



**CRITICAL ANALYSIS OF THIRD PARTY  
POLICY UNDER MOTOR TAKAFUL IN  
MALAYSIA**

**BY**

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for the degree of Master of Science in Islamic Banking  
and Finance**

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## ABSTRACT

Islamic Finance has developed mainly in three directions namely Islamic banking, Islamic capital market and Islamic insurance (Takaful). Takaful is based on the concept of social solidarity, cooperation and mutual indemnification of losses of members. It is a pact among a group of members who agree to jointly indemnify the loss or damage that may inflict any of them out of the funds they donate collectively.

The benefits of Takaful can be divided into two i.e. Family Takaful Plan (similar to Conventional Life Insurance) and General Takaful Plan (General Insurance). Motor Takaful, being part of the General Takaful Plan is a Syariah compliant product, underwritten by the Takaful operators, which offers three main types of Takaful coverage for motor vehicles. They are the Act Only Motor Takaful policy, Third Party policy and Comprehensive policy. Confining the study to the Third Party policy, it is a type of cover that protects the participants against the third party's death, bodily injury and/or property damage. Legal Liability to Passengers (LLP) being part of Motor Takaful is an optional cover to protect those passengers/claimants against negligent drivers in the same vehicle. LLP extension is available to both comprehensive and Third Party policies subject to additional contributions.

Referring to the general definition of Takaful, the protection to be given by the Operators are confined to those contributed to the fund i.e. the participants only. However, today the protection and compensation are also extended to third party including pedestrian, driver or passengers of another vehicle or those who falls under the LLP category. This study observes the inconsistency (if any) between the general definition of Takaful and the extension of permitted compensation awarded to the third party as non-participants under Motor Takaful together with its adherence to the Shariah principles and requirements. At the same time, critical analysis on the Motor Takaful product, structures and its current practice in Malaysia were undertaken. Its respective strengths, weaknesses and other related features were also discussed.

Expert interviews being the primary research instrument were conducted to mainly resolve the gap found supported with findings from other secondary resources.

Based on all the information gathered, it can be observed that the third party policy under Motor Takaful is Shariah compliant and functioning in line with the general definition of Takaful. This is because damages owed to third parties are within the scope of coverage offered by the operators. It very much depends on the scope covered under the policy opted by the participants. The permissibility of the mutual transaction is based on the *Aqad* (contract) agreed between participants. It is homogenous in nature as those policies cover and applicable to all participants having contributed the same amount into the same pool of fund.

## الملخص

لقد تطور النظام التمويلي الإسلامي في ثلاث اتجاهات أساسية وهي المصرفية الإسلامية، سوق رأس المال الإسلامي والتأمين الإسلامي (التكافل). يقوم التأمين الإسلامي أو التكافل على مفهوم التضامن الاجتماعي، والتعاون المتبادل والتعويض عن خسائر الأعضاء. وهو عبارة عن اتفاقية بين الأعضاء بالاشتراك على تعويض الخسارة أو الضرر الذي قد يلحق أيا منهم من الأموال التي تبرعوا بها بشكل جماعي.

ويمكن تقسيم خدمات التكافل إلى قسمين؛ التكافل العائلي (شبيه بالتأمين على الحياة التقليدية) والتكافل العام (التأمين العام). وتكافل السيارات الذي يندرج تحت التكافل العام والذي يتوافق مع الشريعة الإسلامية، تعهدت شركات التكافل بتوفيره وتقديم الشركات المتعلقة بثلاثة أنواع رئيسية من التكافل المذكور. وهي فئة تكافل الحادث فقط، وفئة تكافل الطرف الثالث وفئة التكافل الشامل. ويقتصر البحث على دراسة تكافل الطرف الثالث، وهو نوع من التأمين يغطي المشترك ضد ما يتسببه من أضرار للغير من إصابات جسدية أو أضرار مادية. المسؤولية القانونية تجاه الركاب بوصفها جزءا من تكافل السيارات هي تأمين اختياري يغطي الركاب في نفس السيارة إزاء سوء استعمال السائق وإهماله. وتوسعة نطاق غطاء المسؤولية القانونية تجاه الركاب موفرة لفئة التكافل الشامل وتكافل الطرف الثالث على حسب مقدار التبرعات الإضافية.

