

## **JIBM's Correspondence with Regulators of Banca *Takāful* in Pakistan**

The JIBM, in 'Archives Section' publishes any material published in any journals that might not have gotten broader readership due to some limitations or constraints, or any documents / correspondence that needed awareness of or action by any of the stakeholders and could help in enhancing attentiveness about any socio-economic and business issues.

JIBM, in its June, 2014 Issue published a detailed Editorial on the ways and means to make the *takāful* system really worthwhile and also discussed some issues in banca *takāful* being offered by some IBIs in Pakistan. But, the way the system of banca *takāful* developed quickly, may not only promote 'white collar crime' of kick-backs and commissions in Islamic banks, but most probably also create problems for the policy holders that, in the long run, might affect the credibility of Islamic banks in the country too.

Accordingly, a letter was written by the Chief Editor, JIBM to the Governor State Bank of Pakistan with 'CC' to the Chairman SECP and the members of the Shariah Board of the State Bank of Pakistan. As the formal reply by SBP through its Banking Policy and Regulation Department (BPRD) needed further clarifications, we sent another letter to the Governor suggesting them to resolve the socio-economic issue by involving Islamic banking officials of the State Bank and the joint committee of SECP and the SBP. We received a formal reply of the second letter as well, which indicated that if deemed necessary, the subject matter will be taken up by the State Bank with the SECP at an appropriate level.

Keeping in view importance of the matter, JIBM considers it imperative to publish the correspondence for benefit of all concerned and also to initiate policy related discussion on the issue. JIBM will be pleased to publish any comments / suggestions by the *takāful* companies; Islamic banks offering banca products, any of the regulators, i.e. SECP and State Bank of Pakistan, academia or even any affected persons. Accordingly, the correspondence which is sufficiently self-explanatory is being published in the following sequence:

- Letter from Prof. Dr. Anis Ahmed to the Governor, State Bank of Pakistan dated March 14, 2016
- Reply of the State Bank (Banking Policy and Regulations Department-BPRD) dated March 30, 2016
- Reply from the SECP dated April 25, 2016
- Second letter from Prof. Dr. Anis Ahmed to the Governor SBP dated April 18, 2016
- Reply of the State Bank of Pakistan (BPRD) dated April 28, 2016.



Mr. Ashraf Mahmood Wathra,  
 Governor,  
 State Bank of Pakistan,  
 I.I. Chundrigar Road, Karachi

Ref: JIBM / CE /16/ 01

Dated: March 14, 2016

*Assalamu Alaykum wa Rahmat Allah*

Dear Sir,

**Banca *takāful* offered by Islamic Banking Institutions in Pakistan  
Suggestion for Fix up Measures before it is too Late**

My dear Ashraf Mahmood Wathra,

Takaful is a system approved by the Shariah for joint risk mitigation and mutual help by the members of a group. The Journal of Islamic Business and Management (JIBM) published a detailed editorial in its June 2014 issue to explore how to make the takaful system really worthwhile. It also discussed the Banca *Takāful* policies being offered by many of the IBIs in Pakistan as an agent to the *Takāful* Companies. They charge distribution fees in the same manner as in case of insurance or takaful companies, although they do not have to undertake that level of effort for policy distribution as in the case of distribution agents of the takaful companies. However, the Kafalah policy of Meezan Bank Limited was the only exception in which reportedly no fee was charged from the policy holders and hence an easy exit option any time was available with payment of 100% cash value along with the profit, if earned [they also have started charging some fee now due to pressure from certain quarters]. It was also suggested to the State Bank that it may not allow the IBIs to charge any distribution fee from the policy holders in Banca *Takāful*, and the benefits must go to the policy holders. A thorough study was also suggested by a joint team of the SBP and the SECP experts to explore pros and cons of banca takaful policies being offered by the IBIs. But we are not aware if any such step has been taken in this regard or not.

In the meantime, banca takaful system developed quickly as IBIs' officials were in better position to bring the customer in the ambit of Islamic system than the distribution agents of Takaful companies. As the IBIs charged the same fees as the Takaful / insurance companies charge, it turned out to be a lucrative business for the staff and management of the IBIs. Targets are given to the branches and official for sale of policies, who get share in the commission, and are penalized in case the target is not achieved.

