

FINANCE FORWARD

WORLD TAKAFUL REPORT 2016

Connecting the dots, Forging the future



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WORLD TAKAFUL
CONFERENCE
مؤتمر التكافل العالمي

Executive Summary

Takaful operators, like all insurers in emerging market economies dependent on commodity prices, face a challenging year ahead. They also face additional challenges from inadequate regulation (and inadequate enforcement of regulation), severe price competition from conventional insurers, and questions concerning the optimal structure of their business.

The final issue - the optimal structure of the takaful model - is an unsettled matter. As such, the articles contributed by Takaful Outsource in this report bring incredible value and specialist knowledge to help the Takaful professional understand key challenges going forward. The pressure on takaful operators comes from many stakeholders with competing priorities. Many shareholders expect to see profitability in line with conventional insurers, while consumers expect to see a unique product that fully embraces the ideals around takaful which are based on mutual support among participants.

A challenging economic environment like the one takaful faces today is not ideal for working out such fundamental business issues; however, operators are continuing to debate among themselves what the proper structure should be. Specifically, the current downturn could help push the industry towards the resolution of a longstanding issue in the Gulf Cooperation Council (GCC) region if low oil prices lead to more sovereign sukuk issuance, and if tighter bank liquidity leads to more corporate sukuk issuance.

The shortage of fixed income was a problem noted in our recent Finance Forward Middle East Insurance Outlook - launched at the Middle East Insurance Forum in early February - as being one of the key factors driving an overconcentration in the property sector. Our comprehensive survey of takaful industry leaders highlights the prospect that a concentration in real estate may not be as acute of a problem in takaful as in conventional insurance in the Middle East. However, the lack of suitable fixed income options will also remain a key challenge for the industry, particularly as regulations become more stringent on what investments are permissible for takaful operators in order to support market stability.

The issue of market stability could become a more significant issue if the weak economy in the markets where takaful is the most developed actually continues. The competitive pressure that is driven by too many small takaful operators and a conventional

insurance business that is facing its own competitive threats, has led to an even wider dispersion of fundamental indicators across markets.

Some markets that have large takaful penetration see very high combined and operating ratios (lower is better) while many smaller growth markets see ratios that are far below 100%, indicating significant fundamental profitability and opportunities for further growth.

The combined picture of these diverse themes covered in our analysis of takaful operators, contributions from Takaful Outsource, and our survey of takaful practitioners reveals a market that is struggling to put all the pieces together. This is not to imply that the future is bleak for takaful but that, unlike Islamic banking, there is a lot more work needed in order to achieve growth rates and penetration rates for takaful - rates that have already been achieved in the banking segment.

We sincerely hope that the analysis in this report will serve to help the takaful industry nurture its future growth potential.



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We gratefully acknowledge the contribution of the leaders of the global takaful industry for sharing their valuable insights through our extensive survey, and ultimately shaping the outlook of this emerging sector. We would also like to acknowledge experts from Takaful Outsource Ltd for contributing their insights on pressing issues for this report.

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is the leading global forum for Takaful which has played an instrumental role in the development of the industry for more than a decade by facilitating thought-provoking discussions and producing quality research and actionable insights. WTC serves as a platform to facilitate ideas sharing among the leaders in the industry gathered from various parts of the world - ranging from key markets for Takaful such as the GCC and SE Asia, to emerging markets such as Africa and Europe.

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Takaful Outsource Ltd is a consulting and outsourcing firm specialising in serving the global takaful industry, particularly insurance/takaful companies, reinsurance/retakaful providers, private institutions, training institutes, and government regulatory authorities.

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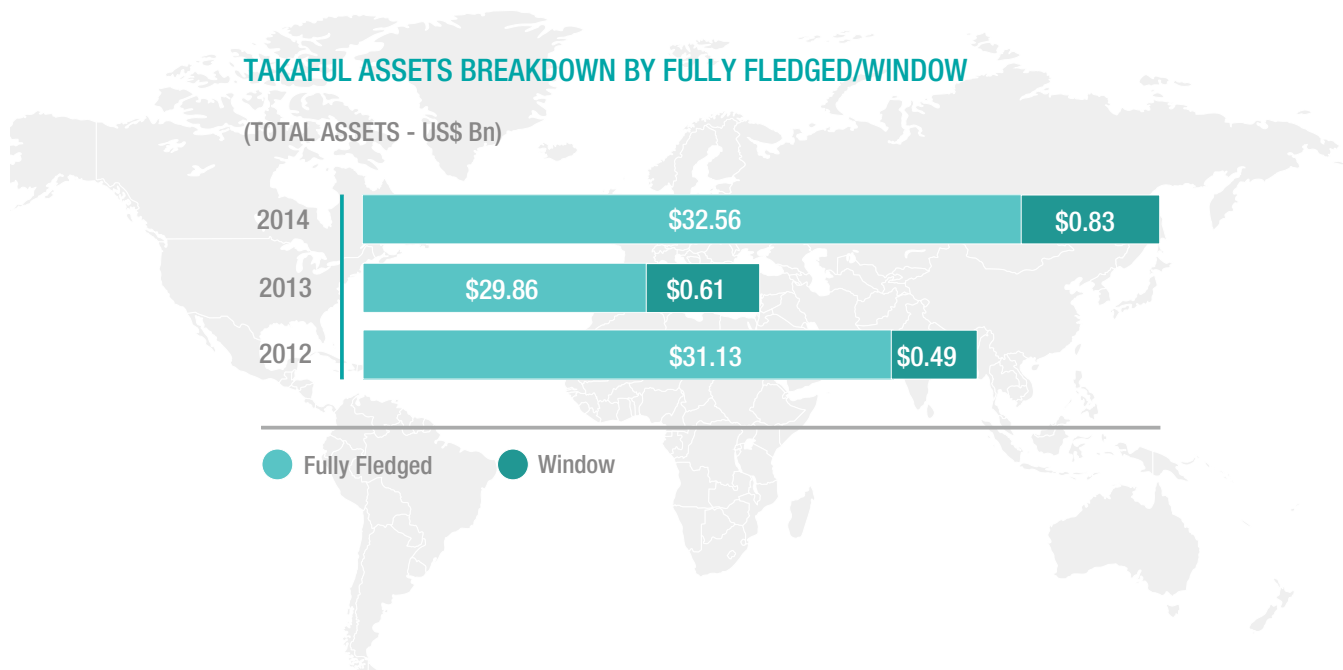
Takaful Market

Overview

Takaful forms an essential element of the Islamic financial ecosystem and it is seen to be spreading out of its core markets albeit at a small pace. One distinguishing factor between takaful and other elements of the Islamic financial system is this that although it has made its mark in the core Islamic markets, its growth has not matched up with the momentum with which other sectors of the Islamic finance eco system have come of age.

Around year-end 2014, the takaful assets were estimated to be around USD 33 billion. Gross takaful contribution were estimated to be around USD 14 billion by the end of 2014. Takaful market is highly concentrated the GCC and South East Asia with Saudi Arabia and Malaysia predominating these markets. Out of total 308

takaful companies, 93 are takaful windows. However these takaful windows own only 2.5% of the total takaful assets. Although still in its nascent stage and with a smaller asset base and more varied performance. Although takaful markets have not grown in tandem with the sukuk and Islamic banking markets, it is estimated to reach the USD 20 billion mark by 2017 (ICD Thomson Reuters, 2014). Up until 2012, the industry grew at a CAGR of 10-12 % in various key Islamic finance jurisdiction and a slowdown has been witnessed ever since. There are various reasons which have been cited and discussed in this report. An important development is the transition in the regulatory setup, the implementation of which will consequently lead to a robust and vigorous takaful system globally.

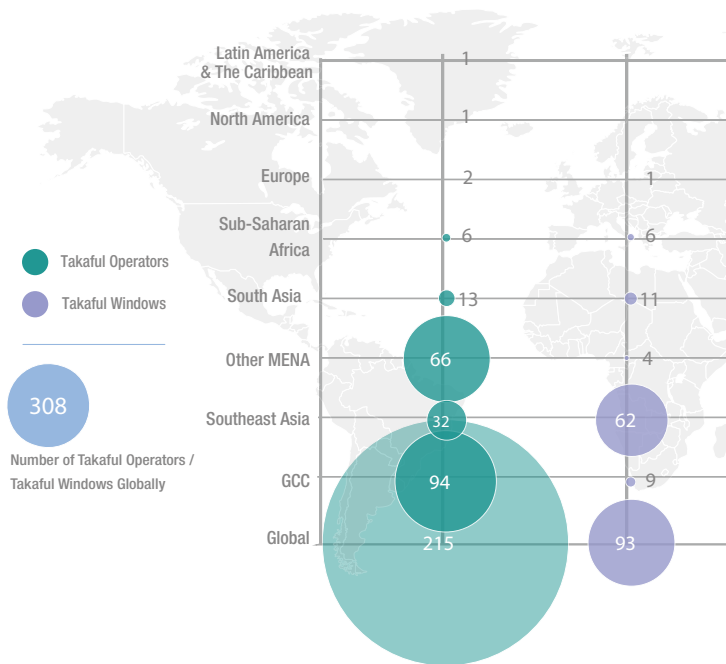


Source: Source: ICD Thomson Reuters (2015)

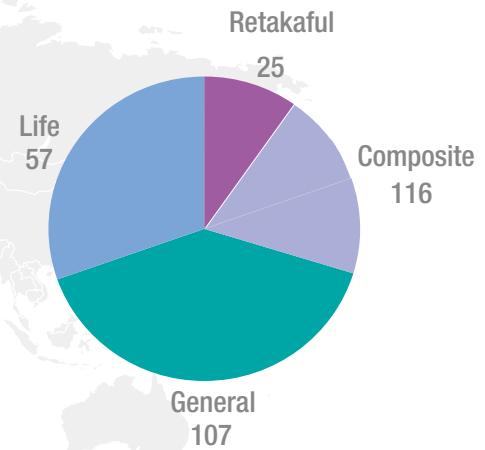
Based on the data available from Thomson Reuters EIKON database and the available financial statements, basic financial analysis for 25 companies in the GCC, Pakistan and Malaysia has been done. As we have described in detail in Finance Forward Middle East Insurance Outlook Report 2016 and Islamic Finance Outlook Report 2016 the penetration and density levels in the Middle-East still lag behind the developed markets global benchmarks. As

expected the penetration and density levels of the Takaful industry in various jurisdiction are very low as compared to the conventional counterparts. The challenging economic outlook along with a lack of awareness and under developed regulatory framework has been the main cause of this lackluster growth.

NUMBER OF TAKAFUL OPERATORS/TAKAFUL WINDOWS GLOBALLY BY REGION (FYE 2014)



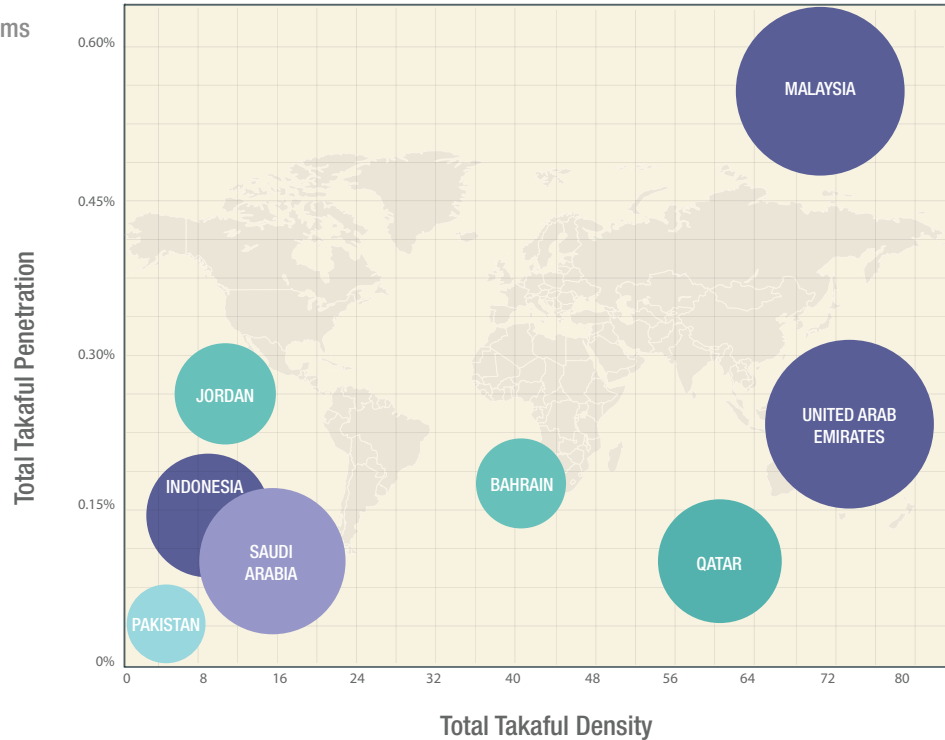
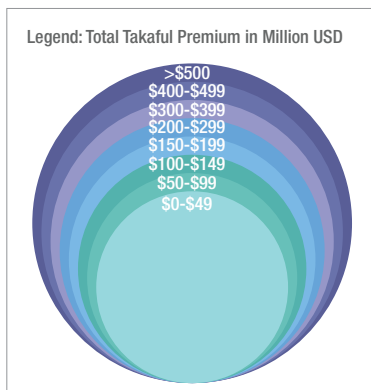
NUMBER OF TAKAFUL OPERATORS/TAKAFUL WINDOWS GLOBALLY BY CATEGORY (FYE 2014)



Source: Source: ICD Thomson Reuters (2015)

Total Takaful Sector

Takaful Penetration, Density & Total Premiums



Source: Thomson Reuters EIKON, World Bank Database and Finance Forward analysis.

GCC Market Overview

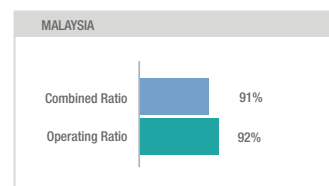
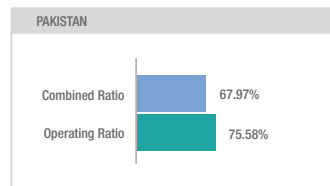
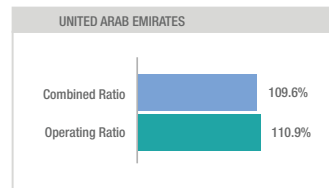
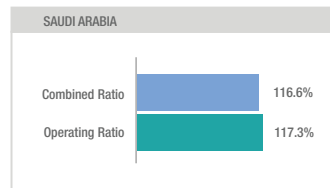
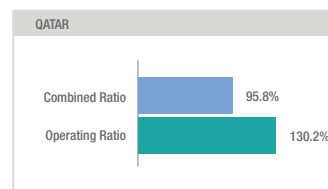
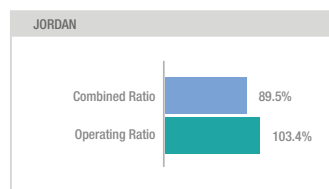
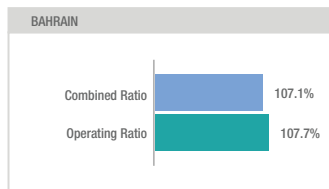
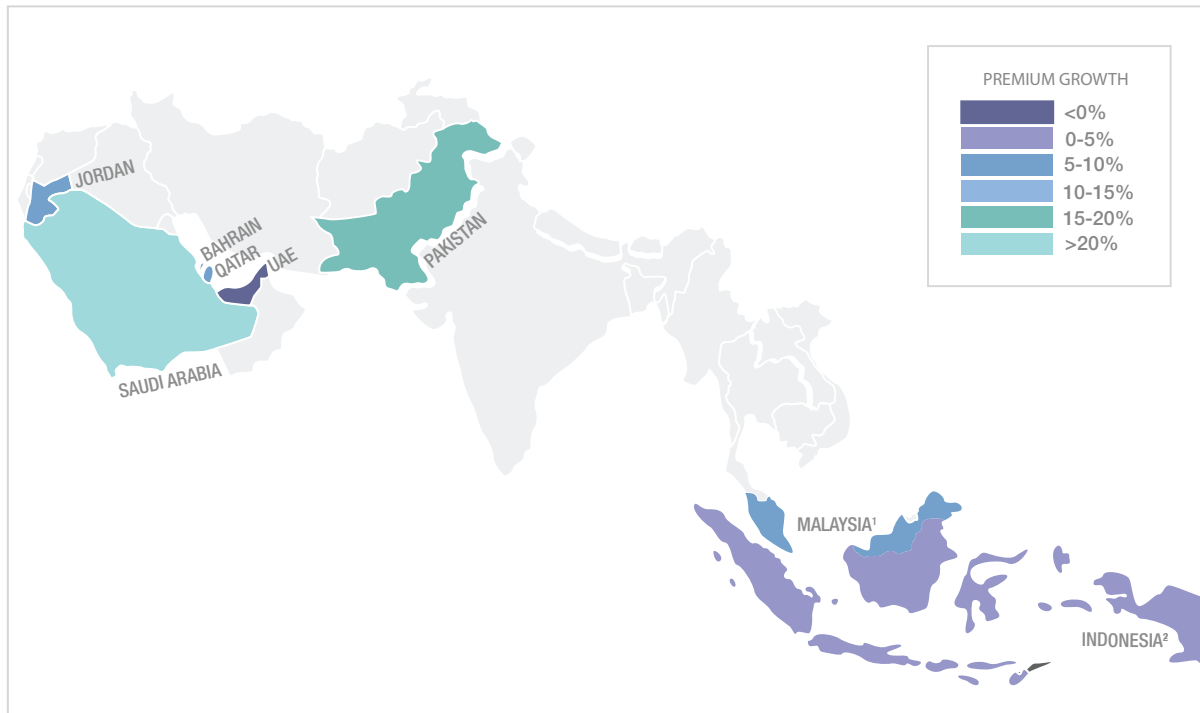
The gross takaful contributions in the GCC region were estimated at USD 8.9 billion showing a Y-o-Y growth of 12%. As mentioned in the Finance Forward Middle East Insurance Outlook Report 2016 the strong growth of the takaful industry in Saudi Arabia is primarily driven by strong regulatory support.

