

The global Takaful insurance market Charting the road to mass markets



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Foreword



The Deloitte ME IFKC practice insights series is a series of knowledge-sharing reports published by the Deloitte Middle East Islamic Finance Knowledge Center. These point of view reports address practice and policy challenges in the Islamic finance industry in areas of risk and regulatory compliance, governance, products and market strategies, human capital and leadership development. As part of our Islamic finance advisory group, we are able to draw on our audit, tax, consulting, risk management services and financial advisory expertise, as well as the Islamic finance knowledge and experience of our regional consultants in 26 offices in the MENA region. Our research approach combines our deep knowledge in Islamic finance, business and regulatory strategy with the competencies of professional advisory services. This series aims to promote knowledge-sharing behavior and seeks to help inform market participants worldwide.

The sustainable growth of Islamic finance in many parts of the world and in particular MENA and SEA will stimulate additional growth in the Takaful sector as finance and insurance services are intertwined. The heightened focus on governance, fiduciary responsibility, risk management and accountability are direct consequences of the global financial crisis and will likely present Takaful with challenging practice and regulatory issues during the next five years. It is my hope that the issues and trends in this report will intensify industry discussions and dialogue, provide direction and help identify potential business strategies to help address and deal with these compelling challenges.

This report looks at the emerging regulatory and practice challenges that will impact the Takaful industry. It seeks to assess the business structures and strategies, market development and growth trends globally.

Throughout the report we explore key emerging practical and strategy issues pertinent to the industry and suggest the ways in which Takaful operators can adapt and respond to these challenges for the coming new phase of growth.

Preparing for assessment is an important exercise for Takaful executives and leadership, and one which will provide them with insights and analysis on areas of strength, and areas that may be improved. This thought leadership report provides a case study of the industry in Bahrain and highlights growth trends and challenges to sustain growth.

The methodology of developing this report is based on original research whose aim is to analyze key markets in MENA and SEA. The report combines the insights and first-hand experience of Deloitte's leading practitioners and prominent industry executives from the Takaful sector. Interviews were carried out with a number of thought leaders from academic and research institutions, law firms, regulatory authorities and industry self-regulatory organizations. I am most grateful to all who participated in the formal and private discussions and dialogue.

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Executive summary

Achieving growth in the Takaful insurance sector and breaking through into the mainstream might be easier said than done. This is especially true because the Takaful industry faces enormous challenges to achieve growth and build mass coverage globally. Yet, the growing industry has a number of opportunities to set the stage for both short- and long-term growth and achieve Takaful inclusion.

The prominence of concerns about market conduct around the world, and the emphasis placed on consumer needs and protection are increasingly driving us toward greater financial regulation, possibly as a means to restore confidence and the ‘trust’ buzzword among consumers. Martin Wheatley, CEO of the newly set up Financial Conduct Authority (FCA), which replaced the FSA, asserts that “the FCA is there to make

sure that consumers get well treated in financial markets, and that conduct of firms that provide products and services is beyond reproach.”

The discussion with industry practitioners yielded useful insights on practices and policy issues. Our analysis and assessment led to forming the debate on the future of the industry in ten key challenges worthy of attention from industry policy-makers and practitioners. We group these ten challenges into five industry disciplines. These interdependent challenges should be addressed by industry stakeholders to embrace leading practices and improve market conduct in the Takaful sector. Not every challenge applies to every Takaful firm and there are other challenges not explored herein. To adapt to these challenges, the industry executives and policy-makers need to address the following:

The ten challenges classified by industry disciplines



Adapting to industry challenges

1. Governance and regulatory compliance

How can Takaful operators improve their governance practices and capital and liquidity base?

Strengthening the regulatory frameworks of the Takaful industry requires focused effort and the support of all industry stakeholders. National regulators as well as industry standard-setting bodies (SSBs) need to work together to take bold actions and initiatives to improve Takaful practices and policy-making processes.

1. There is a need for more consistent regulatory frameworks amongst key markets and regulators.
2. Optimizing capital adequacy through consolidation will achieve growth and sound corporate structures.

Key messages:

- Market conduct regulation - around the world - is becoming increasingly intrusive and judgment-based, with regulators demonstrating readiness to intervene at all stages of the business cycle. This seems less of a regulatory concern in the Takaful industry, and operators are left without adequate scrutiny in product governance and offerings. This is particularly true in the case of complex investment-linked products.

- A number of national regulators across MENA and SEA are taking bold actions and collaborative initiatives with other government authorities to enhance regulatory and practice related issues in the Takaful business. Several European and Western countries are also implementing sound regulatory changes to protect consumers and provide a level playing field for Islamic financial services in general.
- Takaful operators are being challenged by greater transparency and oversight from different regulatory and self-regulatory organizations, which require increased reporting and self-disclosure exercises that will necessitate greater investment in technology and information management.
- Further complications exist because of the inconsistent Takaful regulations around the world. Takaful operators are often faced with the burden of tailoring their product features, distribution approach, statutory reporting and disclosures, and in some parts around the world, such as the GCC, hiring and employment regulations, to take into account the particular national regulatory requirements of markets in which they wish to operate. This is likely to persist for some time unless a drastic regulatory harmonization is reached.

Takaful operators are being challenged by greater transparency and oversight from different regulatory and self-regulatory organizations

2. Risk management and internal controls

How can Takaful operators establish effective risk controls and a sound corporate culture?

With a confluence of regulatory changes likely to impact the international expansion of Takaful business, executive management and boards are advised to strategize risk management functions and governance. Sharia'a compliance risk should be embedded in all phases of operations and management. This effectively

means that Takaful insurers will be better equipped for a business cycle that develops new, innovative products and services, penetrates new markets, competes with conventional counterparts, and be better prepared for adverse market turbulence and shocks.

1. Making risk-based business a priority, unified with Takaful operators' strategic planning.
2. Improve risk and Sharia'a disclosures and governance.

Key messages:

- Takaful firms are likely to face unprecedented regulatory pressures on their risk management and internal control processes to ensure that the Takaful business model and product strategies deliver value to all stakeholders' interests.
- Among the top regulatory issues facing insurance and Takaful firms is preparing for a full implementation of the Risk and Own Risk and Solvency Assessment (RM-ORSA). The key challenge to complying with this new act may involve changes or modification of Takaful companies' business models, risk management systems, information systems, human resources, and Sharia'a advisors.
- This in turn may also add impetus to industry practitioners to coordinate efforts on practice synergies and collaboration to adopt leading practices through awareness programs and industry discussions.

3. Operational and business excellence

How can Takaful operators achieve operational efficiency to reach mass markets?

