

Will Takaful Penetration Meet Conventional Insurance?

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**The 2nd International Takaful Summit 2008. Takaful / Re-takaful: The Emerging Growth Story
14-16 July 2008, Jumeirah Carlton Tower, Knightsbridge, London**

Whenever the size of takaful industry is discussed, it is compared with the size of global insurance industry with the conclusion that it is miniscule. It would be miniscule in that context but is that the right context? Global takaful premiums of US\$5.08 billion in 2006 compared with global insurance industry of US\$3.7 trillion. Are we comparing like for like here? Muslims constitute around 25% of the World population. Should US\$3.7 trillion be scaled down by 75% before we compare that with US\$5 billion? Or should we see what US\$5 billion constitutes as a share of the markets in which it is being written alongside conventional insurance?

Takaful Industry may be small but small can be big and this is what is demonstrated in this paper. The related question is 'Will Takaful penetration meet conventional insurance'? This is best answered with a YES and a NO.

YES, for several reasons. Takaful is growing, it has been the fastest growing form of insurance for many years and there are still so many new markets around the world where it is poised to enter. We see so many investors, banks and institutions associated with it who are committed to the industry with their dollars, there is good demand for takaful, it is an ethical and fair proposition, it appeals to many and it is in harmony with anything we want to do for the good of society.

The answer is NO, for only one reason. But this one reason has so many implications that if we are not careful, it can overshadow all other reasons on the yes-side. And this reason is the MIND-SET, the mind-set of the stakeholders of takaful industry that is still driven by a way of thinking hinged on conventional insurance; bring on a successful insurance executive to manage a takaful company, and this is quite common as shareholders want capable people with proven track record to look after their investments and future dividends; when this executive joins the company, he brings with him the benefit of years of relationships built in the industry, which should be all very well if this were to bring Shariah credibility. Instead, Shariah compliance to the extent of doing the minimum is mostly what is achieved in maintaining these relationships. Shariah Credibility by the way is more than Shariah Compliance and we achieve this when we together build a Mind Set to take care of the spirit and not just the letter of Shariah principles. The industry may be Shariah compliant but not yet Shariah credible and we need to work on it. By the way, what I am saying here must not be taken in the wrong context. Many a times, a non-Muslim practitioner of takaful follows the stipulated rules and processes in a manner that makes his actions very much Shariah compliant. The UK regulator has been much more proactive in understanding and accommodating the underlying issues of Islamic finance and takaful than many of the regulators in Muslim countries. The Regulator in Morocco is still grappling with the issues of double taxation on Islamic mortgages while the customer there is becoming disillusioned as his Islamic mortgage is proving to be more expensive than conventional one.

Here are two aspects drawn from real life experiences of the author as examples to highlight the point about Mind-Sets.

The first example is about the principle of necessity.

As the evolution of takaful goes, it started and grew rapidly in general takaful more than family takaful. But whatever the case, it started from zero in the early 80's. The available capital then was not enough for direct writing companies to have enough capacity to write different types of risks on competitive terms. The only available recourse was conventional reinsurance capacity. The Shariah Scholars very rightly allowed takaful companies under the principles of necessity or Dharurah, to reinsure on conventional basis. That helped the industry to move forward. A confrontation in the market with the customers developed with fierce debates at times as to how do we in the takaful industry call this insurance 'Islamic' when large chunks of claims paid came from conventional reinsurance..... the very reason why customers did not want to purchase conventional insurance in the first place? The principle of necessity was always very handy to explain the industry's stance.

Some years later in the late-90s, few investors with a foresight put their money together to set up retakaful companies and pools on the basis that the industry had moved on and there was enough business generated by takaful companies that could be pooled on retakaful basis. The flow into these pools was painfully slow. As there was no rated retakaful capacity, takaful players continued with reinsurance capacity. By this time family takaful business started to make a difference. The poor customer in the market however still had the same argument mixed now with frustration as he listened to the explanation of principle of necessity. Some takaful companies channeled their business to these early retakaful companies and pools.

