

# What Malaysia needs to be a global centre for retakaful



With contributions of about US\$750 million in 2008, or 34% of global takaful contributions, Malaysia is one of the biggest takaful markets worldwide. But is it also a global centre for retakaful? **Mr Marcel Omar Papp**, Head of Swiss Re Retakaful based in Kuala Lumpur, examines the necessary building blocks.

For Malaysia to be a global centre for retakaful, the following five pillars have to be in place:

- Availability of highly capitalised and rated retakaful security;
- Development of innovative concepts and products;
- Favourable regulatory environment;
- Harmonisation of practices; and
- Availability of skilled human resources.

At the core of these pillars is a clear understanding of and adherence to Shariah as highlighted in the illustration below. Let us now assess if Malaysia fulfills these factors.

## First pillar: Availability of highly capitalised and rated retakaful security

The global retakaful market was very small until recently. There were only a few active players which were mostly small in size. Therefore, takaful operators had to use conventional reinsurance under the darurah exemption.

However, since 2004, retakaful has risen in stature and popularity. More than a dozen new retakaful companies have been established, and the majority has chosen Malay-

sia as their global base. As a result, Malaysia currently has the biggest concentration of retakaful operators worldwide, with four companies licensed onshore in Kuala Lumpur and more than half a dozen in the offshore centre in Labuan.

Among them are also an increasing number of multinational retakaful operators such as Swiss Re Retakaful with a strong capital base and solid financial rating, which are also able to offer first-grade retakaful capacity. This has made the darurah exemption obsolete as there is now enough retakaful and also retrotakaful capacity available for most business classes.

The large number of retakaful operators in Malaysia helps the continuing growth and competitiveness of takaful operators, both within the country and abroad.

## Second pillar: Development of innovative retakaful concepts and products

Besides capacity, retakaful players should also bring in their technical expertise. A lot of takaful operators have only recently been established and may not have the necessary expertise for all business lines as yet. Retakaful operators can assist by providing underwriting support and training.

In addition, retakaful companies can play a vital role in developing products and solutions in business areas such as microtakaful or longevity which are still mostly untapped by the takaful market. Another challenge is the development of unique solutions that are more in line with the spirit and objectives of the Shariah, rather than simply duplicating existing conventional products.

Retakaful operators should also innovate in order to keep up with the changing needs of the takaful industry. For example, Swiss Re Retakaful has successfully introduced the innovative wakala waqf model to Malaysia.

Malaysia is well-placed to be at the forefront of innovation, given the significant number of market players with the necessary technical expertise and interest groups such as the Malaysian Takaful Association (MTA), Global Takaful Group (GTG), Islamic Financial Services Board (IFSB) and International Shariah Research Academy (ISRA).

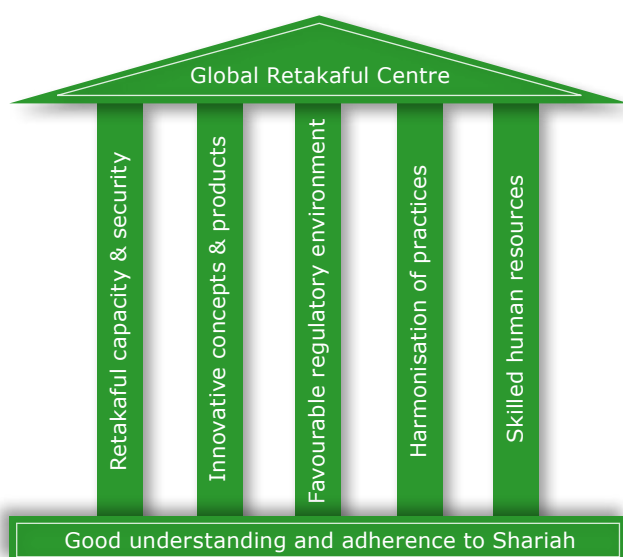
Ultimately, this will attract business to retakaful, which is currently going into the conventional reinsurance market.

## Third pillar: Favourable regulatory environment

For retakaful operators, it is important to be governed by a robust but conducive regulatory regime.

Malaysia has introduced various measures to make

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itself attractive to potential new companies, among them tax incentives for international retakaful business, and the option for international companies to set up a branch rather than a subsidiary.

