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Reform of Retakaful Industry: A Quest

AHMAD ALSHAMMARI*

OTHMAN ALTWIJRY**

Abstract

One of the fundamentals in the risk management system for a takaful company is that it needs to cede its risks to the second level of risk carriers (retakaful companies). At the same time, being a sharī'ah-compliant company, the expectation is that its operational chain is in line with Islamic rules and principles. However, due to limitations on the maturity of the retakaful market, sharī'ah scholars have used the precept of necessity (ḍarūrah) in the use of conventional reinsurance. The permissibility of using conventional reinsurance has been adopted for decades, going back to the establishment of takaful. However, this practice has, to a certain extent, weakened the perception of the sharī'ah compliance aspect of takaful. This article aims to enhance the arrangement of the takaful industry practices in relation to the fatwā on the permissibility of using conventional reinsurance based on the precept of ḍarūrah. It has employed a qualitative method, in the form of semi-structured interviews, to explore the views of six sharī'ah scholars on whether the concept of ḍarūrah is still applicable. It is found that the majority of scholars, i.e., five, were not provided information or analysis that could have facilitated them in assessing and making the informed decision on the applicability of the precept of ḍarūrah in the use of conventional reinsurance. There is a consensus among the scholars on the given proposals to enhance the current practices of the market and boost the retakaful market. This study introduces new perspectives pertinent to review the retakaful industry's legitimacy.

Keywords

Islamic reinsurance, necessity, ḍarūrah, takaful, retakaful.

1 Introduction

A *fatwā* is a religious resolution or ruling, which is considered a powerful and impactful statement in determining all aspects of Muslim life, including Islamic finance. The establishment of the takaful sector can be attributed to a *fatwā*, when the OIC Fiqh Academy issued Resolution No.

* Founder, ResearchMate Platform, Tallinn, Estonia.

** Assistant Professor, Department of Economics and Finance, College of Business and Economics, Qassim University, Buraydah, Kingdom of Saudi Arabia.

9/(2/9) regarding insurance in December 1985. Various *fatwās* have also contributed to adjustments in market practices, such as in February 2008, Muhammad Taqi Usmani commented that *mushārah* and *muḍārabah sukūk* should not promise guaranteed returns.¹ This significant statement led issuers to refocus on other *sukūk* structures, bringing advancements, and increasing the use of models such as *ijārah sukūk*.²

On the flip side, a *fatwā* (or even a view of scholars) may also be seen as having limiting growth and development. One such example is the permissibility of using conventional reinsurance based on the precept of necessity (*ḍarūrah*), which could be seen as a factor restraining the growth of the retakaful business. Previous studies have identified the factors that have led to the issuance of such *fatwā*, e.g., inadequate number of retakaful companies, small size retakaful companies, and low credit rating of retakaful providers.³ The permissibility of using conventional reinsurance became a norm to the point that the takaful stakeholders (such as takaful companies and *sharīah* boards) feel comfortable using conventional reinsurance and thus put less effort into adjusting or enhancing the practice. Hence, this article aims to enhance the arrangement of the takaful industry's practices in relation to the *fatwā* on the permissibility of using conventional reinsurance based on the precept of *ḍarūrah*. In December 2022, the central bank of Malaysia Bank

¹ Mohammed Abbas, "Sukuk Should Be Equity Instruments," *Gulf News*, June 7, 2008, <https://gulfnnews.com/business/markets/sukuk-should-be-equity-instruments1.110624>.

² Daliah Merzaban, "Scholar Critique Spurs Ijara Islamic Bond," *Reuters*, April 15, 2009, <https://www.reuters.com/article/us-islamicbanking-summit-sukuk idUSTRE53C0ZX20090415>.

³ A. Ab Rahman, "Exploring Shari'ah Views on the Practice of Takaful Company Reinsuring with Reinsurance Company," in *ISRA Shari'ah Conference on Takaful* (2009); A. Ab Rahman, W. M. W. Ahmad, and A. H. Buang, "Can a Takaful Company Reinsure with a Reinsurance Company?" *African Journal of Business Management* 5, no. 30 (2011): 11768–78; Aznan Hasan, "Shari'ah Issues in the Operation of Retakaful and Reinsurance: A Preliminary Exploration from Shari'ah Perspective," *IIUM Law Journal* 19, no. 2 (2011): : 149-78; Ehsanullah Agha and Zurina Shafii, "Hājah in Islamic Finance: Mastering the Doctrine of Need in Shari'ah Decision Making," *Journal of Fatwa Management and Research* 26, no. 1 (2021): 37-50, <https://doi.org/10.33102/jfatwa.vol26no1.395>; Hartini Ab. Ghani et al., "Is Hajiyat still the Basis for Takaful Operators to Resort to Conventional Re-Insurance?: An Appraisal on Malaysian Takaful Industry," in *Islamic Development Management: Recent Advancements and Issues*, ed. Noor Zahirah Mohd Sidek, Roshima Said, and Wan Norhaniza Wan Hasan (Singapore: Springer, 2019), 207-14; H. Zakariyah and A. A. Ahmed, "Contemporary Issues and Challenges Faced by the Takaful Industry in Malaysia: Special Reference to Shariah," *Al-Hikmah: International Journal of Islamic Studies and Human Sciences* 2, no. 4 (2019): 123–35.

Negara Malaysia (BNM) issued an exposure draft⁴ for public consultation. It set the tone for the market to change the dimension by not classifying ceding to conventional reinsurance under the precept of *darūrah*, classifying it under *hājah* (need).