بالإشارة إلى المفهوم العام للتكافل، يتم تأمين الحماية من قبل شركات التأمين للمساهمين في الصندوق فقط وبعبارة أخرى للمشارك فقط. ومع ذلك، فلقد تم توسيع نطاق الحماية والتعويض في فئة تكافل الطرف الثالث ليشمل المشاة، السواق أو ركاب السيارة الأخرى (الطرف الثالث)، أو كل من تشمله المسؤولية القانونية تجاه الركاب. تتناول هذه الدراسة، أيضا، التناقضات (إن وجدت) بين التعريف العام للتكافل وتوسعة نطاق غطاء التعويضات المسموحة منحها للطرف الثالث ولغير المشاركين في إطار تكافل السيارات، بالإضافة إلى مدى تطابقها مع مبادئ الشريعة الإسلامية ومتطلباتها. وفي الوقت نفسه، تم إجراء التحليل النقدي على منتجات تكافل

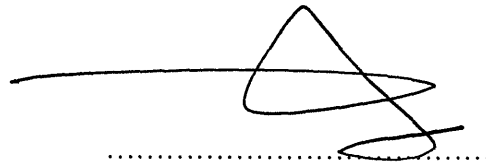
ii

وتم إجراء مقابلات مع خبراء، باعتبارها وسيلة أساسية في البحث، لغرض إيجاد حل للفجوات التي تم العثور عليها مدعومة بالنتائج من المصادر الأخرى.

وبناء على البيانات والمعلومات التي تم جمعها؛ يلاحظ بأن تكافل الطرف الثالث تحت تكافل السيارات متوافق مع الشريعة الإسلامية ويتطابق مع التعريف العام للتكافل. وذلك لأن الأضرار التي يستحق الطرف الثالث التعويض عليها تدخل ضمن غطاء تأمين الذي تقدمه شركات التأمين. وهذا يعتمد بشكل كبير على نطاق سياسة التغطية التي اختارها المشترك. ويستند جواز المعاملة المتبادلة على العقد المبرم والمتفق عليه بين المشتركين. وهي متجانسة في طبيعتها لأن تلك السياسات تغطي وتنطبق على جميع المشاركين الذين ساهموا بنفس المبلغ في نفس مجموعة الصندوق.

## APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a thesis for the degree of Master of Science in Islamic Banking & Finance.



.....  
Younes Soualhi  
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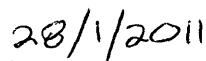
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## DECLARATION

I hereby declare that this thesis 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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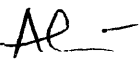
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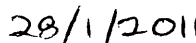
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*To Mummy, Daddy, Dila, Duby, Tika and Jack*

*with lots of love....*



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# **CRITICAL ANALYSIS OF THIRD PARTY POLICY UNDER MOTOR TAKAFUL IN MALAYSIA**

## **CHAPTER 1**

Motor Insurance, also known as, vehicle, auto or cars insurance is the insurance purchased for all types of vehicles. Used in providing fortification against losses, damages or unexpected incident incurred of traffic or road accidents and liabilities occurs in such.

Motor Takaful is the name for Motor Insurance in Islamic Insurance concept. This policy endows several mutual financial aids for the policyholders. However, there is contradiction found between the definition and custom of Motor Takaful in Malaysia, regarding third party coverage and its liability, which had been extensively elaborated under Clause 1.2, Problem Statement below. This research conducted in finding whether such contradiction truly exists.

The first chapter shall describe the background of this thesis. In this chapter, researchers stated some problem statements related to the case, and early conclusion of this research. Past researches regarding the similar issue will be instrumental in pointing out the main objective and scope of this thesis. Therefore, the significance and methodology of this thesis revealed at the end of the chapter.

## 1.1 BACKGROUND OF RESEARCH

The birth and development of motor vehicle not only brought conveniences and comfort to life but also brings harm and destruction, which requires protection. The increase of such invention has highly contributed to the growth of road accidents in the country.

Shown below are the road accidents facts for 10 years as statistically proven by the Road Safety Department of Malaysia from year 2000 until 2009<sup>1</sup>.

**Road Accident Fact for 2000 - 2009**

YEAR		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
ACCIDENT INJURY TYPE	Fatal Accidents	5,440	5,230	5,378	5,634	5,674	5,604	5,711	5,672	5,952	6,218
	Serious Injury	8,067	6,942	6,696	7,163	7,444	7,600	7,375	7,384	7,020	6,978
	Minor Injury	28,778	30,684	30,259	31,357	33,413	25,928	15,596	13,979	12,893	12,072
TOTAL ACCIDENT INJURY		42,285	42,856	42,333	44,154	46,531	39,132	28,682	27,035	25,865	25,268
TOTAL ACCIDENT WITHOUT INJURY		208,144	222,319	237,378	254,499	280,283	289,136	312,550	336,284	347,182	371,926
TOTAL ACCIDENT		250,429	265,175	279,711	298,653	326,814	328,268	341,232	363,319	373,047	397,194
Injury Type	Fatal	6,035	5,854	5,891	6,286	6,228	6,188	6,287	6,282	6,527	6,745
	Serious Injury	9,790	8,689	8,425	9,040	9,229	9,397	9,254	9,273	8,866	8,849
	Minor Injury	34,375	35,974	35,236	37,415	38,631	31,429	19,884	18,444	16,901	15,823
TOTAL INJURY		50,200	50,517	49,552	52,741	54,088	47,014	35,425	33,999	32,294	31,417
FATALITIES INDEX	10 000 registration vehicle)	5.70	5.17	4.88	4.88	4.51	4.18	3.98	3.73	3.63	3.55
	Every 1 Billion VKT	26.25	23.93	22.71	22.77	21.1	19.58	18.69	17.6	17.2	17.28

