



Takaful in the UK: Ripe for Development

With nearly US\$8 billion in Shariah-compliant bonds registered on the London Stock Exchange, four licensed Islamic banks, a conducive regulatory environment and a growing takaful market, the UK is well-placed to be an Islamic financial hub of Europe. **Mr Ben Macfarlane**, Solicitor and Principal of BJ Macfarlane & Co, elaborates.

In the UK domestic market alone, the Muslim community consists of between 1.5 to 2.0 million people and some 350,000 households. In the past, there have been very few Islamic financial products available for this sizeable market. However, this lack of Shariah-compliant financial products for the resident UK Muslim community is changing dramatically.

In principle, the UK regulators do not seem to have any objection to Shariah-compliant financial products. Players like Lloyds TSB, Royal Bank of Scotland, Islamic Bank of Britain, ABC International Bank, United National Bank and HSBC Amanah are all offering Shariah-compliant products in the UK. They have teamed up with Muslim institutions to try to address the regulatory issues that have, so far, discouraged the launch of Islamic housing finance and other products. The market in the UK is growing significantly with a range of takaful products, including Shariah-compliant bank/mortgage products. Each sector relies on the other for real growth. One of the unique selling points for these special products and services in the UK and elsewhere is that they are ethically based and, therefore, appeal to non-Muslims as well as Muslims.

The total volume of Islamic home financing schemes offered by various financial institutions in the UK is set to reach US\$2 billion by 2009, and according to the UK Treasury, since 2003, the Islamic mortgage market has grown to over US\$1 billion – an increase of about 50% in the last year alone. HSBC Amanah is the only Islamic mortgage provider that currently offers takaful to provide cover for building, contents and mortgage endowment.

One Lloyd's syndicate with a takaful reinsurance offering did not continue this year, but apparently for reasons not connected with the strength of the market. Lloyd's continues to have the structure to take in takaful business, and will consider any applications for other takaful syndicates.

In the 2007 budget, the then UK Chancellor Gordon Brown introduced two key measures to encourage growth in Islamic finance, namely a new regime for sukuk giving comparable tax treatment to conventional securitisations, and guidance clarifying the treatment of diminishing musharakah and takaful products. This new legislation will create the framework for London to emerge as an undisputed global leader in the Islamic finance industry.

Regulatory Environment

Even though takaful involves the payment of a "donation" rather than a "premium," and investment of the "donations" has to be Shariah-compliant, the takaful arrangement will be caught by the regulation of insurance and investment products in the normal way. Any takaful

operation must therefore operate in compliance with the Financial Services and Markets Act (FSMA) 2000.

The FSMA, which came into force in December 2001, governs the regulatory regime in the UK. It provides that carrying on a regulated activity, or purporting to do so, in respect of a specified investment by way of business in the UK, requires authorisation by the Financial Services Authority (FSA), unless the person carrying on such activity is exempted. Effecting or carrying out contracts of insurance is included in regulatory activities.

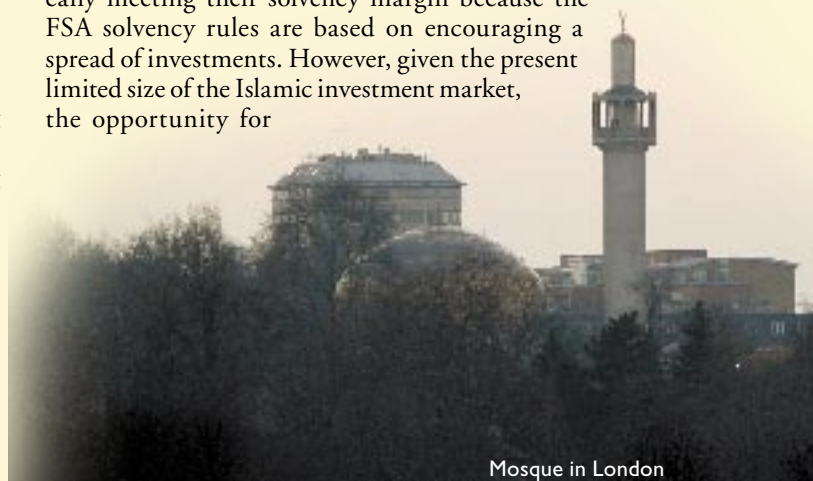
It is a criminal offence to carry on a regulated activity in the UK without being authorised by the FSA. Also, any agreement entered into by a person in contravention of the requirements to be authorised will be unenforceable against the other party, who will thus be able to recover any money or other property paid or transferred by him under the relevant agreement.

In order to become authorised by the FSA, there are certain "threshold conditions" that the applicant must satisfy. Some of these specific threshold conditions are:

- There must be sufficient financial resources to meet claims as they fall due. In particular, there should be a solvency margin as determined and agreed with the FSA. Such a margin represents the excess of assets over liabilities and provides a "cushion" against any unexpected claims.
- There must be adequate resources.
- Adequate systems and controls need to be in place in order to ensure that risk is managed properly.

