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MARKET COMPETITION AND FINANCIAL STABILITY: THE CASE FOR TAKAFUL (ISLAMIC INSURANCE) MARKET

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ABSTRACT
The Takaful market has been growing substantially since its initiation and has begun gaining traction across the globe. Nevertheless, recent pressures for consolidation may bring about significant implications upon market competition, as well as economic and financial performances. As such, this study highlights the recent financial market failures and discusses the ambiguous link between competition and stability. Additionally, this study emphasizes the significance of competition in affecting the stability of Takaful operators to reinforce the comprehension of Takaful market behavior. This study provides important policy implications for regulators, investors, and other market participants to promote the progress of the Takaful sector.

JEL classification: *D4, G2*
Keywords: *Financial stability; Islamic insurance; market competition; Takaful*

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1. INTRODUCTION
Insurance plays a significant role in switching or hedging risks in this modern era. Islam encourages its followers to take precautionary actions to reduce the impact of any risk without oppressing other parties. Anas ibn Malik reported: "One day, Prophet Muhammad (peace be upon him) noticed a Bedouin leaving his camel without tying it. He asked the Bedouin, "Why don't you tie down your camel?" The Bedouin replied, "I put my trust in Allah." The Prophet then said, "Tie your camel first, then put your trust in Allah"[1]. The above hadith suggests that followers should protect themselves from undesirable incidents and then only leave the consequences to Allah SWT. Hence, in Islam, the concept of risk management underlying the operation of Islamic insurance (Takaful) is parallel with the objectives stipulated along the lines of *Shariah* principles. In view of insurance violating several Islamic business principles and the escalating evidence regarding culture impacts upon consumers' purchasing behavior and practices, Takaful appears to be an alternative to conventional insurance,

[1] *At-Tirmidhi*

especially to cater to the needs amongst the Muslims (Lehrer, 2004; Liu et al., 2007). The term 'Takaful' stems from the Arabic verb '*kafala*' that means 'mutual guarantee' or in a broader sense, a treaty that protects its members in a group against damages or losses suffered by any one of them. Its objectives and operations are in line with the elements of solidarity, joint accountability, mutual interest, and shared indemnity; excluding elements prohibited by *Shariah* (Wahab et al., 2007).

Figure 1 illustrates that although the Takaful market has existed for only four decades, its world gross premium growth rate seemed to outperform the conventional insurance. The figure was growing in double-digit from the year 2010 until 2014 with the growth in premium at 13.73% in year 2014, while only 1.71% for conventional insurance. The demand for Takaful has been rapidly growing simultaneously with Islam as the fastest growing religion. Table 1 presents the top eight most Muslim populous nations projected for year 2050 with India and Nigeria being the prospects in becoming the future Takaful gigantic market. Additionally, the recent Takaful penetration across these eight nations appeared to deteriorate to a critically lower level. In this case, it is worth highlighting that Muslims believe in *qada' (*Allah's carrying out his Decrees) and *qadar*' (the Decrees of Allah), which means everything that happens is the will of Allah SWT. Many Muslim scholars believe that purchasing life insurance cover to assure disbursement in the event of death as a hedge against this date; reflects a bet against Allah SWT. Karich (2004) claimed that the acceptance level for life insurance is low amidst Muslim nations because it is not well understood, apart from being associated with misfortune and negative aspects of life. Considering the size of the Muslim population that signifies a largely untapped potential market, Takaful has massive opportunities in these countries. As a result, an exponential growth for the Takaful market is anticipated within the next three decades. Apart from demographics development, the progress of Takaful market is driven by the increasing awareness amongst consumers, innovative *Shariah*-compliant products, expansion of Islamic banking, rapid economic progression, and support from regulatory bodies (see Husin & Rahman, 2016; Thomson Reuters, 2017). In the face of the strong growth rate, the Takaful market, by asset size, seems to remain as a niche market with its total assets valued up to US$35 billion, while US$27.9 trillion for conventional insurance in year 2014.[2]

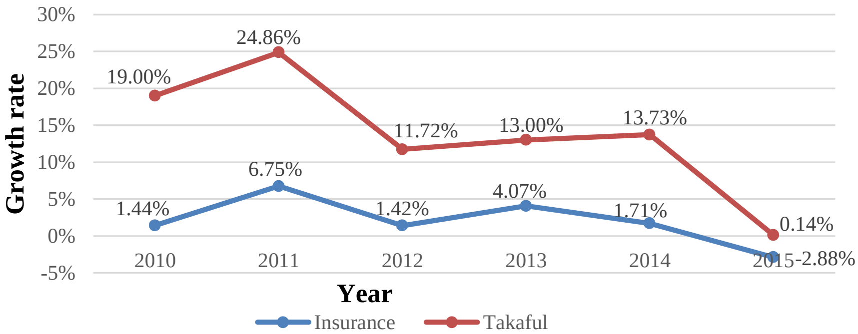

Figure 1. World insurance and Takaful gross contribution premium growth rates.
Sources: OECD Statistics and Global Takaful Report 2017

[2] see Thomson Reuters (2017)

Table 1: Takaful penetration and density across eight countries with the largest Muslim population in year 2050.

