The evolution of Takaful regulations has positive impact on the industry

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The commercial insurance contract operating under the fixed premium method is corrupted with excessive risk, which renders it unlawful in Islamic law. The solution lies in mutual insurance based on the principles of mutual aid and solidarity. The same is true regarding reinsurance. Raised in the wake of Islamic finance, Takaful has experienced phenomenal growth since its inception.

After the unanimous judgment delivered by the Ulama in the First International Conference for the Islamic Economy held in Mecca in February 1976 in favor of insurance under the Islamic model, the first Takaful company was founded in Sudan in 1979.

In Malaysia, a pioneer country in this field, Article 2 of the 1984 law defines Takaful as "a system based on brotherhood, solidarity and mutual assistance". As in mutual insurance companies, although it is sought after, profit is not the primary objective.

In 2006, AAOIFI defined Takaful in Standard No 26 as an agreement between persons with specific risks and whose purpose is the compensation of damages through the payment of contributions based on donations. The mutual insurance fund thus formed may be managed according to the model chosen by a committee chosen among the participants, or by a management company.

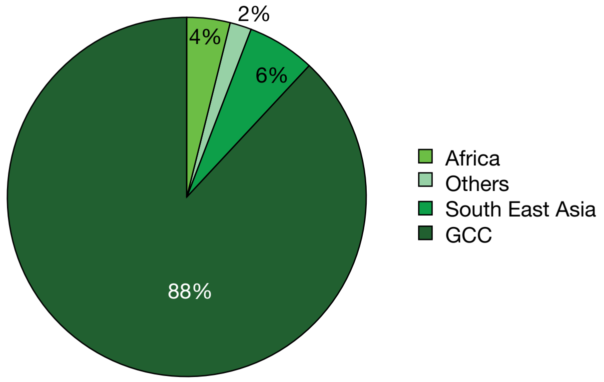
"Whatever the model, the Takaful operator must ensure that operations are Shariah compliant"

There are five key elements:

1. Claims are covered by a fund created by participants' contributions. As in the mutual system, members are both insurers and the insured
2. Insured persons are entitled to the surpluses realized by the fund
3. The contribution takes the form of a donation (Tabarru') or a contribution (Musahamah)
4. The Takaful fund is managed by a committee chosen by the insured or a management company, and
5. All investments must comply with Shariah.

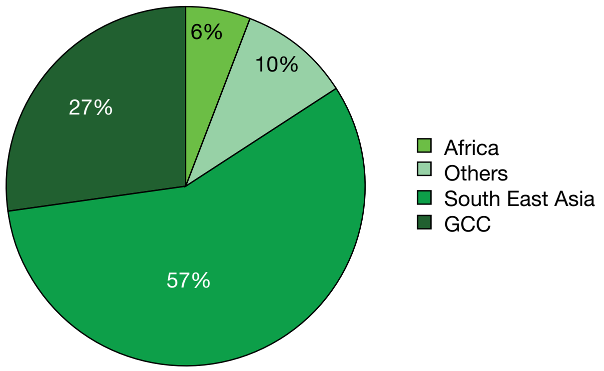
Whatever the model, the Takaful operator must ensure that operations are Shariah compliant. If there is a deficit in the subscription fund, the Takaful operator must grant an interest-free loan to settle the claims or make a recovery of contributions over the participants. To exercise the Takaful, it is necessary to be able to transpose the Shariah in respect of the legal provisions of the country in which the operator wants to exercise it if the latter does not have specific regulations.

Chart 1: Percentage of General Takaful gross written contributions by key regions in 2015



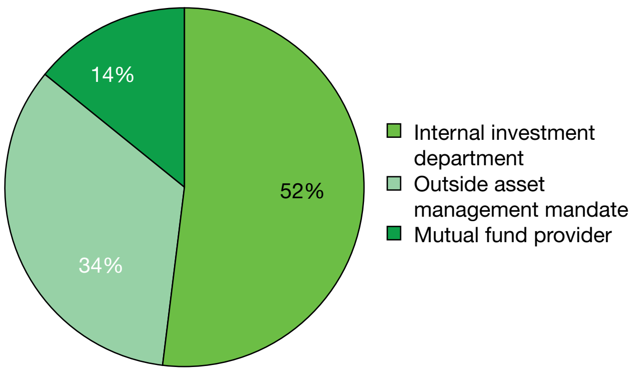
Source: Milliman Research Report Global Takaful Report 2017

Chart 2: Percentage of Family Takaful gross written contributions by key regions in 2015



Source: Milliman Research Report Global Takaful Report 2017

Chart 3: Investment management preference



Source: Global Advisors World Takaful Report 2016

Amid the growth of the Takaful industry, there is a demand for reinsurance for Takaful operators. Consequently, many companies have appeared since 1985 such as the Islamic Reinsurance Company founded in Bahrain or BEST Re in Tunisia.

The reinsurance of Takaful operators according to Islamic law is recognized as re-Takaful and its purpose is to enhance the performance of Takaful funds by mitigating risks. The re-Takaful fulfills two functions.

First, it serves to secure significant risks of high financial value, as well as unexpected or exceptional losses that operators are unable to cover. Second, it allows Takaful operators to expand their hedging capacities, and consequently boost their incomes.

