

Methodology for Takaful & Retakaful Firms

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Takaful Market

- **Global Takaful market estimated at \$ 4 billion vis-à-vis insurance premium of \$ 3.7 trillion.**
- **As Shari'a scholars are increasingly looking to utilize Takaful capacity, there exists an intrinsic demand for growth.**
- **Insurance penetration in most of the Muslim countries still considerably low compared to economies like USA, UK, France, Singapore, etc.**



Pakistan Takaful Market

- Estimated at under \$ 1 billion with insurance penetration being considerably low at under 1% of GDP.
- Number of industry participants: **38**

Rating Distribution

- JCR-VIS' universe of ratings includes almost 70% of the insurance universe.
- Takaful has only started to take root in Pakistan. JCR-VIS rates the entire universe of Takaful operators in Pakistan.

Rating Universe



Industry Participants

General/Life Insurance Companies

ACE Insurance Ltd.

Alpha Insurance Co. Ltd

Asia Insurance Co. Ltd.

Askari Gen. Insurance Co. Ltd.

Capital Insurance Co. Ltd.

Central Insurance Co. Ltd.

Century Insurance Co. Ltd.

East West Insurance Co. Ltd

East West Life Assurance Co. Ltd

EFU General Insurance Ltd.

EFU Life Assurance Ltd

Excel Insurance Co. Ltd.

National Insurance Co. Ltd.

New Jubilee General Insurance Co. Ltd

New Jubilee Life Insurance Co. Ltd

PICIC Insurance Ltd.

Premier Insurance Co. of Pakistan Ltd.

Reliance Insurance Co. Ltd.

Saudi Pak Insurance Co. Ltd.

Security General Insurance Co. Ltd.

Silver Star Insurance Co. Ltd

The Co-operative Insurance Society of Pakistan Ltd

The Crescent Star Insurance Co. of Pakistan Ltd.

The Pakistan General Insurance Co. Ltd

The Universal Insurance Co. Ltd.

UBL Insurers Ltd.



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Rating Universe

General/Family Takaful

Dawood Family Takaful Co. Ltd.

Pak Kuwait General Takaful Co. Ltd.

Pak Qatar General Takaful Co. Ltd.

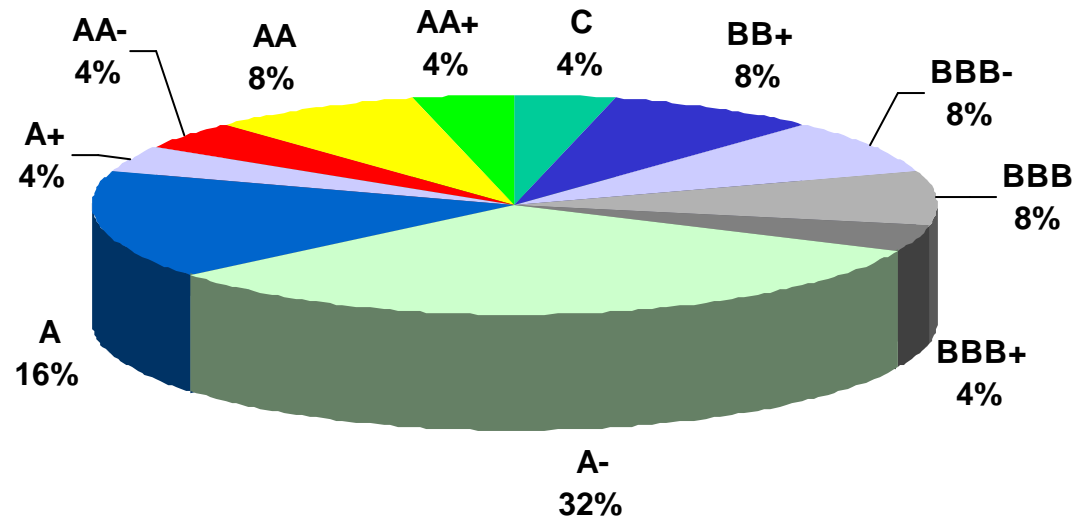
Pak Qatar Family Takaful Co. Ltd.

