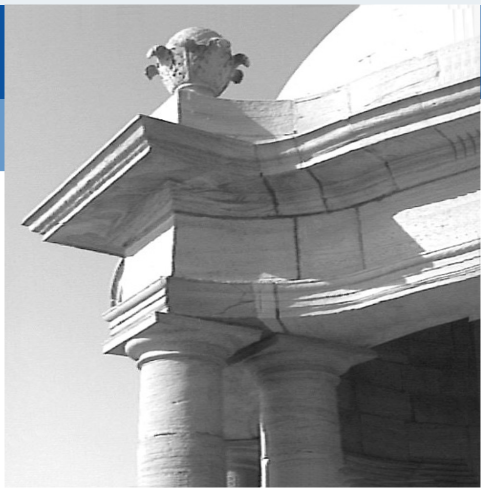


LIFE INSURANCE FAMILY TAKAFUL

Rating Methodology

The primary objective of ratings in the life insurance sector is to provide an independent assessment of the company's ability to pay promised benefits in addition to maintaining its competitive position in terms of providing return on investment linked policies. Similarly, assessment of a Family Takaful firm takes into account the capacity to meet obligations to Takaful pool participants. Key differences between general and life insurance are tabulated below:

	Life Insurance / Family Takaful	General Insurance / Takaful
Scope of risks	Under this contract, life risk of an individual is covered. This includes risk of death and disability.	Under this contract, all risks other than life insurance are covered such as those belonging to fire, marine, health and motor segments.
Term of contract	It is long term in nature and is not renewed annually. It expires only in the case of death of the insured or in the case of a lapse.	It is a short term contract which is renewed annually. Renewal terms are agreed upon beforehand.
Claim Payment	Claims are payable at the time of either an event occurring or on maturity.	Claims are only paid on the occurrence of uncertain event.
Savings & Contract Type	Life insurance includes a component of savings and is considered a form of investment.	There is no savings component in general insurance. It is a contract of indemnity.

OVERVIEW OF TAKAFUL AND FAMILY TAKAFUL

Before going further into a more detailed discussion of the factors considered in rating a life assurance company or Family Takaful firm, it is important to lay down salient features of Takaful and Family Takaful.

Takaful is a Shari'ah compliant arrangement whereby individuals in the community jointly guarantee themselves against future losses or damages. There are two main models of Takaful, namely:

- Wakala Model
- Modaraba Model

A third model is a hybrid of the aforementioned Wakala and Modaraba structures.

The rationale behind the Takaful model is to eliminate the elements of i) Al-Gharar (Uncertainty) ii) Al-Maisir (Gambling) iii) Al-Riba (Interest) prevalent in conventional business models. In principle, the Islamic model is based on mutual cooperation, responsibility, assurance, protection, charity and assistance between groups of participants. The Takaful model actively strives to avoid any possible exploitation of either party i.e. policyholder or shareholder. The primary difference between life insurance and

Family Takaful is that while in the former risk is assumed by the insurance company, in the latter it is shared among the participants through formation of a risk pool managed by the Takaful operator.

The only permissible mode for Takaful companies in Pakistan is the Wakala Waqf model. In this model a separate Waqf (Trust) is incorporated from discretionary Qarde-Hasna/donation made by takaful operator/shareholders. The Waqf has ownership of the Takaful pool assets.

As per Takaful Rules 2012, Participants' Takaful Fund (PTF) is created to which risk related contributions are made. Family Takaful operators also form a separate Participants' Investment Fund (PIF) to which investment related contributions of participants are made.

Apart from contributions from participants, inflows of PTF also include claims received from retakaful operators and share of retakaful pool surplus (profit commission) paid by the retakaful operator while outflows include claim benefits and Takaful pool surplus paid to participants, contributions to retakaful pool and wakala fees to Takaful operator. Wakala fee is paid out to the Takaful operator in lieu of administrative, investment and operational expenses incurred in managing the Takaful pool. The Takaful operator charges separate management fees for managing funds of PIF. In Pakistan, the principal operational model for Family Takaful risk management is based on the concept of wakala, whereas the investment management function is being managed on the basis of modaraba arrangement. The PTF, PIF and Shareholders Fund (SHF) are organized as independent funds.

