



590

THE CHARTERED  
INSURANCE INSTITUTE

**ADVANCED DIPLOMA IN GENERAL INSURANCE**

**590—TAKAFUL**

**Examination Guide  
April 2010 examination**

**SPECIAL NOTICE**

**Candidates entered for the October 2010 examination should study this Examination Guide carefully in order to prepare themselves for the examination.**

**Practice in answering the questions is highly desirable and should be considered a critical part of a properly planned programme of examination preparation.**

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# IMPORTANT GUIDANCE FOR CANDIDATES

## Introduction

The purpose of this Examination Guide is to help you to understand how examiners seek to assess the knowledge and skill of candidates. You can then demonstrate to the examiners that you meet the required levels of knowledge and skill to merit a pass in this unit. During your preparation for the examination it should be your aim not only to ensure that you are technically able to answer the questions but also that you can do justice to your abilities under examination conditions.

## Before the examination

### **Make sure you have a copy of the current Advanced Diploma in Insurance Information for Candidates**

Details of administrative arrangements and the regulations which form the basis of your examination entry are to be found in the current Advanced Diploma in Insurance Information for Candidates brochure, which is essential reading for all candidates; it is available online at [www.cii.co.uk](http://www.cii.co.uk) or from Customer Service.

### **Study the syllabus carefully**

It is important to study the syllabus, which is available online at [www.cii.co.uk](http://www.cii.co.uk) or from Customer Service. The questions in the examination paper are based directly on the syllabus, so it is vital that you are familiar with it.

### **Read widely**

Your knowledge should be wider than the scope of one book. While books specifically produced to support your studies will provide coverage of the syllabus areas, you should be prepared to read around the subject. A reading list can be found at the end of the syllabus.

### **Make full use of the Examination Guide**

The best way to understand what the examiners require is to study the CII Examination Guides, and you can obtain copies online at [www.cii.co.uk](http://www.cii.co.uk). You can use Examination Guides as 'mock' examination papers, attempting them under examination conditions as far as possible, and then comparing your answers to the model ones. The examiners' comments on candidates' actual performance should be noted.

### **Understand the nature of assessment**

Each Examination Guide contains a full examination paper and model answers. The model answers show the type of responses the examiners are looking for, and which would achieve maximum marks. However, you should note that there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown.

### **Know the structure of the examination**

Familiarise yourself with the structure of the examination paper and the time allowed to complete it. This information can be found on the question paper included within each Examination Guide.

## **In the examination**

### **Do justice to yourself in the examination**

**Assuming you have prepared adequately, you will only do justice to yourself in the examination if you follow two common sense rules:**

**1** Spend your time in accordance with the allocation of marks as indicated on the paper. If you do not complete the whole paper, your chances of passing may be reduced considerably. Do not spend excessive time on any one question. If you have used up the time allocation for that question, leave some space, go on to the next question, and only return to the incomplete question after you have completed the rest of the paper. The maximum marks allocated to each question and any constituent parts are given on the paper; the number of marks allocated is the best indication of how much time you should spend answering it. If part of a question has just two marks allocated, there are likely to be only one or two points for which the examiner is looking, so a long answer is a waste of time. Conversely, if part of a question has, for example, eight marks allocated, a couple of lines will not be an adequate answer.

**2** Take care to answer the precise question set. You will see that the model answers provided in this Examination Guide are quite focused and precise; alternative answers would only be acceptable if they still answer the question. However brilliantly you write on a particular topic, if it does not provide a satisfactory answer to the precise question as set, you will not score the marks allocated. Many candidates leave the examination room confident that they have written a ‘good’ paper, only to be mystified when they receive a disappointing result. Often, the explanation for this lies in a failure to think carefully about what the examiner requires, before putting pen to paper.

### **Order of tackling questions**

Tackle the questions in whatever order you feel most comfortable with. Generally, it is better to leave any questions which you feel less confident in answering until you have attempted those with which you are more familiar, but remember not to spend excessive time on your ‘good’ questions.

