



## Issues and Challenges In Retakaful

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## Why Retakaful?

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- Same reason as takaful
  - Increase Capacity
  - Risk management
    - Spreading the risk
  - Will not make the "road" better but the "driving" smoother



## Why Retakaful...?

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- Profit Maximization?
- Growth of Sales
- Market Share
- Solvency



## Issues and Challenges

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- Technical Competence
- Syariah Competence
- Financial Strength
- Market
- Systems and Methods
- Cooperation

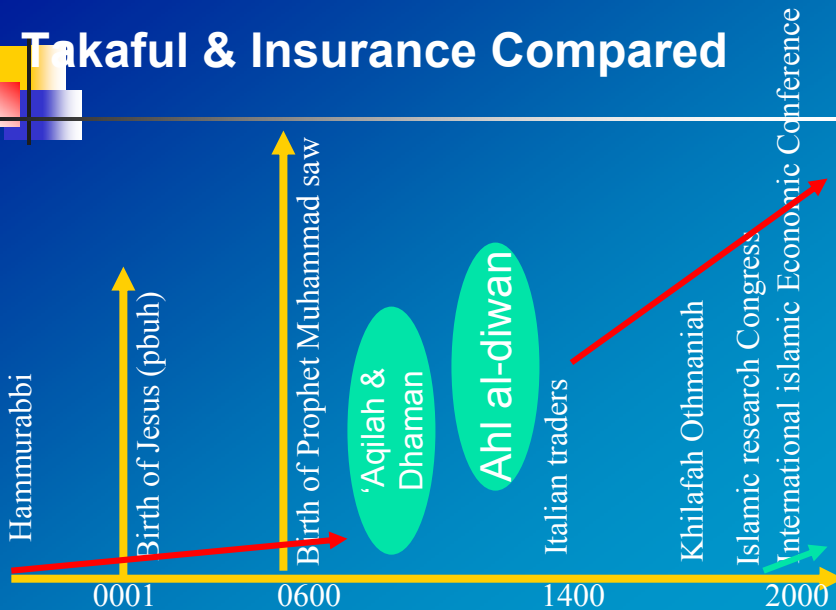


# Technical Competence

- Conventional insurance have developed over 500 years but takaful is less than 50 years old



# Takaful & Insurance Compared





## Technical Competence ...

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- Underwriting skills
- Quantitative Analysis
- Financial Analysis
- Product Development



## Shariah Competence

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- Apart from technical competence, Takaful practitioners lack sufficient shariah knowledge and shariah advisors lack sufficient operational knowledge to be able to develop the takaful industry at par with conventional insurance



## Shariah knowledge ...

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- Usul Fiqh
- Qawaid Fiqhiyah
- Fiqh Mu'amalat



## Financial Strength

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- |                            |  |
|----------------------------|--|
| ■ Conventional             | ■ Retakaful  |
| ■ Premium = USD 2 trillion | ■ Contribution < USD 1 billion                                 |
| ■ Equity > USD trillion    | ■ Equity < USD 100 million (strictly speaking < USD 5 million) |



# Market

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Insurance  
Market

Takaful  
Market



# Systems and Methods

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- Processes and Procedures
- IT Systems
- Turnaround



## Cooperation

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- Common standards
- Research
- Product Development
- Contract
- Financial Models



## On sharing risks

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- Pools
  - Takaful operators agree to cede risks to share aggregate risks
- Retakaful
  - With reinsurers
  - With retakaful operators



## Concept of Lesser Evil (Danger)?

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- For general business, a large proportion is still with conventional reinsurers
- For family business, retakaful is with one major reinsurer
- Applying the concept through fixing the “right” retention amount.



One Way of Facing This  
Challenge Is Through  
Understanding The Retakaful  
Impact On Business.





## Optimizing Retention

- Through Scientific Approach
- Quantitative Factor Apart From Qualitative factors
- Learn from conventional insurers and reinsurers

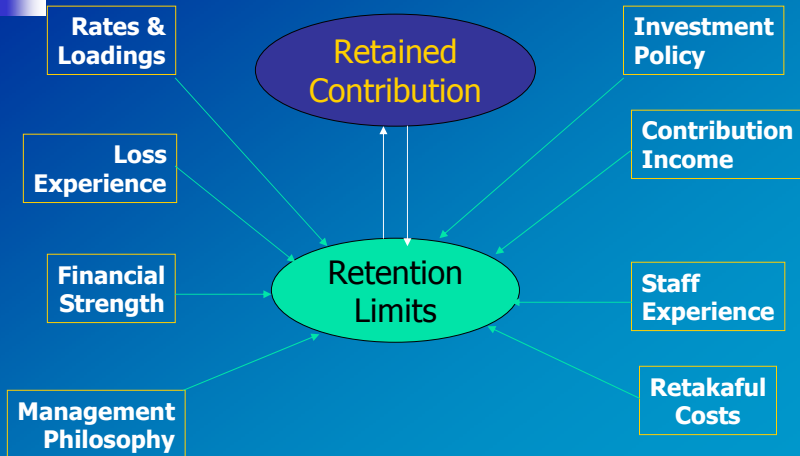


## Current Retention Ratio

Table 1.12  
Retention Ratio<sup>1</sup>

Year	Marine, Aviation and Transit	Fire	Motor			Mis- cella- neous	All Sec- tors
			'Act' Cover	Oth- ers	Total		
%							
1997	60.0	61.8	98.7	98.8	98.8	73.3	80.6
1998	47.0	55.2	100.0	97.4	97.9	67.2	74.7
1999	6.8	56.4	99.5	97.8	98.2	74.9	75.5
2000	25.0	55.1	98.5	97.3	97.5	67.1	71.7
2001	28.9	55.1	95.3	95.1	95.1	63.3	69.9

