

The International Takaful Summit 2015

A.M. Best's Approach to Rating Takaful Companies

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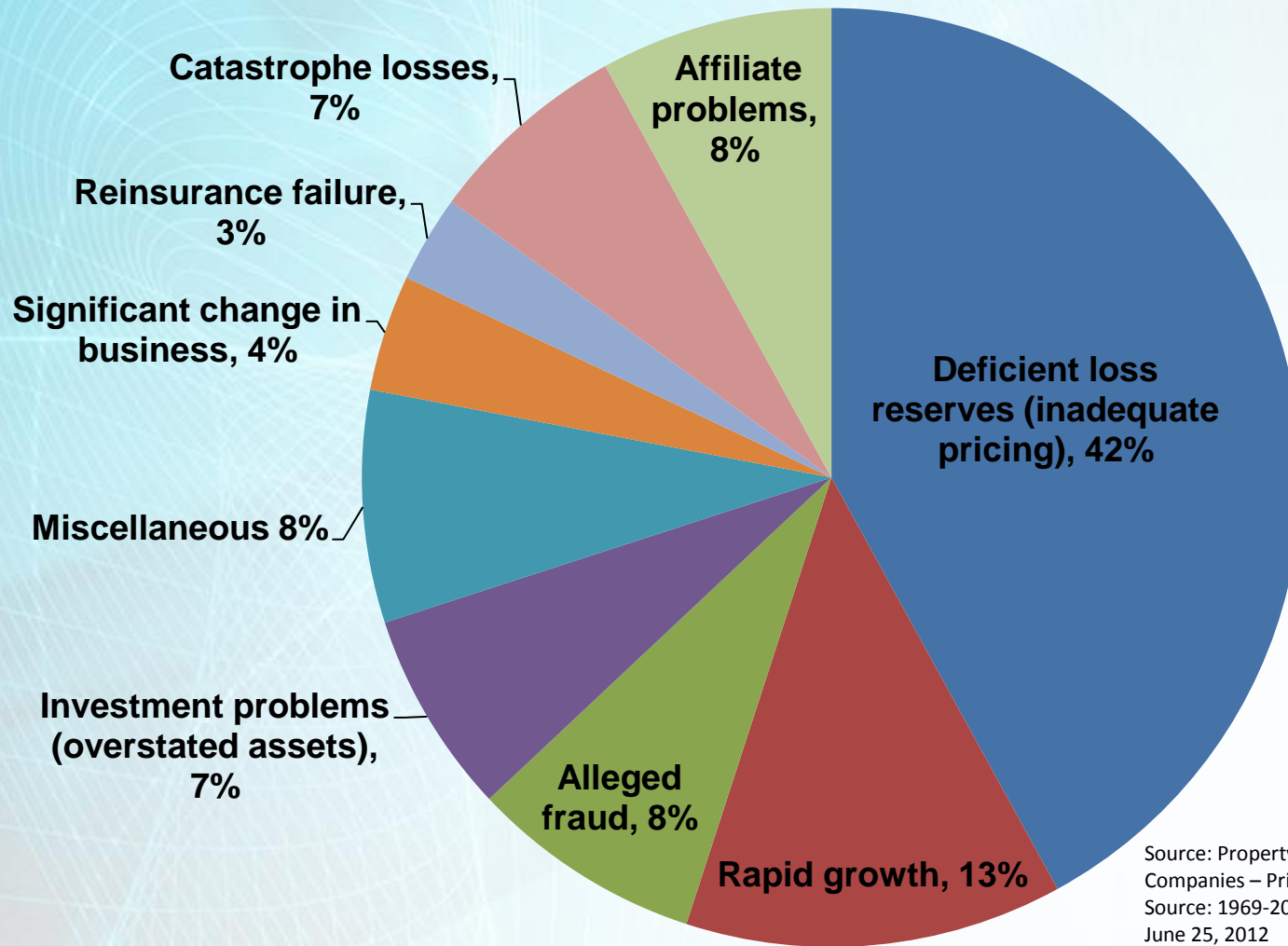


