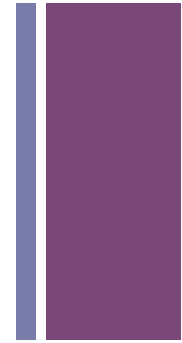


IFSA and Takaful

Zulkifli Hasan, PhD

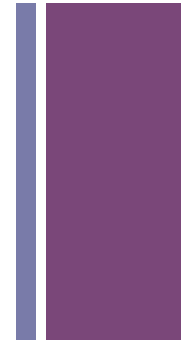
+ Contents

- Legal Framework Overview
- Takaful Act 1984
- IFSA 2013



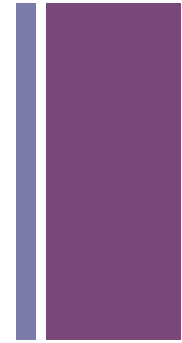
+ Choice of Model

- Shariah concerns
- Regulatory concerns
- Technical and business concerns

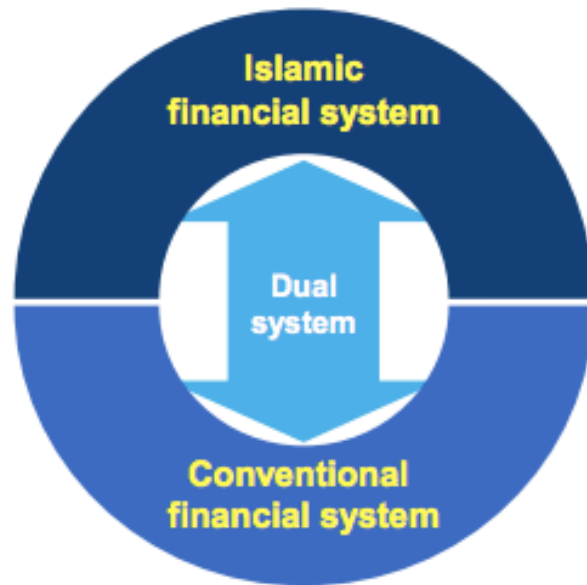


+ Takaful Business Models

- Sudan, Egypt, Syria, KSA- Mudharabah
- Malaysia and Middle Eastern TO- Wakalah hybrid
- Indonesia, Pakistan Sri Lanka- Windows operations.

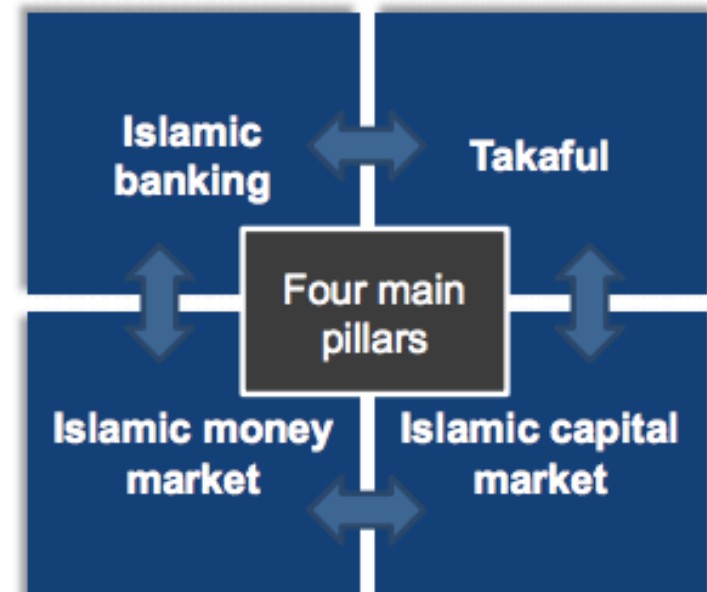


Takaful in Malaysia developed as component of comprehensive Islamic financial system operating in parallel with conventional financial system



