HE pension schemes & Sharia compliance

Executive summary

This briefing note is designed to assist HE Institutions (HEIs) in circumstances where Muslim members of staff raise concerns about their pension provision and Sharia compliance. The note relies heavily on expert advice received by the Scheme Advisory Board (SAB) in respect of the Local Government Pension Scheme (LGPS) and the views expressed by the writer of the advice as well as Counsel opinion[1].

It is important to note that there are differing opinions among Muslim legal experts about how Sharia law applies to defined benefit (DB) schemes and this in turn will mean that individual members of staff will also have differing views and concerns, for example some may be happy to join or remain in a DB scheme, while others may not be.

Where an employee raises concerns about pension provision and Sharia compliance, it is recommended that the HEI speaks to the individual to understand their particular concerns and to ascertain whether a suitable alternative pension offering is available and whether the member of staff would like to join that scheme, for example, a defined contribution (DC) arrangement with a Sharia-compliant fund option.

Principles governing Sharia-compliant saving and investing

Sharia refers to a set of religious principles that are an important part of Islamic tradition for many Muslims. Anything discouraged or banned by Sharia law is regarded as haram, while suitable activities are halal.

The key principles of the Sharia which apply to Islamic finance are: the giving and taking of interest (riba) is prohibited; there is a prohibition on uncertainty (gharar) and speculation (maysir); and the underlying asset or investment must be acceptable.

One of the issues with a DB pension scheme in relation to Sharia compliance is that the member is not directly responsible for the investment of the scheme's assets. Generally, in a DB scheme the Trustee or scheme manager invests in shares, investment funds and bonds based on the need to grow the value of the assets over time in order to provide pensions to members.

Considerations for employers and trustees

The issue of Sharia compliance and wider issues of ethical pensions investments may be raised by Muslim staff as they wish their pension scheme to be fully compliant with their religious beliefs. There are differing opinions among Muslim legal experts about how Sharia law applies to DB schemes.

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[1] https://lgpsboard.org/index.php/board-publications/legal-opinions

While the legal opinion referred to below was provided specifically in relation to the LGPS, any employer with an open DB scheme should take note. Briefly, Counsel concluded:

- Discrimination claims are extremely sensitive to the individual facts and circumstances of the case. However, in principle, if a Muslim employee demonstrated they opted-out as they considered that the available pension arrangement was not Sharia compliant, the employer would have to establish that only offering a non-Sharia-compliant scheme was a 'proportionate means of achieving a legitimate aim' in order to defend against such a claim.
- Employers in the LGPS do have the ability to offer an alternative pension scheme and may wish to consider doing so in order to meet the needs of Muslim staff. If an employer decided to offer a Sharia-compliant alternative, it would need to be available to all employees. There may also be issues regarding the outcome of a DC arrangement not being the same as the DB scheme, even if the employer contribution is the same.
- It is possible that other groups of employees might seek that their own religious or other strongly held beliefs are considered by the pension scheme. For example, in the HE schemes there have been member complaints about fossil fuel investments. This may be countered by having robust policies on ESG and ethical investment.
- The wider impact on the scheme is a legitimate consideration for employers. For example, if the level of opt-outs of Muslim members was such that it impacted on the fund's liquidity and cash flows to the extent that contributions no longer meet monthly pension payments.

While a definitive legal view could not be provided in the absence of a specific claim, employers and trustees may wish to consider their response to queries from staff and also how they might influence their fund to consider these aspects (alongside other factors) when setting their investment strategy. This is something which can assist in enabling employers to increase engagement with Muslim staff and also to reduce the risk of potential discrimination cases being raised (as religion is a protected characteristic), for example, if a Muslim member of staff feels compelled to opt-out of the scheme.

Sharia compliance and the Local Government Pension Scheme (LGPS)
Some LGPS employers raised concerns about opt-out rates among Muslim employees and the risk of discrimination claims against an LGPS fund or its employers. Therefore, the Scheme Advisory Board (SAB) sought Counsel's opinion – not specifically on whether the LGPS is Sharia compliant, but whether employers have an obligation to offer a Sharia-compliant alternative and whether by not doing so they might face successful discrimination complaints.

