

# Establishing a Robust Legal and Regulatory Framework for Takaful

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Bakarudin Ishak  
Director  
Islamic Banking and Takaful Department  
Bank Negara Malaysia



## Instituting core components of financial system



## The importance of greater inter-linkages among core components

- Create synergy for Islamic financial system
- Enhance resilience and robustness to withstand financial shocks and increase the overall stability of Islamic financial system

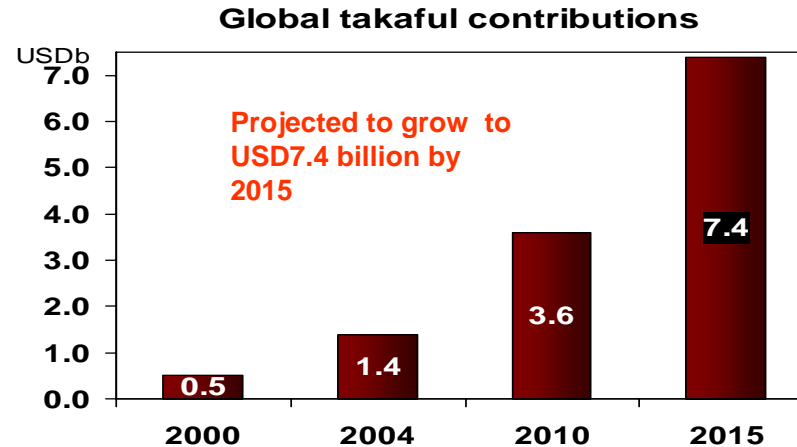
**Conducive environment for Islamic financial system to be an efficient mobiliser of resources and a source of economic growth**

# Global Development of Takaful

Rapid expansion worldwide with potential for future growth...

- Global takaful market is expected to grow 15% - 20% per annum, to reach USD7.4 billion in annual contributions by 2015

Source: Islamic Finance News



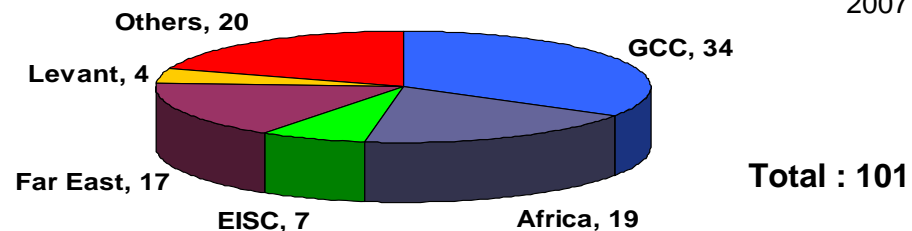
Source: Takaful Industry, Global Profile & Islamic Finance Review

... however, growth mainly focused on Muslim-dominated countries...

- Spread of direct takaful contributions in 2003.
  - Arab countries - 63%
  - Malaysia – 27%
  - Asia Pacific countries – 9%
  - Europe and USA – 1%

Source: Asia Insurance Review, March 2006

**Number of Takaful / Islamic Operators 2005**



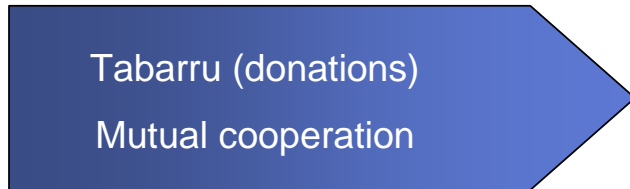
Source: Middle Eastern Insurance Review, Jan 2007

# The Origin of Commercially Driven Takaful Business

- Malaysia initiated the establishment of takaful business in 1984.
- In 1985, the Council of the Islamic Fiqh Academy under the auspices of the Organization of Islamic Conference in its Resolution No. 9(2/9), in its second meeting resolved that:

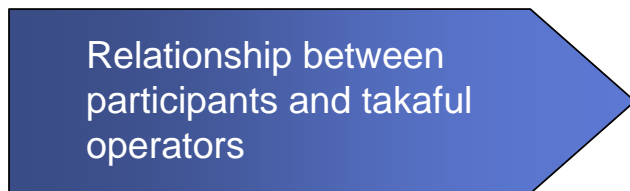
*...“the alternative contract acceptable under Islamic law for the insurance is the contract of cooperative insurance which is founded on the basis of tabarru’ and cooperation, and this is also applicable in reinsurance”...*



