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How the Mutual Model can be adopted for Takaful: addressing the weaknesses of current takaful models

Zainal Abidin Mohd Kassim
International Takaful Summit
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Takaful is ‘Expensive’

- Most takaful operators are start ups. Insurance is a regulated industry and costs of compliance is expensive. There are also additional compliance cost e.g. cost of maintaining sharia compliance.
- Most of takaful expenses are overhead costs, so until and unless volume of business reaches a certain level, the operation would incur expense losses (expense overruns). Higher contribution rates helps to reduce expense losses.
- Takaful operator has to maintain minimum capital levels as determined by the regulators, it also has to ensure a certain solvency level. These ‘tied’ shareholders capital needs to be serviced by profit from takaful, thus increasing the cost of takaful.
- Takaful is a with-profits model, with underwriting surplus refunded to participants. With-profits products are naturally more expensive than non-profit products.

Takaful does not provide a comprehensive product range

- Management’s job is to maximize profit to shareholders. Thus, takaful products which are ‘sold’ are those that optimizes the use of shareholders’ capital. These are not necessarily the products consumers need.
- Some personal line risks cannot be provided by takaful operators as the contributions demanded by consumers are insufficient to cover both the wakala fees and the claims and retakaful cost.
- Some large risks cannot be undertaken by takaful as there is no retakaful support at a competitive price.

Takaful product is no different from conventional insurance

- Other than those operators who are able to distribute surplus back to the participants , particularly in general takaful, the **consumer experience** with takaful is not very different to buying conventional insurance.
- Some takaful products are also mis-sold as intermediaries/agents either overpromised or do not understand takaful themselves.

2013 Fiqh Academy ruling on takaful

- The Fiqh Academy meeting of 18-20th November 2013 reaffirmed the cooperative insurance as the model of choice for insurance for Muslims. It specifically defines cooperative insurance as a new contract based on the *Ta'awuni* (cooperation) principle.
- It proposes that the management of this cooperative be outsourced to a licensed independent entity that operates in compliance with shariah rules.
- That the management services be based on an agency (*wakalah*) basis with or without fees or alternatively on a *mudharabah* basis.
- That the cooperative pool be governed by a pre defined set of rules as to eligibility to benefits, distribution of surplus etc., thus promoting transparency.
- The cooperative fund is solely responsible of bearing any financial loss other than losses based on misconduct or negligence of the managing party.
- Any insurance surplus can be kept in the fund, or distributed partly or wholly to participants.

Discretionary Mutual
- The basis of a new takaful model?

- A Discretionary Mutual pays claims at the discretion of its Board. It is not an insurance company and therefore it is not subject to insurance supervision.
- Claim payments are not guaranteed, however claimants can expect sympathetic claims handling and response.

Who manages a Discretionary Mutual?

- Independent service companies services Discretional Mutuals. These service companies and are responsible for:
  - Underwriting
  - Claims processing
  - Policy documentation
  - Sales and marketing
  - Regulation and accounting
  - Risk Management
  - Legal services
- The Board of the Discretionary Mutual executes a contract with the service company. As the service company is external to the Discretionary Mutual the Board and can dispense with the service company if unsatisfied with services provided.

