

International Takaful Summit

Credit Quality Of Takaful Operators: Market Trends and Observations

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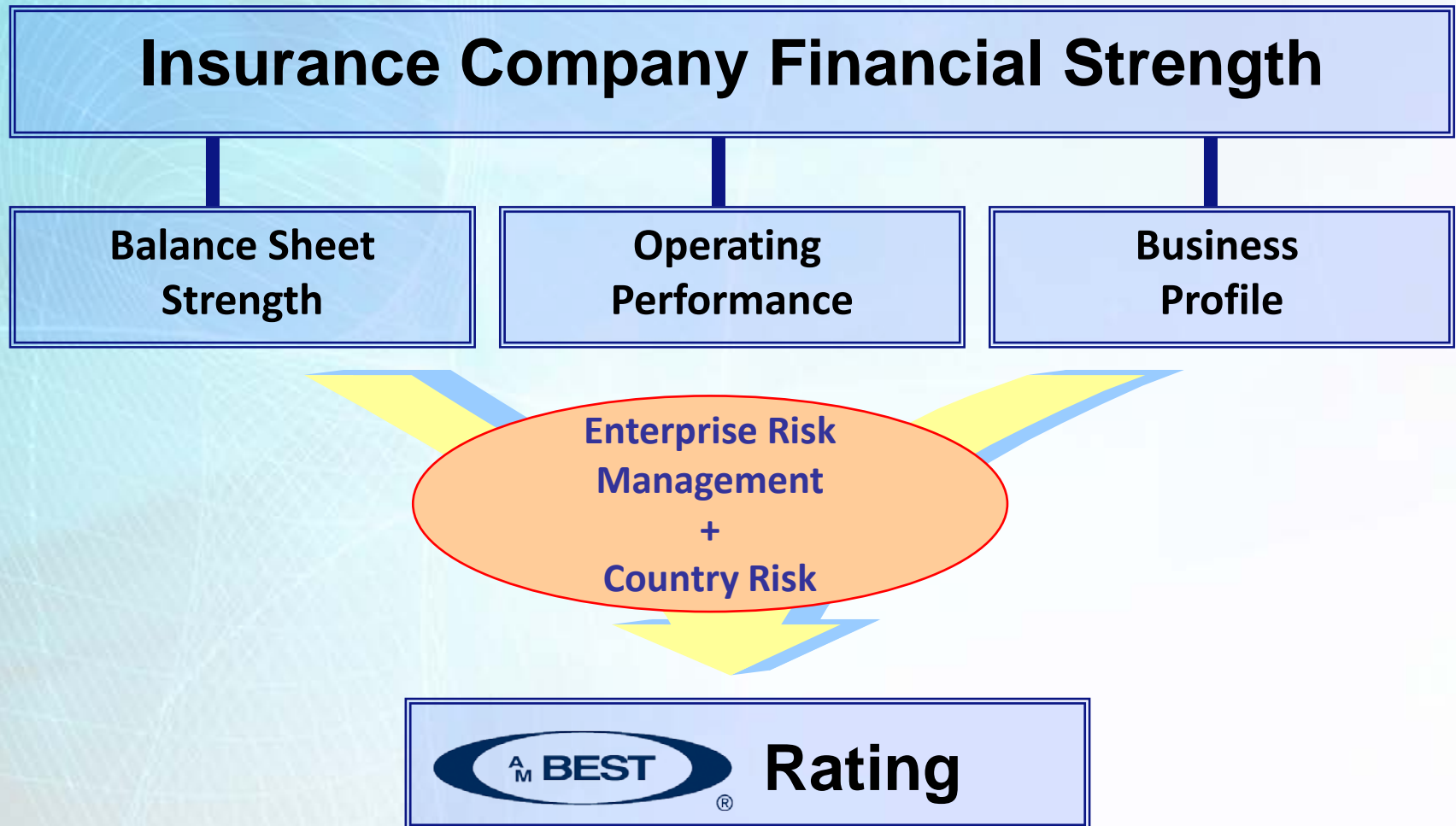


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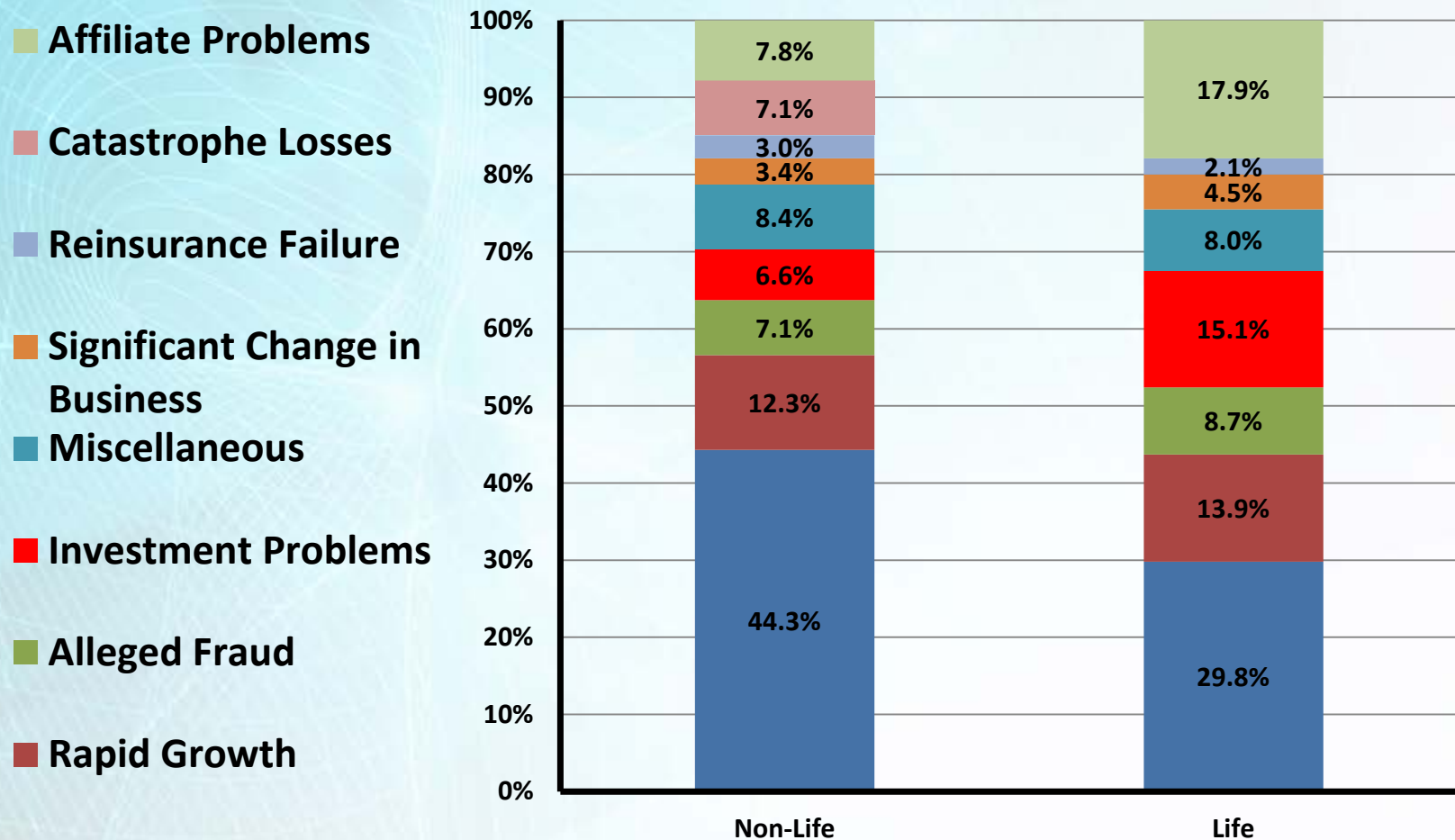
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A.M. Best rating methodology – key rating components



