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The Development of Islamic Banking and Financial Institution in United Kingdom

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Abstract

Purpose - The aim of this study is to investigate the problems, challenges, opportunities and future prospects of Islamic banking and finance in the UK. However, this study brings forward into 3 main purposes. Firstly, to explore the development of financial institutions, products and regulatory reforms. Secondly, to find out the performance of Islamic banking institutions. Lastly, to identify the problems, challenges and Islamic banking future prospects.

Research design, data, and methodology - An in-depth literature review was carried out to fulfil the research objectives.

Results - The findings point out the basic problems of Islamic banking industry in UK such as unfavorable regulatory environment, unfamiliarity with the Islamic Banking System, lack of portfolio management, absence of liquidity instruments, in need of professional bankers, and blending of approach of Islamic scholars with the approach of the conventional bankers. The findings also indicate that there are greater opportunities in the UK for development and growth of Islamic financial system because Muslim community is eager to take financial products.

Conclusions - It is hoped that issues pertaining to Islamic banking products can be resolved through consensus of Shariah scholars. There is need to educate the Muslim community about Islamic financial products and service.

Keywords: Development of Islamic Banking, Islamic Banking, Islamic Finance, Muslim Population, United Kingdom.

JEL Classifications: E62, F36, G18.

1. Introduction

The vibrant growth of Islamic banking products and services in the past four decades is undisputable in financial world today. Recent figures show that Islamic banking assets with commercial banks globally standing at \$1.7 trillion in 2013, suggesting an annual growth of 17.6 percent over last four years (World Islamic Competitive Report, 2013). Although the development of Islamic finance is still young compared to conventional, but by looking at its current asset value, there is a big hope that it will continue

to experience spectacular growth more than conventional finance in the future. Its manifestation in promoting justice and fairness among parties involved in any transactions has captured financial institutions in many countries, and not only limited in Muslim countries, to transact many of its financial product and services based on Shariah principles. In tandem with its rapid growth, many discussions about the development of Islamic banking and finance in various national contexts are invariably appearing in numerous studies and works, notably concentrated on Gulf Cooperation Council (GCC) countries and few Asian countries like Malaysia, Indonesia and India (Wilson, 2009; Fasih, 2012; Pepinsky, 2013).

However, we know little about the development of financial banking in the west region and even such studies were undertaken, the scope of investigations are limited by focusing only on the challenges, opportunities, problems and regulations of Islamic banking faced in Western countries (Wilson, 1999; Karbhari, 2004; Ainley et al., 2007) where each are separately studied. Thorough investigation on the development of financial banking that covers all facets such as development of financial institutions and what type of product they offered, regulation reforms, government support level, the performance – market share, asset growth and etc., as well as problems, challenges and the future of

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Islamic finance, is somewhat untapped in west region. Realizing this, therefore, left a significant room for us to discuss in the current paper and we have our convictions that this study is crucial to facilitating better understanding of what lies in the between of Islamic banking towards its development since consumer acceptance, regulations, profitability and other relevant issues vary significantly across market and what more in Western countries.

Specific country assessment that became of our interest to study is United Kingdom and this selection is due to two reasons. First, UK has posits itself as among countries that currently initiates regulatory reforms to build Islamic banking and capital market. Apparently, government wants to give the UK's relatively large Muslim community access to financial services consistent with their religious beliefs as well as to restore economic sustainability especially after the crisis since there is a strong argument that interest-free finance environment may attract investment from the Gulf region (Fasih, 2012). Second, UK and London plan to remain as the world's leading international and Islamic financial center. The confidence that growth of Islamic finance will continue to soar in this area is assured by combination of its strategic location, variety of skills, modern infrastructure, transparency as well as openness in financial sector. Reasoning this, our curiosity regarding this topic has brings forward three aims, as follows:

- i. To explore the development of financial institutions, products offered and regulatory reforms as well as government supports
- ii. To find out the performance of Islamic banking institutions
- iii. To identify the problems, challenges as well as Islamic banking future prospects

Our paper improves upon existing literatures in the context of offering comprehensive assessment on Islamic banking development in UK since we notice that thorough evaluation on country like UK who had experienced a spectacular growth in Islamic finance in last decade are conspicuously absent, where no prior study at least, to our knowledge, has conducted an investigation on this country. The sources of reference will rely heavily on existing secondary data, referring to report from UK Trade and Investment, financial statement of selected Islamic banks and around few previous studies has been undertaken as well as other reading on reliable sources. The plan of this paper is organized as follows: Section 2 gives an overview of Islamic finance in UK – financial institutions development, products, regulatory reforms, and government supports. Section 3 presents performance of Islamic banking in UK – market share, asset value, total financing. Section 4 identifies problems and challenges faced by Islamic banking institutions in UK and Section 5 provides a summary, concludes and offers few recommendations to further promote Islamic banking financial institutions.

