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Ahli Kumpulan Maybank Takaful
Creating demand

The Takaful industry, in all honesty, has been a bit of a late bloomer. While most other sectors within the Islamic finance industry have seen relative progress over the last few years; or at least been a topic of much debate and open discussion, the Takaful sector has been left behind. Despite efforts and encouraging results in some pockets in Southeast Asia – particularly Malaysia and in Pakistan – there has not seemed to be much movement overall.

A cross-sector view of the Takaful industry shows many hiccups still left to be ironed out in order to create significant impetus. For one, the question of a dearth of long-term paper for Takaful institutions to park their cash is still one of the top issues to be remedied. Apart from that, a lack of talent across a multitude of positions, as well as identifying the most effective marketing and distribution channels are amongst the few issues that need to be tackled to create growth.

Regulatory issues in what has been touted as the market with the most influence and growth potential in the world, the GCC, have been brought to light; with the next due course of action still far from sight. There have also been rumors in the market about Takaful subsidiaries of conventional insurers suffering from neglect; as their conventional parents selfishly stifle their growth by rationing the amount of support the wealthier unit could potentially provide. The fear of customers abandoning their conventional insurance policies for the Shariah compliant alternative has been cited as one of the reasons for this alleged occurrence in the market.

However, in new markets such as the UK, where Shariah compliant consumer financing has been met with sufficient demand and is said to be a potentially substantial contributor to its efforts to grow its Islamic finance sector, conventional insurers have chosen to explore the Shariah compliant route with innovation and enthusiasm. One such example is Cobalt Underwriters, whose aim is to expose global insurance companies to Shariah compliant investment opportunities to tether their risk to. By doing so, the company expects the momentum to drive the Sukuk market, while creating demand for Shariah compliant products.

In this issue of Islamic Finance news Supplements, we highlight the latest in the industry, discuss issues and contemplate possible solutions for the Takaful market; through features, interviews and chapters.
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Banking on Asia

With the amount of growth occurring in the region, coupled by a boom in project and infrastructure financing across Asia and the GCC, the Takaful market is set to benefit from focusing on the Asian market. NAZNEEN HALIM explores the prospects within the region.

Across the board, Takaful and re-Takaful players are discussing strategies and re-thinking opportunities on all fronts, from product development and innovation, new markets, marketing strategies and investment opportunities. Standards and regulations have also become an integral part of the growth of the Takaful and re-Takaful industry, with financial reporting and risk management key areas which are in dire need of attention.

According to Ajmal Bhatti, president and CEO of Tokio Marine Middle East in the UAE, the Takaful industry is still evolving and needs to innovate particularly in the areas of asset management, Sukuk and risk hedging. “These are important areas for Takaful where good asset-liability matching is paramount with secure and competitive returns,” he said.

The global credit crisis has not helped with the sector’s growth either, with market players citing it as an indirect cause of its stymied growth. Tobias Frenz, managing director of re-Takaful & GCC (Life) at Munich Re Underwriting Agents, elucidated: “The crisis has in one way or the other negatively affected all financial institutions, both Takaful and conventional. The direct consequences were felt on both the bottom and top-line, with lower returns for both shareholders and Takaful participants/insurance policyholders and slower new business growth on the back of a slowing or contracting economy. For Takaful in particular, we have observed a notable slowdown in the set-up of new operators in recent years; which is a direct cause of the capital crunch.”

He also commented that the re-Takaful market has not been experiencing a slow-down as far as new operators are concerned and that new players continue to enter the market due in part to lower entry costs and the fact that they can write business globally unlike their counterparts on the direct side.
“However, what we experience is a high degree of overcapacity on Family and General Takaful retail lines as too many re-Takaful operators are competing for a smaller than expected Takaful business,” Frenz said.

Malaysia at the forefront
The Malaysian Family Takaful market is estimated at RM4 billion (US$1.27 billion) at present, and constitutes the largest Family Takaful market in the world, holding 73% of total contributions; followed by the Middle East and Africa at 25%. In terms of sophistication, the Malaysian market is still touted as the best-governed and regulated jurisdiction for Takaful, under the watchful eye of the central bank, Bank Negara Malaysia (BNM). Takaful businesses in Malaysia are subject to the Takaful Act 1984, which was enforced on the 1st January 1985 to provide regulations for Takaful businesses in Malaysia and all matters encompassing Takaful.

Although considered one of, if not the largest Takaful market in the world, Takaful penetration in Malaysia is still relatively low compared to the conventional insurance industry. Even Family Takaful, the largest market segment in the Takaful industry still stands at a mere 11% compared to conventional life insurance at 43% of the population. Takaful operators however are not discouraged by these numbers, and see growth opportunities in this largely untapped market.

Although the Malaysian Family Takaful market is estimated at RM4 billion (US$1.27 billion) at present, and constitutes the largest Family Takaful market in the world, holding 73% of total contributions

Strengthening ties between the GCC and Asia is also expected to be a main push factor in the growth of the reinsurance market, with market players expecting a continuation of capital injection from Asia into the GCC; driven primarily by the desire to partake in soft and hard infrastructure projects, and increasing demand for oil exports.

Medical and health insurance which is expected to be the fastest growing line of business in the GCC, fuelled compulsory insurance requirements which are reshaping some of the region’s non-life markets, particularly in Saudi Arabia. The engineering and construction business ranks second, reflecting a strong rebound after the financial crisis and the subsequent economic downturn. Energy business is also expected to continue to grow on the back of additional on-shore facilities, whilst Family Takaful and General Takaful, which are required by banks for mortgage loans, are also sectors fuelling the demand for reinsurance in the region. An industry player said: “The construction, property and health lines of business offer major opportunities to insurers and reinsurers operating in the GCC.”