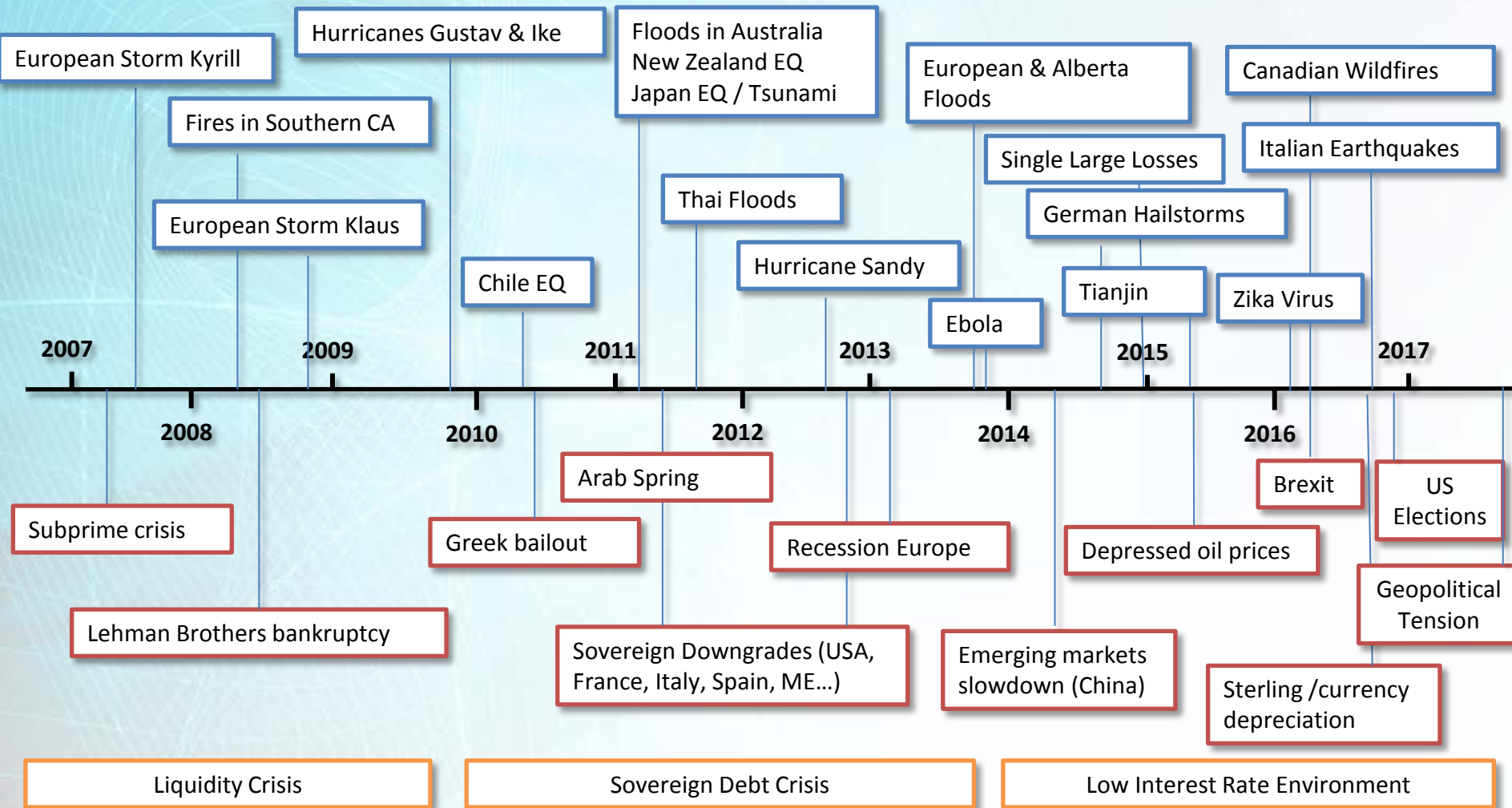
Why do Insurance Companies Fail?



Note: Exhibit percentages are based on companies where the cause of impairment was identified

Source: A.M. Best 1969-2013 U.S. P/C & Life Impairment Review, June 2014

Looking back...



Looking forward...



Insurance

Pricing
Reserving
Premium growth
Nat Cat
Accumulation
Concentration
Pandemic
Terrorism
Man-made disasters
Mortality / morbidity
Competition
Excess capacity
Climate change

Political

Brexit
Elections
Instability / conflict
Change in government policies

Economic

Growth/slowdown
Interest rates
Inflation
Currency
Regulation
Indirect exposures
(e.g. banking, affiliates)

Threats and Opportunities

Other

Globalisation
Energy
Medical advances
Power outages / blackouts

Technology

Distribution
Disruptive innovation
Big data
Block chain
Driverless cars
Cyber
Drones

Oil Prices



Oil prices have fallen to their lowest position over the last decade



Notes:

Europe Brent Spot Price (US Dollars per Barrel). Data to November 07, 2016.

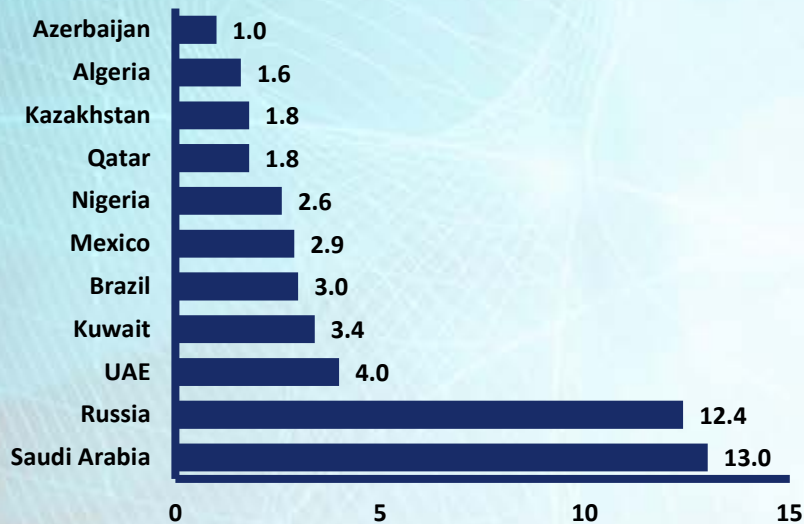
Source: United States Energy Information Administration

Fiscal Pressures

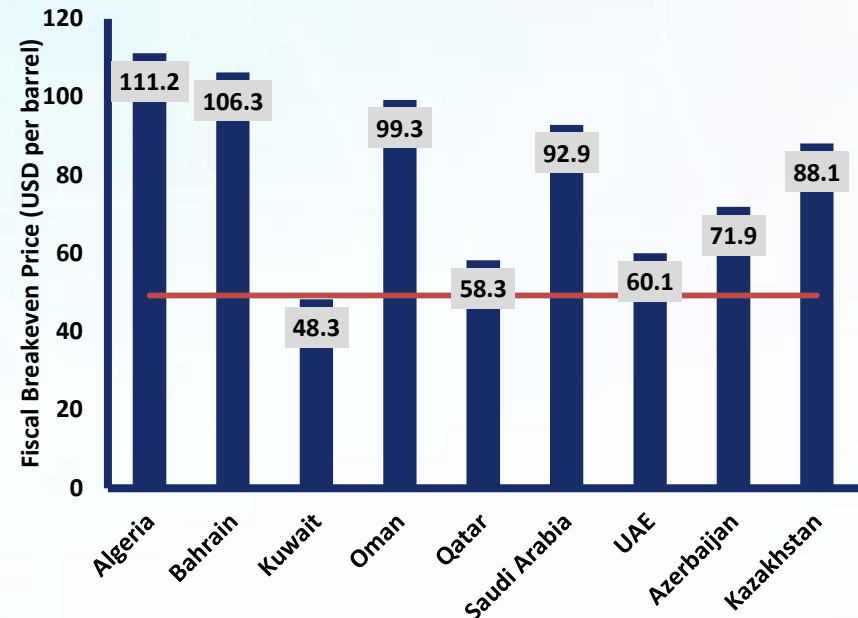


Over 50% of oil production from emerging economies

Contribution to World Oil Production (2015) (%)



Fiscal Breakeven (US Dollar per barrel)



Sources: BP Statistical Review of World Energy, June 2016, International Monetary Fund, IMF Regional Economic Outlook Middle East and Central Asia, October 2016, and A.M. Best research.

