

Younes Soualhi

Article

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ISRA International Journal of Islamic Finance

Provided in Cooperation with:

International Shari'ah Research Academy for Islamic Finance (ISRA), Kuala Lumpur

Suggested Citation: Younes Soualhi (2017) : Challenges of developing a takāful retirement annuity plan in Malaysia, ISRA International Journal of Islamic Finance, ISSN 2289-4365, Emerald, Bingley, Vol. 9, Iss. 1, pp. 95-99,
<https://doi.org/10.1108/IJIF-07-2017-009>

This Version is available at:

<https://hdl.handle.net/10419/236902>

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Challenges of developing a *takāful* retirement annuity plan in Malaysia

takāful
retirement
annuity plan

Younes Soualhi

Research Affairs Department, International Shari'ah Research Academy for
Islamic Finance, Lorong University, Kuala Lumpur, Malaysia

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Received 1 March 2017
Revised 18 March 2017
Accepted 20 March 2017

Abstract

Purpose – This paper aims to explore the challenges facing the development of a *takāful* retirement annuity plan in Malaysia. It also aims at exploring a new platform to re-launch the same product after being withdrawn from the Malaysian annuity market a few years ago.

Design/methodology/approach – The research adopts a qualitative approach to address the possible challenges hindering the development of a *takāful* retirement annuity plan in Malaysia. The research will not discuss the Sharī'ah issues deemed settled in previous researches but will only focus on technical challenges related to the instruments of investment and prudential measures.

Findings – The research found that various challenges face the development of a *takāful* annuity plan in Malaysia. Some of those challenges are the downsizing of the *ṣukūk* market, the shortage of long-term *ṣukūk*, longevity risk and risk-based capitalization. The research found that there is a need for a diversified portfolio of securities instead of solely using *ṣukūk* as an investment instrument in this product.

Originality/value – Re-launching the *takāful* annuity plan in Malaysia requires the identification of actual challenges facing the development of such a product. The product purported to be re-launched would benefit a large segment of retirees who do not have enough savings during the retirement age. The introduction of such a product will also expand the *takāful* market in annuities, which remains untapped.

Keywords *Takāful*, Retirement annuity plan, Longevity risk, *Ṣukūk*

Paper type Research paper

Introduction

Annuities have long been perceived as back-up financial plans during retirement age and a means to reduce longevity risk when an individual outlives his/her assets. The annuitant seeks to secure steady payouts during retirement age by trading liquid lump sums in return for a series of payments until he/she passes away. The product can also include riders such as death benefits or a combination between fixed and variable annuities to protect against the shortfall of investing the annuity fund. The product, which is sold by life insurance and investment companies, passes through two phases: an accumulation phase followed by an annuitization phase. During the accumulation phase, the contributions of the annuitants are accumulated, and the annuity fund is invested in long-term bonds with variant exposure to market risk. During the annuitization phase, the stream of payments during retirement is



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ISRA International Journal of
Islamic Finance
Vol. 9 No. 1, 2017
pp. 95-99
Emerald Publishing Limited
0128-1976
DOI 10.1108/IJIF-07-2017-009

made. The different types of annuities – such as fixed, variant, guaranteed and joint – have helped the market to cater for the needs of annuitants and their heirs before and after retirement age (Alhabshi *et al.*, 2012).

takāful markets such as Malaysia's have sought to develop a Sharī'ah-compliant annuity product serving the same objective sought by a conventional annuity, i.e. guaranteeing a stream of payments during retirement age with available riders to secure death benefits. In 1999, Malaysia launched the first Sharī'ah-compliant annuity plan dubbed Employment Provident Fund (EPF) *takāful* Annuity Scheme (SATK) (Yusof *et al.*, 2011). Although the product was widely received by the industry and employees, it was withdrawn in 2002 due to pricing and risk-based capital (RBC) requirements, among other reasons (Ismail, 2017). Some institutions such as Amanah Raya offered a Sharī'ah-compliant Public Mutual Private Retirement Scheme (PRS) that invested the contributions in both *ṣukūk* and stocks as a strategy to diversify returns in view of the volatility of the stock market. HSBC Amanah offered a non-guaranteed annuity up to the age of 75 years (Ismail, 2017). By and large, this product was offered under the PRS, which insurance companies, *takāful* operators, banks and unit trusts are permitted to offer.

