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Compliance with IFRS17 Standards in Takaful Insurance: Challenges, Solutions, and Future Perspectives for Egyptian Market

الامتثال لمعايير IFRS17 في التأمين التكافلي: التحديات والحلول ووجهات النظر المستقبلية في السوق المصرية

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Abstract

The insurance companies prepare themselves to adopt International Financial Reporting Standard (IFRS 17) insurance contracts from January 2023. IFRS 17 is the first international and comprehensive accounting standard for conventional insurance companies. The Islamic insurance sector would prepare itself to adopt IFRS17. Implementation of IFRS17 to takaful insurance is not straightforward since takaful insurance companies have different operating models.

Implementation of IFRS17 to takaful insurance requires investigating whether IFRS17 standard complies with Shariah standards. Therefore, it requires understanding the issues involved and connecting the technical concept of takaful to financial reporting and disclosure to IFRS17 standards.

Egypt is the first provider of Islamic insurance, which was launched in 2003 and there are now ten takaful companies operating in Egypt. In Addition, many industry figures expect that the premiums of Egyptian takaful insurance companies will grow by between 20% and 25% annually over the next years.

This research aims to explore the challenges and compliance of IFRS 17 implementation with Islamic rules to Takaful insurance, propose and the GAP analysis and financial impact assessment for the takaful insurance companies in the Egyptian market.

To achieve this objective, the researchers applied a qualitative approach, a literature review, and interviews to understand the process of implementation of IFRS17 to takaful insurance companies in Egypt.

This research concluded that takaful companies face significant challenges in applying IFRS17. Additionally, it proposes guidelines for the regulatory authority and takaful insurance companies in the Egyptian market to connect the technical aspects underlying the Takaful industry concerning Shariah rules to IFRS 17.

Keywords:

International Financial Reporting Standard for Insurance IFRS 17, Takaful Insurance, General Insurance, Wekala Fees, Shariah transactions, Modaraba.

الملخص

تقوم شركات التأمين بإعداد نفسها لتطبيق عقود التأمين الخاصة بالمعيار الدولي لإعداد التقارير المالية اعتبارًا من 1 يناير 2023. ويعد المعيار الدولي لإعداد التقارير المالية 17(IFRS17)أول معايير محاسبية دولية وشاملة لشركات التأمين التقليدية. وينبغي علي قطاع التأمين الإسلامي تبني المعيار الدولي لإعداد التقارير المالية رقم 17. يلاحظ أن تطبيق المعيار الدولي لإعداد التقارير المالية رقم 17 على التأمين التكافلي ليس بالأمر السهل نظرًا لأن شركات التأمين التكافلي لديها نموذج تشغيل مختلف عن شركات التأمين التقليدية. يتطلب تطبيق المعيار الدولي لإعداد التقارير المالية رقم 17 للتأمين التكافلي التحقق مما إذا كان المعيار الدولي لإعداد التقارير المالية رقم 17 متوافقًا مع معايير الشريعة الإسلامية، ولذلك، يتطلب الأمر فهم القضايا المعنية وربط المفهوم الفني للتكافل بالتقارير المالية والإفصاح بمعايير المعيار الدولي لإعداد التقارير المالية رقم 17.وتعد مصر أول مقدم للتأمين الإسلامي، حيث تم إطلاقه عام 2003 ويوجد الآن عشر شركات تكافلية عاملة في السوق المصري، وبالإضافة إلى ذلك تتوقع العديد من الشخصيات العاملة بقطاع التأمين أن تنمو أقساط التأمين لشركات التأمين التكافلي المصرية بنسبة تتراوح بين 20% و25% سنويًا خلال السنوات القادمة.ويهدف هذا البحث إلى استكشاف التحديات التي تواجه تطبيق معيار 17 والامتثال لتطبيق المعيار الدولي لإعداد التقارير المالية رقم 17 مع القواعد الإسلامية للتأمين التكافلي، واقتراح وتحليل GAP وتقييم الأثر المالي لشركات التأمين التكافلي في السوق المصري.ومن أجل تحقيق ذلك طبق الباحثون منهجًا يتمثل في مراجعة الأدبيات، وإجراء مقابلات لتحليل عملية تطبيق المعيار الدولي لإعداد التقارير المالية رقم 17 على شركات التأمين التكافلي في مصر. وتوصل البحث إلى أن شركات التأمين التكافلي تواجه تحديات كبيرة في تطبيق المعيار الدولي لإعداد التقارير المالية رقم 17، بالإضافة إلى اقتراح مبادئ توجيهية للهيئة التنظيمية وشركات التأمين التكافلي في السوق المصرية لربط الجوانب الفنية الأساسية لصناعة التكافل فيما يتعلق بالقواعد الشرعية بالمعيار الدولي لإعداد التقارير المالية رقم 17.

الكلمات الدالة:

المعيار الدولي لإعداد التقارير المالية للتأمين: المعيار الدولي لإعداد التقارير المالية رقم 17، التأمين التكافلي، التأمين العام، رسوم الوكالة، المعاملات الشرعية، المضاربة.

1. Introduction

The International Financial Reporting Standard 17 (IFRS 17) is a worldwide accounting standard that outlines the accounting treatment for insurance contracts in January 2023. ***(Hassan & Colgan, 2019)***

IFRS17 introduces the concept of a risk adjustment for non-financial risk, which is an effective factor in how profit from insurance contracts is reported and emerges over time. The objective of IFRS 17 is ensuring that an insurer provides relevant information in financial statements to assess the entity's financial position, financial performance and cash flows, comparability, and transparency between insurance company. ***(PWC, 2023)***

IFRS 17 will replace IFRS 4 in accounting for insurance contracts. The difference between IFRS 17 and IFRS4 can be summarized in the following table:

Table (1): Comparison between IFRS4 and IFRS17

IFRS 17	IFRS 4
Insurance Revenue	Akin to Earned Premiums for GI Lines
Insurance Service Result	Underwriting profit
Contractual Service Margin (CSM)	Profits embedded in existing business
Experience adjustments and change in estimates	- Experience variances – life - Claims adjustments – non-life
Liability for Remaining Coverage (LFRC)	Unearned Premium Reserve, Deferred Acquisition Cost, Unearned Commission Income, Premium Deficiency Reserve, Mathematical Reserve (Unit and Non-Unit inclusive), Receivables & Payables
Liability for Incurred Claims (LIC)	Outstanding Loss Reserves, Incurred but not reported, Unallocated loss adjustment expense Receivables & Payables

Source: Nagy,2023.

