

CIBAFI BRIEFING

Bancatakaful: Building Synergies, Creating Opportunities

CIBAFI is pleased to present its sixth "CIBAFI Briefing", which is developed to build the awareness among the stakeholders of Islamic banking and Takaful industries about important aspects of bancatakaful. The Briefing reviews developments in bancatakaful and explores important prospects, challenges and opportunities.

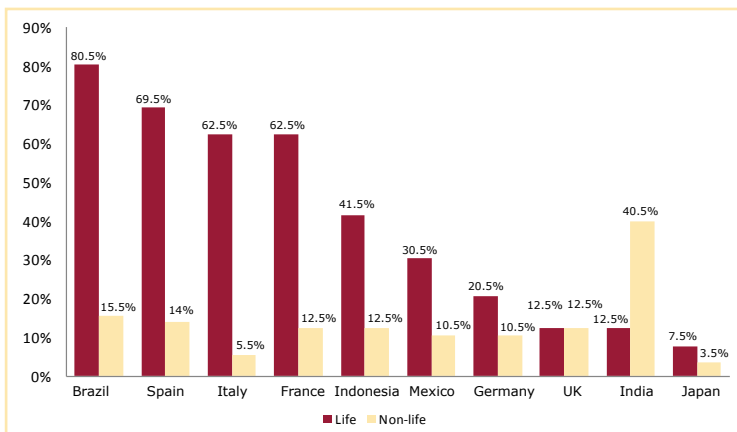
Background: Bancatakaful as a Tool for Developing Takaful Industry

The technological advancement and changing customer expectations are shaping the financial industry while bringing synergies into the continuously evolving financial markets. The banking and insurance sectors too have brought synergies into their operations by embedding the innovation into their distribution channels and points of sale. In this environment, bancassurance offers good opportunities to banks and takaful operators, such as assisting them to diversify the business lines and meet the customers' expectations in most effective manner.

Bancassurance originated in Europe in the mid-1980s and has become the main distribution channel for life insurance products in many markets, including France, Italy and Spain. However, bancassurance has not developed consistently in all markets because of obstacles such as partnerships, regulations, domination of traditional channels, customer habits, the absence of suitable products and tax structures etc.

For example, the market penetration of bancassurance is very low in North American countries (The United States of America and Canada). On the other hand, the market penetration of bancassurance is high in some other developed and emerging countries due to consumers' reliance on banks for seeking financial advice and good relationships between banks and insurance companies in these jurisdictions. (Please see Figure-1)

Figure 1: Bancassurance market penetration in different jurisdictions (Life and Non-Life)



Source: CIBAFI, Finaccord Global Bancassurance Analysis, Press Release

Being a part of the global insurance system, Shariah compliant Takaful industry recorded a 5% and 12% contribution growth in 2016 and 2015 respectively.

Takaful industry is still a small and an underdeveloped segment in many jurisdictions with total estimated contributions of USD 26 billion as of end 2016 and 305 takaful operators (including windows and re-takaful operators)

Takaful sector has a big potential to collaborate with other financial institutions such as Fintech companies, regulatory/ supervisory bodies, financial research centers

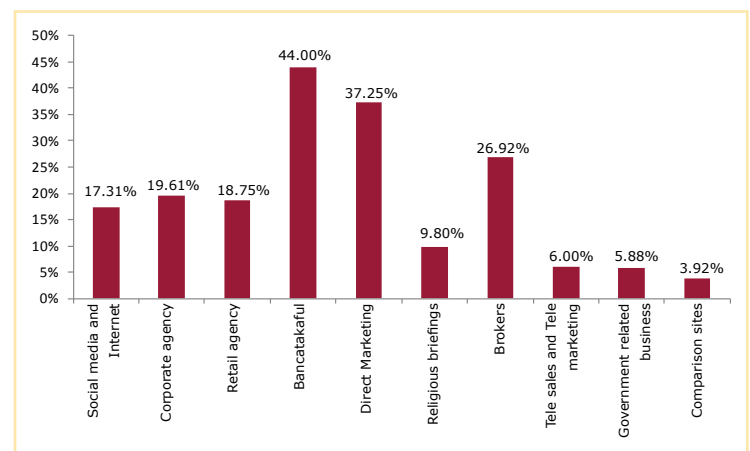
etc. The collaboration between Islamic banks and takaful operators can enhance the bancatakaful's potential to grow and strengthen its presence within the industry. This collaboration will combine value propositions of both Islamic banking and Takaful sectors such as strong linkage with the real economy, risk sharing, and effective risk management, etc.

