Available online at www.jeeir.com

JEEIR

e-ISSN: 2289-2559

Journal of Emerging Economies & Islamic Research 5(4) 2017, 18 – 26.

Journal of Emerging Economies and Islamic Research

General Takaful claims: An experience of Takaful operator in Malaysia

Amirul Afif Muhamat[a], Mohamad Nizam Jaafar[b], Sharifah Faigah Syed Alwi[c]

[b]*Faculty of Business and Management, Shah Alam, Malaysia*

[b,c] *Faculty of Arshad Ayub Graduate Business School, Universiti Teknologi MARA Shah Alam, Malaysia*

ARTICLE INFO

Article history:
Received 5 November 2017
Received in revised form
19 November 2017
Accepted 26 November 2017
Published 30 December 2017

Keywords:
General *takaful*
Takaful claims
Insurance
Insurance claims

ABSTRACT

Takaful is interchangeably referred as Islamic insurance. In Malaysia, the *takaful* sector is part of the main components for Islamic finance industry. The business can be divided into two: general and family *takaful*. To ease understanding on this niche sector; general *takaful* is comparable to general insurance while family takaful is akin to life insurance with special reference needs to be given on the requirement of the business to adhere to the Islamic precepts. The main business in general *takaful* is motor *takaful* and this line of business is faced with high *takaful* claims. This study appraised the factors which affect the general *takaful* claims based on the experience of one *takaful* operator in Malaysia (the name of *takaful* operator is not disclosed due to confidentiality). The factors are: number of claims; fraud; and coverage for protection. The limitation of this study is that the observation period is only 10 years which limits rigorous analysis to be done. Nevertheless, previous studies in this area depict the same limitation – constraint in gathering data that has long observation period. On the bright side, the data in this study is still capable to produce meaningful results to be referred with regards to this issue – general *takaful* claims.

1. Introduction

Takaful claim is a formal request by the *takaful* participant (policyholder) to the *takaful* operator detailing the calamity that has affected him; and requested for compensation as agreed in *takaful* policy. *Takaful* claims or insurance claims is the “crux” of this business since it can influence the company’s financial position (Feinman, 2015). In conventional insurance, the more cases processed for insurance claims indicate the less earnings will be received by the insurance companies since the risks are transferred from the policyholders to the insurance companies (Pathak, Vidyarthi, & Summers, 2005). In the context of *takaful* operator, huge claims payout will impact the participant’s risk fund – it can be deficit. If the fund is deficit, then *takaful* operator through its shareholders has fiduciary duty to be performed; which is granted *qard hassan* (zero interest loan) to the participant’s risk fund.

Therefore, this study aims to explore the factors that affect general *takaful*’s claims. The structure of the article is as follows: the next section is an overview and of the industry followed by discussions on types of *takaful* operators in Malaysia. Next, in Section Four, factors that have been identified in previous studies regarding general insurance as well as general takaful claims which are deliberated in the context of Malaysia. Subsequently, the research method which has been used for this study is presented and limitation of this study is highlighted in Section Five. The two last sections are findings, followed by conclusion.

2.0 Overview of *Takaful*

Takaful propagates on the mechanism for mutual protection on the occurrence of a misfortunate that requires financial support (Wahab, Lewis & Hassan 2007; Engku Ali, Odierno & Ismail 2008). It is also referred as Islamic insurance by providing the relevant products and services that comply with Islamic finance precepts (Islamic Financial Services Board, 2009).

The initial formation of *takaful* was based on societal needs, being intended to alleviate the burden on members of society in the event of difficulty with another group. The ethos can be traced back to an old Arab tradition at which time participants contributed money (*diyyah*) to compensate the other tribe for the unintentional injury or death of a member, under the system known as *aqilah* (Billah, 1993; Kettell, 2011). This was achieved by paying money to the victim's family. In most cases this practice enabled tribal war to be avoided (Engku Ali, Odierno, & Ismail, 2008; Swartz & Coetzer, 2010).

The *takaful* sector which is part of the important components of Islamic financial industry, contributes significantly to the country's financial sector, with its latest (as at 2013) total assets representing 10% of the total financial assets in Malaysia (IRTI 2015). Malaysia is regarded as at the forefront of the Islamic finance industry (Tan, 2015). Furthermore, the government has categorised the Islamic finance industry as one the country's key economic areas under the government's Economic Transformation Programme (PEMANDU, 2014), and intends to make the country as Islamic financial hub in the region (Arab News, 2011).

