Takaful Structure & Models with Practices

Mechanism of mutual help & solidarity, based on Pooling system

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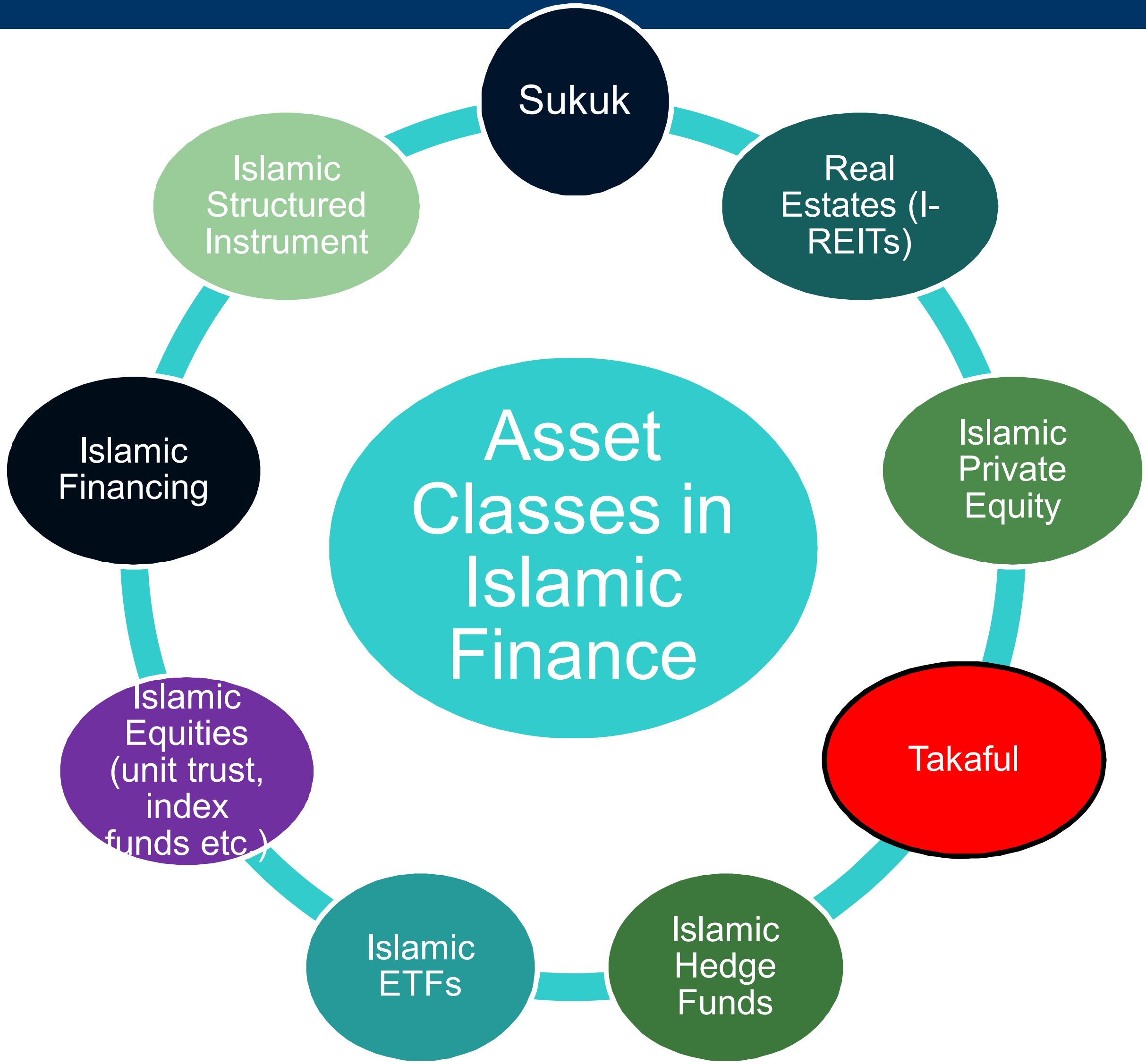
1. **What is Takaful?**

Shareholder's account & Policyholder's account

Asset Classes in Islamic Finance



What is Takaful Insurance ?

- Compliant with Sharia principles (Islamic law)
- Takaful comes from the Arabic root-word ‘kafala’- guarantee

  - Literally translated means “ joint guarantee”
- Similar to co-operative or mutual insurance
  - Policyholders underwrite the risk
  - Policyholders own the company
- Allowance for a charitable donation of surplus
  - Solidarity and Assistance to those that need it
  - Community pooling system
- Terminology
  - General Takaful – general insurance
  - Family Takaful – life insurance and pensions

Theoretical and conceptual aspects of Takaful

- Islamic jurists resolved that the system of insurance, which falls within the confines of Islamic framework, should be founded on the concept of *al-Takaful*.
- An Islamic insurance transacting is a policy of **mutual co-operation, solidarity and brotherhood** against unpredicted risk or catastrophes, in which the parties involved are expected to contribute genuinely.
- The nature of the principles of *Takaful* is fundamentally different from the principles of conventional insurance.

WORKING OF THE TAKAFUL BUSINESS: The Malaysian Case

- Takaful Business is based on the concepts of Mudarabah and Tabarru. Involvement of these two Islamic forms of business eliminates the elements of Riba from insurance contract and convert Gharar into tolerable form.

- In Family Takaful each Takaful installment is divided and credited into two separate Accounts namely, the Participants' Account(PA) and the Participants' Special Account(PSA).

- A substantial proportion of the installments is credited into the PA solely for the purpose of savings and investment.

- The balance of the installments is credited into the PSA as `tabarru‘ to pay the Takaful benefits to the heir(s) of any participant who may die before the maturity of the contract.
- The amount accumulated in the PA is invested in various business according to Islamic financing techniques, and the resultant profits are divided between the company and the participants according to the agreed upon ratio, e.g., 30-70.
- The participant's share is calculated according to their individual share in the PA, and credited into their respective accounts, the PA and the PSA.

2. **Differences Bet'n Conventional & Islamic Insurance**

similar logic with cooperative & mutual insurance

The Difference Between Conventional and Islamic Insurance

<u>Conventional Insurance</u>

1. Based on a buy and sell contract.
2. The subject matter of the contract which is concluded as a buying and selling transaction contains unknown and uncertain factors (Gharar).
3. The whole business is said to have semblance of gambling as profit or loss which is depend on 'chance'.

<u>Islamic Insurance</u>

1. Must not be based on buy and sell contract.
2. The subject matter of the contract must be definite, clear and transparent so that it is known to all parties of the contract.
3. The system contain the element of shared responsibility enabling the spreading and sharing of profits or losses among a group of members.

How is Takaful Insurance Different ?

