

**UNIVERSITI TEKNOLOGI MARA**

**TAKĀFUL SECURITIZATION  
VIABILITY BASED ON  
ALTERNATIVE RISK TRANSFER  
MECHANISM**

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## ABSTRACT

There is a growing demand in the conventional financial market, for ‘Alternative Risk Transfer’(ART) products or structured insurance solutions. It involves securitization of insurance and reinsurance - by transforming certain underwriting and actuarial risks, into tradeable financial securities such as bonds, securities and derivatives. Through ART mechanism, the insurance industry is able to tap and gain access into the huge asset base of the capital market for their reinsurance risks and capital management needs; more efficiently and at lower transaction cost. ART is also a new asset class for investors due to the low correlation with other investment risks. There are currently no ART products in Malaysia and other Muslim countries. Therefore, in the same context, retakāful management and capital management of the takāful industry may be achieved by replicating the economic benefits of similar products. However, ART is a conventional product which is not compliant with Sharī‘ah. For this purpose, this research is undertaken to explore the viability of introducing takāful securitization based on principles and practices of takāful and other relevant Sharī‘ah approved contracts for securitization, such as şukūk. This will also enhance financial intermediation through convergence of the takāful industry with the Islamic capital market. The researcher suggests that the products be termed as ‘Securitized Takāful and Retakāful’ (STAR). This is a qualitative and applied study which is undertaken in the context of Malaysia, a premier centre for Islamic finance; thus, a potential choice for the development of STAR. The primary data gathered from interview conducted with selected industry experts consisting of Sharī‘ah scholars, regulator, takāful and Islamic capital market practitioners, reveals a general lack of understanding on the subject. Nevertheless, the interviewees welcome the beneficial innovation of STAR in order to usher the industry to greater heights, in the context of enhancing retakāful and capital management for the industry. Secondary data is derived from published reports from various authorities on the subject. However, as a new innovation, there is an apparent dearth of literature and research on the subject. Hence, the investigation on the viability of STAR, is benchmarked with the conventional ART mechanism, that has a wide body of knowledge, experience and expertise on the subject. Data comprising of interview, published reports and literature is analyzed using the Atlas.ti 8. Upon condensation of data, a proposed framework is formulated, that encompasses the major elements as a proposed blueprint for the implementation of STAR. This research achieves its objectives of highlighting the viability and the way forward to enhance retakāful and capital management by replicating the economics benefits of ART products through takāful securitization in the form of STAR solutions.

Key words: Takāful, Retakāful, Şukūk, Insurance, Reinsurance, Risk Management, Capital Management, Securitization, Alternative Risk Transfer (ART), Securitized Takāful and Retakāful (STAR).

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# CHAPTER ONE

## INTRODUCTION

### 1.1 Organisation of Chapter

This chapter introduces and synthesizes the research topic by highlighting the overarching aims of the study: to contribute to knowledge in Islamic finance in general and takāful in particular; and to suggest alternative practical means, to enhance the growth of the takāful and retākāful industry. This is undertaken in collaboration with the Islamic capital market. This chapter is organized into eleven sections consisting of: (1.2) background and motivation of research (1.3) development of takāful industry (1.4) development of Islamic capital market (1.5) problem statement (1.6) research questions (1.7) research objectives (1.8) scope and context of research (1.9) limitations of research (1.10) significance of research (1.11) organization of research (1.12) summary.

### 1.2 Background and Motivation of Research

Islamic finance continues to register exponential growth as a practical alternative to conventional finance. Its appeal has grown beyond the borders of Muslim nations, to the wider international financial markets. Though still considered a nascent industry, as compared to the more advanced and matured conventional financial industry, Islamic finance is cruising steadily through its own unique and distinct features as Sharī'ah compliant, yet successful business proposition. To a measurable degree, it can be observed that Islamic finance whether in the banking sector, capital market as well as takāful<sup>1</sup> have been able to provide for the public with products and services which are comparable to the conventional system.

The estimated global Islamic finance assets for 2020, has recorded US\$2.7 trillion mark, marking a growth of 10.7, year-on-year in assets (IFSB, 2021). Islamic banking accounts to sixty-eight-point-three percent (68.3%) of the total volume of global Islamic finance, followed by twenty-five-point-six percent (25.6%) for sukūk, five-point-three percent (5.3%) for Islamic funds, and zero-point-nine percent (0.9%) for takāful. ICD-Refinitiv IFDI Report (2020), projected that by 2024 global Islamic

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<sup>1</sup> The term takāful and retākāful and insurance and reinsurance may be used interchangeably in this research.