



2 June 2011

Takaful - Reviving the Mutual model

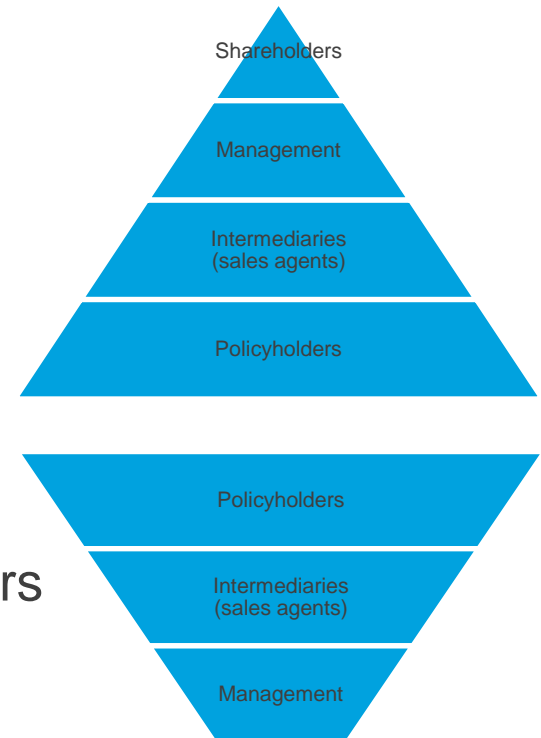
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Proprietary based Insurance

- Consumers are not necessarily an informed lot. Optimistic in nature and driven naturally by “herd mentality”. Insurance is typically sold and not bought. The agency system is still the most successful distribution system in the developing world.
- Two parts to an insurance product, protection and savings. Many parts of the developing world are high savers, savings through insurance imposes a discipline to saving.
- Premiums are paid before cover is effective. Counterparty risk mitigated by Regulations governing the insurer. Risk Based Capital formulated to “identify and quantify” risks.
- Effect of Risk Based Capital on proprietary insurance model
 - Natural tendency of capital providers to maximize return on capital. This results in “selling products that are capital friendly” rather than products that consumers need.

Managing risk the cooperative way

- Plain vanilla insurance, whether it is a term cover or a term with a savings component, is probably what an individual needs along with indemnity cover for loss of property. How can these be provided at minimal cost?
- Four major stakeholders in an insurance pyramid.
 - Shareholders
 - Management
 - Intermediaries (sales agents)
 - Policyholders
- The mutual model turns the pyramid upside down
 - With policyholders double hatting as shareholders



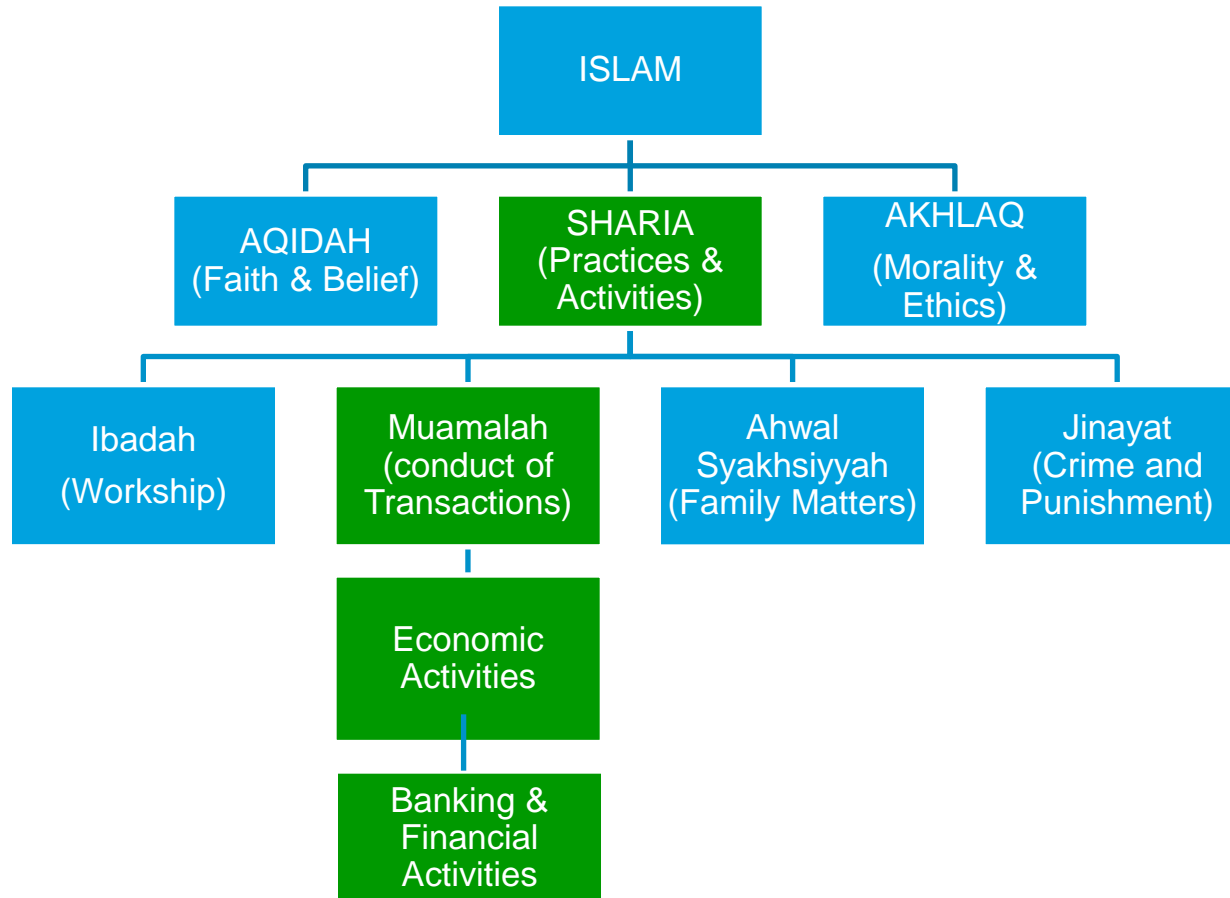
The quest for transparency, accountability and sustainability

