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Profit Commission from Reinsurance Arrangement: An Analysis from Shariah Perspective

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ABSTRACT

This research analyzes the profit commission from reinsurance arrangements payable to the Takaful fund from a Shariah perspective. To address the research questions and achieve the objectives, this study employs a qualitative research methodology, including a literature review and an examination of primary and secondary sources such as academic papers, books, and articles related to the topic. In addition to textual analysis, the researchers have conducted non-structured interviews and discussions with experts from the General Underwriting department of a takaful operator in Malaysia. As a result, the study identifies two differing opinions on this issue, each supported by various justifications. After analyzing these justifications, the researchers acknowledge the presented evidence. However, it is evident that the second opinion allowing the recognition of profit commission from reinsurance arrangements holds stronger justification based on the analysis conducted.

1. Introduction

Kopf (1929) in his article Notes on The Origin and Development of Reinsurance asserts that the first reinsurance contract on record relates to the year 1370, when an underwriter named Guilano Grillo contracted with Goffredo Benaira and Martino Saceo to reinsure a ship on part of the voyage from Genoa to the harbor of Bruges. It is noted reinsurance arrangement began since the 14th century and perceived as a need for the insurance company.

Reinsurance is a financial transaction by which risk is transferred (ceded) from an insurance company (cedant) to a reinsurance company (reinsurer) in exchange for a payment (reinsurance premium) (Wehrhahn, 2009). Reinsurance is a vital instrument within the insurance/takaful industry at a micro and macro level. Its functions are to protect capital/asset base, preserve solvency and encourage balance sheet growth, to stabilize underwriting results, to increase automatic underwriting capacity to spread risks, control aggregations, and/or accumulations, and to help spread risks across geographical boundaries thus reducing the impact of losses in any single company, market or economy (Yusof et al., 2015).

Yusof et al. (2015) also assert that the other function of reinsurance is to develop products,

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utilizing the expertise and financial support of the retakaful market. The experience of retakaful if compared to reinsurance is comparable like heaven and earth. Reinsurance has begun since the 14th century, on the other hand, retakaful has just debuted in the early eighties (80s) which supported in terms of financial and expertise from reinsurance is needed for the takaful/retakaful industry to effectively protect takaful risk (in the absence of retakaful) and nurture the takaful industry's growth.

Principally, takaful operators are not allowed to cede out takaful risk to reinsurance company. Therefore, this restriction might lead to other impacts on takaful industry which could hinder the progress and to remain competitive. In view of this, ceding out takaful risk is allowed based on *hajah* (need) for certain reasons (Bank Negara Malaysia, 2023). Among the reasons, according to Takaful Operational Framework (2019) of Bank Negara Malaysia (BNM) are (a) no takaful operator or retakaful operator is known to accept the particular risk; (b) no takaful operator or retakaful operator has the capacity or expertise to accept the particular risk; or (c) a retakaful arrangement with takaful operator or retakaful operator creates potential detrimental effects to the takaful funds.

This arrangement incurs a profit commission as payment to the ceding company based on the performance of the portfolio. It is noted that scholars have different opinions on this issue, and currently, to the best of the researchers' knowledge, no specific research has explained on profit commission from reinsurance arrangement with its clear and proper picture as well as been discussed from a Shariah perspective.

The scope of this research is to analyze the profit commission from reinsurance arrangements only (excluding profit commissions from the retakaful company) payable to the takaful fund (not the shareholder fund) from a Shariah perspective. The outcome will subsequently serve as a fundamental guidance for the players in the takaful industry in ensuring Shariah compliance at all times. It may also serve as a reference for policymakers when considering any resolution related to the profit commission derived from reinsurance arrangements.

2. Literature Review

2.1. Overview of Profit Commission

Different views of scholars usually due to the different findings in describing and interpreting the real picture of an issue. Therefore, it is imperative to understand the real modus operandi of profit commission as an Islamic legal maxim said, *'judgment is to be based on knowledge and understanding'*. Hence, this section will unravel the definition of profit commission, features and the formula of calculating the profit commission that will help in analysing the permissibility of profit commission by providing Shariah justification.

2.2. Definition and Features of Profit Commission

To understand the definition of profit commission, researchers have compiled definitions from several sources based on the researchers' best knowledge, as outlined below.

Table 1. Definitions of Profit Commission

No.	Title of the References	Definitions of Profit Commission
1.	Policy Document of Operating Cost Controls for General Insurance and Takaful Business (BNM, 2023)	"Profit commission" refers to the performance bonus payable to an insurance or takaful agent in addition to normal commission, based on the underwriting profit or distributable surplus in the agent's portfolio.