Many retakaful operators have been established in different regions, whether in the form of full-fledged firms or windows, with even the giant conventional reinsurance players (i.e., Hannover Re and Munich Re), on board. Many retakaful providers have also received strong credit ratings from top credit rating agencies (see Table 1), a factor which is seen by the authors as somewhat diluting the strength of the justification (i.e., ceding risks to reinsurance firms due to poor credit rating of retakaful firms) for using conventional reinsurance. The article contributes to the literature on the takaful/retakaful market and links academia with the current industry practice.

2 Literature Review

2.1 Reinsurance and Retakaful: Introductory Background

2.1.1 History

Kopf traced the first reinsurance contract back to the year 1370 CE, when a person by the name of Guilano Grillo, an underwriter, entered a contract with Goffredo Benaira and Martino Saceo to reinsure a ship on part of a voyage from Genoa to Bruges harbour. The contract stated that Grillo was to retain the risk of the voyage through the Mediterranean, with the risk to be transferred to Benaira and Sacco upon reaching Cadiz through the Bay of Biscay and along the coast of France.⁵

Gerathewohl highlights that the term “to reinsure” first appeared in 1457, derived from the Italian term “rasichurare.”⁶ In terms of legislation, the oldest law dealing with insurance was found in a 1435 ordinance passed in Barcelona. As for reinsurance, it was explicitly authorized in a law passed in the “Antwerp Customs” of 1609.⁷

⁴ “Exposure Draft on Hajah and Darurah - Bank Negara Malaysia,” accessed on January 24, 2023, <https://www.bnm.gov.my/-/ed-hajah-darurah>.

⁵ E. W. Kopf, “Notes on the Origin and Development of Reinsurance,” *Proceedings of the Casualty Actuarial Society* 16 (1929): 22–91.

⁶ Klaus Gerathewohl, *Reinsurance, Principles and Practice*, vol. 2 (n.p.: Verlag Versicherungswirtschaft, 1983).

⁷ David M. Holland, “A Brief History of Reinsurance,” *Reinsurance News* 65, no. 19 (2009): 4–29.

The Great Fire of Hamburg disaster in 1842, which destroyed over a thousand buildings, proved to be a wake-up call for German insurers, who realized the need for reinsurance in bigger firms.⁸ Subsequently, the first independent reinsurance company the Cologne Re was founded in Germany in 1846 from an idea proposed by Mevissen. It started operating in 1852. Cologne Re was purely a reinsurance firm and did not underwrite policies directly.

Similar to the insurance system, takaful firms needed retkaful to support their operations. Takaful operators needed this second level of takaful to help them to grow and sustain their operations. During the early years of the takaful business, scholars allowed takaful firms to cede their risks to conventional reinsurance companies based on the concept of necessity (*darūrah*). Awang and Zakaria highlight that the expansion of the *takāful* business encouraged the establishment of Islamic reinsurance. They mentioned Islamic Insurance and Reinsurance Company (IIRCO)—under the Albaraka Group, and incorporated in Jeddah in 1986—as the first firm offering Islamic reinsurance. However, it was BESR Re, established in 1985 in Tunisia that was the industry pioneer. The firm is fully owned by the SALAMA Group.⁹ Ahmad, Bin Mahbob, and Ayub state that Asean Retakaful International (L) Limited (ARIL) was the first firm that incorporated the term “retakaful” in its name in 1997.¹⁰

2.1.2 Definitions

Reinsurance can simply be defined as “insurance for insurance companies.” It is known as the “second level of insurance.” Many authors and institutions attempted to define reinsurance. The International Association of Insurance Supervisors (IAIS) defines it as follows:

Reinsurance refers to insurance purchased by an insurer (the ceding insurer) to provide protection against certain risks, primarily underwriting risks of the insurance policies issued by the insurer.

⁸ Dirk Nieder, “Quo Vadis Reinsurance,” *Reinsurance News* 95 (2019): 6, accessed January 24, 2023, <https://www.soa.org/globalassets/assets/library/newsletters/reinsurance-section-news/2019/november/2019-reinsurance-news-issue-95.pdf>.

⁹ Idris Awang and Syukriyah Zakaria, “The Conception and Response of Muslim Community to Takaful Schemes: A Case Study in Bagan Serai, Perak,” *Jurnal Fiqh* 2, no. 1 (2005): 1–18, <https://doi.org/10.22452/fiqh.vol2no1.1>.

¹⁰ Abu Umar Faruq Ahmad, Ismail Bin Mahbob, and Muhammad Ayub, “The Nature of Retakaful: Risk Sharing or Transferring Risks?” in *Takaful and Islamic Cooperative Finance: Challenges and Opportunities*, ed. S. Nazim Ali and Shariq Nisar (Cheltenham: Edward Elgar Publishing, 2016), 171–91.

Reinsurers assume these risks in exchange for a premium. . . .

A reinsurance contract is by nature a business-to-business transaction, made between professional counterparties as part of a wider risk and capital management approach. For this reason, the sort of asymmetry of expertise and knowledge associated with insurance contracts involving general consumers is usually not an issue in the reinsurance sector, although some asymmetry of bargaining power can exist, depending on the precise dynamics of the market.¹¹

For simplicity, a reinsurance contract is an agreement between two or more parties, one party is ceding the risks, generally known as ceding company or reinsured, and the second party accepts the risk ceded and there can be one reinsurer or more, in handling the risk ceded. It is important to mention that the reinsurer does not have a direct contractual relationship with the policyholder/insured.