As per Takaful Rules 2012, when the PTF including reserves is insufficient to meet current payments less receipts, the deficit is funded by way of a markup free loan (Qard-e-Hasna) from the SHF. Fund flow of the PTF also includes receipt and payback of Qard-e-Hasna from/to the shareholders' fund. Surplus of the PTF may be distributed to pool participants after recommendation of the appointed actuary and approval of Shariah Advisory Board and the Board of Directors. While surplus can only be distributed after the full amount of Qard-e-Hasna has been paid back to SHF, payback of Qard-e-Hasna is however subordinate to payout of claim benefits.

In analyzing the financial strength of a Takaful company, it is important to view the operator and the funds as individual components as well as on a combined basis. This tiered analysis is undertaken to ensure that sources of the Takaful firm's strengths and weaknesses are fully understood.

BUSINESS MIX

Life insurance and Family Takaful companies provide coverage to both individuals and groups. Individual life/Family Takaful risks are more granular and long tailed compared to Group life/Family Takaful risks which are short-tailed exposures. Individual regular premium/contribution polices are considered to be the lifeblood in life assurance/Family Takaful business due to their relative stability and generally higher persistency rate.

Life insurance policies can be classified into permanent/temporary & participatory/ non-participatory. There are also several other subclasses including variable, universal life, variable universal life, whole life, unitized variable, endowment, etc.

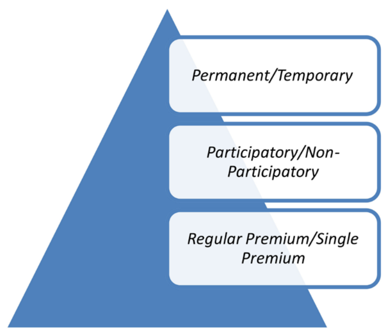


Figure 1: Classification of Life Insurance / Family Takaful Policies

Permanent/Temporary

Temporary life assurance policies are term assurance policies that provide coverage for a specified period of time. The beneficiary is entitled to a benefit in case of death or other insured event during the active period of the policy and will receive nothing on maturity as these have no cash value. Temporary policies are generally renewable. Such policies are widely offered in the group category.

On the contrary, permanent life assurance policies may remain intact till the death of a policyholder or the occurrence of the insured event. Endowment, which is a type of permanent life insurance, also has a specified term; at maturity the insured receives total sum assured. Unlike term policies, permanent policies also carry a cash value. These can be cancelled by the insurer only in case of non-payment of premium or detection of fraud/material misrepresentation by the policyholder. Policyholders have the option to surrender the policy prior to maturity and receive the accumulated cash value. In the local context, permanent policies are largely offered to individuals and mostly have a unit linked structure.

Participatory/Non-Participatory

Participatory policies share underwriting surplus with participants and are also called with-profit policies. Profit may be distributed in the form of bonus/dividend which may be added to sum assured or units held by the insured or paid out to policyholders in the form of cash. Family Takaful model is principally closer to the participatory form of life insurance.

On the contrary, non-participatory life insurance policies are ones in which the benefit is paid only when the policy matures or in case of the death of the life insured. The insured does not participate in the profits of the company and hence is not paid out bonuses or share in profit.

Regular/Single

Based on premium/contribution collection, life assurance/Family Takaful policies may also be segregated into regular premium/contribution and single premium/contribution. Single premium policies entail one time premium payment that is invested in funds while regular premium policies entail premium payment over the life of the policy and constitute major proportion of life insurance premiums. While regular premium/contribution policies provide a stable source of inflow to the insurance company/Family Takaful firm in the long run, single premium/contribution policies mitigate the risk of heavy payout in the event of premature death before substantial cash value has accumulated.

Single premium/contribution policies have lower policy administration cost as the entire premium/contribution is received on the onset of the policy eliminating the need for subsequent follow up. Single premium/contribution policies are more investment/savings focused which make them more prone to surrender under depressed market conditions while regular premium policies take time to build substantial cash values and are more protection oriented. Given that these policies almost entirely comprise investment linked policies, potential claims that a life insurance company can incur decline with life of the policy. Moreover asset risk stands transferred to the policyholder, particularly for policies where cash values exceed sum risk assured. Depending on portfolio allocation and sum assured of the policy, it usually takes a period of 5-10 years from issuance for the policy’s cash value to exceed sum assured. All investment linked policies generally expose insurance companies to a certain degree of market risk. Irrespective of the performance of underlying investments, the company has to pay the promised benefit in case of death or other insured event.