2.	Shari'ah Standard No. (41): Islamic Reinsurance (AAOIFI, 2015)	Reinsurance profit commission, which refers to a percentage amount of the realized increase of revenues (reinsurance contributions) over expenses in the reinsurance agreement (coverage), paid to the Islamic insurance company as a bonus for its excellent performance in managing the insurance operations in general and the reinsured risks in particular, and providing the best services to its customers. Such amount is paid in the form of an agreed upon percentage of the profits of the reinsurance company, as per the reinsurance agreement signed between the two companies. When the reinsurance company earns profits from the reinsurance contracts signed between the two companies, the reinsurance company pays the part of the profits agreed upon to the insurance company.
3.	IFSB-18, Guiding Principles for Retakāful (Islamic Reinsurance) (IFSB, 2018)	Profit commission is a feature of some proportional Retakāful and reinsurance contracts, and represents an amount awarded to the Takaful Undertaking (TU) based on the Retakaful Undertaking's (RTU) result under the Retakaful contract, calculated in accordance with the terms and conditions of the contract. The aim of a profit commission is to provide cedants with an incentive to manage the performance of the business that is ceded.
4.	Introduction to Reinsurance (Wehrhahn, 2009)	"Contingent Commissions (or Profit Commission) - An allowance payable to the ceding company in addition to the normal ceding commission allowance. It is a pre-determined percentage of the reinsurer's net profits after a charge for the reinsurer's overhead, derived from the subject treaty."
5.	General Business Guidance Notes (Labuan Financial Services Authority, n.d.)	Profit commission refers to any profit commission paid or payable to an intermediary.
6.	Profit Commissions – One for You, Three for Me (Weaver, 2007)	Profit commissions are a type of contingent commission whereby the commission paid from the risk carrier or underwriter (typically a reinsurer, insurer or underwriting agency) to the producer/distributor (typically an insurer, underwriting agency, broker or agency) depends on the defined "profitability" of a specific book of business over a fixed period of time. Profit commission may also be known as profit-sharing commission, bonus commission or variable commission. In contrast with straightforward flat commissions, which are based on the premium collected on the sale or renewal of a single policy.

Source: Authors' own

Researchers analyzed the definitions tabled above and strained as possible to come out with a comprehensive *(jami')* and exclusive (*mani'*) definition. In a nutshell, researchers have come out to

propose the definition of profit commission as follows:

A payment at some period from retakaful operator/reinsurer to cedant derived from a pre-agreed arrangement based upon the percentage of positive result of a single cedant's risks.

It is noted that profit commission is also named as contribution to the net surplus based on the angle of interpretations. Profit commission also seems like a surplus however the key difference is that a profit commission is a contractual entitlement, rather than a discretionary distribution, and it is specific to the performance of a contract and the payment of profit commission based upon the result of a single cedant's risks (IFSB, 2016). It is normally derived from the arrangement of Treaty proportional business. While for facultative or non-proportional risk, no profit commission or surplus will usually be returned.

2.3. Formula Calculation of Profit Commission

Basically, holding the definition of certain subject in discussion might not be able to provide a comprehensive data that we require. Therefore, the formula for calculating the profit commission is crucial as it offers a comprehensive overview of the profit commission's actual operation. This formula will facilitate the Shariah justification process, ultimately making it easier to derive a ruling. In this context, a formula helps to translate abstract concepts into practical, quantifiable terms, ensuring that financial practices adhere to Shariah principles and provide clear justification for Shariah rulings.

Profit commission is the amount paid from reinsurers to cedant when the reinsurance arrangement achieves a pre-agreed profitability (positive balance) level. There is no profit commission when the result is below the pre-agreed profitability level. The calculation for profit commission is essentially income minus outgo. The details may be understood as follows:

Table 2. Formula Calculation of Profit Commission

Income	Ceded premium
	Portfolio transfer on premium
	Outstanding losses - from previous treaty year to current treaty year (if any)
Minus Outgo	Losses and loss expenses paid during the year
	Reinsurer's Management Expenses calculated at the rate specified in the Contractual Details
	Levy and Taxes
	Portfolio transfer on premium and outstanding losses from current treaty year to next treaty year (if any)
	Any deficit carried forward from previous year
Balance	Positive = Surplus
	Negative = Deficit
Profit Commission Amount = Positive Balance multiply by Profit Commission %	

A simple calculation as an example:

- If Income is RM10,000 and Outgo is RM7,000, then:

Balance = RM10,000 − RM7,000 = RM3,000

- If the Profit Commission is 10%, then:

Profit Commission Amount = RM3,000 × 0.10 = RM300
Hence, the Profit Commission Amount in this case would be RM300.

By analyzing the formula, it is noted that there are two main components of profit commission which are income and outgo. Income consists of ceded premium, portfolio transfers on premium and outstanding losses from the previous treaty year carried over to the current treaty year. It is noted that this income primarily comes from the contribution of the risk fund of the takaful operator. Then it is ceded out to reinsurer as a premium by the takaful operator getting into the reinsurance arrangement. The outgo, which includes claims, taxes, and expenses of the reinsurance arrangement, are subtracted and multiplied by the agreed percentage to determine the actual amount of profit commission. Additionally, it is noted that there is no other income, such as profit or interest from any investments in this formula as the profit commission is derived solely from the ceded premium without any external funds being included. This was also confirmed by interviewee during interview session on the profit commission formula.

In term of accounting treatment, it is noted from the interview that for reinsurer/retakaful's accounting treatment: Profit commissions are typically recognized as expenses, impacting the income statement of the reinsurer/retakaful operator. On the other hand, for takaful operator: For TOs profit commission may appear as income, influencing the financial position and performance ratios of both parties.