Tackling funds
According to the 2011 Ernst & Young report, Shariah compliant funds totalled to US$58 billion, whilst global Shariah compliant assets are estimated at US$300 billion. The difference of US$242 billion are regarded as institutional mandates, which have not been invested in either mutual funds or unit trust funds, but are instead assets that are managed by fund managers as a segregated account. Therefore, in Malaysia for example, its Shariah compliant fund managers such as BNP Paribas, Nomura Asset Management and AmAsset Management currently manage assets in domestic unit trust and institutional assets from outside of Malaysia; particularly in the Middle East.

On the buy-side of the asset management industry are the Takaful operators, who are crucial in the asset-liability matching process for the institution. According to Norlia Mat Yusof, chief investment officer at Etiqa Takaful, the major challenge to Takaful operators at present is to minimize the duration gap as assets continue to increase, and to seek alternatives in the market outside of the traditional Sukuk and equities investment channels. “We (Takaful operators) have begun to look at alternative classes such as property and private equity. However, in the case of private equity, the risk associated with its returns are higher; with a risk-based charge of 35%. This reflects the risk associated with the returns.” Essentially, she added, Takaful players are still seeking the elusive longer-dated Sukuk.

According to Norlia, Life and Family funds usually have a longer duration of 20-25 years as compared to General funds which have a shorter duration. As there is a scarcity for longer-duration funds in the market, fund managers are presently struggling to seek long-dated Sukuk.

With regards to pricing, Norlia stressed the importance of meeting with asset-liability matching and ensuring that products be delivered as it had been priced and to take into consideration the implication of currency exchanges when overseas transactions are involved. She added that further considerations are needed due to limitations and future risk-based charges in addition to the 10% restriction per fund as dictated by Malaysian Takaful guidelines.

Daniel Choong, executive director and head of business development at Nomura Islamic Asset Management also shared his perspective from a fund manager’s point of view, stating that at present, opportunities in the Takaful market are currently rife, on the back of excellent growth in the GCC and Malaysia. However, he added: “We are seeing a slowdown to a certain extent, and seeing emerging markets gaining traction in terms of Takaful penetration. There has also been talk about Malaysian players exploring Indonesia, given the tremendous growth rate of over 5% in the republic over the last few years. In terms of penetration, there needs to be sustainability in the market. Regulators in the Middle East – the GCC and UAE – are typically viewed as more lax compared to Malaysia. For instance, Malaysian Takaful operators have limits to their overseas investments, and even for segregated mandates...”
there is a risk charge and reserve requirement, which is a lot higher than if they were to invest locally. In the Middle East and the GCC, we see a lot more flexibility, therefore consumers need to be very careful as the overall yield and returns, even in 2008 and 2009, were negative.”

Choong added that Malaysian Takaful operators are looking to explore more asset classes for diversification purposes despite the relative stability of the local industry. Although the Sukuk market has been doing well and is seeing a tremendous improvement in liquidity, the industry is still deemed volatile as reflected by Takaful operators increasing their global Sukuk allocation to 30% from 10% in the last two years. He believes that regulators will play a major part in stabilizing the Takaful industry and implementing more guidelines for its long-term protection, particularly in the investment space.

Munich Re’s Frenz revealed: “The lack of suitable Shariah compliant investments is probably the biggest challenge operators are facing currently, besides the competitive pressure. It is difficult for the industry to rectify this without the full backing of the regulator. But even then, it is a mammoth task. Malaysia is a case in point where Bank Negara Malaysia is pro-active in closing the duration gap and investment options. But it is still far from sufficient to fulfil the operators’ needs. This is reflected in lower returns for Takaful operators compared to their conventional peers.”

He added that operators could cushion the impact by limiting the exposure to implicit long-term guarantees. “Implicit, as by definition there should be no explicit investment guarantee under Takaful. But the mandatory Qard requirement in under most regulations and a lack of transparent and true risk-sharing principles in the Takaful contract wordings are ultimately nothing but indirect guarantees the operator has to fulfil.”

Rising competition, lack of suitable Shariah compliant investments, shortage of expertise and evolving regulations are common challenges to operators in Southeast Asia and the GCC. Moreover, operators in the GCC struggle to control cost and achieve sustainable underwriting profits, calling for the need to consolidate in the mid to long-term. The lack of re-Takaful capacity has also been identified as a major hindrance to the industry’s growth, but has improved between 2009-11, indicating that the influx of new re-Takaful operators in the last five years have been providing sufficient capacity to support the direct writers, particularly in the personal and retail lines of business.

The Sukuk market has been doing well and is seeing a tremendous improvement in liquidity, the industry is still deemed volatile as reflected by Takaful operators increasing their global Sukuk allocation to 30% from 10% in the last two years

Growth challenges
Bahrain, which was one of the frontier markets for the Takaful and re-Takaful industry, had become one of the first countries to create regulations specific to this sector. However, the global credit crisis had hit the kingdom hard, causing assets to decrease by 35% in 2008, and prompted a review of Takaful and re-Takaful operations across the board. The report added: “The deceleration could be hard to reverse because of shrinking sales force in the industry. The number of employees involved in General Takaful sales in Malaysia peaked at 32,997 in 2009, when it soared by 107% from the previous year; but contracted by 5% in 2010. On the other hand, staffing for the conventional insurance industry fell by just 2%. If these patterns continue, the global Takaful industry could slow to single-digit growth in coming years. But some operators are determined to tap new markets to prevent this.”