Top	Countries	Muslim Population Projection in year 2050	% of World Muslim population in 2050 (%)	Takaful penetration (2014) (%)	Takaful density (2014) (US $)
1	India	310,660,000	11.2	-	-
2	Pakistan	273,110,000	9.9	0.03	0.44
3	Indonesia	256,820,000	9.3	0.08	3.37
4	Nigeria	230,700,000	8.4	-	-
5	Bangladesh	182,360,000	6.6	0.11	1.38
6	Egypt	119,530,000	4.3	0.06	1.93
7	Turkey	89,320,000	3.2	0.02	2.16
8	Iran	86,190,000	3.1	1.54	85.74
	World	2,761,480,000		0.03	12.68

Sources: Pew Research Center (2015), World Islamic Insurance Directory 2015 and WorldBank Data

Despite its infancy stage, the Takaful market has been continuously challenged by fierce competition and depleting profits, which may affect its stability. Such issues have grown in importance, particularly after the 2008 financial crisis, which revealed that monitoring and mitigating risks in the insurance market are essential to shield against insolvency risks (Schich, 2009). Although several scholars have claimed that the visible impact of the financial crisis on the insurance market is less prominent than that experienced by the banking industry, its indirect impact is intricate. The financial crisis had a multiplying impact on capital reduction, which further increased insolvency risk amongst insurance companies (Marović et al., 2010). During the global financial crisis, the insurance market was hit with the biggest failure, instead of the banking industry. For instance, the top leading insurer in the world, American International Group (AIG), suffered liquidity crisis and almost collapsed due to credit default swaps that were written for collateralized debt obligations and asset-backed securities[3]. As in Japan, the Yamato Life Insurance Company reported failure in 2008 with $2.7 billion in liabilities due to problematic investments in securitization products[4]. In the case of Malaysia, the Central Bank of Malaysia took control of the Tahan Insurance Malaysia Berhad in May 2009 mainly because the insurer had failed to meet the minimum standard of capital requirement. The insurer recorded a shortage of RM29.2 million in solvency margin, against the requisite RM50 million, and concurrently reported a staggering net loss of RM301.8 million in 2008[5]. After weighing in the function of an insurer as an economic stabilizer and its increasing interconnectedness with the banking industry, the above illustrations reflect a substantial hike in the number of cases related to failure by the insurer that has triggered concern over insolvency and stability of the insurance industry, inclusive of the Takaful market.

Low-profit margin has emerged to be a major problem in dwarfing Takaful operators. Apart from competing with conventional insurers who possess the advantage of scale, they also have to compete with other Takaful operators. Concurrently, Takaful operators are challenged by technology advancement and

[3] see United States (2011)
[4] see Agencies (2008)
[5] see Bank Negara Malaysia (2009)

product innovation (Milliman, 2017). Profitability is crucial for Takaful operators to expand their businesses and to assure sustenance. In view of the dynamic roles of the insurance sector in supporting various economic activities (French et al., 2015) and the significance of Takaful market development in promoting economic growth (Muye & Hassan, 2016), low-profit margin cannot be economical for these companies to sustain their businesses.

The stability of Takaful market highly relies on the extent of risk that the Takaful operators are ready to take. Therefore, the aspect of stability from the context of Takaful market is worth examining since, by nature, the Takaful market may be riskier than the conventional insurance. This is because; conventional insurance operators can invest their funds in fixed income securities, in opposed to Takaful operators. As a result, the stability amongst Takaful operators is in jeopardy with high allocations to equities and real estate (Finance Forward, 2016). Nevertheless, only a handful of studies have associated Takaful market stability with direct assessment of stability in Takaful market. In view of the potential disruption in the provision of essential services to the real economy and proliferation of systemic risk in the financial system (French et al., 2015) due to failure of the Takaful market, the Takaful market definitely deserves equal consideration in the finance literature.

