has accomplished more than 10% of total market share and 17% of the national insurance providers in the UAE market, many challenges have been addressed which break down the dramatic growth of the business during the last decade. These challenges have been discussed critically in the coming chapter.

CHAPTER V

Findings and Discussion

5.Introduction

Having examined the Takaful business features in terms of principles and performance, it has been observed that Takaful business is confronting common challenges, similar to any other business, and specific challenges which arise from the nature of business in terms of concept and operational model where both are preventing the business from growing and expanding as expected. While the common challenges have been discussed in general, the specific ones are intended to be investigated thoroughly in this chapter, mainly those who have had a major impact on Takaful operation.

Regardless of challenges Takaful insurance faces in its home countries, there are many opportunities for the business to be established in non-Muslim countries. The increasing demand for ethical products, the flexible regulatory system to adopt Sharia compliance, the existence of mutuality and the increased number of Muslims, could play encouraging factors for Takaful business in the Western. Nevertheless, each market has its own challenges; but their existence is always a pillar of development. In this chapter, these opportunities and challenges in the non-Muslim markets has been discussed.

Challenges and constraints

From literature, the respondents / interviewees have prioritised the challenges that require the immediate attention of business leaders and regulators and have also addressed the new ones that business faces in general markets as well as local markets. It has been noticed that some of these challenges are brought to the business due to the specificities of Takaful, some are a consequence of the operational cycle and others are a combination of both.

As with any other industries, selling the finished products is the final stage of operation. Prior to the operational stage, the management should make sure that a) the market is mature enough to receive the product or the products could be strategically introduced, b) the right and skilled workforces are available, c) the regulations are in support and d) the marketing channels are secured; in other words, allocate logistical resources to move into operation. Then management shall ensure a smooth operation through setting appropriate corporate governance, comply with regulatory framework and maintain a proper communication channels through all organizational levels.

Having examined Takaful business from theoretical and practical aspects, it has been found that many challenges / constraints are preventing the business from growing, and from the author’s point of view, these could be categorized into:

- **Logistical challenges:** Lack of public awareness of Takaful business, shortage of regulatory support, skilled human resources and Sharia scholars, lack of standardizations and distribution channels
- **Operational challenges**: Productivity, market forces and tendency, product innovation and marketing strategy, competition, insufficient investment of Islamic assets and shortage of rateable Retakaful
- **Organizational challenges**: Corporate governance, regulatory and Sharia compliance, operational models, solvency, and financial requirements

Operational challenges are, indeed, common for any business and shall not be therefore discussed in detail; unless where it is found imperative to enhance the research results. It is intended herein to focus on challenges that arise from the specificities of Takaful nature, either logistical or organizational constraints that it is believed have the most significant influence on Takaful growth and expansion. Having said that, the main constraints which shall be examined in this research is identified under:

- After almost 40 years of operation in countries where Muslims are the majority and the business was allegedly designed to fit their requirements in terms of social protection, solidarity and religious beliefs, the lack of public awareness about the business is undoubtedly beyond expectation. Having determined that the penetration rate and market share of Takaful in all markets, particularly in the UAE, is far away comparing with conventional insurance, it is believed, from the author's point of view, that this issue is the bottleneck which restricts the business to develop and grow. From literature, it has been noted that the matter in question has been highlighted since the early years of operation and it is still prevailing up to the date of writing this research. Therefore, it is inevitably important to investigate all factors around this issue by carrying out a deep discussion with business leaders with the purpose of finding out the root / attributable causes and possibilities to overcome. Theory of Constraints TOC have been used to identify, break down, highlight the impact, and find solutions to overcome the bottleneck constraint which is preventing the business prospering. The final goal is designed to provide answers to the core questions of the TOC and determine, ultimately, what the business needs to bring about change; what should it be changed to and what actions should be applied to lead to the change.

- Another constraint, which is no less important than the lack of awareness, is the existence of ineffective corporate governance mechanism. The specific nature of the Takaful business, particularly the ownership of policyholders' fund and the segregation of two funds, creates a potential conflict of interest between shareholders / managers and policyholders. These issues have been raised by many researchers and practitioners, but it was noticed that no practical solution has been made so far. The way the regulators deal with this issue has made Takaful insurance to be perceived in a similar way to conventional which reflects adversely on public perception; that Takaful is merely, like others, just an insurance provider.

Appointing the SSB members and the Sharia Officer, actuaries and external auditors by the Takaful management leads to another layer of conflict of interest. For the time being, this important issue has not been previously raised or even discussed.

However, as the said constraint is relating to corporate governance where accountabilities toward stakeholders need to be determine, the Theory of Agent-Principal, in addition to utilizing the TOC, are used as a combination of theoretical framework.

5.1- Lack of public awareness of Takaful business

Indeed, all resources confirmed the negative impact of the lack of public awareness on Takaful business in terms of growth and expansion. Most resources have addressed different reasons behind this issue of which all could be considered as constraints or root obstacles such as the lack of an educated and inexperienced workforces, including managers, of running Takaful businesses, few numbers of Sharia scholars who have Sharia and business knowledge, shortage of education systems and knowledgeable regulators, mainly about Takaful specificities. All these issues make Takaful managers unqualified to create innovative products, unable to introduce the business to customers in the right manner and ultimately incapable to differentiate themselves from conventional business (Maiyaki & Ayuba, 2015), (Ayinde & Echchabi, 2012), (Ahmad, Masood and Saeed, 2010), (Ahmad, 2007) and (Soualhi & Al Shammari, 2015). As a result, the Takaful penetration rate in most countries, particularly GCC, is much less than conventional insurance of which the majority of resources have established the lack of awareness is one of the main reasons behind that (Milliman, 2017).

In the Dubai World Insurance Congress carried out in February 2019, Mr. Mohammad Al Hawari, the managing director of Takaful Emarat, stated that Takaful as a word is not clear to people who believe Takaful is merely an insurance company rather than a concept of solidarity. In the same congress, Mr. Al Natoor, the global Head of Islamic Finance at Fitch Rating, outlined that there are three types of Takaful customers a) customers who are Sharia sensitive, b) customers who are non-sharia sensitive or even non-Muslims but believe in the concept and c) customers who look at a Takaful company as competitive insurance providers. However, none of these customers have a clear knowledge about the Takaful business (Benyon & McGee, 2019).

Having discussed this issue with business leaders, the manager (PS) pointed out that the lack of awareness of insurance, in general, is most probably due to lack of needs in the GCC market. For example,

> ***"Individual lines such as homeowners, medical and life is not common in the UAE. While the main risk for homeowners is burglary and fire where these risks have rarely happened in the UAE due to substantial security measures being applied, the need for medical is mandatory, to be provided by the employers to employees and their dependents. Furthermore, as the***

> ***majority of the population in the UAE is expats, long-term health care is not attractive as nobody is supposed to be at retirement age in this county"*. **(PS)**

Therefore, the lack of needs leads to lack of awareness. This is part of the problem which is applicable for both conventional and Takaful alike. In respect of Takaful, the issue is about many factors such as:

a) The small size of Takaful operators could not help to allocate a huge amount of money for advertisement, public education, sponsor big events and invest in technology; all these issues will keep the customer behind the concept of Takaful
b) Takaful operators are not communicating with customers properly and marketing Takaful as a value driven product
c) Distinction of Takaful insurance through innovative products that lead customers to perceive Takaful products dissimilar as conventional

This has also been confirmed by the Reinsurer manager (MAS) and the professional lawyer (PH) where the later commented further that the lack of innovative Takaful products, using the same terms and conditions of conventional, adopting conventional claims handling philosophy and competing on the same tariff and same attitude, are considered key factors of that issue.

The manager (OA) believes that there is, **firstly,** a misconception about Takaful by not looking at it as a business model. This concept is not just affecting customers but investors will be less interested to invest in Takaful if they feel it is just a concept of donation or charity. **Secondly,** the insurance market should be blamed for the lack of awareness because business leaders have transferred insurance products into commodity rather than service. Their concept for getting money through premiums and generating money from investing the collected premiums would produce a fund that should be enough to pay claims, cover operational expenses and leave a good profit to shareholders. Therefore, they started reducing prices to attract more customers and these prices are reduced year by year to the limit that most companies, particularly small sized, are sustaining losses. How has this affected Takaful companies? Takaful business was newly established and could not be able to compete with companies who were established 50 years back with huge reserves and equities. However, Takaful operators have been therefore left with no choice rather than offering competitive prices to customers who used to get annual discount on their premiums. So, he continued

> *"**The market leaders along with shareholders should look again to their practice by adopting a blue ocean strategy rather than keep competing on an existing diminishing market share with fierce competition on price"***. **(OA)**

Increasing awareness is a strategy that operates by focusing on creating new segments and new products, enhancing underwriting client services and honouring commitments. New challenges would come but the insurance leaders should be ready to overcome those challenges.

(PH), while answering a question regarding regulatory issues in the UAE, pointed out that there are no specific requirements for brokers / intermediaries who dealt with takaful products. It would assist in educating the public if such intermediaries had to provide additional information for takaful products (for example, information about the distribution of surplus) and were qualified to properly explain the differences between conventional insurance and takaful.

In this respect, the manager (PS) has confirmed that

> *"Insurance business in the UAE, similar to other markets in the region, is brokerage-driven and none of the existing brokers is having Takaful knowledge".* **(PS)**

Therefore, they are placing business with Takaful based on prices and appropriate terms and conditions compared with other conventional counterparts. As a result, they have no effect on spreading the concept and teaching people about the differentiation between Takaful and conventional insurance. He pointed out that

> *"A knowledgeable broker can help a client make an easier choice between Takaful and conventional through certifying the product that is being offered by the Takaful company is really a Sharia compliant one".* **(PS)**

However, to reach this point the broker should have a level of expertise to introduce Takaful business, in terms of principles, products and operational models, to customers. It might be required by Takaful operators, as well as regulators, to start planning an educational program to brokers about Takaful and this could undoubtedly help by enhancing public awareness of the business.

Furthermore, how the Insurance brokers can play a role of increasing awareness of Takaful business which is a matter of concern for business leaders and why there is no Takaful broker who is offering solely Sharia compliant products, the manager (OA) established the fact that most incoming businesses, particularly in the UAE, are placed through insurance brokers. Unfortunately, the main concern of insurance intermediaries is how to maximize their commission.

> *"Whoever pays more commission, is who will get the business, regardless of whether it is a Takaful or conventional insurance company".* **(OA)**

Having Takaful brokers and firms that have a good knowledge of Takaful, will undoubtedly reflect positively on the business in two areas a) increasing Takaful awareness in community and b) protecting the participants' interest. Having a good knowledge of insurance in general and Takaful in particular, shall enable the broker to give better advice to their customers in respect of policy terms, benefits, exclusions, surplus distribution and other core conditions which, in its turn, will enhance customers' knowledge and establish a comparison base between Takaful and conventional. This will give customers many options to place their businesses

Undoubtedly, he continued, the knowledgeable broker, in general, can protect their customers' interest during a) The underwriting process: they know what the best option, terms and conditions fit the customers' needs and requirements and b) Claim settlement: they can technically argue with the claims team if the customer is not treated fairly during a claim life cycle and enforce correction on any unreasonable decision made against customers. However, he has also given a valid notice that standalone

Takaful brokerage firms are not feasible as the business is new and their share shall be limited to the capacity of Takaful operators in the market. Nevertheless, they can do conventional as well as Takaful subject to having specialized staff in Takaful business. So, he concluded that

> ***"It is workable, achievable and contributes positively to increasing Takaful awareness and at the same time taking care of the customers' interest***". **(OA)**

From primary as well as secondary resources, there are, indeed, many interconnected factors which are playing a major role behind this problem. These have been summarized and discussed as follows.

- Shortage of resources due to small size of Takaful operators
- Lack of skilled workforces of Takaful
- Inappropriate marketing strategy and poor communication channels
- Perceiving Takaful as a concept of charity
- Unstructured practice leads to unfair competition
- Lack of innovative Takaful products
- Adopting same conventional procedures and philosophes in terms of claims and underwriting
- Shortage of knowledgeable brokers of Takaful
- Adopting conventional wordings, terms, and conditions

As addressed in Chapter IV, the low penetration rate of Takaful in Muslim countries is a warning indication of the proposition value of the business among Muslim consumers. It is understandable that competing well-constructed conventional insurance companies would be a big challenge but having innovative products that is not merely Sharia compliant but more competitive than conventional could substantially change the market trend.

Nevertheless, the global Takaful industry is still confronting three key challenges which should be overcome in order to maintain double digit growth: a) Expansion of Distribution Channels where the business in most regions is brokerage-oriented b) Creating innovative products which differ from conventional and meeting customer needs and c) Paying more attention to Corporate Governance Issues (HBRSU, 2016).

It has been claimed that the shortage of innovative Takaful products is a consequence of the absence of Takaful professionals who could create a product that would be attractive to customers' needs as well as agreeable by Sharia scholars. The majority of Takaful staff, including managers, come from conventional backgrounds and they are consequently incapable of tailoring Sharia Compliant products which is a practical valid point. Oseni, Ahmad & Hassan (2016) highlighted that the inadequate skilled workforces of Takaful have slowed down the growth and development of the business.

In respect of marketing policy, the distribution channels of the Takaful sector, are similar to conventional, and mainly rely on insurance intermediaries (such as brokers, agents and BancaTakaful) who are incapable of introducing the business accurately and reaching a large number of consumers (Coolen-Maturi, 2013). Enhancing in-house marketing, moving toward digitalization and targeting multinational companies could help in opening the door into global networks.

However, while some of the Takaful operators are using Islamic Insurance as a benchmark to attract Muslims on the basis that conventional insurance is inadmissible for Muslims, the concept has been perceived not as a business model rather than a sort of charity with some benefits to shareholders. Therefore, large investors, who are capable of injecting huge capital to invest in insurance business, are reluctant to invest in the Takaful sector. That explains one factor in the small size of Takaful operators where the majority is maintaining merely the minimum capital requirement by the IA.

In respect of Takaful policy documents, it has been remarked by the author that the policy wordings are conventional and inconsistent with Takaful principles. For example, in the current wording practiced in the UAE market, the policy stated that "*The Company shall indemnify the Insured Or not indemnify the Insured* ,,,,,," which is in fact conventional wordings and in contradiction with the principle of Takaful where policyholders are the owner of the fund that the company merely manages as an agent (Wakeel). Instead, the wording should be rephrased as "The participants shall be indemnified ,,,,,,," in some circumstances that the loss trigger / do not trigger the response of policy liability. Having said that, the perception of policyholders that Takaful insurance is exactly like conventional insurance is not a matter of surprise.

Brokerage Relationship

The insurance market in the UAE is brokerage oriented with 163 registered brokerage firms up to the end of 2018. Insurance companies rely heavily on the brokers to bring business on board. This is due to the followings.

