Challenges and Opportunities for Re-Takaful

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Praveen Sharma, Head of Regulatory & Compliance, EMEA

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Existing Takaful & Re-Takaful Market

- Approximately 107 Takaful entities
  - Predominately small local players with modest capitalisation
  - Limited expertise and global standardisation
- Darurah or "necessity principle" has afforded Takaful operators the ability to use conventional insurance
- Limited number of established players – BEST Re, ARIL and Takaful Re
- Only a few rated operators
  - BEST Re(BBB+), Takaful Re(BBB), Tokio Marine Retakaful(AA).
- Recent emergence of international players –
  - Tokio Marine Retakaful , Hannover Re Takaful, Swiss Re and Munich Re

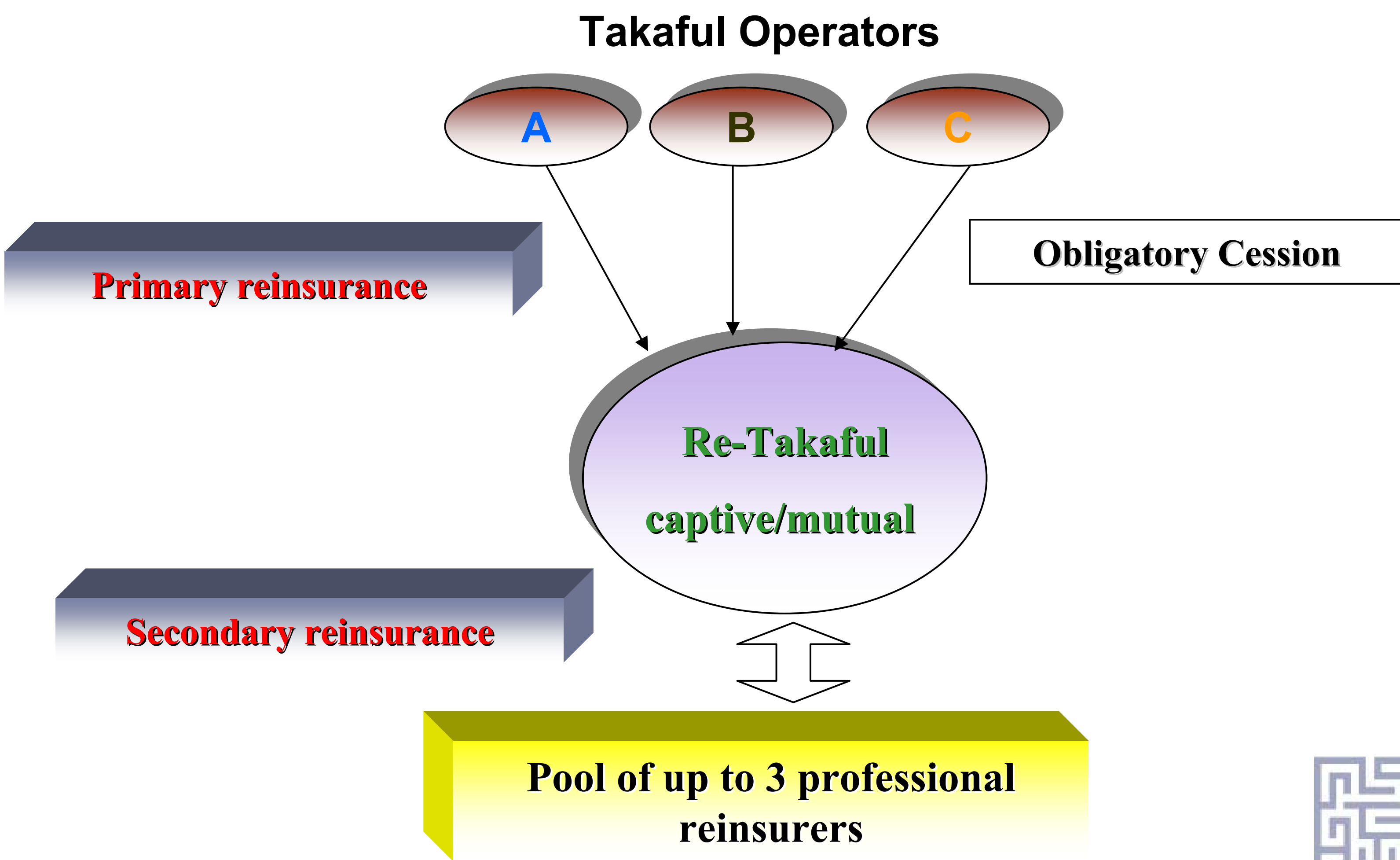
Re-Takaful Current Debate

- There is a technical requirement for risk transfer, reduced aggregation, limiting claims volatility and protection of assets
  - Co-insurance and reinsurance between Takaful operators may lead to no real risk transfer outside of the group
- Capacity and capital
  - Lack of a pool of Re-Takaful operators to spread risk
  - Takaful operators seek conventional reinsurance under the “doctrine of necessity”. However, this authorisation from scholars is only a temporary measure
  - Competition is limited
  - Reinsurance contractual terms remain rigid and underdeveloped
- Non proportional reinsurance may lead to a classic spiral where the risk is not dispersed outside of the market
- Re-Takaful operators must not adopt a “follower” strategy
  - currently there is a lack of underwriting and pricing expertise, limited market knowledge

Proposition

- Principle of pooling risks is important due to the currently small domestic Takaful markets
- Establishment of a Re-Takaful captive/mutual
  - Founded on basis of charity and cooperation
  - Reinsurance based on co-operative reinsurance
  - Capitalised by a group of Takaful operators that cede risks to it
- Compliant retrocession capacity
  - cede excessive risk from the captive is provided by professional reinsurance partners / pool.
- Shortage of skilled resources
  - such as underwriters, actuaries and investment fund managers makes pooling of risks more attractive
- Captive outsources insurance management services to 3rd party

Proposed Structure



Proposed Structure

- Re-Takaful operator could be structured on accepted models
- Wakalah model
  - Operator would act as an agent
  - Administer funds on behalf of participants
  - Receive a fee (over-rider) for operating expenses
- Mudharabah – profit sharing model
  - Operator acts as Mudarib (entrepeneur) with participants the capital providers
  - Losses paid by participants with a pre-agreed profit sharing agreement
- Wakalah/Mudharabah combination
  - Wakalah for insurance activities and Mudharaba for investment
- Waqf
  - shareholders make a donation to establish fund, eg Pakistan

