ISLAMIC FINANCIAL SERVICES BOARD

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REVISED RISK MANAGEMENT FOR TAKĀFUL UNDERTAKINGS

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Comments on this Exposure Draft should be sent to the IFSB Secretariat no later than 6 November 2026 by email to public_consultation@ifsb.org

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ABBREVIATIONS

BOD	Board of Directors
ERM	Enterprise Risk Management
GN	Guidance Note
IAIS	International Association of Insurance Supervisors
ICPs	Insurance Core Principles
IFSB	Islamic Financial Services Board
ORSA	Own Risk and Solvency Assessment
PIF	Participants' Investment Fund
PRF	Participants' Risk Fund
RBS	Risk-Based Solvency
RBSup	Risk-Based Supervision
RSAs	Regulatory and Supervisory Authorities
SHF	Shareholders' Fund
TCPs	Takāful Core Principles
TO	Takāful Operator
TU	Takāful Undertaking

SECTION 1: INTRODUCTION

1.1. Background

1. The IFSB issued IFSB-14: *Standard on Risk Management for Takāful (Islamic Insurance) Undertakings* in December 2013. Since then, international standards and best practices for insurance risk management have advanced significantly. The International Association of Insurance Supervisors (IAIS) adopted the revised *Insurance Core Principles (ICPs)* in 2019 and has issued several supervisory documents to support supervisors on risk management in the insurance sector. The IFSB also issued IFSB-27: *Core Principles for Islamic Finance Regulation [Takāful Segment]* in 2022.

2. The revision of IFSB-14 is intended to align the Standard with IFSB-27 and reflect these developments, while complementing the relevant guidance issued by the IAIS. Although the fundamental objectives of risk management are broadly consistent across conventional and Islamic finance, the structural and operational characteristics of takāful, as outlined in Appendix 1, give rise to distinct risk profiles and considerations that require a tailored approach.

1.2. Objective and Scope

3. This Standard provides guidance to Regulatory and Supervisory Authorities (RSAs) on risk management considerations arising from the distinctive operational arrangements and risk characteristics of takāful undertakings. It complements generally applicable insurance risk management standards by addressing matters that may warrant additional supervisory consideration in the regulation and oversight of takāful business. Risk management requirements that apply equally across the insurance sector are addressed through existing international standards and are not restated in this Standard.

4. The Standard aims to support RSAs in developing supervisory expectations and risk management requirements that appropriately reflect the nature, scale, and complexity of takāful operations, while promoting sound and effective risk management practices within the sector.

5. The Standard provides additional guidance complementing the Takāful Core Principles (TCPs) with particular attention to TCP 9: Risk Management and Internal Controls and TCP 16: Enterprise Risk Management for Solvency Purposes.

1.3. Applicability

6. Upon its effective date, this Standard supersedes IFSB-14: *Standard on Risk Management for Takāful (Islamic Insurance) Undertakings*, issued in December 2013.

7. This Standard should be read and applied in conjunction with TCP 9 and TCP 16 as supplementary guidance addressing takāful-specific considerations.

8. Implementation of the guidance in this Standard should be commensurate with the size, complexity, nature, and risk profile of takāful undertakings (TUs).[1] Supervisors have the flexibility to tailor their supervisory approaches and expectations to suit the circumstances of individual TUs and local market realities. However, the application of proportionality should not compromise the robustness of risk management systems, internal controls, or the protection of participants' interests.

9. This Standard applies to all TUs licensed to conduct family takāful, general takāful or composite takāful business. The Standard is also applied to takāful windows[2] and subsidiaries,[3] with such

[1] Per IFSB-27, the Takāful Undertaking (TU) refers to the entire operation, comprising the TO and the funds it manages.
[2] Per IFSB-27, a 'Window' is a part of a conventional insurer (such as a branch or dedicated unit) that provides *takāful* services (other than purely as an intermediary).
[3] Per IFSB-27, a 'Subsidiary' is a domestically established legal entity, belonging to a group, that requires its own licence.

modifications as may be necessary to reflect differences in their operational frameworks. Such modifications should not compromise the segregation of takāful funds or the protection of participants. A TU may maintain more than one Participants' Risk Fund (PRF). References to the PRF in this Standard shall be construed as references to each PRF maintained by the TU.

10. Retakāful undertakings are excluded from the scope due to their distinct operational characteristics and risk profiles. Retakāful operations involve larger scale and more complex risk portfolios, often with cross-border elements, requiring sophisticated risk management frameworks that differ from those of primary TUs.

11. Effective implementation of this Standard requires supportive legal and regulatory foundations that recognise fund segregation. Supervisors should identify any legal barriers to fund segregation, particularly uncertainty regarding whether segregated funds constitute distinct legal entities with clear ownership and rights. Where legal uncertainty exists regarding the status of segregated funds, supervisors should work with relevant authorities to establish appropriate legal clarity on the ownership of the funds and the rights attaching to them, advocating legislative or regulatory reform where needed. The requirements in this Standard remain applicable regardless of the underlying legal structure.

SECTION 2: SPECIFIC RISKS AND CONSIDERATIONS RELEVANT TO RISK MANAGEMENT OF TAKĀFUL UNDERTAKINGS

12. This section identifies areas where takāful operations require specific considerations within established risk management frameworks. The materiality and relevance of these considerations vary with the operational model adopted, the regulatory framework in the jurisdiction, and the level of Islamic financial market development in the operating environment.

13. The risk considerations identified in this section are examples and not an exhaustive list. Additional considerations or risks may arise from evolving operational models, market developments, or changes in the regulatory environment.

2.1. Fund Segregation[4]

14. Fund segregation necessitates specific risk management considerations as each fund maintains distinct risk profiles, obligations, and stakeholder relationships. For instance, an investment loss may be material to the Participants' Investment Fund (PIF) even when not material to the overall undertaking.

15. Misallocation of expenses or income between funds creates operational risk and may also breach the fiduciary obligations of the takāful operator (TO)[5] toward participants. For example, where a management fee[6] is deducted from gross contributions and surrender values are calculated by reference to those gross contributions, charging the full surrender payment to the PRF may result in the PRF bearing an amount that relates to the management fee retained by the TO. A similar allocation issue may arise in relation to retakāful or reinsurance arrangements. Where contributions are ceded from a participants' fund, commissions, surplus, or other amounts arising from those arrangements may be attributable to that fund. Crediting such amounts to the Shareholders' Fund (SHF) may therefore result in a transfer of value from participants to the TO. Additionally, fund segregation means that assets are not fungible between funds, which necessitates specific considerations for liquidity management. For example, the assets within the PRF are held to meet participant obligations and cannot be used to cover liabilities belonging to the SHF. Each fund's liquidity position therefore has to be managed on a standalone basis, with sufficient liquid assets held relative to its specific obligations and risk profile, particularly during stress scenarios.

2.2. Fiduciary Responsibilities

16. TOs manage participants' funds in a fiduciary capacity and are expected to act in the interests of participants in administering and operating those funds. Participants collectively bear the underwriting risk through the PRF and therefore rely on the TO to manage the fund prudently and safeguard its financial soundness and sustainability. The TO is not contractually liable for underwriting losses in the PRF, except those directly attributable to negligence, misconduct, or breach of contractual terms.

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[4] Fund segregation typically involves three main funds:
(1) Shareholders' Fund (SHF), covering equity and operational expenses;
(2) Participants' Risk Fund (PRF), managing contributions, claims and related expenses; and
(3) Participants' Investment Fund (PIF), primarily for family takāful savings or investments.
See Appendix 1 for more details.

[5] 'Takāful Operator' (TO) is the entity that manages the takāful business. This operator may or may not be part of the same legal entity in which the participants' interests are held.