- What the 2008 financial crisis has taught us;
 - It is never “this time it is different”, risks do not disappear you only exchange one (type of) risk for another.
 - Capital is not “expensive”. Cost of capital is not fixed, it should vary according to the level of risks it is subjected to.
 - Use of capital comes with accountability but interest based lending is preoccupied with “credit risk” with little distinction as to how the credit is put to use.
 - Human behavior is linked to rewards. The human instinct is always to maximize reward while minimizing effort.

The quest for transparency, accountability and sustainability

- Insurance contracts
 - Varying level of transparency depending on product design.
 - Costs elements need not be declared to policyholder. One price, take or leave it. Cash before cover.
 - Policyholder transfers “real” risk for a small premium to the insurer while the insurer takes on “speculative” risk. Speculative risk by its nature will be subject to “tail risk”
 - Management’s task is to maximize return on capital, management works for the shareholders not the policyholders

Contract law is a component of Sharia and an integral part of a “Muslim’s way of life”



Source: Islamic Banking and Finance Institute Malaysia

Law of *Muamalat*

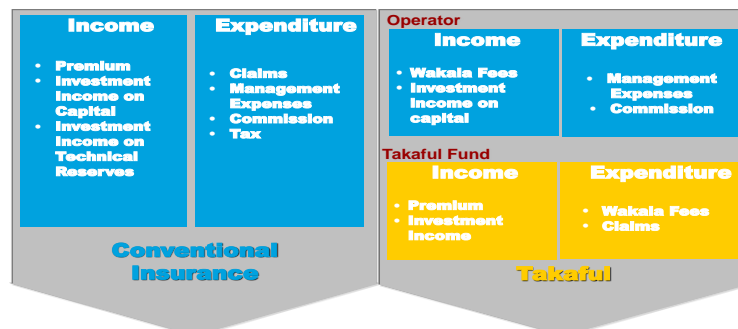
- There are three basic tenets governing services and trade required by the law of *Muamalat* and which must be present in Takaful;
 - Need for complete transparency in the contract. Under the “principal – agent” takaful model, the shareholders manage the business for a predetermined fee, usually determined as a percentage of the premium.
 - Must avoid elements of speculation in the transaction. Speculation is an integral part of risk transfer. Insurance by its nature contains many elements of uncertainty. Takaful opts for risk sharing and circumvents the prohibition of bilateral contracts which have elements of uncertainty by avoiding bilateral contracts altogether. The concept of *tabarru'* is used, this is a unilateral “contract”.
 - The concept of “no return with risk” is integral in the law of *Muamalat*. You must have “skin” in the game. Thus the need to avoid interest bearing securities, where there is no market risk, only credit risk.