2. An Overview of United Kingdom as a Home for Islamic Finance in Europe

The UK, and London in particular, was very much aware that Islamic finance is one of the fastest growing areas in global financial market and so already became a major home to Islamic finance outside the Islamic world thus far. Of 250 total foreign banks in London, 25 offer Islamic finance, where six of them are wholly Shariah compliant and these numbers of banks are more than any other country in Europe. The attraction of London for Gulf clients, which include all the major Islamic banks, is the breadth of specialist financial services offered, the depth to the market and the solidity of the major banks, which include all the leading global players (Wilson, 2000). Its strategic location, which is nearer to Middle East countries than New York, has benefited London in terms of convenient time zone for communications, and huge Muslim community that occupied in UK confirms vast opportunities for Islamic banks to continue growing. Serious attention made by UK's government on Islamic finance noticeably in last few years, therefore, portray its essential role towards wider economy, where the belief is that, more inward investment, job creation, export and trade can be achieved and thus, will help to recovering UK's economy into better shape especially after been hit by global financial turmoil in mid-2007.

2.1. Development of banking institutions and product offered

UK actually has witnessed the existence of Islamic finance in last three decades, precisely in the 1980s, with first commodity murabahah transactions came forward through London Metal Exchange (LME), which aimed particularly at Middle East investors and the first Islamic bank coming into UK's financial stage, Al-Baraka International Bank, has been launched in 1982. Since the product developed were offered exclusively at wholesale and high net worth investors, as well as incomplete product structure and does not fell within the scope of regulatory (Ainley et al., 2007), retail Muslim market keeps untapped. Thus, even Islamic finance takes root the UK long ago, the improvement of product offered and its strong regional presence only emerges in last ten years, where many financial players start coming in with a wider range of products are available in the market, both at wholesale and retail side. Today, UK stands with more than 20 international Islamic banks and owned a status as leading global centre for Islamic finance. <Table 1> reports the development of Islamic financial institutions. The other half of following subsections discusses among earliest Islamic banks that emerged into UK's banking industry, which are Al Baraka International Bank, Ahli United Bank, HSBC Amanah, Islamic Bank of Britain and Lloyds, in more depth.

2.1.1. Al Baraka International Bank

Al-Baraka International bank was the only bank offering exclusively Islamic Banking Services under the 1987 Banking Act (Wilson, 2000). It was initiative by Sheikh Salel Kamel of Jeddah and in 1982, the bank had purchase over of Hargrave Securities, which was, a licensed deposit taking under the previous legislation. Although the takeover took place in 1982 but the business only started five years later, when it opened two branches in London and one in Birmingham. The clients of Baraka mainly Gulf community who were resident in London and. It offered current accounts to its customers as well as investment deposits on a mudarabah profit sharing basis. By 1991, the deposits exceeded £154 million, mostly through mudarabah investment accounts. However, the major initiative made by this bank is in housing finance, where it provided long term Islamic mortgages (10-20 year) and the client making either by monthly or quarterly repayments on fixed basis, following murabahah structure. Al Baraka withdraws from London market after 11 years operations.

2.1.2. Ahli United Bank (United Bank of Kuwait)

This bank was formerly known as United Bank of Kuwait and changes its name in 2003. Islamic Investment Banking Unit has first established in 1995, and partially self-governing operation from Baker Street, with 16 staff in asset and leasing management. As already indicated Al-Baraka provided Islamic housing finance for those seeking to purchase properties in London in the late 1980s, but following the withdrawal of its banking license this left a gap in the market. This bank fill the gap by offering Islamic mortgages called Manzil home ownership scheme through Murabahah based mortgages from 1997 and Ijara based mortgages from 1999. The bank currently provides deposit products including savings, checking, and fixed deposit accounts; lending products such as property finance, business loans, residential mortgages, and trade finance; and online banking services.

2.1.3. HSBC Amanah

HSBC was a dedicated Islamic finance subsidiary and has been a pioneer in the Shariah compliant capital market industry since its establishment in 1998 at London, but headquartered in Dubai. HSBC has a global network in many countries but its focus is more on UAE, UK, US and Malaysia. This bank offered Islamic mortgages - Amanah Home Finance, which has been launched in 2004, was actually following the abolition of double stamp duty. Other products such as Islamic current account also offered to its customers where the £1,000 minimum balance had to be maintained. One of the features is no interest payments or charge was been imposed and it can be used as a multi-functional cards like for direct debits. Amongst other are

Islamic pensions.

