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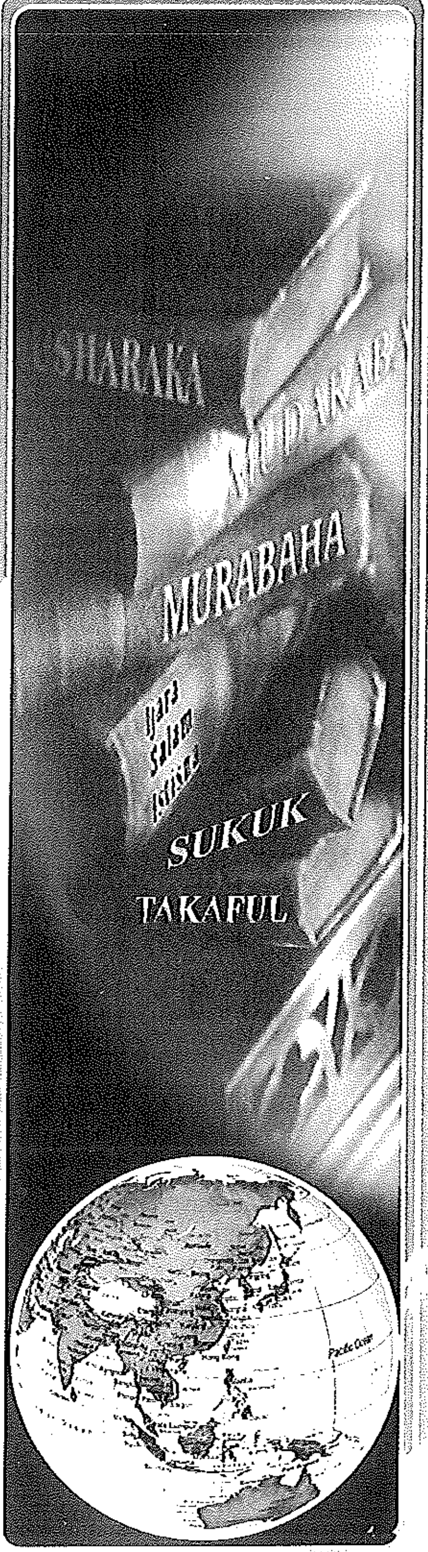

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Practices Of Insurance Operators In Malaysia: Conventional vs. Unconventional Life Insurance

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Abstract

Risk is part and parcel of our daily life and we have been trying to find out the way to protect ourselves in the case of misfortune. That is the reason why insurance came to play an important role in our life. Unfortunately, insurance seems to be not fully complied with unconventional (Islamic) aspect and hence, it has been modified to ensure unconventional requirements. However, to our knowledge, no research has been done to what extent these two differ and hence, the objective of this research is to examine the current conventional and unconventional life insurance practices in Malaysia. Interviews and the questionnaires have been conducted and the findings show that there are no significant differences in practices except for product development and allocation of premium contribution.

Keywords – Life insurance, Family takaful, Insurance operators, Marketing strategy.

1. Introduction

Humans are prone to perils and misfortune. Precautionary steps should be taken to protect individuals from any unforeseen perils and misfortune. One of the

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means to seek the protection is seeking the shelter from insurance coverage. There are basically two main groups of insurance products, namely general and life insurance products. In this study, it will focus on life insurance product. Life insurance policy contract is a legal contract between the life insurance company (*insurer*) and the person proposing for insurance (*insured*). Based on the contract, the insurer agrees to pay the insured a certain amount of money (*sum insured*) and any accrued additional benefits on the happening of some specified unforeseen events such as the death of the insured or his survival to the end of the contract. In return, the insured agrees to pay a regular sum (premium) periodically to the insurer for a specified term until the insured's death. In Malaysia, there are seven types of basic life insurance policies which are the term insurance, whole life insurance, endowment, investment-linked, life annuity plan, supplementary rider/cover, and mortgage reducing term assurance (MRTA). However, current insurance products and their practices have been criticized from the unconventional point of view for the involvement of uncertainty, interest and gambling (Ab-Rahman et al., 2008; Billah 1998). Alternatively, unconventional insurance has been introduced by adopting conventional insurance operating processes and structure and by founding on principles of mutual assistance and the contribution is provided by the insured (Mankabady, 1989).