As a result, a new "white collar crime" area of kick-backs and commissions in the banks has emerged – the commission allowed by the takaful company is distributed among the respective bank and its management, from the person at the front desk to the Head IBD / CEO / COO, etc and in some cases, among other

offers, return tickets are provided for pleasure trips abroad. [The SBP may like to conduct a study as to how much and what kind of benefits have been provided to the staff and the management of the IBIs distributing banca takaful during two years]. It has resulted in a situation that even if a person comes for a deposit account / saving plan, or to invest his small amounts for any earning scheme or his / her rainy days, the staff persuades him to get takaful policy, only to get a share in the Commission. However, the issue is that due to high rate of commission (almost 80 % in first year), the policy holder might reach the break-even only after 4-7 years, as roughly 15 years’ and 5 years’ fees are taken in the first and the second years of 20 years *takāful* policies. This could be highly explosive in case some customers withdraw their policies in early years as the possibility is in our society where people might not have any option but to withdraw their funds from the banks / financial institutions. To the best of our knowledge some such instances have occurred and the customers had bitter experience of Islamic banking and finance due to compulsion of target meeting, misdeeds of the staff and inappropriate operation policy.

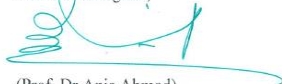
Although, IBIs get signature of the customer at a disclaimer form indicating that all takaful operations like investments and payments would be made by Takaful company, but the issue is that the customers generally do not read such forms. Although the SBP has advised the banks to make full disclosure to the clients, but nothing is told regarding the commission that the IBIs’ shariah scholars allow as wakalah fee, may be, without knowing its distribution.

In our view the above trend may result in a very serious situation - any large scale scandal, causing loss not only to the people of small means, but also to the integrity of Islamic finance. In the words of Warren Buffet, it might be a ‘weapon of self-destruction’ for the IBBs, as he had warned against the financial derivatives, that turned out to be true.

We, therefore, would like to divert your attention to take corrective measures before it is too late to be controlled. We would suggest in this regard that payments, if needed to the banks staff for distributing the takaful policies, may be made from the banks’ own sources and the IBIs’ staff / management may not be allowed any commission / kick-backs / ticket for foreign tours, etc. A pertinent aspect to be kept in view is that when a person approaches a bank for a saving plan in a cooperative framework of takaful, there should be no Commission, except for bank’s share as a mudarib for investing the proceeds in business.

An expert committee comprising officials from SBP, SECP and professionals from banks and takaful companies may also be entrusted with the job to recommend changes in the system as suggested in the Editorial mentioned in the first para above.

With the best regards,



(Prof. Dr Anis Ahmad)  
Vice Chancellor & Chief Editor, JIBM

CC: Chairman SECP, Chairman and Members, Shariah Board, SBP



**STATE BANK OF PAKISTAN**  
**BANKING POLICY & REGULATIONS DEPARTMENT**  
**11 CHUNDRIGAR ROAD**  
**KARACHI**

No.BPRD/ SI&ADCD /7900/2016

March 30, 2016

**Professor Dr. Anis Ahmed**  
**Vice Chancellor &**  
**Chief Editor (JIBM)**  
**Riphah International University**  
**Sector 1-14,**  
**Islamabad.**

**Banca Takaful offered by Islamic Banking institutions in Pakistan**  
**Suggestion for Fix-up Measures before its too late**

**Dear Sir,**

Please refer to your letter ref. no. JIBM/CE/16/01 dated March 14, 2016 addressed to the Governor-State Bank of Pakistan (SBP) on the captioned subject.

2. We highly appreciate your efforts in taking time out of your busy schedule to share your concerns on the subject matter and propose measures to curb malpractices in Banca *Takaful*. SBP has always taken a positive note of feedback received from different forums including Journal of Islamic Business and Management in its pursuit to providing better quality banking services to the stakeholders.

3. Being apex policy making institution for banking industry, State Bank has a very rigorous standard operating procedures to devise policy parameters for various banking issues. Being related to the protection of consumers, the subject matter is quite sensitive in nature, and is accordingly attended with utmost priority.

4. So far as your observation on Banca *Takaful* is concerned, we would like to clarify that this product has been designed by insurance companies, while IBIs are acting as distribution channels for its sale. Both SBP and SECP, being regulators of IBIs and insurance companies respectively, have their own domains to issue regulations/guidelines and ensure their strict compliance. For this purpose, SBP has issued a set of comprehensive instructions for sale of third party products by banks vide its CPI Circular No 2 of 2012. These instructions

are also applicable to .Takaful products, which aim at protecting consumers' right by curbing malpractices of mis-selling, overcharging, non-disclosure of terms and conditions etc.

