



Gateway inside Paris' Central Mosque

Takaful in Europe: What could be the Next Step?

The regulatory environment and presence of a sizeable Muslim population in Europe provides a conducive environment for takaful to develop. **Mr Chakib Abouzaid**, CEO of Takaful Re, delves into the issues to be considered before setting up a takaful provider serving the continent.



Takaful has seen a remarkable surge in Muslim countries but, for the moment, it remains almost invisible in Europe, with the exception of the upcoming launch of British Islamic Insurance Holding scheduled for March 2008.

There is a real need for coverage among Muslim communities which is still not satisfied. Even though statistics about the penetration of insurance for Muslim populations in Europe are not available, there is no doubt that penetration can only be low for many reasons: religion, culture, education, social status and/ or occupation. If religion plays a decisive role, the only answer to this resistance or reluctance could be by marketing Shariah-compliant or takaful products.

There are countries in Europe which might be more permeable to takaful than others because of their Muslim populations, originally from the Indian peninsula and especially with the social model organising the relations between communities or "communitarism". For these reasons, the UK is more prepared to accept an Islamic bank and takaful. The launch of the former in 2006 and the expected launch of British Islamic Insurance Holding this year are testament of this. France would be more resistant because of secularism and dispersion among the Muslim community.

There is an opportunity for insurers to make an offer which should be through mutual companies and associations. It is time to launch a mutual "takaful", which may

extend beyond the rest of the countries of the European Union.

Legal Requirements

The various European regulations could be of great help to the extent that they also organise the mutual companies. A takaful company is a mutual company with different capital and shareholders (not necessarily the policyholders). The freedom to set up operations and sell will help such a company expand across Europe.

Another alternative could be to start a separate fund or a "takaful window", which will exclusively offer takaful products. The "window" requires a complete separation with the conventional, with a Shariah Board and allocated capital invested in Shariah-compliant instruments such as real estate, leasing, and stocks excluding certain activities.

The company, or the "window", should be mutual. The main advantage of the mutual company is the proximity with takaful principles and models; and also its customer base, in general, more receptive to the idea of takaful.

Necessary steps to Implementing a Mutual Takaful Company

There are four main criteria governing takaful:

- Shariah Board (comprising of at least three members);

- Segregation between shareholders and policyholders' funds;
- Commitment to the surplus distribution (technical profit); and
- Investment made in accordance with Shariah.

Shariah Board and Accounting Standards

As per the Accounting & Auditing Organisation for Islamic Institutions (AAOIFI) standards, a takaful company must have a Shariah Board of minimum three members. The scholars must have religious knowledge in the field of jurisprudence applied to financial transactions. They must also be known and recognised by their peers, be flexible and be open-minded to propose solutions conforming to Shariah.

The accounting standards to be used will be those of the IFRS and the AAOIFI. These must be consistent with the IFRS applicable in Europe.

The takaful company will have to segregate the capital and the policyholders' funds, and present two balance sheets and income statements in accordance with AAOIFI standards.

Model

The choice of takaful model to adopt is crucial. It will be either wakala and mudahraba, or a combination of both. The waqf model practiced in Pakistan has not yet been adopted on a large scale.

Marketing

One of the weaknesses of Islamic finance and takaful is the lack of information and statistics. A sophisticated market study is needed. It will include the responsiveness of the Muslims or the reasons for a possible resistance to takaful products, and the determinants of the demand such as pricing and religion.

The associative network in Europe consists of several players, including national associations (for Moroccans, Algerians, Tunisians, Turks and so on), and cultural /religious (cross-border) associations linked to political groups. The feasibility study should identify the players able to provide mobility to expand takaful. In addition, a better understanding of the Muslim community is necessary.

Takaful should focus first on personal lines such as family takaful (life) and health insurance. The small corporate business could be targeted later. Products offered must be simple and not require extensive technical knowledge to sell, if the company is willing to use bancassurance as a distribution channel and e-commerce.

