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Article

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The effect of IFSA 2013 on late payment of *takāful* benefits

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Abstract

Purpose – This paper aims to examine the implications of compensation on late payment of *takāful* benefit imposed in the Islamic Financial Services Act 2013 on the *takāful* industry in Malaysia. It also aims to identify the issues and challenges faced by *takāful* operators in the implementation of the compensation and propose solutions for the benefits of the *takāful* industry.

Design/methodology/approach – This research uses the qualitative approach to understand the practices of claims in *takāful* and to analyze the implication of compensation on late payment of *takāful* benefit to the *takāful* industry in Malaysia. Data are collected through survey and interview with various *takāful* stakeholders.

Findings – Some of the key findings in this research are that the compensation of late payment of *takāful* benefit has a positive impact to the *takāful* industry. The research also found some Shari'ah operational issues in terms of its implementation among *takāful* operators.

Research limitations/implications – The research focuses on compensation on late payment of *takāful* benefit claim in death and personal accident only.

Practical implications – The research offers certainty to the *takāful* industry and an explanation to academic and legal fraternities on the implementation of compensation on late payment of *takāful* benefit according to Islamic Financial Services Act (IFSA) 2013.

Originality/value – The research provides a valuable contribution to the current practices of *takāful* operators, identifies some issues and challenges of its implementation and proposes the solution.

Keywords *Takāful* benefit, claim, late payment, IFSA 2013

Paper type Research paper

Introduction

Buying a life insurance policy is an important financial planning tool that is widely used to protect against financial loss which would result from the premature death of the insured person. Many people die prematurely from illnesses and accidents, with devastating consequences for their families, who are left to pay funeral expenses and outstanding debts and find it difficult to maintain their standard of living. A life insurance policy provides death benefits if the policyholder dies within the tenure; otherwise, it makes available maturity benefits if the policyholder survives the policy term. The life insurance death benefits can only be paid subject to the beneficiary's submission of a death claim to the insurer.



The literature shows that claim fraud and claim denial have grown to voluminous proportions over the years. These factors have resulted in late payment of insurance benefits, which has proven controversial. Both insurers and policyholders have the obligation to act in good faith after an insurance contract has been formed. With the growing manifestation of claim fraud and claim denial in insurance, all stakeholders in the insurance industry understand the importance of the enactment of law to address these issues. Regarding late payment of insurance benefits in Malaysia, the now superseded Insurance Act 1996 imposed an obligation on insurers to pay interest of four per cent per annum in case a claim made under a life or personal accident policy was not paid within 60 days of its intimation (Insurance Act 1996) (BNM, 1996). The new Financial Services Act (FSA) 2013, which supersedes it, made a change requiring the insurer to pay a minimum compound interest plus one per cent or such other rate as may be specified by Bank Negara Malaysia (BNM) (FSA 2013) (BNM, 2013a, 2013b, 2013c).

The discourse on late payment of insurance claims and the development of the insurance regulatory framework are crucial for the reference of the *takāful* industry. However, the interest charges as currently practiced in conventional insurance are not compatible with *takāful* because of the prohibition of *ribā* (interest) in Islam. The now superseded Takāful Act 1984 did not explicitly address the issue of late payment of *takāful* benefits, and thus regulatory guidance on late payment of *takāful* claims was absent in the *takāful* industry. In line with efforts to streamline the regulatory framework of the insurance and *takāful* industry in Malaysia, the Islamic Financial Services Act (IFSA) 2013 introduced compensation on late payment of *takāful* benefits for the *takāful* industry. This is explicit in Schedule 10, Paragraph 12(1) of IFSA 2013. The introduction of this clause has paved the way for the *takāful* industry to develop a standard approach in the case of late payment of *takāful* benefits, which is important for *takāful* operators and *takāful* participants alike.

Research objectives

The objectives of this research are to:

- investigate the practices of *takāful* operators in complying with IFSA 2013 on the issue of compensation on late payment of *takāful* benefits;
- analyze the views of the regulator and *takāful* operators on the implications of this Act; and
- propose solutions for the identified issues.

