Islamic Finance *news*
Research Reports

Takaful & re-Takaful 2010

A Strong Case for Bancatakaful

By ***Sohail Jaffer***

Interest in Takaful from Muslim and secular insurers and insured alike cannot be ignored. According to the latest industry figures, global Takaful contributions grew 29 % in 2008 to reach US$5.3 billion and remain on course to surpass US$8.9 billion by the end of 2010. Those figures clearly demonstrate a growing interest and increasingly so in non-Muslim countries. The upsides of selling or buying a Takaful policy are now fairly well known to the industry players and their clients: fairness, risk sharing principle, transparency and redistribution of re-Takaful surplus. The benefits for both parties are clear and easy to understand, which makes Takaful a very attractive option. However, the way insurers can sell their products and consequently how their customers can buy them is more challenging. What is the best channel to sell Takaful and how can it be achieved?

Bancassurance as win-win scenario for all parties

Bancassurance presents clear advantages for all parties. This has been clearly demonstrated in August 2010 when The Royal Bank of Scotland (RBS) announced that it was drafting terms for a new distribution agreement with Aviva. The two giants, which have an existing joint venture covering protection, pension and investment products, are keen to better align their incentives. Aviva, the insurer, will provide protection and selective pension products but RBS will receive all of the profits from their sale, whilst also providing and distributing investment products of its own. From the bank's perspective, selling insurance amongst other financial products such as mortgage or credit cards, enables them to widen their product offering and consequently to benefit from wider income possibilities, as they get commissions and fees from their insurance business. From the insurers' perspective, the selling of insurance products through the banking channel enables them to depend less upon the agents to sell their products. As the training and remuneration of insurance agents cost a fair amount of money, it is more cost effective to use the existing bank staff, already familiar with financial products. Also, insurers can take advantage of the bank's wide customer base, which they would not necessarily benefit from should they choose to use agents. For the customers, not only do they get to buy insurance products from a trusted source, it is also convenient from a practical point of view. By selling insurance products, banks become one-stop shops and so prospective insurance buyers can save time by visiting their branch instead of trying to find a suitably qualified insurance agent.

Finally, for the Takaful industry as a whole, banks are the perfect vehicle to spread awareness about the products and to a wide number of people. Today, most people have bank accounts. Awareness is one of the risk factors for the Takaful industry: it has been identified as one of the conditions for Islamic insurance to reach critical mass . Banks can definitely have a role in spreading the word, as they usually have dedicated advertising and communication departments. However, in order to succeed in emerging markets, the European bancassurance model is not necessarily the best way to proceed. Indeed, bank marketers have to develop unique strategies attuned to local customers' expectations and adapted to their bank's distribution capabilities.

What would be a good distribution strategy of insurance products?

A good marketing strategy is to understand who the banks are selling to. As the majority of customers are in the mass affluent category, it is vital to target that segment. Customer fact-finding and risk profiling is important. To fully exploit the potential of the mass-market banking channel, insurers need new types of distribution, underwriting, administration, policy issue and delivery, premium collection procedures, customer service strategies and sales approaches. In bancassurance, technology must be combined with fundamental knowledge of insurance to develop processes unique to the banking environment. For example, if a life insurance or investment product offers basic protection or the promise of reasonable return at a fair price, consumers will buy it if the product, the distribution system and the channel are consistent. So if the delivery, the price and the availability's conditions are met, there is no reason why bancassurance should not be a very successful way of selling insurance.

Islamic-specific considerations for Bancassurance

In the Islamic space, developing dedicated sales teams offering Takaful products and offering them sales incentives on par with conventional products are some of the areas to be improved on to widen outreach and increase customer retention. In the majority of cases, Takaful remains deeply embedded within the overall wealth management operations of global financial institutions which typically offer the full range of conventional as well as Islamic banking services. It sometimes results in potential internal conflicts of interest between the Shariah-compliant technicians within the bank who are responsible for product design and development and the retail network responsible for delivering the product to the customer. The conflict arises because very few of the leaders in the Bancatakaful sector have stand-alone sales forces able or willing to dedicate all their resources to the promotion and distribution of Takaful. This issue creates a "shelf space management" challenge whereby Takaful has to jostle its way amongst other conventional insurance and banking products. Those are introduced on the market on a regular basis, whereas Takaful is a life cycle savings and protection solution in its nature. It means that although Takaful knows dynamic innovation, products are not launched with the same

frequency. Consequently, Takaful's challenge is to stand out from credit cards, personal finance and other retail banking products. To remedy this, senior management should offer a level playing field where the sales incentives are similar to other banking products. Alternatively, distribution could be achieved through an investment team responsible for the sale of products with longer shelf life, such as mutual funds and structured instruments alongside Takaful-linked products. Another way to alleviate that challenge is through white labeling whose benefits for the banks are numerous as they can give their own name to the products, integrate their own mutual funds to the mix and avoid too heavy investment in research and development while still diversifying their range of products.

