



Department  
for Business  
Innovation & Skills

SHARIAH-COMPLIANT  
STUDENT FINANCE

Consultation on a Sharia-  
compliant alternative finance  
product

APRIL 2014

# Contents

<b>Contents</b> .....	<b>2</b>
<b>A Sharia-compliant alternative finance product for students</b> .....	<b>3</b>
1. Foreword from the Minister for Universities and Science .....	4
2. Executive Summary .....	5
3. How to respond .....	6
4. Additional copies .....	6
5. Confidentiality & Data Protection .....	7
6. Help with queries .....	7
7. The proposals .....	7
8. Consultation questions .....	15
9. What happens next? .....	16
Annex 1: Consultation principles .....	17
Comments or complaints on the conduct of this consultation .....	17
Annex 2: List of Individuals/Organisations consulted .....	18
Annex 3: A Sharia-compliant alternative finance product for student response form .....	19
Question 1 (refer to relevant para numbers in consultation document) .....	20
Questions 2 .....	21
Questions 3 .....	21
Questions 4 .....	21
Questions 5 .....	21
Questions 6 .....	22

# A Sharia-compliant alternative finance product for students

The Government's reforms of Higher Education came into effect in September 2012, and resulted in changes to the student loan system. Stakeholders have raised concerns that these changes to student loans may have resulted in some religious groups, such as members of the Islamic faith, being unwilling to take out student loans to access the benefits of Higher Education.

The Department for Business, Innovation and Skills (BIS) has been developing a model alternative finance product which would be Sharia-compliant and could potentially be offered alongside traditional loans to students wishing to attend higher education. This model finance product has been developed by experts in Sharia-compliant finance and has received preliminary approval from the Islamic Bank of Britain's Sharia supervisory committee. As part of the development process the Government are seeking opinions from the Muslim community, and the wider public, on the acceptability of the alternative finance product that is being considered.

The Government wish to know whether the model product addresses potential concerns around the charging of real interest rates on student loans, and the extent of the demand for such an alternative finance product among students and Muslim communities as a whole.

Issued: 03/04/2014

Respond by: **12/06/2014**

Enquiries to: Sarah Webb, Higher Education Alternative Finance Team, 2<sup>nd</sup> floor, Abbey 1, 1 Victoria Street, London SW1H 0ET.

Tel: 02072155545

[He.consultation@bis.qsi.gov.uk](mailto:He.consultation@bis.qsi.gov.uk)

This consultation is relevant to: Current and future students, members of religious communities, Higher Education Institutions

## 1. Foreword from the Minister for Universities and Science

This Government is committed to ensure that young people can access all the opportunities available to them. As such we have already announced the creation of a type of Start-Up Loan that is consistent with the principles of Islamic finance while being equitable for other participants in the scheme. We are now looking to examine whether there is a Sharia-compliant alternative to the conventional student loans.

Our Higher Education reforms introduced in 2012 are contributing to maintaining the quality of education and bringing more money into universities. Although there has been a fee increase and the introduction of a real rate of interest to enable higher education to remain sustainable, many graduates will pay back for longer, their monthly outgoings will be less. It is not a commercial loan. No first-time undergraduate student has to pay upfront fees. Students from lower-income households continue to receive support through the student loans and grant system.

There is a concern that some Muslims and member of other faiths may be deterred from taking out a loan due to the interest. We have been exploring the possibility of an alternative finance system that is not interest based but results in identical repayments to the conventional system.

This consultation seeks to determine whether the alternative finance model identified would be acceptable to anyone who might be deterred from the conventional system.

## 2. Executive Summary

In September 2012 changes to higher education funding mean that students are able to take out student loans for tuition of up to £9000 for each year of study. These post-2012 loans carry a different rate of interest, above inflation, to student loans issued before September 2012.

Some students, whose religious beliefs may forbid the taking out of a loan that bears interest, may be unable to take advantage of student loans because of this change. This could make it more difficult for them to benefit from higher education.

The Government have been exploring the possibility of making an alternative student finance product available. This finance product would be Sharia-compliant and overseen by a Sharia advisory committee.

Any such alternative finance product would not result in a student being in any way disadvantaged or advantaged over a student who took out a traditional student loan. Both the size of the finance and the repayment amounts would be equivalent between the two systems. The model of the proposed product could be applied for in the same way as a traditional loan: through the Student Loans Company (SLC).

