



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Guidelines on Takaful Operational Framework

Issued on: 26 June 2013

BNM/RH/GL 004-22	Islamic Banking and Takaful Department	Guidelines on Takaful Operational Framework
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PART I – OVERVIEW

1. Introduction

- 1.1 The takaful industry in Malaysia has witnessed significant progress in the recent years with the increase in number of players as well as the expansion of business scope and product range. The rapid expansion of the industry warrants for an operational framework to be clearly laid out to guide the takaful operators.
- 1.2 The contract underlying takaful operations requires takaful operators to duly observe fundamental obligations towards participants, particularly in terms of adhering to Shariah principles, undertaking of fiduciary duties and meeting prudential standards. These obligations are to be consistently met in an increasingly challenging environment where there are variations in business practices, differences in opinions surrounding the operations of takaful, competition and, changing market and economic conditions. Business operations would have to be effectively managed to meet these challenges, to ensure that takaful operators are able to manage the interest of various stakeholders without compromising prudence. The discharge of fiduciary duties and responsibilities can be met by recruiting appropriate personnel and putting in place appropriate processes and controls, including good governance and oversight structures.
- 1.3 To further promote the orderly growth of takaful business, the Guidelines on Takaful Operational Framework (the Guidelines) is issued, outlining parameters to govern operational processes of takaful operators and defining in detail where necessary, the various rules and requirements for takaful operators without limiting or specifying particular contracts to apply to the takaful operations.

2. Objectives

2.1 The objectives of the Guidelines are as follows:

- a) To enhance operational efficiency of takaful business;
- b) To build healthy takaful funds which are sustainable;
- c) To safeguard the interests of participants; and
- d) To promote uniformity in takaful business practices.

3. Guiding Principles

3.1 The Guidelines is formulated based on the following principles:

a) **Principle 1:**

Ensure **uniformity with Shariah principles** and consistency with the essential features of takaful;

b) **Principle 2:**

Promote **prudent management** of takaful funds to enhance the funds' financial resilience;

c) **Principle 3:**

Promote **fairness and transparency** to protect the interests of participants;

d) **Principle 4:**

Ensure **appropriateness of fees and charges** imposed on participants and takaful funds; and

e) **Principle 5:**

Instil **good governance and risk management** practices.

4. Applicability

4.1 The Guidelines is applicable to all takaful operators¹ registered under the Takaful Act 1984 (the Act). Requirements that are highlighted as applicable to direct takaful operations are not applicable to retakaful operations. The

¹ Includes retakaful operators and international takaful operators registered under the Act.

Guidelines shall be read in conjunction with other relevant provisions of the Act, guidelines and circulars issued by the Bank.

5. Scope

5.1 The Guidelines covers operational processes relating to takaful and shareholders' funds. This includes requirements relating to the setting up of funds, management of takaful operations, management of operating costs and income of the takaful operators, management of assets, liabilities and surplus, and, rectification of deficiency of the takaful funds. The Guidelines also includes broad requirements on disclosure and transparency.

6. Legal Provision

6.1 The Guidelines is issued pursuant to Section 69 of the Act which gives power to the Bank to issue guidelines, circulars or notes as deemed necessary.

7. Implementation Date

7.1 The Guidelines shall take effect on **1 January 2012**, except for the requirements stated in Appendix 2, which shall take effect on 26 June 2013. With regards to the limit imposed in paragraph 12.8, even though the limit shall be made mandatory on new certificates issued on or after 1 January 2012, takaful operators are responsible to ensure that participants of earlier block of business are not disadvantaged by practices which do not comply with this limit. Takaful operators are required to undertake necessary measures to enhance current operational systems, procedures and processes to be consistent with the Guidelines.

PART II – POLICY REQUIREMENTS

8. Establishment of Operational Model

8.1 Takaful operators shall establish an operational model that outlines the key policies, procedures and management's responsibilities in carrying out the takaful operations. The operational model shall be based on contracts preferred by the takaful operator and approved by the Shariah Committee. In setting out the policies and procedures, takaful operators must ensure that the principles outlined in the contracts are appropriately operationalised. The operational model of the takaful operator shall define its relationship with and fiduciary duties towards the participants. The takaful operator shall ensure that the operational model adopted is endorsed by its Shariah Committee and Board of Directors (Board).

8.2 All takaful operators are required to document the operational model to be practised upon implementation of the Guidelines, which shall, at a minimum, cover the information outlined in Appendix 1. The documentation shall be maintained by takaful operators and made available to the Bank when requested. Where subsequent changes are made to the operational model, takaful operators shall ensure that the changes are sufficiently documented. A takaful operator seeking to be registered in Malaysia shall submit the operational model to be used for its operations in its registration application².

8.3 The Banks' approval is needed prior to implementing:

- a) an operational model introduced in Malaysia for the first time;
- b) a new Shariah contract ; or
- c) changes in Shariah contracts.

In this respect, takaful operators shall submit to the Bank relevant documents to facilitate approval at least one month prior to the proposed date of implementation.

² Requirement for operational model submission by new takaful operators shall form part of the procedures for the establishment and registration of the takaful operations, as specified by the Bank.

9. Segregation of Funds

9.1 In line with the legislative provision of the Act, takaful operators are required to segregate the assets of the takaful funds from the assets of the takaful operators. Within the takaful funds, takaful operators are required to establish and maintain separate takaful funds in respect of family takaful business and general takaful business.