Based on The World *Takaful* Report 2011, the global unconventional insurance contributions grew by 31 percent in 2009 to US$7 billion as of 2011. The opportunities in core markets also suggest a US$12 billion industry by 2011. It is also seen that the global gross unconventional insurance contributions reached US$7 billion in 2009, and continue to boast healthy growth. The achievement of this significant growth by the unconventional insurance industry motivates us to conduct this research.

Importantly, many researchers have highlighted the distinction between conventional and unconventional insurance from the theoretical aspects. Among others, are (Anwar, 2008), (Jaffer et al., 2010) and Mubbsher (2011). However, to the extent of our knowledge, there is no research that has been done in comparing and contrasting between their practices starting from the beginning (*product development stage*) until the end (*maturity*). Hence, the main objective of this study is to compare and contrast the conventional and unconventional insurance products in terms of the product development stage and its related operations such as the term of contract, pricing, premium portion, nomination, claims disbursement in the case of suicide, termination of the policy, marketing strategies, lapse ratio and in event of deficit of the risk fund. Since the conventional insurance is repacked to be in line with unconventional requirements with the help of unconventional scholars, this study further examines their opinions on the differences between the conventional and unconventional insurance products.

2. Conventional Life Insurance

In a conventional company, the company receives premiums from the policyholders. Aside from the premiums, the company also takes fund from its shareholders. Therefore, the conventional insurance company's capital consists of money from the premiums and the shareholders' fund. With that, the company sets up its reserves and it generates investment income on the capital and reserves. The conventional insurance company also pays out claims, expenses and reinsurance from the capital and reserves. According to Insurance Info (2009), the main reason for life insurance is to provide income replacement to insured's immediate family after the demise of the insured. The other reasons include financing the insured's children's education, having a saving plan for the future so that the insured have a constant source of income after retirement, and ensuring that the insured have extra financial support in the event of serious illness or accident. There are four main types of life insurances offered in Malaysia and they are explained below.

The first type is whole life insurance policy. Explained in more detail, whole life insurance policy is a policy which provides protection over the insured's entire life. The policy promises to pay the sum insured upon the early death of the insured or upon the insured reaching a specified age such as 85, 90 or 100 years (Insurance Info, 2009). *The second type is term insurance policy.* Term Insurance Policy provides the payment to the beneficiary if the insured dies within a specified time period. The sum insured of the policy is payable only in the event of death of the insured and nothing is payable if he survives till the end of the term. When the term ends, so does the coverage, unless the policy is renewed (Insurance Info, 2009). *The third type is endowment insurance.* Endowment insurance provides the payment of the sum insured (endowment) upon the death of the insured during a fixed term or at maturity if the insured is still alive. The money will also be paid if the insured suffers total and permanent disability during the specified period. An endowment life insurance policy creates two advantages for the insured; savings and protection. *The fourth type is investment-linked insurance.* Investment-linked insurance, under which, the insured's premium is used to buy life insurance protection and units in a fund managed by the life insurance company. The benefits paid to the insured or the insured's nominee will depend on the price of the units at the time the insured surrender the policy or the insured pass away.

3. Unconventional Life Insurance

Similar to conventional life insurance (CLI), unconventional life insurance (ULI) is usually used as a means to provide financial aid for a client's dependents should the client die (Yuen, 2005). Certain types of ULI may also pay out if the client becomes unable to work due to illness or disability whether it is permanent or temporary. In other words, this type of insurance is a combination of a mutual financial indemnity and an investment scheme. Under this type of insurance, the policy holders' premium is divided between the risk fund (*Participant's Special Account or PSA*) and the balance into an account for the purpose of participant's savings and long-term investment (*Participant's Account or PA*). According to Engku-Ali and Odierno (2008), the main types of ULI products are individual unconventional life insurance plan and mortgage unconventional life insurance.

Under the individual unconventional life insurance plan, upon maturity of the certificate, the policyholder shall receive the amount accumulated in the PA which is meant for the saving and investment. The policyholder will also receive any proportionate surplus, if any, that comes from the PSA (Engku-Ali & Odierno, 2008). However, in the event that the policyholder dies before the maturity, the company will pay the benefit to the nominee of the policyholder. The sum that will be paid includes the balance due to the deceased policyholder from PA prior to the date of his/her death and the sum covered payable from PSA.

In the case of education unconventional life insurance, it provides the policyholder with protection and long-term savings to finance the higher education expenses of his/her child. The policy provides the child with financial benefits if the policyholder suffers any setbacks which are covered under the policy. The policy also gives the child long-term saving or education fund that the child can use to further his/her studies.

