

Interpretational Risk In Takaful Insurance Products

by Charles A. Yuen on July 19, 2012

Spurred by petroleum-related and other revenues, Takaful insurance and reinsurance (“ReTakaful”) markets are emerging. Contracts from these markets may soon represent a typical source of additional capacity for an international corporate policyholder. Takaful contracts are intended to comply with Islamic religious – Sharia – law, however. Therefore, policyholders should carefully consider how – and under what law – their claims may be handled.

Sharia legal principles, generally speaking, are based on the Quran and the teachings of Islamic scholars. Business transactions under Sharia must adhere to general Islamic precepts, such as avoiding usury, promoting equity and encouraging fairness.

Specific Sharia principles frown upon established commercial insurance policies. They bar contracts that involve interest on money (riba), forbidden goods or services, such as gambling (haram), or uncertainty (gharar). The gharar-related prohibition has rendered conventional insurance impermissible in various Islamic countries. In its place, Takaful insurance has emerged.

Takaful is essentially a Sharia-compliant form of mutual insurance. Participants subscribe to a fund designed to assist them in regard to stated losses. Theoretically, all participants share in the profits and losses from the fund’s investments.

Sharia principles may present a possibility that the claim may not be assessed or paid as fully as corporate policyholders have come to expect under their policies. For instance, claims arguably based on lost future profits may be regarded as “gharar” and thus barred from recovery under Sharia law. Because there is little published case law discussing Takaful contracts, the additional risk is difficult for international policyholders to assess.

To address the risks of recovery upon a Takaful contract, policyholders may request choice of law and claims procedure provisions. Specifying New York (or other established commercial law) might help avoid adverse Sharia principles. Identifying a specific court or describing an arbitration procedure for resolution of the dispute may also lessen the risk.

A policyholder might further consider seeking an expert legal opinion that such a modified contract is compliant with Sharia law. The policyholder may want to consider an expert in the jurisdiction where the policyholder may need to enforce a judgment (typically, the carrier’s home country). Inasmuch as Takaful insurers might be eager to gain the policyholder’s business, the policyholder may request concessions for some of these “start-up” costs for the initial year(s) of coverage.

In sum, appropriately worded choice of law, forum-selection, and dispute resolution provisions may assist a policyholder in reducing the risk that a Sharia interpretation of a Takaful contract may limit the insurance recovery. They may, in turn, help Takaful contracts become attractive insurance options. If you have any questions or would like to discuss this topic please feel free to contact Charles A. Yuen or your Scarinci Hollenbeck attorney.