Prior studies that have explored competition-stability nexus are mostly linked with the banking sector as this particular line is the primary player in financial service industry. The conventional competition-fragility theory points out that more market power (or less competition) may result in stronger financial stability, especially when greater banking profits lead to larger capital buffers. The negative impact of competition on financial stability takes place when fierce competition ends up in more risk-taking behavior by banks. From a different stance, it appears that more competitions could project higher stability, instead of less financial stability, especially when fragile banks are pushed out of the market, as depicted in the competition-stability theory. This view is verified by the observation that fewer banking crises occur amidst higher competitive banking markets. Nonetheless, such correlation is unclearly defined in the insurance industry, including the Takaful market. With that, this study presents a critical literature review pertaining to the roles of competition in affecting the stability of Takaful market. Since adequate competition level is crucial to ascertain the stability of Takaful market, it is essential to monitor the changes in competiveness and its related determinants.

The rest of the paper is structured as follows: The second section describes the progress of Takaful market to date, and followed by a review concerning the role of competition that has an impact on Takaful market stability in section three. Lastly, the final section offers conclusions, policy implications, and several recommendations towards the end of this paper.

2. TAKAFUL DEVELOPMENT, COMPETITION, AND PROFITABILITY

In general context, insurance aims at minimizing the financial impact in case of any undesirable occasion. In this modern age, insurance has become an essential aspect in promoting economic well-being and development, despite its violating concept and mode of operation in conventional insurance from the stance of Islamic business principles (Maysami & Kwon, 1999). This is because; there are three main non-*Shariah* compliance elements in conventional insurance, including *gharar* (uncertainty), *maysir (*gambling), and *ribā* (interest). *Gharar* refers to contractual risk or uncertainty caused by ambiguity in the elements of contract, such as the subject matter (*mahal al- 'aqd*) or its consideration (*'iwad*). Prohibition of *gharar* in contracts originated from the traditions of the Prophet (pbuh)(Ayub, 2007; Saller, 2013). As for conventional insurance, the uncertainty of compensation is acknowledged as concurred in the policy. The compensation sum and the time for reimbursement in the case of misfortune are unclear until the insured event takes place. The interests of all members involved are directly conflicting, and no member is alerted of their rights and responsibilities prior to the occurrence of the insured events. This is viewed as gamble upon the occurrence of the chance insured against damage and loss (Wahab et al., 2007). Next, *maysir* refers to all categories of gambling or wagering that indicate effortlessly wealth is gained by chance at the cost of the other(s) (Ayub, 2007). There is a component of risk in the conventional setting, whereby policyholders are held to be betting premiums on the condition that the insurance company will pay indemnity due to a particular incident (Wahab et al., 2007). This reflects a game of chance, wherein policyholders pay premiums and stand to win by receiving indemnity if the insured event happens or otherwise. This reflects gambling activity, which is stringently unacceptable under the Islamic Law. Lastly, *ribā*, which literally means ‘increase’, refers to usury that arises from loans or debts (Khorshid, 2004). Conventional insurance has been invalidated from the Islamic viewpoint due to two types of *ribā*: *ribā al-nasi'ah* and *ribā al-fadel*. The former involves advanced fixing of a favorable increase on a loan to compensate for waiting (charged for delay performance), while the latter refers to close sale and purchase of items (price variance) (Khorshid, 2004; Zaher & Hassan, 2001). Therefore, an alternative to conventional insurance known as Takaful, which adheres to the Islamic principles, was initiated. In precise, the very principle of Takaful is based on trust, mutual cooperation, and risk-sharing mechanism, which reflects a scheme that is built on the law of large numbers[6].

The contributions of Takaful worldwide have hit a whopping USD8.3 billion in year 2010 and USD14 billion in year 2014. This figure was estimated to escalate up to 10.8% compound annual growth rate (CAGR) over the next three years to attain USD20 billion by 2017 and USD25.5 billion by 2020[7]. In the end of year 2016, a total of 339 Takaful operators were registered, in which 113 were Takaful windows that sold Takaful products in 48 countries; both Muslim and non-Muslim regions[8]. The Kingdom of Saudi Arabia emerged as the largest Takaful player by contributing as much as 77% of the total Gulf Cooperation Council (GCC) Takaful gross written premium (GWP). Its robust growth has been predominantly driven by strong regulatory support by the Saudi Arabian Monetary Authority (SAMA), which refers to a strong insurance regulatory authority in the GCC (Ali, 2010). Takaful players in Malaysia, on the other hand, contributed 76% of the total gross Takaful premium within the Association of Southeast Asian Nations (ASEAN) region. On top of the favorable demographical statistics (60.4% of Malaysian Muslims population), the growth and development forecasts of Takaful in Malaysia are optimistic due to the full support assured by the government in all aspects. Greater product innovation,

[6] Include numerous companies under the collective umbrella to achieve advantages of the law of large numbers. This reduces the concentration of risk to one fund or one company and protects the financial strength of each pool of contributions or groups of people.
[7] Ernst and Young (2012, 2015), Finance Forward (2016)
[8] Thomson Reuters (2017)

higher intensity of distribution, and effective education and training are bound to increase public acceptance towards the Takaful model, which can exponentially drive the growth of Takaful market. The Takaful sector in Malaysia displayed impressive growth rate than the conventional insurance with 9.7% and 8.3% for growth in family and general Takaful, as compared to -0.4% and 6.6% for growth in conventional life and general insurance, respectively, by end of June 2015[9].

