**Agency problem in *Wakala* with *Waqf* (Principal – Agent) model of Takaful**

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**Abstract**

The global Takaful market is growing at a rate of 14%, while conventional insurance is growing at 5.5%. According to World Takaful Report (2016), number of Takaful companies operating globally has reached to over 300 in 2016. These companies are using different modes of Islamic business like *mudarabah,* agency *(Wakala)* and agency with *Waqf* models in providing their services. Takaful companies in Malaysia are operating on *mudarabah* model while GCC companies are using an agency *(Wakala)* model. Beside these models, *Wakala* with *Waqf* (principal – agent model) is the recent model supported by renowned religious scholar, Mufti Taqi Usmani, and is the only allowed model for Takaful companies operating in Pakistan. It is modified version of agency model being operated in the GCC countries in which pool fund is declared as *Waqf*. The use of *Waqf* in agency model is introduced with an aim to improve the consumption of pool fund regarding paying claims of the clients. The use of the agency model with *Waqf* in Takaful is increasing globally; however, there are some technical issues undermining the performance of *Waqf* and invite discussions on them. In agency model with *Waqf,* Takaful company act as an 'agent' as well as 'Principle' at the same time. In other words, Takaful company also runs the *'Waqf'* which may result in conflict of interest. Therefore, to address this issue, the current study focuses on the role of 'Principal' in agency model and tries to put forward suggestions for addressing the potential conflict of interest. This will also help to

improve the performance of *Waqf*, ensuring its existence in longer terms and beneficial to the global and national Takaful industry.

*Keywords: Mudarabah, Takaful, Wakala, Waqf*

## Introduction

The services of Takaful started in 1979 when first Takaful company was established in Sudan (Kwon, 2007; Sherif & Hussnain, 2017). The growth of Takaful across the globe shows potential in this area. One of the many reasons in this growth can be the increasing trend in Muslims to opt Islamic financial services for their needs. Moreover, many financial institutions in non-Muslim countries have also started offering Islamic financial services. While addressing the economic recession, Pope, the spiritual leader of Christians advised western bankers to use Islamic finance for re-gaining the confidence of the people as it is based on ethics (Romano, 2009). Finding the environment conducive, experts of Islamic finance are developing different products meeting the needs of a common man. Experts are using different models in providing these services. These models are based on *mudarabah*, agency and *Waqf*. At present, based on these concepts, hybrid models are also offered, and many Takaful companies are using these hybrid models of *Wakala* with *Waqf*. In Arabic language, Agent is called *'Wakeel'*, therefore the model based on Agent – Principal relationship is also called *Wakala* model. This model has addressed several issues pointed out in other models, but it also has its own technical issues which may affect the survival, sustainability and growth of the *Waqf* fund. In this study, we have discussed the role of agent and principal in *Wakala* – *Waqf* model, have raised issues and suggested solutions for it through inviting opinion interviews of the technical and shariah experts and practioners of takaful companies operating in Pakistan.

**Modarbah**

It is a form of partnership in which one partner(s) provides the capital while the other partner(s) provides their expertise. The capital owner is called as “Rab Ul Maal” and the partner providing its expertise id called “Mudarib” In takaful, a claim doesn’t immediately after paying contribution by the client and a time gap always exist between paying contribution and occurrence of a loss which can be the death of a person, theft of a car, building on fire. Therefore contributions lying in the waqf fund are invested by takaful company.Here, waqf is the owner of the funds (capital) and is Rab Ul Maal while takaful company provides its investment expertise as mudarib (Usmani, 2002).

***Waqf***

The Oxford dictionary defines *Waqf* as, “an endowment made by a Muslim to a religious, educational, or charitable cause”. The concept of *Waqf* can be traced with this sayings of Prophet Muhammad (Peace be upon him) that *“when a child of Adam dies, his chapter of deeds is closed forever, except for three, for (one who founded) a perpetual charity during his lifetime, (a scholar who left behind him) a legacy of knowledge that benefits people at large, and a pious child of the deceased who constantly seeks Allah’s mercy for him”* (*Muslim, Hadith: 1631*).

There are three types of *Waqf*. ‘*Waqf Ahli’* which is meant for the support of *Waaqif* (donor of *Waqf*) children. ‘*Waqf Kahiri’* is philanthropic *Waqf* which is used for general welfare. It can be both for religious and non-religious purposes. It includes financing mosques, educational institutes and helping needy persons. ‘*Waqf Mushtarak’* which is used for both charities and individuals (Yaacob, 2013).

