

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
INSURANCE AND PRIVATE PENSIONS COMMITTEE**

OECD Roundtable on Islamic Insurance/Takaful Market and its Development

21 June 2017

The REV1 updates the speakers to the Roundtable.

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OECD ROUNDTABLE ON THE ISLAMIC INSURANCE/TAKAFUL MARKET AND ITS DEVELOPMENT

*21 June 2017 (14:30-17:30)
OECD Conference Centre, Paris, France*

I. Introduction

1. Islamic insurance is a practice that respects Islamic principles, although the term Islamic insurance and takaful insurance are often used interchangeably. Strictly speaking, Islamic insurance is the generic term of which takaful insurance is one of the types of Islamic insurance.

2. Takaful is a type of insurance devised to comply with sharia law and comes from the Arabic term for reciprocal guarantee, deriving from the term “kafala”. Takaful incorporates the principles of mutual assistance and voluntary contribution, and is thus similar to mutual insurance with policyholders insuring each other. In their investments, takaful firms must follow religious guidelines such as a ban on interest and pure speculation.

3. Takaful is a specialised insurance practice that is provided primarily to Muslims that wish to acquire sharia compliant insurance products, and while still a minority even in Muslim countries, is a growing segment of the market. Given the large Muslim population in a number of OECD member countries it is a growing segment of the market even in countries where Muslims are the minority. In addition, due to the principles like mutual assistance and joint risk sharing and restriction in investment fields takaful can be considered as an ethical service for non-Muslims too.

4. However, the size and impact of takaful products on regulation and the market are not clear given the limited available data to understand the scale of the market. Of the countries that participate in the OECD Global Insurance Statistical collection, for example, Malaysia and Turkey includes takaful products in its global statistical data, while Indonesia provides separate data for conventional and takaful products and does not include takaful data in its global data.

5. The main takaful markets are in the Gulf and South East Asia. In Europe, London is an important Islamic financing centre, although its takaful market is not well developed. Germany and France have the largest Muslim populations with each having approximately 4.7 million Muslims, or respectively 7.5% and 5.8% of the population. The forecast is for the EU’s Muslim population to reach around 8% by 2030 (Pew Research, 2016), meaning the demand for takaful products may increase in Europe as well.

6. This Roundtable is being organised to inform delegates of the Committee on what takaful insurance is, as well as how it is regulated and what can be expected in terms of market development. There are also implications for how takaful products are taken into account for the OECD Global Insurance Statistics.

II. What is Islamic insurance?

7. As mentioned above, Islamic insurance/takaful is a specialised insurance practice that is provided primarily to Muslims that wish to acquire sharia compliant insurance products. Although protecting

individuals and businesses from undesirable events have been practiced in Islam, conventional mechanism of transferring risk in return for premiums is not deemed to be in line with Islamic Law.

8. The unsuitability of conventional insurance to Islam is related to three concepts (Ayub, 2007):

- *Gharar*: refers to high uncertainty in transactions, which is prohibited in Islam. As conventional insurance is by nature uncertain of whether a risk occurs or not, as well as timing of the risk and level of risk, it is not considered to be in line with Islamic principles.
- *Maysir*: refers to gambling which is strictly prohibited in Islam, as the gain of one party shall not be premised on the loss of another party. Also the gain should be proportionate with the investment. In conventional insurance transactions, if there is no claim, the premium becomes the gain of the insurance company, or if damages are incurred the claim paid is generally higher than the premium amount.
- *Riba*: refers to the prohibition of transactions involving excess interest yield (usury). However, conventional insurance companies would leverage their investment return for part of the claim payment which would be considered inappropriate in Islamic principles.

9. The legal discussion in this field is ongoing and the understanding among scholars may not be the same. For some, *riba* is critical and, should insurers take into account interest free investment concerns, insurance is in line with Islamic principles because it helps protect the wealth of people. However, the transferring of risk can be deemed unsuitable for many due to *gharar* and *maysir* concepts.

