

The World Takaful Report 2009

The Future of Takaful - Opportunities in adversity

14 April 2009

Disclaimer

The contents of the World Takaful Report 2009 are based on qualitative comments and hence provide a subjective assessment of the current market. All quantitative comments are based on published information wherever possible. Where published reliable data was not available, qualitative comments were made which may or may not reflect the true state of affairs. Information has been assimilated from secondary sources, including published country, industry and institutional information, and primary sources in the form of interviews with industry executives.

We are not expressing any assurance on the accuracy or completeness of the information obtained. Although this report has been documented based on our understanding of Islamic financing activities to include only such activities that are deemed Shari'a compliant, no Shari'a opinion whatsoever has been taken on this report. Hence, the contents of this report, in terms of the activities to be carried out, might not necessarily be consistent with Shari'a in all cases, and the opinion of a Shari'a scholar(s) should be taken before any further steps are made to implement suggestions made in the report.

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Cover letter

Dear Takaful Executive,

On behalf of Ernst & Young, I would like to take this opportunity to introduce to you the Ernst & Young World Takaful Report 2009. We are honored to produce the second edition of this report, which we believe sets a benchmark for the Takaful industry and is essential reading for anyone interested in Islamic financial services.

The Takaful industry has strong foundations

The fundamental principles of Takaful have remained the same since the inception of Islam: mutual assistance and Shari'a compliance. Takaful markets now span much of the globe with a particular concentration in underpenetrated Islamic markets, the largest of which are Saudi Arabia and Malaysia. Gross Takaful contributions have grown from US\$ 1.4 billion in 2004 to over US\$ 3.4 billion in 2007. There still exists a large, expanding and untapped Muslim population on almost every continent. Based on research interviews and estimates, the likely size of the global Takaful market could be as high as US\$ 8 billion by the end of 2012.

Risk management in adverse times is essential ... to make the most of opportunities for accelerated growth

The financial crisis has severely impacted financial institutions - over the last year the top 10 US and European banks and insurance companies have seen a US\$ 1.5 trillion drop in market capitalization. The ensuing recession has tempered growth forecasts in almost every region and sector, including major Takaful markets. As a consequence, Takaful operators are especially wary of the strategic, operational, compliance and financial risks they face today.

Takaful operators who can successfully adapt their business models and mitigate against changing business risk will have opportunities to expand through acquisition activity and benefit in the long-term from strong demographic growth, rising income levels and a growing desire to consume Shari'a compliant products.

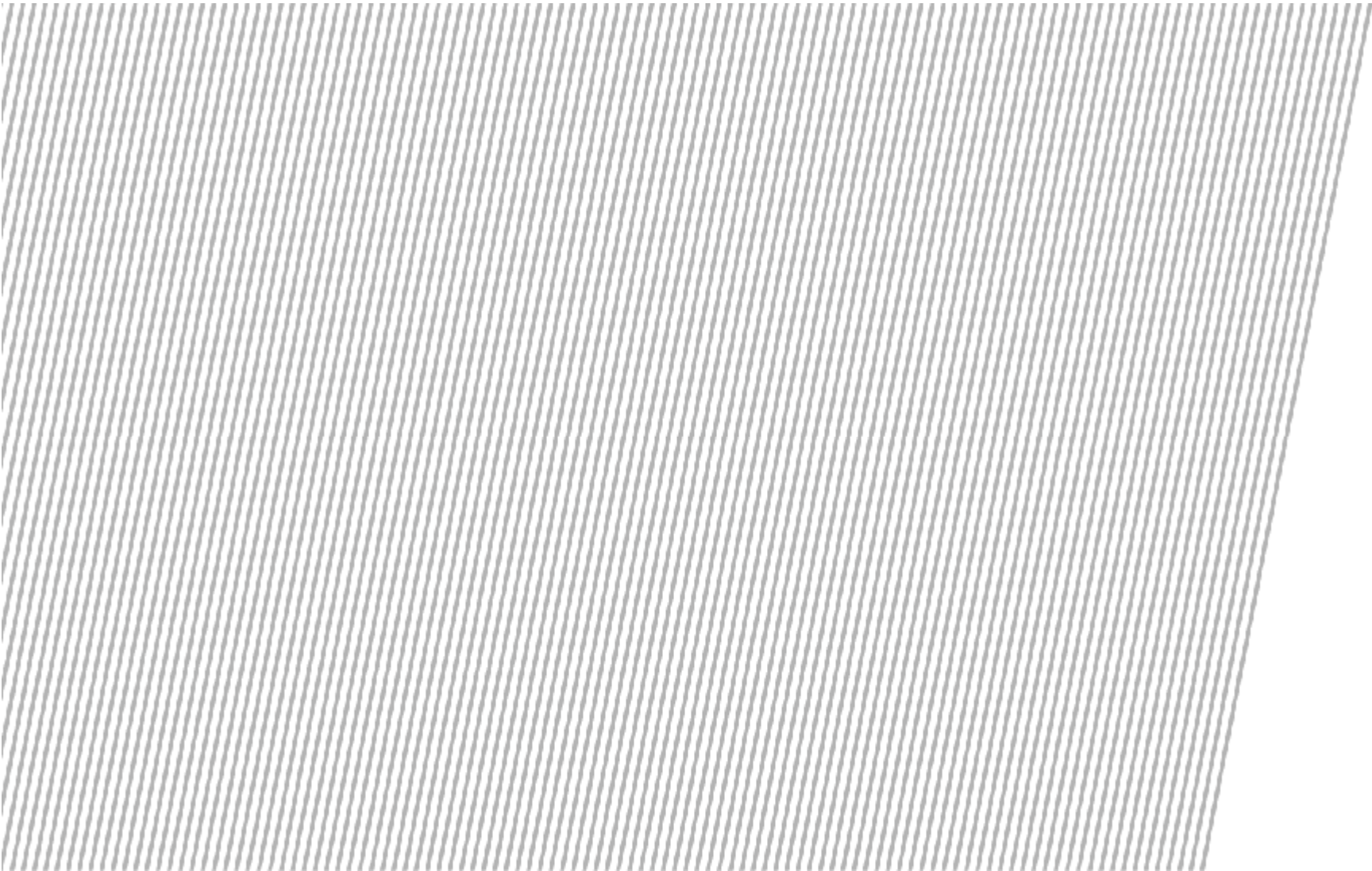
I hope that this report will allow market participants to better understand the growth factors underpinning the industry as well as encouraging new market entrants. I trust that you will find this report informative and helpful in many different ways, allowing you to identify and exploit the various opportunities that exist in the Takaful market today.

Sameer Abdi
Partner
Ernst & Young

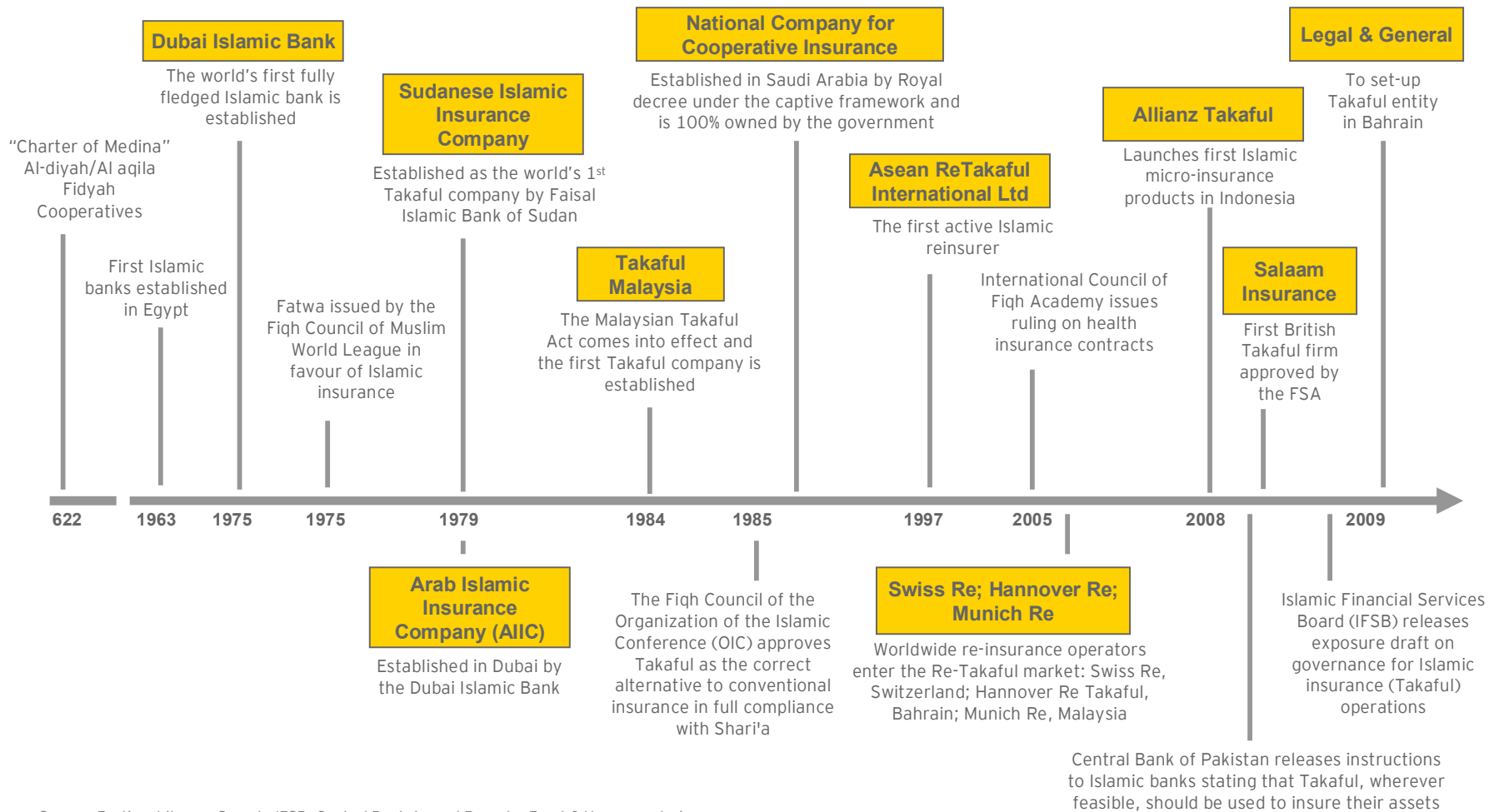
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1. Introduction to Takaful

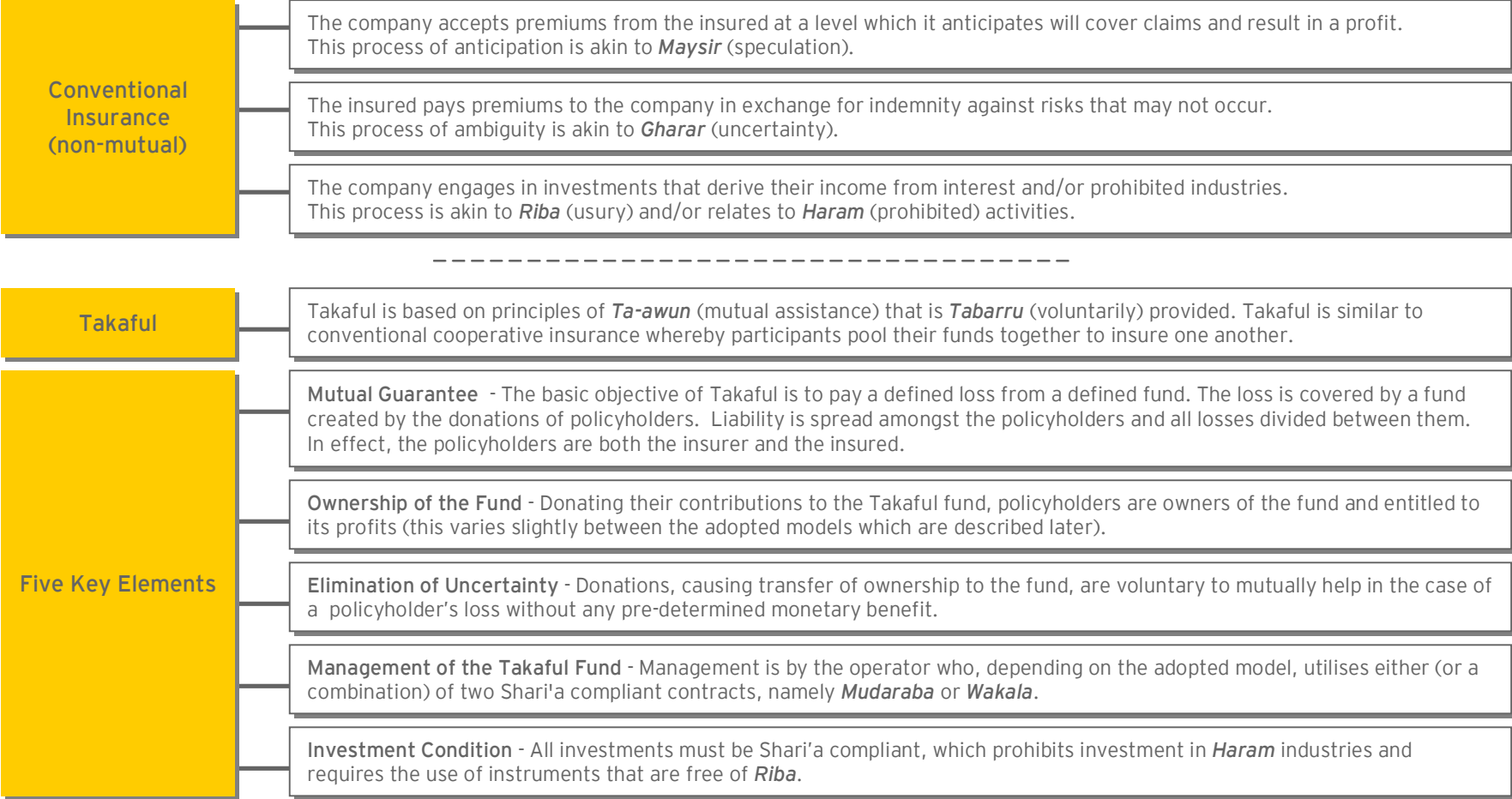


Contemporary execution of Takaful has existed for less than three decades



Source: Factiva; Literary Search; IFSB; Central Bank Annual Reports; Ernst & Young analysis

Takaful can be considered a Shari'a compliant form of conventional cooperative insurance



Source: Ernst & Young analysis

Conventional forms of insurance are prohibited under Islamic law as they contain elements of *Maysir*, *Gharar* and *Riba*

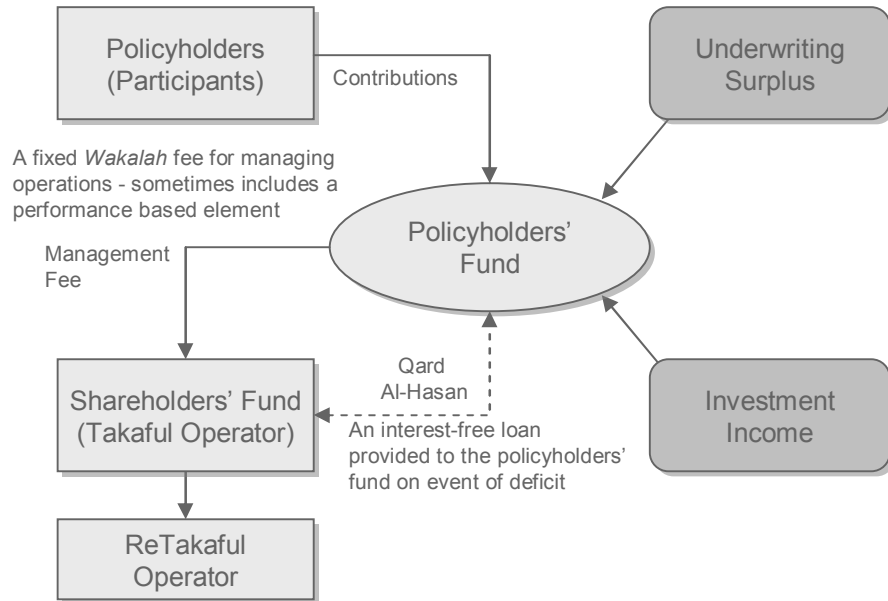
	Takaful	Cooperative Insurance	Proprietary Insurance
Contracts Utilised	Donation and mutual contract.	Mutual contract.	Exchange contract.
Company Responsibility	Pay claims with underwriting fund; interest free loans in case of shortfall.	Pay claims with underwriting fund.	Pay claims from underwriting fund and shareholders' equity.
Participants' Responsibility	Pay contributions.	Pay contributions.	Pay premiums.
Capital Utilised	Participants' funds.	Participating capital.	Share capital.
Investment Considerations	Shari'a compliant.	No restrictions except prudential.	No restrictions except prudential.

Source: Ernst & Young analysis

The Takaful industry currently employs three different models to execute its business with the combined model becoming the most dominant

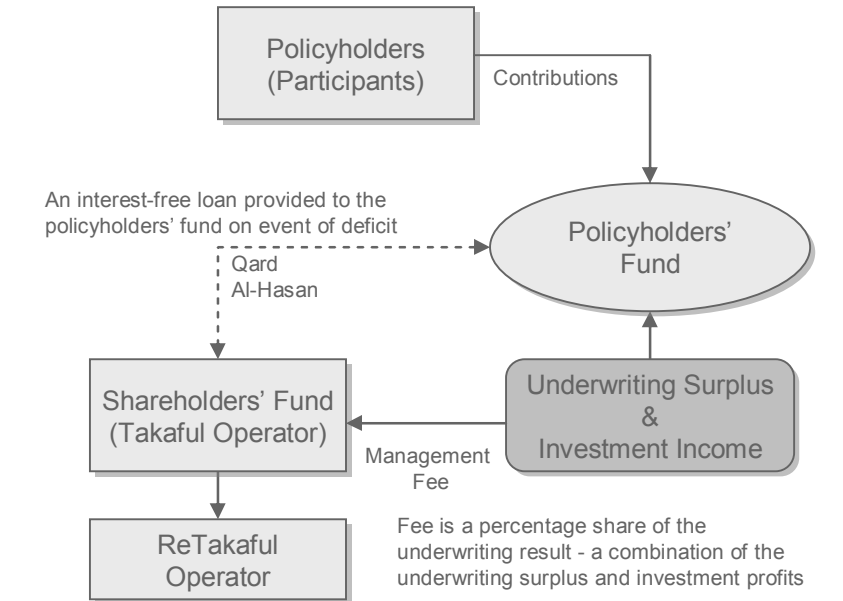
1 Wakala Model

A principal-agent arrangement is used between the policyholders and the Takaful operator for both underwriting and investment activities.



