Astana International Financial Centre

Astana Financial Services Authority

Consultation Paper

No. 13 of 2018

Proposed Takaful and Retakaful Legislative Framework in the AIFC

October 16, 2018

Introduction

1. The Astana Financial Services Authority (AFSA) has issued this Consultation Paper to invite public comments on the proposed AIFC Takaful and Retakaful legislation, including prudential rules (TRR). This paper summarises the approach taken to drafting legislative acts.

2. AIFC (Re)Takaful legislation has been drafted with regard to similar legislation in leading international financial centres. The purpose of TRR is to complement the regulatory framework established by the AIFC Financial Services Framework Regulations ("FSFR") by providing for the prudential regulation of takaful and retakaful companies. In terms of legislative hierarchy TRR sits beneath the FSFR.

3. The proposals in this Consultation Paper will be of interest to individuals, financial services companies, market institutions and investors who are interested in doing business in the AIFC.

4. All comments should be in writing and sent to the address or email specified below. If sending your comments by email, please use "Consultation Paper No 13" in the subject line. You may, if relevant, identify the organisation you represent when providing your comments. The AFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise. Comments supported by reasoning and evidence will be given more weight by the AFSA.

5. The deadline for providing comments on the proposals is **14 November 2018**. Once we receive your comments, we shall consider if any refinements are required to this proposal.

6. Comments to be addressed by post:

   Policy and Strategy Division

   Astana Financial Services Authority (AFSA)

   8 Kunayev Street, Building B, Astana, Kazakhstan
   or emailed to: consultation@afsa.kz

   Tel: +8 7172 613781

7. The remainder of this Consultation Paper contains the following:
   (a) Background to the proposals;
   (b) Key elements of the proposed legislation;
   (c) Annex 1: Draft Takaful and Retakaful Rules (TRR);

Background

1. In 2015 Astana was designated by the President of Kazakhstan as the location of the Astana International Financial Centre ("AIFC"). He stated the need to establish the AIFC on the base of the Expo-2017 infrastructure and to confer a special status on the AIFC. The AIFC participants, bodies and organisations will enjoy a special tax regime, special migration regime, special currency exchange regulation regime.

2. According to Article 2 of the Constitutional Statute of the Republic of Kazakhstan "On the Astana International Financial Centre" (the "Constitutional Statute"), the purpose of the AIFC is to establish a leading international centre for financial services. The objectives of the AIFC are as follows:

   (1) attracting investment into the economy of the Republic of Kazakhstan by creating an attractive environment for investment in the financial services sphere;

   (2) developing a securities market in the Republic of Kazakhstan and integrating it with international capital markets;

   (3) developing *insurance markets*, banking services, and *Islamic financing*, in the Republic of Kazakhstan;

   (4) developing financial and professional services based on international best practice;

   (5) achieving international recognition as a financial centre.

3. The purpose of the TRR Rules is to establish the regulatory framework for Authorised Firms carrying out Takaful Business which involve pooling of the risks faced by its participants in a Shari'ah-compliant manner. These rules are based on:

   (1) the standards and guidelines issued by the Islamic Financial Services Board on governance, risk management and solvency of Takaful businesses

   (2) the standards and guidelines issued by the Islamic Financial Services Board on Retakaful businesses;

   (3) the standards and guidelines issued by the IAIS in regard to governance, risk management and solvency of insurance businesses which also apply to Takaful /Retakaful businesses.

KEY ELEMENTS OF THE PROPOSED RULES

TRR 1 - General

4. TRR 1 introduces a number of key terms and concepts including Takaful Business. It requires Insurers to classify Takaful Contracts they write by reference to the categories of insurance identified in Schedules 1 and 2.

5. A feature of the leading international insurance regimes is a restriction on Takaful Operators combining different kinds of Takaful business. Such requirements are directed at limiting 'internal-contagion' risk. This is the risk that losses or liabilities from one activity might deplete or divert financial resources held to meet liabilities from another activity. TRR, therefore, prohibits Takaful Operators from carrying on both Family Takaful Business and General Takaful Business and requires Takaful Operators to limit non-insurance activities to those that are directly connected with, or carried on for the purposes of, takaful business; guidance explains which activities will normally be considered to be directly connected.

6. TRR 1 also contains guidance as to the more limited extent to which the TRR regime will apply to branches of entities established outside the AIFC. The term AIFC-Incorporated Takaful Operator is used to refer to a Takaful operator that is incorporated as a legal entity under the laws of the AIFC and thus excludes branches of legal entities incorporated outside the AIFC. TRR 1.5 sets out the core obligations of Takaful Operators by reference to the various chapters of TRR. A number of these obligations are limited to AIFC-Incorporated Takaful Operators.

TRR 2 – Governance Framework

7. A Takaful Operator must ensure the adoption and effective implementation of sound risk management practices, robust Shari'ah governance and high standards of business conduct. The board of directors and senior management of a Takaful Operator are responsible for ensuring such effective governance framework as it is critical for achieving the objectives of the TRR rules.

TRR 3 - Risk Management Strategy

8. TRR 3 requires a Takaful Operator to establish and maintain a risk management strategy. This should be clearly defined and well documented, and take into account the Takaful Operator's overall business strategy and its business activities. This strategy contains a number of important components including a Risk Management Policy setting out how all relevant and material categories of financial and non-financial risk are monitored, measured and managed, both in the Takaful Operator's business strategy and its day-to-day operations. Schedule 3 sets out in detail what the AFSA would expect to find covered in a Takaful Operator's Risk Management Policy. A Takaful Operator is also required to prepare a Risk Tolerance Statement which sets out its overall quantitative and qualitative risk tolerance levels.

TRR 4 - Own Risk and Solvency Assessment (ORSA)

9. A feature of the leading international regimes is a requirement that Takaful Operator perform an own risk and solvency assessment (ORSA) regularly to assess the adequacy of its risk management and current, and likely future, solvency position.

10. TRR 4 contains a requirement that every AIFC-Incorporated Takaful Operator (i.e. an Takaful Operator which is not a branch) must conduct an ORSA annually (or with greater frequency if preferred by the AFSA), and that such ORSA must be appropriate to the nature, scale and complexity of the insurer's business. TRR then sets out a detailed explanation of what an ORSA is, its contents, and the matters to which an insurer must have regard in conducting an ORSA. An AIFC-Incorporated Takaful Operator is required to prepare a report after it conducts its ORSA, which is to be reviewed and approved by the Takaful Operator's Governing Body.

TRR 5 - Capital adequacy requirements

11. The amount of capital available to a Takaful Operator is fundamental to its financial strength. It provides a buffer against losses that have not been anticipated and, in the event of problems, enables the insurer to continue operating while those problems are addressed or resolved. In this way, the maintenance of adequate capital resources can engender confidence on the part of policyholders, creditors and the market more generally in the financial soundness and stability of the insurer. TRR 5 accordingly requires an AIFC-Incorporated Takaful Operator to calculate its qualifying capital resources (referred to as its Eligible Capital) on an ongoing basis and to monitor the extent to which its Eligible Capital exceeds two benchmarks referred to as the Minimum Capital Requirement (MCR) and the Prescribed Capital Requirement (PCR).

12. Schedule 4 sets out detailed rules for the calculation of Eligible Capital and identifies two types of capital (Tier 1 and Tier 2 Capital) that an AIFC-Incorporated Takaful Operator is permitted to recognise and which it is obliged to hold in specified ratios. Schedule 5 sets out the calculation for the MCR relating to Family Takaful Business and General Takaful Business. Schedule 6 identifies a more detailed methodology for calculating the PCR which involves a highly sensitive analysis of the different types of risk engendered by the Takaful Operator's Takaful Business.

13. TRR 5.3 provides that an AIFC-Incorporated Takaful Operator may be permitted by the AFSA under certain circumstances to use its own internal models to calculate either the whole or a component of the PCR. However, it should be noted that the AFSA does not initially anticipate accepting applications for permission to use internal models.

14. TRR 5.4 sets out the "solvency control levels" which place various obligations upon an Takaful Operator should it become aware that its Eligible Capital has fallen below or close to either level. Guidance sets outs an indicative range of actions that AFSA may take on breach of either the MCR or the PCR.

15. Further provisions limit the circumstances in which an AIFC- Takaful Operator is permitted to reduce its Eligible Capital and require an AIFC-Incorporated

Takaful Operator to notify the AFSA of all dividends and other distributions to shareholders.

TRR 6 - Investment

16. TRR 6.1 requires Takaful Operator i.e. all Takaful Operators including branches) to ensure that where they invest in assets they invest in assets that are secure, liquid, appropriately located and suitably diversified. Takaful Operators are required to invest in a manner appropriate to their liabilities and only to invest in assets where they are able to assess and manage the risks involved. TRR 6.2 restricts Takaful Operator from investing in certain high risk assets and TRR 6.3 requires Takaful Operator to maintain written risk policies and procedures.

TRR 7 - Segregation of Family Takaful assets and liabilities

17. TRR 7 requires Takaful Operator carrying on Family Takaful Business to segregate the takaful liabilities and matching assets of the various categories of Family Takaful and to establish a fund to which Family Takaful Contracts are attributed. The effect of this is that such assets may only be used to meet obligations to the policyholders with respect to which the fund has been established. Limitations are placed by TRR 7.4 upon the use of assets in a Family Takaful Fund.

TRR 8 - Valuation

18. TRR 8 sets out rules regarding matching of Takaful Operator's assets to liabilities, on the basis of a consistent and transparent economic valuation of those assets and liabilities. An economic valuation of assets and liabilities reflects the risk-adjusted present values of their cash flows. The basic principle of measurement that a Takaful Operator must adopt as the basis of its accounting is specified as the IFRS.

19. TRR 8.1 requires a Takaful Operator to hold supporting assets of a value at least equal to the amount of its liabilities. TRR 8.2 sets out basic principles for the recognition and valuation of such assets and liabilities. TRR 8.3 identifies particular assets relating to General Takaful Business which require special treatment, namely premium liability, future claims payments and expected recoveries. TRR 8.4 takes a similar approach for certain Family Takaful assets and liabilities namely policy benefits due before the Solvency Reference Date (i.e. the date of measurement) and the net value of future policy benefits.

TRR 9 - Actuarial reporting

20. TRR 9 elaborates on the requirements for Insurers which are obliged to retain an Approved Actuary, requiring in particular that an Approved Actuary carry out annually an actuarial investigation to enable him to prepare a report about the insurer's financial condition (a "financial condition report") which is to be submitted to the AFSA annually at the time of the insurer's annual regulatory return. The AFSA will also have a power to direct that financial condition reports more frequently than annually, and also to direct an insurer that the Approved Actuary is to carry out an investigation into any matter which the AFSA specifies.

21. TRR 7.2 requires Takaful Operators not required to appoint an Approved Actuary to consider annually whether to commission an independent actuary to report on its business, and to commission such a report at least once every 3 years.

TRR 10 – Takaful Operators that are members of Groups

22. A Takaful Operator is exposed to risks through the relationships that it has with other companies in its group. Group membership can be a source of strength, but it can also be a source of weakness. TRR 10 contains additional requirements for Takaful Operators that are members of a group to ensure that: (i) the Takaful is capitalised adequately to protect itself against the risks arising from its membership of the group, and is otherwise protected against those risks; (ii) it can be properly supervised by the AFSA; (iii) it provides the AFSA with information about the structure and financial position of the group; and (iv) it assesses the effect of, and notifies the AFSA of, certain transactions within the group.

23. The effect of these provisions is broadly as follows. The structure of a Takaful Operator's group is to be transparent with clear governance, controls and reporting lines, and such that it does not hinder the Takaful Operator's stability and solvency. The AFSA has the power to direct that a Takaful Operator hold additional capital to cover risks arising because of the Takaful Operator's group membership. Takaful Operators are to ensure that any material transaction with another member of its group is entered into on an 'arms-length' basis and on fair and reasonable commercial terms. Certain transactions – such as inter-group loans, guarantees or investments – are not to be entered into unless the Takaful Operator's Governing Body is satisfied that it does not adversely affect the interests of policyholders.

TRR 11 - Transfer of Takaful business

24. TRR 11 then sets out various requirements which will apply to application for an order of the AIFC Court effecting an Takaful Business Transfer. These include that a report ("the Scheme Report") be prepared by an independent actuary. This report is to be put before the AIFC Court and, among other things, must contain: a rationale for the proposed relevant scheme; the categories of business to be transferred; and a confirmation that there will be no materially adverse consequences from the proposed transfer to the policyholders of either the transferor or transferee. Notification of the proposed transfer must also be given to all affected Policyholders.

TRR 12 – Takaful Operators in run-off

25. TRR 15 applies to all AIFC-Incorporated Takaful Operators along with Branches in respect of their AIFC Takaful Business and contains requirements that apply where such insurer has gone into "run-off". This means that an Takaful Operator has ceased to effect Takaful Contracts in respect of the whole or a category of its Takaful Business.

26. Takaful operator that go into run-off will be required to notify the AFSA and provide a run-off plan complying with TRR 12.3, including an explanation of how, or the extent to which, all liabilities to policyholders will be met in full as

they fall due. A Takaful operator in run-off will be required to notify the AFSA of certain contracts and be restricted from making certain distributions.

TRR 13 - Prudential returns

27. TRR 13 requires Takaful Operators to prepare and submit to the AFSA the annual, biannual and quarterly prudential returns set out in Schedule 7 (Prudential returns by Takaful Operator).

TRR 14 - Captive Takaful Operators

28. TRR 14 applies only to Captive Takaful Operators. A Captive Takaful Operators is an Authorised Firm with a Licence to carry on Captive Takaful Business. Captive Takaful Business is defined as the business of effecting or carrying out Takaful Contracts only for the business or operations of the Group to which the Captive Takaful Operators. Only an Authorised Firm which is incorporated under the laws of the AIFC may apply to the AFSA for a Licence to conduct Captive Takaful Business.

29. A Captive Takaful Operator may take the form of a Protected Cell Company (PCC) - which is a form of legal entity that will be introduced under planned amendments to the Companies Regulations. PCCs consist of a core and one or more cells which are legally segregated for the purposes of insolvency law. A Captive Takaful Operator incorporated as a PCC may maintain multiple cells, but requires the permission of the AFSA to create a new cell.

30. The requirements of TRR apply to Captive Takaful Operators either in full or with the modifications set out in TRR 14.3 to 14.14. The key modifications are as follows:

    a. Systems and controls: A Captive Takaful Operator is permitted to outsource its risk management and actuarial functions to a Captive Insurance Manager. This refers to an Authorised Person carrying on the new regulated activity of Captive Insurance Management.

    b. Risk management: A Captive Takaful Operators is required to maintain a Risk Management Strategy and conduct an ORSA in accordance with TRR 3. However, it may apply to the AFSA for a waiver of the requirement to conduct an ORSA.

    c. Capital Adequacy: The requirements of TRR 5 apply to Captive Takaful Operators save for a modified Capital Floor (the base requirement of the MCR) and modifications relating to the application of the capital requirements to PCCs.

Question:

Do you have any concerns relating to the proposed regulatory requirements to (re) insurance companies? If so, what are they, and how should they be addressed?

ANNEX 1

draft Takaful and Retakaful Rules 2018 (TRR)

Contents

1 General provisions 5

1.1 Introductory 5

1.2 Insurance Business 5

1.3 Classification of Contracts of Insurance 6

1.4 Restrictions in respect of Insurance Business 6

1.5 Core obligations of Insurers 7

2 Systems and Controls 10

2.1 Systems for risk management and internal controls 10

2.2 Controlled Functions 11

3 Risk Management Strategy 14

3.1 Risk Management Strategy 14

4 Own Risk and Solvency Assessment (ORSA) 18

4.1 The ORSA 18

4.2 The ORSA Report 20

5 Capital adequacy requirements 21

5.1 Application and purpose 21

5.2 Calculation of Eligible Capital and capital requirements 21

5.3 Use of Internal models to calculate capital requirements 21

5.4 Solvency control levels 25

5.5 Reduction of Eligible Capital 28

5.6 Notification of dividends and distributions 29

6 Investment 30

6.1 Admissible assets 30

6.2 Investment restrictions 32

6.3 Investment policy and procedures 32

7 Segregation of Long Term Insurance assets and liabilities 33

7.1 Establishment of Long Term Insurance Funds 33

7.2 Attribution of contracts to a Long Term Insurance Fund 34

7.3 Segregation of assets and liabilities 35

7.4 Recordkeeping 36

7.5 Limitation on use of assets in Long Term Insurance Fund 36

8 Valuation 39
8.1 Matching assets and liabilities 39
8.2 Recognition and measurement of assets and liabilities 40
8.3 Treatment of particular assets and liabilities - General Insurance Business 43
8.4 Treatment of particular assets and liabilities - Long Term Insurance 43
9 Actuarial reporting 46
9.1 Insurers that are required to have Approved Actuaries 46
9.2 Insurers that are not required to have an Approved Actuary 50
10 Insurers that are members of Groups 54
11 Transfer of insurance business 60
11.1 Introduction 60
11.2 Sanction Order 60
11.3 The Scheme Report 61
11.4 Notice requirements 63
12 Insurers in run-off 65
12.1 Application and purpose 65
12.2 Insurers ceasing to effect Contracts of Insurance in a category 66
12.3 Run-off plans 67
12.4 Provisions in respect of contracts relating to Insurance Business in run-off 69
12.5 Limitations on distributions by AIFC-incorporated Insurers in run-off 70
13 Prudential returns 71
14 Captive Insurers 73
14.1 Introduction 73
14.2 Protected Cell Companies 73
14.3 Systems and Controls 74
14.4 Risk Management Strategy 75
14.5 Own Risk and Solvency Assessment (ORSA) 75
14.6 Capital adequacy requirements 75
14.7 Investment 76
14.8 Segregation of Long Term Insurance assets and liabilities 76
14.9 Valuation 77
14.10 Actuarial Reporting 77

14.11 Insurers that are members of Groups 77
14.12 Transfer of insurance business 77
14.13 Insurers in run-off 77
14.14 Prudential returns 78
Schedule 1 Categories of General Insurance 79
Schedule 2 Categories of Long Term Insurance 83
Schedule 3 Guidance about what should be included in an Insurer's Risk Management Policy 84
Schedule 4 Calculation of Eligible capital 106
Schedule 5 Calculation of Minimum Capital Requirement (MCR) 114
Schedule 6 Calculation of Prescribed Capital Requirement (PCR) 117
Schedule 7 Prudential returns by Insurers 132
WORKING SCHEDULE 1 - List of Defined Terms for TRR and associated rulebooks 134

1 General

1.1 Introduction

1.1.1 Name of rules

These rules are the AIFC Takaful and Retakaful Rules 2018 (or TRR).

1.1.2 Purpose

The purpose of this TRR Rules is to establish the regulatory framework for Authorised Firms carrying out Takaful Business which involve pooling of the risks faced by its participants in a Shari'ah-compliant manner. These rules are based on:

(a) the standards and guidelines issued by the Islamic Financial Services Board on governance, risk management and solvency of Takaful businesses

(b) the standards and guidelines issued by the Islamic Financial Services Board on Retakaful businesses;

(c) the standards and guidelines issued by the IAIS in regard to governance, risk management and solvency of insurance businesses which also apply to Takaful /Retakaful businesses.

1.1.3 Application of TRR

(1) These rules apply to every Takaful Operator except where otherwise provided.

(2) These rules are also applicable to every Retakaful Operator. Except as stated otherwise, all references to a Takaful Operator in the TRR rules must be read as referring also to a Retakaful Operator. Consequently, all the regulatory requirements imposed by these TRR Rules apply to all entities licensed to carry out Takaful Business as defined in Rule 1.1.6 (1) including Retakaful Operators, except for specific sections or rules wherein their applicability is defined in a particular manner. For clarity, all the regulatory requirements imposed by the TRR Rules apply to Retakaful Operators, unless otherwise specified in the TRR.

1.1.4 Commencement

These rules commence on 1 January 2019.

1.1.5 Effect of definitions, notes, examples and references

A definition in the glossary to these rules also applies to any instructions or document made under these rules.

(a) A note in or to these rules is explanatory and is not part of these rules. However, examples and guidance are part of these rules.

(b) An example is not exhaustive, and may extend, but does not limit, the meaning of these rules or the particular provision of these rules to which it relates.

(c) Unless the contrary intention appears, a reference in these rules to an accord, principle, standard or other similar instrument is a reference to that instrument as amended from time to time.

1.1.6 Key Definitions

(1) Takaful Business is the part of Insurance Business conducted by a Takaful Operator that is Islamic Financial Business as defined in AIFC IFR rule 1.5.

(2) A Takaful Operator is

(a) an Islamic Financial Institution that conducts Takaful Business; or

(b) an AIFC-Incorporated Insurer operating an Islamic Window (within the meaning of AIFC IFR rule 1.8).

(3) A Takaful Fund is a fund established and maintained by a Takaful Operator under Rule _____, for its Takaful business.

Guidance: Branches

Note that certain of the obligations set out in this rulebook do not apply to Takaful Operators that are Branches of entities established and regulated outside the AIFC. The term AIFC-Incorporated Takaful Operator is used to refer to a Takaful Operator that is incorporated as a legal entity under the laws of the AIFC and thus excludes Branches of legal entities incorporated outside the AIFC.

1.1.7 Principles underlying TRR rules

The TRR rules are based on the following principles:

(a) Ensure compliance with Shari'ah;

(b) Enable better alignment of risk-return objectives of a Takaful Operator consistent with its fiduciary duty to manage its Takaful Business in a sound manner;

(c) Provide incentives for Takaful Operators to manage business in a risk-based manner and adopt prudent practices;

(d) Provide an early warning signal on any deterioration in capital adequacy or solvency levels to enable prompt and pre-emptive actions to be taken by Takaful Operator and the AFSA;

(e) Promote transparency as a means to protect the interests of participants of the Takaful fund; and

(f) Reduce opportunities for regulatory arbitrage with the conventional insurance business and with the rest of the financial sector.

1.2 Takaful Business

1.2.1 Types of Takaful Business

(1) General Takaful Business is Takaful Business in relation to General Insurance Contracts.

(2) Family Takaful Business is Takaful Business in relation to Long Term Insurance Contracts.

1.2.2 Types of Takaful Contracts

(1) A General Takaful Contract is a Shari'ah-Compliant Contract of Insurance that falls within one of the categories set out in Schedule 1.

(2) A Family Takaful Contract is a Shari'ah-Compliant Contract of Insurance that falls within one of the categories set out in Schedule 2.

1.3 Classification of Takaful Contracts

1.3.1 Classification of contracts

A Takaful Operator must, in its own records, classify all Takaful Contracts carried out by it, including all Contracts of Reinsurance entered into by it as cedant, according to the category to which the Takaful Contracts relate.

1.3.2 Classification of contracts falling into two or more categories

Where a Takaful Contract relates to more than one category, the Takaful Operator must record separately the portions of the Takaful Contract that relate to each category, except that immaterial portions need not be separately recorded.

Guidance

A portion of a Takaful Contract insuring a risk of a category other than the principal category to which the contract relates, will not normally be regarded as material if the interest that it insures is both related and subsidiary to the principal interest or interests insured under the contract, and constitutes less than 10% of the gross written premium under the contract.

1.4 Restrictions in respect of Takaful Business

1.4.1 Restriction on combining certain kinds of Takaful Business

A Takaful Operator must not carry on, in or from the AIFC, both Family Takaful Business and General Takaful Business unless the General Takaful Business is restricted to General Takaful Categories 1 (accident) and 2 (sickness).

1.4.2 Restriction on Takaful Operators carrying on non-Insurance Business

(1) A Takaful Operator must not carry on any activity other than Insurance Business unless the activity is directly connected with, or carried on for the purposes of, Insurance Business.

(2) For this rule, managing investments is not an activity directly connected with, or carried on for the purposes of, Insurance Business.

Guidance

1. The following activities will normally be considered to be directly connected with, or carried on for the purposes of, Insurance Business carried on by an Insurer:

   a. investing, reinvesting or trading, as investor and for the Insurer's own account, that of its subsidiary, its holding company or any subsidiary of its holding company but not any other party, in shares, debt instruments, investment accounts, units in collective investment schemes, or other forms of investments that are intended to earn profit or return for the investor;

   b. rendering other services related to insurance business operations including actuarial, risk assessment, loss prevention, safety engineering, data processing, accounting, claims handling, loss assessment, appraisal and collection services;

   c. acting as agent for another Insurer in relation to Contracts of Insurance in which both Insurers participate;

   d. establishing subsidiaries or associates engaged or organised to engage exclusively in 1 or more of the businesses mentioned in a. to c.;

   e. insurance mediation.

2. The AFSA may give individual guidance on other business activities that may be taken to be directly connected with, or carried on for the purposes of, Insurance Business carried on by A Takaful Operator.

1.5 Core obligations of Insurers

1.5.1 Obligation to establish and maintain systems and controls

A Takaful Operator must establish and maintain systems and controls in accordance with the requirements of TRR 2 (Governance Framework) and GEN 5 (Systems and Controls).

1.5.2 Obligation to maintain a risk management strategy

A Takaful Operator must establish and implement a Risk Management Strategy in accordance with the requirements of TRR 3 (Risk Management Strategy).

1.5.3 Obligation to conduct Own Risk and Solvency Assessment

An AIFC-Incorporated Takaful Operator must conduct an Own Risk and Solvency Assessment and submit a report thereon to AFSA in accordance with the requirements of TRR 4.

1.5.4 Obligation to maintain Eligible Capital

An AIFC-Incorporated Takaful Operator must at all times maintain Eligible Capital in an amount and of a quality required by TRR 5.

1.5.5 Obligations in respect of Investments

A Takaful Operator must make investments in accordance with the requirements of TRR 6 (Investments).

1.5.6 Obligation to maintain Long Term Takaful Funds

A Takaful Operator carrying on Family Takaful Business must segregate its Family Takaful assets and liabilities in accordance with TRR 7 (Segregation of Family Takaful assets and liabilities)

1.5.7 Obligations in respect of Assets and Liabilities

An AIFC-Incorporated Takaful Operator must value its assets and liabilities in accordance with the requirements of TRR 8 (Valuation).

1.5.8 Obligation to produce actuarial reports

A Takaful Operator must prepare and submit to the AFSA the actuarial reports that it is required to produced pursuant to the requirements of TRR 9 (Actuarial reporting).

1.5.9 Obligations in respect of groups

A Takaful Operator that is a member of a group must comply with the requirements of TRR 10 (Takaful Operators that are members of Groups).

1.5.10 Obligations in respect of Takaful Business Transfers

A Takaful Operator that is party to an Takaful Business Transfer must comply with the requirements of TRR 11 (Transfer of Takaful business).

1.5.11 Obligations in respect of Run-off

A Takaful Operator that is in Run-off must comply with the requirements of TRR 12 (Takaful Operators in run-off).

1.5.12 Obligation to prepare prudential returns

A Takaful Operator must prepare the prudential returns that it is required to produced pursuant to TRR 13 (Prudential returns).

