



Takaful Operational Guidelines

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1.0 AUTHORIZATION

IN EXERCISE of the powers conferred by sections 3A (a), (b) and (g) of the Insurance Act, the Insurance Regulatory Authority (herein referred to as Authority) issues the Guideline set out here below, for observance by all insurers registered under the Insurance Act Cap 487 to transact *takaful* business.

2.0 Abbreviations and Acronyms

GDP	- Gross Domestic Product
IRA	- Insurance Regulatory Authority
PIF	- Participants' Investment Fund
PRF	- Participants' Risk Fund
SSC	- <i>Shari'ah</i> Supervisory Council
TO	- <i>Takaful</i> Operator

3.0 Definitions and Terms

Authority – Insurance Regulatory Authority.

Board of Directors – Members of the Board of the *Takaful* Operator.

Conventional insurance business – This means life or non-life insurance business authorized under the Insurance Act, including reinsurance business which is not *takaful* or re-*takaful* business.

Family *takaful* – This is the alternative of life or long term business. This means *takaful* for the benefit of individuals, groups of individuals and their families.

General *takaful* – This is the alternative of general or short –term or non-life business. This is *takaful* other than family *takaful*.

Insurance Act – Insurance Act, CAP 487 Laws of Kenya.

Operator – This is a fully fledged authorized entity that deals exclusively with *takaful* or re-*takaful* business.

Participant(s) – This is the equivalent of policyholder(s) or insured(s). The participant is the contributing party to the *takaful* policy who is covered through the mutual protection and solidarity of the *takaful* policy.

Participants Investment Fund - An account to credit a portion of contributions from the participant for the purpose of investment / savings.

Participants Risk Fund – Also referred to as *Takaful* fund. This is the equivalent of a risk fund where a portion of the participants' contributions are credited to assist participants who might suffer unexpected financial losses.

QardHassan – Benevolent or interest-free loan.

Shareholders' Fund -Also called the operating fund, this account holds the paid-up capital (seed money) provided by the company's shareholders. The start-up administrative expenses are paid from this account and the balance capital is invested. Any profits from those investments go back into this fund. In addition, *takaful* participants pay ongoing management fees that are placed in the shareholders fund to support continuing administrative expenses.

*Shari'ah*Supervisory Council - A committee of Islamic scholars who are well-versed and competent in *Shari'ah* and its approaches to finance, appointed by the *takaful* operator to supervise and ensure that the operations of the operator are *Shari'ah* compliant.

Tabarru' – This is the equivalent of premiums. The amount payable by a Participant to an Operator under a *Takaful* Contract.

Takaful - An alternative to conventional insurance based on the principles of mutuality and cooperation, encompassing the elements of shared responsibility, joint indemnity, common interest and solidarity.

Takaful certificates – This is the equivalent of policies. These are the documents detailing the benefits and obligations of a participant under a takaful contract.

Takaful Operator - is the administrator of the *takaful* fund and manages the fund in trust on behalf of the participants.

Takaful / *re-takaful* 'Window' Operator – A registered insurance or reinsurance company authorized by the Authority to carry on *takaful* business as 'window' operations alongside the conventional insurance business.

4.0 Introduction

- 4.1** The Authority has identified *Takaful* as one of the avenues that can be used to increase insurance penetration in Kenya and increase the contribution of insurance to the national Gross Domestic Product (GDP).
- 4.2** These Guidelines are issued to provide regulatory guidance for *Takaful* operator(s) with the desire of enhancing financial inclusion in Kenya and to ensure *Takaful* operator(s) are not disadvantaged.
- 4.3** These Guidelines provide guidance on elements that are specific to the operations of *Takaful*.
- 4.4** These Guidelines are to be read in conjunction with all other relevant legislations, guidelines and circulars.

4.5 It is the responsibility of the *Takaful* Operator(s) to obtain any clarification required on the applicability of these guidelines, legislations and all other regulations from the Authority.

5.0 Objectives

The objectives of the Guidelines are as follows:

- Establish duties and responsibilities of *Takaful* Operators.
- Provide a framework for the establishment and growth of takaful business that is efficient and leads to financially sound and sustainable *takaful* funds.
- Set requirements and minimum standards for operation and disclosure that aims to protect the interests of consumers/participants.

6.0 Guiding Principles

- Promote prudent management of the *takaful* funds to enhance the funds financial resilience.
- Promote fairness and transparency to protect the interests of participants.
- Ensure appropriateness of fees and charges imposed on the participants and *takaful* funds.
- Impart good governance and risk management practices.

