



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

**Concept Paper –
Guidelines on Takaful Operational Framework**

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PART I – OVERVIEW

1. Introduction

- 1.1 The takaful industry in Malaysia has witnessed significant transformation in the last two decades with the increase in number of players and the expansion of business scope and product range. The rapid expansion of the industry warrants for an operational framework to be clearly laid out to guide the takaful operators.
- 1.2 The takaful contract defines a unique relationship between the takaful operators and participants. It requires takaful operators to duly observe fundamental obligations towards participants, particularly in terms of adhering to Shariah principles, undertaking fiduciary duties and meeting prudential standards. These obligations are to be consistently met in an increasingly challenging environment where there are variation in business practices, differences in opinions surrounding the operations of takaful, competition and changing market and economic conditions. Business operations would have to be effectively managed to meet these challenges, to ensure that takaful operators are able to manage the various stakeholders' interest without compromising prudence. The discharge of fiduciary duties and responsibilities can be met by putting in place appropriate business conduct, effective and efficient systems, processes and controls, including good governance and oversight structures, complemented by competent and qualified persons.
- 1.3 Takaful operators are also expected to conduct operations in a prudent and ethical manner, guided by prevailing legislations, requirements and guidelines issued by Bank Negara Malaysia (Bank). To further promote the orderly growth of takaful business, the Guidelines on Takaful Operational Framework (the Guidelines) is issued, outlining parameters to govern operational processes of takaful operators and defining in detail where necessary, the various rules and requirements for takaful operators. It is envisaged that the Guidelines will promote the sustainability of takaful operations, business

expansion and innovations and concurrently fulfil the prudential requirement expected by the regulatory authority.

2. Objectives

The objectives of the Guidelines are as follows:

- a) To enhance the operational efficiency of the takaful business;
- b) To build healthy takaful funds which are sustainable;
- c) To safeguard the interests of participants; and
- d) To promote uniformity in takaful business practices.

3. Guiding Principles

The Guidelines is formulated based on the following principles:-

- a) **Principle 1:**
Ensure **uniformity with Shariah principles** and consistency with the essential features of takaful;
- b) **Principle 2:**
Promote **prudent management** of the takaful funds to enhance the funds financial resilience;
- c) **Principle 3:**
Promote **fairness and transparency** to protect the interests of participants;
- d) **Principle 4:**
Ensure **appropriateness of fees and charges** imposed on the participants and takaful funds; and
- e) **Principle 5:**
Instil **good governance and risk management** practices.

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4. Applicability

The Guidelines is applicable to all takaful operators¹ registered under the Takaful Act 1984 (the Act). The Guidelines shall be read in conjunction with other relevant provisions of the Act, guidelines and circulars issued by the Bank.

5. Scope

The Guidelines covers operational processes relating to takaful and shareholders' funds and includes, requirements relating to the setting up of funds, management of contributions received from participants, management of fees and operating costs of the takaful operators, management of assets, liabilities and surplus of the takaful funds and rectification of deficiency of the takaful funds. The Guidelines also includes broad requirements on disclosure and transparency.

6. Legal Provision

The Guidelines is issued pursuant to Section 69 of the Act which gives power to the Bank to issue guidelines, circulars or notes as deemed necessary.

7. Implementation Date

The Guidelines shall take effect on XX XXX 2010. With regards to the limits imposed in paragraphs 12.7 and 12.9, even though these shall be made mandatory on new certificates issued on or after XX XXX 2010, takaful operators are responsible to ensure that participants of earlier block of business are not disadvantaged by practices which do not comply to these limits. Takaful operators are required to undertake the necessary measures to enhance current operational systems, procedures and processes to be consistent with the Guidelines.

¹ Retakaful operators registered under the Act are also required to observe the requirements stipulated in the Guidelines, where relevant.

PART II – POLICY REQUIREMENTS

8. Establishment of Operational Model

- 8.1 Takaful operators shall establish an operational model that outlines the key policies, procedures, controls and the management's responsibilities in carrying out the takaful operations. The operational model shall be based on contracts preferred by the takaful operator and approved by the Shariah Committee. In setting out the policies and procedures, takaful operators must ensure that the principles outlined in the contracts are appropriately operationalised. The operational model of the takaful operator shall define its relationship and fiduciary duties with the participants.
- 8.2 Takaful operators shall submit for approval the operational model to the Bank at the point of licensing or prior to adopting a new operational model. Existing takaful operators are required to document their operational model as currently practised, and submit to the Bank not later than XX XXX 2010, for information and reference purposes. All submissions must be endorsed by Shariah Committee and Board of Directors. Any material changes made subsequently that affect the model shall be submitted to the Bank for approval.