2.1.4. Islamic Bank of Britain (IBB)

Islamic Bank of Britain was the first Islamic retail bank in UK and this year, they will celebrate its ten years of providing Shariah compliant retail financial products to UK consumers. The establishment was initiated by a group of investors from Middle East to find opportunity of the growing market in the UK. By August 2004, Financial Service Act granted an official authorisation of the bank, where a month later, first branch came into stage in Edgeware Road. The operational headquarters was in Birmingham with branches at Leicester and Manchester. It offered current account with no interest payments or receipts, chequebook and multi-functional bank card provided. Another product offered was savings account, term deposit savings account, and personal finance and secured funding on car loans. In January 2014, Al Rayyan UK acquires Islamic Bank of Britain and has now become IBB's parent company.

2.1.5. Lloyds TSB

Lloyds is the fifth largest banks in UK by market value. Lloyds TSB unveiled its Sharia-compliant home finance product in March 2005, and the current account was launched in February at the same year, where the products were first piloted in London, Birmingham and Luton branches. Islamic current account offered by Lloyds did not charge interest as well as no minimum deposit was required, whilst the bank's home finance product was based on diminishing musharakah and ijara structure. In June 2006, Lloyds started offering Islamic banking products in all of its 2,000 U.K. branches in an attempt to gain customers among the country's 1.8 million Muslims. <Table 1> shows the developments of Islamic banking institutions in the UK.

<Table 1> Developments of Islamic Banking Institutions in the UK.

Timeline	Financial institutions	Islamic product offered
1982	Al-Baraka International Bank	Islamic mortgages
1996	United Bank of Kuwait	Islamic mortgages
1998	HSBC Amanah	Islamic mortgages, Treasury and investment services and private banking
2004	Islamic Bank of Britain	First Islamic retail bank
	ABC International Bank	Islamic mortgages
2005	Lloyds TSB	Current account and Islamic mortgages
	European Islamic Investment Bank	First wholesale Islamic investment bank
2007	Bank of London and Middle East	Wholesale Islamic investment bank
2008	QIB.UK Finance House	Wholesale Islamic investment bank
	Gatehouse Bank	Wholesale Islamic investment bank
2013	Abu Dhabi Bank	Representative office

2.1.6. Regulatory reforms and government support

What triggers curiosity in Islamic finance is the absence of interest, which is the backbone of western or conventional banking and financial systems (Malik et al., 2011). This, perhaps, can be a reason of why in 1980s to early 2000s, UK's authorities have given not much supports and consequently resulting the momentum of Islamic finance growth stunted and experienced a long pause in the between. However, the momentum started to build up after the industry received political and regulatory support from the UK's government, along with the Financial Services Authority (FSA) and the Bank of England, which have actively contributed to the development of Islamic finance in the UK. Now, what actually drives the warm welcome of Islamic finance by the UK's government? We found that UK Government is now giving strong support to the development of Islamic finance in the UK at least for two principal reasons, first, financial inclusion - it believes that financial services such as bank accounts, mortgages, savings products and insurance protection should be available to all citizens irrespective of religion. Second, business benefits in the UK, where the Government wants to promote the UK as a location for international Islamic finance.

In 2001, Islamic finance working group was set up under the leadership of Andrew Buxton, former Chairman of Barclays Bank and Eddie George of the Bank of England. The working group included representatives from the Treasury, FSA, the Council of Mortgage Lenders, financial institutions and members of the Muslim community. The purpose is to identify the challenges faced by this industry, which have sought to facilitate the development of Islamic finance. Government led initiatives continue to support in the latter years until to date, such as in 2003, tax and regulatory changes have been introduced to enable UK companies to offer a range of Islamic finance products.

For instance, Stamp Duty Land Tax (SDLT) has been amended to remove double charge on Shariah compliant mortgages and the provisions further extended two years later on equity sharing arrangements. We set out the details of Government-led initiatives and legislative changes in the UK as reported in <Table 2> below. Since robust support from working group, regulators and UK government have been formed, it has creates working and market environment between Islamic banks and their customers more convenient and are been treated no differently from conventional counterparties. Perchy Humprey, the CEO of BLME could not agree more with this, where he made a vital remark and validate that Islamic finance is highly welcomed by saying that one of the key strengths of Islamic Finance in the UK is the supportive regulatory framework during an interview with Global Islamic Finance Magazine.

<Table 2> Regulatory Development of Islamic Finance in the UK.