7.0 Scope

These guidelines apply to all processes of *takaful* operator(s), *takaful* 'window', re-*takaful* Operators, re-*takaful* 'windows' and *takaful* funds. These include:

- Authorization
- Establishment of *Takaful* models.
- Segregation of Funds
- Distribution of Surplus
- Surrender of Certificate

- Management of Operating Costs
- Remuneration of the Operator
- Deficiency and Loss Rectification
- Disclosure and Transparency

8.0 General Requirements

- 8.1** The Board of Directors is ultimately accountable to ensure the overall effectiveness of *takaful* operations' management.
- 8.2** Senior management will be responsible to implement the overall operational processes, including ensuring the development and recommendation of comprehensive policies, procedures and internal controls as well as *Shari'ah* compliance.
- 8.3** The Board of Directors will put in place an effective oversight framework that continuously assesses the effectiveness of policies and procedures of the management of *takaful* funds.
- 8.4** The Board of Directors will ensure strong corporate governance processes are in place to enable the *takaful* operator to effectively discharge their fiduciary duties towards participants.
- 8.5** The *Shari'ah* Supervisory Council will act as the advisory and supervisory body on *Shari'ah* issues pertaining to *takaful* Operations.
- 8.6** The *takaful* operator will maintain at its principal office an updated register of *takaful* certificates (policies) for all the classes of *takaful* business.

9.0 Specific Requirements

9.1 Authorization

9.1.1 In order to conduct *takaful* business, the authorized person will have an endorsed license authorizing it to conduct such business as a *takaful* operator or *takaful* 'window'.

9.1.2 No person will carry on *takaful* business or use the word 'takaful' or undertake any activity in the nature of *takaful* business, unless such person is authorized to carry on *takaful* business as *takaful* operator or as *takaful* 'window', as the case may be.

9.1.3 An insurer operating a *takaful* 'window' will:

9.1.3.1 Establish a semi-autonomous 'wing' to handle *takaful* business.

9.1.3.2 Ensure that the words 'Takaful Window Operations' are prominently displayed in all documents pertaining to *takaful* operations.

9.1.3.3 Report separately assets, liabilities, revenues and expenses relating to Conventional business and *takaful* business.

9.1.3.4 Appoint a head for the *takaful* operations who has the relevant experience and knowledge and will not be involved with the conventional insurance operations, in any manner.

9.1.3.5 The insurer will ensure total separation of the *takaful* and conventional business.

9.2 Operating Model

9.2.1 *Takaful* operators will submit to the Authority the operational model that defines its relationship and fiduciary duties with the participants. The model should be approved by the *Shari'ah* Council. The model will be submitted at the point of licensing or prior to adopting a new operational model.

9.2.2 The *takaful* operator will maintain as a minimum, the following documentation relating to the operational model(s) in use:

- Contract(s) between the participants.
- Contract(s) between the *takaful* operator and the participants.
- Any other relevant information required for understanding of the *takaful* operator's operational model.

9.2.3 The *takaful* operator will disclose the operating model(s) adopted for use within the participants' policy documentation and its annual report.

9.3 Segregation of Funds

9.3.1 *Takaful* operators will segregate the assets of the *takaful* funds from the assets of the *takaful* operator. Within the *takaful* funds, *takaful* operators will establish and maintain separate *takaful* funds in respect of family *takaful* business and general *takaful* business.

9.3.2 The *takaful* operator will allocate *takaful* funds separately to family *takaful* business and general *takaful* business.

9.3.3 The *takaful* operator will ensure that the funds are managed in an effective manner and that there are

sufficient funds available at all times to cover all prudently discernible eventualities.

- 9.3.4 Takaful operators will have in place appropriate investment strategy that considers the nature, term, currency, amount and timing of the takaful liabilities and commensurate with the funds' tolerance of risks.
- 9.3.5 The investment strategy must be reasonably formulated to avoid adverse impact on the *takaful* funds.
- 9.3.6 In executing investment operations, *takaful* operators will comply with the prevailing requirements imposed by the Board of Directors, *Shari'ah* Supervisory Council and the Authority.
- 9.3.7 The *takaful* operator will establish investment policies for the Participants Risk Fund and Participants' Investment Fund.
- 9.3.8 *Takaful* operators will have in place effective and reliable infrastructure to support investment management and where relevant, able to tag specific investment to the relevant funds.
- 9.3.9 *Takaful* through a 'window' operation
Where *takaful* business is offered by a conventional insurer, the *takaful* operator must ensure that the *takaful* operations are 'ring-fenced' so as to avoid leakage and comingling with non-compliant funds at any point in the life cycle.

9.4 Distribution of Surplus

9.4.1 *Takaful* operators will develop a written policy on the management of PRF surplus in consultation with the *Shari'ah* Council and approved by the Board of Directors.

At a minimum, the policy will include:

- Details on how the level of surplus to be retained in the fund will be arrived at.
- Details on how surplus will be distributed.

