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THE FEASIBILITY OF ESTABLISHING TAKAFUL IN UGANDA: LESSONS FROM THE EXPERIENCE OF MALAYSIA AND KENYA

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Abstract

Globally, the Takaful industry has experienced an exponential growth and expansion, penetrating not only western but also African Markets too. Takaful insurance is an alternative to conventional insurance. It is free from unlawful elements such as usury, uncertainty and gambling which makes its products Shariah compliant and adoptable to both Muslims and non-Muslims. As conventional insurance operates in the presence of reinsurance, Takaful institutions are also strengthened by Retakaful. It ensures that the Takaful company is feasible and free from any liquidity constraints. For any business to remain feasible and operative in an economy, Regulatory and Supervisory Authorities (RSA) must regulate its processes to ensure consumer's protection. Employing secondary data sources, this qualitative study aims to discuss the Malaysian and Kenyan Takaful regulations and consumer protection mechanism to underline their 'replicability' and feasibility in Uganda. The findings reveal that, as a Takaful operational regulatory requirement, Sharia supervisory board must be appointed to guide every

Takaful institution. Secondly, based on the rationale of "unavoidable circumstances," or necessity, Takaful companies can initially trade with conventional reinsurance companies. Increased awareness on consumer protection regulations can foster transparency and accountability of Takaful players.

Keywords: Takaful Regulation, Consumer Protection, Malaysia Takaful Regulation, Kenya Takaful Regulation

INTRODUCTION

Like Reinsurance is to the Insurance industry, takaful is intertwined with Retakaful industry. Retakaful is the backbone of Takaful industry. Globally, the Takaful industry has experienced an exponential growth and expansion, penetrating not only western but also African Markets too. Handayani & Alam, (2022) noted that, various countries have accepted the phenomenon of takaful as alternative insurance in parts of the world including European countries, such as the United Kingdom, France and Germany. As a sign of the development of Sharia insurance in Europe, Takaful insurance is also found in Switzerland, Belgium, and Australia. Amidst the development of takaful, the African continental region is inseparable from the history of discussion about the modern Sharia insurance. The inception of takaful is dated back in 1979 with the establishment of the first Takaful company "Islamic Insurance Company" in Sudan (H. A. Hassan, 2020). The study conducted by Dinç et al., (2019) observed that, the Takaful industry constitutes only 1.26% in terms of Takaful contributions. They further elaborated that the size of global Takaful industry represents just a half percent of global insurance sector which is US$5.2 trillion as of 2018. The largest share of Takaful contributions is from GCC region (45%), followed by MENA (39%), and Asia (16%). The global Takaful industry is represented by 306 Takaful and Re-Takaful operating companies, including 107 General Takaful Operators (TOs) and 57 Family TOs. Also, there are 45 composite Takaful companies, 76 windows, and 21 Re-Takaful Operators (RTOs) around the world.

According to (Yuhasni & Yusuf, 2011) reinsurance based on Islamic principles is known as Retakaful. Retakaful functions the same way as the conventional reinsurance as the primary risk mitigating tools for the takaful operators. Retakaful is therefore, a form of Islamic insurance business which provides financial risk protection to takaful operators compliant to Islamic rules and principles. In addition, (Karekezi, 2020) revealed that, the early stage of the takaful business, reinsurance capacities for takaful operators are predominantly fulfilled by conventional reinsurance companies, whose operations are not shariah-compliant. He further highlighted that, the practice continues to be acceptable by some Takaful operators based on the argument of “unavoidable circumstances” i.e., a necessity (darurah) due to the lack of Retakaful companies. Motawe Altarturi et al., (2021) states that, the Takaful and Retakaful window operations as a business model has been adopted in some countries such as Indonesia, Nigeria, Pakistan and Turkey to achieve certain objectives, including encouraging financial inclusion, tapping a new market segment, and boosting competitiveness. According to (Ali & Markom, 2021) in the study shariah compliance on Retakaful in Malaysia revealed that, Retakaful are very much needed in the takaful industry.

