



5 December 2012

Risk Based Capital Seminar

-The sum of the total, are we moving closer to risk transfer?

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The Role of Regulators

- Prudential Standards (Valuation Guidelines & RBCT?)
 - 99.5% probability of paying claims.
- Business Conduct (TOF?)
 - Disclosure of key contract terms to participants/policyholders e.g. surplus distribution basis, sharia compliantness.
- Governance
 - Clear lines of accountability
 - Stakeholders responsibilities.

The Role of Financial Reporting

- Defined as the process of providing financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.
 - For takaful that means shareholders NOT participants .
- Would consolidation of shareholders and participant's accounts achieve the purpose of Financial Reporting as defined above?
- Where do participants refer to determine the state of health of the participants risk fund?

The Facts

- The pricing of takaful products is moving (due to competition) to that of equivalent conventional policies. Is this possible/prudent?

Initially solvency margin in takaful will be sourced from the participants

Conventional pricing : best estimate of claims + **cost** of solvency margin

Takaful Pricing : best estimate of claims + solvency margin

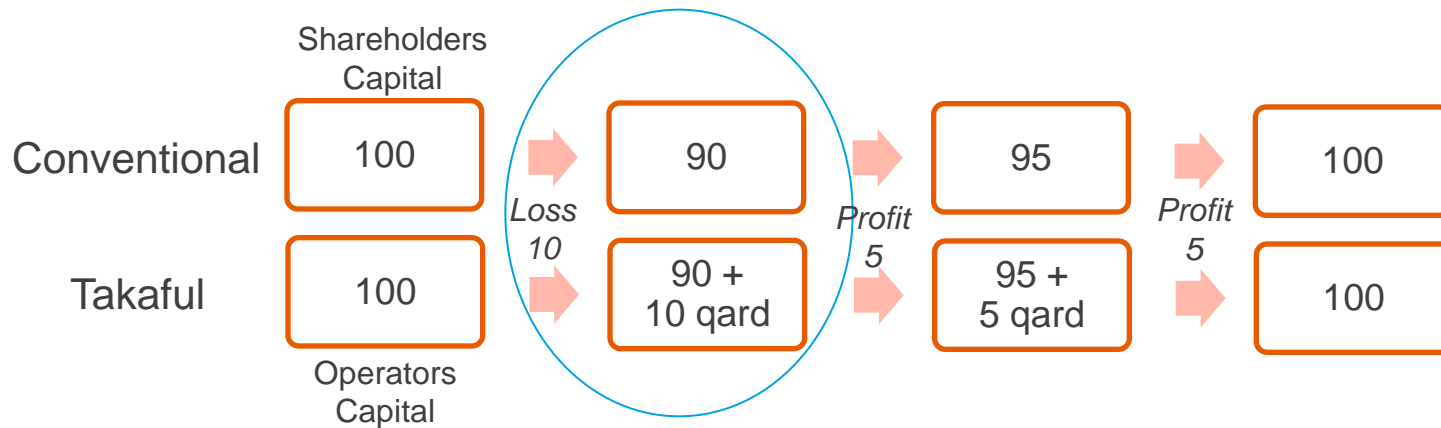
Thus conventional insurance should be 'cheaper' than takaful.

- Shareholders of takaful companies are expecting the same (or better) return on their capital as per their investments in conventional insurers.
- The valuation and RBCT guidelines for takaful are very similar to that of the conventional non-participating policies. This includes the valuation of liabilities and assets and the corresponding risk charges.

The Facts

- Sharia views supports Operator sharing in underwriting surplus. While Qard is subject by the Regulator to impairment tests.
 - Is this not risk transfer?

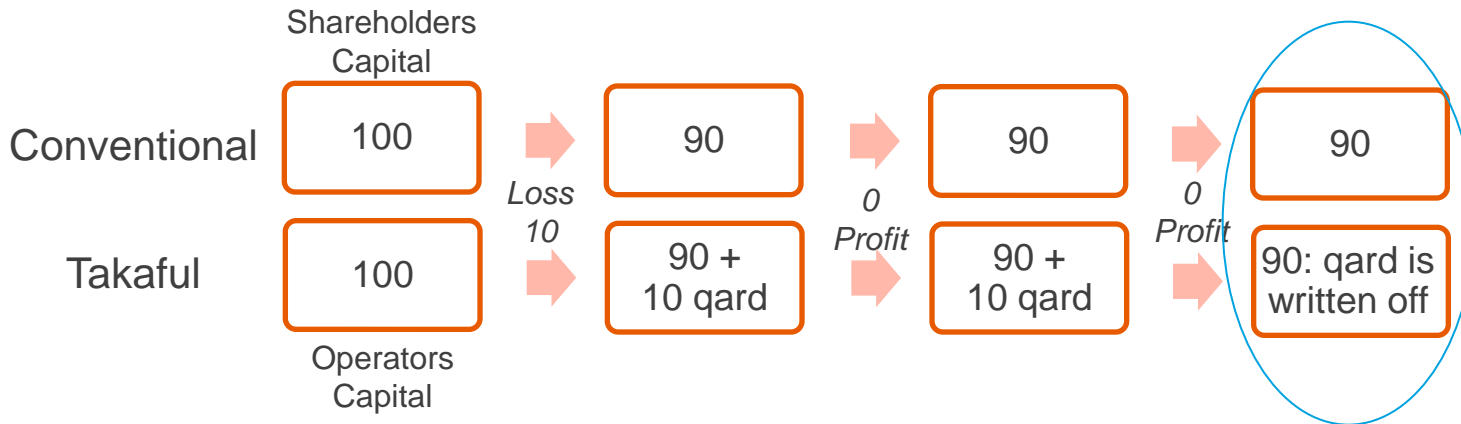
Example Qard is repaid



- All surpluses arising after a deficit is used to repay Qard for the takaful example. Only difference is the Operator does not show a loss initially

The Facts

Example Qard is written off



Is this risk transfer? Sharia is against qard being written off but the Regulator is insisting though not setting a fixed timeline.

- The accounting bodies are pushing for consolidated accounts.
 - Is this not accounting for risk transfer?

What do Malaysians need?

- Affordable takaful/insurance cover
- Fair and transparent rating structure
- Annuity products
- Affordable medical cover



What makes takaful insurance 'expensive'

- Cost of guarantee
 - Is it necessary to have 99.5% certainty that claims will be paid?
 - Is providing a benefit guarantee consistent with the takaful concept of risk sharing?
- Shareholders need for a certain return on capital
 - High returns required by shareholders in banking and insurance is to cover the cost of default/underwriting losses. If shareholders are not responsible for benefit shortfalls should not the shareholders be satisfied with a lower return on capital?

Takaful industry should go back to principles of risk sharing

- Flexible benefit payments depending on what the takaful fund can afford
 - Move away from a benefit guarantee model.
- Create new sharia compliant asset classes that supports the concept of Muamalat
 - Not so volatile as equities but not too close to bonds in its features (i.e.no yield curve).

How to achieve this?

- Takaful companies must take the lead
 - Create products which are less capital intensive under RBCT. As a general rule less capital required from shareholders for solvency margin, less risk transfer and more risk sharing.
 - Lobby for new asset classes suitable for protection (term cover) and retirement (annuities). Lobby for lower capital charges for these asset classes.
- The industry must move together on this. Perhaps the Sharia Advisory Boards of takaful companies need to provide the direction.



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