The Shariah Advisory Council of Bank Negara Malaysia (SAC) Ruling on Ceding Out of Takaful Risk to Insurance Companies Under Hardship Situation

226th SAC Meeting dated 26 October 2022[1]

Part I: SAC Ruling, Its Effective Date and Applicability

Pursuant to section 52 of the Central Bank of Malaysia Act 2009, the SAC at its 226th meeting dated 26 October 2022 ruled that item (ii) of the SAC ruling at the 113th meeting dated 23 June 2011 and 114th meeting dated 28 July 2011 on "*Takaful Semula dengan Syarikat Insurans dan Insurans Semula Konvensional*" (the Existing Ruling) is revised as follows:

(ii) A licensed takaful operator (including a licensed professional retakaful operator) is not allowed to distribute takaful risks through a ceding out arrangement to an insurer (including a licensed professional reinsurer), except under the following circumstances:

i. existing licensed takaful operators do not accept or are not able to accept the risk;

ii. existing licensed takaful operators do not have the capacity or expertise to accept the risk; or

iii. a ceding out arrangement with another licensed takaful operator causes or may cause detrimental effect to the takaful funds of the licensed takaful operators.

In the above circumstances, the need (*hajah*) to distribute the takaful risks through ceding out arrangement to an insurer to address any hardship situation faced by a licensed takaful operator must be assessed and affirmed by the Shariah committee of the licensed takaful operator.

This ruling supersedes item (ii) of the Existing Ruling, while the remaining part of the Existing Ruling would continue to apply.

Note: Please refer ***Appendix 1*** *for the Existing Ruling.*

1.1. This ruling comes into effect on 5 January 2024 and applies to licensed takaful operators (including professional retakaful operators)[2] under the Islamic Financial Services Act 2013 (IFSA) to carry on takaful business. Any reference to "insurer" in this ruling shall include a reference to "reinsurer".

1.2. In line with sections 28(1) and (2) IFSA, licensed takaful operators are required to comply with this ruling. Compliance with any ruling of the SAC in respect of any particular aims and operations, business, affairs and activities of Islamic financial institutions (IFIs) shall be deemed to be in compliance with Shariah.

Part II: Background

2.1. A retakaful arrangement refers to the sharing of takaful risks between a licensed takaful operator with another licensed takaful operator. With an effective retakaful arrangement, a licensed takaful operator may increase its capacity and stabilise its underwriting performance, as well as safeguard the takaful fund from significant financial burden should there be unexpected adverse claims experience.

[1] Issuance of this statement is subsequent to the issuance of *Hajah* and *Darurah* Policy Document to provide additional guidance and clear expectation on the effective application of *hajah*.

[2] Reference to "licensed takaful operators" shall include reference to "professional retakaful operator", where appropriate.

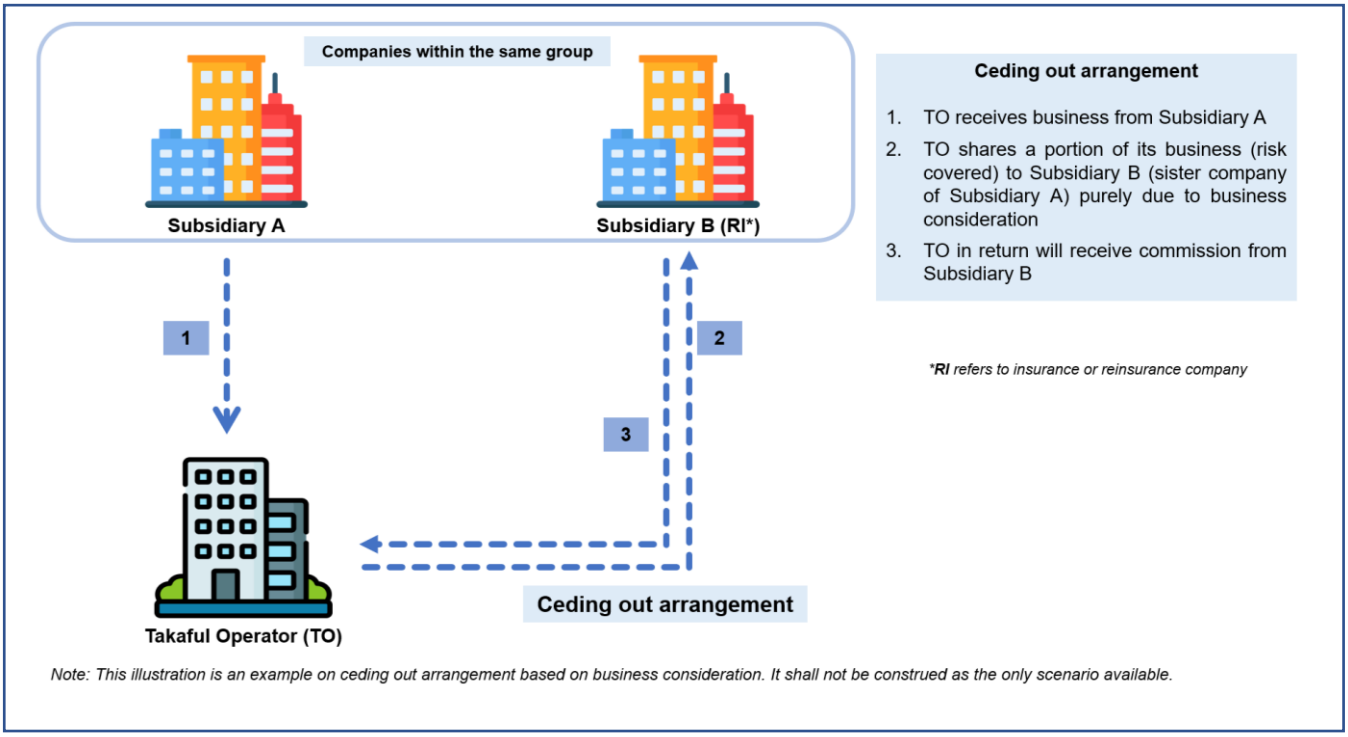
2.2. The SAC had previously ruled[3] that licensed takaful operators are not allowed to cede out takaful risks via outward retakaful arrangement to insurers except in the face of hardship. In such situation, the licensed takaful operators are required to seek views and endorsement from the Shariah committee on the need (*hajah*) to cede out the takaful risks to an insurer. The board of directors of the licensed takaful operator has oversight responsibility on the implementation of the Shariah committee's decision relating to the ceding out arrangement.

