Abstract: Many Muslim scholars maintain that the commercial insurance contract is invalid from the Shari`a perspective based on the fact that it is a financial exchange contract, which is overwhelmed by banned elements such as gharar (uncertainty), riba (interest), and maysir (gambling). Alternatively, a Shari`a-compliant insurance scheme, known as takaful, was introduced in the late 1970s that supposedly operate on the principles of mutual co-operation. Nonetheless, since the majority of existing initiators of this lawful scheme are mainly joint-stock or public limited companies (plc), it seems that the initial concept of takaful was later overshadowed by the element of profit-making observed in commercial insurance entities. The sharing of an underwriting of surplus by the takaful companies is one of the contentious issues related to this form of ‘commercialisation’. This paper therefore sets out to examine the above issue from the Islamic point of view. It argues that since the sharing of surplus in commercial insurance arrangement has led to its prohibition, the same could possibly apply to the present takaful undertaking. This study is mainly qualitative and relies greatly upon the documentation method. It is also based on a fieldwork method, since the business models adopted by several takaful operators in Malaysia are carefully examined. In general, it is found that the surplus sharing practice in takaful entity may not be totally forbidden as in the case of its conventional counterpart.

Keywords: Takaful, surplus sharing, performance fee, tabarru’, ji‘ala

1.0 INTRODUCTION

The majority of the literature found on the subject of Islamic insurance or takaful tends to greatly emphasize the mutual aspect of this Shari`a-compliant risk management technique. Despite being plausibly established, the element of mutuality appears to represent only half of the overall takaful structure, i.e. the contractual relationship amongst the participants only. Another half of the structure, which is also called the ‘second-tier’, seems to revolve around the contractual relationship between the participants and the takaful operator. The contracts that govern this relationship are deemed to be more commercial in nature, unlike tabarru` and ta’awun. Those contracts which include mu`a’araba, partnership, wakala bi ajr, paid agency, and ji‘ala, reward, are widely used by the operators through their business models in order to legally secure their income and profits [1]. One of the most contentious issues related to the above profit-seeking motive, which has yet to find an amicable solution, is perhaps the practice of surplus sharing amongst the operators. This particular issue has been highlighted and debated in various takaful conferences and seminars. Furthermore, many contemporary scholars and Islamic finance experts seem to reject the practice on various grounds. This article aims to analyse critically the above issue in the light of the Malaysian takaful industry practices.
2.0 THE DEFINITION OF AN UNDERWRITING SURPLUS

In general, surplus or underwriting surplus in a takāfūl undertaking is normally defined simply as an excess of the participants’ contributions over claims in the risk pool (i.e. Participant’s Risk Fund or PRF)[2]. Despite being simple and easily comprehensible, this description may ignore certain aspects and details that are usually involved in the determination of the surplus which can be distributed to both the participants and the takāfūl operator. One of the major problems with the above definition is that it indirectly denotes that all other expenses apart from the claims are to be borne by the operator (or to be specific, the shareholders) in order for the surplus to be derived. Perhaps a better definition of underwriting surplus can be found in the AAOIFI’s Accounting, Auditing and Governance Standard for Islamic Financial Institutions. In Standard No. 13 (Appendix B) of the above publication, underwriting surplus has been defined similarly, although with more deductions that can be made from the risk fund [3].

Insurance or underwriting surplus is the excess of the total premium contributions paid by policyholders during the financial period over the total indemnities paid in respect of claims incurred during the period, net of reinsurance and after deducting expenses and changes in technical provisions[3].

Similarly, in the AAOIFI’s Sharī‘a Standards, Standard No. 26 (Appendix C), surplus has been described as “[comprising] residual premiums of the participants (the insured) in addition to the reserves and profits, after deducting all expenses and indemnity amounts (paid or payable during the same year)”[4]. It further states that this excess amount is distinct from profit. Perhaps the latter statement is deliberately stressed to address some confusion in the takāfūl industry, particularly related to the application of the modified muḍāraba model whereby muḍāraba profit is considered equivalent to the definition of surplus. This matter has been dealt by the author in other research paper.

Another definition of surplus can perhaps be inferred from the Pakistan Takāfūl Rules 2005 (under the Insurance Ordinance 2000). Under sub-rule (4) of rule 14, the surplus is determined by the following formula:

Surplus shall arise from the total contributions paid by the participants to the PTF (Participants’ Takaful Fund) less the total value of claims paid (less claims received from reTakaful or reinsurance and recoveries made) to them for the risks covered under the PTF, less Takaful operator’s fee charged related to Takaful operations managed by the Takaful operator, less commission paid to the intermediaries and the change in technical reserves [5].

