



# Australian Academy of Business Leadership (AABL)

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SIBRC 2015 PROCEEDINGS

## Proceedings

### Sydney International Business Research Conference 2015

University of Western Sydney,  
Campbelltown Campus

Friday 17 April — Sunday 19  
April 2015

Sydney, Australia

**ISBN 978-0-9942714-0-2**

All papers were double-blind  
reviewed before accepting to the  
conference

Editor: Dr Afzalur Rashid, University  
of Southern Queensland, Australia



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#### Message from the Conference Chair



I am very pleased to welcome everyone to Sydney International Business Research Conference (SIBRC), 17-19 April 2015 at the University of Western Sydney Campbelltown Campus organised by Australian Academy of Business Leadership (AABL).

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**Distribution of Underwriting Surplus and Investment Profit from Tabarru' Fund: Shariah  
Contracts Applied and Current Market Practice**

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**Abstract**

Takaful is a contract whereby the participants commit to contribute an amount on regular basis or in one lump sum in a specified fund to mutually guarantee each other and appoint a body to act as the fund manager. In this contract, Takaful participants have the opportunity to mitigate the possible financial risk that their families might encounter in case of misfortune. The contribution then will be placed into respective participant's account or also known as Participants' Investment Fund (PIF). The fund manager, i.e. Takaful operator will drip from every PIF an amount on the basis of donation into a collective Participants' Risk Fund (PRF) or known as *Tabarru'* Fund. This fund does not belong to the Takaful operator; it's rather owned by the participants. The Takaful operator only manages the fund on behalf of the participants. Being a fund, money in it is also invested and would possibly generate profit. At the same time, with proper management of the *Tabarru'* fund, it might produce surplus after payment of claims at the end of financial year. There are several Shariah views and methods on the treatment of the investment profit and underwriting surplus generated from the fund. These views differ from one to another depending on the contracts adopted, which ultimately would define the permissibility of sharing the profit and the surplus between related parties. In Malaysia, the sharing of underwriting surplus is allowed according to the resolution passed by Central Bank of Malaysia (Bank Negara Malaysia) subject to the certain guidelines. All eleven (11) Takaful operators in Malaysia have different practices in distributing the surplus and profit with respect to Shariah contracts applied and operational treatments. This research will study these differences and provide recommendations on the issues identified.

## Introduction

Takaful refers to cooperation among a group of individuals to mutually guarantee and aid each other in order to meet certain needs as agreed amongst them, such as providing compensation for a particular loss or any other kind of financial needs\*. This cooperation usually will be entrusted to a Takaful operator to safeguard these individuals' interest as participants.

After an underwriter of the Takaful operator approves the risk borne by the participant, the participant will contribute a sum of money into Participant's Investment Fund (PIF) which subsequently a portion of it will be dripped to Participants' Risk Fund (PRF or also known as *tabarru'* fund) as agreed. At the end of each financial year, the appointed actuary will assess the status of the PRF whether there is surplus or deficit.

The status of the fund will be announced after each financial year end closing. If the status is deficit, unallocated surplus i.e. contingency reserve from the past year will be utilized to cover the deficit. In Malaysia, if the reserve is still insufficient to cover the deficit, Central Bank of Malaysia or also known as Bank Negara Malaysia (BNM) has obliged the Takaful operator to give *qardhasan* (benevolent loan) to PRF. Islamic Financial Services Act 2013 (IFSA) has captured this obligation in paragraph 95<sup>†</sup> which says,

*“Where the value of the asset of the Takaful fund is less than the value specified  
..., the licensed Takaful operator shall provide qard or other forms of financial  
support to the Takaful fund from the shareholders' fund for an amount and on  
such terms and conditions as may be specified by the bank.”*

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\*Shariah Resolution in Islamic Finance, p.62.

†Islamic Financial Services Act 2013, p 63.

If there is surplus, BNM has made it clear via its BNM Shariah Advisory Council (SAC) resolution that the Takaful operator can share the surplus with participants.

### Takaful Model

Below is an example of a family Takaful model used in the industry which adopts a hybrid of *wakalah* and *ju'alah* (with sharing of underwriting surplus):