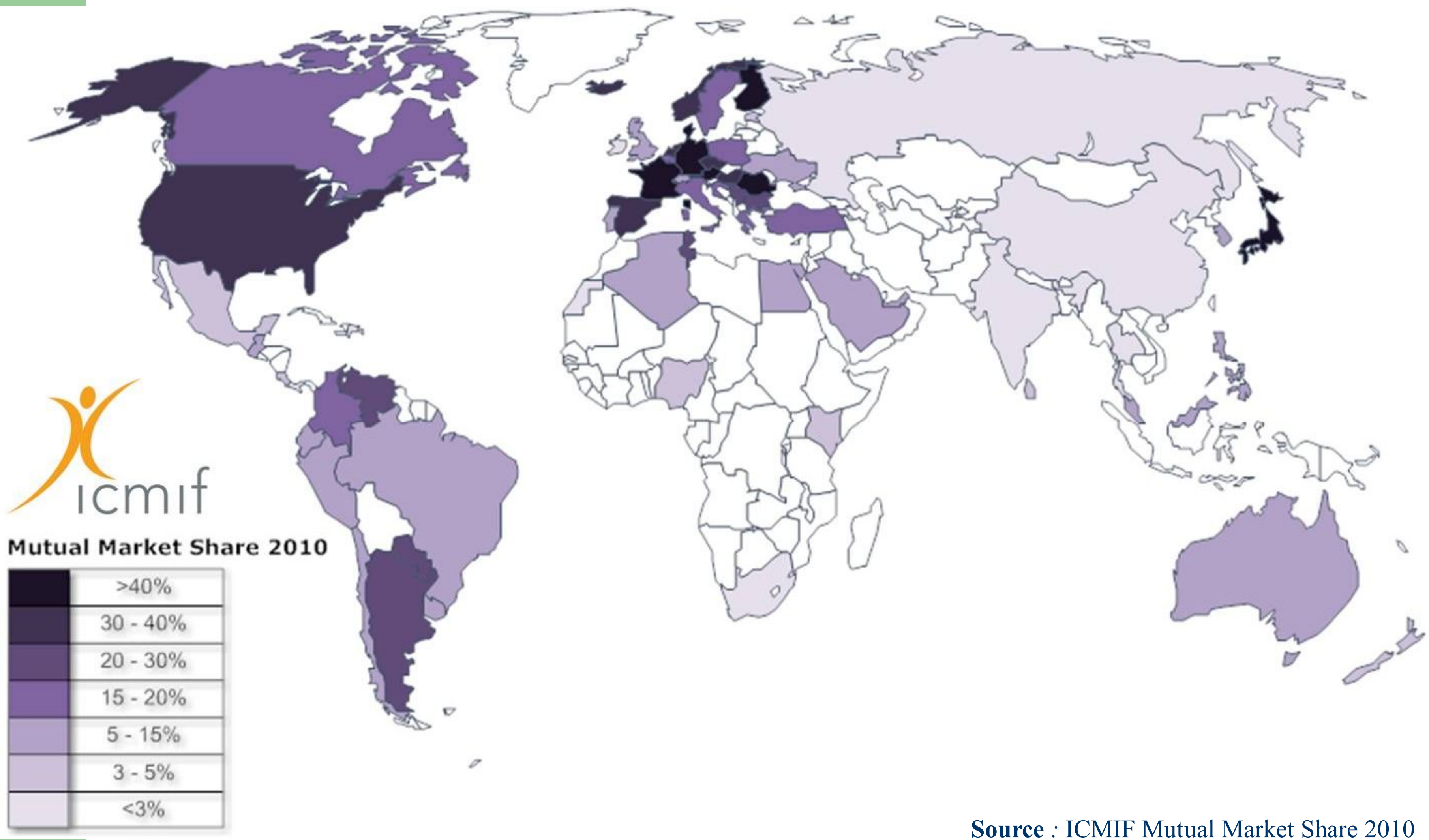
- Certain aspects of normal insurance conflict with Sharia principles

Maysir (Gambling)	-	insurers make bets on the loss occurrence and this is deemed to be gambling
Gharar (Risk & Uncertainty)	-	timing and amount of the loss are uncertain
Riba (Interest)	-	investments in interest bearing securities and possible interest on loans
Haram (Forbidden / Unlawful)	-	investments in commodities or involvement in activities that are forbidden (alcohol, pork etc).

Comparing Takaful to Conventional Insurance

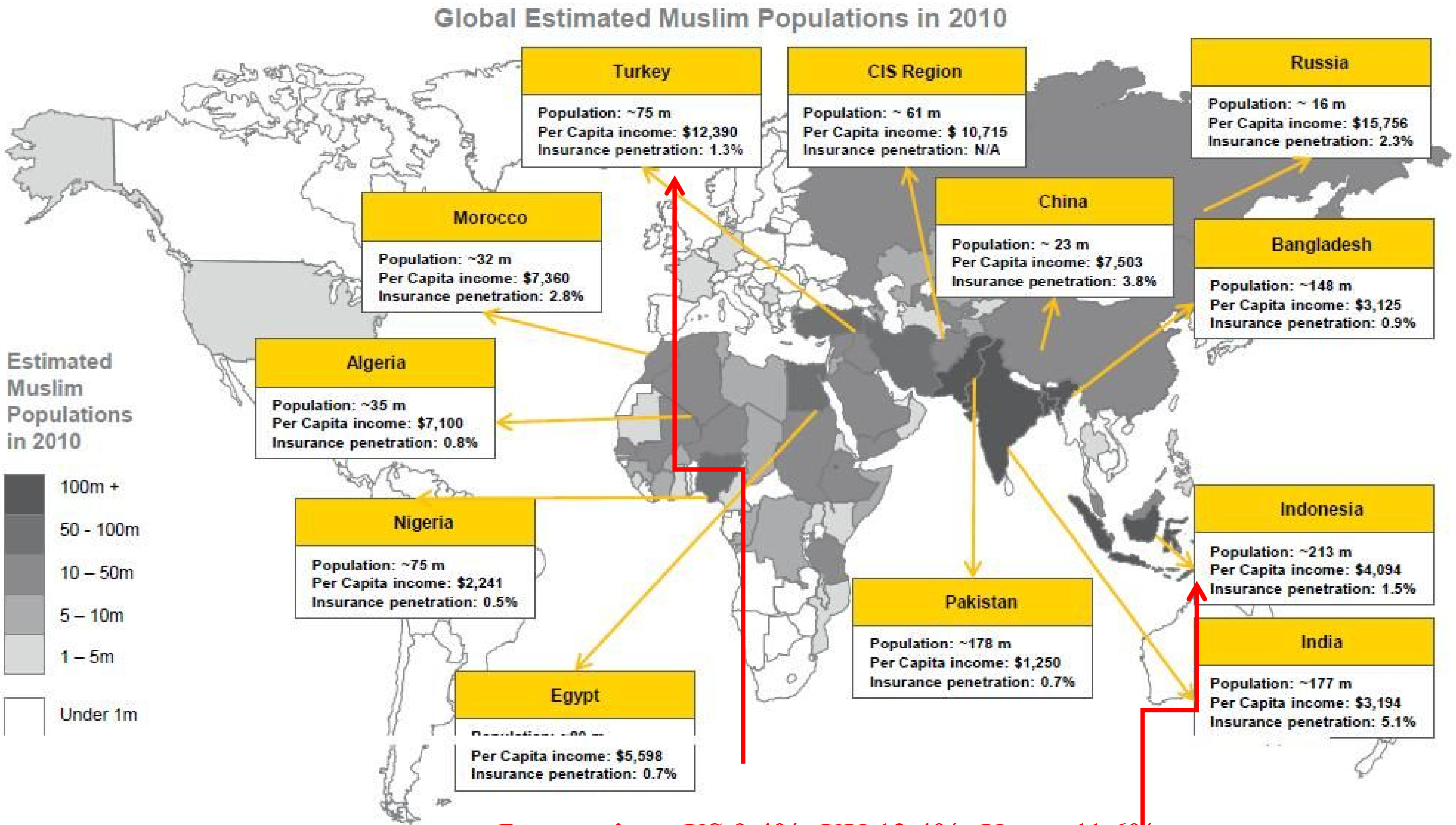
Issue	Conventional Insurance	Takaful
Organization Principle	Profit for shareholders	Mutual for participants
Basis	Risk Transfer	Co-operative risk sharing
Value Proposition	Profits maximization	Affordability and spiritual Satisfaction
Laws	Secular/Regulations	Sharia plus regulations
Ownership	Shareholders	Participants
Management status	Company Management	Operator
Form of Contract	Contract of Sale	Cooperative, Islamic contracts of Wakala or Mudarbah with Tabar'ru (contributions)
Investments	Interest based	Sharia compliant, Riba-free
Surplus	Shareholders' account	Participants' account

Mutual market share 2010



Source : ICMIF Mutual Market Share 2010

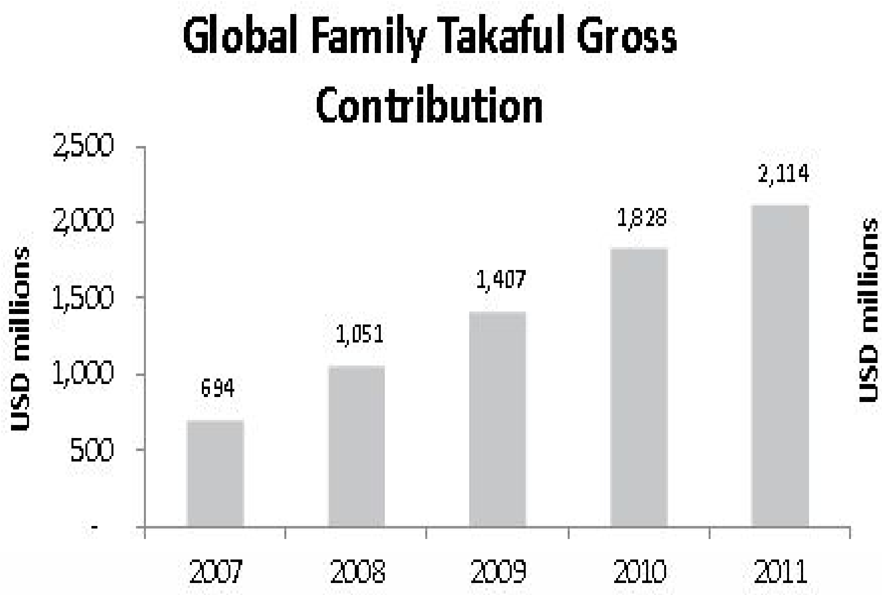
Potential Takaful markets have minimal mutual insurance