Bancatakaful: examples of strategic alliances

The compelling economics of the Bancatakaful business model has proven a real success for joint ventures in Malaysia, such as Maybank and Etiqa, ING and Public Bank or CIMB and Aviva. The GCC has caught on that trend, as the industry is slowly gaining momentum there and as a consequence, similar initiatives have been launched in the Middle East.

In June 2009, AXA announced its partnership with one of the world's largest Takaful and re-Takaful group, Salama in the UAE. In November 2009, Allianz Takaful and Standard Chartered Bank have announced a five-year sales agreement to promote insurance products from Allianz Takaful in Bahrain. In Saudi Arabia, FWU Group, the global Takaful provider, has an equity stake in Al Ahli Takaful Company and has forged successful distribution partnerships, such as with National Commercial Bank. FWU Group also enjoys a very successful partnership with AMAN, based in Dubai.

Potential of the industry

Recent reports predict the Shariah compliant insurance industry will treble in size over the next four years to reach an outstanding US$25 billion .In order to build scale, it is widely believed by experts that the industry needs to concentrate on product development and distribution as well as become more competitive on price and services. According to a study released by Research and Markets in August 2010, total premiums earned by UAE insurance companies are expected to jump 76% to AED33.48 billion (US$9.12 billion) over the next four years from AED19 billion (US$5.17 billion) at the end of 2009. Life premiums will grow from AED2.33 billion (US$634 million)to AED4.44 billion (US$1.2 billion) during the same period. The growth will be supported by the UAE's physical infrastructure, willingness and the country's competitive advantage in logistics and pharmaceuticals. In August 2010, the UAE Insurance Authority reported that the UAE firms generated AED20.1 billion (US$5.47 billion) in premiums in 2009, a growth of 9.8% over the previous year. According to the "Saudi Arabia Insurance Market to 2012"released by RNCOS in August 2010, the industry Compound Annual Growth Rate has been forecast at 55% for 2009-2013, not only an impressive number but also sign of the fantastic potential of the industry in Saudi Arabia. And Bancatakaful can help achieve that growth as a distribution model of choice.

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Table 1: Benefits of bancassurance

Benefits to banks	Distribution	Joint ventures	Integrated operations	Benefits to insurers	Distribution	Joint ventures	Integrated operations
Secure an additional and more stable stream of income through diversification into insurance and reduce their reliance on interest spreads as a major source of income	X	X	X	Tap into the huge customer base of banks	X	X	X
Leverage on their extensive customer bases	X	X	X	Reduce their reliance on traditional agents by making use of the various channels owned by banks			
Sell a whole range of financial services to clients and increase customer retention		X	X	Share services with banks		X	X
Reduce risk-based capital requirement to the same level of revenue	X			Develop new financial products more efficiently in collaboration with their bank partners		X	X
Works towards the provision of integrated financial services tailored to the life cycle of customers		X	X	Establish market presence rapidly without the need to build up a network of agents			
Access funds that are otherwise kept life insurers who sometimes benefits from tax advantages		X	X	Obtain additional capital of banks to improve their solvency and expand business		X	X

Source: Swiss Re, Sigma No 7/2002, "Bancassurance developments in Asia-shifting into a higher gear", page 10.

Surplus in Takaful: A Different Perspective

By ***Arindam Saha***

The term Takaful is derived from the Arabic root, meaning to provide a guarantee or bear responsibility for. In short, it is the Islamic alternative to insurance. From an economics point of view, Takaful refers to a mutual guarantee or assurance given by a set of people living in a particular society against a specific risk that takes place in an individual's life/ possessions.

The basic goal of Takaful is to share the burden of all parties involved in the insurance contract and not to maximize profits as business. According to Islamic jurists, primarily, there are three elements i.e. 'gharar' or uncertainty, 'riba' or interest, and 'maysir' or gambling, which violate Shariah rules and the parts of a conventional insurance contract, and must be eliminated in Takaful.