Takaful Pakistan Limited



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Rating Distribution



Definition of Ratings

- **Insurer Financial Strength (IFS) rating is an assessment of a company's capacity to meet its contractual obligations that mainly constitute claims on insurance policies.**
- **For Takaful companies, the key philosophy remains same in so far as the capacity to meet policy holder obligations is concerned.**



Ratings of Takaful Operators

- **Level of risk borne by a Takaful operator: function of type of business underwritten.**
- **Takaful rating entails evaluation of:**
 - **Management & controls**
 - **Liquidity**
 - **Capitalization**
 - **Earnings and Franchise Value**
 - **Reinsurance arrangements**
 - **External environment**



Key Rating Drivers

- **Management & Controls**
 - **Competency & skills of management team.**
 - **When viewed as modarib or wakeel, the integrity of managers can have implications for franchise, viability & sustainability.**
- **Supervision by Shari'a Board & Board of Directors**
 - **Governance related concerns.**
 - **Heightened “principal-agent” challenges if the Takaful operator does not suffer the negative consequences of poor underwriting.**

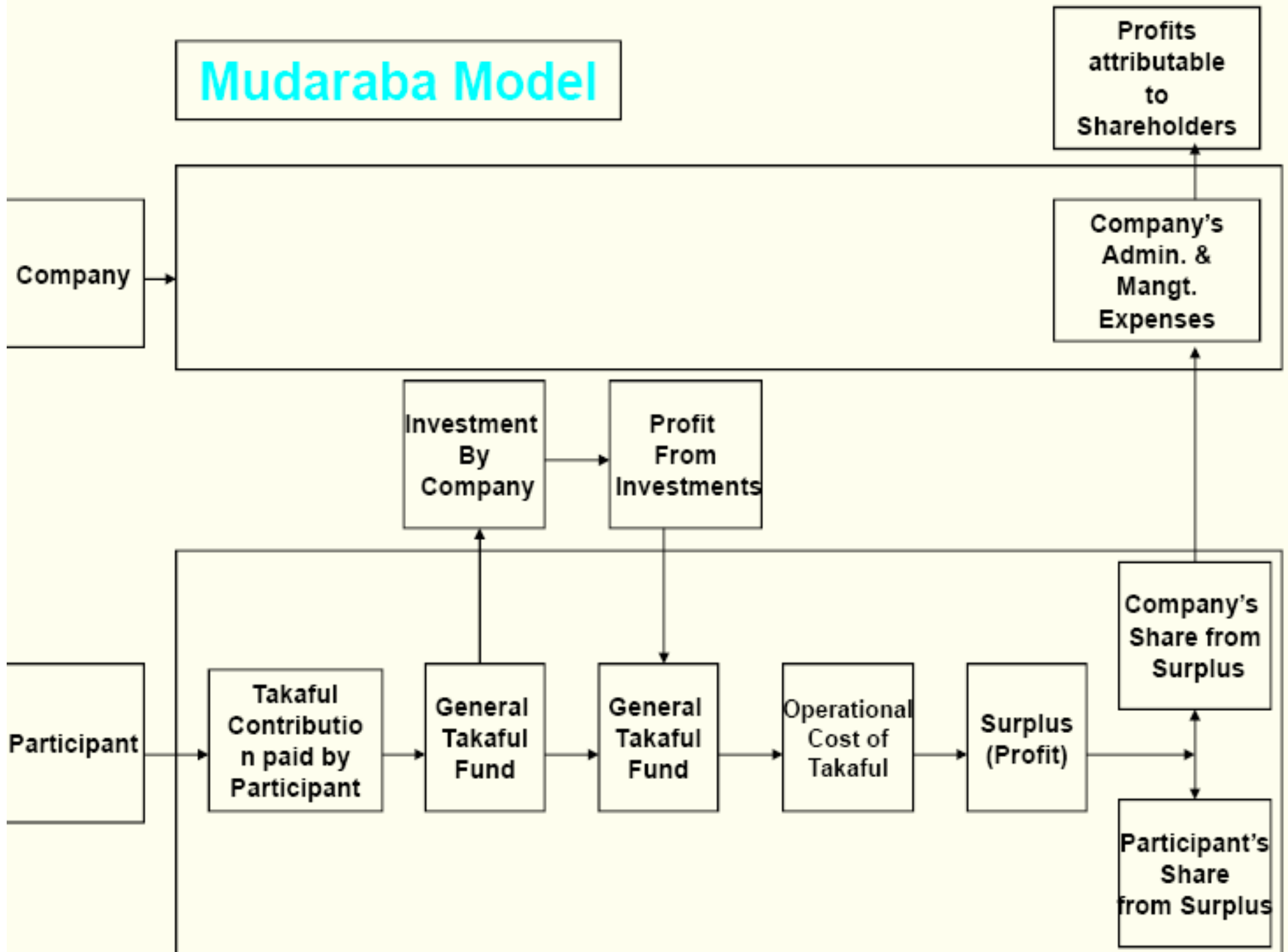


Key Rating Drivers

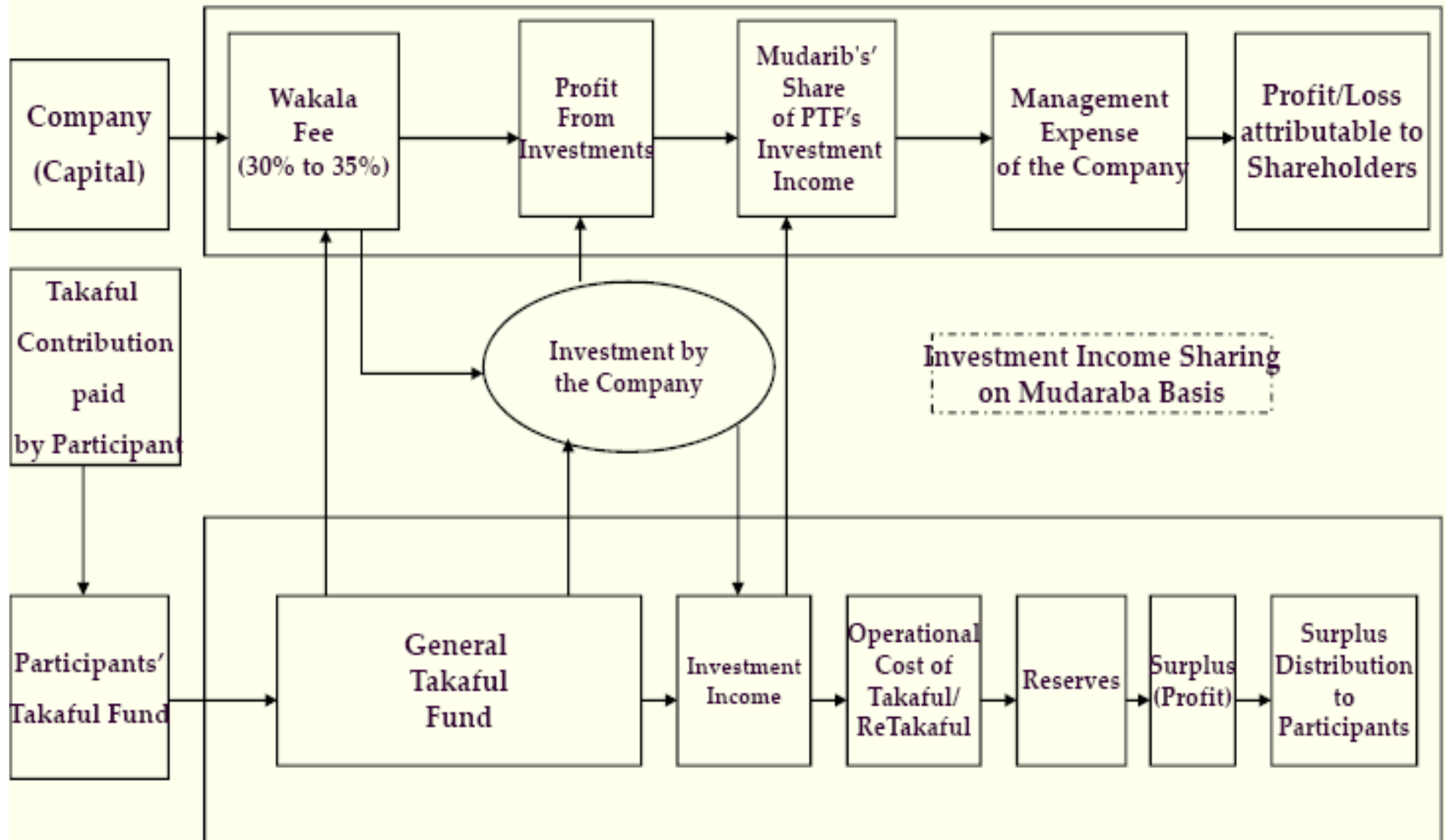
- **Primary distinction between Ta'awuni & Waqf Model.**
- **Within this, there can be two conceptual frameworks:**
 - **Modarabah**
 - **Wakala**
- **Wakala Waqf Model – a hybrid of the above two.**