1) The lack of public knowledge of insurance contracts, terms and conditions either among corporations in general or individuals in particular, leads to the need of professional insurance consultants for appropriate and accurate advice
2) Shortage of distribution channels (enhancing in-house marketing or offering products online or through digital portals is not appropriately yet utilized)
3) Light dependency on technological windows. The insurance industry in the UAE market is lagging behind the technological achievement experienced by its insurance counterparts in other markets

As a competitive market, the business is driven mainly by price in addition, of course, to other factors (such as low deductible, Reinstatement Clause or other benefits to the Insured) which make the decision of the broker in which company the business shall be placed. In respect of international organizations, the requirement of rated insurance companies is prevailing over the price and the brokers in this case have very limited rated national insurance companies in the market, specifically A rated. The size, the history and the financial capacity are also important factors as far as individuals and corporations are concerned. Considering the new emerging business of Takaful, these factors become a critical challenge.

However, a question has been asked whether insurance brokers could play a role of expanding and enhancing Takaful awareness among people. Academic studies in

Malaysia found out that the lack of public awareness of Takaful is associated with the knowledge and understanding of agents towards the principles and concept of Takaful and it has been recommended to prepare a learning environment to establish the well-knowledge Takaful agents. Understanding objectives and practical application of Takaful shall most certainly maintain its sustainability and future developments (Salleha, Abdullahb and Razalic, 2013). However, the matter in the GCC, particularly in the UAE, is worse as there are no requirements to intermediaries who are carrying out conventional insurance business to understand Takaful principles prior to approach customers.

From another perspective, insurance brokers have claimed that conventional products are more competitive than Takaful in terms of price and customers' need as stated by Dave Matcham, the Chief Executive of the International Underwriting Association, (Benyon & McGee, 2019). This statement is undoubtedly correct as addressed in the previous chapter that Takaful products are more expensive than conventional due to many reasons which have already been outlined. In respect of products, Takaful operators are replicating conventional products with few amendments in policy wordings (the Preamble) to fit Muslim's requirements. The concept of owning the fund, distributing surplus and investing the fund in ethical assets are unique selling points of Takaful and without introducing the business based on these principles either by Takaful marketing staff or intermediaries, the lack of awareness is still the first and most obstacle facing one for the Takaful business.

5.1.1- Lack of knowledgeable workforces of Takaful

It has been addressed from both resources, secondary and primary data, that Takaful staff has a shortage of knowledge about the nature, specific features and operational models of Takaful which is reflected negatively in the way of dealing with Takaful products and to the extent of spreading the concept among their communities. This statement is correct to a large extent. From the author's experience in the Takaful sector, the majority of employees, including senior managers, have a general idea about Takaful but very limited knowledge about its specificities such as the concept, principles, Surplus, segregation of funds, Qard Hasan, operational models and over and above the ethical values behind the business. This undoubtedly shall influence their ability to explain these unique features to the public and it works, consequently, in the opposite direction by spreading the right and accurate model of Takaful.

However, there have been many attempts with respect to an educational approach such as the Chartered Insurance Institute in the UK who has noticed the importance of having academic knowledge of the business in question and consequently established a separate subject of Takaful business (Takaful Principles) five years back in an advanced level of study. Subsequently, voluntary short sessions have made available to students / workers about Takaful in the Institute of Banking, Insurance and Finance in the UAE. Unless it becomes a compulsory requirement to people who are working / planning to work in this sector, knowledge of Takaful remains an essential challenge that requires immediate intervention by regulators, business schools and executive leaders.

As addressed by literature, the SSB members have acquired a good knowledge in the banking sector and they have innovated many banking products that allow Islamic banking to dramatically flourish in the GCC markets, including UAE. The issue in respect of Takaful products is different as those members have little or no knowledge of insurance products which makes innovation of Takaful products imperceptible. So, the question which must be answered is how Takaful products shall be distinguishable with unknowledgeable staff about Takaful principles and inexperienced SSB members of insurance products?

It can be noticed that the low level of customers' awareness of Takaful business becomes a consequence of the operational challenges such as competition, marketing strategy, innovative products etc. In other words, logistical challenges are becoming operational challenges where both are working in the same direction. Nevertheless, the majority of operational challenges are common between all other businesses, but it is intended to examine them from the specific nature of the business in question. It has been also observed that the lack of awareness is depending, to a large extent, on the regulatory framework, in addition, to risk cultural and operational behaviours.

5.1.2- Lack of Regulatory Support

As addressed by secondary and primary collected data, many practitioners and researchers outlined that the business requires more intensive involvement by regulators to establish a harmonized framework in terms of operations and financial reporting. The said statement is applicable in the main Takaful markets, such as the UAE, as well as sub-markets.

The responding manager (PS) pointed out that regulations in the UAE are not that Takaful friendly.

> "***Regulators could play crucial roles to improve the landscape of business. For instance, if the Islamic banks operating in the market have made Takaful mandatory for their clients, this will definitely allow growth of Takaful companies"***. **(PA)**

In the Middle East, there are two large markets for Takaful; the UAE and Saudi Arabia. Saudi Arabia is technically considered 100% Takaful or Islamic, while UAE is only 10% Islamic. So, if UAE starts and continues to move toward Islamic, as regulations demand, then Islamic Takaful has an opportunity to grow in UAE.

Regulatory aspects and how regulators look at Takaful is another issue that affects the business, as confirmed by the responding manager (OA) who addressed that

> "***It is not very clear in the mind of the public and authorities the fact that Takaful is not a charity but it is a business model which aims to generate profit and its objectives are not different from any other conventional company of maximizing its returns to shareholders as well as policyholders"***. **(OA)**

The misconception about surplus put a lot of burden on Takaful companies where the shareholders must take care of all expenses associated with the operation such as IT, salaries, buildings and all other aspects. Over and above, the regulators in the UAE have made what should be borne by shareholders is beyond the general operating expenses. He has again raised that

> "***The acquisition cost which is natural and as per AAOIFI is a consequence of insurance activities and should be on the burden of policyholders not shareholders"***. **(OA)**

Practically, customers are approaching the broker or any distribution channels to place their businesses in one of the insurance companies in the aim of getting the best terms and competitive prices. Therefore, it is clear that the commission paid to the broker should be borne by the customers / policyholders. Furthermore, received commission from reinsurance placement shall be deposited in the Policyholders' account and paid commission shall be paid from the shareholders' account. That makes the imbalance and a significant challenge of Takaful operators better placed to compete with conventional insurance players.

Conversely, he continued, conventional insurance companies can be more competitive in paying the distribution channels more commission, which will create bias towards them and against Takaful companies who are somehow restricted because they cannot exceed the Wakala fee charge which should cover the commission, general operating expenses and all others. Adding acquisition costs to it, so there is a limitation on how much the Takaful company can compete to win over the distribution channels.

Another view has been outlined by the professional lawyer (PH) who has highlighted that

> ***"The one size fits all approach used in the Insurance and Financial Regulations means that it is difficult to create smaller Takaful operators with niche offerings***". **(PH)**

Given that the regulation in the UAE is based upon Federal Law No. 6 of 2007 (the Insurance Law), it is still very much in its infancy and continues to evolve. The UAE Insurance Authority is not criticized in this regard as such evolution is both necessary and inevitable. However, the evolving nature of regulation is issue for both conventional insurers and Takaful insurers. It perhaps disproportionately impacts on many Takaful operators due to their limited scale and the impact of additional costs.

The regulator (AM) has reconfirmed that the Insurance authority has established the first specific regulations for Takaful regionally based on the global practice of insurance. The Authority has made the regulation considering guidance provided by AAOIFI and IFSB. Nevertheless, IFRS4, IFRS9 and IFRS17 are the basic standards and guidelines to conduct Takaful business in term of financial reporting.

Indeed, the Insurance Authority of the UAE have established specific regulations for Takaful insurance (Board of Directors Resolution No (4) of 2010) which define and regulate, within 36 articles, Takaful terminologies, the relationship between stakeholders, the rules of Sharia controller and Committee and a provision for the formation of a Supreme Fatwa and Sharia Committee, segregation of funds, Zakat

Fund, application of Qard Hasan and Surplus distribution, Accounting Books and Records, Retakaful and regulatory discipline for violating Sharia Compliance and local regulations. Having reviewed these regulations, it has been noticed that the following points are not yet implemented / overlooked.

- ✓ The Supreme Fatwa and Sharia Committee which is the highest level of supervision and monitoring body of SSBs for all Takaful operators in the UAE is surprisingly not established yet
- ✓ Combination of personal Takaful and Property & Liability Takaful insurance is not allowed any more (Article 7). The existing companies who are undertaking both classes "*should adjust their status within a maximum period of one year from the date of regulations coming into force*". However, the regulators have given a provision for extending the said period. Composite Takaful operators who have been established prior to the date of this regulation are still conducting both types of business. Nevertheless, all established operators afterwards are licensed either to conduct General or Family Takaful.
- ✓ Further, the regulators imposed a complete segregation between Family and General Takaful in terms of surplus distribution (Article 25). However, no separation is required within the sub-classes. For instance, the participants of engineering sub-class can benefit collectively from overall surplus generated from other General Takaful Classes.

However, the responding lawyer (PH) believes that there are areas of regulation which could be benefiting from further development such as:

a) Distribution: Historically, the Insurance Law and regulations envisaged distribution by insurance brokers, insurance agents and banks. The Insurance Authority has recently started to broaden the distribution channels available to insurers and Takaful operators through the issuance of the Point-of-Sale Regulations and draft Producer Regulations and Electronic Insurance Regulations. However, these regulations are, seemingly, overly restrictive as to the distribution channels which may be used (for example, the POS Regulations require insurers to second staff to the point of sale, the Producer Regulations limit the lines of business which may be marketed, and the Electronic Insurance Regulations have a one size fits all model). It would be better to have a set of general principles that apply to all distribution models and require the industry to ensure the compliance of their distributors with these principles

b) Technology / Outsourcing: The regulations do not address the outsourcing of functions by Takaful operators (or their conventional counterparts) or the use of technology. As noted above, the draft Electronic Insurance Regulations are overly prescriptive and are focused on web-based offerings. They also purport to prohibit comparison websites which will not assist penetration. Greater encouragement should be given to the automation of operations (for example, the use of smart contracts)

c) Prudential Regulations – The one size fits all approach of the Financial Regulations is materially hampering the development of the industry. The creation of niche players with specialist product offerings would be facilitated through having more proportionate capital requirements / removing the minimum capital requirements. Likewise, peer-to-peer models may be possible within the overall Takaful construct

d) Reinsurance: Mandatory retention of a proportion of premium written would assist in growing the industry

e) Consistency: The creation of a National Sharia board (as envisaged by the Takaful Regulations) would materially assist in ensuring a consistency of approach by takaful operators. It would also provide a vehicle through which to educate the public

Therefore, the regulators should carry out market analysis for Takaful requirements and capabilities and create regulations based on their findings.

> **"*According to the current commercial model of operation, the regulators seem to look at Takaful business similarly as a stock model and the same regulatory framework is applicable on both models alike".* (PH)**

From this point of view, the claim of the lack of specific regulations for Takaful in the UAE is seemingly invalid as the business does not require further regulations. Conversely, Takaful is mutual in principle and the regulators have made no provisions to capture the nature of risk sharing and its application on business, particularly in terms of financial reporting as confirmed by the responding regulator.

Imposing regulations on Islamic banks to insure their customers' products through Takaful providers, as recommended by (PS), is in fact against free market practice. However, it is not a regulatory obligation rather than the practice of Islamic banks who should not accept dealing with conventional insurance providers as they are inadmissible in view of Sharia Compliance. Again, creating innovative and competitive products shall give no excuse to Islamic banking to deal with conventional as they are claiming that there is lack of existing Takaful products which satisfy their customers' requirements.

From the responding managers' point of view that, and as outlined in Chapter IV, the existing of inconsistency between Sharia standards and regulatory authority for many practical regulations have restricted Takaful capability to flourish and consequently to grow in a competitive marketplace. For instance, the acquisition costs and distributing technical surplus to shareholders, requires reconsideration by regulatory authority and this issue has been found due to the lack of standardization in terms of operation and financial accounting which could play a major role in harmonizing Takaful practice in the UAE market.

5.1.3- Lack of Standardization

5.1.3.1- Operational Standardization

From secondary as well as primary data, it has been established that there is no one single body governs Takaful business in the world and each country has made its own understanding and interpretation for regulating and supervising the industry in question. However, all respondents have confirmed the adverse effect of lack of standardization on business cycle in terms of financial reporting, different interpretation of Sharia, domestic capability of regulatory regime, dissimilarity of management approach which ultimately effect negatively on growth and development of Takaful business in local and global markets. However, while the UAE regulator is claiming that Takaful business has been regulated according to the best practice of international markets, the responding managers as well as the professional lawyer confirmed that without having a standard discipline of regulations, Sharia Fatwas and financial reporting, specifically designed for Takaful sector, the business has no opportunity to develop in the local markets and move consequently out of borders.

Sharia scholar also addressed the fact that Islamic banking business is witnessing a remarkable prosperity due to the existing of quite adequate standards established in coordination between the Sharia Boards and regulators; but Takaful business is still having few standards which is also rarely reviewed and updated.

The below are examples of non-standardization practice of Takaful:

- ❖ Operational Models: some of jurisdictions allow either Wakala or Modaraba model only while others, like the UAE, allow hybrid of Wakala & Modaraba
- ❖ Surplus Distribution: in many countries, regulators do not allow shareholders to share any surplus which is not the practice in the UAE
- ❖ Qard Hasan: while some jurisdictions do not specify a period for recouping Qard Hasan, others make a limit of 5 or 3 years such as Bahrain and UAE respectively; otherwise, the Qard shall be written off
- ❖ Takaful Windows: offering Takaful products through undertaking windows is not permissible in the UAE jurisdiction while it is allowed in other markets

The reason behind that, from the author's point of view, is a consequence of the followings.

a) AAOIFI and IFSB have had no power of authority to impose standards and guidelines on different jurisdictions
b) AAOIFI standards, in many cases, have been challenged by different interpretation from respective Sharia Scholars. For example, Sharia scholars in the UAE have allowed shareholders to share a portion of surplus
c) The absence of an internationalized body to enforce standards on different local authorities
d) The regulatory environment of local jurisdictions is not adjustable to implement some of Sharia Standards
e) Outdated standards, as outlined by Sharia scholar. FAS 13, for example, has been established since 2000, with the effective date of 2002

The lack of operational standardization, Takaful business has been perceived differently by customers in various markets and this has led to a potential confusion of overall understanding about Takaful in practice; and again, the lack of public awareness comes to the light.

