Unlocking the real growth opportunities for takaful

Mr Kirk Austin, Chief Marketing Officer of ACR ReTakaful MEA, analyses whether the takaful market can hit the market forecast of US$11 billion by 2015.

While observers' estimates of likely premium volumes may vary, all are in agreement about one thing: the growth of the takaful market will buck current global trends.

Whereas the size of the takaful market at present may be assessed at approximately $2.4 billion, this is actually a much smaller figure than would be obtained if one were to consider all types of Islamic insurance, such as co-operative insurance as practiced in, for example, Saudi Arabia, and conventional insurance that is rendered Shariah-compliant in territories like Oman.

Added together, these kindred systems would take the figure up to a more realistic volume of $5.7 billion in 2007 and, say, $6.6 billion to date in 2009.

Help and hindrances

It is fair to assume that as takaful develops, it will become the predominant technique for asset protection and risk-sharing within the Islamic financial environment, so that a certain amount of business currently flowing to non-takaful models will, with the passage of time and growth in understanding of the model, flow more naturally to the takaful sector.

However, if certain jurisdictions continue to prefer non-takaful (but equally Shariah-compliant) models, then these will inevitably have the effect of slowing the growth of contributions that may be specifically termed "takaful".

The extent to which governments and regulators may be guided towards embracing the takaful model rather than any other will arguably be influenced by the success of the model in those markets where it is already accepted as the preferred Shariah-compliant mechanism.

But even if we assume the current size of the takaful market to be $2.4 billion and apply a growth rate equal to that which has been experienced throughout the GCC over the past five years, then by 2015 we will reach a maximum volume of $7.5 billion.

Can growth be sustained?

Under current economic conditions, one might ask, is it realistic to imagine that the growth rate of recent years may be sustained?

If Islam is the world's fastest growing religion, we can in part expect growth through a natural or "organic" increase in the appetite for takaful products as a means to protect assets owned by individual Muslims, their families and businesses.

In addition, we can expect growth through economic, commercial and industrial development across the GCC, notwithstanding the impact on all segments of the global economy of the financial mismanagement (in the US and Europe in particular) that has dragged the world into recession.

But even at the very high assumed growth rate year-on-year, it is clear that by 2015, a figure some $3.5 billion short of the $11 billion forecasted by market observers would be achieved. So, a reliance on a natural increase in the takaful business as defined above will not, on its own, bring about the required level of growth.

Other factors, therefore, need to be introduced in order to achieve our industry's goal. In contemplating these, let us first return to the fundamentals of the insurance industry.

Insurance has a number of functions, which perhaps need to be mirrored by the takaful industry, if it is to prosper in the same way. Arguably, the prime function of insurance is the way in which it facilitates and underpins industrial, commercial and personal (or family) security.

Is there enough capacity?

If we consider the current takaful market, there is little doubt about the ability of operators to service the requirements imposed by, for example, personal lines or family business. But on the commercial and industrial side, the picture is not yet quite as straightforward.

Take industrial growth. Very considerable investment in plant and machinery, tooling and materials, is a necessary precursor to any significant industrial enterprise. Consider, for example, the investment required to build and operate a simple aluminium smelting plant, or a plastics extrusion factory.

Clearly, hundreds of millions of dollars must be invested – years before there is any real prospect of a financial return. During the construction and commissioning stage of such projects, and subsequently throughout the operational life of the plant, these hundreds of millions of dollars are at risk.

For the conventional businessman or investor, the solution to much of this exposure has always been simple: insurance. But for the Islamic investor, the solution has never been as straightforward and, in many respects, is still not.

He will need to find sufficient Shariah-compliant capacity, of strong capitalisation and reputable financial rating, to cover all of his potential financial exposures throughout every phase of the construction, commissioning and, ultimately, the operation of his plant – whether this is a refinery, a steel mill, or a smelting plant.

Perhaps, therefore, the first stage of the problem falling for consideration is: Is there sufficient takaful capacity, of sufficient strength and quality, to meet the needs of this potential market?

Opinions may vary as to the precise capacity presently available that may truly be defined as "takaful", but in respect of major project finance coverage, we would probably not be too far from the truth if we assumed an overall net amount of around $200 million. This is sufficient, in other words, to cover a substantial proportion of all small-to-medium enterprise business, but not to allow a pure takaful solution, as required by our investor in question, to exposures of greater amounts.

And this is where the question of retakaful capacity falls for consideration. To match the capacity available in the conventional market – which has, after all, been built over a period of more than a hundred years – the takaful industry must replicate to a certain extent the steps followed by this industry as it grew to achieve its current predominance.

For the purposes of this article, we can probably tie this down to two specific requirements:

- The achievement of sufficient capital strength enabling a meaningful and influential participation in the protection of mega risks; and
- Having access to retakaful support of a strength, capacity and quality at least matching and preferably greater than (but never inferior to) the strength and quality of the takaful operator itself.

Recent events have done nothing to reduce the need for sound retakaful capacity. On the contrary, as the financial markets have descended into turmoil, so those contemplating investing into major projects have become all the more concerned to ensure that their investment is as comprehensively protected as is achievable, in a Shariah-compliant way.

Whose job is it to grow the takaful market?

The quick answer is that the responsibility is shared between four groups:

- **Takaful operators** – They are responsible for:
  - Ensuring that they have the strength and expertise to meet the needs of their clients;
  - Ensuring that their clients know they have the takaful option and need not be obligated to buy conventional insurance;
  - Making every effort to prioritise the use of retakaful operators over conventional reinsurers for their treaty and facultative needs.
- **Retakaful operators** – They are responsible for:
  - Ensuring that they have the financial strength and technical expertise to enable takaful operators to rely on them.
  - Ensuring that they cover all lines needed by their takaful cedants, so as not to drive them back towards conventional reinsurers.
  - Making every effort to accommodate their takaful cedants in their treaty and facultative needs.
- **Buyers of takaful and retakaful**

  Most readers of this article would have experienced the situation where reinsurance terms are quoted for a piece of takaful business by, perhaps, a conventional reinsurer, which are far cheaper than prudence or technical underwriting considerations may support. Understandably, these terms can never be matched by the professional retakaful operator.

  But can we expect the takaful operator not to take the cheapest cover he is offered? That is a matter partly of commercial opinion and, perhaps, partly of conscience.

  Certainly, if the retakaful operators want to be given at least equal consideration by takaful operators when they are deciding how to protect their exposures, then they will need to be competitive in what is, ultimately, an open market.

  That means being competitive in the scope and strength of the coverage as well as maintaining a competitive edge.
- **Shariah scholars**

  Every takaful and retakaful operator has a Shariah committee. It is to be desired that these committees take a proactive role in encouraging the maximum use of all available retakaful capacity every time a takaful operator enters the market for protection, whether on a treaty basis or, increasingly, against exposures to mega risks.

  How many of these committees take a proactive role in guiding their managements to full compliance with the Shariah? For surely it will only be when takaful operators can claim to have pure retakaful security right across their programmes that we will genuinely be able to announce the "arrival" of takaful.