3. Research Methodology

In addressing the problem statement and meeting the objective of this research, this study employs a qualitative research methodology by doing interview, literature review by studying primary and secondary references from academic papers, books and article related to the topic of this research. The key persons interviewed are experts in the reinsurance industry from the General Underwriting department of a Takaful operator in Malaysia (interviewee) to confirm and understand the real modus operandi of profit commission. The interviewee was selected based on their vast experience in reinsurance, general underwriting and broking which are closely related to the subject matter.

The literature review was carried out to understand and to analyze opinions of the scholars in getting their preferred views of the profit commission arrangement with reinsurance from a Shariah perspective. Therefore, employing qualitative research methodology through interviews, and literature review serves as a profound assistance to researchers in comprehensively exploring, analyzing, and interpreting the complexities of the research topic, providing valuable insights that contribute to a quality research paper.

4. Results and Discussion

4.1. Shariah Analysis of Profit Commission from Reinsurance Arrangement

After understanding the clear picture and reality of profit commission from reinsurance arrangement, researchers will divide this section into two subsection. First subsection will present Shariah scholars' views pertaining to this topic extracted from research paper, resolution and standard with some remarks by researchers. The second subsection will present the Shariah analysis of the Shariah scholars' views of the profit commission from the reinsurance arrangement.

4.2. Shariah Views of Profit Commission from Reinsurance Arrangement

Throughout the research process, researchers have explored the articles and journals from websites as reference by searching some keywords for instance: 'profit commission', 'retakaful/reinsurance commission', 'surplus', 'treaty', 'reinsurance' and 'retakaful'. During the literature review, researchers found most of the references are not explicitly highlighting the profit commission from reinsurance arrangement issue. This is probably due to the difference in the profit commission's operation and the terminology used in the industry.

Thus far, Qureshi (2011) in his article 'Analyzing the Shariah Compliant Issues Currently Faced by Islamic Insurance' explains in the conclusion which one of the issues faced by takaful operator is reinsurance arrangement with reinsurer due to the unavailability of retakaful operator. Apart of the non-Shariah compliant of the reinsurance arrangement itself, the contribution from the takaful operator which is ceded to the reinsurer as a premium payment will then be invested in Shariah non-compliant companies. Then he asserts that when takaful company receives the payment as claims, reinsurance commission or profit commission, it is already tainted by the investment by conventional insurers in prohibited areas. Hence, researchers conclude that the writer highlighted that the profit commission may be prohibited due to the payment received being from a tainted income.

Furthermore, Islamic Financial Services Board (IFSB) (2018) in the Guiding Principles for Retakaful (Islamic Reinsurance) standard 18 emphasized the profit commission received from a conventional reinsurer may be prohibited due to some bases of calculation of profit commission may involve elements of riba, and takaful operator need to be alert to the risk of inadvertent Shariah non-compliance.

Meanwhile, researchers observed that the ruling of profit commission from reinsurance arrangement is not clearly stipulated in the Shariah Standard issued by the Accounting and Auditing Organization for Islamic Financial (AAOIFI) even the term reinsurance profit commission is defined in the Definition of Appendix C in Shariah Standard No. (41): Islamic Reinsurance. However, researchers noted in paragraph 7/3 of the same standard No. (41) which stated the impermissible of surplus distribution from traditional reinsurance companies (conventional) to takaful companies as follow:

> *"7/3 Islamic insurance companies should not accept any redistributions of insurance surplus forwarded by traditional reinsurance companies. Nonetheless, Islamic insurance companies can request premium discounts from traditional reinsurance companies."*

Researchers are of the view that if the surplus is also referring to profit commission, it will take the same view and treatment of surplus as the above paragraph. The researchers are wondering why the terminology of 'reinsurance profit commission' is stated clearly in definition but the rule is not clearly explained in any paragraph instead of just using the word 'surplus'. What if the paragraph on the rule of surplus is not referring to the profit commission that probably has a different rule, as in practice, the terminology of profit commission differs from a distribution of surplus, in that, it is a contractual entitlement, rather than a discretionary distribution, and is specific to the performance of a contract based upon the result of a single cedant's risks as stated in Guiding Principles for Retakāful (Islamic Reinsurance) issued by IFSB.

In addition, during industry discussion, it came to researchers' attention that the Shariah Committee of one prominent takaful industry has decided that the profit commission from reinsurance arrangement is impermissible.

Besides to the above, BNM, in the Hajah and Darurah Policy Document (HDPD) outlines on how Islamic financial institutions (IFIs) should handle hardship situations. After reading the HDPD in its entirety, reinsurance profit commission can be perceived as something not permissible to be received and recognized by the takaful operators. In relation to paragraph 8.4 of the HDPD, it states that IFIs are prohibited from applying *hajah* (need) and *darurah* (dire necessity) concepts to address hardships arising solely from the risk to its profitability, while specifically highlighting an example in the footnote related to reinsurance profit commission whereby it states that losing profit commissions from ceding out arrangements (where risks are transferred to reinsurers) does not qualify for applying this concept.