2.3. In light of the prevalent issues in takaful industry relating to cession of takaful risk to insurer, Bank Negara Malaysia (the Bank) has observed that there are ceding out arrangements made by a licensed takaful operators which do not fall within the circumstances stipulated in the Existing Ruling. These include ceding out arrangements with insurer arising solely from the licensed takaful operator's business considerations given the licensed takaful operators' risk of losing business opportunity or risk to profitability[4] (please refer to Illustration 1).

Shariah Issue

2.4. The SAC deliberated on whether a licensed takaful operator's decision to cede out its takaful risks to an insurer due to business consideration could fall within any of the circumstances stipulated in the Existing Ruling.

Illustration 1: Ceding out arrangement of takaful risk to insurer due to business consideration



[3] The SAC ruling was decided in 113th (23 June 2011) and 114th meeting (28 July 2011). The ruling was issued in *Kompilasi Keputusan Syariah dalam Kewangan Islam Edisi Ketiga Terbitan 2017*.

[4] For example, losing profit commission from ceding out arrangement or financial loss arising from the effort to rectify the Shariah non-compliance incident. These examples are non-exhaustive and should not be construed as the only example available.

Part III: Key Discussion

Risk to IFI's profitability does not fall under hardship situation

3.1. In principle, a licensed takaful operator is prohibited from being involved in Shariah non-compliant activities such as providing takaful protection for Shariah non-compliant activities.

3.2. Involvement in Shariah non-compliant activities can also occur from the sharing of takaful risks with an insurer. Licensed takaful operators are not allowed to share the takaful risks with insurers as the business and operations of insurance contain prohibited elements such as ambiguity (*gharar*), element of gambling (*maysir*) and interest (*riba*). As an IFI, licensed takaful operators must avoid elements that will affect the Shariah permissibility of their activities.

3.3. However, a licensed takaful operator is allowed to distribute its risks via ceding out arrangement to an insurer on the basis of needs (*hajah*) where: (i) existing licensed takaful operators do not accept or are not able to accept the risk; (ii) existing licensed takaful operators do not have the capacity or expertise to accept the risk; or (iii) a ceding out arrangement with another takaful operator causes or may cause detrimental effects to the takaful funds of the licensed takaful operator.

3.4. As the permissibility of ceding out arrangement is premised on *hajah* as outlined in the above three (3) circumstances, any ceding out arrangement with insurer that is not justifiable under *hajah* is deemed to be a Shariah non-compliant activity.

3.5. The SAC emphasises on the proper application of *hajah* in which assessment must be carried out adequately and comprehensively supported with clear justifications and impact analysis, among others.

Part IV: Basis of Ruling

Shariah prohibits any form of direct involvement in conventional insurance activities

4.1. In principle, ceding out arrangement of takaful risks to an insurer is strictly prohibited as the arrangement will directly cause the takaful business' involvement in practices of *riba* and other forbidden activities by Shariah. The takaful funds transferred to an insurer will be managed according to insurance practices and operations which may involve Shariah non-compliant activities or businesses.

