



ISLAMIC FINANCIAL SERVICES BOARD

KEY ELEMENTS IN THE SUPERVISORY REVIEW PROCESS OF *TAKĀFUL/RETAKĀFUL* UNDERTAKINGS [IFSB-20]

SUMMARY OF COMMENTS RECEIVED DURING PUBLIC CONSULTATION AND THE IFSB SECRETARIAT RESPONSES*

Release Date of Comments	:	December 2018
Public Consultation Period	:	28 March 2018 to 28 May 2018
Release Date of IFSB-20	:	December 2018
Web URL of IFSB-20	:	https://www.ifsb.org/download.php?id=4967&lang=English&pg=/index.php

*The summary compiles the gist of all the written and oral comments received during the public consultation period, which involved a public hearing and a webinar.

BACKGROUND

1. On 6 December 2018, the Council of the IFSB, in its 33rd Meeting, resolved to approve the issuance of the Key Elements in the Supervisory Review Process of *Takāful/Retakāful* Undertakings (IFSB-20).

2. IFSB-20 is intended to guide the supervision of *Takāful / Retakāful* Undertakings (TUs/RTUs). It aims to support the implementation of common approaches to the supervision of the *takāful* and *retakāful* industry, while addressing the specificities of these institutions. This is to protect the interests of the contracting parties in the TUs/RTUs and the long-term stability of the *takāful* system. IFSB-20 describes key elements of the supervisory review process (SRP) for TUs/RTUs in an integrated form.

3. Prior to the issuance of the IFSB-20, the IFSB issued the corresponding Exposure Draft (ED-20) for public consultation from 28 March to 28 May 2019. The IFSB is now publishing the summary of the feedback received during the public consultation period, along with responses by the Secretariat. The feedback received comprised not only written feedback but also verbal comments shared during a Public Hearing and a Webinar on ED-20 held on 10 April and 7 May 2018, respectively.

4. The IFSB received a total of 59 comments on ED-20 during the Public Consultation. This document is released as a summary of the main feedback to ED-20 received during the Public Consultation process, along with the key actions undertaken by the Working Group which prepared the Standard.

COMMENTS ON ED-20*

No.	Name of Institution/Body/Individual**	Membership Type
1.	Bank Negara Malaysia	Full Member
2.	Financial Services Commission – via Bank of Mauritius	Full Member
3.	Central Bank of Djibouti	Full Member
4.	Central Bank of Kuwait	Full Member
5.	Central Bank of the Republic of Turkey	Full Member
6.	Dubai Financial Services Authority (DFSA)	Full Member
7.	Saudi Arabian Monetary Authority	Full Member
8.	International Monetary Fund	Associate Member
9.	Bangko Sentral ng Pilipinas	Associate Member
10.	Bank of Korea	Associate Member
11.	Securities & Commodities Authority – UAE	Associate Member
12.	Labuan Financial Services Authority	Associate Member
13.	Malaysia Deposit Insurance Corporation	Associate Member
14.	Qatar Financial Centre Regulatory Authority	Associate Member
15.	CIMB Islamic Bank Berhad	Observer Member
16.	Masraf Al Rayan - Qatar	Observer Member
17.	RHB Islamic Bank Berhad	Observer Member
18.	S&P Global	Observer Member
19.	The Hong Kong Association of Banks	Observer Member
20.	Actuarial Partners Consulting Sdn Bhd	Non-Member
21.	Malath Cooperative Insurance Co - KSA	Non-Member
22.	Metlife AIG ANB Cooperative Insurance - KSA	Non-Member

**The IFSB conducted public hearings for ED-20 on 10th April 2018 in Jakarta, Indonesia and then on 7th May 2018. The latter was broadcasted globally via Webinar from the IFSB HQ in Kuala Lumpur, Malaysia. The feedback from these events is included in this report.*