5.1.3.2- Financial Accounting Standardization

AAOIFI have made some specific standards of financial reporting for Takaful business, particularly FAS 12 and FAS 13. The aspect of practical difference between conventional and Islamic accounting standards for Takaful have been examined with business managers to determine whether these standards were implemented and whether the business is in critically need of a specific accounting system.

The responding manager (PS) stated that there are basically three different sets of financial statements to look at.

1) **The IFRS standards** which large companies must follow because the shareholders who are involved in the company want to understand the financial statement and compare it with the financial statement of any other insurance company
2) **The UAE financial statements** which are defined by the Regulators / Regulations and
3) Also, **the UK financial statements** that are defined by UK standards

However, the financial standards for the Takaful companies in the UAE are mostly designed to create an accounting structure between the policyholders and the shareholders' funds, what part of income shall be deposited into each fund, how to distribute the surplus and issues like that. But the practical problem which Takaful operators are facing is when the financial team is carrying out accounting of receivables. For instance, the International Accounting Standard IFRS will help as the process is clearly detailed; while neither the UAE nor European standards are able to advise of how to look at and do a valuation of the assets. Similarly, for liabilities like accounting reserves, financial reserves or mathematical reserves in life cover, some guidelines have been provided in the Takaful regulations of the UAE, but for a simple comparison, these guidelines are the same of those applicable to conventional regulations in the UAE.

How to calculate the outstanding claims, unearned premium and IBNR claims (Incurred but not reported), the guidelines are the same. So, calculating the assets of Takaful business is like those of conventional guidelines. The only difference between conventional and Takaful is how to conduct accounting between the policyholder fund and the shareholder fund in respect of the later. Having done that, it may easily be noticed that most items in the financial statement are calculated based on the IFRS or International Accounting Standards. So, the financial statement whether it is defined in the Takaful regulations or not, is based on IFRS.

In respect of Qard al-Hasan, the manager (PS) pointed out that it is a defined element under Takaful regulations. This free interest loan is treated in a similar way as receivable in a conventional company. For instance, a provision in an accounting statement to Qard, given to policyholders' fund shall be made, considering that this Qard shall be recouped within three years, according to the UAE regulations, otherwise it will be written off. So, a provision of 100% in year one is maintained. At the end of this year, if the policyholders' fund sustains another loss, the possibility of recovery is reduced to 2/3 of the 100% and a provision of 100% for the new Qard, if any, is secured. If the same scenario occurs in the second year and the first Qard becomes irrecoverable, the possibility of recovery is reduced again to 1/3 for the first one and 2/3 for the second Qard. Of course, a new provision will be made for the third Qard and so on. After the third year, if a loan is not recouped, it is unlikely to be recovered and the first Qard will be written off and shall not appear in our statement, as receivable anymore.

However, this will appears quarterly in the e-form template which was designed by the Insurance Authority for that purpose but it is not represented in the company's financial statement because it is prepared based on the IFRS standards, which means all of the loans which are given to policyholder have been written off against capital and this becomes part of the calculation of the solvency.

The manager (OA) absolutely agreed with (PS) and pointed further that

> *"**Unless the regulators have interfered differently, both accounting standards will be more or less the same"**.* **(OA)**

The authority worldwide in that respect is AAOIFI which should meet and follow the accounting standards and advise what the right principles are which should be followed in Sharia compliant Takaful business from an accounting point of view. So, it does follow that unless the regulator has come in a way or another to change those which happened in one aspect on the commission paid (acquisition costs) in the UAE.

He continued to comment that 95% to 98% of both standards go parallel and that does create challenges when a new accounting system comes into place, like IFRS 17 (International Financial Reporting Standards). The committee of AAOIFI has to discuss with the international board of accounting on the IFRS 17 on how to treat and how to amend those rules of IFRS 17 to be in line with the operation and be Sharia compliant for Takaful operators. So, the answer is it should follow. But there are sometimes exceptions, as the regulator has the right to impose certain rules and regulations, not always operating necessary in line and matching with some principles of AAOIFI, and other Islamic financial standards.

The current financial statement for most insurance companies is prepared based on IFRS 4 and IFRS 9 standards; but this will be changed when implementing IFRS 17 which is intended to be fully fledged starting from 2022, unless it is deferred further or postponed by regulators. However, the new standards will pose some challenges because it will be a cash flow in certain aspects generated rather than the earned premium and so on. IFRS 17 will contribute to delay the booking of releasing of profits because it has been embedded with certain additional provisions which might slow down the reporting of the profits. This of course applies to Takaful and non-Takaful companies alike.

The lack of standardization is attributable to different regulatory practices and interpretation of Sharia views which require excessive efforts by AAOIFI and IFSB to unify standardized practice and principle toward improving Takaful sector (ZAWYA, 2019). However, AAOIFI have introduced Financial Accounting Standards on Takaful such as FAS 12, 13, 15, and 19. These standards are being reviewed in view of the new introduction of IFRS 17 and the draft of FAS on Takaful may take its application on or before 2022 (AAOIFI, 2019). Having failed to introduce the same prior to effective date of IFRS 17, Takaful shall have no choice other than implementing the same (COMCEC, 2019).

Having reviewed the UAE Insurance Authority's Financial Regulations (Board of Directors' Decision Number (25) and (26) of 2014 pertinent to Conventional and Takaful Insurance Companies respectively, it has been noted by the following.

- The Minimum Capital Requirement is the same for both insurance and reinsurance provisions (AED 100 m for Insurers / Takaful and AED 250 m for Reinsurers / Retakaful)
- The regulators have made few provisions for Qard Hasan and Surplus Distribution
- In respect of investment, the regulators have made no restriction on invested assets between Takaful and conventional insurers and the available assets for both businesses are limited exactly into the same percentages. However, this is the only difference made by regulators that the Takaful invested assets shall be in line with Sharia Principles.
- Also, there is no requirement to provide investment expenses and segregation between the expenses incurred by policyholders' and shareholders' investment fund
- No requirement to submit a separate financial statement for policyholders as it is combined within the company's financial statement
- All other regulations (Technical Reserves Provisions, Booking Financial Statements, Reporting Models) are applicable to both models
- There are few, but very brief, provisions for Participant's Solvency Fund

It can be said that the difference between the financial accounting standards of conventional and Takaful is seemingly negligible but the impact on the later might be substantial. This could be examined from two points of view:

- Big organizations and governmental entities usually study the financial statement of insurance companies before deciding in which company their business shall be placed. As far as the method of financial reporting for conventional and Takaful is almost the same, the perception of differentiation becomes less recognizable.
- Investors and business providers, through reviewing the financial statement of insurance companies, might feel that the financial reporting of Takaful is more complicated and requires further investigation by specialists of Islamic Finance.

The provisions of Qard Hasan and Surplus could have a negative impact on their decision as these are not well introduced in the financial statement of Takaful.

Having said that the Lack of standardization shall confuse investors as well as public customers of how the business is conducted and what the crucial difference between both provisions in terms of operation and financial reporting. To clear the ambiguity about Takaful business, AAOIFI shall takeover by preparing a comprehensive set of standards and enforce local regulators to refrain giving a trading license unless these standards are followed / implemented. Without this initiative, the Takaful sector shall struggle to grow and augment the penetration rate and ultimately increase the market share as the lack of public awareness of Takaful shall still be dominant if the unified body of standardization is not formed.

5.1.4- Competition

The competition factor is unignorable and its impact on the growth of Takaful business has been noticed by many researchers and international reporters.

The manager (PS) has pointed out that the insurance market in the GCC in general and UAE in particular is overly supplied. Currently, there are 62 insurance companies in a small market like the UAE. If the number of insurance companies has been reduced by regulators, through merging or even acquisition, so the competition in terms of profitability will be reduced and this will open the door for small player such Takaful operators to grow and develop substantially.

The same has been confirmed by the professional lawyer who indicated that there are too many insurers in the UAE market. Takaful operators fundamentally have, in many cases, been unable to articulate a USP that distinguishes them from their conventional counterparts and other takaful operators.

Takaful business has been established forty years ago in Sudan, commented by the responding manager (OA), and then started mushrooming in other countries either as fully-fledged Sharia compliant entities or opening windows, where the regulations allowed, to offer Takaful as well as conventional products.

> ***"In the UAE, the business was mainly established two decades ago where the environment of the start-up was extremely competitive and many Takaful companies had suffered big losses at that time. Competing with companies, established 30 or 40 years before, who have built big reserves, strong balance sheet and huge customer base, was undeniably complicated".***
> **(OA)**

The fierce competition led to significant reduction in technical rates and prices where new companies were unable to compete these prices and cover the start-up expenses. Therefore, the results of takaful companies were not as per the desired objectives. Some of them run in a loss and reduction in capital and equity and few was run into issues of solvency margin. Another challenge is the market in the UAE is not segmented between Takaful and non-Takaful companies. Therefore, the competition is existing across all lines of business.

It could be noticed that Takaful managers have made their statement without considering Takaful specificities which has been outlined by (PH). The failure of Takaful operators to compete other conventional rivals by using USPs of Takaful such as solidarity, surplus distribution and ethical investment, has a negative consequence on attracting more customers and ultimately low penetration rate and market share. It is true that the market is overly supplied by insurance providers comparing with other markets such as Saudi Arabia which is much bigger than the UAE market and there are 34 licensed insurers with one reinsurer (Clyde & Co, 2015). Regardless the fact that the regulators could encourage merging / acquisition or even stop licensing more insurance providers and the slow movement of economy whether in the local as well as global markets alike, these factors are common among all insurance players. Also, competing in prices is unsustainable short-lived strategy taking into account the childhood of the business along with high start-up expenses. Therefore, Takaful operators have had no choice other than introducing the business based on its specificities and marketing Takaful products as a value-oriented instead of price-driven.

From the author’s experience in Takaful business, instead of collaborating with each other to overcome business challenges, Takaful management look to other Takaful operators as competitors and cooperation level among them is minimal, or even not existing. In respect of co-insurance arrangement, Takaful operators prefer to use conventional insurers in the first place benefiting from their capacity and experience. This is an essential factor that keep Takaful operators small sized and struggling to flourish.

Having identified the subject constraint along with relevant factors and its effect on performance, it can be concluded that the lack of Takaful awareness was a critical issue since more than two decades. Surprisingly, after a considerable time of operation this issue is still prevailing and forming a practical bottleneck toward growth and expansion, as confirmed by all respondents. It has been found that this issue is a combination between:

- Common factors: the market witnesses a lack of risk culture and religious obstacles which affect both provisions of insurance
- Specific factors: failure of Takaful operators to introduce the business as an alternative solution of insurance for people who have some concern about the concept of conventional insurance, the absence of regulatory body to deal with the new model and insufficient efforts given by SSBs. Obviously, the link between these parties is unconnected.

Addressing the reason behind this constraint, leads to determine what needs to be changed in terms of risk culture, operational approach, regulatory adjustment and Sharia standardization.

As the matter of concern is affecting adversely on the whole Takaful sector in the UAE, this could be resolved through (actions lead to the change):

a) Takaful operators can form collectively an advertisement pool that can be used for:
   - ✓ Funding researches
   - ✓ Launching advertisement campaigns benefiting from the revolution of technology
   - ✓ Adopting educational programs in collaboration with universities and institutions

b) Regulators to adjust the local jurisdictions to capture Takaful features through:
   - ✓ Unifying the practice along with AAOIFI standards and IFSB guidelines
   - ✓ Making Takaful knowledge as a compulsory requirement to work in this sector

5.1.5- Further Challenges

In addition to the stated challenges, a Sharia scholar (NY) comes up with two more challenges that confront the business toward development.

I. ***"Unlike Islamic banking, the main reason for the weakness of the Takaful movement is that the current model does not encourage businesspeople to invest in this industry as the incentives are not promising"***. In most existing jurisdictions, standards and regulations do not allow shareholders to share any surplus from technical results, Reinsurance profit sharing or commissions other than the restricted Wakala and Modaraba fees. However, AAOIFI has issued few standards which allow shareholders to participate in surplus as an incentive award for good management. Therefore, it is expected in the coming years to record a considerable increase in numbers of Takaful operators.

II. ***"The second reason is the lack of research to develop the model or even create another model of business"***. The existing model is not Qur'anic prevailed or constitutions of countries other than a mutual consent between certain scholars at a certain time. Maybe it is the time for young and energetic researchers to suggest some other models or a revolutionized model that changes the whole practice of Takaful business in the world.

The professional lawyer (PH) has highlighted further challenges for the takaful industry which can be summarized as follows:

- ***Over-dependence on reinsurance***: Too many takaful operators (and conventional insurers) retain too little of the premium written and essentially operate as brokers rather than risk carriers. This limits growth and the development of internal underwriting skills through over-dependence on reinsurers.
- ***Technology:*** The industry has yet to meaningfully embrace insuretech, either as a way of reaching customers or improving operational efficiencies.

While some of these challenges have been, to a different extent, discussed herein, others need more research and studies to address them appropriately. However, from the author's point of view, the UAE Tax Authority has recently imposed Tax in the UAE market and there are many issues of taxation relating to the nature of Takaful which need to be addressed.

5.1.6- Takaful and Taxes

In the UAE, applying taxes on services and goods started from January 2018. The UAE Tax Authority has defined criteria what kind of goods / services which were exempted from Taxes. However, the Insurance sector is subject to Tax except in some lines of businesses, particularly long-term policies, which mainly relate to life / family takaful.

In Malaysia, the Goods and Services Tax authority have implemented GST of 6% from April 2015. Royal Malaysian Customs revised the "Guide of Insurance and Takaful" two times and the last one was in June 2017 (Royal Malaysian Customs, 2017). Salleh, Yussof and Abdulla (2018) have examined whether implementation of GST on Takaful is acceptable from Sharia's point of view and what challenges that may arise on Takaful sector in consequence, in Malaysia. The study revealed that Sharia scholars have a different approach regarding the Tax implementation on Takaful while some of them allowed, others allowed with subjectivities and the remaining believed that Takaful should be Tax exemption. The basic argument is about the nature of the Takaful contract which is donation in nature. The challenges which have been faced are a) there were no specific considerations to the unique nature of Takaful business in terms of contract, Qard Hasan and operational models and b) implementing the GST required Takaful operators to pay huge amounts on IT to build a system that capture GST automatically. However, the researchers concluded that Takaful should not be treated as conventional and some lines of business such as critical illness, medical insurance and personal accident should be free of Tax. Further, they recommend keeping the Wakala Fee and Family Takaful exempt from GST.