2 Governance Framework

2.1 Overall Governance

A Takaful Operator must ensure the adoption and effective implementation of sound risk management practices, robust Shari'ah governance and high standards of business conduct. The board of directors and senior management of a Takaful Operator are responsible for ensuring such effective governance framework as it is critical for achieving the objectives of the TRR rules.

2.2 Takaful Funds and their Governance

2.2.1 Takaful Funds – establishment & attribution of business

(1) A Takaful Operator must establish and maintain one or more Takaful Funds for its Takaful Business.

(2) A Takaful Operator must attribute all Takaful Business that it conducts to one or more of the Takaful Funds it operates.

2.2.2 Takaful Funds – Allocation of assets

(1) A Takaful Operator must ensure the assets allocated to a particular Takaful Fund are only allocated, apart from the exceptions provided for in the rest of this rule below, for the purposes of the Takaful Fund to which it is attributed and must not be allocated or made available for any other purpose of the Takaful Operator.

(2) Rule 2.1.2 (1) above does not preclude the reimbursement of expenditures borne by the shareholders of the Takaful Operator (in the same or the preceding financial year) in discharging liabilities wholly or partly attributable to a Takaful Fund.

(3) Rule 2.1.2 (1) above does not apply to the payment of management fees by a Takaful Fund to the Takaful Operator or an investment manager to whom management of the Takaful Fund has been delegated, even where the manager is the shareholder of the Takaful Operator, provided that the Shari'a supervisory board of the Takaful Operator has approved those fees.

(4) Rule 2.1.2 (1) above does not prevent a Takaful Operator from exchanging, at fair market value, Takaful business assets of any Takaful Fund for other assets of the Takaful Operator including assets held by another Takaful Fund or assets held by the shareholder of the Takaful Operator.

2.2.3 Takaful Funds – Fair transactions

A Takaful Operator must have adequate arrangements for ensuring that transactions involving assets of the Takaful Operator (other than transactions outside its control) do not operate unfairly between a Takaful Fund established and maintained under rule 2.1.1 and the shareholder assets of the Takaful

Operator or, in the case where the Takaful Operator has more than one Takaful Fund, between those Takaful Funds.

2.2.4 Takaful Funds – Prohibition on making or attributing loans

A Takaful Operator must not make or attribute any loans from a Takaful Fund it operates to another Takaful Fund or to any other party, including but not limited to:

(a) the Takaful Operator;

(b) a person in a controlled function;

(c) a participant (policyholder) in the Takaful Fund; and

(d) a controller or person with close links to the Takaful Operator.

Guidance: systems and controls requirements in GEN

As an Authorised Person, A Takaful Operator is required to comply with the Systems and Controls requirements in GEN 5. The requirements of this Chapter are in addition to the requirements of GEN 5.

Guidance: Relevance of the IAIS Insurance Core Principles

In assessing A Takaful Operator's compliance with the systems and controls requirements in GEN 5 and in this Chapter, the AFSA will have regard to the detailed guidance in ICP 8 (Risk Management and Internal Controls). In particular:

- In assessing A Takaful Operator's compliance with GEN 5.1 (Systems and Controls: general requirements), GEN 5.3 (Corporate Governance) and GEN 5.6 (Conflicts of Interest), the AFSA will have regard to the guidance in ICP 8.1 and 8.2 (Systems for risk management and internal controls) and ICP 8.3 (Control function (general)).
- In assessing A Takaful Operator's compliance with GEN 5.2 (Outsourcing), the AFSA will have regard to ICP 8.8 (Outsourcing of material activities or functions).
- In assessing A Takaful Operator's compliance with GEN 5.4 (Compliance), the AFSA will have regard to the guidance in ICP 8.5 (Compliance function).
- In assessing A Takaful Operator's compliance with GEN 5.5 (Internal audit), the AFSA will have regard to the guidance in ICP 8.7 (Internal audit function).

- In assessing A Takaful Operator’s compliance with TRR 2.1.1, the AFSA will have regard to the guidance in ICP 8.4 (Risk management function).
- In assessing A Takaful Operator’s compliance with TRR 2.1.1, the AFSA will have regard to the guidance in ICP 8.6 (Actuarial function).

2.3 Systems for risk management and internal controls

2.3.1 Risk management function

A Takaful Operator must establish and maintain an effective risk management function capable of assisting the Takaful Operator to identify, assess, monitor, mitigate and report on its key risks in a timely way; and to promote and sustain a sound risk culture.

Guidance: additional requirements in GEN

A Takaful Operator is also subject to obligations in respect of operational risk, legal risk and fraud risk pursuant to GEN 5.8 (Management of risks).

2.3.2 Actuarial function

A Takaful Operator must establish and maintain an effective actuarial function capable of evaluating and providing advice regarding, at a minimum, technical provisions, premium and pricing activities, capital adequacy, reinsurance and compliance with related statutory and regulatory requirements.

2.4 Controlled Functions

2.4.1 Designation of roles as Controlled Functions

The following functions are prescribed as Controlled Functions within the meaning of section 20 of the FSFR:

(a) Risk Officer;

(b) Internal Auditor; and

(c) Approved Actuary.

Guidance: relationship with GEN

Rules in this section supplement, and should be read in conjunction with, the Rules in GEN 2.2 (Controlled and Designated Functions). In particular a Takaful Operator should note the following requirements of general application to Controlled Functions and the Approved Individuals performing them:

- GEN 2.2.6. Application for Approved Individual status
- GEN 2.2.7. AFSA discretion to waive requirements

- GEN 2.2.8. Modification or withdrawal of an Approved Individual's registration
- GEN 2.2.9. Dismissal or resignation of an Approved Individual

2.4.2 Obligation to appoint Approved Individuals to certain roles

(1) A Takaful Operator must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

(a) Risk Officer; and

(b) Internal Auditor.

(2) A Takaful Operator must also appoint an Approved Actuary and ensure that such role is held at all times by an Approved Individual if:

(a) it conducts Family Takaful Business; or

(b) it conducts General Takaful Business and;

(i) more than 15% of its gross outstanding liabilities are attributable to Takaful Contracts for General Takaful Business in General Insurance 1 (Accident) or 2 (Sickness); or

(ii) more than 20% of its gross outstanding liabilities are attributable to Takaful Contracts for General Takaful Business in General Insurance Categories 10 (Motor vehicle liability), 11 (Aircraft liability), 12 (Liability of ships), 13 (General liability), 14 (Credit) or 15 (Suretyship).

2.4.3 Risk Officer

The Risk Officer is an individual who has responsibility for the Takaful Operator's risk management function.

2.4.4 Internal Auditor

The Internal Auditor is an individual who has responsibility:

(a) for the Takaful Operator's internal audit policies, procedures and controls; and

(b) for taking appropriate steps to ensure the implementation of and compliance with those policies, procedures and controls.

2.4.5 Approved Actuary

(1) The Approved Actuary is an individual who has responsibility:

(a) for the Takaful Operator's actuarial policies, procedures and controls; and

(b) for taking appropriate steps to ensure the implementation of and compliance with those policies, procedures and controls.

(2) The Approved Actuary must not be an individual who:

(a) exercises the Senior Executive Function for the Takaful Operator or a related body corporate (except a related body corporate that is a subsidiary of the Takaful Operator); or

(b) is an Employee or Director of an auditor for the Takaful Operator.

3 Risk Management Strategy

3.1 Risk Management Strategy

3.1.1 Core obligations

(1) A Takaful Operator must establish, document and implement a Risk Management Strategy that is appropriate to the nature, scale and complexity of its business.

(2) A Takaful Operator must not intentionally deviate in a material way from its Risk Management Strategy unless such deviation has been

(a) approved by its Governing Body in accordance with TRR 3.1.5 (Approval of Risk Management Strategy) below; and

(b) notified to the AFSA in accordance with TRR 3.1.6 (Notification of the AFSA) below.

3.1.2 Contents of Risk Management Strategy

A Takaful Operator's Risk Management Strategy must:

(a) provide for the identification and quantification of material risks under a sufficiently wide range of outcomes using techniques which are appropriate to the nature, scale and complexity of the risks it bears;

(b) include a Risk Management Policy that complies with TRR 3.1.3 (Contents of Risk Management Policy);

(c) include a Risk Tolerance Statement that complies with the requirements of TRR 3.1.4 (Contents of Risk Tolerance Statement);

(d) be supported by accurate documentation;

(e) describe how the Takaful Operator will:

(i) ensure that relevant staff have an awareness of risk issues and the accessibility of the Risk Management Strategy; and

(ii) instil an appropriate risk culture; and

(f) include a business continuity plan for ensuring that critical business operations can be maintained or recovered in a timely fashion in the event of disruption.

(g) be responsive to changes in its risk profile; and

(h) incorporate a feedback loop, based on appropriate and good quality information, management processes and objective assessment, which enables it to take the necessary action in a timely manner in response to changes in its risk profile.

Guidance: Risk Management Strategy

In assessing a Takaful Operator's compliance with TRR 3.1.1(a), the AFSA will have regard to the guidance in ICP 16.1 (Enterprise risk management framework - risk identification and measurement).

3.1.3 Contents of Risk Management Policy

A Takaful Operator's Risk Management Policy must:

(a) describe how all relevant and material categories of financial and non-financial risk are monitored, measured and managed, both in the Takaful Operator's business strategy and its day-to-day operations, including at least the following risks:

(i) credit risk;

(ii) balance sheet and market risk (including investment, asset-liability management, liquidity and derivatives risks);

(iii) reserving risk;

(iv) Takaful risk (including underwriting, product design, pricing and claims settlement risks);

(v) reinsurance risk;

(vi) operational risk (including business continuity, outsourcing, fraud, technology, legal and project management risks);

(vii) concentration risk;

(viii) group risk.

(b) describe the relationship between the Takaful Operator's tolerance limits, regulatory capital requirements, economic capital and the processes and methods for monitoring risk;

(c) include the following specific policies:

(i) a policy regarding investment that specifies the nature, role and extent of the Takaful Operator's investment activities and how the Takaful Operator complies with the investment requirements under these rules;

(ii) a policy regarding asset-liability management that specifies the nature, role and extent of asset-liability management activities and their relationship with product development, pricing and investment management;

(iii) a policy regarding underwriting that specifies the risks to be accepted by the Takaful Operator as part of its Takaful business, the processes for underwriting, pricing and claims settlement;

(iv) a policy ensuring that any Contract of Retakaful / insurance to which it is a party is finalised (and the material documents supporting the contract are completed) before the start of reinsurance cover (the start date), or as soon as possible after the start date (but in no case later than 60 days after the start date);

(v) a policy regarding procedures for business continuity that enable the Takaful Operator to manage any initial disruption of business and to recover critical business operations following such a disruption.

Guidance: contents of Risk Management Policy

Detailed guidance as to what the AFSA would expect to be included in a Takaful Operator's Risk Management Policy may be found in Schedule 3 (Guidance about what should be included in a Takaful Operator's Risk Management Policy). Takaful Operators should also refer to the guidance in ICP 16.3 to ICP 16.7.

3.1.4 Contents of Risk Tolerance Statement

A Takaful Operator's Risk Tolerance Statement must:

(a) set out its overall quantitative and qualitative risk tolerance levels;

(b) define risk tolerance limits which take into account all relevant and material categories of risk and the relationships between them.

Guidance: Risk Tolerance Statement

In assessing a Takaful Operator's compliance with TRR 3.1.4, the AFSA will have regard to the guidance in ICP 16.8 (Enterprise risk management framework - risk tolerance statement).

3.1.5 Approval of Risk Management Strategy

(1) A Takaful Operator's Risk Management Strategy must be approved by its Governing Body.

(2) Any change to or deviation from a Takaful Operator's Risk Management Strategy must be approved by it Governing Body.

(3) In giving its approval to a Risk Management Strategy, or to any amendment to or deviation from a Risk Management Strategy, the Governing Body of a Takaful Operator must be satisfied that:

(a) the strategy and any changes to it mitigate and control the risks included in the Takaful Operator's Risk Management Policy; and

(b) the Risk Management Policy is appropriate and gives reasonable assurance that all material risks facing the Takaful Operator are prudently and soundly managed having regard to the nature, scale and complexity of the Takaful Operator's business.

3.1.6 Notification of the AFSA

(1) A Takaful Operator must give to the AFSA a copy of its Risk Management Strategy, and any subsequently amended version of that strategy, within 10 business days after its approval.

(2) A Takaful Operator must notify the AFSA of any material deviation from its Risk Management Strategy at least 10 business days before the deviation.

4 Own Risk and Solvency Assessment (ORSA)

Guidance: Purpose of the Own Risk and Solvency Assessment

(1) An ORSA is a detailed forward-looking examination of:

(a) the adequacy of an AIFC-Incorporated Takaful Operator's risk management policies, procedures and controls; and

(b) the AIFC-Incorporated Takaful Operator's present and future solvency positions.

(2) The objectives of ORSA are:

(a) to assess:

(i) whether the AIFC-Incorporated Takaful Operator's own view of its solvency position is adequate given its risk profile and risk tolerance; and

(ii) whether its solvency position is likely to remain adequate in the foreseeable future;

(b) to show how the AIFC-Incorporated Takaful Operator proposes to manage (through capital buffers and other risk-mitigation mechanisms) the material risks to which it is exposed; and

(c) to identify potential business vulnerabilities.

4.1 The ORSA

4.1.1 Obligation to conduct an Own Risk and Solvency Assessment

(1) An AIFC-Incorporated Takaful Operator must:

(a) conduct an Own Risk and Solvency Assessment (ORSA) in accordance with TRR 4.1.2 (ORSA – requirements) at least annually; and

(b) submit a report to the AFSA on its ORSA (an ORSA Report) in accordance with TRR 4.2.1 (ORSA Report - requirements).

(2) An AIFC-Incorporated Takaful Operator must conduct a fresh ORSA and submit a revised ORSA report to the AFSA if there is a change to its Risk Management Strategy, strategic plan or business plan and the change results, or there are reasonable grounds to believe that the change will result, in a material change in the capital adequacy or solvency of the AIFC-Incorporated Takaful Operator.

4.1.2 ORSA – requirements

(1) In conducting an ORSA, an AIFC-Incorporated Takaful Operator must assess:

(a) its overall solvency needs, including its own view of the adequacy of its capital resources to meet the regulatory capital requirements;

(b) the risk exposures of each Takaful Fund managed by it independent of every other Takaful Fund it manages to ensure that the risks or potential losses are not masked by the countervailing impact of the availability of capital in other Takaful Funds.

(c) the actions it has taken to manage the risks to which it is exposed;

(d) the financial resources needed:

(i) to manage its business prudently; and

(ii) to meet the capital adequacy requirements in TRR 5 (Capital adequacy requirements);

(e) the nature, adequacy and quality of the capital resources needed, having regard to their loss-absorbing capacity and liquidity;

(f) the adequacy and quality of the capital resources in each Takaful Fund to meet the regulatory capital requirement of that Takaful Fund, as well as its economic capital needs;

(g) the probability and extent of any need for Qard support for the Takaful Fund;

(h) the effect on the Takaful Operator's solvency position of all reasonably foreseeable and relevant changes in its risk profile (including group-specific risks); and

(i) its ability to meet its Minimum Capital Requirements and Prescribed Capital Requirement and continue in business, and the financial resources needed, over periods longer than those typically used for calculating its capital adequacy requirements under TRR 5 (Capital adequacy requirements).

(2) An AIFC-Incorporated Takaful Operator must include as part of any quantitative evaluation in its ORSA:

(a) stress tests;

(b) the occurrence of extreme events to which the Takaful Operator is exposed; and

(c) other unlikely but possible adverse scenarios that would render the Takaful Operator's business model unviable.

(3) The ORSA must be appropriate to the nature, scale and complexity of the AIFC-Incorporated Takaful Operator's business.

(4) The ORSA must cover all Takaful Funds managed by the Takaful Operator, as it is the responsibility of the Takaful Operator to ensure that those funds are managed prudently.

(5) The ORSA must consider the potential impact of transactions between different Takaful Funds, and in particular the impact of any Qard provided by the shareholders' fund of the Takaful Operator to any Takaful Fund. In this respect, the ORSA must involve a forward-looking assessment of the need for provision of Qard and how it will be repaid and the impact of various stakeholders involved in the process.

(6) The ORSA also needs to consider whether the Takaful Operator will be able and/or willing to provide Qard, in a scenario wherein the ability of a Takaful Fund to continue to meet its obligations would be contingent on receipt of Qard support.

Guidance: ORSA - requirements

In assessing an AIFC-Incorporated Takaful Operator's compliance with TRR 4.1.2, the AFSA will have regard to the guidance in ICP 16.11 to 16.13 (Own risk and solvency assessment (ORSA)), ICP 16.14 (Own risk and solvency assessment (ORSA) - economic and regulatory capital), ICP 16.15 (Own risk and solvency assessment (ORSA) - continuity analysis) and ICP 16.16 (Role of supervision in risk management).

4.2 The ORSA Report

4.2.1 ORSA Report - requirements

An AIFC-Incorporated Takaful Operator's ORSA Report must present all of the following:

(a) the qualitative and quantitative results of the ORSA and the conclusions drawn by the AIFC-Incorporated Takaful Operator from those results;

(b) the methods and main assumptions used in the ORSA;

(c) information on the AIFC-Incorporated Takaful Operator's overall solvency needs and a comparison of those solvency needs with its capital adequacy requirements under TRR 5 (Capital adequacy requirements) and its Eligible Capital;

(d) qualitative and (if relevant) quantitative information on the extent to which quantifiable risks to which the AIFC-Incorporated Takaful Operator is exposed are not reflected in the calculation of the Prescribed Capital Requirement.

4.2.2 ORSA Report – approval by the Governing Body

An ORSA Report must include a statement that the Governing Body of the AIFC-Incorporated Takaful Operator participated in the ORSA and approved the ORSA Report.

Guidance: The Own Risk and Solvency Assessment

1 The AFSA will discuss and evaluate the adequacy and prudence of the AIFC-Incorporated Takaful Operator’s ORSA during the supervisory process. In particular, the AFSA will look into its adequacy when there is a material change in the AIFC-Incorporated Takaful Operator’s risk management strategy, strategic plan or business plan.

2 If the assumptions or data used in an AIFC-Incorporated Takaful Operator’s ORSA are inaccurate, inadequate or misleading, or if the AFSA considers that the underlying method is not sufficiently robust, the AFSA will require the AIFC-Incorporated Takaful Operator to conduct a new ORSA or to prepare a revised ORSA Report.

5 Capital adequacy requirements

5.1 Application and Overview

5.1.1 Application

This Chapter applies to an AIFC-Incorporated Takaful Operator.

Guidance: Risk-based capital adequacy framework

1. The risk-based Capital framework for Takaful Operators as defined in this rules, sets the AFSA's expectations for Takaful Operator's capital adequacy and solvency levels, taking into account the risk profile of their Takaful Business and act as financial buffer for their risk exposures. The risk-based capital framework as set out in the remaining chapters of this AIFC TRR rules aims to achieve the following objectives:
   (a) Enable all obligations under a Takaful contract to be met;
   (b) Provide flexibility for a Takaful Operator to operate at different risk levels in line with its business strategies, so long as it holds appropriate level of capital and observe prudential safeguards; and
   (c) Ensure the development of strong Takaful industry that promotes public confidence and contributes to the overall financial system stability.
2. The risk-based capital framework is based on a standardised approach to be applied to all Takaful Operators. A primary consideration in the development of this framework is the fiduciary duties of the Takaful Operator towards the participants in the Takaful funds they operate, to ensure appropriate management of those Takaful Funds and the overall activities of the Takaful Business, in line with the objectives of Shari'ah. In particular, the risk-based capital framework is designed to ensure that the Takaful Operator has an appropriate amount of capital to meet the responsibility to provide for the costs of running the Takaful Business as well as the potential interest-free loan (Qard) in the unlikely event of deficit in any of the Takaful Funds it operates.
3. The risk-based capital framework also recognises the ownership and obligations of the various Funds in the Takaful Business, as well as the extent to which the Funds are impacted by the different risks involved in the Takaful Business.
4. The framework sets out the
   (a) methodology to compute capital adequacy of the Takaful Operators, including the components of capital eligible for recognition in the computation as well as the applicable risk charges for each risk exposure.
   (b) possible actions that can be taken by the AFSA in case of breach of the regulatory requirements specified in the framework; and
   (c) prudential limits for investment and individual counterparty risk exposures.

5.1.2 Overview

(1) The capital requirements for the shareholders' fund of the Takaful Operator must be reflective of the risks directly borne by the Takaful Operator, whilst the capital requirements for the individual Takaful Funds managed by it must be reflective of the risks borne by those Takaful Funds.

(2) If the Eligible Capital available in a Takaful Fund is not adequate to meet the applicable Capital Requirements as defined in the TRR rules, the resulting deficit in capital should be considered as an estimate of the potential qard that may need to be extended by the Takaful Operator to ensure capital adequacy of the relevant Takaful Fund.

(3) The Eligible Capital available in the shareholders' fund of a Takaful Operator must only be available to support risks borne by the Takaful Operator as well as any potential qard it may need to provide to its Takaful Funds, as described in (2) above.

(4) The Eligible Capital available in a Takaful Fund must only be used to support the risk exposures of that Takaful Fund and should be available only to reduce the potential qard that may need to be extended by its Takaful Operator.

(5) The capital adequacy and other prudential requirements as well as the methodologies for determining them, as specified in the TRR rules must be applied to the Takaful Operator or to the individual Takaful Funds it manages, as applicable in the relevant context, to achieve the overall objectives of the TRR rules and to comply with the specific rules 5.1.2 (1) to (4).

(6) All references to a Takaful Operator or an AIFC-incorporated Takaful Operator in the TRR rules specifying capital adequacy and other prudential requirements must be read as referring also to a Takaful Fund.

Guidance: Capital adequacy in Takaful Funds

The capital adequacy framework set out in the TRR rules recognises that a lower amount of capital is required to be held by a Takaful Operator in order to support potential qard needs where its Takaful Funds are stronger and have sufficiently high levels of Eligible Capital to meet their own Capital Requirements.

5.2 Calculation of Eligible Capital and capital requirements

5.2.1 Obligation to calculate Eligible Capital

An AIFC-Incorporated Takaful Operator must calculate its Eligible Capital on an ongoing basis in accordance with the rules set out in Schedule 4 (Calculation of Eligible capital).

5.2.2 Obligation to calculate MCR

An AIFC-Incorporated Takaful Operator must calculate its Minimum Capital Requirement (MCR) on an ongoing basis in accordance with the rules set out in Schedule 5 (Calculation of Minimum Capital Requirement (MCR)).

5.2.3 Obligation to calculate PCR

An AIFC-Incorporated Takaful Operator must:

(a) calculate its Prescribed Capital Requirement (PCR) at least once a year in accordance with the rules set out in Schedule 6 (Calculation of Prescribed Capital Requirement (PCR)); and

(b) recalculate its PCR without delay if its risk profile deviates significantly from the risk profile detailed in its last reported PCR.

5.3 Use of Internal models to calculate capital requirements

5.3.1 Approval by AFSA

The AFSA may, by written notice, allow an AIFC-Incorporated Takaful Operator to use its own internal model to calculate a component or components of its PCR.

Guidance

Note that the AFSA is not currently in a position to consider applications for the use of internal models. The AFSA will notify Takaful Operators when this position changes.

5.3.2 Criteria for approving use of internal models

The AFSA will only consider allowing an AIFC-Incorporated Takaful Operator to use its internal model if it is satisfied that the model:

(a) operates within a risk management environment that is conceptually sound and supported by adequate resources;

(b) addresses all material risks to which the AIFC-Incorporated Takaful Operator could reasonably be expected to be exposed and is commensurate with the relative importance of those risks, based on the AIFC-Incorporated Takaful Operator's business mix;

(c) is closely integrated into the day-to-day management process of the AIFC-Incorporated Takaful Operator;

(d) is supported by appropriate audit and compliance procedures;

(e) is subjected to, as a minimum, three tests: “statistical quality test”, “calibration test” and “use test”, the results of the which demonstrate that the model is appropriate for regulatory capital purposes; and

(f) is subject to adequate processes established by the AIFC-Incorporated Takaful Operator to validate the accuracy of the calculations made using the internal model, as well as for monitoring and assessing its ongoing performance.

Guidance

In assessing an AIFC-Incorporated Takaful Operator’s compliance with this Part 5.3, the AFSA will have regard to the guidance in ICP 17.12 to 17.18

5.3.3 Statistical quality test

An AIFC-Incorporated Takaful Operator seeking approval for its internal model must demonstrate:

(a) that the PCR or component(s) of the PCR calculated using the internal model addresses the overall risk position of the AIFC-Incorporated Takaful Operator subject to the nature, scale and complexity of the AIFC-Incorporated Takaful Operator and its risk exposures;

(b) the theoretical validity of the internal model including:-

(i) the suitability of model structure, data (including completeness and accuracy), and estimation within the AIFC-Incorporated Takaful Operator’s business context;

(ii) the appropriateness of the internal model basis within the industry context, including methodological benchmarking to alternatives and best practice;

(iii) the appropriateness of the parameter estimations. It should be demonstrated that the parameter estimations are appropriate within the market and industry context and parameter uncertainty is addressed to the extent possible; and

(iv) the consistency, soundness and justification of the methodologies, distributions, aggregation techniques and dependencies (within and among risk categories) adopted.

(c) the analytical validity of the internal model including:-

(i) the statistical process for validating that the results of the model are fit for the purpose for which they are used;

(ii) the implementation of the model given the theoretical basis, goodness of fit, forecasting capability for out-of sample observations (backtesting), sensitivity to changes in key underlying assumptions and stability of outputs;

(iii) the backtesting applied at various levels of the business activity;

(iv) the sensitivity analysis undertaken, which should validate the parts of the internal model where expert judgement is used and should examine whether the model output is sensitive to changes in key assumptions;

(v) the convergence of the model to demonstrate that model outputs are statistically significant;

(vi) the processes of monitoring the model's performance; and

(vii) where possible, benchmarking the model results and techniques with peers, available literature and research.

5.3.4 Calibration test

An AIFC-Incorporated Takaful Operator must demonstrate that the PCR or component(s) of the PCR produced by its internal model is consistent with the specified modelling criteria.

5.3.5 Use test

(1) An AIFC-Incorporated Takaful Operator must demonstrate that the internal model (its methodologies and results) is fully integrated within its risk and capital management and system of governance processes and procedures.

(2) An AIFC-Incorporated Takaful Operator's Governing Body is required to:-

(a) have overall control of and responsibility for the construction and use of the internal model for risk management purposes;

(b) have sufficient understanding of the model's construction at appropriate levels within the AIFC-Incorporated Takaful Operator's organisational structure;

(c) have an understanding of the consequences of the internal model's outputs and limitations for risk and capital management decisions.

(3) An AIFC-Incorporated Takaful Operator must have adequate governance and internal controls in place with respect to the internal model.

