



ISLAMIC FINANCIAL SERVICES BOARD

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## EXPOSURE DRAFT (ED-29)

# CONDUCT OF BUSINESS SUPERVISION IN TAKĀFUL UNDERTAKINGS

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29 March 2023

*Comments on this Exposure Draft should be sent to the IFSB Secretariat no later than  
28 May 2023 by email to: [public\\_consultation@ifsb.org](mailto:public_consultation@ifsb.org)*

## **ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)**

The IFSB is an international standard-setting organisation which was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. The organisation promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include the banking, capital markets, and insurance sectors. The standards prepared by the IFSB follow a stringent due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which includes holding several Working Group meetings, issuing exposure drafts, and organising public hearings/webinars and reviews by the IFSB's Sharī'ah Board and Technical Committee. The IFSB also conducts research and coordinates initiatives on industry-related issues and organises roundtables, seminars, and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional, and national organisations, research/educational institutions, and market players.

For more information about the IFSB, please visit [www.ifsb.org](http://www.ifsb.org)

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## ABBREVIATIONS

<b>AAOIFI</b>	Accounting and Auditing Organization for Islamic Financial Institutions
<b>AI</b>	Artificial Intelligence
<b>BOD</b>	Board of Directors
<b>CBST</b>	Conduct of Business Supervision in <i>Takāful</i> Undertaking
<b>COB</b>	Conduct of Business
<b>CPIFR</b>	Core Principles for Islamic Finance Regulation
<b>DFE</b>	Digital Financial Education
<b>ED</b>	Exposure Draft
<b>EIOPA</b>	European Insurance and Occupational Pensions Authority
<b>IAIS</b>	International Association of Insurance Supervisors
<b>IFSB</b>	Islamic Financial Services Board
<b>PIF</b>	Participant Investment Fund
<b>PRF</b>	Participant's Risk Fund
<b>RSAs</b>	Regulatory and Supervisory Authorities
<b>TCP</b>	<i>Takāful</i> Core Principle
<b>TO</b>	<i>Takāful</i> Operator
<b>TU</b>	<i>Takāful</i> Undertakings
<b>WP</b>	Working Paper

## SECTION 1: INTRODUCTION

### 1.1 Background

1. The Islamic Financial Services Board (IFSB), in line with its mandate to promote the development of a prudent and transparent Islamic financial services industry through creating or adapting international standards consistent with Sharī'ah rules and principles, works closely to complement the prudential and supervisory standards issued by the International Association of Insurance Supervisors (IAIS), while addressing the specificities of *takāful* to contribute to the soundness and stability of the Islamic financial system, particularly the *takāful* industry.

2. In its published paper on “Issues in Regulation and Supervision of *Takāful* (Islamic Insurance)” in August 2006, the IFSB and IAIS identified four major themes for the IFSB to focus on with regards to regulation of *takāful*: (i) corporate governance, (ii) financial and prudential regulation, (iii) transparency, reporting and market conduct, and (iv) supervisory review process.

3. Based on these themes, the IFSB issued six standards pertaining to the *takāful/retakāful* sector: IFSB-8: *Guiding Principles on Governance for Takāful (Islamic Insurance) Undertakings (December 2009)*; IFSB-11: *Standard on Solvency Requirements for Takāful (Islamic Insurance) Undertakings (December 2010)*; IFSB-14: *Standard on Risk Management for Takāful (Islamic Insurance) Undertakings (December 2013)*; IFSB-18: *Guiding Principles for Retakāful (Islamic Reinsurance) (April 2016)*; IFSB-20: *Key Elements in the Supervisory Review Process of Takāful / Retakāful Undertakings (December 2018)*, and IFSB-25: *Disclosures to Promote Transparency and Market Discipline for Takāful/Retakāful Undertakings (December 2020)*.

4. Two IFSB standards that apply to Islamic financial institutions generally, including *takāful* institutions, are IFSB-10: *Guiding Principles on Sharī'ah Governance Systems for Institutions Offering Islamic Financial Services (December 2009)* and IFSB-9: *Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial Services (December 2009)*.

5. The Working Paper WP-09: *Consumer Protection in Takāful* examines regulatory and market practices relating to consumer protection in the *takāful* sector. It explores how an effective and comprehensive protection regime can be applied throughout the different stages of the consumer's engagement with *takāful* institutions and intermediaries. The paper recommended areas that the IFSB could consider for standard development, including principles for the development of national regulatory frameworks; documentation of widely

used approaches, such as complaints handling requirements and suitability determination; guidance on the identification of types of business and circumstances where stronger regulation is justified; guidance on supervision of matters such as Sharī'ah compliance and activities of intermediaries, where institutional structures may vary; and guidance on supervisory review approaches to the conduct of *takāful* business. In addition, consideration should be given to consumer education on *takāful* and how this could be delivered.

6. Other issued and ongoing standards relevant to *takāful* are:

- IFSB-27: *Core Principles for Islamic Finance Regulation (CPIFR) (Takāful)* was adopted by the IFSB Council in December 2022.
- *IFSB-AAOIFI Revised Sharī'ah Governance Framework*, for which the Exposure Draft was issued in May 2022.

7. Based on these recommendations, this standard covers the areas of conduct of business and its supervision related to *takāful*. The sound functioning of the *takāful* industry depends, among other things, on *takāful* participants' confidence in the quality of the conduct of business (COB) of the *takāful* institutions and adequate systems of control over the COB by Regulatory and Supervisory Authorities (RSAs).

## **1.2 Objectives of the Standard**

8. The standard aims to provide a framework of principles and rules of COB that RSAs can utilise in regulating their markets and supporting the growth and stability of the industry. This would promote a climate of confidence and a supportive environment to uphold transparency and fair dealing, comparable to conventional frameworks, and to strengthen the relevant moral, social, and religious dimensions essential to the *takāful* business.

9. The standard has the following objectives:

- Promote fairness, safety, and stability in *takāful* markets by addressing *takāful* specific Sharī'ah and conduct issues, as well as considering emerging matters such as digital distribution, intermediaries, and products.
- Define appropriate mechanisms to strengthen consumer protection, Sharī'ah compliance assertions, and public confidence in the *takāful* industry.
- Guide in identifying conduct risks through risk indicators and in addressing market conduct issues specific to *takāful* via risk-based supervision by RSAs.
- Outline success factors for effective and robust consumer education programs for *takāful* with a particular focus on digital financial education.

- Increase harmonisation of regulatory practices in the *takāful* sector.

### 1.3 Scope and Application

10. The standard expands on IFSB-27 “CPIFR - *Takāful*”, which is intended to develop a set of Takāful Core Principles (TCPs), closely aligned with the Insurance Core Principles (ICPs) by the IAIS (as adopted in November 2019) but modifying and adding to them as necessary to reflect the application of Sharī‘ah principles in *takāful*. The IFSB-27 has been developed with reference to the “hybrid”<sup>1</sup> model of *takāful*,<sup>2</sup> but it can also be applied (with some modification) to other forms of Islamic insurance.<sup>3</sup>

11. Similarly, this standard is developed primarily in reference to the hybrid *takāful* model. Provisions of this standard are, where relevant (with modifications if required), also applicable to *takāful* windows<sup>4</sup> and other forms of Islamic insurance. The term “Islamic insurance” for the purpose of this standard refers to the *takāful* model and other Islamic insurance models that have been qualified as Sharī‘ah-compliant by central Sharī‘ah board (as an independent authority or affiliated with a regulatory body), or a government that stipulates that the practice of insurance companies should not be inconsistent with the provisions of Sharī‘ah, or the Sharī‘ah board of an Islamic financial institution structured in line with international Sharī‘ah governance standards.

12. Islamic insurance models conceptualise the insured persons as “contract holders” instead of “policyholders” in conventional insurance or “participants” in *takāful* models.

13. *Takāful* participants contribute to one or more risk-bearing *takāful* funds, also known as participants’ risk funds (PRF) and participants’ investment funds (PIF). The funds are managed by a *takāful* operator (TO), which usually is a shareholding company. The risks are not transferred to the TO but remain with the participants. The PRF, shareholders’ funds (SHF), and the TO together constitute a *takāful* undertaking (TU). The PRF and PIF have to be segregated from SHF and are attributable to the *takāful* participants collectively. They are risk-bearing entities.

14. IFSB-27 notes “that the ICPs developed principally for conventional insurance may, in many but not all respects, be accepted as universally recognised principles, capable of application to *takāful* with little or no adaptation”.<sup>5</sup> However, in some areas, “the ICPs require

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<sup>1</sup> A typical undertaking consists of a two-tier structure that is a hybrid of a mutual and a commercial form of company which is the *takāful* operator (TO).

<sup>2</sup> A mutual guarantee, whereby a group of *takāful* participants agree among themselves to support one another jointly for the losses arising from specified risks, from a fund to which all commit to donate for the purpose.

<sup>3</sup> See paragraph 11.

<sup>4</sup> The term “window” means part of a conventional insurer, which may be a branch or a dedicated unit of that insurer, that provides *takāful* services other than purely as an intermediary.

<sup>5</sup> IFSB-27 paragraph 6

further expansion or amendment for effective application to the *takāful* area. In particular, they do not adequately or clearly address some Sharī'ah considerations (including Sharī'ah governance, *qarḍ*, and *takāful* business models), and the separation of funds between the shareholder and *takāful* funds commonly adopted in *takāful*." (ibid.).

15. Appropriate COB regulations for conventional insurance models (proprietary/joint-stock or cooperative/mutual) also apply to the Islamic insurance models, which that must furthermore comply with Sharī'ah governance provisions.

- There is a wealth of implementation reports, evaluations of different regulatory approaches, best and worst practice examples, and other material provided globally by regulators, media, academia, and conventional standard setters. Regulators in jurisdictions with other Islamic insurance models can draw from this material, so there is no need to repeat here what has already been compiled elsewhere for conventional insurance. The ICPs and IFSB-27 summarise relevant high-level principles applicable to *takāful* and Islamic insurance models.
- The Sharī'ah governance issues for all kinds of Islamic financial institutions (including *takāful* and non-*takāful* Islamic insurance providers) are detailed in the *IFSB-AAOIFI Revised Sharī'ah Governance Framework*, which is currently ongoing.

16. The conclusion for the COB standard is that it will repeat/duplicate neither the work done in conventional insurance regulation nor the principles and recommendations of the Sharī'ah governance framework for Islamic financial institutions. Instead, it will focus on those (limited number of) ICPs identified by IFSB-27 that require further expansion or amendment for effective application to *takāful* and Islamic insurance models.

17. The Sharī'ah rules and principles mentioned for explanatory purposes in the standard do not encompass all the practices followed by TUs in different jurisdictions. In this regard, TUs are expected to fulfil the requirements set by their supervisory authorities and Sharī'ah boards in determining and ensuring that their activities are in compliance with the Sharī'ah rules and principles.

### 1.3.1 Terminologies

18. In this standard, the following terms have specific meanings:

- The term "participant" refers to a person (natural or legal) who participates in a *takāful* arrangement with a TU and has the right to compensation or other entitlements under a *takāful* contract. This includes, where relevant, beneficiaries and claimants with a legitimate interest in the *takāful* contract.

- The term “customer” refers to participants of both *takaful* and Islamic insurance schemes.
- The term “applicant” refers to potential customers who want to join a *takāful* or Islamic insurance scheme.
- The term “consumer” refers to both customer and applicant.
- The term “provider” refers to TU and Islamic insurance undertakings.

#### **1.4 Implementation Date**

19. To encourage consistency in the implementation of IFSB standards across jurisdictions, it is recommended that RSAs implement the standard in their jurisdictions effective from July 2025 onwards, taking into account an adequate pre-implementation period starting from the issuance date of this standard for the standard to be embedded into national regulations and guidelines, and where applicable, implemented into supervisory practices.

20. RSAs are encouraged to implement the standard earlier than this date when they are comfortable and able to do so.

21. The level of implementation of the standard in a particular jurisdiction may depend upon, and be without prejudice to, the general legal framework of that particular jurisdiction.

## SECTION 2: CONDUCT OF BUSINESS IN TAKĀFUL

### 2.1 General Requirements for COB

22. Robust COB supervision is necessary for consumers and the Islamic insurance industry to promote a well-functioning market, ensure a level playing field, improve consumer confidence, and safeguard financial stability. The COB supervision framework assists supervisors in preventing or minimising market misconduct and allows them to act pre-emptively and proactively before misconduct issues become widespread.

23. The RSA needs to supervise the business conduct of providers and intermediaries that comprises all activities from before a contract is entered into through to the point when all contractual obligations have been satisfied. According to IFBS-20, the term “conduct of business,” in general, covers the relationships between a TU and its consumers, including, in particular, the offering and acceptance process, the claims process, and other matters arising during the lifetime of a contract, e.g., communications on investment performance. COB supervision in Islamic insurance can be defined as governing the activities of providers and intermediaries in order to protect the interests of consumers, treat them fairly, and maintain the integrity of the industry.

24. Market conduct supervision can be used interchangeably with COB supervision when the fair treatment of consumers, market efficiency, and integrity are considered as the broader mandate of COB.

25. Approaches to the COB supervision will differ among jurisdictions due to differences in the supervisory frameworks. Supervisors may not even use the term “conduct of business” or have different interpretations of particular aspects. Nevertheless, in substance and either explicitly or implicitly, supervision of providers’ and intermediaries’ COB related to consumers should be performed. The RSAs should enforce TOs’ compliance with set requirements and be cooperative in their behaviour.

26. The intensity of COB supervision will be influenced by the availability of supervisory resources as well as the development of the market. Supervisors need to consider consumer support structures such as the Islamic insurance awareness programs, industry associations, or financial consumer protection bureaus when determining the extent of COB supervision. Where consumer support structures do not exist, are not well developed, or are not yet within the mandate of the RSA and consumers’ level of financial education is low, a jurisdiction may place greater responsibility on the RSA to protect the individual rights of consumers and provide financial education.



27. Factors that influence supervisory approaches include but are not limited to:

- The level of consumers' financial literacy;
- The role of consumer protection organisations;
- The role of industry associations;
- The role and accessibility of the court system and other dispute resolution mechanisms;
- The role of the central Sharī'ah board or Sharī'ah authority (if applicable);
- The role of the Sharī'ah board of providers and intermediaries;
- The competitive environment for conventional and Islamic insurance, and within the *takāful* segment;
- The *retakāful* capacity;
- The level of development of the other sectors of Islamic finance (banking, capital markets).

28. The scope of the COB supervision may include but is not limited to:

- Broader "market conduct" supervision;
- Consumer education and/or financial literacy;
- Financial inclusion;
- Promotion of competition;
- Independent dispute resolution;
- Sharī'ah governance.

### 2.1.1 COB Supervisory Staff

29. Supervisory staff, providers, and intermediaries must use clear communication and understand COB supervision, thus COB supervision staff must have adequate training, experience, and seniority. The staff needs to have a strong understanding of the following:

- Islamic insurance or *takāful* law and regulations;
- General consumer protection practices;
- *Takāful* business models, products, and practices;
- Best practices and risks related to fair treatment of customers;
- Sharī'ah aspects of Islamic insurance operations.

As for suitability requirements of key stakeholders of providers such as the board of directors (BOD), senior management, key persons in control functions, and significant owners, RSAs can refer to *TCP 5: Suitability of Persons* of IFSB-27.

### 2.1.2 *Sharī'ah Compliance Assertions*

30. Sharī'ah compliance is the *raison d'être* of Islamic insurance. The supervisor should require that providers install a Sharī'ah governance structure to ensure that all processes, products, and practices satisfy Sharī'ah principles.

31. A comprehensive Sharī'ah governance system is crucial since compliance with Sharī'ah is the main essence that a provider's stakeholders expect to see in its operations. A major incidence of Sharī'ah non-compliance can result in reputational and financial loss. In a worst-case scenario, it can lead to a loss of confidence in the Islamic Insurance system causing financial stability threats. The BOD has an oversight responsibility to ensure the existence of an effective and robust Sharī'ah compliance environment, mechanism, and culture.

32. The supervisor needs to monitor providers' and intermediaries' Sharī'ah compliance throughout the lifetime of the relationships with their consumers. This can be done by collecting periodic Sharī'ah audit reports or periodic review reports from the Sharī'ah authority. The supervisor can require providers and intermediaries to make the structure of the adopted model and its approval by the relevant Sharī'ah authority accessible on their websites and in marketing materials.

33. RSAs need to oblige TOs to have a policy approved by the BOD and Sharī'ah board to address Sharī'ah non-compliance incidents. This policy should cover the steps that need to be taken if a Sharī'ah non-compliance event is identified, the mechanism to dispose of-Shariah non-compliant income, and sanctions related to non-compliance.

34. For the design of an appropriate Sharī'ah governance framework, supervisors and providers can refer to *TCP 8: Sharī'ah Governance*; *IFSB-8: Guiding Principles on Governance for Takāful (Islamic Insurance) Undertakings*; *IFSB-10: Guiding Principles on Sharī'ah Governance Systems for Institutions offering Islamic Financial Services*.