4. Conventional And Unconventional Life Insurance

Theoretically, there are six main differences between the general practices conventional and unconventional life insurance.

Regarding contract, in CLI, the paid premium creates an obligation against the insurer based on a sale and purchase transaction where the subject matter is the coverage offered by the contract. However, the policyholders of the ULI mutually pool their contributions and share the liability of each participant. In precise words, all participants agree to help one another. Any claims made by a policyholder in case of peril, loss or etc will be paid out of the pool (Anwar, 2008). In the case of investment, for CLI, there is no restriction imposed on the investment of funds except those arising from prudential regulations. However, in ULI, any investment made must only be invested in *Shariah* compliant assets (Anwar, 2008).

For risk sharing, in CLI, a risk transfer mechanism exists whereby risk is transferred from the policyholder (*the insured*) to the insurance company (*the insurer*) in consideration of the premium paid by the insured. In the case of ULI, all participants share the insurance risk. The participants do not transfer the risk to the company. Concerned with profit distribution, for CLI, the policyholders do not get any share of the profit while, in ULI, the policyholders are allowed to share the surplus depending on the ULI models adopted by the company.

Related to the payment of insurance commission and third party fees, in CLI, the commissions are paid out of the premium income fund. However, in UCL, any third party fees are part of the operational expenses and are therefore paid by the company from the shareholders' fund. In addition to that, in practice these fees are specified in the ULI contracts. With regard to extra risk premium loading, in CLI companies, the premiums are usually loaded when extra risks are perceived for example a person in poor health or dangerous occupation such as construction worker. The practice in the ULI is slightly different. Theoretically, in the later, no one is discriminated against for foreseeable extra risk. However, according to the underwriting criteria, the contribution is higher for the participant that will bring a greater threat to the policyholders' fund.

5. Research methodology

Among the CLI and ULI products, the *endowment insurance policy* and *individual saving unconventional life insurance* are selected since both of them have the highest demand according to the preliminary interview. The practices of selected products are examined starting from the product developmental stage until the maturity.

There are eleven licensed ULI and fourteen ULI companies. All of them are approached for interview. In this research, interviews are conducted in three steps. Firstly, the interviews are conducted to know the key practice stages involved for the selected sample products. Secondly, the interviews are conducted with the related personnel of five ULI companies and five CLI companies to find out the difference in practices. Finally, five unconventional advisors are interviewed to seek the rationale behind similarities and differences in practices. The opinions of advisors are crucial since they are the experts who approve ULI products before offering them to public.

6. Findings

6.1 Profile of respondents

There are eleven licensed ULI companies offering various products, five licensed life and general businesses, and nine licensed life businesses only. However, for the second set of questionnaire to examine their current practices, five responses from the ULI companies and five responses from the CLI companies are received. The respondents are from the senior management with at least ten years of working experience and the management team from the product development team with at least five years of working experience. Their profile can be referred to Table 1.

Table 1. List of respondents from the first set of questionnaire

Respondent	Gender	Industry	Position	Area of expertise
1	Male	*Takaful*	Senior Manager	Actuary Product Development
2	Male	*Takaful*	Senior Manager	Family Product and Operation
3	Male	*Takaful*	Senior Manager	Marketing
4	Female	*Takaful*	Management	Product Development
5	Female	*Takaful*	Agent	Family Products
6	Male	Insurance	Senior Manager	Actuary
7	Male	Insurance	Senior Manager	Product Development
8	Male	Insurance	Management	Marketing
9	Male	Insurance	Agent	Life Insurance Product
10	Female	Insurance	Management	Life Insurance Product

The third set of questionnaire is sent to ten unconventional advisors who have more than five years working experience. Out of ten, five agreed to respond to the questionnaire. Their profile can be referred to Table 2.

Table 2. List of respondents from the second set of questionnaire

Respondent	Gender	Industry	Position
1	Male	*Takaful*	*Shari'ah* Advisor
2	Male	*Takaful*	*Shari'ah* Advisor
3	Male	*Takaful*	*Shari'ah* Advisor
4	Male	*Takaful*	*Shari'ah* Advisor
5	Male	*Takaful*	*Shari'ah* Advisor

6.2 Findings on the practices of conventional and unconventional life insurance

Based on the preliminary interviews with the experts from the interviews, we have identified that there are ten main stages of two products, namely the *endowment insurance policy* (*proxy for conventional life insurance*) and *individual saving unconventional life insurance* (proxy for unconventional life insurance). Only these main stages are focused to find out whether there is any significant difference between their practices.

