FINANCE IN ISLAM
LEARNING ISLAMIC FINANCE

Islamic Investment Products In the UK

New Horizon, March 2001, 3-5

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Introduction

London has become the largest international centre for Islamic finance outside the Muslim World, largely as a result of the City's role as a centre for Middle Eastern and Asian banking. Treasury management facilities are provided on behalf of Islamic banks in the Gulf, and Islamic fund management and promotion is becoming more significant. Possibilities for Islamic electronic financial services are opening up, and London is the major centre for information gathering and dissemination on the Islamic banking industry.

London's role in serving the British Muslim community has been disappointing and despite almost two decades of experience of Islamic financing, there are few retail products available. The aim of this article is to ask why this continues to be the case, to review the limited range of products on offer, and to see if there are any more hopeful signs for the future.

Islamic financial services in the UK

The Muslim community in the United Kingdom numbers more than 1.5 million British citizens and permanent residents, with up to another 500,000 temporary residents including students and visitors. The community is ethnically and linguistically diverse however, and geo graphically scattered, that makes marketing aimed at attracting the attention of the community a' major challenge. The community is increasingly affluent, and comprises a growing number of professionals such as doctors, as well as a substantial small business component.

Although casual evidence suggests there, is a greater propensity to use cash for transactions than with the population generally, the demand for banking and financial products is not markedly different from the national picture. Some devout Muslims avoid using conventional interest based banks, and others donate interest earnings to charity in., an attempt to purify their income. The n use conventional financing services, largely because they have little alternative, and tend, like the rest of the population, to have greater trust in large retail financial institutions with established brand names. For Islamic financial institutions to gain acceptance within the community there would need to be a substantial educational and, marketing promotion.

HSBC Islamic Financing, in many respects the HSBC is the best placed British retail bank to potentially offer Islamic financial services to the local Muslim community, but so far it has been reluctant to take on the promotional and marketing risks. HSBC's advantage is that it already has an Islamic finance unit and extensive experience through its global operations in this type of business. It has a significant presence in many Muslim countries, including Malaysia, Pakistan and Bangladesh, and has become a major force in Middle Eastern banking since its acquisition of the British Bank of the Middle East. Its network includes six branches in Bahrain, six in Lebanon, fifteen in the United Arab Emirates, nine in Egypt, and five in Oman. HSBC also owns a minority stake in the Saudi British Bank that has 80 branches in the kingdom. These networks give the bank unparalleled business knowledge of different Muslim societies.

In the United Kingdom HSBC is the only high street bank to have a dedicated network of branches to serve the South Asian community with staff who speak Urdu and are themselves part of the community. It has teams of specialist business banking managers who profess to understand the needs of small Asian businesses. Its South Asian network has 11 branches in Blackburn, Glasgow, Harrow, Leeds, Leicester, London (2), Manchester, Preston, Walsall and Uxbridge. Islamic products could potentially be offered through all these branches.

It is however: easier for HSBC, like other British retail banks, to offer conventional loans and savings products rather than to intro duce differentiated products for a potential market of Muslim clients who do business with the bank in any case. The gains from cross selling Islamic products to existing clients are not thought to be great, and the potential to attract new clients limited due to the inertia of most retail account holders. HSBC therefore has concentrated on serving foreign Muslim clients of high net worth through it's inter national operations, and in serving Islamic banks through wholesale business, rather than the domestic market. The HSBC's Amanah Global Equity Fund is marketed to foreign investors, for example, rather than the British Muslim community.

United Bank of Kuwait's Islamic Investment Banking Unit's Manzil

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Scheme

The most significant Islamic financial product to be launched for the Muslim community in the United Kingdom was the Manzil home purchase plan. Manzil can be translated as home, or in spiritual terms as the house or dwelling of the soul. The original scheme, which was introduced in 1997, provides for murabaha financing through a trading mark-up contract. The Islamic Investment Banking Unit that runs the scheme is a part of the United Bank of Kuwait, which was established in London in 1966 to serve Kuwaiti overseas financial and commercial interests. In August 2000 it was taken over by the Al-Ahli Commercial Bank, which formed a new institution, the Ahli United Bank. This has been registered as an offshore banking unit in Bahrain with its shares listed on the stock exchange in Manama.

Once the client has chosen a suitable property and agreed a price he approaches the bank for Manzil financing. An application form is completed together with a direct debit mandate for the monthly payments if the request for financing is approved by the bank's credit committee. The client must pay 0.1 per cent of the purchase price of the property, or a minimum of £176.25 including VAT, so that the bank can commission an independent valuation of the property. The IIBU will also seek references regarding the client's financial position, usually from an employer or accountant and current bank. The client's solicitor will be expected to lease with the IIBU's solicitor who will seek assurances regarding the legal title of the property, which may involve legal searches.

For murabaha to be legitimate under Islamic law the bank, as financier of the property, must be the first owner. It is therefore the bank, and not the client, who con tracts with the vendor and pays the deposit required when contracts are exchanged. The sale price from the IIBU to the client has to allow for administrative expense a return to the bank's investors and a profit margin. The client pays the purchase price through fixed monthly payments over a period of up to 15 years.