It should be noted that, the mechanism of Takaful works under Islamic Sharia compliance. Shariah is an Arabic term which denotes Islamic law or the Law of Allah (swt) (Anas et al., 2016). This means that Sharia is a divine law which should be complied by human being and the whole of human life to be guided by it. Ambos & Heinze, (2018) denoted that, the primary source of Shariah is Quran and Sunnah (prophet traditions) and the main secondary source namely ijtihad (independent critical reasoning) and ijma (consensus of commentators on a controversial point of law). Accordingly, in any business dealing, what is prohibited by shariah is also consequential to the Islamic faith. Abdullah & Muhammad, (2013) stated that, Islam has its own distinctive value-based ethical system for business dealings. It prescribes certain specific guidelines for governing business ethics. It; (1) enumerates the general ethical rules of business conduct (2) identifies ethically desirable forms of business, and (3) specifies the undesirable modes of transactions.

Therefore, in the perspective of Islamic law, it is important to understand the regulations of the main prohibited elements in financial transactions. This can be viewed from table 1 below;

Table 1: Main prohibited elements

Free from riba (an increase without ‘iwad or equal counter-value).	Free from khilabah (fraud), ghishsh (deception) and al-ikrah (coercion)
In compliance with the Maqasid of shariah.	Entitlement to profit depends on liability of risk.
The subject matter must be halal; That means the substance must be pure and ritually clean and contract elements present and all the essential conditions made complete.	Contracts based on free mutual consent; Mutual consent means that the contracting parties are free to enter into a contract without any coercion, fraud, misrepresentation or some other illegal means that would render a contract invalid in shariah.
Devoid of gharar (uncertainty, indeterminacy).	“What is not explicitly prohibited is permissible”
Free from qimar (gambling) and maysir (games of chance).	Extrinsic conditions or ancillary conditions

Source: (Saiti & Abdullah, 2016)

In the contemporary world, Takaful has existed for over four decades and is continued to be regulated in various jurisdictions. In Uganda, the amendment of Financial Act 2016 gave birth the introduction of Islamic insurance (Financial Amendment Act 2016 Uganda). Further, the Insurance Act of 2017 concluded the introduction and regulation of takaful in Uganda (Insurance Act, 2017). For successful regulation and protection of takaful operators and participants, in 2023 the government of Uganda through Parliament continued to repeal the financial Act section 115B (2) and (4) (Financial Institutions Act, 2023). In the current law the provision from the previous 2016 law providing for a "sharia advisory council" at the Bank of Uganda was removed. This therefore provides an alternative to the regulator (Insurance Regulatory Authority of Uganda) to establish the central sharia advisory council. Likewise, (Belouafi & Belabes, 2010) stress that to pave way for the inclusion of Islamic finance in any conventional legislative authority, it is important to properly comprehend and implement the fundamental principles of shariah that govern the operations of this rapidly developing business. The present and amended law of the land now regulates an equivalent tax treatment for takaful business which is different from the conventional insurance business.

On the other hand, consumer protection is key for any undertakings in Uganda. For example, Bank of Uganda passed financial consumer protection guidelines (Bank of Uganda, 2011). These include; (1) Set standards for financial services providers in dealing with consumers (2) Ensure fair treatment of customers (3) Increase transparency in order to inform and empower consumers of financial services (4) Ensure consumer complaints are handled promptly and fairly. These guidelines assist not only customers but also to be benchmarked by financial institutions and the economy as a whole. As a result, in the pursuit of takaful feasibility, this research discusses the significance of takaful regulation and consumer protection. To achieve this goal, the study explores Malaysian and Kenyan experiences in takaful regulation and consumer protection in order to benchmark Ugandan experience with best practices. Currently, it's hard to trace relevant literature and this makes the study suitable to fill the gap of the scarce literature.

RESEARCH METHOD

This study uses a qualitative research method and secondary data for analysis. Both will be used to comprehend the concept being studied, as well as structures, issues in the takaful regulatory framework and consumer protection. The methodological approaches include historical, philosophical, comparative, analytical, and critical viewpoints. Data collection from secondary sources include; legal statutes, published reports, scholarly articles, and internet repositories.