In the UAE, the Federal Decree-Law No. (8) of 2017 on Value Added Tax has made the landscape of VAT on goods and services in the UAE which has been implemented on 01/01/2018. However, further Guides on the insurance sector were issued on September 2018 which outlined that all lines of insurance business are taxable except, namely:

1. *life insurance and associated reinsurance and*
2. *insurance relating to the international transport of goods and passengers*

Further, the VAT Guide has made no specific treatment to Islamic Insurance and stated that " *Any supply made under an Islamic financial arrangement, which is certified as Shariah compliant, and which has the intention of and achieves effectively the same result as a non-Islamic financial product, shall be treated in such a way as to give an outcome for the purposes of the Law comparable to that which would be the case for its non-Islamic counterpart in order to ensure equality of VAT treatment between Islamic and non-Islamic finance products*". According to that, Family Takaful is tax exempt in Takaful and Retakaful business.

However, the Guide has taken into account some allowances for Non-equivalent products. If an Islamic insurance product has specific features that the direct equivalence in VAT treatment could not be applied to, the regulators shall consider these issues and determine appropriate VAT treatment (Federal Tax Authority, 2018).

The matter in question was discussed with Sharia Scholar (NY) who confirmed that it has been agreed to leave the decision of implementing VAT on Takaful business to local jurisdictions.

Principally, Takaful Insurance, by definition, is a scheme of solidarity where a group of participants have mutually agreed to donate some money to a pool that shall provide financial aid from that pool to any member if anyone suffers losses. Therefore, there is no exchangeable goods or services for forming the participants' fund. Upon formation, the participants then appoint a fund manager to carry out insurance activities and invest part of that fund, in exchange of Wakala and Modaraba fee. It is clearly in the second stage that a service from fund manager shall be provided to participants and a tax could be applicable on that service. Therefore, the Wakala fee should be only Taxable instead of applying Tax on gross contribution. For example, if the GWC is AED 100 m, the participant shall pay AED 5 m Taxes in the current tax operation while it should be 5% of 35% Wakala fee (AED 1.75 M) not from the total of GWC; ultimately the participants shall be charged 1.75% tax from the total 100% instead of 5%. This will reflect positively on Takaful operation as the final price of Takaful product could be reduced by 3.25% which help Takaful operator to compete other conventional counterparts and increase the market share. Also, it shall a) encourage members of public as well as investors to participate / invest in the scheme, b) differentiate the business from the conventional and c) increase the public awareness of Takaful.

This issue is beyond this study, but it is very important to be discussed in deep and it would be highly recommended to carry out, in future, standalone research on this aspect.

5.2- Corporate Governance

As outlined throughout all chapters of this research, the business in question sustains a lack of an effective corporate governance system due to the specific nature of the Takaful model. The main question which must be answered is who the principal is and how managers are acting toward the principal and other stakeholder? in conventional insurance companies, the answer is quite simple as the owners of the company are the principal and there are a lot of existing standards, guidelines and regulations in place to manage the relationship with manager (Agent) and other stakeholders. The matter in Takaful model is completely different and complicated as the business have two principals: shareholders as the owners of the commercial firm and policyholders (customers) as the owners of insurance fund.

In this study, it is intended therefore to break out of the relationship between major stakeholders into Shareholders / Managers and Policyholders / Manager, utilizing Principal-Agent Theory to determine accountabilities toward stakeholders. Furthermore, it has been noticed that the members of SSB could be financially prejudiced and this matter is also examined along with regulatory regime who is monitoring and supervising the conflict of interest between the main stakeholders.

5.2.1- Shareholders / Managers

Indeed, Takaful management would be certainly prioritizing the interest of shareholders over the policyholders due to a) the managers are appointed / dismissed by shareholders through BOD and b) the remuneration benefits for Takaful management is structured on the basis of maximizing the shareholders' profit.

This would undoubtedly cause an imbalance between shareholders and policyholders' interest. Having said that, the managers should bear in mind that the Takaful fund must be, at all times, sufficient to meet its obligations and pays participants' claims which should avoid providing Qard Hasan and enhancing policyholders' loyalty, in return, toward the scheme (Al Nemer, 2016).

(OF) outlined that one of the essential conflicts of interest between managers and shareholders, for any businesses, is usually the incentive system. The remuneration method for managers in a stock company is commonly made by bonus or stock option. Looking for an excessive compensation shall undoubtedly affect their business decisions. For instance, some of the decision making could be out to line their own pockets with bonuses as opposed to generating dividends for the shareholders. Theoretically, at least, it has been found that some cases in the meltdown of 2007 / 2008 the misalignment of the management decision by taking the interests of the overall corporation meant that some individual managers were excessively compensated and this was partly addressed by the FSA in the UK after the meltdown.

Surprisingly, Takaful managers whether (OA) or (PS) have not separated themselves from shareholders as they are merely agents and are implementing the business strategy of shareholders and they can raise recommendations which reflect, if implemented successfully, positively on their remuneration benefits. Another meaning is that, the conflict of interest between managers and shareholders, other than of what already exists in any other businesses, in the Takaful scheme is seemingly negligible and shall therefore not be discussed further in this research.

5.2.2- Policyholders / Managers

Under this title, it has been intended to discuss whether conflict of interests between managers and policyholders are managed appropriately and what the impact of such issue on business performance makes.

From a Sharia point of view, the Sharia scholar (NY) confirmed that the policyholders are not represented and protected in the current Takaful model. It is very difficult to define the criteria by which policyholders should be presented in the BOD as they are dynamic and changing periodically, in and out of the scheme.

> ***"The SSB is trying to establish guidelines and standards to protect all stakeholders' interest and implement justice among them, but this requires a***

> ***massive intervention from regulators to convert these guidelines into regulations and put them in force".*** **(NY)**

It might be a solution, he continued, such as to invite one of general public who has a good knowledge in business and Islamic finance to represent the policyholders in the BOD as an independent party. The consumers protection regulations are very new in the Arabic and Islamic world and even in some areas do not exist. The regulators shall have a responsibility to establish proper rules for consumers' protection rights in this area.

The regulator (AM) has briefly commented on this issue as the Insurance Authority is working to protect the Insured as well as other beneficiaries in insurance business and a lot of articles / regulations have been issued in this respect.

> *"**The Authority, for instance, invites Takaful operators to nominate a number of participants that can attend the ordinary or extraordinary general assembly meetings and then authority can decide which participant is eligible for attendance"**. **However, it is very difficult to determine the criteria among thousands of participants to attend the meeting"**.* **(AM)**

Anyway, the designated participants do have the right to attend and discuss but no right of vote is allowable.

The professional lawyer (PH) stated that

> *"**There is no doubt that there is scope for conflicts of interest to arise within the Takaful models used in the UAE given the potential divergence of interests between the different stakeholders"**.* **(PH)**

From its commercial nature, the management of the Takaful operator is incentivized to maximize profit for the shareholders which leads to a possible conflict with Sharia compliance and/or the interests of participants. In the region, there are generic requirements to manage such conflict. For instance, in Bahrain and DIFC Takaful operators must take all reasonable steps to identify, manage and prevent conflict of interest that may cause harm in the interest of customers (CBB Rulebook PB 1.1.2 and DFSA Rulebook COB 7.9).

From his point of view, (OF) believes that

> *"**The corporate governance related to the hybrid models, which is currently being practiced across the globe, is the key aspects that needs to be redressed. The interest of the policyholders in the risk pool is typically not protected by the shareholder nor the managers appointed by the shareholder"**.* **(OF)**

He has also specified many factors behind the issue in question:

a) The policyholders do not have a legal entity to represent them which means that their fund is not a separate like LLC or SBU (Strategic Business Unit); rather than simply a bank account owned by the shareholders who are running the business throughout a commercial entity. It is that entity that the regulators have given the license to.

b) The regulation, which is driven in most jurisdictions by stock insurance companies that have been established around for a couple of hundred years, is not well adapted to the reality of the mutual operations of Takaful.
c) Another issue is relating to scholarly system and historical context around Takaful which is often in many cases not the subject of careful scrutiny or study or even reflection. So, the lack of a legal structure for the risk pool means that the policyholders in the hybrid model are little more than just holders of policies that have been issued by the shareholders under the Operational management team. In doing so, it does not really function much differently than a stock company.
d) There is no voice or structural mechanism for the policyholders to complain, have grievances on the management or fire the managers. Also, there is no set of rules, regulations, or guidelines to allow for doing that. On the contrary, by running the entire operation as purely mutual, the management is appointed probably at a General Assembly meeting by the policyholders and is directly accountable to them.
e) The last but not the least, there is no representation of policyholder either in the BOD or executive management meetings. It could be confirmed that no single article on Takaful has suggested that there should be, as a minimalistic approach, a couple of policyholders who are at least observers at the shareholders' board meetings

Having said that, it could be observed that the governance capability in the hybrid model of Takaful is rapidly disappearing as the asymmetrical setup of Takaful company favours the shareholders who are granted the license and put up the capital as a so-called commercial risk in this enterprise.

However, he has raised another set of important issues that the shareholders get compensated by a return on their capital, which they choose to invest whatever way they want to, while the policyholders have no say in that right. Secondly, they are compensated by the fees that they charge whether it be Modaraba or Wakala or whether by an asset management fee, where the policyholders again have no say regarding the charged percentage or by giving an incentive fee. Furthermore, what about a strategic merger or acquisition that would be quite clearly having a heavily impact on the capital structure of the business and thereby the point of liquidity to the benefit of the policyholders? Policyholders had nothing to say about pricing and where the capital of their contribution gets invested in securities.

Therefore, it becomes not only a corporate governance issue but the asymmetrical approach which allow the shareholders to have a disproportionate influence on key decisions in the absence of consultation to policyholders. This issue should be written / addressed into the article of association of the operating company from day one.

A further view has been addressed by (SA) who outlined that

"***In conventional mutuals, policyholders are owners and appoint the management. There may still be corporate governance problems owing to a lack of effective monitoring by policyholders, but with Takaful the problem is much worse as policyholders have no monitoring rights".*** **(SA)**

One cannot rely on the SSB to do the monitoring on behalf of policyholders. IFSB suggested setting up a ‘policyholders’ committee’ to perform this function. In the case of conventional proprietary insurers, policyholders are protected to some extent by competition, of which there is much less in the Takaful subsector.

The matter has been discussed with business managers in the aim of gaining a better understanding from a practical point of view. The manager (PS) confirmed that the conflict of interest between shareholders and policyholders is managed by the good performance of the company.

> ***“For example, the managers may decide to underwrite bad risks in order to increase the gross contribution and ultimately increase the Wakala fee for shareholders. The company at the end of the year will definitely incur losses and the shareholders are obliged to provide Qard Hasan”.*** **(PS)**

If the loan has not recovered within three years, the shareholder will suffer a big loss where they are reluctant to accept this fact. Vice a versa, if the company achieved a good performance and the financial results are positive, this means that the management have adopted a prudent underwriting strategy which result in surplus to policyholders and ultimately protecting policyholders’ interest. However, this is not enough to manage the conflict. Having a policyholder represented on the board is a good option or the Insurance Authority can assign someone in-house to represent the policyholders’ interest on the board.

Unsurprisingly, the manager (OA) has confirmed the same and addressed that the conflict of interest will not happen if the balance between stakeholders are maintained. Some Takaful players in the UAE market, for instance, intended to increase the income for shareholders through underwriting too much business, even bad businesses. It is true that more business will lead to more income as the main source of income for shareholders is the Wakala fee which is a percentage of gross written premiums (contributions).

> ***“Unfortunately, it is a short-lived strategy because if the shareholders income increased by AED 30 million from a loss-making business and that business brought a liability of AED 40 million, then the policyholders’ fund will fall into deficit. By law, the shareholders are committed up to the last equity of the company to fulfil its obligations toward policyholders and to make good that deficit”.*** **(OA)**

So, without having a prudent underwriting methodology, shareholders might be exposed to higher liability by covering any deficit in policyholders fund in a form of Qard Hasan and this will be deducted from their net profit. For example, there are many Takaful companies in the market who started with a capital of AED 250 million and their capital is now reduced below AED 100 million because of that short-lived strategy.

Also, the investment part should be prudently approached. Again, Takaful operators may choose to invest their policyholders’ money in risky assets that produce high yield in order to increase the shareholders Modaraba income. If the assets are not invested carefully, the investment return will generate a loss and the shareholders will lose their Modaraba fee and further to that the loss will be recovered from shareholders' fund.

So, the relationship between the two parties is too interconnected. However, misbalancing the interests between both parties will affect the shareholders more than policyholders. At the end of day, any claim submitted by the policyholder must be paid back regardless of whether their fund is in deficit or not and the party who is responsible by law to pay claims and make good of deficit is the shareholders. Therefore, the lesson to be learned, he concluded, is to maintain a balance between all stakeholders by adopting a prudent underwriting approach, diversifying the portfolio and investing the assets carefully; otherwise, the business will not be sustainable.

A further aspect has been discussed with business managers regarding whether the current operational takaful model looks after the interests of policyholders in any different manner compared to conventional model.

The manager (PS) confirmed that the current operation of Takaful does not have any means, different to conventional, for protecting the policyholders' interest. But again, the performance of all managers is measured purely on underwriting profits.

> "***Lots of focus goes under managing the underwriting profit, which obviously creates automatic structure to protect the policyholder interest, basically".*** **(PS)**

However, it would be an advantage if somebody on policyholders' side is represented as a body or individual in the General Assembly Meetings. Again, the regulators can assign one from their side to oversight the operational practice of Takaful management.

The responding manager (OA) has also outlined that it does so only when the operation of Takaful is successful. ADNTC for instance, has paid back significant cash returns of AED 4.7 million and over AED 6 million to its policyholders as surplus from the life fund for the year of 2017 and 2018 respectively and shall continue to do so for 2019 and upwards.

> "***So, from that sense, if the Takaful operation becomes big, well established, and sustainable on a yearly basis, significant returns could be distributed to its policyholders. While this does not happen systematically, it could happen per account wise in conventional".*** **(OA)**

So once the company overcome difficulties in its start-up operations and starts making sustainable money, it could bring value to policyholders whether they be individuals or corporations.

In terms of protection, Takaful and Non-Takaful companies are obliged, by law, to be liable up to their full assets and equities toward policyholders. Therefore, if operational aspects of Takaful go right, surplus distribution is undoubtedly an added value over conventional rivals.

While the manager (PS) has established that, in respect of whether policyholder should have representative in the BOD, it would be a good movement, the manager (OA) has a different view and confirmed that the policyholders in Takaful scheme should not be represented in BOD. Policyholders in mutual are shareholders of the fund as well. In a mutual entity, the policyholders are active members in the scheme and do have a vote. Mutual started in the late of 18th century and it was very popular in the beginning of last century. However, it has a concept called premium recall. If policyholders' fund sustains deficit, they are obliged to pay an additional contribution to cover that deficit. In this scheme, the policyholders are responsible to cover operational expenses and liabilities; therefore, they have the right to vote in the BOD. Dissimilar to that, Takaful policyholders are not requested by any legal requirements or recalled contributing back in case of deficit while the shareholders are obliged to do so.