Hence, sharing in investment returns is an essential feature of re-Takaful. This led Hannover Re and Swiss Re to integrate the Takaful reinsurance industry in 2006 and Munich Re in 2007.

In 2050, forecasts predict that Muslims will number 2.6 billion or nearly 30% of the world's population. The prospects for the Takaful and re-Takaful industry, therefore, seem optimistic, given the low penetration of insurance in Muslim-majority countries. Persistent population growth in these countries and good prospects for economic growth offer immense opportunities.

> **The presence of a welcoming environment can contribute to the proper implementation of Takaful insurance, and the presence of a secondary capital market accessible to Islamic investments is necessary**

As a sector to support the rise of Islamic finance, Takaful has experienced remarkable growth. Gross contributions increased at a compound annual growth rate of 33% between 2005 and 2010, then by 18% between 2008 and 2013 and finally by 6% between 2012 and 2017. Despite a slowdown in global growth compared to many local markets, Takaful continues to grow faster than conventional insurance.

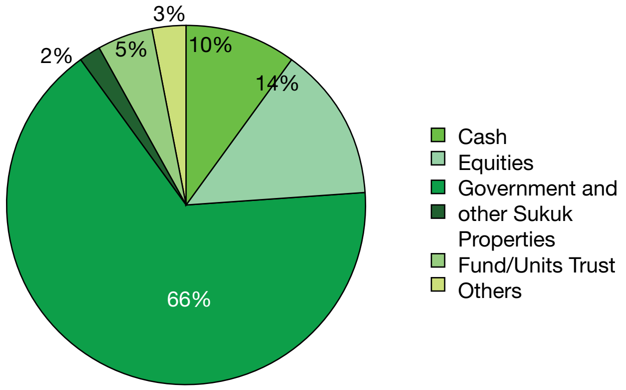
To date, the industry has not yet reached its full potential: it represents less than 5% of the share of the insurance market in most Muslim-majority countries, and even in the most developed Takaful market like Malaysia, it represents less than 20%.

The global assets of Takaful operators reached US$46 billion in 2018 and are expected to reach US$65 billion by 2024. Globally, there are an estimated 335 operators (Takaful, re-Takaful and windows) with 115 mixed operators, 120 general operators, 78 family operators and 22 re-Takaful operators.

Nowadays, 45 countries have developed specific regulations on Islamic finance to promote its development even though the main markets are focused in Saudi Arabia, Iran, Malaysia, Indonesia and the UAE.

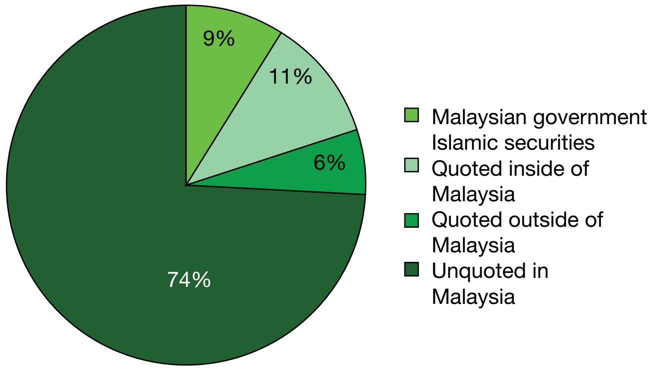
Improving the regulatory framework in the Takaful industry is necessary to build trust by increasing the information available to all stakeholders like investors, potential customers and brokers. Strengthening the regulatory framework is not only the responsibility of regulators; industry players must take all measures and initiatives to improve practices.

Chart 4: Malaysian operators' investment allocations



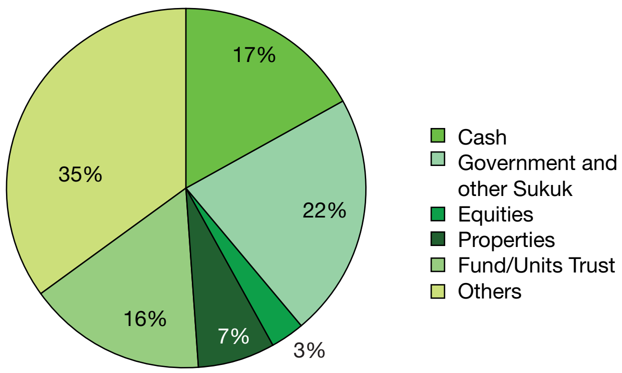
Source: Global Advisors World Takaful Report 2016

Chart 5: Malaysia Takaful operators' Sukuk allocation



Source: Global Advisors World Takaful Report 2016

Chart 6: GCC operators' investment allocations



Source: Global Advisors World Takaful Report 2016

The presence of a welcoming environment can contribute to the proper implementation of Takaful insurance, and the presence of a secondary capital market accessible to Islamic investments is necessary. This includes not only the eligible shares, but also a liquid market of Sukuk.

Without Sukuk, it will be difficult for a Takaful company to manage the investment risks. The evolution of Takaful regulations in several markets and the expansion of the Shariah compliant investment universe, especially Sukuk, have a positive impact on the development of the industry.