SUMMARY OF THE GLOBAL FAMILY TAKAFUL REPORT 2011

Barely scratching the surface – Unfolding the family Takaful potential

The First Global Family Takaful Report

Farzana Ismail, FIA — Consulting Actuary, London

Safder Jaffer, FIA — Takaful Practice Leader, Dubai

Jabran Noor, FIA ,FSA — Consulting Actuary, Dubai

Lindsay Unwin, FIA — Consulting Actuary, London

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THE INTERNATIONAL TAKAFUL SUMMIT 2011

Message from ITS Convener

Dear Takaful Executive

It is a great pleasure to welcome the publication of the first Milliman Global Family Takaful Report 2011. The Report fills a gap in the growing body of relevant expert literature supporting the fast expanding global Takaful market. The specialist coverage of family Takaful provided in the Report highlights an ever present but much neglected aspect of Takaful provision.

Indeed, as the Report shows and analysis of relevant statistics about the target market(s) demonstrate, family Takaful provision has the potential to become the dominant activity of Takaful providers. If the provision of pension and investment linked Takaful is added, then clearly family and family-linked Takaful will constitute the major part of the industry.

The Milliman Report also highlights the fact that family Takaful provision is much more amenable to the risk-sharing spirit of Takaful. Innovation in family Takaful provision is likely to lead to many more products which have close affinity to the basic *Shariah* notion of Takaful.

In this regard, it is pleasing to see Milliman's emphasis on two specialist aspects in its first family Takaful Report. The analysis of the Malaysian family Takaful market shows how family Takaful provision is slowly becoming the dominant activity of Takaful operators in Malaysia. The depth of the Malaysian Islamic Capital market provides a solid underpinning for the long term investment and liability structure of family Takaful.

The second in depth analysis in the Report is the UK Mutual provision market. The affinity of mutual provision with Takaful is evident in the analysis and the Survey seeks to derive tried and tested modalities from the wealth of experience present in the mutual stable. The continuing robust provision by Friendly Societies in the UK provides some key markers for potential family Takaful provision in the UK and Europe.

The Milliman Global Family Takaful Report 2010 fill a lacunae in the materials and analysis available about the Takaful industry. It is hoped that the intended annual family Takaful Report will empower family Takaful provision and help consolidate Takaful as a preferred product for life assurance provision for a diverse range of customers.

M Iqbal Asaria,

Convener, International Takaful Summit, London

Introductory Message

Dear Takaful Practitioner,

Milliman is pleased to present the first exclusive Global Family Takaful Report. With global family Takaful contributions currently estimated at US$1.7 billion, Milliman projects a 250% increase within the next five years to US$4.3 billion. The growth in family Takaful thus far outweighs both general Takaful growth as well as global conventional life insurance growth.

Whilst the Takaful industry produces a number of reports, most of these tend to focus on a combined analysis of general and family Takaful. As actuaries and consultants, we firmly believe that the drivers of general Takaful can be significantly different than those for family Takaful. Hence Milliman identified a need to focus exclusively on a family Takaful report.

This report is a summary report of the Global Family Takaful Report 2011 (full report) prepared by Milliman. The full report provides an in-depth insight into the analysis and issues highlighted in this summary report. I would encourage you to obtain the full report to appreciate the depth with which some of the global trends, issues, and challenges have been tackled. A synopsis is provided in this report.

Milliman now has a dedicated Takaful Practice in Dubai as well as experienced Takaful Consultants in both our London and Singapore offices. We are pleased to present ourselves to the Takaful industry as thought leaders and a reference point to meet some of the industry challenges required within both family and general Takaful.

We hope that this report will allow market participants to understand better the growth factors and global Takaful opportunities, and at the same time provide Takaful practitioners with food for thought on some of the underlying issues and challenges facing the industry.

Bruce Winterhof

Life Practice Leader

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Introduction

Family Takaful accounted for 20% of the global Takaful gross written premiums in 2009.

With bottom-line profitability on the general Takaful front facing stiff competition from a relatively soft market, family Takaful is seen as a long-term and sustainable proposition with strong bottom-line expectations. Higher profit margins and the potential for surplus sharing make family Takaful a more viable long-term proposition and ideally placed to meet the 'spiritual' dimensions of Takaful.

The spirit of 'risk sharing' is more compatible with the modern concepts of Takaful, which makes family Takaful a more viable proposition for operators than general Takaful where the focus is more towards 'risk taking'. Consequently, there is an increasing need for a pertinent reference source to facilitate industry leaders in navigating the evolving family Takaful landscape.

There have been a number of industry reports on Takaful that analyse performances of the Takaful industry globally, but most reports tend to provide a combined analysis of general and family Takaful. The drivers for general Takaful can be significantly different than those for family Takaful. It has been widely noted that such combined analysis may skew and distort results. As such, there is a demand in the market for an industry report which analyses family Takaful separately, and in particular, one which focuses on the characteristics inherent within the family Takaful market, especially the long-term nature of family life products.

Milliman intends to take up this challenge by providing the industry with an exclusive global family Takaful report on a regular basis. The report will cover most dimensions of family Takaful and Retakaful including industry growth, financial highlights, regulatory updates, and pertinent contemporary issues facing the world of family Takaful.

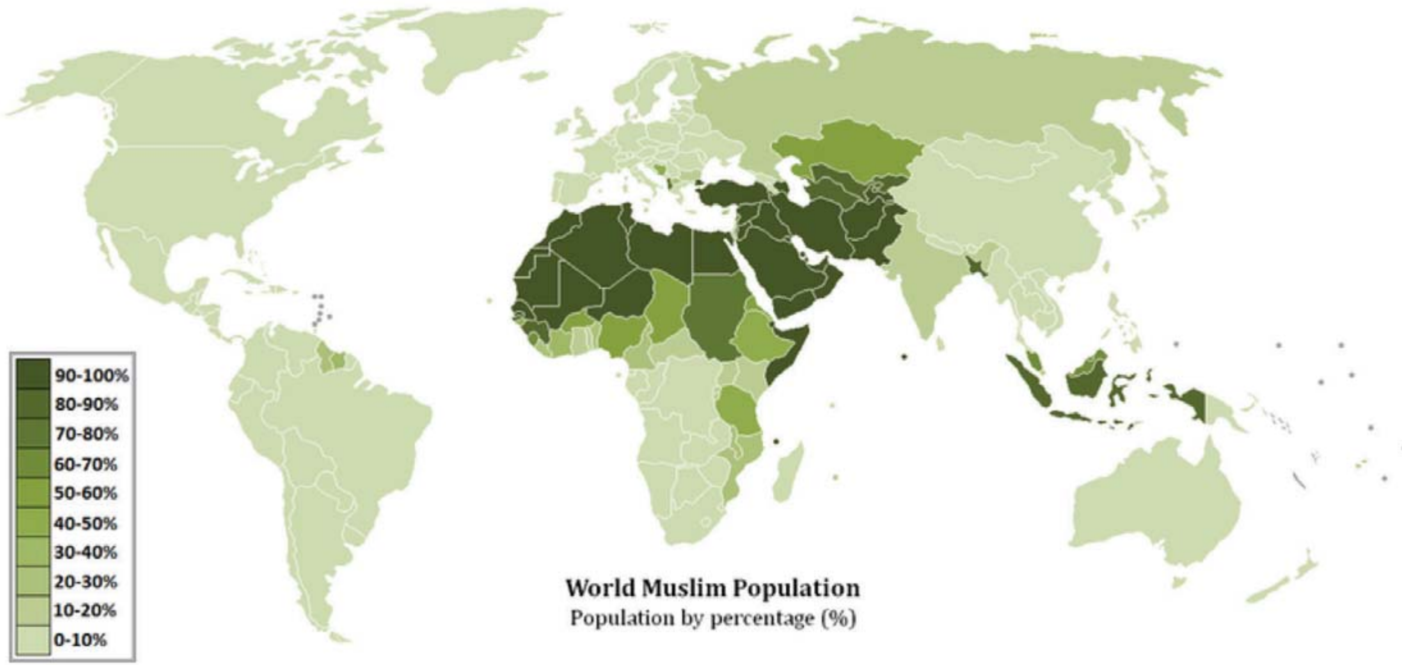
The report also provides a focus on Malaysia as the most established of global family Takaful markets along with a comparison of Takaful business with UK mutual insurers. This comparison also describes the methods used for surplus distribution by with-profits business in the UK, as well as several case studies which highlight the opportunities and challenges faced by UK mutual insurers and the potential lessons learned that may be useful for the Takaful industry.

This report is a summary report of the Global Family Takaful Report 2011 prepared by Milliman. The full report provides an in-depth insight into the analysis and issues highlighted in this summary.
The full report can be ordered online at www.milliman.com/takaful2011

Global Muslim population

”Muslims will make up 26.4% of the world’s total projected population of 8.3 billion in 2030, up from 23.4% of the estimated 2010 world population of 6.9 billion.”

- Pew Research Center’s Forum on Religion and Public Life



Source : Wikipedia

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Life insurance statistics - 2009

Life Insurance in Muslim countries is grossly under developed

Rank by Premium	Country	Life Premium (millions USD)	Life Density (USD Per Capita)	Life Penetration (% of GDP)
33	Malaysia	5,682	206.9	2.9
34	Indonesia	5,066	22.0	0.9
44	Turkey	1,148	15.3	0.2
48	Morocco	825	25.8	0.9
49	United Arab Emirates	732	159.2	0.4
50	Egypt	704	8.5	0.4
54	Bangladesh	636	3.9	0.7
55	Pakistan	543	3.0	0.3
64	Saudi Arabia	267	10.4	0.1
67	Lebanon	232	55.0	0.8
69	Iran	225	3.0	0.1
73	Nigeria	147	0.9	0.1
75	Bahrain	137	173.6	0.6
79	Oman	102	35.9	0.2
80	Tunisia	100	9.7	0.3
82	Kuwait	88	29.6	0.1
83	Algeria	63	1.8	0.0
84	Kazakhstan	63	4.0	0.1
86	Jordan	49	7.8	0.2
1	United States	492,345	1,602.6	3.5
2	Japan	399,100	3,138.7	7.8
3	United Kingdom	217,681	3,527.6	10.0
4	France	194,077	2,979.8	7.2
5	Italy	115,290	1,878.3	5.3
	World	2,331,566	341.2	4.0