***Arranged in alphabetical order as per Membership Type, except international organisations, which are listed first.*

Summary of Main Comments and the IFSB's Responses

General Comments			
No	Theme	Issues / Comments	IFSB's Responses
1.	The scope of coverage	To specify guidance on the supervisory approaches to review suitability of products offered to customers.	<p>The Standard mentions in section 4.2 Conduct of Business, Paragraph 139 that “This standard does not deal in detail with the supervisory review process for conduct of business, since the responsibilities of Regulatory and Supervisory Authorities (RSAs) in this area vary widely and the IFSB has not to date covered the substantive regulation of conduct of business in its standards relating to <i>takāful/retakāful</i>”.</p> <p>However, the forthcoming IFSB Working Paper on consumer protection in the <i>takāful</i> sector may lay the ground for future standards work in this area. Since supervisory review approaches depend on the underlying substantive provisions, until such work is complete, it may be too</p>

			<p>early to specify supervisory approaches.</p> <p>The IFSB is also beginning work on a standard on transparency and disclosure in <i>takāful</i>; this will be relevant to consumer protection, though not necessarily directly relevant to suitability of products offered to customers.</p>
<p>2.</p>	<p>The scope of coverage</p>	<p>In general the paper focuses on the supervisory angle toward the <i>takāful</i> and <i>retakāful</i> companies. However from a distributor perspective, here are some of the pointers that we wish to share toward having better supervisory of the <i>takāful</i> business/industry as a whole:</p> <p>1. Product Offer (Mostly inferior compared to conventional life), making the <i>Takāful</i> product less competitive especially to high end segment of customer.</p> <p>The supervisor should also consider off-site/on-site inspection of the type of products offered by the <i>takāful</i> company vs the conventional life Company.</p>	<p>See the response to Comment 1 above.</p> <p>In addition, on point 1, product development is not the responsibility of the supervisor, but of the commercial companies involved. Point 3 also seems to be focused on product quality, reflecting the same misapprehension about the role of an RSA, and points 4 and 5 also seem to be predominantly about the commercial products offered. This appears to be the kind of issue that the commentator, as a powerful commercial company, could negotiate directly with the</p>

		<p>2. Mystery shopping The Supervisor should set a requirement on the to <i>takāful</i> company to conduct more frequent on-site inspection (Mystery Shopping) on their agent to measure whether the values of <i>takāful</i> are being properly shared to customers or otherwise. Agents normally start with a conventional life product and when there is a need of <i>takāful</i> they will promote <i>takāful</i>.</p> <p>3. Company with composite licence Our view is that the Supervisor should conduct a more thorough inspection and review toward this kind of company. This is due to: 1) Less urgency to develop a competitive <i>takāful</i> product as the same solution to customer can be covered by conventional life products. 2) Less support from trainers and business development managers for <i>takāful</i> products because their responsibilities are normally based on a combination of conventional life and family <i>takāful</i>.</p> <p>4. Shared Service Function in the <i>Takāful</i> Company Since the many services are being shared for both <i>takāful</i> and conventional, we tend to see the <i>takāful</i> product being a "copy-cat" of the conventional version instead of coming out with a fresh product idea.</p>	<p>TUs whose products it distributes. This is also the case with Point 2; though company supervision of intermediaries is a valid supervisory concern, substantive requirements in this area would not be set out in a standard on supervisory review. The substantive requirements sought are again expectations that could be negotiated between the TU and distributor.</p>
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		<p>5. Services offered to the distributor</p> <p>Supervisors should set certain parameters to be observed on the services provided by the <i>takāful</i> Company to their Corporate Agent. The Supervisor should interview the <i>takāful</i> Company's corporate agent on the services provided.</p>	
3.	To discuss Captives	Topic areas which could benefit from further guidance, such as supervisory approach for captives.	In response to this comment the Standard now contains further material on captives, in Paragraph 28.
Section 1: Introduction			
No	Theme	Issues / Comments	IFSB's Responses
4.	Relationship to other Standards	Does ED-20 (IFSB-20) supersede or supplement the previously issued IFSB standards, namely IFSB-5 - Guidance on Key Elements in the Supervisory Review Process of Institutions offering Islamic Financial Services (excluding Islamic Insurance <i>Takāful</i> Institutions and Islamic Mutual Funds) and IFSB-16 - Revised Guidance on Key Elements In The Supervisory Review Process of Institutions Offering Islamic Financial Services (excluding Islamic Insurance <i>Takāful</i>	IFSB-20 is different in its sectoral coverage from IFSB-5 and IFSB-16, neither of which applies to <i>takāful</i> .

