

FAQs on IFSB-18:

Guiding Principles for Retakāful (Islamic Reinsurance)

1. In the case of *retakāful* undertakings (RTUs), there is an incentive for *retakāful* operators (RTO) to engage in self-interested conduct which may negatively impact the cedant *takāful* undertakings (TUs) as well as shareholders. As a regulatory and supervisory authority (RSA), what measures shall be put in place to minimise these conflicts of interest?

Answer: To minimize conflicts of interest in RTUs, RSAs can implement several measures, including:

- RSAs can require RTUs to disclose any potential conflicts of interest to cedant TUs and shareholders. This may include disclosing any financial interests or relationships that may influence their decision-making.
- RSAs can require RTOs to separate their *retakāful* activities from other business activities to avoid conflict of duties. This can help prevent RTOs from engaging in self-interested conduct that may negatively impact cedant TUs and shareholders.
- RSAs can require RTOs to have independent oversight of their *retakāful* activities to ensure accountability.
- RSAs can require RTOs to implement robust risk management practices to identify and manage potential conflicts of interest. This can include establishing internal controls, policies, and procedures to ensure that *retakāful* activities are conducted fairly and transparently.
- RSAs can require RTUs to establish a governance framework that ensures the Sharī'ah-compliance assertion of the RTU is reflected in the actual operations. This includes ensuring the segregation of funds (as envisaged in IFSB-8) and the use of *Retakāful* are properly implemented.
- RSAs can require RTUs to ensure that their officials, including outsourced functions, follow ethical standards commensurate with the levels and significance of their responsibilities.
- Ensuring that RTOs have appropriate disclosure requirements in place to provide market participants with a better understanding of their operations and financial position.

2. Are there any recommended IFSB standards or other references regarding mechanisms for observing and addressing the rights and interests of all stakeholders?

Answer: One of the relevant documents that covers the mechanism to observe and address the rights and interests of all stakeholders is IFSB-8 (Guiding Principles on Governance for Takâful [Islamic Insurance] Undertakings)¹ which applies to RTU as well. The standard requires a clear segregation of the participants' funds from the TO's shareholders' funds. This demarcation is vital in outlining the rights and obligations between the TO and participants.

To address conflicts of interest, TO's can include measures such as:

- Establishing systems for effective communication of relevant information across all levels of management.
- Putting in place strong internal controls and risk management within the organisation.
- Reconciling and aligning the incentives of shareholders and participants so that both parties' interests are appropriately observed and satisfied.

Other standards include IFSB-9 (Guiding Principles on Conduct of Business for Institutions offering Islamic Financial Services) and IFSB-10 (Guiding Principles on Shari'ah Governance Systems for Institutions offering Islamic Financial Services) that guide conduct of business and Shariah governance framework of IFSI, including Takâful and Retakâful.

3. Given the comparatively reduced information asymmetry in RTUs as opposed to TUs, what measures remain necessary for the RSA to protect the interest of cedant TO?

Answer: Although information asymmetry is considered less in RTUs than in TUs, it remains crucial for RSAs to require RTUs to establish a governance framework that ensures Shari'ah compliance assertions reflect the actual operations of the RTU. This includes ensuring that the segregation of funds as envisaged in IFSB-8 and the use of Retakâful is properly implemented.

¹ See Paragraphs 21, 22, 29, and Principle 2.1 of IFSB-8

Proper governance is also important to enable smooth operations of key risk management functions. RSAs should ensure RTUs understand the importance of their role in the risk management arrangements of TUs and are responsive when needed. Additionally, RSAs can require RTUs to ensure that their officials, including outsourced functions, follow ethical standards commensurate with the levels and significance of their responsibilities.

RSAs should also ensure that RTUs exercise due diligence in managing the RRF and that any supplementary business connected to Retakāful business but not constituting Retakāful arrangements is segregated from transactions attributable to the RRF.

For more specific measures, it may be necessary to refer to other relevant IFSB standards such as IFSB-8, IFSB-9, IFSB-10, IFSB-14, and IFSB-28, which guide governance, solvency requirements, risk management, conduct of business, and Sharī'ah governance for Islamic financial institutions including Retakāful operators.

4. What key risk driver activities in RTU should be considered when designing the appropriate risk management policies in the RTO?

Answer: When designing the appropriate risk management policies in the RTO, the key risk driver activities in RTU that should be considered include:

- Setting risk policies and strategies
- Procedures for risk identification, assessment, and decision on response
- A control framework covering key activities
- Procedures for monitoring the status of risks
- Internal reporting procedures for risk

An RTO should ensure that it has in place and documented an effective risk management framework, compliant with IFSB-14, dealing with these key risk driver activities. The risk management framework should include all risks to which the RTU is exposed, including any to which it and its parts are exposed because of the carrying on of supplementary services in addition to Retakāful arrangements. An RTO should also ensure that its risk management framework is overseen by persons with appropriate skills, resources, and objectivity. These individuals should be able to carry out their functions without restriction or conflict of interest.