10. The other important distinction arises from the Islamic philosophy of the economy and finance, which is an asset-based economy rather than a debt-based one. Thus, risk sharing is preferred compared to risk transferring which is deemed to be a transfer of wealth. Different market practices have been employed across different Muslim countries to adhere to this.

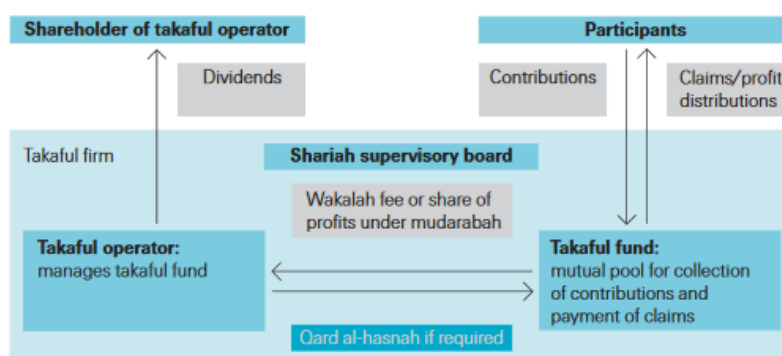
Islamic insurance approaches

11. Islamic insurance approaches can be grouped under three categories (Swiss Re, 2008):

- *Iranian model*: the working mechanism of insurance is the same as conventional insurance and policyholders transfer their risks in exchange for the premium to insurers. The premiums accumulated by insurers shall be directed to instruments that follow to Islamic principles. The main criterion in the Iranian model is related to the suitability of investment instruments to Islam.
- *Saudi Arabia model*: insurance companies shall be operated as stock companies and invest at least 20% of premiums in treasury bonds and 20% in bank bonds. After reserving for technical and legal reserves, 10% of investment returns should be shared with policyholders.
- *Takaful model*: the approach is based on mutual assistance and employs risk sharing instead of risk transfer, as well as the segregation of shareholders' and policyholders' funds. Thus, in *takaful* practice, risk sharing is among the insureds, while risk management is carried out by an insurance company. However, given that mutual structures could be susceptible to volatility of capital, in practice a hybrid structure of administering of a mutual structure by a stock company has developed and formed as the main framework for *takaful* practices (Kassim, 2013).
 - Premiums in *takaful* model are called “contribution” (*tabarru*) and include donation provisions. Therefore contributions are collected in terms of principle of reciprocally which means contributors/policyholders are responsible for the claims of each other.

- Fund management is under the responsibility of a stock company which is called a takaful operator. The operator should manage the risks of contributors and other expenses related. The operator should separately manage the risk fund of contributors and capital of the shareholders.
- After expenses are paid, if there is a surplus of the risk fund, it should be reallocated to contributors. If there is a deficit of the risk fund, the operator should provide interest free loan under the name of qard al-hasnah to the risk fund. When the risk fund reaches a surplus, the debt is paid to the operator.
- The takaful operator is paid management fees under the models of wakala, mudarabah or a mix of both¹.
- All the operations of takaful should be well in accordance with the Islamic principles and supervised by an Islamic Advisory Body.
- In order to mitigate the risks, takaful operators may purchase retakaful products which has a similar working mechanism to takaful although takaful operators cannot be involved in a reinsurance agreement².

Figure 1. Stylised profit-oriented takaful operating model



Source: Sigma 2008/5.

Takaful classes

12. In takaful, non-life insurance takes the form of general takaful while life insurance is defined as family takaful (Maysami and Kwon, 1999). General takaful provides coverage for risks of theft, fire, natural disasters and also on liability and engineering based insurance fields. In general takaful, the risk fund is administered by the takaful operator and in case of a surplus of the fund, it is distributed to the contributors.

¹ There are different business models of takaful with the earning of the takaful operator either sharing the profit between operator and policyholders or based on a set management fee of the takaful operator (or mixture of them). In the mudarabah model, a takaful operator can earn profits if there is a profit in the risk fund. In the wakala model, the operator gains an agency charge. In the hybrid model, operators gain both agency charges and earning from the profit of the risk fund. See Swiss Re (2008 and 2011).

