Indonesia: Companies to assess the impact of spinning off their Syariah business units

Key takeaways:

- Insurers must separate their Syariah business units (or windows) into separate stand-alone entities.

  Key issues would appear to include a lack of skilled insurance professionals, higher capital requirements and operational costs, limits on foreign ownership and uncertainty regarding the single presence policy.
- Insurers can learn valuable lessons from the more mature takaful market in Malaysia, particularly with recent requirements for splitting composites.

In Indonesia, it is common for Islamic insurance, or Syariah business, to operate as a 'window' within a conventional insurance company. However, stand-alone Syariah companies exist too but these are in the minority. As at August 2018, there are 13 fully fledged or stand-alone Syariah companies compared to 50 companies with Syariah windows.

The Insurance Law enacted in 2014, mandates insurance companies to separate their Syariah business units from their conventional business (i.e., spin-off) when:

(a) The value of the tabarru fund and participants' investment funds have reached 50% of the aggregate insurance funds (including conventional funds); or

(b) Within 10 years after the enactment of the Insurance Law (i.e., by October 2024),

whichever occurs earlier.

The major players in conventional insurance also offer Syariah products through windows. Similar to conventional insurance the majority of Syariah business is unit-linked. As at October 2018, the Indonesian regulator, Otoritas Jasa Keuangan (OJK), stated that the majority of the companies had not yet started the process to spin-off their Syariah windows. There are 50 Syariah windows comprising 23 life windows, 25 general windows and two reinsurers with Syariah windows. These companies will add to the existing seven stand-alone life Syariah insurers, five stand-alone non-life Syariah insurers and one stand-alone Syariah reinsurer if all of them proceed to spin-off their Syariah business. The OJK has previously warned that companies who fail to meet the deadline risk having their Syariah licences revoked. In recent years, the OJK has provided recommendations, held workshops and consulted with the industry on the technical requirements that will support the spin off (e.g., covering infrastructure-related matters). However, the majority of companies has not started to consider the implications of spin-off. Several companies were reported to have started, but not all have successfully completed the process due to various issues, including the lack of clarification on foreign shareholding limits. Thus far, only a few of the local insurance companies have completed a successful spin-off of their Syariah windows, including Jasindo Syariah and PT Asuransi Jiwa Bersama (AJB) Bumiputera.

This regulatory development is expected to change the market and product landscape in addition to strengthening the overall industry and enhancing its long-term sustainability. However, despite the initiatives by OJK to hold industry workshops in 2018, any further guidance to industry players on how they should spin-off their business has been limited. In 2016, the OJK, issued *Regulation No. 67/POJK.05/2016*. This regulation requires insurers to submit a business plan giving information on how the Syariah window will be divested, the step plan and timeline for the spin-off. The business plan must be approved by the company's shareholders and Board of Directors and submitted to the OJK. The business plan must be submitted within three months after satisfying condition (a) above or by October 2020 if condition (b) applies. As reported in the Asia Insurance Review in early December 2018, the chairman of the Indonesian Syariah Insurance Association (AASI) stated that insurers with Syariah business units should conduct feasibility studies covering the following six areas prior to the spin-off:

- Business and strategic plans
- Capital
- Legal aspects
- Licensing
- Information technology
- Human resources

Such planning would enable insurers to assess the viability of spinning off the Syariah business units and the timing that may suit specific companies. The AASI are also researching a blueprint for insurers spinning off Syariah windows which it expects to finish by 2020.

What does this mean for companies with Syariah business units in Indonesia?

In our view, a feasibility study, which would include an assessment on the development of a business plan with projections of expected growth and projected capital requirements, is essential to helping companies evaluate the viability of spinning off their Syariah business units. If the expected future growth of the Syariah business is not likely to be sufficient to finance the capital investment and on-going solvency requirements, then it may be more practical to divest the Syariah business rather than conducting a spin-off. This is similar to the recent experience in Malaysia, where companies either sold their general takaful portfolio or gave up their general takaful licence because of a regulatory requirement to split the composite business.

One of the key considerations for spin-off is the need for skilled insurance professionals – especially in the areas of human resources and actuarial – to manage the new Syariah entity. As part of the feasibility study, companies may wish to consider a shared service structure in the areas where this is permitted by regulations, to address the issue of scarce resources whilst trying to keep operational costs low. The lessons learned in Malaysia can help guide companies in developing optimal structures and to avoid pitfalls when setting up and managing a new Syariah operation. Early planning, communication and consideration of the transfer of existing employees in any spin-off will help to provide greater certainty to employees, particularly those who are currently managing takaful windows.

