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making financial sense of the future

Takaful Insurance
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Agenda

- Islamic concerns with Insurance
- How Takaful Insurance works
- Issues facing Takaful Insurance
- Size of the market and Opportunity

Warning

- Not islamic experts – may not fully appreciate some of the complex nuances involved
- Not currently individually involved in this market.

3

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Islamic Concerns with Insurance

Islamic Teachings

- Justice, Equality, Fairness, Ethics and Morality are values inherent to Islamic teaching on business conduct amongst both Muslims and non-Muslims. Any business practice that is not reflective of these values is rejected under Islamic law or Shari'ah.
- Business transactions that contain
 - Riba (Usury)
 - Gharar (Uncertainty), and
 - Maisir (Gambling)are amongst those practices that are rejected.

5

Riba

- Loosely translated as 'interest',
- Islam completely forbids Riba in all forms
 - Taking of interest implies appropriating another persons property without giving them anything in exchange
 - Permitting the taking of interest discourages people from doing good to one another. If interest is prohibited in a society, people will lend to each other with a good will, expecting back no more than what they have lent.
- Problem for insurance
 - most companies invest in interest-bearing securities
 - products such as guaranteed endowments that pay out in certainty an amount greater than the premium

6

Gharar

- Not clearly defined but generally meaning 'uncertainty', 'risk', 'hazard' and 'deceit' in a financial transaction
- An insurance contract contains Gharar because, when a claim is not made, one party (insurance company) may acquire all the profits (premium) gained whereas the other party (participant) may not obtain any profit whatsoever
- Scholars also object to uncertainty in contract terms; limited amount of disclosure, complex contracting terms, lots of exclusions and small print.

7

Maisir

- Gambling' or 'speculation' is also strictly forbidden in Islam.
 - Interlinked with Gharar – where Gharar exists, Maisir follows
- And despite what practitioners say about insurable interest making insurance different from gambling, Muslim scholars don't seem to agree.
 - The participant contributes a small amount of premium in a hope to gain a larger sum.
 - The participant loses the money paid for the premium when the event that has been insured for does not occur.
 - The company will be in deficit if the claims are higher than the amount contributed by the participants.

8

But Insurance Can Still exist ...

- No objection to risk pooling.
- The simple act of many people coming together to help the few in times of need is something that is not only allowed, but also encouraged in Islam
 - The basis of shared responsibility practised in Mecca and Medina laid the foundation of mutual insurance in the second century of the Islamic era when Muslim Arabs expanding trade into Asia agreed to contribute to a fund to cover anyone in the group that incurred mishaps or robberies along sea voyages
- “Takaful” Insurance

9

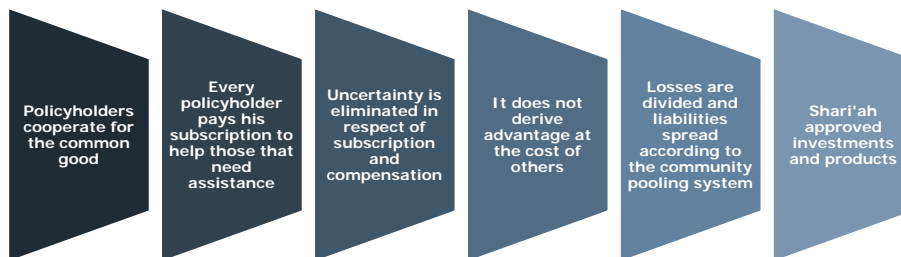


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How does Takaful Insurance work

What is Takaful Insurance ?

- Takaful—“bear ye one another’s burden.” Takaful insurance is based on the concept of mutual cooperation, solidarity and brotherhood
- The Takaful concept underpins the Islamic finance system allowing its institutions and businesses to operate in a manner that is compliant with Shari'ah doctrine.

