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Full Length Research Paper

Can a *takaful* company reinsure with a reinsurance company?

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Insurance is an important mechanism of risk management. However, due to the existence of Islamically unacceptable elements in its operation such as *riba*, *gharar* and *maysir*, insurance is considered prohibited. An Islamic alternative to insurance is *takaful* whose operations are based on Islamic acceptable contracts such as *tabarru'*, *mudaraba*, *wakala* and *waqf*. Considering the technical similarities of *takaful* and insurance, a *takaful* company similarly needs reinsurance facilities, which in this case must be provided by *retakaful* companies. In the early stage of *takaful* business, reinsurance facilities for *takaful* companies were predominantly provided by reinsurance companies. The practice continues to be acceptable by some Muslim scholars based on the argument of unavoidable circumstances or *darura*, among which is the inadequate number of *retakaful* companies. Some scholars, however, believe that *takaful* operators are not in need of reinsurance. This article looks at the issue of whether the argument of *darura* on the use of reinsurance facilities in *takaful* business still holds some ground. This paper shall also discuss the *Shari'a* view on the practice of reinsurance by *takaful* companies to provide better understanding of the subject.

Key words: *Retakaful*, reinsurance, *darura*, *takaful*.

INTRODUCTION

Reinsurance is part and parcel of the insurance business. Virtually, all insurers seek reinsurance, especially for those involved with high-risk insurance. Reinsurance helps the insurance companies share the risk with the reinsurance company and therefore making risk management of the company to be better managed. This is possible since reinsurance is often managed among companies within the same group of companies (Hansell, 1999). As *takaful* operators also deal with insurance, they also need reinsurance in doing their business so that the *takaful* companies can redistribute the risk involved for large amounts and risky insurance. Reinsurance is an important process to ensure the longevity and success of the *takaful* businesses.

Muslim scholars, have not allowed insurance because its operation involves riba (interest), gharar (uncertainty) and maysir (chance), which are prohibitive elements in any transaction from the Islamic law point of view (Khorshid, 2004; Kwon, 2007; Rahman et al., 2008). The Council of the Islamic Fiqh Academy, for instance, during its second session, held in Jeddah from 22 to 28 December, 1985, resolved that commercial insurance is void and prohibited according to the Sharia. The Council proposed the use of cooperative insurance contract as alternative to insurance and urged the Islamic countries to establish such an insurance so that the Ummah can be liberated from exploitation.

Principally, *takaful* is allowed by Shari'a rules as a way to manage one's risk based on a report or hadith of the Prophet Muhammad (God's Blessing and Peace Upon Him) telling a Bedouin to tie a camel before leaving it to the will of Allah. It is understood from the hadith that to reduce the risk of losing the camel, one has to tie the camel first, as without doing so, the possibility of losing

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the camel would be greater. From this incident, it was established among modern Muslim scholars that the concept of insurance does not contradict the Shari'a laws because insurance is a mechanism that can manage and mitigate the pecuniary losses associated with theft, accident, poor health and so on.

Takaful is allowed because it is based on the Islamic contracts of mudaraba (profit sharing) and wakala (agency). The elements of uncertainty in the insurance contract which is prohibited under the Shari'a principle of gharar is offset by tabarru' or gratuitous contribution of the participants in the *Takaful* scheme. The use of tabbaru' enables *takaful* companies to offer insurance-like services acceptable to the Shari'a (Farooq et al., 2010; Thanasegaran, 2008). As *Takaful* companies provide similar services to those provided by other insurance companies, they are also vulnerable to the same risks faced by any other insurance company. In respect of retakaful, it does not differ greatly from *takaful* operations, especially in the use of the Shari'a principles. The difference, if any, is that in re*takaful* operations, the participants are *takaful* operators instead of individual participants. This has made *retakaful* the Islamically accepted alternative to reinsurance. (Arbouna, 2000).

As insurance is prohibited in the Sharia, reinsurance of *takaful* business is therefore not allowed. However, in practice, the *takaful* operators have reinsured with reinsurance companies for years due to the shortage of *retakaful* companies. The issue of *takaful* operators reinsuring with reinsurance companies has been highlighted by various scholars such as Arbouna (2000), al-Salus (2003), al-Ghamidi (2007), Buang (2008), Mohd Hussin et al. (2008) and Hainsworth (2009). Many Shari'a issues concerning this problem have been raised by these scholars and in particular, that which is related to question of the necessity for the *takaful* companies to reinsure with the reinsurance companies due to the inadequate number of established *retakaful* companies. This article will discuss in detail this issue of necessity, with special attention to the practice of Malaysian *takaful* operators. The aim is to examine how the principle of necessity has been used to enable *takaful* operators to reinsure with the reinsurance companies.

What is reinsurance?