DISCUSSION

Takaful regulation

According to the study by (Matsawali et al., 2012) reveals that, shariah compliant insurance has the features of both parties being sincere, the policy being for the sake of the afterlife, and there being nothing prohibited in its aim and operations. It must be a commercial, profit-sharing, mudharabah-based contract between the insurer or takaful operator (custodian and manager of the funds) and the insured or participant. The concept of takaful is regulated based on mutual cooperation which encourage trade and commercial activity to flourish, contribute to poverty reduction and establish a self-reliant society (Nugraheni & Muhammad, 2020). Like in insurance, takaful is categorized into two products namely, general and family takaful. This is justified by (Barre & Mukhtar, 2022) were by general takaful concerns damages such as fire, accident, burglary and flood while family takaful provides needs related to investment and it covers risks linked with human life including death, illness, and disability. In takaful business, there're particularly four main takaful models namely; Wakalah, Mudarabah, Hybrid (wakalah – Mudarabah) and Waqf model (Naim et al., 2018).

Like insurance industry being covered by reinsurance companies, takaful institutions are also covered by Retakaful. Therefore, takaful cannot be discussed in isolation of Retakaful and without exploring all its aspects. Hassan & Mollah, (2018) defined Retakaful as a form of mutual assistance among participating takaful operations in which the operators pay a certain amount of contribution into the Retakaful funds in order to share a certain defined risk in a specified category if these exceed prudent underwriting limits. N. A. Ali & Markom, (2021) explained that, in practice, there are two operational mechanisms of Retakaful: treaty- a type of agreement in which the Retakaful operator agrees to cover all risks as set out in the scope of agreement/treaty with the takaful operator, and facultative- a treaty that allows a takaful operator to select any case or policy to be Retakaful or otherwise.

On the other hand, according to (Janbulat, 2006) issue paper of the Islamic Financial Services Board and International Association of Insurance Supervisors. The regulation between Takaful and conventional insurance clearly has regulatory implications. For example: (1) A Takaful operator has an obligation to ensure that all aspects of the insurance operations are compliant with Sharia rules and principles. To do so, it will draw on in-house religious advisers, commonly known as a sharia board. (2) The Takaful operator will be representing to policyholders, either explicitly or implicitly, that its operations are in accordance with sharia rules and principles. (3) In a Family Takaful plan there are generally no guarantees. This implies that the risk profile is different from the standard insurance product, where guarantees are normally given in terms of maturity benefits, surrender benefits and death benefits. This has implications both for capital adequacy and for disclosure to consumers. (4) The solvency regime needs to reflect the location of risk. This raises the issue in practice of whether liability can be extended to policyholders' investment accounts. (5) Because policyholders share in any surpluses and, in principle, meet any deficits in the underwriting pool, there is a need to determine how their shares should be determined. At present different companies follow different policies in this respect. (6) Because investments must be sharia compliant, a Takaful firm cannot invest in conventional interest-paying bonds, or in certain types of equity (brewers being an obvious example). There are also limitations on the use of derivatives, for example to hedge currency risk. The asset risk profile will therefore be different from that of a conventional insurer.

Similarly, (Haemala and Shaiban, 2014) adds that, the IFSB, recommended that appropriate standards and guidelines on takaful be developed, and in so doing, has in the past worked with and adapted the IAIS's Insurance Core Principles to takaful so that it can stand on a level playing field with its conventional counterparts. Dinç et al., (2019) deposits that, the international regulatory landscape remains dominated by the IFSB and AAOIFI through soft regulatory standards and many institutions across the globe especially the members of IFSB have adopted these standards.

