

Are Takaful Operators at the Sympathy of Retakaful Operators in Malaysia?

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Abstract: The concept of insurance is novel and excellent, since it tries to help the participants in the case of misfortune. It is prohibited from the Islamic aspect because the practice of insurance involves interest, uncertainty and gambling. Takaful has been introduced as an alternative to insurance and at the same time, retakaful has emerged as an alternative to reinsurance. Unfortunately, due to the limited number of retakaful operators and over reliance of the takaful operators on the retakaful operators seem to create takaful operators helpless except to follow the demand of the retakaful operators. In addition, they have more bargaining power than takaful operators. This study provides the evidence that higher proportion of general takaful contribution goes for retakaful expenses. Thus, it is time for the takaful operators to realize that they are at the sympathy of retakaful operators and the former one needs to find an alternative retakaful method, for example retakaful pool method, apart from the traditional way of ceding their risks through retakaful operators.

Key words: Takaful, retakaful, uncertainty and gambling, insurance, Malaysia

INTRODUCTION

The takaful and retakaful industry is undergoing remarkable growth and development, since its debut in the early 80's. Though, still considered a nascent industry as compared to the more advanced and mature insurance and reinsurance industry, takaful and retakaful is evolving steadily through its own unique and distinct features as Shari'ah compliance. It is not enough for the takaful industry to survive and compete with the conventional insurance operators unless it has the viable business strategy in order to serve the socio-economic needs of the people. Nevertheless, much more need to be done to transform the takaful business to achieve the depth and breadth of its business appeal and market share, as well as to create value to the business for the benefit of the public and growth of the industry as a whole. Thus, efforts from researchers, scholars and practitioners are ongoing to redefine and refine the concepts, practices and applications of takaful and retakaful to place the industry on a strong footing and well positioned to contribute to the society at large.

The Shariah aspect of takaful and retakaful generally involves establishing the guiding principles of contractual relationships and obligations of the various parties, as well as determining the acceptable conduct and rules of the business. Operationalizing takaful and retakaful as a business endeavor on the other hand, requires different set of skills and expertise to ensure that takaful is a

profitable venture, benefiting all the stakeholders of the takaful business. However, based on the current practice of takaful operators to seek protection is mainly by contributing retakaful operating expenses and it seems that most of the takaful contribution is eaten up by the retakaful outgoing. Researchers believe that solely relying on the retakaful does not bring optimal benefits to the takaful risk fund. Therefore, the objective of this research is to highlight the problems and issues faced by the takaful operators in engaging and relying on the retakaful operators and to present how significant portion of the takaful contribution has to be allocated for retakaful expenses.

TAKAFUL AND RETAKAFUL

Insurance contracts contain the elements such as interest, uncertainty and gambling which are prohibited from the Islamic perspective. Due to that the prohibition of insurance has been gradually declared, for instance Muslim League Conference in Cairo 1965, National Fatwa Committee of Malaysia in 1972, OIC Fiqh Academy 1985 and etc. An alternative contract that meets the needs for insurance can be undertaken under the concept of takaful, whose contract is based on donation (uqudtabarruat).

Similarly, reinsurance has been prohibited from the Islamic perspective and as an alternative, takaful operators need to engage with the retakaful operators to

cede their risks. In other words, takaful operators need to manage the takaful risks against exposures to claims beyond the technical and financial capabilities of the takaful operator to underwrite the risks.

Retakaful can be arranged either on a proportional or non-proportional basis, each with its own unique features to cater to the varying retakaful needs of the takaful operators whether for the family, as well as general takaful business:

- Proportional retakaful in essence means that an identified proportion of the primary takaful risks is covered, sharing the takaful contributions and claims proportionately as well
- Non-proportional retakaful on the other hand is a method of retakaful which is not based on the original risk but rather to the loss amount. Here, the takaful operator retains losses up to a specified threshold and the retakaful operator is liable for the balance, up to the stipulated limit. The retakaful contribution is based on the share of the total contribution of the covered portfolio (Ferguson, 1980)

PROBLEMS AND ISSUES OF TRADITIONAL RETAKAFUL METHOD

Every unit of takaful contribution should be optimized for the benefit of the takaful risk fund which belongs to the participants. In practice, a sizeable portion of the contribution received shall be allocated to cover certain costs and expenses such as wakalah fees, acquisition costs, claims, retakaful, reserves and etc. If these costs and expenses in takaful risk funds are not prudently managed, it will strain the financial position of the takaful risk fund. One major cost to the fund is retakaful. In addition, the cost of transferring risks to retakaful is expensive and may in some cases be much larger than the actuarial price of the risk transferred (Cummins *et al.*, 2008).

Records from BNM (BNM) annual takaful reports (2002-2012) reveal that retakaful expenditure by the takaful operators in Malaysia for the last 10 years period was at an annual average of 25% of the gross general takaful contribution, against claims recoveries from retakaful amounting to only 36% of the retakaful contribution outgo. This simply means that out of every RM1 ringgit spent for retakaful cover, only RM0.36 was recovered from retakaful. From this statistics, it can be deduced that the current retakaful practices by takaful operators are inefficient and most importantly does not bring optimal benefits to the takaful risk fund. This practice surely

affects the growth potential of the nascent takaful industry in the long run.

