Islamic Finance Task Team (IFTT)

Islamic insurance and reinsurance

-Issues and recommendations-

Joint Workshop on Statistical Treatment of Islamic Finance in National Accounts and External Sector Statistics and Experimentation and Testing of new recommendations in GCC countries

14-16 March 2022

Outline

- **Understanding takaful and retakaful**
- **Comparison of takaful and conventional insurance**
- **Current situation**
- **Issues considered**
- **Recommendations**

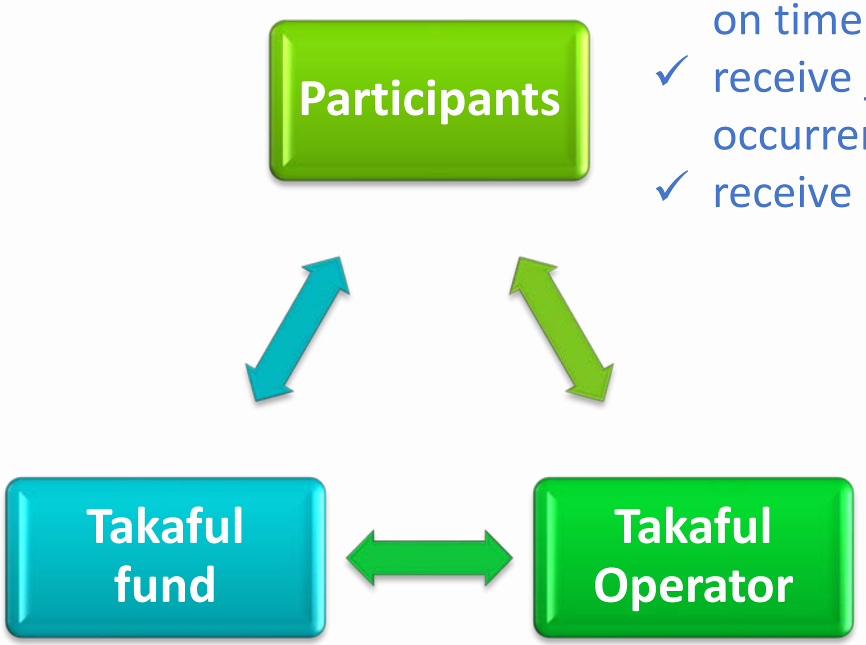
Understanding takaful and retakaful

- Two contractual relationships
  - Contract between participants and takaful funds, based on concepts of mutual assistance (ta'awun- at the stage of providing compensation for injury), donations commitment (tabarru'- at the stage of making contributions) and cooperative risk-sharing
  - Contract between the group of participants and the takaful operator, which is appointed by the participants to manage and invest the takaful fund for them, using several types of contracts to govern their relationship (Mudaraba –profit sharing, wakalah –payment of fees, ju'alah –reward or a combination of these contracts).

Understanding takaful and retakaful

- Fully-fledged takaful/retakaful:

- The account established by the company to accommodate the premiums of the participants and their returns as well as the reserves.
- Disaggregated into PIFs and PRFs:
  1) Participants' Investment Fund: to which a portion of contributions is allocated for the purpose of investment and/or savings
  2) Participants' Risk Fund: to which a portion of contributions is allocated to meet claims by participants on the basis of mutual assistance or protection



- ✓ make the payment of contribution on time as per agreement
- ✓ receive indemnities at the occurrence of the risk insured
- ✓ receive a share of Takaful surplus

The company should maintain two separate accounts:
1) for the rights and liabilities of the policy holders
2) for its own right and liabilities

Understanding takaful and retakaful

Principles

- mutual assistance
- donations commitment
- cooperative risk-sharing

Parties

- participants
- takaful fund
- takaful operators

Products

- general takaful
- family takaful
- Re-takaful

Models

- Mudarabah-based
- Wakala-based
- hybrid model
- Waqf takaful

Surplus

- (+) total contributions paid
- (-) total indemnities paid
- (-) retakaful operations, expenses and changes in technical provisions
- → reallocated to participants

Understanding takaful and retakaful

- Two other variations:

Light takaful

- Contracts are not based on tabarru principles
- No segregation of takaful operators and takaful funds

Takaful windows

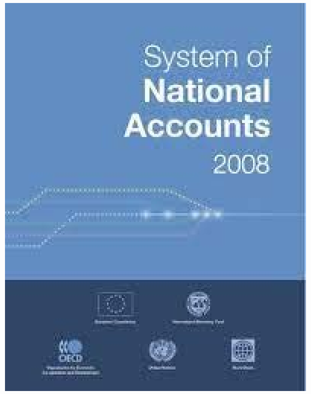
- That part of a conventional financial institution that provide takaful or retakaful services
- May be a branch or a dedicated unit of that institution
- Have separately identified assets and liabilities