9. Segregation of Funds

- 9.1 In line with the legislative provision of the Act, takaful operators are required to segregate the assets of the takaful funds from the assets of the takaful operators. Within the takaful funds, takaful operators are required to establish and maintain separate takaful funds in respect of family takaful business and general takaful business.
- 9.2 The takaful funds for the family takaful business shall be segregated into two, namely:
- a) the takaful Annuity fund; and
 - b) the takaful Non-annuity fund
- to facilitate better management of investments activities, risk management

and preserving fairness in the treatment of surplus and deficit from the funds.

9.3 Within the family takaful funds, takaful operators shall separately establish Participants' Risk Fund (PRF) and Participants' Investment Fund² (PIF), to cater for the risk and savings/investment³ components of participants' contributions, respectively. The separation of the risk and savings/investment components is necessary to recognise the different ownership, purpose and risks associated with the contributions. Description of the PRF and PIF are as follows:

- a) The PRF shall be used to pool the tabarru' portion of the contributions, and serves to provide mutual financial aid and assistance to participants when claims are made for risks covered under the takaful contracts. For annuity products, the PRF shall be used to pool the tabarru' contributions meant to provide payments during the annuity period. Under the tabarru' contract, the fund is owned by the pool of participants. In managing the PRF, the takaful operators shall adopt appropriate set of policies and procedures to ensure the availability of funds to meet takaful benefits when due.
- b) The PIF shall be used to pool the savings and/or the investment portion of the contributions. Consistent with the requirements of Shariah, the PIF is individually owned by participant. In managing the PIF, the takaful operators shall adopt appropriate investment and management strategies to achieve returns that are in line with the participants' reasonable expectations and where relevant, to ensure the availability of funds for future tabarru' apportionment into the PRF. For investment-linked takaful, the PIF shall be in unitised form (where the amounts invested are converted into units).

² Applicable only to products with savings element.

³ Products with savings element refers to those family takaful products which provide benefits on survival to maturity or during the certificate term (this excludes payments of surrender benefits), and shall include investment-linked and annuity certificates.

- 9.4 For general takaful business, takaful operators shall establish a PRF to pool the tabarru' portion of the contributions for the general takaful products. The PRF shall be utilised to provide mutual financial aid and assistance to participants when claims are made for risks covered under the general takaful contract.
- 9.5 Where a takaful operator manages part or parts of PRF and PIF under smaller sub-funds, the takaful operator shall consistently segregate the management of these sub-funds throughout the term of the takaful contract. This includes consistency in regards to determination of surplus and deficit in the manner in which the funds are to be managed. Takaful operator is required to inform the Bank if part or parts of the sub-funds above are managed differently, as part of the operational model submission. The Bank, depending on the circumstances, may view or require these sub-funds to be combined or continued on a stand-alone basis, taking into account the impact on the participants and the takaful funds' viability.
- 9.6 The Bank, based on its assessment of takaful product design or features, may require takaful operators to establish other funds to clearly reflect the specific nature, purpose or risk of a component of the contribution or other elements of the takaful products. This is intended to protect the interest of the participants, the soundness of the takaful funds or where it is appropriate, to reflect the Shariah requirement.
- 9.7 Takaful operators shall maintain records of and properly allocate the assets, liabilities, revenues and expenses to the relevant funds. The method of allocation and the proportion of contribution allocated to the takaful funds must be made transparent in the takaful contracts. It is essential that the wordings in the takaful contracts are consistent with the operation and management of the takaful products and funds. In the case of family takaful as well as medical and health products, the method and proportion of allocation must also be consistent with the actuarial certificate filed with the Bank.

10. Management of Takaful Funds Operations

- 10.1 Takaful operators must ensure that efficient processes are established to manage the takaful funds including putting in place effective risk controls and monitoring systems with a view to safeguard the takaful funds and protect the interests of the stakeholders. An effective risk management system should be established to enable identification, assessment and analysis of frequency and severity of the risks involved. To manage risks effectively, risk-mitigation strategy shall be formulated to take into consideration among others, the takaful operator's capital position, solvency of the takaful funds, liquidity requirements and volatilities of asset classes. At all times, takaful operators are responsible for the interest and well-being of takaful funds.
- 10.2 Takaful operators shall have sufficient resources to operate the takaful business, and ensure that parties connected to the business operations are competent and well trained to perform their functions. Takaful operators are also responsible for the conduct of their agents including outsourcing parties.
- 10.3 The Board of Directors is ultimately accountable to ensure the overall effectiveness of takaful operations' management. Senior management shall be responsible to implement the overall operational processes, including ensuring the development and recommendation of comprehensive policies, procedures and internal controls. The Board of Directors shall put in place an effective oversight framework that continuously assesses the effectiveness of policies and procedures of the management of takaful funds. The Board of Directors shall ensure strong corporate governance processes are in place to enable effective discharge of takaful operators' fiduciary duties towards participants.