Table 2: IFSB main standards relating to Takaful

Standard	**Reference**
Guiding Principles on Governance for Takaful (Islamic Insurance) Undertakings	(Islamic Financial Services Board (IFSB), 2009)
Standard on Solvency Requirements for Takaful (Islamic Insurance) Undertakings	(Islamic Financial Services Board (IFSB), 2010)
Standard on Risk Management for Takaful (Islamic Insurance) Undertakings	(Islamic Financial Services Board (IFSB), 2013)
Guiding Principles for Re-Takaful (Islamic Reinsurance)	(Islamic Financial Services Board (IFSB), 2016)
Key Elements in the Supervisory Review Process of Takaful/Re-Takaful Undertakings	(Islamic Financial Services Board (IFSB), 2018)
Conduct of Business Supervision in Takaful Undertakings	(Islamic Financial Services Board (IFSB), 2023)

Takaful and Consumer Protection

Consumer protection regulation is a legal framework established to safeguard consumers' interests against fraudulent or unfair business practices by the producers and sellers of goods and services. It protects consumers' rights, safety, and welfare while ensuring fair business competition (Bashir, et al., 2023). In consumer protection, preventive protection is protection provided by the government which aims to prevent violations of consumer normative rights (Kerti, 2023). Substantially where the government establish authorities, the relevant authority should ensure relevant regulation for consumer protection are implemented. In the context of takaful institutions, the general regulatory and market practices issues relating to consumer protection where drafted by the IFSB and where derived from recommended or observed practices from a number of national and international statutes and regulations (IFSB, Working Paper on Consumer Protection in Takaful, 2019). They include the following;

I. The legislative framework should set consumer protection objectives and responsibilities regarding conduct of business regarding takaful products and services, and provide a clear definition of the scope of consumer protection mechanisms.

II. The institutional structure should provide for regulatory and supervisory authorities with a mandate, authority and resources to make, supervise and enforce (whether directly or indirectly) conduct of business requirements for takaful undertakings and intermediaries dealing with consumers, in an objective, timely and fair manner.

III. RSAs should require a compliance culture among providers of takaful products and services.

IV. Takaful operators and intermediaries offering consumer products should be subject to requirements for fair treatment of consumers, including: (i). regard to information needs of consumers; (ii) avoidance or management of conflicts of interest - in particular, through incentive structures; (iii) fitness and propriety of those advising consumers; (iv) training and competence requirements for those advising consumers; (v) establishment and maintenance of processes for assessment of suitability; and (vi) establishment and maintenance of processes for complaint handling.

V. Consumer business should be presumed to be given on an advised basis with an implied duty of care, with limited justifications for consumer opt-out.

VI. All contract and promotional material relating to takaful products should be required to be fair, clear and not misleading.

VII. The institutional structure should provide for alternative dispute resolution mechanisms providing credible alternatives to formal legal action, for consumers to obtain redress.

