

Islamic financial services in Canada: Recent developments and long-term prospects

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AT A GLANCE

The Canadian Financial and Economic Environment

Activity to date

Prospects for the future

As in many Western nations, the awareness and availability of Islamic financial services in Canada continue to grow, although still at a relatively modest rate. While some limited Shari'ah-compliant products are currently available, there has been limited activity to date, and no major financial institution yet offers a meaningful suite of Islamic financial products or services. However, given the burgeoning Islamic population in Canada, the growing potential for Islamic financial services in Canada is being carefully followed by Canadian financial institutions, regulators, government agencies, professional advisors and media outlets. For additional background on Islamic finance, please see Stikeman Elliott's *Financial Services Updates* of May 2007 and January 2008.

Much like in the United Kingdom, Canada's Muslim population has experienced significant recent growth – from an estimated 253,000 in 1991 to between 800,000 and 1,000,000 in 2006. By 2017, Muslim Canadians are expected to comprise from 3.7% to 4.9% of the Canadian population. Moreover, the Muslim population, which is younger and more educated than the overall population, is concentrated in Canada's largest cities. Consequently, there is expected to be increased demand for Islamic financial services in Canada in the coming years, potentially providing a tremendous opportunity for financial firms prepared to serve this growing community.

The Canadian financial and economic environment

A number of other factors may also support the growth of Islamic finance in Canada in the longer term. Canada continues to enjoy a relatively stable economic and political environment and has generally avoided the level of turmoil currently being experienced in the United States with respect to subprime lending and restricted credit availability issues. Further, a world-class regulator, the federal Office of the Superintendent of Financial Institutions (Canada) (OSFI), regulates the solvency of most of the larger financial institutions, including the large banks and life insurance groups, while also regulating the market conduct of the large banks. Canada also benefits from a strongly multicultural and tolerant society, a rapidly appreciating currency, robust regulatory and legal systems, a neutral and balanced foreign policy and favourable tax treaties with certain Gulf states.

Activity to date

Despite significant recent media coverage of issues related to Islamic financial services in Canada, there has been limited meaningful activity to

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date. As previously widely reported, an Ontario-based Islamic mortgage provider, UM Financial, has been indicating for some time that it expects to launch a suite of products in collaboration with a major Canadian financial institution. No further announcements in this regard, however, have recently been made. One of the large banks offers Shari'ah-linked notes through its private banking division and in 2004 offered a similar retail investment product through its branches. The Co-operators mutual insurance group, meanwhile, offers certain limited Islamic insurance products, and Islamic mutual funds have also been sold across Canada. Many of the products, however, have been short-lived, including a group of funds, offered through a leading mutual fund group, which were discontinued in 2006 with only C\$6.1 million in assets under management.

Overall, participation in the Islamic financial services sector is still rather peripheral and limited, and no major financial institution is currently offering a meaningful package of Islamic financial services. It is suspected that the current significant credit crunch and subprime mortgage exposures, although not as significant an issue in Canada as in the United States, are currently more pressing priorities for the larger Canadian financial institutions.

A number of applications have recently been made to OSFI, however, for newly-incorporated Canadian banks offering Islamic financial services. While some of the applications are understood to be quite far advanced, they appear to be on hold pending the response of a federal multi-agency task force established last year to consider issues related to Islamic finance in the Canadian financial services marketplace. Interestingly, earlier this year, the Canada Mortgage and Housing Corporation, a federal Canadian crown corporation, also turned its attention to the issue of Islamic finance in the Canadian marketplace, issuing a Request for Proposal for a research report on the subject. As previously widely reported, the request generated some controversy and resulting media coverage, with UM Financial and others supporting the exercise and at least one other Islamic group in Canada criticizing the exercise.

Prospects for the future

Canada is still a number of steps behind the United Kingdom, where Islamic finance is in turn still growing slowly. Major developments in Canada are likely some time away, although, as noted above, the demographic prospects are excellent. The same structural issues are present in Canada as were identified in the U.K. by the Financial Services Authority's November 2007 discussion paper respecting developments in Islamic finance in that country. While there is significant interest from a wide variety of stakeholders, the eventual products will need to be extremely competitive in order to achieve wide distribution in the Canadian marketplace.

Future activity will likely include one or more of the major international financial institutions with Islamic windows offering retail home finance products in Canada, credit unions and mid-size banks offering home finance products in Canada, major existing Canadian banks breaking into the retail market, and, in the longer term, one or more newly-established Canadian Islamic banks.

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