Dual Financial System

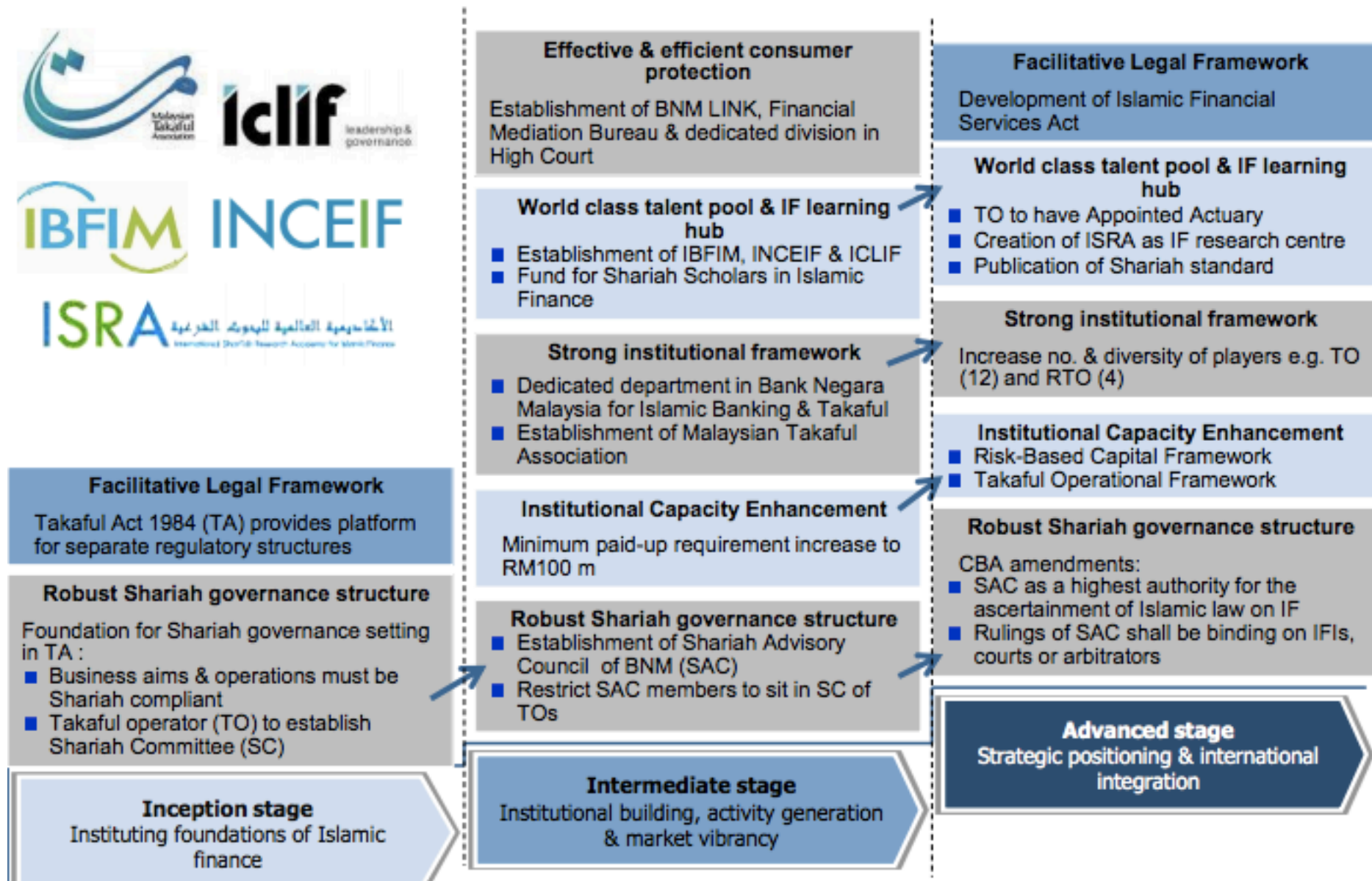
The mandate for developing dual financial system explicitly codified in Central Bank of Malaysia Act 2009



