

**AN EXAMINATION OF PERCEIVED DISCLOSURE OF
TAKAFUL OPERATORS IN MALAYSIA**

BY

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the degree of Doctor of Philosophy (Accounting)**

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ABSTRACT

Takaful is still in its early stages as compared to conventional insurance with regard to regulatory maturity and market penetration (EY, 2013). In Malaysia, Bank Negara Malaysia has issued guidelines to ensure the operational efficiency of takaful operators, safeguard the interests of participants and promote uniform practices between operators. From a reporting perspective, in the Financial Stability and Payment Systems Report 2013, Bank Negara Malaysia (2014) mentioned the importance of having meaningful disclosure to protect participants. However, it did not provide details of the elements of meaningful disclosure. There is no specific guidelines or standards of what should be disclosed and how detailed the items should be disclosed. Takaful operators have more knowledge in the operational aspect of takaful, compared to the participants. Authorities try to harmonise all the possible variations and gaps between takaful operators (preparers) and participants (users) for the benefit of the industry. Any gap between what is expected to be disclosed (desirable) and what is actually disclosed needs to be analysed in order to provide more information relevant to the users and to standardise the disclosure level. There are four objectives of the study. The first is to examine what meaningful disclosure is to authorities. The second is to examine what meaningful disclosure is to users (the desired). The third is to examine what meaningful disclosure is to preparers (the actual) and the fourth objective is to analyse the gaps between the desirable and the desired (authorities and users); the desired and the actual (users and preparers) and between the desirable and the actual (authorities and preparers). A checklist was developed to represent the desirable level of disclosure based on various requirements and standards guided by accountability theory. To measure the desired level of meaningful disclosure, the checklist was distributed to takaful agents to examine their perception of meaningful disclosure based on decision usefulness theory. The disclosure checklist was employed as a benchmark to evaluate the actual level of meaningful disclosure in takaful operators' annual reports and websites. The gap analysis was conducted among the desirable, the desired and actual level of meaningful disclosure based on institutional theory. There are significant differences among all the gaps. Additionally, the average level of actual mandatory disclosure is 95% while average level of voluntary disclosure is 38%. It is hoped that the findings will assist authorities in formulating guideline or policy pertaining to meaningful disclosure in takaful industry in Malaysia.

مُلخَصُ البَحْثِ

ما يزال التكافل في مرحلته الأولى مقارنة بالتأمين التقليدي فيما يتعلق بالاستحقاق التنظيمي واختراق السوق (EY, 2013)، وفي ماليزيا؛ أصدر المصرف المركزي الماليزي مبادئ توجيهية لضمان الكفاءة التشغيلية لمزوّدي خدمات التكافل وتعزيز الممارسات الموحدة بينهم وحماية مصالح المشاركين، وفي تقريره عن الاستقرار المالي وأنظمة الدفع للعام 2013؛ ذكر المصرف المركزي الماليزي أهمية "الإفصاح المالي الهادف"، وذلك لحماية المشاركين في الخدمات التكافلية، ولكن لم يقدم المصرف تفاصيل عن عناصر الكشف الهادف، ولا إرشادات أو معايير محددة لما يجب الكشف عنه، وكيفية الكشف عن العناصر التفصيلية، ثم إن مزوّدي خدمات التكافل يعرفون أكثر من المشاركين الجانب التشغيلي للتكافل، وتحاول السلطات مواءمة جميع الاختلافات وسدّ الفجوات المحتملة بين مزوّدي خدمات التكافل والمشاركين بما يخدم صناعة التكافل، فيلزم تحليل أّي فجوة بين المرغوب بالإفصاح عنه، وبين ما أُفصح عنه حقاً؛ من أجل توفير مزيد من معلومات تتعلق بالمشاركين، وتوحيد مستوى الإفصاح، وعليه كان لهذا البحث أربعة أهداف؛ أولها تفحص ماهية الإفصاح المالي الهادف لدى السلطات (الإفصاح المطلوب)، وثانيها تفحص ماهية الإفصاح المالي الهادف لدى المشاركين (الإفصاح المرغوب به)، وثالثها تفحص ماهية الإفصاح المالي الهادف لدى مزوّدي خدمات التكافل (الإفصاح الحقيقي)، ورابعها تحليل الفجوات بين الإفصاحات؛ المطلوب والمرغوب به (السلطات والمشاركين)، والمرغوب به والحقيقي (المشاركين ومزوّدي خدمات التكافل)، والمطلوب والحقيقي (السلطات ومزوّدي خدمات التكافل)؛ لذا طوّر الباحث قائمة مرجعية لقياس مستوى الإفصاح بناءً على متطلبات ومعايير مختلفة استرشاداً بنظرية المساءلة، وذلك لقياس المستوى المطلوب من الإفصاح الهادف، ووُزعت القائمة المرجعية على وكلاء التكافل لتحديد تصوراتهم عن الإفصاح الهادف بناءً على نظرية فائدة القرار، واستُخدمت القائمة المرجعية معياراً لتقييم المستوى الحقيقي للإفصاح الهادف في التقارير السنوية لمزوّدي خدمات التكافل ومواقعهم الشبكية، وأُجري تحليل الفجوة بين المستويات المرغوبة والمطلوبة والحقيقية للإفصاح الهادف على أساس النظرية المؤسسية، فتبيّنت اختلافات كبيرة بين جميع مستويات الإفصاح، وبلغ متوسط مستوى الإفصاح الإلزامي الحقيقي 95٪، بينما بلغ متوسط مستوى الإفصاح الطوعي 38٪، ومن المؤمل أن تساعد النتائج السلطات في صياغة مبادئ توجيهية أو سياسات تتعلق بالإفصاح الهادف في صناعة التكافل في ماليزيا.

