جامعة حمدان بن محمد الذكية
Hamdan Bin Mohammed Smart University
مركز دبي للصيرفة والتمويل الإسلامي
DUBAI CENTER FOR ISLAMIC BANKING & FINANCE

TAKAFUL:
GLOBAL CHALLENGES TO GROWTH, PERFORMANCE & GOVERNANCE

آفاق
aafaq
islamic finance الإسلامية للتمويل

دبي عاصمة الاقتصاد الإسلامي
DUBAI THE CAPITAL OF ISLAMIC ECONOMY

I am proud to share that DIEDC, with the support of our strategic partners and stakeholders, is well on track to achieve our ambitious targets for 'Dubai: Capital of Islamic Economy'. This unique report on the growth and development of the takaful industry developed and published by Hamdan Smart University in collaboration with the Dubai Center for Islamic Banking and Finance (DCIBF) is an example of our sustained efforts in accelerating the development of the Islamic finance and domain ultimately articulate Dubai's vision to emerge as the global capital of Islamic economy.

I thank Hamdan Smart University for its insights and efforts in collating the report and for highlighting the future directions that market players and decision makers must adopt to assure sustainability and success for the industry.

As the global takaful industry continues its momentum and looks poised to reach a value of US$20 billion by 2017, there is still significant potential for the development of Islamic investment and insurance products in the European, American and Asian markets.

In the GCC, the United Arab Emirates currently provides the most holistic basket of products, as well as a diversified suite of family and Takaful general products.

Between 2012 and 2014, the takaful industry in the UAE grew at an average of 3.9% per annum. Notably, forecasts also suggest that the industry remains poised to grow at above 5% in the coming years. Despite these projections, there is certainly scope for improvement. Industry experts must collaborate with the government to develop the quality and competency of professionals driving the industry while encouraging innovation across all aspects of the business.

On the regulatory side, the UAE's Insurance Authority has engaged an industry-wide discussion on solvency, financial reporting and investment practices. Furthermore, the Authority has introduced new measures to scale up the regulatory framework of the Takaful industry, including putting in place the Takaful Act.

Rigorous scientific research conducted by leading and credible academic entities such as the Dubai Center for Islamic Banking and Finance (DCIBF) help increase awareness of the strategic measures policy makers and market participants need to adopt to further boost the Islamic insurance sector.

We are confident the findings of this report will indeed play a significant role in the mission of Dubai and the wider UAE to shape a viable future for the global Takaful industry.

His Excellency Essa Kazim,
Governor of Dubai International Financial Centre (DIFC),
Secretary General of Dubai Islamic Economy Development Centre

Since the establishment of Hamdan Bin Mohammed Smart University (HBMSU) in 2002, we have spared no effort to be an institution for providing academic and professional knowledge as well as a center for intellectual enlightenment on local, regional and international levels.

After the announcement of the initiative "Dubai the Capital of Islamic Economy" spearheaded by His Highness Sheikh Mohammed Bin Rashid Al Maktoum, the UAE Vice-President, Prime Minister and Ruler of Dubai, with the objective of diversifying the UAE strong economic base by providing it with a new vital hub, HBMSU pledged to be the educational arm of the initiative by establishing The Dubai Center for Islamic Banking and Finance (DCIBF). HBMSU is the first learning institute to launch a dedicated platform to boost academic knowledge and enhance the human capital development in Islamic Banking and Finance across the Arab World and beyond through the provision of quality education, training, research and community service and promotion of best practices in this area.

This report "Takaful: Global Challenges to Growth Performance and Governance" represents another milestone for the Dubai Center for Islamic Banking and Finance (DCIBF) as it comes in response to technical and socio-economic development issues that are of common concern to the Islamic Banking and Finance industry.

The report is produced in two languages; namely English and Arabic. It quantifies investment trends in this sector, and explores how these trends are affected by changes in market demand and industry structure.

DCIBF will continue its effort in enhancing the understanding of current practice of Islamic banking by going beyond mere analysis of its business model. DCIBF will take a more futuristic view on understanding the dynamics of investment decisions and resource allocation in this industry as well the changing perspectives of the potential clientele of the industry.

Dr. Mansoor Al Awar
Chancellor
Chairman of the Governing Board, UNESCO Institute for Information Technologies in Education (IITE)

The recent remarkable growth of the global Takaful industry is the focus of this scientific report published by the Dubai Center for Islamic Banking and Finance (DCIBF). Takaful: Global Challenges to Growth Performance and Governance examines the efficiency and financial stability of the Takaful industry in countries with dual financial and economic systems for the purpose of drawing conclusions on the future growth of this important sector of the Islamic economy.

The report identifies challenges and pressing issues faced by Islamic insurance, it quantifies investment trends in this sector, and explores how these trends are affected by changes in market demand and industry structure. The report also examines the governance structure of the Takaful Industry, refers to a divergence of Takaful operational models and provides stakeholders and policy makers with recommendations based on scientific and rigorous research.

The Takaful: Global Challenges to Growth Performance and Governance report is an initiative by the DCIBF to engage with its stakeholders and the Islamic Insurance industry on significant recent development and drivers shaping the future of this industry worldwide. The report encourages informed debate in an attempt to influence policy makers and market participants in the Islamic insurance sector.
This report represents another milestone of the Dubai Center for Islamic banking and finance in its efforts to support the important initiative of His Highness Sheikh Mohammed bin Rashid Al-Maktoum, Vice President and Prime Minister of the UAE and ruler of Dubai, establishing "Dubai the Capital of Islamic Economy", and the Dubai Strategic Plan which highlights knowledge economy and sustained socio-economic development, by providing rigorous scientific research that addresses topical issues in the area of Islamic Banking and Finance.

The Center will continue to conduct and facilitates research to advance the professional and theoretical foundation for Islamic insurance.

Professor Nabil Baydoun
Vice Chancellor for Enterprise & University Advancement
HBMSU

Aafaq Islamic Finance prides itself on being a leading Islamic financial institution in the UAE. To further bolster such a concept, aafaq signed a number of multilateral and local strategic partnerships in order to respond to, and be in line with the vision of HH Sheikh Mohammad Bin Rashid Al Maktoum to make of Dubai the Capital of Islamic Economy.

Within this framework, aafaq is proud of its strategic partnership with Dubai Center for Islamic Banking & Finance (DCIBF) to cooperate in further deepening such a concept and consolidating such a holistic strategic value.

Takaful Report is among other reports aafaq is planning to jointly issue with DCIBF. It is meant to cover the most current controversial issues in the Takaful industry. The report will deal with the structure of supply and demand, manpower in the Takaful sector, current status and forecast of contributions, Takaful models and growth challenges.

Takaful as a concept is a risk sharing management tool which emerged in response to the risk transfer tool in conventional insurance. It is based on mutual help and cooperation. The concept appeared long ago and dates from the pre-Islamic era through Aqila, Daman Khatar Tariq, Diya and other practices having appeared before the advent of Islam.

Conventional insurance is based on the transfer management tool of risk which requires the insured to pay a premium on the basis of a sale contract: the insured pays a premium as a price in exchange for the insurance coverage and protection offered by the insurer. Doing so, the insured transfers the risk to the insurer for a certain amount of money, thus the uncertainty is transferred to the insurer.
Such a mechanism is not allowed by Sharia since transferring risk and uncertainty is likely to bring about a main prohibited element in Shari'a that is Gharar.

According to Takaful mechanism, risk is not transferred but shared among participants who are owners of the same risk pool called participants' fund, or policyholders' fund, made out of the participants' contributions. Such a fund is then used to indemnify any participant undergoing a loss.

It is evident that insurance companies, whether they are Shari'a compliant such is the case for Takaful companies, or non-Shari'a compliant such are conventional insurance companies, either for profit or not—for-profit companies, have to cover the expenses incurred because of claims.

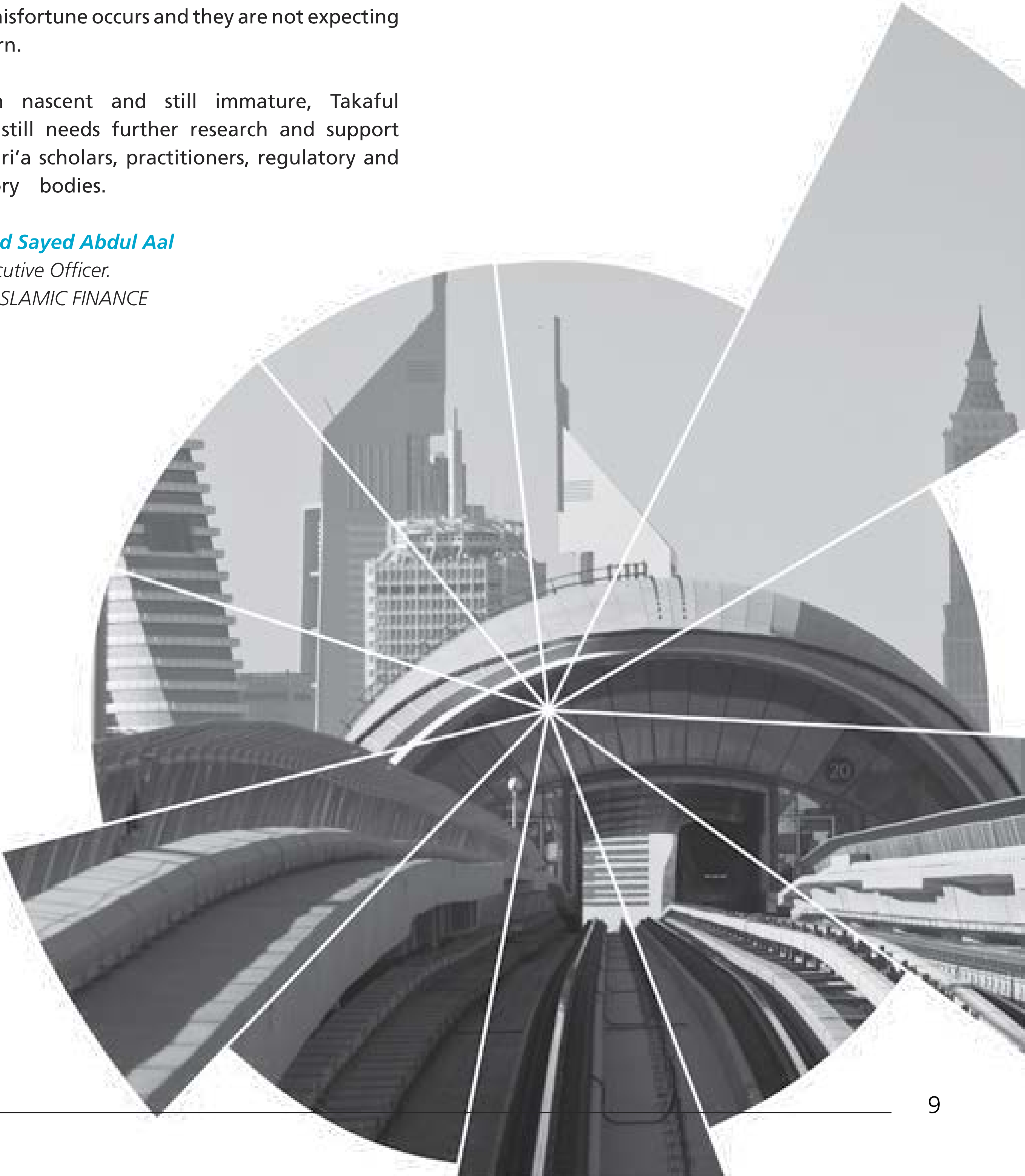
AAOIFI Accounting Standard determines four ways of surplus distribution. This may as well represent another challenges rather than giving more options and solutions.
"(A) Distribution of the surplus among the policyholders in proportion to their respective contributions, and regardless of whether the policyholder has received indemnity during the financial period or not, (B) Distribution of the surplus among the policyholders who have not received indemnity during the financial period. (C) Distribution of the surplus among policyholders after

deducting the amounts of indemnity they receive during the same financial period. (D) Distribution through any other method approved by the Shari'a Advisory Board"

Some scholars view that running a Tabarru' pool which is a non-profit mechanism with a commercial contract is controversial. Some view that distributing a surplus is against the very basic objective of creating a risk fund. Participants contribute to the fund with the pure intention to help one another when a misfortune occurs and they are not expecting any return.

Although nascent and still immature, Takaful industry still needs further research and support from Shari'a scholars, practitioners, regulatory and supervisory bodies.

Mahmoud Sayed Abdul Aal
Chief Executive Officer.
AAFAQ - ISLAMIC FINANCE



EDITOR'S NOTE

Though the application of the concept of Takaful, an Islamic and Sharia compatible alternative to contemporary practice of Insurance companies, enters only its 4th decade as contrasted with conventional business whose longevity exceeds 400 years, yet one may assert that formidable challenges still lie ahead in sound implementation of the essential Takaful principles. Sector growth remains impressive overall yet this masks a reality that many of the 233 Takaful operators are in fact struggling with their business models: in GCC only five (5) of 16 Takafuls produced surplus in 2013; whereas in Asia only 10% of 56 Takafuls produced deficit results between 2011-2013. Thus, sub-optimal financial and operational performance (as evidenced in this report) of Takaful suggests that now is time to reflect on origins, fundamentals, strengths and weaknesses, and what attributes stamp Takaful with a natural competitive edge.

Over the past 20 years, there have been 8 closures of Takaful operations – several were outright failures in their respective markets. While circumstances most certainly differ – poor management, weak planning, wrongheaded product decisions or pricing—typical risks in any modern business—one cannot conclude that Takaful principles are at fault, nor that Islamic values are not welcomed by target customers.

On the contrary, customers in the 21st century are savvier than ever, can access pricing and product information instantaneously on their digital devices, more vocal about quality of customer service and fulfillment of a brand "promise".

To propel growth, Takaful must become "customer centric", improve and innovate products/services address real customer needs, and adopt enterprise risk management systems and techniques to accurately assess and price risks, while adhering throughout to core Islamic values.

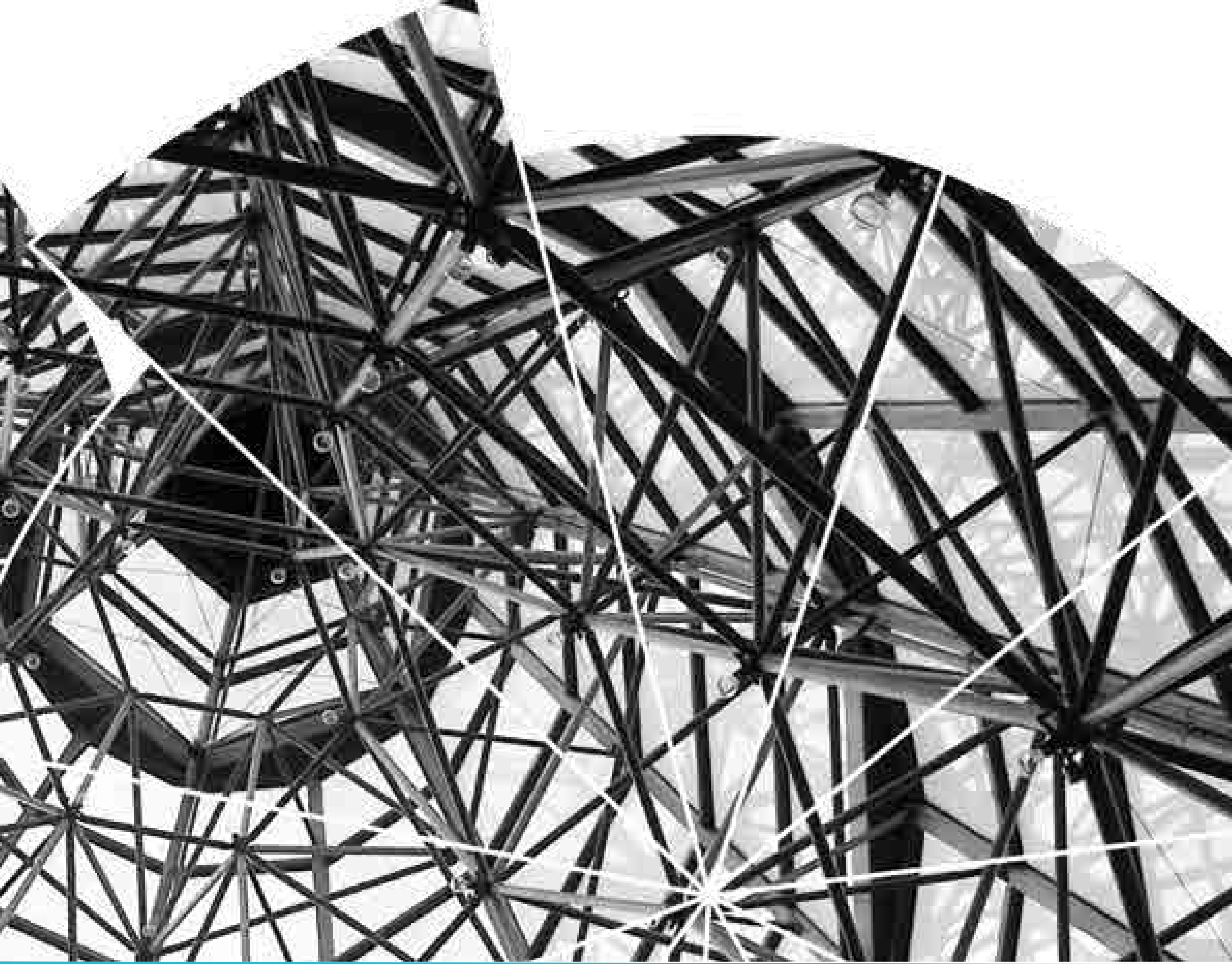
A pathway forward should lead to re-balance shareholders-policyholders responsibilities and obligations, realign policies and decision-making processes to promote more involvement by policyholders and develop a policyholder legal structure to protect their mutual and collective rights. Also, the Takaful model itself needs to be re-cast consistent with its ancient and original principles to transform it into a pure mutual model.

It is increasingly apparent that today's insurance buyers are seeking socially responsible products and ethical insurers. Takaful is a possible answer. The concept of Takaful with modern practice is elucidated in this volume. It is left to the reader to choose carefully a provider that exceeds their expectations and it is hoped, that the concept and its practice may drive Takaful companies into the forefront of the global insurance industry.

Dr. Omar Clark Fisher, PhD.

Managing Director - Khidr Solutions (UAE)

PROJECT TEAM



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CHAPTER 1

OVERVIEW:
STRUCTURE OF SUPPLY AND DEMAND

1.1 BACKGROUND

This is an uncertain world. Uncertainty has cost which appears in the form of risk. An Islamic legal maxim implies that costs have to be reduced and objectives of Islamic law imply priority to be given to minimizing of costs over maximizing profits. Reducing risk is thus an Islamic objective. Insurance concepts prevailing in the contemporary world for covering risk is not acceptable in Islam because the prevalent model of insurance involves prohibited elements such as interest, commercial exchange of risks and the spirit of gambling. The emergence of the concept of Takaful rests in the spirit of mutual cooperation and meeting needs of the community to manage risks arising out of uncertainties of the future.

Takaful is a concept of mutual agreement to help each other in case of unexpected loss of life or property. The spirit of cooperation and mutual indemnification are the fundamental concepts of Takaful. To motivate and promote Takaful in competition with the prevailing Insurance business has to integrate the Takaful risk concepts with investment opportunities.

Takaful business has two components, a Takaful Fund (which is a pool of the contributions made by the participants who are in fact policy holders) and a shareholders' fund where the participants hold a share in the business and share the profits/losses of the shareholder's capital.

Takaful business spreads the risk and, in the process, reduces the collective risk, which concomitantly lowers the individual policy holder risk and hence justifies the Takaful business[1]. Takaful business does not get involved in interest-based activities. The Takaful business invests the funds collected from participants and shareholders in Shari'ah-compatible securities and assets only.

The nature of relationship between Takaful business and its participants (policy holders) is designed in a way that rules out a gambling element.

There are several models of Takaful relationship with the participants:

- **A for-profit sharing company**
- **A Cooperative organization**
- **A combination of both**

This is a report on the current state of Takaful business at global level. DCIBF has included, in its scope of operations, the subject of Takaful as an important component of commercial finance and risk management for more than one reason. First, commercial finance is a market tool to allocate financial resources efficiently, inter temporally. Banking is one institutional arrangement to achieve this end and insurance (in Islamic jargon, Takaful) is another institution carrying out compatible functions to achieve financing objectives. Second, Islamic banking has emerged as an Islamic alternative to conventional banking to manage efficient allocation of risk-bearing capital in the economy in inter temporal scenario. Takaful as an Islamic alternative to the conventional business of insurance also deals with inter temporal management of risk-bearing capital. DCIF therefore thought it is useful to issue reports on Islamic banking and Takaful simultaneously at the occasion of World Islamic Economic Forum. The nature of challenges faced by the two industries, Islamic banking and Takaful are intertwined and it may generate fruitful discussion how the two industries are growing over time, competing with their conventional counter parts and what strategies can make them re-enforce each other.

