



Issues and Challenges In Retakaful

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Why Retakaful?

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



Why Retakaful...?

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



Issues and Challenges

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

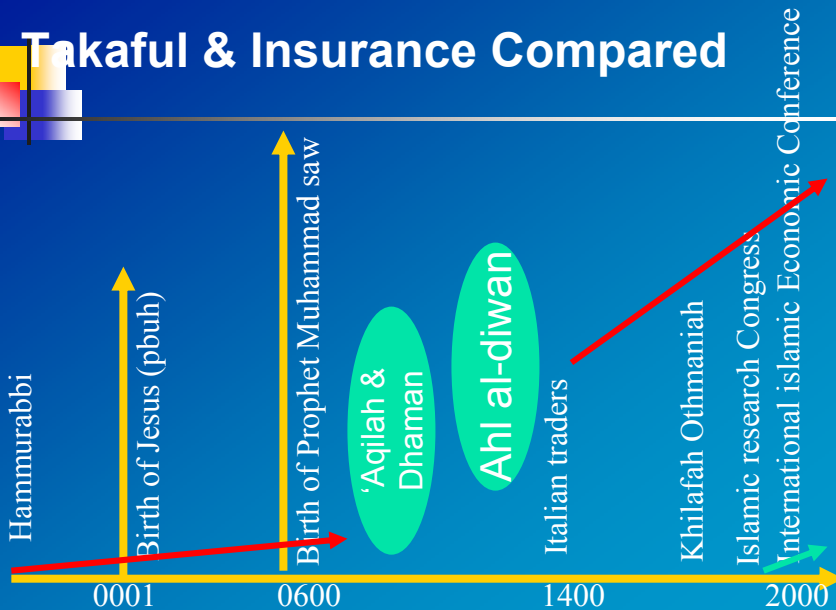


Technical Competence

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



Takaful & Insurance Compared





Technical Competence ...

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



Shariah Competence

- 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 ...

- Usul Fiqh
- Qawaid Fiqhiyah
- Fiqh Mu'amalat



Financial Strength

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



Market



Insurance
Market

Takaful
Market



Systems and Methods

- Processes and Procedures
- IT Systems
- Turnaround



Cooperation

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



On sharing risks

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



Concept of Lesser Evil (Danger)?

- 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

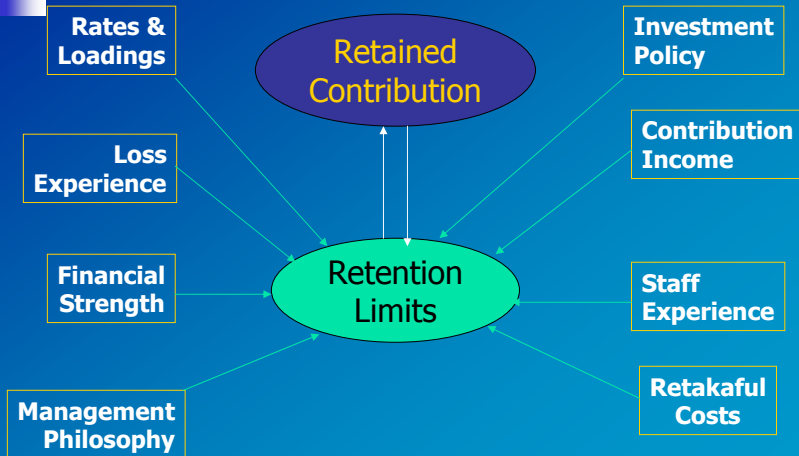


Current Retention Ratio

Table 1.12
Retention Ratio¹

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

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



Staff Experience

- Underwriting skills
- Quantitative skills
- Background
- Training



Loss Experience

**Table 1.15
Claims Ratio¹**

Year	Marine, Aviation and Transit	Fire	Motor			Mis- cella- neous	All Sec- tors
			'Act' Cover	Oth- ers	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

¹ 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 Ratio¹**

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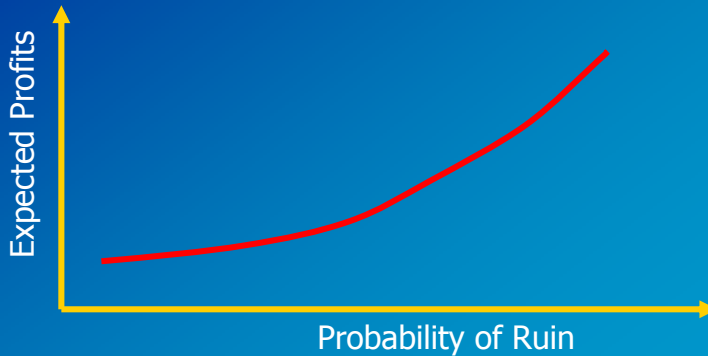
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Retakaful Costs

- Utility
- Probability of Ruin
- Expected Profits



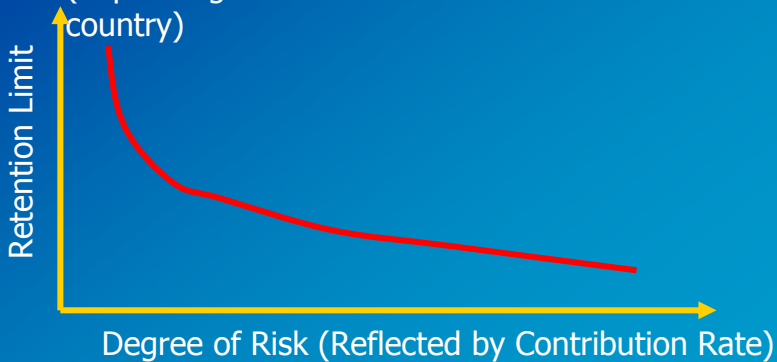
Investment Policy

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



Rates & Loadings

- 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

- 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

- $R = y \times (\text{Capital} + \text{Free Reserves})$
 - 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

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

Where

X = 1% - 5%

S = surplus

EC = earned contribution

GC = gross contribution

L = loss ratio

E = expense ratio



So,

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



Conclusion

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



Wassalam