Other challenges plaguing the industry include a lack of long-term Shariah compliant investments for Takaful companies, lack of resources and human capital, as well as the issues of risk sharing and risk transfer, including risk-based capital and returns to shareholders – all of which are fundamental issues that could potentially stymie the growth of the industry if not addressed promptly.
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Investment conundrum

Despite a thriving Sukuk market, based on the size and volume of recent issuances and a relatively positive outlook moving forward, the Islamic finance industry has not been able to satiate the voracious demand from Takaful operators for long-term Sukuk investments. This has unfortunately led to a dampened Takaful market and increased competitive pressure from its conventional counterparts due to the inability for Takaful operators to provide similar or higher returns to its customers, NAZNEEN HALIM writes.

In a bid to diversify their investment portfolios whilst adhering to the Shariah, Takaful companies such as Takaful Malaysia recently announced their intention of investing in the commercial property market to broaden its income base following in the steps of Takaful Ikhlas, another Malaysia-based operator which begun investing in the property market since 2010. The purchase of the property, a new office space, was done through the company’s Family Fund which, at the time of investment stood at RM720 million (US$236.7 million), or 60% of its RM1.2 billion (US$394.51 million)-worth of total assets.

Takaful Malaysia, which revealed its intentions to acquire commercial properties in London this year, is also bullish on the prospects of property investments as a viable form of investment. Group managing director, Mohamed Hassan Kamil said: “A depreciated currency and a devalued market is making London properties a worthy investment. It is a good time for investments, both for potential capital gains as well as reaping good yields.” He added that yields of between 5.5 – 8.5% could be achieved in London’s main office and financial district, where demand was hit hard due to the credit crunch. However, the Malaysian central bank, Bank Negara Malaysia, currently has a 5% cap on overseas investments for Malaysian insurers.

If successful, Takaful Malaysia will become the first Malaysian Takaful player to own properties overseas. More than 50% of
Takaful Malaysia’s current asset allocation is in Sukuk and equity and government investment issues, while properties also constitute 5% of the company’s investment portfolio.

**Risky business?**

However, in a 2010 report by S&P entitled “Islamic finance outlook”, the ratings agency expressed that investments in the property market, particularly for Takaful companies which are lacking capital, could potentially be a cause for concern.

The report stated: “Will a legitimate desire to avoid non-compliant investments constrain a Takaful operator’s ability to prudently diversify its asset portfolio or, more significantly, will Shariah compliance encourage over-exposure to potentially volatile equity markets, or volatile and often illiquid property investments? At Takaful companies, we usually find significant market risk in the form of equity and property investments, which will be a concern unless the company has a sufficiently strong capital base to support the periodic mark-to-market price volatility of such investments. As the sophistication and availability of Shariah compliant banking and capital market products increases, we would expect to see much more use of cash placements with Islamic banks, and investments in Sukuk-type bonds and funds.”

Although global property prices, particularly in the real estate market have been encouraging, there are still lingering fears of the occurrence of a property bubble, not dissimilar to the Dubai crash in 2010. However, the numbers have so far been in favor of a stable outlook, with properties in major cities such as London, Dubai and Kuala Lumpur seeing unprecedented growth in terms of prices, up to 44% in prime areas in London according to property agents Knight Frank.

This has been further driven by troubles in the Eurozone, with the ultra-rich of Spain and Greece rushing into the UK property market.

Dubai emerged as the world’s top performing real estate market in the first quarter of 2012, recording a 4% rise on the Knight Frank Prime Global Cities Index, while Jakarta recorded a 3.3% increase. Overall, the index rose 1.4% in the 12 months to March 2012. Nicholas Holt, Knight Frank’s Asia-Pacific research director, said the overall index is likely to remain subdued in 2012 fluctuating between marginal price falls and rises.

“Properties in major cities such as London, Dubai and Kuala Lumpur seeing unprecedented growth in terms of prices”

For as long as there remains a mismatch between the demand and availability of long-term Shariah compliant capital markets instruments as investments for Takaful operators, it will always be a game of dice when it comes to deciding the most suitable form of investment which will provide a favorable yield.

An industry player affirmed: “The lack of suitable Shariah compliant investments is probably the biggest challenge operators are facing currently, besides the competitive pressure. It is difficult for the industry to rectify this without the full backing of the regulator. But even then, it is a mammoth task. Malaysia is a case in point where Bank Negara Malaysia is pro-active in closing the duration gap and investment options. But it is still far from sufficient to fulfill the operators’ needs.”
Market leaders

Dubbed as the number one Takaful operator in Malaysia, Etiqa Takaful & Insurance, a subsidiary of Maybank – the largest Malaysian bank by assets – has grown from strength to strength over the years. The CEO of Etiqa, Ahmad Rizlan Azman, speaks to Islamic Finance news on future growth prospects and the Malaysian Takaful market.

Etiqa Takaful’s market share saw an increase of 36.6% in its Family Takaful line and a 49.7% growth across its General Takaful business from January to December 2012. The firm, which also has a broad business mix and supported by a variety of distribution networks, expects its growth to continue on a positive trajectory in the coming years.

Ahmad Rizlan Azman, the company’s CEO, attributes this to the diverse mix of agents employed by the firm, comprising Muslim and non-Muslim agents, which has enabled the company to successfully penetrate the non-Muslim market. “The competition level between Malaysia’s Takaful players is quickly growing as the number of Takaful operators is increasing. The industry is growing on its own as the Takaful market is considered very new and untapped. In addition to that, Takaful products can also be offered to both Muslim and non-Muslim consumers and at the same time, maintaining Shariah compliance in the daily business operations. This is why we have non-Muslim agents who markets a wide range of Takaful products to customers both in the Muslim and non-Muslim regions.”