An applicant also needs to satisfy the FSA's risk assessment process. This involves an assessment of the risk posed by an applicant against a number of probability and impact factors.

Takaful insurers may have some difficulty in technically meeting their solvency margin because the FSA solvency rules are based on encouraging a spread of investments. However, given the present limited size of the Islamic investment market, the opportunity for



Mosque in London

UK: Muslims May Be Able to Buy Takaful Soon

BIIH General, the general insurance subsidiary of British Islamic Insurance Holdings (BIIH), has moved a step closer to being fully authorised by UK's Financial Services Authority (FSA), having recently received notification from the FSA that it expects "to be in a position to authorise the firm". BIIH hopes to receive full FSA approval and start providing takaful products in the UK in spring 2008.

Formed in 2006, BIIH has raised initial capital of £19 million (US\$37.2 million) from Gulf-based institutional and private investors. The long-term vision of the company is to become the Islamic insurance partner of choice and a provider of an ethical insurance alternative on a selective basis. It aims to focus first on the UK and, in due course, enter Europe and high-growth potential GCC countries (eg Saudi Arabia, the UAE, Qatar). Here, it provides some insights on the Muslim population in the UK.

There is currently no Shariah-compliant insurance available in the UK where an estimated 3%-5% of the population, or around two million people, are Muslims.

The annual contribution to the British economy of the country's Muslims is estimated to be around £51 billion. Out of the two million Muslims in the UK, more than 500,000 own cars. There are more than 500,000 Muslim homes, and more than 130,000 Muslim-owned businesses. This means that there is a sizeable UK market of consumers who are forced to purchase products that are not totally compatible with their needs. Like the rest of the UK population, Muslims need to have insurance to cover their houses, cars and businesses.

The British Muslim population is younger than the rest of the UK: some 70% are under 35 years of age. Furthermore, the population is highly geographically concentrated: more than 70% of the British Muslim population live in around 700 postcode sectors (there are nearly 10,000 postcode sectors in the UK).

Anyone with knowledge of Britain would not be surprised by where Muslims homes are located. London has the

largest concentration: with Birmingham; the East Midlands; Lancashire (Manchester, Blackburn, Rochdale); Yorkshire (Leeds, Bradford, Sheffield); South Wales (Cardiff); and South Scotland (Glasgow) all featuring prominent Muslim communities. This geographic concentration brings advantages, for example, in terms of focusing marketing effort, but disadvantages too, for example, the resultant risk profile.



Mr Bradley Brandon-Cross, CEO of BIIH

A Preference for Halal Food and Products

New research undertaken by BIIH has shown that the majority of UK Muslims buy halal food and always seek out halal products where possible. It also showed that, despite the fact that only a minority of British Muslims have heard of takaful, once made aware, the majority believed it was important to buy Shariah-compliant insurance products.

It is against this backdrop that BIIH General is seeking authorisation from the FSA to become the UK's first dedicated, stand-alone takaful insurer.■

(1 British Pound = 1.96 US Dollar)

investing widely in Shariah-compliant products is not available to the takaful insurer.

In order to satisfy the "adequate resources" threshold, there must be competent and prudent management, who will be responsible for managing the various risks involved in the takaful operation. In addition, there must be sufficient expertise so that legal, accounting and underwriting matters can be efficiently managed. There is also a requirement for an efficient and reliable IT system to process applications, handle claims and deal with general administration.

Since the FSA, in discharging its general functions, must have regard to the desirability of facilitating innovation in the market, the international character of financial services and the desirability of maintaining the competitive position of the UK will also be major drivers. Therefore, although the FSA may be relatively unfamiliar with takaful as a product, it will be receptive to any application for authorisation to conduct takaful business in the UK that fulfils FSA conditions.

Conditions for Growth

Insurance, especially life insurance, has a vital role in providing protection against the unforeseeable to all members of society, and no less so in the Islamic community.

However, traditionally within the Muslim culture, there has been a rejection of the commercial principles behind conventional insurance as being "haram". The takaful or co-operative insurance model, which is Shariah-compliant, is ripe for development and has been greeted with enthusiasm by Muslim and ethically conscious investors alike.

There has been tremendous growth in takaful in the UK. Standard & Poor's, the credit ratings agency, has cited the growth of takaful insurance as being "substantial". The UK's FSA is open to encouraging takaful products in the UK, although providers are required to comply with its regulatory framework. There are also high hopes for takaful reinsurance. However, the retakaful market is unlikely to do well without a groundswell of takaful primary insurance operations.

The success of retakaful is inherently bound up with the success of the takaful market generally. The range of Islamic investment opportunities needs to be broadened for the UK market to become an attractive opportunity to be exploited either by specialist takaful insurers or conventional insurers with takaful operations. The development of Islamic capital and investment markets is a pre-requisite to its growth, as the takaful providers concerned need to be in a position to spread their investments in Shariah-compliant products.■