5.3.6 Documentation

(1) An AIFC-Incorporated Takaful Operator must document, at a minimum:

(a) the design, construction, modelling criteria and governance of the internal model;

(b) the justification for and details of the underlying methodology, assumptions and quantitative and financial bases;

(c) if applicable, why it has chosen to only use a partial internal model for certain risks or business lines; and

(d) if applicable, the reliance on and appropriateness of the use of external vendors/suppliers.

(2) The documentation must be sufficiently detailed to demonstrate compliance with the statistical quality test, calibration test and use test.

(3) The documentation of the internal model must be timely and up to date.

5.3.7 Ongoing validation and supervisory approval of the internal model

An AIFC-Incorporated Takaful Operator using an internal model must:

(a) monitor the performance of its internal model and regularly review and validate the ongoing appropriateness of the model's specifications against the criteria set out in 5.3.2 to 5.3.5;

(b) notify the AFSA of material changes to the internal model made by it for review and continued approval of the use of the model for regulatory capital purposes;

(c) properly document internal model changes;

(d) report information necessary for supervisory review and ongoing approval of the internal model on a regular basis, as determined appropriate by the AFSA.

5.4 Solvency control levels

5.4.1 Obligation to maintain Eligible Capital at or above MCR

An AIFC-Incorporated Takaful Operator must at all times have Eligible Capital equal to or higher than the amount of its MCR.

5.4.2 Obligation to maintain Eligible Capital at or above PCR

An AIFC-Incorporated Takaful Operator must at all times have Eligible Capital equal to or higher than the amount of its PCR.

5.4.3 Non-Compliance with the PCR

If an AIFC-Incorporated Takaful Operator becomes aware that it does not have, or there is a risk that within the following three months it will not have, Eligible Capital equal to or higher than the amount of its PCR, it must:

(1) immediately inform the AFSA;

(2) within one month, submit to the AFSA for its approval a short-term realistic plan which complies with the requirements of TRR 5.4.6 (Contents of recovery plans and finance schemes);

(3) within six months (or such longer period as the AFSA may specify), take the measures necessary to achieve the re-establishment of Eligible Capital covering the PCR, or the reduction of its risk profile to ensure compliance with the PCR; and

(4) take such steps (if any) as the AFSA may require, which steps may be specified by the ASFA as in addition to, or instead of, the measures in (3).

Guidance: actions that the AFSA may take on a breach of the PCR

Possible intervention actions that the AFSA may take if an AIFC-Incorporated Takaful Operator breaches its PCR include one or more of:

(a) measures that are intended to enable the AFSA to better assess and/or control the situation, either formally or informally, such as increased supervision activity or reporting, or requiring auditors or actuaries to undertake an independent review or extend the scope of their examinations;

(b) measures to address capital levels such as limitations on redemption or repurchase of equity or other instruments and/or dividend payments;

(c) measures intended to protect policyholders pending strengthening of the AIFC-Incorporated Takaful Operator's capital position, such as restrictions on licences, premium volumes, investments, types of business, acquisitions, reinsurance arrangements;

(d) measures that strengthen or replace the AIFC-Incorporated Takaful Operator's management and/or Risk Management Strategy and overall governance processes;

(e) measures that reduce or mitigate risks (and hence required capital) such as requesting reinsurance, hedging and other mechanisms; or

(f) refusing, or imposing conditions on, applications submitted for regulatory approval such as acquisitions or growth in business.

5.4.4 Non-Compliance with the MCR

If an AIFC-Incorporated Takaful Operator becomes aware that it does not have, or there is a risk that within the following three months it will not have, Eligible Capital equal to or higher than the amount of its MCR, it must

(1) immediately inform the AFSA;

(2) within two months, submit to the AFSA for its approval a short-term realistic plan for infusion of additional Eligible Capital which complies with the requirements of TRR 5.4.6 (Contents of recovery plans and finance schemes);

(3) within six months (or such longer period as the AFSA may allow), take the measures necessary to achieve the re-establishment of the level of Eligible Capital covering the MCR, or the reduction of its risk profile to ensure compliance with the MCR; and

(4) take such steps (if any) as the AFSA may require, which steps may be specified by the ASFA as in addition to, or instead of, the measures in (3).

Guidance: actions that the AFSA may take on a breach of the MCR

Possible intervention actions that the AFSA may take if an AIFC-Incorporated Takaful Operator breaches its MCR include one or more of:

(a) stopping the activities of the Takaful Operator;

(a) withdrawal of the Takaful Operator's Licence to carry on Takaful Business;

(c) requiring the Takaful Operator to close to new business and run-off the portfolio;

(d) requiring the Takaful Operator to transfer its portfolio to another Takaful Operator; or

(e) requiring the Takaful Operator to arrange additional Retakaful / reinsurance.

5.4.5 Other regulatory actions not precluded

The fact that an AIFC-Incorporated Takaful Operator has Eligible Capital equal to or in excess of its PCR or its MCR does not preclude the AFSA from intervention, or from requiring action by the AIFC-Incorporated Takaful Operator for other reasons, such as weaknesses in the risk management or governance of the Takaful Operator.

5.4.6 Contents of recovery plans and finance schemes

Any recovery plan or finance scheme must as a minimum include:

(a) estimates of management expenses, in particular current general expenses and commissions;

(c) estimates of income and expenditure in respect of direct business, reinsurance acceptances and reinsurance cessions;

(d) a forecast balance sheet;

(e) information about the AIFC-Incorporated Takaful Operator's overall policy regarding reinsurance; and

(f) such other information as the AFSA may specify in writing.

5.4.7 Eligible Capital below the level of the Capital Floor

If at any time an AIFC-Incorporated Takaful Operator becomes aware that it does not have Eligible Capital in excess of the amount of the Capital Floor specified in Schedule 5 (Calculation of Minimum Capital Requirement (MCR)), it must immediately

(a) stop effecting new Contracts of Takaful; and

(b) inform the AFSA.

Guidance

The Capital Floor specified inSchedule 5 is the minimum bound of the MCR below which no AIFC-Incorporated Takaful Operator is considered by the AFSA to be viable to operate effectively.

5.5 Reduction of Eligible Capital

Guidance

A reduction of an AIFC-Incorporated Takaful Operator's Eligible Capital includes, but is not limited to:

a. share buybacks;

b. the redemption, repurchase or early repayment of any Eligible Capital instruments issued by the AIFC-Incorporated Takaful Operator or a special purpose vehicle trading in its own shares; or

c. where aggregate interest and dividend payments on Tier 1 Capital exceed the AIFC-Incorporated Takaful Operator's after-tax earnings in the year to which they relate (i.e. dividend and interest payments on Tier 1 Capital wholly or partly funded from retained earnings).

5.5.1 Tier 1 Capital not to be reduced without approval

An AIFC-Incorporated Takaful Operator must not reduce the Tier 1 Capital component of its Eligible Capital without the prior written approval of the AFSA.

5.5.2 Capital plan to be provided

When seeking approval for a reduction of its Tier 1 Capital under TRR 5.5.1 (Tier 1 Capital not to be reduced without approval), an AIFC-Incorporated

Takaful Operator must provide to the AFSA a capital plan that has incorporated the effects of the proposed reduction and:

(a) demonstrates that the AIFC-Incorporated Takaful Operator will remain in excess of its MCR for 2 years without relying on new capital issues;

(b) is consistent with the AIFC-Incorporated Takaful Operator's business plan; and

(c) takes account of any possible acquisitions, locked-in capital in subsidiaries and the possibility of exceptional losses.

5.5.3 Notice to be given of proposed reduction of Tier 2 Capital

An AIFC-Incorporated Takaful Operator must notify the AFSA of its intention to reduce its Tier 2 Capital at least 6 months before the actual date of the proposed reduction, providing details of how it will meet its MCR after the proposed reduction.

5.6 Notification of dividends and distributions

5.6.1 Dividends and distributions to be reported

An AIFC-Incorporated Takaful Operator must report to the AFSA all dividends and other distributions to shareholders within 15 business days following the declaration of the dividend or distribution.

6 Investment

6.1 Admissible assets

6.1.1 Security, liquidity, location and diversification

(1) A Takaful Operator must invest only in assets or investment opportunities which are approved as Shari'ah-compliant, by its Shari'ah Supervisory Board.

(2) A Takaful Operator when, investing in assets, must consider whether, for the portfolio as a whole -

(a) its assets are sufficiently secure having regard to their capacity to protect their value and preserve their economic substance;

(b) its assets are sufficiently liquid to ensure that the Takaful Operator is able to make payments to policyholders and creditors as they fall due

(c) its assets are held in the appropriate location for their availability; and

(d) its assets are sufficiently diversified subject to the nature, scale and complexity of the business.

Guidance: Security, liquidity, location and diversification

In assessing a Takaful Operator's compliance with TRR 6.1.1 (Security, liquidity, location and diversification), the AFSA will have regard to the guidance in ICP 15.3.

6.1.2 Assets appropriate to liabilities

(1) A Takaful Operator must invest in a manner that is appropriate to the nature of its liabilities.

(2) In particular, a Takaful Operator must:

(a) consider the extent to which the cash flows from its investments match the liability cash flows in both timing and amount and how this changes in varying conditions;

(b) consider the investment guarantees and embedded options that are contained in its policies;

(c) consider the currency or currencies of its liabilities and the extent to which they are matched by the currencies of the assets;

(d) manage conflicts of interest (e.g. between the Takaful Operator's corporate objectives and disclosed Takaful policy objectives) to ensure assets are invested appropriately;

(e) for with-profits liabilities, hold an appropriate mix of assets to meet policyholders' reasonable expectations; and

(f) if it is part of an insurance group, hold investments tailored to the characteristics of its liabilities and its needs and not be subject to undue influence from the wider objectives of the group.

Guidance: Security, liquidity, location and diversification

In assessing a Takaful Operator's compliance with TRR 6.1.2 (Assets appropriate to liabilities), the AFSA will have regard to the guidance in ICP 15.4.

6.1.3 Ability to assess risks

(1) A Takaful Operator must only invest in assets whose risks it can properly assess and manage.

(2) In particular, a Takaful Operator must:

(a) ensure its investments, including those in collective investment funds, are sufficiently transparent and limit its investments to those where the associated risks of the asset can be properly managed by it

(b) ensure that it understands all of the risks involved in an investment before any investments are undertaken;

(d) if it is able to look through the structure of an investment to the underlying assets, consider the risk characteristics of the underlying assets and how this affects the risk characteristics of the investments itself

(e) if it is not able to look through the structure of an investment to the underlying assets, develop appropriate techniques to assess the risks associated with the investment.

Guidance: Security, liquidity, location and diversification

In assessing a Takaful Operator's compliance with TRR 6.1.3 (Ability to assess risks), the AFSA will have regard to the guidance in ICP 15.5.

6.2 Investment restrictions

6.2.1 Assets not admitted to trading on a regulated financial market

A Takaful Operator must ensure that assets and securities that are not admitted to trading on a regulated financial market are kept to prudent levels.

6.2.2 Derivatives

(1) A Takaful Operator must not use a Derivative instrument for speculation or proprietary trading.

(2) A Takaful Operator may only use a Shari'ah-compliant Derivative instrument:

(a) to apply an index tracking strategy to part or all of a portfolio;

(b) to apply capital protected strategies to part or all of a portfolio;

(c) to apply efficient portfolio management techniques to a portfolio; or

(d) to reduce investment risk currently employed on a portfolio.

6.2.3 Forward foreign exchange transactions

A Takaful Operator must not invest in forward foreign exchange transactions save to the extent that they hedge currency exposures to currencies other than the reporting currency in its prudential returns.

6.3 Investment policy and procedures

6.3.1 Investment policy

A Takaful Operator must establish and maintain an investment policy which specifies

(a) the nature, role and extent of its investment activities; and

(b) how it complies with TRR 6.1 (Admissible assets).

6.3.2 Procedures for complex and non-transparent investments

A Takaful Operator must establish procedures for managing the risk associated with more complex and less transparent classes of asset and investment in markets or instruments that are subject to less governance or regulation

7 Segregation of Family Takaful assets and liabilities

7.1 Establishment of Family Takaful Funds

7.1.1 Family Takaful Funds to be established

A Takaful Operator conducting Family Takaful Business must either:

(a) establish and maintain one or more Family Takaful Funds; or

(b) notify the AFSA that the Takaful Operator is deemed to constitute a single Family Takaful Fund.

7.1.2 Family Takaful Fund

(1) Unless (2) applies, all the Family Takaful Assets of a Takaful Operator constitute its Family Takaful Fund.

(2) Where a Takaful Operator identifies particular Family Takaful Assets in connection with different parts of its Family Takaful Business, the assets identified in relation to each such part constitute separate Family Takaful Funds of the Takaful Operator.

7.1.3 Family Takaful Assets

(1) A Takaful Operator's Family Takaful Assets are the items in (2), adjusted to take account of:-

(a) liabilities in respect of the Takaful Operator's Family Takaful Business; and

(b) any transfers made out of the Family Takaful Fund in accordance with TRR 7.5.2 (Transfers of assets out of Family Takaful Funds).

(2) The items are:-

(a) admissible assets identified by the Takaful Operator as being available to cover liabilities arising under or in connection with Family Takaful Business with due regard to generally accepted actuarial practice (including assets into which those assets have been converted) but excluding any assets identified as being held to cover liabilities in respect of subordinated debt;

(b) any other assets identified by the Takaful Operator as being available to cover its liabilities arising from Family Takaful Business (including assets into which those assets have been converted) including, if the Takaful Operator so elects, assets which are excluded under (a);

(c) premiums and other receivables in respect of Family Takaful Business;

(d) other receipts of the Family Takaful Business; and

(e) all income and capital receipts in respect of the items set out in (2).

7.1.4 Takaful Operator deemed to constitute Family Takaful Fund to be treated as though it had established such fund

A Takaful Operator that is deemed, in accordance with TRR 7.1.1(b), to constitute a single Family Takaful Fund shall be treated for all purposes relating to these rules as though the Takaful Operator had established a Family Takaful Fund to which all of the assets and liabilities of the Takaful Operator are attributed.

7.1.5 Treatment of Branches

(1) A Takaful Operator that is a Branch and that is subject to a regulatory requirement in another jurisdiction to arrange its affairs in a manner that is equivalent or substantially equivalent to the requirements of TRR 7.1.1 may make an application to the AFSA for that arrangement of its affairs to be deemed to constitute a Family Takaful Fund.

(2) A Takaful Operator that is a Branch must hold Family Takaful Assets in relation to Family Takaful Business carried on in the AIFC, in either the AIFC or the Republic of Kazakhstan.

Guidance

If the AFSA approves an application under TRR 7.1.5(1), it will give a written notice to the Branch stating the manner in which the arrangement will be deemed to constitute a Family Takaful Fund.

7.2 Attribution of contracts to a Family Takaful Fund

7.2.1 Business to be attributed to Family Takaful Funds

A Takaful Operator must attribute all Family Takaful Business that it conducts to a Family Takaful Fund.

7.2.2 Attribution of General Takaful Contracts

(1) Except as allowed for in (2), a Takaful Operator may not attribute General Takaful Contracts to a Family Takaful Fund.

(2) A Takaful Operator may attribute Takaful Contracts in General Insurance Category 1 (Accident) and General Insurance Category 2 (Sickness) to a Family Takaful Fund.

7.3 Segregation of assets and liabilities

7.3.1 Separate identification of assets, liabilities, revenues and expenses

A Takaful Operator that is required under TRR 7.1.1 (Family Takaful Funds to be established) to establish and maintain one or more Family Takaful Funds, or has attributed Takaful Contracts in General Insurance Category 1 (Accident) or General Insurance Category 2 (Sickness) to a Family Takaful Fund under TRR 7.2.2(2) (Attribution of General Insurance Contracts), must:

(a) identify separately in its books and records the assets, liabilities, revenues and expenses attributable to that business; and

(b) ensure those assets, liabilities, revenues and expenses are recorded separately and accounted for as Family Takaful Fund.

7.3.2 Recording of assets, liabilities, revenues and expenses

A Takaful Operator must record all assets, liabilities, revenues and expenses in respect of a Family Takaful Contract that is attributed to a Family Takaful Fund as assets, liabilities, revenues and expenses of that Family Takaful Fund.

7.3.3 Attribution of assets not already attributed

A Takaful Operator may at any time attribute any of its assets to a Family Takaful Fund that were not previously attributed to such a Family Takaful Fund.

7.3.4 Recording of revenues and expenses

All revenues and expenses arising by way of earnings, revaluation or other change to the assets and liabilities of a Family Takaful Fund must be recorded as revenues and expenses, or movements in capital, of that Family Takaful Fund.

7.4 Recordkeeping

7.4.1 Accounting and other records to be maintained

A Takaful Operator must maintain adequate accounting and other records to identify

(1) the Takaful Contracts attributed to a Family Takaful Fund in accordance with TRR 7.2 (Attribution of contracts to a Family Takaful Fund); and

(2) the assets, liabilities, revenues and expenses attributed to a Family Takaful Fund in accordance with TRR 7.3 (Segregation of assets and liabilities).

7.5 Limitation on use of assets in Family Takaful Fund

7.5.1 Application of assets

A Takaful Operator must ensure that, except as provided in TRR 7.5.2 to 7.5.6, assets that are attributable to a Family Takaful Fund are applied only for the purposes of the business attributed to the Family Takaful Fund.

7.5.2 Transfers of assets out of Family Takaful Funds

A Takaful Operator must ensure that assets attributable to a Family Takaful Fund are not transferred so as to be available for other purposes of the Takaful Operator except:

(a) where the transfer constitutes appropriation of a surplus determined in accordance with TRR 9.1.3(4)(g) (Requirements for Financial Condition Report) and the transfer is performed within four months of the reference date of the Financial Condition Report that this determination forms part of;

(b) where the transfer constitutes a payment of dividend or return of capital, in accordance with TRR 7.5.4 (Payment of dividends by Takaful Operator constituting a single Family Takaful Fund);

(c) where the transfer is made in exchange for other assets at fair value;

(d) where the transfer constitutes reimbursement of expenditure borne on behalf of the Family Takaful Fund and in respect of expenses attributable to the Family Takaful Fund; or

(e) where the transfer constitutes reattribution of assets attributed to the Family Takaful Fund in error.

7.5.3 Assets of Family Takaful Funds not to be distributed

A Takaful Operator must not make any distribution by way of dividend, or return of capital assets attributable to a Family Takaful Fund, if by doing so that would result in a breach of its obligations under TRR 5 (Capital adequacy requirements).

7.5.4 Payment of dividends by Takaful Operator constituting a single Family Takaful Fund

A Takaful Operator that is deemed to constitute a single Family Takaful Fund may only make a dividend or return of capital where:

(a) the dividend or return of capital constitutes appropriation of a surplus determined in accordance with TRR 9.1.3(4)(g) (Requirements for Financial Condition Report), and either

(b) the payment is made within four months of the reference date of the Financial Condition Report determining that surplus and does not cause the total aggregate amount of the dividends or returns of capital made by the Takaful Operator since that reference date to exceed the amount of that surplus; or

(c) the payment is made more than four months after the reference date of Financial Condition Report determining that surplus and does not cause the total aggregate amount of the dividends or returns of capital made by the Takaful Operator since that reference date to exceed 50% of the amount of that surplus.

7.5.5 Assets not to be lentg

A Takaful Operator must not lend or otherwise make available for use for any other purposes of the Takaful Operator, or any purposes of any party related to the Takaful Operator, assets attributable to a Family Takaful Fund.

7.5.6 Certain reinsurance-like arrangements prohibited

A Takaful Operator may not enter into any arrangement, whether or not described as a Retakaful Contract or a Contract of Reinsurance, whereby a Family Takaful Fund of the Takaful Operator stands in the same relation to the Takaful Operator as though the Takaful Operator were the Retakaful Operator in a Retakaful Contract or Contract of Reinsurance in which the Family Takaful Fund is the cedant.

Guidance

TRR 7.5.6 (Certain reinsurance-like arrangements prohibited) operates to prohibit reinsurance between Family Takaful Funds of the same Takaful Operator, as well as arrangements of the nature of internal contracts of reinsurance where the cession transaction is attributed to a Family Takaful Fund but the corresponding reinsurance acceptance transaction is not.

7.6 Distribution of a surplus or funding a deficit in a Takaful Fund

7.6.1 Policies about surpluses and deficits

(1) A Takaful Operator must have a written policy, or subject to rule 7.6.2, policies, for determining the surplus or deficit arising from its Takaful Business, the basis of distributing that surplus or deficit between the participants and the shareholders, and the method of transferring any surplus or deficit to the participants.

(2) The policy or policies must comply with all relevant AAOIFI standards including but not limited to, Financial Accounting Standard No. 13 'Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies'.

(3) Each policy must be approved by the Takaful Operator's Shari'a Supervisory Board, as defined in AIFC IFR rule 5.1.

7.6.2 When 2 or more policies permitted

A Takaful Operator may develop and/or offer more than one policy at any point in time, where the Takaful Operator conducts different categories of Takaful Business.

7.6.3 Copies of policies to be given to the AFSA

(1) A Takaful Operator must provide a copy of the policy referred to in rule 7.6.1 above to the AFSA immediately following its approval by its Shari'a Supervisory Board, but within one business day following the day such approval was given.

(2) Any amendments to the policy referred in rule 7.6.1 subsequent to its submission to the AFSA, must be approved by the Shari'ah Supervisory Board of the Takaful Operator. The amended version of the policy must be submitted to the AFSA immediately following that approval.

(3) A Takaful Operator must ensure that a copy of the policy approved under rule 7.6.1 or rule 7.6.3 (2), forms part of every Takaful policy sold it.

Guidance

As part of its process to approve any amendments to a policy under rule 7.6.3(2), the AFSA will consider the impact of the proposed amendments on the rights and obligations of existing policyholders of the Takaful Operator who are affected by those proposed amendments.

7.6.4 Surplus or deficit to be determined annually

(1) On an annual basis, every Takaful Operator must determine any surplus or deficit arising on each Takaful Fund it operates, in a distinct manner.

(2) A Takaful Operator must not distribute a surplus or deficit from any one of the Takaful Funds it operates for Family Takaful Business until the value of the surplus or deficit involved, has been determined by an approved actuary in accordance with rule 9.1.3(4)(g).

(3) Any distribution must be performed within 4 months of the reference date of the actuarial investigation referred to in (2).

7.6.5 Reports of distributions of surplus or deficit to the AFSA

A Takaful Operator must report to the AFSA all distributions of profit or surplus (however called or described) to policyholders within 15 business days of the date of declaration of the distribution.

7.6.6 Prohibitions on distributions

A Takaful Operator must not make any distributions to participants, regardless of the rules governing the Takaful Operator, if it fails to, or because of the payment of the distribution would fail to, meet its minimum capital requirement.

8 Valuation

8.1 Matching assets and liabilities

8.1.1 Value of Takaful Operator's assets to match its Takaful Liabilities

(1) A Takaful Operator must hold supporting assets of a value at least equal to the amount of its Takaful liabilities.

(2) Such asset must be of a sufficient amount, and of an appropriate currency and term, to ensure that the cash inflows from the assets meet the expected cash outflows from the Takaful Operator's Takaful liabilities as they fall due.

8.1.2 Projecting cash flows - treatment of options

In determining the expected cash outflows from its Takaful liabilities for the purposes of TRR 8.1.1, a Takaful Operator must take into account any options that exist in the Takaful Operator's Takaful Contracts including:

(a) any unilateral option available to the policyholder to extend a Takaful Contract; and

(b) any unilateral right available to the Takaful Operator to either cancel or renew a Takaful Contract.

8.1.3 Projecting cash flows - Family Takaful Business

In projecting cash flows in relation to Family Takaful Business for the purposes of TRR 8.1.1, a Takaful Operator carrying on Family Takaful Business must take into account the nature of the projections and the factors relevant to its Family Takaful Business, including:

(a) expected investment earnings;

(b) expected reinsurance recoveries;

(c) mortality and morbidity;

(d) expenses;

(e) options and guarantees; and

(f) persistency.

Guidance: Projecting cash flows - Family Takaful Business

1 Investment earnings—If the cash flow to be valued depends on future investment earnings, the assumption for investment earnings should reflect the expected investment earnings applicable to the assets on which the cash flows depend.

2 Reinsurance or Retakaful —A Takaful Operator should value reinsurance or Retakaful cash flows using methods and assumptions that are at least as prudent as the methods and assumptions used to value the underlying Takaful Contracts that have been reinsured.

3 Mortality and morbidity—Assumptions about mortality and morbidity should use prudent rates of mortality and morbidity that are appropriate to the country or territory of residence of the persons whose life or health are insured.

4 Expenses—A Takaful Operator should make provisions for expenses, implicitly or explicitly, in its mathematical reserves of an amount that is no less that the amount expected, on prudent assumptions, to be incurred in carrying out its Family Takaful Contracts.

5 Options and guarantees—If a Takaful Operator establishes its mathematical reserves for a Family Takaful Contract, the Takaful Operator should include an amount to cover:

(a) any increase in liabilities that might be the direct result of the policyholder exercising an option under that contract, and

(b) all vested, declared or allocated bonuses to which policyholders are collectively or individually entitled under their contracts.

If the surrender value of a contract is guaranteed, the amount of the mathematical reserves for that contract at any time should be at least equal to the value guaranteed at that time.

6 Persistency—Assumptions about voluntary discontinuance rates in the calculation of the mathematical reserves may be made if the assumptions meet the general requirements for prudent assumptions in TRR 8.2.3 (Methods and assumptions that may be used).

8.2 Recognition and measurement of assets and liabilities

8.2.1 General provisions

(1) A Takaful Operator may:

(a) measure the value of an asset at less than the value determined in accordance with this Chapter;

(b) measure the value of a liability at more than the value determined in accordance with this Chapter; and

(c) use approximate methods to measure an asset or a liability, where the result obtained by the use of that approximate method would not be materially different from the result obtained by applying a measurement method prescribed in this Chapter.

(2) However, if the AFSA directs a Takaful Operator to measure an asset or a liability in accordance with principles that differ from those specified in this Chapter, the Takaful Operator must measure such assets or liability in accordance with those principles as directed.

Guidance

AFSA is likely to give a direction to a Takaful Operator in accordance with TRR 8.2.1(2) where it has concerns over any asset or class of assets being counted at full value (for example: Retakaful / reinsurance assets that may be limited risk transfer arrangements).

8.2.2 Basis of accounting

Save where directed otherwise by the AFSA or where inconsistent with the Rules in this Chapter, a Takaful Operator must recognise its assets and liabilities and measure their value in accordance with the IFRS basis of accounting.

8.2.3 Methods and assumptions that may be used

In measuring assets and liabilities, a Takaful Operator must use methods and prudent assumptions that:

(a) are appropriate to the nature, scale and complexity of the Takaful Operator’s business;

(b) are made using professional judgement, training and experience;

(c) are made having regard to reasonably available statistics and other information;

(d) are consistent from year to year and without arbitrary changes;

(e) include appropriate margins for adverse deviation of relevant factors;

(f) recognise the distribution of profits or emerging surplus in an appropriate way over the duration of each Takaful Contract; and

(g) are in accordance with generally accepted actuarial practice.

