Regulatory Framework for Takaful

International Conference on Mutual Insurance and Takaful
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Agenda ...

- Snapshot of Malaysia’s Takaful Industry
- Dual Financial System in Malaysia
- Fundamentals for Sound Takaful Development in Malaysia
- Regulatory and Supervisory Framework in Malaysia
- Regulatory Requirements For Takaful
  - Takaful Operational Framework
  - Shariah Governance
  - Risk-Based Capital Framework
- Moving Forward
Snapshot of Malaysia’s Takaful Industry

MARKET STRUCTURE
12 Takaful Operators (TOs)
4 Retakaful Operators (RTOs)

PENETRATION RATE
12.82%

MARKET SHARE
14.2%

ASSET
Family business - RM 15.3 bil
General business - RM 2.7 bil

AVERAGE GROWTH (2006-2011)
Net contributions – 23.8%
Assets - 19.1%

NET CONTRIBUTIONS
Family business - RM 2.18 bil
General business - RM 0.67 bil

* as at 30 June 2012
Takaful in Malaysia developed as component of comprehensive Islamic financial system operating in parallel with conventional financial system.

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

Dual 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 ...

**Facilitative Legal Framework**
- Development of Islamic Financial Services Act

**World class talent pool & IF learning hub**
- Establishment of IBFIM, INCEIF & ICLIF
- Fund for Shariah Scholars in Islamic Finance

**Strong institutional framework**
- Dedicated department in Bank Negara Malaysia for Islamic Banking & Takaful
- Establishment of Malaysian Takaful Association

**Institutional Capacity Enhancement**
- Minimum paid-up requirement increase to RM100 m

**Robust Shariah governance structure**
- Foundation for Shariah governance setting in TA:
  - Business aims & operations must be Shariah compliant
  - Takaful operator (TO) to establish Shariah Committee (SC)

**Intermediate stage**
- Institutional building, activity generation & market vibrancy

**Effective & efficient consumer protection**
- Establishment of BNM LINK, Financial Mediation Bureau & dedicated division in High Court

**Facilitative Legal Framework**
- Takaful Act 1984 (TA) provides platform for separate regulatory structures

**Robust Shariah governance structure**
- SAC as a highest authority for the ascertainment of Islamic law on IF
- Rulings of SAC shall be binding on IFIs, courts or arbitrators

**Strong institutional framework**
- Increase no. & diversity of players e.g. TO (12) and RTO (4)

**Institutional Capacity Enhancement**
- Risk-Based Capital Framework
- Takaful Operational Framework

**Advanced stage**
- Strategic positioning & international integration
Regulatory and Supervisory Framework in Malaysia …

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

Objectives

- 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

Pragmatic approach to regulation

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

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

- Governance
  - Duties & responsibilities of board of directors, senior management, appointed actuary & external auditor
  - Minimum expectation for TO on outsourcing of takaful activities, functions or processes
  - Duties & responsibilities of the Shariah Advisory Council & Shariah Committee
  - Fiduciary duties of takaful operator (TO)
  - Stature of participants in takaful

- Assets, Investments & Liabilities
  - Diversification rules, basis for valuation & safekeeping of assets
  - Investment limit permissible
  - Determination & provisioning of liability
  - Invest in Shariah-compliant instruments
  - Management of takaful fund
  - Accounting treatments

- Solvency
  - Capital adequacy based on risk profiles
  - Stress test process that commensurate to nature, complexity & sophistication of the business
  - Qard to rectify deficit in takaful fund

- Product Requirements
  - Sound risk management practices in developing, managing & controlling product risk
  - Shariah endorsement on product
  - Fees, charges & surplus distribution

- Reporting, market conduct & market protection
  - Disclosure & presentation of reports & statements
  - Minimum standard on product transparency & disclosures
  - 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....

Establishment of Operational Model

Funds Segregation

Shareholders’ Fund
- Income
  - Upfront fees
  - Performance fees from takaful funds
- Operating Costs

Takaful Funds
- Pricing
- Underwriting
- Retakaful
- Investment
- Claims
- Liabilities
- Valuation

lead to

Surplus / Deficit

Fiduciary duties & relationship between TO - participants

Qard to rectify deficit

Supported by:
- Effective governance & oversight
- Adequate disclosure & transparency
- Sufficient & competent resources
- Efficient processes & procedures
Shariah Governance ...

Shariah Advisory Council (SAC) of BNM

Management  Board  Shariah Committee (SC)

Shariah Compliance Functions:
- Review
- Risk Management
- Audit
- Research

Shariah Governance Framework
- Shariah Parameters
- Shariah Resolutions & Rulings

Foster Shariah innovation whilst promoting stability in marketplace via harmonization of Shariah interpretation...

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
Risk-Based Capital Framework for Takaful Operators (RBCT) …

Objectives

- Enable all obligations under a takaful contract & costs of managing the takaful business are met
- Provide flexibility for takaful operator (TO) to operate at different risk levels as long as there is supporting capital
- Ensure availability of funds to provide interest-free loan (qard) should the need arise

CAPITAL REQUIRED RELATES TO THE FOLLOWING RISKS

- Credit
- Market
- Takaful Liabilities
- Surrender Value
- Expense Liabilities
- Operational (include risks from Shariah non-compliance)

On shareholders’ fund only

CAPITAL AVAILABLE TO ADDRESS THE IDENTIFIED RISKS

- Aggregate of Tier 1 and Tier 2 capital, minus deductions for assets not readily available to meet policyholders’ obligations (e.g. goodwill & investment in subsidiaries)
- The capital available under shareholders’ fund shall be fully recognised
- The capital available under takaful fund shall be recognised limited to meeting takaful funds’ own capital requirements

TO’s financial strength to support its business operations & meet potential qard reflected through two indicators

Individual Target Capital Level

Reflects TO’s:
- Own risk profile
- Overall risk tolerance & appetite
- Quality of risk management

Supervisory Target Capital Level (STCL)

- TOs operating below the STCL will attract stricter supervisory actions of increasing intensity

On shareholders’ fund only
Moving forward …

Future development & initiatives under Financial Sector Blueprint

1. Regulatory & supervisory regime
   - Enactment of a comprehensive legislative framework for the conventional & Islamic financial systems respectively

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

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

4. Increase market efficiency
   - Facilitate the development of standard retakaful documentation

5. Talent development
   - Promote standards & accreditation of Islamic finance programmes
   - Introduce dedicated training programmes for Shariah graduates

6. Wide range of products & services
   - A regulatory framework that facilitates the offering of affordable microtakaful