General Council for Islamic
Banks And Financial Institutions

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المجلس العام للبنوك
والمؤسسات المالية الإسلامية

مؤسسة منتمية لمنظمة التعاون الإسلامي
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CIBAFI

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Mr. Jaseem Ahmed
Secretary General
Islamic Financial Services Board
Level 5, Sasana Kijang
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Kuala Lumpur
Malaysia

Dear Mr. Ahmed,

السلام عليكم ورحمة الله وبركاته،،،

CIBAFI Comments on the IFSB's Exposure Draft – 18 of Guiding Principles for Retakāful (Islamic Reinsurance)

The General Council for Islamic Banks and Financial Institutions (CIBAFI) compliments the Islamic Financial Services Board (IFSB) and takes this opportunity to express its appreciation of the work that the IFSB does to promote and enhance the Islamic financial services industry.

CIBAFI is the official umbrella for all Islamic financial institutions, whose services and products comply with the Shariah rules and principles. CIBAFI acts as the voice of the Islamic finance industry, where our members comprise banks and non-bank financial institutions, both large and small, and reach nearly 120 members from 30 countries and jurisdictions.

هاتف: ٣٠١ - ٣٠٠ ٣٥٧ ١٧ ٩٧٣+ فاكس : ٩٠٢ ٣٢٤ ١٧ / ٣٠٧ ٣٥٧ ١٧ ٩٧٣+ ص.ب: ٢٤٤٥٦ المنامة مملكة البحرين
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We would like to express our thanks to the IFSB for its efforts and commitment with respect to developing standards that accommodate the needs of the global Islamic finance industry. We noted the request for comments on the IFSB's Exposure Draft – 18 of Guiding Principles for Retakāful (Islamic Reinsurance) and welcome this opportunity to offer our comments and recommendations. The comments contained in this letter represent the general views of CIBAFI Secretariat and feedback received from our members. CIBAFI's perspective on the ED – 18 reflects our mission and the identity of our members. Our perspective is that of practitioners who will have to implement standards and regulations, while finding a balance between the requirements of the regulators, the market, their shareholders, customers, and other stakeholders.

1. The need to address special issues clearly

We acknowledge that the Exposure Draft – 18 (ED) has set out the basic principles and best practices pertaining to Retakāful activities, without superseding the previous IFSB standards on Takāful. While the ED focuses primarily on Retakāful at the level of the individual entity, we also note that with suitable modifications, the principles can be applied with respect to the group-wide Retakāful activities as well as for Retakaful Units (RTUs) operating in different jurisdictions.

However, we believe that all high level principles set out in the ED are very general, and are applicable to Takāful, Retakāful, insurance or reinsurance. The areas covered by the standard such as governance; code of ethics; due diligence; system and procedure; assurance of Sharī'ah compliance; adequate risk management framework; mechanism in place to ensure solvency; sound investment strategy; and appropriate disclosure are all "motherhood statements". Hence, in the special issues mentioned in Section VIII, Paragraph 27, we would appreciate if the IFSB can provide specific guidance with respect to how these issues can be addressed, such as through giving a specific reference to the principles in the document.. This is also to promote "harmonization" in the Retakāful industry. It would also be helpful to the industry that dedicated workshops can be organized in the future, which will certainly help the market players in addressing these issues and the regulators in establishing the appropriate framework.

2. Tackling the challenge of industry segmentation related to the international nature of the Retakāful business

We conform to the statement in the ED that Takāful undertakings may seek cover in international as well as domestic markets in order to avoid concentration of credit risk, and RTUs may seek cedants in different markets so as to obtain diversification of risks. We believe that this is highly relevant to the existing nature of Takāful and Retakāful industry, with (i) the absence of large number of participants, and (ii) the presence of homogeneous risks in Retakāful Risk Fund.