Research methodology

The research adopts a qualitative approach and uses insurance as well as *takāful* literature and *takāful* operators' policies and operational documents to analyze this issue from the *takāful* perspective. In the effort of understanding this issue from the *takāful* operator's perspective, a survey questionnaire has been distributed to *takāful* operators to seek their views. In addition, semi-structured interviews and meetings with representatives from the regulator, Shari'ah authorities, as well as relevant personnel in selected *takāful* companies in Malaysia have been conducted. This research has been conducted with the collaboration of the Malaysian Takaful Association and *takāful* operators in Malaysia.

The concept of claim in insurance

The word “claim” literally means demand, assertion and right ([Dictionary.com, 2017](#)). In insurance, a claim refers to an application by a policyholder for reimbursement for loss or damage within the terms of an insurance policy ([Oxford, 2005](#)). In other words, life insurance benefits are not paid automatically by the insurer to the beneficiary without going through the claim process. Another relevant term which relates to the concept of claim is loss. “Loss” is used to denote the payment that the insurance company makes to the policyholder for the damage covered under the policy.

Settling a claim refers to its fair and prompt payment. It is one of the key objectives of insurance companies. The first step generally required by insurers in settling a claim is notification of the insurer of a death or loss. The insurer will require the claimant to submit a death certificate, claim form and the policy document as evidence. After the claimant submits the required documents, the insurer will investigate and make an assessment based on the documents and facts provided by the claimant. The most crucial part of the claim process is the decision as to whether the claim should be paid, delayed or denied.

Typically, an insurer will take 30-60 days after the date of the claim to review and pay it. Although the time frame for the insurer to settle the claim is not well regulated, insurers in many jurisdictions have had interest charges imposed on them for delay of claim payments. A longer period of delay will result in higher interest charges on the insurer. However, the payment of claims depends on the claimant providing sufficient documentation and accurate information to the insurer. Otherwise, a delay can be as long as several years and might end up with the claim being denied. In some cases, the insurer will take extra time to review the claim and delay the payment because of the contestability clause; for example, whether the insured died within the first two years after the policy was issued or the cause of death was homicide ([Investopedia](#)).

The mantra of some insurance companies is that insurance is a business of paying claims. In addition, some insurance companies have used efficient payment of claims as a marketing tool. However, the common perception among people is that insurance companies or their agents are warm and welcoming when they are trying to get business but quickly become cold and unwelcoming when they hear the word “claim” ([Rosenfeld, 2014](#)). This perception must be seriously tackled by the insurance industry because claims play an important role in the success or failure of an insurance company. In 2015, the total claim payouts to policyholders of life insurance in Malaysia amounted to RM 9.2bn. They increased by 5.1 per cent in 2016 when total payouts rose to RM 9.7bn ([Life Insurance Association of Malaysia, 2016](#)).

IFSA 2013 and compensation on late payment of *takāful* benefit claims

In 2003, BNM, the central bank of Malaysia, moved to strengthen consumer protection in the insurance industry by introducing guidelines on fair practices ([BNM, 2003](#)). Failing to promptly settle claims to a policyholder or beneficiary under one insurance policy to influence settlements under another insurance policy is deemed an unfair insurance practice in the guidelines.

According to the section on claims management in the Takaful Operational Framework issued by BNM on 26 June 2013, *takāful* operators must ensure that claims processing and payments are done promptly without unnecessary delays and that participants are treated fairly during the process. The growing significance of the *takāful* industry requires the development of an effective regulatory framework to provide an enabling environment to support its development. The timely introduction of IFSA 2013 addressed this need. Schedule 10, Paragraph 12(1) of IFSA 2013 states:

Where a claim or a part of a claim made under a family *takāful* certificate, or under a personal accident *takāful* certificate upon the death of a *takāful* participant is not paid by a licensed *takāful* operator within sixty days of notification of the claim, the licensed *takāful* operator shall pay a minimum compensation at the rate of investment yield of the participant's risk fund, plus one per cent or such other rate as may be specified by the Bank, on the amount of *takāful* benefits upon expiry of the sixty days until the date of payment, whereby the one per cent is to be paid from shareholders' funds.

