THE INTERNATIONAL TAKAFUL SUMMIT

17-18 February 2015 - The Savoy Hotel - London

Middle-East Takaful
Re-thinking the model

By: Chakib Abouzaid

GROUPMED
Reinsurance Brokers Limited

(Regulated by DFSA)

Agenda

- MENA insurance industry & Takaful statistics;
- Takaful companies performances:
  - Bahrain, the GCC pioneer;
  - UAE case study;
  - KSA cooperative market;
- The perpetual Qard issue: Rethinking the model;
- Conclusion & Outlook

Different Definitions = Different Statistics

- **Three definitions:**
  - ✓ **Large definition, including KSA and Iran (W.I.I.D): USD 17.5 billion;**
  - ✓ **2nd definition: excluding Iran (E&Y): USD 9.5 billion;**
  - ✓ **Strict definition: excluding Iran and KSA cooperative companies: USD 4.5 – 5 billion;**
- **Takaful vs. World insurance in 2011:**
  - ✓ **World insurance : USS 4,595,123 million (Sigma)**
  - ✓ **Takaful : USD 17,445.9 million (WIID)**
  - ✓ **Takaful represent: 0.4% of the world insurance premium!**

After 37 years, the impact of Takaful on the world insurance is negligible, because of the very low penetration and non ability of the industry to become a sizeable player.

GROUPMED Reinsurance Brokers Limited

Source: Swiss Re +Arig

Arab Insurance Markets

USD Million

2012(*)	Country	Total GPI	Non Life % of GPI	Life % of GPI	Penetration %	Density USD
GCC	Bahrain	688.00	74.86	25.14	2.1	557
	Kuwait	952.00	80.89	19.11	0.5	323
	Oman	947.00	90.71	9.29	1.1	321
	Qatar	1,471.00	95.65	4.35	0.7	697
	KSA	6,360.00	95.69	4.02	0.9	221
	UAE	7,959.00	75.71	24.29	2.0	872
	Sub-Total	18,377.00	85.33	14.67		
Levant	Egypt	1,851.00	56.78	43.22	0.6	23
	Jordan	686.00	90.38	9.62	2.0	105
	Lebanon	1,475.00	69.20	31.80	3.2	341
	Sub-Total	4,012.00	66.73	33.27		
North Africa	Algeria	1,440.00	92.88	6.80	0.8	39
	Morocco	3,180.00	67.83	32.17	3.0	97
	Tunisia	830.00	84.83	15.78	1.8	77
	Mauritania	72.70	98.90	1.10	n/a	n/a
	Libya	325.80	98.30	1.70	0.3	42
	Sub-Total	5,848.50	76.82	23.18		
Other Arab	Iraq	16.40	93.90	6.10	n/a	n/a
	Palestine	318.34	98.30	1.70	n/a	n/a
	Sudan	329.50	98.27	1.73	0.4	7.97
	Syria	84.10	91.68	8.32	0.3	7.17
	Yemen	84.10	91.68	8.32	0.2	3.38
	Sub-Total	905.14	93.04	38.81		
Grand Total		29,142.64	84%	16%		

General Remarks On Arab Insurance Markets

- Total premium: USD 29 billion;
- Penetration 3% and above in Morocco and Lebanon; 2% and above in 5 countries;
- High density in GCC (UAE & Qatar)
- Low density in non oil producing countries, except Algeria
- Insurance is driven by Medical and Motor compulsory and government spending;
- In most of the markets Life insurance is growing, especially in UAE, Morocco, Lebanon and Egypt, but yet to develop in other countries;
- “Low penetration, rising risk awareness and favorable demographics provide a positive outlook for life insurance.” (Sigma)

Arab markets are growing fast, especially CGG; however, density, penetration and Life are still small comparatively to developed countries;

