TAKAFUL FEATURE

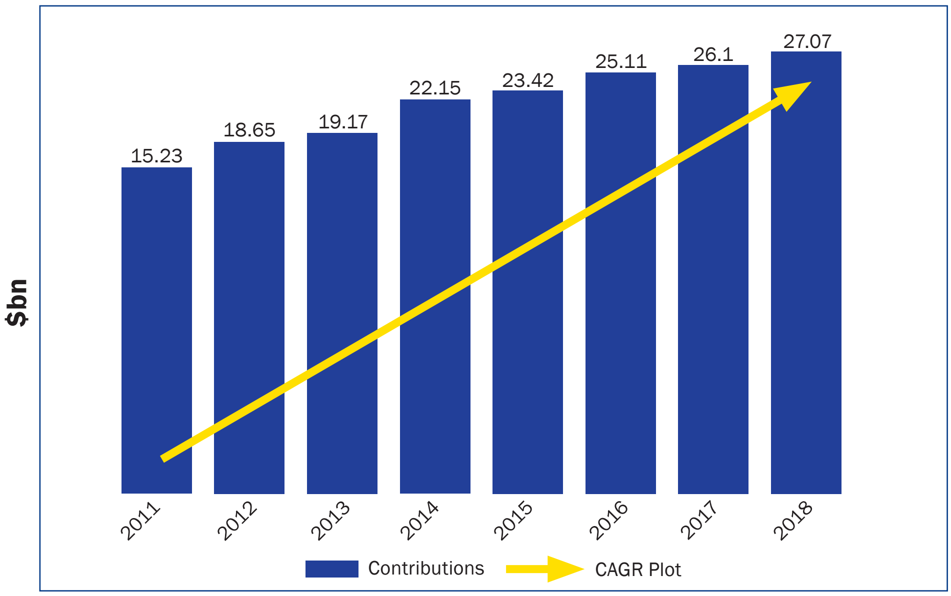
The critical role of retakaful in Africa

Dr Corneille Karekezi of **Africa Re** notes the challenges retakaful operators face and recommends key factors for success.

Africa is the home of the world's first Islamic bank and takaful operator. The first Islamic bank, Mit Ghamr Bank was established in 1963 in Egypt. The first Islamic insurance policy was later issued in 1964. Since then, more Islamic banks were founded in Egypt, Saudi Arabia, Malaysia, Indonesia, UAE and Sudan. In 1979, the establishment of the Islamic Insurance Company in Sudan as the first shariah-compliant insurance company took things further and birthed the takaful industry.

Global takaful contributions reached $27.07bn in 2018, up from $26.10bn in the preceding year. This upward movement varies across the geographic regions in the world, according to the Islamic Financial Services Industry Stability Report 2020.

