

# **Corporate Governance Workshop: The Changing Landscape in the Insurance Industry**

**31<sup>st</sup> May 2010**

**Sohail Jaffer  
Partner and Head of International Business Development  
FWU Group**



# Content

## Section I → Definition of Corporate Governance

Section II → Particularities for Takaful Corporate Governance

Section III → Models for Takaful Operators

Section IV → Conflicts of interest

Section V → Why does Takaful need special corporate regulation

Section VI → Conclusion

# Definition of Corporate Governance

Sir A. Cadbury, architect of  
UK Combined Code

Dr. Nasser Saidi,  
Executive Director,  
Hawkamah Institute  
for Corporate Governance

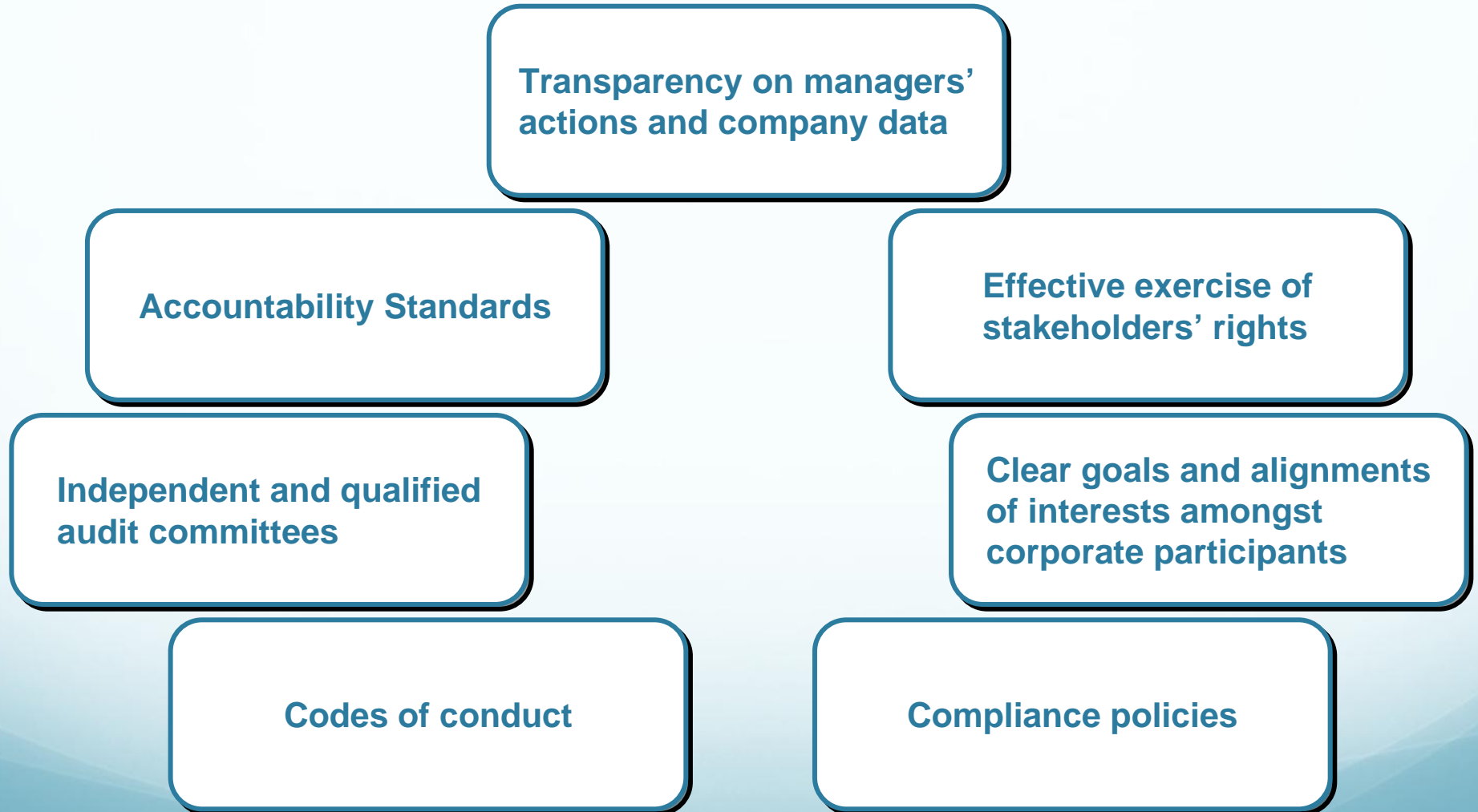
OECD definition

*"The system by  
which business  
corporations are  
directed and  
controlled"*