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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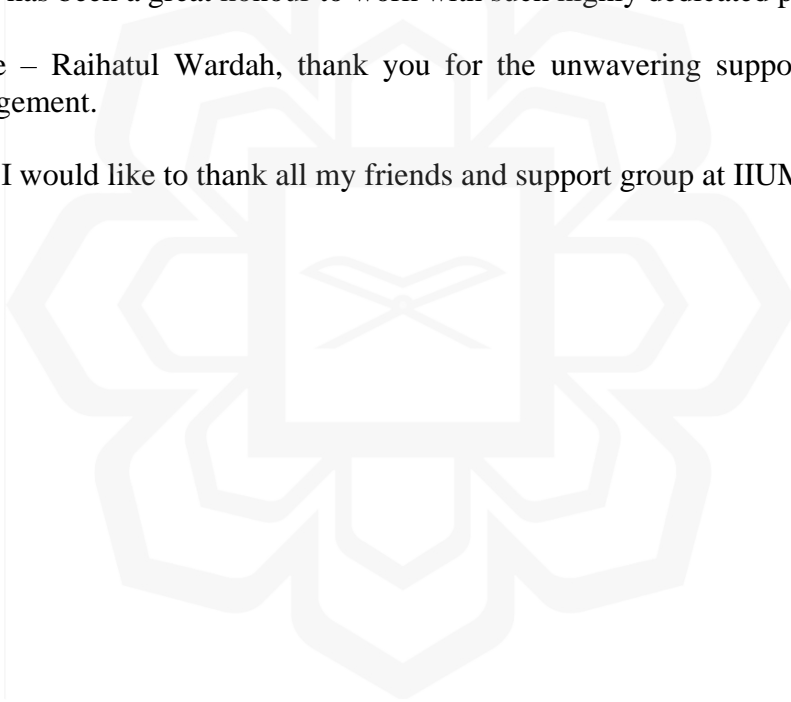


