THE WORLD TAKAFUL REPORT

تقرير التكافل العالمي

Transforming Operating Performance

The World Takaful Report 2011

ERNST & YOUNG

Quality In Everything We Do

6th Annual
THE WORLD TAKAFUL CONFERENCE
مؤتمر التكافل العالمي
10 & 11 April 2011, Dusit Thani Dubai, UAE

Dear Insurance Industry Leader,

It is with great pleasure that we present to you the 4th annual edition of the **World Takaful Report**, a ground-breaking original research project developed in collaboration with leading global professional services organization, **Ernst & Young**. The insights provided in this year's Report will be all the more critical as leading industry players in the global Takaful industry are seeking to re-tune their business strategies in order to fast-track growth in the industry as the global economy enters a stronger recovery phase.

The **World Takaful Report** is exclusively launched onsite annually at the **World Takaful Conference (WTC)**, during a special plenary session and now in its 4th annual edition has established itself as an indispensable reference resource for the key decision-makers in the global Shari'ah compliant insurance industry who are in a continuous pursuit of improving their competitive performance and operational efficiencies. With a principal focus on **'Transforming Operating Performance'**, the **World Takaful Report 2011**, will analyze the key trends shaping the industry, map out the strategic direction of the market leaders and probe the emerging landscape of opportunities.

We would like to express our sincere gratitude to **Ernst & Young** and their **Islamic Financial Services Group** for investing their considerable talent and resources in developing the **World Takaful Report**.

We hope that the analysis in this year's Report will provide practical, constructive and valuable insights which will be useful in your own strategic planning activities and will assist your organisation in its quest for success as the global Takaful industry enters the next phase of growth. To know more on how your organization can play a part in this initiative in the future, please email sophie@megaevents.net

Yours sincerely,

David McLean
Managing Director
The World Takaful Conference
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April 2011

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Disclaimer

The contents of the World Takaful Report 2011 are based on a combination of quantitative data and qualitative comments and hence provide a subjective assessment of the current market. All quantitative comments are based on published information wherever possible. Where published reliable data was not available, qualitative comments were made which may or may not reflect the true state of affairs. Information has been assimilated from secondary sources, including published country, industry and institutional information, and primary sources, in the form of interviews with industry executives.

We are not expressing any assurance on the accuracy or completeness of the information obtained. Although this report has been documented based on our understanding of Islamic financing activities to include only such activities that are deemed Shari'a compliant, no Shari'a opinion whatsoever has been taken on this report. Hence, the contents of this report, in terms of the activities to be carried out, might not necessarily be consistent with Shari'a in all cases, and the opinion of a Shari'a scholar(s) should be taken before any further steps are made to implement suggestions made in the report.

Whilst every care has been taken in the preparation of this report, no responsibility is taken by Ernst & Young as to the accuracy or completeness of the data used or consequent conclusions based on that data, due to the respective uncertainties associated with any assumptions that have been made.

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- Business Models
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- Competing for growth
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- ▶ Executive brief
- ▶ Key features of takaful

Executive Brief

Dear Takaful Executive,

On behalf of Ernst & Young, I take this opportunity to introduce to you the 4th annual edition of Ernst & Young's World Takaful Report (WTR11). We believe that the tremendous market response to WTR makes it a benchmark for the takaful industry and an essential global reference source for decision makers in Islamic finance.

The takaful industry and its core markets have experienced another challenging year, where positive signs of economic recovery and improved business sentiment were shaken by the socio-political uncertainty witnessed across the MENA region in Q1 of 2011. In terms of reported industry growth, 2009 was a comparatively slow year for the takaful industry, where global contributions grew 31% to reach US$ 6.9 billion, and remain on course to surpass US$11.9 billion by 2011. The industry is not without risks, but its potential remains an important feature of Muslim emerging markets for many indigenous and global insurance players.

Based on our assessment of published company financials, 2010 was a better year for takaful growth, although poor profitability and an overreliance on investment income remain key challenges. Most industry CEOs we interviewed agree that it is no longer business as usual. Over 70% of respondents identified competition as a key risk going forward. Also, the takaful industry is yet to witness the much talked about consolidation, and organic growth still appears to be the preferred route for many operators.

The majority of industry leaders we spoke to are clearly focused on *Transforming Operating Performance* of their businesses over coming months. The primary focus of this transformation is increasing customer acquisition, albeit selectively, while maintaining a more flexible cost structure. The cost-effective availability of operational expertise across underwriting, claims, actuarial, finance and investments will determine the success of this strategy. This expertise is scarce and comes at a premium.

To help address the above, we have drawn upon the results of our global research programs which suggests that high performers, i.e. those with top quartile growth and profitability, are significantly ahead in driving improvement in four critical areas:

- Customer reach - The markets and customer segments you are in determine your opportunity.
- Operational agility - Your growth is determined by your ability to adapt and respond to changes in regulations and market conditions.
- Cost competitiveness - Your profitability is determined by appropriate pricing and the competitiveness of your cost base.
- Stakeholder confidence - Your value, and ability to fund growth, is determined by the confidence of your stakeholders.

We believe that competitiveness is best achieved through real market insights. I hope that you will find this report informative and useful for your business.

Ashar Nazim
Executive Director & Islamic Financial Services Leader
Ernst & Young

Justin Balcombe
Executive Director & MENA Insurance Leader
Ernst & Young

Introduction to Takaful

Takaful can be considered a Shari'a compliant form of conventional cooperative insurance

Conventional Insurance (non-mutual)

- The company accepts premiums from the insured at a level which it anticipates will cover claims and result in a profit. This process of anticipation is akin to ***Maysir*** (speculation).
- The insured pays premiums to the company in exchange for indemnity against risks that may not occur. This process of ambiguity is akin to ***Gharar*** (uncertainty).
- The company engages in investments that derive their income from interest and/or prohibited industries. This process is akin to ***Riba*** (usury) and/or relates to ***Haram*** (prohibited) activities.

Takaful

- Takaful is based on principles of ***Ta-awun*** (mutual assistance) that is ***Tabarru*** (voluntarily) provided. Takaful is similar to conventional cooperative insurance whereby participants pool their funds together to insure one another.

Five Key Elements

- **Mutual Guarantee** - The basic objective of Takaful is to pay a defined loss from a defined fund. The loss is covered by a fund created by the donations of policyholders. Liability is spread amongst the policyholders and all losses divided between them. In effect, the policyholders are both the insurer and the insured.
- **Ownership of the Fund** - Donating their contributions to the Takaful fund, policyholders are owners of the fund and entitled to its profits (this varies slightly between the adopted models which are described later).
- **Elimination of Uncertainty** - Donations, causing transfer of ownership to the fund, are voluntary to mutually help in the case of a policyholder's loss without any pre-determined monetary benefit.
- **Management of the Takaful Fund** - Management is by the operator who, depending on the adopted model, utilises either (or a combination) of two Shari'a compliant contracts, namely ***Mudaraba*** or ***Wakala***.
- **Investment Conditions** - All investments must be Shari'a compliant, which prohibits investment in ***Haram*** industries and requires the use of instruments that are free of ***Riba***.

Source: Ernst & Young analysis

Introduction to Takaful

Conventional forms of insurance are prohibited under Islamic law as they contain elements of Maysir, Gharar and Riba

	Takaful	Cooperative Insurance	Proprietary Insurance
Contracts Utilised	Donation and mutual contract.	Mutual contract.	Exchange contract.
Company Responsibility	Pay claims with underwriting fund and an interest free loans in case of shortfall (Qard Al-Hasan).	Pay claims with underwriting fund.	Pay claims from underwriting fund and shareholders' equity.
Participants' Responsibility	Pay contributions.	Pay contributions.	Pay premiums.
Capital Utilised	Participants' funds.	Participating capital.	Share capital.
Investment Considerations	Shari'a compliant.	No restrictions except prudential.	No restrictions except prudential.

Source: Ernst & Young analysis

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- **Industry Growth**
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- Global takaful contributions grew by 31% in 2009, to US$7b
- Opportunities in core markets suggest a US$12b industry by 2011
- Most GCC markets have witnessed a slowdown in takaful growth, with only Saudi's cooperative insurance market remaining strong on the back of compulsory medical.

Summary of Key Events

March 2010 - September 2010

March 2010

Al Hilal Takaful

Signed a MOU with various ministries in Abu Dhabi to provide medical Takaful services and solutions.

Amana Takaful - Maldives

Amana Takaful (Maldives) has received regulatory approval to carry out Takaful business in the archipelago. The firm is a subsidiary of Amana Global which is a fully owned unit of Sri Lanka-based Amana Takaful.

HSBC Amanah (Malaysia)

Launched a new regular premium retirement plan.

T'azur Company - Bahrain

Signed an agreement to form a strategic partnership with NAS Administration Services.

Methaq Takaful

Al Yah Satellite Communications has secured the first ever takaful space policy which covers the launch and in-orbit operations of Y1A and Y1B.

Bank AlJazira Saudi

Received the government's approval to form a Takaful company with a capital of US$93 million.

Tokio Marine Holding

Teamed up with Alinma Bank in Saudi Arabia, along with 4 other partners to establish a joint venture for Family and non-life Takaful business

Metropolitan Life Insurance -Ghana

Launched a life insurance and investment scheme, 'Labaika'

Noor Takaful General

Signed an agreement with the Dubai Taxi Corporation and the Roads & Transport Agency to provide Takaful coverage

African Reinsurance Corporation

Established a new subsidiary known as African Takaful Reinsurance Company (Africa Retakaful) in Egypt

Bank Negara Malaysia (BNM),

Awarded four licenses to joint venture companies for operating Family Takaful in the country.

The Securities and Exchange Commission of Pakistan

Set a formula which directs every Takaful and insurance company to deposit a share of collected premiums to the Insurance Ombudsman Secretariat.

Prudential BSN Takaful - Malaysia

Launched three new insurance plans — PruBSN Protect, PruBSN Protect Plus and PruBSN Crisis Cover.

Cornerstone Insurance (BNM),

Set up a Takaful division to offer Shari'a compliant insurance products and services

T'azur Company

Signed an Islamic re-insurance agreement with Hannover Retakaful - Bahrain.

September 2010

Summary of Key Events

October 2010 - February 2011

October 2010

Pak-Qatar Family Takaful& FWU
Signed an agreement with Dawood Islamic Bank to distribute bancaTakaful products

Allianz Takaful - Qatar
Allianz Takaful has partnered with Doha Bank to promote and sell the insurer's products in Qatar

Gulf Takaful Company-Kenya
GulfCap Investments, the principle shareholder of Gulf African Bank, launches the First takaful operator in Kenya.

Fitch Ratings
Updated its Takaful Rating Methodology, a sub-sector criteria report within its insurance group

Etiq Takaful
Completed its merger with Mayban Life Assurance.

Takaful IBB and Takaful BIBD
Merged their Takaful operations and rebranded as Takaful Brunei Darussalam.

Alliance Bank Malaysia
Signed an agreement with American International Assurance to set up a joint venture Family Takaful company, called AIA AFG Takaful.

Prudential BSN - Takaful
Launched a Family Takaful plan named PruBSN Ummah,.

Takaful Insurance of Africa-Kenya
Granted an operating license by the Insurance Regulator Authority of Kenya

The Malaysia Deposit Insurance Corporation Bill 2010
Tabled in parliament to provide for the establishment of an explicit national Takaful and insurance benefits protection system.

Cornerstone Insurance
Launched its Islamic insurance arm, Halal Takaful Nigeria to introduce Shariah compliant insurance products in the country.

Hong Leong Tokio Marine Takaful
Launched a Family Takaful scheme named HLTMT Ehsan,

Dar Al Takaful
Tied up with Al Zaabi Insurance Brokers to extend its Shariah compliant services to the emirate of Umm Al Quwain.

AIA and Alliance Bank Malaysia
Launched their new joint venture, AIA AFG Takaful with the first three of four Family Takaful products named A-Mas, A-Prima and Mortgage Reducing Term Takaful.

Takaful International
Italian Assicurazioni Generali has signed an agreement to appoint Takaful International operator as Generali's representative in Bahrain.

Alinma Bank
Issued a stock exchange announcement saying that it has signed a deal with partners to form an insurance firm. The Joint Venture will have a paid-up capital of SAR 200m (USD 53m).

Takaful International
Bahrain based Takaful International announces its plans to open its first office abroad in Qatar

AMMB Holdings
Announced the incorporation of a new subsidiary, AmFamily Takaful.

Bank Kerjasama Rakyat Malaysia
Launched three new Takaful products in collaboration with Etiqa Takaful.

Oman Insurance Company UAE (Tameen)
Announces its interest in setting up a takaful operator in the UAE. The insurer has appointed an advisory firm to carry out the due diligence

Wataniya Takaful
Announces plans to raise USD 22.5m, or 55 percent of its capital, through an IPO.

Pak-Qatar Family Takaful
Signs an agreement with Habib Bank to provide takaful coverage to Al-Ziarat Hajj account holders (Hajj and Umrah savings plan).

Allianz Utama
German based Allianz Utama Indonesia announces plans to spin off its Takaful unit, Allianz Indonesia Sharia in 2014, in light of the country's potential in the Islamic finance industry

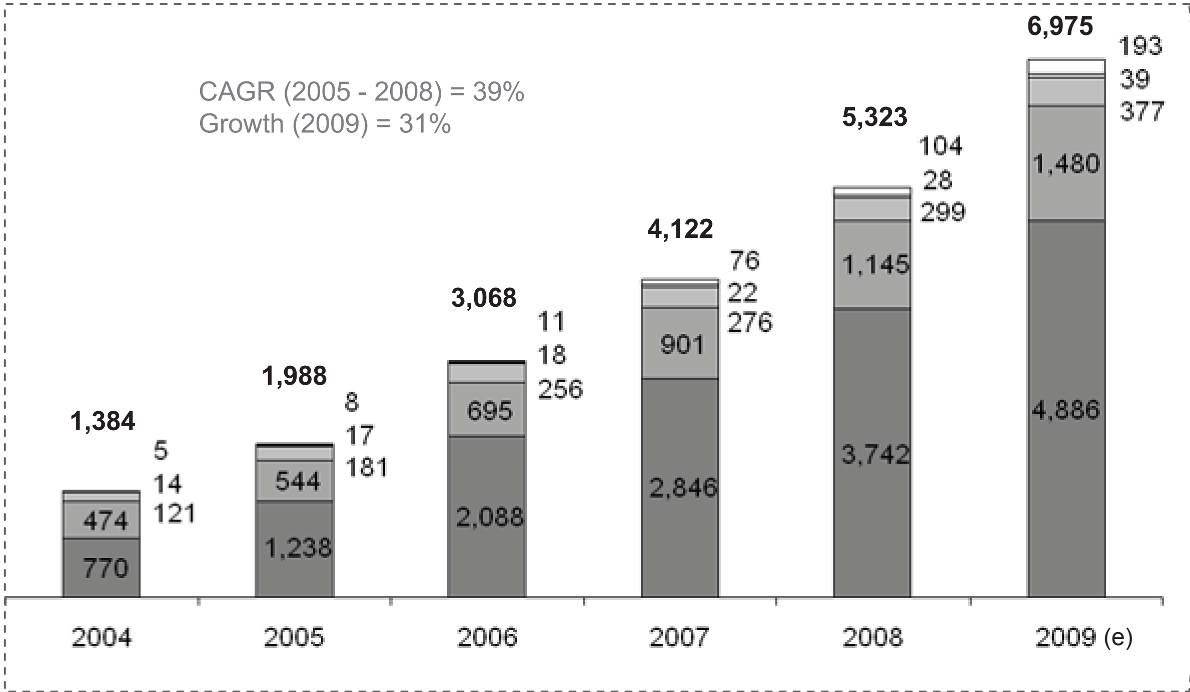
Allianz Takaful
Bahrain-based fully owned subsidiary of Allianz Group and HSBC Amanah have entered into Bancassurance partnership to promote Islamic insurance products in the State of Qatar.

February 2011

Global Takaful Contributions

Global gross takaful contributions reached US$ 7 billion in 2009, and continue to boast healthy growth, although below that seen in 2005-2008

Global Gross Takaful Contributions (US$m)



	CAGR 2005-2008	2009 growth
Levant	18%	40%
Indian Sub-continent	135%	85%
Africa	18%	26%
South East Asia	28%	29%
GCC	45%	31%

Iran - Gross Contributions by Year (US$m)

2004	2005	2006	2007	2008	2009 (e)	CAGR 2005-2008	2009 growth
2,164	2,561	2,896	3,644	4,128	4,144	13%	0.4%

Notes: Iran's financial services sector is entirely Islamic and as such, has been shown separately from the global analysis. Saudi Arabia requires that all insurance companies operate under a cooperative business model, which is a key feature of takaful. As such, Saudi Arabia has been included in the global analysis. However, not all cooperatives in Saudi Arabia operate fully as takaful companies.