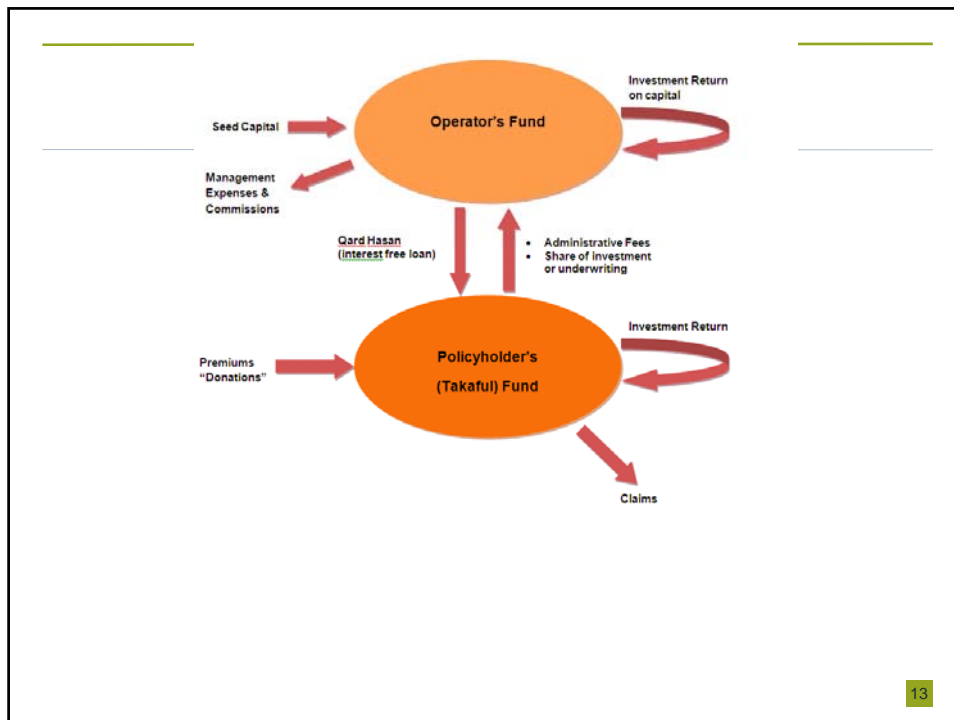


11

Tabarru

- Takaful participants contribute (donate) to help protect one another against the impact of unpredicted risk and catastrophe, whereas in the conventional insurance model, policyholders pay premiums to protect themselves, or their interests, from some form of risk.
- Takaful adopts the concept of donation (Tabarru) in place of a buy-sell transaction associated with premiums to make it Shari'ah compliant.

12



Funds

- Two funds
 - A Takaful (or Policyholder's) Fund
 - An Operator (or Shareholder's) Fund
- The takaful fund operates under pure cooperative principles, in a very similar way to conventional mutual insurance entities.
- Underwriting deficits and surpluses are accrued over time within this fund, to which the operator has no direct recourse.
- The takaful fund effectively is ring-fenced and protected from default of the operator's fund.

14

Expenses and Fees

- Management expenses and seed capital are borne by the operator's fund, where the main income takes the form of either a predefined management fee (to cover costs) or a share of investment returns and underwriting results (or a combination of both).
- The management and investment practices of Takaful companies are governed by a board of scholars selected to ensure that they remain compliant with Shari'ah law.

15

Qard-hasan

- loosely translated as 'interest-free loan'.
- In case there are more "claims" than expected than the money in the tabarru funds, the takaful provider agrees to provide an interest-free loan that can be reclaimed from future underwriting surpluses.
- This is the way any shortfall in the tabarru account is made up by the takaful provider'.

16

Solidarity principle and equal surplus distribution

- The takaful fund is seen as a pool of risks managed under solidarity principles
- It is not meant to accumulate surpluses at levels excessively higher than those strictly needed to protect the fund from volatile results and to support further growth.
- Likewise, any fees or profit shares received by the operator should be just sufficient to cover management and capital costs while keeping the company running as an ongoing concern.

17

Shari'ah Board

- An essential component in a takaful company's corporate governance is the establishment of a Shari'ah board in addition to the conventional board of directors.
- The Shari'ah board is made up of recognised Islamic scholars, who ensure the company's operational model, profit distribution policies, product design and investment guidelines comply with Islamic principles.

18

Family Takaful and General Takaful.

- Takaful is usually divided into Family Takaful and General Takaful.

Family Takaful:	General Takaful:
Individual Life	Property
Group Life	Motor
Health	Accident
Investment Linked	Liability
	Marine

19

Takaful Insurance Models

- Mudaraba
- Wakala
- Waqf
- Combination

20

Mudaraba

- This is a modified profit and loss-sharing model.
- The participant and the takaful insurer share the surplus.
- The sharing of such profit (surplus) differs based on a ratio mutually agreed to between the contracting parties.
- Generally, these risk-sharing arrangements allow the takaful insurer to share in the underwriting results from operations, as well as the favourable performance returns on invested premiums.

21

Wakala

- An agent fee based arrangement is used
- Cooperative risk-sharing occurs among participants where a takaful insurer simply earns a fee for services (as a Wakeel, or “Agent”)
- Does not participate or share in any underwriting results.
- The insurer’s fee may include a fund management fee and a performance incentive fee.