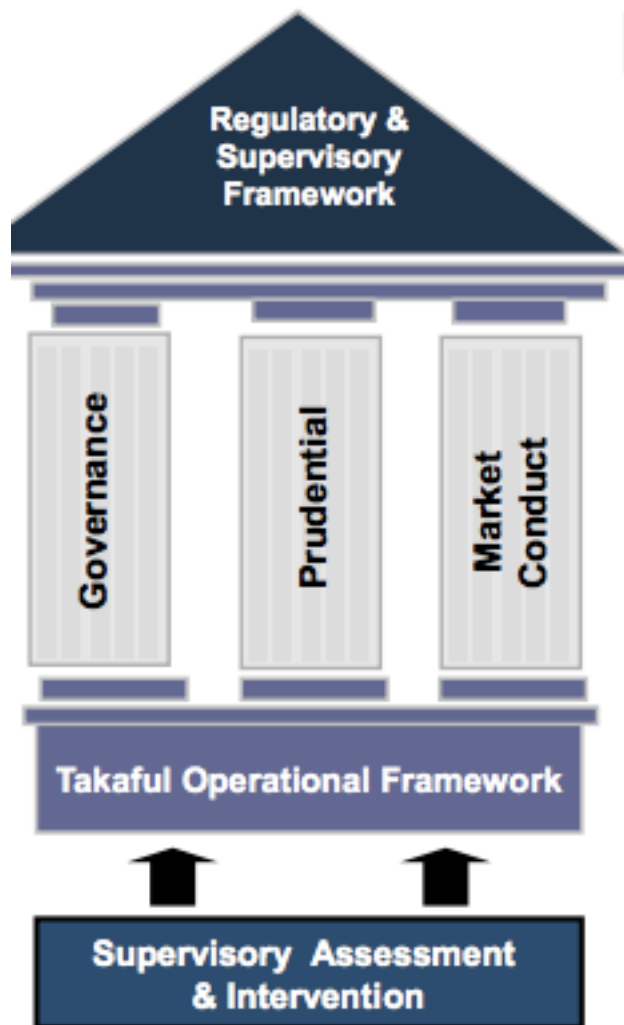
Comprehensive Islamic Financial System

- Ensure sustained industry viability via optimised synergies from interlinkages
- Underpinned by :
 - ◆ Strong & diversified players
 - ◆ Wide range of products & vibrant financial market

Fundamentals for sound takaful development in Malaysia ...



Regulatory and Supervisory Framework in Malaysia ...



Objectives

- Preserve financial stability & public confidence
- Prevent risk of contagion & systematic failure
- Ensure good market practices
- Promote high standard corporate & Shariah governance

Pragmatic approach to regulation

- Leveraging on established field of conventional system
- Separate rules to address takaful industry peculiarities
 - Shariah-compliant in all aspects of the takaful operation
 - Balance between interests of shareholders & participants
 - Separation of funds between shareholders & takaful fund
- Efficient and forward looking supervision under Risk-Based Supervisory Framework

Regulatory framework for insurance broadly applicable... but requires adaptation to be more takaful-attuned

Legal framework being strengthened by Islamic Financial Services Act to enable more comprehensive regulation and supervision of the takaful industry

Regulatory Requirements for Takaful ...

