Leveraging on the Mutual Model

13th International Takaful Summit 2019

THE INTERNATIONAL TAKAFUL SUMMIT

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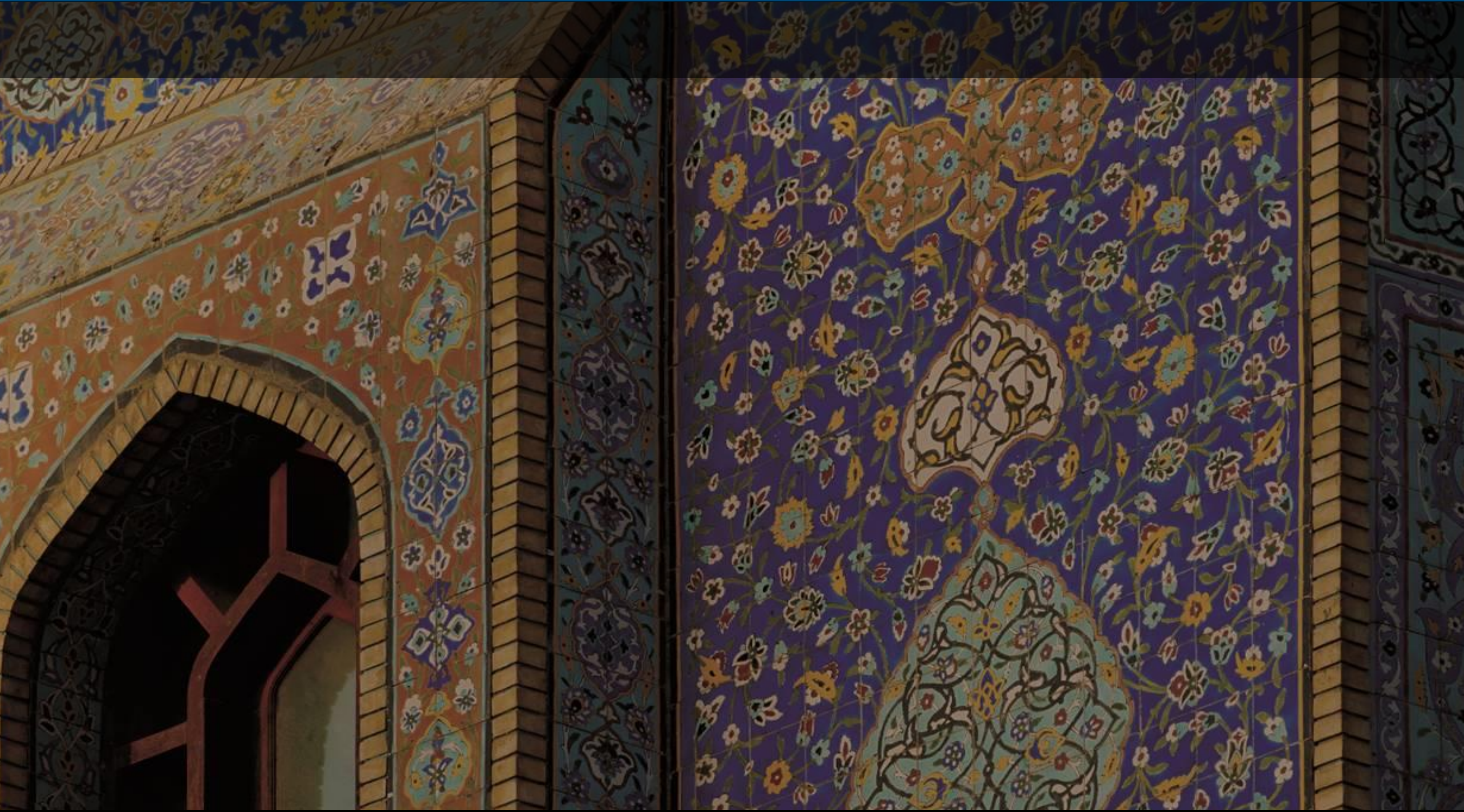
Special feature: UK mutuals and Takaful

THE FIRST GLOBAL FAMILY TAKAFUL REPORT -- 2011



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Mutual Insurers Defined

Unlike proprietary companies, mutuals are owned by their members. However, like takaful companies, both operate within the principle of mutual guarantee and any surplus arising ultimately belongs to these members.

Mutuals played a key role in UK insurance provision managing in aggregate over £90 billion and touching the lives of 1 in 3 UK residents (history?)

There are no shareholders to pay dividends to and hence mutuals can distribute surplus to its with-profits members or reinvest to provide a more secure fund position

Regulated in a similar manner to proprietary companies

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Differences between Takaful and 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 consider 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.

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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.

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.

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Applications in Takaful

Empathy Between Mutuals and Takaful

Can we Make the Marriage Work?