Table 1: Global takaful has continuously grown to reach $27bn in 2018



Source: Islamic Financial Services Industry Stability Report 2020

Table 2: Breakdown of the global takaful contributions by key regions

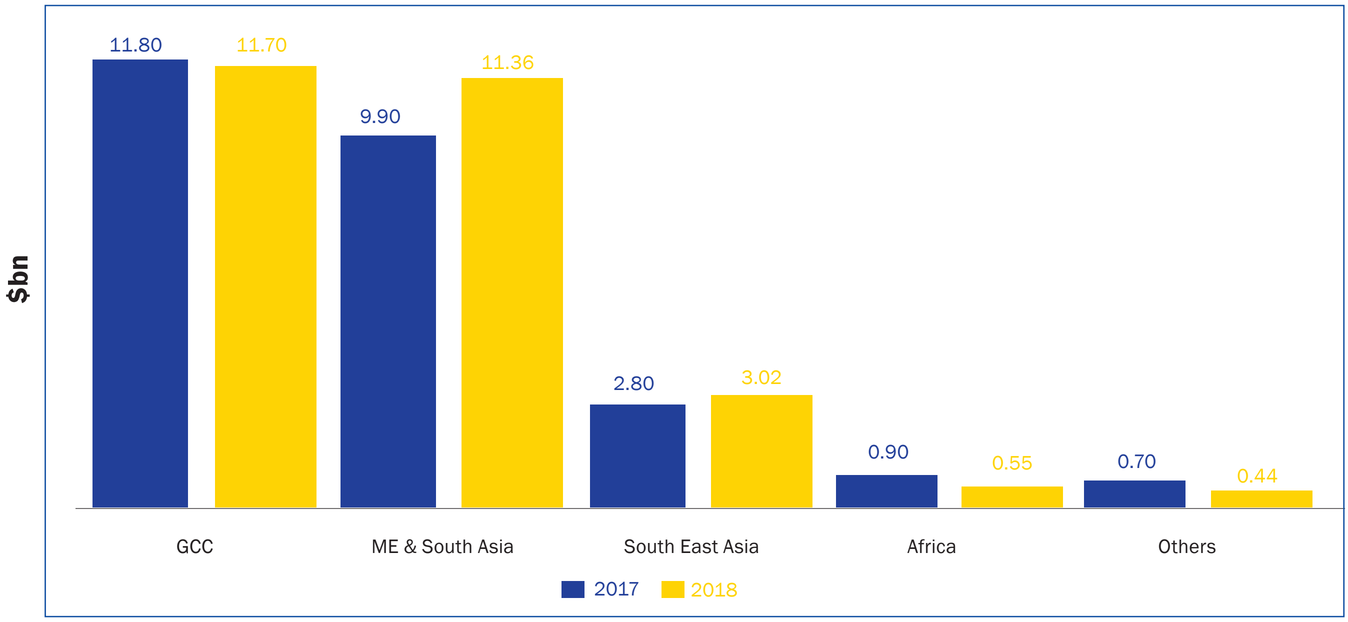


Table 2 indicates that there is a marginal decline of 0.85% in takaful contributions in the GCC countries, while Africa saw a significant decline of 37.14%. Takaful contributions increased remarkably in the other regions. According to research conducted by the Islamic Financial Services Board (IFSB), insurance penetration is 2.37% while takaful penetration is 0.01%. This could be responsible for the small contribution from Africa. The portfolio in Africa is spread across family and general takaful at 15.2% and 84.8%, respectively according to 2018 data.

Gradual expansion and suppressed growth in Africa

Takaful has progressed in Africa at a slower pace than in other regions as the industry found most of its success outside the continent, as far as East Asia and the GCC region. While the first Islamic insurer/takaful operator started in Sudan in 1979, it was only after a decade that it was followed by South Africa, and gradually spread to other countries including Egypt, Nigeria, Senegal, Tunisia, Libya, Tanzania, Mauritania, Kenya, Algeria, Morocco, The Gambia, Zambia and many more. It is worthy to note that South Africa was the second African country to write Islamic insurance business, but unfortunately, the trial failed and the operators closed.

The reasons for slower development of the takaful industry in Africa are as follows: the misconception that takaful is only for Muslims; inadequate governmental initiatives to develop takaful regulations and models compared to other regions; fewer investors and investments; and capital constraints affecting competitive position.

Nevertheless, the takaful industry has a great potential to expand its customer base in Africa whilst attracting newer customers for the following reasons: the opportunity to penetrate many new markets such as the Muslim communities who believe that conventional insurance is haram or non-shariah-compliant; lower-income people and SMEs are another example of the potential markets for takaful as they perceive it as a solidarity concept rather than profit-making; the comparative advantages of Islamic insurance compared to conventional insurance such as surplus distribution among participants and the guarantee that insurance investments are on shariah-compliant vehicles; and the projected strong economic growth of African countries as compared to the more developed economies. It is expected that as the economy expands, there will be organic growth in the number of people requiring takaful insurance.

While COVID-19 has slowed the growth of the insurance industry including takaful, experts believe that takaful has a much better chance of recovery based on its model of solidarity and the common good.

Retakaful in Africa

In the early stage of the takaful business, reinsurance capacities for takaful operators were predominantly fulfilled by conventional reinsurance companies, whose operations are not shariah-compliant. The practice continues to be acceptable by some takaful operators based on the argument of 'unavoidable circumstances' ie, a necessity ('darurah') due to the lack of retakaful companies. Consequently, this has created a huge demand for retakaful capacities that can be supported by shariah-compliant capitals and provide a shariah-compliant capacity. The existence of retakaful operators gives no reason for takaful operators to rely on conventional reinsurance capacity; it is compulsory to give priority and preference to retakaful operators compared to conventional reinsurers.