[6] In this Standard, 'management fee' means the wakālah fee that the TO receives for managing the PRF and/or the PIF, whether deducted from contributions on receipt or charged to the fund. Alternatively, where the TO manages the investments of the PRF and/or the PIF under a muḍārabah contract, its entitlement is a share of investment profit, referred to as the TO's share of investment returns. Where 'operator remuneration' is used in this standard, it means the aggregate of the management fee or muḍārib fee, the TO's share of investment returns and any performance fee linked to the underwriting surplus of the PRF where permitted under the regulatory framework and the rulings of the Sharī'ah Board or authority concerned.

17. At the same time, the TO derives income from the funds it manages, principally through management fees,[7] and a share of investment returns from the PIF. These remuneration arrangements may create incentives that are not fully aligned with the interests of participants and give rise to potential conflicts of interest between the fiduciary duty to manage the fund in participants' interests and its commercial objective to generate returns for shareholders.

18. Management fees charged to the PRF may give rise to fiduciary concerns where the TO's interest in its remuneration is not aligned with the interests of participants. For example, such concerns may arise where a TO maintains its management fee despite deteriorating underwriting experience, reduces contribution rates in response to competitive pressures without a corresponding adjustment to the management fee, or consistently charges the maximum fee permitted under the regulatory framework without regard to the financial position of the PRF. In such circumstances, the fee arrangement may preserve the TO's remuneration while the resulting financial impact is borne by the PRF, giving rise to a potential conflict between the TO's commercial interests and its fiduciary responsibility to manage the PRF in the interests of participants.

2.3. Financial Soundness of the Fund

19. In a TU, the PRF bears the obligations arising from the takāful coverage provided to participants and is expected to meet those obligations from the resources available to the fund. Its financial soundness therefore depends on whether it has sufficient financial resources to meet its current and prospective obligations as they fall due.

20. The financial position of the PRF is affected by the adequacy of participant contributions, claims experience, technical provisions, retakāful arrangements, investment performance, expenses borne by the PRF, operator remuneration, and other allocations affecting the resources available to the fund. These factors need to be considered together in assessing the current and prospective financial soundness of the PRF.

21. Persistent or recurring deficits may indicate underlying weaknesses in contribution levels, underwriting, remuneration arrangements or other aspects of fund management. Where such weaknesses are not addressed, financial support from the SHF or other sources may enable the PRF to continue meeting its obligations while delaying corrective action on the underlying causes of the deterioration.

22. Where the applicable operating model or regulatory framework provides for qarḍ,[8] it may be used to provide financial support to a PRF that is unable to meet its obligations from its available resources. Where the regulatory framework recognises qarḍ as an eligible resource for meeting the solvency requirements of the PRF, it is sometimes used to restore compliance with those requirements. The circumstances in which qarḍ is provided, the events that trigger its provision, and its treatment for prudential purposes vary across jurisdictions. As qarḍ is generally repayable from future surpluses of the PRF, repeated or prolonged reliance on it may affect the capacity of the fund to rebuild its financial position and may also create financial exposure for the SHF where repayment becomes uncertain.

23. More generally, repeated or prolonged reliance on qarḍ or other forms of financial support may indicate that the PRF is unable to restore its financial position from its own resources. This may delay the recognition of underlying weaknesses and the implementation of corrective measures, particularly where the provision of support allows the PRF to continue meeting its obligations without addressing the factors contributing to its deterioration.

[7] Per IFSB-8, the fee is expected to cover the total sum of: (a) management expenses; (b) distribution costs, including intermediaries' remuneration; and (c) a margin of operational profit to the TO.

[8] Qarḍ refers to an interest-free loan provided by the SHF to the PRF and is repayable from future surpluses of the fund. The circumstances in which qarḍ may be, or is required to be, provided, and its treatment in solvency calculations, vary across jurisdictions.

2.4. Level of Development of Islamic Financial Markets

24. The level of development of Islamic financial markets varies across jurisdictions, creating different operational contexts for TOs that directly influence risk management capabilities and strategic options. In jurisdictions with limited Islamic finance options, TOs may face constraints in portfolio construction, potentially creating concentration risks within specific asset classes, geographical regions, or economic sectors. Such limitations may restrict diversification opportunities compared to conventional insurance operations and potentially result in greater volatility of asset-liability matching or investment returns relative to broader market indices.

25. In some jurisdictions, the limited availability and secondary-market liquidity of eligible assets may also constrain liquidity management and increase vulnerabilities during periods of market stress, particularly where multiple Islamic financial institutions seek to liquidate similar assets simultaneously. Additionally, TOs may face challenges when investments lose their compliance status by breaching a screening threshold, requiring TOs to dispose of those holdings within prescribed timeframes and potentially under unfavourable market conditions. These features may further restrict portfolio management flexibility and introduce additional sources of market and liquidity risk that the risk management framework should address.

2.5. Retakāful Capacity

26. Where applicable, limited availability of retakāful capacity may require TOs to accept higher retention levels or concentrate retakāful arrangements with a limited number of counterparties. The inability to share risks at optimal levels may necessitate more conservative underwriting approaches or enhanced capital buffers to maintain appropriate financial strength. Concentration of this kind creates additional counterparty credit risk and reduces the diversification benefits typically achieved through broader reinsurance relationships. It may also create systemic vulnerabilities where difficulties experienced by major retakāful providers could affect multiple TOs simultaneously. Geographic limitations in retakāful capacity may require cross-border arrangements that introduce further considerations, including currency and political risk.

27. In jurisdictions where conventional reinsurance is permitted under necessity principles, TOs face additional considerations in ensuring appropriate Sharīʿah oversight of these arrangements, including regular reassessment of whether the conditions for necessity continue to be met, and transparent governance processes for making such determinations.

2.6. Group Structure and Window Operation Considerations

28. Takāful windows and group risk management approaches require adaptation to takāful-specific considerations and operational vulnerabilities. These operations may share systems, personnel, and infrastructure with the host conventional insurer, and personnel unfamiliar with takāful requirements may execute takāful transactions without appropriate consideration of Islamic finance principles.

29. In a window operation, fund segregation applies between the host entity's conventional insurance funds and each of the takāful funds: the PRF(s) across all takāful business lines and the PIF(s). Group risk diversification benefits that apply to conventional insurance entities may therefore not extend to takāful operations. This may result in risk assessments at the group level that do not adequately reflect the limited fungibility of resources between conventional and takāful operations.

2.7. Participants' Expectations

30. TOs may face risks arising from participants' expectations regarding surplus distributions, reduced contributions, or product performance, even where such expectations are not supported by explicit contractual guarantees. The prospect of surplus distribution, for example, is frequently

highlighted in marketing and distribution as a distinguishing feature of takāful products. Product illustrations and historical surplus distribution patterns may further reinforce these expectations. Where surplus distributions fall below expected levels, or below those of peer TOs, the PRF may experience higher surrenders and non-renewals, and consequent liquidity pressure.

31. Where peers within the same market distribute surplus or reduce contribution levels, TOs face competitive pressure to match those practices regardless of the financial position of their own PRF. This market dynamic may effectively compel the TO to meet expectations shaped by competitor behaviour rather than by the performance of the fund it manages, constraining management flexibility in investment strategy, surplus retention, and expense management.

32. These may create pressures on PRF reserves. During favourable underwriting periods, participant expectations and competitive benchmarking against peer funds may create pressure toward distribution at levels that limit the PRF's capacity to build reserves against future adverse experience. During unfavourable periods, the PRF may consequently lack accumulated reserves to absorb losses.

2.8. Sharīʻah Non-Compliance Risk

33. Sharīʻah non-compliance is an operational risk that may arise across all aspects of takāful operations. Conventional insurance operational risk encompasses process failures, system deficiencies, human errors, and external events. TUs face additional potential losses or reputational damage arising from inadvertent or deliberate non-compliance with Sharīʻah parameters as interpreted by the TO's Sharīʻah governance framework or by the relevant regulatory authority in the jurisdiction. A breach of Sharīʻah principles may render contracts invalid and deprive participants of takāful protection, cause financial losses, damage the reputation of the TU and that of the wider takāful sector, expose the TU to regulatory action, and affect the management of other risks.