Some argue that the mandatory requirement by the Saudi Arabian Monetary Agency (SAMA) that all insurance companies in Saudi Arabia have to be established based on the cooperative business model departs from the existing takaful model. However, it actually does more to support the introduction of a Shariah compliant insurance model in the country. That should not preclude further work to ensure that the cooperatives' operations are fully consistent with evolving takaful models.

Next, the UAE is the second largest takaful market in the GCC region. The UAE's gross takaful contribution accounts for 15 per cent of the total gross takaful contribution in the region. The highest premium growth was witnessed in Saudi Arabia and Qatar and Jordan. The data from the heat map [see page 9] shows that highly competitive markets in Saudi Arabia and the UAE in particular where the aggregate combined ratio of the companies included in our sample is close to or above 100%. This doesn't mean that the takaful operators are running in losses—the combined ratio includes only underwriting expense and operating expenses relative to net earned premiums— but it does mean that the competition has driven down the underwriting profits available to low or negative levels.

Takaful Industry Heat Map

Premium Growth, Combined Ratio and Operating Ratio



Source: Thomson Reuters EIKON and Finance Forward analysis.

Note: Premium growth, operating ratio and combined ratio are based on the data from a sample of operators in the following countries (number of operators in sample). Bahrain (1); Jordan (3); Qatar (3); Saudi Arabia (6); United Arab Emirates (8). For Malaysia and Pakistan, data was collected from the annual reports.

¹The premium growth figure for Malaysia is from RAM Ratings. "RAM Ratings: Malaysian insurance and takaful sectors to experience slower growth amid challenging climate", Press release, 31 March 2016

²The premium growth figure for Indonesia is from the article Fitch: Indonesia Offers Vast Potential for Takaful Products (2016, Feb 16), Reuters.

ASEAN Market Overview

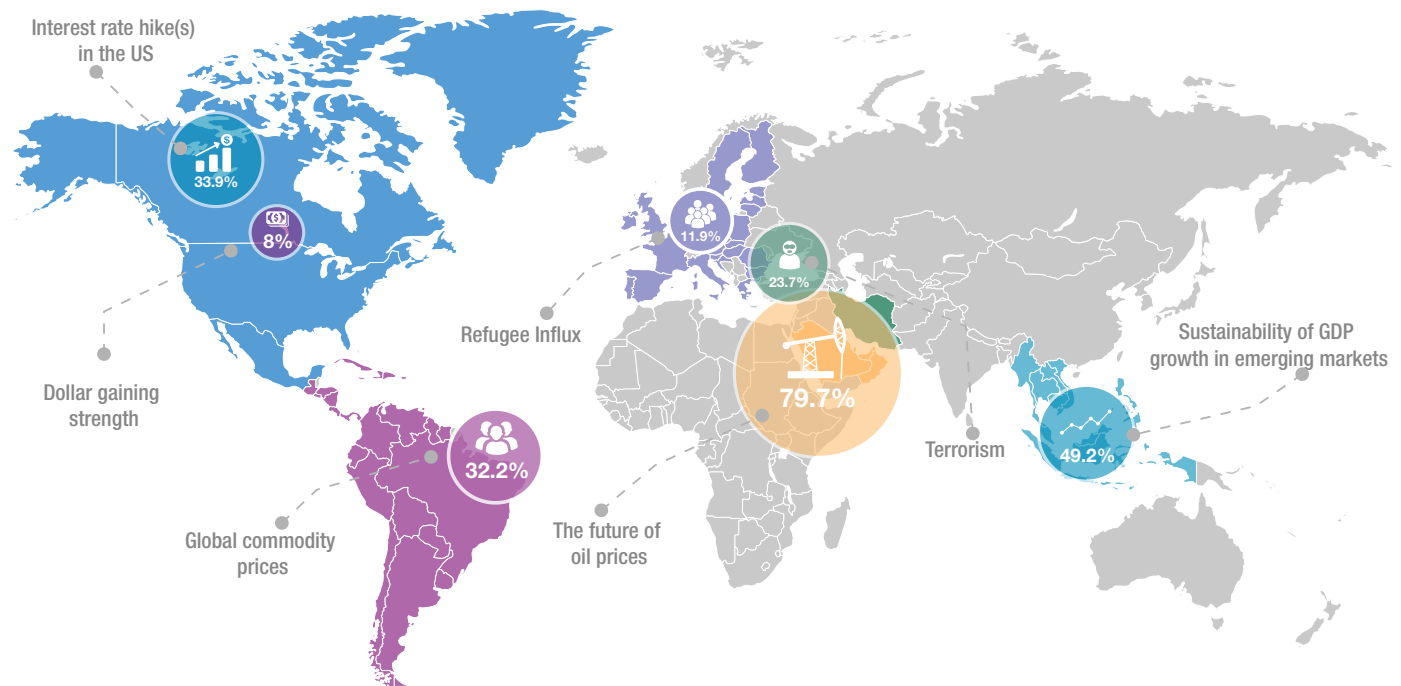
Malaysia leads the takaful industry in the South-east Asian region. It is home to 12 registered takaful operators. The growth prospects of takaful in Malaysia are bright as the industry has the support of the government support in all aspects in addition to favorable demographical breakdown. Wider product innovation and distribution coverage is likely to drive sector growth as public acceptance of the model increases. Malaysia's takaful industry grew faster than conventional insurance, with general and family takaful recording 8.3% and 9.7% growth, respectively, at end-June 2015, compared with conventional general and life insurance growth of 6.6% and -0.4%, respectively.

In Indonesia, takaful has expanded to account for 6.2% of Indonesia's insurance market by gross written contributions as of

end- 2015, from 2.6% as of end-2010. The sector's contributions expanded by around 4.1% to around USD 757 million (IDR10.5trn) in 2015, slower than the previous year amid a slowdown in the country's real GDP growth but outperforming the conventional insurance product segment that had more modest growth of 1.6%.

The survey responses also showed some insightful reviews about the outlook of the takaful industry in these markets. Majority of the respondents were split between GCC and Southeast Asia. Both these regions are affected by the global commodity markets performance and thus the economic outlook of the financial markets in these regions is hitched to commodity price movement which has been corroborated by the survey responses as well as shown in the chart below.

MAJOR DEVELOPMENTS IMPACTING THE GLOBAL ECONOMY IN 2016 (INDUSTRY PERCEPTIONS)



This chart is based on the response by our survey respondents (see page 23)

Takaful Snapshot [1]

Huge rise in GCC sovereign issuance to support takaful stability

One of the major challenges facing the GCC takaful market – excess allocation to real estate due to limited alternatives – may see an avenue for relief in the next few years. The region, home to two of the three leading markets globally (Saudi Arabia and the United Arab Emirates), will see \$58 billion in bond and sukuk issuance in 2016 and \$385 to \$390 billion through 2020 according to Kuwait Finance Centre Markaz.

The stability of all insurance companies (including those operating takaful funds) has been put at risk by high allocations to equities and real estate. The high allocation to these asset classes can be beneficial while times are good but leave the solvency of insurers and takaful operators more at risk when the economy slows. The excess allocation towards real estate (something which is common among insurers as well as takaful operators) has been exacerbated by the shortage of Shariah compliant fixed income.

Going forward, the next few years may be challenging for the GCC and its takaful companies if energy prices stay low because the low penetration rate of insurance and takaful has led to an extremely competitive market. When Finance Forward surveyed insurance professionals in the region about the major challenges facing insurers, the top response (and the only one with more than 50% of responses) was pricing pressure driven by the over-competitive market.

With competitive pressures putting pressure specifically on underwriting margins, the investment side of the takaful business

will be crucial for ensuring the long-term success for takaful operators. Many of them are relatively well capitalized and thus helping improve their resiliency of their investment allocations by including more of the (upcoming) sovereign sukuk.

A unique challenge facing takaful, even compared to conventional insurers with similar asset allocation problems, is the dearth of Shariah compliant fixed income, and particularly a shortage of sovereign sukuk. This shortage makes it challenging to implement the new rules being proposed or phased in that put a cap on real estate and equity exposure. The new caps generally also limit foreign exposure making domestic, sovereign sukuk a highly desirable asset for takaful operators.

The benefit from rising sovereign issuance is that it will have a chance of reaching such a volume that meets both banks' (particularly Islamic banks which are highly liquid) need for high quality liquid assets and takaful operators need for domestic, Shariah compliant fixed income. A pipeline of around \$60 billion per year for the next 5 years will support banks and takaful operators' ability to manage their balance sheets and, thus, support growth.

Reproduced from *Finance Forward*. Read more at: <https://meglobaladvisors.com/huge-rise-in-gcc-sovereign-issuance-to-support-takaful-stability/>

Takaful Operating Models (Mudaraba, Wakala and Waqf) Impact on Stakeholders



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Background

There are many different operating models of takaful in action. A brief look at the key milestones in the historical development and evolution of Takaful may explain why – from the establishment of cooperative takaful in Sudan in 1979, to the setting up of the mudaraba-based first takaful company in Malaysia in 1984, to the creation of hybrid Wakala / Waqf based takaful company in Pakistan, and finally to the proliferation of current modern day takaful companies with multitude of models – Wakala, Mudaraba, Waqf, cooperative and hybrid.

Choice of takaful model

The ultimate choice of takaful model adopted by Takaful Operator is driven by many factors such as:

- » Shareholder's commercial objectives
- » Ruling by Shariah scholars
- » Regulatory influence
- » Operational efficiency
- » Line of business (General vs. Life takaful)
- » Pricing and profitability goals

To begin with, takaful is an ecosystem of mutual, solidarity and brotherly cooperative assistance among members of takaful group. To render this system practical, a third party (Takaful Operator) must exist to coordinate administration on behalf of members in exchanging of certain rewards.

The rewards must be commensurated with physical and financial efforts:

- » Takaful operator will need to inject a seed money (capital)
- » It needs to take risks on potential benevolent loan (providing capital in the event of potential deficit in case claims exceed donations and reserves)
- » It needs to pay for management expenses which may exceed collected income (Wakala fees and investment income with or without underwriting surplus)
- » It needs to generate certain return on capital to satisfy its shareholders.

In the takaful world, the following are commonly adopted models to enable appropriate reward system for takaful operator:

- » Mudaraba
- » Wakala
- » Wakala and Waqf
- » Cooperative

Which model(s) are the most optimal for shareholders? Which one is most beneficial to consumers?

Relative to the conventional system, the takaful system has not reached a similar maturity level in terms of its IT system. Which takaful model generates less complication for the takaful operator in administering shareholder and participant risk funds from an IT system perspective? One has to take note that complicated takaful model if not fully developed and tested may result in disgruntled customers when takaful administration system behaves poorly in servicing policyholders.

This article is not intended to give detailed explanation of each model; rather, it will endeavour to summarize the pros and cons of key models based on the author's experience.

Mudaraba

This model is applicable to the investment aspect of both participant risk fund and investment fund of participants. The entrepreneur (takaful operator) will manage and invest the capital (takaful funds) to generate investment profit, which it will be shared on agreed proportion between the takaful operator and participant. This model can co-exist within other models (Wakala and Waqf).

Application of profit sharing under Mudaraba is only valid to excess of capital (investment profit) and generally such sharing is not allowed on surplus from the risk fund, even though some companies did practice surplus sharing on the back of Mudaraba arrangement. Some companies, which adopt this practice, will see that break-even period can take longer time because high initial acquisition costs can only be recovered from future investment profit sharing only. In the typical takaful company set-up, a life or general fund will only grow in size in over years, as will investment profits earned on the funds.

In summary this model is neither appropriate nor shareholder friendly to set up takaful, except for the application on investment profit sharing.

Wakala

Wakala is an agency system where takaful operator (being an agent) is appointed by participant (principal) to act on latter's behalf in exchange of Wakala fee. Normally, the Wakala fee is expressed as a percentage of contributions and can vary by policy duration even though such Wakala fee can also be expressed as a percent other variables such as sum covered, risk charges or fixed amount

like a policy fee. The takaful operator will earn net profit if collected Wakala fee (together with investment profit share from Mudaraba arrangement as explained above) less operating expenditure, expense reserve and marketing expenses become positive. It is all about good marketing and operational efficiency. Irrespective of position of risk fund (being in deficit or surplus), the takaful operator will still get Wakala fee as long as new business is issued and remain in-force. The only downside, as in all commercial form of takaful organization, the operator will have to bear any potential deficit in risk fund and pay it from future emergence of surplus. Recouping loss from deficit from future surplus can take years if there is a series of poor claims experience. A good example will be issuance of personal accident policies with a large value covered and small contributions, which can wipe out the risk fund upon occurrence of big claim amount. Under a true ideal cooperative takaful model, it is the participants' duty to increase donation amount to help cover any shortfall in risk fund, but this will be difficult to implement in the real world because participants do not know each other.

There is a disagreement on treatment of surplus sharing among takaful operators under Wakala model. Some argue that the surplus should be shared with the operator as an incentive for good performance in exercising prudent underwriting to safeguard the risk fund from turning into deficit. Some argue that this is not allowed as donations are solely meant for mutual assistance to compensate members inflicted with unfortunate events.

The author is of the opinion that it should not be shared and such surplus should remain in the risk fund to mitigate against risk of potential deficit and to provide agility to price takaful products aggressively in future to be able to compete with conventional companies which have far higher capital adequacy level due to the latter's level of maturity. Furthermore, what is the use of compensation to the operator via Wakala fees if it cannot perform its job with full accountability? Being an agent (wakeel) in a Shariah compliant environment, the operator has been entrusted to perform its duty with high level of trust, integrity, professionalism, responsibility and accountability. This job description must include the safeguarding of risk fund under prudent risk selection, rating and classification together with prudent claims management. Being forced to give up because it is being denied of receiving its share of surplus should not impair the operator's job.

Operationally, by not distributing surplus to individual policyholders it will remove one big system hurdle of quantifying the right amount of allocated surplus, determining rightful claimant, dealing with policyholders who have contributed to surplus but have left the book, among other issues related to surplus distribution scenarios. The potential issue of unclaimed money associated with distributable surplus can be ignored if the takaful operator retains it.

Wakala / Waqf

This model is similar to the Wakala model explained above, with an exception that the takaful operator needs to contribute seed capital to formalize formation of Waqf. The Waqf fund has been recognized since the days of Prophet Muhammad (PBUH) and in the case of takaful, it is created to address deficiency in a pure Wakala model related to the degree of ownership relinquishment and treatment of surplus if donations exceed claims. Under a Waqf fund, donations once made will be owned by the Waqf fund (neither operator nor participant have ownership of donations) and distribution of money from Waqf fund will be done according to Waqf rules which include claims payment and potential surplus distribution. The Waqf system will eliminate the debatable issue related to status of partial or entire donations which a participant makes. Some Shariah scholars are perfectly fine not to subject takaful operation under Waqf requirements and proceed with pure Wakala model as explained above in the implementation process.

The Wakala / Waqf model is “cleanest” in terms of addressing the ownership of donations. Some takaful companies in the case of pure Wakala model, created a concept called ‘commitment to make donation’ (iltizam bittabarru’) which means that initial donations by the participant is not deemed as a donation until such amount is used to pay claims. Any unused portion of donations will belong to

participants and can be distributed as surplus. The author finds this iltizam bittabarru’ concept to be too complicated and also suffering from too many administrative flaws.

Cooperative

Under the cooperative model, appointed members among participants will become administrators of the takaful funds and administrative or operating expenditure to manage takaful funds shall be borne by takaful funds.

Conclusion

Of the variety of takaful models, the optimal choice is Wakala / Waqf hybrid as this provides clarity on ownership of donations, and the rules of Waqf fund can be constructed to allow when and how funds can be disbursed. By keeping the surplus within the risk fund (Waqf fund), the operator can eliminate administrative tasks with respect system development and complications, which may arise during actual operations of takaful business. This model will be easiest to explain to customers.

Pricing Regulations of Takaful Products in Different Regions



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Dawud is a Co-founder and Director at Takaful Outsource Ltd, a boutique professional consultancy registered in the U.K. and the Netherlands. With more than 30 years of professional actuarial experience, both in his native U.S.A. and Saudi Arabia, Dawud's expertise covers a wide spectrum of management and actuarial responsibilities in the field of pensions, life insurance, health insurance, and family (life) Takaful. He is an associate of the U.S. based Society of Actuaries and has been a member of the American Academy of Actuaries.

The Takaful industry is nearing a milestone in its growth trajectory whereby a natural convergence of regulatory guidelines will pave the way for a much needed standardization of Takaful operational models, agreed upon terminology, preferred methods for preparation of financial statements, and actuarial considerations for risk-based capital frameworks, among other concerns. The pricing of Takaful products is one of these "other" important concerns and this brief feature will present an overview of the current regulatory environment for six selected countries – Pakistan, United Arab Emirates, Indonesia, Nigeria, Kenya, and the Maldives (as summarized in the table).

It should be no secret that Takaful regulation is still in its infancy, both in general (globally speaking) and specifically with respect to regulatory reference to the pricing of Takaful products. One would also expect that the countries with the largest Muslim populations and/or Muslim majorities would be the regulatory leaders in this regard. However, the correlation between country size and ideal Takaful regulation is not quite as one would perceive with a country like Indonesia (the largest Muslim nation), which is just beginning to contribute to the Takaful regulatory narrative; as well as other huge markets such as Saudi Arabia which is choosing to sit on the side-lines of the narrative with its unique interpretation of its 'cooperative model'.