In Africa, *Waqf* based systems is termed as *“Habus”* which provides municipal services and public utilities in a sustainable way with the income generated from the donated buildings

(Hamouche, 2007). Zuki (2012) mentioned *Waqf* as a mechanism of resource distribution between wealthy and underprivileged people for reducing the socio-economic gap.

**Takaful**

Takaful was developed as an alternate to the conventional insurance with a motive to eliminate all those elements which are not allowed in Islam. These elements are interest, uncertainty and gambling (Farooq, Chaudhry, Alam & Ahmad, 2010; and Maysami & Kwon, 1999). Takaful is based on *Shariah* principles of helping each other in time of need. Takaful companies are using *mudarabah, agency (Wakala)* and *Waqf* modes for offering their services (Htay & Zaharin, 2011). In Malaysia, Takaful services commenced with the passage of Takaful Act in 1984. Initially, models based on *Wakala* and *mudarabah* were used by Takaful companies. From 2005 onwards, use of the agency model with *Waqf* started. This model was adopted by Takaful companies when Takaful rules in 2005 were developed in Pakistan. Over the period of 40 years, there are more than 300 Takaful companies operating globally (World Takaful Report, 2016). Still global Takaful industry is facing challenges relating to its *Shariah* compliance, technology, structure and penetration (Fauzi et al., 2016).

***Wakala* – *Waqf* with *Mudarabah* Model**

The current study focuses on Principle – Agent (*Wakala* model) with Waqf. In this model, Takaful company establishes an endowment *(Waqf)* fund in which all participants contribute with an intention that if any of the participants faces any defined financial loss, he or she will be compensated from the fund. The common fund is created by the company. After its creation, the company invites the clients to be participants (member) of that common fund. The common fund provides different risk protection coverages against a specified contribution (premium). A client can become a member of the fund if he or she contributes specified amount in the fund for a defined coverage (Malik and Ullah, 2016). The contribution is calculated according to the nature and amount of coverage, the client is requesting. This contribution is further placed in the common fund. Takaful company does not own that fund, but it only operates on behalf of all the participants of the fund (Wahab, Lewis & Hassan, 2007). In its operation, the company decides the inclusion of the client as participant in the waqf fund and its terms and conditions.

All these functions need to be performed by a team of experts and should be offered through a properly registered company. The services of these companies should be monitored through a regulatory authority. Due to these reasons, only licensed Takaful companies can invite clients to be member/participants of the common fund by paying their contribution. Regulatory authority grant license to only those companies which fulfill its pre-requisites for license including minimum paid up capital requirement, Board of Governors, *Shariah* Governance, setting up of the common fund, products, and administrative set up etc. One or more shareholders arrange all the requirements of the regulatory body and get the license. After getting the license, the company invites public to be member of the common fund by paying contributions and getting their required coverage. Here, the relationship of the company and the common fund is the “Agent–Principal” in which company is the agent *(Wakeel)* and the common fund is the Principal. The company does not own the common fund but is only the caretaker or agent of the fund. All the claims are paid from the common fund. Money in the common fund belongs to the participants and through risk sharing mechanism; all claims are paid from the common fund collectively owned by the participants of the fund (Htay, Arif, Soualhi, Zaharin, & Shaugee, 2012).

Round the year, claims occur and company process and pay these claims from the common fund. After paying all the claims, the remaining amount in the common fund is called surplus and belongs to those participants who did not make any claim, or their claim amount was less than their contribution. While in insurance, if anything remains in the common fund, it belongs to the insurance company. Takaful company cannot get anything from the surplus. The deficit may occur, if total amount of claims exceeds than the contributions. In that case, principally, the participants should be asked to pay more in the common fund, but it is not a viable option. Therefore, shareholders are made bound by the regulators to provide *Qard-e-hasna* (interest free loan) to the common fund in accordance to its share in the company for paying the claims. Every shareholder provides its share of *Qard-e-hasna* in accordance to its shareholding in the Takaful company. In future, if any surplus occurs, it is first used to pay the *Qard-e-hasna* (Malik and Ullah, 2016).