Other Riders to Life Coverage

In modern day life assurance, numerous innovative products are being offered keeping in view the requirement of customers. Life assurance companies offer customized plans like loan protection policy, micro-insurance, etc. There are also plans combining protection with a saving element. In addition to the basic cover, insurance companies offer riders that provide protection in the event of accidental death, critical illness, temporary and permanent disability, etc. Life insurance companies also write pension policies and provide standalone accident and health cover to clients. Disbursement of benefit may also vary from a one-time single claim to a series of periodic outflows (annuity) to the beneficiary.

Right Business Mix

From a risk perspective, an early death prior to receiving profitable level of premium would result in underwriting losses in that account. Similarly, prolonged life in pension plans may lead to an outflow of higher amount than originally estimated.

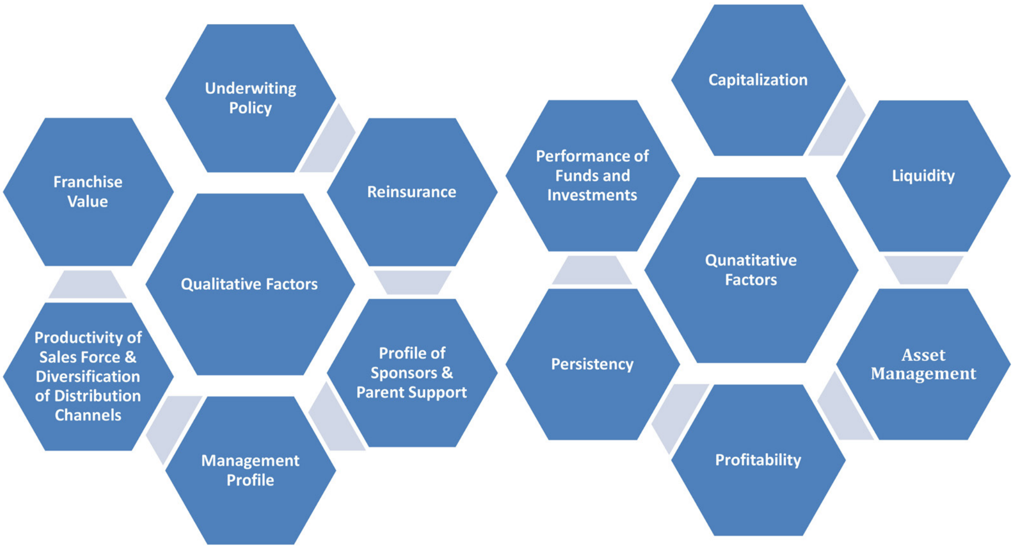
Therefore, the business mix has to be an optimal combination of individual and group, temporary and permanent policies, regular and single premium, life and saving products, etc. The mix would ultimately determine the company's future viability. High proportion of individual life/Family Takaful policies is an indicator of a healthy business mix and outreach of the company. Due to granularity of individual life/ Family Takaful risks and need for a sizeable distribution network to underwrite significant quantum of such business, optimal mix is generally evident in mature life insurance/Family Takaful companies.

ANALYSIS OF LIFE INSURANCE / FAMILY TAKAFUL

The following analysis is applicable to both life assurance companies and Family Takaful firms. Significant differences between the two models and specific risks of each and their impact on claim paying ability of companies will be specifically highlighted where needed.

A well-structured life assurance sector is vital to economic balance, as its ability to absorb risk and provide financial stability is a key contributor to socio-economic growth. The rating assessment conducted by JCR-VIS is on the waterfall model i.e. starting with an overview of the overall economy followed by dynamics of the industry and the company's own financial strength.

Macroeconomic metrics including GDP growth, inflation, per capita GDP, percentage of population under poverty line, markup rate scenario and depth in capital markets contribute towards an assessment of the overall economy. The impact of macroeconomic environment on the life assurance and Family Takaful industry, its supply and demand dynamics, its penetration in the country, elasticity of demand, barriers to entry, regulatory oversight and level of competition in the industry are some of the issues that assist in forming an opinion of industry risk. Depending on stage of development of the industry and its strategic importance, regulators impose certain restrictions or allow relaxations which have a bearing on the performance of industry participants.



Assessment of any company comprises an analysis of both quantitative and qualitative factors. Qualitative factors may include top management qualification, stability and experience, focus on training, growth potential of the company, vision and quality of strategic planning, control infrastructure and systems, board supervision and direction, productivity of sales force and diversification in distribution channels along with franchise value of company, level of sponsor support and credit worthiness of sponsors. Additionally, as life assurance companies also manage large investment portfolios, JCR-VIS assesses profile of the fund management team and the independence and quality of the fund management function.