		Institutions and Islamic Collective Investment Schemes)?	
5.	Scope and Application	It is suggested to consider covering guidelines on framework for systemic consideration of <i>takāful/retakāful</i> industry, as may be applicable.	The impact of a TU/RTU's failure on the wider market is touched upon in Paragraphs 17 and 24. However there is doubt whether <i>takāful</i> is systemically significant and if so whether any specificities require separate attention.
6.	Takāful Operator's model	We feel the document should be made more clear that when there are practical differences in the <i>Takāful</i> Operator's model which reduces risks to the operator, the RSA should account for this in its various supervisory actions to the operator. To be more precise, where the <i>takāful</i> model being used has a lower level of risks, for instance if the level of benefits to the participant is not guaranteed but rather depends on the experience of the fund, then the capital requirements should be lower which will benefit participants. By fairly incorporating differences by model the regulator can encourage such innovative structures. This will allow for innovation in <i>takāful</i> and bring benefits to the participants, a prime goal of this ED. Of course with any model sufficient corporate governance,	There do exist, in some countries, entities whose contractual obligation to pay claims is limited to the funds that they have, so that claims are reduced if the funds are not there. There are also mutual entities operating in the marine insurance market that can call on participants for more funds if claims are higher than expected. However in the first case there is usually a statutory limitation on the types of business and benefits that may be offered, and in the second case the participants are highly sophisticated. The presumption in the Standard is that participants

		<p>Sharī'ah governance and other aspects as detailed in ED20 will be required.</p>	<p>and beneficiaries of the contract depend upon the contract in effect transferring risk. Its provisions relating to proportionality and the risk-based approach allow for flexibility of the SRP. More generally, modification of substantive requirements for undertakings whose contracts reserve risk to the participants in this way would be a matter for the substantive standards rather than for this Standard on SRP.</p>
7.	<p>Outsourcing</p>	<p>In this new world order many aspects of operations can be outsourced, whether it is systems, distribution costs, human capital or the model itself such as the removal of guarantees in the benefit payouts. This is the essence of a discretionary mutual, one future direction for <i>takāful</i>. For ED20 (IFSB-20) to help the RSA remain relevant as conditions develop it will need to encourage the RSA to understand differences in differing models and account for them fairly in capital and other requirements.</p>	<p>Proportionality is a feature of IFSB-20, and the risk-based approach is intended to allow for just these sorts of developments.</p> <p>The respondent appears principally to refer to substantive requirements rather than the supervisory review process which is the subject of this Standard.</p>
<p>Section 2: Supervisory Approaches For Effective Supervision Of Takāful/Retakāful</p>			

No	Theme	Issues / Comments	IFSB's Responses
8.	Outsourcing	It should be made clear that outsourced activities or services should be drawn up and managed in such a way that the supervisor's ability to conduct its supervisory activities is not impeded.	Additional text was added at the end of Paragraph 68 as follows: "... For functions that are outsourced, the RSA should satisfy itself that the TO/RTO retains responsibility for these functions, and that the RSA's ability to conduct its supervisory activities is not impeded by the arrangements."
9.	Off-site Monitoring	<p>In Section 2.2, RSAs could benefit from further guidance on how they could analyse "various risks relevant to the TU/RTU, such as credit, market, underwriting, reserving, liquidity, operational, conduct of business, Sharī'ah non-compliance, legal, strategic and reputational risks."</p> <p>Actuarial review could also include a review of the TU/RTU's capital adequacy calculations and results and amortisation policy with respect to earned premiums and deferral of expenses.</p>	<p>Section 2.2 deals with the architecture of the SRP rather than giving specific guidance on risks, which is provided later in the Standard. In addition, IFSB-20 focuses in particular on the aspects of supervision that are specific to <i>takāful</i>, and therefore does not duplicate all the material on the supervisory process to be found in conventional standards, particularly the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors.</p> <p>However, Paragraph 36 has been inserted to provide further</p>

			information regarding to off-site monitoring activities.
10.	On-site Inspection	To include assessment on the corporate culture of TU and RTU).	<p>Paragraph 22 states that the supervisor needs to evaluate, among other things, the corporate culture and the effectiveness of the TO/RTO's corporate governance and risk management.</p> <p>Further guidance has now been included in Paragraph 43, referring to 'assessment of the culture of the organisation, through observation and interview, and examining internal communications and incentive arrangements;'</p>
11.	On-site Inspection	To include on-site inspection on market conduct issues.	See the response to Comment 1 above.
12.	On-site Inspection	Perhaps this section can include guidance on how a RSA could determine the frequency and scope of on-site inspections.	Paragraph 12 states that "The standard should be applied with due consideration to "proportionality", taking account of the size, nature and complexity of each institution and the characteristics of the environment