The insurance industry in general is fast becoming a technology business, so Takaful operators should embrace technology in all operational, sales and marketing strategies. Operators could achieve cost efficiency and improve productivity through the building of technology capabilities to tap into new markets and increase revenue.

Takaful operators should embrace technology in all operational, sales and marketing strategies

1. Need for new business models to accommodate for wider niche markets e.g. 'generic' insurance.
2. Improved technology capabilities to achieve cost efficiency and productivity.

Key messages:

- The existing intense competition amongst Takaful product providers, on some of the high risk insurance markets such as auto and medical insurance, is causing harm to the natural growth of the industry and risks the integrity of the impetus of the Sharia'a-compliance element in the Takaful business altogether.
- There is a need for improved operational processes and controls to accommodate new regulatory changes and enhance compliance practice and business excellence. New methods for distribution channels and embracing technology will help reduce product costs and improve sales efficiency and marketing.
- Takaful insurers should develop best practice customer service management systems and processes to ensure that policyholders and customers are treated honestly, fairly and professionally.

Takaful firms are challenged with adapting new strategies that provide cash flow streams and developing innovative ‘protection and saving’ products in general family Takaful

4. Product governance and strategy

How can Takaful operators improve penetration rates more effectively and reach the mass ‘uncovered’?

Takaful firms are challenged with adapting new strategies that provide cash flow streams and developing innovative ‘protection and saving’ products in general family Takaful. The social and demographic needs of the key markets in MENA and SEA offer ample room for new product offering and growth. The global recognition and acceptability of Islamic finance, as an alternative mode of investment and finance, will arguably boost long-term growth for Takaful insurers and will enhance its internationalization and acceptability.

1. Improve product governance and product development processes including the Sharia’a process.
2. Emphasis on target market, sales and distribution channels to achieve growth and profitability.

Key messages:

- Takaful operators are required to develop a robust product governance system to ensure that policyholders and customers are treated honestly, fairly and professionally. Recent Deloitte research

addressed key areas of regulatory scrutiny in this regard and identified five important areas of practice that Takaful providers may well address to enhance product offerings and governance:

- Governance process
- Target market
- Product features and pricing
- Transparency
- Distribution channels and systems

- Life Takaful product development is poised to gain priority amongst key operators, along with direct sales and BancaTakaful. The latter puts Takaful firms at an advantage if they leverage Islamic banking growth and the potential cross-selling of life Takaful, education, healthcare and investment-linked products.
- Clearly there is a low rate of penetration in key markets reviewed. Firms need to continue to explore new niche markets and develop specialty products and tap into mass markets in Indonesia, Egypt, Turkey and KSA. Meanwhile, Takaful providers are required to invest in educating consumers about their product offerings.

5. Capacity building - Talent and leadership development

How can Takaful operators solve the talent paradox?

The role of leadership and talent in the Takaful business has become increasingly important as Takaful operators seek to respond to uncertain economic conditions and stagnant growth opportunities, as well as to address the aforementioned regulatory and organizational structures.

1. Switching emphasis on internal development to build the specialized knowledge and skills required.
2. Refocus on competency-based training and leadership programs.



Key messages:

- The human capital and talent challenge in the Takaful industry is exacerbated by the shortage of skilled and qualified personnel, and the subsequent high turnover rate this causes. This has created a pressing need for specialized skills in areas of underwriting, risk management, and product development.
- Takaful operators should strategize talent development and knowledge base in Islamic finance and Takaful, and explore personal, technical and professional attributes deeply.
- Three key influences that should be addressed to build an effective competency-based training strategy:
 - Skill assessment and gap analysis
 - Knowledge and skills identification.
 - Develop a professional development education encompassing three capabilities as shown in the chart on the right.

Evolving talent-building approach



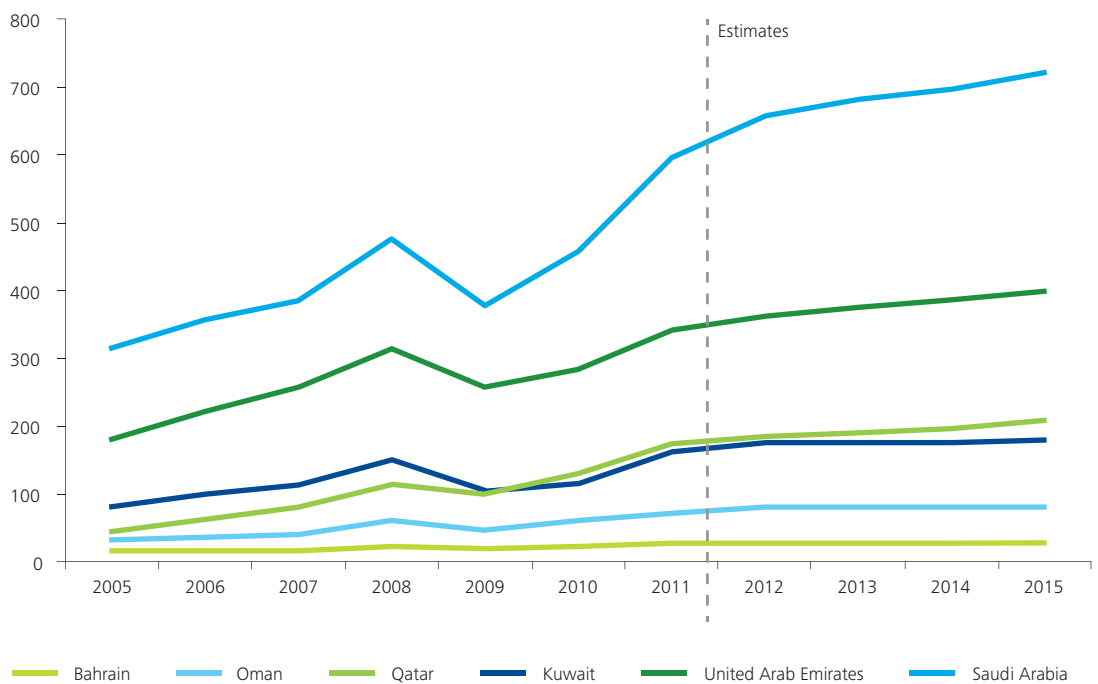
Generating growth in the Takaful sector

The economic setting

A recent report published by Forbes Middle East in association with the International Monetary Fund (IMF), entitled 'the Best Performing Economies in the Arab World', revealed that a number of countries in the Arab region have recovered from the impact of the Arab Spring. The report also noted that the Kingdom of Saudi Arabia outperformed its regional counterparts and achieved 11% growth in total government revenue which stood at USD355.32 billion in 2012. In addition, the report highlights positive transformations in oil-exporting countries including economic diversification and increased public spending in health, education and employment. The table below charts the GDP growth in the GCC, which shows a steady increase with combined total GDP estimated to reach USD1.5 trillion in 2013.