Takaful Product Design and Pricing

- 10.4 Takaful operators shall exercise diligence in product design and ensure that the products offered include adequate takaful coverage, and are suitable and

appropriate to the targeted market segment. In determining the price of the products, prudence must be maintained to avoid under pricing and balanced with due care to avoid participants from being charged excessively. Key factors such as the expected frequency and severity of risk exposures and expected management costs and expenses must be considered in pricing of takaful products. Pricing could be based on the takaful operators' or industries' past experience and future expectations. Given the nature of the business which may involve payments of contributions or liabilities long into the future, products should be priced to include appropriate buffers or designed with flexible features which could absorb future fluctuations and uncertainties.

- 10.5 Consistent with the basic concept of takaful which involves pooling of contribution by participants for the purpose of deriving mutual risks coverage on the occurrence of a pre-agreed event, sufficient amount of contributions must be allocated to the takaful funds. Takaful operators shall ensure adequate tabarru' allocation into the PRF to cover risks and obligations associated with the takaful contract. Takaful operators shall also ensure that the contribution charged is sufficient to cover the tabarru' throughout the term of the product.

Underwriting of Takaful Risks

- 10.6 Takaful operators shall manage the underwriting process effectively to avoid anti-selection⁴ and ensure viability of takaful funds in the long run. Management of the underwriting shall be in line with assumptions used in pricing of products. Participants as owners of takaful funds should expect takaful operators to establish a robust process to select risks into the takaful funds. In this respect, clear underwriting policy which is properly documented and periodically reviewed to suit changing market conditions shall be established. Officers responsible for underwriting function should fully

⁴ Refers to tendency of individuals to enter into takaful cover where risks of these individuals to experience a loss is more likely than an average individual.

understand various policies relating to such matters as parameters for risk evaluation, categories of risks, limitations on the type of risks to be accepted and where relevant, the circumstances under which further investigation and/or documentation is required prior to acceptance of risks (for example medical underwriting). Takaful operators are responsible to objectively evaluate and assess the underwriting risks and exposures of potential participants, to ensure that risks accepted are consistent with assumptions used in pricing the contributions. Where relevant, rating differentials including contribution loadings, benefit exclusion or limitation on coverage should be imposed when accepting participants with higher risk profile.

Retakaful

- 10.7 As part of good risk management, takaful operators must have in place effective retakaful management strategy which is appropriate to the overall risk profile of the takaful business. Takaful operators are also expected to monitor, review and update the retakaful management strategy on a regular interval in response to changes in the takaful funds' risk profiles.
- 10.8 Takaful operators are expected to secure retakaful arrangements which commensurate with the size, business mix and complexity of the takaful business. The retakaful arrangement must be consistent with the interests of the takaful funds, and achieve the objectives of risk mitigation that protect the solvency of takaful funds and ensure the funds' ability to pay liabilities when due. Strength of the retakaful operators must be the main consideration, as effective risk mitigation can only be achieved if the retakaful operator is financially sound. The amount of business to be ceded as retakaful must be in line with the level of risk tolerance of the takaful funds and/or the takaful operators, taking into consideration availability of capital or surplus to cushion future experience.
- 10.9 Takaful operators must ensure that the retakaful arrangements are well-diversified to avoid over-concentration of risks. In addition, any commissions

receivable or profit sharing arising from the retakaful arrangement shall be fairly redistributed to the relevant funds taking into consideration the source of the retakaful contributions and the performance of the funds leading to the commissions or profits.

Investment of Takaful Funds

- 10.10 Sound investment management in takaful operations is important to achieve not only appropriate returns to meet different objectives of the takaful funds but also to ensure that the funds can meet the obligations when takaful benefits fall due, including on surrender and maturity of takaful certificates. It is the takaful operators' fiduciary duty to manage the investments in a sound and prudent manner, in line with Shariah requirements and participants' expectations.
- 10.11 Takaful operators shall have in place appropriate investment strategy that considers the nature, term, currency, amount and timing of the takaful liabilities (including the need to ensure the PIF can meet future tabarru' drips into the PRF) and commensurate with the funds' tolerance of risks. The investment strategy must be reasonably formulated to avoid adverse impact on the takaful funds. Takaful operators, in executing investment operations shall comply with the prevailing policies and requirements imposed by the Board or the Bank.
- 10.12 Takaful operators shall have in place effective and reliable infrastructure to support investment management and where relevant, able to tag specific investment to the relevant funds. This is especially important in the management of the PIF (due to the individual participant's ownership of the PIF) as the value of each PIF should reflect the value of a defined and specific set of assets invested in by the PIF. In addition, the infrastructure must facilitate accurate determination of investment profit to avoid errors, in particular the distribution of profit between the participants and between the participants and takaful operators. The policy and manner in which the profit is

calculated shall be documented and should be consistent across time horizon. Any changes made shall be justified and adequately documented.