9.1A Each takaful operator shall establish and maintain a separate takaful fund for its Malaysian takaful certificates and for its foreign takaful certificates. However, the Bank may, on an application in writing, allow³ takaful operators with small volume of foreign takaful certificates to maintain one takaful fund for its Malaysian takaful certificates and foreign takaful certificates, where:

- a) for family takaful, the total family fund in respect of foreign takaful certificates does not exceed RM5 million or 5% of the takaful protection⁴ fund, whichever is lower; and
- b) for general takaful, the gross contributions in respect of foreign takaful certificates does not exceed RM5 million or 5% of total gross contributions, whichever is lower.

9.2 The takaful funds for the family takaful business shall be segregated into two further funds, namely:

- a) the takaful protection fund; and
- b) the takaful annuity fund.

9.3 Within the family takaful funds, takaful operators shall separately establish Participants' Risk Fund (PRF) and Participants' Investment Fund⁵ (PIF) as follows:

³ Subject to the extent of pooling of contributions permitted in the contract of the takaful certificates.

⁴ Covers takaful business of non-annuity products e.g. ordinary takaful and investment-linked takaful as established under paragraph 9.2.

⁵ Applicable only to products with savings and/or investment element.

- a) The PRF is compulsory for all products and refers to the fund used to pool the portion of contributions paid by participants on the basis of *tabarru'* (donation) for the purpose of meeting claims on events/risks covered under the takaful contracts⁶. For annuity products, the PRF shall be used to pool the *tabarru'* contributions meant to provide payments during the annuity period. Under the *tabarru'* contract, the fund is owned by the pool of participants. In managing the PRF, the takaful operators shall adopt appropriate set of policies and procedures to ensure the availability of funds to meet takaful benefits when due.
- b) The PIF refers to the fund in which a portion of the contributions paid by takaful participants for a takaful product is allocated for the purpose of savings and/or investment. The PIF is individually owned by participant. In managing the PIF, takaful operators shall adopt appropriate investment and management strategies to achieve returns that are in line with the participants' reasonable expectations and where relevant, to ensure the availability of funds for future *tabarru'* apportionment into the PRF. For investment-linked takaful, the PIF shall refer to the unit fund(s).

9.4 For general takaful business, takaful operators shall establish a PRF to serve a similar purpose to that explained in paragraph 9.3(a).

9.5 Where a takaful operator manages part or parts of PRF and PIF under smaller sub-funds, the takaful operator shall consistently segregate the management of these sub-funds throughout the term of the takaful contract including when determining surplus and deficit. Takaful operators are required to inform the Bank where further segregation of PRF and PIF is

⁶ The Shariah Advisory Council of Bank Negara Malaysia (SAC) resolved that payment of takaful benefits from PRF can be made contingent upon specific events beyond those arising from a defined financial loss or a misfortune, subject to agreement by the participants. The decision is made in line with the concept of *tabarru'* and *ta'awuni* (mutual assistance) underlying the takaful contract, which is entered into by the participants, which allow participants to agree on the events leading to payment of the takaful benefits. (Press statement dated 25 August 2010).

practiced and document the segregation as a feature of their operational model.

- 9.6 The Bank, based on its assessment of takaful product design or features, may require takaful operators to establish other funds to clearly reflect the specific nature, purpose or risk of a component of the contribution or other elements of the takaful products. This may be intended to protect the interest of the participants, the soundness of the takaful funds or where it is appropriate, to be more in line with Shariah requirement.
- 9.7 Takaful operators shall maintain records of and properly allocate the assets, liabilities, revenues and expenses of the takaful operations to the relevant funds. The method of allocation and the proportion of contribution allocated to the takaful funds must be made transparent in the takaful contracts. It is essential that the wordings in the takaful contracts are consistent with the operation and management of the takaful products and funds and provide clarity in terms of how the contributions are pooled. In the case of family takaful as well as medical and health products, the method and proportion of allocation must also be consistent with the actuarial certificate filed with the Bank.

9A. Assets of Takaful Funds and Shareholders' Fund

- 9.8 With respect to the assets of a takaful fund, takaful operators shall not include any of the following as assets of a takaful fund:
- (a) any amounts on account of goodwill;
 - (b) a development expenditure or any amount capitalised in respect of such expenditure; and
 - (c) any other items similar to item in subparagraph (b) which is not realizable apart from the business or part of the business of the takaful operator.

9.9 Takaful operators shall observe requirements set out in paragraphs 16.1 to 16.3 in maintaining documents evidencing title to assets of takaful fund.

9.10 Takaful operators shall not pledge, mortgage or charge any of the assets or securities of takaful fund and shareholders' fund except with the prior written approval from the Bank.

9B. Registers of Takaful Certificates and Claims

9.11 Each takaful operator shall maintain a separate register for its Malaysian takaful certificates and for its foreign takaful certificates, and a separate register for claims under its Malaysian takaful certificates and for claims under its foreign takaful certificates, as follows:

- a) Information relating to takaful certificates and claims to be recorded in the registers shall include the information necessary for identification of the liabilities underwritten as well as the processing and validation of the liabilities and claims against the takaful certificates, respectively.
- b) The information for register of takaful certificates shall be recorded upon issuance or transfer of the certificate, whereas for register of claims, the information shall be recorded upon the takaful operator becoming aware of the claims.

9.12 Takaful operators shall, at the request of any person having an interest in the certificate or claim, inform that person whether or not the certificate or claim is entered in the register.

9.13 These records shall be kept in Malaysia at all times and maintained as long as the takaful operator is under any liability in respect of any takaful certificate or claim registered.