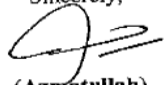
5. You would appreciate that SBP has required all banks to formulate a "Fair Treatment of Consumers' (FTC) framework circulated vide Circular No. 04 of 2014. In order to assess compliance of banks on FTC, another framework is under review which explicitly covers all areas including culture, affordability, sales practices and complaint handling to ensure that no deceptive and unsuitable product is sold to consumers.

6. It is pertinent to mention here that SECP has recently notified detailed Bancassurance Regulations 2015 through its Circular No. 27 of 2015, which are also applicable for Banca*Takaful*.The regulations put in place all the necessary checks and balances on the bank and insurer / *Takaful* operator to ensure customer's protection, transparency and proper disclosures to the policyholders.

7. So far as your observation on perks and bonuses of bank's staff is concerned, it is clarified that these incentives are not directly given by the insurer / *Takaful* operator nor do these perks cost the policyholders anything extra. Further, as per Para 8.3 of the Bancassurance Regulations applicable from January 01, 2016, the banks are bound not to charge any service fee, processing fee, administration charges etc to the policyholders. Moreover, some limits relating to payment of commission to the bank have also been introduced in the said regulations.

8. Besides, the inspection departments of SBP ensures proper implementation of its regulations/guidelines/instructions through periodical on-site visits, if at any stage, it is observed that ba.1-\*/DFI is in violation of the regulatory instructions, SBP initiates proper enforcement action including penal action against the institution. Customers of the banks can also launch their complaints against any malpractice of Banks/OFIs with Banking Mobtbasib, which is an independent institution and act as a second fora for redressal of public complaints. This service is free of cost and governed under Section 82 of Banking Companies Ordinance, 1962 and Federal Ombudsmen Institutional Reform Act, (FORA) 2013,

9. We hope that our above explanation would address your concerns relating to the sale of Bancassurance/Takafid through banks

Sincerely,  
  
(Azmatullah)  
Additional Director



"Say no to corruption"

**Fida Hussain Samoo**

Commissioner

I D/P RDD/M ISC/2016/48

20 April 25, 2016

Prof. Dr. Anis Ahmad  
Vice Chancellor,  
Riphah International University,  
Sector 1-14, Islamabad.

**RE: BANCA TAKAFUL OFFERED BY ISLAMIC BANKING INSTITUTIONS IN PAKISTAN SUGGESTIONS FOR FIX UP MEASURES BEFORE IT'S TOO LATE**

Dear Prof. Dr. Anis Ahmed.

Reference is made to your letter dated March 14, 2016 bearing reference no JIBM/CE/16/01 in respect of the captioned subject.

**2.** At the very outset, we would like to extend our gratitude for the concerns that you have shared with this office in respect of the subject and assure you that the SECP is working and shall continue to work in a manner that the interests of all the existing and prospective insurance/takaful policyholders is ensured in true spirit.

**3.** With this letter, we wish to bring in your kind knowledge, the major reforms undertaken by the SECP in order to streamline the selling of bancassurance/bancatakaful policies through banks. We understand that many of your concerns are being sufficiently addressed, through the recently notified Bancassurance Regulations, 2015 (hereinafter referred to as the "Regulations") notified via S.R.O 722(1)/2015 dated July 31, 2015 effective on Bancassurance business undertaken on or after January 1, 2016. It is important to state that the Regulations have been formulated by the SECP in active consultation with all the stakeholders including the State Bank of Pakistan (the "SBP").

**4.** A summary of the major reforms contained in the Regulations is as follows:

**(a) Objective process to establish misselling:** The Regulations provide for an objective process for establishing that a policy has been missold or

otherwise, by defining misselling and stating parameters, which if not undertaken by the bank or the insurer, would be construed as misselling.

**(b) Mandatory After Sales Call Back [Regulation 17(h)]:** Under this regulation, every insurer is compelled to make after sales call to every bancassurance/bancatakaful customer, within fourteen days of the issuance of the policy. In case of any adverse response from the policyholder, the premium/contribution paid by the policyholder is to be refunded within a period of 30 days.

**(c) Commission claw-back provision [Regulation 15]:** The Regulations, in the larger interest of the policyholders also address the issue of misselling of bancassurance/bancatakaful policies, wherein, if the case of misselling is proven under the Regulations, within a period of thirteen months after the issuance of policy, then the entire first year commission paid by the insurer to the Bank is required to clawed back and 100% premium shall be paid to the Policyholder under the Regulations.

