


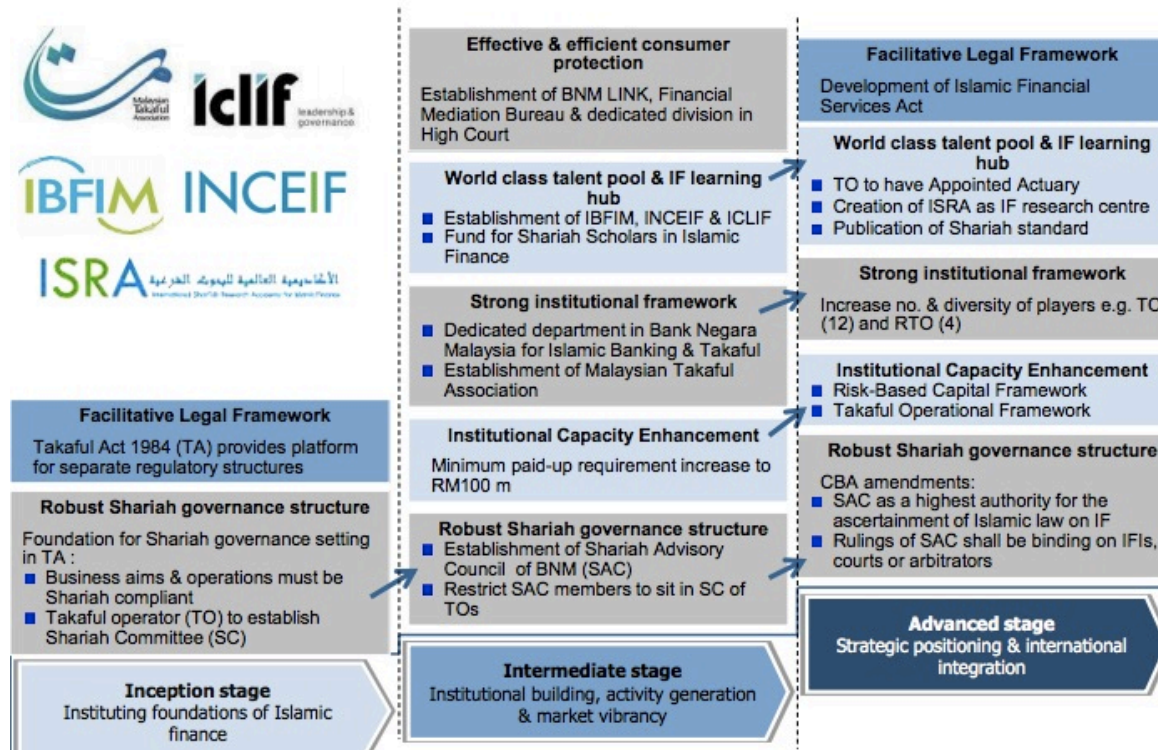
# Regulatory Framework of Takaful



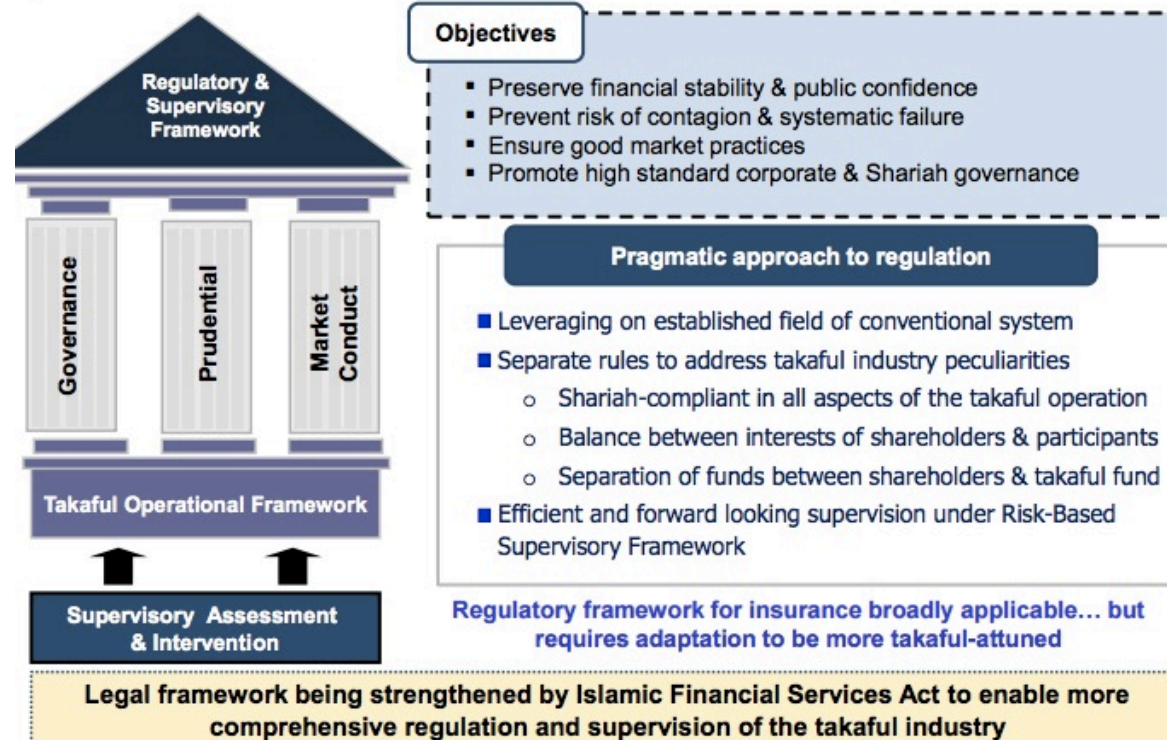
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## Fundamentals for sound takaful development in Malaysia ...



## Regulatory and Supervisory Framework in Malaysia ...



## Regulatory Requirements for Takaful ...

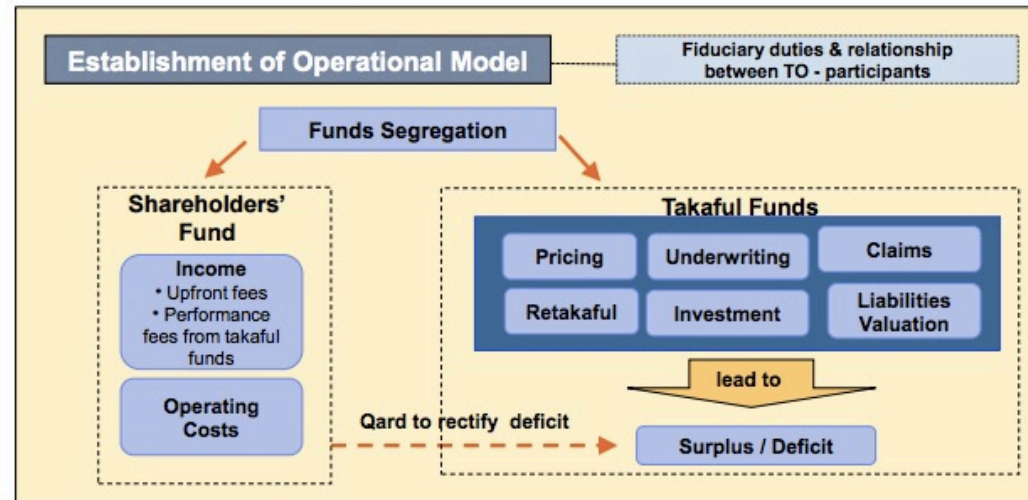
Shariah compliance in all aspects	<b>Governance</b>	<ul style="list-style-type: none"> <li>Duties &amp; responsibilities of board of directors, senior management, appointed actuary &amp; external auditor</li> <li>Minimum expectation for TO on outsourcing of takaful activities, functions or processes</li> </ul>	<ul style="list-style-type: none"> <li>Duties &amp; responsibilities of the Shariah Advisory Council &amp; Shariah Committee</li> <li>Fiduciary duties of takaful operator (TO)</li> <li>Stature of participants in takaful</li> </ul>	
	<b>Prudential</b>	<b>Assets, Investments &amp; Liabilities</b>	<ul style="list-style-type: none"> <li>Diversification rules, basis for valuation &amp; safekeeping of assets</li> <li>Investment limit permissible</li> <li>Determination &amp; provisioning of liability</li> </ul>	<ul style="list-style-type: none"> <li>Invest in Shariah-compliant instruments</li> <li>Management of takaful fund</li> <li>Accounting treatments</li> </ul>
		<b>Solvency</b>	<ul style="list-style-type: none"> <li>Capital adequacy based on risk profiles</li> <li>Stress test process that commensurate to nature, complexity &amp; sophistication of the business</li> </ul>	<ul style="list-style-type: none"> <li>Qard to rectify deficit in takaful fund</li> </ul>
	<b>Product Requirements</b>	<ul style="list-style-type: none"> <li>Sound risk management practices in developing, managing &amp; controlling product risk</li> </ul>	<ul style="list-style-type: none"> <li>Shariah endorsement on product</li> <li>Fees, charges &amp; surplus distribution</li> </ul>	
	<b>Reporting, market conduct &amp; market protection</b>	<ul style="list-style-type: none"> <li>Disclosure &amp; presentation of reports &amp; statements</li> <li>Minimum standard on product transparency &amp; disclosures</li> </ul>	<ul style="list-style-type: none"> <li>Separation of funds</li> <li>Disclosure on aqad, fees, profit sharing ratio</li> </ul>	
<b>Effective supervisory assessment on safety &amp; soundness of TOs under Risk-Based Supervisory Framework</b>				

