

## **The International Takaful Summit**

# **Ratings Perspective on Investment Challenges for Takaful Operators**

with focus on Financial Strength, Operating Performance and Risk Management

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# Takaful developments



## Main features

- Low Takaful penetration
- Enhanced and developing regulatory frameworks
- Not reached the heights of Shari'a compliant banking
- Influx of Takaful entrants
- Contrast between Asian and Middle Eastern markets
- Surplus generation and profit distribution
- Mutuality: aligning shareholder and policyholder interests

**Investment environment remains challenging**

# Challenging investment environment



## Main features

- Low interest rates
- Depressed oil prices
- Volatile equity and real estate markets
- Sovereign downgrades
- Sustainability of currency pegs
- Depressed returns in real terms

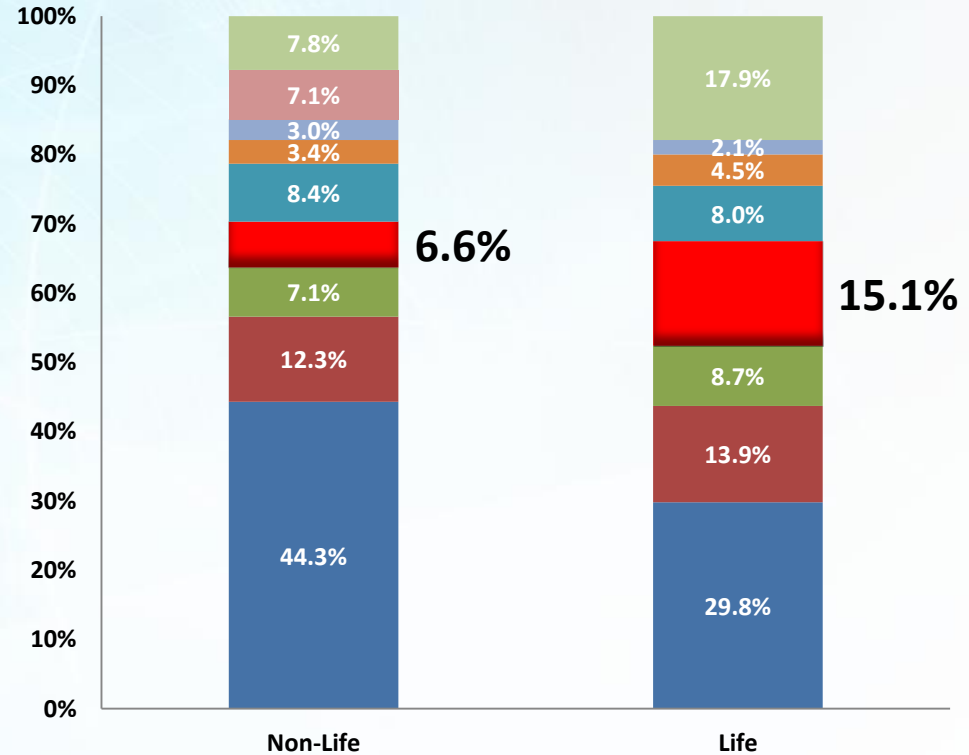
**Increased pressure of return on shareholders' equity**



# Why do insurance companies fail?



- Affiliate Problems
- Catastrophe Losses
- Reinsurance Failure
- Significant Change in Business
- Miscellaneous
- **Investment Problems**
- Alleged Fraud
- Rapid Growth
- Inadequate Pricing / Deficient Loss Reserves



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

# Key Rating Components



# Investment issues

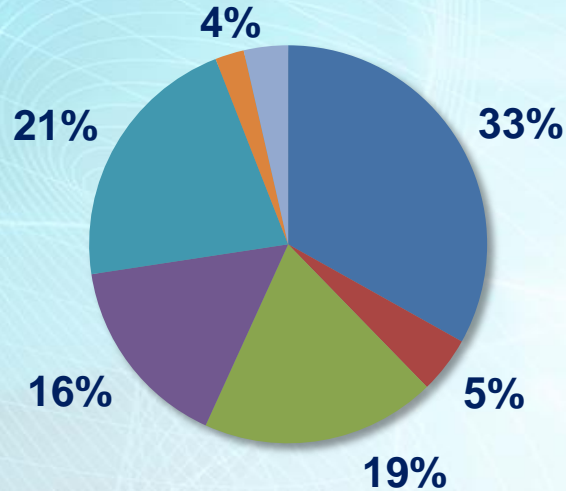
- Aggressive investment strategies in MENA
- Investment performance dictates earnings
- Single market players – limited diversification of assets
- Underdeveloped capital markets – restricted opportunities
- Concentrated profile with limited counterparties
- Complexity of managing both shareholders' and policyholders' funds
- Segregation between investment and underwriting
- Asset liability and liquidity management



