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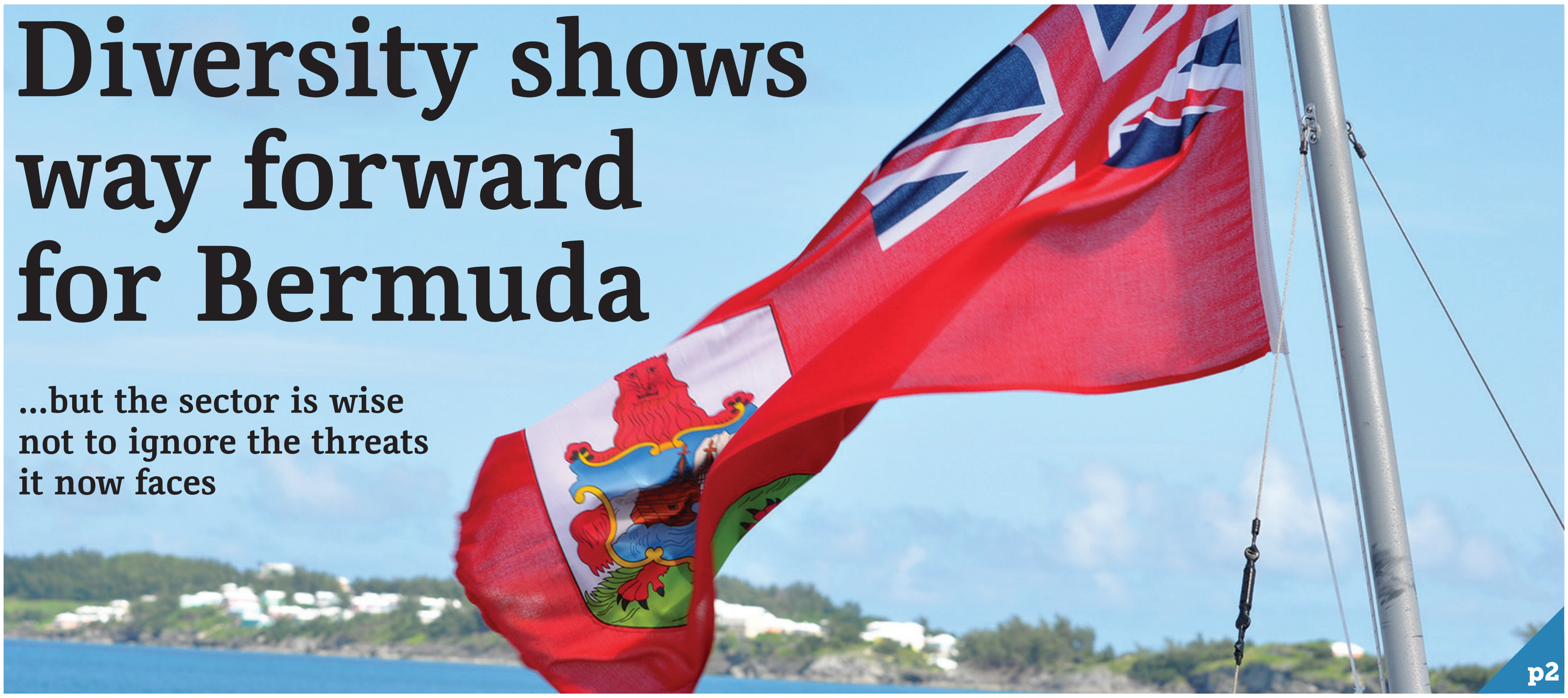
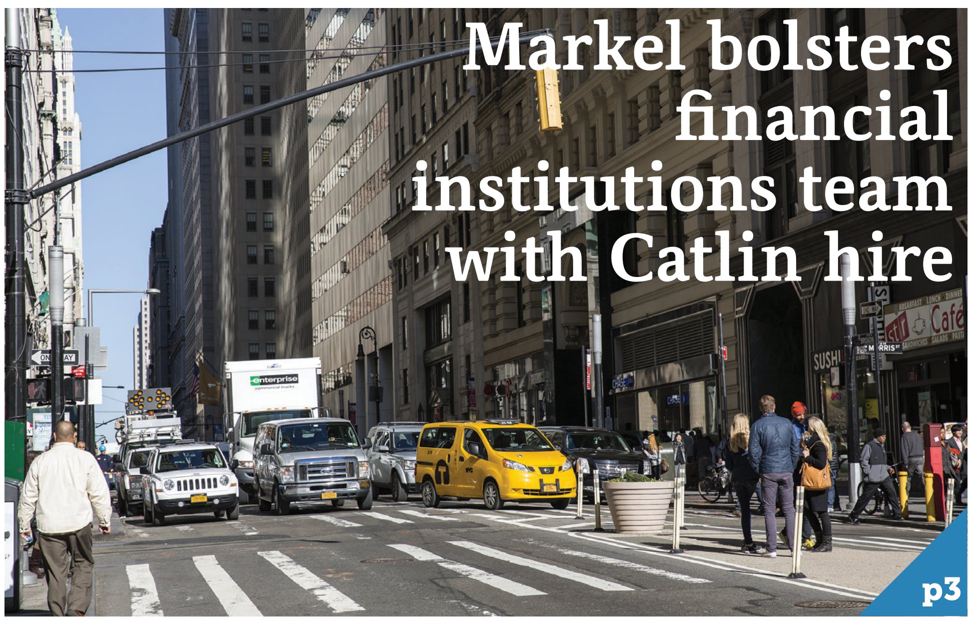