Valuation of Liabilities

10.13 In executing with the fiduciary responsibilities in managing the takaful funds, takaful operators are expected to set appropriate and adequate provisions for the takaful funds liabilities to meet future obligations. In this respect, takaful operators shall appoint a person with the appropriate qualifications and technical skills to be responsible for liabilities valuation. The appointment shall comply with requirements specified by the Bank. For family takaful business, the valuation shall be the responsibility of an Appointed Actuary as defined in the "Guidelines on the Role of the Appointed Actuary". For general takaful business, the valuation shall be the responsibility of a Signing Actuary as defined in Appendix of this Guidelines.

10.14 The Appointed Actuary and Signing Actuary (hereafter referred to as 'Actuary') shall be responsible to apply appropriate and prudent valuation basis and methodologies taking into consideration the nature of the products, the term of the takaful contracts and the amount of takaful benefits. The valuation basis and methodologies shall be in line with actuarial principles and the requirements specified by the Bank. In valuing the liabilities, the Actuary is also expected to consider the expectations of the participants on the takaful benefits, based on the marketing materials and documentations used earlier by the takaful operators. Where judgement call is required, the Actuary should take a conservative view, if in his professional judgment, it is appropriate to do so. For example, where the Actuary expects future experience to be highly volatile or where there is inadequate data or empirical evidence to support a less stringent valuation basis or method. The Actuary shall apply the valuation basis and methodologies consistently in subsequent valuations and where changes are made in future valuations, there must be sufficient disclosure on the reasons for and the impact of the changes. The Actuary's valuation work

and the results shall be documented appropriately and submitted to the Bank in line with prevailing requirements.

Claims Management

10.15 Takaful operators must have in place appropriate systems and controls in claims-handling process. It is the takaful operators' fiduciary duty to assess the validity of claims and settlement amount, and establish appropriate measures to prevent fraudulent claims or payment of invalid claims that can adversely impact the takaful funds. Takaful operators must ensure that claims processing and payments are done promptly without unnecessary delays and that participants are treated fairly during the process. The amounts payable upon a claim and the source of the payments must be from the correct funds, in line with the takaful contracts.

Management of Underwriting Surplus

10.16 Good and effective management of takaful funds' operations would ensure that the funds' experience is within that assumed in the pricing of the takaful products. Where the experience is better than that expected, there should be an underwriting surplus in the PRF during the term of the takaful contracts. The level and pattern of surplus is a good indicator of the performance of the PRF and in turn, is a good reflection of the takaful operators' performance, for example in underwriting and claims management. Surplus retained within the PRF would need to be managed appropriately as it acts as cushion for future volatilities in experience and would give flexibility to the takaful operators in the management of the takaful funds.

10.17 Takaful operators are required to establish a written policy on the management of PRF surplus and approved by the Shariah Committee and the Board of Directors. Written policy established shall comply with Shariah principles underlying the operational model adopted, and shall include, among others, the policy on utilisation of surplus and level of surplus to be retained

for contingency. Where surplus is distributed, it shall be done in accordance with the surplus management policy.

10.18 In the surplus distribution process, takaful operators are required to observe the following requirements:

- a) The surplus to be distributed shall be recommended by the Actuary and endorsed by the Board of Directors;
- b) The surplus distribution shall be in line with the underlying contract of the product;
- c) The surplus shall be determined after meeting claims and other outgoes of the fund, setting up of provisions for liabilities and where relevant, after meeting solvency requirement;
- d) The surplus shall be determined based on full valuation of liabilities as certified by the Actuary and full audited results;
- e) The PRF shall not be in a deficit after surplus is distributed out;
- f) The surplus distribution shall not cause adverse financial implications on the PRF;
- g) The surplus distribution shall be based on generally accepted actuarial principles;
- h) The surplus shall be distributed in a manner which ensure fair treatment; and
- i) Other requirements as specified under paragraphs 12.7 – 12.8.

10.19 The Actuary shall assess the strength of the takaful funds to ascertain the extent to which it would be appropriate for surplus distribution and such distribution will not affect the solvency of the fund. The Actuary shall not recommend surplus distribution if in his professional judgment, the surplus should remain in the PRF as a buffer to maintain the ability of the takaful funds to meet future liabilities or to meet participants' reasonable expectations not specifically provided for in the actuarial valuation.