To be precise, BNM in explaining paragraph 12.10 in the footnote, states that the IFIs are expected to identify potential profit or loss scenarios that may arise when *hajah* is applied and must establish a plan to manage any financial impacts including the expectation on IFIs to purify that profit commission by donating it to charity. Consequently, it can be understood that reinsurance profit commission is deemed impermissible from BNM's perspective. Nonetheless, there is no specific SAC ruling issued to address this issue in particular.

Based on the analysis conducted on the relevant paragraph of the HDPD, the researchers appreciate that the basis of the prohibition on recognizing the profit commission (arises from reinsurance arrangement under the concepts of *hajah* and *darurah*), is rooting back to the relevant principles related to the application of *hajah* and *darurah*, particularly on the principle of 'need is to be assessed and treated proportionately' (Murad, 2023). In this context, it is believed that the profit commission is viewed as exceeding the permissible limits i.e., only to obtain adequate retakaful/reinsurance support, necessitating its purification.

On the other hand, one of the takaful operators allows the recognition of profit commissions received from insurance/reinsurance companies as income to Tabarru' Fund. It is noted that the main Shariah justification is based on the Islamic legal maxim of 'harm must be eliminated'. It is applied where the exclusion of profit commission will dilute the General Takaful Fund and Family Takaful Fund which may be harmful to participants. At the same time, it is argued that the business aspects could not be neglected as the stability and *maslahah* of the participants, and shareholders fund need also to be well addressed.

As far as this research is concerned, all the papers, resolutions, and standards found that explicitly highlight the issue of profit commission from reinsurance companies are limited. The rest of the papers primarily discuss reinsurance commissions or ceding commissions.

4.3. Analysis of Shariah Scholars' Views

This section will analyze previous Shariah views and will shed further light on the arguments raised. The researchers identify two opinions regarding profit commissions from reinsurance arrangement. The first opinion prohibits profit commissions for three reasons: first, the possibility of receiving tainted income; second, some bases for calculating profit commissions may involve elements of *riba*; and third, it is considered prohibited based on the proportionality requirements under *hajah* and *darurah* application. On the other hand, the second opinion allows the receipt of profit commissions in order to protect the takaful and serve the *maslahah* of participants' and shareholders' funds.

Based on the reasons stated, the researchers view that the prohibition of this issue from two different perspectives: micro and macro level. The former consists of the first two reasons for prohibition which are tainted income and riba in some bases of calculation, which focus on that specific arrangement of profit commissions. The latter includes the prohibition based on the concepts of *hajah* and *darurah*, considering the overall arrangement of ceding out to a reinsurance company.

Researchers hold the view and principle that 'basic principle in contracts and transactions (*mu'amalat*) is permissible and is not forbidden except what the Shariah prohibits' derived from the Islamic legal maxim of 'the original rule to something is permissible except what the Shariah prohibits' (Che Abdullah, 2011). Hence, this maxim should be applied at all times when related to any transaction. However, it is believed, this maxim is not universally applied across all cases or contexts. It is imperative to pay attention to the second part of the maxim which is 'it is not forbidden except what Shariah prohibits'. Ibn Taymiyyah in Majmu' al-Fatāwā emphasizes that before implementing this maxim, sufficient effort has to be made to ensure that there are no prohibited elements in the transaction (Al Sulayman, 2018). Therefore, the arguments for the prohibition of this issue should be challenged to ensure their validity, in order to avoid permitting what is haram and prohibiting what is halal.

4.3.1. Prohibition of Profit Commission from Reinsurance Arrangement Due To the Tainted Income

The first argument categorized under the micro perspective identifies that the prohibition of profit commission from reinsurance companies is due to the fact that the amount ceded to the reinsurance company may be invested in both Shariah-compliant and non-compliant companies. Therefore, when the takaful operator receives the payment as profit commission, it may already be tainted by the investments made by conventional reinsurer in prohibited areas.

Tainted income is basically an income derived from Shariah non-compliant sources. It is also known as non halal income or *mal haram* (prohibited income). According to Dusuki et al. (2012) prohibited income is categorized into two major types. The first is prohibited in its essence (*li-dhatihi*) and second is prohibited due to external reasons (*li-ghayrihi*). Examples of items prohibited in its essence are pork, wine and other impure items. On the other hand, prohibited due to external reasons are divided into two which are income acquired without the consent of the legal owner such as income realized through theft, usurpation and deception. Secondly, income that has the owner's consent but is not approved by Shariah includes transactions involving *riba* (usury), *gharar* (uncertainty), or *maisir* (gambling). In this context, income derived from non-Shariah-compliant investments may fall under this category, as the business and the contract used contain Shariah non-compliant elements.

Following this discussion, it is understood that money is not categorized under the prohibited item in its essence. Hence, payments received from a conventional reinsurer cannot be simply considered as non-Shariah compliant. Researchers propose to differentiate the two different arrangements between conventional reinsurer–investee and conventional reinsurer–takaful operator. Looking into the reinsurer-investee arrangement, it is noted that the contracts and nature of the investments made may not be Shariah-compliant, which could result in tainted income from the dividends or interest paid to the reinsurer. In this arrangement, it is undisputable that tainted income occurs.