p2

Markel bolsters financial institutions team with Catlin hire



p3

Insurance industry disaster resilience initiative receives UN backing

p3

Special report: takaful

Steady but slower growth p4

It is time for takaful to sink or swim p4-5

Towards a more targeted product offering p7

NEWS

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Insurance Day is the world's only daily newspaper for the international insurance and reinsurance and risk industries. Its primary focus is on the London market and what affects it, concentrating on the key areas of catastrophe, property and marine, aviation and transportation. It is available in print, PDF, mobile and online versions and is read by more than 10,000 people in more than 70 countries worldwide.

First published in 1995, *Insurance Day* has become the favourite publication for the London market, which relies on its mix of news, analysis and data to keep in touch with this fast-moving and vitally important sector. Its experienced and highly skilled insurance writers are well known and respected in the market and their insight is both compelling and valuable.

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Diversity shows way forward for Bermuda

Most insurers would be happy with the kind of results the Bermudian market is turning in but the sector is wise not to ignore the threats it now faces

Graham Village
Global markets editor

Bermuda: companies are diversifying as core business conditions deteriorate
© Ritu Manoj Jethani/Shutterstock

RenaissanceRe's planned acquisition of Platinum, while the most important strategic diversification in Bermuda this year, is not the only one. Many Bermudian companies are taking big steps to reorient their operations in the face of deteriorating conditions for their core business, even though results are still looking good.

Insurance Day's quarterly analysis of the wider Bermudian market, featured in tomorrow's Companies House, will show a sample of 20 companies (see table) posted a 3.6% increase in pre-tax profit for the first nine months of the year compared with the same period of last year.

The deterioration in net result was caused mainly by a large fall at XL due to the impact of its divestment of XL Life Reinsurance and a reduction at Ace, the largest company surveyed, because of heavy realised investment losses.

The analysis covers what is generally regarded as those companies most closely associated with Bermuda, although not all companies covered are domiciled there.

On a net basis, 10 of the companies posted an increase in profit for the nine months and nine showed a reduction, indicating the market cooling is starting to have an impact on some players.

The onus is more firmly on underwriting as the investment environment remains volatile. Investment income for the sample fell 1.6% and realised gains were down 38.2%, though mainly because of Ace.

But underwriting performance remained strong at the nine-month mark, rising 6.7% overall to $5.6bn, with only one company, Third Point Re, recording a loss.

Premium growth of 5.9% gross and 5% net belies the struggle some companies are having in the face of the surplus capacity and heavy competition. Many are looking to start or expand special lines capabilities in both insurance and reinsurance sectors as an alternative to the hard-pressed property and property catastrophe reinsurance segments.