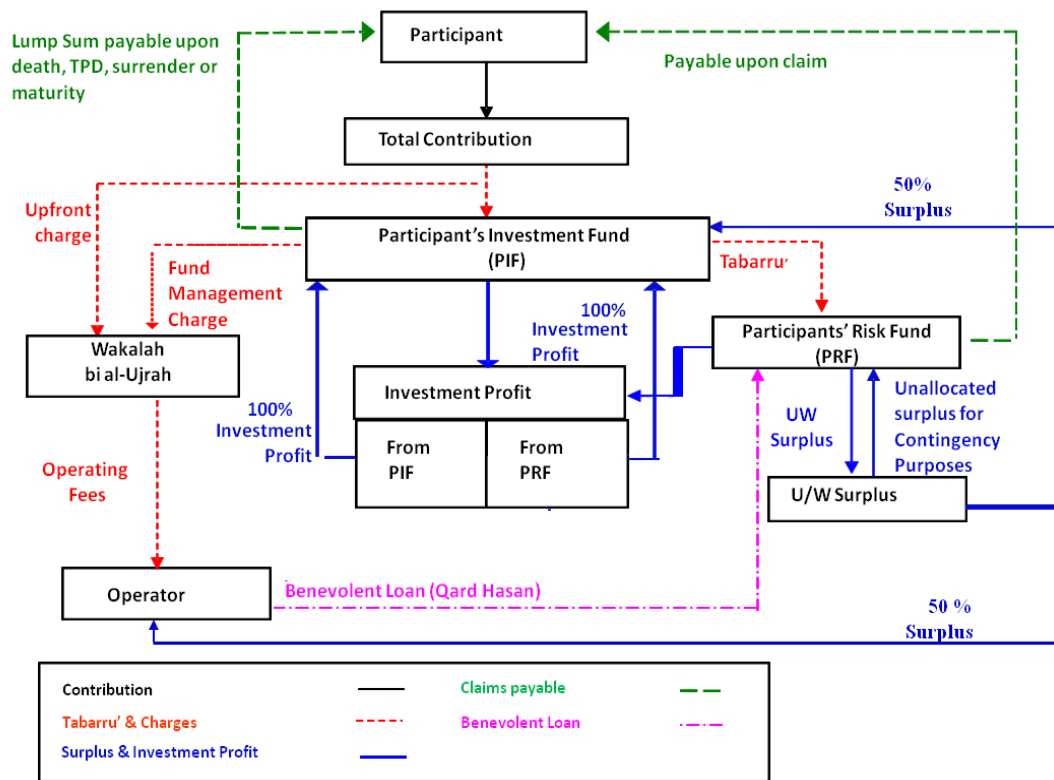


Diagram 1: Example of a *Wakalah-Ju'alah* Family Takaful Model in Malaysia

Based on the model, participant will give his/her commitment to contribute to the fund according to the risk carried. The contribution made will be deducted first as upfront charge before going into PIF. The upfront charge is a *wakalah* fee which is payable because of the services and expertise that will be provided by Takaful operator. This is where the contract of *wakalah bi al-ujrah* takes place.

The money in PIF will then be dripped into PRF. All of the money in PIF and PRF will be invested in Shariah-compliant portfolios. In this model, the contract used for investment is *wakalah bi al-istithmar*. To invest on behalf of participants, the Takaful operator can charge the participants for the fund management services rendered. In the model above, Takaful operator charge its customer with a Fund Management Charge (FMC). At the end of the financial year, 100% of the investment profit will be given and credited into PIF.

The Shariah concept applicable would be as follows<sup>‡</sup>:

- i. *Tabarru'*: The amount of donation that the participants willingly relinquish in order to help each other in the event of misfortunes.
- ii. *Wakalah bi al-Ujrah*: The contract of agency where:
  - Participant authorizes the Takaful operator to manage PRF on behalf of him/her.
  - The Takaful operator will invest the monies in accordance to *wakalah bi al-istithmar* principle.

The Takaful operator is entitled to receive the fees as agreed at the beginning of the contract upon the services rendered.

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<sup>‡</sup>Great Eastern Takaful Berhad. *Product Disclosure Sheet*, p 1.

- iii. *Ju'alah*: Literally, it means compensation for a given service. Legally, it is a contract for performing a given task against a prescribed fee in a given period. *Ju'alah* concept is used in a situation where underwriting surplus is shared among the participants and the Takaful operator. Entitlement to underwriting surplus depends on a completion of work and delivery of result.
- iv. *Qard Hasan* (Benevolent Loan): A loan which is returned at the end of the agreed period without any interest or share in the profit or loss of the business. For the purpose of Takaful, in the event of deficit in the PRF, Takaful operator will arrange for *qardhasan*. The *qardhasanis* repayable from the future underwriting surplus of the PRF.

As a comparison to model above, the following is an example of a family Takaful model in the industry that adopts a hybrid of *wakalah* and *mudarabah* (without sharing of underwriting surplus):

