



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Broader Application of Ta`awun in Takaful Discussion Paper

Applicable to: Licensed takaful operators including professional retakaful operators

This Discussion Paper (DP) outlines Bank Negara Malaysia's (the Bank) policy perspective in respect of the broader application of mutual assistance (*ta'awun*) by licensed takaful and professional retakaful operators (TOs) in the provision of family and general takaful business. Specifically, this DP seeks feedback from TOs and Shariah Committee of the TOs on the following areas:

- (a) scope of the broader application of *ta'awun* in takaful business;
- (b) Shariah guiding principles and parameters;
- (c) scope of reviews of existing regulatory requirements; and
- (d) potential operational challenges.

Feedback received from this exercise will serve as input for the formulation of the Bank's holistic regulatory expectations to be issued later.

The Bank invites written feedback, including suggestions on areas requiring further clarification, elaboration or alternatives that the Bank should consider. The feedback must:

- (a) be prepared based on inputs from relevant parties within the TOs, including from the origination/business units and other relevant control functions including the back office (e.g. actuarial, risk management, compliance, Shariah) given the cross cutting implications of the proposals to a TO's business strategies, capital adequacy, operations and offerings;
- (b) include specific inputs and constructive views from the Shariah Committee of the TOs;
- (c) include specific responses to the questions posed in this DP; and
- (d) be supported with clear justification, including accompanying evidence or illustrations where appropriate, to facilitate an effective and constructive consultation process.

Responses must be submitted to the Bank via email to shariahstandard@bnm.gov.my by **31 May 2022**. In the course of preparing your feedback, you may direct any queries to the following officers:

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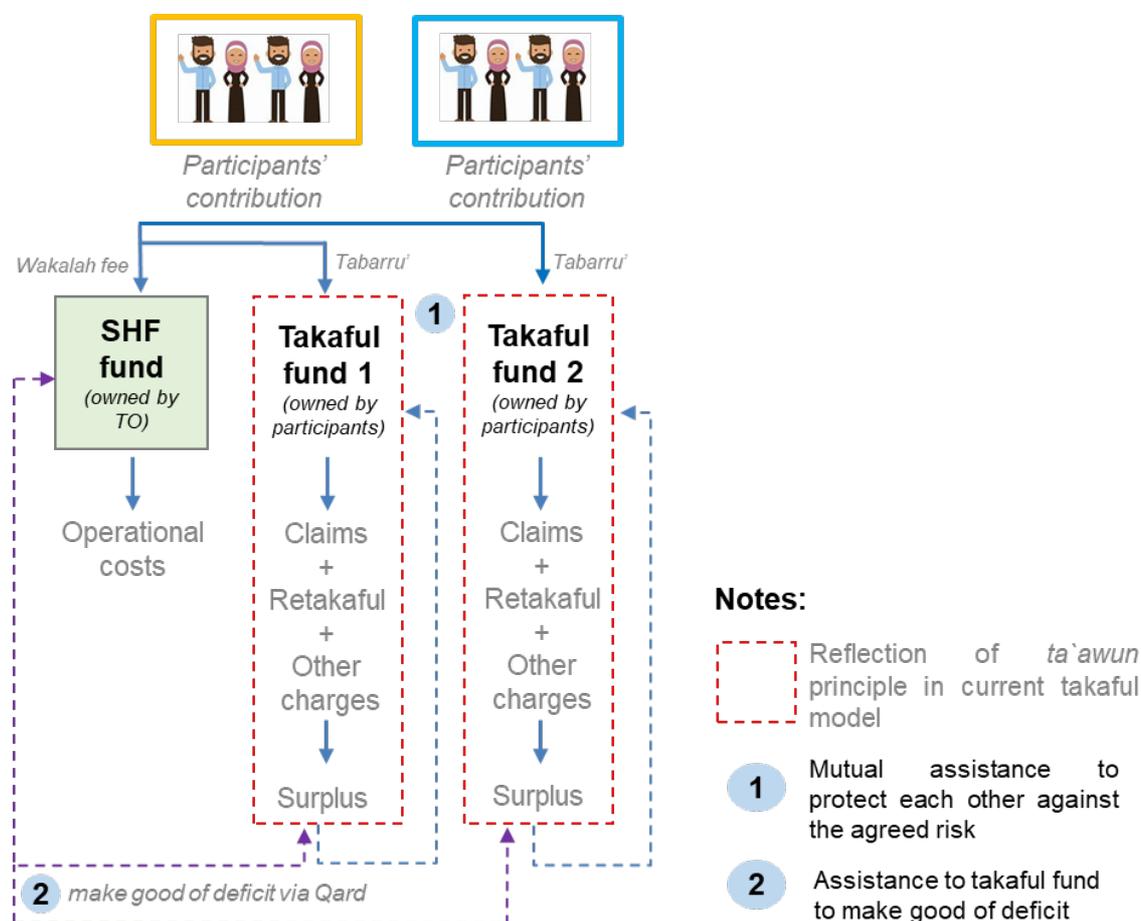
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PART A OVERVIEW