10. Management of Takaful Funds Operations

- 10.1 Takaful operators must ensure that efficient processes are established to manage the takaful funds including putting in place effective risk controls and monitoring systems with a view to safeguard the takaful funds and protect the interests of the stakeholders. An effective risk management system should be established to enable identification, assessment and analysis of frequency and severity of the risks involved. To manage risks effectively, risk-mitigation strategy shall be formulated to take into consideration among others, the takaful operator's capital position, surplus or deficit position of the takaful funds, liquidity requirements and volatilities of asset classes. At all times, takaful operators are responsible for the interest and well-being of takaful funds.
- 10.2 Takaful operators shall have sufficient resources to operate the takaful business, and shall ensure that parties connected to the business operations are competent and well trained to perform their functions. Takaful operators are also responsible for the conduct of their agents including outsourcing parties. In the marketing and sales process, takaful operators shall be responsible to establish appropriate procedures for their respective distribution channels, placing strong emphasis on good marketing ethics, conduct and disclosure.
- 10.3 The Board is ultimately accountable to ensure the overall effectiveness of takaful operations' management. Senior management shall be responsible to implement the overall operational processes, including developing and recommending comprehensive policies, procedures and internal controls, for the Board's endorsement. The Board shall put in place an effective oversight framework that continuously assesses the effectiveness of policies and procedures of the management of takaful funds including obtaining the endorsement and advice from Shariah Committee and ensures that the takaful operation is carried out in accordance to these policies and requirements. The Board shall ensure strong corporate

governance processes are in place to enable effective discharge of takaful operators' fiduciary duties towards participants.

Takaful Product Design and Pricing

10.4 Takaful operators shall exercise diligence in product design and ensure that the products offered include adequate takaful coverage and, are suitable and appropriate to the targeted market segment. In determining the price of the products, prudence must be maintained to avoid under pricing and balanced with due care to avoid participants from being charged excessively. Key factors such as the expected frequency and severity of risk exposures and, expected management costs and expenses must be considered in pricing the takaful products. Assumptions used in pricing the takaful products could be based on the takaful operators' or industries' past experience and future expectations. Given the nature of the business which may involve payments of contributions or liabilities long into the future, products should be priced to include appropriate buffers or designed with flexible features which could absorb future fluctuations and uncertainties.

10.5 Consistent with the basic concept of takaful which involves pooling of contribution by participants for the purpose of meeting claims arising from a pre-agreed event, sufficient amount of contributions must be allocated to the takaful funds. Takaful operators shall ensure adequate tabarru' allocation into the PRF to cover risks and obligations associated with the takaful contract. Takaful operators shall also ensure that the contribution charged is sufficient to cover the tabarru' throughout the term of the product.

10.5A In designing the benefits⁷ of a takaful product, takaful operators shall ensure that:

⁷ The SAC has further resolved that takaful benefits offered under a takaful product must meet conditions as specified in paragraph 10.5A, to ensure that all takaful benefits are in line with Shariah and to preserve the main objective of takaful.

- a) the benefits do not have elements which contradict the Shariah principles;
- b) the events leading to payment of the benefits are pre-agreed by the participants;
- c) the main benefit payable from PRF is in line with the objective of takaful which is to provide mutual assistance amongst the participants against specific events/risks through the concept of risk pooling; and
- d) other benefit in addition to the main benefit must be related to the main benefit. In addition, where the additional benefit is paid from the PRF, the features of the additional benefit shall not weaken the concept of mutual assistance and risk pooling in takaful. Where the additional benefit is paid from the shareholders' fund, takaful operators shall submit the proposed underlying contract used for the benefit payment to the Bank for approval.

Underwriting of Takaful Risks

10.6 Takaful operators shall manage the underwriting process effectively to avoid anti-selection⁸ and ensure viability of takaful funds in the long run. Participants as owners of takaful funds would expect takaful operators to establish a robust process to select risks into the takaful funds. In this respect, clear underwriting policy which is properly documented and periodically reviewed to suit changing market conditions shall be established.

10.7 Takaful operators are responsible to objectively evaluate and assess the underwriting risks and exposures of potential participants, to ensure that risks accepted are within that assumed in pricing the contributions. Underwriting activities must be consistent with the underwriting capacity of the takaful operators. It is prudent to expect that risks underwritten are not

⁸ Refers to tendency of individuals to enter into takaful cover where risks of these individuals to experience a loss is more likely than an average individual.

beyond that assumed in pricing. Where relevant, rating differentials including contribution loadings, benefit exclusion or limitation on coverage should be imposed when accepting participants with higher risk profile.

- 10.8 In managing the underwriting operations, takaful operators shall ensure that the officers responsible for underwriting function fully understand various policies relating to such matters as parameters for risk evaluation, categories of risks, limitations on the type of risks to be accepted and where relevant, the circumstances under which further investigation and/or documentation is required prior to acceptance of risks (for example medical underwriting).

Retakaful

- 10.9 As part of good risk management, takaful operators must have in place effective retakaful management strategy which is appropriate to the overall risk profile of the takaful business. Takaful operators shall ensure that risks are ceded to takaful operators or retakaful operators. Where risks are ceded to a foreign retakaful operator, the takaful operator shall ensure that the retakaful operator is conducting its business in compliance with Shariah.
- 10.10 Takaful operators shall not cede out risks to insurance or reinsurance companies unless in cases where it is unavoidable as follows:
- a) There is no existing takaful or retakaful operator that accepts a particular risk;
 - b) There is no existing takaful or retakaful operator that has the capacity or expertise to accept a particular risk; or
 - c) A retakaful arrangement with existing takaful or retakaful operator willing to accept the risk will be detrimental to the takaful fund. A retakaful arrangement can be deemed detrimental to the takaful fund primarily where the takaful or retakaful operator may be unable to meet its financial obligations towards the takaful fund,

which can arise in instances where the takaful or retakaful operator, among others, is:

- i) managed by incompetent board of directors or senior management;
- ii) not financially strong as may be evidenced by financial statements and/or financial rating;
- iii) not properly regulated or supervised by its home regulator;
- iv) not legally established in accordance with the laws of its home regulator; or
- v) based in a country that is experiencing political or financial instability which has the potential to affect the retakaful operator and/or industry.