Takaful – in a nutshell

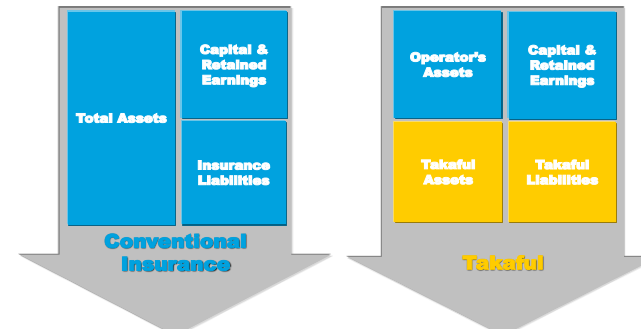
- Takes the mutual model and fixes a “service entity” (the Takaful Operator) at its helm. Risks are explicitly allocated between policyholders and shareholders;
 - A “principal – agent” contract between the takaful company and the policyholders where the shareholders provide capital and own the takaful company which manages the business for a predetermined fee.
 - Self contained takaful fund or funds which pools risks to be shared among policyholders in the pool. This can be risks dependent on a contingent or just investment risks (either pooled funds or unitised).

Comparison between conventional and takaful

▪ Revenue Account



▪ Balance Sheet



Development of Takaful in Malaysia

- Started with the first takaful company in 1986, and for nine years it was the only takaful company in Malaysia. Now there are 12 takaful companies (8 of which are composites).
- Malaysia espouses an Islamic financial system running in parallel to the existing conventional system. However, Sharia law applies only to Muslims and then only on family matters. Thus business matters are subject to secular law.
- Malaysians, like most Asian communities, have a high savings rate. However due to a significant statutory retirement scheme in place for those in employment, the growth of the insurance for savings has been muted.
- The growth of Islamic banking and sukuks (islamic bonds) have outstripped that of their conventional cousins. Approximately 60% of Malaysians are Muslims but a significant proportion of users of the Islamic financial system are non Muslims.

Issues with Takaful

- Separation of takaful shareholders' funds from the various takaful pools needs to have the backing of the law of the land.
- Issues of the management of qard (loans) from the shareholders to the takaful pools, how is it treated, how will it be repaid.
- Alignment of the various stakeholders interests. To manage the principal – agent relationship, where the agents here are the policyholders, so as to ensure the stability of the takaful company.
- Should benefits on the happening of the insured event be guaranteed? If so how? Where should the capital to underwrite this guarantee come from?
- Can takaful function in a situation where there is low frequency of occurrence but high volatility in severity?
- Reconcile Regulators' expectations and model limitations to meet those expectations.

A list of multinationals with Takaful or Retakaful operations.

FriendsLife



CHARTIS 

AVIVA

hannover re®



ING 




ZURICH®

Allianz 

HSBC 

 **Great Eastern**



RGA®

Munich RE 

Swiss Re


PRUDENTIAL 



Questions

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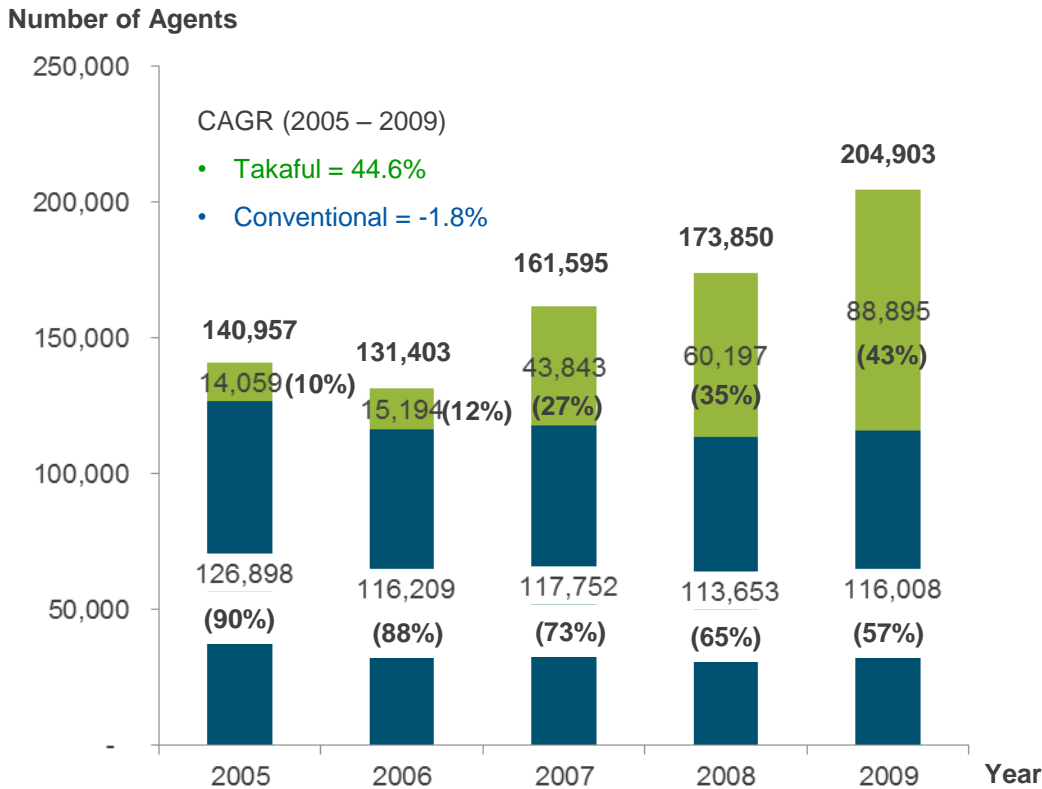
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Appendices

The number of agents in Takaful has grown tremendously as compared to conventional agents.