*"A good  
corporate  
governance is a  
major contributor  
to economic  
growth and  
prosperity"*

*"Corporate governance  
specifies distribution of  
rights and  
responsibilities among  
different participants in  
the corporation and  
spells out the rules and  
procedures for making  
decisions on corporate  
affairs"*

# What makes a good corporate governance





# Content

Section I → Definition of Corporate Governance

## Section II → Particularities for Takaful Corporate Governance

Section III → Models for Takaful Operators

Section IV → Conflicts of interest

Section V → Why does Takaful need special corporate regulation

Section VI → Conclusion

# Particularities in Takaful governance

## Takaful distinctive corporate features

### Conventional Insurance

Conventional insurance is a profit-driven corporate

Thus, its ultimate goal is to create shareholder value

Policyholders aim to receive the maximum added-value via the insurance product, defined in the insurance contract

### Takaful

Takaful operator act as the policyholders' fund trustee

Thus, its aim is to build a profitable and sustainable takaful business with these funds in order to receive a competitive reward

Policyholders act as donors. Takaful benefits depend on trustee's quality management. So does the fund's yearly surplus, or the corporate profit they receive.

# Particularities in Takaful Governance

## Regarding Processes, Customs, Policies, Laws and Institutions

- Shari'ah principles

## Regarding Relationship amongst Stakeholders

- Shareholders do not own the solidarity funds. The Participants do, in line with Takaful's trust character.
- Both Participants and Shareholders directly compete for payoff <sup>(1)</sup>.
- Participants' Takaful benefits are not guaranteed by contractual terms, but depend on corporate results <sup>(2)</sup>.
- Both Shari'ah Board & Management are final decision makers
- Shari'ah Board members are usually external experts and on operator's payroll.

(1) *In the Mudarabah model they both share corporate profits. In the Wakalah model participants' fund surplus share crowds out Takaful management fees*

(2) *Participants' benefits are share of Takaful profits, in Mudarabah model, or fund surplus, in Wakalah model.*