## Takaful Operational Framework ...

### Objectives & Principles

- Ensure uniformity with Shariah
- Safeguard interests of the participants
- Promote prudent management
- Enhance operational efficiency
- Build healthy takaful funds
- Promote uniformity in practices

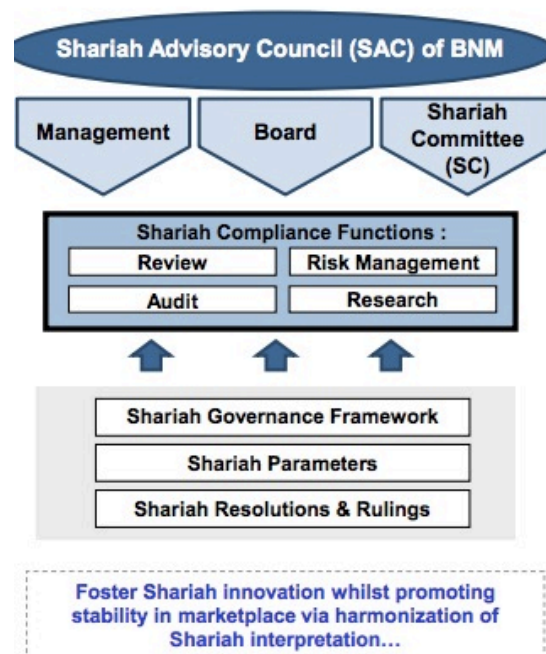
Outlines requirements in the following areas....



### Supported by:

- Effective governance & oversight
- Adequate disclosure & transparency
- Sufficient & competent resources
- Efficient processes & procedures

## Shariah Governance ...



### Shariah as overarching principle in Islamic finance

Proper governance provides assurance on Shariah compliance & confidence on takaful operation:

1. **SAC's legislative stature as highest authority** accorded under Central Bank of Malaysia Act 2009
2. SC of takaful operator **accountable on decision, views & opinions**
3. Board & senior management with **sufficient expertise & capability** on takaful (Islamic finance) issues
4. Function of Shariah risk management, research, review & audit to **provide check & balance**
5. SC member of another takaful operator shall not be appointed – **avoid conflict of interest & maintain info confidentiality**
6. Shariah parameters provide **guidance on main features, principles & rulings**
7. **Institutionalise mutual respect** by recognising differences of Shariah interpretations

# INTRODUCTION

IFSA 2013

Takaful  
Operational  
Framework

Shariah  
Governance Policy  
Document

# Takaful Act 1984

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Malaysia's Takaful Act 1984 has been introduced as a package toward development of Islamic Finance in Malaysia.