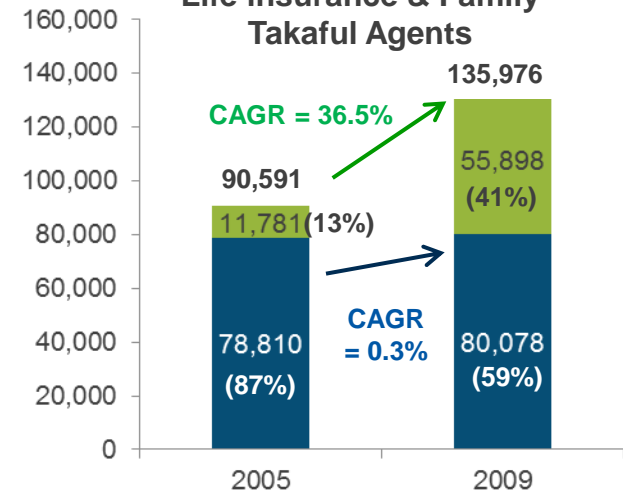
Total Number of Agents (Conventional & Takaful) in Malaysia



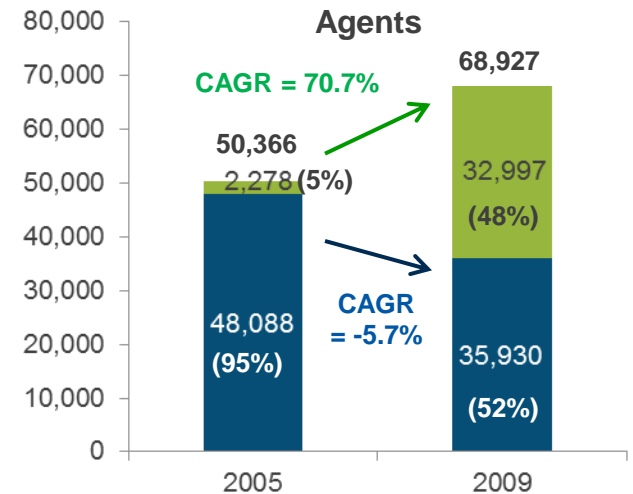
Conventional Takaful

Source: BNM Insurance & Takaful Statistics

Life insurance & Family Takaful Agents



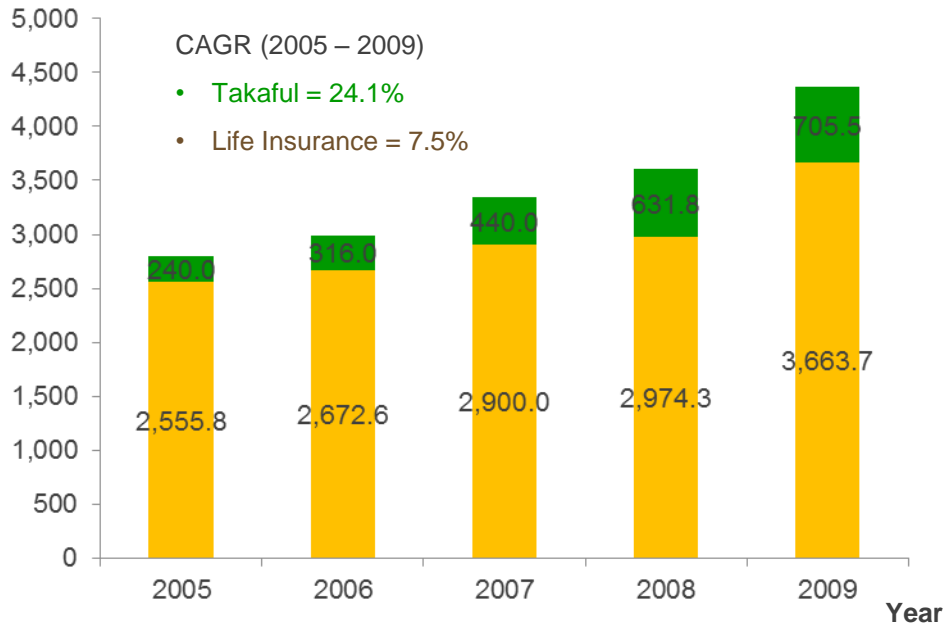
General Insurance & General Takaful Agents



The new business in Family Takaful has grown significantly as compared to the Life insurance industry.

