

**CONVENTIONAL INSURANCE (MNI) AND ISLAMIC
INSURANCE (STMSB) WITH SPECIAL REFERENCE
TO THEIR MODUS OPERANDI**

BY

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بَوْتَنَبَرُوتِنَتِي اِسْلَامُ اِنْبَارَا اِنْبَارَا اِنْبَارَا

INTERNATIONAL ISLAMIC UNIVERSITY

CONVENTIONAL INSURANCE(MNI) AND ISLAMIC INSURANCE(STMSE)
WITH SPECIAL REFERENCE TO THEIR
MODUS OPERANDI

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To my beloved father, mother, akak, bang Mat, Amin, Jijot, Diah,
Din, Halim, Nora, Nunui and Dayah.

-whose love, patience and understanding have b . unfailing.

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Needless but always necessary to say, I alone am responsible for errors of fact and interpretations.

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LIST OF ABBREVIATIONS.

- STMSB- Syarikat Takaful Malaysia Sendirian Berhad.
- MNI - Malaysia National Insurance.
- DGI - Director General of Insurance.
- BMP - Business Motor Policy.
- PMP - Personal Motor Policy.
- ICA - Inter Company Agreement.
- PA - Participant's Account.
- PSA - Participant's Special Account.
- MGIC - Malaysian Government Investment Certificate.
- IGSF - Insurance Guarantee Scheme Fund.

Chapter I

INTRODUCTION.

From the earliest times people have tried to protect themselves from loss. The ancient Greeks organised a life insurance system. The first insurance company was chartered in Flanders in 1310 to protect cargoes. But insurance did not really begin until about 17th century when shipowners, navigators and merchants in London began to share the risk of losing a ship at sea. These men met at Lloyd's coffeehouse. Lloyds eventually changed from a coffeehouse to one of the largest insurance organisations in the world.¹

In Malaysia the number of insurance companies operating excluding the national re-insurance company totalled 63 at the end of 1985 of which four conducted life insurance, forty five general insurance and fourteen both life and general insurance business. Three foreign companies restructured during the year, thereby increasing the total number of locally incorporated companies from fifty in 1984 to 53 at the end of 1985. The number of brokers and loss adjusters operating domestically at the end of the year remained unchanged at 61 and 51 respectively.²

Since the Muslims all over the world experienced what is being termed as "Islamic Resurgence"³, Muslims in Malaysia never been excluded. Therefore in August 1982, to meet the insurance needs of the Muslim community the government established a working group comprising representatives from the universities and relevant ministries concerned to study the possibility of establishing takaful companies, that is insurance companies based on Islamic principles of mutual responsibility, cooperation and assistance. Takaful, as an alternative to

1. The Children's Encyclopaedia, The New Book of Knowledge, Canada, Grolier Incorporated, 1967, p. 293-297.

to the present interest based insurance schemes will fill the gap in providing the Muslim community the savings, protection and cover elements based on the syariah concept of solidarity and fraternity among Muslims. The working group submitted the Takaful Report to the Islamic Consultative Body in April 1984. With the adoption of the report by the government, the Takaful Act 1984 was gazetted on December 31, 1984.

A. Project Procedure.

1. Objective of Study.

All the insurance companies except for Syarikat Takaful Malaysia Sendirian Berhad (STMSB) carry out their operation according to the western economic doctrines, whereas Takaful Business means business of takaful whose aims and operations do not involve any element which is not approved by syariah.

Since the development of STMSB still at initial stage, we are yet to see the extent to which the company has played its role in achieving the national objectives and to uplift the economy of Malaysian Muslims.

Specifically the objectives of this study are:-

- a. To study the principles and nature of both conventional and Islamic system.
- b. To study STMSB and Malaysia National Insurance (MNI) carry out their modus operandi mainly focus on life and general insurance.
- c. To evaluate the growth of both insurance systems.
- d. Overview and problems of insurance industry in Malaysia.
- e. To suggest policy changes with a view to improve the insurance industry in Malaysia and the possibility to set up Islamic reinsurance facilities.