1 Introduction

1.1 Mutual assistance (*ta'awun*) forms the foundation of the risk-sharing mechanism in takaful¹. Takaful participants would mutually agree to contribute to a common fund that provides mutual financial benefits payable to takaful participants or their beneficiaries in accordance with the terms and conditions on the occurrence of pre-agreed events². This fundamentally differentiates takaful from the conventional insurance that works on the basis of a risk transfer from policyholders to insurers. At present, the regulatory framework mainly focuses on the application of *ta'awun* among takaful participants in a takaful fund. This is intended to preserve the best interest of takaful participants as the collective owner of the takaful fund.

Diagram 1: Simplified illustration of a takaful model in Malaysia



¹ Shariah Resolutions in Islamic Finance (Second Edition), Bank Negara Malaysia (2010).

² As per definition of "takaful" in section 2(1) of the Islamic Financial Services Act (IFSA) 2013.

- 1.2 In recent years, the Bank has received takaful product applications involving a broader application of the *ta`awun* concept. These include utilisation of surplus generated in takaful fund for donation or financial assistance to a third party, who are not existing participants.
- 1.3 The Bank acknowledges that the absence of clear Shariah parameters and supportive policy framework may inadvertently limit the ability of TOs to harness the full potential of *ta`awun* in enhancing the broader socioeconomic resilience and in meeting the needs of unserved/underserved segments.
- 1.4 This discussion paper (DP) outlines the Shariah parameters to guide a more effective application of *ta`awun* by the industry. It is also intended to initiate industry discussions as well to facilitate future review of existing regulatory requirements. The Bank is, therefore, seeking feedback on the following:
 - (a) proposed scope of broader application of *ta`awun* in the takaful business;
 - (b) proposed Shariah guiding principles and parameters;
 - (c) scope of proposed reviews of existing regulatory requirements; and
 - (d) potential operational challenges.

2 Interpretation

- 2.1 The terms and expressions used in this DP shall have the same meanings assigned to them in the Islamic Financial Services Act 2013 (IFSA) and the Financial Services Act 2013 (FSA), as the case may be, unless otherwise defined in this DP.
- 2.2 For the purposes of this DP –

“**takaful fund**” or “**takaful funds**” refers to the definition of “Participants Risk Fund” as provided in the Policy Document on Takaful Operational Framework issued on 26 June 2019.

