

## Takaful Rules and Regulations for Asean Countries: A Comparative Study

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**Abstract:** Rules and regulations are the main important tools to ensure the perfectness of the implementations of any guidelines. Each country applies their own rules and regulation and it's usually different when compares one country with another. This paper intends to identify the takaful rules and regulations for Malaysia and Indonesia and to analyse the similarities and differences of takaful rules and regulations between Malaysia and Indonesia. In order to achieve these research objectives, a case study on a leading takaful operator was undertaken. The main findings of this research found that takaful rules and regulations of Malaysia and Indonesia are governed by Islamic Financial Services Act 2013 (IFSA 2013) and Undang-Undang No 40 (UU40) respectively; IFSA (2013) is a special Shariah compliance guidelines for financial services including takaful whereas UU40 only focus on takaful and insurance service. The results of this research could provide a significant contribution to takaful operators in ASEAN countries especially Malaysia and Indonesia.

**Key words:** Takaful rules and regulations • Comparative study • ASEAN • Malaysia • Indonesia

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### INTRODUCTION

Rules and regulations are the main important tools to ensure the perfectness of the implementations of any guidelines. Rules and regulations are a set of principles and visibly commanding roles [1] based on the behavior of the market and the principle prudentially [7] under regulatory supervision that create a situation which represents a major part in determining what can and cannot be done by the industry [2]. Any organization around the world acknowledges the importance of rules and regulations, to curb or minimize mismanagement, increase the level of solvency and strengthen the position of the company in the face of increased competition and this includes takaful operators in the takaful industry. Therefore, each country applies their own rules and regulation and it's usually different when researcher compares one country with another. In some countries, the rules and regulations are governed by either government or independent agency.

In Malaysia, Bank Negara Malaysia (BNM) is a regulator and supervisor of the takaful operating system

based on the principles of Islamic law which proves the importance of regulation in regulating takaful operators [1]. Meanwhile, in Saudi Arabia, SAMA (Saudi Monetary Agency), is the enforcement of the regulations issued in 2004 for small-sized insurers [4]. Furthermore, Central Bank of Bahrain (CBB) is the ruling body for controlling the takaful industry in Bahrain to strengthen the solvency position of the firm, improve the efficiency of its business operations and at the same time safeguard the interests of all stakeholders or participants. This is seen as a healthy development and will enhance the financial sector, especially in the field of Islamic Takaful industry [3].

In the world economy, 2011 was a breakthrough for the insurance industry, where the global occurrence of the implementation of regulations and financial procedures. Based on a set of reliable and standard international regulatory requirements, the insurance sector is still far from that level. At the present time, the practice of rules and regulations is based on the country itself. This is not in line with the requirements made by global financial regulators as a whole. Malaysia as a developing country with similarities to neighboring Indonesia, makes light-

touch approaches that run periodically and gradually. At the same time, long-term regulatory principles are important events. Among them are minimum risks, creating stringent rules and maintaining high standards. However, in regulating the insurance industry in Malaysia there are some new things that change the approach. Among the new developments are the globalization and explosion of information technology, the concentration of the financial industry and the rise of consumerism [8]. This will provide the insurance industry in Malaysia for a more proactive and developmental approach. In Indonesia, with the regulation, it is one of the challenges faced in developing the takaful industry.

However, the rule is an important basis and represents a milestone in the establishment of institutions and so on in their daily activities [10, 15]. Based on Ingram *et al.* [6] if any regulation should be held, of course, the uncertainty can be reduced. On the other hand, if a regulation was not thorough and comprehensive, it probably will not be able to attract foreign investors to enter the takaful industry [13]. In other words, the existing rule in Indonesia at the moment is not to force any individual to have any kind of insurance. For a good development is expected in developing the takaful industry specific insurance policies must be required. This issue should be addressed by making improvements and enhancements regulations. Thus, the objective of this paper is to present and discuss the takaful rules and regulations for Malaysia and Indonesia and to analyze the similarities and differences of takaful rules and regulations between both countries.

**Literature Review:** The establishment of the ASEAN Free Trade Area (AFTA) allows insurance companies from any member country to establish operations in another member country. The open market of insurance requires a set of minimum standards of rules and regulations to protect the industries from misconduct and unethical practices. ASEAN Insurance Training and Research Institute (AITRI) (2013) emphasized that it is important to build harmonized rules and regulations in the process of achieving an ASEAN Economic Community. It is hoped that deeper liberalization and integration of insurance market will develop the financial infrastructure, harmonize the regulations as well as strengthen the national capacity.

The introduction of General Agreement on Trade and Services (GATS), requires the domestic company to have the ability to compete with world-class companies in the

national market. In the context of the insurance industries, it is essential for the ASEAN countries to establish rules and regulations which will facilitate an increased competitive advantage to the insurer and the insured.

