

## INTERMEDIARIES ARE A POOR MARKET CONDUCT AND DISCLOSURE CHANEL: AN EMPIRICAL STUDY ON SAUDI ARABIA

DR. HASHEM ABDULLAH ALNEMER.

ASSISTANT PROFESSOR IN FINANCE  
COLLEGE OF BUSINESS, UNIVERSITY OF JEDDAH  
SAUDI ARABIA.

### ABSTRACT

**M**arket conduct refers primarily to the way insurers deal with existing or prospective policyholders whether directly or through intermediaries; it also covers other market players such as investments managers, The strength of market conduct varies from one jurisdiction to another. However, even in advanced jurisdictions market conduct regimes for insurance have lagged behind the development of prudential regulation and behind other sectors. Accordingly, the main market conduct problem faced by Takaful Operators (TOs) is the issue of intermediaries and regulations, which vary from one jurisdiction to another in regulating intermediaries. For example, some jurisdictions regulate intermediaries directly, and some place the onus on the insurer, while others have scarcely any provisions at all. Although regulations might ask takaful companies to take the responsibility of letting their intermediaries disclose the required information to the customers, a suitability regime however, is very difficult to apply especially if an intermediary is an agent to another company. No studies have been conducted to systematically document takaful participants' perceptions of the quality and knowledge of TOs intermediaries' personals. This paper attempts to fill the gap. The paper reports a result on the perceptions of 420 participants of takaful companies in Saudi Arabia. The research findings indicate that, although the Saudi Arabian Monetary Agency (SAMA) has identifies the duties of intermediaries, such as (communicate all relevant information including coverage details, acceptance conditions, exceptions and restrictions of the insurance policy to the customers in a timely manner, and ensuring customers are aware of the commitment they are about to make to enable them to make a suitable decision), the majority of participants are against the idea of selling takaful products via intermediaries. Participants believe that takaful products shall be sold by the TOs agents. Participants believe that intermediaries in Saudi Arabia have a weak knowledge about sharia'h and takaful business.

*Keywords: Market Conduct, Takaful Operators & Participants, Intermediaries, Saudi Arabia.*

## 1. INTRODUCTION

*Takaful* is derived from the Arabic root word *kafala* a verb which means guarantee, bail, warrant or an act of securing one's need. The idea of insurance in Islam must be in harmony with the objectives *maqasid* of *Shari'ah* with regard to securing benefits for the Muslim client and preventing elements of *harm* (sin). The specific objectives are to protect religion, life, intellect, lineage and property. In 2007 AAOIFI<sup>1</sup> defined Islamic insurance as per its *Shari'ah* Standard 26 (2) 2007: "Islamic insurance is an agreement between persons who are exposed to risks to protect themselves against harm arising from risk by paying contributions on the basis of a commitment to donate (*iltizam bi al-tabarru*). Following from that, the insurance fund is established and it is treated as a separate legal entity (*shakhsiyyah i'tibariyyah*) which has independent financial liability. The fund will cover the compensation against harms that befall any of the participants due to the occurrence of the insured risks (perils) in accordance with the terms of the policy." Additionally, IFSB<sup>2</sup> and IAIS<sup>3</sup> (2006) described *takaful* as the Islamic counterpart of conventional insurance which can exist in either life (or family) and general forms. It is based on concepts of mutual solidarity and a typical *takaful* undertaking will consist of a two-tier structure that is a hybrid of a mutual and a commercial form of company. Akin to the English insurance law, Islamic insurance has its fundamentals and conditions which must be adhered to. These include the parties to the contract, legal capacities of the parties, offer and acceptance, consideration, subject matter, insurable interest and utmost good faith. The presence of certain elements and the absence of others can make a difference between a valid or void contract as per the Islamic laws. The *takaful* contract, however, will definitely rely on the used *takaful* model. For instance, the relationship between participants and the TOs will differ in the case of *wakalah* model than the *mudarabah* model (Alnemer, 2013). These fundamentals and conditions must be clearly conveyed to participants for better understanding of their benefits in the *takaful* scheme. Good market conduct and disclosure can be an advantage for the participants since they are the main stakeholders; their equity consists of ownership of the underwriting activities and the investment funds. They have a claim on assets of these funds in case of liquidation and they are entitled to have their claim paid if there is enough underwriting funds to finance payout; they are also entitled to share in the distribution of any investment and underwriting surplus. However, the only right that participants can exert on the *takaful* scheme is to disconnect their contractual relationship with the company in case of dissatisfactions. In other words, one of the main challenges faced in the *takaful* industry is shareholders and management discretions, power and activities due to the unclear structure of the *takaful* operational scheme.

This paper explores the sequences associated with the insurance companies' failure in applying a good market conduct and disclosure, one of the main causes of such failure was due to intermediaries weak knowledge of *takaful* and *Sharia'h* principles. However, such failure will be faced with strong policies and regulations from the international insurance regulatory bodies' to comply with the proper way to conduct an insurance business via the implementations of effective's market conduct and disclosure. Such implementations will guarantee fair treatment of *takaful* participants, especially when dealing with an important market conduct issues that address the disclosure of participants' fund investment returns. This paper will also highlight how strong the Saudi insurance market is, such facts was reflected with a strong growing rate of 19.2% of the gross written premium between year 2012 and 2013. It shows how the compulsory medical insurance has played a vital role in such growing figures. SAMA's on the other hand, has made it mandatory for insurance companies and insurance intermediaries working in Saudi Arabia to comply with the market conduct and disclosure policies and regulations to satisfy the expectations, needs

---

<sup>1</sup> Accounting and Auditing Organization for Islamic Financial Institutions.

<sup>2</sup> Islamic Financial Service Board.