The key principle of IFRS17 can be summarized as ***(Nagy, 2023)***

- **Identifying as insurance contracts in which the entity accepts significant insurance risk from another party (the policyholder) in exchange for agreeing to compensate the policyholder.**
- **Separating components of contracts, where insurance contracts may contain components that must be separated and accounted for under another standard (IFRS9 and IFRS15).**

- **Dividing the contracts into groups for recognition and measurement.**
- **Aggregation Insurance Contracts for measuring insurance contract liabilities and related profitability.**

  IFRS 17 includes three optional measurement approaches, depending on the type of insurance contract can be summarized in the following figure.

Figure (1) : Comparison between measurements models under IFR17

	Key features	Products that might be measured with this approach
Building Block Approach (BBA) / General Measurement Model (GMM)	• Default model in IFRS 17 • Probability weighted discounted cash flows • Contractual service margin (CSM): to spread recognition of profit and impact of changes • Risk adjustment for non-financial risk	• Decreasing term insurance • Level term assurance • Risk attaching reinsurance treaties • Engineering (Construction all risk and Erection all risk)
Variable Fee Approach (VFA)	• Based on the GMM / BBA, but with additional features for direct participating features (DPF) contracts • Market volatility passes through CSM	• With-profits Life • Unit Linked Life
Premium Allocation Approach (PAA)	• Simplified approach • Optional approach for short duration contracts • (pre-claims liability).	• Motor • Medical • Liability lines • General Accident • Property • Casualty

Source: PWC,2023

The General Measurement model under IFRS 17 requires that the fulfilment cash flows in determining the liability including a Risk Adjustment (RA) for non-financial risks and the contractual service margin (CSM), where CSM is the excess of cash inflow over outflow (unearned profit) and the risk adjustments *(Yousuf, et al, 2021)*.

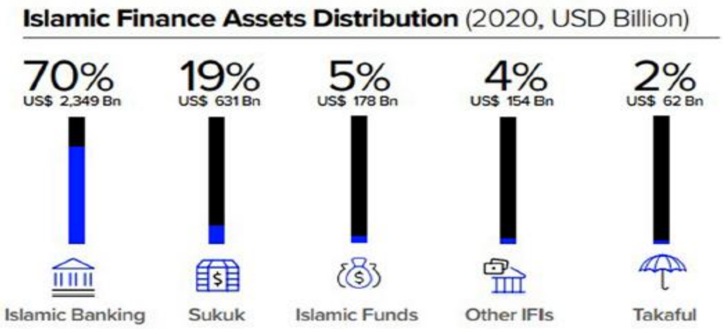
The risk adjustment for non-financial risk under IFRS17 reflects uncertainty about the amount and timing of the cash flows that arises from non-financial risks and should calculated from the present value of future cash flows and the contractual service margin that form the liability for remaining coverage (*H*anniba, 2020) .

IFRS 17 does not provide any details about Takaful insurance industry and was designed specifically for insurance since it is international standard. Therefore, interpreting IFRS 17 for Takaful is often not straightforward. In Addition to, it is important to understand the technical differences between insurance and Takaful because there is a significant difference in the conceptual framework between takaful and conventional insurance companies.

Islamic finance has achieved a significant growth rate for the last 10 years. According to the Islamic Finance Development Report 2021, the growth rate of Islamic finance has increased by more than 70% in the last six years as shown in figure 2. where, the global Islamic finance assets in the Takaful Insurance account for US$ 62 billion, compared to US$ 2.4 billion in Islamic Banking *(Wahyuni, 2023)*.

In Addition to, the Egyptian Islamic Finance Association (EIFA) announced that the growth rate of Islamic banking in the Egyptian market has increased by more than 25% compared to March 2022. EIFA showed that there are 17 investment funds, and 11 Takaful insurance companies in the Egyptian market, all of which operate in compliance with Islamic Sharia principles. *(Mounir,2023)*

Figure (2) : Islamic finance Distribution



Source: Refinitiv (2021)

The adoption of IFRS 17 by 2023 will bring about significant changes in the accounting entries of insurance contracts for both conventional insurers and Islamic insurers Here are some key changes that you can expect in the accounting entries under IFRS 17 *(Kassim, 2023):*

- **Measurement of Liabilities: IFRS 17 introduces a new approach to measuring insurance contract liabilities, known as the "building block approach." This involves calculating the fulfillment cash flows, risk adjustment, and CSM. The CSM is considered as unearned profit and replaces the current practice of recognizing premiums as revenue and claims as expenses when incurred.**
- **Amortization of CSM: The CSM represents the unearned profit on a contract. Under IFRS 17, the CSM is systematically amortized over the coverage period of the contract. This amortization is recognized as an adjustment to the insurance revenue and expenses in each reporting period.**
- **Interest Expense: IFRS 17 requires the inclusion of an explicit presentation of the time value of the money component in the measurement of the liability for remaining coverage. This leads to the recognition of interest expense over the coverage period, reflecting the time value of money.**
- **Risk Adjustment: A separate risk adjustment is recognized in the liability measurement to reflect the uncertainty and risk inherent in insurance contracts. This risk adjustment is updated over time to reflect changes in risks.**
- **Policy Acquisition Costs: Acquisition costs related to obtaining new insurance contracts are treated differently under IFRS 17. These costs are recognized as an asset and amortized over the coverage period of the related contracts.**
- **Changes in Estimates: If there are changes in estimates, such as claims experience or risk assessments, these changes are reflected immediately in the profit or loss.**
- **Presentation in Financial Statements: IFRS 17 prescribes specific presentation requirements for insurance contracts in the financial statements. The separate components of insurance liabilities, revenue, and expenses are typically disclosed to provide transparency.**
- **Disclosure Requirements: IFRS 17 mandates extensive disclosures to help users of financial statements understand the**

nature and risks associated with insurance contracts. This includes information about insurance contract terms, sensitivity analysis, and risk management practices.

- **Transition Adjustments: Upon adoption of IFRS 17, there might be adjustments needed to transition from previous accounting standards. This could impact on opening balances and require retrospective adjustments to prior periods.**

This paper will be the first to discuss the challenges of implementation of IFRS17 to the takaful insurance market, propose amendments to IFRS17 to comply with the conceptual framework of takaful in the Egyptian market and propose a framework of GAP analysis to deal with the challenges of IFRS17 implications to takaful insurance.

IFRS17 implementation to Takaful insurance requires understanding the concepts, and operational aspects of takaful insurance, and connecting to the technical of IFRS17.

2. Takaful Insurance: Concepts and operational aspects

Takaful insurance is an Islamic alternative to conventional insurance with a normative economic basis derived from Shari'ah Law. Takaful policyholders assist one another by mutually protecting if any of them suffers a loss. Takaful will be able to promote social solidarity, as well as the mutual and collaboration concept in the community, because of this. Takaful, like insurance, can provide financial support while avoiding the prohibited elements involved in insurance practices.