Looking into the second arrangement between the reinsurer and the takaful operator, it may be deemed a reinsurance arrangement based on the concepts of *hajah* and *darurah*, and any commission involved including the profit commission should be considered part of a single arrangement. This will be further discussed in later sections addressing the third argument, i.e., prohibition arising from proportionality requirement in *hajah* and *darurah* application. Nevertheless, tainted income transferred to the takaful operator as a claim or commission may be viewed as a different arrangement (reinsurance arrangement allowable under *hajah* situation), as it eliminates the prohibited element and lead to a different ruling. This issue may be viewed in the context of dealing with individuals or entities that derive income from prohibited sources.

Muhammad (2010) in discussing this issue gave a preference to the opinion of allowing dealing with individuals or entities that derive income from prohibited sources. The basis of the ruling is based on:

i. Al-Quran as Allah SWT said in chapter 35: *Fatir*, verse 18:

وَلَا تَزِرُ وَازِرَةٌ وِزْرَ أُخْرَىٰ

Meaning: *And no bearer will bear the burden of any other person.*

He comments on the verse, noting that it demonstrates the flow of transaction that if any, the first prohibited transaction cannot be linked to the second allowed transaction in instances mudharabah, salam, and similar arrangements. These are not directly related to the first haram transaction, such as *riba* and alcohol. Therefore, the offense resulting from the first haram transaction (i.e., usury, alcohol, and so on) cannot be associated with the second halal transaction, which involves halal investments such as mudharabah and musharakah.

ii. Al-Sunnah as narrated by Umm al-Mu'minin A'ishah:

حَدَّثَنَا مُحَمَّدُ بْنُ بَشَّارٍ، حَدَّثَنَا غُنْدَرٌ، حَدَّثَنَا شُعْبَةُ، عَنْ قَتَادَةَ، عَنْ أَنَسِ بْنِ مَالِكٍ ـ رضى الله عنه ـ قَالَ أُتِيَ النَّبِيُّ صلى الله عليه وسلم بِلَحْمٍ فَقِيلَ تُصُدِّقَ عَلَى بَرِيرَةَ قَالَ " هُوَ لَهَا صَدَقَةٌ، وَلَنَا هَدِيَّةٌ ".

Narrated Anas bin Malik: Some meat was brought to the Prophet (ﷺ) and it was said that the meat had been given in charity to Barirah. He said, "It was Sadaqa for Barirah but a gift for us. (Sahih al-Bukhari 2577)

He explains this hadith shows that a change in ownership also leads to a change in law and ruling, even if the *'ain* (meat) is the same. In other words, the alms meat given to Barirah should be forbidden for the Prophet Muhammad (SAW) to eat, as he was prohibited from receiving and consuming alms. However, the fact is that the meat has changed ownership from Barirah to the Prophet Muhammad (SAW), and this transfer of ownership represents a second contract (Barirah's gift to the family of the Prophet Muhammad [SAW]) that is separate from the first contract (alms given to Barirah). Therefore, the Prophet Muhammad (SAW) refuted the suspicion that the meat was forbidden because it was charity meat. On the other hand, when the meat is transferred from Barirah to the Prophet's family, it is considered a gift.

iii. Islamic Legal Maxim:

تبدل الملك موجب لتبدل العين حكما مع أن العين واحد

Meaning: *The change of ownership requires a change in the rules (hukm) of the property, even though the property itself remains the same.*

He clarifies this method means that even if the property is illegal to the original owner because the source is illegal, but by changing the ownership, the *'ain* (property) makes the rule (*hukm*) changed even if the property is the same. After all, there is no denying that sources of employment in gambling companies, alcohol companies, usury companies and the like are illegal from the point of view of Shariah. However, when illegal money has changed ownership, such as handed over to a seller for buying goods or handed over to an employee to be worked on or invested in (mudharabah), then the rule of these contracts is halal because the owner has changed hand. In this case, the above maxim means that even though *'ain* (i.e. money) is the same money, it still changes to halal due to the change of

hands.

iv. Qias

He also elucidates the permission to deal with parties whose income comes from illegal sources is alluded to the need to deal with non-Muslims inside and outside Muslim countries. If dealing with people whose sources are haram, then a Muslim is not allowed to do business with non-Muslims who trade alcohol or pork inside or outside Islamic countries because their source of income is haram. As far as this study is concerned, there is no prohibition mentioned in the book of *fiqh* that is imposed on a Muslim interacting with a non-Muslim even though the source is clearly illegal.

Those are among the basis of justifications in allowing dealing with individuals or entities that derive income from prohibited sources. On top of that, as we can see from the method of calculation, there is no such thing as profit or interest from investment, as the income is purely from the ceded contributions/premiums. In conclusion, researchers hold the view that the argument for prohibiting profit commissions from reinsurance companies due to tainted income is not a strong justification for deeming profit commissions as prohibited. This matter requires a different ruling (*hukm*), based on the justifications outlined above.

4.3.2. Prohibition of Profit Commission from Reinsurance Arrangement Due to Certain Bases for Calculating Profit Commissions Involving Elements of Riba.