## Underlying principles

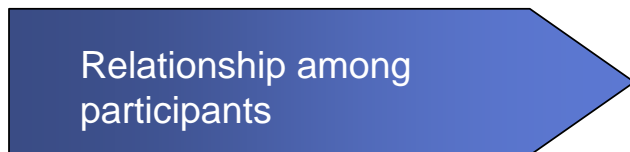


**Islamic concept of pooling together a sum of contribution for consideration of protection for oneself and fellow participants**

## Contracts




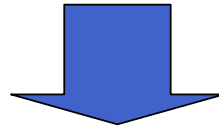
- **Wakalah** 
- **Mudharabah** 
- **New forms of contracts are being introduced such as waqaf and musyarakah as basis of accepting the contribution**



**Tabarru’ and mutual cooperation**



**Ownership of takaful fund** – belongs to participants, as oppose to insurance company whereby the fund belongs to shareholders 



Define the basis of **LEGAL & REGULATORY** framework for takaful business

# Takaful fund belongs to participants...what does this entail?

- ❖ Element of non-guarantee for protection cover in the event of deficit
- ❖ Legal redress is limited to negligence of takaful operators in managing the fund
- ❖ Full disclosure by takaful operators on management of takaful fund



## Conduct of Takaful Business

- **Licensing**
- **Establishment and maintenance of takaful fund**
- **Allocation of surplus**
- **Requirements as to assets of takaful fund**
- **Intermediaries**
- **Shariah requirement**

## Returns, Investigation, Winding Up & Transfer of business

- **Annual accounts & audit**
- **Actuarial investigation & report**
- **Power of investigation**

## • Requirement to conduct takaful business

- Capital requirement, annual registration fee, statutory deposit, surplus of asset over liabilities
- Eligibility criteria
  - Financially sound and competent institutions
  - Managed by qualified and competent management team

## • Governance

- Establishment of Shariah Committee
- Directorship for takaful operators
  - Board responsibilities and oversight management accountability
  - Appointment of Chairman, directors and CEO
  - Structure of duties of board committees
- Role of the Appointed Actuary
  - Duties and responsibilities of the appointed actuary
  - Reporting requirement by the appointed actuary