Windows

The takaful company or window must have an independent management from the conventional company or promoter.

The concern here is to avoid contamination and / or non-differentiation of takaful products within the range of conventional products offered by a conventional company.

A motivated and dynamic team of technicians and sellers, but more importantly, commitment to takaful principles is a must.

Even in the context of a "window", it would be necessary to allocate capital to the operations. This capital must be invested in Shariah-compliant instruments. If a new company is incorporated, it has to comply with the local rules for investment, where the risk of illicit income from fixed interest rates (treasury bonds). But the law being applicable to all, the investment income must be "purified", ie, split between Shariah-compliant income and illicit income to be dedicated to charity.

Commitment to the Surplus Distribution to Policyholders

There are two options acceptable from the Shariah point of view: distribution among all without exception or distribution to those who have not had claims (bonus to be paid in cash or by cheque), which will be the best advertising for takaful.

Shareholders are not authorised to benefit from the surplus. In case of technical loss, the shareholders ask for an interest-free loan from policyholders, to be repaid from future profits. The sub-base of the religious prohibition comes from the principle of capital that would benefit or be penalised for its management to account takaful pool which is owned by policyholders.

The question, therefore, is what will be the interest for shareholders to launch an operation in which they will not recover all or a portion of profit?


Shareholders will receive revenues from:

- Investment returns on capital;
- Wakala could generate a profit once a critical size is reached; however, some scholars are considering this as an illicit profit;
- As mudharib responsible for investing the policyholders' fund, they will be entitled to have a share in the profits;
- Reinsurance: Compliance with the Shariah requires ceding of the business to retakaful in priority; nowadays, this is not a problem considering the existing capacities offered by retakaful operators.