### 2.1.3 *Segregation of Funds*

35. The *takāful* model requires the segregation of participants' and shareholders' funds, given different rights and obligations between the TO and *takāful* participants. *Takāful* participants are not like financial consumers who enter into an exchange contract with a

conventional insurance company. The *tabarru'* contract makes participants risk bearers and “participatory stakeholders”.<sup>6</sup> On the most basic level, the supervisor must ensure that the segregated funds are established, maintained, and appropriately managed.<sup>7</sup>

36. The segregation of funds requires, at a minimum, the establishment of:

- A fund that holds the equity of shareholders of the TO (SHF) and bears all administrative and management expenses of the TO;
- One risk-bearing fund (PRF) that pools the risk-related parts of the participants' contributions and covers all claims and claims handling costs. Temporary excess liquidity of the PRF can be invested, and investment returns belong to the PRF. However, the investment could be structured as a *muḍārabah* contract with the TO as the *muḍārib* who gets a share of the investment profit. A surplus of the participants' donations to the PRF over the claims-related expenses of a given period (which would be equivalent to an underwriting surplus in conventional insurance) belongs to the participants collectively. This surplus has a different legal underpinning (*tabarru'*) than the profit from the investment of temporary liquidity surpluses (*muḍārabah*) and the TO must not share the surplus (as it may share in the investment profit). A TU can establish more than one PRF; e.g., there could be several PRFs for different risk categories. The TO manages the PRF on behalf of the participants and charges a *wakālah* fee to the PRF for this service. In case of a deficit in the PRF, the SHF may provide an interest-free loan (*qarḍ*) to the PRF.

37. The supervisor needs to ensure that the TOs manage the PRFs throughout the term of the *takāful* contract. If one TU comprises several PRFs, each must be managed separately, particularly in relation to deficit compensation by *qarḍ* and surplus utilisation with distributions to participants.

38. The supervisor should require that the TO has established an efficient process to manage funds, including effectual risk management and a monitoring system, to safeguard the participants' interests. Ensuring the participants' interest in managing the funds is a continuous responsibility of the TOs.

39. TOs should have policies, which are approved by the BOD and Sharī'ah board, in place for each PRF they are establishing and managing. These policies should be made available to participants and, at a minimum, cover the following:

- Types of risks covered;

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<sup>6</sup> The archetype of participatory or risk-sharing stakeholders are the investment account holders in Islamic banks.

- Types of events that trigger payment of benefits or claims to participants and method of determining the amounts payable as claims or benefits;
- Types of expenses attributed (e.g., claims-handling costs, *retakāful*, remuneration, etc.) to the PRF;
- Approach and incidence of determining surplus and deficits of each fund;
- Principles and processes for the utilisation of surplus and covering deficit of each PRF;
- Procedure for winding up of funds.

40. The policies for PRFs should include the details of the types of payments and income that will be received in the fund. Types of receivables may consist of the following:

- Contributions from the participants (for family *takāful* with the specified amount or percentage of contributions that is credited to the PIF);
- Income generated from the PIFs that is retained in the PRFs;
- Claims, rebates, and surplus received from *retakāful*;
- *Qarḍ* and/or donations received from shareholders.

41. The policy should also include the details of the types of expenses attributed to the fund. Types of payables or expenses attributed to the fund may consist of the following:

- Direct costs related to underwriting and investment (e.g., pre-cover inspection, acquisition, issuance, or disposal of a financial asset);
- Claims paid and direct costs related to claim settlement (e.g., adjustor and legal fees);
- Contribution to *retakāful* and/or reinsurance;<sup>8</sup>
- Fees, profit, and commission paid or payable to TOs;
- Contribution refund to participants;
- Repayment of *qarḍ*.

42. RSAs should understand these TOs' policies under the contracts, including justification of these policies by reference to the rights of participants and shareholders and to Sharī'ah compliance.

43. The supervisor can allow TOs to consolidate any additional PRF(s) if it can improve the long-term stability of the funds, benefit the *takāful* participants, and be fair to related participants. The consolidation can only be allowed if the TOs have proper policies and procedures in place that can cover, but are not limited to:

- Assessment of the sustainability of the PRF(s) to meet future claims;

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<sup>8</sup> The concept of "*darurah*", or necessity in the absence of a compliant alternative, is used by some TUs to justify the use of conventional reinsurance rather than *retakāful*. Different authorities may hold different opinions as to whether the conditions for *darurah* are satisfied. The International Islamic Fiqh Academy (IIFA) resolved that Islamic insurance companies should reinsure only with Islamic reinsurance companies except where that is not possible and "for other valid reasons".

- Assessment of the impact of consolidation on the fair treatment of participants (e.g., surplus distribution);
- Actuary's assessment of the impact of consolidation on the financial condition of the PRF(s);
- Assurance that there is no outstanding *qarḍ* in the respected PRF(s).

44. Where a TO applies more granular segregation of funds to manage different types of products, e.g., different fees, remunerations, riders, rates, etc., for the same basic type of risk, the fairness principle and the fiduciary duty requires that the TO offers the best value for money from the participants' perspective rather than offering the alternative that is most profitable for the TO.

45. The ultimate accountability to ensure effective management of funds lies with the BOD. The board needs a robust oversight framework that will continuously examine the policies and procedures of TO's fund management. Obtaining endorsement and advice from the Sharī'ah board or externally from either professional practitioners or a recognised Sharī'ah authority in its own jurisdiction is required to ensure that the management of funds does not violate Sharī'ah principles.

#### 2.1.4 Surplus Distribution

46. Surplus distribution to the participants is a unique feature of *takāful* (except for the *Waqf*-based model). The distribution of underwriting surplus is a phenomenon of the PRF based on the participants' contributions. The contributions comprise a service cost component (*wakālah* fee) for the TO's management and marketing services, credited to the shareholders' funds, and a protection component (*tabarru'*) for risk coverage, channelled to the PRF. The contributions of participants in family *takāful* schemes include, in addition, a savings or investment component credited to the participant's investment fund (PIF). Surplus is generated in the PRF if the contributions paid by the participants exceed the claims (and any movement in technical provisions) and claim-related expenses, net of *retakāful*/reinsurance and fees paid to the operator and adding investment returns (income and gains on investment assets). In the past, some jurisdictions and Sharī'ah boards had approved a surplus-sharing with the TOs, but a near-consensus has emerged that this should not be done.

47. The concepts of *tabarru'* and surplus distribution are closely linked to each other. In an insurance system based on exchange contracts between the insured and the insurer, the underwriting surplus belongs to the insurance company (which could be a shareholding company or a cooperative). In a *takāful* system based on *tabarru'*, the surplus consists of residual donations not needed to cover claims-related expenses (and to build reserves);

hence, it belongs to the participants. The disposition of surpluses is dealt with either in legislation, in the constitutional documents of the TU, in the TU's prudential policies, or in the *takāful* contracts themselves. Surpluses may be retained within the fund to provide working capital, applied directly or indirectly to the benefit of the *takāful* participants, or spent for charitable purposes.

48. The TO cannot claim a share in the surplus but can have a share in the investment profits as a *muḍārib*. TOs cannot charge participants any performance-related or incentive fee, irrespective of whether fixed or a percentage, and linked to and paid from a surplus in the PRF.

49. Apart from Sharī'ah concerns, surplus distribution requires the attention of RSAs as it can raise fairness issues from expectations created during the pre-contract stage for applied distribution methods. Where TOs strongly influence the disposition of surpluses, supervisors should require them to establish a written policy on the surplus distribution, which the BOD and Sharī'ah board should approve. The written policy should comply with the Sharī'ah principles of the underlying model adopted and consider the fiduciary duties of the TOs. The policy should include, e.g., the utilisation of surplus, including surplus distribution and the level of surplus to be retained in the PRF to cushion future volatilities, surplus distribution among participants, and the method of transferring any surplus to other PRFs. TOs can develop separate policies for different categories of *takāful* business, e.g., separate policies for general and family *takāful* or different lines of business (motor, health, home, etc.).

50. Monitoring the surplus calculation method of TOs is necessary as it can have market conduct implications. For instance, a TO can delay reporting claims and/or delay the decision on the indemnity for claim events to generate a surplus for a certain period, which can impact the sustainability of PRFs in the long run.

51. The long-term sustainability of the PRF should be the main consideration for the surplus distribution policy. TOs may opt not to distribute the surplus to the participants when alternatives such as retaining it as reserves or using it to support future levels of contributions are considered critical for the viability of the fund and thus are also in the interest of the participants.

52. Supervisors need to monitor the approaches of TOs for using surplus distribution as a promotional tool during the distribution of *takāful* products as it might create unrealistic expectations of future financial performance. IFSB-14: *Risk Management for Takāful (Islamic Insurance) Undertakings* stated that TOs should be aware of the risk of creating participant

expectations regarding the distributions of underwriting surplus. Where a TO has intentionally, by representations or actions, e.g., in illustrations of contract benefits, created such expectations, RSAs may take punitive actions against the TO, notwithstanding that no actual guarantee for surplus distribution has been provided, if it is proven to have committed misconduct, negligence, or have misled the customers while promoting and distributing *takāful* products. Additionally, the supervisor should require TOs to not distribute surplus if the fund has *qarḍ* payable. The surplus should be used for fully paying off the outstanding *qarḍ* first and a proper information policy regarding *qarḍ* should be there.<sup>9</sup>

53. Supervisors also need to consider the TOs' method of surplus distribution as it can have an element of unfair treatment. For example, the surplus can be calculated for a specified period, e.g., one calendar year. If only those who held a contract for the full period participate in the surplus distribution, this could be seen as unfair treatment towards other participants. One of the fair distribution mechanisms could be a pro-rata allocation where all the participants can receive their share of surpluses.

54. Supervisors may require that an actuary recommends rules for surplus distribution. The BOD along with the senior management of TO are entrusted to oversee the management of surplus distribution which must be endorsed by the firm's Sharī'ah board.

55. Some of the ways the surplus can be utilised are as follows:

- The surplus can be distributed amongst participants in proportion to their contributions net of any claims received during the period.
- The surplus can be distributed in cash, as reduced future contributions or – in family *takāful* – by transfer to PIF as an additional investment.
- Participants may have the choice to donate the surplus for social or charitable purposes.<sup>10</sup>
- The surplus can be retained in the PRF fund to enhance solvency.
- In family *takāful*, the surplus can be declared and entrusted in the name of participants, but the amount may remain in the PRF.<sup>11</sup> The entrusted surplus is paid when the participant surrenders or a death claim occurs. This deferred distribution process can enhance long-term solvency by compensating for future deficits through the return earned on surplus and enables participants to earn surplus on surplus.

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<sup>9</sup> See paragraphs 81 and 90.

<sup>10</sup> It can be done collectively by mentioning at the beginning of the contract, as a feature of the product, that a certain portion or the total surplus will be used for social purposes.

<sup>11</sup> This is similar to the concept of "reversionary bonus". This type of incentive is often announced at the end of each year. However, it is not paid out immediately. Instead, it is added to the insurance policy each year and paid out when the policy matures or death occurs.

- The surplus can be distributed to participants by enhanced benefits, such as higher life coverage, critical illness coverage, expense indemnifications, enhanced services, etc.

56. TOs may determine any surplus or deficit arising from each *takāful* fund it manages annually.

## 2.2 Responsibilities for COB

57. IFSB-20: *Key Elements in the Supervisory Review Process of Takāful/Retakāful Undertakings* mentions that due to fiduciary duty towards both participants and shareholders, the supervisor needs to oversee how a TO balances or gives proper consideration to the interests of both parties. This is a relatively complex task.

- There is no mechanism in the governance system of shareholding companies that gives a direct “voice” to participants.<sup>12</sup> Therefore, it is not easy to know their interests. The RSA may take recourse to consumer surveys and received complaints or combine assumptions about the interests of a “stylised” participant with economic theory and observed practices.
- Participants may not be aware of what is in their best interest. For example, is it in their interest to pay contributions that regularly result in PRF surpluses that will only be partially redistributed to them? What will be distributed to participants is typically less than the contributions that exceeded the amount needed for claims settlement. Neither the *wakālah* fee on exceeding contributions nor the respective performance fees need to be refunded, and the TO’s share of the profit from the investment of the excess contributions remains with the SHF. The participants would be financially better off if contributions were actuarially fair so that, on average, the balance of the PRF would be zero, and *wakālah* fees are calculated on a management cost basis. This, however, would reduce the shareholders’ profits unless the *wakālah* fees exceed costs by an amount that compensates for the loss of income caused by lower gross contributions, and the smaller size of shared investments profits. There is an obvious potential for a conflict of interests between participants and shareholders.
- Not all participants have the same interests, e.g., regarding the utilisation of PRF surpluses. Participants who shop around at renewal time may prefer a cash distribution. In contrast, “loyal” participants may prefer a rebate on contributions in the next period (preferably in proportion to the number of years as a participant). RSAs may be concerned that such schemes would create disincentives to switch the *takāful* provider and therefore tend to impede competition.

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<sup>12</sup> See paragraphs 68 and 69 for example of giving “voice” to the participants.



58. The interests of participants often diverge from those of shareholders. For example, whenever an investment opportunity arises, there must be a process or framework to decide whether the investment should be made using shareholders' or participants' funds. In this regard, a TO may be induced to maximise the income generated from contributions to benefit itself, even if the investment may not be in line with the participants' interest. IFSB-8: *Guiding Principles on Governance for Takâful (Islamic Insurance) Undertakings* recommended a Governance Committee to find an appropriate balance between the interests of all stakeholders. Additionally, it also noted that alternative institutional arrangements might be possible. IFSB-20 recommends that where the governance arrangements assign specific responsibility for representing participants' interests to a body or individual, the RSA should evaluate whether this responsibility is being discharged effectively, e.g., by considering the resources and authority available to that body or individual, any other responsibilities they have, their incentives for proper performance, and the substantive decisions made.

59. According to IFSB-20, the RSA should ensure that the BOD establishes a clear allocation of responsibilities to various members of management and organs of governance (such as the Audit Committee, Internal Audit, and Internal Sharī'ah Audit). When evaluating the independence of the board members and their suitability in overseeing the TO's fiduciary responsibilities and duties concerning the rights of and obligations towards the various stakeholders, tools available to the RSA include: (a) interviewing members of the BOD; and (b) reviewing and analysing the minutes of meetings of the BOD and its committees, the remuneration structures adopted by the BOD, auditors' and actuaries' reports, and, if any, IT audits.

60. The RSA needs to communicate that it is the responsibility of the BOD, Sharī'ah board, and senior management to ensure that fair treatment and Sharī'ah compliance are the core values of providers' culture.

61. The BOD should set the tone for the senior management by approving policies related to proper business conduct and ensuring those policies are reflected in business strategies and operations. For example, the BOD should provide constructive feedback to the senior management during board meetings on how to implement and embed the culture of good conduct and recommend specific actions in this regard.

62. The senior management is responsible for integrating the business conduct policies in all stages of the product life-cycle, as well as training and communicating with all the relevant stakeholders. As a good practice, the management should periodically update the BOD about any material concern or weakness in policies related to fair treatment or conduct of business. Poor practices such as not providing specific guidance to staff, basing remuneration on sales

targets without considering customers' interest, or improper complaint handling related to intermediaries should be avoided.

63. The role of the Sharī'ah board will be to ensure the Sharī'ah compliance assertion in all the activities of the provider. For example, the Sharī'ah board should have a role in supervising the implementation of policies related to the fair treatment of consumers. The Sharī'ah board may supervise the business transactions, products, services, contracts, documents, and conduct of business in light of Sharī'ah parameters. The RSA can mandate that the Sharī'ah board considers relevant consumer protection concerns in its decisions.

### 2.2.1 *Fiduciary Duties of TOs*

64. Good conduct requires providers and intermediaries involved in the design, marketing, distribution, and servicing of products to act in the participants' best interest throughout the contract's life-cycle, due to their fiduciary duty.<sup>13</sup>

65. In *takāful*, the participants' contributions are pooled in a risk fund owned by the participants. This pool is managed by a TO – possibly with the help of third parties – concerning underwriting, structuring, and pricing of risk-covering arrangements, and the investment of funds on behalf of the participants. The Sharī'ah basis for this undertaking, typically a *wakālah* (agency) contract, creates a fiduciary relationship between the participants as principals and the TO as the agent (*wakīl*). As fiduciaries, the TO and *takāful* intermediaries are not only bound in their actions by suitability standards but must give participants' interest precedence over their own profit motives.<sup>14</sup>

66. The supervisor should require the TO to disclose the legal quality of the contractual relations with the participants. If it is a *wakālah* contract, the TO should explain its fiduciary duties to the participants. If it is not a *wakālah* contract, the TO should explain the underlying principles that make it Sharī'ah-compliant and whether it requires advice and decisions in the best interest of the participants (i.e., to give participants' interest priority over own profit in cases of conflict).

67. Supervisors may require TOs to disclose how they incorporated the culture of fiduciary duty through appropriate strategy and policies as well as the rationale behind the chosen approaches. TOs can report to the supervisors an assessment of their effectiveness in serving the participants' best interests.

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<sup>13</sup> IFSB-8 mentions that due to the different nature of the underlying contracts, the fiduciary relationships between the TO and *takāful* participants differ substantially from those in conventional proprietary insurance.

<sup>14</sup> It is sometimes argued that this is not possible because the corporate law of jurisdiction imposes an obligation on TOs to maximise the profit of their shareholders. However, shareholders of a TO must be aware of the implications of *wakālah* contracts as the basis of *takāful* undertakings. They should feel (at least morally) obliged not to put profit over participants' interests.

### *2.2.2 Representation of Participants*

68. The fiduciary obligations of the TO oblige it to create organisational structures and procedures to give participants "a voice". This could be, e.g., a regular participant assembly, scheduled online meetings with digital voting, a director for participants' affairs, or a liaison office for communication (apart from complaints).