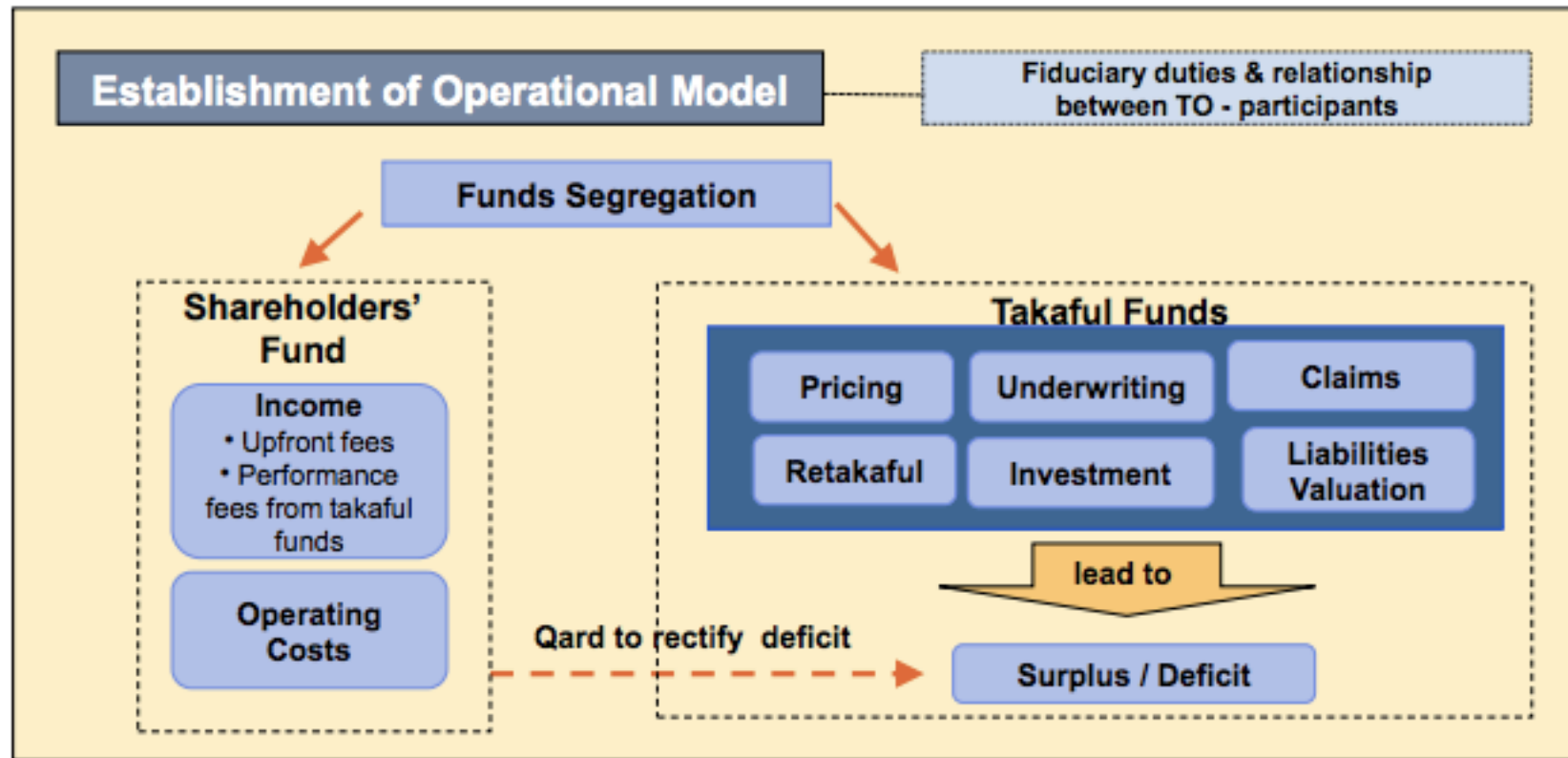
Shariah compliance in all aspects	Governance	<ul style="list-style-type: none"> • Duties & responsibilities of board of directors, senior management, appointed actuary & external auditor • Minimum expectation for TO on outsourcing of takaful activities, functions or processes 	<ul style="list-style-type: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