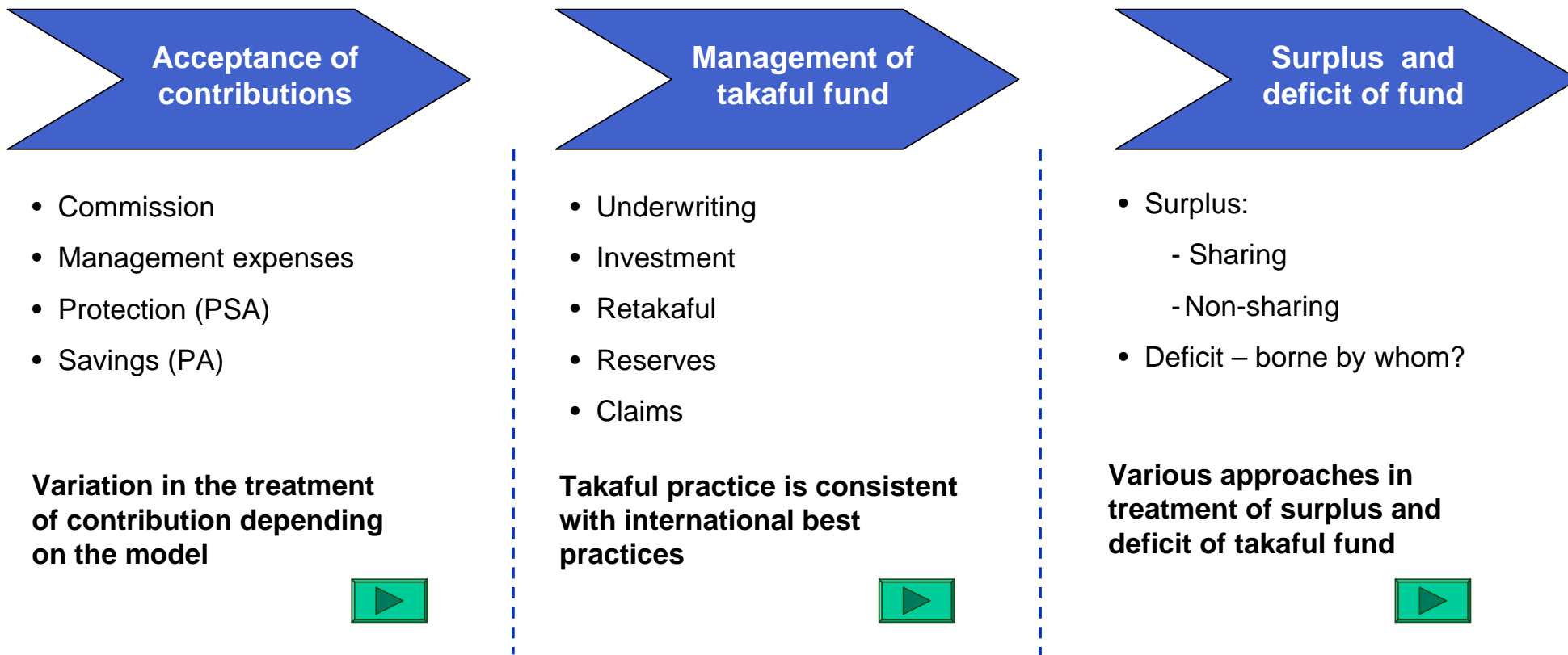
## Broad Objective

- ❖ Establish and promote sound and credible takaful sector that conforms to Shariah tenets

## Main Thrust

- ❖ Ensure prudent management of takaful fund with high standard of corporate governance
- ❖ Safeguard participants' and other stakeholders' interests
- ❖ Facilitate the intermediation role of financial system in economy
- ❖ Maintain public confidence as takaful operators are custodians of public fund

# Broad Operational Business Flow of Takaful

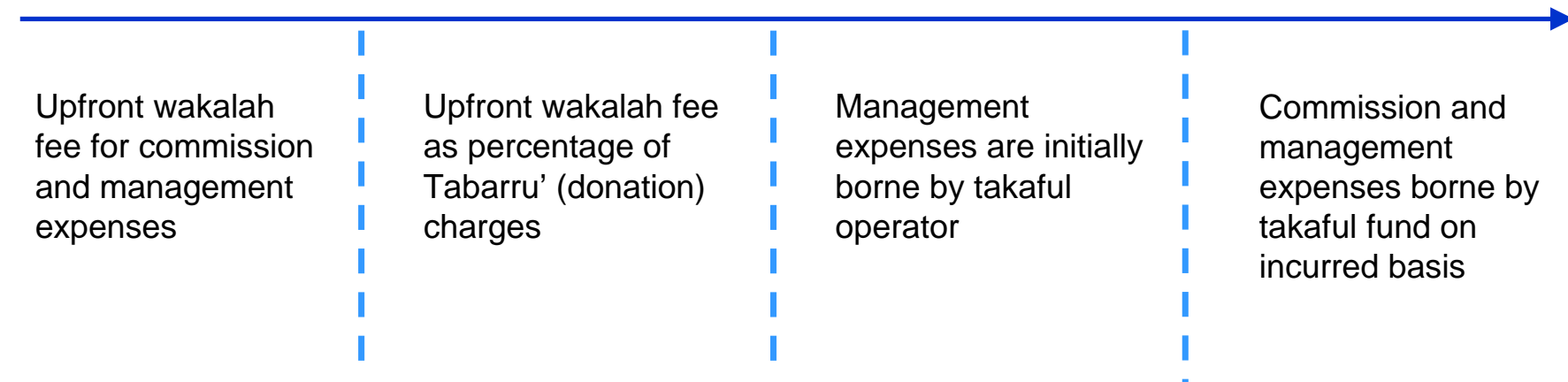


**TRANSPARENCY AND FULL DISCLOSURE OF TAKAFUL BUSINESS OPERATION**  
- IFSB Working Group on Corporate Governance for Takaful -

# Broad Operational Business Flow of Takaful – Acceptance of Contributions

## Treatment of operating expenses - commission and management expenses:

- No international takaful standard currently available, depends on practices of takaful operator
- Range of options available:



### Issues for consideration

- Determining the appropriate limit for wakalah fee
- Profit margin in wakalah fee
- Ability of the fund to pay for future claims



# Broad Operational Business Flow of Takaful – Management of Takaful Fund

## Underwriting

- **Assessment of risks underwritten**
- **Reasonableness of assumptions used to fix contributions**