6.2.1 Findings on product development process

The main stages of process under product development and the comparison of both products can be referred to Table 3.

Table 3: Product Development Processes

List of the main processes under product development	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
The product owner will initiate the product		
The product owner will construct the desired product specifications and the analysis of the product i.e. profitable or not		
If everything is fitting, the product owner will present the product to the Product Committee for approval		
After the approval from the Product Committee, the product will be presented to the *Shari'ah* Board		X
After the approval of the *Shari'ah* Board, the product will be subjected to the Product Working Group which includes the corporate planning, underwriting, compliance and risk management, policy serving, investment, customer relationship management and administration		X

Both products go through the same product development processes except in the cases of the inspection and approval of the unconventional board. Thus, the role of the unconventional board is absent in the product working development of the life insurance product. The absenteeism of this specific role will expose the product to any flaws from the unconventional aspect. Therefore, it can be summed that the difference is only having unconventional advisors' approval for the products in ULI.

6.2.2 Findings on the terms and conditions

The main contents of the terms and conditions of the products and the comparison of both products can be referred to Table 4.

Table 4: Terms and conditions

The terms and conditions	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
a) Age of issuance: 30 days - 60 years old, age next birthday, male/female. Total or permanent disability (TPD) cover is only available for participants below the age of 65	✓	✓
b) The limits of sum covered: Minimum – RM 10,000 Maximum – Subject to underwriting decision	✓ ✓	✓ ✓
c) The limits of contribution: Minimum - RM 600.00 Maximum - Subject to underwriting approval	✓ ✓	✓ ✓
d) Age of expiry: Up to 75 years old.	✓	✓
e) Terms of coverage: Minimum - 5 years. (For participant age less than 14 years old, the minimum maturity age is 19 years old). Maximum - 74 years	✓ ✓	✓ ✓

Both categories have the same contents in their terms and conditions. However, we find that some companies' prescribed age limits or the sums covered are slightly different from each other. For example, Etiqa's coverage for age of issuance is from 18 years old to 55 years old while Takaful Ikhlas's coverage for age of issuance is from 30 days to 60 years old. It is believed that this is the companies' method of differentiating themselves from their competitors. Therefore, it can be concluded that generally, the practices of both CLI and UCLI companies are the same.

6.2.3 Findings on the pricing

The comparison of both products in terms of the pricing can be referred to Table 5.

Table 5: The pricing

The pricing	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
Basic principle of pricing:		
a) Adequacy – sufficient to pay losses and reasonable operating expenses of the operator	✓	✓
b) Not excessive – should not be too high that participants are paying more than the risks covered in the contract	✓	✓
c) Responsive – should be responsive over time to changing losses exposure and changing economic condition	✓	✓

All of the responses confirmed that in real life, this is where substantial actuarial work is involved. It is a complicated process that needs precise and truthful details of a particular participant or customer in order to come up with a value. Therefore, it may be assumed that basically, the pricing mechanism is almost the same for both.

6.2.4 Findings on the premium portion

The segregation of the risk portion and the comparison of both products can be referred to Table 6.

Table 6: *Tabarru'* portion

The *tabarru'* portion/risk portion	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
a) The contribution by the participants will be split into a *tabarru'* portion and also the savings portion	✓	X
b) The money from the *tabarru'* portion will be used to pay any claims made	✓	X

The respondents mention that in CLI, all premiums will be taken by the company and there is no segregation between the premiums and the shareholders' fund. Any claim payments will be taken out from the company's account. In the case of ULI companies, the premium received is split into PA and PSA. Any claim payment will be disbursed from the PSA, in which policyholders are sharing their risk. In sum, CLI and ULI companies implement an entirely different method on the segregation of the premium portion.

6.2.5 Findings on the nomination

The purpose of nomination in the product and the comparison of both products can be referred to table 7.

Table 7: The nomination

The nomination	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
a) The purpose of nomination is to ensure that the beneficiaries of the participants have access to the *takaful* proceeds as quickly as possible without going through the administrative delays of estate administration (nomination is not subjected to the Probate and Administration Act 1959 and the Will Act 1959)	✓	✓
b) The nominee is just a trustee and not a beneficiary to the death *takaful* benefits	✓	✓

All of the respondents stated that the nomination process for both follow the same general process listed in the interview questions. It might be due to the fact that Takaful Act 1984 was adapted from the Insurance Act 1963. In addition to that, the Section 6(1) of the Takaful Act 1984 is an exact replica of Section 44(1) of Insurance Act 1963.

