

# Takaful Market: The Challenges of the Fast Growing Industry



In the one year that we have been closely covering takaful events, there has been an implosion of ideas on how to nurture its growth and an actual explosion in the number of takaful operators from around the world. Here, **Mr Chakib Abouzaid**, CEO, Takaful Re, gives a quick global overview of what has been happening in the global takaful market, the challenges faced, and urges takaful operators to position the industry not only from a strict religious point of view, but also from a social, ethical perspective and to target very low income population (micro-insurance) as well as non-Muslims who like the co-operative aspect or surplus distribution element of the takaful business. This article is a good revision of what our readers should by now also know about the fundamentals of takaful and more.

**T**akaful is not a new concept. In fact, it has been practiced by Muslim communities for the longest time ever. The objective of takaful is to guarantee to help each other.

The concept of takaful (Islamic insurance), where resources are pooled to help the needy does not contradict Shariah principles. It is in line with the principles of compensation and shared responsibilities among the community.

Basically takaful is a mutuality arrangement among the community members. And the cooperative takaful way is seen as the unique alternative to avoid the elements of gharar (uncertainty), riba (interest) and maisir (gambling), which makes conventional insurance not acceptable to Muslim scholars.

### A Quick History

The modern history of takaful can be summarised as:

- 1979: The pioneer’s phase: New companies in Sudan & Saudi Arabia;
- 1985: The first retakaful operator was launched;
- 1984 to 2004: Expansion phase in Malaysia and Far East countries;
- 2004 till now: boom in Middle and Far East;
- The recent developments following the increase in oil prices and the Islamic finance boom – new takaful companies started operations in different countries: UK, South Africa, Saudi Arabia, Kuwait, UAE, and Malaysia.

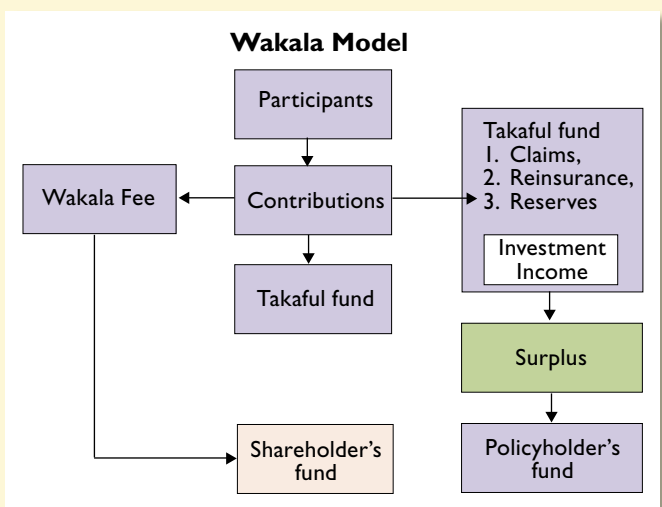
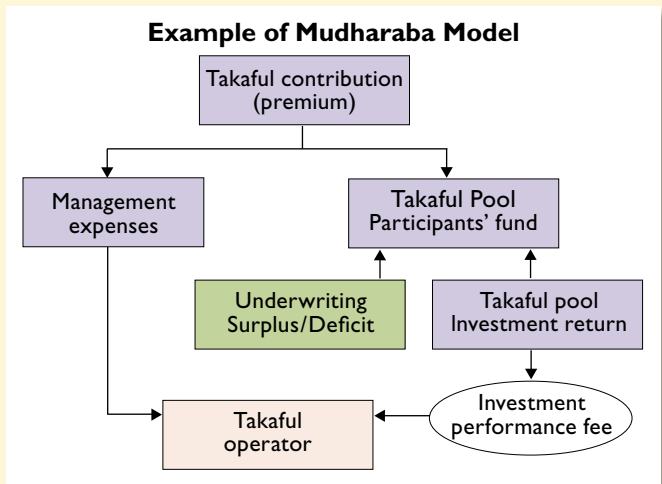
### The Models

From the beginning, there was an intense debate and discussion about the “optimal” or the more Shariah-compliant model. At least three models are practiced in the Muslim world:

- **Mudharaba** (Profit sharing), which is used mainly in the Far East;
- **Wakala**: The operator deduct an “up front” management fee from the contribution (premium);
- **Waqf**: the principle is to consider the premium as donation /contribution used as a charity. Waqf is a new model used only in Pakistan and South Africa.