# Investment composition: year-end 2014

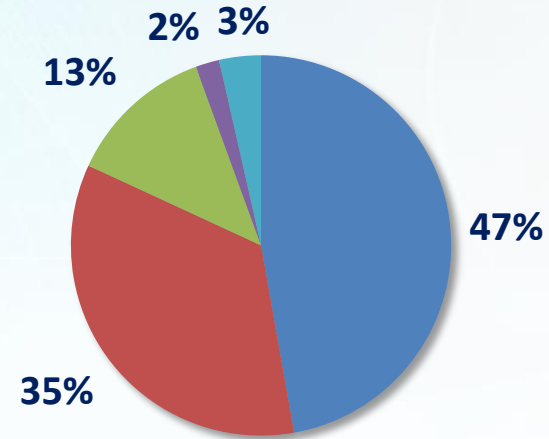


Middle East Takaful Asset Distribution



■ Cash ■ Fixed Income ■ Equities (public) ■ Equities (unquoted) ■ Real Estate ■ Other

Malaysia Takaful Asset Distribution



■ Cash ■ Fixed Income ■ Equities ■ Real Estate ■ Other

Gross Written Premium Split (Non-Life & Life)

98%

Gross Written Premium Split (Non-Life & Life)

33%

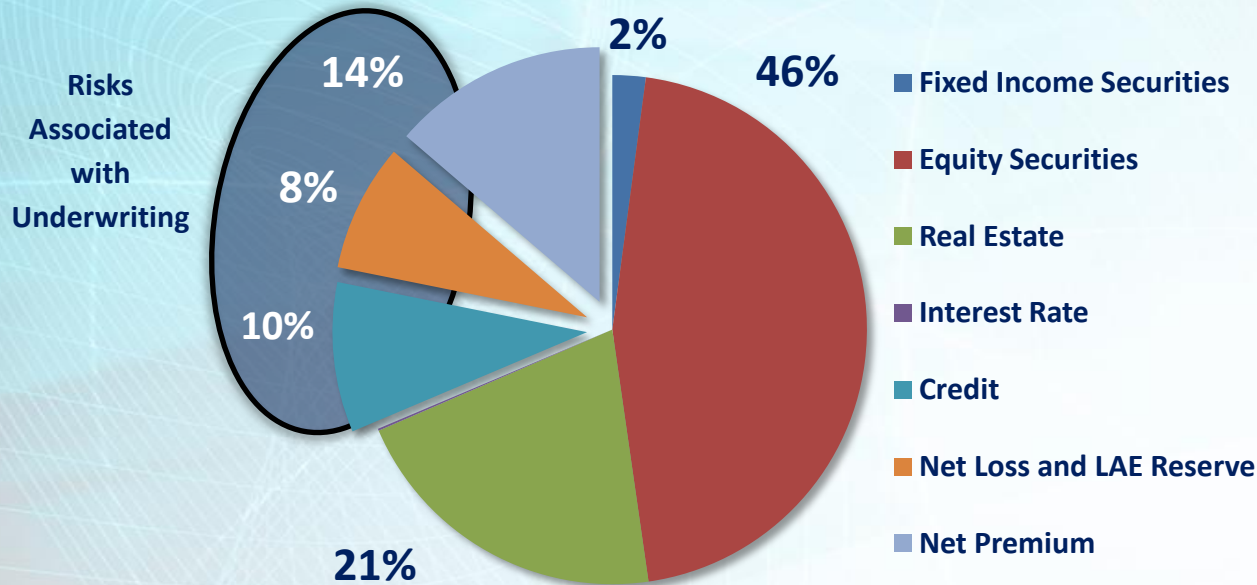
67%

Sources: Public financial data and A.M. Best research



# Capital requirements

## Best's Capital Adequacy Ratio (BCAR) Sources of Risk to Middle East Takaful Insurers



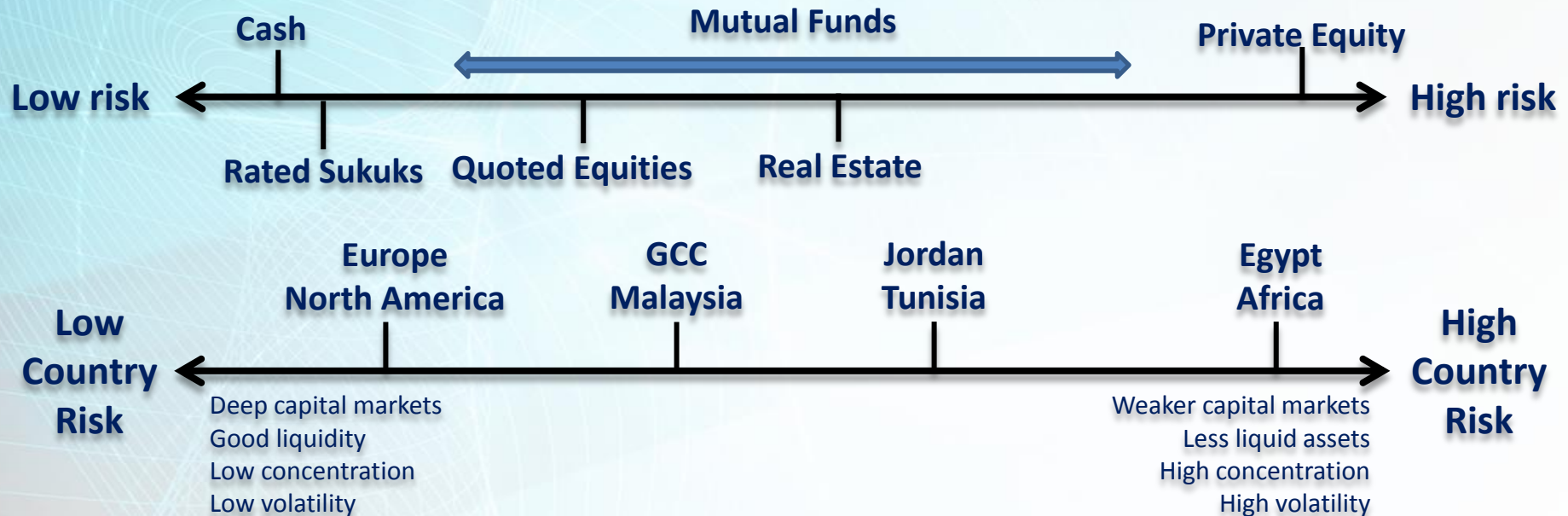