2 Mudaraba Model

A principal-manager agreement is used between the policyholders (*Rab al Mal* - capital providers) and the Takaful operator (*Mudarib* - entrepreneur) for both underwriting and investment activities.



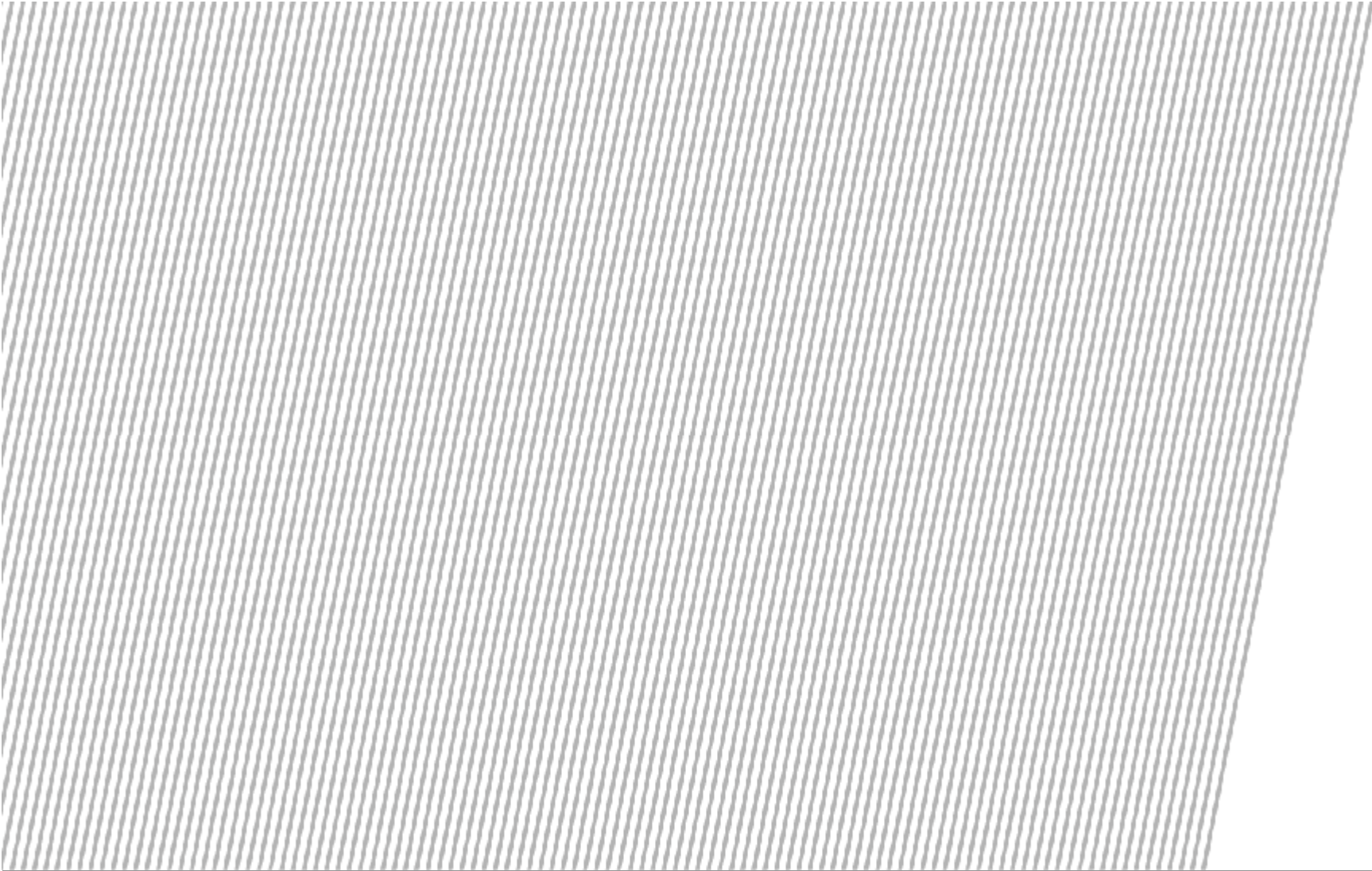
3 Combined Model

The combined model utilises both contracts. The *Wakala* contract is used for underwriting activities, while the *Mudaraba* contract is used for investment activities. This model is recommended by certain financial services regulators (including the Central Bank of Bahrain).

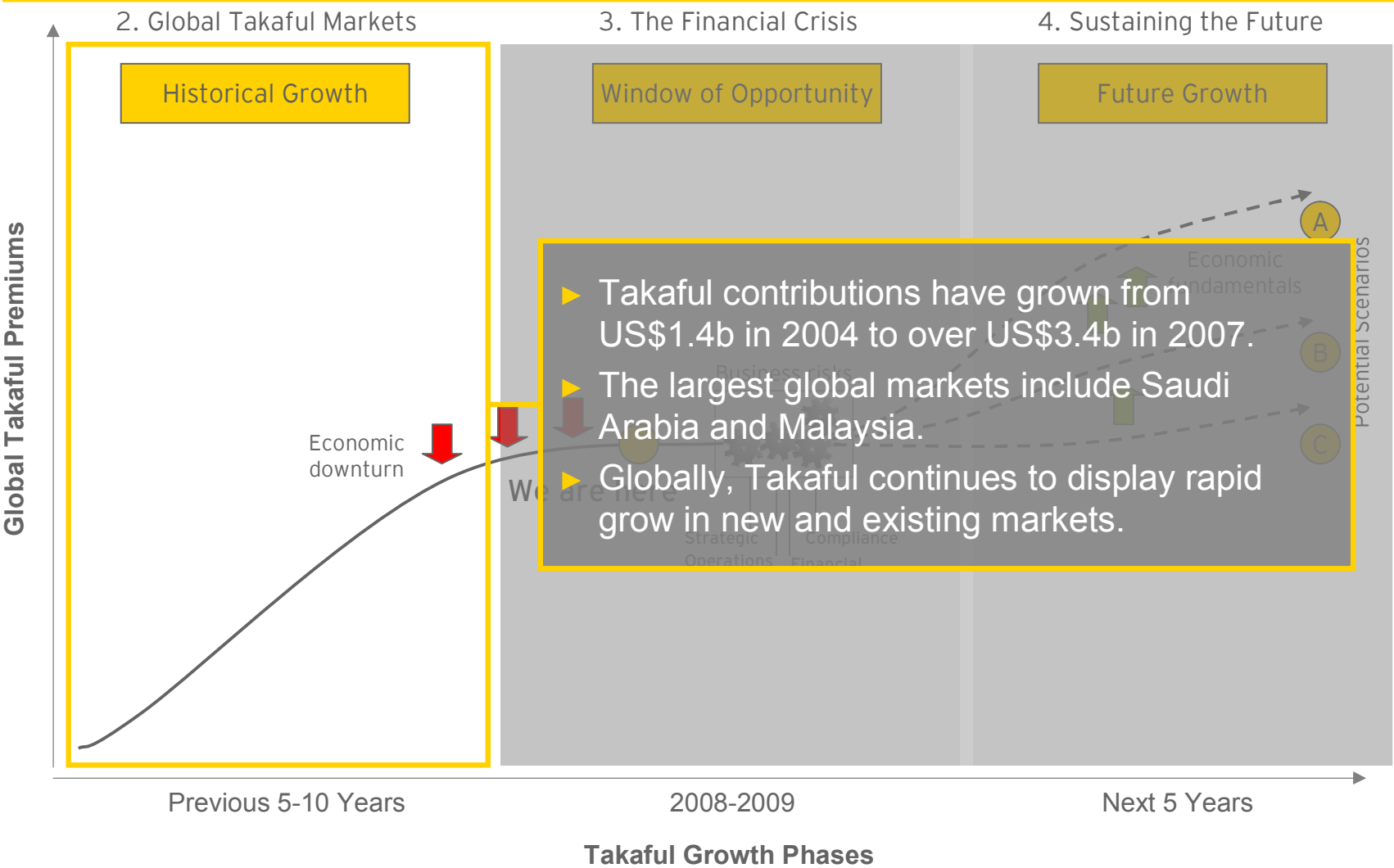
Note: Critics of the *Mudaraba* model argue that, in the cooperative framework, the underwriting surplus is not considered a profit and the Takaful operator does not therefore have any right to it. Furthermore, the *Mudaraba* contract entitles the Takaful operator to a share in the underwriting surplus, but not to a share in any deficit.

Source: Ernst & Young analysis

2. Global Takaful Markets



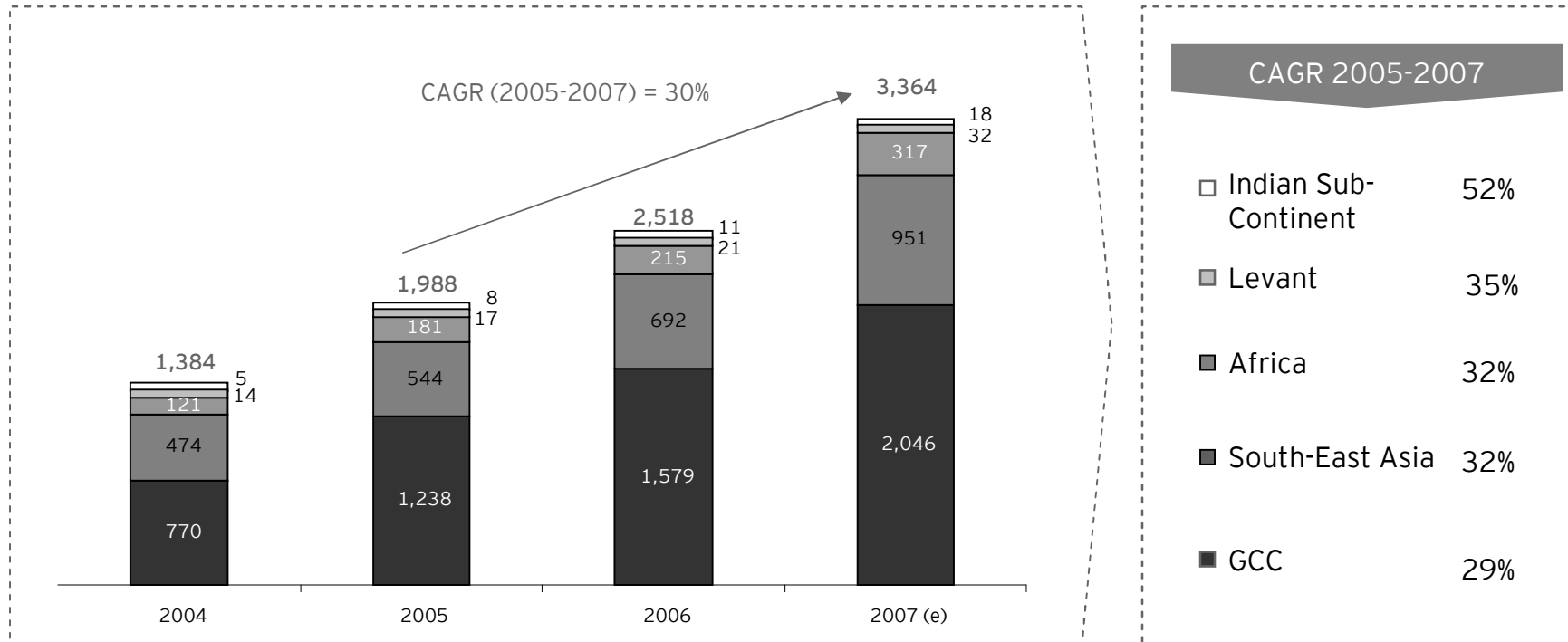
Takaful continues to show strong growth in underpenetrated insurance markets



Source: Ernst & Young analysis

Global gross Takaful contributions have grown with contributions in 2007 reaching US\$ 3.4 billion

Global Gross Takaful Contributions by Year (US\$m)*



Iran - Gross Takaful Contributions by Year (US\$m)

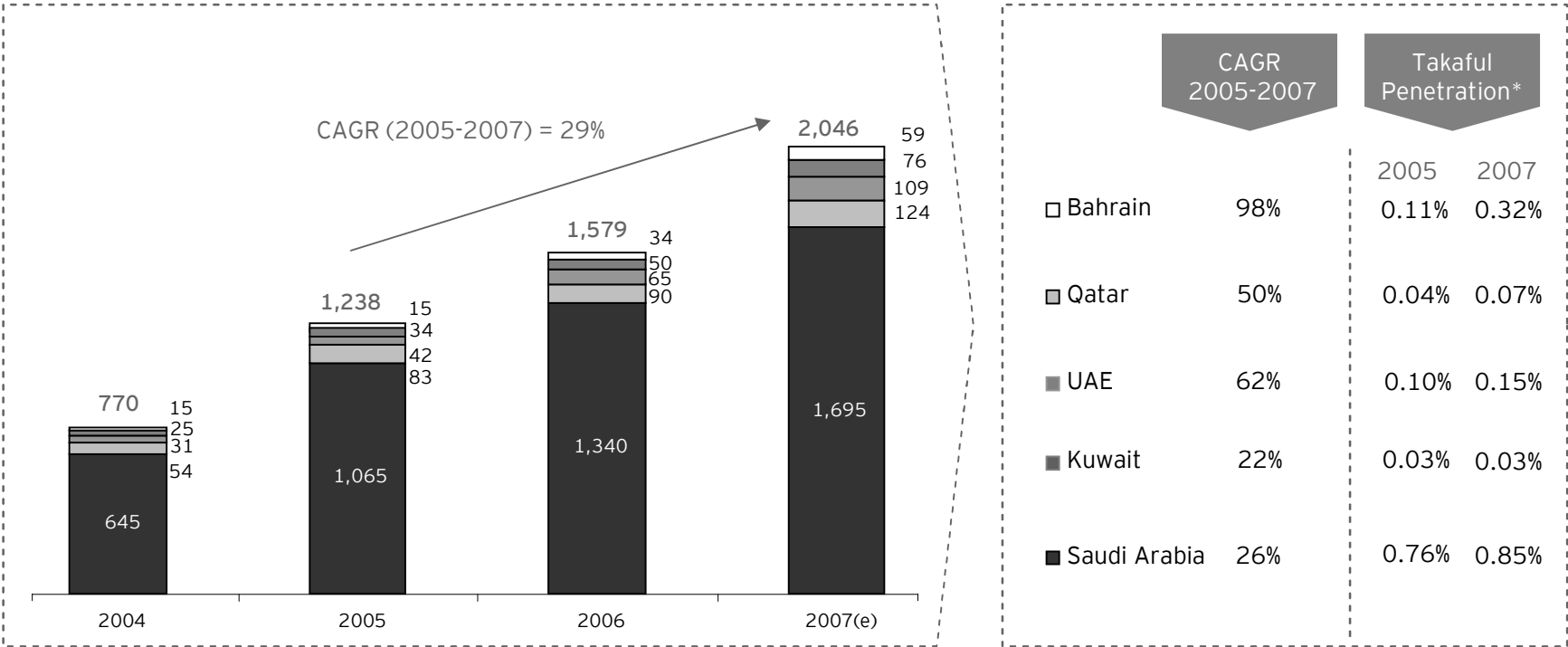


Source: Ernst & Young WTR08, Ernst & Young analysis

* Note: Iran's financial services sector, which is entirely Islamic, has been shown separately from the global analysis.