According to the latest figures by the Insurance Services Malaysia, Malaysia is currently the largest and most mature Family Takaful market, holding 73% of total global contributions. Family Takaful is also the dominant business line in Malaysia and accounted for 76% of the total Takaful market in Malaysia.
in 2011 according to actuarial firm Milliman. Based on these figures, Ahmad believes that Malaysia’s Takaful industry is expected to remain healthy and sustainable due to strong fundamentals and low insurance penetration rates in the country.

The Malaysian Takaful industry has seen consistent growth since 2009, with the number of operators increasing from eight to 12 in 2012, as a result of the liberalization of the industry. Bank Negara Malaysia, the central bank, had awarded four new Takaful licenses in 2009, spurring further competition in the sector. “With the increasing number of Takaful companies, I believe that it will provide more opportunities for healthy competition. Through this competition, all operators can improve their services and bring their performance level to new heights. Although there is a surplus of Takaful operators than ever before, the penetration rate of Takaful service segments is still considered low at about 11% of the total population, compared to the 42.8% for the conventional industry,” said Ahmad.

He also believes that there is much room for growth for the Malaysian Takaful industry due to increasing demand for investment-linked products. Ahmad added: “In addition to that, it is also supported by the increase in gross domestic product per capita as well as the lack of capacity of Malays who do not have insurance or Takaful.”

“Moving forward, the development of the Takaful industry in Malaysia will be enhanced by the new Takaful players, in particular to penetrate the untapped areas of business,” Ahmad elucidated.

On the horizon
The upcoming implementation of the risk-based capital framework (RBC) which is expected to come into force in 2014 is good news for the Takaful market, according to Ahmad, who sees this as a buffer towards risks currently faced by the industry. He said: “The RBC framework for the Takaful industry started its parallel run in 2013 and will come into force in 2014, to be based on the parameters of the conventional insurance framework but with more stringent framework. The framework will be a catalyst to ensure that all Takaful operators have an adequate level of capital to assume risks in their day to day operations.

“With the introduction of the RBC for Takaful, issues of capital insolvency can be mitigated. Under this new framework, adequate capital level must be maintained at all times by all Takaful operators, to act as a financial buffer against any exposure to risks. In addition, this framework will also strengthen and align individual operators’ solvency and capital position according to their respective risk profiles.”

For the company itself, which expects its growth to be paralleled to the Malaysian Takaful market, there are three main growth factors that Ahmad views as critical to the insurance and Takaful industry in Malaysia. These include medicine and health, retirement and education. “The spending on healthcare is growing, in line with the demand for the best healthcare benefits. These factors provide for an opportunity for insurers/Takaful to provide healthcare and shelter needs in a cost-effective manner. The opportunities for retirement products are also growing as improved quality of life has led to an increase in life expectancy, while the rising cost of education makes early planning important for people to be better prepared in funding educational needs. Therefore, we can see the opportunity for insurers and Takaful companies to fill this need.”

With the increasing number of Takaful companies, I believe that it will provide more opportunities for healthy competition. Through this competition, all operators can improve their services and bring their performance level to new heights

New blood
According to Ahmad, the presence of new Takaful operators exploring new business segments will increase the awareness and competitiveness in the sector. “I feel that the awareness and competitiveness of sector players will increase by itself as the development of the Takaful industry in Malaysia will be enhanced by the presence of new Takaful operators, particularly in penetrating the business opportunities that have yet to be explored (eg. medical and health Takaful, retirement, education and micro-Takaful) and contribute towards strengthening Malaysia’s position as an international Islamic financial hub.”

On the whole, consolidation is expected to strengthen Takaful operators with better capitalization, resulting in stronger claim paying ability, more competitive pricing of products and improvement in infrastructure to better service the customers. Ahmad observes that there might be further consolidation through mergers and acquisitions activity in the Malaysian Takaful market, following the recent acquisition of ING Insurance by the AIA Group, where both entities have separate Takaful operators.

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May 2013
Takaful structures: Flexibility and growth

Takaful as a concept is generally well-understood, but the multiple variants of structure and model – which can differ greatly between countries – are less easy to grasp and can represent significant challenges for participants attempting to analyze performance. In this feature, Islamic Finance news gives a basic rundown of the various Takaful models and assesses their individual features, advantages and challenges.

Takaful, like mutual insurance, offers a transparent sharing of risk by pooling individual contributions for the benefit of all subscribers. The word Takaful is derived from the Arabic Al-Takaful – "bear ye each other’s burden". Under the Takaful Act of Malaysia, it is described as: "A scheme based on brotherhood, solidarity and mutual assistance, which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose."

The core concept on which Takaful is based is Tabarru’, meaning gift or donation, that makes the element of uncertainty acceptable. A Takaful contract is a combination of Tabarru’ and an agency or profit-sharing contract between the policyholder and the pool. An operating company with share capital is normally at the top of the organizational structure and is responsible for overall governance, risk underwriting and investment management. Below this, the second tier of the structure consists of the policyholders’ funds. Subscribers pay their premiums based on an actuarial model similar to the conventional industry, but without a margin for profit and including a margin for risk.

Ta’awuni: Shariah for all
The Ta’awuni model (cooperative insurance) practices a pure Mudarabah concept and encourages the Islamic values of brotherhood, unity, solidarity and mutual help. Under this concept, there are two basic structures: Mudarabah and Wakalah.

Under the Mudarabah (profit-sharing) contract, most common in Malaysia, the model is designed as a profit-sharing arrangement between the operating company and the policyholders’ fund. The Takaful company and the participant share the direct investment income and the participant is entitled to 100% of his share of the surplus with no deductions prior to distribution. The agreed profit sharing allows the Takaful insurer to share in the underwriting results from operations as well as performance returns from invested premiums.

Under a Wakalah (agency fee) structure, prevalent in the Middle East, policyholders pay a management fee to the shareholders of the operating company in return for managing their policies.