Takaful is also known as ethical insurance. It is based on the idea of mutual assistance and cooperation, and it promotes solidarity and brotherhood among participants *(Rifasa, et al, 2023).*

The Islamic Financial Services Board (IFSB) through its Standards and Guidance Articles has published for addressing the issue of Risk Management and Governance in Takaful (*COSKUN, 2021).*

There are many dissimilarities between conventional and takaful insurance concerning the ownership of the portfolio (Insurance and investment), The accounting framework, and the relationship between

policyholders and shareholders, and among the policyholders themselves.

The first difference between the takaful and Insurance companies is the fundamental framework. Takaful Insurance is a unique risk-sharing and Loss distribution mechanism rather than a risk transfer vehicle as in the conventional risk, where Insurance is a risk transfer mechanism whereby the insureds are exposed to the risk of losses (measurable and financial) can transfer the risk to the insurer. Additionally, the takaful insurance is based on Islamic conditions "**No Riba** ", "**No Ghrar",** and **"No Maysir"** ***(Mohamaed,etal., 2014)***.

These conditions would imply that the fundamental principle of Islamic Finance is that the risk of any business venture should be shared by the provider of capital and the user of capital. Islamic Finance is defined by the concept of partnership, specifically the various bases for sharing profit or loss, i.e., equity financing. Thus, in a Shariah-compliant business transaction, risks would be shared rather than transferred, and money would be used only as a medium of exchange rather than as a commodity (which can be traded for profit, i.e., debt, earning interest). Shariah Law expressly forbids interest-based debt financing. Insurance companies that invest in interest-bearing bonds would be considered Shariah-compliant ***(Akhtar, 2018)*****.**

Islamic insurance is practiced through two channels "fully flagged "or "Islamic counters ". **The different between these approaches can be summarized under two main financial system**: ***(Chartered Institute Of Management Accounts , 2008)***

- **Single Islamic Financial System**: **this system means establishing any conventional financial institutions are not allowed.**
- **Dual Islamic Financial System: allows the financial system to work in parallel with conventional system.**

The main difference between the takaful and the insurance are summarized in the following table.

Table (2): The comparison between conventional and takaful Insurance

ISSUE	Conventional Insurance	Takaful Insurance
Insurance contract	Risk transfer contract	Mutual risk-sharing contract.
Economic objective	Maximization of the profits for the benefits of shareholders.	It aims to profit sharing system between policyholders and shareholders.
The role of insurance company	Insurer	Operator (portfolio manager)
Law & regulation	Country regulation	Country regulation and shari'ah rules
Contract forms	Commercial insurance contract	Mutual Insurance contract in addition to Management contracts (Wekala, Mudarabah, waqf)
Underwriting Policy	Insurability/ profit making/ company strategy /regulations.	Sharia's rules in addition to Insurability/ profit making/company strategy /regulations.
Investment	No restrictions	Sharia'ah-complaint investment instruments
Surplus	Shareholders account	Participants account or sharing with takaful operator in some models.
The capital requirement 's goal	Meeting the regulatory requirements to meet the insurance companies' liabilities.	Providing a benevolent loan in the case of deficits when there is no accumulated surplus.

Source: By the Researchers

In terms of surplus distribution, the surplus is profit in insurance, and insurance companies keep it without sharing it with policyholders. On the other hand, Takaful, divides the surplus among the participants, making it a good and unique practice.

Takaful contributions are structured that a percentage of the contribution is allocated to the risk-sharing fund from which claims are

paid. This fund is based on the concept of risk sharing among participants under the authority of takaful operators to assist participants with their financial needs in respect of terms and conditions of their Takaful contract. ***(Akhter, 2010)***

<u>The two commonly approved approaches of surplus distribution by takaful insurance are:</u>

A) Distribution of the surplus to all policyholders:

This method allows all policyholders to get a proportion of the surplus whether or not they made claims during the accounting year. Then, the surplus will be shared Proportionally based on the premium (contribution) paid to the mutual fund, which can be calculated as: ***(Seif, 2018)***

$$Sr = \frac{GPWr}{GPW} \times S$$

Where, S: Underwriting surplus.

GPW: gross premium Written (total for fund)

GPW_r : gross premium Written (total for policyholder)

B) Distribution of surplus to all policyholders based on the net results of each policyholder.

This method is based on the contributions of the policyholders to underwriting surplus. This method can be considered as the most equitable for many practitioners and Sharia's supervisory board manners. This method can be calculated as:

$$Sr = \frac{GPWr-(C+R))}{GPW-(C+R))r=1,2,\ldots..n} \times S$$

Where,

C: claims.

R: reserves.

$\boldsymbol{GPWr - (C + R)}$: $\boldsymbol{underwriting\ results\ of\ participants\ (r)}$.

$\boldsymbol{GPW - (C + R))r = 1, 2, \ldots\ldots n}$ **:**

$\boldsymbol{underwriting\ results\ of\ participants\ with\ surplus}$.

In Egypt, surplus sharing is subject to minimum regulatory requirements and must be consistent with the company's surplus management policy and taking into considerations statutory reserves.

under IFRS 17 standard, it is not clear that the surplus sharing should reflect regulatory reserves and capital requirements or accounting requirements.

Ignoring reserves and capital requirements will likely accelerate the emergence of surplus to shareholders fund and may not necessarily reflect timing of expected future cashflows. ***(Hassan and Colgan, 2019)***

2.1. The Takaful Model: Conceptual Framework

This Section illustrates the takaful Operational Framework (TOF) under the agreed Shariah contracts when interpreting the accounting of Takaful under IFRS 17.

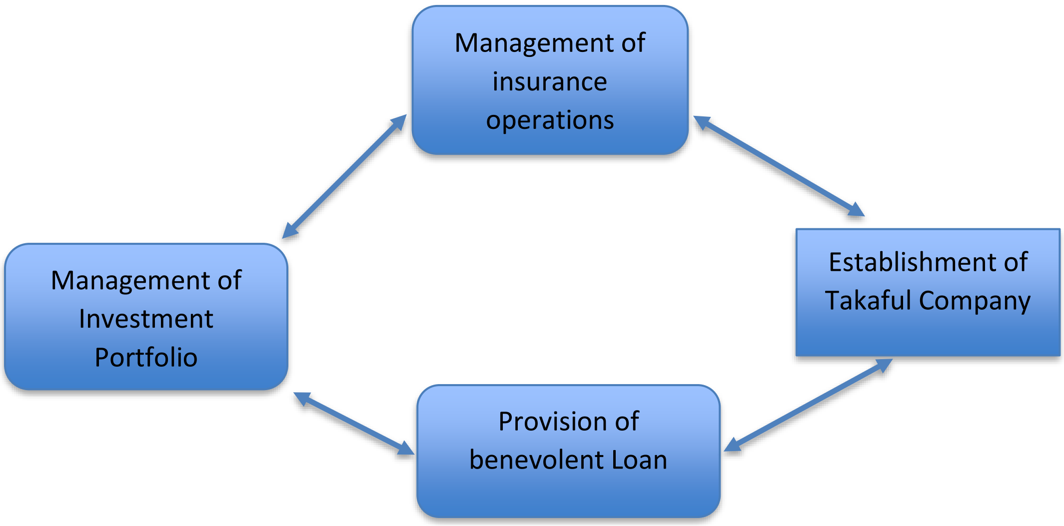
A shariah compliant business model is the second requirement of takaful operations, in addition to a mutual insurance fund. Under the Takaful model of operation, the mutual insurance pool is owned by the policyholders, and they are solely responsible for its financial results, either surplus or loss.