11. Management of Operating Costs

- 11.1 To instil financial discipline and improve operational cost efficiency, takaful operators are required to establish effective policies and procedures to manage operating costs. The Board of Directors are expected to play an active oversight role to achieve this objective. Controls must be put in place to ensure that actual expenses incurred do not lead to cost overruns which can affect the viability of the takaful operators and would have a negative impact on their ability to manage the takaful funds effectively. An effective operating cost management is expected to result in fairer contributions being charged and higher returns to the shareholders.
- 11.2 The operating costs of the takaful operations which include commissions and related expenses payable to the distribution channels, management expenses and other operational expenses, are met through the remunerations⁵ received from participants or the takaful funds. In this regard, the takaful operators shall ensure that commissions and related expenses paid to the distribution channels and management expenses of the takaful operations are in compliance with requirements and limits set by the Bank.
- 11.3 Takaful operators shall ensure that management expenses are paid from the shareholders' fund. Takaful operators shall not pay expenses out of the takaful funds, except if these are direct claims related expenses⁶ or direct investment related expenses⁷. These expenses must be approved by the Shariah Committee and qualify only if these are not already factored into the determination of the upfront fees or other sources of remuneration to the takaful operators. The amount shall be limited to the actual amount of expenses incurred. Takaful operators must ensure that the expenses charged to the takaful funds are documented as part of the operational model and shall be clearly disclosed to participants in marketing materials. Where the

⁵ Refer to section on Management of Income from Takaful Business.

⁶ Relate to fees for the services of professionals and other costs of similar nature directly associated with settling claims such as adjustor's and legal fees.

⁷ Transaction costs directly attributable to the acquisition, issuance or disposal of a financial asset of the takaful fund.

expenses charged to the takaful funds are deemed inappropriate, the Bank may disallow or require the expenses to be repaid and apply retrospective adjustments to the takaful funds.

12. Management of Income from Takaful Business

- 12.1 In consideration of the services rendered and costs incurred in administering the takaful operations, takaful operators are entitled to be remunerated through fees and charges imposed on participants and takaful funds or through share in profit/surplus of the takaful funds. The remunerations shall be consistent and in accordance with the operational model being adopted. Takaful operators shall ensure at all times the appropriateness of the fees and charges being imposed on the takaful funds. In order to ascertain the profitability of a product, takaful operators shall consider remunerations received from all sources of the takaful business. These remunerations shall also be used in determining adequacy of takaful operators' expected income against the expected operating cost throughout term of the contract.
- 12.2 Takaful operators shall ensure that the fees and charges received are managed prudently to cover operating costs. In particular, appropriate amounts should be available to meet the operating costs until the end of the takaful contracts and, the recognition of income and profits must be aligned to related expenses and liabilities.

Upfront Fees

- 12.3 For products based on the wakalah contract, a fixed upfront fee can be charged on the contributions based on contractual terms entered with the participants. The wakalah fee is to cover commissions and management expenses incurred in the management of takaful funds.
- 12.4 When ascertaining the upfront fee, takaful operators are required to appropriately determine the level of management expenses expected to be

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incurred in servicing the certificate throughout the takaful contract term. This can be based on internal or industry's past experience, taking into consideration expected future experience with reasonable prudence. The actual commissions payable to the relevant distribution channels in the acquisition of the takaful business can also be included. The upfront fees shall include only the expenses which are expected to be incurred by or paid from the shareholders' fund.

- 12.5 Takaful operators shall also comply with requirements on rebates to consumers on the commissions loaded in the contributions. In general, where participants arrange for the takaful coverage directly with the takaful operators or through direct distribution channels such as the internet, rebates should be made to these participants as there is no acquisition costs incurred. For wakalah contract, the amount of rebate shall be deductible from the upfront fees charged to the participants. This shall be reflected as a reduction in the upfront fee (i.e. as a reduction in the contribution) or as higher allocation of contribution into the relevant takaful funds.
- 12.6 For family takaful and medical and health products, the basis in deriving the wakalah fees must be clearly justified and documented in the Actuarial Certificate of the products submitted to the Bank. For other takaful products, the justification and documentation shall be maintained by the takaful operators and shall be made available upon request by the Bank. Any changes to the upfront fee shall be justified and documented and where relevant, submitted to the Bank.