If there is a need to cede out the risk to insurance or reinsurance company under the above conditions, takaful operators shall provide the necessary justifications to substantiate this need to be assessed and endorsed by the Shariah Committee and approved by the Board, based on the facts of each cession⁹. Similar considerations as per paragraph 10.10(c) shall apply when selecting a suitable insurance or reinsurance company.

- 10.11 Takaful operators shall not accept inwards reinsurance from insurance or reinsurance companies except where the risk is Shariah-compliant and the arrangement is based on a Shariah-compliant retakaful contract. Takaful operators shall provide the necessary justifications to the Shariah Committee and Board that the risk is Shariah-compliant with the aim to seek the endorsement by the Shariah Committee and the approval by the Board⁹. The Bank may review circumstances for the acceptance of the inwards reinsurance from insurance or reinsurance companies and impose conditions, to be in line with the current need and state of development of the market.

⁹ No.12 of *Resolusi Syariah dalam Kewangan Islam Majlis Penasihat Syariah Bank Negara Malaysia (2010 - 2011)*.

10.12 Takaful operators are expected to secure retakaful arrangements which commensurate with the size, business mix and complexity of the takaful business. The retakaful arrangement must be consistent with the interests of the takaful funds, achieve the objectives of risk mitigation and protect the sufficiency of takaful funds to pay liabilities when due. Strength of the retakaful operators must be the main consideration, as effective risk mitigation can only be achieved if the retakaful operator is financially sound. The amount of business to be ceded as retakaful must be in line with the level of risk tolerance of the takaful funds and/or the takaful operators, taking into consideration availability of capital or surplus to cushion future experience. In addition, takaful operators must ensure that the retakaful arrangements are well-diversified to avoid over-concentration of risks. Takaful operators are also expected to monitor, review and update the retakaful management strategy and arrangement on a regular interval in response to changes in the takaful funds' risk profiles.

10.13 In order to preserve the spirit of mutual assistance and joint ownership of the PRF, any form of performance-based payment to a cedant of a retakaful arrangement out of the retakaful PRF shall only be made based on the overall performance of the fund¹⁰. In addition, any commission, profit-sharing or other performance-based payments arising from the retakaful arrangement shall be fairly redistributed to the relevant funds taking into consideration the source of the retakaful contributions and the performance of the funds leading to such payment.

Investment of Takaful Funds

10.14 Sound investment management in takaful operations is important to achieve not only appropriate returns to meet different objectives of the

¹⁰ The SAC resolved that any form of performance-based payment to an individual cedant of a retakaful arrangement out of the retakaful PRF prior to determining overall performance of the fund is not permitted. The decision is made as such practice is deemed inconsistent with the concept of *ta'awuni* underlying the retakaful contract, which is entered into by the pool of cedants.

takaful funds but also to ensure that the funds can meet the obligations when takaful benefits fall due, including on surrender and maturity of takaful certificates. It is the takaful operators' fiduciary duty to manage the investments in a sound and prudent manner, in line with Shariah requirements and participants' expectations.

- 10.15 Takaful operators shall have in place appropriate investment strategy that considers the nature, term, currency, amount and timing of the takaful liabilities and, commensurate with the funds' tolerance of risks. The investment strategy must be reasonably formulated to avoid adverse impact on the takaful funds.
- 10.16 Takaful operators shall have in place effective and reliable infrastructure to support investment management and where relevant, shall be able to tag specific investment to the relevant funds. This is especially important in the management of the PIF to preserve fairness to participants who individually own the PIF, as the value of each PIF should reflect that of a defined set of assets invested in by the PIF. Robust investment management of PIF is of particular importance, in view that the PIF investment management is at the full discretion of the takaful operators, whilst the investment risk is fully borne by participants. In addition, the infrastructure must facilitate accurate determination of investment profit and avoid errors in distributing profit to participants and takaful operators.

Valuation of Liabilities

- 10.17 In executing their fiduciary responsibilities in managing the takaful funds, takaful operators are expected to set appropriate and adequate provisions for the takaful funds to meet future obligations. In this respect, takaful operators shall appoint a person with the appropriate qualifications and technical skills to conduct the valuation of liabilities. The appointment shall comply with requirements specified by the Bank.

For family takaful business, the valuation shall be conducted by an Appointed Actuary as defined in the Guidelines on the Role of the Appointed Actuary. For general takaful business, the valuation shall be conducted by a Signing Actuary, as defined in Guidelines on Valuation Basis for Liabilities of General Takaful Business.

- 10.18 The Appointed Actuary and Signing Actuary (hereafter referred to as 'Actuary') shall be responsible to apply appropriate valuation basis and methodologies taking into consideration the nature of the products, the term of the takaful contracts and the amount of takaful benefits in valuing the liabilities of the takaful business. The valuation basis and methodologies shall be in line with the requirements as specified in the Guidelines on Valuation of Liabilities of Family Takaful Business and Guidelines on Valuation Basis for Liabilities Basis for General Takaful Business accordingly.

Claims Management

- 10.19 Takaful operators must have in place appropriate systems and controls to handle claims. It is the takaful operators' fiduciary duty to assess the validity of claims and settlement amount, and establish appropriate measures to prevent fraudulent claims or payment of invalid claims that can adversely impact the takaful funds. Takaful operators must ensure that claims processing and payments are done promptly without unnecessary delays and that participants are treated fairly during the process. The amounts payable upon a claim and the source of the payments must be from the correct funds, in line with the takaful contracts.