22

Waqf

- Waqf operates as a social/governmental enterprise, and programmes are operated on a non profit basis.
- This establishes a fund by initial donation and this is then managed.
- The surplus or profit is not owned directly by either the insurer or the participants, and there is no mechanism to distribute the surplus funds.
- In effect, the insurer retains the surplus funds to support the participant community.
- This model, with a single surplus fund, is most like a conventional mutual insurance model.

23

Combinations

- Many combinations are possible for example
- Wakala /Waqf model
 - The operator simply manages the investments for which they charge a fee. There is no obligation to support solvency of takaful fund
 - The policyholders provide the seed capital and share in all investment and underwriting profit and losses.

24

Issues facing Takaful Insurance

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- Investment
 - Reinsurance / Re-Takaful
 - Capital and Solvency
 - Regulations
 - Underwriting and Claims
 - Pricing
 - People Concerns

Investment

- The practice of conventional insurance companies to generate investment income from fixed income securities breaches the Shari'ah prohibition of usury (Riba)
- Investment in certain industries such as alcohol, tobacco, gambling or arms are regarded as forbidden (Haram) by Shari'ah.
- Sukuk bonds – specialist Islamic investment

27

Sukuk investments

- Islamic equivalent to bonds
- complies with Shari'ah, Islamic religious law.
- The issuer of a sukuk sells an investor group the certificate,
- The investor then rents it back to the issuer for a predetermined rental fee.
- The issuer also makes a contractual promise to buy back the bonds at a future date at par value.
- But they are controversial !

28

Sukuk controversy

- Criticised by Sheik Usmani President of the Shari'ah Council of the Accounting and Auditing Organisation for Islamic Financial Institutions in a paper "Sukuk and their Contemporary Applications" released in November 2007
- Identified the following three key structuring elements that differentiate Sukuk from conventional bonds:
 - must represent ownership shares in assets or commercial or industrial enterprises that bring profits or revenues
 - Payments to Sukuk-holders should be the share of profits (after costs) of the assets or enterprise
 - The value payable to the Sukuk-holder on maturity should be the current market value of the assets or enterprise and not the principal originally invested.

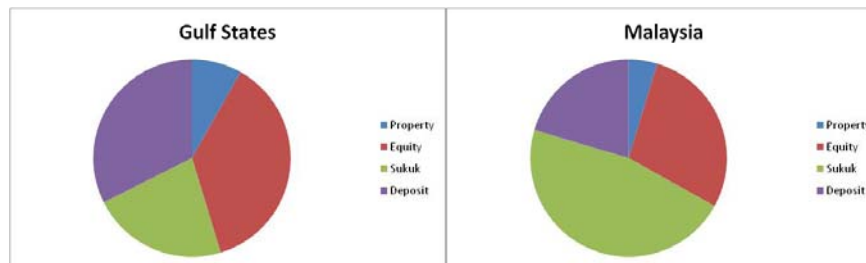
29

Investment mix and concerns

- Concerns
 - Limited permissible sukuk bonds
 - Investment in equity and property high
 - Activities of investments more closely monitored and expensive to manage
 - "Purifying" Income
 - Increased volatility
 - Mismatching issues
 - Over-concentration of risks

30

Typical Investment mix



Source: E&Y Takaful report

31

Reinsurance / Retakaful

- Retakaful is the equivalent of Reinsurance
- Retakaful required to spread the risk and avoid the insolvency risk.
- Retakaful should be similarly governed by the risk sharing principle.
- One of the major challenges facing Takaful has been lack of retakaful capacity
- “darura” (religious necessity) to seek “risk transfer” has allowed the use of conventional reinsurance.
- Retakaful has gained momentum and Shari'ah compliant capacity is now increasingly available.
- With the increasing number of Retakaful operators, mostly rated, does the “darura” persist?

32

Capital and Solvency

- Takaful cannot escape investment volatility and are just as open to counter-party risk and low interest rates as the conventional insurers.
- The strength of the operator is as important as the strength of the takaful fund, and the provision of an interest free loan in difficult solvency scenarios has yet to be fully tested.
- Most companies are young and so are generally small with limited experience.
 - more volatility in both investment and underwriting results
 - Less experience in monitoring and controlling risks
 - Need to hold more capital
- A major challenge for the Takaful operators is raising equity capital.
 - Need to compete against other potentially more attractive propositions.

33

Regulations

- Regulation and compliance have some way to go to be fully developed.
- The regulation varies significantly between countries
- No “supreme” Shari'ah judicial authority – and current lack of consensus.