Reinsurance may be defined as the shifting by the primary insurer, called the ceding company, of a part of the risk it assumes to another company, called the reinsurer. In other words, reinsurance is a form of insurance whereby a risk that is already insured is insured again (by the insurer) (Hansell, 1999). The portion of risk kept by the ceding company is known as the line, or retention, while the portion that is reinsured is called the cession. The process by which a reinsurer passes on risks to another reinsurer is known as retrocession (Trieschmann et al., 2001) (Chart 1). It is a mechanism constructed to divide the task of handling risk among several insurers. Often, this task is accomplished through cooperative arrangements called treaties that delineate the ways in which the risks will be shared by members of the group.

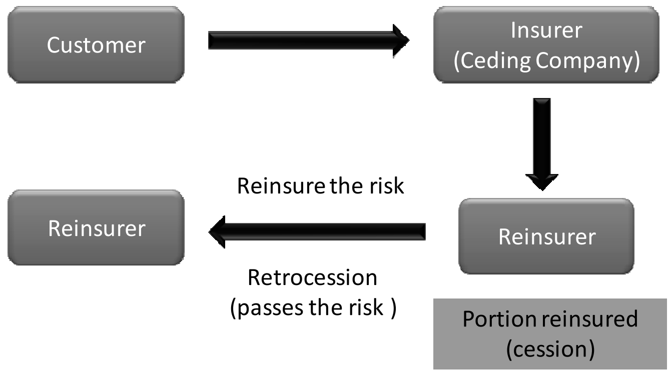

Chart 1. Reinsurance.

A reinsurance contract is legally an insurance contract. The reinsurer agrees to indemnify the primary insurer for a specified share of delineated types of insurance claims that have been covered by the primary insurer for a single insurance policy or for a particular set of policies. The terminology used is that the reinsurer assumes the liability ceded on the subject policies. The cession, or share of claims to be paid by the reinsurer, may be delineated on a proportional share basis (a specified percentage of each claim) or on an excess basis (the part of each claim, or aggregation of claims, above some specified dollar amount) (Patrik, 2009).

Reinsurance of *takaful* business under Islamic principles is known as "retakaful". *Retakaful* enhances *takaful* activity by distributing the risks. It is mainly for covering large risks and the accumulation of risks subject to common loss. It also ensures that *takaful* funds manage to meet the indemnity obligations of the insured and reinsured and to assure the continuity of *takaful* operations (Billlah, 2007).

Retakaful protects a primary *takaful* against unanticipated or extraordinary losses. The reason for its introduction is similar to the *takaful* scheme, which is to introduce an acceptable alternative to reinsurance from Islamic point of view. *Retakaful* assists the *takaful* operators in managing their risk by increasing their capacity in handling the *takaful* transaction and contract. By reinsuring with retakaful, the *takaful* operator can spread and share their risk with other operators or companies (Engku et al., 2008). In other words, *retakaful* is an Islamic alternative to conventional reinsurance based on a Shari'a compliant approved concept for reinsurance. The *takaful* company pays an agreed sum (premium) to the *retakaful* company in return for the *retakaful* company to provide security and assurance that the *takaful* company is protected against adverse risks (Chart 2).

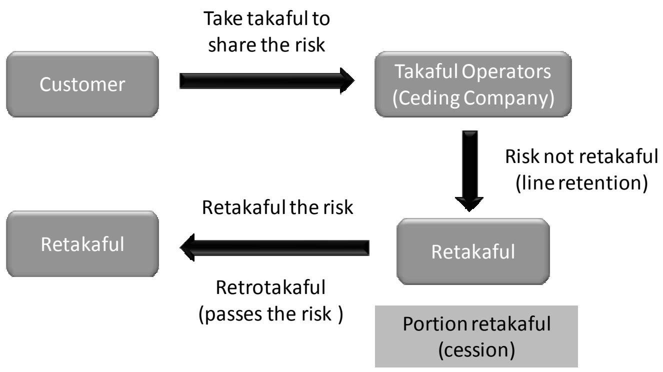

Chart 2. *Retakaful*.

The features of reinsurance

The important features of reinsurance are that the risk is dispersed over an even wider field and shield the fund of the original insurer. This gives policy holders some additional security as they will not be implicated if reinsurer falls short. The importance or advantage of reinsurance is that it helps to spread insurance risk amongst a number of insurers. Every insurer endeavours to write a balanced account. If he were to accept his own account risks which were, in terms of the sum insured or limits of indemnity, very much greater than standard, the possibility is high that one or two losses in respect of such risks could result in serious losses in the account as a whole. Instead, if the account consists of a comparatively small number of large risks, losses would tend to fluctuate within very wide limits from year to year, minimizing the insurer's probability of losses. Much larger reserves would have to be established to ensure that the insurance companies are able to compensate the risk if there is no reinsurance (Trieschmann et al., 2001).