It is apparent from these three definitions that takāfūl operators are allowed to charge some expenses to the PRF before any surplus or deficit can be declared. In other words, not all expenses need to be borne solely by the shareholders’ fund, as suggested by the above simple definition. Apart from indemnity or benefit payments, other expenses which may also be charged to the PRF include re- takāfūl costs, wakāla fees (if applicable), claims handling fees, loss adjuster fees, risk survey fees, medical test costs, hospital reports and other underwriting-related expenses. Shareholders, however, should bear other operational costs including marketing, agent’s commission, administrative and investment expenses. It is also
acknowledged from these definitions that technical reserves or provisions will be taken into account in determining the surplus. In most cases, *takaful* operators are required to set up several reserves out of the PRF. These reserves may include: (1) unearned contributions reserves; (2) incurred but not reported reserves; (3) deficiency reserves; (4) contingency reserves; (5) reserves for *gardi hasan* to be returned in the future; and (6) surplus equalization reserves [5]. Moreover, they tend to indicate that the PRF will possibly be invested by the operators/shareholders to enhance its capacity for meeting all claims and other related expenses. Likewise, the surplus itself, if any, may be further invested according to AAOIFI depending on the approval of the participants [3].

Another dimension of the definition of underwriting surplus tends to revolve around the idea of assets and liabilities. Accordingly, surplus has been described as the excess of *takaful* fund assets over the fund liabilities outstanding at any given point in time. The major component of the fund liabilities will be the amount needed for future claims [6]. Although this may appear to be simple and straightforward, the actual actuarial calculation of surplus as provided by Ismail and Abdul Razak is rather complicated and greatly depends on how *takaful* fund assets and liabilities are valued.

On the assets side, statutory or regulatory definitions of which assets will be counted and which assets will not have a significant consequence on the level of *takaful* assets and, accordingly, the surplus recorded [6]. For instance, a *takaful* operator which has invested its risk fund in thousands of pounds’ worth of assets may have those assets excluded in the process of determining its statutory assets. As a result, the remaining allowable assets in the risk fund may be inadequate to meet risk fund liabilities. On the liabilities side, the reserving basis or set of assumptions used in calculating or valuing the actuarial liability provisions may also influence the level of reserves and consequently the level of surplus available. As a general rule, the more conservative the reserving basis, the higher the provisions or reserves for liabilities and therefore the lower is the surplus on hand. However, the actual amount of surplus that would be unveiled at any point during a financial period is influenced by the difference in the valuation basis and what has emerged in reality.

Ismail and Abdul Razak further argue that the obvious sources of surplus in a *takaful* risk fund will arise from several factors, including the following:

1. Difference between mortality experienced and assumed in calculating the actuarial valuation reserve;
2. Difference between actual investment performance of the fund and that assumed in calculating the actuarial valuation reserve; and
3. Difference between funds paid (if any) to surrendering participants and the release (i.e. writeback) in liability provision or reserves on surrender [6].

From the above definitions it can be concluded that the availability of a surplus or an underwriting surplus is the function of the level of the PRF, which is wholly contributed to by the participants, being more than the amount required for the purpose of paying indemnity and other related expenses including the reserves. Nevertheless, the actuarial calculations involved in determining the actual amount of surplus in a *takaful* undertaking at any point in time are by no means less complicated than its conventional insurance counterpart. This is true particularly when the actuarial tools found useful in commercial insurance practices may
also be employed in takāful schemes. However, it is admitted that some differences can still exist in determining the surplus in both takāful and insurance institutions, especially when the former should always conform to the law of Sharī`a. Takāful operators may also differ from one another in terms of their business models, which could affect the level of surplus recorded at any particular time. Some operators may invest the PRF and immediately acquire some portion from the investment profit, while others might not. Regardless of the different angles and perspectives engaged in defining the surplus, it is perhaps much easier to describe the subject based on the following formula or equation.

![Takāful Surplus Equation](image)

Based on the above diagram, the takāful fund is likely to record a surplus if the amount credited into the PRF during a particular time period is larger than its corresponding outflow, which comprises claim payments and other operational expenses including reserves. Conversely, a zero surplus or deficit is likely to be recorded in situations where the PRF revenues are equal to or less than the subsequent PRF expenses respectively. The latter situation may normally occur during the first few years of a newly launched takāful operation, whereas the former will usually be achieved when the takāful operation has shifted from its introductory phase to a more stable phase, i.e. either growth or maturity [1].

### 3.0 LEGAL OPINIONS WITH REGARDS TO SURPLUS ENTITLEMENT AND DISTRIBUTION

In general, the practice of distributing surplus in the takāful industry is greatly influenced by several legal rulings issued on the ownership of the surplus itself. Since the surplus is basically derived from an unused portion of the participants’ contributions, it can be easily understood why surplus is commonly judged as the property of the participants but not of the operators or shareholders. Yet since the contributions are normally paid on the basis of tabarru’, some may also argue that the surplus is actually detached from the participants’ ownership. Consequently, the distribution of surplus to the participants as well as to the operators may be deemed appropriate by certain jurisdictions but not others. At present, there are at least three rulings issued by Sharī`a scholars concerning this matter.

#### 3.1 Surplus Belongs neither to the Participants nor to the Operator

At one end of a continuum, some scholars are of the opinion that both the participants and the shareholders (or operators) may have no rightful claim to the takāful surplus. This ruling is apparently made on the basis that the participants’ contributions are considered to be pure tabarru’. According to Ma`sum Billah, the term tabarru` is similar to ṣadaqa, charity, or hiba, gift, whereby it is unlawful for the donor to seek any benefit from the donated property after it is given away [7]. Since the participants have relinquished their rights to the amount
contributed to the PRF, any surplus that arises therein should go to charity instead [2]. The shareholders, as mere trustees of the fund, obviously cannot make any claim (to the surplus) on any grounds.

