ACTUARIAL PARTNERS

Treatment of Participants' Investment Fund under the RBC Framework

The recent solvency guidelines have raised an issue on whether the Participants' Investment Fund (PIF) should be subjected to credit and market charges.

Bank Negara in its RBC Framework for Takaful Operators Concept Paper clearly states that the participants bear the investment risk under the PIF. This is similar to the Investment Linked Plans (ILP) under conventional and for such plans there is also no credit or market charge on the ILP funds. Thus, unless the takaful operator provides a capital guarantee on the PIF, no market or credit charges should apply.

An argument has been made by some takaful companies that for risk type products (e.g. Mortgage Reducing Term Takaful or MRTT) where the single (or in fact even regular) contribution is not fully tabarru' at the outset but resides temporarily in a PIF, the PIF for risk type products should be subject to credit and market charges on the basis that had all the contribution been tabarru' at the outset (the single fund approach) then credit and market charges would have applied.

We feel that this argument is not necessarily true as the two Plans (the 'drip' MRTT and the 'single fund' MRTT) are not the same. They are different for the following reasons:

(i) On death of the life covered under the drip product, the PIF is payable in addition to the remaining sum covered. This by extension already makes the product more 'expensive' than a single fund approach.

(ii) On surrender before the term expires, and for the single fund approach, a fixed formula driven refund of contribution is paid regardless of the investment performance of the tabarru' pool. Thus unlike the drip approach there is a guaranteed surrender value.

(iii) Bank Negara already mandates that any shortfall in the drips under the MRTT drip plan should be provided in a separate reserve (the tabarru' deficiency reserve). This reserve **would be subject** to market and credit risk as it is not part of the PIF.

(iv) There are unit-deducting riders in the conventional product sphere where the unit fund remains free of credit and market charges. A MRTT drip product is similar in operation. Why should the Takaful PIF of the MRTT be subject to market and credit charges when the ILP fund of the unit-deducting rider plans of conventional is not?

We believe BNM is correct in not requiring market and credit charges on the PIF for drip MRTT products and the takaful community need not request for a change of this basis.

Should you need further clarification on this note please contact:

Email:

enquiry@actuarialpartners.com

Office Address:

Actuarial Partners Consulting Sdn Bhd
17.02 Kenanga International
Jalan Sultan Ismail
50250 Kuala Lumpur
Malaysia

Tel: +603 2161 0433
Fax: +603 2161 3595