CHAPTER 5
Bancatakaful

5.1 Introduction

With Generali International choosing Takaful International as their representative in Bahrain, there is no denying that takaful continues its ascension to success. For both organisations, this agreement means that all Generali customers in Bahrain will benefit from Takaful International's services in health insurance and similarly, takaful family policy holders will benefit from Generali's expertise in the field of insurance and reinsurance. This example is just one of many showing how takaful is quickly being embraced by international insurance companies. With assets over USD 1000 billion, Islamic finance has shown amazing resilience over a turbulent 2009 and great promise so far for 2010. More particularly, growth has been noticeable in the field of Islamic insurance or takaful. Indeed, an increasing number of favourable factors contribute to this growth in the GCC (Gulf Cooperation Council made of the UAE, Kuwait, Saudi Arabia, Bahrain, Oman and Qatar) region as well as in Asia, amongst these, the emergence of a young, affluent and educated Muslim population. As demand increases, it makes sense to optimize product distribution and seek the best way of doing so.

5.2 The GCC

According to a report issued by Alpen Capital in January 2010[1], life insurance premiums in the Middle East and Central Asia grew at a CAGR of 9.3% in 2008, well above the global average of 4.1% and -3.5% for conventional insurance respectively.

In the Middle East, life insurance accounted for about 26% of all insurance products sold in 2008. If we look at patterns from developed economies, non-life insurance grows faster at the early stages of the insurance industry development, whereas the life insurance does so later. Consequently, there is significant room for growth for family takaful, as penetration is still low (1.5% compared to a global average of 7.1%). Analysts at Alpen Capital have identified several key drivers of life takaful in the GCC: besides demographics and greater affluence bringing on a change in consumer habits, there is also a wider choice of takaful products available and the fact that they are far better regulated as the industry gains momentum and learns from experience.

There are several ways to distribute takaful products. The popularity of each channel depends on the level of maturity of the industry in the country those products are sold. By optimizing their distribution networks and including takaful in their product range, banks open themselves to cross-selling opportunities, therefore generating annuity fee income. It also allows banks to achieve valuable economies of scale in areas such as marketing, IT and back-office processes. The compelling economics of the bancatakaful business model has proven a real success for joint ventures in the region.

The GCC has caught on that trend, as the industry is slowly gaining momentum there and as a consequence, similar initiatives have been launched in the Middle East. In November 2008, Zurich Financial Services signed an agreement to establish a joint venture with Abu Dhabi National Takaful. In June 2009, AXA announced its partnership with one of the world's largest takaful and retakaful group, Salama in the UAE. In November 2009, Allianz Takaful and Standard Chartered Bank have announced a five-year sales agreement to promote insurance products from Allianz Takaful in Bahrain. In Saudi Arabia, FWU Group, the global takaful provider, has a stake in Al Ahli Takaful Company and has forged successful distribution partnerships, such as with National Commercial Bank (NCB). FWU Group also enjoys a

[1] GCC Takaful Industry

very successful partnership with AMAN, based in Dubai.

If we take the example of Saudi Arabia, in many cases, banks have shareholding links with insurance companies and while they have not developed specific insurance schemes, they have influenced the placement of insurance through referrals. Some of the new joint-stock companies have major banks as leading shareholders, and these companies use the bank's distribution network to market takaful and simple personal lines insurance products. Al Ahli Takaful Company co-operates with NCB to distribute its products. There is no question that bancassurance is becoming an increasingly more important distribution channel in respect of individual and credit life business. For instance, one major majority bank owned takaful company acquires about 90% of its business through the bank.

According to the GCC Takaful Report, there are still some opportunities to be explored in the bancatakaful arena to maximize the use of this promising channel of distribution. Developing dedicated sales teams offering takaful products, offering them sales incentives at par with conventional products, designing customized long-term investment-linked savings and pension products for as well as investing in technology to deliver high customer service standards are some of the areas to be improved on to widen outreach and increase customer retention.

5.3 The case of takaful in Asia

According to the recently-issued World Takaful Report by Ernst & Young, the global takaful contributions grew 29% in 2008 to reach USD 5.3 billion. Experts forecast those contributions at USD 8.9 billion in 2010 and at USD 15 billion in 2015. While the GCC (Gulf Cooperation Countries) are leading in terms of volume, Asia comes second with contributions reaching USD 1.146 billion and registering a CAGR (Compound Annual Growth Rate) of 28%, in line with the global trend of the industry. The forecast for the region shows great promise: according to Ernst & Young, Asia should post results of USD 1.847 billion for the takaful industry in 2010. Malaysia remains the largest takaful market in South East Asia, with contributions nearing USD 0.8 billion in 2008, while Indonesia is the country knowing the fastest growth (35%). In terms of insurance penetration, Brunei makes an entrance in this year's statistics, with 0.23% achieved in a single year (as a reference, Malaysia's rate is 0.40%).