Retakaful is the *sharīah*-compliant structure of conventional reinsurance. Many authors have defined retakaful.¹² Basically, the definitions revolve around the parties involved in a retakaful contract, where the cedent (the party that cedes or shares the risks) is the takaful operator, and the party that offers capacity for and underwrites the ceded risks is the retakaful operator. In this section, the definition used is one by an international standard-setting body the Islamic Financial Services Board (IFSB), which defined retakaful as “An arrangement whereby a *takāful* undertaking cedes a portion of its risks on the basis of treaty or facultative *retakāful* as a representative of participants under a *takāful* contract, whereby it would contribute a portion of the contribution as *tabarru‘* into a common fund to cover against specified loss or damage.”¹³ The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defined Islamic reinsurance as follows:

Islamic Rensurance refers to the agreement among insurance companies, on behalf of the insurance funds under their management, to devise a mechanism for the avoidance of part of the risks which the insurance funds may encounter. On the basis of such agreement a reinsurance fund

¹¹ IAIS, “Insurance Core Principles and Common Framework for the Supervision of Internationally Active Insurance Groups” (November 2019), para. 13.0.1 and 13.0.5, <https://www.iaisweb.org/uploads/2022/01/191115-IAIS-ICPs-and-ComFrame-adopted-in-November-2019.pdf>.

¹² For example see Ahmad, Bin Mahbob, and Ayub, “The Nature of *Retakaful*,” 171-91; Nurwajihah Ajlaa Ali and Ruzian Markom, “Shariah Compliance on Retakaful in Malaysia,” *Diponegoro Law Review* 6, no. 1 (2021): 1-16, <https://doi.org/10.14710/dilrev.6.1.2021.1-16>.

¹³ IFSB, “Guiding Principles for Retakāful (Islamic Insurance) IFSB-18” (April 2016), p. 38, s.v. “retakāful.” Also see <https://search.emarefa.net/en/detail/THSD-2578-re-takaful-islamic-law>.

which has a distinct legal personality and independent financial liability is formed up through making contributions out of the insurance funds paid by the insurance clients on the basis of donation. The reinsurance fund, thus formed, assumes the task of covering part of the risks encountered by the insurance funds.¹⁴

2.1.3 Types of Retakaful

The contract between reinsured and the reinsurer is built around different types of arrangements and this area is one of the commonalities between retakaful and reinsurance.⁵ A reinsurer/retakaful operator (RTO) provides coverage to direct insurers/takaful operators (TOs) in two main arrangements: on a treaty or facultative basis. A treaty arrangement, also known as an obligatory arrangement, covers the whole or part of all contracts within a given portfolio. The name obligatory is given due to its nature where the reinsurer/RTO is obliged to accept all risks ceded by the reinsured and does not have the right to reject specific risks in the ceded portfolio. The facultative arrangement is different. It is designed for a single contract and each risk is written separately. As such, the reinsurer/RTO can choose whether to accept or reject the risk to be ceded by the reinsured.¹⁵

The treaty and facultative reinsurance/retakaful arrangements can be further classified into proportional and non-proportional arrangements. This is where the direct insurer/TO and the reinsurer/RTO in a proportional arrangement, divide premiums/contributions and losses between them at a contractually defined ratio (surplus quota shares for treaty and quota share for facultative). For a non-proportional arrangement, the reinsurer/RTO assumes a defined tranche of the risk (stop loss for treaty and excess of loss for facultative).¹⁶

¹⁴ AAOIFI, "Shari'ah Standards for Islamic Financial Institutes" (2017), Shari'ah Standard No. 41, para. 2.1.

¹⁵ R. L. Carter, *Reinsurance* (Dordrecht: Kluwer Academic, 2014); H. Albrecher, J. Beirlant, and J. L. Teugels, *Reinsurance: Actuarial and Statistical Aspects* (n.p.: John Wiley & Sons, 2017).

¹⁶ A. D. Putri, S. Nurrohmah, and I. Fithriani, "Quota-Share and Stop-Loss Reinsurance Combination Based on Value-at-Risk (VaR) Optimization," *Journal of Physics: Conference Series* 1725, no. 1 (2021): 1-11, <https://doi.org/10.1088/1742-6596/1725/1/012097>; Yang Zhao, Jin-Ping Lee, and Min-Teh Yu, "Catastrophe Risk, Reinsurance and Securitization Risk-Transfer Solutions: A Review," *China Finance Review International* 11, no. 4 (2021): 449-73, <https://doi.org/10.1108/cfri-06-2021-0120>.

2.1.4 Differences

The definitions of reinsurance and retakaful can give an insight into the differences between them, where the key differentiator is the mechanism of dealing with the risk. While reinsurance transfers risk from insurer to reinsurer, retakaful is built on the sharing of risks. IFSB provides the following salient points relating to the retakaful business: The retakaful contract is based on the cooperation concept and complies with the principles of Shariah. The RTO should have governance policies pertaining to *qard* and underwriting surplus, where the RTO is required to provide financial assistance like *qard*¹⁷ should a deficit occur in the retakaful risk fund (RRF). The ownership and allocation of the underwriting surplus should be clear, whether it is fully distributed to cedants, or a share goes to the RTO. The cedants and Tos are considered the owners of the RRF and cooperate and mutually support any member who suffers from certain risks. The RTO should ensure that investment activities are in line with the *sharīah* rules and principles. The roles of the retakaful parties are unique, and the RTO acts as an agent on behalf of the RRF to run the business activities. Retakaful operations should be reviewed and endorsed by the *sharīah* committee/board/advisors (depending on the jurisdiction's regulations).¹⁸