PART B SHARIAH PARAMETERS

3 Scope of *ta`awun*

- 3.1 *Ta`awun* is a broad concept ordained in the Al-Quran that encourages mutual assistance for good causes and prohibits assistance or cooperation for ill-intent causes³. The concept has been widely discussed by classical and contemporary Shariah scholars. Such discussions centred on encouraging piety (*taqwa*) and cooperation among Muslims towards good causes. These aim to promote the attainment of benefits for the ummah, including:
- supporting each other towards becoming a better Muslim (encouraging towards good relationship with Allah)⁴;
 - promoting social cohesion by sustaining communal relationship (encouraging social harmony towards building a good community/ummah)⁵; and
 - effective resource sharing to promote fair and equitable wealth distribution⁶ as encouraged in Islam⁷.
- 3.2 The application of *ta`awun* in modern Islamic finance practices strives to realise the above benefits and outcomes. *Ta`awun* as practised in takaful, for example, is premised on the ground of mutual assistance among takaful participants within a similar takaful fund to protect each other from specified risks as pre-agreed in the takaful certificate.
- 3.3 The stricter application is intended to safeguard the rights and ensure fair treatment of takaful participants as the collective owner of the takaful fund. The existing policy requirements include limitation on the usage of surplus in a takaful fund (other than its own use) for solvency purposes⁸, prohibition of cross-subsidisation of surplus between different takaful funds⁹, and limitation on surplus withdrawals that is confined to purposes of takaful participants in the takaful fund.

³ Surah al-Maidah: 2.

⁴ Al-Qurtubi (2006), *Al-Jami' li Ahkam al-Quran (Tafsir Al-Qurtubi)*, j. 6, p. 46-47.

⁵ Ibnu Qayyim, *Zaadul Muhajir*, j.13, p.1, Al-Baladhuri, *Futuh al-Buldan*, p. 441.

⁶ Ibnu Khaldun, *Muqaddimah Ibnu Khaldun*, p. 429.

⁷ For example, the encouragement of Prophet for people with surplus to share their provision with those with no provision. Refer Appendix on classical views of *ta`awun*.

⁸ Paragraph 9.1 in Part B of the Policy Document on Risk-Based Capital Framework for Takaful Operators issued on 17 December 2018.

⁹ Paragraph 9.10(b) of the Policy Document on Takaful Operational Framework issued on 26 June 2019.

- 3.4 Nevertheless, as the industry progresses, the Bank is of the view that the *ta`awun* concept can be applied more broadly. This will enable the takaful industry to contribute more meaningfully in the nation's development while continuing to preserve the rights of takaful participants and consistently achieving the initial objective of the takaful (*muqtada aqad*). Specifically, the broader application of *ta`awun* in takaful can serve to achieve the following outcomes:
- i. promote equitable wealth circulation by encouraging effective resource distribution
 - For instance, in addition to the fiduciary duty of TOs to provide *qard* to the takaful fund in the event of a deficit and effectively maintain sufficient capital buffers for the takaful fund, the Bank is considering to allow the usage of excess surplus in a takaful fund to absorb losses of another takaful fund(s) that has insufficient capital available¹⁰, to meet the Total Capital Required (TCR).
 - ii. promote social cohesion by sustaining communal relationships
 - For instance, the Bank is considering to review surplus management requirement that allows a wider scope of surplus utilisation for socioeconomic wellbeing purposes¹¹, beyond takaful fund and existing takaful participants, including takaful participants in other takaful fund, governed by the respective TOs' internal policies and proper governance arrangement¹².
- 3.5 The broader application of *ta`awun* can be considered across different business situations or circumstances. As such, a clear interpretation of each of these situations or circumstances needs to be supplemented with justified reasoning, including specific events leading to or necessitating such broader application of *ta`awun*.

¹⁰ In reference to the Discussion Paper on Risk-Based Capital Framework for Insurers and Takaful Operators (Framework Design) issued on 30 June 2021.

¹¹ Examples of surplus utilisation for socioeconomic wellbeing purposes may include providing financial assistance to takaful participants in other takaful funds who are affected by certain hardships, or channeling financial assistance to provide takaful coverage to low-income households, thereby improving their financial resilience.