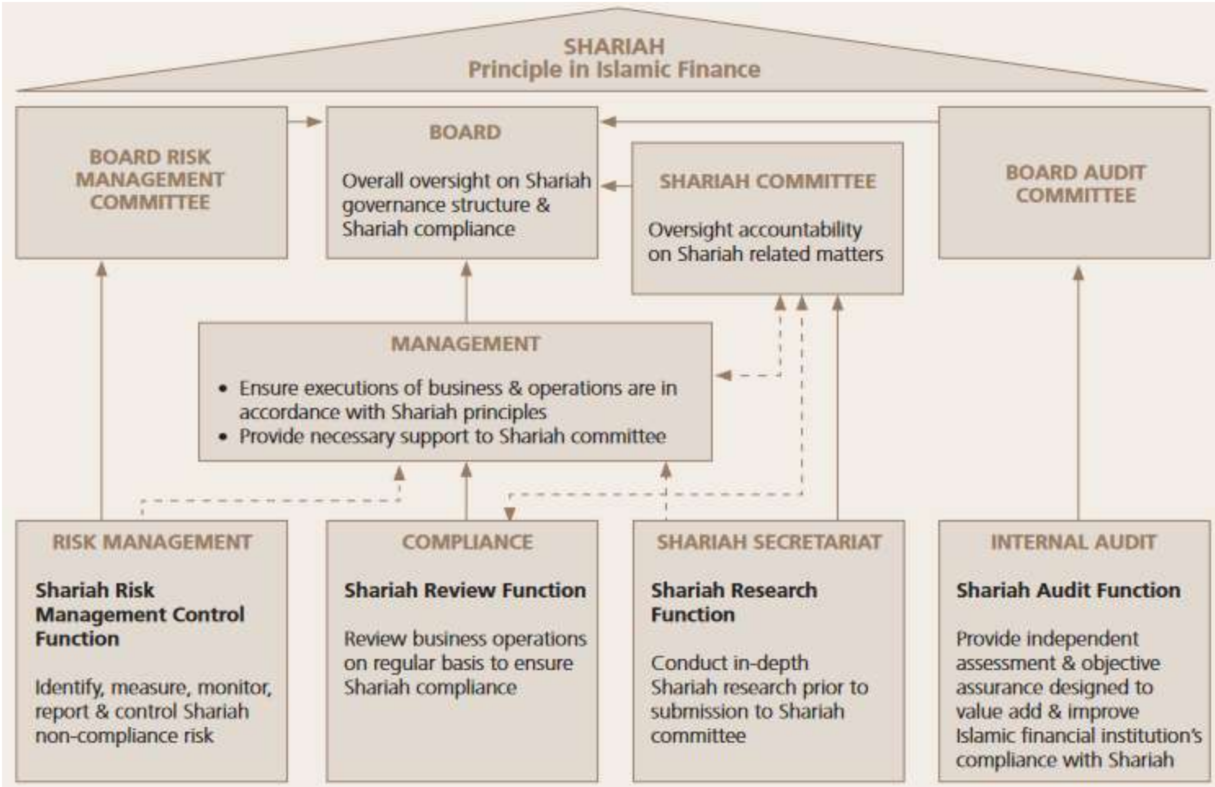
Consumer education, on the other hand, is critical in order to reinforce consumer protection regulation. Consumer education can contribute to the development of a culture of transparency and accountability that benefits both consumers and businesses. It raises consumer awareness, openness, responsibility and competitiveness (Bashir et al., 2023).

Takaful Regulation in Malaysia

The Malaysian takaful industry started in 1984 and Retakaful 1997 (Bank Negara Malaysia, 2005). According to (Islamic Finance Development Report, 2022) Malaysia is among the most developed country worldwide in Islamic finance. In the same manner, It is also observed that other jurisdictions can benchmark similar measures of Malaysia model to regulate the Islamic finance industry which provide a good model for other emerging jurisdictions across the world (Oseni et al., 2016). In Malaysia, both the conventional insurance and takaful industries are regulated by the Central Bank of Malaysia (BNM) through the Islamic Financial Services Act 2013 (Wan Daod et al., 2019). Therefore, takaful industry in Malaysia is regulated by Bank Negara Malaysia and the main role as supervisor is to enhance the strong governance standards in the organization and administration of Takaful operators, direct communication towards consumer on decision making, integration in supervision across sectors and boundaries, instill public confidence in Takaful industry and uphold the stability of Takaful industry in Malaysia (Binti et al., 2021).

Bank Negara Malaysia established a sharia advisory council (SAC). The Shariah Advisory Council (SAC) was established in May 1997 as the highest Shariah authority for Islamic financial institutions in Malaysia. The Central Bank of Malaysia Act 2009 (CBA 2009) reinforces the roles and functions of the SAC as the authority for the ascertainment of Islamic law for the purposes of Islamic financial business which are supervised and regulated by the Bank. Further, the SAC has nine members comprising Shariah scholars and practitioners with vast experience, domestically and abroad in the areas of Shariah, law, Islamic economics, and finance (www.bnm.gov.my/committees/sac). Central Bank has established the necessary mechanism for the Islamic financial system to operate in a manner consistent with Shariah Muamalat principles, with a clearly defined institutional arrangement within Islamic financial institutions regulated by the Bank. A two-tiered Shariah governance structure has been established, comprising an apex Shariah advisory body at the Bank and a supervisory Shariah committee formed at the respective Islamic financial institutions (BNM, 2010). Figure 1 below illustrates the shariah governance framework model for Islamic financial institutions in Malaysia.

