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Research Article
Retakaful Pool Framework for Takaful Operators in Malaysia: Experts’ Opinions
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Abstract: Malaysia is trying to position itself as a hub of Islamic finance and the government is promoting the Islamic finance industry. Takaful industry is rapidly increasing however, Retakaful industry is not catching up with the dynamic and complex needs of Takaful industry. In addition, the existence of the limited number of Retakaful operators causes Takaful operators not much bargaining power in negotiating the Retakaful agreement and Takaful operators have no option except to follow the requirements set by Retakaful operators. Thus, this study intends to propose framework for Retakaful pool mechanism by seeking the opinions of experts in Malaysia. By introducing Retakaful pool among the Takaful operators, it will create mutual and friendly business environment among them and reduce dependency on Retakaful operators. In addition, the experts believe that Retakaful pool will bring more benefit to the Takaful operators, compared to the traditional Retakaful method, i.e., engaging with Retakaful operators.

Keywords: Malaysia, pool, retakaful, takaful

INTRODUCTION

Insurance is known as a risk transfer mechanism and it is widely practiced all over the world. When the operational part of insurance is examined, the backbone of the insurance industry is reinsurance industry whose support will determine the success or failure of the insurance industry. The main reason is that unpredictable risks make insurance companies engage with reinsurance industry in order to cover any claims that the insurance industry is not able to pay (Kopf et al., 1929; Plantin, 2006). In the market, there are many reinsurance companies compared to the Retakaful companies since the later ones are relatively new industry. Similarly, Takaful industry is new compared to the insurance industry. Takaful companies usually follow the traditional way of ceding their risk, i.e., through Retakaful. Due to the limited number of Retakaful operators and over reliance of Takaful operators on Retakaful operators, Takaful operators do not have much bargaining power and they are at the sympathy of the Retakaful operators. Thus, the purpose of this study is to seek the experts’ opinion towards the possibility of introducing Retakaful pool method and to propose the framework for Retakaful pool method. It is believed that this proposed method is able to bring the optimal benefit to the Takaful operators and participants.

LITERATURE REVIEW

Reinsurance is defined as insurance over effected by an insurer with a second insurer of the risks, wholly or partly, it has accepted and includes any similar arrangement by a branch of the insurer in Malaysia with its branch outside Malaysia (Financial Service Act, 2013). Reinsurance is a risk management device which enables an insurer to transfer its risk exposures that it cannot manage within its own resources (Kavita, 2013). In addition, it provides benefits to the insurance industry in both the micro and macro levels. At the micro level, reinsurance plays an instrumental role in the provision of ‘capital’ whereby the insurance company is able to leverage on the higher capital of the reinsurance company to write bigger and complex risks over and above its own financial and technical resources. Essentially, when a reinsurer takes over parts of risk/risks, he commits his own capital to cover these risks (Geonka, 2003).

It is standard practice that an insurance company based on prudential reasons, will only commit a small portion of its financial resources for a risk/risks which is commonly known as the retention policy. This represents the heart of a reinsurance programmed where, after its own net retention, the insurance company will reinsure (cede) the balance of the risk to the reinsurers. Another important role of reinsurance at the micro level to the insurer is by limiting the impact of catastrophe losses which will affect the capital of the...
insurance company (Hoerger, 1990; Garven and Lamm-Tennant, 2003). Reinsurance also helps to stabilize the net operational result by reducing the potential fluctuation of actual result over a period of years where an unusually bad year in terms of claims experience can be balanced at some time by good years with satisfactory claims experience (Cummins et al., 2008).

At the macro level, reinsurance provides for the enhanced security and long-term stability of the insurance industry, making it feasible for insurance companies to write more complex risk beyond its financial and technical capacity, helps develop new products and tap on the reinsurer’s specialized underwriting expertise, its vast knowledge and experience of the business because of the international nature of the reinsurance business. On the global scale, reinsurance helps spread risks across geographical boundaries thus reducing the impact of losses in any single company, market, or economy (International Association of Insurance Supervisors, 2012).

Reinsurance may be arranged in a number of methods depending on the needs as well as the underwriting and reinsurance strategy or philosophy of each insurance company which are subject to review in tandem with the growth of the company.

One of the reinsurance methods, i.e., reinsurance pool is defined as an arrangement whereby a certain number of insurers agree to automatically cede a defined business to a common central association between themselves and to divide such business among them in certain agreed proportions (Golding, 1987). The pool may be activated in the form of a fixed share of the whole business, or as a surplus over and above a fixed retention, or of an agreed excess of loss. The premiums, claims and expenses, as well as profits or deficits of the pool are shared in agreed amounts as stipulated in the ‘Pool’ agreement among the pool members (Schwepcke, 2004). Pools are generally used as a means of exercising reciprocity among insurance companies especially for types of risks which are difficult or too expensive to be placed in the traditional reinsurance markets such as energy risks, nuclear risks, marine war risks, catastrophe risks, health risks, etc. For example, in Malaysia, the regulator has requested the local insurance companies to form the Malaysian Motor Insurance Pool (MMIP) as a high risk insurance pool for motor vehicle insurance for vehicle owners who have difficulty in obtaining motor insurance cover from the market. This pool is jointly owned by Malaysian insurance companies and managed by a third party. A pool is not an insurance company, but a jointly owned and managed insurance facility by the member insurance companies (A.M. Best Methodology Criteria-Reinsurance, 2013; Guideline to the Insurance Industry on Reinsurance Arrangements, 2013). A simple pool arrangement is described in the Fig. 1.