Bancatakaful has gained momentum in recent years with an increasing number of Islamic banks and financial institutions that have widened the horizon of bancatakaful. It has become one of the main leading distribution channels in GCC and Southeast Asian markets, particularly for Family Takaful products.

Bancatakaful as an Optimal Distribution Channel for all Stakeholders

Banks and takaful operators' collaboration can add value for banks, takaful operators and their customers. Hence, all partners leverage from each other and bancatakaful makes sense from all perspectives. Bancatakaful is expected to be the most important distribution channel in terms of achieving higher revenues (see Figure-2).

Figure 2: Top takaful distribution channels as future revenue drivers



Source: CIBAFI (2017)

The target market is easier to reach via bancatakaful as people seeking Shariah compliant products are connected with the Islamic banks that are providing such bancatakaful products. It thus creates a synergistic effect and offers wide-ranging advantages to participants from financial, functional and marketing perspective. From the perspective of Islamic banks, they can differentiate their business activities through bancatakaful. It enables Islamic banks to further increase their offerings and allow customers to meet all their financial requirements from a single provider. Some other benefits can be summarised as follows:

1. Bancatakaful increases productivity of sales teams because of minimal distribution cost.
2. Islamic banks can benefit from takaful operators' extensive knowledge of bancatakaful products.

3. Bancatakaful can be an additional fee based income and a way of creating a new revenue flow for banks. As such, it helps in maintaining their income stability.
4. It helps retain bank customers and enhance customer loyalty with longer duration takaful product contracts (investment linked family takaful products, etc.).
5. Banks can give a positive image to their customers because of bancatakaful product offerings and increased the range of products.

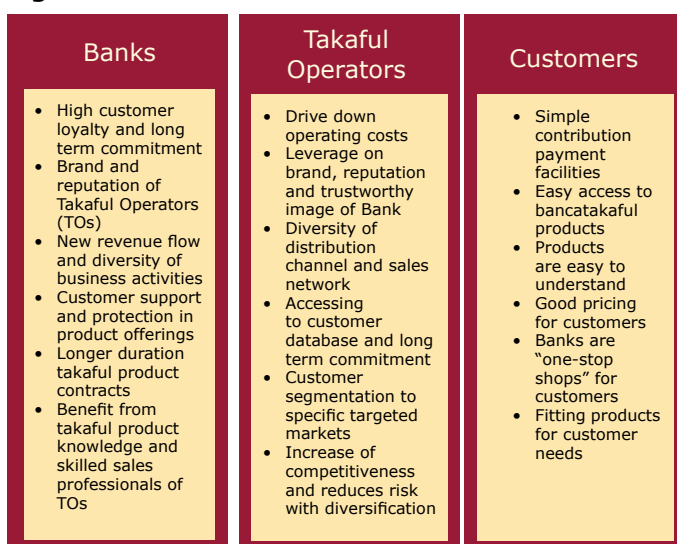
Bancatakaful also offers advantages to takaful operators. For example, takaful operators can employ different distribution channels and extend their customer base through the banks' developed branch network and customer contacts. The capability to tap into Islamic banks' customer bases is a major motivation for the distribution of mass-market offerings. Some of the advantages for takaful operators can be summarised as follows:

1. Takaful operators can design their products for specific targeted markets by extracting important information from the bank's clientele such as customers' gender, age and social-economic life differences, etc.
2. Takaful operators benefit from brand recognition and reputation of banks and their service reliability.
3. Cost saving and improved distribution efficiency increase the competitiveness of the takaful operators.