2.2 Why a Takaful/Insurance Business Needs Retakaful/Reinsurance?

Reinsurance has become part and parcel of the insurance system. Its functions add value to direct insurers thus making reinsurance indispensable in the insurance cycle. As mentioned above, an insurer needs a reinsurer to meet certain financial objectives within the framework of the insurance business. Similarly, this second-level protection is essential in takaful. The following are the key functions that could assist the reinsured, as stated by Swiss Re and Organization for Economic Cooperation and Development (OECD):

1. Capacity Increase: Direct insurers have limited capacity size in underwriting risks. A reinsurance arrangement enables insurers to underwrite risks bigger than their capital size. It helps insurers in achieving their financial objectives by expanding their businesses by providing insurance coverage to large industrial and mega risks.
2. Avoid a Single Large Loss: Handling a large claim could severely affect the financial position of an insurer. A reinsurance arrangement is a

¹⁷ *Qard*, a non-interest loan, is generally not a contractual responsibility of the RTO; rather, it is the operator that may offer funds for *qard* if the pool is in deficit.

¹⁸ IFSB, "Guiding Principles for Retakāful (Islamic Insurance) IFSB-18" (April 2016), para. 85.

protection level against major individual risks and natural catastrophe risks, acting as a backup for the insurance market as it spreads the risks across the globe and minimises the potential loss for a single company.

3. **Expertise:** The nature of the reinsurance business allows a reinsurer to deal with many direct insurers in different regions. This gives reinsurance professionals access to more information and experiences, putting them in a better position to advise and provide assistance to cedants on underwriting, pricing, claims handling, loss prevention, actuarial, reserving, investment, and other areas. A reinsurer may provide an overview to cedants, particularly a small or medium size insurer, on the general issues and trends, e.g., on cyber coverage and risk.
4. **Stabilisation:** An insurer is bound by a capital size which leads to limitations on the firm's underwriting and accumulation capacities. Reinsurance arrangements can assist insurers in absorbing large unpredictable losses, while insurers retain the small and predictable claims. Ceding to reinsurers help insurers reduce claims volatility and have more stability in their underwriting and financial results.¹⁹

2.3 Common Shari'ah Issues in the Retakaful Business

This secondary level of risk protection, reinsurance, and retakaful face several issues in their respective practices. There are various *shari'ah* issues pertaining to reinsurance and retakaful operations (e.g., retakaful dealings with conventional insurers, reinsurance commission, surplus distribution, and takaful ceding risks to conventional reinsurers). This section discusses these issues in brief, except the issue of takaful dealings with conventional reinsurers, which has been discussed separately as it is the core of the article.

2.3.1 Retakaful Dealings with a Conventional Insurer

AAOIFI Shari'ah Standards grant approval for an Islamic reinsurer to provide coverage service to a traditional insurer, subject to three conditions: 1) the contract to be used should be an Islamic reinsurance contract; 2) there should be no linkage (other than the retakaful ceding arrangement) between the conventional insurance and retakaful company; and 3) reinsurance should not involve a *shari'ah* prohibited

¹⁹ Swiss Re, *The Essential Guide to Reinsurance* (Zurich: Swiss Re, 2010); OECD, "The Contribution of Reinsurance Markets to Managing Catastrophe Risk" (2018), <https://www.oecd.org/finance/the-contribution-of-reinsurance-markets-to-managing-catastrophe-risk.pdf>.

object.²⁰ In this matter, IFSB emphasizes that the RTO should have a procedure in place, before accepting risks from conventional insurers, so that the risk, the contract and any other pre-agreed arrangements, such as contribution retention by the conventional insurer (and the way it is invested), are *sharīah*-compliant.²¹

2.3.2 Reinsurance Commission and Surplus Distribution

This is related to the structure of reinsurance and retakaful associated with the flows of money between parties involved. The reinsurance commission is one of the most important features of the proportional treaty arrangement. It is defined in the AAOIFI glossary as “a percentage amount of the contributions payable to the reinsurance company, paid to the Islamic insurance company for the efforts it exerts in mobilizing the reinsured insurance contracts.”²² AAOIFI Shari’ah Standards state that it is not permissible for an Islamic insurer to receive a reinsurance commission from a conventional reinsurer.²³ This is adopted by many jurisdictions including Malaysia.²⁴ However, it is proposed for an Islamic insurer to seek premium discounts from the conventional reinsurance company. This practice is called Ceding Commission and is defined in a glossary published by IFSB as “a discount based on a percentage specified in the contract, deducted from the contribution or premium paid by a cedant under some forms of *retakāful* or reinsurance arrangement. The contribution or premium paid, less the ceding commission, reflects the net price paid for the cover obtained.”

For surplus distribution, AAOIFI Shari’ah Standards state that an Islamic insurer should not accept any redistributions of surplus forwarded by a conventional reinsurer. Nonetheless, Islamic insurance companies seek to ask for premium discounts from a traditional reinsurer.²⁵ IFSB states, “Policy and procedures are in place with regard

²⁰ AAOIFI, “Shari’ah Standards for Islamic Financial Institutes” (2017), Shari’ah Standard No. 41, para. 8.3.

²¹ IFSB, “Guiding Principles for Retakāful (Islamic Insurance) IFSB-18” (April 2016), para. 85 (vii).

²² AAOIFI, “Shari’ah Standards for Islamic Financial Institutes” (2017), Shari’ah Standard No. 41, s.v. “reinsurance commission.”