Source: Swiss Re Sigma No 2/2010

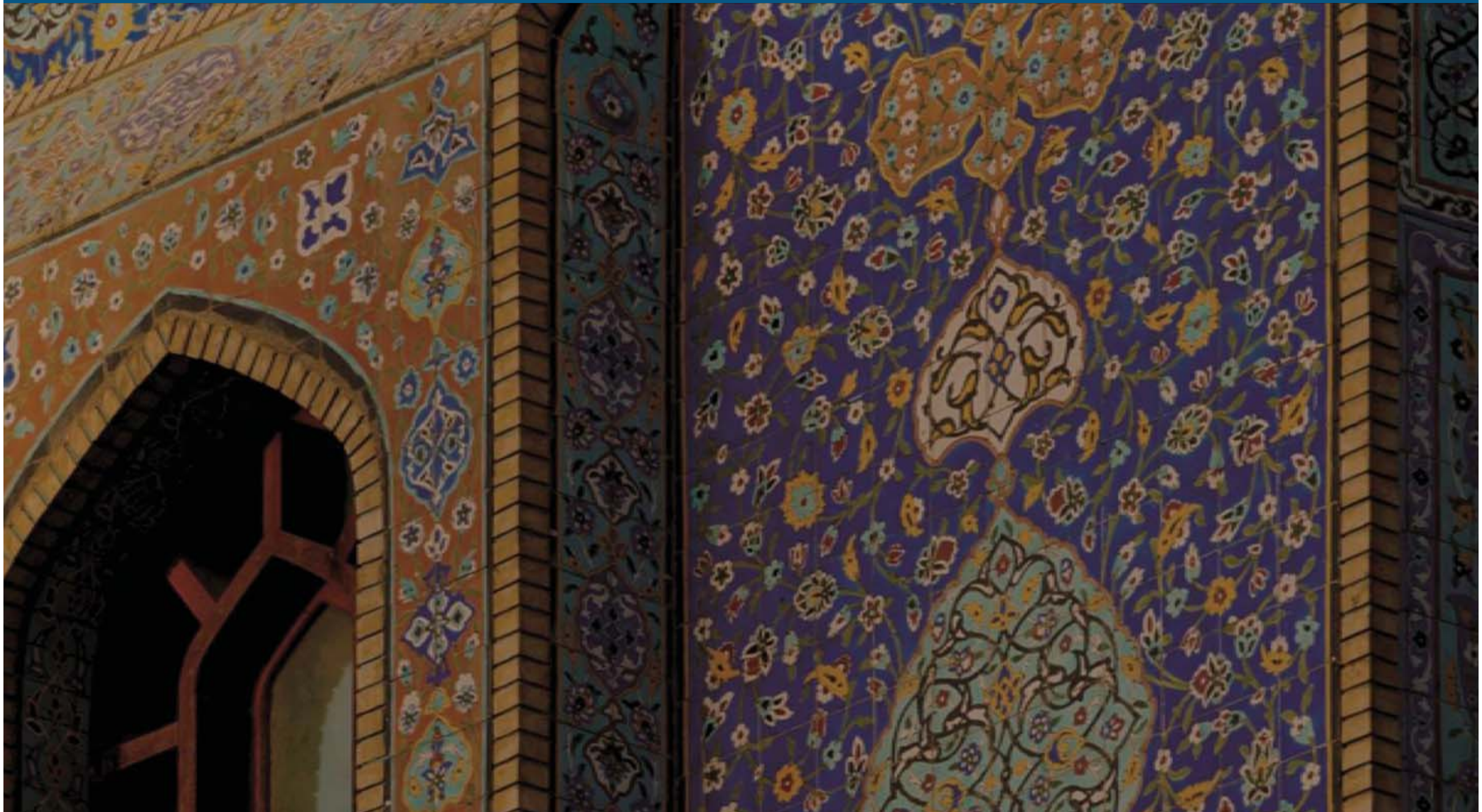
0.72%

Life insurance premiums of Muslim countries as % of world premiums

8x

Size differential based on Life Insurance density between highest ranked Muslim country (Malaysia) and global leader (USA)

Industry growth in key regions



Quantifying family Takaful

There is no single source containing quantification of family Takaful premiums (or contributions) globally, or by region or country.

Milliman has estimated the family Takaful numbers from company financials, industry reports and internal estimates, where necessary.

Financials of the companies within countries having family Takaful business were used to develop industry estimates.

The gross contribution industry estimates were aggregated into three main regions:

- Southeast Asia (primarily Malaysia, Indonesia and Brunei)
- Middle East and Africa (primarily GCC countries and Sudan)
- South Asia (primarily Bangladesh, Pakistan and Sri Lanka)

Global estimates were aggregates of the three main regions listed above.

Future projections were based on the estimation of growth rates by country, regions, and globally.

Family Takaful has been taken as the business equivalent to life insurance, covering both group and individual life. Both single and regular contributions have been taken into account.

Global family Takaful gross contributions

The global family Takaful gross contributions in 2010 are estimated to be US$ 1.7billion (24% higher than 2009).

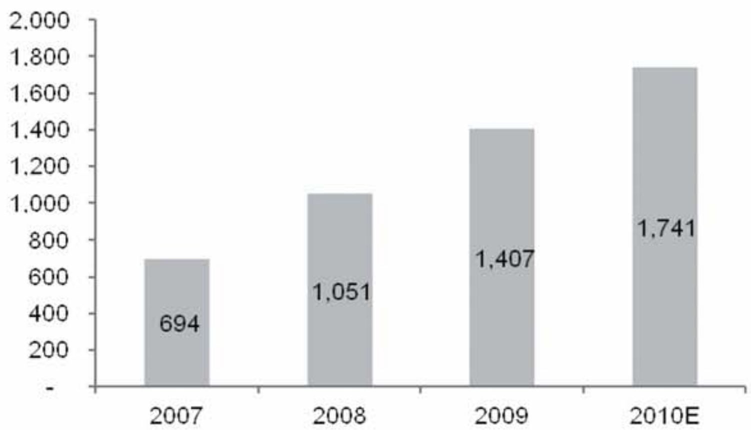
The global family Takaful gross contributions increased at a compound annual growth rate (CAGR) of 36 % (2007-2010).

The Middle East and Africa region has a volatile growth rate.

In 2010, South East Asia contributed about 73% of global contributions, followed by the Middle East and Africa at 25% and South Asia at 2%.

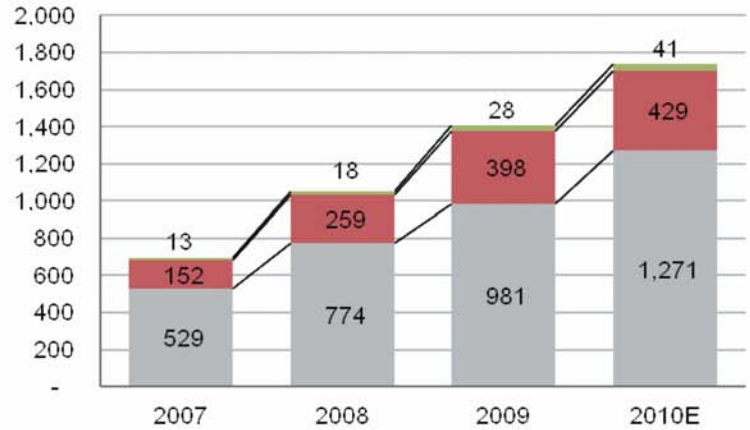
Global Gross Contributions

US$ million



Family Takaful Contributions by Regions

US$ million



	Growth 2008 / 2007	Growth 2009 / 2008	Growth 2010E / 2009	CAGR (2007-2009)
South East Asia	46%	27%	30%	34%
Middle East and Africa	70%	54%	8%	41%
South Asia	36%	59%	45%	46%

Further details on historical and projected growth rates by key countries and key regions are provided in the full report.

Source: Company Financials, Industry Reports, Milliman Estimates

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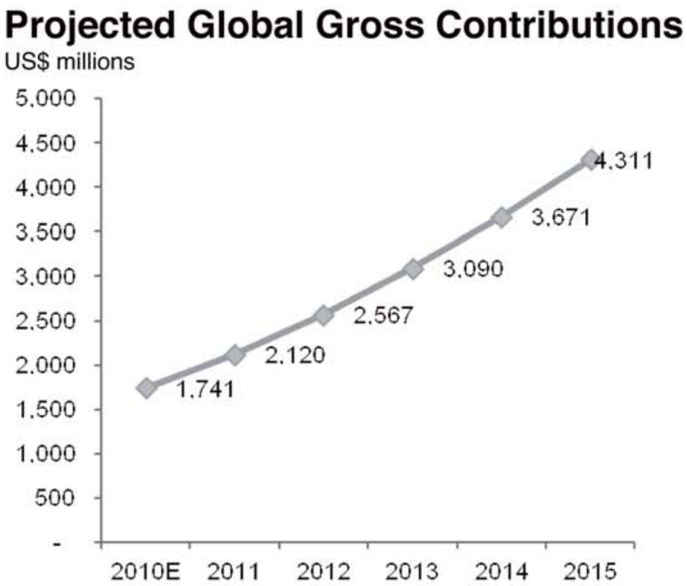
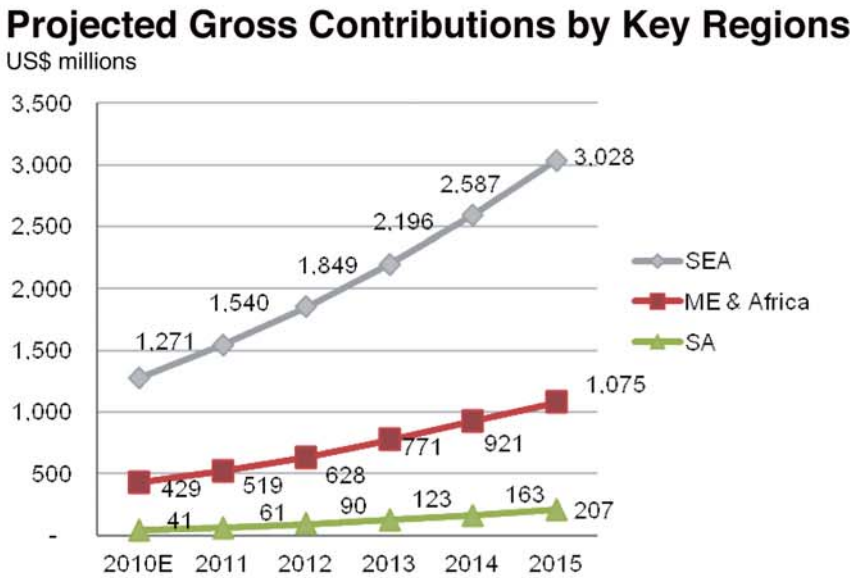
Projected global gross contribution

The gross contribution is projected to increase to US$4.3 billion by 2015.

South East Asia (SEA) is projected to continue as the leader followed by the Middle East and Africa (ME and Africa) and South Asia (SA).

Indonesia is growing at a faster pace than Malaysia and is expected to have a similar market share to Malaysia within Southeast Asia by 2015.