We note that the Guiding Principles focus more towards the Shariah compliance of any contractual relationships between conventional reinsurer/insurer and Retakāful/Takāful. In particular, the Guiding Principles rely heavily on the central role of Shariah governance of both Retakāful and Takāful, including the importance of Shariah adviser of those institutions. This is addressed in Principle 2.1., Paragraphs 73 – 84 and particularly 74 and 75. Given the complexity and lack of understanding of the business, this has been addressed in Principle 1.3, Paragraph 58.

However, we believe that applying these Principles is highly subject to different Sharī`ah interpretations across jurisdictions and institutional levels. Hence, the industry expects IFSB to come up with other Principles that are able to "standardize" the practice of Retakāful globally with respect to the existing international nature of the Retakāful business. One example is of how risk governance framework could play a central role in harmonizing the practices of Retakāful in different jurisdictions.

The ED also shows the various models of Retakāful in different countries, but it does not give any view or recommendation on which model to encourage, or address the issue of how to achieve the harmonization. In other words, the Guiding Principles need to address the challenges of industry segmentation, considering the existing nature of the current Retakāful industry. This is of importance to strengthen and broaden the market base of the Takāful industry. This will also provide the supervisor with a standardized framework towards Retakāful undertakings arising from overseas operations.

3. Risk sharing for capital-intensive of the Retakāful business

We believe that Retakāful /reinsurance is mostly needed for volatile risks as to which Takāful operators tend to have limitations. In that case, we note the statement in the ED, Section B.VIII. Paragraph 27.iv.b. that "…whereas a direct Takāful operation may reasonably plan to accumulate sufficient surplus, over time, within the PRF(Participant's Risk Fund) to make the PRF self-sufficient as to capital, an RTU is unlikely to be able to achieve this aim due to the size and volatility of its exposures." We also note in Section B. IX., Paragraph 28. that "…some parameters may be varied to recognise the generally greater volatility of reinsurance risks."

If it is necessary for a Retakāful operator to provide capital support to its Retakāful Risk Fund by way of *Qard*, as envisaged in IFSB-11, the time frame for repayment of that capital support is likely to be long. With the nature of Retakāful as a sharing business model, vis-a-vis conventional reinsurance which is 'risk transfer' in nature, the industry expects the IFSB to address this issue from a standard-setting perspective. Specifically, the opportunistic behavior might exist on the part of the Retakāful participants. Given the nature of Retakāful in sharing the risk instead of risk transfer, we believe that no Retakāful would want to share the highly-volatile risk with a Takāful operator if they know that their *Qard* will be irrecoverable or is of a very long term in nature. In addition, the IFSB may need to consider addressing the issue of risk modeling aspect of Retakāful operators with high volatile business to come up with some sort of a standardized formula.

4. Improving the governance framework for Retakāful

We note that the Guiding Principles have accommodated the governance framework for Retakāful Undertakings, including an appropriate code of ethics and conduct, the highest standards of truthfulness, honesty and fairness, due care and diligence in all its operations, the thoroughness of research and risk management, etc. Specifically, the ED has set out the main recommended best practices for good governance in Section C.I, Paragraph 41.

On the other hand, the industry is also aware of the most recent developments in the area of governance framework globally. The 2015 update to the OECD Principles heavily focuses on the rights of shareholders and the role they should play in the oversight of companies, while they also include recommendations on the Responsibilities of the Board, where all Boards should consider establishing audit committees and, committees to oversee risk management and remuneration, review its own performance and assess whether it possesses the right mix of backgrounds and skills, etc.

The 2015 update to the Basel Principles has also re-enforced the Board's responsibility to oversee the risk governance, key elements of risk governance, such as risk culture and risk appetite, as well as specific roles for the Board, the Board risk committee, senior management, and the control functions such as the independence of the CRO and internal audit.

Therefore, the industry expects the IFSB in this Exposure Draft to enhance the risk governance framework for each model of Retakāful as indicated. We believe that the IFSB standard needs to be at the same level in maintaining the governance strength aligned to the development in global regulations.

We remain at your disposal should you need any further clarifications on the above.

Yours sincerely,

Abdelilah Belatik
Secretary General

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