<sup>3</sup> International Association of Insurance Supervisors.

and wants of policyholders. SAMA's has posted strong intermediaries regulations to guarantee easy transformation of necessary information's that can make a difference for participants to decide either to buy an insurance policy or not. The last part of this paper reflected participants' perceptions in regards to the intermediaries' knowledge about the basics of *takaful* business and *Sharia'h* concepts. The results was quite disappointed as the majority of participants clarified that intermediaries in the Saudi insurance market are in strong need to enhance their knowledge about *takaful* insurance and associated *Sharia'h* concepts. The last part of this paper, recommends an effective framework that enhances market conduct and disclosure concepts in the Saudi insurance market. By doing so, will reduces the gap between the *takaful* companies and participants, which in away enhances future selling and development of Islamic insurance products.

## 2. INTERMEDIARIES AS INSURANCE HIDDEN MARKET CONDUCT PROBLEM

Market conduct refers primarily to the way insurers deal with existing or prospective policyholders whether directly or through intermediaries. The main market conduct problem faced by TOs is the issue of intermediaries<sup>4</sup> and regulations, which vary from one jurisdiction to another in regulating intermediaries. For example, some jurisdictions regulate intermediaries directly, and some place the onus on the insurer, while others have scarcely any provisions at all (Casey, 2009). However, TOs should ensure that their representatives provide relevant and meaningful information to the *takaful* participants to avoid any risk of misleading the *takaful* participants into expecting that *takaful* is no different from conventional insurance (IFSB, 2009). Although regulations might ask *takaful* companies to take the responsibility of letting their intermediaries disclose the required information to the customers, a suitability regime however, is very difficult to apply especially if an intermediary is an agent to another company. Thus, the suitability issue will be much easier if the *takaful* product is sold via the operator itself, since intermediaries will be required to acquire a wide set of information about customer preferences, such as customer perspective and their views on *Shari'ah* issues (Ali and Odierno, 2008). Therefore, some international organizations have identified a certain criteria to enhance the work of insurance intermediaries. IAIS (2011) has identified ICP 18 as one of the core principles to enhance the intermediaries' roles in the insurance business, which are considered essential for intermediaries: (i) be licensed or registered, (ii) have adequate general, commercial and professional knowledge and ability, (iii) have a good reputation, (iv) have sufficient safeguards to protect participants funds, (v) to provide consumers with information on their status. In case of *takaful* insurance the intermediaries shall have adequate knowledge on *Shari'ah* issues and its implications (Ali and Odierno, 2008). It is also important to highlight that even when intermediaries are directly regulated, the supervisors' roles should be there to measure the required output and to make sure that the prescribed disclosures are made, and that this is done in a way that is clear, fair and not misleading (Casey, 2009). As a result supervisory bodies have made it clear for insurance companies to adhere to the public disclosure requirements.

### 2.1 PUBLIC DISCLOSURE REQUIREMENTS

Public disclosure to the market contributes to good corporate governance by identifying those insurers who are using best practices and those who are lagging behind, as well as insurers, key stakeholders who are responsible for such underperformance. In short, disclosure, transparency, proper corporate governance and internal control will contribute to proper corporate conduct and deter fraud and corruption, allowing insurers to compete on the basis of their products offered and to differentiate themselves from insurers who do not practice good governance (IAIS, 2011; OECD, 2011). One of the IAIS (2011), core principles is ICP 20 (Public Disclosure), which states that supervisory authorities are to require that insurers disclose relevant

---

<sup>4</sup> An agent such as a broker, who is given commissions by insurance company for selling its policies (Source: Dictionary of Insurance Terms, 4<sup>th</sup> Edition, 2000, Barron's).

information on a timely basis. Since proper disclosure will give market participants a clear view of the business activities and financial positions of the insurers and facilitate the understanding of the risk exposures of the insurers, disclosure shall also address insurance company obligations and commitments towards their customers. Accordingly, the concept of disclosure is closely linked to the requirement to provide information to the prospective policyholders to enable them to make proper and informed choices as to the suitability of the proper insurance product to be selected to meet their needs. Suitability is linked to the insurer's obligation to ensure that the product sold is suitable for the policyholders to prevent policyholders suffering when insolvency situations are encountered. Unfortunately, *takaful*, contracts and product information tend to be drafted in legalistic and protective terms, with the aim primarily of protecting the TO, rather than of plainly informing the *takaful* participants of their rights and obligations (IFSB, 2009). Hence, it's vital for TO to disseminate some necessary information for participants in order to make a proper choice either to buy the policy or not.