In the event that an insurer finds itself unable to indemnify a client's insurance need, for the sake of competition and the desire to offer the best possible service for clients, he will not limit the amount he is prepared to grant cover to the insured for a particular class of risk, just to his own normal acceptance. Instead, he or his broker would approach a number of other insurers in order to obtain the full coverage required. Therefore, the insurer will be able to issue a policy covering the whole risk, which the insured wishes to cover. The insurer will cover part of the policy and arrangements will be made with other insurers or reinsurers to reinsure the other part of the risk. It is important to note that the insured is not a party to the reinsurance contract, and acquires no rights and incurs no obligations under it. In the event of a claim arising, the original insurer must settle the whole amount of the claim to the insured, and recover the appropriate amounts from the reinsurers. If for example, a reinsurer became insolvent and was incapable to pay his share of a claim, the resulting loss would have to be borne by the insurer and not by the insured (Trieschmann et al., 2001).

Another reason for an insurance company to reinsure is that reinsurance stabilizes the insurance company's profit and loss. By reinsuring, it reduces the size of its potential loss and thereby trims down the size of the reserves that it must maintain. This is not to imply that reinsurance arrangements necessarily reduce average loss levels, but they do smooth out the fluctuations that normally occur. Furthermore, reinsurance also results in the procurement of new business. It is an accepted practice that as a member of a group of ceding companies organized to share mutual risks, one ceding company must usually accept the business of other insurers.

The difference between *retakaful* and reinsurance

As shown earlier, reinsurance, just like insurance, is viewed by Muslim jurists as prohibited. An Islamic alternative to reinsurance is *retakaful* whose transaction is based on the principles of al-tabarru'. In the *takaful* contract, the tabbaru' is achieved through the participants agreement of sharing responsibility to provide some material security against unpredicted loss or damage resulting from unexpected risks on both life and property. Hence it is important that *retakaful* contracts must essentially be financial transactions that bind both the reinsurance company and the insurance company on the general Islamic principles of al-'aqd or contract. In addition to the use of Islamic contracts in its operation, *retakaful* does not earn commission as a profit or interest because this commission is subject to riba and dilutes the purpose of setting up a *takaful* operation (Buang, 2008). For instance, the reinsurance commission, which the insurance company earns directly from the reinsurance treaty, does not conform to the principles of Shari'a.

This is because the commission is structured in a way that renders the commission with interest and implicates it with a high degree of gharar. This is in contrast to *retakaful* operation which is dependent on actual expenses spent by the *takaful* operator in the process of *retakaful*.

Why *takaful* business needs *retakaful*

Takaful business needs *retakaful* for similar reasons as insurance business need reinsurance. *Takaful* operators need *retakaful* to balance their portfolios. They have to maintain homogeneity of risks and avoid unbearable exposure of their portfolio and capital. They also need *retakaful* to avoid rapid fluctuations in their financial portfolios. They need enough premiums and spread to balance their own portfolios (Mohomed, 2009). They need *retakaful* as a technical requirement to spread the risk and avoid the insolvency risk. In short, *takaful* companies cannot survive without *retakaful* and/or reinsurance (Mohomed, 2009).).

Scholars have summarized the objectives of *retakaful* as: (1) to protect the *takaful* business for the treat of insolvency, underwriting and interest of the participants, (2) to forge cooperation among participating companies mainly through investment of accumulated fund, (3) to provide underwriting flexibility and consolidate financial stability of the participating companies and (4) to allow participating companies to utilize the retained deposit reserves of the *takaful* fund in the interest of the their clients (Mohd Hussin et al., 2008, Engku et al., 2008, Chakib, 2007).

The issue on why *takaful* operators have to use conventional reinsurance

As stated earlier, the *takaful* companies are obliged to comply with all Shari'a requirements. This includes re-insuring with *takaful* companies. However, in practice, some *takaful* operators reinsure their *takaful* with con-ventional reinsurance companies. The Shari'a advisors of the *takaful* operators allow this practice based on the reason that *retakaful* alternatives are not yet available or very limited to fulfil the functions of reinsurance. The use of reinsurance was dictated by the lack of *retakaful* capacity and the necessity to protect the policyholder and shareholder's funds (El-Gamal, 2006). This was in addition to the small numbers of *takaful* operators and limited size of their funds as in case of Malaysia. *Takaful* operators had therefore reinsured with conventional insurance and conventional reinsurance companies. It was further explained that it was as a result of the limited funds that the *takaful* operators had to pay to the partici-pants when they made claims for their losses (Yusof, 2006). This is further complicated by the lack of *retakaful* companies that are capitalized to the levels required by insurers, particularly the lack of 'A' rated *retakaful* companies.