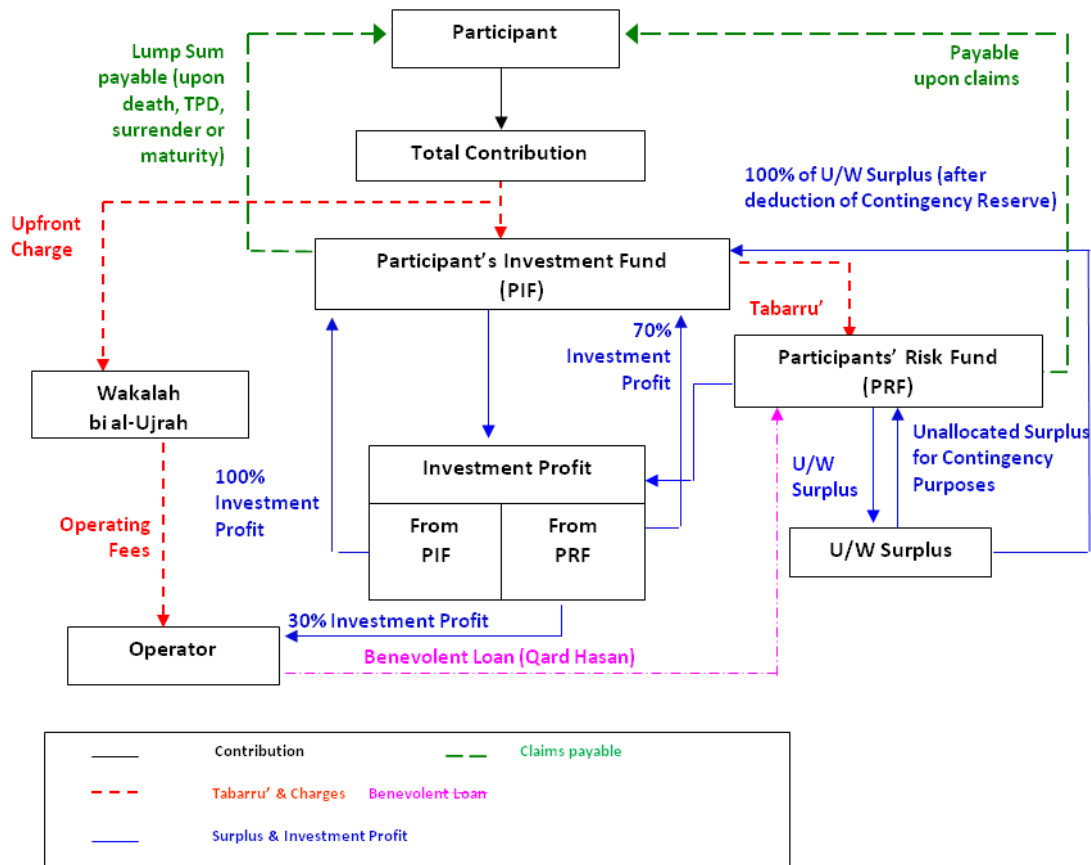


Diagram 2: Example of a *Wakalah-Mudarabah* Family Takaful Model in Malaysia

There are two differences between this model and the former which are:

- i. Investment profit sharing from PRF.

The former model does not share profit because it is based on *wakalah bi al-istithmar* where they have enjoyed the FMC. Meanwhile, the latter model does share investment profit from PRF on the basis of *mudarabah*. International Shari'ah Research Academy for Islamic Finance (ISRA) defines *mudarabah*<sup>§</sup> as a type of partnership for profit in which one partner provides capital and the other partner contributes his labour. The profit will be shared between them according to the terms that they have mutually agreed.

- ii. Sharing of underwriting surplus

<sup>§</sup> ISRA Compendium For Islamic Financial Terms, pp 288-289.



The former model does share underwriting surplus on the basis of *ju'alah*, meanwhile, the latter model does not share underwriting surplus despite the fact that the Takaful operator can actually include it in the contract in the first place.

To understand underwriting surplus, we must first understand underwriting. In addition to that, we also need to clarify who is the person that is entitled to the investment profit generated from PRF.

### **Definition of Underwriting, Underwriting Surplus and the status of Investment Profit in PRF**

#### Definition of Underwriting

Underwriting in the Takaful business is the process of selecting, assessing and classifying the degrees of risk of an applicant for the purpose of granting coverage in exchange for a contribution<sup>\*\*</sup>. The definition is not entirely accurate with regards to the usage of the term “exchange”. In reality, Takaful is not a *mu'awadat* (exchange) contract, but it is a type of voluntary donation.

Hence, the suitable definition will be, “the process of selecting, assessing and classifying the degrees of risk of an applicant for the purpose of granting coverage to the applicant who will contribute to the risk pool” by keeping silence on the “exchange” term.

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<sup>\*\*</sup> Takaful: Realities and Challenges, p 291.

The layman understanding of underwriting is applicant have to pass underwriting first if he/she wants to be a participant in a Takaful contract. Among the reasons that an applicant is declined to participate in a Takaful scheme would be his/her health conditions such as high Body Mass Index (BMI), existing critical illness and it might also be due to regulatory requirements such as Anti-Money Laundering and Anti-Terrorism Financing Act.

There is also a concept that we refer to as “degree of underwriting”. If a Takaful operator is being prudent and adopts a stringent underwriting philosophy to protect the *tabarru'* fund, it is likely that less claim will happen, resulting in underwriting surplus from PRF at the end of a financial year. But if the Takaful operator takes an aggressive approach, there is a high possibility that the PRF will suffer underwriting deficit.

### Underwriting Surplus

Underwriting surplus is a surplus; it is not a profit. *Investopedia* defines surplus as the amount of an asset or resource that exceeds the portion that is utilized<sup>††</sup>. Hence, surplus is not a result from investment activity, but rather, unutilized resource, such as underwriting surplus.

### The Status of Investment Profit in PRF

Although the primary function of PRF is to honour claim, PRF is also being invested. Takaful operators being financial institutions; it will be a waste of opportunity if they do not invest the participants' money. Although PRF is a separate fund, the fund is still owned by participants, likewise its derived profit.

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<sup>††</sup> Retrieved from <http://www.investopedia.com/terms/s/surplus.asp> on 18 Nov 2014

### Views of Proponent and Opponent on Surplus Sharing and Profit Distribution

BNM through its SAC, in its 42<sup>nd</sup>, 59<sup>th</sup> and 62<sup>nd</sup> meeting dated 25 March 2004, 25 May 2006 and 4 October 2006 respectively resolved<sup>‡‡</sup> that:

- i. Surplus from participants' risk fund may be distributed amongst the participants and the Takafulcompany.
- ii. For Takaful model based on *wakalah* concept, the risk fund surplus may be taken by the Takaful fund manager as a performance fee based on an agreed percentage.
- iii. For Takaful model based on *mudarabah* concept, the surplus from participants' risk fund may be shared between the participants and Takafulcompany based on percentage or profit sharing ratio as agreed by all contracting parties.

It is understood from the above that the Shariah contracts used in surplus sharing is either *ju'alah* or *mudarabah*.

The practice of surplus sharing is not widely accepted internationally, especially in the Gulf Countries. Accounting and Auditing Organization for Islamic Financial Institutions<sup>§§</sup> (AAOIFI) has issued a standard in its Shari'a Standard No. 26 on Islamic insurance, under statement no. 5/5, AAOIFI has stressed that the managing company is not entitled to any share of the surplus<sup>\*\*\*</sup>.