34. Where national laws or regulatory requirements conflict with Sharīʻah principles, additional considerations arise. Examples include mandatory investment in interest-bearing government securities to meet capital adequacy requirements, or required contract provisions that contradict Sharīʻah principles, such as penalty clauses that may constitute interest. Such conflicts arise most often in jurisdictions whose regulatory frameworks were developed primarily for conventional insurance, without specific accommodation for takāful operations.

SECTION 3: RISK MANAGEMENT AND INTERNAL CONTROLS

35. Effective risk management and internal controls are fundamental to the safe and sound operation of TUs and the protection of participants' interests. This section provides supplementary guidance to TCP 9 and TCP 16 on risk management and internal control considerations arising from the operational structure of takāful.

36. Supervisory oversight has an important role in safeguarding participants' interests, particularly as participants are not directly represented in the governance of the funds in which they bear risk. In assessing a TO's risk management and internal controls, supervisors should therefore consider whether the risks borne by participants are adequately addressed and their interests appropriately protected.

3.1. Systems for Risk Management and Internal Controls

3.1.1. Basic Components of a Risk Management System

37. TCP 9.1.1 provides guidance that TOs should address all (identified) risks TUs face and that their risk management systems should include all appropriate risk mitigation techniques.

38. Supervisors should assess whether the TO's risk management system addresses the specific considerations arising from the structure and operation of takāful, including fund segregation, the TO's fiduciary responsibilities in managing participants' funds, operator remuneration, surplus management, and arrangements for financial support to the PRF. Supervisors should require the TO to establish and maintain policies and processes to ensure that each PRF has sufficient financial resources to meet its current and prospective obligations.

39. Supervisors should assess the governance arrangements through which the TO manages its fiduciary responsibilities to participants. The TO should be required to establish governance structures, decision-making processes, and oversight mechanisms that address potential conflicts between fiduciary duties to participants and commercial obligations to shareholders, covering investment strategy decisions, surplus distribution policies, and operator remuneration. Supervisors should review the records of decisions taken in these areas to determine whether participants' interests were prioritised in practice, rather than relying on a documented process as evidence that they were.

40. Supervisors should require TOs to ensure that each fund maintains a risk register recording the risks identified for that fund, their quantification where relevant, and the measures taken to manage and mitigate them.[9] Supervisors may require that TOs establish risk taxonomies that categorise all material risks consistently across funds and operational areas, covering both insurance risks and takāful-specific considerations. The TO may also maintain Risk Event Registers that record material risk events and 'near misses', documenting which fund was affected, the nature of the event, how it was managed, what remediation was provided (particularly where participant funds were impacted), and what lessons were learned. The register supports the TO's organisational learning and gives supervisors evidence of the effectiveness of its risk management processes and risk culture, particularly the TO's capacity to fulfil its fiduciary responsibilities. The registers and taxonomy should be updated regularly as risks emerge or evolve, with current risk profiles maintained at both fund and enterprise levels.

41. Supervisors should assess whether takāful-specific parameters are integrated throughout the risk management framework rather than treated as an isolated risk category. The TO should be required to document in its risk policies how Islamic finance principles and guidelines set by the relevant authority[10] inform the identification, measurement, and mitigation of Sharīʿah non-compliance risks, with clear escalation procedures for timely corrective action.[11] The policy approved by the board of directors

[9] See Appendix 2.
[10] For example, National or Central Sharīʿah Authority (if it exists) or the Sharīʿah Board of the IIFS, and national regulations on Sharīʿah governance.
[11] See Principle 4 of IFSB-31: *Guiding Principles for Effective Supervision of Sharīʿah Governance*

(BOD) should require the Sharī‘ah Board to be consulted on any matter where an inherent risk of Sharī‘ah non-compliance is identified, or where it is uncertain whether an activity carries a significant risk of Sharī‘ah non-compliance.

42. TCP 16 requires TOs to establish enterprise risk management (ERM) that addresses risks in an ongoing and integrated manner and to develop an Own Risk and Solvency Assessment (ORSA). Supervisors should assess whether ERM and ORSA operate at both enterprise and fund levels and reflect the takāful-specific considerations. Risk appetite statements should be established at the level of each segregated fund, recognising that the objectives of the PRF include meeting participants' expectations that claims will be met in full, whilst the objectives of the SHF include earning reasonable returns through fees for managing the TO's underwriting and investment activities. ORSA processes should incorporate forward-looking assessment of each fund's capacity to meet its obligations under adverse experience and identify scenarios where this capacity could be impaired.

3.1.2. Risk Management at the Fund Level

Retained Reserves

43. Supervisors should require each PRF to maintain, in addition to adequate technical provisions, an appropriate level of retained reserves to support its financial soundness and capacity to absorb any adverse experience across the underwriting cycle. Retained reserves should be built from the contributions allocated to the PRF and from underwriting surplus retained in the PRF. The reserve should form part of the financial resources maintained by the PRF for solvency purposes.

44. Supervisors should establish the minimum requirements for retained reserves, including the basis for their determination. Each PRF should maintain retained reserves at least at the required minimum and at a higher level where warranted by an actuarial assessment of its risk profile, taking into account, among other factors, claims volatility and the nature and maturity of its liabilities.

Operator Remuneration

45. Supervisors should require the management fee charged by a TO, to be based on an independent actuarial assessment, that takes into account the financial soundness of the PRF and an appropriate assessment of the TO's relevant expenses. The basis and level of the management fee should be subject to periodic review to ensure that they remain appropriate. The expense study supporting the determination of the management fee should be submitted to the supervisor and reviewed and updated periodically, and whenever there are material changes in the TO's expense structure or experience.

46. The actuarial recommendations on contribution levels and the calibration of the management fee, together with the decisions of the BOD on those recommendations, should be documented and submitted to the supervisor.

47. Appropriate governance arrangements should be in place for the determination and approval of the management fee, including to address conflicts of interest arising from the TO determining its remuneration from the PRF.

48. Where an upfront management fee is charged, the financial soundness of the PRF should take precedence in determining the allocation of contributions between the PRF and the management fee. Where the management fee is insufficient to meet the TO's relevant expenses, any resulting shortfall should be borne by the SHF, and the associated risk reflected in the capital adequacy requirements applicable to the TO.

49. Where contributions are set below the level recommended by the actuarial assessment, supervisors should require that this does not result in the amount allocated to the PRF falling below its assessed financial requirements, and that any resulting adjustment is instead reflected in the

management fee. Any departure by the BOD from the actuarial recommendation should be documented, together with the reasons for the departure, and submitted to the supervisor.

50. Supervisors should require the TO to identify and rectify any management fee charged to the PRF that does not meet the requirements set out in the preceding paragraphs, including by restoring amounts inappropriately charged to the PRF.

51. Where the regulatory framework prescribes a maximum management fee, the fee charged should remain subject to the assessment and governance requirements set out above and should not be determined solely by reference to the prescribed regulatory ceiling.

Underwriting Surplus

52. Supervisors should require underwriting surplus arising in a PRF should be retained for, or distributed to, the participants of that PRF. Underwriting surplus should be available for distribution only to the extent that the applicable retained reserve requirements continue to be met after the distribution and should not be distributed while the PRF is in deficit, has not met the required minimum level of retained reserves in the PRF or is reliant on financial support to meet its financial requirements.

53. Any proposed distribution should be subject to actuarial assessment of its impact on the financial soundness of the PRF. The availability of underwriting surplus should not be relied upon to support contribution levels that are inadequate in relation to the risks and obligations of the PRF.

Participants' Investment Fund

54. Where a TU maintains a PIF, supervisors should assess the investment policy is consistent with the risk profiles of the participants whose savings it holds and with the basis on which the product was presented to them. The TO's remuneration from the PIF should not create incentives to take higher investment risk inconsistent with participants' risk profile. The liquidity of the PIF should be managed against expected and stressed levels of surrender and withdrawal activity. For family takāful products in which contributions to the PRF are drawn from the PIF, TOs should be required to assess whether the amounts drawn remain adequate over the duration of the contract, and to identify the measures available where they do not.