Stock Market Performance



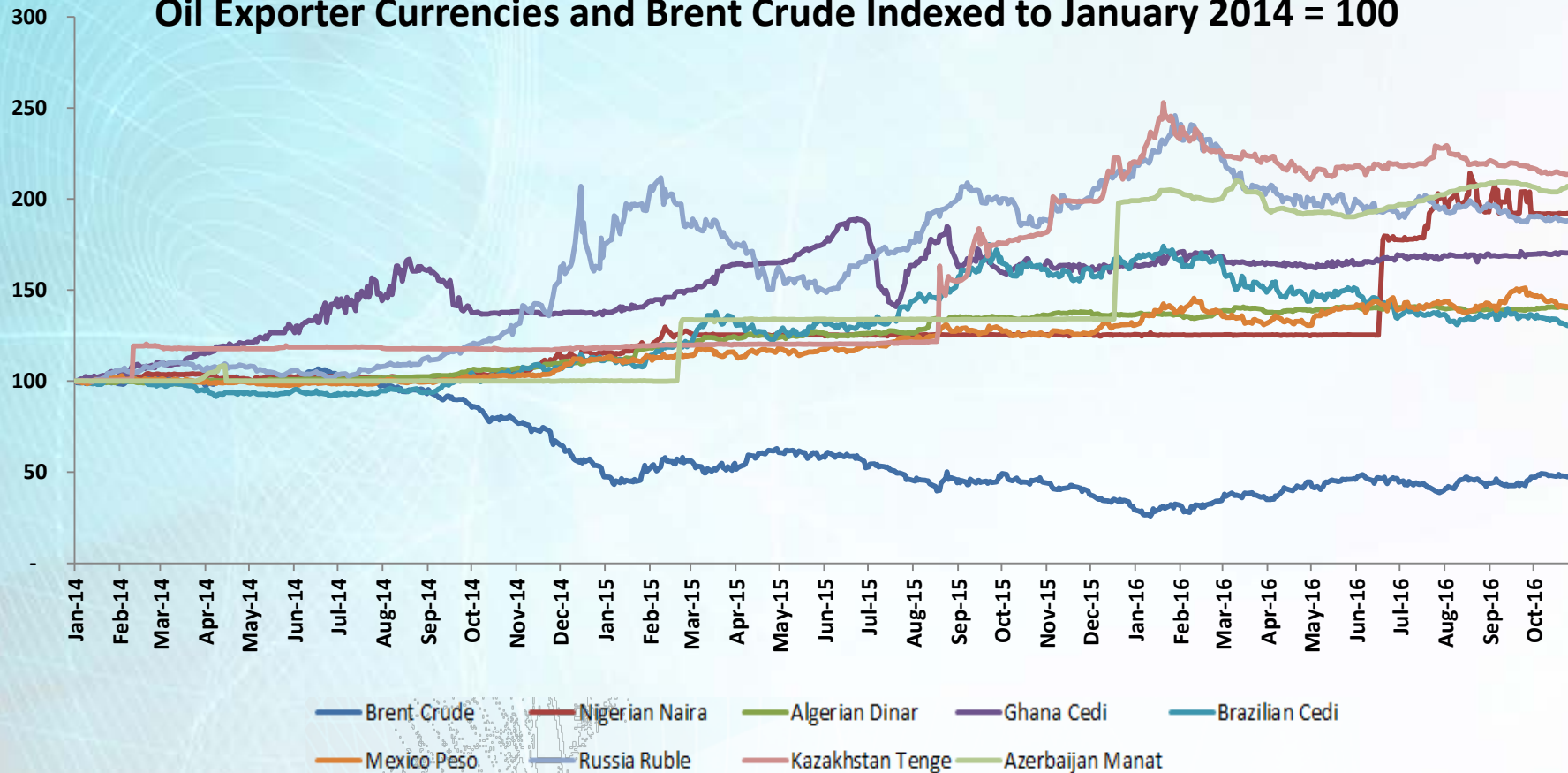
GCC Stock Markets and Brent Indexed to January 2014 = 100



Currency Risk



Oil Exporter Currencies and Brent Crude Indexed to January 2014 = 100

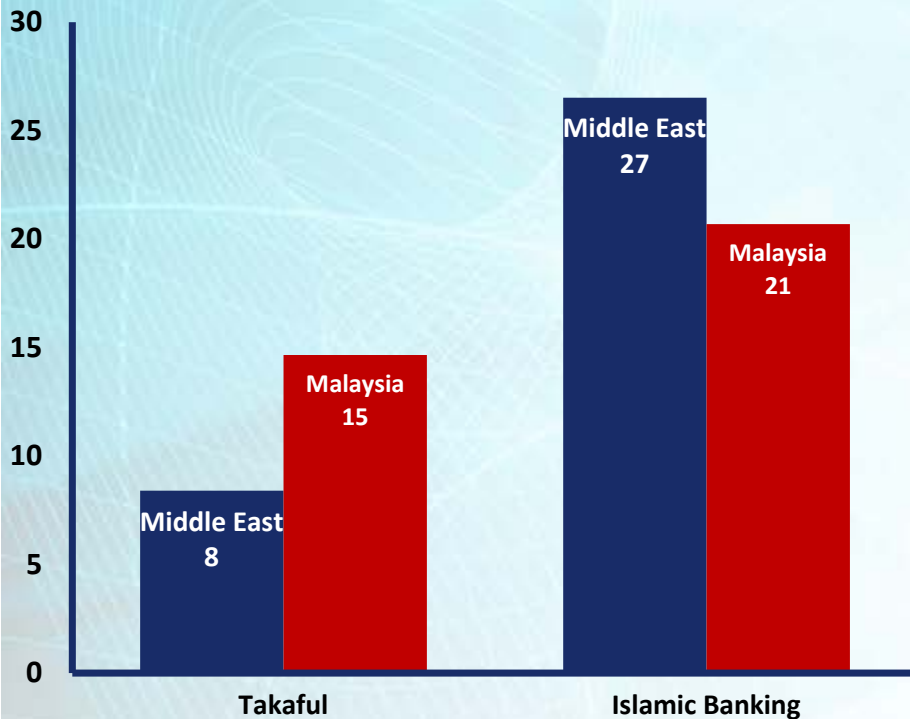


Low oil prices and currency depreciation a major concern for many insurers operating in emerging markets