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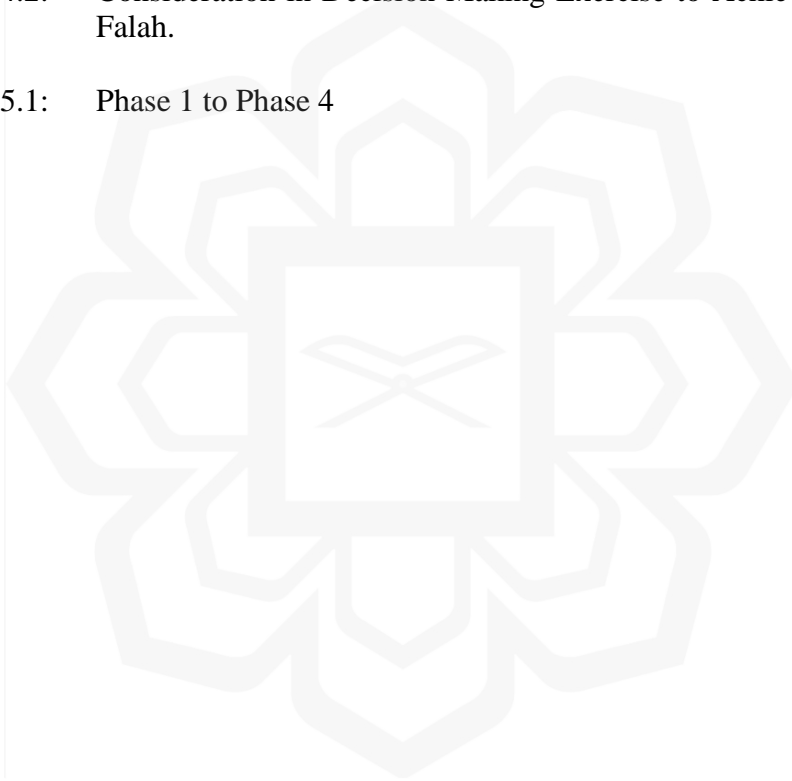
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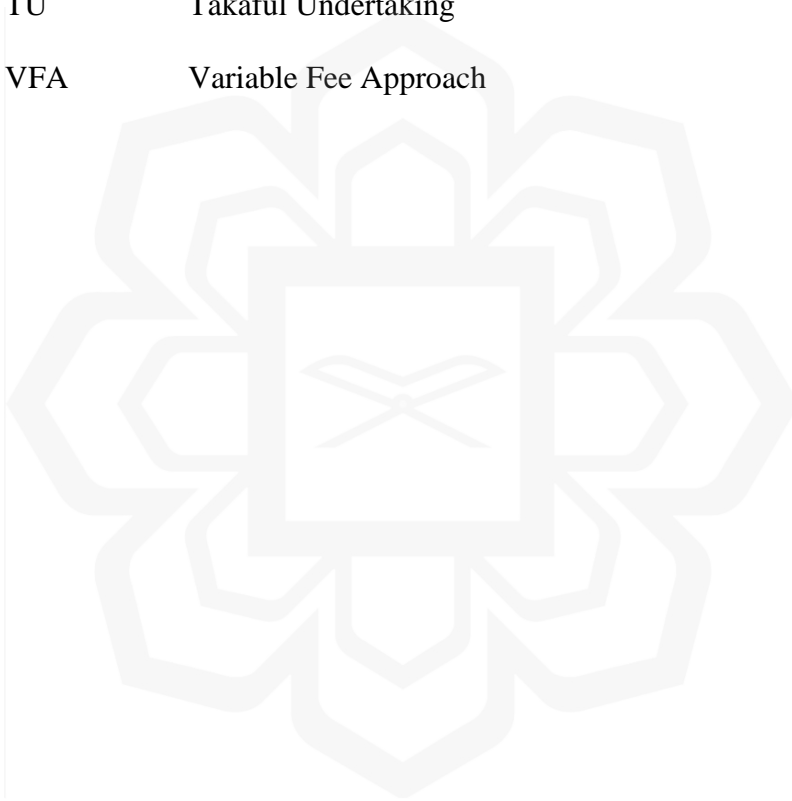


LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
ALM	Asset and Liability Management
ASEAN	Association of Southeast Asian Nations
BAR	Behavioural Accounting Research
BNM	Bank Negara Malaysia (National Bank of Malaysia)
CDI	Corporate Disclosure Index
CFI	Conventional Financial Institutions
CSM	Contractual Service Margins
CSR	Corporate Social Responsibility
CSRD	Corporate Social Responsibility Disclosure
ED	Exposure Draft
EII	Ethical Identity Index
ERM	Enterprise Risk Management
FAS	Financial Accounting Statements
FASB	Financial Accounting Standards Board
FCF	Fulfilment Cash Flows
FRA	Financial Reporting Act
FRTO	Financial Reporting for Takaful Operators
FTSE	Financial Times Stock Exchange
GCC	Gulf Co-operation Council
GPT	Garis Panduan Takaful (Takaful General Guidelines)
IAAS	International Association of Insurance Supervisors

ICAAP	Internal Capital Adequacy Assessment Process for Takaful Operators
IFI	Islamic Financial Institutions
IFRS	International Financial Reporting Standards
IFSA	Islamic Financial Services Act
IFSB	Islamic Financial Services Board
ISR	Islamic Social Reporting
ITCL	Individual Target Capital Level
MASB	Malaysian Accounting Standard Board
MFRS	Malaysian Financial Reporting Standards
MIA	Malaysian Institute of Accountants
ORSA	Own Risk and Solvency Assessment
PA	Participant's Account
PAP	Premium Allocation Approach
PIDM	Perbadanan Insuran Deposit Malaysia (Malaysia Deposit Insurance Corporation)
PRF	Participants' Risk Fund
PSA	Participant Special Account
QT2	Quantitative Testing 2
ROA	Return on Average Assets
ROE	Return on Equity
SAMA	Saudi Arabian Monetary Authority
SECP	Securities and Exchange Commission Pakistan
SHF	Shareholders' Funds
SOP	Statement of Principals