For Family Takaful operators, additional focus is placed on profile of Shariah board members, systems put in place and training provided to ensure Shariah compliance and the infusion of Shariah guiding principles and knowledge of Takaful in the mindset of management as well as personnel/agents. In startup companies, higher weight is given to qualitative factors.

However, for a mature company, financial drivers serve as a major input to the rating process. Financial drivers include capitalization, liquidity, solvency, persistency, profitability, performance of funds under management and returns on investment portfolio. JCR-VIS also reviews the company's performance relative to its own strategic and financial objectives and also vis-à-vis the developments on an industry wide basis including any changes in the company's relative position in the industry.

Additionally, JCR-VIS also monitors the level of regulatory compliance, including solvency and minimum capital requirements, as failure to do so may lead to penalties or in extreme cases cancellation of license. Punitive measures taken by the regulators may also result in loss of brand value which may affect financial metrics like persistency and eventually profitability. Any changes in regulatory directives relating to pricing freedom, solvency margin, accounting norms and investment guidelines are assessed for impact on players within the industry.

UNDERWRITING POLICY

Sound underwriting policies and techniques are pivotal to the long-term viability of a life assurance company/Family Takaful firm. Claims can arise due to death, accident, surrender or maturity. In property and casualty insurance, due to absence of a statistically viable sample, it is more difficult to accurately assess probability of occurrence of events compared to life insurance where large data samples pertaining to mortality and life trends exist. Actuarial valuation on the basis of assumptions applied to these data sets can provide a reasonably good estimate of risks in life insurance. JCR-VIS assesses the quality of external actuaries based on franchise, reputation and quality of actuarial report, and relies on working, assumptions and conclusion of external actuaries regarding adequacy of reserves and determination of policyholder liabilities.

Comprehensive risk assessment procedures are important. Factors such as occupational profile, health conditions, male-female ratio and the age group would have a profound impact on the quality of the insured portfolio. Once the underlined risk has been evaluated, calculating an optimized level of premium in line with the level of exposure would determine the profitability of the company.

REINSURANCE

Reinsurance arrangements are an effective tool against large losses. The level of retention indicates the risk being borne by an insurer and should be assessed in conjunction with the financial strength of an entity. While, high retention levels might strain the balance sheet of a company and expose it to excessive levels of risk, low retention levels could lead to a compromise on profitability. A balanced approach, taking into account the company's size, is more desirable.

In mature life assurance companies, the proportion of individual business is generally considerably higher than group business. As a result, a large proportion of overall liability assumed comprises small sized risks, which are largely retained and as such the reliance on the reinsurer is limited.

JCR-VIS studies the underlying treaty terms before arriving at a conclusion regarding the adequacy of reinsurance available vis-à-vis loss probabilities. The financial strength and credibility of the reinsurer is also as important as the extent of reinsurance acquired.

While the number of Family Takaful operators is fast increasing, the availability of strong re-takaful operators remains a source of concern. A scarcity of suitable re-takaful can have implications for financial strength ratings where it exposes a company to re-takaful of inadequate financial strength. However, entry of credible international reinsurers with their re-takaful windows has helped in improving the situation.

DISTRIBUTION

A life insurer's key target market is individuals and penetration in this segment is pivotal. Therefore, a wide and strong retail distribution network is essential to build appropriate business volumes. An effective distribution channel would translate into sustainable growth and optimized distribution expense. Companies having presence in different geographical areas with a wide network of agents indicate a greater potential for growth.

Life assurance also demands consistent counseling and education to its potential customers before they can eventually turn into life-long premium yielding clients. This whole process requires proximity with customers and extensive personal efforts on the part of an agent. In case of Family Takaful, this also entails training and knowledge of Family Takaful and basic Shariah concepts. JCR-VIS measures the quality and productivity of the agents by measuring policies sold per agent per month; an important indicator in determining the agent's productivity ratio.

Although, core strength in distribution lies in the direct sales force (DSF) of a company but other channels may also provide relevant business support. JCR-VIS assesses the effectiveness of those channels with respect to cost efficiency, quality controls embedded and prior performance in marketing insurance products. One such channel bank assurance is assessed for the extent of networking of marketing banks and system support available. While business generation across different distribution channels varies with different industry players in case of individual life unit linked business, most of the growth in premiums/ contributions has been generated through the bank assurance channel in recent years.