### **Handwriting**

Provided your handwriting is legible, you will not lose marks if it is untidy. We recommend that you do not write in block capitals, because you will be slowed down so much by doing so and, paradoxically, block capitals can become more difficult to read than joined-up writing when done quickly.

### **Answer format**

Unless the question requires you to produce an answer in a particular format, such as a letter or a report, you should use ‘bullet points’ or short paragraphs, since this allows you to communicate your thoughts in the most effective way in the shortest time. The model answers give an indication of which style is acceptable for the different types of question.

## **Calculators**

If you bring a calculator into the examination room, it must be a silent, battery or solar powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetical or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements. It is important that you show all the steps of any calculation in your answer. The examination is testing your ability to carry out all the appropriate steps in calculating a value. A proficient mathematician is someone who follows the correct method, i.e. carries out the appropriate steps. The majority of the available marks will be allocated for demonstrating the correct method of calculation.

## **After the examination**

All Advanced Diploma in Insurance examiners, one of whom will mark your answer book, are either active practitioners in the insurance industry or are experts on the subject. They have been specially trained to mark papers using a detailed marking scheme: the model answers in Examination Guides are based on those marking schemes.

The marking of each examiner is closely monitored throughout the marking period and all marked answer books are carefully checked. This process means that all answer books are marked to the same standard.

After all the answer books have been marked, a moderation meeting is held, at which all available statistical information is considered, together with the views of the Senior Examiner for that unit and other assessment experts. At the meeting a pass mark is set to ensure that the standard of knowledge and skills required to gain a pass in the paper is comparable with that of previous papers. All candidates at or above the agreed pass mark will pass: the CII does not operate a quota system whereby only a fixed percentage of candidates can pass a paper.



**THE CHARTERED INSURANCE INSTITUTE**

**ADVANCED DIPLOMA**

**APRIL 2010 EXAMINATION PAPER**

**UNIT 590  
PRINCIPLES OF TAKAFUL**

**INSTRUCTIONS**

- Three hours are allowed for this paper.
- Fill in the information requested on the answer booklet and on form B.
- You are allowed to write on the inside pages of this question paper but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- **The answer booklet and this question paper must be handed in personally by you to the invigilator before you leave the examination. Failure to do this may result in your paper not being marked and you may be prevented from entering this examination in future.**

**READ THE INSTRUCTIONS OVERLEAF CAREFULLY BEFORE ANSWERING ANY QUESTIONS.**

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**590 – Principles of Takaful**

**CANDIDATE INSTRUCTIONS**

**READ THE INSTRUCTIONS BELOW BEFORE ANSWERING ANY QUESTIONS.**

Three hours are allowed for this paper. You should answer all questions in Part I, the compulsory question in Part II and three out of the five questions in Part III.

The paper carries a total of 200 marks, as follows:

Part I	8 compulsory questions	48 marks
Part II	1 compulsory question	38 marks
Part III	3 questions selected from 5	114 marks

You are advised to spend no more than 45 minutes on Part I.

The number of marks allocated to each question part is shown next to the question and you should spend your time in accordance with that allocation.

Answer each question on a new page. If a question has more than one part, leave several lines blank after each part.

It is important to show each step in any calculation, even if you have used a calculator.

You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.

## Part I

### Answer ALL questions

**Note form is acceptable where this conveys all the necessary information**

1. Over the past 20 years, businesses and corporations have developed new ways of financing their insurance risks, collectively called Alternative Risk Transfer (ART).  
  
State the **four** main types of risk. (6)
2. List the main values of co-operatives. (6)
3. Describe the mechanism whereby shareholders provide a loan to the company in a Takaful organization. (6)
4. Discuss the importance of effective liaison between insurance company functions and Shariah Supervisory Board (SSB). (6)
5. Outline the main features of Takaful insurance companies' investment policies. (6)
6. State the risks that a Takaful insurance company cannot accept. (6)
7. Describe the **four** basic features of Contracts in Sharia. (6)
8. Explain what restricted Mudaraba is. (6)



## Part II

### Compulsory question This question is worth 38 marks

9. XYZ Insurance Company is based in Bahrain. As per AAOIFI financial accounting standards, XYZ is due to prepare the company's set of financial statements for 2009.