The Government is seeking feedback from current and prospective students as well as members of the public, community representatives and higher education providers on an alternative student finance product which has been developed by experts in Sharia-compliant finance.

The Government wishes to know if the finance product outlined in this consultation would meet the needs of students who believed that a traditional student loan was incompatible with their beliefs. The Government particularly want to hear from Muslims about the acceptability of the finance product, since it is important that any Sharia-compliant finance product is transparent, understandable and acceptable to the majority of students who might wish to apply for a finance of this type.

The consultation will run for 12 weeks and will offer respondents an opportunity to provide feedback on the questions posed by the Government. The Government have already approached many stakeholders interested in the development of alternative finance and will continue to engage with them as part of the consultation process.

Responses will be used by the Government to gauge the level of demand for Sharia-compliant alternative student finance (in combination with other research that BIS has carried out). The Government will also use feedback on the proposed finance product to determine if this would be a product that would meet the needs of Muslim, and other, students and if it would be acceptable to the Muslim community at large.

After the consultation the Government will use the feedback provided by respondents, in conjunction with other evidence, to decide if the alternative finance product is acceptable. If the finance product is acceptable, the Government will begin to explore how this product might be made available through the Student Loans Company in a Sharia-compliant way.

### 3. How to respond

When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation form and, where applicable, how the views of members were assembled.

You can reply to this Consultation online at  
<https://www.surveymonkey.com/s/studentfinanceconsultation>

Consultation opened on 03/04/2014

Last date for responses is: **12/06/2014**

The Consultation Response form is available electronically at  
<https://www.gov.uk/government/consultations/sharia-compliant-student-finance> (until the consultation closes). The form can be submitted online/by email or letter to:

Sarah Webb  
Alternative Finance Team  
Higher Education Directorate  
2<sup>nd</sup> floor, Abbey 1  
Department for Business, Innovation and Skills  
1 Victoria Street  
London  
SW1H 0ET

A list of those organisations and individuals consulted is in Annex 2. We would welcome suggestions of others who may wish to be involved in this consultation process.

### 4. Additional copies

You may make printed copies of this document without seeking permission.

The standard electronic version is at :

<https://www.gov.uk/government/consultations/sharia-compliant-student-finance>

Other versions of the document in Braille, other languages or audio-cassette are available on request.

## 5. Confidentiality & Data Protection

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

## 6. Help with queries

Questions about the policy issues raised in the document can be addressed to:

Sarah Webb  
Alternative Finance Team  
Higher Education Directorate  
2<sup>nd</sup> floor, Abbey 1  
Department for Business, Innovation and Skills  
1 Victoria Street  
London  
SW1H 0ET

The consultation principles are set out in Annex 1.

## 7. The proposals

### The existing student loans system

As part of the Government's reforms of Higher Education from September 2012 Higher Education institutions may now charge tuition fees of up to £9000.

Eligible Higher Education students starting their studies after September 2012 can take out loans of up to £9000 to cover their tuition fees and up to £4375 for their maintenance costs. They may do this for every year of their course. While they are studying the loan carries an

interest rate of the Retail Price Index (RPI) + 3%.<sup>1</sup> After graduation, when borrowers reach their statutory repayment due date, the interest rate is based on their income and will be between RPI and RPI + 3%. For those living in the UK repayments are made through the UK tax system, managed by HMRC.

Repayment amounts for student loans are based on earnings and not on what was borrowed. Repayments are normally collected automatically through the tax system once the student has finished their course and is earning more than the threshold, which is £21,000. Repayments are made at a rate of 9% of any yearly income over £21,000 (or weekly/monthly equivalent). If the borrower's income drops below £21,000 then repayments stop for this period.

This differs to the pre-2012 student loan system. Under this older system students could take out a maximum tuition fee loan of around £3000 every year. Interest is charged at rate of RPI or 1% above the highest Base Rate of a nominated group of banks, whichever was lower. Repayments are also made at a rate of 9% of any yearly income above a threshold but the threshold was lower for these types of loan, and is currently £16,365.