This view has recently been shared by Soualhi, who maintains that the participants’ contribution is to be considered as pure hiba, hence will render the amount donated to be no longer under their ownership. He further argues that the reliance on the contract of hiba bi shar’t al-`iwad, conditional gift for a consideration, cannot also render the surplus belonging to the participant [8]. The author, however, has proven that the latter contract is actually good for establishing the participant’s entitlement not only towards making claims but also for sharing in the surplus [9]. Yet Soualhi emphasizes that the absence of a rightful ownership of the surplus does not necessarily mean that it cannot be distributed. In fact, he appears to encourage the distribution of surplus to both the participants and the operator based on the use of general principles of law (i.e. mašlaṭa, public interest, and `urf, customary practices) provided that the parameters of equitable surplus distribution are carefully observed. Some of the suggested parameters which are meant for both the participants and the operators are listed as follows [8]:

(1) The ratio of surplus distribution is to be decided by both takāfūl operators and the participants or their representatives in the administrative board;

(2) The takāfūl operator may or may not share in the underwriting surplus depending on the model adopted, which should be approved by the respective Sharī’a board;

(3) It is permissible for a takāfūl operator to dispose of the underwriting surplus with the prior approval of the participants;

(4) The ratio of surplus sharing may not necessarily have a numerical equivalence, such as 50:50, in order to have an equitable surplus distribution. The mašlaṭa, `urf, and `adāla, justice, must be the main Sharī’a principles that help determine such ratios;

(5) It is permissible to adopt different surplus distribution ratios according to the different lines of products; and

(6) It is permissible to state in the policy that the ratio of surplus distribution may be reduced as a result of the default record of the participants

3.2 Surplus Belongs Exclusively to the Participants

In the middle of the continuum, several verdicts have been endorsed confirming that the participants are the only rightful owner of the surplus, since it is the fā‘id, remainder, of the participants’ contributions that are not put to use [3, 10, 11]. Hence, the surplus may only be validly distributed amongst themselves. The shareholders do not have any rights to the PRF’s excess, as it belongs collectively to the participants. Apparently, this ruling is consistent with the general assumption made on the legal status of the PRF itself (i.e. as shaksīyya i’tibāriyya, legal personality), in which it technically belongs to the participants as a group but not to the operator [4, 12]. One of the important verdicts made to this effect can perhaps be inferred from the AAOIFI’s Sharī’a Standard No. 26 regarding Islamic insurance. Item 5/5 of the Standard maintains that surplus can only be used for the benefit of the participants.
The adopted rules may comprise disposal of the surplus in a way that serves the cause of common interest of the participants, such as accumulation of reserves, reduction of the contribution, charitable donations and partial/full distribution of the surplus among the participants. The managing company is not entitled to any share of the surplus [3, 4].

Similarly, in Pakistan, it is stated in the Takāfūl Rules 2005 that any surplus should only be distributed amongst the policyholders. Under sub-rule (2) of rule 10 it is stated that “the income of the Shareholders Fund shall not be determined with reference to the surplus in the Takaful Fund” (i.e. PRF). Furthermore, under sub-rule (5) of rule 14, the participants’ exclusive entitlement towards the surplus is affirmed [5].

The rest of the surplus shall be distributed to participants in proportion to the contributions to the PTF (i.e. PRF) net of any risk related claims, which they may have received during the intervaluation period.

This particular view appears to be held by most Sharī‘a scholars in the Middle Eastern region and obviously Pakistan due to the specific rules mentioned above. Yet some scholars in other parts of the world, including Malaysia (where the distribution of surplus to the shareholders is pronounced lawful by BNM), may also find the above resolution very convincing. In fact, it could be said that most contemporary scholars and experts in the field of Islamic finance concur with above ruling. According to Ayub, based on the ongoing scholastic discussions and studies, many scholars feel that the entire underwriting surplus should only belong to the participants, while the operator should get wakāla fees and/or share in the muḍāraba profit [13]. Mohd. Kasim, on the other hand, argues that it may seem weird that the policyholders have to split any surplus with the shareholders whilst any deficit in the risk pool (i.e. PRF) is borne solely by the former [2]. In addition, Abdul Wahab, K. Lewis and Hassan argue that the practice of sharing surplus with the shareholders is unacceptable and may render takāfūl almost the same as conventional insurance (other than investment in Sharī‘a -compliant instruments).

Sharing in underwriting surplus is something that does not appear to be in line with the concept of mutual assistance and hiring of the professional expertise of a risk manager, although it may be argued that it is meant to provide an incentive to the operator to better manage the risk … The view of most prominent Sharī‘a scholars in this regard is also that any sharing in surplus by way of incentive is not permissible [14].