Identify and prepare the XYZ Insurance Company financial statement of policyholders' revenue and expenses for the year 2009, **showing all your workings.**

(38)

Item	Debit (£)	Credit (£)
Gross contributions		150,000
Acquisition Cost	15,000	
Remuneration of XYZ for managing insurance operations		37,500
Total policyholders' investment income		1,000
Reinsurers share of contributions	105,000	
Reinsurance Commissions		31,500
Paid Claims	10,000	
Unearned contributions	20,000	
Recovered claims from reinsurers	7,600	
XYZ share for managing investments		100
Outstanding claims-end of period	20,000	
Recoverable outstanding claims from re-insurers		15,000

### Part III

**Answer THREE of the following FIVE questions  
Each question is worth 38 marks**

10. Explain, in detail, the Islamic Evidence supporting the Concept of Insurance. (38)
11. Compare Takaful insurance and conventional insurance. (38)
12. Describe the relevant General Disclosure Requirements that should accompany a Takaful insurance company's financial statement. (38)
13. Describe the **similarities** and **differences** between the structure of General Takaful and the structure of Family Takaful. (38)
14. Explain the governance issues and rights of Takaful policyholders. (38)

### ***NOTE ON MODEL ANSWERS***

***The model answers given are those which would achieve maximum marks. However, there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown. An oblique (/) indicates an equally acceptable alternative answer.***

1.
  - Captive insurers (a method of risk retention).
  - Finite risk transfer (includes reinsurance).
  - Risk insurance derivatives.
  - Securitization of insurance risks directly into capital markets.
  
2.
  - Self-help and self-responsibility.
  - Democracy, equality and equity.
  - Solidarity.
  - Honesty and openness.
  - Social responsibility and caring for others.
  
3.
  - The shareholders will provide the money needed to finance the deficit and they may collect the repayment of their money either through as an interest free loan Qardh Hassan (Qard Hasan).
  - Increasing the premiums (contributions) in the next year(s) or using the next year(s) surplus (if any).
  - The contract between the shareholders and policyholders to finance the deficit by giving (Qardh Hassan), is called a Kafalah (Sponsorship) contract.
  - The method of handling the surplus and deficit must be stated in the insurance policy at the inception of the insurance contract 1.
  
4.
  - The conformity with Islamic law (Shariah) is the essence of Islamic financial services, therefore any Islamic insurance company must have a mechanism to ensure that all transactions (underwriting, claims and investment) are Shariah compliant.
  - The Shariah Supervisory Board (SSB) is a pre-requisite for any Islamic financial Institution.
  - Its main role is to ensure that all dealings are strictly compliant with Shariah, and to protect Islamic financial institution from any Haram transactions.
  - The Shariah Supervisory Board (SSB) is usually appointed in annual general meetings upon the recommendation of BOD, taking into consideration the local regulation (if any) in this respect.
  - The number of the SSB must be odd, usually three to five Members.

5.
  - Like any insurance company, the Islamic insurance company has to manage two types of funds; the first for life assurance (family takaful) and the second for general insurance (general takaful).
  - Obviously all transactions must be Shariah compliant 1.

The main features of the investment policy of an Islamic insurance company are:

- interest-free investment.
  - entire conformity with Shariah (i.e. avoidance of investment in haram, e.g alcoholic beverages and pork meat and seeking halal activities only).
6. All the following are not allowed to be covered by an Islamic insurance company:
    - alcohol and drugs based products and activities;
    - prostitution;
    - Haram: prohibited products;
    - any transaction involving Gharar, Riba and Miser.
  7. An Islamic contract requires the existence of following elements:
    - Ijab/offer which means making a positive proposition by one party in a transaction.
    - Qabul (Acceptance) which is response to the offer by the other party showing approval of the proposition.
    - ahliyyat al-'adaa (active legal capacity) which means that the persons (or their agents) who attend the contract session must enjoy active legal capacity by Sharia measures.
    - Sharia Permissibility; The subject matter of the contract, and its terms or conditions must be well defined and permissible by Sharia. The contract should not explicitly or implicitly, directly or indirectly contain any practices, that are not permissible by Sharia.
  8.
    - A restricted Mudaraba contract is one in which the capital provider restricts as he considers appropriate, the actions of the Mudareb to a particular location or market or a particular type of investment.
    - However, restriction should not be in a manner that would unduly constrain the Mudareb's ability to take freely his business decisions or to decide actions and manage his operations in practice, as this may adversely affect profit which is the major target of the company.