RenRe, perhaps most heavily identified with property cat business, trimmed its net cat account by 19.4% over the nine months. The reinsurer upped its specialty reinsurance book but is now aiming for greater diversification through the $1.9bn purchase of fellow Bermudian Platinum.

On a pro-forma basis, the move will cut RenRe's property cat account from 60% of the total at present to 50%, with liability and specialty business increasing from 22% to 31%.

Rating agency Fitch said the takeover could trigger more acquisition activity in the reinsurance market as companies similarly try to bolster their position through scale and diversity.

In another acquisition, Hamilton has agreed to take control of Lloyd's agency Sportscover Underwriting, manager of syndicate 3334, a specialist in sports and leisure insurance.

Other diversification moves include Arch's entry into the mortgage insurance market this year and the underwriting of additional primary lines business such as crop cover by many companies. But primary insurance typically offers less scope for outstanding profits, and those players with both insurance and reinsurance capability found their reinsurance operations provided the bulk of their profit for the nine months.

The Bermudians may need to manage downwards investors' profit expectations as the reinsurers diversify.

Although many companies have reduced their property cat accounts in 2014, some have used sidecars and other alternative structures to maintain or even increase their position. Aspen has written more cat business by making use of its new Aspen Capital Markets division, enabling it to write larger line sizes.

Table: Bermudian market† first nine months ($m)

	2013	2014
Gross written premium	56,131	59,461
Net written premium	45,828	48,112
Underwriting result	5,246	5,597
Investment income	4,752	4,677
Realised gains	1,410	872
Pre-tax result	9,509	9,852
Net result	8,471	7,819
Shareholders' funds*	97,687	100,870

Source: Insurance Day/company filings
†Sample comprises Ace, XL, Everest, PartnerRe, Arch, Axis, White Mountains, RenRe, Validus, Allied World, Aspen, Endurance, Enstar, Platinum, Montpelier, Argo, Third Point, Lancashire, Maiden, Blue Capital
*2013 figure at December 31

NEWS

Insurance industry disaster resilience initiative receives UN backing

Risk stress testing could be introduced into financial and accounting rules by 2020

Michael Faulkner
Editor

Hurricane Sandy: despite the scale of natural disasters such as Sandy, the industry has been able to absorb the losses they have caused

© 2014 Mike Groll/AP

Insurance industry proposals to integrate disaster risk and resilience into the financial system have received support from the UN.

The "one-in-100" initiative is a drive by public and private sector organisations, promoting disaster resilience and protecting against climate risk.

At the initiative's core is the one-in-100-year financial stress test, similar to that developed in recent decades by the insurance sector to assess its ability to underwrite risks.

In a joint action statement, released following the recent UN Climate Summit in New York, the UN outlined the commitments made by insurance-related organisations involved in the one-in-100 initiative.

These commitments include liaising with regulatory authorities and stakeholders to determine how the one-in-100 stress test approach could be implemented beyond insurance into wider financial regulation and accounting standards by 2020.

They also included establishing a resilience modelling and mapping forum to co-ordinate research programmes and provide open modelling and mapping platforms that are key to providing organisations with the data they need to evaluate their exposure to disaster risk, with the aim of co-ordinating at least $100m of annual investment into public science research by the global insurance industry and related sectors from 2016 onwards.

International bodies, supervisors, the re/insurance industry and rating agencies have been working on the initiative.

Under the proposals, disaster risk will be used to discount the value of assets, while resilience will be rewarded. A one-in-100 tolerance would be used to as a solvency stress test, while a 20-year return period would be used as an earnings stress test, and annual average loss as a benchmarking tool.

This means physical and financial resilience, including insurance, would be recognised as a business asset.

Dominic Casserley, chief executive of Willis Group, which is leading the private sector work on the initiative, said: "Over quarter of a century the insurance industry has developed metrics and regulatory frameworks that have transformed our resilience to natural disaster risk, enabling us to meet our commitments to the global economy and society during years of unprecedented natural catastrophe losses. We are sharing the lessons we have learned during this process with the financial sector and the wider economy.

