

# ISSUES SURROUNDING MANAGEMENT OF TAKAFUL SURPLUS



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# OBJECTIVES OF THE PRESENTATION

- **To explain the differences in the treatment of surplus between conventional insurance and Takaful**
- **To highlight several issues surrounding the management of takaful surplus and come out with some possible solutions to solve the issues**

**This presentation is the summary of a study prepared using library/literatures based method.**

# **Underwriting Takaful Surplus**

- **Underwriting surplus is the excess of the total contributions paid by policyholders during a financial period over the total indemnities paid in respect of claims incurred during the period, net of reinsurance and after deducting expenses and charges in technical provisions (AAOIFI, 2010).**
- **Effective Management of Takaful surplus is very important to ensure long term viability of Takaful fund.**

# Differences in The Treatment of Surplus between Conventional Insurance and Takaful

- In conventional insurance, the underwriting surplus is treated as **a part of the company's operating profit**, thus it is reported in income statement of the company.
- In Takaful, since the contributions are wholly or partially donated (tabarru') by the policyholders, the underwriting surplus is distributed among the policyholders (AAOIFI, 2010) . It should be reported in a separate statement called "Statement of the Policyholders' surplus" (AAOIFI, 2010).
- **In Takaful, underwriting surplus is not a part of the company's operating profit.**

**Al Ahlia Insurance Company B.S.C.****Statement of income for the year ended 31 December 2007****(Bahraini Dinars)**

	<u>Notes</u>	<u>2007</u>	<u>2006</u>
<b>Gross premiums</b>	24	9,860,283	9,035,554
Reinsurance ceded		(5,682,846)	(5,603,388)
<b>Retained premiums</b>		4,177,437	3,432,166
Adjustment in unearned premiums		(441,744)	(367,152)
<b>Net premiums earned</b>	24	<b>3,735,693</b>	<b>3,065,014</b>
<b>Gross claims paid</b>		(3,724,474)	(2,769,715)
Claims recovered from re-insurers		1,472,064	1,382,769
Outstanding claims adjustment – gross		(75,163)	(771,253)
Outstanding claims adjustment- re-insurance recoveries		(23,268)	32,294
<b>Net claims incurred</b>	24	<b>(2,350,841)</b>	<b>(2,125,905)</b>
Management expenses	19	(471,927)	(421,172)
Net commission income	24	527,067	512,763
		55,140	91,591
<b>Underwriting profit for the year</b>	24	<b>1,439,992</b>	<b>1,030,700</b>

# Statement of changes in participants' funds

For the Financial Year Ended on 31 December 2009

Expressed in Bahrain Dinars

			Investment fair value reserve		Total
	General	Family	General	Family	
	takaful	takaful	takaful	takaful	
At 31 December 2007	(520,646)	106,794	23,801	4,708	(385,343)
Realised fair value gains/(losses) on available-for-sale investments	-	-	(30,511)	-	(30,511)
Unrealised fair value gains/(losses) on available-for-sale investments	-	-	(45,345)	(9,629)	(54,974)
Surplus for the year	277,458	73,673	-	-	351,131
At 31 December 2008	(243,188)	180,467	(52,055)	(4,921)	(119,697)
Realised fair value gains/(losses) on available-for-sale investments	-	-	2,061	4,921	6,982
Unrealised fair value gains/(losses) on available-for-sale investments	-	-	52,757	-	52,757
Surplus for the year	316,578	88,838	-	-	405,416
At 31 December 2009	73,390	269,305	2,763	-	345,458