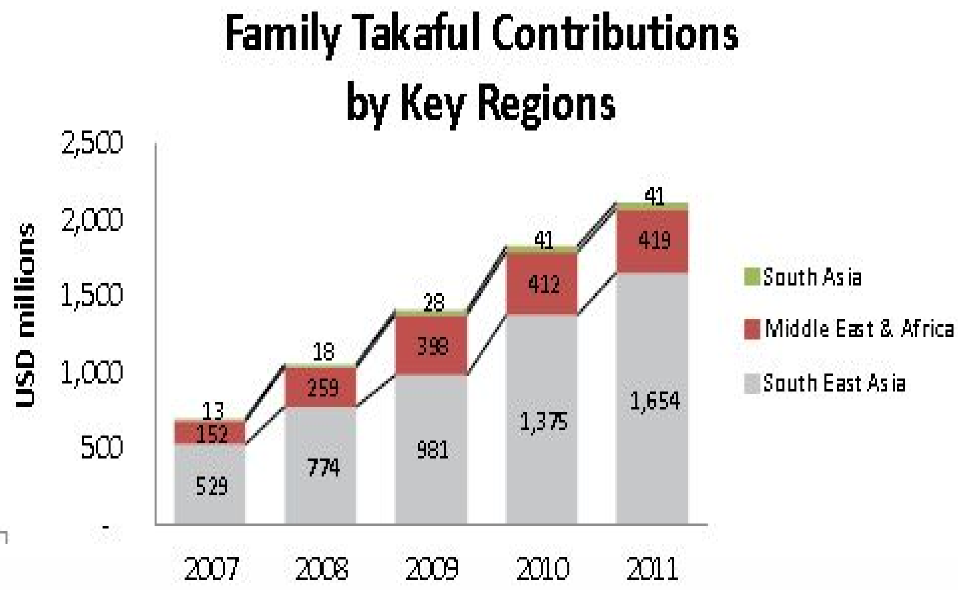


Penetration : US 9.4%, UK 12.4%, Korea 11.6%

Source: : The World Takaful Report 2012, Ernst & Young

Family Takaful Gross Contribution

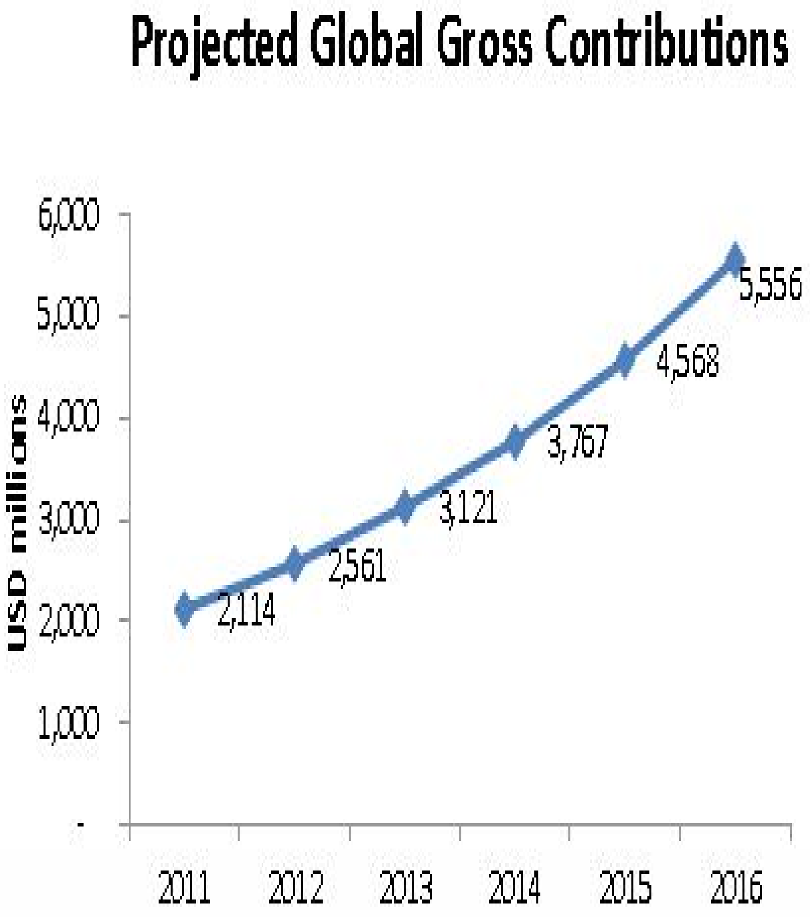


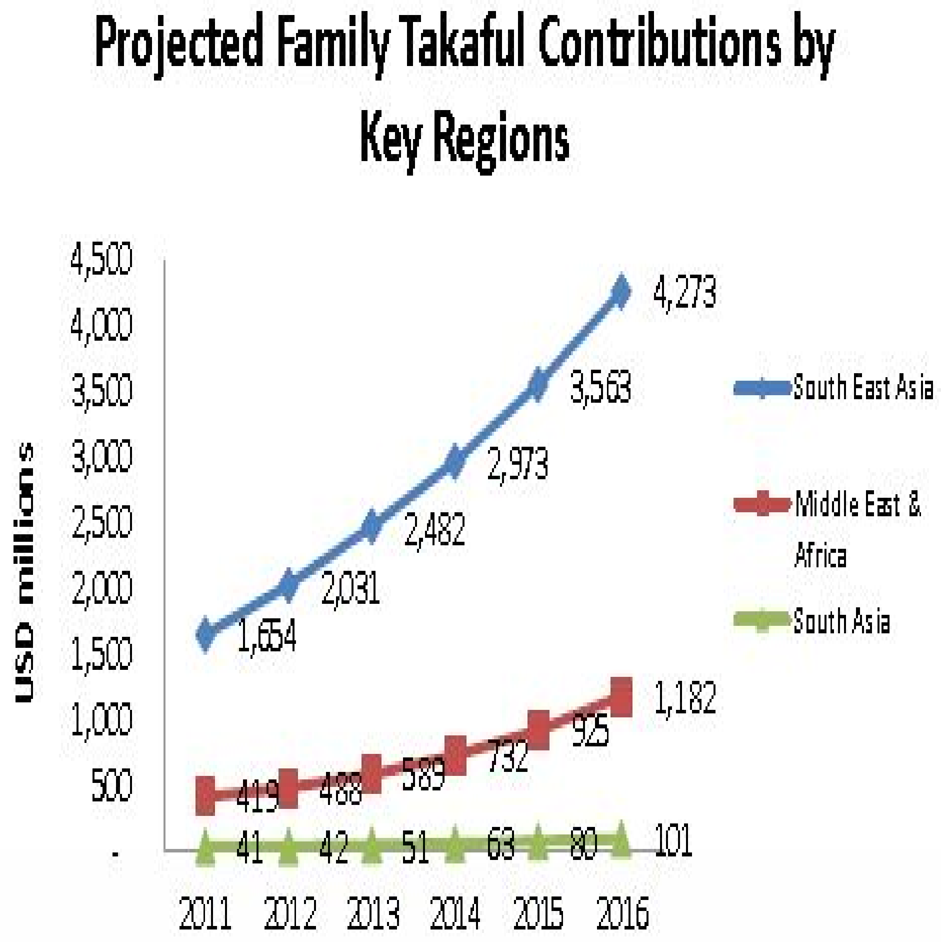


	Growth 2008 / 2007	Growth 2009 / 2008	Growth 2010 / 2009	Growth 2011 / 2010	CAGR (2007-2011)
South East Asia	46%	27%	40%	20%	33%
Middle East and Africa	70%	54%	4%	2%	29%
South Asia	36%	59%	46%	0%	33%

Source: Global Family Takaful Report, 2013, Milliman

Family Takaful Gross Contribution - Projections





Source: Global Family Takaful Report, 2013, Milliman

Takaful Projection(2015)

Sector	**US$ (billion)**	**%**
Global Conventional Insurance	1,600	99.3
Global Takaful Market	11	0.7
Total Insurance Industry	**1,611**	**100.0**

Region	**US$ (million)**	**%**
Arabian Countries	4,200	38.2
South East Asia	3,700	33.6
All Other	3,100	28.2
Total	**11,000**	**100.0**

Type	**US$ (million)**	**%**
General	4,125	37.5
Family	6,875	62.5
Total	**11,000**	**100.0**