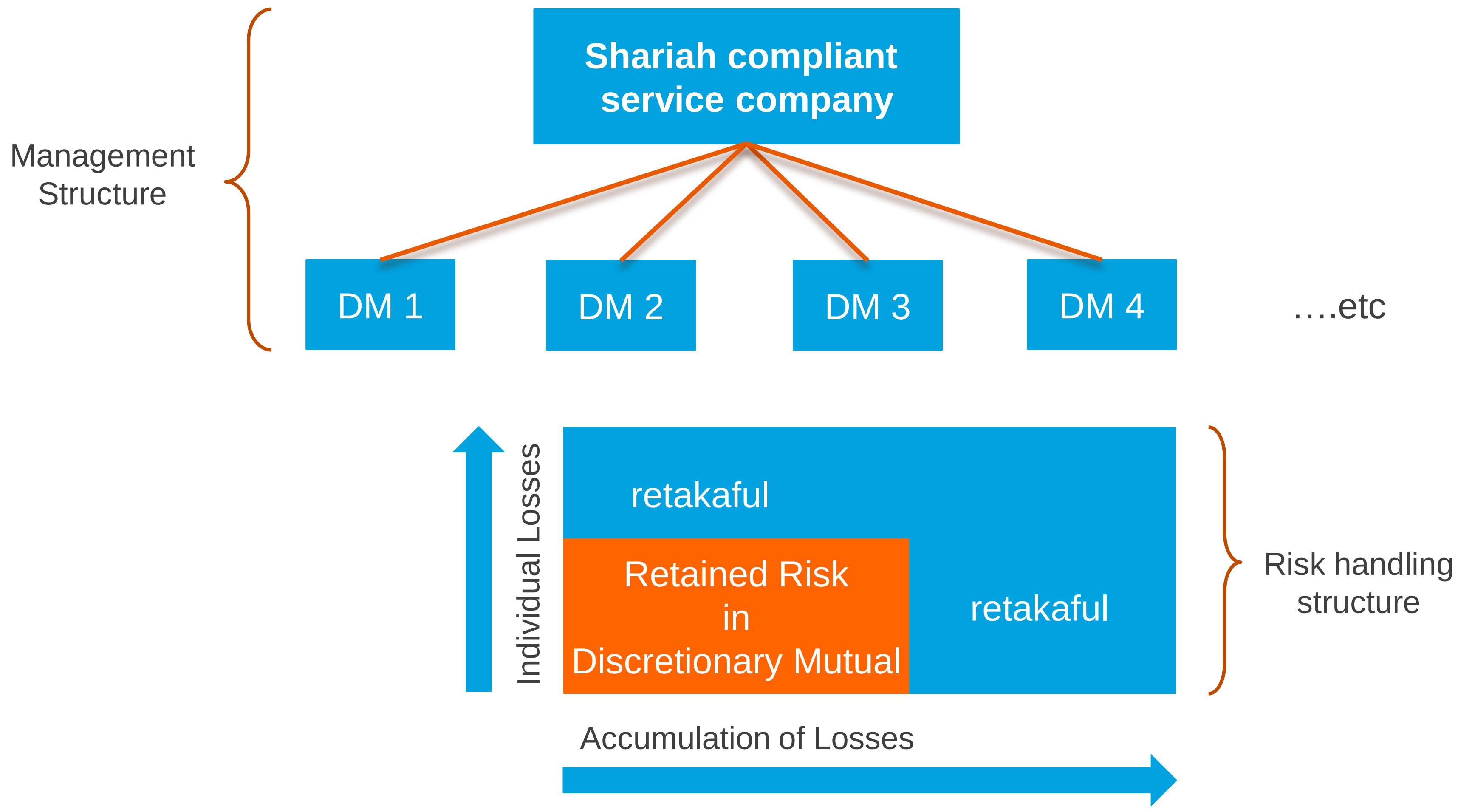
Advantages and Disadvantages of a Discretionary Mutual over a hybrid proprietary takaful set-up

Event	Discretionary Mutual	Takaful Operator
Claim Payments are guaranteed	No. However, with a 'wrapper' of retakaful, some certainty can be provided as to benefits payable.	Guaranteed by shareholders capital through payment of *qard*.
Exposed to Expense overruns at set up	No. Service company takes on the risk of fees being less than expenses incurred. Service company is usually an established entity with multiple Mutuals managed. There is no need to duplicate functions and services as you would with multiple takaful operators. Good for an industry that has limited trained Human Capital pool.	Yes. All new takaful operators would usually incur expense overruns in the initial years (can be in excess of 10 years)

Advantages and Disadvantages of a Discretionary Mutual over a hybrid proprietary takaful set up

Event	Discretionary Mutual	Takaful Operator
Expensive compliance cost	Not subject to insurance regulations. Also, Shariah compliance can be outsourced to the service company.	Subject to expensive compliance cost which is independent of the business volume.
Shariah compliance business model	Complies with *Fiqh* Academy ruling of November 2013.	Model not universally accepted by shariah (e.g. the current use of *tabarru'* and *hibah* to managed contributions and surplus refunds in takaful pools).
Product range	Limited only by demand. Can combine family and non-family products in one pool.	Driven by profit (ROE) requirements of shareholders. Also need to separate family from P&C products leading to additional costs.

Business Structure



Example of a Discretionary Mutual in the UK -The Military Mutual

- Managed by a Mutual Management company (Regis Mutual Management Ltd)
- Provides personal lines cover, e.g. Home, Contents and Motor for individuals who are part of the Military Family.
- The Military Family includes not only current service men and women but also veterans and their families.
- Expected to gradually roll out 16 classes of cover and other services that individuals need.
- The Mutual will also sell some insurance products on a “white labelled basis”.
- The Mutual is owned by the members themselves and is controlled by a Board of Directors elected from the membership.

Conclusion

- Should Regulators conclude that takaful and insurance are the same from a risk carrying perspective then the solvency requirements for both industries would be also be the same/very similar. As takaful is a very recent industry, the advent of Solvency ll is likely to squeeze the current takaful operating model 'out of business'.
- On the same note, if takaful products are indistinguishable from products of conventional insurers from a consumer's experience perspective, then takaful operators are at a competitive disadvantage to the bigger more established conventional insurance companies.
- After over 30 years there is still no universal consensus among all sharia scholars that the hybrid proprietary takaful model is shariah compliant.
- Takaful needs a version 2.0 NOW.

ACTUARIAL PARTNERS

Actuarial Partners Consulting Sdn Bhd
Suite 17.02 Kenanga International
Jalan Sultan Ismail
50250 Kuala Lumpur
Tel +60 3 21610433 Fax +60 3 21613595
www.actuarialpartners.com