CHAPTER - III

REINSURANCE

A. UNDER COMMON LEGAL SYSTEM
B. UNDER ISLAMIC LEGAL SYSTEM
Chapter-III

REINSURANCE

A. Under Common Legal System

Mankind is exposed to many serious hazards such as fire, disability, premature death etc. While it is impossible for the individual to foretell or prevent their occurrence, so men want to be cautious against all these. This need of getting cautious or secure gave rise to the concept of Insurance. Insurance is a promise to pay possible future claims against a premium today. It is a function of insurance by its numerous forms to enable individuals to safeguard themselves against such misfortunes. The progress of science and technology brought many revolutions in the functioning of the insurance companies, thus making insurers to face more complex risks, and special type of cover. In turn, the, insurers also want some security. An insurer can accept only those risks that may be entirely handled by him, so to overcome the problems of insurers and to increase their risk taking capacity concept of Reinsurance was introduced. That can help the insurers to provide protection for vide range of risks. In principle, both these Insurance and Reinsurance are tools of risk management and mutually support. They supplement each other in providing risk mitigation to the individuals and organizations at micro level and to the nations at macro level. Conceptually both insurance and reinsurance are instruments of risk transfer and risk financing.

After Independence, the general insurance business has seen significant growth. It has also witnessed the need for reinsurance protection which could be available only through foreign reinsurers. However, this had implications for the conservation of scare foreign exchange. Hence in 1956, some general insurance companies came together and formed “India Reinsurance Corporation”, a professional reinsurance company. In 1961 an amendment was made to the Indian Insurance Act of 1938 to formalize the
voluntary arrangement by notifying the Indian Guarantee and General Insurance Company Ltd., a government company as "Indian Reinsurers".

In 1966, Indian insurance companies initiated the formation of the reinsurance pools in the fire and marine insurance. Under this, a percentage of their fire and marine insurance business was ceded to the fire insurance pool and marine insurance pool, respectively. Such business was recorded among the same insurers, thereby spreading a portion of the risk under every policy among the members of the pool. At the time of naturalization, each company had its own reinsurance arrangement. After the formation of General Insurance Corporation of India (GIC), it was designated as the Indian reinsurer under section 101(A) (8) (ii) of the Indian Insurance Act of 1938.

Thus reinsurance operations in India were controlled by the GIC with understanding with all companies. In order to ensure the retention of maximum business in the country and to secure the best terms from foreign reinsurers, the GIC and its subsidiaries had a common programme for reinsurance cessions. This programme was submitted by the GIC to the Government of India for approval. The Reserve Bank of India (RBI), permitted foreign exchange remittances on the basis of the approved programme.

To control, manage and ensure the quality of the reinsurance business, the Single Window International Facultative and Treaty Division (SWIFT) was formed in 1991 at the GIC. It is working with the objective of concentrating on and pooling of the reinsurance capacity of the individual companies, thereby ensuring a better quality of business acceptance.

The GIC has now been designated as the national reinsurer for the entire public sector as well as for private sector companies in respect of business generated in India.¹

Meaning of Reinsurance

Reinsurance is a transaction in which an insurer agrees for a premium, to indemnify another insurer against all or part of the loss that insurer may sustain under its policy or policies of insurer.\(^2\)

For example: X company accepts a risk of Rs. 40,00,000 and transfers a part of it say 10,00,000 to another, Z company.

A contract of reinsurance is made mainly between the insurers but the insured is in no way concerned with and possesses no right to make a claim against the reinsurer in case of loss. The original insured is in no way affected by this reinsurance contract and he has no relationship with the reinsurer.\(^3\)

Definitions of Reinsurance

1. "When an insurer transfers a part of his risk on a particular policy by insuring it with some other insurer, it is called reinsurance."

   Prof. R.S. Sharma

2. "Reinsurance is an arrangement whereby an insurer who has accepted insurance transfers a part of risk to another insurer so that his liability on any one risk is limited to a figure proportionate to his financial capacity."

   The Federation of Insurance Institute

3. "Where any amount of risk or risks from one hazard is such that it is beyond the limits which it is prudent for one insurer to carry it is necessary to affect reinsurance."

   Dr. R.K. Garg

4. "An agreement between insurance companies under which one accepts all or part of the risk or loss of the other."

   German Commercial Law

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5. "Reinsurance is a contract by which an insurer is to be indemnified against any loss which he may sustain by reason of being himself compelled to indemnify the assured under the original contract of insurance."


From the above definitions we can attempt to define Reinsurance as:

1) A Contract of indemnity against liability by which the insurance company procures another insurance to insure against loss or liability by reason of the original insurance.

2) Insurance by one insurance company of all or part of a risk accepted by it with another insurance company which agrees to reimburse the insurance company for the portion of the claim insured.

**Nature and Object of Reinsurance**

Contract of reinsurance is essentially a contract of indemnity, hence the reinsurers before paying money must be satisfied that the sum originally insured has been paid by the reinsured.4

The object of reinsurance is to indemnify the insured against the risk or the part of the risk covered by the policy they themselves have insured.5

The essence of a contract of reinsurance is that it is a contract of complete or partial indemnity to the insurers on the original policy. In case of reinsurance the liability of the insurers is shifted to the reinsured, and the liability of the reinsurers is, therefore contingent upon the liability of the insurers, and the insurers will be indemnified accordingly. If the insurer does not pay under the original policy, the liability of the reinsurers does not arise,

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4. See Athenaeum Life Assurance Society Case (1859) 29 L.J.Ch. 35.
and the insurer in such a case is only entitled to a return of the premium, from the reinsurers.6

Features of Reinsurance

Following are the important features of reinsurance-

1. All the principle and rules of insurance are to apply on reinsurance contract.
2. Under reinsurance contract reinsurer accept the liability of original insurer.
3. Reinsurance contract is a contract between two insurers.
4. Reinsurance contract is a contract of indemnity.
5. Reinsurance contract and insurance contract are two different contracts.
6. Reinsurer will only responsible for the legal responsibility of the insurer.
7. Reinsurance can insure the same amount as the original insurer does.7

Benefits of Reinsurance

Reinsurance is an arrangement whereby an original insurer, who has insured a risk, insures a part of that risk again with another insurer in order to reduce his own liability. There are certain other benefits of reinsurance which are as follows:

1. **Wider Follow up of risk:** Reinsurance enables a wider follow up of risk and hence the personal incidence of loss is spread over the widest possible area. Due to this, the insurers are enabled to limit their maximum loss on any one fire to the amount which does not exceed their funds.

2. **Increase in Insurance Business:** With the advent of reinsurance facilities any insurance company can accept the huge amount of insurance proposal and transfer the part of risk to the other insurer called reinsurer. In this way their insurance business can increase.

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3. **Increase in the goodwill of insurance company**: With the enlarged facilities of reinsurance the goodwill of new company will increase. New company will accept the proposal of any amount if reinsurance facilities are available. This will lead to increase in the goodwill of new company.