Line of business	Agents	Brokers	Direct sales
Group life	5	40	55
Individual life	75	5	20
Group health	5	40	55
Individual health	35	5	60

Note: Agents includes distribution through banks.
Source: Axco estimates based on market opinion.

Takaful has been popular since it was introduced in Brunei with the setting up of two takaful operators, Insurans Islam TAIB and Takaful IBB.[2] Currently, Brunei counts three takaful operators and the industry will see another development with the coming merger of Takaful IBB and Takaful BIBD.

In order to further strengthen the industry, Insurans Islam TAIB is currently tapping its own capital to meet the capitalization needed under a government order. Indeed, the firm will have to restructure its general takaful and family takaful units so that the two bodies will have a capital of USD 5.8 million each.

In Southeast Asia, Malaysia holds the strongest position in terms of takaful contributions volume, which stood at USD 889 million in 2008. According to the World Takaful Report, Malaysian takaful operators have fared better than their Middle East counterparts in terms of returns on equity since 2007, when world economies underwent the global financial crisis stress. Malaysian takaful companies also came out better in terms of risk retention; an indication that Malaysia has a more sophisticated operational capability. On retention, Bank Negara Malaysia's (BNM) Financial Stability and Payment Systems Report 2009 released in March 2010, had noted that the 'consistently high' net retention level of 72.3% for Malaysian general and general takaful business enabled counterparty reinsurance risks to be kept at 'manageable level'.

It added that as a majority of the offshore and foreign reinsurers were reputable companies with high ratings, it further reduced the extent of counterparty risk during the challenging financial climate in 2009. Indeed, the Malaysian landscape is made of global powerhouses such as

[2] Osman Mohd Jair, managing director of Insurans Islam Taib

Distribution channel	2004	2005	2006	2007	2008
Direct and telemarketing	61.0	44.3	38.0	32.0	30.0
Bancatakaful	6.5	20.4	25.0	30.0	32.0
Agency network	17.3	19.3	20.0	20.0	22.0
Brokers	14.6	14.2	15.0	15.0	14.0
Others	0.6	1.8	3.0	3.0	2.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank Negara Malaysia for 2004 and 2005; market estimates for 2006, 2007, 2008

Swiss Re, Hannover Re and Munich Re, but also of local operators such as MNRB Retakaful and ARIL, increasing the underwriting capabilities of the national insurance industry.

The country is a glowing example of how takaful is part of the financial awareness of customers: some banks report a share of non-Muslim takaful customers of over 50% and in some cases, over 70%, a sign of the successful integration of takaful in Malaysia.

BNM has recently approved the inclusion of takaful products and services within the scope of business which can be distributed by financial advisers. The inclusion of takaful products is a significant initiative as it will allow financial advisers to capitalise on the potential for growth of the takaful sector, given that the market penetration rate for takaful products is low at 7.7% and given the largely untapped Muslim population in Malaysia, who are usually more inclined towards Sharia-compliant products.

BNM however recognises that it will be essential for all financial advisers to be trained correctly and have the necessary knowledge in takaful, to understand the Sharia requirements and the differences between takaful and conventional products. It will therefore be necessary for financial advisers to obtain certain specific qualifications prior to being able to distribute takaful products. Distribution through bancatakaful has been increasing annually. In 2005, it represented 20.4% which is estimated to have increased to 32% by the end of 2008. This is due largely to competitive pricing and strong agency-driven distribution. BNM is playing an important role in the promotion of takaful in the country and has recently issued four new family takaful licenses. Already present in Malaysia, financial giants such as HSBC, Barclays and Standard Chartered are raising the bar for others to follow. The main Malaysian players are CIMB Aviva Takaful Bhd, Etiqa, Hong Leong Tokio Marine Takaful Bhd, Prudential BSN Takaful Bhd, Takaful Ikhlas Sdn Bhd, AIA Takaful International Bhd and Syarikat Takaful Malaysia Bhd, all having greatly contributed to the success of takaful in the country. Also, Bank Negara Malaysia has launched an initiative called "insuranceinfo" which is a joint effort between the Bank and takaful industry to provide educational information enabling consumers to make well-informed decisions when purchasing insurance or takaful products from their banks.