Saudi Arabia remains the largest Takaful market in the GCC with contributions of US\$ 1.7 billion in 2007

Gross Takaful Contributions in the GCC (US\$m)

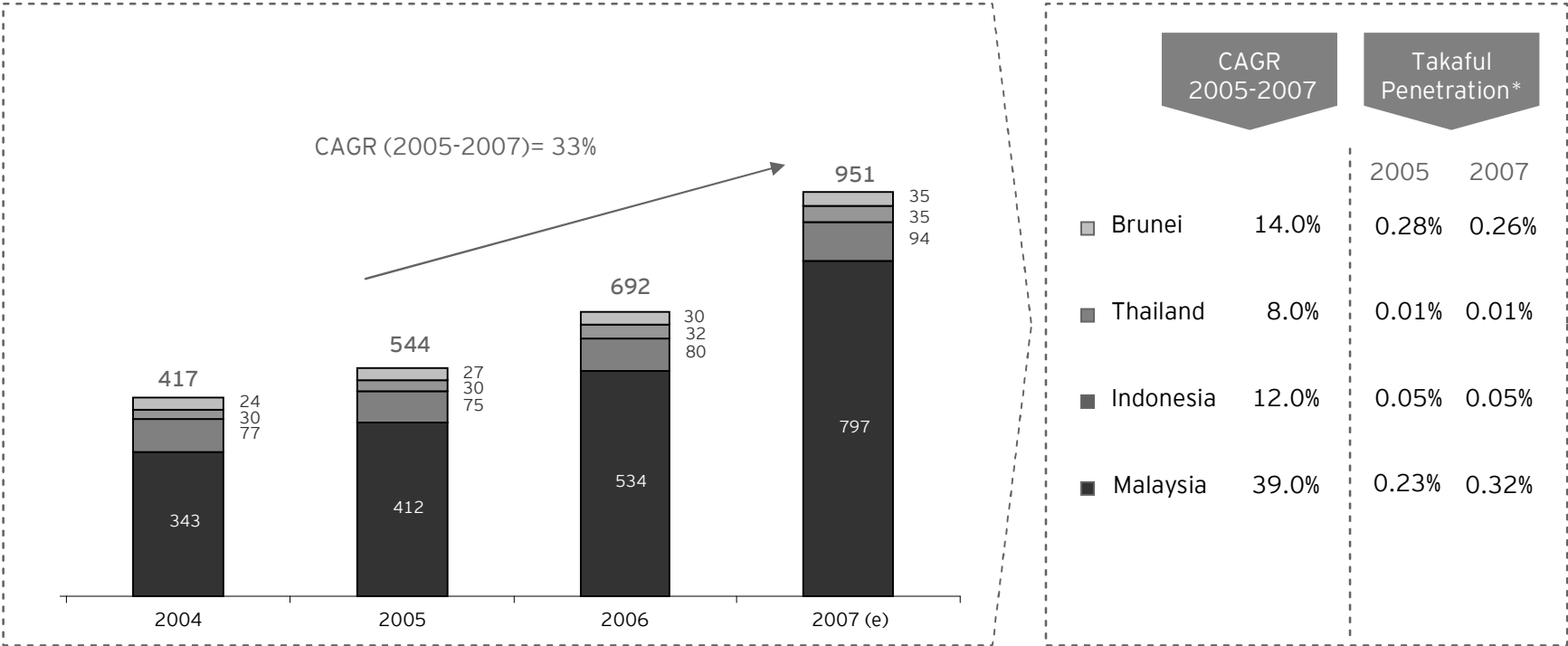


Source: Ernst & Young WTR08, Global Insight, Ernst & Young analysis

* Takaful penetration is gross contributions as a percentage of nominal GDP in respective year

Malaysia remains the largest Takaful market in South East Asia with contributions of US\$ 0.8 billion in 2007

Gross Takaful Contributions in the South East Asia (US\$m)

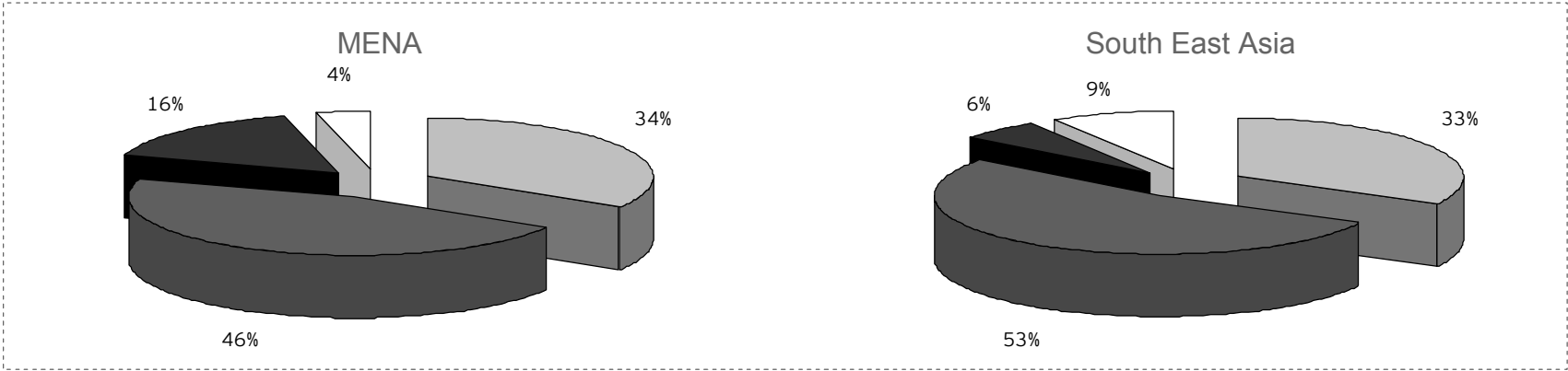


Source: Ernst & Young WTR08, Global Insight, Ernst & Young analysis

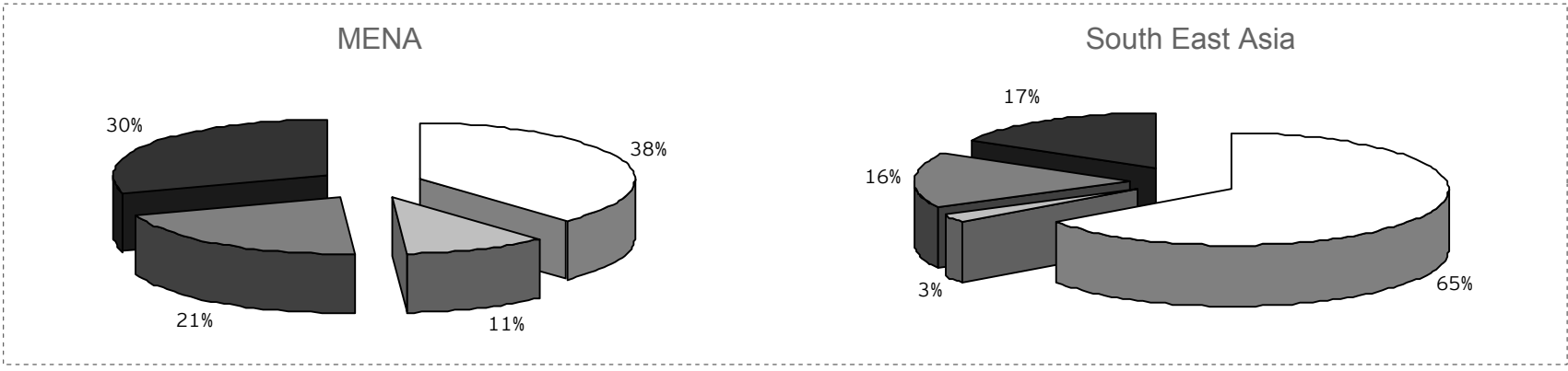
* Takaful penetration is gross contributions as a percentage of nominal GDP in respective year

Contributions towards family and medical Takaful have become especially significant

Gross Takaful Contributions by Business as Percentage of the Total (2006)*



Gross Takaful Contributions by Business as Percentage of the Total (2007)*



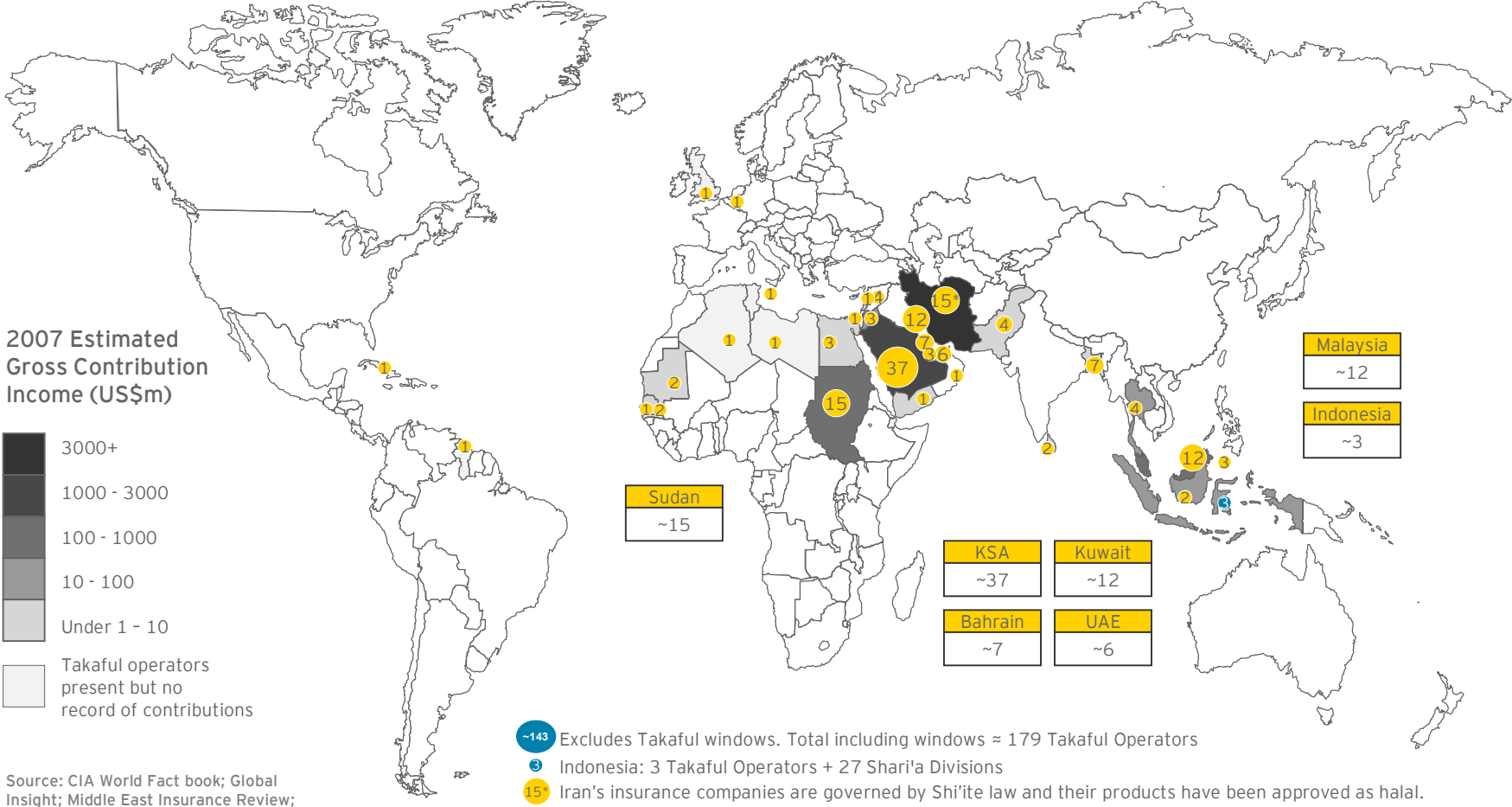
□ Family and Medical ▒ Marine & Aviation ■ Property & Accident ■ Motor

Source: World Islamic Insurance Directory 2008 and 2009

* Note: MENA includes the GCC, Africa and Levant.

The Takaful industry has been expanding by tapping into large Muslim markets globally

~124 January 2009 Takaful Companies (+38 Windows)
 Global Takaful Operators and Contributions in 2008
~143 September 2008 Takaful Companies

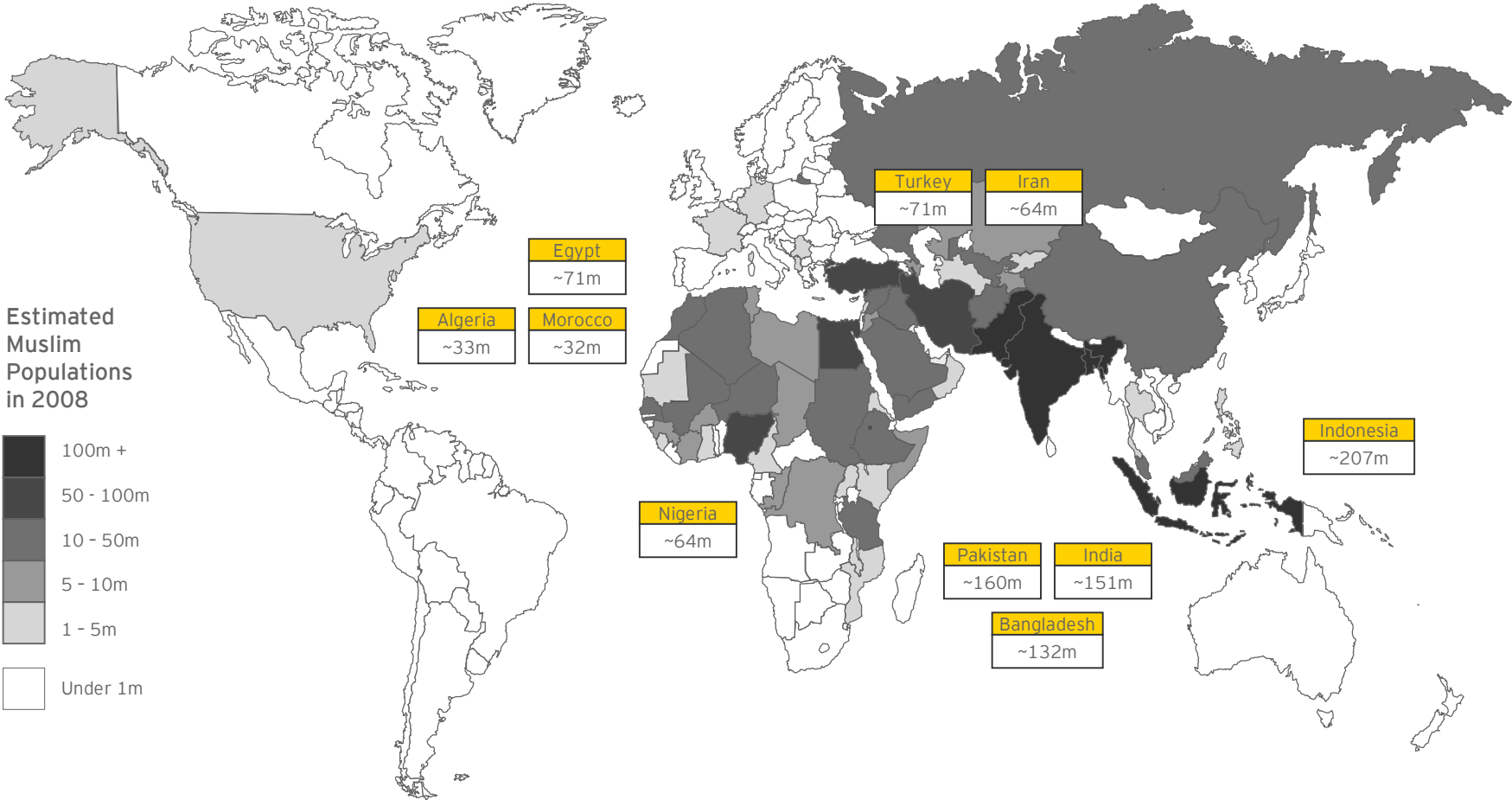


Source: CIA World Fact book; Global Insight; Middle East Insurance Review; World Islamic Insurance Directory 2009; Ernst & Young analysis

Note: Due to varying definitions, the number of Takaful operators differs depending on source. We have assumed the broadest definition.

But there are still significant untapped markets in Asia and MENA

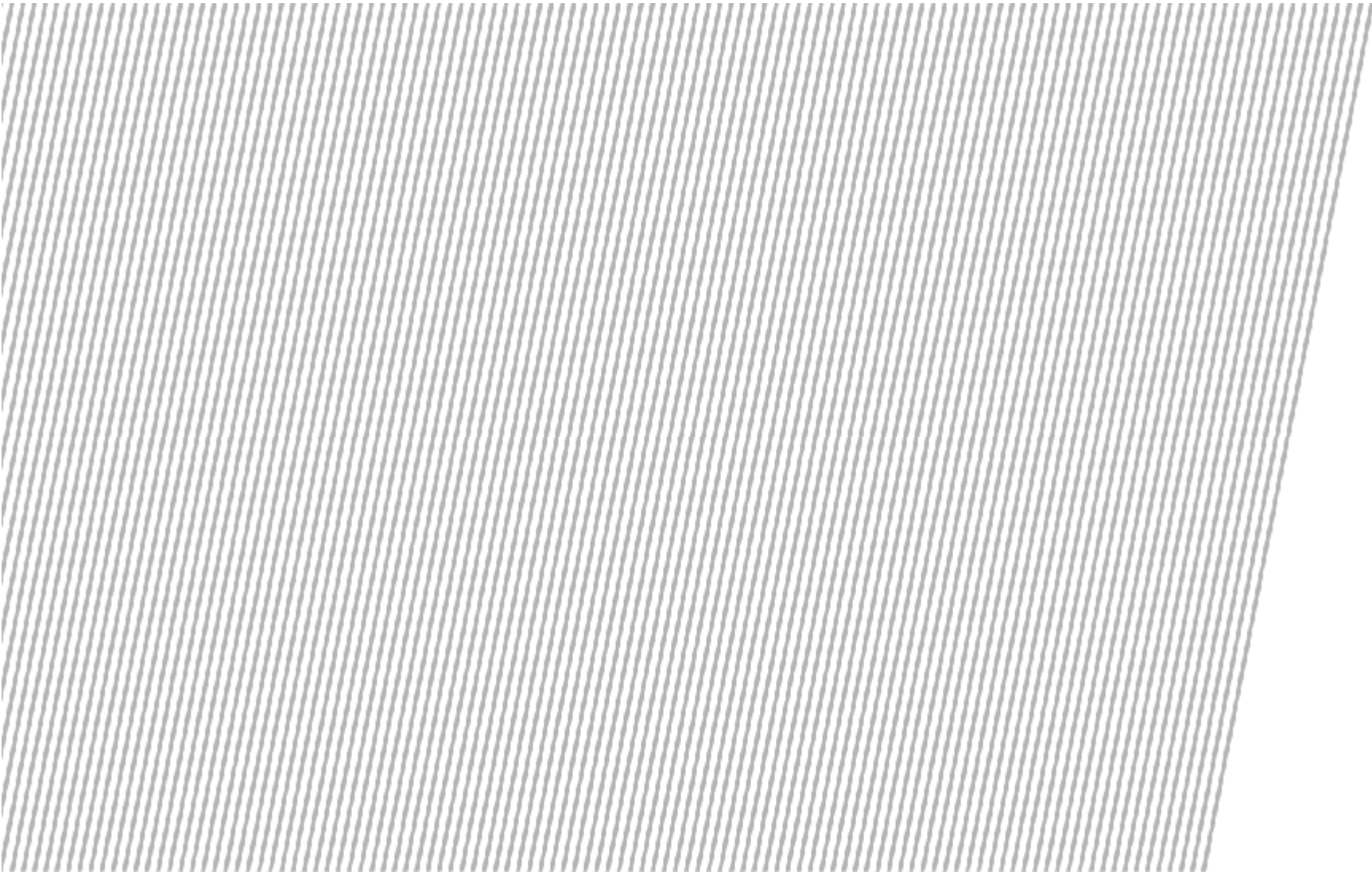
Global Estimated Muslim Populations in 2008