The *takaful* industry can be divided into two which are family *takaful* and general *takaful*. To ease understanding, family *takaful* resembles life insurance, while general *takaful* is akin to general insurance; albeit consideration for the differences occur between the *takaful* and conventional insurance. Three main factors that render the operations of conventional insurance as haram, or non-permissible are: the presence of gharar or excessive uncertainty; maisir or gambling; and riba or usury or interest (Billah, 2007; Kwon, 2007; Wahab, Lewis, & Hassan, 2007).

2.1 General *Takaful* operators in Malaysia

There are three types of *takaful* operators in Malaysia when referring to their operations: family *takaful*; general *takaful*; and both – known as composite *takaful* (Muhamat, Jaafar, & Alwi, 2017). At this point of time, none of the *takaful* operators focused exclusively on general *takaful* business but as mentioned earlier, the general *takaful* business is managed side by side the family *takaful* operation (referred as composite *takaful* operator). The composite *takaful* operators are Syarikat *Takaful* Malaysia Berhad, *Takaful* Ikhlas Berhad, Etiqa *Takaful* Berhad, Sun Life *Takaful* Berhad, HSBC Amanah *Takaful* Berhad, Hong Leong MSIG *Takaful* Berhad and MAA *Takaful* Berhad.

With the implementation of the new Islamic Financial Services Act 2013 (IFSA 2013), there will be significant changes for the *takaful* operation since the act requires a dedicated *takaful* operator for each *takaful* business. In other words, the composite type *takaful* operator will not be allowed to continue its current operation since each business (family and general *takaful*) must have distinctive management for the company.

The composite *takaful* operators have been given a five-year transition period to observe the new regulation. Several changes are expected to be seen in the near future, such as potential mergers between general *takaful* businesses, shifting of ownership due to a changing of stakes in the general *takaful* business or the winding up of companies after transferring the remaining cases or policies to other *takaful* operators (Singh, 2013).

2.2 General *Takaful* Claims

General *takaful* offers protection or coverage against risks of a general nature for companies or individuals (*takaful* contributors). Some of the products are motor insurance, fire and allied perils, worker compensation, marine cargo, engineering insurance, property, transport and so on. In the context of India, it was reported that the general insurers in the country received three times more complaints higher than the life insurers (Joji Rao & Pandey, 2013). It signifies the tardiness of the insurers in managing claims as well as it indicates higher rate of claims cases for this business. It is important to emphasise that, for *takaful* operator, the investment returns from the general *takaful* business are used to smoothen the *takaful* premium (contribution) cost since general *takaful* mostly comprised short-term contractual policies. Thus, too many claims cases will impact the *takaful* operator's financial position.

This study appraised three factors that have been referred in various articles as the important elements that influence the general insurance's claims. The factors are: number of accidents (specifically focused on motor *takaful*); fraud on *takaful* claims; and coverage (in terms of amount) of *takaful* claims. Thus, we laid down the research questions of this study:

i. What is the relationship between the number of accident cases (claim ratio) towards the claim on *takaful* company?
ii. What is the relationship between insurance frauds towards the claim on the *takaful* company?
iii. What is the relationship between *takaful* coverage protection towards the claim on *takaful* company?

2.1. Number of accidents' claims (motor takaful)

Road accident is the most common incidents happened in Malaysia. According to statistic provided by the central bank, the highest general *takaful* claim is motor *takaful*. Ismail (2013) describes that motor insurance occupies 37.6% of gross contributions in 2004. He highlighted that the rate keeps on rising to 48.4% in 2007 and the *takaful* motor insurance business experienced high claims proportion which surpassed 100% for the years 2005 to 2007. This signifies that road accident is one of the main factors that caused claims over *takaful* operator. General rule of thumb indicates that the higher number of cases for road accident means the higher the *takaful* claims will be. Therefore, high number of *takaful* claims can affect the financial performance of *takaful* operators' risk funds. Nevertheless, high number of claims does not necessarily mean high compensation because there are many allegations that *takaful* operators or insurance companies are late when approving the claims (Boadi, Tee, & Opoku, 2017; Gowanit, Thawesaengskulthai, Sophatsathit, & Chaiyawat, 2016; Ren, Morano, Henrickson, & Burton, 2014).

Claim ratio is used to measure the number of road accident cases versus *takaful* claim. Hence, the calculation for claim ratio is net claim incurred to the earned contributions. A decent range of claim ratio for motor insurance normally is between 40% to 60%. Companies that are in range of 40% to 60% claim ratio indicate that they are paying out compensation more than the premium (contribution) received. Pervan, Poposki, and Curak (2014) assess the insurance sector in Macedonia and their results informed that insurance company profitability is influenced by the cost ratio, claims ratio, monetary development and inflation. Ismail (2013) emphasises that several components which hike the premiums (contributions) of general insurance or general *takaful*: burglaries or thefts; and road accident.