**RESEARCH METHODOLOGY**

This study uses both primary and secondary data. Primary data is collected by interviews using the Delphi technique. The secondary data is from the books, articles and internet resources relevant to our research. The interview questions focus on the general criteria for Retakaful pool, applicable contracts, financial projections for future and how Retakaful pool can replace traditional Retakaful. Nine experts in Takaful are identified and interviewed for three times to reach the findings.

**RESULTS**

The interviewees believe that it is possible to introduce Retakaful pool method in order to reduce dependency on the traditional Retakaful method.

**Overview criteria for retakaful pool:** For the sake of clarity and simplicity to initiate the establishment of the Retakaful Pool, the Retakaful contribution to be ceded to the Pool shall follow the same basis as a normal Retakaful arrangement which should be adequate to cover the actual Retakaful liabilities and cushion for adverse claims experience and provision for Wakalah fee to cover actual expenses for management of the Retakaful Pool fund.

Terms and conditions for the Pool can be benchmarked against the existing insurance and reinsurance pools structures and framework in the market as well as the Protection and Indemnity Club as shown by Kazlow and King (2001), Schwepcke (2004) and Iqbal (2005). Some of the suggested criteria are as follows:

- **Membership eligibility:** This sets out the criteria for membership. In this case, it is opened to all the licensed Takaful operators in the same country. This is to ensure that members admitted are subject to similar regulatory and corporate governance
frameworks especially in writing the Takaful risks. At a later stage, subject to strict guidelines, Takaful operators from other jurisdictions may be admitted on a case by case basis. These guidelines are aimed at ensuring the Pool’s resilience and long-term sustainability.

- The classes of business to be covered under this Pool can be any type of general Takaful products such as fire Takaful, Accident Takaful, Marine Takaful and Motor Takaful. Later on, using different Retakaful Pools can ensure homogeneity of the risks to be covered by such Pools.

- Details of risks ceded such as type, class, size, volume, value, pricing must meet the minimum criteria to ensure homogeneity of risks ceded as a measure of ensuring the Pool’s viability and security in meeting its liabilities. The Pool should not be treated as ‘dumping ground’ for badly underwritten or inferior priced risks.

- Method of Retakaful arrangement can be based on the proportional Retakaful arrangement, either on quota share or surplus basis.

- Exclusions can be normally applied in Retakaful contracts but may be tailored to members’ needs.

- Retrotakaful can be linked with the appropriate Retrotakaful to protect the Retakaful pool fund against adverse claims as well as catastrophic losses.

- Claims management should be simplified to cater for the needs of members.

- Regarding capital and operational expenses, the initial seed capital may be required to set-up the pooling fund collected from the founding members. When the new members join, they should contribute accordingly and an appropriate Wakalah fee will be charged to cover the actual operational expenses.

- Retakaful pool surplus from the Pool including the investment income will be shared proportionately with pool members. Deficit of the Pool will be charged to members in the form of levy.

- Management of the Retakaful pool can be jointly managed or outsourced to third party with adequate oversight from members especially on the technical and Shari’ah issues through special committees appointed from the pool members. Close monitoring of the pool’s operations by the various committees as well as the main board of the pool comprising of all the registered pool members will ensure adequate oversight and successful implementation of the pool’s objectives.

- Prudent manner for the security and sustainability of the pool fund is important and hence, timely report on the management of its risk exposures due to accumulations, adverse claims experience and catastrophic losses and exposures should be provided.

Applicable contracts for retakaful pool: The Retakaful Pool may be established by applying the following contracts:

- Musharakah contract between the various Takaful operators where each operator shall contribute to the capital of the pool.

- Wakalah contract between the Takaful operators and the appointed pool manager to manage the Retakaful pool.

- Tabarru’ contract between the Takaful operators who agree to jointly contribute a portion of the original Takaful contributions to the Retakaful pool fund for the purpose of joint guarantee against specified Takaful liabilities, including the necessary Retrotakaful placements.

- Mudharabah contract between the Takaful operators and the pool manager for the investment of the Retakaful pool fund.

- Juala’ contract between the Takaful operators and the pool manager as incentive from the surplus of the Retakaful pool fund.

Sample financial projection for retakaful pool: The Fig. 2 will provide an illustration of the proposed Retakaful pool fund. It shall be based on the projected financial projection for the period 2014-2019 (RM’000).