Nevertheless, the shareholders may not be prevented from taking the surplus in order to recover the amount of ḍār al-ḥasan, benevolent loan facility, extended to the PRF in the case of deficit. The former may also hold a portion of the surplus as a contingency reserve over and above the technical provisions. In addition, they may invest the surplus (with the permission of the participants) and in exchange may earn additional income either in the form of a percentage of the investment profit or a fixed fee [3, 19].

### 3.3 Surplus is Judged to be Claimable by Both the Participants and the Operator

At the other end of the continuum, some Sharī‘a scholars permit the shareholders to share in the underwriting surplus with the participants [3,19]. This ruling appears to be concluded by
the majority of scholars in Malaysia and Bahrain, as exemplified by the common practice of
the operators therein whereby they are allowed to acquire a certain proportion of the surplus,
if any, either directly (under the notion of surplus sharing) or indirectly (under the notion of a
performance fee). As for the Malaysian case, it was discovered in 2011 that six out of eight
takāful operators have been permitted by their Sharī‘a Boards in to transfer certain
percentages from the PRF surplus to the Shareholders’ Fund. Those operators are Syarikat
Takaful Malaysia Sendirian Berhad (STMB), Etiqa Takaful Berhad (ETB), Takaful Ikhlas
Sendirian Berhad (TISB), Sun Life Malaysia Takaful Berhad [(SLTB) formerly known as
Commerce Aviva Takaful Berhad(CATB)], MAA Takaful Berhad (MATB) and HSBC
Amanah Takaful Sendirian Berhad (HATSB). STMB, however, is claiming to share the
surplus under the provision of muḍāraba profit since it applies the modified muḍāraba
business model [1].

This is not surprising, since the practice is basically deemed valid by the BNM. In 2007, the
Sharī‘a Advisory Council of BNM made a resolution that the distribution of surplus to the
participants and the shareholders from the tabarru‘ fund (i.e. PRF) for both General and
Family Takāful schemes is permissible from the Sharī‘a perspective. It is argued that this
decision is based on two underlying premises, as follows [15]:

1. The takāful contract is mainly established on the Sharī‘a principles of tabarru‘,
donation, and ta‘āwun, mutual co-operation; and

2. The permissibility to charge a ‘performance fee’ by the takāful company.

It seems that the first premise tends to justify the allocation of surplus amongst the
policyholders based on the underlying contract of tabarru‘ and ta‘āwun. As shown by the
author in other research paper, this contract (particularly in its specific form of hiba bi sharṭ
‘iwaṣṭ) has indeed offered strong justification for the participants to receive the surplus in the
form of permissible rujū‘ or mere hiba from the Fund. The latter premise, on the other hand,
can perhaps be substantiated by the use of the ji‘āla (reward) contract, as suggested by the
respective operators during earlier conducted interviews [1]. Nevertheless, neither the
operators nor BNM have formally indicated the use of this particular contract (in writing) in
support of the above performance fee. The suitability of using ji‘āla for the above purpose
will not be examined in this article as it will be discussed in different research paper. In
BNM’s latest guidelines entitled “Guidelines on Takāful Operational Framework”,
the resolution to allow the operators to acquire a fraction of the PRF surplus (under the
performance fee) is further enhanced by specifying the following requirements which need to
be observed by the operators [16]:

1. The performance fee can be taken only if the participants’ portion of the PRF surplus
is also paid or accrued to the participants;
2. The total amount of remuneration from the PRF payable to takāful operators shall not
exceed the amount of surplus paid or accrued to the participants;
3. There is no outstanding qard due to the shareholders’ fund at the point where surplus
is determined; and
4. The performance fee is in line with the takāful operator’s policy on the management
of surplus.

In conclusion, it appears to the author that the third resolution is more sensible than the first
two rulings. It is suggested that the participants (collectively) will continue to become the
rightful owners of the PRF and hence its surplus based on the fact that the PRF is a legal personality (although not fully) that represents the rights and liabilities of the participants as a group. Even if the PRF were to be considered as a separate entity without the participants’ ownership, it could not deny the latter’s entitlement to the surplus based on the provision of permissible rujū, as suggested earlier. Alternatively, an arrangement could be made by the operator (as the appointed manager of the PRF) which results in the distribution of surplus to the participants under the notion of hiba from the PRF.

Similarly, the lack of ownership on part of the operators with regards to the Fund will not necessarily prevent them from getting a fraction of the surplus. In fact, the operators as the administrator of the PRF may legally acquire any amount of the surplus so long as it is consented to and approved by its rightful owner (i.e. the participants or the Fund itself as a separate legal personality). Perhaps this can be achieved through the application of certain appropriate contracts (such as ji‘āla for instance), which necessitate the owner to allocate a fraction of the surplus to the operators or shareholders under certain conditions. This is thought to be consistent with the following hadīth: “Muslims are bound by the conditions they stipulate to each other, except when those conditions prohibit what is permissible, or permit what is prohibited [17].” Therefore, it is perhaps erroneous to propose the non-distributable feature of surplus to the shareholders as an absolute standard for the entire takāful industry.