At present, the biggest headwind facing the industry in the Middle East region is the 'Arab Spring syndrome', which has resulted in the reluctance of corporates to invest for expansion and to hire. In addition, growth rates of Takaful penetration are slowing due to a lack of customer education and inadequate product awareness programs. This has been further hindered by a lack of clear strategies from Takaful providers, and lack of research and development (R&D) in product innovation and marketability, with the latter being a chronic practice that has shaped the industry since its early days.

GDP (2005-2015-e) USD billion

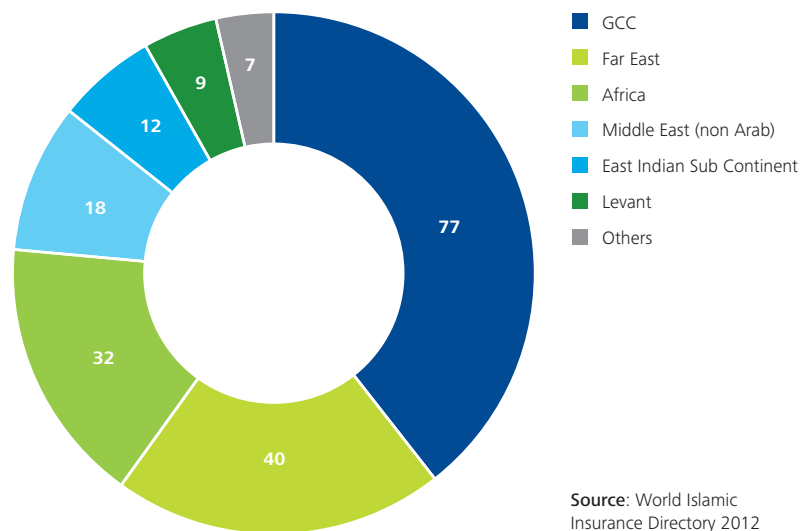


The GCC Takaful market

The GCC Takaful market remains at the forefront of the industry. The latest industry data reveals that the GCC contributes more than 62% of the gross Takaful premiums globally. Reports estimate that Takaful business will grow significantly in the coming five years to reach USD20 billion by 2017. In 2010, the Far East region recorded the highest growth rate of 32% on the back of USD1.95 billion in contributions, while the GCC, led by the Kingdom of Saudi Arabia (KSA), maintained the largest share of contributions, growing a further 17% to USD5.7 billion. The GCC region accounted for almost 40% of the total Takaful business with South East Asia coming a distant second with an 11.8% share in 2010, based on figures compiled through inputs given by the various Takaful operators around the world.

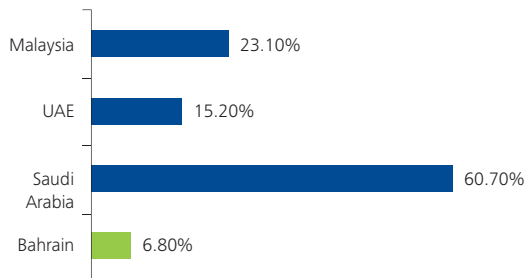
The GCC contributes more than 62% of the gross Takaful premiums globally

Number of Takaful firms (2010)

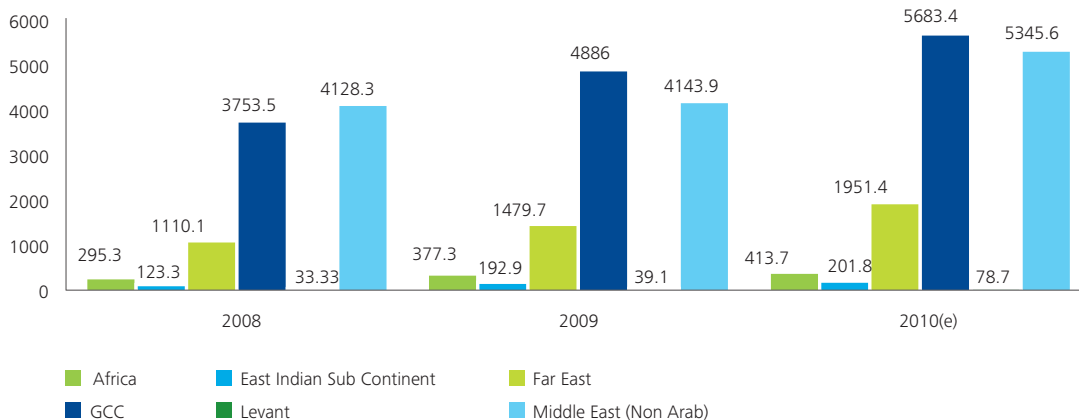


Source: World Islamic Insurance Directory 2012

Global Takaful CAGR (2009-2011)



Gross Takaful contribution by region (2008-2010, USD millions)



Source: World Islamic Insurance Directory 2012

Bahrain continues to attract Takaful providers as well as other professional services firms, making the Kingdom attractive to Islamic finance and Takaful investors

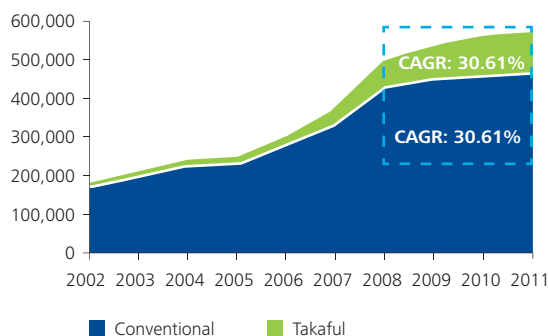
The case of Bahrain: a veteran Takaful center

The Kingdom of Bahrain has long been a key market for Takaful. Bahrain continues to attract Takaful providers as well as other professional services firms, making the Kingdom attractive to Islamic finance and Takaful investors. Local talent and international expertise available in the country is one of the key factors making the Kingdom a jurisdiction of choice for the industry. This section attempts to showcase the Takaful growth trend in the country and highlight aspects of the key business and financial performance of Takaful firms operating in the Kingdom. The research analysis included a review of seven Takaful firms and two ReTakaful companies.

Gross contributions versus premium growth

Gross contributions of Takaful firms in the country have increased significantly in the last ten years, achieving a CAGR of 30.61 % compared to the 11.73 % recorded by conventional insurance firms. In addition, The Takaful firms' gross contributions represented 19% of Bahrain's total gross premiums/contributions in 2011, and amounted to USD106 million compared to USD102 million, an increase of around 4% over the previous year. Conventional insurance firms' gross premiums reached USD463 million in 2011, representing an increase of 1.64% over 2010.

