

**RISK MANAGEMENT, *SHARI'AH* COMPLIANCE AND
PERFORMANCE OF TAKAFUL OPERATORS IN MALAYSIA**



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DECEMBER 2012

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Surat Kami : 100-RMI/ARI 16/6/2 (46/2010)
Tarikh : 10 Ogos 2010

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Y. Bhg. Prof./Prof. Madya/Dr./Tuan/Puan

KELULUSAN PROJEK DI BAWAH GERAN PENYELIDIKAN ARI HICoE

Tajuk Projek : Risk Management and Shari'ah Compliance of
Takaful Operators in Malaysia

Jumlah Peruntukan : RM 36,400.00

Tempoh : 1 Julai 2010 – 30 Jun 2011 (12 bulan)

Ketua Projek : Puan Roszana Tapsir

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4. Bagi pihak Universiti kami mengucapkan tahniah kepada Prof./Prof. Madya/Dr./Tuan/Puan kerana kejayaan ini dan seterusnya diharapkan berjaya menyiapkan projek ini dengan cemerlang.

Sekian, harap maklum.

"SELAMAT MENJALANKAN PENYELIDIKAN DENGAN JAYANYA"

Yang benar


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5. Report

5.1 Proposed Executive Summary

Islamic finance has unique characteristics that give rise to a set of risk management challenges namely credit risk; liquidity risk; legal and fiduciary risk; financial supervision and transparency; and *shari'ah* supervision risk (Morisano, 2009). Due to the rapid growth in Islamic finance, a major issue arises in terms of shortages of qualified and knowledgeable risk management professionals. Therefore, there is a need for a unique risk framework for Islamic institutions covering risk categorisation and documents roles, responsibilities and authorities that support the approach and processes. The structures and processes established within an Islamic Financial Institution (IFI) for monitoring and evaluating *shari'ah* compliance rely essentially on the arrangements internal to the firm. By being incorporated in the institutional structure, a *Shari'ah* Supervisory Board (SSB) has the advantage of being close to the market. Competent, independent, and empowered to approve new *Shari'ah*-conforming products and/or services, the SSB can enable innovation likely to emerge within the institution. Grais and Pellegrini (2006) reviewed the issues and options facing current arrangements for ensuring *shari'ah* compliance and suggested a framework that draws on internal and external arrangements to the firm and emphasizes market discipline. This could ensure adequate consistency of interpretation and enhance the enforceability of contracts and lead to more effective options available to stakeholders for further improve Islamic finance.

Keywords: Risk management, Shari'ah compliance, Takaful

5.3 Introduction

Islamic finance has emerged as a growing and acceptable alternative to the conventional finance. Takaful as part of the Islamic finance component will need to adhere to the same *Shari'ah* principles required for the other Islamic financial institutions (IFIs).

The need for a scheme of insurance that is in line with Islamic tenets was officially affirmed when the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia declared on 15 June 1972 that the western concept of insurance as practiced in Malaysia, is by *Shari'ah*, prohibited (*haram*), as it contains elements that raised doubts and uncertainty (*gharar*), usury (*riba*) and gambling (*maisir*). This inspired our interest to examine the progress and the implication of the takaful industry since its introduction in 1984 in Malaysia.

The concept of takaful or Islamic insurance is when a group of people participate in a scheme that enables them to share the burden of any misfortunes faced by any of the participants, where appropriate compensation is paid using the funds contributed by the participants. Losses are divided and liabilities are spread according to the community pooling system.

The structures and processes established within an IFI for monitoring and evaluating *Shari'ah* compliance rely essentially on the arrangements internal to the firm and this must be closely monitored by a *Shari'ah* Supervisory Board (SSB). A standardised framework by a central regulatory is also required to ensure such control can be done in ensuring a 'fair play' between the conventional and Islamic finance especially where dual financial system exist. The SSB could be guided by standardised contracts and practices that could be harmonized by a self-regulatory professionals' association. A framework with the suggested internal and external features could ensure adequate consistency of interpretation and enhance the enforceability of contracts before it is being launched to the public.

Malaysia's total takaful assets expended at compounded annual growth rate (CAGR) of 20.6% between 2005 and 2009 reaching USD3.9 billion, making it the largest takaful market in Southeast Asia. However, takaful contribution and market penetration remain low compared to conventional insurance despite it gaining momentum in the economy. The low awareness of takaful among Malaysians has prompted Bank Negara Malaysia (BNM) as the regulator, to educate and promote the importance of takaful.