> *"**Similar to conventional, policyholders are having the full right to stay, renew or leave the scheme at any time and their claims must be paid regardless of what loss they have brought to the fund. It is true that their contributions are the start point of operation, but this money is paid to medicate the risk they bring to the fund not an investment through distributing surplus at the end of financial year".*** **(OA)**

So, as far as they are not bearing the loss or recalled back to inject more money, they do not have the right in the legal framework to be represented or being a part of the BOD. Again, the interest of policyholders is self-protected as it is the main interest for shareholders to avoid providing Qard Hasan.

The statistics in the UAE market reveals that the vast majority of Takaful operators sustained huge losses. For instance, the capital of the one of well-established Takaful operator in the market has been reduced from AED 250 million to AED 118 Million during the last decade and the shareholders have lost a huge capital and assets while the policyholders have lost nothing. Also, their claims have been paid and if not, they have the right to enforce their claims at the court, unless of course the company goes bankrupt.

However, (PH) has suggested possible solutions to mitigate the issue of conflict of interests that might be put in place, categorized under.

1- More radical solutions to this issue would be:
   - ***Remove the commercial element of the business*** (for example, through the creation of a public takaful operator utilising the waqf model); or
   - ***Allow the creation of a mutual insurance company*** as recognised in other jurisdictions, whereby the participants are shareholders in the business.

At present, the Insurance Law simply does not envisage mutual insurers and the Financial Regulations would likely make the creation of such an entity commercially unviable.

2- As a less radical approach, the mutuality concept would benefit from participants having a direct role in the management of the Takaful operator. This would involve:

   - The ability to collectively appoint an independent member of the board of directors to represent the interests of participants.

- A right to attend the General Assembly meetings and raise questions of the board (voting would likely require participants to be a shareholder and would only be achieved through the introduction of a mutual insurance model);
- Enhanced corporate governance requirements for Takaful operators to ensure that appropriate governance structures are in place to protect the interests of participants as a stakeholder in the business

In this regard, the manager (PS) simply stated that the current mechanism of protecting policyholders, at the organizational level, is the same as conventional insurance. In conventional companies, the policyholders are not represented in the BOD or have the right of votes and the competition forces are the main protection layer for policyholders. Looking at what Takaful operators are doing; it is exactly the same as commercial companies.

From other practical views, the manager (OA) has established systematically some governance mechanisms, outlined as under.

- Prudent underwriting methodology along with a conservative investment approach which was explained earlier
- The regulatory body (Insurance Authority). The regulators are playing an important role to make sure that the policyholders' rights are always preserved. In the UAE, the regulators allow a maximum of 35% for Wakala and Modaraba fee to be charged to the policyholders' fund and they are monitoring whether Takaful Operators have charged participants any other expenses such as GOE.
- The Sharia Supervisory Board. The Sharia Committee in any of Takaful companies will take care of policyholders' interest. They decide of the level of Wakala fee to be charged at the beginning of each fiscal year, they monitor claims service and whether the participants have been treated fairly and reasonably during claims' life cycle and they supervise also the investment revenue and returns.
- Policy wordings. In the preamble of each policy document, it is clearly written that the rights and obligations of participants from the date of joining the scheme with plain definition of the model used in operation and other clauses which explain the relationship between shareholders and policyholders.

So, these are many dynamic mechanisms which altogether, if everybody does their job correctly, the regulators, operators, shareholders, policyholders and Shariah committee, it will have a very sound protection and work well for all parties involved.

However, others believe, he continued, that policyholders must be represented irrespective of all mechanism of protection. The question here, how to classify who is to be selected and from which category of participants? If there is a regulation to enforce policyholders to stay at least for continuous five years, it could be a reasonable way to invite those representing policyholders in the BOD; but this is impractical and illegal as well.

5.2.3- Sharia Supervisory Board / Managers

Takaful, as a newly emerged business, is a part of IFSI and shall be therefore subject to the same prohibitions applicable to IFIs. In general, all products and activities which might cause harm to human beings are absolutely forbidden in Islam. For example, Takaful operators cannot insure or invest in places producing or selling alcohol, tobacco, or weapons. The same scenario is applicable for gambling and interest-bearing institutions. These ethical principles must be preserved at all time for all business transactions. Therefore, SSB along with SO shall be appointed from inception to monitor all business dealings and make sure that all transactions have been made in compatibility with moral ethics of Sharia compliance.

From one side, as these principles shall enhance solidarity, transparency and protection of society as a whole, they might be a real obstacle of business growth from the other side. As the key target of Takaful managers is how to increase profitability, market share and growth, these principles could tie their hands and restrict opportunities to do so. Then a balance between profitability and business ethics is a matter of concern and conflict of interest between managers and SSB members becomes a challenge that needs to be examined.

From literature, it has been noticed that the SSB are nominated by BODs and remunerated by shareholders, and this might affect independency of SSB members and a conflict of interest arises. In terms of profitability, the SSB shall prevent Takaful management from undertaking any business that include / might include a prohibited element and ultimately restrict business opportunity.

In respect of the appointment and remuneration of the SSB, (NY) stated that

> ***"The SSB is appointed by and reporting to the General Assembly not by or to the BOD and the SSB is, in fact, above the BOD and they can even dismiss the board of directors if they violate the rules of Sharia".*** **(NY)**

Regarding the SSB, the Insurance Authority has addressed the necessary steps to choose Sharia members, as stated by the regulator (AM). The nominated candidates of scholars will be presented by the BOD to the Insurance Authority for approval after soliciting the Supreme Fatwa and Sharia Committee. Then the approved names shall be presented to the general assembly for appointment as members. However, the Supreme Fatwa and Sharia Supervision Committee has not, at the time of writing, yet established, but shall be formed within the Insurance Authority of at least three members and no more than five members, and to be referred to for the purpose of these Regulations as (the Supreme Committee). Considering the above procedures and the fact that the SSB are only appointed by the general assembly, the conflict of interest is not, mostly, there.

From a corporate governance standpoint, the responding (OF) stated that it is a challenge not for Takaful business but also for Islamic banks. In fact, the SSB is working hard to the best of their ability to give guidance on structuring new products, on pricing and how the risk is managed and most importantly, gives guidance on not gouging the policyholders with a fee structure, Wakala or otherwise, which is overly burdensome. In some Takaful companies, it has been found that the Wakala fees were like 40% of the premium on a property casualty which puts the value of the policy under water in actual fact. So, the scholars stepped in and turned them back to 25%. In fact, they have certainly exerted, over time, a positive and competent guidance to the company at large, and in many cases have played a rule to rebalance policyholders and shareholders' interests. Regardless of that, he continued

> ***"The main problem that the Islamic business needs to solve is the lack of Sharia Auditing".*** **(OF)**

Sharia scholars are usually only highly Islamic educated but they all have a lack of accounting and managing auditing skills. Therefore, they are unable to trace, accounting wise, how the financial statements have been prepared and whether the figures represent the actual numbers in terms of pay-in and pay-out. Furthermore, how the Qard Hasan is recouped and why the policyholders fund sustains deficit. In case of surplus, what the right percentage to be distributed to policyholders and what should be retained for contingencies? This lack of auditing skills has restricted their intentional ability to play a role of managing the conflict of interest among business stakeholders.

It has been also noticed by the author that the same conflict is applicable with the assigned external auditors and actuaries. As those entities are appointed and paid, as well, by shareholders, their independency is becoming questionable. It is to be noted that the conflict of interest between SSB, External Auditors, Actuaries and the managers has not been discussed previously to the most knowledge of the writer.

5.2.4- Corporate Governance of Retakaful

In respect of conflict of interests regarding Retakaful operators, the Reinsurance manager highlighted the fact that reinsurance is inherently a way of aggregating losses from different players around the world and pooling the risks together in the aim of achieving some profit to shareholders and rewards to cedents / insurance companies. However, Retakaful is different from the Takaful business as the customers / policyholders in the case of Retakaful are Takaful operators (corporations not individuals), therefore the conflict of interest between two organizations is managed properly by regulations. Again, reinsurance is a concept of solidarity between Reinsurers and insurance companies and the only difference between conventional reinsurance and Retakaful is that the later shall be operated within a framework of Sharia Compliance.

IFSB in its Corporate Governance Guidelines confirmed that the governance issue of Retakaful in entirely different from those arising from Takaful operation as the participants in the former are Takaful funds managed by commercial companies rather than individuals or members of the public. Therefore, the corporate governance, which is well regulated, it is applicable to other commercial business and is practiced between TO and RTO. However, it was recommended to carry out a thorough study of Retakaful arrangements before issuing further guideline in respect of governance structure (IFSB 8, 2009). Nevertheless, this issue is behind the aim of this research and shall not be discussed further.

5.2.5- Discussion

To provide an understandable meaning of the issue in question, it is intended to address the type of customers / policyholders of any insurance company, whether conventional or Takaful, operating in the UAE market which could be categorized as under:

Indirect policyholders

The insurance market in the UAE has been described as Brokerage-Oriented where most of the business comes through brokers and intermediaries. The Takaful managers in this case can be seen as agents to the policyholders' agent / broker. Therefore, the interest of policyholders is, to a large extent, protected by their brokers who are keen to bring maximum benefit to their customers. However, brokers can technically obtain better underwriting terms & conditions and challenge any decision made by a claims team in respect of applying irrelevant policy terms / condition and convert the interpretation of policy wording toward policyholders' benefit. This is in fact an advantage to the insurance market as a whole and brings fairness and transparency to all stakeholders.

Nevertheless, brokerage firms eventually are business entities, and their interest are over and above any others' interests. Therefore, they can fight for prestigious clients who bring huge income to the firms while their willingness to fight will be less for medium accounts and might be even not existing for small or individual accounts.

- **Direct policyholders**

This category could be divided into:

Captive Policyholders

Shareholders of any insurance company usually own huge organizations with multiple lines of business such as Property developing, banking, Real estates, transportation, marine services, construction and oil projects whereas these lines of business together with workforces are insured with their insurance company. The practice is more likely to be as a captive insurance provision. The total contributions received could form a considerable percentage of the total gross written premium. Therefore, the policyholders in this case are the same as shareholders and they are represented in the BODs. However, this shall apply more pressure on management of how to deal with claims submitted by shareholders – policyholders and how they shall make a balance between providing the actual cost of damage and apply the restricted terms / conditions and keep the shareholders' interest maintained.

However, this aspect has been managed properly by regulators in the UAE regarding transactions toward related parties. Article (34) is relating to Transactions with Related Parties determines the framework for the management to deal with any transaction related to shareholders. For example, the company requires the consent of the BOD when the value of transaction is less than 5% of the capital and approval of the General Assembly if it exceeds that percentage. Furthermore, the related party has no vote in the decision taken by the BOD or GA regarding this transaction (Decision No.

3/Chairman of 2020 concerning Approval of Joint Stock Companies Governance Guide).

Regardless of the relevant regulations, high attention has been offered by Takaful management to satisfy the said category in terms of policy conditions and claim services.

Walk-in policyholders

Small firms and individuals are located under this category, and they are neither protected by professional agent nor by insurance management. As they are forming a small portion of the total contribution, insurance managers may not offer them a proper attention in their operational policy. As the household and individual life insurance is infrequently offered in the UAE market, motor insurance forms most of this category. However, the market force could play a major role to maintain their interest protection.

Dissimilar to conventional insurance, the specificity of the Takaful model where policyholders are the owners of Takaful fund brings a major challenge of corporate governance. Regardless of which category the policyholders are placed in, the lack of protection mechanism is not ignorable in Takaful model.

From literature, it can be noticed that there are two aspects of Corporate Governance in Takaful model observed whether in operational or organizational level. While the latter is relating to the relationship between Shareholders / Regulators / SSB and policyholders, the former is purely relating to managers / policyholders.

Organizational conflict of Interest

It has been addressed that the duality of the Takaful model as a combined relationship between the risk sharing pool and commercial firms has created a potential conflict of interest between shareholders and the policyholder. These could be outlined from organizational aspects as below.

- Remuneration mechanism
- Surplus distribution
- Incentive Management Fee
- Investment assets
- Liquidation / winding up
- Acquisition / Merging

All critical decisions for the above components, from the organizational level, are made by BODs with consultation of SSB and in line with applicable regulations. The policyholders, for example, have no say to what extent the Wakala or Modaraba fee is calculated, whether surplus to be distributed / reserved and what the percentage of such distribution, does the management deserve an incentive fee or in which assets their fund could be invested. For major decision like merging / acquisition and liquidation, the policyholders are not represented in any of BOD's committees and ultimately, they have no influence on any decision made regarding the above.

In its guiding principles on Governance for Takaful, IFSB has relied intensively on BOD to establish a governance framework in terms of operational performance as well as protecting stakeholders' interest. For this purpose, IFSB recommended that a Governance Committee should be established by the BODs, comprising of at least three members, to monitor the implementation of governance policy. The committee might include an independent non-executive director, one of Sharia scholars (preferable from SSB) and an actuary.

The main objective of Governance Committee is to maintain a sense of balance between all business stakeholders, but giving a special consideration to the policyholders' interest, who, as confirmed by IFSB, are "*largely underrepresented and lack adequate access to information*". The IFSB concluded that any gaps of implementing the governance policy, the BODs are responsible for making appropriate corrections (IFSB, 2009). This has not been adopted / implemented by IA in the UAE market.

It is, in fact, impractical to rely on shareholders to manage their conflict of interest with policyholders. Regardless of any arrangements carried out by shareholders to protect the policyholders' interest, including independent auditing firms, their interest shall undoubtedly prevail. Therefore, the intervention of regulators to stand at the same distance between both parties becomes inevitable. Furthermore, the lack of auditing skills experienced by SSB members, shall draw down their ability to advise and monitor any of the above aspects.

Operational conflict of interest

The operational level of corporate governance could be found in:

- Underwriting pricing
- Undertaking risks
- Measuring performance
- Managing claims
- Customer's service

The level of contribution, the type of undertaking risks and the way of handling claims is solely the decision of management. Inaccurate pricing, accepting poor risks to increase the portfolio and ultimately Wakala level, considering non payable claims on ex-gratia basis for particular participants, particularly captive policyholders, or applying unfair deduction to others, all these activities are essential to determine the overall performance of a Takaful operator. Another important issue is that Takaful managers may attempt to maximize shareholders' profit through reducing operational expenses which should reflect indirectly on policyholders' service where the policyholders have no say in any.

The valid question which has been raised by Zainal Abidin (2013) that can the participants dismiss the agent / Takaful operators if they are not managing the business in a professional manner or misuse the agency contract for their own benefits? The answer in the current structure of Takaful is simply "No".