**(d) Commission Payable to Bank [Regulation 8]:** The Regulations place the restriction that the commission to be paid to the Bank must be computed on premiums received by the insurer and under no circumstances the commission on premiums to be received in future, be paid. Furthermore, the Bank is not allowed to charge, to the policyholder, any service fee, processing fee, administration charge or any other charge unless such a charge has been included by the insurer in the premium and communicated to the policyholder in advance.

**(e) Rationalization of bank's remuneration structure [Regulation 12 to 14]:** The commission rates for the banks have been reduced in the Regulations both for first year and for the overall term of the policy.

Decrease in the first year commission rates for banks has directly resulted in increasing the first year allocation of premium/contribution of the policyholders to their investment account. Furthermore, in order to address issues such as low level of persistency in the case of bancassurance business, minimum persistency benchmarks have been introduced which have been linked with the payment of persistency bonus, so that the bank undertakes efforts that the second year and renewal premiums against the policies are collected and the policy is kept inforce for a longer period of time.

**(f) Restriction on recycling of life insurance policies [Regulation 17(f)]:** The Regulations provide that where a regular premium individual life policy is lapsed /surrendered after the third

policy year, **the Bank will not sell any new individual life policy to the same Policyholder through the same insurer or through a different insurer within a year from the effective date of the policy** acquiring lapsed /surrendered status. Restriction on recycling of policies ensures that the employees/agents of bank are restricted to engage in the practice of compelling a particular policyholder to lapse or surrendered his policy and thereafter luring the same policyholder to purchase new insurance policy so that he/she can Genera=income.

**5.** We would further like to clarify that the commissions associated with the selling of bancassurance/bancatakaful policies are paid by the insurer to the bank and not to the employees of the bank. Furthermore, the SBP undertakes regular onsite visits of banks, due to which we understand that any purported non-compliance of applicable laws by the banks, is adequately taken care at the SBP level.

**6.** You would appreciate that the aforementioned reforms are a few of the major reforms contained in the Regulations. We understand that your concern that the bank does not have to undertake that level of effort for policy distribution and eating of commissions from the money of policyholders, is counter balanced from the provisions of commission claw back, restriction on recycling and mandatory after sales call back as contained in the Regulations.

**7.** Trust that your concerns would have been adequately addressed and we assure you that the SECP would bring in further reforms in the case of bancassurance business, as and when considered necessary, for the protection of the interests of the insurance/takaful policyholders.

Regards,



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Mr. Ashraf Mahmood Wathra,  
Governor,  
State Bank of Pakistan,  
Chundrigar Road,  
Karachi

Ref: J1BM / CE /16/ 02

April 18, 2016

*Assalamu Alaykum wa Rahmat Allah*

Dear Sir,

**Banca *takaful* offered by Islamic Banking Institutions in Pakistan  
Suggestion for Fix up Measures before it is too late**

This is with reference to our letter No. JIBM / CE /16/ 01 of March 14, 2016 on the above subject and its reply from the State Bank vide Letter No. BPRD /SI&ADCD/7900/2016 dated March 30, 2016 (both attached).

- 1) I highly appreciate the prompt action by the State Bank of Pakistan for giving utmost priority to the issue. Alhamdulillah, it has been strong vigilance and timely actions of the State Bank that we have not seen any failure Or bail-outs in the banking sector or run on any bank over last 2/3 decades despite the most serious recent global financial crises in which hundreds of financial institutions collapsed even in the developed world. It was with this intention Only that I, as Chief Editor of our research Journal JIBM, intended to convey our concern as an early warning signal so that a proper action could be taken with joint efforts of SBP and the SECP.
- 2) However, from the reply we received, it seems that expected steps have not been taken. The current • practice may lead to unappealing repercussion for Islamic banks in terms of their integrity, in addition to loss to the prospective policy holders. Hence, the authorities dealing with Islamic banks, namely Deputy Governor Islamic Banking, Islamic Banking Department and the Shariah Board of the State Bank should have been involved. We could also be called, if needed, to explain the concern relating to the social issue.
- 3) Para 7 of the reply explains that as per SBP regulations, banks are not bound to charge service fee, administrative charges, etc to the policyholders. According to our 'research, however, the IBIs selling takaful policies [except for Meezan Bank] deduct, after the cooling off period of 14 days as in case of

normal takaful, around (40) % of the contribution as bank's income, (4) % to the bank employee whomarketed, (2) % to the coordinator of Bancatakful and (2) % to bead Bancatakful. Remaining about (48) % is remitted to the Takaful Company, the major part of which is further distributed among different stakeholders. This is clearly charged to the client. This is why, "the policy holders reach the break-even only after 4-7 years, as roughly 15 years' and 5 years' fees are taken in the first and the second years of 20 years takaful policies" as we indicated in our earlier letter. [Accordingly, we had suggested to the SBP in JIBM Editorial, on Takaful that the IBIs may be advised to adopt Meezan Bank's approach with regard to bancatakaful]