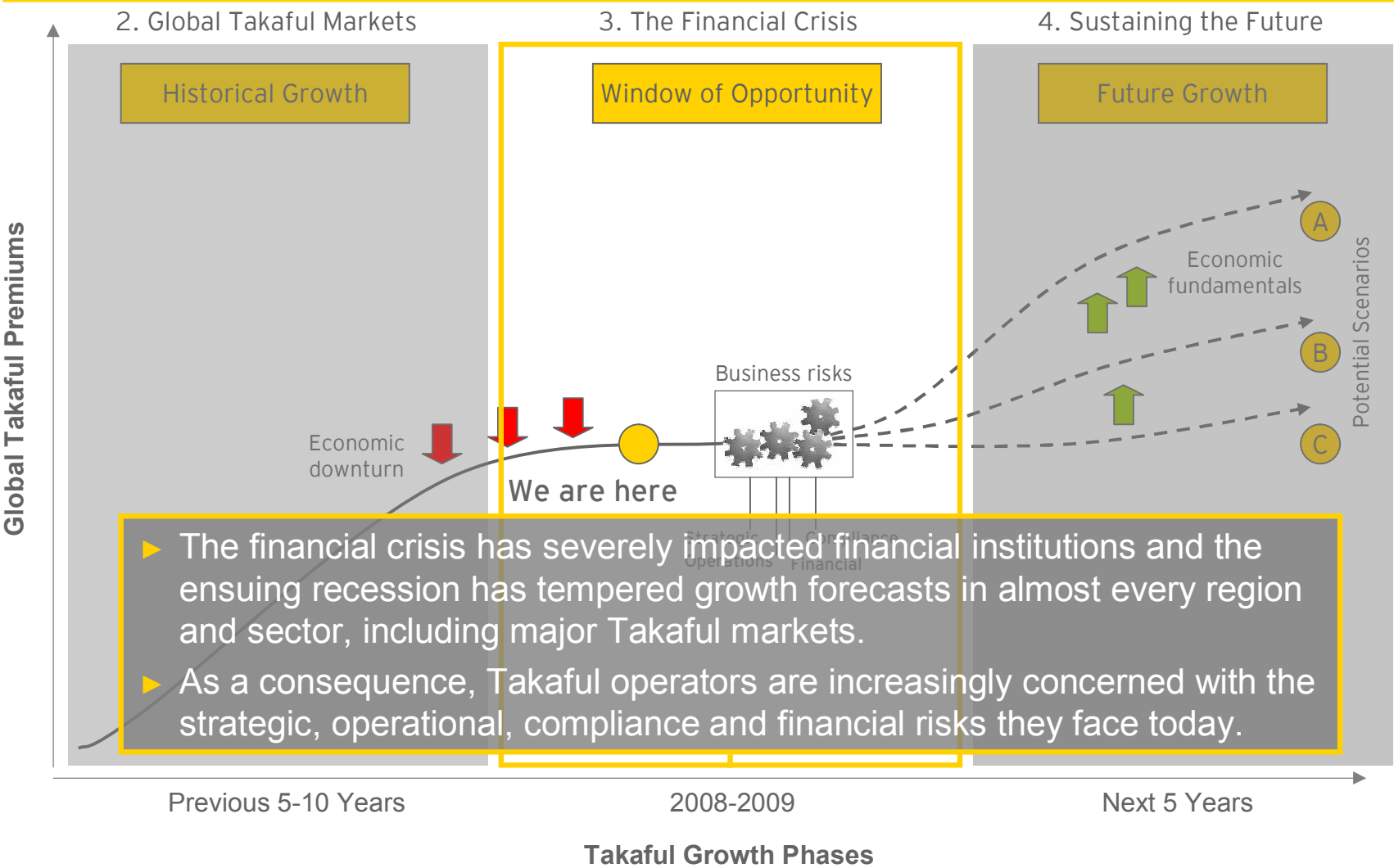
Source: CIA World Fact book; Global Insight; Ernst & Young analysis

Note: Muslim populations have been determined using estimated Muslim percentages of totals and 2008 population data.

3. The Financial Crisis

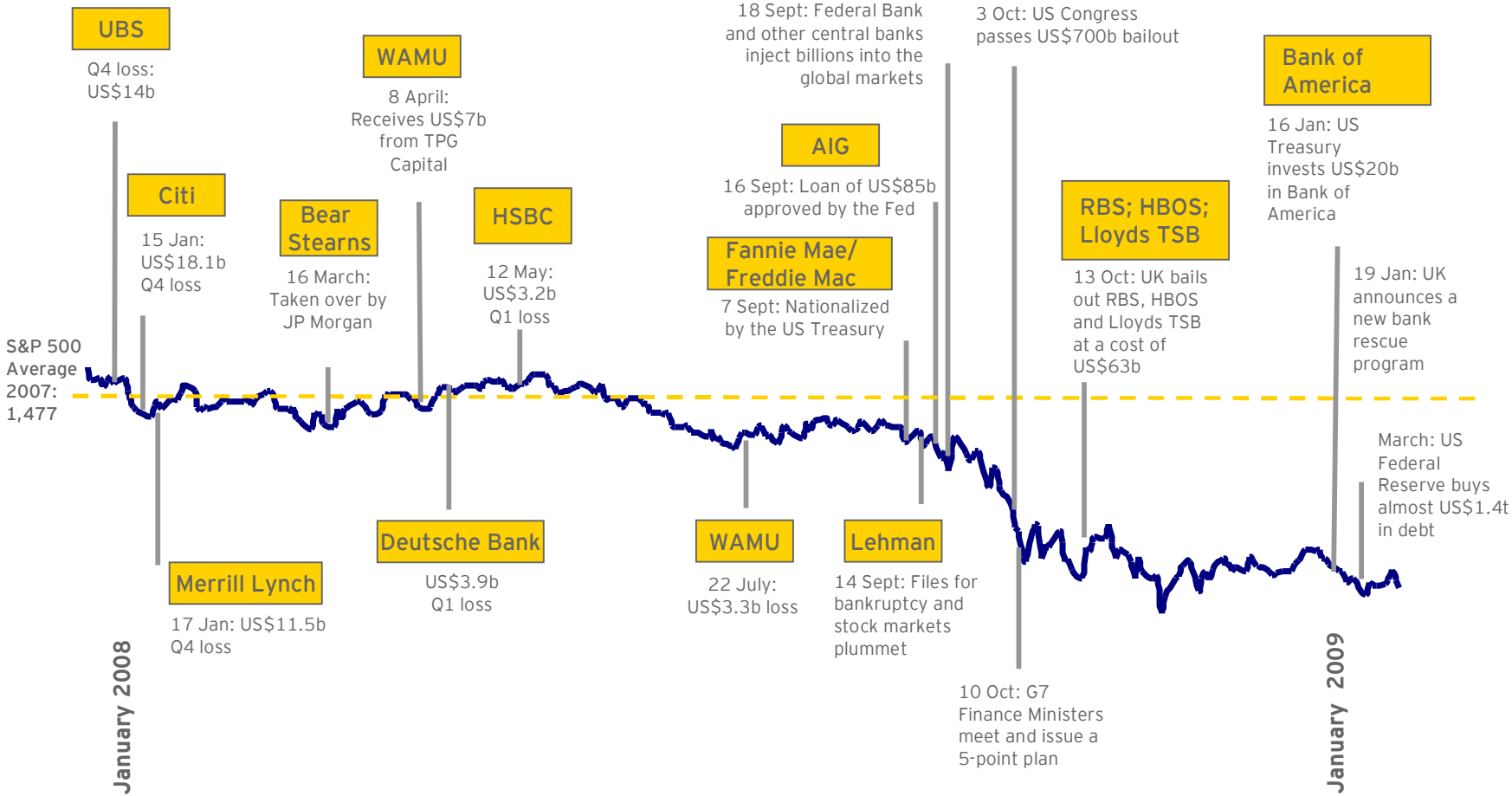


Takaful operators that successfully manage their business risks will be well placed to take advantage of emerging opportunities



Source: Ernst & Young analysis

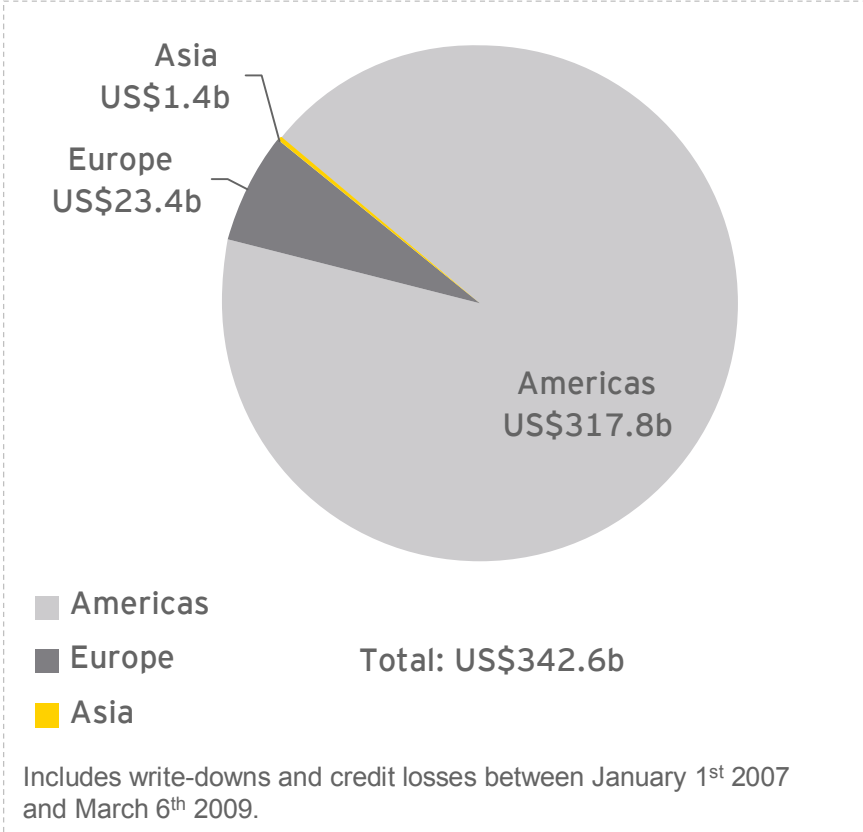
The financial landscape has experienced significant shifts with many institutions collapsing or requiring government capital support



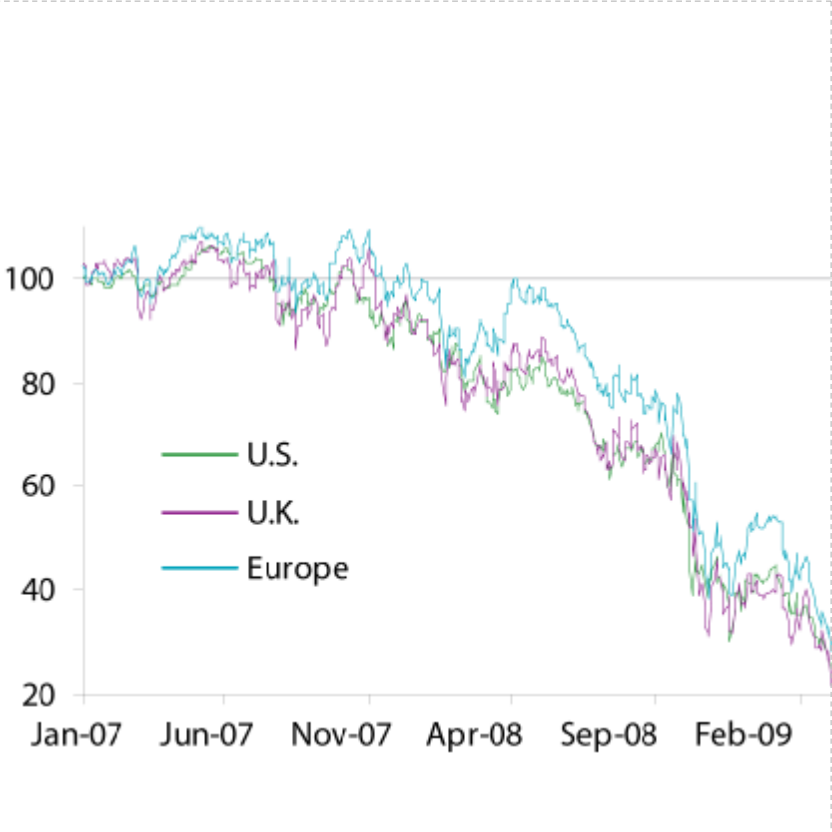
Source: Factiva; Bloomberg; Ernst & Young analysis

Insurance firms in particular have suffered major losses

Reported Losses of Insurers and Government Supported Enterprises*



Insurance Company Equity Performance MSCI indices (US\$ returns): Jan 1 2007=100



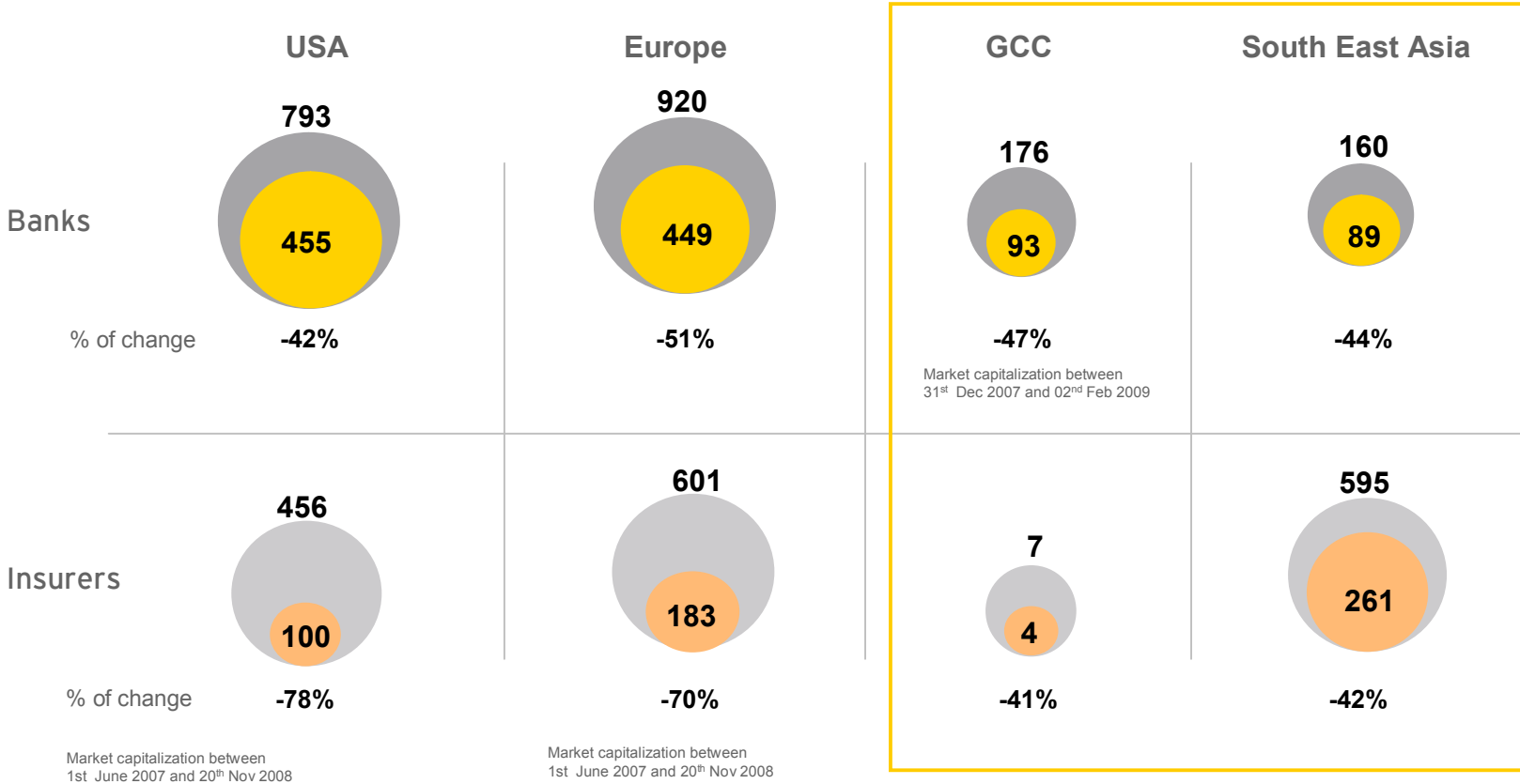
* GSE: e.g. Freddie Mac

Source: IIF, March 2009

Source: Bloomberg; IIF, March 2009

Surviving financial institutions have lost significant value

Market Capitalization of top 10 Financial Institutions by Region



Bank Capitalization in US\$b ● 13th Mar 2009 ● 1st Jan 2008 (unless stated otherwise)
Insurer Capitalization in US\$b ● 13th Mar 2009 ● 1st Jan 2008 (unless stated otherwise)

Source: US/Europe Banks: Factset; US/Europe Insurance: The Banker, Bloomberg, One Source; Asia Banks: The Banker, Bloomberg, One Source; Asia Insurance: One Source, Bloomberg; MENA Banks: Reuters; MENA Insurance: Zawya, One Source

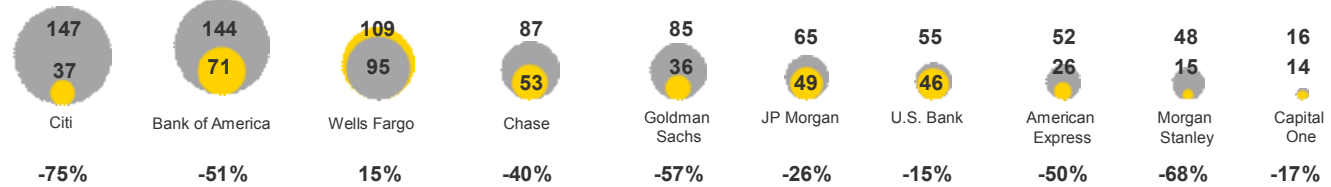
American and European financial institutions have lost over US\$1.5t in value