Waqf: Limited application
Unlike Mudarabah and Wakalah, Waqf operates as a social enterprise on a non-profit basis. The surplus or profit is not owned by the shareholder/insurer or by the participants and no surplus funds are distributed, with the operator retaining the funds to assist in operation. Although it is a social (or often a government-funded) enterprise, the Waqf model is actually

Under both structures, loss expectations are conservative and surplus is returned to the policyholders either through refunds or through a reduction in future premiums. However, although theoretically any deficits likewise should be reimbursed to the operating company by the policyholders, in practice any shortfall is usually bridged by an interest-free loan from the operating company which is then recovered through future surpluses.
most similar to a conventional mutual insurance model and it
is rated in a similar manner by most agencies. However, apart
from in Pakistan, this model is rarely used in the leading Takaful
markets.

A lesser-used Ta’awuni model operates under the Wadiah Yah
Damanah structure and is often seen as an alternative to the
Waqf model. In this case, all contributions are allocated to a
Wadiah fund. The Takaful operator acts as the agent investing
the Wadiah fund and all profits from the investment go directly
to the Takaful operator, who then has the option of giving some
of the investment profit to the participants. According to AAOIFI
guidelines, this model is offered as an alternative to the Waqf
model as it clarifies ownership issues.

A variety of models
In practice, Takaful models can vary significantly across different
markets based on differences in local insurance regulations,
Shariah compliance and regional standards. AAOIFI identifies
four main Takaful models currently in use, each of which can
then be implemented and interpreted in different ways, creating
multiple sub-variants:
1. Wakalah
2. Mudarabah
3. Hybrid (Wakalah and Mudarabah)
4. Waqf

All models have common elements including the requirement
for two separate sets of financial statements (shareholders’
accounts and policyholders’ accounts), a Shariah compliant
investment strategy and a Shariah supervisory board. However,
from here the differences start to emerge.

Wakalah: The most efficient?
The Wakalah model is a fee-based model in which operating
expenses are borne by the shareholder and agency fees are
charged upfront as a fixed percentage of contributions. The
Wakalah concept is essentially an agent-principal relationship,
where the operator acts as an agent on behalf of the participants
and earns a fee for services rendered. The fee can be a fixed
amount or based on an agreed ratio of investment profit or
surplus of the Takaful funds.

This model is most prevalent in the Middle East and is based
on the argument that the operator requires a specific and
pre-agreed compensation for its management services. Bank
AlJazira, which uses the Wakalah contract, identifies the
reasons why it believes an agency fee should be charged
to make the Takaful operator as commercially effective as
possible, by listing the responsibilities of a Takaful manager:
1. Promote participation of new members (e.g. via advertis-
ing). Takaful is not sold but participation is invited.
2. Explain the concept of a Takaful cooperative to the
masses.
3. Set up a proper administrative system to run the Takaful
program.
4. Keep records of newly-registered members.
5. Maintain records of all participants in the event there is a
change in information about a member.
6. Invest the donations in Halal investments.
7. Develop new Takaful products to meet the needs of par-
ticipants.
8. Maintain statistical information and perform experience
studies.
9. Determine the appropriate contribution to be made by
each member – such contribution shall be determined
actuarially to enable an adoption of an equitable and fair
charging to all members.
10. Pay Takaful benefits when a participant makes a claim.
11. Prepare the balance sheet, revenue accounts and other
financial statements – to enable public accountability of
the management.
12. Perform actuarial valuation to determine the surplus of
Tabarru’ at fund.
13. Distribute the surplus equitably to participants.

Mudarabah: Structurally suspect?
The Mudarabah model is a profit (surplus) sharing structure in
which operating expenses, like the Wakalah model, are borne by the shareholder but shareholders are compensated through the sharing of surplus. In addition, a further variant of the Mudarabah model can be found which is profit-sharing but not surplus-sharing. In this model, operating expenses are borne by the policyholders rather than the shareholders, with the costs being charged after they are incurred (unlike the Wakalah model, which charges them upfront).

Under a Mudarabah contract, the operator acts as a Mudarib and the participants as Rab’ul Mal (capital providers). The Takaful contract will specify how the surplus from operations is to be shared between the operator/shareholders and the participants. The key difference is that losses are borne by the participants; although to protect the interests of the policyholders, the operator must observe various rules including the provision of interest-free loans to the Takaful funds in the event of a deficit.

Kuwait offers a further example of yet another variant on the Mudarabah model: which is based on a non-surplus-sharing Mudarabah and in which operating expenses are borne by the policyholder, but the policyholders receive a minimum of 50% of the sum of the underwriting surplus and investment income. In effect however, this translates simply into a timing issue. Under its Mudarabah model, Kuwait charges policyholders at the end of the year with the actual charges incurred throughout that year; compared to other GCC states which operate hybrid or Wakalah models and as such, charge costs upfront in the form of Wakalah fees.

There is an argument that the Mudarabah model encourages the operator to generate the maximum investment income in order to yield the most shareholders’ profit, which makes it attractive. However, others have argued that the model pushes providers to seek profit over-aggressively in order to increase rewards and there have been doubts raised over its Shariah compliance. AAOIFI has identified a number of concerns in the application of Mudarabah to Takaful operation and the sharing of surplus by the operator, including:

1. In Mudarabah, profit is to be generated and distributed in the commercial framework. Underwriting surplus (excess of premiums over claims, reserves and expenses) is cooperative risk-sharing (not a commercial venture) and hence not considered profit. Therefore, the Takaful operator does not have any right to it.

2. The sharing of surplus in itself is something which makes the structure into a business venture and moves it away from its core purpose as a mutual contract for assistance.