Remuneration from PRF

- 12.7 For managing the PRF, takaful operators are entitled for remuneration through performance fees⁸ paid from PRF surplus. The performance fees

⁸ The Shariah Advisory Council of Bank Negara Malaysia resolved that distribution of surplus from PRF to the participants and takaful operator is permissible based on the premise that takaful contract is generally established on the principles of tabarru' and ta'awun (mutual cooperation), apart from the agreement among the

shall be paid from surplus determined through full valuation of liabilities and full audited results (refer to paragraphs 10.16 – 10.19). The performance fee can only be paid to the shareholders if the participants' portion of the surplus is also paid or accrued⁹ to the participants. The amount payable to the takaful operators shall not exceed the amount paid to participants. The payment of performance fees out of surplus shall be in line with takaful operators' written policy on management of surplus, as outlined under paragraphs 10.17 and 10.18. This paragraph is similarly applicable to takaful operators remunerated solely from the investment profit portion of the surplus.

- 12.8 Takaful operators that do not charge an upfront fee may apply to the Bank for an exemption from the requirements in paragraph 12.7 by providing sufficient justification and details of an alternative proposal. The application must be made as part of the submission of the operational model (or its changes). The application must be accompanied by the Shariah Committee's endorsement.

Remuneration from PIF

- 12.9 Takaful operators are also allowed to be remunerated an amount not exceeding 20% from the investment profit of the PIF for the relevant non-investment-linked family takaful products. The remuneration shall only be distributed upon completion of full valuation of liabilities, as certified by the Appointed Actuary and full audited results. The Appointed Actuary shall be responsible to recommend the amount of investment profit to be transferred to the shareholders fund within the limit stipulated in this paragraph or in the takaful contract, whichever is lower. Where the PIF is used to meet future tabarru', the Appointed Actuary shall ensure that the remuneration to shareholders is reasonable and will not affect the future ability of the PIF to meet the tabarru'. The Appointed Actuary shall also consider participants' reasonable expectation when recommending the remuneration. The

contracting parties. The resolution is also based on the permissibility of performance fee for the takaful company. (Press statement dated 25 September 2007).

⁹ Accrued surplus refers to surplus that is allocated to participants but not yet transferred out of the PRF. The accrued surplus becomes a liability of the PRF and will be paid to participants at a pre-determined time as per the takaful contract.

Appointed Actuary is expected to balance the interests of the participants considering that PIF investments management is at the full discretion of the takaful operators. For investment-linked takaful products, the remuneration shall be in the form of fund management fee based on the net asset value of the PIF subject to the prevailing limits specified by the Bank (refer to "Guidelines on Investment-linked Insurance/ Takaful Business").

- 12.10 Takaful operators that do not charge an upfront fee may apply to the Bank for an exemption from the requirements in paragraph 12.9 by providing sufficient justification and details of an alternative proposal. The application shall be made as part of the submission of the operational model (or its changes). The application must be accompanied by the Shariah Committee's endorsement.

13. Payment and Charges on Surrender

- 13.1 Participants have the contractual right to surrender takaful certificates at any time. Incompatibility of products marketed compared to participants' needs, resources and financial capabilities may be a reason for early surrender. As such, takaful operators should not recommend a product unless the product features and its associated risks are appropriate for a particular customer on the basis of information sought and obtained from the customer. Surrenders, if not managed appropriately, may have adverse impact on the takaful funds and the remaining participants by creating a constraint on the size of the takaful funds, thus limiting the ability to benefit from cross subsidisation (to the level permissible by Shariah) or earn the investment returns anticipated during the product design stage.
- 13.2 The surrender value basis shall be appropriate and fair, and embedded in the product design. For example, if a single tabarru' is taken upfront to provide for a long term cover, takaful operators are encouraged to return the unexpired tabarru' upon early surrender. To facilitate this, the purpose of tabarru' (due to its nature as "donation") should be defined appropriately in the certificate contract to include payments of amounts on surrender. Takaful operators are

required to return the balance of PIF and accrued surplus in PRF, consistent with the ownership rights and entitlement of the participants, upon surrender of a certificate.

- 13.3 Takaful operators shall ensure that the amounts payable to participants on surrender are made from the correct funds. For example, under the wakalah model, if the surrender amount is determined based on gross contribution, the amount must be paid from both the takaful and the shareholder's funds. Paying the total amount only from the PRF will impair the value of the PRF unfairly, since wakalah fee was deducted upfront to the shareholder's fund based on the gross contribution.
- 13.4 Takaful operators are allowed to impose a reasonable amount of surrender charge to recoup a reasonable amount of expenses incurred in managing the certificates, which have not been charged up to the point of surrender. The surrender charge may also include administrative expenses incurred in processing the surrender. Any amount imposed over and above actual expenses incurred by the takaful operators must be reallocated to the PRF. In addition, the surrender charge may only be imposed if it is clearly specified in the takaful contract and marketing literatures.
- 13.5 In general, the surrender value, including the cost of any applicable surrender charge, shall be determined:
- a) where relevant, in accordance with generally accepted actuarial principles;
 - b) in a manner ensuring fair treatment of participants; and
 - c) in compliance with standards on market conduct or fair treatment of participants issued by the Bank.
- 13.6 For family takaful and medical and health products, the basis in deriving the surrender amount and surrender charge must be clearly justified and documented in the Actuarial Certificate of the products submitted to the Bank. For other takaful products, the justification and documentation shall be

