

CHAPTER 2

OVERVIEW OF CORPORATE GOVERNANCE, TAKAFUL, AND SHARIAH COMMITTEE

2.1 Introduction

This chapter provides an overview and background for this study. The focus is directed toward CG structure and the effectiveness of the Takaful industry in Malaysia, and the moderating role played by SCQ on corporate performance. This chapter is organized and discussed consistent with the objectives and research questions of this study. Therefore, the relevant issues are presented under subheadings. Section 2.2 include the background of CG in general and in Malaysia in particular, CG definitions and importance, the stages in which governance has evolved. Section 2.3 deal with the Malaysia Code on CG and revised code. Section 2.4 explain the Islamic corporate governance issue. Section 2.5 and 2.6 review the Takaful or Islamic insurance industry concept, the origin of Takaful, authorities from Quran and Hadeeth, Islamic insurance background, Takaful models, and the Takaful industry in Malaysia. In addition, section 2.7 it compares Takaful and conventional insurance. Section 2.8 and 2.9 review about Malaysian Takaful industry and future challenges. Last section 2.10 sheds light on SC's moderating role on BOD effectiveness and AC effectiveness on financial performance. It clarified the SC's responsibilities and duties to enhance firm performance.

2.2 Corporate Governance Background

2.2.1 Corporate Governance Definitions

A particular definition that consolidates all the changing circumstances of CG is non-existent. Different authors, institutions, and countries have given distinctive definitions to the term. CG can comprise codes and rules that control agency conflicts and fortify the connections among a firm's administration, its BOD, shareholders, and partners. CG can successfully influence those rules and controls of a firm, leading to high financial performance in the long run.

The Cadbury Report (1992) defined CG as the system by which companies are directed and controlled. The report issued several guidelines. They determined the responsibilities of the BOD, auditors, and committees. The BOD's responsibility was to set goals and strategic plans, choose company leadership, supervise the work, and report to the shareholders. All the BOD procedures were to be determined by law, and procedures were to be approved at the shareholders' meeting. The auditors' role was to conduct an external and objective examination of the financial statements that the company's management submitted, which formed the basis of the financial reporting system. The ACs selected from the BOD were to help raise CG standards and confidence in the published financial statements by clearly defining the responsibilities and duties of all concerned in the firm.

According to Shleifer and Vishny (1997), CG deal with methods in which investors ensure that their investments will return in the future. Therefore, in these regards, some questions can be asked: How do investors profit in the future? How can they guarantee that management will not violate and squandered the capital? How do

investors monitor and control managers? Even in developed economies such as the US and UK, disagreement exists on governance mechanisms.

Per Imam and Malik (2007), CG comprises a broad mechanism of monitoring and control, both internal and external, which promotes and ensures the effective use of a company's resources and accountability for the efficient use of these resources. The study highlights the importance of CG, including preserving the interests of all parties, individuals, companies, and society based on an ethical and legal framework. Good CG leads to a better structure of market share and leadership of the company. A company must take care of the interests of all beneficiaries, e.g., shareholders, debtors, employees, customers, local community, and the country of the business at large, both in terms of physical effects, social and economic population. Through CG, all legal, ethical, and regulatory requirements through which the company carries out the activities are complied with.

The governance construction indicates the distribution of responsibilities and rights among diverse members within the firm (such as the BOD, managers, shareholders, creditors, auditors, regulators, and other stakeholders). Moreover, CG indicates the rules and regulations for decision-making regarding corporate matters. Governance gives firms a structure to pursue their objectives, reflecting the social, administrative, and market environment. Governance could be an instrument for observing the activities, approaches, and decisions of firms. Governance creates regulations boundaries for the stakeholders (Jarboui et al., 2014).

Organisation for Economic Cooperation and Development (OECD) defined CG as a set of relationships between a company's management, its board, its shareholders, and other stakeholders that provides the structure through which the company's objectives are set and the means of attaining those objectives and monitoring

performance (OECD, 2004). OCED also stated that the CG depends on many factors such as work environment, professional ethics, legal awareness, regularity, environment, and the benefit of the society in which the company operates (Htay & Sakman, 2013).

Sanda et al. (2010) argued that CG comprised the procedures by which all parties concerned could successfully ensure that the company's management and employees take all measures and mechanisms to protect the shareholders' interests. Jarrar (2016) stated that CG refers to the compatibility between the practices and the correct procedures that work according to the standards and rules imposed by the official bodies that work on the organization of the profession, which aims to ensure the compatibility between the strategic objectives of the company and the procedures and practices used to achieve these goals.

The MCCG (2017) defined CG as the process and structure used to direct and manage the company's business and affairs towards promoting business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value while taking into account the interest of other stakeholders (Malaysia, 2017).

An analysis of the previous definitions demonstrates that no single accepted definition of CG is agreed upon but that definitions differ according to each concept and usage. Furthermore, CG focuses heavily on procedures and processes that ensure that all parties in a company work to maximize its benefits to the owners, investors, shareholders, and other partners. The BOD has a large role in monitoring the implementation of the governance procedures, which ensures the commitment to all systems, laws, and ethics that lead to the achievement of strategic objectives. In addition, all committees and members charged with tasks must be committed to ensuring the protection of all rights and making sure there is no default or overflow.

2.2.2 Importance of Corporate Governance

Principally, CG aims to maintain a balance of interests between corporate investors and stakeholders in a firm (Ngaton et al., 2021). CG effectiveness is critical and includes using good practices and the implementation of the principles. Existing CG codes enhance the activation of CG practices. Governance philosophies are meant to safeguard and increase stockholders' value and guarantee that all shareholders' interests are considered, eliminate conflicts of interest, and enforce transparency and accountability appropriately regarding macroeconomic issues.

CG emphasizes the strategic dimension of accountability and monitoring to achieve effective performance for all types of companies. An effective governance system focuses on a set of dimensions in a company, like the optimal distribution of resources and mechanisms of elections. Also, CG distributes authority, responsibility, and strategic decision-making in a company (Thorne et al., 2011).

Adequate CG is significant if international organizations are to flourish in a competitive global market (Du et al., 2018). Good CG leads to better use of an organization's resources, which is the foundation of a company's growth (OECD 2004). Previous literature has found a significant and positive relationship between effective CG and firm performance (Zeckhauser & Pound, 1990; Yermack 1996; Brown & Caylor, 2004; Beiner et al., 2004). For example, good CG assists corporates through recovered cash flow, supporting access to low-cost capital.

Companies with good governance are likely to have appropriate control mechanisms and an appropriate allocation of resources that ultimately contribute to their growth and prosperity and improve economic and financial stability in domestic and global financial markets (Alagha, 2016).

2.2.3 Development of Corporate Governance in Malaysia

Before 1997 and the emergence of the financial crisis in Asia, most Asian countries, including Malaysia, had rules and regulations similar to British laws, corporate regulations, and policies. This situation was especially true in the Malaysian capital market due to the British colonial link to Malaysia. The impact of the British colonial rule provided a framework for Malaysian CG in the requirements of the inclusion of the Kuala Lumpur Stock Exchange (KLSE), with a focus on transparency and accountability in CG (Nickmanesh et al., 2013).

Table 2.1 summarises governance initiatives from 1965 to 1997 before the financial crisis of 2007-2008 in Malaysia.

Table 2.1: Governance Initiatives from 1965-1997

Year	Initiative Established
1965	The Malaysian Companies Act
1973	The Securities Act
1987	Malaysian Code on Take-Overs and Mergers
1989	Banking and Financial Institution Act
1991	The Securities Industry (Central Depositories) Act
1993	Securities Commission Act
1993	The futures Industry Act
1995	Amendments to Securities Commission Act
1997	The Financial Reporting Act

Source: (Nickmanesh et al., 2013)

CG in Malaysia has received much criticism since numerous failures of multiple companies during and after the financial crisis (Chai, 2001). In the wake of the 1997-1998 financial crisis, many reforms were established to introduce the accountability, transparency, and protection of shareholder's benefits in Malaysia. In 1998, a High-Level Finance Committee (HLFC) was formed. Members of the Finance committee included representatives from the Ministry of Finance, the Securities Commission, the Companies Commission of Malaysia, the Financial Reporting

Foundation, the Malaysian Accounting Standards Board (MASB), Bank Negara Malaysia, the Association of Banks Malaysia, the Association of Merchant Banks Malaysia, then Kuala Lumpur Stock Exchange (now Bursa Malaysia), the Association of Stockbroking Companies Malaysia, the Malaysian Association of The Institute of Chartered Secretaries and Administrators and the Federation of Public Listed Companies (Khadaroo & Shaikh, 2007). The committee was tasked with reviewing company frameworks and making recommendations to develop CG in Malaysia. The Committee found that there were actual weaknesses in CG, especially in financial disclosure, transparency, corporate responsibility, corporate monitoring responsibilities, and minority shareholders' rights.

In January 1999, the Malaysian Institute of Code, Turnovers, and Mergers expanded and developed corporate disclosure standards and behaviour for acquisitions and mergers to reflect global best practices. In the same period, the requirements for listing on Bursa Malaysia were amended to require quarterly financial reports prepared following Malaysian Accounting Standards (Nickmanesh et al., 2013).

In March 2000, a Malaysian Code on CG was issued. The code provides a group of principles for good CG practices for firms to avoid the collapses and crises in the future (Finance Committee, 2000).

On top of that, the Securities Commission Act was promulgated in 2000. The Act described the Security Commission's responsibilities and the Registrar of Companies in prospectus regulation, resulting in greater legal and regulatory certainty. Furthermore, the Minority Shareholders Watchdog Group (MSWG) was established in 2000 as a public company limited by guarantee.

When an update of the listing requirements for KLSE was issued in 2000, the focal point was to promote CG standards and protect investors among listed

companies by introducing new provisions and strengthening existing provisions. In 2001, the Financial Sector Master Plan was issued. Its main objective was to establish a dynamic, flexible, competitive, and financial system capable of meeting consumer requirements and business.

In 2001, the Malaysian Capital Market Master Plan was issued to improve CG reform in Malaysia. It included 152 recommendations related to developing a regulatory framework and institutional for the capital market from 2001 to 2010, and ten of them were for CG.

The Institute of Internal Auditors released guidelines on the internal control function in July 2002. They were meant to help the BOD in discharging their roles concerning the establishment of internal audit functions. The Guidelines on Internal Audit Function was a combined effort among different interest groups from the professional and industry bodies, including the Malaysian Institute of Certified Public Accountants (MICPA) and the Malaysian Institute of Accountants (MIA). It was supported by the KLSE and the Securities Commission (Khadaroo & Shaikh, 2007).

The Corporate Law Reform Committee was established to lead the corporate law program in 2003 to carry out a comprehensive review of Malaysian corporations. In April 2003, the Securities Commission provided motivations in its Guidelines on Issue of Securities and Policies to simplify speedier approval of firms' corporate proposals with corporate conduct track records and good CG (Securities Commission, 2003). In January 2004, the Securities Commission improved its securities laws to present Provisions Governing Whistle Blowing to make it compulsory for auditors to report breaks of securities laws and requirements to the related authorities. This requirement complemented the requirements of the Malaysian Companies law, which imposed a similar task on auditors. Furthermore, the reviewed laws introduced

protection against retaliation to company secretaries, chief executive officers, chief financial officers, and internal auditors who reported mishandling to the relevant authorities (Khadaroo & Shaikh, 2007).

To enhance the profile of Bursa Malaysia's competitive advantage and install transparency, discipline, and efficiency on the Bursa Malaysia Berhad was registered in 2005, in the Main Board of Bursa Malaysia Securities. In addition, Bank Negara Malaysia formed Guidelines on CG for Licensed enterprises in 2005. It was issued to provide high standards to implement by licensed companies and bank/finance holding firms. Prospectus Guidelines were reviewed in 2005 to facilitate transformation and boost the efficiency of raising funds and corporate proposals. In 2005, the shareholder's Pro Term Committee was created to provide recommendations and decide on good practices and standards for organizational Shareholders. The Malaysian Code on Corporate Governance was reviewed in 2007 to enhance best practices towards local and international capital markets. The amendments introduced in 2008 on CG related to the AC's effectiveness and the internal audit function (Nickmanesh et al., 2013).