While both industries face almost an equal competition from their respective conventional counterparts, the Islamic banking has globally exceeded a size of US dollar one trillion, the size of global Takaful revenues industry is still less than US$ 50 billion despite that both industries started at almost same point of time, towards the end of 1970s. How to explain this divergence in growth? Is it on account of lack of demand or there are problems on supply side or it is the nature of business models that are making Takaful Industry to lag behind Islamic Banking industry.

These are the questions that these reports may lead the stakeholders to look for solutions for Takaful industry to promote its effective role in the Islamic financial market.

[1] Unlike conventional Insurance that transfers risk from the policyholders to the insurance company, Takaful business distributes risk among the policyholders. Distribution of risk leads to reduction of total risk. Transfer of risk keeps the risk unchanged.

1.2 FEATURES OF TAKAFUL

It can be asserted that the concept of Takaful pre-dates conventional insurance by at least one thousand years and that is why it may not be surprising if aspects of systematic risk sharing appear quite similar—especially when viewed in the context of modern concept of corporate mutual insurance.

Modern "Takaful" business as an Islamic alternative to insurance is based on the concept of mutual risk sharing consistent with Shari'ah principles, avoiding involvement of any element of interest or gambling as defined in Islamic law. Essential attributes of the Takaful based insurance are:

- The insurance contract is Shariah compatible in which the participants (or policyholders mutually indemnify each other in the spirit of cooperation and not in the spirit of gambling.

- The mutual indemnification is done through a pool of Takaful funds built up from the donations contributed by participants for this purpose.

- The Takaful operations can be managed under Agency contract or as Business Company for management of common risk pool.

- The management is done either on the principle of Wakala, Mudarabah, or Waqf.

- Under Takaful business, all contracts, operations and investments must be Shariah compliant .

- Takafuls must, to the fullest extent possible, share risk prudently with Re-Takafuls rather than conventional re-insurers.

- The objective of Takaful Fund in the Takaful Business is "self-sustaining operations".

- Members join Takaful Fund seeking fulfillment of noble goals of solidarity, brotherhood and community well-being.

- Advisory board of Islamic scholars supply direction on adherence to Shariah regulations and precepts.

1.3 TAKAFUL OPERATORS

The Takaful business as an Islamic alternative to conventional insurance is emerging rapidly worldwide. From just a handful of players in the 1980s, the number of Takaful operators climbed to 58 in 2003 and swelled to 241 operators in 39 countries worldwide in 2012. This includes full-fledged Takaful operators (TOs), Takaful "windows" within conventional Insurance companies and Re-Takaful Operations. In the last 10 years alone the number of companies has expanded nearly 4-fold. A comprehensive directory[2] of Takaful companies worldwide (as of 2012) reveals that currently there exist:

- 142 primary Takaful companies,
- 22 Re-Takaful Businesses,
- 69 Takaful Cooperatives (including Iran 18 in Iran, 35 in Saudi Arabia and 16 Sudan, and
- 8 closed Takaful businesses

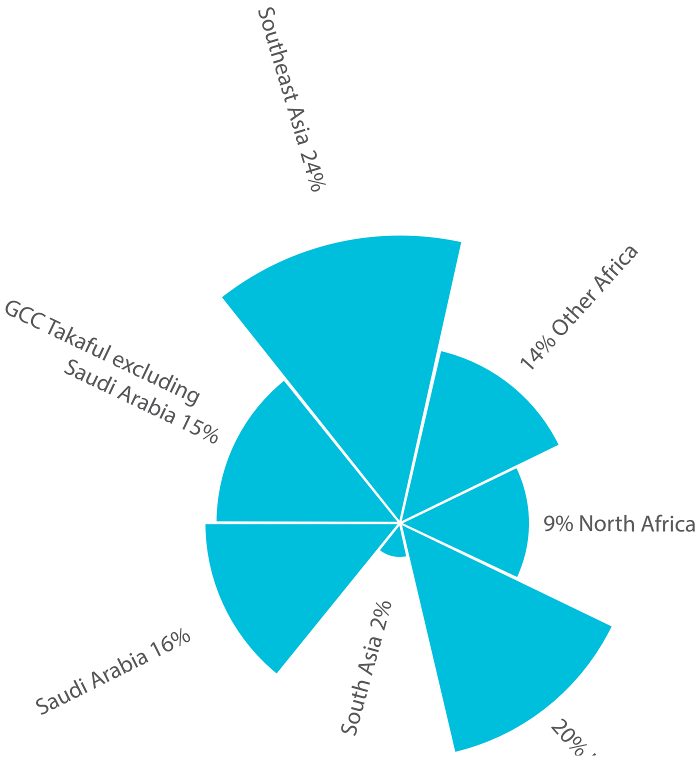
When examined from a regional perspective, there are presently seven (7) major geographical groupings, which shall be used throughout this chapter:

- South Asian Region – India, Pakistan, Bangladesh
- North Africa
- Other Africa
- Islamic Republic of Iran
- Gulf Cooperation Council
- South East Asia
- EU/Caribbean/Turkey and Other

Due to their relative importance and influence on global Takaful, the countries of Malaysia, Iran and Saudi Arabia will be sometimes discussed separately as well. Throughout this chapter best efforts have been made to assure accuracy of the data yet because many Takaful businesses are privately held, their data could not be included in the report. Some inferences and extrapolations of their data were necessitated for comparison purposes.

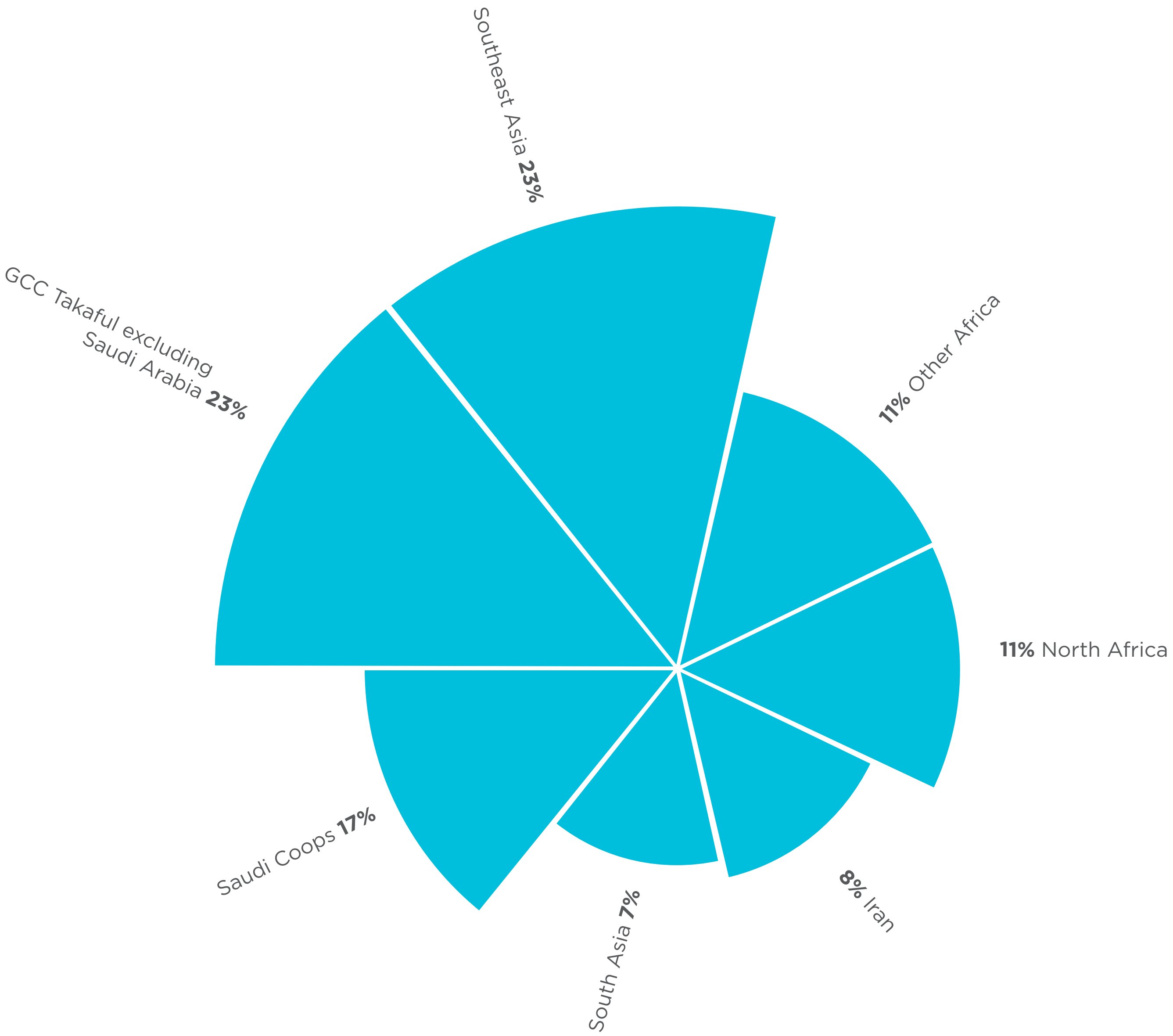
Since 2003, the South Asian countries showed highest rate of expansion in formation of new Takaful Operators (from 1 to 15) whereas the GCC remains home to the largest number of Takaful Operators (from 8 to 49). Refer to Fig.1 and 2 below.

FIGURE 1. NUMBER OF TAKAFUL OPERATORS BY REGION 2003



[2] Directory compiled from GCC Insurance Directory, World Islamic Insurance Directory 2005-2013 (ARIG/Takaful RE) and author's data sources.

FIGURE 2. NUMBER OF TAKAFUL OPERATORS BY REGION 2012



GCC region dominates the Takaful business. Southeast Asia and Africa are the next dominant regions.

At individual country level, the three countries Islamic Republic of Iran, Malaysia, and Kingdom of Saudi Arabia, host the highest number of Takaful and Re-Takaful Operators: Iran (18), Saudi Arabia (35) and Malaysia (25).

From table 1, it is apparent that within these regional markets, Takaful operators have carved out a competitive foothold that varies from 6% of total number of licensed insurers in EU/Other markets, 10% in Levant, 46% in Malaysia and nearly 100% in Iran and Saudi Arabia:

TABLE 1. ACTIVE TAKAFUL AND RE-TAKAFUL OPERATORS WORLDWIDE

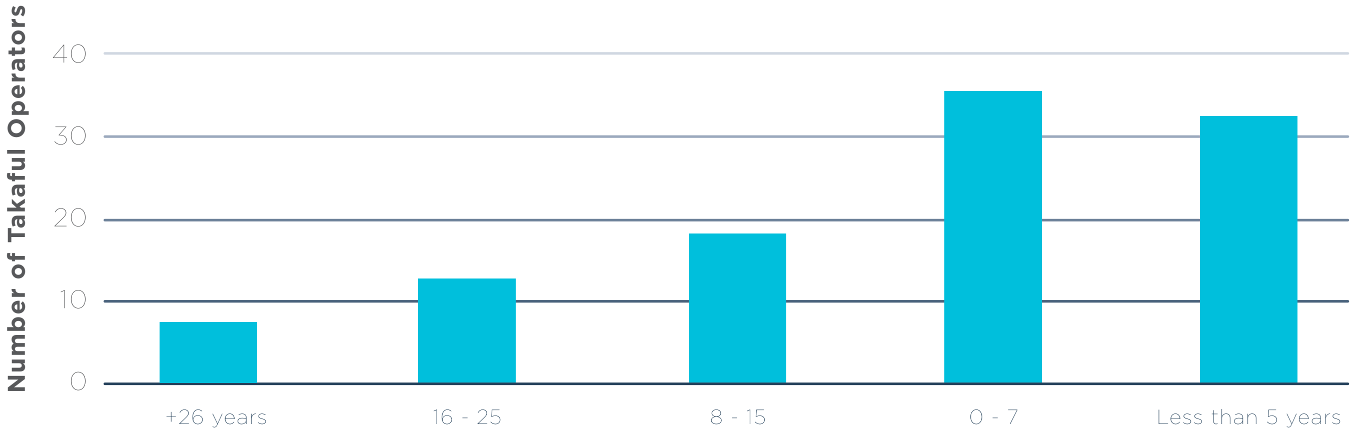
Sources: Dr. O. Fisher's research.

1.4 TIME IN BUSINESS

Since Takaful risk sharing was re-discovered in 1979 in Sudan, it can be inferred that this young industry must contain numerous youthful players that are striving to penetrate and sustain in the competitive insurance markets and struggling hard to make a pathway for scaling up operations. The figures 3 and 4 below paint a portrait of the global Takaful industry from data gathered on establishment dates for both Takaful and Re-Takaful businesses.

FIGURE 3. TIME IN BUSINESS (SAMPLE 122)

GLOBAL TAKAFUL OPERATORS 2005
NUMBER OF YEARS IN BUSINESS



Sources: Dr. O. Fisher's research.

FIGURE 4. TIME IN BUSINESS (SAMPLE 224)

GLOBAL TAKAFUL OPERATORS 2012
NUMBER OF YEARS IN BUSINESS

Sources: Dr. O. Fisher's research.

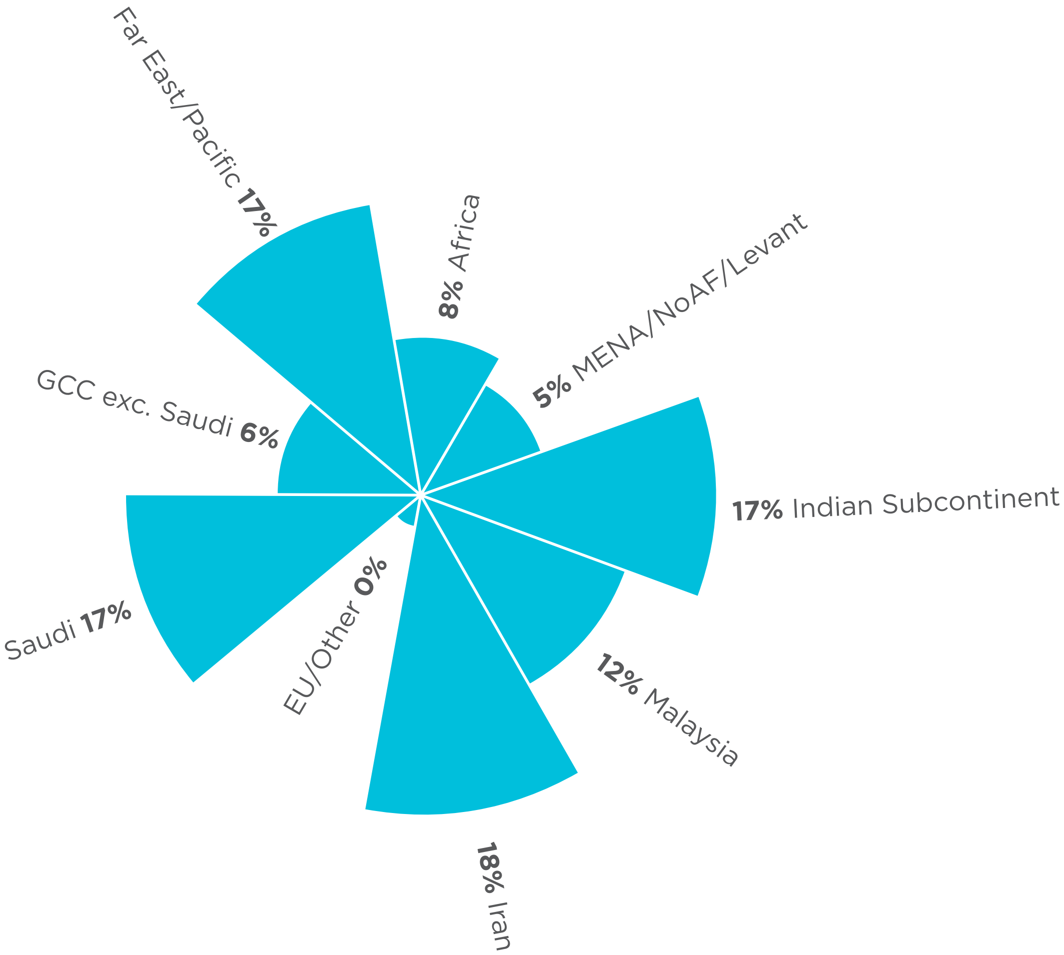
It is remarkable to note that 75% of Takaful companies in 2005 were in business for less than 15 years and 46% operated for less than 5 years. Sixty-four new Takaful companies were launched between 2003 and 2005 end. Due to the rapid expansion of new Takaful Operators, by 2012, 80% were in business less than 15 years, with 47% having less than 5 years operating experience. Between 2006-2012, there were no less than 101 new Takaful companies formed. The global dominance of GCC Region in Takaful business is gradually eroding as more Takaful operators come on-stream in Africa, Levant, Near East and Asia Pacific regions as well as in the EU/Other region. Of the 101 new Takaful, 25 were established in GCC states but more than triple that number were launched in other regions.

1.5 PROFILE OF MANPOWER IN GLOBAL TAKAFUL

According to a representative sample of Primary Takaful Operators (203) from Thompson Reuters Zawya database and Dr. Fisher research, the total manpower in the Primary Takaful sector worldwide is estimated at 70,010 as of 2013. Figure 5 below shows estimated numbers of employees by region [data from 171 Takaful companies]:

FIGURE 5.TAKAFUL EMPLOYEES DISTRIBUTED BY REGION

TAKAFUL EMPLOYEES BY REGION 2011 - SAMPLE 171 COMPANIES = 49,645



From the data available, Far East/Pacific/Malaysia consists of 29% of global Takaful employees, whereas GCC/ Saudi Arabia has 34%, Iran 18% and the Indian Sub-Continent 15%. Africa – home to 24 Takafuls – has only 8% (3,902 employees), hence holds great potential for employment creation as Takafuls deepen penetration into the emerging markets of Africa.

Source: Data from T. Reuters/Zawya; supplemented by Dr. Fisher's research.

1.6 RE-TAKAFUL

Primary Takaful companies are constrained by their adherence to Shariah compliant operations to prudently manage risk exposures by sharing them with (re)insurers that possess a larger capital base, more diversified portfolio or risks and generally more technical sophistication with actuarial skills. With the re-birth of Takaful came the establishment of Re-Takaful. Until some 10 years ago, there were only three (3) Re-Takaful companies. As to be expected, the emergent growth of primary Takaful players spawned risk sharing thru Re-Takaful (equivalent to reinsurance), whereby some 22 full-fledged Re-Takaful and "windows" of Re-Takaful capacity were been formed during this period.

Their average Time in Business is generally less than nine (9) years, putting aside the reinsurance operators in Sudan, which began in 1979. With the exception of "Islamic windows" for Re-Takaful by Munich RE and Swiss RE and plus +100 Mil capitalization of ACR Takaful and Takaful RE, other Re-Takaful businesses are modestly capitalized and localized in scope of coverage. Table 2 lists the major Re-Takaful operators:

TABLE 2. RE-TAKAFUL OPERATORS

Name of Company - Country	Time in Business	Type of Re-Takaful Model	Estimated Gross Takaful Cessions 2011
HANNOVER RE (BAHRAIN)	7 years	Mudarabah	$125 Mil
ACR MEA TAKAFUL (BAHRAIN & MALAYSIA)	6 years	NA	NA
AFRICA RE (EGYPT)	4 years	Window	NA
TUGU REINDO (INDONESIA)	10 years	Window	NA
AMIN REINSURANCE (IRAN)	11 years	NA	NA
BEST RE – (TUNISIA) AND (MALAYSIA)	29 / 4 years	Mudarabah	NA
LABUAN RE (MALAYSIA)	6 years	Window	$2 Mil
ARIL (MALAYSIA)	17 years	Mudarabah	$45 Mil
SWISS RE (MALAYSIA)	5 years	Window	NA
MUNICH RE (MALAYSIA)	4 years	Window	NA
SAUDI RE – (SAUDI ARABIA)	6 years	NA	$43 Mil
TOKIO MARINE NICHIDO RETAKAFUL (SINGAPORE)	7 years	NA	NA
SHEIKAN ISLAMIC INSURANCE & REINSURANCE (SUDAN)	31 years	NA	$25 Mil *
NATIONAL INSURANCE & REINSURANCE (SUDAN)	35 years	Window	$14 Mil *
TAKAFUL RE (UAE)	9 years	NA	$225 Mil
DUBAI ISLAMIC INSURANCE & REINSURANCE (UAE)	16 years	NA	$34 Mil *
AL FAJR (KUWAIT)	6 years	Wakala	$62 Mil

Note* assumed 20% to 30% of total premiums written as cession

Sources: Dr. O. Fisher's research.