The second argument identifies that the prohibition of profit commission from reinsurance companies is due to the fact that some bases for calculating profit commissions may involve elements of riba.

Riba literally means excess and technically defined as an increase or excess which accrues to the owner in an exchange or sale of a commodity or, by virtue of a loan arrangement without giving in return equivalent counter value to the other party (Engku Ali, 2012). From the definition, it is noted *riba* consists of two primary types which are the exchange or sale of a commodity (*ribawi* item) and loan arrangement without giving in return equivalent counter value to the other party. The former is known as *riba al-buyu'* (sale-based) and the latter is known as *riba al-duyun* (debt-based).

Simply put, *riba al-duyun* is divided into two types. The first type is *riba al-qard*, which occurs in a loan agreement when no equivalent counter value is given in return to the other party. The imposition of excess amount occurs in the *aqad*. For instance, Ahmad borrows RM1,000 from Fatima to cover urgent medical expenses. They agreed that Ahmad would repay RM1,000 with an additional condition imposed of an excess value of RM500 within two months. In this case, the agreed upon of an excess amount of RM500 is deemed *riba*. Hence, the additional condition of imposition of RM500 must be eliminated. The second type is *riba al-jahiliyyah*. The difference from *riba al-qard* is that the imposition of an excess amount occurs at the end of the tenure. The borrower is then asked either to repay or to defer the payment, with an excess amount imposed.

Looking back at the other type of *riba*, which is *riba al-buyu'*, it is related only to *ribawi* items. There are six basic *ribawi* items stipulated in the *hadith*: gold, silver, dates, wheat, salt, and barley. These have been extended to other commodities that share the same characteristics (*illah*). In this context, money is also considered one of the *ribawi* items, as jurists hold the view that it shares the same *'illah* of *thamaniyyah* (monetary value). *Riba al-buyu'* is divided into two types which are *riba al-fadhl* and *riba al-nasiah*. *Riba al-fadl* refers to the unequal exchange of like *ribawi* items. For instance, this occurs when gold is exchanged for gold but with different measurements. Conversely, *riba al-nasiah* occurs when two *ribawi* items are exchanged, with one being delivered immediately and the other deferred.

An example of this is the exchange of gold for silver with a delay in payment.

After understanding the overview of *riba* and its branches, we can assess whether there is an element of *riba* in the calculation of profit commission. It is important to note that the original reinsurance arrangement is impermissible except in cases of *hajah* (need). The concept of reinsurance is similar to insurance, where the financial burden of a misfortune is transferred from the insured (the person requesting protection) to the insurer (the company willing to accept the risk or uncertainty). *Riba al-fadhl* and *riba al-nasiah* are among the Shariah issues that arise when the insured pays an amount of RM in premiums, which is exchanged for a higher amount of RM in deferred payment upon a claim (Shabir, 2007). In contrast, the takaful/retakaful arrangement adopts the concept of protecting and supporting among participants.

Since the argument of involvement of *riba* in some bases of calculation of profit commission presented is very brief, the researchers themselves must unravel the justification for the argument raised. There are different scenarios that have been considered. Perhaps the argument arises from the original arrangement of reinsurance itself, which contains elements of *riba*, as it is viewed as a claim that is exchanged for a premium in deferred payment, without an equivalent change. However, it is noted that the IFSB (2016) in the Guiding Principles for Retakāful (Islamic Reinsurance) standard 18, paragraph 28 (vii), e, stated:

> *"In circumstances where TUs cede business to a conventional reinsurer, an issue may arise as to whether it is acceptable for the TUs to accept commission from a conventional reinsurer which is non-Sharī`ah compliant. In the case of ceding commission, this is in substance merely a means of arriving at the negotiated price for the cover obtained. However, some bases of calculation of profit commission may involve elements of Riba, and TUs need to be alert to the risk of inadvertent Sharī`ah non-compliance".*

It is understood from the paragraph that there may be some issues for takaful operators when ceding to reinsurers. One of the issues is accepting commissions from reinsurers. Focusing on the profit commission, it is noted that some bases for calculating profit commissions may involve elements of *riba* while others may not. Therefore, it is acknowledged that IFSB is not generalizing that the profit commission involves *riba* because of the reinsurance arrangement itself which occurs in the exchange of premium and claim. However, some of the calculations itself may contain the element of *riba*.

Hence, when examining the formula for calculating the profit commission, which consists of income and outgo as explained in the previous chapter, the researchers propose to focus only on income, as it is the source of which will be given to the takaful operator for any profit commission or surplus after deducting the claim and expenses. It is noted that the profit commission given consists solely of the surplus from contributions or premiums ceded, without involving any elements of interest, profit, or dividends paid from investments or loans. In conclusion, the researchers are of the view that the formula for calculating profit commission stated in the previous section does not contain any elements of *riba*. The researchers propose IFSB to specify further details on the possibility of having elements of *riba* in the base calculation of profit commission to avoid such issues.