The Government believes that most students are currently willing to take out student loans from the Student Loans Company to benefit from Higher Education. However, student loans issued after September 2012 bear a real rate of interest above inflation and concerns have been raised that some religious groups, particularly Muslims, may feel that the charging of such an interest rate is incompatible with their beliefs.

In addition, some stakeholders have suggested that Muslim students were able to borrow from family members to cover the cost of tuition and maintenance fees before 2012, but that the increase in tuition fees in 2012 has meant that families are no longer able to cover the entire cost of higher education.

It is possible that some Muslim students, who are unwilling to take out an interest bearing loan from the Student Loans Company, may be deterred from entering higher education because of their inability to fund higher education through a loan. The Government has some evidence to suggest that this may be the case.

**Q1: To what extent, if any, are you aware that students with religious objections to the charging of interest have been affected by the changes in tuition fees and student loans? Please illustrate your answer with any specific examples you may have**

- 
- <sup>1</sup> Her Majesty's Revenue and Customs (HMRC), who collect the repayments through the taxation system, are unable to take repayments under the new system before April 2016. Some borrowers who are on short courses or who leave their course early will be due to repay before that date. Those borrowers will be charged interest at RPI + 3% until the April after they leave their course; RPI only between that date and April 2016; and the appropriate rate of variable interest from April 2016.



## Islamic Finance

Islamic finance is a model of financial activity that operates in accordance with the principles of Sharia law, the religious code of the Islamic faith. The charging of interest (Riba) is forbidden (Harām) under Sharia law. This has led to the development of financial institutions and services which specialise in providing Sharia-compliant financial products. This allows those who feel that traditional financial services are incompatible with their beliefs to take advantage of a diverse range of financial products such as personal and business finance, mortgages or insurance in accordance with the principles of Sharia law.

Islamic financial institutions have existed in the UK for over 30 years and are growing rapidly worldwide. Currently 22 banks in the UK offer Sharia-compliant services and there are five banks which offer exclusively Sharia-compliant products. Each has been authorised by the UK Financial Services Authority<sup>2</sup>.

Since 2011, the Government has been working with experts in Sharia-compliant finance to develop a model alternative student finance product based on the principles of Islamic finance, which would be compliant with Sharia law. This finance product could potentially be offered alongside traditional loans to students entering higher education who wished to take out a student finance that was Sharia-compliant.

The Government believes that it is important to ensure that any alternative student finance product would be acceptable to the majority of the UK's Muslim community and to others who may wish to take advantage of this type of finance.

**Q2: Do you believe that there would be demand among students and potential students for an alternative finance product which was Sharia-compliant?**

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<sup>2</sup>On 1 April 2013, the Prudential Regulation Authority (PRA) became responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

## Choosing a Sharia-compliant finance product

The Government has evaluated five potential ways of providing alternative finance products to higher education students. These were each based on financial structures already used in Islamic finance.

The Government evaluated the suitability of these products based on their ability to meet the key objectives that the Government believes that a Sharia-compliant student finance needs to achieve. These criteria were that:

Repayments after graduation and debt levels must be identical to that of a traditional loan, so that students who chose the alternative finance product would be in no worse or better position than those who took out a traditional loan.

Making repayments should be as easy for students who chose the alternative finance product as it is for those students with traditional loans, therefore it should be possible for repayments to be made directly through the UK tax system.

The alternative finance product must be applied for in the same way as a traditional loan, through the Student Loans Company, to ensure that no extra burden be imposed upon the student.

The finance product should be transparent in its workings and easy for potential students to understand.

Using these objectives, the Government has worked with experts in Islamic Finance to select one potential finance product which could meet all of these key criteria. The finance product the Government has identified is based on the 'Takaful' structure used in Islamic finance to allow groups of people to cooperate to provide mutual finance assistance to members of the group. This type of mutual fund model is familiar to Sharia scholars and many UK Muslim families, who use a similar concept to raise funds between cooperating relatives.

This model of student finance product was proposed and developed by experts in Islamic finance and has been approved by the Sharia Supervisory Committee of the Islamic Bank of Britain.

The model's underlying principle is one of communal interest and transparent sharing of benefit and obligation, with the repayments of students participating in the fund being used to provide finance to future students who select to join the fund. This ensures that all members of the fund benefit equally from it.