When a conventional insurance contract is made, gharar exists because neither the insurer nor the insured knows the exact outcome of the contract. The insured does not know clearly whether he/she will receive compensation as an exchange to the premium paid.

In the Holy Quran, riba or interest is strictly prohibited but insurance policies contain an element of riba. This is possible partly because the conventional insurance premiums are invested at compound interest. The prohibition of riba is accepted by all Islamic jurists and is considered to be an absolute prohibition covering both, simple and compound interests as well as loans for production and consumption.

Islam prohibits all forms of business dealing where monetary gains originate from change or speculation. The maysir aspect in modern insurance was removed by the introduction of the concept of insurable interest. However, insurable interest is clearly attributable but not always clearly quantifiable. Conventional insurance contracts still involve some maysir because an insurer loses by way of sacrificing the premiums if the claim does not occur.

Surplus:

A typical insurance transaction consists of contributions paid into a risk pool or insurance fund from which claims or benefits are paid out to the policy holder as per the terms of the policy; administrative and management fees are deducted; and any reinsurance premium or re-Takaful risk sharing costs are deducted.

In a Takaful contribution (premium), there are three basic elements: risk protection; management fees (Wakalah or Mudarabah); and a reserves element, for incurred but not reported claims. If the contribution is linked with a savings plan, there is a fourth element for investment purposes. The

portion of the contribution as a risk protection element is designated as Tabarru' (or donation) and accumulates in a risk pool out of which claims and/or other types of mutual assistance are paid to the policy holder as needed.

The term surplus in Takaful is actually the excess contribution over claims payments in the risk pool. A surplus in Takaful operations is the total contribution paid by the insured less the total value of claims paid (adjusted for any claim recoveries from re-Takaful/reinsurance), less operator fees charged, and less reserves for outstanding claims. This is different from the 'surplus' in conventional insurance, which arises from:

- Excess/deficit of premium expenses loading over expense incurred;
- Excess/deficit of investment income realized over expected income and
- Favourable/ unfavourable mortality/morbidity experience over the expected.

Surpluses may exist at the reinsurer level as well. Depending upon the reinsurance treaty, any surplus may be returned to the reinsured based on a sharing formula. It is important to note that surplus is not profit. There is an important distinction between Takaful insurance transactions and profit-loss making commercial transactions.

Distribution of Surplus

Overall surplus is allocated pro-rata across profitable classes according to their contribution. If there is any deficit in the underwriting business, all classes will be treated as one portfolio and the distribution of profit will not be made for any class of insurance (Takaful).

Any remaining funds from the annual operations of the Takaful model forming the surplus should be treated in one of four ways: charitable donations; credit to contract holders; cash payouts; or credit to the next year's contribution. It is noteworthy that the option for charitable donations is not offered by a conventional firm.

Distribution of surplus is determined by the model of insurance selected. Conventional insurers retain the surplus, if any, and distribute it to the shareholders alone. Takaful insurers distribute the surplus among the contract holders. The decision to reduce surplus distributions to contract holders who may have suffered losses and, consequently, qualified for claims or benefits, or compensation during the year in question is managed differently among Takaful operators. Some practitioners favour treating all Takaful members equally with regard to the distribution of surplus, as they were original sources of the risk capital. Others prefer to adjust and reduce the return of surplus to any contract holder who has already benefited from the Takaful pool through claims during the same year. The benefits paid to a claimant from prior years (such as fire, marine or liability losses or disability payments) generally do not carry forward and affect the surplus calculation for that contract holder in the current year.

The issue of contribution comprises the prime difference between Takaful and conventional insurance alongside many features which distinguish the principles of Takaful as a means of mutual assistance and risk sharing. Takaful operators follow the Islamic finance principles of Mudarabah and Wakalah in conducting their businesses. While Mudarabah is mostly used in Asia-Pacific countries and Wakalah is mainly spread in the Middle East and Africa. A hybrid Waqf-Wakalah model is being developed, at present, in South Africa and Pakistan.

Takaful is a market with great potential and is currently witnessing remarkable achievements in various countries around the globe. Leading insurers also recognize the growing demand of this Islamic alternative to conventional insurance. The Takaful industry offers a huge untapped potential for growth and prosperity as more and more Muslims worldwide are seeking better opportunities each day to satisfy both their financial and spiritual needs.

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