Some more years later as we come to the present time, we find quite a few rated retakaful players. These retakaful companies are finding some business but there is a lot more that should flow into these companies. The principle of necessity does not hold anymore, a point that should be emphasized by every Shariah scholar advising the takaful companies. The poor customer is wondering why he or she should go to a takaful company any more that is reinsuring on conventional basis. Guess which product the customer will prefer out of two equally competitive products on the market, one fully reinsured on conventional basis, and the other on retakaful basis? Both companies are Shariah compliant, but only one of them is Shariah credible. The company reinsuring on conventional basis is doing so only because there is a history of relationship between its management and conventional reinsurers and sadly that takes precedence over the trust that the customer places in the management of that company in offering its customers Shariah compliant products.

The second example is about how we in the takaful business see ourselves as a small niche within the larger universe of conventional insurance market. Looking back at early articles of some 25 years ago, written by industry commentators from conventional insurance, described Islamic insurance as a niche appealing to small segments of the market. The word niche is still associated with takaful 25 years later; This is hardly

surprising when you find senior people within some takaful companies who think that only family takaful works better on co-operative basis, who feel takaful is not so well suited to insuring the larger commercial lines. Sadly this perspective is of insurance executives within the very markets where Islamic banking is flourishing, where the market has preference for Shariah compliant products such as the GCC (Saudi Arabia, Kuwait, UAE, Bahrain, Qatar with the exception of Oman). But the facts speak for themselves. Islamic banking has been growing at 15% pa. By 2007 there were over 300 Islamic Banks in 75 countries with assets of \$750 billion. This may rise to US\$ 1 trillion by 2010 as per Mckinsey's recent report.

Takaful companies were allowed to be set up in these markets to give them a fair chance to conduct themselves in Shariah credible manner and also to prove that this was a perfect response to the demand for takaful. I think that has been demonstrated very well. The world insurance has been growing at 2% to 2.5% pa over the last few years. Takaful has been growing at 20% pa globally and at 25% pa in the GCC. Takaful premium for some of the Middle East countries (The GCC, Jordan, Pakistan and Iran) for 2006 is estimated at around \$2.9bn out of total insurance premium of \$9.6bn, approximately 30%. These are estimates based on author's understanding of these markets. For example, life insurance premium per capita for Saudi Arabia is generally quoted as \$0.8 from published data. One research study (Business Monitor International) suggests that it is much higher at \$10 per capita.

With this kind of demand for takaful, with this type of growth and with so many takaful companies in these markets chasing finite number of clients (for commercial lines at least), is it perhaps time for conventional insurance companies to convert into takaful. The conventional players have been there for years, they are being served by international brokers and reinsurers for years, and the conventional conveyor belt goes on and on with the familiar tune that keeps soothing the bottom lines. The fear for conventional companies may be that as takaful means sharing of surplus (perhaps resulting in reduction of traditional returns) then better be defensive against takaful companies gaining conventional market share instead of becoming part of takaful industry.

The insurance industry in these markets should benefit from rationalization. It is the conventional insurance that should in fact be the niche in these markets to cover insurance risks that may be uninsurable under takaful (for example the hotel and catering industry that may have prohibited activities under Shariah) or larger oil and energy risks that may require international placements.

In reference to takaful being a 'niche', let's see how small this 'niche' is?

Takaful in 2006

Author's estimates developed from published statistics, media reports, knowledge of industry

Size of the 'niche'

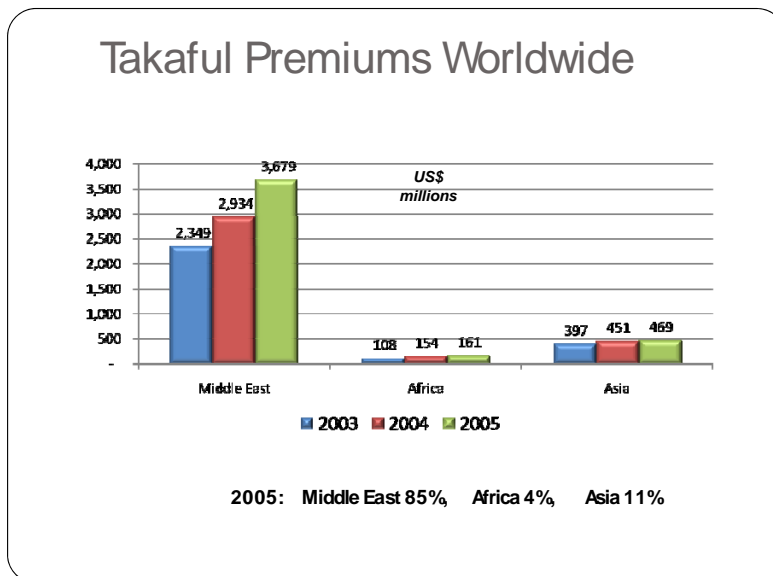
- Capital invested in takaful companies: US\$ 3.5 billion
- Global Takaful premiums: US\$ 5.08 billion (2006, estimated)
- Global Insurance premiums: US\$ 3.7 trillion (2006, Sigma)
- Insurance premium in takaful markets: US\$24.8 billion
- Global takaful share: 20%
- Takaful share in the Middle East: 30% (\$2.9bn takaful out of \$9.6 bn total insurance and takaful)