Management of Surplus

- 10.20 Good and effective management of takaful funds' operations would ensure that the funds' experience is within that assumed in the pricing of the takaful products. Where the experience is better than that expected,

there should be a surplus¹¹ in the PRF during the term of the takaful contracts. The level and pattern of surplus is a good indicator of the performance of the PRF and in turn, is a good reflection of the takaful operators' performance, for example in underwriting, assets and claims management.

- 10.21 Takaful operators are required to establish a written policy on the management of PRF surplus which shall be approved by the Shariah Committee and the Board. Written policy established shall comply with Shariah principles underlying the operational model adopted. The policy shall include the policy on utilisation of surplus including surplus distribution and the level of surplus to be retained in the fund to cushion future volatilities in experience of that PRF. Long-term viability of the PRF shall be the main consideration when establishing the surplus management policy. The policy shall consider the segregation of fund as per paragraphs 9.1 - 9.7 and ensure that surplus of a segregated fund/sub-fund is used for that fund/sub-fund only.
- 10.22 In the surplus distribution process, takaful operators are required to observe the following requirements:
- a) The surplus to be distributed shall be recommended by the Actuary and endorsed by the Board;
 - b) The surplus distribution shall be in line with surplus management policy and the underlying contract of the product;
 - c) The surplus distribution shall only be made subject to there being no deficit as defined in paragraph 14.2;
 - d) The surplus shall be determined and distributed:
 - i) based on full valuation of liabilities as certified by the Actuary and full audited results;
 - ii) after meeting claims and other outgoes of the fund such as retakaful contributions;

¹¹ Refers to the excess of the participants' fund carried forward less actuarial liabilities.

- iii) after observing any other prudential requirements as may be set by the Bank;
 - iv) based on generally accepted actuarial principles; and
 - v) in a manner which ensure fair treatment of different groups of participants; and
- e) The surplus distribution shall not cause adverse financial implications on the PRF or result in a deficit in the PRF.

10.23 The Actuary, in determining the amount of surplus to be recommended for distribution, shall observe the following:

- a) assess the strength of the takaful funds to ascertain the extent to which it would be appropriate for surplus to be distributed such that the long-term sustainability of the fund is not affected; and
- b) refrain from recommending surplus distribution if in the Actuary's professional judgment, the surplus should remain in the PRF as a buffer to maintain the ability of the takaful funds to meet future liabilities or to meet participants' reasonable expectations not specifically provided for in the actuarial valuation.

11. Management of Operating Costs

11.1 To instil financial discipline and ensure efficient operational cost management, takaful operators are required to establish effective policies and procedures to manage operating costs. The Board shall ensure that effective controls are put in place to ensure that actual expenses incurred do not lead to cost overruns which can affect the viability of the takaful operators and would have a negative impact on their ability to manage the takaful funds effectively. An effective operating cost management is expected to result in fairer contributions being charged and higher returns to the shareholders.

- 11.2 The operating costs of the takaful operations which include commissions and related expenses payable to the distribution channels, management expenses and other operational expenses, are met through the remunerations¹² received from participants or the takaful funds. Takaful operators shall ensure that commissions and related expenses paid to the distribution channels are in compliance with requirements and limits set by the Bank.
- 11.3 For direct takaful business, takaful operators shall also comply with requirements on rebates to consumers on the acquisition costs loaded in the contributions. In general, rebates should be given to consumers where there is savings in acquisition costs i.e. acquisition costs have been priced in the product but there is no or minimal acquisition costs that were actually incurred, for example where participants arrange for the takaful coverage directly with the takaful operators or through direct distribution channels such as the internet.
- 11.4 Takaful operators shall ensure that commissions and management expenses are paid from the shareholders' fund. Takaful operators shall not pay expenses out of the takaful funds, except if these are direct claims related expenses¹³ or direct investment related expenses¹⁴. The direct claims and investment related expenses to be charged to takaful funds must be approved by the Shariah Committee and qualify only if these are not already factored into the determination of the upfront fees or other sources of remuneration to the takaful operators. The amount shall be limited to the actual amount of expenses incurred. Takaful operators must ensure that the expenses charged to the takaful funds are documented as part of the operational model and shall be clearly disclosed to participants in marketing materials. Where the expenses

¹² Refer to section on Management of Income from Takaful Business.

¹³ Relate to fees for the services of professionals and other costs of similar nature directly associated with settling claims such as adjustor's and legal fees.

¹⁴ Transaction costs directly attributable to the acquisition, issuance or disposal of a financial asset of the takaful fund.

charged to the takaful funds are deemed inappropriate, the Bank may disallow or require the expenses to be repaid and apply retrospective adjustments to the takaful funds.

12. Management of Income from Takaful Business

- 12.1 In consideration of the services rendered and costs incurred in administering the takaful operations, takaful operators are entitled to be remunerated through fees and charges imposed on contributions and takaful funds or through share in profit/surplus of the takaful funds. These remunerations shall be consistent and in accordance to the operational model being adopted.
- 12.2 In order to ascertain the profitability of a product, takaful operators shall consider all remunerations received from the takaful product. In determining the appropriate amount and structure of remuneration to be taken from a product, takaful operators shall ensure that the following requirements are observed:
- a) There must be specific and clear intended outcome from the work undertaken to justify the remuneration. There shall not be double charging within a takaful product;
 - b) The remunerations to be taken shall be appropriate and reasonable, and determined with due regard to provide fair treatment to stakeholders;
 - c) Implications on takaful funds, in particular on the funds' long-term viability shall be considered; and
 - d) The level of remunerations to be taken must commensurate the complexity of the services rendered and the associated risks.
- 12.3 Takaful operators shall ensure that all remunerations received are managed prudently to cover operating costs. In particular, appropriate amounts should be available to meet the operating costs incurred in managing the takaful funds for the full contractual obligation of the

takaful certificates. In this respect, appropriate and adequate provision shall be set to meet the expense liabilities of the shareholders' fund, according to the requirements as set out in the Guidelines on Valuation Basis for Liabilities of Family Takaful Business and the Guidelines on Valuation Basis for Liabilities of General Takaful Business.

