ISLAMIC REINSURANCE: RETAKAFUL

cobalt.
ADVISORY

OVERVIEW

- ❑ What is reinsurance
- ❑ Why have reinsurance
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WHAT IS REINSURANCE?

- An insurance company (The ‘ceding company’) purchases an insurance policy from another insurance company (the "reinsurer") as a means of risk management and mitigation.
- The ceding company enters into a reinsurance contract with the reinsurer which details the conditions upon which the reinsurer would pay a share of the claims incurred by the ceding company in return for a premium contribution.
- There is usually no direct relationship between the Reinsurer and original insureds (the Participants or the clients)

WHY HAVE REINSURANCE?

1) Accept more risk

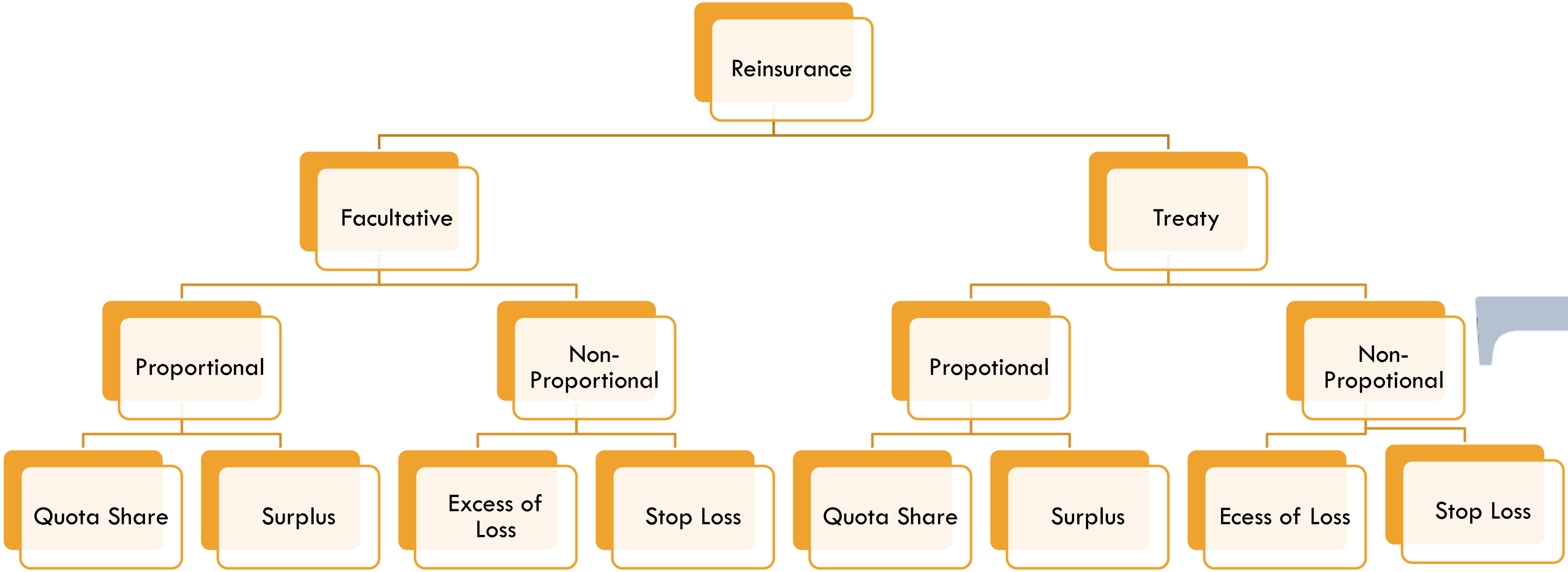
- An insurance company's capacity is limited by its balance sheet. To enable the insurance company to write insurance beyond its capacity, it can opt to purchase reinsurance.
- The insurer can then issue policies with higher limits than would otherwise be allowed, thus being able to offer a large participation in that risk as now some of that risk is shared with the reinsurer.

WHY HAVE REINSURANCE?

2) Protect the company

- The ultimate goal of reinsurance is to distribute risk across multiple balance sheets, mitigate aggregation of similar risks or to remove the volatility of certain events have a disproportionate affect up a single insurers' balance sheet.
- Examples of such events are the significant losses resulting from catastrophic disasters such as hurricanes, tsunamis and earthquakes.
- Reinsurance helps to ensure that insurance companies maintain

REINSURANCE ARRANGEMENTS



SHARIAH ISSUES & SOLUTIONS

1) The Ceding Commission

The insurer will be in receipt of a ceding commission for placing the business with the reinsurance company.

Should the insurer be entitled to such commission as compensation for acquisition and overhead costs?

SHARIAH ISSUES & SOLUTIONS

2) Profit Commission

The insurer may be awarded an incentive based on the reinsurer's profitability under the reinsurance contract, calculated in accordance with the terms and conditions of the contract. The aim of an incentive is to provide the insurer with an incentive to manage the performance of the business that is ceded. Normally a profit commission differs from a distribution of surplus in that it is a contractual entitlement, rather than a discretionary distribution, and is specific to the performance of a contract.

Would the insurer be entitled to keep such commission as Performance Incentive?

SHARIAH ISSUES & SOLUTIONS

3) Interest receivable

There is the potential presence of interest/usury in other aspects of reinsurance contracts entered into. For example, it is common practice under proportional treaties for insurers to retain a part of the premiums on account of possible future claims, and in the conventional insurance market such “retentions” are typically interest-bearing.

All interest elements must be removed. Any interest received will be isolated and donated as a purification process.

SHARIAH ISSUES & SOLUTIONS

4) The attribution of the recoveries claimed from the conventional reinsurer.

a. Should the recoveries be credited to the Participants Trust Fund (PTF), because:

- the claims were paid out from the PTF;
- the purpose of reinsurance was to assist with claims and strengthen the PTF
- conflict of interest: if the recoveries are not paid into the PTF, it could be viewed as a method and strategy to divert the contributions from the PTF into other accounts.

b. Should the recoveries be credited to the non PTF account because:

- the source of recoveries is not Shariah compliant
- the funds in the PTF must remain pure and not co-mingled with recoveries obtained from non-Shariah complaint sources
- they recoveries will be offset against any loans and in the absence of any loans, will be distributed to charity as a process of purification.

SHARIAH ISSUES & SOLUTIONS

5) Inward Treaty Reinsurance

Particularly if the retakaful accepts business from conventional insurers, the insurer will not have performed Shariah review and therefore non-compliant elements are inadvertently contained in aggregations of otherwise compliant risks bundled together for cession.

What are the implications of accepting business that is not Shariah compliant and how do we determine if the business is acceptable. Should there be an acceptable threshold and/or purification process that arises as a result of accepting mixed risks.