As a benchmark to observe prior to over-viewing conditions, let us start with the "gold standard" for Takaful products' pricing guidelines promulgated by Bank Negara Malaysia in its June 2013

document entitled, "Guidelines on Takaful Operational Framework". An excerpt from this trend-setting document reads as follows:

"Takaful operators shall exercise diligence in product design and ensure that the products offered include adequate Takaful coverage and, are suitable and appropriate to the targeted market segment. In determining the price of the products, prudence must be maintained to avoid under pricing and balanced with due care to avoid participants from being charged excessively. Key factors such as the expected frequency and severity of risk exposures and, expected management costs and expenses must be considered in pricing the Takaful products. Assumptions used in pricing the Takaful products could be based on the Takaful operators' or industries' past experience and future expectations. Given the nature of the business that may involve payments of contributions or liabilities long into the future, products should be priced to include appropriate buffers or designed with flexible features that could absorb future fluctuations and uncertainties."

It can be added that Malaysia also has directives in place for defining family Takaful products according to ratios of sum covered amounts against contributions as well as maximum sales' commissions, for example – both of which have direct implications on the product pricing process.

Other than Malaysia, which drafted its first Takaful Act in 1984,

other regulatory references to Takaful or Shari'ah Insurance can be found in some of the Arab and GCC countries (e.g. Oman drafted its Takaful Insurance Law in early 2016 that included 58 classified subjects in 8 chapters).

Lack of Takaful regulation should continue into the foreseeable future to be the rule rather than the exception in the West (Europe, America, etc.). What is noteworthy is that several countries in the nascent markets in which Takaful is gaining ground, such as West and East Africa, have drafted or passed Takaful regulatory

guidelines that augurs well for the emerging Takaful operators and setting the norm for the expectations of actuarial soundness in the pricing of Takaful products.

The table on the following page summarizes the overview for the selected nations. We stand in awe and admiration of the tiny nation of the Maldives that is demonstrating to the Takaful world the importance of meaningful Takaful regulation as a precursor to the marketing of Takaful products.

Summary of Regulatory Guidelines for Takaful Product Pricing (Selected Countries)

Country	Estimated total population [Millions] 2013*	Estimated Muslim	Seaprate Takaful Regulation (Date)	Regulator Guideline for Takaful Pricing	Author's Comments
Pakistan	182.1	97%	Yes (2012)	Takaful operators must formulate 'risk management and rating procedures' approved by the appointed actuary	This is too vague, not descriptive enough. Pricing actuaries need to have professional flexibility, but too much leaves the door open for abuse.
United Arab Emirates	9.3	96%	Yes (2014)	A Financial Condition Report (FCR) is required to be certified by the Acturay and endorsed by the chairman of the Board of Directors including evaluation of the pricing policies and procedures of the Company	The document is heavily skewed toward actuarial recognition and recommendation of investment activities. Pricing is only addressed from a retrospective viewpoint instead of prospectively, the preferred practice.
Indonesia	249.9	95%	Yes (Revised 2013)	"Generally Silent" with respect to product pricing, instead of focusing on takaful windows needing to spin-off to full fledged takaful entities, risk-based capital as a solvency safegaurd, and increased paid-up capital requirements.	The importance of actuarial soundness in product pricing is not given a high priority.
Nigeria	173.6	75%	Yes (2013)	NAICOM's comprehensive Operational Guidelines for Takaful insurance operators is groundbreaking for the region. As part of the licensing process applicants are required to document the proposed pricing mechanism as part of the marketing strategy.	Although little is mentioned on pricing, the document acknowledges the importance of the actuary (cited 5 times) for opining on underwriting surplus sharing with operator, risk-related wakala fee, investment profit on the participants' risk fund, and auditing procedures.

Country	Estimated total population [Millions] 2013*	Estimated Muslim	Seaprate Takaful Regulation (Date)	Regulator Guideline for Takaful Pricing	Author's Comments
Kenya	44.4	29.50%	Yes (2015)	IRA's takaful operational guidelines is a bright light for the emergence of takaful in the region. The 20 page document makes no separate mention of product pricing, but mentions the word 'actuary' 4 times.	It's still too early to fairly assess conditions, but the focus on the document is on surplus wherein the actuary is responsible for calculating surplus and recommending surplus distribution. Shariah board endorsement of the actuary's surplus distribution recommendation and approval by BOD is required.
Maldives	0.3	100%	No	Although no separate takaful regulation exists, takaful is "regulated" under the "work-in-progress" insurance regulation and supervisory advancement for conventional insurance. The world Takaful is mentioned in 16 times in the document showing continued interest in developing the market, beginning from the regulatory standpoint.	The insurance business had been operating without a specific legislation for more than two decades until the "Insurance industry Regulations" (IIR) came into effect in late 2004. Its no less than remarkable that this tiny nation of less than 300,000 persons with miniscule insured data (compared to other Muslim majority nations) might soon have Takaful Act!

A Glance at Pricing Regulations of Takaful Products in Different Regions - APPENDIX

The Appendix illustrates the pricing of a family takaful product for the 6 countries we compared.

The life tables used in the pricing exercise are country specific insured lives tables taken from the U.S. based Society of Actuaries life tables' archives. Not all countries have published insured lives' tables, therefore the nearest country with life table data was used and the ratio of the country without insured lives' data to the nearest country with an insured life table was derived based on the

ratio of the "with" to "without" country specific life tables developed by the World Health Organization.

Table Two on the next page refers and, as examples, the Maldives is assumed to have 77% improved mortality over South Africa, whereas Kenya's assumed mortality is 19% worse than South Africa.

Table One: Assumptions for Protection Only (Term) Family Takaful Plan

Covered Person Data		Fees & Charges		Other	
Entry Age (Yrs)	35	Participation Wakalah Fee [% of Gross Contribution]	20% for 1st 5 years, nil thereafter	Operator's Facilitating Fund (Used for Investing Gross Level Contribution) Growth Rate	3% p.a.
Term (Yrs)	30	Risk Management Wakalah Fee [% of Risk Contribution]	15%		
Gender	M	General Reserve [% of Risk Contribution]	5%		
Sum Assured (USD)	\$100,000				
Benefit Pattern	Level				

Table Two: Gross Level Contribution for “Table One” Family Takaful Plan

(a)	(b)	(c)	(d) = $\frac{(a)}{(b)}$	(e)
Country	Nearest Country with Insured Life Data	Insured Life Table Name	Ratio of Country (a) to Country (b) based on WHO Life Tables by Country	Gross Level Annual Contribution (USD) per 100,000 of Sum Assured [Death ONLY Benefit]
Maldives	South Africa	1985-1990 South Africa Assured Lives Heavy	0.23	\$221.97
Kenya			1.19	\$1,148.42
Nigeria			1.73	\$1,669.56
UAE	Egypt	Egyptian Insurance Standard Mortality Table 2003-2006	0.54	\$473.84
Pakistan	India	Indian Assured Lives Mortality (2006-08) Ult, ANB	1.11	\$698.51
Indonesia	Indonesia	TMI '99 – Laki-laki (Male)	1.00	\$790.35

Table Three: Population by Gender, Age, Fertility Rate

Pakistan	Country	2013 Population	Males	Females	Age 0-14	Age 15-24	Age 25-64	Age 65+	Fertility Rate
4	Indonesia	249,865,631	50.30%	49.70%	28.10%	16.80%	49.70%	5.40%	2.35
6	Pakistan	182,142,594	51.40%	48.60%	32.80%	20.90%	41.90%	4.40%	3.22
7	Nigeria	173,615,345	50.90%	49.10%	44.40%	18.90%	34.00%	2.70%	6.01
31	Kenya	44,353,691	49.90%	50.10%	41.80%	19.30%	36.10%	2.80%	4.41
93	United Arab Emirates	9,346,129	70.10%	29.90%	16.10%	12.10%	71.20%	0.50%	1.82
177	Maldives	345,023	50.40%	49.60%	28.20%	19.70%	47.20%	4.90%	2.29

Islamic Capital Markets Universe

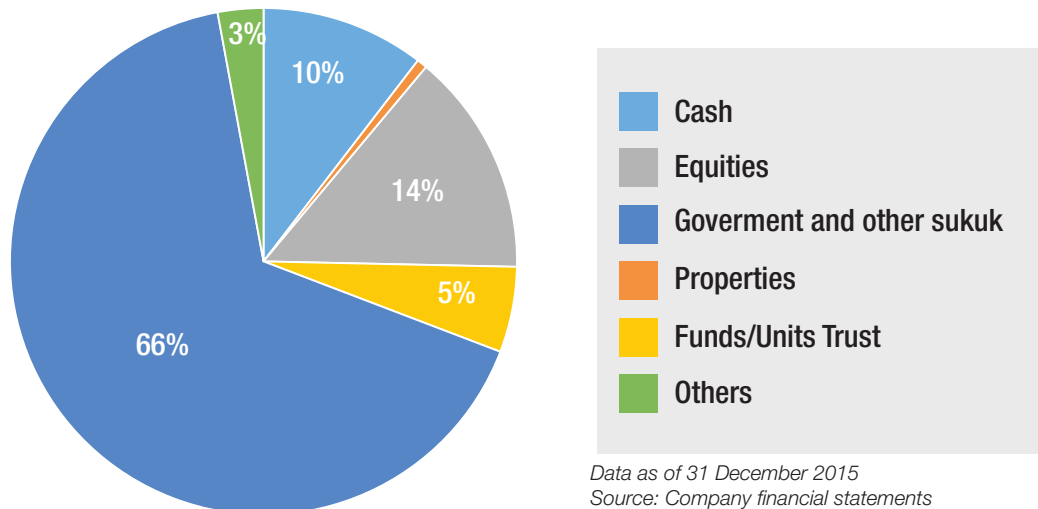
Limited corporate sukuk pushes GCC takaful operators towards suboptimal investment allocations

The takaful industry's growth depends in large part on the two components that make up its operations. Other sections of this report have covered challenges relating to competition and underwriting profitability. The focus here is capital markets instruments which are key, particularly to developing the generally more profitable takaful market.

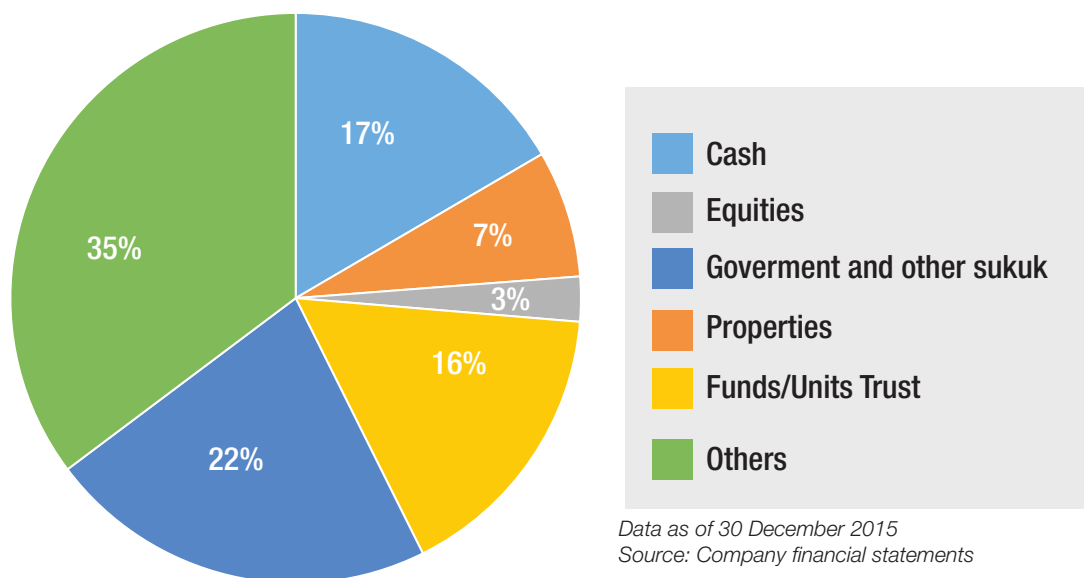
The backdrop of the analysis here are the two charts below showing the investment asset mix for two large takaful operators:

one based in the GCC and one in Malaysia. The mix of assets held by each reflects the degree to which there are (or are not) suitable investments to fulfil the investment needs of takaful operators in the markets where most takaful exists today. A careful comparison between Malaysia, which has an active Islamic fixed income market, and the GCC, which has a less developed capital market overall, illustrates possible future trends for takaful operators' investment allocations.

Malaysian Operator



GCC Operator



Before delving more deeply into the specific asset class gaps, it is important to remember the purpose of the investment for takaful operators. The goal is to align the investment of surplus liquidity available from takaful operations into a mix of investments to provide investment income and growth of assets to meet the anticipated liabilities arising from their takaful operations.

The Malaysia takaful operator has an asset breakdown that is in line with what one would expect from a takaful operator with modest cash balances to cover current liabilities from claims, a large share of sukuk, some equity exposure and a small allocation to properties. The large sukuk exposure and negligible property exposure represent the most significant difference with the GCC takaful operator.

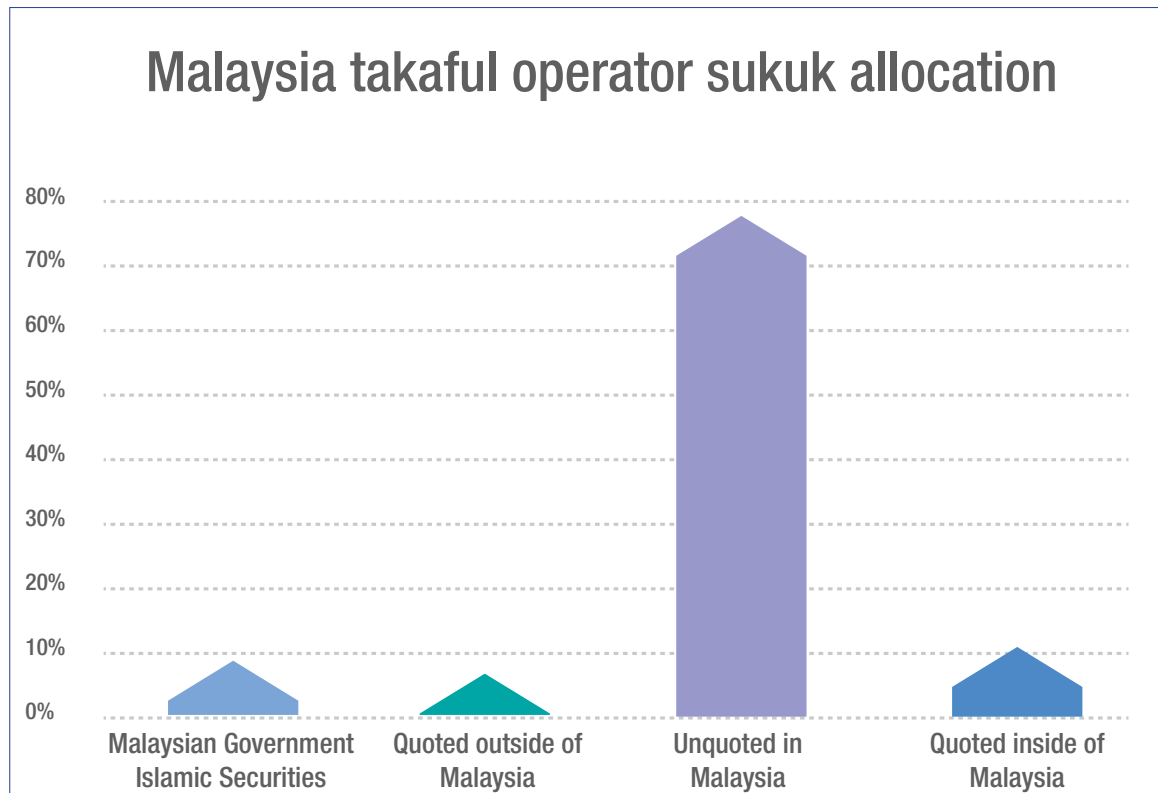
The most significant difference in asset allocation between the GCC and Malaysian takaful operator is the degree to which sukuk make up a large portion of the overall investment allocation of the Malaysian takaful operator's assets. However it makes up just about half the share of the GCC takaful operator's balance sheet. The difference in balance sheet structure is not as pronounced as it appears if you consider the use of Islamic placements by GCC takaful operators and the higher allocation to properties.

These allocation decisions are not entirely just a reflection of the different composition of the business and the split between general and family takaful (where the former is a more significant share of business in the GCC while the latter is in Malaysia). More likely, the lower sukuk allocation in the GCC represents a limited supply of high-quality sukuk, particularly corporate sukuk.

Most of the Malaysian takaful operators' sukuk allocations are held in unquoted instruments within Malaysia, most of which are likely to be the corporate sukuk not listed on Bursa Malaysia and are able to deliver higher yields than the government sukuk. Sukuk from outside Malaysia represent a small portion of the investment allocation to sukuk within Malaysia.

Comparing the breakdown of available sukuk in the GCC, the paucity of issuance from within the corporate market and limited issuance of local currency sukuk - these both contribute to a lower supply available for takaful operators. The shortage of the supply that Malaysia's takaful operators likely has the greatest impact on the holdings of sukuk by GCC takaful operators.

However, it is not alone in influencing their investment decision. A combination of a liquid Islamic banking system searching for high quality liquid assets and limited local currency government issuance



means less supply available for takaful operators and lower yields on what is available. This pushes most operators to choose from four suboptimal choices.

They can hold the assets in cash, earning nothing. With GCC interest rates mostly pegged to the US Federal Reserve as a result of the currency peg, this is not as taxing as it would be if rates were higher, and takaful operators hold more in cash (and according to our survey, desire to hold even more).