"Applying a one-in-100-year solvency stress test to current assets and current climate conditions can help organisations to truly understand their risk and manage it in an economically rational way. Working closely with the UN secretary-general's office and regulatory authorities, we aim to apply these tried and tested principles within the global financial system by 2020."

Industry experts said the initiation could dramatically increase the demand for insurance. At the Monte Carlo Rendez-Vous, Willis Re international chairman, James Vickers, said if it were successful, the extra capital needed to underwrite the additional risks would be considerable.

He said the initiative had the potential to "re-energise and reposition" the global re/insurance industry and he urged the rest of the sector to support it.

"If disaster resilience is encoded then current capital levels are not sufficient," he said.

Markel bolsters financial institutions team with Catlin hire

Markel International has appointed former Catlin underwriter Martin McCarron to head its financial institutions team, *writes Sophie Roberts*.

McCarron will join the specialist insurer on December 3 alongside Nick Rugg, who joins the team as underwriter.

At Catlin, McCarron was class underwriter in the group's financial risk division, underwriting a book covering bankers' blanket bond, commercial crime, professional indemnity, directors' and officers' (D&O) liability and plastic card insurance.

Before this he was at Lockton, where he was a divisional director in the professional and financial risks team.

Rugg, who has more than eight years' insurance industry experience, has most recently held the role of financial institutions and D&O underwriter.

James Hastings, managing director of Markel's professional and financial risks division, said: "Financial institutions is an important class for us. We look forward to [McCarron and Rugg] playing an important part in the further development of our professional and financial risks team."

Insured loss from Brisbane hailstorm at A$109.2m

Insurers have received more than 15,000 claims following a hailstorm in Brisbane and south-east Queensland that the Insurance Council of Australia (ICA) has described as a "growing catastrophe", *writes Scott Vincent*.

Latest ICA figures show 15,060 claims have been recorded, at an expected insured cost of A$109.2m ($96.4m).

The ICA said it has set up a taskforce to liaise with the Queensland government, local governments and emergency services organisations to help manage issues and concerns as they arise.

ICA chief executive, Rob Whelan, said it was "much too early" to estimate the total damage bill from the event.

The hailstorms are only the third event to be declared a catastrophe by the ICA this year and by far the costliest.

January's Perth bushfires, with an estimated insured loss of A$15m, and April's cyclone Ita (A$8.4m) were the previous two.

The ICA issues a catastrophe declaration when insured losses from an event are expected to top A$10m.

SPECIAL REPORT/TAKAFUL

Steady but slower growth

The takaful growth story continues into 2014 but undifferentiated strategies and regulatory compliance efforts have dented the short-term financial dynamics of operators in some markets

Abid Shakeel
EY

The growth of takaful markets is driven by the prospects of the Islamic banking and finance sector in predominantly Muslim countries. Over the past decade the double-digit growth of Islamic banking assets has been accompanied by a similar growth of gross takaful contributions across key Muslim developing markets, including Saudi Arabia, the United Arab Emirates (UAE) and Malaysia.

Despite takaful's strong double-digit growth, the insurance penetration rates in these key markets are generally low (on average just 2%), indicating the possibility of strong underlying growth potential. In the longer term, given the demographics and economic structures, rapid-growth markets such as Turkey and Indonesia offer wider upside potential.

In the near to medium term, takaful operators in markets with stable domestic economies, good macro-management and sizeable young Muslim demographics such as Malaysia, the UAE, Indonesia and Turkey can look toward capturing profitable opportunities in niche segments.

Overall, Saudi Arabia is likely to be the core market for Islamic insurance business, commanding half (50%) of the global contributions. Among the Gulf countries, the UAE, Qatar and, more recently, Oman will continue to set the pace for the development of takaful products for the Middle East and west Asian markets.

The takaful markets of members of the Association of South-East Asian Nations (Asean), led by Malaysia and Indonesia, hold one-third share of the global takaful market at present. They have conducive market growth prospects, driven by factors such as:

- large, young Muslim populace with good employment prospects;
- stable and buoyant economic growth prospects catalysed by Asian market dynamics; and
- wide regulatory reforms for the adoption of best practices.

