Debate flourishes about the right level of regulation.

While the Takaful industry has been developing rapidly in the countries of the Gulf Cooperation Council (GCC), the development of Takaful regulation varies significantly country by country. As a result, the levels of policyholder protection differ from one state to another, which has created opportunities for Takaful operators to pursue regulatory arbitrage.

Indeed, there is significant debate as to the right level of regulation. Market participants in some of the more demanding regimes consider the regulations to be stifling their companies. A.M. Best believes the solution is not less regulation but more consistent application of regulation throughout the region, which has the potential to provide sufficient policyholder protection, and thus safeguard the long-term viability of the Takaful industry.

There are three key issues that need to be examined to establish an adequate level of policyholder protection provided by the regulatory system:

1. *Takaful-specific regulation*: Regulation tailored to the demands of the Takaful model is important, especially in recognizing the existence in Takaful of separate funds for policyholders and shareholders. This is a major difference between Takaful and traditional insurers. Regulation needs to provide the rules under which these funds interact, both during insolvency and when the company is viewed as a going concern.

2. *Obligation to provide Qard Hassan at all times*: Based on key principles of the Takaful model, operators are obliged to provide a Qard Hassan (an interest-free loan) to cover arising deficits. However, the principle leaves unclear the permanence of Qard Hassan because, as a loan, it may need to be repaid to the shareholders when it becomes evident that the Takaful fund is not viable over the long term. Regulators therefore are called to establish the rules of permanence for Qard.

3. *Policyholder priority*: This is important particularly in cases of insolvency, and in most cases, it is provided by the general law rather than the provisions established by insurance regulators.

This special report maps the provisions for Takaful regulation in the GCC and identifies the implications for policyholder protection and its impact on A.M. Best ratings.

GCC Regulatory Landscape

Each GCC country has its own regulatory system for financial services and insurance. Furthermore, the Dubai International Financial Centre (DIFC), in Dubai, United Arab Emirates (UAE), and the Qatar Financial Centre (QFC), in Doha, Qatar, are subject to their own civil and commercial laws and are exempt from the relevant laws of the countries in which they reside. GCC regulatory regimes can be divided into three categories depend-
ing on their regulation of Takaful:

1. Jurisdictions with Takaful-specific regulation, including the UAE, the DIFC, Bahrain and the QFC.

2. The Kingdom of Saudi Arabia, where insurance legislation is applicable to both Takaful and conventional insurance companies.

3. Jurisdictions that currently make little provision for, or recognise, Takaful as a separate type of insurance in their regulatory regimes (Kuwait, Oman and Qatar, excluding QFC).

However, the regulatory landscape for the insurance sector is evolving in the GCC. Oman is expected to issue a new insurance law and Takaful regulations shortly.

**Jurisdictions With Takaful-Specific Regulation**

**United Arab Emirates**

The UAE insurance market, broadly speaking, is divided into two sectors:

1. The wider UAE market in which insurers and intermediaries are required to register with the UAE Insurance Authority; and

2. The DIFC (see below), which is regulated by the DIFC Authority (DIFCA) and the Dubai Financial Services Authority (DFSA).

The two sectors are distinct, with the UAE sector primarily concerned with direct insurance of retail customers and risks located in the UAE, and the DIFC being largely a wholesale reinsurance/Retakaful market.

**UAE Federal Law 6 of 2007** (2007 UAE insurance law) established the Federal Insurance Authority to govern and issue regulations for the UAE insurance market. The 2007 UAE insurance law repealed the previous insurance legislation, **UAE Federal Law 9 of 1984** (1984 UAE insurance law). However, the 2007 legislation did not address some topics, and as a consequence, some of the regulations published under the 1984 UAE insurance law (as amended by various ministerial decisions) remain in force until they are repealed and replaced.