Figure 1: Shariah governance framework model for Islamic financial institutions in Malaysia



Source: (BNM, 2010)

Bank Negara Malaysia had also specifically issued guidelines for Retakaful through Takaful Operational Framework (TOF) in 2013 and revised TOF 2019. TOF 2019 requires the takaful operator to have arrangements compatible with the sound Retakaful principles for the recovery of liabilities regarding risks incurred or undertaken by the operator during its takaful business (Central bank of Malaysia, 2019). Binti et al., (2021) revealed that, the reasons why Malaysia has become the central movement in Takaful within ASEAN region and second biggest market in the world is due to the support given by the Malaysian government where there are efforts in creating beneficial environment, regulation enhancement and strengthening. Binti et al., (2021) maintains that, Malaysia to become a global reference could be as a result of its continuous impactful regulatory developments that had occurred for a period of over three decades in phases that's phase 1 (1982-1992) phase 2 (1993-2000) phase 3 (2001-2010) and phase 4 (2011-2020).

Takaful Regulation in Kenya

Kenya, located on the east coast of Africa, shares borders with Somalia, Ethiopia, Sudan, Uganda and Tanzania (Country profile, 2010). The country's statistics estimates that the population is 47.8 million (EAC, 2019). The country's financial structure is broadly defined with a mixture of financial instruments, financial markets, and financial institutions not excluding takaful. The study by (Kinoti et al., 2017) reveals that, the establishment of takaful has contributed to a significant positive relationship between Islamic insurance and the growth of Kenya's insurance industry. It should however be noted that, the takaful industry in Kenya was launched in 2011 and also started operation in the same year (Association of Kenya Insurers, 2015) and (Annual report, 2012).

In the region of East African countries Kenya is a pioneer country to adopt takaful (Islamic) insurance. This is evidenced in table 3 below;

Table 3: Status of takaful and Retakaful industry in East African Countries

Country	**Takaful Regulation**	**Takaful operation**	**Retakaful operation**
Tanzania	Established 2022	July 2023 up to date	Pending
Congo	Not established	No operation	No operation
Uganda	Established 2016	Pending	Pending
Kenya	Established 2011	From 2011, up to date.	From 2013 up to date.
South Sudan	Not established	No operation	No operation
Rwanda	Not established	No operation	No operation
Burundi	Not established	No operation	No operation

Source: Authors' Compilation

In Kenya the insurance business is governed by Insurance Regulatory Authority of Kenya. According to Insurance Act Revised, (2020), the Insurance Regulatory Authority (IRA) was established with the following objectives and function; (1) ensure the effective administration, supervision, regulation and control of insurance and reinsurance business in Kenya; (2) formulate and enforce standards for the conduct of insurance and reinsurance business in Kenya; and (3) license all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters and assessors, risk surveyors and valuers. The IRA created a regulatory sandbox to encourage innovation in insurance products while ensuring compliance with regulations. Products under scrutiny included takaful and Retakaful insurance (https://uk.practicallaw.thomsonreuters.com). Similarly, in 2018 the IRA issued new guidelines were takaful and Retakaful operators have to appoint Shariah Advisory Council (TEMA 11, 2018). Kenya being a pioneer country in East Africa to launch Retakaful. The Retakaful Window was launched in 2013 by Kenya Re which is a composite Retakaful operator offering Retakaful support on proportional and non-proportional basis for treaty as well as facultative business (Magazine Of Kenya Reinsurance Corporation Limited, 2021).

In addition, Kenya Re invested in Retakaful window following increased interest across continent. Kenya Re Managing Director Jadiah Mwarania in one of the public interview said: “We cannot be left behind as one of our strategic imperatives is to retain our existing business and expand into new markets (www.commercialriskonline.com). The model of takaful chosen by Kenya Re is the hybrid model. This model is a Wakalah-Mudarabah model. In this model, each contract is distinct from the other. The Wakalah contract is the agency contract which is based on taking a fee from the participants for the management of the participant’s fund. The Mudarabah contract, investments contract is based on sharing of profits. Further, the company has a committee of five shariah supervisory board members (www.kenyare.co.ke/our-solutions/rekataful).