²³ *Ibid.*, Shari’ah Standard No. 41, para. 7.2.

²⁴ A resolution of the Shariah Authority Council (SAC) of Malaysia in its fourth special meeting on November 29, 2007, stated that treating retakaful commissions (received from a retakaful company) as income of the shareholders’ fund is not allowed. This resolution was published earlier than the Shari’ah Standard No. 41

²⁵ AAOIFI, “Shari’ah Standards for Islamic Financial Institutes” (2017), Shari’ah Standard No. 41, para. 7.3.

to the treatment of surplus arising in the RRF [Retakaful Risk Fund]. The presumption should be that underwriting surplus arising in the RRF is attributable to cedants, and that if any of the surplus is distributed rather than being retained within the RRF, it should be distributed to the cedants' PRFs [Participants' Risk Fund].²⁶ Exceptions to these presumptions should be justified based on Sharī'ah."²⁷

2.4 Takaful Dealing with a Conventional Reinsurer

As mentioned in section 2.2, takaful firms need support from second-level risk carriers. The ideal approach is dealing with retakaful providers. However, many takaful providers still reinsure with conventional reinsurers. To protect the takaful funds and shareholders' funds, takaful firms have been allowed to reinsure with conventional reinsurers due to the reasons discussed by Ab. Rahman and others⁴ and Ab. Ghani and Lambak⁷ as follows: 1) an inadequate number of retakaful companies in the market to support the expansion of the number and size of products, services and large geographical places of takaful companies; 2) small-size retakaful companies that have limited or lack of capacity, where disallowing takaful operators to cede with conventional reinsurance may harm the whole takaful industry; 3) lack of retakaful companies with high ratings. These are the key reasons for the *sharī'ah* justification in applying the doctrine of *ḍarūrah*, which is known under the legal maxim as necessities which render unlawful acts lawful.

Ḍarūrah is "an absolute necessity that permits the forbidden except for what is excluded. However, if a necessity is below that, it is expressed as a need (*ḥājah*), but sometimes it is also included in necessity as a broad use."²⁸ It is seen as a crucial and essential necessity that, without it, could lead to loss of life or severe damage and losses. In this context, each case is subject to different assessments on whether it falls under the *ḍarūrah*

²⁶ The Council of the International Islamic Fiqh Academy (IIFA), in its 21st meeting in Saudi Arabia, resolved in relation to takaful: "The insurance fund surplus is the financial amount that remains from the collected contributions, the revenues of investing them, and any other revenues after paying the compensations after deducting the provisions and reserves needed and paying all the expenses and liabilities due to the fund. The insurance surplus can be kept in the fund; or it can be distributed; or a part of it could be justly apportioned to the policyholders (participants) in accordance with the fund regulations." By analogy, this principle is also applied to retakaful.

²⁷ IFSB, "Guiding Principles for Retakāful (Islamic Insurance) IFSB-18" (April 2016), para. 85 (ii).

²⁸ 'Abd Allāh b. Bayyah, *Sinā'ah al-Fatwā wa Fiqh al-Aqalliyāt* (n.p.: Al-Muwatta Center, 2018).

concept and its consequences. There are several conditions to apply this principle and permission to use a non-*sharīah*-compliant option. For instance, 1) Other permitted options do not exist; 2) Use should be limited to a certain time until other options exist or become available; and 3) Use should be at a minimum level.

Due to the reasons stated above, many institutions (e.g., AAOIFI, Bank Negara Malaysia, and *sharīah* boards of takaful firms) allow takaful operators to reinsure with conventional companies in cases where there is no alternative Islamic reinsurance provider, and it must be limited to a certain time until an alternative becomes available. As the *ḍarūrah* concept in *sharīah* is linked to time and availability, the necessity should be examined and assessed from time to time to identify whether the necessity still exists. The researchers feel the *fatwā* of permissibility has been taken for granted with a minimum effort taken by the key stakeholders in the takaful industry to re-examine the need. This non-action brings the legitimacy of this industry into question.

International Islamic financial organizations have provided their respective guidance on the matter. In its twenty-first session, held in Saudi Arabia in November 2013, the IIFA states in Clause 10, “Islamic insurance companies are committed to do all their reinsurance arrangements with Islamic reinsurance companies.” Dealings with conventional reinsurance companies are only allowed when such a commitment is impossible and with reasonable justifications. The agreement between the two parties should be controlled by conditions set by *sharīah* boards or any other controls they deem suitable. Clause 10 mentions various controls on Islamic insurers, such as trying to keep the ratio of coverage with conventional reinsurance at a minimum, and the agreement with conventional partners should be for the minimum possible duration.

Similarly, AAOIFI Shari’ah Standards state several provisional controls to govern the dealings between Islamic insurance and conventional reinsurance.²⁹ This research will explore the implementation of three of these main controls: 1) Islamic insurance companies should first reinsure with Islamic reinsurance companies, to the largest possible extent; 2) The period of the reinsurance agreements sought by Islamic insurance companies from traditional reinsurance companies should be commensurate to the actual need; and 3) Islamic insurance companies should stick to the minimum size of reinsurance

²⁹ AAOIFI, “Shari’ah Standards for Islamic Financial Institutes” (2017), Shari’ah Standard No. 41, para. 6.1-6.5.

with traditional reinsurance companies. In this regard, *sharīah* boards play an important role in monitoring and revisiting the justifications (i.e., *ḍarūrah*) for using conventional reinsurance.