During the year, this act is presently the world's only specifically legislated the structure on governing the operation of Takaful funds.



# Takaful Act 1984

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**S 4 of the TA- takaful operators only 1. Company 2. Cooperatives Society.**

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**In order to carry on takaful business the TO must:- 1. registered under the Act. 2. Maintains a surplus of assets over liabilities of not less than the amount prescribed from time to time. 3. made deposit with the Accountant General a value of not less than the amount prescribed by the minister**

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S8- DG responsible for registration

S10- DG may impose conditions for registration.

S 8(5)- Vital Section- DG must be satisfied that the aims and operations -Syariah principles. The AOA to establish SSC.

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S 16- TO shall establish and maintain a takaful fund in respect of each classes of takaful business.

# IFSA 2013

Banks and Takaful

For stability

More power to BNM

To protect consumers

To strengthen Shariah governance

Heavy penalty

Scope of IFSA  
2013 and  
Takaful

1. Prudential Matters and  
Corporate Governance

2. Shariah Governance

3. Business Conduct and  
Consumer Protection

# Takaful under the IFSA

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“takaful” means an arrangement based on mutual assistance under which takaful participants agree to contribute to a common fund providing for mutual financial benefits payable to the takaful participants or their beneficiaries on the occurrence of pre-agreed events;

“takaful business” means the business relating to the administration, management and operation of a takaful fund for its takaful participants which may involve elements of investment and savings and includes retakaful business and a reference to carrying on takaful business may include all or any of the activities set out in paragraph 5(4)(a);

# Definition

**'Takaful certificates'** are expanded; whereby issuing a takaful certificate shall be construed as entering into a contract of takaful, whether or not a formal contract has been issued

**'Takaful contribution'**, which was mentioned only once in the TA, is now extensively mentioned and regulated under the IFSA

**'Retakaful'** now also covers arrangement between head office and branch

**'Senior officer'** is statutorily defined and covers everyone having authority and responsibility for planning, directing or controlling the activities of a TO; excluding the Shariah Committee

**'Shariah Committee'** is formally required - with governance framework, statutory duties and privileges similar to actuaries and auditors (no longer just a Shariah advisory body)

# Definition

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“family takaful business” means the business relating to the administration, management and operation of a takaful arrangement under a family takaful certificate;

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“family takaful certificate” means a takaful certificate by which takaful benefits are payable on death or survival, including those takaful benefits payable in respect of personal accidents, disease or sickness, and includes an annuity but excludes a personal accident takaful certificate;

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“international takaful business” means takaful business in currencies other than ringgit;

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“retakaful” means takaful cover arranged by a takaful operator with a second takaful operator on the risks of the takaful fund it administers, wholly or partly, and includes any similar arrangement by a branch of the takaful operator in Malaysia with its branch outside Malaysia (the head office of the takaful operator being, for this purpose, treated as a branch);

# Classification of, and construction of references to, takaful business (Section 5)

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takaful business shall be into two classes—

family takaful business, which in addition to all takaful business concerned with family takaful certificates shall include any type of takaful business carried on as incidental only to the family takaful operator's business; and

general takaful business, which means all takaful business which is not family takaful business.

# Scope of Business

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A licensed takaful operator shall not carry on both family takaful business and general takaful business, except that it may carry on the general takaful business relating to medical by reason of disease or sickness or medical expenses subject to such requirements and conditions as may be specified by BNM - s.16, IFSA



A transition period of five years from the time the IFSA comes into operation is allowed- separate family takaful business and general takaful business to comply with this - s.286, IFSA.



Only licensed professional retakaful operator can carry on both family takaful business and general takaful business (S 16)



Any breach of the above may be liable to imprisonment not exceeding eight years or a fine not exceeding twenty-five million ringgit or to both.