34

Regulations

- Saudi Arabia – The regulators follow a Mudaraba (co-operative) model in which profits are shared 90/10 – shareholder / policyholder.
- Some scholars argue this does not meet Shari'ah compliance as there are no requirements on the asset investments.
- Iran follows Shia Islamic law and takaful insurance does not exist as conventional insurance is thought to be Shia compliant

35

Regulations

- Shari'ah board and compliance can add complications compared to conventional insurance.
- Governance to balance the risk between policyholder and shareholder is yet to be fully implemented.
- FSA taken a “no obstacles, but no special favours approach” to regulate Takaful in current regulations

36

Underwriting and Claims

- Disclosures
 - likely to be less non disclosure as this breaks Shari'ah law (or may be more accidental than deliberate)
 - Potential issues around Alcohol and Smoking which are considered Haram (“forbidden”)
 - Some occupations may be declined if activities are forbidden in Islam
- Contracts usually “null and void” if non-disclosure found – may not meet FOS guidelines
- Not only Muslims may apply for contract

37

Underwriting and Claim considerations

- Cultural
 - No different to conventional insurance
 - Language
 - Access to past medical information
 - Intrusiveness of medical exams etc

38

Example exclusions – life contract

- Attempted suicide or self-inflicted injury whether you are sane or insane.
- If you breached the law.
- If you provoked an assault.
- If you were under the influence of drugs or alcohol.
- If you were to suffer from AIDS or HIV.
- **Any other causes prohibited by Shari'ah.**

39

Pricing

- Higher customer loyalty and policy persistency driven by the participants' belief in the principles of takaful.
- Significant business mix risk from low volumes.
- Inexperience of underwriting and claims.
- Different Population – different lifestyles, habits etc – different experience?
- Drivers for Prices to be higher than conventional insurance
 - Lower volumes leading to higher expenses
 - Higher capital requirements
- Drivers for Prices to be lower than conventional insurance
 - Poorer regulation and lower capital requirements (in some countries)

40

People Concerns

- The global shortage of recognised Islamic scholars in the insurance arena and lack of consensus in terms of what constitutes Shari'ah compliance.
 - Emergence of some inter-regional and government-supported initiatives
 - participation of individual scholars in more than one Shari'ah board
- Takaful must compete for and retain suitably skilled staff. Their exposure to expertise shortage is especially keen however given the specific knowledge requirements needed to operate this model.

41

Other

- Awareness
 - Both generally of insurance and that Takaful option exists
- Distribution
 - Specialist agents
 - New distribution
- Low Penetration rates
- Industry bodies, training, promotion etc (for example Malaysia Takaful Association)

42

Size of Takaful Market and Opportunity

Worldwide Demographics

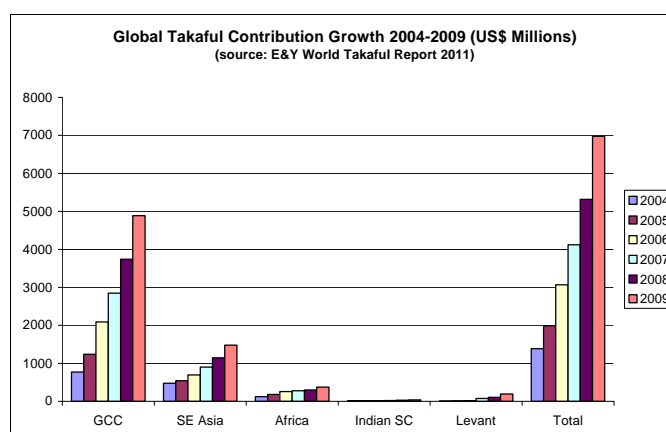
- 1.6 billion worldwide population of Muslims in 2010 (approx 25% of the world's population)
 - 1.1b in Asia, 462m in Africa, 44m in Europe, 7m in North America
- The Muslim population is youthful and increasingly affluent
 - AM Best estimate that 60% of Muslim lives are aged under 25.
- Muslim countries have a lower penetration of insurance than other emerging markets
- Growth of business in some countries show the potential

Growth In Takaful

- First company opened in the Sudan in 1979
- Subsequently companies opened in Asia (most notably Malaysia) and the Gulf Region (GCC – Gulf Co-operation Council)
- There are now over 180 Takaful operations including “windows” (operations affiliated with conventional insurers)
- A US\$ 7 Billion market in 2009, expected to grow to \$12 Billion by 2011