In all 22 Re-Takafuls that have been established in 11 countries. Malaysia is the favored domicile, with 8 Re-Takafuls enjoying the lucid Takaful regulations and tax advantaged status of Malaysia, as shown below:

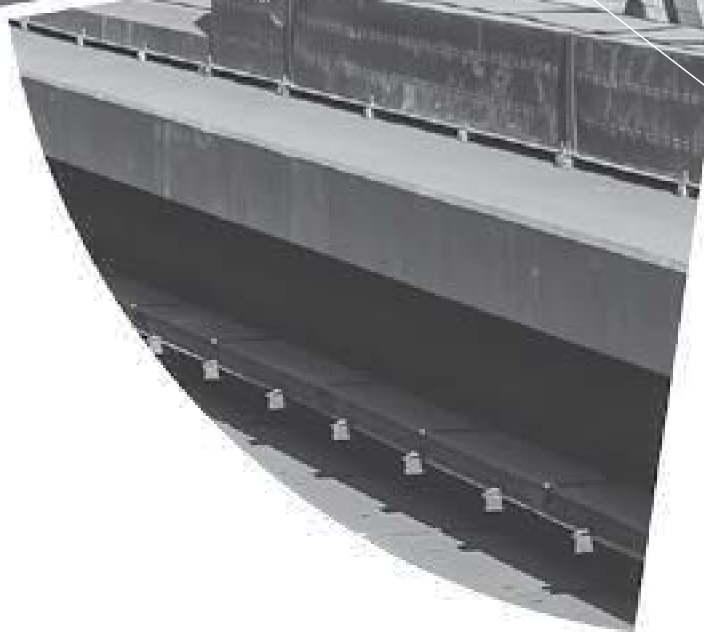
Country	Number of Re-Takaful
BAHAMAS	1
BAHRAIN	2
EGYPT	1
INDONESIA	1
IRAN	1
KUWAIT	1
MALAYSIA	8
SINGAPORE	1
SUDAN	3
TURKEY	1
UAE	2
TOTAL	22

By a rough estimation rounding up the figures in Table 2, total Re-Takaful premiums ceded in 2011 could reach $1 bill; if so, this represents only 6% of the global Takaful primary premiums underwritten in that year. Despite moral imperatives to maintain Shariah compliance, clearly many Takaful operators elect to conclude risk-sharing treaties with conventional reinsurers. One plausible explanation here is that few primary Takaful operators carry any financial rating (e.g. From AM Best, S&P or Phelps & Dodge) and "A" rated Re-Takaful companies are rare; hence Takaful management prefers to share risk management with reputed, financially sound and rated conventional reinsurers.

As with any new financial service enterprises, young Takaful companies must identify and capture a "niche" market segment, bring new products and/or technologies to customers or perfect pricing of risks and business process efficiencies in order not simply to survive, but flourish. Overall, the rate of introduction worldwide of new Takaful entities between 2003 and 2012 (31% annualized increase) far outstrips the 4.4% increase in number of conventional insurers in same markets [as per sample of our data]. However, ramping up the "supply" of Takaful services certainly does not guarantee long-term success.

Moreover, widening supply is more likely causing "head-to-head" heated competition in selected markets where multiple Takaful operators have added further to fragmentation of insurance business. Perhaps the massive population, sheer size and geography of Indonesia requires +17 Takaful operators, and Sudan 16, yet it is questionable that a Kuwait market requires 14 Takaful companies, or Bahrain 12, or UAE 15, or Saudi Arabia 35. Consolidation of Takaful companies may actually spur future growth by engendering greater confidence in larger size underwriters and help stabilize the current downward spiral of pricing of risks.

CHAPTER 2



CURRENT STATE OF CONTRIBUTIONS AND FORECASTS

In as much as Takaful is a close cousin to mutual insurance, a review of public reports from ICMIF[3] yields a perspective on worldwide mutual insurers: 2,900 organizations span 75 countries and underwrite $1.2 trillion in gross premiums annually. Global employment is approximately 1 million staff. Mutual insurance in USA counts 1,300 with over 400,000 staff writing $391.7 billion in gross premiums[4]. Mutual insurance captures 31.7% of total conventional insurance market and represents roughly 20% of the total global employment including direct insurers, brokers, agents and TPAs. Mutual employment in major markets is shown in Table 3 below. Note also that some 85,000 sales force personnel in Malaysia serve 28 insurers. Hence it can be appreciated that the global Takaful sector is undermanned and quite evidently at an early "start-up" phase of development of its manpower.

TABLE 3. MUTUAL MARKET SHARE IN MAJOR MARKETS

% Mutual Market Share	Country	Total Mutual Gross Premiums $ Billion	Employees
7.2%	U.K.	$21.5	36,000
38.8%	France	$115.4	83,000
44%	Germany	$108.6	86,000
15.5%	Italy	$28.3	9,000
31.8%	Netherlands	$34.1	3,000
27.6%	Singapore	$21.3	n/a
41.6%	Japan	$234.2	201,000
31.7%	U.S.A.	$391.7	400,000
39.2%	Norway	$7.7	n/a
18.5%	Canada	$21.0	23,700
34.9%	Hungary	$3.9	7,800

Source: ICMIF Market Share Annual Report 2012

[3] ICMIF Annual Mutual Market Share Report 2009-2010, UK 2012

[4] IBID pages 9-15

2.1 VOLUME AND MIX OF RISK BUSINESS

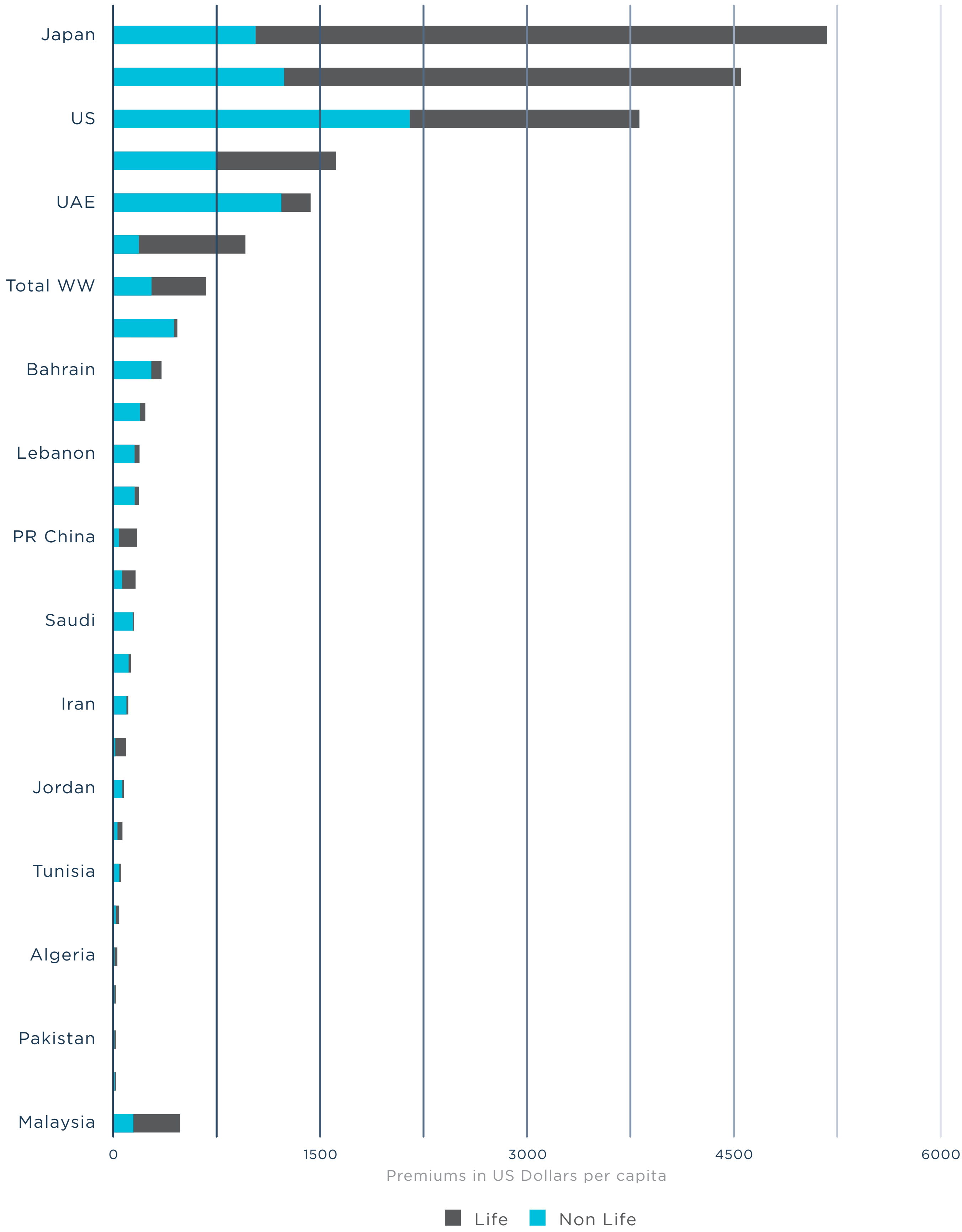
Worldwide gross annualized Takaful contributions (gross premiums) of approximately $750 million in 2000 and have grown impressively to $2.5 billion in 2005 and then to an estimated $12.4 billion (and up to $23.9 billion including Iran) in 2012, representing an annualized growth rate of more than 20%. However, in the last five years (between 2007-2012) the compound annual growth rate of gross contributions in the industry seems to have accelerated in many diverse markets– rising above 29 per cent per annum. Many observers forecast Total Global Takaful volume of contributions to exceed $29.1 Billion by 2015 and reach to $52.5 billion by 2020. Major components of these forecasts are as follows:

- Global Takaful $14.8 billion
- Saudi Arabia Cooperatives $14.1 billion
- Iran Islamic Insurance $23.6 billion

Data from reports of World Islamic Insurance Directory (2013) by Takaful RE and ARIG and World Takaful Reports (2010 to 2014) by Ernst and Young indicate that General (non-life Takaful) business is, generally, in the ratio 40:1 to Life (Family) Takaful [except in Malaysia]. This may perhaps be reflecting a strong cultural and traditional public aversion to the concept of life insurance. As youth in emerging markets age and step up their savings rates, it is anticipated that Life/Family Takaful demand will accelerate. Given the strong propensity in mature insurance markets of OECD countries to use Life insurance as an important form of personal and corporate savings—especially for pensions and retirement goals—the expectation for global demand in future for Takaful is robust, as shown in Figure 6.

Thus future product mix between Non-Life and Life business could shift to thirty-to-one ratio in 2020. Realization of such optimistic forecasts will depend heavily upon building primary demand for Takaful generally as well as on enhancing public awareness and acceptance to utilize unit-linked Takaful instruments for promotion of long-term savings, private retirement and pension plans. However, a primary demand driver in mature markets for such protection plans is the tax-advantaged feature of insurance, which element is totally absent in parts of MENA and less pronounced in other emerging economies.

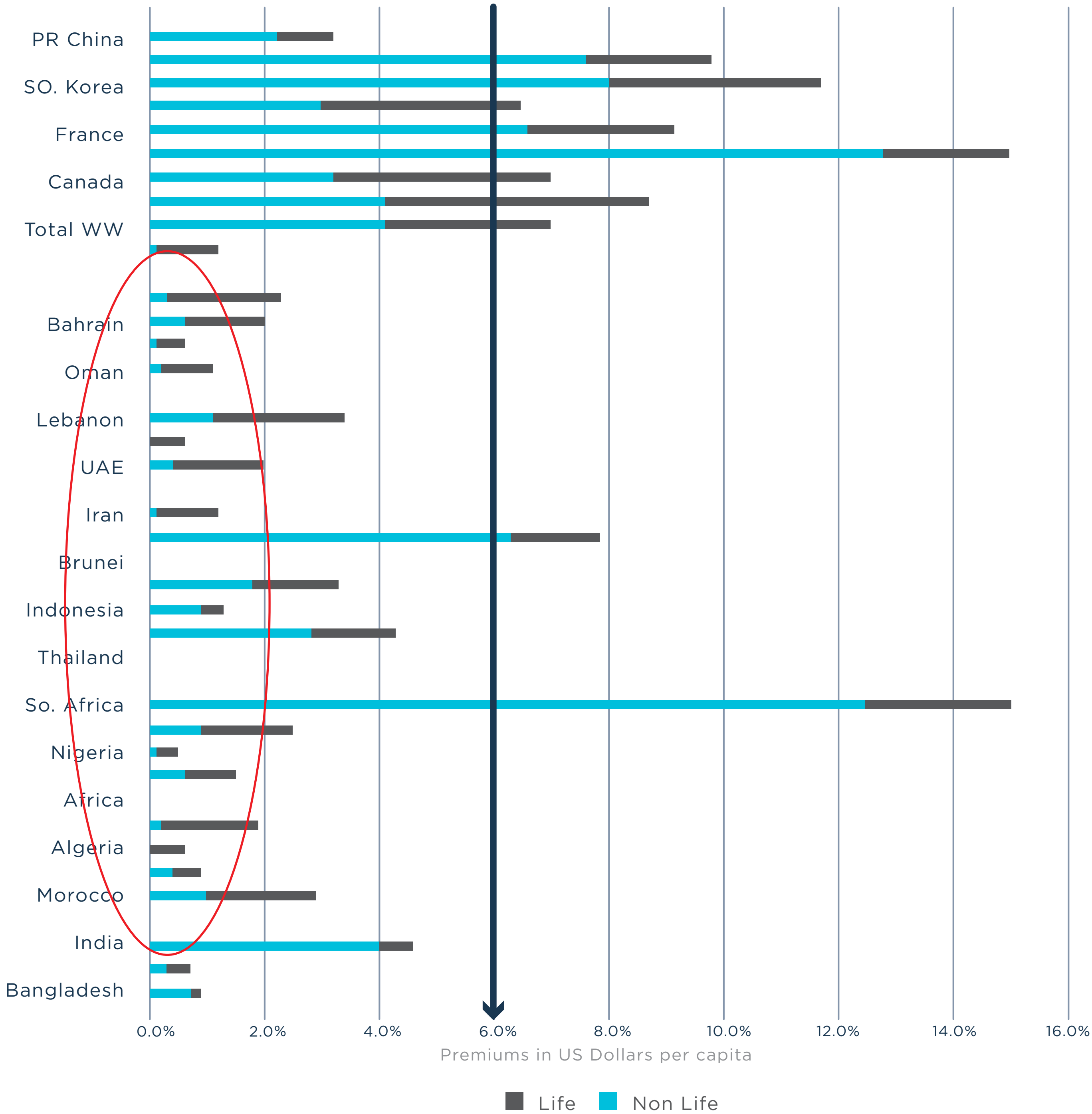
FIGURE 6:
INSURANCE DENSITY PER CAPITA 2011



2.2 LINES OF BUSINESS BY COUNTRY

Worldwide examples of Lines of Business by country are shown in Figure 7 and demonstrate that more than 50% of coverages written are Life business in developed OECD markets. Note the worldwide average is 38%.

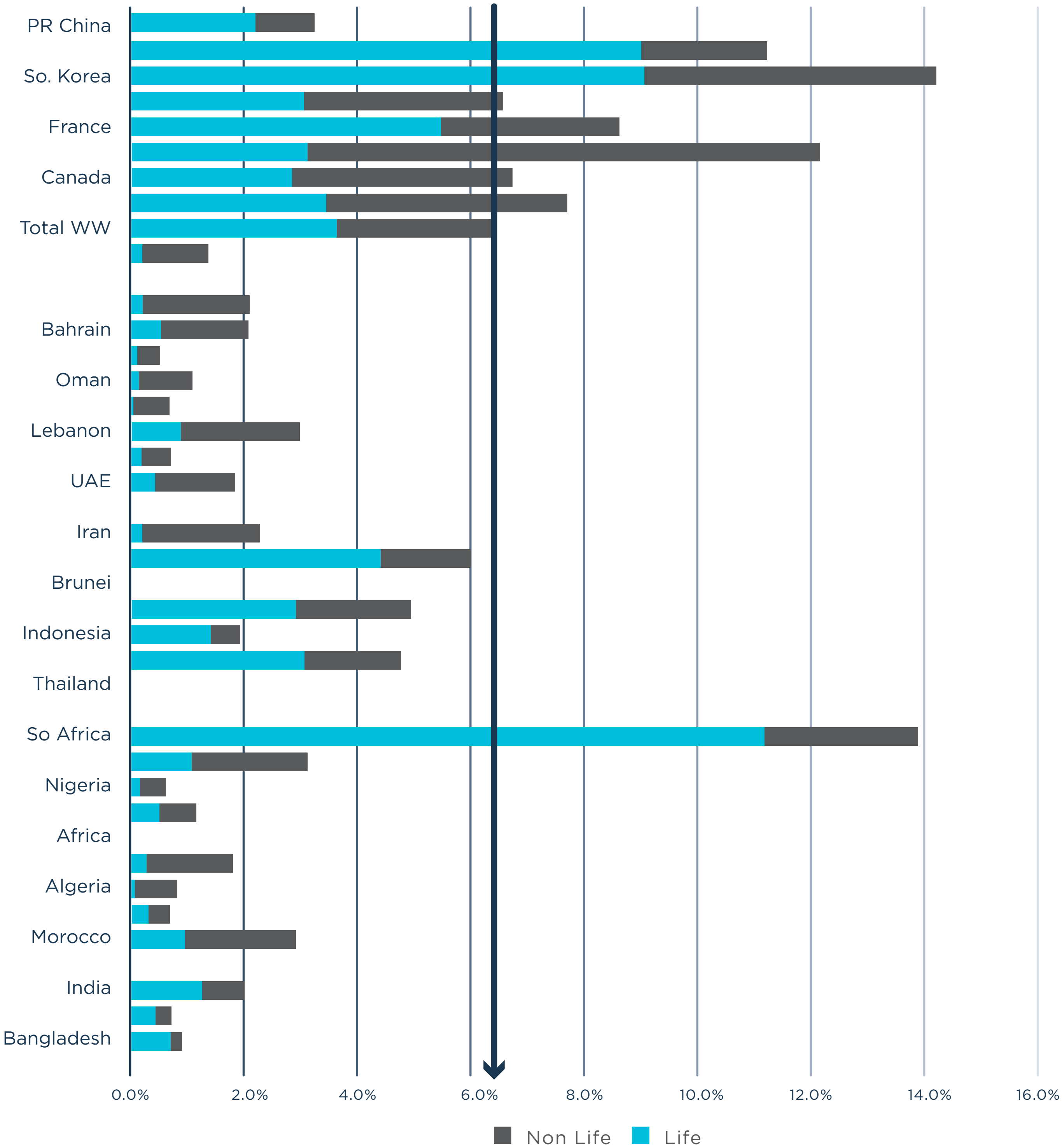
FIGURE 7A: GLOBAL LIFE VS. NON LIFE AS PERCENT OF PER CAPITA INCOME 2008



DCIBF

Insurance Density (insurance per capita as percent of annual income) is shown above for major Muslim countries worldwide and for OECD countries for comparison. Note the worldwide average is 7.1%, equivalent to $661 dollars per annum, where 4.1% is expended on Life and 2.9% on Non Life coverage in 2008. By 2012, the worldwide average decreased to 6.5%, equivalent to $657 dollars, where 3.7% is Life and 2.8% is Non Life. It is apparent that emerging markets generally have neither yet adopted insurance savings plans nor group risk protection (i.e. Life) coverage as essential financial services to be secured with disposable income.

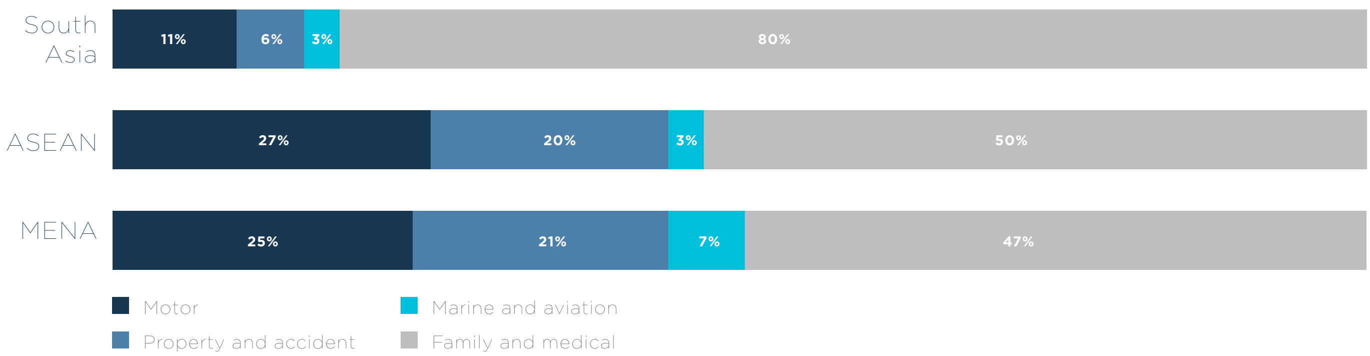
FIGURE 7B: GLOBAL LIFE VS. NON LIFE AS PERCENT OF PER CAPITA INCOME 2012



In emerging Takaful markets, General and Non-Life lines of business clearly dominant with offerings such as motor, fire and personal accident coverages. By contrast in, Malaysia and Indonesia Family Takaful (LIFE) business is the dominant coverage sold.