# Must Be A Public Company

Except with the prior written approval of BNM, a licensed takaful operator shall not carry on annuity certain business, financial guarantee takaful business or credit guarantee takaful business – s.15(4), IFSA

Must be a public company – s. 21,

# Due Regard to SC Decision (Section 65 (3))

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**BoD to have regard to interest of takaful participants; have due regard to any decision of the Shariah committee on any Shariah issue relating to the carrying on of business, affairs or activities of the institution**



the board of directors of a licensed takaful operator shall, in the event of conflict between the interest of the takaful participants and the shareholders, give priority to the interest of the takaful participants.



## Takaful funds to be separate from shareholders' fund (Section 91)

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A licensed takaful operator shall keep any takaful fund established and maintained under section 90 separate from its shareholders' fund.

## Withdrawal from takaful funds (Section 94)

A licensed takaful operator shall not make any withdrawal from a takaful fund, whether from the surplus or otherwise of that takaful fund, unless

- it has complied with such requirements on withdrawals as may be specified by the Bank;
- the withdrawal does not impair the sustainability of the takaful fund to meet its liabilities; and
- the interests and fair treatment of takaful participants, including their reasonable expectations, have been given due regard.

## Deficiency of takaful funds (Section 95)

Where the value of the assets of the takaful fund is less than the value specified under paragraph 92(1)(b), the licensed takaful operator shall provide *qard* or other forms of financial support to the takaful fund from the shareholders' fund for an amount and on such terms and conditions as may be specified by the Bank.

# Takaful Certificate

**S. 140, IFSA - Schedule 8** sets out provisions relating to takaful certificates

# Pre-Contractual Duty of Disclosure

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**S. 141, IFSA - Schedule 9 :** Sets out the pre-contractual duty of disclosure and representations for contracts of takaful in Part 2, and the remedies for misrepresentations relating to contracts of takaful in Part 3

Breach of duty of disclosure under paragraph 11 of Schedule 9 is punishable with imprisonment not exceeding five years or fine not exceeding ten million ringgit or both.

*\*Note that Schedule 9 explicitly states that it does not have retrospective effect*

# Payment of Takaful Benefits



## **S. 142, IFS - Schedule 10**



sets out provisions for the payment of takaful benefits upon death of a takaful participant under a family takaful certificate, or personal accident takaful certificate issued in respect of a contract of takaful entered into by the takaful participant upon his life



# Winding-Up

Division 3 sub 2 (ss. 212 - 218), IFSA – In the winding up of a Licensed takaful operator:


the valuation of its assets and liabilities, of the shareholders' fund and takaful fund, including liabilities in respect of takaful certificates, shall be on a basis determined by BNM and excludes the application of the law relating to bankruptcy or insolvency.

termination of all takaful certificates issued by a licensed takaful operator is effective from the date of the winding up order and sets out the items which a takaful participant can claim as a debt due to him.


# Cont...

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a liquidator of a licensed takaful operator which is being wound up shall pay in good faith to any of its claimants without requiring strict proof of debt of such claims to facilitate payment.



issuance of a takaful certificate by a director, officer, agent or contributory, past or present, of a licensed takaful operator which is being wound up after its cessation of takaful business is prohibited.



the liquidator of a family takaful operator is empowered to carry on its existing family takaful business with a view to its transfer as a going concern to another takaful operator.  
provisions relating to the priority of payment in winding up of a licensed takaful operator are to be followed.

A construction site at sunset. A large crane is visible in the upper left, with its hook and cables extending towards the center. Several workers are silhouetted against the bright, golden sky, working on a structure of steel beams and scaffolding. The sky is filled with soft, golden clouds, and the overall scene is backlit by the setting sun.

# Civil Actions

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Civil actions can be brought by any persons or institutions or by BNM (Section 250) on their behalf against any persons who contravenes or is in breach of the IFSA provisions.