5. **According to the standard, RTO is held accountable to ensure Shari'ah compliance in its overall businesses and operations, including in the event where a third party is involved e.g., outsourced, or accepting business from a conventional insurer. Can you please give instances where non-compliance risk may arise as a result of third-party activities?**

Answer: Non-compliance risk may arise as a result of third-party activities in several instances, such as:

- If the RTO outsources activities such as investment management, and these third-party do not have a proper shariah governance framework, it may lead to Sharī'ah non-compliance risk.
- If the RTO accepts business from a conventional insurer without ensuring that the business is Sharī'ah compliant, this may result in non-compliance.
- Pressures of competition with conventional reinsurers may lead RTOs to mis-describe the products provided by them. Such compromise might lead to inadvertent non-compliance with Sharī'ah principles.
- In certain cases, third parties may structure the coverage by utilising the name of the RTO. In situations where the RTO claims to offer takāful, the actual terms and conditions may not adhere to takāful principles.

6. **What measures should be set out by RTO to identify and manage such risks?**

Answer: Answer to the Question 4 applies to this question.

7. **How does the IFSB-18 define Sharī'ah advisors? What is the equivalent term in the IFSB-10 on Shari'ah Governance for IIFS?**

Answer: IFSB-18 does not provide a specific definition of Sharī'ah advisors. However, the role of Sharī'ah advisors in IFSB-18 holds a critical governance function, ensuring the ongoing compliance of Retakāful operations with Sharī'ah principles. Their responsibilities include, among others: approving and conducting periodic reviews of Retakaful model as well as assessing the adherence of operational-related policies and procedures towards Shariah principles. Through these measures, Sharī'ah advisors contribute to maintaining the integrity and compliance of Retakāful activities in line with Islamic principles.

In line with that, the term Sharī'ah advisors in IFSB-18 can be equivalent to Sharī'ah board in IFSB-10, since both play a convergent leading role in ensuring sound Shari`ah governance and are comprised of a panel of Shari`ah scholars acting as special *advisers* to the institutions (see Footnote 2 in IFSB-10)

8. Should RSA differentiate its requirements based on the type of business the RTO provides – i.e., based on general, family, or composite RTU?

Answer: IFSB-18 standard does not specifically differentiate requirements based on the type of business. The focus of the standard is to ensure that all Retakāful activities are conducted in compliance with Sharī'ah principles and guidelines and to provide guidance for the regulatory framework and supervision of Retakāful operations. Therefore, the decision to differentiate requirements based on the type of business the RTO provides is left to the discretion of the RSAs.

If RSAs opt to differentiate requirements, they may consider factors such as the nature of risks, time horizon of products, complexity of operations, and specific characteristics of each type of RTU when formulating their regulatory requirements. Additionally, RSA may need to consider the diversification of risks when supervising RTOs. For example, a natural disaster in general business, and mortality or morbidity in family business, may require different risk management strategies.

9. Based on principle 3.3., each Participant's Risk Fund (PRF) is separated by those who bear the risks of that fund. In the context of liquidity support, should RSAs allow the transfer among these funds (for example as qard when necessary)?

Answer: Based on the IFSB-18 standard, there is no explicit mention of allowing RSA to transfer funds among the PRFs for liquidity support purposes.

While the standard does not provide specific guidance on this matter, it is important to note that the standard emphasises the need for proper risk management policies and procedures to be in place to ensure that Retakāful activities are conducted in compliance with Sharī'ah principles and guidelines. This includes having adequate liquidity management policies and procedures to ensure that the Retakāful operations have sufficient liquidity to meet their obligations.

Therefore, whether the transfer of funds among PRFs is permissible for liquidity support should be determined by the RSA. The flexibility provided by IFSB standards (IFSB-18 and other relevant IFSB standards) allows jurisdictions to make decisions based on their unique regulatory considerations.

10. According to IFSB-18, what are the recommended treatments for the surplus of the RRF? Should RSA review the attribution, calculation, and distribution of such surplus?

Answer: IFSB standards provide some recommendations regarding utilisation of surplus, such as distributing among the participants or retaining the surplus in the risk fund. Notably, IFSB Shari'ah Board is of the view that the surplus should not be shared with TO/RTO, though different practices may be observed in different jurisdictions. However, IFSB standards emphasise that the ultimate objective of the surplus distribution policy will be the long-term sustainability of the PRF/RRF. IFSB does not prescribe or provide a recommendation to review attribution, calculation, and distribution of surplus by RSAs but recommends that RSAs should ensure TO/RTOs have proper policies in place that are approved by the Board and Shari'ah Board.