3. The requirement to provide Qard Hassan (in case of deficit) in a Mudarabah contract in itself is against the concept of Mudarabah, which is a profit sharing contract – a Mudarib cannot be a guarantor.

4. A Mudarabah contract entitles the Takaful operator to share in the underwriting surplus, but not to a share in any deficit.

Many operators have chosen not to use the Mudarabah model because of the view by many scholars that it is in conflict with the original form of the Mudarabah contract and is more controversial in terms of compliance than the Wakalah or Waqf models. As the expenses of managing the fund (if they exceed the profits made) are paid from the Mudarabah capital (the Takaful contributions), it is thought that this invalidates the Mudarabah contract. In contrast, a Wakalah model contains less Gharar or uncertainty because the expenses are covered upfront.

Hybrid model: Best of both worlds?
The hybrid model, as expected, is a mixture of Wakalah and Mudarabah in which fees are charged upfront (as per Wakalah) but a performance incentive fee as a percentage of the surplus is also agreed by the shareholders and Shariah board to encourage performance. The hybrid Wakalah/Mudarabah model charges a Wakalah fee on contributions and applies a Mudarabah contract to investments.

This is the official Takaful model adopted in Bahrain and is the model recommended by AAOIFI. Increasingly, more countries and companies are moving towards this model as a means of combining Shariah compliance with efficient performance and cherry-picking the best of both structures.

A recent analysis of Takaful operating models in Malaysia by the International Islamic University of Malaysia (IIUM) found some issues with the hybrid model which are raising concerns. In particular, there are fears that the hybrid Wakalah structure is too complicated with too many layers of fees, which has a negative result for policyholders. “Interview results find out that most of the practitioners think that the Wakalah fees imposed on the participants are too much and the hybrid Wakalah/modified Wakalah model has too many layers of charging profits from the funds and consequently, the currently adopted models are at the disadvantage of participants.”

Several Malaysian Takaful firms (including Takaful Malaysia, Takaful Ikhlas, HSBC Amanah, CIMB Aviva Takaful, Prudential BSN Malaysia and Great Eastern Takaful) recently participated in a survey on their choice of Takaful structure. A key response noted that especially for Family Takaful, a hybrid or modified Wakalah structure was preferred because unlike General Takaful, Family products are long-term in nature and generate very little profit in the early years. As such, a modified Wakalah model is more appropriate because the upfront fees allow for a more efficient cash flow structure and give the operators a better chance of survival.

Cross-border challenges
Different countries use different models, which are enforced to varying degrees. The Central Bank of Bahrain operates a practice of Wakalah for underwriting activities and Mudarabah for investment activities, for example. In Kuwait, the central bank has not issued any specific Takaful rules, but require all Takaful companies to use the Mudarabah model and charge a management fee at the end of the year from the Takaful fund; while Pakistan uses a Waqf model. Other countries, including Saudi Arabia, Qatar, the UAE and Malaysia, do not specify the model to use as long as companies comply with insurance law. However, in the GCC most firms use a Wakalah or a hybrid model. In Malaysia, while traditionally the Mudarabah model has been used, increasingly more companies are now moving towards the AAOIFI-recommended hybrid model.

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Despite the gradual movement towards a hybrid model, the current disparity can pose significant issues for multinational Takaful operators, including issues of cross-border standardization (how can products be used across different models in different countries?) and reporting requirements (how can a firm consolidate statements from subsidiaries that use different models in different countries?)

In addition, disagreements on Shariah compliance can also cause difficulties. For example, the issue of the sharing of the underwriting surplus is a key current concern. Shariah scholars have for the last few years been in hot debate over the ownership of the surplus – does it belong to the shareholders or the participants? AAOIFI prohibits Takaful operators from sharing the underwriting surplus.

However, some other scholars approve – the IFSB for example acknowledges the practice, while Bank Negara Malaysia allows it. The lack of standardization over this and other issues continues to present serious difficulties in operating international cross-border Takaful services.

**Market growth**

It must be noted that most participants believe their choice of model has little impact on customer choice or decision over provider or policy. The recent IIUM survey noted that: “The model adopted has no effect on the sales of the Family Takaful product as the consumers’/participants’ awareness about the model or contract is very limited. In Malaysia, the participants or consumers are very profit oriented and they do not actually give concern about the structure of the Family Takaful Fund. There is no such situation in Malaysia whereby a participant would choose to participate in a Family Takaful fund simply because of its mechanism/structure.”

However, this does not mean that the structure of a Takaful model is not important to its growth and to the growth of the market. A Takaful firm must be allowed to select the model it feels is appropriate based on its customer requirements, country regulation and Shariah compliance concerns.

The various aspects of the different Takaful models serve only to emphasize the healthy range of options available in the industry and homogenizing or standardizing this to too great an extent through the imposition of overly stringent guidelines to operational models, would serve only to restrict growth.

The industry must be given flexibility to determine its own path, with market players able to decide the suitability of the most appropriate model based on demand.
Zafri Abdul Halim is to some extent, the antithesis of your usual CEO. For one, he is one of the few who would admit to being “surprised” when asked to head up the Takaful unit of one of the region’s largest insurers; Great Eastern. This pioneer, who has served a substantial duration at the company before being elected as its CEO, is recognized amongst his peers as a strong leader with much to share in terms of know-how and experience. Trained as an accountant, with a Master of Science in Project Management from George Washington University, Zafri’s experience in the financial world spans over 20 years.

The following is an excerpt of the CEO’s exclusive interview with Islamic Finance news:

First and foremost, congratulations on your current role as CEO. What are your hopes and plans for Great Eastern Takaful?

Thank you for the congratulatory note. I did not actually expect to be appointed with this position. It is actually an honor for me that shareholders have put trust in me to lead Great Eastern Takaful. I hope to be able to drive the organization to bring it to a greater level and achieve its aspiration of becoming a leading Takaful operator locally and Insya Allah, regionally.