# Statutory Duties

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1. Shariah  
Compliance

2. Reporting  
Duties

# Shari'ah Compliance and Reporting Duties

**s.28, IFSA) (3) Where an institution becomes aware that it is carrying on any of its business, affair or activity in a manner which is not in compliance with Shariah or the advice of its Shariah committee or the advice or ruling of the SAC, the institution shall —**

**(a) immediately notify BNM and its Shariah committee of the fact;**  
**(b) immediately cease from carrying on such business, affair or activity and from taking on any other similar business, affair or activity;**

**and**  
**(c) within 30 days of becoming aware of such noncompliance or such further period as may be specified by BNM, submit to BNM a plan on the rectification of the non-compliance.**

# Claims Regulations under IFSA

Participants can opt to nominate under 2 scenarios (Schedule 10)

- 1. conditional hibah
- 2. executor

Late payment benefits-para 12  
(Schedule 8)

- 1. to credit at the average rate of return of the PRF
- 2. 1% paid from shareholders fund.

Rights and  
Responsibility  
of Takaful  
Agent  
(Para 12  
Schedule 9)

(1) A person who is authorized by a licensed takaful operator to be its takaful agent and who solicits or negotiates a contract of takaful in that capacity shall be deemed, for the purpose of the formation or variation of the contract of takaful, to be the agent of the licensed takaful operator and the knowledge of that takaful agent shall be deemed to be the knowledge of the licensed takaful operator.

Section 2, Takaful agent has been defined as a person who does all or any of the following: (a) solicits or obtains a proposal for a Takaful certificate on behalf of a Takaful operator; (b) offers or assumes to act on behalf of a Takaful operator in negotiating a Takaful certificate; or (c) does any other act on behalf of a Takaful operator in relation to the issuance, renewal, or continuance, of a Takaful certificate;

# Warranties and representations (para.10, Sch.9)

*“Any representation made before a consumer takaful contract was entered into, varied or renewed shall not be converted into a warranty by means of any provision of the consumer takaful contract or of any terms of the variation or of any other contract, whether by declaring the representation to form the basis of the contract or otherwise.”*

**Abolishes the ‘basis of contract’ clause in consumer takaful contracts.**

**Takaful operators can no longer argue that an inaccurate answer constitutes a breach of warranty to render a consumer takaful contract void from its inception.**

**Therefore, takaful operators can only void a consumer takaful contract on grounds of misrepresentation.**



Cont..

**Non-Consumer takaful (trade, business and profession): Basis of Contract Clause-Void**

**Consumer Takaful:**

- **Misrepresentation: reckless-contract void and no refund of contribution**
- **Innocent: Contract void and refund the contribution.**

# Duty to Disclosure

Party	Non-consumer takaful contracts	Consumer takaful contracts
<b>Takaful Operator</b>	<b>Duty to not:</b> <b>Make misleading or false statements,</b> <ul style="list-style-type: none"> <li>•fraudulently or otherwise;</li> <li>•Fraudulently conceal a material fact; or</li> </ul> <b>In the case of takaful agents,use</b> <ul style="list-style-type: none"> <li>•unauthorised sales brochures</li> </ul>	<b>Same</b>
	<b>Duty to clearly inform a proposer in writing of the proposer's pre-contractual duty of disclosure, and that this duty of disclosure shall continue until the time the contract is entered into, varied or renewed</b>	<b>Onus is on TO to ask a consumer to answer specific questions</b>

# Prohibited Business



List of prohibited business conduct (Schedule 7)



Engaging in conduct that is misleading or deceptive in relation to the nature, features, terms or price of financial service or product



Inducing financial consumer to an act or omit to do an act in relation to financial service or product by  
Making misleading, false or deceptive statements;  
Dishonestly concealing or omitting material facts;  
Recklessly making any statement, illustration, promise, forecast or comparison which is misleading, false or deceptive.

# Cont...

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Exerting	Exerting undue pressure, influence or using or threatening to use harassment, coercion, or physical force in relation to the provision of or payment for financial service or product.
Demanding	Demanding payments for unsolicited financial services or products unless the financial consumer has communicated his acceptance of the offer either orally or in writing.
Exerting	Exerting undue pressure on, or coercing, financial consumer to acquire financial service or product as a condition for acquiring another financial service or product.
Colluding	Colluding to fix or control the features or terms of financial service or product to the detriment of financial consumer, except for tariff or contribution rates or policy terms approved by BNM.