Total New Business APE in Malaysia

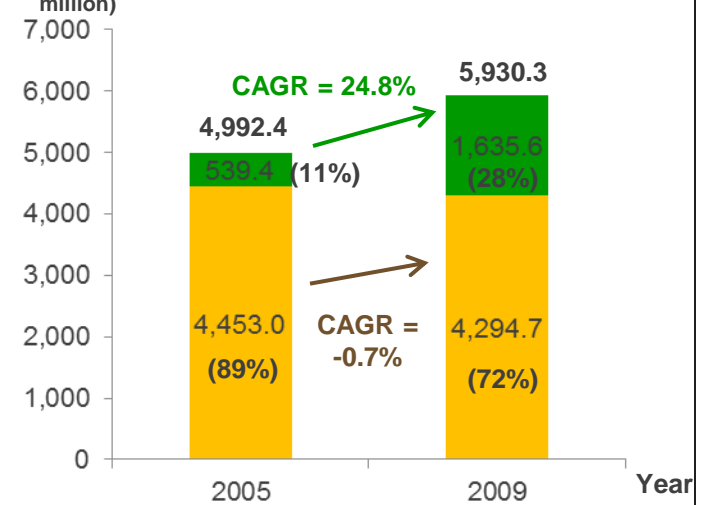
APE (RM million)