69. To give participants more control over the funds, RSAs can introduce "participant advocates" through regulation, who will represent the participants in annual meetings and, when necessary, in Sharī'ah board discussions. The participant advocate will be an independent party with technical knowledge who will be responsible for reviewing the operations and fair treatment of consumers by the TOs. The participant advocate can document and present its findings during the annual meeting. Supervisors can periodically ask for such reports, which can be a good source for understanding market practices. The participant advocate might be appointed by the participants through appropriate procedures or nominated and appointed by the RSAs. It could also be an industry-wide self-regulatory institution. Costs of a TU's participant advocate could be borne by the participants' fund or split between participants and shareholders.

### *2.2.3 Managing Conflicts of Interests*

70. The providers should disclose their policies related to conflict of interest and how these policies have been applied to discharge their fiduciary duties. They should explain how they have identified and managed any actual or potential conflicts and disclose examples of how they have addressed them. Supervisors may require the provider to disclose conflicts which may consist of:

- A detailed description of the conflict of interest in the question;
- Information about the general nature and sources of the conflict of interest;
- An outline of risks to the customers that may arise as a result of the conflict of interest and the steps to mitigate those risks.

71. The board is responsible for formulating policies related to conflicts of interest, and an internal audit report (including an internal Sharī'ah audit report) will assist the board in overseeing the implementation of the policies. Internal audit and internal Sharī'ah audit will provide assurance and independent assessment to the board on the providers' management of conflicts of interest.<sup>15</sup>

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<sup>15</sup> TCP 9: Risk management and internal controls (IFSB-27) covers the details of the internal control function to manage conflicts of interest.

72. If conflicts of interest cannot be resolved, the disclosure should clearly state that the organisational and administrative arrangements to manage the conflict of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the consumer will be prevented.

73. RSAs should also have legal requirements in place that induce intermediaries to have proper policies to manage actual or potential conflicts of interest and disclose them to the customers. Potential conflicts of interest that must be disclosed could typically include compensation arrangements with third parties (including referral fees), significant ownership interests in providers (and vice versa), and factors influencing objectivity, such as remuneration based on sales targets. Additional intrusive measures, such as prohibiting intermediaries from being a partner, administrator, employee, etc. of a provider or acting on behalf of both the customers and a provider can be considered if the absence of such requirements may lead to poor conduct.

74. Supervision of remuneration arrangements is necessary as it can raise the issue of conflicts of interest, heightening the risk of moral hazard and potentially resulting in biased advice to applicants. For example, due to the remuneration arrangement, intermediaries might have financial incentives to recommend certain products that might be less beneficial for customers than others, i.e., are not in the customers' best interest.

75. Some conflicts of interest can be specific to unit-linked family *takāful* products,<sup>16</sup> which require separate consideration:

- The pre-selection of suitable funds can be biased towards funds with prospects of the highest benefits for the TO, which may not offer the best value for the money from the participants' perspective. However, the suitability requirement for the fund selection alone does not prevent biases. Benefits could be direct (e.g., paybacks to the TO, see next bullet point) or indirect, for instance, through promoting funds that have been launched and are managed by financial firms that belong to the same group of financial institutions as the TU. A variable component of the *wakālah* fee with a tie to the performance of the units held by participants may not be an effective remedy. Group benefits may more than outweigh the underperformance of the selected funds.
- The fund managers<sup>17</sup> charge fees for the management of the investment funds, and providers pass them on to the participants as direct costs (in addition to the *wakālah*

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<sup>16</sup> Providers can manufacture these products, simply speaking, by combining a life cover with an investment vehicle for the participants' (periodic or lump-sum) savings. The core of this vehicle are "units", i.e. certificates sold to and held by the participants, that represent shares in a basket of investment funds. The provider will pre-select a number of funds that are deemed suitable for the participants, who then can make the final selection.

<sup>17</sup> Usually, these funds would not be managed by the TUs themselves but by separate legal entities. The fund managers can be independent third parties or members of a group of financial institutions.

fee charged to compensate the TO for the management of the TU). This could be done by subtracting the costs from the units owned by the participants. The participants should be interested in keeping these costs as low as possible, while the TO could be indifferent in this regard. The conflict of interest can be even worse in cases where the TO negotiates from the fund manager a discount on the management fees that are structured as a rebate. The TO would receive the rebate with no obligation to pass it on to the participants unless the *takāful* contract specifies otherwise.<sup>18</sup>

76. A TO should act in the participants' best interest and must select suitable funds for structuring unit-linked schemes that give the participants the most value for money. Regulations could enforce disclosure of selection criteria, but disclosure alone does not eliminate the conflict of interest. Financial inducements from outside the undertaking create incentives for the TO to select investment funds based on remuneration and other benefits. This can only be addressed by limiting or eliminating the financial inducements. For instance, regulators may require, in addition to disclosing any inducement received by the TO, a clause in the *takāful* contract that inducements received by the TO have to be passed on to the participants.

77. In any principal-agent arrangement such as the *takāful* model based on *wakālah*, conflict of interest can arise about the *wakālah* fee. When the *wakālah* fee is calculated as a percentage of gross contributions, conduct issues arise when TOs increase turnover through poor underwriting and improper pricing. A higher turnover will benefit the TOs who earn higher *wakālah* fees, but it might lead to a deficit in the PRF caused by underwritten high risks. The supervisor needs to have a mechanism in place to identify such conflicts of interest and resolve them in the participants' interest.

#### 2.2.4 *Qarḍ*

78. Poor underwriting or unexpected increases in loss events may lead to a deficit in the PRF that cannot be covered by previously retained surpluses. When a *takāful* fund has insufficient funds to meet its obligations, legislation, constitutional documents, or contracts may provide different mechanisms for meeting the deficiency. For a temporary financing facility, the TO may provide a *qarḍ*, out of the shareholders' funds (SHF) or procured from a third party, to be repaid out of future surpluses. To the extent that a deficit is due to negligence or misconduct of the TO, the TO is responsible for compensating the *takāful* fund.

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<sup>18</sup> If the discount would be structured as a fee reduction, the participants would benefit because the payments to the fund manager would be reduced. Structuring the discount as a rebate means that the fees are paid as specified in the terms of the fund, but the TO will get a payback from the fund manager. It depends on the terms of the *takāful* contract as to whether rebates received by the TO will be passed on (in full or partially) to participants.

79. Supervisors should ensure that the TOs clearly understand and disclose the features and treatment of the *qard* to the supervisors.

80. RSAs should require the TOs to have a comprehensive and clear written policy on the mechanism of the *qard* facility. Supervisors should ensure that it considers the interests of the participants and is developed in a fair, transparent, responsible, and professional manner. For example, excessive management fees can lead to persistent and even accumulating deficits in a PRF, making the *qard* quasi-permanent. The RSA must ensure that the *qard* policy and determining management fees do not lead to such a bad practice. For instance, if the deficit is persistent due to mismanagement the supervisor may require the TOs to write off *qard* after a certain period of time or to reduce (even retroactively) management fees to a reasonable amount. The RSA may compel the TOs to manage the expenses and underwriting in a way that does not produce a deficit in the PRF in the normal course of the business. Creating persistent deficits and providing constant *qard* can also raise Sharī'ah issues, as such practices may make the whole activity a risk transfer from participants to TOs.

81. The policy should cover the process of the *qard* repayment. The repayment policy should consider the funds' long-term viability and ability to meet current obligations. When a fund has a *qard* which is not fully paid, the policy must specify the use of surplus, e.g., priority of repayment over other forms of surplus utilisation.

82. The supervisor should require the TOs to bear full responsibility for rectifying the deficit or loss due to mismanagement or negligence of the TO. If the supervisor can prove that the deficit is due to TO's negligence, then it can order the TOs to resolve the deficit by an outright transfer of ownership of assets (instead of a *qard*) from SHF to the PRF.

83. Supervisors should require TOs to have a clear written policy to identify incidents that can occur due to negligence and a procedure to mitigate them. The policy should be developed so that the TOs can explain to the supervisors the reasons for the deficit, remedial measures, and their implication on the fund.

#### *2.2.5 Intermediaries*

84. Most Islamic insurance products are marketed through intermediaries. The activities of intermediaries range from promoting Islamic insurance awareness and identifying the suitability of products for applicants' needs to the delivery (acceptance) of Islamic insurance products. Consumer protection concerns arise when distribution techniques favour adverse outcomes for customers, potentially due to wrong incentives or a lack of competence. The conventional model of remunerating intermediaries on a commission basis may operate against customer interests, especially when the intermediary is advising the applicants' product selection. RSAs may establish baseline requirements for objectivity and quality of

advice. They may also ban specific incentive systems that lead to adverse customer outcomes.

85. RSAs may require providers to report identified significant issues concerning intermediaries. Providers should ensure that their intermediaries deliver relevant and meaningful information to the consumers to avoid any risk of misleading them into expecting that Islamic insurance is no different from conventional insurance. Providers need to have processes in place (e.g., training) to ensure the intermediaries gain adequate knowledge of the underlying Shari'ah rulings of the products and their implications.

86. The RSAs might take a principles-based approach to guide and compel intermediaries to adopt a culture of consumer fairness. These may include an explicit requirement to treat customers fairly, an obligation to conduct business activities with due skill, care, and diligence in customers' interests, and the establishment of internal policies and procedures promoting fair treatment. Specific regulations can be put in place for intermediaries to develop and embed a customer-oriented corporate culture.

87. TCP 19 (Conduct of Business) addresses COB supervision with respect to intermediaries and TOs, whereas TCP 18 addresses other aspects of supervision that are specific to intermediaries applicable here. Other TCPs that apply, generally or in part, to the supervision of intermediaries are TCP 8 (Shari'ah Governance), TCP 21 (Countering Fraud in Insurance), and TCP 22 (Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)) which are also applicable here.

### SECTION 3: FAIR TREATMENT OF CONSUMERS

88. The main objective of supervising the COB in the Islamic insurance industry is to ensure fairness, stability, and protection of all stakeholders. As Sharī'ah compliance is one of the essential interests of stakeholders, supervision of business conduct of Islamic insurance requires the RSAs to ensure that the basis of Sharī'ah compliance is sound.

89. Fair treatment of consumers requires providers to have a proper explanation of the basis of Sharī'ah compliance assertions and the achievement of Sharī'ah compliance. The explanation should be made accessible to customers and other interested parties, e.g., in a printed brochure, on a website, and in an appendix to the published annual report. Additionally, it should explain the adopted Islamic insurance model and Sharī'ah governance mechanisms and processes. Access to explanations is a prerequisite for consumers to form their own opinion on the Sharī'ah qualities of an undertaking and its products. Consumers who are not well versed in Sharī'ah matters could be supported by, e.g., specialised advisors, consumer bureaus, media reports, or bodies for *ḥalāl* certifications. All documentation related to the explanation should be verified and approved by the central Sharī'ah authority (if applicable), a recognised external Sharī'ah advisor, or the Sharī'ah board of the provider.

90. The fair treatment of participants has additional dimensions, including balancing the interests of those participants in an existing fund with those of applicants when determining whether to offer participation in a particular fund. For example, for the long-term sustainability of a PRF, a sufficient number of risk fund participants is needed. If a fund is in deficit or has an unpaid *qarḍ*, the disclosure of this fact might prompt current participants to switch to another provider or cause new applicants to withdraw, which would be detrimental to the fund and its remaining participants. Should this happen on a large scale, the sustainability of the TU and even the stability of the industry may be endangered. If the TO does not disclose the deficit or *qarḍ*, information is withheld that may be needed by applicants to make an informed decision. The supervisor has to take a position in this possible conflict between the long-term sustainability and soundness of the *takāful* industry on the one hand and the fair treatment of different groups of actual and potential participants on the other hand. The result should be reflected in a requirement that TOs implement a proper information policy (e.g., explaining details of the funds in financial statements to allow customers to make decisions in their own interest without undue risks for systemic stability).

91. Conduct issues can also arise because the ultimate risk bearers are the existing participants, not the shareholders. This may induce a TO to accept higher risks in a fund, which is to the disadvantage of the existing participants when higher risks are not compensated by higher risk-adequate contributions but is to the benefit of the TO whose fee



income increases. Competition may solve this fairness issue if the pricing regulation allows risk-adequate individual contributions. If a TO collects the same contributions from low- and high-risk participants, a competing TO with risk-adequate individual contributions would attract low-risk participants and eventually drive the first TO out of the market or force it also to apply principles of actuarial fairness.<sup>19</sup>

92. The shareholders appoint the management of the TU, and the TOs manage the shareholders' and participants' funds – within the limits of law and regulations – according to shareholders' instructions. Consequently, when conflicts of interest arise, the TOs are tempted to favour the shareholders rather than the participants. Therefore, RSAs must ensure that TOs have a proper governance framework<sup>20</sup> that will safeguard the interests of participants and ensure that conflicts of interest are resolved in a manner that is also fair to participants and stakeholders.

93. RSAs may require providers and intermediaries to disclose their legal relationship. Intermediaries should be directed to disclose to the customers any interest in a transaction (e.g., commissions or other sales incentives). To ensure transparency and fair treatment of customers by intermediaries, RSAs can create awareness, e.g., distinctions between agents and brokers in consumer education programs. This can ensure consumers understand whose interests are represented by the intermediaries during the distribution process (e.g., an agent can represent one or more TUs, whereas a broker can represent only consumers).

94. It is crucial to identify the role of the Sharī'ah board of providers to promote fairness in the policies and procedures of providers and intermediaries, especially in those areas where a risk of non-compliance can arise due to the activities of providers and intermediaries. The Sharī'ah board should ensure there is no circumvention of Islamic laws, e.g., the laws of inheritance and bequest.

### **3.1 Product Development and Pre-Contractual Stage**

95. The good conduct of business includes treating customers fairly throughout the product's whole life cycle. The process begins with product design and continues until all obligations under the contract are fulfilled.

96. Supervising the product development and distribution process is important in terms of both consumer protection and Sharī'ah compliance assertion. Sharī'ah non-compliance in product development can occur due to improper structuring of products, lack of understanding of Sharī'ah concepts, etc. RSAs should require providers to get all products certified by their

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<sup>19</sup> More detailed discussion in section 4.

<sup>20</sup> IFSB-8 provides some best practices examples. Refer to pages 13-15.

Sharī'ah authority, which must be backed by relevant evidence and reasoning before submitting them to the RSA for approval.

97. Communications from Sharī'ah boards about Sharī'ah compliance issues to relevant stakeholders such as the audit team of the RSA can also be important during the product development stage. Additionally, providers must ensure that a comprehensive end-to-end Sharī'ah-compliant product development and implementation process and a Sharī'ah governance framework are in place. The RSA must require that the product (including its accompanying documentation) is approved by the undertaking's Sharī'ah board and the jurisdiction's central Sharī'ah board (if applicable) before it is submitted to the supervisor for approval.

98. RSAs need to compel providers to consider the interest of different types of customers. This can be achieved through a product approval approach, a principles-based approach, or a combination of both. In a product approval approach, the supervisor requires providers to submit the product for supervisory review and approval prior to the product launch. In a principles-based approach, the onus is placed on the provider's BOD and senior management to ensure that products and distribution strategies are developed in accordance with the principles.

99. The BOD, senior management, and the Sharī'ah board have the ultimate responsibility to ensure that new products are developed by taking into consideration the interest of consumers, Sharī'ah-compliance elements, capacity to manage related risks, and compliance with applicable regulatory requirements.

### *3.1.1 Product Approval Approach*

100. Where supervisors approve contract conditions or pricing, the approval process should balance the protection of customers with potential implications for innovation and choice of products. For example, supervisory approval of contract conditions or pricing is likely to be more appropriate in certain circumstances, such as where a provider is dealing with less financially capable or vulnerable consumers, where products are new to the market or complex, or *takāful* contracts that are required by law such as automobile liability *takāful* or health *takāful*. Therefore, RSAs need to ensure that the providers understand the implications of innovation as well as have adequate resources and a risk management framework in place. For example, robo-advisors may be an effective way to evaluate proper customer needs and reduce the cost and time needed to serve them. However, robo-advisors may advise the use of products that are not suitable for applicants but are profitable for providers, due to the algorithm adopted by the providers. In such cases, the supervisors need to have regulation in

place that can supervise the approaches adopted by the providers to ensure they do not exploit consumers through innovation.

101. The supervisor may review products for compliance with the following:

- mandated policy limits;
- coverage of specified risks, procedures, or conditions;
- absence of prohibited exclusions;
- compliance with specifically required policy language.

102. The final approval of product design relying on differential pricing practices<sup>21</sup> should be at a hierarchical level that is sufficiently high to assume the risks and responsibilities and to avoid risks of unfair treatment resulting from differential pricing practices.

103. While approving products, RSAs may also supervise the benefits designed by the providers. The benefits should ensure the following:

- The benefits and procedures to disburse them should be in line with Sharī'ah principles.
- Additional benefits other than the claim paid from the PRF should align with the concept of mutual assistance.
- Applicable to family *takāful*, providers should mention to participants, based on the jurisdiction's preference, the Sharī'ah basis of the distribution of benefits (e.g., Islamic Law of inheritance, bequest, or *hibah*), which can be applied where the participant does not mention the role of the nominee.