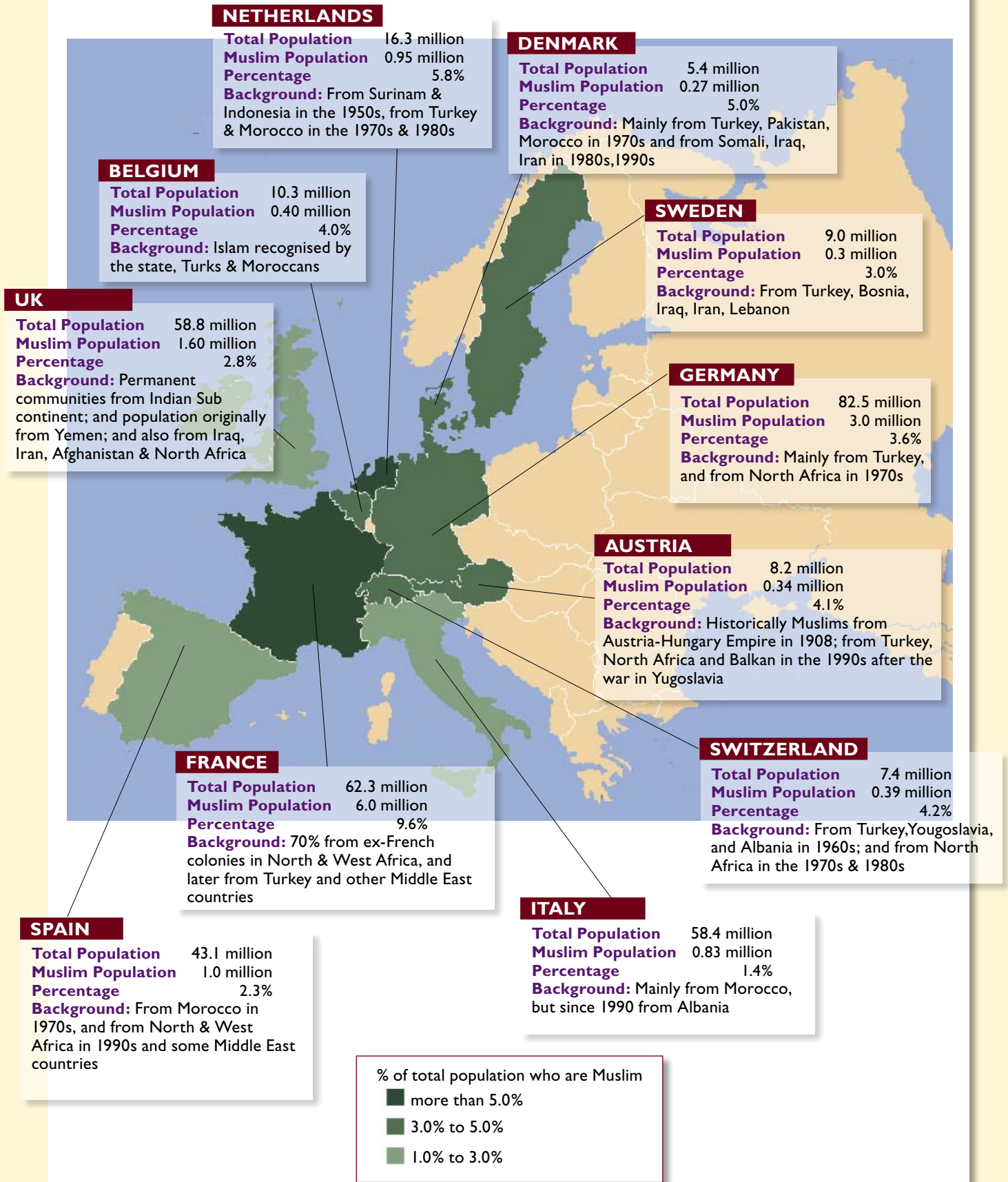
Conclusion

The presence of Muslim communities in Europe, the current lack of any kind of takaful on offer and the latest developments in the takaful industry must encourage European companies think seriously to explore this segment. It is time that one or more companies or mutuals can be launched.

Cross-border entities may have a better expansion. The project or projects can succeed only if they are profitable for their promoters. That is why we must avoid a "charity" or "non-profit" approach to be clearly explained to the partners (Muslim associations).

There is, however, another approach to be avoided: a strict capitalistic approach that markets takaful without ethics, and above the risk of non-differentiation or contamination. Takaful would thereby confine itself to being a product or product range. This is an approach that I would like to avoid. Otherwise, takaful runs the risk of drowning in pure considerations of profitability, and thus, becoming very similar to conventional insurance, and will never take off. 

MUSLIMS IN EUROPE*



Source: BBC News

* Figures for Greece and Luxemburg were not available

Takaful in the EU: Brimming with Potential



Mr Mohammed Amin

With over 20 million Muslims, the EU is naturally the next potential major takaful market, provided the market can be accessed appropriately. **Messrs Mohammed Amin**, Partner and **Mohammad Kahn**, Director, PricewaterhouseCoopers UK, look into some key considerations for those eyeing this lucrative market.



Mr Mohammad Kahn

Takaful business is one of the hottest topics in the insurance industry, currently growing at 10%-20% globally per annum. This compares to an average rate of growth for conventional insurance of around 9% per annum in emerging markets and 5% per annum in OECD countries. Takaful allows Muslims to access methods of minimising financial risk that were not open to them through conventional insurance and has also spurred the growth of mutual insurance business among the non-Muslim populations of the Middle East and Southeast Asia.

The next potential major market for takaful is the EU. With over 20 million Muslims, there is a significant opportunity for developing takaful if the market can be accessed appropriately. Some companies have already spotted this opportunity. For example, British Islamic Insurance Holdings and First Takaful have announced that they will commence writing general takaful business in the UK this year.

This article examines the key considerations for developing takaful business within the EU. We start by briefly examining the key differences between takaful business and conventional insurance as this affects the considerations for developing takaful.