The Takaful market is only 39 years old as in 2018, as compared to the 380-year-old conventional insurance industry. Nonetheless, the demand for Takaful seems to be growing rapidly in double-digit due to the nature of Islam being the second most dominant faith in Africa and Asia after Christianity and Hinduism, respectively (Hackett & Grim, 2012). Islam is also the fastest growing religion with the prediction to surpass the Christian faith by year 2050 (Hackett et al., 2015). Besides, the Takaful market has recorded steady growth and has remained unsaturated with a huge growth potential due to the untapped Takaful market amidst Muslim populated nations, such as the vast Muslim populations in India and China (Ahmad et al., 2010). Although the number of Takaful penetration reflects an increasing trend, the penetration is viewed as low due to low accessibility of Takaful protection (Rahman et al., 2008; Yazid et al., 2012). The rapid growth and high potential in the Takaful sector reasonably indicate a perfect avenue to further probe into this vastly untapped market.

In the attempt to evaluate the market competitiveness across Takaful market, four-firm concentration ratio (CR4) and Herfindahl-Hirschman Index (HHI) have been commonly employed to measure market concentration. Table 2 shows the market structure of Takaful markets in Malaysia and Saudi Arabia, which appears to have been moved from a highly concentrated market in 2007 to a moderately concentrated market in 2016. The slump in the market structure implies the increased competition in Takaful market for the both nations.

Table 2: Market structure in Takaful market for Malaysia and Saudi Arabia, 2007-2016.

		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CR_4	Malaysia	0.95	0.82	0.87	0.89	0.85	0.82	0.79	0.72	0.75	0.74
	Saudi Arabia	0.97	0.87	0.71	0.61	0.56	0.60	0.59	0.60	0.59	0.61
HHI	Malaysia	2753	2081	2416	2735	2999	2293	1986	1671	1746	1647
	Saudi Arabia	3300	2821	1798	1284	1072	1258	1115	1156	1148	1247

Source: Author’s calculation.

Table 3 summarizes the profitability of Takaful market in Saudi Arabia and Malaysia. It shows that the profitability of the Takaful market in Saudi seems to be lower than that reported in Malaysia upon comparing the average low return on equity (ROE) and profit margins. One can note that despite the losses incurred in some years, the performance has never failed to improve. Meanwhile, Figure 2 demonstrates that the average ROE for Malaysia insurance market has experienced a downward sloping trend. Concurrently, the ROE for Takaful operators appears to be lower than that for conventional insurers within Malaysia’s insurance market.

[9] Finance Forward (2016)

Table 3: Average ROE and profit margin for Saudi Arabia and Malaysia's Takaful markets, 2007-2016.

	Countries	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Average ROE (%)	Saudi Arabia	-7.92	-17.22	-7.88	-7.29	-7.45	0.20	-30.32	-4.85	-3.18	5.01
	Malaysia	14.49	4.91	2.99	3.12	4.67	6.27	6.12	3.93	0.54	-2.39
Average Profit margin (%)	Saudi Arabia	10.6	-6.08	2.59	3.55	2.65	3.26	-5.45	2.73	2.58	6.52
	Malaysia	14.56	4.02	2.86	0.38	-6.67	0.48	0.45	1.2	0.16	-2.26

Source: Author's calculation.