According to Backman (2001), there must be basic rules to create good and efficient CG systems. These basic rules will form an underlying groundwork for the Malaysian CG system, as follows:

Effective CG standards to ensure that shareholders and managers are doing the right thing;

- A high level of corporate adequate external auditing and transparency;
- Efficient financial stock exchanges;
- Competitive markets or facing a constant risk may face real competition;

- Efficient and transparent legal frameworks with judicial systems to enforce rules reliably and without charge;
- There must be a clear superiority between the regulated and regulators;
- Banking systems that are transparent, and independent competitive; and
- A well-resourced, independent, and inquisitive media (Backman, 2001).

The Asian Development Bank (ADB) conducted a CG and financing study in selected developing member countries (ADB Study, 1998) in November 1998. The study found several factors led Malaysia and other South-east Asian countries to face severe problems with their economies and corporate sectors during the financial crisis (Zhuang, 2000). These factors found that an ineffective BOD, weak internal controls, poor audits, a lack of inadequate disclosure, and a lack of tax enforcement characterized CG in many South-east Asian countries (Asian Development Bank, 1999). The ADB study recommended that a good CG system should consist of:

- A set of rules that define the relationships (including respective rights and responsibilities) between shareholders, managers, creditors, the government, and other stakeholders; and
- A set of mechanisms that help directly or indirectly to enforce these rules (Singam, 2003).

2.3 Malaysian Code Corporate Governance

The Malaysian Code Corporate Governance was issued in 2000, which was approved by the HLFC. It included self-regulation, which means that the state would impose no penalties imposed for any violation of regulations. The attractiveness of self-regulation is that the procedures are flexible and relevant. The possibility of government intervention exists if self-regulation fails to prevent market failure (Ferran, 2001). In addition, the possibility of peer sanctions and consequent damage to

reputation, in theory at least, promote compliance. In this context, the ineffective state of enforcement in Malaysia makes self-regulation particularly attractive. However, Malaysian code is driven by regulatory controls instead of a business-based code in the UK (Ow-Yong & Cheah, 2000; Cheah, 2005).

The Bursa Malaysia makes it compulsory for companies listed on the bourse companies to disclose in their annual reports their compliance or non-compliance with code in a “comply or explain approach”. This is done through listing requirements at Bursa Malaysia in 2001. Chapter 15 of Bursa Malaysia Listing Requirements addresses CG issues. One advantage of listing requirements is the need for a specific source to ensure that the BOD makes statements in its annual report regarding its compliance with the CG Act (Salim, 2011).

The HLFC has considered three approaches to governance practices. First, is the perspective of sets of standards on CG practices. Second is a concentration on disclosure of corporate CG and selection of practices according to organizational needs. Third, is a hybrid of the two, meaning that it adopts both approaches (Nickmanesh et al., 2013).

There are four sections of the MCCG:

1. Corporate Governance Principles

(a) Board of Director

The board has to include executive directors and non-executive directors, including independent and non-independent directors.

(b) Directors’ remuneration

There must be a limitation on the level of remuneration. Firms have to provide a transparent platform for the remuneration policies, and the firm's annual report had to have the directors' remuneration details.

(c) Shareholders

The firm must communicate with its shareholders through the Annual General Meeting (AGM).

(d) Accountability and Audit

The BOD must present an unbiased and logical evaluation of the firm's position and visions and maintain a proper relationship with its auditor. This code motivates all the companies on Bursa Malaysia to prepare a description of their annual reports to show how the applied codes are perceived enough for shareholders to evaluate the firms.

2. Best practice in CG

This section identifies a set of guidelines intended to assist the companies in designing their approach to CG. An example may be determining the structure of the board the relationship of the board with the management.

3. Principles and best practices for other corporate participants

This section of the code the responsibilities of the corporate investors and auditor's responsibilities in developing CG.

4. Explanatory notes

These are descriptive notes for the earlier parts of the Code. Four other developments were designed to the regulatory and governing institutions to complement any oversight arrangements that have to do with CG in Malaysia. They include:

- The formation of the companies' commission of Malaysia

- The introduction of the capital Market Plan.
- The establishment of the Financial Sector Master Plan by BNM.
- The demutualization of Bursa Malaysia.

2.3.1 The Revised Code on Corporate Governance

Many CG amendments have been made in Malaysia due to corporate misconduct (Hussin & Ibrahim, 2003). After accounting crises and irregularities, the Malaysian Government made extensive reforms and amendments to cases related to the regulatory, legal and information framework for management control, shareholder's rights, and supervisory technics (Koh, 2003; Suto, 2003). The amendments and reforms included altering the listing requirements on the Malaysian Stock Exchange and setting up a high-level finance committee of CG. This committee aimed to establish a general framework for CG and identify best practices for improving CG standards. The committee established the MCCG in 2000 (Finance Committee, 2000). In 2001, MCCG was fully implemented. The best practices of CG and principles under the Malaysian code of 2001 were introduced to influence CG development among Public Listed Companies. The law highlighted internal and external management and audits as key monitoring and control mechanisms. External management included the role of external auditors.

Malaysia reviewed CG rules to stimulate proper governance performance (Khongmalai et al., 2010; Ahmed & Mubaraq, 2012), and the MCCG was revised in 2007. The revised MCCG made no changes to part 1 but made 11 changes to part 2. These changes raised CG standards for companies listed on the Main Board, the Second Board and MESDAQ Market to increase investors' confidence (Nickmanesh et al., 2013).

The MCCG 2012 focused on strengthening the board structure's components and explaining board members' role as effective and accountable actors. They must be effective trustees and managers by monitoring the work and planning strategic direction and assuring that the company operates following ethical laws and values and maintains an effective governance structure to ensure appropriate risk management and internal controls (Laallam et al., 2017).

Later, the Securities Commission of Malaysia (SCM) issued the new Malaysian Code on Corporate Governance (MCCG, 2017) in 2017. This sets out best practices to strengthen corporate culture based on accountability and transparency. The new code took effect immediately and superseded the 2012 code. The MCCG 2017, which was the fourth version of CG codes (with previous ones in 2000, 2007 and 2012) was the result of a comprehensive review by the SCM in 2016 with input from local and international stakeholders, lessons from corporate governance failures and changes in market structures and business needs.

2.4 Islamic Corporate Governance

Malaysia is a model representing a modern Islamic country. Its Islamization process (i.e., Islam Hadhari) has infused Islamic values throughout the country at all levels, from individual to organization (Othman et al., 2009). However, there is a lack of literature on Shariah governance compared to conventional CG, although there has been a significant development in the Islamic finance industry over the past few decades. The concept of shariah governance has its foundation in the Quran and Sunnah, shariah means “the way”, guidelines of conduct Muslim treatment in all aspects of their life including financial issues (Shamsher et al., 2020). Islamic finance practices have been organized in a way that strictly follows the principles of Shariah

by observing its conditions, tenets and principles. Through this approach, business operations of IFIs are expected to be Shariah-compliant. Shariah governance system ensures that all activities and business transactions of intuitions are free from unauthorized elements such as riba, maisir, gharar and other similar attributes (Alnasser & Muhammed, 2012).

Choudhury and Hoque (2006) “describe Islamic CG as a theoretic decision-making process based on faith that uses the Islamic social principles of the theory of knowledge in Tawheed, the oneness of Allah. The Islamic view of CG is useful to reduce transaction costs in decision-making environments and to achieve the institution's objectives within the framework of Shariah law or Islamic rules and principles”. The major weakness of the traditional perspective of financial inclusion measurement is its failure to recognize the concept of wealth redistribution as what had been recommended in Islam (seman et al., 2019a).

Through compliance with Shariah principles, Islamic CG can fulfil the customers, competitors, suppliers, and employees' needs and desires, including spiritual and community needs (Lewis, 2005). CG from an Islamic viewpoint is a duty that transcends companies and individuals. Shareholders' interests are not limited to just the shareholders themselves but extend to the whole society and the environment. Islamic CG is based on fairness to all stakeholders.

In the context of Shariah Governance in Malaysia, the BNM, in an effort to establish proper Shariah compliance in IFIs, issued SGF in 2010 (BNM, 2010) (thereafter SGF 2010), which later was revised to SGPD in 2019 (BNM, 2019) (thereafter SGPD 2019). In between, the Islamic Financial Services Act (IFSA) was passed into law in 2013 (BNM, 2013). SGF 2010 contains sections on Shariah risk management, Shariah review, Shariah research and Shariah audit functions, whereas

the IFSA was designed to encourage Shariah compliance in IFIs. Hence, the requirements of SGF 2010 are mandatory for all IFIs as its implementation is mandated by the law stipulated in IFSA (2013). The Act also highlighted various penalties for Shariah non-compliance (SNC). Both SGF 2010 and IFSA 2013 were meant to ensure adequate implementation of Shariah compliance across Malaysian IFIs. In addition to that, the SGPD 2019 further strengthened the oversight functions of the Shariah Committee and other Shariah control functions to continuously ensure strong practices of Shariah compliance within the IFIs (Isa et al., 2020).

A list of common CG principles shows how the structure of Islamic CG differs from the structure of conventional CG. In Islamic CG, attention must be paid to the application of Shariah rules as they are stated in the Holy Qur'an. See Table 2.2.

Table 2.2: OECD Principles Compared to Islamic Principles

OECD principles	Islamic principles
The right of shareholders and key ownership functions	Property as a trust from Shariah rules
Promotion of transparent and efficient markets with the rule of law and division of responsibility	Sole authority is Shariah
Basic shareholder rights	Society as stakeholders
Participation in decision making at the general meeting	Accountability not only to stakeholders but also to God, the ultimate owner
Structure and arrangement for corporate control	Just and fairness of value
Ownership rights by all shareholders, including institutional shareholders	Equitable distribution of wealth to all stakeholders and disadvantage members
A consultative process between shareholders and institutional shareholders	In the form of Zakat and Sadagat
The equitable treatment of shareholders	Social and individual welfare with both spiritual and moral obligation
Protection to minority and foreign shareholders	Sense of equality
The role of stakeholder in corporate governance	Islamic accountability to Falah and social welfare orientation
Creating wealth, jobs and sustainability of for a financially sound enterprise	Haram/Halal in transactions