4.2. Additionally, through the ceding out arrangement to an insurer, the licensed takaful operator is perceived to recognise the conventional insurance contract and its activities as permissible under Shariah.

4.3. This is clearly in contrary to the basic principles and objectives of Shariah as per the following verse of al-Quran:

وَتَعَاوَنُواْ عَلَى ٱلْبِرِّ وَٱلتَّقْوَىٰ وَلَا تَعَاوَنُواْ عَلَى ٱلْإِثْمِ وَٱلْعُدْوَٰنِ[5]

"…and to help one another in furthering virtue and God consciousness, and not in what is wicked and sinful..."

[5] Surah al-Ma'idah, verse 2.

Strict application of hajah under hardship situation

4.4. The SAC allows ceding out arrangement of takaful risk by a licensed takaful operator to an insurer that is due to either one of the stipulated circumstances under this ruling, and it should not be practiced loosely beyond hardship situations, such as to manage risk of the licensed takaful operator's existing business relationship or profitability. This approach is based on the following *fiqh* maxim:

الضرورة تقدر بقدرها[6]

"Necessity is to be assessed and treated proportionately."

إن الأمر إذا ضاق اتسع وإذا اتسع ضاق[7]

"When a matter is constricted (by the hardship) flexibility is accorded but when the hardship is addressed, the flexibility is rescinded."

Terms and conditions of a contract imposed shall not contravene Shariah principles

4.5. Based on the principle of freedom to contract, both contracting parties are free to stipulate mutually agreed contractual terms and conditions. However, the conditions stipulated must be in line with Shariah principles and do not lead to any Shariah prohibitions. In cases where any terms and conditions agreed between the contracting parties contravene Shariah principles, such terms and conditions shall be deemed unenforceable and shall not be fulfilled. This is in line with the following hadith of Rasulullah SAW:

عن أبي هريرة رضى الله عنه قال، قال رسول الله ﷺ: المسلمون على شروطهم إلا شرطا أحل حراما أو حرم حلالا[8]

"Abu Hurairah RA narrates that Rasulullah SAW said: Muslims are bound by the conditions in which they agreed upon, except for the one that permits the haram (forbidden) and forbids the halal (permissible)."

Part V: Implication of the SAC Ruling

5.1. This ruling provides clarity and certainty to the industry on the applicability of the ruling and the roles of the parties involved in ceding out arrangement to ensure its conformity with Shariah.

5.2. In addition, this statement also provides clear message to the industry to take the necessary measures in ensuring proper application of *hajah* as outlined in this ruling, policy documents or frameworks issued by the Bank.

5.3. Additionally, this ruling clarifies that the previous ruling on ceding out arrangement (item ii of SAC ruling on Retakaful with Conventional Insurance and Reinsurance Companies) is superseded by this ruling.

[6] Ibnu Nujaim, *Al-Ashbah wa Al-Naza'ir, Dar Al-Kutub Al-`Ilmiyyah*, 1999, p. 73.
[7] Ibid, v. 1 p. 72.
[8] Abu Daud, *Sunan Abi Daud*, *Bait al-Afkar al-Dawliyyah*, 1999, p. 398, hadith no. 3594.

Appendix 1

Takaful Semula dengan Syarikat Insurans dan Insurans Semula Konvensional

Keputusan MPS Berhubung Alir Keluar Risiko Takaful Kepada Syarikat Insurans / Insurans Semula

Merujuk kepada perkara (ii) dibawah, MPS pada mesyuarat ke-113 bertarikh 23 Jun 2011 dan mesyuarat ke-114 bertarikh 28 Julai 2011 telah memutuskan:

(ii) Pengendali takaful (dan takaful semula) tidak dibenarkan untuk mengagihkan risiko secara takaful semula alir keluar kepada syarikat insurans (dan insurans semula) kecuali untuk kes-kes yang tidak dapat dielakkan iaitu:

(a) Pengendali takaful (dan takaful semula) sedia ada tidak menerima risiko tersebut;

(b) Pengendali takaful (dan takaful semula) sedia ada tidak mempunyai kapasiti atau kepakaran untuk menerima risiko tersebut; dan

(c) Pengaturan takaful semula dengan pengendali takaful (dan takaful semula) yang bersedia menerima risiko tersebut akan lebih memudaratkan dana takaful.

Sekiranya berlaku kes-kes di atas, keperluan untuk mengagihkan risiko secara takaful semula alir keluar kepada syarikat insurans (dan insurans semula) perlu mendapatkan penilaian dan pengesahan daripada jawatankuasa atau penasihat Syariah dan diluluskan oleh lembaga pengarah pengendali takaful (dan takaful semula) tersebut.

Reference: *Resolusi no. 10 - Takaful Semula dengan Syarikat Insurans dan Insurans Semula Konvensional, Kompilasi Keputusan Syariah Dalam Kewangan Islam Edisi Ketiga Terbitan 2017*