Source: Global Takaful OutLook, 2013, HSBC

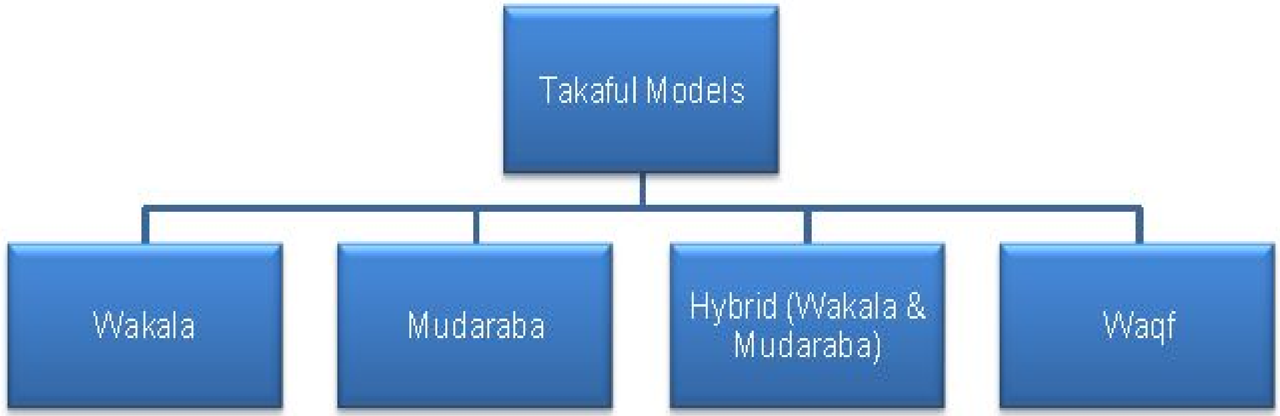
3. Takaful Models

Wakala, Mudarabah & Hybrid and more Waqf

Source: Islamic Life Insurance: The world of Takaful, 2012, AON

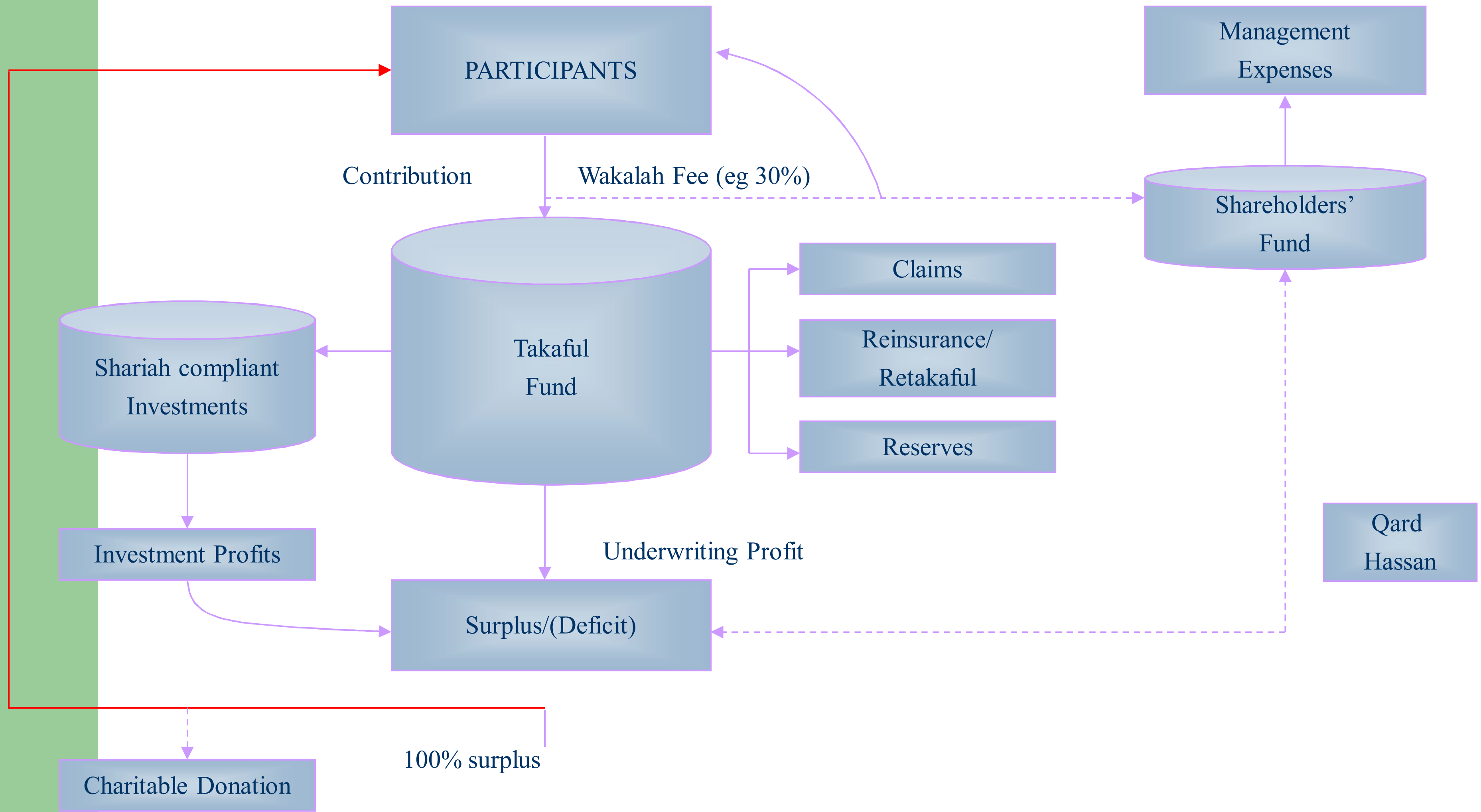
Introduction to Takaful Models

There are **four main different Takaful Models in use today.**

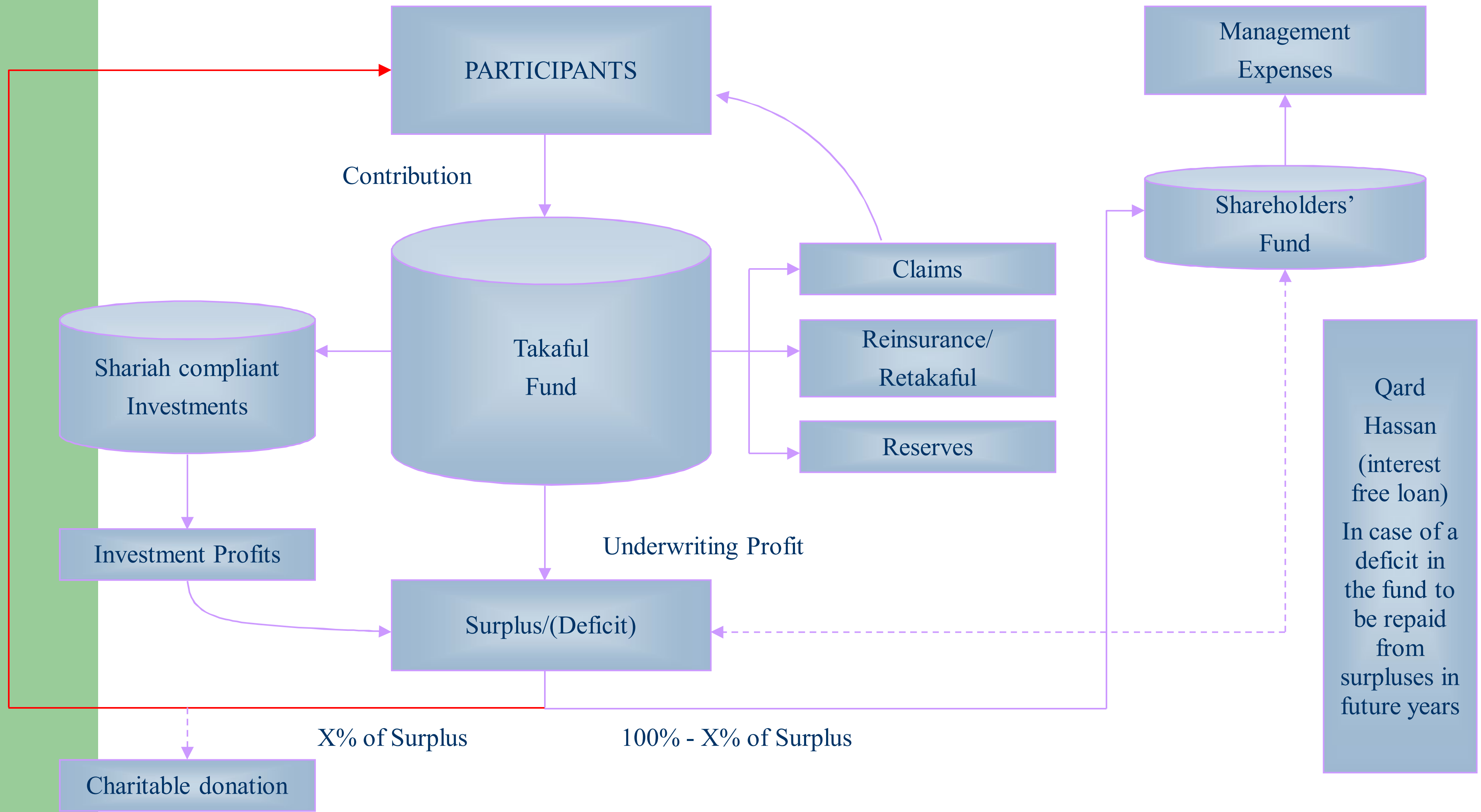


- Note that each one of those basic models can be implemented in slightly **different ways, creating a number of sub-variants of those models.**