In terms of profit distribution, AAOIFI has kept silent on its opinions and resolution. Nevertheless, SAC of BNM did pass a resolution on profit distribution from PRF, apart from surplus distribution.

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<sup>‡‡</sup> Shariah Resolutions in Islamic Finance 2010, p 78.

<sup>§§</sup> Based in Bahrain, is an Islamic non-profit corporate body that prepares among others accounting and Shariah standards for Islamic financial institutions.

<sup>\*\*\*</sup> Shari'a Standards for Islamic Financial Institutions, p 439.

SAC of BNM, in its 62<sup>nd</sup> meeting dated 4 October 2006 resolved<sup>†††</sup> that:

- i. A Takaful company is allowed to share or to impose fee or performance fee on the investment profits from participants' risk fund.
- ii. For Takaful model based on *mudarabah*, the Takaful company is allowed to share the profit.
- iii. Whereas for Takaful model based on *wakalah*, the Takaful company is allowed to charge a fee or performance fee on the investment profit of the participants' risk fund.

This would mean that, for profit distribution; *mudarabah*, *wakalah bi al-istithmar* and *ju'alah* would be applicable. However, the usage of *ju'alah* contract (or performance fee) in investment activity is odd. This is because there would be no difference in terms of *mudarabah* and *ju'alah* and it is not in line with the spirit of *ju'alah* itself.

### **Combined Distribution vs Separate Distribution**

After discussing the permissibility of distribution of surplus and profit between Takaful operator and participants, this section will discuss methods adopted by Takaful operators to distribute the profit and surplus.

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<sup>†††</sup>Shariah Resolutions in Islamic Finance 2010, p 80.

There are differences in the methods adopted for surplus and profit distribution between Takaful operators depending on a Takaful operator’s management decision. There are Takaful operators that combine the investment profit and the underwriting surplus first before distributing them, which is referred to as combined distribution. There are also cases where the investment profit and the underwriting surplus are distributed separately, which are referred to as separate distribution.

Earlier in this paper, it is noted that underwriting surplus is not an investment profit. As such, some Takaful operators might want to revisit their practices in dealing with underwriting surplus so that they apply the right contract.

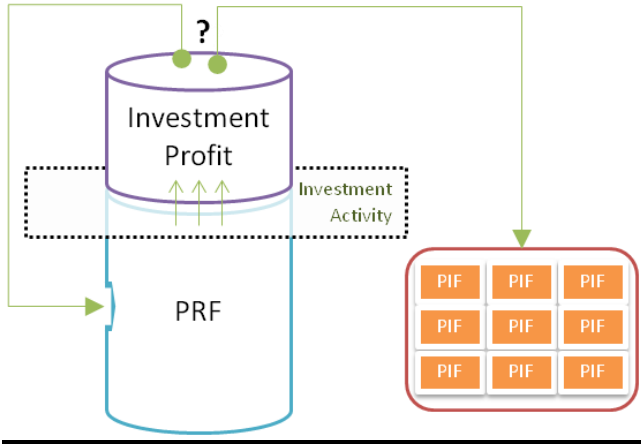


Diagram 3: Issue of Distribution of Investment Profit from PRF

If a Takaful operator adopts *wakalah contract*, the Takaful operator is not entitled to take any investment profit that arises but it is entitled to charge for investment management as *wakalah fee*. *Al-Ju’alah* cannot be considered here because it is absurd to charge performance fee on investment profit.

The fundamental issue is where should the profit be channelled to? It is either to PRF or PIF? Based on the research conducted, investment profit should be channelled to PIF as long as Takaful operator has the operational capacity to do that. This is to avoid 'double distribution' to Takaful operator, hence injustice to participants.

In case the profit is channelled to PRF, the double distribution may occur if the Takaful operator has already charged wakalah fee upfront on investment management activities, and later, it also shares underwriting surplus whereby the investment profit is a part of surplus.

For Takaful model that is based on *mudarabah*, it would be more adequate and accurate if *mudarabahon* profit sharing and *mudarabahon* surplus sharing are kept separately, in which the investment profit that emerged from PRF is channelled straight away to PIF, whereas the underwriting surplus is shared between the Takaful operator and the participants.

### **Experience and Stance of Great Eastern Takaful Berhad (GETB)**

In the beginning of establishment of GETB, Shariah Unit of GETB did send a proposal paper to BNM in 2010 on surplus sharing, taking a stance that it is not permissible to share surplus based on these arguments:

i. *Iltizam bi at-Tabarru'* (commitment to donate)

The contribution that participants have paid is considered only a commitment, and not yet turned into donation. The contribution will turn into donation when it is been used to pay claims. Hence, surplus arising from PRF is still participants' money and Takaful operator should not take it.

ii. Ratio of Underwriting

If Takaful operator wanted to take 50% of the underwriting surplus, the ratio would be 50:50. At the same time, 0:100 is also still considered a ratio. If Takaful operator takes 100%, there will be no difference between a Takaful operator and an insurer.

iii. Application of *Ju'alah*

Malikites, Shafi'ites and Hanbalites stipulate that in *ju'alah*, the performance fee should be clearly stated in number, not only a ratio. Moreover, it is outside of the Takaful operator's capability to ensure that they realize underwriting surplus because it is subject to number of claims that happened for the year, which is uncertain in nature. So, application of *ju'alah* here is not suitable.

iv. Prudence of Takaful operator

Some might say that there is no harm to give Takaful operator a share in surplus to further motivate them to be prudent in ensuring capabilities of PRF to honour claims. However, BNM has already stipulated a *qard* arrangement from Takaful operator in case there is deficit in the PRF. *Qard* liability should be enough to motivate Takaful operator in being prudent.

v. AAOIFI Shariah Standards on sharing of underwriting surplus

AAOIFI's resolution in 2010 has made clear that underwriting surplus is participants' money and shareholders of the Takaful operator cannot enjoy the surplus.

