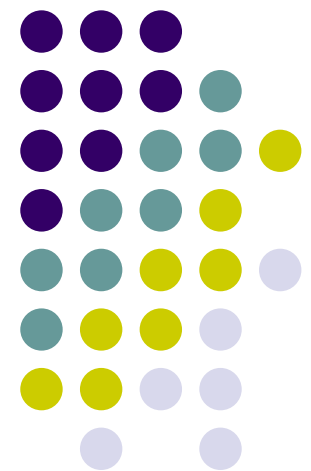


# REGULATORY ISSUES IN ISLAMIC INSURANCE/ *TAKĀFUL*



SECP *Takāful* Conference  
Karachi, Pakistan  
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# OUTLINES



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## Regulatory Issues in *Takāful*

- Mandate of the IFSB
- Joint Working Group with the International Association of Insurance Supervisors (**IAIS**)
- Findings from the IFSB-IAIS Issues Paper - August 2006

## Update on the IFSB

- Latest membership counts
- Standards issued and/or in progress
- First prudential standard for *takāful* industry: Governance of *Takāful* Operators

# MANDATE OF THE IFSB



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The IFSB is an **international standard-setting body** of the regulatory and supervisory agencies that have vested interest in ensuring the **soundness and stability** of the Islamic financial services industry, which is defined broadly to include **banking, capital market and insurance.**

# THE IFSB-IAIS JOINT WORKING GROUP



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- The IFSB and the Insurance Commission of Jordan co-organized an inaugural Seminar on the Regulation of *Takāful* on 10-11 January 2005 at the Dead Sea, Jordan.
- The Seminar adopted the following recommendations:
  - The IFSB to play an active and complementary role to that of the IAIS by issuing prudential and supervisory standards for *takāful* that would safeguard the interests of the consumers and the soundness and the stability of the financial system as a whole;
  - Priority in the IFSB work plan for *takāful* should be given to specific and immediate regulatory issues that require, as far as reasonably possible, harmonization across the *takāful* industry; and
  - To this end, the IFSB is encouraged, as an initial step, to establish a joint working group with the IAIS to produce an issues paper on the applicability of the existing IAIS core principles to the regulatory and supervisory standards for *takāful* to be developed by the IFSB.
- Following the above recommendations, the IFSB-IAIS Joint Working Group was established and met in Jordan on 10 May and 13 September 2005.

# FINDINGS FROM THE IFSB-IAIS JOINT ISSUES PAPER



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- There is no international regulatory standards for *takāful* at the moment, resulting in either full or partial adoption of the IAIS Core Principles (ICP) for regulating *takāful* operators.
- ICP generally useful and applicable to *takāful* due to some similarities shared with insurance, but ICP has not taken into account the specificities of *takāful*.
- Hence, there is a need for standardization of international regulatory framework for *takāful*, in order to:
  - provide benchmarks for use by *takāful* supervisors in all jurisdictions adapting and improving existing regulatory regimes or, where necessary, establishing new ones;
  - address regulatory issues, such as risk management and financial stability, for the *takāful* industry;
  - provide appropriate levels of consumer protection in terms of both risk and disclosure; and
  - support the orderly development of the *takāful* industry in terms of acceptable business and operational models, design and marketing of *takāful* products.

## ICPs which apply as they stand

- ICP 2: Supervisory Objectives
- ICP 4: Supervisory Process
- ICP 5: Supervisory Cooperation and Information Sharing
- ICP 8: Changes in Control and Portfolio Transfers
- ICP 11: Market Analysis
- ICP 12: Reporting to Supervisors and off-site Monitoring
- ICP 13: On-site Inspection
- ICP 14: Preventive and Corrective Measures
- ICP 15: Enforcement or Sanctions
- ICP 17: Group-wide Supervision
- ICP 18: Risk Assessment and Management
- ICP 20: Liabilities
- ICP 27: Fraud
- ICP 28: Anti- money Laundering, Combating the Financing of Terrorism (AML/CFT)



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## Areas for Consideration

- **ICP 9: Corporate Governance**

The corporate governance framework recognises and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.