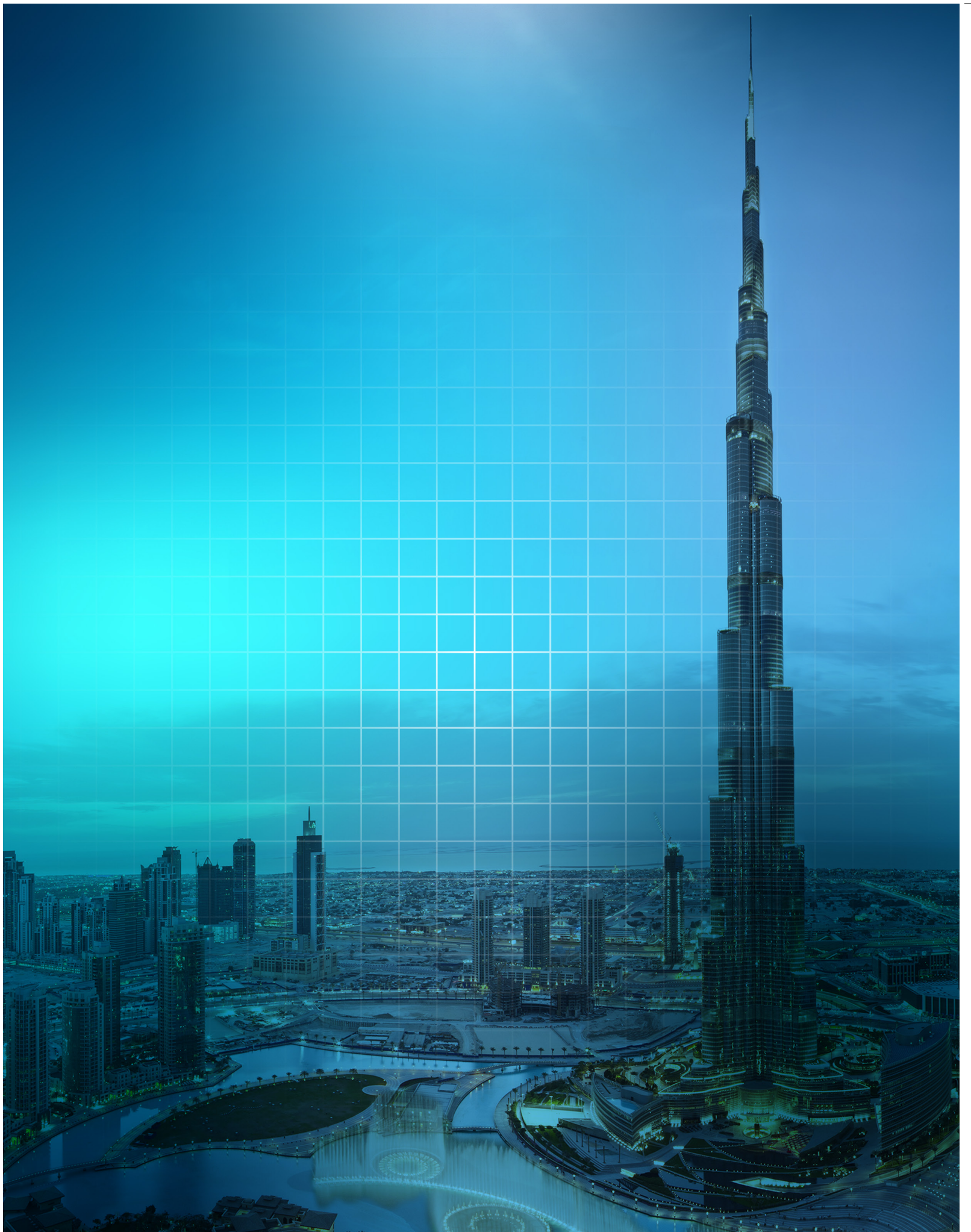
Another alternative is to invest in foreign sukuk. These are mostly in US dollar so the practical impact of the currency risk is limited as long as the pegs remain.

Besides the cash or foreign sukuk, takaful operators have two other alternatives: buy other yielding assets like properties and turn to Islamic placements to keep the liquidity of cash while generating marginally higher yields. With a sharp property market downturn in the UAE in recent memory, the investment into the property markets are modest (much more so than in conventional insurers in the region). The bulk of the excess liquidity held by takaful operators is in the form of low-yielding placements (represented as 'other' in the charts above).

A comparison of GCC and Malaysian takaful operators' investment allocation, particularly the allocation towards fixed income (or cash equivalents as the case may be), highlights some of the most important capital markets gaps relevant to takaful operators. For the takaful operators considered in this analysis, the problem is different than on the conventional side where excessive real estate market exposure is the most significant.

The biggest gap is the limited availability of local market, corporate sukuk issuance in the GCC. For many years the problem was said to be the need for a benchmark yield curve created by government issuance and the relatively cheap availability of easily accessible bank financing. With low oil pricing leading to high budget deficits and lower bank liquidity, it will be interesting to watch whether low oil prices and high government budget deficits lead to increases of supply of sukuk of sovereign sukuk and more costlier bank financing, setting off a wave of corporate issuance.

If each of these occurs, look for takaful operators' investment allocations to shift towards more sukuk holdings.



Industry Perceptions

Business Conditions & Global Outlook

(Q1) In your opinion, which of the following changes will have a major impact on the global economy in 2016?

Top 3 developments impacting the global economy in 2016

80% The future of oil prices

80% of respondents cited a drop in oil prices will have a major impact on the global economy in 2016. The presentiment of a lower cap on oil prices exists for an obvious reason: the majority of respondents of our survey were based in the GCC or South-east Asia, economies that are highly dependent on oil. As uncertainty regarding oil prices looms ahead and the impact will be more than adverse for the oil exporting economies than those which are net oil importers.

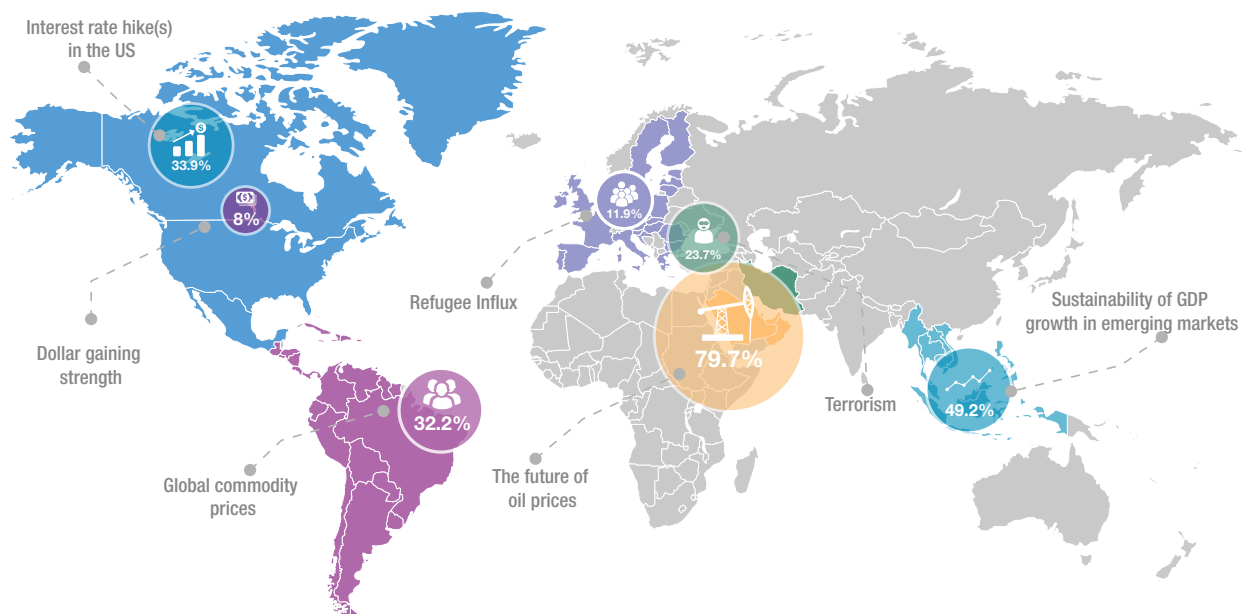
49.2% Sustainability of GDP growth in emerging markets

For 49.2% of our respondents, sustainability of GDP growth in emerging markets remains a matter of high concern. The

commodity and currency market fluctuations experienced in the last leg of 2015 gushed out signs of a plausible recession and a slow down in emerging markets.

33.9% Interest rate hike(s) in the US

34% of respondents were of the view that the recent rate hike by the US Federal Reserve would impact the global economy significantly. In December 2015, the Fed raised key interest rates for the first time in almost a decade which is likely to affect the other global economies significantly, albeit at a slower pace. As the rates rise and the trend spreads over on to other economies, the cost of doing business will go high which will hamper the economic growth of both developing and developed economies.



(Q2) What external factors do you think hamper the growth of the takaful industry?

Low oil prices and inflation – likely to hamper the growth of the industry

76% Drop in oil prices

The plunge in oil prices was cited to have a strong (and negative) impact on the takaful industry. As mentioned earlier, more than a third of the total number of full-fledged takaful operators and windows are based in the GCC, the largest economies of which are highly dependent on income from oil. Malaysia, another major player in terms of high contribution growth and number of takaful operators, is also a net oil exporter and has been hurt by a slide in oil prices. Thus, Takaful operators based in these jurisdictions are of the view that the drop in revenues of oil exporters will have a trickle-down effect via a contraction in the spending expenditure in those economies. The effect is likely to be most pronounced in the commercial sector with delays or cancellation of new projects. A stagnation in this area will lead to slower contribution growth in these regions.

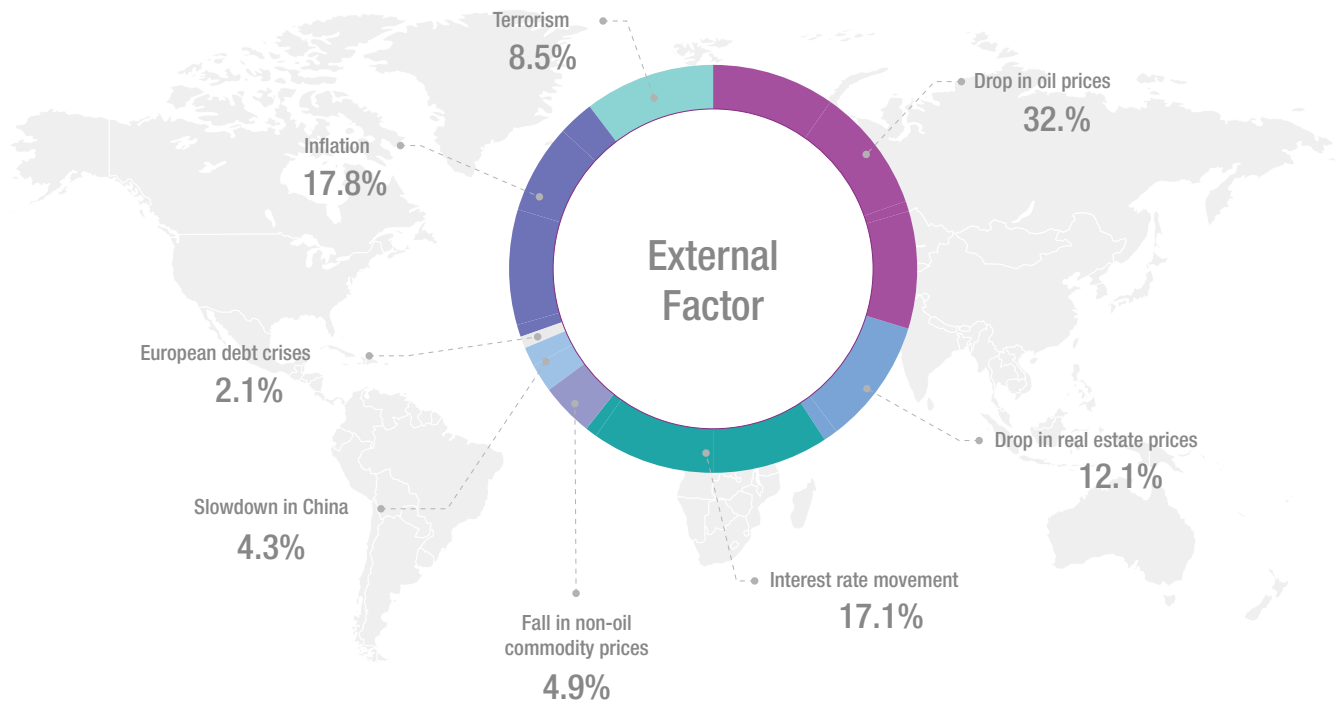
42.4% Inflation

Inflation was cited as an external factor that is likely to hamper the growth of the takaful industry. This stems from the potential for depreciating EM currencies, caused by higher US interest rates,

to lead to higher domestic inflation in these markets. Under a high inflationary environment, the takaful operators are in danger of receiving less contributions as opposed to the claims that they will have to give out in case the claims for the insurance are made. A specific concern reflected in the survey participants' response on inflation potential is that a change in the dollar peg would result in devaluation and higher prices of imported goods, which account for a lot of what is consumed in the GCC.

40.7% Interest rate movements

Conventional insurers, specifically the life-segments, benefit the most from a rise in interest rates as the asset-liability mismatch is minimal during such periods. However, in the case of takaful companies there is a reversal. The negative impact of increases in interest rates potentially arises from the longer duration of nominal assets versus that of nominal liabilities. The duration mismatch further suggests the lower flexible-rate of nominal assets versus that of nominal liabilities, hence a negative income gap is seen for takaful companies.



(Q3) What are the top business risks in 2016 for the takaful industry?

Too many small takaful players have resulted in intense price competition and price wars

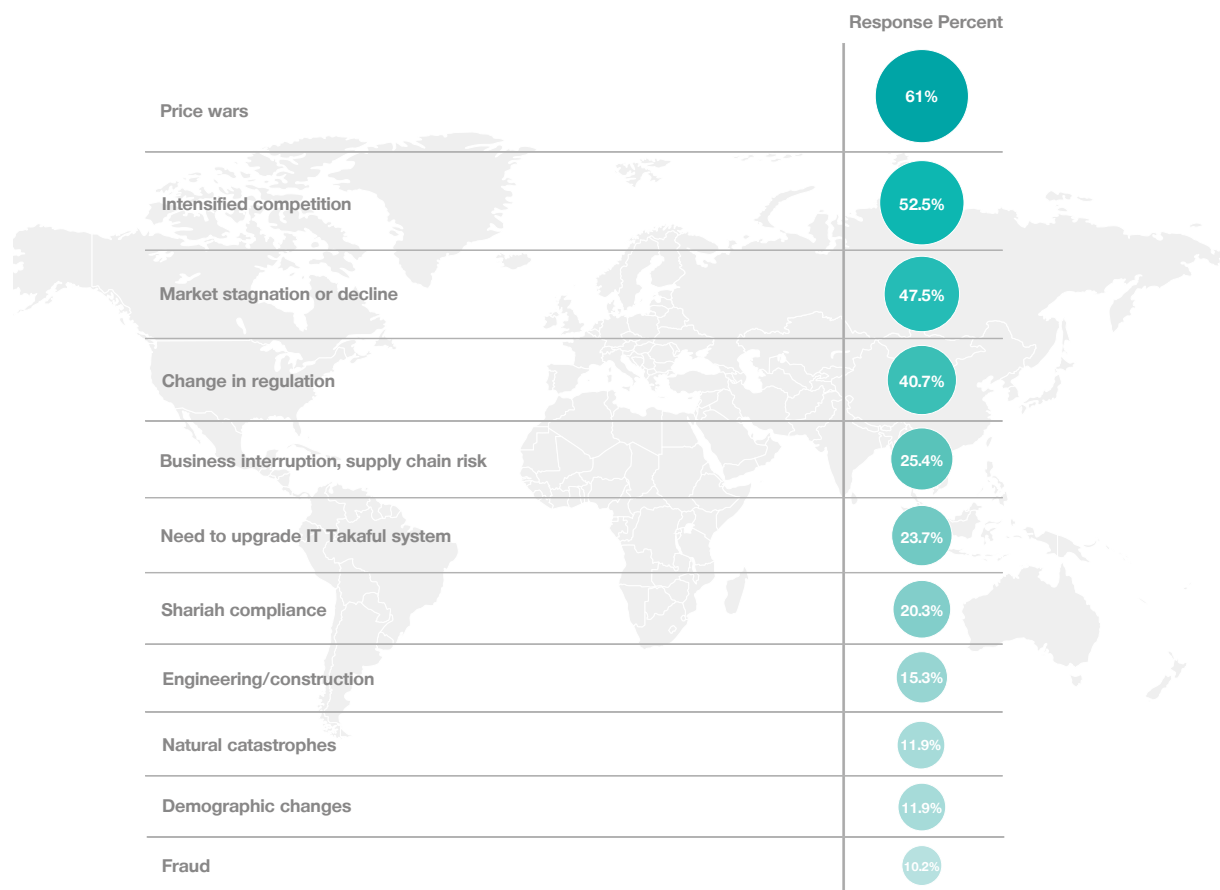
Price wars (61%) and Intensified Competition (52.5%)

The survey respondents viewed price wars (61%) and intensified competition (52.5%) to be major business risks in the year 2016. Presumably, since the potential scope of growth is higher for takaful firms and the industry has lower penetration levels, our attention is directed to the fact that competition should be the least of industry players' worries. However, this is one of the major business risks cited by survey respondents. Price wars constitute a major threat because the increase in the number of takaful players is not matched with the growth in its assets or contributions. The presence of too many small takaful players have resulted in intense price competition – these players are not only competing with each other over pricing strategies and costing models but also

face competition from conventional players who have an edge over takaful players, in part due to better cost models and in part due to their sheer scale and size.