Hot on Malaysia's steps is Indonesia, which has shown impressive growth levels in 2008. The takaful sector in Indonesia continues to grow steadily, due mainly to the popularity of unit-linked products. Today, takaful contributions amount to USD 150 million (1.5% of total insurance premiums of the country) and the whole activity is shared between three takaful operators and 39 takaful windows. A glowing example of bancatakaful success in Indonesia is provided by PT Bank Mandiri, who in 2003, joined forces with AXA, the French insurance giant. Together, through their combined distribution channels, they reach an impressive 72 million customers who have exposure to their unit-linked takaful products (Mandiri Investasi Sejahtera and Mandiri Rencana Sejahtera). Another way to make the wider audience aware of the takaful offering in Indonesia is through advertising. This is the case for PT Prudential, who, since launching its takaful operations in September 2007, saw takaful contributions reach USD 85 million) in 2008 – accounting for nearly 25% of its total business in Indonesia[3].

In Singapore, the Islamic insurance or takaful market is expected to see strong growth this year according to Daud Vicary Abdullah of Deloitte, quoting a 15% increase for this market.

In Pakistan, the agent-oriented network is the dominant distribution channel. Agents are also known as salesman or development staff according to the insurers' particular practice. Whatever denomination is used, the channel of distribution is exclusive to one insurer. A minority of agents operate on an independent basis, working with a number of companies. These are known colloquially as "cash and carry" agents. EFU Life, for example, has links with Faysal Islamic Bank and Barclays Bank for the purposes of distributing life and related products. New Jubilee Life Insurance is a subsidiary of the Aga Khan Fund for Economic Development based in Switzerland (AKFED), which also has management control of the Habib Bank Ltd, the largest commercial bank in the private sector. The newly established Adamjee Life has a distribution agreement with Muslim Commercial (MCB) Bank, one of its shareholders. Standard Chartered Bank is a leader in bancassurance.

5.4 Good governance and best practice

However, some developments in the industry will need to take place. According to the Alpen Capital report, one of the solutions would be mergers and acquisitions: that way, takaful operators would not see their profit margins decrease. Some takaful operators in the GCC and Asia have already chosen to combine forces with large international players by creating joint-ventures with them. For takaful to truly flourish, it seems that partnership in the sector is essential to achieve economies of scale as well as enable cross-border distribution of takaful. According to Dato Hj Syed Moheeb innovation is key, as are the following: a new approach to product and process development (such as dynamic equity principal protection strategy), new distribution models to reach an evolving consumer base (optimised bancatakaful) as well as exploring new investment avenues. Measures such as these will help drive growth by focusing on consumer needs. Again, the involvement of global players will facilitate implementation of innovation, as their internal operational infrastructure and better budget allocation are most conducive to introducing beneficial changes.

For Ernst & Young, one of the growth factors identified, is a consistent governance and risk management policy for takaful operators globally. Currently, there are as many codes of conduct and ethics as there are Shari'a interpretations, that is to say, too many. According to Professor Rodney Wilson of the Faculty of Islamic Studies in Qatar, good governance could impact the takaful industry in more positive ways than one: not only would it enhance public confidence that the operator they are

[3] Kevin Holmgren, President Director of PT Prudential Life Assurance, Middle East Insurance Review August 2009

dealing with is conforming to appropriate sets of rules, but it also would provide useful and relevant information to participants or potential consumers. There are indeed some best practices that could help takaful players operate more efficiently and have a more transparent infrastructure: clear definition of strategic and operational roles for each decision-making body and implementation of Shari'a-compliance at every investment and underwriting stages. Indeed, the IFSB, based in Malaysia, has issued an exposure draft on "Standard on Solvency requirements for takaful undertakings", in which it identifies the components necessary for an Islamic insurer to operate efficiently from a governance and risk management perspective. According to the IFSB, an essential part of good governance is the existence of an appropriate mechanism for sustaining a takaful undertaking's solvency and adherence to sound risk management. In view of their importance and in particular of their effects on systemic stability – so crucial and relevant these days - takaful operators should always bear these in mind while planning and mapping their governance strategies, whatever the strength of the solvency regime imposed by the supervisory authority. Another consideration to take into account is the retakaful capacity: global brands such as Munich Re, Hannover Re and Swiss Re, together with regional players like Takaful Re and MNRB Retakaful have contributed to enhancing the Islamic reinsurance capabilities. Today, there are nine fully-fledged retakaful operators and most have operations in Malaysia. It is a well-known fact that Malaysia has always been at the forefront of regulations for the industry. Indeed, it is widely acknowledged that the South East Asian model should be a blueprint for all insurers who have the desire to explore takaful, whether local operators or international players.