Gross contributions/premium growth in Takaful vs. conventional firms (2008-2011): USD'000

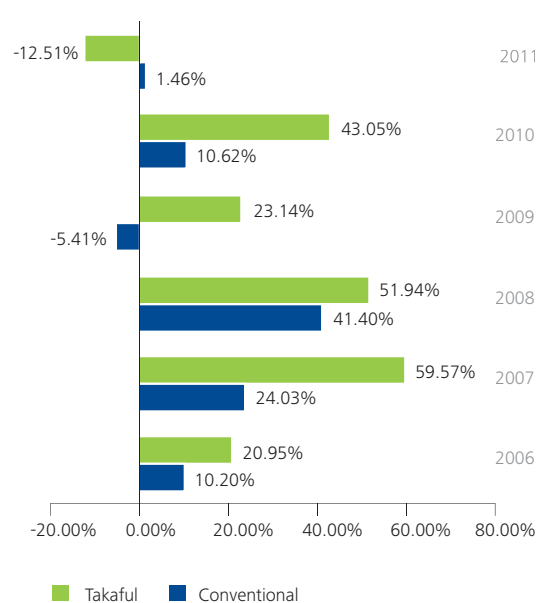


Note: Data excludes Reinsurance and ReTakaful firms.
Source: CBB Bahrain Insurance Industry Review and Deloitte Analysis

YoY% Change in gross claims of Takaful vs. conventional firms

Gross claims of Takaful firms decreased significantly to USD55 million in 2011 from USD62 million in 2010. Over the same period conventional firms registered gross claims of USD227 million, an increase of 1.46 % from the previous year. This is largely attributed to the impact of lower business growth rates in some sectors as a result of social and political issues in 2011.

YoY% change in gross claims of Takaful vs. conventional firms (2008-2011)



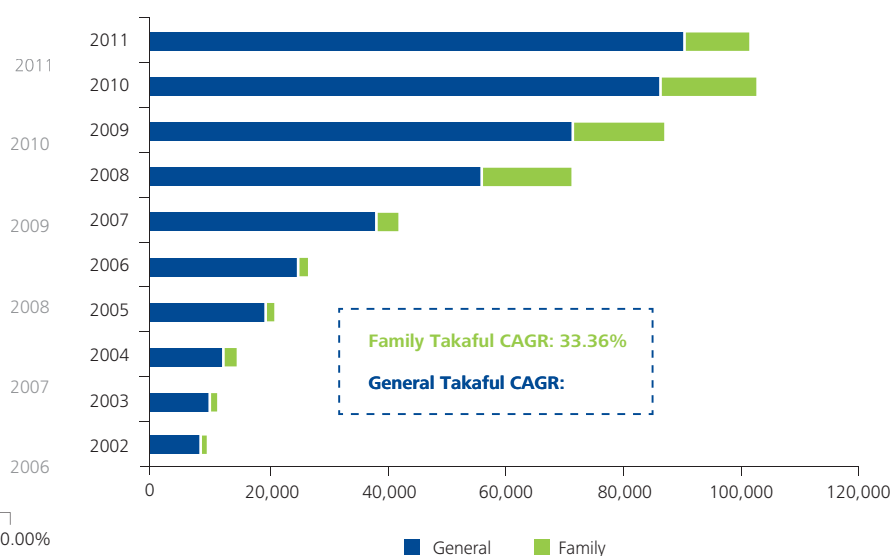
Note: Data excludes Reinsurance and ReTakaful firms.

Source: CBB Bahrain Insurance Industry Review and Deloitte Analysis

General and family Takaful growth in Bahrain

The General Takaful business has seen strong growth in recent years. In 2011, General Takaful's contributions represented 89% of the total Takaful contributions and 15.5% of the total gross premiums of the insurance sector in 2011. Likewise, the Family Takaful business has increased in recent years. Starting from 2007, Family gross contributions increased to reach USD3.93 million in 2011, which represents 11% of total Takaful contributions.

Gross contributions growth in family and general Takaful (2002-2011), USD'000



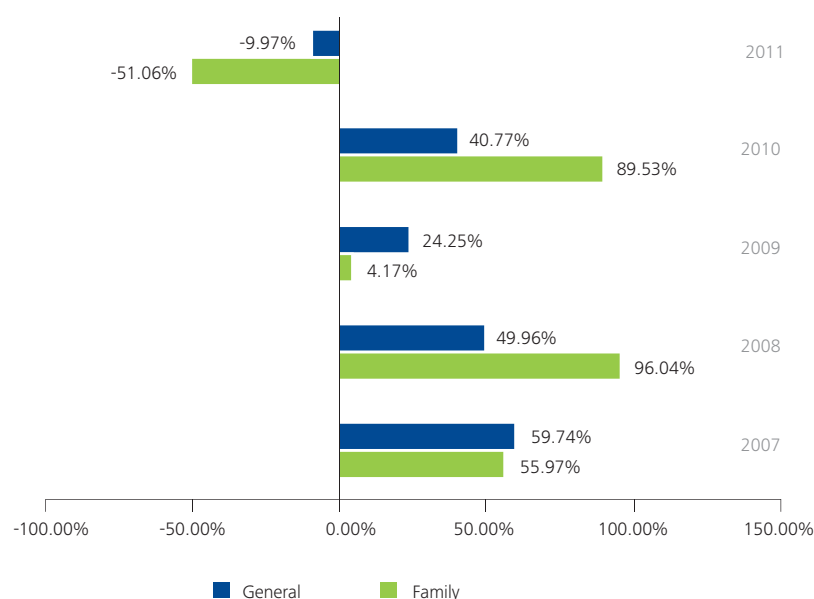
Source: CBB Bahrain Insurance Industry Review and Deloitte Analysis

Based on past trends, it is clear that the Bahrain Takaful industry has been growing rapidly and is continuing to grow faster than conventional insurance

YoY% Change in gross claims in family and general Takaful

Takaful's gross claims increased to record USD55 million in 2011 compared to USD4.8 million in 2001. General and Family Takaful's gross claims accounted for 96% and 4% respectively of the total Takaful gross claims in 2011. The gross claims from Takaful business represented 19% of the total gross claims in 2011.