- What rules should apply to the *Sharī'ah* board?
- How does it relate to other governance structures?
- Do members have conflicts that need to be managed?
- Should contributors' interests be represented, and how?

- **ICP 7: Suitability of Persons**

The significant owners, board members, senior management, auditors, and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.

- How far is this requirement applicable to the *Sharī'ah* Board?



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## Areas for Consideration (2)

- **ICP 10: Internal Control**

The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.

- What about *Sharī'ah* controls, audit/review process, etc?

- **ICP 19: Insurance Activity**

Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks they underwrite, in particular through reinsurance, and to have the tools to establish adequate levels of premiums.

- Do we have adequate *Sharī'ah*-compliant risk management tools?
- Who monitors the charges and expenses charged against the *takāful* fund?



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## Areas for Consideration (3)

- **ICP 6: Licensing**

An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.

- How far is this clear for *takāful* operators?

- **ICP 16: Winding up and Exit from the Market**

The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.

- How does the insolvency regime cope with a *takāful* structure?



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## Areas for Consideration (4)

- **ICP 3: Supervisory Authority**

The supervisory authority: has adequate powers, legal protection and financial resources to exercise its functions and powers; is operationally independent and accountable in the exercise of its functions and powers; hires, trains and maintains sufficient staff with high professional standards; and treats confidential information appropriately.

- What is the role of the supervisor with regard to *Sharī'ah*?
- Does it need additional capabilities?

- **ICP 21: Investments**

The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching and risk management.

- What is the role of the *Sharī'ah* Board?
- Screening of *Sharī'ah*-compliant assets.
- What effect does the different asset profile have on risk?
- Conflicts between contributors' and shareholders' interests.
- Derivatives (ICP 22).



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## Areas for Consideration (5)

- **ICP 23: Capital Adequacy and Solvency**

The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.

- Relationship between shareholders and contributors
- Will qard (loan) be given when needed?
- A different asset profile
- Admissibility or risk weighting
- What about reinsurance assets?
- Solvency control levels

**CAN ONLY BE ADDRESSED IF THE  
GOVERNANCE ISSUES ARE FULLY  
IDENTIFIED AND TACKLED**

## Areas for Consideration (6)



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### **ICP 24: Intermediaries**

The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.

### **ICP25: Consumer Protection**

The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been fulfilled.

### **ICP 26: Information, Disclosure and Transparency towards the Market**

The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.

# THE IFSB LATEST MEMBERSHIP COUNTS



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As of February 2007,

- 110 members comprising:
  - 27 regulatory and supervisory authorities, including the State Bank of Pakistan;
  - 5 international intergovernmental organizations, including the World Bank, the IMF, the ADB, the IDB and the BIS; and
  - 78 market playersfrom 21 countries.

Note: Despite the strong international support it has been enjoying, surprisingly the IFSB does not have a single member from amongst the Pakistan market player yet.

# STANDARDS ISSUED AND/OR IN-PROGRESS



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## Issued

- Guiding Principles on Risk Management for Institutions offering Islamic Financial Services (**IIFS**)
- Capital Adequacy Standard for IIFS
- Guiding Principles on Corporate Governance for IIFS

## Exposure Drafts

- Guidance on Key Elements for Supervisory Review Process for IIFS
- Disclosure to promote Transparency and Market Discipline for IIFS