Growth of takaful

- 20 % : Global takaful growth pa
- 25 % : GCC takaful growth pa
- 2.5% : Global insurance growth pa

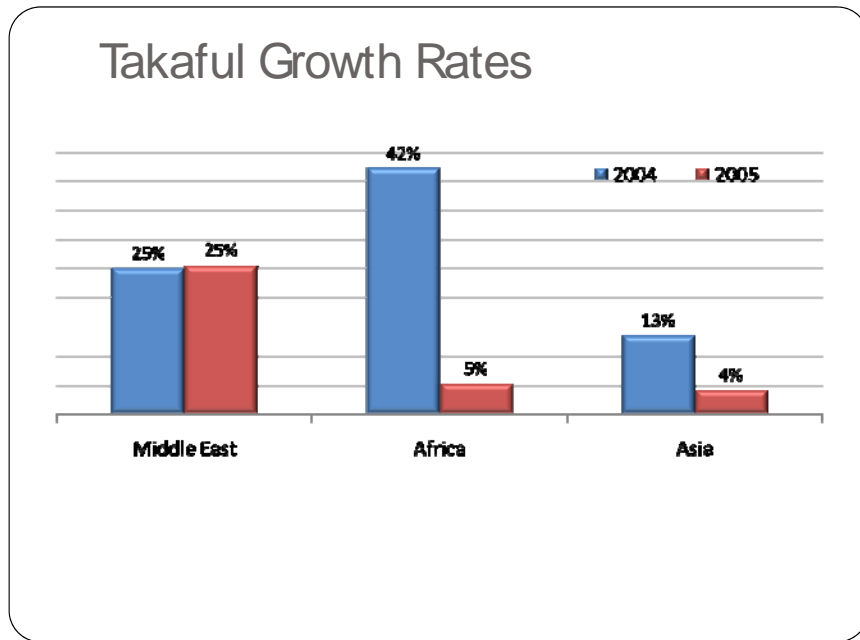
The takaful industry has currently invested in excess of US\$3.5 billion of shareholder capital and this is increasing, as the rate at which new takaful and retakaful companies are being formed including windows would be equivalent to around one a month. Consider the growth of takaful, 20% to 25% pa compared to 2.5% pa growth in world insurance premiums.

On global scale takaful premiums may be miniscule, \$5 billion against \$3.7 trillion, but if we look at only the markets where takaful is written then the size of the niche is around 30% in the greater Middle East and 20% in countries where takaful is operational globally. Can we call this a niche?



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Although Malaysia took off in takaful and showed impressive build up in the early phase, it is the Middle East that is witnessing tremendous growth in takaful. The Middle East has more than 80% of the global takaful size as illustrated above.



The Middle East shows the highest growth at 25%. The growth in Asia after 2005 should be higher, as major players were established in 2006 and 2007, especially in Malaysia.

Number of Takaful Companies	Jan 2008	In formation	Total	Windows	Local takaful companies: UK, UAE, Kuwait, Qatar, Saudi Arabia, Bahrain, Yemen, Iran, Egypt, Jordan, Syria, Lebanon, Pakistan, Sri Lanka, Bangladesh, Sudan, Senegal, Tunisia, Malaysia, Singapore
Middle East	41	16	57	1	Local takaful windows: UK, Singapore, Thailand, Australia, Sri Lanka, Ghana, Niger, Lebanon, Indonesia, Brunei
Africa	19	2	21	2	
Asia Pacific	40	1	41	25	
The Rest	24	1	25	10	
Total	124	20	144	38	

International players entering takaful and retakaful market	Tokio Marine AIG, HSBC Allianz, Prudential	Tokio Marine Re Swiss Re, Hannover Re, Munich Re
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There are probably now 150 takaful companies worldwide in some 26 countries. International players are now very much part of the takaful industry.

