

Takaful Provision for Long Term Care Needs



**Session : Providing for Pensions, Annuity
and Healthcare**

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Background

- ❑ The need for Takaful emanated from a need for mutual cooperation to protect against events leading to financial loss
- ❑ Takaful has emerged to an alternative to conventional insurance.
- ❑ Many speakers in the summit have called for the need for Takaful providers to innovate in order to create a niche for themselves.
- ❑ This presentation deals with an opportunity to do exactly that
 - ❑ Fulfill a need which will arise which can potentially be fulfilled by insurance/takaful products
 - ❑ Takaful operators in some countries can take the lead in designing such products.
- ❑ To innovate is not, however, a simple process
 - ❑ It needs a thorough understanding of the need, careful analysis and potential solution for potential issues

Background

- ❑ With respect to events affecting human lives takaful products have focused largely on:
 - ❑ Savings to meet specific needs (education, retirement, marriage)
 - ❑ Protection against death and disability
- ❑ Although products to generate pensions have emerged these have focused very largely on generating a lump sum at retirement
- ❑ Little attention has been paid to a much greater need which is likely to emerge in the future – that arising from people living longer as a result of advances in medical science

The Phenomenon of Ageing

- ❑ A Report on Ageing was prepared by the United Nations in 2002. The report provides a description of global trends in population ageing and includes a series of indicators of the ageing process by development regions, major areas, regions and countries. The report shows that:
 - ❑ Population ageing in recent times is unprecedented, without parallel in human history—and the twenty-first century will witness even more rapid ageing than did the century just past.
 - ❑ Population ageing is pervasive, a global phenomenon affecting every man, woman and child—although countries are at very different stages of the process, and the pace of change differs greatly. Countries that started the process later will have less time to adjust.
 - ❑ Population ageing is enduring: we will not return to the young populations that our ancestors knew.
 - ❑ Population ageing has profound implications for many facets of human life.

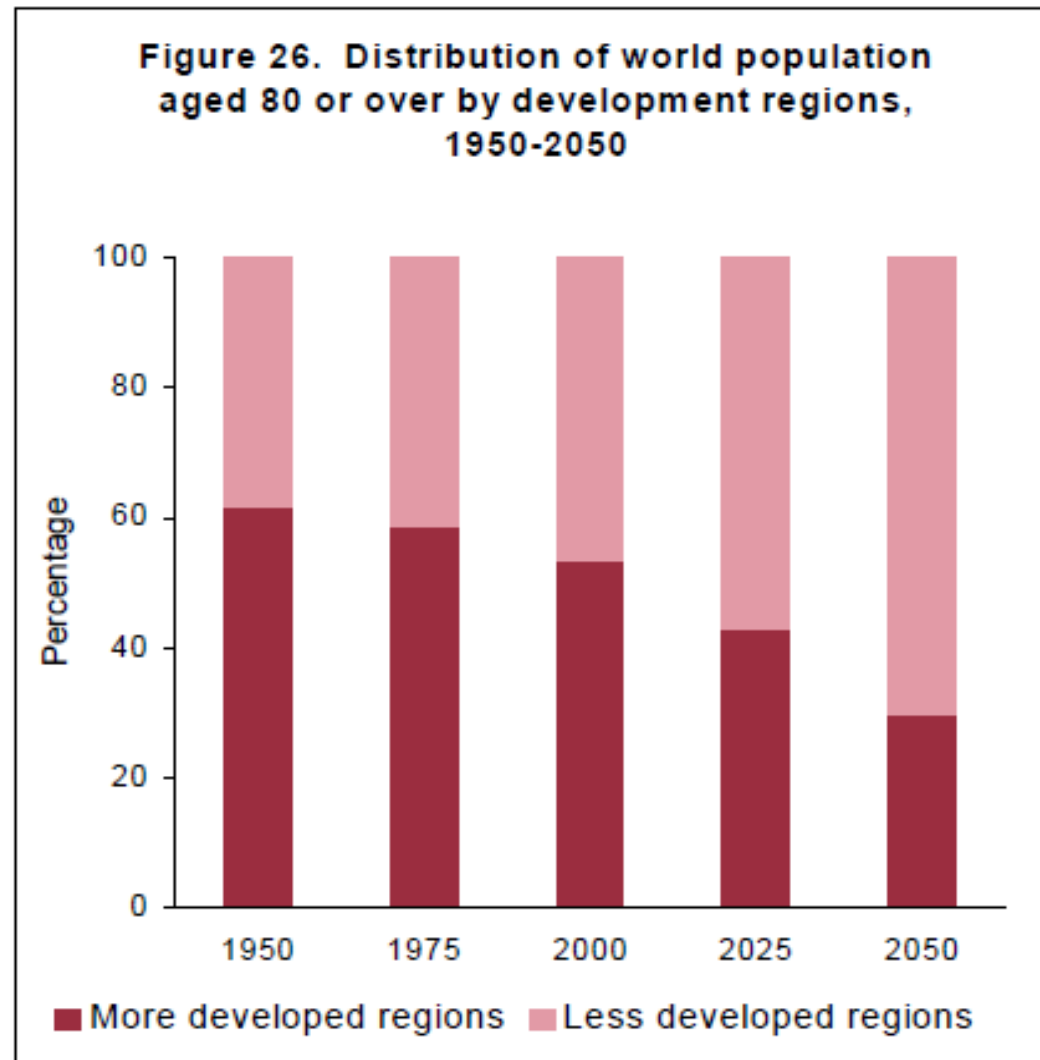
Percentage of World Population at Higher Ages