Lessons from Malaysia and Kenya Takaful Regulations

Malaysia's experience with takaful regulatory architecture gives valuable lessons on the importance of centralized regulation, governance standards, consumer communication, integrated supervision, Shariah compliance, and legislative support for regulatory agencies. The lessons also include the importance and necessity of regular regulatory framework revisions, the positive impact of government support, the role of government in creating a beneficial business environment, and the critical importance of rules and regulations in ensuring the success of Takaful operations in a regional context.

On the other hand, the lessons learnt from Kenya's takaful industry include the significance of a solid regulatory framework, stimulating innovation through regulatory sandboxes and embracing Shariah-compliant solutions. The absence of a central sharia council does not always rule out the use of takaful insurance. To strengthen the commitment to Shariah compliance, the authority can begin with a Shariah Supervisory Board. Having a separate board guarantees that regulated business operations are in accordance with Islamic standards, lending credibility to takaful operations.

CONCLUSION

The takaful industry is governed by two world-class regulatory bodies: IFSB and AAOIFI. In many jurisdictions, regulations are fully or partially benchmarked. For this case Malaysia benchmark its regulations with AAOIFI standards. Malaysia Takaful industry is regulated by the central bank, Bank Negara Malaysia. The bank established Shariah Advisory Council (SAC) as the highest Shariah authority for Islamic financial institutions in Malaysia and each financial institution in Malaysia is required to establish a supervisory Shariah committee formed at the respective Islamic financial institutions. The laws and principles governing takaful business are similar to those governing Retakaful business. Takaful regulation and consumer protection are key to the industry's feasibility and viability. With the takaful industry's rapid expansion and development, takaful operators demand support from Retakaful companies in order to diffuse the operational risks. However, based on the rationale of "unavoidable circumstances," i.e., a necessity (darurah) due to a scarcity of Retakaful firms, Takaful companies can initially conduct business with conventional reinsurance companies. The takaful guidelines and regulations requires each takaful and Retakaful operators to appoint sharia supervisory board. Kenya; the sole country operating on both takaful and Retakaful business in East African region. Furthermore, the takaful industry is regulated by the Insurance regulatory Authority of Kenya (IRA).

This study is exploratory and qualitative in nature; it discusses Malaysian and Kenyan Takaful regulatory and consumer protection experience to draw recommendation for Uganda's Takaful industry. Further studies can be leveraged in the same interest using different research design and approaches to add on the existing body of knowledge.

RECOMMENDATIONS

By adopting these recommendations, the Insurance Regulatory Authority of Uganda may build a strong regulatory framework that not only ensures compliance but also promotes the region's takaful industry's long-term growth and prosperity;

I. Establishment of centralized sharia council: Establishing a central Shariah council to provide overall advice and support for the takaful business is fundamental and also recognition of the role of Shariah Supervisory Board in encouraging Shariah compliance.

II. Governance Standards: Implement strong governance standards for takaful operators based on current successful jurisdictions, including clear instructions on board composition, risk management, and internal controls. This contributes to industry transparency and accountability.

III. Consumer protection and communication: prioritize effective protection and communication procedures to educate customers about their rights, takaful products, principles, and benefits.

IV. Government Support: Encourage and maintain government support for the takaful business through measures that promote its growth. Incentives and joint ventures can all have a good impact on the development of the sector.

V. Innovation and Regulatory Sandboxes: Introduce regulatory sandboxes to encourage innovation in the takaful industry. This creates a safe environment for testing new products and services, encouraging creativity while guaranteeing regulatory compliance.

VI. Regular Regulatory Framework Revisions: Establish a procedure for reviewing and updating the regulatory framework on a regular basis to stay up with changing market dynamics, technology breakthroughs, and worldwide best practices.

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