### 3.1.2 Principles-based Approach

104. RSAs can set principles-based requirements for product development so that it can be more flexible and technology-neutral, and also promote innovation. Principles can be complemented with more detailed rules that are subject to periodic review to reflect the dynamic nature and the competitiveness of the Islamic insurance industry. The supervisor may set principles-based requirements that product design must take into consideration the consumers' interest as well as offer value for money and not mislead in terms of features (e.g., high expectations of surplus distribution).

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<sup>21</sup> EIOPA defines differential pricing practices as follows: "On top of risk-based actuarial tariffs (expected cost of claims) and premium adjustments to take into account costs of service (e.g., commissions paid to distribution channels and other overheads like taxes, salaries, etc.), some insurance product manufacturers further adjust the premium using a number of different techniques which are unrelated to the risk profile of the consumer and the cost of service."

EIOPA (2022) Consultation paper on Supervisory statement on differential pricing practices in non-life insurance lines of business

[https://www.eiopa.europa.eu/sites/default/files/publications/consultations/consultation\\_paper\\_on\\_the\\_supervisory\\_statement\\_on\\_differential\\_pricing\\_practices.pdf](https://www.eiopa.europa.eu/sites/default/files/publications/consultations/consultation_paper_on_the_supervisory_statement_on_differential_pricing_practices.pdf)

105. The supervisor might still require product approval on the following cases, including but not limited to:

- A product has innovative features that have been introduced to the market for the first time.
- New Sharī'ah contracts have been applied for the first time.
- Changes are made to Sharī'ah contracts for an existing product.
- Products require the creation of at least one new PRF.

106. Regardless of whether a product-approval or a principles-based approach is followed, RSAs must have the power to prohibit the introduction or to suspend the sale of a product, to require an amendment of a product, or to issue a regulatory sanction if concerns regarding the product (e.g., Sharī'ah non-compliance) are identified.

107. Supervisors need to ensure that providers and intermediaries do not create unrealistic expectations about product features to look competitive. For example, highlighting surplus distribution as the main feature of General *takāful* can lead to unrealistic expectations about the financial performance of the product.

108. Where the practice of fund segregation is minimal or not applied, cross-subsidisation among different product lines can exist. For example, poor underwriting of one product line can be covered by surplus from another product line in the same risk pool. The fairness principle requires TOs to explain this mechanism to customers to adjust their expectations regarding surplus distribution and their Sharī'ah opinion because of the cross-subsidisation.

109. Supervisors should require the providers to have a robust and comprehensive product development process which should, at the minimum, include the following:

- It should cover both the pre-approval and post-approval processes.
- It should ensure that products pass through Sharī'ah scrutiny. This includes a review of terms and conditions, nomination forms, product manuals, and marketing materials endorsed by the Sharī'ah board.
- It should monitor Sharī'ah compliance throughout the life-cycle of the product.

110. To encourage innovation or address unforeseen issues such as Covid-19, supervisors can implement the "Use and File" approach<sup>22</sup> if a product falls under the conditions set by the RSAs.<sup>23</sup> It can help to launch products faster to cater to consumers' needs, which can arise

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<sup>22</sup> Under the "File and Use" approach providers are allowed to offer products immediately after their filing or after they receive a quick analysis by the supervisor.

<sup>23</sup> An example is the Use and File (U&F) procedure for life insurance products and riders by the Insurance Regulatory and Development Authority of India IRDAI (2022) <https://irdai.gov.in/document-detail?documentId=1301766>

from unforeseen events, or speed up the introduction of a new tool. Providers must ensure the product is approved by the BOD, senior management, and Shari'ah board (para 97 is applicable here). Use of the approach can also depend on the maturity of the jurisdiction's Islamic insurance industry. Supervisors also need to classify the types of products or business lines that can use such an approach. For example, complex unit-linked family *takāful* might not be suitable for this approach.

### 3.1.3 Adequacy of Information Provided to Consumers

111. During the pre-contract stage, there should be disclosure of all related facts about the product that may affect the judgment or decision of the other party in the contract. Therefore, as an advisor, providers and intermediaries must provide sufficient, correct, and relevant information for applicants to make informed decisions. The TOs and intermediaries also need to ensure that the party responsible for selling the products (e.g., own sales staff or bank staff in *bancatakāful*) does not overload applicants with information. To make an informed decision, the product features must be presented to the applicant in plain language, avoiding as many confusing technical terminologies as possible.

112. Opportunistic behaviour of sales staff, brokers, and other intermediaries can persist in the pre-contract stage: for example, presenting surplus distribution as the main feature for general *takāful*, which can create unreasonable expectations. Opportunistic tendencies lead to unfair treatment of consumers and even a violation of fiduciary duties.

113. Misconduct can arise in products that are not well suited or have poor value for money but are provided through brokers or other intermediaries (even outside the financial services industry) as add-ons, e.g., tyre and rim *takāful* sold by car dealers).

114. Add-ons and riders can enhance the scope of a contract, but they can also make products more expensive, have poor value for money, and provide very little or no benefit to consumers. Information may be presented such that applicants do not understand what product they participate in, the costs involved, what risks are covered, and what the exclusions are. These uncertainties can lead to *gharar*, which is not permissible in Shari'ah.

115. RSAs by themselves or providers need to establish a proper product oversight and governance system to ensure that add-ons and riders do not lead to poor value for customers and violate the Shari'ah rules and principles.

### 3.1.4 Disclosure of Rights and Obligations

116. TOs need to explain to consumers the right to surplus and its distribution process. For example, if the *takāful* business model applies *waqf* and *muḍārabah* structures, the TO must clarify that a surplus of the PRF belongs to the *waqf* fund only. The TO also needs to explain

how the *muḍārabah* profit is calculated and shared between the TO and the *waqf* fund. The participants must be aware that they participate individually neither in the surplus nor in investment profits in any *takāful* model. Whatever model is adopted, the TOs need to clarify how balances (surpluses/deficits and investment profits/losses) in the risk pool (PRF) are handled.<sup>24</sup>

117. The treatment of a deficiency in the PRF is determined by the constitutional documents of the TU, the underlying contracts, and the laws and regulations of the respective jurisdiction.<sup>25</sup> For example, as an alternative to giving *qarḍ* from the SHF, TOs could have the right of calls for additional contributions or to reduce compensations. Alternatively, they might procure a *qarḍ* from a third party, to be repaid out of future surpluses. Customers need to be fully informed about such features and their implications. The TO must disclose the details on the treatment of a deficiency in the financial statements to allow customers to make decisions in their own interest before a contract is signed.<sup>26</sup>

118. Rights and obligations related to benefits and their disbursement must be clearly communicated in the pre-contract stage. For example, a family *takāful* product might have the feature that the benefit or part of it might be given at the will of the participant as *waqf* or charity when the contract matures or the participant dies. In that case, the benefit might be distributed for a social cause (e.g., mosque, orphanage) in the name of the participant. TOs need to explain to the participants the approach to *takāful* benefits disbursement (key points related to disbursement are highlighted in paragraph 101).<sup>101</sup>

### **3.2 Contract Servicing**

119. Treating consumers fairly throughout the product cycle is part of good conduct in business practice. This cycle starts with product design and continues until all contract requirements are met. Therefore, it is necessary to supervise the post-sale activity of providers, and RSAs need to monitor the effectiveness of their controls over the quality of ongoing contract servicing and disclosure. The supervision also extends to the intermediaries and third-party service providers.

120. RSAs can require providers to have a proper framework to ensure ongoing contract servicing and communication with the customers. It can be done by adopting a combination

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<sup>24</sup> For examples of surplus utilisation see paragraph 55.

<sup>25</sup> For a number of alternatives, see IFSB-28 paragraph 6.

<sup>26</sup> IFSB-28 mentions “On the principle that the funds are attributable to *takāful* participants, a deficiency might be met by calling additional contributions from *takāful* participants or reducing compensation due to them where that is provided for in both the constitutional documents of the TU and the contractual arrangements. However, such mechanisms may be impracticable or represent risks to the interests of beneficiaries that are unacceptable to policymakers, and in practice are likely to be limited either to very small operations offering limited entitlements or to very large and specialised operations (similar to reciprocal insurance exchanges and protection and indemnity clubs in the conventional insurance sector) attractive only to a limited constituency of highly sophisticated *takāful* participants.”

of: 1) principles-based requirements to act honestly and fairly, and to provide clear and adequate information before and during the whole product life-cycle; and 2) a rules-based approach where RSAs can compel providers to disclose specific information during the product life-cycle. The role of intermediaries in contract servicing needs to be clearly identified. RSAs may communicate with the providers that the ultimate responsibility for servicing contracts remains with them. They must ensure that intermediaries have proper policies and procedures in place to perform their duties concerning contract servicing on behalf of the providers.

121. When functions related to the conduct of business of a provider, such as contract servicing, are delegated to a third party, the supervisor may require the provider to ensure that the third party conducts these tasks in compliance with the laws, regulations, and guidelines applicable to the provider's or intermediary's activities as well as in line with the Sharī'ah governance framework of the provider and/or central Sharī'ah board (if applicable).

### *3.2.1 Information on the Provider*

122. Customers require ongoing information to monitor the performance of the product or service and determine whether it continues to meet their needs and expectations. It is also important that providers communicate relevant information promptly on their own initiative and in response to transactions or enquiries, events affecting the customer's interest in the product (such as a change of contract terms where the provider can do this unilaterally), or any other event with significant implications for the customer. IFSB-8 recommends that where appropriate, additional information be provided on investment policies and practices, such as in the case of unit-linked family *takāful* products. Disclosures that meet consumer needs can facilitate transparency and effective service delivery. Disclosure requirements for investment-type contracts would extend to periodic statements, for which IFSB-8 also makes recommendations.

123. Contract servicing includes providing relevant information to customers throughout the contract's life, which may include:

- any change in the name of the provider, its legal form, or the address of its head office and any other offices as appropriate;
- any acquisition by another undertaking resulting in organisational changes as far as the customer is concerned;
- where applicable, information on a portfolio transfer<sup>27</sup> provided it is not in violation of Sharī'ah rules and principles (including participants' rights in this regard);

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<sup>27</sup> Section 4.3 of IFSB-20 highlighted that the RSA should consider whether any proposed transfer has been subjected to Sharī'ah review in the transferor and transferee TUs.

- any changes in the Sharī'ah board that may have implications for the customers; and
- any changes in or adoption of the business strategy that can have an impact on the performance of the funds (PRF and PIF).

124. If the Islamic insurance undertaking is a foreign company, the provider or intermediary should be required to inform the participant of details such as:

- the home authority responsible for the supervision of the provider;
- the jurisdiction in which the head office or, as appropriate, the branch where the contract is to be concluded is situated;
- the relevant provisions for making complaints and independent dispute resolution arrangements; and
- the process of how the provider manages different opinions between jurisdictions and how it asserts Sharī'ah compliance.

125. If the provider ceases its relationship with agents or other intermediaries, it should inform the relevant customers (by written notice or electronic means) of the following:

- that the relationship with the intermediary or agent has been ceased;
- the new point of contact for contract servicing; and
- how future contributions can be transmitted, if applicable.

126. The RSA should compel the providers to maintain, at minimum, the following information related to its operation:

- Islamic insurance contract;
- fee details (*wakālah* fee, *mudarābah* profit share);
- agreement on any terms of *retakāful* cover and *retakāful* contracts;
- underwriting policies and procedures;
- *retakāful* registers for assumptions and cessions showing details of underwriting information by treaty, subscriptions, losses, commissions, etc., balances due to/from *retakāful* operators, and supporting source documents; and
- consumer complaints register.

### 3.2.2 Information on Terms and Conditions

127. In order to ensure fair treatment of customers, appropriate contract servicing requires communication with the participants whenever there is a change in the terms and conditions of the contract. RSAs may require that providers have a standard disclosure document (e.g., an updated "Product Disclosure Statement") and publish an annual statement/report to the customers.



128. Wherever applicable, any material changes in a product's underlying contract must be disclosed. The Shari'ah board of the provider should approve such changes, and an explanation of the reason for the change and how it can affect the customers must be communicated. Supervisors may require Shari'ah boards' approval before such changes are made and communicated.

129. The providers should elaborate on the details of the contribution payments, including:

- whether the contribution is made periodically or in a single lump-sum amount;
- the payment extension, allowing the customer additional time after the due date;
- for family *takāful*, the ratio of contribution divided between PRF and PIF;
- that the contribution rate applies to standard risks; and
- that the contract conditions and rates may change based on the underwriting criteria (e.g., due to better underwriting, providers may determine a new rate for contribution periodically).

130. Providers need to disclose and explain the nature, amount, and frequency of the payment of all applicable fees and charges borne by the customers, including:

- details of fees that are borne directly by the participants, e.g., the *wakālah* fee. The *wakālah* fee should be expressed both in terms of the absolute amount for each participant and as a percentage of contributions payable.
- the components of fees charged; for example, the *wakālah* fees must cover the management expenses, distribution expenses including intermediaries' remuneration, agents' commission, and other expenses involved in making products available to customers, and a reasonable and appropriate margin of operating profit.
- the amounts and purposes of any other fees and charges that are not included in the contributions but also have to be paid by customers.
- all the fees must be certified by the providers' actuary and must be considered and subsequently approved by the Shari'ah board.

131. Participants need to know in detail the implications of *qard* as a solvency mechanism.<sup>28</sup> As the *qard* shall be recovered by future surpluses, participants should be made aware of this commitment. Participants should know the amount to be recovered and TO's intended recovery strategy (especially the intended time frame and the portion of future surpluses used for the recovery). This information allows participants to analyse changes in their future "value for money".

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<sup>28</sup> See paragraph 90.

132. Providers should explain the risks covered by the contract (with all contractual inclusions and exclusions<sup>29</sup>). Whatever approach providers adopt, their communication should provide sufficient information on key features of the product, such as a benefits illustration and associated risks. It should not obscure important elements or warnings, such as exclusions, so that applicants can make well-informed decisions about the purchase of the product. Where there can be situations or events for a total or partial rejection of claims, the provider should give an explanation with the rationale for such exclusions. The explanation should be made in easy and understandable language so that consumers can understand what is covered and what is not. The providers should not use misleading and general terms such as “If the customer dies, we will cover everything” when there is, e.g., an exclusion clause for death by suicide.

133. The conditions for a free look or cooling-off period should be properly explained to the customers. The provider should inform the customers clearly that they can use the free look or cooling-off period to examine the suitability of the product. It should be highlighted that the customer has the right to return the contract within the determined period after reviewing its terms and conditions. Any expenses incurred by the provider for the period and a breakdown of such expenses should be properly disclosed.

134. The provider should inform the customer about the potential benefits and drawbacks of moving from one type of contract to another or from one provider to another. Such information must not be prejudiced and should prioritise the customer’s interests.

### **3.3 Claims Management**

135. After the inception of the contract, providers must handle claims in a timely, swift, fair, and transparent manner. They should ensure that claims are not rejected, delayed, or cut arbitrarily. RSAs should assess, in particular, whether providers:

- support customers with appropriate resources and process to file a claim;
- provide claimants with suitable and timely information;
- pay out agreed upon claims without undue delay;
- have contracts that contain clauses that function as disincentives to file genuine claims;
- impose procedural barriers to filing or pursuing claims; and
- have suitable mechanisms in place to manage complaints of unfair treatment.

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<sup>29</sup> Types of exclusions have been mentioned in TCP 19.8.12.

136. As for disputes arising from claims settlement, IFSB 27 recommends that the staff handling claims disputes be experienced and qualified, and the dispute resolution should be balanced and impartial.<sup>30</sup>

137. Providers might opt to outsource parts or all of the claim management to third parties. Prior approval from the supervisor may be required based on the jurisdiction's preference. RSAs may clearly communicate that the providers still bear the ultimate responsibility for meeting all the requirements. The RSA may use on-site inspections of the service provider to ensure that customers are treated fairly by the service provider and that the claims management is free of misconduct.

### **3.4 Complaints Management**

138. Ensuring consumer protection and fair treatment requires both RSAs and providers to have a proper complaint management system in place. The definition of complaint may vary from jurisdiction to jurisdiction. However, the definition should be wide enough to encompass all scenarios including Sharī'ah non-compliance issues. Supervisors may require providers to submit a periodic report of complaints. Reported complaints data will allow the RSAs to examine the volume of complaints and providers' efficiency in dealing with them. They can also identify certain products or situations where frequent or substantial complaints suggest further supervisory inquiry.

139. The RSAs may compile, record, and categorise types of complaints submitted by providers and received directly from consumers. This may facilitate the calculation of ratios and indicators for assessments and comparisons and for tracing industry trends in complaint management.

140. The supervisor may require providers and intermediates to implement policies and processes for complaint handling that comply with minimum standards and address complaints swiftly and fairly. They must provide several options for customers to submit complaints such as dedicated email and snail mail addresses, phone numbers, support desks, or chatbots. Such channels must be conveniently accessible and always available to customers or their agents. The complaint processes must be well recorded, and customers must be aware of them.

141. RSAs can compel providers to communicate about procedures related to claim processing and all available options for resolving disputes. Providers can monitor the action of intermediaries through ongoing observations (e.g., following complaints, mystery shopping).

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<sup>30</sup> See TCPs 19.11.9, 19.11.10, and 19.11.11 of IFSB-27.

