



دار التكافل
للتأمين وإعادة التأمين الإسلامي

Dar Altakaful
Islamic Insurance and Reinsurance

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

“Wakala Incentive Model”
A WIN A WIN Model



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1) Overview of Current Takaful Models

The Two Main Models Widely Used

- **Wakala Model**
 - Principal-Agent Relationship
 - Takaful Operator does not share any risks
any surplus
- **Mudaraba Model**
 - Mudarib/Rab Al Mal Relationship
 - Underwriting Fees take the form of
specified % UW Surplus and Investment
Income



2) Limitations of Current Models and Need for Alternative Solution

Limitations:

Wakala Model:

- No motivation to aim for underwriting surplus
- Risk Selection: No Risk Transfer and Low Underwriting Quality
- Accountability Towards Policyholders: Top Line Management At The expense of Bottom Line Results
- Abuse of Qard Hassan

Mudaraba Model:

- Cash Flow Constraints
- Unpopular Model



3) Overview of “Wakala Incentive” Model

Alternative: Wakala Incentive Model

- The purpose of the model is to encourage operators to have an invested interest in the underwriting outcome of the Takaful operation without hindering its commercial interests through a minimal Wakala fee and a share of the surplus.
- The Wakala Fee (% of the earned gross contributions) paid upfront to the Takaful Operator in this model, becomes a symbolic admin fee to manage the cash flow for daily operational expenses. This provides the Takaful Operator an incentive.