Bancatakaful also can provide great benefits/advantages to the customers. Customers have convenient and easy access to a range of integrated bancatakaful products from a single provider or they can also gain access through their trusted bank's brand.

Moreover, contribution payment facilities are easy for customers since they are collected directly from their accounts. Bancatakaful products can be easily understood and can meet the diversified financial needs of the targeted segments such as wealthy customers, mass-affluent customers, and retail customers. In addition, attractive pricing of bancatakaful products is also one of the important incentives.

Figure-3: Benefits of Bancatakaful for Stakeholders



Key Growth Drivers: Factors for Strategic Partnerships

The strategic partnership between takaful operators and Islamic banks may help to sell takaful products at a faster pace and increase takaful penetration in the market.

It is a fact that success of the takaful partnerships depends on creating the right business model in line with transparency, and mutual benefit.

This partnership may consist of clearly well-defined interfaces and responsibilities in the relevant processes (See Figure-4).

Figure4: Factors for successful relationship



Source: CIBAFI, RGA (Reinsurance Group of America) Europe Quarterly (2016)

The partnerships must offer equal benefits to both parties and there should not be any sort of biasness to favor one party on the cost of other. The strategy formulation should ensure a win-win situation. The partnership deed must clearly explain the decision-making process, associated benefits and risks and division of responsibilities, etc.

Bancatakaful has not fully developed in all jurisdictions yet. It is not easy for the industry to understand the reasons behind the slow progression in some areas.

However, some factors that foster or hinder the progression include legal, regulatory and taxation framework, market characteristics, customer habits and size of banking and/or insurance networks.

The keys to success are several, and sometimes unanticipated because of the differences in country-related dynamics such as socio-economic situation, history, prevailing regulations, tax structure, and business culture, etc.

Before embarking on creating a model and collaboration, below are some important questions that need to be answered by banks and takaful operators for a successful and mutually beneficial partnership:

- What are the objectives of the partnership?
- Do the partnership support cooperation and growth objectives?

- What are the motivations and needs of the other party?
- How will the relationship operate at a functional level?
- Will the relationship offer traditional, new or combination/tailored products?
- What is the role of participants in branding?
- What is the role of Takaful operator's staff in managing of sales channel?
- How will the sales approach be (responsive, proactive etc.)?
- What governance and operating models will be implemented?
- What are the sustainability requirements for a mutually advantageous relationship over the long term?
- How is Shariah compliance ascertained and not compromised in the course of the relationship?
- How is divergence a divergence of business strategies and conflict of interest managed in a bancatakaful set-up?
- How is bancatakaful affected when Family and General Takaful are segregated?

Adoption of Suitable Bancatakaful business model

The form and structure of the bancatakaful partnership arrangements between Islamic banks and takaful operators may differ in different regions according to respective legal frameworks, market conditions, level of development of the partner entities, internationalisation of operations etc. In addition to this, product types, customer segments, bancatakaful stakeholders' needs also affect the choice of the bancatakaful model.

Takaful Subsidiaries (Integrated) Model: This model may offer the greatest potential for long term growth. In this model, Islamic banks establish or acquire their own takaful providers and bank branches distribute selected takaful products. The result a deep operational integration within every aspect of partnership creates synergy and minimizes cultural differences between partners and support personnel. This appears to be gaining popularity among a number of Islamic banks and conventional banking giants that distribute Takaful products to their clients in the GCC, Malaysia and the UK.