Arab World Takaful/Cooperative Insurance Industry 2010- 2012

Region	Country	in USD million				
		2010	2011	2012 Est.	(2010-11)%	(2012-11)% Est.
North-Africa	Libya	1.50	2.00	2.20	33.33	10.00
	Mauritania	0.40	0.40	0.40	0.00	0.00
Sub-total		365.30	337.30	288.90	33.33	10.00
GCC	Bahrain	102.20	119.80	125.80	17.22	5.01
	Kuwait	133.10	138.90	169.30	4.36	21.89
	Qatar	259.80	273.80	318.90	5.39	16.47
	Saudi Arabia	4,370.00	4,933.70	5,455.00	12.90	10.57
	UAE	818.40	909.40	1,028.00	11.12	13.04
Sub-total		5,683.50	6,375.60	7,097.00	12.18	11.32
Levant	Jordan	45.90	49.50	28.40	7.84	-42.63
	Egypt	58.90	72.50	98.20	23.09	35.45
	Lebanon	1.20	1.20	1.20	0.00	0.00
	Syria	29.10	19.10	13.20	-34.36	-30.89
	Palestine	7.90	11.40	12.50	44.30	9.65
Sub-total		143.00	153.70	153.50	7.48	-0.13
Others	Yemen	19.30	22.30	24.20	15.54	8.52
	Sudan	363.40	334.90	286.30	-7.84	-14.5
Sub-total		382.70	357.20	310.50	-6.66	-13.07
Grand Total		6,574.70	7,223.80	7,849.90	9.87	8.67
Source: WIID						

Current Takaful Landscape

- *Models: are almost the same since the beginning, except for the Waqf, which is limited for the time being to Pakistan and South Africa;*
- *The main model adopted by CBB and generalized to other countries is Wakala + Mudharaba;*
- *Takaful companies: their number has increased in the past 10 years to reach around 200, including windows*
- *Cooperative companies:*
  - *Sudan: by law, all the companies must be Islamic;*
  - *KSA:*
    - *SAMA do not consider Takaful, but a cooperative model instead, with limited surplus sharing;*
    - *Few companies are "pure Takaful" (Al Rajhi, ACIG, Solidarity…)*

Takaful Regulations In The Arab World

- *Sudan: first country to adopt cooperative model;*
- *Bahrain: pioneer in regulation; sophisticated legal framework and deficit close follow-up, amended in 2014;*
- *KSA: 2004 cooperative law;*
- *UAE: new regulatory framework*
- *Morocco: new rules, …but no companies;*
- *Tunisia: three companies, no specific regulation yet;*

- *Accounting standards applicable to Takaful: AAOIFI and IFRS and/or local accounting standards*

Arab Takaful /Cooperative Insurance Markets

- Although KSA is not a Takaful, but cooperative , we have deliberately decided to include it;

- In 2012, Takaful / cooperative represented roughly 25% of the Arab GWP; without KSA, Takaful contributions were 2.2 billion in 2012, or 8.5% only i.e. Takaful is still a small segment in the Arab world; Why?

  - Even if Takaful started in Sudan in 1979, it didn't expand in the Arab world until 2000;
  - Takaful is not yet perceived as different from Conventional;

- Takaful is growing faster; new companies looking for market share;

