Frequently Asked Questions (FAQ)
IFSB-8: Guiding Principles on Governance for Takaful (Islamic Insurance) Undertaking

Q1. Which type of takaful undertakings/models does IFSB-8 cover?

Answer: IFSB-8 applies to all *Takaful* undertakings, irrespective of their legal status. It also applies to all operational models adopted by *Takaful* undertakings. Hence, *Takaful* undertakings are encouraged to undertake continuous adoption of best practices, consistent with the objectives set out by these Guiding Principles, and to explain this by making relevant disclosures.

Q2. What are the main structural distinguishments between takaful undertakings and conventional insurers?

Answer: *Takaful* undertakings must duly observe their fundamental obligations towards the participants (policyholders), particularly with regard to compliance with *Shar*i`*ah* rules and principles. *Shar*i`*ah* governance must remain an inherent feature of *Takaful* Operators (TOs), since the *raison d'être* of *Takaful* is the offering of a protection scheme that complies with the requirements of the *Shar*i`*ah*.

Q3. Why does the applicability of the Guiding Principles mentioned in IFSB-8 on Retakaful operators is limited? Is there a special IFSB standard that discusses issues related to Retakaful?

Answer: The applicability to *Retakaful* operators is limited because their operating concepts differ in important respects: for example, the participants are direct *Takaful* undertakings (as cedants) rather than members of the public, so that the governance issues that arise are somewhat different. A thorough study of business models of *Retakaful* operators is required before good governance structures and processes can be recommended. Nevertheless, *Retakaful* operators and supervisory authorities are encouraged to consider this IFSB-8 in strengthening their governance framework, and to apply them where appropriate.

Q4. What is the "comply or explain" approach?

Answer: The "comply or explain" approach builds on the idea of market discipline, whereby stakeholders are empowered to react to unsatisfactory governance arrangements or sub-standard disclosures (which can be either false, substantially incomplete or misleading). The stakeholders' sanctions may range from reputational damage, to loss of trust in the management (forcing some managers to quit), to taking legal action based on contractual terms. Supervisory authorities particularly should have adequate enforcement instruments, from the power to direct the necessary disclosures, to imposing reprimands and fines to curb deliberate serial non-compliances.

Q5. What is the Actuarial Investigation Report? And what information is it supposed to contain?

Answer: Actuarial Investigation Report is a report on the financial standing of *Takaful* funds conducted by an actuary, to assess if the assets of a *Takaful* fund could meet its liabilities. It should cover the present and future liabilities of the *Takaful* fund in order to determine its financial solvency in accordance with the duly recognised actuarial and accounting methods.

Q6. What is the difference between the Takaful Fund and the Participants Risk Fund?

Answer: Takaful fund is the aggregate of Participant Investment Funds (PIF) and Participant Risk Funds (PRF). PRF is a risk fund – that is, an element of the business that is inherent in the underwriting activities, and the contributions to which are made on the basis of *Tabarru'* commitment.

Q7. How does the Participants' Investment Fund differ between general and family takaful?

Answer: In Family *Takaful*, the paid *Takaful* contribution of a participant will usually be segregated into two accounts which feed two different funds. The first is the Participants' Investment Fund (PIF), and the aggregate PIFs constitute an investment fund for the purpose of capital formation. The second is the Participants' Risk Fund (PRF), which is a risk fund – that is, an element of the business that is inherent in the underwriting activities, and the contributions to which are made on the basis of *Tabarru'* commitment.

For General *Takaful* business, the investment strategy may differ significantly in terms of risks and liabilities for different lines of business. Although investment activities in the General *Takaful* pool or fund are secondary to the underwriting activities, they may be important for the solvency of the fund, especially in the case of longer-tailed risks.

Q8: What is the Qard facility provided by the takaful operator? And why is it important?

Answer: The TO should be prepared to provide a *Qar*d facility whereby it may make an interest-free loan to an underwriting fund if necessary to meet an underwriting deficiency. A deficiency occurs when a deficit exceeds any surplus retained in the *Takaful* fund. This loan stands to be recovered out of future underwriting surpluses and does not constitute a taking on of underwriting risk.

Q9: “Commingling of the PIF’s and the shareholders’ funds would raise governance concerns regarding potential conflicts of interest”. What could these potential conflicts of interest be?

Answer: A clear separation is required in Family *Takaful* between the assets of the PRFs and those of the PIFs, as well as between the assets of the *Takaful* Fund and those of the shareholders’ funds. Commingling of the PIF’s and the shareholders’ funds would raise governance concerns regarding potential conflicts of interest. Particularly, the accumulation of investment profits in the PIFs requires transparent methods of profit calculation and accounting, as well as an efficient accounting system to record the declared PIF’s profit and credit it to the respective *Takaful* PIF.

Q10: Why investment is more important feature for the family takaful compared to general takaful?

Answer: The investment products of Family *Takaful* undertakings, being *Shari`ah*-compliant, generally do not provide guarantees regarding the amount of the *Takaful* benefit payable. (For example, pension products operate on a “defined contribution”, rather than a “defined benefit”, basis.) The benefits depend on the performance of the assets in the relevant fund, which are exposed to market risk. The risk profile is thus different from that of conventional insurance products, where guarantees are normally given in terms of maturity benefits, surrender benefits and death benefits. This has an impact on the risk management and solvency strategies, as well as on the appropriate disclosures regarding *Takaful* funds.

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