6.2.6 Findings on claims in the case of suicide

The comparison of both products with regards to claims in the case of suicide can be referred to Table 8.

Table 8: Claims in the case of suicide

Claims in the case of suicide	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
The beneficiaries will only get the amount from the Participant's Account (PA) but not from the risk fund as suicide is *haram* in Islam	✓	X

All respondents confirm that "the beneficiaries will only get the amount from the balance in the PA but not from PSA as suicide is prohibited in Islam". This scenario is only applicable to the ULI companies.

The respondents further explained that in the most recent practice, generally all policies issued by the CLI companies contain a suicide clause[1] regarding the liability of the company in case of suicide. In addition to that, two of the respondents further stated that with a suicide clause, the beneficiary of someone who commits suicide within a specified period of time would not be able to claim the death benefit at all. Only the premiums paid by the deceased will be refunded to the beneficiaries.

According to the respondents, in Malaysia, the fixed period of time mentioned in suicide clause varies, usually between 1 or 2 years. Once the mandated period of time has elapsed, suicide is treated as any death that could occur. Hence, the death benefits will be paid to the beneficiaries. However, in the case where the policy has no evident of a suicide clause, the death benefits on the life of a suicide victim would generally be honored after two years of the issue date.

However, it is believed that the amount the beneficiaries will get in the case of a suicide with a suicide clause evident in the policy will be higher in the conventional insurance rather than unconventional insurance. This is due to the fact that in the conventional insurance with a suicide clause, all the paid premiums will be returned to the beneficiaries while this is not so in unconventional insurance. As being explained before, the contributions in unconventional insurance will be divided into two portions namely the PA and PSA. In the case of a suicide in unconventional insurance, only the balance in PA will be returned to the beneficiaries and this amount is believed to be comparatively lesser than the amount the beneficiaries will acquire through conventional insurance.

6.2.7 Findings on the termination of the policy

The comparison of both products with regards to the termination of the policy can be referred to Table 9.

Table 9: Termination of the policy

The termination of the Policy	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
a) In case of a cancellation of the certificate/plan before maturity, the surrender value will be the accumulated amount in the PA at that point in time	✓	✓
b) Upon maturity, the maturity benefit will be the accumulated amount in the PA	✓	✓

1 A suicide clause is a condition incorporated in the policy to prevent claims from suicides, whether sane or insane, within a fixed period of time from the policy's issue date. In cases like this, the insurer will refund the premiums paid.

All respondents confirmed that they follow the practices outlined in (a) and (b) in the questionnaire. In addition to that, the respondents which are from the insurance companies stated that in a regular premium life insurance endowment plan, early termination of the plan usually involves high costs and the surrender value payable is likely to be less than the total premiums paid. They further added that buying a life insurance policy is a long-term commitment. An early termination of the policy usually involves high costs to the companies and the surrender value payable may be less than the total premiums paid. In a nutshell, the general practices between *takaful* operators and insurance companies with regards to the termination of the policy are similar.

6.2.8 Findings on the marketing strategy

The comparison of both products with regards to the marketing strategies can be referred to Table 10.

Table 10: Marketing strategy

Marketing	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
a) Marketing is based on the needs of the participants	✓	✓
b) Do not sell the product but invite the participant to join the scheme	✓	✓

Half of the respondents say that the marketing strategies stated in the questionnaires under (a) and (b) are applicable to them. The other half states that the strategies are not applicable to the endowment life insurance product since the agents of the product are expected to sell as much as they can to their customers. The respondents said that some companies have the options of attaching additional benefits to the policy. They said that generally, the marketing strategy of insurance companies is to sell and invite and promote. It can be concluded that generally, the marketing strategies of both products are the same.

6.2.9 Findings on the lapse ratio of the product

The comparison of both products with regards to the lapse ratio of the products can be referred to Table 11.

Table 11: The lapse ratio

The lapse ratio	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
Lapse ratio – the ratio that a participant surrenders the policy before maturity	Not known	Not known

None of the respondents are able to give an actual lapse ratio to the particular products being analyzed. However, five of the respondents state that the lapse ratio for the individual saving and unconventional insurance plan is lower than the conventional endowment plan. It is believed that this is due to the information that the agents in ULI companies are trained to promote policies based on the needs of a participant rather than trying to promote as much policies as possible. In sum, it can be concluded that the lapse ratio for the ULI product is lower than the CLI product.