4.3.3. Prohibition of Profit Commission from Reinsurance Arrangement Due to the Proportionality Requirement under Hajah and Darurah Application

The last argument of prohibition of profit commission from reinsurance companies that was categorized under the macro perspective is due to the concepts of *hajah* and *darurah*. Basically, this

argument is also not clearly explained and justified however it is understood that the prohibition is closely related to the principle of 'need is to be assessed and treated proportionately' which will be elaborated further.

Based on Hajah and Darurah Policy Document issued by BNM which focuses on the context of Islamic financial institutions (IFI), it is well established that *hajah* and *darurah* concepts are applied only in a situation of hardship or difficulties in executing financial transactions or arrangements based on Shariah principles. The application of *hajah* and *darurah* arises during unavoidable circumstances or distress situations encountered by IFI, whereby leniency or concession is given to prevent harm (*mafsadah*) and ultimately attain benefit (*maslahah*) of effective financial intermediation.

The application of *hajah* and *darurah* concept to addressing hardship is subject to the preconditions to be fulfilled which are the certainty (*al-yaqin*) or high possibility (*ghalib al-zann*) on the materialisation or occurrence of hardship, deviation from Shariah principle or Shariah ruling, absence or impracticality of Shariah compliant alternatives and the impact of the application of *hajah* and *darurah* does not cause greater or equal harm.

In the context of insurance and reinsurance, it is basically prohibited due to the existence of *riba*, *gharar* and *maisir*. Takaful operators that need to cede out to reinsurance may be applying the *hajah* and *darurah* concept while fulfilling the said preconditions. Those are several reasons that may lead to hardship which are:

i. no takaful operator or retakaful operator is known to accept the particular risk;
ii. no takaful operator or retakaful operator has the capacity or expertise to accept the particular risk; or
iii. a retakaful arrangement with takaful operator or retakaful operator creates potential detrimental effects to the takaful funds.

BNM has divided *hajah* and *darurah* into three categories: Hajah Type 1, Hajah Type 2, and Darurah, each accompanied by specific parameters in addition to preconditions to be fulfilled as stated above:

i. Hajah Type 1
   a. The hardship arises due to practices or situations which are difficult to avoid (*`umum al-balwa*) or are widely accepted as a customary commercial practice (*`urf tijari*);
   b. the SAC issues a ruling on the permissibility of the application of Hajah Type 1 without stipulating specific conditions or limitations; and
   c. the Shariah ruling remains applicable until it is overridden by a later Shariah ruling.
ii. Hajah Type 2
   a) the hardship does not arise from practices or situations which are widely accepted as customary commercial practice (*`urf tijari*);
   b) the hardship is experienced by a specific person(s) and the severity of the hardship does not reach the stage of *darurah*;
   c) the SAC issues a ruling on the permissibility of the application of Hajah Type 2 with specific conditions or limitations; and
   d) the Shariah ruling needs to be applied temporarily and proportionately depending on the complexity of the hardship by considering the appropriate duration and quantum.
iii. Darurah
   a) the hardship does not arise from practices or situations which are widely accepted as customary commercial practice (*`urf tijari*);
   b) the hardship experienced by a specific person(s) may or may not cause systemic impact, but trigger recovery or resolution actions 19;

c) the SAC issues a ruling on the permissibility of the Darurah application with specific conditions or limitations in light of the extreme stress situation; and
d) the Shariah ruling needs to be applied temporarily and proportionately based on the complexity of the hardship by considering the appropriate duration and quantum.

In the context of the research paper, Hajah Type 2 will be applicable as the profit commission is derived from a reinsurance arrangement. Ceding out to reinsurer falls under Hajah Type 2 because it is not widely accepted as customary commercial practice (*`urf tijari)* and the hardship is experienced only by takaful operator/ participants and the severity of the hardship does not reach the stage of *darurah*. Hence, all the parameters must be met including the last parameter which is the Shariah ruling needs to be applied temporarily and proportionately depending on the complexity of the hardship by considering the appropriate duration and quantum. The parameter is derived from an Islamic legal maxim of 'dire necessity/need is to be assessed and treated proportionately. Based on this parameter, it is assumed that profit commission from reinsurance arrangement is prohibited as it is extended to and beyond the need and not proportionate.

Zuhayli (2017) explaining conventional insurance, concluded that it is basically prohibited. However, it may be allowed due to the *hajah* with the condition that it must be general (*'ammah*) or specific (*khassah*) to a certain category and must be essential (*mut'ayyinah*). He also explains that *hajah 'ammah* is the *hajah* for all people and *hajah khassah* is for specific to a group of people such as the people of a country or a specific profession. Meanwhile, the condition that *hajah* must be *mut'ayyinah* means that all legitimate (*mashru'ah*) ways to achieve the goal are non-existent, except for the contract in which there is uncertainty (*gharar*). Zuhayli (2017) means, in that context of insurance, that *hajah* may be applied even if there is prohibited element such as *gharar* with the condition that there is no halal alternative such as takaful. He also added that at the current time a need to insurance is not *hajah mut'ayyinah* since there is takaful product offered in the current market currently. Then he resumes if we assume that the need is *hajah mut'ayyinah*, it is permissible to insure only to the extent that eliminates the need, in accordance with the Islamic legal maxim of 'need is to be assessed and treated proportionately. Scholars explain this maxim by asserting that it means one must be satisfied with what is needed, and what is related to luxury and enjoyment is forbidden (Bankiran, 2022).