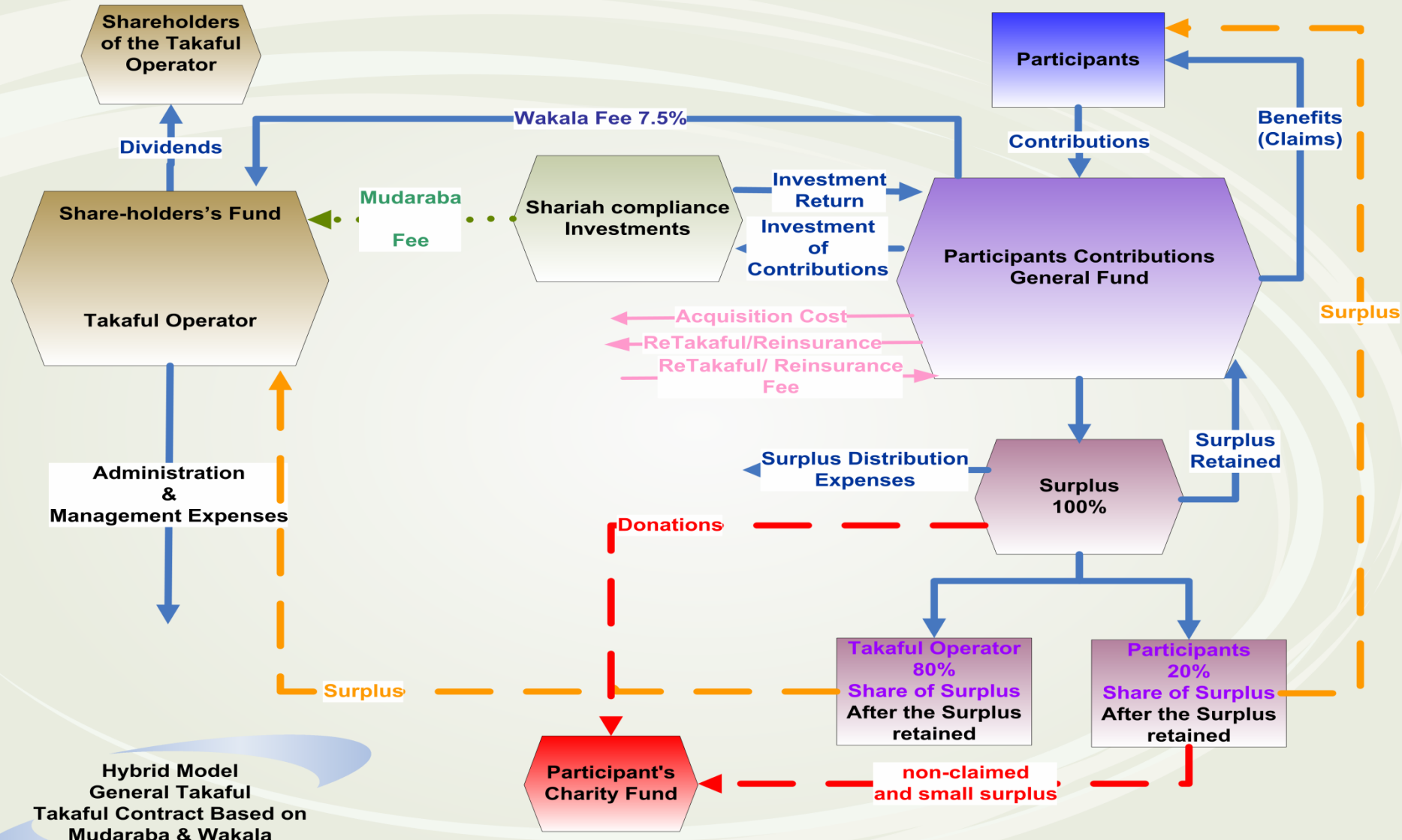
3) Overview of “Wakala Incentive” Model

Alternative: Wakala Incentive Model

- In this model, the role of the Takaful Operator will be
 - Mudarib (fund/investment manager) and
 - A Wakeel Agent that will provide operational management, technical underwriting and risk management of the Takaful operation.
- In return, for the Takaful operator acting as a Mudarib, will receive a fee for investing the Participant’s funds in a Shariah-compliant investment with the supervision of the Shariah Board. Secondly, he will also receive a share of the surplus out the underwriting surplus.



3) Overview of "Wakala Incentive" Model



Hybrid Model
 General Takaful
 Takaful Contract Based on
 Mudaraba & Wakala

3) Overview of “Wakala Incentive” Model

Calculation of Surplus Distribution:

Gross Written Contributions	
Less: Retakaful Share	—
A - Net Retained Contribution	
Less: Change in Unearned Contribution (Net)	—
B - Net Earned Contribution	
Less: Net Claims Incurred (Claims Paid, LAE, OSLR, IBNR)	—
Less: Net Earned Wakala Fees	—
Less: Net Earned Acquisition Costs	—
Plus: Net Earned Retakaful Surplus/Reinsurance Commissions	+
C - Operating Surplus	
Add: Net Investment Income	+
Less: Wakeel’s Share of Net Surplus	—
D - Net Surplus Available to Participants	

4.1) Wakala Incentive Scenario Analysis Goals and Framework

Testing Objective:

- To assess which combination of Wakala Fee Rate and Surplus Distribution Ratio will:
 - Create the Maximum Amount of Total Wealth
 - Benefit the Participants the most
 - Benefit the Operator the most
 - Provide the fairest share of the Wealth between the Operator and the Participants



4.1) Wakala Incentive Scenario Analysis Goals and Framework

Framework:

- The Wakala and Mudaraba contracts between the Takaful Operator and the Participants must be commercially viable for the Operator and must be attractive to the Participants
- The Participants' Fund should aim at an operating U/W surplus by Y2
- The Participants' Fund should be in a position to distribute surplus by Y3
- Only the Wakala Fee Rates and Surplus Distribution Ratios will be the changing variables in all the 15 scenarios
- Statements of Participants' Fund and Shareholders' Fund have been built over 10 years starting from 2009 with a detailed forecast of all underwriting undertaking parameters by line of business



4.1) Wakala Incentive Scenario Analysis Goals and Framework

Main Assumptions:

- 10-year P&L projections have been based on prudent growth projections, actual and ultimate loss ratios, current reinsurance market and current UAE commission structure
- The Takaful Operator will provide Qard Hassan to the Participants' Fund to cover whenever necessary any deficit
- U/W surplus is distributed to the Participants and Shareholders after the full repayment of the Qard Hassan granted by the Takaful Operator
- 2009 Balance Sheet and Cash Flow trends are assumed unchanged for all the years
- Operating Cash must be kept <US\$ 100K to ensure that any excess of cash is adequately invested
- Takaful General Expenses are exclusively borne by the Operator
- Investment Rates are assumed to decrease from 8% in Y1 to a flat 5% by Y4



4.2) Results and Findings

Results:

Wealth Growth



60/40 Surplus Operator/Participants	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
Policyholder Created Wealth	\$10,840	\$8,160	\$5,520	\$2,940	\$300
Operator Created Wealth	-\$4,316	\$4,816	\$12,492	\$21,100	\$29,471
Total Wealth Distributed	\$6,524	\$12,976	\$18,012	\$24,040	\$29,771

70/30 Surplus Operator/Participants	Scenario 6	Scenario 7	Scenario 8	Scenario 9	Scenario 10
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
Policyholder Created Wealth	\$8,130	\$6,120	\$4,140	\$2,205	\$225
Operator Created Wealth	-\$947	\$6,618	\$14,274	\$22,028	\$29,599
Total Wealth Distributed	\$7,183	\$12,738	\$18,414	\$24,233	\$29,824

80/20 Surplus Operator/Participants	Scenario 11	Scenario 12	Scenario 13	Scenario 14	Scenario 15
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
% Policyholder Share of Wealth	\$5,420	\$4,080	\$2,760	\$1,470	\$150
% Operator Share of Wealth	\$2,340	\$9,032	\$15,932	\$22,906	\$29,685
Total Wealth Distributed	\$7,760	\$13,112	\$18,692	\$24,376	\$29,835

4.2) Results and Findings

Results:

60/40 Surplus Operator/Participants	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
% Policyholder Share of Wealth	166%	63%	31%	12%	1%
% Operator Share of Wealth	-66%	37%	69%	88%	99%

70/30 Surplus Operator/Participants	Scenario 6	Scenario 7	Scenario 8	Scenario 9	Scenario 10
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
% Policyholder Share of Wealth	113%	48%	22%	9%	1%
% Operator Share of Wealth	-13%	52%	78%	91%	99%

80/20 Surplus Operator/Participants	Scenario 11	Scenario 12	Scenario 13	Scenario 14	Scenario 15
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
% Policyholder Share of Wealth	70%	31%	15%	6%	1%
% Operator Share of Wealth	30%	69%	85%	94%	99%

4.2) Results and Findings

Results:

60/40 Surplus Operator/Participants	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
Policyholders Surplus Distribution	Y2	Y2	Y2	Y3	Y7
Operator Positive Net Income	Y8	Y6	Y5	Y4	Y3

70/30 Surplus Operator/Participants	Scenario 6	Scenario 7	Scenario 8	Scenario 9	Scenario 10
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
Policyholders Surplus Distribution	Y2	Y2	Y2	Y3	Y7
Operator Positive Net Income	Y7	Y6	Y5	Y4	Y3

80/20 Surplus Operator/Participants	Scenario 11	Scenario 12	Scenario 13	Scenario 14	Scenario 15
Wakala Fees	5.00%	10.00%	15.00%	20.00%	25.00%
Policyholders Surplus Distribution	Y2	Y2	Y2	Y3	Y7
Operator Positive Net Income	Y7	Y5	Y5	Y4	Y2

4.2) Results and Findings

Findings:

- The Model that distributes the Most Aggregate Value:
 - - **80/20 Surplus Share Ratio (*)**
- Without destructing the initial capital raised by the Operator, the Most Favorable Combination of Wakala Fee Rate and Distribution Share Ratio for Participants:
 - - **80/20 Model at 5% Wakala Fee Rate**
- The models that provide the Fairest Share of Wealth between the Operator and the Participants:
 - » - **70/30 Model at 10% Wakala Fee Rate**
 - » - **60/40 Model at 10% Wakala Fee Rate**

Note: This is valid for all Wakala Fee Rates



4.3) Other Comments

- Takaful Entities should be able **to adjust, with the approval of the Sharia'h Board, the rates of their Wakala Fees and ratios of Surplus Distribution** of the “Wakeel Incentive” Model according to the underwriting performance and future strategy of the Operator
- However, **Wakala rates exceeding 20%** are not providing the required and expected benefits to the Participants
- Under normal market conditions and when the Operator has demonstrated fair underwriting quality, **Wakala Rates should be within the range of 5% to 15%**
- When all the above conditions are within acceptable ranges, the Operator should be able in a position to build U/W technical reserves and start distributing surpluses to the Participants **within the next 2/3 years**

Note: Analysis Done Using prudent growth projections, actual and ultimate loss ratios, current reinsurance market and current UAE commission structure



THANK YOU