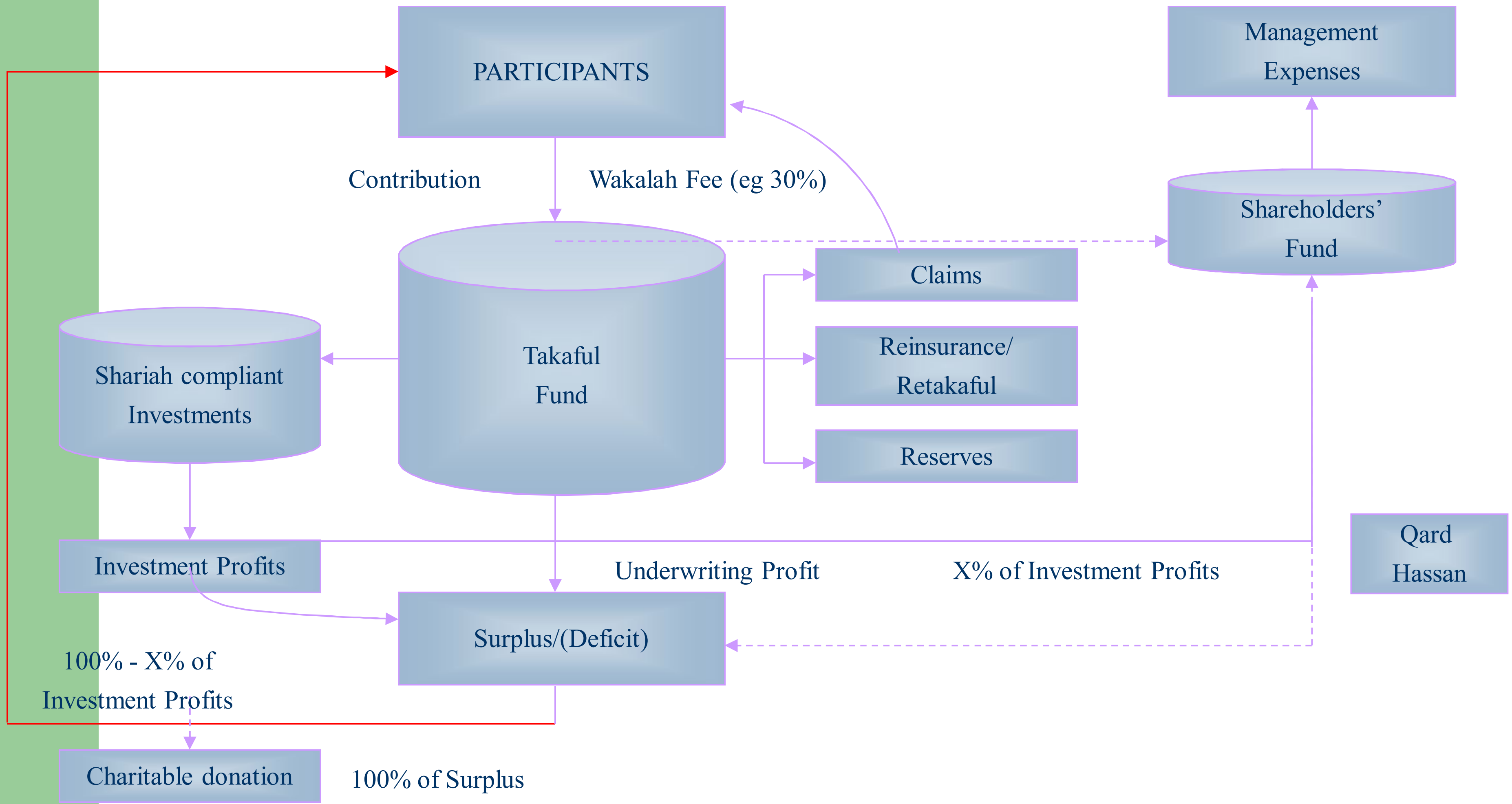
Wakalah Model



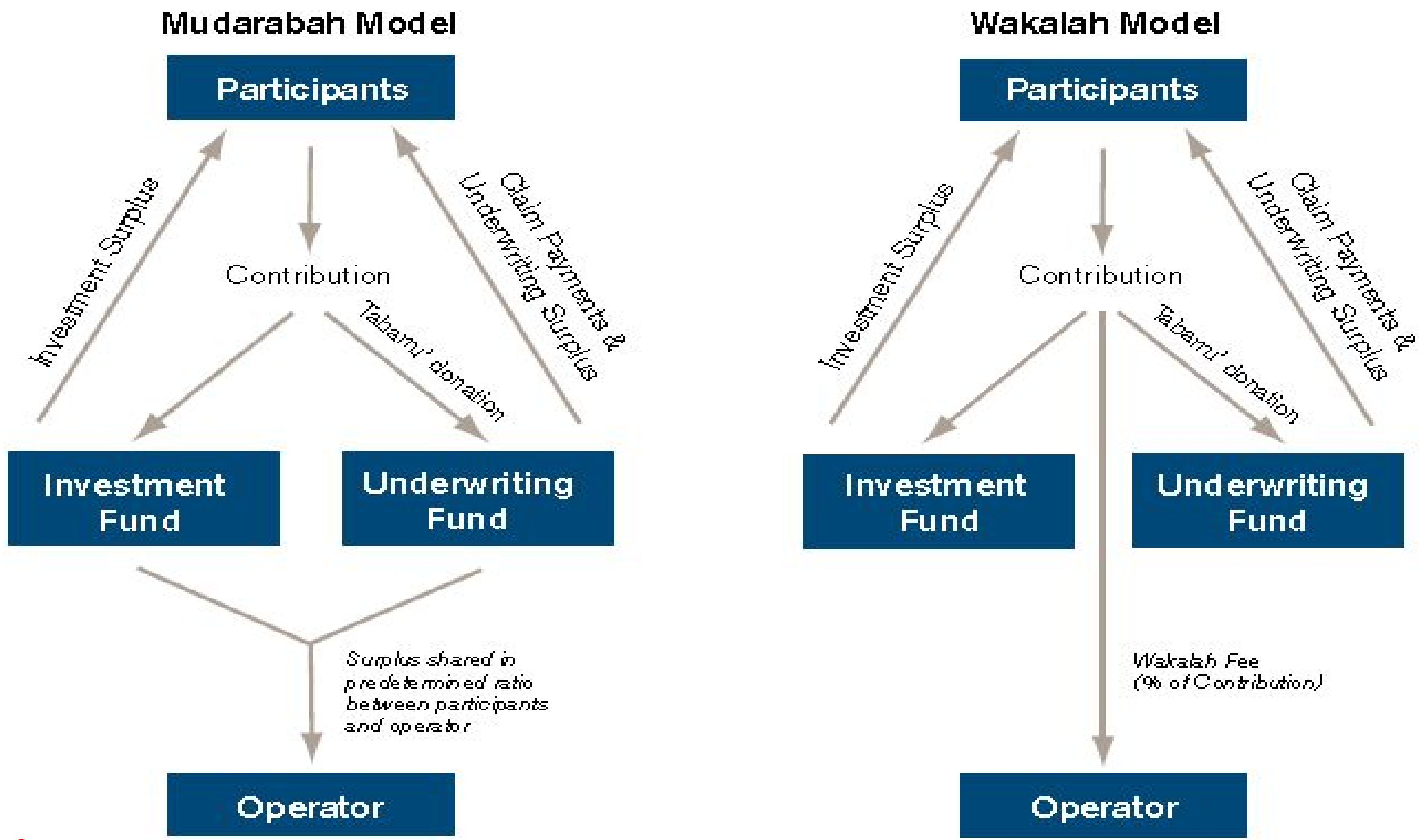
Mudharabah Model



Wakalah / Mudharabah Hybrid

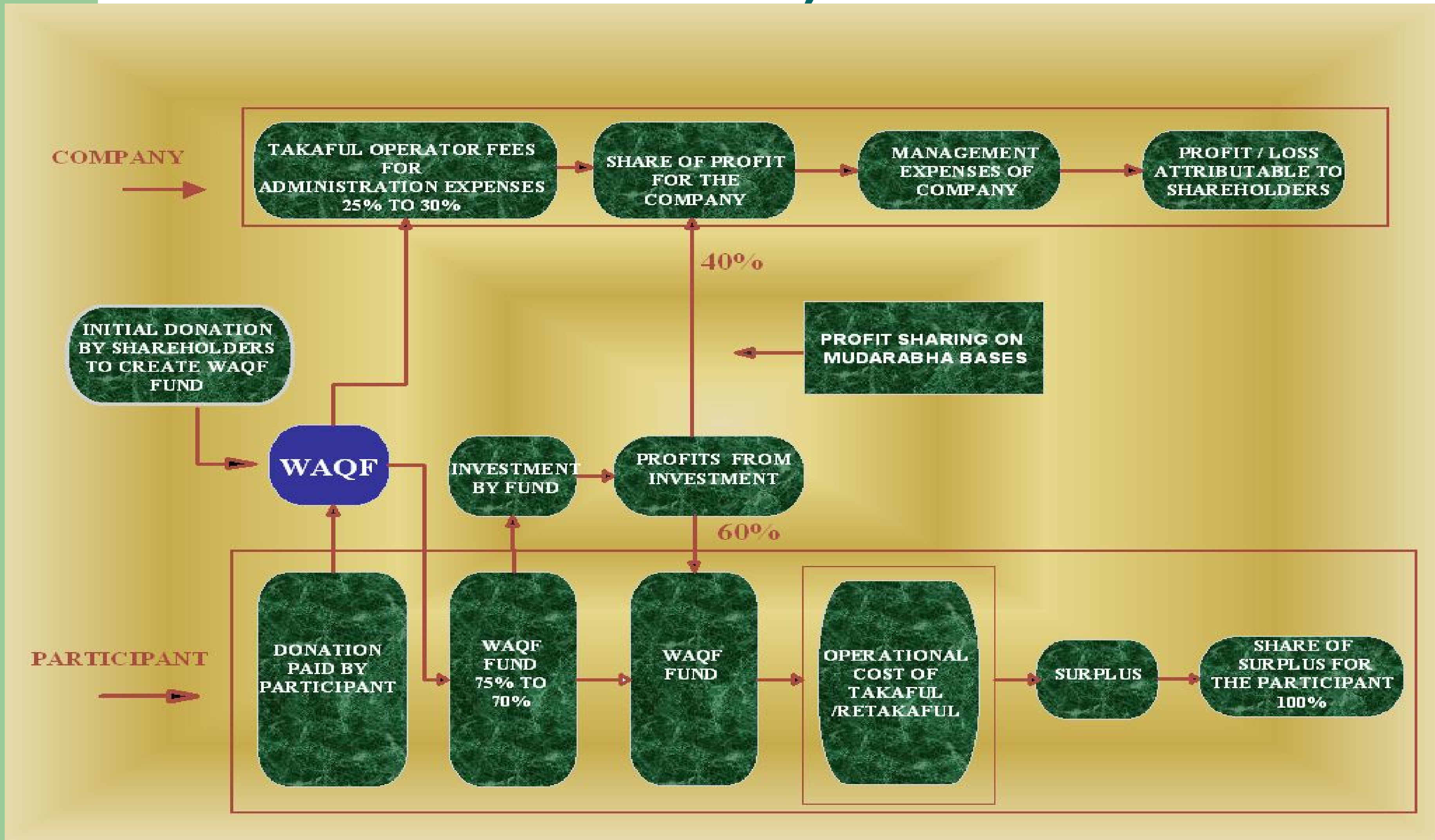