Source: Milliman estimates based on a range of macro economic indicators and historical growth rates

Further details on projected growth rates by key countries within each region are provided in the full report.

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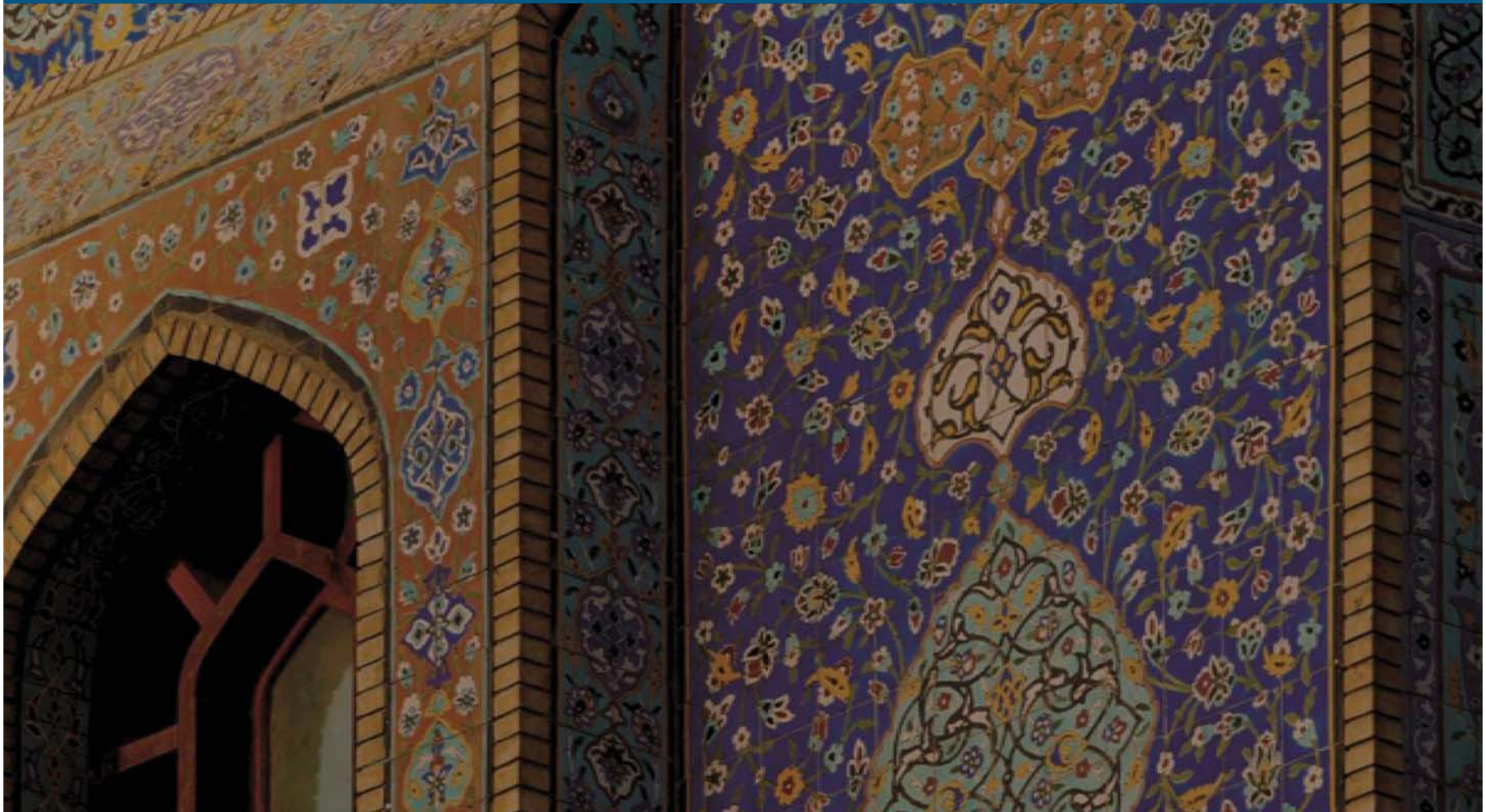
Overview of the Takaful regulatory landscape



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Overview of Takaful regulatory landscape

There are a wide variety of regulatory-practices in the Takaful industry. The Islamic Financial Services Board (IFSB), which is a self-regulatory body of the Islamic financial services industry, has developed a standard for solvency requirements in Takaful undertakings, which encourages a regulatory framework that is consistent with the recent international developments in conventional insurance regulations. However, these recommendations do not seem to be receiving much attention at regulatory levels beyond Malaysia.

Overall, Malaysia arguably has the most robust regulatory framework for Takaful, with the introduction of the Takaful Operational Framework and the draft Takaful Risk-Based Capital framework, which goes some way to meeting a number of the solvency requirements described in the IFSB ‘Standard for Solvency Requirements in Takaful Undertakings’.

Further details on the Takaful regulatory updates in each key country can be found in the full report. In summary:

- Bahrain is one of the first regulators to recognise the distinct characteristics of Takaful for regulatory purposes, and has developed a framework that is consistent with some of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards.
- Pakistan, Qatar, and the UAE have all issued new Takaful regulatory frameworks in recent years, and have also endeavoured to be consistent with the AAOIFI standards.
- Saudi Arabia on the other hand has been strengthening its insurance regulatory framework on a cooperative model approach without explicit recognition of Takaful.
- Indonesia is gradually putting together a framework that could be moving towards the Malaysian approach though it currently tolerates a window approach which is likely to change in future.
- Although the UK has its eye on becoming the leading financial centre in Europe for Islamic finance, the Takaful industry remains limited in Europe. Currently, the insurance regulator in the UK has adopted a ‘level playing field’ approach in regulating conventional and Takaful firms. Although this is fair, there may be challenges faced by new Takaful start-ups given the distinct characteristics of Takaful business compared to conventional insurance. In addition, the uncertainty in the development of Solvency II for insurance business in Europe means that it may be more practical to develop Takaful products or set-up a Takaful operator once the Solvency II regulations and the overall capital requirements have been finalised.

Overall, the journey towards some form of standardised Takaful framework has only just begun, however recognition amongst the community of regulators on the need for such a framework is a good start.

A detailed update on the regulatory position for each of the key regions and countries can be found in the full report.

Islamic Financial Services Board (IFSB)

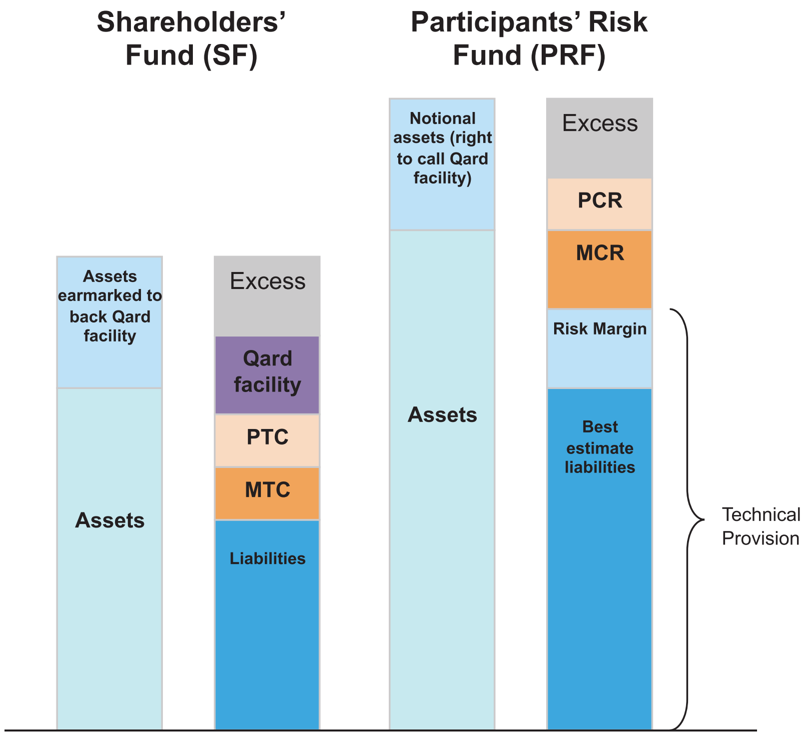
The IFSB, which is an international standard-setting organisation for the Islamic financial services industry, issued the 'Standard on Solvency Requirements for Takaful Undertakings' (the Standard), which are intended to be the global prudential standards and guiding principles for the industry.

The Standard breaks down a Takaful operator's funds into :

- The shareholder fund (SF).
- The participants' risk fund (PRF): The underwriting fund, and where contributions are made on a Tabarru' (Donation) basis.
- The participants' investment fund (PIF): Typically a pure investment fund with a savings element.

The Standard requires a distinct segregation between the PRF and the SF in determining the solvency requirement in each individual fund. Although the SF may not be contractually accountable for any deficit or loss arising from the PRF, the Takaful operators may be required to establish a Qard facility to meet any deficiency in the PRF fund in order to meet regulatory solvency requirements. The SF also needs to have sufficient capital resources to meet its own financial obligations, including the need to provide the Qard facility.

The solvency requirements for the PIF is not considered as the investment risk is fully borne by the Takaful participants. In addition, the surplus arising from the PIF may not be used to meet any shortfall in the PRF fund.



PTC: Prescribed Target Capital **PCR: Prescribed Capital Requirement**
MTC: Minimum Target Capital **MCR: Minimum Capital Requirement**

Source: Standard on solvency requirements for Takaful undertakings, December 2010, IFSB

Further analysis on the IFSB standard on solvency requirements can be found in the full report.

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Family Takaful business models and product proposition

Family Takaful business models

Popular models typically adopted

Country	Model				
	Variant Mudarabah *	Wakala (with or without incentive fee)**	Wakala Mudarabah (hybrid)***	Wakala With Waqf	Others
Bahrain		●	●		
Malaysia	●	●	●		
Pakistan			●	●	
Qatar			●		
Saudi Arabia****		●	●		●
South Africa			●	●	
UAE		●	●		

* There has been a gradual move away from it but legacy business remains on this model.
** Primarily used for protection products such as term life.
*** Primarily used for saving products such as investment-linked.
**** Uses the cooperative model

Further details on the various models and their practical application to family Takaful products can be found in the full report.