142. Adequate measures should be established to address disputes that may arise from interactions and relationships between the provider and the consumer. As mentioned in IFSB-24, an accessible, fair, accountable, and efficient complaint handling and redress mechanism is important, but if internal routes cannot resolve a complaint, it may be referred to an external mediator for arbitration or some other form of alternative dispute resolution (ADR) such as an ombudsman. The processes and means for seeking redress and non-judicial dispute resolution mechanisms must take into account the relevant features of Sharī'ah-compliant contracts and the Sharī'ah-related issues involved in providing an appropriate resolution for customers. These solutions must be simple, affordable, easily accessible, equitable, and independent of providers and intermediaries.

143. In cases of disputes related to Sharī'ah issues, published rulings of the Central Sharī'ah board (if applicable) should be taken into consideration by the arbitrator or ombudsman. Furthermore, Sharī'ah experts can be used as competent witnesses who will help the arbitrator or ombudsman to resolve the Sharī'ah disputes. Supervisors may also require the arbitrator or ombudsman to acquire sufficient knowledge in Sharī'ah matters. The RSAs can put some eligibility criteria for resolution of Sharī'ah issues, such as:

- being a Muslim;
- knowledge and competence in the matters disputed;
- familiarity with arbitration procedures in Sharī'ah matters;
- knowledge of the Sharī'ah; and
- neutrality and impartiality.

144. Complaints must first be filed with the appropriate provider and only be escalated to ADR if the issue is not handled within the time specified or the customer is unsatisfied with the outcome of the complaints handling procedure. In these cases, the provider must inform the customer about the ADR and how to seek redress through this channel.

## SECTION 4: DIGITAL DISTRIBUTION AND PRODUCTS

145. In the first phase of digitalisation, insurers and providers supported face-to-face distribution by agents and brokers with electronic devices (e.g., tablets linked to the insurers' IT systems) that simplified and accelerated the sales and claims handling process (e.g. through instant rate quotes and on-the-spot underwriting, paperless contract management, or digital photo and video claims documentations). The next step was replacing human sales staff with animated product presentations on websites and apps, interacting via chatbots, and concluding contracts by clicking a box. In most jurisdictions, these new sales procedures were treated as an additional distribution channel where the same regulations, as in traditional channels, were applied, at least in principle.

146. Jurisdictions that were early adopters of online insurance/Islamic insurance distribution (more than two decades ago) emphasised the various risks of online distribution and insisted on adequate risk management practices, focusing on online and digital peculiarities such as technology failures, cyberattacks, data privacy issues, fraud, and the need for contingency and business resumption plans. Some jurisdictions have issued specific regulations for digital insurance sales, for example, giving instructions on digital-adequate means of communication, types and forms of pre-contractual information, tools for a self-assessment of product suitability in non-advisory sales, digital onboarding and AML/CTF procedures, cooling-off periods and withdrawal rights, understandable disclosures, data storage, contract documentation requirements, and so on.

147. Digitalisation has entered the second phase of its evolution where the focus is shifting from digital distribution channels to new types of digital insurers, intermediaries, and products. Examples are:

- digital-only insurers ;
- insurance aggregators – often starting with a sandbox licence – that act like digital intermediaries creating personalised and targeted protection packages by bundling products of several insurers;
- non-licensed firms, such as e-commerce firms or price comparison websites, that sell insurance as add-ons to other products, e.g., travel insurance; and
- short-term usage-bound risk covers, e.g., pay-as-you-use car insurance for car sharing users.

148. Overall, the result is a more differentiated and complex insurance value chain. Digital platforms that operate like regulated intermediaries outside the insurance supervision, P2P schemes resembling mutuals, or innovative tech-dependent insurance products are examples of new regulatory challenges. However, not all jurisdictions are affected by these challenges

in the same way, and responses of legislators and regulators differ in practice. A standard based on core principles that should be applied globally can only deal with issues that have attracted widespread attention and a consensus has emerged on the need for regulatory action – even if approaches and practices still differ among jurisdictions. This explains why this section deals only with issues that have attracted RSAs' attention across the globe and why high-level recommendations can point to issues but not yet refer to recognised good practices.

#### 4.1 Fairness Issues

149. *Takāful* is defined as a "mutual guarantee, whereby a group of *takāful* participants agrees among themselves to support one another jointly for the losses arising from specified risks, from a fund to which all commit to donating for the purpose." (IFSB-27, p. 432). Textbooks on *takāful*, commentaries by Sharī'ah authorities, and self-presentations of *takāful* undertakings highlight solidarity and brotherhood as the hallmarks of *takāful*, suggesting intentionally or unintentionally that the strong or prosperous support the weak or poor.

150. Such "social fairness" with a redistributive dimension can be found in social insurance systems, but it is at odds with the "actuarial fairness" that underpins private insurance schemes.

151. In conventional insurance, the simplest form of actuarial fairness is the "pure risk premium": policyholders pay a premium equal to the expected size of claims. The expected size of claims is primarily determined by the sum insured (i.e., the maximum amount of compensation when loss or damage occurs) and the likelihood of the occurrence of loss or damage. TOs are commercial enterprises competing with conventional insurance companies, and committed donations are functional equivalents of insurance premiums. Providers will be forced to apply the criteria of actuarial fairness in their rate calculations when competing with conventional insurers who charge risk-equivalent rates (unless RSAs set different rates).

152. Providers must identify individual risk factors determining the likelihood that a customer will make a claim. Then they could classify customers into risk categories according to their likelihood of future claims.

- A TO can create separate risk pools for different risk categories. The required donations will be the same for all participants in a particular risk pool (because they are in the same risk category) but differ from the required donations for participants in the other risk pools. For each risk pool that is treated as a separate PRF, the TO has to provide information on the assets, liabilities, technical balances, and solvency position of that fund, as well as information on *qard* used or available for use.

- An alternative would be to operate only one risk pool and thus only one PRF for all participants but to personalise the donations to reflect each participant's individual risk factors. The handling of all risks in only one PRF with personalised donations reflecting individual risk profiles maximises the operational flexibility of the TO but minimises the transparency for the participants (and the RSA) and blurs the conceptual differences between conventional insurance and *takāful*.

153. The greater operational flexibility, the competitive environment, and the access to risk-relevant big data make it attractive for TOs to practice the segregation of funds (which is conceptually a necessary condition in *takāful*) only at the top level of participants' and shareholders' funds.

154. In jurisdictions where segregation of funds is permitted or required, the RSAs should clarify the minimum and/or the maximum number of segregated funds that must/can be formed.

155. If the legal and regulatory system allows (or mandates) risk-equivalent rates, a competitive environment will push TOs towards lower rates for low-risk participants and higher rates for high-risk participants. Risk-adjusted rates meet the criteria of actuarial fairness. Equal rates for all with an implied subsidy of high-risk participants by low-risk participants will not prevail in a competitive market.

156. Consumer financial education (see section 6) should explain the concept of actuarial fairness in its technical and ethical dimensions. TUs are free to deviate from this concept towards more "social fairness" with a redistributive dimension, but they should explain how this can be sustained in the market.

157. If equal rates are desired, regulatory intervention is required and needs justification. One justification is that social fairness (solidarity) calls for risk-independent equal rates when an individual cannot control the risk factors. For example, inherited disorders or defects are beyond the control of individuals and should not be considered in health *takāful* pricing decisions.

158. The RSA should provide guidance on restrictions for the risk-equivalent pricing of contracts that result from anti-discrimination, equal treatment, personal data protection, and other general laws, regulations, and court decisions.

## **4.2 Knowledge about Customers through Digitalisation**

159. Providers have to act in the best interest of customers. This requires knowledge about customers' interests. Traditionally, providers gain knowledge about individual consumers primarily during the contracting process. In recent years, the digitalisation of nearly all

dimensions of life has generated an enormous pool of data ("Big Data") that providers can utilise to enhance their knowledge about consumer behaviour and develop new products that better meet individual consumer preferences.

#### *4.2.1 Artificial Intelligence and Protected Groups*

160. Providers can use Big Data to learn more about individual risk factors. Artificial intelligence (AI) systems have identified particular consumer data (e.g., social media activities or credit scorings) as good predictors for claims with no apparent causal relationship to the likelihood of loss or damage. If underwriting is based on AI systems, the result could be a refusal to underwrite or a prohibitively high price due to AI-detected risk factors. AI-detected risk factors can be highly correlated with and proxies for factors that define protected groups. Thus, algorithmic decisions could result in discrimination. Biases in historical training data for machine learning algorithms can produce such effects. Such issues with algorithmic decisions or decision support fall primarily within the competence of privacy and data protection authorities. RSAs for the Islamic insurance industry should coordinate interventions with them.

161. Because of the potentially life-altering consequences of adverse actions (like the refusal to underwrite or prohibitive pricing) and their obligations as fiduciaries, providers should present the RSAs with full details of the data used for the training of algorithms, the data processing methods, and the results of tests against biases. Insurers and providers should inform potential and actual customers about relevant data protection.

162. TOs must inform customers about using AI-driven devices and models. Consumers should know whether they interact with robots or humans. Applicants and customers should be informed whether decisions on contract terms, pricing, and claims are taken by AI or by human beings supported by AI. They have a right to get a substantial explanation of the reasons for an AI-driven adverse action in a language understandable by non-experts. Providers should be encouraged to engage in initiatives that promote the ethical use of AI.

#### *4.2.2 Behavioural Insights and Products*

163. Digitalisation has opened up new sources of data on consumers' risk and shopping behaviour. The data can be collected by providers themselves or sourced from data vendors (within the limits of the data protection laws of the respective jurisdiction).

##### *Risk-related Data*

164. People use wearables and activity trackers to monitor their health and fitness, smart IoT devices (sensors, cameras, etc.) to enhance home security, and telematics to record their driving habits. Consumers who are fit, healthy, living in a secure environment, and consider themselves safe drivers are willing to share risk-related data from their devices with providers



in exchange for lower premiums/contributions on their health, life, home, and motor insurance. Digital technologies enable risk carriers to offer contracts based not only on group-level (average) risk data but (also) on individual customers' risk information. Customers are comfortable with the stringent adherence to the principle of actuarial fairness in pay-as-you-behave contracts.

165. Digital technologies have enabled not only individual behaviour-related pricing but also usage-bound risk covers for very short periods ("episodic cover"). Pay-as-you-use contracts or on-demand insurance are offered in particular for activities in the sharing economy (e.g., as a temporary homestay landlord, carpool driver, or user of a carsharing vehicle), for motor insurance by driven miles, or travel insurance by hours/days of travel.

166. In conventional insurance, the prime motive to buy highly individualised and targeted risk covers at individual prices is not to support others (i.e., solidarity or mutuality). The motive is to transfer residual (pure) risk that the consumers cannot eliminate by individual preventive measures to a capable risk carrier.

167. Providers that offer highly individualised pay-as-you-behave and pay-as-you-use contracts should clearly define the triggers that switch the cover on and off and list covered and excluded risks in detail.

168. TUs should explain to applicants in a comprehensible language the particularities of the *takāful* structures compared to conventional products.

169. Most pay-as-you-behave and pay-as-you-use contracts are based on technical devices that record and transmit data. For these data-intensive products, data protection and cyber security are top priority. Other important issues are procedures and consequences in case of an interruption of data recording and transmission or malfunctions of essential devices.

170. When the recording and transmission of data are necessary, insurers must provide manuals with the detailed rights and obligations of the contracting parties in cases of technical defects and malfunctions and install contingency and business resumption plans.

171. Price comparison gets more difficult when individual risk factors that co-determine prices are not publicly known. Prices charged for the same risk can vary notably between customers, but the reasons for this variance are not evident to third parties. To determine whether a rate is reasonable, the customer must get individualised quotes from other insurers based on the customer's individual risk factors. Customers may be reluctant to reveal their identity and sensitive personal data to several insurers just for rate comparison. If this reluctance is widespread, price competition would be hampered, which is not in the interest of consumers.

172. To support the transparency of individualised prices, consumers should be able to get individualised rate quotes based on their risk factors without being forced to reveal their identity multiple times. Providers should be encouraged to make available rate calculators that generate quotes based on individual risk factors by anonymous self-service. As long as users do not reveal their identities, quotes are not binding. Alternatively, service providers such as comparison platforms, online brokers, aggregators, or consumer organisations could be authorised to collect quotes on behalf of the consumer.

#### *Digital Insurance as Add-On*

173. Digitalisation has enhanced the knowledge about consumer behaviour (unrelated to individual risk factors) and facilitated the design and distribution of insurance contracts that are often sold as bundles with or add-ons to other goods or services (including a main insurance). Examples are mobile phone and gadget insurance, purchase protection insurance, personal accident insurance, and travel insurance. Cross-selling insurance in packages may bring convenience for customers and give them some cost advantages. Still, there are also significant risks of mis-selling. Sellers of the main product with which insurance is bundled, such as e-commerce firms or digital platforms, have no fiduciary duties to customers. The customers themselves must find out whether the insurance add-on is suitable for them and a reasonable value for money. RSAs in several jurisdictions have observed that this is often not the case.<sup>31</sup> Customers may be pushed or nudged to accept insurance add-ons – e.g., by "only now" pop-ups or pre-ticked boxes at check-out – with little or no time to assess the value for money, calculate future costs and benefits, and look for alternatives.

174. To prevent digital cross mis-selling of tied and bundled add-on insurance products, the insurance sale should be clearly separated from the sale of the main product. The add-on insurance should be described appropriately in a separate document or dedicated section of the seller's/provider's website or app. Furthermore, the following should be considered:

- provide channels for interactive enquiries;
- display prices for each component of a package/bundle separately;
- make each component (de)selectable individually;
- avoid using pre-filled tick boxes with acceptance as default; and
- allow for distinct cooling-off periods or deferred sales arrangements for tied and bundled *takāful*.

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<sup>31</sup> For example, the Financial Conduct Authority of the United Kingdom systematically measures the value for money of general insurance products (<https://www.fca.org.uk/publications/policy-statements/ps20-9-general-insurance-value-measures>). It was particularly concerned about the potential value of personal accident and key coverage where these are sold as "add-ons" to other insurances. For the 2019 data, less than 20% of the value of premiums firms received for these add-ons was, on average, paid out in claims. <https://www.fca.org.uk/data/general-insurance-value-measures>

175. For bundles of products from different providers, the bundling firm should act as the contact point for all kinds of complaints, passing them on to the appropriate product provider for a response. Alternatively, the bundling firm could list what kind of complaint should be addressed directly and to which provider.

#### 4.2.3 *Behavioural Insights and Pricing Strategies*

176. Consumers' digital footprints (from e-commerce, social media, digital finance, telematics, etc.) grant insights into their lifestyle and behaviour. Insurers use the data for various purposes, e.g., for marketing, product development, fraud detection, and pricing. Behavioural characteristics of individual consumers can be identified from Big Data (i.e., from non-insurance databases and consumer profiles sourced from data vendors).

177. Providers that source data from third parties and use them for risk classification should document their assessment of the quality and reliability of the sourced data. They must ensure that externally sourced data and their collection procedures do not violate personal data protection laws and regulations of the customer's country of domicile.

178. Providers should explain the conformity of their own and their service providers' data practices with privacy principles.

179. Sensitive data is not always utilised in the customers' best interest. A main concern of RSAs is pricing strategies where price differentials do not reflect differences in expected losses and expenses but are due to non-risk factors, such as the customer's price sensitivity and propensity to shop around for alternatives at renewal. Consumer advocates criticise that price optimisation exploits the customer's willingness to pay to increase the insurer's profit. The result can be an unfair price structure where customers with the same risk profiles are charged different rates (price discrimination). Customers who are less likely to shop around pay higher prices. This may be customers with low financial literacy and limited access to alternatives.

180. A special form of price optimisation is price walking, where customers with existing contracts and a low propensity to switch to new providers pay higher rates at renewals than new customers. In addition, the renewal rates increase regularly without changes in the underlying risk profiles of the customers. As a result, loyal consumers pay the highest prices.

181. Legislators and regulators in many jurisdictions have taken measures against unfair discriminatory rates. Even though IFSB complements IAIS and does not cover pricing principles in the *takāful* core principles standard, consumer protection requires some thoughts on the conduct of business related to pricing that can result in unfair treatment of customers.

182. The RSA should explicate what pricing practices would violate the principle of fair treatment of customers. Price differentials should reflect differences in expected claims and expenses. To avoid unfair discrimination, insurers should charge the same rates to customers with the same risk profiles. Providers should disclose which personal risk and non-risk data from Big Data pools are utilised for underwriting and personalised pricing.

183. Providers should refrain from pricing strategies that differentiate rates according to the individual likelihood of switching at renewal. In jurisdictions where automatic renewals are not banned, informing consumers about their right to cancel an autorenewal and how to do so conveniently would be good practice. Providers should disclose the rules for price adjustments when autorenewal is active. As a best practice, providers should commit themselves to charge renewal prices that are not higher than the prices for equivalent new contracts.

184. Insurers that apply predictive modelling (e.g., data mining, AI, machine learning, deep learning, etc.) for insights about consumers and pricing should disclose the findings in detailed form to the RSAs.

### **4.3 New Digital Market Players**

185. The second phase of digitalisation gave birth to several new business models and institutional arrangements in the insurance industry: digital-only insurers, P2P mutuals, online brokers, aggregator websites, etc.

186. In some jurisdictions, platforms and aggregators have achieved strong positions in retail markets. RSAs for the insurance industry should cooperate with competition authorities to avoid market power abuse and foster consumer protection.