Change in Market Capitalization

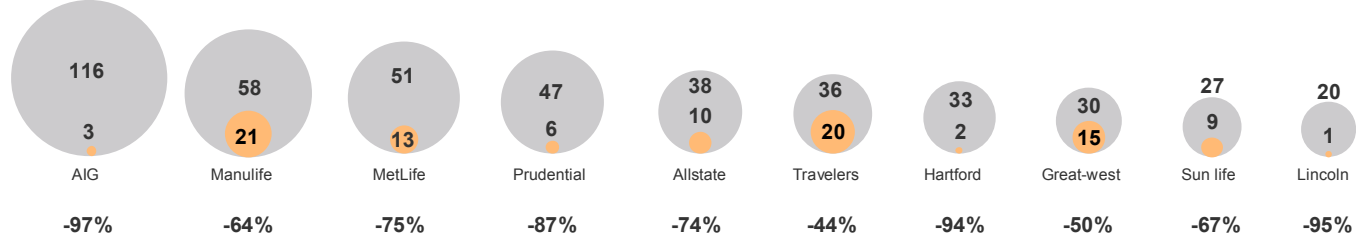
USA



Banks by market capitalization



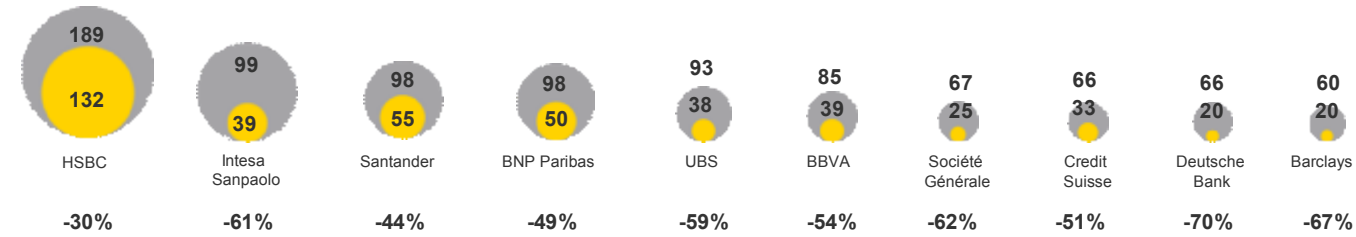
Insurer by market capitalization (1st June 2007 and 20th Nov 2008)



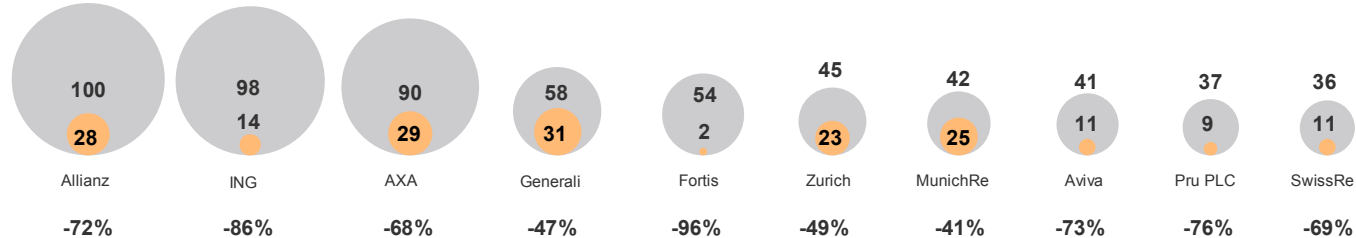
EUROPE



Banks by market capitalization



Insurer by market capitalization (1st June 2007 and 20th Nov 2008)



Bank Capitalization in US\$b ● 13th Mar 2009 ● 1st Jan 2008 (unless stated otherwise)

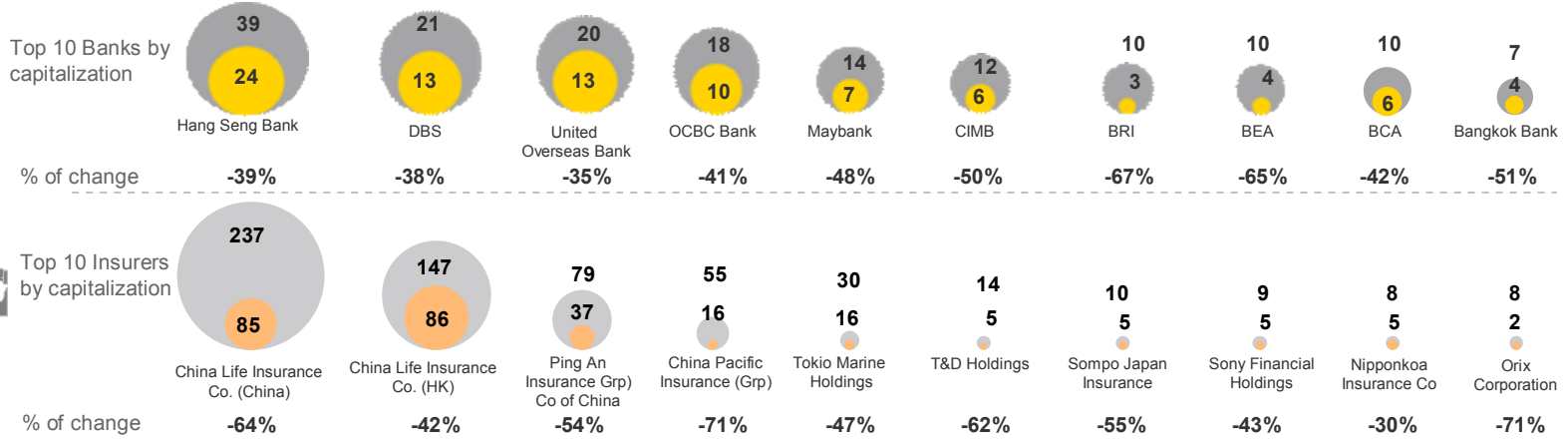
Insurer Capitalization in US\$b ● 13th Mar 2009 ● 1st Jan 2008 (unless stated otherwise)

Source: US/Europe Banks: Factset US/Europe Insurance: The Banker, Bloomberg, One Source

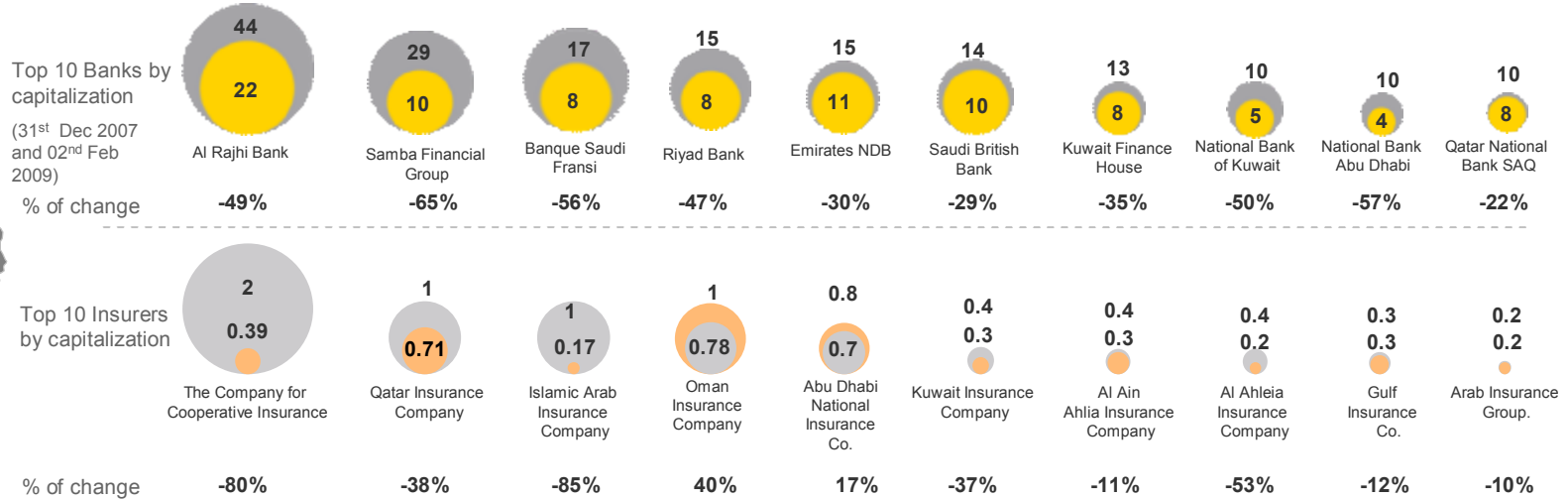
Asia and MENA have also experienced significant losses

Change in Market Capitalization

ASIA



MENA

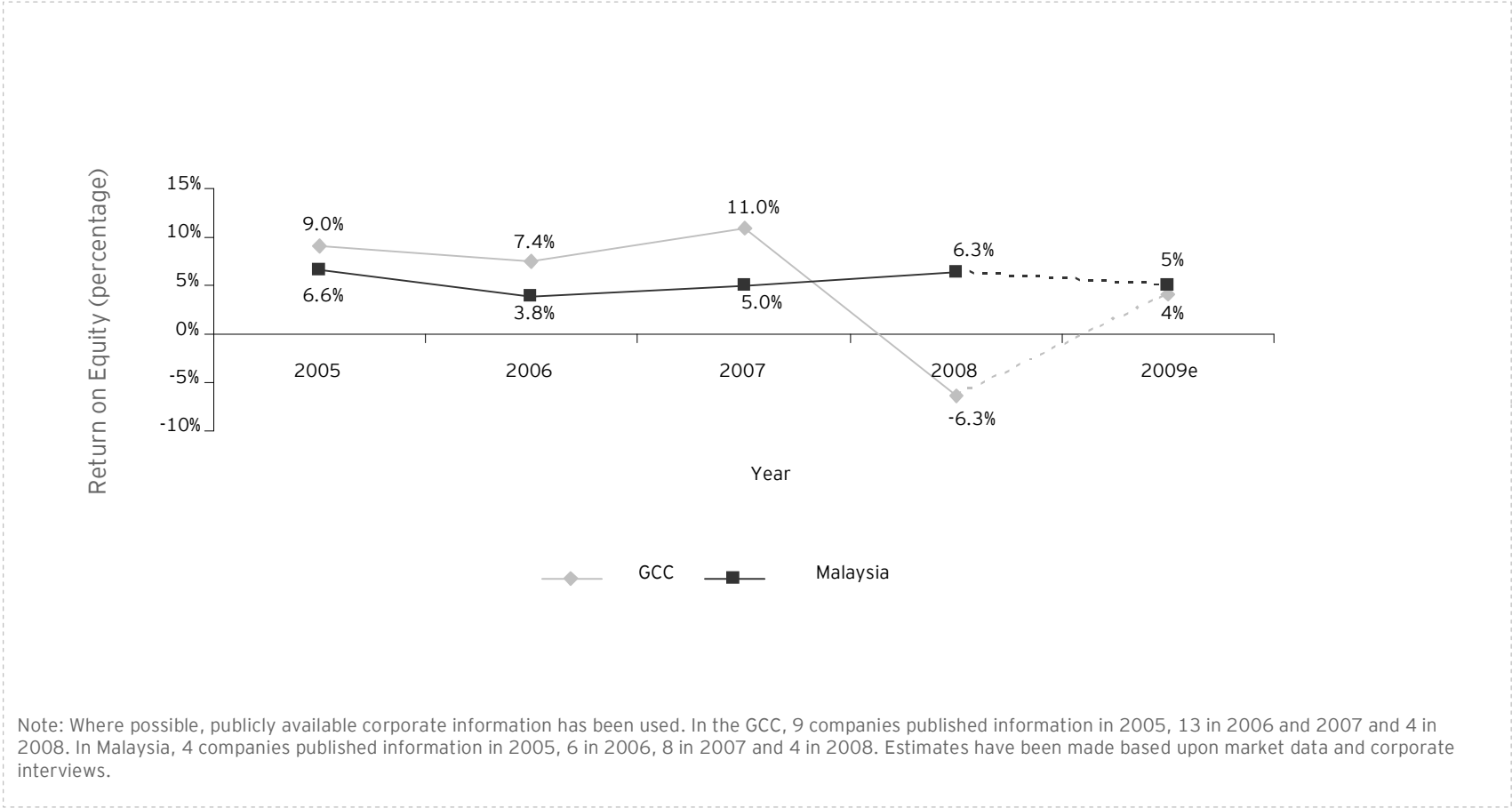


Bank Capitalization in US\$b ● 13th Mar 2009 ● 1st Jan 2008 (unless stated otherwise)
 Insurer Capitalization in US\$b ● 13th Mar 2009 ● 1st Jan 2008 (unless stated otherwise)

Source: Factset, Reuters, The Banker, Bloomberg, One Source

Short-term performance of Takaful operators has been impacted

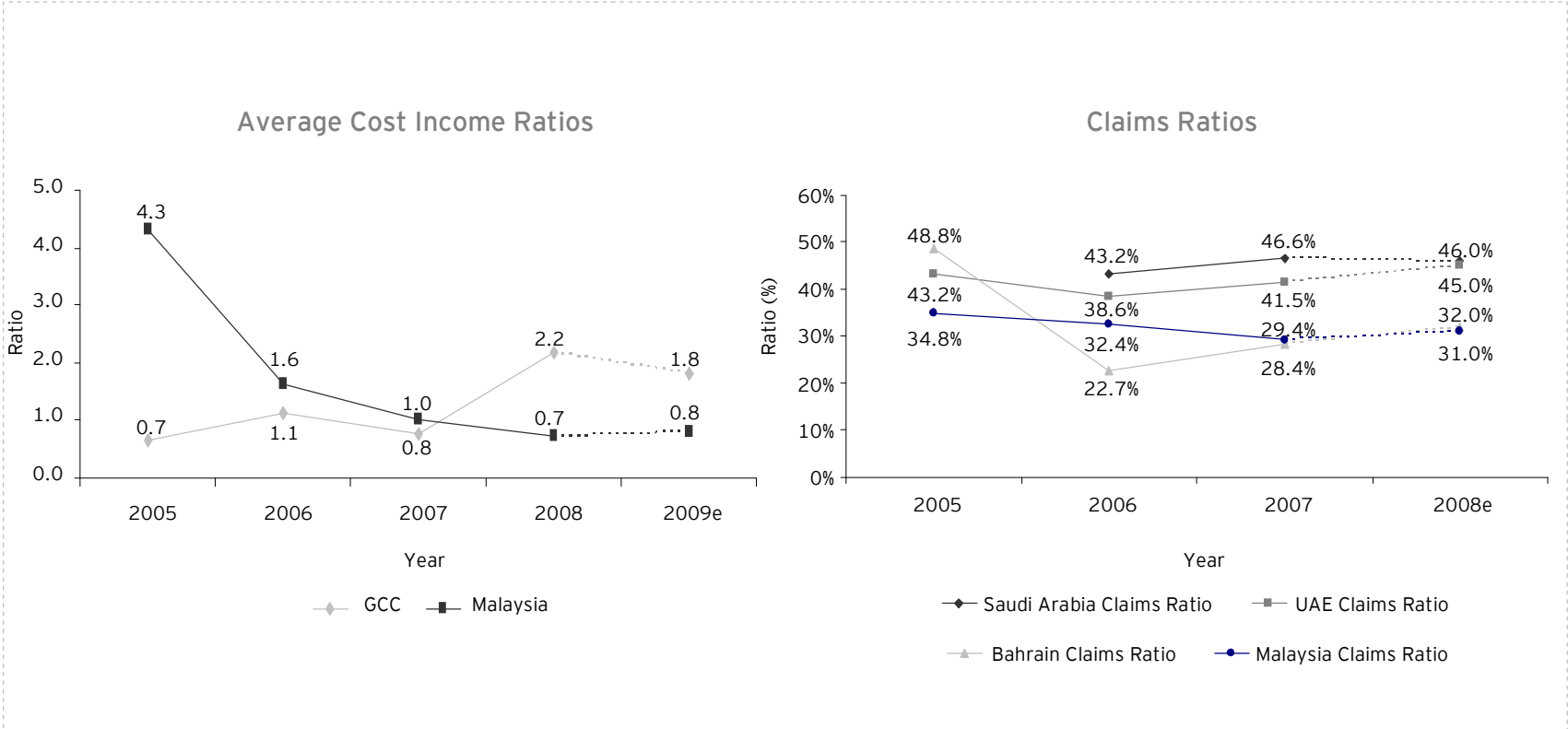
Average ROE for a Sample of GCC and Malaysian Takaful Operators



Source: Company Annual Reports, Corporate Interviews, Ernst & Young analysis

Despite improvements in efficiency, Takaful operators need to better manage their costs in a more challenging market

Average Cost Income and Claims Ratios for a sample of GCC and Malaysia Takaful Operators



Note: Where possible, publicly available corporate information has been used. In the GCC, 9 companies published information in 2005, 13 in 2006 and 2007 and 4 in 2008. In Malaysia, 4 companies published information in 2005, 6 in 2006, 8 in 2007 and 4 in 2008. Estimates have been made based upon available market data and corporate interviews. For claims ratios, the data for Malaysia and Bahrain is specific to the Takaful industry, while data for Saudi Arabia and the UAE is specific to the insurance industry as a whole. No data is available for Saudi Arabia in 2005.

Source: Company Annual Reports, Bank Negara Malaysia Takaful Annual Report, SAMA Annual Reports, UAE Central Bank Annual Reports, CBB Insurance Annual Reviews, Ernst & Young analysis

Especially in the face of large exposures to volatile equity markets

Average Equity Exposures and Cash Holdings for a sample of GCC and Malaysia Takaful Operators



Note: For equity exposures, data for Malaysia includes family and general Takaful operators and was derived from holdings of Islamic private debt securities and equities, where it was assumed that 50% of the total holdings were in the form of public equities. All estimates have been made based upon available corporate interviews.

For cash holdings, where possible, publicly available corporate information has been used. In the GCC, 10 companies published information in 2005, 13 in 2006 and 2007 and 6 for 2008. In Malaysia, 4 companies published information in 2005, 6 in 2006, 8 in 2007 and 4 in 2008.

