Qard Hasan Issue In Mudarabah Takaful Model

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ABSTRACT

This paper aims to examine the issues of Qard Hasan in relation to Mudarabah model in Malaysian takaful practises. This paper has reviewed the problem of Qard Hasan in takaful practises and the alternatives in mitigating the issues arose. Hence, qualitative research methodology is advocated to ensure the objectives are answered progressively. The primary data were collected from the interview process together with the integration of related documents analysis. Based on analysis, the Shari'ah Advisory Council (SAC), Bank Negara Malaysia (BNM) and AAOIFI resolutions decided that any deficit from takaful fund due to over claims must be borne by shareholders of takaful companies such as Qard Hasan. AAOIFI standard added that Takaful Operator (TO) should first, utilize all their reserves and Qard Hasan is the last option to cover the deficit. However, another issue arises which is the fairness and transparency of the TO to divulge information about this deficit becomes questionable. Therefore, the best solution would be to opt for other models which have less issues. The findings will be a guide to the TO in selecting the right model for their operations. This study would be useful to all players in the takaful industry including academicians and potential customers. This paper empirically justifies the issue of Qard Hasan in Mudarabah takaful model and recommends ways of mitigating the issue.

Keywords : Mudarabah takaful model, Qard Hasan, issue in takaful model.

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1.0 INTRODUCTION

Mudarabah model is the earliest model that was implemented by takaful operators (TO) in Malaysia (Macey, 2008; Mohd Akram Laldin, 2008). Most of the TO in Malaysia used Mudarabah model during the establishment of takaful industry in Malaysia in 1984. This model is also known as "profit sharing" model or, "surplus sharing" model (Zahar Ahmad Khan, 2000). Recently, many TO have migrated to Wakalah model. However, there are still other companies that practise Mudarabah takaful model such as Takaful International (Bahrain) (Asyraf Wajdi, 2013).

In practise, TO act as a Mudarib which is the party that has the skills and knowledge, and participants act as Rabbul Mal, which is the party that has property to invest. Under this model, profit sharing contract is signed between the participants and the TO. Mudarib in takaful can be defined as the person who is entrusted to manage and administer the takaful business on behalf of participants. Whereas the participants are capital providers (Rabbul Mal) who will provide the funds and contributions. After a period of time, any profit will be shared between the TO and participants based on a pre-agreed ratio. In the case of a loss, where there is a deficit or claims amount exceeds the takaful funds, Qard Hasan will be used. The Qard Hasan scheme (free-interest loan) is the unique feature in Mudarabah takaful model practices which is a method to overcome deficit in takaful funds due to claims. This free-interest loan will be repaid once the fund is in surplus (Htay et. al, 2013).

Participants will contribute an agreed amount of money into takaful funds, then the TO who act as the investment manager (Mudarib), will invest some portion from the funds contributed. Any profits generated from the investment will be divided to participants and TO based on pre-agreed ratios. Profits which belongs to the participant will be deposited into the participant fund. Any surplus, which is derived from the total contribution and profit in the participant's fund minus total claims made by participant, will be given to the participant. Figure 1.1 will give a better picture on the modus operandi of the Mudarabah takaful model.

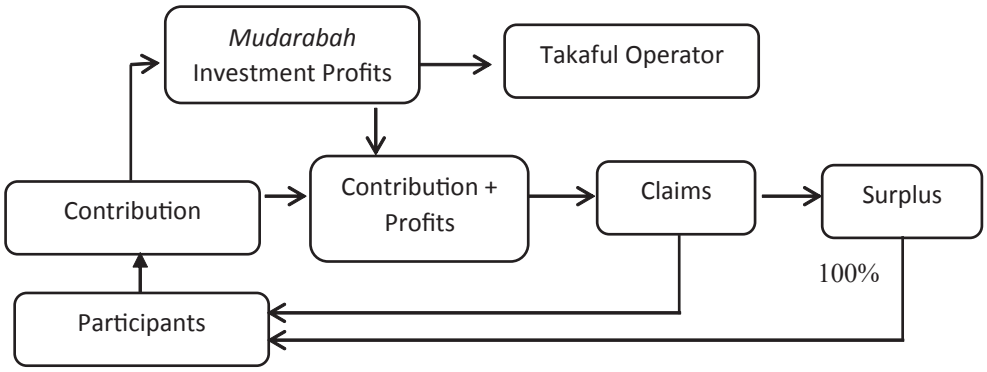

Figure 1.1: Basic Mudarabah Takaful Model

Source : Engku Rabiah & Hassan Scott, 2008, pp.45

For a more detailed discussion about the operation, an example is given as figure 1.2.