## 2.2 THE REQUIRED DISCLOSED INFORMATION AND THE PROPER WAY TO DISSEMINATE

It is necessary for participants to make proper judgments about TOs before entering into a contract, and for better comparison<sup>5</sup> between different TOs available in the market (Casey, 2009). Hence, information should be characterized as accessible, comprehensive, reliable, comparable<sup>6</sup> and consistent. Information should reflect *takaful* benefits, the *takaful* fund's asset allocation, claims information, encountered expenses, fees and other relevant aspects of the operations of the *takaful* fund, including methods applied, assumptions used, and the accounting and actuarial policies (IFSB, 2009). *Takaful* contracts should be written in plain language utilizing consistent *takaful* terminology (including applications of the *takaful* core principles). In this respect, it is recommended that the supervisory authority develop a set of prescribed disclosures to be made prior to contract, including disclosures on the *takaful* core principles and *Shari'ah* governance arrangements (IFSB, 2009). Another way of proving company obligations and commitments towards their customers is by spending more efforts on research and development. Insurance companies should also disclose their strategies toward research, development, education and training of their employees for better reputation in gaining good results on financial performance and risk- management achievement (IAIS, 2011a). Information should be properly disseminated according to the international standards and designed through adequate methods and assumptions to bring to the attention of participants of the relevant information. Hence, one of the best channels to disclose information to the public is by using the internet as an effective way to disseminate information, which can easily reflect the development patterns over time with a comparison against the previous periods (IAIS, 2011). Other channels that might be used as a way of disclosing information might include insurer annual reports, interim financial reports, annual general meetings of shareholders, prospectus reports for public offers and/or listings, merger and takeover documentation, and ad hoc statements. These disclosure channels should reflect the company financial position, financial performance and its risk management by identifying intangible assets and the way to mitigate them. TOs might also reflect the developmental state of the industry and the overall balance of products and markets (IAIS, 2011b). Despite the fact that disclosure is a vital approach to participants, more disclosure might increase direct and/or indirect cost for the company and the companies may experience a competitive<sup>7</sup> disadvantage from increased disclosure of proprietary information (IAIS, 2002; 2008). Therefore, various jurisdictions have different requirements on what communication channels to use, contents of disclosure and disclosures timing (IAIS and OECD, 2009; Pakistani *takaful* rule, 2005).

---

<sup>5</sup> By exploring one reporting period to another, which can only be made if the reader is informed how the methods and assumptions of preparation have changed and, if practicable, the impact of that change.

<sup>6</sup> It is recognized that, until international standards are developed and adopted uniformly, true comparability cannot be achieved.

<sup>7</sup> It is appropriate that commercially sensitive information (such as trade secrets, proprietary information or information that, if disclosed, may have adverse effects on the insurer) not be publicly disclosed (IAIS, 2008).

### 3. INVESTMENT RETURN AS A PRIMARY SOUND MARKET CONDUCT AND DISCLOSURE

Investment strategy, objectives and the rationale behind conducting investments business is an important factor to attract customers. Some of the objectives might be to create a balance between underwriting and investments activities of the participants. In order to cover deficits of underwriting activities a back-up should be available either from the reserves built through underwriting surpluses or through participants' investments return or by relying on shareholders interest-free loans (*qard hasan*). Accordingly, IFSB (2009) asserts that TOs should disclose their investment objectives and assets allocation rationale with the content of the assets instruments and their weight in the investments portfolio, and whether they are suitable to match short-term or long-term liabilities. TOs should explain the difference between Participant Risk Fund (PRF) and/or Participant Investment Fund (PIF) accounts and the expected investment return on each account, with a brief on the type of assets instruments used on each account and the expected time horizon to gain profit on their investment fund. Accordingly, TOs should disclose a framework that includes the used *takaful* model, either *wakalah* or *mudarabah* with the investment management function, the investment profit-sharing distribution, product benefits<sup>8</sup>, termination charges in the case of early termination of a *takaful* contract with the exit options and the consequences of losing benefit payments from both the (PRF) and/or (PIF). The framework should also disclose the frequency of investment profit and/or underwriting surplus declaration and their estimated returns and the complaints-handling and other contractual arrangements (IFSB, 2009). The disclosed framework should also fit with the main organization structure, the corporate governance mechanism used by the (BoDs)<sup>9</sup> to control the company, overall risk management, and with the control and update mechanisms<sup>10</sup>. The disclosure framework would also address the issue that will affect participants' investments return, such as disclosure about the management who handle the investment procedures of the *takaful* fund and their incentive fees and remuneration (IFSB, 2009). AAOIFI standard on Investments Disclosure No. 13, also states that disclosure should be toward the party that manage the investment policyholders' funds and shareholders' funds and the remuneration it receives<sup>11</sup>. AAOIFI asserts that TOs should disclose the basis applied for determining incentive remuneration. AAOIFI Standard No 13 indicates that the basis applied by the company in determining the remuneration of the party that manage the company's investments on the basis of *mudarabah* or a specified agency fee should be disclosed. TOs are also required to disclose the used methodology and approach to distribute investment returns among participants, since it will also affect the *takaful* fund's overall investment return. Therefore, as per AAOIFI No 13, there should be disclosure of the basis applied by the company in allocating the profit generated from investing policyholders' funds and shareholders' funds. *Takaful*-charged expenses can also affect participants' financial benefits in the *takaful* fund; hence TOs need to disclose sufficient information on different type of expenses. According to AAOIFI No.13 disclosure is to be in line with the bases applied by the company in calculating expenses affecting policyholders' funds such as pre-operating expenditures, reserves, cost of assets used in operations, claims and compensations.

#### 3.1 DISCLOSURE OF INVESTMENTS RETURN AND ITS IMPACT ON PARTICIPANTS' CLAIM SITUATIONS

Comprehensive disclosure should be conducted towards claim coverage strategies, i.e. how the TO is going to cover PRF claims – is it from the investments return fund of the PIF, or does the TO strategies imply that investment return of a certain PIF should cover a deficit of other business lines of the same *takaful* company for later compensations. Such information, which should be clearly disclosed to the public, will have a great effect on participants' expectations to receive investments return and profit in due time or not, and hence a

<sup>8</sup> (Ex, aims of product, cover, conditions).

<sup>9</sup> Board of Directors

<sup>10</sup> It is a mechanism that works in accordance to the changes on the local market behaviour and to the political forces.