3.1.3. Risk Identification and Assessment

55. TCP 9.1.7 provides guidance that TOs should assess the materiality of each risk with regard to its incidence, recognising that a risk may be material to specific funds even if immaterial to the overall entity. TOs should be required to ensure that risks are prioritised and managed according to their impact on specific stakeholders, rather than solely by enterprise-wide metrics that may obscure fund-level vulnerabilities.

56. Supervisors should assess whether TOs incorporate risk interaction analysis across segregated funds and operational areas in their risk assessment processes. TOs should be required to identify risks that appear isolated but may create cumulative threats when combined or transmitted between funds.

57. Supervisors should assess whether TOs, in their risk assessment processes, evaluate how restrictions on fund fungibility affect risk exposure, recognising that a limited ability to transfer resources between funds has implications for capital planning and contingency arrangements. TOs should be required to ensure this assessment informs decisions about appropriate capital buffers, liquidity management approaches, and risk transfer strategies at both fund and enterprise levels.

58. Supervisors should assess how TOs establish processes to evaluate the formation and materiality of participants' expectations regarding investment returns, surplus distributions, and fund performance as highlighted in Section 2. Those processes should determine whether the expectations give rise to implied contractual obligations, and quantify the potential financial impact where such obligations must be met.

59. Supervisors should assess whether the TO's ORSA and stress testing address takāful-specific considerations and reflect the constraints and opportunities realistically available to management in the environment in which TOs operate. Examples include:

(a) the failure of a major retakāful counterparty or a significant reduction in available retakāful capacity, requiring the TO to retain a greater share of underwriting risk and the resulting capital implications.

(b) investments losing their Sharī'ah-compliant status and requiring divestment during adverse market conditions that may result in losses to the affected fund.

(c) significant increases in participant withdrawals or non-renewals following surplus distribution announcements that fall below expectations, and the resulting effects on fund liquidity and the risk profile of the remaining participant pool.

(d) market developments affecting the availability of eligible investment opportunities such that the range of permissible investments becomes more limited.

(e) a material deterioration in the financial position of a PRF that impairs its ability to meet its obligations from its available resources, and the measures available to restore its financial soundness.

(f) a loss of confidence in the TU's Sharī'ah compliance, following a non-compliance event at the TU or in the wider sector, leading to elevated surrenders and reduced new business.

3.1.4. Risk Monitoring

60. TCP 9.1.11 provides guidance that TOs' monitoring of Sharī'ah non-compliance risk should take into account Sharī'ah Board judgements and be reviewed where new rulings may affect existing risk exposures. TOs should be required to assess whether their monitoring frameworks remain effective in identifying Sharī'ah non-compliance risks following such rulings, and to make adjustments where necessary.

61. Supervisors should satisfy themselves that the escalation thresholds defined by TOs for each fund are appropriate to that fund's risks and prompt management action when breached.[12] TOs should be required to ensure these trigger points reflect the specific characteristics and obligations of each fund, recognising that intervention may be required at different levels for different funds.[13]

62. Where applicable, supervisors should assess whether TOs establish monitoring systems to evaluate the underwriting quality and financial condition of retakāful providers, recognising that limited provider options can concentrate exposures. TOs should be required to evaluate whether retakāful arrangements continue to provide effective risk protection and to maintain documented contingency arrangements for potential retakāful failure ensuring that TOs can respond effectively to disruptions in retakāful coverage.

3.1.5. Risk Mitigation

63. TCP 9.1.12 provides guidance that TOs' risk management systems should include strategies to mitigate material risks, including remedial actions such as purification of non-compliant income where appropriate.

[12] Examples of fund-specific thresholds may include: the PRF's claims experience exceeding pricing assumptions over successive periods; qarḍ levels approaching predetermined limits relative to the SHF's capacity to provide support; surplus distribution levels that would reduce PRF reserves below minimum adequacy; and participant withdrawal rates exceeding assumptions following surplus distribution announcements or qarḍ disclosures.

[13] See GN-10: *Recovery and Resolution for Takaful Undertakings,* Section 2.3

64. Supervisors should assess whether mitigation strategies are calibrated to the specific risk profile and appetite of each fund. TOs should be required to recognise that the appropriate response to a risk in the same risk category may differ depending on which fund bears the risk.

65. Supervisors should require that when traditional risk mitigation tools are unavailable or inappropriate because of Sharīʿah parameters, TOs develop alternatives that achieve equivalent risk management objectives. For instance, TOs should be required to evaluate Sharīʿah-compliant risk sharing mechanisms beyond traditional retakāful, such as co-takāful arrangements.

66. Supervisors should require that, for situations where conventional reinsurance needs to be considered under the principles of need, TOs establish, based on the principles and guidelines set by the relevant authority,[14] clear criteria defining permissible arrangements, documentation, and approval processes. The process should specify review terms and the conditions that would trigger reassessment of whether necessity continues to apply, so that conventional reinsurance is used only when genuinely necessary and subject to appropriate ongoing oversight.

67. Supervisors should require that TOs establish processes for handling investments that become non-compliant due to changes in underlying business activities or financial structures.[15] TOs should be required to address operational, liquidity, and market risks during divestment, particularly during stressed market conditions. TOs should be required to define response timeframes, decision authorities, and execution procedures.

TCP 15.0.7 provides guidance that supervisors should avoid imposing requirements that could force TOs into non-compliance, recognising that legal or regulatory frameworks developed primarily for conventional insurance may inadvertently conflict with Islamic finance principles. Supervisors should require that TOs establish structured processes for identifying, escalating, and documenting such conflicts, with clear decision-making procedures involving Sharīʿah governance functions. Where a conflict arises, supervisors should develop functionally equivalent requirements or work with TOs to identify alternative approaches that accommodate Islamic finance parameters without compromising prudential objectives. TOs should be required to engage proactively with supervisory authorities to present functionally equivalent solutions, and to disclose transparently to participants any regulatory constraints and the resolutions adopted.

Qarḍ

68. The use of qarḍ in relation to a PRF requires particular supervisory attention, given the repayment obligation it creates for the PRF. Its use should not substitute for measures to address recurring deficits or weaknesses in the financial soundness of the PRF.

69. Where a PRF is in deficit, supervisors should require the TO to identify and address the underlying causes, including, as relevant, underwriting performance, contribution levels, operator remuneration and the allocation of income and expenses between the PRF and SHF. The measures taken should reflect the underlying causes of the deficit. Where the deficit has resulted from actions or decisions of the TO that have inappropriately reduced the resources of the PRF, the TO should be required to rectify the resulting impact without recourse to qarḍ or otherwise creating a liability for the PRF or its participants.

70. Supervisors should monitor any use of qarḍ, including its frequency and duration. Recurrent or prolonged use should prompt further assessment of the financial soundness of the PRF and the adequacy of corrective measures taken. Outstanding qarḍ and its recoverability should also be appropriately reflected in the assessment of the financial and capital position of the TO.

[14] For example, National or Central Sharīʿah Authority (if it exists) or the Sharīʿah Board of the TU, and national regulations on Sharīʿah governance.
[15] See Principle 10 of IFSB-31: *Guiding Principles for Effective Supervision of Sharīʿah Governance*

71. Where material, recurrent, or persistent weakness in the financial position of the PRF is identified, supervisors should require immediate corrective measures to restore the fund's financial soundness. Such measures may include adjustments to contribution rates, restrictions on underwriting activities, reductions in expenses, adjustment of operators' remuneration, appropriate retakāful arrangements, or revisions to surplus distribution practices. Supervisors should require appropriate governance and internal processes for assessing the severity of the situation, approving remedial actions, and monitoring their implementation and effectiveness. Where forward-looking assessment indicates that the PRF cannot restore its claims-paying capacity from its own resources under current operating conditions, supervisors should consider more fundamental recovery measures such as write-off or, where necessary, an orderly run-off of the affected business or of the fund.