In 2010, the UAE Insurance Authority issued its first regulations specific to the Takaful industry (the UAE Takaful regulations), pursuant to which Takaful operations may only be undertaken by licensed Takaful companies. Article 24 (1) of the UAE insurance law requires that such entities be public joint stock companies, branches of foreign insurance companies or insurance agents. Each of these entities must be registered and licensed by the UAE Insurance Authority. Additional licensing requirements apply for health insurance in the Emirate of Abu Dhabi. Health insurance-specific legislation is expected shortly in the Emirates of Dubai and Sharjah.

Takaful operators also are required to comply with the provisions of the UAE insurance law. As such, the UAE Takaful regulations must be read in conjunction with the UAE insurance law and the implementing regulations issued from time to time by the UAE Insurance Authority.

**Dubai International Financial Centre**

The DIFC was established in 2004 as a financial free zone within the UAE and is subject to its own
bespoke set of laws and regulations based on those of a number of different jurisdictions (including the United Kingdom and Bermuda). These include contract, employment and data protection laws, among others. The financial free zone concept allows 100% foreign ownership; exemption from the majority of the UAE’s commercial laws; and independent regulation of the financial services sector by the DFSA in accordance with the DFSA Rulebook.

In general, the DIFC is a “wholesale” financial centre, from which the conduct of “retail” insurance business is prohibited. In relation to the UAE, a DIFC entity may not enter into a direct insurance contract or act as an intermediary to a direct contract for a risk based in the UAE. It is therefore intended that only reinsurance or Retakaful business in relation to UAE-based risks be conducted from the DIFC.

Establishment in the DIFC can be by way of a branch of a foreign company or a corporate entity. In each case, the establishment and authorisation process requires dual approval, from both the DIFCA and the DFSA. The Prudential Insurance Business (PIN) Module of the DFSA Rulebook provides that the minimum capital requirement for reinsurers is USD 10 million. The DFSA has waived the requirement to maintain capital locally for branches of multinational reinsurers.

Reinsurance activities are governed principally by the PIN. However, the DFSA has a specific module relating to all types of Islamic financial business, including Retakaful business, set out in the Islamic Financial Rules (IFR) module. Any person wishing to undertake Retakaful business must have an endorsement to undertake Islamic financial business, in addition to being authorised to effect and carry out contracts of insurance.

The Kingdom of Bahrain

All financial institutions, including Takaful and Retakaful operators, are subject to the supervision of the Central Bank of Bahrain (CBB). The CBB publishes a rulebook, Volume 3 of which deals with insurance and includes a specific Takaful module. The CBB Rulebook supersedes Legislative Decree 17 of 1987 and Ministerial Order 6 of 1990, which set out regulations to implement Bahrain’s insurance law. The Central Bank of Bahrain and Financial Institutions Law 2006 (Central Bank law) provides that the rules and regulations of the prior laws remain in force as long as they do not contradict the Central Bank Law (Article 4).

Takaful and Retakaful operators can be established as a branch of a foreign entity or a Bahrain joint stock company. The CBB Rulebook’s capital adequacy module (CA) provides that an insurance company whose business is limited to reinsurance must maintain Tier 1 capital of BD 10 million (USD 26 million). For a branch, no minimum capital requirements apply, but solvency margin requirements are based on the Takaful operator’s parent company. For a branch office, the CBB requires written confirmation from the head office to provide financial support to meet its obligations. Retakaful operators are required to maintain BD 150,000 (USD 400,000) as a cash deposit with a commercial bank licensed to do business in Bahrain. The CBB Rulebook (GR 7.2) further states that a subsidiary (but not a branch) has to maintain a compulsory reserve of a proportion of its annual profits, being no less than 10% of annual profits until the balance of such compulsory reserve equals 50% of the paid-up capital.

Qatar Financial Centre

The Qatar Financial Centre Regulatory Authority (QFCRA) is the body specifically set up in order to regulate entities within the QFC and is charged with implementing the QFC regulatory framework, pursuant to Qatar Law No. 7 of 2005 (QFC law).