What are your thoughts on the current environment for Takaful in Malaysia and what are its key growth drivers?

With the entrants of new players and mergers happening, the market is now more competitive. Growth is driven by higher productivity of distribution channels and competitive products and services being introduced in the market. These are mainly driven by the culture of many of the foreign players which entered the industry over the last seven years.

How competitive are Malaysian Takaful players versus conventional insurance players in the country?

Takaful players are now becoming more competitive compared...
to many years ago. This is driven by many factors and among others is the demand for Takaful products itself by the natural market, which is increasing. With the conventional market space becoming saturated year by year, this has become an advantage for Takaful players, which also indirectly forces them to evolve to become competitive. However, there is still a need for Takaful players to catch up with the more matured conventional players in terms of service and infrastructure.

How dependent are Takaful subsidiaries, such as Great Eastern Takaful on their parent companies? In what areas do they require the most support?

Most young Takaful companies leverage on their sister company on infrastructure support. This is on top of the other best practices that are imported for high quality service. This approach enables cost effectiveness and efficiency besides being able to leverage on a tested successful infrastructure and model. There are various areas that support is needed especially on areas where it involves large investments on human capital and infrastructure, such as customer service, call center and branches. On the other hand, support on distribution management also enables the new operators to quickly boost up their business in the initial years.

"Growth is driven by higher productivity of distribution channels and competitive products and services being introduced in the market"

In your current role, how do you see yourself creating more awareness in the market on Takaful products?

As a person, I might be too small to make a big difference but I believe Great Eastern Takaful as an organization will be able to do so. This is via introduction of new product offerings suited to the needs of the market particularly skewed to Muslim market, professionalism of the Takaful distribution force, and quality service delivery to our customers. All these combined, I believe, will increase the awareness.

Where do you see Great Eastern Takaful in the next five years?

I hope for Great Eastern Takaful to become one of the top five players in the industry. Also, besides the financial objectives, which is a given, the main objectives for the company revolves around people and delivery of quality services. People have always been at the heart of our organization and I believe the development of great people shall be a main objective that I personally will strive to achieve over the next 12 months. At the same time, there is also a critical need to ensure the delivery of our services is at the best level and exceeds customers’ expectations.

What are the challenges currently facing the Takaful market on a global scale, in your opinion?

There are various challenges facing the Takaful market on a global scale. These include: efficiency in operations, distribution channels and human resource in particular. Although many Takaful operators have been around for quite some time, there is still a challenge for most Takaful operators to achieve critical business volume. Distribution capabilities, along with service quality remain a key challenge to better performance for Takaful operators. Expense ratio also remains higher than its conventional peers.

In terms of distribution channels, it is a common challenge that there are limited distribution channels/capabilities available. In Malaysia where we operate, it is still mainly dependent on the traditional agency channel. BancaTakaful channel is still at an early stage as its growth is also in line with the younger Islamic banking industry. The challenge is to manage a cost-effective channel without an economy of scale, compared to the conventional insurance sector, as it is still in the development stages.

Human resources, which is the quintessential challenge of our sector is probably the more challenging one, as there has been an introduction of new requirements where there is a need of talents who are well-versed in Shariah and/or insurance technical specialists that have Shariah awareness.

There is also a concern among many Shariah scholars where senior management at many Takaful operators come from the insurance industry. Whilst they are professionals with deep understanding of insurance, many are not familiar with the key Shariah issues associated with the conventional insurance model. This imposes a more important need of having Shariah-sensitive talents within the organization especially at the senior/middle management levels. Another main challenge is on the retention side where significant competition for resources has led to aggressive recruitment strategies backed by attractive remuneration.

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May 2013
One of the key developments in the insurance market has been the rise of bancassurance, a distribution channel which offers a means of efficiently accessing a wider customer base. As Islamic insurance grows and overall penetration increases, bancaTakaful is poised for further growth, especially in its key Southeast Asian markets of Indonesia and Malaysia. LAUREN MCAUGHTRY looks at the current trends.

Malaysia: A leading market
Malaysia is one of the largest Takaful markets in the world and Bank Negara Malaysia, the central bank, believes that the growth of bancaTakaful will continue to reinforce the market. “BancaTakaful, which uses bancassurance as a key growth channel for Shariah compliant insurance, is seeing positive growth for general Takaful and is now the leading distribution channel for Family Takaful products in Malaysia, accounting for 50.3% of contributions in September 2010,” according to the late deputy governor, Mohd Razif Abd Kadir. “With the development of bancaTakaful, consumers will have access to...
integrated financial services from banking institutions in a cost-effective manner.”

This success has allowed Malaysia to play a key role in promoting and developing bancaTakaful growth in neighboring countries, particularly in Indonesia, where several Malaysian Takaful operators have already entered the market. Leading provider Great Eastern Takaful entered Indonesia in 2011 in collaboration with OCBC Bank, which has over 400 branches in the country. In 2012 the group reported “encouraging growth in the bancassurance channel”. It currently derives a reported 10% of its revenue from bancaTakaful.

Indonesia: Growth and opportunity
Bancassurance was first introduced in Indonesia in the 1990s and has evolved into a successful channel driven by the increased spread of banking services, which has encouraged the purchase of insurance through banks due to its convenience and competitive pricing. According to the Indonesia Life Insurance Association or Asosiasi Asuransi Jiwa Indonesia (AAJI), bancassurance currently accounts for around 37.26% of the total premium income of life insurance in Indonesia; and almost every provider now offers a bancassurance service. Bank Indonesia, the central bank, has a Shariah unit (BNI Syariah) which operates in conjunction with BNI Life Syariah to offer bancaTakaful through 21 outlets. Bank Mandiri, one of the country’s biggest banks in terms of assets, loans and deposits, in 2003 collaborated with French provider AXA to combine their distribution channels and offer unit-linked Takaful products.