4. **Stability in Profits**: Reinsurance helps in stabilizing income and losses over a period of years.

5. **Benefits to the insured**: The insured person has many indirect benefits of reinsurance facilities. If reinsurance facilities are provided one can insure huge amount from one insurance company. In the same way settlement of claim will be easy with this facility. Beside this reinsurance facilities help in the development of insurance business resulting in decrease in premium rates.8

**Functions of Reinsurance**

The reinsurer performs three fundamental functions, together with a number of additional functions:

1. Reinsurance enables direct underwriting companies to even out their results when major or exceptional losses occur. For example, a hurricane or an earthquake for instance can seriously affect the accounts of the insurance company. Reinsurance considerably reduces this type of potential imbalance.

2. Insurance companies use reinsurance to increase the maximum amount they are able to cover as primary insurer for any given potential loss or loss category, in other words, their available capacity is hereby increased. As a result of which insurance companies can write more risks, or larger risks, without becoming over extended.

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8. Id.
3. Reinsurance also provides insurers with the large amount of cash needed in the event of a major loss, enabling them to manage their assets safely and profitably.\textsuperscript{9}

\textbf{Parties to Reinsurance}

Reinsurance is a contract in which an insurer agrees for a premium to indemnify another insurer against all or part of the loss, that insurer may sustain under its policy or policies of insurer. The company purchasing insurance is known as the ceding insurer and the company selling insurance is known as the reinsurer.\textsuperscript{10}

\textbf{Methods of Reinsurance}

These are three main methods by which reinsurance may be effected:

1. \textbf{Facultative Method}: This is the oldest method of reinsurance and it necessitates the consideration of each risk separately.\textsuperscript{11} Under this method each individual risk is submitted by the original insurer to the reinsurer who can accept or decline whatever sum they consider appropriate subject to the amount of their acceptance being approved by the original insurer. The reinsurer is offered with the particulars of original contract. The reinsurer will see the proposal and report on the risk offered for reinsurance. The reinsurer has the option of rejecting an offer if he so likes. The reinsurer will accept a risk only after proper security of the case. It is very important under facultative reinsurance that all information's which are given to reinsurer must be true and there must be no misrepresentation.

2. \textbf{Treaty Reinsurance}: Under this method there is an agreement between the insurer and the reinsurer that the amount of insurance on a policy above the retention of the insurer shall be submitted by it for

\begin{footnotesize}
\begin{itemize}
\item[9.] See Tripathy Prava Nalini and Pal Prabir, \textit{op. cit.}, pp. 90-91.
\item[10.] Id.
\end{itemize}
\end{footnotesize}
reinsurance and the same shall be accepted by the reinsuring company. As soon as the original contract is completed the excess amount becomes automatically reinsured under the agreement.

The insurer needs not to even inform the reinsurer immediately, that a risk has been accepted by it. The terms and conditions of the reinsurance contract are same as of the original insurance contract. The maximum reinsurance amounts acceptable to the reinsurer bear a definite relationship with the retention limit of insurer\(^\text{12}\) there are several types of treaties:-

(a) **Quota Share Treaty:** - Under this type of treaty, a fixed proportion of a given class of insurance as a whole is ceded. For example, Reinsurance is arranged on 50\% basis, the reinsurer accepts half of each risk, obtains half the premium (less commission), and bears half the claims. Commission is, of course, a matter of mutual arrangement. This type of reinsurance is suitable for a company with a small portfolio, but its disadvantage is the necessity of paying away premiums on small risks instead of retaining the whole for the direct insurers own account. There is no risk of selection against the reinsurer, all business coming to the treaty.\(^\text{13}\)

(b) **Surplus Treaty:**- Under this treaty, the reinsurer agrees to accept the surplus. In other words we can say that under this arrangement the insurer agrees to transfer to the reinsurer a percentage of the insurance that exceeds its limit. The surplus can be reinsured and it is determined by the size of the treaty. The scope of treaty is defined with the scope of geographical area, clans of business etc. The liability of the insurer commences immediately and simultaneously with that of two insurer as soon

\(^{12}\) Dr. Garg, R.K., *op. cit.*, p. 98

\(^{13}\) See Dinsdale, W.A., *op. cit.*, p. 119
as retention of the ceding insurer is exceeded. The original insurer has right to demand immediate payment from the reinsurer of the latter share of any loss exceeding an agreed value.

(c) **Excess of Loss Treaty:** This is non proportional method of reinsurance. Under this treaty, the reinsurer agrees to pay to the insurer the amount by which any loss exceeds a stipulated figure. The treaty applies to every loss on business that falls within the scope of the treaty. The excess of loss treaty comes into operation when the total net loss suffered by the insured due to one event exceeds the amount agreed in the treaty. Such excess of the amount or a proportion of it, being paid by the reinsurer is subject to a maximum limit. If the total net loss exceeds the maximum limit. If the total net loss exceeds the maximum limit provided in the treaty the excess amount is paid by the reinsurer. Excess loss treaty can be explained with the help of example: For say if the pre agreed amount, called underlying limit is Rs. 10 lakhs and the coding company’s loss due to one event is Rs. 15 lakh the excess of loss reinsurer pay Rs. 5 lakh.

(d) **Excess of Loss Ratio Treaty:** Under this treaty the reinsurer protects the insurer against the total results for the year rather than against the consequences of a single occurrence. If the insurer insured losses exceeds a certain percentage ratio, the reinsurer will pay a certain loss ratio.\(^{14}\)

3. **Pooling Method:** This method is mainly used for catastrophe risks, that is, where the happening of an insured event may involve unusually heavy loss, damage, or liability, so that the total claims upon the insurer will be considerable. All claims (and all losses) may be pooled, or the surplus above a fixed retention, or an agreed excess of loss may be dealt with in this way. Each member in effect receives back

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a share of the cessions of others, thus each is liable for only a comparatively small share of a wide spread business.\(^{15}\)

**Growth of Reinsurance Business in India**

For the convenience of the study, the growth of reinsurance is classified into three categories.

1. Reinsurance before Nationalization
2. Reinsurance after Nationalization
3. Reinsurance after Liberalization

**I. Reinsurance before Nationalization**

In India the period from 1951 onwards was marked by a rapid growth of insurance business: this was because of large scale economic development in the country during the period. The increased insurance business required the reinsurance protection. At that time reinsurance was arranged from the foreign markets mainly British and Continental.

In 1956, Indian Reinsurance Corporation, a professional reinsurance company was formed by general insurers operating in India and it started receiving voluntary quota share cessions from member companies.