Now, we come to the other side of the picture. On behalf of the common fund the company performs all functions related to the risk coverage it provides to the participants. These functions include its marketing, underwriting and claims management. Underwriting is a process in which the company assesses the risk of the client and decides whether to give client the desired coverage or not. If it decides to give the coverage then how much contribution, the client should pay in the common fund. Later, if the defined loss occurs to the client (like, accident of his/her car, factory on fire or death) the company processes the claim for compensation and pays the amount from the common fund.

Being agent of the fund, the company is compensated by paying an up - front fee (*Wakala* fee) or admin fee for carrying out the mentioned functions. Coverages provided by the common fund may include life, motor, building, physical stock, cash, health, liability and others.

The advance fee is always a percentage of the total contribution and the company is required to meet all its administrative expenses and generate an adequate profit for the shareholders. *Wakala – Waqf* with *mudarabah* model seems beneficial for both clients and Takaful companies but it has its own issues which need to be identified and addressed.

**Issues in Principle – Agent with *Waqf* model**

In 'financial economics literature' the concept of Principle – Agent (*Wakala – Waqf)* model is related to the Agency Theory. The agency primarily relates to the nexus of contracts between shareholders and managers. This relationship sometimes results in the conflict between the shareholders (Participants being common fund owners) and managers (Takaful operator as agent) and is most commonly termed as 'Agency Problem'. This agency problem has implications for corporate governance and usually gives rise to agency costs. Like, any Principal – Agent model, the agent performs its duties while in case of under or non- performance, it may be removed and in extreme cases, it may be required to compensate the Principal for the losses incurred due to negligence of agent. In Principle – Agent with *Waqf* model, Takaful company is agent while *Waqf* is principal (Hassan, Abbas & Zainab, 2018). This model was adopted in Takaful rules 2005 when Takaful first started in Pakistan. Takaful rules of 2005 have now been replaced with Takaful Rules 2012. While going through both rules, it can be noted that the concept of 'Principal' is not mentioned anywhere. If there is an 'Agent', then there should be a 'Principal' as well but these rules are silent about the entity and role of 'Principal'. It gives an impression that the Takaful operator (company) is only accountable to the regulator, which can undermine the performance and sustainability of *Waqf* in Takaful.

In Pakistan, Securities Exchange Commission of Pakistan (SECP) regulates both insurance and Takaful companies. Takaful companies need governance of a regulator as well as

*Waqf* as a Principal in this model. The *Waqf* is operated by Takaful company while large number of participants (members) make contributions to the *Waqf* fund. The large number of participants and absence of expertise in Takaful makes it difficult for them to question the company if it does not perform its duties as agreed. Therefore, it is important to investigate the threats posed to the *Waqf* in this model by taking opinion interviews from the experts in Takaful industry. The participants include *shariah* scholars and managers working in key positions of Takaful companies. Identification of problems and exploring their solutions is important for the sustainability of *Waqf* and the same is investigated by many authors including Sadeq (2002), Bello (2009), Ali (2009), Karim (2010), Tohirin (2010), Chepkwony (2008) and Farooq (2010).

The objectives of this study includes identification of the inherent problems existing in Wakala waqf model of takaful and suggesting possible solutions by the people working in takaful companies in areas of operations and shariah compliance. Regulator has so far regulated conventional insurance companies and lacks the expertise of regulating takaful companies. Therefore, experts of takaful are invited to identify the problems and suggest solutions for it.

## Methods, Procedures and Process

This study is an effort to analyze the views and opinions of experts working in Takaful companies about the problems and their solutions in the Principle – Agent with *Waqf* model of Takaful through opinion interviews. Models of *Takaful* is a complex phenomenon and merits a qualitative study for collecting opinions of the experts. In qualitative studies, one can opt any strategy among narrative, phenomenology, ethnography, case study and grounded theory depending on its nature (Creswell, 2014, p.254).