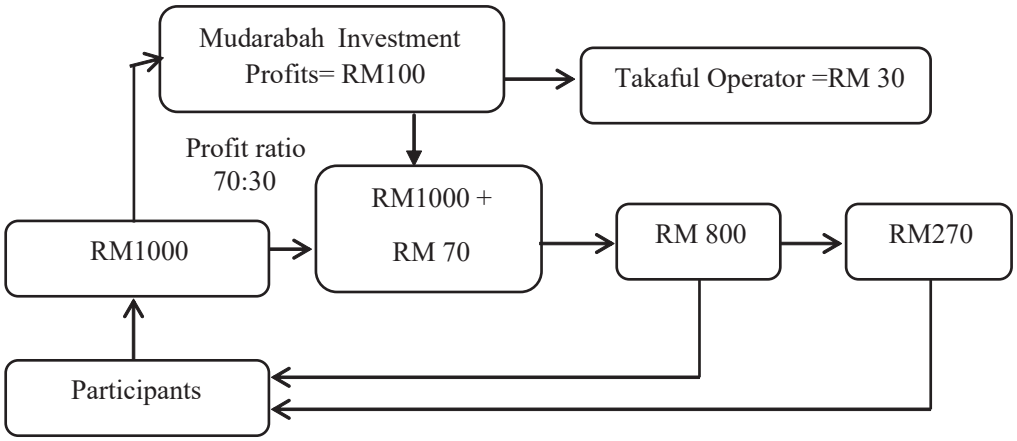

Figure 1.2: Example of Mudarabah Takaful Model

Source : Engku Rabiah & Hassan Scott, 2008, pp.45

For example, the amount received from the participant is RM1000. TO will invest the fund and at the maturity period of the investment, the profit generated is RM100. From the profit generated, the amount will be divided into two, which is to participant and TO based on a ratio that has been agreed upon. In this case, the ratio is 70:30, which is 70% belongs to the participants and the other 30% is for the TO. In other words, out of the profit of RM100, RM70 will be deposited into participant fund and RM30 will go to TO. If the claim made by the participant was RM800, RM800 will be deducted from RM1070, which brings a surplus of RM270. Hence, the total surplus will be given to the participants. This is the operational structure for Mudarabah takaful model.

1.1 Problem statement

Until today, the takaful industry is faced with numerous issues and challenges related to the operational and transformational that may affect its functioning (Waheed & Tajammal, 2012; Tahani, 2013). The same situation occurred in Malaysian takaful industry. After more than 30 years the implementation of Mudarabah takaful model in Malaysia, some takaful experts have made some criticism to the model.

They criticised that the Mudarabah model is best suited for short-term rather than long-term products, such as yearly renewable insurance motor products, where surplus sharing can occur earlier than long-term products. Besides, another challenges for takaful operators who are using the model are their direct exposure to investment. They are vulnerable to the ups and downs of businesses because of the profit sharing nature of the business (Asyraf Wajdi, 2013).

Furthermore, the main issue that has always been highlighted by scholars is Qard Hasan (benevolent loan). The common issue related to Qard Hasan is who will be responsible to cover the loss if deficit of fund occurres and what are the methods that should be used to overcome the situation. Since Qard Hasan is a benevolent loan, it means that under this original principle, the borrower cannot be forced to make repayment. In the event when the borrower is unable to settle the loan, the lender must accept this transaction as a charitable act (Htay, 2011). In the takaful context, if shareholders are responsible to cover the deficits, what are the rights and the limits of shareholders liability in covering the deficits? Hence, this paper attempted to examine the Qard Hasan issues in Mudarabah takaful model.

1.2 Research Objectives

Thus, this paper aims to address the following research objectives:

1. To examine the issues of Qard Hasan in Mudarabah takaful model practices.
2. To identify alternatives in mitigating the issue.