47.5% Market stagnation

Since the financial crisis, global financial markets (including the insurance industry) have moved towards stronger regulation and regulators based in the Middle East have followed suit in upgrading and amending regulations to ensure a stable insurance sector. The changing regulatory landscape has been cited as a threat by the insurance companies based in the Middle East although as they have shared in other sections of the survey, respondents see a risk from too little and not fully implemented regulations that would support the industry's growth.



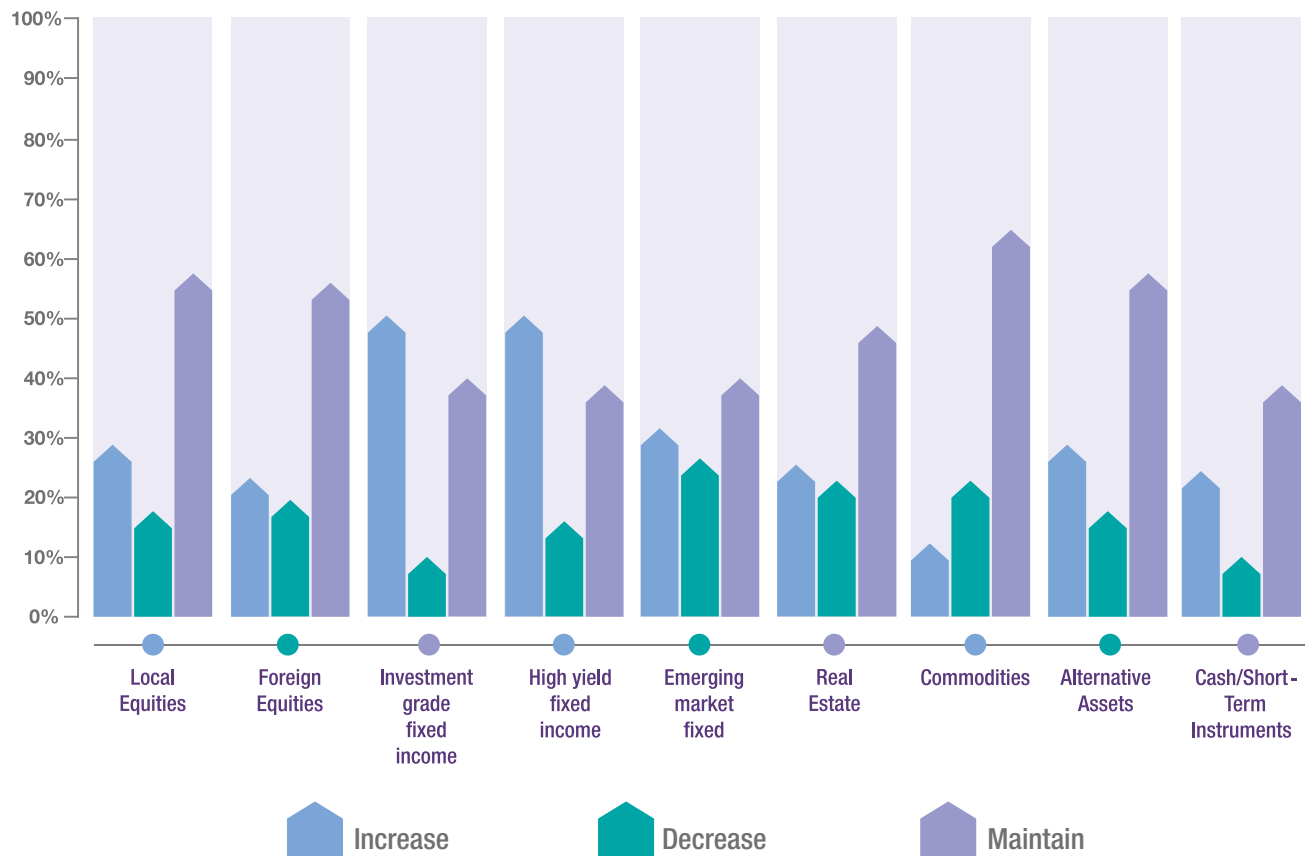
Financial Performance & Growth Strategies

(Q4) Are you planning to increase, decrease or maintain your allocation to the following asset classes in the next year?

Fixed Income markets are the preferred investment class for takaful operators

There is a consensus regarding the portfolio allocation. This by and large reflects a market sentiment that is skewed towards fixed income markets in general due to the erratic and volatile behaviour seen in the equity markets over the past 12 months. The majority of the survey respondents plan to continue investing in investment-grade fixed income and high yield fixed income, which includes US treasury bonds. As the regulatory framework for insurance and takaful operators are developed, the players in these markets will

search out for not just high yielding foreign fixed income products but also revert to local fixed income market. A unique challenge facing takaful, even compared to conventional insurers with similar asset allocation problems, is the dearth of Shariah compliant fixed income, and particularly a shortage of sovereign sukuk.



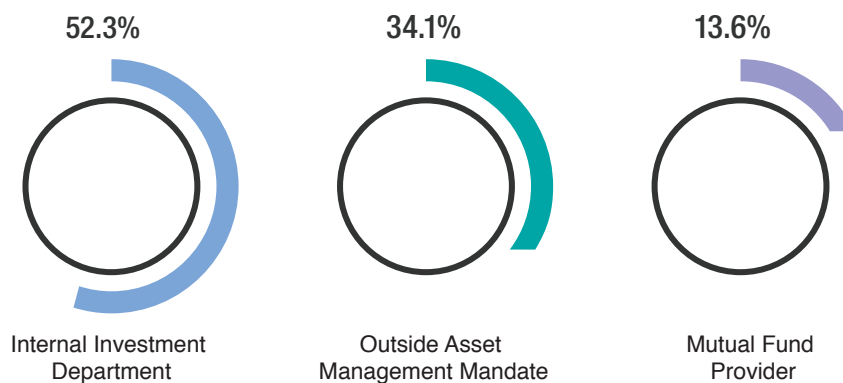
(Q5) What does your investment portfolio comprise of?

For most of the takaful operators, cash and fixed income were cited to be the optimal portfolio asset allocation class. This partly reflected the negativity and volatility ensuing in the short term due to commodities' price plunge and equity bubble and partly due to proxy wars engulfing different regions in the coming few years which is making the operators wary of any unforeseen events which can make various asset classes vulnerable to sharp declines in nominal values.



(Q6) With which party do you prefer to manage your investments?

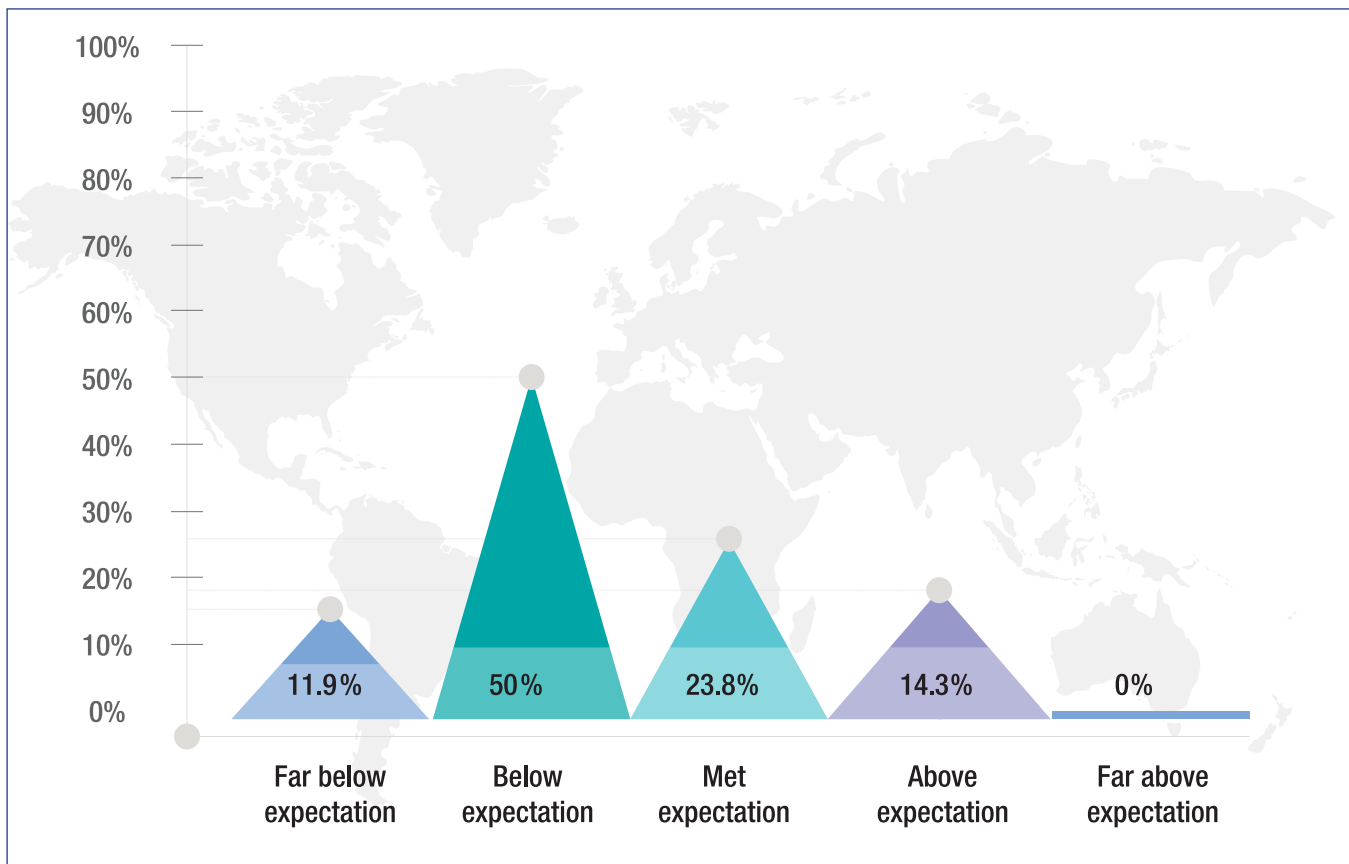
The majority of the takaful operators have in-house investment management departments, while 34.1% of the remaining, who are mandated to take the services of outside asset managers, actually have outsourced it to outside asset managers.



(Q7) How would you rate the financial performance of takaful industry in your jurisdiction over the past 5 years?

As mentioned in the beginning of this report, the takaful industry has not been able to accelerate at the same pace as other Islamic financial segments. The growth and financial performance of most takaful operators has been dismal. The problem lies in education and acceptance of the notion on which takaful is based in Muslim populated areas. Although the demographics at the face of it seems very promising to support the growth of the industry, in reality insurance/takaful is a luxury product which could only see growth if the people with higher income bracket could be targeted. Countries such as Pakistan, Indonesia and Egypt possess demographics

that can support this growth. In reality these countries face a plethora of problems which include: lack of education regarding the importance of insurance and the practicality/viability of Shariah compliant insurance, and the absence of Shariah compliant investment products, which can help takaful operators generate impressive returns on investments. These factors have hampered the growth of takaful industry. An industry which showed promising signs of growth when it took off in the past decade has instead failed to surpass expectations.

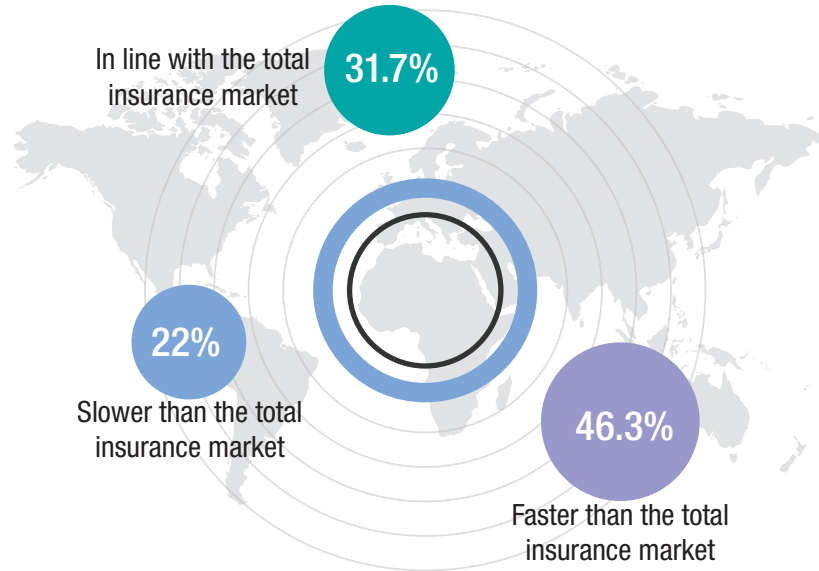


(Q8) What are the growth prospects of takaful in your jurisdiction?

Respondents optimistic regarding the growth outlook of the takaful industry

Despite not meeting the expectations of industry practitioners as cited by the survey respondents in the previous question, the general sentiment about the growth prospects of the takaful

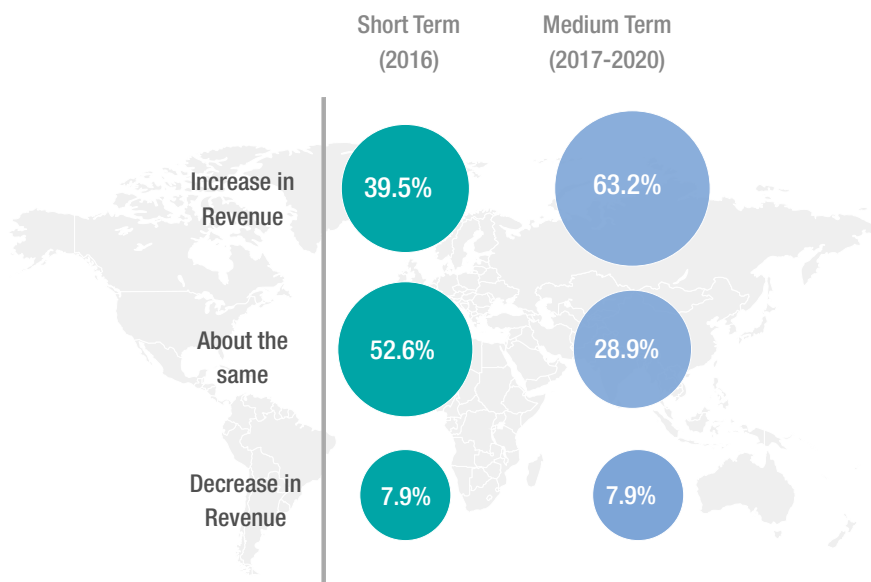
industry was positive. Over 46% of the respondents expected the takaful industry to grow faster than its conventional counterpart.



(Q9) What are your expectations regarding your takaful company's revenue in Personal Lines?

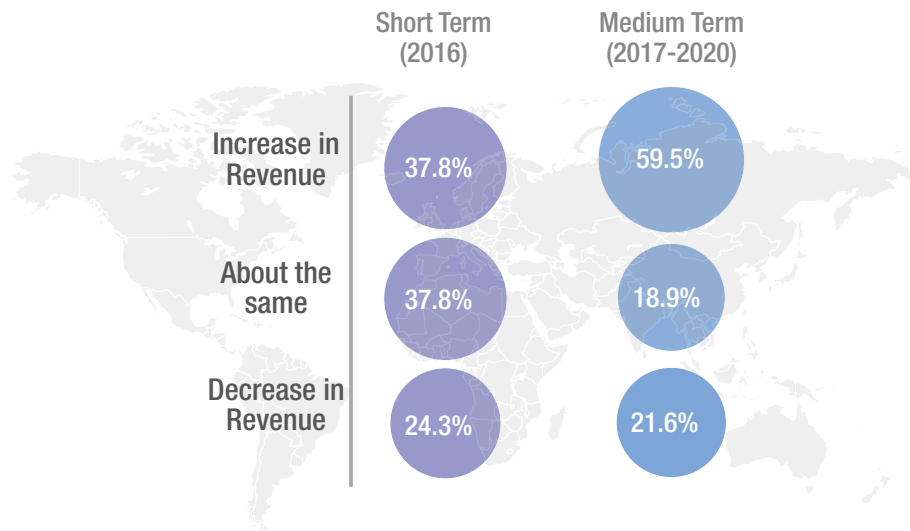
In the short term, 40% of the respondents expect takaful operators to see an increase in their revenues whereas the majority (53%) of the respondents believe that the takaful operators will be able to

maintain their revenue margins. In the medium term, respondents are more optimistic as 64% of the respondents expect to see an increase in their revenue margins.



(Q10) What are your expectations regarding your takaful company's revenue in Commercial Lines?

The short term outlook for the commercial lines in takaful is expected to be bleak as 24% of the survey respondents expect to see a decrease in revenue. However, the medium-term outlook is positive as 60% respondents believe that an increase in revenue in the commercial segment is on the cards for takaful operators.

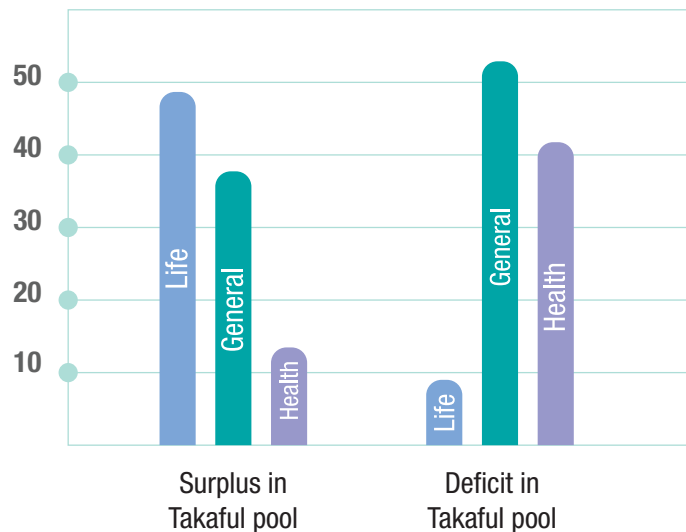


(Q11) What do you expect your underwriting surplus/deficit to be in year 2016 and for which line of business?