2.2. Fraud on takaful claims

Fraud on *takaful* claims occur when a formal claim procedure is submitted with additional financial implication on the inexistent damages as a result of the particular accident. The Triangle Fraud Theory propagated by Donald Cressy is best to be referred in the context of insurance or *takaful*. The theory emphasized on three factors: pressure; opportunity and rationalisation (Powell, 2017). The financial pressure that the policyholders faced in their lives might prompt the policyholders to commit the act, or opportunity to dishonestly claim for compensation on damages which do not occur as a result from the accident because they are confident they the act will not be caught, and the policyholders will tend to rationalise this by using excuse that they have paid premium for the *takaful* service or protection.

Based on information gathered from the Insurance Information Institute, this study hypothetically standardised the insurance fraud to be at 10% from the *takaful* claims. It means that, 10% of the yearly claims submitted are having some elements of fraud. The insurance fraud transpires when the insurance firms or *takaful* operators are not able to decide if the accident or damages happened as a result of particular incident or otherwise (Okura, 2013). In other words, there are issues with the claims since they have exaggerated value of claims, a claim for resources which did not exist or false documentation (Agarwal, 2008). Nderitu (2006) findings on high claims for motor insurance caused by government agencies' vehicles in which the insurance costs borne by the government, inflated as well as fraud contributed significantly to the high claims situation. Hence, insurance fraud must be avoided since it can cause the increase in *takaful* claim.

2.3. Coverage (in term of amount) of takaful claims

The compensation that the *takaful* operators need to distribute is based on the coverage of protection mentioned in the policy. Therefore, if there are many claims and each claim coverage is high, it will affect the *takaful* operators' risk fund. It is well understood that the risk fund belongs to the policyholders and not the *takaful* operators (Archer, Karim, & Nienhaus, 2009). However, if there is deficit then *takaful* operators through their management needs to inject free interest loan to the risk fund which will be paid in the future when the risk fund is having surplus or from profit of the investment fund (Gönülal, 2012). Nevertheless, it is important to emphasize again that the high amount of protection that needs to be paid will influence the general *takaful* claims over the *takaful* operators.

3. Research method and limitations

This study is aware that the dataset is not in-depth, thus it prevents rigorous analysis. It is important to highlight here that some of the information is confidential, thus not much can be shared by the company. Nevertheless, the 10 years observation period (time series is adopted in this study) is still a useful information since it can provide an overview on this area which receives limited attention. Previous study presented by Boadi et al. (2017) on factors affecting outstanding claim provision of non-life insurance also used limited observation data for only six years (2007-2012); but managed to depict an overview on the issue. Accordingly, for this study, the analysis is carried out to find the descriptive result of the *takaful* operator based on the three identified variables: number of accidents; fraud on *takaful* claims; and coverage of protection. A correlation analysis is also presented in the findings section.

Furthermore, the study has reviewed relevant articles in this area and it is a reality that not much study has been done with regard to this issue. On the bright side, this study within its limited capacity has been able to present and share factors that affect one *takaful* operator in Malaysia regarding the company's general *takaful* claims. To some extent, it can be generalised to other *takaful* operators in Malaysia or overseas.

4. Findings

Table 1. Description

Item	Claim Ratio	*Takaful* Coverage	*Takaful* Fraud
Mean	61.634	11.12364	11.01106
Median	64.59	10.95957	11.01166
Maximum	77.97	13.23559	11.73309
Minimum	40.65	9.993968	10.11176
Std. Dev.	13.22212	0.935712	0.570159
Skewness	-0.426633	0.993597	-0.21017
Kurtosis	1.795389	3.672061	1.918373
Jarque-Bera	0.90798	1.833587	0.561085
Probability	0.635089	0.399799	0.755374
Sum	616.34	111.2364	110.1106
Sum Sq. Dev.	1573.421	7.880018	2.925733
Observations	10	10	10

Table 1 depicts the descriptive result of this study. The skewness for each variable indicates that the data is fairly asymmetrical even though the period of observation is only 10 years, which signifies that the pattern which this study aimed to assess can be driven from the data. The kurtosis for each variable is leptokurtic distribution as they are more than zero, perhaps due to the limited observation period. Thus, the findings are still useful with special attention that needs to be given to the limitation as highlighted before.