# Insurable Interest?

Def: Interest an individual must have in insurance coverage carried by someone else.

Legal perspective: the party to the insurance contract who is the insured or policy holder must have a particular relationship with the subject matter of the insurance whether that be a life or property or a liability to which he might be exposed.

The absence of this requirement under conventional insurance will render the contract illegal, void and simply unenforceable.

The purpose: 1. to determine the motive for purchasing insurance and in the assignment of a beneficiary in a life insurance policy.

“A” pays premium on behalf of his wife and names her as beneficiaries= The insurance co. recognizes it coz in the event of unexpected death, the family would suffer an economic loss.

“A” pays premium of insurance for another party let say his best friend, if that person names him as the beneficiaries. The insurance co will not issue the policy.

Whether the principle of insurable interest is relevant in takaful?

Schedule 8 of the IFSA Permissible Takaful Interest

(3) Where a takaful participant entering into a contract of family takaful under subparagraph (1) does not have a permissible takaful interest in the person covered at the time such contract is entered into, the contract shall be void.

(6) Subject to subparagraph (8), a person shall be deemed to have a permissible takaful interest in the person covered if that other person is—

(a) his spouse or child; (b) his ward under the age of majority at the time the person entered into the contract of takaful; (c) his employee; or (d) a person on whom he is wholly or partly dependent for maintenance or education at the time he entered into the contract of takaful.

# Insurable Risk

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**Def: Chance of loss, the possibility of loss or uncertainty concerning the occurrence of a loss.**



**Two types of risk Pure Risk and Speculative Risk. Only pure risk is insurable. Conventional Insurance is concerned with the economic problems created by Pure risk. Eg. Accident =may suffer a loss.**



**Speculative Risk: where either profit or loss is possible. Eg shares of common stock.**

# Should the takaful be confined to Pure Risk?

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**All types of risks can be covered under takaful contract:-**

- 1. Takaful is based on brotherhood, solidarity and mutual assistance.**
- 2. Al-tabarru concept- all types of risks are acceptable.**







Parameters that govern the operational requirements relating to the management of takaful funds and shareholders fund.



TOF aims to achieve operational efficiency of takaful business and sustainability of takaful funds, thereby safeguarding the best interest of the takaful participants.



Requirements pursuant to sections 29(2), 57, 90, 93, 94, 95 and 155 of the IFSA.



Guidance pursuant to S 277

# Takaful Operational Framework

# Definition

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“S” denotes a standard, obligation, requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action;



“G” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;



“Participant Individual Fund” or “PIF” refers to a takaful fund established to allocate a portion of a takaful participant’s contributions for the purpose of investment or savings;



“Participants Risk Fund” or “PRF” refers to a takaful fund established to pool a portion of a takaful participant’s contributions for the purpose of meeting takaful claims associated with events or risks specified in the takaful certificate;



“PIF Investment” refers to a takaful fund established for the purpose of investment where the principal amount is not protected and risk from the investment is borne by the individual takaful participant.

# Operational Framework of Takaful

(Minimum, policies and  
procedures)

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(a) application of Shariah contracts;

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(b) establishment and maintenance of takaful funds and shareholders fund, including, where applicable, establishment of additional takaful funds or consolidation of additional PRF(s);

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(c) product structuring;

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(d) management of underwriting;

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(e) management of retakaful;

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(f) management of investments;

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(g) management of claims;

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(h) remuneration for management of takaful funds;

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(i) management of operating costs;

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(j) management of surplus in PRF; and

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(k) management of deficiency and loss rectification.

# Establishment and Maintenance of Takaful Funds

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G 9.1 Section 91 of the IFSA imposes an obligation on a licensed takaful operator to establish general takaful funds or family takaful funds separate from its shareholders fund.



S 9.3 Pursuant to paragraph 8.2(b), a licensed takaful operator must establish and implement policies and procedures governing the establishment of the takaful funds which must include, at the minimum, the following:

(a) the establishment of PRF under the general takaful funds or family takaful funds; (b) where relevant, the establishment of a PIF Investment or PIF Savings under the family takaful funds; and (c) where relevant, the creation of additional PRF(s) or PIF(s) in addition to the establishment of funds as specified in paragraphs 9.3(a) and (b).

