

# Takaful industry: global challenges and opportunities

During the past few years there have been significant developments in the world of Islamic banking and finance. The industry has evolved from a regional business into one of global scale.

The Islamic retail financial services industry has also grown significantly. Banks and other service providers are aware of the significant liquidity available in the Middle East and emerging market economies and are keen to better understand their specific customer needs and to tailor suitably structured products. The choice of Shari'a compliant investments has also broadened and includes structured products; mutual funds; multi-manager products and funds of funds; direct investments in Initial Public Offerings (IPOs); Sukuk (Islamic bonds); leasing and real estate projects; discretionary portfolios; alternative investment strategies including hedge funds; private equity; venture capital and commodities.

Encouragingly, Islamic retail banking and finance products have gained popularity with non-Muslim communities due to their competitiveness and efficiency. Recently Lloyds TSB Bank in the UK began offering its individual customers Shari'a compliant current accounts and home finance products.

## Takaful Industry growth

The Takaful industry has grown significantly as the Islamic alternative to conventional insurance and evolved from being a regional business to a global one. The renaissance in Socially Responsible Investing (SRI) and customer demand for Shari'a compliant solutions has enhanced the community banking appeal of Takaful related products. Major markets currently include Malaysia, Iran, Pakistan, Saudi Arabia and other GCC countries. Annual average individual market growth rates range between 15% to 30%. The Takaful product family spans across General, Life, Health and Pensions business lines. Currently, the general Takaful business has a dominant market share of the overall product mix in Iran and the Middle East region. Both the US and Europe offer considerable untapped potential for the Takaful industry.

According to Bank Negara's 2004 Takaful Industry report, market penetration of the Takaful industry rose to 5.1% in 2004 from 4.5% in 2003 in Malaysia. Family Takaful business continued to expand in 2004 due to growth in contributions from ordinary Family Takaful plans and improved demand for investment linked Takaful plans, endowment and Health Takaful plans. The global Takaful industry is relatively small in comparison to its conventional insurance counterpart and the current Takaful market size is estimated between \$ 2.5 to \$3.5 billion of annual premium. The major challenges faced by the national and cross border Takaful suppliers include: raising customer awareness and education, expanding product innovation, creative product

design and marketing, offering attractive investment choices, and finding a 'AAA rated' international reinsurance company willing to accept a Retakaful. Such achievements would also enhance customer experience and overall consumer satisfaction level.

## Product innovation

Acceptance of Islamic Savings, Education, Marriage and Retirement Plans is gradually growing among the affluent customer base, but significant investment in customer education and training of financial planners and investment advisers is needed. A successful distribution model needs to develop a thorough understanding of customer needs, deliver on its promise, offer product and process innovation, eliminate flaws in product terms and enhance customer service delivery.

One case study where innovation has taken place is in Family Takaful linked investment plans. The FWU group has pioneered innovation and developed technology to create a 'white label' Savings, Education and Retirement Plan offering customized products for the bank's mass affluent customer segment. The FWU group's accomplishments culminated by a Euromoney Islamic Finance Award for being the 'Best White Label Provider' in February 2005.

The FWU Group's product development approach was a modular one and focused on thinking outside the box. It gave priority to understanding the individual customer needs and concerns by conducting customer focus groups and surveys with its bank distribution partners. Efficient product design, open investment architecture, customer convenience and transparency were some of the salient points, which were reviewed carefully.

## Strategic product partner selection

Banks are keen to work with strategic product partners who offer a bespoke Family Takaful investment-linked programme, the opportunity to 'white label' such a programme and an open investment architecture. The latter enables banks to create a best-of-breed investment offering by blending their own brand funds with top quartile third-party performing Shari'a compliant funds. Recent product innovation includes the embedding of risk-calibrated, multi-manager portfolios in Islamic retail banking investment-linked programmes, where each investment strategy offered to the individual customer is composed of more than one underlying fund. This permits the investment adviser to remain in control of asset allocation, manager selection and portfolio rebalancing.

Challenges	FWU Group's Solutions
a) Life Takaful products are more expensive than traditional products and therefore economically inefficient.	Our Wakala Takaful structure eliminates the structural inefficiencies of traditional Mudarba Takaful programmes.
b) Existing Takaful products regarded as a mere blend of traditional Western product ingredients with pure Takaful related product ingredients. The major issue in this respect was the non-existence of Retakaful arrangements in the market.	We were convinced right from the start that for a pure Shari'a compliant Takaful product, a Shari'a compliant Retakaful arrangement is an absolute must. Therefore, we have jointly developed with Hannover Re, an "AAA rated" major international reinsurance company a Retakaful solution with: <ul style="list-style-type: none"> <li>• an unlimited 'Quard Hasna' in the Retakaful Fund for any deficit; and</li> <li>• 'Riba' – free investment for the assets of the Retakaful fund.</li> </ul>
c) Lack of product flexibility in the terms and conditions.	Apart from achieving a high degree of flexibility, we have also incorporated some unique features in our Savings Plan: <ul style="list-style-type: none"> <li>• no customer will be declined, irrespective of his or her health condition. Minimum insurance coverage of \$25,000 will be offered to all bank customers;</li> <li>• attractive risk/reward calibrated investment strategies are offered;</li> <li>• the plan offers attractive early surrender values;</li> <li>• costs and charges remain the same throughout the term of the plan, which is a unique feature; and</li> <li>• transparent investment terms and conditions at highly competitive institutional rates.</li> </ul>
d) Hidden agenda – Items such as the forbidden elements of 'Gharar' (uncertainty) – in the terms and conditions.	Our product range is fully transparent. For example, suicide, newly discovered diseases, including HIV, and changes in occupation will not affect the Family Takaful benefits.
e) Unattractive investment programmes of Family Takaful	We offer a Dynamic Fund Select and Allocation Model for individual retail customers and an innovative Shari'a compliant technical stock picking model for private and institutional customers seeking to achieve superior risk-adjusted absolute returns in the different market environments.

One of the challenges encountered by banks wishing to distribute such investment-linked plans is the cost in technology and service infrastructure required by such programmes. Banks prefer a seamless processing environment where customer risk profiling, application processing, illustrative calculations and printing plan certificates are completed in an efficient manner designed to enhance customer satisfaction levels.

The use of an internet-based point of sale and online administration system developed by the FWU group has made the sales process convenient and has introduced economies of scale in both front and back offices. It has enabled banks to track the quality of their sales management and fulfillment processes and the overall quality of their business portfolio.

### Global opportunities

There is significant untapped expansion potential for Islamic banking, investment and insurance products into the US, Europe and Asia. Creative product design, customer convenience and attractive packaging are the key to gaining a competitive advantage across General, Life, Health and Pensions businesses. The Takaful industry needs to cater to the growing needs of both the Muslim and non-Muslim customers around the world.

Primary markets within Europe that have a sizeable Muslim population include the UK, France and Germany. In Asia, China, India and Indonesia also offer opportunities. Islamic centres of product excellence include Malaysia, Bahrain and the UAE, but Indonesia, Saudi Arabia and Pakistan are fast evolving and building their product expertise in this important business segment. The major regional and international players such as Dubai Islamic Bank, National Commercial Bank, Kuwait Finance House, HSBC, Citigroup, Maybank and Bank Mandiri are well positioned to export and adapt their distribution capabilities and customer-centric value proposition to the mature regulatory, tax and accounting regimes of the major OECD jurisdictions.

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