Takaful and Conventional Insurance Compared

In a takaful business, there are two separate funds, a Policyholders' Fund (PF) and a Shareholders' Fund (SF).

The PF represents the insurance operations of the takaful company. The policyholders are entitled to the profits achieved from the insurance operation (ie, underwriting profits plus any investment income on policyholder funds).

The SF provides the capital required by the takaful business. Should the PF fall into deficit or make a loss, the SF must give an interest-free loan (qard hassan) to the PF. This loan should be paid back to the SF once the PF is in surplus. The SF also needs to pay all working expenses incurred by the takaful business and to manage the takaful operation on behalf of the PF. For example, the SF is responsible

for the hiring and payment of all staff and, therefore, the business strategy of the takaful company.

The SF is remunerated via fees charged to the PF for operating the takaful business on its behalf. There are two major mechanisms for charging fees to the PF – a wakala model (fixed agency fee applied to either contributions or investment income) or mudahraba model whereby the SF participates in the results of the PF as well as charging a management fee. The mudahraba model is seen in Malaysia while the prevalent model in the Middle East is wakala.

Figure 1: Mudahraba Model

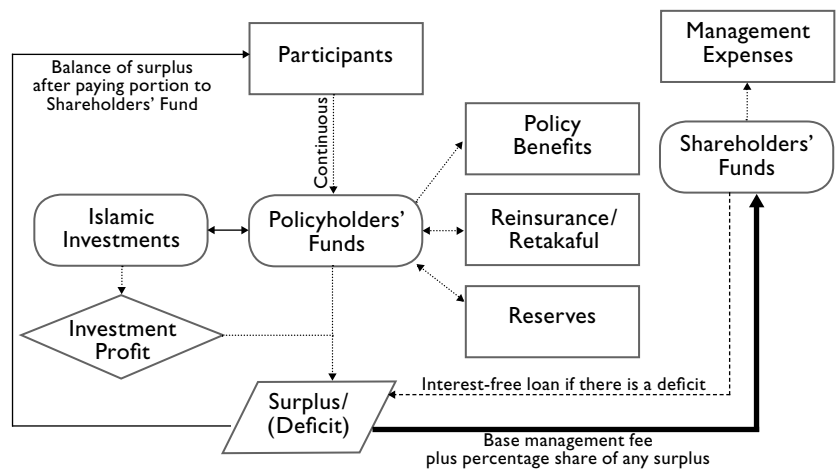
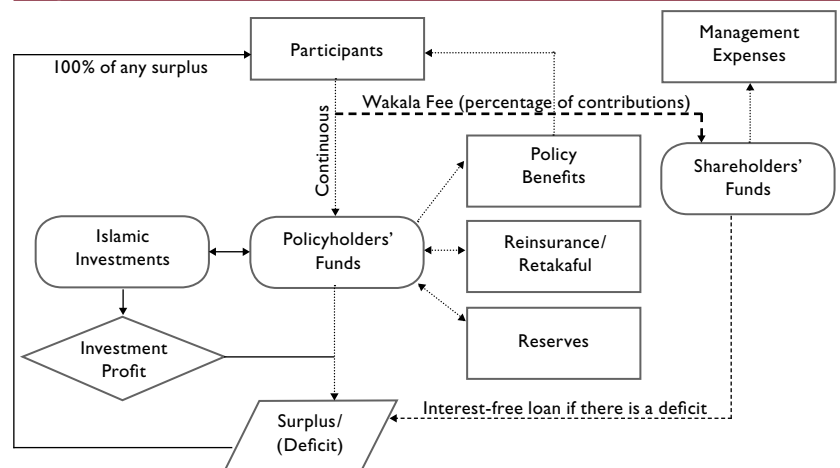


Figure 2: Wakala Model



There are other methods for remunerating the SF, but these are not as common and not explored in this article.