Students participating in the fund would not be borrowing money and paying it back with interest to a third party, which would not be compliant with Sharia law. Instead, the Takaful fund will be established with an initial amount of money that can be donated to the fund or on the basis of Qard Hasan (interest-free loan) and based on a concept of mutual participation and guarantee.

Students will obtain finance from the fund by applying in a similar manner to the conventional loan. The contract will be based upon a unilateral promise guaranteeing that they will repay a Takaful contribution - which is perceived as a charitable contribution from a

Sharia perspective for the benefit of the members of the fund. Monies will be released once the contract is signed. Repayment will be made to the fund once they are in employment and earning above the repayment threshold, which would be set at the same level as for traditional student loans.

The contribution paid back into the fund by the student would help future students benefit from the fund, allowing them to complete their studies as the original student did. The mutual basis of this structure, with members (borrowers) of the fund helping each other attend higher education, makes this model acceptable under Sharia-law. This is because the lending/borrowing relationship which results in a payment of interest by the students to the SLC does not exist in this model.

The student finance fund, i.e. the Takaful fund, is managed by a fund manager under the Islamic finance principle of *Wakala* (agency) for a specified fee (in this case the SLC). The fund is completely segregated from the traditional student loans to ensure full compliance with Shariah in the whole cycle of the fund.

## The finance product under consideration

The alternative student finance product that the Government has selected would function as follows;

A student wishing to take out alternative student finance for either tuition or maintenance would apply to the SLC, indicating that they wished to take out the alternative finance product. This would be done in the same manner as a traditional student loan, with the student selecting which product they wished to apply for at the point of application.

The student would sign a Sharia-compliant contract fully explaining the details of the alternative finance and the repayment terms. The terms of participation in the fund would be detailed in the contract so that the student was fully aware of the terms of the finance upfront, eliminating financial uncertainty in accordance with the principles of Sharia law.

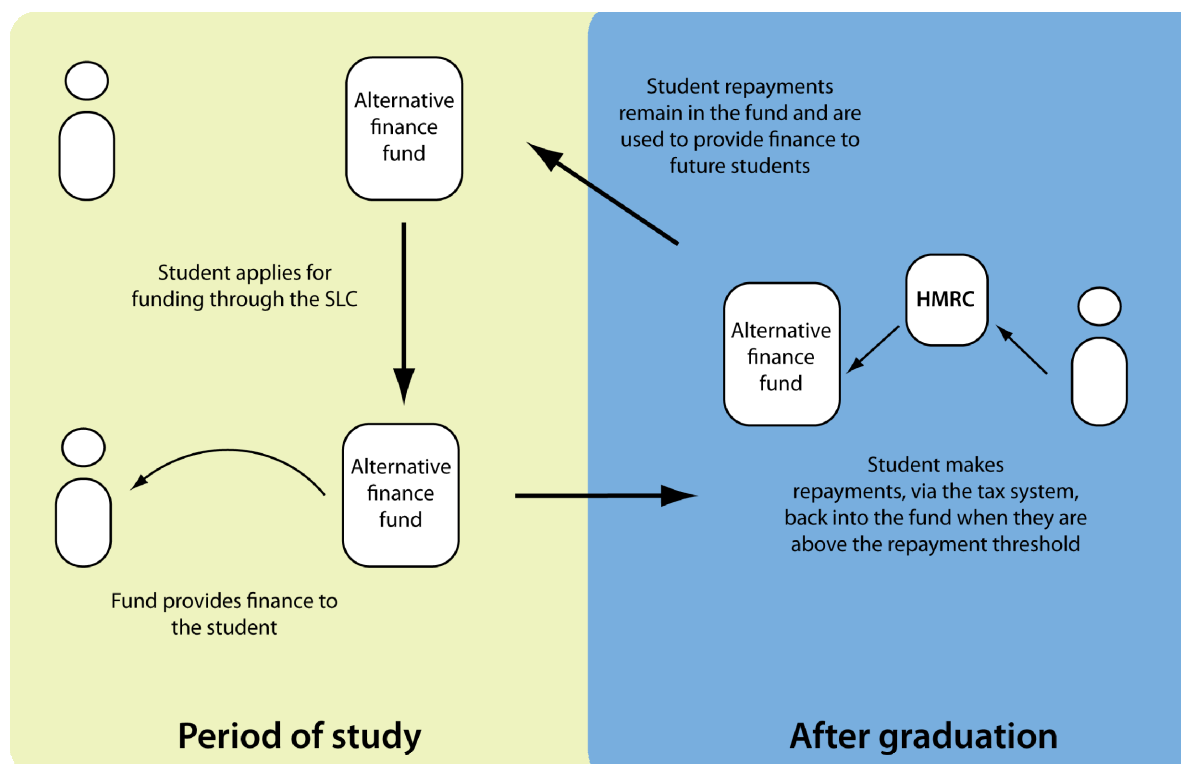
A special alternative finance fund managed by the SLC, and overseen by a Sharia supervisory board, would provide the alternative finance to the student through their higher education institution. This would continue each year while the student studied.