Furthermore, from Figure 7B. one can see that the dominant usage of insurance coverage across the Arab world is General/ Non-Life (NL), for protection of assets and property. Typically, the Life/Family Takaful insurance accounts for 5 per cent to 15 per cent of total insurance sales only. Morocco is an exception where the utilization of Life insurance exceeds 25 per cent of total insurance premiums annually. Malaysia, where Muslims represent 50 per cent of local population, presents an anomalous picture because Family (life) Takaful and savings plans inn 2012 were 64 per cent of total annual premiums nationwide ($331 of $515 per capita), in reaction to the central bank's active encouragement of savings habits and because payroll deduction schemes made it convenient to do so.
Revenue growth in regional markets of Asia/Pacific are heavily influenced by the Family Takaful/ Life take-up as compared with General/ NL usage which dominates in MENA/ GCC regions. In the latter, Auto and Property, including General Accident protections, clearly account for 30% to 50% of books of business written whereas Engineering/ Construction, Marine and Aviation are limited typically to less than 15% annual exposures. One plausible explanation is that these large asset value exposures require sophisticated underwriting and significant balance sheet to support the desired large sum assured. By contrast, Takaful operators are aggressively underwriting Medical risks, which often have Life embedded in such policies, because group medical coverages are now mandatory for workers and staff of companies across the GCC beginning 2011 to present. Estimates are for Lines of Medical/healthcare coverage to double in annual contributions in Saudi Arabia and UAE.

FIGURE 7C: LINES OF BUSINESS BY MAJOR REGIONS - 2012

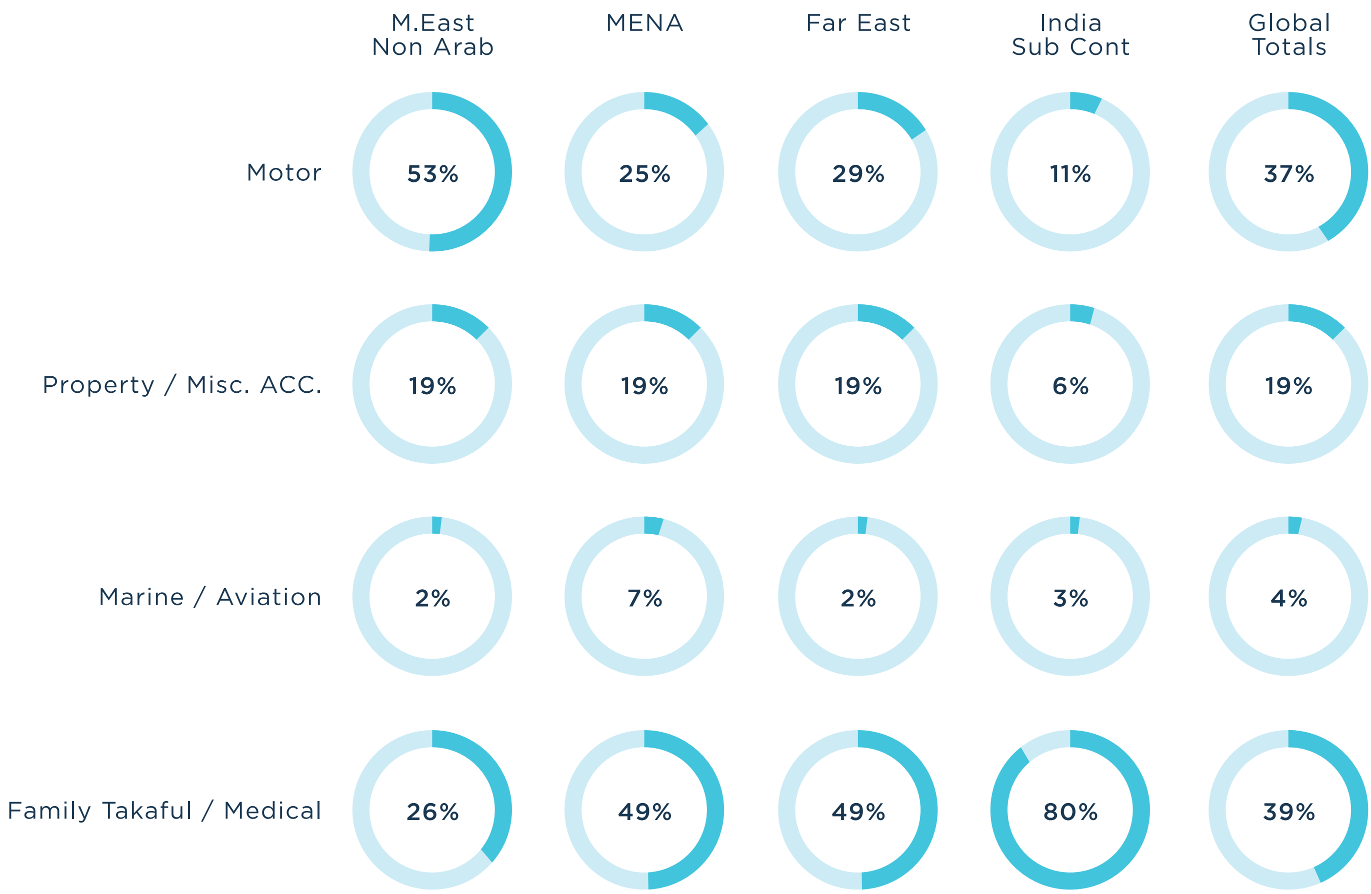


Based upon ARIG Arab World Book of Business data (2004) compiled from 203 companies, Takaful's mix of products of premiums $1,367 Millions were:

- **Life 27%**
- **Medical 8%**
- **Motor 22%**
- **Non Life/General 25%**
- **Other/Marine 1%**

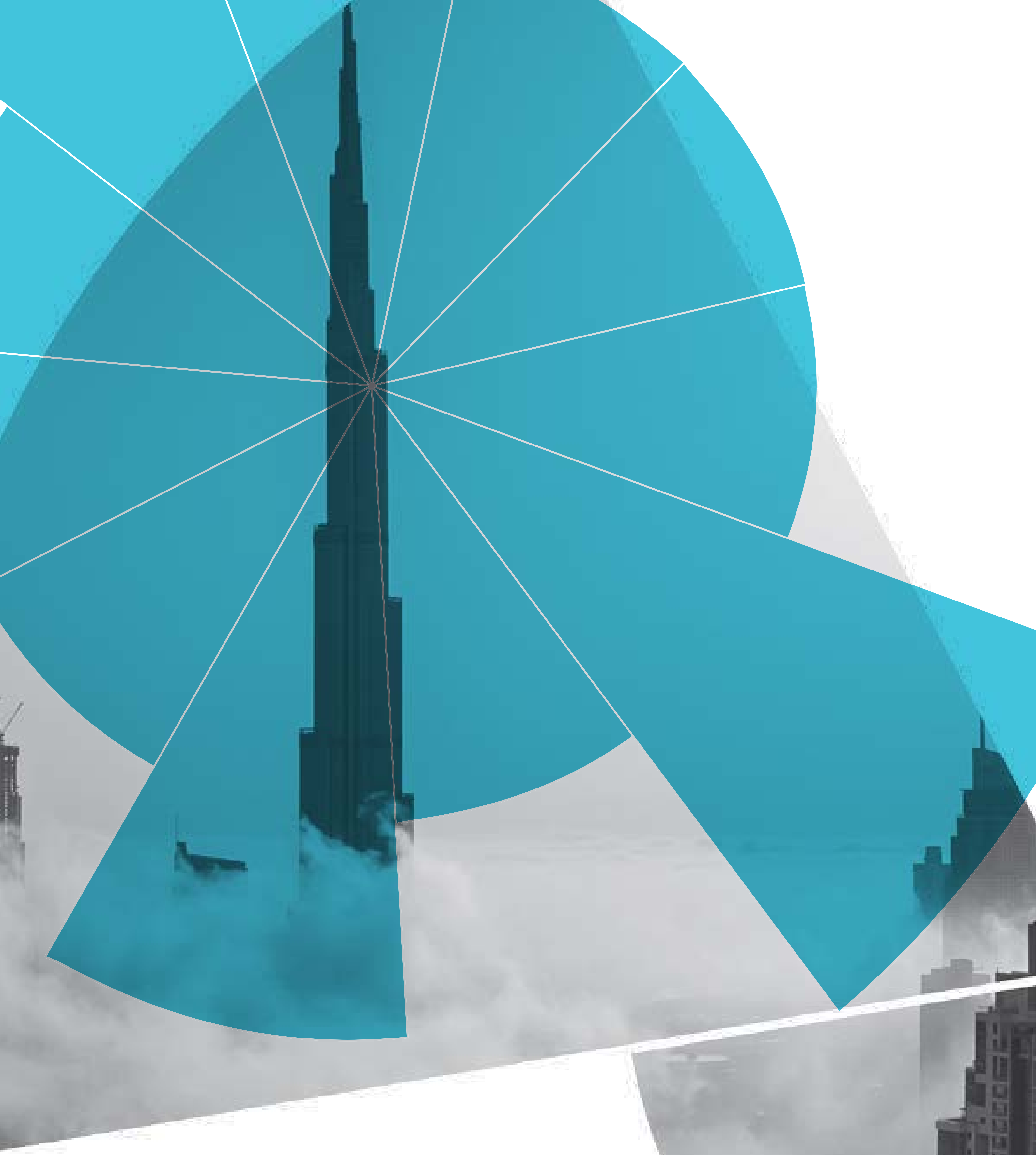
Eight years later, the MENA book of Takaful business gives similar picture. Medical/Life insurance has expanded in importance to 47% (up from 35%) due to the advent of mandatory medical benefits and worker's compensation coverage introduced in 2011. Figure 7D makes clear that the dominant book of business for Takaful operators is Motor and Property/Misc. Accident which relates mostly to Personal Lines, rather than larger corporate risks or coverage associated with infrastructure or massive construction projects, ships, aviation or large assets. In MENA region, mandatory medical and healthcare coverage has triggered a significant expansion of General/Group Life and medical insurance—rapidly approaching 50% of business written for the composite insurers. However, with the exception of the mono line medical insurers (e.g. BUPA/MEDGULF) other insurance companies are struggling to generate consistent profits from this volatile type of risk exposures: especially in extremely price sensitive markets.

FIGURE 7D: MIX OF INSURANCE BUSINESS 2012



Despite this record of remarkable growth of Takaful enterprises globally, the cold fact remains that, of $4.3 trillion in global insurance gross premiums written in 2012, only $23.9 billion (or 0.2 per cent) were written globally on Takaful basis.

Source: World Takaful Report 2014 Takaful RE



CHAPTER 3

ASSESSMENT OF PERFORMANCE OF TAKAFUL

To assess comparative performance of Takaful across the globe, consideration can be given to 4 tracks:

- 3.1 Revenue Top Line Growth
- 3.2 Expansion into new territories and number of Takaful players
- 3.3 Financial and Operational Performance
- 3.4 Productivity of Employees

3.1 REVENUE TOP LINE GROWTH

The top line growth in Takaful is evaluated in multiyear time series and also in contrast to conventional growth rates in same markets. Ultimately, revenue growth cannot be evaluated in isolation, rather it must be linked also to overall financial performance and health (including net income) because Takaful companies might be “buying” market share with lower prices yet sacrificing profitability. Examination shows Takaful outcomes surely point to annual operating deficits, weaker underwriting ratios, jeopardy to financial ratings and postponement of adding to prudent reserves, thereby delaying surpluses so vital to sound operations and Policyholder loyalty.

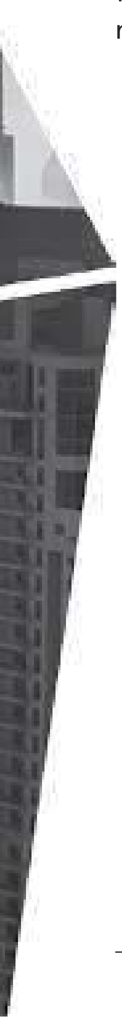


TABLE 4. GLOBAL TAKAFUL REVENUES (MILLION OF DOLLARS $) BY REGION

	2008	2009	2010	2011	2012
GRAND TOTAL TAKAFUL	9,617	11,291	14,569	18,202	23,990
GLOBAL TAKAFUL EXC. IRAN	5,315	6,975	8,329	10,039	12,407
SOUTH ASIA	123	193	202	211	469
LEVANT	33	39	79	160	197
AFRICA	295	377	413	452	544
SOUTHEAST ASIA	1,110	1,480	1,951	2,572	3,390
GCC ALL	3,753	4,886	5,683	6,643	7,808
GCC (EXC SAUDI ARABIA)	842	990	1,313	1,741	2,310
SAUDI COOPS	2,911	3,896	4,370	4,902	5,498
TAKAFUL EXCLUDING SAUDI COOPS	2403	3079	3958	5434	6910
IRAN	4302	4316	6240	8163	11583

Source: E&Y World Takaful Reports 2011-2013, plus Author’s research.

TABLE 4A. TOTAL GLOBAL TAKAFUL

	2012 Takaful Companies	2010 Total Insurance	2010 Takaful Companies
TOTAL GLOBAL TAKAFUL	224	781	207
SOUTH ASIA	15	60	15
IRAN	18	20	18
NORTH AFRICA	24	221	24
OTHER AFRICA	24	99	23
MALAYSIA	25	25	19
OTHER SOUTHEAST ASIA	26	69	24
SAUDI COOPS (LICENSED)	35	34	34
OTHER GCC	50	153	44
REST OF THE WORLD	6	100	6
GLOBAL TAKAFUL EXCLUDING IRAN	206	761	189
PERCENT OF GLOBAL TAKAFUL			
SOUTH ASIA	6.7%	7.7%	7.2%
IRAN	8.0%	2.6%	8.7%
NORTH AFRICA	10.7%	28.3%	11.6%
OTHER AFRICA	10.7%	12.7%	11.1%
OTHER GCC	22.3%	19.6%	21.2%
SAUDI COOP	17%	4.3%	16%
REST OF THE WORLD	2.7%	12.8%	2.9%

Compiled from Ernst &Young World Takaful Reports 2009-2012, the recent average annual growth rates per country were as follows:

TABLE 5. TAKAFUL REVENUES GROWTH 2009 – 2011 BY COUNTRY

	Growth Rate Total Market %	
	2009-2011	Avrg. / 3 Yrs
MALAYSIA	44.3%	14.8%
INDONESIA	21.7%	7.2%
THAILAND	N/A	N/A
BRUNEI	N/A	N/A
IRAN	75.5%	25.2%
UAE	21.5%	7.2%
SAUDI	27.6%	9.2%
LEBANON	28.3%	9.4%
QATAR	24.3%	8.1%
OMAN	23.7%	7.9%
KUWAIT	37.9%	12.6%
BAHRAIN	8.6%	2.9%
JORDAN	21.0%	7.0%
MOROCCO	10.7%	3.6%
EGYPT	9.5%	3.2%
ALGERIA	12.8%	4.3%
TUNISIA	7.3%	2.4%

For comparison, the Global Insurance Report of the International Insurance Institute (III-April 2014) in New York shows that Property Casualty (P/C) insurance sector in USA had uneven growth in the same period:

Sector	2009	2010	2011	2012
USA P/C	-4.2%	1.0%	2.6%	4.3%
MUTUALS, GLOBAL	14.6%	N/A	3.1%	4.0%

Average increase in top line revenues for USA P/C sector between 1987-2012 is 7.6%, and 8.8% for Life insurers.

From Table 5, it is apparent that certain Takaful markets are expanding with double-digit growth and surpassing growth rates of conventional insurance. However, due to the impacts of global financial crisis and the turmoil of "Arab Spring", the Arab MENA markets display growth rates only at or slightly above conventional benchmarks.
Indeed, selective individual Takaful Operators in Malaysia are chalking up impressive growth in top line revenues, which indicates rapid gains in acceptance as of 2011:

- Takaful Malaysia $456 Million, up 64.8% (Malaysia)
- Etiqa Takaful Berhad $617.3 Million, up 43.7% (Malaysia)
- Tawwuniya $1,114 Million, up 3.6% (Saudi Arabia)
- Salama $541.7 Million, up 26.5% (UAE)
- Prudential BSN Takaful $125.8 Million, up 12.7% (Malaysia)

Such significant growth rates are partly explained by the small revenue base of TOs upon which growth is built up-- consistent with their relative youthful phase of development. Table 6 below displays the average volume of revenues for selected countries (noting the number of Takaful being analyzed).

TABLE 6. AVERAGE SIZE OF GROSS REVENUES FOR TAKAFULS (2012)

	No. Takaful Cos	Average Gross Contributions for Takafuls
SAUDI ARABIA	34	$145.0
MALAYSIA	11	$145.0
GCC	43	$34.0
ASEAN	29	$22.0
SO. ASIA	12	$18.0
AFRICA	36	$13.0
LEVANT	9	$10.0

* Source E&Y Insights 2013

The sample in Table 6 accounts for 86% of the Takaful Directory's 203 Takaful Operators and is indicative of the relative modest average production size per region. Malaysia has enjoyed +30 years of building acceptance for Takaful where the average size of gross premiums is $145 Million. This compares to the quite new African markets that average $13 Million in production (2012).

By comparison, the average size of gross premiums written in 2010 by mutual companies in Europe is $2,081 Million (210 Mutuals), in North America is $1,796 Milion (225 Mutuals), in Asia Oceania $ 4,733 Million (54 Mutuals) $306.3 Million in Latin America (8) and $136.7 Million in Africa (3).

It is not the main purpose of this chapter to conjecture on this relatively slow adoption rate of Takaful. However, three important challenges confront the global Takaful industry which, like a nettle, must be seized and neutralized if the optimistic revenue forecasts so widely circulated are to be realized: a) expanding the reach of and gaining depth in distribution channels; b) innovation in products and services and c) resolving governance issues. Discussion of governance issues follows in Section 5.3.

3.2 EXPANSION INTO NEW TERRITORIES AND NUMBER OF TAKAFUL PLAYERS

There are major markets home to Muslim minority communities which once opened can engender substantial new Takaful sales. Presently there are no Takaful operators established in:

- Morocco
- EU countries – Germany, France, Spain
- Former Russian republics – Ukraine, Uzbekistan, Turkmenistan
- India and China
- North America – USA and Canada
- Latin America – Argentina

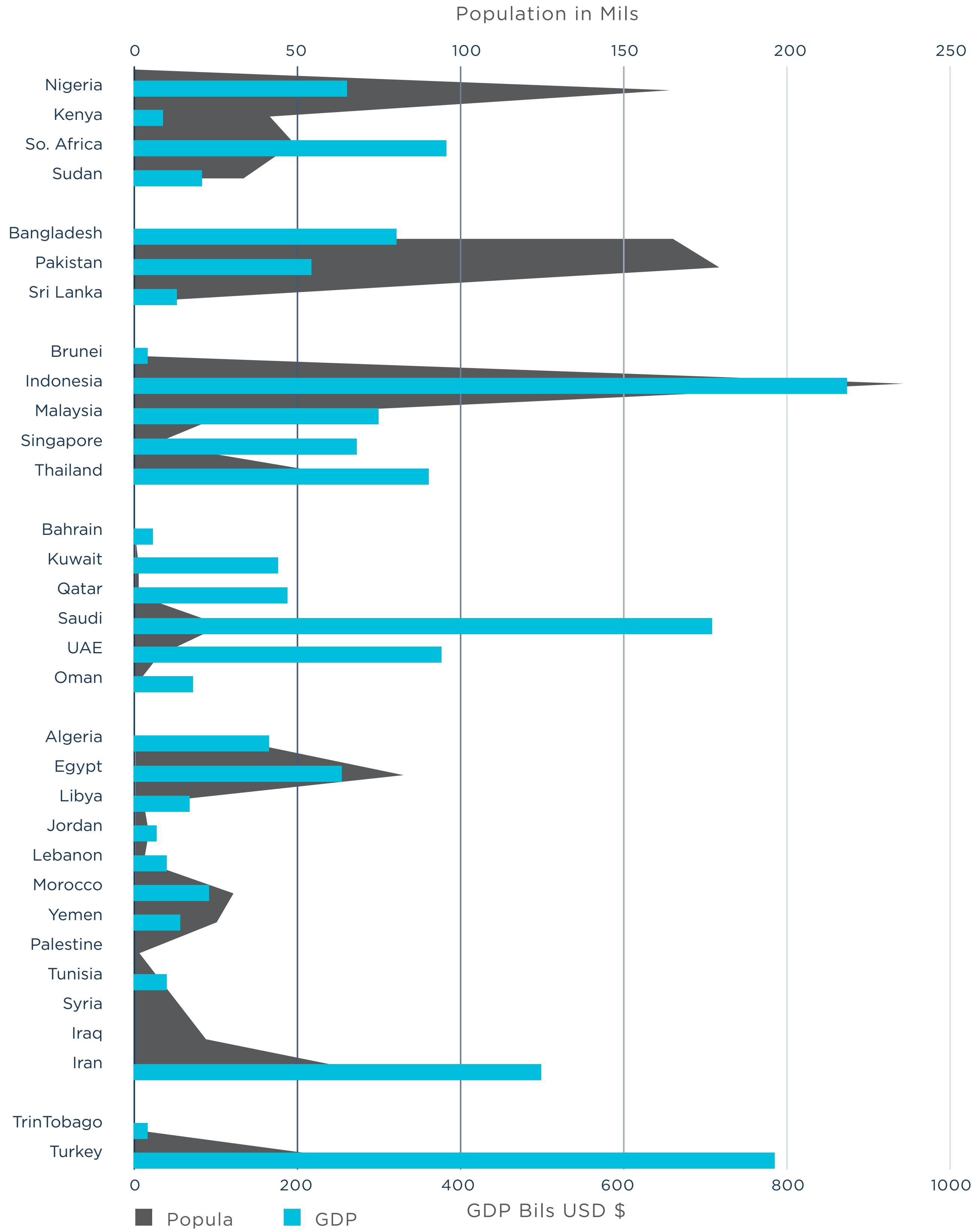
It is highly probable that Takaful entry into these virgin markets will propel the global industry to double or triple in annual contributions. Based upon a conservative penetration rate of less than 2% and per capita spending on insurance in the range from $50 annually for CIS region, to $105 annually in Turkey and to $3400 annually across EU, the potential future Takaful market expands to add roughly $16 billion latent demand.