The health segment of takaful sector likely to weaken

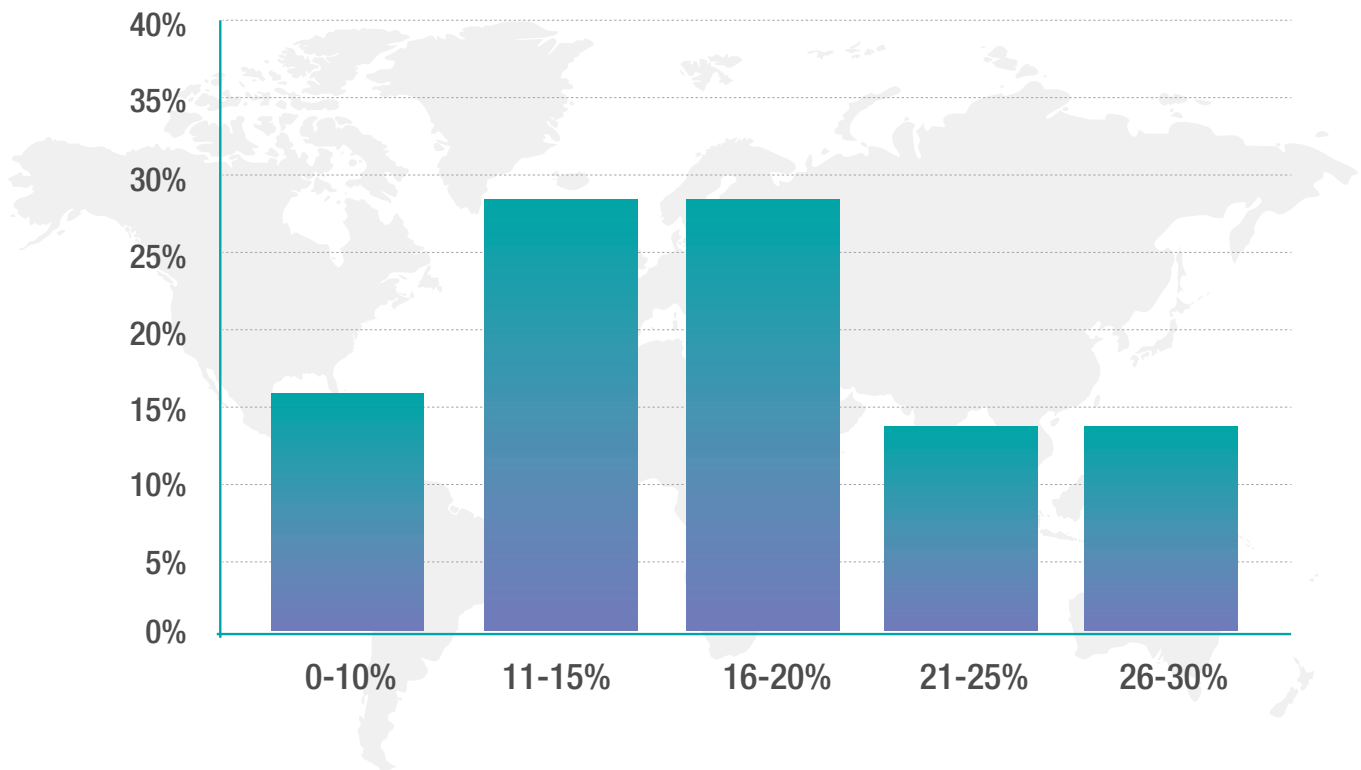
47% of respondents expect the life takaful segment to pace up which will result in surpluses in the year 2016; whereas 52% expect that a deficit will be seen across the general business. The majority of the respondents had a consensus regarding the health segment

of takaful operators, as only 14% of the respondents cited that surpluses are expected in that pool and a very large number of respondents (41%) believed that the health segment of takaful will result in deficit.



(Q12) What do you expect your company's average commission ratio to be in 2016?

The majority (58%) of the respondents were of the view that the expected average ratio will range between 11-20%

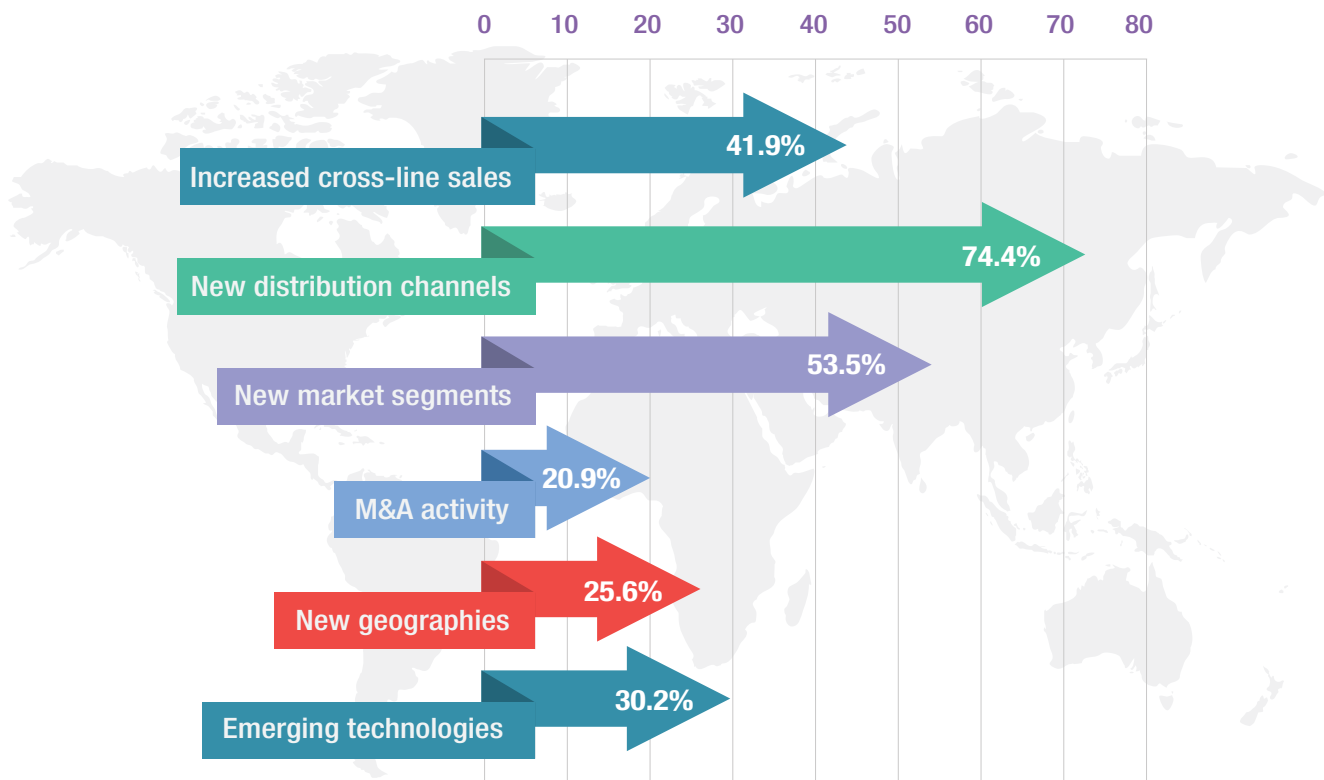


(Q13) Which of the following channels/segments will be the biggest drivers of your company’s revenue’s growth in the next 1-3 years?

New distribution channels key to increasing revenue for takaful operators

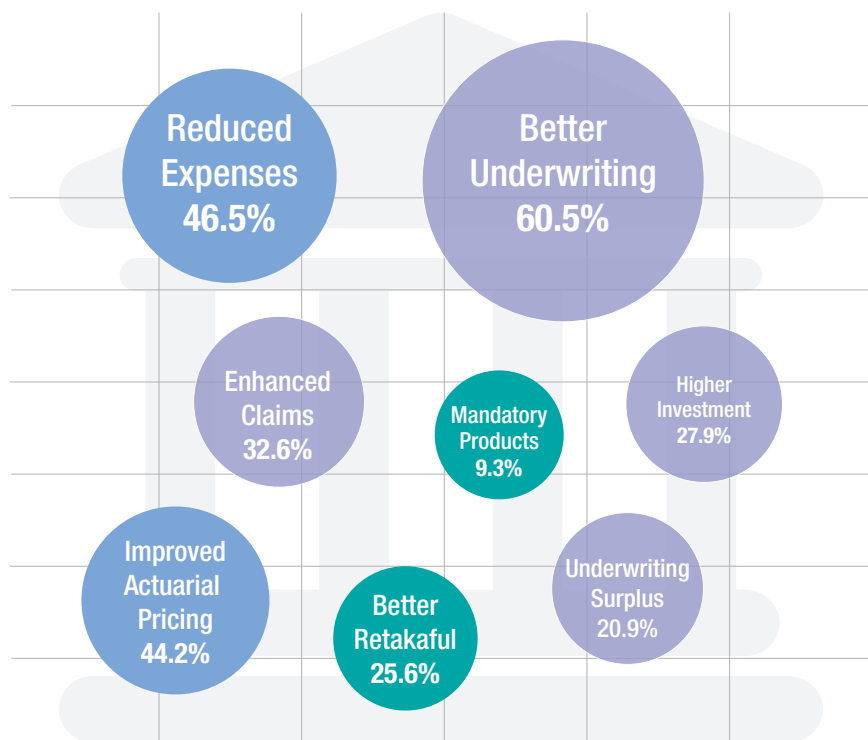
It is interesting to see how the traditional distribution strategies (such as increased cross-line sales or the strategy to enter newer market segments) are preferred in comparison to new distribution channels which includes, but is not limited to, platforms such as online channels. Takaful players are likely to make use of the efficiency of digital and online marketing and achieve their targets by reaching out to customers via such new distribution channels. 74% believe that new distribution channels will be the biggest

driver of revenue for takaful operators. Since penetration rates are very low in this region, there are opportunities if takaful operators build channels to reach out to Muslims seeking Shariah compliant insurance. Keeping costs aside, one strategy that could be effective in reaching consumers who are otherwise unserved or underserved is through digital technology via social media, or increasing effective communication through website and personalized emails.



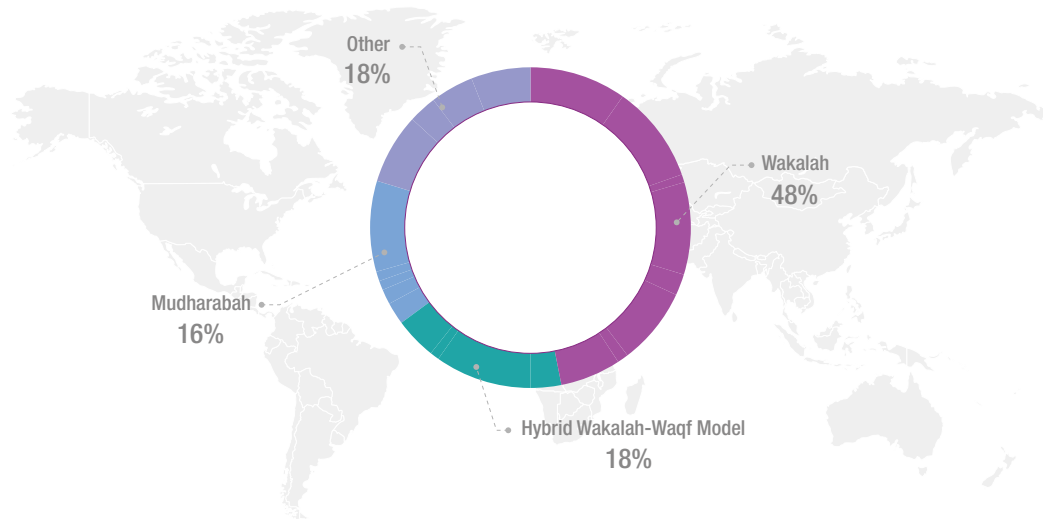
(Q14) Which of the following will be the three biggest drivers of your company's profit's growth in the next 1-3 years?

The focus of the takaful operators would be to increase the underwriting profits. Takaful operators would be looking out to adopt a business strategy which can retain and attract more customers, keep the costs low and also adopt a pricing strategy which is more precise and efficient. Implementing better pricing and risk management strategies would entail them to improve their 'actuarial pricing', which was cited to be the 3rd most important factor driving the profits.



(Q15) Which takaful model does your company use?

The majority of the respondents cited the 'Wakalah' business model to be the most widespread model implemented by takaful operators. [See page 12, 'Takaful Operating Models' for more details.]

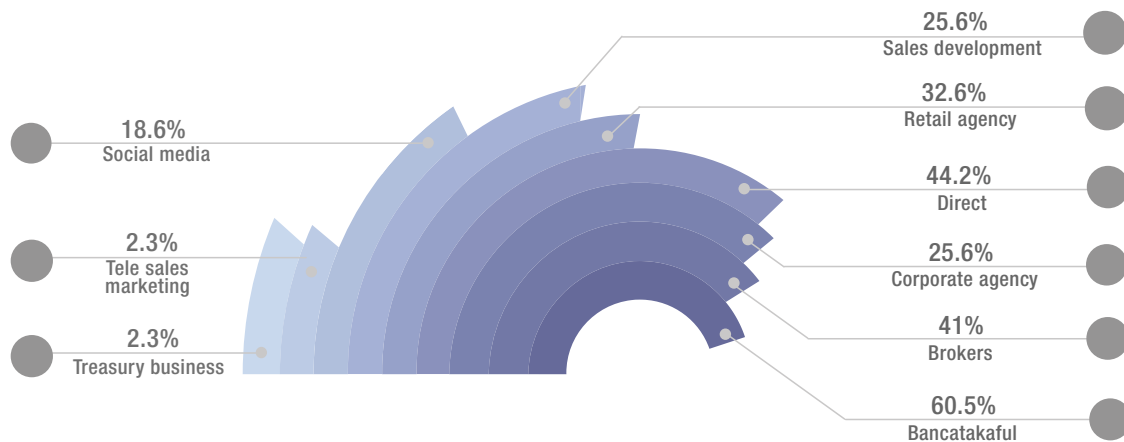


(Q16) Which of the following distribution channels will be the biggest drivers of your company's revenue's growth in the next 1-3 years?

Bancatakaful and Brokers – the distribution channels to increase revenues

Bancatakaful is expected to be the most optimal distribution channel in terms of achieving higher revenues. The target market is easier to reach out via banktakaful as people seeking Shariah compliant

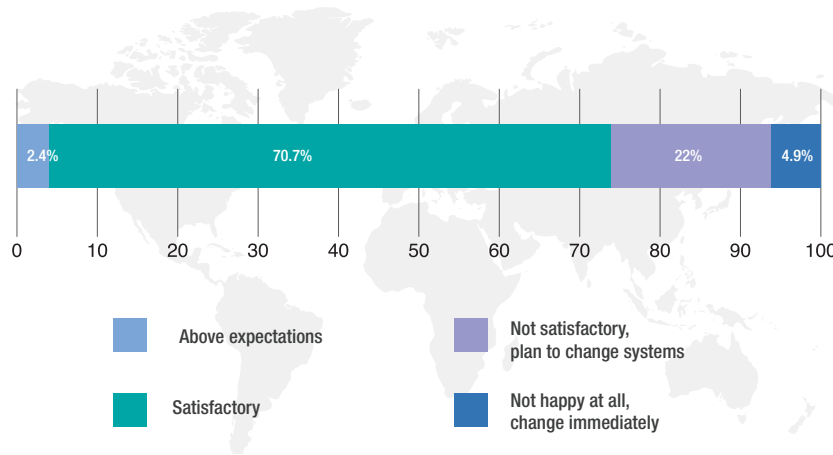
products are connected with the Islamic banks which are providing such bantakaful products. Next, brokers and direct channels are expected to be the biggest revenue drivers.



(Q17) How is the performance of your current IT Takaful System?

According to the survey respondents, the IT systems in place at the majority of the takaful operators are en par with the IT systems in that 70% of the respondents cited as having satisfactory performance in terms of IT management. However, 26% of the respondents

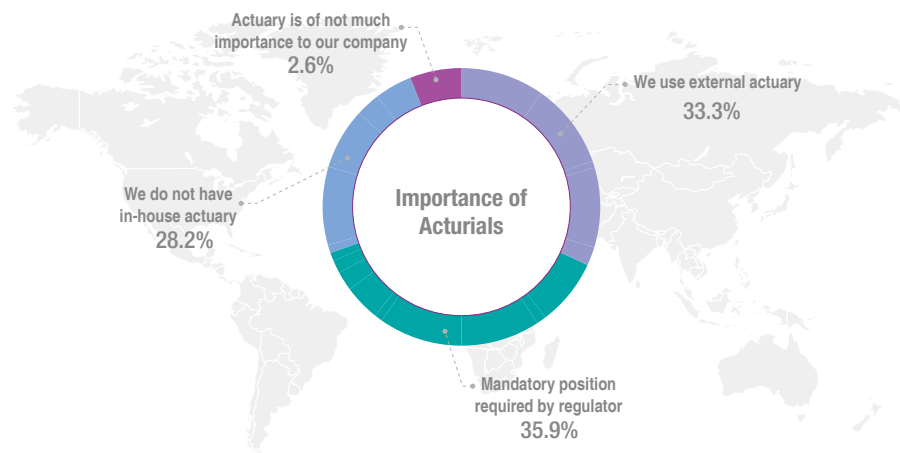
(22% citing not satisfactory performance, 5% planning to update IT systems immediately) showed eagerness to change their IT systems to streamline their processes and systems.



(Q18) In what capacity is an actuary used in your company?