3 Research Methodology

This article has adopted an exploratory research design, deemed suitable in situations where few literatures have examined a subject,³⁰ which, in this case, is “the permissibility of using conventional reinsurance based on necessity concept.” Accordingly, the article has used a qualitative method in the form of semi-structured interviews to solicit the views of *sharīah* scholars on the concept of necessity in the takaful/retakaful market. The semi-structured interviews were conducted in an online conversational manner to allow experts to freely explore and provide feedback on the issues raised.

The target population for the study are *sharīah* scholars who sit on a takaful firm’s *sharīah* board. The basis for determining the sample frame was the “substantive areas of expertise and by virtue of experts’ knowledge in the field.”³¹ The sample size determined for the study is twelve experts. This size is considered adequate, as for a flexible design study, the number of interviews has not been specified.³²

The interview questions comprised two open-ended questions that allowed the scholars the freedom to express their opinions in their responses.²⁷ The questions were related to the doctrine of *ḍarūrah* in approaching conventional reinsurance. The items in the questionnaire were validated by peer experts as suggested by Sandelowski.²⁹ The researchers included four proposals that were given to the interviewees to see whether these proposals are useful in improving and enhancing the takaful industry. The aim of the proposals was, rather than continue relying on the concept of *ḍarūrah*, to set a plan for moving forward and to show the seriousness of takaful firms in their approach to using retakaful.

4 Results and Discussion

At the time of preparing, and to assist the drafting of questions and proposals for the *sharīah* scholars, the researchers explored the list of

³⁰ W. L. Neuman, *Social Research Methods: Qualitative and Quantitative Approaches*, 7th ed. (Essex: Pearson Education Limited, 2014).

³¹ Margarete Sandelowski, “Writing a Good Read: Strategies for Re-Presenting Qualitative Data,” *Research in Nursing & Health* 21, no. 4 (1998): 375–82, [https://doi.org/10.1002/\(sici\)1098-240x\(199808\)21:4<375::aid-nur9>3.0.co;2-c](https://doi.org/10.1002/(sici)1098-240x(199808)21:4<375::aid-nur9>3.0.co;2-c).

³² C. Robson and K. McCartan, *Real World Research* (New York: John Wiley & Sons, 2016).

takaful operators in different countries. Based on the websites of 28 takaful operators in the Gulf Cooperation Council (GCC), the researchers searched for three aspects: 1) Does the takaful operator disclose to whom the risks are ceded to? 2) Does the takaful operator disclose the ratio of conventional reinsurance in its portfolio? and 3) Does the *sharīah* report state the justification for ceding to conventional reinsurance? It was found that only six firms provide information about the secondary risk level (see Appendix).

The researchers attempted to present the performance ratios of retakaful providers. However, very few firms disclose their annual reports and firms offering retakaful as a window do not segregate between the host and the window, except for Malaysian Re and Tunis Re. Thus, table 1 shows the availability of the retakaful providers in the market (the market may have other retakaful providers) and states the general information relating to each firm, including the credit ratings.

Table 1: General Information of Selected Retakaful Providers (2021)

Company	Incorporation	Rating	Rated by
Saudi Re	Full-fledged Islamic reinsurance firm, established in 2008 in Saudi Arabia	A3	Moody's
Kenya Re	Retakaful window, established in 2013 in Kenya	B	AM Best
Africa Re	Full-fledged Islamic reinsurance firm (subsidiary in Egypt), established in 2010	A A-	AM Best Standard & Poor's
Arig (Takaful Re Limited)	Full-fledged Islamic reinsurance firm, established in 2005 in the UAE	B++	AM Best
Kuwait Re	Offers retakaful products as a window, established in 2007 in Malaysia	A-	AM Best
Hannover Re Takaful	Full-fledged retakaful firm, established in 2006 in Bahrain	A+	Standard & Poor's
General Insurance Corporation of India (GIC Re)	Offers retakaful products as a window, established in 2008 in India	B++	AM Best
Malaysian Re	Retakaful window, established in 2016 in Malaysia	A- A	AM Best Fitch
Munich Re	Full-fledged retakaful firm, established in 2007 in Malaysia	A+ AA	AM Best Fitch

Company	Incorporation	Rating	Rated by
		Aa3	Moody's
		AA-	Standard & Poor's
Tunis Re	Retakaful window, established in 2011 in Tunisia	B+	AM Best
		AA	Fitch
AIG Retakaful	Full-fledged retakaful firm, established in 2014 in Malaysia	A	AM Best
ACR Retakaful Holdings Limited ("ACRR")	Full-fledged retakaful firm, its subsidiaries established in Malaysia and Bahrain in 2008	A-	AM Best
Best Re	Full-fledged Islamic reinsurance firm, established in 1985 in Tunisia	A-	AM Best
Swiss Re	Retakaful window, established in 2009 in Malaysia	A+	AM Best
		Aa3	Moody's
		AA-	Standard & Poor's
Labuan Re	Retakaful window, established in 2007 in Malaysia	A-	AM Best
Reinsurance Group of America (RGA)	Retakaful window, established in 2009 in Malaysia	A+	AM Best
		A1	Moody's
		AA-	Standard & Poor's

The researchers were able to reach out to only six scholars from the targeted 12. The data from the questionnaire was recorded and transcribed to facilitate analysis and presentation.

Table 2(A) shows the questionnaire and the scholars' responses. Undoubtedly, making informed decisions require sufficient and timely information. In this context, the scholars were asked in Q1 whether their respective takaful companies provided sufficient information and proper analysis in the management proposals for ceding risks to conventional reinsurance. It is found that only one out of six scholars receives such analysis assisting him in making such a decision while others mention that their takaful companies do not provide any analysis to the scholars to justify approaching conventional reinsurance. One of the scholars states that the takaful company does not present financial analysis to the *shari'ah* board but it shows the result of the correspondence indicating the rejection of retakaful companies in accepting the risks.