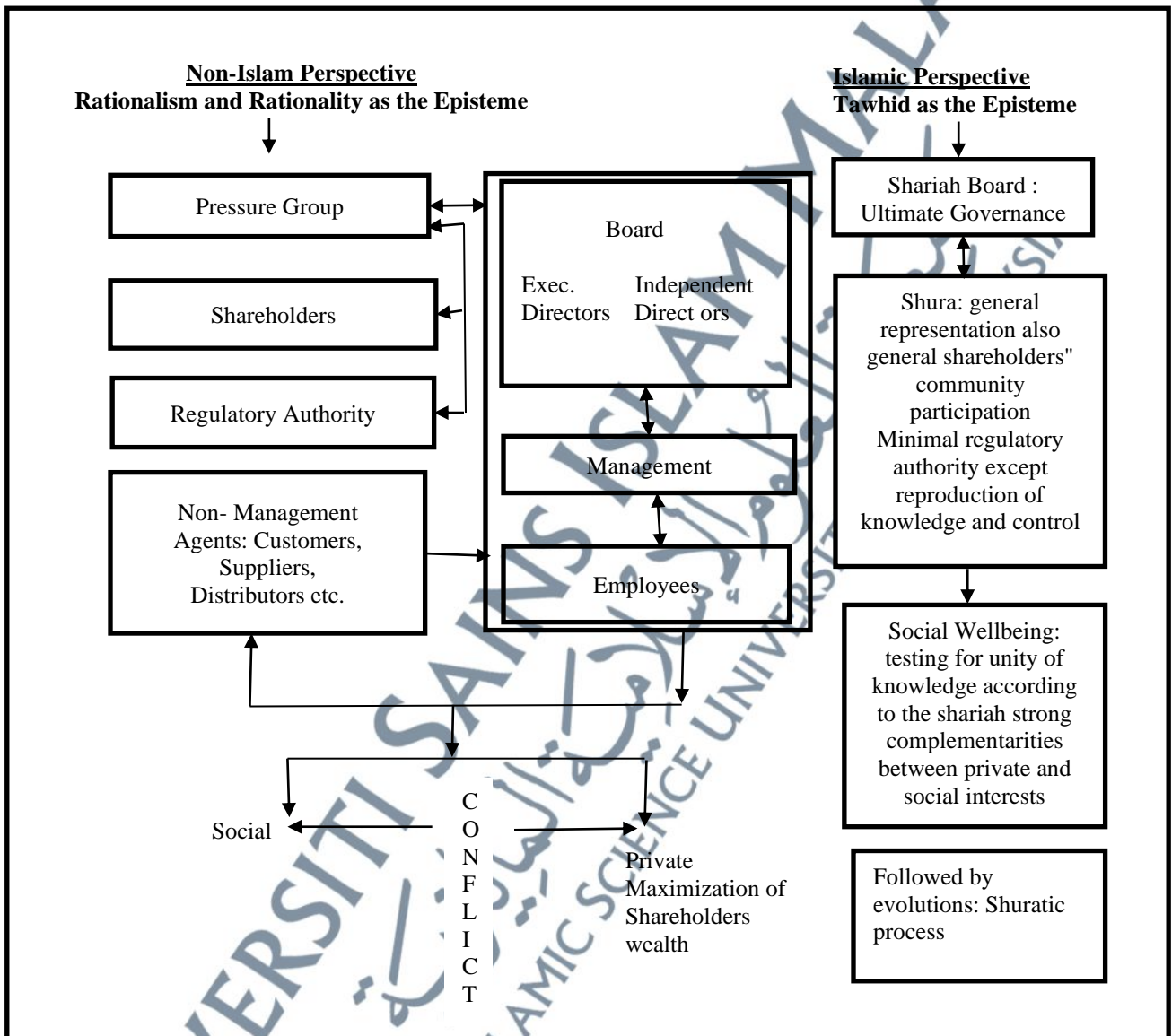
Source: Alnasser & Muhammed (2012)

From a Western perspective, the main difference between CG and the religiously driven Shariah governance is its epistemological orientation (Choudhury & Alam, 2013; Grassa, 2013; Platonova et al., 2016). Uniquely to Islam, Muslims and Islamic organizations are accountable to God and are required to comply with a strict ethical code. Moreover, Islamic accountability incorporates responsibility towards society at large to eliminate poverty and promote fairness or social justice (Kamla, 2009, Fathi et al., 2017; Karbhari et al., 2020). According to Seman et al., (2019b), financial comprehensive from the Islamic view can be tackled in two methods: first, aspect through risk-sharing, and second, through the instruments of redistribution.

Kasri (2009) determined the main differences between Islamic and traditional CG views regarding philosophical attitudes, corporate objectives and goals, the types of contracts participatory and key players in governance, and relationships between players. Governance in the Islamic perspective focuses on governance in terms of a Muslim's promise, responsibility and obligations to Allah. Islamic governance means a tacit contract with Allah and a written contract with people. In the end, Allah and Islam are important actors in the practice of CG in contrast to the conventional process that concentrates on material and physical aspects (Kasri, 2009).

The reason for creating an Shariah Supervisory Board (SSB) is to guarantee that operations are carried out according to Islamic principles. If transactions do not follow the Shariah rules, an organization may suffer a loss of confidence by many people. So, these rules are clearly essential to improving IFIs operations. The Fatwa and SSB monitors the application of numerous aspects of Shariah in IFIs. It also ensures that all operations comply with Shariah rules. In the event of any violations or irregularities, the BOD can delegate authority to the SSB to represent it in correcting a violation (Alnasser & Muhammed, 2012).

Figure 2.1 below shows the differences between the non-Islamic perspective and the Islamic perspective regarding authority sources for managing a company.



Source: Choudhury & Hoque (2006).

Figure 2.1: Corporate Governance: Islamic and no Islamic Perspective

2.5 Conventional Insurance

According to Najjar (2012), the concept of insurance is to collect money from a group of individuals or institutions to compensate them in the event of future losses or

disasters. These entities are insured against risks by paying fees to companies that are determined by the frequency of an event and the amount of damage.

Conventional insurance may be defined “as an agreement whereby an insurer undertakes (in return for the agreed premium) to pay a policyholder an amount of money (or its equivalent) on the occurrence of a specified event”. The specified event must have some element of uncertainty about it. The uncertainty may either lie in the fact that, although the event is bound to happen in the ordinary course of nature, the timing of its occurrence is uncertain; or the fact that the occurrence of the event depends upon accidental causes, and the event, therefore, may never happen at all (Anwar, 2008).

Insurance is a commercial activity carried out by businesses and represents a large part of the financial services industry. Good CG practices are viewed as necessary by international institutions such as the International Association of Insurance Supervisors (IAIS) in all sectors. Therefore, the Malaysian government has decided to prepare a set of fundamental principles of insurance that define the most important standards and principles governing CG to provide a wide range of best regulatory and supervisory practices in the governance and management of insurance companies (Najjar, 2012).

2.5.1 The Malaysian conventional insurance industry

A former president of the Life Insurance Association of Malaysia (LIAM) reported in 2019 that group insurance was seeing an upward trend. The group insurance business premium saw a growth of 14.19% to a record of RM11.8 billion in total premiums in 2010 compared to RM10.3 billion in 2009 (LIAM, 2019). Similarly, the life insurance new business sum assured enjoyed a positive growth of 6.91% in 2019, as measured by the total new business sum assured, which were RM 483.3

billion in 2019 compared to RM 452.1 billion in 2018. The growth in investment-linked business came from annual 2019 Life Insurance Industry's Highlights (LIAM, 2019).

The impact of the COVID-19 pandemic is expected to cause the Malaysian general insurance industry to contract by 2.2% in 2020. According to Global Data, it has revised Malaysia's general insurance forecast, taking the pandemic into account. With the latest data, the sector is expected to grow at a compound annual growth rate (CAGR) of 2.4% from 2019 to 2024, compared to the earlier forecast growth of 4.9% (Olano, 2020).

BNM estimates that 24.4% of conventional and *Takaful* or Islamic insurance assets are potentially exposed to liability risks, asset impairment, and rising claims from climate change. The central bank says it's important for Malaysian financial institutions to treat climate change like any other financial risk which could affect their profitability and balance sheets and hurt their ability to raise funds. "If not dealt adequately, climate change can also pose a systemic risk," the report says. "Collectively, these could lead to a contraction in important financial activities that support the economy (Thean, 2020).

2.6 Takaful Industry

2.6.1 Concept of Takaful

Takaful or Islamic insurance systems originated from the ancient Arab tribes. The concept was well known and used among the Ansar of Medina and the Muhajirin of Mecca for centuries, resulting from the Hijra of the Prophet Muhammad (May Peace Be Upon Him) more than 1400 years ago (Anwar, 2008). Takaful is derived from the concepts of "Aqilah and Diyah" (Manjoo, 2007; Nazarov & Dhiraj, 2019).

Subsequently, this concept was expanded to include various aspects of individual life and maritime trade and help any individual or group facing a disaster or loss of maritime work.

Takaful originates from its Arabic root *Kafalah*, which means “to aid one another” and or “mutual guarantee,” and all products or transactions must completely conform to “Islamic law” (Jaffer et al., 2010). The practice of insurance was first founded in the early second epoch of the Islamic era in Asia when Muslim Arabs began to enlarge their trade to India, the Malay Archipelago, and other Asian countries (Sadeghi, 2010).

Owing to the long distance involved, the dangers inherent in the journey, and the losses arising from mishaps and misfortunes or robberies, Muslim Arab traders got together and mutually agreed to contribute to a fund that would be used to compensate anybody in the assembly who suffered losses (Thanasegaran, 2008; Hussin et al., 2014).

Takaful in Malaysia is defined in the Malaysia Code as “A scheme based on brotherhood, solidarity, and mutual assistance which provide for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose” (Takaful Act, 1984). This description characterizes the Islamic standard of Takaful whereby an assembly of members consents to promise to compensate each other against a specific loss or harm

Similarly, the Islamic Financial Services Act 2013 (IFSB), in its published guidelines, entitled Guiding Principles on Governance for Takaful Undertakings, describes Takaful as follows, “*Takaful is the Islamic counterpart of conventional insurance, and exists in both Family (Life) and General forms*” (BNM, 2013). As Islamic protection, consistence with Shariah standards and standards is the foundation;

as it is undoubtedly the particular trademark that reflects the Islamic character of Takaful business (BNM, 2010). The Takaful industry plays a crucial role in reducing risks and global economic growth, predominantly in the financial sector (Sherif & Shaairi, 2013; Arifin et al., 2018, Eldaia et al., 2020b).

Between the mid-1960s and 1970s, about 93% of the global insurance market was based in Europe and Northern America. The late 1970s oil price shocks and the subsequent inflationary pressure had a deteriorating impact on the percentage of these nations' global insurance market, which was 56% in 2012 (Swiss Re, 2013). During this period, the share of emerging Asian economies improved from 3.8% of the world total in the 1960s to 30% in 2012. It was anticipated that emerging economies of Asian countries would have a yearly growth of 8% going forward, which was more than triple of developed countries growth rate of 2.6% (Swiss Re, 2013).

2.6.2 ReTakaful

The ReTakaful concept is an arrangement in which the ReTakaful Company agrees to indemnify a Takaful Operator, the ceding company, against a portion of the primary risks underwritten by the ceding company. ReTakaful, however, does not discharge the ceding company from its liability to a participant. The Malaysian Takaful Act 1984 does not define the term per se but requires that “an operator shall have arrangements consistent with sound Takaful principles for ReTakaful of liabilities in respect of risks undertaken or to be undertaken by the operator in the course of his carrying on Takaful business” (BNM, 2012)

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) refers to Islamic reinsurance (ReTakaful) as “the agreement among insurance companies, on behalf of the insurance funds under their management, to

devise a mechanism for avoidance of part of the risks which the insurance funds may encounter. Based on such an agreement, a reinsurance fund with a distinct legal personality and independent financial liability is formed through contributions from insurance clients' insurance funds based on donation. The reinsurance fund assumes the task of covering part of the risks that the individual insurance funds encounter (AAOFI, 2015).

Yusuf (2011) notes the main objectives of ReTakaful are three. The first objective is to safeguard operators against the possibility of insolvency and to engage operators in Shariah-compliant investment. The second objective is to provide adaptable underwriting practices for operators. The last objective is to prohibit interest in the reserves of ReTakaful fund. Those three objectives clearly show that even conventional reinsurance and ReTakaful share the same functions, but the objectives have put the risk-mitigating tools into a different set of processes and aims.

2.6.3 Religious Foundations of Takaful

- **Authorities from the Holy Quran**

1. God wants us to leave our family ready and in good shape.

“And those who are taken in death among you and leave wives behind - for their wives is a bequest: maintenance for one year without turning [them] out. But if they leave [of their own accord], then there is no blame upon you for what they do with themselves in an acceptable way. And Allah is Exalted in Might and Wise” (Al-Qur’an. Al-Baqarah 2:240).

2. Muslims must fulfil contracts and obligations.

“Oh you who have believed, fulfil all contracts.” (Al-Qur’an. Al-Mā'idah 5:1)

3. Mutual cooperation is required in Islam.

“And cooperate in righteousness and piety, but do not cooperate in sin and aggression. And fear Allah; indeed, Allah is severe in penalty.” (Al-Qur’an. Al-Mā’idah 5:1).

- **Authorities from the Hadith**

1. Narrated by Anas bin Malik “The Prophet advised us to do our part before leaving the result to God: ‘When the Holy Prophet asked a Bedouin Arab, who entered the mosque with his camel left outside untied, if his camel would run astray, he said: “Insha Allah”. The Prophet then said: “Tie your camel first, then say Insha Allah” (Hadith. Al-Termethy. Kitab al-tawakul: Juz’ 5: #2517).

2. Narrated by Abu Hurairah radiyallahu ‘anhu, that the Prophet, Sallallahu ‘Alayhi Wasallam, said: “Whosoever removes a worldly hardship from a believer, Allah will remove from him one of the hardships of thereafter. Whosoever alleviates the needy person, Allah will alleviate from him in this world and the next” (Sahih Muslim, Kitab 36, #6250).