FRANCHISE VALUE

The stability of an insurers' financial performance over a period of years eventually translates into a goodwill that is termed as the franchise value. Franchise recognition determines an insurer's ability to respond to market challenges, economic volatility and regulatory changes. JCR-VIS looks into the key elements that determine the credibility of an insurer in the eyes of the customer.

The quantity and quality of business underwritten at appropriate premium rates portrays the confidence level of the policyholder in an insurer. The bargaining power of companies with high franchise value should be reflected in their pricing structure. Such companies are expected to have ample diversification in their insured portfolio to mitigate potential risk and possible impairment.

JCR-VIS looks into attributes such as brand image, market position, market share, competitive advantage and bargaining power of an insurer. It is the combination of these elements that translates into higher franchise value.

In Family Takaful, composition of Shariah board is a key factor affecting its franchise value. Credible Shariah board members reinforce the confidence of participants' vis-à-vis Shariah compliance. JCR-VIS takes into account the individual professional profile of Shariah board members in finalizing ratings giving due weight to competence in their own field and familiarity with present day commercial transactions. As per rules Takaful companies undergo Shariah audit. The findings of Shariah audit are also given due consideration.

PARENT SUPPORT

Many life assurance companies are subsidiaries of bigger entities or backed by strong financial groups. JCR-VIS analyzes the economic incentive to the parent company to assist its subsidiary in times of stress, the subsidiary's strategic importance to the parent company and the structure of ownership, to quantify the degree of support.

The parent company's track record of support to the company and other subsidiaries, in terms of management control, startup capital and assistance under distress scenarios; all form crucial factors during the assessment process.

In local currency terms, as an issuer of currency and treasury instruments, JCR-VIS views the government to have the highest credit worthiness in the national economy. Institutions wholly owned or majority owned by the government derive significant strength from the relationship due to high probability of government supporting the institution in adverse scenario. Institutions having liabilities/obligations explicitly guaranteed by the government are assigned ratings which are at par with the sovereign. However, in such cases, a standalone assessment may also be made of the financial strength of the institution in the absence of government support.

MANAGEMENT CONTROL

JCR-VIS gives substantial weight to the management review of an insurer. Due diligence meetings are an integral part of the rating process and account for much of the qualitative assessment conducted by the rating agency. The standards adopted by JCR-VIS require the management to demonstrate high level of commitment to the establishment and possess adequate relevant experience and competence. The due diligence meetings provide insight into the strategic vision of the company's stakeholders, its growth plans, financial projections, long term goals and risk tolerance. Additionally, one to one meetings assist in assessing the cohesion of vision and strategic direction at all key executive levels.

JCR-VIS looks into the quality of management by assessing the experience profile, previous qualifications, turnover, succession plans, training methods, organizational structure and reporting lines.

JCR-VIS expects the management to be fair, transparent and conservative in its financial reporting policies. There should be adequate risk control systems incorporated in the organizational structure. It is for this purpose that the role and performance of the Management Information Systems (MIS) and the Audit department is an important area of due diligence. The control of the Internal Audit department should be comprehensive and reliable. JCR-VIS also reviews the reports of internal and external auditors to monitor compliance with all relevant policies and regulations and steps taken by the management to address critical issues highlighted in the management letter given by the external auditors and reports of internal auditors.

The extent of networking, timely availability of data, quality of MIS system and website, system security and backup data arrangements are fundamental in assessing Information Systems. It is important to evaluate the quality of software operational in the company. High level of automation and implementation of state-of-the-art computer application programs can reduce various risks of an operational nature at different stages of business generation.

In case of Family Takaful operators, a management team that is well versed with both the principles of Shariah as well as the fundamentals of insurance will be considered a positive rating factor. However, the rating does not comment on the degree of compliance of the takaful operator with Shariah guidelines. JCR-VIS places significant emphasis on non-financial risks in an Islamic Financial Institution (IFI), such as a Takaful operator being perceived as non-Shariah compliant. In their capacity as modarib or wakeel, a question on integrity of managers may have implications on franchise value of the operators and viability & sustainability of the Takaful Fund.