Around the world, particularly in rapid-growth markets where critical mass can be prospected with detailed planning, takaful can serve as a sharia-compliant and ethical-based alternative to conventional insurance. With the high potential for internationalisation of takaful, there is urgency to grow regional champions within high-growth and stable regions to realise the market potential for takaful.

Positive growth

As both general and family takaful operators continue to broaden their distribution coverage and product offerings, we expect positive growth in dynamic and resilient market. Over 2013 to 2016, we expect the global takaful market to grow by 14% annually. In particular, the Saudi Arabia, Gulf Co-operation Council (GCC) and Asean markets are likely to maintain their present growth path in the next five years, but their growth quantum is highly subject to their economic growth. With a renewed focus on future growth after the economic crisis, operators are now looking at their operational deficiencies seriously with capital expenditure and operational expenditure investments being considered after pausing for a number of years.

Asean's dynamos, Malaysia and Indonesia, will be key markets to watch as they enhance their market practices, widen their delivery channels and strengthen their regulatory infrastructures.

Over the longer term, the Turkish government's aim to triple the share of Islamic banking assets in the country by 2023 (the 100th anniversary of the republic) with the help of state-owned participation banks and incoming players will help support the gradual growth of Turkey's takaful industry. With Turkey having a higher insurance penetration level, the introduction of a takaful proposition holds much promise and with a sizeable population, this could become the largest takaful market by customers and contributions within the medium term.

Profitability threatened

Among the GCC countries, competition, operational issues and the lack of qualified talent continue to pose a challenge. Profitability of takaful companies has been threatened not just by undifferentiated strategies but also by the lack of uniform regulations that will allow them to operate across different models. If the GCC regulators were to consider a passporting system as seen in the EU, this could accelerate growth and development of a true global takaful operator from within the region.

With strong competition from conventional incumbents, takaful operators are likely to continue their struggle in the medium term with profitability, although some will look at alternative customer segments and explore merger options. Despite intense competition, there is potential for growth, especially in the areas of family takaful and medical insurance, particularly in rapid-growth markets like the UAE, Malaysia and Indonesia.

Rapid-growth markets like Indonesia and Turkey will take off once the regulatory infrastructures are operationalised. For example, in Turkey, while some companies have been established with the intention to write insurance on a takaful basis, the existing regulatory framework limits the scope for full takaful operations. Challenges for Turkey's takaful market also include a fragmented market, which lacks pricing power, and tough competition among insurers at the lower end of the market. ■

Abid Shakeel is senior director of the global Islamic banking centre at EY

It is time for

The Islamic insurance industry has long risk being swallowed by the conventional

Peter Hodgins
Clyde & Co Dubai

Providers of sharia-compliant insurance products are under increasing pressure to produce returns for their shareholders. This focus on return on equity means there is a real danger takaful operators cannot build the scale and capacity to participate meaningfully in the commercial lines sector. As such, they risk becoming marginalised and, potentially, will be overtaken by their conventional counterparts as they increasingly focus on the opportunities in sharia-compliant insurance. Thankfully, a potential solution exists, should they choose to take it.

Takaful has long been highlighted as an area with significant potential. In recent years it has experienced continued strong double-digit growth. Global gross takaful contributions in 2012 are estimated at $11bn (up from $9.4bn in 2011), although year-on-year growth has slowed from a compound annual growth rate of 22% for the period 2007 to 2011 to a more sustainable growth rate of 16%, according to a report by EY.

The industry fared better during the global financial crisis than its traditional counterpart as a result of the nature of its investments, which were less volatile. However, as equity markets recovered, takaful operations have not benefited to the same extent as their conventional counterparts for the same reason.

More fundamentally, recent studies also suggest shareholders in takaful operators on average receive a lower return on equity than those in traditional insurance. The sector overall is failing to live up to shareholder expectations and deliver expected returns on equity. It remains to be seen if this is an inherent aspect of the takaful structure or a reflection of the relative youth of the industry.

Whether or not future growth will allow takaful operators to offset their initial start-up costs, is a factor which is exerting additional pressure on the management of these operators. There is also the looming threat from larger, conventional insurance players moving into the sector. This has been seen, for example, with the establishment of Cobalt at Lloyd's to offer sharia-compliant coverage backed by market-leading capacity including AIG and XL.