In 1961, the government made it completely mandatory on the part of every insurer to cede 20% in Fire and Marine Cargo 10%, 10% in Marine Hull and Miscellaneous insurance and 5% in Credit and Solvency business to approve Indian reinsurers, namely Indian Reinsurance Corporation and Indian Guarantee and General Company. The above mentioned percentages were to be allocated equally between the two reinsurers. Thus the reinsurance market was further strengthened by the addition of second professional reinsurers.

\(^{15}\) See Dinsdale, W.A., *op. cit.*, p. 120.
In 1966, Indian Insurance Companies Association initiated the formation of Reinsurance Pools in Fire and Hull departments to increase the retained earned premium in the country.

II. Reinsurance after Nationalization

At the time of Nationalization of general insurance business in 1971, there were 63 domestic insurers and 44 foreign insurers operating in country and each company had its own reinsurance agreements. In 1973 these companies were reconstituted into four companies. They are:

1. National Insurance Company Limited
2. The New India Assurance Company Limited
3. Oriental Insurance Company Limited
4. United India Insurance company Limited

These four companies were thus left to operate in the country as subsidiaries of a holding company known as General Insurance Corporation (hereinafter GIC) (National Reinsurer Act 1972).

After nationalization GIC became the Indian reinsurer. After nationalization of general insurance the outward reinsurance agreements of the Indian insurance companies were rearranged. The main objectives were rearranged to maximize domestic retention.

III. Reinsurance After and Liberalization

As a part of the process of liberalization of the insurance industry in India, the Indian Regulatory and Development of India (IRDA) has been given the authority of regulating and controlling the conduct of insurance business in India. IRDA frames rules and regulations for various aspects of the Insurance business including reinsurance. The four subsidiaries viz. National Insurance Company Limited, The New India Assurance Company Limited, The Oriental Insurance Company Limited and the United India insurance company Limited have been delinked form GIC and private
insurance companies have been allowed to do insurance business after obtaining license from IRDA.

Each insurer in India is free to structure his annual reinsurance program in compliance with regulation and solvency requirement. The program would need to be approved by the IRDA.

In November 2000, GIC is again notified as the Indian Reinsurer and by administrative instruction, its supervisory role over subsidiaries was ended. With the General Insurance Business (Nationalization) Amendment Act 2002 (40 of 2002) coming into force from March 21, 2003 GIC ceased to be a holding company of its subsidiaries. Their ownership now vests with Government of India. General Insurance Corporation of India (GIC Re) is the only reinsurance company in India in the domestic reinsurance market. The headquarter and registered office of the GIC is based in Mumbai.

As Indian government has restricted the direct entry of foreign reinsurers, some of the companies are working by having joint venture like Munich Re, Swiss Re, Insurance group of America and according to latest news Buffet Berkshier is also coming as an agent with Bajaj Allize to India. GIC Re’s is providing Reinsurance in the following areas: Property Reinsurance, Fire, Engineering, Accident/Liability Reinsurance, Marine Reinsurance, Aviation Reinsurance, Life Reinsurance and Miscellaneous.

To study the total performance of the GIC Re business, Comparison of the various areas of reinsurance have been studied along with the analysis of the Total Earned premium and profit after Tax of five years (2005-10).16

Business Performance of General Corporation India (GIC): The Indian Reinsurer

For analyzing the business performance of the GIC during the period of five years i.e. from 2005-2010, comparison of Earned Premium and Incurred claims and comparison of different segments of the business have

been studied. Analysis of Total earned premium and Profit after tax deduction have been studied to analyze the growth trend of GIC business. Analysis is as follows:

I. Comparison between earned premiums of different classes of business.

II. Comparison of incurred claims of different classes of business.

III. Five year premium of GIC.

IV. Profit after Tax of Five years.

(1) Comparison between Earned Premiums of Different Classes of Business

In this part of analysis comparison is made between different classes of reinsurance. This include fire, engineering, marine, aviation and miscellaneous on the basis of earned premium of five years i.e. from year 2005 to year 2010. The purpose of this comparative study is to analyze the class of business giving maximum business to the GIC. Following table describes earned premium from different classes of business.
TABLE NO. (I)

Comparison of Earned Premium of Different Classes of Reinsurance
(Year 2005-2010)

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>681.51</td>
<td>173.19</td>
<td>207.61</td>
<td>1.26</td>
<td>34.68</td>
<td>2174.19</td>
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<tr>
<td>2006-07</td>
<td>771.55</td>
<td>250.70</td>
<td>158.56</td>
<td>0.48</td>
<td>37.74</td>
<td>1026.16</td>
</tr>
<tr>
<td>2007-08</td>
<td>817.01</td>
<td>382.51</td>
<td>238.06</td>
<td>9.50</td>
<td>52.00</td>
<td>1606.77</td>
</tr>
<tr>
<td>2008-09</td>
<td>660.71</td>
<td>394.50</td>
<td>393.61</td>
<td>5.53</td>
<td>48.19</td>
<td>1673.81</td>
</tr>
<tr>
<td>2009-10</td>
<td>633.57</td>
<td>373.48</td>
<td>278.58</td>
<td>5.50</td>
<td>43.17</td>
<td>1619.40</td>
</tr>
<tr>
<td>Total</td>
<td>3564.35</td>
<td>1574.38</td>
<td>1276.42</td>
<td>22.27</td>
<td>215.78</td>
<td>8100.33</td>
</tr>
</tbody>
</table>

Source: Annual reports of General Insurance Corporation (GIC) and Insurance Regulation Development Authority (IRDA) of different years.

FIG. (I)

Comparison Between Earned Premium of Different Classes of Reinsurance (Year 2005-2010)

The above table and pie-diagram represents five years (2005-2010) data for earned premium for different class of reinsurance business—fire, engineering, marine, life, aviation and miscellaneous. It is evident from the table and pie—diagram that the maximum earned premium for five years...
is earned from miscellaneous reinsurance business which is INR 8100.33 crores. The second class of business earned maximum premium after miscellaneous, is fire reinsurance business having earned premium of INR 3564.34 crores. This increase in earned premium in spite of two major losses of Indian Oil Corporation and Haldia Petro chemical in 2009-10 is or may be due to two reasons first may be increase in the fire reinsurance business, secondly, it may be due to decrease in incurred claims of the fire reinsurance business.

The next class of business having 3rd largest earned premium in five years (2005-10) is engineering reinsurance which is INR 1574.38 crores. This increase in earned premium of this class of business is continues year by year growth in the earned premium as evident from the table during 2005-10. Next reinsurance business is marine reinsurance business having premium of INR 1276.42. Marine reinsurance business includes both cargo and hull reinsurance business. This class of business is showing up and down trend in five years (2005-10).

The fifth class of business has earned premium lesser than the marine business but more than the rest class of business is aviation reinsurance business. It has earned premium of INR 215.78 crores. This class is showing irregular growth pattern increase from 2005-07 then decrease from 2008-10. In the last class of business having minimum earned premium for the five year period (2005-10) is Life reinsurance business. It has earned premium of INR 22.27 crores. The reason behind this is unpopularity of life insurance in India.