In respect of Takaful managers, it can be noticed that the way of looking at the business is the same as any other commercial insurance business. The prudent underwriting with conservative investment strategy is a method applied by all insurance companies, with of course a slight difference of risk appetite and investment policy. Therefore, dealing with policyholders from this aspect, from the author's point of view, is a critical ignorance of the fact that policyholders are the owners of the fund that Takaful operators are being appointed to manage. Another essential issue is that Takaful is a scheme of solidarity and cooperation among participants who must be treated fairly regardless the size of their contribution or the source of distribution channels. Takaful managers must stand at the same foot distance of all participants to comply with the spiritual meaning of cooperation which is the core concept of the business. From the author's view, this could be a consequence of the following factors:

- In the absence of forcible regulations, Takaful managers are not blameable as their appointment, discharge and incentive remuneration mechanism is the decision of Shareholders. Conversely, regulators do not have a clear knowledge about the nature of Takaful business, the core principle of mutuality and the ultimate aim of the subject scheme. Therefore, they have no other choice rather than applying the same existing regulations governing the insurance sector in the country with some provisions to shelter the unique features of Takaful such as Qard Hasan, Surplus and operational models
- The lack of auditing experience of Sharia scholars, as confirmed by (OF), extends their inability carrying out rigorous analysis of financial statement of Takaful operators and determines the extent of Wakala / Modaraba, Qard recouping, surplus, paid out claims and deficiency of policyholders' fund. Takaful managers therefore might be in a position to mislead the final decision of SSB regarding policyholders' potential interest
- The lack of cooperation among business leaders, Regulators and Sharia scholars in the aim of forming a unified body to govern the specificities of Takaful segment and encompass involvement of policyholders in the overall objectives of the company

From regulatory point of view, as the policyholders' fund has no recognizable legal personality, the policyholders have no right of control on overall operational process and therefore the business is unquestionably conventional in practice. Conversely, the nature of risk sharing, as mutual, shall allow policyholders to participate in monitoring the operation and have the right of control, ultimately the right of having a representative in the BODs.

As attempt by regulators to manage the conflict of interest, a compulsory Qard Hasan is a tool of balance as the policyholders have legally no right to be represented in the BODs. From one side, this shall impose obligations on Takaful manager to adopt prudential underwriting policy with conservative investment strategy in order to avoid deficiencies in policyholders' fund and consequently providing the Qard Hasan by shareholders but from another side, it will convert the model purely into risk transfer as the policyholders have no duty for contribution recall. It is a complicated issue that need to be resolved and it is intended in this research to discuss practical solutions to overcome.

Indisputably, Regulators are playing essential roles to manage and protect the interest of stakeholders for any business. In respect of Takaful model, the IA in the UAE have made no distinction between the interest of shareholders as the owner of commercial firm and policyholders as the owner of Takaful fund which is considered the first step to start up. For example, in the preamble of Takaful contract, it has been clearly declared that policyholders shall appoint Takaful manager to carry out insurance activities and invest their fund on their behalf in an exchange of a fixed percentage of Wakala fee and Modaraba profit sharing. The UAE regulators have determined the max fee to be charged but what has been missed is that there are no obligations on Takaful management to declare the way of calculating the Wakala / Modaraba at the beginning of financial year.

The regulatory framework, also, considers Takaful participants are merely customers who are exposed to market forces and regulations to the same extent as conventional customers. This has led to misconception that Takaful is exactly the same as conventional insurance in terms of risk mitigation and operational practice. As Takaful operators are struggling to compete well established conventional rivals and failure of introducing the concept as a value driven, the regulatory regime indirectly enhances the lack of public awareness of Takaful which ultimately reflected negatively on the penetration rate, which is significantly lower than conventional.

It is understandable that representing policyholders in the BOD is not legally supportable as they are not shareholders who have been given a license to operate. Furthermore, assigning an independent expert to carry out supervision on company's transactions is not practically workable. Theoretically, both options could be partially implemented but to overcome this issue, from the author's view, a standalone Takaful body within IA that governs all stakeholders' interest, similar to Malaysia, could be principally and practically a solution. Therefore, the intervention of regulators in this regard is inevitable. For example, the IA could assign a full-time professional practitioner who has well knowledge of finance and insurance, to be a member of Takaful regulatory body, paid by all Takaful operators as a percentage of Wakala fee, and shall be in a position to attend GA meetings, auditing financial statement and report findings to the IA for further monitoring and applying discipline whenever it requires.

In respect of the issue of SSB, as one of the major concerns, AAOIFI have issued a separate Governance Standard No. (5), relating to independency of an SSB member in any Islamic Financial Institutions IFI. It has been given guidelines for members of SSB of how to maintain independency and the ways to monitor and supervise it while carrying out their duties.

For examples:

- *SSB members should not be employee of the same IFI*
- *SSB members should not be involved in managerial decisions and operational responsibilities of the IFI*
- *SSB should not be offered or rendered to an IFI under an arrangement whereby no fee will be charged unless a specified finding or result is obtained or when the fee is otherwise contingent upon the findings of results of such services*
- *SSB should not be offered or rendered to an IFI under an arrangement whereby the SSB benefits from bonus payment related to the performance of the IFI*

It is to be noted that there is no separate standard for SSB specifically relating to Takaful companies.

Furthermore, the IA in its article (10), Formation of Sharia Control Committee stated that:

- *The committee members shall be nominated by the company's board of directors.*
- *The candidates' names and qualifications shall be presented to the Insurance Authority forty-five days prior to the meeting of the company's general assembly which will consider the nominations. After soliciting the opinion of the Supreme Fatwa and Shariah Control Committee at the Authority, the company shall be notified of the Authority's approval or objection. In case of objection, the company shall nominate a substitute to the disapproved candidate.*
- *The candidates' names shall be presented to the company's general assembly to approve their appointment as Committee members and to inform the Authority of the names of those appointed as Committee members within ten days after the general assembly meeting.*

In fact, the listed Takaful companies in the UAE are owned by huge organizations, normally two or three, who are having the major shares while the small remaining shares are issued to the public. Most BOD's members, including the Chairman, are mainly representing / and protecting the interest of these organizations. Therefore, the statement of Sharia scholar (NY) that the SSB is appointed by GA, is not reflecting the actual fact that the GA is dominated by those who are having a large number of voices, represented by BODs.

As the Supreme Fatwa Committee is not formed yet within IA body, the decision of appointing the SSB is undoubtedly in hand of the BODs. Therefore, the SSB members can be financially influenced and might prejudicially hide or ignore some important breaches of Sharia principles the TO have made and favour the shareholders' interest over the principles of Sharia to maintain their renewable contract (on an annual basis as per IA's regulations). In practice, undertaking risks involve forbidden elements is inadmissible by Sharia Principles. However, some of Sharia scholars in the UAE have allowed insuring, for instance, hotels which offer Alcohols subject to reinsure the risk 100% with conventional reinsurers. In the light side, it could increase the volume of business and the capacity of underwriting but in the opposite side it is damaging the image of Takaful business as the participants are not aware about reinsurance arrangement and ultimately having a policy document from Takaful operator. This is a crucial issue that increase the misconception about Takaful which is already an existing challenge.

Another important issue is the remuneration benefits to SSB members which differ among Takaful operators. The absence of a unified fee scale, either determined by IA or AAOIFI, has consequently led to a huge variation of paid fees ranging from USD 20 K to USD 90 k for each member depending on the availability of qualified scholars.

These expenses paid by shareholders and do not appear in the financial statement explicitly as SSB costs; but included in it as general expenses. However, these figures have been collected from two different Takaful operators in the UAE market. Furthermore, the company shall bear all other expenses such as booking a business class air ticket, reserving luxury rooms in five stars hotels and offering a generous allowance for transportation for members who are not living in the UAE; where the majority in fact are living outside. Simple calculation could result in an average cost of USD 200 k for three members of SSB for each Takaful operator. Knowing that there are 12 Takaful operators working in the UAE market, an amount of USD 2.4 m is paid for SSB's expenses.

From another practical aspect, while the main role of SSB is supervising, intervalley, the overall operation of Takaful transactions, contracts and reinsurance treaties, the SO (Sharia Officer) is carrying out internal control in a daily basis where the aim of both is to ensure that Takaful business is conducted in line with Sharia compliance. In addition to supervision roles, the members of SSB have to approve / decline insurance products innovated / offered by the Takaful operators or recommend some amendment to make them comply with Sharia and to determine the investment assets that Takaful operators can invest in. this undoubtedly restrict Takaful manager to unwrite or invest in any business that are not Sharia compliant which ultimately decrease the opportunities to grow and compete conventional counterparts. As SSB and SO must be appointed as per regulations, Takaful management is obliged to pay their remuneration. Seemingly it a controversial relationship as Takaful management shall pay a portion of the Wakala fee to SSB and SO whose ultimate goal of their job could restrict capability of Takaful management to underwrite some products / activities and preclude some sort of assets for investment.

The SSB members carry out Sharia auditing 4 times a year including reviewing selected underwriting policies, samples of claims and few of reinsurance contracts. Regardless the fact that the associated costs incurred to carry out this task is overestimated; the conflict of interest is apparently prevailing. In order to overcome this critical issue, the author has suggested replacing the 12 SSBs with one full time committee formed in the Takaful regulatory body. This committee is paid by all Takaful operators, in equal percentage, as a part of Wakala fee. Also, the committee shall carry out Sharia supervision in a monthly basis and the need of SO might be, therefore, unnecessary. Having said that, the cost borne by Takaful operators shall be reduced significantly and the issue of a conflict of interest, to the large extent, is mitigated.

Regarding External auditors and actuaries, it has been noted that they have been appointed and remunerated by shareholders and the issue of conflict of interest could be discussed from two aspects.

- ✓ Wakala fee: as per AAOIFI and IFSB, the external auditors and actuaries' fees are not specified clearly in Wakala fee other than covering the operation expenses to manage the policyholder's fund. Therefore, it could be argued that why shareholders should bear these costs as they are not part of their remuneration fee

- ✓ Remuneration perspective. As far as they have been paid by shareholders, by law, their independency shall be potentially influenced, and their reports might be in favour of shareholders over policyholders' interest

From literature, the external auditors and actuaries shall submit their finding reports, annually, to the UAE IA of overall performance of the company in terms of operational standards as well as financial fulfilments. It is believed that these reports shall be reviewed by the executive management of the company before releasing them to the insurance authority; again, without consulting or giving an opportunity to policyholders to review and discuss these reports. Therefore, it would be suggested that these firms should be appointed by and their reports must be submitted directly to Takaful regulatory body, formed within the IA, as recommended above.

These points have not been discussed previously and it would be a valid controversial argument by researchers as well as practitioners. Furthermore, the lack of auditing and accounting experience of SSB members shall make the matter worse.

To conclude

Having examined the current operational model of Takaful, it has been found that:

- The contract of conditional donation creates mutual consideration and converts the model from risk sharing into risk transfer (conventional)
- Qard Hasan eliminates the concept of risk sharing in Takaful scheme
- No representation of policyholders in BOD
- No vote is allowable for participants in the GA meetings
- Lack of educational system about Takaful business
- Lack of standardizations
- Lack of auditing skills of SSB members
- Takaful operators fails to innovate Takaful product rather than duplicating conventional ones
- Instead of working together, hand by hand, to develop the business, Takaful operators are competing each other and preferring to use conventional insurance providers to share risks in facultative basis / Coinsurance

It has been established that the mutual part of the hybrid model of Takaful brings major challenges to the business in terms of corporate governance. It is a mutual in concept but conventional in practice. Apparently, Takaful managers have the same view that the better the performance of the Takaful fund the more corporate governance is in place. Allowing shareholders to receive a proportional share of underwriting results may incentivize Takaful managers to underwrite risks prudently which would reflect positively on their annual remuneration. However, this practice is undoubtedly insufficient in respect of Takaful model. The current way of managing the conflict of interest between stakeholders is a problematic one and needs to be changed. Looking at the business from conventional' point of view is a crucial mistake that needs to be converted into a new mechanism of corporate governance that capture Takaful specificities in all levels of operations.

Having addressed that, the following actions that lead to the change could be summarized; either by:

a) a significant involvement of regulators, Sharia scholars and Takaful managers to provide an appropriate solution to overcome these challenges
b) forming a separate Takaful regulatory body within IA including
    1. Sharia Supervisory Committee SSC to conduct Sharia monitoring and product innovation for all Takaful operators
    2. Professional practitioner to represent policyholders and monitor Takaful operation from the view of corporate governance
    3. Professional lawyer who is having knowledge of Insurance law in general and Takaful principles in particular

c) Otherwise, convert the business entirely into mutuality (for example: Mutual Takaful). The regulators could allow Mutual within the local jurisprudence benefiting from the existing Mutual Act in the UK

5.3- Takaful and Global Market

5.3.1- Opportunities

It has been claimed from business researchers that Takaful industry is having the foundation to operate in every place in the world, side by side, or even an alternative model to conventional insurance (Ghlamallah, 2018).

The first Takaful company has been established, out of its home, in Luxembourg followed by the UK in 2002 and 2008 respectively. It is undeniable fact that the tendency of purchasing insurance products is much more in developed rather than developing countries. Hence, the business was open to much mature market including 53 million of Muslims living in Europe (Jaffer, 2013). The investment in the concept has been attracted by the largest conventional insurers such as AXA, Allianz, UK prudential and others who offered Sharia-compliant insurance products through Takaful windows. Hannover-Re, Munich-Re and Swiss-Re have also received this opportunity to provide Retakaful solutions, opening up the door for Takaful products to flow into western markets.

In the USA, the concept of risk pooling by policyholders is familiar through Mutual and insurance pools which could introduce Takaful as another mean of insurance provider to the market. As an attempt to bring Takaful to the UAS market, AIG have offered the first Takaful homeowners' policy in the late of 2008. Offering Motor and Life insurance have been planned by AIG but legal challenges were a barrier of further expansion (Masud, 2011).

The professional lawyer (PH) outlined

> ***"The fact that Sharia compliance product is one facet of attractiveness for Muslim' consumers. Nevertheless, the desire to ensure Sharia Compliance needs to be balanced by other feature such as competitive price***

and service, particularly for individuals' mandatory lines (motor, property / life for mortgage finance and such a like)". **(PH)**

Considering the sizable Muslim population in many western countries would be, with no doubt, a potential factor of expanding. For instance, the Muslim population in the European Union is almost 19 million, United Kingdom 2.6 million, United States 3.45 million and 1.1 million in Canada, representing 3.8%, 6%, 1.1% and 3.2% of population respectively. It is not ignorable to confirm that the business attracts non-Muslims either. For example, statistics of Malaysian Sukuk show that most subscribers are non-Muslims. A critical factor in this regard would be emphasizing:

a) The service offered by a takaful operator (and, in particular, attempting to differentiate from the perception of claims experience with conventional insurance);

b) The ethical nature of the investment activity of a takaful operator. Indeed, this may involve moving from just emphasizing Sharia compliance to a broader (but still compliant) ethical investment proposal.