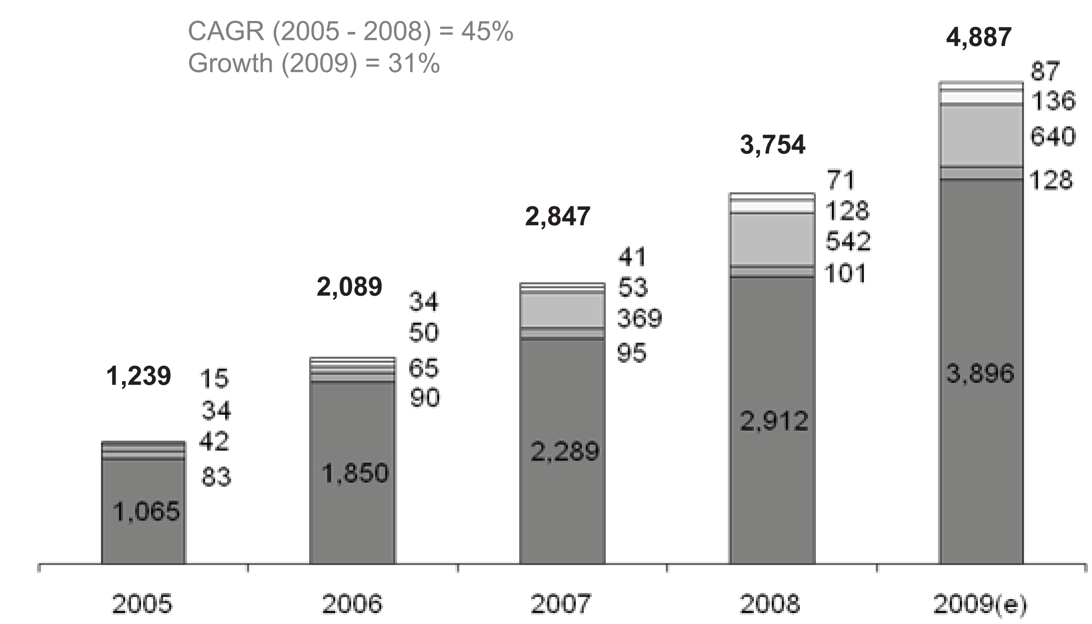
Data from the World Islamic Insurance Directory has been cross referenced with published national statistics for takaful where available. Numbers may not total correctly due to rounding.

Source: World Islamic Insurance Directory 2011 (Reproduced with permission from Takaful Re Limited), Ernst & Young analysis

GCC Takaful Contributions

Most GCC markets have witnessed a slowdown in takaful growth, with only Saudi's cooperative insurance market remaining strong on the back of compulsory medical

Gross Takaful Contributions in the GCC (US$m)



	CAGR 2005-2008	2009 growth
Bahrain	68%	22% ↓
Qatar	56%	6% ↓
UAE	135%	18% ↓
Kuwait	7%	27% ↑
Saudi Arabia	40%	34% ↓

Penetration 2009	Bahrain 2008	Bahrain 2009	Qatar 2008	Qatar 2009	UAE 2008	UAE 2009	Kuwait 2008	Kuwait 2009	Saudi Arabia 2008	Saudi Arabia 2009
Takaful	0.33% ↑	0.45%	0.12% ↑	0.14%	0.21% ↑	0.31%	0.07% ↑	0.12%	0.62% ↑	1.05%
Insurance	1.82% ↑	2.59%	2.26% ↓	0.79%	1.97% ↑	2.19%	0.62% ↓	0.61%	0.65% ↑	1.04%

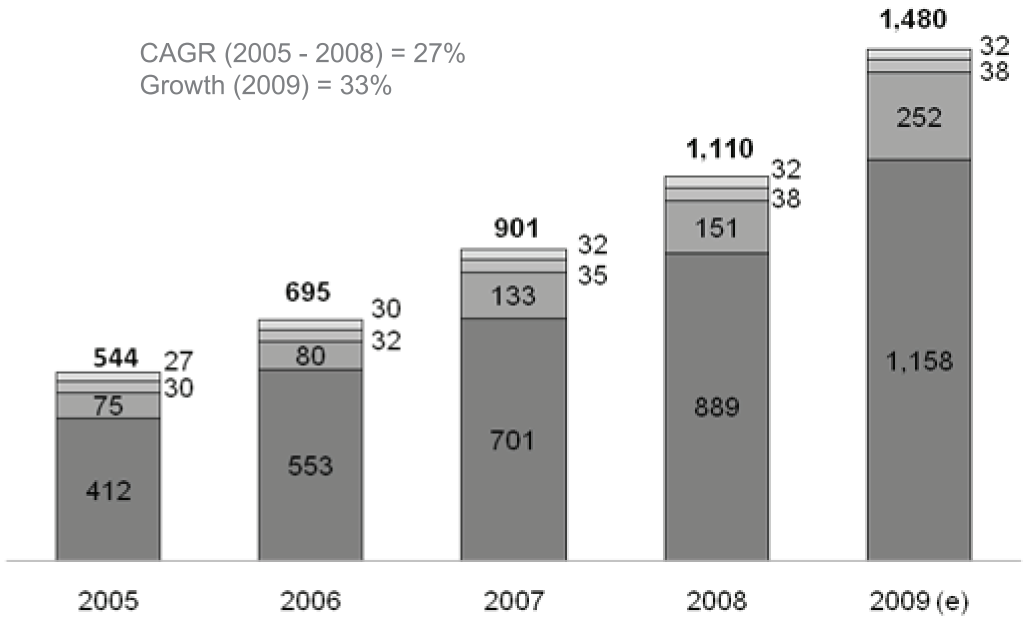
Note: Takaful penetration is gross contributions as a percentage of nominal GDP in respective year. Numbers may not total correctly due to rounding.

Source: World Islamic Insurance Directory 2011, Ernst & Young analysis; Global Insight; Swiss RE - Sigma No. 3 (2010)

South East Asian Takaful Contributions

Unlike the GCC, the South East Asian markets have continued their strong takaful growth. Indonesia is rapidly emerging as an important takaful market

Gross Takaful Contributions in South East Asia (US$m)



	CAGR 2005-2008	2009 growth
Brunei	6%	0%
Thailand	8%	0%
Indonesia	26%	67%
Malaysia	29%	30%

Penetration 2009	Brunei 2008	Brunei 2009	Thailand 2008	Thailand 2009	Indonesia 2008	Indonesia 2009	Malaysia 2008	Malaysia 2009
Takaful	0.23%	0.23%	0.01%	0.01%	0.03%	0.05%	0.40%	0.60%
Insurance	N/A	N/A	3.34%	4.07%	1.35%	1.33%	4.22%	4.84%

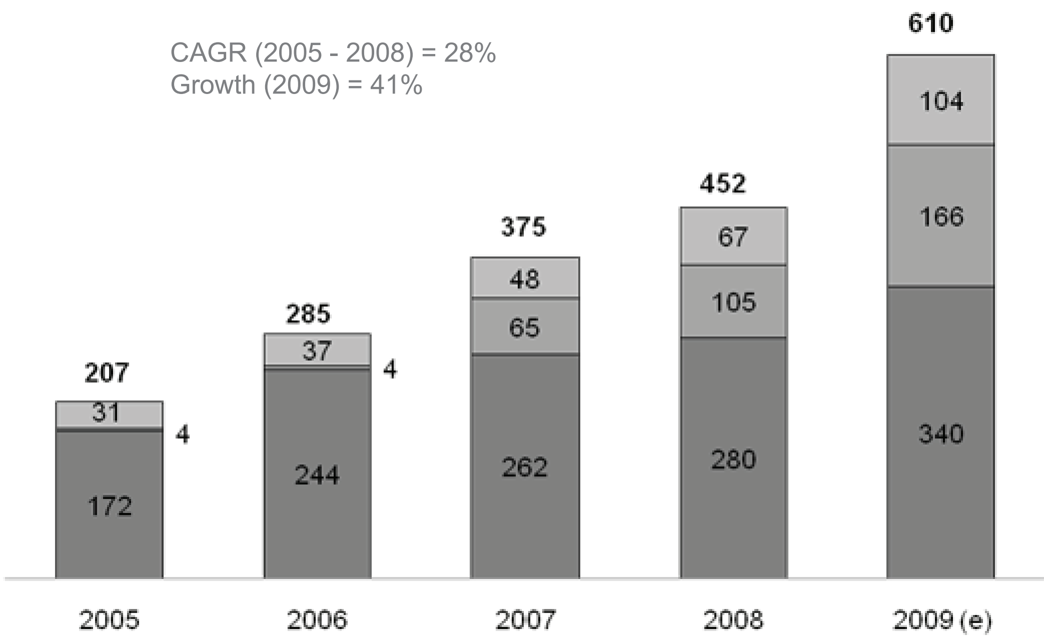
Note: Takaful penetration is gross contributions as a percentage of nominal GDP in respective year. Numbers may not total correctly due to rounding.

Source: World Islamic Insurance Directory 2011, Ernst & Young analysis; Global Insight; Swiss RE - Sigma No. 3 (2010)

Other Markets Takaful Contributions

Sudan is the most significant market outside of the GCC and South East Asia, while Egypt, Bangladesh and Pakistan are experiencing rapid growth

Gross Takaful Contributions in Other Markets (US$m)



	CAGR 2005-2008	2009 growth
Others	29%	55%
Bangladesh	191%	58%
Sudan	18%	21%

Penetration 2009

	Bangladesh 2008	Bangladesh 2009	Sudan 2008	Sudan 2009	Others 2008	Others 2009
Takaful	0.13%	0.19%	0.48%	0.63%	N/A	0.05%
Insurance	0.9%	0.94	N/A	N/A	N/A	N/A

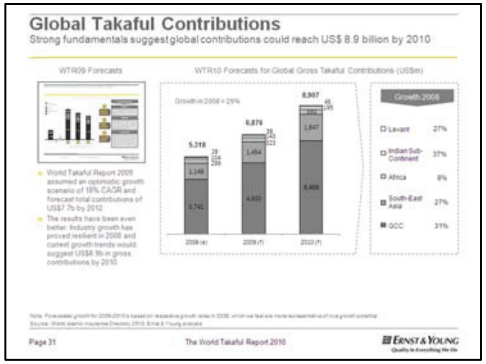
Note: Takaful penetration is gross contributions as a percentage of nominal GDP in respective year. Numbers may not total correctly due to rounding. The others category are countries with less than US$40m contributions including: Singapore, Senegal, Egypt, Mauritania, Jordan, Lebanon, Yemen, Palestine, Pakistan and Sri Lanka.

Source: World Islamic Insurance Directory 2011, Ernst & Young analysis; Global Insight; Swiss RE - Sigma No. 3 (2010)

Global Takaful Contributions

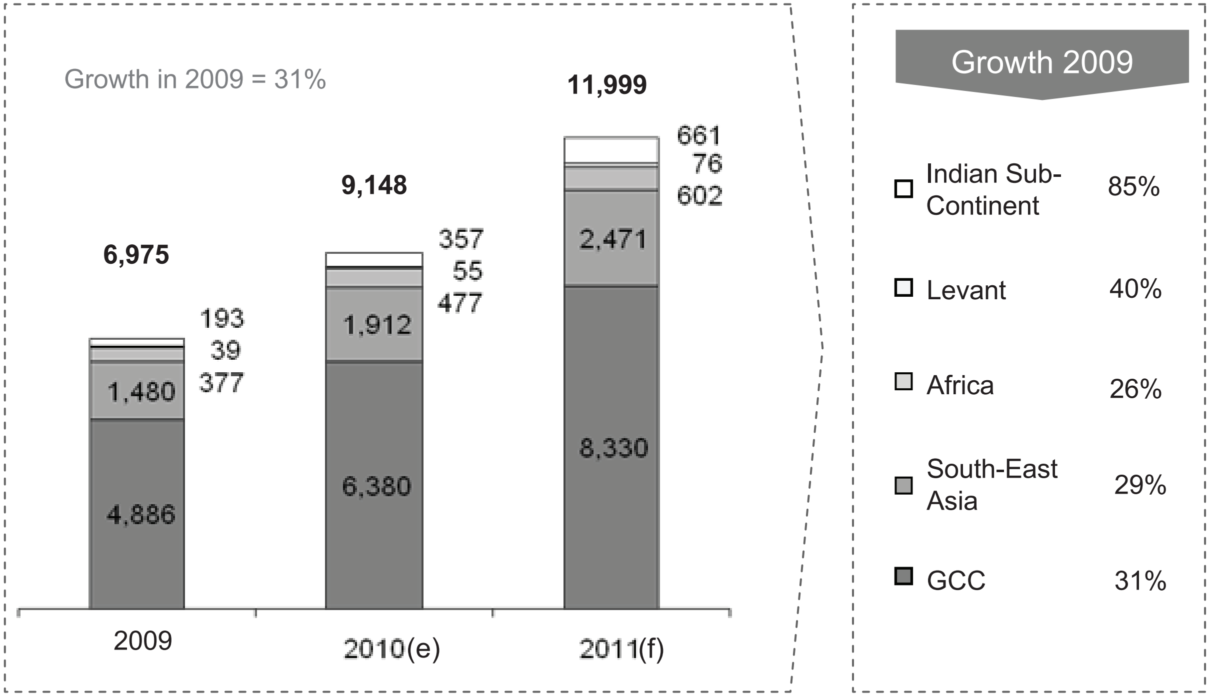
Continued strong growth in the takaful industry suggest that global contributions could reach US$ 12 billion by 2011

WTR10 Forecasts



- The World Takaful Report 2010 forecasted total contributions to reach US$6.8b in 2009.
- The results have been slightly better despite the economic slowdown in key markets. Takaful growth has continued to remain strong in 2009 and current growth trends would suggest US$12b in gross contributions by 2011.

WTR11 Forecasts for Global Gross Takaful Contributions (US$m)

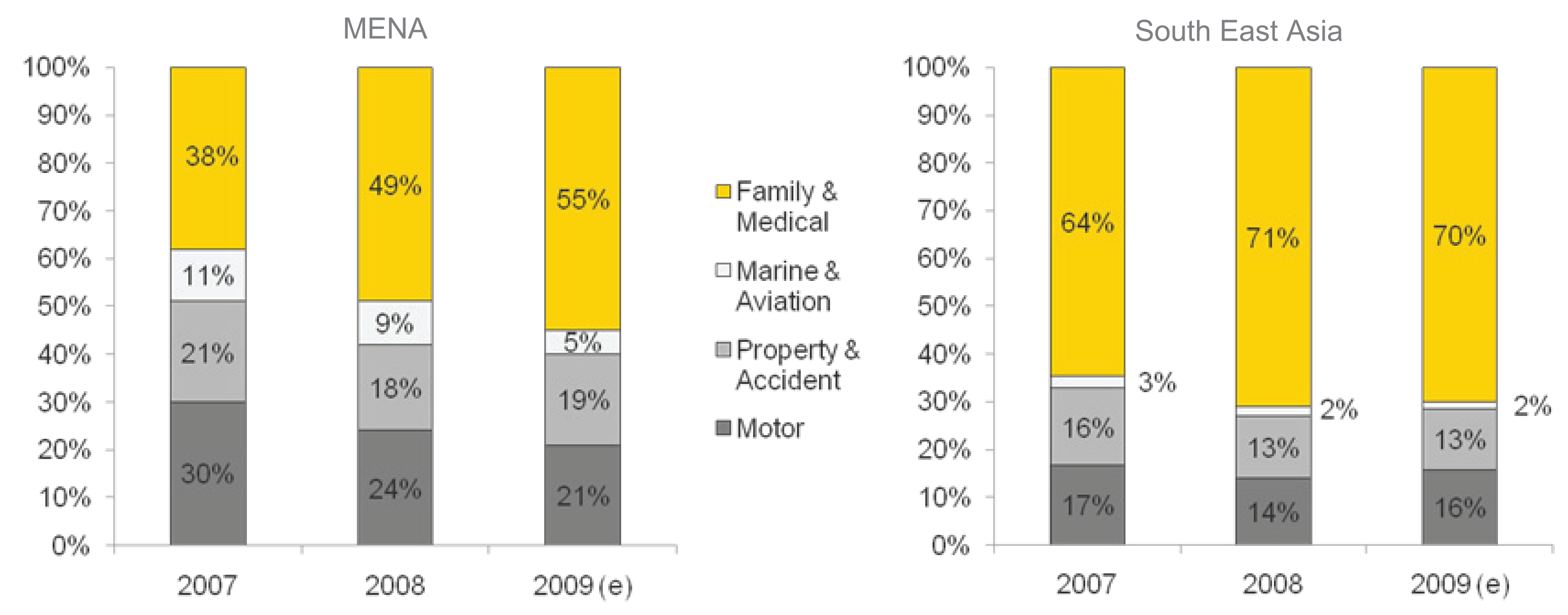


Note: Forecasted growth for 2010-2011 is based on respective growth rates in 2009, which we feel are more representative of true growth potential.
Source: World Islamic Insurance Directory 2010, Ernst & Young analysis

Key Lines of Business

Family and medical takaful continue to grow strongly in the MENA region, primarily fueled by Saudi Arabia's introduction of compulsory medical insurance policy

Takaful Contributions by Business



- Compulsory medical insurance requirements in Saudi Arabia have contributed to growth in Family & Medical.
- Family takaful remains underpenetrated and is estimated to contribute only 5% of gross contributions in the MENA region. Conventional Life accounts for approximately 15% market share

Source: World Islamic Insurance Directory 2011, Ernst & Young Analysis, Sigma Swiss Re Report, March 2010

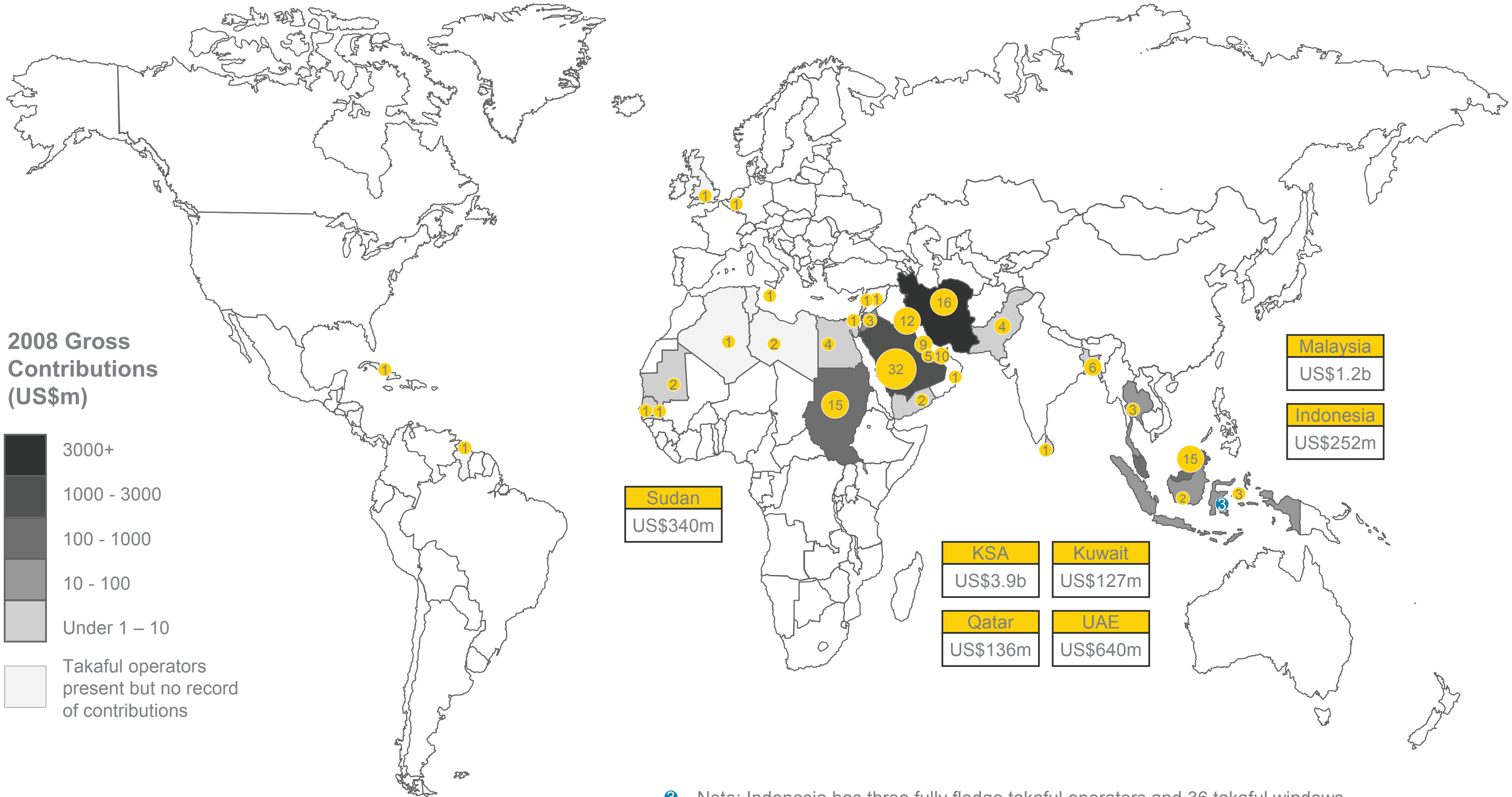
- Family takaful in Malaysia is highly penetrated and is estimated to contribute 77% of net takaful contributions in 2010.
- By comparison, in 2009, life insurance contributed 58% of gross global insurance premiums.