From the above discussion it can be concluded that miscellaneous, fire and engineering reinsurance businesses are affecting the economy of India as having maximum earned premium in five years (2005-10).

(II) Comparison between Incurred Claims of Different Classes of Reinsurance

In this part of analysis comparison is made between the incurred claims of different classes of reinsurance. This includes, fire, engineering, marine, aviation and miscellaneous on the basis of incurred claims of five
years i.e. from 2005 to 2010. The purpose of this comparative study is to analyze the class of business having maximum uncertainties. Following table describes incurred claims form different classes of reinsurance.

**TABLE NO. (II)**

Comparison Between Incurred Claims of Different Classes of Reinsurance (Year 2005-2010)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>421.36</td>
<td>112.13</td>
<td>206.43</td>
<td>1.35</td>
<td>30.91</td>
<td>2810.53</td>
</tr>
<tr>
<td>2006-07</td>
<td>617.55</td>
<td>182.09</td>
<td>258.13</td>
<td>0.71</td>
<td>39.90</td>
<td>604.96</td>
</tr>
<tr>
<td>2007-08</td>
<td>914.33</td>
<td>253.27</td>
<td>339.81</td>
<td>1.77</td>
<td>56.48</td>
<td>1379.41</td>
</tr>
<tr>
<td>2008-09</td>
<td>621.08</td>
<td>193.31</td>
<td>329.98</td>
<td>3.73</td>
<td>41.90</td>
<td>1339.05</td>
</tr>
<tr>
<td>2009-10</td>
<td>783.57</td>
<td>186.74</td>
<td>451.02</td>
<td>2.39</td>
<td>26.81</td>
<td>1781.33</td>
</tr>
<tr>
<td>Total</td>
<td>3357.89</td>
<td>927.54</td>
<td>1585.37</td>
<td>9.95</td>
<td>196</td>
<td>7915.28</td>
</tr>
</tbody>
</table>

Source: Annual reports of General Insurance Corporation (GIC) and Insurance Regulation Development Authority (IRDA) of different years.

**FIG. (II)**

Comparison of Incurred Claims of Different Classes of Reinsurance (Year 2005-2010)
The above table and pie-diagram represents five years (2005-2010) data for incurred claims for different class of reinsurance business such as fire, engineering, marine, life, aviation and miscellaneous. The purpose of this representation is to compare the different class of reinsurance business so that it can be determined that which class is having maximum incurred claims in five year (2005-2010) duration.

It is evident from the table and pie-diagram that the maximum incurred claims for five years (2005-10) are incurred in miscellaneous reinsurance business which is Rs. 7915.28 crores. Although this class of business is number one in respect of incurred claims but if we see five years (2005-10) data of the incurred claims from miscellaneous reinsurance business, it is decreasing continuously from 2005 which is a good sign because if incurred claims decrease the earned premium will increase. The second class of business having maximum incurred claims after miscellaneous, is fire reinsurance business having incurred claims of Rs. 3357.89 crores. As the table indicates that claims in fire reinsurance business recorded a growth in claims from 2005-07 after that it followed a de-growth pattern but suddenly increased in 2009-10. This increase in claims was due to two major losses of Indian Oil Corporation and Haldia Petro chemical in 2009-10 of Rs. 75 crore each.

The next class of business having 3rd largest incurred claims in five years (2005-10) is marine reinsurance which is Rs. 1585.37 crores. Marine reinsurance business includes both cargo and hull reinsurance business. This increase in incurred claims of this class of business is continues each year growth in the earned premium as evident from the table from 2005-10. The next class of reinsurance business showing maximum incurred claims after marine reinsurance business is engineering reinsurance business having claims of Rs. 927.54 crores. This class of business is showing up and down trend in five years (2005-10).
The next class of business having lesser claims than the marine business but more than the rest class of business is aviation reinsurance business having incurred claims of Rs. 215.78 crores. This class is showing irregular growth pattern increase from 2005-07 then decrease from 2008-10. in the last is the class of business having minimum earned premium for the five year period (2005-10) is Life reinsurance business having earned premium of Rs. 9.95 crores. The reason behind this is unpopularity of life insurance in India.

From the above discussion it can be concluded that miscellaneous, fire and marine reinsurance business are having maximum incurred claims hence a big challenge for the reinsurers.

(III) Five Year Performance of General Insurance Corporation (GIC) In Reinsurance Business

The purpose of this analysis is to study the performance of GIC in last five years (2005-10). Following table describes the net premium and incurred claims of GIC.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NET PREMIUM (In Rs. Lakhs)</th>
<th>NET CLAIMS (In Rs. Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>423488</td>
<td>457307</td>
</tr>
<tr>
<td>2006-07</td>
<td>642087</td>
<td>362271</td>
</tr>
<tr>
<td>2007-08</td>
<td>831114</td>
<td>601149</td>
</tr>
<tr>
<td>2008-09</td>
<td>740233</td>
<td>621714</td>
</tr>
<tr>
<td>2009-10</td>
<td>877687</td>
<td>685639</td>
</tr>
</tbody>
</table>

Source: Annual reports of General Insurance Corporation (GIC) and Insurance Regulation Development Authority (IRDA) of different years.
The above table shows General Insurance Corporation (GIC) data for Net Premium and the Net claims for the period during 2005-10. As it is shown in the above table that the net premium for the year 2005-06 is Rs. 423488 lakhs and net claims for the year was Rs. 457307 lakhs. In the next year 2006-07 the net premium was Rs. 642087 lakhs which recorded a growth of 51.61 percent as compared to the previous year (2005-06) net premium. This increase in net premium is due to increase in the economic activity in the country as a result of which volume for reinsurance business has increased especially for marine reinsurance. Other classes of reinsurance also recorded profit this year as a result of which net premium has increased. The net claims for the year 2006-07 were Rs. 362271 lakhs which recorded de-growth of 20.78 percent as compared to previous year (2005-06). In this year no major losses were reported. Few of the losses which affected the books of GIC at net basis were: floods in Surat Rs. 50 crores, loss at Balko- Rs. 54 crores, Lanco-Kodapalli- Rs. 26 crores, Tata Motors- Rs. 58 crores and J & W steel- Rs. 53 crores.
During the year 2007-08 the net premium as Rs. 831114 lakhs which recorded a growth of 29.43 percent as compared to previous year (2006-07) premium which was Rs. 642087 lakhs. This growth was recorded in spite of the crisis in the US subprime mortgage market and other credit market exposure deepened and spilled over to markets for other assets. This spill over of the crises on the Indian economy was not significant enough to disturb the growth trend in India. The net incurred claims during the year were of Rs. 601149 lakhs which increased by 65.93 percent as compared to previous year net claims which were 362271 in the year 2006-07. The major losses during the year were — Alok Industries- Rs. 50 crores (fire reinsurance). Cyclone in Oman- Rs. 2 crores (52 crores). Loss to cotton storage in transit —Rs. 5.57 crores (Marine Cargo reinsurance) and many more. Year 2007 saw a consistent level of airline hull losses throughout the year which resulted in increase in claims.