The rapid growth of the Malaysia takaful industry contributes about 71% of ASEAN gross takaful contributions by country [3]. Among the contributing factors to the progress are the enactment of Islamic Financial Services Act 2013 (IFSA 2013) and the support of Bank Negara Malaysia (BNM) as the regulator of takaful and insurance industries. BNM as the main regulator for insurance and takaful industry in Malaysia set the minimum capital requirement at RM100 million for both the life and non-life takaful operator. Simultaneously, all takaful operators are subjected to solvency regulation. In comparison to Indonesia, Malaysia has set a target capital available at the level of 130%. The perspective of policyholder protection under the Malaysia Deposit Insurance Corporation (MIDC) administers the Takaful and Insurance Benefits Protection System (TIPS) which protects specific benefits under life and general insurance. Interestingly, foreign ownership is generally limited to 70% and the amount exceeding 70% must get the approval from BNM on case to case basis [11].

Indonesia currently adopted Undang-Undang No 40 (UU40) for both takaful and insurance companies. The new act of UU40 covers the aspect of corporate governance, market conduct, consumer protection and licensing. The move is expected to reshape Indonesia takaful industry by spurring mergers as companies try to meet capital requirement for their expansion purposes. According to Sivalap, Chuchep and Arunee [11] the regulator set the minimum capital requirement, the solvency regulation, policyholder protection and foreign ownership restrictions to protect the industry. Therefore, the Indonesia decided that the RBC solvency margin ratio of at least 100% and each Takaful operator must form its own protection fund to protect the interest of participants. Additionally, in terms of foreign ownership restriction, the Indonesia's fixed that the foreign shareholders of the entity carrying Takaful activities are limited to 80% at the establishment of the company.

Based on the above discussion, the countries in ASEAN had a rules and regulations that provide by their own regulator to protect the takaful industry. The regulator is responsible for setting usually on a minimum capital requirement, the solvency regulation, policyholder protection and foreign ownership restrictions. This will basically will open new opportunities in rapid growth market, especially in Malaysia and Indonesia.

## METHODOLOGY

This research adopts Yin's [16] definition of a case study as empirical inquiry that investigates a contemporary phenomenon within its real-life context when the boundaries between phenomenon and context are not clearly evident and in which multiple sources of evidence are used. These definitions used to guide through the implementation of the research. Qualitative is chosen for this research since it attempts to get an in-depth opinion from participant. The objective of this research is to identify the takaful rules and regulations for Malaysia and Indonesia and to analyse the similarities and differences of takaful rules and regulations between Malaysia and Indonesia. Hence, single case study has been adopted in this research since it was more appropriate to the nature and context of this research in order to get a holistic view of the phenomenon under research.

This research uses a semi-structured interview process, non-participant observation and document analysis, where the researcher was the key instrument for data collection [9]. The Case Study Protocol and Implementation have been developed to express the nature of the interview and the interview questions as well as elaborate intricately on how the respondents are selected. Furthermore, content analysis has been chosen for data analysis. In content analysis, the researcher examines artifacts of social communication. Typically, these are written documents or transcriptions of recorded verbal communication [12]. Holsti [5] defined content analysis as any technique for making inferences by systematically and objectively identifying special characteristics of messages. Content analysis is a powerful empirical method for analysing text and as a method that technical communicators can use in the research [14]. It can also expose hidden connections among concepts, reveal relationships among ideas that initially seem unconnected and inform the decision-making processes associated with many communication practices.

The ways that the researchers choose to analyse data should stem from a combination of factors, which include the research questions, the theoretical foundation of the research and appropriateness of the technique for making sense of the data.

## RESULTS

The findings are reported according to two research questions which are (1) What are the takaful rules and regulations for two ASEAN countries (Malaysia and

Indonesia)? (2) How the takaful rules and regulations differs between two ASEAN countries (Malaysia and Indonesia)?

*What are the Takaful rules and regulations for two ASEAN countries (Malaysia and Indonesia)?*

Two participants involved in the interview were from Company XYZ. They worked as a President and Client Manager for the general insurance and the family business.

The research indicated that the current general takaful rules and regulations is IFSA 2013 in Malaysia and UU40 in Indonesia. They were further confirmed that the IFSA was on the administrative matters.

**Leader X Said:** "We confirmed that the current general takaful rules and regulations is IFSA 2013 in Malaysia and Undang Undang No 40 in Indonesia."

It was revealed that IFSA was an administrative rules and regulations for takaful operators to set up a business. However, in IFSA there was a special rules and regulations on Shariah compliance comparatively to UU40.