SPR	Security Price Research
STMB	Syarikat Takaful Malaysia Berhad
TO	Takaful Operator
TOF	Takaful Operating Framework
TPB	Theory of Planned Behaviour Model
TR	Technical Releases
TRA	Theory of Reasoned Action
TU	Takaful Undertaking
VFA	Variable Fee Approach



CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Takaful is a fast-growing industry with family and general takaful business expanded by 12.9% and 7.1%, respectively, in the first half 2018. This is much higher than the growth in life (5.4%) and general insurance (0.9%). Malaysia, with the fastest takaful growth in Southeast Asia, is focusing on Family Takaful. In fact, Malaysia has emerged as the world's largest Family Takaful market with the total Family Takaful business growing from RM4.35 billion in 2017 to RM4.91 billion in 2018, an increase of 13.1%.

Conventional insurance differs from takaful primarily because of its inconsistency with Islamic law (Shariah) in terms of uncertainty in the transactions (*gharar*), interest income, interest expense (*riba'*) and gambling elements (*maisir*) applied in the conventional insurance. Unlike insurance which transfers risk, takaful is based on the principle of *tabarru'* (donation) and the concept of risk sharing. This would indirectly eliminate uncertainty (*gharar*). More importantly, the investments made by takaful operators accord with Shariah requirements. Essentially, what this means is that such investments are free from interest (*riba'*) and gambling (*maisir*).

In Malaysia, takaful operators are required to adhere to the Malaysian Financial Reporting Standards (MFRS) to the extent that the standards in preparing their financial statements are consistent with Shariah principles. To further enhance the growth of the takaful industry in Malaysia, Bank Negara Malaysia (BNM), has issued guidelines on the takaful operational framework for takaful operators (TOs). Indeed, BNM in its 2013 Financial Stability and Payment Systems Report, highlighted the need for TOs to

provide “meaningful disclosure” to participants to enable them to make more informed decisions. Meaningful disclosure refers to relevant and reliable information that will assist potential participants to make a balanced and informed decision on the takaful products that would fulfil both their investment needs as well as providing takaful protection. Accordingly, one may regard meaningful disclosure as synonymous with useful information. Thus, meaningful disclosure is used interchangeably with useful information in the thesis. Other than indicating information on the costs and benefits as well as associated risks of takaful products in order to assist potential participants in their decision to “purchase” a particular takaful product, the guidelines did not really specify what “meaningful disclosure” is. This is indeed a concern. Accordingly, this study attempts to determine what constitutes meaningful disclosure.

1.2 PROBLEM STATEMENT

In Malaysia, Bank Negara Malaysia (National Bank) has issued guidelines to ensure operational efficiency of takaful operators, safeguard participants’ interests and promote uniformity of practices amongst operators, as Takaful is still new in the market in terms of product range and business scope compared to conventional insurance. There are two types of takaful which are general takaful and family takaful.

General Takaful gives protection to participants for losses due to risks such as accident, fire, flood, liability, and robbery. On the other hand, family takaful focuses more on providing assistance to individuals (the *tabarru’* concept) who experience misfortunes such as death or permanent disability. The processes involved in the family takaful is first the participants will have to contribute a sum of money to a common takaful fund. Next, they will enter into an agreement (*aqad*) for part of their contribution as participative contribution (*tabarru’*) and partly as savings and investment. However,

in Malaysia the most preferred takaful market is family takaful which involves long term investment. Nonetheless, takaful operators are allowed to adopt any takaful model in their takaful operation. Thus, with different model adopted and long-term investment in family takaful, there is a need to adequately disclose important information. This is vital for security purposes specially to protect the participants' well-being.

In Financial Stability and Payment Systems Report 2013, the report highlighted the importance of having meaningful disclosure in order to help potential participants to understand the costs, benefits and risks pertinent to takaful product. In addition, the Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) have introduced the consumers pre-contractual disclosure requirements, and available resolutions to insurers or takaful operators for misrepresentations. The modifications were made applicable to consumer insurance or takaful contracts to safeguard policyholders or participants against inconsistent actions by insurers or takaful operators and to avoid insurance or takaful contracts in a case of unintentional misrepresentation by the participants.