## Fixing Retentions...



## Management Philosophy

- Management Attitude Towards Risk
- Knowledge of Management
- Acceptable nature & range
- Priorities



## Contribution Income

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- Gross Contribution
- Risk Profile
- Retention =  $k C$
- Per risk – 1% to 10%
- Per event - depends



## Staff Experience

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- Underwriting skills
- Quantitative skills
- Background
- Training



# Loss Experience

Table 1.15  
Claims Ratio<sup>1</sup>

Year	Marine, Aviation and Transit	Fire	Motor			Miscellaneous	All Sectors
			'Act' Cover	Others	Total		
%							
1997	54.4	12.1	68.1	25.4	34.8	67.2	37.2
1998	14.5	12.5	33.8	28.2	29.5	96.6	36.0
1999	103.4	14.0	30.7	38.8	36.9	71.8	38.1
2000	60.8	15.3	43.3	33.6	35.6	73.0	38.6
2001	103.5	10.2	48.7	44.6	45.3	80.0	41.5

<sup>1</sup> Net claims incurred as a ratio of earned contribution income

- Either on gross or net
- Degree of fluctuation over time
- Effectiveness of retakaful arrangements



# Deviation ...

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Claims Ratio<sup>1</sup>

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			'Act' Cover	Others	Total		
%							
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1999	103.4	14.0	30.7	38.8	36.9	71.8	38.1
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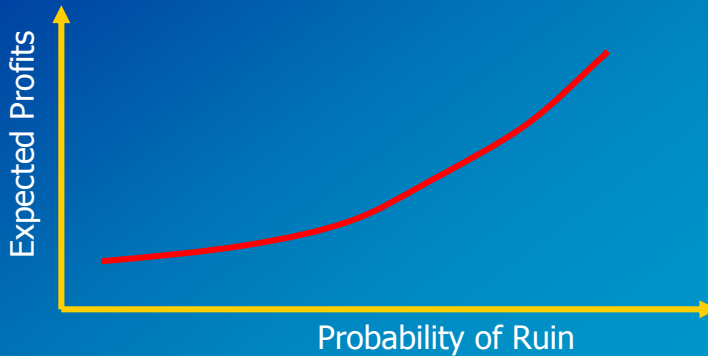
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## Retakaful Costs

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- Utility
- Probability of Ruin
- Expected Profits



## Investment Policy

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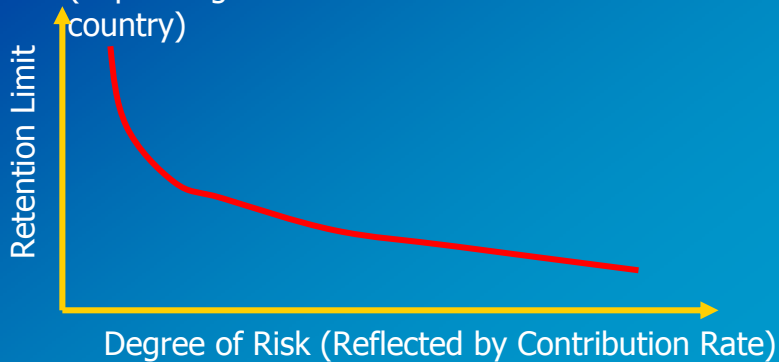
- Cashflow - liquidity
- Currently does not impact much on takaful retention but should consider long-tail business



## Rates & Loadings

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- Lower rated risks carry higher retentions
- Loadings – expenses (including commission), profit - depending on financial model, contingency and tax (depending on the model & tax structure of the country)



## Financial Strength

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- Shareholders Fund
- Takaful Fund
- Potential Variation In Claims Experience
  - Example, (study on 300,000 fire risks – largest 5 million and 1,000)



## Rule of Thumb

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- $R = y \times (\text{Capital} + \text{Free Reserves})$ 
  - where -  $1\% < y < 5\%$
- $R = 100/n \times A$ 
  - Where n is the # of times of large claims per year requiring immediate payment
  - And A equals the liquid assets (should be 5 X max retention per loss in company's most important branch)



## A more exhaustive method

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$$R = \frac{X (S) (EC)}{(GC) (L + E)}$$

Where

X = 1% - 5%

S = surplus

EC = earned contribution

GC = gross contribution

L = loss ratio

E = expense ratio



So,

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- Have we set the correct retention limits?
- Can we optimize our retention?
- Can we improve the bottom line of takaful and retakaful operators?



Conclusion

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- Retakaful challenges can be met with :
  - Greater knowledge
  - Enhanced skills
  - Higher financial strength
  - Political will
  - Greater cooperation





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