Year	Regulatory
2001	Bank of England established the Islamic Finance Working Group chaired by Lord George to investigate obstacles facing the industry and enable the development of Islamic Finance in the UK
2003	Revenue & Customs Tax Technical Group established to understand details and specific concerns of technical nature for Islamic Finance Finance Act – Stamp Duty Land Tax (SDLT): Catered for individuals using alternative property financing arrangements (covering Islamic mortgages), removing the double charge to SDLT that might otherwise arise where a financial institution buys a property and then re-sells it to the individual
2005	The SDLT provisions were extended to equity sharing arrangements and in 2006 to companies Government legislated for Murabaha instruments as a purchase and resale arrangement
2006	Government legislated for diminishing Musharaka ownership for property or asset financing arrangements. SDLT relief extended to corporate entities
2007	HM Treasury Islamic Finance Experts' Group formed to advise Government on how to best support the development of Islamic finance in the UK. representatives of the group are from the Government, legal and advisory firms, and from the Muslim community. UK Government started reviewing the feasibility of issuing wholesale sovereign Sukuk. FSA regulation of Home Purchase Plans. HMRC guidance on tax treatment of all financing techniques covering: Capital allowances, Value Added Tax (VAT) and Capital Gains Tax (CGT).
2008	UK Government announcement of potential Sukuk issuance
2011	UK Islamic Finance Secretariat (UKIFS): Supporting the promotion and development of Islamic finance in the UK
2013	Islamic Finance Task Force: IFTF is a Ministerial-led Task Force set up to promote the UK as an Islamic financial centre and to attract inward investment

2.1.7. Performance of Islamic banks in the UK

The global financial crisis that hit the world also shaken the UK economy and since then, it is struggling to recover. The market pressure has eased thanks to an early commitment to minimize the deficit. However, the endurance of investors and credit rating agencies will not be indefinite, as Moody's negative outlook has demonstrated. At that time, for the UK and its banks, the frustration will be that success or failure in the short term depends primarily on perseverance of the Eurozone crisis. Recently, it is recorded that the global market for Islamic finance at the end of 2012 was worth around US\$1.3 trillion according to the UK Islamic Finance Secretariat. Apart from that, the total value of Sharia compliant assets had also grown by 150 percent since 2006. UK now is becoming prominent western country and become Europe's premier centre for Islamic finance with US\$19 billion of reported assets.

In addition to that, London is now a major centre for international bonds and therefore is an important centre for issuance and trading of sukuk. Sukuk are issues of Islamic notes that represent an alternative to conventional bonds. As the market keeps growing, sukuk market is now considered as an essential part of Islamic finance market. In 2012 and 2013, there were 14 sukuk listings on the London Stock Exchange worth \$14.3bn (Chart 1). A total of 49 sukuk have been listed on LSE with a total value of \$34bn. Elsewhere, Nasdaq Dubai with 12 sukuk listings and Luxembourg with 16 sukuk listings are also important centres. LSE highlights have included the GE Capital sukuk in 2009, the first listed sukuk by a US corporate, and the Kuveyt Turk sukuk, the first by a European bank. The first UK corporate sukuk was issued in 2010 by International Innovative Technologies (IIT). In long-term point of view, the development of sukuk globally is seen as having positive growth, especially in United Kingdom Islamic banking industry. Sukuk nowadays hold an important role for both government and the private sector as a domestic source of finance.

Moving on, UK currently has twenty international banks operating in UK. From that, there are actually six wholly Shariah compliant banks that operate in United Kingdom, namely Islamic Bank of Britain plc, European Islamic Investment Bank plc, Bank of London and Middle East plc, Gatehouse Bank plc, Qatar Islamic Bank-UK plc, and Abu Dhabi Islamic Bank plc. However, for the purpose of this paper, we are going to discuss only two banks namely The Bank of London and the Middle East (BLME) and European Islamic Investment Bank plc (EIIB). This study chose these two banks mainly because they are the only banks providing the latest financial report which is in 2013, where other banks are not. The financial data was derived in seven years period. Both of the banks are successful investment banks.

2.2.1. The Bank of London and the Middle East (BLME)

Bank of London and The Middle East (BLME) is an independent UK, wholesale Sharia'a compliant bank based in London. BLME received FSA (Financial Services Authority) authorization in July 2007. Apart from that, it is the largest Islamic bank in Europe. BLME is managed by a strong and experienced administration team as well as leading experts in Islamic finance from some of the best institutions in the UK. BLME had made quite numbers of achievements throughout the past years. One of the outstanding success is it was appointed as Co-lead Manager on the Islamic Development Bank Sukuk in June 2013. Apart from participating in the award winning Yaas Sukuk I, BLME also shine by being awarded as the best Islamic bank in the UK for the sixth consecutive years. The bank also shows a significant increase in the number of depositors.