# Content

Section I → Definition of Corporate Governance

Section II → Particularities for Takaful Corporate Governance

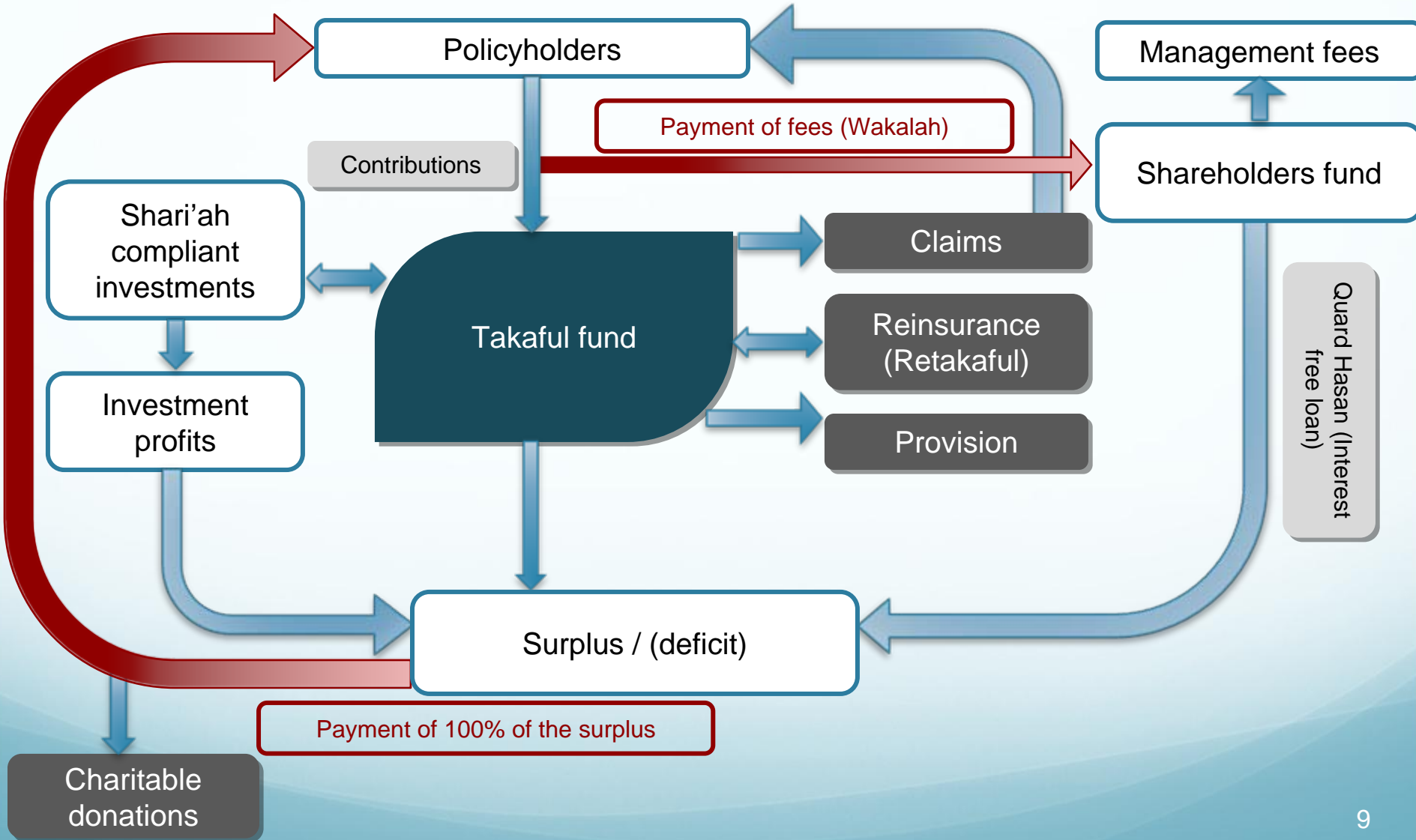