Takaful Contributions Vs. Conventional GWP

USD

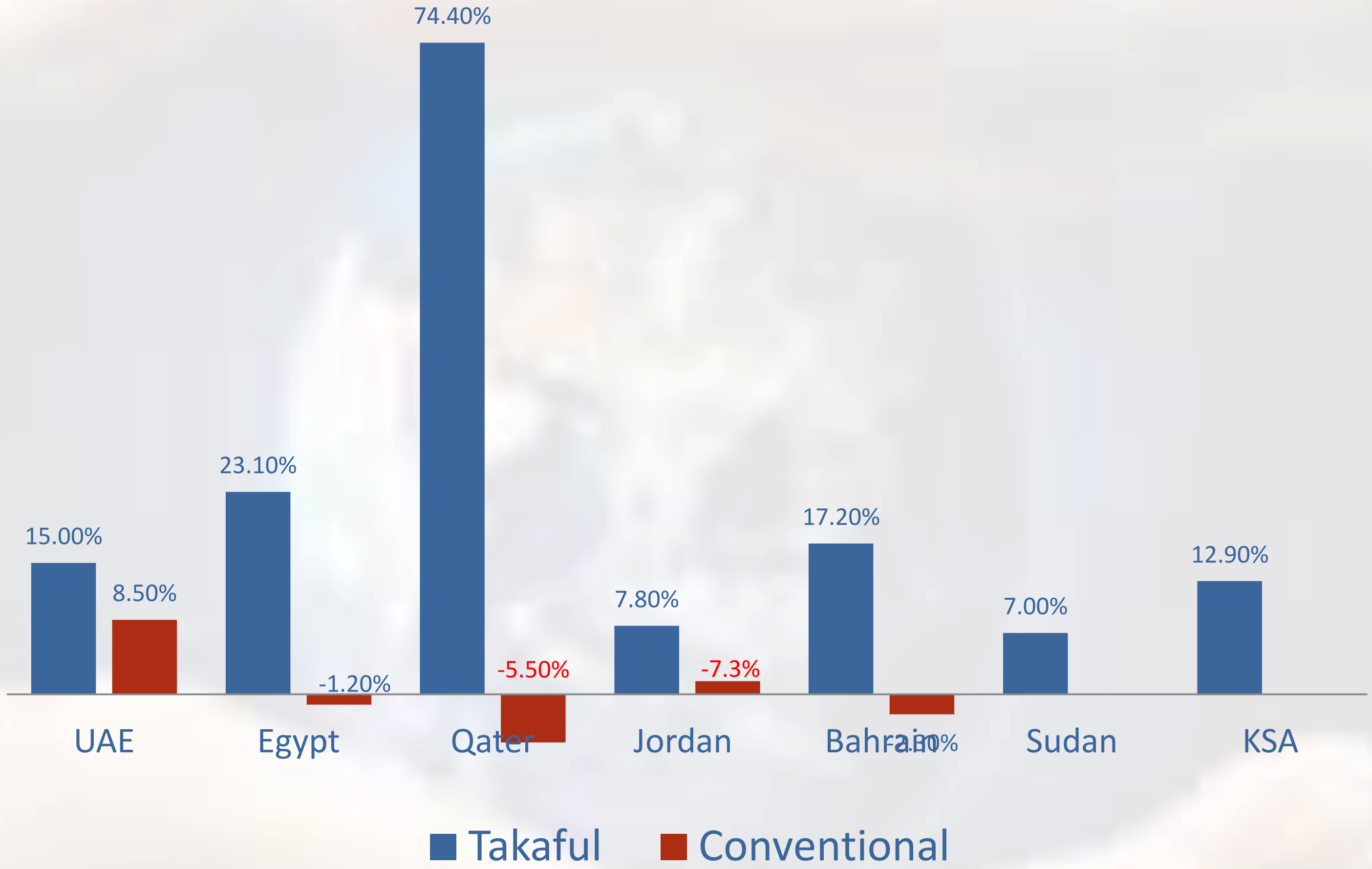
Country	Total Gross Premium Income vs. Total contributions						
	2007	2008	2009	2010	2011	2012	CAGR % / annum
Kuwait Conv.			441.2	494.3	559.3	613.4	9.73
“ Takaful			127.7	133.1	138.9	169.3	10.4
U.A.E. Conv.	3,895.8	4,974.6	5,455.5	6,003.7	6,513.8	6,931	12.98
“ Takaful	369.2	542.1	639.6	818.4	941.2	1,028	29.74
Bahrain Conv.			430	457	426.3	562.2	7.69
“ Takaful			102.2	102.2	119.8	125.8	5.9
Egypt Conv.	1,088.3	1,392.6	1,567.1	1,612.8	1,592.7	1,752.8	10.17
“ Takaful	6.1	6.2	29.3	58.9	72.5	98.2	251.64

Except Bahrain, Takaful contributions are growing faster comparatively to conventional; while Takaful has grown by 14.50% between 2009 and 2012, conventional grew by 10.11%; considering the fact that Takaful are new comers and growing very fast the first years.