² Takaful operators cannot be involved in reinsurance, although in exceptional circumstances they may purchase reinsurance products with the approval of Islamic Advisory Board (Mahbob, 2013; Rahman, Ahmad and Buang, 2011).

13. In family takaful, there is a saving fund in addition to the risk fund and all the contributions are directed to these two funds (most of them directed to the saving fund). The risk fund provides coverage for the death of the contributors and the contributions are mutually collected in this fund (it has the same working mechanism as a general takaful). The saving fund is a type of private account, created for each contributor. At the end of the contract period, the accumulated amount of this account is paid back to the contributor.

Retakaful

14. Conventional reinsurance is, in principle, not allowed in takaful operations. Takaful operators are expected to use retakaful which can be described as an Islamic way of reinsurance (Akoob, 2009)³. Retakaful is simply a derivative of takaful mechanism. Retakaful operators manage the risk of takaful funds and obtain earnings for their operations (as in Footnote 1).

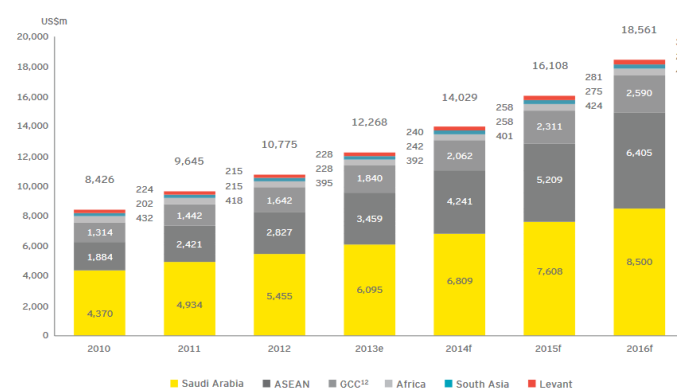
15. The development of the retakaful market is considered essential for development of the takaful market itself. Through retakaful, risk can be diversified and provide greater capacity to, for example, cover catastrophic risks.

16. International reinsurance companies such as Munich Re, Swiss Re, Hannover Re have developed branches in this field and operate in the market.

III. Where the takaful market stands

17. The global takaful market is growing, and Ernst and Young (2014) estimated that global takaful premiums might reach USD 18.5 billion by 2016. Saudi Arabia is the largest market with half of global contributions, followed by the ASEAN, led by Malaysia, and Gulf market (Figure 2 and Table 1). Malaysia and Bahrain are considered to be the most developed takaful markets (Swiss Re, 2011).

Figure 2. Gross takaful contributions by region (2009-2016f)



Source: Ernst & Young Global Takaful Insights, 2014.

³ In theory, takaful operators are expected to make businesses with retakaful operators but because of the market development, it may not be possible for takaful operators to find retakaful coverage for the written risks. In this case, regarding the principle of necessity (dharura), with the approval of Advisory Board, they may be allowed to make businesses with conventional reinsurance companies (Mahbob, 2013).

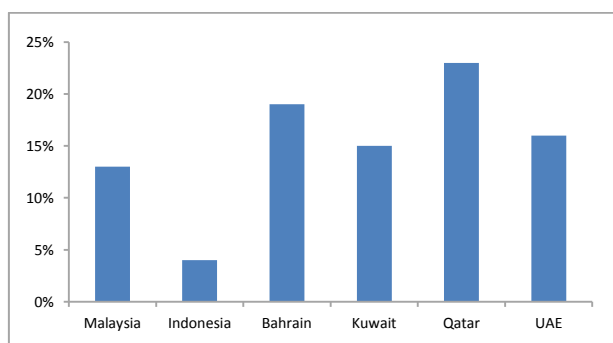
Table 1. Takaful contributions by country (2012, USD million)

Country	Contributions
Saudi Arabia	5,455
Malaysia	1,962
UAE	1,028
Indonesia	633
Qatar	319
Kuwait	169
Bahrain	126

Source: Ernst & Young Global Takaful Insights, 2014.