As for the quantitative measurement achievement of BLME, <Table 3> reports the summary of financial performance for BLME over seven years. In its second year of operation, BLME records a high growth of its annual total assets which is 191.31 per cent, despite the financial crisis that strikes the world at that time. However, as can be seen from the table, it fluctuates from year 2009 onwards. The same happens with return on equity (ROE) which measures how many dollars of profit a company generates with each dollar of shareholders' equity. There are years that records BLME as having negative ROE which is not good as it suggests that the bank cannot increasing its ability to generate profit without needing as much capital.

However, in the last financial year, BLME has done quite well in order to strengthen their ROE. Last but not least, as far as total financing is concern, BLME is mostly governed by debt financing, rather than equity financing. It indicates that the bank is using more proportion of debt rather than equity in order to finance its assets. All in all, BLME is expected to have a brighter future to coop with global Islamic banking demands as it has the experience, the liquidity and an increasing number of products to leverage the growth of Islamic banking demands.

2.2.2. European Islamic Investment Bank (EIIB)

European Islamic Investment Bank plc (EIIB) is a London listed specialist investment banking and asset management group that focused on the oil rich markets of the Gulf Cooperation Council (GCC) countries. It was incorporated in England and Wales in January 2005 and received its authorization from the UK's Financial Services Authority (FSA) on 8 March 2006. It then therefore becomes the first independent Sharia'a compliant Islamic investment bank that is authorized and regulated by the UK's FSA.

As can be seen from <Table 4>, EIIB Annual Growth of Total Assets was not in a good position. Fortunately, by their dedicated effort, the bank gain positive net income for the past financial year. It indicates that EIIB's new strategy and business model start to yield positive results. The bank also took an initiative to launch new products in Equity, Leasing and Trade Finance. Apart from that, EIIB also arranged for mid-market sukuk financing and was awarded "Europe Deal of the Year". EIIB also received a shock during global crisis on 2007. Most of their funds dropped. However, from the analysis, we found that despite of the crisis; EIIB was able to maintain their equity financing which means they limit their borrowings from outside institutions. As for the last fiscal year, EIIB equity to total assets ratio shows a very good measure, which is 80 percent. <Table 3> shows the financial highlights of Bank of London and the Middle East.

<Table 3> Financial Highlights of BLME over 7 years

	2007	2008	2009	2010	2011	2012	2013
Total Operating Income (£)	13,012,053	12,103,966	3,370,141	9,710,051	9,710,051	3,899,701	10,181,252
Total Operating Income (£) Profit before Tax (£)	9,274,163 (2,482,486)	27,963,922 563,861	30,283,001 (23,698,714)	40,438,597 (6,652,314)	43,019,334 (8,495,342)	52,467,235 (10,077,514)	56,013,962 1,484,774
Profit before tax (£) Net Income (£)	332,389 (4,476,781)	4,446,222 (527,672)	(18,888,940) (22,179,315)	5,015,924 (5,922,702)	(10,848,690) (11,381,530)	5,515,158 (9,877,408)	6,069,785 1,222,150
Net Income (£) Total Assets (£)	171,237 (316,848,322)	3,517,677 277,658,840	(13,240,927) 166,978,380	3,517,677 181,541,685	(8,897,990) 158,933,142	3,840,755 171,695,445	4,314,726 153,603,492
Total Assets (£) Total Liability (£)	297,716,181 135,928,915	867,275,741 114,301,552	758,715,228 25,659,967	711,933,748 34,460,373	807,131,416 26,626,872	1,038,958,177 42,763,878	1,233,713,291 26,626,872
Total Liability (£) Shareholders' Equity (£)	118,318,581 180,919,407	614,873,515 163,357,288	515,222,727 140,378,808	464,941,769 143,076,070	568,490,954 128,669,403	799,309,055 119,760,973	990,930,402 122,934,328
Total Shareholders' Equity (£) Annual Growth of Total Assets (%)	179,397,600 -	252,402,226 -12.37	243,492,501 -39.86	246,991,979 8.72	238,640,462 -12.45	239,649,122 8.03	242,782,889 -10.54
Annual Growth of Total Assets (%) Return on Equity (%)	- -2.47	191.31 -0.32	-12.52 -15.80	1.42 18.98	-3.73 -16.75	28.72 -8.25	18.75 0.99
Return on Equity (%) Debt/Total Assets Ratio (%)	0.10 42.90	1.39 41.17	-5.44 15.37	65.31 78.81	70.43 80.96	1.60 24.91	1.78 17.33
Debt/Total Assets Ratio (%) Equity/Total Assets Ratio (%)	39.74 57.10	70.90 58.83	67.91 84.07	65.31 78.81	70.43 80.96	76.93 69.75	80.32 80.03
Equity/Total Assets Ratio (%)	60.26	29.10	32.09	34.69	29.57	23.07	19.68