Heavily involved in retakaful engagement may affect the solvency and liquidity of the takaful risk fund itself in meeting its obligations to the takaful participants. Due to the limited number of retakaful operators, they have the upper hand in dictating to the takaful operators what to write or what not to write as a pre-condition for coverage, thus inhibiting the independence of takaful operators to manage its business portfolio. In addition, the probability of retakaful failures to honor its obligations in a timely manner may create the credit risks to the takaful operators and consequently it will have negative impact on the solvency and liquidity position of the takaful operators (Yusof *et al.*, 2011).

In order to minimize the failure of retakaful operators' duty, Central Bank of Malaysia has provided the guideline regulatory framework for retakaful. Therefore, rather than relying heavily on retakaful operators to hedge their takaful risks exposures, takaful operators should embark on other prudential means, for instance, retakaful pool to achieve the same desired objectives.

RESEARCH METHODOLOGY

This research is written based on the secondary data collected by adopting the library research. Selected literature included is the books, articles and internet resources. This is the preliminary overview of the traditional retakaful engagement by the takaful operators with retakaful operators and thus it is believed that secondary data is the most suitable data for this study.

HIGHLIGHTS ON SPENDING ON RETAKAFUL EXPENSES

The purpose of this study is to highlight to what extent the retakaful expenses are incurred by the takaful operators. This study is written based on the annual reports of selected takaful Operators and BNM (2011). Sample takaful operators include STM (2011), Takaful Ikhlas (2011), Etiqa Takaful and CIMB AVIVA (2011), since they are the leading takaful operators in Malaysia.

Figure 1 shows gross general takaful contribution and retakaful expenses incurred by Syarikat Takaful Malaysia over the period from 2002-2011. It can be seen that the minimum amount of retakaful expenses is 66.10 thousands and the maximum amount is 131.90 thousands with the average amount of 94.01 thousands. The average gross contribution is RM313.72 thousands. On average, almost 30% of the general takaful contribution is allocated for the retakaful expenses.

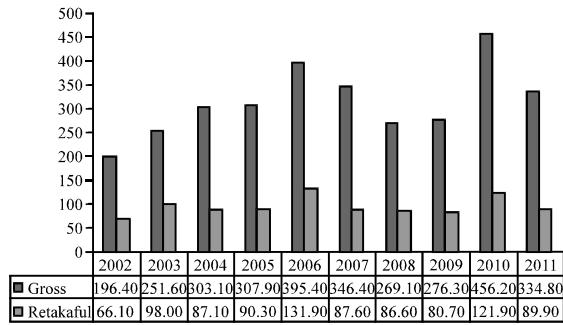


Fig. 1: Gross general takaful contribution and retakaful outgo: Syarikat takaful Malaysia (RM'000)

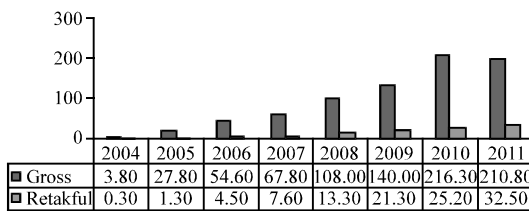


Fig. 2: Gross general takaful contribution and retakaful outgo: Takaful Ikhlas (RM'000)

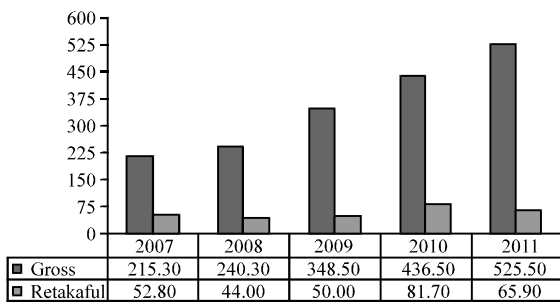


Fig. 3: Gross general takaful contribution and retakaful outgo: Etiqa takaful (RM'000)

Figure 2 shows gross general takaful contribution and retakaful expenses incurred by Takaful Ikhlas over the period from 2004-2011. It can be seen that the minimum amount of retakaful expenses is 0.3 thousands and the maximum amount is 32.5 thousands with the average amount of 13.25 thousands. The average gross contribution is RM 103.64 thousands. On average, almost 13% of the general takaful contribution is allocated for the retakaful expenses.