- New operators with insufficient scale
- Policyholders' fund assumes underwriting risk
- Shareholders' fund assumes investment risk
- Investment profile creates volatility in risk-adjusted capitalisation
- Capital buffers required to absorb fluctuations in asset prices
- Malaysian operators have more balanced risk profiles

Note:  
Risk is represented as Gross Required Capital in the BCAR model  
Sources: Public financial data and A.M. Best research incorporating the BCAR model

# Capital Requirements: Asset Charges



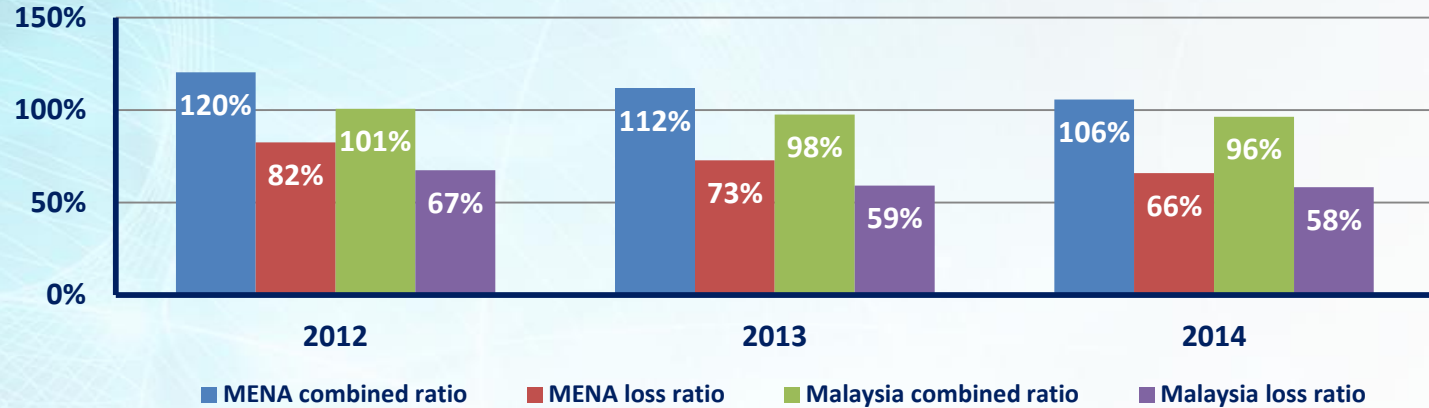
Investment policy should consider capital and solvency requirements.  
MENA operators' asset composition is generally higher risk