## Investment of asset

- **Investment in shariah-approved transactions**
- **Diversification of asset**
  - ✓ Restriction on amount to be held in particular types of financial instruments
  - ✓ Separation of takaful operators' and participants' asset
  - ✓ Appropriate matching of assets and liabilities
- **Valuation of asset**
  - ✓ Book value or fair value

## Retakaful

- **Credibility of retakaful operator**
  - ✓ Strong security rating
- **Sound retakaful arrangement**
  - ✓ Provide coverage appropriate to the risk profile of the takaful fund
- **Transparency in all retakaful transactions**
  - ✓ Terms of retakaful arrangement



## Reserves

- **Best estimate with risk margin for adverse deviation**
- **General takaful:**
  - ✓ Outstanding claims including Incurred-but-not-reported (IBNR)
  - ✓ Provision for unearned contribution reserves
- **Family takaful:**
  - ✓ Net premium valuation
  - ✓ Gross premium valuation

## Claims management

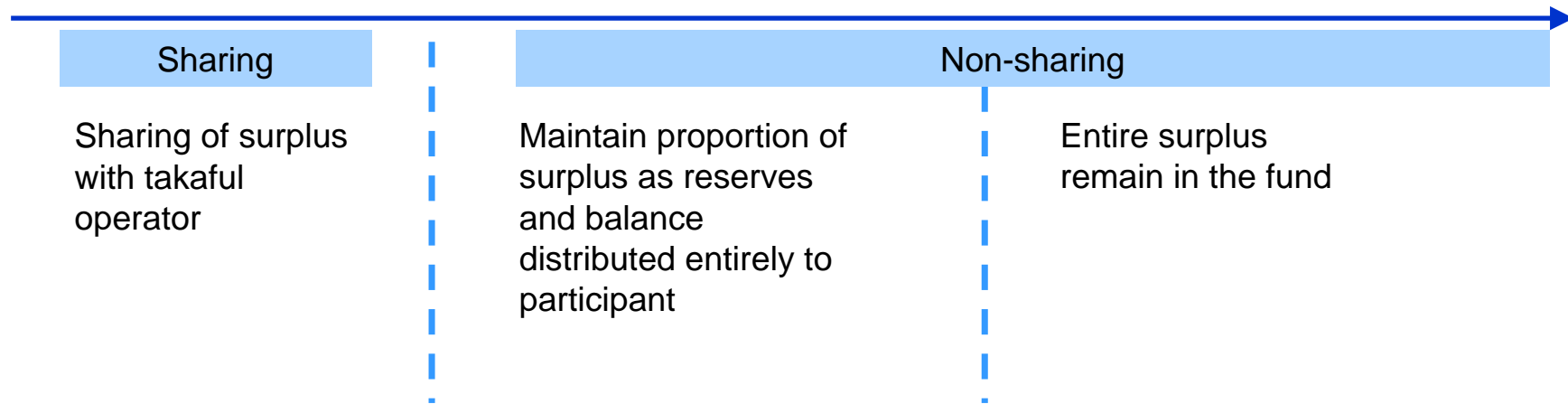
- **Procedures of claims settlement**
  - ✓ Minimum standard for prompt and fair payment of claims and to ensure claims is made on timely manner
- **Claims resolution framework**
  - ✓ Complaints unit at takaful operators
  - ✓ Financial Mediation Bureau



# Broad Operational Business Flow of Takaful – Surplus of Fund

## Treatment of surplus in Tabarru' fund:

- AAOIFI's Standard 13 on the Disclosure on Determination and Allocation of Surplus for Takaful
- Shariah accepted ruling – surplus is the excess of contributions paid by participant
- Range of options:



### Issues for consideration

- Solvency of fund to pay for future claims
- Ensure stability of takaful fund

# Broad Operational Business Flow of Takaful – Deficit of Fund

## Deficit in takaful fund & role of shareholders' capital:

- Arise due to contractual relationship and ownership of takaful fund
- Range of options available:

Participants to inject more fund to cover deficit

Takaful operator to provide benevolent loan to cover deficit

Outright transfer by takaful operator if prolonged deficit in takaful fund

## Issues for consideration

Top-up contributions pose unlimited liability to participants

Takaful operator as fund manager shares the risk of deficiency in takaful fund

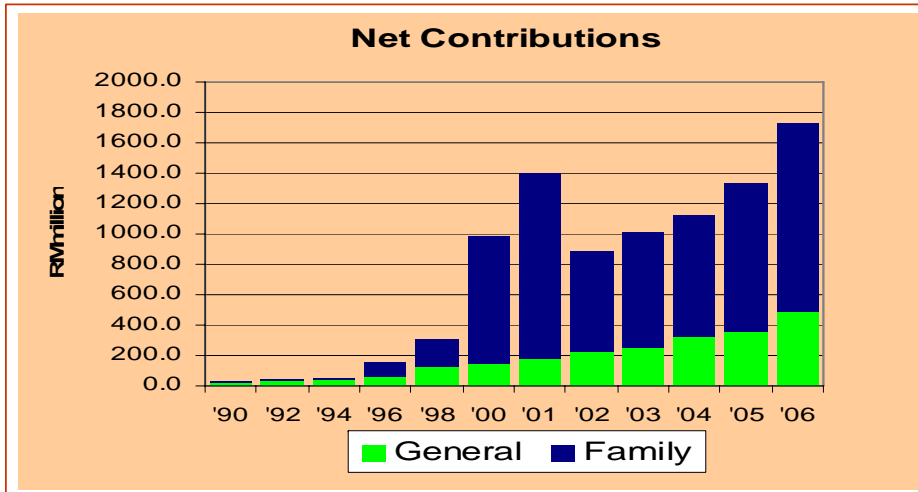
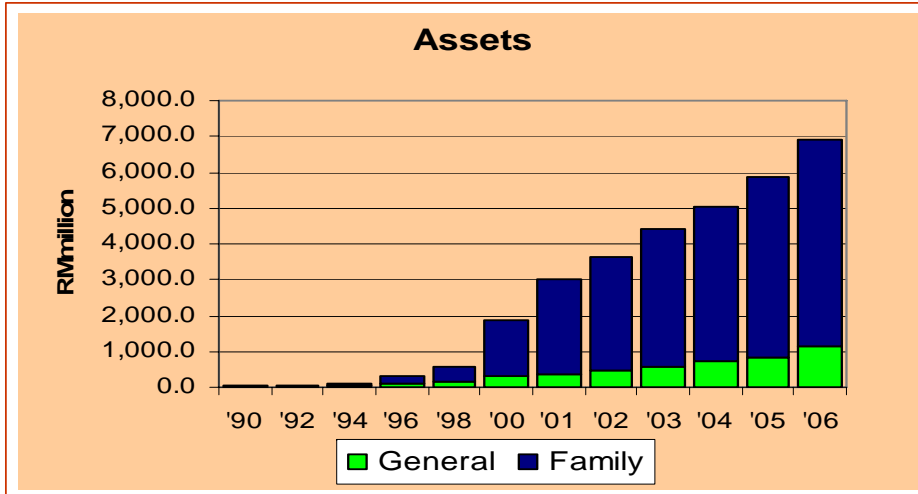
Manage fairness to different generation of participants – balancing past experience of fund with future generation of participants



- ❖ Allow flexibility on various business models whilst ensuring prudent management of takaful fund and fairness among stakeholders
  - Maintain and ensure fairness in pricing, managements and terms of contract
  - Balance between profit maximisation and prudent management of fund to ensure sufficient level of reserves while meeting expectations of shareholders
  - Disclosure requirement with the objectives to enhance corporate governance and protect interest of participants

# Malaysian Experience

Robust growth over the last 20 years, with market share of 6.0% and growing at 17.9% in terms of total asset



Market Share (%)	'86	'90	'95	'00	'05	'06
Net contributions	3.8	4.1	5.3	5.4	5.4	6.7
Assets	3.7	5.0	5.3	5.6	5.7	6.0