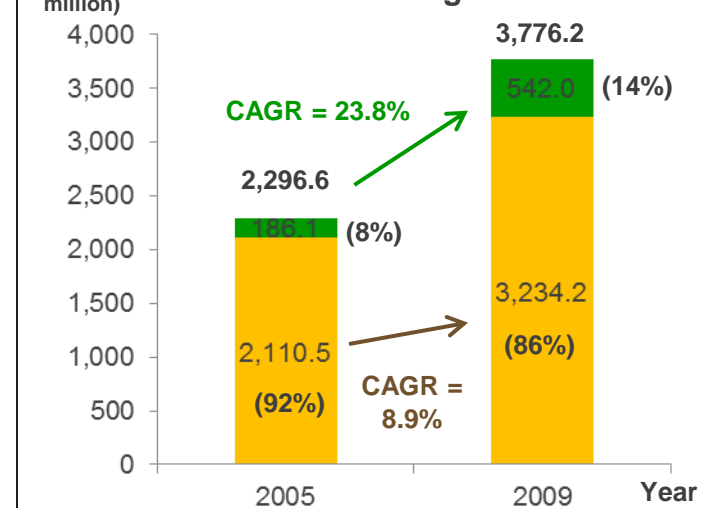
■ Life Insurance ■ Takaful

Source: BNM Insurance & Takaful Statistics

Amount (RM million) New Business – Single Premium

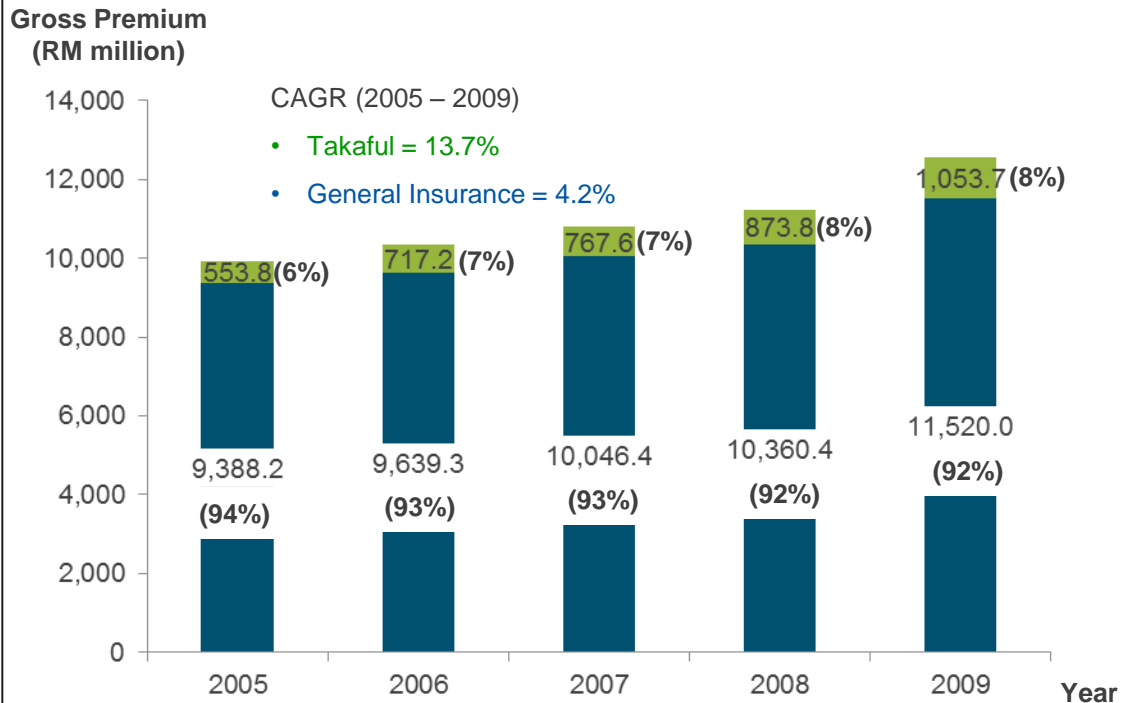


Amount (RM million) New Business – Regular Premium

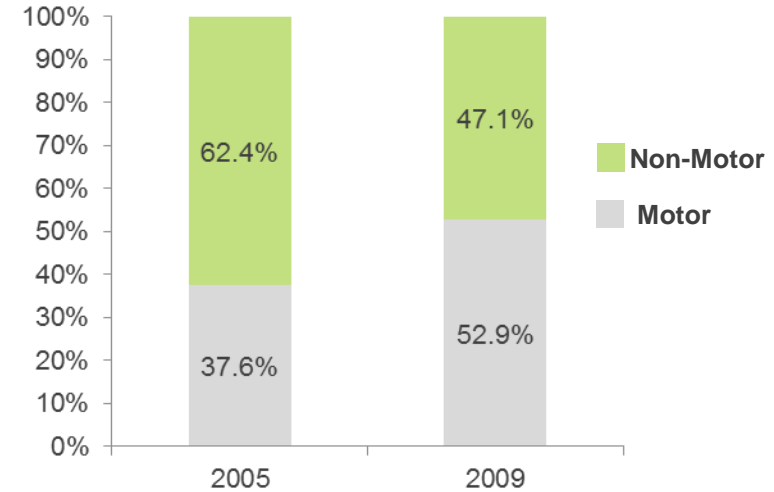


The growth in General Takaful is lower as compared to Family Takaful with the bulk of business coming from motor.

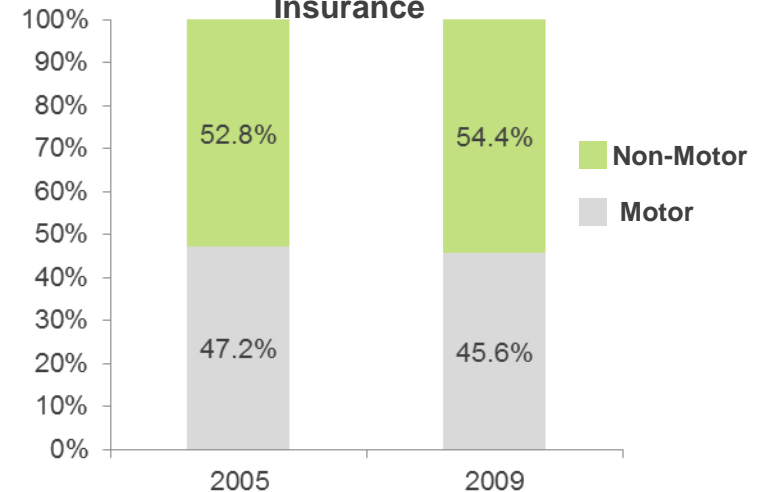
Total Gross Direct Contribution in Malaysia