# Statement of participants' revenues and expenses

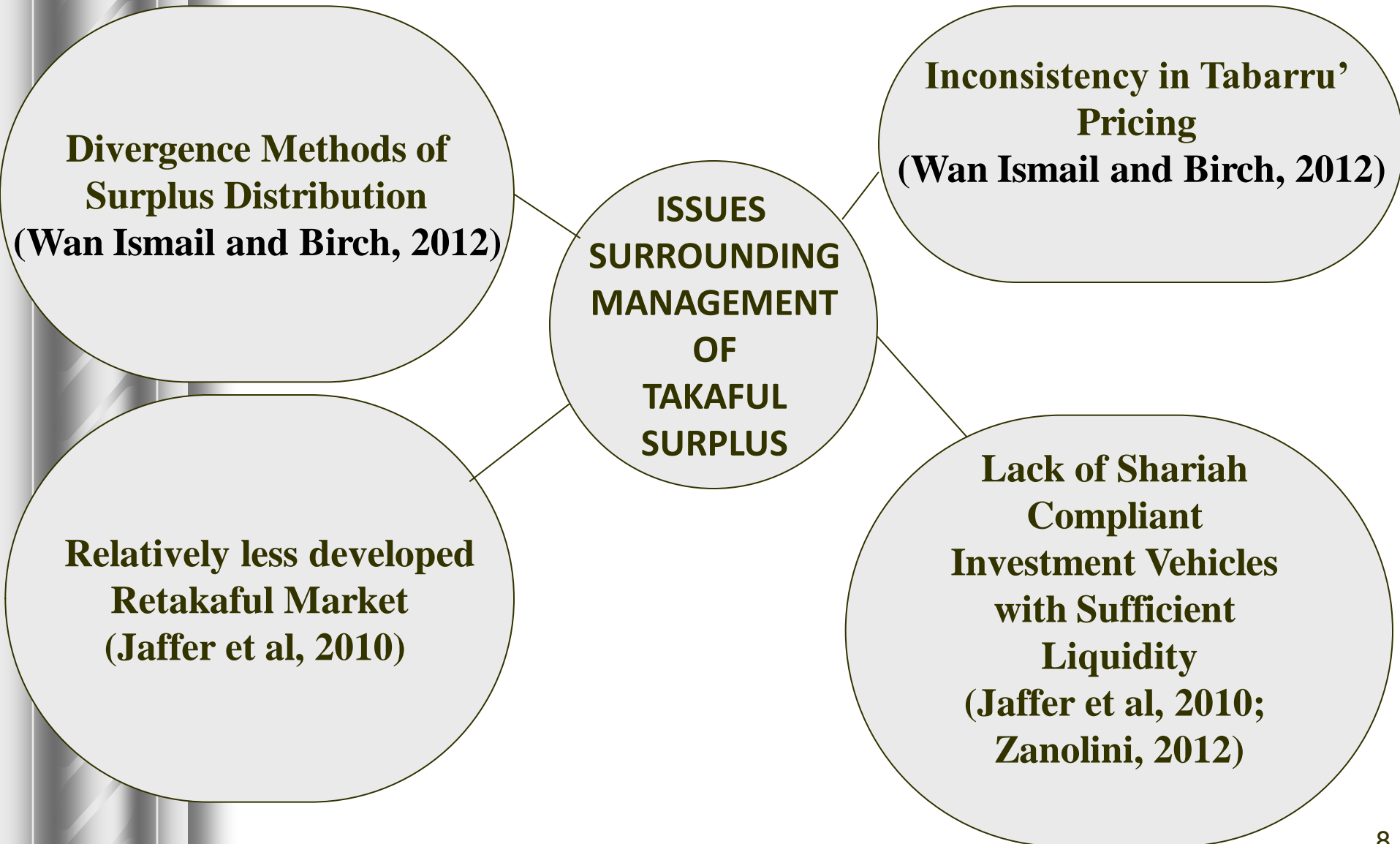
For the Financial Year Ended on 31 December 2009

Expressed in Bahrain Dinars

	Notes	General takaful		Family takaful		Total	
		2009	2008	2009	2008	2009	2008
Gross contributions	29	13,381,131	12,614,175	1,637,210	1,408,371	15,018,341	14,022,546
Retakaful share	29	(7,615,940)	(7,055,992)	(983,378)	(959,460)	(8,599,318)	(8,015,452)
Retained contributions		5,765,191	5,558,183	653,832	448,911	6,419,023	6,007,094
Movement in unearned contributions	29	(21,041)	(554,949)	-	-	(21,041)	(554,949)
Net retained contributions		5,744,150	5,003,234	653,832	448,911	6,397,982	5,452,145
Commission received		1,409,936	1,365,885	8,218	75,656	1,418,154	1,441,540
Movement in unearned retakaful commission income		(42,093)	(268,890)	42,850	(23,622)	757	(292,512)
Other income		308,210	191,286	3,804	-	312,014	191,286
Retakaful commissions and other takaful income	29	1,676,053	1,288,281	54,872	52,034	1,730,925	1,340,314
Total takaful revenues		7,420,203	6,291,515	708,704	500,945	8,128,907	6,792,459
Gross claims settled		9,813,612	8,210,481	265,281	436,255	10,078,893	8,646,736
Recovered from retakaful and other parties		(6,032,088)	(4,770,223)	(201,424)	(390,013)	(6,233,512)	(5,160,236)
Net claims settled		3,781,524	3,440,258	63,857	46,242	3,845,381	3,486,500
Movement in outstanding claims (net of gross over retakaful)		24,946	214,031	27,410	(16,053)	52,356	197,978
Net claims incurred	29	3,806,470	3,654,289	91,267	30,189	3,897,737	3,684,478
Commissions paid	29	875,423	811,185	33,729	15,039	909,152	826,224
Transfer to charity provision		1,944	-	-	-	1,944	-
Wakala fees	24	2,249,482	1,419,095	388,837	323,925	2,638,319	1,743,020
Doubtful general takaful receivables	8	249,777	64,999	-	-	249,777	64,999
Transfer to technical reserves		-	-	159,838	118,360	159,838	118,360
Total takaful expenses		7,183,096	5,949,568	673,671	487,513	7,856,767	6,437,081
Surplus from takaful operations		237,107	341,947	35,033	13,432	272,140	355,378
Investment income	25	105,962	92,810	56,637	63,412	162,599	156,222
Mudarib share	24	(26,491)	(23,203)	(2,832)	(3,171)	(29,323)	(26,373)
Net investment income before impairment		79,471	69,607	53,805	60,241	133,276	129,849
Impairment loss on available-for-sale investments	7	-	(134,096)	-	-	-	(134,096)
Surplus for the year transferred to participants fund		316,578	277,458	88,838	73,673	405,416	351,131