2.6.4 Takaful Models

Four types of Takaful mode are discussed below:

2.6.4.1 Takaful Ta’awuni (Non-Profit Model) (التأمين التعاوني)

The concept of Ta’awuni model is established upon the idea of commonality, collaboration, and brotherhood among the members to help the partaking members in the event of the urgent need for support because of an unexpected accident or a certain tragedy. This form of insurance seeks to realize the wellbeing of the members and society at large. A Takaful operator can be the custodian on behalf of customers without considering about making a gain. Thus, this model is termed a non-profit. Any excess is allocated in full to all members (Billah, 2004). Members contribute to the

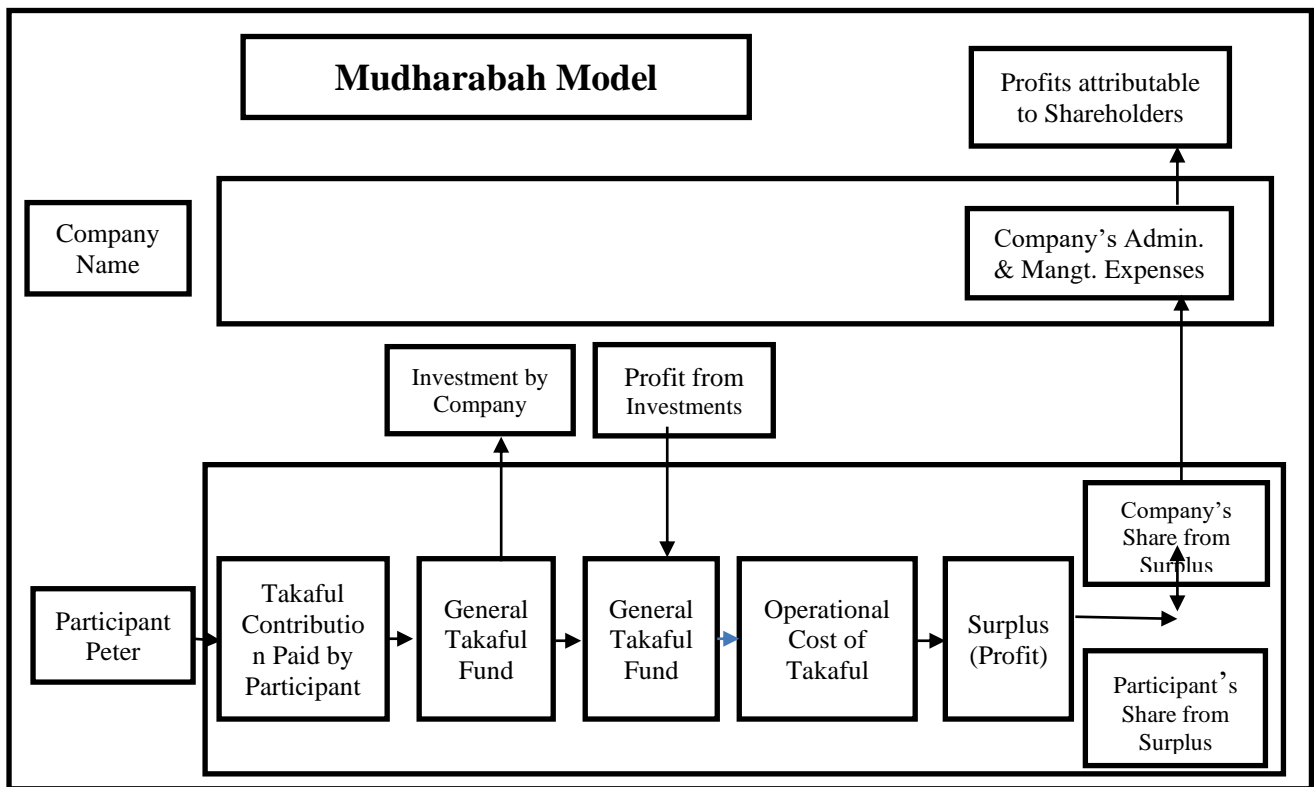
Takaful Fund to pay other members in the event of calamities and afflict. Consequently, Takaful members and operators are to know their rights and responsibilities to the fund and the premiums in the contributions are spread to contributors only (Billah, 2004).

This model was coined in Sudan in 1979 when the first Takaful events began. Afterwards, insurance firms were compelled to follow the “Takaful Ta’awuni” (cooperative insurance) model and adopt the Takaful project under the law. The Ta’awuni model was adopted and implemented by Bank Aljazira Saudi Arabia when the scholars advocated for Islamic insurance compliance with Shariah.

2.6.4.2 Mudharabah Model (Tijari) (مضاربة)

Mudharabah is a deal between a capital supplier (Rab-al-Maal) and a business individual (Mudharib) through which the Rab-al-Maal offers wealth to be managed by the Mudharib and any profit made from the wealth is divided between the Rab-al-Maal and the Mudharib in line with a mutually consented profit-sharing ratio (PSR). In the process, any financial losses are borne by the Rab-al-Maal if such losses are not caused by the Mudharib’s transgression (Ta addi), carelessness (Taqsir) or break of stated terms (Mukhalafah al-shurut). This model has been practised in Malaysia for two decades.

The Takaful Company was the first and is the largest company in Malaysia and has demonstrated the success of the Mudharabah model as profitable for both customers and shareholders. This model is also practised in Brunei, where Takaful companies pay 36% to their contributors (Saleh, 2016). The Mudharabah model is illustrated in Figure 2.2 below.



Source: (Razimi et al., 2017)

Figure 2.2. Mudharabah Model

2.6.4.3 Wakalah Model (الوكالة)

The Wakalah model is a remunerated Islamic deal where one party provides funds, and another manages the funds. The other party receives fixed payments instead of profit-sharing as in the Muddarabah deal, to offer managerial services to invest and manage the funds prudently. Under the Takaful contract, members offer wealth in the form of a contribution. The Takaful operator manages the capitals with a fixed fee (termed Agency Fees) for its services (Alnemer, 2013). Agency fees must be fair, appropriate, determined, and approved by the SSB.

This model is more transparent than the speculative model as fees are fixed and predetermined by both parties. There are no hidden charges. Some Takaful operators charge excess surcharges as an incentive to manage funds effectively. Conversely,

some Takaful operators receive supplementary fees as a spur for their efficacy in running finance and their profit achievement.

This model is practised in Takaful all Malaysian Takaful companies. The Government of Bahrain has also started to enforce a mandatory model on Takaful and Re-Takaful businesses in all its operations. This model has enjoyed acceptance worldwide due to benefits such as transparency and the purpose of fixed fees. This brings about an upsurge in the company's impact to work better and increase its profits. Furthermore, there are less Shariah related issues associated with this model that might create conflicts of interests among Shariah scholars of different schools of thoughts (Razimi et al., 2017). The Wakalah model is illustrated in Figure 2.3 below.

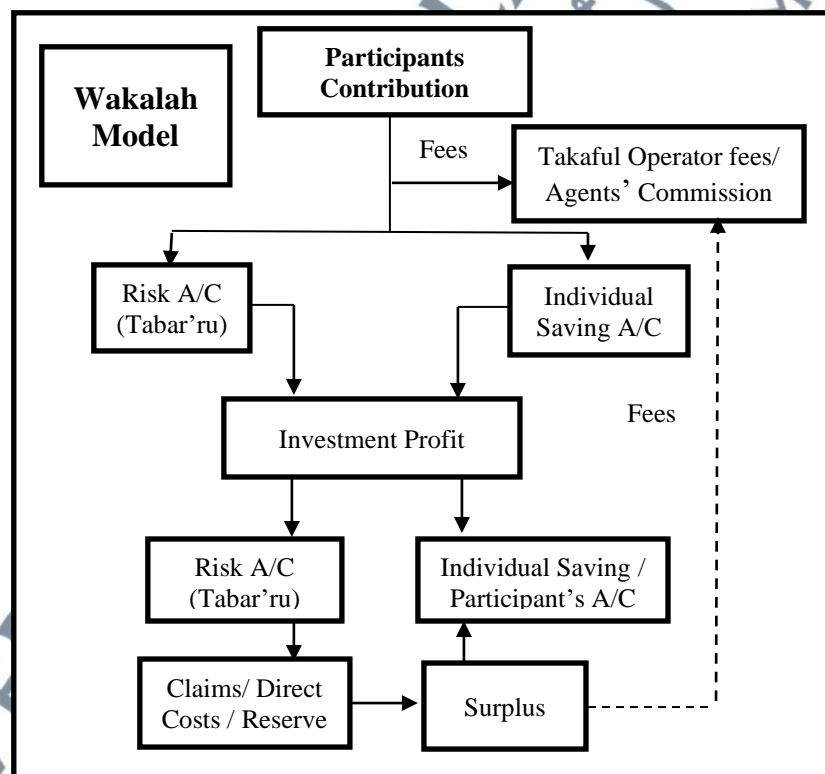


Figure 2.3: The Wakalah Model

Source: (Bank Al-Jazira, Saudi Arabia, 2009. www.baj.com.sa)

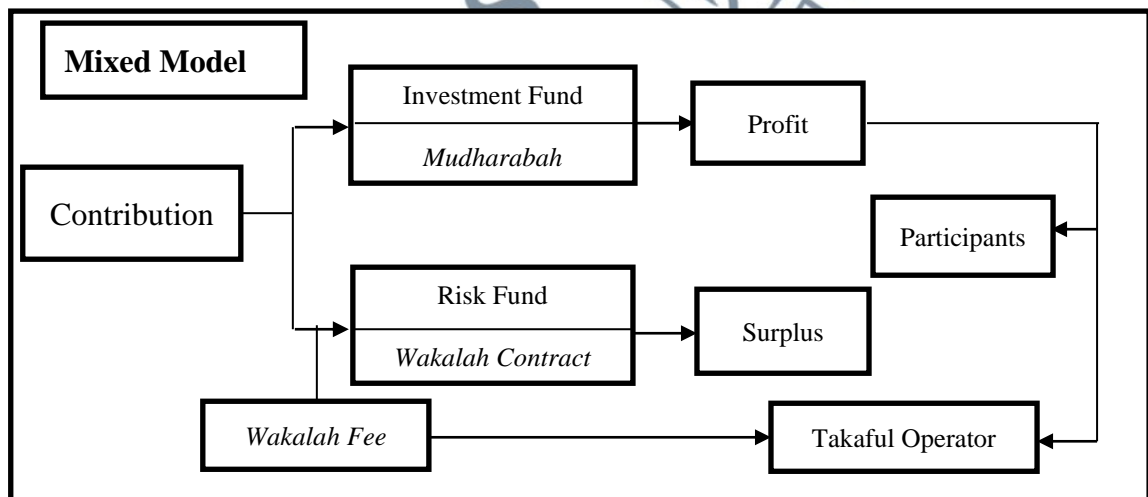
2.6.5.4 Mixed Model

The mixed model is a fusion of Wakalah and Mudharabah model where Mudharabah deal is implemented for investment purposes whereas the Wakalah deal is applied for underwriting agreement (Tolefat, 2006; Djafri et al., 2018). The stakeholders act as the wakeel (agent) on behalf of contributors to manage their capitals. The Takaful company (stakeholders) gets a contribution, pays claims, arranges Re-Takaful, and all other obligatory activities related to Takaful business. The company charges each contributor a fee recognized as a Wakalah fee, which is commonly a percentage of the contribution paid by each contributor in exchange for execution these tasks. Regarding investment, the company invests the extra contributions in Shariah-based devices based upon the Al-Mudharabah perspective, where the company acts as Mudharib on behalf of contributors (Rab-al-Maal or capital providers).

Nevertheless, to fulfil the Shariah condition for Al-Mudharabah, the ratio of profit is set and contracted between the two parties, at the start of the deal. Adherents of this model assert that a Mudharabah procedure is better suited for management and investment of Takaful finance (Obaidullah, 2005; Almulhim, 2019) and offers a reason to Takaful operator to boost its return by sharing the profit. The Wakalah model is possibly more appropriate than the Mudharabah for running the Takaful business for the agency fee (cost of insurance). It is more transparent and freer from the contentious indicting of expenses (including marketing commissions) to the Takaful fund. These measures need to be deemed an aspect of attempts to seek the best Takaful model and create concord among existing Takaful models (Akhter, 2009).