The sharia scholar (NY) has an optimistic view to spread the concept out of boarders. Trade and business are, historically, one of the good bridge-buildings between communities and it would be a good step to expand through establishing relationship with branded and rated insurance companies in the west to build a mutual knowledge.

"Insurance business had been initially established on a mutual basis and if Takaful business is introduced as a concept of mutuality along with Islamic view of business transactions and adopt a certain legal framework, Takaful insurance might be spread faster as a viable commercial business in non-Muslims' communities". **(NY)**

Another factor that could help expansion is that the number of Muslims in these countries has been increased dramatically during the last years due to instability of political situation, particularly in the Middle East, and with the existing Muslims this will form a huge market for Islamic products.

The manager (PS) has emphasized that mutual, which are well established in the USA and Western countries, is the closest model to Takaful. If the investment policy of mutual is Sharia compliance, they are absolutely Takaful. Muslim population in the USA and Europe is growing and they are always looking at Sharia compliance solutions, but the challenge is that the players are not there to offer them the solution they are looking for. However, there were many attempts which have been made by some investors to set up Takaful entities, but they get frustrated very quickly when the result was disappointed in a short period of time. From personal experience, he added

"A lot of people in these countries are looking for Sharia compliance insurance but there is no real player that can meet with all requirements. The opportunity to establish strong players is existing as the landscape of the concept is being in practice in these countries since very long time". **(PS)**

Furthermore, it has been highlighted by the manager (OA) that Takaful business should be introduced as a concept first. In the last decade and due to critical situation in certain countries, unfortunately it has been noticed that there is a growing sentiment against Islam and Sharia, sometimes led by public and social media. This will not allow people to look at the concept of Takaful on its merits and form a practical obstacle to sell Islamic products in these countries.

> "***It would be a significant mistake if the business is sold based on religious aspects rather than the ethical values behind it; otherwise, the Takaful business will never spread across the world".*** **(OA)**

What happened in 2008, could be solid evidence of the legitimate concept of Takaful. For instance, conventional banking and insurance industry in America had been very close to bankruptcy which led the federal government to inject huge amount of money in order to save the sector from tremendous collapse. Millions of poor people became homeless and lost their money due to the unethical practice of this sector. While the crisis has had a horrendous impact on the whole world, Islamic banking and Takaful business were almost untouched. So, the lesson from that is if you carry out business with ethical framework, the business can spread wide and fast regardless of whether Sharia compliant or not. However, Takaful concept could be one of them because it does have certain aspects which make it sellable more, again if it is introduced and practiced properly. Therefore, good concepts should have a place in the world and Takaful could move out of boarders due to the increased need of ethical products.

The Prof. (SA) has outlined that

> ***"The difficulty in setting up a new mutual is meeting the regulatory solvency requirements. Retail policymakers will not be willing to pay in the amounts needed to create the solvency reserves. That is the one main reason why Takaful undertakings are set up as hybrids, with the risk funds being mutual but with a Takaful operator (TO) providing solvency in the form of Qard or a Qard facility".*** **(SA)**

Takaful may well be practicable in western countries in this hybrid form. But what the business needs to move out of borders are: (1) meeting regulatory solvency requirements; (2) dealing with the governance issues; (3) competitive marketing and underwriting practices, and (4) effective asset management for Family Takaful.

Another aspect was discussed with corresponding interviewees that Islamic banking and financial institutions, in the last decade, have witnessed a substantial growth and expanded dramatically to western countries. As Takaful is a part of Islamic financial system, is that could help Takaful business to develop and grow in these countries?

The manager (PS) has absolutely agreed that Muslims in western countries received the establishment of Islamic financial institutions at their places pleasurably and they immediately transferred all financial transactions into Islamic banking, particularly for funding a car or a house where they were aggressively reluctant to deal with conventional banking systems. These cars and houses need insurance, and it would be no other place rather than Takaful insurance. The opportunity is existing on the back of the growth of Muslim population in Europe, Australia and USA and their economical ability is increasing also which enable them to buy cars, houses and properties that need to be insured. However, there were many attempts but they were not structured appropriately.

The manager (OA) was confident that the growing of Islamic institutions around the world is considered as a strategic influencing factor to establish a landscape of Takaful business. The number of Muslims is not material because people are looking for a product which meet their needs regardless religious factors. When Islamic funds grow in any place, the funding money shall be used by investors to create factories, building homes, establishing projects which, by its own, will create more demand for Takaful and it will contribute significantly in its growth.

> ***"For instance, a Takaful company could not be established in Australia if there are no Islamic banks offer Sharia products. So, if there is dynamic of loans, lending, liquidity, and money movements of Islamic funds which are Sharia compliance, this will be one of the major factors to grow Takaful business".*** **(OA)**

Talking about Muslims, Jewish, Christians, is insignificant and they are not really the move in the real world. The world moves by investments and the American model businessman is evidence. They went around the world and created chain of restaurants and companies worldwide. This what drives the American capital to a degree almost dominating the world. It was how the money moved and invested. If Islamic financial institutions have adopted this strategy, this will impact positively on the growth and expansion of Takaful business. He also outlined that It is to be established that the concept of Takaful could be better implemented in European countries as the foundation of such model already exists. For instance, AIG has opened a Takaful company in Bahrain to sell Takaful products in the local market as well as in Europe in general and in France and UK. The main problem which was faced were the local regulations in these countries had prevented the business to spread.

The Prof. (SA) underestimated this factor and stated briefly that

> ***"It probably will, but it would not be decisive. For Takaful to develop and grow, the challenge is to provide effective marketing and efficient underwriting so that the products are attractive and competitive. For Family Takaful, asset management performance is also very important".*** **(SA)**

The number of Muslims in Europe and America, in 2010, was accounted approx. 50 million and the estimated projected figure might reach 70 million in 2030 according to Pew Research Centre of 2011. Generally, the slow economic movement in Muslims' countries and instability of political situation in MENA region, in particular, due to what is called "Arabic Spring"; have led to a significant increase of immigrants to western countries and the projected figure might be dramatically amplified.

Islamic financial products have been initially introduced, particularly banking, to offer Sharia-compliant financial services to Muslims who are living in Europe. Statistics show the demand for the same was realistically increased during the last decade because of economic failure the conventional financial services faced after the crisis of 2008. This growth of Islamic banking in the region have subsequently led to increase the demand of Sharia-compliant insurance.

It is surprising to know that the largest populated countries in the Middle East, Egypt, and Turkey, where Muslims form 90% and 97% out of 100 million and 84 million respectively, the former contains 9 Takaful operators (4 Family Takaful and 5 General Takaful, according to Insurance Federation of Egypt 2019) while Turkey is housing just 5 operators (COMCEC 2019).

Having said that, and regardless the fact that the large volume of Takaful contribution is dominated in the Middle East and Far East Asia, Takaful segment could achieve a potential prosperity, more than in its origins, in traditional European markets benefiting from the following particulars.

a) The maturity of Insurance industry
b) Creative regulatory environment to equip the promised opportunity of Takaful
c) The existence of risk sharing concept in the form of mutuality and friendly societies
d) Large number of distribution channels benefiting from technological advantages
e) Cross-border selling and marketing (easy to offer Takaful products in any of EU states)
f) Experienced and skilled insurers, reinsurers and banks play a major role of introducing Takaful products into European markets

5.3.2- Challenges

A study was conducted in 2013 to examine the perception of Takaful among Muslims in the UK. It has been found that the majority of respondents a) have a lack of awareness about the business, b) doubt whether Takaful is in line with Sharia-compliant, c) most like to buy Takaful products through Islamic banking channels rather than a standalone Takaful company and d) prefer to use Arabic terms in the policy to differentiate them from conventional terms and to attract ultimately more participants (Coolen-Maturi, 2013).

As a Sharia-compliant instrument, the misunderstanding of Sharia particularly due to Islamic extremists who carried out their criminal activities by the name of Sharia has caused, indeed, a harm damage to Islamic image in western countries, and consequently a reluctant attitude toward any of Islamic financial services (Masud, 2011).

Renat (2007) claimed that the operational model of Takaful could be successfully regulated in non-Muslim countries within the regulatory discipline of conventional insurance framework. The principles of Sharia are largely applicable to the internal operation of the company without violating the local jurisprudences. Therefore, Takaful companies might be established in Russia, for instance, and complied with the Organization of Insurance in the Russia Federation’s requirements. Knowing the regulatory challenges confronting Takaful business in its origins, this point is refutable from the author’s point of view.

From business managers’ view, the structure of Takaful business imposes some obstacles in these countries which could be classified into:

- Logistical issues: lack of Takaful awareness among non-Muslims societies, the skilled forces to operate Takaful business are inexistent
- Operational constraints: sever competition in a market where conventional insurance culture prevails and the lack of innovative Islamic products which meet market requirements
- Regulatory perspectives: the specific nature of Takaful structure could not, in some areas, be adjustable in regulatory regime adopted in non-Muslim countries

Having addressed the above, it can be said that the number of Muslims is not a factor to spread the concept other than the financial opportunities and ethical values the business brings to investors, customers and communities. It also could establish that Takaful business has a great opportunity to flourish in non-Muslim countries due to many reasons such as:

- The concept of risk sharing is already an existing culture among non-Muslims’ societies
- The number of Muslims who are looking for Islamic insurance products
- The ethical values and ownership of policyholders’ fund could be a matter of attraction to non-Muslims
- The potential growth of Islamic Financial products, particularly banking sector, shall increase the needs and enhance the opportunity of Takaful products to enter the market
- Transparency and ethical investment of Takaful appeal to a large customer base including non-Muslims

However, it might be fair to confirm that the existing conceptual foundation of Takaful in non-Muslim communities would be the first block to build upon. To overcome the logistical barriers, it would be recommendable to establish a joint venture with well-established conventional Insurers / Reinsurers to introduce Takaful business to all people and ultimately increase public awareness of the Takaful concept in these societies. Benefiting from flexible regulatory approach and distributional channels, the business might have a foot hold in these markets.

CHAPTER VI

Conclusions & Recommendations

6.1- Conclusions

Takaful business has been discussed from historical principles, principles in practice, modern application and business performance, challenges and opportunities. It has been classified as a risk sharing provision subject to be in line with Sharia compliant. Further consideration to Sharia prohibitions for commercial dealings, particularly to those relating to the business in question, was examined. Broad view of Takaful industry in main markets, including legal system and adopted regulations regarding the business, has been generally examined, but much more specific in the UAE market.

As outlined in chapter I, by answering research questions regarding the first objective regarding the impact of Islamic principles on Takaful performance, whether the regulatory system in support and could Takaful business be an alternative option of conventional model, it has been found that Islamic principles have narrowed the scope of Takaful business in terms of productivity as well as investment activities. Therefore, the business is not performing as much as conventional insurance counterparts. Also, the current model of Takaful operation along with existing regulations and Sharia standards are not in support of the business to flourish whether in the main markets or the submarkets alike. On the other hand, it has been addressed that the Takaful sector could have all of the means of foundation to grow and be an alternative option of conventional insurance provision when the business is practiced professionally and has regulatory support and unified Sharia standards. Takaful is not a commodity to sell; but it is a system to be implemented. This is the crucial message that needs to be delivered.

It has been also found that the interaction among business leaders of Takaful operators in the UAE have, to a large extent, been non-existent while the communication channel between them and regulators maintained at the lowest level. On the other hand, the Sharia opinion (fatwas) endorsed by SSB members is not announced publicly and / or shared with other operators. Consequently, these activities would not have opportunity to be argued with other scholars in the purpose of examining its validation and were, in mostly, duplicated. More publication of these activities less divergence of Sharia opinions and this would enhance corporate governance mechanism (Odiern, 2009).

In respect of the second objective regarding challenges / constraints and the impact of these on business performance, the research focused on the key constraints the business face, mainly the lack of Takaful awareness and ineffective system of corporate governance. It has been found that these constraints form the bottleneck of business growth and development. The conflict of interest is a major issue that needs to be overcome. The critical conflict of interest between **SSB /external auditors / actuaries** and **shareholders / managers,** which is the first time being examined, requires high level of regulatory engagement. These constraints restricted the scope of growth in original as well as sub markets.

The knowledge of Takaful managers, employees, regulators and SSB members is still lacking behind the core objective of Takaful business in terms of solidarity, brotherhood, and spiritual cooperation among communities. It would be reconfirmed that Takaful business is not merely a commercial enterprise or a charity; it stands in a mid-point between both. Achieving maximum profit to shareholders is one of its main targets and it should move equally and in parallel with implementing social solidarity and cooperation.

All Takaful operators are using IFRS standards in their financial reporting. The segregation of policyholders and shareholders fund, the way of accounting Qard Hasan, surplus distribution and the separate investment portfolio are not considered under the IFRS. This make, from one hand, the understanding of Takaful results by stakeholders is fundamentally unclear and from another hand, the differentiation between both models would be undistinguishable.

As addressed in literature, Sharia scholars in the UAE allowed Takaful operators to assure un-halal products / activities such as hotels which serve alcohol subject to arrange a 100% reinsurance with conventional insurers in the aim of increasing Takaful revenue. In addition to the concept of conditional donation which create consideration between two parties, imposing Qard Hasan is another aspect to support the perception that Takaful business is similar to conventional in terms of principles and operation. Also, the surplus distribution, which is the unique feature of Takaful, has been rarely practiced in the UAE while conventional insurers have successfully applied the no claim bonus to their customers. Having said that, the current model of Takaful operation requires a huge intention by business leaders, regulators and Sharia scholars.

In the aim of justifying the challenges arise from the concept of Tabarru, a conditional donation has been introduced. The commercial aspect of this donation shall create a consideration between policyholders and shareholders. Therefore, the excessive Gharar and Maysir is practiced during exchanging mutual consideration and the model, consequently, converted into conventional. From another aspect, the pure mutual structure is not recognised in many of legal systems, such as GCC countries, and the most fundamental issue is the standard requirements for capital adequacy where new mutual companies would be incapable to meet, particularly in the early years of which the fund is most probably insufficient to meet its liability (IFSB 8, 2009). Eventually, the concept of Qard Hasan is imposed on Shareholders to offer free interest loan to the policyholder's fund to overcome the challenge of solvency requirements. Again, the concept of Qard Hasan is enhancing the conventional model over the risk sharing model. Therefore, adopting Mutual Takaful could be the most proper alternative solution.