8.2.4 Changes in methods and assumptions on which valuations depend

(1) Where the valuation of an asset or liability is dependent upon the adoption of assumptions or the adoption of a calculation method, a Takaful Operator must ensure that any change in the assumptions or methods adopted is reflected immediately in the value attributed to the asset or liability concerned.

(2) The recognition of the effects of changes in assumptions or methods may not be deferred to future reporting periods.

8.2.5 Actuarial principles

The AFSA may specify actuarial principles to be used by a Takaful Operator in measuring assets and liabilities.

8.2.6 Derecognising liabilities

(1) A Takaful Operator must not derecognise a Takaful Liability (or a part of a Takaful Liability) until the obligation giving rise to the liability expires or is discharged or cancelled.

(2) To avoid doubt, if Retakaful / reinsurance covering the liability (or part of the liability) is purchased, the liability must not be derecognised unless the purchase results in the discharge or cancellation of the obligation giving rise to the liability.

8.2.7 Discount rate

In calculating the present value of a Takaful liability, the discount rate must be a prudent estimate of the yield expected to be earned by assets of the Takaful Operator that are sufficient in value and appropriate in nature to cover the provisions for the liability being discounted.

Guidance

The AFSA expects that the Takaful Operator, in its approach to estimating a suitable yield for the discount rate, will have adequate regard to the profile of the liabilities (for asset-liability matching purposes) and the quality of the assets backing those liabilities.

8.2.8 Valuation of expected future payments

Where this Chapter requires a Takaful Operator to recognise as a liability the value of expected future payments, that liability must be measured as the net present value of those expected future payments.

8.2.9 Valuation of expected future receipts

Where this Chapter requires a Takaful Operator carrying on General Takaful Business to recognise as an asset the value of expected future receipts, that asset must be measured as the net present value of those expected future receipts.

8.3 Treatment of particular assets and liabilities - General Takaful Business

8.3.1 Treatment of premium liability

A Takaful Operator carrying on General Takaful Business must recognise as a liability for the relevant Takaful Fund, the value of future claims payments and associated direct and indirect settlement costs, arising from future events insured under policies that are in force as at the Solvency Reference Date (premium liability).

Guidance

Premium liability may be represented as two separate provisions: the unearned premium provision and the premium deficiency provision.

8.3.2 Treatment of value of future claims payments

A Takaful Operator carrying on General Takaful Business must recognise as a liability for the relevant Takaful Fund, the value of future claims payments and associated direct and indirect settlement costs, arising from insured events that have occurred as at the Solvency Reference Date.

8.3.3 Treatment of expected recoveries

A Takaful Operator carrying on General Takaful Business must recognise as an asset for the relevant Takaful Fund, the value of Retakaful / reinsurance and other recoveries expected to be received in respect of claims referred to in TRR 8.3.1 (Treatment of premium liability) and TRR 8.3.2 (Treatment of value of future claims payments).

8.4 Treatment of particular assets and liabilities - Family Takaful

8.4.1 Treatment of policy benefits due before Solvency Reference Date

A Takaful Operator carrying on Family Takaful Business must recognise as a liability the amount of policy benefits that are due for payment on or before the Solvency Reference Date.

8.4.2 Treatment of net value of future policy benefits

A Takaful Operator carrying on Family Takaful Business must recognise as a liability the net value of future policy benefits under policies that are in force as at the Solvency Reference Date, taking into account all prospective liabilities as determined by the policy conditions for each existing contract, and taking credit for premiums payable after the Solvency Reference Date.

Guidance

TRR 8.4.2 (Treatment of net value of future policy benefits) does not require a Takaful Operator to obtain a valuation by an actuary or actuaries performing the actuarial function of the liability referred to in that rule, at a Solvency Reference Date other than the Takaful Operator's annual reporting date.

8.4.3 Measuring net value of policy benefits as liability

In measuring the liability associated with future policy benefits, a Takaful Operator carrying on Family Takaful Business must:

(a) use actuarial principles;

(b) provide for all liabilities based on assumptions that meet the general requirements for prudent assumptions in TRR 8.2.3 (Methods and assumptions that may be used) including appropriate margins for adverse deviation of relevant factors that are sufficient to ensure that there is no significant foreseeable risk that liabilities to policyholders for Family Takaful contracts will not be met as they fall due; and

(c) take into account:

(i) all guaranteed policy benefits, including guaranteed surrender values;

(ii) vested, declared or allotted bonuses to which policyholders are already either collectively or individually contractually entitled;

(iii) all options available to the policyholder under the terms of the contract;

(iv) discretionary charges and deductions from policy benefits, in so far as they do not exceed the reasonable expectations of policyholders;

(v) expenses, including commissions; and

(vi) any rights under contracts of Retakaful / reinsurance in respect of Family Takaful Business.

8.4.4 Negative values for reserves—Family Takaful

A Takaful Operator carrying on Family Takaful Business must not calculate a negative value for its mathematical reserves for a Family Takaful Contract unless:

(a) the calculation is based on assumptions that meet the general requirements for prudent assumptions in TRR 8.2.3 (Methods and assumptions that may be used);

(b) the contract does not have a guaranteed surrender value at the actuarial valuation date; and

(c) the total mathematical reserves established by the Takaful Operator have a value of at least:

(i) if the Takaful Operator's Family Takaful Contracts include linked Family Takaful contracts—the sum of the surrender values of all its linked Family Takaful contracts at the actuarial valuation date; and

(ii) in any other case—zero.

9 Actuarial reporting

Guidance: Actuarial reporting

Takaful Operators that conduct Family Takaful Business, and certain Takaful Operators that conduct General Takaful Business, are required to appoint an Approved Actuary. A Takaful Operator that is required to appoint an Approved Actuary must have the Approved Actuary prepare and submit a report, called a Financial Condition Report, in accordance with TRR 9.1.2 (Financial Condition Reports), to the Takaful Operator's Governing Body and the AFSA every year. A Takaful Operator that is not required to appoint an Approved Actuary must consider every year whether to obtain an actuarial report in accordance with TRR 9.2 (Takaful Operators that are not required to have an Approved), and must actually obtain such a report at least every 3 years.

9.1 Takaful Operators that are required to have Approved Actuaries

9.1.1 Application

TRR 9.1.2 to 9.1.5 apply to a Takaful Operator that is required to have an Approved Actuary.

Note For the Takaful Operators that are required to have an Approved Actuary, see TRR 2.2.2 (Obligation to appoint Approved Individuals to certain roles).

9.1.2 Financial Condition Reports

(1) The Approved Actuary for the Takaful Operator must annually carry out an actuarial investigation to enable him or her to prepare a report about the Takaful Operator's financial condition (a Financial Condition Report).

Guidance

An actuarial investigation is a full analysis of individual policy and claims data and other relevant information using actuarial techniques to estimate technical provisions.

(2) The Takaful Operator must ensure that the Approved Actuary is given appropriate access (that is, such access as the actuary reasonably believes to be necessary to prepare the report) to—

(a) all relevant data, information, reports and staff of the Takaful Operator; and

(b) so far as possible, any contractor of the Takaful Operator.

(3) The Approved Actuary must prepare, sign and date the report.

(4) The Approved Actuary must give the report to the Takaful Operator sufficiently in advance of the Takaful Operator's next annual return date to allow the Takaful Operator's Governing Body a reasonable

opportunity to consider and use it in preparing the Takaful Operator's next annual prudential return.

(5) The Takaful Operator's Governing Body must give a copy of the report to the AFSA on or before the Takaful Operator's next annual return date.

(6) In this rule, the next annual return date for a Takaful Operator means the date on which it must give its next annual prudential return to the AFSA under TRR 13.1.1 (Obligation to prepare prudential returns).

9.1.3 Requirements for Financial Condition Report

(1) A Financial Condition Report must set out an objective assessment of the overall financial condition of the Takaful Operator concerned.

(2) For a Takaful Operator conducting Family Takaful Business, such a report must include an objective assessment of the financial condition of each Family Takaful Fund established by the Takaful Operator.

(3) In preparing a Financial Condition Report, an Approved Actuary must act in accordance with the relevant professional actuarial standards, and must use appropriate actuarial valuation principles, techniques and methodologies.

(4) The Approved Actuary must ensure that the report covers at least the following matters (so far as relevant):

(a) an overview of the Takaful Operator's business;

(b) an assessment of the Takaful Operator's recent experience and profitability, including the experience during the year ending on the valuation date;

(c) an assessment of the value of the Takaful Operator's Takaful Liabilities that fall within TRR 8.4.1 (Treatment of policy benefits due before Solvency Reference Date) and TRR 8.4.2 (Treatment of net value of future policy benefits);

(d) for a Takaful Operator to which sub-rule (5) applies, an assessment of the value of the Takaful Operator's Takaful Liabilities that fall within TRR 8.3.1 (Treatment of premium liability) and TRR 8.3.2 (Treatment of value of future claims payments), using the relevant professional actuarial standards and appropriate actuarial valuation principles, techniques and methodologies;

(e) an assessment of whether the Takaful Operator's past estimates of the liabilities referred to in paragraphs (c) and (d) were adequate, especially if there has been a change in the assumptions or the valuation method from that adopted at the previous valuation;

(f) an explanation, in relation to the valuation of those liabilities, of—

(i) the assumptions used in the valuation process;

(ii) the adequacy and appropriateness of data made available to the Approved Actuary by the Takaful Operator;

(iii) how the Approved Actuary assessed the reliability of the data;

(iv) the model or models used by the Approved Actuary;

(v) the approach taken to estimate the variability of the estimate; and

(vi) the sensitivity analyses undertaken;

(g) a determination of the value of any surplus or deficit in each Takaful Fund operated by the Takaful Operator for conducting Family Takaful Business;

(h) an assessment of asset and liability management, including the Takaful Operator's investment strategy;

(i) an assessment of the Takaful Operator's current and future capital adequacy and a discussion of its approach to capital management;

(j) an assessment of the Takaful Operator's pricing, including the adequacy of its premiums;

(k) an assessment of the suitability and adequacy of the Takaful Operator's Retakaful / reinsurance arrangements, including the documentation of those arrangements and the existence and impact of any limited risk transfer arrangements;

(l) an assessment of the suitability and adequacy of the Takaful Operator's Risk Management Policy .

(5) This sub-rule applies to a Takaful Operator if it engages in General Takaful Business and—

(a) more than 15% of its gross outstanding liabilities are attributable to Takaful Contracts for General Takaful Business in General Takaful Categories 1 (Accident) or 2 (Sickness); or

(b) more than 20% of its gross outstanding liabilities are attributable to Takaful Contracts for General Takaful Business in General Takaful Categories 10 (Motor vehicle liability), 11 (Aircraft liability), 12 (Liability of ships), 13 (General liability), 14 (Credit) or 15 (Suretyship).

(6) The Approved Actuary —

(a) must consider the implications and outlook for the Takaful Operator of each matter mentioned in sub-rule (4); and

(b) if the implications for the Takaful Operator are adverse, must make recommendations to address the problem.

(7) A Financial Condition Report for a Branch must be prepared in relation to the Takaful Operator's AIFC operations, but must take into account the financial position of the head office.

Guidance

A Takaful Operator's Approved Actuary may rely on other expert opinion to address any matter required by a Financial Condition Report which the Approved Actuary does not feel qualified to comment on. However, any third party opinion relied on for a Financial Condition Report should be clearly identified in the report.

9.1.4 AFSA may direct more frequent Financial Condition Reports

(1) The AFSA may direct a Takaful Operator to ask require its Approved Actuary to prepare a Financial Condition Report at a higher frequency than that specified in TRR 9.1.2 (Financial Condition Reports), if the AFSA considers it necessary or desirable for the prudential supervision of the Takaful Operator.

(2) A Takaful Operator must comply with a direction under subrule (1).

9.1.5 AFSA may direct special review

(1) The AFSA may direct a Takaful Operator that the Takaful Operator's Approved Actuary—

(a) is to carry out a review of matters specified by the AFSA relating to the Takaful Operator's operations, risk management or financial affairs; and

(b) is to prepare a report on the basis of that review.

(2) The Takaful Operator must bear the cost of the review.

(3) A Takaful Operator must comply with a direction under sub-rule (1).

(4) The Takaful Operator's Approved Actuary must give the report simultaneously to the AFSA and the Takaful Operator within 3 months of the date of the direction, unless the AFSA grants an extension of time in writing.

9.2 Takaful Operators that are not required to have an Approved Actuary

9.2.1 Application

TRR 9.2.2 to 9.2.5 apply to a Takaful Operator that is not required to have an Approved Actuary.

Note For the Takaful Operators that are required to have an Approved Actuary, see TRR 2.2.2 (Obligation to appoint Approved Individuals to certain roles).

9.2.2 Actuarial reporting requirements for general Takaful business

The Governing Body of a Takaful Operator to which this Rule applies—

(a) must consider annually whether to commission an independent actuary to report on its business; but

(b) must commission such a report at least once every 3 years.

9.2.3 Qualifications etc of independent actuary

(1) If a Takaful Operator decides to commission an actuarial report, it must appoint, to prepare the report, an individual who—

(a) has the qualifications set out in sub-rule (2); and

(b) satisfies the criteria set out in sub-rule (3).

(2) The qualifications are—

(a) that he or she has appropriate formal qualifications and is a member of a recognised professional body;

(b) that he or she has at least 5 years' relevant experience in providing actuarial services to Takaful Operators, either in the AIFC or in other jurisdictions; and

(c) that the experience is sufficiently recent to ensure that he or she is familiar with current issues in the provision of such services to Takaful Operators.

(3) The criteria are the following:

(a) that he or she does not exercise any Controlled Function or Designated Function for the Takaful Operator or a related body corporate (except a related body corporate that is a subsidiary of the Takaful Operator);

(b) that he or she is not—

(i) an auditor (under section 136(1) of the Companies Regulations for the Takaful Operator;

(ii) an Employee or Director of an entity of which that auditor is an Employee or Director; nor

(iii) a partner of that auditor.

9.2.4 Actuarial reports

(1) The actuary who prepares an actuarial report for the purposes of TRR 9.2.2 must sign it.

(2) The Takaful Operator concerned must ensure that the actuary is given appropriate access (that is, such access as the actuary reasonably believes to be necessary to prepare the report) to—

(a) all relevant data, information, reports and staff of the Takaful Operator; and

(b) so far as possible, any contractor of the Takaful Operator.

(3) The report must give details, for each category of General Takaful Business that the Takaful Operator conducts, of the following matters:

(a) recent trends in the business;

(b) the actuary's estimate of the value of the Takaful Liabilities and assets arising in respect of those liabilities, determined in accordance with TRR 6 (Assets and liabilities – General Takaful Business);

(c) if the assumptions or the valuation method used for that estimate differ from those adopted for the previous valuation of those assets and liabilities, the effect, as at the date on which the actuary signs the report, of those changes on the value of those liabilities and assets;

(d) the adequacy and appropriateness of the data that the Takaful Operator made available to the actuary;

(e) the procedures that the actuary used to assess the reliability of that data;

(f) the model or models that the actuary used;

(g) the assumptions that the actuary used in the valuation process (including, without limitation, assumptions made as to inflation and discount rates, future expense rates and, if relevant, future investment income);

(h) how the actuary estimated the variability of the estimate;

(i) the nature and findings of sensitivity analyses that the actuary undertook.

(4) The Takaful Operator's Governing Body must give a copy of the signed report to the AFSA on or before the date on which the Takaful Operator must give its next annual prudential return to the AFSA under TRR 13.1.1 (Obligation to prepare prudential returns).

9.2.5 Additional powers of the AFSA

(1) If at any time the AFSA believes it is necessary that a Takaful Operator to which this Rule applies should obtain an actuarial report relating to the Takaful Operator's operations, risk management or financial affairs, it may direct the Takaful Operator to do so at the Takaful Operator's expense.

(2) The Takaful Operator—

(a) must appoint an actuary who satisfies the criteria in TRR 9.2.3 (Qualifications etc of independent actuary) to prepare the report; and

(b) must notify the AFSA of the name and credentials of the actuary appointed.

(3) If the AFSA is of the opinion that the actuary appointed by the Takaful Operator fails to satisfy the relevant criteria, the AFSA may direct the Takaful Operator to appoint an actuary chosen by the AFSA to prepare the report.

(4) The Takaful Operator must submit the report to the AFSA within 3 months of the direction, unless the AFSA allows an extension of time in writing.

10 Takaful Operators that are members of Groups

10.1.1 Application

TRR 13 applies to every Takaful Operator that is a member of a Group.

Guidance

Group is defined in the Glossary as a group of entities which includes an entity (the 'first entity') and: (a) any parent of the first entity; and (b) any subsidiaries (direct or indirect) of the parent or parents in (a) or the first entity.

10.1.2 Purpose

TRR 13 imposes additional requirements on a Takaful Operator that is a member of a Group to ensure that:

(a) the Takaful Operator is capitalised adequately to protect itself against the risks arising from its membership of the Group, and is otherwise protected against those risks;

(b) it can be properly supervised by the AFSA;

(c) it provides the AFSA with information about the structure and financial position of the Group; and

(d) it assesses the effect of, and notifies the AFSA of, certain transactions within the Group.

10.1.3 Group structure

(1) The structure of the Takaful Operator's Group must be transparent and must not hinder the effective supervision of the Takaful Operator.

(2) The structure and risk profile of the Group must not hinder the Takaful Operator's stability and solvency.

(3) The overall governance, high-level controls and reporting lines within the Group must be clear so far as they affect the Takaful Operator.

(4) A Takaful Operator must not be subject to material control or influence from another Group member that is exercised through informal or undocumented channels.

(5) There must be clear and certain protocols for the performance of functions for the Takaful Operator at the Group level.

10.1.4 Direction regarding Eligible Capital

(1) A Takaful Operator must hold such additional Eligible Capital as the AFSA may direct (above the Capital Requirement for the Takaful

Operator, as specified by these rules) to cover risks arising because of its Group membership.

(2) If the AFSA directs a Takaful Operator to hold additional Eligible Capital, the Takaful Operator must increase its Eligible Capital by the amount directed by the AFSA within such period as the AFSA may specify.

(3) A direction under sub-rule (1) may specify that the additional Eligible Capital is to take a particular form.

Guidance: When AFSA might give direction regarding capital resources

By way of example only, the AFSA might direct a Takaful Operator to hold additional capital:

- if the Group is conducting an intra-group transaction that may adversely affect the solvency or financial position of the Takaful Operator;
- if there are risks that arise from the existence of a non-regulated entity within or connected to the Group and may adversely affect the solvency position of the Takaful Operator; or
- if there are risk transfer or Retakaful / reinsurance arrangements within the Group that impose disproportionate risks on the Takaful Operator.

10.1.5 Intra-group transactions

(1) A Takaful Operator must ensure that any material transaction with another member of its Group:

(a) is entered into on an ‘arm’s-length’ basis; and

(b) is on fair and reasonable terms.

Guidance

A single transaction or series of connected transactions that constitute a sale, purchase, exchange, loan or extension of credit, investment or guarantee involving 0.5% or less of a Takaful Operator’s Eligible Capital as at the end of the last standard quarter (the standard quarters end on 31 March, 30 June, 30 September and 31 December) before the effective date of the transaction would not normally be considered material for the purposes of this rule.

(2) The Takaful Operator must ensure that its books, accounts and records clearly and accurately disclose the nature and details of the transaction, including any accounting information necessary to demonstrate that the terms were fair and reasonable.

10.1.6 Certain transactions to be inquired into by Takaful Operator's Governing Body

(1) An AIFC-Incorporated Takaful Operator must not enter into a transaction of a kind described in sub-rule (2) unless its Governing Body is satisfied, after reasonable inquiry, that the transaction does not adversely affect the interests of policyholders.

(2) The kinds of transaction are the following:

(a) an intra-group transaction (including a sale, purchase, exchange, loan, guarantee or investment) the amount of which is 3% (or more) of the Takaful Operator's Eligible Capital;

(b) a loan to a person not related to the Takaful Operator, if there is an agreement or understanding that the proceeds of the loan, or a substantial part of those proceeds, will be used to make loans to purchase assets of, or make investments in, another Group member, and the amount of the loan is 3% (or more) of the Takaful Operator's Eligible Capital;

(c) an intra-group reinsurance agreement, or a modification to such an agreement, if the reinsurance premium or change in the Takaful Operator's liabilities is 5% (or more) of the Takaful Operator's Eligible Capital ;

(d) a reinsurance agreement, or a modification to such an agreement, involving the transfer of assets from the Takaful Operator to a person not related to it, if:

(i) there is an agreement or understanding between the Takaful Operator and that person that any part of the assets will be transferred to one or more other persons related to the Takaful Operator; and

(ii) the reinsurance premium or change in the Takaful Operator's liabilities is 5% (or more) of the Takaful Operator's Eligible Capital;

(e) an intra-group management agreement, service contract or cost-sharing arrangement.

(3) A reference in sub-rule (2) to a Takaful Operator's Eligible Capital is a reference to that capital as at the end of the last standard quarter before the relevant transaction.

(4) A Takaful Operator's Governing Body may delegate its responsibility under sub-rule (1) to the Takaful Operator's senior management if the Takaful Operator's Risk Management Strategy and internal control framework permit the Governing Body to do so.

(5) In this rule:

loan includes the extension of credit.

standard quarter means each 3-month period ending on 31 March, 30 June, 30 September and 31 December.

Guidance: use of supervision powers by the AFSA

The AFSA has power to impose a requirement upon a Takaful Operator pursuant to section 100 of the FSFR. The AFSA is likely to exercise such power if it considers that the Takaful Operator's Group is conducting an intra-group transaction that may adversely affect the solvency or financial position of the Takaful Operator, or there are risks that arise from the existence of a non-regulated entity within or connected to the Group and may adversely affect the solvency position of the Takaful Operator, or risk transfer or Retakaful / reinsurance arrangements within the Group that impose disproportionate risks on the Takaful Operator. Requirements imposed by the AFSA pursuant to such power are likely to relate to the Takaful Operator's treatment of intra-group transactions, the Takaful Operator's treatment of risk concentration within the Group and/or supervisory reporting and disclosure of information by the Takaful Operator.

The AFSA has power under section 96 of the FSFR to require an Authorised Person provide specified information or produce specified documents. The AFSA also power under section 97 of the FSFR to require the production of a report. The AFSA is likely to exercise such powers if the Takaful Operator's Group is conducting an intra-group transaction that may adversely affect the solvency or financial position of the Takaful Operator or if there are risks that arise from the existence of a non-regulated entity within or connected to the Group and which may adversely affect the solvency position of the Takaful Operator. Examples of directions that the AFSA is likely to issue pursuant to such powers include a requirement to produce a statement of the consolidated financial position of the Takaful Operator's Group and/or information about any of the following: another entity or other entities in the Takaful Operator's Group, the structure of its Group, the relationships between entities in its Group and/or the procedures and controls to manage Group risk in the Group.

10.1.7 Specific obligations of Group members

(1) If a Takaful Operator is a member of a Group, the Takaful Operator's senior management should monitor any functions of the Takaful Operator, performed by any member of its Group.

Guidance

Examples of functions that may be performed for a Takaful Operator at Group level include:

- Group risk management
- capital planning
- liquidity
- compliance.

(2) The Takaful Operator's senior management should establish and maintain procedures and controls to identify and monitor the effect on the Takaful Operator of its relationship with the other members of the Group and the activities of those other members.

(3) The procedures and controls should include procedures to monitor:

(a) changes in relationships between Group members;

(b) changes in the activities of Group members;

(c) conflicts of interest arising within the Group;

(d) events in the Group, particularly those that might affect the Takaful Operator's own regulatory compliance (for example, any failure of control or compliance in another Group member);

(e) the effect on it of:

(i) its relationship with the other members of the Group;

(ii) its membership in the Group; and

(iii) the activities of the other members of the Group; and

(f) the Group's compliance with:

(i) the supervision requirements applicable to it, including systems for the production of relevant data; and

(ii) Group reporting requirements.

(4) The Takaful Operator should have procedures to insulate it, so far as practicable, from the adverse effects of other Group activities (for example, transfer pricing or fronting) or Group events that might expose the Takaful Operator to risk.

Guidance

Such procedures could include:

- a requirement for transactions within the Group to be at arm's length
- maintenance of "Chinese walls"
- development of contingency plans.

(5) The Takaful Operator's senior management should take reasonable steps to ensure that:

(a) other Group members are aware of the Takaful Operator's management and reporting obligations in relation to Group risk;

(b) Group capital and Group risk reporting requirements are complied with; and

(c) information about the Group provided to the AFSA is accurate, and is provided in a timely manner.

11 Transfer of Takaful business

11.1 Introduction

11.1.1 Application

This Chapter applies to every AIFC-Incorporated Takaful Operator.

Guidance

If a Takaful Operator established outside the AIFC participates (as transferor or transferee) in a transfer of Takaful Business from or to a branch of that Takaful Operator in the AIFC, the AFSA expects that Takaful Operator to take such steps as may be necessary to ensure that transfer is recognised in the AIFC, including for the purposes of TRR.

11.1.2 AIFC Takaful Business Transfer Scheme - definition

An AIFC Takaful Business Transfer Scheme is a scheme for transfer of the whole or part of the Takaful Business undertaken by an AIFC-Incorporated Takaful Operator.

11.2 Sanction Order

11.2.1 Requirement for order of the AIFC Court

No AIFC Takaful Business Transfer Scheme is to have effect unless an order sanctioning the scheme (a Sanction Order) has been made by the AIFC Court under section 112 of the FSFR.

11.2.2 Application for a Sanction Order

An application for a Sanction Order must be made by:

(1) whichever of the transferor or transferee concerned is an AIFC-Incorporated Takaful Operator; or

(2) by both transferor and transferee, if both are AIFC-Incorporated Takaful Operators.

11.2.3 Requirements on the applicant

Subject to such directions as the AFSA may give pursuant to section 112(2) of the FSFR, the applicant for a Sanction Order must ensure that:

(a) the application for a Sanction Order is accompanied by

(i) a written report on the terms of the scheme (the Scheme Report) that complies with rule 11.7; and

(ii) a written summary of the scheme (the Scheme Summary) that complies with rule 11.8;

(b) notice of the application for the Sanction Order is given to every policyholder resident in Kazakhstan who is affected by the scheme, in accordance with rule 11.9; and

(c) notice of the application for the Sanction Order is published in accordance with rule 11.10.

11.3 The Scheme Report

11.3.1 The Skilled Person

A Scheme Report may only be made by a person (the Skilled Person):

(a) appearing to the AFSA to have the skills necessary to enable him to make a proper report; and

(b) nominated or approved for the purpose, in writing, by the AFSA.

Guidance

In deciding whether or not to nominate or approve a person as a Skilled Person the AFSA may have regard to factors including that person's qualifications, experience, professional standing, access to necessary resources and independence from the transferor or transferee.