Distribution of Contribution in Takaful

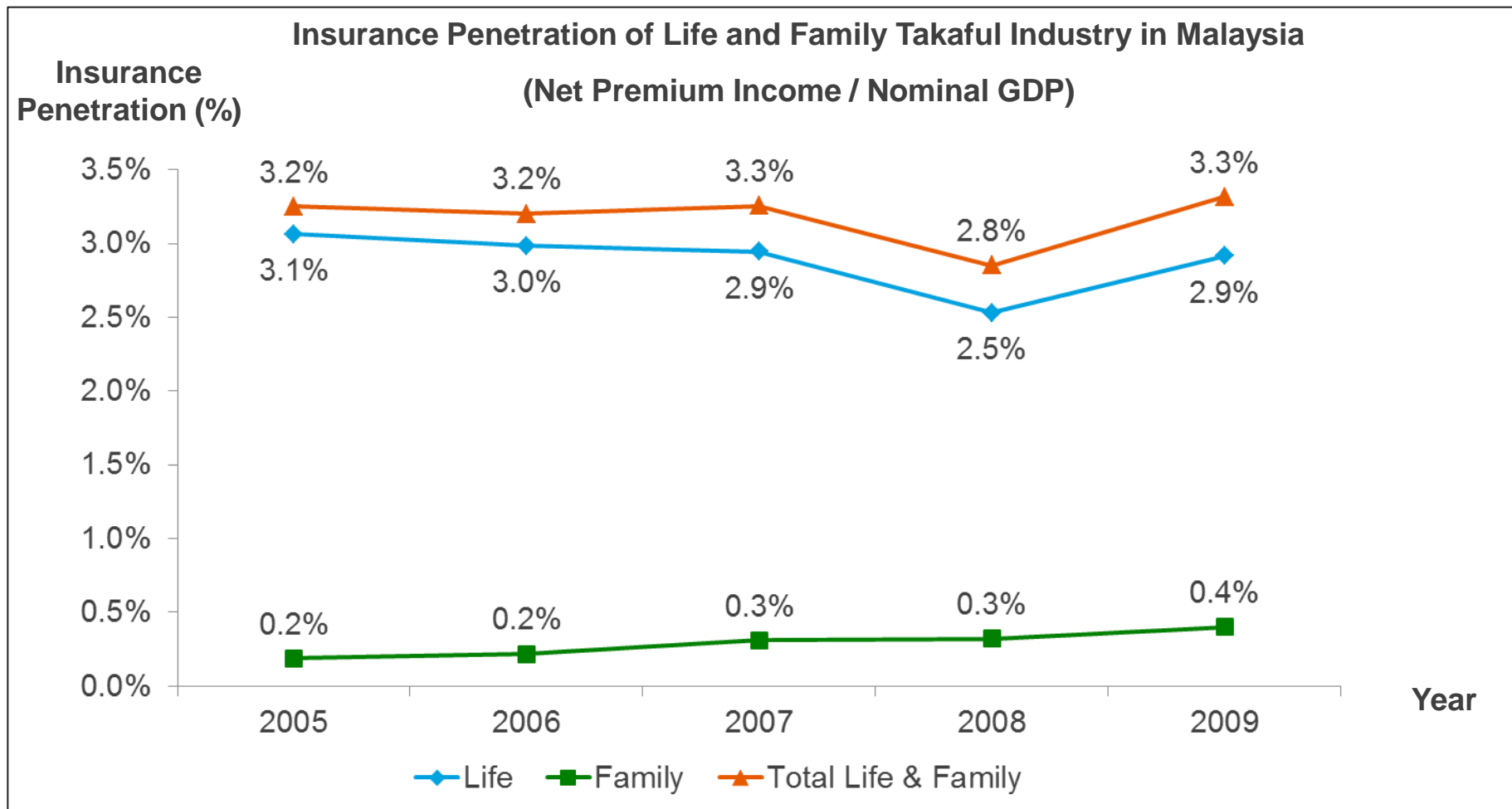


Distribution of Premium in General Insurance



Source: BNM Insurance & Takaful Statistics

Life insurance and family takaful penetration in Malaysia



Insurance Penetration = Net Premium Income / Nominal GDP

Source: BNM Insurance & Takaful Statistics, BNM Bond Info Hub

The Islamic Banking Growth in Malaysia

	2006	2007	2008	2009	2010 ¹	CAGR
Total Assets ²						
Amount (RM million)	170,542.0	203,835.1	250,981.9	303,262.1	350,802.2	15.5%
% of total assets of entire banking system	14.4	15.5	17.4	19.6	20.8	n/a
Total Financing ²						
Amount (RM million)	102,955.0	121,988.9	150,499.0	186,864.3	222,282.0	16.6%
% of total financing of entire banking system	16.0	17.3	18.9	21.6	22.7	n/a
Total Deposit ²						
Amount (RM million)	126,555.7	154,763.0	194,385.5	235,938.1	277,549.7	17.0%
% of total deposits of entire banking system	14.7	16.8	18.8	20.7	22.6	n/a