Source: Bank Negara Malaysia Annual Takaful Statistics 2007, Company Annual Reports, Ernst & Young analysis

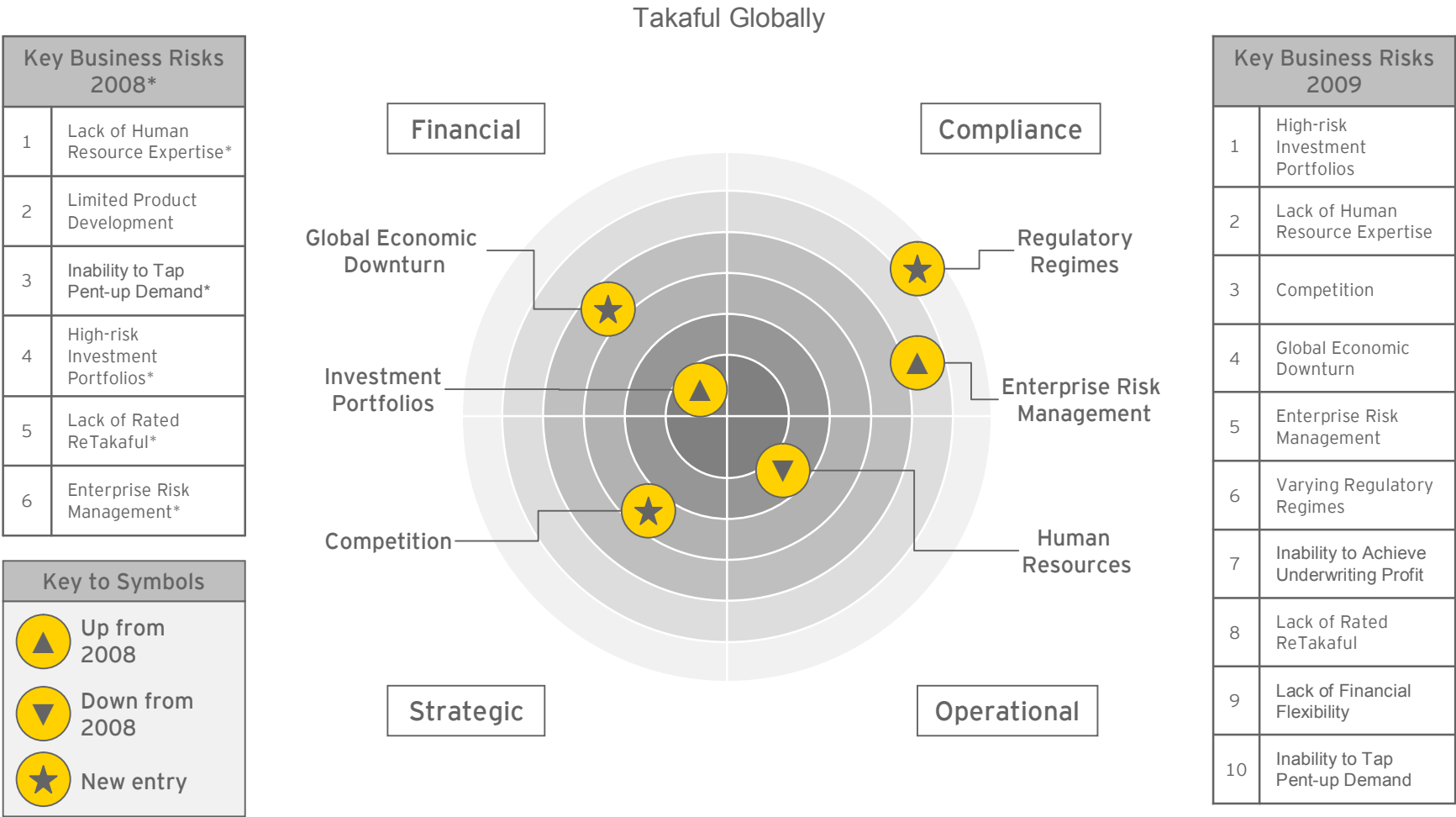
The 2009 Takaful business risks landscape has changed substantially

How the Business Risks match up - 2009 and 2008 results

Risk and Category	Investment Portfolios	Human Resources	Competition	Global Economic Downturn	Enterprise Risk Management	Regulatory Regimes
	Financial Risk	Operational Risk	Strategic Risk	Financial Risk	Compliance Risk	Compliance Risk
2009	1 st	2 nd	3 rd	4 th	5 th	6 th
2008	4 th	1 st	N/A	N/A	6 th	N/A
Contributing Factors	<ul style="list-style-type: none"> ▶ Restricted investment universe and unbalanced investments. ▶ High equity exposures. ▶ High counterparty risks. ▶ Reduced Sukuk issuance is further limiting fixed income equivalents. 	<ul style="list-style-type: none"> ▶ Lack of skilled HR and increasing competition for resources. ▶ Limited pool of scholars with suitable knowledge. ▶ Lack of operational expertise in certain lines of business. 	<ul style="list-style-type: none"> ▶ Low barriers to entry (minimum capital requirements). ▶ Increasing competition and aggressive pricing. ▶ Competitive pressures reducing safety margin in premiums. 	<ul style="list-style-type: none"> ▶ Decrease in new premium growth. ▶ Increase in defaults and claims. ▶ Market risk and resulting negative effect on investment portfolios. ▶ Economic crisis caused by the collapse of the banking sector. 	<ul style="list-style-type: none"> ▶ Reputational risk from varying business models. ▶ Controls, risk management and reporting framework. ▶ Obtaining an independent rating. ▶ Conflict between motives of the Takaful fund and the shareholders' fund. 	<ul style="list-style-type: none"> ▶ Varying regulatory requirements - business models requirements. ▶ Young and inexperienced regulatory regimes. ▶ Evolving capital requirements (risk based capital).

Source: Ernst & Young analysis

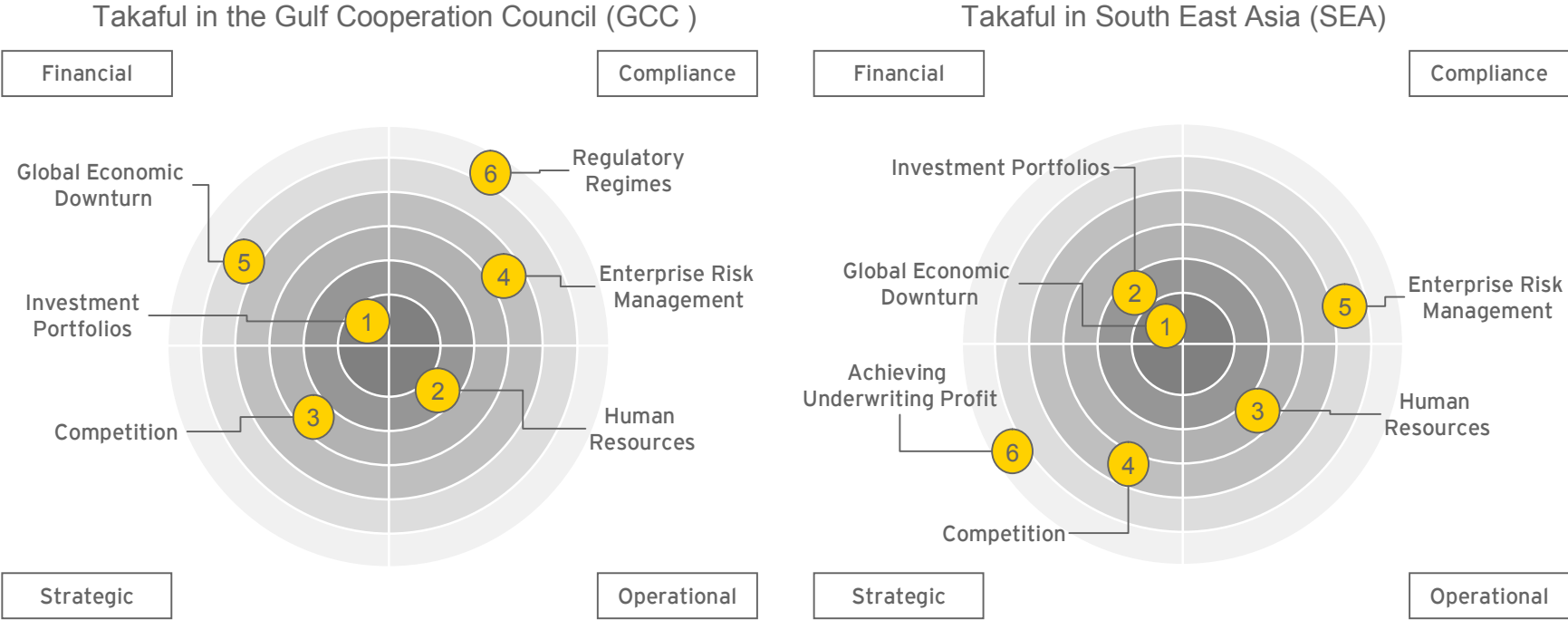
High risk investment portfolios, human resource expertise and competition will be the most pressing global Takaful business risks over the next 12 months



Source: Corporate Interviews, Ernst & Young analysis

* Note: To ease comparability, the names of these 2008 risks have been amended to reflect responses from this years.

Takaful operators from the GCC and South East Asia are facing similar risks, but regional nuances exist



Business Risks in the GCC

- ▶ Equity concentrated investment portfolios are a key risk.
- ▶ HR continues to concern many operators.
- ▶ Increased competition has emerged as a new risk.

Business Risks in SEA

- ▶ The global downturn is seen as the most important risk.
- ▶ Although more diversified, investment portfolios are also a key risk as equity markets and interest rates fall.
- ▶ HR continues to concern many operators.

Source: Corporate Interviews, Ernst & Young analysis

High risk investment portfolios have moved up the agenda

Commentary and Contributing Factors

The limited investment universe results in concentrations:

- ▶ Takaful operators are required to invest only in Shari'a-compliant investments. The investment universe is thus reduced and lacks fixed income equivalents. The result is an unbalanced investment portfolio, particularly with regard to the policyholders' fund, which is over-concentrated in high-risk equity investments, illiquid real estate and low-return cash deposits (Murabaha).
- ▶ Sukuk issuance has been negatively affected by the global collapse of capital markets and by concerns over Shari'a compliance - the result has been a reduction in new fixed income investments.
- ▶ A large allocation to cash, which is particularly evident for GCC-based operators, is often accompanied with a concentration in a small number of Islamic financial institutions.
- ▶ This risk has highlighted shortcomings in the industry, particularly in the GCC, where operators are reliant upon investment income. For one GCC Takaful executive, recent events have been a wakeup call: "The economic crisis has brought to light weaknesses in the insurance sector...this will hopefully help them to take corrective measures to concentrate on their core activity [insurance underwriting]".
- ▶ In Malaysia, regulatory restrictions on foreign investment have also limited opportunities for diversification.

However, conservative investment strategies do exist:

- ▶ Takaful windows argued that their "conservative investment strategies" have made this risk less pertinent. Their focus has instead been on achieving an underwriting profit.

" The ability to deliver adequate investment performance in today's shell-shocked environment is seen as the key risk - challenges are falling asset values, market volatility and extra low interest rates. "

- SEA Takaful executive

" The economic crisis has brought to light weaknesses in the insurance sector. "

- UAE Takaful executive

" Equity/real estate investments, particularly regional, are highly risky and low-risk instruments are limited in volume. "

- Ratings executive

Key Considerations

Increase retention, focus on underwriting and seek professional asset management:

- ▶ Those operators who have relied upon investment income need to enhance their portfolio management capabilities to improve risk adjusted returns. This risk is an opportunity for asset managers, who need to address the unique risk/return profile of Takaful operators.

Source: Corporate interviews, Ernst & Young analysis

Human resource expertise has remained a key risk for operators

Commentary and Contributing Factors

Human resources risks are still high on the executive agenda:

- ▶ As with the wider Islamic financial services industry, Takaful continues to suffer from a shortage of human resources with the requisite expertise. This risk was considered more important in the GCC, but South East Asian operators also acknowledged its continued relevance. According to interviewees, human resource risk is particularly acute in specialist fields, including life insurance, risk management and Shari'a compliance.
- ▶ The continued under-penetration of life insurance in the GCC has resulted in the near non-existence of indigenous expertise. As a result, a number of recent attempts to expand family Takaful in this market have included participation from international conventional insurers.
- ▶ Executives in both key markets (GCC and Malaysia), voiced concern over the availability of Shari'a scholars with relevant business acumen.

“ The availability of business/ financially qualified scholar in the industry is still an issue. ”
- SEA Takaful executive

“ We have created a good culture and focus on hiring locally, which has greatly reduced executive turnover. ”
- GCC Takaful executive

However, not all operators are suffering to the same extent:

- ▶ Takaful windows are tapping large pools of conventional talent relocated from depressed markets.
- ▶ There has been a shift towards the recruitment and development of indigenous talent in recognition of the additional expenses of expatriate staff and their willingness to repatriate. Such sentiment was confirmed by a SEA Takaful executive who pointed out: “During this period, companies with financial strength can target new employees - a lot of those Malaysians working abroad are being retrenched.”

“ There is an openness in terms of the movement of conventional skilled personnel into Takaful. ”
- Takaful window executive

Key Considerations

Focus on developing local talent and partnering for quick market entry:

- ▶ Hiring indigenous talent and providing structured internal training programs helps to create a development culture and reduce turnover.
- ▶ For conventional insurers, partnering with established local operators can provide brand equity, infrastructure and access to HR including expertise in Shari'a compliance. For local Takaful operators, international insurers provide expertise in risk management and specialist lines.

Source: Corporate interviews, Ernst & Young analysis

Competition has emerged as a major global risk for operators

Commentary and Contributing Factors

New local operators and international windows are crowding the landscape:

- ▶ Regulatory authorities in many established Takaful markets have recently relaxed restrictions on the insurance sector. Licenses have been awarded to new locally-backed entities and Takaful windows of large conventional incumbents. Interviewees, particularly in the GCC, argued that increased competition in a contracting market had resulted in overly aggressive pricing for group and commercial risks.

“ Competition has become very tough in the last year, competitors are cutting rates aggressively - the market is changing, due to lower business. ”
- GCC Takaful executive

The wakalah business model puts Takaful at a pricing disadvantage:

- ▶ Price remain a key differentiating factor - “Customers still go for ‘value for money’ insurance purchases over faith purchases” is how one GCC Takaful executive described preferences.
- ▶ When competing for business that does not require Shari'a compliant coverage, wakalah-based operators are unable to use retained underwriting surplus to discount. As a result, a number of interviewees argued that Takaful pricing for group and commercial cover was often uncompetitive. This lack of competitiveness reduced an operator's ability to use brokerage as a “cost-effective mechanism” to source business.

“ Because we can't share in underwriting income, we can't adjust pricing and can't meet the same terms brokers are offered by conventional insurers. ”
- GCC Takaful executive

But competition is still lacking in GCC family Takaful:

- ▶ The specialist nature of family Takaful and long gestation period has limited competition - “What competition? I wish we had more”, was the response from one GCC Takaful executive. For the majority of GCC-based interviewees, critical mass has not yet been established for family Takaful.

“ Competition drives the industry to better itself. ”
- Takaful window executive

Key Considerations

Partnerships and specialization can differentiate operators, but critical mass is essential:

- ▶ Partnerships with conventional incumbents and specialization in specific lines can differentiate operators from their competition. However, without critical mass, profitability in family Takaful will be delayed and competitiveness when bidding against insurance companies will be limited.
- ▶ Distributions are a unique value proposition for Takaful and should be emphasized when competing against conventional competition.

Source: Corporate interviews, Ernst & Young analysis

The global economic downturn has now begun to affect market conditions

Commentary and Contributing Factors

The global economic downturn is now impacting the GCC and SEA:

- ▶ Emerging markets were largely shielded from the early impacts of the global economic downturn. However, the situation has now changed and the majority of interviewees acknowledged a drop in premiums. In SEA, reduced business confidence and a corresponding reduction in lending has negatively affected finance Takaful - a key family product in that region. In the GCC, the collapse of equity markets has reduced uptake in investment-linked family products.
- ▶ A number of interviewees argued that, despite the relatively sound performance of the Takaful industry vis-à-vis conventional financial services, contagion had also taken its toll.

“ We saw a down-turn [in premiums] in the previous quarter of about 30-40%, especially in life, property and motor. ”
- GCC Takaful executive

“ Business confidence is down. ”
- SEA Takaful executive

The downturn has increased claims and the prevalence of fraud

- ▶ Underwriting risk has grown as bullish economies begin to slow and asset bubbles deflate. Claims ratios across the GCC and SEA are expected to rise as defaults increase. One GCC Takaful executive gave an example of: “Warehouses bought at inflated prices being burnt down to collect insurance payouts”.

“ As personal financing has reduced, so too has finance Takaful. ”
- SEA Takaful executive

Opportunities exist for family Takaful

- ▶ A handful of interviewees argued that the downturn could potentially increase demand for family Takaful as customers seek annuity products that offer long-term diversification. For one GCC-based Takaful executive, “the growth in life insurance [family Takaful] is purely due to the investment element.”

“ With bad conditions, the risks of underwriting have increased. ”
- GCC Takaful executive

Key Considerations

Improve the core business function and diversify income:

- ▶ To meet the challenges of a depressed market and increased competition, Takaful operators need to enhance their underwriting capabilities and capacity.
- ▶ Operators should also consider the benefits of diversifying exposures, both across lines of business and across geographies.

Source: Corporate interviews, Ernst & Young analysis

Enterprise risk management has moved up our rankings and reflects market turmoil

Commentary and Contributing Factors

The global financial crisis brings risk management to the fore:

- ▶ Volatile markets, slowed economic growth, realized losses and the subsequent possibility of regulatory intervention or increased monitoring are all weighing heavy upon Takaful operators.
- ▶ As a nascent and fragmented industry, enterprise risk management (ERM) has been slow to develop with only a handful of established operators and windows claiming to have fully implemented an effective framework. The importance of risk management has been underlined by the current crisis.
- ▶ A sharp decrease in investment income, which followed a sustained bull-run in both the GCC and South East Asia, has also made the management of stakeholder expectations more challenging. As one SEA Takaful executive points out: "The pressure is to remain solvent, profitable, and be able to meet client claims and expectations".

" In such an environment, people are learning to be more cautious. "

- GCC Takaful executive

" Compliance plays a major role and it's fundamental to starting any business - it's a differentiating factor for companies. "

- Takaful window executive

Getting rated - a mixture of opinions:

- ▶ Recent events in the financial services sector have exposed ratings agencies to criticism. A number of our interviewees questioned the validity and merit of ratings - a GCC-based Takaful executive explained how a ratings downgrade assigned to one of their reinsurance companies would not effect future treaties. Track record, reputation and existing due diligence were sufficient.
- ▶ That said, other interviewees described ratings as a necessity if Takaful was to more effectively compete with its conventional counterpart in industrial and commercial underwriting.

" These days, ratings are overrated. "

- GCC Takaful executive

" Get themselves financially rated in order to compete for bigger business. "

- GCC Takaful executive

Key Considerations

Prioritize risk management and seek ratings:

- ▶ The Takaful industry is facing a combination of insurance and Shari'a risks, fragmentation and a lack of financial strength, a concentration in emerging markets and a reliance upon inexperienced regulatory regimes. Implementing effective ERM is key to sustainability.
- ▶ For all its failings, an independent rating remains a differentiating factor in the insurance industry. If Takaful operators are to effectively compete with their conventional counterparts for high value underwriting, a rating appears essential.