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Years of Excellence

# ISSUES SURROUNDING MANAGEMENT OF TAKAFUL SURPLUS





# Shari'ah Rulings on Distribution of Surplus

- **It is widely accepted that underwriting surplus cannot be described as a profit for the takaful company since the surplus is derived from the contributions .**
- **Therefore, policyholders have the exclusive rights to the surplus (AAOIFI, 2010)**

# Shari'ah Rulings on

## Distribution of Surplus (Cont)

- **However, there are some fatwas issued by shariah boards that permit shareholders (Takaful Operators) to share in underwriting surplus with the policyholders.**
- **In order to give incentive for prudential underwriting practice, on top of the fee, a part of the underwriting surplus can also be given to the operator, depending on the level of the performance.**
- **However, the underwriting loss, if any, has to be borne only by the participants.**

# Takaful Surplus Distribution Methods (AAOIFI)

- 1. Allocation of surplus to all participants, regardless of whether or not they have made claims during the financial period.**
- 2. Allocation of surplus only among participants who have not made any claims during the financial period.**
- 3. Allocation of surplus among those who have not made any claims and among those who have made claims of amounts less than their contributions, provided that the latter category of participants should receive only the difference between their contributions and their claims.**

# Takaful Surplus Distribution Methods (AAOIFI)

- 4. Allocation of surplus between policyholders and shareholders.**
- 5. Allocation of surplus by using other methods:**
  - The operator partially distributes the surpluses to participants and holds the remainder as “contingency reserves.**
  - The operator doesn't distribute any surpluses to the participants on the basis that a donation is unconditional as under waqf model and hence the surplus is donated to charity.**

# Possible Impacts from Lack of Uniform Surplus Distribution Practice

- Unaware customers will lose confidence in Takaful products simply due to **confusion** and or feel that they are **inequitably treated**.
- It also presents challenges in **accounting for and monitoring takaful business**.
- Therefore, regulators need to require takaful operators to put a transparent surplus management policy in place.

# Inconsistency in Tabarru' Pricing: Conservative Vs Competitive Methods

- **How the amount of tabarru' is priced?**
- **If it is priced using conservative method with the tabarru' amount should be able to cover the expected claims as well as capital, all surplus should be returned to participants.**
- **However, competition or the need to keep the cost affordable for target customers may prevent a takaful operator from conservative tabarru' pricing.**

# Inconsistency in Tabarru' Pricing (Cont)

- **As a result, Takaful operators have to retain a certain portion of the surplus to cushion future adverse experience**
- **A Takaful operator is justified to get an incentive from Takaful surplus only when good underwriting and other management of risk in place (actual experience outperforming expected results)**
- **Otherwise, it might be viewed as unfair practice by policyholders (participants)**

# Lack of Shariah Compliant Investment Vehicles with Sufficient Liquidity

- **The are relatively limited ranges of Shariah-compliant asset (Sukuk, Equity and Real Estate**
- **Competitions with Islamic banks in purchasing short term sukuk in the primary market**
- **Relatively Illiquid and expensive secondary market for sukuk**
- **As a result, it exposes takaful operators to higher investment risks when they invest the takaful surplus.**



# Relatively less developed Retakaful Market

- Retakaful plays a big role in influencing the surplus positively or negatively.
- Choosing the best retakaful agreement is one of the key factors for long term viability of takaful fund.
- However, retakaful market is still relatively less developed hence it forces some takaful operators to use the service of conventional reinsurance companies. **This practice rises shariah issues.**
- Although the emergency reason might be used to legitimate the practice, there should be more efforts to develop retakaful markets, thus at the end no more takaful funds are ceded to conventional reinsurance companies.

Expressed in Bahrain Dinars

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# POSSIBLE SOLUTIONS

- **Regulators need to issue “guidelines on takaful operational framework” in order to tackle the issues of lack of uniform in surplus distribution as well as inconsistency in pricing tabarru’.**
- **Islamic finance stakeholders need to develop more Islamic capital and money market instruments that are easily tradable in secondary market in order to address the issues of lack Shariah Compliant Investment Vehicles with Sufficient Liquidity.**
- **Development of Retakaful market should be the focus of all industry stakeholders in order to avoid Takaful companies using the service of conventional reinsurance companies**

# Conclusion

- **Effective Management of Takaful surplus is very important to ensure long term viability of Takaful fund.**
- **However, there are several issues that should be addressed in order to promote an effective management of takaful surplus.**
- **All industry stakeholders need to find out solutions to the above issues, thus sound takaful industry can be put in place.**

# SPECIAL THANKS

- The speaker would like to convey his sincere thanks to Dr Syed Farooq and Mr Delil Khairat for their invaluable supports.

وبالله التوفيق