It is suggested that the above matter should be evaluated on a case-by-case basis, since different operators may adopt different business models, hence different sets of contracts. Arbouna seems to concur with this approach, as he argues that the decision about whether or not to allow the shareholders to share in the surplus is not a fixed rule or principle. While the practice may be unacceptable under a particular rule, the sharing of surplus with the shareholders may be justified under some other Sharī‘a principles (or contracts) [10]. For example, the sharing of surplus (termed profit) under the modified muḍaraba model appears to be inappropriate, since it would lead to the grave alteration of the definition and recognition of muḍaraba profit. On the other hand, the surplus attributable to shareholders under the wakāla model might be justified under the contract of ji‘āla, as it is commonly maintained by takāful operators in Malaysia. The legitimacy of this claim, however, will be evaluated in other research paper.

In should be noted, however, that since the business models and the corresponding contracts were actually designed and proposed by takāful operators without direct involvement from the participants (or their representatives in the administrative board), certain parameters must be established in order for the surplus to be appropriately and justifiably allocated to the shareholders. This set of guidelines is also crucial to ensure that the practice is disengaged completely from forbidden elements that could invalidate any contract, particularly gharar, jahāla and injustice/unfairness. The rule of gharar is thought to be applicable to the practice of surplus distribution, since it is mainly based upon mu‘āwaḍa-type contracts (such as ji‘āla and muḍaraba) rather than tabarru‘. The practice may also invoke the issue of unfairness, since in most cases the share of surplus attributable to the operator is considered as a ‘performance fee’ that needs to be borne by the participants or PRF, despite the fact that the former has already been remunerated by the latter via wakāla fees. Perhaps what Soualhi and BNM have suggested earlier can constitute the basis of the parameters regardless of the specific contract chosen to underlie the practice of surplus allocation to the shareholders.
4.0 METHODS OF ALLOCATING THE UNDERWRITING SURPLUS TO THE PARTICIPANTS

Before further analysing the issue of surplus distribution to the shareholders, it is perhaps useful to highlight several methods adopted by takāful operators to distribute surplus amongst the participants. These methods are thought to be applicable to all takāful models regardless of whether or not the surplus is subject to the shareholders’ entitlement. According to Soualhi, there are three major modes of surplus distribution adopted by takāful operators worldwide. These modes are either pro-rata, selective of off-setting [8]. The following paragraphs will explain each of these modes in detail.

4.1 Pro-rata Mode

Under this mode, the surplus, if any, will be distributed in proportion to the contribution paid by the participants, regardless of their account status (i.e. either claimable or non-claimable). In other words, each and every participant is entitled to the surplus allocation regardless of whether or not he has received compensation on the policy during the financial period. Soualhi argues that this approach is in line with the objective of takāful ta’āwnī, co-operative takāful, which provides a mutual guarantee and reciprocal risk protection. Nonetheless, this mode appears to be inappropriate should the participants’ contributions be regarded as hiba bi sharṭ ‘iwāḍ, as suggested by the author. Under this particular contract, the distribution of surplus is parallel with the concept of permissible rujū, retraction of hiba, whereby it is only permitted for the participant who has yet to receive ‘iwāḍ, return, in the form of compensation or takāful benefit. Perhaps this mode is relevant to the contract of pure hiba (in which the surplus allocated to the participants is considered as hiba from the PRF) or mushāraka ta’āwniyya, as suggested by the OIC Fiqh Academy in its recent meeting [9]. Amongst the takāful operators who adopt this approach to surplus distribution is Sharikat al-Barakah in Sudan [18].

4.2 Selective Mode

Unlike the previous mode, this approach towards the distribution of surplus tends to differentiate between participants with claim records and participants with no claim history. Accordingly, any surplus will only be distributed to the latter category of policyholders, not to the former. Obviously, this mode is fully compatible with the contract of hiba bi sharṭ ‘iwāḍ, which is proposed by the researcher as the basis for the payment of contributions by the participants. The mode may also be found compatible with the other two underlying contracts for the above payment, i.e. pure hiba and mushāraka ta’āwniyya. Perhaps this mode appreciates the spirit of mutual assistance amongst the participants better than the previous mode, as it tends to provide an incentive to prudent participants while at the same time encouraging the ill-fated ones to be more cautious in the future. Soualhi, however, seems a bit sceptical about the common argument put forward by scholars to justify this mode (i.e. surplus is the exclusive property of the participant). He maintains that this particular mode as well as the other two modes are mainly valid based on the principles of maṣlaḥa and ʿurf but not based on the theory of milk, property [8]. As indicated earlier, the author finds that the above argument is credible enough, especially when the contract of hiba bi sharṭ ‘iwāḍ or mushāraka ta’āwniyya is involved in the process. Based on the survey conducted, most of the takāful operators in Malaysia, if not all, adopt this approach.

4.3 Off-setting Mode
Soualhi claims that this particular mode is the most equitable, since it tends to offset the rate of distributable surplus from the amount claimed. He further argues that the mode is more accurate in terms of calculation and more so in terms of justice and co-operation (ta‘awun). Nevertheless, in clarifying this mode, Soualhi appears to give a rather confusing description, as follows:

This is applicable only on accounts whose underwriting surplus is less than the claims. If the underwriting surplus is equal to or more than the claims, then the participant does not share in the surplus [8].