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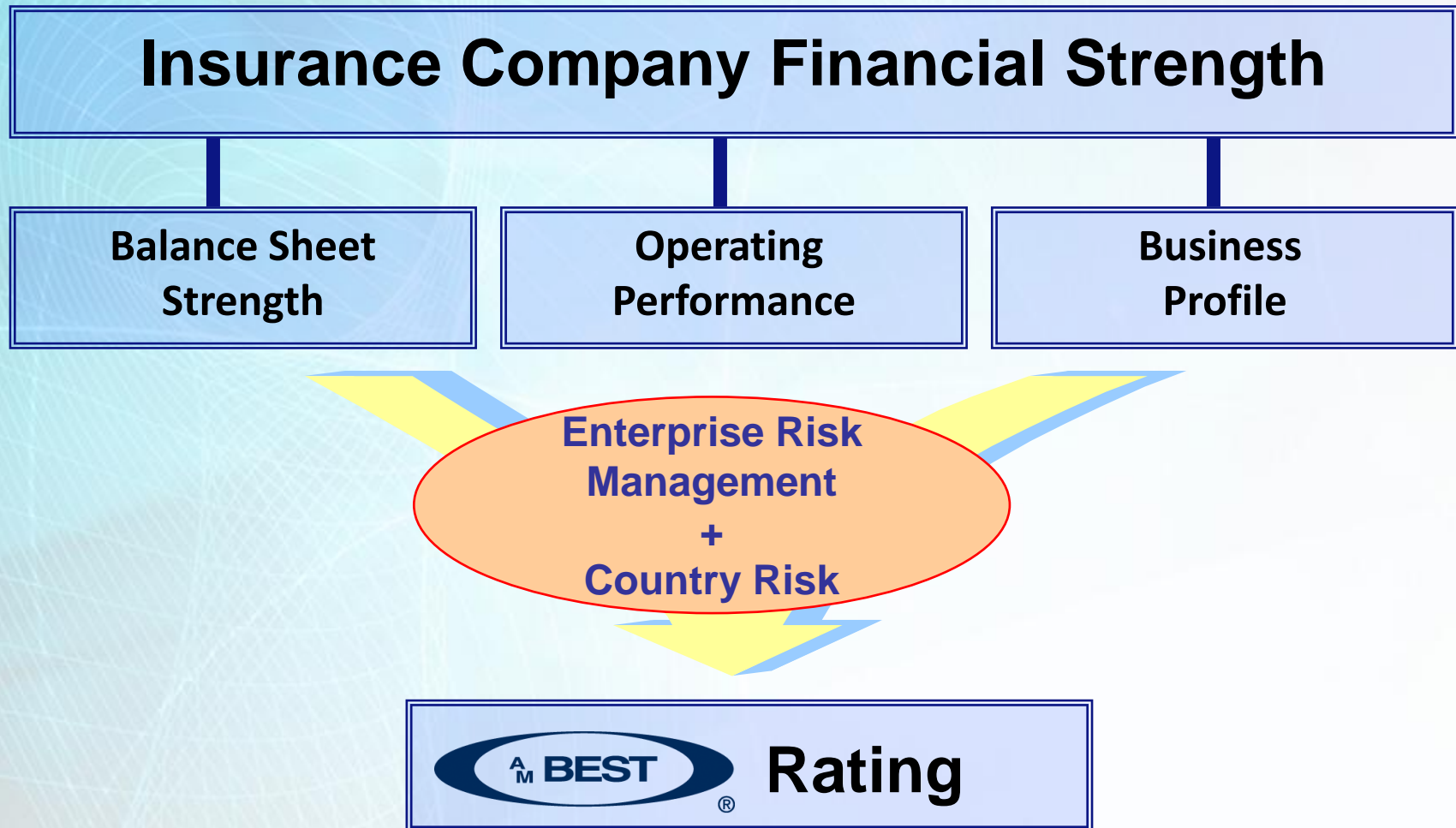
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Why Do Insurance Companies Fail?



Source: Property/Casualty Financially Impaired Companies – Primary Causes (1969-2011)
Source: 1969-2011 U.S. P/C Impairment Review, June 25, 2012