Islamic finance has introduced different models to have financial segregation between policyholders and the takaful operator (Shareholders of a takaful company)

The role of the takaful operator is as portfolio manager rather than risk transfer, The takaful operator takes responsibility for managing the mutual fund, managing the insurance portfolio, arranging reinsurance for the mutual insurance fund, managing the claims, support solvency, and provide a benevolent loan (Qardh-Hassan) to finance any underwriting deficit in the mutual pool. ***(Muhamata, 2017)***

The following figure illustrates the role of Takaful operator.

Figure (3) The different roles of a Takaful Operator



Source: by the researchers

<u>There are different models that govern the relationship between Policyholders and shareholders. These models can be summarized as:</u>

<u>A. Takaful *Mudarabah* Model</u>

The Mudarabah contract is one such contract type, which is a partnership contract between one party, who is the capital provider or investor, and the second party who is the entrepreneur.

The amount payable as remuneration in the Mudarabah contract (profit sharing) must be known in a manner that eliminates uncertainty and minimizes the possibility of dispute. *(Seif, 2018)*

According to the Egyptian interpretation of the Mudarabah contract, the shareholders' and participants' financial alignment is less tight. Under the interpretation of Mudarabah, any interest-free loan payable to the participants' pool can be used to cover expense overruns in addition to when claims exceed premiums.

<u>B. Takaful Wekala Model</u>

The Wekalah model is another contract type used by Takaful operators. Wekala contract can be defined as" an agency, which is responsible for one party delegation the another to act on its behalf in what can be subject matter of delegation". *(Seif, 2018)*

The Takaful operator is paid a fee for this service, which is typically expressed as a proportion of the contribution. Under this model, the regulator must act as a "referee" to ensure that both shareholders and participants are treated fairly. The characteristics of this model can be summarized as follows:

- **The shareholders, as the tankful operator can be entered into Wekalah contract with policyholders to manage both the insurance operations and the investment portfolio as a wakil.**
- **Takaful operator covers all management expenses in the context of all levels from its fees.**
- **Both the underwriting surplus and investment return are bee distributed to the policyholders.**
- **In the case of deficit, the Takaful operator is obliged to grant a benevolent loan.**
- **while the Takaful Funds are managed by the operator, the operator is not a beneficiary of the Funds (the share of any surplus is referred to in Shariah as a performance fee), but rather holds the Funds in trust for the participants.**

C. Tabarru' (The waqf) model

After several objection was raised by shariah's scholars for using "profit-sharing" contract for managing insurance fund .in addition to, some shariah's scholars regarding the conditionality of Tabrru', which lead to establishing Waqf model. This model is in practice and is used only in Pakistan and south Africa. It is relatively new and is usually adopted by non-profit organizations. The main characteristics of this model can be summarized as: ***(jaffer, 2013)***

- **A waqf fund was established by the shareholders of the takaful operator.**
- **The waqf fund has no owner, however, the takaful operator has the right of identifying the regulations to manage this model.**
- **At the end year, the surplus in the waqf fund will be returned to the fund again.**
- **The contributions to the waqf fund are invested in shariah'-compliance with interments.**
- **The funding position deficit by injection benevolent loan is still unclear in this model.**

In the Egyptian market, the most common model is Wakalah or Mudarabah with underwriting surplus sharing by the takaful operator. A comparison of the features of the takaful models is shown in the following table.

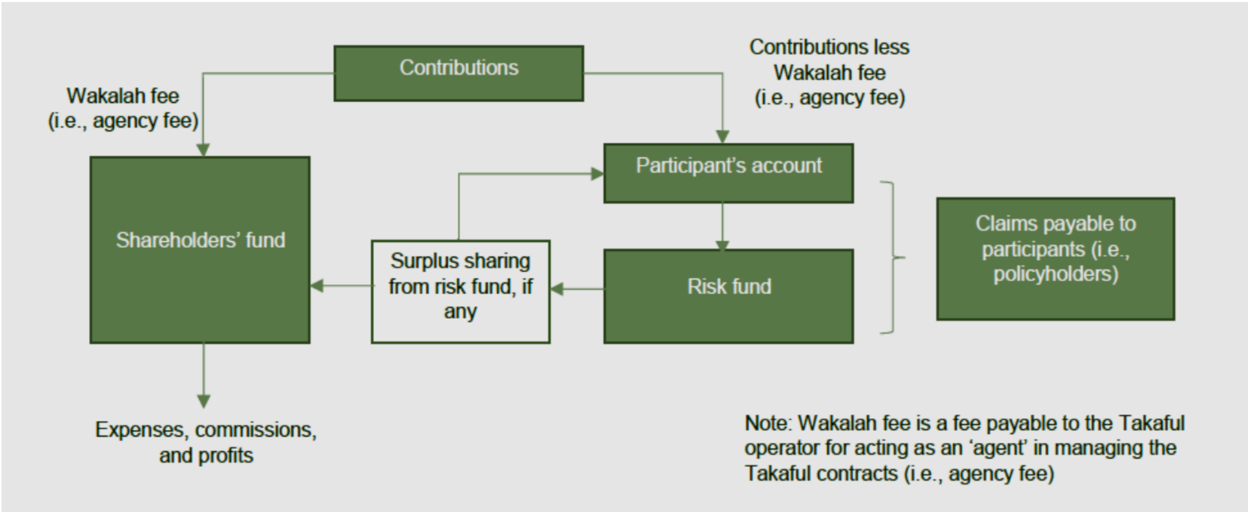
Table(3) : Features of main Takaful Models

Properties	Mudarabah	Wakalah	Waqf
Mutual pool ownership	Policy holders	Policy holders	Waqf
Up-front fees (Takaful operator)	None	Up-front fees as agreed	Waqf with Wakalah
underwriting surplus	Policy holders	Policy holders	Waqf
underwriting Losses	Benevolent loan from the Takaful Model	Benevolent loan from the Takaful Model	Unclear
Investment profit share (Takaful operator)	Yes	None	Waqf Mudarabah
Investment Losses	Borne by participants	Borne by participants	Borne by Waqf
Insurance Portfolio expenses	Borne by participants	Borne by participants	Borne by participants
Management expenses (company)	Borne by Takaful operator	Borne by Takaful operator	Borne by Takaful operator

Source : By the researchers

An example of a typical takaful operating model in Egyptian Market can be illustrated in the following figure.