YoY% Change in gross claims in family and general Takaful (2007-2011)

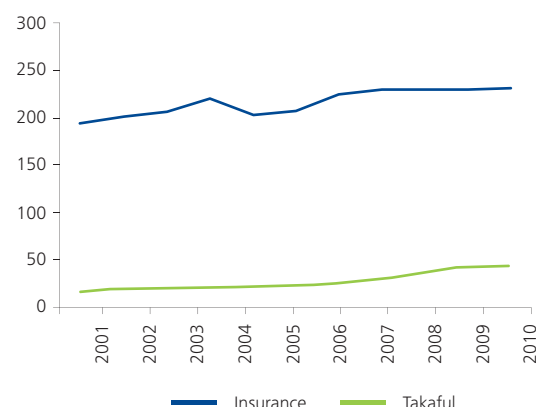


Source: CBB Bahrain Insurance Industry Review and Deloitte Analysis

Sustained penetration growth

Based on past trends, it is clear that the Bahrain Takaful industry has been growing rapidly and is continuing to grow faster than conventional insurance, evidenced by the high Takaful penetration ratio CAGR of 25% (2001-2010) compared to a CAGR of 3% for conventional insurance providers over the same period.

Penetration ratio (2001-2010)



Note: Data excludes Reinsurance and ReTakaful firms.

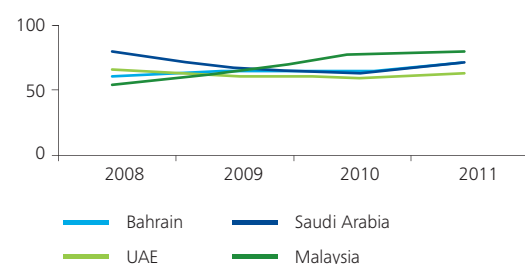
Source: CBB Bahrain Insurance Industry Review and Deloitte Analysis

Industry financial highlights

Claims ratio

The chart below shows claims incurred as a percentage of net contributions. The average claims ratio for Bahrain amounted to 60% compared to 65.5% in Saudi Arabia, 57% in the UAE and 64.5% in Malaysia.

Claims ratios 2008-2011

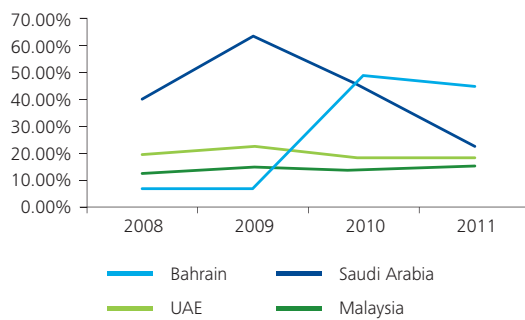


Source: CBB Bahrain Insurance Industry Review, Firms' Financials and Deloitte Analysis

Reinsurance ratio

In the same period, the Reinsurance ratio represents the proportion of the total gross premium ceded to other insurance companies. The ratio for Bahrain has declined since 2010 showing a strengthening of operators' confidence in the economy. The average in Bahrain stood at 26%, compared to the UAE with 19% and Malaysia with 14% over the period of 2008 to 2011.

Reinsurance ratios (2008, 2011)

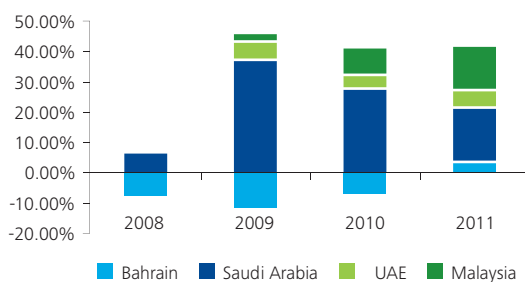


Source: CBB Bahrain Insurance Industry Review, Firms' Financials and Deloitte Analysis

Return on equity

Return on Equity improved for Bahrain in 2011, indicating improved growth in the economy. In the UAE Takaful operators generated an average return of 4%, and in Malaysia Takaful companies achieved 6.08% between 2008 and 2011.

Return on equity (2008-2011)

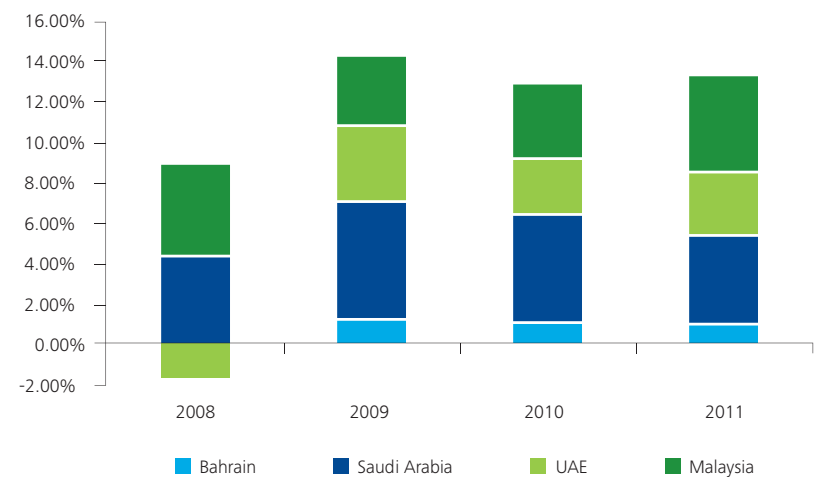


The ratio for Bahrain has declined since 2010 showing a strengthening of operators' confidence in the economy

Return on investments

Takaful operators in Bahrain, the UAE and Saudi Arabia have high exposure to securities and the real estate market. Returns in Bahrain have been volatile as the country has gone through political turmoil in the last two years. The average returns in Bahrain are 0.82%, compared to 2.18% in the UAE and 3.98% in Malaysia.

Return on investments (2008-2011)



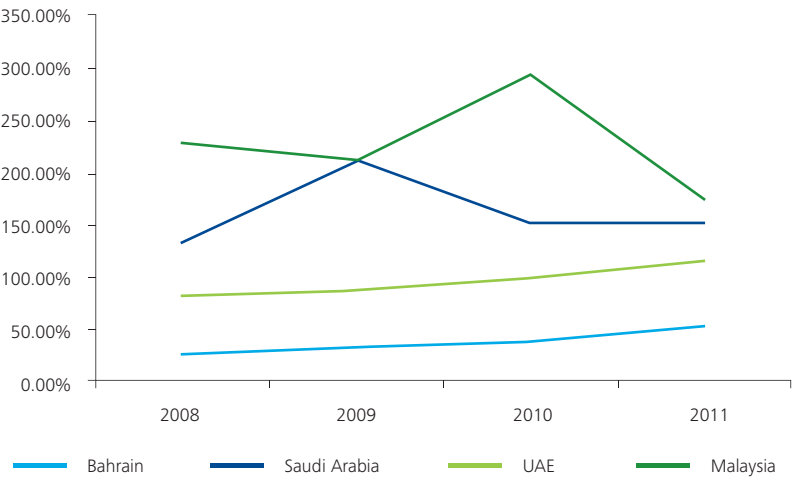
Source: CBB Bahrain Insurance Industry Review, Firms' Financials and Deloitte Analysis

The potential for firms to tap into regional and international markets is great

Net contributions to equity

The chart below shows company risk levels due to written premiums relative to the level of equity capital. The level is lowest in Bahrain indicating that companies are taking less risk in relation to equity levels. Operators in other economies like Saudi Arabia and Malaysia have high risk-taking capabilities.