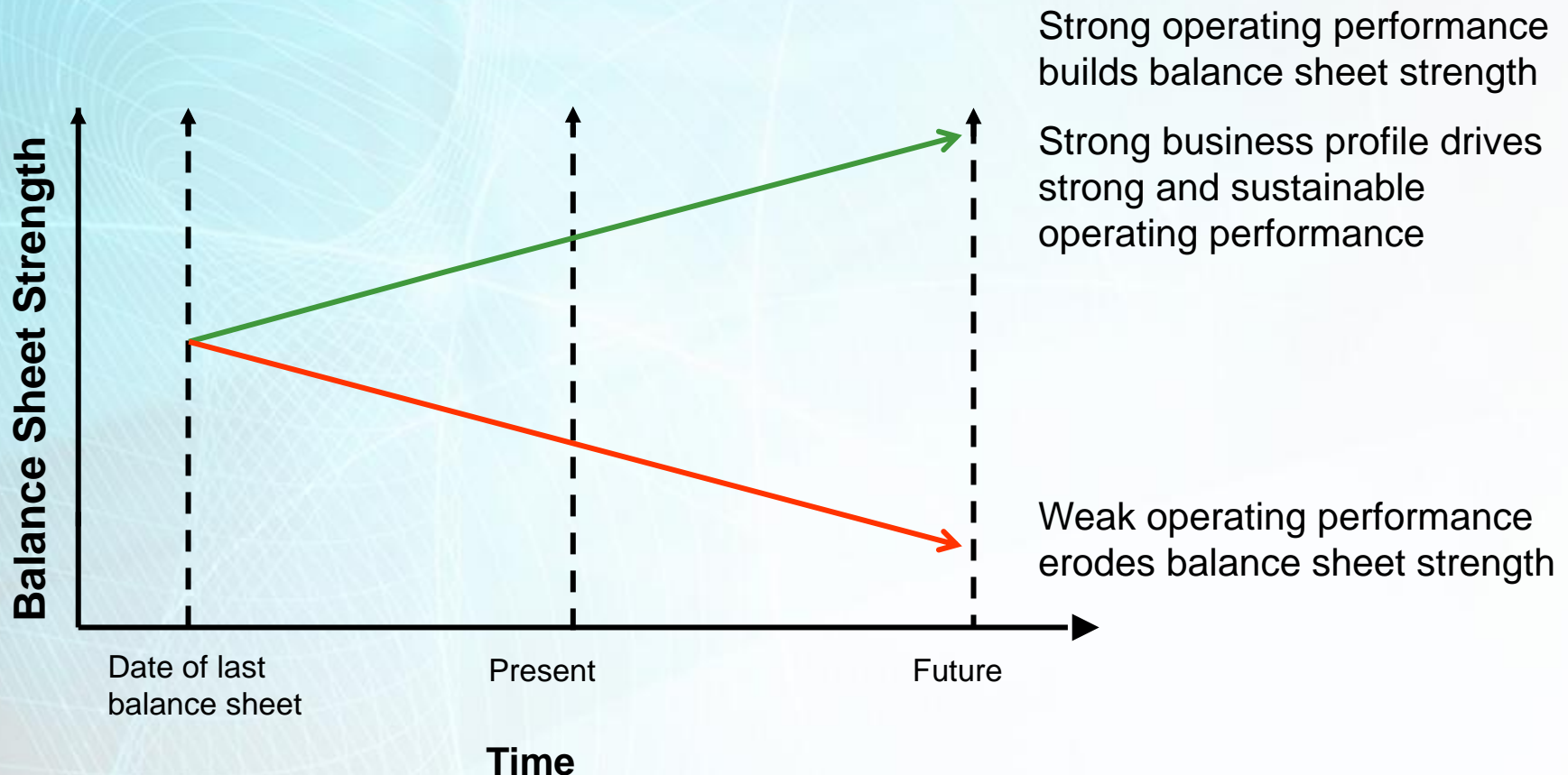
A.M. Best rating methodology – key rating components



Interaction of Rating Factors



Operating performance and business profile are leading indicators of future balance sheet strength