# Product Structuring

S 10.3 A licensed takaful operator must incorporate, at the minimum, the following elements in its product structuring: (a) a tabarru' element for the PRF of family or general takaful products; (b) where relevant, an investment element for family takaful products; and (c) where relevant, a savings element for family takaful products.

# Retakaful

S 12.5 A licensed takaful operator must not cede out risks to an insurer or reinsurer except under unavoidable circumstances, as per applicable rulings by Shariah Advisory Council.

S 12.6 Pursuant to paragraph 12.5, a licensed takaful operator must establish and implement internal policies and procedures that clearly outline the unavoidable circumstances to allow cession(s) to an insurer or reinsurer which shall include the following:

(a) no takaful operator or retakaful operator is known to accept the particular risk;

(b) no takaful operator or retakaful operator has the capacity or expertise to accept the particular risk; or

(c) a retakaful arrangement with takaful operator or retakaful operator creates potential detrimental effects to the takaful funds.

# Investment of takaful funds

S 13.1 A licensed takaful operator must manage investments of takaful funds in a sound and prudent manner, in line with Shariah requirements and takaful participants' reasonable expectations as specified in the Guidelines on Investment Management for Takaful Operators.

# Remuneration for Management of Takaful Fund

S 16.3 In relation to paragraph 8.2(h), a licensed takaful operator must establish and implement remuneration policies which ensure that - (a) the remuneration structure reflects the specific work or services undertaken and commensurate with the nature, scope and complexity of the work or services; and (b) the remuneration is consistent with prudent risk-taking, preserves the interest of the takaful participants and ensures the long-term sustainability of the takaful funds.

Upfront wakalah fee G 16.6 A licensed takaful operator adopting a wakalah may be remunerated based on a fixed upfront fee which may be charged as a percentage of the takaful contributions.

Remuneration from PIF Investment G 16.16 A licensed takaful operator adopting the wakalah bi al-istithmar or mudarabah may be remunerated based on an agreed profit sharing ratio from the PIF investment.



# Management of Operating Cost

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17. Management of operating costs Operating costs incurred by shareholders fund S 17.1 As manager of the takaful funds, the operating costs incurred by a licensed takaful operator in carrying out the takaful operations must be borne by shareholders fund.



Expenses charged to takaful funds S 17.6 A licensed takaful operator must not pay expenses out of the takaful funds except for - (a) direct claims-related expenses which refer to fees or costs directly associated with settling of claims such as adjustor and legal fees; and (b) direct investment-related expenses which refer to transaction costs directly attributable to the acquisition, issuance or disposal of a financial asset of the takaful funds.

# Management of surplus in PRF

S 18.1 A licensed takaful operator must manage the operations of takaful funds to ensure that the funds' experience is within that assumed in the pricing of takaful products. S 18.2 In relation to paragraph 8.2(j), a licensed takaful operator must establish and implement policies to manage surplus in PRF which shall consist of the following:

- (a) manner for the utilisation of the surplus, including surplus distribution and the level of surplus to be retained to cushion future volatility of the PRF;
- (b) preservation of the long-term viability of the PRF and fair treatment to takaful participants, including monitoring of cross-subsidisation among different group of takaful participants;
- (c) requirement that the surplus in PRF and where applicable, the additional PRF(s), is managed separately from each other; and
- (d) the mode in which surplus is to be distributed to the takaful participants.

Deficiency  
and loss  
rectification  
Deficiency  
and loss in  
PRF

G 19.1 Section 95 of the IFSA imposes an obligation on a licensed takaful operator to provide qard or other forms of financial support to the takaful fund which would include PRF, from the shareholders fund for an amount and on such terms and conditions as may be specified by the Bank.

# Complaints and Disputes Resolution

Consumers are able to forward their matters towards Takaful operators or directly to Malaysian Takaful Association

Unresolved cases will be brought forward to

- Ombudsman of Financial Services (OFS) or
- Bank Negara Malaysia LINK.