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

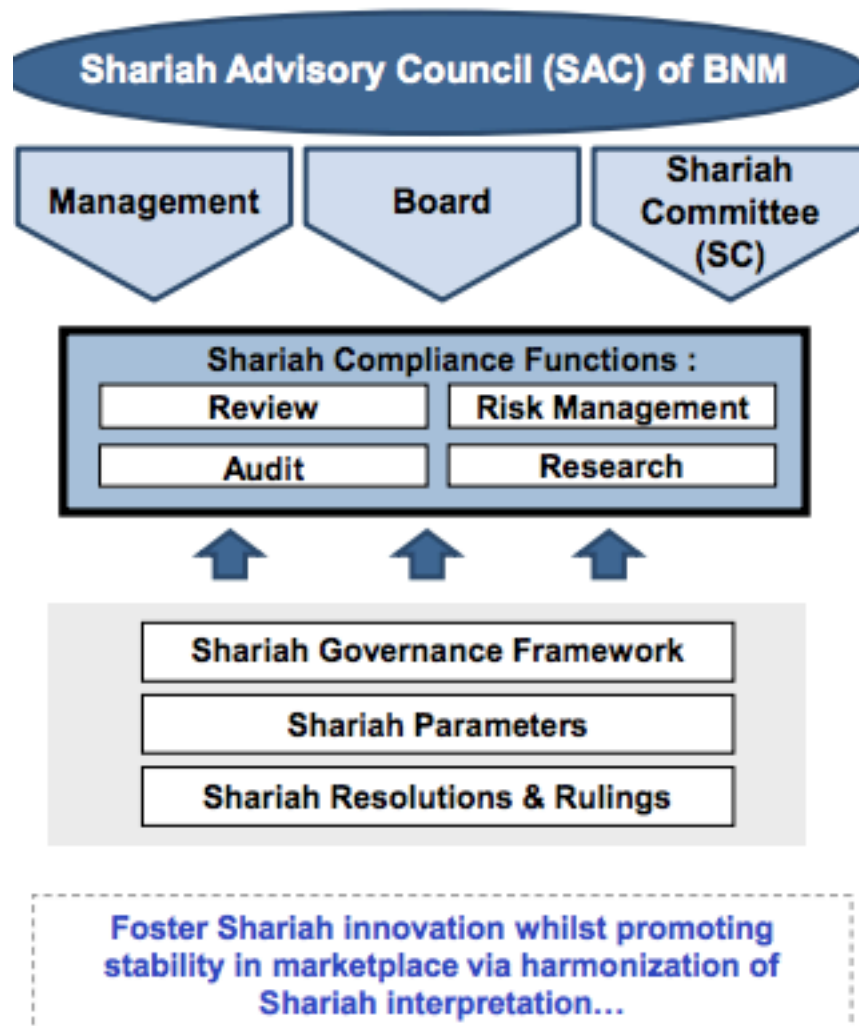
Outlines requirements in the following areas....



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



Future development & initiatives under Financial Sector Blueprint

1 Regulatory & supervisory regime

- Enactment of a comprehensive legislative framework for the conventional & Islamic financial systems respectively

3 Increase the diversity of players

- Issue new takaful licenses to institutions with specialised expertise
- Encourage international players to establish retakaful operations
- Promote greater involvement of takaful brokers

5 Talent development

- Promote standards & accreditation of Islamic finance programmes
- Introduce dedicated training programmes for Shariah graduates

2 Strengthen Shariah governance framework

- Establish a single legislated body as the apex authority on Shariah matters
- Strengthen International Shariah Research Academy for Islamic Finance to become a premier international research agency

4 Increase market efficiency

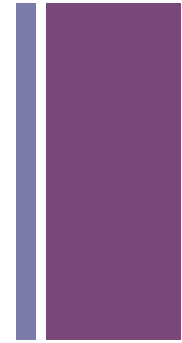
- Facilitate the development of standard retakaful documentation

6 Wide range of products & services

- A regulatory framework that facilitates the offering of affordable microtakaful

+ Takaful Act 1984

- 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.