9.4.2 *Takaful* operators will observe the following when distributing the surplus:

- a) The surplus to be distributed will be recommended by the Actuary and endorsed by the *Shari'ah* Supervisory Council and approved by the Board of Directors.
- b) The surplus distribution will be in line with the underlying contract of the product.
- c) The surplus will 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 will be determined based on full valuation of liabilities as certified by the Actuary and full audited results.
- e) The PRF will not be in a deficit after surplus is distributed.
- f) The surplus distribution will not cause adverse financial implications on the PRF.
- g) The surplus distribution will be based on generally accepted actuarial principles.
- h) The surplus will be distributed in a manner which ensures fair treatment of participants and in line with the approved model.

9.4.3 The Actuary will 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 adversely affect the solvency of the fund.

9.4.4 The Actuary will 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.

9.4.5 The profits made in the Participants Investment Fund (PIF) will be distributed to the participants and the *takaful* operator based on the underlying agreed contract.

9.5 Surrender of Certificate

9.5.1 Where a participant requests to surrender a *takaful* policy, it may be appropriate for the *takaful* operator to make a surrender payment to the participant.

9.5.2 The *takaful* operator will ensure that the *takaful* contract specifies the circumstances where a surrender payment would be made to the participant and the basis of calculation for the surrender payment.

9.5.3 The *takaful* operator will ensure that the surrender value basis is appropriate and fair, and embedded in the product design.

9.5.4 The *takaful* operator will ensure that the amounts payable to the participants on surrender are made from the relevant funds.

9.5.5 The *takaful* operator may only apply a surrender charge where it is clearly specified in the *takaful* contract. The *takaful* contract should specify the basis of calculating the surrender charges.

9.5.6 The *takaful* operator will retain the basis for deriving surrender amounts and surrendercharges and make this available to the Authority upon request.

9.5.7 Generally, the surrender value, including the cost of any applicable surrender charge, will be determined:

- where relevant, in accordance with generally accepted actuarial principles;
- in a manner ensuring fair treatment of participants; and
- in compliance with standards on market conduct or fair treatment of participants issued by the Authority.

9.6 Management of Operating Costs

9.6.1 *Takaful* operators will establish effective policies and procedures to manage operating costs.

9.6.2 *Takaful* operators will put in place controls 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.

9.6.3 Costs relating to *takaful* operations will be defined by the model adopted by the operator and submitted to the Authority.

9.6.4 The *takaful* operator will bear the costs relating to the operation of the *takaful* business. These costs include:

- a) Expenditure of starting the *takaful* business, for example product design, advertising, IT systems and office fittings.
- b) Policy drafting and issuance.
- c) Premium collection.

d) Professional services for example, actuaries, accountants, and auditors etc.

9.6.5 The *takaful* operator will 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 Authority.

9.6.6 The *takaful* operator can only pay expenses out of the *takaful* fund if they are direct claims related, re-*takaful* expenses or direct investment related expenses. The expenses to be charged to the *takaful* fund must:

- a) Not have been previously incorporated into upfront fees or remuneration set by the *takaful* operator.
- b) Be endorsed by the Shari'ah Council.
- c) Be limited to the actual amount of expenses incurred.
- d) Be documented and disclosed to the participants in the marketing materials.

9.6.7 *Takaful* involves participants adopting a mutually supportive structure and subsequently the *takaful* operator should not make any discretionary ex-gratia payments. Any ex gratia payments request need to be reviewed and preapproved by the *Shari'ah* Council.

9.7 Remuneration of the Operator

9.7.1 The remuneration arrangements for the *takaful* operator will be set and documented in *takaful* contracts before a *takaful* agreement is signed.

9.7.2 The *takaful* operator will receive a fee or remuneration depending on the underlying *takaful* model and contracts.

9.7.3 *Takaful* operators will ensure at all times the appropriateness of the fees and charges being imposed on the *takaful* funds.

9.7.4 *Takaful* operators will 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.

9.8 Deficiency and Loss Rectification

9.8.1 Where assets of the PRF are insufficient to meet the liabilities of the PRF, *takaful* operators will immediately rectify the deficit via *qardhassan* from the shareholders' fund.

9.8.2 For the purpose of determining such deficit, *takaful* operators will be guided by the following:

- "Assets" refer to the total assets of the PRF, as reported in the balance sheet of the fund; and
- "Liabilities" refer to the sum of the actuarial liabilities and other liabilities of the PRF, as reported in the balance sheet of the fund.

9.8.3 The *qardhassan* from shareholders' fund will be repaid from the excess of assets over liabilities (as per the definition above) arising in the PRF in the future years.

