

# The Need for Retakaful and Available Capacities



Retakaful has come of age and is no longer the “missing link” in a takaful operation, says **Mr Chakib Abouzaid**, CEO of Takaful Re, in this summary of a speech at the World Takaful Conference in April.

The lack of capacity has, for many years, been one of the major challenges facing the takaful industry, and is also used an argument from some operators for not ceding their business to retakaful companies. However, recent developments and the emergence of new sizeable retakaful company is an opportunity for the whole takaful industry to have an integrated approach, and move to the next step, retrotakaful.

As the retakaful companies are new, there are legitimate questions about their solvency and/or ability to meet their commitments, the size of the consolidated capacities, whether the demand can fit, and whether the darura (religious necessity) can be used in the future in dealing with conventional.

### The Need for Retakaful

Takaful companies need retakaful as a technical requirement to spread the risk and avoid the insolvency risk. Therefore, takaful cannot survive without retakaful and/or reinsurance. However, the main question concerns the nature of retakaful. Is it a risk transfer or risk sharing?

Takaful and retakaful are risk-sharing operations even if formally the operation appears as a risk transfer. Takaful and retakaful providers are liable for all the claims

occurred and falling under the contract and in case of deficit, they must call their shareholders for a qard al hassan, and/or adjust the pricing for the new or renewed contracts.

From a Shariah point of view, takaful companies are obliged to comply with all Shariah requirements, including the retakaful. Using conventional reinsurance when unnecessary is harmful for the credibility of takaful.

In the past, the use of conventional reinsurance was dictated by the lack of takaful capacity and the necessity to protect the policyholder and shareholder’s funds. But now, with the number of retakaful companies increasing (six operators and three rated “A-” as of April 2008), is darura still the rule?

### Existing Operational Retakaful

The six existing retakaful companies in operation have a total paid-up capital of US\$375 million. Except BEST Re and Asean Retakaful International (L) Limited (ARIL), the rest are newcomers in the market, but backed by groups having a long experience, whether global (eg, Hannover Retakaful) or regional (eg, Takaful Re, Labuan Re and MNRB).

In the coming months, more operators (Saudi Re, Al

**Table 1: Retakaful Operators (as of April 2008)**

Company	ARIL	BEST Re	Takaful Re	Hannover Re	Labuan Retakaful	MNRB Retakaful
Incorporation	1997	1985	Dec 2005	Oct 2006	Company: 1992 Retakaful Division: 2007	Dec 2006
Capital (US\$million)	Paid-up: 14.1 Authorised: 50	100	Paid-up: 125 Authorised: 500	Paid-up: 55 Authorised: 150	Allotted but not called: 50 Issued & paid-up: 150	Paid-up: 31 Authorised: 154
Rating	Not rated	• BBB+ (S&P) • A- (AM Best)	BBB stable (S&P) stable	A stable (S&P)	• FSR A- (excellent) (AM Best) • IFS A- (stable outlook) (Fitch)	• Nil yet • A- (Parent company)
GPW for takaful (US\$million)	10.876 (2005/06)	10 – 12 (2005 est)	20.3 (2007)	15 (2007)	11.0 (2007 est)	Started operations in Aug 2007
Takaful Model	Mudharaba	-	Wakala policyholder’s Mudharaba for investment	Wakala / Mudharaba	Wakala for both retakaful and investment	Wakala, optional mudharabah/ wakalah on investment
Business Model	Takaful / Conventional Mix	Conventional / Takaful Mix	Takaful Co’s only outsourcing agreement with Arig	Takaful only	• Conventional • Takaful	Takaful cos only for treaty. Allowed fac on halal risk from conventional

**Table 2: Capacities of Retakaful Operators (as of April 2008)**

(US\$ million)	ARIL	BEST Re	Takaful Re	Hannover Re	Labuan Re	MNRB Retakaful
<b>Property/Eng</b>						
• Proportional	2	2	5	30 per program	3	3
• Non-Proportional	3	2	5		1	
<b>Marine</b>						
• Proportional	2		2	30 per program	1.5	3
• Non-Proportional	3		4		1.5	3
<b>Family Takaful</b>	0.1		1 per life	1 per life		1.66 to 3.33
<b>Fac capacity</b>						
• Property	12 PML	6	20 PML	30 PML	3	3
• Marine	12		4			

Fajer Retakaful and ACR Retakaful) are planning to start their operations, adding \$716 million in fresh capital to the industry.

With the addition of the newcomers, the retakaful industry will have \$1.09 billion total paid-up capital.

Except ARIL, all the retakaful players are rated “BBB” and above, and three are “A” rated companies.

The addition of total retakaful capital and rating confirms the existing retakaful financial strength, with good or very good claims paying ability, which is the main requirement from a reinsurer.

However, having an adequate capital and an acceptable rating cannot be considered sufficient to boost the development of takaful industry. Takaful requires capacity for all lines of businesses, including long-tail business and/or special lines. As the business is developing, additional capacity is needed and new lines of businesses require assistance from retakaful to the direct takaful. This remains lacking and to be able to play a major role, retakaful companies are required to move from a following to a leading position.