There is a risk if takaful players do not act now, they risk entirely losing out in the commercial lines space. But what can operators do to improve their performance?

Jumping in

There is a compelling argument the solution is to create a pool of takaful insurers that brings together providers from multiple locations. This would increase capacity, allow larger exposures to be underwritten and create a platform for knowledge sharing that would allow the industry to grow more rapidly.

Pooling of risks is not a new concept. In fact, in other parts of the industry – protection and indemnity (P&I), terrorism and aviation, for example – it is a well-established concept. The longest-standing example of a pooling arrangement is between the International Group of P&I Clubs, which between them provide indemnity cover for approximately 90% of the world's ocean-going tonnage.

This example of pooling is one where all the clubs carry out the same business. However, there have been other examples where mutuals that carry out different types of business have merged, thereby reducing the risk to all members through diversification. Other benefits of creating a significant pool include higher economies of scale, increased revenues and reduced distribution costs.

In practical terms, there are a number of challenges to making the creation of a takaful pool a reality. For example, to get the concept off the ground would require:

- international co-operation;
- increased regulatory awareness and a more unified approach by regulators;

takaful to sink or swim

offered latent promise, but the sector is rapidly approaching a tipping point where it needs to act or insurance sector

- a familiarity with the pooling structure and the other member organisations within it; and
- the ability to move from consumer lines (the primary focus for takaful at present) to larger commercial risks.

In the regulatory arena, there are some steps being taken that could be helpful. For example, several countries have announced forthcoming regulations governing the takaful market. Like the wider industry sector, governments are concerned by the number of small, local players without scale and are hoping to facilitate consolidation and produce a smaller, stronger number of providers.

It might be that the improving economic picture, as well as new markets opening in north Africa and improved education among populations unaware of the concept of takaful, will lead to continued and improving market growth. But the challenges to the sector are clear and there is a dearth of takaful operators that are capable of providing leadership to the growing internationalisation of the industry. So, could the answer be closer collaboration, rather than more competition? ■

Peter Hodgins is corporate insurance partner at Clyde & Co Dubai

Mosque: sharia-compliant insurers are under increasing pressure to provide returns for shareholders

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SPECIAL REPORT/TAKAFUL

Towards a more targeted product offering

The growth of the takaful market continues to be in double digits, particularly in the Middle East and north Africa, but the figures do not tell the whole story

Richard Bishop
Cobalt Underwriting

There is growth in the takaful markets but it comes from such a low starting point that the fact remains takaful markets across the Gulf Co-operation Council (GCC) countries at least have underperformed their local traditional peers.

The reason, I suspect, remains a case of too much capital and too little expertise. However, the potential for the Islamic insurance and reinsurance markets remains significant and in the London market there is a growing recognition of that fact.

The recent study by the London Market Group (LMG) and Boston Consulting Group makes it clear while London has been maintaining its share in the established and mature markets, its share of the emerging and high-growth markets has been falling.

Now there may well be a case that clients in these markets are looking to place their risks locally and we have seen both underwriters and brokers looking to put staff into these markets to better compete for those risks, but there is also a question of exactly what type of products we are offering.

In Asia it has become clear we cannot simply repackage the products that work so well in the mature markets and believe they will work elsewhere. Nowhere is this more evident than in the Islamic insurance markets. The value of the Islamic business economy is huge and there is tangible proof the appetite for Islamic financial products matches that size. The UK's first sukuk (a type of Islamic investment product) was oversubscribed tenfold and the UK government continues to see the establishment of London as a global centre for Islamic financial services as a high priority, given the huge investment in the country by Islamic companies and funds. This is now starting to be seen in the London insurance market.

The planned launch of the Islamic Insurance Association of London early next year also highlights the importance London places on the sector and the recognition the major Islamic banks and corporations require insurance solutions that are commensurate with the size and the complexity of the risks that need to be mitigated.

London rightly has a history of innovation when it comes to new and emerging risks and remains the market where complex and sophisticated risks find their home. The sharia-compliant sector is yet another clear example where London has recognised the need and reacted to meet that need and the expectation is the market will continue to grow as the Islamic business community become increasingly aware of the option they have to place their risks in a sharia-compliant way.