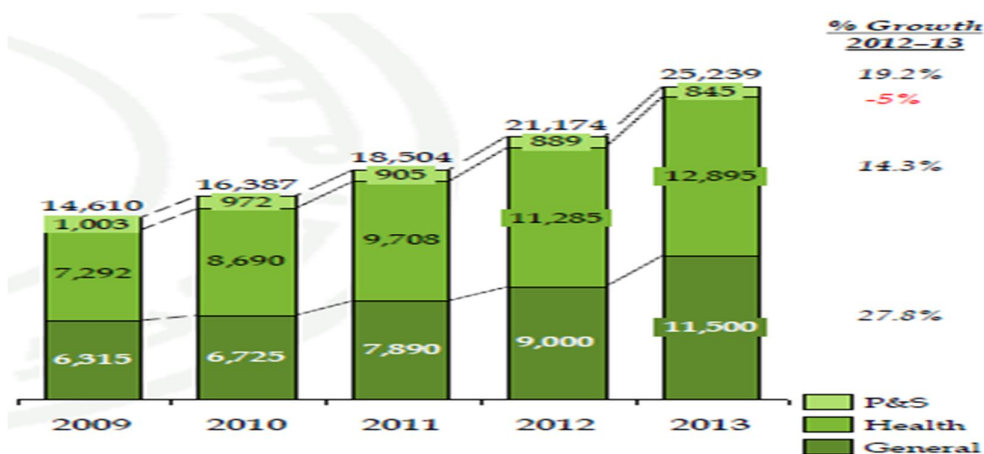
<sup>11</sup> Percentage of investments profit in the case of *mudarabah* or a specified agency fee

proper decision can be made by participants to either do business with these *takaful* companies or not. Disclosure should also reflect the *Shari'ah* mechanisms in valuing assets. Hence, TOs should adhere to *Shari'ah* in order to satisfy participant's desire to invest their funds. Therefore, TOs will need additional governance structures and processes that facilitate (i) the consistent screening of the investment portfolios in order to ensure they remain *Shari'ah*-compliant, (ii) the purification of any return on the investment from non-*Shari'ah*-compliant income (Hussain, 2009). Disclosure should also be made to guarantee participants' rights on receiving investments return and clearly identify a fast and sound *Shari'ah* board response channel that can quickly and effectively approve availability of assets for investment. Also a safeguard mechanism should be disclosed to ensure proper allocation of participants' investments return are reached with no priorities being made to favour shareholders over participants as per AAOIFI No. 13, which requires disclosure of any priority given to policyholders or shareholders in making allocation of income-producing investments and the basis for the priority, in cases where such funds could not be fully utilized for income-producing investments.

#### 4. THE SAUDI ARABIAN INSURANCE MARKET

Saudi Arabia is the largest *takaful* market in the GCC as its accounts for nearly half (48%) of share of global gross *takaful* contributions, which estimated to reach US\$14 billion in 2014 from an estimated US\$12.3 billion in 2013 (E & Y, 2014). Locally, Saudi Arabia hosts a number of prominent multinational firms in addition to several domestic players that rival them in size. In 2013, Gross Written Premiums (GWP) in the Saudi cooperative insurance market reached SR 25.24 Billion, up from SR 21.17 Billion in 2012. This represents an increase of 19.2%, compared to a 14.4% growth rate in 2012 (SAMA, 2013). This was due to the compulsory medical insurance mandated by the government. Saudi Arabia's introduction of compulsory medical insurance policies has contributed to a strong growth in family and medical *takaful* in the (MENA)<sup>12</sup> region. The medical insurance GWP, represents 51% of the Saudi insurance market, which increased by 14.3% to SR 12.9 Billion in 2013 compared to SR 11.3 Billion in 2012. Followed by General insurance GWP, which represents 46% of the insurance market, increased by 27.8% to SR 11.5 Billion in 2013 compared to SR 9 Billion in 2012. The Protection & savings (P&S) insurance GWP, come on the third largest insurance products in Saudi Arabia which represents 3% of the insurance market, decreased by 5% to SR 845 Million in 2013 compared to SR 889 Million in 2012 (please refer to table 1 below).

**Figure1: Saudi Insurance Market - Gross Written Premiums (2009 – 2013, SR Million)**



Source: (SAMA, 2013; pp - 6)

<sup>12</sup> Middle East and North Africa.

Saudi Arabia requires all insurance companies to operate under a cooperative business model which is a key feature of the *takaful* model<sup>13</sup> (E & Y, 2011). *Shari'ah* scholars indicate that the Saudi cooperative model is similar to *takaful* models due to funds segregation and surplus distribution (Alnemer, 2013). However, Saudi Arabia like other countries (Malaysia, Kuwait, Egypt, UAE, and Lebanon) that allowed *takaful* companies to operate in their jurisdictions do not follow AAOIFI standards and polices (with the exception of Bahrain and Qatar) (E & Y, 2011). Despite SAMA regulations which are directed towards cooperative insurance, only a number of cooperatives operate as sole TO (SAMA, 2005a). By July, 2011 SAMA has given operation licenses to seven *takaful* insurance providers to operate in Saudi Arabia (Al Ahli Takaful, SABB Takaful, *Wiqaya* Takaful Insurance & Reinsurance, Solidarity Saudi Takaful, *AlJazira* Takaful *Ta'awuni*, Saudi Takaful insurance, *Watani* Takaful) (OBG, 2011). These TOs are using the *wakalah* model to operate their *takaful* scheme and they have appointed *Shari'ah* boards to supervise business operations, including investments and ensure compliance with Islamic law. However, these TOs are following the Saudi cooperative insurance laws, as SAMA did not issue specialized *takaful* laws and directives (Alnemer, 2013).

### 5. SAMA'S MARKET CONDUCT AND DISCLOSURE REFORMS

The supervisory regime requires insurers to have sound market conduct policies and procedures, especially when dealing with policyholder expectations (IAIS, 2002). Disclosure is considered as a prudential aspect for proper efficiency of the financial market, as per IAIS (2002: 3):

“When provided with appropriate information that allows them to assess an insurer’s activities and the risks inherent in those activities, markets can act efficiently, rewarding those companies that manage risk effectively and penalizing those that do not. This is often referred to as market discipline. It serves as an adjunct to supervision”.