They also perceived that UU40 was more simple compared to IFSA 2013. The IFSA 2013 was quite thick because all the takaful rules and regulations were stated compiled of banking, takaful and money market. However, UU40 only discuss on the headlines for insurance and takaful and the explanation will be provided in the Peraturan Otakritas Jasa Keuangan (POJK).

**Leader Y stated:** "Even the Undang Undang no 40, I think, is much thinner than the IFSA 2013."

Furthermore, they also suggested to compare chapter to chapter and also part to part of two acts to see in most areas they will be alike. Based on their perception, it was more appropriate to compare the Takaful Operational Framework (TOF) and the Peraturan Otakritas Jasa Keuangan (POJK) rather than compare the IFSA 2013 and UU40. The reason behind was the IFSA 2013 and UU40 were referred to the basic and general policy of the takaful rules and regulations. The TOF and POJK will discuss on the practical part of takaful operation.

**Leader X Said:** "So its mean here the perception on the operator's side when involve with issues of globalization and other factors, so we will refer to the TOF and POJK more compare to UU 40 and IFSA because is based on the basic rules and very general."

*Research Question 2: How the Takaful rules and regulations differs between two ASEAN countries (Malaysia and Indonesia)?*

In order to address the second research question, the researchers designed questions related to differences between the two acts. They suggested to make a comparison with regards to the operational matters because it will find more differences such as the Takaful Operational Framework (TOF) and the Peraturan Otoritas Jasa Keuangan (POJK).

**Leader Y Stated:** “I have the same comment with Mr. X because even in Malaysia we have Bank Negara at the top and we have RBC, so subsidiary we will have a lot of differences. So, depend on how deep you want to go, they might look at the different standard or guideline. For us, essentially, as a practitioner we do refer a lot to TOF (Takaful Operations Framework).”

They further confirmed that there were a lot of differences regarding the operational parts of takaful rules and regulations. In Malaysia, the takaful operators were referred to the TOF as their main guidelines for operational framework. It applied same with Indonesian market, where they would follow the operational parts based on the POJK and also the Surat Edaran Otoritas Jasa Keuangan (SEOJK). These were the immediate law which reflected the current operation of the takaful industry in Indonesia.

**Leader X Said:** “And same also in Indonesia, the practitioner will more on POJK and SEOJK. That’s because the impact is an immediate on the operation. In our case also when we discuss on the law we refer to our legal person that keep an eye on the law.”

Besides, the standard law for takaful rules and regulations like IFSA 2013 in Malaysia and UU40 in Indonesia, they also have the details of the law such TOF and also the POJK in Indonesia. At the same time in Malaysia, they had Shariah guidelines in order to control the Shariah governance. In Indonesia, they also have the Dewan Syariah Nasional (DSN) to discuss on the Shariah compliance. Such guidelines also spell out the model and the separation of the fund. There was a difference between the BNM and Bank of Indonesia (BI). BNM would control all the financial institutions' activities in Malaysia. But in Indonesia, the Otoritas Jasa Keuangan (OJK) was taken over the function of BI. In terms of similarities, the TOF in Malaysia was equal to POJK in Indonesia.

**Leader Y Said:** “So, in Malaysia Bank Negara is equal in Bank of Indonesia but BNM do all the supervisory functions not only do the monetary function. That’s it. They are not supervising banking anymore. Supervision function is taken over by OJK.”

## DISCUSSIONS

The findings showed that the current general takaful rules and regulations is IFSA 2013 in Malaysia and UU40 in Indonesia. However, UU40 referring to takaful company and conventional insurance company was more simple and only discuss on the headlines for insurance and takaful because the further explanation of it will be provided in the Peraturan Otoritas Jasa Keuangan (POJK). Whereas, IFSA 2013 totally referred to takaful company covered all the takaful rules and regulations and also compiled of banking, takaful and money market. In spite of making a comparison with regards to the general rules and regulations and more on administrative matters which referred to IFSA 2013 and UU40, it was suggested to compare the respected operational matters because it will find more differences such as the TOF from Malaysia and the POJK in Indonesia.

## CONCLUSION

Takaful rules and regulations are very critical to ensure a sound takaful operations in ASEAN countries. Regulations could reduce mismanagement, increase the level of solvency and strengthen a company’s position in the face of global competition. This is vital to ensure sustainability in takaful businesses. The findings of this research indicate that IFSA (2013) and UU40 are the most referred takaful rules and regulations for Malaysia and Indonesia respectively. Furthermore, IFSA (2013) is a Shariah compliance guidelines for Malaysian financial institutions and UU40 is the takaful and insurance guidelines for Indonesia.. However, since this is a case study based on a leading takaful company in Malaysia, it is recommended to include more case studies to rectify this finding.

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