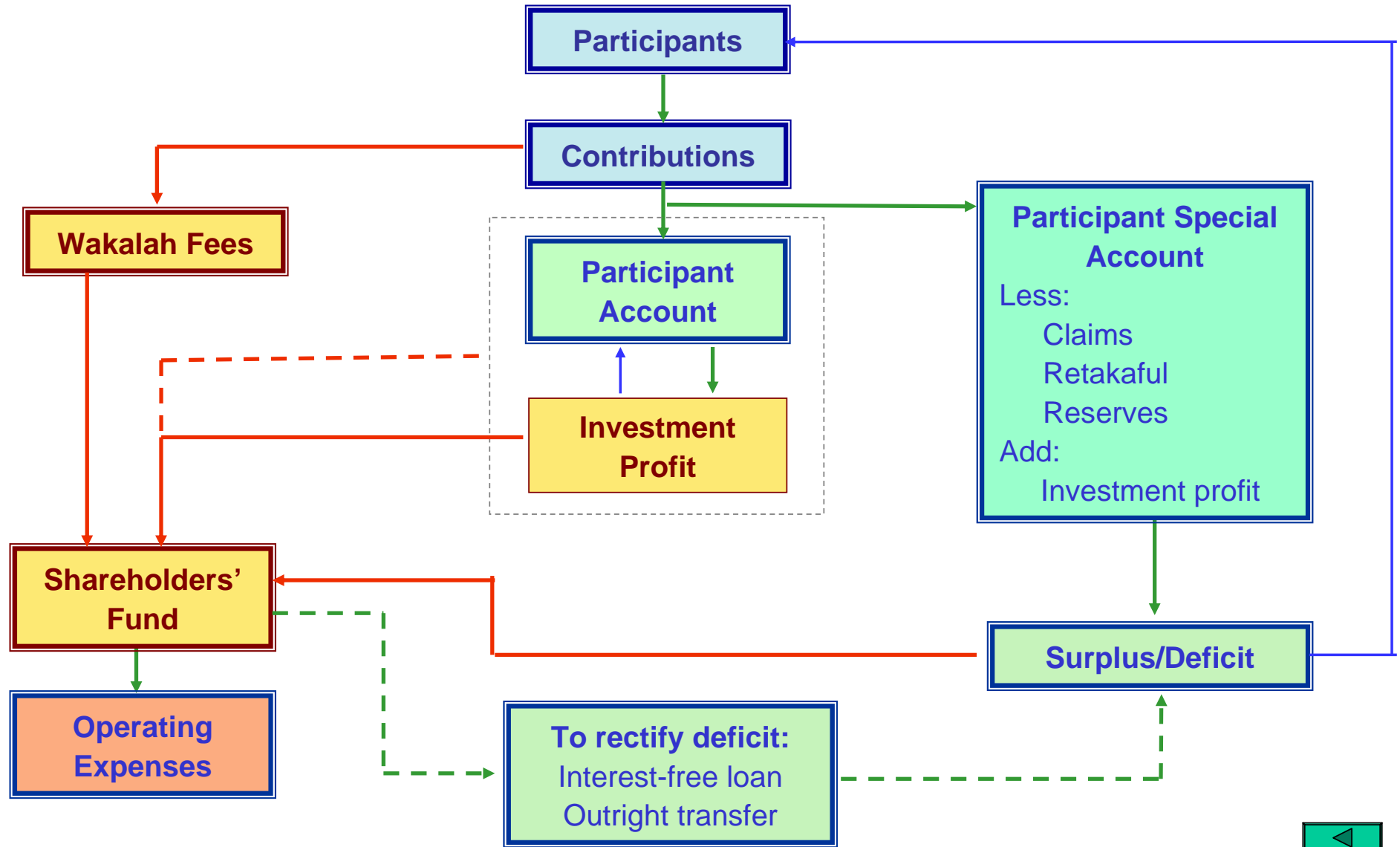
New entrants of takaful players to intensify the competition and advancement of the industry

Syarikat Takaful Malaysia Berhad	1984
Takaful Nasional Sdn. Berhad	1993
Takaful Ikhlas Sdn. Berhad	2003
Commerce Takaful Berhad	2005
Prudential BSN Takaful Berhad	2006
HSBC Amanah Takaful Berhad	2006
Hong Leong Tokio Marine Takaful Berhad	2006