In the next year 2008-09 the net premium was Rs. 740233 lakhs which recorded a de-growth of 10.93 percent as compared to previous year (2007-08) net premium which was Rs. 831114 lakhs. This was due to the global economic conditions which deteriorated during the year 2008. Several advanced economies experienced sharpest declines in the post war II period. The global financial environment entered a critical phase in mid —Sep 2008 following the growing distress among large international financial institutions and declaration of bankruptcy. All this caused decrease in the net premium of the GIC’s business. The net claims for the year were Rs. 621714 lakhs. The major losses in the year which are recorded in the GIC’s books are- Fire in telecom company- Rs. 39 crores (fire reinsurance). Oil contamination - Rs. 3.70 crores (marine cargo). Spain air loss- Rs. 4.81 crores and so on.

In the year 2009-10 the net premium was Rs. 877687 lakhs recording a growth of 18.56 percent as compared to 2008-09 premiums which was Rs. 740233 lakhs. This was due to recovery in the global economy which picked up momentum in the 4th quarter of 2009. Although the speed of recovery was
slow. The net claim for the year was Rs. 685639 lakhs which increased by 10.28 percent as compared to previous year (2008-09). The major losses which affected the books of GIC on net basis were - Fire in Indian Oil Corporation Limited-IOCL’s (marketing Div.)- Rs. 75 crores. Haldia Petrochemical amounting- Rs. 75 crores (fire reinsurance), L & T (construction) - US $ 20 crores, reliance industries US $ 75 crores Air France (aviation reinsurance) and many more.

Thus can be concluded that General Insurance Corporation (GIC’s) business in terms of Net premium has increased from 2005-2010, although there is small increase in the net claims. The expectation for 2010-2011 looks positive.

(IV) Profit after Tax of General Insurance Corporation (GIC) In Reinsurance Business

The purpose of this analysis is to know the profit trend of the GIC in last five years.

**TABLE NO. (IV)**

Profit After Tax of GIC In Reinsurance Business

(Year 2005-2010)

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit After Tax (In Rs. Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>598.51</td>
</tr>
<tr>
<td>2006-07</td>
<td>1531.35</td>
</tr>
<tr>
<td>2007-08</td>
<td>992.79</td>
</tr>
<tr>
<td>2008-09</td>
<td>1407.20</td>
</tr>
<tr>
<td>2009-10</td>
<td>1774.60</td>
</tr>
</tbody>
</table>

Source: Annual reports of General Insurance Corporation (GIC) and Insurance Regulation Development Authority (IRDA) of different years..
The above table and graph represents the profits after tax of GIC in last five years (2005-10). In year 2005-06 the profit after tax was Rs. 598.51 crores. Indian economy has been on a high growth curve from last few years. It continued to show growth during 2006-07. The Profit after tax was Rs. 1531.35 crores after registering a growth of 60 percent, as compared to previous year (2005-06) profit after tax which were Rs. 598.51 crores.

During the year 2007-08 the profit after tax was Rs. 992.79 crores which registered de-growth of 54 percent as compared to previous years (2006-07) profit after tax. This decrease was due to de-tariffing of general insurance sector that year. In the next year i.e. in 2008-09, the profit after tax had shown a growth of 29 percent as compared to the profit of 2007-08, and was Rs. 1407.2 crores.

During 2009-2010, profit after tax was Rs. 1774.6 crores after registering a growth of 20 percent as compared to the previous year profit after tax which
was Rs. 1774.6 crores. Thus it can be concluded that profit after tax deduction is following a pattern of growth as insurance business is increasing from year to year.

General Insurance Corporation (GIC) the national reinsurer is performing well in the country. Analysis concludes that business of GIC as an Reinsurer has recorded a continuous growth pattern in last five years in terms of its earned premium and profit. It is also revealed that the miscellaneous, fire and engineering reinsurance business showed maximum earned premium during last five years in comparison to other segments of reinsurance. As discussed in the earlier part of the work that risk is increasing day by day. As is shown from the analysis that reinsurance claims also registered continuous growth pattern from the year 2005—2010. Maximum claims were recorded in the miscellaneous, fire and marine reinsurance business. The Researcher would like to submit that Reinsurance is essential for the insurance security and GIC as a National Reinsurer is maintaining its role as the great protector of Insurance business in India.
B. Under Islamic Legal System

The sums insured today have become so great that no insurance company can meet all its possible losses from its own competent resources and has to distribute the liabilities among other insurance companies, which are known as reinsurance companies. Thus, there is a contract between the insured and the insurance company on one hand and on the other between the insurance company and the reinsurance company. The reinsurance or retakaful, for Islamic Companies must be contracted under the same set of principles and regulations as the original contract, that is, it must in conformity with the Sharia’h principles. Moreover, the retakaful companies must, without any doubt be reliable, reputable and financially sound.\(^\text{17}\) This means retakaful protection can contribute to the financial stability of Takaful Operators whose performance is projected to grow very fast in the near future.\(^\text{18}\) It is evident that retakaful protection is an instant necessity for Takaful operations. However, a cautious approach should be exercised within the framework of Islamic law as far as this need involved conventional re-insurers.\(^\text{19}\)

Rational Behind Retakaful

Under the conventional insurance, the insured transfers risk to an insurer, in exchange for a certain sum called “premium”. The premium is calculated on the nature of risk undertaken and the quantity of risk transferred, which is known as “sum insured”. By getting insurance cover against adverse events or circumstances, the insured enjoys greater security and feel good.

The insurance company faces issues similar to those faced by an individual insured that is, determining which probable cost will arise from

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the collection of risks received from the insured. The total sum of probable claims the insurer may incurred be able to be much higher than the total amount of premiums collected plus investment income on insurance fund assests.