187. All jurisdictions should clarify which laws and regulations apply to new types of insurance distribution and service providers (particularly digital platforms and aggregators). They should, where necessary, amend existing laws and regulations to ensure a level playing field and prevent regulatory arbitrage.

188. All players in the insurance market, in particular platforms and aggregators, should provide on their websites clear and understandable information about their business model, services provided to customers, pricing principles, and the contractual relations (including remunerations) between them, their customers, insurance providers, and other third parties. The following need to be ensured:

- Platforms should be transparent in their listing, ranking, and de-listing decisions.
- Comparison websites and aggregators should display their regulatory status (e.g., not licenced, sandbox, fully licensed) and explain whether they are allowed to provide

recommendations/advice to consumers. They should inform users about commissions they receive for brokered contracts.

- All players must install easily accessible complaint handling mechanisms.

189. International standards or national laws and regulations for Shari'ah governance apply to the providers of *takāful* or other types of Islamic insurance contracts but usually not to independent distributors and other providers of services for the Islamic insurance industry (like digital platforms and IT firms). Regardless, businesses that handle Islamic financial products should be able to explain to consumers their Islamic characteristics.

190. A firm that actively promotes Islamic insurance products (e.g., by highlighting Shari'ah compliance as a distinguishing feature compared to conventional alternatives) must be able to explain the Islamic characteristics of a product compared to conventional or other Islamic products. The firm should operate an interactive system where customers can ask questions about Shari'ah specificities in natural language.

191. A firm that claims to be Islamic in a jurisdiction where no specific laws and regulations are in force should apply the international Shari'ah governance standards proportionate to its size and type of activity.

192. Important new players in digital markets can achieve strong or even dominant market positions in parts of the digital insurance value chain, e.g., in algorithmic risk modelling, natural language procession, or real-time data communication. These new players may be InsurTech firms, Big Techs, or telecommunication companies not regulated or supervised by insurance RSAs. Nevertheless, their market strength can significantly impact the conduct of the business of insurers who depend on the products and services of these firms.

193. Insurance RSAs are encouraged to cooperate with regulatory authorities responsible for communication infrastructure and competition to identify possible concentration and interconnectedness risks in the insurance sector caused by dominant market positions of technology and infrastructure providers.

## SECTION 5: RISK-BASED SUPERVISION

194. Risk-based supervision for the conduct of business will assist supervisors in adequately using scarce resources by identifying the depth and scale of issues, focusing on priorities and resources where they matter most, and prioritising riskier customer issues and providers while constantly monitoring and improving the dynamic capacity of RSAs to respond to innovation and change.<sup>32</sup>

195. A risk-based consumer protection supervision adheres to the same fundamental notions as risk-based prudential supervision, such as inherent risk and risk mitigants. However, COB risks are distinct from prudential concerns which require additional attention from the supervisors.

196. According to IFSB-20, while distinctions are sometimes drawn between risk-based and compliance-based approaches to supervision, confirming compliance by the TUs with supervisory requirements is an essential part of supervision. Those requirements are generally formulated to prevent or mitigate risks. While an approach based purely on compliance can readily lead to a checklist mentality, compliance monitoring is essential to assure that intended outcomes are achieved and may also help identify more deeply-seated risks.

197. A risk-based supervision framework to address prudential concerns of the *takāful* industry has been provided in IFSB-20, which can assist RSAs in building a risk-based framework for the COB. The standard also mentions that a risk-based approach should consider specificities of *takāful* as the assessment of impact must take account of the segregation of funds and the risk of Sharī'ah non-compliance, which may have impacts from both the prudential perspective and that of conduct of business.

198.

### 5.1 Conduct of Business Risk

199. IAIS defines the conduct of business risk as “the risk to consumers, insurers, the insurance sector or the insurance market that arises from insurers and/or intermediaries conducting their business in a way that does not ensure fair treatment of consumers.”<sup>33</sup> Retail risks are a subset of COB risks with a focus on consumer outcomes.<sup>34</sup>

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<sup>32</sup> EIOPA (2021) Conduct of Business Supervision Strategy

<https://www.eiopa.europa.eu/sites/default/files/publications/eiopa-strategy-on-conduct-supervision-2021.pdf>

<sup>33</sup> IAIS (2015) Issues Paper on Conduct of Business Risk and its Management

<https://www.iaisweb.org/uploads/2022/01/151123-Issues-Paper-on-Conduct-of-Business-Risk-and-its-Management.pdf>

<sup>34</sup> EIOPA defines retail risks as "possible risks to consumers due to insurers and intermediaries conducting their business in a way that may not always serve the interests of the customers."

200. The development of effective risk-based conduct supervision requires a systematic analysis of the conduct of business risk in the market. Types of conduct risks can vary from jurisdiction to jurisdiction due to factors such as macroeconomic conditions, size, structure, growth and product mix of the Islamic insurance industry, distribution models (including digital distribution), etc. RSAs need to have a proper mechanism to exchange information between authorities if separate supervisors do prudential and conduct supervision because prudential issues can indicate market conduct problems and vice versa.

## **5.2 Identification of Conduct of Business Risk**

201. Identification of risks requires supervisors to collect quality data in an appropriate quantity and a timely manner. The main source of data for the supervisors can be information provided by the providers. To ensure the quality and adequate quantity of timely collected data and their appropriate usage, the supervisor should have a proper framework to define the data needs and required collection frequencies in detail. It will assist the RSA in linking the data collected to supervisory objectives and determining the specific usage of each data point. Quality data also require the standardisation of definitions by the supervisors (e.g., complaints vs enquiries).

202. Based on jurisdictions' capabilities and resources, RSAs can also expand their data collection to unstructured data in large quantities (Big Data) by utilising digital technologies (e.g., RegTech). This will assist the supervisors in collecting public information from the internet (e.g., complaints data for the whole Islamic finance industry from ADR and customer complaints on different social media platforms).

203. Through a risk-based approach, RSAs need to ensure that differential pricing practices do not lead to an unfair treatment of customers. Supervisors should carry out market monitoring activities to identify those products and market segments for which differential pricing practices are used and have the highest risks related to consumer protection.

### *5.2.1 Supervisory Tools to Identify Conduct of Business Risks*

204. While the framework for risk-based conduct supervision may differ, RSAs can commonly use some tools for both prudential and conduct supervision purposes. IFSB-20 has recommended<sup>35</sup> the following tools which can apply to both prudential and market conduct risk identification and mitigation:

- supervisory reporting

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EIOPA (2021) Retail Risk Indicators – Methodology

[https://www.eiopa.europa.eu/sites/default/files/publications/retail\\_risk\\_indicators\\_methodology\\_for\\_publication.pdf](https://www.eiopa.europa.eu/sites/default/files/publications/retail_risk_indicators_methodology_for_publication.pdf)

<sup>35</sup> For details see section 2.2 Supervisory Tools.

- off-site monitoring
- on-site inspection
- supervisory follow-up
- enforcement
- event-based supervision
- thematic review

205. Some additional tools and techniques that can be used specifically for conduct supervision<sup>36</sup> are:

1. **Consumer Trend Report:** RSAs can prepare a consumer trend report by analysing the market and complaints, if appropriate, in collaboration with other supervisors (e.g., separate supervisors for Islamic banking and capital markets). The result can be a snapshot of trends related to specific consumer protection issues in Islamic insurance and the overall Islamic finance industry with implications for *takāful*. The report can take inputs from different stakeholders, such as associations of actuaries, consumer protection bureaus, Shari'ah boards, researchers, and media, to get a more granular understanding of the issues.
2. **Risk Heatmap<sup>37</sup>:** A graphical presentation of identified main risks can give the supervisor a broader understanding of risks that need prioritisation and emerging risks. The heatmap can complement the consumer trend report.
3. **Mystery Shopping:** Through mystery shopping, supervisors can collect information related to providers' and intermediaries' practices. Mystery shopping requires a staff of RSAs or an appointed representative (e.g., a market research firm) to act as a retail customer. Through this, the supervisor can experience the practices of providers and intermediaries at different points of the contract life. By documenting the process, RSAs can identify or confirm normal practices of providers and the industry that could not be verified through other means.
4. **Whistleblowing:** Apart from consumer complaints, a whistleblowing programme can help RSAs to collect market misconduct information from former or current employees of providers, industry practitioners, actuaries, and any interested group. This can be through an online platform where related parties can anonymously provide relevant information or report issues such as potential breaches in operations that can have an impact on customers, likely conflicts of interests, or any other material concerns. The

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<sup>36</sup> Some of the tools are adopted from EIOPA's Conduct of Business Supervision Strategy, EIOPA (2021) Conduct of Business Supervision Strategy

<https://www.eiopa.europa.eu/sites/default/files/publications/eiopa-strategy-on-conduct-supervision-2021.pdf>

<sup>37</sup> An example can be:

[https://www.eiopa.europa.eu/sites/default/files/working\\_groups/reports/eiopa\\_2021\\_consumer\\_trends\\_report\\_-\\_heat-map.pdf](https://www.eiopa.europa.eu/sites/default/files/working_groups/reports/eiopa_2021_consumer_trends_report_-_heat-map.pdf)



reporting of misconduct can be incentivised to encourage related parties to use the whistleblowing platform (e.g., by a financial reward if the information provided leads to enforcement action by the supervisor or enhancement of consumer protection). For the whistle-blower programme to work effectively, the RSAs must have whistle-blower protection<sup>38</sup> in place. A whistle-blower protection framework requires supervisors to provide effective legal protection and clear guidance on reporting procedures.

### 5.2.2 Assessing Conduct of Business Risk through the Product Lifecycle

206. The product lifecycle starts with the development and design of a *takāful* or Islamic insurance product. It is paramount that providers have sound principles and procedures to ensure that product development and design do not result in unfair treatment of consumers.

#### *Business Model and Management Risks*

207. Business model and management risks arise from how undertakings structure, drive, and manage their business and relationships with other entities in the value chain. These risks can impact customers throughout the whole product lifecycle, while product development and design, delivery, and product management risk only materialise at different stages.

208. An example of a relevant business model risk is the use of third parties (such as a marketing agency, claims adjustor, or InsurTech firm providing data and algorithms for predictive analytics). Customers can expect Shari'ah compliance of all products and processes. Providers that use outsourcing arrangements must ensure the Shari'ah compliance of all the services provided by external partners. However, risks may arise if Shari'ah aspects do not play a role in the usual business of these partners or if they lack adequate knowledge of Shari'ah.

209. Another group of business management risks is the business culture and governance structures. If the undertaking presents itself as *wakil*, the principle of "consumer first" should be internalised by everybody in a TO, from directors to sales staff. It should also guide the behaviour of all intermediaries. Furthermore, the governance structure should not only ensure Shari'ah compliance but also consider the special status of participants and give them an appropriate voice to avoid or mitigate conflicts of interest.

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<sup>38</sup> For examples of different whistleblower protection frameworks refer to "Committing to Effective Whistleblower Protection" by OECD [https://read.oecd-ilibrary.org/governance/committing-to-effective-whistleblower-protection\\_9789264252639-en#page4](https://read.oecd-ilibrary.org/governance/committing-to-effective-whistleblower-protection_9789264252639-en#page4)

### *Product Development and Design Risks*

210. Product development and design risks arise from how providers develop and design Islamic insurance products before they are marketed and how the products are targeted to consumers. A risk specific to Islamic insurance in design and development is the Sharī'ah non-compliance and failing to adhere to respective regulatory requirements of products. Less obvious dimensions of development and design risks are related to market targeting, value for money, and pricing of products.

211. Providers should also consider the affordability of their products in their pricing policies, especially in jurisdictions where financial inclusion ranks high on the political agenda. Higher prices for Sharī'ah compliant products with the same level of protection as cheaper conventional insurance policies do not go together well with ideas of solidarity and mutual help. Unaffordable prices that force poorer Muslims to remain unprotected or buy protection from conventional insurers would damage the reputation of the Islamic insurance industry.

212. Where Islamic undertakings compete with conventional insurance firms for customers, providers may use similar price optimisation techniques or design elements that hamper the switching to another Islamic provider. Such practices harm participants and should be addressed by the RSAs. Sharī'ah authorities should examine such issues and give advice on how to avoid reputational and Sharī'ah non-compliance risks.

213. In general, fairness in pricing should be an important consideration for Islamic insurance. An undertaking that holds itself out as ethical and bound by Sharī'ah creates (intentionally) high consumer expectations regarding its business practices. It is in its own interest to avoid reputational and Sharī'ah non-compliance risks. Lack of transparency and obscurity related to practices that have attracted the attention of regulators and have come under public scrutiny could cause reputational damage. Consumer protection and self-interest of providers suggest (and the regulator may stipulate) that their Sharī'ah boards take a common stance on disputed practices and communicate it in an appropriate format.

214. When no general regulation exists, and a provider publicly declares Sharī'ah-motivated self-restraint regarding disputed pricing and design practices, this should be done in a way that allows the measurement of the adherence to the self-restraint, and the provider should disclose measurement results in an appropriate format.

### *Marketing and Distribution Risk*

215. Marketing and distribution risks arise from how products are brought to the market and from the interaction between customers and Islamic insurance undertakings or intermediaries at the point of sale. A particular feature of *takāful* contracts – that the participants are the

owners of the PRF and entitled to the underwriting surplus – may give rise to a conflict of interest and risks when marketing strategies or sales pitches create unrealistic consumer expectations regarding surplus distribution.<sup>39</sup> The realised surplus may be less than expected by consumers (or even negative), or it may have to be used to repay a *qarḍ* or build up necessary technical reserves.

216. A more fundamental conflict of interest can be easily overlooked because the TO and the participants may both welcome surpluses in the PRF – even when the TO is not entitled to any surplus in the risk fund. However, the TO may have an incentive to create a surplus by overcharging the participants as much as the competitive situation permits.<sup>40</sup>

217. Other marketing and distribution risks specific to Islamic insurance result from the complexity of advanced protection products, particularly those with a savings and investment element as in unit-linked family *takāful* and unit-linked Islamic family insurance products. The diversity of assets (funds) for the Sharī‘ah compliant investment of the savings of customers and the great flexibility and adaptability to changing circumstances or customer preferences make the unit-linked concept attractive for structuring an Islamic insurance scheme. However, these features also create a fertile ground for marketing, distribution, and sales risks, including but not limited to difficulties in demonstrating products’ Sharī‘ah-compliance to consumers, inappropriate marketing campaigns, intermediaries’ lack of knowledge, scarcity of qualified distribution partners who share the principles and culture of the provider, and mis-selling due to misunderstanding of product features by both the customer and the salesperson. This all leads to poor outcomes for customers.

218. Poor outcomes for customers could also be due to insufficient customer knowledge of particular Sharī‘ah rules related to an Islamic insurance contract, such as the role of the nominated beneficiary in a family *takāful* contract. While the death benefit paid by a conventional insurer to the nominee of a life insurance policy will belong to that beneficiary, this should be different in Islamic insurance.<sup>41</sup> There is a detailed Islamic law of inheritance that must not be circumvented by Islamic insurance contracts. If nothing else is determined,

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<sup>39</sup> Consumers may join a *takāful* scheme with the expectation of regular or higher surplus returns. This might not be a fairness issue but one of incorrect expectations which have not been addressed effectively by the TO during the sales process (or maybe even supported by misleading information). A remedy might be a change in marketing (to generate more realistic consumer expectations) or better consumer education.

<sup>40</sup> Neglecting returns from the investment of the PRF assets, the source of a surplus is the inflow of participants’ contributions (e.g., \$100). The TO charges a *wakālah* fee that is a percentage of the paid contributions (e.g., 25%). It may turn out that only an amount of  $x$  (e.g., \$70) is needed to match the liabilities. Anything the PRF has received beyond  $x$  is a surplus and can be re-distributed to the participants. However, since the *wakālah* fee is charged upfront as a percentage of the paid contribution, the PRF will only receive the paid contribution net of the *wakālah* fee (= \$75 in the example). While the surplus ( $75 - 70 = \$5$ ) can be distributed to the participants, the *wakālah* fee needs not to be refunded in proportion. It is entirely at the discretion of the TO to do so or not. This creates an incentive for the TO to overcharge, which cannot be in the interest of the participants.

<sup>41</sup> Some jurisdictions might have a different practice which can be in line with Islamic inheritance law.

the nominated beneficiary should play the role of a trustee and facilitate the distribution according to the Sharī'ah rules. The provider or intermediary should inform customers about these peculiarities.<sup>42</sup>

219. An additional risk related to product management arises about how contracts are managed and how providers and intermediaries interact with consumers from the sale until the completion of the contract. Providers have to give priority to the Sharī'ah qualities of their products at all times and their market acceptance. Data on handling complaints about Sharī'ah aspects could help identify weak points and guide the providers when overhauling the contractual terms or the public presentation of a product or modifying critical design elements. Data on the use and outcomes of external dispute settlement mechanisms (where available) can also help to improve future customer experiences. Providers should collect data on complaints and complaints handling and submit them to the competent RSA.

220. Theoretical knowledge and practical examples have facilitated the systematic listing of conduct of business risks over a product lifecycle. Not all of these risks materialise everywhere, and the likelihood of materialising is higher for some risks than for others. Therefore, developing a set of indicators that can flag situations where hypothetical risks could soon materialise would be useful.