The AFSA would normally expect a Skilled Person to have an actuarial qualification and expertise relevant to the categories of Takaful Business with which the scheme is concerned.

11.3.2 The Scheme Report

A Scheme Report must

(a) be in a form approved by the AFSA;

(b) include a reasoned opinion as to whether or not the scheme (if it is sanctioned by the Court) is expected to have any material adverse impact on any of the policyholders of the transferor or the transferee; and

(c) include a reasoned conclusion as to whether (if the scheme is sanctioned by the Court) each AIFC-Incorporated Takaful Operator concerned with the scheme (whether as transferee or as transferor) will, taking the scheme into account, comply with the requirements of TRR.

Guidance

The AFSA may approve the form of a Scheme Report if the AFSA is satisfied that the report addresses all the material the issues raised by the scheme at an appropriate level of detail and is properly reasoned.

The opinion in (b) must address both the financial and non-financial impacts of the scheme. Non-financial impacts include, for example, changes to service levels that may be experienced by policyholders.

In (c), the relevant requirements of TRR include financial or prudential requirements such as the requirements to hold Eligible Assets in excess of the MCR and PCR, and also non-financial requirements, such as the requirement to have adequate systems and controls.

The matters that a Scheme Report should cover (in addition to the requirements in (b) and (c)), include:

(a) the rationale for the scheme;

(b) the terms of the agreement or deed under which the scheme is to be carried out;

(c) the categories of Takaful Business to be transferred by the scheme;

(d) details of assets and liabilities to be transferred by the scheme, including technical provisions, premiums, claims incurred and assets; and

(e) particulars of any other arrangements necessary to give effect to the scheme.

11.3.3 The Scheme Summary

The Scheme Summary must

(a) contain sufficient information, in language that is clear, fair and not misleading, to enable policyholders to understand how they may be affected if the scheme is sanctioned by the Court;

(b) be prepared or approved by the Skilled Person; and

(c) be approved by the AFSA.

Guidance

Examples of the information that a Scheme Summary may include are:

(a) that the AIFC-Incorporated Takaful Operator proposes to transfer the policyholder’s policy or policies to another Takaful Operator, on or after a specified date;

(b) the full name and contact details of the other Takaful Operator;

(c) the effect of the scheme (this explanation may be brief and may, for example, explain that from the date of the transfer all rights and liabilities under the policies will be transferred to the other Takaful Operator, so that premiums will have to be paid to, and claims will have to be lodged with, that Takaful Operator);

(d) any action the policyholder will need to take before or as a result of the transfer (for example, any changes in arrangements relating to paying premiums or lodging claims);

(e) how the scheme compares with possible alternatives;

(f) if the policyholder does not need to take any action before or as a result of the scheme, confirmation of that fact; and

(g) details of the compensation (if any) offered to policyholders for any loss of rights or expectations

11.4 Notice requirements

11.4.1 Notice given to policyholders

(1) The notice given to policyholders must include:

(a) Details of the place or places and times at which and the period during which an affected policyholder may obtain a copy of the scheme and any associated documentation; and

(b) the Scheme Summary referred to in rule 11.8.

(2) The period in (1) must be not less than 30 days, or such other period as the AFSA may direct in writing.

11.4.2 Publication of notice

(1) The applicant must publish notice of the application for the Sanction Order.

(2) The notice in (1) must

(a) be approved by the AFSA before publication;

(b) be published not less than three months (or such other period as the AFSA may direct in writing) before the hearing at which the Court will be asked to sanction the scheme; and

(c) be published in two national papers in Kazakhstan, or in such other publications as the AFSA may direct in writing.

12 Takaful Operators in run-off

12.1 Application and purpose

12.1.1 Application

TRR 15 applies to:

(a) every AIFC-Incorporated Takaful Operator; and

(b) every Branch in respect of its AIFC Takaful Business operations.

12.1.2 Meanings of terms relating to run-off

In this Chapter:

(a) a Takaful Operator in Run-off means a Takaful Operator that has ceased to effect Takaful Contracts in respect of the whole or a category of its Takaful Business (or, in the case of a Branch, the whole or a category of its AIFC Takaful Business), and a Family Takaful Fund in run-off is construed accordingly; and

(b) going into run-off or placing Takaful Business into run-off means ceasing to effect Takaful Contracts, and placing a Family Takaful Fund into run-off is construed accordingly.

12.1.3 Compliance with TRR 15 by Takaful Operator directed to go into run-off

A Takaful Operator in Run-off by virtue of a decision or notice of the AFSA to the effect that the Takaful Operator is to cease to effect Takaful Contracts shall comply with TRR 15 except to the extent the AFSA acting under its powers in the FSFR directs otherwise.

Guidance

1. The purpose of TRR 15 is to set out prudential provisions applying to Takaful Operators that cease to effect Takaful Business, either wholly or in respect of a particular category. The provisions are also applicable to Family Takaful Funds, but do not apply to Non-AIFC Takaful Business of a Branch.

2. A Takaful Operator may be in run-off because of a decision or notice of the AFSA under its powers in the FSFR requiring a Takaful Operator to cease to effect certain Takaful Contracts.

12.1.4 Certain contracts to be disregarded

For the purposes of this Chapter, in determining whether a Takaful Operator is effecting Takaful Contracts or has ceased to effect Takaful Contracts, including Takaful Contracts effected through a Family Takaful Fund, Takaful Contracts effected under a term of an existing Takaful Contract will be ignored unless the AFSA decides otherwise in respect of any particular contract.

Guidance

The effect of TRR 15.1.4 is to disregard, for the purposes of determining whether TRR 15 applies, Takaful Contracts that are effected by a Takaful Operator as a consequence of a term of an existing Takaful Contract. A contract will normally only be regarded as being effected under a term of an existing contract if the Takaful Operator does not have discretion to decline to effect the new contract or if it would be unreasonable for the Takaful Operator, having regard to the interests of the policyholder, to decline to effect it.

12.2 Takaful Operators ceasing to effect Takaful Contracts in a category

12.2.1 Application

TRR 15.2.2 (Takaful Operators to give notice of decision to cease business) and TRR 15.2.3 (Takaful Operators in run-off not to effect certain contracts) apply to a Takaful Operator that ceases or decides to cease to effect new Takaful Contracts or to renew Takaful Contracts:

(a) in a category in which the Takaful Operator has previously effected Takaful Business; or

(b) in respect of a Family Takaful Fund, in a category in which the Takaful Operator has previously effected Takaful Business through that Family Takaful Fund.

12.2.2 Takaful Operators to give notice of decision to cease business

A Takaful Operator to which this Rule applies must, within 28 days of a decision to cease to effect new Takaful Contracts in a category, notify the AFSA of its decision, in a notice specifying the following details:

(a) the effective date of the decision to cease effecting Takaful Contracts;

(b) the category to which the decision relates; and

(c) where relevant, the Family Takaful Fund to which the decision relates.

12.2.3 Takaful Operators in run-off not to effect certain contracts

(1) A Takaful Operator who has provided a notice to the AFSA in accordance with TRR 15.2.2 must not effect any Takaful Contracts in that category without the written permission of the AFSA.

(2) Where the notice referred to in TRR 15.2.2 relates to a Family Takaful Fund of the Takaful Operator, the restriction set out in this rule applies only to that Family Takaful Fund.

12.3 Run-off plans

12.3.1 Application

TRR 15.3.2 to 15.3.7 apply to:

(a) Takaful Operators that go into, or are in, run-off, or that maintain Family Takaful Funds that are in run-off;

(b) Takaful Operators that make a decision to go into run-off or to place a Family Takaful Fund into run-off; and

(c) Takaful Operators whose Licence to effect Takaful Contracts in respect of their entire Takaful Business or in respect of the entire business of a Family Takaful Fund is withdrawn by the AFSA.

12.3.2 Takaful Operator voluntarily in run-off to provide run-off plan

If a Takaful Operator decides to go into run-off or to place a Family Takaful Fund into run-off, the Takaful Operator must, at the same time as the notice referred to in TRR 15.2.2, provide the AFSA with a written run-off plan in respect of the Takaful Business being placed into run-off.

12.3.3 Takaful Operator directed to go into run-off to provide run-off plan

If the AFSA withdraws a Takaful Operator’s Licence to effect Takaful Contracts in respect of the Takaful Operator’s whole, or a category of, Takaful Business or the whole, or a category of, Takaful Business of a Family Takaful Fund, the Takaful Operator must, within 28 days after the day the Takaful Operator is given the written notice of withdrawal of its Licence (or, if later, the period specified in that notice), provide the AFSA with a written run-off plan in respect of that Takaful Business.

12.3.4 What run-off plans must cover

A Takaful Operator must ensure a run-off plan provided to the AFSA in accordance with this Part covers the period until all liabilities to policyholders relating to the Takaful Business in run-off are met and includes:

(a) an explanation of how, or the extent to which, all liabilities to policyholders will be met in full as they fall due;

(b) an explanation of how, or the extent to which, the Takaful Operator will maintain its compliance with the requirements of these rules until such time as all liabilities to policyholders are met;

(c) a description, appropriate to the scale and complexity of the Takaful Operator’s business, of the Takaful Operator’s business strategy;

(d) financial projections showing, in a form appropriate to the scale and complexity of the Takaful Operator’s operations, the forecast financial position of the Takaful Operator as at the end of each reporting period during the period to which the run-off plan relates;

(e) an assessment of the sensitivity of the financial position of the Takaful Operator to stress arising from realistic scenarios relevant to the circumstances of the Takaful Operator;

(f) details of the planned run-off reinsurance protections and the extent to which the planned reinsurance protections match the run-off realistic scenarios;

(g) details of the claims handling and reserving strategy; and

(h) details of the cost of the management of the run-off.

12.3.5 Application of run-off plan to fund

Where a Takaful Operator's Takaful Business in run-off relates to a Family Takaful Fund of that Takaful Operator, the run-off plan must deal with the matters set out in TRR 15.3.4 so far as they relate to that Family Takaful Fund.

12.3.6 Takaful Operator to monitor run-off plan etc

(1) This rule applies to a Takaful Operator that has given a run-off plan to the AFSA.

(2) The Takaful Operator must monitor the matters provided in the run-off plan.

(3) If there is a significant departure from the run-off plan, the Takaful Operator must tell the AFSA immediately, but by no later than the second business day after the day the departure happens or starts.

12.3.7 AFSA may direct Takaful Operator to amend run-off plan

(1) Where a Takaful Operator has notified a matter to the AFSA in accordance with TRR 15.3.6, the AFSA may by notice in writing require the Takaful Operator to provide an amended run-off plan.

(2) The Takaful Operator must provide an amended run-off plan within 28 days of receipt of the notice, unless the notice specifies a longer period.

12.4 Provisions in respect of contracts relating to Takaful Business in run-off

12.4.1 Application

TRR 12.4.2 (Takaful Operator with business in run-off to notify AFSA of certain contracts) applies only to a Takaful Operator that—

(a) is in run-off as regards its entire Takaful Business or the entire Takaful Business of a Family Takaful Fund;

(b) has provided a notice to the AFSA in accordance with TRR 15.2.2 (Takaful Operators to give notice of decision to cease business) in respect of its entire Takaful Business or the entire Takaful Business of a Family Takaful Fund; or

(c) has received a written notice from the AFSA withdrawing the Takaful Operator’s Licence to effect Takaful Contracts in respect of its entire Takaful Business or the entire Takaful Business of a Family Takaful Fund.

12.4.2 Takaful Operator with business in run-off to notify AFSA of certain contracts

(1) A Takaful Operator to which this Rule applies must—

(a) within 10 business days after the day its Takaful Business enters into run-off, tell the AFSA about the existence and principal features of any notifiable contract that existed at the time the business entered into run-off; and

(b) within 10 business days after the day it enters into a notifiable contract in relation to its Takaful Business in runoff, tell the AFSA about the existence and principal features of the contract.

(2) To remove any doubt, subrule (1) (b) applies whether or not the Takaful Business is conducted through a Family Takaful Fund that is in run-off.

(3) In this rule:

notifiable contract means—

(a) a contract with a person related to the Takaful Operator, other than a Takaful Contracts effected by the Takaful Operator before going into run-off;

(b) a contract with any person relating to the management of all or any of the Takaful Business in run-off;

(c) a contract with any person for reinsurance of all or any of the Takaful Business in run-off; or

(d) any other contract with a person mentioned in paragraph (b) or (c) or a person related to such a person.

12.5 Limitations on distributions by AIFC-incorporated Takaful Operators in run-off

12.5.1 Takaful Operator in run-off not to make distributions

(1) An AIFC-Incorporated Takaful Operator in run-off must not make any distribution to shareholders or members of the Takaful Operator, whether by way of dividends or otherwise, or any payment of management fees (other than fees payable under a contract notified to the AFSA in accordance with TRR 15.4.2), without the written consent of the AFSA.

(2) Any such distribution or return of capital or payment of management fees must be made within the period, if any, specified in the written notice of consent given by the AFSA.

13 Prudential returns

13.1.1 Obligation to prepare prudential returns

(1) A Takaful Operator must prepare and submit to the AFSA the annual, biannual and quarterly prudential returns set out in Schedule 7 (Prudential returns by Takaful Operators).

(2) The AFSA may require the Takaful Operator to prepare additional prudential returns, by giving a notice to that effect to the Takaful Operator.

Guidance: Waiver or modification of obligation to prepare prudential returns

A Takaful Operator may apply to the AFSA pursuant to section 9 of the Financial Services Framework Regulations for a direction waiving or modifying the requirements of TRR 6.1.1 (Obligation to prepare prudential returns).

13.1.2 Deadlines for provision of returns

(1) A Takaful Operator must give an annual prudential return to the AFSA within 4 months after the day the relevant financial year of the Takaful Operator ends.

(2) A Takaful Operator must give a biannual prudential return to the AFSA within 1 month after the day the relevant standard biannual period ends.

(3) A Takaful Operator must give a quarterly prudential return to the AFSA within 1 month after the day the relevant standard quarter ends.

(4) In this rule:

(a) standard biannual period means the 6-month period ending on 30 June or 31 December; and

(b) standard quarter means the 3-month period ending on 31 March, 30 June, 30 September or 31 December.

13.1.3 External audit opinion to accompany

When a Takaful Operator submits its annual prudential returns to the AFSA, it must also provide an external audit opinion to accompany those prudential returns.

13.1.4 Method of submission of prudential returns

A prudential return must be submitted by means of the AFSA's [electronic submission system].

Guidance: further supervisory powers of the AFSA to require information

Note that in addition to the obligation to prepare prudential returns in accordance with the Rules in this Chapter, a Takaful Operator may be required to provide specified information or specified documents under section 96 of the FSFR and to provide the AFSA with a report on any subject under section 97 of the FSFR. Without limiting their application, such powers may be exercised to require the Governing Body of a Takaful Operator to provide the AFSA with its view about the Takaful Operator's compliance with any relevant Rule or requirement to which the Takaful Operator is subject to under AIFC law, any prudential returns or any other statement or return being true and correct and not false or misleading; or any other matter the ASFA may specify.

14 Captive Takaful Operators

14.1 Introduction

14.1.1 Definition of Captive Takaful Operator

A Captive Takaful Operator is an Authorised Firm with a Licence to carry on Captive Takaful Business in a Shari'ah-compliant manner.

14.1.2 Definition of Captive Takaful Business

(1) Captive Takaful Business is the business of effecting or carrying out Takaful Contracts only for the business or operations of the Group to which the Captive Takaful Operator belongs.

(2) General Captive Takaful Business is Captive Takaful Business in relation to General Takaful Contracts.

(3) Family Captive Takaful Business is Captive Takaful Business in relation to Family Takaful Contracts.

14.1.3 Captive Takaful Operator to be incorporated in the AIFC

Only an Authorised Firm which is incorporated under the laws of the AIFC may apply to the AFSA for a Licence to conduct Captive Takaful Business.

14.2 Protected Cell Companies

14.2.1 Captive Takaful Operator may be a Protected Cell Company

(1) An Authorised Firm which is a Protected Cell Company incorporated under the Companies Regulations may apply to the AFSA for a Licence to conduct Captive Takaful Business.

(2) A Protected Cell Company may not otherwise carry on Takaful Business.

14.2.2 Captive Takaful Operators that are PCCs not to create cells without consent

A Captive Takaful Operator that is a Protected Cell Company must not create a Cell without the written consent of the AFSA.

14.2.3 Captive Takaful Operators that are PCCs to conduct Captive Takaful Business only through cells

A Captive Takaful Operator that is a Protected Cell Company must ensure that, when it conducts Captive Takaful Business, each Takaful Contract is attributable to a particular Cell of the Captive Takaful Operator.

14.2.4 Captive Takaful Operators that are PCCs not to conduct Captive General and Family Takaful Business through same Cell

A Captive Takaful Operator that is a Protected Cell Company must not conduct both Captive General Takaful Business and Captive Family Takaful Business through the same Cell.

14.3 Systems and Controls

14.3.1 Application of TRR 2 (Governance Framework)

A Captive Takaful Operator must comply with the requirements of TRR 2 (Governance Framework) as if it were a Takaful Operator, subject to the following rules.

14.3.2 Outsourcing of risk management function (TRR 2.3.1)

A Captive Takaful Operator may outsource its risk management function to a Captive Insurance Manager, subject to the rules relating to outsourcing in GEN 5.2 (Outsourcing).

14.3.3 Outsourcing of actuarial function (TRR 2.3.2)

A Captive Takaful Operator may outsource its actuarial function to a Captive Insurance Manager, subject to the rules relating to outsourcing in GEN 5.2 (Outsourcing).

14.3.4 Outsourcing of Controlled Functions (TRR 2.4 and GEN 2.2)

A Captive Takaful Operator may appoint an Employee of a Captive Insurance Manager to perform the Controlled Function of Risk Officer, Internal Auditor, Approved Actuary Finance Officer and/or Compliance Officer, provided that such Employee is an Approved Individual.

14.4 Risk Management Strategy

14.4.1 Application of TRR 3 (Risk Management Strategy).

A Captive Takaful Operator must comply with TRR 3 (Risk Management Strategy) as if it were a Takaful Operator.

14.5 Own Risk and Solvency Assessment (ORSA)

14.5.1 Application of TRR 4 (Own Risk and Solvency Assessment (ORSA)).

A Captive Takaful Operator must comply with TRR 4 (Own Risk and Solvency Assessment (ORSA)) as if it were a Takaful Operator.

Guidance: Waiver of requirement to conduct an ORSA

A Captive Takaful Operator may apply to the AFSA pursuant to section 9 of the FSFR for a direction waiving the requirement to conduct an ORSA in accordance with TRR 4.

14.6 Capital adequacy requirements

14.6.1 Application of TRR 5 (Capital adequacy requirements)

A Captive Takaful Operator must comply with the requirements of TRR 5 (Capital adequacy requirements) as if it were a Takaful Operator, subject to the following rules.

14.6.2 Minimum Capital Requirement (MCR) for a Captive Takaful Operator

For the purposes of Schedule 5 of TRR, the Capital Floor for a Captive Takaful Operator is

(a) [KZT x] for an Captive Takaful Operator carrying on Captive General Takaful Business;

(b) [KZT y] for an Captive Takaful Operator carrying on Captive Family Takaful Business; or

(c) An amount specified in writing by the AFSA.

14.6.3 Minimum Capital Requirement for a Protected Cell Company

(1) Subject to (2), each Cell of a Protected Cell Company must calculate its Minimum Capital Requirement in accordance with TRR 5.2.2 (Obligation to calculate MCR) as if it were a stand-alone Takaful Operator.

(2) For a Captive Takaful Operator that is a Protected Cell Company, the Capital Floor only applies to the overall Protected Cell Company and there is no Capital Floor for each Cell or the Core.

14.6.4 Prescribed Capital Requirement for a Protected Cell Company

Each Cell of a Protected Cell Company must calculate its Prescribed Capital Requirement in accordance with TRR 5.2.3 (Obligation to calculate PCR) as if it were a stand-alone Takaful Operator.

14.6.5 Eligible Capital of a Protected Cell Company

(1) Each Cell of a Protected Cell Company must calculate its Eligible Capital in accordance with TRR 5.2.1 (Obligation to calculate Eligible Capital).

(2) The Core of a Protected Cell Company must calculate its Eligible Capital in accordance with TRR 5.2.1 (Obligation to calculate Eligible Capital).

(3) In calculating its Eligible Capital, a Cell may only rely upon Non-Cellular Assets where it has entered into a recourse agreement with the Core pursuant to which it is entitled to rely upon such Non-Cellular Assets.

(4) The Core of a Protected Cell Company must not enter into a recourse agreement with a Cell where the total capital thereby made available to Cells of the Protected Cell Company would exceed the Eligible Capital of the Core.

14.7 Investment

14.7.1 Application of TRR 6 (Investment)

A Captive Takaful Operator must comply with TRR 6 (Investment) as if it were a Takaful Operator.

14.8 Segregation of Family Takaful assets and liabilities

14.8.1 Application of TRR 7 (Segregation of Family Takaful assets and liabilities)

A Captive Takaful Operator carrying on Captive Family Takaful Business must comply with TRR 7 (Segregation of Family Takaful assets and liabilities) as if it were a Takaful Operator.

14.9 Valuation

14.9.1 Application of TRR 8 (Valuation)

A Captive Takaful Operator must comply with TRR 8 (Valuation) as if it were a Takaful Operator.

14.10 Actuarial Reporting

14.10.1 Application of TRR 9 (Actuarial Reporting)

A Captive Takaful Operator must comply with TRR 9 (Actuarial reporting) as if it were a Takaful Operator.

14.11 Takaful Operators that are members of Groups

14.11.1 Application of TRR 10 (Takaful Operators that are members of Groups)

A Captive Takaful Operator must comply with TRR 10(Takaful Operators that are members of Groups) as if it were a Takaful Operator.

14.12 Transfer of Takaful business

14.12.1 Application of TRR 11 (Transfers of Business)

A Captive Takaful Operator must comply with TRR 11 (Transfer of Takaful business) as if it were a Takaful Operator.

14.13 Takaful Operators in run-off

14.13.1 Application of TRR 12 (Takaful Operators in run-off)

A Captive Takaful Operator must comply with TRR 12 (Takaful Operators in run-off) as if it were a Takaful Operator.

14.14 Prudential returns

14.14.1 Application of TRR 13 (Prudential Returns)

A Captive Takaful Operator must comply with TRR 13 (Prudential returns) as if it were a Takaful Operator.

Schedule 1 Categories of General Insurance

A Contract of Insurance will be a General Insurance Contract if it falls within one or more of the following categories:

General Insurance Category 1: Accident

Contracts of Insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the Person insured:

(1) sustaining injury as the result of an accident or of an accident of a specified class;

(2) dying as a result of an accident or of an accident of a specified class; or

(3) becoming incapacitated in consequence of disease or of disease of a specified class,

including contracts relating to industrial injury and occupational disease but excluding contracts falling within Family Takaful Category 4 (Permanent Health).

General Insurance Category 2: Sickness

Contracts of Insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of loss to the Persons insured attributable to sickness or infirmity but excluding contracts falling within Family Takaful Category 4 (Permanent Health).

General Insurance Category 3: Land vehicles

Contracts of Insurance against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.

General Insurance Category 4: Railway rolling stock

Contract of Insurance against loss of or damage to railway rolling stock.

General Insurance Category 5: Aircraft

Contracts of Insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.

General Insurance Category 6: Ships

Contracts of Insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.

General Insurance Category 7: Goods in transit

Contracts of Insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.

General Insurance Category 8: Fire and natural forces

Contracts of Insurance against loss of or damage to property (other than property to which categories 3 to 7 relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.

General Insurance Category 9: Damage to property

Contracts of Insurance against loss of or damage to property (other than property to which General Insurance Categories 3 to 7 relate) due to hail or frost or any other event (such as theft) other than those mentioned in General Insurance Category 8 (Fire and natural forces).

General Insurance Category 10: Motor vehicle liability

Contracts of Insurance against damage arising out of or in connection with the use of motor vehicles on land, including third-party risks and carrier's liability.

General Insurance Category 11: Aircraft liability

Contracts of Insurance against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.

General Insurance Category 12: Liability of ships

Contracts of Insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability.

General Insurance Category 13: General liability

Contracts of Insurance against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which General Insurance Categories 10, 11 or 12 relate.

General Insurance Category 14: Credit

Contracts of Insurance against risks of loss to the Persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.

General Insurance Category 15: Suretyship

(1) Contracts of Insurance against the risks of loss to the Persons insured arising from their having to perform contracts of guarantee entered into by them.

(2) Fidelity bonds, performance bonds, administration bonds, bail bonds or customs bonds or similar contracts of guarantee, where these are:

  (a) effected or carried out by a Person not carrying on the business of Accepting Deposits;

  (b) not effected merely incidentally to some other business carried on by the Person effecting them; and

(d) effected in return for the payment of one or more premiums.

General Insurance Category 16: Miscellaneous financial loss

Contracts of Insurance against any of the following risks, namely:

(1) risks of loss to the Persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on;

(2) risks of loss to the Persons insured attributable to their incurring unforeseen expense (other than loss such as is covered by contracts falling within General Insurance Category 18 (Assistance)); or

(3) risks which do not fall within sub-paragraph (1) or (2) and which are not of a kind such that Contracts of Insurance against them fall within any other General Insurance Category.

General Insurance Category 17: Legal expenses

Contracts of Insurance against risks of loss to the Persons insured attributable to their incurring legal expenses (including costs of litigation).

General Insurance Category 18: Assistance

Contracts of Insurance providing either or both of the following benefits, namely:

(1) assistance (whether in cash or in kind) for Persons who get into difficulties while travelling, while away from home or while away from their permanent residence; or

(2) assistance (whether in cash or in kind) for Persons who get into difficulties otherwise than as mentioned in sub-paragraph (1).

Schedule 2 Categories of Family Takaful

A Contract of Insurance will be a Family Insurance Contract if it falls within one or more of the following categories:

Family Takaful Category 1: Life and annuity

Contracts of Insurance on human life or contracts to pay annuities on human life, but excluding (in each case) contracts within Family Takaful Category 3.

Family Takaful Category 2: Marriage and birth

Takaful Contract to provide a sum on marriage or on the birth of a child, being contracts expressed to be in effect for a period of more than one year.

Family Takaful Category 3: Linked long term

Takaful Contract on human life or contracts to pay annuities on human life where the benefits are wholly or party to be determined by references to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).

Family Takaful Category 3: Permanent health

Takaful Contract providing specified benefits against risks of Persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that:

(1) are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the Persons concerned, or without limit of time; and

(2) either are not expressed to be terminable by the Takaful Operator, or are expressed to be so terminable only in special circumstances mentioned in the contract.