The trend in the Middle East and now in the Far East is for a combination of both models:

- Wakala for underwriting; and
- Mudharaba for investment.



### Islamic / Takaful Industry Characteristics

The takaful industry is unique in that the professionals are not entitled to provide religious definitions that underpin the operations of the business. It is up to the scholars to define the criteria for Shariah compliance.

But for definition and statistical compilation, the

industry is said to comprise takaful companies all over the world, the Islamic companies (Sudan & Jordan), the Saudi cooperative companies and all the companies in the Iranian market. The Saudi and Iranian companies need to be included as companies working within the whole Islamic economic system. For some Shariah scholars, the Saudi co-operative model is similar to takaful (funds segregation and surplus distribution). The whole Iranian insurance industry is considered by the Shii'a scholars as Islamic. In both countries, Islam is the pillar of the whole system.

### Current Status of Takaful Industry

The current size of the takaful market based on 2005 figures is US\$4.3 billion of premium contributions from about 107 companies if windows are strictly excluded. The industry is characterised by:

- Lack of statistics & information;
- Takaful operators are mostly new companies, local and small-sized players;
- Lack of market research and R&D;
- Lack of expertise & standardisation;
- Limited investment opportunities;
- Heavy reliance on conventional reinsurance.

However, the number and size of the operators are increasing. And the demand for the Shariah-compliant capacity is expected to grow with the industry. The Middle East including GCC is ranked 1st region worldwide in terms of total contribution income because of the impact of the Saudi market, especially NCCI.

### Takaful Potential

There have been many developments encouraging the emergence of a dynamic takaful industry with rapid growth in market share, especially in Malaysia, Kuwait, the UAE, and Qatar. Some of the evolution can be explained by the following factors:

- The increase in oil prices is generating a huge surplus looking for opportunities inside the Middle and Far East. Consequently, there has been a real boom in Islamic finance, which encourages financial institutions to promote takaful companies;
- The introduction of new compulsory classes of insurance (motor in KSA & medical in the UAE and KSA) and boom in infrastructure projects, rise in new economic cities, and more expatriates in the Gulf region;
- In all Muslim countries, the emergence of an educated new middle class and having more awareness is creating a demand for Shariah-compliant insurance solutions;
- In the western countries, the demand from Muslim communities for Shariah-compliant banking and takaful is increasing;
- The low level of penetration of insurance (1% to 3 % maximum except Malaysia) and the density (insurance premium per capita); on the other side, the number of the Muslim population (1.2 to 1.4 billion) are huge opportunities for the takaful industry, and requiring an adequate supply.

### Challenges for Takaful

#### Regulatory & Legal Framework

Except for a few countries (Malaysia, Bahrain, Pakistan,

Sudan), there is no specific legal framework for takaful. The legal framework is a must to protect the policyholder's interests and a key element within long-term strategy aiming to promote takaful. The Malaysian Master plan (2004-2014) is an example which could serve as a guide for other countries.

#### Accounting Standards

Takaful companies as financial institutions are obliged in some countries to follow the IFRS and /or the AAOIFI standards in some other countries. There are as yet no international standards for takaful companies. There is a need for implementing the best practices in all countries to ensure the transparency and protect all stakeholders' interests.

#### Corporate Governance

In addition to ensuring transparency and protecting stakeholder's interests for takaful companies, corporate governance must evolve to ensure Shariah compliance, the policyholder's and shareholder's funds segregation, protect the policyholder's interest, to have the maximum surplus distribution and avoid any conflict of interest between the operator / shareholder and policyholder.

#### Rating & Security

This is a must to provide an independent opinion on the financial strength and solvability for the established companies. It will encourage transparency and protect interests of all stakeholders. Moreover, this will benchmark the companies against conventional insurers. Takaful could also proceed to a Shariah rating to ensure their compliance. At the moment, only the International Islamic Rating Agency (IIRA) provides such ratings, although the more established rating bodies have begun to look at developing rating models for takaful companies.

#### Awareness

At both individual and corporate levels, there is a need to spread the awareness about takaful / insurance in most of the Muslim countries. This requires a joint effort from the insurance companies, insurance associations and the different governments.