International retakaful operators started to emerge in recent years to support the takaful industry. The National Reinsurance Company in Sudan was the first company to adopt Islamic shariah principles. Subsequently, we have seen the establishment of more retakaful operators that were either full-fledged or windows in many parts of the world. Unfortunately, most of them are out of business now due to several factors.

High expectations clash with market realities

Between high expectations and reality, retakaful operators are in a big dilemma. There are many and conflicting expectations from retakaful. First, like conventional reinsurers, the retakaful operator is required to provide capacity for large risks and new products as its main service. Second, the operator is expected to provide a high level of training to assist in bridging the gap in human capital and technical expertise. Third, in this nascent industry, the retakaful operator is also required to enhance market research and statistics development, as well as contribute to increasing takaful awareness, especially in the Muslim-majority countries. Last, the retakaful operator is expected to play an active role in improving collaboration between market operators and the different stakeholders, especially the regulators.

While doing all of that, the retakaful operator should professionally manage the operations and generate surpluses. This challenge is compounded by the fact that the takaful industry has in recent years lagged behind the conventional insurance industry in terms of underwriting profitability. It is generally a loss-making industry in many parts of the world. Overall profitability, especially in Africa, is also impacted by the inability of takaful and retakaful operators to find suitable shariah-compliant investment instruments that are highly-rated with a good return in their core financial markets.

Retakaful struggling to gain a foothold

Retakaful in Africa, like the rest of the world, is struggling to gain a solid foothold due to many reasons including those mentioned above.

Like takaful, retakaful also has similar challenges including competition with the established conventional reinsurers while receiving little support from direct takaful operators. Many retakaful operators find it hard to convince takaful operators to accept a full retakaful panel for reinsurance placement in line with the underlying Islamic principles. In cases where a retakaful operator is on the panel, the same reinsurance conditions such as reinsurance profit commission and retained reserves are applied. This is not helping to build the financial strength of the retakaful operators as compared to the conventional reinsurers. The survival of most retakaful operators is threatened mainly due to a lack of market support. In Africa, the situation is even more difficult as the operators are relatively new in a weak takaful market operating under volatile macroeconomic conditions. The economic volatility with highly deteriorating local currencies and high inflation, usually leads to eroded income and investments.

Furthermore, the overall profitability of retakaful operations is generally poor as evidenced in thinner technical margins, if any, due to the implementations of profit commissions, retained reserves, and very competitive terms that threaten the sustainability of retakaful operators. As is the case for takaful operators, investment income is also under pressure, as there is a relative absence of reliable shariah-compliant investment channels.

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Faced with so many challenges, there is a great tendency to form retakaful windows instead of fully-fledged retakaful companies. This trend has a direct negative effect on the achievement of the full shariah-compliance of the operators and the completion of the segregation of the participants' funds from the retakaful operator's shareholders' funds. This means that Muslims will be excluded from participation in the insurance industry.

Finally, as most Islamic insurance practitioners first started in the conventional insurance industry, old connections to the traditional reinsurance markets remain strong. This reality, among other factors, deprives the retakaful operators of some of their main takaful clients, who are supposed to collaborate first with the fully compliant retakaful operators.

Critical success factors for retakaful operators

Based on the recent experience in Africa, as everywhere else, I believe success factors for retakaful operators include:

1. For a retakaful company to succeed it needs a strong backup from its parent group, as the case with Africa Retakaful being affiliated with the African Reinsurance Corporation.
2. Shareholders need to adopt higher shariah concepts and apply reasonable management fees.
3. Retakaful operators need strong and dedicated support from its small, direct markets and other stakeholders.
4. Retakaful operators are required to work hard to meet the expectations of their core markets, either for capacity or other kinds of technical support.
5. Retakaful operators should always serve by example for full compliance with shariah principles.

Talent and adequate regulations crucial

Africa remains a virgin territory and insurers/takaful operators need to grow their local presence hence the need for reinsurance/retakaful. There is a dire need for local actuaries, loss adjusters, consultants and other experts. Presently, foreign experts dominate such professions and there is a lack of local talent, especially at management levels. Moreover, legislation need to be developed so that there will be a suitable framework and infrastructure for the takaful/retakaful industry to progress. Overall, the demand for insurance is still in its infancy but there are vast opportunities in the future.

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