As the illustrations show, the key difference between the two models is whether the SF participates in the surplus or deficit arising in the PF.

The split between funds has to be physical, not just an accounting split. In the wakala model, the SF cannot even make any call on the funds of the PF unless it is to pay back any qard hassan interest-free loan. This means that any surplus arising in the PF should only be given back to the policyholders. In practice, some countries have allowed the SF incentive arrangements to maximise returns for the PF, such as an additional percentage of investment income to be given to the SF if returns are above a pre-agreed value. In the mudaraba model, the SF participates in the surplus in an agreed proportion.

The situation described above is similar to typical mutual insurance where all insurance surplus arising is due to the policyholders. Conversely, in conventional general insurance companies with shareholders all of the insurance profit/loss is attributable to the shareholders of the company (UK “with-profit” life assurance companies operate rather like the mudahraba model as the surplus is shared between policyholders and shareholders).

It can be useful to think of the takaful business as a mutual insurance company with specific constraints (eg, it cannot invest in certain industries) contained within a shareholder owned “wrapper”.

Challenges in Developing Takaful in the EU

Critical mass

Although there are over 20 million Muslims living in Europe, they are spread over the 27 member states of the EU although being concentrated in the major territories. Legally a takaful insurance company incorporated and licensed in an EU member state can sell its products across the EU. In practice, this is difficult to do as the company would still need to comply with each EU state’s individual insurance regulations, even though it does not need to apply for a separate license to operate in each state.

Further, the mix of backgrounds of the Muslims is different in each EU state. For example, the Muslim populations in Denmark, Germany and Austria are descended primarily from Turkey, Muslims in France are mostly descended from Algeria, whereas the largest Muslim communities in the UK originate from Pakistan and Bangladesh. This will affect how a takaful business would go to market as the propensity to buy insurance products will vary among these ethnic groups.

Awareness of takaful is also generally low among Muslims within the EU. For example, research has found that most UK Muslims did not understand the term. Accordingly companies entering the takaful business need to educate Muslim consumers about what takaful is and its Shariah compliance.

Companies considering setting up a takaful business would be advised to start writing business in EU countries with large Muslim populations that are concentrated within small geographical areas, making it easier to market to those populations. Countries which meet these criteria might include the UK, France, Germany and Spain.

Marketing to Non-Muslims

Takaful businesses have usually been most successful in countries where there has been a high proportion of Muslims. This is not the case in most EU states. Even those with significant populations of Muslims have a relatively low proportion, with France being the highest at 10% and the UK and Germany lower. Consequently, a takaful businesses may need to appeal to both Muslim and non-Muslim customers to be economically viable.

Takaful businesses, by definition, should have ethical investment policies, transparent insurance contracts, as well as the added bonus of returning excess contributions via underwriting surpluses. This is a potential marketing tool within the EU as many consumers are starting to demand more ethical and transparent insurance products.

Shariah Compliance

The Shariah board usually consists of at least three economically educated Islamic scholars who are retained by the takaful business. This presents a resourcing issue. There are not many scholars in the world who understand both the intricacies of Shariah law and the complexities of modern finance. Consequently there is huge demand for appropriate Shariah scholars within Muslim countries where most Islamic finance companies operate.

Shariah compliance also raises a regulatory question. In essence, a takaful business has two “regulators”:



Paris Central Mosque, France

- The state regulator (eg. the Financial Services Authority (FSA) in the UK), who ensures that policyholders are protected; and
- The Shariah Board who ensure that the takaful business is operating in an Islamically appropriate manner. Many state regulators require the management of insurance companies to be formally “approved persons”. Does the Shariah Board fall into this category? In the UK, the FSA has taken the approach that members of the Shariah Board are not undertaking a management function and, therefore, do not need to be approved persons. This means that the FSA does not need to assess the capability or suitability of the individuals who are on the Shariah Board.