The above statement seems to reward participants with a higher claims figure rather than those with no or fewer claims. Logically, the surplus is supposed to be distributed based on the reverse. Perhaps the following description by AAOIFI provides a better understanding of the offsetting mode in surplus distribution. It should be noted, however, that AAOIFI does not give any specific name to this type of mode. It is thought to be parallel with the offsetting mode, since the AAOIFI’s description on the other two possible methods of allocating surplus is equivalent to the description of the previous modes (i.e. pro-rata and selective) supplied by Soualhi [3].

Allocation of surplus among those who have not made any claims and among those who have made claims of amounts less than their insurance contributions, provided that the latter category of policyholders should receive only the difference between their insurance contributions and their claims during the financial period [3].

Consequently, any participant with a claim record may still be eligible for surplus distribution provided that his claim amount is less than his overall takāfūl contributions. In contrast to the zero-claim participants who may receive surplus in proportion to their total contributions, the latter will only gain the surplus in proportion to the difference between the contributions paid and the claims received. Based on this description, it seems that this mode, as with the pro-rata mode, is incompatible with application of hiba bi sharf `iwaḍ to the mutual side of takāfūl. Amongst the operators who have adopted this approach is the Islamic Insurance Company of Jordan [8].

A summary of takāfūl surplus distribution methods can be illustrated by a diagram, as given below.

**Figure 11: Methods of Distributing Surplus in a Takāfūl Undertaking**

Source: Author’s own
In conclusion, there is currently no single method of distributing an underwriting surplus in a *takāful* undertaking. It appears that each and every *takāful* operator is free to choose any method as long as it is approved by the *Sharīʿa* committee. As far as *takāful* operators in Malaysia are concerned, the majority tend to justify their rights in sharing the surplus with the participants based on the contract of *ji`āla*. Only two out of eight operators currently have the disapproval of their *Sharīʿa* committees to share in the surplus. However, this situation will most probably change in the near future, since the bigger the surplus to be realized, the greater the temptation for the shareholders to share in the surplus [1]. Meanwhile, the distribution of surplus amongst the participants is mainly based upon the selective mode. It is suggested that this mode is compatible with the underlying contract of *hiba bi sharṭ `iwaḍ*, which is applied to the mutual side of the *takāful* operation. Other modes will be deemed appropriate only if the participants’ contributions are paid based on contracts other than *hiba bi sharṭ `iwaḍ*.

### 5.0 THE PRACTICE OF DISTRIBUTING SURPLUS BY TAKĀFUL OPERATORS IN MALAYSIA

By analysing each and every operator’s financial report, it appears that the issue of distributing PRF surplus may not be restricted to the application of certain contracts by *takaful* operators alone (such as *muḍāraba* and *ji`āla* to justify their entitlement towards the surplus.). The distribution of a surplus to the participants which is obviously not based on the above mentioned contracts may also invoke some issues. The table below, which summarizes the actual surplus figures distributed (by selected *takāful* operators in Malaysia) to both the participants and the shareholders for the period of four years, perhaps makes the issue more visible. Subsequently, some of the concerns related to the practice of surplus sharing applied by *takāful* operators in Malaysia will be discussed in more detail in the following sections in the light of the given figures.