There are also wider issues concerning corporate governance such as any principal-agent issues that may arise. For a Takaful business, there may be heightened 'principal-agent' challenges if the Takaful operator does not suffer the negative consequences of poor underwriting. This depends on the kind of model adopted, with the more common relationship being that of a wakala between the takaful operator and the PTF and underwriting risk borne solely by the participants. The interests of the participants and the takaful operator may be more closely aligned in a modaraba relationship. Additionally, a company may be able to enhance commitment of the executive management by giving them a share in the profits of the company or a portion of the Wakala fees.

This in turn means that adherence to Shariah guidelines and principles of corporate governance will have a distinct bearing on ratings. Akin to Islamic banking where JCR-VIS views the management as 'modarib', we also appreciate the relationship of the management with the participants, in either its role as modarib or wakeel. We believe that it is important for the promotion of corporate governance, transparency and market discipline that a separate exercise for 'Management Quality Ratings' is undertaken for the Family Takaful operators.

ASSET MANAGEMENT

Modern day life assurance/Family Takaful companies are involved in extensive investment activities. A portion of premium/contribution received is invested into short, medium and long term securities to optimize overall life assurance/Family Takaful coverage. In addition to this, the level of insurance debt of a company is evaluated as an indicator of an insurer's cash cycle benefits. Presence of a quality investment management function in life assurance/Family Takaful firms is critical due to long term nature of policies underwritten. Substandard investment management may trigger withdrawals prior to maturity. Therefore, prudent management of the investment portfolio plays a key role in the overall sustainability of operations.

Investment policies, internal controls, quality of fund management function, profile of fund managers managing the portfolio, independence of the investment function, segregation of fund management of policyholders'/participants' investments and shareholders' investment portfolio, IT systems and MIS supporting the fund management function are critical factors in assessing fund management capability of the company. JCR-VIS gives due weight to market risk including impact of changes in interest rate and performance of stock markets. JCR-VIS assesses financial strength on the basis of market value of assets (where accurately ascertainable) and takes impact of any impairment/surplus on revaluation of assets. The proportion of high risk investments in the total investment mix is an important indicator of portfolio quality. Diversification, credit quality of securities and concentration levels in different asset classes and industries are also key portfolio valuation metrics.

Assessment of the investment management capability of a Family Takaful operator is undertaken on a similar basis. However, as Family Takaful operators can only invest in Shariah compliant securities, their investment universe is significantly limited because of an underdeveloped Islamic bond/Sukuk market and comparatively limited avenues for investment in stocks. This may lead to lower diversification, which has important implications for the overall risk profile of any Family Takaful operator. In the assessment of investment management, return on equity and market based benchmarks are compared with the performance of the company.

LIQUIDITY

Adequate liquid reserves are required to meet policyholder obligations in a timely manner. Primary sources of liquidity are underwriting cash flow and cash flow generated from investments. Presence of liquid investment portfolio is also a key rating driver. While investment in listed securities are treated as liquid assets, companies should ideally have adequate liquidity in near cash securities like term deposit receipts to meet any immediate cash flow needs triggered by large claims or unforeseen surrenders. In case of excessive surrenders, lapses or cancellation, stress on liquidity may develop and presence of credit lines may be a mitigating factor. For Family Takaful operators, JCR-VIS assesses liquidity of Participant's funds and SHF, both separately and on an aggregate basis in arriving at a final conclusion. The liquidity available with the company, in the form of liquid fixed term and equity assets, are compared with probable claims under stress conditions.

Aging of insurance debt gives a picture of the relationship of an insurer/Family Takaful operator with its reinsurers/re-takaful, co-insurers/co-takaful, agents and clients/participants. The adequacy of provisions against long standing insurance debt is assessed to arrive at any conclusion regarding balance sheet quality and sufficiency of liquidity available for future periods. JCR-VIS also reviews compliance with minimum solvency requirements set by regulators.

CAPITALIZATION

Capitalization provides a cushion against unforeseeable underwriting losses and volatility in investment returns. JCR-VIS monitors the regulatory compliance of minimum capital requirement by life insurance/ Family Takaful companies. However, the floor set by the regulators may not be sufficient in all respects and capital requirement may vary from company to company depending on its size and volume of business. Therefore, rate of internal capital generation and support from parent company may be seen as factors further supplementing a company's level of capitalization. In order to gauge the financial strength of a company, JCR-VIS also evaluates the level of capital cover available to the company on a risk basis assessed from probable liabilities occurring under stress conditions.