Indonesia’s insurance market is seeing fast-growing demand across all segments; and active competition is building offerings and bringing out new products and services. Increasing financial awareness along with a population shift from rural to urban areas is also making it easier for insurers to access customers – the World Bank has estimated that in Indonesia the urban population will grow from 42% to 60% from 2005-15 and is seeing annual growth of around 3.4%. The market is also being boosted by a strong government push for corporate, health and pension coverage; and by the attractive returns on unit-linked products due to the rapid growth of the Indonesian stock market, which saw 100% growth between 2006-11 on its main index. Indonesia has a low level of life insurance penetration at just 1% overall compared to 3% for Malaysia and over 7% for developed markets, making it a tempting opportunity for growth. In addition, premiums have been growing faster than the number of policies, thus increasing the average premium per policy – both for Shariah and conventional insurance, and for group and individual.

The mass affluent market is a core component of insurance market growth in Indonesia

Although individual Shariah insurance has seen strong growth, it is still very small in terms of asset size and premium. BancaTakaful can play a significant role in driving this growth, and the channel has seen a good performance over the last five years. Between 2007-10, the bancassurance channel in Indonesia saw compound annual growth of 38%, from IDR44 trillion (US$4.5 billion) to IDR76 trillion (US$7.77 billion), compared to just 13% for other channels. In 2010 bancassurance accounted for around 35% of all life insurance sales in the country.

The mass affluent market is a core component of insurance market growth in Indonesia, with up to 500 million potential customers and an estimated market size of up to IDR28 trillion (US$2.84 billion), or 34% of the total market. FWU Group splits the market into two segments: advice seekers and self-directed purchasers. Of these, advice seekers account for around
IDR15 trillion (US$1.52 billion) and tend to prefer to buy from banks and advisory agents. Self-directed purchasers will use online channels to research, but will also prefer to buy direct from banks and agents, suggesting that bancaTakaful remains a vital part of developing the sector.

**Product innovation**

A key trend in bancaTakaful is product innovation. The general perception of Takaful is changing, and instead of being viewed just as a means of protection it is becoming linked with the whole theme of wealth management and overall financial planning. This has led to demand for a far wider range of customized and sophisticated products, from investment-linked and wealth management services to annuities, medical coverage, specific ladies plans, child protection, personalized coverage and even microTakaful for the lower-income segments. As products become more sophisticated customers are also demanding better service and stronger relationships with their providers; and banks are in an ideal position to offer this, leveraging on their existing reputation and overall financial expertise and using their extended reach to access customers through marketing strategies.

“**At the point of sale,**
digital applications allow the agent to make the most of any sales opportunity and to transact whenever and wherever is convenient to the customer, giving greater ease of access.”

Sohail Jaffer, a partner at FWU Global Takaful Solutions, comments that: “The customers of today seek products that match evolving needs that arise from their lifestyle. This creates several challenges and opportunities.” As customers evolve through different life stages, their needs change. In terms of protection, the type and the amount of cover required changes. In terms of long-term savings, age also alters customer needs. Younger customers have less investable income but can take more investment risk. As they grow, marry and settle down, their risk appetite declines but their investable income grows. Sohail explains that: “Customers should be offered the flexibility to select their own amount of investment risk, and choose the features of their own benefits.”

According to Bank Negara Malaysia, new business contributions from investment-linked products increased to US$125.3 million in 2010 from US$113 million in 2009, making it one of the most popular asset classes. Investment-linked products currently accounted for around 15.6% of total new Takaful business contributions. As customers often have a history with their bank and turn to banks for investment advice, this makes the bancaTakaful channel even more important.

**The digital age**

While the bancaTakaful channel is growing, however, there are still challenges to be met. Ernst & Young’s Global Consumer Banking Survey 2011 noted that: “There is considerable room for improvement in the levels of channel efficiency, personalization and integration that banks offer their customers.” This has led to an increased focus on developing customer-centric processes, and the growth of digital systems has revolutionized this trend. “In a world where customers are in full control of your brand, it is important to go digital,” explains Sohail. “Information is the key to delivering solutions that customers need and want. Digital applications provide vital insight into the lifestyle needs of customers.”

The challenge is to evolve as quickly as possible, as customers become more informed and better able to access information and make choices based on their personal requirements. “Harness the power of social media such as Twitter and Facebook to understand and keep up to date with what customers are thinking,” suggests Sohail. “Use this information to develop improved solutions.”

Digital applications enhance customer service in two main ways. First at the point of sale, digital service helps to facilitate the sales process and provide customer convenience. Secondly, digital applications allow this data to be collected and analysed – capturing information not just from clients but from social media sources and networks; thus giving insight into customer segments and demands, monitoring sales, and therefore improving customer service and assisting with more appropriate and targeted product design.

At the point of sale, digital applications allow the agent to make the most of any sales opportunity, and to transact whenever and wherever is convenient to the customer, giving greater ease of access. It allows for immediate plan issuance and the conclusion of sales on the spot, thus saving the customer time and boosting the overall conversation ratio of visits to sales. This ease of distribution allows for a direct sales force, which is not only appealing to customers but offers a number of key benefits to the provider including enhanced productivity and efficiency of the sales agents, and the administration and underwriting of policies online.

Sohail concludes that: “Digital applications are changing the world we live in; allowing us to learn about evolving customer requirements and give them the solutions they need. All customers are not the same – digital solutions allow the provider to give clients a choice based on their age and lifestyle.”

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