Ideally, this hurdle can easily be managed by *retakaful* companies, but the unavailability of *retakaful* has forced them to resort to using conventional reinsurers. To resolve this issue, the Shari'a advisors of *takaful* operators were of the view that *takaful* operators should initially try their best to reinsure the risk with *retakaful* companies. It is only after all efforts have been made and in devoid of all possible means to find a *retakaful* company that they can reinsure with conventional insurers or reinsurers. The legal basis for adopting such a position is based on the principle of necessity or darura summarized in a maxim which says in Arabic al-darurah tubih al-mahzurat or necessities render unlawful acts lawful. Darura is an indispensable necessity, without which may cause severe hardship such as loss of life or damage to property. However, as will be shown later, the use of this principle is subject to certain conditions.

At present, most *takaful* operators still reinsure with conventional reinsurers. The opinion or view of Shari'a scholars that allows the *takaful* operators to deal with conventional reinsurers, however, is temporary and conditional. The permission to use reinsurers is effective only when there is no practical Shari'a compliant alter-native or their capacities are limited (Abouzaid, 2007). According to Arbouna (2000), the situation also includes when the financial capacity of the existing *takaful* operators is inadequate to meet all their losses based on the views of the experts in the insurance industry.

The availability of reinsurance arrangements and their capacity are important to the overall rating assessment. While there are over 250 *takaful* companies in the world today, the number of *retakaful* operators does not match with this number in proportionate acceptable ratio. The scar-city of suitable Islamic-compliant reinsurers could have implications in the *takaful* operators' financial strength ratings. The scarcity of *retakaful* companies exposes a *takaful* company to the concentration of related risks, or where adequate treaty limits may not be available, this either restricts the size of business that may be written or forces the company to retain greater risk on the net account. In this scenario, the strength of reinsurance arrangements needs to be evaluated on a case-by-case basis.

The retrocession from *takaful* companies ranges from 10% in the Far East where *takaful* companies have rela-tively smaller commercial risks so far, to the Middle East where up to 80% of risk is reinsured on a conventional basis. *Retakaful* companies need to ensure that they are capitalized sufficiently to enable them protect the financial stability of the companies from adverse underwriting results and stabilize claims ratios from one year to the next. They also need to minimize claims accumulation from losses within and between different classes and to geographically spread risk. *Retakaful* would certainly increase capacity and the profitability of insurers through permitting greater flexibility in the size and type of risks accepted. Through *retakaful* new companies would secure technical support and help from more experienced companies.

VIEWS OF MUSLIM SCHOLARS ON REINSURING WITH CONVENTIONAL REINSURANCE

Most *takaful* operators use the earlier mentioned principle of necessity or darura to validate using conventional reinsurance to reinsure their businesses. Nonetheless, there are small numbers of scholars who have different view on the use reinsurance by *takaful* companies. While most of the scholars view such a practice as permissible, some do not.

Permissible view

According to Arbouna (2000), some scholars opined that the legality for the *takaful* operators to place their risks with conventional reinsurers was based on the principles of darura (necessity) or haja (need) and al-maslaha al-`amma (general interest). The necessity was based on the financial capacity of existing *takaful* operators to meet all their losses in accordance with the views of the experts in the insurance industry. This means that reinsurance dealings between *takaful* operators and conventional reinsurers must be regulated by the law of necessity, as defined in the Islamic law. One of the requirements is that it is pertinent that the transaction itself must be exhaustively unavoidable as rooted in Islamic legal maxims that read “necessities render unlawful acts lawful” and “need assumes the rule of necessity whether it is general or specific”.

Non-permissible view

Al-Ghamidi (2007) points out that some scholars do not accept reinsurance by *takaful* companies. Reasons given to disallow this practice are mainly similar to prohibition of insurance such as *riba*, *gharar* and *maysir* (General Presidency of Scholarly Research and Fatwa of Saudi Arabia and Majma’ al-Fiqh). There is no need for reinsurance since there are other reinsurance companies that are already existing (Muhammad ‘Uthman Shubayr). While others gave more general reasons such as insurance is forbidden (Muhammad Abd al-Latif al-Farfur) and reinsurance leads to taking other’s property illegally (Yusuf Qasim).

Further analysis reveals more sophisticated reasons given by these scholars in rejecting reinsurance. First, for the reason of the morality of making profit, as in Islam profit, is not the objective of a transaction but only a mechanism. Thus, if there is an element of doubt or shubha in the profit, a Muslim should avoid it. As in the case of riba, the profit of a particular transaction should be free from doubt that may contain element of riba. This morality stance and precautionary attitude are taken from the saying of Umar al-Khattab, the second Caliph, who said, “I left nine out of ten what is halal because I am afraid that I will run into what is haram”. Second, the principle of “necessity renders an unlawful act lawful” cannot support the permissibility of the reinsurance as no harm is done to the Muslim societies who have lived for centuries without being dependent on insurance and reinsurance. Furthermore, there is a principle applied by Muslim scholars to extrapolate existing rulings of Islamic law to apply to new cases exemplified by the Islamic legal maxim that states that, “one must prioritize what is forbidden above what is allowed” (If it is contrary to Islam, whereby it is permissible provided forbidden) or (if it is contrary inhibitor and appropriate foot inhibitor). On the issue of reinsurance, Muslim scholars argue that the prohibitive elements in reinsurance overwhelm its necessity, thus, making it unacceptable.