Major role

The brokers have a huge role to play in the success of the initiative as they will be face to face with the end client.

I have had conversations with brokers who say their clients have not been asking for sharia-compliant coverage. The reason for this is they have not been made aware it exists and that they have a viable choice as to how they place their risks. Brokers need to engage with their Islamic clients to highlight the fact they can provide cover that meets the needs of the Islamic business community.

It is time to get on the front foot and ensure Islamic business leaders are aware London can provide significant sharia-compliant insurance capacity at a price on a par with the traditional markets. Both Lloyd's and the LMG have made it clear London needs to access the emerging markets to a far greater extent in the years to come and the ability to offer sharia-compliant solutions will no doubt become a major tool in those efforts and a key part of the UK's efforts to ensure London is a global centre for Islamic financial services. ■

Richard Bishop is chief executive of Cobalt Underwriting

Extending the standards

A global standard on risk management for Islamic insurers has been a big step forward. However, it is now necessary to have a well-understood set of principles to facilitate the next stage of the sector's development

Susan Dingwall
Norton Rose Fulbright

The global financial crisis highlighted the weaknesses in existing risk management processes throughout the financial services industry. Conventional insurers have not been immune from those concerns and, in recent years, they have been the focus of increased regulatory scrutiny.

In comparison, the Islamic insurance industry is less mature. However, Islamic insurers recognise the need for effective risk management and the fact their processes and procedures will inevitably need to stand up to the same level of scrutiny as their conventional counterparts. To meet this need, the International Financial Services Board (IFSB) issued a global standard on risk management for Islamic insurers, which seeks to establish certain minimum standards.

Unsurprisingly, the IFSB found the majority of risks faced by Islamic insurers are the same as those faced by conventional insurers, but there are a number of specific risks that are relevant only to Islamic insurers.

The interpretation of sharia compliance differs between scholars, which raises the possibility a particular product marketed across various jurisdictions is ruled compliant in one jurisdiction but not in another. The same is true for investment decisions. Breaching sharia standards can also have a different effect in different jurisdictions. For example:

- it may invalidate contracts under sharia law;
- it may deprive a policyholder (or participant) of cover; or
- it may expose an Islamic insurer to regulatory action and reputational damage.

Sharia non-compliance risk is an operational risk that requires processes and controls to detect and correct any instances that do manifest themselves. An Islamic insurer will need to establish systems and controls to ensure sharia compliance of its products, its selection of investments (and their administration) and the segregation of funds. The Sharia Supervisory Board (SSB) will be key in providing guidance to the business, auditing compliance and reporting to the main board of the Islamic insurer.

Segregation of funds

Under an Islamic insurance structure, every participant pays a charitable donation to help those who suffer a loss. These contributions are then pooled and the risk is shared among the participants. The pool (known as the participants' risk fund) is managed and kept separate to the shareholders' fund.