The
QFCRA has issued a rulebook that governs the authorisation and continuing supervision of all entities established in the QFC, including those operating as authorised firms and carrying out regulated activities, and the authorisation of approved individuals. The Prudential Insurance Rulebook (PINS) governs the operations of insurers established in the QFC and includes specific provisions relating to Takaful operators in Chapter 6. In addition, the QFCRA has laid down provisions and rules for Takaful operators in the Islamic Finance Rulebook (ISFI) module applicable to entities located in the QFC. However, PINS also contains a separate section titled “Additional Requirements for Takaful Entities” that applies to Islamic financial institutions and Islamic windows.

A Takaful or Retakaful operation may be established by way of the registration of a foreign branch, as well as the incorporation of a limited liability company (LLC) or limited liability partnership (LLP). A protected cell company structure is also available, although this normally would be used for captive insurers. With regard to an LLC or LLP, PINS Rule 3.4 provides that base capital requirements are USD 10 million for establishing a Takaful operation and USD 20 million for establishing a Retakaful operation.

Jurisdiction Where Legislation Applies to Takaful and Conventional Insurance

The Kingdom of Saudi Arabia

The Saudi Arabian Monetary Agency (SAMA) is the regulator of the Saudi Arabian insurance market. SAMA has mandated that all insurance companies be established in a “co-operative” manner. SAMA also directs cooperative insurance companies to distribute 10% of net insurance surplus to policyholders directly or in the form of a reduction in premiums for the following year. The remaining 90% of the net surplus is transferred to the shareholders. SAMA also mandated all insurance companies (existing and new) obtain a license by March 2008 to underwrite business or exit the market. Notably, to obtain a license, an insurer must be established as a joint stock company and invest at least 20% of policyholder funds in government bonds and 20% in bonds issued by Saudi-authorized banks.

The cooperative insurance model in the Kingdom of Saudi Arabia is conceptually distinct from Takaful. Although it involves the concept of distribution of surplus and is therefore deemed to be Shari’a compliant, it does not include provisions relating to the segregation of Takaful funds from shareholder funds; a requirement to invest in a Shari’a compliant manner; or the appointment of Shari’a boards. This does not prevent several Saudi companies from having segregated fund information and appointed Shari’a boards, etc. Even for companies with segregated fund information, any deficit in the policyholders’ fund is recompensed from the shareholders’ fund without the mechanism of Qard Hassan. Most, if not all, licensed Saudi insurers offer Takaful products, especially in the context of life insurance (family Takaful) and there are reported to be five entities operating purely on a Takaful model.

SAMA has discouraged Takaful operators from using specialist nomenclature in their accounts so as to ensure comparability with other local insurers’ published accounts. As a consequence the wakala, mudarabah and Qard Hassan arrangements are “hidden” in accounts. Nevertheless, commentators have suggested that such Takaful operators continue to have competitive advantages over their counterparts in the kingdom.

Jurisdictions Without Specific Takaful Regulation: Kuwait, Oman and Qatar (Excluding QFC)

The jurisdictions in which there is no explicit regulation of Takaful are Kuwait, Oman and “onshore” Qatar (i.e., outside the QFC). The insurance legislation in each of these jurisdictions is relatively old and therefore predates the develop-
ment of the commercial Takaful market. Thus:

1. The Ministry of Commerce and Industry regulates the Kuwaiti insurance market in accordance with **Law No. 24 of 1961** (Kuwait insurance law).

2. The Capital Market Authority (CMA) regulates the Omani insurance market in accordance with the **Insurance Companies Law** (Royal Decree 12/79) (Oman insurance law).