Figure (4): Wekala Model in the Egyptian Market



Source : Milliman , 2018

2.2 Investment compliance in the Takaful Insurance

IFRS17 standards require modifying the accounting treatment of insurance contracts and investment guidelines for Takaful insurance. The Takaful operator's governance should ensure the shariah compliance of the investment portfolio either for short or long-term business. The IFSB has stated the guidelines for investment decisions for takaful Insurance that consistent with shariah compliance, Asset Liability Management, assessing the market risks of each investment instrument in which the Takaful operator to invest, and the takaful operator should ensure investing in any kind of investment instruments or any kinds of activities involving credit risk, and ensuring the risks to the different funds are identified, quantified, monitored, and mitigated. ***(Al-Amri, 2015)***

The available investment instruments for takaful operators as follows:

- **Islamic Shares.**
- **Sukuk (Asset-based Securities)**
- **Mutual Fund**
- **Islamic banking deposits**
- **Islamic bonds.**
- **Real Estate Investment trusts.**

The report of *(IFRS,2023*) conducted the potential challenges of IFRS17 adoption to the Takaful insurance as follows:

1. **Regulation Absence of Takaful specific guidance from IASB.**
2. **Absence of an active market for the sale and purchase of the Takaful industry.**
3. **Surplus at the participant level may not be available.**
4. **There are not actuarial models for Cash flows between the Takaful Fund and Takaful Operator.**
5. **Absence of database and sophisticated accounting IT systems due to small size of takaful insurance companies.**
6. **Sharia Compliance: ensuring that the implementation of IFRS 17 requirements is consistent with Sharia principles. The standard's requirements may need to be adapted to align with Takaful's cooperative and risk-sharing nature while remaining compliant with Islamic finance principles.**
7. **The new IFRS17 standard impacts financial metrics and key performance indicators might require takaful insurers reassess their capital management strategies and risk assessment methodologies.**

The above IFRS17 challenges illustrate that IFRS17 is more than just new accounting standards for takaful insurance contracts, it presents an opportunity to redesign IT system for better-collecting data and analysis.

<u>The challenges facing the takaful operator related to the investment portfolios.</u>

There are some challenges facing the takaful operator regarding the investment portfolio: ***(Martin Elinga, 2010)***

- **a- Most Islamic investment instruments are unable to offer minimum guaranteed returns on investment or capital guarantees. This feature places takaful in a less competitive position than conventional insurance which is able to offer such advantages to life insurance policyholders.**
- **b- In many countries, The Islamic insurance companies must invest in interest -bearing deposits to aligned with Local regulations. In this**

case interest earned must be distributed to charities. Neither policyholder nor shareholder accounts can benefit from this income.

2.3 Risk Management Shari'ah Non-compliance Risk:

We can define the boundaries of Shariah-compliant insurance by defining the major risks. The takaful company is exposed to the risks facing any insurance company in terms of Insurance Risks, Credit Risks, Market Risks, Liquidity Risks, and operational Risks.

However, the unique features of risk management in takaful suggested by IFSB as follows: ***(Seif, 2018)***

1. **Shariah-non-compliance risk: This risk may be relevant to Product development, Investment Strategy, and underwriting risk appetite.**
2. **Segregation Risk: the financial Segregation risk: the Financial Segregation risk between policyholder and shareholders leads to agency risks that doesn't exist in conventional insurance companies.**
3. **Re-Takaful Risk: the validity of the use of conventional reinsurance by takaful and re-takaful companies, as well as differences re-Takaful contracts.**

2.4 Takaful insurance industry in the Egyptian market

The Takaful insurance market is considered one of the most promising markets in the Egyptian insurance market.

Egypt is the first provider of Islamic insurance, which was launched in 2003 and there are now ten takaful companies operating in Egypt. In Addition, many industry figures expect that the premiums of Egyptian takaful insurance companies will grow by between 20% and 25% annually over the next years.

In the Egyptian Market, ten takaful companies, comprising six non-life firms and four life companies. The segment is growing, both in absolute terms and as a proportion of the Egyptian insurance market, according to the Financial Regulatory Authority (FRA) report. ***(FRA report,2022)***

FRA report in 2022 revealed the premiums of takaful insurance companies increased by 141% in 2020, reached £4.6bn EGP compared to 2019. Egyptian Takaful Insurance Property ranked the fifth company in Egypt's general insurance market.

According to The International Market Analysis Research and Consulting Group (IMARC Group), The global takaful market size reached US$ 33.6 Billion in 2023. expects the market to reach US$ 74.0 Billion by 2032, exhibiting a growth rate (CAGR) of 8.9% during 2024-2032.

The remaining of this research is organized as follows: The research problem, the objective, and importance of the research. Then, the literature review related the difference between the takaful and conventional insurance and the potential challenges of IFRS 17 adoption to Takaful insurance. Finally, In the Methodology section, we describe the qualitative method used. Finally, this paper discusses the conclusions.

3. Research Problem

While insurance companies are preparing to implement IFRS 17, Takaful insurance companies, which offer Sharia-compliant insurance products, face challenges in interpreting and applying IFRS 17. First according to IFRS17 principles, "An entity identifies as an insurance contract those contracts under which the entity accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder". Therefore, IFRS 17 did not take into consideration the takaful insurance, hence a lot of the takaful-specific features were not considered within this standard. *(CPA, 2022)*

Second, surplus sharing estimation, where it is ambiguous under IFRS 17 whether surplus sharing should reflect regulatory reserves and capital requirements or accounting requirements. In Addition to, Qard calculations can be challenged because the Qard is triggered under the regulatory solvency valuation methodology and basis while the solvency balance sheet can be different from the IFRS 17 Best Estimate Liability and IFRS 17 financial balance sheet.

Third, the differences between Takaful insurance companies and conventional insurance companies lie in how they cover expenses and claims, resulting in significant distinctions between them. Therefore,

applying IFRS 17 in its current form to Takaful insurance companies has challenges, Therefore, determining the risk Adjustment in the takaful insurance will be problematic. ***(Hassan and Colgan, 2019)***

Since the implementation of IFRS 17 in May 2017, Actuarial Partners (AP) has spent considerable time and effort determining how the standard might apply to Takaful. This is significant for Takaful companies because the IASB standards are intended for conventional finance rather than Islamic finance. As a result, applying IFRS standards to Takaful can be complex but not impossible because the Standards are based on principles rather than rules.