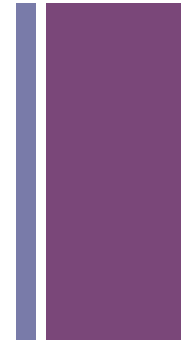


+Takaful Act 1984

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

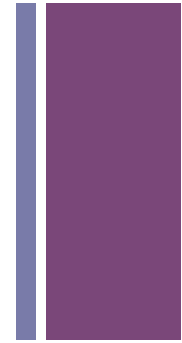
+ Cont...

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



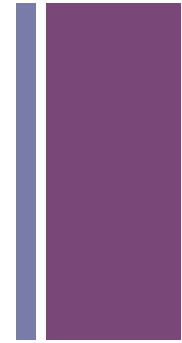
+ IFSA 2013

- IFSA 2013 and Takaful
- For stability
- More power to BNM
- To protect consumers
- To strengthen shariah governance
- Heavy penalty

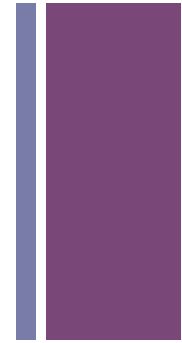


+ Scope of IFSA 2013 and Takaful

- 1. Prudential Matters and Corporate Governance
- 2. Shariah Governance
- 3. Business Conduct and Consumer Protection



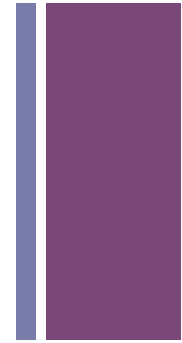
+ Definition



- **‘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 Syariah advisory body)

+ 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

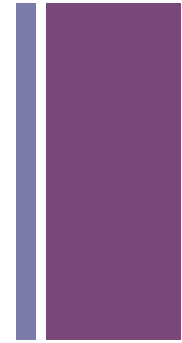


+ Legal Form

- International takaful business (by international takaful operator), which is previously governed under Part IIA of the Takaful Act, continues to exist under the IFSA – no such business or operator under the FSA for conventional insurers
- All takaful operators have to separate family takaful and general takaful businesses within 5 years from Appointed Date
- All takaful operators have to be a ‘public’ company within 12 months from Appointed Date

+ Takaful Certificate

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

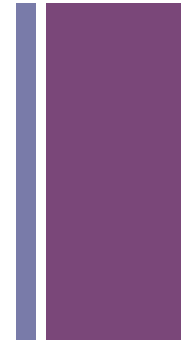


+ Pre-Contractual Duty of Disclosure

- **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*

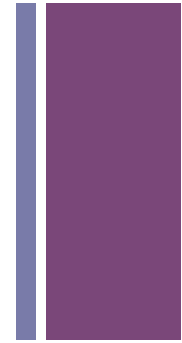
+ Payment of Takaful Benefits

- **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



+ Scope of Business

- 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



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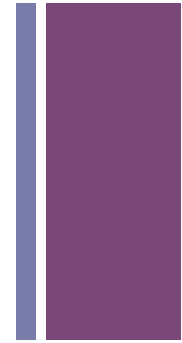
- A transition period of five years from the time the IFSA comes into operation is allowed- separate family takaful business and general takaful business to comply with this – s.286, IFSA.
- Only licensed professional retakaful operator can carry on both family takaful business and general takaful business

+ Cont..

- 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.
- 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,

+ 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.

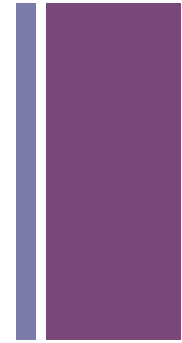


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- a liquidator of a licensed takaful operator which is being wound up shall pay in good faith to any of its claimants without requiring strict proof of debt of such claims to facilitate payment.
- issuance of a takaful certificate by a director, officer, agent or contributory, past or present, of a licensed takaful operator which is being wound up after its cessation of takaful business is prohibited.