9. Insurance Company Statement of Policyholders' Revenues and Expenses for the year 2009

	£
Insurance Revenues	
Gross Contributions	150,000
Less: Reinsurers' Share	(105,000)
Net Retained Contributions	45,000
Less: Changes in unearned contributions	(20,000)
Earned Contributions	25,000
Reinsurance Commissions	31,500
Total Insurance Revenue	56,500
 Insurance Expenses	
Paid Claims	10,000
Recovered claims from reinsurers	(7,600)
Net Paid Claims	2,400
Outstanding Claims-end of year	20,000
Less: Recoverable Outstanding Claims from reinsurers	(15,000)
Net Outstanding Claims	5,000
Remuneration of company for Managing insurance operations	37,500
Acquisition Cost	15,000
Total Insurance Expenses	59,900
Net Loss from Insurance Operations	(3,400)
 Investment Income	
Investment Income	1,000
Less: Owners equity share for Managing investment portfolio	(100)
Net Investment Income	900
 Loss of Revenue over Expenses	(2,500)

## 10. Roshd

- Individual willingness for insurance rests on rational behaviour.
- The word Roshd which in the Arabic language means rationality, comes in the Quran in more than one place. In Sura 2:256, Roshd expresses the ability to select the right path (i.e. believe or disbelieve) and in Sura 4:6 it means sound judgment.
- According to the Quranic verse persons who do not have sound judgment are incapable of using their own resources wisely or efficiently.
- In fact, Roshd as an Islamic economic norm can be defined as “sound judgment, which is guided by consciousness to the right path”. A person who has Roshd is a right-minded man (Quran; 11:78, 87).
- A rich companion of the Prophet Peace be upon him (Pbuh) who was suffering great illness and fearing death because of that, asked if it was better for him, as he had no children but one daughter, to give up two thirds of his wealth for charity? The Prophet Pbuh could not agree with him on that. Then the companion said; well, shall I give up for charity half of my wealth, the Prophet Pbuh said “no and you may give up only one third of your wealth, though one third is still much” adding to him that “It is better to leave (i.e. after your death) your inheritants wealthy rather than leaving them poor and asking people for charity”.
- The concept of insurance is based on the awareness of the individuals to the necessity and importance of co-operation among them.
- Any individual, who cannot stand up independently against a probable loss which may accidentally and heavily fall upon him, knows that same loss would not be burdensome or disturbing if divided among many people.
- The ethics of cooperation among people within the spirit of brotherhood and awareness of their common good and well being is very clear in the Quran. In Sura: 5; 2. “Co-operate in al-Birr and al-Taqwa but never in sin and transgression”. “Al-Birr and al-Taqwa” literally mean virtue, righteousness, and piety.
- Co-operation among a group of people, for the sake of taking care of any one of them who may be subject to an accident, loss of wealth or any other misfortune, results in Takaful, i.e. surety or solidarity.
- To extend help to the one who becomes in need of help. Takaful in Islam is well established as a principle in Zakat which is one of the five pillars of Islam. Zakat is an obligatory charity imposed upon every rich Muslim to purify the soul by spending on the poor and needy a percentage of his / her own earnings and wealth.
- Zakat is spent also to help those who may become heavily indebted because of accidents or sudden misfortune.
- According to the Prophet Pbuh; “The true believers in their mutual feeling of affection and mercy prevailing among them resembles just like one body, whenever any part of this body is afflicted with pain, all other parts will share and feel this pain”. (Narrated by Imam al-Bukhari and Imam Muslim).
- He Pbuh is also saying; “The example of one believer to another believer is just like a building whereby every part in it strengthens the other parts”. (Narrated by Imam al-Bukhari and Imam Muslim) and “Allah SW will always help His servant for as long as he helps others”. (Narrated by Imam Ahmad bin Hanbal and Imam Abu Daud).