- Turkey $1.2 Billion from 75 Million population
- Morocco $388 Million from 32 Million population
- CIS $457 Million from 61 Million population
- USA $5.9 Billon from 12 Million Muslim population
- EU $8.1 Billion from 16 Million Muslim population

Based upon a nine year projected compound growth rate (CAGR) of 12.5%, using the baseline of existing regional Takaful markets in 2011, projections for 2015 and 2020 will arrive at $29.1 Billion for Total Global Takaful Contributions (2015) rising to $52.5 Billion (2020). Approximately 44% of this Islamic insurance business will be underwritten in Iran-- $13.0 Billion (2015) and $23.6 Billion (2020).

An analysis of Muslim majority countries worldwide and their GDP in Billions USD$ (2012), given below, reflects the scope in the potential regional markets for Takaful is shown in figure 8. Disposable per capita income is supposed to serve as a proxy for potential new business

FIGURE 8: A MUSLIM MAJORITY COUNTRIES – POPULATION VS. GDP 2012



Source: SIGMA3 / 2013, CIA Factbook 2013.

TABLE 7: REGIONAL MARKETS STACK UP

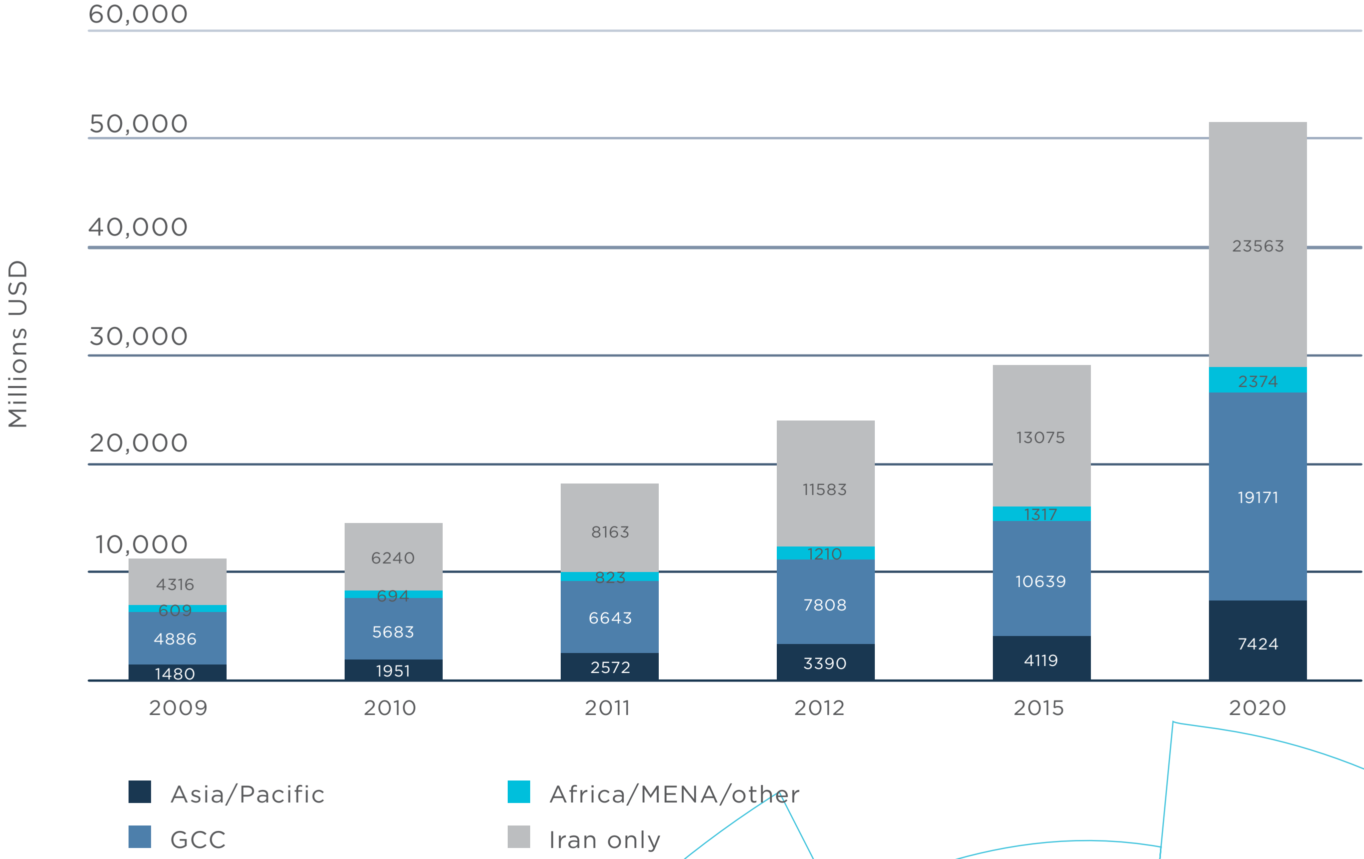
Region	Population Mils	% of Global	GDP PPP USD $ Billions 2012	% of Global
INDIAN SUB-CONTINENT	367.5	5.2%	604.3	0.8%
AFRICA	297.7	4.2%	782.6	1.1%
LEVANT	251.4	3.6%	777.1	1.1%
GCC INCLUDING SAUDI ARABIA	46.6	0.7%	1578.9	2.2%
SO.ASIA/PACIFIC	341.1	4.8%	1848.6	2.6%
IRAN	75.6	1.1%	501.4	0.7%
OTHER/EU/TURKEY	75.4	1.1%	812.0	1.1%
TOTALS	1455.3	20.6%	6904.9	9.6%
Worldwide	**7072**		**71,847**	

Takaful growth has occurred in the populous region of South Pacific due to its moderate per capita income levels, acceptance of insurance and propensity for savings and pensions. The significant size of Takaful in GCC region is due to higher GDP and per capita incomes despite its limited population. Future Takaful growth is very likely in populated regions of Africa and Levant (782 mils and 777 mils respectively) as the economies, heavily dependent upon commodities, expand and their per capita incomes rise.

Regional growth in Takaful business can be forecast by projecting off the baseline of 2011 figures. However to be conservative, we have cut in half the expected future growth rate—using a standard of 12.5% annualized compounded increases. The resulting forecast for 2020 is shown in the following figure.

Source: SIGMA 3/2013

FIGURE 9: FORECAST OF GLOBAL TAKAFUL GROWTH 2009-2020



The above forecast shows that GCC region including Saudi Arabia will dominate the Global Takaful business excluding Iran (which steadily represents about 44% of Total Global Takaful premiums) with roughly 66% of the written business. Again, Saudi Arabia's influence however will wane from 56% of Global non-Iran Takaful premiums in 2009 to 48% in 2020. Whereas the Non-Iran, Non-Saudi and Non-Malaysian vanguard markets of Indian Sub Continent, Africa, Levant and Asia/Pacific regions combined will expand dramatically from 9% of Total Global Takaful premiums in 2009 to nearly 24% by 2020.

Sources: E&Y World Takaful Reports 2010-2012, Sigma World Insurance data and author's estimates.

Actual compounded growth rates for the period 2008 to 2011 by region are shown in the following table.

TABLE 8. ANNUAL GROWTH RATES

	Growth Rate 2008-2011		Growth Rate 2008-2011
INDIAN SUBCONTINENT	23.8%	GCC ALL	25.7%
LEVANT	128.3%	SAUDI COOPS ONLY	22.8%
AFRICA	17.7%	IRAN	29.9%
SO. ASIA/PACIFIC	43.9%	TOTAL GLOBAL TAKAFUL	29.8%

3.3 FINANCIAL AND OPERATIONAL PERFORMANCE

Based upon the sample data for 203 Takaful[5], the following observations can be made about operational performance and efficiency for global Takaful sector. This data is not exhaustive nor perfectly accurate as a profile for the sector because many operators are private entities and do not publish figures for public scrutiny. Nevertheless, these figures provide a factual basis for assessment of Takaful and offer useful comparison to conventional insurers who dominate the global insurance industry.

Analysis will focus on critical financial elements of performance, namely:

Claims Ratio (a), Acquisition Ratio (b), Operating Ratio (c), Combined Ratio (a+b+c); Profits before Tax, Return on Assets, Return on Shareholder Equity and Gross Premiums per employee as proxy for Productivity comparison.

According to World Insurance Report 2013 (data 2011)[6] operational performance figures for the Non-Life segment in USA as an overview were:

[5] Primary data collected from Thompson Reuters Zawiya database (in 2014- data as of 2013), E&Y World Takaful Reports, Islamic Insurance Directory and author's data assembled from conferences 2005 until present.
[6] Published by CapGemini Group USA, 2013

Source: Dr. O. Fisher's research.

TABLE 9. OPERATIONS RATIOS AS PERCENT FOR USA NON-LIFE INSURERS

Item NL	2006	2007	2008	2009
COMBINED RATIO	98.4	101.5	106.1	105.8
ACQUISITION RATIO	17.3	17.1	17.5	18.2
OPERATING RATIO	18.5	18.1	20.1	19.7
CLAIMS RATIO	63	66	69	68
PROFITS BEFORE TAX	19.0	18.4	1.7	10.1
AVERAGE NL CLAIMS				61
AVERAGE NL CLAIMS ADJUSTMENTS EXP.				13

Table 9 above clearly shows that P/C insurers in USA on average carry a Claims Ratio ranging from 63% to 69% with Expenses Ratio ranging from 35% to 37%, and delivered a Net Income (Before Tax) 18% in 2007, 1.7% in 2008 and 10.1% in 2009. Where the benchmark Combined Ratio shows operating results above 100%, this means outflows (claims and expenses) exceed inflows (premiums), which deficit was covered by investment returns and/or a drawdown of reserves.

From a sample of global Takaful operators in the same period, the following tables were compiled [7]

TABLE 10: TAKAFUL COMBINED RATIOS SAMPLES BY REGION

Combined Op Ratio (sample 27)	2011	2010	2009	2008	2007
MALAYSIA TAKAFUL	78.00%	61.00%	70.00%	59.00%	72.00%
CONVENTIONAL MALAYSIA INSURANCE	87.00%	92.00%	91.00%	92.00%	89.00%
GCC TAKAFUL (EXC SAUDI ARABIA)	102.00%	89.00%	91.00%	90.00%	90.00%
CONVENTIONAL INSURANCE	77.00%	81.00%	87.00%	81.00%	78.00%
SAUDI COOPERATIVES	90.00%	86.00%	86.00%	107.00%	91.00%

*Net Claims + Net Comm + Net Exp. = CR

[7] E&Y World Takaful Report 2013 (data 2009-2011)

Combined Ratios of Takaful in Malaysia are more favorable than in Takaful in GCC region partly due to lower Operating Expense Ratios and the tariff regime for motor rates and coverage that stabilizes premium prices. Malaysian Takaful can compete against Conventional insurers effectively due to lower Claims Ratio. Acquisition and Commission Ratios between Malaysian Takaful and Conventional insurers are comparable in compensating agents and sales force to win the insurance business; however are 20% higher than such expenses in GCC region. This suggests that Malaysia Takaful are more "aggressive" in pursuing insurance business and stronger in building up an incentive-oriented distribution channel(s).

By contrast, Takaful average combined ratio in GCC region (2005) was 82% vs. 77% for conventional insurers, which suggests that over the 5 year period ensuing Takaful's Combined Ratios deteriorated roughly 10% whereas the Combined ratios of conventional insurers remained relatively constant. As one might expect, the overall Claims Ratio is similar between Takaful and conventional insurers operating in GCC region, as both are affected by identical natural disasters and risks, injury and healthcare statistics, yet because the Takaful Expenses and Operating Ratio are higher then their Combined Ratio results are concomitantly higher with profits (ROE) pushed lower or into negative results, consequently.

TABLE 11. ACQUISITION RATIOS TAKAFUL (SAMPLE)

	2011	2010	2009	2008	2007
MALAYSIA TAKAFUL	13%	13%	12%	12%	18%
CONVENTIONAL MALASIA INSURANCE	14%	16%	10%	8%	6%
GCC TAKAFUL (EXC SAUDI ARABIA)	4%	9%	17%	14%	9%
CONVENTIONAL INSURANCE	-8%	-5%	-4%	-7%	-10%
SAUDI COOPERATIVES	6%	11%	11%	11%	7%

TABLE 12. OPERATING RATIO TAKAFUL (SAMPLE)

Average Expense Ratio (sample 27)	2011	2010	2009	2008	2007
MALAYSIA TAKAFUL	26%	16%	22%	22%	37%
CONVENTIONAL MALAYSIA INSURANCE	26%	23%	23%	24%	23%
GCC TAKAFUL (EXC SAUDI ARABIA)	33%	28%	31%	25%	35%
CONVENTIONAL INSURANCE	23%	24%	27%	28%	27%
SAUDI COOPERATIVES	21%	38%	28%	23%	18%

* ER= G&A / Net Earned Prem.

TABLE 13. CLAIMS RATIO TAKAFULS (SAMPLE)

Claims Ration (sample 27)	2011	2010	2009	2008	2007
MALAYSIA TAKAFUL	78%	61%	70%	59%	72%
CONVENTIONAL MALAYSIA INSURANCE	87%	92%	91%	92%	89%
GCC TAKAFUL (EXC SAUDI ARABIA)	102%	89%	91%	90%	90%
CONVENTIONAL INSURANCE	77%	81%	87%	81%	78%
SAUDI COOPERATIVES	90%	86%	86%	107%	91%

One plausible explanation for the differences in Claims Ratio is that nearly 60% of Malaysia Takaful business is Family (life) Takaful (vs. 35% in GCC region) where the Life Claims Ratio is typically far lower than General-NL Claims Ratio, especially in the first 5 years of a new policy.

Net Income Before Tax Takaful Profitability

Regrettably, not many Takaful operators routinely publish net income and financial operating results. A somewhat uneven profile was compiled for the period 2009 to 2012 for 100 Takafuls. A summary of major markets appears in Table 14 below:

TABLE 14. A NEGATIVE NET INCOME RESULTS FOR TAKAFULS 2009 TO 2012: MAJOR MARKETS

Markets	Sample No. TOs	2012	2011	2010	2009
UAE	9	4	4	5	5
SUDAN	8	N/A	N/A	2	2
SAUDI ARABIA	27	17	5	8	7
PAKISTAN	5	1	3	5	5
MALAYSIA	11	4	N/A	1	N/A
KUWAIT	7	2	3	5	7
EGYPT	6	N/A	2	3	3
BAHRAIN	3	1	1	1	1

Source: Dr. O. Fisher's research 2014.

It is observed that of worldwide Takaful sampled in 2012 (66) 44% were showing negative income, in 2011 (74) 27% had negative income, in 2010 (91) 36% had negative income and in 2009 (83) 40% ran negative operating results. Thus the global Takaful four-year operating history features well over one-third of operators having "red ink" deficits on a consistent basis in several major insurance markets. This may not be totally surprising because again youthful Takaful operators are absorbing establishment costs and striving to amortize fixed expenses higher than conventional insurers over a small but expanding book of customers.

Applying a average retention ratio of 55% to derive Net Contributions for global Takaful sector's gross contributions of $8,329 Mils, the annual loss amounts of $116 Million equals 3% in 2010 and contributions of $12,407 Mils resulted in an annual loss of $437 Million that equals 6% in 2012. A significant segment of global Takaful are losing money for policyholders and shareholders alike. Coupling soft prices for risk coverage with a drive to take market share away from scores of competitors yields the same unprofitable outcomes for many Takaful spanning the globe. Such an alarming trend is unsustainable, as these deficits erode shareholders paid capital and trigger multiple Qard-Hasan benevolent loans to the common risk pools.

One finding of the GCC Insurance Barometer Report (2012) published by the QFC Authority of Qatar is that lack of efficient operations in insurance can be fatal to an insurer when mixed with rapid growth:

"From a line of business perspective, growth and profitability seem to be inversely correlated. Medical insurance is considered fastest growing line of business but is the least profitable segment of GCC markets, while engineering is viewed as slowest growing but most profitable line of business." [8]

TABLE 15 RETURN ON TAKAFUL ASSETS ROA (SAMPLE)

Reinsurance Ratio (sample 27)	2011	2010	2009	2008	2007
MALAYSIA TAKAFUL	20%	12%	8%	9%	6%
CONVENTIONAL MALAYSIA INSURANCE	25%	23%	23%	22%	18%
GCC TAKAFUL (EXC SAUDI ARABIC)	34%	34%	47%	45%	42%
CONVENTIONAL INSURANCE	50%	52%	47%	50%	52%
SAUDI COOPERATIVES	27%	37%	32%	40%	42%

* RR= Ins. Prem. ceded / GP

Return on Assets (ROA) is an important criteria for evaluation of financial performance for the insurance business as a whole. Table 15 shows that Malaysia Takaful are returning less ROA than conventional counterparts in same markets—yet have reduced the gap from one-half (1/2) less in 2008 to 20% less in 2011. GCC Takaful on average seem to be losing ground by producing ROA less than conventional insurers with 10% less in 2008 and 32% less in 2011. A lingering global financial crisis with extremely low interest rates has dramatically reduced investment yields for insurance companies, with exceptional challenges posed to Islamic financial institutions due to limited scope and supply of high-yielding asset-backed securities.

From financial data of 100 Takaful operators, Total Assets in 2012 were $12.6 Bil up from $10.6 Billion in 2011. This compares to total paid capital in 2012 of $7.55 Bil up slightly from $7.39 Billion in 2011.

[8] GCC Insurance Barometer 2012, QFC Authority of Qatar survey of GCC markets.

TABLE 16. RETURN ON TAKAFUL SHAREHOLDERS' EQUITY (SAMPLE)

Return on Equity (sample 27)	2011	2010	2009	2008	2007
SO ASIA (INC MALAYSIA)					
MALAYSIA TAKAFUL	4%	6%	-2%	4%	5%
CONVENTIONAL MALAYSIA INSURANCE	17%	10%	14%	11%	14%
GCC TAKAFUL (EXC SAUDI ARABIA)	4%	4%	-2%	-2%	10%
CONVENTIONAL INSURANCE	9%	9%	8%	9%	18%
SAUDI COOPERATIVES	-7%	-1%	-12%	-10%	18%

Return on Shareholder's equity (ROE) shows a mixed picture for the period 2007 thru 2011, because of the severe impact of global financial crisis in years 2008-2009. A 10 year moving average of ROE for P/C NL insurers in USA is 7.6% and for Life insurers is 8.8% annual yields. Thus the ROEs for conventional insurers in Malaysia looks favorable as compared with that benchmark- averaging 13.2% over the 5 period – and when compared with Takaful in same market which showed an average ROE of only 3.4 percent. ROEs for GCC region posted an average of 2.8 percent. Coops in Saudi Arabia matched the ROE of conventional insurers in 2007 and 2008, and then fell sharply behind with negative ROEs in 2010 and 2011. Negative ROEs might be explained by tighter insurance regulations on products and pricing plus changes to the reserving rules, which constrained net income. Average ROE for Saudi Coops is 6.4% for the period of 5 years.

Total Assets:

A sample of 69 insurers in GCC (2005) shows that average Total Assets for Takaful Operators was $58 Million vs. $113 Million for conventional insurers[9]. Takaful median assets were merely $17 Million vs. $63 Million for their conventional counterparts.

[9] Dr. O. Fisher unpublished PhD thesis (2005).

TABLE 17. RETENTION RATES TAKAFUL (NON LIFE)

	2011	2010	2009
GCC CONVENTIONAL INSURERS	50%	48%	53%
GCC TAKAFUL OPERATORS	66%	66%	53%
SAUDI COOPS SAMPLE	73%	63%	68%

Takaful average retention of gross contributions was 58% in 2005 vs. 46% for conventional insurers, climbing to 66% retention by Takaful in GCC region in 2011 vs. 50% for conventional insurers. This demonstrates that Takaful are typically underwriting Personal Lines with less severity and catastrophic risks whereby permitting higher retention rates that also assures more funding for investments leading on to more favorable combined ratios.

Risk Retention Ratio and Underwriting Leverage

An additional measure of technical risk management and financial health is the ratio called "Underwriting Leverage", which describes the efficient use of capital by insurers. The ratio is calculated, as a percentage, by dividing the Retained Premiums by the Total Assets. Typically, percentages below 100% indicate inefficient use of Total Assets whereas highly efficient deployment of assets yields 200% to 300% ratios. The next Table 17A shows an average Underwriting Leverage ratio for key Takaful markets worldwide based upon a small sample size of financial data using top line revenues (as statistics on net retained premiums were unavailable).