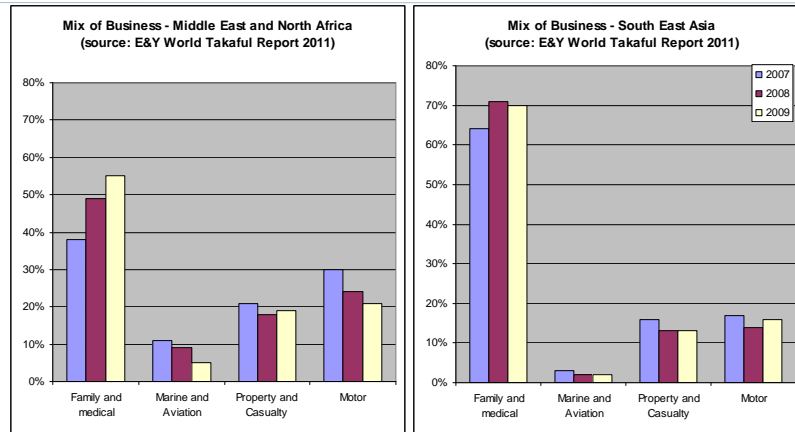
45

Current Worldwide Market



46

Mix of Business in Largest Markets



- Compulsory medical insurance requirements in Saudi Arabia have contributed to growth in Family & Medical.
- Family Takaful in Malaysia is highly penetrated and is estimated to contribute 77% of net Takaful contributions in 2010.

The UK Opportunity

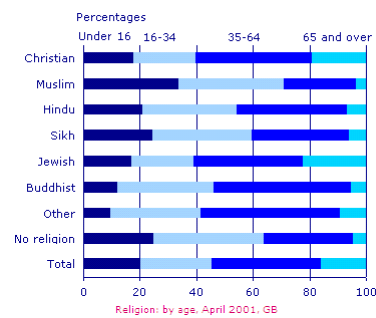
- There are currently no Family Takaful products available in the UK.
- Possible reason is there has been no pressure to seek a Takaful market, rather than there being any fundamental product design issue
 - The market size is considered a small opportunity
 - It is believed that the pricing would have to be competitive with IFA products to compete
 - There would need to be separate distribution set up rather than using current IFA network

UK Demographics

- 2001 census has 1.6m Muslims in UK representing 2.8% of population – represent largest non Christian religion

Population of Great Britain: by religion, April 2001

	Great Britain		
	Total population	Non-Christian religious population	
	(Numbers)	(Percent age)	(Percent age)
Christian	41,014,811	71.82	n/a
Muslim	1,388,890	2.78	51.34
Hindu	558,742	0.58	18.25
Sikh	236,179	0.59	10.99
Jewish	267,272	0.47	8.74
Buddhist	148,157	0.36	4.88
Any other religion	159,167	0.28	5.20
No religion	8,596,488	15.05	n/a
Religion not stated	4,433,520	7.76	n/a
All non-Christian religious population*	3,059,108	5.36	100
All population	57,102,927		100



- Sunday Times reported Muslim population in UK as 2.4m in 2009 – reported rise due to immigration, conversion and post 9/11 strengthening of sense of identity

49

The Opportunity

- Attractive for Islamic lives
 - S&P suggest that 20% of banking customers would choose and Islamic product over a conventional one with similar risk-return profile
 - New policyholders
 - Islamic lives switching from a conventional insurance product
- Attractive for ethical investors
 - £6.6bn invested in ethical funds in UK and net retail sales £280m
 - Around 1.5% of total funds under management but net retail sales grew 80% in 2010
 - 8% hold ethical funds

Source: Investment Management Association

50

The Opportunity

- UK protection market c £800m new business APE per annum
 - On like for like therefore £24m p.a. APE Takaful new business UK market opportunity
 - May be higher at outset due to new sales for Muslims who do not currently have cover and for those who switch from current non-Takaful provider
 - But Assumes all Muslims want compliant Takaful product
 - Islamic Bank of Britain has only 50,000 customers

51

Summary

- Takaful is a solution for the Islamic market
- Takaful market is growing elsewhere in the world
- But yet to start in the UK (for family Takaful)
 - Market size uncertainty
 - Other competitors for resource
- Attractive to Islamic and ethical investors

52

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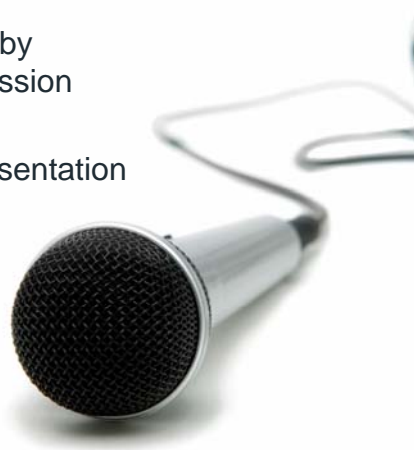
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53

Questions or comments?

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54