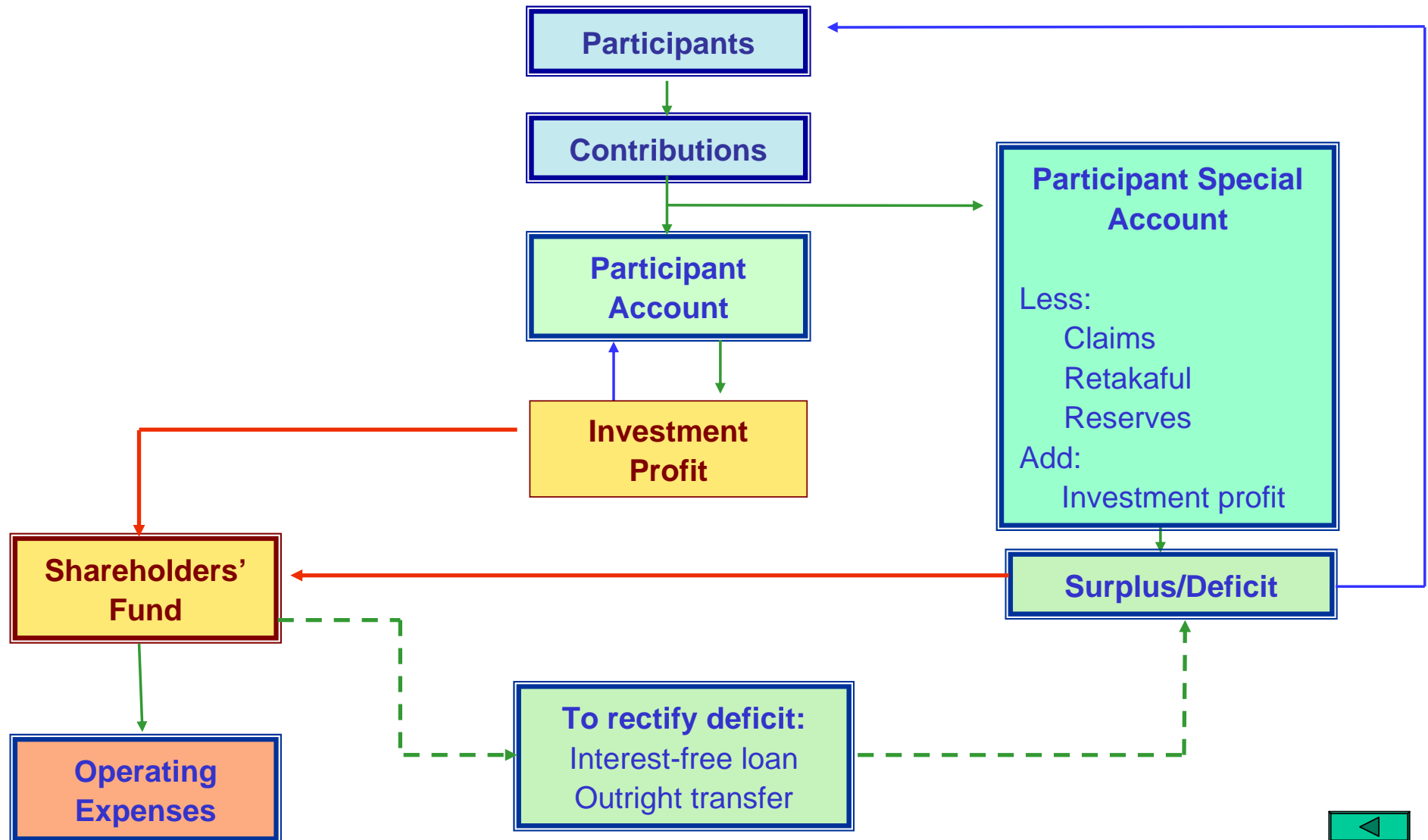
- ❖ Attract takaful players to conduct international currency takaful business
  - 10-year tax holiday
  - Provide support and enabling platform in the origination, issuance and trading sukuk both in Ringgit and multi-currencies to precipitate more investment avenues for takaful and retakaful companies
  - Approved three takaful operators to conduct international currency takaful business
  
- ❖ Awarded 2 new retakaful licences to reputable reinsurance to conduct retakaful family and general business
  - Strengthen underwriting capacity of takaful industry

Thank you

# Brief Illustration of Wakalah Model



# Brief Illustration of Mudharabah Model



## Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies

- Entitlement to the insurance **surplus belongs only to the policyholders**. Shareholders do not share in this surplus, because it belongs to policyholders collectively as defined by the insurance agreement. Several fatwas and Shariah rulings have been issued confirming that policyholders have the exclusive right to the insurance surplus.
- The insurance company may **invest the insurance surplus** for the account of the policyholders, if there is an express provision to this effect in the insurance policy. The consideration payable to the party undertaking such investment (i.e. **percentage of investment profit** in the case of mudharabah or amount of **commission** in the case of agency) should be specified in the insurance policy.
- The party undertaking the investment is entitled only to the consideration specified for this purpose, and **should not appropriate any amount from the insurance surplus** which is a residual from the premium contributions.