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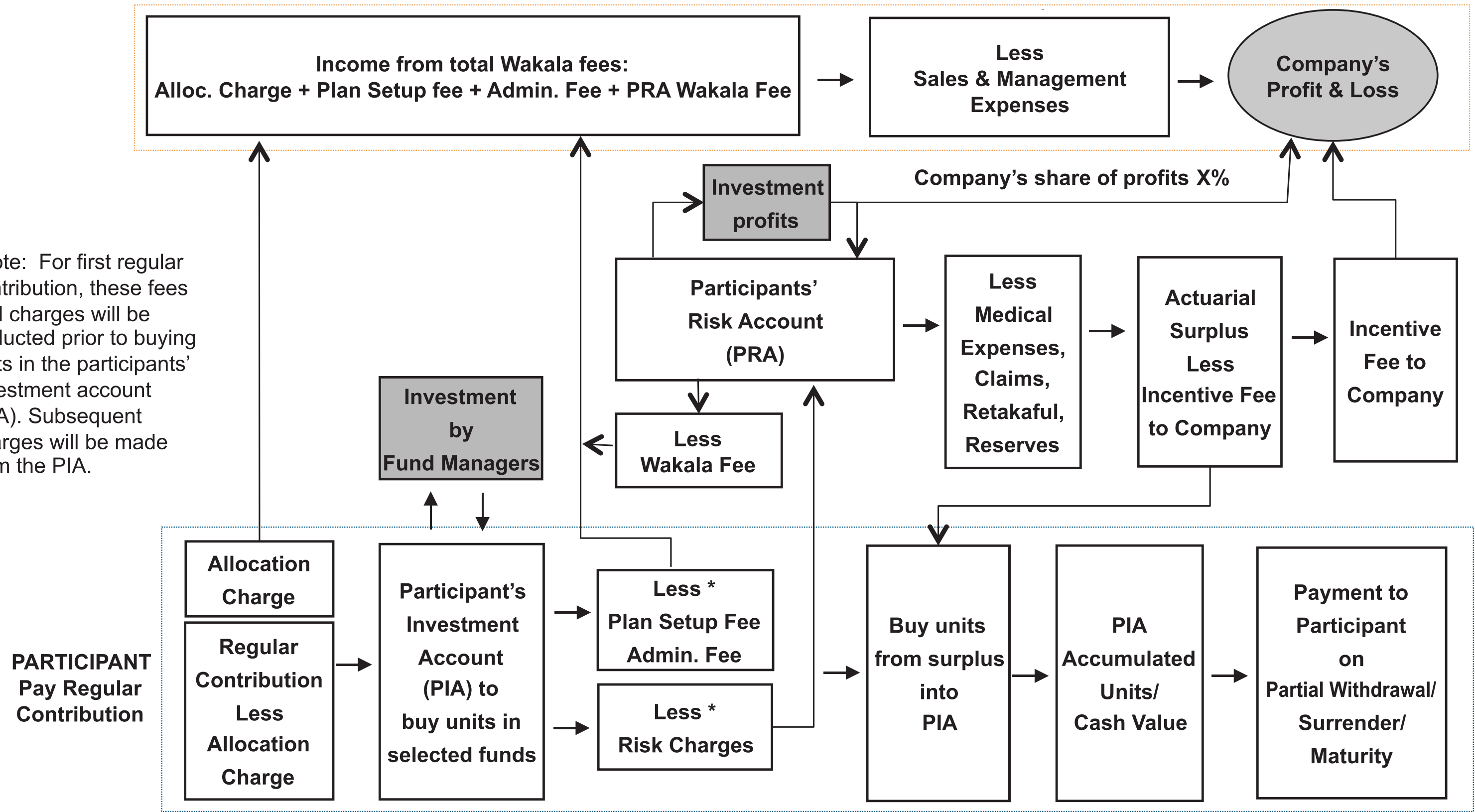
Example: Takaful model for investment-linked plan



*Note: For first regular contribution, these fees and charges will be deducted prior to buying units in the participants' investment account (PIA). Subsequent charges will be made from the PIA.

Courtesy of Noor Takaful, UAE – reproduced with permission and modification

Further examples of family Takaful models for pure protection and long-term savings plans are provided in the full report.

Family Takaful product offerings

Summary of product offerings by large players in various countries

		PROTECTION				SAVINGS					GROUP		
S.No.	Company	Term	Keyman	Mortgage	Critical Illness	Generic	Education	Retirement	Hajj / Umrah	Investment	Life	Accident	Credit
1	Saudi Arabia - 1					●							
2	Saudi Arabia - 2	●				●		●			●		
3	Saudi Arabia - 3	●			●	●					●		
4	Saudi Arabia - 4	●	●	●			●						
5	Saudi Arabia - 5	●				●	●	●			●	●	
6	Saudi Arabia - 6	●					●	●				●	
7	Saudi Arabia - 7	●									●		
8	Saudi Arabia - 8	●	●	●		●	●	●			●		
9	Saudi Arabia - 9	●		●							●		●
10	UAE - 1								●		●		
11	UAE - 2	●				●	●	●			●		●
12	UAE - 3			●	●						●	●	
13	UAE - 4	●			●	●	●	●		●	●		
14	UAE - 5	●			●	●	●	●		●			
15	UAE - 6	●		●	●	●					●		
16	Qatar - 1	●		●		●		●					
17	Bahrain - 1	●		●		●							
18	Bahrain - 2	●		●		●	●	●		●	●	●	
19	Malaysia - 1	●		●		●	●	●			●	●	
20	Malaysia - 2	●		●	●	●				●	●		
21	Malaysia - 3	●		●		●	●		●	●	●	●	
22	Malaysia - 4	●		●	●	●	●	●	●	●	●		
23	Malaysia - 5	●		●		●	●	●			●		
24	Malaysia - 6					●	●	●	●	●	●	●	●
25	Pakistan - 1			●		●	●				●	●	●
26	Pakistan - 2					●	●	●			●	●	●
27	Sri Lanka - 1				●	●	●						
28	Nigeria - 1	●	●	●		●	●	●	●		●		

Source: As provided on company specific websites of Takaful operators. Dark green cells sourced from market information.

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Key findings on Takaful product offerings and distribution

The concept of Takaful is often not communicated fully and effectively to the policyholders.

Most Takaful companies do not highlight the specific Takaful product features in their marketing literature. For example, the surplus distribution mechanism is usually not mentioned and only a few companies provide illustrations on how the surplus is determined and distributed.

Investment-linked products seem to dominate the Takaful product space globally, whereas pure protection is still uncommon in many emerging markets such as in the Middle East.

There has been limited effort to date in creating or highlighting a Takaful product design that appeals to both Muslims and non-Muslims.

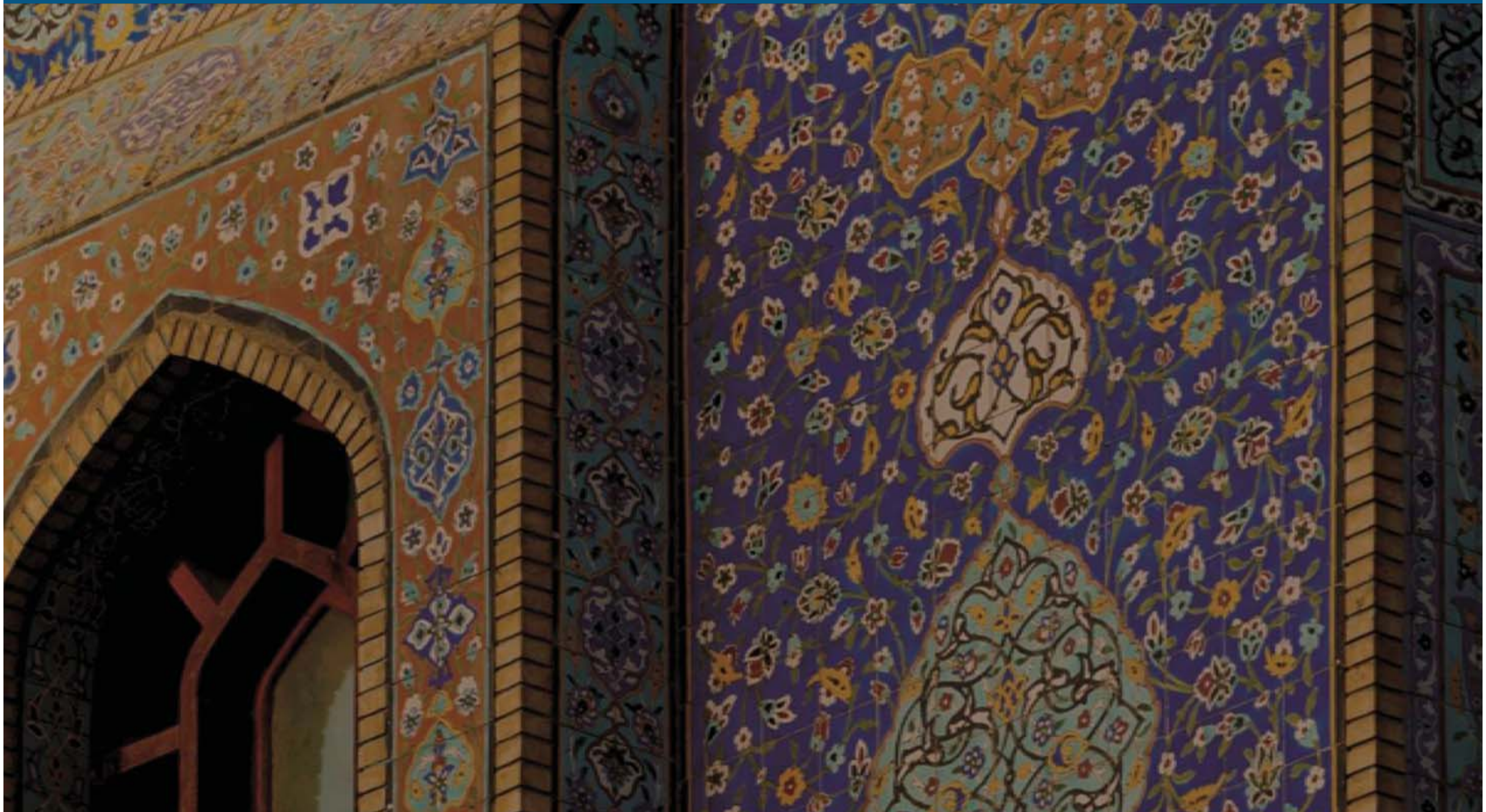
There are certain gaps in the current Takaful product space and many Takaful operators are looking at ways to develop products to meet the needs of the Takaful consumers. This would include, for example, finding ways to provide Takaful life annuities to address the need to have a stable income in retirement.

There is not much distinction in product value proposition between conventional and family Takaful products

Product innovation is significantly lacking within the Takaful space

Further details of the family Takaful product offerings and distribution methods are discussed in the full report.

Milliman Family Takaful Survey 2010



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Milliman Family Takaful Survey 2010

Milliman carried out a survey in late 2010 to explore the key current issues and focus areas of the Takaful players globally, through a qualitative questionnaire designed for Takaful and Retakaful operators.