Certain financial regulators and international organizations (e.g., the Accounting and Auditing Organization for IFI, AAOIFI) advocate the mixed model as it leverages the strengths of the Wakalah and Mudharabah models. Implementing the Mudharabah model to investment events assists lessens principal-agent issues, while the Wakalah model usage permits the operator to convalesce the administrative expenses of underwriting (Swiss Re, 2008).

This model is widely practised in the Middle East market and worldwide in Takaful companies. In Malaysia, Maybank Takaful Berhad (MTB) and Takaful Nasional Berhad practice it. Supporters of this model argue that this model combines the benefits of Mudharabah and Wakalah models (Obaidullah, 2005). Therefore, it may help to build a standardized model to be used around the world. The mixed model is illustrated in Figure 2.4 below.



Source: (Ismail et al., 2017).

Figure 2.4: Mixed Model

Implementing a particular Takaful model makes CG controversial in terms of the rights of contributors to Takaful firms. The concern of Takaful employees is to maximize the profits of the stakeholders while ignoring the rights of the participants,

even though the employees are acting as agents, trustees, and managers of the invested funds that receive their profits in the form of Mudharabah and the Agency fees. In the absence of good CG practices, the BODs is not held accountable, and their decisions are not adequately monitored for participants and the community as a whole because the participants have no positions in the BODs, so they do not have the right to question the BODs (Archer & Karim, 2002).

2.6.5 Products of Takaful

2.6.5.1 General Takaful

General Takaful products are typically designed to provide Shariah-compliant risk-sharing and risk management mechanisms on an annual renewal basis. In this scheme, the relationship among the participants is based on Ta'awuni and Tabarru'; whereas the relationship between Takaful operator and participants, is based on Mudharabah, Wakalah, or Waqf (Yasin & Ramly, 2011; Hussin et al., 2014). Some examples of general Takaful products are:

1. Motor Takaful: This type of policy protects the participant against any losses or damages to the insured vehicle due to theft, accident, fire or third-party property damage or bodily injury. II. Fire Takaful: This type of policy protects the participant against any losses or damages caused by fire, lightning, or explosion to their properties. It includes but not limited to buildings, machinery, plant, furniture, and accessories. The fire Takaful scheme usually excludes damages caused by earthquake, volcanic eruption, or typhoon scheme.
2. Engineering Takaful: This type of policy protects the contractor's interest against any losses, damages, or liability due to different causes to the construction of bridges, buildings, dams, and towers.

3. Marine Takaful: This type of policy protects the participant against any perils or damages to the property while it is in transit. It includes sea peril, collision, stranding, fire, and severe weather. Such coverage may be provided to marine transport or road and aviation. Moreover, it can also be a combination of all (Yasin & Ramly, 2011; Marifa Academy Team, 2014).

2.6.5.2 Family Takaful

Family Takaful products are usually designed to offer protection against the risks of death or permanent disability. Under this system, the participant may benefit from long-term savings and investment returns based on a pre-agreed ratio consistent with Mudharabah. The participants in a family Takaful scheme entrust their money to the Takaful operator and conduct a Wakalah contract that permits the operator to act as their agent. The participants' aid in the form of a contribution to the Takaful fund is deposited in Participants' Special Account (PSA). The funds are used to compensate claimant's family in case of the claimant's demise or permanent disability. The contribution in the form of savings is deposited in Participants' Account (PA) for investment in Shariah-compliant businesses.

The Takaful operator is responsible for distributing the surplus based on participants' contribution to the fund. There are several types of family Takaful products offered by various operators which are primarily divided into two categories:

- 1) Individual family Takaful: In this type of product, the fund member has policy protection against any defined risks, including mortgage, education, or health.
- 2) Group family Takaful: In this type of product, the members have policy protection for themselves and their families against any defined risks, including mortgage, group health, and education. Their families are entitled to receive financial

benefits in case of illness, death or permanent disability (Yasin & Ramly, 2011; Marifa Academy Team, 2014; Nazarov & Dhiraj, 2019).

2.6.6 Takaful Legal Framework in Malaysia

To enable the BNM to meet a central bank's objectives, it is vested with comprehensive legal powers under the following legislation to regulate and supervise the financial system. These pieces of legislation include:

1. Shariah Governance Framework (SGF 2010)

The SGF 2010 issued by BNM in 22 October 2010 sets out the shariah governance process for the IFIs in Malaysia. It issued with the objective to enhance the role of the BOD, the SC and the management of IFIs especially on shariah matters. Besides, this guideline also covers relevant key organs with the responsibility to execute the shariah compliance. Specifically, the SGF 2010 (BNM, 2010).

2. Shariah Governance Policy Document (SGPD 2019)

In September 2019, BNM issued (SGPD 2019) after having issued an ED in 2017. The SGPD tightens the role of the board, management and the SC. The SC in comparison is the guardian for ensuring that products and instruments adhere to shariah principles. Under the latest SGPD, the SC has to bear more responsibility as compared to SGF. This indicates the utmost importance of shariah governance placed by the regulator on IFIs (BNM, 2019).

3. Central Bank of Malaysia Act 2009:

An Act to provide for the continued existence of the Central Bank of Malaysia and the administration, objects, functions and powers of the Bank, for consequential or incidental matters.

4. Islamic Financial Services Act 2013:

An Act to provide for the regulation and supervision of IFI, payment systems and other relevant entities and the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with Shariah and for related, consequential or incidental matters.

5. Banking and Financial Institutions Act 1989 (BAFIA):

An Act to provide new laws for the licensing and regulation of institutions carrying on banking, finance company, merchant banking, discount house and money-broking businesses, for the regulation of institutions carrying on certain other financial businesses, and for matters incidental thereto or connected therewith.

6. Islamic Banking Act 1983

An Act to provide for the licensing and regulation of Islamic banking business.

7. Insurance Act 1996:

An Act to provide new laws for the licensing and regulation of insurance business, insurance broking business, adjusting business and financial advisory business, and other related purposes.

8. Takaful Act 1984:

An Act to provide for the regulation of Takaful business in Malaysia and other purposes relating to or connected with Takaful.

9. Development Financial Institutions Act 2002 (Act 618):

The DFIA that came into force on 15 February 2002 focuses on promoting the development of effective and efficient development financial institutions (DFIs) to ensure that the roles, objectives and activities of the DFIs are consistent with government policies that mandated roles are effectively and efficiently implemented.

DFIA also emphasizes efficient management and effective CG, provides a

comprehensive supervision mechanism and mechanism to strengthen the financial position of DFIs through the specification of prudential requirements.

10. Anti-Money Laundering and Anti-Terrorism Financing Act 2001

This renamed and revised Act which came into force on 15 January 2002, was to provide for the offence of money laundering, the measures to be taken for the prevention of money laundering and terrorism financing offences and to provide for the forfeiture of terrorist property and property involved in, or derived from, money laundering and terrorism financing offences, and for matters incidental to that and connected therewith.

11. Money Services Business Act 2011:

An Act to provide for the licensing, regulation and supervision of money services business and to provide for related matters.

12. Government Funding Act 1983:

An Act to provide for raising funds by the Government of Malaysia following the Shariah principles and providing for matters incidental thereto or connected therewith (Zul Kepli, 2013).

2.6.7 Takaful Industry in Malaysia

There is a belief among the Muslims that conventional insurance is forbidden because of the existence of numerous forbidden properties, for instance, Riba (interest), Maysir (gambling), and Charar (uncertainty). Consequently, a need exists for a substitute form of insurance that meets the demands and needs of Muslims who want to do financial transactions that are harmonious with Islamic Shariah (El-Gamal, 2001; Akhter, 2010).

The first declaration of life insurance was issued on June 15, 1972, when the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia

issued a religious fatwa stating that this type of life insurance was haram (prohibited) because it contradicts Islamic Shariah and Islamic rules. In 1975, this ruling was confirmed by a similar decree issued by the Council of Islamic Fiqh Scholars that conventional insurance is forbidden or unacceptable according to Islamic law.

According to Islamic law and rules, the primary motive for establishing the Islamic insurance system in Malaysia was to adhere to Islamic law and move away from the three forbidden elements. Furthermore, this legitimacy serves as an incentive to develop an Islamic alternative to conventional insurance, which Muslims prefer in Malaysia. Malaysia's Takaful industry was established in 1984 and was developed in three phases (Bank Negara Malaysia, 2005).

The first phase (1984-1992) served as the infrastructure of the Takaful industry in Malaysia. The second phase (1993-2000) strengthened regional cooperation between Takaful operators in the region. In the third stage (2001-2010), the Financial Sector Master Plan (FSMP) sought to enhance the legal, Shariah and regulatory framework and enhance Takaful's capacity. Malaysia's Takaful industry had become a significant focus and critical in the Malaysian economy to help make Malaysia an international Islamic financial center. See Figure 2.5 below.



Source: (Cuyper, 2012)

Figure 2.5: Development of the Malaysian Takaful Industry

The Malaysian Takaful Association (2008) has reported an increase in the Takaful market in the past years: 4.5% in (2003), 5.1% in (2004) and 5.6% in (2005), 6.5 % in (2006) and 7% in (2007). Although the increase has been stable, the Takaful industry's performance is small compared to that of conventional insurance (BNM, 2005). To date, the market share of Takaful has not reached the target set by BNM, which is 20% (Malaysian Takaful Association, 2008). Takaful insurance companies' obstacles in terms of increasing capital and experience. Other threats include market awareness, lack of players, product diversity, capital decline, lack of Re-Takaful, lack of consumer culture and faulty debt. However, Malaysian insurance companies can benefit from citizens' legitimate commitment and product orientation to Shariah compliance as a competitive advantage to increase the Takaful ratio in the market (Kasim, 2012)

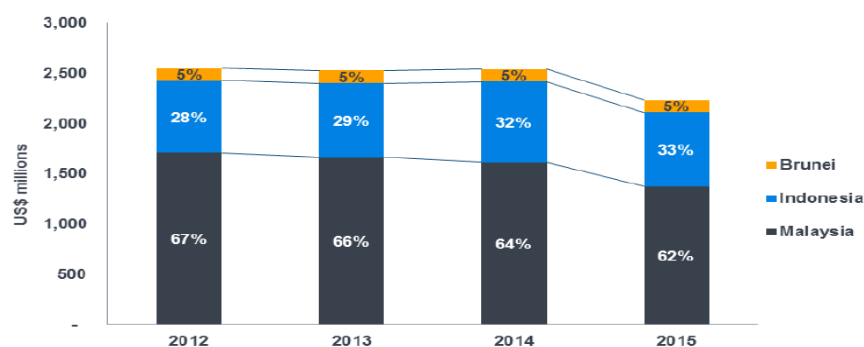
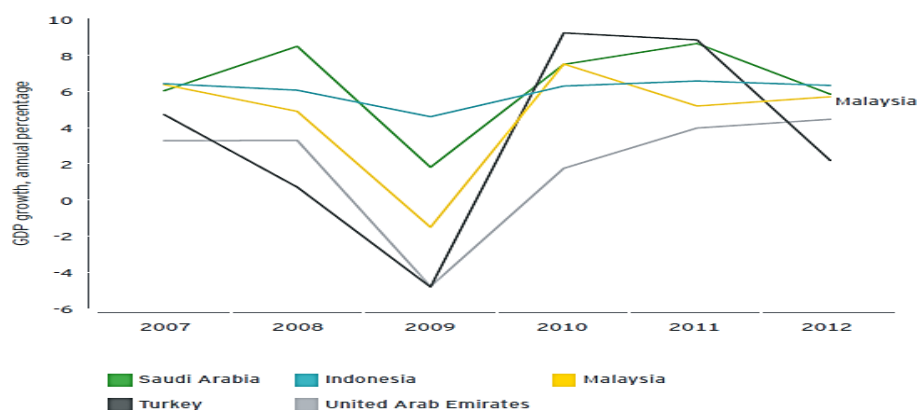
Global Takaful grew between 2004 and 2007 from a commitment of 2.1 billion US dollars to 3.4 billion US dollars, with a yearly development rate (CAGR) around 30%, with Saudi Arabia and Malaysia as the biggest markets. Territorially, the ASEAN area was the largest market for 2005 to 2008. In 2008-2010. Balanced for international expansion, the market developed at 28% against the ordinary market which remained at 5% in Muslim nations and 8% in the MENA during a similar period (Ernst & Young, 2015).