Note: MENA includes the GCC, Africa and Levant. The consolidated split between family and medical is not available.

Current Contribution Concentrations

The takaful industry is concentrated in the MENA and South East Asia

Global Takaful Operators (2008) and Contributions (2009)



Note: Indonesia has three fully fledge takaful operators and 36 takaful windows.
The number of takaful operators shown on this slide are updated as of 2008. 2009 data was not available at the time of print.

Source: World Islamic Insurance Directory 2010; Ernst & Young analysis

Current Contribution Concentrations

Despite having a large number of operators, Malaysia has a relatively high ratio of gross written contributions per operator

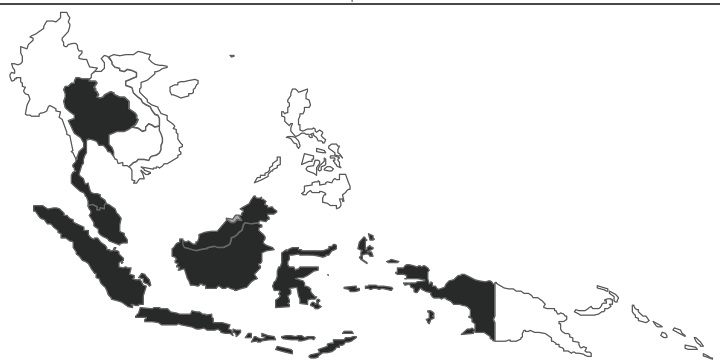
Levant
Contributions per operator
US$4m

GCC
Contributions per operator
US$64m

East Indian Sub-Continent
Contributions per operator
US$16m

Africa
Contributions per operator
US$12m

Malaysia
Contributions per operator
US$116m



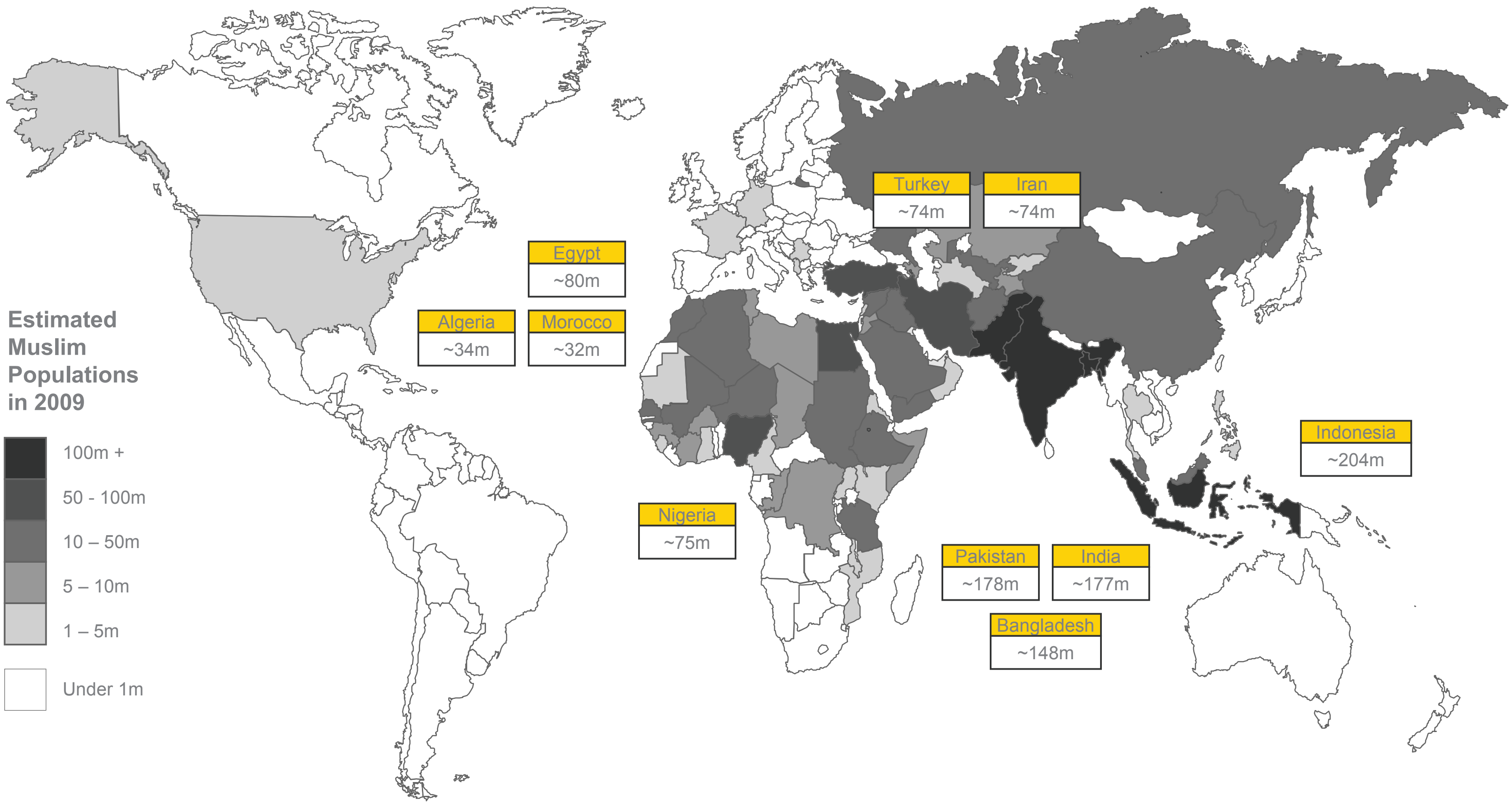
- On average, takaful operators in the GCC and other emerging takaful markets write less business than their counterparts in the more mature market of Malaysia.
- This volume of contribution reflects the relative stages of development across global takaful markets and supports the argument that takaful needs to build scale if it is to successfully compete in many emerging markets.
- The relatively high levels of premium per operator in Malaysia would seem to support the need for further competition.

Source: World Islamic Insurance Directory 2011; Ernst & Young analysis

Muslim Population Centers

Large Muslim population centers can be found throughout the emerging markets of MENA and Asia

Global Estimated Muslim Populations in 2010



Source: Pew Research Center, Ernst & Young analysis

Economic Growth Forecasts – GCC and MENA

The ongoing political turmoil in the MENA region may result in a slow down of economic growth

The current turmoil threatens the reputations of many of the countries in the MENA region. The longer the heightened political and financial system risks last, the longer and more significant the economic impact. The degree to which this political unrest will spill over into the economy and become a longer term issue is still evolving.
A.M. Best Company

Credit Agricole has said that it is revising its GDP forecast for Egypt to 3.7%, down from 5.3%, with tourism being particularly badly affected.
Credit Agricole

Saudi Arabia's economy is seen expanding by 3.9 percent in 2011 and will remain one of the Middle East's prime areas for investment. However, a shadow has been cast over Saudi Arabia's political profile, with the recent social unrest in North Africa increasing risk aversion towards the entire region.
Business Monitor International

Sudan is heading for an acrimonious split but while southern leaders want political independence from the north, economic realities may keep them uncomfortably dependent on their former foes. South Sudan's economy is likely to be vulnerable after the split.
Reuters Africa

The ratings on Bahrain have been lowered by an aggregate three notches since the onset of political tensions and remains on credit watch with negative implications. Indications are that the ratings will be lowered if political tensions continue.
Standard & Poor's

While some global equity markets, especially in emerging markets, have suffered from the escalation of political chaos in Egypt, most of the effect has been focused on other MENA markets, exacerbated by the spread of protests elsewhere in the region. Oil prices have shown volatility. The reduction in Libyan output and fears that the developments could spread to Saudi Arabia has added to fears about oil supply.
Moody's Investors Service

Source: Onesource, Global Insight

Economic Growth Forecasts – SEA

The South East Asian economies are expected to grow steadily, with the unrest in MENA and earthquake in Japan not expected to have significant impact

Indonesia, Southeast Asia's largest economy, which fared better than its neighbors during the 2009 global recession as it is less reliant on exports, expanded at the fastest pace in more than a year. The country's sovereign debt rating was raised to the highest level in 12 years. The outlook is positive.
Standard and Poor's

Indonesia's credit rating was raised to BB+, one level below investment grade, citing the economy's resilience to the global crisis and improved finances.
Fitch Ratings

Source: Onesource, Global Insight

The Asia-Pacific economies are poised to post solid growth in 2011.GDP growth rates in 12 of the 14 major regional economies are expected to be moderate compared to 2010 growth rates, given that US economic conditions remain soft and doubts remain over the sustainability of the euro zone recovery.
Within Southeast Asia, Malaysia is expected to grow by 4.8-5.3 per cent and Indonesia could see an expansion of 5.9-6.4 per cent in 2011.
Standard and Poor's

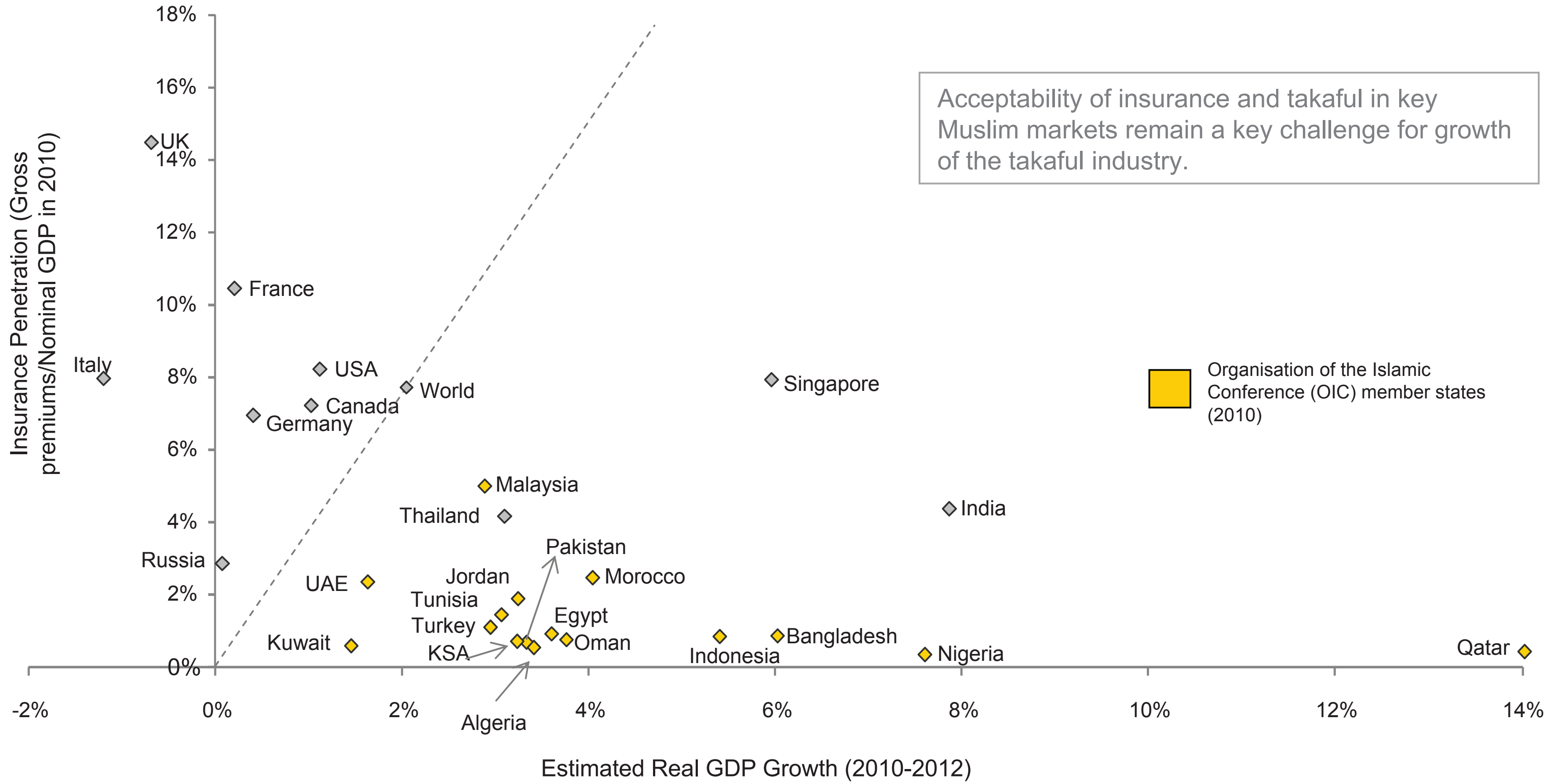
Kenanga Research maintains Malaysia's GDP growth at 5.7 per cent for this year, barring unforeseen events and worsening of Japan's nuclear crisis as well as escalation of the Middle East and Libya's political conflicts. If there was any impact on the massive earthquake and disastrous tsunami, it would likely be neutral for the Malaysian economy this year.
BERNAMA, Malaysian National News Agency

Malaysia's 2011 GDP growth forecast has been raised to 5.5 per cent from 5.2 per cent previously, driven by robust domestic demand. The country's consumer price index forecast has also increased to 3.6 per cent from 3.4 per cent previously. The growth target this year should be easily met, while inflationary pressures continue to build.
Goldman Sachs

Insurance Penetration Rates

Key takaful markets are characterized by low insurance penetration rates and comparatively high rates of economic growth

Insurance Penetration and Real GDP Growth for Select Countries



Source: Swiss RE - Sigma No. 2 (2010), Global Insight, Ernst & Young analysis

Key Strategic Issues

Key challenges to future growth include increasing competition, lack of diversification and cultural and religious implications

Key Strategic Issues

1 Competing for growth

- Increasing number of takaful players in key markets.
- Small local players competing against established conventional players.
- Competing for commercial business requires further capacity, underwriting expertise and enhance broker relationships.
- High political instability in many takaful markets.
- Markets reaching saturation under current demand (when Islamic banking market share of assets is used as a benchmark).
- Recent growth primarily driven by compulsory medical in KSA.

2 Diversification and specialization

- Over concentration in certain business lines. Takaful growth primarily driven by personal lines.
- In the GCC, this growth has also been driven by general lines.
- Shortage/absence of capacity in various commercial lines.
- Limited uptake of family takaful in the GCC.
- Takaful is focused on Muslim countries, many of which have recently experienced political turmoil. Investor risk appetite must be aligned to these markets.

3 Cultural and religious acceptability of insurance

- Social systems of protection and reliance on family ties have traditionally been dominant in Middle Eastern and South Asian countries.
- Awareness of risks, implications and Shari'a permissible takaful solutions is still limited.
- Growth in the GCC primarily driven by compulsory insurance rather than voluntary policies.