TABLE 17A. UNDERWRITING LEVERAGE RATIOS 2010 - 2011

Takaful Markets	Sample TOs	2011	2010
KUWAIT	10	56%	52%
JORDAN	3	66%	68%
MALAYSIA	8	210%	164%
PAKISTAN	5	129%	89%
QATAR	3	58%	58%
SAUDI ARABIA	18	163%	146%
UAE	6/7	88%	130%

It is noteworthy that within selective markets, certain Takaful Operators are achieving Underwriting Leverage ratios comparable to professional conventional insurers; e.g. Tawwuniya/Saudi at 500%, Allianz/Saudi 300%, Malath Takaful/Saudi 200%, MedGulf/Saudi 300%, Eqita/Malaysia 500%, Iklas Takaful/Malaysia 200% and TakafulRe/Malaysia 250%.

By contrast, those Takaful Operators whose Leverage Ratio is under 100% are failing to realize efficient use of risk bearing capital and sufficient scale of operations that underpins basic profitability.

Overall Takaful Operators retain more risk exposure than conventional insurers due to their focus on less complex forms of business classes and due to excess capacity, as Takaful are still building up their book of business. Given Takaful's relatively more modest capitalization, their Net Underwriting Leverage is suboptimal. Across GCC Region Takaful tend to cede higher to reinsurers as many have traditionally acted as "brokers" that pass along the risks rather than performing careful underwriting and statistical analysis required for exact pricing of larger risks.

Source: Dr. O. Fisher research

3.4 PRODUCTIVITY OF EMPLOYEES

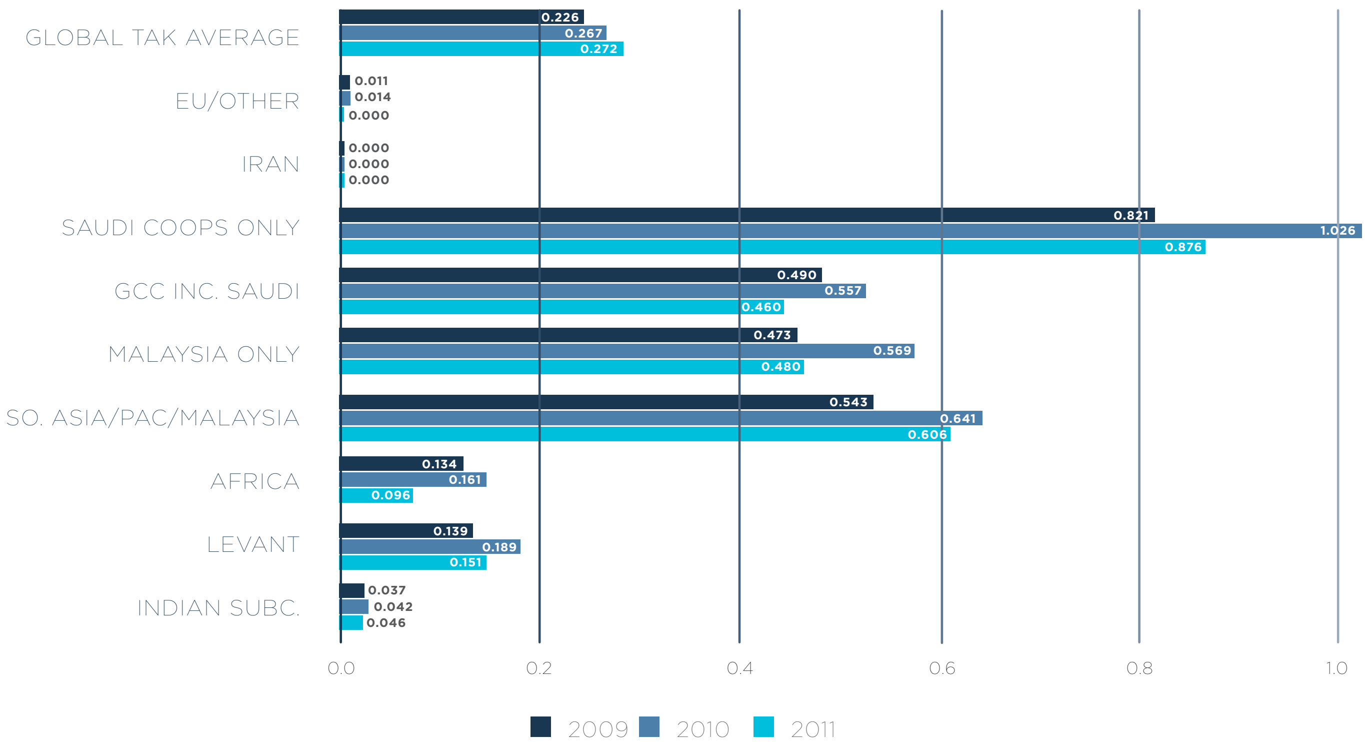
Comparative productivity figures for the Takaful sector can be revealed by analyzing a ratio of top line revenues to number of employees. These ratios are displayed in Figure 10 arranged by major regions. Selected Takaful operators have achieved "reasonable" levels of productivity per employee:

- Malaysia's Maybank/Eqita ranges from $1.0 Million to $0.81 Milion per employee
- Malaysia's Iklas ranges from $1.0 Mil to $0.90 per employee
- Saudi Arabia's Tawuniya ranges from $4.7 Mil to $5.9 Mil
- Saudi's Coop sector as a whole ranges from $0.82 Mil to $1.02 Mil

However the worldwide Takaful sector's average productivity ranges from $0.27 Million to $0.26, which is a fraction of the productivity of the Islamic insurance of the relatively mature markets described above. Newer Takaful operators struggling to carve out a niche position in Levant markets – show productivity below the global Takaful productivity average, ranging from $0.15 Mil to $0.19 Mil per employee.

Based upon a sample of 69 insurers in GCC region (2005), the average productivity per Takaful Employee was $263,000 vs. $500,000[10] for conventional insurers, a 47% shortfall in productivity.

FIGURE 10. PRODUCTIVITY OF TAKAFUL BY REGION: AVERAGE REVENUES PER EMPLOYEE 2009-2011 IN MILS USD $



[10] Dr. O. Fisher, Unpublished thesis on Financial and Operating Characteristics of Takaful Operators in GCC, 2005.

In the 3-year period under review, global average Productivity per Takaful Employee rose from $226,000 to $272,000, a positive 20% gain. Nonetheless, a regional analysis shows that Takaful productivity made strong gains in South Asia/ Pacific/Malaysia (up 12%) and is 122% higher than the benchmark. GCC regional productivity is 69% higher than benchmark yet shows an overall decline of 6% for 2009-2011. Africa region likewise shows a decline in productivity of 32% -- perhaps due to larger headcount and slower adoption rates as a common feature for start-up ventures. Levant regional productivity shows a gain of 9%, however overall employee productivity still lags at only 55% of the global Takaful average.

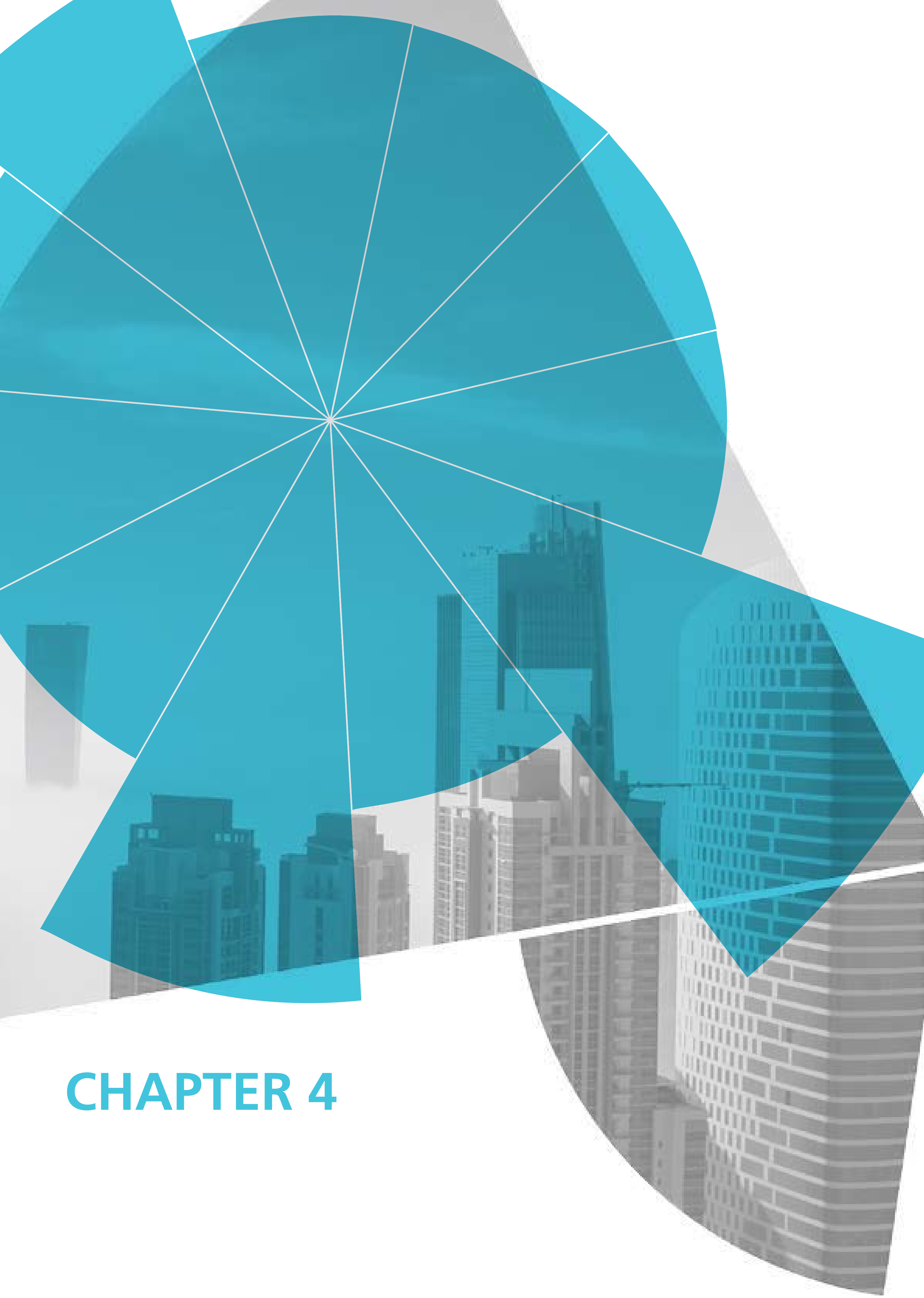
Benchmarks of Employee Productivity using only mutual insurers in developed markets can be calculated from data in the ICMIF Annual Market Share Report (2013) as follows:

FIGURE 11: AVERAGE PRODUCTIVITY PER EMPLOYEE

	Mutuals Gross Premiums 2011 (Million US $)
UK	$0.597
FRANCE	$1.390
GERMANY	$1.263
ITALY	$3.144
NETHERLANDS	$11.367
JAPAN	$1.165
USA	$0.979
CANADA	$0.886

Thus, the average Takaful Employee Productivity of $272,000 is approximately only 20% of the average productivity for established Mutuals of $1.34 Million annually in the above sample.

Benchmarks for Employee Productivity of $1 Mil in Saudi Arabia's Coop sector as a whole and $6 Mil for Taawuniya Coop, provide indications of possible levels of employee productivity that Takafuls can aspire to. Achievement of such productivity outputs will require continuous employee training, adoption of technological and operational improvements, and elastic incentives and compensation programs to reward merit and drive employee productivity higher in the workplace.



CHAPTER 4

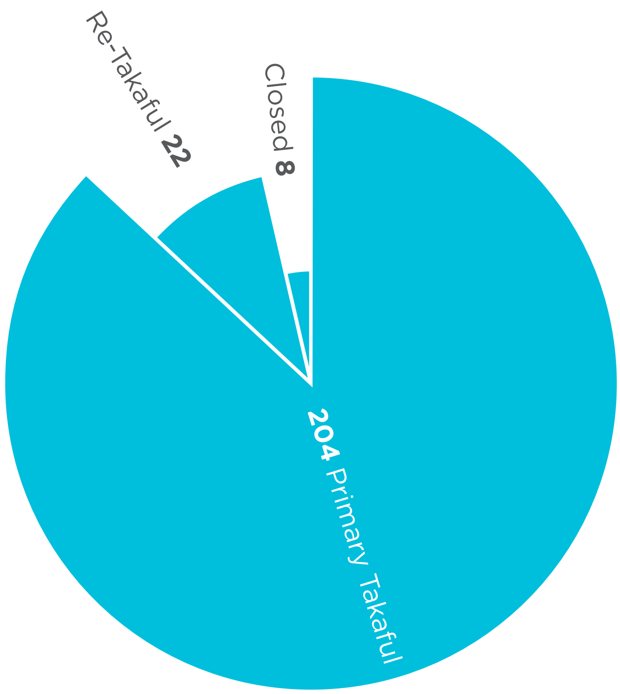
TYPES OF TAKAFUL MODELS

When Takaful re-emerged in Sudan in 1979, a cooperative model for operations was adopted. Over the past three decades, a hybrid model of shareholders forming a stock company to manage a cooperative primary risk pool appeared as well as Takaful "windows" within reinsurance operators to handle Re-Takaful requirements. Figure 12 shows a breakout of global Takaful institutions as of 2012. The total number of institutions that now exist stands as 226. There were 8 institutions that were closed or acquired.

Malaysia's Takaful Act of 1983 regulated operations as a Mudarabah model, which structural model was unacceptable to GCC Takaful founders in Jordan, Saudi Arabia and Bahrain. Thus the GCC and Levant regions have pursued a Wakala[11] operations model, which form was popularized by launching of Takaful Taawuni by Bank Al Jazeera in 2000.

Within the sample of 231 Takaful operators, there are 46 Unknown models although it is certain that 2 models in Pakistan are experimenting with a Waqf model for Takaful. However, changes to Pakistan SEPC's insurance regulations in 2013 promotes the Wakala model and also permits conventional insurers to maintain Takaful "windows" .

FIGURE 12. GLOBAL TAKAFUL INSTITUTIONS BY TYPE OF OPERATING MODEL



Sources: Dr. O. Fisher's research

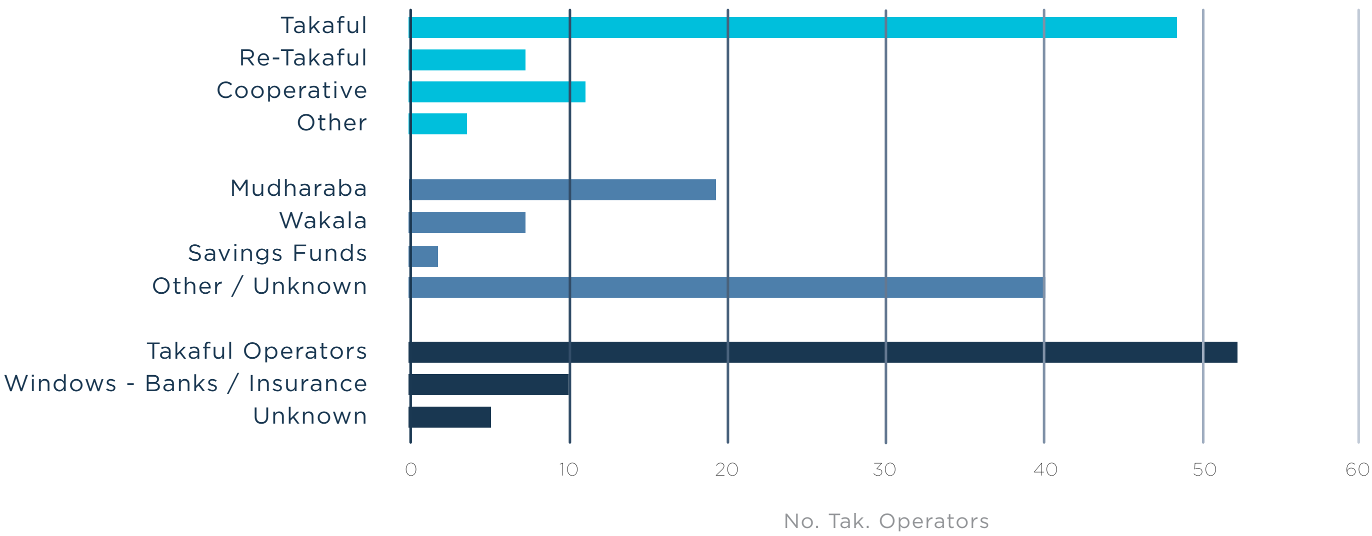
[11] Full descriptions of each model can be found in Principles of Takaful, BIBF Bahrain 2009

Over the past 20 years, there have been 8 closures of Takaful operations – several were outright failures in their respective markets. While circumstances most certainly differ – poor management, weak planning, wrongheaded product decisions or pricing—typical risks in any modern business—one cannot conclude that Takaful principles are at fault, nor that Islamic values are not welcomed by target customers. On the contrary, customers in the 21st century are savvier than ever, can access pricing and product information instantaneously on their digital devices, more vocal about quality of customer service and fulfillment of a brand "promise".

To propel growth, Takaful must become "customer centric", improve and innovate products/services addressing real customer needs, and adopt enterprise risk management systems and techniques to accurately assess and price risks, while adhering throughout to core Islamic values.

Figure 13 describes the forms of Takaful operations likely in use by the 234 Takaful and Re-Takaful institutions in the Directory.

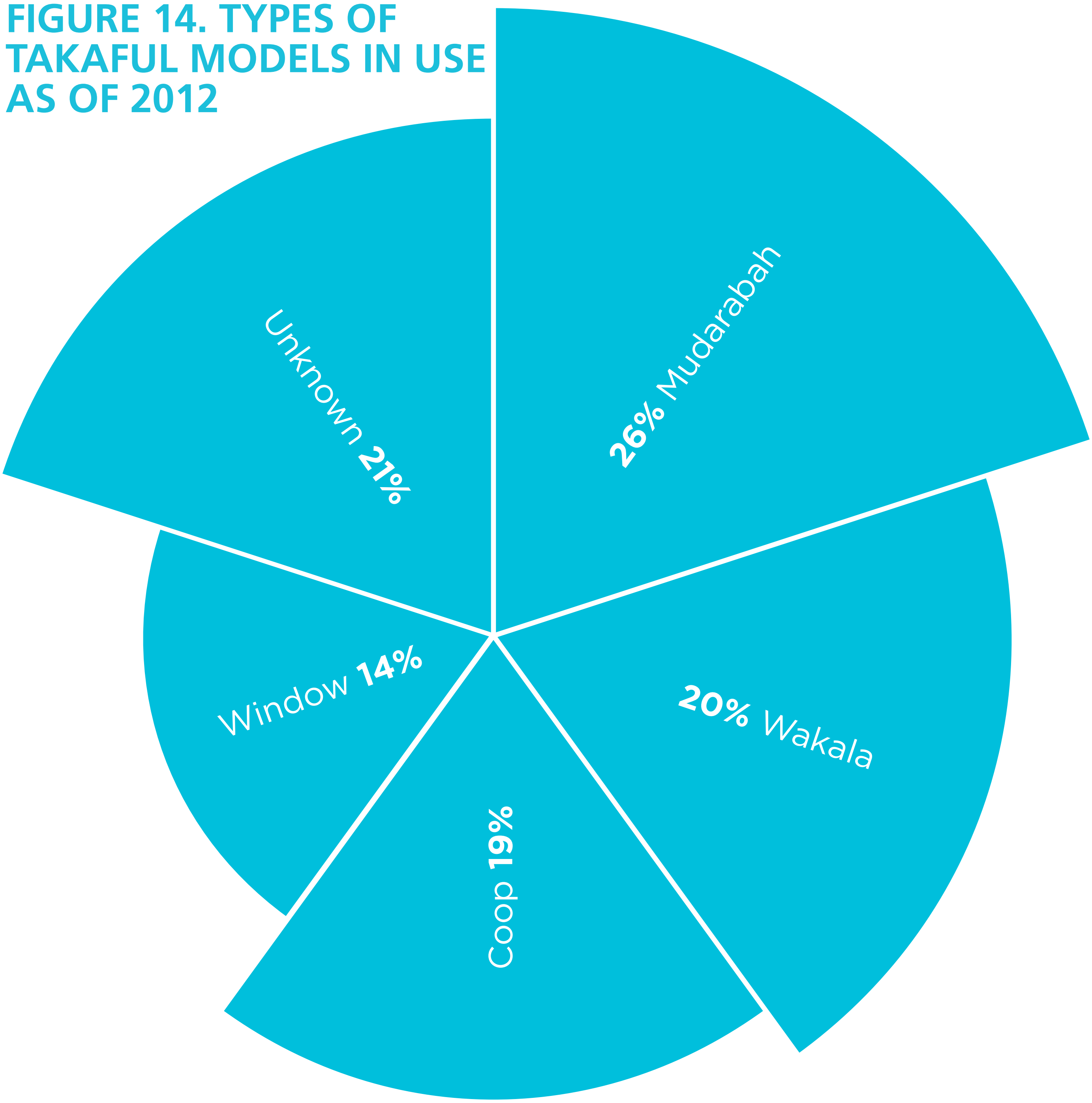
FIGURE 13. TYPES OF TAKAFUL MODELS IN USE AS OF 2005



The data gathered and analyzed with an unpublished PhD thesis (2005) by the author shows that the global dominant model for Takaful is Mudarabah - 29% of the Takaful sample of 69 operators elected the Mudarabah model, whereas 14% chose Takaful "windows" and 12% employed a Wakala model. However, seven (7) years later reveals a more balanced profile of deployment of Takaful models.