2. Malaysia, 1985 Bank Negara Annual Report, Kuala Lumpur, Finance Ministry, p. 103.

3. Ali E. Millal Dessouki, Islamic Resurgence in the Arab World, 1st ed, New York. Praeger Publishers, 1982. p. 3.

2. Hypothesis.

Within the framework of the objectives it is contended that:-

a. For MNI it could be said the general insurance system mainly focus on

1. Fire
- ii. Motor Insurance
- iii. Marine and Aviation
- iiii. Engineering.

b. Since the modus operandi almost alike for both STMSB and MNI and the only different lies on the principles, so naturally the points are interchangeably used through out the chapters.

c. The concept of life insurance being used for MNI whereas for STMSB, the concept of family takaful business shall be used.

d. Since STMSB still at infancy stage, various problems are being expected.

Chapter II

RESEARCH METHODOLOGY

The investigation was carried largely through two ways of study that is to say library research and personal interview.

Library research is needed in analysing and examining the fundamental facts about the insurance system itself. It will also bring good exposition on how writers discuss the contemporary insurance practice. Journals, bulletins, statistical report, magazines and paper cuttings are utilised as well.

Personal interviews also have been carried out in order to get the current information and to get a deeper understanding about every aspect that are being investigated. Personal interviews also mainly focus towards enlightening the dubious issue for both the insurance system.

A. Scope of Study.

It is assumed that the information and data obtained is sufficient to give a good account of both conventional insurance systems and STMSB carry out their operations.

B. Limitations.

Although the investigation was carried largely through library research and personal interviews, certain limitations and shortcomings are being expected.

Since STMSB still at infancy stage, so various problems arise such as lack of expert mastering both in the

field of conventional insurance system and in the field of syariah.

Other shortcoming such as certain data or informations are being kept out from public for various reasons such as for marketing strategy. This also will affect the outcome of this paper.

Certain library set up their own policy not allowing non member to borrow books from their own library. This problem lead to minor defeciency in getting information or data with respect to insurance system.

Even though there exists certain limitations to this study, it is hope that the analysis and conclusion derived will provide valuable insight of both STMSB and conventional insurance system and their role in benefitting the masses.

Chapter III

LITERATURE REVIEW.

STMSB and MNI operates as a business organisation. For both insurance system, their success and growth would greatly depend on the direct and active support of the public. The principle guidelines of Islamic and present conventional insurance system is greatly different due to three main elements that is to say risk, gambling and interest.

A. Western Economics Guidelines.

1. Risk

The word "risk" has been used in connection with insurance. However there is no one generally accepted definition of risk. G. William defines risk as an element of uncertainty as to whether losses may or may not be sustained.⁴ But bear in mind that there is a difference between risk and uncertainty. Risk implies a predictable chance of loss; the whole insurance industry is based on the predictable rates of death, accidents and other disasters. Uncertainty implies the impossibility of knowing or predicting the outcome of a venture. With uncertainty comes the possibility of loss, the waste of time, energy and resources on an objective that was not attained.

At least four additional definitions involving the word risk can be offered.

i. Subjective risk.

ii. Objective risk.

iii. Pure risk.

iiii. Speculative risk.

4. G. William, Understanding Insurance, 1st ed, London. Waterlow Publishers Limited, 1983, p. 1.

Subjective risk refers to the perception of risk by the individual. For example two individuals may have the same exposure to loss, losing their house by fire, but one person may feel much more uncertainty about the event than the other. The individual who feels more uncertainty is said to have a greater subjective risk than the other individual.

Objective risk refers to a state of nature or the actual risk as measured by the chance of loss. In fact the terms "objective risk" and "chance of loss" are interchangeable in some cases, although the term "objective risk" is broader in that it conveys an idea of the variability of outcomes about a predicted chance of loss.

Pure risk refers to those situations that can result only in a loss or in no change. Nothing good can come from exposure to pure risk.

Speculative risk refers to those situations that may result in gain, loss or no change. In this case also the insurer is exposed to a speculative risk in that the value of actual claims insured may be higher or lower than that projected in rate structure. If they are higher, the insurer loses, if they are lower, the insurer gains. Therefore Robert I. Mehr and Emerson Cammack defines speculative risk as "the exposure to fluctuations between actual claims incurred and those expected".⁵

The measure of degree of risk is the accuracy in which losses can be predicted. The degree of risk is measured by probable variation of actual experience from

5. Robert I. Mehr and Emerson Cammack, *Principles of Insurance*, 7th ed, Illinois. Richard D. Irwin Publishers, 1980, p. 19.

expected experience. The lower the probable percentage of variation, the smaller is the risk.

Risk also much depend on the future elements. If the future cause of event is perfectly predictable, no risk exists. If it is known that something will or will not occur, no uncertainty prevails and hence no risk. The inability to predict the cause of future event is the essence of risk. As events become more predictable, risk is reduced.