Source: Corporate interviews, Ernst & Young analysis

Varying regulatory regimes have emerged as a business risk and reflect increased sophistication of players

Commentary and Contributing Factors

Industry expansion has highlighted regulatory risks:

- ▶ In the GCC, a lack of regulation has historically impeded growth in the insurance sector and is now also considered a business risk for Takaful. A number of interviewees argued that the progress made by the industry has not been matched by the regulatory authorities. As one GCC Takaful executive stated; "Regulation and regulators are somewhat immature, there is still a lot of development needed."
- ▶ As competition increases and international conventional incumbents become more active, the sophistication of operators will continue to improve. Regulators will subsequently have to develop supervisory frameworks to match industry innovation. To date, only a small number of countries have implemented tailored regulations for Takaful - Bahrain and Malaysia being the two clearest examples.

The application of conventional regulations to Takaful

- ▶ The application of capital adequacy to Takaful is complicated by the separation of shareholders' and policyholder's funds. A number of interviewees disagree with the application of such requirements to policyholders' funds in isolation, which requires an accumulation of earnings, particularly in the early years of operations, and the subsequent withholding of distribution to policyholders.

" Countries need to properly develop their regulations and aim for standardization - Takaful is treated differently in each country. "

- Takaful window executive

" The Gulf states are highly fragmented in their regulatory approach. "

- Ratings executive

" Solvency criteria are difficult to meet and effectively remove our competitive advantage. "

- GCC Takaful executive

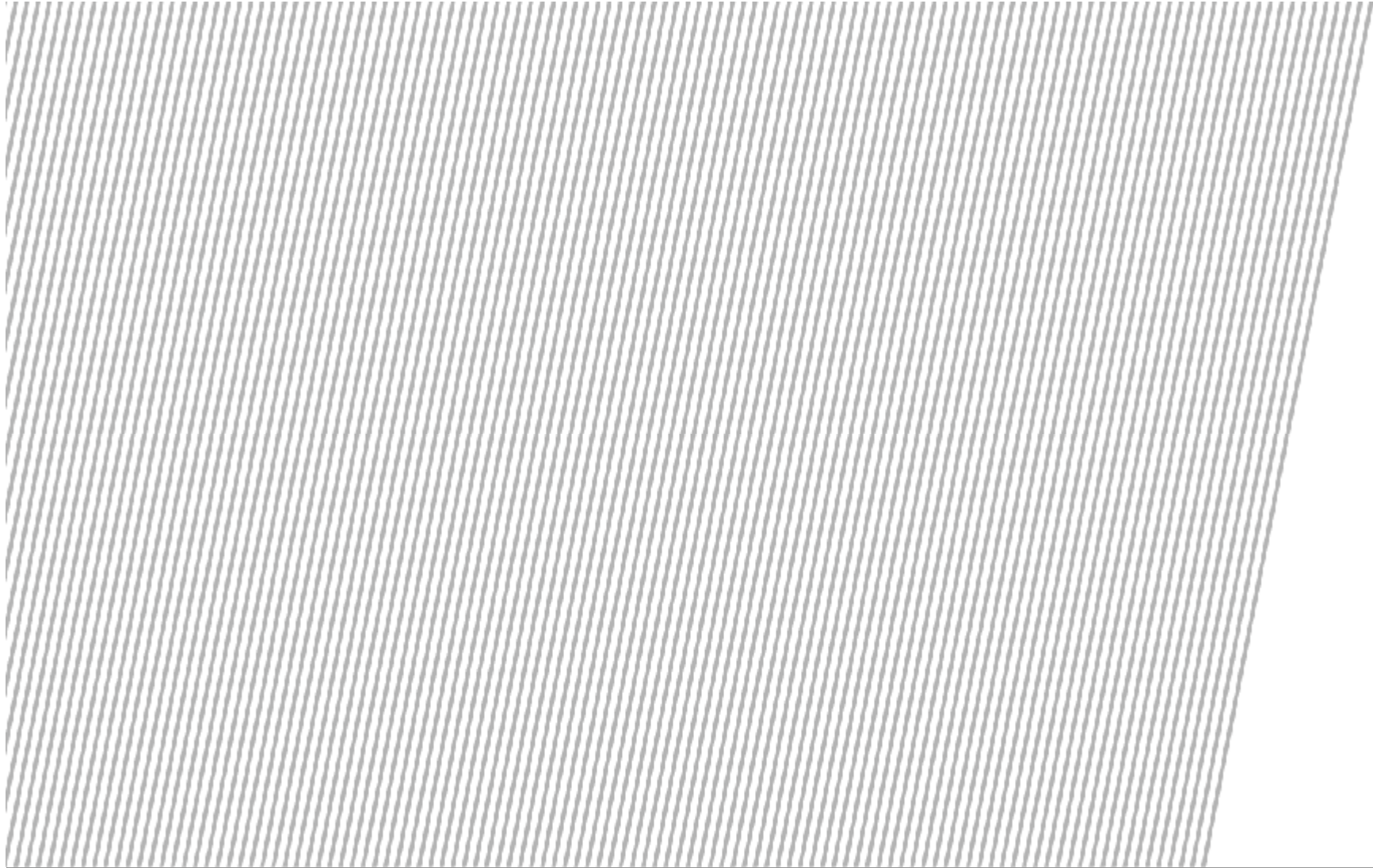
Key Considerations

Transparency and consistency, preparation and dialogue:

- ▶ The ongoing ambiguity and opaqueness of the Takaful industry reduces its appeal to a wider audience. Takaful operators should strive to adopt consistent business models and provide transparency to consumers.
- ▶ Preparation for regulatory changes and continuous dialogue with authorities helps to smooth the learning curve.

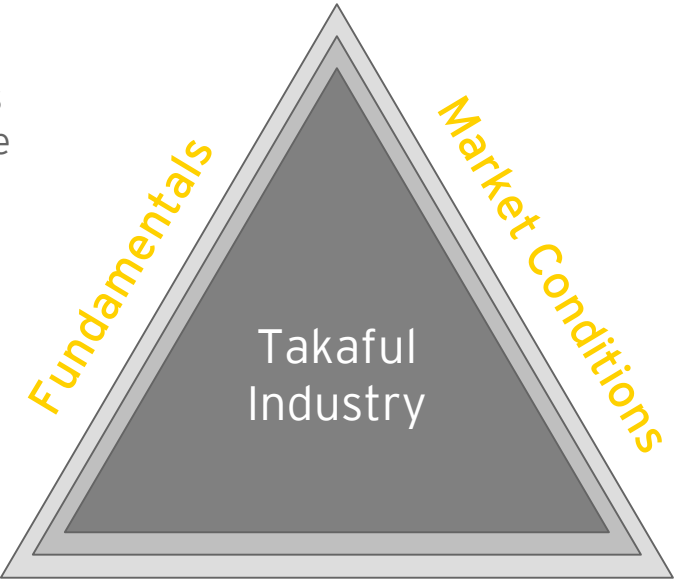
Source: Corporate interviews, Ernst & Young analysis

4. Sustaining the Future



Long term growth of Takaful is predicated on strong underlying factors

- ▶ Favorable demographics
- ▶ Increased income earnings and propensity to consume
- ▶ Changing social attitudes towards insurance



- ▶ Available Shari'a compliant projects
- ▶ Equity markets
- ▶ Investment opportunities
- ▶ Institutional growth

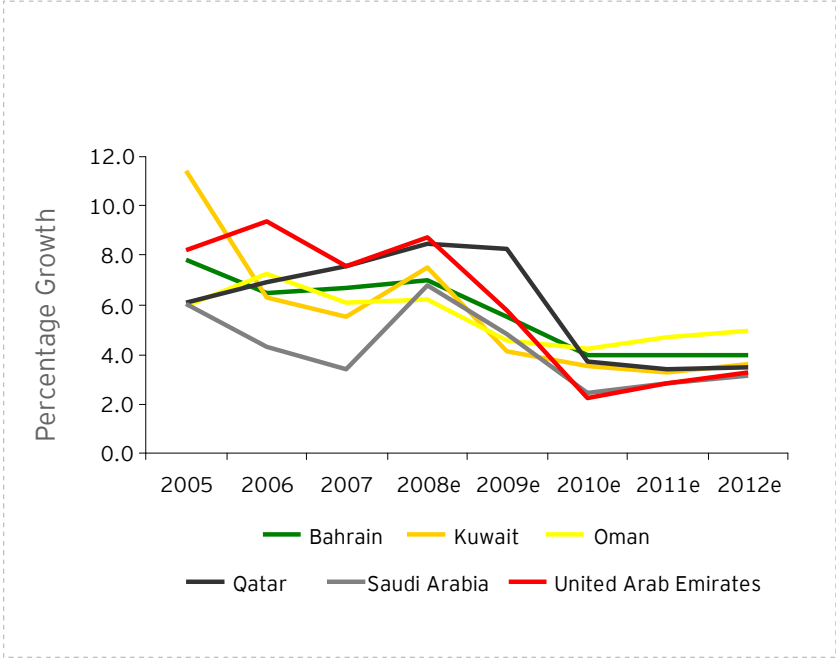
Facilitators

- ▶ Regulatory support and framework
- ▶ Insurance legislation
- ▶ Compulsory coverage

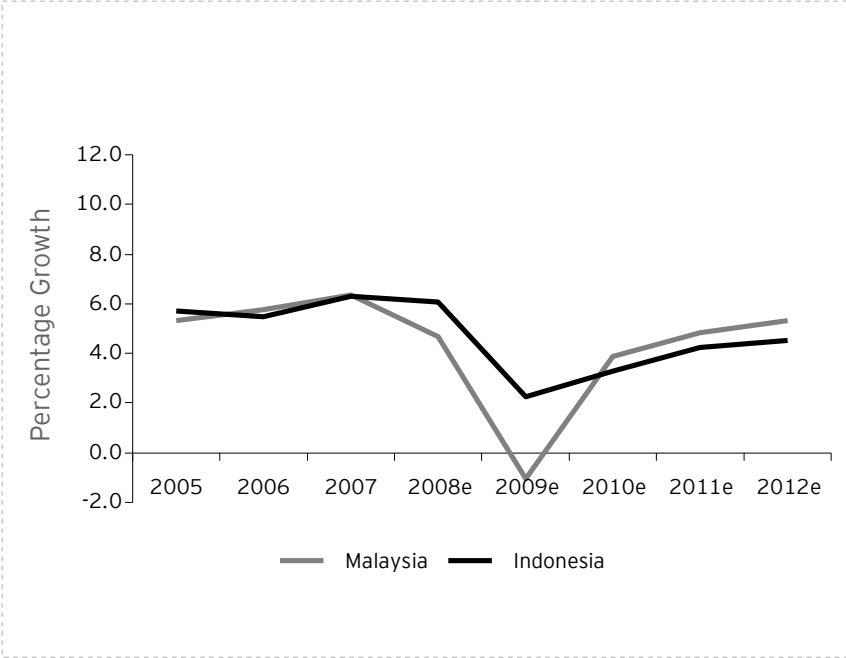
Source: Ernst & Young analysis

Although the global recession has led to a drop in short term GDP forecasts, long term prospects for growth in the GCC and South East Asia remain positive

Real GDP Growth Rate - GCC

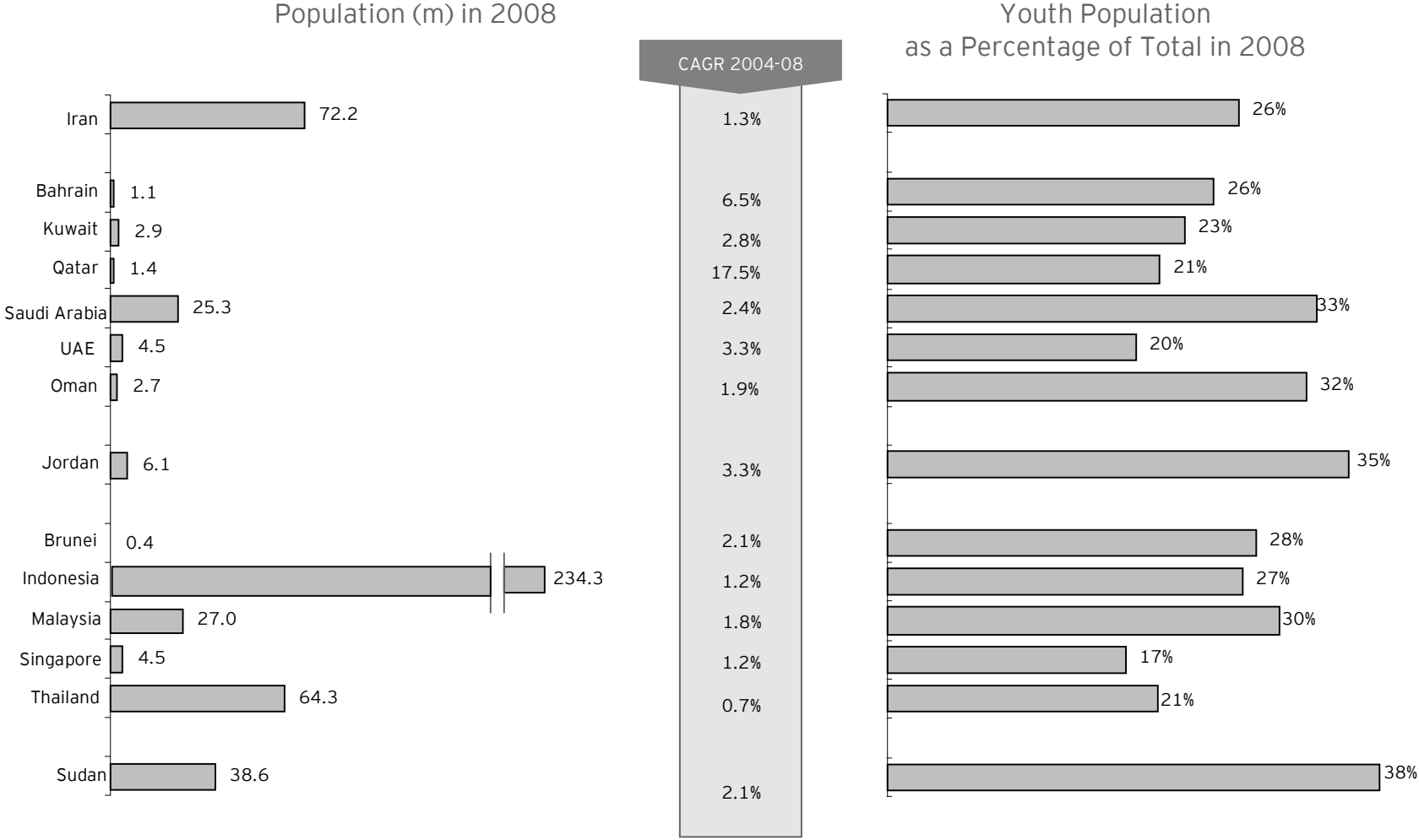


Real GDP Growth Rate - South East Asia



Source: Global Insight

A young population in core Takaful markets will need more coverage as government subsidies decrease and more families require private coverage

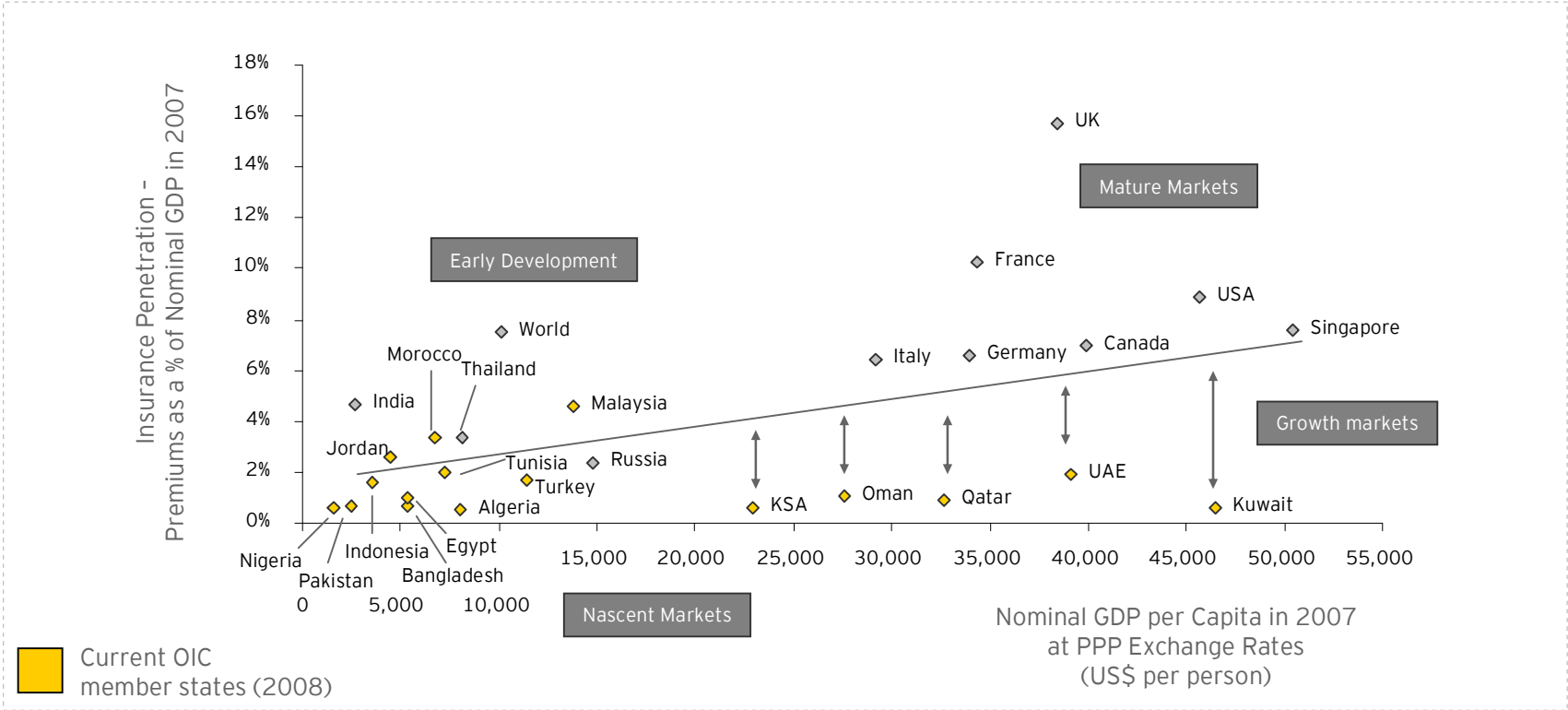


Source: Global Insight

Source: Global Insight

With insurance penetration levels in Muslim countries at their current levels, there is considerable latent demand for Takaful

