General Takaful claims: An experience of Takaful operator in Malaysia

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\textbf{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.

\textbf{Keywords:}
General takaful
Takaful claims
Insurance
Insurance 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* operators. 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

<table>
<thead>
<tr>
<th>Item</th>
<th>Claim Ratio</th>
<th>Takaful Coverage</th>
<th>Takaful Fraud</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>61.634</td>
<td>11.12364</td>
<td>11.01106</td>
</tr>
<tr>
<td>Median</td>
<td>64.59</td>
<td>10.95957</td>
<td>11.01166</td>
</tr>
<tr>
<td>Maximum</td>
<td>77.97</td>
<td>13.23559</td>
<td>11.73309</td>
</tr>
<tr>
<td>Minimum</td>
<td>40.65</td>
<td>9.993968</td>
<td>10.11176</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>13.22212</td>
<td>0.935712</td>
<td>0.570159</td>
</tr>
<tr>
<td>Skewness</td>
<td>-0.426633</td>
<td>0.993597</td>
<td>-0.21017</td>
</tr>
<tr>
<td>Kurtosis</td>
<td>1.795389</td>
<td>3.672061</td>
<td>1.918373</td>
</tr>
</tbody>
</table>

| 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

<table>
<thead>
<tr>
<th></th>
<th>NETCLAIM</th>
<th>CLAIM_RATIO</th>
<th>INSURANCE_COVERAGE</th>
<th>INSURANCE_FRAUD</th>
</tr>
</thead>
<tbody>
<tr>
<td>NETCLAIM</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CLAIM_RATIO</td>
<td>0.2846</td>
<td>1.0000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>INSURANCE_COVERAGE</td>
<td>0.6279</td>
<td>-0.2607</td>
<td>1.0000</td>
<td></td>
</tr>
<tr>
<td>INSURANCE_FRAUD</td>
<td>1.0000</td>
<td>0.2846</td>
<td>0.6279</td>
<td>1.0000</td>
</tr>
</tbody>
</table>

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.

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