Net contributions to equity (2008-2011)

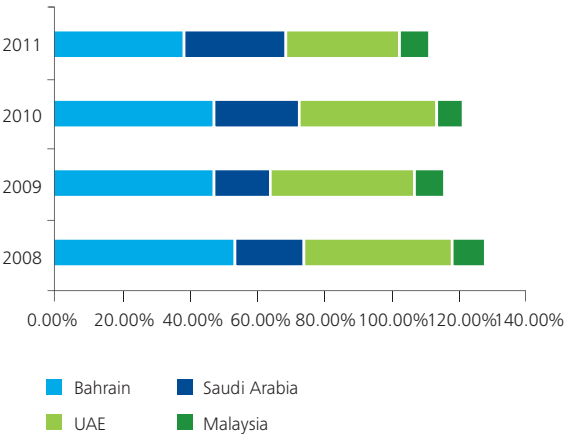


Source: CBB Bahrain Insurance Industry Review, Firms' Financials and Deloitte Analysis

Equity to assets

A more static measure of leverage is the equity to total assets ratio. For Bahrain the ratio has declined over the past four years with an average of 46.82% at the end of 2011, indicating increasing leverage.

Equity to assets (2008-2011)



Source: CBB Bahrain Insurance Industry Review, Firms' Financials and Deloitte Analysis

The analysis shows that the studied group of Takaful operators has made strong growth and that the potential for firms to tap into regional and international markets is great. The support and commitment from government regulators and leadership will help attract more Takaful operators and enhance the country's position as a key hub for Takaful solutions not only for the GCC region, but, more importantly, for exporting their experience to global markets.

‘A forward plan’ for a new Takaful landscape

Thought leaders’ perspectives on Takaful

At a recent Takaful conference, a deputy director at Bank Negara Malaysia (BNM), Azleena Idris said, “Combined efforts by industry players and market participants are important in charting strategic direction for the industry and maximizing its potential”. Deloitte’s analysis shows maximizing industry potential lies in addressing challenges and issues that will better position the industry to reach mass markets and achieve organic growth and development.

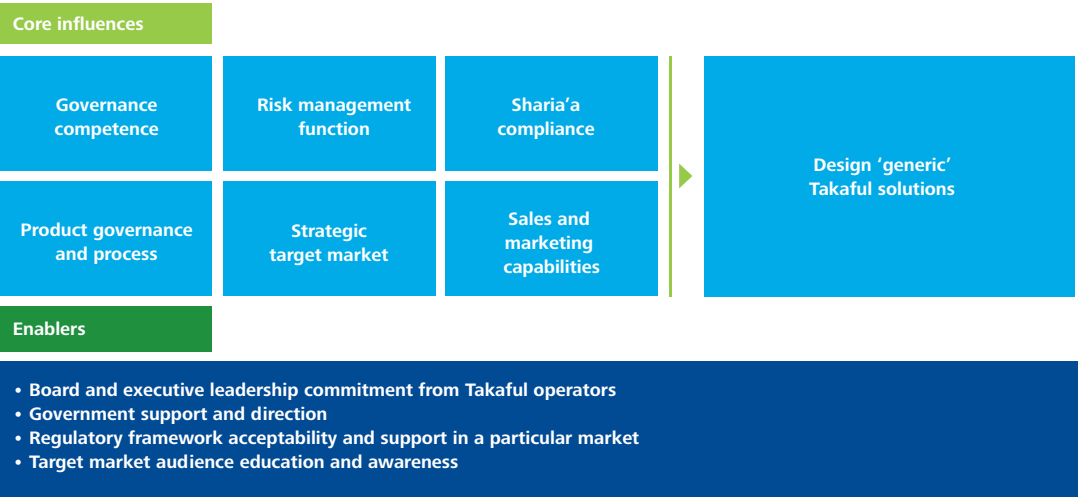
While the global regulation and industry self-regulatory organizations, such as the IFSB, the AAOIFI, and IIFM, have made significant advancements in developing standards in governance, financial reporting, Sharia’a, and capital markets, they have uniformly struggled to gain the wide support of regulators to enforce implementation of these standards and leading best practices. In essence, practitioners as well as regulators need to work together to ensure these well written and well presented standards find their way in a real, practical sense. Thus, the positioning of the new Takaful model and solutions has to address a number of influences and enablers as addressed in the chart below. This section summarizes some of the discussions and insights shared by prominent thought leaders in Islamic finance.

Governance and regulatory compliance

“In discussing the matter of harmonization and standardization, it has sometimes been argued that since diversity is an inherent aspect of Islam, complete harmonization is neither desirable, nor achievable. However, from AAOIFI’s perspectives, greater harmonization and wider application of standards would deliver benefit, especially if standards can help to give clarity and consequently enhance confidence of users of Islamic finance products including Takaful, and can help to enhance cost efficiency of Islamic finance operations and product development,” said Dr Khaled Al Fakih, Secretary General and CEO of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

“There are regulatory differences in the Takaful industry with no uniformity in reporting processes. As an international firm with operations in many countries we have to digest the different set of rules and practices in each country,” said Mahomed Akoob, Managing Director, Hannover ReTakaful. He further pointed out that “the IFSB’s Takaful standards need to be revised. The standards need to more specifically accommodate for the business of ReTakaful.”

Positioning of new Takaful solutions: core influences and enablers



The industry needs to understand the importance of a common platform when it comes to financial reporting

Practitioners have privately criticized the regulators' guidelines on solvency requirements and calculations of ratios for separate funds, e.g. the participants' fund, operators' fund, and shareholders' fund are all treated separately. In addition, the way in which Takaful firms have to calculate Risk Based Capital (RBC) has now been introduced in several countries such as Malaysia, and Bahrain. This less-favored method of Takaful operators appears to penalize Takaful operators and has resulted in adverse practices such as delays in the distribution of dividends, and the cost of additional capital required from the shareholders' fund.