By answering question for the third objective in respect of whether Takaful business has an opportunity to flourish in western markets, It is understandable that the main feature of mutuality is established by small communities in particular geographic areas, initially in the UK, to ensure themselves against, mainly, industrial risks and gradually developed into commercial entities and widened the insurance coverage as circumstance of the lifestyle requires. Thus, the stability and sustainability of mutuals becomes a challenge. Unsimilar to that, the largest common factor of Mutual Takaful is that the business is in line with religious beliefs for millions of people around the world and at the same time it meets with their insurance needs and requirements. Further, the flexible regulatory system and high level of risk awareness, could play major factors to establish Mutual Takaful in Non-Muslim communities. Therefore, the opportunity of growth, development and expansion is, to the most extent and if appropriately regulated, achievable.

According to AAOIFI standards No. 26- Islamic Insurance, the type of Islamic Insurance could be:

a) *The Musharakah (partnership) among the participants, which leads to the establishment of a company that has articles of association and all other documents or*
b) *As a current type of Modaraba and Wakala*

While the first type of mutuality is not regulatory supported in most Islamic countries, the second model has been adopted. Therefore, and as the mutuality model is recognized and in consistent with Sharia, the local jurisprudences are recommended to adjust their regulations to license mutual insurance and ultimately avoid all critical constraints faced as a result of using the current model.

Having said that, it could be concluded:

- Takaful business is still far away from building its unique features as the current model is not adequately structured within the regulatory system and international financial and operational standards. Within a very short period, Takaful business was intended to replace conventional insurance provisions, particularly in countries where Muslims form majorities. Initially, the people who have been employed to conduct a Takaful operation were coming from conventional insurance backgrounds and ultimately failed to introduce the business, sufficiently, to communities. Takaful managers were unfamiliar with the concept and their main target was how to achieve the maximum benefits to shareholders, exactly as similar as to conventional insurance companies. Also, the SSB members appointed to supervise insurance products, contracts and treaties, have had no experience of the same and consequently failed to advise managers for innovating new products that meets Muslims' needs and requirements. Having said that, business leaders have adopted a strategy through using the religious principles behind the business as a marketing tool to attract Muslims and gain a market share over their conventional counterparts. During the early years of operation, this strategy was, to some extent, successful and the business witnessed a dramatic flourish and double-digit growth, as stated above through statistical data. Later, people have realized similarities between Takaful and conventional insurance in terms of policy wordings, products, claim services and so a like and their religious attractiveness has been replaced by market competition in terms of price and service where Takaful operators were unable to compete well established conventional Insurers.

- Furthermore, when Sharia scholars had set up the principle of a Takaful business, they have replaced the contract of consideration, which contains prohibited elements, by a contract of donation (Tabaru) and converted ultimately the contract type from bilateral into a unilateral contract in order to comply with Sharia law. Once the business is established, the first dilemma the operators face is the legal definition of donation which does not impose any obligation on Takaful operators to pay claims arising from unfortunate insured peril. Subsequently, Sharia scholars had, as a solution, introduced the concept of conditional donation which allows participants to claim compensation from the collected fund which, indeed, established for that purpose. Again, this concept has created a mutual consideration between the participants and the fund of which such consideration has been transferred by agency contract into shareholders. On the other hand, and to avoid unsustainability the mutual face during the early years of operation, Sharia scholars had imposed on Shareholders what is called Qard Hasan to cover any deficit the policyholders' fund sustains. Regardless of these initiatives, they insisted to classify Takaful insurance as a risk sharing provision. Having said that, the Takaful model is complicated and has a lot of contradictions which influence the perception that the model is similar or even the same as conventional insurance.

- Over and above, the regulatory framework was unable to capture the legal personality of policyholders' fund, and this has made a substantial impact on the whole business levels whether operational or corporate governance aspects.

- Having examined the theoretical principles as defined by the Takaful Act of 1984 that Takaful is a scheme of solidarity, it has been found that the practical operation is absolutely in contradictory. The concept of Qard Hasan and conditional donation have created a lot of practical issues that have been intentionally imposed / introduced by regulators and Sharia scholars as a solution to make the concept practically workable. Consequently, the model has been converted, in practice, into conventional model and the principle of solidarity was disappeared. The reason behind that was the fundamental lack of knowledge of Takaful managers and regulators about Takaful principles and Sharia scholars about insurance industry.

- Without increasing public awareness of the Takaful business and enhancing the corporate governance mechanism, the business would have no opportunity to grow in the local markets.

- Instead of converting Takaful business ethics into competitive benchmark differentiating the business from other conventional models, these ethics have become an obstacle toward business growth due to current way of operation. Indeed, it would be fair to address that Takaful insurance is still in its infancy stage comparing with conventional insurance and huge efforts are required from all business leaders to establish a value-driven model can compete or become an alternative option of other conventional counterparts.

- Alternatively, Mutual Takaful could be a solution to all of these challenges / constraints through maintaining the core principles of Takaful and enhancing the spiritual cooperation among participants of the scheme. As addressed above, the captive customers could create a fund and invite others to join the scheme. Managers are appointed based on contribution share of each member and the BODs could be elected by participants' votes. The domestic law could benefit from the existing Mutual Acts such as Friendly Society Act 1896, Local Authorities (Mutual Assurance) Act 1926 and Mutual Fire Insurance Act 1960. Undoubtedly, the new model shall bring new operational challenges, mainly how the local law system could be adjusted to embody the new regulations which, indeed, would be problematic.

- It would be worth mentioning that the number of Muslim populations is not a crucial factor for the growth and development of Takaful. Unless, capturing the specific features of Takaful, marketing it as a profit-sharing model, branding Takaful based on values other than market forces, distributing annual surplus as a marketing advantage, introducing the concept to all people irrespective of their faith and beliefs, allocating a small fund to be used for the common good to enhance solidarity, the business will struggle to grow and spread even into other Muslim countries such as Nigeria and Indonesia.

6.2- <u>Recommendations</u>

Nevertheless, if the Mutual Takaful is not practically applicable due to the regulatory constraints, the current model requires many improvements in all business levels. Therefore, the following reforms are strongly recommendable to be implemented in general but more specifically in the UAE market.

<u>6.2.1- Operational Improvements</u>

1- In respect of Takaful policy wordings, it has been established in chapter IV that Takaful operators are using similar conventional wordings which affect the perception of Takaful business as being conventional and it is in contradiction with Takaful concept in terms of ownership of the fund. Inevitably, it would be the first step a Takaful manager, in collaboration with SSB and regulators, should undertake to create Takaful own wordings that distinguish the business from conventional and in compliance with Sharia. Also, the current preamble of Takaful contracts does not refer to reinsurance arrangements where the policyholders, who are the owner of the business, should be informed of any arrangement Takaful managers undertake and therefore it should be included and clearly defined within the policy's preamble. Enhancing the concept of solidarity through waiving some conventional terms such as deductible or depreciation which reflect favourably on differentiation and competition.

2- The most preferable model of operation was a matter of argument among different jurisdictions where some of them allow using one type of operation whether Wakala or Modaraba while others allow a combination of both. As addressed in chapter IV, the hybrid model of Wakala and Modaraba is the most practicable model to be used taking into account the different activities carried out within the firm; insurance activities and investment

3- As shareholders are obliged to provide Qard Hasan to policyholders' fund in case of deficiency, it would be a pragmatic approach if Takaful operators adopt an essential marketing strategy through introducing the business, in addition to other cooperative benefits, as a **Profit-Sharing Model**, instead of what is classified as a risk sharing model

4- Similar to Takaful Malaysia STMB, adopting a continuous surplus distribution as a percentage of final results by way of marketing tool for enhancing the principle of Takaful and attracting more participants, as outlined in chapter IV

5- In respect of Retakaful, the regulators and Sharia scholars are encouraged to allow a profit sharing for those who bring good business to the pool, instead the current method which adopt the overall collective liability of the pool. This will encourage Takaful operators to adopt a prudent strategy and undertake due diligence skills of underwriting and claim services

6- Spreading the business out of original home through, in the first step, branding Takaful industry in home markets and then establishing a joint venture with reputable and reliable insurance companies such as Lloyds, AIG, Swiss Re and others who have gained a market respect and confidence over the years in order to bridge the gap and start operating Takaful in every place in the world. As addressed in chapter V, establishing new and stand-alone Takaful operators in these countries is a strategic mistake and is not recommendable at the time being

6.2.2- Regulatory Improvements

As discussed and outlined in all chapters above, the regulators are encouraged to:

1) Revisiting the current Takaful regulations, such as acquisition cost and financial reporting, issuing appropriate regulations specific to Takaful business and reviewing the suspended legal issues such as the beneficiaries in Family Takaful

2) Establishing a brokerage commission scale for each line of business in order to enhance fairness among all insurance providers in the market

3) Re-reviewing Takaful financial accounting and initiating a harmonized dialogue with business leaders, Sharia scholars and advocates in consultation of AAOIFI standards ad IFSB guidelines to establish a stand-alone Financial Reporting system which is capable to capture all Takaful features and replacing the existing IFRS

4) Allowing one method of surplus distribution, preferable to all participants regardless of their loss records, in order to maintain fairness and enhance transparency

5) Establishing a compulsory Takaful education program within the Emirates Institute of Banking and Finance, funded by all Takaful operators, and enforce a requirement on all employees, management and brokers to complete and obtain Takaful certificate

6) Imposing a requirement on all brokers to employ at least one of those who completed Takaful certificate to deal with Takaful insurance

7) Reviewing Tax implication on Takaful business

8) Allowing international Insurers and Reinsurers to establish Takaful windows in the UAE market to sell Takaful products subject to be in line with Sharia compliance. This would undoubtedly reflect positively on market share and penetration rate

Nevertheless, all the points above could be practically implemented by establishing a Takaful Supervisory Board TSB within IA to be responsible for regulating, appointing auditors and actuaries, monitoring and supporting specificities of Takaful business. The TSB could include professional insurance practitioners, auditors, actuaries, lawyers and Sharia scholars. The essential purposes of TSB are to maintain the core principles of Takaful business, enhance regulations which capture Takaful specificities and mitigate the excessive conflict of interests witnessed in the current operational mode. The operational expenses of STB might be shared between all Takaful operators and IA. The main objectives of the STB are:

- Replacing the SSB of each Takaful operator with one single Sharia Supervisory Committee SSC, which is conducting supervisory roles from the head office of Insurance Authority. This would eliminate / mitigate the conflict of interest, reduce the operational costs and enhance the corporate governance system
- All Sharia Fatwas shall be announced in the TSB website which allow unifying Sharia standards within the market
- Harmonizing Sharia standards, in collaboration with in-house lawyers, with the domestic legal framework
- Assigning one practitioner to attend the GA meetings representing the interest of policyholders
- Reviewing and approving external auditors and actuaries' reports for Takaful operation
- To be an educational place where Takaful leaders can be taught the core principles of Sharia and Sharia scholars could benefit from practitioners' experience of insurance. This should enhance innovation of Takaful products
- A quarterly report of TSB activities including areas to be improved, recommendations and new findings shall be submitted to IA for their final approval / decision

- Establishing a Research & Development Unit within TSB, allocating a fund to invest in R&D and encouraging TSB members to be more engaged in this essential process

6.2.3- <u>Sharia Scholarity Improvements</u>

As clearly addressed and found in chapter III, IV and V, it would be recommendable that:

- Sharia scholars play, crucial roles of not only designing the model of Islamic insurance but also structuring and developing insurance products and carrying out supervising on a day-to-day operation to ensure Sharia compliance. Nowadays, Sharia Scholars are required to understand the rapid growth of financial instruments and economies whether in the international or domestic markets and be well-engaged in administration, particularly auditing financial results, budgeting, investment assets and so a like. Knowing that 75% of Islamic financial institution are supervised by the top 10 scholars in the world, this shall highlight a warning that the shortage of qualified scholars is becoming a fundamental question (Ahmad, 2016). Therefore, Sharia knowledge only is not sufficient, and it should be a regulatory requirement that Sharia scholars must also be a) bilinguals, preferable Arabic / English to recognise the international developments and b) having a certificate of finance and economy

- Due to the lack of insurance knowledge, Takaful managers consider Sharia scholars as preventers of business streamlines, particularly for accepting new products or rendering Takaful managers to offer some products or investing in some assets not because they are un-halal, but because of their insufficient knowledge of the nature of insurance business. As both parties are having the same target, it would be strongly recommendable to carry out regular meeting between SSB and Takaful staff, management and BOD members which enable all having a better understanding of Takaful as an insurance model and Sharia prohibitions as an Islamic Insurance.

- Regardless of tremendous efforts carried out by AAOIFI and IFSB, Sharia standards and guidelines are not compulsory in many of jurisdictions which causes substantial contradictories between these standards and domestic legal systems. Therefore, Sharia scholars of local Takaful companies shall enforce these standards in operations and liaise with the regulatory body to adjust its legal regime with these standards. This shall unify standardization and harmonize business practice across the world.

- It is understandable that it would be impossible that one Sharia scholar is having a prudential knowledge of Sharia, insurance, finance, auditing and regulation. Therefore, the SSB members should be selected from scholars who are having, at least, a knowledge of one field of business in addition, of course, to Sharia principles. This specialization shall make their involvement of the business more effective.

However, while some of the above recommendations are specific to the UAE market, others could be generalized to other markets, whether Islamic or non-Islamic markets, based on Takaful landscaping within each market.

Lastly, from literature, the Insurance Law, in Saudi Arabia, enforced all insurance providers to adopt a cooperative insurance model. In this model, there is no requirement for cooperative insurance companies to a) Appoint a Sharia board and b) Segregate the policyholders' fund from the shareholders' fund. However, Investment activities must be carried out in compliance with Sharia principles. The markable feature of this model is to distribute 10% of the net surplus to policyholders through paying cashback or offering a reduction on the next year's premium (Clyde & Co, 2015) and (Barlow, Alkhaliwi & Neighbour, 2020). Having noticed that, Cooperative insurance is far away from the Takaful model and very close to conventional insurance. Nevertheless, and regardless that cooperative and Takaful are an Islamic insurance provision, considering them and combining their results under Takaful provision is an essentially misleading act which abuses the view of researchers and professional practitioners. Therefore, the international financial reporters of insurance are encouraged to segregate these two models in terms of principles and performing results to trace each model separately.

This research contributes to knowledge through examining the impact of Islamic Financial principles on Takaful performance, investigating whether the current operational model, as practiced in the UAE market, is commercially viable and exploring possible promotive solutions to overcome challenges the business face, in general market, but more specifically in the UAE market. Also, the corporate governance mechanism of Takaful model is the first time being discussed from practical point of view. Also, the conflict of interest between Takaful operators and SSB members, auditors and actuaries has never been examined before.

Determining the core constraints, highlighting the impact of these constraints on business performance and providing possible solutions and recommendation, will help business leaders, regulators and Sharia scholars to reassess the current model of operation which is ultimately considered a significantly contribution into practice.

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