The LGPS SAB then commissioned advice from an Islamic finance expert on Sharia compliance and the LGPS. The report that was produced primarily focuses from the starting point that a statutory DB scheme such as the LGPS is deemed to be an extension of the employer/employee contract and concluded that as a part of the contractual arrangement between employer and employees, Muslim employees can continue to contribute to, and benefit from membership of the LGPS.

It was acknowledged that the pension benefits payable to LGPS members on their retirement could be considered deferred salaries arising from the debt obligation placed on the employer when contributions are paid into the fund, where employees are owed a debt by their employer in the form of salary and pension contributions.

The report outlines how the principle of risk transfer is pivotal when considering ownership in Sharia law. In the LGPS the investment risk lies with scheme employers and legal ownership of the funds rests with the administering authority and not the employee. Consequently, LGPS members do not own the underlying investment assets. This effectively isolates members from the investment activities carried out within the funds.

Furthermore, the money to pay pensions is largely derived from employer and employee contributions, which ultimately come from local government funding or private-sector revenue (which are Sharia compliant), and from investment income. While not bearing the responsibility for, or risk of, the investment choices made by funds, the report highlights that Muslim (and indeed all scheme members) have a legitimate interest in fund investments and whether these can be made in accordance with their moral and religious beliefs.

The report then moves on to advise that LGPS funds contain asset classes and investments that would not be deemed acceptable under Sharia law and that Muslim members would feel uncomfortable in the long-term knowing that contributions are being made in investments that do not align with their ethical principles and values. The LGPS is therefore encouraged to develop a Sharia-compliant fund or segregated asset allocation in the funds.

The SAB who commissioned the report concluded that it has no ability to implement directly any recommendations made in the report and that it can only make recommendations to the Minister who is responsible for the rules of the LGPS.

Following receipt of this report, the Counsel's opinion on the potential for legal claims that LGPS employers indirectly discriminate against Muslim employees was updated. The advice concluded that the legal risk of a case being successfully brought against a scheme employer in an Employment Tribunal on the basis of indirect discrimination, or a judicial review being brought against an administering

authority or government for breach of the public sector equality duty, remains extremely low.

It should be noted that while the advice the SAB received concluded Muslim employees can be in the LGPS, some members may disagree and opt-out. As such, any claim of group disadvantage "would apply only to an unknown (and possibly quite small) subset of people of the Muslim faith".

In principle there is an obligation to consider the possibility of providing an alternative to the LGPS for employees who opt-out on the basis of a protected characteristic, but this was "subject to various legal constraints and carries various potential legal and practical consequences and risks".

Within HE, members of staff opting out of LGPS for any reason, including religious beliefs, may already have access to an alternative DC arrangement at their institution with investment options that better meet with an individual's morals and beliefs. We are also aware that many employers that do not currently offer a DC scheme alongside LGPS are considering this as an option for staff.

Universities Superannuation Scheme (USS)
The USS is a hybrid DB/DC scheme which includes an "exclusivity rule" which means that once an employer commences participation they can only contribute to USS on behalf of eligible employees and not to any other pension scheme[2].

If the same broad principles outlined in the advice received in respect of the LGPS are deemed by a Muslim member to apply to USS, for example, the scheme is seen as an extension of the employer/employee contract by the member,[3] and pension benefits payable to USS members on their retirement are deemed to be deferred salaries where the investment risk and legal ownership of the funds rests with the USS Trustee Board, Muslim members may be happy to join the scheme. However, we acknowledge that the definition of a pension being "deferred pay" is not always aligned to the employer's view.

It should also be noted that the asset allocation and investment strategy within the DB section (Retirement Income Builder) is not Sharia compliant. This is similar to the position in the LGPS and again Muslim members may determine that they do not wish to enrol in USS.