Schedule 3 Guidance about what should be included in a Takaful Operator's Risk Management Policy

1 Introduction

This Schedule sets out in detail what the AFSA would expect to see in a Takaful Operator's Risk Management Policy. Section 2 outlines the range of typical risks faced by a Takaful Operator in running its Takaful Business. The list of risks detailed in section 2 is not an exhaustive list of risks expected to be faced by a Takaful Operator and is only an indicative list of the typical risk exposures. Section 3 of this schedule describes the expectations of the AFSA's regarding the elements to be included in the Risk Management Policy of a Takaful Operator, in order to enable it to deal with its risk exposures.

2 Definitions

2.1 Shari'ah non-compliance risk

(1) Shari'ah non-compliance risk can be defined as the risk of financial loss and/or impairment of franchise & reputation, caused by a potential breach of Sharī`ah principles which may render Takaful Contracts invalid under Sharī`ah or deprive a participant of Takāful protection. The risk of Shari'ah non-compliance risk also includes adverse consequences of repercussions in terms of the incidence of other risks caused by a potential breach of Shari'ah principles.

(2) Sharī`ah non-compliance risk is unique to Takaful Operators as compared to conventional insurers. It could also arise due to the differences in interpretation of Fiqh al-Mu`āmalāt by Sharī`ah scholars. Consequent implications of such differences in interpretation may drive the risk of Shari'ah non-compliance. What may be deemed permissible by one scholar or in one jurisdiction may be considered otherwise by a different scholar or in another jurisdiction. Complications may arise when a parent has several Takaful Operators as subsidiaries in various jurisdictions or a Takaful Operator operating cross-border, particularly if some jurisdictions provide for fatwas and enforcement by a national Sharī`ah board or similar body while in other jurisdictions the responsibility remains with the Shari'ah Supervisory Boards of the individual Takaful Operators.

(3) Sharī`ah non-compliance risk is relevant to the product development process of a Takaful Operator. A Takaful Operator seeks competitive advantage over conventional insurers as well as its Takāful peers. While meeting the demand for innovative products, a Takaful Operator could inadvertently introduce Sharī`ah non-compliance in its products. Sharī`ah non-compliance risk is also relevant to the investment function of a Takāful Operator. The limited availability of Sharī`ah-compliant investment instruments may make a Takāful Operator susceptible to choosing an investment product whose Sharī`ah compliance is

questionable, when seeking to achieve adequate investment yield for its Takaful Funds.

(4) Sharī`ah non-compliance risk is an operational risk which can only be addressed by robust processes, systems and controls to prevent non-compliance and to detect and correct any instances that do occur. This risk is pervasive in the operations of a Takaful Operator. For example, the products of Takaful Operator should be Sharī`ah compliant, and the overall product cycle of a Takaful Operator therefore requires consideration of Sharī`ah compliance, including the possibility that a contract accepted incorporates, or changes during its currency to incorporate, elements that are individually non-compliant. Takaful Operators should establish policies and processes for addressing such instances. Similarly, processes for the selection and administration of investments should embed controls to prevent or detect the inadvertent selection of assets that are not Sharī`ah-compliant or to identify assets that have ceased to be Sharī`ah-compliant for divestment.

(5) Expense misattribution risk is the risk of inappropriate allocation of expenses into segregated funds. Compliance with Sharī`ah principles requires that these funds are not commingled. Consequently, expenses relating to the Takaful Funds which, under the terms of the contract, are not the responsibility of the shareholders should not be borne by the shareholders. Likewise, expenses not relating to the Takaful Funds should not be attributed to them.

(6) The risks in this area are aggravated due to the fact that the Takaful Operator receives remuneration from the Takaful Funds for managing them. Some expenses will relate to this activity, while others may be clearly attributable to a Takaful Fund. It is critical that the allocation of expenses as between funds complies with applicable law, is approved as appropriate by those responsible for governance (including Sharī`ah), and is clearly set out in the contracts and marketing materials with suitable prominence having regard to applicable disclosure requirements.

2.2 Risks arising from segregation of Takaful Funds

(1) This refers to the set of agency risks arising due to the structure of Takaful Business in which the Takaful Funds are separated from those attributable to shareholders of the Takaful Operator. The structure of a Takaful Operator differs from that of a conventional insurer in which shareholders' funds are invariably available to support Takaful activities. Consequently, this risk is unique to the operation of a Takaful Operator and requires specific consideration in the Takaful Operator's risk management framework. In view of these risks arising from the agency relationship in the Takaful structure, fairness and transparency are essential features of the governance framework of a Takāful Operator. There is a need for the Takaful Operator to establish an appropriate governance structure that represents the rights and interests of Takāful participants.

(2) If the Takaful Operator is unable to mitigate these risks by diversification between funds attributable to different stakeholders, the consequent loss of diversification contributes to higher economic capital requirements and, potentially, additional competitive pressures on that Takaful Operator.

(3) The risks that arise from segregation may include those associated with the provision of ancillary financial support by the shareholder's funds to the Takaful Fund in question, to meet its solvency and/or liquidity needs, commonly by way of Qarḍ. The risk implications of the use of Qarḍ depend on the extent to which Qarḍ may be, or is required to be, made available in a jurisdiction and its treatment in solvency calculations and public reporting. The risks to the shareholder's fund include the risk that Qarḍ will be required, as well as the risk that it will not be repaid, resulting in capital loss to the SHF.

(4) Segregation of funds also introduces a risk of incorrect attribution of transactions to a fund, resulting in expenses being borne or income being received by the wrong fund, further resulting in unfairness between the different types of stakeholders. As a consequence, transparency is an important principle to help in protecting the interests of the different stakeholders, so that participants are aware before entering into the contract which revenues and expenses are credited or charged to the relevant Takaful Fund. There is also a need to disclose the details of expenses which would be absorbed by the shareholder's fund as part of its business of managing the Takaful Funds and for which it is remunerated under the Takāful Contract.

(5) The shareholder's fund is also exposed to the risk of inadequate remuneration, if the fees or other income receivable from the Takaful Funds it manages are inadequate to meet the expenses to which the TO is committed under the contracts that it has written. This risk is also present in certain types of conventional insurance, where the expense risk is borne by the insurer rather than by the policyholder.

2.3 Credit risk

(1) Credit risk is:

(a) the risk of default by debtors, borrowers and other counterparties; and

(b) the risk of the loss of value of assets due to deterioration in their credit quality.

(2) Credit risk results from financial transactions with debtors, borrowers, securities issuers, brokers, policyholders, Retakaful Operators and guarantors.

(3) Credit risk includes on-balance-sheet and off-balance-sheet exposures from guarantees, Derivative contracts and performance-related obligations to counterparties. It can increase the risk profile of a Takaful

Operator and can adversely affect the Takaful Operator's financial viability.

2.4 Balance sheet and market risk

Balance sheet and market risk includes:

(a) investment risk;

(b) asset-liability management risk;

(c) liquidity risk; and

(d) derivatives risk.

2.5 Investment risk

(1) Investment risk is the risk of an adverse movement in the value of a Takaful Operator's assets, including off-balance-sheet exposures.

(2) Investment risk includes:

(a) equity risk;

(b) interest rate risk;

(c) foreign exchange risk;

(d) credit risk; and

(e) investment concentration risk.

(3) Because of the nature of Takaful business, there is a close relationship between investment risk and asset-liability management risk.

2.6 Asset-liability management risk

(1) Asset-liability management risk is the risk of an adverse movement in the relative values of assets and liabilities of a Takaful Operator due to changes in general market factors, such as interest rates, inflation and, if relevant, foreign exchange rates.

(2) The expected payment profile of a Takaful Operator's liability portfolios is a crucial part of asset-liability management, because it determines the exposure of the portfolios' value to interest rates. Property business, such as household insurance, is typically short-term. Liability business, such as public liability, is typically long-term. The interest rate sensitivity of assets and liabilities is broadly determined by the timing of cash flows, although that will not always be the case (for example, in the case of floating-rate notes or options).

(3) Assets and liabilities are well managed if their changes in value in response to market movements are highly correlated. If assets and liabilities are not well managed, the possibility of a reduction in asset value that is not offset by a reduction in liability value, or an increase in

liability value that is not offset by an increase in asset value, becomes significant.

(4) Because of the nature of Takaful business, there is a close relationship between investment risk and asset-liability management risk.

2.7 Liquidity risk

(1) Liquidity risk is the risk of the Takaful Operator not having sufficient cash or liquid assets to meet its cash outflows to policyholders and other creditors as they fall due.

(2) The nature of Takaful activities means that the timing and amount of cash outflows are uncertain. This uncertainty may affect the ability of a Takaful Operator to meet its obligations to policyholders or require a Takaful Operator to incur additional costs through, for example, raising additional funds at a premium on the market or through the sale of assets.

2.8 Derivatives risk

Derivatives risk is the risk from transactions in Derivative instruments such as forwards, futures, swaps, options, contracts for differences and other similar instruments.

2.9 Reserving risk

(1) Reserving risk is the risk that the reserves set aside by the Takaful Operator for its Takaful Liabilities (net of reTakaful and other recoveries for those liabilities) will be inadequate to meet the net amount payable when the Takaful Liabilities crystallise.

(2) In this Part, Takaful Liabilities includes:

(a) the liability for claims incurred up to the reporting date;

(b) the premium liability; and

(c) for Family Takaful business—the net value of future policy benefits and reTakaful recoveries anticipated for those liabilities.

2.10 Takaful risk

Takaful risk is the risk that inadequate or inappropriate underwriting, product design, pricing and claims settlement will expose a Takaful Operator to financial loss and consequent inability to meet its liabilities.

2.11 Underwriting risk

(1) Underwriting risk is the risk arising from the process by which a Takaful Operator determines:

(a) whether or not to accept a risk; and

(b) the terms and conditions to be applied, and the premium to be charged, if the risk is accepted.

(2) Weaknesses in underwriting and in its procedures and controls can expose a Takaful Operator to the risk of operational losses that may threaten its solvency position.

2.12 Product design risk

Product design risk, in relation to an Takaful product, means the risk arising from:

(a) the introduction of a new Takaful product; or

(b) the enhancement or variation of an existing Takaful product.

2.13 Pricing risk

Pricing risk, in relation to an Takaful product, means the risk arising from inaccurately estimating:

(a) the claims and other business costs arising from the product; and

(b) the income from the investment of the premium received for the product.

2.14 Claims settlement risk

(1) Claims settlement risk is the risk arising from the process by which Takaful Operators fulfil their contractual obligations to policyholders.

(2) The claims settlement process is triggered when a loss occurs and a claims notification is made to the Takaful Operator. The process begins with verifying the contractual obligation to pay the claim under the policy, and is followed by:

(a) an assessment of the amount of the liability (including loss adjustment expenses); and

(b) the prompt and efficient handling of the claim within the terms of the policy.

(3) Weaknesses in claims settlement and in its procedures and controls can expose a Takaful Operator to additional or increased losses that may threaten its solvency position.

2.15 Retakaful risk

Retakaful Contract risk is the risk that the reinsurance (or) Retakaful cover obtained by the Takaful Operator is inadequate.

2.16 Risks Relating to the Use of Retakāful

(1) Risks relating to the use of reinsurance and alternative risk transfer mechanisms are discussed in IAIS ICP 13: Reinsurance and Other Forms of Risk Transfer. This includes, but are not limited to, basis risk and the risk of excessive concentrations of exposure to individual or

connected counterparties. In addition to these issues, the specific nature of the Takāful raises risks unique to Takaful. The development of the Takāful industry has been accompanied by differing views as to the validity under Shari'ah of the use of conventional reinsurance by Takāful and Retakāful Operators.

(2) In addition, differences have emerged in the manner in which individual Retakāful contracts are effected and the attribution as between funds, in both the ceding Takaful Operators and Retakaful Operators, of revenues and expenses ancillary to the actual risk-sharing transaction (e.g. commissions). Takaful Operators need to ensure that the attribution of such revenues and expenses is transparent to participants, and also that the fairness of the attribution is considered objectively.

(3) A Takaful Operator needs to consider the credit risk exposure to Retakāful providers. The Takaful Operator also needs to consider the quality of risk selection and pricing exhibited by the Retakāful Operator, given that the principle adopted under the Retakāful contracts is one of risk sharing with other cedant Takaful Operators, rather than risk transfer. This is because of the inadequate control over these matters which could expose the Takaful Operator to losses arising from the operations of other Takaful Operators in the same Takaful Fund. A Takaful Operator also needs to consider, having in mind the interests of participants in its Takaful Fund, the financial status of any Retakaful Fund into which it proposes to share risks. The selection of Retakāful Operators and their Retakaful Funds should therefore be subject to due diligence and appropriate governance, with monitoring of exposures to individual providers and Retakaful Funds. If, however, a Retakāful contract does not share the ceding Takaful Operator's risk with that of other Takaful Operators, the Takaful Operator needs to consider whether the contract is effective in mitigating its risks.

2.17 Operational risk

(1) Operational risk is the risk of financial loss resulting from:

(a) inadequate or failed internal processes, people and systems; or

(b) external events.

(2) Operational risk includes:

(a) business continuity risk;

(b) technology risk;

(c) outsourcing risk;

(d) fraud risk;

(e) legal risk;

(f) project management risk; and

(g) any other risks that the Takaful Operator, having regard to its strategic plan and business plan, and the nature, scale and complexity of the Takaful Operator's business and operating environment, determines should be included.

2.18 Business continuity risk

(1) Business continuity risk is the risk of unexpected financial and non-financial losses (such as loss of data, premises and reputation) due to disruptions in a Takaful Operator's critical business operations.

(2) Disruptions may occur as a result of power failure, denial of access to work areas, fire, fraud, loss of key staff, failure of computer or data system, destruction of major equipment and security breaches arising from technology risk.

(3) Critical business operations are the business functions, resources and infrastructure that may, if disrupted, have a material impact on the Takaful Operator's business functions, reputation, profitability and policyholders.

2.19 Technology risk

(1) Technology risk is risk:

(a) that arises from the use of communication information technology infrastructure; and

(b) that generates events that may lead to the disruption or damage of a Takaful Operator's information systems or data.

(2) Technology risk is determined by the type and nature of threats targeting and affecting the Takaful Operator's environment. Takaful Operators rely heavily on technologies such as the internet and applications. In a highly interconnected and market-driven world, a Takaful Operator should have a reliable, flexible, complete and integrated set of operating processes to deal with technology risks.

2.20 Outsourcing risk

(1) Outsourcing risk is the risk posed to a Takaful Operator's business by non-performance, or poor performance, by a service provider of a function transferred to the service provider under a material outsourcing arrangement (within the meaning of CTRL).

(2) A Takaful Operator should not outsource a function if the outsourcing would result in unduly increasing the operational risk of the Takaful Operator.

(3) Financial firms frequently decide to outsource aspects of their operations to other parties, related or not. Outsourcing can bring significant benefits to a Takaful Operator in terms of efficiency, cost reduction and risk management. However, the process of implementing outsourcing arrangements and the outsourcing relationship itself may expose a

Takaful Operator to additional risk. It is therefore important that Takaful Operators take care to supervise the conduct of activities that are outsourced.

(4) The activities of service providers have the ability to undermine the risk management activities of Takaful Operators. Takaful Operators should take particular care in the outsourcing of activities such as underwriting and claims settlement, where inappropriate performance of the functions can expose the Takaful Operator to serious financial loss, for example through acceptance of inappropriate insurance risks, mis-pricing, failure to obtain appropriate reinsurance cover, or failure to detect invalid claims. These considerations apply to such arrangements as binding authorities and other agencies appointed by Takaful Operators.

(5) Takaful Operators should take care to manage the risk that the sound and prudent management of the Takaful Operator's business may be compromised by conflicting incentives in an outsourcing agreement. In particular, Takaful Operators should consider whether the remuneration structure creates any perverse incentives. For example, a service provider with underwriting authority may have an incentive to accept poorer quality business if remuneration is based on commission (especially if bonuses are given for volume) but is not affected by the performance of the Takaful Contract accepted.

(6) Intra-group outsourcing may be perceived as subject to lower risks than using service providers from outside a Group. However it is not risk-free and a Takaful Operator must still assess the associated risks and make appropriate arrangements for their management.

2.21 Fraud risk

(1) Fraud risk means:

(a) risk from unauthorised activities such as those that breach the controls, procedures, limits or other restrictions in a Takaful Operator's policies and procedures and in legal and regulatory requirements; or

(b) risk associated with:

(i) a deceptive act or omission intended to gain advantage for the party committing the fraud or other parties; or

(ii) an intentional act undertaken for personal gain or to tamper with or manipulate the financial or operational aspects of the business.

(2) Fraud risk exposes a Takaful Operator to financial losses if not managed properly.

(3) Fraud risk can result from:

(a) internal sources (such as redirection of premiums); and

(b) external sources (such as fictitious claims).

(4) Countering fraud is the concern of individual Takaful Operators and intermediaries who need to understand, and minimise their vulnerability to, fraud.

2.22 Legal risk

(1) Legal risk is the risk of a Takaful Operator being exposed to losses, penalties or reputational damage due to breaches of laws or regulatory obligations, inadequate Retakaful or other contracts, or changes in the laws affecting the Takaful Operator.

(2) Legal risk includes risks arising from:

(a) fines, penalties or punitive damages from supervisory actions or civil litigation;

(b) legal costs from litigation; and

(c) expenses arising from private settlements.

2.23 Project management risk

Project management risk is the risk that projects involving a Takaful Operator will not achieve the desired objectives or will have a negative effect on the adequacy of resources.

2.24 Concentration risk

(1) Concentration risk is the risk of over-reliance on, or excessive exposure to, a type of risk, counterparty, asset class, industry or region as a result of credit, balance sheet and market, reserving, Takaful, reTakaful, operational and Group risks.

(2) Concentration risk results from risk exposures with a loss potential that is large enough to threaten the solvency position of a Takaful Operator.

(3) A Takaful Operator's exposure to risks should not result in a concentration of risks that could result in losses so large as to threaten its solvency position.

2.25 Group risk

(1) Group risk is the risk of loss to a Takaful Operator as a result of its membership of a Group or linkages within a Group.

(2) Group membership can be a source of both strength and weakness for a Takaful Operator.

(3) The purpose of requiring a Takaful Operator that is a member of a Group to include Group risk in its risk management policy is to ensure that the

Takaful Operator takes proper account of the risks arising from its membership.

3 Risk management policy

3.1 Credit risk

(1) A Takaful Operator's Risk Management Policy for credit risk should include:

(a) a mandate setting out the acceptable range, quality and diversification of credit exposures (including those to Retakaful Operators, brokers and policyholders) and investments;

(b) limits for credit exposures at individual and consolidated levels to:

(i) single counterparties and Groups of related counterparties;

(ii) intra-group asset exposures to subsidiaries and related entities;

(iii) single industries; and

(iv) single regions;

(c) a process for approving changes in the credit mandate and changes in limit structures;

(d) a process for approving requests for temporary increases in limits and a process to ensure excesses are brought within the pre-approved limits within a set timeframe;

(e) a process for reviewing and, if necessary, reducing or cancelling exposures to a particular counterparty if it is known to be experiencing problems;

(f) a process to monitor and control credit exposures against pre-approved limits;

(g) a process to review credit exposures (at least annually, but more frequently if there is evidence of a deterioration in credit quality);

(h) a management information system that is capable of aggregating exposures to any 1 counterparty (or Group of related counterparties), asset class, industry or region in a timely manner; and

(i) a process of reporting to the Governing Body and senior management:

(i) any breaches of limits; and

(ii) large exposures and other credit risk concentrations.

(2) Actual and potential credit exposures to reTakaful Operators arising from current or possible future claims should be included in the Takaful Operator's risk management policy.

3.2 Investment risk

(1) A Takaful Operator's Risk Management Policy for investment risk should include:

(a) the Takaful Operator's investment objective;

(b) formulation of an investment strategy, including allowable asset classes, strategic asset allocation, asset allocation ranges, benchmarks, risk limits and target currency exposures and ranges;

(c) a process for how individual asset classes will be managed, including which of those tasks will be done internally and which will be outsourced to investment managers;

(d) the responsibilities of individuals and committees within the Takaful Operator (such as the investment committee and the asset-liability committee) for deciding and implementing the investment strategy, and for monitoring and controlling investment risk, including reporting lines, decision-making powers and delegations;

(e) a process for the selection of qualified and competent investment managers;

(f) limits and other restrictions on the actions of investment managers, whether internal or outsourced, and the means by which compliance with those limits are monitored;

(g) modelling and stress-testing of the effect of the current and alternative investment strategies on financial outcomes and asset-liability management;

(h) processes for:

(i) ensuring the continuing appropriateness of the investment strategy, including the timing and nature of strategy reviews;

(ii) ensuring the continuing appropriateness of the investment implementation process, including the timing and nature of reviews of investment managers and the manager configuration;

(iii) monitoring compliance with the investment strategy; and

(iv) making contingency plans to mitigate the effects of deteriorating investment conditions;

(i) the segregation of duties; and

(j) performance monitoring and its role in the oversight and control of the investment process.

(2) For paragraph (1) (b), the investment strategy should be formulated taking account of the investment objective, the Takaful Operator's capital position, the term and currency profile of its expected liabilities, liquidity requirements and the expected returns, volatilities and correlations of asset classes.

3.3 Asset-liability management risk

A Takaful Operator's Risk Management Policy for investment risk should include details about how:

(a) the Takaful Operator's investment and liability strategies allow interaction between assets and liabilities;

(b) the correlations between assets and liabilities are taken into account;

(c) cash outflows to policyholders and other creditors will be met by cash inflows; and

(d) the valuations of assets and liabilities will change under an appropriate range of scenarios.

3.4 Liquidity risk

A Takaful Operator's Risk Management Policy for liquidity risk should include:

(a) consideration of the level of mismatch between expected asset and liability cash flows under normal and stressed operating conditions;

(b) the liquidity and realisability of assets;

(c) commitments to meet Takaful and other liabilities;

(d) the uncertainty of the incidence, timing and magnitude of Takaful Liabilities;

(e) the level of liquid assets required to be held by the Takaful Operator; and

(f) other sources of funding, including Retakaful, borrowing capacity, lines of credit and intra-group funding.

3.5 Derivatives risk

A Takaful Operator's Risk Management Policy for derivatives risk should include:

(a) the Takaful Operator's objectives and policies in using Derivatives;

(b) a framework with limits on the use of Derivatives consistent with the Takaful Operator's risk tolerance;

(c) appropriate lines of authority and responsibility for transacting Derivatives, including trading limits;

(d) consideration of worst-case scenarios and sensitivity analysis; and

(e) a process for reporting of scenarios and analysis.

3.6 Reserving risk

(1) A Takaful Operator's Risk Management Policy for reserving risk should include:

(a) a process for the ongoing review and appraisal of the Takaful Liability valuation framework (including the assumptions made and Retakaful recoveries estimated);

(b) procedures and controls to ensure that the provision for Takaful Liabilities is, at all times, sufficient to cover any liabilities that have been incurred, or are yet to be incurred, on Takaful Contracts accepted by the Takaful Operator, as far as can reasonably be estimated;

(c) the methods to be applied in estimating the provision for Takaful Liabilities, including provisions for individual notified incurred claims;

(d) the methods to be applied in estimating the amount of the asset for reinsurance / Retakaful recoveries that are expected to arise on crystallisation of the gross Takaful Liabilities (the manner of estimating those assets must be consistent with the manner of estimating the gross liabilities, unless there is a sound justification for doing otherwise);

(e) procedures and controls to ensure that the selected approaches are applied accurately and consistently;

(f) procedures to review and monitor, on a regular basis, the out-turn of provisions made in previous years for Takaful Liabilities (gross and net of Retakaful recoveries);

(g) procedures to ensure that in-house or external specialists selected have the appropriate level of skill and experience and have available the necessary information to carry out the estimation required;

(h) suitable controls to ensure that the data used in determining the Takaful Liabilities are extracted from the underlying records accurately and to the necessary level of detail; and

(i) scenario testing for several years into the future, particularly for a Takaful Operator conducting Family Takaful business.

(2) For paragraph (1) (a), in conducting a review and appraisal of the Takaful Liability valuation framework, consideration should be given to emerging pricing and claim payment trends.

(3) For paragraph (1) (c), in determining a provision estimation method, a Takaful Operator may consider alternative approaches before selecting those regarded as most appropriate to the nature of the business.

(4) For paragraph (1) (h), the level of detail of the data used in determining the Takaful Liabilities should be sufficient to ensure that the data available covers the whole of the Takaful Operator's liabilities and exposures under Takaful contracts.

(5) In addition to the actuarial advice a Takaful Operator is required to obtain under Chapter 9, a Takaful Operator should consider the use of actuaries or other appropriately qualified and experienced loss reserving specialists to estimate Takaful Liabilities periodically through the year.

(6) The Takaful Operator should undertake periodic testing of its reserving processes and the level of its reserves, including continual reassessment of assumptions used, and testing the sensitivity of the valuation of Takaful Liabilities to stress arising from realistic scenarios relevant to the circumstances of the Takaful Operator.

3.7 Underwriting risk

A Takaful Operator's Risk Management Policy for underwriting risk should include:

(a) a statement of the Takaful Operator's willingness and capacity to accept risk;

(b) the nature of Takaful business that the Takaful Operator is to underwrite including:

(i) classes of Takaful;

(ii) the areas where it conducts business;

(iii) the types of risks included and excluded; and

(iv) the criteria for the use of reinsurance / Retakaful in the different classes of Takaful;

(c) details of the formal risk assessment process in the underwriting of insurance, including:

(i) the criteria used for risk assessment;

(ii) the methods for monitoring emerging experience; and

(iii) the methods by which the emerging experience is taken into consideration in the underwriting process;

(d) the process for setting approval authorities and the limits to those authorities (including controls surrounding delegations given to intermediaries of the Takaful Operator);

(e) risk and aggregate concentration limits; and

(f) methods for monitoring compliance with policies and procedures regarding underwriting, such as:

 (i) internal audit (but only if it is established that the internal audit function has the appropriate skills and experience to perform such activities);

 (ii) reviews by area heads or portfolio managers;

 (iii) peer review of policies (including details of the staff responsible for undertaking the peer review, the frequency of such reviews and the reporting arrangements for the results); and

 (iv) in the case of reTakaful Operators—audits of ceding companies to ensure that reinsurance assumed is in accordance with contracts in place.

3.8 Product design risk

A Takaful Operator's Risk Management Policy for product design risk should include:

(a) the product classes and types of risks in which the Takaful Operator chooses to engage;

(b) setting a business case for new or enhanced products;

(c) market testing and analysis;

(d) cost-benefit analysis;

(e) requirements for limiting risk through measures such as diversification, exclusions and reinsurance / Retakaful (including confirmation that the existing reinsurance will provide protection or new reinsurance protection is being provided);

(f) processes to ensure that policy documentation is adequately drafted to give legal effect to the proposed level of cover under the product;

(g) an implementation plan for the product, including milestones;

(h) clearly defined and appropriate levels of delegation for approval of all material aspects of product design;

(i) post-implementation review; and

(j) methods for monitoring compliance with product design policies and procedures.