3.1.6. Changes to the Risk Management System

72. TCP 9.1.20 provides guidance that TUs should have mechanisms for identifying new risks, with particular attention to risks that may emerge at the segregated fund level due to different stakeholder risk profiles and evolving operational circumstances. TOs should be required to conduct regular assessments to identify fund-specific changes and their implications for risk management approaches, recognising that changes in markets, products, operations, or expectations regarding surplus and investment returns may affect each fund differently.

73. Supervisors should require that changes to the risk management system are subject to appropriate governance oversight, including the BOD's approval for material changes and a Sharī'ah Board resolution where changes may affect compliance. TOs should be required to ensure the change process includes impact assessment at both enterprise and fund levels.

74. Supervisors should require that TOs ensure the Sharī'ah governance function considers whether changing circumstances, such as evolving regulatory requirements or market conditions, introduce previously unidentified non-compliance risks. TOs should be required to ensure that risk management systems remain current with Islamic finance parameters and evolving external factors.

3.2. Internal Control System

3.2.1. Basic Components of an Internal Control System

75. TCP 9.2.2 provides guidance that the internal control system of TOs should cover all units and activities and should be an integral part of the daily activities of a TO.

76. Supervisors should require that TOs' internal control systems integrate Sharī'ah governance functions into routine control processes[16] rather than relying solely on ex-post reviews. TOs should be required to establish clear protocols specifying when Sharī'ah Board consultation is required for risk decisions, particularly where risk responses may have compliance implications.

77. Supervisors should require that TOs implement controls that prevent commercial pressure from compromising the independence of control functions.[17] TOs should be required to implement safeguards against financial performance targets that might incentivise weaker controls or compromise compliance with Islamic finance principles. Internal controls should address areas where TOs' remuneration structures might create incentives that conflict with prudent management of participant funds.

78. Supervisors should require, for takāful windows and groups, that TOs establish appropriate controls for shared resources and systems with conventional operations. TOs should be required to implement safeguards that prevent commingling between conventional and takāful activities whilst enabling efficient shared service arrangements where operationally necessary. TOs should be required

[16] See Principle 3 of IFSB-31: *Guiding Principles for Effective Supervision of Sharī'ah Governance*
[17] See Application Paper on Supervision of Control Functions by IAIS

to ensure that traditional risk management approaches are appropriately adapted to accommodate takāful-specific considerations. TOs should be required to document how operations maintain compliance with Islamic finance principles despite sharing resources with conventional systems and processes.

3.2.2. Policies and Processes

79. TCP 9.2.4 provides guidance on the need for appropriate controls for all transactions between segregated funds of a TO, including the allocation of revenues or expenses.

80. Supervisors should require that TOs establish documented policies, processes, and controls that prevent inappropriate cross-fund transactions whilst enabling legitimate and necessary inter-fund arrangements to be executed efficiently and transparently. TOs should be required to ensure that all transactions within the segregated funds are executed in accordance with contractual terms and regulatory requirements, through clear documentation and verification procedures.

81. Supervisors should require that TOs establish expense and revenue allocation policies that ensure costs and revenues are attributed to appropriate funds according to contractual terms and Islamic finance parameters. TOs should be required to give particular attention to shared expenses and overhead allocations where judgement is exercised, as these represent heightened risk areas for potential misattribution between participant and shareholder funds. For instance, any commissions or surplus received from retakāful arrangements should be fairly allocated to the relevant funds according to the source of the retakāful contributions. TOs should be required to maintain clear documentation and appropriate oversight.

82. Supervisors should require that TOs have policies and processes for handling Sharīʻah non-compliance incidents that might arise from control failures. TOs should be required to define investigation processes to determine root causes, implement remediation approaches to address immediate issues, and ensure reporting to the relevant governance bodies, including the Sharīʻah Board and the BOD as appropriate. These policies should also address the allocation between funds of non-compliant income and any associated disposal costs, having regard to the source and cause of the Sharīʻah non-compliance.

3.2.3. Monitoring and Review

83. TCP 9.2.4 provides guidance that periodic testing and assessments should be carried out by objective parties such as internal or external auditors or Sharīʻah auditors to determine the adequacy, completeness, and effectiveness of the internal control system.

84. Supervisors should require that TOs ensure monitoring and review processes verify that coordination between internal controls and Sharīʻah governance functions operates as intended within the overall governance framework. TOs should be required to verify that control gaps do not emerge where neither internal controls nor Sharīʻah governance functions assume clear responsibility. TOs should be required to conduct regular assessments of control coverage, identify potential overlaps or gaps, and adjust responsibilities and procedures as needed to maintain comprehensive and effective oversight.

85. Supervisors should require that the effectiveness of internal controls is assessed at the individual fund level, not only at entity level. Periodic testing should specifically cover controls over transaction attribution between funds, expense and revenue allocation, operator remuneration, surplus distribution, and governance of financial support provided to the PRF (such as the use of qarḍ, if any) to verify that these controls are operating effectively and that participant funds are appropriately protected. Supervisors should review the substantive findings of such periodic testing rather than only the fact that testing has been conducted and should follow up where findings indicate weaknesses in controls protecting participant funds.

3.2.4. Control Functions

86. TCP 9.3–9.7 require TOs' control functions to have the necessary authority, independence, and resources as well as appropriate competency, expertise, and reporting to governance functions.

87. Supervisors should require that TOs ensure the Sharīʿah governance function carries out a role in internal control that is commensurate with the scope of its duties.[18] TOs should be required to ensure the function provides advice to the governing body and management on control matters relating to compliance whilst maintaining clear boundaries with activities that may raise conflicts of interest.

88. Supervisors should require that TOs ensure control functions address prudential, governance, and Islamic finance requirements whilst maintaining independence and clear boundaries for responsibility and avoiding operational duplication. Where overlapping responsibilities between control functions cannot be eliminated, TOs should be required to establish formal coordination mechanisms ensuring appropriate coverage without gaps or duplication.

89. Supervisors should require that control functions possess appropriate competency[19] and expertise to address the related risks of takāful operations. TOs should be required to ensure personnel have an understanding of Islamic finance parameters, takāful operational models, and Islamic finance market infrastructure to effectively identify and assess risks related to takāful operations.

3.3. Outsourcing of Material Activities

90. TCP 9.8 requires TOs to retain at least the same degree of oversight and accountability for outsourced material activities as applies to non-outsourced activities, with additional considerations for takāful-specific operational requirements.

91. Supervisors should require that TOs ensure the outsourcing of any significant activity is subject to appropriate definition, approval, monitoring, and control, so that it does not introduce additional risk of Sharīʿah non-compliance.[20] TOs should be required to recognise that certain functions may be considered material due to their compliance implications rather than solely on conventional materiality assessments.

92. Supervisors should require that before approving outsourcing arrangements, the BOD assesses the service provider's capability to maintain Sharīʿah compliance. TOs should be required to ensure that service providers possess appropriate knowledge of Sharīʿah principles applicable to takāful operations, recognising that outsourcing providers may be unfamiliar with these requirements. Supervisors should require that, when outsourcing activities that affect participants' funds, TOs retain their fiduciary responsibility notwithstanding the delegation of operational functions and maintain ongoing oversight.

93. Supervisors should require that TOs conduct periodic reviews of outsourcing arrangements to assess the continued adequacy of compliance with Sharīʿah parameters. TOs should be required to ensure that outsourcing arrangements continue to support the TO's operational and Sharīʿah compliance objectives.

94. Takāful intermediaries may also perform functions supplemental to takāful intermediation, many of which may be described as outsourced functions of the TO. See TCP 19 and Section 2.2.5 of IFSB-29 for guidance on intermediaries.