maintained by the takaful operators and shall be made available upon request by the Bank. The Bank reserves the right to require adjustments to the surrender amount and the surrender charge, including requiring retrospective adjustments, if there is evidence that participants have been treated unfairly.

14. Deficiency and Loss Rectification

14.1 Takaful operators are expected to exercise due care to avoid circumstances that could affect the viability of the takaful business, put the interests of the participants at stake or cause the takaful funds at risk of incurring a deficit or loss. Good risk management including effective management of surplus, appropriate reinsurance arrangement and business practices are key in avoiding these negative circumstances.

Deficiency and Loss in PRF

14.2 Where assets of the PRF are insufficient to meet the liabilities of the PRF, takaful operators shall immediately rectify the deficit. Whilst in general the deficit is measured at the individual PRF level, the manner in which the takaful funds are managed may necessitate the deficit to be looked at from a sub-fund perspective. This is to ensure and preserve equity amongst participants. Where the deficit is rectified via qard, the qard shall be repaid from future surplus of the PRF, after the provisions for liabilities and solvency as required by regulatory requirement.

14.3 Takaful operators must have in place, clear written policy on the mechanism to rectify deficit and/or loss of the PRF approved by the Board of Directors. This shall include the repayment of qard that is appropriate to avoid circumstances that might impact participants beyond reasonable expectations and to prevent adverse implications on the long term viability of the takaful funds. The policy must also address the issue of surplus distribution during the repayment of qard, for example, whether the distribution of surplus is reduced or put on hold or resumed once the qard has been fully repaid. If

takaful operators are remunerated from PRF before the full repayment of qard, it must ensure that it is not benefiting from the '*manfaah*¹⁰' of qard. The manner in which the takaful funds are managed must also be considered in coming up with the policy to ensure fairness to different groups of participants. In general, the qard is to be repaid by the group of participants to whom the qard was originally provided. Takaful operators may also specify circumstances when the qard may not be repayable, for example if the deficit persists over a long period of time.

- 14.4 Where a deficit or loss arises in the PRF, takaful operators are required to explain and provide sufficient information to the Bank as to the reasons for the deficit or loss, remedial measures taken, the short and long term implications of the deficit or loss and the expected duration before the situation is rectified. Where the deficit or loss are caused by mismanagement or negligence, the takaful operators shall bear full responsibility and automatically rectify the deficit or loss via an outright transfer. In cases where the Bank, based on its own assessment is satisfied that the deficit or loss in the PRF is due to mismanagement or negligence, the Bank may direct the takaful operators to rectify the deficit or loss via an outright transfer of assets from the shareholders' fund (instead of qard). In circumstances where qard has been given but the PRF or parts of it is continuously in deficit, the Bank may direct the takaful operator to convert the qard into an outright transfer.

Deficiency and Loss in PIF

- 14.5 It is the responsibility of takaful operators to manage the PIF investments with due care and investment strategy employed is sound and prudent that ensure the sustainability of takaful contract to the end of its contractual term. Normal investment deficiencies and losses in the PIF shall be absorbed by the participants, particularly where the contract underlying the PIF is a mudharabah contract. Usage of qard to top-up investment deficiencies will effectively lead the mudharib guaranteeing the mudharabah capital which may

¹⁰ '*Manfaah*' may arise where return arising from qard amount is distributed as surplus.

contradict Shariah principles underlying a mudharabah contract. As such, qard shall not be used to top-up investment deficiency in the PIF or to ensure PIF meet specified returns.

- 14.6 Negligence or mismanagement of the takaful operators leading to the deficiency or loss in PIF shall be made good via an outright transfer from the shareholders' fund. Examples of negligence and mismanagement include poor disclosure of the risks to be borne by the participants, improper or non-compliance of investment strategy execution against approved policies, misalignment of investment policies with representations made to participants, improper illustration of benefits or expected returns including the use of unsupportable illustration rates, and failure to put in place adequate infrastructure leading to ineffective credit control function.