¹² For example, establishment of principle-based internal safeguards that govern the mobilisation of takaful fund (e.g. for capital support or actual transfer between different takaful funds), such as defining an internal tolerance level to apply on any broader application of *ta`awun* that has been agreed by takaful participants.

- 3.6 In respect of paragraph 3.5, this DP proposes the following scope of situations or circumstances and key considerations that may be included in the terms and conditions of a takaful certificate:

Situations/ circumstances	Key considerations
Normal/ business as usual	<ul style="list-style-type: none"> • Clear terms and conditions regarding the areas/situations for the <i>ta`awun</i> application and contractual obligations. These include the implication to takaful participants if the <i>ta`awun</i> is broadened beyond existing takaful participants in a takaful fund, subject to adherence to relevant regulatory requirements.
Exigent/stress	<ul style="list-style-type: none"> • Scope of <i>ta`awun</i> application and indicator of hardship shall be guided by <i>hajah</i> parameters¹³ particularly the type of hardship that invokes the application of <i>hajah</i>. These include an exigent financial situation that necessitates the acceptance of assistance from a conventional insurer through a temporary arrangement of reinsurance or retrocession.
Winding-up	<ul style="list-style-type: none"> • Clear terms and conditions on the scope of <i>ta`awun</i> application in resolution situation. Such situation would be after meeting all rightful liabilities and obligations of the takaful fund, including the scope of utilisation of the excess of assets in the takaful fund.

- 3.7 In relation to paragraph 3.6, the contractual obligations of all contracting parties must be clearly specified in the takaful certificate. These include roles and responsibilities of existing takaful participants in a particular takaful fund, takaful participants in different takaful funds as well as a third party.
- 3.8 TOs need to ensure that the broader application of *ta`awun* must not, in any way, directly or indirectly, impair the fundamental objective of takaful. This means, any mutual assistance amongst takaful participants of a particular takaful fund needs to be underpinned by the occurrence of pre-agreed events based on the terms and conditions stipulated in the takaful certificates.

¹³ As outlined in the Discussion Paper on *Hajah* issued on 15 November 2021.

- 3.9 Such broader application must only be confined to business activities or transactions that are in compliance with Shariah. This, however, excludes exigent circumstances where such application will be subject to applicable Shariah parameters and regulatory requirements.
- 3.10 Any form of *ta`awun* application must not result in a conflict of interest involving TOs as *wakil* in managing the takaful fund. This is necessary to ensure TOs effectively discharge their fiduciary role in preserving the best interest and fair treatment of takaful participants. For this purpose, the Bank proposes for key organs of a TO including its Shariah Committee to have the responsibility in providing an objective and sound advice on the justification and measures to apply broader *ta`awun* under each of the specific circumstances¹⁴. This can also be performed by instituting an independent oversight mechanism¹⁵.

Consultation 1:

- (a) Please provide feedback on the proposed scope of broader application of *ta`awun* particularly on the application of *ta`awun* throughout different business situations or circumstances of TOs. The feedback should also cover the proposal on requiring clear interpretation of each circumstance and supplemented with justified considerations, including specific events leading to or necessitating such broader application of *ta`awun*. Where applicable, the feedback may also cover potential areas in applying broader application of *ta`awun* such as in TOs' operational model, product offerings, surplus management, or capital purposes.
- (b) Expanding the application of *ta`awun* beyond the takaful fund may impact the sustainability of the takaful fund and benefits payable to takaful participants. Please share your views on potential internal safeguards that should be in place when providing mutual assistance to another takaful fund(s) whilst preserving takaful participants' interests and sustainability of the existing takaful fund.
- (c) Where broader application of *ta`awun* is applied for solvency purposes, please provide feedback on the manner in which the excess surplus can be used to support the solvency of another takaful fund. This could be in the form of capital recognition when calculating the Capital Adequacy Ratio (CAR) or would this necessitate an outright transfer.
- (d) Please provide feedback on the distinction between surplus from out-of-force and in-force certificates and whether there would be differences in applying the broader application of *ta`awun* for both types of surpluses.