Till today, there are still consumers in some markets unable to differentiate takaful from conventional insurance. This confusion will not help takaful grow. Therefore, they have to find the way to make their products, approach and market strategy different and innovative.

#### Scalability

The existing takaful companies are mainly small or medium-sized. The expansion via new networks or by using the new technology (e-commerce) needs to reach a critical mass. By maximising their market share, takaful companies will be able to benefit from the economy of scale.

#### Research & Development

Only large entities have the capability to finance R&D. At the institutional level, takaful associations or cross-border companies should invest in R&D for the market segmentation, products structuring and differentiation.

**Innovation**

Takaful companies are not yet in position in all markets to offer new products, and this needs an effort in:

- **Product Structuring:** to differentiate takaful from conventional insurance and to make takaful products more attractive;
- **Customer Service:** Takaful operators should offer at least the same service as conventional insurance to increase their market share; they also have to work on providing better service to customers;
- **Technology:** Takaful operators can invest in cost effective technology to reach more clients using new distribution channels (Internet);

**Distribution Channels**

The target market for takaful is the low-income population especially in rural areas, the middle class and the small and medium-sized businesses. Takaful companies should activate their distribution channels by developing the following areas:

- **Micro-insurance:** As a long-term objective to bring takaful to the very low income population. Although some Southeast Asian companies have started looking at this option as a corporate social responsibility project, most of the takaful companies are still competing with existing conventional for industrial and commercial risks, which by definition are not sensitive to the takaful argument. They are more sensitive to the cost versus protection argument.
- **Life:** The family takaful (life) is a long term saving, which provides the national economy resources for development. But on the social level, the family takaful is an excellent tool to protect the low income families against the risk of death and lost income for the family.
- **Bancassurance** is now developing in all countries; and the banks have better regional spread all over the countries especially in the small towns and some rural areas. The association with banks will bring new clients and offer better territorial coverage

**Human Resources Development**

Takaful companies have to improve the following areas:

- **Shariah advisory expertise:** Currently, there are only a small number of scholars with expertise in takaful. The industry should encourage young scholars to acquire the technical insurance knowledge and to be able to advise and to solve the Shariah compliance problems facing takaful.
- **Academic Qualification:** Till now, most of the technicians and executives working in the takaful companies have a conventional background. To promote takaful, we have to educate new graduates on takaful principles and practices.
- **Professional Certification:** There is a need for specific modules/programmes on takaful. We have to add to the existing certification (CPI, ACII, FCII, CPA, etc) modules on takaful for the candidates who intend to or already work for a takaful company.

**Retakaful Capacity**

Retakaful was the “missing link” in the takaful operation and in spite of newcomers, the existing capacities and their expertise are still not sufficient to meet the demand. By principle, takaful operators are required to cede to the existing Shariah-compliant capacities.

With the number of retakaful increasing including Takaful Re, Hannover Re, Labuan Re, MNRB, and BEST Re in the medium- to long-term, the obligation to cede business to retakaful will be implemented except for large risks and/or special lines.

However, special effort needs to be undertaken by existing retakaful companies to be able to quote, lead treaty programmes and risks by increasing their capacities, improving their expertise and rating. Without assistance and good quality service to the direct companies, there is no chance for takaful companies to convert from conventional reinsurance to retakaful.

**Conclusion**

Takaful is now a trend and no more a “fashion” or an exotic phenomenon. However, takaful operators must:

- Benchmark themselves against international players;
- Differentiate themselves by being innovative;
- Add value to the customers and expand their market share;
- Corporate governance and compliance;
- Takaful have to learn from the conventional experience and to look for more synergy between the two models.

Takaful companies should clarify their strategies and, in the medium term, target individuals and small- and medium-sized firms as well as personal lines and family takaful by using all existing possibilities (e-commerce, bancatakaful). In the long term, the strategy is to move gradually from retail to corporate, industrial and commercial risks by progressing and climbing the learning curve.

Takaful is about solidarity and mutuality. It is a commitment to values. Without commitment, there is no credibility and no future for takaful industry.■

This is an extract of the presentation made at the 43rd Annual Seminar of the International Insurance Society attended by some 600 global CEOs in the industry last July.