The International Sharī'ah Research Academy for Islamic Finance in collaboration with Prudential BSN *takāful* came up with the conceptual framework and structure for a Sharī'ah-compliant model of a retirement annuity plan (Ali *et al.*, 2014). The paper discussed the potential Sharī'ah issues arising in the proposed model and highlighted some challenges of introducing the *takāful* annuity plan in Malaysia.

The current paper explores the possibility of relaunching the annuity retirement plan in Malaysia. It particularly seeks to address the key operational challenges in view of previous practices and input from industry players as well as research findings on annuities in Malaysia.

Proposed Sharī'ah-compliant model for retirement annuity plan

Ali *et al.* (2014) proposed *wakālah* (agency) and *hibah mu'allaqah* (conditional gift) as the underlying concepts for offering a Sharī'ah-compliant retirement annuity plan. The *wakālah* concept is used to manage and invest the annuity fund until the retirement age (i.e. during the accumulation period). This will be followed by *hibah mu'allaqah* whereby the contributions and the profits arising from the investment of the annuity fund will be donated to the *tabarru'* (donation) fund to start the annuitization stage. The *tabarru'* fund is used to make the stream of payments during retirement (i.e. retirement payout) and to pay the death benefits (i.e. death payout). Figure 1 depicts the mechanics of the proposed product.

After establishing the Sharī'ah compliance of the model, Ali *et al.* (2014) identified *ṣukūk* as a potential investment instrument during the accumulation period. Citing longevity risk and lack of investment instruments as potential challenges, the paper recommends issuance of more long-term or perpetual government *ṣukūk*.

Research objectives

The current research aims to achieve the following objectives:

- to unveil the potential market of *takāful* retirement plan in Malaysia;
- to identify the main challenges facing the development and the launching of *takāful* annuity plan in Malaysia;
- to explore the possible synergy between the *takāful* industry and the *ṣukūk* market in Malaysia;

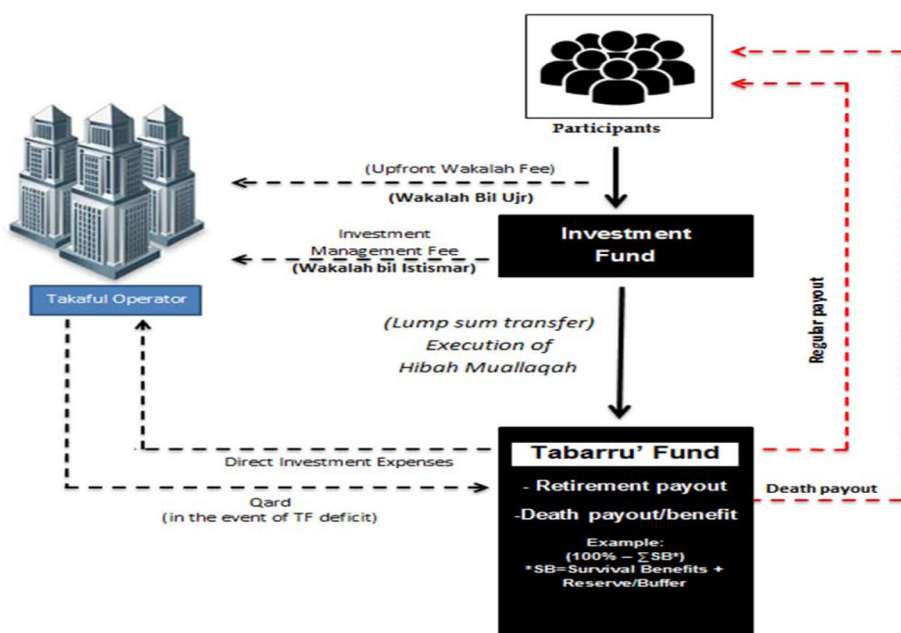


Figure 1.
Proposed model for
takāful annuity plan

Source: Based on concepts explicated in Ali *et al.* (2014)

- to compare the proposed *takāful* annuity product with similar retirement plans in Malaysia such as Government Pension Scheme, EPF and PRS; and
- to explore the possibility of relaunching the annuity retirement plan in Malaysia in view of the identified challenges.