A range of Takaful and Retakaful operators from the key family Takaful markets worldwide participated in the survey. Most respondents were CEOs, General Managers or Chief Actuaries of the large Takaful and Retakaful operators from different key regions.

Six key areas were identified within the questionnaire as the focus for future family Takaful developments:

- Products
- Wakala fees
- Asset classes
- Surplus distribution
- Environment – regulatory, distribution, Retakaful
- Challenges and opportunities

Further details on the key survey findings are available in the full report.

Key findings of Family Takaful Survey 2010 (1)

Products	The education of consumers on the types of family Takaful products available in the market is one of the key factors in increasing family Takaful penetration. Out of all the distribution channels, the key players believe that this is best done through sales agents. Takaful operators believe that consumers would typically base their decision on the 'value proposition' of Takaful products rather than strictly 'Shariah' issues. Retirement was seen as the top growth area for future family Takaful offerings, followed by group products and savings. Pure protection was seen as the lowest area for future growth. Most believed that the current Takaful products mirror conventional products and the industry lacks a distinct Takaful product proposition. There is a recognition that Takaful operators need to offer a unique value proposition to compete with conventional offerings. The industry does not see Takaful offerings as cannibalising conventional business but rather as a complement, increasing market penetration. A majority of operators see Shariah restrictions as a unique selling feature within a family Takaful offering rather than an impediment to product innovation.
Wakala fees	Current wakala fee structures are seen to be reasonable and sustainable. However, wakala fees varied significantly, reflecting regional commission structure variations where up to 50% is charged in year 1 and up to 20% is charged in year 2. In most cases, wakala fees were primarily derived from analysis of underlying expenses and to a lesser extent on competitive pressure. However, Retakaful players felt that this was more driven by competitive pressures.
Asset classes	The vast majority of operators agreed that there was a real shortage of Shariah compliant assets. Most operators felt constrained when designing products due to the lack of availability of Shariah compliant asset classes. Most operators were comfortable with the level of concentration of assets by class, geography and ownership.

Key findings of Family Takaful Survey 2010 (2)

Surplus distribution	There were a range of answers when it came to the extent of surplus distributed by operators. While most operators confirmed that they had distributed some surplus, only a handful had distributed 100% of the surplus arising to the participants. There were a few operators who had not distributed any surplus to the participants. Most considered 'surplus distribution' as a major attraction of family Takaful products. The majority of operators agreed with the proposition that surplus distribution was crucial for the sustainability of family Takaful though a few disagreed with this. From the survey, only a small proportion of the Takaful and Retakaful operators confirmed that they share in the underwriting surpluses (incentive fees) with the majority NOT taking any form of underwriting surpluses. The majority of Retakaful operators did NOT see convergence of surplus distribution policies between their various cedants operating within their pool.
Environment – Regulatory, distribution and Retakaful	All operators concurred that there was no issue with Retakaful capacity. Most operators felt that the regulators did not take into account the unique aspects of Takaful when regulating the market The vast majority felt that the regulator had not addressed the key issues on capital requirements for Takaful operators. All the operators felt that the regulators had not addressed the key issues on the role of Qard. Most operators felt the Shariah Board was cooperative and assisted in finding solutions that fits Shariah constraints. Most operators used ALL the available channels for distribution. Direct sales agents and brokers dominated the responses as the main distribution channels and banks were a close second. The majority of operators saw a 'window' Retakaful solution as a conflict with conventional reinsurance offerings. The majority of operators saw the need for non-conventional Retakaful (financial reinsurance and structured solutions) within the Takaful space.

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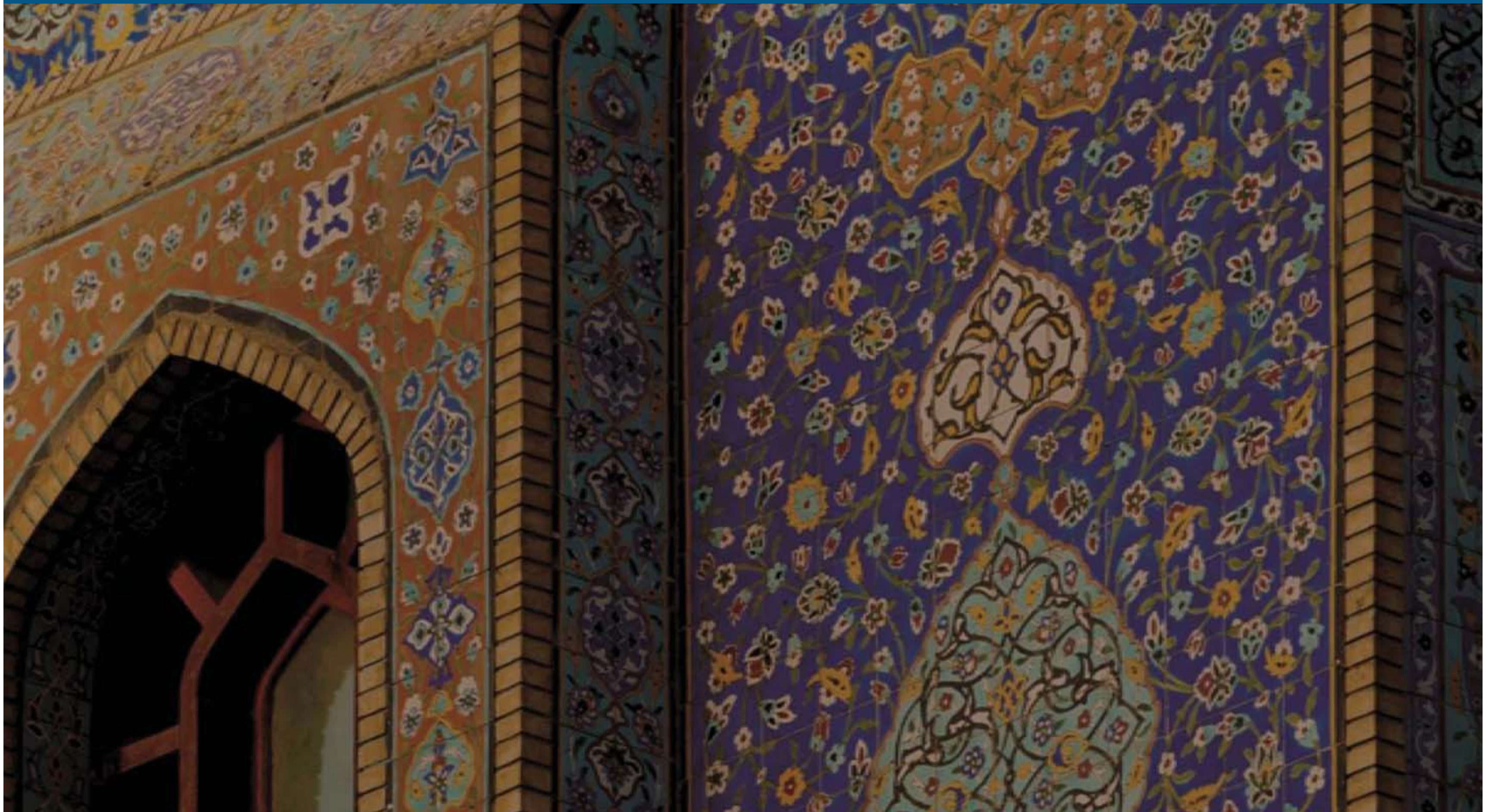
Key findings of Family Takaful Survey 2010 (3)

Key challenges	Key opportunities	Key concerns
Competition intensifies as more players enter market. Lack of awareness in certain markets in GCC is hampering growth in family Takaful. Investment related issues with the downturn has slowed down investment growth. Lack of regulatory understanding of Takaful. Irrational pricing of competitors (Retakaful). Lack of suitably trained sales agents. Lack of interest in savings products due to poor fund performance. Shortage of experienced talent (e.g. actuaries). Product approval cycle time. Lack of growth in mortgage/real estate lending related products following economic downturn. Unresolved technical and Shariah issues. Shortage of Shariah compliant securities. Lack of standard regulatory framework in many countries. Lack of product innovation. Competition with conventional companies.	Growth is here to stay. BancaTakaful is the way forward for effective Takaful distribution. Low penetration in family Takaful markets creates opportunities for exponential growth. MicroTakaful in economies with relatively low GDP per capita. Availability of retirement products. High growth of family Takaful within the growing middle class. Launch of group savings. Improved financial and fund market performance. Increased appetite for Shariah compliant products.	Competition is increasing with more operators. Continuing trend of unsustainable terms and conditions (underpricing and relaxation of underwriting requirements). Many players in the market mean it is not viable or sustainable for many smaller companies. Balancing shareholder and policyholder expectations. Consolidation is expected and with it will come its own set of M&A Takaful issues. Surplus distribution has to happen to demonstrate distinction with conventional. Conventional mindset amongst Takaful operators hampers original thought within the Takaful space. Talent acquisition in the Takaful space is scarce. Takaful awareness remains low. Rationalising of wakala concept/models with plurality of thoughts remains a concern (it may also be an opportunity). Shariah Board have difficulty in understanding technical details.

Further details on challenges and opportunities within family Takaful can be found in the full report.

Special feature: UK mutuals and Takaful



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Takaful operators vs. Mutual insurers

Structure	A mutual has no shareholders. It is owned by its members. In contrast, Takaful has shareholders (the operator). In Takaful operations the underwriting and investment funds are distinct, whereas there is no segregation made with mutual insurers. In Takaful, participants share in any distributable surplus emerging from the underwriting pool whereas in a mutual members share in all surplus emerging, including investment surplus.
Product design	In a mutual insurer there is a transfer of risk from the policyholder to the insurance company as opposed to Takaful where the risk is not transferred but shared by the participants who form a common pool. Mutual insurance contains elements of gharar (uncertainty) which is brought down to acceptable levels in the Takaful model by characterising contributions as Tabarru' (donations). Mutual insurance contains elements of maisir (gambling) whereas under Takaful no bets are made as to the outcome of risk events. Mutual insurers invest primarily in fixed interest bearing instruments containing riba (usury), forbidden in Islam whereas in Takaful only non-interest bearing assets are considered for investment of funds.
Presence of guarantees	Family Takaful contracts do not offer any guarantees being more akin to a defined contribution contract. In stark contrast conventional with-profits contracts are based on guaranteed benefits on maturity, surrender and death. In particular, with-profits surplus distribution mechanisms are driven by regular uplifts to guaranteed sums assured along with a final bonus which is often expressed as a percentage of the guaranteed benefit.
Asset – Liability Matching	A with-profits mutual will typically have an investment strategy such that the investment portfolio consists of fixed interest securities (both government and corporate bonds) to match the guaranteed benefits both in amount and duration; along with a portfolio of equities and property to diversify the portfolio and increase the rate of return. However, from a Takaful point of view many of these investments contain elements of riba, maisir or are haram and would not be acceptable forms of investment for a Takaful product.