**Section III → Models for Takaful Operators**

Section IV → Conflicts of interest

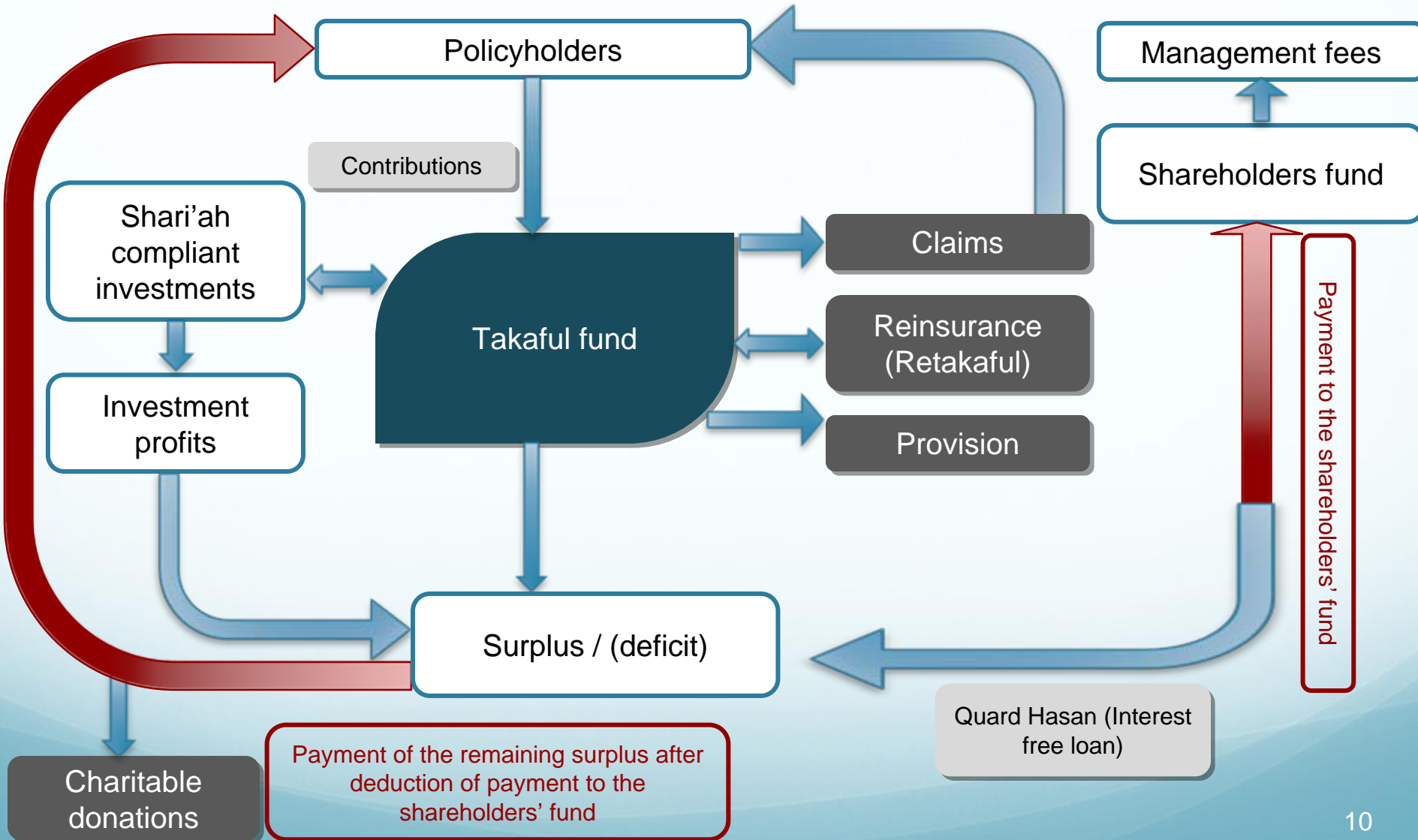
Section V → Why does Takaful need special corporate regulation