SHARI’A PRINCIPLES USED IN DETERMINING THE LEGALITY OF *TAKAFUL* OPERATORS REINSURING WITH CONVENTIONAL REINSURANCE

Obviously, the arguments of the permissible view seem to gain an upper hand as compared to the view of the scholars who disagree, as it would be disadvantageous to the *takaful* companies to ignore seeking assistance from reinsurance companies. Nevertheless, the principle of darurah used in permitting reinsurance is a non-exclusive and must be taken into consideration with other principles. In this respect, the maxims which says “what is permitted for the reason of darurah is limited to the extent of what is required”. This maxim implicates that a *takaful* company can only reinsure with a reinsurance company the portion of risk that *retakaful* companies cannot retakaful. Based on this principle, *takaful* operators can take reinsurance to manage the risk for the amount that they cannot *retakaful* with a *retakaful* company. For example, if a *retakaful* company can *retakaful* 60% of the risk, then they should only reinsure with a conventional reinsurance company the other 40%.
Another principle that must be taken into account is the maxim which says “what is allowed because of an excuse will be no longer lawful when the excuse disappears”. This maxim entails that the condition of darura is no longer applicable when the reason for the permission to do what is prohibited disappears (Al-Zarqa’, 2007). In a situation when there are many *retakaful* companies that can *retakaful* all the *takaful* insured by *takaful* companies, there is no need for reinsurance anymore. Thus, the situation of darura does not exist anymore. When there is no darura, the law will revert to its original position, which is, “reinsurance with the conventional companies is prohibited”. Thus, when there is a sufficient *retakaful* company in the market, the takaful company can no longer take reinsurance to spread its risk.

The principle of “necessities render unlawful acts lawful”

The preceding paragraphs have touched in brief the meaning of darurah. For a better understanding of the term the following paragraphs will explain its meaning as expounded by Muslim jurists. Al-Zarqa’, a Professor at University of Damascus, Syria (2007) explains that the principle is related to two other important maxims which says “when a matter is restrictive, it is eased (by the law)” and “hardship causes the giving of facility”.

The principle of darurah is accepted among the jurists as exemption in a situation whereby observation of the general rules may cause hardship or even harm or injury. The basis of this exemption is taken from the Quran itself which allows consuming forbidden food or drink in the face of extreme hunger or thirst (al-Quran, surah al-Baqarah: verse 173). Muslim jurists have reached a

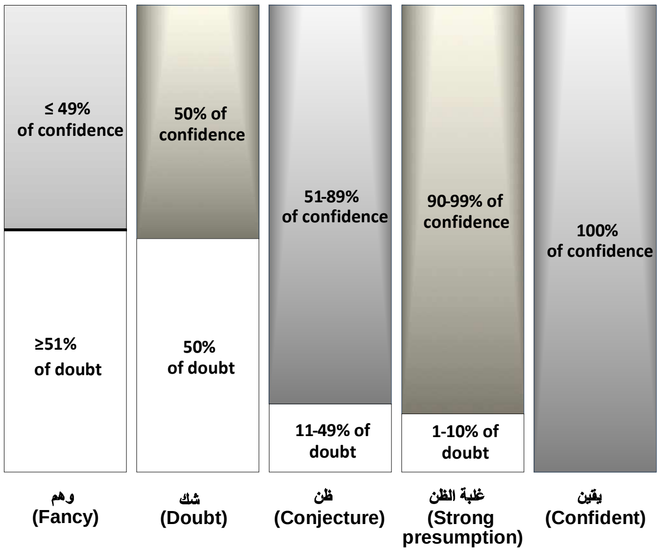

Chart 3. Level of confidence in the existing dharura.