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- Introduction
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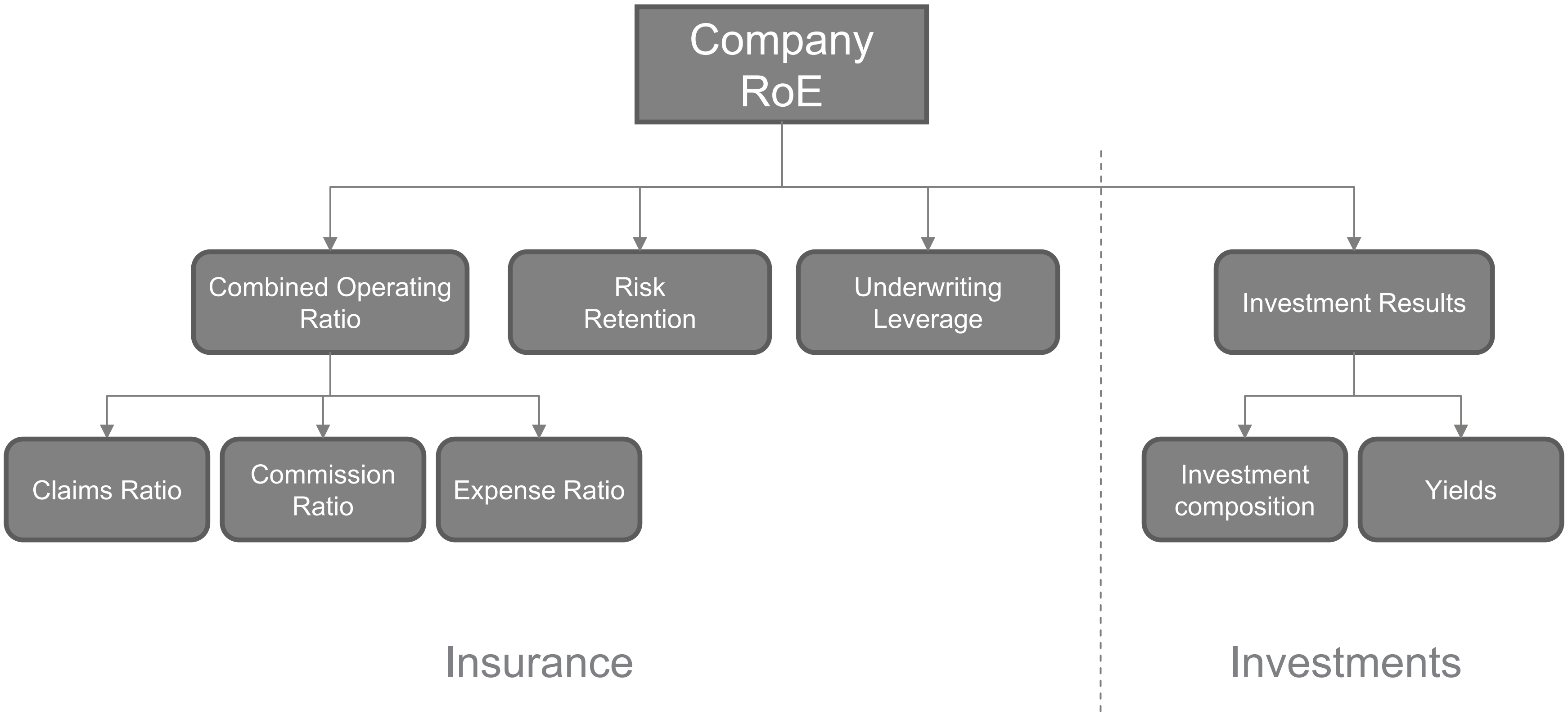
- Takaful companies saw their ROE recover in 2010 but they remain below their conventional counterparts.
- Expense ratios in the GCC remain higher than Malaysia, while within these regions, there is little difference between takaful and insurance.
- Investment returns for GCC takaful companies were positive for the first time since 2007.

Breakdown of Financial Performance

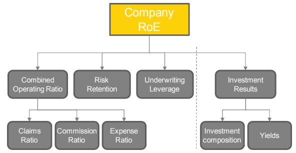
Insurance companies and takaful operators generate shareholder returns through a number of key drivers



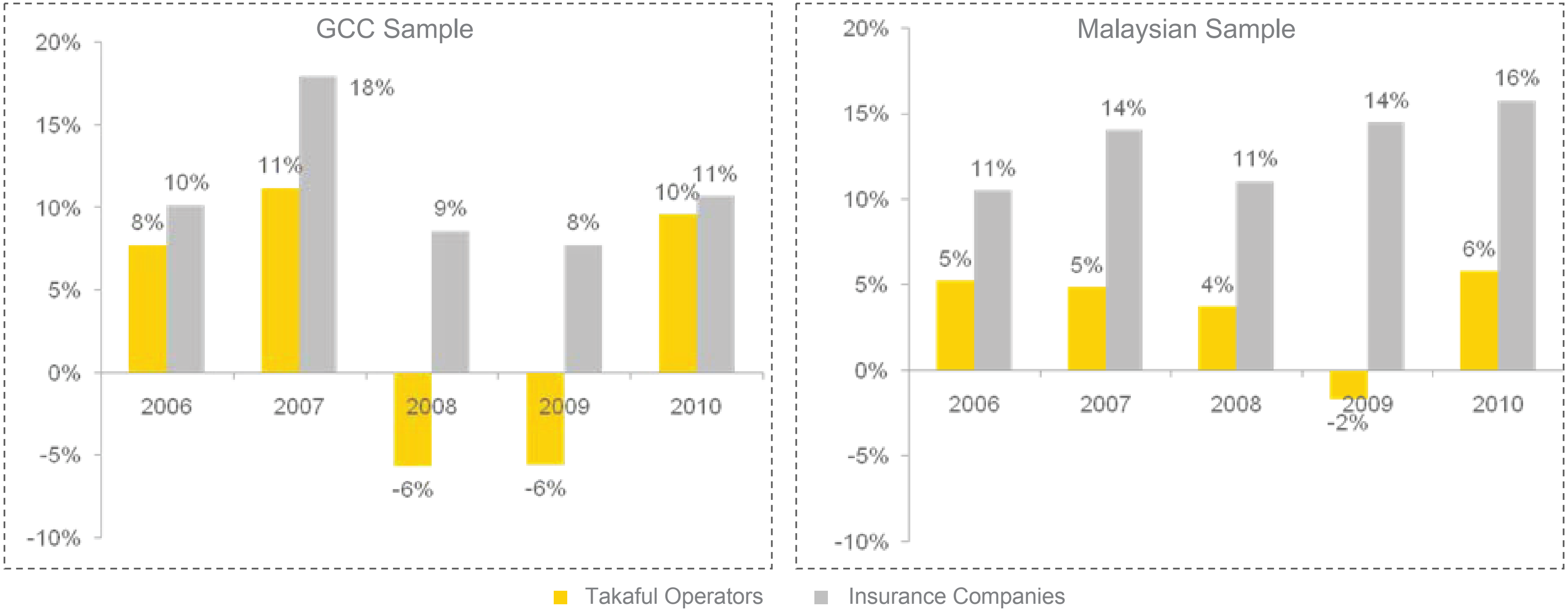
Note: Data used for the analysis is based on the annual reports of a sample of takaful operators and insurance companies covering both the GCC and Malaysia, including public companies and non-public companies (wherever possible), and reports from regulators. Reports from regulators in Bahrain and Malaysia are specific to takaful industry whereas, in Saudi Arabia and UAE reports are specific to the insurance industry. Annual reports for some of the companies for the year 2010 were not available at the time of publishing. Numbers may differ from previous reports as the sample size has been enhanced. Refer to appendix for a full list of operators included in our sample.

Return on Equity

Conventional insurers have maintained better ROEs than takaful operators, especially through the financial crisis



Average Return on Equity for Sample of Takaful Operators and Insurance Companies

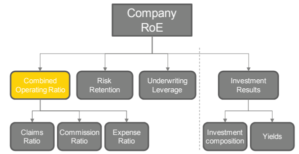


Note: Where possible, publicly available corporate information has been used.
GCC Takaful operators publishing their information:12 in 2006, 12 in 2007, 22 in 2008, 27 in 2009, and 21 in 2010. In Malaysia: 4 in 2006, 5 in 2007, 6 in 2008, 6 in 2009 and 3 in 2010.
GCC Insurance companies publishing their information: 20 in 2006, 24 in 2007, 26 in 2008, 27 in 2009 and 11 in 2010. In Malaysia: 7 in 2006, 7 in 2007, 6 in 2008, 6 in 2009 and 6 in 2010.
RoE = Net profit / Shareholders' equity

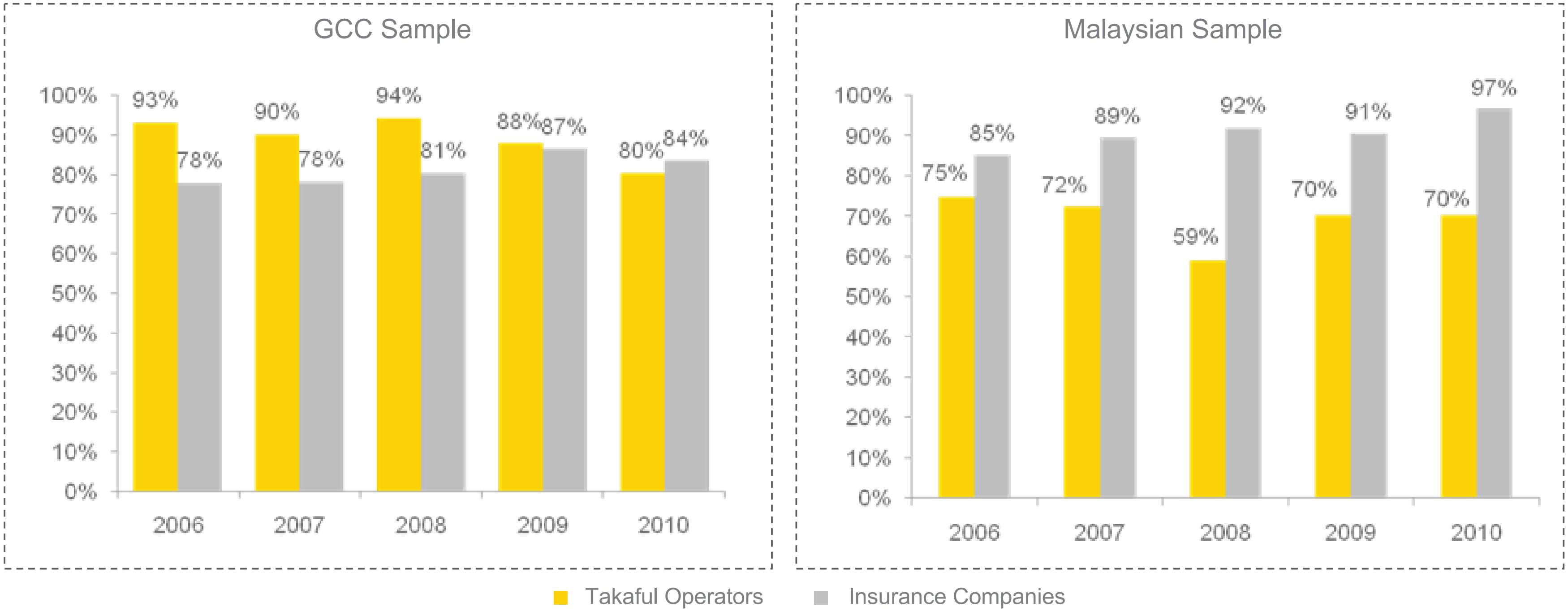
Source: Company Annual Reports, Ernst & Young Analysis

Combined Operating Ratio

Malaysian takaful operators have better combined ratios than conventional counterparts while the reverse is true for GCC companies



COR for Sample of Takaful Operators and Insurance Companies

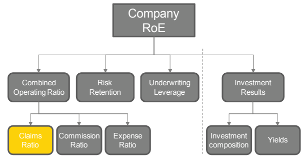


Note: Where possible, publicly available corporate information has been used.
GCC Takaful operators publishing their information:10 in 2006, 10 in 2007, 12 in 2008, 22 in 2009, and 21 in 2010. In Malaysia: 3 in 2006, 5 in 2007, 5 in 2008, 3 in 2009 and 3 in 2010.
GCC Insurance companies publishing their information: 19 in 2006, 23 in 2007, 24 in 2008, 26 in 2009 and 13 in 2010. In Malaysia: 7 in 2006, 7 in 2007, 7 in 2008, 7 in 2009 and 5 in 2010.
Combined Operating Ratio = Net Claim Ratio+ Net Commission Ratio+ Net Expenses Ratio

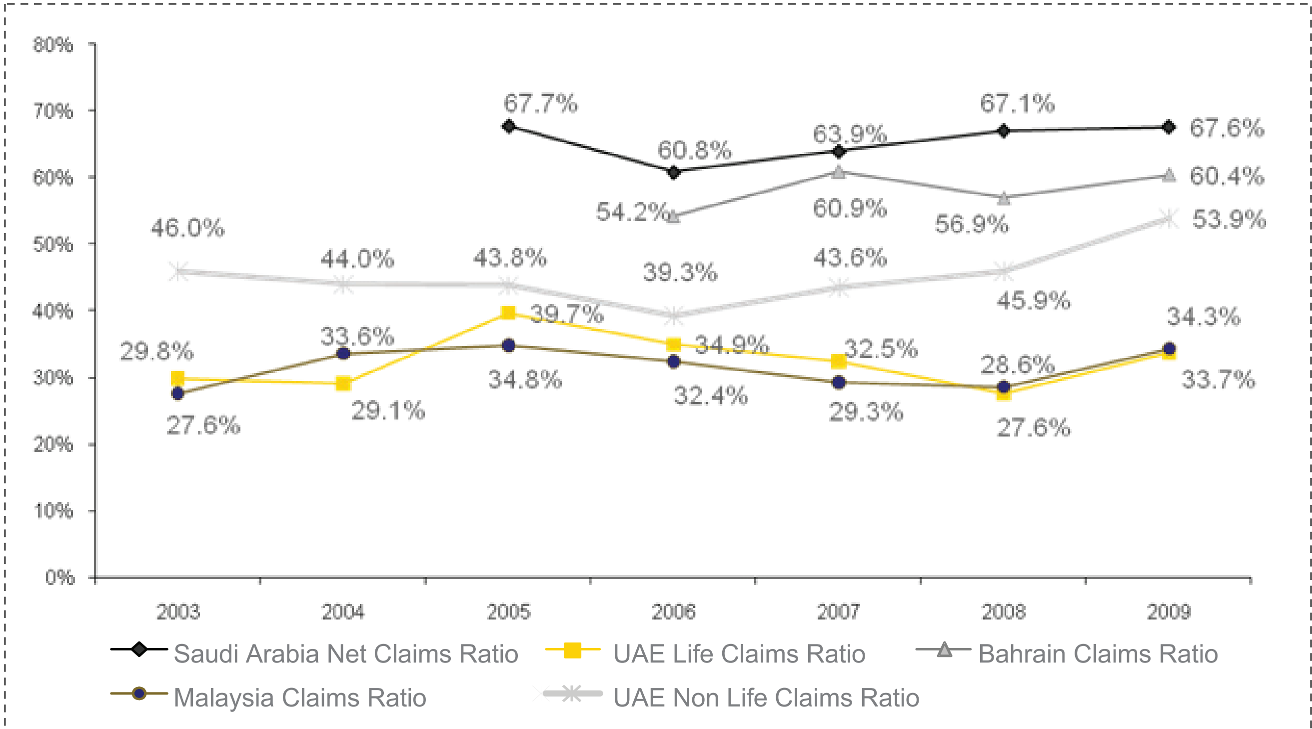
Source: Company Annual Reports, Ernst & Young Analysis

Claims Ratios

Claims ratios in the GCC remain higher than Malaysia, due largely to the prominence of life assurance in that market



Claims Ratios for Different Jurisdictions

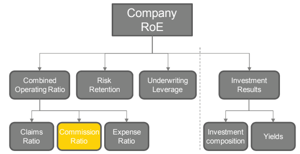


Malaysia's boasts significantly lower claims ratios than it's GCC counterpart. However, this is largely due to the difference in dominant business lines in the two jurisdictions. The GCC is largely dominated by general takaful whereas Malaysia is mostly family takaful.