There are wider business, tax and legal considerations for the spin-off process, which should also be considered as part of any feasibility study, including the implication of any limit on foreign ownership (which is 80% for a newly established insurance company). If the conventional company has exceeded this 80% limit through ‘grandfathering’, then there needs to be clarification on the implication for any new stand-alone Syariah company. Companies spinning off their Syariah business may need to find a local partner to comply with this regulation, which may be challenging given the likelihood that there may be a limited number of local partners, especially those that may have access to distribution. Clarity on any restrictions around the single presence policy may also need to be sought. The timing of any spin-off may also need to take into account the dilution of earnings (relative to the existing conventional business), relative to the speed at which an attractive local partner emerges for the Syariah entity.

Although companies may strategically choose to delay the spin-off process, such a decision should be supported by a comprehensive feasibility study to assess the potential implications. Such an approach would also help to manage the expectations of various stakeholders in the decision-making process.

Lessons learned from Malaysia

Malaysia has the largest family takaful (Syariah) industry globally, which has evolved and experienced significant changes in the last decade. Takaful business in Malaysia is governed by the Islamic Financial Services Act 2013 (IFSA2013), which is separate to the Financial Services Act 2013 (FSA2013) which governs conventional insurance business.

Malaysia prohibits the ‘takaful window’ structure, thus companies are required to have a separate operating licence and paid-up capital to sell takaful business. Consequently, there are many companies operating in Malaysia with two separate licences for their conventional insurance and takaful business. Over the last decade, the regulator, Bank

Negara Malaysia, has issued several new takaful licences, resulting in various multinationals entering the takaful market. The decisions of multinationals to enter the takaful industry in Malaysia has also been supported by a feasibility study or business plan which has helped shareholders to understand the dynamics of a takaful business and which was subsequently leveraged and used for the licensing process.

Prior to 2018, most takaful companies operated as a composite, selling both family takaful and general takaful business under a single licence. The IFSA2013 prohibits composites and all existing composite companies were required to split their licences by mid-2018. The requirement to split the composite business translates to companies having to hold separate capital requirement of RM100 million (circa US$25 million) for each of the family takaful and general takaful entities. Most takaful companies in Malaysia have a larger portfolio of family takaful business compared to their general takaful business, and as a result, many takaful composites had to re-assess whether it was financially viable to continue selling general takaful business via a stand-alone entity. A number of takaful companies deduced that it was no longer financially viable to sell general takaful business given the small general takaful portfolio and the high capital requirement after the split. As a consequence, the number of general takaful providers in Malaysia was halved from at least eight providers (as composites) in 2013, before the enactment of IFSA2013, to only four general takaful providers at the end of 2018.

Despite being the largest family takaful industry globally, the takaful industry in Malaysia continues to face a shortage of good quality and experienced human resource professionals. There are several companies in Malaysia which operate their conventional and takaful businesses on a shared service basis for certain functions, where this is permitted by the regulations. This shared service approach has enabled companies to leverage on the experience of the conventional industry, particularly where experience has been limited for takaful. Some employees also find a shared service structure more attractive, as it gives them valuable exposure and experience to both conventional insurance and takaful industries. On the other extreme, we observed there are companies which operate on a much more limited shared services structure. The benefit of such structure is that it provides greater autonomy to the takaful company in developing strategies that would be more specific to the takaful industry.

We have also observed there are takaful companies in Malaysia that are required within their group to sell similar products as their conventional counterparts. Such approach to selling similar products may be driven by the need to manage distribution efficiently. However, this approach often results in limited product innovation for the takaful company.

Next steps for companies considering a Syariah unit spin-off

Given developments in 2018, it is timely for companies in Indonesia to consider the impact of spinning off their Syariah business in 2019. As suggested by AASI, a suitable next step would be to conduct a feasibility study covering business and strategic plans, and the requirements on capital, legal, licensing, as well as operational aspects (e.g., information technology and human resources), which will help the management and the Board of Directors to assess the requirements and the viability of spinning off its Syariah business.

Milliman is well-positioned to support you in conducting such feasibility studies. We have in-depth knowledge of the insurance and Syariah market in Indonesia, a significant understanding of takaful business in Malaysia and globally, and strong experience in strategy work in Asia. The valuable lessons learned from the takaful industry in Malaysia can help support companies in Indonesia when conducting their feasibility studies and developing the business strategies and planning in the spin-off of their Syariah business units.

For more details on how Milliman can help you spin-off a Syariah business unit, please contact:

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