Source: Annual report of The Bank of London and The Middle East over (2007-2013)

3. Problems

Islamic banking is gradually moving into a growing number of conventional financial systems such as the United Kingdom or Japan (Sole, 2007). Islamic banking faced problem by the regulators of the conventional financial system in the earliest commencement of Islamic banking in the UK. Karbhari et al. (2004) found that Islamic banking in United Kingdom was facing a problem of legal system due to mismatch of understanding between the Islamic banking and its regulator. Islamic banking in UK was very new at that time and their practice were yet been properly regulated. After several years of its commencement, Islamic banking in the UK is still facing some problems such as lack of qualified Shariah scholars. Because of this shortage, Mashayekhi et al. (2007) found that Shariah scholars hold Shariah supervisory board position in more than one Islamic bank. Another issue raised by the authors is whether Shariah supervisory boards of the Islamic firm in the UK is responsible for the audit process in the Islamic banking and approving products with Shariah compliance. Moreover, the Muslim population in the UK is increasing with high growth rate, but the Islamic banking institutions are still in infancy stage and facing different challenges in this Western society such as socially, economically, fund management and regulations. With increasing popularity of Islamic banking in the UK, there are some difficulties in the way of Islamic Shariah law, Islamic banking system as well as the role of Financial Services Authority and UK Government itself

(Ahmad, 2008).

The literature review and above discussion provide several basic problems that are facing by Islamic banking industry in UK: (1) unfavorable regulatory environment, (2) unfamiliarity with the Islamic Banking System, (3) lack of portfolio management, (4) absence of liquidity instruments, (5) in need of professional bankers, (6) blending of approach of Islamic Scholars with the approach of the conventional bankers, (7) the problem of forward contact/ booking of foreign currency, (8) inland bill purchase/foreign bill purchase, (9) lack of committed professional who can create new instruments, and (10) lack of committed sponsors who can pressurize the professionals.

4. Problems, Challenges, Opportunities and Prospects Faced by IBIs in UK

4.1. Challenges

Islamic finance is based on the principles established by the Shariah known as fatwa, issued by qualified Muslim scholars (Sole, 2007). Some of the issues covered by these rulings are quite complex and interpreted differently by various Muslim scholars which raised challenges in the practice of Islamic banking particularly in the conventional financial systems. Islamic banking industry is suffering with the various opinions of Islamic scholars regarding a product or practice (Ahmad, 2008). Some Islamic scholars accept

some Islamic banking products while others do not consider them as Islamic products. It creates a dilemma among people to take their stance and choose Islamic products. It turned out to be a big problem in the development of new Islamic product which hurdle the growth of Islamic banking industry. In addition, Islamic banking is facing the complications of lack of authentication of decisions as there is lack of unity in the Muslim community. There are various believe system exist among Muslim community which further complicating the acceptance of a product across Muslims. For example the product accepted in Malaysia may not necessarily be accepted in the UK. Islamic banking industry is having a shortage of qualified Scholars and managers. According to Iqbal, Ahmad and Khan (1998) the managers of Islamic banking industry are not well trained for the practices of Islamic finance. The goal of Islamic finance industry is somehow being distracted by the people who have lack of proper training and guidance for the practice of Islamic finance. Bokhari (2007) found that Islamic finance industry is encountering various challenges and difficulties owing to lack of skilled and trained professionals that can help to fulfil the requirements of this fast growing industry.

Islamic banking in UK is encountering various legal problem due to its lack of proper regulations (Ahmad, 2008). This issue is creating tension between Islamic banking and regulators. The other major factor that contributing to the lack of regulation in the UK Islamic banking is the weak branch network. In comparison with the Muslim community in UK, the number of branches of Islamic bank of Britain are limited. This limitation is restricting the growth of Islamic banking industry in the UK. Apart from that Islamic banking is being challenged by the Islamic banking window opened by the conventional banks in UK. In one sense it helps Islamic banking industry to improve their service and reach more customers. On the other hand, it is challenging for the Islamic banking industry to maintain proper Islamic law in their practices (Iqbal et al., 1998). Islamic finance industry is also been challenged in UK for their liquidity management issue which raised because of the limited number of Shariah-compliant products. Islamic banks cannot simply deal with inter-bank deposits, government and corporate bonds or notes that are interest bearing due to the issue of Shariah compliance. Therefore, they often encounter problems regarding liquidity management. It is necessary for Islamic banking industry to develop other methods to deal with the liquidity management problem. However, Islamic banking industry do have some products that have almost exactly the same effect in terms of liquidity as the inter-bank deposits of conventional banks but they are controversial in nature. Some Shariah scholars have approved it while others have rejected it. This disagreement among Scholars became a big challenge for Islamic finance industry in UK as well as other part of the world. For instance, Tawarruq is one of the method that became controversial and no consensus has been reached on whether it is Sharia