Table 2. Correlation

	NET_CLAIM	CLAIM_RATIO	INSURANCE_ COVERAGE	INSURANCE_ FRAUD
NET_CLAIM	1.0000			
CLAIM_RATIO	0.2846	1.0000		
INSURANCE_COVERAGE	0.6279	-0.2607	1.0000	
INSURANCE_FRAUD	1.0000	0.2846	0.6279	1.0000

Table 2 shows the correlation results of each variable. The net claim has positive relationship with all variables, and perfect correlation with insurance fraud. The claim ratio has negative relationship with insurance coverage but positive relationship with insurance fraud. In addition, the insurance coverage has positive relationship with the insurance fraud. The only negative relationship is between claim ratio and insurance coverage. This implies that the minimum coverage has been agreed as in the policy when the policyholders signed up for it. Thus, increase in claim ratio does not push the compensation to be higher and vice versa.

Therefore, it is to answer the research questions which have been identified earlier:

i. What is the relationship between the number of accident cases (claim ratio) towards the claim on *takaful* company?

The result shows that there is positive relationship between the number of accidents toward the claims made by the policyholders over this *takaful* operator, which means that perception on the tardiness of *takaful* operator to distribute the claims are not true. In addition, it reflects that most of the claims that were forwarded to *takaful* operator were verified and approved for compensation. Once again, allegation on the behaviour of *takaful* operator to find excuse from paying the policyholders is not substantiated with solid evidence. Nevertheless, this data is only for this *takaful* operator and perhaps does not reflect other companies. On another perspective, with the implementation of detariffication on motor policy (Persatuan Insurans Am Malaysia, 2017), it will possibly become as a deterrent for the policyholders to submit for claims since it will affect their future premiums. Even though this practice is not new, with the liberalisation of motor policy, stiff competition between insurance and *takaful* providers is expected and the risks considerations which previously were standardised are now subjected to insurance or *takaful* companies' framework.

ii. What is the relationship between insurance frauds towards the claim on the *takaful* company?

The result shows that there is positive significance relationship between insurance fraud and *takaful* claim of the company. This proved that an increase in insurance fraud will affect claims made on *takaful* operator. Insurance fraud is due to moral hazards behaviour which if there is no concerted effort to curb this, then *takaful* operator will be burdened with costs which are not real and hefty. Kiana (2010) warns that fraud will pressure the insurance companies to raise future premiums which will affect the whole policyholders in order to sustain the business. Moreover, for takaful operators, the risk fund is borne by the policyholders themselves.

iii. What is the relationship between *takaful* coverage protection towards the claim on *takaful* company?

It shows that there is positive relationship between *takaful* coverage and *takaful* claim. It indicates that the more *takaful* claims are approved then more compensation will be paid out to the policyholders. Furthermore, if the pricing of the policy does not commensurate with the compensation; it can cause deficit and eventually the *takaful* operator can run into financial trouble and lead towards close-down of the business. This has happened to a United Kingdom's *takaful* operator which is known as Salaam Takaful (Aziz, 2015). The *takaful* operator before ceased operation has only 10,000 policyholders and small number of clients' base is not enough to sustain the business.

5. Conclusion

It is important for the *takaful* operators to consider factors that will affect general *takaful* claims especially when the IFSA 2013 requires the composite *takaful* operators to divide the business into general and family *takaful*. Therefore, if the general *takaful* claims are high especially when there are elements of fraud and the coverage of protection is too "luxurious" compared to the contribution received; it can cause deficit. The central bank prescribed that *takaful* operators need to grant zero interest financing to the risk fund if deficit happens. Even though this loan will be paid in the future from the policyholders' funds either from investment profit derived from the policyholders' investment fund or surplus of the risk fund; it still does not bring positive image as well as not a prudent business practice to incur deficit. To connect this situation with the findings from this study, it clearly signifies that *takaful* operators need to give proper consideration on the factors that affect firms' claims. In terms of implication, if the *takaful* operators are not able to suppress this problem, then it will affect the stability of the companies in the long run due to high claims, unattractive policies as a result of higher pricing as well as lost customers' confidence.

The findings show that fraud and number of claims will have positive influence on the general *takaful* claims whereas the coverage of protection is negatively related. For future study, it is recommended to gather more data from other *takaful* operators so that more rigorous analysis can be executed. Fraud on *takaful* claims is an area that has not been researched to the best of authors knowledge. By exploring this area, mitigation on fraud attempt can be suggested for the benefit of the industry.

Acknowledgements

We would like to express our gratitude to Encik Abang Muhammad Nasrullah bin Abang Sulaiman for the assistance given in conducting this study.

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