Section VI → Conclusion

# Wakalah Model



# Mudarabah Model



## Wakalah

- Surpluses repaid to participants
- Fee income for Takaful operator
- Takaful fund only covers claims
- Takaful operator profitability results from management fees minus costs
- Participants give donation (Tabarru)
- Funds invested for shorter periods as surplus repaid after claim payment, although some surplus builds claim reserves.
- More suitable for household, vehicle and general insurance

## Mudarabah

- Profit-sharing by participants
- Profit-sharing by Takaful operator
- Takaful fund generates profits
- Takaful operator profitability depends on investment performance of participant solidarity fund
- Participants give insurance premium
- Funds invested for longer term with performance incentives for the Takaful operator
- More suitable for long-term savings plans and family Takaful



# Content

Section I → Definition of Corporate Governance

Section II → Particularities for Takaful Corporate Governance

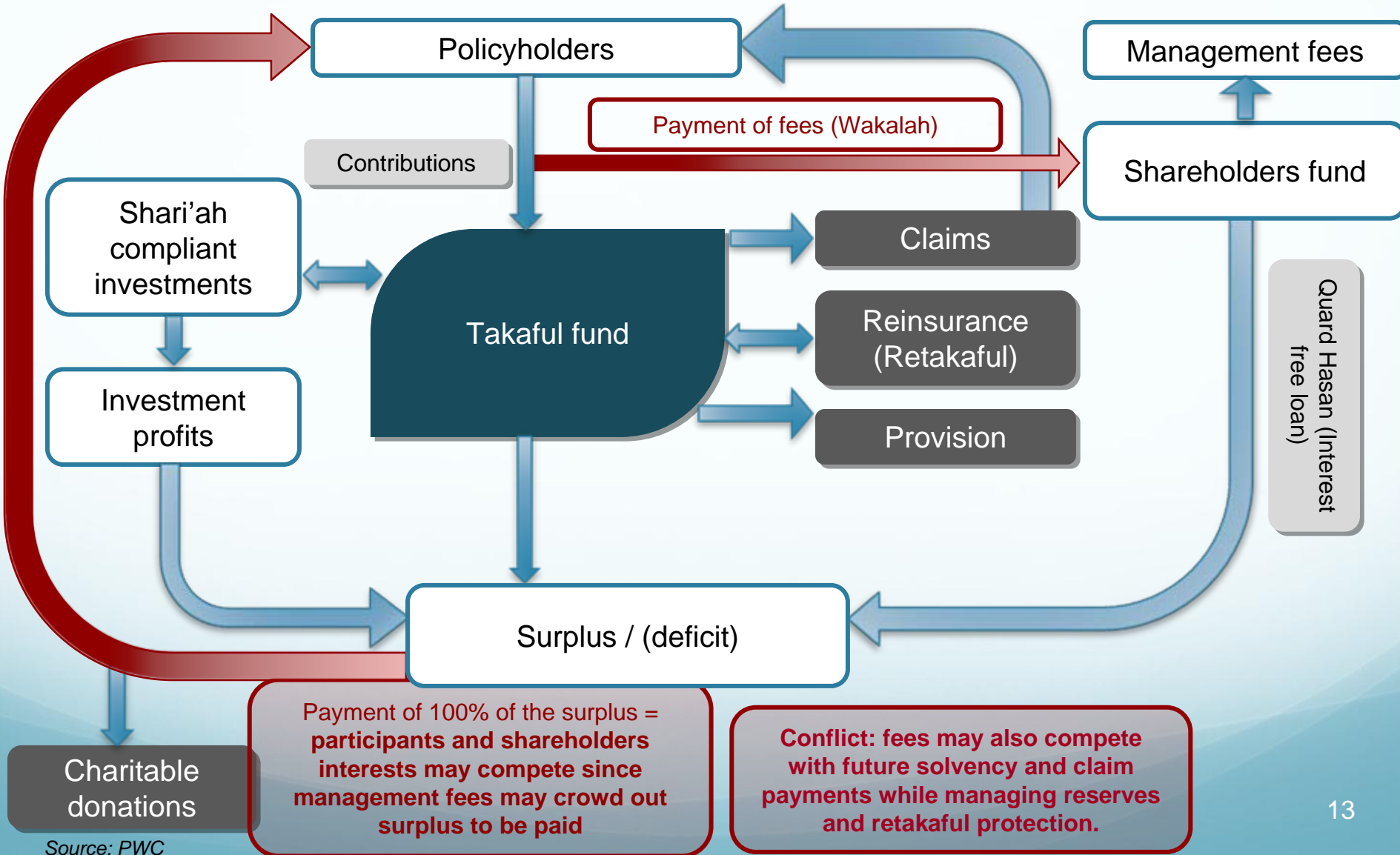
Section III → Models for Takaful Operators

**Section IV → Conflicts of interest**

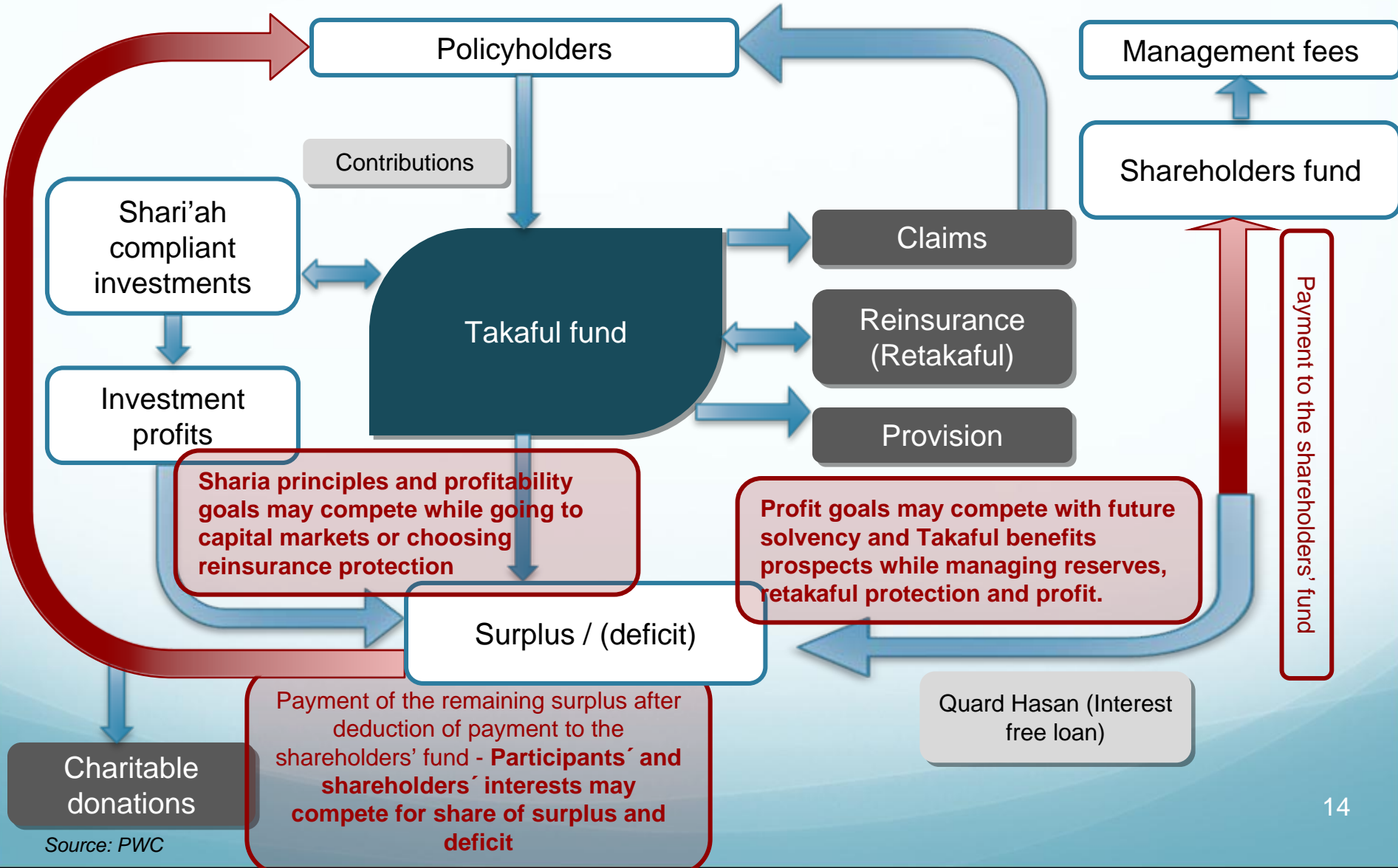
Section V → Why does Takaful need special corporate regulation