Comparison of Mudharabah & Wakala Models



Source: Takaful - Challenges & Opportunities, S.Jaffer,2011

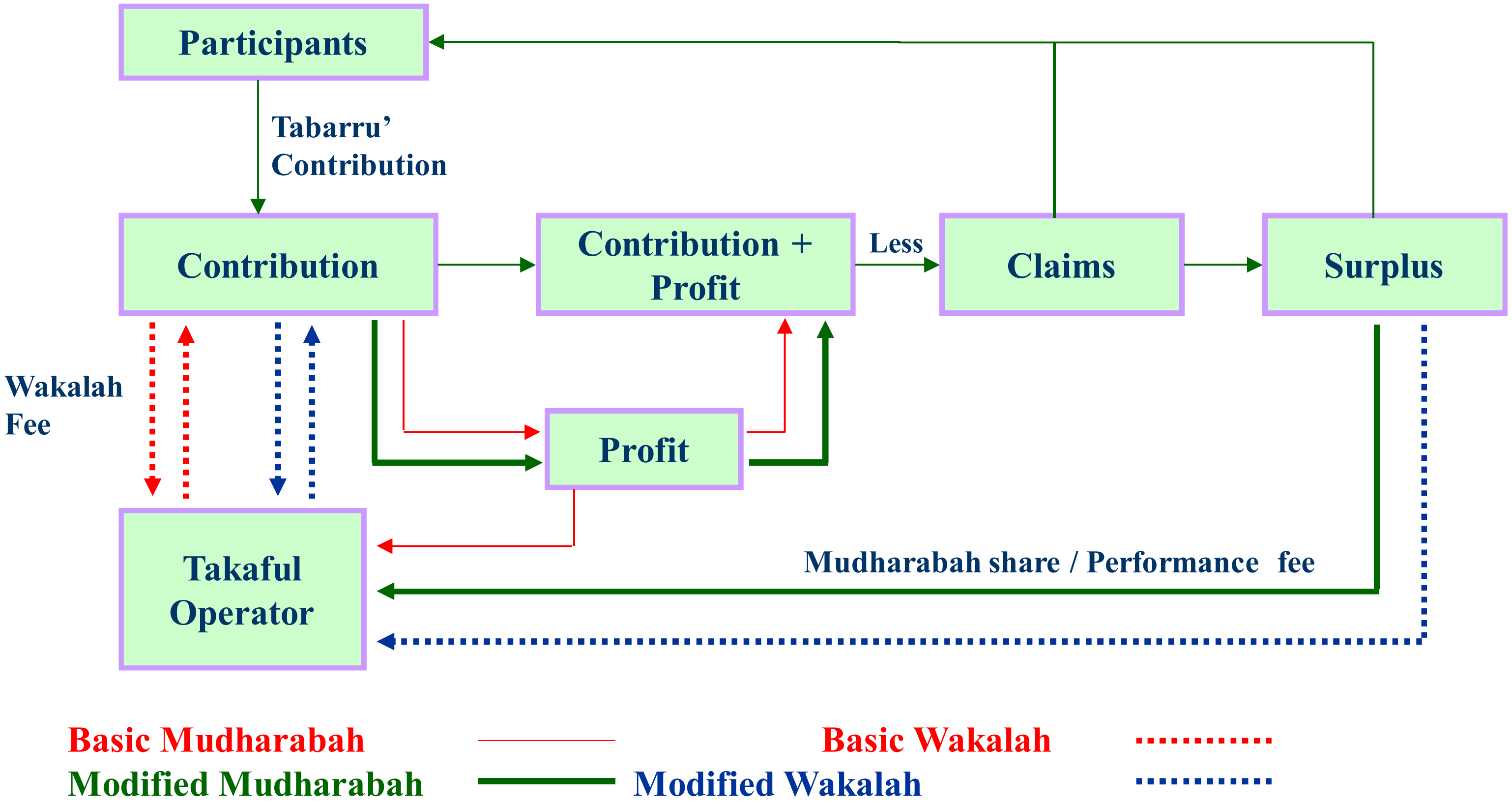
WAKALA-WAQF MODEL (INDIVIDUAL TAKAFUL SCHEMES)