As expected the role of actuaries in takaful companies was cited to be very important to the functioning of takaful firm as they are cardinal in assessing the risks that are associated to determine the anticipated number of claims and the amount consumers should pay for takaful coverage. More than 68% of the respondents were

using the services of an actuary either due to a mandatory rule by regulator or by using a service of an actuary externally. However, 30% of the respondents did not have any in house- capacity of actuaries.



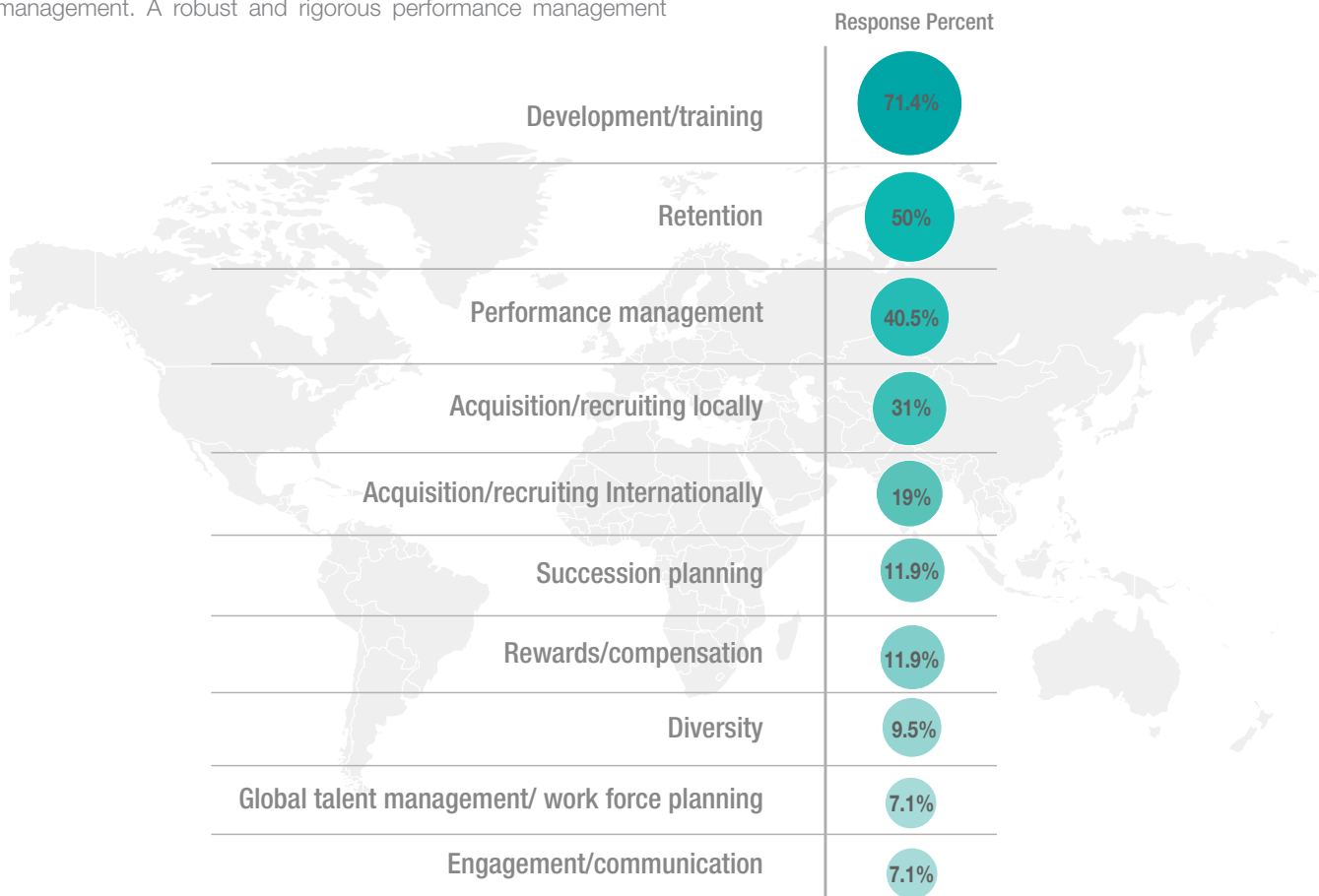
The Human Capital Challenge

(Q19). What are your company’s key areas of focus with respect to talent management in the next 12 to 24 months? (Multiple responses acceptable)

Development and training is top-of-mind in terms of talent management

Approximately 71% of the survey respondents cited development and training as the key area demanding attention in terms of talent management. The next area in line was ‘performance management’ with 50% of the respondents citing it to be the most important area for takaful industry operators. The 3rd area of focus that was cited was ‘retention’ which is closely linked with performance management. A robust and rigorous performance management

system is key to evaluating and reviewing a workforce’s productivity and herein lies the opportunity to identify the top performers and laggards affecting the performance of takaful operators.

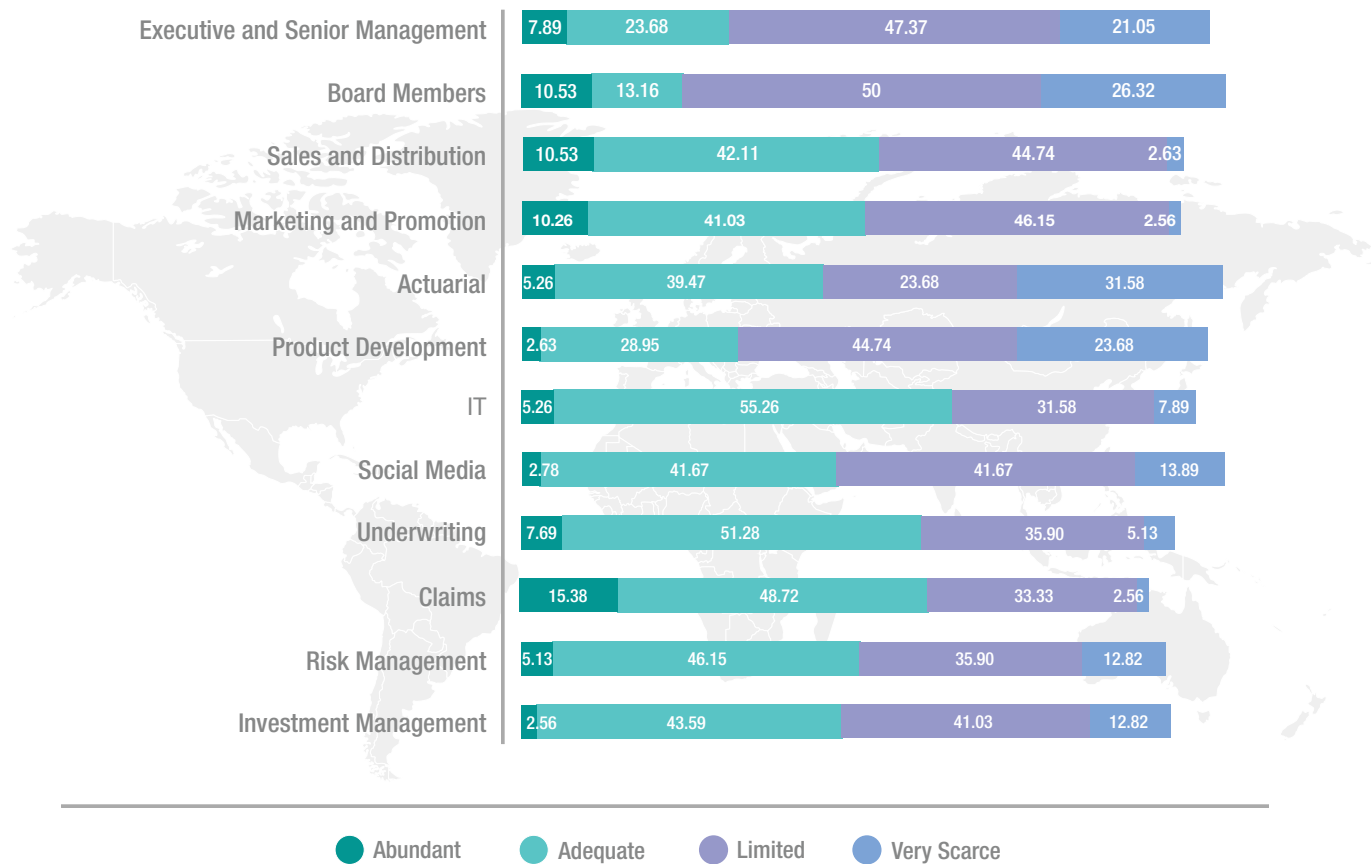


(Q20) How would you describe the availability of appropriately qualified takaful staff in the following functional areas in your jurisdiction?

Shortage of soft skills looming the growth of takaful industry

The response to this question directs our attention to the human capital challenge the takaful industry is facing currently. One clear factor that is highlighted in this response is that, although there is a slight shortage in certain technical areas within the industry, the main cause of concern remains on the managerial front. Concerns for qualified executives with good leadership and managerial skills were brought to light as 47% of the respondents cited that

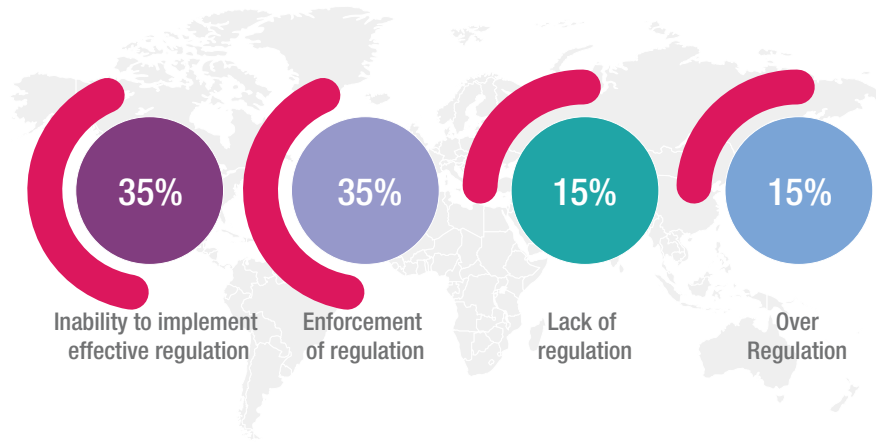
there is limited availability of competent executives and senior management. 50% cited that the number of board members is also very limited. This appears to be a big human capital challenge if the industry is to forge ahead. Refer to Takaful Snapshot [2] 'Closing the human capital gap in the takaful industry' on page 45 for more insights on this topic.



Regulatory Developments

(Q21) From a regulatory perspective, how would you rate the significance of the following issues in your jurisdiction?

The survey respondents did not deem the regulatory support or developments regarding takaful operations to be adequate. Inability to implement and enforce regulations in various different jurisdictions remains a major cause of concern for our survey respondents. Transparent practices and prudential regulations which are just about appropriate for takaful operators to follow and abide, should be in place so that irregularities are removed from the system.

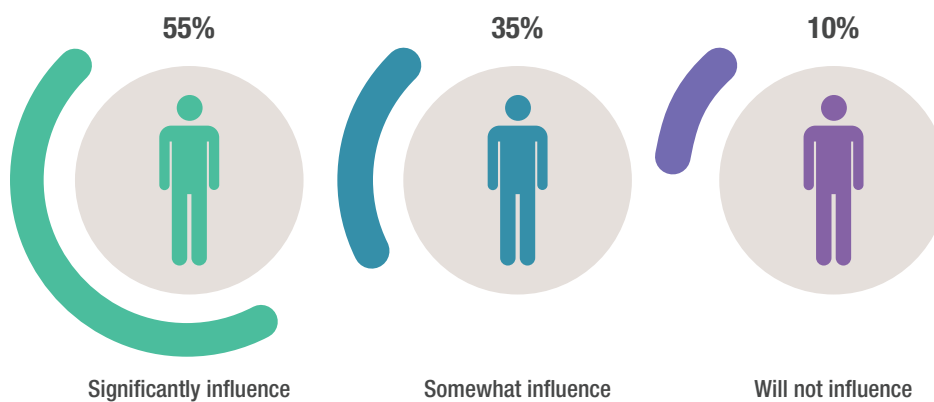


(Q22) To what extent will regulatory capital requirements influence your asset allocation decisions in the next 12 months?

Regulatory Capital requirements to significantly affect capital allocation decisions

55% of respondents cited that the regulatory capital requirements will significantly influence their asset allocation decisions. The regulatory requirements relating to liquidity in particular will affect the takaful operators as there is an acute shortage of Shariah compliant high-quality liquid assets (HQLA) in the Islamic capital

markets. Sovereign sukuk issuances provide a silver lining to the takaful players as well as Islamic banks specifically as authorities in the GCC and Malaysia will be looking out to infrastructural spending requirement via sukuk.





Annual Reporting by Takaful Companies



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Muktisjah is a Certified Pension Advisor, Bachelor in Pensions and Life Assurance. He studied Business Administration at the Erasmus University Rotterdam, The Netherlands, and is a Fellow at U.S. based Life Management Institute (FLMI) of the Life Office Management Association (LOMA). He has received basic actuarial and investment training. Additionally, he has written articles on Islamic finance and takaful and is regularly invited to be a speaker as well as a moderator at Islamic finance and takaful conferences and seminars.

Professionally he has worked for more than 15 years both in conventional insurance as well as in takaful practise in Europe (The Netherlands) and GCC (Saudi Arabia), lately as senior manager, Head Product Research and Development at the Takaful Division of Bank Aljazira and spin-off company Aljazira Takaful, being in charge in creating and developing innovative takaful products and solutions.

Currently, as co-founder and partner he holds the position as Director at Takaful Outsource Ltd.

Most jurisdictions require companies to prepare and disclose annual reports. An annual report is a comprehensive report on a company's activities throughout the preceding year. Annual reports are intended to give stakeholders information about the company's activities and financial performance.

Annual reporting gives a company the opportunity to communicate with its stakeholders, whether it be investors, employees, customers, suppliers or society at large. The quality of its annual report helps to shape a company's reputation. A strong annual report will provide good publicity.

Trends in annual (corporate) reporting

The financial reporting model, consisting of financial statements and accompanying notes that comply with generally accepted accounting principles (GAAP), is still the core of the corporate reporting model.

However, the 2008-2009 economic crisis was a sharp reminder that financial reporting alone cannot provide sufficient insight into business performance and resilience. Investors - and other stakeholders - are looking for a more holistic picture of how

organisations create value and of the external drivers that impact their business model now and in the medium to long term.

Integrated reporting

The last year's annual reporting is evolving and we see a move from the traditional financial report to a more integrated report containing financial and non-financial information. Integrated reporting is an emerging trend among listed companies.

According to the International Integrated Reporting Council's Framework, Integrated reporting (IR) in corporate communication is a "process that results in communication, most visibly a periodic "integrated report", about value creation over time. An integrated report is a concise communication about how an organization's strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term.

The integrated reports include also corporate responsibility disclosures; and information about how companies understand and manage their impact on people, clients, suppliers, society and the environment, in order to deliver increased value to all their stakeholders.

Integrated reporting helps boards of directors to see the issues they face more clearly, and enables them to explain their business rationale to stakeholders with greater clarity and authority.

“Integrated reporting helps boards of directors to see the issues they face more clearly, and enables them to explain their business rationale to stakeholders with greater clarity and authority.”

Going digital

Another trend in annual reporting is that the traditional annual reports have moved online. The reports are available online in a PDF format. This format is appreciated by both companies and users. Users prefer a PDF format as it can be downloaded (and therefore not then able to be manipulated or removed) and is searchable. For companies this format also has the advantage of being relatively cheap, quick and easy to produce. Almost all annual reports of listed companies are online available in PDF.

Furthermore, a big trend in online reporting is the use of video: stakeholders can get a view of the company through videos of the CEO in the field, embedded into a streamlined annual report that can be viewed on the website or offline in a dedicated app.

There are also companies who even post their annual report on Instagram. The use of these digital opportunities is allowing companies to show off much more than their profit margins or net debt to EBITDA.

Infographics

Another growing trend is the use of infographics. Companies are recognizing the power of data visualization. Stakeholders are inundated with information, and companies recognize that there must be a better way to present and digest information – infographics make complex business information more accessible.

Quick scan of annual (corporate) reporting by takaful companies

We conducted a high level quick scan on 41 Takaful companies in different jurisdictions. We looked at whether the companies have published an annual report online, which sections comprise the annual report and the extent to which trends in annual reporting as mentioned above are visible in the annual reporting of the Takaful companies.

The most important results of the quick scan are:

- » Only 50% of the Takaful companies have an annual report (year 2013, 2014 or 2015) online available (PDF format). From the other 50% Takaful companies no annual report is available;
- » Only 10% of the Takaful companies have an operational and financial review included in the report.
- » All the Takaful companies disclose a balance sheet, income statement, cash flow statement and notes to the financial statements;
- » The size of the annual reports varies from 18 to 190 pages;
- » 43% of the Takaful companies is using IFRS, 10% AAOIFI accounting standards and 47% a combination of local GAAP and IFRS.

Conclusion

We must conclude that, apart from the availability of the annual reports in PDF, the trends in annual reporting are not recognized in the annual reports of the Takaful companies. The annual reports are mainly focused on financial reporting and compliance with the regulatory requirements instead of telling the story of the company.

Also the online availability of the annual reports is disappointing: only half of the Takaful companies published an annual report on their corporate website. This is a missed opportunity, especially because publishing an annual report is a good opportunity to communicate with the stakeholders and to be accountable.

“The annual reports are mainly focused on financial reporting and compliance with the regulatory requirements instead of telling the story of the company.”

