

SPEECH MADE BY LORD SHEIKH\* AT ISLAMIC FUNDS  
CONFERENCE IN EDINBURGH ORGANISED BY THE ISLAMIC  
FINANCE COUNCIL ON 2<sup>nd</sup> APRIL 2009. THE SUBJECT OF HIS  
TALK WAS “LIFE OPPORTUNITIES IN THE ISLAMIC FINANCE  
ARENA”

As Islamic arrangements are mutual arrangements it is very appropriate that this Conference is being held in Scotland. There is a long history and culture of mutuality in Scotland and it must be noted that Scottish Widows was founded in 1815 as Scotland's first mutual life office. Subsequently a number of life offices were established and at one time there were nine long established organisations in Scotland including Standard Life which was once the largest mutual life office in Europe. Standard Life was established in 1825.

As a teetotaller I was interested in the history of Scottish Union which was originally founded as the Scottish Temperance Assurance Society Ltd. by Adam Roger who despite being a brewer's son, was a teetotaller who felt that temperance was not only healthy but good for business as well.

I am the Chairman of Camberford Law Plc which is a Lloyds Brokering organisation undertaking general and financial services. Camberford Law have successfully developed and are marketing 14 different niche products which are now

utilised by over 1500 intermediaries. These products are also sold directly to the public and there are special arrangements with affinity groups. Over a period of 3 years we were either the winners or were highly commended on 12 leading insurance industry awards. These awards were given to us for innovation, marketing, customer care and professionalism. I am a Fellow of the Chartered Insurance Institute and also hold a Financial Planning Certificate which enables me to deal with all classes of Insurances and financial products. I have been a great supporter of mutual offices and in fact some years ago I personally dealt with the second contracting out pension arrangements in the country which I placed with Scottish Provident. I have also believed in the building societies with their mutuality arrangements where there was a great deal of accent on prudence and good housekeeping. This is the main reason why I am attracted by Islamic Financial arrangements.

Life insurance is a very essential part of the social protection needed for any society. Why do we need Islamic life insurance? The reason is because Muslims find conventional life insurance contrary to their religious beliefs which are enshrined within Shariah law. This applies to general insurance as well, but its impact is felt more when applied to protecting people rather than when protecting physical assets.

Life insurance has a rightful place in Islam but years of misunderstanding and misconception have created mental blocks against insurance in the Muslim culture. Takaful is the right way forward to try and address these mental blocks that have been created. This type of insurance has a great deal to offer in countries where the spread of insurance per person and per cent of GDP can increase greatly if the system of takaful is projected correctly and understood properly. It can genuinely enlarge the insurance market in areas where traditional insurance has not been able to grow, as it should have done.

Islamic banks have more than 300 institutions spread over 51 countries, as well as an additional 250 mutual funds that comply with the Islamic principles. So there is already a large structure for Islamic finance in place but I must stress that the majority of these institutions are in the Middle and Far East in Muslim majority countries so there are definitely opportunities in the UK Islamic finance arena.

Takaful insurance is based on solidarity and risk-sharing principles and is an Islamic form of financial protection, similar to conventional insurance. Takaful companies have to follow Islamic finance principles, such as producing Shariah-compliant contracts for clients and appointing a board of Shariah scholars to ensure that both the products and the operations of the company comply with Shariah laws.

In the takaful system, the policyholders of the takaful business agree to pool their contributions and share the liability of each policyholder. So if one policyholder makes a claim, this is paid from the combined pool of the policyholders' contributions. A difference from conventional insurance is that the policyholders all share in the insurance risk, the risk is not passed on to the company. Therefore if at the end of the financial year, the takaful business makes a profit, a proportion of this profit is shared amongst all of the policyholders.

The assets of the takaful business must be invested in Shariah-compliant assets. So for example, the business cannot make investments in gambling institutions, companies that produce alcohol, companies that sell weapons and also assets that pay interest. This is a key part of making the takaful structures acceptable under Islamic law. Examples of takaful investment channels are real estate investment, profit sharing trusts, sukuks and any other Islamic funds or transactions which are interest-free activities.