5.5 A changing landscape for all takaful players

However, there is unanimous agreement among experts that the global markets for takaful remain largely under-penetrated. Consequently, for takaful to have a fair share of the USD 4 trillion-worth global insurance pie, it is essential consumers become aware of its advantages. Again, Malaysia is at the forefront of consumer education with its education programme launched by its central bank, Bank Negara Malaysia. Information and education are especially crucial in the aftermath of the global financial crisis, as consumers tend to choose safety above risk taking. Takaful can provide this sense of security for consumers as investments are asset-based and its principles based on solidarity and sharing of risk and profits. For example, the dynamic principal protected equity strategy - like the one offered by FWU Group - is one of the most significant innovations that will certainly have a great impact on takaful consumers as well as on takaful operator's growth. The main benefit for the customer is that the new technology secures capital growth at maturity by locking in the highest net asset value (NAV) of the strategy measured on a monthly basis during the complete term of the investment. The new technology is used in FWU's family takaful investment-linked programmes. But the global crisis also had repercussions on banks distributing takaful: increasingly, banks have seen increased terminations for non payments and high lapsation rates. Again, in this instance, the role of good governance and the implementation of best practices are essential: assessing consumers' appetite for the products as well as conducting the appropriate risk profiling will ensure consumers are offered the products which are most suited to their needs. Also, the lack of investment opportunities for takaful operators is having a negative impact on consumer choice. Diversifying the investment opportunities would not only dilute the risk and increase the range of products available but also would be more in line with the risk management direction the takaful industry needs to take.

5.6 Bancatakaful

In the majority of cases, takaful remains deeply embedded within the overall wealth management operations of global financial institutions which typically offer the full range of conventional as well as Islamic banking services. It inevitably results in potential internal conflicts of interest between the Shari'a-compliant technicians within the bank who are responsible for product design and development and the retail network responsible for delivering the product to the customer. The conflict arises because very few of the leaders in the bancatakaful sector have stand-alone sales forces able or willing to dedicate all their resources to the promotion and distribution of Takaful.

This issue creates a "shelf space management" challenge whereby takaful has to jostle its way amongst other conventional insurance and banking products. Those are introduced on the market on a regular basis, whereas takaful is a life cycle savings and protection solution in its nature. It means that although takaful knows dynamic innovation, products are not launched with the same frequency. Consequently, takaful's challenge is to stand out from credit cards, personal finance and other retail banking products. To remedy this, senior management should offer a level playing field where the sales incentives are similar to other banking products. Alternatively, distribution could be achieved through an investment team responsible for the sale of products with longer shelf life, such as mutual funds and structured instruments alongside takaful-linked products. This is the case for DIB – one of the most successful distributors of takaful in the UAE - with their AlIslami Takaful Programme, the latest addition to their suite of wealth management solutions, which include Shari'a-compliant savings schemes, mutual funds and other structured products.

Another way to alleviate that challenge is through white labeling, the benefits of which for the banks are numerous, as they can give their own name to the products, integrate their own mutual funds to the mix and avoid heavy investment in research and development, while still diversifying their range of products.

Another related challenge for more generalist players with a background in conventional products is to ensure that their staff has access to constantly updated and practical training programs on takaful. Providing staff with access to thorough and ideally web-based educational programs will give specialist sales teams the knowledge and confidence they need to distribute takaful products more effectively. Indeed, big major international banks tend to have dedicated on-line training departments, such as Barclays, HSBC and Standard Chartered, who all have entered the market of Islamic insurance by opening dedicated windows in the GCC.

The fourth edition of the World Islamic Insurance Directory published jointly by Takaful Re and Middle East Insurance Review also showed an increase in the number of operators in the takaful market. According to both organisations, the Gulf Cooperation Council has 77 takaful operators, Iran 18, the Far East, 37 and Africa, 29. It begs the question: if all those companies were abiding by the same rules and regulations, would it mean the industry would finally gain the impetus and credibility it needs to move forward?

Bancatakaful can only be described as a win-win situation for all stakeholders: for the takaful operator (by having access to the bank's wide customer base and benefiting from lower costs than those charged by agencies for example), the banks as distributors (by enabling them to increase their product offering and revenue generating capabilities) and the customers (by having access to a wider range of financial products from a trusted source.) However, though the first signs of improvement are certainly very clear due to the foreign players visibly and increasingly investing in takaful, there is still much to be done if bancatakaful is to realise its very rich potential. However big the challenge, there is certainly a willingness for it to become the predominant channel of distribution in the Middle East and Asia.

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