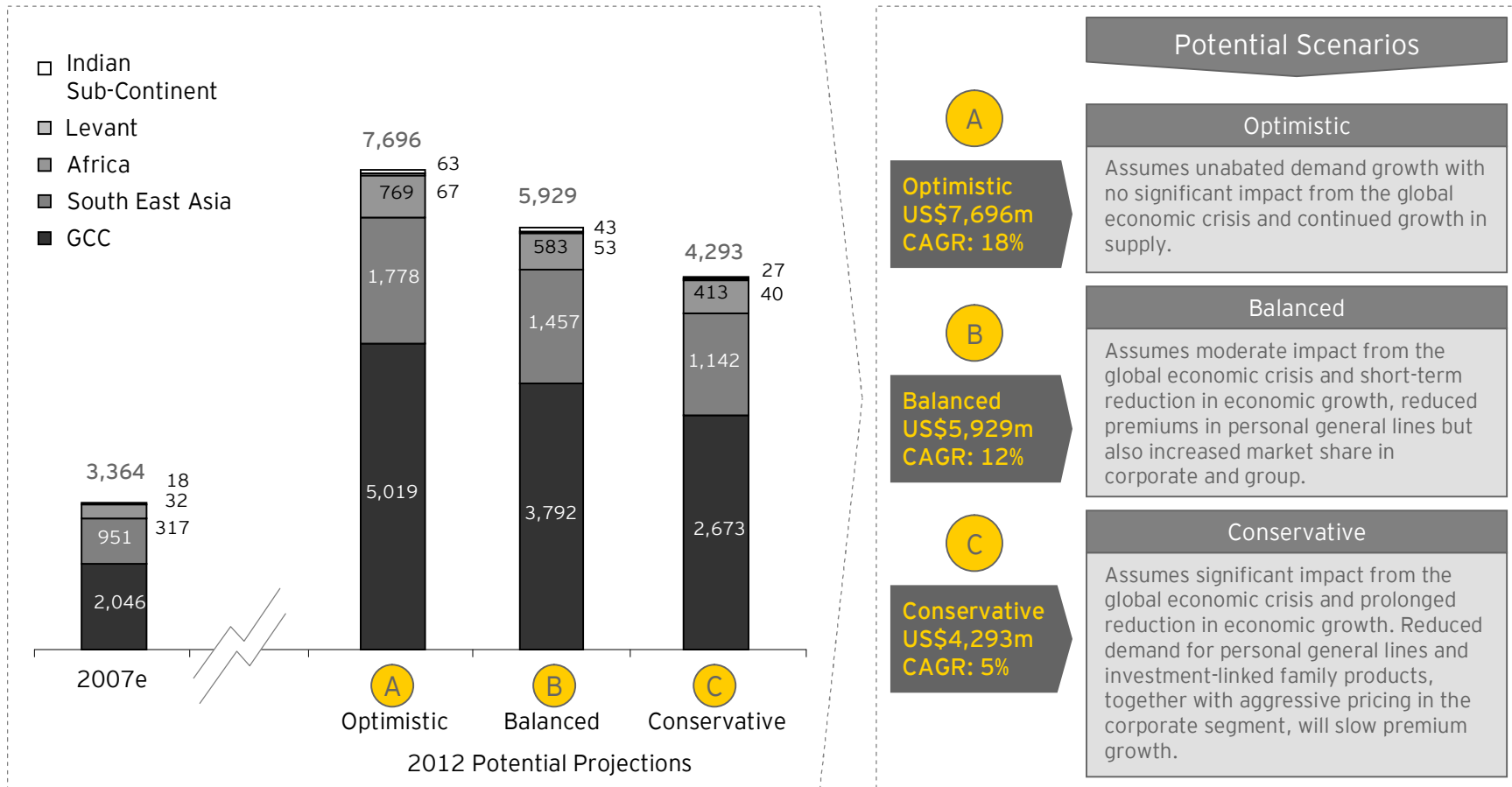
Insurance Penetration and GDP per Capita for Select Countries (2007)



Source: Swiss RE - Sigma No. 3 (2008), Global Insight, Ernst & Young analysis

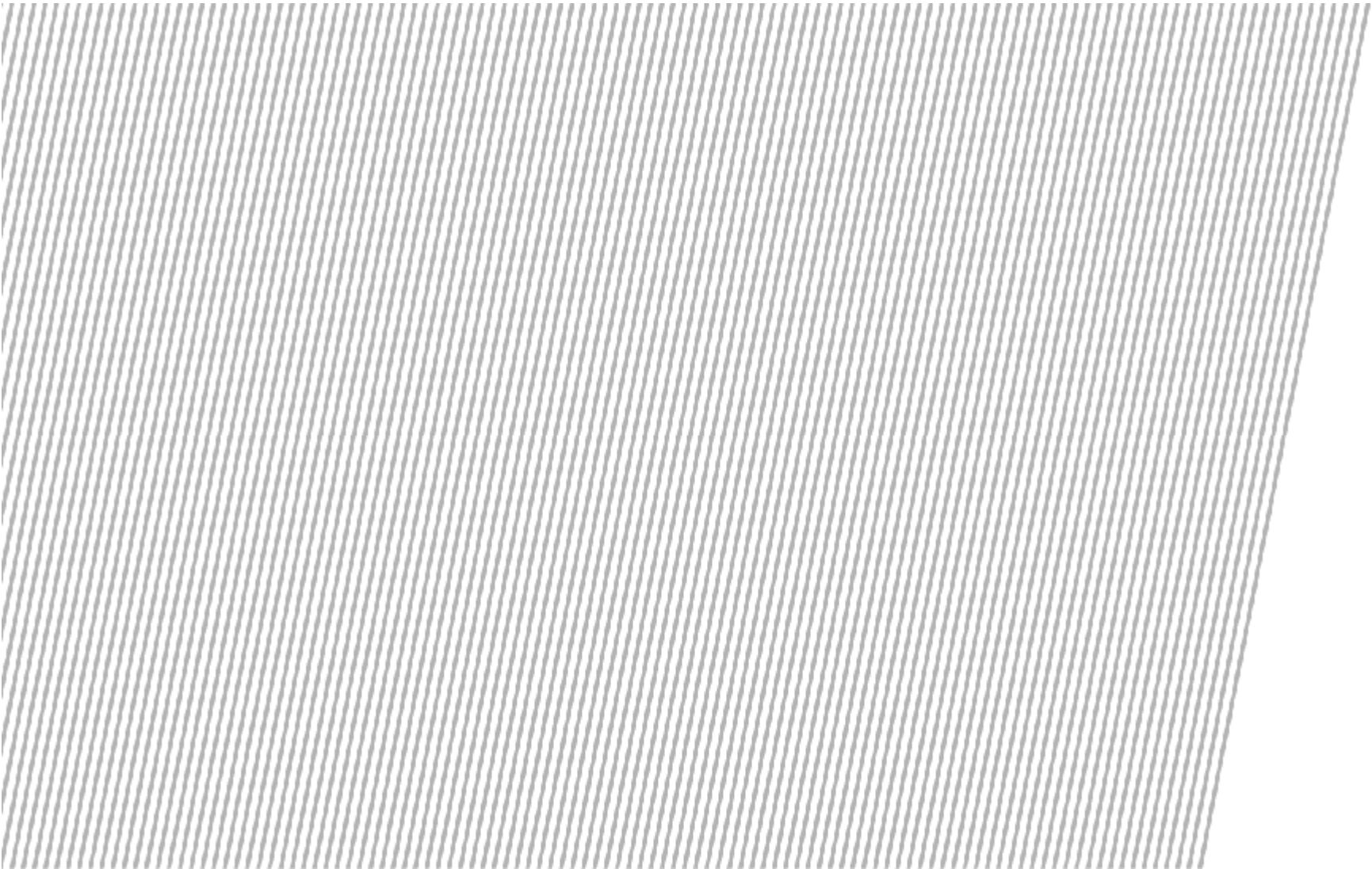
By 2012, total Takaful contributions could reach US\$ 7.7 billion

Global Gross Takaful Contributions by Year (US\$m)

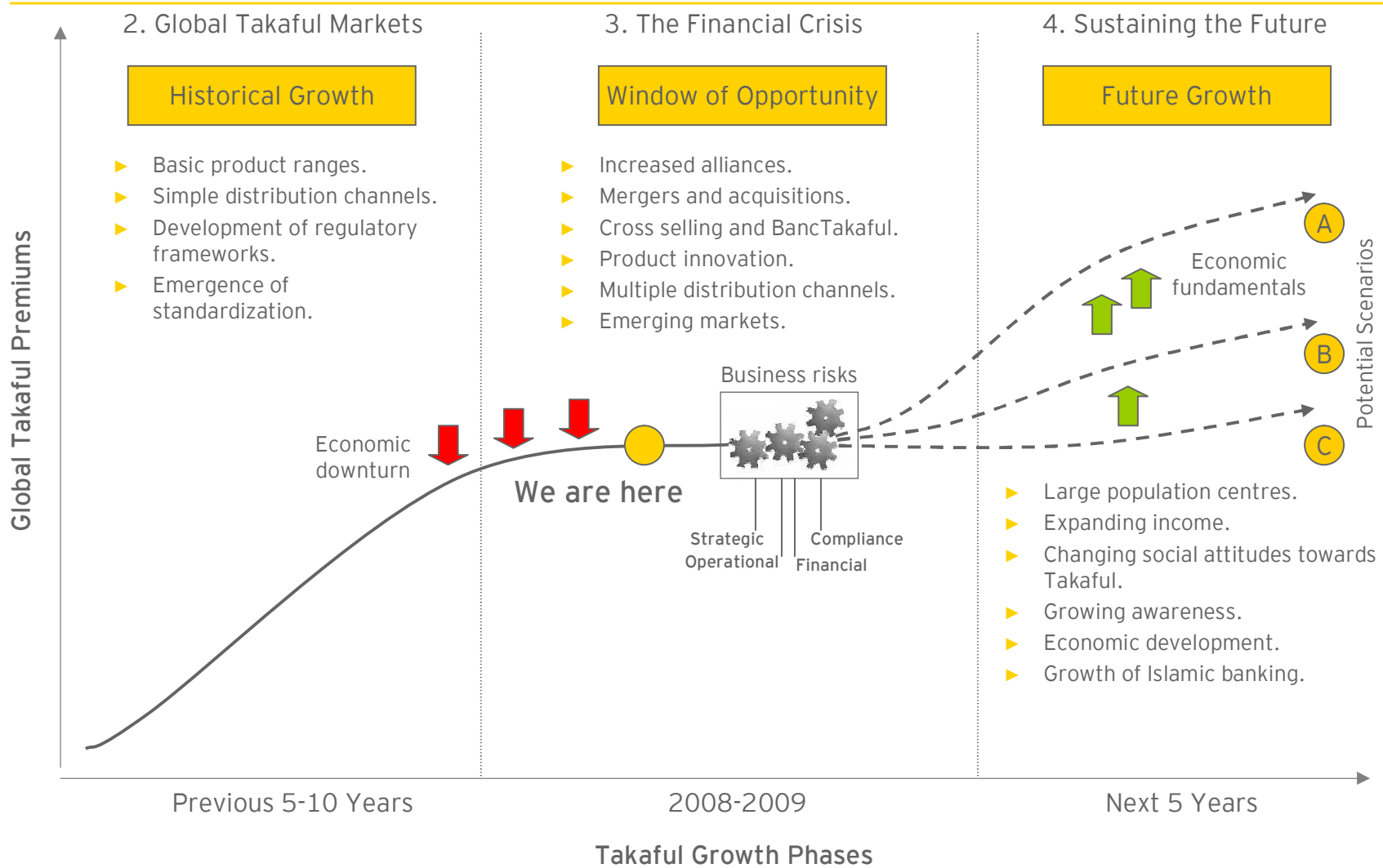


Source: World Islamic Insurance Directory 2008; Ernst & Young analysis

5. Conclusions

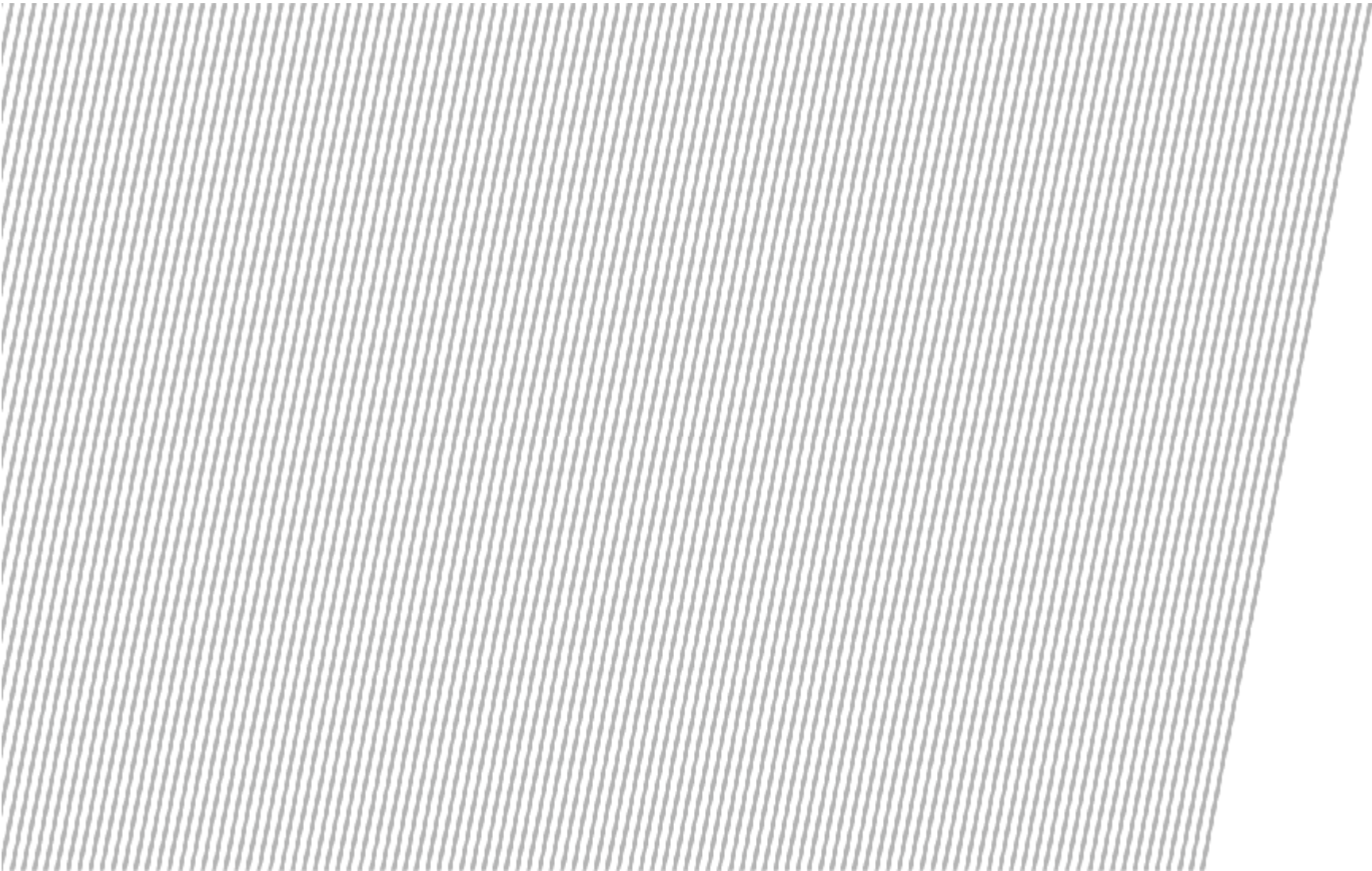


Historic growth is now being affected by the economic downturn - a window of opportunity has materialized for those Takaful operators that can manage their risks and sustain future growth



Source: Ernst & Young analysis

6. Appendix



Ernst & Young's Islamic Financial Services Group

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* Note: Europe, Middle East, India and Africa

The report's methodology and our interviews

Survey Methodology

- ▶ Our survey sought to identify key trends and business risks for the global Takaful industry through in-depth interviews with executives and industry observers.
- ▶ These discussions were used to gauge business sentiment and identify key areas for inquiry.
- ▶ Interviews were conducted in February and March of 2009. A total of 21 interviews were conducted in seven different countries by Ernst & Young staff.
- ▶ Interviews centered on three main topics of discussion, namely;
 - ▶ Business confidence, demand and supply
 - ▶ Mega trends
 - ▶ Business risks

Business Risk Ratings

- ▶ Ernst & Young subject matter experts from the Middle East, Asia and Europe developed a list of Takaful business risks and contributing factors.
- ▶ All interviewees were provided with this list of business risks and requested to rate each to reflect its severity to their respective business over the coming 12 months. Interviewees were also asked to add any additional risks they felt were important.
- ▶ The results of this rating process were tallied and a relative ranking assigned to each. This rank formed the basis for our comparative study with 2008 results.

Business Risks Radar

- ▶ The Ernst & Young risk radar is a simple device that allows us to present the top 6 business risks in the Takaful industry.
- ▶ The risks at the center of the radar are those that the individuals we interviewed thought would pose the greatest challenge to the industry in 2009.

Business Risk Categories

- ▶ The radar is divided into four sections that correspond to the Ernst & Young Risk Universe™ model.
- ▶ **Compliance** threats originate in politics, law, regulation or corporate governance;
- ▶ **Financial** threats stem from volatility in markets and the real economy;
- ▶ **Strategic** threats are related to customers, competitors and investors; and
- ▶ **Operational** threats impact the processes, systems, people and overall value chain of a business.

Anonymity and Quotes

- ▶ All interviewees were assured of anonymity and minutes documented during our discussions were approved by respective interviewees.
- ▶ Quotations have been used to support argument made in the report.

References and the Project Team

Sources

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