Section VI → Conclusion

# Wakalah Model

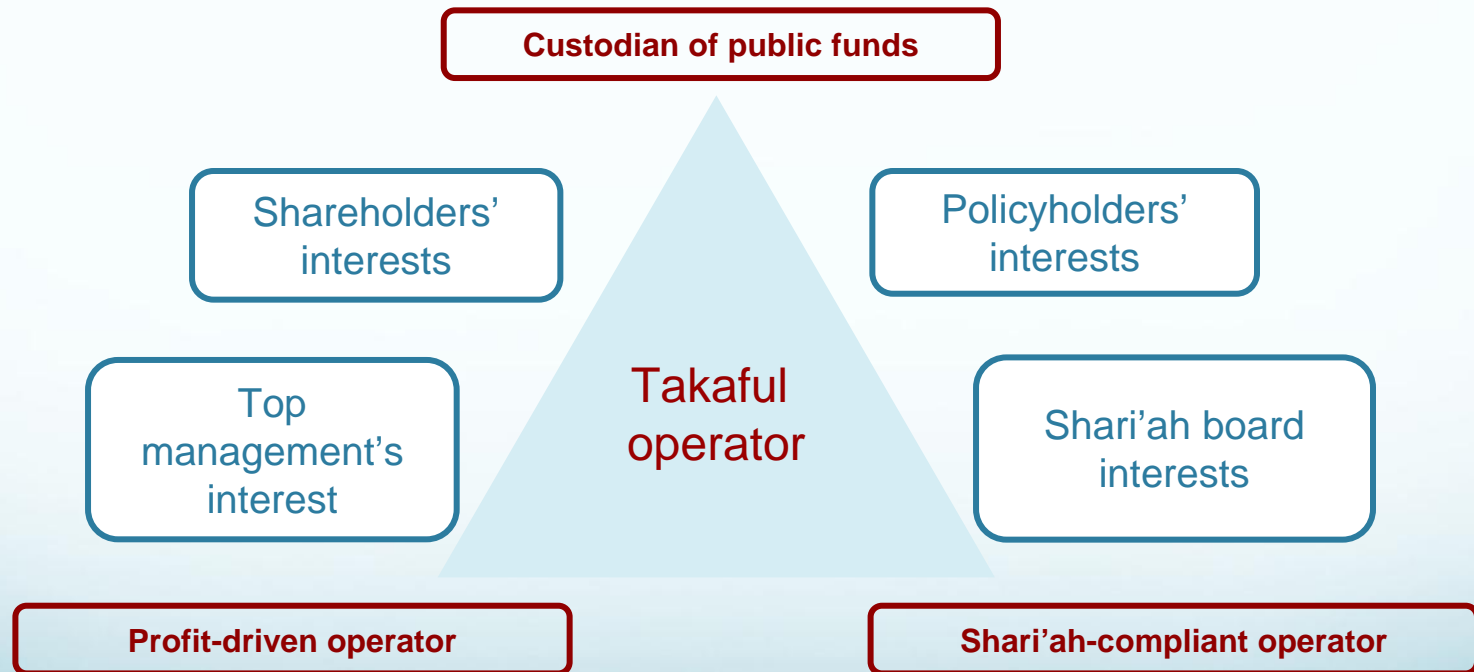


# Mudarabah Model



# Conflicts of interest – Looking at Takaful operators' corporate roles

The **three corporate roles** of the Takaful operator should be institutionally balanced so that the **interests of the four stakeholders** operate in efficient and fair mutual conditions





# Content

Section I → Definition of Corporate Governance

Section II → Particularities for Takaful Corporate Governance

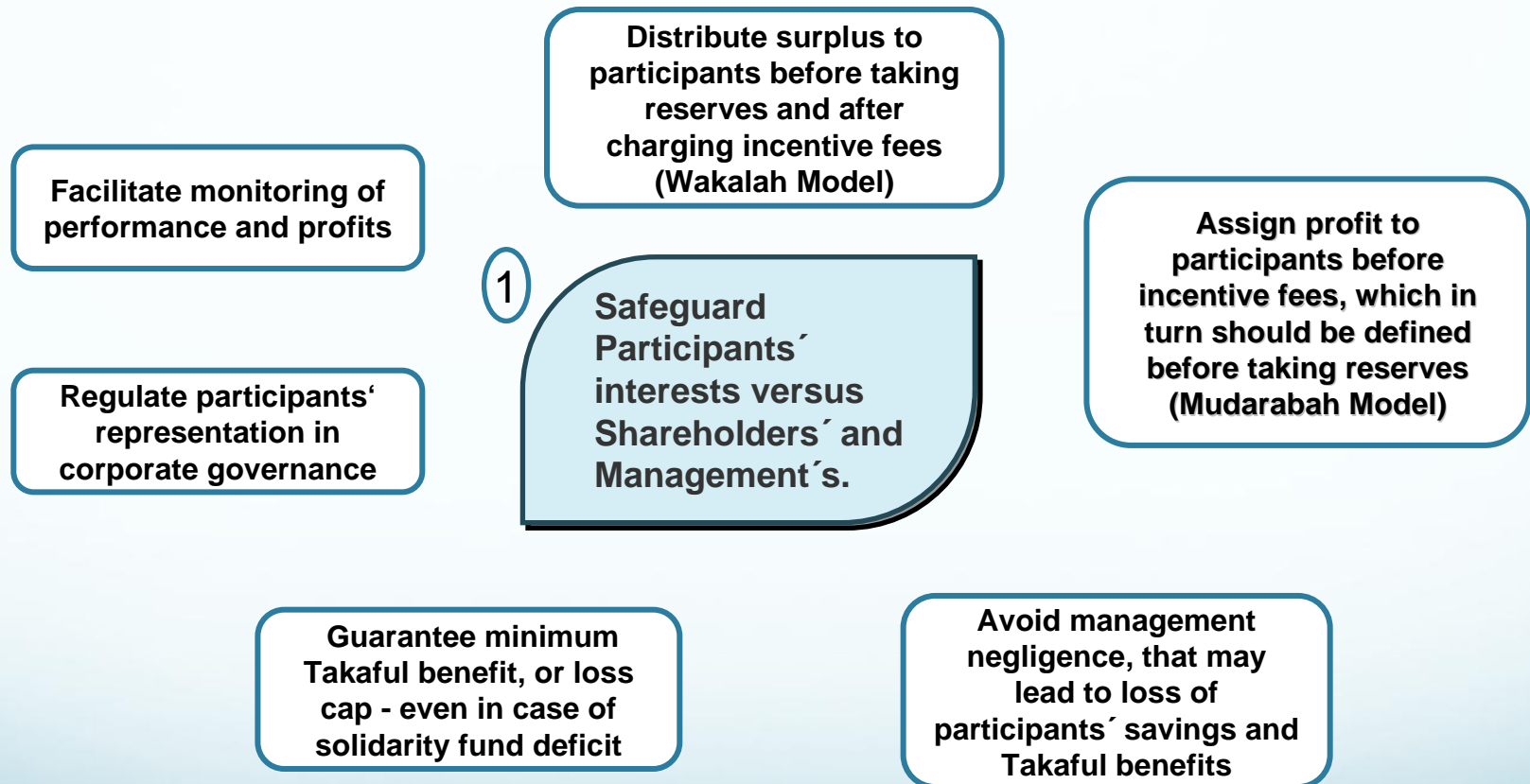
Section III → Models for Takaful Operators