Other Regulatory and Accounting Challenges

Currently, insurers within the EU use International Financial Reporting Standards (IFRS) for their accounts. Under IFRS, takaful businesses would publish their accounts at a combined corporate entity level, ie, with the PF and SF combined. Recently, the FSA in the UK announced that takaful businesses will be regulated as mutual insurance companies, ie, at a combined PF and SF level, and they do not expect to change the accounting rules for takaful operations in the near future.

This leads to questions of transparency. How will potential shareholders be able to assess the results of the company if the accounts combine the results of the SF and the PF, since shareholders only derive economic benefits, such as dividends, from the SF? Should the accounts show the PF and SF separately? Conversely, to compare the performance of takaful businesses with conventional insurance businesses would require the combined results to be shown as a conventional general insurers report on a combined company basis.

Are there any alternatives? In Bahrain, all conventional insurers account using IFRS. However, takaful insurers in Bahrain must account using the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards – these are akin to IFRS but were specifically developed for Islamic companies. The AAOIFI standards show the accounts for the SF and the PF separately. They also require an annual statement from the Shariah Board confirming what issues the Shariah Board looked at in the relevant accounting year.

A takaful business in the EU could include the accounts for the PF and SF and the Shariah Board statement as appendices to the main IFRS accounts, which may help transparency and may also enable them to be compared with other takaful entities around the world which use the AAOIFI standards. Comparability with overseas companies which use AAOIFI standards may help EU takaful businesses demonstrate their performance competitiveness.

Takaful businesses setting up within the EU need to be aware of the impact of the proposals for capital requirements known as Solvency II and the developments for insurance accounting in IFRS Phase II. These could have a significant impact on the operations of the company, specifically how financial information is obtained and assessed within the company.

For example, Solvency II will explicitly look at the capital of a company and estimate reserve requirements

based on a best estimate plus risk margin basis.

However, within a takaful business, although the best estimate reserves will be retained within the PF, any working capital required to cover the risk margin will be within the SF. This causes complications if trying to model the takaful entity using a risk based capital approach.

Retakaful

As part of Shariah compliance, the retakaful programme should be placed with a retakaful company. At the time of writing, there are only three retakaful companies that have a rating of A- or above and there are altogether fewer than 20 retakaful entities in the world. This lack of retakaful capacity may force takaful companies to use conventional reinsurance (on the grounds of necessity) until more capacity becomes available.

Investment Compliance

Takaful businesses should invest their funds in Shariah-compliant assets. However, this may cause regulatory issues. Some EU member states have restrictions on the proportion of certain types of assets that an insurance company can invest in. Many of the investments preferred by regulators (eg, bonds) are not Shariah-compliant. Even if there are suitable Shariah-compliant investments, there may not be enough of them, eg, if there is only one sukuk bond available for a takaful company to invest in, the company may fall foul of local regulations concerning “concentration risk”, ie, the local regulator may want its companies to be invested in at least three sukuk bonds – not just one. Currently there is a huge shortage of Shariah-compliant investments within the EU that takaful businesses can invest in.

EU governments are aware of this issue and some are starting to take some action. For example, the UK Government is consulting on whether or not it should issue sukuk.

Lack of Skilled Resource

A common problem affecting takaful companies in the Middle East is a lack of skilled technical resource in the underwriting, claims, finance, actuarial and reinsurance functions. Although the EU does not suffer from a general shortage on these fronts, what is lacking are insurance specialists who also understand Islamic finance and takaful business, and the intricacies of how takaful business operates within the modern financial world.

There are now several specialised Islamic finance training institutions, but the supply of qualified personnel from these institutions is not enough to satisfy the demand for people with real life experience of takaful business.