Financial Services Penetration

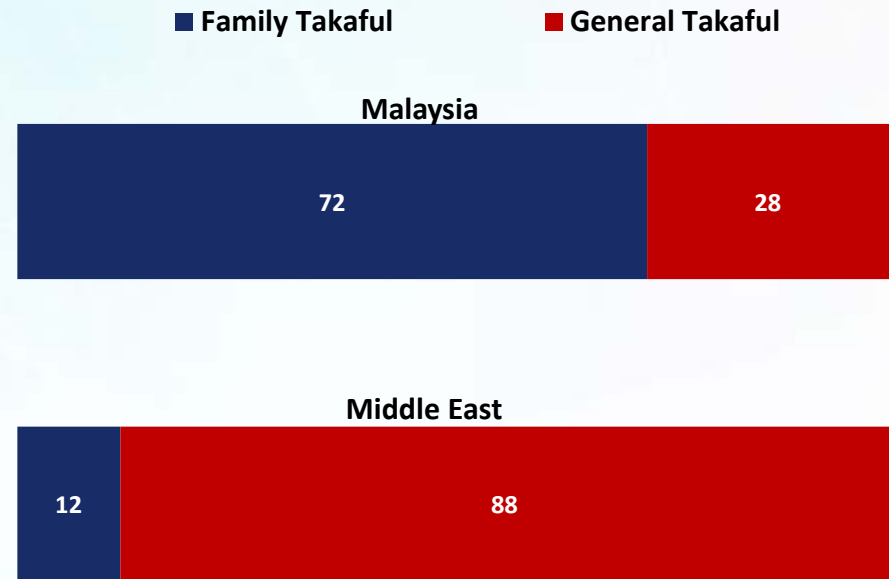


Middle East and Malaysia - Islamic Footprints in Financial Services (2015)
(%)



Sources: Swiss Re sigma No. 4/2015; MENA Insurance Directory 2015, World Bank, Malaysia Takaful Association, EY World Islamic Banking Competitiveness Report 2014, A.M. Best research

Portfolio composition of takaful operators (2015)
(%)

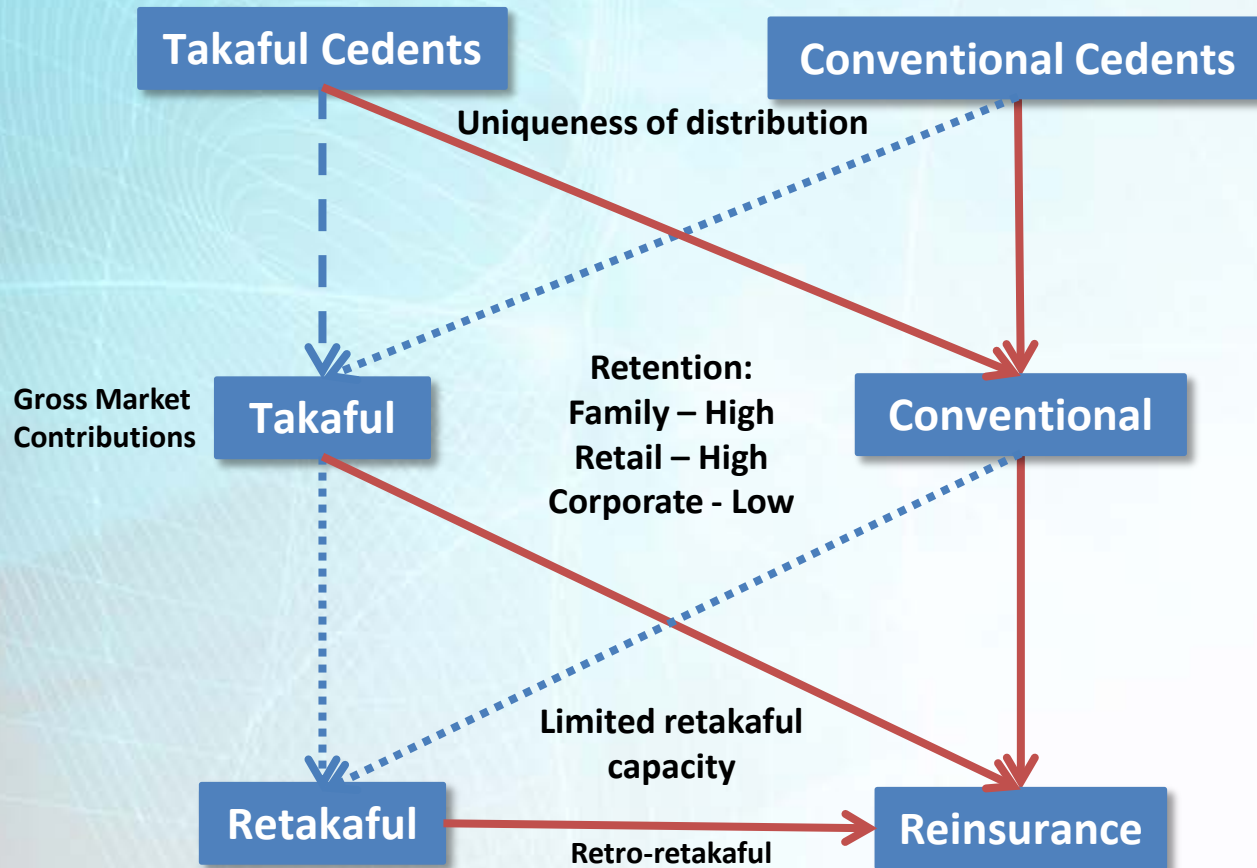


Source: A.M. Best Research

Assessing Market Size



Flow of contributions / premiums through the insurance chain



Reinsurance Utilisation	
Business Line	Net Retention
Family	> 95%
Motor	> 90%
Health	60% to 80%
A&L	40% to 60%
Marine	20% to 35%
Property	< 15%
Engineering	< 15%
Aviation	< 5%
Energy	< 2%

The majority of risks are ultimately transferred to the conventional market, particularly for corporate risks

Market Challenges



Mergers & Acquisitions



Malaysia

- Zurich – MAA Takaful

Others:

- Foreign interest in Syarikat Takaful Malaysia
- Allianz – HSBC Amanah

Conversion to Takaful:

- Al Madina (Oman)
- Arab Scandinavian (UAE)

Interest from International Players for Regional Expansion in Malaysia

Middle East

- First Insurance – Yarmouk Ins (Jordan)
- Bahrain Kuwait – Takaful International (Bahrain)
- Solidarity – Al Ahleia (Bahrain)
- Al Madina – Watania (UAE)
- Merger of Saudi Companies
- New entrants e.g. Orient UNB Takaful
- Runoff – Takaful Re (UAE), Al Barakah (Jordan)

Gradual Market Consolidation in ME – generally Single Market Strategies

UAE: ADNT



Abu Dhabi National Takaful Company (USD Thousands)

	2011	2012	2013	2014	2015	2016
C&S	39,784	45,060	52,656	57,853	65,610	73,778
GWP	53,522	56,583	73,999	80,434	80,830	87,355
NWP	22,454	24,200	29,821	34,648	35,514	40,399
UW Result	6,886	8,130	8,597	7,222	10,882	11,823
Inv Income	1,294	1,278	1,753	2,295	2,063	2,841
S/H Div	-	3,089	3,540	4,357	4,357	4,357
P/H Div	-	-	-	-	-	-
L/R	36%	25%	33%	38%	28%	34%
E/R	40%	37%	31%	38%	36%	30%
C/R	76%	62%	64%	72%	64%	64%
ROE	17%	16%	18%	16%	17%	17%

Source: A.M. Best Research.

UAE: QIIC



Qatar Islamic Insurance Company (QAR Thousands)

	2011	2012	2013	2014	2015	2016
C&S	268,143	277,269	293,875	310,983	341,230	344,569
GWP	210,113	206,507	212,333	235,988	293,103	313,045
NWP	155,809	158,407	157,677	164,759	199,287	205,566
UW Result	26,752	28,064	18,659	30,251	44,500	41,914
Inv Income	10,784	31,963	54,326	47,672	19,322	12,305
S/H Div	40,500	45,000	52,500	56,250	60,000	60,000
P/H Div	Yes	Yes	Yes	Yes	Yes	Yes
L/R	67%	68%	69%	57%	54%	44%
E/R	13%	14%	19%	18%	21%	21%
C/R	80%	82%	88%	75%	75%	65%
ROE	17%	21%	24%	24%	21%	17%

Source: A.M. Best Research.