Source: Takaful Re

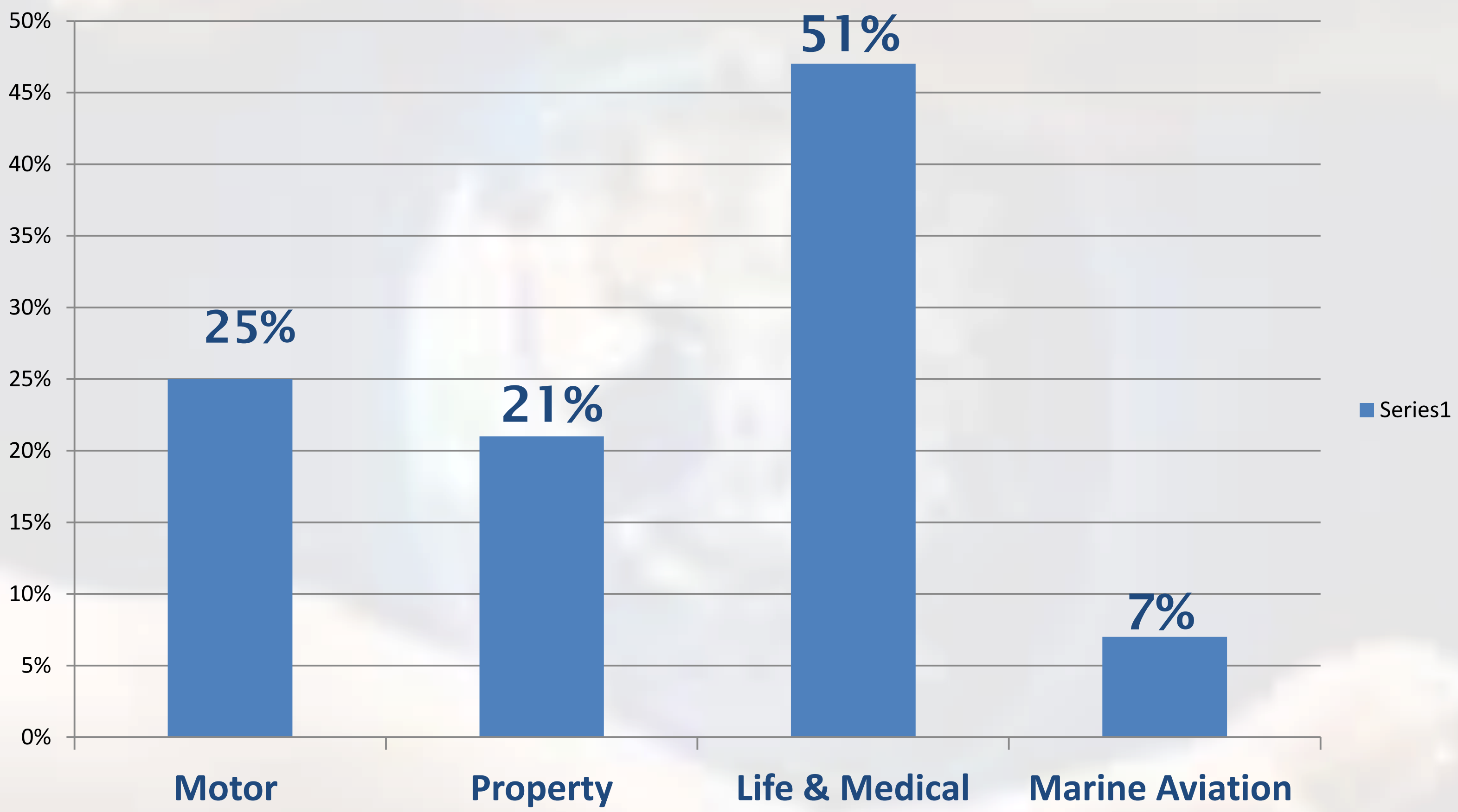
GROUPMED Reinsurance Brokers Limited

Takaful Growth Vs. Conventional



Source: Takaful Re

Takaful/Cooperative By LOB 2011



Source: Takaful Re

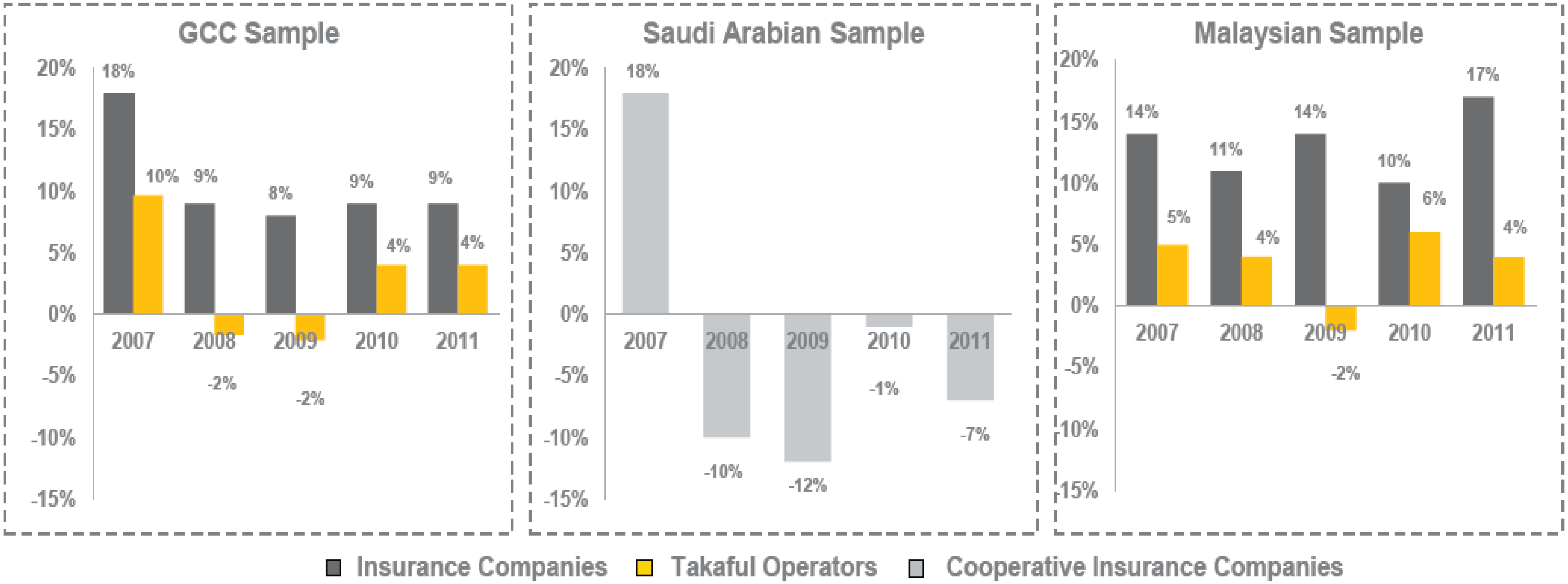
Technical / Accounting Issues

- Unbalanced portfolios:
  - ✓ Medical represent more than 40%, mainly in the GCC (KSA 53%);
  - ✓ Motor represents 25% over all and over 40% for many companies;
  - ✓ Family Takaful is still negligible;
- High L/R + High Wakala → Accumulated deficit
  - ✓ Treatment of Qard Al Hassan still an issue;
  - ✓ Insolvency risk for some KSA cooperative operators and some Takaful;
- Conventional mindset and practice : Reputation risk
- Low investment income;
- ROE lower comparatively to conventional

Takaful vs. Conventional ROE

- Shareholder returns on insurance operations are higher than Takaful shareholder returns, both in the GCC and Malaysia. Insurers, having more long term / short term investment options, have made higher investment income than Takaful operators. Their scale, longer operating history and market relationships have allowed them to build a more profitable business mix while Takaful has relied predominantly on retail business and relatively fewer product classes.
- Saudi cooperatives have struggled for profitability. Most Saudi operators are new in the market and are absorbing their pre-incorporation costs. The market is dominated by three players with the remaining operators incurring high expense ratios and loss ratios in their effort to quickly build market share.