6.2.10 Findings on the event of deficit in the risk fund

The comparison of both products in the event of deficit in the risk fund can be referred to Table 12.

Table 12: Deficit of the risk fund

The event of deficit of the risk fund	Family Takaful Product: Individual Saving and Protection Plan	Life Insurance Product: Individual Endowment Plan
a) Shareholder will lend the money from the shareholder's fund and this sum will be paid using the future surplus	✓	X
b) However, if the deficit continues on the shareholder will have to relinquish the sum loan as outright loan which means the sum loan to the deficit fund will not be recovered	✓	X

All respondents confirm that on the occurrence of this event, the shareholders will lend the deficit amount to the fund which is expected to be paid using future surpluses. According to the respondents, firstly, the amount in the contingency fund will be utilized. Then, the loan from shareholders' fund will be used if this amount fails to cover the deficit. The respondents also say that this event does not apply to CLI companies as the risk fund and the shareholders' fund is not separated. However, if the fund runs into deficit the company may take up a policy loan or an automatic premium loan from the bank.

Based on the interview results, it has been found that only product development, premium allocation and risk fund management are different between conventional and unconventional life insurance. The following subsection further elaborates on the opinions of unconventional scholars on these differences.

6.3. The opinions of unconventional scholars on the differences found based from the previous sections

The first difference found is in the development process of the product where there is an absence of the unconventional committee members in the conventional process. During the interview sections, three key concerns are highlighted by them. They are (a) the agreement between the insurers and insured must be fulfilled, (b) the stated model must be consistently abided throughout the contract period and (c) the terminology used in the proposal form, certificate, Product Disclosure Sheet (PDS), brochure and all the product collaterals must be reviewed to ensure their adherence to unconventional standards and requirements. In addition to the key concerns addressed above, they say the potential unconventional problems and the possible solutions and the information are summarized in Table 13.

Table 13: *Shari'ah* related problems and solutions

No.	*Shari'ah* related problems	Solutions
1.	The *aqad* is not reflected in the product	Verification of proposal form and *aqad*
2.	Wrong terminologies used in the product's collaterals	Verification of all product's collateral
3	Relevant charges/ fee	• Approval from *Shari'ah* Committee • Mentioned in the *aqad* (to make sure of the transparency)

In the case of premium, the unconventional advisors say that they are still looking at the process of determining the premium portion of the fund and suspect two issues that require attention. The issues are relating to the surrender value of the participants and the outstanding contribution of the death participants. However, they are still working to solve these issues and no clarifications are given yet. When the management of risk fund is concerned, the unconventional advisors state that they are consulted when any deficit occurs in the risk fund. Most of ULI companies practice is that in the case of need in risk funds, shareholder will lend the money from the shareholder's fund and this sum will be paid using the future surplus. However, their concern is that it might not be fair to shareholders if the deficit fund is not recovered.

Therefore, the opinions of unconventional advisors are analysed, and it is found that there are many issues that they have not solved yet. In addition, some issues have not been exposed to them by ULI companies, for instance, pricing policy.

7. Conclusion And Policy Implementation

This research is undertaken to help the public to better understand the similarities and differences of conventional and unconventional life insurance. From the interview results, it can be concluded that there are not much significant difference between them, except approval of the product by the unconventional advisors, allocation of premium in unconventional life insurance and management of risk funds in the case of deficits in the unconventional life insurance. When the opinions of unconventional advisors are examined, it seems that they are not exposed to some of the practices such as pricing policy and furthermore, it has been found out that there are some issues which have not been resolved by them.

There are two main limitations attributed to this research. Firstly, all life insurance practices are not examined as the researcher only researched on the products that have the highest demand from the clients. Finally, there is the issue of the privacy and confidentiality of the company and hence, some companies also did not answer the questionnaire completely whenever some questions were regarded as confidential.

It is expected that future research should look at the difference between the technical deficit (*the forecasted deficit by the company*) and the actual deficit (*the actual deficit faced by the company by the end of the accounting period*). Based from the interviews, the researchers have been told that the expected deficits may be different from the actual deficit faced by the company. Therefore, the causes for such difference should be examined.

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