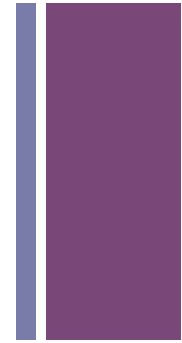
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- the liquidator of a family takaful operator is empowered to carry on its existing family takaful business with a view to its transfer as a going concern to another takaful operator.
- provisions relating to the priority of payment in winding up of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



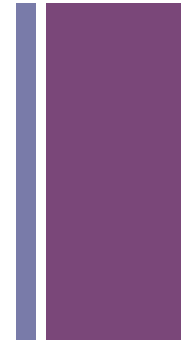
+ Due Regard to SC Decision

- **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**
- **Potential conflict of interest between majority shareholder and takaful participants**



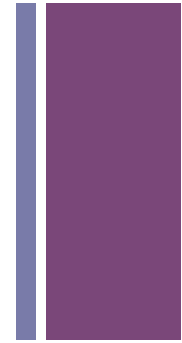
+ Civil Actions

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



+ Statutory Duties

- 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.**

+ Takaful fund

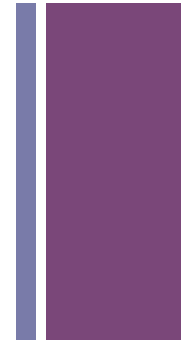
- **S 94 prohibits a licensed takaful operator from making any withdrawal from a takaful fund, whether from the surplus, or otherwise, of that takaful fund unless all the conditions set out is fulfilled.**
- **S 91 makes it mandatory for takaful operator to separate takaful fund and shareholders' fund.**
- **S 95 makes *qard* or loan provision is compulsory to every takaful operator in the event of deficit of the risk fund.**

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

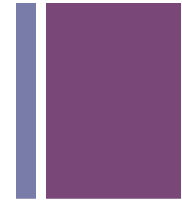
- *“Any representation made before a consumer takaful contract was entered into, varied or renewed shall not be converted into a warranty by means of any provision of the consumer takaful contract or of any terms of the variation or of any other contract, whether by declaring the representation to form 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: Basis of Contract Clause-Void**
- **Consumer Takaful:**
 - **Misrepresentation: reckless-contract void and no refund of contribution**
 - **Innocent: Contract void and refund the contribution.**

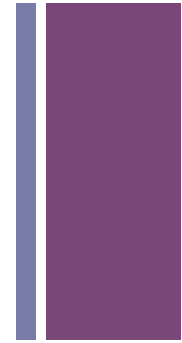


+ Duty to Disclosure



Party	Non-consumer takaful contracts	Consumer takaful contracts
Takaful Operator	Duty to not: Make misleading or false statements, <ul style="list-style-type: none"> • fraudulently or otherwise; • Fraudulently conceal a material fact; or In the case of takaful agents, use <ul style="list-style-type: none"> • unauthorised sales brochures 	Same
	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	Onus is on TO to ask a consumer to answer specific questions

+ Prohibited Business

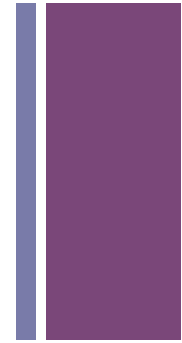


- List of prohibited business conduct (Schedule 7)
- Engaging in conduct that is misleading or deceptive in relation to the nature, features, terms or price of financial service or product
- Inducing financial consumer to an act or omit to do an act in relation to financial service or product by Making 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...

- 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 payments for unsolicited financial services or products unless the financial consumer has communicated his acceptance of the offer either orally or in writing.

+ Cont....



- 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 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.

+ Claims Regulations under IFSA

- Participants can opt to nominate under 2 scenarios
 - 1. conditional hibah
 - 2. executor
- Late payment benefits-
 - 1. to credit at the average rate of return of the PRF
 - 2. 1% paid from shareholders fund.