Human Capital

The Role and Importance of Actuaries in Takaful Companies



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 Director
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Dawud is a Co-founder and Director at Takaful Outsource, Ltd, a boutique professional consultancy registered in the U.K. and the Netherlands. With more than 30 years of professional actuarial experience, both in his native U.S.A. and Saudi Arabia, Dawud's expertise covers a wide spectrum of management and actuarial responsibilities in the field of pensions, life insurance, health insurance, and family (life) Takaful. He is an associate of the U.S. based Society of Actuaries and has been a member of the American Academy of Actuaries.

In assessing the role and importance of actuaries in Takaful companies it's apropos to begin by defining a basic platform for which all company staff, not only actuaries, must subscribe. At the heart of the matter of this basic platform is understanding and appreciating the continual "balancing act" of fairness that exists between maintaining the rights of shareholder value in the company (with full disclosure intendment for policyholders), and maintaining the rights of policyholder value in the company.

The ethical imperative of this platform is thus acknowledging that striving to look after this balancing act of fairness is not something that is simply articulated and stored away in a given company's mission statement, but rather a living injunction that is cultivated by all concerned in the day-to-day activities throughout the company.

Without this understanding in place one may ask, and rightly so, what's the real difference between conventional insurance and Takaful; or more appropriately for the purposes of this article, what's the difference between the responsibilities of an actuary working for a conventional insurance company, and those of an actuary working for a Takaful company?

Let me begin the discussion of the Takaful actuary's ethical imperative with the fictional story of a 1991 Hollywood film entitled, *Class Action*, starring Gene Hackman and Mary Elizabeth

Mastrantonio. The story is about a lawsuit concerning injuries caused by a defective automobile. The auto manufacturer in the film uses a so-called "bean-counting" approach to risk management, whereby the projections by actuaries (who work in the conventional insurance industry) for probable deaths and injured car-owners is weighed against the cost of re-tooling and re-manufacturing the car without the defect (exploding gas tanks) with the resulting decision to keep the car as-is to positively benefit short term profitability. This outrageous decision to keep the car as-is represents the antithesis to the ethical imperative for the Takaful actuary – one lost life or even one injured person is enough to put aside the purely technical financially preferable profit-centric results of any actuarial projections!

The role of the Takaful company actuary, whether a company employee or an external consultant, dictates that he or she must first be committed to the best practices organizational framework of the company. These practices include:

- 1) Normal corporate governance requirements also found in the conventional insurance company space, i.e., Board of Directors, CEO/Key Persons (Fit & Proper Minimum Requirements) Auditors, Appointed Actuary, etc.
- 2) Fiduciary Duties - Financial Reporting (Key performance

indicators, published annual statements -please refer to section entitled “Annual Reporting by Takaful Companies”), Management Expense Monitoring, Transparency and Full Disclosures, Auditor’s Report, and Funds’ Segregation. This last item, Funds’ Segregation, is of paramount importance in the Takaful company space, especially for conventional insurance companies that offer Takaful products via a Takaful “window” to ensure that there is no leakage between Shari’ah compliant and non-Shari’ah compliant transactions.

3) Shari’ah Governance – Shari’ah Board or Shari’ah Advisory Council with Fit & Proper Minimum Competency Requirements, Duties and Responsibilities of Members, Members Code of Conduct, Internal Shari’ah Compliance Unit, Independent Access and Sign-off Members, and Shari’ah Opinion in Annual Reports.

Within the requisite governance framework, the actuarial community of professionals, like many other professionals belonging to professional bodies, has its ethical guidelines for a separate code of conduct and standards of practice wherein legal is intended to be based on what is generally assumed to be ethical and illegal is intended to be based on what is generally assumed to be unethical.

Yet, so much “grey area” exists within the conventional insurance space with regard to these items and clear examples can be found wherein actuaries were “asleep at the wheel” in the U.S. during the 1980’s where corporate raiders bought companies and immediately withdrew substantial sums of cash from pension plans of those companies. An estimated US\$21 billion, originally set aside for employee pensions, went into the pockets of the corporate raiders – all of which was legal. Financial security programs involve risk and even more so for the actuary working in the Takaful space, he/she must have the financial security of the marketing public as a high priority concern. It is the Takaful actuary’s special concern where there are risks that could impair that financial security.

The list of direct actuarial responsibilities and technical skill sets is barely distinguishable between the conventional insurance actuary and the Takaful company actuary. They include (although are not exhaustive): product design, pricing, investment strategy, reserving, experience studies, profitability measurement, financial monitoring, actuarial valuation, dynamic financial analysis, risk management strategies, merger and acquisitions assessment, and stochastic modeling.

Table One: Skewed Toward Shareholders’ Interests

Year	Age	Sum Covered	Gross Contribution	Cumulative Contribution	Policyholder Outgo				Investment Fund	Sales Commission	Mgt Expenses	Claim Cost	Net Income
					Total Wakala Fees	Risk Contribution	Reserves	Total Policyholder Outgo					
1	40	50,000	1,200	1,200	420	50.63	50.63	483.29	758.91	120.00	60.00	37.97	213.59
2	41	50,000	1,200	2,400	420	55.69	55.69	489.61	1,555.80	120.00	60.00	41.77	221.92
3	42	50,000	1,200	3,600	420	61.26	61.26	496.58	2,392.23	120.00	60.00	45.95	230.48
4	43	50,000	1,200	4,800	420	67.33	67.33	504.16	3,269.88	120.00	60.00	50.50	239.30
5	44	50,000	1,200	6,000	420	74.42	74.42	513.03	4,189.81	120.00	60.00	55.82	247.98
6	45	50,000	1,200	7,200	420	82.52	82.52	523.15	5,153.19	120.00	60.00	61.89	256.58
7	46	50,000	1,200	8,400	420	91.63	91.63	534.54	6,161.22	120.00	60.00	68.72	265.11
8	47	50,000	1,200	9,600	420	102.27	102.27	547.84	7,214.52	120.00	60.00	76.70	273.17
9	48	50,000	1,200	10,800	420	113.40	113.40	561.75	8,315.10	120.00	60.00	85.05	281.58
10	49	50,000	1,200	12,000	420	126.57	126.57	578.21	9,463.05	120.00	60.00	94.93	289.18
Totals		12,000			4,200	826	206	5,232		1,200	600	619	
Yr 10 Investment Fund % of Cumulative Contribution									78.9%	Profit Margin (8% Discounted Cash Flows)			20.5%
Total Policyholder Outgo as % of Total Contributions									44%				

However, what is clearly distinguishable between the work of the conventional insurance actuary and the Takaful company actuary is the fundamental starting point from which he/she operates. In terms of this fundamental starting point, some would say that generally conventional insurance companies are organized based on a pure profit motive and that policyholders are simply a necessary ingredient in the recipe toward achieving that goal – the work of conventional insurance company actuaries therefore follows this directive, generally speaking.

On the other hand, many opine that Takaful companies should be organized as a service for policyholders to avail financial security programs in a Shari’ah compliant manner and that shareholders simply “come along for the ride” in order to professionally administer such programs for which they are then entitled to a ‘reasonable’ return on their capital as well as service fees (e.g. Wakalah fees) to cover the administrative expenses. In practice, the mandated fundamental starting point for which the Takaful company actuary applies his craft, lies somewhere between these two aforementioned polar opposites.

Let’s now turn to an example to illustrate what this looks like with using an example of the pricing for a hypothetical family (life) Takaful investment-linked product.

I’ve modeled a 10-year “flexible” contribution investment-linked product issued to a 40 year-old male who has chosen a sum

covered (death benefit only) for USD 50,000 and chooses {flexible} to contribute USD 1,000 each year. The pertinent assumptions were chosen to simplify the resulting “management type” illustrations, for the sake of brevity. Several assumptions such as the Wakala fee were considered to be consolidated as one, where in reality Wakala fees may be classified as three separate fees (one as a percentage of gross contribution, one as a flat fee per contract, and one as a percentage of the risk contribution). Likewise, expenses for example could be segregated as acquisition costs versus renewal costs, etc.

Using the Wakala Fee assumption as the control variable and keeping all other assumptions fixed in the exercise, the Table entitled “Skewed Toward Shareholders’ Interests” demonstrates that a 35% Wakala Fee is needed to meet the ‘risk appetite’ requirements of the shareholders, i.e. a minimum of 20% lifetime profit margin [defined as the ratio of the actuarial present value of net income to the actuarial present value of gross contributions, both with a discounted cash flow rate of 8%]. With this 35% Wakala Fee the lifetime profit margin is 20.5% [grey shaded cell], but the trade-off borne by the policyholder is that the expected fund accumulation is only 78.9% of total gross contributions [grey shaded cell], i.e. the policyholder never “breaks even” [terminal fund value never exceeds contributions]. Also, the total policyholder outgo, as a percent of the gross contributions, is 44%.

Table Two: Skewed Toward Policyholders’ Interests

Year	Age	Sum Covered	Gross Contribution	Cumulative Contribution	Policyholder Outgo				Investment Fund	Sales Commission	Mgt Expenses	Claim Cost	Net Income
					Total Wakala Fees	Risk Contribution	Reserves	Total Policyholder Outgo					
1	40	50,000	1,200	1,200	228	50.63	12.66	291.29	962.21	120.00	60.00	37.97	24.68
2	41	50,000	1,200	2,400	228	55.69	13.92	297.61	1,974.38	120.00	60.00	41.77	36.30
3	42	50,000	1,200	3,600	228	61.26	15.32	304.58	3,038.76	120.00	60.00	45.95	48.33
4	43	50,000	1,200	4,800	228	67.33	16.83	312.16	4,157.78	120.00	60.00	50.50	60.82
5	44	50,000	1,200	6,000	228	74.42	18.61	321.03	5,333.28	120.00	60.00	55.82	73.40
6	45	50,000	1,200	7,200	228	82.52	20.63	331.15	6,567.29	120.00	60.00	61.89	86.12
7	46	50,000	1,200	8,400	228	91.63	22.91	342.54	7,861.88	120.00	60.00	68.72	99.00
8	47	50,000	1,200	9,600	228	102.27	25.57	355.84	9,218.61	120.00	60.00	76.70	111.68
9	48	50,000	1,200	10,800	228	113.40	28.35	369.75	10,640.48	120.00	60.00	85.05	124.99
10	49	50,000	1,200	12,000	228	126.57	31.64	386.21	12,128.64	120.00	60.00	94.93	137.77
Totals			12,000		2,280	826	206	3,312		1,200	600	619	
Yr 10 Investment Fund % of Cumulative Contribution									101.1%	Profit Margin (8% Discounted Cash Flows)			6.0%
Total Policyholder Outgo as % of Total Contributions									28%				

Takaful Snapshot [2]

Closing the human capital gap in the takaful industry

A shortage of human capital is felt across the takaful industry and is more acute than in the rest of the Islamic financial services industry. The dearth of human capital and the challenges the takaful industry faces due to this acute shortage were highlighted in a survey conducted as part of the Finance Forward World Takaful Outlook Report 2016.

When we asked about the availability of appropriately qualified takaful staff in various functions in the survey respondent's jurisdiction, the biggest gaps were seen on the managerial side rather towards the technical front. There is a shortage of qualified executives with good leadership and managerial skills, and 47% of the respondents cited this role as having limited availability of competent executives and senior management. Moreover, 50% cited a shortage in the number of board members which, combined with shortages at the executive level, raises questions about the strategic vision guiding many operators which is set at the board level.

Fixing and filling this gap could help the industry take a major leap as competent leaders and managers would not only help takaful companies survive locally but also help them to navigate into the global insurance landscape.

Further hindering growth at the level of human capital is the absence of qualified staff in the 'product development area' as approximately 45% cited such staff to be limited. With limited qualified marketers who can promote or create awareness of takaful products, the takaful industry will be held back further. Only 40% cited 'marketing

and promotion' to be adequate, whereas more than 45% respondents deemed the availability of skilled staff in this area to be limited. Practitioners taking new product initiatives and infusing innovations can support the industry which otherwise has been lacking greatly.

Although, takaful industry still lags behind the conventional insurers in terms of the presence of technically sound staff, the respondents showed considerable confidence in the industry's human capital compass on the technical front. With the exception of actuaries (Only 29% respondents cite them to be adequate and over 50% cite them to be either limited or very scarce), the rest of the technical staff was deemed to be adequately available.

Although respondents showed confidence for staff in the areas falling under claims, underwriting and risk management, without the senior management and board level expertise needed to set the long-term vision for each takaful operator, they will have trouble competing with their conventional competitors

This analysis is based on the response by our survey respondent on the availability of appropriately qualified takaful staff in various functional areas in different jurisdictions. (See pg 37 for more details)

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Crowd Takaful

The New Fintech Initiative



Muktisjah Ramli
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Muktisjah is a Certified Pension Advisor, Bachelor in Pensions and Life Assurance. He studied Business Administration at the Erasmus University Rotterdam, The Netherlands, and is a Fellow at U.S. based Life Management Institute (FLMI) of the Life Office Management Association (LOMA). He has received basic actuarial and investment training. Additionally, he has written articles on Islamic finance and takaful and is regularly invited to be a speaker as well as a moderator at Islamic finance and takaful conferences and seminars.

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Currently, as co-founder and partner he holds the position as Director at Takaful Outsource Ltd.

The recent emergence of so called fintechs in the banking sector is just a first wave of exciting new type of players and entrants in the financial services industry, which was previously dominated by banks who acted as the intermediary of capital between deposit holders and those in need of financing. These fintechs heavily use technology as the enabler for financial services in the field of payments, investments, financing, advisory, infrastructure, security, but also insurance. Alone in 2014, Fintech investment worldwide has increased threefold from USD 4.05 billion to USD 12.2 billion, with Fintech centers clustered around Silicon Valley, New York and London. However in regions, such as the GCC, and South East Asia where takaful is growing in prominence, fintech companies and investments need to catch up.

Nevertheless the fintechs have also started to emerge in the Islamic financial services industry in the field of investments, where Sharia compliant crowd funding platforms have opened their business in various regions. This type of crowd funding platforms invites public investors to subscribe directly online and choose the project they

like to invest in, the crowd funding platform then makes use of Sharia compliant contracts for investing in the various (start-up or growing) businesses. This is indeed a welcome initiative for SME's who are often neglected by the larger corporate and investment banks for financing, because of their small size or they lack having a long track record in running their business.

Interestingly a similar trend is emerging in the conventional insurance industry where a few years ago peer-to-peer insurance is being provided through a fintech company Friendsassurance, which has attracted investments from a Hong-Kong based billionaire and venture capital fund. The same trend may also be followed by the takaful industry where a hybrid version of crowd funding and takaful protection, the so-called Crowd Takaful concept could provide a relatively low-cost solution for communities and persons, who in turn can rely on a technology platform, and not necessarily a full-sized takaful company or even retakaful company, to have themselves or their assets insured.

How does Crowd Takaful work? An example.

As in crowd funding, in crowd takaful, a participant for example has an asset to be insured at the value of USD 100,000, instead of going to a takaful company, the participant could go to a crowd takaful platform, where he proposes the type of risk (fire, theft) and the asset to be insured at the sum covered of USD 100,000 to the general public in the platform. The crowd takaful platform then does the underwriting and filtering of the insured object and offers the public to subscribe or invest in the takaful pool until the requested USD 100,000 has fully been subscribed. The actuarial calculation of the premium or contribution to be paid by the participant then takes place, using the same methodology as if a risk needs to be insured against USD 100,000 in regular takaful model. The contributions are then payable over the term of the policy for, say, a 10 year period. In case of claim during the 10-year period, the USD 100,000 is to be paid from the single dedicated takaful fund to the participant and in case of no claim the USD 100,000 is to be returned to the investors/subscribers plus the annual premiums paid as annual surplus distribution, minus wakalah fees payable to the crowd takaful platform.

The above mentioned crowd takaful would fit for both SME's / corporates, but fits also retail clients as well. Suppose the same participant, wants to have a family takaful coverage instead, he will then submit his proposal with personal profile to the crowd takaful platform, where he requests a sum cover of USD 500,000 to be paid in case of death (any cause), the platform then opens for subscription by the public to an amount of USD 500,000. Once the single dedicated takaful fund has been fully subscribed for this participant, he will then start to pay premiums for example a 30 year period.

The policy issued can be done on protection-only basis, or the takaful fund and contributions payable can also be invested in unit-linked mutual fund(s). In case the participant dies during the 30 year period, the USD 500,000 is payable out of the single dedicated takaful fund and after 30 years the USD500,000 could be increased to higher amounts. The investment profits is then to be shared between the subscribers and the client (participant). After the 30-year period if the participant survives, the surplus is then to be paid to the subscribers as investor.

The Crowd Takaful platform would be able to earn income from two sources:

1. Wakalah fees from the contribution payable by the participant
2. Share of the investment returns for the long term unit-linked policies

Any underwriting profit would thus go to the investors/subscribers.

Type of takaful contract in Crowd Takaful

The crowd takaful platform as a fintech company operates as the agent for the participant and thus receives income through wakalah fees collected.

The main advantages of using crowd takaful platform are as follows:

3. Low cost platform: No full-sized takaful company is required to be set up for certain risks and lines of business. The Crowd Takaful Platform would be able to charge lower wakalah fees, with less management expenses, less physical office space needed and higher anticipated volume of business.
4. Access to larger public as subscribers/investors to be reached on national and, depending on regulations, also regional and global level.
5. Client or participant can place his/her request for coverage at any time, any place in the world through the platform and, depending on regulations, would not be restricted to jurisdiction where takaful companies are active. This would open doors for new markets for takaful coverage.
6. Fully automated underwriting through platform and individual risk appetite of subscribers who have full control to invest / subscribe to certain risk or not.
7. Crowd takaful platform is 100% solvent as only the invested or subscribed amount to be used as coverage. Retakaful may not be needed.

Although the crowd takaful platform is a very interesting initiative to explore further, it is unknown yet under which regulations the crowd takaful platform will fall - either under investment or insurance / takaful regulations. It is also unknown if national regulators would allow regional or global operation of the platform.

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