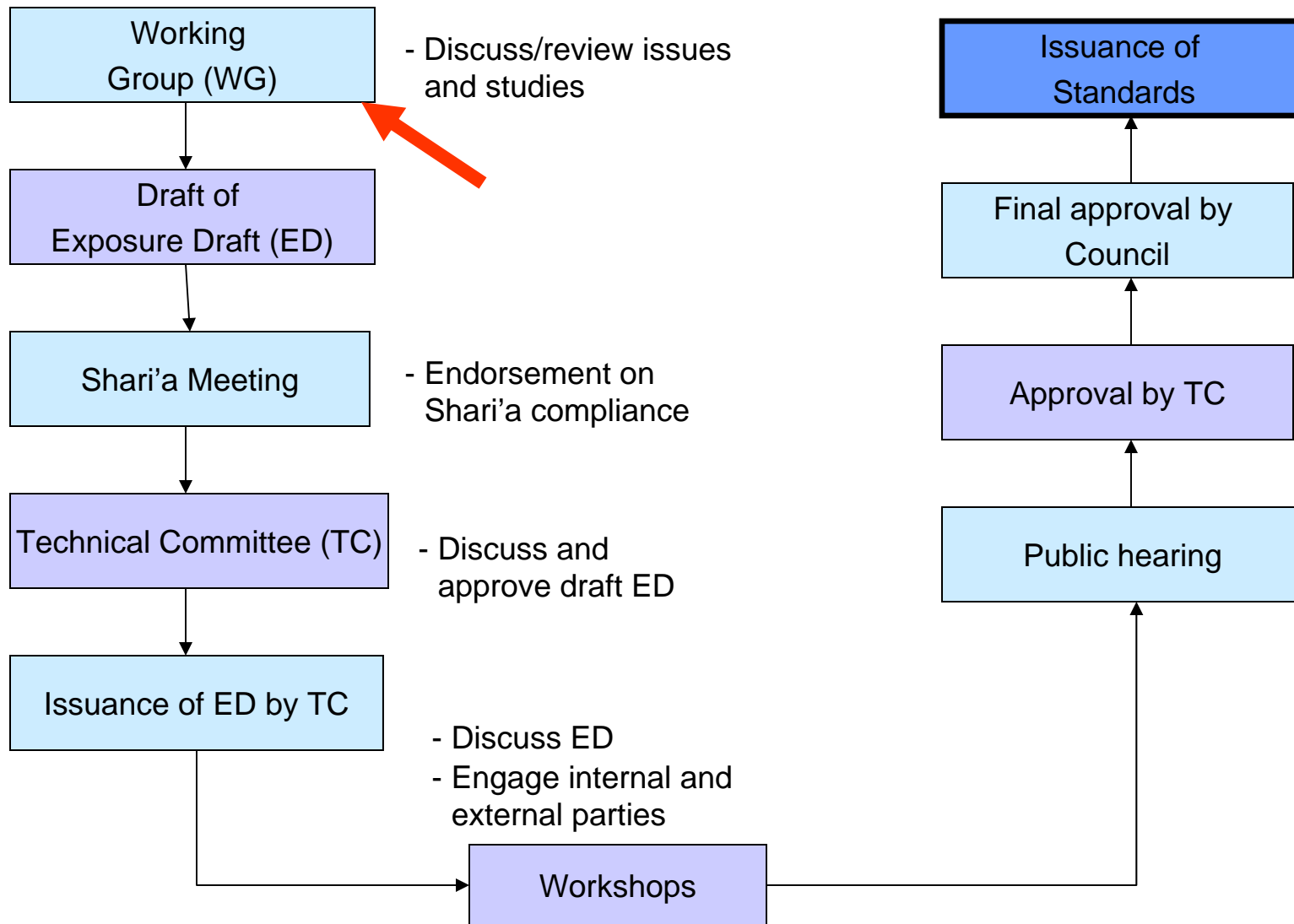
## In-Progress

- Special Issues on Capital Adequacy Standard
- Guiding Principles on Governance for Islamic Collective Investment Schemes (ICIS)
- Guiding Principles on Governance for *Takāful* Operators

# STANDARD ON GOVERNANCE OF *TAKĀFUL*



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THANK YOU FOR LISTENING



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