Malaysia leads the Takaful industry in South-East Asia. The Islamic finance industry assets were forecast to account for 40% of the banking sector by 2020 (Husin, 2019). For the case of Malaysia, Takaful industry have recorded positive growth in recent years (Abdul Razak. et al., 2021). The share of Takaful net contribution as a proportion of the total insurance and Takaful business increased to 18.3% in 2019 compared to 16.6% in 2018. This indicates consistent growth of the

Malaysian's Takaful business (Bank Negara Malaysia, 2019). Takaful has encountered unparalleled development in the most recent decade. MTA statistics showed that in 2019 new Takaful protection grew 17.3% to MYR 380.2 billion (US\$ 93.62 billion) from MYR324.2 billion (US\$79.83 billion) in 2018 (MTA, 2019).

The Governor of BNM, who is also the Director-General of Takaful, stated the aim of developing the Takaful industry in Malaysia was to create progressive world-class Takaful operators able to successfully position themselves as leaders in the area of Takaful, thereby developing Malaysia as an international Islamic financial center (Bank Negara Malaysia, 2005). Consistent with the goal of strengthening Malaysia as an Islamic financial center, competition in the Takaful market has been increasing in the last decades. There were eleven Takaful companies in the Malaysian market in 2020. The performance and achievements of the Takaful industry in Malaysia have made it a strong competitor to traditional insurance. (Sherif & Shaairi, 2013).

Currently, the Takaful industry in the Malaysian market faces considerable competition from the traditional insurance industry in many fields. The absence of a secondary market, the organizational infrastructure of Islamic law and the lack of research on the central issues of Takaful have hindered the development of Islamic products. The Islamic insurance companies also face the lack of Islamic products in Shariah-compliant insurance. Though, the GDP growth of major global Takaful markets remain unstable throughout this period of economic crisis and still continues to be, as displayed by the data (Figure 2.6) reported by Malaysian Takaful Association (2014). Territorially, the ASEAN region has been described as the huge market between 2007 and 2012.



Source: (Ismail et al., 2017).

Figure 2.6: (A) GDP Growth of Major Global Takaful Markets (Annual %; Malaysian Takaful Association, 2014). (B) Takaful GWC in South East Asia.

2.7 Conceptual and Operational Differences Between Takaful and Conventional Insurance

Takaful insurance companies and traditional insurance companies differ in their basic concept models (Kwon, 2007; Kwon, 2010; Lee et al., 2010; Hussain & Pasha, 2011; Maysami & Kwon, 2011; Matsawali et al., 2012). Traditional insurance includes an undertaking from an insurance company in the event of payment either to the insured or to another in the event of a particular event. Takaful is an Islamic substitute for traditional insurance and is built upon the concept of “social solidarity, cooperation and joint compensation for loss of members.”

Table 2.3 presents the main differences between Takaful and conventional insurance to clarify how to understand Islamic aspects and why the Muslim community prefers Islamic insurance.

Table 2.3: Main Differences Between Takaful and Conventional Insurance

Item	Takaful	Conventional
Benefits	Paid from the related participants' funds under mutual assistance.	Paid from the company reserves.
Investments	The funds shall be invested in any interest-free Shariah approved assets and meet any required national insurance regulations and laws.	The funds may be invested in any assets so long as they meet required national insurance regulations and statutes.
Operations	Operational mechanisms shall be in line with the Shariah rules.	Operational mechanisms should align with national insurance regulations and laws.
Profit	Underwriting profit is distributed to the policyholders. Shareholders' profit is generated from the return on the investments of the shareholder capital and expenses paid to the shareholders by the policyholders for (i) managing the company on behalf of the policyholders; and (ii) managing the policyholders' investment funds on behalf of the policyholders.	Policyholders do not get any share of the underwriting profit (except in mutual companies); shareholders' profit is generated from the company's underwriting profit plus any investment returns.
Premiums	Paid premium is treated as both donation and saving (Mudharabah).	Paid premium creates an obligation against the insurer on a sale and purchase relation.
Company	Company is better known as an operator, which acts as a trustee, manager, and entrepreneur.	Relationship between the company and the policyholders is on a one-to-one basis.
Shariah	Takaful practices are free from riba and other prohibited elements and revolve around the aspects of Mudharabah, and other Shariah - justified elements	Conventional insurance (including mutual insurers) may involve riba and additional features that may not be justified by Shariah principles
Policyholder Fund	The policyholder fund belongs to the policyholders on a collective basis and is managed by the shareholders.	Both policyholder and shareholder funds belong to the company, though separation of assets may be maintained between shareholders and policyholders for specific insurances (e.g., with profits).
Regulations	The operational mechanisms and products must be Shariah-compliant and follow required national laws and insurance regulations.	Operational mechanisms and products have followed the required national laws and insurance regulations.

Source: Khan (2005)

Nonetheless, some similarities between these two types of insurance. The similarities are the following:

1. The two forms of insurances require payment from the insured to the insurer; in traditional, it is termed premium while under Takaful, it is termed contributions in the form of endowment.
2. The value insured is returned to the insurer when particular events happen.
3. The two forms of insurances have a substantial investment or savings components developed in them.

2.8 Malaysia's Takaful Industry Bodies

Malaysia is an Islamic finance and banking industry forerunner and well-known globally for having the most established and effective Takaful market. This reputation is because, through the decades, Malaysia has advanced and well-regulated Islamic financial industry, i.e., well-supported with essential regulatory contexts and conventional physical structures (Hussin et al., 2014; Remli & Rosman, 2018).

The Takaful Act (1984) and the Islamic Financial Services Act (2013) were introduced to advance the industry towards realizing tremendous growth and development in Malaysia's Takaful insurance industry and globally. Furthermore, the numerous regulators that are vigorously backing the whole value chain of Islamic finance have helped the industry expand optimally in the country. Additionally, many committed regulators are keenly supporting the complete value chain of Islamic finance, which have also helped the industry develop. Further, numerous structures have been developed to catapult Islamic insurance into the forefront of Malaysia insurance industry (Cuyper, 2012). These are discussed below.

I. The Malaysia International Islamic Financial Centre (MIFC)

A cooperative network started for the country's financial segment regulators in 2006, including the Bank Negara Malaysia (Central Bank of Malaysia), Securities Commission Malaysia, Labuan Financial Services Authority, Bursa Malaysia (Kuala Lumpur Stock Exchange), Government ministries and other financial agencies and institutions offering bank services, Takaful, re-Takaful, capital market, human capital development and proficient auxiliary services.

II. International Takaful Operators (ITO)

Licenses financial institutions to carry out a broad range of Takaful and Re-Takaful (Islamic reinsurance) business with foreign currencies.

III. International Currency Business Unit (ICBU)

The ICBU is a platform for firms to carry out dealings comprising foreign denominated currencies. It is a scheme that provides opportunities for undertaking international currencies trade in offshore markets and a network by which the accessible technical proficiency and expertise in Islamic finance in Malaysia are being predisposed and exported.

IV. The Malaysian Takaful Association (MTA)

The MTA is an organization founded to offer training, research, and education through institutions such as the International Centre for Education in Islamic Finance (INCEIF) and Islamic Banking and Finance Institute Malaysia (IBFIM). Because of the dissemination of the Islamic financial industry in Malaysia, especially the Takaful industry, some professionals believe that the Takaful industry in Indonesia, Brunei, and Singapore in Southeast Asia might be threefold that of the Middle East by 2015 (Ismail et al., 2011).

2.9 Opportunities and Future Challenges:

The Takaful industry in Malaysia is expected to grow, given the following opportunities:

1. Ongoing government support to propagate the Takaful segment by executing strong regulations, intensifying public awareness and providing adequate assets for investments;
2. Industry players developing innovation Takaful products (e.g., universal life products); and
3. Opportunities in the retirement savings space.

Yet, the Takaful industry is also anticipated to encounter the following challenges:

I. Key Issues and Challenges

- **Lack of consumer awareness**

Many consumers are still unaware of Takaful as a substitute. Some view Takaful as commercialising conventional insurance into the Islamic world and reject the notion that it is a Shariah-compliant instrument. In addition, many individuals tend to downplay the significance of this system; this is particularly evident in the Middle East. Like conventional insurance, Takaful coverage is typically a proposition that needs to be sold to consumers (instead of one that consumers purchase). There is a need to fundamentally address Takaful and individual risk management's educational issues amongst Muslim societies to develop consumer awareness. Most current education on Takaful is among interested or related practitioners and investors, and few awareness campaigns are designed for the target population.

- **Insurance and Shariah Expertise Shortages of Human Capital**

The current small group of specialists with appropriate Takaful expertise in law, sales, and actuarial services can hinder future development. With traditional insurance

experience, most Takaful companies would frequently use human resources. These resources would generally tend to know Takaful's Shariah effectiveness and familiarize their previous knowledge with integrating Shariah compliance laws into their fresh responsibilities. Therefore, standard opinions and resolutions tend to determine the attitude of many carriers and, consequently, creative thoughtfulness in the sector has been limited. Several Takaful classes have been provided recently. The Chartered Insurance Institute (CII) provides training of human resources in both insurance and Shariah skills.

- **Shortage of Shariah Scholars with Enough Practical Experience**

Each Takaful company must have a Shariah Supervisory Committee whose members include not less than three Shariah scholars to supervise its business. Takaful companies face significant regional challenges, so they are required to build confidence in their target markets. Therefore, they must rely on the preferred Shariah scholars and those who have practical experience in the Takaful markets. Shariah scholars should be experienced in Shariah issues in financial fields, especially in Takaful private financial transactions. The Shariah Committee members' main task is to implement and control the work of the Shariah transactions and ensure compliance with Shariah. Unfortunately, the number of Shariah academics with expertise in Islamic jurisdiction and insurance is restricted. Those who are qualified often sit on multiple boards that can generate conflicts of interest and reduce counselling quality. The scarcity of academics continues a short-term barrier and boosts the costs of developing a Shariah board (Ismail et al., 2017).

- **Lack of Standardization in the Industry as a Result of Shariah Explanation**

Because the Takaful sector has only been recognized recently, a broad series of problems are presently being deliberated amongst technocrats and Shariah scholars,

mainly those considering the descriptions and practices considered suitable and Shariah-compliant.

- **Different Legislative Approaches and Absence of Centralized Rules**

The Takaful sector relies on Shariah Committee, which applies Islamic Shariah provisions, subject to any local legislative constraints. However, these local constraints result in the absence of standardization of a worldwide Takaful regulatory scheme. When it comes to coping with Takaful, local authorities have implemented a variety of techniques.

- **Solvency and capital requirements**

Numerous regulatory contexts, specifically those implemented to create a level playing field, create liquidity and principal obstacles for Takaful companies the same as conventional insurance companies. However, the following challenges, which are particular to Takaful companies, need to be resolved. These include

- Suitable attention in treating Qard-El-Hasana in determining solvency necessities for a Takaful operator (i.e., the Qard-El-Hasana);
- Whether the level playing field concept is justifiable in the long run for Takaful;
- Excess dissemination and likelihood reserve techniques that can result in a lesser capital requirement for Takaful bodies;
- Mutual conduct under Solvency II and whether the same approach can be appropriate to Takaful businesses; and
- Treatment and techniques that rating agencies use for Takaful bodies.

- **Corporate governance problems and challenges**

The current relationship between a Takaful operator's Board of Directors and Shariah Supervisory Board is usually one of enormous trust and integrity.

Nonetheless, setting clear, written standards on the Shariah board's scope and duties remain essential. Compliance with Shariah must include all operational effectiveness, the implemented Takaful model, products introduced, investments, fee structures, contract contents, and marketing expression. There are currently no compliance guidelines and normal reference conditions for Shariah boards in the sector.