Source: Dr. O. Fisher research

FIGURE 14. TYPES OF TAKAFUL MODELS IN USE AS OF 2012



Mudarabah, Wakala and Cooperative models of Takaful are quite evenly divided across the global Takaful sector. Use of Takaful "windows" instead of full-fledged licensed Takaful companies is widely spread in Iran (12), Indonesia (10) and Malaysia (3). Nevertheless, regulations under advisement in Indonesia as of 2014 will close Takaful "windows" and compel composite insurers to split Life and Non-Life books of business. Moreover, Bank Negara is encouraging new Takaful licensed over the past 3 years to adopt the Wakala model, which points towards its increasing preference as a disciplined, transparent and fair model for both shareholders and policyholders.

Sources: Ofisher PhD Nov. 2005; Takaful Directory and author's data, 2012.

CHAPTER 5

KEY CHALLENGES TO SUSTAINED GROWTH

Much is written and spoken about during Takaful conferences analyzing the main obstacles to growth. Among the most commonly cited obstacles are:

- Lack of scale in operations - affecting economies of scale, competitive pricing and geographic reach.

- Weak diversification of business lines – concentration on personal lines and yet to be developed prowess in Casualty or Liability lines (including D&O coverage or Medical Malpractice).

- Scarcity of skilled personnel – knowledgeable about insurance, underwriting, actuarial studies as well as Shariah principles as apply to Islamic insurance. Key issues mentioned are: slow trickle of new recruits to insurance careers overall; aging generation of practitioners (especially Arab world); limited number of skilled Islamic Scholars knowledgeable about insurance; few trained Actuaries familiar with Takaful principles.

- Limited distribution channels- over-reliance on either direct sales force, brokerage or bancassurance rather than strategic development of multiple distribution avenues, including transactional internet web presence.

- Limited investment instruments and securities – especially in Family Takaful and long term savings plans limited array of investment securities on Sharia compliant basis to pair up the risk protection coverage.

- Weak innovation- tendency to imitate proven conventional insurance products/services rather than re-think the risk protection service model and probe Islamic values to identify potential areas for innovation. Hajj and Umrah Takaful coverage was first proposed by Bank Al Jazeera Takaful taawuni in 2001 yet today this form of Travel Insurance can be refined further to better suit the pilgrimage circumstances of millions of muslims annually.

- Underdeveloped corporate governance – Islamic insurance companies have generally not adopted governance policies, practices nor standards for ethics and codes of conduct for Board members as well as client-facing personnel. Malaysian Takafuls are one exception, as Bank Negara supports and the Takaful Association actively promotes specific governance initiatives.

From the list above, there are three critical challenges to sustained growth in the Takaful global insurance sector without which Takaful may be relegated to a “niche” line of business rather than claim a significant stake in the global mainstream of risk protection.

5.1 RATE OF INNOVATION

Innovations - both incremental and break- through - rejuvenate any business. Customers are conditioned to seek out "new" and "better" products and services. Companies that are not innovating in modern business are lagging behind, and certainly will lose relevance, market share, and eventually profitability. Takaful operators are not immune to such market forces. Simple imitation or offering "me too" products identical to conventional insurance rarely boosts sales for Takaful players. Regrettably, research shows that globally Takafuls are not innovating and expenditures on Research & Development are minimal or non-existent. By contrast, leading edge consumer corporations (such as Apple/Samsung) expend upwards of 8% to 10% of net income on R&D annually. There is no systematic reinvestment evident by Takafuls into new products, new ways of delivery of insurance nor into re-inventing the business model itself. The advent of social media – Facebook Twitter, Snapchat, Google, etc. – is yet to be integrated into Takaful operations, despite the deeply social nature of Takaful's roots and membership community.

Fortunately, there are some examples to illuminate innovations in the Takaful space: refer to the below examples. Substantial opportunities beckon for: micro - takaful, rural risk protection schemes for farmers and cooperatives, unit-linked savings plans, online Internet comparison and procurement of risk protection, to name a few.

Examples of Takaful Innovations:

• Takaful insurance of Africa: Today, for the first time in Africa, an insurance policy that combines an Islamic-compliant financial instrument with innovative use of satellite imagery is compensating Muslim pastoralists for drought-induced losses suffered in Kenya's northeastern Wajir County, where livestock are valued at Ksh46 billion (USD550 million). The pilot program is paying approximately Ksh500,000 (USD5,800) for losses suffered to their herds of sheep, goat, cattle and camels during the long dry season that typically ends in March. (2014)

• Noor Takaful: Employers of the UAE's privately sponsored 400,000 domestic workers can now insure their drivers, cooks, cleaners, maids, or gardeners against illness, accidents, or loss of life, with the launch of the Domestic Aid Medical Plan by Noor Takaful, the Islamic insurance arm of Noor Investment Group (Noor). The Domestic Aid Medical Plan bundles two offerings within one easy-to-obtain package that provides domestic workers with up to Dhs50,000 medical insurance coverage, plus an additional capital sum of Dhs50,000 in the event of loss of life. (2013)

• COBALT Takaful risk platform at Lloyds: the new exchange platform allows each insurer to have a Takaful window. Policy holder funds are segregated from conventional funds, without affecting their rating levels, which helps price the risk competitively. Many transactions are at least an A rating in order to satisfy the requirements of both buyers and their financiers. The risk is priced by a lead insurer and other Takaful firms then subscribe under similar terms. This window approach mirrors the subscription model used in London's broader insurance market. Cobalt has secured underwriting capacity from XL Group to insure commercial property risks with capacity of up to $300 million. (2013)

• Noor Takaful launched the GCC's first online real-time, web based, Islamic insurance service in 2009. With a simple click of a mouse, the easy to use online facility allows customers to shop for a variety of insurance products which are offered at very competitive and transparent rates. Noor Takaful is the Shariah compliant insurance brand of Noor Investment Group. Noor Takaful inaugurated the new online service with a motor insurance product that covers both private and commercial vehicles. Other types of insurance products are to be available online in near future. (2009)

• Dar Al Takaful PJSC, an Islamic Insurance & Reinsurance Company, has announced the launch of the world's first Sharia-compliant bloodstock policy, which will include a new insurance product to horse owners across the GCC to protect them from certain financial losses in the result of deteriorating health or incurred accidents involving their animals. From international competitors to large stables and club teams, all equestrian owners stand to benefit from the new insurance product. These take into account the different requirements of owners who need to insure a large number of animals or who compete in high-risk events. (2010)

• Bank Al Jazeera Takaful Taawuni launched the world's first Waqf Savings Plan. Policyholders can contribute a lump sum or monthly installments to the Waqf Savings Plan toward development of a personal trust for charitable purposes. Bank Al Jazeera makes investments on behalf of the policyholder. At any time, the Plan can be ended and converted into a living trust (waqf) to fulfill its religious and charitable purposes in perpetuity. (2002)

5.2 DISTRIBUTION CHANNELS

A major factor inhibiting the future rate of growth of Takaful sales is the relative under-development of insurance distribution channels in many emerging markets into which Takaful is being introduced. For example, across the GCC there does not yet exist a network of insurance agents or independent franchises as one commonly sees in Europe, Asia, or North America. Therefore, boosting insurance/ Takaful sales must occur by assembling "legends" of direct sales personnel, which is time-consuming and costly for young Takaful operators, or by arranging relationships with banks, or through a reliance on brokers.

Research from Malaysia explains in part that the impressive growth of Takaful sales from 2006 to 2011 was driven by a combination of: a) direct marketing through an extensive network of agents and independent agencies, and b) the establishment of bancatakaful (banc-assurance) sales through bank branches [refer to Figures 15 and 16] Distribution in Malaysia evidences a shift away from direct sales forces (51 per cent in 2002 vs. 39 per cent in 2006) and towards independent agents (29 per cent, up from 17 per cent) and bancatakaful (30 per cent, up from 7 per cent). Neither of these forms of distribution are well advanced yet in emerging markets – particularly GCC , MENA or Africa regions.

FIGURE 15. DISTRIBUTION OF BANCASSURANCE NON LIFE - 2006

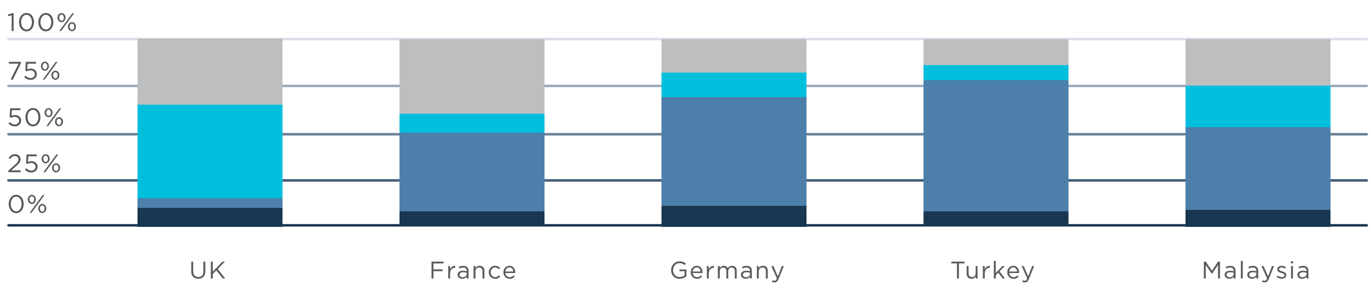
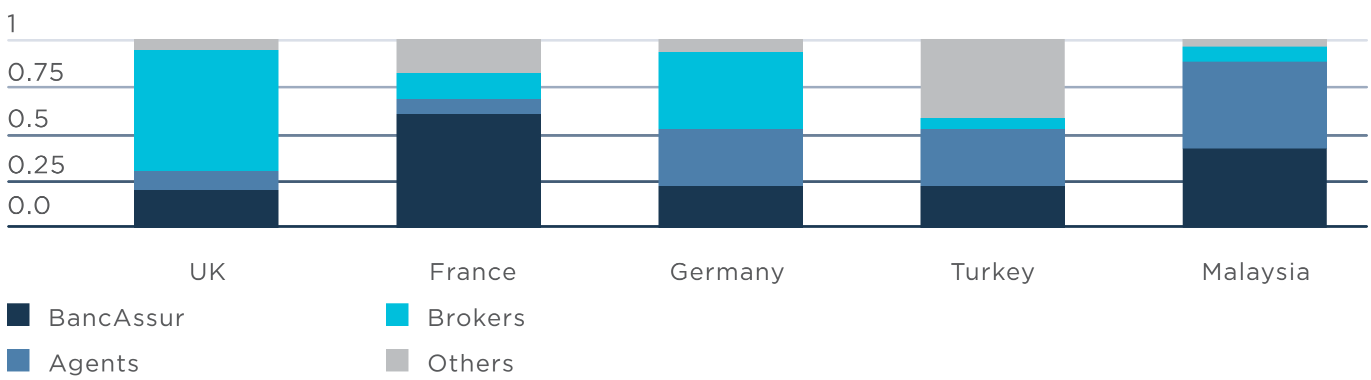


FIGURE 16. DISTRIBUTION OF BANCASSURANCE LIFE – 2006

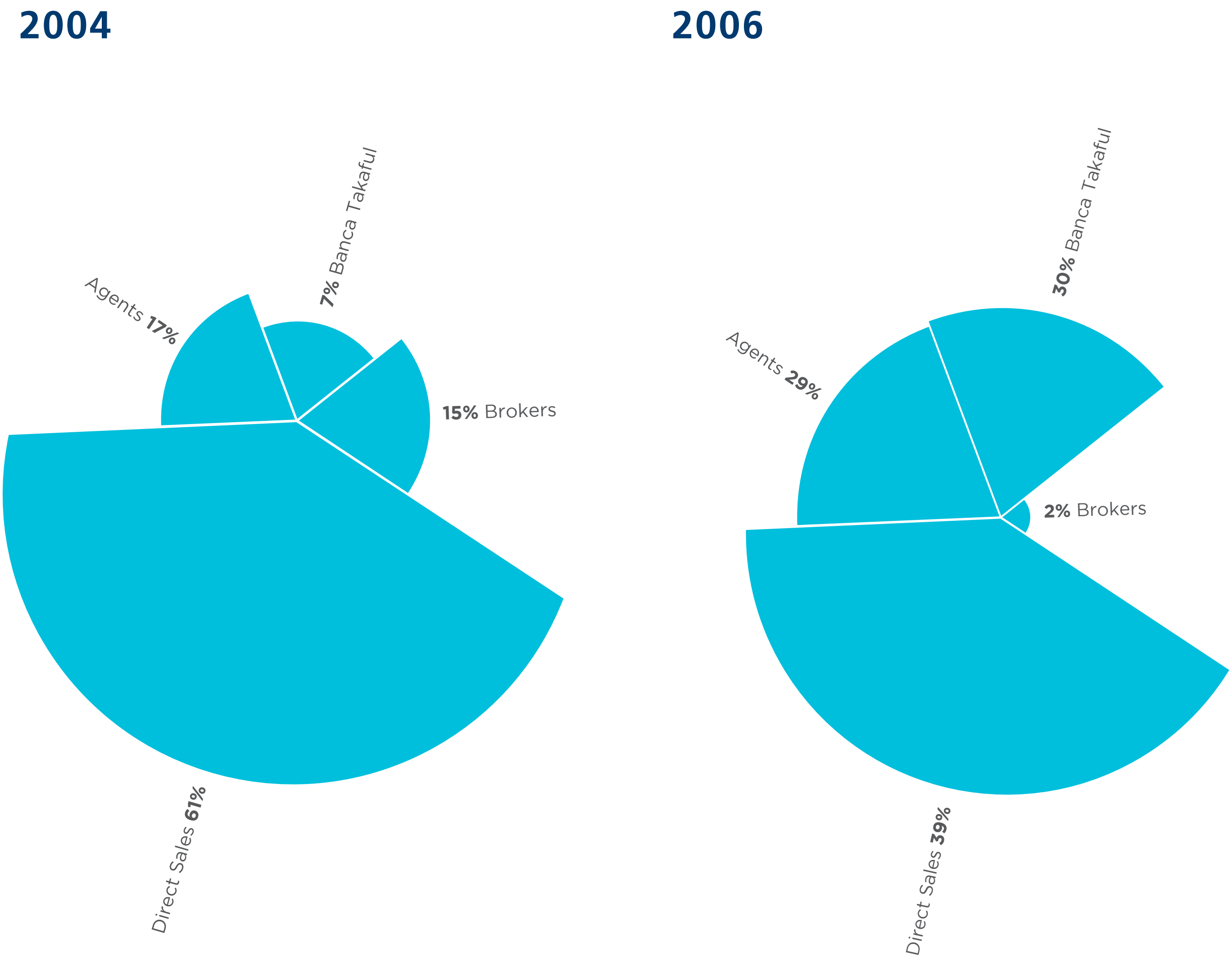


Typical distribution channels for insurance include: bancassurance (using bank branches to sell insurance to bank customers), agents, brokers, internet/ online and direct sales forces. Malaysia sells Non-Life insurance primarily through agents (50%) and captive direct sales force (22%), whereas distribution of Life-Family Takaful is via bancatakaful (40%) and by agents (42%).

Bankatakaful can be the best instrument to distribute takaful products in markets with very low penetration rate. Studies show that Bancassurance is still very popular (see Swiss Re sigma No 5/2007, "Bancassurance: emerging trends, opportunities and challenges") but it carries very high costs compared to the other channels."

To the extent that BancaTakaful sales can be stimulated through Islamic and other regional banks in GCC, additional sales may materialize whereby rosy future sales projections still may prove conservative.

FIGURE 17. TAKAFUL SALES DISTRIBUTION MALAYSIA 2004 & 2006



Source: Mayban presentation in London at Takaful Conference November 2007, by Mohd T.A. Tarmizi

5.3 GOVERNANCE

The third major challenge to self-sustaining growth for Takaful lies in transparent corporate governance, which is inextricably entwined with enterprise risk management (ERM). To explore this matter properly, we must firstly recall the roots of Takaful, and then understand the similarities with mutual insurance of today. Much is written that describes Takaful as similar to cooperative or mutual insurance, yet rarely is this topic really probed in any depth. Firstly, it must be pointed out that Takaful systems are 14 centuries old and thus pre-date both conventional mutual and cooperative insurance schemes. Takaful's origins lie in the 6th century with tribal practices on the Arabian Peninsula where merchants of Makkah formed funds called Hilf to assist the victims of natural disasters, or to protect them from the hazards of long trade journeys. A surety, called daman khatr al-tariq was placed on traders against losses suffered during these journeys caused by bandits, pirates or natural calamities.

Another common tribal practice called a'qila prevented revenge killings and bloodshed by extending shared compensation to ransom captives or to settle a claim from an accidental killing. Such practices from the Jahilaya, or pre-Islam period, were validated by the Prophet Muhammad (PBUH) and incorporated into acceptable practices of the early Islamic state. Moreover, in 622 A.D. (C.E.) the first constitution of Medinah describes the use of ta'awun, or social insurance, in three instances, including (a) mutual assistance extended to "Jews, Ansar, and Christian minorities in the community", (b) a reference to "wergild", or blood money (a'qila) and (c) the provision of Fidyah, or ransom for captives.

Therefore, we can conclude that thousands of years prior to the advent of modern day conventional insurance, Takaful mutual assistance (ta'awun) was commonplace among Arab tribes.

5.3.1 TAKAFUL LEGAL STRUCTURE

It is self-evident that such original Takaful schemes were not organized as commercial transactions, nor contained any profit or gain at the expense of policyholders/members. Rather, origins of Takaful are rooted in social practices to mitigate the misfortunes of individuals by dividing that burden among his fellow members (group/social unit), or tribe in order to secure community well-being.

Intuitively, people feel safer in a group. Providing that the cost of joining that group (i.e. the contribution/donation) is affordable, most people will opt for the security, relative safety and economic benefits to themselves of mutual risk-sharing. When examining insurance arrangements, the over-arching element should be the legal structure and contractual relationship between the insureds (policyholders) and the insurer or risk-taker (insurance company or risk pool). Upon closer inspection, while similarities are striking amongst the three forms of mutual risk management, there are clear differences which are shown in Table 18[12].

[12] Author's research.

TABLE 18: COMPARISON OF COOPERATIVE, MUTUAL AND TAKAFUL RISK SHARING

	Cooperative	Mutual	Takaful
OWNERSHIP	Voluntary, jointly owned	Open, jointly owned by members yet no individual rights over property	Joint indemnification yet no individual rights over property (contribution is tabarru / donation)
MOTIVATION – BUSINESS OBJECTIVE	Affordable risk protection for members	Affordable and economic risk protection for members	Affordable coverage for Policyholders (members) and profits for Shareholders
GOVERNANCE	Governance by democratic voting	Governance one man one vote	Governance is arranged by shareholders; typically, no special voting rights of members
OFFERINGS	Products for coop members only	Products for all; buyer becomes a member	Products to all; buyer becomes member
SHAREHOLDERS	No shareholders	No shareholders	Shareholders for Takaful Operator separate from members of risk pool / fund
MANAGEMENT	Management appointed by coop members	Management appointed by board of mutual, elected by general assembly of members	Management self-appointed by shareholders of Takaful company; structure is consented to by members when buying policy
INVESTMENTS	As per conventional insurance regulations, equities, bonds, real estate, etc.	As per conventional insurance regulations, equities, bonds, real estate, etc.	As per Takaful regulations, must be sharia compliant and Riba-free
DEFICIT	Members may be assessed to cover deficits	Members may be assessed to cover deficits	Members may be assessed to cover deficits but typically shareholders of Operator extend benevolent loan (interest free) to cover deficits in risk pool; such loan must be repaid
LIQUIDATION	Members will own assets in liquidation	Members will own assets in liquidation	After settlement of liabilities, shareholder assets distributed to shareholders and assets of risk pool are donated to charity upon liquidation

Sources: Principles of Cooperatives and Mutuals, presentation by ICMIF, November 2007 and Author's research.

A principal distinction between stock insurers and mutual insurers is that the former is a corporation owned by its shareholders who participate for the gains and losses of the insurance business as operated by the corporation. Shareholders have a right to vote in all corporate matters and elect the board of directors. The articles of incorporation specify which type of insurance business will be implemented.

A modern mutual insurer is a corporation owned entirely by its policyholders, who elect a board of directors and these in turn recruit and appoint management to operate the corporation. Typically the mutual is not a profit maximizing entity but rather concentrates on broad, affordable coverage for its members who share in favorable outcomes through surplus distributions or credit reduction in future policy premiums payable.