2. Interest

Interest plays a very important role in western economic doctrines and practices. Mc Connell defines interest as money income payments which flow from private business as supplies of money capital.⁶

Interest as defined by G. Lipsey is a payment for the use of money.⁷ The interest rate is the price of using money for one year, and then returning it. One does not buy money, he buys its services and the interest rate is the price paid for those services.

Although most of the modern western economists accept interest as defined above, certain traditional and contemporary western economists have a different view regarding interest.

The classical economists like Adam Smith, Ricardo treated interest as the compensation which the borrower paid to the lender for the profit the former would make by the use of the latter money.⁸ Among the classical writers like St. Augustine, St. Thomas Aquinas, Antonius of Florence, Plato and many of their followers condemning the element of interest.

6. Campbell R. Mc Connell, Economics, 6th ed, London. Mc Graw-Hill Book company, 1980, p. 68.

7. Richard G. Lipsey, An Introduction To Positive Economics, 5th ed, London. Weiden Feld and Nicholson, 1978, p. 470.

8. Mannan M.A., Islamic Economics, Theory and Practice, ? ed, Islamabad. Sh. Mohammad Ashraf, 1970, p. 161.

Thomas Aquinas was of the opinion that to take usury for money lent is unjust in itself because this is to sell what does not exist.⁹

Some of the western economist argue that interest play very important role in determining saving. But this was heavily criticised by Keynes. He held the view that it is the level of income rather than the rate of interest that ensure equality between saving and investment.¹⁰ Saving do not much depend on interest as on the level of investment and employment.

In insurance practice the principle of insurable interest is the basic concept being used. For example in the case of property insurance, an insurance interest is any financial interest based on some legal right in the preservation of the property. In a property insurance contract the time at which this interest must be shown to exist is when the loss occurs. In the event that the insured survives the term of contract, he or she will get back all the premiums paid plus some interest.

3. Gambling.

Gambling is playing games for money, taking risks for possible advantage.¹¹ Examples of gambling are games involving money stakes or bidding. According to Encyclopaedia Britannica, gambling is the form of betting or staking of something of value with consciousness of risk and hope of gain on the outcome of a game, a contest or any other uncertain event.¹²

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9. Afzalur Rahman, Economic Doctrines of Islam Vol 3, 2nd ed, United Kingdom. Islamic Publications Limited, 1975, p.12.
10. Keynes J.M., The General Theory of Employment, Interest and Money, 2ed, New York. Harcourt Brace and World Inc, 1936, p.196-197.
11. Hornby A.S., Oxford Advanced Learner's Dictionary of Current English, 21st ed, Oxford. Oxford University Press, 1985, p.402.
12. The New Encyclopaedia Britannica, Volume IV, 1982, p.402.

One of the characteristics of the insurance contract is that contract maybe either commutative or aleatory. The insurance contract however is aleatory. The distinguishing feature of an aleatory is the presence of chance. For example there is an element of gambling where if a loss is suffered, a much larger amount may be received from the insurer than was paid in premiums and if no loss is suffered (the more likely outcome), nothing will be paid.

According to Robert I. Mehr and Emerson Gammack, all gambling contracts are aleatory but not all aleatory contracts are gambling contracts.¹³ Unlike a gambling contract insurance is not designed to offer insureds a chance for profit but the opportunity to offset possible losses by providing a method of reducing risks.

B. Islamic Economic Guidelines

1. Risk

Human life can never be free from risk and uncertainty. We do get used to some small risks and anxieties. Man in his day to day life is invariably exposed to the possibility of meeting catastrophes and disasters which may give rise to misfortune and tragedies such as death, accident, sickness etc. As a Muslim we must believe in any catastrophe and disaster that fall on him as "Qadha'" and "Qadar" from Allah and he must face these events of ill luck with strength of faith and patience. Regarding this Allah said in Al-Quran Surah An'am, verse 65¹⁴,

Say: "He hath power to send calamities on you from above and below, or to cover you with confusion in party strife, giving you a taste of mutual vengeance—each from the other."

13. Robert I. Mehr and Emerson Gammack, *op. cit.*, p. 127-128.

14. For further explanation, please refer A. Yusuf Ali, The Holy Qur'an: Text, Translation and Commentary, 1st ed. Lahore. Amanah Corp, 1954, p. 306.