It is worth mentioning that ethical funds have been provided by British life offices for some time. I have supported the ethical funds issued by companies such as Friends Provident which have performed well.

In takaful arrangements, there are three main models that are widely used around the world which are the *mudharaba* model, the *wakala* model and the hybrid model.

The *mudharaba* model is known as the profit sharing model. The shareholders share in the profit or loss with the policyholders. The shareholders are paid a pre-agreed proportion of any surplus generated by the policyholders' fund in return for running the insurance operations of the takaful business on behalf of the policyholders. If the policyholders' fund makes a loss then the operator provides an interest free loan to cover the loss.

In the *wakala* model, the operator acts as an agent of the policyholders. In this model, the shareholders are paid a pre-agreed proportion of the contributions paid by the policyholders in return for running the insurance operation of the takaful business on behalf of the policyholders. If the policyholders' fund makes a loss, the operator provides an interest free loan to the policyholders' fund that is repaid out of future surpluses in the fund.

The hybrid is a mix of the *mudharaba* and *wakala* models. In this model the operator receives a *wakala* fee for managing the insurance operation of the policyholders' fund as well as a *mudharaba* fee for managing the investment fund. This model is widely used in the GCC (Gulf Co-Operation Council) countries.

The Shariah Supervisory Board (SSB) is a pre-requisite for any Islamic financial institution. Its main role is to ensure that all dealings are strictly compliant with Shariah law, and set out any recommendation to make them in line with Shariah requirements.

The SSB's role is not limited to veto, restrict or consent to the insurance transactions. It goes beyond this; to support, assist and guide the insurance company whenever the Shariah viewpoint on any transaction has to be identified. They may also assist in estimating the Shariah training needs of the employees and preparing the relevant training materials.

There are two types of takaful, family takaful and general takaful. Family takaful is an alternative to the conventional life insurance plans. A family takaful plan is a long-term savings and investment programme with a fixed maturity period. Apart from enjoying investment profit, the plan provides mutual financial assistance among its participants. It is a financial programme that pools efforts to help the needy in times of need due to untimely death and other accidents that result in personal injury. Whereas general takaful schemes are basically contracts of joint-guarantee on a short-term basis, normally a year, between a group of participants to provide mutual compensation in the event of a defined loss.

The takaful plans designed by the company would enable people to participate in a takaful scheme with the aim of saving regularly and investing with a view of earning profits which are Shariah-compliant. If a person were to die before the maturity of the takaful plan, his beneficiaries would be paid the total amount of takaful instalments paid by him up to his death as well as the outstanding takaful investments which would have been paid by the deceased participant. If the person were to survive until his takaful plan matured, he would be paid the total amount of takaful investments that he paid during the length of the plan as well as a share of the profits from the investment of his takaful investments.

Under the family takaful arrangements, cover can be provided for education, group hospitalization and medical benefit, mortgage plans and group family takaful plans.

Looking at the figures for family takaful compared to the rest of the takaful market, we can see that it is largely under-utilised. In most areas it only makes up a very small percentage of the entire takaful market compared to general takaful which contributes a very large proportion of the market.

Takaful is price competitive when compared to equivalent conventional insurance products and there are also significant numbers of non-Muslim customers. The world's

1.5 billion Muslims represent a huge potential customer base. The bulk of the world's Muslim population is youthful. A staggering fact is that 60% of the global Muslim population is under 25 years old. This youthful population is becoming more affluent and if captured early, has the potential to be a customer base to be retained for 40 years or more. The under-insured status of most Muslims is also a significant enticement to potential takaful operators.