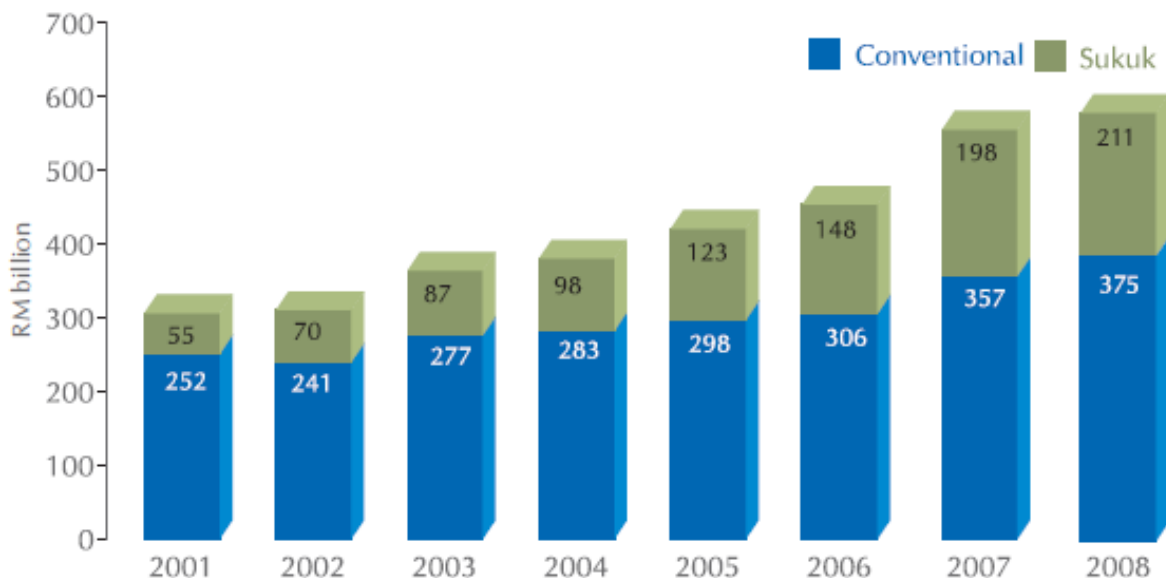
Note:

1. Preliminary
2. Including development financial institutions under the Development Financial Institutions Act 2002

Source: BNM Financial Stability and Payment Systems Report 2010

The Debt Securities and Sukuk Market in Malaysia

Outstanding Malaysian debt securities and sukuk by issuance principal



	2001	2002	2003	2004	2005	2006	2007	2008
Conventional	251.6	240.6	277.0	283.1	297.9	306.3	357.4	374.5
Sukuk	55.2	70.1	87.3	97.8	123.2	147.6	198.4	211.0
Total	306.8	310.7	364.3	380.9	421.1	453.9	555.8	585.5
of which								
Corporate sukuk	40.2	52.7	64.3	71.8	90.7	105.1	141.5	157.8
Government sukuk	15.0	17.4	23.0	26.0	32.5	42.5	56.9	53.2
Sub-total	55.2	70.1	87.3	97.8	123.2	147.6	198.4	211.0

Source: Malaysian Debt Securities and Sukuk Market, A Guide for Issuers & Investors, BNM & Securities Commission Malaysia

The Development of Major Guidelines in Takaful Industry Malaysia

	Guidelines	Descriptions
1	Guidelines on Family Takaful Products	<ul style="list-style-type: none"> • Implemented on 16 Oct 2006. • Set minimum requirements for the introduction of new family products to the public. • This guideline is similar to the following conventional guidelines: <ul style="list-style-type: none"> • Code of Good Practice for Life Insurance Business issued in 1997 which was subsequently revised in Nov 2006. • JPI 23 - Submission of Actuarial Certificate issued in April 2000.
2	Guidelines on Stress Testing for Takaful Operators	<ul style="list-style-type: none"> • Implemented on 1 Dec 2008. • Similar to the conventional “Guidance Paper for Stress Testing by Insurers” issued in October 2003 which was subsequently replaced by the Guideline on Stress Testing for Insurers which was implemented on 1 Dec 2008 as well. • This is to ensure that takaful operators identify problems early so that pre-emptive measures can be instituted at an early stage.

The Development of Major Guidelines in Takaful Industry Malaysia

	Guidelines	Descriptions
3	Guidelines on Product Transparency and Disclosure	<ul style="list-style-type: none"> • Issued in 2009. • Guidelines on the minimum information to be disclosed on financial products and services to consumer.
4	Guidelines on Introduction of New Products for Insurance Companies and Takaful Operators	<ul style="list-style-type: none"> • Issued in Sept 2010 • Prior to this guideline, all insurers and takaful operators were required to wait for BNM's approval before launching any product. • This 'launch and file' guideline allows insurers and takaful operators to launch certain products without waiting for BNM's approval.
5	Guidelines on Valuation Basis for Liabilities of Family Takaful & General Takaful Business	<ul style="list-style-type: none"> • To be implemented on 1 July 2011.
6	Guidelines on Takaful Operational Framework	<ul style="list-style-type: none"> • To be implemented on 1 Oct 2011. • This guideline is to govern operational processes of takaful operators
7	Risk Based Capital Framework for Takaful Operators	<ul style="list-style-type: none"> • Issued in April 2011 and first test run will be required by end of August 2011. • RBC for conventional insurers has already been implemented on 1 January 2009.



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