			<p>in which it operates, as these will differ from institution to institution and from jurisdiction to jurisdiction.” Paragraph 39 also says that “...on-site inspection is usually customised to the particular TUs/RTUs, taking into consideration the nature, scale and complexity of the TUs/RTUs ...” In addition, Paragraph 24 mentions that lower-risk undertakings may be visited less frequently, and Paragraph 43 that not all areas may be looked at every time.</p> <p>The actual frequency of inspections will be a function of several components, including the profile of the industry and the supervisory resources available. The Standard cannot provide quantitative guidance under those circumstances.</p>
13.	On-site Inspection	<p>The process in relation to regulatory on-site inspections broadly looks fine. However, it would be useful if the regulator also issues a formal written report to the company following an on-site inspection, even if there are no significant findings. A number of companies in different</p>	<p>Some form of formal communication can be very useful to the firm and the supervisor. However, some RSAs may have limited flexibility in official communication. In view of this</p>

		markets indicate that they tend to spend a lot of time with the regulator during on-site visits, but we understand that they often do not get any form of feedback after the review has been completed.	Paragraph 46 now says that: 'It is desirable for a summary of findings of the supervisory review to be provided to the Board of Directors (BOD) of the TO/RTO.'
14.	Thematic Review	The thematic review concept effectively covers the macro-prudential or macro-economic perspective and impact of the <i>takāful/retakāful</i> industry. We suggest to refer to and consider relevant standards and guidelines issued by the International Association of Insurance Supervisors (IAIS) to have an appropriate perception on this section, including clarity on the expectation from the RSA.	<p>The IAIS does not mention the thematic review concept in any core principles, except in 18.2.5 "Off-site monitoring may include supervisory reporting, analysis of complaints, thematic reviews and other forms of information ...", without further elaboration.</p> <p>Thematic review is not the same as macroprudential surveillance, which is covered in ICP 24; on this subject see the response to Comment 5 above.</p>
15.	On-site Inspection	In some jurisdictions, on-site inspection is delegated to independent experts. In such cases, RSA should ensure effective oversight over the work performed, especially in ensuring that the risk assessment is forward looking having regard to the protection of policyholders, independence from the TO/RTO and its external auditor,	In Paragraph 40 it is stated "The RSA needs to establish priorities for the areas to be inspected, define the nature and scope of inspection, and identify individuals with the right expertise to perform the inspection." This may be felt to imply the possible use of third

		maintain confidentiality and the RSA retains the ability to take legal action.	parties. However, in response to the comment, the use of third parties is now dealt with explicitly in Paragraph 45.
Section 3: Key Elements In The Supervisory Review Process Of Takāful/Retakāful Undertakings			
No	Theme	Issues / Comments	IFSB's Responses
16.	Corporate Governance	Engagement with board members is one of the ways to assess board members' oversight function. It is suggested to include engagement with Board members.	Paragraph 43 refers to 'evaluation of the BOD' which implies engagement. However explicit reference to 'interviewing members of the BOD;' has now been made in Paragraph 66.
17.	Sharī'ah Governance	Engagement with Sharī'ah board members may assist supervisors to assess that complete, adequate and timely information is provided to Sharī'ah members for purpose of Sharī'ah deliberation.it is suggested to include engagement with Sharī'ah board members.	The words "and/or by interviewing Sharī'ah board members" have been added at the end of the penultimate sentence of Paragraph 73.
18.	Determination of Capital Requirements	When assessing the resolvability of the TU/RTU, how should the RSA consider the potential impact of the resiliency of guaranteed funds?	The concept of guaranteed funds is potentially problematic in <i>takāful</i> , as guarantees are a characteristic