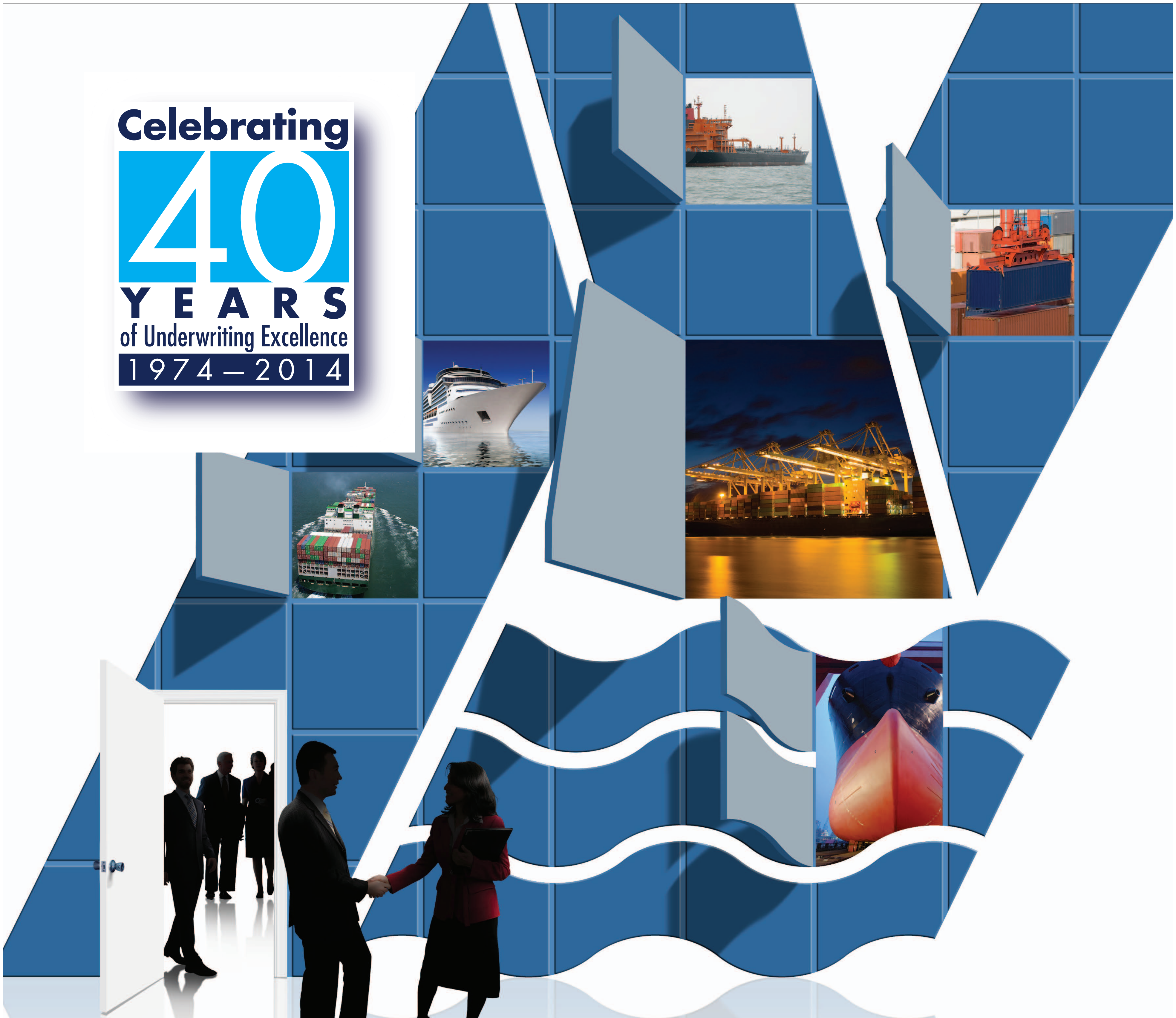
The requirement to separate the participants' risk fund from other funds can lead to risks associated with governance and management of the funds, including misattribution of expenses and revenues, resulting in expenses being borne or income being received by the wrong fund.

The risks arising out of the use of conventional reinsurance, such as basis risk and the risk of excessive concentration of risk to a particular counterparty, apply equally to Islamic reinsurance. However, in addition to these considerations, there are particular risks for the Islamic insurance industry. Sharia scholars hold differing views about the validity of an Islamic insurer using conventional reinsurance. Islamic insurers may seek to rely on the concept of darurah (necessity) to justify their use of conventional reinsurance. They may argue a sharia-compliant alternative is unavailable. However, that argument holds less weight now capacity in the Islamic reinsurance market has expanded.

Different methods of effecting Islamic reinsurance contracts have developed and Islamic insurers need to be alive to those differences. As with the risks relating to maintaining segregation of participants' funds, Islamic insurers must ensure the attribution of revenues and expenses is fully transparent to participants.

A global standard on risk management for Islamic insurers has been a significant step forward for an industry that has faced criticism for the lack of standardisation in regulation. A well-understood set of principles that everyone can buy into will also ultimately lead to the growth of the Islamic insurance industry as it will be seen as a safe and prudent environment in which to do business. ■

Susan Dingwall is head of the Islamic insurance practice at Norton Rose Fulbright



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