15. Disclosure and Transparency

- 15.1 Takaful operators shall be transparent in undertaking activities as part of good governance and to promote better understanding of takaful. Takaful operators are expected to publish details of its operational model to enable stakeholders and the public at large to understand its operations, ascertain the relationship between the takaful operators and the participants, including the parties' rights and obligations. In addition, takaful operators shall establish appropriate procedures in marketing process, placing strong emphasis on good marketing ethics, conduct and disclosure. Participants and other stakeholders should be provided with accurate, adequate and up-to-date information (in particular with regards to the marketing materials and takaful contracts), to reflect the true nature of products and services being offered. Disclosure of information should also include the takaful operators' performance that enables stakeholders to make an assessment on the takaful operators' financial standing. Such disclosure could be made via publications of annual reports and financial statements.

- 15.2 Takaful operators shall clearly disclose the Shariah principle underlying the takaful product. It is the responsibility of takaful operators that the execution and implementation of the underlying contracts are consistent with the Shariah principle being used. In addition, takaful operators shall provide broad disclosure of the operational model and relevant terms and conditions of the takaful contracts that would enable participants to clearly understand the rights, obligations and the risks associated with the product. All charges and fees shall be disclosed with respect to the aggregate amount and percentage of contributions payable in marketing materials. To further promote transparency, takaful operators should publish on website, details of products, fees and charges. All expenses chargeable to the takaful funds shall also be clearly disclosed. Takaful operators are expected to comply fully with the prevailing commission disclosure requirements. Takaful operators shall also disclose information on the method of distribution for investment profits and underwriting surplus, in particular, the sharing ratio. The disclosures must be made apparent to the participants and should be disclosed in documents used at the pre contractual stage, upon signing the contract and throughout the duration of the contract.
- 15.3 Takaful operators must ensure consistency in information being disclosed in the different documents. The information given to participants shall be consistent with the information provided to the Bank via the product submission process.
- 15.4 For products with savings or investment elements, where participants bear the investment risks, information disclosed should be sufficient to enable understanding of market movements and its implications on the takaful funds, including the potential risk of lapsation of the takaful certificate. For the PIF, information disclosed in marketing materials and takaful contracts should also include investment strategy, type of assets invested to meet the illustrated benefits, future tabarru' payments and other liabilities of the takaful funds. At the marketing stage, potential participants must be provided with clear and sufficient explanation by marketing personnel or agents. On an on-going

basis, where appropriate, takaful operators shall also provide an up-to-date and timely information to the participants. For example, where the market has moved against the takaful funds or where the value of the PIF has deteriorated. Under such situation, annual statements sent to participants should include sufficient warning of potential shortfall of the PIF, the consequences of the PIF shortfall and remedial options available to participants, if any (for example, top-up contribution from participants for investment-linked takaful products).

- 15.5 Where takaful operator makes modifications or changes to its operational model or to the terms and conditions of the products, participants should be sufficiently informed of the changes and the impact of the changes. If the impact of the changes is material and significant financially, such disclosure should be sufficiently detailed to be reasonably understood by the participants. In any event, any modification or changes to the terms and conditions of takaful products shall be within the scope of the takaful contract.

Appendix – Signing Actuary for General Takaful Business

1. Takaful operators shall seek the Bank's approval to appoint a Signing Actuary. Application should be made in writing, at least one month before the end of each financial year.
2. Takaful operators that conduct both family and general takaful business are required to make separate applications to appoint its Appointed Actuary and Signing Actuary, even if the two positions are to be held by the same person.

Criteria for Signing Actuary

3. A takaful operator shall ensure that its applicant fulfils the following criteria:
 - a) holds a Fellowship in either the Institute or Faculty of Actuaries in the United Kingdom, Casualty Actuarial Society in the United States of America, or the Institute of Actuaries in Australia;
 - b) is resident in Malaysia; and
 - c) is fit and proper to carry out the function and has relevant and appropriate general insurance experience.
4. Notwithstanding paragraph 3, takaful operator may apply for exemption in the appointment of the Signing Actuary. The Bank, however, reserve the right to make a decision on the application based on its sole discretion.
5. A Signing Actuary shall cease to be the Signing Actuary of a takaful operator if he resigns or has his appointment terminated by the takaful operator or by the Bank. Where a person ceases to be the Signing Actuary of a takaful operator, the takaful operator shall notify the Bank in writing with reasons for it within 14 days from the date of cessation. Takaful operator shall appoint another person as its Signing Actuary within specified time as the Bank may approve.

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6. A Signing Actuary shall ensure that the responsibilities and duties outlined in the Guidelines and other prevailing guidelines are effectively carried out according to the standards as specified by the Bank. To ensure effective discharge of duties by the Signing Actuary, takaful operators shall furnish information which the Signing Actuary may require and shall ensure that the information furnished is not false, incomplete or misleading in any material.