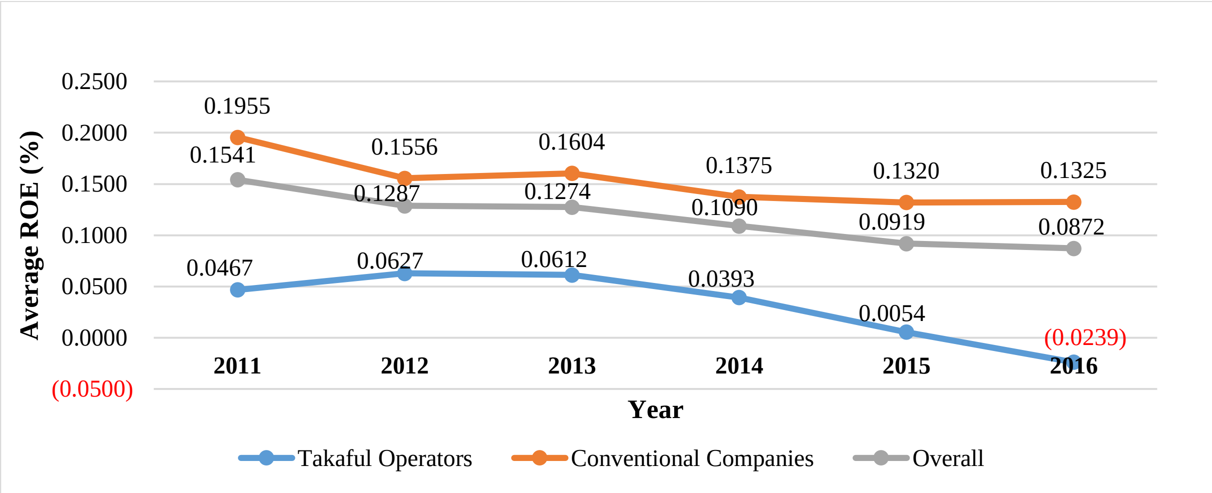

Figure 2. Average ROE in Malaysia's insurance market.
Source: Author's calculation.

Figure 2 displays escalating competition and decreasing profitability within the Takaful market arena for both Saudi Arabia and Malaysia. The low-profit margin scenario is uneconomical for Takaful operators for sustenance of their businesses. Due to its significance and upward trend over the years, this paper looked into the importance of the correlations between competition condition and stability of the Takaful market.

3. LITERATURE REVIEW

3.1 Concepts of competition and stability

The conventional view states that market power may go hand-in-hand with lower competition, but higher stability due to the uprising competition level that may eventually erode "charter values", hence generating a negative correlation between competition and stability (Keeley, 1990). In line with this view, Baumol et al. (1988), Boyd and Prescott (1986), Diamond (1984), Ramakrishnan and Thakor (1984), and Shepherd (1986) asserted that more concentrated markets signify lower competition, wherein conglomerates attain the capacity to diversify better and enjoy economies of scale. Hence, contribution to more stability generates less competition reward, but higher stability. Under supervised authority, Allen and Gale (2000) claimed that it is easier to supervise and monitor a smaller number of banks in a more concentrated market, which assures stability in the overall banking system. Boot and Thakor (2000) proposed that larger banks are expected to have better credit monitoring services and to be involved in high-grade credit investments so as to achieve higher individual investment profits, thus, increasing both credit rating and financial stability. Mishkin (1999), as well as Boyd et al. (2004) reported that higher profit benefited from highly concentrated banking market allows the monopolistic banks to reserve it as buffer against asset quality deterioration. This protects them against macroeconomic risk and liquidity crisis, thus minimizing financial fragility.

The second strand of literature states that competition improves financial stability. In this case, reference is made to the fact that crises occur less frequently in competitive systems. The "too big to fail" notion suggests that policymakers are extra anxious about bank distress and failures in highly concentrated banking system. This is because; larger institutions have higher tendency to participate in possibly risky undertakings and expose their financial system to higher systemic risks (Mishkin, 1999). Jacob and Van (2015) reported that nations cultivating healthy competition with less regulatory restrictions on banking transaction and lower barriers entry for banks are bound to push the more fragile banks out of the market, hence minimizing systemic risk during the banking crisis. Akins et al. (2016) contributed to the literature by evaluating the risk-taking behavior amongst banks and discovered a negative correlation between competition and risk-taking, which is linked to greater financial stability. Their study claimed that competition also conveyed a favorable impact on financial stability by encouraging innovation and promoting efficiency. Competition enhances financial stability through an efficiency mechanism, as postulated by Schaeck and Cihak (2014) in the Transmission Mechanism Hypothesis. Wheelock and Wilson (1995) supported this hypothesis by using the Boone indicator to measure competition, which was grounded by the efficiency hypothesis. The outcome seems parallel with the findings reported by Htay et al. (2013), who weighed in the competition itself towards improvising a firm to be more efficient. Besides, empirical evidence in the banking sector points out that an efficient bank has better asset quality (Billah, 2007).