Sustainable takaful fund with regular surplus distribution

Business Profile



Takaful Considerations

Competing in the same space as conventional insurers

Many Takaful entrants (new and existing) are finding it difficult to establish themselves

Fragmented markets with intense pricing pressure due to competition

Limited franchise and market position

Uncertainty of competitive advantage over conventional companies

Limited product differentiation

Lack of skilled professionals

Developing a market profile is a key challenge

Operating Performance



Takaful Considerations

Understand the performance and balance of earnings between the shareholder and policyholder funds

Ability to generate surpluses in the policyholder fund (competition, pricing pressure, high Wakala fees)

Dependence on Qard' Hasan

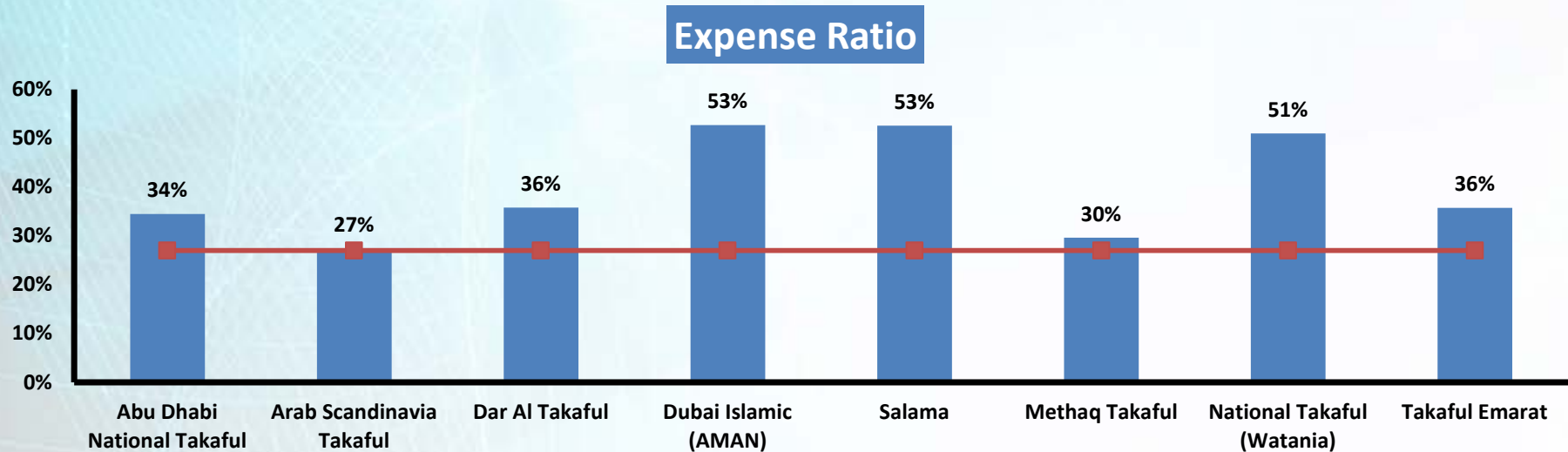
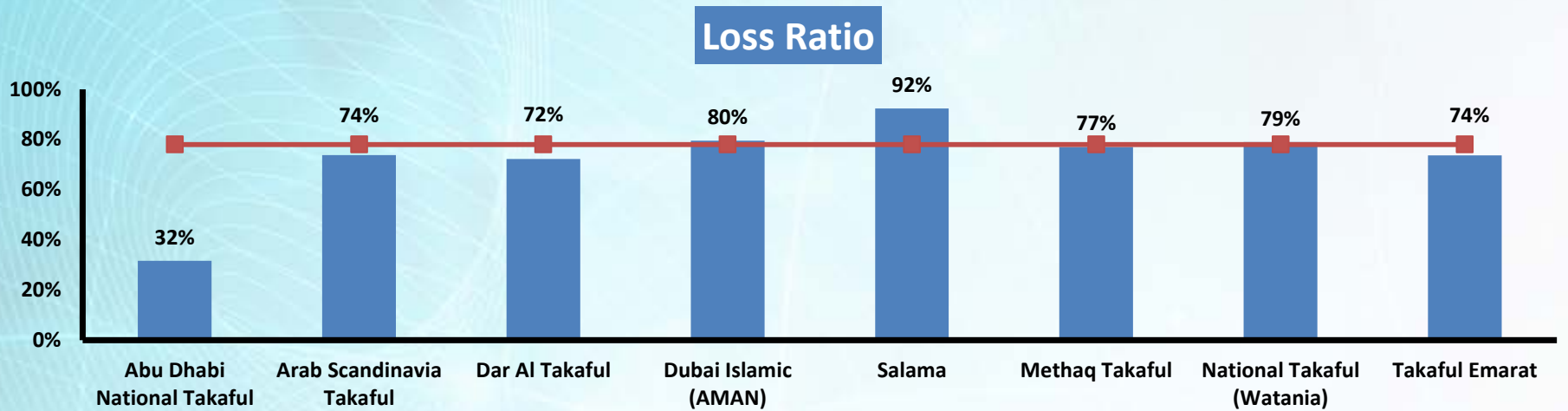
Investment profiles can be concentrated and lack diversification

Lower investment yield due to restrictive investment policy

Over-dependence on investment income

Important to adopt a suitable model so that surpluses are created within the Takaful fund, with an appropriate fee structure

UAE Market Review (5-year average)

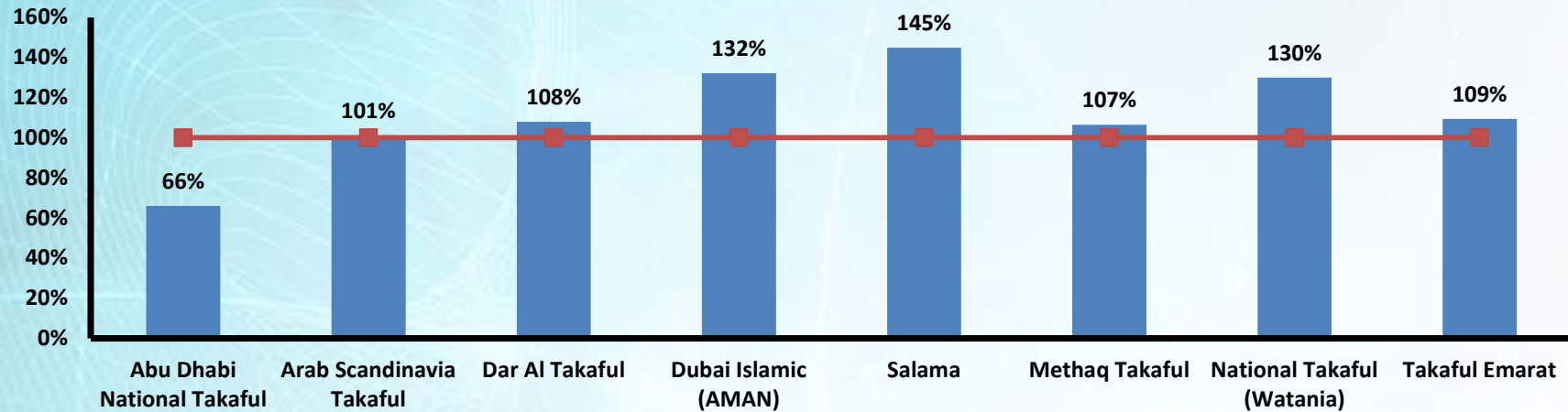


Source: A.M. Best Research.