3. **Decree Law No. 1 of 1966** (Qatar insurance law), which establishes the legislation that governs insurance activities in Qatar, has not evolved significantly since its promulgation. Qatar differs from Kuwait and Oman insofar as the development of the QFC as a hub for the insurance sector has, to some degree, rendered the “onshore” regulations obsolete. Although theoretically the Minister of Business and Trade supervises the “onshore” market, in practice the sector has seen limited regulatory supervision. Newspaper articles have reported that the Qatar Central Bank (QCB) will act as the insurance regulator once forthcoming draft insurance legislation is enacted. However, there are also reports of a merger of the supervisory bodies of the State of Qatar and the QFC, with the result that the insurance business in the State of Qatar may be submitted to the regulatory supervision of the QFCRA and to the QFC rules and regulations that apply in this respect. It is therefore not clear how any upcoming changes will affect the local insurance market.

Oman is in the process of updating the laws and regulations applicable to the insurance sector, and a new insurance law and specific Takaful regulation are being finalised.

Similar developments are expected in Kuwait, where a new insurance law is reported to have been prepared but is yet to be tabled in Parliament. The new insurance law is expected to increase the minimum capital requirement for insurers to USD 55 million from the current USD 525,000 for local insurers. The new law also is expected to carry a separate code for Takaful companies, focusing on areas such as policyholders’ funds, Qard Hassan and the Shari’a supervisory board, among others.

**Policyholder Protection**

For the purposes of an A.M. Best rating, the protection available to a Takaful company’s policyholders is a material consideration. The following section considers some of the legal and regulatory aspects of such protection:

**Availability of Qard Hassan**

If a Takaful fund runs a deficit, the Takaful operator may be required to provide an interest-free loan (Qard Hassan) from its shareholder funds to make good the shortfall. This is described by the Auditing and Accounting Organisation for Islamic Financial Institutions (AAOIFI) in Shari’a Standard No. 26 (Islamic Insurance) paragraph 10/8 as follows:

*Where the insurance assets along with indemnities received from re-insurance companies fall short of covering indemnity commitments, the Company may cover the deficit from project financing or Qard Hassan (interest free or benevolent loan) debited to the account of the insurance fund. In this regard, the deficits resulting from commitments of the current year may be covered from the surpluses of the succeeding years. The company may also claim settlement of the deficit from the policyholders if they undertake to do so in the insurance policy.*
An operator's fund with much higher financial strength than its corresponding Takaful fund normally will enhance the capitalisation assessment in respect of the whole insurance operation, reflecting the increased financial strength provided to the Takaful fund's participants. This enhanced financial strength stems from the operator’s obligation to provide the Qard Hassan to the Takaful fund in situations of financial distress. From a ratings perspective, whether the provision of Qard Hassan is mandatory under the applicable Takaful regulations is a material consideration when rating a Takaful company.

The provision of Qard Hassan is mandatory in the UAE. Article 9 of the UAE Takaful Regulations explicitly provides that the subscription document issued by the Takaful company to its participants must include the company’s commitment to provide such a loan. This is reinforced by Article 28 (1), which provides that such loan must be provided and is limited only by the amount of the shareholders’ equity in the Takaful company. A failure to provide Qard Hassan may result in the suspension of the Takaful company’s activities by the insurance authority (Article 28 (4)).

An equivalent provision is contained in the CBB Rulebook’s CA Section 8.4.5, which provides that where a Takaful fund is failing to meet the requisite solvency requirements, the Takaful company must increase the capital of the fund by way of Qard Hassan. Such Qard Hassan may only be provided with the prior consent of the CBB (CA Section 8.4.9). In addition, CA Section 8.5.1 provides that:

*Every takaful firm must develop a policy for determining the surplus or deficit arising from takaful operations, 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. The policy developed must consider all relevant AAOIFI standards including Financial Accounting Standard No. 13 ‘Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies’.*

In contrast, in the QFC, the details of how a deficit is to be treated are required to be set out in a written policy, and the actual treatment disclosed by an operator in its financial statements in accordance with the AAOIFI FAS 13 (QFCRA Insurance Business Rules 2006 [PINS] Section 6.6.1). Such policy must be provided to the QFCRA, may not be amended without the QFCRA’s approval and must be included with the insurance policies sold by the Takaful operator.