Hence, the significance of this research <u>is evident in shedding light on the differences in implementation IFRS 17 to Takaful insurance companies.</u>

4. Research objective

The aim of this research is to:

1. **Propose a conceptual framework for the GAP analysis and financial assessment impact of the application of IFRS17 in a manner that aligns with the nature of Takaful insurance in the Egyptian Market and does not conflict with Islamic Sharia.**
2. **Analyzing and interpreting the issues of IFRS17 implication to takaful insurance in terms of:**
    - **The concept of the insurance contract.**
    - **Wekala fee**
    - **Valuation of Liabilities and Reporting.**
    - **VFA eligibility**
3. **Compliance with the application of IFRS17 to takaful insurance with conventional insurance.**

5. Research Importance

The importance of research is to overcome the challenges of implementation of the IFRS17 standards in the takaful insurance industry. This research is important for Takaful insurance in the Egyptian market, through the following:

- **Ensuring good progress with the implementation of IFRS17 in the takaful insurance industry.**
- **improving the quality of services and increasing confidence in the Takaful insurance industry in the Egyptian Market in the long term**
- **proposing potential solutions for implementation of IFRS17 standards to takaful insurance to ensure compatibility, and this can be a time process and require additional efforts to coordinate with the regulator, Takaful companies may face difficulties in modernizing their regulatory structures and developing new information systems to ensure compatibility with IFRS17.**
- **Increasing the allocation of additional financial and human resources for the Egyptian takaful market.**
- **For regulator: providing specific guidelines on Takaful transactions in the Egyptian market in context of compliance implementation of IFRS17 to Islamic principles.**

6. literature review

6.1 Previous studies related to the nature of the business

Takaful insurance companies adopt different operating models than conventional insurance, therefore interpreting IFRS17 for Takaful insurance companies is not straightforward. implementation of these unique structures to the requirements of IFRS 17 could be challenging. There are additional uncertainties face takaful insurance companies than the traditional insurance due to the pooling risks than transferring the risk from the policy holders to the company. Moreover, there is significant insurance risk borne by the risk fund.

***Hachemi, et al (2014), (Ab Rahman et al ,2023) &(ULLAH,etal,2023)*, they compared the difference between takaful and conventional insurance according to the concept, comparative advantage, and application in the market. This paper showed the four parties involved in Takaful insurance: the participant, the operator, the insured, and the beneficiary. Additionally, it illustrated the principles of takaful models: al-Mudarabah**

and al-Wakalah models. Finally, this paper summarizes the reasons why takaful is better than traditional insurance.

Additionally, several studies describe takaful models, the basic difference between the common takaful models (Mudarabah and al-Wakalah models) and the hybrid model the Wekala -Wekala-Mudarabah model, the management, and other indirect expenses allocation. The Wekala model has only one operating fund, where the Insurance revenue is deposited, and all expenses and claims are paid from the same operating fund. However, under the Mudarabah model (profit sharing), where there are at a minimum two operating funds: the Operator Fund and Risk Fund. All management and other indirect expenses are allocated to the operator fund while all claims and direct costs are allocated to the Risk Fund. Finally, the hybrid model concludes two contracts: Wekala Model (managing the insurance operations) and Mudarabah Model (the investment portfolio). ***(Kassim ,2022) & (Seif ,2018)***

In addition to, several studies conclude the challenges that are faced by takaful insurance such as: Governance and regulatory compliance, risk management and internal controls, IT accounting system, operational efficiency, product innovation and capacity building for talent and scarcity of human resources. ***(Trokic,2017) & (slam and Sultana, 2018)***

Moreover, ***(World Bank,2016)*** **illustrated the investment strategy challenge for takaful insurance. It concludes with the reasons for the investment challenges. the main reasons are: that Islamic investment is against fixed interest, and this puts the burden on takaful operators reducing long-term management and its ability to compete with traditional life insurance.**

The difference in the structure of the takaful model and legal framework creates a lot of challenges regarding the accounting and reporting framework, especially because the International Financial Reporting Standards (IFRS) does not take into consideration the salient features of takaful and its related underlying contracts. ***(Seif,2018)***

(***Mukhlisin, 2017***)**, this study conducted that the accounting and financial reporting requirements of takaful are significantly influenced by the model in terms of Segregation between policyholders' equity and**

shareholders' equity, the nature of underlying contracts used in the Takaful business model, Allocation of management expenses between policyholders and shareholders, and Profit sharing and surplus distribution, The previous reasons may appear to be problematic when IFRS is implemented.

6.2 Previous studies related to the Potential challenges of IFRS17 adoption to the Takaful insurance.

***(Mejri et.al,2022)*, This study conducted that The AAOIFI standards are issued to offer the compliance of takaful companies to Shariah standards. Two accounting standards ae issued for Takaful by the AAOIFI: Disclosure for Takaful institutions), and recognition and measurement of takaful contracts. Both standards are proposed to be effective from January 1, 2022, a two-year delay after IFRS. Finally, this study recommended comparing the difference between the two new AAOIFI standards and IFRS 17 according to aggregation contracts and the concept of CSM, which is called" Takaful residual margin".**

Based on Kassim,2022, the potential challenges of IFRS17 implications for each takaful model can arise from takaful principles. First, IFRS 17 requires that mutual entities should account for insurance contracts. Under the Takaful model, the risk Fund satisfies the requirements to be accounted as a mutual entity under IFRS 17. however, the accounting relationship between the takaful Entity and the takaful risk fund is not insurance and should not be accounted for under IFRS 17 requirements. Second, IFRS 17 applies to insurance contracts within its scope, regardless of the legal form of the issuing entity. Under the Mudarabah Model, the risk fund is by itself not a legal entity and the takaful contract has been issued under the name of the takaful operator. However, this contractual feature alone cannot be used from the IFRS perspective to conclude that the takaful operator is underwriting the insurance risk.

In Addition, *(Azmy etal.,2019)*, conducted IFRS17 challenges technical issues to Takaful contracts. These issues are Using a premium allocation approach to handle surplus /profit sharing, the Cost of an interest-free loan to fund the deficit at the fund level, and Mutual structure within the

Takaful operational framework (pooling of risks, sharing of surplus, and takaful operator).

Moreover, (*Hassan &Colgan,2019),* illustrated other IFRS17 challenges and technical issues to Takaful contracts for Contract Boundary, Multiple Takaful Funds, and Re-Takaful. In Addition to, this research conducting the issues of Single CSM or CSM by the fund, how different are the valuation of liabilities under the IFRS17 Framework. Finally, this study recommends a modification basis (i.e. zeroization, capital calculations).