3.2 Competition and stability in banking studies

Since the 2007-2008 global financial disaster, many have probed into the competition-financial stability nexus within the banking industry for both academic and practical considerations, mainly due to its significant impact on the real economy. Nevertheless, prior studies were keen in developed nations (the European market) with mixed outcomes. Akins et al. (2016) revealed that greater competition increases financial stability. Nonetheless, most of the studies supported that less competition contributes to financial stability (Matutes & Vives, 2000; Mishkin, 1999; Kasman & Kasman, 2015; Keeley, 1990). Although this competition-stability nexus is critical to investigate other financial intermediates, only two studies within the insurance market have assessed the competition-stability hypothesis (Cummins et al., 2017) and the competition-fragility hypothesis (Shim, 2017). Hence, a review of prior competition and stability studies within the banking industry is presented in this study.

Through the application of charter value hypothesis in the banking deposit insurance system, Keeley (1990) showcased that the bank charter value (capital) is reduced due to higher competition, which minimizes monopoly power. This encourages banks to take excessive risks to invest in risky assets. As a consequence, this action is deemed to hike their non-performing loan (NPL) and the possibility for a bank to face failure. Mishkin (1999), although supported competition and the fragility hypothesis, had varying arguments and perspectives. As opposed to Keeley

(1990), Mishkin (1999) suggested that larger banks tend to have excessive risk-taking trait that may threaten stability. Although larger banks do benefit from diversified loan portfolios, under the regulator “too big to fail” policies, both failure and distress experienced by a larger bank can expose its banking system to systemic risk. Nonetheless, this finding contradicted with that reported by Akins et al., (2016), who found a negative link between competition and risk-taking.

On the topic of bank deposit-taking, Matutes and Vives (2000) assessed the impact of competition on deposit-taking and risk-taking motivation among banks. Their outcomes were in favor of the competition-fragility hypothesis, primarily because competition encourages high deposit rates and this subsequently increases asset risk. However, as for bank lending, Koskela and Stenbacka (2000) demonstrated that competition encourages banks to offer lower lending rates in the credit market by generating more investments that are unaccompanied by any increase in debtors’ bankruptcy risks. Their model further denotes that competition-fragility nexus is ambiguous. In fact, their findings are in agreement with that reported by Caminal and Matutes (2002), which suggested that the ambiguity of market power-bank failure nexus relies heavily on monitoring cost, which is far from being related to market structure. They further emphasized that moral hazard is the key factor for monopoly banks to charge higher lending rates and ineffective credit monitoring, which would eventually increase the chances of bank failure.

Although most of the earlier theoretical studies displayed their support towards competition-fragility hypothesis, Boyd and Nicoló (2005) presented empirical evidence and proposed a contradicting view on the competition-stability hypothesis, wherein banks are deemed to benefit from monopoly rents when competition declines. This is because; banks have the ability to increase their profits by charging lower deposit rates and higher loan rates. This reduces the likelihood of a bank to end up in a catastrophe. Nevertheless, charging higher loan rates may lead towards higher default risk (inability of borrowers to re-pay) and lower profitability. Thus, the competition-risk relationship has yet to be clarified. Undeniably, an inverse correlation does exist between competition and fragility as competitive banks charge lower loan rates and reduce individual bank’s default risk, hence stimulating banking stability. Fiordelisi and Mare (2014) are in agreement with this notion, while Martinez-Miera and Repullo (2010) contended. Similarly, Boyd and Nicoló (2005) assumed that bank failures are closely linked with borrowers’ default. Boyd and Jalal (2009) extended Boyd and Nicoló's (2005) study and discovered that increment in competition level affected the ratio of loans to deposits. Hence, Berger et al. (2009) suggested that loan portfolio risk may be partially offset by higher equity capital ratios.

Allen and Gale (2004) contributed to the literature by presenting that the variance in methodology is the reason for the inconsistent outputs. Parallel with Beck et al. (2006), their finding supported that regulatory policies and actions devised by government unions play an integral role. Their findings indicated that government actions that limit competition activities could eventually lead to higher banking system instability.

The empirical review for the correlation between competition and stability from the stance of banking industry concludes that most studies reported findings in favor of competition-fragility hypothesis, while no consensus regarding the competition-stability hypothesis. It appears to be apparent that the outcomes and the conclusions are inconsistent due to a wide range of assumptions and methodologies. Scholars who reviewed fragility from the light of risk-taking behavior and focused on rivalry on the deposit side are regularly in favor of competition-fragility hypothesis. Meanwhile, scholars who embedded adverse selection problem and moral hazard into the analysis consideration to assess stability as bank failures would eventually support the competition-stability hypothesis.