Average return on equity for a sample of Takaful operators, insurance companies and cooperatives



Sample: No. of Companies	2007	2008	2009	2010	2011
GCC – Insurance	24	26	27	20	21
GCC – Takaful	11	11	12	6	6
Saudi Arabia – Cooperative Insurance	2	11	15	13	19
Malaysia – Insurance	7	6	6	6	6
Malaysia – Takaful	5	6	6	3	3

Notes:

1. *Where possible, publicly available corporate information has been used.*
2. *Quarterly results have been used in 2011 to approximate data where annual accounts were not available.*
3. *GCC Takaful sample excludes Saudi operators in this report. Therefore, the graph shows a significant variation from WTR 2011.*
4. *RoE = Net profit / Shareholders' equity.*

Source: Companies' annual reports, Ernst & Young analysis

Bahrain Takaful Legal framework:

- CBB rule book 2005;
  - Amended in 2007, 2011 & 2014;
  - Model has been the reference in all GCC: wakala +Mudharaba;
  - All principles, regulations and requirements for conventional to apply to Takaful;

- Solvency & Qard: specific to Takaful;
  - Actuary to be appointed for Family;
  - Actuarial review every 2 years for general;
  - Capital adequacy, amended in April 2014: if a company is not meeting the solvency requirements, shareholders must inject capital;
  - Solvency fro General based on GWP and Incurred claims;
  - Family fund solvency based on the aggregate of mathematical reserves and capital sum at risk calculation;
  - In case of fund cash deficit and inability to meet day to day expenses and obligations, a Qard must be extended to shareholder's fund;

- Wakala to be proportional to the cost of establishing and maintaining the contract

(*) Source: CBB rule book

Bahrain Takaful companies performances

USD million 2013	Hannover Re (1)	ACR (2)	Takaful International (3)	Solidarity 2012 (4)	Tazur 2012 (4)
Paid –up Capital	53.05	200	16.6	20	58
GWP	135	21.5	53.7	31.2	n/a
Profit/ loss Participants	(18.7)	7.0	0.063	7.3	n/a
Accumulated deficit	37.4	70.5	3.8	13.7	n/a

(1) http://www.hannover-re.com/resources/pc/generic/HR_Takaful_2013_FS_Audited.pdf
(2) http://www.acrretakaful.com/PageFiles/58/ACR%20Retakaful%20MEA%20B.S.C.(C)%20Financial%20Statements%2031%20December%202013.pdf
(3) http://www.acrretakaful.com/PageFiles/58/ACR%20Retakaful%20MEA%20B.S.C.(C)%20Financial%20Statements%2031%20December%202013.pdf
(4) WIID

Takaful / Cooperative Performances Vs. Conventional UAE Case (1)

UAE (*) %	Gross L/R		Reinsurance L/R		Net L/R	
Years	2013	2014	2013	2014	2013	2014
Takaful companies	57%	58%	43%	51%	68%	64%
Conventional companies	51%	56%	38%	51%	72%	69%

- Takaful Companies retention is higher, mainly due to the percentage of Motor and medical business in their portfolio;
- Although Gross and Net L/R for Takaful companies are improving between 2013 and 2014, the overall performance for Takaful is not satisfactory, because of high Wakala (up to 32.5%) and lower investment returns:

(*) Source: Taha Actuaries report 01 09 2014

Takaful / Cooperative Performances Vs. Conventional UAE Case (2)

- "For Takaful companies, Returns on Assets, Share Capital and Equity for the year (2014) are all zero percent on a consolidated basis due to a Net Profit figure of slightly more than AED 3 million, on a consolidated basis;
- Three (3) Takaful companies – Dubai Islamic Insurance and Reinsurance Co (AMAN), Islamic Arab Insurance Co (SALAMA), and Methaq Takaful Insurance Company (METHAQ) – reported negative returns;
- Returns for the rest of the Takaful companies, on an individual basis, are positive." (*)

(*) Source Taha Actuaries report 1 09 2014

Takaful / Cooperative Performances Vs. Conventional UAE Case (3)

- Five (out of 8) Takaful companies are at higher risk as their Equity is below their Share Capital level.

- Equity as percentage of Assets is higher for Conventional companies than for their Takaful counterparts(*)

- Industry's Net Profit has increased for Conventional companies, but has decreased for Takaful companies during the period 2013-2014.