<sup>1</sup> JKJR, Statistics: Road Safety Fact, Road Accidents from 2000 to 2009.

This is why the need to provide compensation for victim of road accidents became evident (Poh Chu Chai, 1990).

Insurance today has become an integral part of our modern life. It has permeated deeply into every sector of our economy. The average layman is no doubt familiar with the fact that he cannot drive his car without insurance coverage against third party risks (Poh Chu Chai, 1990). This has now been made as part of the rules and regulations that needs to be observed by every individual in relation to motor insurance<sup>2</sup>

The vital role that motor insurance plays in alleviating one against a material risk resulting from an unexpected peril or catastrophe is not questionable. However, many Muslims find that the conventional insurance is incompatible with their religious belief (Zainal Abidin, 2005). This is in due to the rising awareness of the Muslim consumers that the conventional insurance practice is dominated by the usury based economic system and uncertainty which is strictly forbidden in the eyes of Syariah (Billah, 2003a).

The concept of Islamic insurance, or Takaful, introduced (Bank Negara Malaysia (BNM), 2005) in 1980's since conventional motor insurance is against Islam. Takaful practices based on various models namely Mudharabah, Wakalah and Waqf financing techniques whereby no one has the opportunity to hope for a gain instead of material security against unpredicted loss or damage (Billah, 2003a). The Takaful Company may insure any valuable thing,

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<sup>2</sup> Road Transport Act, 1987 (Section 90 of 1987).

which is at risk. Things at risk may be insured mainly by two types of insurance policies which are general policy i.e. properties which are at risk on a short-term basis and life scheme i.e. life and health which are at risk on a long-term basis.

It must be noted that the conventional as well as Islamic insurance accept the central idea of insurance as a mutual financial transaction aimed at safeguarding a person against an unexpected material risk despite both systems operating through different methods(Billah, 2003a).

The first Takaful Company in Malaysia established in 1985 under the Takaful Act 1984 (Mahadzir Ahmad, 2009). It is evidently observed that the local Takaful industry has been around for 25 years. The insurance industry on the other hand emerged and started about 100 years back, which makes the Takaful industry, relatively young compared to the insurance industry (Mahadzir Ahmad, 2009).

Despite the infancy stage that the Takaful industry is currently evolving in, it has been gaining momentum and increasingly recognized as a significant contributor to Malaysia's overall Islamic financial system.

As in 2008, total assets of Malaysia's Takaful industry amounted to USD2.8 billion, with market penetration of 7.5%<sup>3</sup> Takaful assets and net contributions experienced strong growth with an average annual growth rate of RM 21.9

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<sup>3</sup>BNM, *Annual Takaful Statistics*, 2008.



million and RM 54.6 million respectively from 2004 to 2008<sup>4</sup>.

The rapid liberalization of Malaysia's Islamic financial industry has encouraged foreign institutions' participation in Malaysia, thus creating a diverse and growing community of domestic and international Takaful operators. There are currently eight Takaful operators and four Retakaful operators, with six foreign participations from the Germany, Dubai, Switzerland, Hong Kong, China and Japan. These Takaful operators conduct both domestic and foreign currency business(BNM,2010).

Malaysia continues to progress and build on the industry's rapid development by inviting financial institutions across the world to establish Takaful and Retakaful operations in Malaysia. Nevertheless, it is a known fact that Takaful is covered less in literature and many issues on Takaful are still in conundrum.

Below are the key Takaful indicators from year 2005 to 2009 provided for under the Malaysian Consolidated Takaful Operators Statistic.

**Key 1.1 : Key Takaful Indicators**

	2005 <sup>5</sup>	2006	2007	2008	2009
<b>Market Structure</b>					
No. of Registered Takaful Operators <sup>6</sup>	5	8	8	8	8

<sup>4</sup>Takaful Industry in Malaysia: Performance and Key Developments *MIF Monthly 2008 Supplement Series*.