4) Our concern is that the problem has erupted despite the strict consumers' protection regulations of the SBP (FTC policy, as indicated in the SBP reply), meaning that some bankers are not taking the regulations seriopsly, or are benefiting from some loopholes. One reason may be that while penalties by the SBP, even if levied, after the inspection, would be on the banks, the incumbents would have got their personal benefits — one in the form of income and award for achieving the target of policies distribution (or avoiding the punishment) and other possibly in the form 'kick-backs' and commissions for higher level incumbents.

5) The reply letter's explanation that the perks / commission paid to the bakers do not 'cost the policy holders anything extra' (para 7) is also questionable. The issues to be considered are: i) Should the Takaful Company be allowed to charge for bancatakaful policies in the same way as they charge for takaful policies in general; and ii) while a client of a Takaful company would approach it only for takaful policies, the clients of banks mainly approach banks for savings plans, but as the bankers can get nothing for themselves in case of any savings / investment accounts while they are given a share in the commission given by the takaful company, bankers persuade the clients, both existing deposit holders as well as the walk-in, to get bancatakaful policy; and this is the issue of '*conflict of interest*' that we raised in our earlier letter.

6) As the Takaful companies do not have to make efforts for selling the policies to the clients of banks, as they have to do for selling, policies to the general public, no fee should be charged for policies distributed through banks, as banks as per their nature of business, are not expected to charge on the Savings Plans. If necessary, banks' own charge should be reduced from (40) % as indicated above to (10) %. Currently, as the commissions paid to Takaful officials and the B.Ms. are ill-earned, kickbacks are provided to those who are at the helm of the affairs. This is why, we had suggested a study to be undertaken as to how much and what kind of benefits have been provided to the staff and the management of the IBIs distributing bancatakaful during 2015.

7) Levying heavy penalties on banks after the error / irregularity is committed and identified during inspection, or suggestion to go to the 'Banking

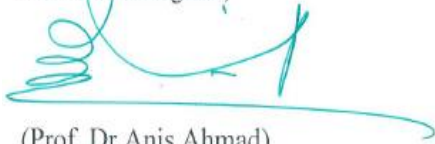
Mohtasib' after the clients come to know that they have been defrauded, cannot be termed as timely actions for any issue raised as '*early warning*' signal.

8) Bankers serve the respective banks and get reward for that from the banks, bancatakaful must not be a business for the bankers; otherwise, it would create conflict of interests.

9) As far as we know, there exists a framework for collaboration between the SBP and the SECP. As the matters pertaining to bancatakaful are common and serious for both the regulators, the issue needs to be discussed in their joint meetings for deciding about distribution of takaful policies through banks. [This is why, we had sent a copy to the Chairman, SECP, but as clients are directly dealing with the banks, we wrote to the SBP for taking care of the matter.]

I, therefore, again suggest, you again to resolve the socio-economic issue by involving Islamic Banking officials of the State Bank and the joint committee of SECP and the SBP.

With the best regards,



(Prof. Dr Anis Ahmad)  
Vice Chancellor & Chief Editor, JIBM

CC:

Chairman, SECP and Members of the Shariah Board, SBP



**STATE BANK OF PAKISTAN**  
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**KARACHI**

No.BPRD /SI&ADCD /10531/2016

April 28, 2016

**Professor Dr. Anis Ahmed**  
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Sector I-14,  
**Islamabad.**

**Banca Takaful offered by Islamic Banking Institutions in Pakistan**  
**Suggestion for Fix-up Measures before its too late**

Dear Sir,

Please refer to your letter ref. no. JIBM/CE/16/02 dated April 18, 2016 addressed to the Governor-State Bank of Pakistan (SBP) on the captioned subject.

2. In this regard, SBP is well cognizant with the issues prevailing in the sale of third party products through banking channels owing to its supervisory framework. As mentioned in our previous letter, we have taken a number of steps to address the issues and strengthen our regulatory framework on the subject matter.
3. Notwithstanding, if deem necessary, the subject matter will be taken up with SECP at an appropriate level.

Sincerely,

A handwritten signature in black ink, appearing to be 'Azmatullah'.

(Azmatullah)  
Additional Director