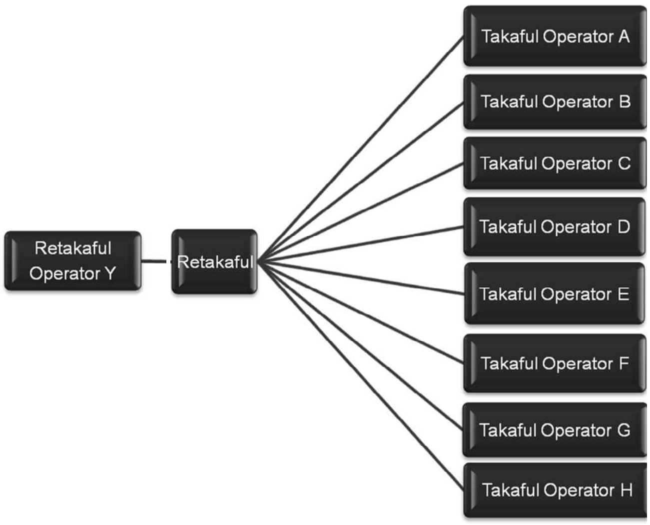

Chart 4. Ratio of *retakaful* to *takaful*.

consensus that in a famine, Muslims are allowed to eat food that is prohibited by Shari'a when it is the only food available. In such a situation, a person may only eat to satisfy their hunger and, thus, saving them from death. Imam Malik, the founder of the Maliki school of law, says that "the amount of it is what will satisfy the hunger, and one should not eat more than what will keep one alive" (Al-Qurtubi, 2006). The permission to eat the prohibited food is in accordance with an objective of Shari'a that is to protect one's life. Based on this argument, the principle of darura is then extended to the case of reinsurance by *takaful* companies with limitation that its permissibility is subject to non-availability of *retakaful* companies.

ANALYZING DARURA CIRCUMSTANCES FACED BY THE *TAKAFUL* COMPANY

Shari'a emphasize that darura must exist to allow *takaful* operators to reinsure with the reinsurance companies. Before *takaful* companies reinsure with the conventional reinsurance, they should ensure the darura actually existed based on research, observation and established experience. To measure the level of darura and its existence, it can be suggested that the industry employ the measurement used by the Islamic court to substantiate the soundness of claims. According to Mahmassani (1961), "the proof of a matter requires presentation of evidence until the matter attains the degree of certainty" or at least attain the level of strong presumption (Md Noor, 2007) (Chart 3).

How do we measure a darura situation faced by *takaful* operators? What are the indicators that may show that *takaful* operators are in the condition of darura? To try to answer these questions, this paper will first try to explore what is the darura faced by the *takaful* companies that forced them to reinsure with conventional reinsurance.

At the early stage of the *takaful* industry, there was no *retakaful* operator. Thus, the situation was accepted as darura because the *takaful* operators (Chart 4) did not have any choice to reinsure except with the reinsurance. However, after three decades of development in the *takaful* industry, there have been a significant number of *retakaful* operators, both locally and internationally. The number of *takaful* operators and *retakaful* operators in 2009 are shown in Table 1. The list of *retakaful* operators in the world is shown in Appendix 1.

Based on the data provided by the International Cooperative and Mutual Insurance Federation (ICMIF) in 2009, there were 171 *takaful* operators and 20 *retakaful* companies around the world. Are these 20 *retakaful* operators in the world capable of servicing all the 171 *takaful* companies? What parameters can be used to consider whether it is possible for *takaful* operators to reinsure with these 20 *retakaful* operators?

The exact number of *takaful* operators that each *retakaful* operator can *retakaful* depend on the size of company, and each *retakaful* operator has limitations on how much they can retakaful. For example, the minimum paid-up capital for a *retakaful* company to be established in Malaysia is RM100 million. Consultation with professionals, including actuarial and management experts, is crucial in order to use the correct methodology to calculate the number of *retakaful* operators that can *retakaful* the *takaful* operators. From the number of *takaful* and *retakaful* companies identified earlier, a ratio of *takaful* companies to *retakaful* companies can be calculated and used as a rough guide in determining whether there are enough *retakaful* companies for the *takaful* operators for a specific country. The international ratio calculated was 1:8.55 indicating that each *retakaful* company can *retakaful* at least 8.55 *takaful* operators. If it

Table 1. Number of *takaful* company versus *retakaful* companies in the world.

***Retakaful* operators around the world**	***Takaful* operators around the world**
20	171

Source: http://www.Takaful.coop/index.php?option=com_content&view=article&id=46&Itemid=40, 19 April (2009).

Table 2. Retakaful and *takaful* companies in Malaysia.

***Retakaful* company**		***Takaful* company in Malaysia**	
1.	ACR *Retakaful* SEA Berhad	1.	CIMB Aviva Takaful Berhad
2.	Munchener Ruckversicherungs-Gesellschaft (Munich *Retakaful*)	2.	Etiqa Takaful Berhad
3.	MNRB *Retakaful* Berhad	3.	Hong Leong Tokio Marine Takaful Berhad
		4.	HSBC Amanah Takaful (Malaysia) Sdn Bhd
		5.	MAA Takaful Berhad
		6.	Prudential BSN Takaful Berhad
		7.	Syarikat Takaful Malaysia Berhad
		8.	Takaful Ikhlas Sdn. Bhd.
		9.	AIA Takaful International Bhd

Source: http://www.bnm.gov.my/index.php?ch=13&cat=insurance (2009).

can be proven that the *retakaful* operators have to *retakaful* more than 9 *takaful* operators, then the *takaful* operators in a country have to seek reinsurance from the conventional companies.