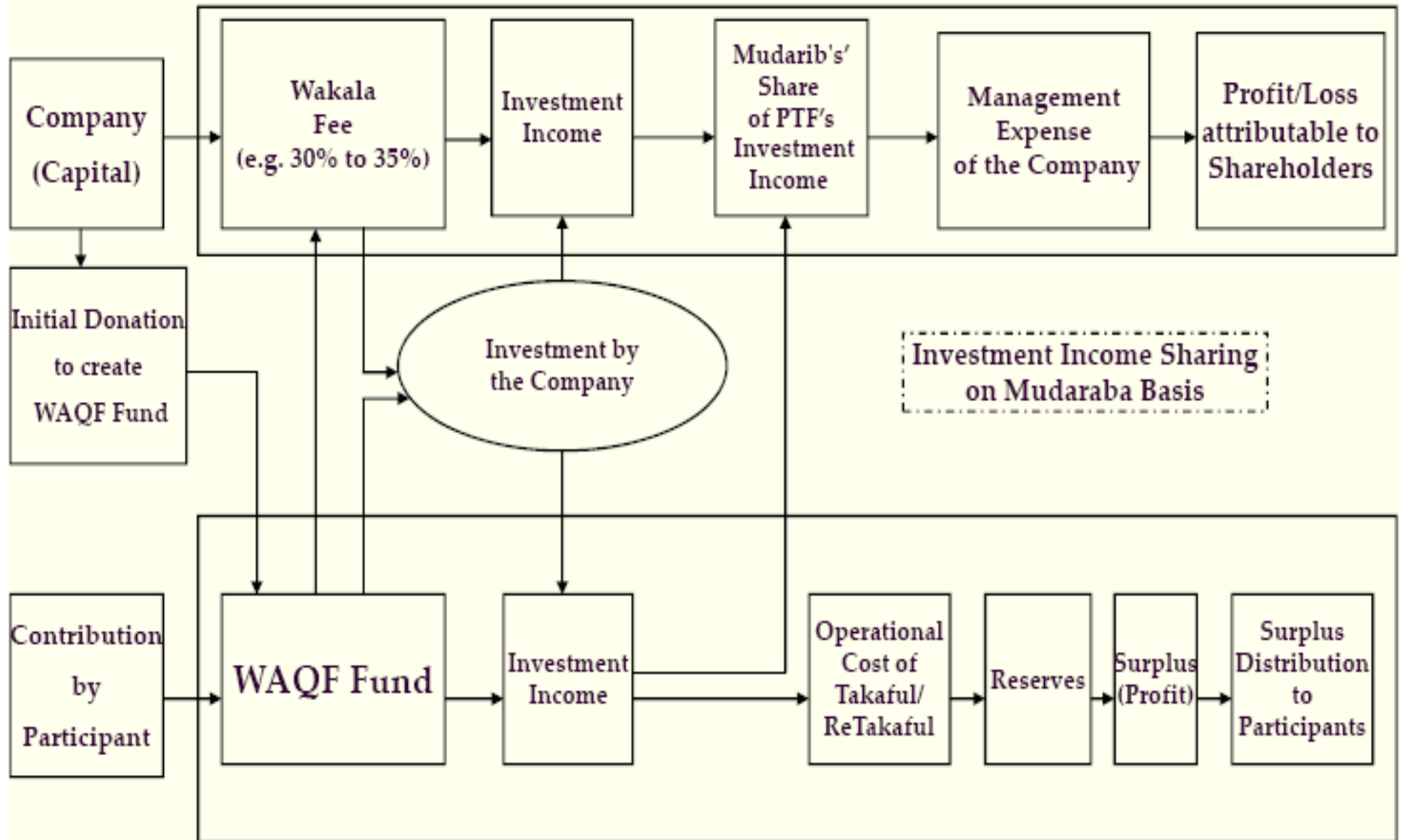
Mudaraba Model



Wakala Model



Wakala-Waqf Model



Key Rating Factors

- **Type of business model**
 - **The model adopted by Takaful operators defines the relationship between the shareholders' fund (SHF) and the participants' fund (PTF).**
 - **Claims paying ability, as reflected in financial strength ratings, are impacted by the degree of commitment of management to sound underwriting practices and prudent investment management.**