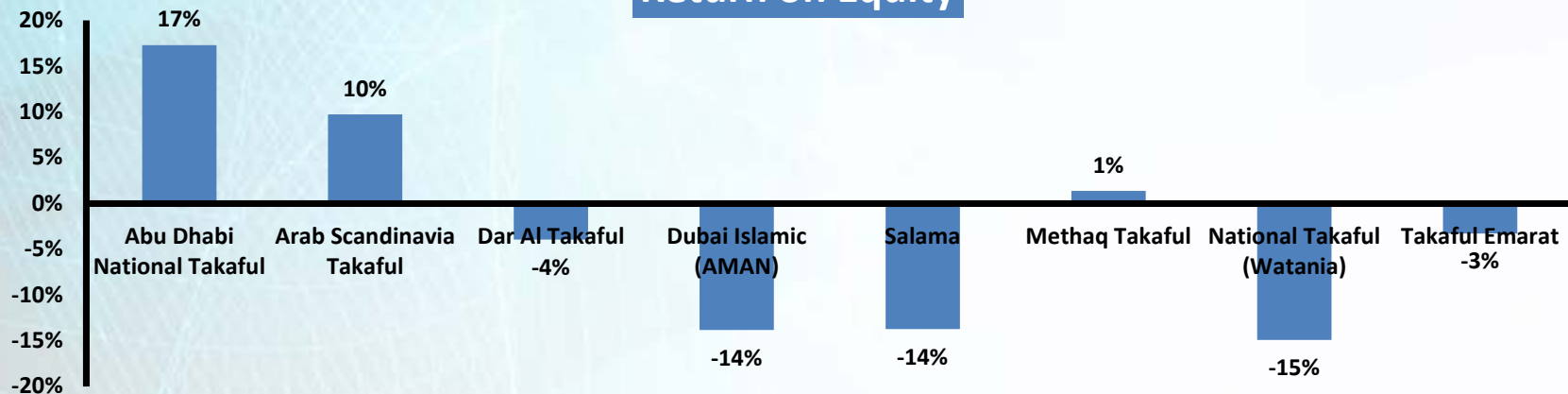
UAE Market Review (5-year average)



Combined Ratio



Return on Equity

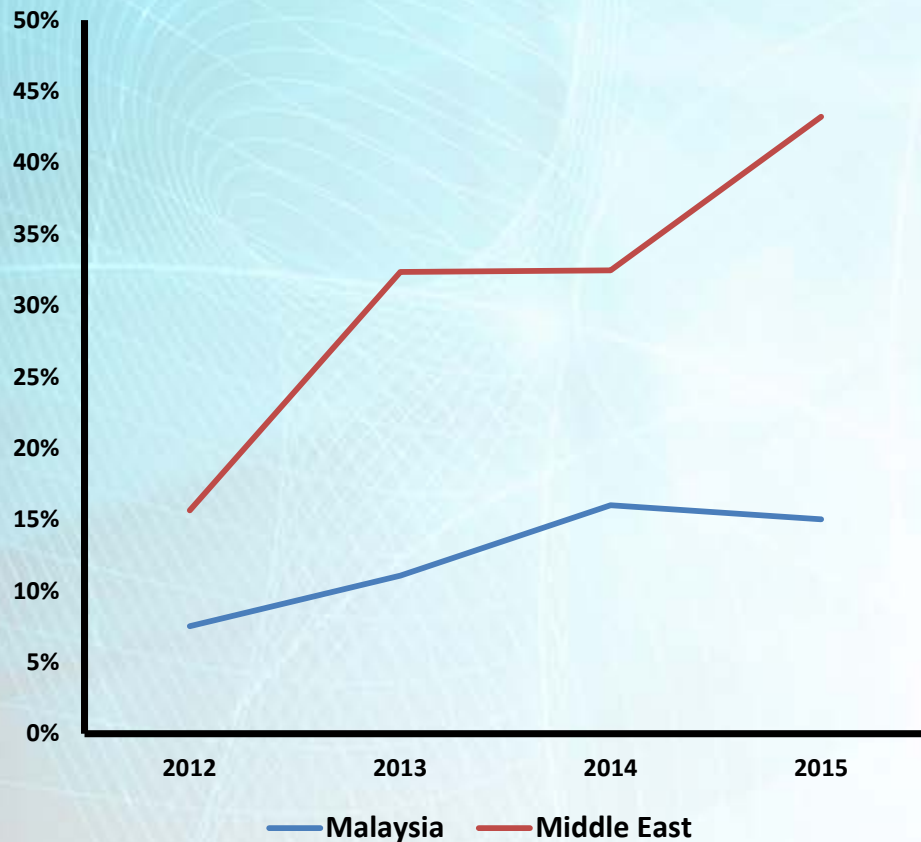


Source: A.M. Best Research.

Wakala Fees



Margin of Wakala Fee over Expenses



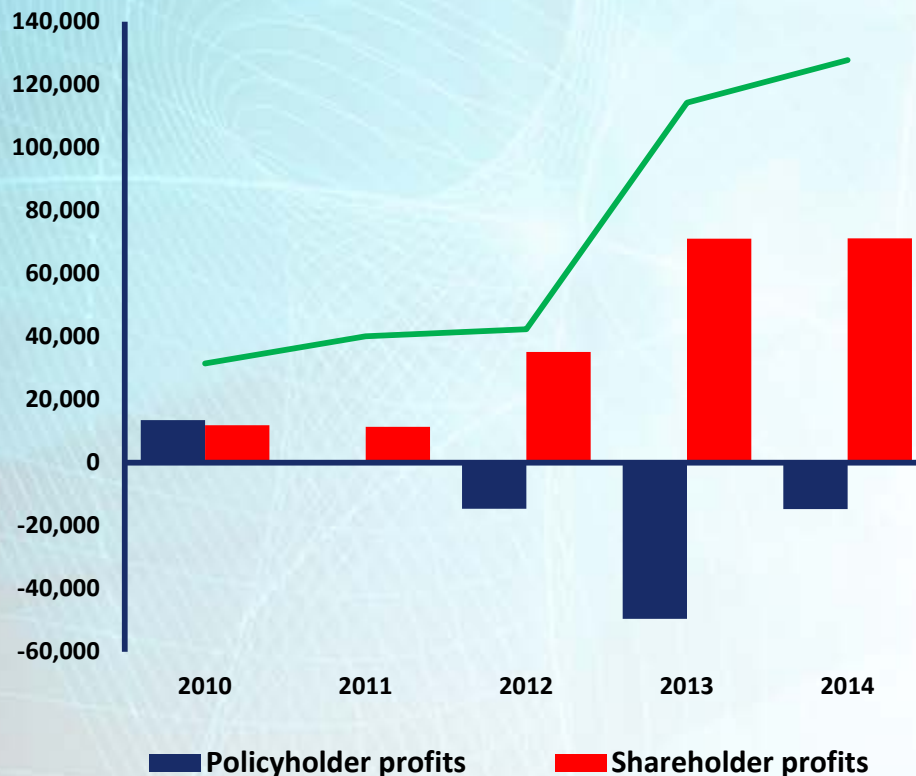
A.M. Best research

- **Wakala fees more prudent in Malaysia over the Middle East**
- **Wakala fees should reflect expenses, plus the cost of capital**
- **Wakala fees can distort the actual underlying underwriting performance**
- **Growing divergence between Wakala fees and actual expense – excessive fees charged to policyholder funds**
- **High wakala fees create greater pressure on performance and higher dependence on Qard' Hasan**

Balance of Earnings



Middle East: Balance of Earnings Between Shareholder and policyholder Funds



- Shareholder funds are generating profit whereas policyholder funds are in deficit
- Accumulated deficit of policyholder funds continues to rise
- Increasing dependence on Qard' Hasan