**Table 6 : The Amount of Surplus Recorded and Distributed to the Shareholders and the Participants from 2007 to 2010**

<table>
<thead>
<tr>
<th>OPERATOR DESCRIPTION</th>
<th>ETB</th>
<th>TISB</th>
<th>SLTB</th>
<th>PBTB</th>
<th>MATB</th>
<th>HLMT</th>
<th>HATSB</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRF Surplus/ (Deficit) Before Tax (RM million) 2007</td>
<td>3.354</td>
<td>3.404</td>
<td>(10.971)</td>
<td>(1.173)</td>
<td>(0.285)</td>
<td>(0.029)</td>
<td>Data Not Available</td>
</tr>
<tr>
<td>2008</td>
<td>67.661</td>
<td>(4.299)</td>
<td>(16.588)</td>
<td>0.241</td>
<td>(7.847)</td>
<td>(0.287)</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>56.476</td>
<td>(11.042)</td>
<td>11.578</td>
<td>1.088</td>
<td>(2.525)</td>
<td>(0.068)</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>90.102</td>
<td>21.599</td>
<td>N.A</td>
<td>N.A</td>
<td>N.A</td>
<td>N.A</td>
<td>(2.228)</td>
</tr>
<tr>
<td>Declared Percentage Attributable to the Shareholders</td>
<td>50%</td>
<td>Not Declared</td>
<td>50%</td>
<td>Not Applicable</td>
<td>50%</td>
<td>Not Applicable</td>
<td>80%</td>
</tr>
<tr>
<td>Actual Surplus Acquired by the Shareholders (RM million) 2007</td>
<td>5.537</td>
<td>1.226</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>Data Not Available</td>
</tr>
<tr>
<td>2008</td>
<td>32.537</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>Data Not Available</td>
</tr>
<tr>
<td>2009</td>
<td>28.238</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>45.051</td>
<td>8.095</td>
<td>N.A</td>
<td>N.A</td>
<td>N.A</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Declared Percentage Attributable to the Participants</td>
<td>50%</td>
<td>100% (in full)</td>
<td>50%</td>
<td>70% (30% reserves)</td>
<td>50%</td>
<td>30% (70% reserves)</td>
<td>20%</td>
</tr>
<tr>
<td>Actual Surplus Paid to the Participants (RM million)</td>
<td>2007</td>
<td>3.547 (106%)</td>
<td>0.094 (3%)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>---------------------------------------------------</td>
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<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>2008</td>
<td>1.245 (2%)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2009</td>
<td>23.771 (42%)</td>
<td>0.168</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2010</td>
<td>16.005 (18%)</td>
<td>0.080</td>
<td>N.A</td>
<td>N.A</td>
<td>N.A</td>
<td>N.A</td>
<td>0</td>
</tr>
<tr>
<td>Net Surplus/Deficit Transferred to the General Fund (RM million)</td>
<td>2007</td>
<td>(6.714) (18%)</td>
<td>2.083 (61%)</td>
<td>(8.758)</td>
<td>(1.368)</td>
<td>(0.285)</td>
<td>(0.029)</td>
</tr>
<tr>
<td></td>
<td>2008</td>
<td>33.879 (50%)</td>
<td>(4.299)</td>
<td>(12.328)</td>
<td>(7.847)</td>
<td>(0.287)</td>
<td>(0.287)</td>
</tr>
<tr>
<td></td>
<td>2009</td>
<td>4.552 (8%)</td>
<td>(10.291)</td>
<td>9.025</td>
<td>1.064</td>
<td>2.525</td>
<td>(0.068)</td>
</tr>
<tr>
<td></td>
<td>2010</td>
<td>29.046 (32%)</td>
<td>10.73 (50%)</td>
<td>N.A</td>
<td>N.A</td>
<td>N.A</td>
<td>(2.228)</td>
</tr>
</tbody>
</table>

5.1 Surplus Distributed to the Shareholders

Based on the above table, it is clear that not all of the operators surveyed have acquired a share in the surplus recorded in the PRF. As one might expect, the main reason behind this is the ruling issued by the PrudentialBSN Takaful Berhad (PBTB) and Hong Leong MSIG Takaful (HLMT) Shari’a Boards, which strictly disapprove of the practice. Apart from these two operators, the others (excluding TISB) appear to have clearly indicated the rate of surplus they require as a performance fee (from the participants). While HATS’s rate of 80 per cent seems to be out of the acceptable limit, the other operators (i.e. ETB, CATB and MATB) decide to go for the maximum allowed limit currently set by BNM at 50 per cent of the realized surplus [16]. TISB, on the other hand, fails to publicly disclose the above rate despite actually acquiring a portion of the realized surplus in 2007 and 2008 which amounted to over 36 and 37 per cent respectively. Even more surprisingly, the figures do not match the rate of the ‘surplus administration fee’, which is claimed by the TISB personnel to be at the rate of 10 per cent [1].

Yet even though the rate is clearly specified by the operators, this may not necessarily make the practice immune to *gharar*. *Gharar* could still occur if the actual amount of the surplus acquired by a particular operator is more than the rate it officially declared to the participants. This situation can perhaps be observed in ETB’s 2007 Financial Report, whereby the company transferred more than RM5 million to the shareholders’ account despite the fact that the actual recorded PRF surplus was only RM3.3 million. The company even distributed surplus to the participants totalling more than the above figure. This has resulted in the General Fund’s net deficit of RM6.7 million during that particular year. It is suspected that the above practice was deliberately perpetrated by the company to take advantage of the abundance of reserves registered to the Fund prior to 2007.

There are also several incidents which indicate that the operators on some occasions have not fully acquired the amount of surplus attributable to them. For example, in 2008, ETB seemed to acquire 48 per cent of the surplus even though it could have acquired another two per cent. Similarly, in 2009, SLTB did not acquire any of the RM11.6 million gross surplus recorded despite its entitlement to receive up to half of the surplus as a performance fee. Nevertheless, in this latter case, SLTB is judged not to be eligible for the surplus, since the entire amount was allocated to pay the outstanding *qard* which has been extended by the shareholders to cover PRF deficits over the previous financial years amounting to over RM30.575 million as
at the end of 2008. The allocation of surplus to the shareholders (as a reward) prior to the full settlement of *qard* is not permitted by *BNM* in view of the potential *manfa`a*, benefit, from investment returns of the *qard* given to the PRF [16]. The above regulation appears to be consistent with the opinion of the majority of Muslim scholars, who identify that any benefit which follows a loan granted may lead to *ribā*. MATB, on the other hand, has yet to succeed in creating a surplus in the PRF and is thus not entitled to receive any payment.