<sup>5</sup> As at 31 December

No. of Agents	14,059	15,194	43,843	60,197	88,895
Family	11,781	11,188	32,987	44,222	55,898
General	2,278	4,006	10,856	15,975	32,997
No. of Offices	147	151	154	157	104
No. of Employees	2,670	2,967	2,863	2,411	2,499
<b>Net Income Contributions</b>					
Total (RM million)	1,333.7	1,720.9	2,565.0	3,025.1	3,251.8
<b>Combined Contributions</b>					
(% of GNI) <sup>7</sup>	0.3	0.3	0.4	0.4	0.5
Family (% of GNI)	0.2	0.2	0.3	0.3	0.4
General (% of GNI)	0.1	0.1	0.1	0.1	0.1
<b>Per capita contributions</b>					
<b>(RM) on:-</b>					
Family <sup>8</sup>	36.6	46.3	73.3	85.7	96.0
General <sup>9</sup>	13.4	17.9	21.3	23.5	28.4
<b>Net Benefits and</b>					
<b>Claims Payments</b>					
Total (RM million)	464.1	557.9	753.3	866.1	1,208.2
Family	347.2	400.8	534.7	632.0	904.0
General	116.9	157.1	218.6	234.1	304.2
<b>Takaful Fund Assets</b>					

<sup>6</sup> Composite Takaful operators

<sup>7</sup> Gross National Income

<sup>8</sup> As per revenue account

<sup>9</sup> Contributions on gross rate charged to the participants without deduction for commission and brokerage

Numbers may not necessarily add up due to rounding

Total (RM million)	5,874.4	6,899.0	8,818.3	10,569.4	12,445.4
Family	5,048.4	5,800.9	7,445.2	8,900.1	10,536.2
General	830.0	1,098.1	1,373.1	1,669.3	1,909.2
% of GNI	1.2	1.2	1.6	1.5	1.9
% of total assets of the Insurance and Takaful industry	5.7	5.9	6.7	7.5	8.0

Source: BNM Annual Takaful Statistics 2009

Motor Takaful is one of the Islamic products offered by the Takaful industry that falls under the General Takaful category. Motor Takaful is a Syari'ah compliant product, underwritten by the Takaful operators, which offer three main types of Takaful coverage for motor vehicles. They are the Act Only Motor Takaful policy, Third Party policy and Comprehensive policy. All Takaful operators in Malaysia are members of the General Insurance Association of Malaysia (PIAM) whereby the adherence to PIAM' guidelines not only applicable to the insurance industry but also to Takaful.

Engku Ali, P.Ordieno & Ismail (2008) have mentioned that the legal liabilities to third parties (Section 2) fall within the scope of coverage under the participant's Takaful certificate. Under this section, the Takaful fund will indemnify the participant against all sums including claimant's costs and expenses which the participant shall become legally liable to pay in respect of:-

- (a) Death of or bodily injury to any person

- (b) Damage to property other than property belonging to the Participant or held in trust by or in the custody or control of the Participant or any member the Participant's household.

However, the Takaful fund does not pay for:

- (i) Damages compensation in respect to judgments not in the first instance delivered or obtained from a Court of competent jurisdiction within Malaysia, the Republic of Singapore or Brunei;
- (ii) Costs and expenses of litigation recovered by any claimant from the participant which are not incurred in and recoverable in Malaysia, the Republic of Singapore or Brunei.

## **1.2 STATEMENT OF PROBLEM**

Takaful as it is stated in Malaysia is a scheme based on unity, solidarity and mutual assistance that provides 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). It is a Syari`ah compliant insurance which is based on principles of Ta-awun (mutual assistance) that is Tabarru (voluntarily) provided (Ernst & Young (EY), 2008). It is not a contract but an agreement for mutual help among the group and visualized as a pact among clients who agree to jointly guarantee among themselves against

loss or damage that may befall any of them. The basic objective of Takaful is to pay for a defined loss from a defined fund (Saiful, 2007).

All the functions of a Takaful undertaking should conform fully to Islamic law whereby any element of speculation, uncertainty and gambling be eliminated or minimized (Islamic Financial Services Board (IFSB) and International Institute of Advanced of Islamic Studies (IAIS), 2006). The Tabarru concept is incorporated in Takaful agreements to eliminate the “uncertainty” element. A participant shall agree to relinquish as Tabarru, certain proportion of his Takaful contributions that he agrees or undertakes to pay. Consequently, enables him to fulfill his obligation of mutual help and joint guarantee should any of his fellow participants suffer a defined loss.<sup>10</sup>

Based on the above it is observable that the mutual financial aid and assistance offered confined only to those participants who have contributed to the fund. The mutual help given to those who are within the group, which does not extend to third parties. However, the current practice of the Motor Takaful industry in Malaysia shows otherwise. Under Motor Takaful, the industry offers three types of policy coverage<sup>11</sup> whereby Third Party policy is one of them. It is the requirement under the law to have minimum third party liability coverage while other types of coverage remain optional (Road Transport Act

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<sup>10</sup> *Takaful or Islamic Finance* <<http://www.auburnmountain.com/Portals/0/Koran-Web.jpg>>, viewed on 10 September 2009.