In terms of the key considerations in permitting the adoption of conventional reinsurance, the scholars stated various points in response to Q2, as follows: 1) lack of retakaful companies in some countries; 2) lack

of retakaful companies that meet the legislations required in a country, such as having a high rating, diversification of providers, and solvency requirements; 3) financial capacity and risk appetite for risk exposure of reinsurance companies exceed those of the prevalent retakaful companies; 4) weak professional capabilities and accumulated experiences of retakaful companies; and 5) price consideration where retakaful options affect the provision of the minimum profit margin of the takaful business operations, as specified by the regulatory authorities. One of the scholars expressed his view that generally *sharīah* boards are lenient in allowing the use of conventional reinsurance based on the *fatwā* of permissibility, and generally do not go into detail, leaving it to the management of the takaful company to decide to whom they cede their risks. He sees this as adversely affecting the growth of the retakaful industry.

Table 2(B) shows the opinions of the *sharīah* scholars on four proposals to enhance the current takaful/retakaful practices. The proposals were raised from the regulatory viewpoint. However, market discipline is the responsibility of all stakeholders, including *sharīah* board members. From this perspective, *sharīah* board members can play an important role in enhancing the *sharīah* compliance of takaful processes, starting from the customer to the retakaful firm, via the operations of the takaful operator.

It is important to mention that the responses showed a consensus among the scholars on these proposals. The researchers noted that the *sharīah* board reports of several takaful firms do not emphasize revisiting the *ḍarūrah* concept in the use of conventional reinsurance. P1 proposes to disclose in the *sharīah* board report that the members revisit the *ḍarūrah* concept and state whether it is still applicable or not. This proposal aims to show the *sharīah* Board's concern about ensuring that the whole takaful operation chain is in line with Islamic rules and principles. The scholars agree with the proposal (P2) to encourage takaful firms to disclose their reinsurance and retakaful partners on their websites. The agreement on P2 is important to: a) boost the confidence of participants that the firm cooperates with, and is supported by, reliable partners, and b) reveal that the takaful funds are ceded to reputable and strong firms.

The scholars agree with proposal (P3) to promote disclosing the rough percentage of retakaful (at least to treaty arrangements) in the company's overall ceded risks. Simply disclosing the names of the reinsurance and retakaful partners may not provide a sufficiently clear picture of the percentage of retakaful in the overall fund. For example, a

takaful firm may deal with four retakaful and one reinsurance firm, but the majority of the ceding risks may be channelled to conventional reinsurance. Over time, disclosing the percentage of the ceded risks may show the commitment of a takaful firm in subscribing to retakaful. This will subsequently enhance the growth of the retakaful market and serve to build their financial capacity.

There is sound justification for adopting the *ḍarūrah* concept for certain risks (e.g., cede certain risks to conventional reinsurance using the facultative arrangement). However, the researchers are of the view that the common practice and ambiguity in using the necessity concept to use conventional reinsurance is unhealthy and shows an unwillingness among the industry players to move to retakaful. Thus, proposal P4 suggests that the takaful operator should disclose the justification for using conventional reinsurance and any plans to reduce the percentage of ceded risks. This proposal was also agreed to by the scholars, with five scholars not objecting to stating the justification under the *sharīah* board report while one scholar holds that the disclosure should be made in the company's financial statements, in consultation with the *sharīah* supervisory board.

Table 2: Survey Questionnaire on the Precept of Necessity (*ḍarūrah*) in Using Conventional Reinsurance

A: Questions (Q)	Responses
Q1: Does a takaful company provide analyses to its <i>sharīah</i> board members when it proposes the transferring of risks to conventional reinsurance?	Yes: 1 No: 5
Q2: What are the key considerations that facilitate a <i>sharīah</i> Board's decision to permit a takaful firm to use conventional reinsurance?	<ul style="list-style-type: none"> • Low numbers of retakaful players • The low financial profile of retakaful companies • Low capacity and risk appetite of retakaful companies • Weak experience
B: Proposals (P)	
P1: Do you think it is important to disclose whether a revisit of the <i>ḍarūrah</i> concept was conducted in published <i>sharīah</i> board reports?	Yes: 6 No: 0

P2: A takaful operator should disclose its reinsurance and retakaful partners on the company's website.	Yes: 6 No: 0
P3: A takaful operator should disclose roughly the percentage of retakaful (at least to treaty arrangements) in overall ceded risks.	Yes: 6 No: 0
P4: A takaful operator should disclose, possibly in the <i>sharīah</i> board report, the justification for using conventional reinsurance and any plans to reduce the percentage of ceded risks. For instance, a takaful operator may still need to cede certain risks to conventional reinsurance, using a facultative arrangement.	Yes: 6 No: 0

5 Conclusion

Takaful companies operate within a broader system that requires accepted risks to be shared among other partners (e.g., retakaful and reinsurance partners). This function assists takaful companies to increase their operational capacity and avoid large losses, leverage on other experts with larger exposure and knowledge, and other benefits. The ideal situation for takaful operations is to have dealings with retakaful companies to ensure that the overall chain is in line with Islamic rules and principles. However, the limitation on the maturity of the retakaful market has necessitated *sharīah* scholars to use the precept of *ḍarūrah* in allowing dealings with conventional reinsurance. The permissibility of using conventional reinsurance has been adopted for decades, since the initial establishment of Islamic insurance. Recently, Bank Negara Malaysia issued an exposure of a discussion paper and did not classify conventional reinsurance under the precept of *ḍarūrah* anymore, which may provide an indicator that the industry is moving towards a different positive direction.