Methodology

The research is qualitative in nature and uses three methodological instruments:

- literature review: review the main literature on annuities to identify the main challenges of *takāful* retirement plans;
- content analysis: analysis of the literature from Sharī'ah, legal and operational perspectives; and
- semi-structured interviews: identify the main challenges facing the development of a viable *takāful* annuity retirement plan in Malaysia and the way forward.

Challenges of introducing *takāful* annuity plan in Malaysia

From the practices of *takāful* annuity in Malaysia as well as some research outputs conducted on the feasibility of the proposed product, there is a need to assess the cited challenges of the proposed product and zoom in on the real challenges hindering the development of *takāful* annuities in Malaysia. The present research focuses on operational

challenges in view of previous practices and input from industry players as well as research findings on annuities in Malaysia. Preliminary challenges found are the following:

- Insufficient *ṣukūk* instruments that can be used in the accumulation stage of the annuity product. This is based on statistics that showed that the number of long-term *ṣukūk* (20 to 30 years' maturity) and perpetual *ṣukūk* are dwindling, which makes it difficult to develop an annuity product that guarantees a stream of payments from retirement till death of the annuitant.
- Downsizing of the *ṣukūk* market as a result of *ṣukūk* under-rating and possible default events.
- The majority of *ṣukūk* are redeemed long before maturity, a factor that would affect the expected returns on *ṣukūk*, jeopardizing the long-term payouts during retirement.
- The challenge of longevity risk as people are living longer due to improved living conditions and health care programmes. This would mean that the regular payouts of the annuities would have to undergo a harmonization of assets and liabilities to avoid paying more annuities for longer lives (asset-liability mismatch).
- The deficit of the annuity fund and the operational aspect of *qarḍ* (loan) injection and its repayment. As depicted in Figure 1, in the event of deficit, the *takāful* operator provides *qarḍ* to the *tabarru'* fund. This may be seen as a capital guarantee on its part, as it is merely a *wakīl* (trustee) not a guarantor during the accumulation period. If the *qarḍ* is injected into the *tabarru'* fund, then it would be difficult to justify the occurrence of the deficit if the payout is based on an "upon claim basis".
- RBC requirement makes *takāful* annuity products less affordable as the uncertainty featuring the longevity risk would require more allocation of capital with prices soaring beyond the affordability of annuitants.
- EPF is unlikely to accept any withdrawals by employees to contribute to the annuity scheme. Annuitants would have to find other sources to buy the product, which is practically very challenging in view of the scarcity of sources and strict regulations on pension schemes.
- The applicability of the Islamic Financial Services Act 2013 on the proposed *takāful* annuity plan has yet to be put to the test. The definition of a defined risk in a typical *takāful* arrangement versus a known event in an annuity may pose a Shari'ah and legal issue as far as this product is concerned. Governance issues may arise as well.

Conclusion

The present study capitalizes on previous practices of *takāful* retirement plans and research conducted on *takāful* annuities in Malaysia. The research aims to identify the main challenges facing the development of such a product and the possibility of relaunching it by *takāful* operators in Malaysia. The preliminary findings of the research have unveiled a number of challenges that will be put to the test via content analysis and semi-structured interviews. Preliminary conclusions suggest that the *takāful* annuity product should have diversified investment portfolios both in terms of maturity and asset quality. Capitalization of annuities should be better regulated to reduce cost and price. Besides, outsourcing the contributions from funds such as EPF is not recommended in view of a *ṣukūk* market marred by uncertainty and scarcity of long-term *ṣukūk* instruments.

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Further reading

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About the author

Younes Soualhi, PhD, is a Senior Researcher at the International Shari'ah Research Academy for Islamic Finance (ISRA), Kuala Lumpur, Malaysia. He holds a master's degree and PhD in Shari'ah. His research interests are in the areas of *fiqh al-mu'amalat*, *takāful*, Islamic banking and the Islamic capital market. Younes Soualhi can be contacted at: younes@isra.my