- For more than fourteenth centuries more than one form of Takaful was practiced by Muslims. First to mention is Deya (blood money), to be paid by the person who has committed the crime of killing by mistake or causing serious physical body injury to another person.
- When Deya is collected only from family or tribe people it is called Acqela.
- In case the person who has committed the killing crime is not known, the extended family or tribe members would divide the amount of Deya among themselves and pay it to the nearest relative (s) of the deceased person. This called Qasama

## 11 Insurance Contract

- Conventional – Risk transfer mechanism.
- Risk is transferred from insured to specialized party (insurance company).
- Islamic – Risk sharing mechanism.
- Mutuality and Participant responsibility

### Economic Objectives

- Conventional – Profit maximisation for the benefits of shareholders.
- Islamic – mutual interest/joint guarantees.

### Insurance Company role

- Conventional – insurer.
- Islamic – Operator (portfolio manager).

### Law

- Conventional – secular regulations.
- Islamic – Shariah regulations.

### Ethical framework

- Conventional – Codes of conducts for business purposes to maximum long term value of shareholders funds.
- Islamic – Islamic business ethics of social responsibility.

### Contract forms

- Conventional – Commercial insurance contract (Bilateral contact).
- Islamic – Cooperative (unilateral contact) Plus Islamic contracts of Wakala/Mudaraba/Kafala.

### Underwriting policy

- Conventional – Insurability / Profit making / Underwriting techniques.
- Islamic – Sharia framework (Haram business is restricted)/Insurability/Underwriting techniques.

### Investment

- Conventional – Equity/debt-no restrictions.
- Islamic – Interest-free Shariah-compliant investments.

### Surplus

- Conventional – shareholder's account.
- Islamic – Participants account or sharing system.



12. Islamic Insurance Companies need to make a number of disclosure notes to accompany their financial statements including the following:
- the company shall include comparative financial information in all of its financial statements, at least for the current and previous year;
  - it shall be noted that, “notes to the financial statements form an integral part of the financial statements.”
  - the financial statements shall disclose all material information that is necessary to make the financial information relevant, adequate and reliable to their users;
  - the financial statements shall disclose basic information about the Islamic Insurance Company including its name, country of incorporation, legal form, formation date, activities and the major services it provides, location of head office, branches, names of subsidiaries, percentage ownership in each subsidiary, names of subsidiaries whose financial statements are not consolidated and names of associates and affiliates;
  - names of the members of the Shariah Supervisory Board 1 and the board role and authority;
  - the authority responsible for the supervision of the company;
  - disclosure of the reporting currency and accounting methods in use for the translation of foreign currency balances.

Disclosure of significant accounting policies to recognise:

- earned contributions;
- outstanding claims and claims incurred but not reported;
- unearned contributions;
- insurance business acquisition cost;
- commission earned from re-insurers.

Disclosure of significant accounting policies relating to the:

- translation of foreign currency assets and liabilities to local currency;
- amortization of development cost;
- consolidation of subsidiaries;
- choice of an acceptable accounting alternative, for example, choice of depreciation method;
- accounting policies/methods which are not consistent with AAOIFI financial accounting standards;
- revaluation of assets;
- disclosure of unusual supervisory restrictions;
- disclosure of earnings/expenditure prohibited by Shariah;
- disclosure of concentration of asset risks;
- disclosure of risks associated with assets/liabilities which are denominated in foreign currency;
- disclosure of amounts recoverable from re-insurers;
- disclosure of contingencies not recognized in the statement of financial position and outstanding financial commitments;
- disclosure of restricted assets or assets under pledge.

Disclosure of accounting changes including:

- changes in accounting policies;
- changes in accounting estimates;
- correction of material errors in prior periods;
- disclosure of the party managing insurance operations, the contract in use and the remuneration he receives;
- disclosure of the party managing policyholders' investment funds, the contract in use and the bases for profit allocation;
- disclosure of the basis for allocating surplus among the policyholders;
- disclosure of related party transactions;
- disclosure of transactions with External Auditors and/or members of the Shariah Board;
- disclosure of the concentration of insurance and re-insurance risks.