Age		1950	1975	2000	2025	2050
Total	60+	8.2	8.6	10.0	15.0	21.1
	65+	5.2	5.7	6.9	10.4	15.6
	80+	0.5	0.8	1.1	1.9	4.1
Female	60+	9.0	9.7	11.1	16.3	22.7
	65+	5.9	6.6	7.9	11.6	17.3
	80+	0.7	1.0	1.5	2.5	5.0
Male	60+	7.3	7.5	8.9	13.6	19.4
	65+	4.5	4.8	5.9	9.2	14.0
	80+	0.4	0.6	0.8	1.4	3.1

Source : UN Report on World Population Ageing

<http://www.un.org/esa/population/publications/worldageing19502050/>

Distribution of Aged Population By Region



Solutions

- ❑ Many developed nations have extensive social security systems which provide for the old – albeit to a limited extent.
- ❑ Even in a country like the UK ageing has become a significant issue with a gap opening up between demand for long term care and the supply of funding
 - ❑ A recent report commissioned by the government relating to funding for care and support proposes a number of measures for closing the gap
 - ❑ The recommendations include proposing a greater role for the financial services sector
- ❑ Social security systems in much of the Muslim world tend to deliver very little
 - ❑ Hence the role in these countries for financial services is potentially much greater

Aspects of Old Age Care

- ❑ Old Age Care includes:
 - ❑ Provision of post retirement income – generally pensions
 - ❑ Post retirement medical insurance to pay for medical costs when ill
 - ❑ Long Term Care – simply taking care of old people who cannot take care of themselves even if they are not ill – hence not covered by medical insurance
- ❑ This presentation deals with Long Term Care

Responsibility for Long Term Care

- ❑ In Muslim and other traditional communities the elderly have often been taken care of by their families
- ❑ This pattern is, however, changing, partly due to changing lifestyles but also due simply to lack of capacity
 - ❑ There therefore has to be an alternative
- ❑ There is obviously some responsibility on the state
 - ❑ However in many Muslim societies the state struggles to even provide basic services adequately for the young and healthy
 - ❑ Hence expecting it to provide adequately for the elderly may be unrealistic
- ❑ There is, therefore, a need for those who can afford it to make provision for long term care for themselves
 - ❑ There is obviously an opportunity for Takaful to play a role

Is the Role of Takaful Companies any Different than of Conventional Insurers?

- ❑ Through the summit many speakers / participants referred to the role of Takaful as somehow being different to conventional insurance.
 - ❑ Some mention Tabarru – implying that this is somehow different from a simple risk premium
 - ❑ In conceptual terms there should certainly be a difference
 - ❑ In practical terms there is none
 - ❑ Cross-subsidization of the less fortunate by the more fortunate should certainly be an objective of most civilized societies – especially Islamic ones
 - ❑ This is best done, however, by the state and taxation/social security systems
 - ❑ Given the structure of (and, despite the noble words sometimes said, the practical values of) Takaful operators their roles are to provide risk and investment pooling of their participants in a fair and transparent manner
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Conventional Long Term Care Insurance

- ❑ Conventional long term care insurance has existed in the developed world for some time, and generally covers the cost for providing;
 - ❑ Home Care
 - ❑ Assisting Living
 - ❑ Nursing Home
 - ❑ Alzheimer's Facilities
- ❑ Like other insurance products LTC is also based on the idea of indemnifying the policy holder for the expenses associated with the benefits availed in the form of LTC. The need for LTC services may be the result of an accident or an illness, or may be due simply effects of aging.
- ❑ Based on the covered benefits, the product is structured to fund the future expenses. The technical feature of the product deals more with the funding and investment element than that of contingencies, diseases in this case.
- ❑ The benefit payment structure can be
 - ❑ Fixed income or can be reimbursement of costs;
 - ❑ Be inflation linked or not