3.9 Pricing risk

(1) A Takaful Operator's Risk Management Policy for pricing risk should include:

(a) clearly defined and appropriate levels of delegation for approval of all material aspects of pricing;

(b) a process for the reflection of emerging experience in price adjustments;

(c) profit-loss analysis, including monitoring the effect of price movements;

(d) price discounting authorities;

(e) a process for the Takaful Operator's product pricing to respond to competitive and other external environmental pressures;

(f) a process for monitoring, and the ability to monitor, deviations of actual price from the technical underwriting pricing;

(g) methods for monitoring compliance with pricing policies and procedures for proposed pricing variations; and

(h) the relationship between pricing, product development and investment management so that they are appropriately aligned.

(2) The AFSA expects Takaful Operators to consider doing the following in relation to pricing Takaful products:

(a) incorporating ongoing actuarial review of, and actuarial involvement in, the pricing process;

(b) undertaking independent reviews of:

(i) pricing for schemes; and

(ii) pricing for larger or more complex risks.

3.10 Claims settlement risk

A Takaful Operator's Risk Management Policy for claims settlement risk should include:

(a) clearly defined and appropriate levels of delegation of authority;

(b) claims settlement procedures and controls, including loss estimation and investigation procedures;

(c) criteria for accepting or rejecting claims;

(d) dispute resolution procedures; and

(e) methods for monitoring compliance with claims settlement procedures, such as:

(i) internal audit (but only if it is established that the internal audit unit has the appropriate skills and experience to perform such activities);

(ii) reviews by area heads or portfolio managers;

(iii) peer review (including details of the staff responsible for undertaking the peer review, the frequency of such reviews and the reporting arrangements for the results);

(iv) assessments of brokers' procedures and systems to ensure that the quality of information provided to the Takaful Operator is of a suitable standard; and

(v) in the case of reTakaful Operators—audits of ceding companies to ensure that the value of claims paid is in accordance with contracts.

3.11 Retakaful risk

A Takaful Operator's Risk Management Policy for Retakaful risk should include:

(a) the Takaful Operator's objectives (within its risk tolerance) for Retakaful/reinsurance management;

(b) the process for selection of reinsurance/Retakaful brokers and advisers;

(c) the processes for prudent and sound selection, management and monitoring of its Retakaful /reinsurance programme;

(d) managerial responsibilities and controls;

(e) the methods for determining all aspects of a Retakaful /reinsurance programme, including:

(i) identification and management of aggregations of risk exposures;

(ii) selection of probable maximum loss factors;

(ii) selection of realistic adverse scenarios, return periods and geographical aggregation areas; and

(iv) identification and management of vertical and horizontal coverage of the programme;

(f) the process for ensuring that there is accurate and complete Retakaful / reinsurance documentation;

(g) the selection of participants in Retakaful Contracts, including the criteria and procedures to ensure, and monitor, their diversity and creditworthiness;

(h) the procedures for identifying actual and potential credit exposures to individual Retakaful Operators or Groups of connected Retakaful Operators on programmes that are already in place; and

(i) the processes for entering into a limited risk transfer arrangement.

3.12 Business continuity risk

A Takaful Operator's Risk Management Policy for business continuity risk should:

(a) describe the process for identifying and analysing:

(i) events that may lead to a disruption in business continuity;

(ii) the likelihood of those events occurring;

(iii) the processes most at risk; and

(iv) the consequences of those events;

(b) include a plan (business continuity plan or BCP) describing:

(i) objectives and procedures for crisis management and recovery in order to minimise financial, legal, regulatory, reputational and other material consequences arising from the disruption of its business;

(ii) procedures to be followed if business continuity problems arise;

(iii) detailed procedures for carrying out the BCP, including manual processes, the activation of an off-site recovery site (if needed) and the persons responsible for activating the BCP;

(iv) a communications strategy and contact information for relevant staff, suppliers, regulators, market authorities, major clients, the media and other key staff;

(v) a schedule of critical systems covered by the BCP and the timeframe for restoring those systems;

(vi) the pre-assigned responsibilities of staff;

(vii) procedures for staff awareness and training on all aspects of the BCP; and

(vii) procedures for regular testing and review of the BCP; and

(c) procedures for backing up important data on a regular basis and storing the data off site.

3.13 Technology risk

A Takaful Operator's Risk Management Policy for technology risk should include:

(a) information technology policies and procedures to identify, assess, monitor and manage technology risks;

(b) arrangements for adequate information technology infrastructure that:

(i) meet its current and projected business requirements (both under normal circumstances and in periods of stress);

(ii) ensure data and system integrity, security and availability; and

(iii) support integrated and comprehensive risk management;

(c) the use of appropriate technology to manage adequately the financial, medical and personal information held by a Takaful Operator;

(d) procedures and controls on data security to enable it:

(i) to report, in a timely manner, security breaches to affected customers and to the AFSA; and

(ii) to meet other reporting requirements;

(e) processes to assess the risks associated with major breaches in data security and to mitigate the effects of such breaches on its resources, operations, environment and operations;

(f) as part of business continuity planning, measures to be taken in case of breaches of data security; and

(g) measures that ensure that Group structures are not used to circumvent prohibitions on the sharing of personal information.

3.14 Outsourcing risk

A Takaful Operator's Risk Management Policy for outsourcing risk should include:

(a) a process for negotiating or assessing outsourcing agreements with service providers;

(b) the setting and monitoring of authority limits and referral requirements;

(c) the identification and assessment of performance targets;

(d) the procedures for evaluation of performance against targets;

(e) the provisions for remedial action;

(f) the reporting requirements imposed on the service providers (including content and frequency of reports);

(g) the ability of the Takaful Operator and its external auditors to obtain access to the service providers and their records;

(h) the protection of intellectual property rights;

(i) the protection of customers' and the Takaful Operator's confidentiality;

(j) the adequacy of any guarantees, indemnities or Takaful cover that a service provider agrees to provide;

(k) the ability of a service provider to provide continuity of business; and

(l) the arrangements to change, or terminate, outsourcing agreements.

3.15 Fraud risk

A Takaful Operator's Risk Management Policy for fraud risk should include:

(a) internal controls and mitigation strategies;

(b) segregation of duties at an operational level and in relation to functional reporting lines;

(c) financial accounting controls;

(d) staff training and awareness; and

(e) appropriate processes for monitoring compliance with the Takaful Operator's procedures, controls, limits or other restrictions (such as those placed on investment managers or those making decisions on underwriting).

3.16 Legal risk

A Takaful Operator's Risk Management Policy for legal risk should include:

(a) processes for ensuring that documentation is accurate and complete;

(b) processes to ensure that policies are adequately drafted so that the Takaful Operator does not have to pay out for risks not priced into the original premium; and

(c) procedures and controls for ensuring that the Takaful Operator complies with all legal, prudential and other regulatory requirements.

3.17 Project management risk

A Takaful Operator's Risk Management Policy for project management risk should include:

(a) a method for the promulgation of project initiatives including:

(i) setting a business case for the project;

(ii) cost-benefit analysis of the project; and

(iii) stakeholder sign-offs;

(b) clearly defined and appropriate levels of delegation of authority;

(c) ongoing monitoring of project objectives and timeframes; and

(d) post-implementation review.

3.18 Concentration risk

A Takaful Operator's risk management policy for concentration risk should include:

(a) identification of large risk exposures;

(b) a description of the way in which large risk exposures are being managed, controlled and mitigated by the Takaful Operator;

(c) a description of any limits put in place by the Takaful Operator to control concentration risk;

(d) identification of on-balance sheet and off-balance sheet exposures to concentration risk;

(e) risk management procedures in relation to concentration risk; and

(f) processes to ensure that the Takaful Operator's exposures to large potential losses due to concentration risk are in line with its risk tolerance.

3.19 Group risk

(1) If a Takaful Operator is a Branch, or part of a Group, the Takaful Operator's Risk Management Policy for Group risk should:

(a) include a summary of the Group policy objectives and strategies;

(b) state whether the local risk management strategy is derived wholly or partly from the group-wide risk management strategy;

Note The Governing Body of a Takaful Operator must know the implications for the Takaful Operator of any group-wide risk management strategy (see CTRL, r 4.1.5 (4)).

(c) summarise the linkages and significant differences between the local risk management strategy and the group-wide risk management strategy, including differences arising from local business and other conditions;

(d) outline the procedures and timing for monitoring by, or reporting to, the parent entity or head office;

(e) describe the approach to reviews of the procedures in paragraph (d);

(f) include, if applicable, a summary of the Group policy objectives and strategies relating to Retakaful;

(g) summarise the linkages between local and Group Retakaful / reinsurance; and

(h) detail any arrangements relating to the existence of, and accessibility to, intra-group Retakaful / reinsurance.

(2) If a part of a Takaful Operator's Risk Management Policy is controlled by another entity in the Group, or by the head office, the risk management policy must describe the arrangement and how it works.

(3) If the Takaful Operator is a Branch or is part of an insurance Group and the head office or ultimate holding company is outside the QFC, the risk management policy should include a summary of the supervisory

arrangements regarding risk management in the jurisdiction where the head office or holding company is located.

Schedule 4 Calculation of Eligible capital

1 Application and purpose

1.1 Application

This Schedule applies to every AIFC-Incorporated Takaful Operator.

1.2 Purpose

Guidance

1. In assessing the adequacy of an AIFC-Incorporated Takaful Operator's financial resources, attention must be paid not only to the types of events or problems that it might encounter, but also the quality of the support provided by various types of capital instruments.
2. The purpose of this Schedule is to identify those capital instruments that can be included as Eligible Capital to meet the AIFC-Incorporated Takaful Operator's minimum capital requirement. In determining the rules governing whether a capital instrument is adequate for supervisory purposes, the AFSA has identified the following relevant matters, namely the extent to which each instrument:
    a. provides a permanent and unrestricted commitment of funds;
    b. is freely available to absorb losses from business activities;
    c. does not impose any unavoidable servicing charges against earnings;
    d. ranks behind the claims of policyholders and other creditors in the event of the winding-up of the AIFC-Incorporated Takaful Operator.
3. As Takaful Operators authorised to conduct Takaful Business in or from the AIFC in the legal form of a Branch will be subject to the regulatory capital requirements applicable in their home jurisdiction, the requirements of this Schedule do not apply to Branches.

2 Calculation of Eligible Capital

2.1 Calculating Eligible Capital

An AIFC-Incorporated Takaful Operator must calculate its Eligible Capital in accordance with the Eligible Capital Calculation Table in rule 2.2 (Eligible Capital Calculation Table) and the provisions in this Schedule.

Guidance

The AFSA may recognise forms of capital instruments in addition to those set out in the Eligible Capital Calculation Table for inclusion in an AIFC-Incorporated Takaful Operator's Eligible Capital where those instruments comply with accepted international standards.

2.2 Eligible Capital Calculation Table

The Eligible Capital Calculation Table is as follows:

(A) Tier 1 Capital:
Permanent Share Capital
Undistributable Reserves
Fund for future appropriations
(B) Deductions from Tier 1 Capital
Investments in own shares
Intangible assets
Interim net losses
(C) Tier 1 Capital after deductions = A-B
(D) Tier 2 Capital:
Perpetual qualifying hybrid capital instruments
Fixed dividend ordinary shares
Subordinated debt
Fixed term preference shares
Any other item approved for inclusion as Tier 2 Capital at the discretion of the AFSA
(E) Total Tier 1 Capital plus Tier 2 Capital = C+D

(F) Deductions from Total of Tier 1 and Tier 2 Capital:
Investments in subsidiaries and associates
Connected lending of a capital nature
Inadmissible assets
(G) Total Tier 1 Capital plus Tier 2 Capital after deductions = E-F = Total Eligible Capital

3 Components of Tier 1 Capital

3.1 Permanent Share Capital

Permanent Share Capital means ordinary paid-up share capital, or equivalent however called, which meets the following conditions:

(a) it is fully paid up;

(b) any dividends in relation to it are non-cumulative;

(c) it is available to absorb losses on a going concern basis;

(d) it ranks for repayment upon winding up or insolvency after all other debts and liabilities;

(e) it is undated;

(f) the proceeds of an issue of permanent share capital is immediately and fully available to the AIFC-Incorporated Takaful Operator;

(g) the AIFC-Incorporated Takaful Operator is not obliged to pay any dividends on the shares (except in the form of shares that themselves comply with this rule);

(h) the AIFC-Incorporated Takaful Operator does not have any other obligation or commitment to transfer any economic benefit in relation to that permanent share capital;

(i) dividends and other charges on the shares can only be paid out of accumulated realised profits;

3.2 Undistributable Reserves

(1) Undistributable Reserves has the meaning attributed to it by Article 72(7) of the AIFC Companies Regulations (AIFC Regulations No. 2 of 2017) namely any of the following:

(a) a Company's share premium account;

(b) a Company's capital redemption reserve;

(c) the amount by which a Company's accumulated, unrealised profits (so far as not previously utilised by Distribution or capitalisation) exceeds its accumulated, unrealised losses (so far as not previously written off in a reduction or reorganisation of capital duly made);

(d) any other reserve that the Company is prohibited from distributing by its Articles of Association or under any applicable AIFC Regulations or AIFC Rules.

(2) Undistributable Reserves also include capital contributions if—

(i) the capital contributions satisfy the requirements of rule 3.1 (a) to (i); and

(ii) the AIFC-Incorporated Takaful Operator told the AFSA of its intention to include the capital contributions at least 1 month before the day they were included.

3.3 Fund for future appropriations

Fund for future appropriations means the fund comprising all funds the allocation of which either to policyholders or to shareholders has not been determined by the end of the financial year, or the balance sheet items under international accounting standards which in aggregate represent as nearly as possible that fund.

3.4 Intangible assets

Intangible assets include goodwill, capitalised development costs, brand names, trademarks and similar rights and licences.

4 Components of Tier 2 Capital

Guidance

Tier 2 Capital consists of instruments that, to varying degrees, fall short of the quality of Tier 1 Capital but nonetheless contribute to the overall strength of an AIFC-Incorporated Takaful Operator. Such instruments include some forms of hybrid capital instruments that have the characteristics of both equity and debt, that is they are structured like debt, but exhibit some of the loss absorption and funding flexibility features of equity.

4.1 Perpetual qualifying hybrid capital instruments

An AIFC-Incorporated Takaful Operator may only include perpetual qualifying hybrid capital instruments as part of its Tier 2 Capital if:

(a) they are unsecured, subordinated and fully paid-up;

(b) they are perpetual; and

(c) they are available to absorb losses on a going concern basis.

4.2 Subordinated debt

(1) An AIFC-Incorporated Takaful Operator must not include subordinated debt as part of its Eligible Capital unless it meets the following conditions:

(a) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;

(b) no interest or principal may be payable:

(i) at a time when the AIFC-Incorporated Takaful Operator is in breach of its minimum capital requirement; or

(ii) if the payment would mean that the AIFC-Incorporated Takaful Operator would be in breach of these rules;

(c) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding-up of the AIFC-Incorporated Takaful Operator;

(d) the remedies available to the subordinated creditor in the event of non-payment in respect of the subordinated debt must be limited to petitioning for the winding up of the AIFC-Incorporated Takaful Operator or proving for the debt and claiming in the liquidation of the AIFC-Incorporated Takaful Operator;

(e) any events of default and any remedy described in paragraph (d) must not prejudice the matters in paragraphs (a) and (b);

(f) in addition to the requirements about repayment in paragraphs (a) and (b), the subordinated debt must not become due and payable before its stated final maturity date except on an event of default complying with paragraph (c);

(g) the agreement and the debt are governed by the laws of a jurisdiction—

(i) under which the other conditions mentioned in this subrule can be met; or

(ii) that is otherwise acceptable, generally or in a particular case, to the AFSA;

(h) to the fullest extent permitted under the law of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the AIFC-Incorporated Takaful Operator against subordinated amounts owed to them by the AIFC-Incorporated Takaful Operator;

(i) the terms of the subordinated debt must be set out in a written agreement or instrument that contains terms that provide for the conditions set out in paragraphs (a) to (h);

(j) the debt must be unsecured and fully paid up;

(k) the AIFC-Incorporated Takaful Operator has notified the AFSA that it intends to include subordinated debt as part of its Eligible Capital and the AFSA has not advised the AIFC-Incorporated Takaful Operator in writing within thirty days of the date of the notification that the subordinated debt must not form part of its Eligible Capital.

(2) An AIFC-Incorporated Takaful Operator must not include in its Eligible Capital subordinated debt issued with step-ups in the first 5 years following the date of issue.

(3) For the purposes of calculating the amount of subordinated debt that may be included in its Eligible Capital, an AIFC-Incorporated Takaful Operator must amortise the principal amount on a straight-line basis by 20% per annum in its final 4 years to maturity.

4.3 Legal opinions on Tier 2 Capital instruments

(1) An AIFC-Incorporated Takaful Operator must obtain a written external legal opinion stating that the requirements of rules 4.1 or 4.2 have been met in respect of any perpetual qualifying hybrid capital instrument or subordinated debt that the AIFC-Incorporated Takaful Operator is proposing to include as Eligible Capital.

(2) An AIFC-Incorporated Takaful Operator must provide copies of the opinions referred to in subrule (1) to the AFSA if requested by the AFSA to do so.

4.4 Other Tier 2 Capital instruments

An AIFC-Incorporated Takaful Operator may include additional items in its Tier 2 Capital with the written approval of the AFSA.

Guidance: ASFA approval of other items of Tier 2 Capital

The matters that will be taken into account by the AFSA in considering an instrument for potential approval as Tier 2 Capital include (but are not limited to) the following:

(a) the extent to which and in what circumstances the proposed capital element is subordinated to the rights of policyholders in an insolvency or winding up;

(b) the extent to which the proposed capital element is fully paid and available to avoid losses;

(c) the period for which the proposed capital element is available; and

(d) the extent to which the proposed capital element is free from mandatory payments or encumbrances.

5 Deductions from total of Tier 1 and Tier 2 Capital

5.1 Investments in subsidiaries and associates

An AIFC-Incorporated Takaful Operator must deduct investments in subsidiaries and associates from the total of Tier 1 Capital and Tier 2 Capital.

5.2 Connected lending of a capital nature

An AIFC-Incorporated Takaful Operator must deduct connected lending of a capital nature from the total of Tier 1 and Tier 2 Capital.

Guidance

The AFSA regards connected lending of a capital nature to be any lending to a company in the same Group as the AIFC-Incorporated Takaful Operator for activities which that company would find hard to finance from another source, and is typically on a long term basis. Unless there is a genuine ability for the funds to be repaid within a short time, it is generally considered that the loan is of a capital nature.

5.3 Inadmissible assets

An AIFC-Incorporated Takaful Operator must deduct the following inadmissible assets from the total of Tier 1 Capital and Tier 2 Capital:

(a) tangible fixed assets, including inventories, plant and equipment and vehicles;

(b) deferred acquisition costs;

(c) deferred tax assets;

(d) deficiencies of net assets in subsidiaries;

(f) any investment by a subsidiary of the AIFC-Incorporated Takaful Operator in the AIFC-Incorporated Takaful Operator's own shares;

(g) holdings of other investments which are not readily realisable investments; and

(h) any other assets to be deducted from Eligible Capital as directed by the AFSA.

Guidance

The above assets have been identified as inadmissible assets because:

a. a sufficiently objective and verifiable basis of valuation does not exist;

b. their realisability cannot be relied upon with sufficient confidence;

c. their nature presents unacceptable custody risks; or

d. the holding of these may give rise to significant liabilities or onerous duties.

6 Limits on the use of different forms of capital

6.1 Instruments not to be included in Tier 2 Capital—exceeding 100% of Tier 1 Capital

A capital instrument is not eligible for inclusion in Tier 2 Capital to the extent that its inclusion will result in the aggregate amount of Tier 2 Capital exceeding 100% of eligible Tier 1 Capital (net of deductions).

Schedule 5 Calculation of Minimum Capital Requirement (MCR)

1 Minimum capital requirement (MCR)

Guidance

The MCR represents the supervisory intervention point at which the AFSA would invoke its strongest actions, if further capital is not made available. However, that this does not preclude such actions being taken by the AFSA for other reasons, and even if the MCR is met or exceeded. Therefore, the main aim of the MCR is to provide the ultimate safety net for the protection of the interests of policyholders.

1.1 The Capital Floor

(1) An AIFC-Incorporated Takaful Operator must maintain a paid up share capital of not less than the Capital Floor, or an equivalent sum in any currency acceptable to the AFSA.

(2) An AIFC-Incorporated Takaful Operator must maintain minimum shareholders' funds of at least 75% of the Capital Floor or an equivalent sum in any currency acceptable to the AFSA.

(3) The Capital Floor is –

(a) [KZT x] for an AIFC-Incorporated Takaful Operator carrying on General Takaful Business;

(b) [KZT y] for an AIFC-Incorporated Takaful Operator carrying on Family Takaful Business; or

(c) An amount specified in writing by the AFSA.

Guidance

The Capital Floor is a minimum bound on the MCR below which no Takaful Operator is regarded to be viable to operate effectively.

1.2 The MCR for General Takaful Business

(1) The MCR for an AIFC-Incorporated Takaful Operator carrying on General Takaful Business is an amount not less than the higher of -

(a) 2% of that Takaful Operator's gross written contributions for all of the Takaful Funds operated by it during the previous financial year, net of –

(i) the amount of any taxes on contributions, rebates, refunds, and commissions accrued by the Takaful Operator, and

(ii) the gross amount of any Retakaful contributions (after deduction of any rebates or commissions receivable by the Takaful Operator) ceded by the Takaful Operator in respect of all of the Takaful Funds forming part of its General Takaful Business during that preceding financial year;

(b) 12% of the value of claims reserves and contribution reserves, net of Retakaful and amounts reserved to maximum; and

(c) the Capital Floor applicable to that Takaful Operator.

(2) For the purposes of rule 1.2(1)(a) any funds received by a Takaful Operator in return for the assumption of Takaful obligations under a novation, portfolio transfer or other scheme or arrangement must be included in the gross contributions computation at a value:

(a) determined on a basis acceptable to the AFSA; and

(b) supported by an actuarial opinion acceptable to the AFSA.

Guidance

The AFSA generally expects the amounts received for an assumption of Takaful obligations to reflect the market value of that assumption, determined on an arms-length basis.

(3) Retakaful or Reinsurance ceded by a Takaful Operator to an Associated Party shall not be taken into account for the purposes of the MCR calculation unless

(a) the Associated Party is an AIFC-Incorporated Takaful Operator and meets the solvency requirements in these rules, or

(b) the AFSA, in any particular case, consents in writing to that Retakaful or reinsurance being taken into account.

1.3 The MCR for Family Takaful Business

(1) The MCR of a an AIFC-Incorporated Takaful Operator carrying on Family Takaful Business is an amount not less than the higher of -

(a) 2.5% of that Takaful Operator's total reserves including the reserves of all of its Family Takaful Funds, net of Retakaful; and

(b) the Capital Floor applicable to that Takaful Operator.

(2) Where a Takaful Operator has entered into Takaful Contracts falling within Family Takaful Category 3 Linked Family Takaful business, the value of the total reserves in rule 1.3(1)(a) should be reduced by the value of the linked liabilities.

(3) Reinsurance ceded by a Takaful Operator to an Associated Party shall not be taken into account for the purposes of the MCR calculation unless -

(a) the Associated Party is an AIFC-Incorporated Takaful Operator and meets the solvency requirements in these rules, or

(b) the AFSA, in any particular case, consents in writing to that Retakaful / reinsurance being taken into account.

Schedule 6 Calculation of Prescribed Capital Requirement (PCR)

1 Prescribed capital requirement (PCR)

1.1 Calculation of the PCR

The PCR for an AIFC-Incorporated Takaful Operator is the higher of:-

(a) 150% of the AIFC-Incorporated Takaful Operator's MCR; and

(b) the AIFC-Incorporated Takaful Operator's Risk-Based Capital Requirement.

2 Definitions

2.1 Risk-Based Capital Requirement

(1) For an AIFC-Incorporated Takaful Operator that has been approved to use its own internal model to calculate its Risk-Based Capital Requirement under TRR 5.3.1, the amount calculated using that model is the Risk-Based Capital Requirement.

(2) The Risk-Based Capital Requirement for an AIFC-Incorporated Takaful Operator that, under TRR 5.3.1 (Approval by AFSA), has been approved to use its own internal model to replace 1 or more components of its Investment, Takaful and Operational Risk Requirements is the amount calculated using those components as replaced and the other components of the AIFC-Incorporated Takaful Operator's Investment, Takaful and Operational Risk Requirements.

(3) The Risk-Based Capital Requirement (RBC) for any other AIFC-Incorporated Takaful Operator is the aggregate of the Risk-Based Capital Requirements for each of the Takaful Funds operated by it and the Risk-Based Capital Requirements for its own operational and financial risk exposures.

RBC for the Takaful Operator

$= \sum_i$ (RBC for Takaful Fund$_i$) + RBC for the Takaful Operator's own risk exposures

(4) RBC for the Takaful Fund or for the Takaful Operator as the case may be, is calculated as the sum of the following component requirements:

(a) Investment Risk Requirement;

(b) Takaful Risk Requirement; and

(c) Operational Risk Requirement.

Guidance

Among the three components of RBC detailed in 2.1 (4) above, only the investment risk requirement is applicable for the Takaful Operator. Therefore, the Takaful risk and operational risk requirements need not be calculated for the Takaful Operator. For each of the Takaful Funds operated by the Takaful Operator, all the three requirements must be calculated using the methodologies detailed below.

2.2 Investment Risk Requirement

The Investment Risk Requirement referred in 2.1 (a) above is defined as the sum of:

(a) Asset Risk Component;

(b) Off-Balance Sheet Asset Risk Component; and

(c) Off-Balance Sheet Liability Risk Component.

2.3 Takaful Risk Requirement

The Takaful Risk Requirement referred in 2.1 (b) above is defined as the sum of:

(a) Premium Risk Component;

(b) Outstanding Claims Risk Component;

(c) Family Takaful Risk Component; and

(d) Takaful Concentration Risk Component.

2.4 Operational Risk Requirement

(1) The Operational Risk Requirement referred in 2.1 (c) above is defined as 2% of whichever is the higher of:

(a) the gross contributions of the Takaful Fund in the 12 months ending on the Solvency Reference Date; and

(b) the technical provisions for the Takaful Fund (without deduction for Retakaful / reinsurance) as at the Solvency Reference Date.

(2) However, if the amount calculated under sub-rule (1) is more than a ceiling, calculated as:

$$\{ \text{investment risk requirement} + \text{Takaful risk requirement} \times \} \left(\frac{0.15}{0.85}\right);$$

then the Operational Risk Requirement is the amount of the ceiling.

3 Counterparty Grades

3.1 Meaning of Counterparty Grade

(1) In this Schedule:

(a) Counterparty Grade (or Grade) has the meaning given by sub-rule (2); and

(b) Invested Asset means an asset, right or interest held by a Takaful Operator or by a Takaful Fund for the primary purpose of generating revenue or for directly providing funds to meet potential cash outflows.