Furthermore, not all the amount of these premiums is available to pay claims. A portion of it has to be spent on other expenses such as operational expenses, staff salaries, acquisition cost and other fixed costs. Just as the individual policyholder wants to protect itself by taking out insurance cover against unforeseeable and unpredicted events, the insurer who has taken such a large number of risks also needs to replace some of its risks with the other insurers. Thus, the insurer needs to insure itself with other risk carriers. This leads to the concept of reinsurance.\(^{20}\)

Secondly, the insurance business needs to spread risks as a technical requirement to reduce the claims volatility, that is, the impact of the amount of claims made Retakaful protects the direct insures assests. It is the insurance of insurance companies. This is the basic requirement of Retakaful business.\(^{21}\)

![Diagram](image)

From the above diagram, it is clear that takaful holders are the individuals or companies that purchase Takaful product either General Takaful products or Family Takaful products and pay the specified amount of


premium to the Takaful operator to protect them from unpredicted losses. Then, the takaful operator will take a portion of money from takaful fund and pays premium to the Retakaful operator to get reinsurance protection to spread its risk and in return, retakaful operator protects the takaful operator from losses incurred by the happening of any extraordinary losses.22

**Meaning of Retakaful**

Takaful is a risk management tool not only on an individual level but on a corporate level as well. Takaful operators resort to reinsurers to help cover outstanding risks.23 Therefore, Retakaful has a close and unique relationship with takaful operations where retakaful is a kind of takaful and the effectiveness and competitiveness of retakaful market depends upon the effectiveness and competitiveness of the direct takaful market. As Retakaful is a kind of insurance whereby the takaful operators pay an agreed amount of premium from the takaful fund to the retakaful operator, and in return the retakaful operator will provide security for the risk reinsured. The best possible meaning for reinsurance can be summed up as "insurances for insurance companies". Alternatively, we can say that Retakaful is a "takaful for takaful operators". It is a solution for a primary insurer to protect against unforeseen or extraordinary losses. Reinsurance works upon a principle to limit liability on specific risks, to increase individual insurer's capacity, to share liability when losses overwhelm the primary insurer's resources and to help insurers to stabilize their business in the face of the wide swing in profit and loss margin inherent in the insurance business.24

**Definitions of Retakaful**

1. According Section 2 of Takaful Act, 1984 of Malaysia:

   "Retakaful means an arrangement consistent with sound takaful principles for retakaful of liabilities in respect of risks incurred or to be

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incurred by the takaful operator in the course of his carrying on takaful business.”

2. Section 2(o) of Takaful Act, 2005 of Pakistan:

"Retakaful means an arrangement consistent with sound takaful principles for retakaful of liabilities in respect of risks accepted or to be accepted by the takaful operator in the course of his carrying on takaful business and includes ceding risks from takaful pool managed by the takaful operator to one or more retakaful pool managed by any other one or more takaful operators in line with takaful principles.”

3. "Retakaful is a form of reinsurance whereby the takaful operator, lacking the financial capacity to cover risks from its own resources, ceds to a takaful pool managed by a larger operator, the Retakaful Company.”

- Khaled Kassar

4. "Retakaful is a form of insurance whereby the takaful operator pays an agreed amount as premium from the takaful fund to the reinsurance Company or retakaful operator and in return, the reinsurance company or the retakaful operator will provide security for the risk reinsured”.

- Prof. Mohd. Ma’sum Billah

5. "Retakaful is the business of insuring an insurance company or underwriter against suffering to a great loss from their insurance operations; and allowing an insurance company or underwriter to lay off or pass on part of their liability to another insurer on a given insurance which they accept.”

- Robert Kiln and Stephan Kiln

From the above definitions we can conclude that; retakaful is a kind of insurance where the retakaful operator is willing to bear all risks and losses of takaful operator who has a limited financial capacity to pay for losses on a
agreed amount of premium to be paid from takaful fund collected from takaful holders.

**Nature of Retakaful**

Retakaful follows the same basic Islamic principles that are applicable for takaful. Retakaful is essentially about managing risk. It is a risk transfer method where by a takaful ceding company resorts to a retakaful operator to reinsure original insured risks against an unforeseen situation, if the risk insured are above the normal underwriting clause. Therefore, a takaful ceding company may, base on limited financial resources, hedge against possible incapability to meet all takaful reinsurance protection from a financially capable reinsurers, which will take over the coverage of the large proportion of the risk.\(^{25}\)

Fathi Lashin\(^{26}\) stated that retakaful does not; in principle differ from takaful operations. The Shariah principles applying to takaful apply to retakaful also. The difference, if any, is that in the retakaful operations, the participants are takaful operators instead of individual participants. It is rightly argued that the current practice of insurance business has shown that a takaful ceding company cannot do without retakaful facility. Thus, there is a need for takaful operators to split risks by way of establishing retakaful operators. By doing so, they share their risks with retakaful companies. The retakaful operator, on the other hand assumes the responsibility of managing and investing the premiums of takaful operators based on Profit Loss Sharing. It shoulders the responsibility to compensate for losses, which may occur on any of the takaful operators that have agreed to present monetary contributions in the form of a retakaful scheme.\(^{27}\)

**Objectives of Retakaful**

Retakaful is a mechanism to increase takaful activity by distributing risks. Its basic objective is to provide safety cover for large risks and large

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25. See Billah, Mohd. Ma'sum, *op.cit.*, pp. 2-3
26. Member of Shariah Supervisory Board of Dubai Islamic Bank.
combined risks subject to common loss. It is to ensure that takaful funds are managed to meet indemnity obligations of the insured and the reinsured and to assure the continuity of takaful operations. This means retakaful gives the underwriting capacity to the takaful ceding company. Therefore, the objectives of retakaful can be summed up in the following:

1. Protecting takaful operator from the threat of insolvency, underwriting and interest of the participants, forging co-operation among the participants and investing the accumulated fund in an Islamic way.

2. It provides underwriting flexibility and further consolidating the financial stability of the takaful operator in order to compete with conventional insurance companies in accepting risks. This means retakaful “build a very close continuing business interest in common between the takaful ceding company and the reinsurer because they are both at risk.”

3. It may allow the takaful operator to utilize the retained deposit reserves of the retakaful fund in the interest of its clients without paying interest as a process of making the reinsurance industry an interest free business.28

**Functions of Retakaful:**

From the retakaful company’s perspective, there are at least four fundamental functions:

1. Retakaful is an effective and convenient way to spread the takaful company’s risk portfolio over different risk carriers as well as territories.

2. Retakaful provides underwriting capacity to the insurance market, enabling it to fulfil the needs of the public, particularly, the insurance of large industrial and mega risks.

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28. See Bhatti, Mohd. Ajmal, “Emergence of Reinsurance Practice: An Islamic Paradigm and Reflecting some Misconceptions” a paper presented at Labun International Summit on Takaful (Islamic Insurance), Lebanon, Malaysia, 19-20 June, 1997,

29. See Akoob, Mahomed, *op.cit.*, p.145
3. Retakaful acts as a backup to insurance market against the risk of ruin arising out of any catastrophic event.
4. Retakaful is a cost-effective substitute for capital.  

Parties to Retakaful

The operation of retakaful mechanism involves two parties:

1. **Takaful Operator (Insured):** Takaful operator (the insured), that is, the direct insurer, which desires to relieve itself from the part of the risks, insured; and

2. **Retakaful Operator (Insurer):** Retakaful operator (the insurer), that is, the company, which accepts that portion of risk, which is reinsured.  