Key Rating Factors

- **Legal separation of PTF/SHF**
 - **Legal separation makes it necessary to conduct tiered analysis.**
 - **Adequacy of contributions relative to the volatility and level of claims.**
 - **Firm wide assessment of capitalization on account of legal recourse to the SHF in the form of Qard-e-Hasanah.**
 - **Shareholders liability limited to the extent of capital contributed.**
 - **Calculation of deficit undertaken from a cash-flow perspective rather than an accounting loss.**



Nature of Relationship

- **Legal separation of PTF/SHF**
 - **Having accounted for the business model:**
 - **SHF with greater financial strength than PTF will serve to enhance the capitalization assessment on firm-wide basis.**
 - **PTF is ring-fenced and weak financial strength of the SHF will not reduce the claims paying ability of the PTF.**
 - **Criterion for leverage ratios:**
 - **A dollar of capital supporting more than three dollars of premium written denotes high operating leverage.**
 - **Technical reserves exceeding three times capital indicates high financial leverage.**



Key Rating Factors

- **Priority of Claims**
 - **Relative priority of claim of Qard-e-Hasanah offered by the SHF vis-à-vis other obligations, is also an important rating factor.**
 - **Qard-e-Hasanah not explicitly subordinated to the interests of policyholders in some countries like Malaysia.**
 - **In Pakistan, however, this is not the case as the company is only required to pay Qard-e-Hasanah from underwriting surplus.**



Key Rating Factors

- **Surplus distribution**
 - **Surplus generated within the PTF is shared with the participants, which may prevent capital formation.**
 - **Policy with respect to creation of surplus equalization reserve is considered important in terms of future assessment of claims paying ability.**
 - **A more rigid structure may result in a greater need to call for capital from the SHF:**
 - **Extent of ring-fencing amongst various product lines.**
 - **Degree to which surplus from one may be used to off-set the losses on others.**



Key Rating Factors

- **Liquidity**
 - **Liquidity position will need to be analyzed both from the perspective of the Takaful fund itself as well as the company as a whole.**
 - **Two sources of liquidity. Operating cash flows (including re-insurance arrangements) & investment portfolio.**
 - **Limited spectrum of investible assets while a young sukuk market may render over-exposure to equities.**
 - **Analyze concentration in terms of exposure, credit worthiness of counterparties and any impairment in the portfolio.**



Key Rating Factors

- **Re-Takaful**
 - **There are over 250 Takaful companies in the world today, yet there are fewer re-takaful operators.**
 - **Scarcity of suitable (Islamic-compliant) re-insurers exposes a company to concentration related risks**
 - **Regulations & Shari'a scholars in Pakistan however allow takaful operators to seek re-takaful support from conventional re-insurers.**
 - **Strength of re-insurance arrangements would be evaluated on a case by case basis.**



Key Rating Factors

- **Earnings**
 - **Profitability: function of underwriting and investment strategy**
 - **Results from underwriting operations affected by:**
 - **Choice of business segment**
 - **Geographical outreach**
 - **Diversification of underwritten risks**
 - **Primary profitability analysis conducted at the PTF level while a supplementary analysis also undertaken for the SHF.**
 - **Level of Wakala fees is expected to enable the PTF to generate surplus over the long term while also allowing the operator to cover its costs.**
 - **The investment management function may be based on either of Wakala or modaraba concept, with varying degrees of implications in terms of incentive for improving returns for the operator.**



Takaful Ratings

- **Future Challenges**
 - **Development & harmonization of regulatory framework.**
 - **Ability to extend outreach and diversify underlying risks.**
 - **Creation of strongly capitalized global re-Takaful operators.**
- **Introduction of Management Quality Ratings**
 - **Akin to Islamic banks where management is considered as ‘modarib’, JCR-VIS appreciates the role of managers in a takaful firm.**
 - **Undertaking the first ‘Management Quality Rating’ for Takaful operators.**



Thank You

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