[18] See Principle 3 of IFSB-31: *Guiding Principles for Effective Supervision of Sharīʿah Governance*
[19] See Principle 2.2 of IFSB 10: *Guiding Principles on Sharīʿah Governance Systems for Institutions Offering Islamic Financial Services*
[20] See Principle 8 of IFSB-31: *Guiding Principles for Effective Supervision of Sharīʿah Governance*

SECTION 4: RISK-BASED SUPERVISION

95. Risk-based supervision (RBSup)[21] allocates supervisory resources and activities based on the risks posed to takāful participants, the takāful sector, and the financial system. IFSB-27 emphasises that RBSup for takāful must consider the specificities of takāful operations and their impact on both prudential and conduct supervision. This section provides guidance to supervisors on implementing effective RBSup frameworks that appropriately address takāful-specific considerations.

4.1. Risk Assessment

96. When assessing the risk profile of a TO, supervisors should have regard for the takāful-specific risks and considerations identified in Section 2. The standard supervisory risk assessment process of evaluating inherent risk, the quality of risk mitigation, and the resulting net risk applies to takāful operations. The inherent risk assessment should also pay particular attention to risks arising from the chosen takāful model, fund segregation, and fiduciary conflicts between the TO and participants. The assessment of risk mitigation quality should include the effectiveness of the Sharī'ah governance function alongside generally applicable risk management and control functions.

97. Supervisors should conduct risk assessments at both enterprise and fund levels and should assess the financial position and performance of each segregated fund. Each segregated fund should be treated as a separate area of supervisory assessment, given the distinct stakeholder interests and risk exposures involved. The PRF in particular should be a distinct supervisory focus alongside the enterprise-wide assessment. Supervisors should incorporate Sharī'ah noncompliance risk, commingling of funds, and misattribution of expenses and revenues when assessing operational risk.

98. Supervisors should have sufficient information to assess the financial position and performance of each segregated fund and should not rely on entity-level information alone. Supervisors should establish reporting requirements that provide, for the PRF, its underwriting result before and after deduction of the management fee, reserves, liquidity position, and the amount and movement of any outstanding qarḍ. Supervisors should determine the frequency of such reporting by reference to the financial condition of the fund, and should require more frequent reporting, including statements of expected inflows and outflows, where the fund's liquidity or solvency position or its reliance on qarḍ gives rise to concern. Supervisors should collect this information in a form that permits comparison across TOs and should enquire into the position of a TO whose contribution levels, expense ratios, remuneration derived from the fund, or reliance on qarḍ diverge materially from those of its peers.

99. When assessing a TO's systemic importance, supervisors should consider its significance within the domestic takāful sector and the broader Islamic finance ecosystem. The failure of a prominent TO could disproportionately affect public confidence in Islamic financial products more broadly.

100. When assessing the risk profile of TOs, supervisors should consider, among other matters, the following takāful-specific areas:

(a) The adopted Islamic finance contract and takāful model;

(b) Adequacy of contribution levels relative to the PRF's risk profile and emerging claims experience;

(c) Financial support provided to the PRF (e.g., qarḍ), including the extent of reliance on such support and, where applicable, the repayment or recoverability of qarḍ and its implications for the SHF;

(d) Surplus distribution practices and participants' expectations management;

[21] See Appendix 3

(e) Retakāful dependency and counterparty concentration risks;

(f) Any constraints in the available investment universe and concentration of exposures (where applicable);

(g) Discharge of fiduciary responsibility in managing participant funds;

(h) Effectiveness of Sharī'ah governance,[22] non-compliance track record, and the adequacy of remediation following non-compliance incidents; and

(i) Operational risk considerations relevant to window or group operations, where applicable.

101. In jurisdictions with limited Islamic finance investment or retakāful options, supervisors should apply informed judgement in the risk assessment, recognising that certain risk exposures are unavoidable given current market infrastructure. High concentration risk, for example, may arise from limited diversification opportunities in the market rather than from poor risk management, and should be weighed accordingly in the assessment of net risk. Supervisors should support TOs in developing alternative risk mitigation approaches suited to local market conditions. Whilst accommodating these realities, supervisors should work with market participants and infrastructure providers to identify priorities for market development.

102. Supervisors should maintain systematic documentation of TOs' risk assessments, management of risks, learnings from risk events and near misses, and overall risk profiles at both enterprise and fund levels. Such documentation should support consistent assessment across TOs and enable changes in risk profile to be tracked over time.

4.2. Supervisory Response and Intervention

103. When determining early warning indicators for intervention, supervisors should include at least:

(a) persistent deficits or weakening financial positions in PRFs;

(b) material or recurring reliance on financial support by a PRF;

(c) contribution levels or operator remuneration arrangements that materially weaken the current or prospective financial position of the PRF;

(d) market practices that may indicate persistent underpricing of risks or weakening underwriting discipline across the sector; and

(e) repeated Sharī'ah compliance incidents or weaknesses in Sharī'ah governance and controls.

104. Supervisory response should be graduated and proportionate to the severity of the identified concerns, progressing from enhanced monitoring through supervisory dialogue to formal corrective action. Supervisors should incorporate takāful-specific corrective measures[23] into supervisory intervention that address the operational and governance characteristics of TOs, including:

(a) requiring the TO to adjust contribution levels where supervisory assessment indicates that contributions are insufficient relative to the PRF's risk profile and claims experience;

(b) imposing fund-specific restrictions or enhanced monitoring arrangements for individual funds where risk indicators warrant;

[22] See Principle 12 of IFSB-31: *Guiding Principles for Effective Supervision of Sharī'ah Governance*
[23] For corrective actions and interventions for recovery and resolution scenario, see GN-10: *Guidance Note on Recovery and Resolution for Takāful Undertakings*

(c) requiring appropriate measures governing the provision, monitoring and, where applicable, repayment or recovery of qarḍ provided to the PRF;

(d) requiring strengthened Sharīʻah governance arrangements;[24]

(e) requiring investment strategy adjustments that consider the limited universe of Sharīʻah-compliant options when addressing concentration risks (where applicable);

(f) imposing limits on surplus distribution to protect PRF reserve adequacy, including requirements that minimum reserve conditions are met before distribution is permitted;

(g) requiring remediation where supervisory assessment identifies misattribution of expenses or revenues between funds;

(h) requiring the TO to review and address contribution levels, operator remuneration, or other arrangements affecting the PRF through an independent actuarial assessment where they are contributing materially to weakness in the financial position of the fund, and to demonstrate that contribution levels and operator remuneration are consistent with the PRF's capacity to achieve financial soundness; and

(i) where a PRF is assessed as structurally unviable, requiring orderly restructuring or run-off of the fund, with appropriate measures to protect participant interests including the treatment of outstanding claims, handling of any qarḍ obligations, and facilitation of participant transfer to alternative providers where possible.

105. Where supervisory intervention involves matters with Sharīʻah implications, supervisors should consider how the intervention interacts with the TO's Sharīʻah governance arrangements. Where a proposed supervisory direction may conflict with a Sharīʻah board ruling, supervisors should engage with the TO and, where appropriate, with national or central Sharīʻah authorities to find approaches that achieve supervisory objectives whilst respecting Sharīʻah parameters.

106. Supervisors should recognise the fiduciary responsibilities of TOs toward participants whilst maintaining the effectiveness of their intervention measures. Supervisors should ensure that corrective actions appropriately balance the interests of different stakeholder groups, particularly where intervention measures may affect the distribution of costs and benefits between participants and shareholders.

107. Supervisors should adapt supervisory expectations and intervention measures to acknowledge market infrastructure constraints whilst maintaining prudential standards appropriate to the current environment. This may include accepting higher concentration limits for Sharīʻah-compliant investments where diversification options are restricted, adapting liquidity expectations to reflect available Sharīʻah-compliant liquid assets, and developing alternative risk mitigation approaches where traditional tools are unavailable. Such adaptations reflect supervisory judgement on the appropriate application of prudential standards given the operating environment and should not be understood as a reduction in supervisory standards. Supervisors should maintain prudential expectations appropriate to available alternatives.