However, not all mutual insurers are identical. In fact in mature insurance markets of USA and EU there are five (5) variant types[13]:

- Assessment mutual – reserves right in its policy to charge more premiums to members in event that losses or expenses are greater than expected. Not popular form of mutual as unfavorable financial results are to be recovered from members.

- Advance premium mutual – no special right to charge members for unexpected losses, yet sets initial premiums to result in surpluses which are transferred into reserves or returned to members as distributions – which are non taxable. Popular model for mutual life insurers.

- Factory mutual – commercial property insurer focused on factories, industrial and construction sites to control risk management costs, to promote safety and to reward its members with lower rates and broader protections.

- Fraternal mutual – restricted to members of social or religious organizations who pool their life and health risks as a "fraternity" to reduce insurance costs and to reinforce the common ties.

- Reciprocal Exchange – generally a private membership group (can be unincorporated) whereby each members insures every other member through a common risk pool. Popular for auto and personal lines, smaller risks. The exchange contracts with an Attorney-in-Fact, usually a company, that manages the exchange's daily insurance operations: marketing, underwriting, claims, investments and reinsurance. However, the Manager has no liability for any losses and may be replaced by vote of the mutual exchange members.

It is noteworthy that a mutual policyholder / member enjoys two sets of rights: I) membership rights and II) contract rights. Mutual membership rights are associated with voting on operations matters, strategic corporate decisions and proxy votes associated with major investments as well as sharing in the distribution of any residual assets upon liquidation of the mutual. Mutual contract rights relate to terms and conditions of the policy itself- scope of coverage, exclusions, obligations to notify in case of claim, share in surplus, etc. By comparison, Takaful policyholders/members enjoy contract rights vis a vis the terms and conditions of contractual coverage – albeit motor, business, home or medical. What is less clear amongst Takaful operators worldwide is how and whether membership rights exist.

[13] NAMIC website, USA and http://thismatter.com/money/insurance web site (2014) plus legal and investment securities sources from www.forc.org, 2009

5.3.2 MISALIGNMENT OF SHAREHOLDERS' AND POLICYHOLDERS' INTERESTS

With one exception[14], today's Takaful models employ an organizational structure whereby shareholders assert themselves as "agents" for the policyholders through Mudareb or Wakala contractual arrangements. This arrangement is typically legitimized by voluntary purchase by the policyholder/member of a Takaful Operator's policy. However, many Takaful policies are frankly oblique in terms and conditions, and may not fully disclose membership rights, responsibilities and fees attendant to this arrangement. Hence, the first important observation is the membership rights, responsibilities and role of policyholders in decision-making are not always clearly set forth and readily disclosed in ads, brochures, web sites let alone in actual policy wordings. Common practice under good corporate governance requires that customers (read policyholders/members) be provided clear, unambiguous and easily accessible descriptions of all rights, responsibilities and other consumer protection disclosures, today circumscribed by normal business practices—especially in financial services. No doubt in reaction to the recent global financial crisis (2007-2009), regulators and insurance practitioners alike are giving more attention to transparency and disclosures.

Second, nearly all Takaful Operators establish themselves as managers of the risk pool with no consultation with policyholders—the main beneficiaries of that risk pool. Of the various policies the author has read, not one specifies how policyholders can appoint management or even remove management. It seems their sole recourse is to lapse their policy, or to terminate early if aggrieved or somehow poorly represented by their "agent", the Takaful Operator. Again, good corporate governance practices amongst stock companies generally (including insurance) sets forth the manner in which customers (read policyholders) can complain, influence business management or in extreme cases, mount an appeal to the Board via a proxy campaign or via legal recourse called "class action suit" to impress upon management its grievances.

Third, on a slightly more technical point, the calculation of Surplus at year-end is conducted by shareholders only through a management process with no consultation (again) with policyholders. The decision about retaining Surplus, adding to Reserves or size and timing of Distribution of funds is totally determined by the Takaful Operator. Some industry experts take comfort in the Sharia Supervisory Board's oversight of Takaful business operations, which often can include this issue of Surplus calculation. Nonetheless, Surplus is a right of policyholders who have contributed that risk capital to the Takaful pool. Good corporate governance should dictate that policyholders be actively involved in such calculation and decision-making, rather than resort to a "watch-dog" status for scholars or discovery through a Sharia audit, which is not yet a regular and respected fixture of Takaful operations globally.

Fourth, a survey of Takaful companies around the globe will demonstrate that so far the Board of Directors represents solely the shareholder's interests. Many boards do not yet have even independent members[15], or any representatives from policyholders[16].

Fifth, despite the importance of policyholder capital (in the forms of annual contributions as well as accumulated reserves) in addition to shareholder capital (albeit not at direct risk to claims payments), the Takaful companies typically are not involving policyholders in either investment decision-making neither in major decisions such as mergers, acquisitions or divestment of large assets. Again, these decisions significantly influence the financial strength of the Takaful yet occur at the Board level with no consultation or inputs from the Takaful's constituency—the policyholders. By contrast as shown in the descriptive Table 33 above, mutual insurers dare not resolve such decisions at the Board level alone, and usually consult policyholders via a referendum, survey or even proxy voting.

[14] In Sudan, the original home to rediscovered Takaful (1979), several of the cooperative risk pools do not have shareholder capital and hence like mutuals appoint management from amongst members.
[15] ISAS recommends 1-3
[16] Excluding those standing Board members who coincidentally may also own a Takaful policy issued by their company.

5.3.3 TREATMENT OF QARD HASAN (BENEVOLENT LOAN)

Whenever a Takaful's annual results are in deficit, the shareholder's are generally obligated to extend additional capital to cover the shortfall as a benevolent or interest free loan, as per Shariah rules. Refer to AAOIFI Sharia standard No. 26 for specifics on provision for covering operating deficits. UAE's Article 9 of Takaful Regulations (2012) requires that "a loan by Shareholders must be extended up to limit of Shareholder equity. Failure to do so may result in suspension of Takaful company activities by insurance Authority." However, there are several questions unanswered in this respect. For example, what is the proper accounting treatment, or whether the Qard Hasan can continue to accumulate and be carried forward until repaid from policyholders' surpluses of subsequent years or whether the Qard Hasan would become part of permanent capital or would it become charged off and expensed?

Clarity on this matter is crucial for A.M. Best and others in assessment for financial rating to Takaful Operators. If the Qard Hasan is to be treated as capital for policyholders because it is a continuing asset for shareholders, then this weakens the financial solvency of the risk pool. Moreover, Qard Hasan cannot be treated as tangible capital asset for shareholders as it is exhausted in covering a deficit, and in some cases may never be fully repaid. There is also, a technical issue. Cross-subsidization among the various categories of risk pools is prohibited[17]. Among Takaful regulators, only the QFCRA explicitly prohibits loans from one Takaful fund to another[18]. Furthermore, an analysis of a Takaful operator's solvency using a risk based capital approach holds that funds belonging to Shareholders must be kept separate from funds belonging to policyholders. Thus, financial outcomes of Policyholders' risk pool are totally separate from performance of Shareholder's funds. Where a Qard Hasan has been extended to cover deficits, AMBest treats this as base capital added to Policyholder's fund for enhanced capital adequacy. On a consolidated basis, the financial statements cannot count this capital twice.

Issue of Risk Based Capital (RBC) and Solvency.

Under the Basel conventions, insurance regulations have mandated that all insurers conform to RBC regime [by 2014 in EU Region, by 2015 in GCC Region]. On a purely technical point, can the Takaful Operator (TO) as Agent be held legally responsible for solvency of risk pool at any cost to Shareholders? Recall that TO has no ownership interest in the policyholder's risk pool; they are only contractual risk managers. Regulations are so far silent on the extent of Takaful Operators fiduciary responsibility in event that the magnitude of claims threatens to erase all Policyholders capital as well as all Shareholders capital. If catastrophic claims jeopardize the survival of the Takaful Operator, will TO simply walk away from threat of insolvency of the risk pool? Up to what level of commitment is Qard Hasan mandatory on Shareholders? Practices vary on accounting treatment of Qard Hasan—some Takaful Operators use accrual methods, while other expense the Qard Hasan. Such uncertainties in this critical area of solvency erode confidence in Takafuls and beg for a standardized approach.

[17] Bahrain adheres to AAOIFI standards that forbid this practice which is common amongst conventional stock insurers.

[18] AM Best GCC Insurance Report, 2013, p. 12.

5.3.4 DISSOLUTION

Another concern is that the rights of policyholders in the event of winding up of Takaful business or insolvency remain a matter of mystery. There are no clear written rules and no tested examples to guide how to decide priorities in the claims of the policyholders on the assets of the risk pool. Conventional stock insurers assure that the rights of insured beneficiaries have priority in dissolution over claims of creditors and shareholders. By contrast, stock insurers distribute net remaining assets after settling claims to a few stockholders. This issue is further clouded by the Shariah principles which mandate settlement of all liabilities [including claims payments to beneficiaries] and thereafter residual assets in the risk pool be given away to charity, because policyholders have willingly contributed funds as donations. This is the same problem that is faced in Islamic finance too when a Mudarabah based project investment is dissolved or bankrupt. These problems need to be resolved for the sake of promotion of Takaful business.

5.3.5 UPGRADES TO TAKAFUL MODEL

Due to the range of serious governance issues cited above, it is apparent that Takaful models can and should be modified and updated. To do so, guidance can be derived from the comparison of the cooperatives/ Mutuals and Takafuls as described in the Table 18 above, in order to achieve transparent governance and to hard-wire a system of "checks and balances" into the Takaful system that empowers Takaful members with a strong collective voice.

Balancing the conflicting responsibilities and interests of shareholders/policyholders within hybrid Takaful model pertain to:

- **Capital adequacy** - refers to the ratio of base capital to risk weighted exposures underwritten by the insurer. Views on financial resilience differ as between shareholders and policyholders yet there is no company forum to exchange opinions and reach consensus. Shareholders generally seek risk exposures to build up a volume or book of business (i.e. gain market share) whereas policyholders generally seek to grow reserves to cover risks and to safeguard base capital against catastrophic losses.

- **Risk management** - both shareholders and policyholders have a common goal of sustainability for the Takaful company; however, their perspective on risk management is divergent. As Agent for the insureds, the shareholders manage the risks, perform underwriting and reap rewards from operations yet bear no direct financial responsibility for claim losses. Better alignment of interests in risk management and active involvement by policyholders in decisions are imperative to assure prudent risk exposures only are accepted.

- **Transparency** - Alignment of incentives – (Presently, shareholders through the CEO they appoint set the rates, dividends and surplus policies without inputs from Policyholders. Note that some Takaful Operators charge their expenses and fees to the Policyholders' risk pool and also demand an incentive bonus.

- **Conflicts of Interest** – Particularly those arising in those circumstances where Shareholders make all business decisions, which gives rise to potential for a Conflicts of Duties – Shareholders serving own aims over those of Policyholders.

- **Representation and "Voice"** – The author is unaware of any Takaful operator that gives an active role to Policyholders. Among the potential roles—representation on the Board of Directors (non-voting), representation on the Executive Operations Committee (observer status), representation on Committees of the Board or Executive Management, are some examples.

- **Market discipline/disclosures** - The conduct of business which considers various risks to stakeholders and provides timely disclosures of decisions, actions taken and financial results. Here Takaful shareholders' appear reluctant to openly share information – especially with policyholders – so as to reduce uncertainty and promote market forces across all aspects of the business. Financial data reported by listed Takaful companies is often sparse and late.

- **Information asymmetry** – i.e. Takaful Operator has all data, and develops all financial statements whereas the Policyholder has no access to data and no role in financial decision-making.

- **Financial returns** - dividends vs. surplus refunds (Since financial objectives are generally not aligned, surplus enhancing activities quite often reduce the final profits to Shareholders and potential for dividend payouts).

Following are the possible courses of action to upgrade the Takaful model:

- **Develop a policyholder advisory board** to deliberate and recommend to managers or operators.

- **Empanel one or more policyholders** on the stock company's board of directors.

- **Formalize the legal status** of the policyholders' risk pool to form a trust or limited liability corporation, which elects policyholder representatives. This new entity would retain the operator via a contract (Wakala model) and negotiate for representation in the management of the trust or company.

Among chief advantages of the formation of a trust or limited liability company for policyholders rights are:

- The members' risk pool/fund takes on a juridical presence of its own.

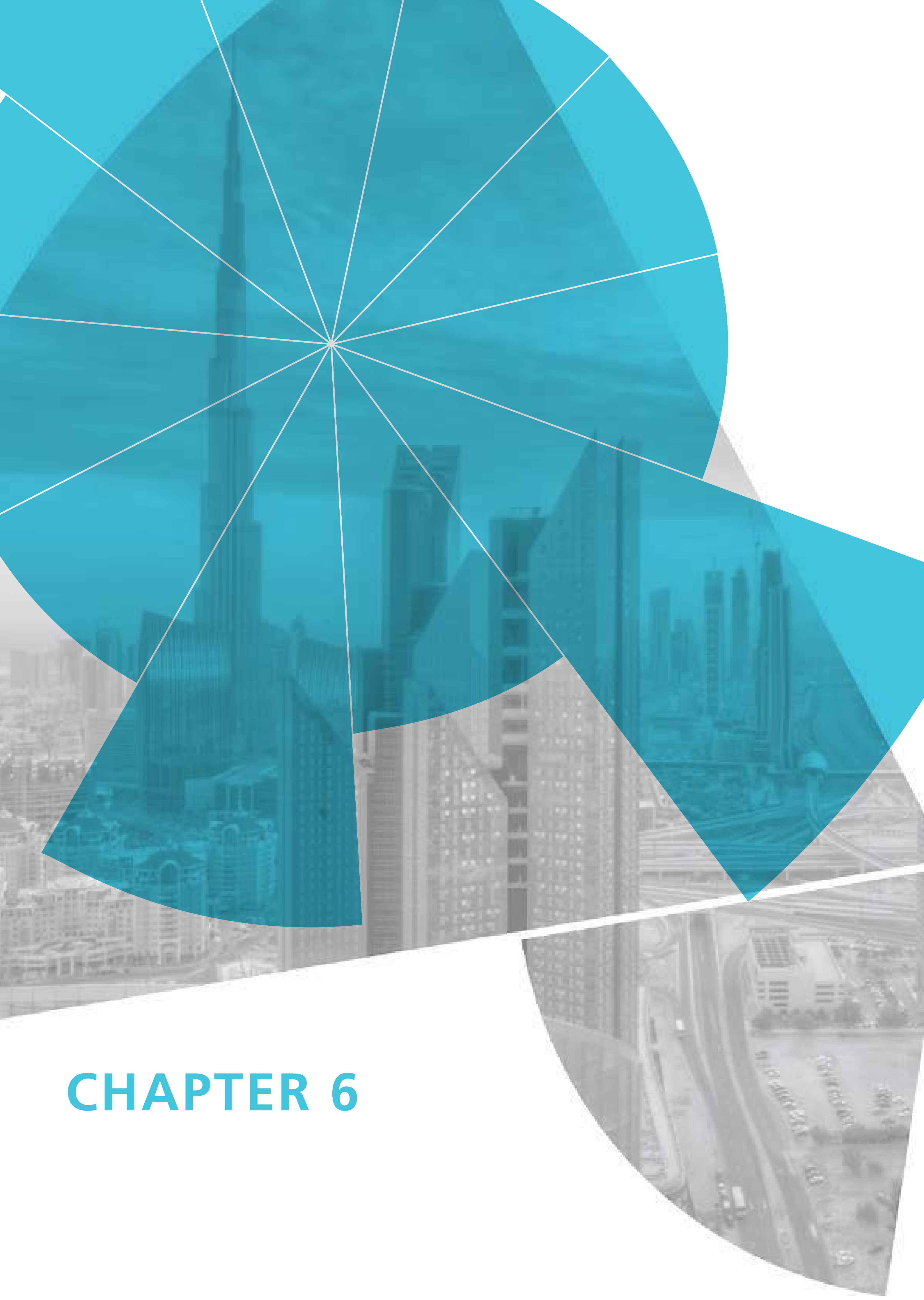
- The risk pool is transformed from ad hoc fund into a perpetual legal entity.

- The risk pool gains an organizational structure capable of representing policyholder interests.

- The mechanism for safeguarding the voting rights of members relating to major decisions on mergers or disposal of assets as well as directly overseeing liquidation of members' assets upon dissolution.

Governance rights and procedures have evolved within the cooperative and mutual insurance systems over hundreds of years – sometimes prodded onwards by new insurance regulations or serious events of fraud or malfeasance. Takaful business was re-discovered as recently as 1979 when a mixture of cooperative insurance and an Islamic alternative (Takaful) was introduced in Sudan. Thus, regulation of Takaful operations is a very recent phenomenon; to date, only Malaysia, Brunei, Bahrain, Pakistan, QIFC, DIFC and soon UAE will have enacted special insurance regulations recognizing Takaful as a unique form of insurance.

One could predict that, as more public attention and scrutiny is placed on good corporate governance across the Islamic banking and Takaful sectors, "best practices" in good governance from mutual and cooperative insurers will be transferred or imitated in the Takaful industry. Among the desired outcomes are ensuring full and proper disclosure of financial information, proper assessments of risk exposures, calculations of surplus and reserves and, finally, and adequate protection of "consumer rights" of policyholders, all of which after all lies at the true core of the Takaful system of values.



CHAPTER 6

MOVING FORWARD - THE MAJOR CHALLENGES

As Takaful companies enter only their 4th decade of existence, as contrasted with conventional insurers whose longevity exceeds 400 years, one may assert that formidable challenges lie ahead in execution of good corporate governance; namely:

- **Upgrade and revitalize the Takaful model. Broadly,** the sub-optimal financial and operational performance (as evidenced by prior sections) of Takaful cannot but lead to a less than resounding success in competition with conventional insurance. Now is best time to reflect on origins, fundamentals, strengths and weaknesses, and what attributes stamp Takaful with a natural competitive edge.

- **The pathway forward has two divergent roads:** (I) modify existing hybrid Takaful model to safeguard policyholders' rights, re-balance shareholders-policyholders responsibilities and obligations, realign policies and decision-making processes to promote more involvement by policy holders and develop a policyholder legal structure to protect their mutual rights, OR (II) re-set the underlying basis of modern Takaful—transform it into pure mutual model. A pure mutual model. A corporate mutual model (see section 5.3.1) is already well-accepted model by regulators in numerous insurance markets. Moreover, a mutual model can be converted to entirely Shariah compliant by:

- **Adding Shariah Supervisory Board (SSB)**
- **Assuring investments adhere to Shariah rules**
- **Adopting an Islamic contract**
- **Converting Shareholders capital into either**
  a) surplus notes, or
  b) letters of credit backing up the mutual risk pool.

A pure mutual Takaful model would adopt essential elements of Takaful risk sharing and good corporate governance for Takaful operations as follows:

- **Be consistent with Takaful mutual indemnification (congruent with Takaful business principles)**

- **Existence of Ethics Code for business operations and binding on personnel**

- **A fair balance of Shareholder (SH) interests and Policyholder (PH) interests, whereby existing Shareholders' role is transformed into financial backer only**

- **Encourage policyholder representation and, where possible, participation in management decision-making in matters of direct impact to policyholders**

- **Market discipline imposed through disclosures and financial reporting**

- **A goal to manage the business to be self-sustaining, fulfilling solvency requirements (in compliance with insurance regulations of that jurisdiction) rather than maximizing profits for only the Shareholders**

- **Pursue sound investment strategies (matching assets/liabilities, sound liquidity, safety and diversification) in accordance with Shari'ah compliant rules**

Given a trend sweeping the financial services industry for "socially responsible" investing and an awakening amongst the Muslim community for values-based products (including Takaful), it is safe to assume that over time a strong preference will emerge for ethical products, and so help to push up Takaful utilization rates closer to global norms. Eventually, capturing two per cent of global risk coverage, perhaps achievable by 2050, could elevate Takaful volumes to $86 billion in insurance business, which will guarantee it ascends to its rightful place alongside cooperative and mutual insurance as the coverage of choice for millions of policyholders.

Data compiled by global Takaful reports makes clear that the nascent industry has spread into 39 countries and is growing rapidly – more than 25% per annum in many places – and far outstrips the growth rates of conventional insurance. Although, global Takaful contributions amount to less than 1 percent of insurance industry annual premiums of $4.6 Trillion dollars (2014), both the impressive rates of adoption of Takaful coverage and the proliferation of new Takaful entities assure that this segment of the industry will swell in breadth and importance. Uppermost in a proposed **Takaful Action Agenda** should be enhancement of ERM, embracing innovation in risk products/services plus drilling down into internal operations to realize efficiency and greater effectiveness to control costs. Swift implementation by Takaful of good corporate governance equally fair to shareholders and policyholders is consistent not only with espoused Islamic values but also can position Takaful in the vanguard of modern corporate and risk management "best practices" and most assuredly propel enduring growth for this Takaful sector.

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Hamdan Bin Mohammed Smart University
دار النشر
Publishing House

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مركز دبي للصيرفة والتمويل الإسلامي