There are other problems concerning the Shariah board function and potential conflicts of interest among Shariah academics. The risk may be from the Shariah board's primary focus on jurisprudence issues related to Shariah and a lack of focus on major technical issues, such as underwriting, actuarial issues, and broader risk management. Because the management's concern is to maximize shareholders value, this can create clashes with Shariah compliance. There are also issues in the concentration of assets invested in related businesses with interest and risk management (Jaffer et al., 2010).

- **The limited size and capacity.**

Despite relatively rapid growth, the industry is still tiny compared to the conventional insurance market. In 2006, participants' contributions stood at US\$2 billion, accounting for only 1 per cent of the US\$3.7 trillion global insurance premiums. The Takaful assets are estimated to be around US\$20 billion, in contrast to the Islamic banking assets of US\$500 billion. Takaful enterprises need capital injections, making it a challenge to compete with traditional insurances due to a lack of economy of scale for various Takaful operators (Ismail et al., 2017).

II. Practical Challenges and Difficulties

Furthermore, numerous practical problems in the Takaful sector may be relevant to the Takaful industry's evaluation and risk management. Some of the primary technical issues considered are:

- **Handling of Qard-El-Hasana (Interest-Free Loan).**

Qard-El-Hasana or “benevolent loan” is an interest-free loan given by a Takaful Company in the case of scarcity in Takaful finance. Shariah rules do not dictate this development, but an expectation exists that an operator will introduce funds in the case of a shortage. The loan or Qard can then be reimbursed for future surplus development. However, the loan's instrument and subtleties and its consequent payments are highly insecure and lack precision.

- **Determination and Allocating surplus**

Because a third party's risk insurance (risk transfer) is prohibited in Islam, any excess or profit gained from the risk share is prohibited by default. There is a distinction of perspective as to the nature and management of Takaful's supporting surplus, as listed below:

Opinion 1: Because insurance risk transfer is prohibited, Takaful operators may not take advantage of any surfacing surplus underwriting. These must therefore be disseminated to the contributors who guarantee each other together.

Opinion 2: The excess is the result of the extensive risk management of the Takaful operator. A surplus ratio should be distributed as a reward to the operator.

Opinion 3: The underwriting surplus does not benefit either the Takaful operator or the contributors as favourable underwriting experience is considered possible by Allah (Subhanahu wa Taala). Therefore, in the real spirit of Takaful, all surpluses should be provided to charity.

- **Handling of Emergency Reserves**

As an alternative to allocating all surpluses, the possibility of retaining a portion of the underwriting surplus is considered to counter the possibility of future demand for capital maintenance (Jaffer et al., 2010).

III. Future Strategies Can Be Considered for Planning and Implementation

- There is a strong need to form a more globalized Takaful industry through better connectivity across jurisdictions. Takaful operators need to give satisfactory importance to cross-border associations at regional and international levels. This connectivity will not only broaden the market but also more significantly bring disclosure to the different challenges to establish strength and competitiveness.
- Attempts for rigorous branding for Takaful must be developed and implemented. Through intensive branding, the appeal of Takaful to the global community could be increased. The Takaful philosophies of mutuality, transparency, and assistance could be further popularized to produce exclusive products for the global community.
- Globally, Shariah must be the enabler of higher connections for Takaful markets. Research and training in the Shariah and Shariah-related problems and fields may be one strategy to boost the impact of the Shariah and Takaful in all markets that Takaful can serve. The critical shortage of human capacity cannot be overlooked.
- Like any business that deals with numerous customers, Takaful must have appropriate infrastructure to accelerate processes and enhance precision to alleviate risks. These are not limited physical infrastructures such as IT. It needs the reinforcement of the regulatory framework.
- Takaful should not be viewed simply as a business concern because socio-economic support is required. Corporate Social Responsibility activities could reach out to assist in community development.

- The area needs internationally accepted Shariah compliance standards.
- Training on Islamic finance on a global scale should be provided from the core centers of expertise in Islamic finance.
- Awareness for customer needs in insurance, and Takaful (e.g., mortality gap, retirement, pensions, and longevity) is necessary.
- Micro Takaful for the poor should be developed.
- Vigorous new product development should be utilised to achieve the financial needs of modern days consumers. Takaful operators need to offer an exclusive value proposition to compete with conventional offerings.
- The distribution channels should be diversified to reach a greater segment of the market.
- Re-Takaful capacity should be built to cater to the unique principles of Takaful products and to provide essential technical capabilities in managing risks.
- Takaful talent should be developed, particularly in the advisory and operations level.
- Investment should be made in research and development for market divisions, products structuring, and differentiation that would provide advantages to Takaful operators in the long run (Cuyper, 2012).

2.10 Shariah Committee (SC)

The SC comprises Shariah scholars appointed by the IFIs. “The Committee is formed of Shariah scholars, world-renowned experts in Islamic commercial jurisprudence (fiqh al-Muamalat) and finance, with the fundamental role of setting business standards in all situations in which a company needs to ensure that its activities abide by Shariah” (Hassan et al., 2018, Eldaia et al., 2020a). To ensure

Shariah compliance in all transactions and activities, each IFIs prepares an SC, which is unit of a larger Shariah division and a Shariah conformity unit and a Review Unit /Shariah Audit (Ullah et al., 2014, Islam & Bhuiyan, 2019). As part of an institution's internal governance structure, this body functions as an internal control body of the institution, thereby enhancing institutions' credibility in the eyes of its shareholders and customers and enhancing their Islamic qualifications (Rammal 2006).

2.10.1 Shariah Committee Members Criteria:

Members of the SC are distinguished individuals with in-depth knowledge of Islamic Fiqh and finance. Moreover, in the performance of their role, members of the SC must commit themselves firmly to the development of international financial institutions within the framework of Islamic Shariah (Matoussi & Grassa, 2014). In other words, the SC has a unique relationship with the international financial institutions, as it is responsible for monitoring adherence to Shariah procedures for transactions and issuing Shariah products (Wardhany & Arshad, 2012). The SC's existence is one of the most critical requirements because it works to ensure the operations of the institution following Shariah law. The scholars of Islam have stressed the need to pay attention to the SC to promote Islamic governance principles and have dealt with it in many articles and reports. Still, the committee's procedures need to be reviewed and realized (Zeineb & Mensi, 2018).

CG in IFIs differs slightly from traditional corporate governance. IFSB-3 defines the concept of CG in IFIs as a set of organizational arrangements whereby the actions of the management of institutions offering Islamic financial services are aligned, as far as possible, with the interest of its stakeholders (IFSB, 2006); provision of proper incentives for the organs of governance such as the BOD, Shariah Supervisory Board and management to pursue objectives that are in interests of

stakeholders and facilitate effective monitoring, thereby encouraging IIFs to use resources more efficiently; and comply with Islamic Shariah rules and principles (IFSB, 2006; Wardhany & Arshad, 2012). According to (Muhamad Sori, 2015) agree that identified Shariah committee independence safeguards and threats, and implied better effectiveness through clearly defined meaning of independence and guidelines or code of best practices as a guide for the committee and related parties.

2.10.2 Shariah Committee Role:

The SC's main objective is to ensure that Islamic institutions operate according to Islamic principles and ethics as stipulated in the regulations and legislation that professional and legal authorities have adopted (Rammal, 2006). The SC advises the BOD on Shariah issues to ensure that the processes comply with Shariah philosophies, authorizing and validating related documentation about services and products, and the manuals and marketing advertisements and internal policies (Hasan, 2009).

Excellent dynamic Shariah governance is at the core of the evolution of Islamic financial growth dynamics (Hasan, 2009). Shareholders concerns may extend further than financial interests to religious, ethical or other values when demanding good corporate governance. In IFIs, shareholders and Islamic scholars require activities and services offered to comply with Shariah law; otherwise, no permission will be granted.

According to Grais and Pellegrini (2006). Shariah Supervisory Board has five main prerogatives. These are an endorsement of permissible financial tools through fatwas (ante-Shariah audit), investigation of transaction compliance with a delivered fatwa (post-Shariah audit), accounting for and payment of Zakat, removal of non-Shariah payment compliant receiving, and recommending the distribution of expenses or income among the institution's shareholders and investor. (Grais & Pellegrini, 2006; Alnasser & Muhammed, 2012)

CG literature has been very interested in SC because it is an essential and distinctive committee in governance today. A group of studies has pointed out that an SC should be composed of those with various knowledge and experience. This view confirms that the board's diversity plays an important role and provides benefits to improve committee performance and, thus, the institution's performance. Scholars from different backgrounds can help solve problems in different ways, which adds creativity and flexibility to the Shariah Committee (Grassa, 2016).

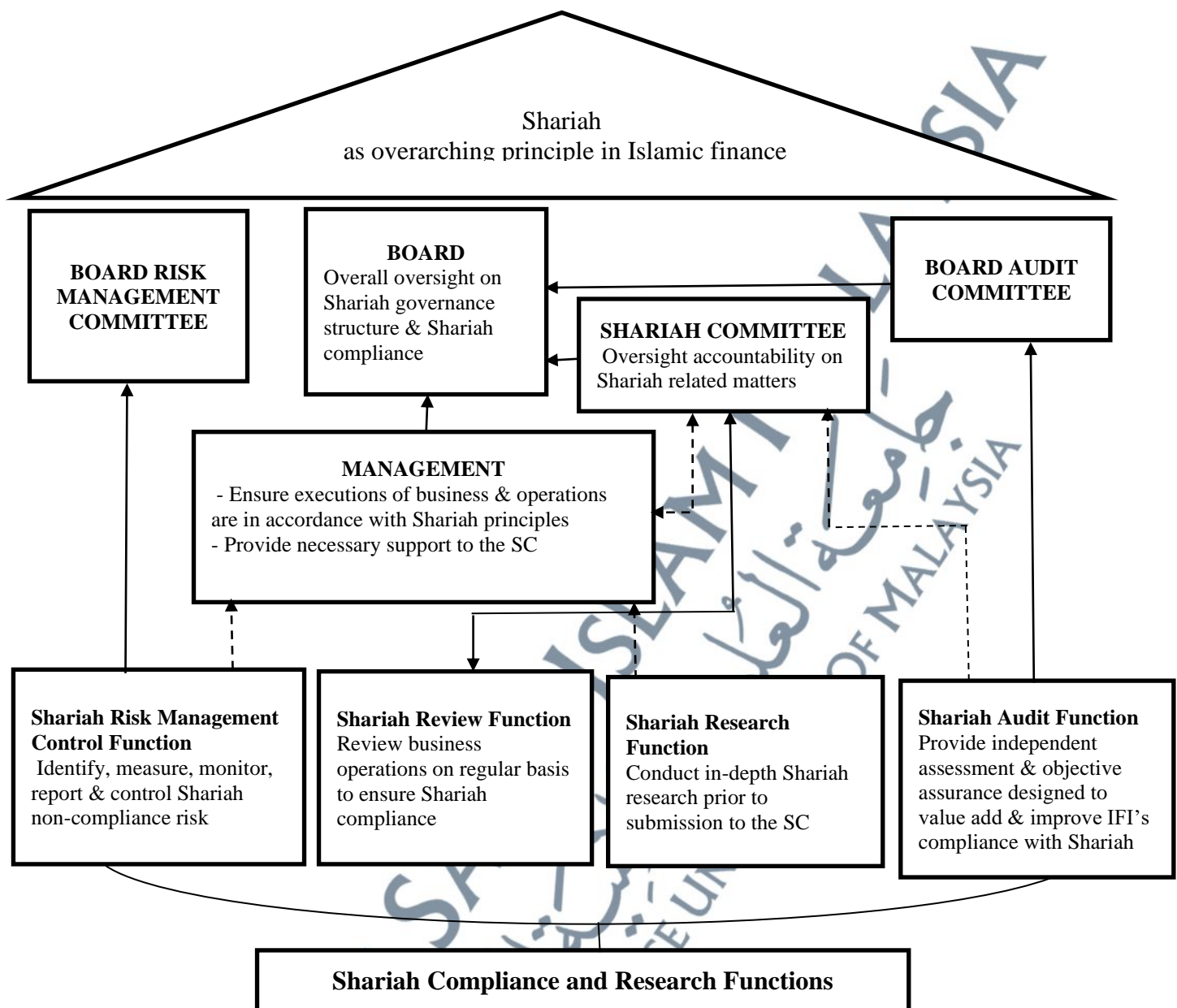
Suleiman (2000) argued that an effective SC leads to strict loyalty to Islamic religious principles and ethics, which will counterbalance motivation problems and moral risk behaviour. Indeed, Islamic legislation will prevent employees and management from acting illegally or immorally while reducing incentives costs. Islam serves as an incentive to increase staff and committees' efficiency while reducing costs resulting from asymmetrical information and risks resulting from immoral behaviour. Therefore, an effective SC leads to additional efficient monitoring by an organization, and the profits from monitoring are joint by all stockholders.