4.3. Supervisory Expertise and Resources

108. Supervisors should recognise that effective RBSup requires an understanding of both conventional risk management principles and Islamic finance specificities. Supervisory staff should understand Islamic finance principles and takāful operational models, together with their prudential implications, so that they can assess both prudential soundness and takāful-specific considerations.

[24] See Principle 13, IFSB-31: *Guiding Principles for Effective Supervision of Sharīʻah Governance*

Supervisors should assess supervisory resource requirements, including actuarial capability, and develop capacity-building strategies that secure the expertise required.

APPENDIX 1: SPECIFICITIES OF TAKĀFUL

Concept of Takāful

Takāful can be defined as 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. It is the Islamic alternative to conventional insurance and exists in both Family (or "Life") and General forms.

Takāful is based on two fundamental principles:

(1) Ta'āwun (mutual assistance): Under this principle, participants undertake to assist and support each other against losses arising from specified risks in the spirit of cooperation and mutuality.
(2) Tabarru' (donation): Under this principle, participants commit to donating specified amounts to a common pool, which is used to fulfil the mutual assistance agreement by compensating members for covered losses.

In takāful, policyholders are referred to as 'participants' because they play a dual role. They are both individually the insured parties (contributing to the risk pool and being entitled to compensation from it) and collectively the insurer (as the risk bearer).

Operational Structure

Typically, a takāful undertaking (TU) operates on a two-tier structure:

(1) Takāful Operator (TO): This is the entity responsible for managing the takāful business. The TO is often structured as a commercial company owned by shareholders. Its primary role is to manage the takāful scheme on behalf of the participants, including underwriting, claims management, and investment of funds.
(2) Participants' Collective: This comprises all the participants who have joined the takāful scheme.

This two-tier structure creates a unique hybrid model that combines elements of both mutual and commercial forms of insurance. The TO provides professional management and initial capital, whilst the participants are the collective beneficiaries of the risk pool.

Fund Segregation

Fund segregation arises from the need to reflect the distinctive rights and obligations of the TO as a manager, and participants as the beneficiaries of the risk pool.

Fund segregation typically involves the separation of three main funds:

(1) Shareholders' Fund (SHF): holds shareholder's equity and covers operational expenses.
(2) Participants' Risk Fund (PRF): receives participants' contributions and is used to pay claims and related expenses. It is owned collectively by participants and managed by the TO.
(3) Participants' Investment Fund (PIF): primarily used in Family takāful, holds the savings or investment portion of participants' contributions. It is managed by the TO, often on a profit-sharing basis, with returns shared between participants and the TO.

Surplus

The surplus in the PRF is equivalent to the underwriting profit in conventional insurance. It belongs to the participants collectively, unlike in conventional insurance, where the underwriting profit belongs to the insurer. This distinction reflects the fundamental principle that participants are the beneficiaries of the PRF and thus share both the risks and any resulting surplus.

Qarḍ (Interest-free loan)

Depending on the regulatory requirements, the TO may provide a qarḍ (interest-free loan) to the PRF when it faces a deficit. The qarḍ is to be repaid from future surpluses in the PRF.

Sharī'ah Governance

The Sharī'ah governance structure adds a layer of oversight beyond conventional corporate governance to ensure that all aspects of takāful operations comply with Sharī'ah principles. Regular reviews and audits are typically conducted to verify ongoing compliance, with implementation varying across regulatory frameworks.

APPENDIX 2: RISK TAXONOMY AND RISK REGISTERS

This Appendix outlines a risk taxonomy and its application in risk and risk event registers.

Risk Taxonomy

1. Paragraph 37 of this document clarifies that TUs should address all (identified) risks TUs face and that their risk management systems should include all appropriate risk mitigation techniques. Paragraph 42 requires TUs to establish enterprise risk management (ERM). Consequential risks that arise from the interactions between individual risks should also be included.[25] The set of risks being managed should be considered and managed as a portfolio.

2. The spectrum of risks requiring consideration evolves continuously as the risk environment develops. A structured framework supporting systematic risk identification supports comprehensive and consistent risk identification and coverage. Such a framework can be called a Risk Taxonomy.

3. No risk taxonomy is complete or absolutely correct given the continuously evolving nature of risk landscapes but adoption of a coherent framework provides substantial value to both TUs and supervisors. The value comes from using a coherent and comprehensive structure in which new and evolving risks can be readily incorporated as they emerge. A risk taxonomy typically adopts a hierarchical structure.

4. The high-level risk categories listed are illustrative rather than exhaustive or prescriptive and in practice should be fleshed out in more detail. Additional items may be added reflecting evolving risk contexts, supervisory priorities, and TU-specific considerations.

   (1) **Financial risks** (internal to TU operations): These include strategic risk, underwriting and insurance risk, credit risk, market risk, liquidity risk, etc.

   (2) **Non-financial risks** (internal to TU operations): These include board's capacity and competence, quality of governance (processes and control functions), human skills and capacity, remuneration structures, organisational culture and risk culture, etc.

   (3) **Operational resilience** (internal to TU operations, assessed concerning continuity of essential services during stress scenarios): The focus encompasses the TU's capability to provide participants with essential services whilst facing operational adversity. These risks include operational risks, business continuity risk, third party dependency risks, etc.

   (4) **Market conduct risks**[26] (relating to TU interactions with participants and potential participants): These include risks arising from providing information and advice to actual and potential participants, distributor education and management, participant complaint procedures and resolution processes, etc.

   (5) **External and systemic risks** (internal and external to TU operations, potentially not directly manageable by the TU): These include economic conditions and cycles, legislative changes, regulatory developments, other systemic issues, etc.

   (6) **Environmental and social risks** (external to the TU): These include the impacts of risks changing environmental and social factors, reputational risk, etc.

   (7) **Shari'ah compliance risks:** These include, but are not limited to, the specific risks discussed in this document.

[25] An example of this is Asset Liability Management risk. This reflects the issues that arise due to the differing behaviours of assets and liabilities as conditions may change. That is, the interactions between these two risks.
[26] In some jurisdictions, prudential supervision, often focused on financial, non-financial, and operational resilience risks, may be addressed by different lead supervisors than those responsible for market conduct oversight, with other supervisory authorities potentially playing roles in the overall supervisory framework within which TOs operate.

Risk and Risk Event Registers

5. Establishing a risk taxonomy provides essential support for effective risk assessment and management. This can be accomplished by developing and maintaining of a risk register. A risk register serves as a forward-looking tool primarily focused on identifying potential future risk events and establishing frameworks for their management and mitigation.

6. A risk-based approach recognises that risk events will occur despite effective risk management. A risk event register, complementing the risk register, provides a systematic record of materialised risk events and near-miss incidents. This supports organisational learning and refining procedures to reduce the impact of similar events in future. It also provides supervisory insight into the effectiveness of a TU's risk management processes and capacity to respond to risk events.

7. For TUs, risk and risk event registers should also reflect takāful specificities and Sharī'ah compliance assessments. This can be done by including a separate explicit assessment of Shari'ah implications into each item of the registers (summarised below). The outcome is an integrated approach to risk management for TUs, reflecting the overlay of Sharī'ah compliance onto overall risk management.

8. An effective risk register is current, comprehensive, and actively reflected in management activities and provides a basis for reporting the status of the risk portfolio. This includes managing residual risks within risk appetites, business planning processes, and strategic decision-making. Reflecting the standard approach to risk management, the high-level structure of a TU's risk register would typically include:

   (1) specific risk identification consistent with the risk taxonomy used by the TU;

   (2) inherent risk assessment, evaluated in terms of the likelihood and severity of potential adverse outcomes;

   (3) risk mitigation steps;

   (4) residual risk assessment, evaluated in terms of the likelihood and severity of potential adverse outcomes; and

   (5) operational controls and responsibilities.