The Retakaful Contract

The Retakaful contract is a company-to-company contractual relationship and it is essentially about managing risk where there is an agreement between the takaful operator and retakaful operator. Therefore, the original policyholders are not party to the reinsurance agreement. Nonetheless, the insured party may like to know that a professional and reliable reinsurer is administering the original policy, since, this concerns its security, but the insured party has not and cannot have any direct interest in the reinsurance contract. On the other hand, some legal scholars from the field of Islamic finance emphasized that the contract of retakaful should stay between the takaful operator and retakaful operator, whereas the original policyholders of takaful fund are not involved in the contract in any way. Morally, it is, however, recommended to have the consent of the original takaful participant before entering into a retakaful contract.

Based on above discussion the legal and operational relationship of the retakaful and takaful operators may be summarised in the following words:

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30. See Billah, Mohd. Ma' sum, op. cit., p. 3.
1. The retakaful operator assumes the responsibility to invest the fund on the basis of al-Mudarbha and shares the profits with takaful operators by mobilizing premiums or contributions of takaful companies.

2. In the event of profit earned, it will be distributed between the retakaful and takaful operators according to the agreed percentage contained in the agreement certificates issued.

3. In the event of perils or loss, the retakaful operator indemnifies the defined risks and settles the expenses of the process of takaful from the gross premiums, reserves and profits of the investment.

4. If there is any surplus, it should be proportionately accredited into takaful operator's account.

5. The retakaful operator undertakes to underwrite the insolvency of the takaful operator by providing a loan from the retakaful shareholders fund from which the takaful operator settles claims.³¹

Thus, the legal and contractual relationship of the retakaful and takaful operator comprises of accumulation of premiums from takaful operator on the basis of al-Mudarbha financing technique.

Kinds and Methods of Re-Takaful

From this figure, the kinds and methods of Retakaful may easily be understood:

Retakaful

   Facultative     Obligatory Treaty

      Proportional    Non Proportional Treaty
     Facultative    Treaty

     Quota Shape    Excess of Loss Treaty
     Surplus        Stop Loss

Figure 1.1: Kinds of Retakaful

³¹ See Arbouna, Mohammed Burhan, op. cit., pp. 342-343.
Facultative Re-takaful

In facultative retakaful, the ceding company cedes and the reinsurer covers the part of the risk assumed by a particular insurance policy. Facultative retakaful is arranged separately for each single risk and for each insurance contract if reinsured. Facultative retakaful normally applies for individual risks not covered by their reinsurance treaties, or exceeding treaty limits, for amounts, which exceed the monetary capacity of reinsurance treaties, and for unusual risks. Premiums written on a facultative basis are higher because each risk is individually written.32

Treaty Retakaful

In treaty retakaful, the ceding company is bound to cede and the reinsurer is bound to cover a specified part of a certain type or category of risks insured by the ceding company. Treaty retakaful operators do not separately evaluate each of the individual risks assumed under their treaties. The retakaful’s evaluation of the ceding company’s risk management, underwriting practices, and claim settlement practices and procedures usually determines the extent of coverage and affects the pricing of the treaty at inception.33

Proportional of Prorata Retakaful

Under proportional or prorata retakaful, the retakaful operator indemnifies the ceding company against a predetermined portion of the losses of the ceding company in return for the same portion or share of the insurance premium collected by the ceding company.34

Example

Suppose, there is a property with a total sum insured of Rs. 10 million. The cedant (that is, the reinsured) retains 40% of the risk and cedes the rest 60%, to

32. See Kassar, Khaled, op. cit, p. 132.
33. Id.
34. Id.
the retakaful operator or group of retakaful operators. Assuming a premium rate of 0.1%, this results into a gross premium for the whole risk of Rs. 10,000. This premium is then distributed in the same proportion of 40:60%. Figure (1.2).

<table>
<thead>
<tr>
<th>Sum insured Rs. 10 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained sum insured</td>
</tr>
<tr>
<td>40% × 10 million</td>
</tr>
<tr>
<td>= Rs. 4 million</td>
</tr>
<tr>
<td>Retained gross Premium:</td>
</tr>
<tr>
<td>40% × 10,000</td>
</tr>
<tr>
<td>= Rs. 4,000</td>
</tr>
</tbody>
</table>

Figure 1.2 **Risk and Premium distribution under Proportional Retakaful**

By ceding a part of the risk to the retakaful operator, the cedant is entitled to receive a retakaful commission to cover its own operating costs. The Objective behind levying commission is to reimburse the cost incurred in procuring the business in ratio to the premium ceded, and to make some contribution towards expenses for servicing the business. This is logical since the retakaful operator receives a share of the all inclusive direct premium, which includes the pure risk premium, acquisition costs and overheads. The retakaful operator therefore returns to the ceding company by way of reinsurance commission a part of the premium, expressed in all-embracing percentage of the premium as compensation for expenses incurred.

On the basis of reinsurance commission of say 30%, the premium flows from the cedant to the retakaful operator as shown in Fig. 1.3. The retakaful operator has to return 30% of its gross reinsurance premium (Rs. 1,800) to the cedant as reinsurance commission, leaving a net reinsurance premium of 0% of the gross reinsurance premium (Rs. 4,200) for the retakaful operator.
Suppose a loss of Rs. 8 million occurs, the same proportion applies in the distribution of the amount to the cedant's retention and the retakaful operator's share. This is shown in figure 1.4:

**Figure 1.4: Loss distribution under Proportional Retakaful**

In the case of retakaful written on non-proportional basis the retakaful operator indemnifies the ceding company against all or specified portion of losses on a claim by claim basis or in excess of a specified amount, known as the ceding company's retention up to a retakaful contract limit.\(^{35}\)

\(^{35}\) Ibid., p. 133.
Non-proportional retakaful is structured in layers as shown in figure 1.5. The retakaful operator may either participate in all layers or select certain layers and avoid others. The reinsured will participate in each loss, but the maximum amount is limited to the priority. Retakaful operators of the first layer will only be liable if the loss exceeds the priority, for the amount above the priority up to the upper limit of the layer. The second layer will work only when loss exceeds the upper limit of the first layer and so on. For example, the retakaful operator has to pay the whole loss 1 shown in figure 1.5, as it is within the priority. For loss 2, the priority and first layer have to pay up to their maximum liability, but the second layer is only partially affected. The third layer and all other layers above it will not have any involvement for this particular loss.