Accordingly, sound market conduct policies and procedures will not be satisfied without having effective supervisors that can encourage insurers to make effective disclosure, by maintaining efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders (IAIS, 2002). The supervisors will need to have sufficient knowledge about *takaful* to be able to understand the products, which they are dealing with, and the significant differences between *takaful* contracts and conventional ones. SAMA has affirmed that the insurance company shall communicate all relevant information to customers in a timely manner to enable them to make informed decisions, hence, companies must take reasonable measures to ensure the accuracy and clarity of the information provided to customers and make such information available in writing (SAMA, 2008). The wording of the document shall use simple language and sentences, and printed in clear, readable text, with no fine print. The policy shall include a disclosure statement indicating that the policy contract is the entire contract. The policy should reflect the coverage period, and coverage descriptions and limits, deductibles and retentions, insurance rates and premium amounts, basis of premium calculation and the amount of commission paid under the policy (SAMA, 2008). The policy shall also give a description of the insured’s duties after a loss has been incurred, and description of the claims and dispute handling procedures (SAMA, 2008). Furthermore, the insurance company shall also notify customers promptly of any changes in the disclosures or conditions made to the customers at the time of entering into the insurance contract. This includes changes in the company’s’ contact details and changes in the claims filing procedure (SAMA, 2010a). The annual statements are considered vital pieces of

<sup>13</sup> There are several *takaful* operational models that have been adopted by *takaful* operator companies world-wide such as *mudarabah*, *wakalah*, *waqf*, hybrids of *mudarabah* and *wakalah*, *ta'awuni* and non-profit funds.

information to policyholders. Accordingly, the insurance company should provide an annual statement to their policyholders to include the projected amount received at the policy period, with the current sum insured, total premiums paid in the previous year, while the insurance investments policy should show the value of the units in each fund (SAMA, 2010b).

Another important disclosure issue is policyholders' rights whenever an insurance company is planning to cease their operation in Saudi Arabia. Accordingly, SAMA has requested insurance companies to provide evidence that they have fully discharged their obligation to the policyholders, and they shall provide evidence that they kept aside an adequate reserve to meet their obligations toward the policyholders. The insurance company shall also transfer all policyholders' policies in force to another company. Insurance companies shall also announce their intention to cease their insurance services in two local newspapers, and policyholders shall file their objections to SAMA within a period not exceeding three months from the publishing date of the notice (SAMA, 2005b). SAMA's on the other hand has devoted specific regulations in regards to intermediaries work to disseminate the required information to policyholders.

### **5.1 SAMA'S REGULATIONS FOR INTERMEDIARIES**

SAMA has issued the Insurance Intermediaries Regulations in (2011c) which states that non-compliance with this regulation may subject intermediaries to enforcement actions (SAMA, 2011c: 5). SAMA stresses that the intermediaries shall act in an honest, transparent and fair manner to fulfill their obligations towards policyholders and the insurance company, and where these obligations have not been fully codified intermediaries should abide by internationally accepted best practice. SAMA also stresses that the intermediaries shall have proper knowledge, training and enough experience (SAMA, 2011c). SAMA also identifies the duties of intermediaries which are to communicate all relevant information including coverage details, conditions, exceptions and restrictions of the insurance policy to the customers in a timely manner, and to ensure that customers are aware of the commitment they are about to make to enable them to make a suitable decision. Hence, intermediaries will have the burden to take all the necessary measures to ensure that the customer fully understands the type of service being offered and to ensure that the policy proposed is suitable for the customer's needs. Intermediaries shall advise on the matters within their field of expertise and seek or recommend specialists if necessary, to identify and address conflict of interest to ensure fair treatment to all clients (SAMA, 2011c). In another regulatory document, SAMA (2005b) identified the duties of intermediaries to provide customers with comparisons in terms of price among several products, premiums paying mechanism, services fees charged and additional fees that might be encountered, guidance of the claim and proper handling process. SAMA' has also identified the proper way to disclose surplus and investment returns to policyholders.

### **5.2 INVESTMENT AND SURPLUS DISTRIBUTION DISCLOSURE**

In an effort to regulate the investment technicalities and administrations of the Saudi insurance industry and to protect stakeholders' financial benefits, SAMA (2011d) has issued the investments regulation. In this regulation SAMA has stressed the importance of the insurance company to adopt an investment policy that complies with the SAMA regulations. All insurance companies operating in Saudi Arabia shall establish an investment policy and submit the policy to SAMA on a quarterly and yearly basis for approval. The investment policy shall include the company's investment strategy, rationale for asset allocation and values, investment management and governance structure, segregation of investment assets with described details of assets classes, policyholders' and shareholders' funds segregation, asset portfolio testing and valuation analysis, investment performance measurements, audit and internal procedures to control investments



procedures and encountered investments risk. SAMA stresses the importance of communicating the investment policy to all company departments and staff members for transparency and easiness of information transference among the whole of the employees. SAMA also requires that the insurance company assign a qualified and expert employee who will be responsible for implementing, conducting, monitoring, controlling and reporting investment activities.

SAMA regulation maintains that the insurance company shall have an effective disclosure system to reflect investment qualitative information to the public in general and to policyholders in specific. The company disclosure system shall reflect investment performance management, assets historical cost, methods used to monitor performance, investments assets classes' criteria, expected future return and cash flow, and expected expenses. Insurance companies are also required to disclose specific information about each assets class, for example if the investments portfolio includes *sukuk* or bond security assets, properties assets, equities/securities assets, etc. The company shall also break these assets down into small classes. In the case of bond security assets, the company shall break it down by government, semi-government and corporate securities with its rating percentage and maturity date. SAMA has also classified the percentage of the investments portfolio assets class, in accordance to the type of insurance activities, general, protection and savings.