11. What are key considerations for RSAs in designing a resolution policy about insolvent RTO?

Answer: IFSB-27 Takaful Core Principle 12 (Exit from the Market and Resolution) provides comprehensive guidance in this regard which can be equally applicable to RTOs.

12. Should RSA set out separate capital adequacy requirements for RTU operating as windows from its conventional parent reinsurer?

Answer: While IFSB-18 does not prescribe such requirement, the recent IFSB-27 Takaful Core Principles (TCP) 26.6 discusses the application of capital adequacy requirements by the supervisor at the level of the window. The TCP highlights that the supervisor's approach to a window reflects its understanding of how the window will be treated in insolvency. The supervisor applies capital adequacy requirements comparable to those that apply to a full-fledged TU. In assessing the eligibility of

resources as capital, the supervisor considers whether funds advanced to the window from the host are capable of absorbing losses within the window.

13. For RTU operating as Windows, can it receive financial assistance or liquidity support from its conventional parent reinsurer in times of liquidity distress?

Answer: According to the standard, where the solvency or liquidity of the window is supported by assets of the conventional operation, the RTO needs to ensure that the assets in question are identified and are Sharī'ah-compliant. The RTO also needs to ensure that the contracts issued by the window are Sharī'ah-compliant and are not unduly influenced by the forms of contract used in the conventional operation. Therefore, RTU operating as a window may receive financial assistance or liquidity support from its conventional parent reinsurer in times of liquidity distress, but the assets and contracts involved must be Sharī'ah-compliant and the RTO must ensure that the window remains Sharī'ah-compliant.

14. What items are recommended to be disclosed by RTO to allow market participants to access material and relevant information?

Answer: According to the IFSB-18 standard, the following items are recommended to be disclosed by RTOs to allow market participants to access material and relevant information:

- The nature and scope of the Retakāful activities undertaken by the RTO.
- Underlying Retakāful model used
- The financial statements such as the balance sheet, income statement, and cash flow statement.
- The risk management policies and procedures of the RTO, including the measures taken to manage and mitigate risks.
- The Sharī'ah governance framework of the RTO.
- The governance structure of the RTO.
- Any material changes to the Retakāful activities, financial position, or governance structure of the RTO.

Additionally, it is worth noting that IFSB-25 (Disclosures to Promote Transparency and Market Discipline for Takāful/Retakāful Undertakings) can be equally applicable to the RTOs.

15. What are key areas of supervision for RSA concerning Retakaful and Retakaful?

Answer: Key areas of supervision for RSA concerning Retakaful, as outlined in the IFSB-18 standard, include:

- Ensuring that Retakaful activities are conducted in compliance with Shari'ah principles and guidelines.
- Ensuring that RTOs have appropriate risk management policies and procedures in place to manage and mitigate risks.
- Conduct regular assessments of the financial health and solvency of RTOs to identify potential risks and take appropriate action to mitigate them.
- Ensuring that RTOs have adequate capital and liquidity buffers to support their Retakaful operations.
- Ensuring that RTOs have proper governance structures in place, including clearly defined roles and responsibilities of the board of directors and senior management.
- Ensuring that RTOs have appropriate disclosure requirements in place to provide market participants with a better understanding of their operations and financial position.

16. How is the relevance of IFSB-18 to dealing with recently emerging issues such as climate change and digital developments? For instance, should the RTO take climate and sustainability into consideration when conducting due diligence as prescribed in Principle 1.4?

Answer: IFSB-18 requires RTOs to conduct due diligence in their activities. While the standard does not explicitly require RTOs to take climate and sustainability into consideration when conducting due diligence, such factors may be relevant to the financial soundness of a cedant. For example, a cedant that is heavily exposed to industries that are vulnerable to climate change risks may be less financially sound than a cedant that has diversified its portfolio to include more sustainable industries. Therefore, it is possible that RTOs may need to take climate and sustainability into consideration when conducting due diligence on their counterparties, depending on the specific circumstances of each case.

Similarly, while IFSB-18 does not explicitly address digital developments, it does require RTOs to ensure that their operations are conducted in a manner that is consistent with Sharī'ah principles and ethical values. As such, RTOs may need to consider the implications of digital developments on their operations, particularly with respect to issues such as data privacy and cybersecurity, to ensure that they are conducting their business in a manner that is consistent with Sharī'ah principles and ethical values.