4. COMPETITION AND STABILITY IN THE TAKAFUL MARKET

Healthy competition is imperative, especially when the primary concern is regarding its impact on financial stability and real economy (Greenwood et al., 2012; Hassan et al., 2011; Zhang et al., 2012). As in most other industries, the extent of competition has a nexus with the degree of innovation that could affect production or services efficiency, products quality, sustainability of financial system, and welfare of society (Allen & Gale, 2004; Claessens & Laeven, 2005; Demirgüç-Kunt & Huizinga, 2010; Fu et al., 2014).

The nexus of competition-stability in the insurance industry may differ from the banking sector due to the varying business models, leverages, and risks absorption (Thimann, 2014). As advised by Insurance Europe (2014), the risk profiles of banks and insurance companies vary fundamentally as they have different roles within the economy domain. The insurance business is believed to be less exposed to financial market turbulence. In fact, there are numerous conceivable reasons for this distinction. Credit events within the insurance industry may have less visible impact on financial instability of the insurance market. This scenario is less prominent than that experienced by the banking industry because of the more rigorous rules on minimum capital requirement in insurance industry (Harrington, 2009). Additionally, insurance companies do not encounter considerable liquidity risk, where an unforeseen shortage in cash that may trigger bank runs as they dismiss deposits from customers. During market turbulence, it is typical for policyholders to be less willing to cancel their policies in order to enjoy protection amidst financial downturn (Insurance Europe, 2014). In a similar vein, Das et al. (2003) asserted that insurance business is more stable than bank given the fact that insurance companies often hold more long-term liabilities than short-term liabilities. Since policyholders are bound to suffer a penalty for early surrender, they are discouraged from doing so. The termination procedure for insurance policies is lengthier than closing a bank account. Bell and Keller (2009) claimed that insurance companies are less contagion mainly because they have no "interinsurer" and hence, less interconnected than banks. Financial instability faced by the insurance industry can worsen if insurance companies mismanage short-term financing events or involve heavily in trading derivatives off the balance sheet (Geneva Association, 2010). Schinasi (2005) and Rule (2001) discovered that investment in asset-backed securities had increased in insurance industry. Concurrently, more insurance companies purchase credit default swaps to hedge their credit risk and transfer catastrophe risk to other investors by applying alternative risk transfer (ART) tools, such as catastrophe bonds. Acharya et al. (2009) proposed that large insurance companies are associated with varied financial institutions, thus higher tendency to invest in high-risk assets. With that, insurance companies tend to become more vulnerable during financial crises (Baluch et al., 2011). Given the fact that insurance companies are becoming riskier, it is indeed vital to investigate the drivers of financial instability.

The insurance industry, including the Takaful market, has emerged to be a significant element in supporting the whole financial system and economic growth. It is interesting that despite the Takaful operators are claimed to be relatively more efficient risk management than conventional insurers (Yakob et al., 2014), however a number of high-profile insolvency cases within the Takaful market, such as the Asuransi Takaful Umum (ATU) - a leading Takaful operator in Indonesia. The operator was targeted for liquidation when it failed to compete with other insurers in 2017 and requested additional IDR150 million to fulfil its capital requirement[10]. Another weak player, Solidarity Takaful, was liquidated in year 2012 in Egypt, while Al Baraka Takaful in Jordan that faced financial difficulties was forced to liquidate by the Insurance Commission of Jordan (IC) in year 2014[11]. The cases above highlight the significance of financial stability amongst Takaful operators worldwide as this is an important aspect to protect the interests of policyholders and investors, mainly because financial planning of most households rely on properly functioning insurance market. Given the fact that Takaful operators are becoming risker, it is essential that the drivers for the fragility of Takaful market is investigated.

Critics have maintained that insurers with significant monopoly power may exercise their power to charge consumers with unfavorable insurance premium, hence reaping massively phenomenal profits and causing unhappy consumers (Dafny, 2015; Havighurst, 2005). Likewise, insurers with high monopoly power may lower their insurance premium due to greater bargaining power (Beck et al., 2013; Derbel et al., 2011). For example, negotiations between healthcare insurers and healthcare providers to hold down the healthcare price in order to improve cost efficiency may ultimately benefit consumers. Although competition promotes better market performance, the substantial number of players within the industry could cultivate price competition as low-profit margin is uneconomical for firms seeking sustenance. As a consequence, the recent global financial crisis offers a platform to reinforce one's comprehension by raising inquiries, *inter alia*, such as: 'what is the financial stability status quo in the Takaful sector?' or 'has Takaful market competition enhanced or impeded the financial stability?'