Direct Selling & Agency Model: In this model, the bank acts an agent for the takaful operator and distributes takaful products for a commission. This model is relatively quick, easy to set up and gaining more importance for developing a customer-orientated bancatakaful franchise. However, employment of this model requires a high level of product knowledge and cross-selling skills. Bancatakaful sales professionals and operators must be proficient to reduce the risk of mis-selling. This model is popular in a number of countries, including those with large Muslim minority populations who are currently unable to insure themselves through conventional insurance products.

Implant & Joint Venture Model: This model is effective in optimizing the real potential and offering personalized services to customers. It is based on the establishment of a joint venture between a bank and takaful operator for developing the products in accordance with the needs of the bank's clients and the nature of the bank's other products. Bancatakaful products can be stand-alone or integrated with other banking products. Compared to other business models, this model avoids any conflict resulting from negative staff interactions and also reduces other risks associated with the business. It has demonstrated a real success in the GCC region.

Open Architecture Model: In this model, banks work with multiple takaful operators. Some studies state that bancassurance multi-channel and multi product strategies are considered one of the key factors for future successes. Hence, some strategic alliances such as "open architecture model" started to develop in different bancassurance jurisdictions such as India. A shift from the product focused cross selling to customer focused cross selling has been observed.

However, experience with conventional bancassurance indicates different models have possible disadvantages. These include the following:

1. Where the model relies on mainstream banking staff to sell the takaful product, they are likely to be less expert than specialist takaful sales staff. This increases the risk that the customer will be sold an inappropriate product.
2. Limited knowledge and cross-selling model make it difficult to undertake detailed underwriting, for example, to consider medical data. Where protection is an important part of the product offering, this can lead to adverse selection and higher prices for the better risk customers
3. Because the bancatakaful model relies on a close alliance between the bank and the takaful operator, banks will in general offer only the products of one operator. This has disadvantages for the customer, at least in environments where there are other distributors (brokers or financial advisers) who can offer a wide range of products.
4. Managing a takaful subsidiary or even a close relationship with a separate takaful operator requires significant management resource from the bank, and may distract their focus on the banking business.
5. In the model in which the bank works with multiple takaful operators, closing the deals process may become a very long process, such as investigating various products offered by Takaful operators. This situation would make the bank a crowded place.

Experience in the conventional industry suggests that the benefits of bancassurance outweigh the associated challenges where consumers are accustomed to visiting banks for seeking financial advice, and where banks are already geared towards wealth management, with the knowledge of investment products that this implies.

Table-1: Advantages & Disadvantages of Bancatakaful Models

| MODELS | ADVANTAGES | DISADVANTAGES |
|------------------------------|---|---|
| SUBSIDIARY/ FULL INTEGRATION | <ul style="list-style-type: none"> -Potential for long term growth and suitable for larger banks -Demonstrating advanced performance -Very little risk of cannibalization of customers by competitor -Products are fully integrated into the bank's savings / investment products -Mostly medium/long term tax advantaged investment offerings | <ul style="list-style-type: none"> -As a large investment, it requires significant management resources from the bank -It may distract bank from their focus on the banking business. |
| AGENCY / DISTRIBUTION | <ul style="list-style-type: none"> -Operations start quickly and easy to set up -Suitable for mid-sized banks -No capital requirement -It is less costly compared together models | <ul style="list-style-type: none"> - Lack of flexibility in the new offerings, -Professional difficulties and increases risk in product selling. -Banking staff is likely to be less expert than takaful sales staff -Involvement of bank is low level. -Training of sales team is an expensive to process and difficult to undertake detailed underwriting. |
| IMPLANT/JOINT VENTURE (JV) | <ul style="list-style-type: none"> -It avoids conflict from negative staff interactions and reduces business risks -More inclusive and intricate relationship -Suitable for larger banks -Gives income plus profits -Better control on service levels | <ul style="list-style-type: none"> -Requires a high level of product knowledge and selling skills -Difficult in management -Complex product packaging -Banks offer only the products of one operator. |
| OPEN ARCHITECTURE MODEL | <ul style="list-style-type: none"> -Offering opportunity for products through many banks with multiple tieups -Simple products only -No risk for insurance operations | <ul style="list-style-type: none"> -No long-term commitment - the Deal process is very long (i.e. investigating products) -Bank is a crowded place for many products by some clients. |

example, Bank Negara Malaysia (BNM) regulates the bancatakaful sector and aims to make gradual changes such as operating flexibility, product disclosure, and limitations on commissions etc.