IFSA 2013 has thus imposed a compensation to be paid by the *takāful* operator to the claimant if the *takāful* benefits are paid later than 60 days after a claim is made. The compensation comprises two components:

- (1) an amount at the rate of investment yield of the participant's risk fund; and
- (2) one per cent of the *takāful* benefits, which is to be paid from the shareholders' funds.

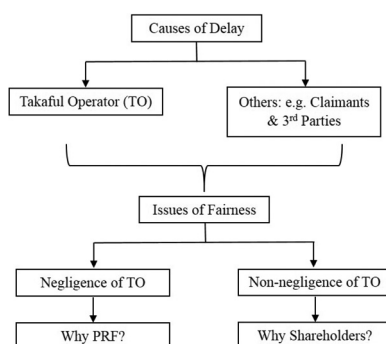
Implementation challenges relating to compensation on late payment of *takāful* benefits

Efforts to strengthen the claim practices in *takāful* operations are a positive development for the *takāful* industry. There are, however, several Sharī'ah and operational issues surrounding the implementation of compensation of late payment of *takāful* benefits.

The first question relates to the source of the money to be paid as the first portion of the compensation, which is at the rate of the investment yield of the participant's risk fund. It is not clear whether the money should come from the shareholders' fund or the participant's risk fund. IFSA 2013 mentions that "the *takāful* operator shall pay". However, it could be implying that the payment may come from the participant's risk fund. This is because *takāful* benefits are paid mainly from the participant's risk fund; hence, the claimant should also be entitled to any investment yield generated in the fund.

The second question arises from ambiguity about the rate of the investment yield. The Act does not specify whether it is the monthly rate or the yearly rate.

The third issue is that the *takāful* operator is required to pay the compensation regardless of the cause of the delay. The delay in payment could be because of the inefficiency of the *takāful* operator or it could arise from the claimant's act or omission or it could be because of a third party, as shown in Figure 1. In case the delay arises because of the *takāful* operator, it can be considered negligent and would therefore deserve to bear the consequences. In another



Source: Authors' own

Figure 1.
The issue of fairness
in the source for
compensation of late
payment of *takāful*
claim benefits

scenario, the delay could be because of the claimant's non-cooperation in providing the needed documents on time. Alternatively, the delay may occur because of a pending investigation or decision by a third party. In all three scenarios – whether the cause of delay is because of the *takāful* operator or a third party and/or the claimant – the issue of fairness arises. On the one hand, if the delay is not caused by the *takāful* operator, then shareholders will still be held liable and burdened with extra costs even though they are not the cause of the late payment. On the other hand, if the delay is really caused by the *takāful* operator, then the participant's risk fund may also have to bear the compensation. The question is whether this is fair to the fund and to all the participants. The Sharī'ah principles relating to negligence and misconduct, as well as the principle of liability, need to be analyzed in this regard.

The fourth question relates to disclosure. If the investment yield is paid from the participant's risk fund, does this feature require disclosure to the participants, for instance in the agreement? If such disclosure is made, then it may expose the *takāful* industry to manipulation and fraud by irresponsible parties, and worse still, this is not within the control of *takāful* operators.

Conclusion

The introduction of the compensation clause has provided the *takāful* industry with a standard approach in the case of late payment of *takāful* benefits, which is beneficial for *takāful* operators and *takāful* participants alike. The present study examines the impact on the *takāful* industry in Malaysia of compensation for late payment of *takāful* benefit claims. The research concludes that despite the positive response from the *takāful* industry on the requirement to compensate *takāful* participants for late payment of *takāful* benefits, some operational and Sharī'ah issues require further deliberation. The research aims to propose solutions and recommendations for the identified issues. The research will offer certainty to the *takāful* industry and explanation to academic and legal fraternities on the implementation of compensation for late payment of *takāful* benefits according to IFSA 2013.

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Further reading

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