Source: Takaful Business Models, A.Rahim,2011

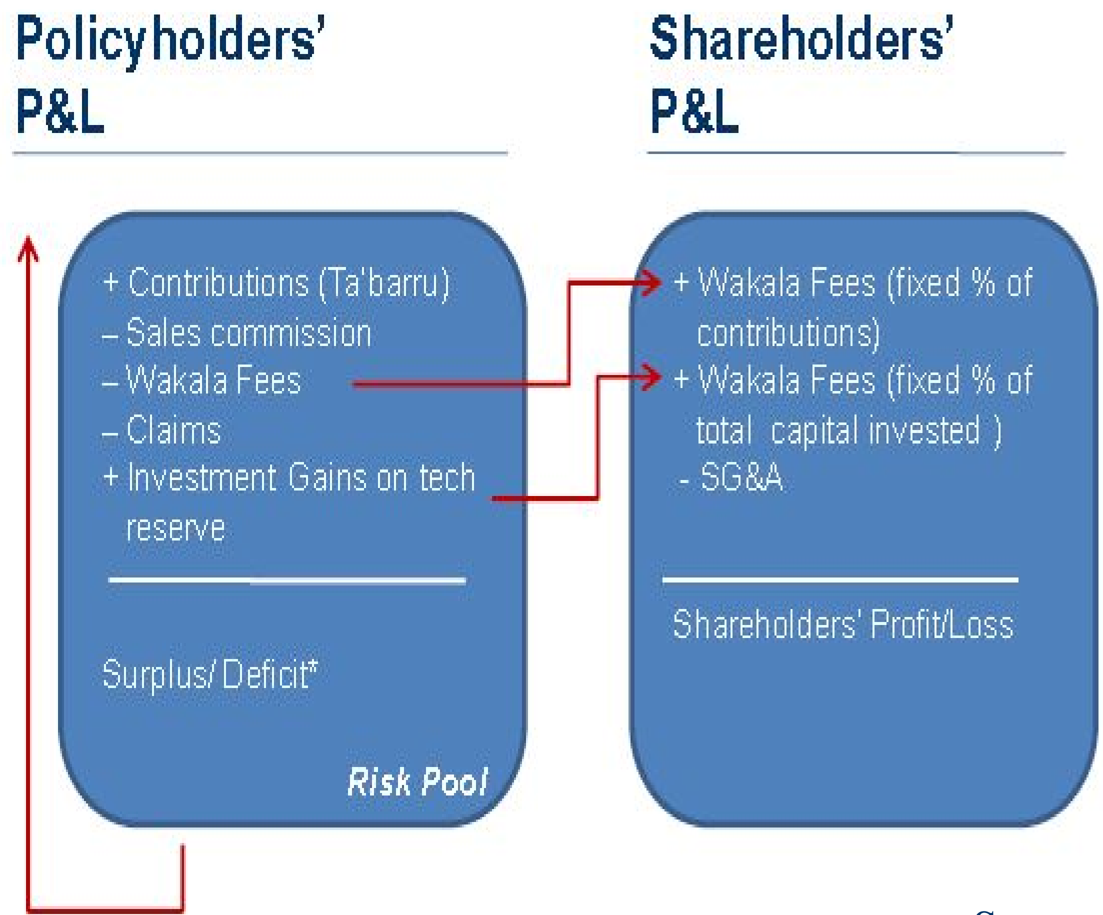
VARIOUS TAKAFUL STRUCTURES

Adaptation by asset managers is dependent on different form of fee/profit/surplus flows



Source: CERT Workshop on Takaful (February 2008)

Pure Wakala Model Mechanics



Key Features:

- A fee based model
- Operating expenses are borne by **shareholders**
- Wakala fees charged upfront
- Discipline to operate within cost structure to yield Shareholder profit

Source: AAOIFI-World Bank Conference,2012

Takaful Models' Features

	Pure Wakala	Mudaraba (Surplus Sharing)	Mudaraba (Non Surplus Sharing)	Mudaraba (Kuwait)	Hybrid (Bahrain)	Waqf
Shareholder income from fees	Yes	No	No	No	Yes	Yes
Shareholder income from investment gains	Fee as a % of capital invested	Profit share	Profit share	Profit share	Profit share	Fee as a % of capital invested
Shareholder income from underwriting surplus	No	Profit share	No	Profit share	Profit share	No
Operating Expenses borne by	Shareholders	Shareholders	Policyholders	Policyholders	Shareholders	Shareholders
Operating Expenses are paid	Upfront Wakala fee to compensate for SG&A	None – shareholder pays	SG&A charged to policyholders at year end	SG&A charged to policyholders at year end	Upfront Wakala fee to compensate for SG&A	Upfront Wakala fee to compensate for SG&A

Source: AAOIFI-World Bank Conference,2012

Payment of claims

Should the Participant die or suffer Permanent and Total Disability in the fifth year of participation, Takaful benefit will be paid in the following manner:-

1. From Participant's Account = RM 4,890
   (RM978 x 5)
   profit if any, say = RM 400
2. From Participants Special Accounts (RM1000 x 5) = RM 5,000

Total Takaful Benefit Payable(1+2) = RM 10,290

In case the Partcipant survived

Should the Participant survive until the maturity of his FTP, payment of Takaful benefit will be made to him as follows:-

1. From his Participant's Account (RM978 x 10)	=	RM 9,780
profit from investment	=	RM 1,800
2. From Participants Special Account(PSA)	=	RM XXXX
Total Takaful Benefit(1+2)	=	RM 11,580 + surplus determined by Shariah Takaful.

4. Retakaful

Takaful of Takaful

- Treaty & FAC

Risk Sharing trough Retakaful/reinsurance

Takaful Holders

- Individuals or companies that purchase takaful products by paying an agreed upon contribution to the takaful operator.

Takaful Operator

- The operator will use some amount from the takaful fund to pay a contribution to the retakaful operator

Retakaful Operator

- Retakaful operators cannot operate without the operation of takaful operators. Thus, the competitiveness of retakaful markets depends on the competitiveness of takaful markets.

The Importance of *Retakaful in Takaful* Business

Generally, to assist *takaful* operators by:

- Protecting the solvency of the *takaful* operator and its participants.
- Providing underwriting flexibility and the capacity to accept risk.
- Stabilizing claims cost and therefore giving greater stability to *takaful* contribution pricing
- Allowing *takaful* operator to effectively utilize the assets of the *retakaful* provider to give coverage to its clients

TYPES OF RETAKAFUL

1) Treaty retakaful

Retakaful is placed under a standing agreement.

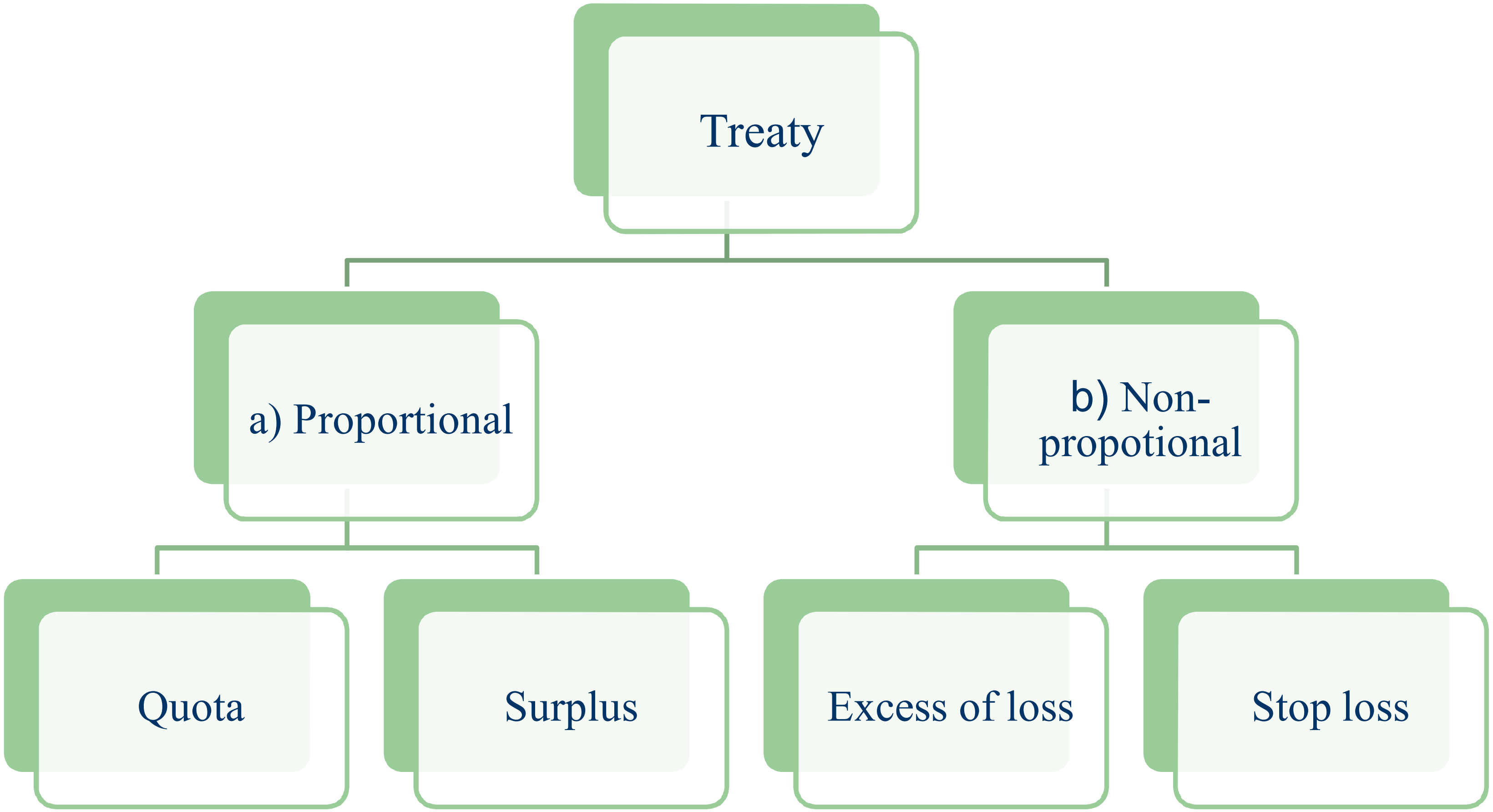
All risks within the agreement are automatically accepted by the ratakaful companies