Consequently, after the introduction of the Takaful Operational Framework guidelines by BNM which imposes new requirements, a thorough deliberation took place to revisit this decision. Taking into consideration various factors and discussions between related parties, GETB including its Shariah Committee and Shariah Unit agreed to allow surplus sharing.

This stance was made based on market practice in Malaysia and prudent guidelines from BNM on surplus sharing. On distribution of investment profit, it has been a practice of GETB to channel the profit from PRF to the PIF straight away.

### Current Market Practice

A market research<sup>\*\*\*</sup> had been conducted to see other Takaful operators' practice in distributing profit and surplus from PRF. The research findings as at December 2014 are as follows:

No.	Takaful Operator	Practice of Takaful Operator in Regards to Surplus Sharing and Profit Distribution from PRF
1.	Takaful Operator A	<ul style="list-style-type: none"> <li>• Takaful Model: 1) <i>Wakalah</i> 2) <i>Mudarabah</i></li> <li>• Shariah contract for surplus sharing: 1) <i>Ju'alah</i> 2) <i>Mudarabah</i></li> <li>• Shariah contract for profit distribution: 1) <i>Ju'alah</i> 2) <i>Mudarabah</i></li> <li>• Combined distribution</li> </ul>
2.	Takaful Operator B	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Wakalah</i></li> <li>• Shariah contract for surplus sharing: <i>Ju'alah</i></li> <li>• Shariah contract for investment in PRF: <i>Wakalah</i></li> <li>• Shariah contract for profit distribution: Not applicable</li> <li>• Combined distribution<sup>§§§</sup></li> </ul>
3.	Takaful Operator C	<ul style="list-style-type: none"> <li>• Takaful Model: 1) <i>Wakalah</i> 2) <i>Mudarabah</i></li> <li>• Shariah contract for surplus sharing: 1) <i>Ju'alah</i> 2) <i>Mudarabah</i></li> <li>• Shariah contract for profit distribution: 1) <i>Ju'alah</i> 2) <i>Mudarabah</i></li> <li>• Combined distribution</li> </ul>
4.	Takaful Operator D	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Wakalah</i></li> <li>• Shariah contract for surplus sharing: <i>Ju'alah</i></li> <li>• Shariah contract for profit distribution: <i>Wakalah bi al-Istithmar</i></li> <li>• Separate distribution</li> </ul>
5.	Takaful Operator E	<ul style="list-style-type: none"> <li>• Takaful Model: 1) <i>Wakalah</i> 2) <i>Mudarabah</i></li> <li>• Shariah contract for surplus sharing: <i>Ju'alah</i></li> <li>• Shariah contract for investment in PRF: <i>Wakalah</i></li> <li>• Shariah contract for profit distribution: No specified contract</li> <li>• Combined distribution</li> </ul>

<sup>\*\*\*</sup> All tele-conversations with Shariah officers from respective Takaful operators on current market practice are not recorded. The information on market practice is also subject to accuracy of the respondents' replies and deemed true at the time of survey. The survey form is as attached in the appendix.

<sup>§§§</sup> Takaful Operator B argued that underwriting surplus is not related directly to investment profit although obviously it is related. Thus, in researchers' assessment, the distribution will be regarded as combined distribution. This is also applicable to the same argument that has been made by Takaful Operator E.



No.	Takaful Operator	Practice of Takaful Operator in Regards to Surplus Sharing and Profit Distribution from PRF
6.	Takaful Operator F	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Wakalah – Ju’alah</i></li> <li>• Shariah contract for surplus sharing: <i>Ju’alah</i></li> <li>• Shariah contract for investment in PRF: <i>Ju’alah</i></li> <li>• Shariah contract for profit distribution: <i>Ju’alah</i></li> <li>• Combined distribution</li> </ul>
7.	Takaful Operator G	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Wakalah</i></li> <li>• Shariah contract for surplus sharing: <i>HibahMu’allaqah</i></li> <li>• Shariah contract for profit distribution: <i>HibahMu’allaqah</i></li> <li>• Combined distribution</li> </ul>
8.	Takaful Operator H	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Wakalah bi al-Ujrah</i></li> <li>• Shariah contract for surplus sharing: Performance Fee</li> <li>• Shariah contract for profit distribution: <i>Wakalah bi al-Istithmar</i></li> <li>• Combined distribution</li> </ul>
9.	Takaful Operator I	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Wakalah</i></li> <li>• Shariah contract for surplus sharing: <i>Ju’alah</i></li> <li>• Shariah contract for profit distribution: <i>Ju’alah</i></li> <li>• Combined distribution</li> </ul>
10.	Takaful Operator J	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Wakalah</i></li> <li>• Shariah contract for surplus sharing: <i>Ju’alah</i></li> <li>• Shariah contract for profit distribution: <i>Wakalah bi al-Istithmar</i></li> <li>• Combined distribution</li> </ul>
11.	Takaful Operator K	<ul style="list-style-type: none"> <li>• Takaful Model: <i>Mudarabah</i></li> <li>• Shariah contract for surplus sharing: Gift****</li> <li>• Shariah contract for profit distribution: <i>Mudarabah</i></li> <li>• Combined distribution</li> </ul>

Table 1: Practice of Takaful Operators with regard to Surplus Sharing and Profit Distribution from PRF

Out of eleven (11) Takaful operators, ten (10) of them practiced combined distribution. Below is the ratio between practice of combined distribution and separate distribution:

\*\*\*\* Takaful Operator K previously used the contract of *hibah* in distributing the surplus. After a discussion with their Shariah Committee, which they then resolved that it has to be changed to a contract of gift because in *hibah*, there should be no condition that bind and tie the *hibah*.