I chair the Conservative Muslim Forum. There are over 2 million Muslims in the United Kingdom and over 1 million Muslims are under the age of 30. I have a Muslim friend who is a general manager of a bank. He has educated his children and his eldest son is a dentist. About a year ago I saw his son who said to me that he would like to apply for a mortgage but he does not want to pay any interest. I said to him that your father has made his money by lending funds to his customers and charging them interest but I was very pleased to hear from him that now he has grown up he dislikes paying interest. The point I am making is that a number of young Muslims do wish to effect transactions which are Shariah compliant and there is therefore a need to provide these types of arrangements. In the House of Lords I have supported faith schools as I feel that people in Britain should be given the choice to send their children for education to faith schools if they would like to do so. Similarly we need to make the arrangements for Shariah compliant financial transactions which will give the

opportunity to the consumers to effect transactions which conform to their religious beliefs.

Consider the global picture. If you considered 30% of Muslims to be bankable, it gives approximately 500 million potential customers with a buying power for life products. Sigma Swiss Re have estimated that if all Muslims currently buying insurance were to switch to takaful it would generate 35 billion US Dollars of premiums (life and non life) in 2008. In many markets, the traditional protection and savings products may not work. There would be the need to come up with products more attuned to the local culture and social customs and savings habits.

And this is just the beginning of what we can expect as potential in the field of takaful akin to life products offering protections and savings including pensions. As Islamic Finance is all to do with ethical forms of investment, ranging from non-interest driven asset backed solutions to investing in businesses and industries that are good for society and the environment at large, takaful should not remain a niche, but through its appeal to everyone irrespective of religion, its market should be part of the mainstream market, increasing its potential manifold.

Takaful customers will of course look for competitive returns. The mere fact that it is takaful is not necessarily enough incentive for people to buy the product. A general

rule of thumb is that about 20% of Muslims would buy takaful insurance irrespective of the price, another 20% would not really be bothered whether it was takaful or conventional insurance. But a large portion, some 60% would prefer takaful over conventional if the price was the same.

There is a huge potential for expansion in the takaful industry. Globally, some estimate that the global takaful industry is growing at 20% a year, which easily outstrips the 2.5% annual growth rate for conventional insurance premiums. Some outlooks suggest that the takaful market will be worth \$4bn in the next few years at the present rate of expansion compared to just \$170m right now.

The combination of ethical investment policy, significant growth potential and price competitiveness is something that can be attractive to non-Muslims as well as Muslims. In markets where there are less Muslims for example, the UK and Europe, where there are only 2 million Muslims in the UK and 20 million in Europe, if you were to factor in the potential for having non-Muslim customers, the market would grow to over 60 million in the UK and around 450 million in Europe.

If we are to promote and develop takaful products it is important that we look at the human resources. We need to seriously examine the training of staff to ensure that they are well aware of technical Islamic insurance principles and

are also well versed in Shariah finance. I used to be a visiting lecturer on insurance subjects and have also been President of the Chartered Insurance Institute. The Chartered Insurance Institute in collaboration with the Bahrain Institute of Banking and Finance are preparing courses for takaful subjects which will become part of the Chartered Insurance Institute examinations. I have been asked to chair a committee which is involved in the preparation and promotion of the courses and the subjects.

I have been Chairman and Director of the British Insurance Brokers Association and I have been asked to chair a committee focusing on takaful insurances which in due course will be distributed by the members of the Association in the United Kingdom. The Association has over 2400 members.

One of the other big challenges that companies are facing is customer awareness, which I have already touched upon. Many Muslims live under the misconception that insurance is contrary to the principles of Islam, particularly with regard to life insurance. People have to be made aware that Takaful provides an acceptable, religiously validated solution. Similarly non-Muslims need to be made aware of the reasons why Takaful is ethical.

There is a low awareness of Takaful among Muslims within the EU. But if the message can be put across to these

Muslims then there will be a positive outcome. A survey was conducted amongst British Muslims which found that half would buy Takaful products as long as cover and price were compatible with existing products.

Capital protection is important too despite the fact that Shariah principles do not encourage guarantees and is more about sharing risks or rewards. Capital protection becomes almost a necessity as a function of confidence at the unsophisticated retail end of the family takaful market. Security of capital and income becomes paramount for pension products especially approaching retirement or during retirement.