			<p>of conventional rather than Islamic insurance operations.</p> <p>Furthermore, the work done so far on issues of resolution of <i>takāful</i> operations, for example in IFSB WP-07, is limited by the dearth of experience of <i>takāful</i> resolution in practice. However, if national law provides for guarantee in substance, RSAs are entitled to take these into account under the principle of proportionality set out in Paragraph 12.</p>
19.	Own Risk and Solvency Assessment (ORSA)	The section on ORSA effectively relates to the ICAAP regulations and standards for the banking industry, hence, we suggest to include, as well, relevant guidelines and standards covering the recovery planning framework of <i>Takāful</i> Operator/Re- <i>Takāful</i> Operator (TO/RTO).	<p>The underlying principles concerned are applicable to both banking and insurance sectors as indicated by references to ORSA in ICPs, and recovery planning in ICP 25.</p> <p>Recovery and resolution planning generally, as a substantive matter, is outside the scope of the Standard, but a reference to recovery and resolution planning has been inserted in Paragraph 22.</p>
20.			

	<p>Own Risk and Solvency Assessment</p>	<p>The section on ORSA provides limited guidelines on the use of stress testing as part of the Own Risk and Solvency Assessment performed by the TO/RTO. We suggest to include guidelines covering governance aspect of stress testing, adoption of appropriate methodology/ies and the practical consideration of how TO/RTO will utilize the result of stress testing in capital planning and decision making process.</p>	<p>IFSB-20 sets out principles highlighting the areas that RSAs need to consider in their supervision, rather than substantive requirements for TOs/RTOs. Substantive aspects of stress testing are discussed at IFSB-14 Paragraph 93.</p>
<p>21.</p>	<p>Own Risk and Solvency Assessment</p>	<p>Companies that have to produce an ORSA report should also conduct some stress testing. Since not every company may be required to produce an ORSA report, it would be useful if regulators organize market-wide stress tests on a periodic basis, to simulate common stress scenarios and to assess the impact of these scenarios on the capital adequacy of the industry.</p>	<p>The expectation of IFSB-14 would be that every TO/RTO would perform an ORSA.</p> <p>Macro-prudential regulation is outside the scope of the Standard and would need to be considered for future work, while stress tests, in general <i>takāful</i> at least, need to have an idiosyncratic element based on the TU/RTU's actual portfolio. (For example, the kind of scenario that would cause material stress to a health insurer would be different from the scenario that would stress a property insurer).</p>

Section 4: Additional Specific Issues To Be Addressed Under The Supervisory Review Process Of <i>Takāful/Retakāful</i> Undertakings			
No	Theme	Issues / Comments	IFSB's Responses
22.	To extend the scope and coverage	Supervision related to <i>takāful</i> intermediaries may also be included under the additional specific issues.	Supervision of <i>takāful</i> intermediaries is not within the scope of the Standard, though future work may be conducted in due course on the topic of intermediaries in the <i>takāful</i> sector.
23.	Conduct of Business	Assessing fair treatment of customers may not be appropriate for a prudential regulator where a separate market conduct regulator exists in the country.	Paragraph 139 makes clear that the responsibilities of RSAs for conduct regulation vary widely, and the parts of the Standard dealing with this in general apply only where the RSA does have this responsibility. However, a prudential supervisor may still consider conduct risk as a potential threat to safety and stability. See also the response to Comment 1.
24.	Run-off	Perhaps there could be some guidance on how a RSA should deal with situations where	Reviving a run-off is an unusual situation, and for this reason is not

		shareholders of a TO/RTO wish to sell the TU/RTU and, in doing so, restructures the TU/RTU and temporarily puts it in run-off.	specifically covered in the IFSB-20. Considerations where a TO proposes to bring the undertaking out of run-off are similar in many respects to the considerations one would apply when an undertaking seeks authorisation.
25.	Run-off	A run-off plan should also cover the TU/TRU's reinsurance, <i>retakāful</i> , and/or retrocession arrangements and the impact of these on the financials, including capital adequacy calculations.	Points a) and d) of Paragraph 147, and Paragraph 149, might be felt to imply coverage of these matters. However for clarity a new sub-paragraph has been inserted into Paragraph 147 indicating that a run-off plan should cover: 'the impact on existing and future <i>retakāful</i> /reinsurance arrangements;'