Regarding the word "calamities", A. Yusuf Ali refer calamities from above and below such as storms and blizzards, torrential rain, earthquakes, floods, landslides etc.

Since the human life is too expose to the calamities as stated above, so the only solution is to seek protection from Allah S.N.T. In Surah An'am, verse 62¹⁵, Allah said,

"Then are men returned unto God, their protector, the (only) reality: Is not His the command? And He is the swiftest in taking account".

With reference to the word "reality", A. Yusuf Ali explain that it is Al-Haqs, the Truth, the only True one. The point is that our illusions of the life of this lower world now vanish, when we are rendered back to God, from whom we came. And now we find that so far from the results of our actions being delayed, they follow swiftly than we can express in terms of time. Here is the answer of those who were impatient of the working of God's plans.

It is also the duty of every Muslim to find ways and means to avoid such catastrophes and disasters or unfavourable incident wherever possible and to lighten his or his brother's burden should such events occur. Here it give rise to the concept of cooperation among Muslim brothers. In order to lighten the burden of unfavourably risk, A. Yusuf Ali clearly gave the essence of Surah An-Nisā from verse 71 to 91 as follows!¹⁶

Keep together in your noble brotherhood. Share its joy and sorrow. Strive and fight the good fight and never fear. For this life is short and the Hereafter eternal. Allow

15. Ibid, p. 305.

16. Ibid, p. 1062.

not ourselves to be drawn into unbelief and cowardice. Maintain the right. Protect yourselves against hypocrites and deserters, but pursue them not unrelentingly.

2. Interest

The Holy Quran declared interest unlawful in the Muslim community. Allah said in Surah Al-Baqarah verse 275-276¹⁷,

"Those who devour usury will not stand except as stands one whom the evil one by his touch hath driven to madness that is because they say: "Trade is like usury, but God hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist shall be pardoned for the past, their case is for God (to judge), but those who repeat the offence are companions of the fire, they will abide therein (forever). God will deprive usury of all blessing but will give increase for deeds of charity. For He loveth not creatures ungrateful and wicked."

In the following verse of the Holy Qur'an, the Muslims are warned to obey injunctions regarding interest as contained in the book, or else they shall suffer the same fate as the Jews, who were forbidden (to take) interest but they continue taking interest. In Surah An-Nisā, verse 161¹⁸, Allah said,

"That they took usury though they were forbidden and that they devoured men's substance wrongfully, we have prepared for those among them who reject faith a grievous punishment".

17. Ibid, p. ?

18. Ibid, p. ?

Interest is also strictly prohibited in Islam as being viewed from the hadith.¹⁹

From 'Aun ibn Hanifa who reported from his father that the Holy Prophet had condemned both the receiver of interest and its payer. In other occasion, 'Abdullah ibn Mas'ud reported that the Holy Prophet cursed the receiver of interest as well as its giver. Then the Holy Prophet on his last pilgrimage and in his last address said, "Every form of interest is cancelled, capital indeed is yours which you shall have, wrong not and you shall not be wronged. God has given his injunctions that interest is totally forbidden."²⁰

Muslim scholars such as Imam Razi and 'Abul A'la Maududi has discussed lengthy arguments on the evilness of interest. Imam Razi has attempted to explain why interest is prohibited in Islam. He has given many reasons supporting the prohibition of interest. The first argument according to him is that interest devouring other peoples wealth. The transaction of interest necessitates taking another persons without any consideration or reward. Such transaction very often reduce the debtor to poverty through exploitation.

Imam Razi also argue that interest prevents wealthy people from adopting any profession or occupation because they find it easier to earn their livelihood through interest. They do not like to invest their capital in other commercial enterprise which entail hardship as well as risk.

The second argument is that interest will abstain people from borrowing. When people borrowed money they must pay exceed the amount that they have borrowed.

19. Said Ramadan, Islamic Law: Its Scope and Equity, 2nd ed, Geneva. 1970, p.43. He defined hadith as an Arabic word which literally means "method" was applied by the Prophet as a legal term comprising what he said, did and agreed to.

20. Afzalur Rahman, op.cit., p, 66. The hadith was reported by Bukhari, Muslim and Imam Malik respectively.

The third argument is that the institution of interest helps in spreading ill-will and hatred in society, the poor people realising that the creditor has been eating their wealth through interest curse him and wish evil on him.

The fourth argument is the fact that the rich grows richer and the poor become poorer. It may seem apparent that increases wealth of lender (richer) and diminishes the wealth of the borrower (poor).