**Insolvency Protection**

There remains an inherent lack of transparency in certain jurisdictions concerning liabilities upon the winding up of a Takaful company. The relative youth of the Takaful industry exacerbates this issue, as there are no recent examples of how Takaful companies have been wound up.

The UAE insurance law (Article 95) provides that the debts and liabilities of an insurance company (including Takaful companies) will be settled in a specified order, whereby the rights of insurance beneficiaries under insurance policies are to receive priority over the ordinary creditors and shareholders of the Takaful company. The technical provisions established by the Takaful operator are to be allocated for this purpose.

Similarly in the DIFC, the DIFC Insolvency (Insurers) Regulations (Article 2.2) provide that “Insurance Debts,” to which “an insurer is or may become liable pursuant to a con-
tract of insurance, other than a contract of reinsurance, to a policyholder or other person who has a direct right of action against that insurer…” will rank above the ordinary creditors of the Takaful company.

There are no equivalent provisions in the QFC insolvency regulations, CBB Rulebook and Financial Institutions Law 2006 or under Saudi insurance law.

In Kuwait, the position is unclear as there are no provisions of the Kuwait Civil Code concerning priority of policyholders’ claims, other than in respect of the return of premium.

In Oman the issue is under consideration. The current insurance law issued by Royal Decree No. 12/79 does not address policyholder protection in the provisions relating to insolvency of insurance companies. However, A.M. Best understands that the forthcoming insurance law will provide for policyholders to have priority over the ordinary creditors of such entities.

**Permanence of Qard Hassan**

Qard Hassan, by its nature, is a loan and therefore is expected to be repaid by future profits of the Takaful fund. Absent a binding legal commitment, either in the Takaful legislation of a jurisdiction or in the Takaful policy with regard to the repayment, there is potential risk that the additional funding provided by Qard Hassan could be withdrawn when it is most needed.

Best practice, as reflected in the AAOIFI standards, provides that “the deficits resulting from commitments of the current year may be covered from the surpluses of the succeeding years.” It follows, therefore, that the Qard Hassan should be recouped only if the Takaful fund generates a surplus; it should not be repayable in the event of a continuing deficit.

This principle is reflected in the UAE Takaful regulations, which provide at Article 28 (3):

*The company may recover such loan from the surplus achieved in the next periods whether in one or more payments as decided by the company in general assembly.*

In the QFC, the above principle must be reflected in the policy or policies to be established pursuant to QFCRA Rulebook PINS Module Section 6.6.1. As these policies must be consistent with AAOIFI standards, this would include an obligation only to recoup Qard Hassan when the Takaful fund is in surplus.

The CBB in Bahrain takes a similar approach; the policies governing Qard Hassan must take into account the AAOIFI standards. In addition, the CBB’s approval for the issuance of Qard Hassan and the requirement to include a note in the financial statements of the Takaful operator will compel public disclosure that the Qard Hassan will be recouped only from future surplus.

There is no direct equivalent to the above provisions in the DFSA Rulebook. However, in practice, the DFSA will require the policies and procedures of the Takaful operator to address this issue, and variations from the AAOIFI standards will need to be justified.

In jurisdictions that do not have specific Takaful legislation, an issue may arise as to the permanence of the Qard Hassan. A.M. Best is aware of no cases in which a Takaful operator has been subject to an insolvent winding up. A.M. Best would, however, expect the insolvency laws to be applied (as opposed to the priority of debtors being
determined by Shari’a scholars). Typically, shareholders’ rights will be subordinate to the Takaful operator’s ordinary creditors.

