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Omar Mustafa Ansari

Secretary General

Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI)

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Dear Mr. Ansari,

السلام عليكم ورحمة الله وبركاته،،

**CIBAFI Comments on the AAOIFI Exposure Draft on “Presentation and
Disclosures in the Financial Statements of Takaful Institutions”**

The General Council for Islamic Banks and Financial Institutions (CIBAFI) presents its compliments to the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) and takes this opportunity to express its appreciation of the work that the AAOIFI 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, and our members comprise more than 130 Islamic banks and non-bank financial institutions, both large and small, from 34 jurisdictions.

We welcome this opportunity to offer our comments and recommendations on the AAOIFI exposure draft (ED) on the revised FAS 12: “Presentation and Disclosures in the Financial Statements of Takaful Institutions”. The comments contained in this letter represent the views of the CIBAFI Secretariat and feedback received from our members.

First: CIBAFI and its members noted that there are some areas in which the ED appears restrictive, though these may be oversights. One is that it seems to envisage that Takaful institutions will have no more than one participants’ Takaful fund (PTF) and no more than one participants’ investment fund (PIF), whereas in the past it has been envisaged that more than one PTF might be employed to group together different types of business. The ED also assumes that a Takaful institution will have external shareholders; it is difficult to see how it would be applied to a pure mutual model, which could be argued to be the purest form of Takaful. Nor does it seem to cope with the possibility of a Takaful institution where management is contracted out to an external operator (a structure which is sometimes used for small conventional mutuals).

These difficulties stem partly from the fundamental decision, in para IN5 (b), about the treatment of the PTF and PIF, which we note may be at variance with their legal treatment under companies and insolvency law in some jurisdictions.

Second: another fundamental point concerns the treatment of Qard Hasan when paid from shareholders’ funds to the PTF. The ED, in para IN6, indicates that Qard Hasan should be treated as a debt repayable from the PTF. The consequence of this would be that, in the insolvency or other resolution, the shareholders would have a claim on the PTF, leading to the possibility that not all of the Qard Hasan paid down would be available to pay policyholder claims. This is contrary to the normal aims of regulators, whose reason for requiring Qard Hasan is precisely to provide increased assurance that policyholder claims will be met, including in resolution. In our view, the final FAS should, at minimum, provide guidance on the accounting treatment to be followed where regulators impose requirements

intended to limit the ability of the extent to which Qard Hasan may be repaid to the owners' fund, either in a going concern situation or in resolution.

Third: the ED, in para 6, adds new definitions that do not exist in the previous standard. One definition is in para 6 (f) on “re-Takaful”. In this definition, a reference is made to Shariah Standard (SS) 26 on “Islamic Insurance” to refer to the principles of Takaful and mutuality that re-Takaful is also based upon. CIBAFI believe it would be better if a reference is also made to SS 41 on “Islamic Reinsurance” where a definition of re-Takaful already exists.

Two other definitions that are also added in this ED are in para 6 (h) for the “Takaful institution” and in para 6 (i) for the “Takaful operator”. It is observed that these two definitions can cause confusion for the reader on different levels. For example, within the definition of the “Takaful institution”, an explanation is provided at the end where it is mentioned that: *“The notion Takaful institution, unless the context suggests otherwise, includes the Takaful operator and the participants’ funds”*, however earlier in the definition it is mentioned that: *“The institution undertakes its operation based on a remunerated Wakala (agency) contract. In addition to managing the Takaful operations, the institution also assumes the responsibility of investing the assets of the fund through Mudaraba or investment agency”*. This latter statement can only be associated with the Takaful operator and not with the institution. There are other points where the usage of “Takaful institution” and “Takaful operator” appear inconsistent, and it is suggested that AAOIFI should review these uses wherever they appear.

Fourth: the ED, in para 7, lists the complete set of financial statements that a Takaful institution is expected to prepare. In the previous FAS 12, there has been a separate statement for sources and uses of funds in the Zakah and charity fund which has been removed in this ED of the revised standard to have it included in the notes of the financial statements following the revised FAS 1. CIBAFI and its members believe it would be clearer if a footnote is placed on para 7 (h) indicating that the notes include disclosures for

Zakah, charity, and Qard Hasan funds, even if this is already outlined in FAS 1. This will provide more clarity for institutions when transitioning into the implementation of the new revised standard.

Fifth: the ED, in para 11, outlines the accounting policies that a Takaful institution should disclose. In para 11 (c), disclosures on policies regarding the recognition of outstanding claims and claims incurred but not reported, and the recognition of provisions against onerous situations are mentioned. CIBAFI believe it would be better if a reference is made here to the AAOIFI FAS that governs this aspect. Also, in addition to the mentioned policies, some policies are not included under this section in the ED such as policies on reserves for the Takaful operator and the managed PTF, surplus distribution, and Zakah calculation. These areas are recommended to be added.

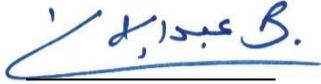
Finally, CIBAFI and its members notice that, in para BC10, it is mentioned that the standard is developed on *'the Wakala model and Wakala-Waqf model as both are accepted by AAOIFI SS, whereas the Mudaraba model and cooperative model are not acceptable'*. However, the mixed model, where Wakala bil Ujrah is used for operations and Mudaraba is used for investments, is not mentioned although the standard mentions previously the term 'Mudarib's share' and clearly regards this as permissible. It is recommended for this to be reflected in the ED to avoid confusion.

We would like to express our appreciation to AAOIFI for its great effort and commitment with respect to developing standards that accommodate the interest of the global Islamic finance industry.

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

The General Council for Islamic Banks and Financial Institutions takes this opportunity to renew to the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) the assurances of its highest respect and consideration.

Yours sincerely,



Dr. Abdelilah Belatik
Secretary General