Note: Data of claims ratios for Bahrain and Malaysia are specific to the Takaful industry, while data for Saudi Arabia and UAE covers the insurance industry as a whole. Data was unavailable prior to 2006 for Bahrain and 2005 for Saudi Arabia.
SAMA has modified its method of reporting claims ratios. In past years its reporting was based on gross claims, but it has now begun using net claims instead. Consequently, figures reported above for Saudi Arabia will differ from the last years report.
Claims Ratio = Claims incurred / Earned contribution

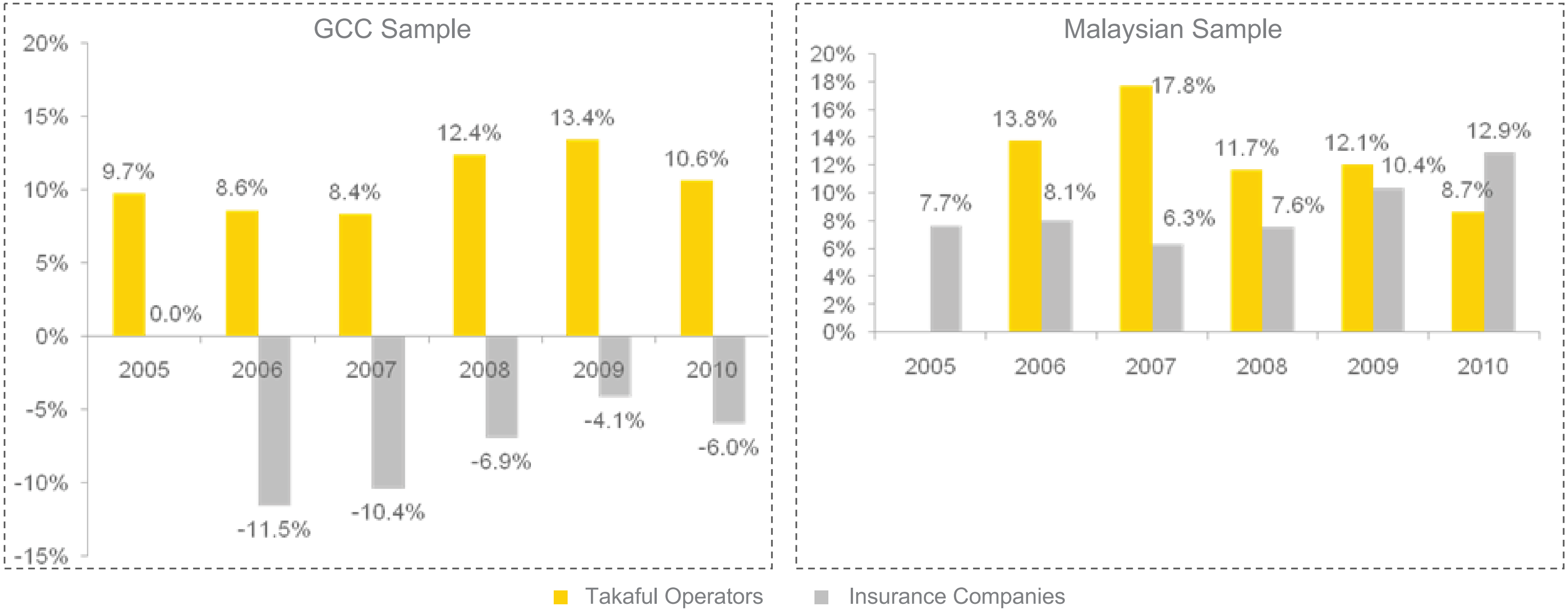
Source: CBB Insurance Market Review (Bahrain), Annual Takaful Statistics issued by Bank Negara Malaysia (Malaysia), Annual Insurance Statistics issued by Insurance Authority (UAE), SAMA Insurance Review (Saudi Arabia)

Average Commission Ratio



Takaful operators in the GCC appear to be paying more in commissions for their business, and receiving less in reinsurance commission

Average Net Commission Ratio for Sample of Takaful Operators and Insurance Companies

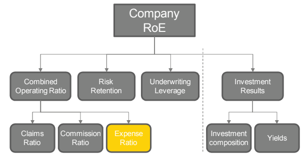


Note: Where possible, publicly available corporate information has been used.
GCC Takaful operators publishing their information: 8 in 2006, 7 in 2007, 13 in 2008, 22 in 2009, and 17 in 2010. In Malaysia: 2 in 2006, 3 in 2007, 4 in 2008, 5 in 2009 and 3 in 2010.
GCC Insurance companies publishing their information: 14 in 2006, 17 in 2007, 19 in 2008, 21 in 2009 and 10 in 2010. In Malaysia: 4 in 2006, 6 in 2007, 5 in 2008, 6 in 2009 and 4 in 2010.
Average Commission Ratio = Net Commission /Net Earned Premium

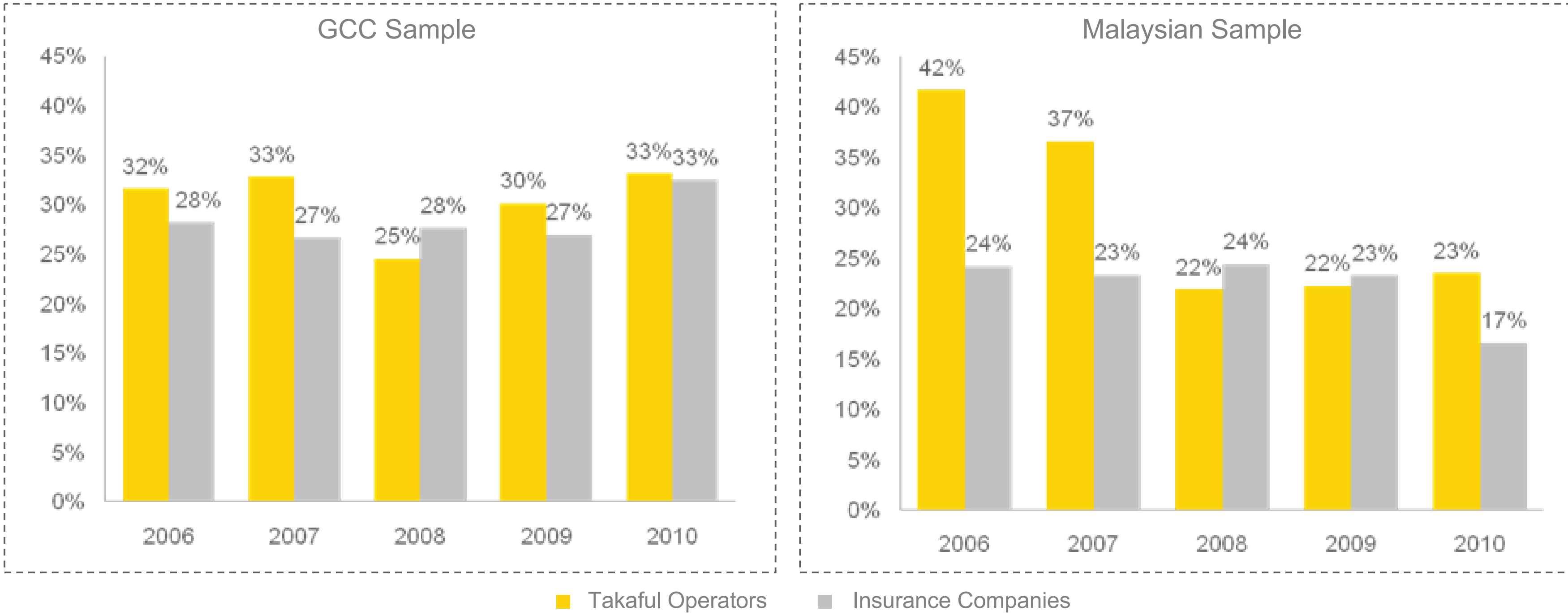
Source: Company Annual Reports, Ernst & Young Analysis

Average Expenses Ratio

Expense ratios in the GCC remain higher then Malaysia, while within these regions, there is little difference between takaful and insurance



Average Expenses Ratio for Sample of Takaful Operators and Insurance Companies



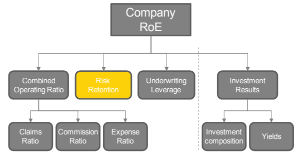
Note: Where possible, publicly available corporate information has been used.
GCC Takaful operators publishing their information: 7 in 2006, 8 in 2007, 8 in 2008, 9 in 2009, and 8 in 2010. In Malaysia : 2 in 2006, 3 in 2007, 4 in 2008 and 2009 and 3 in 2010.
GCC Insurance companies publishing their information : 19 in 2006 , 23 in 2007, 24 in 2008, 26 in 2009 and 13 in 2010. In Malaysia : 7 in 2006, 2007, 2008 and 2009 and 4 in 2010.
Average Expense Ratio = General and Administrative Expenses /Net Earned Premium

Source: Company Annual Reports, Ernst & Young Analysis

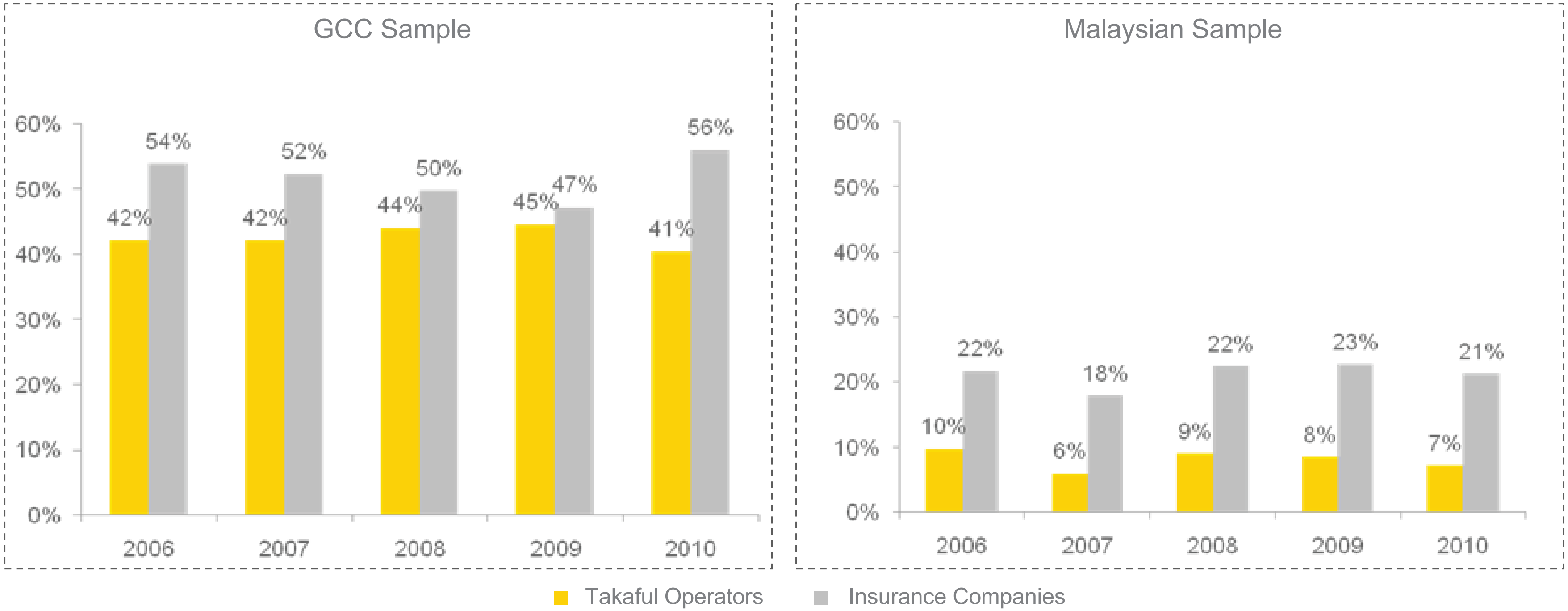
THE WORLD TAKAFUL REPORT

Reinsurance Ratio

Takaful operators generally retain more business, which reflects a focus on less complex lines and extra capacity



Reinsurance Ratio for Sample of Takaful Operators and Insurance Companies

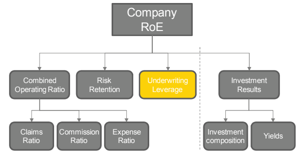


Note: Where possible, publicly available corporate information has been used.
GCC Takaful operators publishing their information:10 in 2006, 10 in 2007, in 2008, 27 in 2009, and 21 in 2010. In Malaysia: 4 in 2006, 5 in 2007, 6 in 2008, 6 in 2009 and 3 in 2010.
GCC Insurance companies publishing their information: 20 in 2006 , 24 in 2007, 26 in 2008, 27 in 2009 and 11 in 2010. In Malaysia: 7 in 2006, 7 in 2007, 6 in 2008, 6 in 2009 and 6 in 2010.
RoE = Net profit / Shareholders' equity

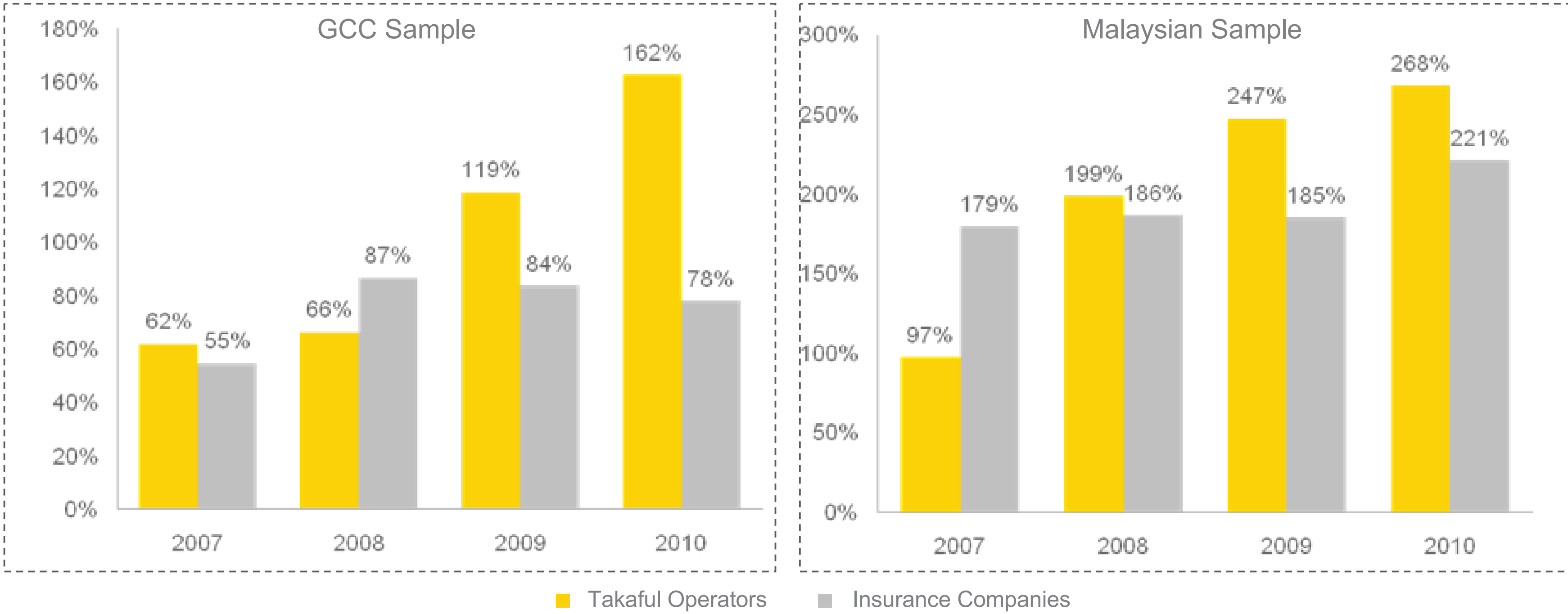
Source: Company Annual Reports, Ernst & Young Analysis

Underwriting Leverage

Takaful operators have higher U/W leverage, a result of less equity when compared to established insurers and limited solvency requirements



Underwriting Leverage for Sample of Takaful Operators and Insurance Companies

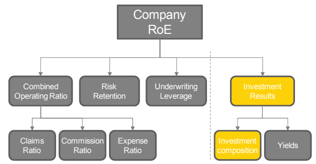


Note: Where possible, publicly available corporate information has been used.
GCC Takaful operators publishing their information: 10 in 2006, 11 in 2007, 13 in 2008, 20 in 2009, and 14 in 2010. In Malaysia : 3 in 2006, 5 in 2007, 5 in 2008 , 5 in 2009 and 3 in 2010.
GCC Insurance companies publishing their information : 19 in 2006, 23 in 2007, 24 in 2008,25 in 2009 and 11 in 2010. In Malaysia : 7 in 2006 , 7 in 2007, 6 in 2008, 7 in 2009 and 5 in 2010.
Risk Retention Ratio = Gross Premium/Shareholder's Equity

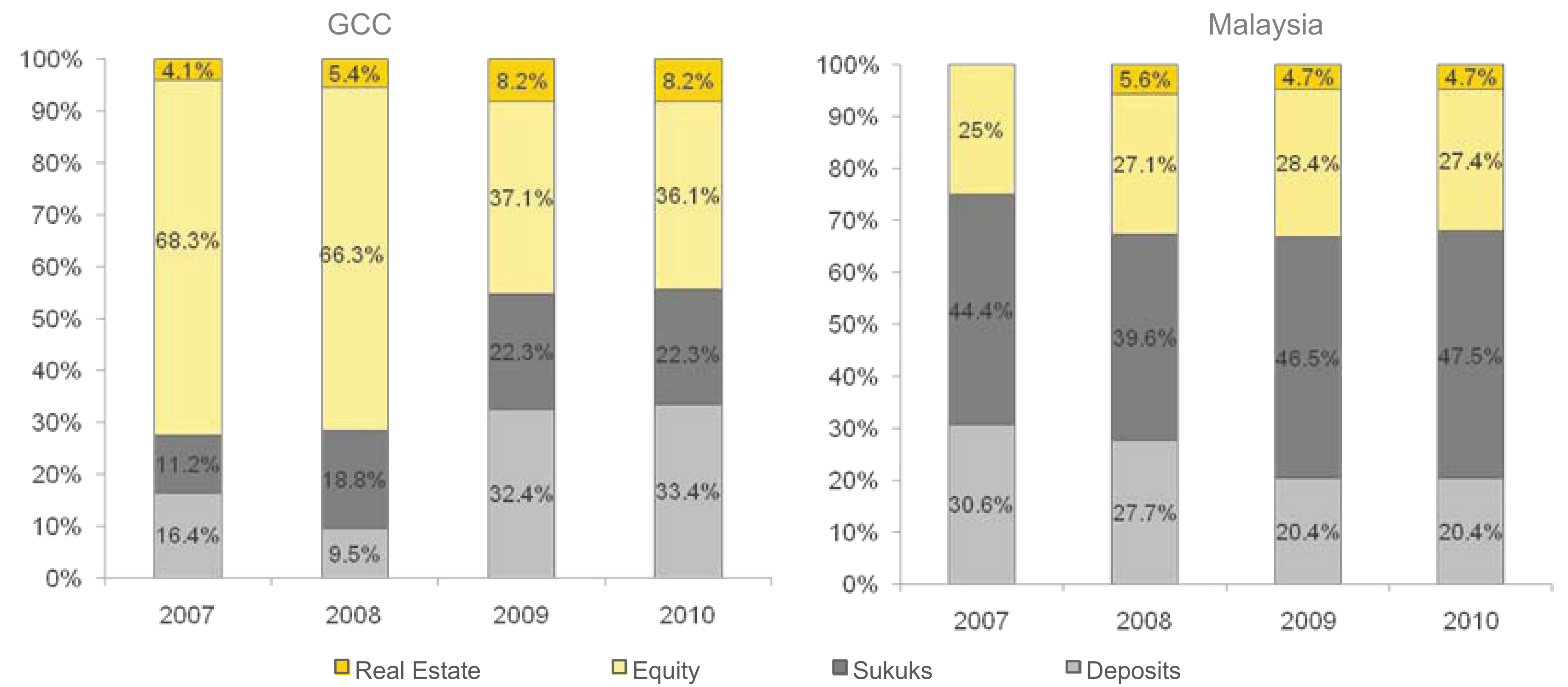
Source: Company Annual Reports, Ernst & Young Analysis

Investment Composition

Investment strategies have remained largely unchanged in 2010, while GCC operators continue to adopt a more relatively aggressive strategy



Average Investment Portfolio Composition for a Sample of Takaful Operators



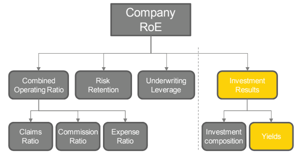
Note: Where possible, publicly available corporate information has been used. In the GCC, 6 companies published information in 2007, 9 in 2008 and 6 in 2009. In Malaysia, 3 companies published information in 2007, 4 in 2008 and 2 in 2009. Data for 2010 was not available at the time of print. Figures for 2010 are based upon discussions with industry leaders.