Global Muslim Population, 2007

Growing Middle Classes, Improving Human Development.....

Large sections in Asia and Africa are poor.....

Bankable / insurable 30% means 500 million Muslim customers....

No. of countries	Continent	Population in 2007	Muslim Percentage	Muslim Population in 2007
56	Africa	861.2	53.6%	461.8
51	Asia	3,830.5	30.4%	1,163.9
42	Europe	727.4	7.3%	53.2
2	North America	323.1	2.1%	6.8
38	South America	539.6	0.6%	3.1
16	Oceania	32.1	1.9%	0.6
205	Total	6,313.9	26.8%	1,689.3



TOKIO MARINE
MIDDLE EAST

Source: Islamicpopulation.com, CIA Fact Sheet, Arab Net, AME Info, Islamic News Agencies, US Center For World Mission Report

Going forward, the potential is that of bringing takaful to a bankable Muslim population around the world. If this is say 30%, it is equivalent to at least 500 million customers out of a population of 1.6 billion. This is not including the fact that takaful should appeal to many more on grounds of its ethical and fair proposition that is good for society, community and our environment at large as funds are ethically channeled into environmentally friendly businesses and commercial activities.

Many of the countries that have takaful potential are showing good improvement in United Nations Human Development Index. The Human Development Index is a measure of life expectancy, literacy, education, standard of living, and GDP per Capita. It is a standard means of measuring well-being, especially child welfare. It is used to determine and indicate whether a country is a developed, developing or is underdeveloped. It is also used to measure the impact of economic policies on quality of life.

As you can see on the next diagram, many of the countries with takaful potential are in the Medium and High categories of Human Development with some countries moving places from Medium to High and others getting closer to High level.

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Human Development Index

Ranking amongst 177 countries: Source UNDP

The **Human Development Index (HDI)** is the normalized measure of life expectancy, literacy, education, standard of living, and GDP per Capita. It is a standard means of measuring well-being, especially child welfare. It is used to determine and indicate whether a country is a developed, developing or is underdeveloped. It is also used to measure the impact of economic policies on quality of life.

Index of Human Development:		HIGH =1 to 70		MEDIUM = 71 to 155		LOW = 156 to 177	
Middle East	2002	2007	Moving Places	Asia	2002	2007	Moving Places
Saudi Arabia	77	61	16	China	94	81	13
Oman	74	58	16	India	127	128	-1
Qatar	47	35	12	Indonesia	111	107	4
Kuwait	44	33	11	Pakistan	142	136	6
Bahrain	40	41	1	Malaysia	59	63	-4
UAE	49	39	10	Thailand	76	78	-2
Turkey	88	84	4	Kazakhstan	78	73	5
Syria	106	108	-2				
Iran	101	94	7	EU and Americas			
Africa				Belgium	6	17	-11
Egypt	120	112	8	France	16	10	6
Libya	58	56	2	Germany	19	22	-3
Algeria	108	104	4	UK	12	16	-4
Tunisia	92	91	1	Russia	57	67	-10
				USA	8	12	-4

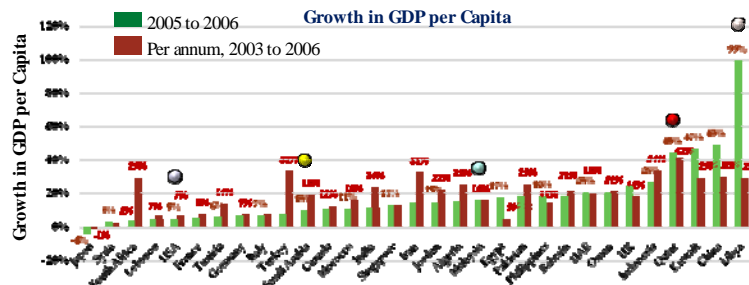
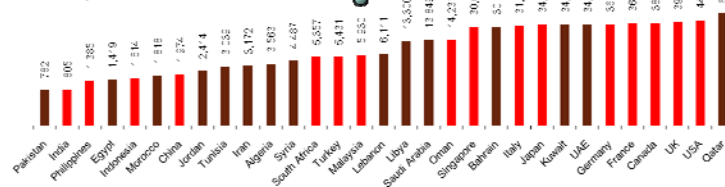
The GDP per capita and insurance premium per GDP are usually compared to have a feel of insurance penetration. The following diagram looks at not just the GDP per capita but the movement in GDP per capita over one year, 2005 to 2006 and over 3 years from 2003 to 2006.