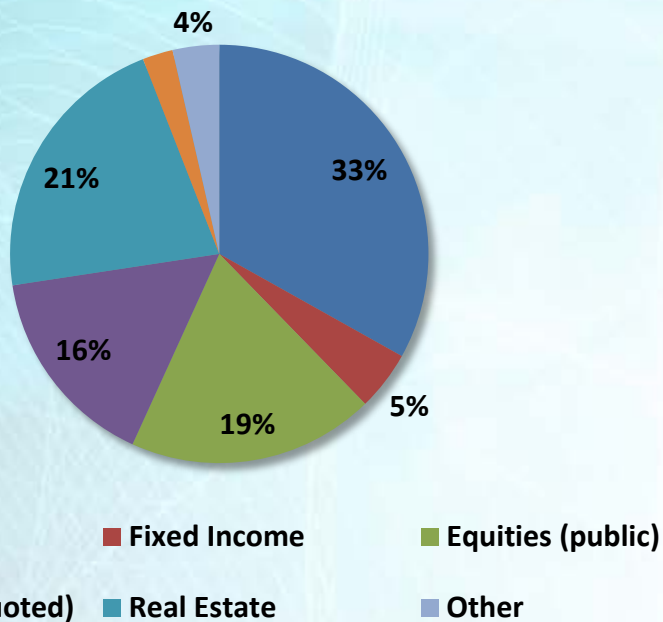
Suitable model and appropriate fee structure are critical to the sustainability of the model

A.M. Best research

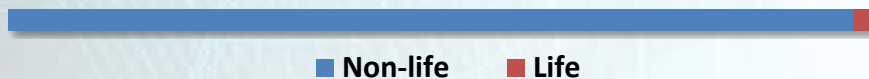
Investment Composition



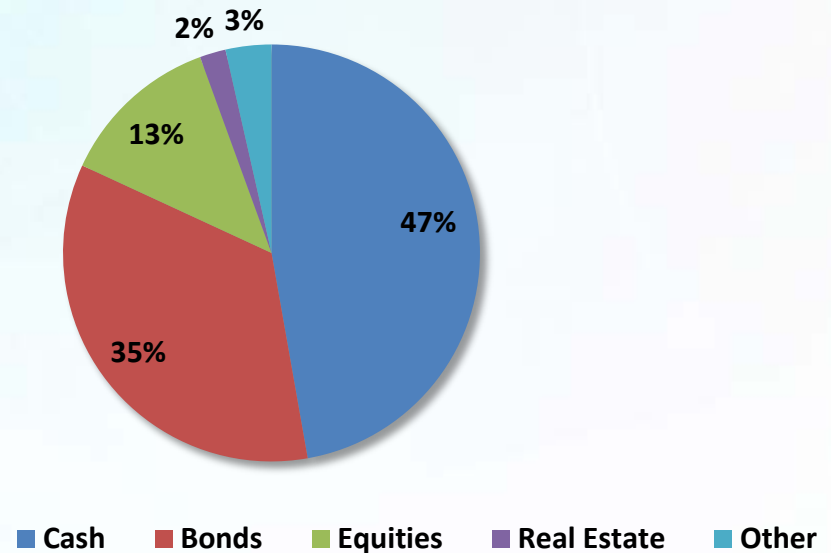
**Middle East Takaful Asset Distribution
year-end 2015**



Non-Life/Life Split by Gross Premium Written



**Malaysia Takaful Asset Distribution
year-end 2015**

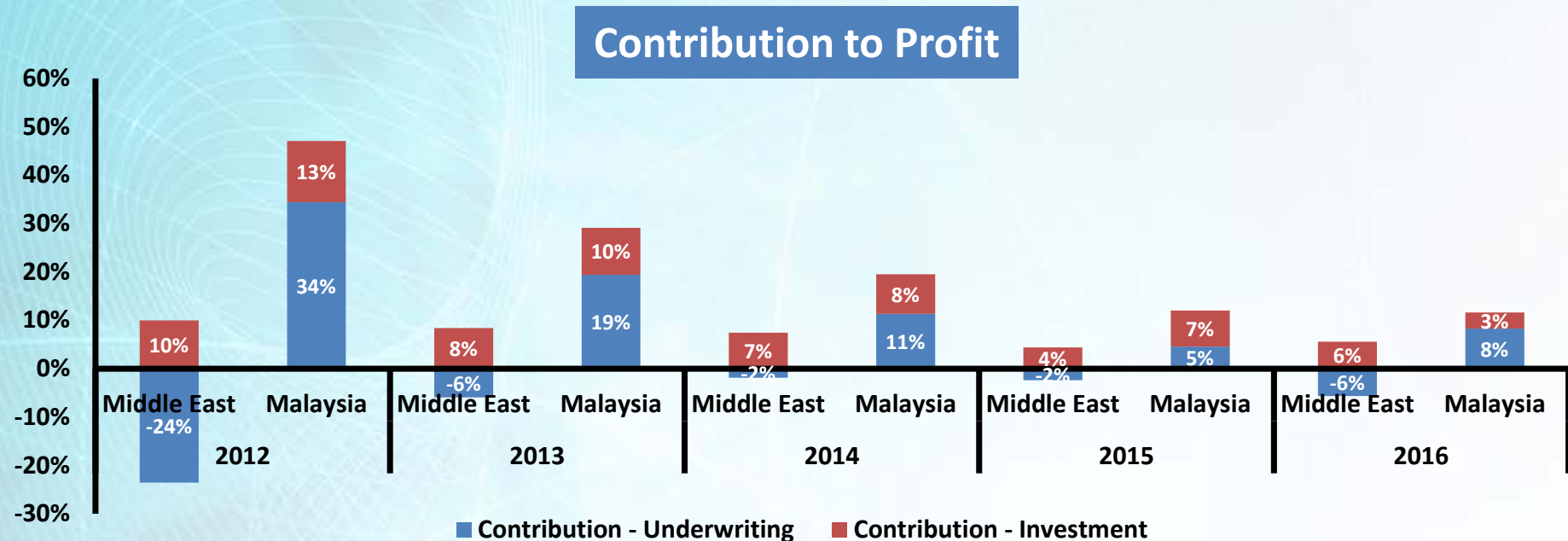


Non-Life/Life Split by Gross Premium Written



Source: Public Financial Data and A.M. Best Research

Earnings Dependent on Investment Income



MENA: Weak technical performance highlights dependence on investment income

Malaysia: Underwriting performance is marginal; however earnings supplemented by steady investment income

Balance Sheet Strength



Takaful Considerations

Strength of regulatory framework is a key component

- **Commitment from shareholder fund to policyholder fund**
- **Permanence of Qard' Hasan**
- **Uniformity of regulation**

Strength of Takaful fund can be limited due to:

- **Low surplus accumulation**
- **High wakala fees charged to Takaful fund**
- **Over dependence on Qard' Hasan to cover deficit**

Insufficient Retakaful capacity

Unleveraged balance sheets

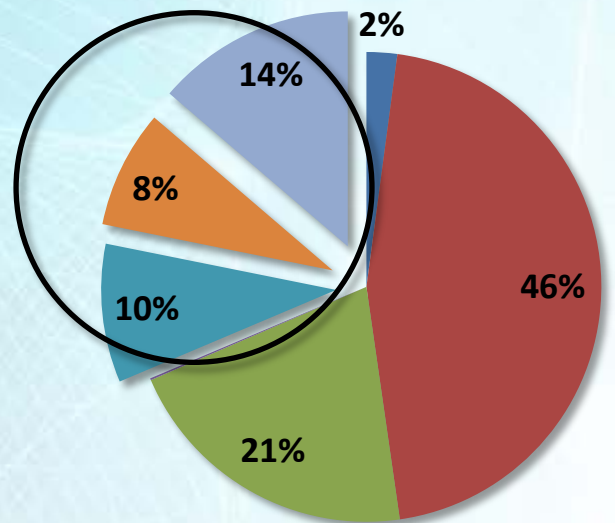
Adequacy of loss reserves

Capital Requirements



Best's Capital Adequacy Ratio Sources of Risk to MENA Takaful Operators (excludes Saudi Cooperatives)

Risks
Associated
with
Underwriting



■ Fixed Income Securities Risk ■ Equity Securities Risk
■ Real Estate Risk ■ Credit Risk
■ Net Loss and LAE Reserve Risk ■ Net Premium Risk

Source: Public Financial Data and A.M. Best Research incorporating the BCAR model.
Risk is represented as Gross Required Capital in the BCAR model.