Surplus distribution by UK mutual insurers

Surplus Distribution	In the UK all surplus distribution must take place in a fair and equitable manner. Contrary to Takaful, surpluses emerging from both underwriting and investment activities will be distributed.
Reversionary Bonus (RB)	This is an addition made to the guaranteed benefits which once declared cannot be removed. It is typically set on an annual basis, having due regard to the overall financial strength of the fund and expected future investment return on that fund. Reversionary bonus takes three main forms: Simple bonus – percentage of sum assured Compound bonus – percentage of sum assured plus existing bonuses Super compound bonus – as for compound bonus but with a lower percentage applied to the sum assured Reversionary bonus rates have fallen to very low levels in recent years, adding to the problems facing the with-profits insurance sector.
Terminal Bonus (TB) - (Final Bonus or Loyalty Bonus)	This is a loyalty bonus, payable on maturity, death and in some cases surrender. Final bonuses are set in conjunction with existing reversionary bonuses to bring a claim up to a value which reflects a policyholder's equity share based on his contributions to assets.
Smoothing	Many with-profits firms operate a smoothing mechanism which protects policyholders from the effects of sharp changes in the market value of the assets backing their policies. Smoothing is intended to have a neutral impact over time. It operates by the insurer effectively retaining some of the potentially distributable surplus during periods of high investment returns and releasing this during a market downturn. This could be likened to a claims fluctuation reserve in Takaful. Smoothing mechanisms can take many forms, some insurers operate a smoothing account to monitor the distribution process and most insurers reserve the right to remove smoothing in the event of extreme adverse market conditions.
Estate Distribution	If there are excess surplus assets then there will be a further distribution reflecting accumulated and undistributed profits built up from in force and historic business.

Lessons learned

Lessons learned from challenges facing UK mutuals and with-profits business	The challenges facing with-profits business have arisen as a combination of industry wide reputational damage in conjunction with an economic climate no longer conducive to saving. Reputational damage is best avoided with tight and consistent regulation which gives rise to clear and transparent operational procedures, thus leaving no room for doubt or suspicion in the policyholder's mind. As such further development of a standardised and well regulated Takaful model should be encouraged if family Takaful is to escape the troubled times witnessed by the UK with-profits industry over the last few years.
Lessons learned from the case studies	It is interesting to consider the measures taken by the different mutuals to survive in an ever challenging world. Those that continue to offer all products to all men are faced with the problem of managing the burden of ever escalating expenses associated with providing such a diversified portfolio of products, in addition to the marketing efforts that are required to maintain policy numbers in order to support this expense base. In an attempt to obtain further market share and more importantly keep costs to a minimum, Takaful operators could look to target certain affinity groups who share the same careers, interests or live in a similar area. Operators should also take advantage of any marketing opportunities that may arise from networks already in place within these groups. For example, are there centralised meeting places or training sessions where pastoral advice sessions could be freely provided as a means of promoting the brand? Alternatively, if there is a particular family Takaful product that is sustainable and attractive to participants, then the operator may wish to consider a strategy to concentrate all efforts in becoming known as the best provider and market a single product across an entire region. In any event, in order to remain successful an insurer must be constantly reviewing and reacting to the underlying changes in the market, making small adjustments to products, marketing styles etc. to maintain any chance or running a viable business. In the significant consolidation and raft of mergers and acquisitions witnessed in the UK life insurance industry over the last ten years – it was only the proactive that survived.

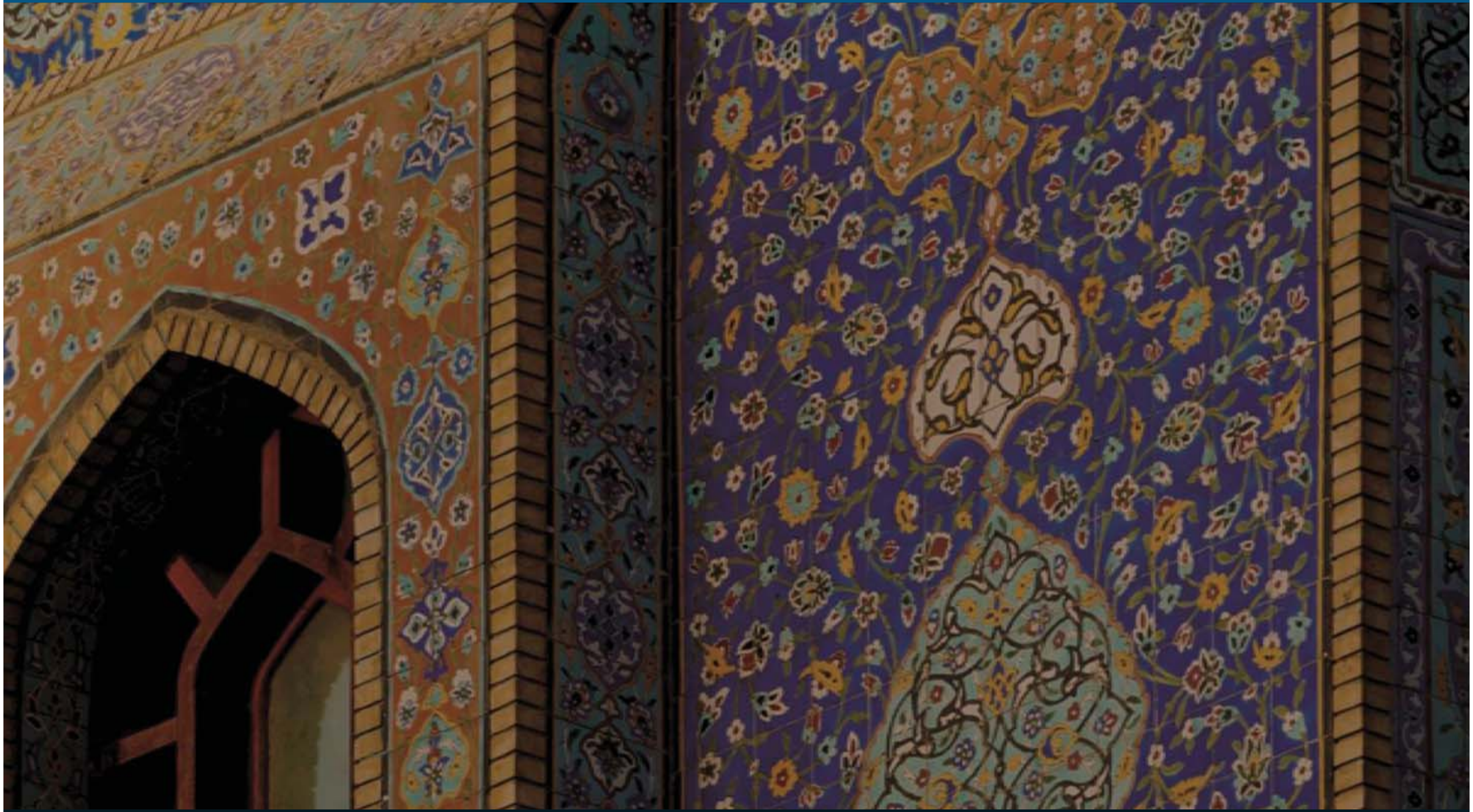
Applications in Takaful

Surplus Distribution	The inclusion of appropriate surplus distribution within the product design of Takaful schemes is in its early development and many operators currently use more ad hoc methods when distributing surplus. Much can be learned from the UK distribution methodologies to ensure that any distribution of surplus is executed in a fair and equitable manner, with due regard to the contribution that a policyholder may have made to a given surplus. Takaful operators should also consider the various smoothing mechanisms in operation in the UK and whether these ideas could be applied to Takaful products.

Despite the challenges faced by UK mutuals it may still be possible for Takaful operators to learn from the experiences of the UK Mutual Sector

Further details, including case studies, are described in the full report.

Special feature: Focus on Malaysia



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Family Takaful history in Malaysia

1984
Takaful Act 1984 enacted

First Takaful operator, Syarikat Takaful Malaysia, was incorporated on 29 November 1984 and commenced operation on 1 August 1985

1988
BNM entrusted with the regulatory and supervisory role over both the insurance and Takaful industries

1995
Setting up of ASEAN Takaful Group

1997
Appointment of members of the National Shariah Advisory Council for Islamic Banking and Takaful

2001
Establishment of Islamic Banking and Finance Institute Malaysia

Launching of the Financial Sector Masterplan

2002
Establishment of the Malaysian Takaful Association and the Islamic Financial Services Board

2003
Takaful Ikhlas is established

2005
Merger of Mayban Takaful and Takaful Nasional. (later rebranded as Etiqa Takaful)

Commerce Takaful was registered in December 2005.

2006
New licenses awarded to four Takaful companies: MAA, Hong Leong Tokio Marine Life, PruBSN, HSBC Amanah

2010
Four further new Takaful licenses Issued

Guidelines on Takaful Operational Framework were issued on 23 December 2010

2011
Draft Risk-Based Capital Framework for Takaful operators published in April 2011

Source: BNM

The Malaysian government's support in developing the Takaful industry has been a critical factor in encouraging growth. The government has been able to provide a conducive environment and set clear directions for the development of the industry.

Malaysia: Regulation of family Takaful

Perhaps the most robust regulatory regime as far as Takaful is concerned exists in Malaysia, with the regulator, Bank Negara Malaysia (BNM), adapting to the evolving Takaful market and thus raising the bar for Takaful regulations globally. However, there is still much to be achieved to ensure the robustness of the conventional system is also reflected within the Takaful framework.

Malaysia has adopted a pragmatic middle ground approach where the regulators have adopted a comprehensive Islamic financial system running parallel with the conventional insurance system, with an evolving attitude to regulations over time.

Malaysia was the first country to adopt a regulation specific to Takaful through the passing of the Takaful Act of 1984 (the Act). This Act was amended in 2007 allowing global players to setup Takaful branch operations. This Act requires:

- -Takaful companies to establish a separate capitalised operation rather than allowing a window option.
- -Takaful companies to obtain separate licenses for Family and General business. Though composite operations are allowed, a segregated approach to financial reporting is required where no cross-subsidy is allowed between family Takaful and general Takaful for the policyholders' fund.

BNM is one of the few regulators globally that has its own dedicated Shariah Advisory Council. The Shariah Advisory Council of BNM was established in 1997 to advise on matters in relation to Islamic banking and Takaful businesses or any other Islamic finance area that is supervised and regulated by BNM.