In discussing the application of Islamic legal maxim that states "need is to be assessed and treated proportionately" in profit commission from reinsurance arrangement, it is agreed that a takaful operator should minimize the contribution/premium ceded to reinsurers based solely on need, rather than seeking profit, interest, or enjoyment beyond that necessity. Therefore, researchers have a different perspective at certain points and argue that receiving a profit commission is still consistent with that maxim, as it is not extended beyond a need and is not intended for luxury or enjoyment. In fact, while looking at the reinsurance arrangement with profit commission as a whole in macro level, it is perceived that the contribution/premium ceded out to the reinsurer is in actual, lower than a case of takaful operators not receiving or taking profit commission. This can be realised when the takaful operator receiving back the contribution/premium ceded in the form of profit commission, as indicated by the formula for profit commission, which consists of the contribution/premium ceded minus outgo as explained in the previous chapter.

Additionally, although the term "profit commission" implies a dividend, interest, charge or fee for a task, in reality, it functions more like an adjustment or deduction of the premium given from the surplus (income minus outgo) over a certain period which does not involve any interest or dividend from Shariah non-compliant investment. This may be understood as in the simple illustration below:

Profit Commission	20%
Income:	
Ceded Contribution/Premium (From Takaful Fund)	RM 100,000
Outgo:	
Management Expenses (For reinsurer)	10%
Outstanding and Paid Claims	RM 70,000

Profit Commission Formula: (Income – Outgo) x 20%

Scenarios:

i. Receiving Profit Commission
   a. (RM 100,000 – RM 10,000 – RM 70 000) x 20%
      = RM 4000 (Returned Ceded Contribution/Premium to Takaful Fund)
   b. Adjusted Ceded Contribution/Premium (RM 100,000 – RM 4000)
      = RM 96,000

ii. Not Receiving Profit Commission
   a. (RM 100,000 – RM 10,000 – RM 70 000) x 20%
      = RM 4000 (Returned Ceded Contribution/Premium to Takaful Fund)
   b. No Adjusted Ceded Contribution/Premium. Hence, the ceded contribution will remain at RM 100,000

Based on the above illustration, it is evident that the actual amount paid and ceded to the reinsurance company is lesser, i.e., RM 96,000, if profit commission is recognized by the cedant takaful operator as compared to the scenario of no profit commission being recognized, i.e., RM100,000. Hence, the recognition of profit commission is in line with the proportionality requirements under the hajah application in terms of the quantum of the contribution/premium amount ceded to the reinsurer.

In conclusion, researchers hold different views on the interpretation of the aforementioned maxim, contending that the profit commission received from reinsurance companies aligns with its proportionality principles i.e., the realised profit commission will reduce the amount of ceded contribution/premium to reinsurance companies.

4.3.4. Permissible of Profit Commission from Reinsurance Arrangement to Eliminate Harm of Takaful Fund

The opponent views the profit commission from reinsurance arrangement is permissible with the argument to eliminate harm of takaful fund based on the Islamic legal maxim of 'harm must be eliminated'.

According to Muhsin et al. (2019), asserts not all harms warrant consideration, prompting jurists to establish specific criteria for determining whether an action or inaction constitutes significant harm. The major conditions are as follows:

i. The harm should be real.
ii. The harm should be excessive (*fāḥish*).
iii. The infliction should occur as a result of infringement or arbitrariness or negligence.
iv. Infliction of the harm is on a legitimate benefit owned by the right owner.

In determining if there is any harm to the takaful fund, the above conditions must be met. Researchers believe that data from actuaries is necessary to assess whether there is any harm to the takaful fund if the takaful operator decides not to receive a profit commission.

However, it is believed that receiving profit commission leads to the positive impact of risk funds to cover expenses, claims and benefits for participants. It also benefits the takaful industry by allowing the amount of profit commission paid to the Takaful fund to be developed further, instead of being given to or retained in reinsurer's account that is likely to be invested in non-Shariah-compliant ventures.

5. Conclusion

In a nutshell, researchers are of the view that profit commission from reinsurance arrangement is **permissible** based on the justifications as summarized below:

i. Basic principle in contracts and transactions (*mu'amalat*) is permissible and is not forbidden except what the Shariah prohibits.
ii. Reinsurance arrangement and investment conducted by the reinsurer are totally different and separate arrangements with different contracting parties. The argument on the prohibition of profit commission based on tainted income is not valid as it refers to the profit from a Shariah non-compliant investment, a separate transaction and arrangement, i.e., between the reinsurer and investee, whereby the cedant takaful operator is not a party to such investment. (Addressing tainted income issue).
iii. No Shariah issue in dealing with conventional company. (Addressing tainted income issue).
iv. It is not definite that *riba* (Shariah non-compliant element) exists in all bases of profit commission formula. (Addressing *riba* element in the formula of profit commission).
v. Consistency of the profit commission with proportionality requirement under *hajah* and *darurah* application.
vi. Positive impact on the risk fund i.e., takaful fund.

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