The last argument according to Imam Razi is that the institution of interest will diminish the creditor position in the society. He loses his respect in the community and is considered an enemy and a parasite, rather than a friend and a benefactor.

There are two types of interest that is to say interest in debt 'Riba Nasia' and interest in barter 'Riba al-fadl'. For riba nasia was quite wide spread and well known in the time of Holy Prophet. This type of interest was normally found in all those credit transactions where a loan was advanced to a person on the payment of a monthly interest over and above the principal and if the debtor was unable to repay it, the former would extend the period of payment on the condition that the latter would pay a certain additional sum of money which was determined at the time of transaction. That certain additional sum of money is prohibited in Islam.

There is one occasion where Abdullah ibn Umar was asked about a person who had lent some money to another person for a specified period. The borrower had requested the creditor to reduce the sum due and that he would repay it just then (i.e. before time) but Abdullah disliked it and forbade not to accept the offer for there was doubt of the element of interest in it.²¹

²¹. Reported by Imam Malik, Muatta respectively.

Riba al-fa'äl is the excess over and above the loan paid in kind. It lies in the payment of an addition by the debtor to the creditor in the exchange of commodities of the same kind that is to say wheat for wheat, barley for barley or grapes for grapes etc. The Holy Prophet did not confine the application of riba to credit transaction in money only but to cover all other forms of barter sales (or purchases) of commodities as in one occasion, 'Umar reported that the Holy Prophet said, "To sell wheat for wheat, barley for barley, dates for dates is riba except when sold from hand to hand (i.e. transaction is completed on the spot)²²."

So the element of interest as being witnessed by the sayings of Holy Prophet bear evidence to the fact that an element of interest is found not only in money transactions in which one person receives an excess over and above the commodity exchanged.

3. Gambling

The third element forbidden by Al-Qur'an is gambling.²³ In Surah Al-Baqarah, verse 219, Allah said,²⁴

"They ask thee concerning wine and gambling.

Say in there is great sin and some profit, for men but the sin is greater than the profit".

²². This was reported by Bukhari.

²³. A. Yusuf Ali, *op. cit.*, p. 86. He defines the word gambling as getting profit without working for it, hence gambling. That is the principle on which gambling is prohibited. The form most familiar to the Arabs was gambling by casting lots by means of arrows, on the principle of a lottery: the arrows were marked and served the same purpose as a modern lottery ticket.

²⁴. A. Yusuf Ali, *op. cit.*, p?

Islam prohibits any game which involves an element of gambling in it. Gambling makes a person dependent on chance, luck and empty wishes. Infact the Islamic teaching urge the Muslim to follow Allah's directive for earning a living and to use natural laws and direct means for the attainment of his objectives. Gambling is a danger to the society as well as to the individual. This habit consumes gambler's time and energy, making them non productive and parasites on society. It often happens that a gambler sells his honour, religion and the country for the sake of the gaming table.

Chapter IV

THE ESTABLISHMENT OF SYARIKAT TAKAFUL MALAYSIA SENDIRIAN BERHAD (STMSB).

The government's aim in establishing a company to carry out the takaful business is to ensure that Muslims can participate actively in insurance scheme which adheres strictly to Islamic principles.

As a result Syarikat Takaful Malaysia Sendirian Berhad (STMSB) was incorporated as a private limited company in accordance with the companies act 1965 on 24th November 1984. The incorporation and launching of the company represents the culmination of efforts by the government and Muslims in Malaysia to establish an Islamic insurance company which in conformity with syariah.

STMSB has a paid up capital of \$10 million with Bank Islam Malaysia Berhad holding a 51% equity.²⁵ The remaining 49% share comprise mainly the various state religious councils and state religious foundation within Malaysia. As a result the takaful act 1984 was gazetted on December 31, 1984 and began business operation on 2nd August 1985.

A. Takaful As A Basis For Islamic Insurance.

The word takaful in Arabic means joint guarantee. The members of the group agree to guarantee jointly that should any of them suffer a catastrophe or disaster, he will receive a certain sum of money to help him meet the loss. The concept of takaful therefore embodies the principles of cooperation, mutual help and shared responsibility. All these principles are intended to generate values and practices which are incidentally beneficial to all man.

²⁵. STMSB is the subsidiary of Bank Islam Malaysia Berhad, a licensed bank incorporated in Malaysia.