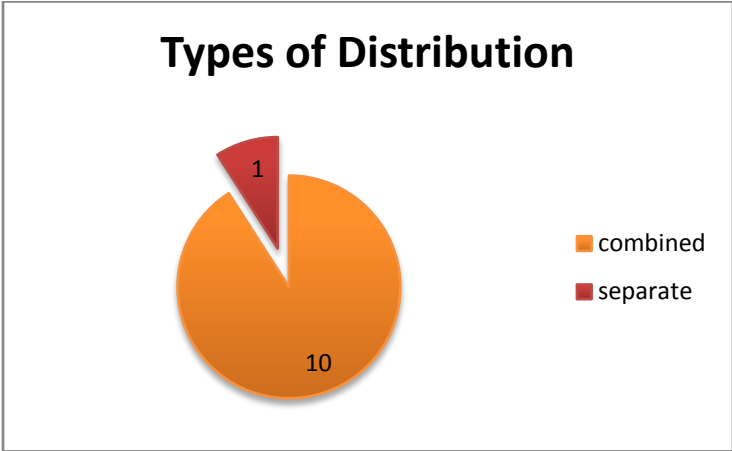


Diagram 4: Types of Distribution

For surplus sharing, different Shariah contracts are applied as follows:

- i. *Ju'alah* (used by eight (8) of eleven (11)Takaful operators)
- ii. *Mudarabah* (used by two (2) of eleven (11) Takaful operators)
- iii. Performance Fee (used only by one (1)Takaful operator)
- iv. *HibahMu'allaqah* (used only by one (1) Takaful operator)
- v. Gift (used only by one (1) Takaful operator)

The pie chart reflecting the contracts used are as below:

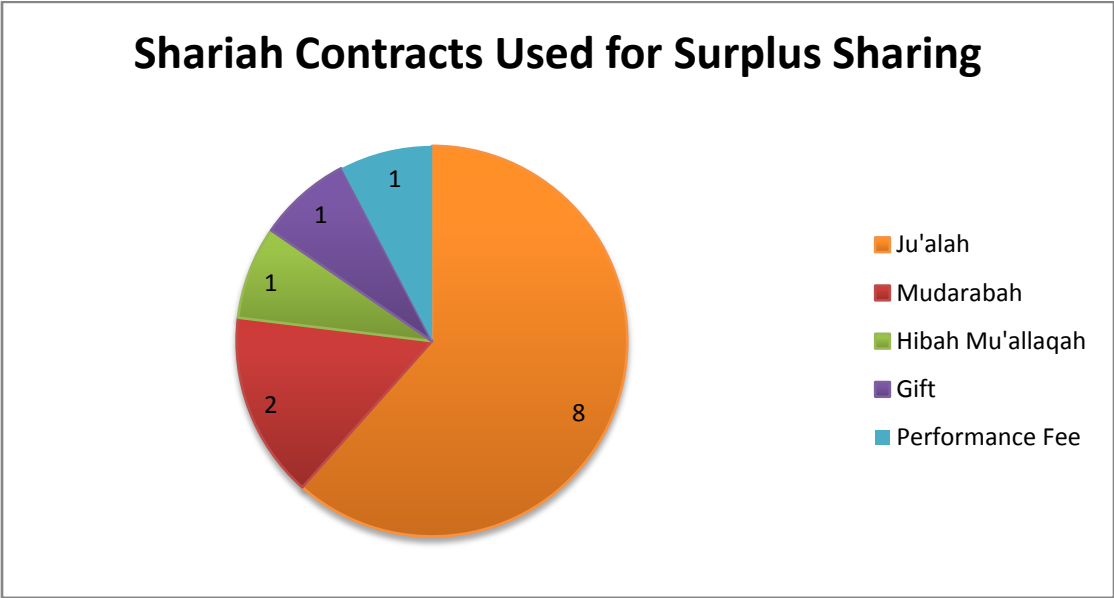


Diagram 5: Shariah Contracts used for Surplus Sharing

Obviously, *ju'alah* is the preferred contract for surplus distribution. We also may consider performance fee to be regarded as *ju'alah* because they are similar to each other. As for *hibahmu'allaqah* (contingent *hibah*) as the underlying contract for surplus sharing, Takaful Operator G opined that the basis is what has been resolved by SAC of BNM in which SAC said<sup>††††</sup>:

الأصلر ضالمتعاقدينوننتيجتههيمالتزم ماهابالتعاقدا

“The original ruling for a contract is the consent of the contracting parties and its effect is based on what have become the rights and duties as agreed in the contract.”