- 12.4 For family takaful and medical and health products, the basis in deriving the fees and charges must be clearly justified and documented in the Actuarial Certificate of the products submitted to the Bank. For other takaful products, the justification and documentation shall be maintained by the takaful operators and shall be made available upon request by the Bank. Any changes to the fees shall be justified and documented and where relevant, submitted to the Bank.

Upfront Fees

- 12.5 For products based on the wakalah contract, a fixed upfront fee can be charged on the contributions based on contractual terms entered with the participants. The upfront fee is mainly used to cover commissions and management expenses incurred in the management of takaful funds.
- 12.6 When ascertaining the upfront fee, takaful operators are required to appropriately determine the level of management expenses expected to be incurred by the shareholders' fund, in servicing the certificate throughout the takaful contract term. This can be based on internal or industry's past experience, taking into consideration expected future experience with reasonable prudence. Takaful operators shall ensure that any margin included to compensate shareholders for effort taken in managing takaful operations, is appropriate and reasonable.

Remuneration from PRF

- 12.7 For managing the PRF, takaful operators are permitted to be remunerated through performance fees paid from the PRF surplus¹⁵ determined in paragraph 10.22. Takaful operators may base the performance fee as a proportion of total surplus or any component of the surplus.
- 12.8 In taking the performance fee, takaful operators shall ensure that the following requirements are observed:
- a) The performance fee can be taken only if the participants' portion of the PRF surplus is also paid or accrued¹⁶ to the participants;
 - b) The total amount of remuneration from PRF payable to the takaful operators shall not exceed the amount of surplus paid or accrued to participants;
 - c) [Deleted]¹⁷; and
 - d) The performance fee is in line with takaful operator's policy on management of surplus and in line with the requirements as per paragraph 10.20 - 10.23.
- 12.9 Takaful operators that are remunerated solely from a share in the PRF surplus may apply to the Bank for an exemption from the requirements in paragraph 12.8(b) by providing sufficient justification and details of an alternative proposal. The application must be accompanied by the Board and Shariah Committee's endorsement.

¹⁵ No. 52 of Shariah Resolution in Islamic Finance – 2nd Edition

¹⁶ Accrued surplus refers to surplus that is declared to individual participants but not yet transferred out of the PRF. The accrued surplus becomes a liability of the PRF and will be paid to participants at a pre-determined time as per the takaful contract.

¹⁷ The SAC resolved that distribution of remunerations/surplus of PRF to takaful operator prior to full settlement of qard is permitted, in view of the ability to prevent manipulation in the distribution of remunerations/surplus to the takaful operator. This is due to clear distinction between the obligation of the PRF to distribute the remunerations/surplus to takaful operator and the obligation to repay qard, where the mechanisms of respective payments are subjected to different requirements as issued by the Bank. As such, the concern on takaful operator getting '*manfaah*' from the investment returns of the qard given to the PRF does not arise.

Remuneration via Fee on Tabarru'

12.10 Where takaful operators impose a fee on tabarru', the takaful operators shall ensure that the following requirements are observed:

- a) The fee shall be allocated to and maintained in the PRF until it can be distributed as income to takaful operators, subject to the PRF being in surplus position as described in paragraph 10.22(d) (i) to (iii). The distribution as income shall only take place when there is surplus in the PRF¹⁸;
- b) The amount to be distributed as income to takaful operator shall be subject to the Actuary's recommendation. The Actuary shall observe the requirement in paragraph 10.23 in recommending the distribution of the fee;
- c) Any undistributed fee in a particular year shall not be carried forward for distribution in a future year; and
- d) The distribution as income shall comply with the same requirements applicable to where takaful operator takes a performance fee out of surplus of the PRF, as described in paragraph 12.8. For purpose of meeting requirements in paragraph 12.8(b), the amount of fee to be distributed as income shall form part of the total amount of remuneration from PRF.

Remuneration from PIF

12.11 Takaful operators are also allowed to be remunerated from the investment profit of the PIF for the relevant non-investment-linked family takaful products. Takaful operators shall establish a policy on the appropriate method to be adopted in the determination of investment profit of PIF. The policy and manner in which the profit is calculated shall be documented and should be consistent across time horizon. Any changes made shall be justified and adequately documented.

¹⁸ Requirement in paragraph 12.10(a) does not apply to fees charged on tabarru' for unit-deducting riders (i.e. riders for which no explicit contributions has been paid or priced upfront), in consideration of work undertaken by the takaful operator which has not been factored into the determination of other fees.

- 12.12 In the distribution of PIF investment profit, takaful operators shall ensure that the following requirements are met:
- a) The amount of investment profit to be distributed is determined based on full audited result and upon completion of full valuation of PRF liabilities, as certified by the Appointed Actuary;
 - b) The amount of investment profit to be distributed must be recommended by the Appointed Actuary and endorsed by the Board;
 - c) The amount of investment profit to be distributed to the takaful operator shall be within the profit-sharing ratio stated in the takaful contract;
 - d) The distribution is reasonable and where relevant, does not affect the future ability of PIF to meet the tabarru' apportionment to PRF; and
 - e) Due consideration shall be given to participants' reasonable expectation when recommending the distribution of PIF investment profit.
- 12.13 For investment-linked takaful products, the remuneration shall be in the form of fund management fee based on the net asset value of the PIF subject to the prevailing limits specified by the Bank (refer to Guidelines on Investment-linked Insurance/ Takaful Business).