- New operators with insufficient scale
- Policyholder fund assumes underwriting risk
- Shareholder fund assumes investment risk
- Investment profile create volatility in risk-adjusted capitalisation.
- Capital buffers required to absorb fluctuations in asset prices
- Malaysian operators have more balanced risk profiles

Saudi Market



Volatility in capital position – many companies below regulatory requirements

Company	2011				2016			UW Leverage	
	Paid up capital	Income	Capital & Surplus		Paid up capital	Income	Capital & Surplus	2011	2016
Tawuniya	750,000	1,298,858	2,048,858		1,000,000	1,927,525	2,927,525	188%	291%
Medgulf	800,000	373,505	1,173,505		1,000,000	- 47,480	952,520	187%	376%
BUPA	400,000	122,430	522,430		800,000	1,227,054	2,027,054	458%	462%
Solidarity	555,000	- 84,280	470,720		555,000	- 308,784	246,216	0	125%
SABB	340,000	- 13,797	326,203		340,000	21,201	361,201	242%	147%
United	200,000	117,550	317,550		490,000	- 99,301	390,699	311%	155%
Saudi Enaya	400,000	- 100,425	299,575		200,000	- 28,253	171,747	2%	66%
Trade Union	250,000	44,513	294,513		275,000	22,525	297,525	156%	351%
Malath	300,000	- 19,466	280,534		300,000	- 210,641	89,359	185%	2185%
Al Sagr	200,000	54,921	254,921		250,000	258,880	508,880	98%	58%
Amana	320,000	- 65,472	254,528		320,000	- 198,394	121,606	9%	154%
Arabian Shield	200,000	31,705	231,705		200,000	150,163	350,163	102%	183%
ARABIA	200,000	- 26,199	173,801		265,000	- 20,709	244,291	256%	160%
AXA	200,000	- 29,236	170,764		450,000	49,549	499,549	283%	304%
Gulf General	200,000	- 31,131	168,869		200,000	- 4,227	195,773	306%	109%
Allianz Saudi Fransi	200,000	- 42,006	157,994		200,000	21,354	221,354	556%	252%
Saudi United	200,000	- 45,514	154,486		400,000	35,488	435,488	128%	241%

Source: A.M. Best Research.

Saudi Market



Company	2011			2016			UW Leverage	
	Paid up capital	Income	Capital & Surplus	Paid up capital	Income	Capital & Surplus	2011	2016
Gulf Union	220,000	- 70,906	149,094	220,000	- 73,439	146,561	144%	138%
Chubb Arabia	100,000	40,897	140,897	100,000	126,380	226,380	91%	72%
Al Alamiya	200,000	- 63,684	136,316	400,000	- 69,044	330,956	134%	84%
Al Ahli Tak	100,000	35,593	135,593	166,667	49,040	215,707	395%	489%
Metlife	175,000	- 54,311	120,689	350,000	- 112,915	237,085	2%	83%
Alinmi Tokio Marine	200,000	- 81,225	118,775	450,000	- 158,346	291,654	21%	60%
Weqaya	200,000	- 83,218	116,782	-	-	-	70%	0
Al Rajhi	200,000	- 90,664	109,336	400,000	29,363	429,363	358%	540%
Sanad	200,000	- 92,891	107,109	200,000	- 178,642	21,358	226%	44%
Buruj	130,000	- 44,871	85,129	250,000	65,065	315,065	100%	184%
Salama	100,000	- 15,009	84,991	250,000	- 56,824	193,176	253%	359%
Wataniya	100,000	- 16,604	83,396	200,000	- 14,649	185,351	173%	183%
Saudi Arabian	100,000	- 35,602	64,398	250,000	48,117	298,117	589%	234%
Saudi Indian	100,000	- 48,876	51,124	205,000	- 83,926	121,074	163%	504%
Al Ahlia	100,000	- 67,339	32,661	320,000	- 215,608	104,392	635%	213%
Allied	100,000	- 80,929	19,071	200,000	- 74,601	125,399	823%	102%
Al Jazira Tak	-	-	-	350,000	28,864	378,864	-	40%

Source: A.M. Best Research.

“Enterprise” Risk Management



A few questions...

What are the main risks or threats to a company?

How does a company control and mitigate risks effectively?

How embedded is Enterprise Risk Management (ERM) throughout the organisation?

How has ERM assisted in decision making?

Risk Management capability should be viewed relative to a company's risk profile

“Enterprise” Risk Management



A few observations...

Given the added complexity of Takaful companies; ERM plays an important role within companies; particularly to gain a competitive advantage over peers

Corporate governance is important, particularly for start-up Takaful companies, given the higher level of execution risks

Companies tend to manage risk on a silo basis. Further integration is required to reach ‘enterprise-wide’ risk management

Risk management is only valuable if it is conducted by company management to protect and strengthen the key fundamentals of the company, and not meet requirements of outside parties

The Right Balance



Balancing growth and profitability is a key challenge

Profitability

Growth

The Right
Balance

Financial Stability

Takaful

- New formations pre-financial crisis
- High exposure to volatile asset classes
- Fierce market competition
- Limited differentiation
- Desire for market share

Growth

- Is growth important for insurers?
- Is it sensible to grow in the current economic environment?
- Are there any opportunities to grow?

Aggressive growth in tough market conditions can lead to weaker credit quality

Catalysts for Future Growth



Sustainability of Takaful model - Value Added Proposition

Distribution

- Access to business

Demonstrate the 'value added benefit' of the Takaful model:

- Emphasise mutuality: alignment of interests between shareholders and policyholders
- Appropriate balance of earnings between shareholders and policyholders
- Wakala fees closely reflect actual expenses
- Lower dependence on Qard' Hasan
- Evidence of surplus distribution

Developments of Shari'a compliant investment markets

- Greater investment opportunities
- Reduced concentration risk

Regulation

- Uniformity across markets
- Improved transparency
- Actively police the market

Demonstrating the financial health of Takaful operators

Quality of Management

A.M. Best MENA Ratings

10 July 2017



Country	Company Name	Issuer Credit Rating	Outlook / Implication
Algeria	Compagnie Centrale de Reassurance	bbb-	Stable
Bahrain	ACR Re Takaful MEA B.S.C. (c)	bbb+	Stable
	Arab Insurance Group (B.S.C)	a-	Stable
	Bahrain Kuwait Insurance Company	a- u	Developing
	Life Insurance Corporation	bbb+	Stable
	Bahrain National Insurance	bbb+	Stable
	FAIR Oil & Energy Insurance Syndicate	bb+	Positive
	Trust International	a-	Stable
	Saudi Arabian Insurance Company	a- u	Negative
	Saudi National Insurance Company	bbb-	Stable
	Solidarity General Takaful	bbb u	Positive
Egypt	Arab Misr Insurance Group	bbb	Stable
	Misr Insurance Company	bbb	Stable
	Misr Life Insurance Company	bbb	Stable
Jordan	Arab Orient Insurance Company	bbb u	Negative
	First Insurance Company	Bbb u	Stable
	ARABIA Insurance Company – Jordan	bbb-	Stable
	Jordan Insurance Company Plc	bbb+	Negative
	Jordan International Insurance Co	bbb-	Stable
	Middle East Insurance Company Plc	bbb-	Stable
Kuwait	Al Ahleia Insurance Company	a-	Stable
	Gulf Insurance Group	a	Stable
	Gulf Insurance & Reinsurance Company	a	Stable
	Kuwait Reinsurance Company KSC	a-	Stable
Lebanon	Al Ittihad Al Watani	bb	Stable
	Arab Reinsurance Company S.A.L.	bbb-	Stable
	ARABIA Insurance Company	bbb	Stable
	Bankers Assurance	bbb	Stable
Morocco	Societe Centrale de Reassurance	bbb	Stable

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Q&A

Mahesh Mistry
Senior Director