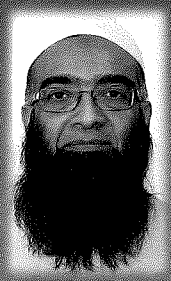
The nomination clause in takaful and pension contracts



Sheikh Faizal Manjoo of **Hannover ReTakaful** explores the legal and fiqhi aspects of the nomination clause in takaful and pension contracts, and looks at how these are handled in different jurisdictions.

In developed countries where the financial sector could be said to dominate the real economy, and where the level of disposable income is usually higher than in the developing world, much of the workforce may try to provide for its old age by investing in life insurance or takaful and pension provisions. In the UK, for instance, these two financial products combined can constitute up to 40% of a person's estate, and in some cases, exceed the value of the home.

There is one particular benefit offered by most pension schemes which is the subject of this article – where an individual employee dies while in service.

So often there is provision for an automatic pension for the spouse and dependent children – and in addition, a lump sum, cash amount payable on death. In order to place it outside the individual's estate for inheritance tax purposes, under pension scheme rules the cash is deliberately not made payable automatically to the estate. Instead, under workplace pension arrangements, there is commonly a provision for a "nomination clause".

This clause allows the trustees of the scheme to decide who to pay the money to. In practice, they often pay it to the survivor, the widow or widower, in accordance with a "letter of nomination" written by the individual before his death in anticipation of possible death, and stored with the trustees, to be opened only in the event of death. But the trustees do not have to comply with the terms of the letter. They can instead use their discretion to pay it to anyone else, or to spread it among several beneficiaries. This discretion puts the amount outside the estate, and therefore is tax free.

Heritable or a gift?

For Islamic jurists, this system may pose a juridical challenge. There is a debate as to whether this consequential lump sum is regarded as "heritable" under Islamic law, ie, the nominee is regarded as receiving the money as a trustee for distribution among the legal heirs – or is the money regarded as a gift to the nominee *in personam*? Some consider the lump sum to have an accrued value and be a "personal right" of the deceased.

So far, there is little consensus on this matter among Muslim jurists. This article aims at exploring both the legal and fiqhi aspects of this debate.

Nomination clause vs personal rights

First, it is necessary to clarify two concepts: nomination clause and personal rights. A nomination clause grants powers to the pension fund's trustee or the insurance company, but while it indicates who the deceased would like the money to go to, and the trustees must consider the request, they are free to ignore it.

One issue is whether the money accrues to the policyholder or contributor of the pension fund as a personal right. Personal rights refer to the rights which a person has strictly in relation to the duties owed to him by others and the wrongs consequent to the breach or violation of such duties. Those rights can only be enforced by the parties to the agreement or contract. A personal right is not binding on someone else (a third party) who is not a party to the contract.

The classification of the legal rights is problematic because it is only in case of premature death that the lump

sum is calculated and the right to pay arises. Is this then a form of life insurance? Life insurance is a contract between an insured (policyholder) and an insurer, where the insurer "promises" to pay a designated beneficiary a sum of money (the "benefits") in exchange for a premium, upon the death of the insured person.

This is somewhat different from takaful as the tabarru' given is unilateral and is not a conventional contract per se, due to the absence of the doctrine of consideration. Therefore, Islamically the problem is to determine whether this lump sum is a right which the deceased had over the money prior to his death, or is this lump sum realised after his death? If it is the first, the beneficiaries as decided by the trustees will receive the benefits *a priori* due to the wa'ad effect (promise), and therefore it can be regarded as hibah (gift). If it is the second, if it does not accrue to the beneficiary *a priori*, then the issue of ownership does not arise before the death and the funds will arise only after his death – but will not be transferred to his estate.

Secular law seems to be clear regarding the effect of a nomination clause in some jurisdictions but remains uncertain in others, such as France. The takaful arrangement, which might be treated as a contractual arrangement by the courts, could be employed as an Islamic solution to the nomination issue, reflecting the understanding employed in conventional insurance and pension arrangements.

How this is handled in three jurisdictions

Three jurisdictions – the UK, France and Malaysia – are compared to consider how this is dealt with.

Under English law, the actual beneficiary can be the nominee, but does not have to be. Under French law, both possibilities can be accommodated though the nomination clause stands, but one can make a will as well. Under Malaysian law, the Insurance Act 1996 provides that a nominee is always a trustee. However, Malaysia's Takaful Act 1984 uses the term "proper claimant" as the recipient of the takaful benefits, while the Islamic Financial Services Act 2013 states that a takaful participant may nominate an individual to receive takaful benefits. There is also a fatwa dating from 1976, which considers a nominee as a trustee and not a beneficiary. Bank Negara Malaysia resolved that the "takaful benefit can be used for hibah (gift) since it is the right of the participants. Therefore, the participants should be allowed to exercise their rights according to their choice".

This confusion is not a satisfactory situation. It might be helpful if a test case were presented to the Malaysian High Court which, in turn, could refer it to the Shariah Advisory Council of Bank Negara Malaysia. The Council could give its opinion under the recent provisions of the Central Bank Act so that this religious ruling becomes binding on the High Court. Then the High Court could issue a judgment to create a legal precedent which could be used as guidance for other Islamic jurisdictions.

In conclusion, secular law seems to be clear regarding the effect of a nomination clause in some jurisdictions but remains uncertain in others, such as France. The takaful arrangement, which might be treated as a contractual arrangement by the courts, could be employed as an Islamic solution to the nomination issue, reflecting the understanding employed in conventional insurance and pension arrangements. However, a definite judgment from the Malaysian High Court would be welcome.

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