### **13. Structure of Family Takaful**

- It is important to point out that a family takaful plan is a long-term saving and investment programme with a fixed maturity period.
- The family takaful plans have a defined period of participation.
- The takaful company and the participant will enter into a long-term takaful contract which is based on the principle of Profit Sharing.
- The takaful contract outlines all details about the rights and obligations of the parties to the contract. The participant is required to pay regularly the takaful installments in consideration for his participation in the takaful plan.
- The participant will decide the amount of takaful installments that he wishes to pay, but such amounts shall be subject to the minimum sum as determined by the company.
- Each takaful installment paid by the participant shall be divided and credited by the takaful company into two separate accounts, namely the participant's account - The investment fund for participants (Saving Fund). It is similar to assets management fund and the participant's special account - The risk protection fund. It is similar to a general fund.
- Any profits generated from the investment shall be shared between the Participant and the Company in a ratio to be mutually agreed between the participant and the company in accordance with the contract of Mudharabah.
- Shareholder's fund – Shareholders assets and liabilities.

### **Structure of General Takaful**

- Contrary to the family takaful discussed above, general takaful schemes are basically contracts of joint-guarantee on a short-term basis, (normally one year), between a group of participants to provide mutual compensation in the event of a defined loss.
- The schemes are designed to meet the needs for protection of individuals and corporate bodies in relation to material loss or damage resulting from a catastrophe or disaster to properties, assets or belongings of participants.
- Participants of a general takaful scheme shall also enter into a contract with the company on a profit-sharing base type of contract. The contract stipulates the right and obligations of the participants as well as the company.
- In consideration for participating in the various schemes, the participants agree to pay the takaful contributions as donation or tabarru'.
- The company manages the general takaful business including managing the investment of the general takaful fund assets.
- As Mudharib, the takaful company will invest the general takaful fund in accordance with Sharia's principles and all returns on the investment will be pooled back to the fund.
- In the same regard, the participants agree that the company shall pay from the general takaful fund, compensation or indemnity to fellow participants who have suffered a defined loss upon the occurrence of a catastrophe or disaster.

- Suppose that there is a surplus (profits) in the general takaful fund after all the operational costs of general takaful have been met, that surplus will be shared between the participants and the company, provided the participants have not incurred any claims and that no takaful benefits have been paid to them.
- Funds – Two segregated funds one for shareholders and the other for policyholders.
- Underwriting – Takaful company manage the takaful fund on behalf of participants on an agency basis.

14. Typically, in mutual insurers (similar to Takafuls) policyholders have rights that divide into three categories:

- membership rights;
- contractual rights;
- governance rights.

#### **Membership rights**

- Covers the legal and ownership rights of policyholders as a member of the mutual.
- While not identical to “ownership” rights of shareholders of a stock insurers because there is no control over property.
- A mutual member does have a shared right to excess surplus and may have a claim against assets of a mutual in bankruptcy or dissolution.

#### **Contractual rights**

- Covers the express benefits and obligations under the policy contract which is binding upon the member/policyholder.
- Technically, the member shares in the mutual risk pool only and should have no claim against the Takaful Operator’s shareholder capital nor related investments.

#### **Governance rights**

- Covers governance of the entire organization.
- Mutual policyholders should have a voice in how an entity is managed, how the records and books are kept as well as open access to financial accounts and ideally in selection of a board of directors.
- In similar fashion, it is common sense that a Takaful is operated for the chief benefit of policyholders, and yet very few Takaful Operators globally have a mechanism whereby representation by members is included on the board level.
- Many conventional mutuals enable members to exercise governance rights pertaining to fundamental “corporate” transactions such as mergers, acquisitions, or sale of substantial portions of mutual assets.
- If Takaful enterprises are to truly differentiate themselves from conventional insurance companies, including mutual insurers, they must eventually address these members’ rights and actively encourage the empowerment of a customer base with possibly additional benefits accruing including stronger loyalty.