After the student graduated they would begin to make repayments back into the fund once they were in employment and earning over the repayment threshold. These repayments would be equal to those that would have been made if the student had taken out a traditional loan. They would be collected in the same way as repayments for a traditional loan, through the tax system.

Under the terms of the alternative finance product the amount owed to the fund by the student would increase by the same amount over time as for a traditional loan. However, no rate of interest would be applied to the student's obligation to the fund. The principles of Sharia law recognise the value of money over time. Given the long period over which most students would make repayments into the fund, the total contribution they would be obligated to make would be based on a benchmark. This benchmark would be set relative to the traditional loan system and would ensure that students who made use of either the alternative finance product or traditional loans would be treated the same.

The repayments of students who selected the alternative finance product would not be treated in the same way as repayments from a traditional loan. Rather, repayments would be returned to the fund and would be used to provide future finance to new students who wished to take out an alternative finance product.

The money within the alternative finance fund would be ring-fenced and would only be used to provide alternative finance to other students. The money held within the fund would be treated in a Sharia-compliant manner and would not have interest charged upon it while it remained in the fund. A Sharia supervisory committee employed by the SLC would audit the fund at regular intervals to ensure that Sharia-compliance was being maintained.



The Government have worked closely with experts in Islamic finance to develop this alternative student finance product. The evidence gathered by BIS so far suggests that it will provide an acceptable way to provide Sharia-compliant finance to students who may be interested in taking out a finance product of this type.

Were this alternative finance product to be made available, a Sharia supervisory committee would oversee the operation of the fund and ensure that it was operating in a Sharia-compliant manner. The committee would provide an annual report on the operation of the fund to provide assurance to students that it was in compliance.

**Q3: Do you believe that students will be provided with sufficient assurance by a Sharia supervisory committee as to the Sharia-compliance of an alternative student finance product?**

The Government are seeking the opinions of the public on the alternative student finance product we are proposing. In particular, the Government are interested in the views of those who feel that they might take advantage of such finance were it to be offered through the Student Loans Company.

**Q4: Do you believe that students and potential students whose faith has resulted in concerns about the interest rate on traditional loans would find this alternative finance product acceptable? Please provide an explanation for your answer.**

**Q5: Do you believe that the working of the proposed alternative finance product would be understandable to those applying for a loan?**

**Q6: Do you believe it will be clear to students why this alternative finance product is Sharia-compliant? If not please provide an explanation.**

## 8. Consultation questions

Q1: To what extent, if any, are you aware that students with religious objections to the charging of interest have been affected by the changes in to tuition fees and student loans? Please illustrate your answer with any specific examples you may have.

Q2: Do you believe that there would be demand among students and potential students for an alternative finance product which was Sharia-compliant?

Q3: Do you believe that students will be satisfied with the opinion of a Sharia advisory committee as to the Sharia-compliance of an alternative finance product?

Q4: Do you believe that students whose faith has resulted in concerns about the interest rate on traditional loans would find this alternative finance product acceptable? If not please provide an explanation.

Q5: Do you believe that the working of the proposed alternative finance product would be understandable to students?

Q6: Do you believe it will be clear to students why this alternative finance product is Sharia-compliant? If not please provide an explanation.

## 9. What happens next?

The Government will publish a response to this consultation within 3 months of the close of the consultation.

The Government have not yet examined the feasibility of making the alternative student finance product being consulted on available through the Student Loans Company. If the feedback received from respondents to this consultation indicates that the student finance product being proposed meets the needs of students concerned about the charging of interest, the Government will begin to examine what may be required to allow this product to be offered to students through the Student Loans Company.



