



## **GUIDELINES ON TAKAFUL AND RETAKAFUL BUSINESSES IN LABUAN INTERNATIONAL BUSINESS AND FINANCIAL CENTRE (IBFC)**

### **1.0 Introduction**

- 1.1 The purpose of the Guidelines is to regulate the proper conduct of Takaful and Retakaful businesses to ensure prudence, professionalism and Shariah compliance with the aim to create a sound and robust Takaful and Retakaful industry in Labuan IBFC.
- 1.2. These Guidelines serve to complement the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA) and the Directive on Islamic Financial Business in Labuan IBFC (Directive) issued by Labuan FSA on 1 October 2003. These Guidelines are issued pursuant to section 4B of the Labuan Financial Services Authority Act 1996 and sets out additional requirements to be observed by all Labuan companies that carry on Labuan takaful business and Labuan takaful related activities licensed under the LIFSSA that are offering Takaful and Retakaful products and services in Labuan IBFC.
- 1.3 For Labuan takaful business and Labuan takaful related activities that were licensed under the repealed Offshore Insurance Act 1990, they are deemed to be licensed under LIFSSA and would not be required to apply for a new license.

### **2.0 Scope of Coverage**

- 2.1 These Guidelines are applicable to all Labuan companies that carry on Labuan takaful business and Labuan takaful related activities that are licensed under the LIFSSA offering Takaful and Retakaful products and services. These institutions, for the purpose of these Guidelines, shall be termed as Islamic Insurance Firms and Entities (IFI).
- 2.2 Other guidelines and circulars with respect to the Labuan insurance business and insurance-related activities which are relevant to Labuan takaful business and Labuan takaful related activities in Labuan IBFC are also to be fully observed by the IFI.

### **3.0 Definition**

- 3.1 "Takaful Business" means business of takaful whose aims and operations do not involve any element which is not approved by Shariah. For the purposes of these Guidelines, takaful business shall be divided into two classes namely, Family Solidarity Business which, in addition to all takaful business concerned with solidarity certificates shall include, in the case of any takaful operator, any type of takaful business carried on as incidental only to the operator's other solidarity business; and General Business that is to say, all takaful business which is not family solidarity business. Takaful business includes undertaking takaful activities through an agent or as an agent.
- 3.2 "Takaful Operator" means a company or a society which carries on takaful business; and "takaful broker's means any individual, firm or company who for compensation as an independent contractor, in any manner solicits, negotiates or procures takaful contracts or the renewal or continuance thereof on behalf of the participant other than himself.
- 3.3 "Retakaful" means an arrangement consistent with sound takaful principles for retakaful liabilities in respect of risks incurred or to be incurred by the takaful operator in the course of his carrying on takaful business. For the purpose of these Guidelines, the retakaful liabilities under takaful certificates shall be treated as takaful business of the class and type to which the certificates would have belonged if they have been issued by the retakaful operator.
- 3.4 Where there is any conflict or inconsistency between the provisions in this Guidelines and the LIFSSA, the provisions under the LIFSSA shall prevail.

### **4.0 Takaful Operation Model**

- 4.1 The principle operational models commonly used for operating a takaful and retakaful funds are based on the following Shariah concepts:
- i. the Wakalah (agency model); and
  - ii. the Mudharabah (profit-sharing model).
- 4.2 Under the concept of Wakalah takaful participants pay contributions to the IFI from which the IFI builds a Takaful Fund or usually called Participants' Investment Account (PIA). The PIA does not belong to the IFI but rather belongs to all participants collectively. The IFI's role is purely as an agent or wakeel to manage the funds to be invested into Shariah compliant asset classes including but not limited to managing the contribution for further risk sharing scheme (into a

retakaful fund) as well as for the provision of adequate reserves. The IFI does not share the risks of the PIA nor the surplus/(deficit) of the PIA. IFI as an operator receives a pre-determined fee for the services rendered in managing the PIA on the participants' behalf. In addition, the IFI is entitled to a performance fee or a fund management fee that is charged against any surplus, as an incentive to effectively manage the PIA. Thus, the IFI under the Wakalah model generates income by ensuring expenses of managing the operations are less than the fee received for the services rendered.

- 4.3 Under the Mudharabah model, the participants are considered as the capital providers whereby the IFI manages the contributions from the participants under the PIA. The surplus from the PIA is shared between the participants and IFI as the operator. The profit sharing ratio may be in a ratio as mutually agreed between the contracting parties. Generally, the concept of pure Mudharabah allows the participants and the IFI to share the direct investment income from the PIA and the participants are entitled to the entire surplus with no deduction made prior to the distribution.
- 4.4 Some IFI under the Mudharabah model share the underwriting surplus, while others do not, depending on the models adopted by the contracting parties.
- 4.5 Notwithstanding the above, IFI may adopt the above models or other Shariah compliant models as approved by its Internal Shariah Advisory Board (ISAB). In this regard, IFI is to submit to Labuan FSA copy of the paper submitted to its ISAB and extract of the minutes of its meeting or letter of endorsement to certify that the product or model used is Shariah compliant for notification purposes.
- 4.6 The IFI must provide the participants and stakeholders with clear information about the business operations to enable the relevant parties make informed choices and decisions. The information must comply with the relevant accounting standards and best practices depending on the nature of transactions to ensure prudent practices and robust corporate governance is observed at all times.

## **5.0 Investment Guidelines**

- 5.1. Investment of funds under the PIA must be done based on the Shariah concept of the Mudharabah or Wakalah or other Shariah compliant models as approved by its ISAB at the option of the IFI as long as this is clearly spelt out in the participants' membership documents. The funds must be invested in Shariah compliant instruments available in the market as advised by the respective ISAB. The ISAB would have both supervisory and consultative functions to ensure compliance with the operational guidelines and Shariah principles.