JCR-VIS uses a number of ratios to ascertain the capital requirement of a company. Key ratios among these are operating leverage and financial leverage. In a mature company, as a life insurer/Family Takaful operator underwrites and retains a larger number of risks, its capital should grow in tandem with growth in business and increase in policyholder liabilities.

For Family Takaful operators JCR-VIS takes into consideration both the size of takaful pool and its adequacy in meeting policyholder liabilities and the shareholders' fund which can finance any deficit (by giving Qard-e-Hasna) in the takaful pool. Support available to takaful pool is limited by size of the shareholders' fund as Family Takaful operators cannot engage in commercial borrowing.

Unlike conventional insurance, any surplus generated within the PTF is shared with the participants, which may prevent reserve formation. This risk is mitigated to an extent, as any surplus distribution is subject to approval of appointed actuary who takes into account adequacy of the Takaful pool reserve. Past experience as regards the underwriting quality and policy with respect to creation of surplus equalization reserve is considered very important in terms of future assessment of claims paying ability. This reserve would only gradually grow with time; depending upon the policy adopted by the Family Takaful operator/appointed actuary and any credit thereof is built accordingly into ratings.

In view of the practice of distributing surplus, the claims paying ability strictly from the PTF perspective may actually vary significantly from year-to-year and undertaking a firm-wide capitalization analysis is therefore considered more appropriate. JCR-VIS also considers the extent of ring-fencing amongst the surpluses generated by various products and the degree to which surplus from one may be used to offset the losses on others. A more rigid structure may result in a greater need to call for capital from the SHF. Leverage ratios, both operating and financial, are analyzed on a consolidated basis for the firm.

There is another critical difference between Family Takaful and life assurance companies. In Family Takaful model, wakala fees is transferred to profit & loss account irrespective of surplus/deficit in takaful pool while in life insurance capital transfer to shareholders' equity is subject to surplus in revenue account of statutory fund and recommendation of appointed actuary. While this may allow takaful operators to generate profit at a relatively earlier stage which may be distributed to shareholders, payment of wakala fee also weakens the takaful pool and it takes longer for the PTF to achieve self-sufficiency. In the conventional life insurance model, a larger amount of fund is allowed to be built in the statutory fund before any transfer is made to the shareholders' fund, from where this may be distributed. This may have implications towards risk assessment of a Family Takaful firm.

PROFITABILITY

The profitability analysis of a life assurance company is broken down into two parts, i.e. analysis of statutory fund performance and the performance of shareholders' fund investments. For Family Takaful firms the performance of PTF, PIF and Shareholders' fund are viewed on separate basis. Profitability is a function of underwriting and investment strategy. The choice of business segment, geographical outreach and diversification of underwritten risks are the key determinants of claim incidence, operating expenditure as well as the company's cash cycle.

In order to arrive at a true picture of earnings, it is important to capture the different components of the statutory fund and identify key areas that add to the overall profitability equation. In life assurance/ Family Takaful firms, actuarial valuation determines the reserves against policyholders' liabilities. It involves discounting all future inflows and outflows to arrive at a valuation surplus or deficit. The outcome of valuation determines the movement of funds from statutory to shareholders' fund or vice versa. It is equally important to review the cost and pricing structure against various risk exposures. JCR-VIS relies on opinions and working of external actuaries regarding adequacy of reserves to cover underwriting exposures. Trends in claims ratio and its volatility from year to year are monitored to draw important conclusions about the underwriting strategy.

Due to transfer of wakala fee irrespective of surplus/deficit in PTF, in the Family Takaful model followed in Pakistan, the gestation period for PTF to become self-sufficient may be longer. This will however also result in relatively higher profitability for the Family Takaful operator at an earlier stage. The long gestation period in life assurance renders continuity of policies a deciding factor in determining the profitability or at times even survival of the company.

High persistency rates may be critical to formation of a sizeable and self-sufficient risk pool. Even a prolonged deficit in statutory fund is reflective of weak underwriting performance and excessive burden on shareholders vis-à-vis capital contributions. It is for this reason that individual regular premium/contribution polices are considered to be the lifeblood in life assurance/Family Takaful business due to their relative stability. JCR-VIS considers persistency rate as a yardstick to determine policy retention levels. As a standard, persistency rate of 90% and above signifies strong business retention ability of an insurer. High persistency rate portrays the confidence level of policyholders in the company. Low levels of retention can hamper an insurer's profitability over the long run.