18. In countries where both takaful and conventional insurance are available, takaful is still a minority. The market share of takaful by premiums is highest in Qatar at 23% of insurance market premiums, followed by Bahrain at 19%. In the ASEAN market, the ratio is 13% and 4% respectively in Malaysia and Indonesia.

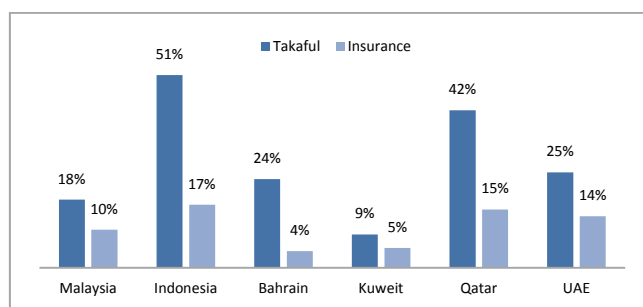
Figure 3. Share of takaful in relation to all insurance premiums (2012)



Source: OECD Secretariat based on Ernst & Young Global Takaful Insights (2013) and Sigma (2013/3).

19. The annualised growth during 2007-2012 surpassed the conventional market in all markets.

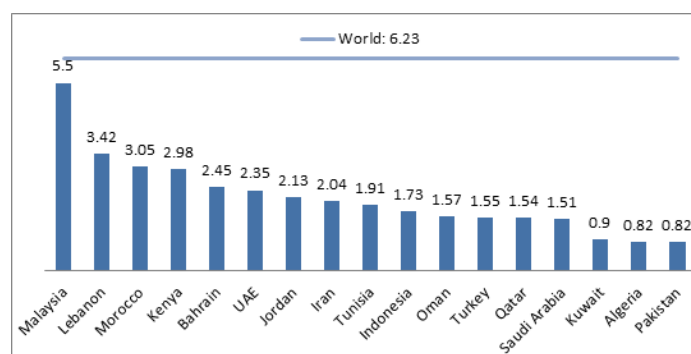
Figure 4. Annualised growth of takaful and conventional insurance for the period between 2007-2012



Source: OECD Secretariat based on Ernst & Young Global Takaful Insights (2013), Sigma (2013/3), Sigma (2009/3) and Sigma (2008/3).

20. In Muslim countries, insurance penetration (direct gross premium/GDP) is lower than the world average at 6.23%. This indicates that there is scope for the insurance market to grow, which could be particularly important for the takaful market.

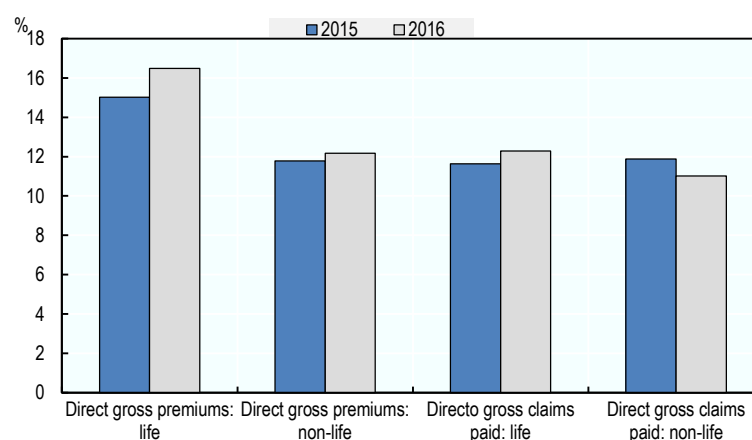
Figure 5. Penetration of insurance premiums in Muslim countries (%), 2015



Source: Sigma (2016/3).