Conclusion

The large Muslim populations within EU countries make takaful business an attractive opportunity. The current accounting and regulatory regimes in the region do not preclude takaful businesses from setting up and marketing to consumers. Indeed this is starting to occur. However, companies evaluating this option will need to consider how to keep their operations Shariah-compliant, while also complying with local accounting and solvency regulations. They also need to consider how best the advantages of their products can be marketed to, and understood by, both Muslims and non-Muslims. ■



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.■

Growing Takaful via the Friendly Society Route

Much effort has gone into devising legal structures to deliver Shariah-compliant mortgage and savings products for the UK market. However, for insurance, an ideal vehicle has existed for over 200 years and is waiting to take on a new lease of life to serve the growing Muslim community, not only in the UK but throughout the European Union: the friendly society. **Mr John Gilbert**, Consultant, Lovells, elaborates.



In essence, a friendly society is a mutual association which exists to provide benefits to its members. Friendly societies were first recognised under an Act of the British Parliament in 1793, but their origins have been traced back as far as mutual assistance groupings that existed in the Roman legions from North Africa, which raises the possibility that friendly societies may share a common origin with the concept of takaful. There are now around 50 active UK friendly societies with some five million members and assets under management of about £15 billion (US\$30 billion).

From a legal point of view, an incorporated friendly society is similar to a company formed under the Companies Acts, but it is not the same, and the Companies Acts do not apply to friendly societies. In terms of ownership and capital structure, there are differences between friendly societies and most companies. The separate legal framework for friendly societies also results in slightly different rules on the constitution of a friendly society, the manner in which directors operate and the reporting requirements.

Recognised Legal Vehicle for the Provision of Insurance in the UK

In the UK, friendly societies are a recognised legal vehicle for the provision of insurance under the Financial Services and Markets Act 2000. They are regulated by the Financial Services Authority (FSA). This means that a friendly society based in the UK can operate throughout the European Union and the European Economic Area under the “single passport” with minimal formalities in the other countries in which it operates. Although the traditional market for friendly societies products has been within the UK, several societies have expanded their activities elsewhere in Europe.

Similar Ethos to Takaful

Friendly societies share much of the ethos of takaful. They are firmly embedded in a culture of mutual assistance and exist for the benefit of their members. They have no shareholders and any surplus from their operations is shared among the members. They have a charitable ethos and are funded by voluntary contributions in a manner that has parallels to the concept of tabarru’.

Additional Support & Services to Members & Support Muslim Charities

Furthermore, a friendly society operating a takaful scheme for Muslim members could also offer additional support and services to its members and support Muslim charities. However, this does not mean that the traditional mudahraba, wakala or mixed models of takaful structures cannot be applied to a friendly society; they

can, and similar structures have been used to provide traditional insurance in the UK market through friendly society vehicles.

This flexibility, the encouragement of the FSA (which appears from the paper it published on Islamic Finance in November 2007 to be sympathetic to the development of Shariah-compliant products by the firms it regulates) and the tax advantages of friendly societies make them an ideal vehicle for takaful not only in the UK, but throughout Europe.■

(1 British Pound = 1.96 US Dollar)

About Friendly Societies

- Started to flourish in the industrial revolution with the movement of population in the UK to the industrial towns and as traditional social support systems in rural villages broke down
- Many of the earliest societies were burial societies: members of the society contributed a small sum each week and were guaranteed a decent funeral on their death
- After World War II and before the advent of the welfare state in the UK, friendly societies were the main channel through which medical and pensions benefits were delivered to the general population
- Welfare state resulted in a decline in friendly society membership but the societies evolved during the second half of the 20th century to serve a niche small savings market and a market for “Holloway” products which provide a form of income protection during sickness and also contain an investment element which pays a lump sum on retirement
- Small friendly society life assurance investment products are exempt from UK tax and all non-life activities carried on by societies established before 1975 also are exempt from tax.
- Most friendly societies become incorporated bodies under the Friendly Societies Act 1992 although some so-called “registered” societies continue to exist under earlier legislation
- Insurance benefits include most classes of life insurance and accident and sickness insurance but not other classes of general insurance, which friendly societies may provide through subsidiaries.