***(Nazmi & Mehmood, 2021),* the objective of this study is to shed light on the challenges of the implications IFRS17 to takaful insurance in terms of the definition of an insurance contract, Wekala fee, and Liability measurement, and reporting Variable Fee Approach eligibility. It concluded that the fulfillment cashflows and contractual service margin be computed at the fund level (the risk fund, participant fund, and the shareholder funds), and Computing liabilities at the fund level may cause additional operational complexity and challenges, which requires setting assumptions at a more granular level. finally, this study recommended interpreting IFRS17 guidelines for takaful insurance market.**

Additionally, several previous studies argued the challenges of IFRS17's implications for the takaful model. First, the selection of the model of measurement.

under IFRS17 requirements, the insurance entity needs to group all contracts with similar insurance risks. however, takaful insurance companies have multiple funds (policyholders' account, risk fund, and operator's funds), which requires the takaful insurance companies to prepare granular disclosure by fund level. The second challenge of IFRS17 is the fulfillment of cash flow and CSM, where insurance companies suffer from uncertainty on disclosure requirements. This uncertainty arises from the calculation of fulfillment cashflows and CMS at each fund. Third, the challenge of IFRS17 is that surplus-sharing distribution should be in line with the company's surplus management, taking into consideration the regulatory reserve.

However, IFRS17 requirements don't specify the profit-sharing distribution should reflect the regulatory reserve and capital requirement or accounting requirements. *(Milliman ,2020 & 2023)*.

Literature review for implications IFRS17 guidelines for Takaful insurance companies have been limited. Moreover, the previous studies concluded that there are significant challenges in application and interpreting IFRS17 to Takaful insurance business because takaful insurance has a different operating model.

Additionally, there are not previous studies related to analyzing the implications IFRS17 for Takaful insurance companies in the Egyptian market, studying the , the GAP analysis, financial impact assessment of takaful insurance companies under IFRS17 requirements, studying the changes the accounting entries of Takaful insurance to deal with the Quard and Wekala concepts for the takaful, and determining risk adjustment and Surplus sharing in IFRS 17 standards vs statutory basis for Takaful insurance Market.

7. Research Methodology

The objective of this paper can be achieved through Applying a qualitative approach using a literature review and comparative analysis of the adoption of IFRS 17 on Takaful contracts in other countries, literature review, and interviews to prepare the assessment of gap analysis and financial impact assessment of takaful insurance in the Egyptian market. The researchers conducted interviews with the CEOs of the Takaful insurance companies in Egypt. The documents used in this study include various reports from regulators, and professional associations as well as meeting papers of regional standards, which discuss the attitudes of some other Muslim countries in adopting IFRS 17.

Most interviews were conducted online using Zoom meetings and are recorded. These are the main questions are used:

Q1. Why was IFRS 17 adopted for Takaful insurance different from insurance companies?

Q2. How was the process of IFRS 17 adoption in Egypt?

Q3. What were the issues with IFRS 17 implementation for insurance companies?
Q.4 What are the requirements of GAP analysis and financial impact assessment for the takaful insurance companies in the Egyptian market?

8.Implications and findings

8.1 The implementation of IFRS17 to takaful insurance: other countries experience

Implementation of IFRS 17 insurance contracts has caused major challenges in the global insurance sector. In this section, this paper provides the experience of other countries according to Asian-Ocean Group in the implementation of word-by-word IFRS17 to takaful contracts, the modifications made for national GAAP, and the exclusions for takaful contracts under IFRS17. Moreover, some countries have developed their accounting standards for the Takaful industry as shown in the following table.

Table (4) the comparison of guidelines in implementation IFRS17 to takaful insurance in other countries

Country	Implementation IFRS17 to takaful Insurance
Malaysia	**Implantation of the scope of IFRS17 to takaful contracts. Additional three technical** Bulletins **have been issued. Considering the Qard term forms part of local statutory requirements.**
Indonesia	**Exclusion implementation IFRS17 scope to Takaful contracts.**
Saudi Arabia	**Implementation of IFRS 17 in jan.2023. However, additional guidance and disclosure are required, excluding that the Qard term forms part of local regulatory requirements.**
Syria	**Implementation of the scope of IFRS17 to takaful insurance without any additional guidance for takaful contracts. Moreover, excluding that the Qard term forms part of local regulatory requirements.**
Turkey	**Implementation of the scope of IFRS17 to takaful insurance without any additional guidance for takaful contracts.**
Uganda	**Implantation of the scope of IFRS17. Additional guidance of accounts standards is issued, including nominal amount of Qard to the takaful fund.**

Source: By the researchers

The above table illustrates the experience of other countries Some countries develop their guidance of accounting standards for the

Takaful industry, which may or may not be referenced to the AAOIFI standards in their due process.

In terms implementation IFRS 17 for Takaful insurance sector, Malaysia achieved progressive step among other countries. In 2021, Malaysia decided to implement IFRS 17 for the takaful contracts. Malaysian Financial Reporting Standards (MFRS) 17 issued IFRS17 without any exclusion in the scope of the standard for Takaful contracts and issuing three technical bulletins on how to adopt IFRS 17 for Takaful contracts. This is a strong support from the regulator to achieve compliance with Shariah standards in the adoption of IFRS 17. On the other hand, Indonesia excludes applying IFRS17 to takaful Insurance.

8.2 The Conceptual Framework of GAP Analysis of Implementation IFRS17 to Egyptian Takaful Insurance

The results of interviews and Zoom meetings with officials of Egyptian Takaful operators and technical staff agreed that IFRS 17 implementation has resulted in significant challenges for the takaful industry and is complex to interpret to develop a GAP analysis of Egyptian takaful insurance. The researchers summarized these issues as follows:

1. **Definition of an insurance contract**: **IFRS 17 does not provide details for Takaful business currently. This is further supplemented by Paragraph B16 of IFRS17 which states that "an entity can accept significant insurance risk from the policyholder only if the entity is separate from the policyholder.**
2. **Wekala fee**: **it is the percentage of premium that the takaful operator charges for managing the risk and any individual investment funds. The issue that arises is whether the determination of the Wekala fee requires assessing the risk associated with the participant.**
3. **Liability measurement and reporting disclosure**:

As mentioned before, the surplus sharing element of the takaful contract has multiple funds (i.e. risk fund, participant fund, and the shareholder funds), which are aggregated to arrive at the entity-wide

results. Therefore, the issue arises whether the fulfillment cashflows and CSM under IFRS17 should be computed at the fund level. In Addition, calculating liabilities at fund level may cause additional operational complexity and challenges as it requires setting assumptions at a more detail level among other things. Also, there is uncertainty whether the Quard element should be included in cashflow fulfilment.