The strategy adopted in this study is Phenomenology which is suitable for collecting views of the experts about a phenomenon. In this strategy, a researcher set aside his/her own beliefs about the phenomenon and invites the opinions of experts having lived experiences about the phenomenon (Creswell, 2009). Here the phenomenon is Principal – Agent with Waqf model of Takaful and experts are the *shariah* scholars and managers working in Takaful companies of Pakistan working at their head offices. Data is collected through interviews which is a better method for deep understanding of a phenomenon through beliefs and experiences of the participant (Mann, 2010). Data is collected through interviews when the researcher cannot observe the phenomenon directly. The study involves complex questions about the working of *Waqf* in Takaful. Therefore, data is collected through semi structured interviews in which open ended questions are asked from the *shariah* advisors and managers of Takaful companies operating in Pakistan. The questions for interviews are developed from existing literature and feedbacks of the industry experts. As mentioned earlier, for all Takaful companies operating in Pakistan, Principal – Agent with Waqf is the only model to be practiced. There are five full - fledged companies and more than 15 window Takaful operators working in Pakistan. In this study, *shariah* scholars and managers of following three full - fledged Takaful companies were interviewed:

1. Pak Qatar Family Takaful
2. Pak Qatar General Takaful
3. Takaful Pakistan Limited

Six interviews were recorded and transcribed. The text was cross checked with the audio data. Content analysis method was used to analyze the collected data.

## Analysis and Discussion

Neuman (2007)says about analysis of data as "a search for patterns in data-recurrent behaviours, objects, or a body of knowledge. Once a pattern is identified, it is interpreted in terms of a social theory or the setting in which it occurred. The qualitative researcher moves from the description of a historical event or social setting to a more general interpretation of its meaning" Creswell (2009) says the process of data analysis involves making sense out of the text and image data. Merriam (1998) claims that in qualitative studies, data analysis is carried out simultaneously with the data collection. Qualitative data is analysed using different techniques including content analysis, narrative analysis, thematic analysis, and discourse analysis. In this study, thematic analysis technique is used for analysing. Thematic analysis is "A method for identifying, analyzing and reporting patterns within data" (Braun & Clarke, 2006). This study uses thematic analysis as we are looking for the common themes and patterns in the answers of the respondents for identifying issues in wakala waqf model and solutions suggested by the experts. We analyse answers of all respondents to a single question and try to find commonalities into it. Data is transcribed and crossed checked with the verbal data for avoiding any omission. Different responses to the same question are collectively analysed. Similar patterns and difference of opinions were identified showing agreement and disagreements in responses and were then interpreted.

To document the views of *shariah* scholars and managers on the role of 'Principal' in *Wakala – Waqf* model, below mentioned questions are summarized as under:

***Q1. In this model, Takaful company is performing as an agent, who has appointed the company as an agent?***

According to Takaful rules 2005 and 2012, in addition to other pre-requisites, a Takaful company can get its license of operations from the regulator only, when it establishes a *Waqf* fund. So, the company becomes *Waaqif* and issues *Waqf* deed which contains the details of relationship between the company and the *Waqf*. Being *Waaqif*, the company also appoints itself as an 'Agent' of the *Waqf* fund.

***Q2: If Takaful company is an agent in this model, then who is the Principal?***

*Waqf* fund is the 'Principal'.

***Q3: How the Waqf fund plays its role as a Principal?***

The *Waqf* acts through its agent which is Takaful Company and it plays its role according to the *Waqf* deed.

***Q4: Which entity develops Waqf deed?***

Takaful company develops the *Waqf* deed on behalf of *Waaqif* (creator of the *Waqf*)

***Q5: What if the company do not correctly perform its role of agent, resulting a loss to the Waqf fund. Can the Principal (Waqf fund) keep a check on its agent, the company?***

*Shariah* Board (SB) of the company keeps a check on operations of the company and protects the *Waqf* fund from such losses. SB is empowered to take action against the company if it is negligent in discharging its duties as agent of the waqf fund. However, the rules are not explicitly giving such role to SB for taking action against the company. One of the respondent further added that if any deficit occurs in waqf fund, the company has to extend an interest free loan for meeting the deficit. This rule also keeps a check on the company for being more vigilant and careful while accepting a risk in the waqf fund.

***Q6: Is shariah board part of the company?***

Yes, it is part of the company.

***Q7: How the SB, being part of the company, can keep check on its own self?***

Although, *S*B is part of the company, but it keeps a check on the company for its proper working within the ambit of *Waqf* deed. The role of SB in acting as a check on company is more implied one and should be made more clear and explicit.

***Q8: So, the company is acting as Principal as well as Agent in this model?***

Yes, presently, both roles are being performed by the company. One of the *Shariah* person of the company mentioned that the company performs their functions according to the directions given by the *Shariah* Board which ensures the better performance of the *Waqf* fund. The Board makes these decisions in the best interest of the *Waqf* fund.