<sup>11</sup> Engku Ali E.R., Odierno H.S.P., *Ismail A . Essential Guide to Takaful (Islamic Insurance)*, CERT (Centre for Research and Training) Publications Sdn Bhd, Malaysia, 2008), 58.

(RTA), 1987). It is an offence for any person to use or cause or permits any other person to use a motor vehicle without the necessary coverage.

A third party is an injured person, or a person who suffered loss or damages arising from an accident involving the participant's motor vehicle. A third party may be a pedestrian, a driver or passengers in another vehicle<sup>12</sup>.

Besides providing coverage against death and injury to third parties, Third Party Takaful policy coverage provides protection against other legal liabilities such as damage to the property of a third party (usually somebody else's car or motorcycle or a neighbor's gate) and certain specified legal costs. A policyholder may opt to include protection for loss or damage to own vehicle due to fire or theft only (Persatuan Insurans Am Malaysia (PIAM) Guidelines, 2008).

Further, it was firmly embedded under this Motor Takaful category a policy known as Legal Liability to Passengers (LLP). This is applicable for those claims made by passengers against the participants of the same car for dangerous reckless driving that has caused the accident to occur.

The RTA 1987 does not make it compulsory for the car owner to cover those liabilities towards non-fare paying passengers because such private car policies in Malaysia usually excludes Legal Liability to Passengers<sup>13</sup> However this does not mean that an injured passenger of a car cannot successfully sue the negligent driver.

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<sup>12</sup> <<http://www.insuranceinfo.com>>, viewed on 17 October 2009.

<sup>13</sup> Road Transport Act, 1987 (Endorsement 100 of 1987).

In view of this possibility, owner of the private car might want to consider purchasing LLP cover as additional benefits. LLP extension is available to both comprehensive and Third Party policies subject to additional premium. The premium to cover for LLP depends on the capacity of your vehicle. LLP extension however, does not cover liability towards fare paying passengers because as a car owner, the driver is not supposed to charge his passengers' fares like a bus or a taxi (Easy Commerce, 2009)

The third party has the right to claim against property damage with the maximum limitation of RM3 million as well as those losses that caused death or bodily injury which the amount claimable is of no limitation (Etiqua Report, 2008)

The third party shall be entitled to claim for those damages towards properties not belonging, in trust or control of the participants or members of the participant's household (Engku Ali et al., 2008). Nevertheless, the third party are not to be compensated for any damages in respect of judgment not in the first instance obtained from a court of competent jurisdiction within Malaysia, Singapore or Brunei. Further, the third party is not entitled to the cost and expenses of litigation, which not incurred in these three countries. The third party may also claim for the loss of use of the vehicle under repair and this shall extend to the loss of use that includes items such as cost of taking alternative transportation or hiring a replacement vehicle<sup>14</sup>.

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<sup>14</sup> <<http://www.insuranceinfo.com>>viewed on 17 October 2009.

It is the policy of the Takaful Company to undertake in compensating for death or bodily injury to any person including the passengers in the vehicles. This shall not include the insured or the driver at the time of the accident, their families spouse, parents and children and the employees of the insured. If they are injured during the working hours or because of their work (Islamic Arab Insurance Co. (SALAMA), 2007) such limitations provided under the policy is an example of the current practice upheld by the Motor Takaful industry locally as well as worldwide.

Going back to the definition of Takaful itself, Ta-awun and Tabarru forms the fundamental grounds for Takaful to be in line with the Syari`ah. As far as the Takaful definition is concerned, these two essential elements are applicable to those who have contributed their part into the fund, namely the participants only. This means should the participants suffer any losses arising out of any accidents or misfortunes, they have the right to claim from the Takaful fund since they have donated their contributions towards the pool of fund.

However, based on the current practice both globally and in Malaysia, it can be evidently observed that such compensation is extended to third party including pedestrian, driver or passengers of another vehicle or those who falls under the LLP category. The inconsistency observed between the definition of Takaful and the extension of permitted compensation awarded to the third party as non-participants under Motor Takaful has caused confusion to many.