13. Payment and Charges on Surrender

- 13.1 Takaful operators shall ensure products are marketed to suitable customers, taking into account the customers' needs, resources and financial capabilities, in order to minimise occurrence of surrender of takaful certifications by participants. Surrenders, if not managed appropriately, may have adverse impact on the takaful funds and the remaining participants by creating a constraint on the size of the takaful funds, thus limiting the ability to benefit from cross subsidisation or earn

the investment returns anticipated during the product design stage. Whilst the requirements in paragraphs 13.2 - 13.6 shall be applicable for surrender of takaful certificates by participants in direct takaful business, retakaful operators are to be guided by the broad principles advocated by these paragraphs.

- 13.2 The surrender value basis shall be appropriate and fair, and embedded in the product design. Due to the nature of tabarru' contract (i.e. as unilateral donation contract), participants can agree to the events under which the PRF will pay out, which can include at the event of a surrender¹⁹. Generally, it will be fair, for example in the event where a tabarru' is taken upfront to provide for a long term cover, for the unexpired tabarru' to be returned to participants upon early surrender. To facilitate this, the events for which the tabarru' is meant to cover, should be defined appropriately in the certificate contract to include payments of specified amounts on surrender. Takaful operators are required to return the balance of PIF and accrued surplus in PRF, consistent with the ownership rights and entitlement of the participants, upon surrender of a certificate.
- 13.3 Takaful operators shall ensure that the amount payable to participants on surrender are made from the correct funds. For example, under the wakalah model, if the surrender amount is determined based on gross contribution, the amount shall be paid from both the takaful and the shareholder's funds. Paying the total amount only from the PRF will impair the value of the PRF unfairly, since wakalah fee was deducted upfront to the shareholder's fund based on the gross contribution.
- 13.4 Takaful operators are allowed to impose a reasonable amount of surrender charge to recoup the expected incurred expenses in managing the certificates, which have not yet been recouped by other

¹⁹ Refer footnote 5

charges levied up to the point of surrender. The surrender charge may also include administrative expenses incurred in processing the surrender. Any amount over and above the expected incurred expenses which is imposed to mitigate risks of surrender shall remain within the relevant fund such that it meets the aim of surrender risk mitigation. In addition, the surrender charge may only be imposed if it is clearly specified in the takaful contract and marketing literatures.

- 13.5 In general, the surrender value, including the cost of any applicable surrender charge, shall be determined:
- a) where relevant, in accordance with generally accepted actuarial principles;
 - b) in a manner ensuring fair treatment of participants; and
 - c) in compliance with standards on market conduct or fair treatment of participants issued by the Bank.
- 13.6 For family takaful and medical and health products, the basis in deriving the surrender amount and surrender charge must be clearly justified and documented in the Actuarial Certificate of the products submitted to the Bank. For other takaful products, the justification and documentation shall be maintained by the takaful operators and shall be made available upon request by the Bank.

14. Deficiency and Loss Rectification

- 14.1 Takaful operators are expected to exercise due care to avoid circumstances that could affect the viability of the takaful business, put the interests of the participants at stake or cause the takaful funds at risk of incurring a deficit or loss. Good risk management including effective management of surplus, appropriate retakaful arrangement and business practices are key in avoiding these negative circumstances.

Deficiency and Loss in PRF

14.2 Where assets of the PRF are insufficient to meet the liabilities of the PRF, takaful operators shall immediately rectify the deficit via qard from shareholders' fund. For the purpose of determining such deficit, takaful operators shall be guided by the following definitions:

- a) "Assets" refers to the total assets of the PRF, as reported in the balance sheet of the fund; and
- b) "Liabilities" refers to the sum of actuarial liabilities and other liabilities²⁰ of the PRF, as reported in the balance sheet of the fund.

The qard from shareholders' fund shall be repaid from the excess of assets over liabilities (as per the definition above) arising in the PRF in the future years.

14.3 Takaful operators must have in place, clear written policy on the mechanism to rectify deficit of the PRF approved by the Board. The policy should address the manner in which qard will be repaid. The repayment of qard must be appropriate to avoid circumstances that might impact participants beyond reasonable expectations and to prevent adverse implications on the takaful funds' ability to meet its obligation and the long term viability of the takaful funds. The policy must also address the issue of surplus distribution to participants during the period where qard has not been fully repaid by the PRF, for example, whether the distribution of surplus is continued, reduced, or put on hold. Where a takaful operator is remunerated from PRF, it shall also consider restriction as per paragraph 12.8(c) when establishing the policy on qard repayment.

14.4 Takaful operators shall specify the time period over which the qard shall be repaid. Beyond this period, the qard shall be deemed irrecoverable.

²⁰ The amount of 'other liabilities' shall exclude the amount of qard outstanding.

Takaful operators may also specify other circumstances under which the qard is not repayable. In determining the suitable time period over which the qard shall be repaid, takaful operators should take into account the likelihood of qard repayment over the foreseeable future, considering the expected future experience of the fund to generate surplus and potential adverse impact to the viability of the fund should the qard persists. Notwithstanding the above, the Bank may on a case-by-case basis, after taking into consideration the best interest of participants, long-term sustainability of takaful funds and the stability of the takaful business, direct the takaful operator to convert the qard into an outright transfer prior to the time period as specified by takaful operators.