**Subordination Between Takaful Funds**
Where a Takaful operator manages multiple Takaful funds, an additional issue arises as to whether a surplus in one fund can be utilised to subsidise a deficit in another fund. With the notable exception of the QFCRA Rulebook, this issue is not addressed directly in the region’s Takaful regulations. It is submitted that such subsidisation is inconsistent with the mutual nature of a Takaful fund whereby the participants share the risk. The QFCRA Rulebook PINS Module, Section 6.5.1, therefore expressly prohibits loans from one Takaful fund to another.

**Analysing a Takaful Company – Two-Stage, Risk-Based Capital Approach**
Given that one of the key characteristics of a Takaful operation is the existence of two separate funds (the Takaful fund and the operator’s fund), the starting point for assessing a particular insurance company’s financial strength is to apply Best’s Capital Adequacy Ratio (BCAR) proprietary model to the Takaful fund in a way very similar to a mutual company.

This first-tier analysis compares the Takaful fund’s surplus to the capital required to support the fund’s obligations to participants, per the BCAR model. The BCAR ratio for the Takaful fund, as well as an analysis of trends in the ratio and other key metrics, are the primary drivers of A.M. Best’s assessment of the Takaful company’s balance sheet strength.

A second-tier capital assessment also is performed on the operator’s fund. This second-tier analysis compares the surplus position of the operator’s fund to the capital required to support the fund’s obligations, per the BCAR model. An operator’s fund with much higher financial strength than its corresponding Takaful fund normally will enhance the capitalisation assessment of the whole insurance operation, reflecting the increased financial strength provided to the Takaful fund’s participants. This enhanced financial strength stems from the operator’s obligation to provide an interest-free loan (Qard Hassan) to the Takaful or policyholders’ fund in situations of financial distress. In cases where such a loan has been made to the Takaful fund, the loan will be considered part of the fund’s capital base. Additionally, in circumstances where the potential Qard’ Hassan (dependent on strength of regulation) is not sufficient to bring the Takaful fund to a suitable capital adequacy level, consideration will be given for shareholders’ commitment to the Takaful fund, such as ring-fencing assets in favour of policyholders.

This consolidated view of capital, in effect combining the Takaful and operator’s fund for analytical purposes, is particularly important in the assessment of Takaful insurers in the early years of operation. Currently, it is not uncommon for the operator’s fund to be in a stronger relative position, given the relatively short track record of most companies, with the resulting low level of surpluses, if any, accumulated at a Takaful fund level. An operator’s fund with a weaker financial position may not detract from the overall analysis significantly, since the operator’s fund cannot access the Takaful fund surplus. However, in all cases, regardless of which fund is in a stronger relative position, it also is important to compare the capital accumulation trends in each of the separate funds to ensure an appropriate balance in the surplus distribution and fee structure.

Regulation is extremely important in A.M. Best’s assessment of Takaful companies. Where regulation is deemed to be weak or unclear, benefit can be given for additional commitments to the Takaful fund from shareholders in favour of policyholders, such as ring-fenced assets, which will be made explicit in A.M. Best’s analysis of a company. Additionally, A.M. Best considers the role of the Shari’a board within the organization.
and any potential differences with regulators on winding up a company. Moreover, A.M. Best believes some of the regulatory safeguards (e.g., ring-fencing of assets within the Takaful fund) are yet to be tested.

The development of the Islamic insurance industry, including the regulatory environment, needs to keep pace with the rest of the financial industry in the GCC region (especially banking).

A.M. Best believes a robust regulatory regime can provide crucial assistance in the development of a sound risk management culture. A.M. Best also believes that given their constraints, Takaful companies need to develop and demonstrate that they can apply an adequate risk-based approach to investment management (because of the reduced investment opportunities); capital adequacy and reserving (given the need for building up surpluses in the long term, especially for family/life business); and control over pricing and adverse selection (given the restrictions on charging extra risk premiums for policyholders representing a greater risk of loss than the aggregate participant pool).

**Regulatory Impact in Ratings of Takaful Companies**

The regulatory frameworks of the GCC countries clearly provide different levels of policyholder protection for Takaful companies.