Long Term Care Insurance Market

- ❑ Long term care plans are popular in United States, United Kingdom and Canada. In U.S about 60 percent of individuals over age 65 will require at least some type of long-term care services during their lifetime. The average monthly cost in a nursing home is nearly \$5,000 per month (U.S. Department of Health and Human Services, <http://www.cms.gov/partnerships/downloads/LTCdropin.pdf>)
- ❑ Statistics relating to the use of or the cost of third party long term care in the Muslim world (the Middle East, South Asia and South-East Asia) are not easily available.
 - ❑ However some long term care centers do exist and some insurance products also exist (although these tend to focus on medical care)
- ❑ However it is clear that social structures are changing and therefore care facilities are being developed in response to the demand emerging from this change. We can therefore expect that there will be an increasing number of people needing long term care.

Takaful and Long Term Care

- ❑ As it has done for other needs, takaful has great potential to provide an alternative to conventional insurance
- ❑ There can be both group and individual products
 - ❑ Group products providing an extension of employer schemes to include coverage for long term care
 - ❑ Possibly including an element of employee contribution while in service
 - ❑ Individual schemes along the lines of family takaful retirement plans
 - ❑ Albeit with a more complex post retirement component
- ❑ There are, however, certain complexities which need to be considered – some being generic and some relating to the nature of Takaful

Generic Issues

- ❑ These are issues which are common to both conventional and takaful entities operating in regions where Muslims are in majority, which is incidentally where the vast majority of takaful operators exist
 - ❑ Lack of adequate statistical data is perhaps the most important impediment
 - ❑ Is likely to lead to initial providers of long term care products being very conservative in pricing
 - ❑ Price volatility in some countries
 - ❑ Expected changes in the near future in International Financial Reporting Standards relating to Insurance Contracts (the IASB website states that this is expected to be issued within 2011)
 - ❑ Will require expected profitability (“residual margin”) to be recognized over the future duration of the contract
 - ❑ Residual margin includes a “risk adjustment”
 - ❑ Will be very difficult to determine for classes such as long term care without adequate experience

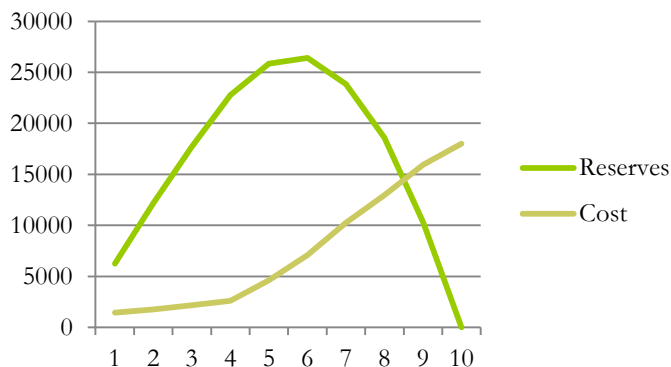
Takaful Specific Issues

- ❑ Takaful specific issues include:
 - ❑ Serious capacity issues with Takaful Operators (some companies in Malaysia excepted)
 - ❑ There is a lot of talk about governance, controls and systems but very little “walk”
 - ❑ Development of innovative products will require serious upgradation in capacity (actuarial, systems, governance)
 - ❑ Issues arising from the long term nature of the cover and the need to retain and invest reserves resulting from the increasing pattern of expected costs
 - ❑ Difficulty in getting retakaful cover – given the long term nature of the cover required (akin to long term disability)

Issues Arising Related to Reserving

(1) Age	(2) Annual Per Capita Expenditure
0	\$3,432
20	\$1,448
40	\$2,601
65	\$10,245
85	\$17,071

Source : Health Services Research Paper (2004)
Figures in constant US\$ as of year 2000



- ❑ The above table illustrates the increasing cost of medical care by age.
- ❑ This has implications in that reserves are created in the early years and released in later years
- ❑ Problems will arise due to :
 - ❑ A need for determining reserves for surplus distribution
 - ❑ Margins will be retained for the long term to deal with uncertainty which will mean that early exits will get lower surplus shares than due
 - ❑ Lack of availability of suitable assets for investing reserves in

Solutions to Issues

- ❑ Solution to these issues need to be found and are beyond the scope of this presentation
- ❑ There is an interesting thought – though – which could be used to find a solution to the issue of uncertainty prevalent in covering long term risks of this nature (in fact can be used to find solution to even other needs which involve uncertainty)
 - ❑ If uncertainty were to be priced in a “guaranteed” way (this includes cases where the takaful operator effectively guarantees the rate through the qard mechanism) then the product may be priced out
 - ❑ The product could be priced in a pure (defined as without qard) basis allowing the takaful operator to either make calls for additional contributions or reduce benefits in the event of adverse experience

Thank You