### 5.2 Surplus Distributed to the Participants

Based on the above figures, it appears that all of the operators surveyed indicated that the surplus is distributed to the participants. Apart from TISB, the other operators appear to have clearly specified the percentage of surplus to be given to the participants. HATSB’s rate of 20 per cent seems to be the lowest, followed by HLMT at 30 per cent and subsequently by ETB, SLTB and MATB with a rate of 50 per cent each. PBTB’s commitment to pay up to 70 per cent of the surplus to the participants is considered to be the highest. It should be noted, however, that since PBTB and HLMT do not distribute surplus to their shareholders, the entire surplus (100 per cent) is actually allocated for the benefit of the participants. However, both companies clearly indicate that a portion of the surplus will be retained in the PRF as a reserve. PBTB states that 30 per cent of the surplus will be allocated for the above purpose, while HLMT decides to set the figure much higher (at 70 per cent). TISB, on the hand, is perceived to allocate less than 70 per cent of the surplus to the participants, even though it clearly states (in the company’s proposal form) that the net surplus arising from the PRF shall be allocated “in full” to the participants on a *hiba* basis.

By considering the fact that the surplus attributable to the participants in other companies (i.e. ETB, TISB, SLTB, MATB and HATSB) would also be subjected to reserves retention, it is most likely that the actual percentage of the surplus payable to the participants will be lower than the declared figures. For example, for the period 2008 to 2010, the actual amount of surplus paid by ETB to its participants varies substantially. In 2008, the payment only comprised two per cent of the total surplus recorded. In 2009, the figure increased to 42 per cent before going down again to 18 per cent in 2010. Similarly, in the case of TISB, the actual amount of surplus paid to the participants only constituted three per cent in 2007 and 0.3 per cent in 2010. Perhaps the above payments were deemed appropriate by the actuaries to ensure the solvency of the PRF in subsequent years. Since the practice of not distributing the entire amount of surplus (attributable to the participants) seems to be common, it is suggested that a clear statement regarding this matter should be made accessible to the participants to avoid confusion or dispute. Perhaps it should be stated in the proposal form that the company has the rights to retain part of the surplus attributable to the participants as a reserve when it is deemed necessary. This will give a clear indication to the participants that they might not receive any payment despite positive underwriting results.

Another issue which could be raised from the given figures is the distribution of surplus which seems to be over and above the available amount. As stated earlier, ETB distributed more than 100 per cent of the available surplus to its participants in 2007. From the RM3.4 million surplus recorded during that year, the company paid more than RM3.5 million surplus to its participants. What is more surprising is that the payment was made under the notion of *muḍāraba*, which is unlikely to be applied by the company in its general *takāful* schemes. Even if the company were to apply a modified *muḍāraba* model similar to STMB (which it obviously is not), there is no way that the *muḍāraba* profit could be distributed, because the fund actually recorded a loss. Perhaps the distributed profits were meant for certain general
products which encompass a savings element. Yet if this were the case, it should be specified in the revenue account that the payment is made prior to the determination of the surplus amount attributable to the company and the participants.

It can also be seen from the above table that some companies have not distributed any surplus despite having positive underwriting results. For example, even though PBTB recorded a net surplus of RM0.24 million and RM1.06 million in 2008 and 2009 respectively, it has not distributed any amount to its participants. It is understood that the participants were not eligible for the payment in 2008, since the PRF was still in an aggregate deficit of RM1.04 million. In 2009, however, the company should have distributed RM18 900 of surplus to the participants considering the fact that the Fund managed to register a positive balance of RM27 000 and the qard, which was extended by the shareholders in 2008 (worth RM1.28 million), should have been fully settled during that year. Perhaps it was not economically feasible to distribute that amount and the retained reserve has yet to achieve the minimum required level. The latter assumption might also be the reason that the qard has not actually been repaid despite the positive underwriting result achieved in 2009. A similar case can also be noted from SLTB’s Financial Statement for 2009. In this latter case, however, the net surplus, which was worth more than RM9 million, was not distributed to either the participants or the company because it was totally used to repay qard, which amounted to over RM30.6 million as at the end of 2008.

6.0 CONCLUSION

To conclude the discussion, it has been shown that a surplus is indeed distributable not only to the participants but also to the operators (hence shareholders) even though they may not be considered as the rightful owner of the realized surplus. The distribution of surplus to the participants appears to be less controversial, since they (as a group) are commonly judged to be the rightful owner of the Risk Fund and hence any surplus therein. This decision is also supported by the fact that their contribution to the Fund on the basis of hiba bi sharf `iswaq would entitle them to receive the surplus based on the concept of permissible rujū. Yet, in practice, the distribution of surplus to the participants (as shown earlier) may lead to several problems which could undermine the genuine form of takaful.

On the other hand, the distribution of surplus to the operators is justified only if it is consented to and approved by the owner of the surplus, i.e. the participants, under certain conditions. Obviously, this could be achieved through the conclusion of specific contracts that underline the rights and liabilities of both parties. Ji`āla is argued to be one of the contracts that could be used as a basis for allocating the surplus to the operators. However, in practice, the application of ji`āla by the operator is susceptible to faults and errors that might render the practice invalid. This is true especially when the contract is classified under the mu`āwaq category and thus subject to the rules of gharar.

REFERENCES