2.0 LITERATURE REVIEWS

2.1 Mudarabah Takaful Model

Few studies related to the Mudarabah and Musharakah concepts had been conducted by few researches such as Asmadi et. al. (2016a), Asmadi et. al. (2016b), Asmadi et. al. (2016c) and Mahmud Abd. Arrahman et. al. (2015), but the studies just tackle on the products in banking sector. However, those concepts can be applied for takaful practices.

In takaful practises, mudarabah model is based on profit sharing contract (Billah, 2004) where TO acts as a Mudarib (Manager of the fund) and participant as Rabbul mal or capital provider. The nature of Mudarabah contract principles is that the profit from the transaction will be shared according to the ratio pre-agreed during the contract by the TO and participants. Profit sharing in takaful is undertaken after all the related claims and expenses of takaful have been accounted for. This model also called tijari model as it works on commercial business basis. However, Bashir et al, (2011) stated that TO that using Mudarabah models in their businesses have different variations practices, such as in charging management fees, various product distribution channels and products' designs.

Engku Rabiah & Hassan Scott, (2008) explains that in this model, the participants contribute to the Family Takaful Fund. The investment and saving will be credited into the Participant's Account (PA) while the Participant Special Account (PSA) is used for

donation purposes and both of accounts must be invested in shari'ah compliant investments by the TO (Bank Negara Malaysia, 2010; Hanif and Abdullah, 2017). Any profit will be shared between the participants and the TO based on the pre-agreed ratio. The PSA will be used for claims, reserves and others expenses. Whereas the PA will be accumulated and paid together with the coverage amount from the PSA to the participants based on claims or upon maturity (Hanif and Abdullah, 2017).

Wahab (2006) mentioned that the contribution of participants and investment income can be used for the payment of claims, retakaful costs and other expenses incurred. The participants and shareholders will share the total surplus in the takaful funds based on the defined proportion. He added that the shareholders are responsible for the expenses related to the management and marketing expenses out of their share and the profit generated from the investment.

2.2 Issue in benevolent loan (Qard Hasan)

The issue in Mudarabah model is Qard Hasan (benevolent loan). Under the Mudarabah model, the shareholders are responsible to provide Qard Hasan loans to the participants in the event of any deficit in the PSA fund. However, the terms and conditions of Qard Hasan in terms of repayment and timing of the drawdown are not certain and clear (Sohail, 2007). Onagun (2011) mentioned that there is difficulty to know how to maintain fairness in the different generations of participants. It is because the new participants may be adversely affected with paying higher contribution or receive small or no underwriting surplus due to the need of making repayments of Qard Hasan. The participants will never know whether the TO has managed the fund wisely or not. It must be noted that the setting of contribution levels must not be higher in order to support the Qard Hasan loan, otherwise this will defeat the purpose of Qard Hasan as a benevolent or interest free loan.

This practice has been discussed and mentioned in the Shari'ah Resolutions in Islamic Finance issued by the Bank Negara Malaysia as one of the mechanisms to overcome deficit in the PSA fund. Recently, an academic study found that Muslim scholars do not agree with the issue of Qard Hasan adopted in the Mudarabah model (Htay, 2011). The research also found that takaful operators chose certain models only to maximize their self-interest, rather than to fulfil the participant's interest.

Apart from that, one common issue related to Qard Hasan is the misinterpretation and misunderstanding of its concept (Farooq, 2011). Since Qard Hasan is a benevolent loan, it means that under this original principle, the borrower cannot be forced to make repayment. In the event when the borrower is unable to settle the loan, the lender must accept this transaction as a charitable act. In the context of takaful, this is the main reason why some shareholders are quite reluctant to offer Qard Hasan when takaful fund is in deficit (Htay, 2011).

These are some of the issues arise in the takaful industries nowadays. Due to this endless debate profit and surplus issues in Mudarabah model, the majority of TO in Malaysia has now switched from Mudarabah model to the Wakalah model after more than two decades applying the Mudarabah model (Soualhi, 2008). Basically, the agreement to differ among scholars in term of views and practices is a blessing according of saying of Prophet PBUH that stated "difference of views among my Ummah is a mercy" (Nawi, 2011; Frenz and Soualhi, 2010; Frenz, 2009).

3.0 METHODOLOGY

The qualitative research method has been used in this paper to answer the objectives stated earlier. Qualitative research method can be traced via facts, information, statements, comments, assumptions, meanings, concepts, specifications, symbols, perceptions, metaphors and feelings. Sources of data can be in the form of manuscript, newspaper, diary, picture, official and personal letter, artefact, statements of certain people by using method of interview and researches in situation that have been analysed using ethnography (Bruce L. Berg, 2001).