4. Measurement of the model selection in takaful insurance

IFRS 17 broadly classifies insurance contracts into those with and without Variable Fee Approach (VFA). An insurance contract with VFA is defined as a contract that has three conditions: ***(Kazmi& Mehmood, 2021)***

- **“The policyholder participates in a share of identified pool of underlying items.**
- **The entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items.**
- **The entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items”.**

From the above conditions, all the conditions fit takaful products with the participant’s account and surplus sharing, which has similarities to investment linked products. While most takaful contracts satisfy the first requirement, the second and third conditions are less clear. Therefore, **Certain takaful contracts may not satisfy the conditions for a VFA if we consider:**

– The standards describe VFA contracts as insurance contracts that are substantially investment- related service products.
– According to a probability-weighted basis, a substantial proportion of the amounts paid to policyholders may consistent with the fair value of the underlying items. (in the case of a contract with a savings component.

5. Lack of Human resources and IT system in takaful insurance companies.

8.3 The Financial Impact Assessment of Implementation IFRS17 to Egyptian Takaful Insurance

From the above GAP analysis and previous Literature review, the researchers propose the solutions to the challenges of implications IFSR17 to develop the financial impact assessment of Takaful Insurance in the Egyptian market as follows:

- **A. According to Asian-Oceanian Standard-Setters Group (AOSSG) in 2014, which is conducted that takaful contracts meet the definition of an insurance contract since the risk-sharing feature in takaful insurance is similar to mutual insurance, which is within the scope of IFRS 4 and IFRS 17.**
- **B. Treating the Wekala Fees as considering that there are two contracts at play and excluding the Wekala fee from the TF revenue. Additional, treating the surplus distribution to participants from the Tabarru' Fund as an investment component and thus does not feature in the Income Statement**
- **C. Takaful insurance Companies need to assess each product separately to determine if they qualify for VFA.**
- **D. Projections of liability valuations separately because IFRS 17 standard takes into consideration mutual entities for insurance contracts. The Risk Fund satisfies the requirements under IFRS 17.**

Finally, the Financial Impact Assessment of takaful insurance in the Egyptian market as shown in table (5) for takaful fund, takaful operator and takaful company should be presented separately in order to reflect the economics of the business, ensure transparency and comparability between entities of reporting accounts under IFRS17. Additionally, this is consistent with a Shariah-Compliant manner by differentiating the rights and obligations between the takaful operator and the takaful fund.

Table (5) Financial Balance Sheet of takaful insurance

Statement of Financial Position	(A) Takaful Operator (Shareholder fund) SHS’000	(B) Family Takaful fund (fund SHS’000	(C) General Takaful fund SHS’000	((A+B+C) Takaful Company (Combined) SHS’000
Assets				
Cash and cash equivalents	Xxx	Xxx	Xxx	Xxx
Investment assets	Xxx	Xxx	Xxx	Xxx
Takaful contract assets	Xxx	Xxx	Xxx	Xxx
Retakaful contract assets	-	Xxx	Xxx	Xxx
Current tax assets	Xxx	-	-	Xxx
Trade and other receivables	Xxx	Xxx	Xxx	Xxx
Takaful receivables	-	-	Xxx	Xxx
Retakaful assets	-	Xxx	Xxx	Xxx
Deferred tax assets	Xxx	-	Xxx	Xxx
Intangible assets	Xxx	-	-	Xxx
Property, plant, and equipment	Xxx	-	-	Xxx
Total assets	Xxx	Xxx	Xxx	Xxx
Equity, Liabilities, and Participants’ Funds				
Equity				
Share capital	Xxx	-	-	Xxx
Reserves	Xxx	-	-	Xxx
Total equity	Xxx	-	-	Xxx
Liabilities and Participants’ Funds				
Current tax liabilities	-	Xxx	Xxx	Xxx
Other current liabilities	-	Xxx	-	Xxx
Investment contract liabilities				
Takaful contract liabilities	-	Xxx	Xxx	Xxx
Retakaful contract liabilities	-	Xxx	Xxx	Xxx
Provision for wakalah fees	Xxx	-	-	Xxx
Deferred income tax liabilities				

Participants' funds				
Total liabilities and participants' funds	**Xxx**	**Xxx**	**Xxx**	**Xxx**
Total equity, liabilities, and participants' fund	**Xxx**			**Xxx**

Source: CPA, 2022

9. Conclusion and recommendation

Implementation of the IFRS 17 insurance contract has major challenges in the global insurance industry. IFRS 17 is the first international and comprehensive accounting standard for conventional insurance companies, therefore the Takaful was never considered in its design phase.

This study contributes to the literature by providing the compliance of IFRS standards with takaful Industry, understanding the technical concepts, and challenges underlying Takaful sector, and disclosure required under IFRS 17. In Addition to providing a comparative study to the Muslim countries that decided to apply IFRS17 to takaful insurance companies. Finally, providing the guidance to prepare the GAP analysis and financial impact assessment for Egyptian takaful insurance companies under IFRS17.

Malaysia is a role model in the implementation of IFRS17 to takaful insurance companies, which makes Malaysia can become a case study for other countries that are still deciding on adopting IFRS 17, especially for the Islamic insurance sector. Malaysia is a successive model in providing technical guidelines to guide Takaful operators in applying IFRS 17. where, issuing three technical bulletins on the specific issues of Takaful contracts, which are supported by the regulator and the committee of Shariah practitioners.

This study concludes that the challenges and issues of IFRS17 implications to takaful insurance:

- **The concept of the insurance contract.**
- **Wekala fee treatment.**

- **Surplus sharing treatment.**
- **Valuation of Liabilities and Reporting at each fund for takaful contracts.**
- **Selection of suitable model for takaful contracts.**

Additionally, this study concludes that a suitable implementation of IFRS 17 for Takaful industry leads to transparency and fairness in reporting and disclosure under IFRS17. As an attempt to ensure the successful implementation of IFRS17 to Egyptian Takaful Insurance companies, this paper proposed the conceptual framework of GAP analysis and financial impact assessment in the Egyptian market.

According to the above conclusions which are discussed, this paper recommends that the Egyptian takaful insurance companies should not underestimate the challenges in developing appropriate IFRS17. In Addition, this paper recommends some guidelines to reshape the accounting standards, and achieve fair implementation under IFRS17 in the context of shariah principles.

In addition to, it recommends issuing specific guidelines and modifications on Takaful transactions in the Egyptian market. These guidelines should have been developed in collaboration between the Financial Regulatory Authority (FRA) and committee of Shariah practitioners according to the new united insurance law.

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