Finally, growth trends in terms of revenues can be a useful indicator to assess the overall direction of the company. In case of new entrants, JCR-VIS looks at run rate of business growth over smaller time periods (e.g. quarterly) to estimate their potential.

For Family Takaful, JCR-VIS will also specifically note the agreed fees or split of profits between the Takaful fund and operator. This is because neither fund is meant to generate excessive profits, at the expense of the other party.

As can be discerned from the above discussion, a number of factors are brought under review in determining an IFS rating. To be prospective, our appraisal is influenced not only by the current performance indicators, but also by trends and volatility and future business strategies. There is no prescribed mix of factors or achievement of specifications that will allow a company to receive a specific rating. It is the combination of quantitative measures and qualitative judgment that makes credit analysis a dynamics process JCR-VIS.

RATING SCALE & DEFINITIONS: INSURER FINANCIAL STRENGTH

AAA
Highest capacity to meet policyholder and contract obligations; Risk factors are negligible.

AA+, AA, AA-
Very high capacity to meet policyholder and contract obligations; However, risk is modest, but may vary slightly over time due to business/economic conditions.

A+, A, A-
High capacity to meet policyholder and contract obligations; Risk factors may vary over time due to business/economic conditions.

BBB+, BBB, BBB-
Adequate capacity to meet policyholder and contract obligations; Risk factors are considered variable over time due to business/economic conditions.

BB+, BB, BB-
Marginal capacity to meet policyholder and contract obligations; Risk factors may vary widely with changes in business/economic conditions.

B+, B, B-
Low capacity to meet policyholder and contract obligations; Risk factors are capable of fluctuating widely with changes in business/economic conditions.

CCC
Very low capacity to meet policyholder and contract obligations; Risk may be substantial.

CC
Weak capacity to meet policyholder and contract obligations; Risk may be high.

C
Very weak capacity to meet policyholder and contract obligations; Risk may be very high

D
Extremely weak capacity to meet policyholder and contract obligations; Risk is extremely high.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

Faheem Ahmad

President & CEO, JCR-VIS Credit Rating Company Limited
Founder, VIS Group
Chairman, Association of Credit Rating Agencies in Asia

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters Degrees in Engineering and Business Administration from USA. He could be contacted at faheem@jcrvis.com.pk

Javed A. Callea

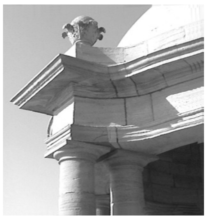
Advisor

Mr. Callea is a professional in the financial sector with over 35 years of experience mostly in the financial institutions with certain exposure to service and infrastructure sectors in Pakistan. He has held the position of Chief Executive of a leasing company for 10 years. His core areas of expertise cover leasing, development financing, project management, investment & merchant banking, strategic investment management and real estate. Major financial institutions he worked for include Pakistan Industrial Credit and Investment Corporation, State Life Insurance Corporation, Bankers Equity, Crescent Leasing Corporation and Saudi Pak Ind. & Agri. Inv. Company. He has also served as Member Finance of Water & Power Development Authority of Pakistan and as member of the Inquiry committee on stock exchange crises in 2000 commissioned by the SECP. He earned his MBA degree from the Institute of Business Administration in 1974.

Muniba Khan

Manager

Muniba Khan is involved in the credit analysis of various industrial companies and financial institutions. She has been associated with JCR-VIS since 2013 and her overall experience in ratings includes insurance, microfinance banks, commercial banks and manufacturing sectors. She holds a Masters degree in Business Administration from Institute of Business Administration, Karachi (IBA). She is also currently pursuing a Masters degree in Economics from IBA.".



Jahangir Kothari Parade

National Excellence, International Reach

JCR-VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

Jahangir Kothari Parade (Lady LLoyd Pier)
Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose genrosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.

JCR-VIS Credit Rating Company Limited

Technical Partners Islamic International Rating Agency, Bahrain
JV Partner CRISL, Bangladesh
Member Association of Credit Rating Agencies in Asia

KARACHI
VIS House - 128/C, Jami Commercal Street 14, D. H. A. Phase VII, Karachi - Pakistan

LAHORE
VIS House - 431, Block Q Commercial Area, Phase II, DHA, Lahore - Pakistan

CONTACT
E-mail: info@jcrvis.com.pk | Website: www.jcrvis.com.pk
Tel: (92-21) 5311861-70 Fax: (92-21) 5311872-73