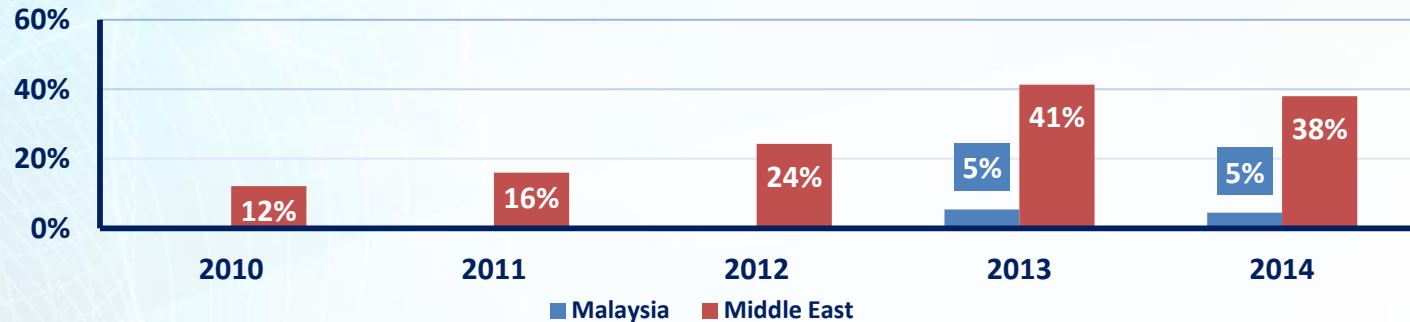
# Strain on technical performance



## MENA vs. Malaysia – Non-Life Technical Ratios



## Margin of Wakala Fee over Expenses

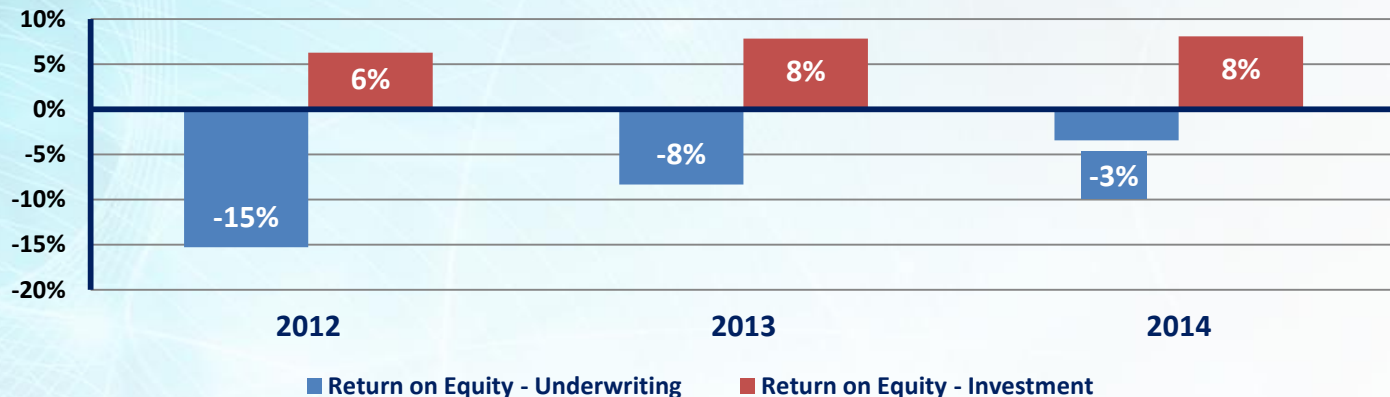


Note:  
Malaysia data unavailable for 2010 to 2012.  
Source: A.M. Best research

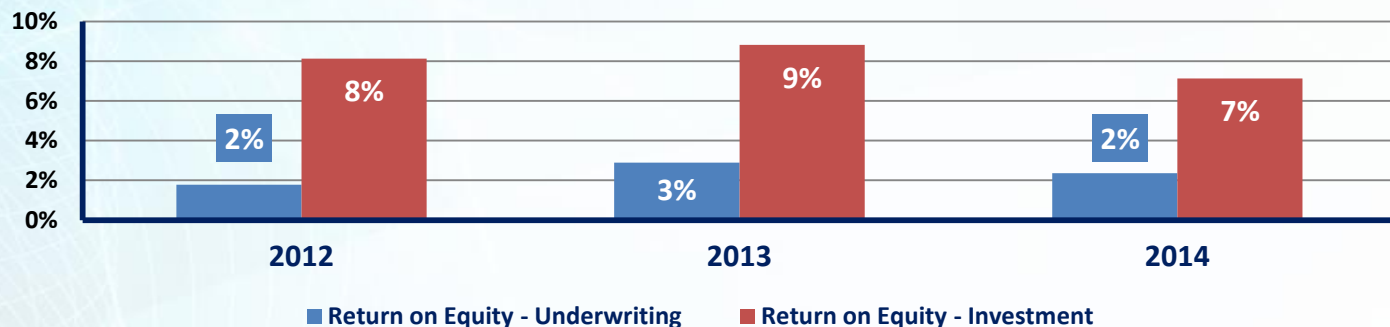
# Earnings Dependent on Investment Income



## Return on Equity – MENA



## Return on Equity – Malaysia



Source: A.M. Best research



# Operating performance



## MENA

- Weak technical performance
- Excessive Wakala fees
- Dependence on Qard Hasan
- Increasing policyholder deficits
- Weak Takaful model

**Dependent on investment income**  
**Investment profile creates volatility in earnings**

## MALAYSIA

- Marginal technical performance
- Balanced Wakala fee
- Lower dependence on Qard Hasan
- Adequate balance of earnings between policyholders' and shareholders' funds

**Conservative profile creates steady investment income which supplements earnings**

# Investment management

## A few questions...

- Are investments the main risk or threat to the company?
- How does a company control and mitigate investment risk effectively?
- How does investment risk interact with other key risks?
- What investment stress tests are conducted?
- How are investments managed between the policyholders' and shareholders' funds?
- Important of investments when considering capital or solvency requirements?

## A few observations...

- MENA investment policies can be aggressive, introducing volatility to earnings and capitalisation