## 6. SAMPLING FRAMEWORK AND EMPIRICAL METHOD

*Takaful* participants are considered the main source of accumulating surplus in the *takaful* fund as they are the main stakeholders and their equity consists of ownership of the underwriting activities and the investment funds. However, participants in the *takaful* industry have a very weak position in managing or controlling their fund. Such a situation may be due to the complicity structure of the *takaful* industry. The vast majority of *takaful* undertakings have a two-tier hybrid structure in which the risk funds operate on a mutual basis but are managed by (TOs) which are companies with shareholders (IFSB, 2010). This hybrid structure involves complexities and it raises the fundamentals of the true identity of the *takaful* scheme. Thus, at least as far as the regulators are concerned, the *takaful* scheme is not a mutual (Hussain, 2009). Accordingly, it was necessary to review if there are a disclosure mechanism to reflect the advantages and disadvantages of buying a *takaful* policy. More specifically if the intermediaries have conveyed the right message of the *takaful* business. Accordingly, as Saudi Arabia remains the largest *takaful* market in the GCC, *takaful* participants in Saudi Arabia were identified to be the main research population for this study. The targeted populations were clients of all TOs in Jeddah, Saudi Arabia, since a number of large TOs have their headquarters in Jeddah. The researcher, with the support of an 8-survey distributor team, has managed to distribute the questionnaires among 9 branches of 3 TOs in Jeddah. The targeted participants are those with a family *takaful* policy. Thus policyholders are expected to have a long-term contract with the TOs and expected to have periodic financial returns (Underwriting Surplus & Investment Return). The participants should not possess *takaful* contracts that belong to corporations, *i.e.* the *takaful* contracts are between the TOs and the participants' directly.

Therefore, questionnaire was chosen as the method by which the survey was completed. Questionnaires are a useful tool for investigating patterns and trends in data and are frequently used with success in management, marketing and consumer research (Easterby-Smith *et al.*, 1999; 2008). Most of the survey questionnaire was designed with close-ended type questions. The closed-ended or forced-choice type of question is preferable in this research because it will increase the response rate, since it is easier and faster to be answered by the prospective respondents, especially when using a phone-call approach. A drop-off of a self-administered survey questionnaire and telephone calls techniques were used to collect participants' responses. Accordingly, a total of 500 questionnaires were distributed, of which 420 completed

questionnaires were received, where 120 questionnaires were rejected, leaving 300 completed and usable questionnaires for the research, yielding a usable response rate of 60 %. The responses yielding a usable rate reflected the success of using these types of questionnaires to attain the aims and objectives of the study. The survey questionnaire consists of 25 questions which are divided into 7 disclosure dimensions<sup>14</sup>. However, for the sake of this research, this paper will address the questions that address the visibility of intermediaries in conveying the right message to policyholders. Accordingly, a statistical description with frequency distributions together with the measurement of mean, standard deviations and a chi-square test has been used in this research. The purpose of the Chi-Square test is to identify whether there is difference in proportion in each category (50%/50%), *i.e.* it will find out if the discrepancy between categories (possible responses) is small, and whether that discrepancy is statistically significant or not. In short, the larger the Chi-Square test statistic, the greater the discrepancy, and the significant between categories, for example; “yes” and “no” responses (Pallant Julie, 2010). The data has been analyzed by using SPSS version 17 software.

### **7. PARTICIPANTS' PERCEPTIONS ABOUT INTERMEDIARIES KNOWLEDGE**

In this section the results from the survey on the disclosure variables, specifically exploring the intermediaries' knowledge and the way information were disseminated to participants are presented. In doing so, the results are compared with different international standards and principles.

---

<sup>14</sup> The selection of the 7 disclosure dimensions and their questions were based on the researcher's readings of comprehensive topics, which address several researchers suggestions and findings and are based on the on the imposed polices and standards by the international *takaful* and insurance regulators such as AAOIFI, IFSB, IAIS, OECD, *etc.* These policies and standards have one main goal which is to provide proper protection to insurance policyholders, whether the insurance contract is Islamic or conventional. Participant protection will be achieved by satisfying customer perceptions, needs, wants and preferences which in a way enhance customer satisfaction levels.

## I. Disclosure Mechanism Tools

**Table 1: Disclosure Mechanism Tools**

Q1- Which approach does the company use to communicate with me:					
1-1) The Internet					
Valid	Options	Frequency	Percent	Chi-square test	
	No	287	95.7	Chi-square	Sig.
	Yes	13	4.3	250.253	0.000
	Total	300	100.0		
1-2) Letters					
Valid	No	94	31.3	41.813	0.000
	Yes	206	68.7		
	Total	300	100.0		
1-3) Meeting					
Valid	No	294	98.0	276.480	0.000
	Yes	6	2.0		
	Total	300	100.0		
4-4) Seminars					
Valid	No	299	99.7	296.013	0.000
	Yes	1	.3		
	Total	300	100.0		
4-5) SMS					
Valid	No	274	91.3	205.013	0.000
	Yes	26	8.7		
	Total	300	100.0		
4-6) Phone					
Valid	No	217	72.3	59.853	0.000
	Yes	83	27.7		
	Total	300	100.0		
4-7) Brochures					
Valid	No	300	100.0	298.003	0.000
	Yes	0	0		
	Total	300	100.0		
4-8) The company often communicates with me					
Valid	No	287	95.7	250.253	0.000
	Yes	13	4.3		
	Total	300	100.0		

Table 1, shows the communication channels that TOs use to contact participants, as TOs are supposed to properly disseminate information to participants in accordance with international standards. Such information should be designed in light of adequate methods and assumptions to bring the relevant information to the attention of participants. Surprisingly, 287 (95.7%) of participants answered ‘No’ to the use of the internet as a communication channel between them and the company. Letters are the most used communication channel between them and the company as 206 (68.7%) participants answered ‘Yes’. On the other hand, the Chi-square test revealed the variations of responses in all sub-questions to be statistically significant (Asymp. Sig. < 0.05).