"However, it is essential to create a structure such that the Takaful operator (TO) is not taking on or being exposed to the insurance risk of the participants' risk funds, as this would make the TO into a kind of proprietary insurer. Hence, the segregation between participants' and shareholders' funds is essential, and each needs to meet different solvency requirements. See IFSB's ED-14 on Takaful Risk Management. The situation is complicated by the fact that the risk funds typically do not meet solvency requirements, as they have little or no reserves (participants' equity) in them. Hence, they are reliant on capital support from the TO's funds in the form of a Qard facility which, to be eligible internationally for regulatory purposes, has to meet certain conditions that are set out in the IFSB Solvency standard. These requirements and the resultant structural complexity may not be fully understood by some practitioners," said Professor Simon Archer, Henley Business School, University of Reading, UK, Adjunct Professor, INCEIF, Malaysia.

"IFSB's Standard on Solvency Requirement for Takaful Undertakings provides an important basis for regulators and supervisors to put in place a regulatory and supervisory framework relating to capital and solvency requirement for Takaful operators," added Dr Khaled Al Fakih.

"The industry needs to understand the importance of a common platform when it comes to financial reporting," said Ashraf Bseisu, Group Chief Executive CEO, Solidarity Group. He asserts that as an international firm operating in many countries, they expect better coordination between regulators to streamline financial reporting standards and other practices. This view was also supported by A Aziz Al Othman, Deputy General Manager, Takaful International, who in particular highlights that "the AAOIFI's guidelines on the treatment of Qard Hasan and commissions of Reinsurance need to be revised, and the discrepancy of treatment between AAOIFI and IFRS in several accounting and auditing reporting issues in the Takaful business is a point in case".

"On many countries, with the notable exception of Bahrain, Malaysia, Pakistan, and more recently Qatar and Oman, Takaful firms operate in the absence of a dedicated 'rulebook' or specific act of regulation for the Takaful business. This will clearly not help the industry to grow and adapt leading Takaful practices," states Dr Omar Fisher, Acting CEO at Al Hilal Takaful Co. "More emphasis should be put on regulation and oversight and the industry should look into the priorities in two key areas: first, financial rating has to be improved and made universal, and secondly, technical software companies should aggressively innovate better methods of selling and marketing Takaful products," added Dr Omar Fisher.

On the point of legal risks in the industry, Oliver Agha, Partner, Head of Islamic finance and MENA Practices at Holland & Knight and Managing Partner, Agha & Co, assesses the concept of 'Tabarru' in Takaful and highlights that the insurance contract at its core is unenforceable if 'Tabarru' is relied upon. He argues that



"by making a unilateral gift/donation, the premium payer is not entitled to a return upon the occurrence of an insurance event". He further elaborates that "by the same token, the insurer is not required to pay back the insured upon the occurrence of an event of loss because the insurer has received merely a donation (rather than a contractual premium payment). The AAOIFI standards on Takaful refer to both contributions and donations but can only be read sensibly if contribution is understood to be the intent of the standard. In this regard, AAOIFI guidelines (and the Sharia'a position) need to be harmonized, otherwise we are looking at legally, logically and conceptually flawed constructs on which this nascent industry is being built."

Risk management and internal controls

The discussion with practitioners and thought leaders highlights the importance risk in Takaful and, in particular, the impact that one type of risk could have on other areas of practices or functions. For instance, the point of view about 'Tabarru' discussed above, addresses a Sharia'a compliance risk, as well as operational risk, which ultimately causes a legal risk of enforceability and indeed a reputational risk issue in the event of any dispute between the participants'

fund and shareholders. Essentially, this point emphasizes the importance of harmonization of Sharia'a standards and the actual application of the law of the land to the Sharia'a pronouncements, internal controls and processes.

"Emphasis on enterprise-wide ERM systems and corporate governance is the key to operational excellence in the industry," stated Ashraf Bseisu, Group Chief Executive CEO, Solidarity Group.

"There seem to be different interpretations of structures such as the Mudaraba, which causes some confusion to market participants in the practices context," said Dr Fisher. The business model should be improved to accommodate for increasing regulatory reforms and Takaful firms should design KPIs, consider measurement tools and dashboards and improve MIS frameworks, added Dr Fisher.

"Surplus distribution in the fund pool needs some form of standardization or uniformity to ensure fair and transparent treatment, and perhaps mitigate any possible Sharia'a compliance risks," said Akoob.

Takaful operators need to innovate and go into a ‘generic insurance market’ that could involve both family and general Takaful

Operational and business excellence

“The importance of sound risk management and governance practices has been discussed more in the context of Islamic banking, relative to Takaful firms, and increased focus on this third pillar of financial markets, with regards to Sharia’a and risk governance is now due. IIRA’s fiduciary rating approach to Takaful firms has very recently been published and takes a wide range view of the assessed institution, including governance related aspects. Viewing the firm as an asset manager and thereby assessing funds separately, as well as from a holistic perspective, to assess its ability to protect participants, (as required by relevant regulations, which often declare funds transfers when needed, in the form of Qard-e-Hasna mandatory) gives a well-rounded view of the firm and caters to multiple stakeholders,” said Sabeen Saleem, Chief Executive Officer, Islamic International Rating Agency (IIRA).

“A significant component of IIRA’s fiduciary rating methodology is an analysis of the Sharia’a governance infrastructure of the Takaful provider and the degree of adherence to Sharia’a related best practices. Our methodology discusses both General and Family Takaful, and assesses the firm on two distinct levels, i.e. a Takaful Financial Strength Assessment and a Fiduciary Score. The latter further devolves down to a two tiered score comprising an Asset Manager Quality Score, which scales the financial resilience of the Takaful fund on a standalone basis, and the governance and policy framework employed to achieve financial objectives. A Sharia’a Governance Score is provided separately for greater information on Sharia’a related practices in effect, for increased information to stakeholders and participants. The methodology is also scalable to Re-Takaful firms,” said Sabeen.

“The harmonization of operational practices, especially in the form of underwriting, is essential so that co-Takaful can be coordinated well... Due to competition, the regulators have to be aware of the pricing strategies adopted by various Takaful operations; in some jurisdictions the application of the tariff could have resolved the pricing issues,” said Daud Vicary Abdullah, President and CEO, INCEIF.

“After sales service is a key driver of business excellence, and Takaful firms should be encouraged to enhance their capabilities in this important area. Consumer interest groups should also be encouraged to play a role in this respect,” said Sohail Jaffer, Deputy CEO, FWU Global Takaful Solutions. Consumer watchdogs should also be encouraged to play a role in this respect, he added.

“Strategically, the industry should pay more attention to the importance of educating customers and the workforce. Private Takaful associations could take an active role in this respect, and perhaps a premium tax (of say 0.5% or 1%), might be introduced for this cause to invest in the education and training of industry stakeholders,” said Dr Fisher.