## Annex 1: Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

<http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf>

### Comments or complaints on the conduct of this consultation

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

John Conway,  
BIS Consultation Co-ordinator,  
1 Victoria Street,  
London  
SW1H 0ET

Telephone John on 020 7215 6402  
or e-mail to: [john.conway@bis.gsi.gov.uk](mailto:john.conway@bis.gsi.gov.uk)

However if you wish to comment on the specific policy proposals you should contact the policy lead (see section 6).

## **Annex 2: List of Individuals/Organisations consulted**

NUS

FOSIS

Islamic Bank of Britain

1st Ethical Charitable Trust.

Al Qalam Shariah panel

City UK Islamic Finance Secretariat

Islamic Finance Council UK

Professor Mohammed Abdel-Haq - Centre for Islamic Finance, University of Bolton

Bank of London and the Middle East

IFAAS



## Department for Business, Innovation & Skills

### Annex 3: A Sharia-compliant alternative finance product for student response form

You may find it helpful to facilitate responses to hard-copy format consultations. Under each question number a different example of setting out a request for a response is shown – you can decide which are useful to your consultation.

You should still use web response form and point users to this first. Say clearly if the web version is fully interactive or downloadable and include the web address with this response form. You should make the hard copy response form as similar as possible to the web response form.

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

The closing date for this consultation is **12/06/2014**

Name:

Organisation (if applicable):

Address:

Please return completed forms to:

Alternative Finance Team

Higher Education Directorate

2<sup>nd</sup> floor, Abbey 1

Department for Business, Innovation and Skills

1 Victoria Street

London

SW1H 0ET

Telephone: 02072155545

Email: [he.consultation@bis.gsi.gov.uk](mailto:he.consultation@bis.gsi.gov.uk)

	Advisory/consultancy
	Academia
	Business representative organisation/trade body
	Central government
	Charity or social enterprise
	Individual
	Large business (over 250 staff)
	Legal representative
	Local Government
	Medium business (50 to 250 staff)
	Micro business (up to 9 staff)
	Small business (10 to 49 staff)
	Trade union or staff association
	Other (please describe)

Questionnaires need careful design so as not to encourage a biased response (contact the Operational Research Unit in the Strategy Unit for help and information). Responses in other forms and on different but relevant questions should always be accepted. A mix of open and closed questions seems to work well and the sample questionnaire provided uses a selection of different approaches to question setting, all of which have been effective. The use of tick-boxes enables teams to gauge the strength of feeling behind proposals and present quantitative analysis. However, space for comments should always be added, whether questions are open or closed, offering respondents the opportunity to qualify their choices. Issues arising in narrative should form the framework for qualitative analysis of responses. This draft questionnaire is intended as a “pull out” design as part of a consultation document.

### Question 1 (refer to relevant paragraph numbers in consultation document)

**To what extent, if any, are you aware that students with religious objections to the charging of interest have been affected by the changes in tuition fees and student loans? Please illustrate your answer with any specific examples you may have**

No impact       some impact       large impact       Not sure

Comments:

## Questions 2

**Do you believe that there would be demand among students and potential students for an alternative finance product which was Sharia-compliant?**

Yes       No       Not sure

Comments:

## Questions 3

**Q3: Do you believe that students will be satisfied with the opinion of a Sharia advisory committee as to the Sharia-compliance of an alternative finance product?**

Yes       No       Not sure

Comments:

## Questions 4

**Q4: Do you believe that students whose faith has resulted in concerns about the interest rate on traditional loans would find this alternative finance product acceptable? If not please provide an explanation.**

Yes       No       Not sure

Comments

## Questions 5

**Q5: Do you believe that the working of the proposed alternative finance product would be understandable to students?**

Yes       No       Not sure

Comments:

## Questions 6

**Q6: Do you believe it will be clear to students why this alternative finance product is Sharia-compliant? If not please provide an explanation**

Yes       No       Not sure

Comments:

**Do you have any other comments that might aid the consultation process as a whole?**

Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

Thank you for your views on this consultation.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

Yes       No

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This publication is also available on our website at [www.gov.uk/bis](http://www.gov.uk/bis)

Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills  
1 Victoria Street  
London SW1H 0ET  
Tel: 020 7215 5000

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