2) Facultative retakaful

Case by case basis.

No obligation for both takaful and retakaful operators to enter into the arrangement.

TYPES OF TREATY RETAKAFUL



5. Takaful Practices – Family & Motor

How much do I get in case of claims?

HSBC Amanah, Etiqa & May Bank

Family Takaful Example
- HSBC Amanah (LifeSelect Regular Plan)

Contribution Allocation Rate Table

Year	1	2	3	4	5 to 9	10 onwards
Allocation Rate	55%	70%	75%	85%	95%	100%

Example: Illustration for an Annual Contribution of RM8,000

Year	1		2		3		4		5 to 9		10 onwards	
Annual Contribution	RM8,000		RM8,000		RM8,000		RM8,000		RM8,000		RM8,000	
	%	RM	%	RM	%	RM	%	RM	%	RM	%	RM
Annually Allocated Contribution	55	4,400	70	5,600	75	6,000	85	6,800	95	7,600	100	8,000

Products of Islamic Insurance

Sum Covered Multiple Table

Age Band	Minimum Sum Covered (Multiple of Annual Contribution)
0-16	60
17-25	55
26-35	50
36-45	35
46-55	25
56-65	15

- Sum Covered calculation example:

- If you are 32 years old and to pay a contribution of RM3,600 a year,

- Your minimum amount of Sum Covered is as follows:

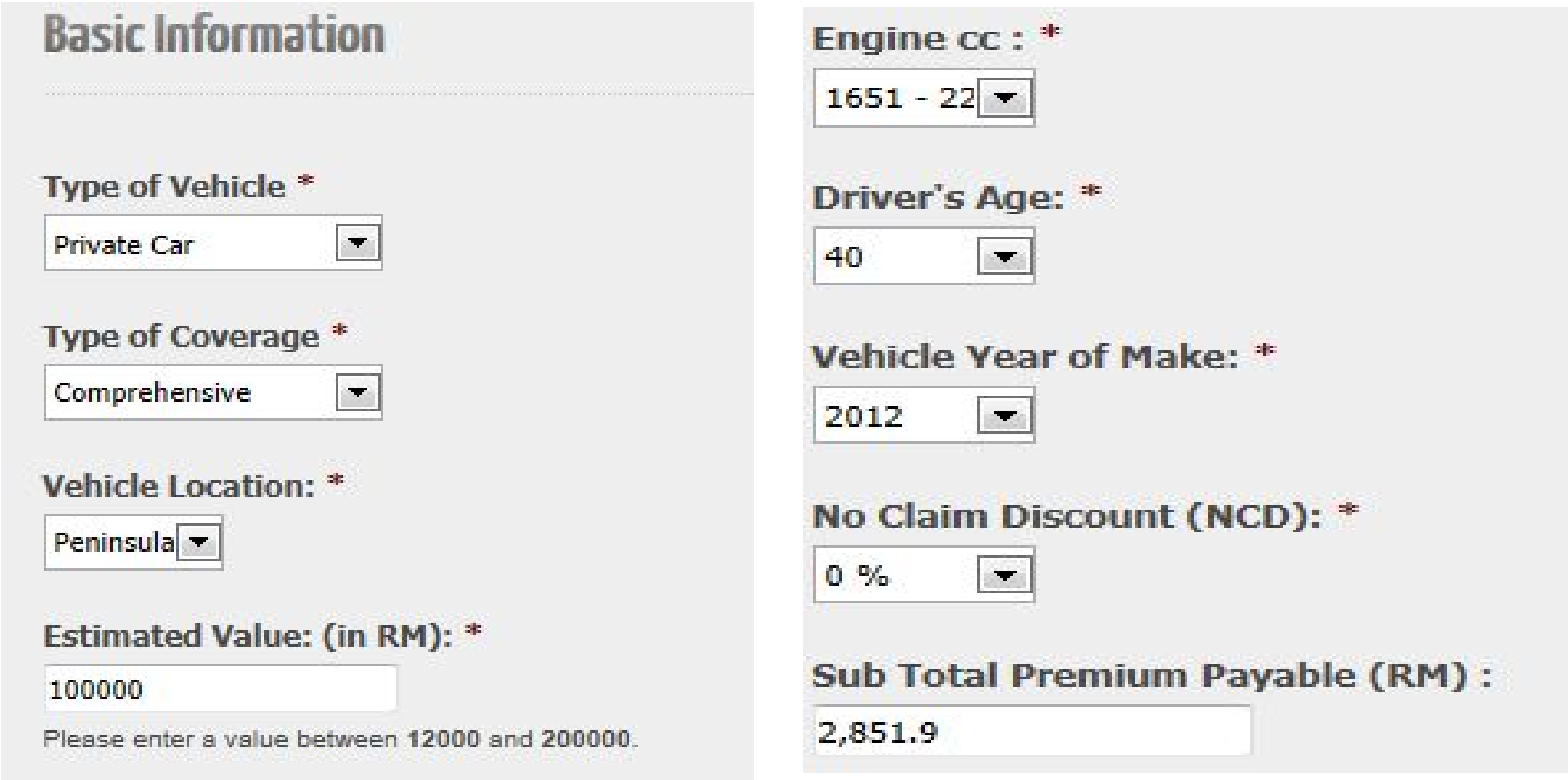
RM3,600 x 50 (Minimum Sum Covered multiples)

= RM180,000

Family Takaful Example
- HSBC Amanah (LifeSelect Regular Plan)

Description	Fees and Charges
Wakalah Fee (Agency Fee)	A portion of the *Wakalah* Fee will be used to pay the commission to the intermediaries. *Wakalah* Fee as a percentage of contribution: • Annual contribution – from 5% to 45% • Initial / Ad hoc top-up – 5%
Monthly *Tabarru'* (Donation)	• *Tabarru'* rates are not level and are based on covered persons' attained age • Additional *Tabarru'* is payable for Riders
Monthly Service Fee	RM5 per month
Fund Management Fee (chargeable as a percentage of investment fund value)	• HSBC Amanah LifeSelect Equity Fund – 1.5% p.a. • HSBC Amanah LifeSelect Fixed Income Fund – 1.0% p.a. • HSBC Amanah Takaful's Asia Pacific Islamic Equity Fund – 1.5% p.a. • HSBC Amanah Takaful's Dana Dividen – 1.5% p.a.
Stamp Duty	A one-time stamp duty of RM10 will be borne by the Participant, to be paid with the initial contribution

Motor Takaful calculation


Basic Information

Type of Vehicle *

Private Car

Type of Coverage *

Comprehensive

Vehicle Location: *

Peninsula

Estimated Value: (in RM): *

100000

Please enter a value between 12000 and 200000.

Engine cc : *

1651 - 22

Driver's Age: *

40

Vehicle Year of Make: *

2012

No Claim Discount (NCD): *

0 %

Sub Total Premium Payable (RM) :

2,851.9

Motor Takaful Surplus calculation

(1) A takaful operator has a total surplus (S) of RM4 million

(2) total general contribution (GC) of RM10 million.

(3) Your contribution (C) for the year is RM1,000

(4) the surplus will be shared between you and the takaful operator at a pre-agreed sharing ratio (PSR) of 50:50.

Then, share of surplus that you will receive is ⇒⇒

(1) Surplus sharing ratio

= 50%(PSR) * RM4M/RM10M

= 20%

(2) Your portion

= PSR * Contribution

= RM 200

THANK YOU