Figure 3 shows gross general takaful contribution and retakaful expenses incurred by Takaful Ikhlas over the period from 2007-2011. It can be seen that the minimum amount of retakaful expenses is 44 thousands and the maximum amount is 81.70 thousands with the average amount of 58.88 thousands. The average gross

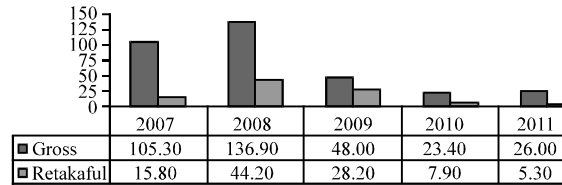


Fig. 4: Gross general takaful contribution and retakaful outgo: CIMB AVIVA (RM'000)

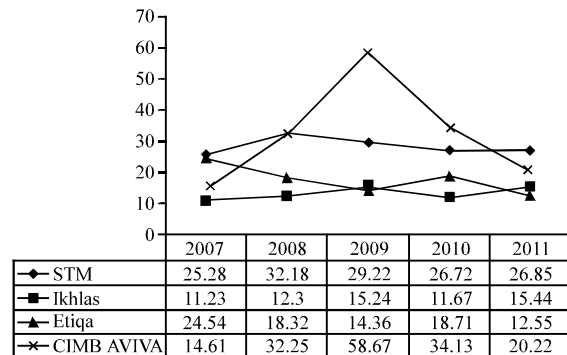


Fig. 5: Retakaful outgo as percentage of gross takaful contributions: Comparison among takaful operators

contribution is RM 353.22 thousands. On average, almost 16% of the general takaful contribution is allocated for the retakaful expenses.

Figure 4 shows gross general takaful contribution and retakaful expenses incurred by Takaful Ikhlas over the period from 2007-2011. It can be seen that the minimum amount of retakaful expenses is 5.30 thousands and the maximum amount is 44.20 thousands with the average amount of 20.28 thousands. The average gross contribution is RM 67.92 thousands. On average, almost 30% of the general takaful contribution is allocated for the retakaful expenses.

Figure 5 makes a comparison of the percentage of retakaful expenses of gross general takaful contribution among four sample takafual operators. It shows that CIMB AVIVA is generally ranked as the highest position in allocating retakaful expenses and it is followed by Syarikat takaful Malaysia, Etiqa and Takaful Ikhlaq.

Figure 6 shows gross general takaful contribution and retakaful expenses incurred by Takaful Ikhlas over the period from 2002-2011. It can be seen that the minimum amount of retakaful expenses is 94.40 thousands and the maximum amount is 440.90 thousands with the average amount of 226.59 thousands. The average gross contribution is RM812.64 thousands. On average,

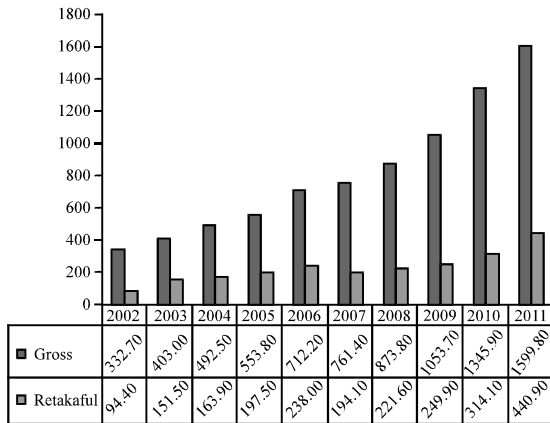


Fig. 6: Gross general takaful contribution and retakaful outgo: Overall takaful operators (RM'000)

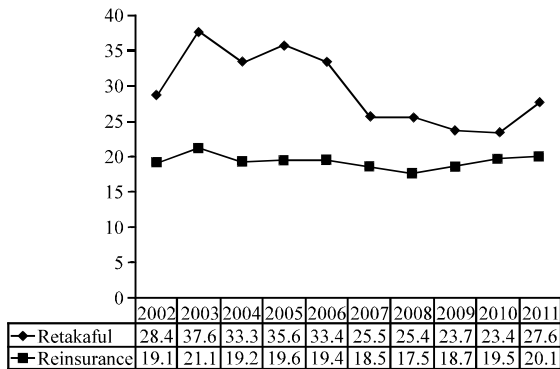


Fig. 7: Percentage of retakaful and reinsurance outgo against gross general takaful market contribution and gross general insurance market premiums: Overall takaful and reinsurance operators

almost 28% of the general takaful contribution is allocated for the retakaful expenses.

Figure 7 illustrates the comparison of retakaful and reinsurance expenses from the gross general contribution (premium) over the period of 2002-2011. It shows that takaful operators are allocating more retakaful expenses than insurance operators.

CONCLUSION

Takaful has been recognized as an alternative to the insurance and with the emergence of takaful industry; the retakaful industry plays the significant role to support the takaful operators. Takaful operators are required to comply with Shari'ah while taking into considering the efficiency and long term survival of the business. Therefore, this study tries to highlight that takaful operators are at the sympathy of retakaful operators due to the limited number of retakaful operators and overreliance on them. It has been evidenced that on the average around 28% of the gross general takaful contribution is used to pay the retakaful expenses. In addition, when the comparison is done (Fig. 7), retakaful expenses given by the takaful operators is much more than reinsurance expenses paid by the insurance operators. It shows that takaful operators should think an alternative how to manage the takaful risk fund efficiently and effectively since they are entrusted by the participants. It is expected that the highlights of this study will be the interest of the regulators, industrial players, participants and the society at large.

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