## **6.0 Risk Management**

- 6.1 The IFI should adopt best practices and standards on underwriting techniques to assess and manage the risks to protect the PIA from undue risks. The amount of contribution may be based on the quantum of risk/sum assured and duration of participation as defined under the scheme.

## **7.0 Establishment of Takaful and Retakaful Divisions under Conventional Entities**

- 7.1 No separate license is required for the establishment of Takaful and Retakaful divisions by existing Labuan companies undertaking insurance and insurance-related activities that are already licensed under the Labuan Financial Services and Securities Act 2010 (LFSSA). These companies are allowed to use their existing licenses under the LFSSA to establish the Takaful or Retakaful operations. However, submission for Labuan FSA's approval must be made prior to the establishment of such divisions.
- 7.2 No additional annual fee is imposed in regards to the opening of Takaful and Retakaful divisions.
- 7.3 The Takaful and Retakaful divisions are subject to the following requirement:
- i. Seed Capital**

The seed capital for the funding of the Takaful or Retakaful divisions is at least one million ringgit or its equivalent in any foreign currency and be treated separately from the net working funds at the company level that are used for the insurance and insurance-related businesses under LFSSA that are not Shariah compliant.

Existing Labuan companies undertaking insurance and insurance-related activities that are licensed under LFSSA and intend to undertake Takaful and Retakaful activities within their operations, can use the existing funds from the above non-Shariah compliant businesses to be channelled as 'seed capital' to the Takaful and Retakaful divisions for the following purposes:

- a. For the business commencement of the Takaful or Retakaful divisions;  
and
- b. For the payment of underwriting deficit (i.e. based on the Qard-ul-Hasan contract) or any other forms of payments that are Shariah compliant as advised by the IFI's ISAB.

Upon placement of the 'seed capital' into the Takaful or Retakaful divisions, the said capital must be utilised for the Takaful or Retakaful activities or other Shariah compliant activities as advised by the respective ISAB. The seed capital from the Takaful or Retakaful business cannot be reversed for the use of the IFIs' conventional businesses. The sum of money specified above should be maintained in a Shariah compliant account of the applicant with a financial institution in the Federal Territory of Labuan. A certificate evidencing the deposit should be provided to Labuan FSA before commencement of business.

## **ii. Underwriting Deficit**

In case of the underwriting deficit, the IFI would need to provide an undertaking to the participants to make good of the deficit. The deficit would be made good by way of giving a Qard-ul-Hasan to the Takaful or Retakaful division or by way of any other forms of payment to finance the deficit that are Shariah compliant as advised by the IFI's ISAB. In case of deficit payments by way of Qard-ul-Hasan, the IFI would however have the right to recover the Qard-ul-Hasan payments from future surpluses in the PIA. The definition of Qard-ul-Hasan should be incorporated in the policy documents and be construed as a binding contract between the participants and the IFI. Similarly, any other forms of payment as advised by the IFI's ISAB to finance the deficit are to be clearly spelt out in the policy documents between the participants and the IFI.

## **iii. Distribution of Surplus Funds**

At the end of each financial year, the IFI would need to evaluate the assets and liabilities of the Takaful operations and determine whether the operation for that particular period results in a surplus or a deficit. IFI may compute the distributable surpluses on the basis of the combined results of all classes of business or calculate the surpluses separately for each class. The

distribution of surpluses to the participants may be carried out depending on the contractual obligation between participants and IFI.

**iv. Management/Marketing Expenses**

All the administrative and management expenses of the IFI, including those attributable to participants' affairs, shall be borne by the IFI in consideration of receiving a stipulated proportion of the gross contributions. The IFI will be responsible for all expenses of management and marketing expenses. The shareholders' income will come from the IFI's fee and investment management for the PIA and the investment income on the shareholders funds. IFI fees to be charged or the investment management share would need to be explicitly defined in each contract.

**v. Physical Resources**

The Takaful or Retakaful division may share the same physical resources in terms of human resources and systems, provided the accounts and funds are separated as defined under Item III of the Directive.

**vi. Retention Ratio**

While the Guidelines do not specify a ratio, the retention policy of IFI should be based on proper business risk management. The retention strategy must take into account not only single risk claims but also multi-risk events to ensure adequate protection for all classes of business underwritten to enable it to pay its liabilities when they materialised.

**vii. Retrocession**

Retention strategy should also include placement of business under Retakaful arrangements. It is necessary to first offer the retrocession where practicable, to Retakaful operators. Where the retakaful capacity is insufficient to cover the required risks, the risks could be ceded to other reinsurance capacity. Where retrocession is made, IFI should ensure that the reinsurers or Retakaful operators meet the financial and other prudential requirements of the IFI.

## **8.0 Computation of Solvency Margin**

- 8.1 The computation of solvency margin both for full-fledged Takaful and Retakaful entities as well those undertaking Takaful and Retakaful divisions, are subject to Section 84 of the LIFSSA. For compliance purposes, margin of solvency may be computed on company basis, but a separate solvency computation for takaful and retakaful portfolio must be submitted to Labuan FSA every six months for monitoring the orderly development of the Takaful and Retakaful industry.

## **9.0 Implementation Date**

- 9.1 The Guidelines shall be observed by IFI licensed under LIFSSA with Takaful and for Retakaful operations effective from 1 August 2007.

**Labuan Financial Services Authority**  
**15 June 2007**