### **5.3 Indicators for the COB Risks**

221. Customer-centric conduct monitoring necessitates a focus not just on the risks to which the provider exposes itself but also on the risks to which the conduct exposes its customers.<sup>43</sup>

222. To supervise COB risks, RSAs need risk indicators that differ from or add to those relied on for prudential supervision. For example, COB supervisors must consider the extent to which the risk management frameworks and risk categorisation tools used by providers are effective in identifying COB risks.

223. The indicators will assist in understanding trends and identifying potential risks to customers due to providers and intermediaries conducting business in ways that may not always serve the customer's best interests. These indicators can also provide a forewarning of how specific characteristics and distribution procedures of various products may influence consumer behaviour.

224. The following indicators for potential COB risks can be calculated based on the data collected by the RSAs in the jurisdictions:

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<sup>42</sup> Consumers should also be informed by the TO or intermediary about the treatment of *takāful* contracts in the law of the land if that does not recognise the Islamic law of bequest and inheritance.

<sup>43</sup> IAIS (2014) Application Paper on Approaches to Conduct of Business Supervision [https://www.iaisweb.org/uploads/2022/01/Application\\_Paper\\_COB\\_supervision\\_final.pdf](https://www.iaisweb.org/uploads/2022/01/Application_Paper_COB_supervision_final.pdf)

- *Commission Rates.* High commission rates create incentives to push sales to generate income. High commission rates are a potential driver for mis-selling and could imply a disproportion between consumer benefits and premiums paid, giving consumers a low value for money.
- *Wakālah.* High *wakālah* fees can prevent the recovery of an outstanding *qard* or even force the PRF into deficit and are detrimental to the interest of customers.
- *Surrender Ratio.* A high surrender ratio could point to a product not being adequate for the target market, and, respectively, for consumers' needs.
- *Claims Ratio.* In the non-life business, an extended period of a low or sharply decreasing claims ratio may result from high claim refusals or low claim payouts, which indicates potential mis-selling or bad wording of contracts and could lead to more claims-related complaints. However, a decreasing claims ratio could also relate to external factors or positive developments regarding loss events.
- *Claims Rejected Ratio.* A high claims rejected ratio can indicate potential mis-selling or a poor product design. It could also indicate inadequate documentation of claims by consumers or claims for issues not covered. A low rate combined with a low claims ratio could signal over-insurance.
- *Claims Open Ratio.* A high percentage of open claims at the end of the year can signal delays in handling, but also the complexity of claims.
- *Combined Ratio.* A combined ratio below 100% indicates profit. Combined ratios "lower than normal" (= "profits beyond normal") could result from products that offer poor value for money to consumers and inappropriate marketing and sales behaviour.
- *Gross Written Contribution (GWC) Growth.* A high GWC growth could result from good consumer policies, general market trends, or aggressive sales practices. Rapid growth can enhance operational and other risks.
- *New Contract Growth.* Same as GWC growth, measured in terms of the number of contracts.
- *New Contract Ratio.* A high proportion of new contracts over the total number of contracts may point to aggressive sales practices, especially if GWC growth and New Contract growth are also high.
- *Return Ratio.* Low or negative returns (= sum of dividends, rent, net gains and/or losses, and unrealised gains and/or losses) on unit-linked assets have a significant detrimental impact on consumers, especially if coupled with high costs. The return ratio reflects the overall return for assets held in unit-linked and index-linked contracts.
- *Ongoing Costs.* High ongoing costs (expected expenses on expected contribution and liabilities best estimate) potentially reduce the yield for unit-linked products.

- *Illiquidity Ratio*. A high proportion of less liquid assets to total assets backing unit-linked contracts could pose an illiquidity risk to consumers.
- *Variation of Illiquidity Ratio*. An increase in the illiquidity ratio increases the risk for consumers and could indicate a shift in the business model.

225. Additional risk indicators can identify COB risks during the product life-cycle. The list of risk indicators for the product development and design and the delivery stages of the product lifecycle can be enhanced by risk indicators for the product management stage based on complaints data.

- *Percentage of product-related complaints on total complaints* can indicate specific product-related risks.
- *Product complaints received by Islamic Insurance undertakings year-on-year growth* indicate specific product-related risks and trends.
- *Product complaints as a percentage of total complaints received by an external dispute resolution mechanism* can indicate specific product-related risks and point to issues with the undertaking's internal complaints handling mechanism (such as speed, fairness, and transparency).
- *Product complaints received by an external dispute resolution body year-on-year growth* can support the diagnosis of product-specific issues and deficiencies of the internal complaint handling mechanism.
- *Percentage of cause-related complaints on total complaints* can indicate specific cause-related and product lifecycle risks.
- *Cause-related complaints received by Islamic Insurance undertakings year-on-year growth* allows the monitoring of trends and identification of emerging risks related to stages in the product lifecycle.
- *Cause-related complaints as a percentage of total complaints received by an external dispute resolution mechanism* can confirm cause-related risks and identify issues with the internal complaints handling mechanism.
- *Cause-related complaints received by an external dispute resolution body year-on-year growth* can support the diagnosis of cause-specific issues and deficiencies in the internal complaint handling mechanism.

226. Supervisors can also cluster indicators based on the focus area, which can assist them in setting strategies and allocating resources based on the priorities. The examples provided

by the IAIS report<sup>44</sup> on how different jurisdictions cluster indicators into focus areas, can also be applied to Islamic insurance COB supervision.

	Focus area	Example indicators <sup>45</sup>
1	<b>Claims</b>	<ul style="list-style-type: none"> <li>• Claims volumes and amounts</li> <li>• Claims outcomes or status such as registered, pending, denied, accepted, or withdrawn</li> <li>• Claims ratio</li> <li>• Reasons for claims not being paid or delayed</li> </ul>
2	<b>Persistency, renewals, and alterations</b>	<ul style="list-style-type: none"> <li>• Lapse and cancellation rates or persistency ratio</li> <li>• Renewal ratio</li> <li>• Reasons for poor persistency</li> <li>• Proportion of cancellations post a certain period, e.g., free-look or time tranches, churn and replacement rates</li> </ul>
3	<b>Complaints</b>	<ul style="list-style-type: none"> <li>• Overall complaint volumes</li> <li>• Complaints by issue, status/resolution outcome, or by channel, insurer, and product line</li> <li>• Complaint rates</li> <li>• Complaint reasons</li> <li>• Dispute numbers and rates</li> </ul>
4	<b>Pricing and cost structure - fees, commissions, expenses</b>	<ul style="list-style-type: none"> <li>• Combined ratio</li> <li>• Expense ratio</li> <li>• Amount of commission and non-commission fees</li> </ul>
5	<b>Micro-takaful-specific</b>	<ul style="list-style-type: none"> <li>• Take-up rate</li> <li>• Renewal ratio</li> </ul>
6	<b>Investigation for fraud</b>	<ul style="list-style-type: none"> <li>• Number/proportion of claims flagged or investigated for fraud and the outcomes</li> </ul>
7	<b>Industry-wide indicators</b>	<ul style="list-style-type: none"> <li>• Includes areas such as distribution and product landscape, prudential data, business and policy growth</li> </ul>
	<b>Other</b>	<ul style="list-style-type: none"> <li>• Includes areas such as product design and selling practices, product landscape, customer satisfaction, information delivery, advertising channels and practices, outsourcing, and providers' internal policies and practices</li> </ul>

227. TCP 19 outlines certain outcomes that need to be achieved regarding the fair treatment of consumers. The risk indicators can also be used to assess multiple conduct outcomes. The following table highlights the most frequently used indicators to assess each conduct outcome.<sup>46</sup>

<sup>44</sup> Report on Supervisors' use of key indicators to assess insurer conduct, IAIS (2022).

<sup>45</sup> Indicators are explained in Annex 2 of the report.

<sup>46</sup> See footnote 52

Outcome	Indicators most frequently used
<b>Appropriateness of target market</b>	<ul style="list-style-type: none"> <li>• Complaint volumes, issues, and reasons</li> <li>• Consumer segmentation and target market</li> <li>• Cancellation rates</li> </ul>
<b>Quality of advice</b>	<ul style="list-style-type: none"> <li>• Complaint volumes, issues, and reasons</li> <li>• Lapse rates and reasons for poor persistency</li> <li>• Claims outcomes</li> </ul>
<b>Customer experience</b>	<ul style="list-style-type: none"> <li>• Complaint volumes, issues, and reasons</li> <li>• Claims turnaround times</li> <li>• Complaint handling turnaround times</li> </ul>
<b>Quality of service</b>	<ul style="list-style-type: none"> <li>• Complaint volumes, issues, and reasons</li> <li>• Claims turnaround times</li> <li>• Lapse rates</li> </ul>
<b>Mis-selling</b>	<ul style="list-style-type: none"> <li>• Complaint volumes, issues, and reasons</li> <li>• Lapse and cancellation rates</li> <li>• Complaints by channel/insurer/product</li> </ul>
<b>Customer value</b>	<ul style="list-style-type: none"> <li>• Claims ratio, volumes, and values</li> <li>• Rates and reasons for claim denied</li> <li>• Claims turnaround times</li> </ul>
<b>Appropriateness of product</b>	<ul style="list-style-type: none"> <li>• Complaint volumes, issues, and reasons</li> <li>• Complaints by channel/insurer/product</li> <li>• Lapse and cancellation rates</li> <li>• Advertising expenses</li> </ul>

228. As for *takāful*, Sharī'ah compliance, surplus distribution, and *qard* have additional COB risk dimensions. To address them, the following indicators can be used:

1. **Sharī'ah non-compliant income:** The trend of Sharī'ah non-compliant income can highlight a TO's approach toward managing Sharī'ah non-compliance risk. If the trend is increasing or the individual TO has a higher Sharī'ah non-compliant income than the industry, this can indicate a COB issue.
2. **Disputes related to Sharī'ah compliance:** The pattern of disputes related to Sharī'ah compliance can indicate a potential mechanism, certain types of products, and conduct of TOs or intermediaries prone to Sharī'ah non-compliance.
3. **Surplus level:** As a unique feature of *takāful*, it is necessary to supervise the surplus distribution level and its pattern. A higher surplus can be the result of good underwriting practice. However, it could also result from charging higher contributions or honouring



fewer claims. If a TO is generating an unusual surplus (e.g., significantly higher than the industry average), this could be an implication of a COB issue.

4. **Deficit of PRF:** Being only the manager of the PRF, a TO might be tempted to take higher risks at the cost of participants. Continuous deficits and persistent reliance on *qard* can be against the best interest of participants. Monitoring the deficit of the PRF can also disclose practices of a TO that harm participants, such as charging high fees that overtax the PRF. Trends and patterns of deficits may identify industry practices that can have prudential implications.

## SECTION 6: CONSUMER FINANCIAL EDUCATION

229. The financial landscape has developed in recent decades, providing individuals with more options to access finance and to manage and plan their financial affairs. Simultaneously, the financial landscape has grown more complicated, with digital financial services introducing new problems and risk considerations. Demographic, socioeconomic, and financial trends, such as ageing populations and financial, social, and economic crises, have increased the strain on welfare systems. These problems can be exacerbated by unforeseen socio-economic catastrophes such as the COVID-19 epidemic or natural disasters.

230. Financial consumers need considerable financial skills, since poor financial decision-making can have long-term adverse consequences for individuals and society. Despite the increasing complexity of the financial and risk landscape, consumers – particularly from disadvantaged groups – often lack even basic financial understanding and are unprepared to make wise financial decisions. As a result of these challenges, policies have aimed at improving consumer knowledge of financial products and their associated risks. Consumers' financial competencies, overall financial resilience, and well-being are critical and shall be strengthened within a strong financial consumer protection framework. The RSAs need to have the mandate to improve the financial capability<sup>47</sup> of consumers.

231. The availability of customer recourse mechanisms may influence the extent to which COB supervisors can protect individual customers. Some of the consumer support structures (e.g., consumer bureaus or industry associations) are more prevalent in developed Islamic insurance markets than in emerging markets. Jurisdictions with no or only rudimentary consumer support structures and low levels of financial literacy may place greater responsibility on the supervisor to protect the individual rights of customers and/or provide financial education.

232. Effective consumer education programs should be adapted to attributes of the targeted consumers, such as education level (including Sharī'ah knowledge), age, mental ability, and income. Additionally, intermediaries must be well-equipped with the knowledge about Islamic insurance and its related Sharī'ah issues as they play a significant role in advising and distributing Sharī'ah compliant products to consumers.

233. For individual providers, arranging consumer literacy programs can be costly. Therefore, the RSAs can collaborate with providers and other relevant stakeholders to develop contents and strategies to enhance consumer awareness and capabilities.

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<sup>47</sup> Financial capability is defined by the World Bank Group as “the capacity of a consumer to make informed decisions and act in one’s best financial interest, given socioeconomic and environmental conditions.”

234. In many jurisdictions, RSAs might not have a formal mandate for promoting better Islamic insurance awareness for the public. Nevertheless, it is important to integrate Islamic insurance specificities in responsive actions on identified issues and to specify the role of supervisors, providers, intermediaries, and non-market players (such as professional associations, educational institutions, or consumer-focused government agencies) for the improvement of consumers' knowledge of Islamic insurance.

235. Public awareness campaigns are an essential tool for supervisors to ensure consumer protection as well as good market conduct. Improving consumers' awareness related to their legal rights, their possible redress in the event of unfair treatment, and steps to protect their interests are important to promote a fair Islamic insurance marketplace. For example, a provider may be marketing a product that guarantees a fixed investment return, although it is based on *muḍārabah*. If a customer is not aware that there is a Sharī'ah non-compliant element in the product and thus does not lodge a complaint, the supervisor may not become aware of such practice. An effective public awareness initiative assists RSAs by increasing consumers' understanding of unfair treatment and bringing these unfair practises to the regulator's notice.

236. Supervisors can disclose relevant information, e.g., product description, types of benefits covered, underlying Sharī'ah contract and mechanism, set of statistics and reports, etc. in order to improve transparency and financial literacy. Such disclosure will help consumers and be useful for academics, media, researchers, and other relevant organisations to study and investigate different issues. In addition, supervisors may require providers to develop policies in a way that is easy to understand. The policies can be written in plain and conversational language which should be consistent with the legal standing as a contract.

237. RSAs need a proper strategy and procedure to reach the target audience with the relevant information to have an effective financial literacy program. Therefore, if supervisors can communicate to the specified consumers (e.g., deliver timely, simple, bite-sized messages about a fraudulent activity through SMS), it can help them to be more aware of unfair practices they might be exposed to.

238. The use of technology can also help supervisors to develop an effective financial education program within a reasonable budget. Increased usage of the internet and mobile phones allows supervisors to distribute documents, messages, or training modules to a large number of people at a low cost. Supervisors' websites can be another important platform where RSAs can disburse different types of information and resources to improve consumer awareness. On their website, supervisors can provide information on licensed providers and

intermediaries, alerts on fraudulent activities, complaint submission, statistics, comparisons of contributions and benefits of different Islamic insurance products, etc.

239. To build an effective consumer education programme framework, RSAs should adopt the approach of test-evaluate-adapt. This will help supervisors to learn about what approaches and methods work based on the industry, market, target consumers, and time. By collaborating with different stakeholders, RSAs can test different approaches and methods to improve awareness and fairness. The test will provide the supervisors with evidence of what approaches work and help them to build an effective adoption strategy. RSAs can issue guidance (or regulations, if required) for providers to facilitate the approaches.

240. In order to design and implement a robust consumer education programme, the supervisors need to consider the following points:

1. **Clear vision and objectives:** The program should have a clear vision and set of objectives that it is intended to achieve. It will assist RSAs in knowing what outcomes are expected from the initiative. For example, an objective can be customers' better understanding of their rights in an Islamic insurance contract.
2. **Appropriate and applicable strategies:** The RSAs need to define proper strategies to design and implement the program, and these strategies should be applicable based on the resources available. The message and knowledge the program wants to deliver should be clear and understandable to the target audience. The program should aim to deliver the message and knowledge in such a way that can change the awareness and behaviour of the target audience.
3. **Plan resources:** The RSAs must assess the resources needed to deliver the programme and ensure that the appropriate resources are accessible and available. If the essential resources are insufficient, the strategies to design and implement can be modified to match the current resources better.
4. **Monitoring and evaluation framework:** A consumer education programme should design a monitoring and evaluation system relevant to the program's goals and objectives and within the limitations of available resources. The assessment framework should be designed at the beginning stage of the program, with monitoring components included in the work plan.

241. Ongoing digitalisation has not only widened the scope of Islamic insurance products and consumer-facing service providers, but it has also opened up new digital sources for consumers to inform and educate themselves about Islamic insurance, such as comparison platforms, aggregators, and social media.

242. Service providers and platforms in the Islamic insurance industry should provide information about their business model (including pricing structures, product bundling, and use of consumer data) in a format that is accessible and understandable for consumers.

243. Digital financial education (DFE) should give consumers the knowledge, skills, and competencies to understand the features, risks, and benefits of Islamic insurance products and familiarise them with digital communication, sales channels, and service platforms.

244. In their DFE efforts, RSAs and providers have to make sure that consumers understand the differences between conventional and Islamic insurance as practised and permissible in the jurisdiction.

245. To prevent unrealistic expectations, DFE initiatives should clarify how Islamic insurance schemes adhere to or deviate from principles of actuarial fairness and, in *takāful*, what a deficit, excessive *wakālah* fees, and unpaid *qarḍ* in a PRF mean for the participants' value for money for those who conclude or renew a short- or long-term contract.