*Hibah* is a Shariah contract for granting ownership of an asset to another person without consideration. *Hibahmu'allaqah* is a conditional *hibah* whereby a donor will donate if the conditions are met. In sharing of underwriting surplus, Takaful participants (donor) will give up part of their underwriting surplus to Takaful operator (donee) only if the donee can realize underwriting surplus in that financial year.

Although *ju'alah* and *hibahmu'allaqah* differ based on their nature, actually the effect is still the same; Takaful operators are able to have a share of underwriting surplus. The reason why there are differences in the Shariah contracts adopted in this regard is because SAC of BNM only provides a general ruling on the matter as clarified above.

Based on the above table as well, it is noted that there are Takaful operators that still use *mudarabah* contract in one of their models namely Takaful Operator A, C, E and K. Nevertheless, Takaful Operator E and K use different Shariah contract for their surplus sharing.

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<sup>††††</sup> Shariah Resolutions in Islamic Finance 2010, p 79.

For distribution of profit (from PRF), different Shariah contracts are also applied as follows:

- i. *Ju'alah* (used by four (4) of eleven (11)Takaful operators)
- ii. *Mudarabah* (used by three (3) of eleven (11) Takaful operators)
- iii. *Wakalah bi al-Istithmar* (used by five (5) of eleven (11) Takaful operators)
- iv. *HibahMu'allaqah* (used only by one (1)Takaful operator)

This can be visualized in the following pie chart:

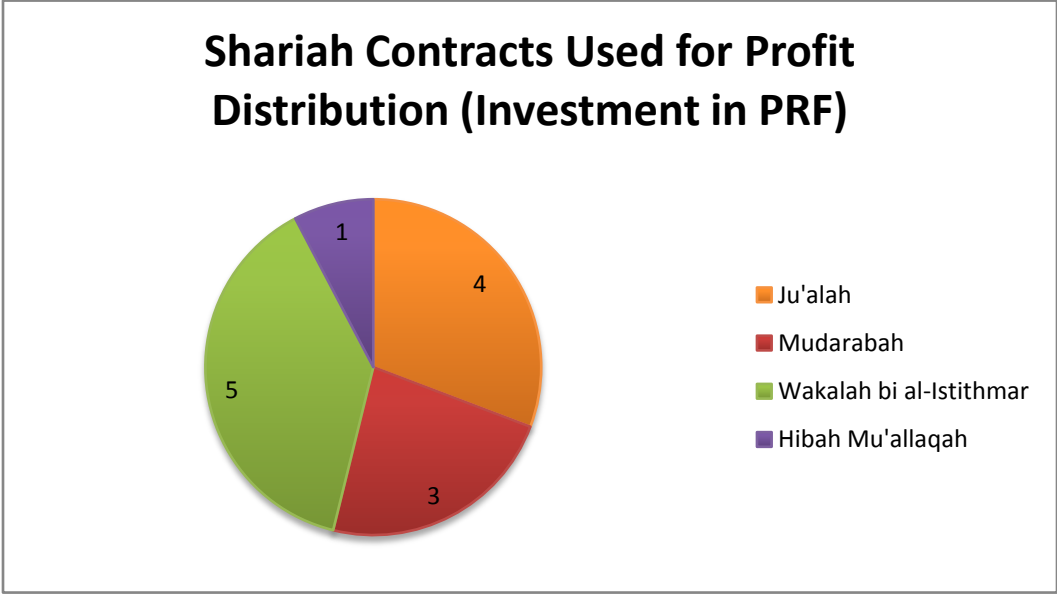


Diagram 6: Shariah Contracts Used for Profit Distribution (Investment in PRF)

From the diagram above, *wakalah bi al-istithmar* is the contract practiced by majority of the Takaful operators. It means that Takaful Operator B, D, E, H and J are being remunerated upfront to perform the investment management activities. While the second largest contract used is *ju'alah*, which is used by four (4) Takaful operators.

From this observation as well, it can be concluded that these four (4) Takaful operators are applying the same Shariah contract (*ju'alah*) in profit and surplus distribution. This is likely due to the fact that most of the Takaful operators will channel the profit gained from investment in PRF back to PRF and regard it as part of surplus before being distributed. Only Takaful Operator D has separated the profit from surplus before being distributed.

Most Takaful operators uphold *wakalah* as their Takaful model and use *wakalah bi al-istithmar* in their investment in PRF. This is because *wakalah bi al-istithmar* will make Takaful operator entitled to charge upfront fees. On top of that, the profit that emerged will be combined with underwriting surplus and subsequently distributed between the Takaful operator and participants on the basis of *ju'alah* contract.

Meanwhile, Takaful operators which uphold *mudarabah* as their Takaful model will also use *mudarabah* in their PRF investment. Nevertheless, there are Takaful operators that uphold *mudarabah* as their Takaful model but use *wakalah* in their investment in PRF.

Based on the researchers' observation on the combined distribution, it is noted that there are three (3) different scenarios of distribution of profit and surplus from PRF as follows:

- i. Takaful operator that up holds *wakalah* or *mudarabah* as their Takaful model and applies *wakalah bi al-istithmar* as Shariah contract in their investment in PRF,
- ii. Takaful operator that up hold *smudarabah* as their Takaful model and applies the same contract as Shariah contract in their investment in PRF,
- iii. Takaful operator that up hold *swakalah* as their Takaful model and applies *hibahmu'allaqah* as Shariah contract in their investment in PRF.

### **Scenario i**

For scenario i, Takaful operator up holds *wakalah* or *mudarabah* as their Takaful model and apply *wakalah bi al-istithmaras* Shariah contract in their investment in PRF. The profits that emerged from the investment will be combined with underwriting surplus and subsequently distributed between the Takaful operator and participants on the basis of *ju'alah*.