Balance Sheet Strength



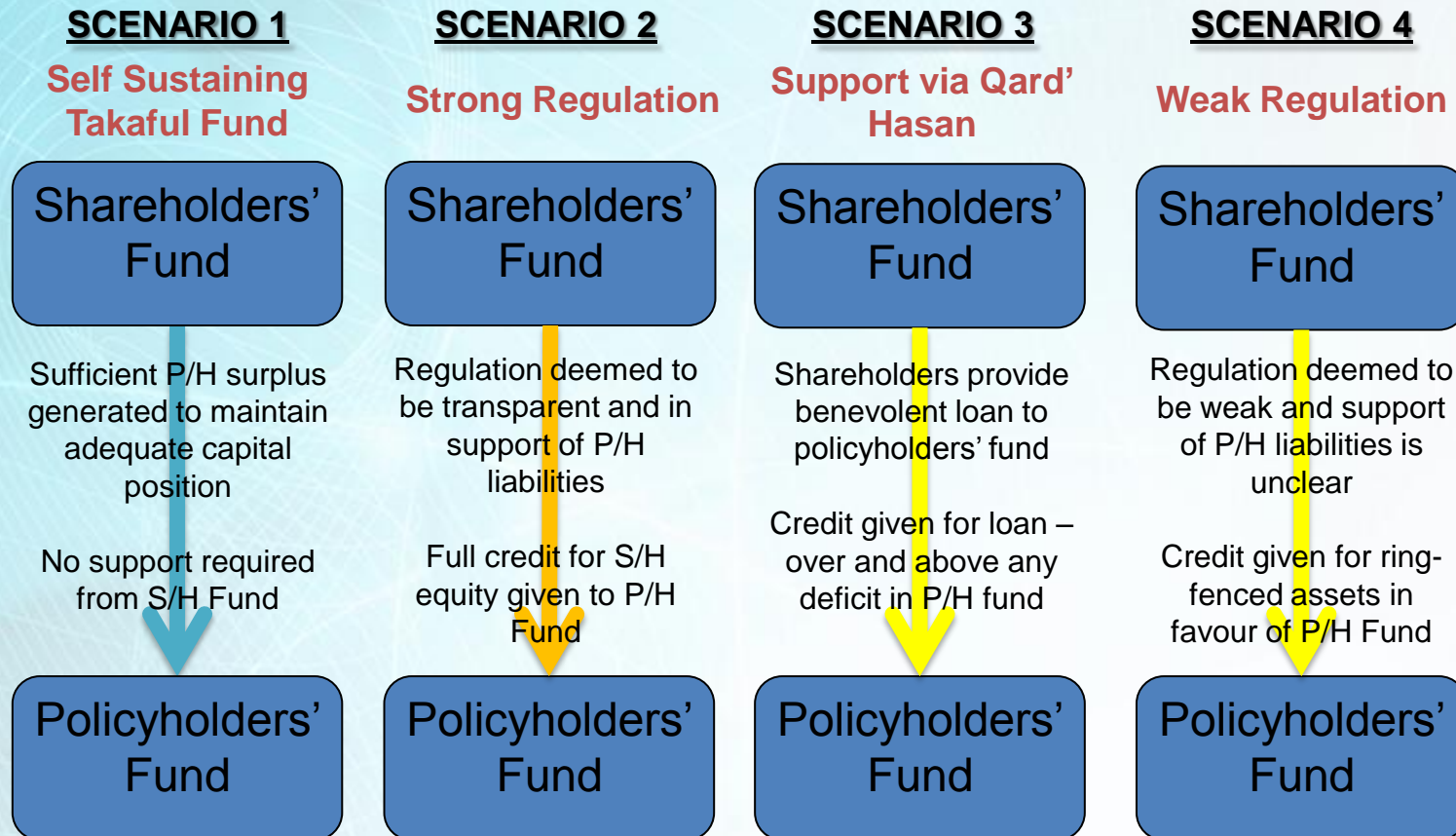
Rating Factors

- Risk-adjusted capitalisation
- Capital structure
- Financial flexibility
- Debt leverage / interest coverage
- Liquidity
- Quality / soundness of reinsurance
- Adequacy of loss reserves

Takaful Considerations

- Regulatory framework - commitment from s/h's fund to p/h's fund
- Strength of Takaful fund can be limited due to:
 - Low surplus accumulation;
 - High Wakala (management) fees charges to Takaful fund
 - Over dependence on Qard' Hasan (loan) to cover deficit
- Restrictive Investment Policy
 - Reduced diversification
 - Asset concentration
 - ALM limitations
- Insufficient Retakaful capacity

Understanding Takaful Regulation



Strength of regulation forms an important component in assessing the financial strength of Takaful companies.

Operating Performance



Rating Factors

- Historic and prospective
- Underwriting and investment
- Sustainability of earnings
- Ability to meet strategic objectives

Takaful Considerations

- Performance of both s/h and p/h funds
- Ability to generate surpluses in p/h fund (competition, pricing pressure, high Wakala fees)
- Over-dependence on Qard' Hasan
- Concentrated investments
- 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

Business Profile



Rating Factors

- Market position / size
- Competitive advantage
- Market environment
- Management experience
- Diversification
 - By business line
 - Territory

Takaful Specific

- Competing in the same space as conventional insurers
- New Takaful entrants finding it difficult to establish themselves
- Fragmented market with intense pricing pressure due to competition
- Limited franchise and market position
- Uncertainty of competitive advantage over conventional companies

Market profile vs profitability is a key challenge

“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 ERM throughout the organisation?
- How has ERM assisted in decision making?
- What role does capital play when considering ERM?

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

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 risk
- Companies tend to operate 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 the company, and not meet requirements of outside parties

Final Remarks



- Takaful companies rated by AM Best have secure ratings
- Regulation continues to develop
- Takaful models becoming more robust:
 - Wakala fees closely reflect actual expenses
 - Lower dependence on Qard' Hasan
 - Evidence of surplus distribution
 - Greater investment diversification

Key challenge: Sustainability of Takaful model – profile vs performance

Questions?

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