Deposits and placements with financial institutions in GCC are mostly less than three months. In Malaysia, deposits and placements with financial institutions vary from short term to long term.

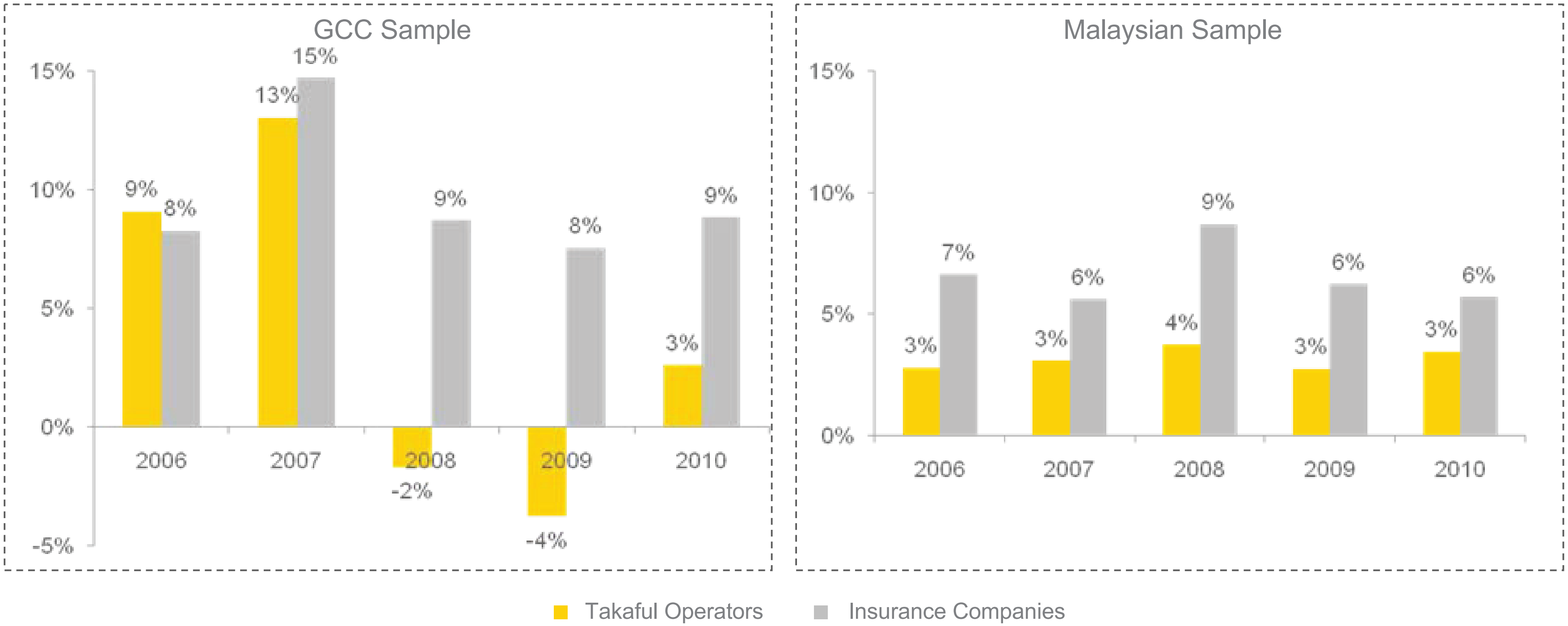
Source: Company Annual Reports, Ernst & Young analysis

Investment Returns

Takaful operators in the GCC have witnessed high volatility, which reflects their aggressive investment strategies



Average Return on Investments for Sample of Takaful Operators and Insurance Companies



Note: Where possible, publicly available corporate information has been used.
GCC Takaful operators publishing their information:10 in 2006, 11 in 2007,11 in 2008, 12 in 2009, and 4 in 2010. In Malaysia : 3 in 2006, 4 in 2007, 5 in 2008 , 4 in 2009 and 4 in 2010.
GCC Insurance companies publishing their information: 14 in 2006 , 14 in 2007, 16 in 2008, 16 in 2009 and 6 in 2010. In Malaysia: 7 in 2006, 7 in 2007, 7 in 2008, 7 in 2009 and 4 in 2010.
Average Yield on Investments=Total Investment Returns /Total Investment

Source: Company Annual Reports, Ernst & Young Analysis

Financial Performance - Summary

Financial performance has varied significantly between key takaful markets

Drivers	GCC	Malaysia
Return on Equity	▶ Takaful operators have returned better results than their Malaysian counterparts. However, they have suffered through the crisis from having aggressive investment strategies. ▶ Returns have again picked up in 2010 after a significant fall during 2008 and 2009.	▶ Conventional insurers have produced far better results than their takaful counterparts, based significantly on their investment returns. ▶ Takaful returns have recovered after a slight fall during the financial crisis.
Risk Retention	▶ Takaful operators retain more business than conventional insurers due to focus on less complex business classes and potentially excess capacity. ▶ On a whole, the GCC industry cedes more to reinsurers than Malaysian players. This broking approach causes excessive reliance on investment returns to generate profitability.	▶ On average, operators cede between 5-15% of gross premiums to retakaful entities, retaining a larger proportion of business on their books and converting this into better technical results. ▶ This strategy requires greater underwriting competence and track record (using historical data) to build a quality book.
Underwriting Results	▶ Average combined ratios have continued to improve over 2010 to reach 80%, coming closer to the operating performance of conventional players. ▶ Younger takaful players with predominantly general takaful based business, have higher claims ratios than the Malaysian market. ▶ Expense ratios have risen for both takaful and conventional players in 2010.	▶ Takaful operators have better combined ratios than their conventional counterparts. ▶ Claims ratios have remained largely stable up to 2009 following which they have risen sharply by 6%. ▶ Expense ratios have remained stable for takaful operators but improved for conventional players.
Investment Results	▶ There was a small recovery in takaful investment income in 2010, following two years of losses. Conventional players continued to post healthy returns. ▶ Significant volatility owing to large allocation to high-risk asset classes. Flight to safety witnessed in 2009, with lower allocations to equity and higher allocation to deposits.	▶ Average yield on investments have remained stable for takaful operators and fallen slightly in 2009-2010 for conventional players. ▶ Large allocation to fixed income securities results in limited volatility.

Source: Ernst & Young analysis

Key Strategic Issues

Financial performance remains a challenge for Takaful Operators in many markets

Key Strategic Issues

1 Efficiency in operation

- Most takaful operators are yet to achieve critical business volume, despite incurring substantial establishment costs over the years
- Expense ratio remains larger higher than conventional peers, although improvements have been made
- Service quality remains sub-optimal for many operators

2 Quality of underwritten business

- Most takaful operators are startups or small players, limiting their access to quality customers which negatively impacts their loss ratios
- Access to potentially lucrative commercial lines is limited due to underdeveloped broker relationships
- Complex risks are not well understood and potentially mispriced
- Business mix is sub-optimal for many operators

3 Ensuring investment discipline

- Dearth of Shari'a compliant capital market instruments exerting pressure on returns
- High direct exposure to equity markets to maximize returns
- Ad-hoc approach to portfolio management
- More stringent regulations being applied in several countries will restrict current practices

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- Introduction
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- Competing for growth
- Appendix

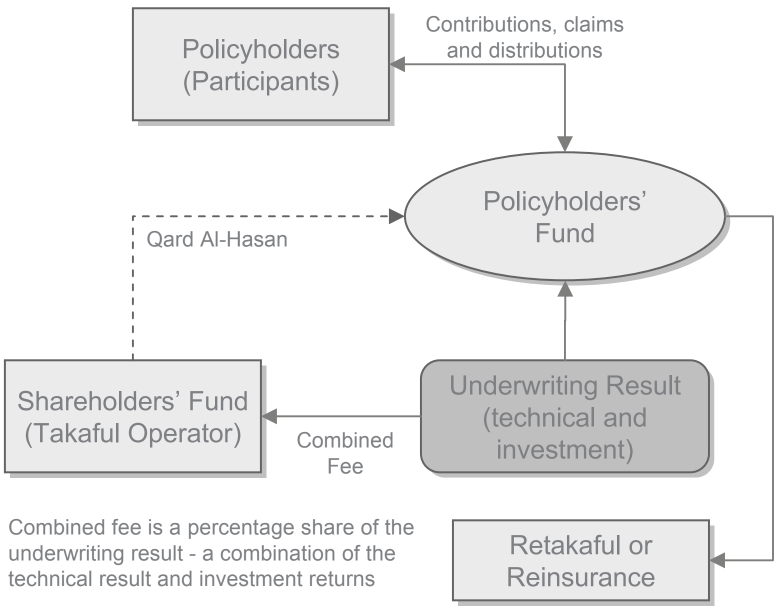
- There are four takaful models currently in use
- Revenue drivers for each differ significantly
- Shari'a and regulatory requirements are evolving and vary across geographies
- Thorough feasibility analysis and strong governance are key to profitable growth

Business Models - Mudaraba and Wakala

Both the Mudaraba and Wakala models are based on single management contracts

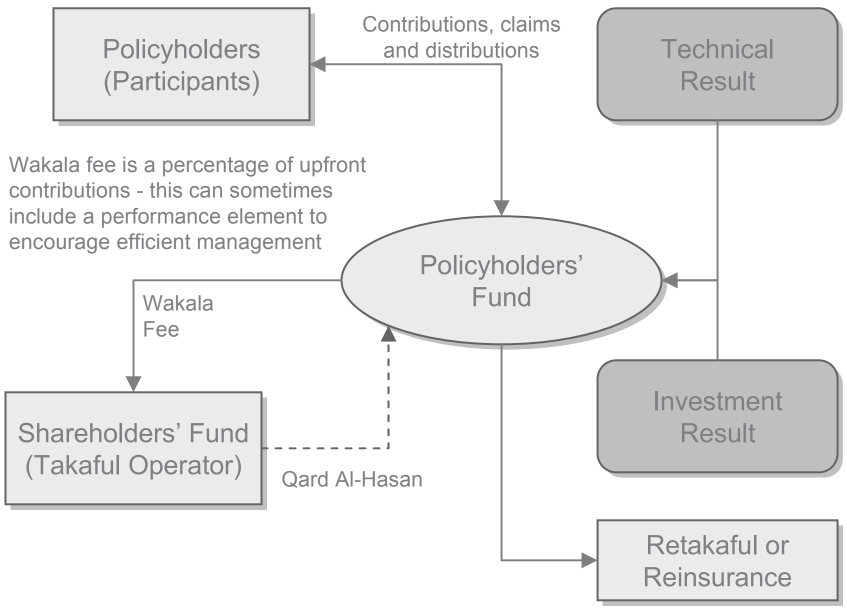
1 *Mudaraba* Model

A principal-manager agreement is used between the policyholders (*Rab al Mal* - capital providers) and the takaful operator (*Mudarib* - entrepreneur) for both underwriting and investment activities.



2 *Wakala* Model

A principal-agent arrangement (wakala) is used between the policyholders and the takaful operator for both underwriting and investment activities.



Notes: Critics of the mudaraba model argue that, in the cooperative framework, the technical result is not considered a profit and the takaful operator does not therefore have any right to it. The mudaraba contract also entitles the takaful operator to a share in the underwriting result, but not to a share in any deficit.

The Qard Al-Hasan is an interest-free loan provided by the Shareholders to the policyholders' fund in the event of deficit.

All takaful fees are preapproved as limits by the Shari'a board and vary between general and family offerings. The actual fees charged to participants is at the discretion of management. For example, if the Shari'a board approves a wakala fee of up to 40% the operator is permitted to charge anything equal to or below that number.

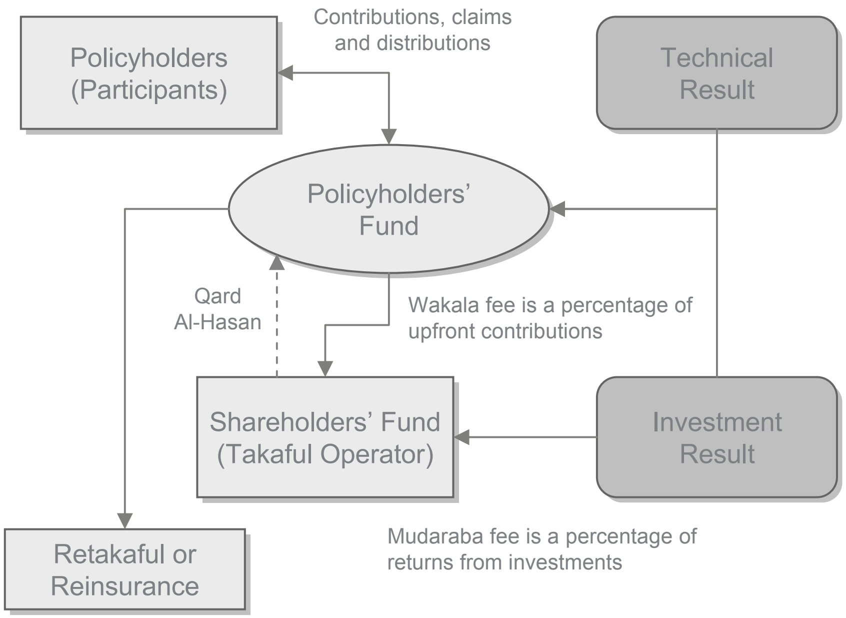
Source: Ernst & Young analysis

Business Models - Combined and Waqf

The combined and Wakala waqf model are both based on a combination of Wakala and Mudaraba

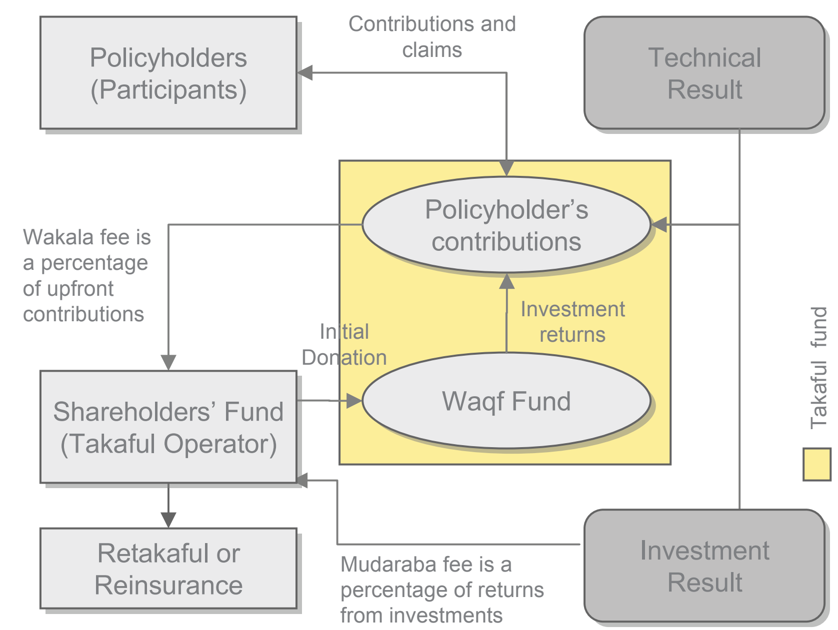
3 *Combined* Model (Hybrid Model)

A combination of the principal-agent (wakala) and principal-manager (mudaraba) arrangement is used with wakala is used for underwriting activities and mudaraba is used for investment activities.



4 *Wakala Waqf* Model

A Waqf fund is established via a donation by shareholders. This Waqf cannot be used to settle claims. The combined model is used to manage participant contributions with a Qard facility provided by shareholders.



Notes: There is growing consensus that the combined model be considered leading practice. It is now mandatory in a number of markets including Bahrain and Malaysia. However, critics of the combined model claim that there is a conflict of interest between the operator which seeks to maximize shareholder profits and the participants which seek to collectively and sustainably indemnify themselves from risk and benefit from any surplus that is created. Furthermore, the Shari'a board is tasked with representing the rights of participants, but this feature of Islamic corporate governance does not provide input at the executive decision making level.

The wakala waqf model has proved popular in Pakistan and relies upon an initial donation from the shareholders to establish a waqf fund for the participants. Only the investment returns from this fund, (and not the waqf amount itself), may be used to pay claims. Contributions are managed through the combined model with shortfalls in the participant fund being met through a qard facility from shareholders. Pakistani Shari'a scholars do not allow surplus distribution amongst participants .

Source: Ernst & Young analysis

Business Model Features

The four takaful business models share many of the same features with some differences

<table>
<tr><th></th><th>Mudaraba</th><th>Wakala</th><th>Combined</th><th>Wakala Waqf</th></tr>
<tr><td>Share of technical results</td><td>None</td><td colspan="3">Percentage of upfront contribution (no share in result)</td></tr>
<tr><td>Share of investment result</td><td colspan="2">None</td><td colspan="2">Agreed profit sharing ratio</td></tr>
<tr><td>Share of surplus (technical and investment results)</td><td>Percentage of surplus</td><td colspan="3">None</td></tr>
<tr><td>Loss on investments</td><td colspan="4">Borne solely by policyholders</td></tr>
<tr><td>Operating expenses</td><td colspan="4">Borne solely by shareholders’ fund</td></tr>
<tr><td>Investment instruments</td><td colspan="4">Acceptable Shari’a compliant instruments</td></tr>
<tr><td>Deficit in the policyholders’ fund</td><td colspan="4">Qard Al-Hasan provided to policyholders’ fund</td></tr>
<tr><td>Creation of takaful fund</td><td colspan="3">Policyholders’ contributions</td><td>Policyholders’ contributions and initial waqf by shareholders</td></tr>
<tr><td>Liquidation of policyholders’ fund</td><td colspan="3">Accrue to policyholders only</td><td>Waqf amount must go to another existing Waqf fund and cannot be disbursed amongst participants.</td></tr>
<tr><td>Prevalent countries</td><td>Partially in Malaysia and Saudi Arabia*</td><td>United Kingdom</td><td>Bahrain, Malaysia and Sudan</td><td>Pakistan</td></tr>
</table>

Source: Ernst & Young analysis

* Note: See subsequent page on regional characteristics.