Insurance Affordability: GDP

GDP Per Capita and its growth from 2005 to 2006 and annual growth since 2003

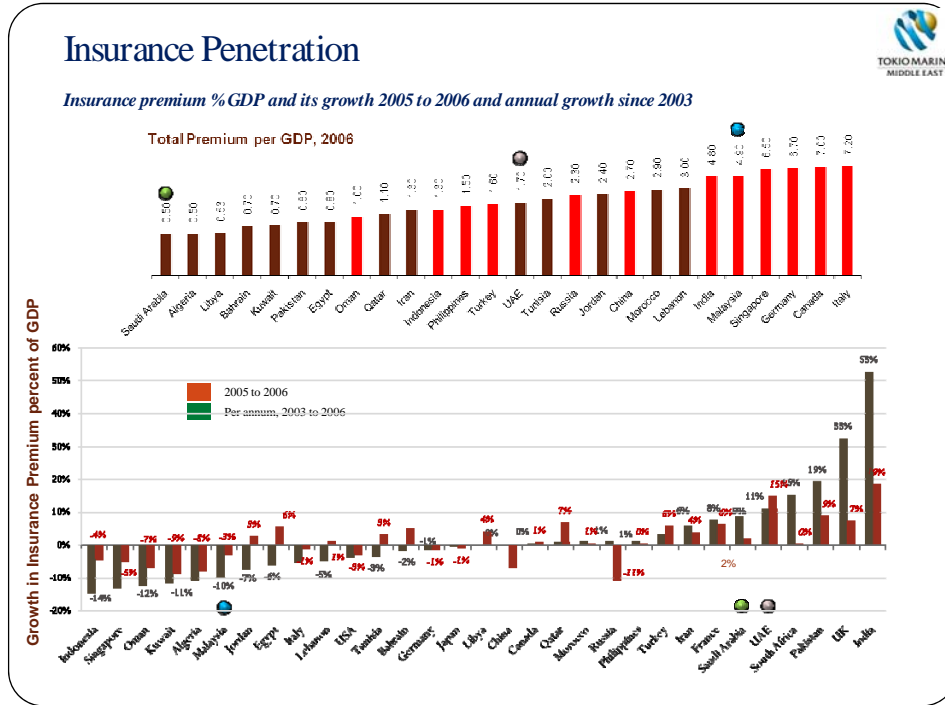


GDP Per Capita, 2006



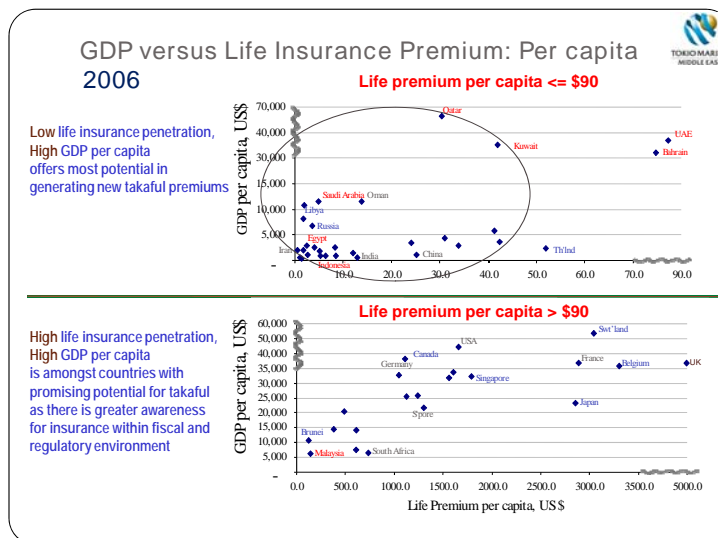
Will Takaful Penetration Meet Conventional Insurance?

In the above diagram, it can be seen that a lot of countries with takaful potential have shown good growth in GDP per capita over these years. Qatar, the highest in GDP per capita has shown over 40% growth. Libya that is somewhere in the middle in GDP per capita, has shown highest growth in 2005 to 2006.