2. Human resources and optimizing Incentives

Skilled staffs' availability is highly essential within the Takaful sector for designing/ offering appropriate bancatakaful products. Bancatakaful requires effective training to be included in the general banking curriculum, with emphasis on developing cross-sell opportunities and bundling bank and insurance products.

Incentives for front-line staff can strengthen sales and marketing capabilities and improve the performance of the bancatakaful partnerships. These can include establishing appropriate specific goals and key performance indicators (KPIs) as well as compelling individual and team rewards that focus on the long-term value creation.

Challenges and Opportunities in Bancatakaful

Despite the successful growth, a number of challenges are faced by the bancatakaful industry players that inhibit them from accomplishing the full potential. Some of these are discussed below:

1. Regulatory and Legal Framework

Bancatakaful needs a set of regulations in different jurisdictions to facilitate bancatakaful offerings. There are only some countries such as Bahrain, Malaysia, Pakistan, United Arab Emirates (UAE) and Jordan that have specific Takaful laws and regulations. Legal frameworks that govern the insurance and distribution of takaful products vary from country to country. Some countries have introduced bancassurance/bancatakaful regulations to varying degrees. For example, Bahrain has structured regulation for bancassurance based on an "Appointed Representative" model. However, banks cannot build partnerships with more than one insurance operator. The Insurance Commission of Jordan (ICJ) has issued the Bancassurance guidelines in 2011 to regulate the bancassurance/bancatakaful, aimed at developing and strengthening the collaboration between the banking and insurance/takaful sector.

The legal frameworks and the regulators' attitudes directly influence the model's conditions for success. These regulations should protect the economic and legal interests of banks' customers (ensuring accuracy and clarity within the documentation process, simplifying the process of acceptance of declarations) assuring adequate qualifications of bank personnel, setting appropriate customer service standards, preventing unfair market practices and ensuring that all personnel activities are performed with reasonable skill and care. In Malaysia, for

3. Technological applications

Technology and digital applications are key factors that lead towards the success of the bancatakaful industry. Lack of adequate technological systems for smooth implementation of policies, and addressing the prevailing regulatory issues is one of the key challenges faced by the bancatakaful industry. Digital technology deployment facilitates stability and provides continuity of service across all distribution channels. Moreover, it provides excellent services by consistently tracking the needs and preferences of their customers in real time. Innovation/digitisation has the potential to transform operational processes, and enhance the interaction with customers. Moreover, installing e-solutions to enhance the processing and speed up underwriting can also reduce expenses.

4. Increasing Customer Awareness

There is still lack of awareness and some misunderstanding among customers about the bancatakaful product features and particularly the family takaful products. To raise the awareness and promote full transparency, education is extremely important for consumers to be in a better position to select takaful products.

As a good example of customer education, Malaysia has initiated a Consumer Education Programme (CEP) on insurance/takaful. It is a joint effort between Bank Negara Malaysia (BNM) and the insurance and takaful industry. The programme is aiming for consumers to be in a better position to select products that best meet their needs as well as to understand their rights in the services and products of takaful / insurance¹.

1-Please see for more detail: <http://www.insuranceinfo.com.my>

CIBAFI BRIEFING

Bancatakaful: Building Synergies, Creating Opportunities

5. Customer Satisfaction is key to retention

There are two important points that the sector needs to consider while seeking to attain the growth objectives: i. proactively identifying suitable customers, and ii. understanding the consumer behavior drivers while developing bancatakaful partnership arrangements and products. In addition to this, simple and flexible bancatakaful product offering, providing reliable service, establishing call-back procedures, collecting customer feedback, reducing mis-selling and introducing resolution procedures for customer complaint would increase customer satisfaction and loyalty. Hence the responsibilities lie on both sides. Banks and takaful operators, both should provide more effective services by training the staff and equipping them with the latest knowledge of bancatakaful products to satisfy the diversified consumer needs.