Section IV → Conflicts of interest

**Section V → Why does Takaful need  
special corporate regulation**

Section VI → Conclusion

# Corporate regulation and institutions tailored to Takaful



# Corporate regulation and institutions tailored to Takaful

**Maintain confidence of takaful operators as custodians of public funds**

2

**Safeguard participants' and shareholders' interests versus Management's**

**Choose reinsurer based on technical risk criteria and not commission**

**Facilitate the intermediation role of financial system (Mudarabah model)**

# Corporate regulation and institutions tailored to Takaful

**Regulate Shari'ah Board members' shareholding or senior management roles within company**

3

**Safeguard balance between Shari'ah compliance and economic interests**

**Define and allocate responsibilities between Shari'ah Board and Management**

4

**Regulate Shari'ah Board members' shareholding or senior management roles in Takaful operator's competitors**



# Content

Section I → Definition of Corporate Governance

Section II → Particularities for Takaful Corporate Governance

Section III → Models for Takaful Operators

Section IV → Conflicts of interest

Section V → Why does Takaful need special corporate regulation

**Section VI → Conclusion**

# Conclusion

## Critical issues to consider

Application of internationally recognised corporate standards on transparency, supervisory, risk assessment or accountability standards (\*).

Management monitoring and shareholder protection issues

Conflicts of interest in corporate practices and regulation.

Custodian of public funds and safeguard participants' interests consistent with Shari'ah board principles.

\* AAOIFI principles have lately completed international standards as IFSB and IAIS core principles, to capture the islamic insurance particularities. For an overview, see [http://www.bnm.gov.my/microsites/giff2007/pdf/frf/07\\_02.pdf](http://www.bnm.gov.my/microsites/giff2007/pdf/frf/07_02.pdf).

# Conclusion

## Recommendations

**Implement two-tier corporate board, management board and supervisory board**

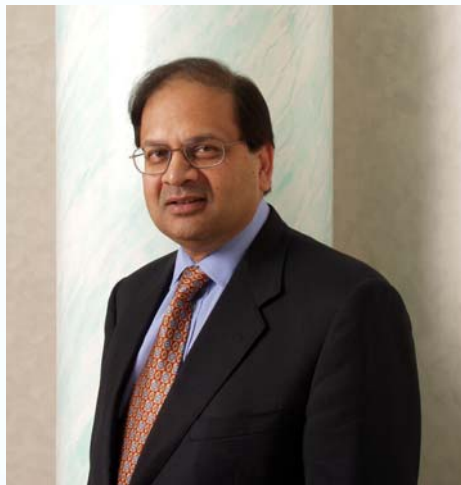
**Establish and regulate audit committee to monitor accounting standards, internal control processes and hiring of external auditors**

**Improve legal restrictions to avoid Shari'ah Board's potential conflict of interests.**

**Sound risk management procedures, to ensure long-term viability and high standards of risk control.**

**Promote corporate core values on accountability, disclosure, fairness and transparency via active industrial policy (\*).**

# Contact



**Mr. Sohail Jaffer**  
Partner, FWU Group  
FWU International Branch  
4a, rue Albet Borschette  
L-1246 Luxembourg  
Tel: +352 – 26 197 701  
Fax: +352 – 26 197 801  
Email: [S.jaffer@fwugroup.com](mailto:S.jaffer@fwugroup.com)

*The information in this presentation does not constitute a sales offer, investment advice or an offer for the acquisition of financial products or instruments, and shall not in this regard imply legal obligations for the FWU Group or anybody else towards the readers of this presentation.*

*This presentation is solely intended to provide information on matters of interest for the readers and such information is not meant to replace the knowledge and the judgment of the readers who should make all appropriate inquiries.*