9. An effective risk event register to systematically record and analyse material risk events and 'near misses'. A risk event is a risk that has materialised, and financial loss has or will be incurred. A 'near miss' is an unplanned event or unsafe situation that is a 'close call' that does not result in injury, illness, or property/financial damage, but had the realistic potential to do so. In an insurance context, near misses typically occur in an operational risk context. The high-level structure of a risk event register would typically include data that reflects, for both risk events and near misses:

   (1) identification of risks;

   (2) event descriptions, including identification and management data, costs or potential costs (direct and indirect), resources required, responsibilities, etc.;

   (3) resolution process, including ownership, resolution planning, implementation, etc.; and

   (4) learning and consequences, including root cause analysis, process and/or system updates, training update, etc.

APPENDIX 3: RISK-BASED SUPERVISION (RBSup)

This appendix outlines a high-level introduction for supervisory authorities planning to adopt a risk-based supervision (RBSup) framework.[27]

The RBSup Assessment Process

1. RBSup is a structured and forward-looking supervisory approach where the allocation of supervisory resources and the intensity of oversight are proportional to the supervisor's assessment of the risks the insurer poses to a financial sector and system reflecting supervisory objective.

2. Typically, RBSup follows a structured supervisory process to obtain a holistic view of a TU's risk profile. This culminates in an overall risk rating, which determines the required level of supervisory attention and intervention. Having such assessments supports the supervisor in prioritising its available resources in an informed, risk-based way.

3. In broad terms, the RBSup assessment process consists of the following:

   (1) **Potential impact:** The process typically begins with an assessment of the TU's potential impact on the financial system and the *takāful* sector, should it come under stress and require supervisor attention. Factors to consider in making this assessment include size, complexity, quality of governance (including Shari'ah compliance), other non-financial risks, interconnectedness with other financial institutions, and the substitutability of the TU.

   (2) **Significant activities:** The supervisor then identifies the TU's significant activities fundamental to its ongoing stability and continuance in an unfettered business as usual mode.

   (3) **Holistic TU risk assessment:** This is an ERM approach. All identified material risks, including both financial and non-financial risks, should be considered in making an overall TU risk assessment. When TU's come under stress, the trigger may be an immediate financial issue, but it may be that the underlying root causes are non-financial risks, such as poor governance, inadequate processes, poor culture, or lack of human capacity.

   (4) **TU risk and risk event registers.** Supervisors should review[28] both a TU's risk and risk event registers and the reporting generated from them to assist in assessing the comprehensiveness of risk identification, appropriateness of risk assessments, effectiveness of mitigation strategies, and quality of risk governance processes. From a supervisory perspective, material risks should be identified by the TU in its risk register. The supervisor should consider requiring appropriate adjustments to address deficiencies it identifies.

   (5) **TU's risk appetite:** The supervisor should review the TU's assessment how well it stays within its risk appetite, both in aggregate and for individual risks. The supervisor should consider requiring appropriate adjustments to address deficiencies it identifies. This includes the need for adjustment or additions to the set of risk appetites.

   (6) **TU's responsibility for making primary risk assessments:** The supervisor should not make the primary assessment for TU risk assessments or of risk appetite compliance for the TU, since the TU should 'own' and understand its risks and their management. The supervisor's

[27] A fundamental conceptual distinction must be understood between RBSup and risk-based solvency (RBS). RBS and RBSup represent distinct yet interconnected regulatory concepts that serve complementary functions within the overall supervisory framework. Both approaches share the common objective of enhancing supervisory effectiveness, but they address different aspects of supervision. See International Monetary Fund (2024). '*Implementing Risk-Based Solvency for Insurers—Lessons from Kenya, Mexico, and South Africa*'; and IAIS (2025). '*Guidance on Transitioning to a Risk-Based Solvency (RBS) Regime*.'

[28] If the insurer has prepared an ORSA or a Financial Condition Report, and the supervisor has access to them, then the supervisor might anticipate that some analysis has been done considering both risk registers and risk appetites and may start by reviewing this.

role is to assess and then require amendment (where necessary) of the quality of the TU's risk management.

(7) **TU Resilience:** The supervisor evaluating the TU's resilience. This is its capacity to absorb losses and remain viable should risks materialise and/or the TU becomes stressed. This includes the adequacy and quality of capital, liquidity, earnings sustainability, quality of non-financial risk management, and stress preparedness including business continuity and crisis management capabilities.

(8) **Overall supervisory TU risk rating:** The combination of the overall residual risk profile and the resilience assessment produce the overall risk rating, which is the primary input for determining the allocation of supervisory resources and the appropriate supervisory response.

(9) **Supervisory risk assessment matrix:** The supervisor should consider recording its risk assessment process in a risk assessment matrix.

- This process should be structured, consistent, transparent, and flexible. Assessments should be commensurate with the size, complexity, nature, and TU risk profile.
- A high-level structure for the supervisory risk assessment matrix for a TU may be as follows:
  - **Rows:** The risks identified for consideration (possibly clustered). These risks should be sourced from the TU's risk register, as amended by the supervisor.
  - **Columns:** Supervisory residual risk assessments, supervisory issues identified, and supervisory assessment made. If this is unsatisfactory, then the severity, priority for addressing it, management of TU implementation of adjustments, etc. are recorded.
  - **Shari'ah issues:** Columns might have some sub-columns. For example, supervisory issues identified might have separate sub-columns to identify Shari'ah issues. This would be consistent with enhancing a conventional approach to reflect Shari'ah issues.

Supervisory Strategy and Intervention

4. The overall risk rating determines the level and intensity of supervisory engagement. Intervention levels and actions are proportionate to the identified risk and typically follow an escalating scale. The process is not rigid as circumstances vary and supervisor judgement may be required.

(1) **Routine Supervision:** The insurer is well-managed with a low-risk profile. Supervision consists of routine off-site monitoring, standard reporting, and periodic meetings.

(2) **Early Warning/Enhanced Monitoring:** Deficiencies or areas of concern have been identified that could lead to problems if not resolved. Supervisory actions may include requiring remediation, more frequent reporting and meetings, and placing the insurer on a watchlist.

(3) **Escalated Action:** Problems pose a significant risk, though not an immediate threat, to the insurer's viability. Supervisors may impose restrictions on business lines, require capital injections, or mandate independent reviews. Supervisors will allocate more resources and supervisory attention.

(4) **Formal Remediation:** The insurer's situation has worsened, and there is an imminent threat to its viability. Actions may include imposing changes to senior management or the Board, requiring a recovery plan, or restricting new business.

(5) **Resolution/Liquidation:** The insurer is no longer viable, or insolvency is imminent. The supervisor's actions focus on an orderly exit from the market, such as license withdrawal and initiating liquidation to protect remaining policyholder interests.

DEFINITIONS

Management fee	The wakālah fee that the TO receives for managing the PRF and/or the PIF, whether deducted from contributions on receipt or charged to the fund.
Operator remuneration	The aggregate of the management fee or muḍārib fee and the TO's share of investment returns.
Participants	Policyholders in takāful, who are both individually the insured parties (contributing to the risk pool and being entitled to compensation from it) and collectively the insurer (as the risk bearer).
Participants' Investment Fund (PIF)	The fund, primarily used in family takāful, that holds the savings or investment portion of participants' contributions. It is managed by the TO, often on a profit-sharing basis, with returns shared between participants and the TO.
Participants' Risk Fund (PRF)	The fund that receives participants' contributions and is used to pay claims and related expenses. It is owned collectively by participants and managed by the TO.
Qarḍ	An interest-free loan provided by the SHF to the PRF, which is repayable from future surpluses of the fund. The circumstances in which qarḍ may be, or is required to be, provided, and its treatment in solvency calculations, vary across jurisdictions.
Shareholders' Fund (SHF)	The fund that holds shareholders' equity and covers operational expenses.
Surplus	The surplus in the PRF, which is the underwriting profit and belongs to the participants collectively.
Takāful	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.
Takāful Operator (TO)	The entity that manages the takāful funds.
Takāful Undertaking (TU)	The entire operation, comprising the TO and the funds it manages.

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