21. In Malaysia, the insurance market is regulated by the Bank Negara Malaysia (BNM) and there is an Islamic Advisory Board in BNM which supervises Islamic finance operations. The Islamic Financial Services Board (IFSB) in Malaysia develops standards for Islamic finance operations. Malaysia enacted the Takaful Act in 1984, and Syarikat Takaful Malaysia was the first company authorised to operate in takaful business. There are eleven companies operating in Malaysia⁴. The Malaysian takaful market is 16.5% for the life sector and 12.2% for the non-life sector (by direct gross premiums)(Figure 6). The share of general takaful to nonlife insurance was 10% while the share was 16% in family takaful to life insurance (Ernst and Young, 2013).

Figure 6. Share of takaful insurance in the insurance market (2015 and 2016)



Source: Bank Negara Malaysia

22. Bahrain has a well-regulated takaful market. In 2006, the regulatory infrastructure was developed and insurance and takaful operations are regulated by the Bahrain Central Bank. In addition, all Islamic finance enterprises are required to adopt the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards where there are standards for takaful and retakaful operations. In the Bahrain, there are six takaful and two retakaful companies. Gross contributions of takaful represent around 21% of the total Bahrain gross premiums/contributions in 2014⁵.

⁴ For further information follow: <http://www.bnm.gov.my/index.php?ch=li&cat=insurance&type=TKF>

⁵ For further information follow:

23. Takaful has still not seen major developments in Europe although, the first takaful company was established in Luxembourg in 2002, followed by the UK in 2008 when Britain's first sharia-compliant insurance company, Salaam Halal Insurance was founded, although the company stopped accepting new business and was placed into "solvent run-off" after a rights issue failed to raise sufficient funding after a year in operation.

24. While additional dedicated takaful companies have not been established, few products have been introduced, such as the recent initiative by Swiss Life which launched Europe's first family takaful product, primarily aimed at French customers looking for Islamic finance or ethical investment solutions. In Germany, FWU, a Munich-based financial group, launched a Family Takaful Savings plan in 2012 which is distributed through intermediaries.

25. Another aspect of Islamic financial services growth in Europe is much about ethical financing. The transparency of contracts used in takaful and the avoidance of industries such as alcohol, gambling and tobacco in the investment portfolios of takaful companies potentially appeals to customers looking for ethical financial services especially with the increasing interest in socially responsible investments.

26. Islamic insurance has been operating in the United States without any specific changes to insurance regulations. In 2008, AIG introduced the Takaful Homeowners Policy as a first step in bringing takaful products to the United States. There are additional initiatives in United States market on takaful. Zayan Takaful is the first and only insurance brokerage firm offering custom-tailored Shariah compliant insurance solutions to consumers across the United States. Iman Insurance Services, L.P. (IIS), through Lockton Affinity (Lockton), has secured partnerships with some of the main insurers in the United States to offer insurance products that are designed specifically for businesses.

IV. Structure of Roundtable

27. The Roundtable discussion will be structured as below:

1. What is Islamic insurance and its implications

- What is Islamic insurance?: Sami Guellouz, Principal Officer and General Manager, BEST RE Family (L)
- Data challenges on takaful market: Mahesh Mistry, Senior Director, Analytics, A.M. Best Europe
- The investment implications for takaful: Professor Mehmet Asutay, Professor of Middle Eastern and Islamic Political Economy & Finance, Durham University Business School

2. Where the takaful market stands: by regional and country basis

- Asia and Africa: Sami Guellouz, Principal Officer and General Manager, BEST RE Family (L)
- Europe (UK): Susan Dingwall, Partner, Norton Rose Fulbright
- Retakaful: Mahomed Akoob, Managing Director, Hanover Re

3. The regulatory structure of takaful

- Mohamed M. Shamsi, Head, Conventional Insurance & Reinsurance Firms, Insurance Supervision Directorate, Central Bank of Bahrain

4. How the Islamic/takaful insurance market might develop

- Mahomed Akoob, Managing Director, Hanover Re

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