However, retakaful operators licensed “onshore” in Kuala Lumpur are still at a disadvantage compared to companies operating out of Labuan with regards to capital requirements and tax treatment. Certain tax aspects are also less favourable compared to conventional reinsurers. Such disadvantages should be eliminated in order to achieve a level playing field and to make Kuala Lumpur an even more attractive retakaful hub.

An important new legislation is the risk-based capital (RBC) framework which is to be introduced in Malaysia in the near future. As it will affect retakaful operators significantly, they should also be involved in the consultation process.

As sufficient highly-rated retakaful capacity is now available, the regulators in Kuala Lumpur and Labuan should issue guidelines that takaful operators should use retakaful rather than conventional reinsurance.

#### Fourth pillar: Harmonisation of practices

Retakaful companies are currently adopting different operating models, practices and wordings. This can be very confusing for takaful operators and intermediaries. This is compounded by the fact that certain practices may be acceptable to some Shariah boards but not to others.

The industry has to harmonise retakaful practices to achieve greater operational efficiency and to ensure that doing business with retakaful companies is not more complicated than with conventional reinsurers.

It is vital for the various retakaful players in Malaysia to come up with industry best practices through regular discussion of technical and operational issues. A first step in this direction is the imminent finalisation of the standard retakaful wording by the MTA.

A more radical step towards harmonisation especially of Shariah rulings is the idea of having one common Shariah Board for all operators rather than each company having its own.

#### Fifth pillar: Availability of skilled human resources (HR)

As highlighted in a recent report by Ernst & Young, the lack of skilled HR, increasing competition for resources, and limited pool of scholars with relevant knowledge are considered the biggest business risks in takaful worldwide.

With the establishment of the International Centre for Education in Islamic Finance (INCEIF) and ISRA, Malaysia has undertaken important steps to improve the situation.

The Malaysian retakaful industry itself can play an important role in building expertise and knowledge by engaging takaful players, Shariah scholars and other interested parties. They should also offer internships to young professionals.

#### The underlying foundation: Good understanding and adherence to Shariah

The five pillars described above must be underpinned by a good understanding of and adherence to Shariah, which is at the core of retakaful.

The importance of Shariah compliance cannot be over-emphasised. Without it, there is a temptation for new retakaful companies to consider retakaful as an alternative distribution channel and apply the same practices as in conventional reinsurance. Some retakaful operators merely front business, and cede the bulk of it out to conventional reinsurance either internally or externally. Another contentious issue is the mingling of takaful and conventional risks.

These practices, if allowed to continue unabated, will result in a loss of reputation for retakaful, lead to direct and vicious competition with conventional reinsurers, and ultimately end in a loss of business for retakaful.

Hence, takaful operators and their Shariah Boards need to have a good understanding of the Shariah compliance of their retakaful partners, in order to make informed decisions about where to place their risks. Brokers must also be engaged as these intermediaries can be important influences in the buying decisions of takaful operators.

Most importantly, the local retakaful industry itself has to enhance the knowledge of market players in key retakaful practices and Shariah matters. Takaful operators and Shariah scholars do not always understand the specifics of retakaful. Therefore, the industry under the umbrella of the MTA and GTG should come up with guiding principles on Shariah-compliant retakaful practices which can then be used as benchmarks to ensure a more consistent application of retakaful, not only in Malaysia but worldwide. This, in turn, will ensure a more level playing field between the various operators.

The industry should also work with ISRA to establish a database on Shariah principles and rulings relating to retakaful.

The commitment to Shariah compliance needs to be at the core of retakaful in order to promote it as a viable alternative to conventional reinsurance and by this, to ensure the growth of the (re)takaful industry.

#### Conclusion

Malaysia is in a good position to become a global retakaful centre. It already has a significant number of operators with good security and technical expertise in the country.

However, the various stakeholders will still have to come up with additional initiatives as outlined above. The regulator needs to do their part to make sure there is a conducive business environment in Malaysia.

At the same time, the retakaful industry in Malaysia has to harmonise practices, improve the understanding of the various stakeholders about retakaful and provide guidance on Shariah compliance in retakaful in order to ensure that Malaysia will become the true global centre for retakaful. ■



Dome of National Mosque, Kuala Lumpur, Malaysia