9.8.4 The *takaful* operator will have a documented policy on deficit resolution for the Participants Risk Fund.

9.8.5 The policy must be endorsed by the *Shari'ah* Council and approved by the Board of Directors and includes the following:

- Events which would require the prompting of the *qardhassan*.
- The process and assessment methodology to determine loan repayments that provides assurance that there is nonegative short or long term impact on the fund in meeting participants' claims.
- Surplus distribution methodology to participants while the interest free loan is outstanding.
- Remuneration to *takaful* operator while the interest free loan is outstanding.
- Time period over which the interest free loan is to be repaid. In determining the suitable time period over which the loan shall be repaid, *takaful* operators should take into account the likelihood of loan repayment over the foreseeable future, considering the expected future experience of the fund to generate surplus and potential adverse impact to the viability of the fund should the loan persist.
- Circumstances where the loan may no longer be required to be repaid.
- Consideration required for any sub funds operated in the Participants Risk Fund.
- Where deficit occurrences in one fund are allowed to be offset with surpluses in another fund. This will have implications on the use of loan facilities and must be clearly defined in the policy.

9.8.6 The *takaful* operator cannot use interest free loan from its shareholders funds to meet any loss occurring in the Participants Investment Fund.

9.8.7 The *takaful* operator is required to make a transfer from its shareholders funds to the Participant Risk Fund or the Participants Investment Fund where a loss in either was the result of negligence or mismanagement by the *takaful* operator.

9.8.8 The *takaful* operator is required to report any scenario where loss has occurred or is expected to occur in either the Participants Risk Fund or Participants Investment Fund to the Authority.

9.9 Disclosure and Transparency

9.9.1 *Takaful* operators will be transparent in undertaking activities as part of *Shari'ah* compliance, good governance and to promote better understanding of *takaful*.

9.9.2 *Takaful* operators are expected to publish details of its operational model together with its underlying *Shari'ah* principles, to enable participants, stakeholders and public to better understand the underlying *takaful* operations. The information should be accurate, adequate and up-to-date to enable stakeholders to make an informed decision.

9.9.3 Information disclosed must be clear and understandable to the participants in documents used at the pre contractual stage, upon signing the contract and throughout the duration of the contract.

9.9.4 The level of information disclosed, in particular with respect to the operational model, the underlying *Shari'ah* principles, and the relevant terms and conditions of the *takaful* contract shall be appropriate to enable participants to clearly understand their rights, obligations and the risks associated with the product. 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 potential shortfall of the PIF and possibility of certificate lapsation.

9.9.5 *Takaful* operators will ensure consistency in information being disclosed in different documents. The information given to participants shall be consistent with the information submitted to the Authority.

9.9.6 Where a *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. Where the impact of the changes is material and financially significant, 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.

10.0 Enforcement

10.1 Remedial Measures

10.1.1 Where the Authority determines non-compliance with the provisions of this guideline, it may take any intervention as prescribed in the Insurance Act.

10.1.2 Where the Authority determines that the operator's non-compliance with the provisions of this guideline impacts the operator's ability to meet claims as and when they fall due, the Authority may issue such orders which it considers necessary to protect participants in accordance with the Insurance Act.

10.2 Administrative Sanctions

10.2.1 Where the Authority determines that an operator has not met the requirements of this directive including Shari'ah compliance, the Authority may impose any or all of the administrative sanctions to correct the situation in accordance with the provisions of the Insurance Act, including but not limited to:

- i. Prohibition from declaring and/or paying dividends.
- ii. Suspension or closure of the *takaful* operator to new business.
- iii. Monetary penalties.

11.0 Effective Date

The effective date of this guideline is 1st June 2015.

12.0 Transitional Arrangements

12.1.1 All applicants for a license to conduct business as a *takaful* operator must comply with the minimum requirements of this guideline with immediate effect.

12.1.2 All existing registered *takaful* operators who are currently not compliant with the requirements of the new directive shall be required to regularize their status by 31st December 2015.

13.0 Enquiry

Enquiries on any aspect of this guideline shall be referred to:

Address: The Technical Manager,
Insurance Regulatory Authority,
P.O. Box 43505-00100,
Nairobi

Telephone: +254 20 4996000

Facsimile: +254 20 2710126

E-mail: commins@ira.go.ke



Appendix 1 – Minimum Information for Documenting Operational Model

1. Contract underlying relationship between participants and *takaful* operator.
2. Contract underlying relationship between participants.
3. Fund segregation policy, with details of sub-fund if applicable.
4. Policy on investment strategy and method used for the calculation of investment profit for PIF.
5. Policy on recognition of surplus/deficit and its allocation/ distribution.
6. Policy on deficit rectification mechanism including the repayment of *qard*.
7. Remunerations to *takaful* operator policy and relevant *Shari'ah* principle/contract underlying the remunerations.
8. Any other relevant information which is necessary for holistic understanding of *takaful* operator's operational model.