¹⁴ Such expectation forms part of existing roles of Shariah Committee as outlined in Policy Document on Shariah Governance issued on 20 September 2019.

¹⁵ Refers to any credible independent party that has sufficient competency to provide an independent view on the TO's proposed broader application of *ta`awun* in their operational model and product.

- (e) Please provide feedback on your current strategic initiatives that are consistent with the perspective of the broader application of *ta'awun*. These may include social finance initiatives, donations to charity, or capital assistance to other takaful funds. The feedback may also include other proposed initiatives in the industry such as *musyarakah* retakaful, peer-to-peer (P2P) model, or microtakaful.
- (f) Please provide feedback on other key organs of TOs that can be leveraged to maintain the independence of the decision making process in broader application of *ta'awun*.

4 Fairness to contracting parties

- 4.1 Takaful is structured based on the benevolence (*tabarru'at*) contract. In applying the Shariah contract in takaful business, the terms and conditions in a takaful certificate are agreed upon by all contracting parties on the basis of principle of freedom to contract (*huriyah al-ta'aqud*)¹⁶. Shariah recognises the principle of freedom to contract is built on the concept of mutual consent (*taradhi*)¹⁷ that should be applied within boundaries such that it preserves the fairness and interest of the contracting parties.
- 4.2 Such principle also emphasises for elements that nullify consent to be absent from a contract, terms and conditions to be aligned with the objective of the contract, and fair bargaining power between contracting parties that includes the rights to have access to clear information prior to obtaining contractual agreement. As such, when *ta'awun* is applied beyond the currently limited scope, there must be clear and effective communication to takaful participants on the wider scope of *ta'awun*. This serves to ensure that all takaful participants understand the potential impact of such application.

¹⁶ In a takaful certificate which is based on *tabarru'* contract, the contractual terms and conditions that are agreed among takaful participants are premised on the concept of *huriyah al-ta'aqud* (The SAC's Shariah Resolutions in Islamic Finance, Third Edition, 2017, page 40).

¹⁷ Ibid.

- 4.3 In establishing appropriate parameters to guide the application of the principle of freedom to contract in takaful, the Bank has considered the specificities of a *tabarru`* contract that are different from an exchange contract (*mu`awadhat*). Therefore, to preserve the attainment of the fundamental rights of contracting parties that are involved in a *tabarru`* contract, this DP proposes for TOs to consider the following:
- (a) provide clear disclosure to takaful participants, including the implication of the contractual terms of the takaful certificate to facilitate informed decision making;
 - (b) contractual terms that do not give rise to conflict of interest to the TO as *wakil* in managing the takaful fund on behalf of the takaful participants;
 - (c) no elements that nullify consent such as undue influence, coercion, or deliberate disregard of any material information; and
 - (d) contractual obligations of the TO and takaful participants are given appropriate prominence.

Consultation 2:

Please provide TO's and Shariah Committee's feedback on the proposed parameters on fairness in a contract from the context of principle of freedom to contract in a *tabarru`* contract.

- 4.4 The Bank is considering a requirement for TOs to ensure that appropriate consent is obtained from the takaful participants regarding every scope of application of *ta`awun* and the terms that affect the takaful participants' rights and obligations. In ensuring the consent and mandate from takaful participants are properly obtained, the terms and conditions of takaful certificate should include all pre-agreed events leading to the broader application of *ta`awun*.
- 4.5 For the avoidance of doubt, broader application of *ta`awun* involving in-force certificates requires the expressed consent from the affected takaful participants. The Bank is considering similar requirements to be imposed pertaining any changes in terms and conditions involving in-force takaful certificates, for example, in effecting broader application of *ta`awun* during exigent circumstances or any other situations.
- 4.6 In relation to paragraph 4.5, TOs must have in place a clear and robust mechanism when dealing with any variation to the terms and conditions of a takaful certificate and for effecting such variation. In any case, takaful certificates must incorporate explicit clauses and specified parameters of the circumstances which allow changes to the contractual terms and conditions.