Potential participant and takaful operator are advised to disclose relevant information accurately before signing up the takaful contract. The information must be well-defined, brief and in timely manner to allow the potential participant to make a well-versed decision and for the takaful operator to choose more appropriate terms of acceptance of the risk. Indirectly, the meaningful disclosure will assist and enhance the understanding of potential participants on pre-contractual disclosure.

Besides, meaningful disclosure is undeniably important as there is no specific guidelines or standards of what should be disclosed and how detailed such items should be disclosed. Takaful operators have more knowledge in the operational aspect of takaful, compared to the participants. As a result, the authorities try to harmonize all the

possible variations and gaps between takaful operators (preparers) and participants (users) for the betterment of the whole industry. Therefore, any gap between what is expected to be disclosed (desirable) and what is actually disclosed need to be analysed in order to standardise the disclosure level.

1.3 RESEARCH OBJECTIVES AND QUESTIONS

This study will focus at three different perspectives of disclosure: from authorities' perspective, users' perspective, and preparers' perspective. Authorities produced framework, guidelines, and standards to be followed by preparers of the report. Users read the reports and used the information to make decision. Sulaiman (2005) developed a framework on the expectation gaps between what ought to be desired (the desirable) and what is actually desired (the desired) as well as what is actually disclosed (the actual) in her study on the perceived usefulness of accounting information between Muslim and non-Muslim users. In this study, authorities' perspectives represent the desirable level of disclosure, users' perspectives represent the desired level of disclosure and the preparers' perspective represent the actual level of disclosure. This study adopts Sulaiman's (2005) framework (figure 1.1) to determine what authorities, users and preparers perceive as meaningful disclosure for takaful operators. The first three objectives are to determine the disclosure perspectives of the three parties while the fourth objective is to examine if gaps exist amongst the three stakeholders.

Table 1.1 Summary of study

Level of Disclosure	Phases/ Objectives	Stakeholders	Methodology	Theory
Desirable	Phase 1/ Objective 1	Authorities	Disclosure Index (Mandatory and Voluntary)	Accountability
Desired	Phase 2/ Objective 2	Users	Questionnaire (Voluntary)	Decision Usefulness
Actual	Phase 3/ Objective 3	Preparers	Content Analysis (Mandatory and Voluntary)	Institutional (Coercive and Mimetic)
Analysis of the gaps	Phase 4/ Objective 4	Authorities, Users and Preparers	-	-

From Table 1.1, the desirable level of meaningful disclosure (from authorities' perspective) is by providing a checklist drawn from various takaful guidelines and frameworks that are currently available. Given the strong theoretical basis on which such guidelines and frameworks have been developed, one may regard the checklist as information that participants (users) *ought* to desire (i.e. desirable) in their decision making.

The desired level of meaningful disclosure (from users' perspective) is based on empirical testing, whether such information aligns with what users actually desire (the desired). Thus, while the former relates to what is ethically right and is related to ideology, the latter relates to more pragmatic issues (Hofstede, 1980). Finally, what is

actually being disclosed by TOs in their annual reports and on their websites reflect the “actual” disclosure by the preparers though content analysis.

One may regard what is being disclosed by TOs as information that TOs perceive as meaningful disclosure. Accordingly, what is regarded as desirable information by the authorities (those that users *ought* to perceive as meaningful) may not align with what is actually being disclosed by TOs. The definition of ‘meaningful’ information or disclosure is rather subjective and thus, it is also not surprising if what constitutes as desirable by the authorities is not in line with what is desired by users. Likewise, what is desired by users may not be in line with the information preparers actually disclose in their annual reports and websites. Indeed, each level of disclosure provides interesting insights as to what form meaningful disclosure may take, in the final instance.

The first objective of the study is to examine what is meaningful disclosure to standard setters or regulators (authorities). As mentioned earlier, the checklist of meaningful information that users ought to find useful (the desirable), will be drawn from the Takaful Operational Framework and Guidelines on Financial Reporting for Takaful Operators by Bank Negara Malaysia (BNM), the Internal Capital Adequacy Assessment Process for Takaful Operators (ICAAP), the Islamic Financial Services Act (IFSA) 2013, standards issued by the Islamic Financial Services Board (IFSB), pronouncements on Islamic financial transactions issued by the Malaysian Accounting Standard Board (MASB) and related Malaysian Financial Reporting Standards (MFRS). These parties are regulators and standard setters in takaful industry in Malaysia. In this study, these group of regulators and standard setters will be referred to as “authorities”.