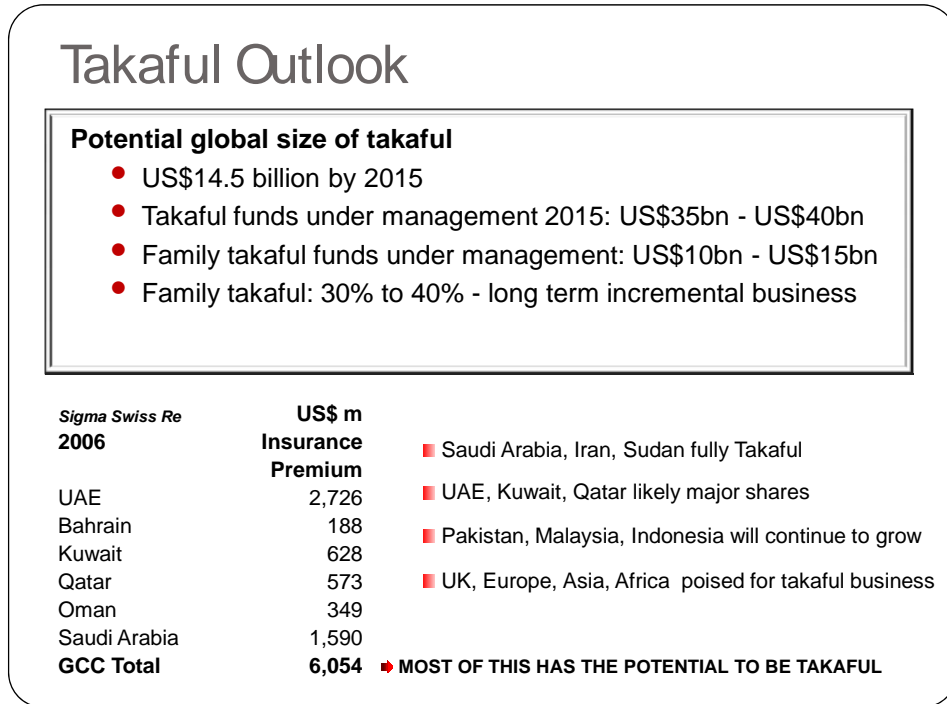
In terms of Insurance Premium as Percentage of GDP, the story is again quite different if we look at the improvement over the same period, see above. What is on the left for some countries in the upper graph, is on the right side in the lower graph showing higher growth.

Here is a look at life insurance penetration to assess the potential.



Countries with low life insurance penetration and High GDP per capita offer most potential in generating new takaful premiums . These are in the top graph. But countries with High life insurance penetration and High GDP per capita also hold promising potential for takaful as there is greater awareness for insurance within the fiscal and regulatory environment in these countries.

So, what is the outlook? There have been various figures circulating in the industry, lowest being \$7.4 billion by 2015. The highest is here, \$14.5 billion.



The argument at the beginning of this paper was put forward with a YES and a NO to the question of whether takaful penetration will meet conventional insurance. In the same manner, both estimates of the potential size of takaful industry have equal chance to be right depending on the degree to which takaful industry proves to be Shariah credible, whether or not we change our Mind Sets about retakaful, about working hard to make ourselves as the mainstream and not a niche and the degree to which we are committed to change the perceptions of our conventional counterparts and how actively we lobby with the regulators about fiscal and insurance legislation that should not impede the growth of Islamic finance and takaful. We need good standards of corporate governance and responsible Boards to ensure that this takes place. We need staff within takaful companies and regulatory bodies who are knowledgeable about Shariah and insurance and can act as Shariah experts within agreed Shariah Compliance Rules and standards acceptable within wider geographical regions and if we are lucky more globally. We need local associations of takaful and retakaful operators in addition to the one and only international body we have right now. In these associations, local issues and problems should be debated and resolved quickly. All this is essential to be Shariah Credible that will keep the trust of the consumer. The rest is all about operational management based

Will Takaful Penetration Meet Conventional Insurance?

on our technical strengths in Products, Systems, Distribution, the need for Banctakaful, the need for having long term products including pensions, the need for micro-takaful serving the poorer segments of society etc. Do that, and we can be sure that we will meet the penetration levels of conventional insurance in these markets over the coming few years.