- 4.7 For any changes to the terms and conditions of the takaful certificate, all contracting parties must be provided with adequate means and reasonable opportunities to indicate their preference and choice concerning their rights and obligations.
- 4.8 In line with section 94 of the IFSA, TOs must take into account the sustainability of the takaful fund before considering to apply or invoke the broader application of *ta'awun* as specified in the takaful certificate. In doing so, the Bank expects the Appointed Actuary¹⁸ of a TO to ensure appropriateness of such recommendation and justification with regard to any utilisation of surplus in a takaful fund within the current and/or expanded scope of *ta'awun*. This is considering that the utilisation of excess surplus in a takaful fund for the purpose of broader application of *ta'awun* without reasonable consideration to the overall sustainability of the takaful fund could be detrimental to existing takaful participants.

Consultation 3:

- (a) Please provide feedback on the proposed fairness parameters, specifically on the requirement to balance between applying *ta'awun* beyond the current application and ensuring the long-term sustainability of the takaful fund.
- (b) Please provide feedback on the operationalisation of consent requirements, specifically on methods and ways of effecting the changes in relation to broader application of *ta'awun* during the in-force period of a takaful certificate. Please also provide feedback on legal constraints, if any, in applying such changes to the in-force takaful certificates.
- (c) Please outline specific challenges in complying with the proposed fairness parameters in broadening the application of *ta'awun*.

5 Disclosure and transparency

- 5.1 The Bank acknowledges that disclosure and transparency are imperative in facilitating informed decision making by takaful participants. On this premise, TOs must ensure timely, reasonable, and reliable disclosure is made to takaful participants with regard to the terms and conditions of a takaful certificate.
- 5.2 All forms of broader application of *ta'awun* must be supported by a strong Shariah basis and safeguards to ensure reasonable application while preserving the fair

¹⁸ Such expectation forms part of existing role/duties of Appointed Actuary as outlined in Policy Document on Takaful Operational Framework and Policy Document on Appointed Actuary: Appointment and Duties issued on 28 April 2014.

treatment to takaful participants of a takaful fund. These need to be explicitly stipulated in the takaful certificate, before it can be applied beyond the current scope.

- 5.3 The takaful certificate must clearly disclose the definition and scope of application of *ta`awun*, particularly on specific events leading to such application.
- 5.4 All contracting parties must be kept well-informed and provided with clear and accurate information on the proposed broader application of *ta`awun* by the TO including risk/implication of terms and conditions in the takaful certificate. For example, the implication of waiving entitlement to surplus, agreement to participate in charitable activities, and Shariah treatment¹⁹ for each application of *ta`awun*.
- 5.5 In relation to paragraph 5.4, the Bank is exploring other avenues of disclosure on all pertinent information regarding the broader application of *ta`awun* by TOs and its implication to the takaful participants. This may include specific disclosure in financial statements, Directors' Report and Shariah Committee Report regarding the basis of such application. TOs are expected to disclose the available modes of communication to relevant stakeholders, particularly the takaful participants.

Consultation 4:

- (a) Please provide feedback on the proposed Shariah parameters on disclosure and transparency in the takaful certificate. Please also provide feedback on other avenues of disclosure that should be considered to ensure broader application of *ta`awun* as practised by the TO is clearly communicated and informed to relevant stakeholders.
- (b) Please share feedback on the implications of the disclosure on broader application of *ta`awun* to existing takaful participants from a legal perspective and operational aspects.
- (c) Please provide feedback on whether properly worded takaful certificates and transparent disclosure as proposed are sufficient, or there needs to be further regulatory guidance on the extent of TO's obligation with regard to broader application of *ta`awun*.