The Shariah Advisory Council of Bank Negara Malaysia was established in 2009, which recognized under Section 51 of the Central Bank of Malaysia Act. This council serves a supreme reference to ensure Islamic law application in institutions operating in the Islamic financial business (Alnasser & Muhammed, 2012). The act says that

The BOD of an IFIs upon recommendation of its Nomination Committee shall appoint the members of the SC. The appointment and reappointment of an SC member shall obtain prior written approval of Bank Negara Malaysia. The appointment shall be valid for a renewable term of two years (BNM, 2009).

An increasing number of international and national level conferences, seminars, and workshop programs to deliberate issues related to Shariah governance in IFIs have been conducted (Hanefah & Kamaruddin, 2019). These programs involve not only academia but also experts in Shariah governance who are interested in the issues. Moreover, these conferences and programs have helped enhance societal awareness and understanding of Shariah governance and assurance and put this agenda on a higher pedestal over the past few years (Kamaruddin et al., 2020).

The BNM (2005) issued framework is divided into six segments explaining the Shariah governance framework's general requirements, responsibility and accountability of the board, oversight, independence, competency, consistency, confidentiality, research functions and Shariah compliance. BNM introduced the Shariah Governance Framework (SGF) in 2010 and required all Islamic Financial Institutions to fully implement in 2011 (Muhamad et al., 2015). The Shariah governance framework has three primary segments: the board, the management, and the SC (See Figure 2.7). Each department participates in ensuring the implementation of the basic principles and legal guidelines. Shariah compliance functions support these sections, including audit functions, Shariah review and Shariah, strengthened by Shariah risk management procedures (BNM, 2010).



Source: (BNM, 2010).

Figure 2.7: Shariah Governance Framework

The real goal of creating BNM-SGF is to provide guidance on operations, structure and decisions in order to conform to the principles of Islamic law (Fatmawati et al., 2020). The framework shows that a sound and robust Shariah governance framework is reflected by an effective and responsible board and management, an independent Shariah Committee that is both competent and accountable, supported by

a robust internal Shariah research capacity, and monitored through active Shariah review, Shariah audit and Shariah Risk Management Department. The effective practice of good governance requires all those involved to carry out their responsibilities in the best manner possible with the infrastructure support in the form of procedures, processes and oversight mechanisms. For an IFIs, the oversight mechanism is usually done by their Shariah department. In Malaysia, this is further strengthened by the Central Bank's requirement that all IFIs are required to have a Shariah Committee (Bahari & Baharudin, 2016). The SGF grounded on the epistemology of tawhid and shura for each level of institutions that describes the roles and functions, goals and principles of Shariah (Choudhury & Hoque, 2004).

According to Abu & Sharif (2014) From the study participants and agents accordingly viewed that takaful operators are handling their activities in accordance to maqasid of Shariah. The interviews also indicated that each takaful operator has its own processes, policies and procedures and are conforming their activities to Shariah. The basis of these policies are established in line with the Shariah Governance Framework and each process is done with the aim to achieve the *Maqasid of Shariah* (Abu & Sharif, 2014).

The *Shariah Governance Policy Document* (SGPD) issued by the BNM on 19 September 2019 strengthened the oversight accountabilities of the BOD, the SC, and other key organs that are involved in the implementation of Shariah governance. Besides, this policy document also relates to the SC's objective to effectively manage Shariah non-compliance risks by strengthening their decision-making process and internal control functions. By implementing SGPD 2019, it is expected that IFIs will have a better arrangement in supporting a strong Shariah compliance risk culture. This is based on more active roles from the BOD, the SC, and senior management.

Generally, there are six main parts highlighted in SGPD 2019, covering: (i) the BOD; (ii) SC; (iii) senior management; (iv) control functions; (v) Shariah compliance culture and remuneration; and (vi) transparency and disclosures (Kamaruddin et al., 2020).

SGPD spells out the responsibilities of the SC, SC meetings, appointment, cessation and disqualification of the SC, SC composition and secretariat to the SC. Among the SC responsibilities include provides an outline that stressed on their mandate, responsibilities and procedures, provide objective and sound advice to the IFIs, responsible for every decisions and advice made, develop a comprehensive procedure to guide its decision-making process, immediately update the BOD on shariah issues, requests for a ruling or advice from the SAC or advice and submit SC decisions and advices to the BNM. Besides, responsibilities of the individual SC members are to exercise objectivity and free from conflict of interest, allocate adequate time for preparation and for attending the SC meetings, ensure consistency in providing their views and not contradict with the SAC and SC rulings, inform on the nature and extent of his or her conflict of interest with the IFI and constantly learns to understand the IFIs' business and operations (BNM, 2019).

- **The Duties, Responsibilities & Accountability of the Shariah Committee are as follows:**

- 1. Responsibility and accountability**

The SC must understand that it is accountable and responsible for all Shariah decisions, views and opinion it submits to the decision-makers. This is among the duties and responsibilities of the SC.

2. Recommendations to the board and IFIs

The expectation is that the SC will advise the Board and offer a response to IFIs on Shariah issues so, that IFIs will comply with Shariah principles at all times.

3. Approve Shariah procedures and policies

The SC is to approve Shariah procedures and policies prepared by the IFIs and ensure that all transactions do not violate Islamic shariah.

4. Endorse and validate relevant documentations

a. To guarantee that the products and services of the IFIs meet the terms with Shariah law, the SC must approve:

- The conditions and terms enclosed in the forms, agreements, contracts, or other legal documents used in performing the transactions; and

- The marketing advertisements, product manual sales diagrams and brochures used in marketing the product.

5. Evaluate duties carried out by Shariah audit and Shariah review

To evaluate the duties carried out by the Shariah audit and Shariah review to guarantee compliance with Shariah principles that are part of their duties and responsibilities in providing their valuation of Shariah compliance and insure information in the annual report.

6. Support interrelated parties on Shariah issues

It expected that the SC would offer the necessary support to the requesting party. The associated parties of the IFIs such as its auditor, consultant or legal counsel, may looking for advice on Shariah issues from the SC.

7. Provide recommendations on problems to be referred to the SAC

The SC may recommend the IFIs to ask the SAC on Shariah matters that difficult be resolved.

8. Deliver written Shariah views

The SC is required to deliver written Shariah views in situations where the IFIs make mention to the SAC for extra deliberation, or when IFIs submits applications to the IFIs for new product approval (BNM, 2009).

Jensen and Meckling (1976) argued that an increased CG quality level reduced the management's opportunistic behaviour and, therefore protected the shareholders' interests, minimized agency problems, and consequently enhanced firm performance. Regarding Takaful companies, Grassa (2016) argued that an inefficient Shariah supervisory system increased the risk of IFL non-compliance, which affected the majority of investors and clients' confidence and consequently decreased the performance of IFIs. Finally, in a similar empirical study, Mollah and Zaman (2015) found that SB positively affected IB's performance. In connection with disclosure, Farook et al. (2011) asserted that the existence of SB in an IB increased its disclosure level. Based on this discussion, it can be concluded that the more the IFIs had an effective SB, the more the managers of better-performing IFIs disclosed high-information quality.

2.11 The Impact of COVID-19 on Malaysian Takaful and Future Challenges

The COVID-19 infection first reached Malaysia shores on 25 January 2020, with a forty-one old man from Selangor who became the reference case Malaysian to be infested by the COVID-19 (Abdullah, 2020). Along with this, there are four established cases in kids who were diagnosed with the virus in Malaysia. The cases varied from infant and adult of age and all 4 cases were probable gotten from China.

Out of these, only one was a Malaysian that spent holiday break in Wuhan to celebrate Chinese New Year been a mother origin. The infection reached 22 positive cases in February. By middle March, the cases had swollen to 20-times with 428 cases.

It is a clear fact that the COVID-19 had a momentous impact on the financial markets globally. The economic impact of the virus incidences on the takaful industry is regarded as severe but temporary, and the Islamic insurance market would slowly and steadily recover by year-end (Goodell, 2020). The COVID-19 upsurge is still persistent around the world, the downside risks remain, reflecting on the high level of uncertainty throughout the impetus of the spread of COVID-19 and its eventual global pinnacle (Calvin, 2020). The productivity and effectiveness of the Takaful business, in general, are also anticipated to be tense in the hard economic environment, as the industry has seen thin net supporting boundaries, particularly in Malaysia (Conefrey & Walsh, 2020).

When the position of Malaysia takaful amid COVID-19 explores in terms of global available support, many international organizations have assumed a position to offer lends and other financial assistance to nations in need to help alleviate the shock due to the new virus pandemic. These and other engagements have been considered as “unprecedented,” a term that has been applied often to designate a COVID-19 and strategy reactions. The challenge for legislators is remained in place, as the legislators are shoulder with the responsibility of applying targeted guidelines to address what is to be expected to form short-term COVID-19 crisis issues without making alterations in economies that can last for long after the effect of the COVID-19 itself. Conversely, legislators are being devastated by the rapidly varying characteristics of the universal health crisis with a great impact on international trade and economic crisis (Goodell, 2020).

As the economic effect of the coronavirus continues, the legislators are considering strategies that address the direct economic effects at the expense of longer-term concerns, including debt accumulation. Originally, several legislators felt reserved in their capability to respond to the crisis because of restricted suppleness for financial and economic support within traditional values given the broad-based go-slow in universal economic development, particularly in industrial and trade that had established before the COVID-19 pandemic. Likewise, these policies have a direct impact of takaful operations in Malaysia, since they affect individuals who the main human resources of the takaful industry and the market operations. Because Takaful contract long-term the real effect of COVID-19 will appear and measured after October and December 2020. This will be a challenge that has to be dealt with in the future, following persistent of the COVID-19 pandemic (Eldaia et al., 2021).

By this time, it is obvious that the pandemic has intense detrimental effect on both the Malaysian macroeconomic and economic welfare of the people. Bank Negara Malaysia in 2020 has forecast that GDP growth will fall between 3.5% and 5.5%. Currently, unemployment is expected to rise to 5%. Islamic economy is also being affected by the virus incidence. The Malaysian Takaful industry is not excluded from the anticipated impact of the economic slowdown in 2020 amid the COVID-19 pandemic. Apart from considerably hampered growth in 2020, Takaful operators will also have to cope with the increased volatility and rising credit risks of their investments in 2021 and may be 2022. During the pandemic spread of COVID-19 the Malaysian government took financial actions to save the economic sector and to reduce the negative effects of MCO. Malaysian Takaful companies provide better service by using new technological tools; thus, to maintain the operations and social responsibility (Eldaia et al., 2020c).

2.12 Chapter Summary

This chapter discussed CG's background and had an in-depth examination of the CG development stages in Malaysia. Further, it highlighted the Malaysia code on CG since 2000 and the revisions strengthening this code. The concept of Takaful was also discussed in general and the Takaful industry, especially in Malaysia. It presented regulations that dealt with the Takaful industry and clarified models of Takaful transactions. The chapter explained conventional insurance in Malaysia and the comparison between Takaful and conventional insurance. Finally, SC was presented as an essential part of IFIs, especially in Takaful companies in Malaysia, and details the responsibility of SC and duties that must be followed to implement an efficient role in Takaful companies. An efficient Shariah governance adds additional values to the existed corporate governance framework. It inculcates transparency, trust, ethical behavior, credibility, values underlying faith and beliefs and *Akhlaq*.