3.1 Selection of Data Collection Method

The paper relies on the primary data to answer the research objectives. The primary data is collected from in-depth interviews of the takaful informants regarding the Qard Hasan issue in Mudarabah takaful model that is governed by Malaysian takaful companies. The face to face interviews were done using an interview guide tips provided by Sekaran and Bougie (2013) where the topic and questions are notified in advanced before the actual interview sessions took place. However, the secondary data via document analysis has also been used to support the data generated from the interview process. The data was integrated wisely to provide a good finding analysis.

3.2 Sampling

Four experts had been chosen as informants in interview session. The interview session conducted consists of one informant practitioner, one informant academician and two from Shari'ah advisory. In-depth interviews were conducted to assist the researcher to obtain the information on takaful model and the issues of the model.

The informant from practitioner is an expert in the field of takaful study. Besides that, he also has the professional qualification from Chartered Islamic Finance Professional (CIFP). He has lots of experience and is a recognised expert in takaful industries especially in law and regulations in Malaysia. The second informant is from the academic side. He is a lecturer at Universiti Sains Islam Malaysia (USIM). He is an INCEIF PhD holder in takaful and has vast experience in the takaful industry.

The next informant is a Shari'ah committee member for MAA takaful. He has long been in the takaful industry especially as a Shari'ah committee member. This interview gave a lot of benefits, in terms of inputs for the researcher from the Shari'ah perspectives and their views about takaful industries practises nowadays. The fourth informant is a Shari'ah committee member of Hong Leong MISG Takaful. She gave more inputs to the researcher in the area of Shari'ah governance in the takaful industry.

3.3 Data Analysis

The data collected is interpreted based on data gained from interviews. The researchers had listened several times to the recorded interview data before transcribed and reviewed in a written form. Thus, the data is organized by questions to look across all respondents and their answers to identify similarities and differences. The researchers then coded and categorized the answers according to the themes. Then, the researchers identified the pattern and connections among the interviewee's answers to make the analysis.

4.0 RESULT AND FINDING

In answering these issues, five interview questions were developed and the summary of the interview results is as follows:

1. Briefly explaine the Mudarabah takaful models in Malaysia.

    1. Mudarabah model is the earliest model that has been implemented by TO in Malaysia.

    2. In practise, TO act as Mudharib, the person who has the skills and knowledge, whereas participants act as Rabbul Mal, which is the person that has the property to invest.

2. Has this Mudarabah model which been implemented in parallel with the Shari'ah perspectives?

    All of the informants agreed that Mudarabah takaful models that have been practised nowadays in Malaysia are parallel with the Shari'ah perspectives. However, some of them believe, there are still some space and methods to improve the operation in each model.

3. What are the issues arise in this model?

    The popular issue in Mudarabah model is Qard Hasan. It happens when claims exceed the contribution funds. The question is who should be responsible to the deficits; whether TO or participants, and the methods in handling the situation.

4. What/how are the methods/ways in order to resolve that issues?

    1. Need to choose a more transparent contract that may enable the TO to manage the fund efficiently.

    2. Another way to resolve the issue is that the SAC should make the decisions. Meaning that, the higher authority makes the decisions to resolve everything.

    3. TO must have a good Shari'ah governance framework.

4.1 Discussion

Qard Hasan (Interest Free Loan) Issue

One of the issues in Mudarabah takaful model is the Qard Hasan or interest free loan. Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah (1993) defined, Qard as is giving a property to be consume in which the party shall return it later (replacement of the items that has been consumed). Majority scholars of the views the permissibility of Qard as according to al-Quran, Sunnah and ijma`. The evidence from Quran is regarded as the basis for permissibility of Qard in Surah al-Baqarah verse 245.

In takaful practises, the issue occurs when the sum of claims exceed the contributions. In other words, the TO will face a deficit in contributions, where the contributions will not be enough to cover the claims. Hence, the third informant (2016) during the interview session argued that, who will be responsible to cover the deficit. If shareholders should cover the deficit, another issue will arise which is whether the TO will act fairly to manage in covering the deficit or the TO will charge a higher contribution to participants in order to cover the deficits.