Prior studies claim that Islamic finance has been performing rather well and appears to be more stable than conventional finance, particularly in absorbing shocks during the financial crisis (Beck et al., 2013; Derbel et al., 2011). In fact, Islamic finance, including Takaful market, seems to be facing greater challenges insolvency and capital requirement compliance. Takaful operators are riskier than conventional insurance due to the fact that conventional insurance operators are able to invest their funds in fixed income securities, whereas Takaful operators are prohibited to do so (Karim, 2010). Hence, the stability of all Takaful operators is threatened by high allocations to real estate and equities. Furthermore, only two studies have taken the effort to look into the impact of competition on soundness within the European life insurance markets context, as reported by Cummins et al. (2017). Their study highlighted a notion; competition promotes stability. Nevertheless, Shim (2017) discovered that competition led to instability in the property-liability insurance industry. Therefore, the correlation between competition and stability within the insurance industry has remained a grey area. Increased competition in the insurance industry may drive premiums down due to poor profitability, which in turn, may

[10] see 'Akuisisi Asuransi Takaful rampung Maret', (2017)
[11] see 'Jordan : Regulator to liquidate Al Baraka Takaful', (2014)

increase the chances of insolvency. Low-profit margins give little room for one to commit errors in running a business. For instance, the Penn Treaty Network America Insurance Company, which is the largest health insurance in the US, filed for insolvency in March 2017 as their premium charges were insufficient to fund all projected future claims. Hence, the insurer failed to renew the underpriced policies 'Insurance commissioner announces court approval of liquidation of Penn Treaty and American Network Insurance companies; Assures policyholders claims will be paid by State Guaranty Funds pursuant to State Law' (2017). As such, the company was unable to pay the promised benefits to their policyholders in unfortunate events; contrary to the intent of the policyholders for participating in the scheme.

As for the Takaful sector, increased competition may benefit policyholders with lower premium rates in the short-run. Nonetheless, in the long-run, the insurance benefits of the policyholders may be at risk. In the case of GCC, despite of the impressive growth recorded for general Takaful operators, significant pressure is felt across their overall profitability. To add salt to wound, Takaful operators are not only pressed due to loss from poor quality of business written, but also competition from established conventional players for similar target market (especially compulsory lines, e.g. motor and medical lines). Thus, a substantial number of Takaful operators have lost their capital and face adverse outcomes, hence stealing the hope for a boost in their business performance (Milliman, 2017). Competition cultivates efficiency that is beneficial for all stakeholders in both short and long runs in a mutual manner. The impact of competition on this particular complex trade-off between Takaful premium and consequently its sustainability is meaningful for further exploration of the competition within the market, which appears to be scarce in the literature. Jacob and Van (2015) concluded that there is ample room to improve in competition and efficiency among insurers due to higher degree of competition for banks than for insurers, which is consistent with the lower inefficiencies for banks, when compared with insurers.

5. CONCLUSION AND RECOMMENDATIONS FOR FUTURE RESEARCH

The research area pertaining to Takaful is relatively new, hence awaits progression for further investigations. The literature review presented in this paper showcases that scholars have the tendency to consider the degree of competition as a prominent factor with substantial impact on financial stability. Despite of the rich coverage on the banking industry within the financial stability area (Karim, 2010), the literature, so far, has yet to deliberately address the distinctive roles of competition in affecting the stability of Takaful market. As such, this area demands in-depth analyses since it serves to secure both the health and stability aspects of other segments embedded in the financial system. It is of great imminence that Takaful operators have to maintain their financial soundness so as to ensure the promised payout benefits, especially those involving family Takaful (life insurance) policies with longer terms. Against this background, this paper suggests a thorough investigation concerning the impact of competition on stability in the insurance industry, including the Takaful market, for several reasons. Initially, as insurers have been hardly hit by the global financial crisis due to the high degree of interconnectedness with the banking sector (Baluch et al., 2011), this investigation is deemed to bridge the existing gap in the literature, which so far, has been largely confined to the banking sector and that amidst developed nations. Despite functioning as financial intermediaries, both banks and insurers have varying business models and balance sheet structures. The roles of their capital, leverage, and risk absorption seem to be varied. Besides, most Takaful market derives from developing nations with presence of economic inequality between developed and developing nations that may affect the stability of Takaful market in a different manner.

As this study discusses the correlation between competition and stability through theoretical lenses, empirical evidence is required in future study to document the actual behavior of Takaful market. Second, future research can be extended to the national level via cross-country analysis to determine if the stability of Takaful market may be affected by various nation-specific variables. Assessing competition and its influence on the stability of Takaful operators may assist regulators, such as the Central Bank and other policymakers to take early action for the purpose of protecting this young and promising industry. The regulators could use such findings to review the existing policies and place a possible limit on the degree of competition to ensure a healthy and stable Takaful market.

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