- Affected by external factors; global financial markets, changes in oil price and regional instability
- Investment decisions generally controlled by board - concerns over asset liability and liquidity management
- Limited availability of assets can lead to concentration risk (by country, asset or counterparty)

# Final remarks

- Investments are an important component of an insurer's balance sheet; particularly for emerging market players
- Investment strategies increase volatility in risk-adjusted capitalisation and operating performance
- Operators must consider capital, solvency and regulatory requirements
- The market for Sharia' compliant investments is steadily improving
- Improve diversification / reduce concentration risk

**Investment environment remains challenging**

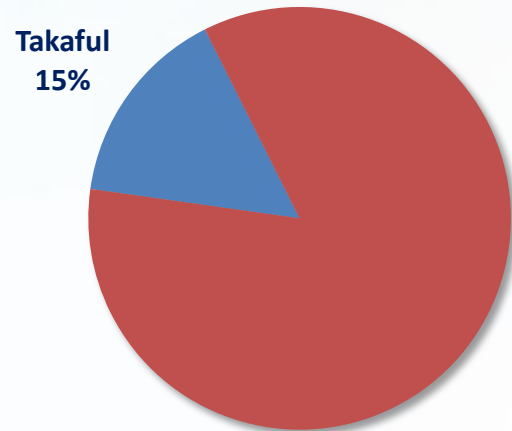
# A.M. Best MENA ratings



## A.M. Best Rated Takaful Insurers (Feb. 17, 2016)

Domicile	Company	Best's Long-Term Issuer Credit Rating (ICR)	Outlook/ Implication
Bahrain	ACR ReTakaful MEA B.S.C. (c)	bbb+	Stable
Bahrain	Solidarity General Takaful BSC (c)	bbb	Stable
Jordan	First Insurance Company	bbb	Stable
Qatar	Qatar Islamic Insurance Company Q.S.C.	bbb+	Stable
Saudi Arabia	Saudi United Cooperative Insurance Company (Wala'a)	bbb-	Stable
United Arab Emirates	Abu Dhabi National Takaful Company P.S.C.	bbb+	Positive
United Arab Emirates	Emirates Retakaful Limited	bbb+	Positive
United Arab Emirates	National Takaful Company (Watania) PJSC	bbb- u	Negative

## Takaful Insurers as percentage of A.M. Best MENA ratings (Feb. 17, 2016)



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