246. DFE has to address (at least) two very different target groups:

- The first group comprises people who are financially excluded due to their low or irregular income and often low general literacy level. DFE is one component of the digital financial inclusion strategy for this group. Two other components are internet access and simple and affordable essential Islamic insurance products.
- The second group consists of people who can afford to buy digital Islamic insurance products, but have limited capabilities to assess the suitability and value for money of these products. Social media has brought forth a new type of opinion leader and quasi-advisor, the so-called "finfluencer" (a combination of "finance" and "influencer"). Finfluencers have a strong presence and credibility on social media. They articulate views on financial products that are understood as advice by large numbers of followers. Statements of finfluencers – including celebrities – are often not based on competent analysis but on commissions they receive and advertisement contracts. The challenge for DFE is to fight biases, misinformation, herding behaviour, scams, and fraud. The objective is to create risk awareness, financial competence, and a critical attitude towards finfluencers among potential customers of digital Islamic insurance products.

247. Licensed providers should initiate DFE campaigns or support campaigns organised by RSAs for well-defined target groups. The campaigns should be aligned with each target group's financial position and lifestyle. The format of DFE campaigns must be adapted to the

communication and information habits of the target group and should include social media channels.

## DEFINITIONS

The following definitions explain terms used in this document. It is not an exhaustive list.

Deficit	The situation where claims and other claims-related expenses exceed <i>takāful</i> contributions to the PRF for a financial period, whether or not a deficiency arises.
Fiduciary Risk	The risk that arises from an institution's failure to perform in accordance with explicit and implicit standards applicable to its fiduciary responsibilities.
<i>Hibah</i>	The payment of money or transfer of an asset to another party without a consideration.
Islamic Insurance	Refers to the <i>takāful</i> model as well as other Islamic insurance models that adopt approaches other than <i>takāful</i> , so far as it has been qualified as Sharī'ah-compliant by a relevant authority with an appropriate mandate.
<i>Muḍārabah</i>	A partnership contract between a capital provider ( <i>rabb al-māl</i> ) and an entrepreneur ( <i>muḍārib</i> ) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless the losses are due to misconduct, negligence, or breach of contracted terms.
Participants' Investment Fund (PIF)	A fund accumulating the portions of contributions paid by <i>takāful</i> participants for investment and/or savings purposes. The PIF is collectively managed by the TO but owned individually by the participants according to their contributions to this fund.
Participants' Risk Fund (PRF)	A fund accumulating the portions of contributions paid by <i>takāful</i> participants for meeting claims and claims handling expenses. The PRF belongs to the participants collectively and is managed by the TO.
Pre-contract illustration	A numerical representation and basic terms and conditions used by a TO to explain a <i>takāful</i> product to a potential <i>takāful</i> participant.

Provider	Islamic insurance undertakings based on <i>takāful</i> or other approach qualified as Sharī'ah compliant by a relevant authority with an appropriate mandate.
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<i>Qarḍ</i>	The payment of money to someone who will benefit from it, provided that its equivalent is repaid. The repayment of the money is due at any point in time, even if it is deferred.
<i>Retakāful</i>	An arrangement whereby a <i>takāful</i> undertaking cedes a portion of its risks on the basis of treaty or facultative <i>retakāful</i> as a representative of participants under a <i>takāful</i> contract, whereby it would contribute a portion of the contribution as <i>tabarru'</i> into a common fund to cover against specified loss or damage.
Shareholders' Fund	A fund that represents the assets and liabilities of a <i>takāful</i> or <i>retakāful</i> undertaking that are not attributable to participants.
Sharī'ah	The practical divine law deduced from its legitimate sources: the Qur'ān, Sunnah, consensus ( <i>ijmā'</i> ), analogy ( <i>qiyās</i> ) and other approved sources of the Sharī'ah.
Sharī'ah non-Compliance Risk	An operational risk resulting from non-compliance of the institution with the rules and principles of <i>Sharī'ah</i> in its products and services.
Stakeholders	Those with a vested interest in the well-being of <i>takāful</i> or <i>retakāful</i> undertakings, including: <ul style="list-style-type: none"> <li>• employees;</li> <li>• <i>takāful</i> participants or cedants under <i>retakāful</i> arrangements;</li> <li>• suppliers;</li> <li>• the community; and</li> <li>• supervisors and governments.</li> </ul>
<i>Tabarru'</i>	The amount of contribution to be paid by the <i>takāful</i> participant to fulfil the obligation of mutual help and to be used to pay claims submitted by eligible claimants.
<i>Takāful</i>	A mutual guarantee, whereby a group of <i>takāful</i> participants agree among themselves to support one another jointly for the losses arising from specified risks, from a fund to which all commit to



	donate for the purpose. In this standard, includes <i>retakāful</i> unless the context requires otherwise.
<i>Takāful</i> operator	Any establishment or entity that manages a <i>takāful</i> business – usually, though not necessarily, a part of the legal entity in which the participants’ interests are held.
<i>Takāful</i> participant	A party that participates in the <i>takāful</i> product with the TU and has the right to compensation or other entitlements under a <i>takāful</i> contract.
<i>Takāful</i> undertaking	An undertaking engaged in <i>takāful</i> business in which the Participants’ Risk Fund(s) and any Participants’ Investment Fund are managed separately from the Shareholders’ Fund (if any) attributable to the <i>takāful</i> operator managing the business.
Underwriting	The process of evaluating an application for <i>takāful</i> or <i>retakāful</i> cover, carried out by a <i>takāful</i> or <i>retakāful</i> operator on behalf of the <i>takāful</i> or <i>retakāful</i> participants, to determine the risk associated with an application and decide whether to accept the risk and, if so, on what terms.
Underwriting risk	The risk of loss due to underwriting activities relating to the <i>takāful</i> Participants’ Risk Fund or <i>retakāful</i> Risk Fund. Sources of this risk include assumptions used in pricing or assessment that are subsequently shown to be incorrect by experience of, for example, claims.
Underwriting surplus or deficit	The Participants’ Risk Fund’s or <i>retakāful</i> Risk Fund’s financial result from the risk elements of its business, being the balance after deducting expenses and claims (including any movement in technical provisions) from the contributions income and adding any investment returns (income and gains on investment assets) attributed to the technical result.
<i>Wakālah</i>	An agency contract where the <i>takāful</i> or <i>retakāful</i> participants (as principal) appoint the <i>takāful</i> or <i>retakāful</i> operator (as agent) to carry out the underwriting and investment activities of the <i>takāful</i> or <i>retakāful</i> funds on their behalf in return for a known fee.

## Gap Analysis

Issues	Conventional Standards		IFSB Standards		Gaps	CBST
	IAIS	Others	TCP	IFSB		
Factors influencing Supervision of COB Approaches	Application paper on approaches to conduct of business supervision	-	-	-	<i>Takāful</i> -specific factors	Paragraph 27 includes the <i>takāful</i> -specific factors
Scope of COB supervision	Application paper on approaches to conduct of business supervision	-	-	-	Shari'ah Governance	Paragraph 28 includes Shari'ah governance as the scope of COB supervision
Prerequisites for COB supervisory staff	Application paper on approaches to conduct of business supervision	-	-	-	<i>Takāful</i> specificities	Paragraph 29 addresses the <i>takāful</i> specificities
Shari'ah Compliance assertions	N/A	N/A	<ul style="list-style-type: none"> <li>TCP 8</li> <li>19.0.3</li> </ul>	<ul style="list-style-type: none"> <li>IFSB-8</li> <li>IFSB-10</li> <li>IFSB-AAOIFI Revised Shari'ah Governance Framework (ongoing)</li> </ul>	Oversight responsibility and relevance to consumer disclosure	Paragraphs 30 to 33 address the gaps
Segregation of funds	N/A	N/A	<ul style="list-style-type: none"> <li>19.0.4</li> </ul>	<ul style="list-style-type: none"> <li>IFSB-8</li> </ul>	<ul style="list-style-type: none"> <li>Fragmented discussion</li> <li>Clarification of types of segregated fund</li> <li>Conduct issues specific to <i>takāful</i></li> <li>Management of different PRFs</li> <li>Consolidation of PRFs</li> </ul>	Section 2.1.3 addresses the gaps

Issues	Conventional Standards		IFSB Standards		Gaps	CBST
	IAIS	Others	TCP	IFSB		
					<ul style="list-style-type: none"> <li>• Role of different governance bodies</li> <li>• Disclosure and breakdown of policies, income, and expenses</li> </ul>	
Surplus Distribution	N/A	N/A	<ul style="list-style-type: none"> <li>• 19.0.5</li> </ul>	<ul style="list-style-type: none"> <li>• IFSB-14</li> <li>• WP-09</li> </ul>	<ul style="list-style-type: none"> <li>• Fragmented discussion</li> <li>• Fairness issues related to surplus sharing</li> <li>• Fairness issues related to surplus distribution</li> <li>• Legal underpinning of surplus</li> <li>• Surplus and incentive fee</li> <li>• Monitoring surplus calculation</li> <li>• Surplus distribution as a promotional tool</li> <li>• Ways to utilise surplus</li> </ul>	Section 2.1.4 addresses the gaps.
Balance of interests of consumers and other stakeholders	N/A	N/A	-	<ul style="list-style-type: none"> <li>• IFSB-8</li> <li>• IFSB-20</li> <li>• IFSB-AAOIFI Revised Shari'ah Governance Framework (ongoing)</li> </ul>	<ul style="list-style-type: none"> <li>• Understanding the interests of participants</li> <li>• Conflicts of interests in balancing the interests of different stakeholders</li> <li>• Role of BOD, Shari'ah Board and Senior Management</li> </ul>	Paragraphs 57-63 address the gaps.
Fiduciary duties of TOs	N/A	N/A	<ul style="list-style-type: none"> <li>• 19.0.11</li> </ul>	IFSB-8	<ul style="list-style-type: none"> <li>• Contractual meaning of fiduciary duty in <i>takāful</i></li> <li>• Providing participant's voice as fiduciary obligations</li> <li>• Culture of fiduciary duty</li> </ul>	Section 2.2.1 addresses the gaps.

Issues	Conventional Standards		IFSB Standards		Gaps	CBST
	IAIS	Others	TCP	IFSB		
Representation of consumers in the governance system	N/A	N/A	-	-	<ul style="list-style-type: none"> <li>Give participants “a voice”</li> <li>Participants advocate mechanism</li> </ul>	Section 2.2.2 addresses the gaps.
Managing conflict of interests	N/A	N/A	<ul style="list-style-type: none"> <li>19.1.2</li> <li>19.4.8</li> </ul>	-	<ul style="list-style-type: none"> <li>Disclosure of conflicts</li> <li>Intermediaries conflict of interest management</li> <li>Conflicts of interest related to unit-linked family <i>takāful</i></li> <li>Conflict of interest related to <i>wakālah</i> fee</li> </ul>	Section 2.2.3 addresses the gaps
Qarḍ as consumer protection	N/A	N/A	<ul style="list-style-type: none"> <li>19.0.12</li> <li>19.4.7</li> <li>19.7.4</li> <li>19.8.15</li> <li>19.14.6</li> </ul>	WP-09	<ul style="list-style-type: none"> <li>Explanation of qarḍ mechanism related to fairness issues</li> <li>Qarḍ policy by TOs</li> </ul>	Section 2.2.4
Fair treatment of consumers  Product development and pre-contractual stage	-	-	<ul style="list-style-type: none"> <li>19.1.2</li> <li>19.2.1</li> <li>19.2.2</li> <li>19.2.3</li> <li>19.2.4</li> <li>19.2.5</li> <li>19.2.6</li> <li>19.3.5</li> <li>19.4.7</li> <li>19.6.2</li> <li>19.6.3</li> </ul>	WP-09	<ul style="list-style-type: none"> <li>Contractual relationship of TOs with existing participants and potential applicants</li> <li>Basis of Shari’ah compliance assertions and how to achieve</li> <li>Conduct issue due to participants being ultimate risk bearer</li> <li>Legal relationship between TOs and Intermediaries</li> <li>Role of Shari’ah board in promoting fairness</li> <li>Role of Shari’ah board in the product development stage</li> </ul>	Paragraphs 95-99 address the gap.

Issues	Conventional Standards		IFSB Standards		Gaps	CBST
	IAIS	Others	TCP	IFSB		
					<ul style="list-style-type: none"> <li>Role of BOD, senior management, and Shari'ah board in ensuring fairness and Shari'ah compliance during product development stage</li> </ul>	
Product-approval approach	-	Consultation Paper on Supervisory statement on differential pricing practices in non-life insurance lines of business	<ul style="list-style-type: none"> <li>19.6.7</li> </ul>	-	<ul style="list-style-type: none"> <li>Balancing consumer protection and innovation as well as the choice of products</li> <li>Supervision of design of benefits</li> <li>Application of beneficiary requirements</li> <li>Product approval and differential pricing</li> </ul>	Section 3.1.1 addresses the gaps
Principles-based approach	-	-	<ul style="list-style-type: none"> <li>19.7.3</li> <li>19.7.4</li> </ul>	-	Cases when product approval might be required with reference to <i>takāful</i> specificities	Paragraphs 104 and 105 address the gap
Product feature, cross subsidisation, and innovative supervisory approach to address unforeseen issues	-	-	-	IFSB-14	<ul style="list-style-type: none"> <li>Using <i>takāful</i>-specific features such as surplus distribution to create unrealistic expectations</li> <li>"Use and File" approach</li> </ul>	Paragraphs 106-110 address the gap
Information to consumers	-	-	<ul style="list-style-type: none"> <li>19.8.12</li> <li>19.8.14-19.8.17</li> </ul>	-	<ul style="list-style-type: none"> <li>Shari'ah basis of disclosing information to potential consumers</li> <li>Opportunistic behaviour and consumer protection</li> </ul>	Section 3.1.3 addresses the gaps

Issues	Conventional Standards		IFSB Standards		Gaps	CBST
	IAIS	Others	TCP	IFSB		
					<ul style="list-style-type: none"> <li>Fairness issues related to add-ons and riders</li> </ul>	
Rights and obligations of participants	N/A	N/A	<ul style="list-style-type: none"> <li>19.8.20</li> </ul>	IFSB-28	<ul style="list-style-type: none"> <li>Right and treatment of surplus distribution</li> <li>Alternative of qarḍ during deficit</li> <li>Rights and obligations related to benefits and disbursement</li> </ul>	Section 3.1.4 addresses the gaps.
Information on terms and conditions	N/A	N/A	<ul style="list-style-type: none"> <li>19.8.12</li> <li>19.10.8</li> </ul>	-	<ul style="list-style-type: none"> <li>Shari'ah approval of changes in the underlying contract</li> <li>Details of contribution payment</li> <li>Details of fees and charges</li> <li>Implication of qarḍ</li> <li>Application of exclusions in <i>takāful</i></li> </ul>	Section 3.2.2 addresses the gaps
Shari'ah dispute resolution	N/A	N/A	-	-	<ul style="list-style-type: none"> <li>Shari'ah disputes</li> <li>Shari'ah disputes resolution</li> </ul>	Paragraphs 142-143 address the gaps
Digital distribution and products	<ul style="list-style-type: none"> <li>ICP 19</li> <li>Issues Paper on Increasing Digitalisation in Insurance and its Potential Impact on Consumer Outcomes</li> <li>Application Paper on The Use of Digital</li> </ul>	Emerging issues and impact of digitalisation on insurance addressed by regulators and industry bodies globally, but no international standards yet.	<ul style="list-style-type: none"> <li>19.8.24-19.8.28</li> </ul>	WP-09	<ul style="list-style-type: none"> <li>Actuarial fairness</li> <li>Artificial intelligence and inclusion</li> <li>Behavioural insights related to products and pricing strategies</li> <li>New digital market players</li> </ul>	Section 4 addresses the gaps.

Issues	Conventional Standards		IFSB Standards		Gaps	CBST
	IAIS	Others	TCP	IFSB		
	Technology in Inclusive Insurance	Potential relevance for advanced Islamic insurance markets.				
Assessing conduct risk through the product lifecycle	-	EIOPA-Framework for Assessing Conduct Risk through the Product Lifecycle-EIOPA (2019)	-	-	Addressing <i>takāful</i> Specificities	Section 5.2.2 addresses the gap
Indicators for COB risks	Report on Supervisors' use of key indicators to assess insurer conduct, IAIS (2022)	EIOPA-Framework for Assessing Conduct Risk through the Product Lifecycle-EIOPA (2019)	-	-	<i>Takāful</i> -specific indicators	Paragraph 228 addresses the gap
Consumer financial education for consumer protection	Application paper on approaches to conduct of business supervision	<ul style="list-style-type: none"> <li>OECD/INFE Policy Handbook-National Strategies for Financial Education</li> </ul>	-	<ul style="list-style-type: none"> <li>WP-09</li> <li>IAIS &amp; IFSB (2015): Issues in Regulation and Supervision of <i>Microtakāful</i> (Islamic Microinsurance)</li> </ul>	<ul style="list-style-type: none"> <li>Shari'ah awareness</li> <li>Framework for robust consumer education program</li> <li>Digital financial education</li> </ul>	Section 6 has addressed the gaps

Issues	Conventional Standards		IFSB Standards		Gaps	CBST
	IAIS	Others	TCP	IFSB		
		<ul style="list-style-type: none"> <li>OECD: Effective Approaches for Financial Consumer Protection in the Digital Age</li> </ul>				