What is the Future of Global Takaful?

Takaful or Islamic insurance is the next big global trend.

KUALA LUMPUR, MALAYSIA , February 3, 2015 /EINPresswire.com/ -- Camille Paldi, FAAIF CEO sponsors Future of Global Takaful Conference in Kuala Lumpur, Malaysia, January 28-29, 2015. Paldi notes that although takaful or Islamic insurance has been witnessing an approximately 20% per annum growth rate, much needs to be done in terms of regulation, legislation, and a dispute resolution framework for the global takaful industry. The future of the global takaful industry is vibrant and robust similar to the Islamic finance industry as long as we can ensure investor confidence and reputation through implementing a proper regulatory and accounting framework, regulation including capital adequacy regulation, legislation, proper financial reporting, and effective adjudication of disputes. Paldi notes that the capital adequacy regulation and requirements for the takaful industry are insufficient and bare minimal at the most.

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> *Camille Paldi*

Paldi says that her fellow Westerners are excited about the takaful concept, which includes return on investment and the return of the premiums at the end of the policy. Takaful is almost the same concept as conventional mutual insurance, except that the takaful operator can inject an interest free loan called qard hassan into the fund in the event of insolvency. Islamic insurance is based on cooperative risk sharing and joint-guarantee, which are concepts already widely used in the West and favored by ethical people, Christians, Muslims, and Jews. Takaful can be considered a form of investment insurance with coverage and is a valuable financial tool for people seeking coverage, investment returns, diversification of portfolios, wealth management, and retirement plans. It is also quite useful and widely used by people of all faiths, nationalities, and backgrounds in international trade finance. Paldi believes that if marketed properly, takaful can become a wildly popular mass consumer product in the West and the world.

A unique and harmonized regulatory and reporting regime is required for takaful for many reasons including the two-tier structure of takaful companies, which includes shareholder and policyholder funds. Shareholder and policyholder funds are managed separately and capital may not be fungible or transferable between the two separate accounts. Furthermore, takaful funds have unique policyholder entitlements and rights, different structures, and face different risks compared to conventional insurance. The main difference between conventional and Islamic insurers lies in the fact that in Islamic finance, the assets underlying the underwriting pools are owned by the policyholders, whereas assets in conventional proprietary insurance companies are owned by the shareholders and must at all times be sufficient to cover their obligations to the policyholders. Accordingly, in contrast to conventional insurance companies, takaful companies must make disclosures about the underwriting pools and underlying assets.

The AAOIFI regulations FAS 12 General Presentation and Disclosure in the Financial Statements of Islamic Insurance Companies and FAS 13 Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies address many of these issues. The AAOIFI standards require disclosures on policyholders' funds and the determination and allocation of surplus and financing of deficits. However, the requirements in respect of movements between the funds should be enhanced and the individual rights of the policyholders should be clearly stated in the financial statements. There is also a lack of transparency in the financial statements of some takaful companies in regards to undistributed fund balances. Overall, the current financial reporting practices of takaful companies do not provide adequate information regarding the company's investment strategy, funds allocation, and revenues and expenses accruing to their particular investment funds. Exacerbating the situation, takaful companies have not yet adopted a single framework for financial reporting and this has resulted in the lack of transparency and comparability of financial statements.

In terms of capital adequacy regulation, it may be difficult to apply ratio-based methods as it can be difficult to accommodate them to the different structures adopted by takaful operations and their different risk profiles. For this and other reasons, it is more advantageous to develop risk-based capital regulation (RBC) for the takaful industry. In the RBC, calculating the capital requirement is combined with evaluating management practices and internal controls. In this process, there is a major role for the regulator in reviewing and evaluating the process by which the calculated capital requirement was arrived at and imposing additional capital add-ons if the regulator is not satisfied with the insurer's risk management. The insurer determines its minimum capital requirements by applying risk factors to each of the identified risk components, reducing the resultant amounts by identified risk mitigants, and aggregating the results. Some further reductions may be possible by identifying diversification effects, though on the other hand the regulator may impose add-ons. Takaful operators may be comparatively overweight in assets such as equities and real estate, which tend to be more volatile and/or less liquid, thereby attracting higher risk weightings. In many jurisdictions, solvency and capital requirements for takaful companies remain simple, however, several countries including Malaysia, Indonesia, and certain GCC countries are moving towards risk-based capital regulation.

Takaful is faced with various other challenges including scarcity of suitable Shariáh compliant investments and very few retakaful or reinsurance operators in the world today. These shortages can lead to concentration risks or lower-quality assets than desired by the takaful business. Furthermore, there is a limited availability of risk management tools for takaful similar to Islamic finance and more attention needs to be paid to product design, IT, and control processes. Camille Paldi can be reached at camille@faaif.com.

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