***Q9: Is such role of the shariah board supported by Takaful Rules 2012?***

There is no provision in Takaful rules 2012 which support such role of the *Shariah* Board. In fact, Takaful rules 2012 do not require a window operator to establish a *Shariah* Board within a company. A Takaful window operator is only required to appoint *shariah* advisor, *shariah* compliance auditor. *Shariah* Board is optional now. In such situation, the performance of *Waqf* fund becomes questionable.

***Q10. Do you agree that agency problem arises, if both roles are performed by one entity, i.e. Takaful company? How this problem can be solved?***

Such problems can undermine the performance of *Waqf* fund, affecting its existence and sustainability. This problem can be solved if regulator establishes a body which may be given the role of Principal in wakala waqf model which keeps a check on takaful companies. The body can be the central shariah board of the regulator and its composition should contain people expert in underwriting and claims management. This body should be empowered to take action when a takaful company doesn’t fulfill the role and responsibilities of the agent especially when takaful company is making profit while waqf fund is deficient.

## Conclusions and Recommendations

This study attempted to identify issues in the Wakala *Waqf* model and suggesting solutions. People working in Takaful companies including their *shariah* advisors were interviewed. It was found that almost all respondents agreed that agency problem exist in this model where takaful company plays two roles i.e. of Principal and agent at the same time which can undermine the performance and sustainability of takaful companies using this model. A takaful company using this model develops and implements waqf deed and waqf rules. Shariah boards keep a check on takaful companies but these boards are in itself part of companies. Moreover, in Pakistan, takaful rules 2012, window takaful operators are not required to have a shariah board at all, therefore, their check and balance seems to be further weakened. Most of the interviewers opined that *Shariah* board is part of the company so there can be an agency problem and conflict of roles while keeping a check on the operator. Therefore, the role of the Principal should be performed by a Central body established by the regulator. This body should be monitoring the performance of all Takaful companies which will also promote uniformity in practices. The central body should ideally be composed of professionals well versed with the operations and *Shariah* aspects of a Takaful company.

The findings show that there are many areas where Takaful companies can take such decisions which may undermine the interest of the *Waqf* fund while increasing the *Wakala* income of the operator. Such practices may result in big cash outflows from the *Waqf* fund and may leave it in deficit or insufficient for the future claims of the clients, thus undermining the sustainability of *Waqf*, although for deficit, the shareholders must give interest free loan to the *Waqf* fund for meeting the claims but that is recoverable from future surplus.

In *Waqf* deed, it is always written that the operator will accept only appropriate risk according to its underwriting policy. The underwriting policy determines the acceptable range of risk, however this policy is also developed by the operator itself. What if for earning more *Wakala* fee, the company accepts inappropriate risk and passes on to the *Waqf* fund which may result in large claim and hence, extra ordinary cash outflow from the *Waqf* fund. There is no authority mentioned in the Takaful rules which will decide whether the company is liable to compensate the *Waqf* fund for the loss due to negligence of the company. In the Agent – Principal theory, if the agent goes beyond its limits, resulting in a loss to the Principal then the Agent has to bear the loss. While, in Takaful rules, no such provision is present which may compel the operator to bear the loss if it happens due to its negligence? The feedback of the interview was that there are following options for becoming a Principal in *Wakala* – *Waqf* model of Takaful:

1. Participants
2. *Shariah* Board
3. Central body developed by the regulator

The participants are large in number and lack the skill to manage the operator. *Shariah* Board is part of the company, so there can be conflict in roles. Majority of the interviewees supported a central body to be developed by the regulator having a composition, well versed in operational and *shariah* aspects of Takaful. This body will act as the ‘Principal’ for all Takaful companies operating in the country. It will bring uniformity in the companies and the operator will not be able to influence it. Moreover, a strong independent body monitoring the companies will result in more transparency and confidence of the participant in *Wakala* – *Waqf* model of Takaful. The chances of deficit in the *Waqf* fund will reduce and it sustainability will improve.

The number of participants in *Waqf* fund may increase, thus, bringing more stability in the fund and reduction in the cost of Takaful coverages. Having more funds in *Waqf* fund will spur the investment opportunities in the country.

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