(2) For this Schedule, the Grade of an asset is its Grade according to the rating of its counterparty, in accordance with table A.

3.2 Table A Grade of assets according to counterparty ratings

Item	**Rating of counterparty by:**				**Grade of asset**
	Standard & Poor's	**Moody's**	**A. M. Best**	**Fitch**	
1	AAA	Aaa	A++	AAA	1
2	AA+ AA AA-	Aa1 Aa2 Aa3	A+	AA+ AA AA-	2
3	A+ A A-	A1 A2 A3	A A-	A+ A A-	3
4	BBB+ BBB BBB-	Baa1 Baa2 Baa3	B++ B+	BBB+ BBB-	4
5	BB+ or below	Ba1 or below	B or below	BB+ or below	5

Unrated assets, exposures and counterparties must be classified as Grade 4.

3.3 Using different credit rating agencies

(1) An AIFC-Incorporated Takaful Operator must rely on the ratings issued by the same credit rating agency for determining Counterparty Grades

unless the AIFC-Incorporated Takaful Operator has good reason to use a different credit rating agency or agencies.

(2) If a counterparty or debt obligation has been rated by more than 1 rating agency and there are 2 or more ratings that lead to different capital charges, the AIFC-Incorporated Takaful Operator must use the credit rating that results in the highest capital charge.

(3) An AIFC-Incorporated Takaful Operator must not use the rating of an agency that is not in table A unless the AIFC-Incorporated Takaful Operator has the written permission of the AFSA.

4 Investment Risk Requirement

4.1 Asset Risk Component

(7) The Asset Risk Component for a Takaful Operator or for any Takaful Fund is the sum of the amounts obtained by multiplying the value of each asset held by the relevant entity categorised according to the Counterparty Grade of the asset, by the percentage applicable to that asset, as detailed below:

(a) for assets that are not reinsurance / Retakaful assets—table B1;

(b) for assets that are Retakaful / reinsurance assets where the reinsurer / Retakaful Operator is subject to prudential supervision by a sub-rule (2) regulator—table B2; or

(c) for assets that are reinsurance assets where the reinsurer / Retakaful Operator is not subject to prudential supervision by a sub-rule (2) regulator—table B3.

(8) A regulator is a sub-rule (2) regulator if it is located:

(a) in the AIFC or the Republic of Kazakhstan;

(b) in 1 of the member states of the European Union;

(c) in Australia, Canada, Hong Kong, Iceland, Japan, Norway, Singapore, Switzerland, the United States of America; or

(d) in any other jurisdiction that is a signatory to the Multilateral Memorandum of Understanding on Cooperation and Information Exchange initiated by the International Association of Insurance Supervisors.

Note 1 For the list of the member states of the European Union, see http://europa.eu/about-eu/countries/index_en.htm.

Note 2 For the list of signatories to the Multilateral Memorandum of Understanding on Cooperation and Information Exchange, see http://www.iaisweb.org/MMoU-signatories-605.

4.2 Table B1 Percentage applicable to assets that are not reinsurance / Retakaful assets

Item	Asset	%
1	cash, bank deposits and other cash equivalents Grade 1 sovereign bonds	0.50
2	bonds that mature, or are redeemable, in less than 1 year issued by a counterparty with a rating of Grade 1 or 2 (excluding subordinated debt and government debt obligations dealt with anywhere else in this table) cash management trusts with a counterparty rating of Grade 1 or 2	1.00
3	unpaid premiums due 6 months or less previously from a counterparty with a rating of Grade 1, 2 or 3 bonds that mature, or are redeemable, in 1 year or more issued by a counterparty with a rating of Grade 1 or 2 (excluding subordinated debt and government debt obligations dealt with anywhere else in this table)	2.00
4	unpaid premiums due 6 months or less previously from an unrated counterparty or a counterparty with a rating of Grade 4 or 5 bonds issued by a counterparty with a rating of Grade 3 (excluding subordinated debt) cash management trusts with a counterparty rating of Grade 3 secured loans	4.00
5	unpaid premiums due more than 6 months previously from a counterparty with a rating of Grade 1, 2 or 3 bonds issued by a counterparty with a rating of Grade 4 (excluding subordinated debt) cash management trusts with a counterparty rating of Grade 4	6.00

Item	Asset	%
6	unpaid premiums due more than 6 months previously from an unrated counterparty or a counterparty with a rating of Grade 4 or 5 bonds issued by a counterparty with a rating of Grade 5 (excluding subordinated debt) cash management trusts with a counterparty rating of Grade 5 listed subordinated debt	8.00
7	unlisted subordinated debt preference shares	10.00
8	listed equity investment listed trusts	16.00
9	direct holdings of real estate unlisted equity investment unlisted trusts	20.00
10	loans to: (a) directors of the Takaful Operator; (b) directors of *related* parties; or (c) dependent relatives of such directors unsecured loans to employees (except loans of less than KZT350,000) assets subject to a fixed or floating charge	100.00
11	other non-reinsurance assets not mentioned in this table	20.00

4.3 Table B2 Percentage applicable to reinsurance assets—reinsurer / Retakaful Operator supervised by sub-rule (2) regulator

Item	Asset	%
1	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 1	1.00
2	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 2	2.00

Item	Asset	%
3	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 3	4.00
4	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 4	6.00
5	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 5	8.00

4.4 Table B3 Percentage applicable to reinsurance assets—reinsurer / Retakaful Operator not by supervised by sub-rule (2) regulator

Item	Asset	%
1	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 1	1.20
2	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 2	2.40
3	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 3	4.80
4	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 4	7.20
5	reinsurance assets due from reinsurer / Retakaful Operators with a counterparty rating of Grade 5	9.60

4.5 Effect of guarantee or collateral

(1) Assets that have been explicitly, unconditionally and irrevocably guaranteed for their remaining term to maturity by a guarantor with a counterparty rating in Grades 1, 2 or 3 who is not a related party to the AIFC-Incorporated Takaful Operator may be assigned the asset risk charge that would apply to a debt instrument issued from the guarantor.

(2) Where an AIFC-Incorporated Takaful Operator holds collateral against an asset, and this collateral takes the form of a charge, mortgage or other security interest in, or over, cash, or any debt security whose issuer

has a counterparty rating of Grades 1, 2 or 3, the AIFC-Incorporated Takaful Operator may apply the asset risk charge relevant to the collateral (instead of applying the asset risk charge that would otherwise apply to the asset).

(3) The provisions in sub-rules (1) and (2) above apply only to so much of the asset that is covered by the guarantee or the collateral.

4.6 Assets subject to mortgage or charge

(1) Subject to (2), assets of the AIFC-Incorporated Takaful Operator that are under a fixed or floating charge, mortgage or other security are subject to an asset risk charge of 100% to the extent of the indebtedness secured on those assets. This would replace the asset risk charge that would otherwise apply to the secured assets.

(2) Where the security supports an AIFC-Incorporated Takaful Operator's Takaful Liabilities, the asset risk charge of 100% is applicable only to the amount by which the market value of the charged assets exceeds the AIFC-Incorporated Takaful Operator's supported liabilities.

4.7 Excluded assets

An AIFC-Incorporated Takaful Operator need not include an amount in the asset risk charge for any asset excluded from Eligible Capital in accordance with the table in rule 4.2.2.

5 Off-Balance Sheet Asset Risk Component

5.1 When Off-Balance Sheet Asset Risk Component must be calculated

The Off-Balance Sheet Asset Risk Component must be calculated, if the AIFC-Incorporated Takaful Operator or any of its Takaful Funds are, as of the Solvency Reference Date, a party to a Shari'ah-compliant Derivative contract, including a forward, future, swap, option or other similar contract, but not:

(a) a put option serving as a guarantee;

(b) a foreign exchange contract which has an original maturity of 14 calendar days or less; or

(c) an instrument traded on a futures or options exchange which is subject to daily mark-to-market and margin payments.

5.2 How to calculate Off-Balance Sheet Asset Risk Component

The Off-Balance Sheet Asset Risk Component must be calculated as the sum of the amounts obtained by applying the calculations set out in paragraph 5.3 in respect of each Shari'ah-compliant Derivative contract entered into by the AIFC-Incorporated Takaful Operator or any of the Takaful Funds managed by it that meets the description in paragraph 5.1.

5.3 Amount of Off-Balance Sheet Asset Risk Component

To calculate the amount of the Off-Balance Sheet Asset Risk Component, the asset equivalent value of each Shari'ah-compliant Derivative (as determined in paragraph 5.4) is multiplied by the Asset Risk Component as though the asset equivalent value were a debt obligation due from the Derivative counterparty.

5.4 Asset equivalent value

(1) The asset equivalent value is the current mark-to-market exposure of the Shari'ah-compliant Derivative (where positive) and a potential exposure add-on.

(2) The potential exposure add-on is determined by multiplying the notional principal amount of the Shari'ah-compliant Derivative in accordance with the following table, according to the nature and residual maturity of the Shari'ah-compliant Derivative.

Residual maturity	**Interest rate contracts**	**Foreign exchange & gold contracts**	**Equity contracts**	**Precious metal contracts (except gold)**	**Other contracts**
Less than 1 year	Nil	1.0%	6.0%	7.0%	10.0%
1 year to less than 5 years	0.5%	5.0%	8.0%	7.0%	12.0%
5 years or more	1.5%	7.5%	10.0%	8.0%	15.0%

6 Off-Balance Sheet Liability Risk Component

6.1 How to calculate Off-Balance Sheet Liability Risk Component

(1) The Off-Balance Sheet Liability Risk Component must be calculated by applying, to the face value of any credit substitute it has issued (including letters of credit, guarantees and put options serving as guarantees) the asset risk component that would be applied to the obligation or asset over which the credit substitute has been written.

(2) Where the credit substitute is supported by collateral or a guarantee, the provisions of paragraph 4.5 (Effect of guarantee or collateral) may be applied by the AIFC-Incorporated Takaful Operator or any of the Takaful Funds managed by it.

7 Contribution Risk Component

7.1 Application

(1) Paragraphs 7.2 to 7.4 apply to General Takaful Business.

(2) The calculation of Contribution Risk Component of the Takaful risk requirement is applicable only to every Takaful Funds and it does not apply to the Takaful Operator's own balance sheet.

7.2 Contribution Risk Component

(1) The Contribution Risk Component for each of the Takaful Funds, is calculated as the sum of the amounts obtained by multiplying the Takaful Fund's net contribution liability that falls within each Category of General Takaful Business by the percentage applicable to that liability under table C.

Table C Percentage factor— Contribution Risk Component

Item	**Category of General Takaful Business**	**Direct Takaful %**	**Retakaful: proportional %**	**Retakaful: non-proportional %**
1	Category 1, 2	16	18	21
2	Category 3, 18	13	15	18
3	Category 4, 5, 6, 7, 8, 9, 16, 17	16	18	21
4	Category 10, 11, 12, 13, 14, 15	21	23	26

(2) In this rule, net contribution liability means contribution liability less any expected retakaful and non-retakaful recoveries in respect of that contribution liability as at the Solvency Reference Date.

7.3 AIFC-Incorporated Takaful Operator may apply for different percentages

(1) The AFSA may, on application of an AIFC-Incorporated Takaful Operator conducting General Takaful Business in Category 1, give written consent to the use of percentages other than those in table C if the AFSA is satisfied that:

(a) adequate mortality and morbidity information exists in respect of that business; and

(b) the information provides a reasonable basis for reliance on actuarial principles.

(3) The percentages that may be used must be those stated in the notice but may not be lower than:

(a) 12% in the case of direct Takaful and proportional Retakaful; and

(b) 16% in the case of non-proportional Retakaful.

7.4 Certain contracts not included

(1) If an AIFC-Incorporated Takaful Operator underwrites Takaful Contracts in General Takaful Categories 1 and 2 that are Family Takaful Contracts, the AIFC-Incorporated Takaful Operator need not calculate a Premium Risk component in respect of those contracts.

(2) For Takaful Contracts in General Takaful Categories 1 and 2 that are Family Takaful contracts, the AIFC-Incorporated Takaful Operator must calculate a Family Takaful Risk Component.

8 Outstanding Claims Risk Component

8.1 Application

(1) Paragraphs 8.2 to 8.4 apply to General Takaful Business.

(2) The calculation of Outstanding Claims Risk Component of the Takaful risk requirement is applicable only to every Takaful Funds and it does not apply to the Takaful Operator's own balance sheet.

8.2 Outstanding Claims Risk Component

(1) The Outstanding Claims Risk Component is calculated for each of the Takaful Funds, as the sum of the amounts obtained by multiplying the Takaful Fund's net liability for outstanding claims that falls within each Category of Takaful Business by the percentage applicable to that liability under table D.

Table D Percentage factor— Outstanding Claims Risk Component

Item	**Categories**	**Direct Takaful %**	**Retakaful: proportional %**	**Retakaful: non-proportional %**
1	Category 1, 2	11	12	14
2	Category 3, 18	9	10	12

Item	Categories	Direct Takaful %	Retakaful: proportional %	Retakaful: non-proportional %
3	Category 4, 5, 6, 7, 8, 9, 16, 17	11	12	14
4	Category 10, 11, 12, 13, 14, 15	14	15	17

(2) In this rule:

net liability for outstanding claims means the liability in respect of future claims referred in TRR 8.3.2 (Treatment of value of future claims payments), less any expected retakaful and non-retakaful recoveries in respect of that liability as at the Solvency Reference Date.

8.3 AIFC-Incorporated Takaful Operator may apply for different percentages

(1) The AFSA may, by written notice, allow the AIFC-Incorporated Takaful Operator to use percentages other than those in table D if the AFSA is satisfied that:

(a) adequate mortality and morbidity information exists in respect of that business; and

(b) the information provides a reasonable basis for reliance on actuarial principles.

(2) The percentages that may be used must be those stated in the notice but may not be lower than 8%.

8.4 Certain contracts not included

(1) Family Takaful Contracts written to cover risks in General Takaful Categories 1 and 2 need not be included in the calculation of Outstanding Claims Risk Component for the Takaful Funds to which they are attributed.

(2) Family Takaful Contracts written to cover risks in General Takaful Cateogries 1 and 2, must be included in the calculation of the Family Takaful Risk Component.

9 Family Takaful Risk Component

9.1 Application

(1) Paragraphs 9.2 and 9.3 apply to Family Takaful Business.

(2) The calculation of Family Takaful Risk Component of the Takaful risk requirement is applicable only to Family Takaful Funds and it does not apply to the Takaful Operator's own balance sheet.

9.2 Family Takaful Risk Component

The Family Takaful Risk Component is calculated as the sum of the following amounts, so far as they relate to the Family Takaful business of the AIFC-Incorporated Takaful Operator:

(a) 1.25% of the amount of provisions in respect of Family Takaful Business that is [investment-linked Takaful, where the contracts are subject to a capital guarantee;]

(b) 0.5% of the amount of provisions in respect of Family Takaful Business that is investment-linked Takaful, where the contracts are not subject to a capital guarantee;

(c) 3% of the amount of provisions in respect of Family Takaful Business other than business described in paragraphs (a) and (b);

(d) the amount obtained by multiplying the amount of capital at risk under paragraph 9.3 by 0.1%;

(e) if the relevant Takaful Fund includes policies that are contingent on mortality—the amount of anticipated claims cost arising from a 0.5 per thousand increase in the rate of lives insured dying over the following year.

9.3 Capital at risk

(1) Capital at risk of a Family Takaful Fund means the total amount of sums assured on Family Takaful Contracts issued by that Family Takaful Fund, less:

(a) the total amount of mathematical reserves for those contracts; and

(b) any expected Retakaful and non-Retakaful recoveries as at the Solvency Reference Date.

(2) For an annuity, the sum assured must be taken to be the present value of the annuity payments.

(3) The contribution of each contract to capital at risk must be determined separately. If the capital at risk calculated for a contract is less than zero, the capital at risk for that contract is taken to be zero.

10 Takaful Concentration Risk Component

10.1 Application

(1) Paragraphs 10.2 and 10.3 apply to General Takaful Business.

(2) The calculation of Takaful Concentration Risk Component of the Takaful risk requirement is applicable only to Takaful Funds and it does not apply to the Takaful Operator's own balance sheet.

10.2 Takaful Concentration Risk Component

(1) The Takaful Concentration Risk Component for an AIFC-Incorporated Takaful Operator is:

MER + CoR (if any) – RP (if any)

where:

MER has the meaning given in paragraph 10.3 (Maximum event retention).

CoR or cost of reinstatement, in relation to an extreme event, means:

(a) the rate that a Takaful Fund has contractually agreed to pay the Retakaful Operator concerned to reinstate the retakaful cover relating to the extreme event; or

(b) if the Takaful Fund has not agreed on the rate for the Retakaful / reinsurance cover—the Takaful Fund's estimate of the cost of reinstating that cover based on current Retakaful / reinsurance market conditions (but no less than the original rate of reinsurance cover).

RP or reinstatement premiums, for a Takaful Fund that also writes retakaful, means the amount of inward reinstatement premiums from cedants in respect of catastrophe retakaful if that Takaful Fund or the AIFC-Incorporated Takaful Operator managing it has a binding netting arrangement with the cedant.

(2) An AIFC-Incorporated Takaful Operator must seek advice from its Approved Actuary about estimating the MER for every Takaful Fund it operates, if the AIFC-Incorporated Takaful Operator:

(a) issues policies that do not have a maximum amount insured;

(b) insures risks in multiple lines of business; or

(c) has a complex portfolio of Takaful risks.

10.3 Maximum event retention

(1) MER or maximum event retention, in relation to an extreme event, is the maximum amount of loss to which the Takaful Fund will be exposed due to an accumulation of exposures, after netting out any potential reinsurance / Retakaful recoveries.

(2) In calculating its MER, a Takaful Fund must:

(a) set the amount based on the accumulation of exposures of the Takaful Fund to a single extreme event;

(b) assume a return period of 1 in 250 years (or greater), where the return period is the expected average period within which the extreme event will re-occur; and

(c) take into account:

(i) its risk profile and risk tolerance;

(ii) its claims history (using available internal and external data);

(iii) the capital resources available to it;

(iv) its current and future solvency needs;

(v) its Retakaful / reinsurance programme;

(vi) the classes of Takaful business underwritten by it; and

(vii) the areas where it conducts business.

(3) If the Takaful Fund is exposed to more than 1 extreme event, its MER is the largest of the MERs calculated for those events.

(4) Despite anything in this rule, the AFSA may require the Takaful Fund or the AIFC-incorporated Takaful Operator, to make adjustments in calculating its MER.

Schedule 7 Prudential returns by Takaful Operators

Item	Title of return	Form number	Frequency for AIFC-Incorporated Takaful Operators.	Frequency for Takaful Operators which are not AIFC-Incorporated
1	Statement of financial position / balance sheet	INS100	Annually and quarterly	Annually and quarterly
2	Statement of comprehensive income / income statement	INS200	Annually and quarterly	Annually and quarterly
3	Analysis of Derivative activities	INS111	Annually and quarterly	n/a
4	Analysis of investment concentrations in foreign currency	INS113	Annually and quarterly	n/a
5	Analysis of investment concentrations risk	INS114	Annually and quarterly	n/a
6	Supplementary information	INS210	Annually and quarterly	Annually and quarterly
7	Calculation of Eligible Capital	INS300	Annually and quarterly	n/a
8	Calculation of prescribed capital requirement (PCR)	INS310	Annually and quarterly	n/a
9	Calculation of asset risk component	INS320	Annually and quarterly	n/a

10	Calculation of off balance sheet asset risk component	INS330	Annually and quarterly	n/a
11	Calculation of off balance sheet liability risk component	INS340	Annually and quarterly	n/a
12	Calculation of premium risk component	INS350	Annually and quarterly	n/a
13	Calculation of technical provisions risk component	INS360	Annually and quarterly	n/a
14	(For Long Term Takaful Operators only) Calculation of Family Takaful risk component	INS370	Annually and quarterly	n/a
15	Calculation of Takaful concentration risk component	INS380	Annually and quarterly	n/a
16	Statement of Retakaful / reinsurance	INS400	Annually	Annually and quarterly
17	Statement of premium information	INS500	Annually and quarterly	Annually and quarterly
18	Statement of technical provisions and claims	INS600	Annually and quarterly	Annually and quarterly
19	(For Long Term Takaful Operators only) Statement of changes in long term business	INS610	Annually	n/a
20	Statement of intra-group transactions	INS700	Annually and quarterly	n/a

21	Statement of largest clients	INS800	Annually and quarterly	Annually and quarterly

WORKING SCHEDULE 1 - List of Defined Terms for TRR and associated rulebooks

AIFC-Incorporated Takaful Operator	a Takaful Operator that is incorporated as a legal entity under the laws of the AIFC
Approved Actuary	The Approved Individual performing the role identified at TRR 2.4.5 (Approved Actuary).
Asset Risk Component	The capital component identified in paragraph 4.1 of TRR Schedule 6 (Asset Risk Component)
Associated Party	(a) a holding company, subsidiary or related company of an AIFC-Incorporated Takaful Operator, (b) a subsidiary or related company of a holding company of an AIFC-Incorporated Takaful Operator, (c) a holding company of a subsidiary of an AIFC-Incorporated Takaful Operator, or (d) a company that, alone or with associates, is entitled to exercise, or control the exercise of, more than 50% of the voting power in the general meeting of an AIFC-Incorporated Takaful Operator.
Capital Floor	The minimum paid up share capital, or equivalent in any currency acceptable to the AFSA, which must be maintained by an AIFC-Incorporated Takaful Operator pursuant to paragraph 1.1 (The Capital Floor) of TRR Schedule 5 (Calculation of Minimum Capital Requirement (MCR)).
Takaful Contract	any contract of insurance which is Shari'ah-compliant and is either a Family Takaful Contract or a General Takaful Contract
Contract of Reinsurance	a Contract of Insurance covering all or part of a risk to which a Person is exposed under a Contract of Insurance
Counterparty Grade	the grade of an asset according to the rating of its counterparty, in accordance with the table at paragraph 3.2 (Table A Grade of assets according to counterparty ratings) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR))
Eligible Capital	the capital instrument that may be recognised by an AIFC-Incorporated Takaful Operator for the purpose of meeting its MCR and PCR in

	accordance with TRR Schedule 4 (Calculation of Eligible capital)
Financial Condition Report	the report identified in TRR 9.1.2
General Takaful Business	Takaful Business in relation to General Takaful Contracts
General Takaful Contract	a Takaful Contract that falls within one of the categories set out in Schedule 1 of TRR.
Insurance Business	the business of conducting either or both of the following regulated activities: (a) effecting Contracts of Insurance; (b) carrying out Contracts of Insurance.
Takaful Liabilities	liabilities of a Takaful Operator arising out of its General Takaful Business and Family Takaful Business.
Takaful Risk Requirement	The capital component identified in 2.3 (Takaful Risk Requirement) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR)).
Insurer	an Authorised Firm with an authorisation to conduct Takaful Business.
Internal Auditor	The Approved Individual performing the role identified at TRR 2.4.4 (Internal Auditor).
Investment Risk Requirement	the sum of an AIFC-Incorporated Takaful Operator's Asset Risk Component, Off-Balance Sheet Asset Risk Component and Off-Balance Sheet Liability Risk Component
Life Policy	a Family Takaful Contract (other than a Retakaful Contract or a Pure Protection Contract) and includes a Family Takaful Contract
Long Term Care Takaful Contract	a Family Takaful Contract: (a) that satisfies the following conditions: (i) it provides (or would at the Policyholder's option provide) benefits for the Policyholder in the event that the Policyholder's mental or physical health deteriorates to the extent that he or she is incapacitated, is unable to live independently without assistance, and is not expected to recover

	to the extent that he or she could live independently without assistance; (ii) those benefits are payable or provided for services, accommodation or goods that are necessary or desirable for the continuing care of the Policyholder because of that incapacity; (iii) those benefits can be paid periodically for all or part of the period during which the Policyholder is unable to live independently without assistance; or (b) that is sold or held out as providing benefits for the Policyholder as set out in paragraph (a).
Family Takaful Business	Takaful Business in relation to Family Takaful Contracts
Family Takaful Contract	a Shari'ah-Compliant Takaful Contracts that falls within one of the categories set out in Schedule 2 of TRR
Family Takaful Fund	A fund established by a Takaful Operator for the purposes of TRR 7 (Segregation of Family Takaful assets and liabilities)
Family Takaful Risk Component	The capital component identified in paragraph 9.2 (Family Takaful Risk Component) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR)).
MCR	Minimum Capital Requirement
Non-Investment Takaful Contract	a Takaful Contracts that is a General Takaful Contract or a Pure Protection Contract but is not a Long Term Care Takaful Contract
Off-Balance Sheet Asset Risk Component	The capital component identified in paragraph 5 (Off-Balance Sheet Asset Risk Component) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR)).
Off-Balance Sheet Liability Risk Component	The capital component identified in paragraph 6 (Off-Balance Sheet Liability Risk Component) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR)).

Operational Risk Requirement	The capital component identified in paragraph 2.4 (Operational Risk Requirement) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR))
Outstanding Claims Risk Component	The capital component identified in paragraph 8 (Outstanding Claims Risk Component) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR))
Packaged Product	(a) a Life Policy; or (b) a Unit in a Collective Investment Scheme
PCR	Prescribed Capital Requirement
Policyholder or Participant	the Person who for the time being is the legal holder of a Takaful Contract, including any Person to whom, under the Takaful Contract, a sum is due, a periodic payment is payable or any other benefit is to be provided or to whom such a sum, payment or benefit is contingently due, payable or to be provided
Premium Risk Component	The capital component identified in paragraph 7) Contribution Risk Component) of TRR Schedule 6 (Calculation of Prescribed Capital Requirement (PCR))
Product Disclosure Document	for a Packaged Product produced by an Authorised Firm : a statement in writing prepared by the firm for the product in accordance with COB 5.6 (Packaged products—additional disclosure)
Pure Protection Contract	a Family Takaful Contract that meets all of the following conditions: (a) the benefits under the contract are payable only on death or for incapacity due to injury, sickness or infirmity; (b) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium; (c) the contract makes no provision for its conversion or extension in a way that would result in it ceasing to comply with paragraph (a) or (b); (d) the contract is not a Contract of Reinsurance.

Risk Management Policy	a written policy that complies with the requirements of TRR 3.1.3
Risk Management Strategy	a written strategy document that complies with the requirements of TRR 3.1.2
Risk Officer	the Approved Individual performing the role identified at TRR 2.4.3.
Solvency Reference Date	The date at which a Takaful Operator's compliance with the requirements of TRR 5 is assessed.
Takaful Business	the business of conducting either or both of the following regulated activities: (a) effecting Contracts of Insurance; (b) carrying out Contracts of Insurance, in a Shari'ah-compliant manner.
Tier 1 Capital	The components of capital identified at paragraph 3 of TRR Schedule 4.
Tier 2 Capital	The components of capital identified at paragraph 4 of TRR Schedule 4.