- 14.5 The manner in which the takaful funds are managed must also be considered in coming up with the deficit rectification policy to ensure fairness to different groups of participants. Where a takaful operator manages the takaful funds into smaller sub-funds as mentioned in paragraph 9.5, the deficit shall be measured at the sub-funds level accordingly, to ensure and preserve equity amongst participants. Takaful operators shall ensure that the accounting and other relevant systems will enable tracking of the individual sub-funds to facilitate management of the deficit at the sub-funds level accordingly.
- 14.6 Where there is a loss arising in the PRF due to mismanagement or negligence, the takaful operators shall bear full responsibility and automatically rectify the deficit or loss via an outright transfer. For this purpose, takaful operators must have in place a written policy that identifies circumstances which tantamount to mismanagement or negligence. In cases where the Bank, based on its own assessment is satisfied that the deficit or loss in the PRF is due to mismanagement or negligence, the Bank may direct the takaful operators to rectify the deficit or loss via an outright transfer of assets from the shareholders' fund (instead of qard).

- 14.7 Where a deficit, or loss due to mismanagement or negligence of takaful operators, arises in the PRF, the takaful operators are required to explain and provide sufficient information to the Bank as to the reasons for the deficit or loss, remedial measures taken, the short and long term implications of the deficit or loss and the expected duration before the situation is rectified.

Deficiency and Loss in PIF

- 14.8 Takaful operators shall manage the investments of the PIF soundly and with due care to ensure sustainability of takaful contract to the end of its contractual term. Normal investment deficiencies and losses in the PIF shall be absorbed by the participants, particularly where the contract underlying the PIF is a mudharabah contract. Usage of qard to top-up investment deficiencies will effectively lead to the mudharib guaranteeing the mudharabah capital which may contradict Shariah principles underlying a mudharabah contract. As such, qard shall not be used to top-up investment deficiency in the PIF or to ensure PIF meet specified returns.
- 14.9 Negligence or mismanagement of the takaful operators leading to the deficiency or loss in PIF shall be made good via an outright transfer from the shareholders' fund. Examples of negligence and mismanagement include poor disclosure of the risks to be borne by the participants, improper or non-compliance of investment strategy execution against approved policies, misalignment of investment policies with representations made to participants, improper illustration of benefits or expected returns including the use of unsupportable illustration rates, and failure to put in place adequate infrastructure leading to ineffective credit control function.

15. Disclosure and Transparency

- 15.1 Takaful operators shall be transparent in undertaking activities as part of good governance and to promote better understanding of takaful. Takaful operators are expected to publish details of its operational model together with its underlying Shariah principles, to enable participants, stakeholders and public to better understand the underlying takaful operations. Information provided should be accurate, adequate and up-to-date to enable stakeholders to make an assessment on the takaful operators' financial standing.
- 15.2 Information disclosed must be made apparent to the participants in documents used at the pre contractual stage, upon signing the contract and throughout the duration of the contract. The level of information disclosed, in particular with respect to the operational model, the underlying Shariah principles, and the relevant terms and conditions of the takaful contract shall be appropriate to enable participants to clearly understand their rights, obligations and the risks associated with the product. For products with savings or investment elements, where participants bear the investment risks, information disclosed should be sufficient to enable understanding of market movements and its implications on the takaful funds, including potential shortfall of the PIF and possibility of certificate lapsation.
- 15.3 Takaful operators must ensure consistency in information being disclosed in the different documents. The information given to participants shall be consistent with the information provided to the Bank via the product submission process. To further promote transparency, takaful operators should publish on their website, details of products, fees and charges.
- 15.4 Where takaful operator makes modifications or changes to its operational model or to the terms and conditions of the products,

participants should be sufficiently informed of the changes and the impact of the changes. If the impact of the changes is material and financially significant, such disclosure should be sufficiently detailed to be reasonably understood by the participants. In any event, any modification or changes to the terms and conditions of takaful products shall be within the scope of the takaful contract.

16. Document Evidencing Title to Assets of Takaful Fund

- 16.1 Each takaful operator shall secure any documents evidencing the operator's title to assets of the takaful fund or any retakaful operator's deposit held by the takaful operator to meet liabilities of a takaful fund.
- 16.2 The documents shall be kept in Malaysia in the custody of the takaful operator, a licensed Islamic bank or a licensed bank and, where for any special reason a document is kept in the custody of any other person on its behalf, the takaful operator shall notify the Bank in writing of that person and the reasons for his custody and of any change in that custody and the reason for it.
- 16.3 Notwithstanding paragraph 16.2, the documents:
- a) may be kept outside Malaysia in the custody of a person at such place subject to such terms as may be approved by the Bank; or
 - b) may be kept in the custody of the takaful operator or a bank, in the country where the takaful operator is carrying on business to the extent the assets relate to its business in that country. The takaful operator shall notify the Bank in writing of the custodian of its documents and the Bank may require the takaful operator to produce a certificate from the custodian or its auditor verifying the existence of the documents.

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Appendix 1 – Minimum Information for Documenting Operational Model

1. Contract underlying relationship between participants and takaful operator.
2. Contract underlying relationship between participants.
3. Fund segregation policy, with details of sub-fund if applicable.
4. Policy on investment strategy and method used for the calculation of investment profit for PIF.
5. Policy on recognition of surplus/deficit and its allocation/ distribution.
6. Policy on deficit rectification mechanism including the repayment of qard.
7. Remunerations to takaful operator policy and relevant Shariah principle/contract underlying the remunerations.
8. Any other relevant information which is necessary for holistic understanding of takaful operator's operational model.

Appendix 2 – Implementation of Specific Requirements Updated on 26 June 2013

1. The following requirements shall take effect on 26 June 2013.
 - (a) paragraph 9.1A;
 - (b) paragraphs 9.8 to 9.13;
 - (c) paragraph 10.5A;
 - (d) deletion of subparagraph 12.8(c); and
 - (e) paragraphs 16.1 to 16.3.