### Existing Capacities

The total of the six retakaful capacities (Table 2) may not be considered as the available retakaful capacity supply, as the companies do not always use their capacity in full because of the accumulation and their approach by market. In some cases, companies can offer more capacity depending on their appetite for business, existing accumulation or simply the level of support they are willing to provide to a sister company or a company with whom they could have excellent relations. Some companies may use proportional retro capacity to accept more business, which could increase the available capacity.

By presenting the available capacities, we could respond to an argument frequently repeated to justify the cession to conventional, and to demonstrate that retakaful companies are now able to absorb almost 90% of the required capacity for treaties.

Table 3 shows that only in very few cases of takaful or co-operative (KSA 1 & 2 and Far East 3), the available retakaful capacity cannot meet the demand, and this requires additional conventional capacity.

**Table 3: Sample Takaful /Cooperatives' Treaties Capacities**

US\$ million	Property	Engineering	Accident	Marine	Non-Marine XL	Marine XL	Motor XL
<b>Africa</b>							
Sudan	30.0	12.5	9.0		0.5	1.0	2.25
<b>Middle East</b>							
KSA 1	122.0	122.0		26.0			13.0
KSA2	60.0	60.0	10.0	8.0			4.0
Kuwait	11.2	11.2	1.5	1.5			1.5
UAE 1	34.0	34.0	2.5	8.5			2.5
UAE 2	17.75	17.75	20.5	2.4	4.0		
<b>Far East</b>							
Company 1	30.0	9.0	7.0	5.0			
Company 2	39.0	16.8	2.4	16.2	9.0		
Company 3	73.8	29.7	9.0	15.7	7.5		6.0

However, with the upcoming retakaful operators, available capacity will increase dramatically to absorb all the demand for retakaful treaty capacity.

On the facultative side, it is obvious that ceding to the international conventional market will remain necessary as the retakaful industry is part of the global insurance industry and, therefore, for areas such as mega projects, aviation and special lines, the co-operation between takaful and conventional is always required.

**Challenges For Retakaful**

Being a new industry, direct companies’ expectations of retakaful are huge. However, if the intention is for retakaful to replace the conventional, they have to move fast and provide the needed capacity for the development of the industry. The retakaful provider must price all lines of business and move from the follower position to lead the company’s programmes, and take advantage of the facultative business offered to them by assisting, pricing and writing substantial shares. Moreover, as the markets are developing, retakaful providers have to offer solutions for specific lines, and benefit from the bancatakaful by offering family takaful, PA or medical “on the shelf”, especially in the GCC with its booming medical, engineering and property lines.

Depending on their maturity, the level of development of the business model, and corporate strategy, direct takaful companies should have a dual strategy:

- For personal lines, to develop their offer on family takaful, medical and PA, all needed by the ceding companies;
- For industrial risks, the cumulative expertise build up to have the tools and the pricing models.

Whatever the choice made by their ceding takaful operator, the retakaful operator has to adapt its strategy to both strategies, to benefit from all offered opportunities. In the long term, personal lines will increase the awareness and therefore the potential market for takaful and retakaful.

Industrial and commercial risks are important for both takaful and retakaful; even if they are written by some companies because of the generated high volume of premium with small retentions and without expertise,

the retakaful company must accommodate their ceding companies, and direct them in pricing and underwriting such business. Both will build their expertise following a learning curve.

However, the most important challenge for retakaful companies in the coming years is to complete the takaful chain by creating the retotakaful capacity, which is now the missing link.

For the time being, retakaful can rely on the international market in the absence of Shariah-compliant retro, by limiting their retrocessions – as required by the scholars – to the non-proportional. This transition period must end soon as it is possible for the retakaful company to find ways of retroceding only to Shariah-compliant entities. This can be done through the launch of a syndicate and/or a pooling system with the inconvenience of accumulation and spiral within a small market segment.

**Conclusion**

Retakaful is no longer the “missing link” in the takaful operation. We have now six operational retakaful, four newcomers and global players’ windows.

The available retakaful treaty capacity exceeds the needs of almost 90% of the existing takaful operators. However, takaful will continue relying on conventional insurance for specialty lines and large risks, and retakaful will continue to rely on conventional for retrocession.

For Shariah compliance, takaful operators are required to cede to existing Shariah-compliant capacities, and darura is no longer invoked as a rule. The exception lies in large risks and/or special lines.

Retakaful companies have the hard task of reaching at least the level of their conventional counterparts, and this requires capacity, expertise and ability to accompany the direct takaful in their evolution by developing for them – and with them – new products, distribution channels (eg, bancassurance), and also enable them to reach the peak of the learning curve to become real risk takers.

Retotakaful needs to be addressed in order to complete the chain. However, if retakaful companies can still invoke darura, they have to apply to themselves the rule they want direct takaful to implement, ie ceding mainly to retakaful. Without this retro capacity, the takaful chain will remain incomplete.■

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