Malaysia: Takaful Operational Framework (TOF)

To further promote the orderly growth of Takaful business, the "Guidelines on Takaful Operational Framework" (TOF) was issued by BNM on 23 December 2010. The framework outlines the parameters governing the operational processes of Takaful operators to ensure that business activities are within their risk management capacity. The Guidelines will take effect on 1 October 2011.

The TOF is viewed by many as one of the most comprehensive drafts of a Takaful framework globally and shows BNM's strong commitment to the industry. This is further supported by the publication of the draft risk-based capital framework for Takaful operators in April 2011, as discussed on the next page.

Under the TOF, it is likely that existing Takaful operators will have to enhance their institutional capabilities and operational efficiency to strengthen their competitive position. There may also be capital implications as the role of Qard is explicitly defined within the framework.

The TOF will also require Takaful operators to be more transparent on the mechanism for surplus distribution, in order to provide enhanced disclosures and ensure the Takaful providers operate within the capped charges. Such requirements are likely to further develop a level playing field with conventional life insurers. This could impact the local Takaful providers who have dominated the Takaful market for nearly two decades as they may struggle with legacy issues in dealing with some of these requirements. Some smaller operators may also struggle under the TOF requirements, leading to further triggers in consolidation within the market.

Objectives of TOF

- To enhance operational efficiency of Takaful business
- To build healthy Takaful funds which are sustainable
- To safeguard the interests of participants
- To promote uniformity in Takaful business

Malaysia: Overview of the draft Risk-Based Capital Framework (RBC) for Takaful Operators

In April 2011, BNM issued the 'Draft Risk-Based Capital Framework for Takaful Operators' (the RBC framework), which requires Takaful operators to hold capital commensurate with its risk profile.

The framework outlines the responsibility of Takaful operators, which includes ensuring the Takaful fund or Participant's Risk Fund (PRF) is able to meet the Takaful benefits to participants at all times. There is an explicit requirement for the Takaful operator to provide Qard (interest-free loan) in the event of a deficit in the Takaful funds and the requirement to have sufficient capital to meet both the potential Qard obligation and its on-going business obligations in its shareholders' fund.

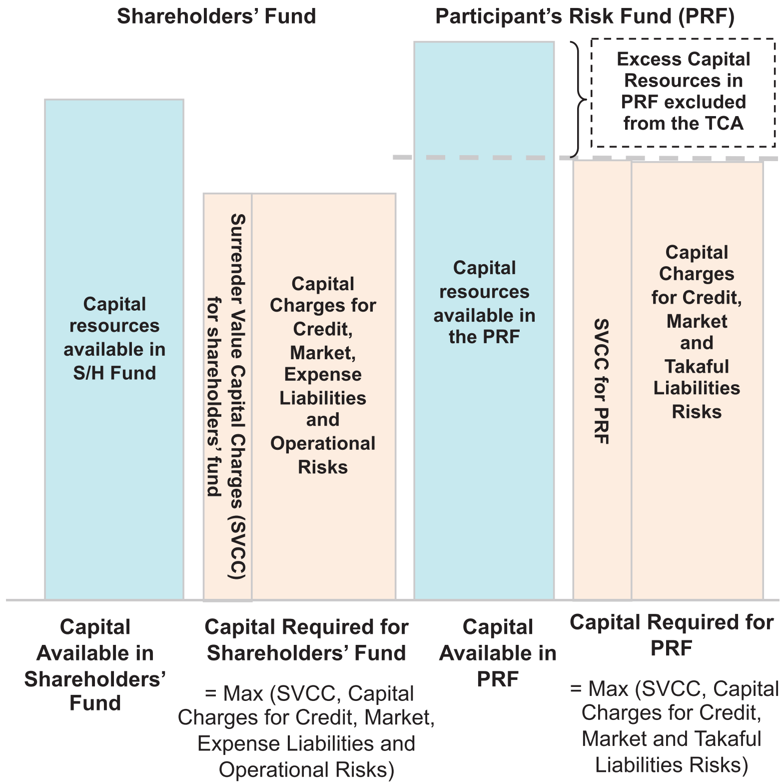
The framework also sets out BNM's expectations on the risk management policies. This responsibility of adopting a sound risk management practice, governance as well as identifying, monitoring, controlling risks that are not adequately addressed in the framework and allowing for these risks in the Individual Target Capital level lies with the Board of Directors and senior management.

Takaful operators are required to provide their Capital Adequacy Ratio (CAR) at the end of each financial year and at every quarter (although quarterly CARs do not have to be externally audited).

CAR = TCA / TCR * 100%

TCA = Capital Available in Shareholders' Fund + Capital Available in PRF (excluding Excess Capital above the Capital Required Amount for PRF)

TCR = Capital Required for Shareholders' Fund + Capital Required for PRF



Further analysis on the framework, including details on the calculation of capital by key risks, as well as the potential Impact of the proposed guidelines on the industry, are provided in-depth in the full report.

Financial highlights

	2007	2008	2009	2010
Gross Contribution	100.0	100.0	100.0	100.0
ReTakaful Contributions	(1.4)	(3.2)	(3.0)	(1.1)
Net Contributions	98.6	96.8	97.0	98.9
Investment and Other Income	20.8	17.9	15.4	15.3
Total Income	**119.5**	**114.7**	**112.4**	**114.2**
Net Claims	32.0	24.9	27.8	30.3
Operator's Fee	7.7	12.7	16.4	8.5
Expenses Charged to Fund	10.2	8.1	10.7	15.9
Total Outgo	**49.9**	**45.7**	**54.8**	**54.8**
INCOME - OUTGO	**69.5**	**69.0**	**57.6**	**59.4**
Other Surplus / (Deficit)	0.9	(1.4)	1.3	0.0
Adjusted Net Income before Tax	70.4	67.7	58.8	59.5
Tax	**0.2**	**(0.0)**	**0.1**	**0.1**
Adjusted Net Income After Tax	**70.2**	**67.7**	**58.8**	**59.3**
Increase in Fund	**63.2**	**71.6**	**54.9**	**55.4**
Net Adjusted Surplus / (Deficit)	**7.0**	**(4.0)**	**3.8**	**4.0**

Source: Published Company Financials (7 companies in 2007-2009 and 3 in 2010)

Figures have been shown so that yearly contributions are scaled to 100 based on arithmetic summation of filings of companies and subsequent scaling. The scaling has been carried out for ease of analysis of the financial ratios and to standardise the numbers as we do not have the financials of all companies in 2010.

The financials considered are at a policyholder level. As composite companies exist in Malaysia and such companies provide their financial results in aggregate, shareholder / operator value for family Takaful business only is not publicly available from the annual financial reports.

The reporting format does not explicitly state the technical reserves for family Takaful and hence the "Net Adjusted Surplus / (Deficit)" has been calculated using the change in family Takaful fund as the proxy to change in reserves.

Further details on the financial highlights of Malaysia can be found in the full report.

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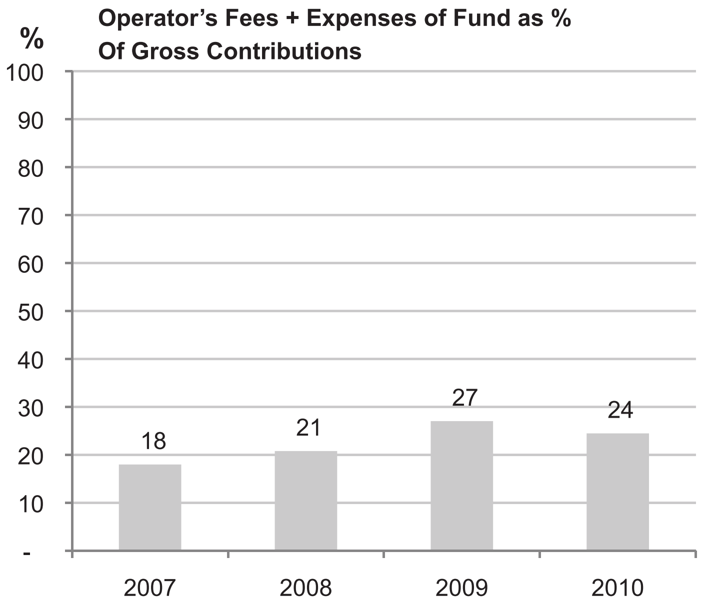
Malaysia: Expense ratio & net surplus

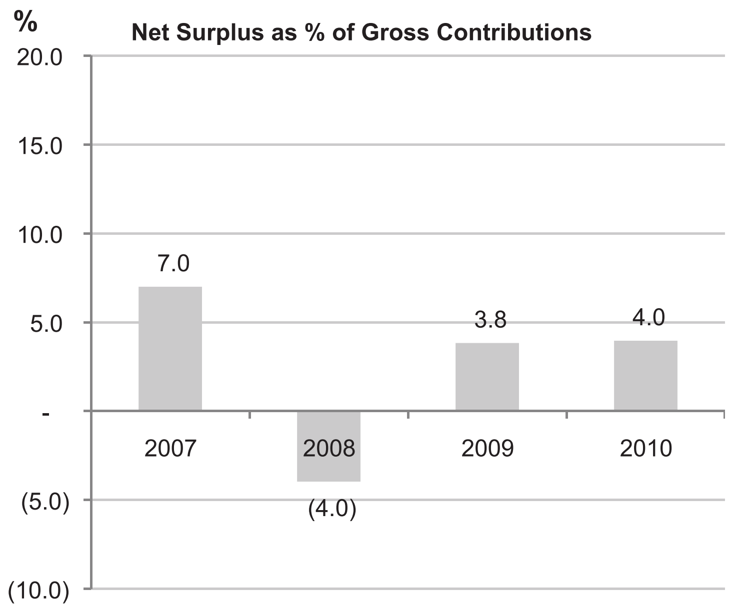
The expense ratio is around 20-30% of the gross contributions
The net surplus available to policyholders ranges from - 4% to 7%

This in effect is the wakala fee charged by operators as a % of gross contributions.
This would typically cover Actual Expenses (including expenses charged on the Takaful fund for investment-linked products) + Cost of Capital + Profit Margins for Takaful operators



Source: Published Company Financials (7 companies in 2007-2009 and 3 in 2010)

The Net Surplus is calculated as the (net income) less (the change in the Takaful fund)
A proxy change in reserve is calculated in the analysis using the change in the family Takaful fund. Therefore, this analysis estimates the net surplus available to policyholders in each year