¹⁹ For example, clear Shariah treatment in any application of *ta`awun* may include the Shariah basis of *tanazul/hibah/mubara`ah* in the relinquishment of rights to certain threshold of surplus by takaful participants, or Shariah basis of *qard/hibah* in providing assistance to other takaful fund with lower capital available.

PART C REVIEW OF REGULATORY POLICIES

6 Regulatory review in line with broader application of *ta`awun*

- 6.1 The Bank is considering to review existing regulatory requirements to facilitate a smooth and effective broader application of *ta`awun*.
- 6.2 This review is intended to foster broader application of *ta`awun* in the industry, as well as to address potential risks arising from operational changes and product innovations introduced by TOs.
- 6.3 To this end, the review would include, but not limited to, the following regulatory policies:
- (a) Shariah requirements on application of *ta`awun* in takaful, such as cross-subsidisation between takaful funds, requirements on utilisation and distribution of surplus, and *ta`awun* in winding up situation;
 - (b) Conduct and consumer protection requirements on safeguarding the interest of existing takaful participants, and enhancing consent requirements;
 - (c) Takaful operational framework, such as surplus management policy²⁰ that includes surplus utilisation beyond a takaful fund and takaful participants; and
 - (d) Risk-based capital requirement on utilisation of excess surplus in sufficiently capitalised takaful fund to assist another takaful fund that is in need for capital²¹.
- 6.4 The Bank will be reviewing relevant policies in phases, centred on the principle of proportionality while preserving the capability of achieving the initial objective of takaful and safeguarding financial stability and the interests of certificate owners and takaful participants.

Consultation 5:

- (a) Please provide feedback on the above identified policies and other policies that may require review in facilitating effective implementation of the broader application of *ta`awun*, including practices observed in other countries, where relevant.

²⁰ As outlined in Paragraph 18 of the Policy Document on Takaful Operational Framework issued on 26 June 2019.

²¹ As detailed out in Paragraph 2 of Appendix 2 of the Discussion Paper on Risk-Based Capital Framework for Insurers and Takaful Operators (Framework Design) issued on 30 June 2021.

APPENDICES

Appendix Scope of ta`awun

Ta`awun from the Quran and Sunnah

The following verse of the Quran implies the broad encouragement of assistance for good causes and piety, and prohibition against cooperation on sinful deeds and transgression:

وَاتَّقُوا وَالْعُدْوَانَ الْإِثْمَ عَلَى تَعَاوُنُوا وَلَا وَالتَّقْوَى الْبِرِّ عَلَى وَتَعَاوُنُوا
الْعِقَابِ شَدِيدُ اللَّهِ إِنَّ اللَّهَ

And cooperate with one another in virtuous conduct and for piety, and do not cooperate with one another in sin and transgression. And fear Allah. Indeed, Allah is severe in retribution (Surah Al-Maidah, 5:2)

The following *hadith* implies the general advocacy for people with excess to help others who are in deficit, and consciousness towards other people's needs:

الله صلى النبي مع سفر في نحن بينما: قال عنه الله رضي الخدري سعيد أبي عن
رسول فقال، وشمالاً يميناً يصرف فجعل له راحلة على رجل جاء إذ وسلم عليه
، له ظهر لا من على به فليعد ظهر فضل معه كان من: وسلم عليه الله صلى الله
ما المال أصناف من فذكر، له زاد لا من على به فليعد زاد من فضل له كان ومن
فضل في منا لأحد حق لا أنه رأينا حتى، ذكر
مسلم رواه

Abu Sa`id Al-Khudri reported: While we were on a journey with the Messenger of Allah (peace and blessing of Allah be upon him), a person came and began to stare on the right and left. The Messenger of Allah (peace and blessing of Allah be upon him) said: He who has an extra mount should give that to one who has none, and he who has surplus of provisions should give them to him who is without provision, and he named various kinds of possessions/wealth, until we began to think that none of us had any right over anything of surplus [Muslim]