compliant or not. Islamic banking industry has been facing many challenges since its origin. In UK, Islamic banking industry is facing more challenges due to high local and global competition by the conventional financial system which turned out to be the attractive system up there (Ahmad, 2008).

In addition, the United Kingdom is a non-Muslim country and all its financial rules and regulations are in favor of conventional banking (Ahmad, 2008). Based on the above discussion we can conclude that Islamic banks in UK are facing some challenges due to lack of awareness about Islamic banking by its customers and as well as some other issues related to UK regulatory authority, structure of Islamic Shariah Board and its implementation. However, the potential challenges should be taken care of to make Islamic banking more user friendly in every level of society. There is need to make a clear and transparent system of general Islamic banking which concerned to all sectors of society and economy in order to address the challenges and threats of the future needs of the financial sector.

4.2. Opportunities

The United Kingdom is the hub of Islamic banking and finance in the West. A large number of Muslims from all over the world are living in the UK. The opportunity for Islamic banking industry to grow in UK is comparatively high in Europe as the number of Muslims are increasing every year. The prior studies show that there are greater opportunities in the UK for development and growth of Islamic financial system as Muslim community is keen to take financial products. According to Ahmad (2008), Islamic banking has a great opportunities in UK because it has achieved an outstanding position in the UK financial market in less than five years. It is also a good opportunity for UK to expand this industry when London hosted the World Islamic Economic Forum (WIEF), for Islamic finance with the expertise, innovation and services fundamental to the industry's growth. The growth has been proved in the Sukuk (Islamic bonds) market, where London acted as a major centre for the issuance and trading of international bonds and it gives room for Sukuk to be listed for trading. In 2012, a total of US\$34 billion has been raised through 49 issuance of Sukuk on the London Stock Exchange (LSE), which in 2007, the first Sukuk listed was for the UAE-based National Central Cooling Company (Tabreed) amounted US\$200 million. Beside, at the end of 2012/2013 the UK market for Islamic finance was worth around \$19 billion which indicates a great opportunity ahead for Islamic banking industry in UK.

In addition, currently in UK, Islamic banks and their clients are treated similar way as to their conventional counterparties. Many initiatives have been taken to make the Islamic finance industry more viable and competitive in UK. Some of the initiatives are: (a) extending tax relief on

Islamic mortgages to companies as well as to individuals, (b) removing double tax on Islamic mortgages, and (c) reforming arrangements for issues of debt. Moreover, currently UK is the 9th largest country by Sharia compliant assets which has more than 20 Islamic finance institutions and six full fledged Sharia compliant banks. There are ample of facilities in UK which will create great opportunities for Islamic banking and finance industry to grow such as (1) more than 20 international banks in the UK are working in Islamic finance, and 6 of them are fully Sharia compliant, (2) British banks are increasingly active in the international Sukuk market, (3) UK domestic banks are expanding their Islamic finance offering to meet demand, (4) Islamic finance has helped transform London's skyline by financing in whole or in part developments such as The Shard, Chelsea Barracks, Harrods and the Olympic Village, (5) the UK has the largest legal services market in Europe and over 25 law firms with offices in the UK are supplying Islamic legal services, (6) there are 9 fund managers offering Islamic asset management services to their clients and all of the UK's largest accountants, consultants and professional service firms have Islamic finance departments, (7) new standards and qualifications in Islamic finance are being offered by professional institutes, universities and business schools across the UK, (8) the London Stock Exchange has raised a total of US\$34 billion through 49 issues of Sukuk, and (9) the London Metal Exchange (LME) is an important avenue for the growth of Islamic finance globally - a significant volume of liquidity management transactions concluded by Islamic finance institutions and other Sharia compliant firms are supported by metals on LME warrant. The above facilities will open the door for Islamic finance industry to grow. The problems facing by the Islamic finance industry are not insurmountable to handle. Therefore the ahead future of Islamic banking and finance will be noteworthy.