- Net Premium Earned and Net Claims Incurred have increased for Conventional companies but have decreased for Takaful companies during this period (*)

(*) Source: Taha Actuaries report 1 09 2014

GroupMed Reinsurance Brokers Limited

Saudi Cooperative Market Performance 2013 (*)

SAR

	2013	2012	VAR
▪ Gross Written Premium	25,022,737.00	20,867,447.00	19.91%
▪ Net Written Period	18,959,830.00	15,675,663.00	20.95%
▪ Net Claims incurred	16,088,661.00	11,045,574.00	45.66%
▪ Insurance Surplus / deficit	(1,706,020.00)	682,303.00	-350.04%
▪ Policyholder's fund investment income	246,877.00	120,762.00	104.43%
▪ Shareholder's Investment income	449,137.00	308,089.00	45.78%
▪ Net income ▪ Before Tax & Zakat (2.5%)	(1,292,688.00)	864,050.00	-249.61%
Source: Tadawul, SAMA and Companie's information;			

(*) 2013 is an exceptional year for Saudi market, because of SAMA requirements to increase the provisions for premium adequacy and Medical performances; 2014 companies performances are much better (Tawunia SR 600 million profit);
This performance cannot be considered as a general rule for the whole Takaful/ Cooperative;

GROUPMED Reinsurance Brokers Limited

The perpetual(*) Qard issue

Obvious causes of the deficit

- High start-up cost;
- Nature of the markets: fragmented, less regulated and severe competition ;“cut throat rates;
- Portfolios volatility;
- Takaful writing mainly Motor, medical, property and CAR, very competitive LOB with limited margin;
- Absence of clear strategy and lack of underwriting discipline and no proper risk management framework;

High L/R ratio + High Wakala = High C/R

Deficit is accumulating in most of the companies; situation is not sustainable!

Paradox: Takaful are not meeting their commitment to share surplus, while shareholders are receiving dividends…

NB: No Qard issue in KSA…

Qard Treatment

AAOIFI

Current accounting standard is not solving the problem; however, KPMG has produced a draft of new accounting standard on Takaful and it is currently under review and not finalized

“The Standard sets out important key principles for the structure of solvency requirements for Takaful; ….TO’s can maintain assets in the shareholders' funds that it holds out as available for transfer as Qard to the PRF”; i.e. ring-fencing part of the capital; (*)‘

”regulatory capital provides a buffer to absorb loss it is not a sufficient risk mitigant on its own. Accordingly a TO should have in place a comprehensive risk management framework …to hold adequate capital against material risks”.(*)

Central Bank of Bahrain

Bahrain: New regulation since April 2014;

Saudi approach: at the end of each year, the deficit in the policyholders fund is payable from shareholders fund

(*) IFSB, Standard 11, 2010

Re-thinking the model

- To adopt Saudi model; however, some scholars are not "comfortable" with this model; or
- To ring-fence part of the capital, to be released to write-off the deficit (IFSB, Bahrain, Am Best);
- Capping the Wakala to the real operating cost, keeping it minimum the first years, to be increase progressively, once the policyholders start generating Surplus;
- To create a Waqf fund: shareholders to allocate a percentage of the capital to cover the start-up cost and first years deficit;
- No dividends distribution, before deficit absorption;
- Shareholders to write-off the deficit after 3 years;

  Shareholders will be clearly liable for the deficit and <u>as a compensation, their remuneration should consider the "cost of capital" and risk to lose it;</u>

Let’s be positive…

Despite the recent developments, there is a Potential For Takaful In The Arab World, subject to overcome the challenges / obstacles;need for:

- Takaful mindset; Shari’a compliance;
- Political support: specific Takaful regulations & harmonization;
- Diversification; improve underwriting performance by a technical approach geared toward profitability;
- Rethinking the model and solving the Qard issue;

Takaful should develop, as the demand for Shari’a compliance is growing; Islamic banks and Sukuks are developing; demographics are also in favor of increasing demand (i.e. middle class and increased income/ capita);

Takaful should exist at least to allow consumers must have the right of choice between conventional and Shari’a compliant insurance.

GROUPMED
Reinsurance Brokers Limited

Thank you;

GROUPMED
Reinsurance Brokers Limited