In case of Malaysia, do *takaful* operators face the darura situation? From the list of *retakaful* and *takaful* companies provided by the Bank Negara Malaysia in 2009, it can be seen that there were nine *takaful* operators and three *retakaful* operators that operate locally (Table 2).

The list provides a ratio of *takaful* companies to *retakaful* companies at 1:1.5. As compared to the international ratio earlier mentioned, the situation of *darura* is no longer applicable to the Malaysian *takaful* industry as, at most, each *retakaful* company only has to *retakaful* three *takaful* companies. Based on this parameter and without looking into the size of the *takaful* operators and *retakaful* operators, it seems that each *retakaful* operator is able to comfortably reinsure *takaful* operators in Malaysia. The sufficient number of *retakaful* operators shows that they are able to reinsure some portion of the risk assured by takaful operators.

Nevertheless, it should be emphasized that profess-sional opinion should always be sought to measure the exact capacity of each *retakaful* company. If the profess-sional opinions state that this ratio is still inadequate, then the darura situation is still applicable.

When deciding on the *retakaful* provider's capacity, caution has to be taken as sometimes there are cases where a provider is indeed using conventional reinsurance with Shari'a contract wording and/or retroceding to a conventional reinsurer, both of which might not be acceptable to the ceding company's Shari'a Board. In addition, the lack of rated, reputable *retakaful operators* may also affect *takaful* operators' ability to sustain their double-digit growth rates in the future. This is because the ability of the takaful industry to tap extrinsic demand, particularly those that are created by Islamically financed assets, has been dependent upon access to multiple, rated *retakaful* pools to manage risks. Even now, many takaful companies still reinsure with conventional reinsurers on the basis of dharura because of the lack of *retakaful* capacity.

However, not everyone believes that there is a real shortage of capacity. Mahbob, President and Chief Executive of Malaysia-based MNRB *Retakaful* argues that: "Except for two, all other *retakaful* operators are already rated. Capacity is relative to demand and most primary operators focus on writing personal lines risks which are non-capacity risks. I would say the existing capacity is already catering for most markets worldwide, after putting aside costs and specialized cover such as terrorism" (Borhan, 2008).

Abouzaid (2007) states that "using conventional reinsurance unnecessarily is harmful for the credibility of takaful". The takaful operators are, therefore, required to cede to the existing Shari'a compliant capacities. He further adds that the increasing number of *retakaful* companies (six operators and three rated "A-" as of April, 2008) shows that the applicability of the concept of darura

Existing *retakaful* capacities

Another method to respond to the argument frequently used to justify the *takaful* cession to conventional reinsurance companies based on necessity is by presenting the existing capacities of the *retakaful* industry. According to Abouzaid (2007), there were six *retakaful* companies in 2006 (Table 3) that could be considered as the available

Table 3. Capacities of *retakaful* operators (as of April, 2008).

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

Source: The Need for *Retakaful* and Available Capacities http://www.whatsTakaful.com/people/chakibabouzaid.pdf, 14 April, 2009.

Table 4. Retakaful operators (as of April 2008).

Company	ARIL	BEST Re	Takaful Re	Hannover Re	Labuan Retakaful	MNRB Retakaful
Incorporation	1997	1985	December 2005	October 2006	Company: 1992 Retakaful Division: 2007	December 2006
Capital (US$ million)	Paid-up: 14.1 Authorized: 50	100	Paid-Up: 125 Authorized: 500	Paid-Up: 55 Authorized: 150	Allotted but not called: 50 Issued and paid-up: 150	Paid-Up: 31 Authorized: 154
Rating	Not rated	BBB+ (S&P) A- (AM Best)	BBB stable (S and P) stable	A stable (S and P)	1. FSR A- (excellent) (AM Best) 2. IFS A-(stable outlook) (Fitch)	1. Not rated 2. 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 operation in Aug 2007
Takaful model	Mudharaba	-	Wakala for policy holders/ Mudharaba for investment	Wakala / Mudharaba	Wakala for both *retakaful* and investment	Wakala, optional Mudharaba / Wakala on investment
Business model	Takaful / conventional Mix	Conventional / Takaful Mix	Takaful Co's only outsourcing agreement with Arig	Takaful only	1. Conventional 2. Takaful	Takaful companies only for treaty. Allowed facility on halal risk from conventional

Sources: The Need for *Retakaful* and Available Capacities, http://www.whatsTakaful.com/people/chakibabouzaid.pdf, 14 April 2009.

considered as the available suppliers for *retakaful* capacity.