The Manzil Ijara Home Hire Purchase Plan

The Manzil ijara scheme, which was introduced in March 1999, has proved much more popular than original murabaha house purchase plans. It is the flexibility that seems to appeal to clients, who can repay larger amounts as and when they can afford to do so to reduce their rental payments. They have the right to purchase the entire property from the bank at any time, but few are likely to choose to do so in the first few years, largely because they lack the funds. Those with the necessary funds to purchase a property out right would not have sought a Manzil home purchase arrangement in the first place.

Under the Manzil ijara scheme the property is registered in the bank's name, not just initially, but throughout the period of the lease that may extend to 25 years. The tenant or lessee agrees at the outset to eventually purchase the entire property, but at the original price that the bank paid without any mark-up. The monthly payments by the client comprise three elements. The first represents the repayments of the funds that the bank has used to purchase the property. The second is the rent on the property, which is the source of the bank's profit. The rent is reassessed annually to ensure the bank is making a reasonable return and adjusted downward to reflect payments already made. The third element of the monthly payment, referred too as insurance rent, is to recover the cost of the insurance that the bank has to pay on the property. Over time the monthly payments may increase or reduce or both, depending on the size of the first repayments element that the client decides he can afford. Early repayment could be potentially unprofitable for the bank, unless it can obtain a higher return by reinvesting the funds.

The Success of the Manzil Scheme

Although there has only been limited marketing effort put into the Manzil schemes there are between 50 and 80 potential clients a week who phone to enquire about Manzil house purchase and a further 40 who respond by email to the Web pages. This translated into around 20 applications per week for Manzil house purchases. The majority of applications are for housing purchase in the South East of England, but there is also a steady stream of enquiries from the Midlands and the North. Because of the different conveyancing system under Scottish law; Manzil financing is not available for house purchases north of the border. A clown payment of 20 percent of the value of the property is required for all Manzil financing, which is higher than for conventional mortgages, but ensures that the client has a significant equity stake in the property from the outset. The mini mum value of the property purchased is £50,000, which is a very modest sum in relation to property values in the South East, but which has applied to some of the inner city properties acquired in the Midlands and the North.

Under the Manzil ijara scheme clients can convert existing interest based mortgages. The banks shariah board's members, Justices Shaikh Muhammed Taqi Usmani and Shaikh Nizam Yaquby, have approved a conversion plan whereby the IIBU purchases the property from a client for a sum sufficient to repay the cur rent loan plus certain costs and expenses, with the bank's payment being repaid over a period of years by the client. The bank's profit is derived from the rent the client pays over under the ijara wa-Iqtina hire purchase scheme.

Fund Management Possibilities

London is the major European centre for fund management, both for funds listed onshore and offshore funds listed in the Channel Islands, Dublin, Luxembourg and other centers. There are seven Islamic funds that are promoted in the Muslim world but managed from London and four that are both promoted and managed from London. All of these are designed for clients in Saudi Arabia and the Gulf, with the prices denominated in dollars and the funds administered from offshore tax havens. The HSBC Amanah Global Equity Fund is typical of these offerings, being listed in Luxembourg and managed to provide exposure to leading companies worldwide with a particular focus on major multinationals whose primary listing is in New York.

There have been mixed fortunes for Islamic funds managed from London with Kleinwort Bensons' Islamic Fund, the first to be established in 1986, being wound up in 1989 because of poor subscriptions. Flemings Oasis Fund was launched with great promise back in 1996, but was liquidated in 2000 following the take-over by Chase of Flemings. The Institutional Investor of Kuwait, which managed the Ibn Majeed Fund that was listed in Dublin, decided to close its London office in 2000 and focus its operations in the Gulf.

The only sterling denominated fund was the Halal Mutual, also listed in Dublin, and managed by the Gulf based Al Tadamon Group. It was designed to provide income from commodity trading rather than equity investment, the price being fixed at £250, but with the income dependent on trading profits, which in practice was always around 3.6 to 3.8 percent gross, a very modest return.

None of these funds is of much interest to the British Muslim community, who as United Kingdom residents has potential tax liabilities on both income and capital gains, and therefore cannot take advantage of offshore funds. For local Muslims what is required is an Islamic fund that can qualify for tax exemptions under the Individual Savings Account (ISA) scheme. This provides for exemption from capital gains and income tax for up to £7,000 invested in any tax year for qualifying funds in a maxi ISA. This has proved popular with and ethical and ecological investors, with funds such as the Friends Provident Stewardship and the Jupiter Merlin Ecology qualifying for this status. Similar on shore funds that complied with the Shariah law could potentially appeal to British Muslim investors if a major fund management group was willing to take the initiative.

Conclusion

Although London has emerged as the major western centre for Islamic finance so far it has failed to serve the United Kingdom Muslim community. The major retail banks and fund management institutions seem reluctant to take the initiative by promoting shariah compliant products for the local market. Whether the new on-line financial services groups such as ii-online.com or ihilal.com break into this market remains to be seen, but this may be one way forward.