It should also be noted that the DC (Investment Builder) contains a Sharia-compliant investment option. However, at present members cannot choose to just join the

[2] There are examples where this does not apply e.g. clinical academics and the NHSPS
[3] It is important to note that neither the USS Trustee nor UCEA are asserting that USS scheme benefits are an extension of the employer/employee contract

Investment Builder only; there is no right, for example, for an individual eligible for USS to only join the Investment Builder section. Furthermore, the exclusivity rule would prevent the employer from 'establishing, maintaining or contributing to' an alternative scheme for eligible employees.

Research conducted in 2022 when USS commissioned an Insights Survey where options around lower cost pension saving were being considered surveyed 1,700 individuals who were not members of USS to ask them why. Of the 1,700 responses a total of 11 cited "Sharia / Ethical concerns". While this category mixed Sharia issues with the much wider 'ethical' label it perhaps gives an idea of the very small proportion of USS members who – at least in this survey - raised Sharia compliance as a barrier to their participation. But this issue has been raised as part of the discussions on the potential for a low-cost/flexible option within USS.

Superannuation Arrangements for the University of London (SAUL) and Self-Administered Trusts (SATs)

SAUL is a hybrid DB/DC scheme. Again, if the same broad principles outlined in the advice to the LGPS SAB are deemed to apply to SAUL, noting the investment risk and legal ownership of the funds rests with the SAUL Trustee Board, Muslim members may be happy to join the scheme[4] noting that the asset allocation and investment strategy within the main DB section is not be Sharia compliant.

The set-up of SAUL is different to USS in that all new scheme members join the DC section (SAUL Start) for a period of three years. Within SAUL Start there is a Sharia-compliant investment option. After three years members of SAUL Start can choose to join the main SAUL DB scheme or can remain in SAUL Start. This potentially addresses issues with Sharia compliance within that scheme.

In addition to SAUL there are a number of DB SATs operated by pre-92 HEIs. It is likely to be more straightforward to address any Sharia pension issues for HEIs with their own SAT particularly as many of these are closed to new joiners and an alternative DC arrangement is offered where a Sharia compliant investment option can be incorporated.

NHS Pension Scheme & Teachers' Pension Scheme

Both the NHSPS and TPS are unfunded public service schemes that rely on employer and employee contributions plus any incoming transfer receipts to offset any payments that are made from each scheme e.g. pension commencement lump sums, repayments, cash transfer sums and pensions in payment. The shortfall in the income received by each scheme is compared with expenditure and any shortfall is made good by the Exchequer.

[4] It is important to note that neither the SAUL Trustee or UCEA are asserting that SAUL scheme benefits are an extension of the employer/employee contract

If the same broad principles outlined in the advice received in respect of the LGPS are applied in respect of the unfunded NHSPS and TPS where each scheme is deemed by the individual member to be an extension of the employer/employee contract, that pension benefits payable to scheme members on their retirement are deferred salaries Muslim members may be happy to join either scheme in particular noting that there are no assets or investments within either the NHSPS or TPS. It should, however, be noted that Money Purchase Additional Voluntary Contributions (AVCs) within both the NHSPS and TPS may not offer an appropriate Sharia-compliant investment option.

DC pension arrangements

The main DC providers, including auto-enrolment solutions such as NEST, NOW:Pensions and the People's Pensions alongside traditional insurers including L&G, Aviva, Standard Life and Scottish Widows offer access to Sharia-compliant investment options. It would be advisable to review DC pension scheme(s) investment choices to ensure that a Sharia-compliant fund option is made available where appropriate.

As part of the work to set up a new sector-wide DC scheme, one of the key criteria for the arrangement includes the availability of a Sharia-compliant investment option.

State pensions

For completeness, we felt it useful to confirm that the State Pension is considered Sharia compliant as all workers are required to pay their National Insurance contributions which then count towards the qualifying years required to be entitled to the State pension from the government at State Pension Age rather than the funds being invested on their behalf.

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