In the researchers' view, this practice is not accurate in terms of '*adalah* (justice), *maqasid* Shariah (objectives of Shariah) and the fundamental contract.

If a Takaful operator took *wakalah* charge upfront, they are no longer entitled for the profit of the investment. If they share the profit and surplus, it could be considered as double charge. So, 100% of investment profit must go to the participants' PIF and not to be returned to PRF. If not, it will be unjust to the participants. It is as if participants are forced to share their investment profit indirectly.

It is also an obligation to the Takaful operator to ascertain that their earning is not through unlawful means based on one of objectives of Shariah which is to protect wealth.

If a Takaful operator does not charge *wakalah* fee upfront and they share the profit via the combined distribution, it is not *wakalah* anymore; it would become another contract. It could be *mudarabah* (profit sharing) or *musharakah* (profit and loss sharing). The Takaful operator should clearly spell out in the contract that the investment management activity is based on *mudarabah* or *musharaka* to reflect the actual or fundamental nature of the contract.

### **Scenario ii**

For scenario ii, Takaful operator upholds *mudarabah* as their Takaful model and uses the same contract as Shariah contract in their investment in PRF. Hence, the investment profit should be distributed on the basis of *mudarabah*.

However, in Malaysia, SAC of BNM had previously passed a resolution on distribution of surplus which stipulates that any Takaful model that is based on *mudarabah*, its surplus can be shared by using *mudarabah* contract.

Nevertheless, fundamentally, *mudarabah* is actually a contract of investment by two parties; investment manager (*mudarib*) and capital provider (*rabb al-mal*). In Takaful context, participants are the capital provider whereby they put their contribution (capital) in PRF, whereas the Takaful operator is the investment manager. If the investment activities yield profit, Takaful operator can only share on the profit that emerged, not on the PRF as a whole. This is because, in *mudarabah*, the capital is still owned by the capital provider unless if there is a loss.

Hence, if some monies remain in PRF at the year-end, it's not necessarily profit unless the remaining money is larger than the monies at the beginning of the year; it might not really be *mudarabah* because obviously they distribute the remaining capital in the fund not the profit.

For example: The fund is started with RM100 million (capital). At the year end, the remaining money in the fund is RM50 million. Thus, RM50 million cannot be considered as profit because it is still a portion of capital. However, in this case, the money is considered *mudarabah* profit and subsequently defined as surplus.

Thus, if there is really investment activity in the fund, the profit generated from it should be distributed separately between participants and Takaful operator; it should not be mixed up with the capital (monies in PRF).

### **Scenario iii**

For scenario iii, Takaful operator upholds *wakalah* as their Takaful model and applies *hibahmu'allaqah* as Shariah contract in their investment in PRF.

Based on the assessment conducted, application of *hibahmu'allaqah* for profit distribution from PRF is not accurate. This is because *hibah* is not an investment contract. In Shariah, investment contract is an exchange contract (*aqd al-muawadah*) and must be known, whereas *hibah* is charitable contract (*aqd at-tabarru'at*).

It would be more appropriate if the investment activity is based on *mudarabahor wakalah bi al-istithmar* whereby the profit emerged which is attributable to participants is channelled to their respective PIF. Only then, if there is surplus in the PRF, it can be shared between Takaful operator and participants based on *hibahmu'allaqah*.

## **Conclusion**

In researchers' view, neither contracts applied for the Takaful model nor contracts applied for investment activity are the real issue. The real issue arises when the investment profit and the underwriting surplus are combined together due to the reasons discussed.

This is why researchers prefer to segregate between investment profit and underwriting surplus because this practice is more accurate, removes the prohibited elements in Shariah such as *gharar*(uncertainty) and *jahalah*(unknown) and evade double distribution of profit to the Takaful operator which is against the principle of fairness (*'adalah*).

Double distribution occurs when the Takaful operator earns profit from upfront charge for investment management activities in PRF and also enjoys sharing of investment profit through surplus sharing from the same fund.

It is advisable to all Takaful operators to revisit the implementation of surplus and profit distribution from PRF. May God help and guide us to ensure compliance in Shariah at all times.

*Wallahu'alam*



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**Appendix:**

Survey Form

**Great Eastern Takaful Berhad**

- 1) Which Takaful model that your institution adopt?
  - Wakalah
  - Mudarabah
  - Other: \_\_\_\_\_
- 2) Does your institution enjoy underwriting surplus?
  - Yes
  - No
- 3) If yes, what is the adopted Shariah contract to distribute the surplus between Takaful operator and participants?
  - Ju'alah
  - HibahMu'allaqah

Mudharabah

Other: \_\_\_\_\_

4) Please give justification on above answer.

\_\_\_\_\_

5) Does your institution enjoy sharing of investment profit from **participants' risk fund**?

Yes

No

6) If yes, what is the adopted Shariah contract for the profit sharing?

Mudharabah

Ju'alah

Wakalah bi al-Ujrah

Other: \_\_\_\_\_

7) Please give justification on above answer.

\_\_\_\_\_

8) What happened to the profit from investment in **participants' risk fund**?

Profits will return to participants' risk fund and will be regarded as part of surplus

Profit will be directed to participants investment funds accordingly; separated  
from underwriting surplus

Other: \_\_\_\_\_

9) Any comments / questions?

\_\_\_\_\_

**Thank you**