## II. Disclosure Mechanism *via* Intermediaries

**Table 2: Disclosure Mechanism *via* Intermediaries**

Q2-Did you buy your policy from intermediaries? If yes, go to question 3, otherwise go to question after.					
Valid	Options	Frequency	Percent	Chi-square test	
				Chi-square	Sig.
	No	171	57.0	5.88	0.015
	Yes	129	43.0		
	Total	300	100.0		
Q3- Does the intermediary have sufficient knowledge of <i>Sharia'h</i> ?					
Valid	Options	Frequency	Percent	Chi-square test	
				Chi-square	Sig.
	No	96	74.0	69.120	0.000
	Yes	33	26.0		
	Total	129	100.0		
Q4-Does the intermediary have sufficient knowledge of <i>takaful</i> business?					
Valid	Options	Frequency	Percent	Chi-square test	
				Chi-square	Sig.
	No	96	74	65.333	0.000
	Yes	33	26		
	Total	129	100.0		

Table 2, reflects the importance of insurance intermediaries to convey the right information to participants, which requires that intermediaries have sufficient knowledge of different *takaful* issues. This is in addition to being aware of *Shari'ah* issues and their implications for *takaful*. The role of intermediaries/brokers in the Saudi insurance market seems to compete fairly with the role of the salesperson for the *takaful* companies; 129 (43%) participants bought their *takaful* policies from brokers. Surprisingly, when participants were asked to clarify whether these intermediates have sufficient knowledge of different *takaful* and *Shari'ah* issues relating to *takaful*, 96 (74%) out of 129 participants replied with 'No', indicating that the intermediary that sold them the *takaful* policy had insufficient knowledge of these issues. This finding strongly requires the attention of Saudi insurance regulations to take the qualifications of those intermediaries/brokers more seriously and try to improve their *takaful* principles and *Shari'ah* knowledge. On the other hand, the Chi-square test revealed that the variations of responses in all three questions are statistically significant (Asymp. Sig. < 0.05).

### 8. CONCLUSION AND RECOMMENDATIONS

Although SAMA has stressed that the intermediaries should have proper knowledge, training and enough experience (SAMA, 2011a), it did not specify the required knowledge and skills needed for the intermediaries - knowledge related to the economic and political situation of the Saudi market. The intermediaries should possess the necessary knowledge about different aspects on *Shari'ah* to sell a *takaful* policy. Researchers have a common complaint regarding the lack of training of life insurance salesmen (Gower, 1984). One of the IAIS (2011) requirements is for the intermediaries to be licensed. Similarly, it is recommended that SAMA enforces the intermediaries to be licensed or at least to possess the Insurance Fundamentals Certificate Exam (IFCE), which has been assigned by SAMA to all insurance employees working in Saudi Arabia and to comply with the UK Financial Services Act 1986, which made it mandatory for intermediaries to comply with the code of conduct. Indeed, 96 (74 %) out of 129 participants state that the intermediaries who sold them the *takaful* policy have insufficient knowledge about different issues of *takaful* principles and insufficient knowledge about the associated *Shari'ah* knowledge. SAMA has identified the duties of intermediaries to provide sufficient information to customers in terms of price

comparisons, premiums payments, payable fees and expenses, claims required documents. However, SAMA did not touch on the element of human action/intervention when delivering the service. Finally, researchers are critical about the conflicts of interest that can arise from the commission payments structure by which intermediaries remunerated and the cultural environment in which they work (Mercantile & General Reinsurance, 1993; Gower 1984). Accordingly, it is preferable that SAMA becomes involved in setting up fair amounts of commissions and remunerations for intermediaries by comparing the domestic commission rates with the international advanced insurance market. It is expected that by setting fair intermediaries commission, a good service quality will be delivered to the perspective policyholders. Finally, customer orientation and education about their rights and obligations is an important issue in the market conduct subject. It is considered a responsibility of the regulators to examine consumer education to achieve better public awareness and better policyholder protection. Accordingly, SAMA should launch a participant's education programme especially with those who possess a life family *takaful* policy as they have long-term contractual agreements with the insurance company, which entitles them to receive periodic financial benefits.