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Contribution</th>
<th>Retakaful</th>
<th>Recoveries</th>
<th>Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>2,627</td>
<td>657</td>
<td>328</td>
<td>328</td>
</tr>
<tr>
<td>2015</td>
<td>3,100</td>
<td>775</td>
<td>388</td>
<td>388</td>
</tr>
<tr>
<td>2016</td>
<td>3,658</td>
<td>915</td>
<td>458</td>
<td>458</td>
</tr>
<tr>
<td>2017</td>
<td>4,316</td>
<td>1079</td>
<td>540</td>
<td>540</td>
</tr>
<tr>
<td>2018</td>
<td>5,093</td>
<td>1273</td>
<td>637</td>
<td>637</td>
</tr>
<tr>
<td>2019</td>
<td>6,010</td>
<td>1503</td>
<td>751</td>
<td>751</td>
</tr>
</tbody>
</table>

Fig. 2: Projection for 2014-2019 (RM’000)
From the projection shown above, the pool members can immediately note that the surplus from the Retakaful pool fund belongs to them as members of the Pool, which otherwise, will be enjoyed by the Retakaful operators should the Retakaful be placed on normal Retakaful practices. This surplus may be utilized by the Takaful operators for the benefit of the participants and the industry as a whole such as through price reductions, to strengthen the reserves and resilience of the Takaful risk fund to cater for future adverse claims experience. In addition this surplus can be utilized to enhance further research and educational/public awareness activities on Takaful.

In culmination of the successful launch of the Retakaful Pool described above, the industry should prepare a business plan and timelines to include other classes of business in order of priority into the pool as well as slowly increasing the pool’s limits in tandem with its growth and experience. Likewise, risks ceded to Retakaful operators shall be reduced incrementally over the years as proposed below.

Figure 3 indicates that should Retakaful business ceded to the Retakaful pool be increased incrementally (2014-2022) every two years, starting with a ratio of 80:20 (Retakaful against Retakaful pool), the ratio will reversed to 80:20 (Retakaful pool against Retakaful), representing the optimal amount of Retakaful to be placed to the Pool, thus reaping the benefits as mentioned earlier. The 20% ratio to Retakaful is the residual Retakaful needs of the Retakaful operators especially for catastrophe covers as well as for large risk exposures.

Table 1: Projected profit and loss of the proposed surplus fire retakaful pool (RM’000)

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retakaful contribution revenue *(note 1)</td>
<td>51.58</td>
<td>68.10</td>
<td>89.81</td>
<td>118.60</td>
<td>156.60</td>
<td>206.71</td>
</tr>
<tr>
<td>Less wakalah fee *(2%) (note 2)</td>
<td>(1.03)</td>
<td>(1.360)</td>
<td>(1.79)</td>
<td>(2.37)</td>
<td>(3.13)</td>
<td>(4.13)</td>
</tr>
<tr>
<td>Net retakaful contribution *(note 3)</td>
<td>50.55</td>
<td>66.74</td>
<td>88.02</td>
<td>116.23</td>
<td>153.47</td>
<td>202.58</td>
</tr>
<tr>
<td>Add investment income *(5%) (note 4)</td>
<td>2.53</td>
<td>3.34</td>
<td>4.40</td>
<td>5.81</td>
<td>7.67</td>
<td>10.13</td>
</tr>
<tr>
<td>Total income *(note 5)</td>
<td>53.08</td>
<td>70.08</td>
<td>92.42</td>
<td>122.04</td>
<td>161.14</td>
<td>212.71</td>
</tr>
<tr>
<td>Less claims reserves, retrotakaful *(50%) (note 6)</td>
<td>(26.54)</td>
<td>(35.04)</td>
<td>(46.21)</td>
<td>(61.02)</td>
<td>(80.57)</td>
<td>(106.35)</td>
</tr>
<tr>
<td>Surplus *(50%) (note 7)</td>
<td>26.54</td>
<td>35.04</td>
<td>46.21</td>
<td>61.02</td>
<td>80.57</td>
<td>106.35</td>
</tr>
</tbody>
</table>

CONCLUSION

Malaysia positioning as one of the leading countries in Islamic finance, it promotes Takaful industry. However, the number of Retakaful operators is not catching up with the rapid growth of Takaful industry. In order to cede the risks faced by the Takaful operators in addition to engaging with the Retakaful operators, this study seeks the experts’ opinion towards the possibility of introducing Retakaful pool method and proposing the framework for Retakaful pool.
method. The findings from interviewing 9 experts by using the Delphi technique show that there is a possibility to introduce Retakaful pool method in Malaysia and this proposed method seems to pro with the concept of mutual help and cooperation among the Takaful operators. The results of this study will be of interest of the regulators, Shari’ah advisors, industrial players and the participants.

REFERENCES


End notes:

1 Extracted on 15th November 2012