Extending from this issue, Onagun (2011) stated that there is a difficulty to the TO to maintain the fairness in terms of difference in participants based on the time period of involvement. He was worried that the new participants need to contribute more to cover the deficit in the previous years. Another possibility from that deficit issue is the new participants may receive a small or no underwriting surplus due to decisions of covering the deficit. This occurs because the terms and conditions of Qard Hasan in timing and repayment the funds are not clear and uncertain (Sohail, 2007).

Since the Qard Hasan is a benevolent loan, it indicates that under this basic principle, the borrower or in this case the participants cannot be forced to make repayment. In the case where participants fail to repay the benevolent loan, the lender, which is the shareholder, must accept it as a charity. This is why some shareholders are not comfortable when the deficit issue happens in the takaful operation.

In this case, the shareholders are responsible to provide Qard Hasan to the participants if there is any deficit in the fund. This practice has been discussed and explained in the Shari'ah Resolutions in Islamic Finance issued by the Bank Negara Malaysia as one of the mechanisms to overcome deficit in the fund. The Shari'ah Advisory Councils (SAC), had resolved in the 38th meeting on 28 August 2003, 46th meeting on 28 October 2004 and the 62nd meeting on 4 October 2006 that:

> *"Takaful company shall be responsible for any insufficiency of the participants' risk fund by injecting fund from the shareholders fund on the basis of Qard".*

Besides that, the SAC resolution in the 38th meeting on 28 August 2003 and the 100th meeting on 30 April - 1 May 2010, had resolved that:

i. *Utilisation of general takaful fund to cover deficit in family takaful fund or vice versa is not allowed;*

ii. *Utilisation of participants' investment fund to cover deficit in participants' risk fund based on Qard is not allowed.*

It is important to highlight that, based on AAOIFI, Qard Hasan will only occur when all the reserves of the contribution has been used. Thus, Qard Hasan is the last option to cover the deficit. If there are still other sources to cover the deficits, the TO should use that reserve. In AAOIFI, it is stated that:

a) *to settle the deficit from the reserves of the policyholders, if any.*

b) *to borrow from shareholders' funds or from others, the amount of deficit which should be paid back from future surpluses.*

c) *to ask the policyholders to meet the deficit pro-rata.*

d) *to increase the future premium contribution of policyholders on a pro-rata basis.*

However, in the shari'ah resolutions under BNM, there is no specific clause that states to resolve the deficit from which fund. This resolution only touches the prohibition to utilize the profit from different accounts such as from the PA and PSA account.

Therefore, it can be concluded that any deficit from the fund due to cover claims must be borne by the shareholders. Besides that, the TO is not allowed to take the portion from participants in any circumstances to cover their deficits. However, another issue maybe highlighted is about the fairness and transparency of the the TO to provide information about the deficit.

4.2 Significance/ Limitation

The outcome of this research will have a great impact to researchers, academicians and the industry itself. This research came out with suggestions and recommendations in overcoming the issues of Qard Hasan in Mudarabah takaful model in Malaysia since its establishment. Apart from that, it provides clearer outcomes of several recommendations to minimize the issues. Further, researchers and academicians can extend the research more in depth on this area such as to study whether the issues will have major impacts on public confidence about takaful.

5.0 CONCLUSION

The issue in Qard Hasan has arisen since the establishment of Mudarabah takaful model and it has continuously been debated among scholars for a long time. Due to these endless debates, some of the TO decided to change to another model that has less issues to avoid another risk such as shari'ah-compliant risk.

The great resolution from SAC and AAOIFI to some extent has mitigated the issue. It is in line with informants gathered comments that resolutions to specific issues should come from the highest authority body. Although the basic issue of Qard Hasan has been resolved, other issues still arise. The issues such as the fairness of TO in performing the Qard Hasan, shareholders whom act as Mudharib not guarantors in providing Qard Hasan fund, Mudarabah is not a suitable form of a donation (Tabarru) based scheme and Mudarabah is not suitable for long term investment products, still haunt the takaful industry.

Hence, this paper makes a strong conclusion that this Mudarabah takaful model is not suitable to be used anymore in the current situation. Thus, the takaful company should switch to another model that has limited issues. It is in line with the informants in the interview session who suggested the TO should choose the most transparent contract in their daily operations.

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