Takaful has its challenges in finding the right asset solution in this area. The universe of Shariah compliant investments available to takaful is much smaller than what a conventional company has at its disposal. Because of this a takaful company runs the risk of mismatching assets to liabilities. Options and derivatives do not have a place in a takaful portfolio. A takaful portfolio deals more with equities and lease based instruments and often has to seek alternative ways of maximising returns including unlisted securities and less liquid or not so marketable instruments.

The fund managers should find takaful an area of great interest, offering a lot of opportunities now and in the future. The takaful industry needs all the help to develop

more instruments and avenues to invest on a Shariah compliant basis. The one big gap that exists is that of fixed returns akin to interest based gilts and loan stocks. The equivalent instrument on the Islamic Finance side is the 'sukuk' or 'Shariah compliant bond'. Sukuks are a relatively new innovation, and are still limited in range by term and return with no secondary market. Sukuks would be ideal for takaful companies but these do not find their way readily into takaful portfolios as they are offered in large tranches and with limited terms.

In the past there have been several barriers to growth of the UK Islamic finance market including high charges and costs and disagreement about what exactly constitutes Islamic banking as well as scepticism about the religious validity of the products available. Recently though these barriers have been addressed and changes have been made. There will always be disagreements over what constitutes Islamic banking but the other barriers such as the high costs are now less of a factor.

The UK is the first country in Europe to promote and encourage retail Islamic banking. The UK is now the leading centre for Islamic finance outside of the Gulf countries and Malaysia. The Government's intention is to establish and maintain Britain as the gateway to international Islamic finance. The British Government would like to ensure that

principles of fairness, collaboration and commitment will apply to Islamic financial arrangements.

I would like to draw your attention to the booklet published by HM Treasury in which it is stated that “Islamic finance is available to everybody”.

At the present time, the only takaful product available is motor insurance and any form of life assurance is not provided by anybody. There is therefore a market to be established and strengthened.

The FSA, as the UK’s financial services regulatory body, has committed itself to combating financial exclusion. Robust measures have been taken to remove any barriers that result in the unwillingness of households to access banking and other financial services because of distance, poverty or religion. These measures are increasingly giving UK Muslims an equal opportunity to access finance in compliance with their faith.

The development of Takaful “Islamic Insurance” products is deemed to be another major step towards providing UK consumers with a better and bigger choice of Islamic and ethical financial products. And if the last few years are any indication, there is a lot more to come.

An organisation can arrange Islamic Finance or Takaful arrangements by three broad models which are as follows:

1. establishing a stand alone institution
2. setting up a specialist subsidiary
3. having a window/branch operation

The first two models are self explanatory and in regard to the third it is necessary to segregate the accounts and operation of the Islamic from the conventional activities. If there is any interest on your part, or if there is any appetite to look into the matter further, my suggestion is to set up a subsidiary. The subsidiary will have the benefit of the financial standing of the parent. The parent company can set up a subsidiary, or outside funders can make the investment which will enable the main company to establish the subsidiary. The subsidiary will work in accordance with the Shariah principle and have the appropriate structure.

The other alternative could be that the funders can acquire a friendly society and introduce the appropriate arrangements which would be Shariah compliant.

\* Lord Mohamed Sheikh was trained by and commenced his business career with Sun Alliance Insurance Group in London. He is a Fellow of the Chartered Insurance Institute. He is the Chairman of Camberford Law Plc who are Lloyd's brokers undertaking every class of insurance business. Lord Sheikh is now promoting Islamic finance and takaful insurances.

Lord Sheikh was elevated to the House of Lords in 2006 and was in fact the first Muslim to be appointed a Peer by the Conservative Party. He is Chairman of the Conservative Muslim Forum. Lord Sheikh takes an active role in the proceedings of the House of Lords and has spoken on a variety of subjects including Insurance and Financial Services