Strengths and Constraints

Each model has inherent strengths and constraints

	Mudaraba	Wakala	Combined	Wakala Waqf
Strengths	▶ Comparatively simple model. ▶ Enhanced profitability as the operator shares in the surplus. ▶ Operator is incentivized to achieve strong technical results as it shares in the surplus. ▶ The provision of the Qard Al-Hasan partially limits excessive risk taking by operators.	▶ Comparatively simple model. ▶ No sharing in the technical result. ▶ Excessive risk taking in investments is fully mitigated as no upside exists for the operator.	▶ Two sources of revenues - Wakala from contributions and mudaraba from investments. ▶ No sharing in the technical result. ▶ The provision of the Qard Al-Hasan partially limits excessive risk taking by operators.	▶ Two sources of revenues - Wakala from contributions and mudaraba from investments. ▶ No sharing in the technical result. ▶ The provision of the Qard Al-Hasan partially limits excessive risk taking by operators. ▶ No surplus distribution to policy holders, potentially resulting in a positive effect on the operators financial strength over time.
Constraints	▶ Shareholders are permitted to share in the technical results, which, under the cooperative model, should be fully attributed to the policyholders through distribution. ▶ The operator has incentive to take on excessive risk in investments (partially mitigated through Qard).	▶ Profitability is reduced as there is no investment upside from the policyholders' fund. ▶ Direct financial incentives to improve technical results are limited (indirect benefits are realized through distributions to participants and through increased fund size).	▶ The operator has incentive to take on excessive risk in investments (partially mitigated through Qard). ▶ Direct financial incentives to improve technical results are limited (indirect benefits are realized through distributions to participants and through increased fund size).	▶ The operator has incentive to take on excessive risk in investments (partially mitigated through Qard). ▶ Direct financial incentives to improve technical results are limited (indirect benefits are realized through distributions to participants and through increased fund size).
	▶ No system of corporate governance that effectively addresses and represents the rights of participants. ▶ No accounting policy which addresses issues of equitable distribution of surplus over time given varied entry and exit by participants.			

Source: Ernst & Young analysis

Regional Characteristics

The business execution of takaful varies significantly between key markets

Saudi Arabia - Cooperative Model

- Insurance companies are required to operate under the cooperative model by the regulator (Saudi Arabian Monetary Agency). They are required to have a 90-10 split of profits between the shareholders and policyholders respectively and the corresponding segregation of funds (similar to the mudaraba model described in this report). However, any deficit in the policyholders' fund is borne solely by the shareholders.
- A number of cooperatives operate as sole takaful operators. These companies have appointed Shari'a boards to supervise business operations, including investments and ensure compliance with Islamic law. There are 4 such operators at present that account for 5% of the overall market.
- A number of other cooperatives in the Kingdom also offer takaful products along with their main business lines. These operators have also established Shari'a boards to overlook their takaful operations.

Malaysia - Combined Takaful Model*

- All takaful operators operate under the combined model. The first two licenses issued by the regulator (Bank Negara) were under the Mudaraba model but these have now switched to the combined model for all new business. The segregation of funds between shareholders and policyholders is required and in case of a deficit in the policyholders' fund, the operator is required to provide a Qard Al-Hasan.
- Operators also charge an additional nominal Surplus Administration Charge (SAC) when surplus targets are met in the participants' fund to encourage efficient management.
- Surplus distributions to policyholders is allowed by regulators.
- New guidelines have been issued by Bank Negara Malaysia, covering the valuation of liabilities, financial reporting and the operational framework.

Bahrain - Combined Takaful Model

- All takaful operators are required by the regulator (Central Bank of Bahrain) to operate under the combined model, disclose corresponding fees to policyholders, use AAOIFI's accounting standards and segregate policyholders' funds from that of the shareholders.
- In case of a deficit in the policyholders' fund, the operator is required to provide a Qard Al-Hasan.

UAE – Wakala or Combined model

- Takaful operators may operate under the Combined Model or the Wakala Model.
- The segregation of funds between shareholders and policyholders is required and in case of a deficit in the policyholders' fund, the operator is required to provide a Qard Al-Hasan. For family takaful, segregation is also required for the participants' investment fund.
- The insurance will require all composite operators (and insurers) to separate family and general business operations.
- The regulation also requires the operators to be supervised by a central Shari'a board established by the regulator.

Source: Local Regulatory Rule Books, Ernst & Young Subject Matter Experts

Regional Characteristics

Takaful is expanding into new markets. The preferred model appears to be the combined model with variations in certain aspects

Indonesia – Wakala or Combined*

- Conventional insurers are allowed to write takaful business through licensed takaful windows. However the regulators have indicated that these windows will be phased out in time.
- Takaful operators and windows may operate using Wakala or Mudaraba arrangements. Takaful contracts with participants must be based on the principle of Tabarru (donation).
- Segregation is required between the Tabarru funds (participant contributions), shareholders' funds and participants' investment funds (in case of family takaful).
- A Qard al Hassan facility must be provided by the shareholders to meet deficiency in the takaful fund.
- Underwriting surplus can be retained in the takaful fund, or partly retained and the remainder either distributed to participants or distributed between participants and shareholders as per an agreed percentage. Sharing of surplus is allowed by a Fatwa by the National Shari'a Council of Indonesia. No distribution is permitted until Qard has been repaid, or if it would cause the fund to breach solvency requirements.

Kenya – Combined model

- Kenya has recently been introduced to the Takaful proposition with the launch of one full-fledged takaful operator in 2011 and another conventional insurer launching takaful products in late 2010.
- These operators are currently allowed to offer only general takaful products.
- Takaful operators are regulated by the Insurance Act of 2009 and there is no formal framework specifically recognizing the unique dimensions of takaful.
- Takaful operators have adopted the combined business model. They have segregation of funds between policyholders contributions and shareholders equity. Underwriting surplus is allowed to be distributed amongst participants or donated to charity.
- The operators have also appointed Shari'a Boards to advise them on their compliance with Shari'a.
- The operators are leveraging the distribution channels of the 2 Islamic banks operating in Kenya along with the channels of various Islamic windows.

Source: Local Regulatory Rule Books Ernst & Young Subject Matter Experts, Middle East Insurance Review, March 2010

Key Strategic Issues

Each takaful model offers a different set of opportunities that need to be understood to drive sustainable growth

Key Strategic Issues

1 Revenue drivers for each model vary significantly

- Differing fee structures mean that profitability of models can vary substantially
- Resilience of each model is impacted by the timing, process and obligations attached to each set of revenue streams

2 Shari'a and regulatory requirements vary

- Takaful regulations remain specific to jurisdictions, with direct impact on feasibilities and go to market strategies
- There is some convergence in preferred model with the combined model commonly adopted in UAE, Bahrain, Malaysia and Indonesia.
- Shari'a framework is yet to be convincingly applied as a business advantage
- Significant differences exist in Shari'a rulings between jurisdictions.

3 Building customer trust / brand loyalty

- Industry is yet to implement governance standards to effectively address the balance between mutual insurance and profit orientation
- Policyholders are sole providers of risk capital but acknowledgment is missing

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- Competition ranked as the highest risk by senior executives as downward price pressures continue.
- Evolving regulations likely to result in larger capital requirements.
- Sociopolitical uncertainty in MENA, the largest market for takaful poses considerable growth risks.
- Achieving technical profits remains a challenge but more engagement with actuaries being seen.

Takaful Business Risks

Competition, shortage of expertise and socio-political uncertainty are key business risks for takaful in 2011

How the Business Risks Match up - Results from 2011 and 2010

Risk and Category	Competition	Shortage of Expertise	Socio-political Uncertainty	Evolving Regulation	Misaligned Cost	Inability to achieve underwriting profit
	Strategic Risk	Operational Risk	Financial Risk	Compliance Risk	Operational Risk	Operational Risk
2011	1st	2nd	3rd	4th	5th	6th
2010	2nd	1st	not ranked	6th	not ranked	4th
Contributing Factors	▸ Low barriers to entry (minimum capital requirements). ▸ Increasing competition and aggressive pricing. ▸ Competitive pressures reducing safety margin in premiums. ▸ Market share being eroded by new competitors.	▸ Lack of skilled HR and increasing competition for resources. ▸ Lack of retention of skilled professionals. ▸ Limited pool of scholars with the requisite knowledge. ▸ Lack of operational expertise in certain lines of business.	▸ Current political unrest has destabilized the economy in many markets across MENA. ▸ High growth markets may experience slower premium growth as a result of reduced economic activity, FDI and tourism.	▸ Varying regulatory requirements, also specific to business models. ▸ Young and developing regulatory regimes. ▸ Evolving capital requirements (risk based capital).	▸ Challenges with effectively aligning cost base with current market conditions. ▸ Large cost base, not matched by anticipated growth in business volumes.	▸ Limited technical underwriting capabilities. ▸ Potential increase in claims ratios. ▸ Aggressive pricing strategies and limited safety margins. ▸ Investment volatility.

Source: Ernst & Young analysis

Takaful Business Risks

Alongside the top three risks, evolving regulations, misaligned cost base and achieving an underwriting profit are all key risks

Key Business Risks 2010	
1	Shortage of Expertise
2	Competition
3	High-risk investment portfolios
4	Inability to Achieve Underwriting Profit
5	Limited Financial Flexibility
6	Regulatory Compliance
7	Inability to Tap Pent-Up Demand
8	Enterprise Risk Management
9	Global Economic Downturn
10	Lack of Rated Retakaful

Takaful Global Business Risks

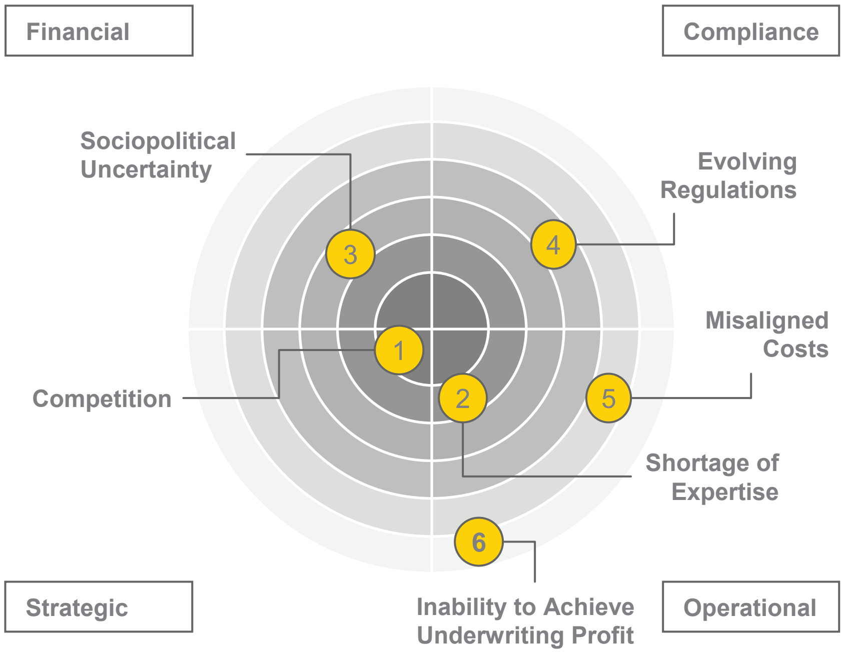
Key Business Risks 2011	
1	Rising Competition
2	Shortage of Expertise
3	Sociopolitical Uncertainty
4	Evolving Regulations
5	Misaligned Costs
6	Inability to Achieve Underwriting Profit
7	Limited Financial Flexibility
8	Inability to Tap Pent-Up Demand
9	Global Economic Downturn
10	High-risk investment portfolios

Source: Corporate Interviews, Ernst & Young analysis

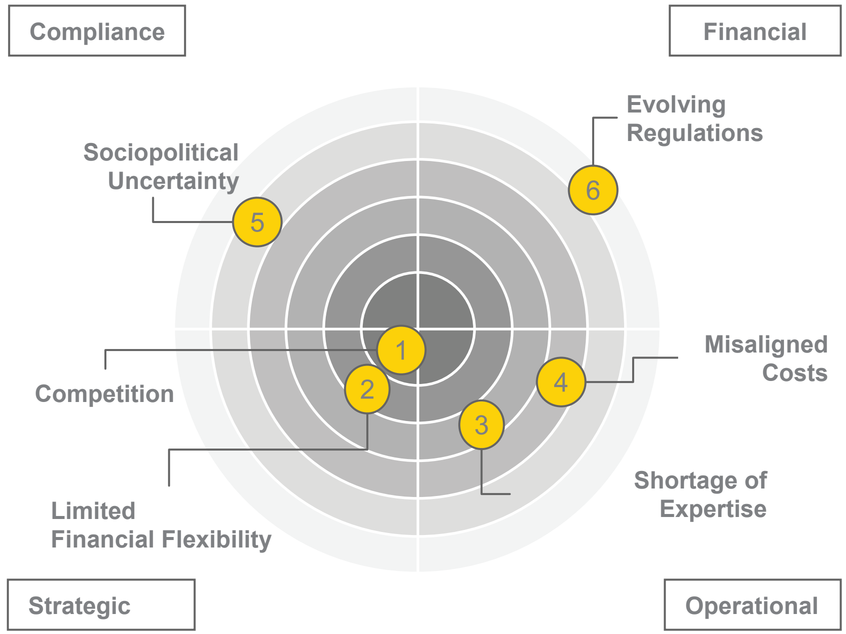
Takaful Business Risks

Shortage of qualified talent pool and rising competition have consistently been identified as key risks in both the GCC and SEA

Takaful in the Gulf Cooperation Council (GCC)



Takaful in South East Asia (SEA)



Business Risks in the GCC

- Competition and human resources remain key business risks for takaful operators.
- Recent sociopolitical events across the MENA region have also been identified as a key area of concern.

Business Risks in SEA

- New licenses in Malaysia are pushing up competitive risks, while financial constraints have also become more prominent.

Source: Corporate Interviews, Ernst & Young analysis

Rising Competition

A further increase in the number of operators in the GCC and additional licences in Malaysia have pushed competition to the top of the risks agenda

Commentary and Contributing Factors

New operators are aggressively acquiring market share:

- Newly established operators continue to capture market share through aggressive pricing strategies that were described by a number of interviewees as "unsustainable". Interviewees, particularly in the GCC, argued that this trend was especially evident in pricing for group and commercial risks.
- However, there are some signs that the situation in the GCC is improving. Interviewees also argued that pricing pressures are not attributable only to takaful operators.
- Entry of four new family takaful operators in Malaysia will further enhance competition in that market.

The argument for consolidation:

- Regulatory authorities across the GCC have indicated that there would be no further licenses issued until market conditions stabilize. There were also suggestions that consolidation was needed in the insurance and takaful industries to help build scale.
- However, this stance appears flexible given that a small number of new operators have been announced and rights issues have been approved for companies which could have become targets for M&A. Consolidation that has taken place in the GCC has been driven by international insurers and has not impacted takaful.

Family takaful still seen as an opportunity:

- Family takaful in the GCC remains an underpenetrated segment of the market, where critical mass has not been achieved and effective distribution remains a challenge.

> **" Insurance generally is oversupplied, takaful operators are more criticized because they are younger - 15% of the market cannot drive down prices alone."**
> - GCC ratings exec

> **" I have seen some stability in pricing…we refuse to get into a price war."**
> - GCC takaful exec

> **" Takaful should focus on Islamic customers, that's where is can differentiate."**
> - GCC takaful exec

> **" Other competitors are not bombarding my clients."**
> - GCC family takaful exec

Key Considerations

The customer is king - engagement and understanding is critical:

- Takaful needs to focus on customer segments that are attracted by an Islamic proposition. A clear understanding of customers and their preferences is key.
- Personal lines and family takaful should be priorities. Access to more lucrative commercial lines requires further differentiation around service quality, broker propositions and technical underwriting capabilities.

Source: Corporate interviews, Ernst & Young analysis

Shortage of Expertise

Availability of a qualified talent pool remains a key risk for takaful executives

Commentary and Contributing Factors

Human resources risks are high on the executive agenda:

- Takaful continues to suffer from a shortage of human resources with requisite expertise. This risk was considered equally important in both the GCC and South East Asia. According to interviewees, human resource risk is particularly acute in specialist fields, including life insurance, risk management and Shari'a compliance.
- Retention was identified as a key element of this risk, where significant competition for resources has led to aggressive recruitment strategies backed by attractive remuneration.
- Key-person-risk was also identified by a number of interviewees as a key concern. Institutionalization of knowledge and expertise was a priority for these companies as they tried to mitigate these risks.

Misalignment of resources:

- A number of interviewees argued that aggressive recruitment campaigns and unrealistic business growth targets, paired with the economic slowdown, had resulted in significant cost overhangs.
- Certain operators also pointed out that recruitment of specialists to assist with particular issues, such as regulatory licensing, had resulted in a misalignment of resource and business needs.
- Operators in Malaysia appear more willing to outsource key functions of their business to experts. This is largely due to the group structure of many operators in this market.

> " **…many professionals move in and out of the business, few are willing to commit for the long-term."**
> - GCC takaful exec

> " **The challenge is to build strong institutions which are not reliant upon a small number of individuals for technical knowhow."**
> - GCC takaful exec

> " **We have outsourced our investment activities to our holdings company to leverage on the system and expertise of the Group."**
> - Malaysian takaful exec

Key Considerations

Focus on retention and selective outsourcing:

- Long-term incentive schemes are key to enhancing retention and reducing key-person-risk. Identifying and recognizing internal talent is key.
- Partnerships and outsourcing should remain considerations, particularly in the short and medium term, to help gain cost-effective access to specialist expertise.