“The use of dashboards is well overdue, and Takaful firms must be encouraged to use dashboards to build up their business models, monitor their product cost structures and customer product relationships, and develop a strategic map of product value and cost positioning,” added Dr Fisher.

“The joint venture model, blending international insurance expertise with a local insurance firm that has the local market knowledge to offer Takaful solutions, has proved successful in many markets in the region,” said Gassan Marrouche, General Manager of Takaful Emarat, in an interview in Gulf News, July 11, 2011. “Life and medical Takaful products provide strong cash flow streams for Takaful firms, thus enhance the operators’ solvency ratios and ultimately keep capital adequacy base in line with regulators,” added Gassan.

Product governance and strategy

“Takaful operators need to innovate and go into a ‘generic insurance market’ that could involve both Family and General Takaful,” said Daud Vicary Abdullah.

"The defined contribution pension market in the emerging and frontier markets is underserved, and the industry needs to develop annuity and lifetime income products to tap into this fast growing market. Takaful providers need to develop suitable solutions and also optimize the use of Sukuk, particularly the long dated securities for asset/liability matching," noted Sohail Jaffer. "Takaful operators' departments of investment should be on a constant lookout for short-term and long-term investments such as Sukuk to park their funds," said Daud Vicary Abdullah.

"The recent surge in Sukuk issuances at domestic as well as international level and long dated tenor Sukuk by several issuers from Indonesia, Malaysia, Saudi Arabia etc., is a welcome news for Takaful operators to plan out their investment portfolio", said Ijlal A Alvi, Chief Executive Officer International Islamic Financial Market (IIFM).

"In the UAE, for example, 85% of the Takaful products are sold through brokerage. This makes price a key issue for customers whereby many Takaful operators are forced to get into a 'price war' that shapes the industry scenes these days," said Dr Fisher.

"Instead of just concentrating on the so-called conventional family Takaful products, Takaful operators should look into other areas such as education products, health products and other family products related to life," argues Daud Vicary Abdullah.

Capacity building: talent and leadership development

"Talent is the area of Takaful that seems most lacking; the Takaful operator can enhance its employees through conducting in-house training (over weekends) or by sending some selected employees to institutes of higher learning especially in the area of Takaful...To enhance the Takaful business, Takaful operators should inculcate the culture of research, either through outsourcing the service to a third party or by forming a market research-driven CRM team. Industry associations across the region can assist in developing priorities and organizations such as INCEIF, IRTI and the World Bank can be asked to support," said Daud Vicary Abdullah.

There is clearly a shortage of expertise in Takaful generally and ReTakaful in particular

"There is clearly a shortage of expertise in Takaful generally and ReTakaful in particular. We expect more cooperation from labor and work regulators in the Gulf in particular, by allowing highly skilled foreign professionals in highly technical areas of practice such as special underwriting skills and actuarial analysis," said Akoob.

"Islamic finance education and training is essential for the innovation and growth of the industry," said Qasim Aslam, Partner, Dentons.

"When the original UK Islamic finance working committee reported to the Late Lord George (Governor of the Bank of England), its members from both the conventional banking and Islamic finance industries converged to advise the British government that a legitimate, sustainable Islamic finance market in the UK will require a three-pronged solution, viz. (1) The Licensing of Retail Islamic Banking, (2) Islamic Investment Banking and (3) The creation of a workable Takaful alternative. These founding members motivated me personally and far more senior experts to work on delivering (1) and (2) above, which culminated with the creation and subsequent licensing in August 2004 of IBB (Islamic Bank of Britain plc.) and EIIB (European Islamic Investment Bank plc.) soon thereafter," said Shabir Randeree, CBE, Member, UK Islamic Finance Task Force (IETF). He continues, "With this, two parts of the three-pronged plan were in place, theoretically at least. I believe that the growth of Islamic banking in the UK has slowed much more than we anticipated post the Credit Crisis in 2008 and it is likewise most feasible to accept the same over the development of Takaful. However, this must be addressed and I am encouraged by the experts in the field who are focusing thus. I refer back to our visionary members of that original task force, who

The impetus of an enterprise-wide risk strategy should not be overlooked, and support and oversight from boards is a key driver for the implementation of an effective risk-based business in the Takaful sector

expressed the view that without a reliable, workable and profitable Takaful industry, the development and growth of Islamic finance will be handicapped, if not impeded seriously. From my experience of Al Baraka South Africa, I can suggest that there is a seriously adverse effect on customers fully committing to Islamic finance in the absence of a widely available, competitive Takaful option. Going forward, the need to legislate, educate and develop Takaful as a viable alternate is essential and urgent. It is one of the issues that the IFTF will also be looking at, working with those markets that are far more developed in this area, like Malaysia."

Final thoughts

It is clear that national and international regulatory initiatives will affect the way in which firms interact with their retail clients and regulation. Senior executives of Takaful providers should begin assessing the challenges addressed in this report that might affect their ability to generate growth and profitability. As noted in this report, there is a lot going on in the regulatory and practice environment. Takaful business strategies and models will need to be revamped, taking into account expanding regulation, increasing competition from conventional insurers, pricing strategies and costing models. General and Life Takaful solutions may need to be redesigned to accommodate a wider customer base

including non-Muslims and should provide for generic insurance coverage in all kind of Takaful products. Product governance and processes should be improved to ensure regulatory and Sharia'a compliance.

There is a strong message to Takaful firms who have been criticized as 'unsatisfactorily Sharia'a-complaint' to improve their product governance and internal Sharia'a advising and audit mechanisms, to ensure fairness to policyholders and stakeholders. These plans cannot simply be implemented or improved without a clear firm-wide strategy, to develop internal competencies in business and Sharia'a. Building on this, Takaful executives are expected to invest more generously in education and training and develop leadership programs.

At the same time, it is not sufficient for these challenges to be addressed or implemented without the commitment and support of boards and executives of Takaful firms. Thus, the leadership of Takaful operators should enhance their risk management governance and controls process. The impetus of an enterprise-wide risk strategy should not be overlooked, and support and oversight from boards is a key driver for the implementation of an effective risk-based business in the Takaful sector.

Finally, perhaps the exercise of 'preparing for assessment' to design a way forward plan should be the business equivalent of an emergency checklist of review of the firm's existing business structures, addressed in this discussion, to identify any impediments to growth. The plan should aim to set out, in detail, the practical steps a firm should take to map out its strategic vision and objectives. Most notably, the 'forward plan' should lay out how the firm plans to address these emerging challenges and other related issues, to enhance its capabilities in capital, risk, operations, products, and people.

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