These six *retakaful* companies had a total paid-up capital of US$375 million.

Except for BEST Re and Asean *Retakaful* International Limited (ARIL), the rest were newcomers to the market but were supported by experienced groups, either global (for example, Hannover Retakaful) or regional (for example, Takaful Re, Labuan Re and MNRB). All the other *retakaful* players were rated as “BBB” and above (except for ARIL), and three were A-rated companies. He claims that these companies could absorb almost 90% of the required capacity for takaful treaties. He further claims that only in a very few cases of takaful or cooperative, the available *retakaful* capacity could not meet the demand, and required additional conventional capacity.

With the new *retakaful* operators, the available capacity will increase dramatically to absorb all the demand for *retakaful* treaty capacity, further reducing the need for conventional reinsurance.

The addition of total *retakaful* capital and rating substantiates the existing *retakaful* financial strength, with good or very good claims-paying ability, which is the main prerequisite for a reinsurer.

However, having adequate capital and acceptable rating cannot be considered as sufficient to boost the development of the takaful industry. Takaful requires *retakaful* capacity for all lines of business, including long-tail business and/or special lines. As the business is developing, additional capacity is needed from *retakaful* as well as the ability to indemnify new lines of business. For now, this remains lacking in the *retakaful* industry (Table 4).

Furthermore, ceding to the international conventional market will remain necessary as the *retakaful* industry is part of the global insurance industry. Cooperation between takaful and conventional reinsurance companies for areas such as mega projects, aviation and special lines will undoubtedly always be required.

Conclusion

Shari’a allows Muslims to take part in insurance that is prohibited in the situation of darura. This is also applicable to the takaful operators who reinsure with prohibited reinsurance companies due to the lack of capacity of the *retakaful* companies. If the takaful operators are strictly disallowed from reinsuring with conventional reinsurance, it might harm the whole takaful industry, especially during unpredictable risks such as major catastrophes. It might also expose the takaful companies to the risk of insolvency. It will also affect the policy holders when they are not able to pay compensation to the customers who are in need of help.

Based on a report by Ernst and Young (2008), although *retakaful* capacity is increasing in volume, the availability of reputable *retakaful* operators is limited. Therefore, the darura condition is still considered as existing in the *takaful* industry. However, practitioners in the takaful industry have to be aware that if there is adequate capacity of *retakaful* operators for the *takaful* operators to reinsure their risks, then the condition of darura is no longer applicable and reinsuring their risks with conventional reinsurance companies is forbidden by the Shari’a.

This study also finds that to measure and determine the darura situation can be problematic where professionals’ opinions must be sought to assess it. It is therefore timely for the regulators to have a standard parameter to measure the necessity of the *takaful* business to reinsure with the conventional reinsurance in order to guarantee that the industry can operate within the Shari’a framework.

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Appendix 1. *Retakaful* companies in the world.

S/N	Takaful operator	Country	Year established	Rating
1.	Asean Re-Takaful International	Malaysia	1997	
2.	MNRB Retakaful Berhad	Malaysia		
3.	Munchener Ruckversicherungs-Gesellschaft (Munich Re Retakaful)	Malaysia		
4.	ACR Retakaful Holdings Limited	UAE		
5.	Takaful Re Limited	UAE	2005	BBB
6.	Dubai Islamic Insurance and reinsurance Co.	UAE		
7.	Islamic Takaful and Re-Takaful Co. (ITRCo.)	Saudi Arabia		
8.	Islamic Takaful and Re-Takaful Co.	Saudi Arabia		
9.	National Re-insurance Co. (NRICo.)	Sudan	1979	
10.	Sheikhan Insurance and Reinsurance	Sudan		
11.	Sudanese Insurance and Reinsurance Co	Sudan		
12.	Amin Reinsurance Company	Iran		
13.	Al Fejr Retakaful Insurance Co. www.alfajerre.com	Kuwait	2008	A-
14.	BEIT Iaadat Ettamine Tounsi Saoudi Re-insurance (B.E.S.T. Re)	Tunisia	1985	BBB+
15.	Hannover Retakaful B.S.C. (c)	Bahrain	2006	
16.	Solidarity Islamic Takaful and Retakaful Co.	Bahrain		
17.	Islamic Takaful and Retakaful Co. (IRTCo.)	Bahamas		
18.	PT Reassuransi Internasional Indonesia	Indonesia		
19.	Tokio Marine Nichido Retakaful Pte Ltd	Singapore		AA
20.	Swiss Re			

Source: http://www.Takaful.coop/index.php?option=com_content&view=article&id=47&Itemid=41, 23 March 2009, http://non-life.hannover-re.com/prod_sol/retakaful/index.html, 23 March 2009.