4.3. Prospects

To some extent, opportunities and prospects of Islamic banking and finance in UK overlap each other. Wilson (2000) has forecasted about the prospects of Islamic banking and finance in UK. First, London will likely to maintain its place as the major center for Islamic financing in Europe and second, the number of businesses by British Muslim community will increase, but the value of this business will remain limited. However this value can be address by introducing more education and training in the UK such as university degrees and professional training courses. Apart from that, the firms must place the less experienced scholars besides the experienced one to help them to develop more knowledgeable scholars (Mashayekhi et al., 2007). Ahmad (2008) found that the future opportunities for UK to develop and growth of Islamic financial system because Muslims community prefers to take the financial products that accordance with their religion which is Shariah

compliance. Nevertheless, there is still a need for them to educate the Muslim community toward Islamic financial products and services and the communities in the Islamic banking institution also has to work hard to improve the system in Islamic banking and finance. Prime minister of UK, Rt. Hon. David Cameron MP in his opinion said that the UK – London are already becoming a center for Islamic finance.

Therefore, he forecasted that the Islamic investment in the UK might grow to £1.3 trillion by 2014. Moreover, telephone banking in UK could offer huge hope if regulatory issues can be overcome in the long run. This service would create demand of Islamic banking in UK market. Branding is one of the important factor that can spread the name of Islamic banking and the level of acceptance among the people including non-Muslims. It is quite hard for a new bank to have success without brand names and very unlikely to appeal the British Muslim community. For instance, many lost significant sums when BCCI collapsed, and the main long term consequence was a flight to quality.

Yet an Islamic banking operation needs a distinct brand from its parent for marketing purposes. Even though, it seems much of the growth in Islamic finance will involve existing institutions, mainly investment banks and fund management groups, offering specialized products. But there is only one general international equity based fund at present, Flemings Oasis Fund, the products offered by the halal fund and Dresdner Kleinwort Benson being trade based. Therefore, there is huge prospect for new international equity based fund to explore in UK market. In our understanding, the prospect of Islamic Banking is very optimistic in UK. In UK, to give an example, few conventional Banks have opened separate Islamic branches recently. Most of the problems facing by Islamic banking and finance industry in UK can be solved with more research and dedicated efforts. IDB, OIC Fiqh Academy, International Islamic Banking organizations and individual Islamic banks should put more resources in research in Islamic Banking, Finance and Economic issues.

5. Conclusion and Recommendations

The absent of existing literatures in providing comprehensive assessment of the development of Islamic banking financial institutions in the western region has brought forward this current paper to fill the gap left. By selecting UK as a case study, we attempt to explore the development of Islamic banking and product they offered, regulation reforms, government support level, the performance as well as challenges and the future prospects of Islamic finance in the UK. It is observed that in a past ten years, the Islamic banking industry has sped up rapidly in the UK, where it has been moved from an interesting curiosity with the absence of interest rate.

This rapid expansion grown along with diversity in product offered by Islamic banking as well as warmly welcome from the government and a reform in regulations. Islamic banking in the UK is performing toward positive movements due to its fast growth and most importantly support from the government itself. London is now a major center for international bonds and therefore is an important center for issuance and trading of sukuk. Sukuk nowadays hold an important role for both government and the private sector as a domestic source of finance. Looking forward, improving asset quality and a pickup in economic growth are expected to benefit the Islamic banking sector in longer term. Despite the fast growth of Islamic banking in this country, they are still facing problems and challenges in their practices. However, there are light for them to shine with the opportunities that they hold such as becoming a hub of Islamic banking and finance in the West. This opportunity can bring a bright prospect in the future for Islamic banking in the UK.

The only limitation that the author found is in collecting the data to measure performance of all Islamic banks in United Kingdom. As mentioned before, the author intended to measure the performance of the six fully Shariah compliant banks in UK, but then due to data constraints, the author was unable to do so. For instance, some of the banks opt not to disclose their previous financial statements in the website.

To further promoting Islamic banking and finance in the UK, we recommend that banks should improvise their marketing strategies and more education about the product should be imparted to develop understanding among the public. As there is lot of potential in Islamic banking institution worldwide, it is hoped that Islamic banks at UK will also improvise its quality of services and expand their line of products if they intended to penetrate the worldwide market and thus gains customers from all over the world. There is need to educate the Muslim community toward Islamic financial products; service providers need to improve the information system within the communities and Islamic banking institution is need to work hard for survival and compete with conventional banking system in the sector of regulations and supervisions. It is hoped that issues pertaining to Islamic banking products can be resolved through consensus of Shariah scholars. Therefore, efforts should be strengthened to offer practicable solutions to help provide better and more legitimate structured implementation of Islamic banking and finance in UK.

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