6. The Role of Branding in Marketing Bancatakaful

Branding in partnership is important and could be considered as a viable competitive strategy to thrive in the local market. It plays a big role in bancatakaful commercial activities. A “white labelling” approach, in which the product is supplied by a takaful operator but sold under the bank’s name, can be useful in some business operations. However, it will do little to boost the takaful undertaking’s brand recognition. Furthermore, customers benefit from branding through different ways such as functional benefits and emotional benefits of offerings. Preferring the partners with strong brands will strengthen the competitiveness of Islamic banks and takaful operators.

Policy Recommendations and Key Messages

1. The bancatakaful sector can design great offerings to reflect the reality of the market environment and differentiate product types to reach different customer segments.
2. The sector should keep innovating around these areas to sustain the competitive positioning. In addition to this, they should invest in the best technologies to ensure combined systems that can be implemented successfully by either side to improve customer relationships.
3. Bank staff may be given appropriate training to cross-sell takaful products so that they can respond to any queries of the customers and can provide information to them on products according to their needs.
4. Banks and takaful operators need to work together in order to educate customers particularly in those markets where knowledge of such takaful products is not high.
5. Bancatakaful must have a regulatory framework and operational standards to foster sustainable growth. The framework for bancatakaful should ensure the protection of the economic and legal interests of banks’ customers.
6. Financial authorities may facilitate bancatakaful offerings based on a selected appropriate structure or follow common business models in their jurisdictions.

About CIBAFI

CIBAFI is an international organization established in 2001 and Headquartered in the Kingdom of Bahrain. CIBAFI is affiliated with the Organization of Islamic Cooperation (OIC). CIBAFI represents the Islamic financial services industry globally, defending and promoting its role, consolidating co-operation among its members, and with other institutions with similar interests and objectives. With over 120 members from over 32 jurisdictions, representing Islamic Banks, market players, international intergovernmental organizations and professional firms, and industry associations, CIBAFI is recognised as a key piece in the international architecture of Islamic finance. In its mission to support Islamic financial services industry by being the leading industry voice advocating regulatory, financial and economic policies that are in the broad interest of our members and that foster the development of the Islamic financial services industry and sound industry practices, CIBAFI is guided by its Strategic Objectives, which are 1. Policy, Regulatory Advocacy, 2. Research and Publications, 3. Awareness and information sharing and 4. Professional Development.

Contact Information:

General Council for Islamic Banks and Financial Institutions (CIBAFI) Jeera 3 Tower, Office 51, Building No. 657, Road No. 2811, Block No. 428 Manama, Kingdom of Bahrain. P.O. Box No. 24456

Email: cibafi@cibafi.org
Telephone No.: +973 1735 7300
Fax No.: +973 1732 4902
www.cibafi.org

Bibliography

- Affat (2016), Ronald Poon, Reinsurance Group of America (RGA): Bancassurance Trends and Best Practices.
- CIBAFI Global Takaful Survey (2017).
- EY Global Takaful Insights (2014)
- Finaccord Global Bancassurance Analysis (2013), Press Release
- IFSB IFSI Stability Report (2017)
- Jaffar, S. (2014). “Emergence of bancatakaful worldwide”, World Commerce Review.
- KPMG International (2016), The Power of Alliances
- Milliman (2017), Global Takaful Report: Market Trends in Family & General Takaful
- RGA (Reinsurance Group of America) Europe Quarterly (2016)
- World Bank (2012): Bancassurance Policy Research and Working Paper
- World Takaful Report (2016). Middle East Global Advisors.