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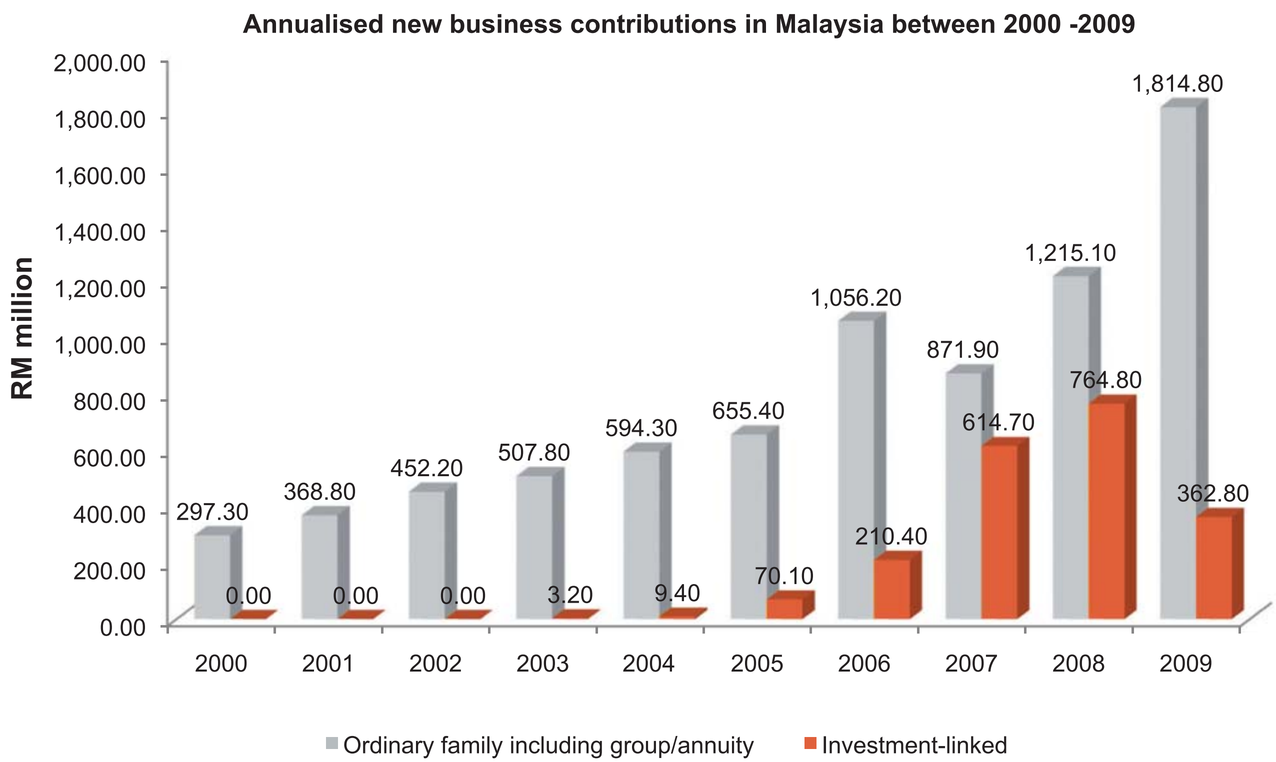
Family Takaful: Product mix in Malaysia



Source : Insurance Service Malaysia Berhad (ISM)

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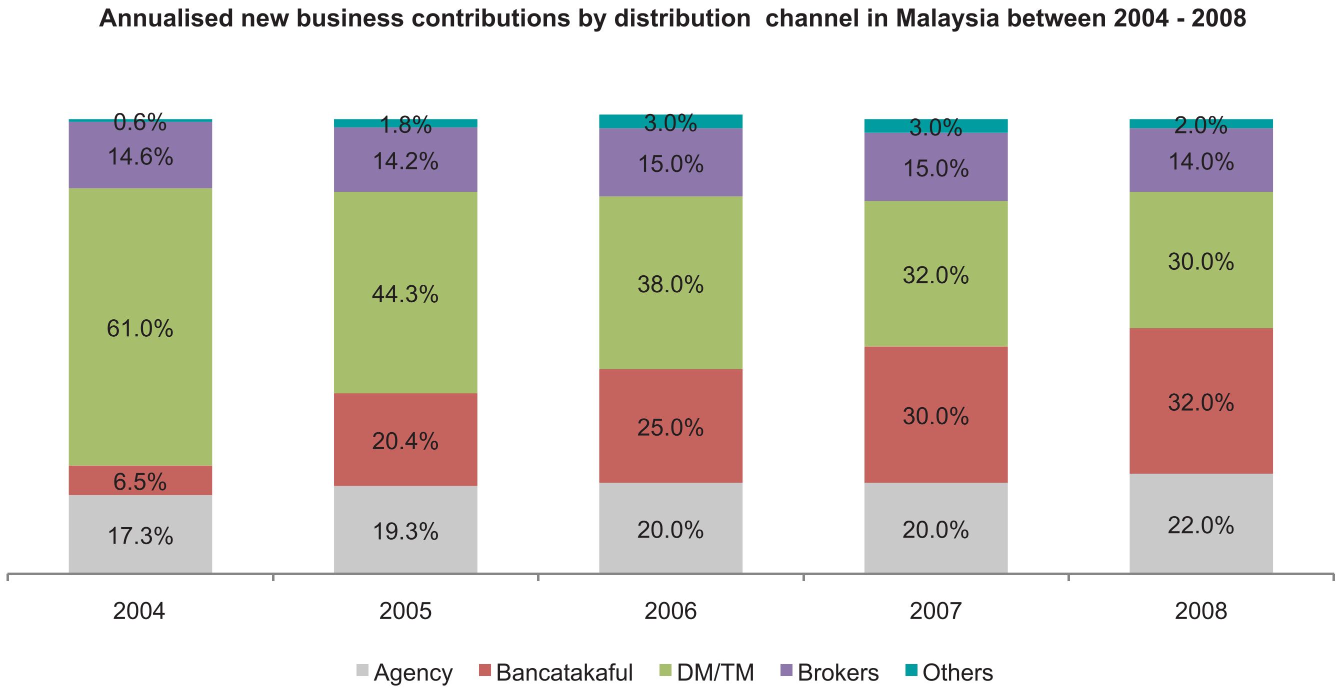
Family Takaful: Sales by distribution channel



Source: Axco 2010

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Appendix

Details on obtaining the full report: "Global Family Takaful Report 2011"

The Global Family Takaful Report 2011 is a 'first-of-its-kind' industry report, focusing on the recent developments within family Takaful.

This comprehensive report provides further analysis and insights on the issues and opportunities within the family Takaful industry as highlighted in this summary report.

To purchase the full report, please visit www.milliman.com/takaful2011

Alternatively, please contact one of the authors of the report or Millimanís Takaful Practice Leader, Safder Jaffer at safder.jaffer@milliman.com

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In carrying out our work and producing this report, we have relied upon information supplied to us by third parties as well as upon published financial information. Data has been collected from a variety of sources and includes data obtained from market sources that is not published. As such, although every effort is made to ensure that the information in this report is accurate, we cannot always verify some of the data that has been presented and have hence relied on this data. To the extent that there are any material errors in the information presented, the conclusions presented in this report may be affected. Milliman accepts no responsibility whatsoever for any errors, or omissions, or the actions of third parties.

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Key sources of data

Draft Risk-Based Capital Framework for Takaful Operators, Bank Negara Malaysia, April 2011.

Standard on Solvency Requirements For Takaful (Islamic Insurance) Undertakings, Islamic Financial Services Board, December 2010.

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2010 Takaful Statistical Yearbook ñ Insurance Services Malaysia Berhad.

Saudi Insurance Market Survey Report - SAMA 2008 and 2009.

Guidelines on Takaful Operating Framework ñ BNM.

Buku_Perasuransian_Indonesia_2009.

Tadawwul.

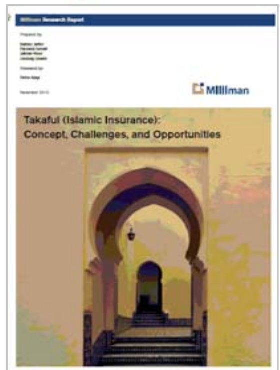
Zawya.

Takaful expertise in Milliman

We have acquired significant experience in Takaful and Retakaful from working on a number of assignments

- **Developing Re-Takaful Solutions and Structures**, including Re-Takaful pricing basis
- Providing assistance in **developing and reviewing the actuarial pricing basis** for family Takaful products
- **Appointed Actuary roles** for several Takaful operators
- **Assisting new start-up Takaful and Re-Takaful operators** in developing a sound business plan
- Providing expertise in **product design and development** for family Takaful products

Milliman's team of Takaful experts recently published a research paper entitled "Takaful (Islamic Insurance): Concepts, Challenges and Opportunities"



Range of Takaful solutions in Milliman

Range of Services	Description
Review business plans	Create and review business plans for new and existing Takaful and Retakaful companies.
Product development	Create and design life and non life product lines that are Shariah compliant and actuarially sound.
Risk management	Create innovative solutions for larger risks within the bounds of Shariah principles.
Modelling	Build tools for sound surplus distribution and allocation of wakala fees.
	Ensure efficient management and monitoring tools for meeting shareholder, policyholder and Shariah board expectations.
	Provide modelling packages that are tailor made to meet Takaful requirements.
Regulatory & Compliance	Create and advise on funds (subject to authorisation restrictions), pool and underwriting procedures to meet Shariah requirements.
	Assist with Shariah board and regulatory audits.
	Provide innovative solutions for Shariah compliant investment policy, including framework for Asset-Liability Management (ALM).
Mergers & Acquisitions	Assess Joint Venture / mergers and acquisitions plans / partnership with other Shariah compliant organisations.
Actuarial valuation	Actuarial valuation and reserve certification of Takaful and Retakaful portfolios.
Due Diligence	Carrying out due diligence activities.
Capital management	Determine optimal capital structure including Retakaful strategy to align shareholder and policyholder interests.
Others	Provide support for Takaful staff at all levels and in various functions i.e. actuarial, investments, underwriting, claims and administration.

Milliman project team and contact details

Project Team

Farzana Ismail, FIA	Consulting Actuary, London
Safder Jaffer, FIA	Takaful Practice Leader, Dubai
Jabran Noor, FIA ,FSA	Consulting Actuary, Dubai
Lindsay Unwin, FIA	Consulting Actuary, London

Reviewer

Debo Ajayi, FSA,MAAA	Managing Director, Dubai

For questions or comments on this report please contact : safder.jaffer@milliman.com

Dubai office:

Grosvenor Business Tower
Suite 2010
Sheikh Zayed Road
P.O. Box 506784
Dubai, United Arab Emirates

Tel: +971 (0)4 328 9828
Fax: +971 (0)4 328 9838

Email : safder.jaffer@milliman.com
Email : jabran.noor@milliman.com

London office:

11 Old Jewry
London
EC2R 8DU
United Kingdom

Tel: +44 (0)20 7847 1500
Fax: +44 (0)20 7847 1501

Email: farzana.ismail@milliman.com
Email: lindsay.unwin@milliman.com

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