The two offshore centres of DIFC and QFC, as well as Bahrain and the UAE, seem to provide the clearest definitions and a more comprehensive set of provisions for the protection of policyholders. In these cases, there is a specific Takaful regulation in place, taking into account the particulars of the Takaful model. The provision of Qard Hassan as a method of support from the policyholders’ fund to the Takaful fund is either part of the regulation or included in the contractual agreement between the insured and the insurance company, as the shareholders’ fund is obligated to make this loan permanent, if need be. In DIFC and UAE there is the added benefit of clarity in that policyholder liabilities rank senior to any other obligation.

**Exhibit 1**

**Takaful Life & Non-Life – Jurisdictions With/Without Takaful-Specific Regulation**

<table>
<thead>
<tr>
<th>Countries</th>
<th>Takaful-Specific Regulation in Place</th>
<th>Obligation To Provide Qard Hasan</th>
<th>Permanence of Qard Hasan</th>
<th>Policyholder Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No Provision</td>
</tr>
<tr>
<td>Kingdom of Saudi Arabia</td>
<td>No¹</td>
<td>No²</td>
<td>No</td>
<td>No Provision</td>
</tr>
<tr>
<td>Kuwait</td>
<td>No</td>
<td>No²</td>
<td>No</td>
<td>Unclear</td>
</tr>
<tr>
<td>Oman</td>
<td>No</td>
<td>No²</td>
<td>No</td>
<td>Unclear</td>
</tr>
<tr>
<td>Qatar</td>
<td>No</td>
<td>No²</td>
<td>No</td>
<td>Unclear</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>Yes</td>
<td>No²</td>
<td>No</td>
<td>Most Senior</td>
</tr>
</tbody>
</table>

**Free Zones**

| Dubai International Financial Centre | Yes | Yes | Yes | Most Senior |
| Qatar Financial Centre             | Yes | Yes | Yes | No Provision |

¹ In the Kingdom of Saudi Arabia the same regulation applies to traditional and Takaful companies
² No regulatory obligation to provide Qard Hasan but Qard Hassan is always part of the contractual agreement

Source: A.M. Best research
of the insurance company. The shareholders’ fund therefore is obliged to provide up to 100% of its funds for the protection of policyholders. In this case, the shareholders’ fund supports, in its totality, policyholder liabilities.

By contrast policyholder protection is unclear in the countries where there is no specific regulation for Takaful companies. Here, the provision of support from the shareholders’ fund to the Takaful fund can depend only on the contractual agreement between the company and the policyholders. Similarly, it is unclear as to how permanent such support can be, or indeed the priority of policyholder liabilities in case of insolvency. It is therefore important, in these regimes, to focus on the specifics of the company when evaluating the strength of a Takaful company in such regimes. This takes the form of:

a. The two-level analysis mentioned above and

b. Any additional support the shareholders’ fund provides to the Takaful fund. Forms of such support can be segregation of assets for the benefit of shareholders; contractual recognition of the seniority of policyholder liabilities; and the obligation to provide permanent Qard Hassan, etc.

Conclusion
In many instances, GCC insurance regulators have failed to keep up with the emergence and growth of Takaful in their countries. The specificities of the Takaful model mean that the general insurance regulation fails to provide sufficient protection to policyholders of insurance companies. This obviously creates risks not only for specific companies but for the prospects of the Takaful industry, which despite its strong growth to date, is still small compared with the traditional insurance market.

Takaful operators that need to provide sufficient support to their policyholders are required to establish complex and expensive safeguards, e.g., ring-fencing of assets to mitigate the weaknesses of some regulatory regimes.

It is therefore important for both the success of the nascent Takaful operators and for the broader viability of Takaful that regulators develop coherent provisions for the industry. These should be tailored to the specifics of the Takaful model and provide strong policyholder protection.
A.M. Best Company
Special Report

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SR-2013-400