Proposed Structure

- Interests of Takaful and Re-Takaful operators aligned
  - Income of Re-Takaful is fully transparent
- Contracts between Takaful and Re-Takaful operators likely to be based on Wakalah model
- Investment operations likely to be based on Mudharabah model
- Interest free loan (Quard Hassan) to cover deficits to be repaid by future surplus
- Distribution of surplus to should be made once adequate free reserves
- Choice of adopted model such as Wakalah, Mudharabah or Waqf has an impact on regional acceptance, domicile location for Re-Takaful operator

Advantages of Proposed Structure

- Compliance
  - Ceding risk to the Re-Takaful captive/mutual ensures that a higher proportion of reinsurance passes into the compliant market
- Pooling of reinsurance
  - Improved operating margins and increase in capacity of Takaful operators
  - Lead to lower expense ratios for Takaful operators
  - Protect Takaful operator from insolvency
  - Build a close continuing business interest in common between the Takaful and Re-Takaful operators because they are both at risk
- Increase in level of expertise within Takaful market
  - Represents intermediate solution that can evolve into a Re-Takaful operator that accepts third party risks
  - Using an outsource partner for insurance management helps impart knowledge, deal with expertise/resource shortages and adopt market best practise on good corporate governance & compliance

Advantages of Proposed Structure

- Professional reinsurer pool can assist direct writers with underwriting expertise
- High execution risk through lack of track record and unproven ability is mitigated by arrangements with professional reinsurers
- Opportunity to achieve insurer credit rating enhanced by well capitalised intermediate solution/entity with robust corporate governance framework
- National government initiatives encouraging joint ventures and foreign equity participation may help facilitate secondary reinsurance arrangements

Advantages of Re-Takaful Captive

MAJOR ATTRIBUTES	
1. Compliance with Shari'ah law & consistency throughout the Takaful and Re-Takaful market	✓
2. Capacity to write more direct business by Takaful operators	✓
3. Increase in Re-Takaful capacity	✓
4. Increased leverage of secondary reinsurance	✓
5. Increase in knowledge, expertise and resource	✓

Aon's Global Capabilities

- Insurance management services providing best practise underwriting services including claims management
- Direct, reinsurance and retrocession broking including DFA modelling and pricing support
- Enterprise risk management consulting including Shariah compliance audits
- Risk Based Capital modelling
- Capital raising
- Strategic consulting and market intelligence
- Support for new distribution channels
- Rating agency consulting
- Strong relationships with regulators
- Training and technical assistance

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