International organisations such as AAOIFI and IIFM have issued resolutions and guidelines for applying the principle of *ḍarūrah* to reinsurance. However, the current practice in the takaful market has seen the use of conventional reinsurance as a norm for takaful companies, which impedes the development of the retakaful market. Justifications such as a low number of providers and low financial profile among retakaful players may be considered weak excuses with the entrance of many retakaful players (full-fledged and windows), some of which have international experience, into the market. However, it is not clear whether the current players are sufficient to meet the takaful industry's needs since the disclosure is weak in the takaful/retakaful industry.

The precept of *ḍarūrah* for using conventional reinsurance can be

seen as an obstacle to the growth and development of retakaful, and it seems that there is little to no action being taken to move away from this practice. Hence, this article aims to enhance the arrangement of the takaful industry practices in relation to the *fatwā* on the permissibility of using conventional reinsurance based on the precept of *ḍarūrah*. The article has used a qualitative method in the form of semi-structured interviews to seek the views of six *sharīah* scholars from the *sharīah* boards of takaful companies on the concept of necessity in the takaful/retakaful market. It is found that the majority of scholars, i.e., five, stated that they were not provided information or analysis to assist them in making an informed decision on whether the precept of *ḍarūrah* for using conventional reinsurance is still applicable.

Presented with a proposal in the second part of the questionnaire, the *sharīah* scholars agreed with the four proposals that aim to enhance the current takaful/retakaful practice and show the initiative and good intention of takaful companies to move away from conventional reinsurance. Implementation-wise, the proposals could be introduced as requirements from the regulator. However, it is also the responsibility of all stakeholders, including the *sharīah* boards, to be productive and enhance the market. As the *fatwās* and resolutions from the *sharīah* board carry weight in the operations of a takaful company, *sharīah* board members may encourage or request a takaful company's management to adopt the following proposals: 1) *Sharīah* board members should state in the annual *sharīah* board report whether they have revisited the *ḍarūrah* concept and if so, mention whether it is still applicable or otherwise; 2) Takaful companies should publicly disclose their reinsurance and retakaful partners (it may be of value to participants concerned about whether their funds are backed by prudent and sound players); 3) Takaful companies should disclose the rough percentage of retakaful in their overall ceded risks (showing the seriousness of a takaful company in approaching retakaful), which may start with the (separate) disclosure of treaty arrangements for both retakaful and reinsurance; and 4) Takaful companies should disclose the justification for using conventional reinsurance and any future plans to reduce the percentage of risks ceded to them.

Each industry requires a regular assessment to grow and develop its current practices, and the takaful industry is no exception. It requires collaboration between, and the attention of, all stakeholders to enhance its market practices. It may be seen as a negative point that *sharīah* scholars request people to approach takaful companies while they are relatively flexible with those same takaful companies ceding risks to

conventional reinsurance. The proposals in this article may serve to close some gaps and change the perception that takaful companies are taking the *darūrah* concept for granted and are not taking any effort to depart from it. The implications of the article can be significant to various parties: firstly to regulatory and supervisory authorities in helping them develop certain standards or guidance to takaful companies for disclosure enhancement in the areas of retakaful/reinsurance; and secondly, *sharīah* board members, in strengthening *sharīah* governance in the takaful market, may adopt certain initiatives to push the market to the next level. The researchers strongly feel that the scholars' role can positively impact the industry's growth and development, especially as the market operates predominantly based on their views.

Appendix: Takaful Operators' Practices in Ceding Risk

Takaful Operator	Does it mention to whom the risks are ceded to?	Does it mention the ratio of reinsurance?	The justification for ceding to reinsurance is in the Shariah report.
Saudi Arabia			
Alrajhi Takaful	NA	NA	NA
SABB Takaful	NA	NA	NA
Tawnya	NA	NA	NA
Watanya	NA	NA	NA
Al Jazirah Takaful	Yes	NA	NA
Alahli Takaful	NA	NA	NA
Alinma Tokyo Marin	NA	NA	NA
Malath	Yes	NA	NA
MedGulf For Insurance and Reinsurance	Yes	NA	NA
Allianz SF	NA	NA	NA
Salama	NA	NA	NA
Walaa	NA	NA	NA
ACIG	NA	NA	NA
Saudi Re	NA	NA	NA
UAE			
Dar Al Takaful PJSC	NA	NA	NA
National Takaful Company P.S.C.	NA	NA	NA
Methaq Takaful Insurance Company	Yes	NA	NA

Kuwait			
First Takaful Insurance Company	NA	NA	NA
Wethaq Takaful Insurance Company	NA	NA	NA
KFH Takaful Insurance Company	Yes	NA	NA
Boubyan Takaful Insurance Company	NA	NA	NA
Qatar			
General Takaful Company	NA	NA	NA
Qatar Islamic Insurance Company	NA	NA	NA
Daman Islamic Insurance Company	NA	NA	NA
Bahrain			
Takaful International Co.	NA	NA	NA
T'azur Takaful Co.	Yes	NA	NA
Solidarity	NA	NA	NA
MedGulf Takaful	NA	NA	NA
Oman			
Al Madina Takaful Company	NA	NA	NA
Takaful Oman Insurance	NA	NA	NA

* Not Available (NA)

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