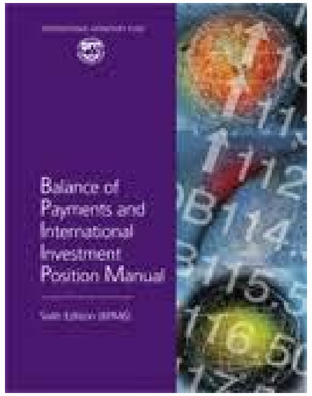
Comparison of takaful and conventional insurance

Conventional insurance	Takaful
Indemnification component is a commercial relationship between insurance company and the insured	Indemnification component is based on contract of mutual assistance (ta'awun) and reciprocal donation (tabarru')
Contract of exchange (sale and purchase of insurance policy) between insurer and insured	A combination of tabarru' contract and agency and/or profit-sharing contract
The company owns the premiums against its commitment to pay the insurance indemnities	The takaful fund rather than the company owns the contributions
The company is an original party that signs the contract in its own name. The insurer and the participant are totally different	The insurer and the participant are in fact the same person since the takaful fund belongs to the participants and the operator just manages on their behalf
The company owns and receives the premiums as soon as it signs the contract. The premiums and returns on them constitute part of the revenue and profits of the company.	The returns on investment of premiums belong to the policyholders collectively, after deduction of the operator's share. The surplus is distributed among them or given to charity.
The company is obligated to pay claims from its assets even if the claims exceed the amount of premiums paid	If claims paid from the takaful fund exceed the amount of premiums, participants should increase their contributions
Risks are transferred from the insured to the insurer	Risks are distributed to the whole group of participants, and the burden of losses is shared equitably among them
The premiums might be invested in interest-bearing securities	The premiums must be invested in Shari'ah-compliant instruments and halal businesses

Current situation

- 2008 SNA and BPM6 provide recommendations to record conventional insurance transactions, other flows and positions
- Both do not provide explicit recommendations for the treatment of takaful and retakaful activities





Conventional insurance output

Non-life insurance	Life insurance	Reinsurance
Total premiums earned (+) premium supplements (-) adjusted claims incurred	Premiums earned (+) premium supplements (-) less benefits due (-) increases (+) decreases in life insurance technical reserves.	The method of calculating the output of reinsurance is the same as for non-life insurance (with some provisions for commissions and profit sharing)

Issues considered

Issue 1
Are takaful operators and funds separate institutional units?

If so,

Issue 2
Sectorization of takaful operators and funds

Issue 3
Output calculation for takaful operators and funds

- The three issues are equally relevant to takaful and retakaful activities

Recommendations

- **(issue 6.1)** The GN recommends to classify takaful operators and takaful funds as **separate institutional units** in the compilation of national and international accounts statistics
  - The two groups of units have the main attributes of institutional units, including the existence of a complete set of accounts
  - The recommendation applies also to retakaful operators and retakaful funds
  - This apply also to takaful/retakaful windows that have distinctly identified assets and liabilities, separate from those of the conventional operation of the belonging financial entity
  - Does not apply to “light” version of takaful and retakaful in some economies where these arrangements remain similar to conventional insurance and thus, the GN recommends to consider the combined unit as one institutional unit
- **(issue 6.2)** The GN recommends to sectorize takaful operators and takaful funds if they are classified as institutional units, respectively, into the financial auxiliaries subsector (**S126**) and insurance corporations subsector (**S128**)
  - The combined unit of “light” takaful and the takaful windows are recommended to be sectorized into the insurance corporations subsector (**S128**)

Recommendations

- **(issue 6.3)** The GN recommends the following calculation of output of takaful operators and takaful funds if they are classified as institutional units:
  - Output of takaful operators: as the wakalah fees they charge to administer takaful funds and/or the share of profits earned from investing takaful funds
  - Output of takaful funds: as sum of costs as the wakalah fees they pay to takaful operators and/or the share of profit payable to takaful operators plus other intermediate consumption, if any
  - For the "light" takaful, the GN recommends to calculate the output of the combined unit using the existing methods that are used to calculate the output of conventional insurance

Issues considered and recommendations

Entity	Are they institutional units (issue 6.1)?	Sectorization (issue 6.2)	Methods to calculate output (issue 6.3)
Takaful/retakaful operators	Yes	Financial auxiliaries (S126)	Fees charged and/or the share of profits earned from investing the funds
Takaful/retakaful funds	Yes	Insurance corporations (S128)	Sum of costs
Light takaful (combined unit)	Yes	Insurance corporations (S128)	Conventional insurance formula in 2008 SNA
Takaful windows	Yes	Insurance corporations (S128)	Sum of costs

Thank you