For each layer, there is no proportional relationship between premium amount paid by the retakaful operator and the size of a certain layer in relation to the total protection of all layers. Instead, it is determined by the probability of each layer being affected by losses, based on factors such as frequency, severity and exposure at risk.\(^\text{36}\)

![Diagram of Non-Proportional Retakaful]

**Figure 1.5: Structure and loss allocation of Non-Proportional Retakaful**

36. See Akoob, Mahomed, *op. cit.*, pp. 149-151.
Quota Share

Quota share is the basic form of a participating treaty whereby the retakaful operator accepts a stated percentage of each risk within a defined category of business on prorata basis.37

Surplus

Surplus is the excess of assets over liabilities. It determines an takaful or retakaful operators capacity to write business by maintaining this excess at standard ratios or multiples.38

Excess of Loss

Excess of loss is a forms of retakaful under which recoveries are available when a given loss exceeds the cedants retension defined in the agreement.39

Stop Loss

Stop loss is a form of retakaful under which the retakaful operator pays some or all of a cedants aggregate retained loses in excess of a predetermined amount or in excess of a percentage of premiums.40

Operational Mechanism of Retakaful

Operational Mechanism of Retakaful is based on two principles. The first principle is co-operation and the second one is solidarity. The reason behind this is, retakaful operation is needed to strengthen the takaful sector and since relations of reinsurance with conventional reinsurance may put up some hick ups on the genuineness of Islamic insurance as a whole, a cooperative reinsurance is relevant to meet this need. Thus, in this situation, to strengthen the function of the takaful operation, co-operative re-insurance

37. See Kasser, Khaled, op. cit., p. 133.
38. Ibid.
40. Ibid.
mechanisms have to be developed. In doing so, the mechanisms below rightly function as guidelines for Islamic reinsurance operations:

1. All takaful operators must give a portion of money as a donation based premiums to establish a retakaful fund.

2. The payment shall be equal to the defined risks of each takaful operator.

3. The person or individual who manage the fund will be paid on the basis of ijara (hire contract) or according to the rules of Profit Loss sharing (Mudharaba).

4. Takaful operators also may defer payment of their premium instead of advanced payment of contributions but with a pledge to settle their financial obligations at a later date.

5. Initially, the mechanisms of the retakaful operation above may face many impediments. If there are any immediate extraordinary losses, which have to be paid out of the indemnities kept for this purpose according to the retakaful agreement, it will threaten the perpetuity of the fund.41

The Example of Retakaful Flow Chart Operation

![Retakaful Flow Chart](image)

Fig. 1.6: Retakaful Flow Chart

41. Ibid, p. 9.
The diagram above shows example of Retakaful flow Chart operation, which was taken from Asean Retakaful (Labuan) Limited (ARIL). Firstly the company invests Rs. 1,000,000 that are taken from Retakaful fund. Let say the investment brings profit of Rs. 100,000 to the Company; this profit will be added back to the retakaful fund. This amount of money will be used for operational cost of Retakaful to pay for claims up to Rs. 500,000 and also reserve for Rs. 300,000. Then, the surplus profit of Rs. 300,000 will be divided between retakaful company and also cedants, which are the takaful operators. The Retakaful company will get 60% from the profit which is Rs. 180,000 and Takaful operators will get 40% from the surplus profits which is Rs. 120,000.

Shari’a Compliance of Retakaful

To conduct retakaful co-operation with conventional reinsurers in a manner compatible with Islamic law, certain conditions must be fulfilled. These conditions are categorised into two; namely, general and specific conditions.

General Conditions

1. The retakaful co-operation of Takaful operators with conventional reinsurers should not cause financial injury to Muslims or destabilise the financial systems of Muslim countries. If it does so, the co-operation becomes unlawful for its failure to serve the purpose for which it was permitted.

2. The takaful companies must prevent capital flow from the Takaful fund to conventional reinsurance firms. Moreover, preference shall be given to Islamic reinsurance operators in the matter of securing reinsurance protection whenever possible.

3. The reinsurance experts of takaful operator should carefully determine the quantum of liability to be reinsured.

4. The takaful operator shall reinsure on a net premium basis and shall not receive any reinsurance remunerations or profit commissions or
interest on premiums it has retained from premiums payable to its reinsurer.

5. The Takaful operator should review its reinsurance requirement annually and should progressively reduce dependence on conventional reinsurers.

6. The takaful operator must stipulate a condition exempting it from payment of or receiving interest from the conventional reinsurance company.

7. The takaful operator must encourage the participants and shareholders to contribute to a Retakaful fund by consenting to increase their proportion of tabarru and seek their consent to use their contribution for the purpose of reinsurance protection.

8. The premium paid for securing reinsurance protection shall be as low as possible.

9. The takaful operators should endeavour to persuade its conventional reinsurer to enter into a profit-sharing agreement and even suggest a method of management and investment compatible with Islamic principles.

10. The ultimate goal of Takaful operators shall be to put an end to their relations with conventional reinsurers whenever adequate reserves, or when numerous Islamic reinsurance companies, are established.

11. It is incumbent upon Takaful operators to appoint a Shari’ah Supervisory Board to monitor their operations according to the Shari’ah principles. 42

Specific Conditions:

Specific Conditions are divided into three heads:

42. See Arbouna, Mohammed Burhan, op. cit., p. 349.
a) **The need for reinsurance protection should be unavoidable:** For co-operation with conventional insurers to be justifiable, the need for co-operation must be unavoidable. Unavoidability here means that reinsurance protection is so crucial that if it is not practised the society may suffer a considerable financial and social crisis. In this situation, such a reinsurance agreement is permissible because it serves the maqasid al-Shari'a or objectives of the Sharia, which are protection of religion, life, intellect, lineage, and property.

b) **The need for reinsurance protection should be either general or specific:** It must be noted that dealings with conventional reinsurance companies are justified on the basis of haja when such dealings are badly needed by the public or certain business groups whose business have the potential to bring prosperity to society. It is necessary thus to evaluate the co-operation with conventional reinsurance companies in the context of the damage that society might suffer.\(^{43}\) It must be noted, therefore, that the law of need or haja alone is not a sufficient legal norm for the legality of any financial transaction. It has to be supported by the customary practise of society and the magnitude of the need for such a transaction.

c) **The need for reinsurance protection must be material and substantial:** In the application of haja as a legal norm, the question as to whether there is another alternative lawful means of reinsurance should be carefully evaluated. In other words, any transaction the legality of which is based on compelling need is deemed as having exhausted all lawful avenues of investment and financial transactions. Thus, if there is another alternative lawful means of doing such business, the application of haja is unjustified. It is, therefore, evident that in the context of the above limitations of necessity/need, seeking reinsurance protection from conventional reinsurance protection from

\(^{43}\) Id.
conventional reinsurance firms is legally valid. The uncertainty or gharar under the above-stated conditions is tolerated for reasons of compelling need.\textsuperscript{44}

Lastly it is submitted that retakaful is "takaful of takaful". The retakaful contract is essentially a contract of takaful, so that all the basic principles of takaful must also be used in the operation of retakaful. Retakaful is actually a means of widening the spectrum of the principles of solidarity or mutual help. Without retakaful, implementation of the principle of tabarr'\textacute{u} is limited within the boundary of a single takaful pool being managed by a takaful operator. However, through retakaful a participant in one takaful pool essentially helps or is being helped by other participants in the other takaful pools. This concept is a unique dimension of retakaful that is not to be found in insurance under common legal system.

\textsuperscript{44} Id.