Source: Corporate interviews, Ernst & Young analysis

Sociopolitical Uncertainty

The current socio-political turmoil in several key markets will impact growth, but opportunities may also arise

Commentary and Contributing Factors

Short-term impact of sociopolitical instability in the MENA region:

- The political turmoil in the MENA region may potentially lead to reduced economic growth in some markets. Prolonged instability will impact foreign direct investment, real estate development, tourism and in turn impact the insurance and takaful growth.
- Operators and insurers that derived significant business from these markets have also been impacted by sovereign and corporate ratings downgrades.
- Current uncertainty has also forced a number of insurance and takaful companies to revisit growth strategies, including potential transactions.

Opportunities may appear in the medium to long-term:

- Many interviewees were keen to highlight potential opportunities from the current situation.
- Stimulus packages announced by governments in the GCC, should lead to increased consumption, while increased risk aversion from customers was identified as a driver for protection products such as term life. Other interviewees also suggested that reforms could potentially lead to greater private sector participation in welfare and result in increased use of compulsory insurance schemes.

> **" Takaful is highly sensitive to the current unrest as most companies are young. They are also focused primarily on the affected markets."**
> - GCC Executive

> **" The political unrest has definitely impacted expansion plans of a number of growing players."**
> - Malaysia Exec

> **" The recent turmoil in Egypt and parts of the Middle East has affected the takaful industry, but long-term opportunity remains strong."**
> - GCC Exec

Key Considerations

Maintaining stakeholder confidence is key:

- During challenging times, it is essential that confidence is maintained with all stakeholders. Executive management should be identifying and explain business risks, enhancing reporting lines and actively engaging with internal talent and regulators.

Source: Corporate interviews, Ernst & Young analysis

Evolving Regulations

Recent economic events have resulted in continued regulatory intervention and evolution

Commentary and Contributing Factors

Regulations vary significantly and continue to evolve:

- Further regulatory changes are impacting key takaful markets.
- Noticeable examples include stricter solvency requirements taking effect in Saudi Arabia after an initial grace period. The UAE has issued regulations specific to the takaful industry, including the appointment of a central Shari'a committee similar to that seen in Malaysia. This is in addition to the 2007 insurance law and recently issues insurance regulations covering solvency, investment and technical reserves. Bahrain meanwhile has issued bancassurance regulations restricting the number of banks that insurance and takaful operators can distribute through.
- Interviewees agreed that new regulations were a positive development. However, there were some reservations, particularly over product approvals and the restrictions this placed on innovation.
- Meanwhile in Malaysia, Bank Negara is in the process of implementing risk-based capital (RBC) requirements for takaful operators and has issued new guidelines covering the valuation of liabilities, financial reporting and operational framework. FRS 101 covering presentation of financial statements on a combined basis has also been introduced.

Consolidation in the GCC:

- Regulatory authorities across the GCC have advocated consolidation in the insurance industry, although this stance is yet to result in significant M&A activity beyond that seen with international insurance companies.
- A number of interviewees also pointed out that many operators were not attractive targets for M&A.

> **“ Regulatory change is very difficult to anticipate”**
> - GCC takaful executive

> **“ Restrictive regulations make it very difficult to differentiate…products are homogenous”**
> - GCC takaful executive

> **“ If the regulator wants consolidation, then why are they still authorizing rights issues?”**
> - GCC takaful executive

> **“ The problem is that many of these companies are better off going into runoff”**
> - GCC takaful executive

Key Considerations

Anticipate regulatory change:

- A consultative approach will be key to directing and anticipating regulatory change across markets.

Source: Corporate interviews, Ernst & Young analysis

Misaligned Costs

Challenging market conditions have exposed inflexible and misaligned cost bases

Commentary and Contributing Factors

Unrealistic targets for business growth:

- The business case of many takaful operators was developed in the context of bullish market conditions. Operators that have been launched in the last two years have instead been faced with soft markets and comparatively modest rates of growth.
- For many interviewees, this shift in business environment exposed a significant cost overhang and has proved problematic for operators trying to build market share in very competitive markets.

Effectively managing the cost base:

- The fee based nature of a takaful operators' revenues makes active cost management key to ensuring sustainable growth in the policyholders fund. Interviewees acknowledged difficulties in aligning costs to wakalah fees in deteriorating market.
- The majority of takaful operators are not large enough to support expertise and competence across locations. In order to compete against more established insurers, interviewees acknowledged the need to centralize functions, particularly within country. Claims (excluding first notification of loss - FNOL), low-touch underwriting, actuarial and some areas of finance all have the potential to be centralized if appropriately supported by processes and technology.

> **" We have had to right-size operations…we probably overload ourselves with expertise not needed."**
> - GCC Takaful Executive

> **" The success of takaful lies strictly in its cost management…Earning operating revenue via fees, it is pertinent to spend within the allocated percentage."**
> - Malaysian Takaful Executive

> **" We have tried to bring together functions where appropriate, to reduce cost."**
> - GCC Takaful Executive

Key Considerations

Be more cost competitive then your peers:

- Soft market conditions and intense competition place great strain on the operations of insurance and takaful operators. In order to right size, it is key to develop a clear understanding of the composition of your cost base and its drivers. It is then possible to identify, through benchmarking costs and efficiency across functions, possible areas for improvement.

Source: Corporate interviews, Ernst & Young analysis

Limited Financial Flexibility

Financial flexibility has fallen down the risk agenda, but new regulations and increased socio-political risks will impact capital needs

Commentary and Contributing Factors

Market downturn has created financial constraints:

- Solid returns are key to ensuring financial flexibility. Takaful operators in the GCC have been more adversely impacted by the downturn then their conventional and Malaysian counterparts.
- Poor results have been further compounded by increased sovereign risk and recent socio-political uncertainty across the MENA region. Such circumstances could make further capital raising challenging.

Recent developments will impact future capital raising:

- Interviewees acknowledged that more stringent solvency requirements, particularly in Saudi Arabia and UAE, will force some insurance and takaful operators to revisit current capital.
- A recent successful IPO and capital raise was however identified as a positive trend.

Prudent use of retakaful:

- Retakaful is a key source of financing for takaful, especially for GCC-based operators. Its prudent use requires standard review and acceptance of all providers, thorough creditworthiness and the use of brokers with a solid track record.

> **" Recent solvency and investment regulations will have a significant impact on existing businesses"**
> - GCC Takaful Executive

> **" The recent IPO has show that there are still pockets of capital willing to invest in takaful"**
> - GCC Ratings Executive

> **" Our loss ratios are good, so we have carefully revisited our reinsurance program and providers"**
> - GCC Takaful Executive

Key Considerations

Review and enhance capital planning process:

- Careful consideration of new regulations and effective capital planning is key to ensuring future business expansion can be met.
- Boards to actively direct strategic initiatives including mergers and consolidation and ensure financing is readily available.
- Prudent usage of retakaful.

Source: Corporate interviews, Ernst & Young analysis

Key Strategic Issues

Key business risks can be mitigated through proper planning and effective strategy execution. Role of Boards and senior leadership team will be instrumental

Mitigating Key Strategic Business Risks

1 Managing competition

- Takaful needs to focus on customer segments that are attracted by an Islamic proposition. Personal lines and family takaful are priorities.
- Access to more lucrative commercial lines requires further differentiation around service quality, broker propositions and technical underwriting capabilities.

2 Developing talent pools

- Long-term incentive schemes are key to enhancing retention and reducing key-person-risk. Identifying and recognizing internal talent is key.
- Partnerships and outsourcing should remain considerations, particularly in the short and medium term, to help gain cost-effective access to specialist expertise.

3 Managing socio-political uncertainty

- During challenging times, it is essential that confidence is maintained with all stakeholders.
- Executive management should be identifying and explain business risks, enhancing reporting lines and actively engaging with internal talent and regulators.

4 Responding to regulatory change

- If unanticipated, regulatory change can be a significant risk to existing businesses. A consultative approach is key to directing and anticipating these changes across markets.
- Understanding the practical implementation of regulations is another important consideration.

5 Achieve Cost Competitiveness

- Soft market conditions and intense competition place great strain on operations.
- It is key to develop a clear understanding of your cost base and then identify, through benchmarking costs and efficiency across functions, possible areas for improvement.

6 Creating financial flexibility

- Careful consideration of new regulations and effective capital planning is key to ensuring future business expansion can be met.
- Boards to actively direct strategic initiatives and ensure financing is readily available.
- Prudent usage of retakaful.

Source: Ernst & Young analysis

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- Takaful operators face a highly competitive market place with significant business risks
- The need to transform operating performance is crucial for survival
- The four key drivers of customer reach, operational agility, cost competitiveness and stakeholder confidence will help operators compete for growth

Competing for growth

Takaful operators and insurance companies face a highly competitive market place with significant business risks

" Almost 70% of all respondents believe competition is the biggest threat to their company's performance with new entrants, more distribution channels and restrictions on working capital available to them "

" Over 75% of respondents believe the political instability and social unrest being seen in the MENA region will have some form of impact on the takaful industry over the coming 12 months "

" 70% are concerned about the lack of profit contribution coming from the underwriting performance "

Our findings have shown that takaful operators are under intense competitive pressure, which is augmented by other key business risks.

Holistic solutions are required to address these multiple challenges. The end game will be to effectively engage with customers in the most cost efficient way.

" 70% of respondents believe they have misaligned costs which are impacting their efficiency "

" Regulators are evolving and repositioning their requirements at a faster pace then ever before. Takaful operators will need to adapt quickly to ensure they can meet the new regulation and reporting requirements being set in each country "

" Over 60% believe a shortage of operational expertise across underwriting, claims, actuarial and investments will prevent the company from performing to its full potential "

How are high performers responding?

Our research has identified four key drivers which we use as a framework to help you compete for growth

For the past two years, EY has been engaged in a program of research and work with clients as they seek to survive and respond to the downturn. This has led to many thousands of client meetings around the world through our 'Opportunities in Adversity' and 'Lessons from Change' programs.

Between September and October 2010, we interviewed some 1,400 companies from around the world and across all sectors. We have identified the "high performers" in terms of both profit and revenue growth and tracked their responses to see if a pattern of successful management action can be found.

Our research indicates that high performers – top quartile growth and profit - are significantly ahead in driving improvement in four critical areas:

The markets you are in determine your opportunity

Your growth is determined by your ability to respond

Your profitability is determined by your pricing and the competitiveness of your cost base

Your value – and ability to fund growth is determined by the confidence of your stakeholders

Achieving the right balance

High performers are ahead on seeking to finding the right balance between the four growth drivers

Where do you sit?

We have observed a range of positions ranging from widespread practice, to best in class - these can be used to benchmark your organisation

	Widespread practice						Best in class
Customer Reach	▸ Broad go-to-market approach ▸ Narrow product/service range broadly targeted ▸ Broad but shallow market footprint ▸ Primary competition through price						▸ Clear segmentation and buyer focus ▸ Broadening of product/service range around existing buyers (e.g. products per customer) ▸ Prioritised and deep market foot print ▸ Reinforced brand and clear unique selling proposition (USP)
Operational agility	▸ Centralised decision-making and control ▸ Fixed working platform and practices ▸ Focus on the organisation ▸ Adhoc innovation process						▸ Accelerated speed of decision making and differential control ▸ Focus on flexible working platform and practices ▸ Focus across the supply chain (e.g. claims) ▸ Advanced innovation management strategy
Cost competitiveness	▸ Standardised pricing ▸ Still focused on cost reduction – especially discretionary spend ▸ Focus on directly controllable costs ▸ Having a siloed approach to funding and capital allocation						▸ Fully informed pricing ▸ Seeking a sustainable cost base through strategic change ▸ Seeking to adopt a holistic cost approach across the supply chain (e.g. claims) ▸ Having a clear strategy to optimise capital
Stakeholder confidence	▸ Fragmented risk functions with compliance mindset ▸ Reactive approach to regulatory change ▸ Comply with reporting requirements ▸ Assumed workforce engagement						▸ Leading on identifying and explaining risk ▸ Anticipating and seeking to influence regulatory change ▸ Enhancing frequency and depth of reporting ▸ Proactive internal engagement strategy

Recommendations

Key issues captured in the report can be addressed by focusing on your customer, operating model and maintaining stakeholder confidence

Addressing Key Strategic Issues

1 Customer Reach

- Identify key customer segments
- Develop innovative products and propositions
- Diversify your product range across multiple lines
- Evolve distribution capabilities to engage with customers when and how they want

2 Operational Agility and Cost Competitiveness

- Undertake a full review of your expense base
- Benchmark your costs against peers
- Identify functions that could be cost-effectively managed through outsourcing and/or centralization
- Develop new distribution channels and evolve operating model

3 Stakeholder Confidence

- Plan ahead and engage with regulators on forthcoming regulatory requirements
- Ensure capital is effectively deployed
- Develop technical capability to maximize underwriting profit and retain rather than cede to retakaful companies

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  - Sample of insurance companies and takaful operators
  - References and acknowledgements

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Report methodology and our interviews

Survey Methodology

- Our survey sought to identify key trends and business risks for the global Takaful industry through in-depth interviews with executives and industry observers.
- These discussions were used to gauge business sentiment and identify key areas for inquiry.
- Interviews were conducted in February and March of 2011 A total of 14 interviews were conducted in five different countries by Ernst & Young staff.
- Interviews centered on three main topics of discussion, namely;
  - Business confidence, demand and supply
  - Mega trends
  - Business risks

Business Risk Ratings

- Ernst & Young subject matter experts from the Middle East, Asia and Europe developed a list of Takaful business risks and contributing factors.
- All interviewees were provided with a list of business risks and requested to rate each to reflect its severity to their respective business over the coming 12 months. Interviewees were also asked to add any additional risks they felt were important.
- The results of this rating process were tabulated and a relative ranking assigned to each. This rank formed the basis for our comparative study with 2010 results.

Business Risks Radar

- The Ernst & Young risk radar is a simple device that allows us to present the top 6 business risks in the Takaful industry.
- The risks at the center of the radar are those that the individuals we interviewed thought would pose the greatest challenge to the industry in 2011.

Business Risk Categories

- The radar is divided into four sections that correspond to the Ernst & Young Risk Universe™ model.
- **Compliance** threats originate in politics, law, regulation or corporate governance;
- **Financial** threats stem from volatility in markets and the real economy;
- **Strategic** threats are related to customers, competitors and investors; and
- **Operational** threats impact the processes, systems, people and overall value chain of a business.

Anonymity and Quotes

- All interviewees were assured of anonymity and minutes documented during our discussions
- Quotations have been used to support arguments made in the report.

Sample of takaful and insurance operators

Takaful operators that contributed data to our sample:

Saudi Arabia
- Allied Cooperative Insurance Group E C
- Sanad for Cooperative Insurance and Reinsurance
- Alahli Takaful Company
- Arabia Insurance Cooperative Company
- Company for Cooperative Insurance-Tawuniya
- SABB Takaful
- Gulf Union Cooperative Insurance Company
- Saudi Indian Company for Cooperative Insurance
- Saudi IAIC Cooperative Insurance Company
- Saudi Fransi Cooperative Insurance Company
- Saudi Arabian Cooperative Insurance Company
- AXA Cooperative Insurance Company
- Al Sagr Company for Cooperative Insurance
- Amana for Cooperative Insurance Company
- Arabian Shield Cooperative Insurance Company
- BUPA Arabia for Cooperative Insurance
- Gulf General Cooperative Insurance Company
- Saudi Insurance Company
- Trade Union Cooperative Insurance Company

Qatar
- Qatar Islamic Insurance Company

Bahrain
- Takaful International Company
- Solidarity

Insurance companies that contributed data to our sample:

Kuwait
- Al Ahleia Insurance Company
- Gulf Insurance Company
- Warba Insurance Company

Qatar
- Qatar Insurance Company
- Doha Insurance Company

Bahrain
- Al Ahlia Insurance
- Bahrain Kuwait Insurance Company
- Bahrain National Insurance

Sample of takaful and insurance operators

Takaful operators that contributed data to our sample:

Malaysia

- CIMB Aviva Takaful Berhad
- Etiqa Takaful Berhad
- Hong Leong Tokio Marine Takaful Berhad
- HSBC Amanah Takaful (Malaysia) Sdn Bhd
- Allied Cooperative Insurance Group E C
- MAA Takaful Berhad
- Prudential BSN Takaful Berhad
- Takaful Ikhlas Sdn. Bhd.

UAE

- Abu Dhabi National Takaful Company PSC
- Dar Al Takaful
- Methaq Takaful Insurance Company
- Islamic Arab Insurance Company (Salama)
- Takaful Al Emarat – Insurance

Insurance companies that contributed data to our sample:

Malaysia

- Lonpac Insurance Bhd
- Allianz Malaysia Berhad
- PacificMas Berhad
- Manulife Malaysia
- MNRB Holdings Berhad
- Jerneh Asia Berhad
- Kurnia Asia Berhad
- MAA Holdings Berhad
- Pacific & Orient Berhad

UAE

- Abu Dhabi National Insurance Company
- Al Ain Ahlia Insurance Company
- Al Buhaira National Insurance Company
- Al Dhafra Insurance Company
- Al Fujairah National Insurance Company
- Al Khazna Insurance Company
- Al Sagr National Insurance Company
- Al Wathba National Insurance Company
- Arab Orient Insurance Company
- Arabian Scandinavian Insurance Company
- Dubai Insurance Company
- Emirates Insurance Company
- Green Crescent Insurance Company
- National General Insurance
- Oman Insurance Company
- Sharjah Insurance Company
- Union Insurance Company

References and Acknowledgments

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- Annual Insurance Statistics 2009 - Bank Negara Malaysia
- Financial Stability and Payments Systems Report 2009 - Bank Negara Malaysia
- Company Annual Reports (published information for takaful operators)

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