## REFERENCES

1. AAOIFI. (2007). Islamic insurance in line with shari'ah Standard. No 26 (2). Manama: Accounting and Auditing Organization for Islamic Financial Institution.
2. AAOIFI. (2007). Accounting, Auditing and Governance Standards on takaful. p.437. Manama Bahrain.
3. AlAHLI Takaful (2010). Annual Report Board of Directors AlAHLI Takaful Company. At (<http://www.alahlitakaful.com>)
4. AlJazira (2008). Annual Report. AlJazira Bank. Visited at: (<http://www.baj.com.sa>).
5. Alnemer, Hashem, (2013). Revisiting Takaful Insurance: A Survey on Functions and Dominant Models. Afro Eurasian Studies. 2 (1&2), Spring & Fall 2013, 231-253.
6. Bank Aljazira (2009). Bank Aljazira Annual Report 2009. Reviewed on: ([www.baj.com.sa/baj](http://www.baj.com.sa/baj)).
7. Bank Aljazira (2010). Bank Aljazira Annual Report 2010. Reviewed on: ([www.baj.com.sa/baj](http://www.baj.com.sa/baj)).
8. Easterby-Smith, M., Thorpe, R. and Jackson, P. (2008). Management Research. (3rd ed). SAGE Publications Ltd., London.
9. Easterby-Smith, M., Thorpe, R. and Lowe, A. (1999). Management Research, an introduction. London: SAGE Publications.
10. Engku Ali and Hassan Odierno. (2008). Essential Guide for Takaful (Islamic Insurance). CERT Publications Sdh. Bhd. K.L. Malaysia.
11. Ernest & Young, E&Y (2011, 2014). World Takaful Report. <http://www.ey.com>
12. Gower, L.C.B. (1984) Review of Investor Protection, Report: Part I, Cmnd 9125, HMSO, London).
13. IAIS and IFSB (2006). Issues in Regulation and Supervision of Takaful (Islamic Insurance). Retrived 12 June, 2009, from <http://www.ifsb.org>.
14. IAIS and OECD (2009). Issues Paper on Corporate Governance. Available at ([www.iaisweb.org](http://www.iaisweb.org)) and (<http://www.oecd.org/daf/insurance/governance>).
15. IAIS. (2011). Insurance Core Principles, Standards, Guidance and Assessment Methodology. Available at: ([www.iaisweb.org](http://www.iaisweb.org)).
16. IAIS (2002). Guidance Paper on Public Disclosure by Insurers. Guidance Paper No. 4. Available at: ([www.iaisweb.org](http://www.iaisweb.org)).
17. IAIS (2003). Insurance Core Principles and Methodology. Principles No. 1. Singapore.
18. IAIS (2008). Standards on the use of Internal Models for Regulatory Capital Purposes. Standard No. 2.2.7.
19. IAIS and OECD (2009). Issues Paper on Corporate Governance. Available at ([www.iaisweb.org](http://www.iaisweb.org)) and (<http://www.oecd.org/daf/insurance/governance>).
20. IAIS (2002). Guidance Paper on Public Disclosure by Insurers. Guidance Paper No. 4. Available at: ([www.iaisweb.org](http://www.iaisweb.org)).
21. IAIS (2003). Insurance Core Principles and Methodology. Principles No. 1. Singapore.
22. IFSB (2009) Guiding Principles on Governance for Takaful (Islamic Insurance) Undertakings. Working Paper No. IFSB-8.
23. IFSB (2008). Guiding Principles on Governance for Islamic Collective Investment Schemes. Working Paper No. IFSB-6.
24. Julie Pallant (2010). SPSS Survival Manual. McGraw-Hill Education.
25. Madzlan Mohamad Hussain (2009). "Legal Issue in Takaful". Simon Archer, Rifaat Ahmed Abdel Karim, Volker Nienhaus (eds.). Takaful Islamic Insurance Concepts and Regulatory Issue. West Sussex. UK. John Wiley & Sons. pp. 67 – 82.

26. Mercantile & General Reinsurance (1993). Survey of crop insurance in Australia. Hill, Jeanene Publisher: [Sydney] : ISBN: 0646153188 DDC: 36812.
27. OECD (2011). OECD Guidance in Insurer Governance. Available at (<http://www.oecd.org/daf/insurance/governance>).
28. Oxford Business Group OBG (2011). Saudi Arabia: Insured growth. Reviewed on:([http://www.oxfordbusinessgroup.com/economic\\_updates/saudi-arabia-insured-growth](http://www.oxfordbusinessgroup.com/economic_updates/saudi-arabia-insured-growth)).
29. Pakistani takaful rule (2005). Ministry of Commerce. Government of Pakistan. Islamabad.
30. Peter Casey. (2009). "Supervisory Issues in Takaful: An Overview". Simon Archer, Rifaat Ahmed Abdel Karim, Volker Nienhaus (eds.).Takaful Islamic Insurance Concepts and Regulatory Issue. West Sussex.UK. John Wiely& Sons, (pp. 113 - 137).
31. SAMA (2005a). Law on Supervision of Cooperative Insurance Companies. At: (<http://www.sama.gov.sa>).
32. SAMA (2005b). Implementing Regulations. At: (<http://www.sama.gov.sa>).
33. SAMA (2008). Insurance Market Code of conduct Regulations. At: (<http://www.sama.gov.sa>).
34. SAMA (2009). The Saudi Insurance Market Report. At: (<http://www.sama.gov.sa>).
35. SAMA (2011a). Audit Committee Regulation in Insurance and/or Reinsurance Companies. At: (<http://www.sama.gov.sa>).
36. SAMA (2011b). Actuarial Work Regulation for Insurance & Re-Insurance Companies. At: (<http://www.sama.gov.sa>).
37. SAMA (2011c). Insurance Intermediaries Regulation. At: (<http://www.sama.gov.sa>).
38. SAMA (2011d). Investment Regulation for Insurance & Reinsurance Companies. At: (<http://www.sama.gov.sa>).
39. SAMA. (2010a). Forty Sixth Annual Reports - The Latest Economic Developments. At: (<http://www.sama.gov.sa>).
40. SAMA. (2010b). The Saudi Insurance Market Report. At: (<http://www.sama.gov.sa>).
41. SAMA (2013). The Saudi Insurance Market Report. At: (<http://www.sama.gov.sa>).
42. Takaful Act 1984. LAWS OF MALAYSIA.
43. World Development Bank (2009). The World Development Bank Indicators. Reviewed at: (<http://data.worldbank.org/indicator>).