

Regulation of Islamic Financial Contracts: The UK Case Study

Abdelhafid BENAMRAOUI (Westminster Business School, United Kingdom)
Yousef Alwardat (Saudi Arabia)

There are two main views regarding the issue of regulating and supervising of Islamic financial contracts across the globe. According to the first view the regulatory and supervisory rules applied on Islamic banks needs to be completely different from those of conventional banks. Hence, it is necessary to have two separate central banks, one central bank dealing with conventional banks and another one dealing with Islamic banks. This view is held, for example, in Malaysia and Yemen. The second view states that a single central bank should take the position of supervising and regulating both conventional and Islamic banks with some modifications to be made to the rules applied on Islamic banks taking into account the nature of their activities and their customer base. This is the wider view and is implemented in most countries offering Islamic financial solutions including for example UAE, Egypt and the UK.

Many international institutions are created for the purpose of setting *sharia* compliant standards. The aim is to harmonise the existing rules used for Islamic financial contracts. The main bodies are: the Islamic Financial Services Board (IFSB); the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI); the International Islamic Rating Agency (IIRA); and the Liquidity Management Centre (LMC). Each of these bodies is given specific duties to improve the overseeing of Islamic financial solutions. Despite the great effort by these bodies to ameliorate the rules used by Islamic or conventional banks with Islamic financial windows, various concerns are still raised on the process of overseeing of Islamic financial contracts. The research article aims to investigate the main constraints of regulating and supervising of Islamic financial contracts with specific focus on the UK financial market. The author draws lessons from the existing regulatory experience of both wholesale and retail financial instruments and suggests areas of improvements in terms of the role of sharia board in overseeing the Islamic financial contracts.

Cluster analysis is used to discuss the various issues surrounding the regulation of institutions offering Islamic financial products in the UK. Financial institutions are divided into groups based on the various financial services they offer in the market. In total four groups of institutions are identified: (1) wholly Islamic commercial banks; (2) wholly Islamic investment banks; (3) conventional commercial banks with Islamic windows; (4) conventional investment banks with Islamic banks.

Published reports by the ten institutions offering Islamic financial solutions in the UK are scrutinised to find any relevant information on the principles adopted by each institution in ensuring that market rules are fulfilled. This is to address how different financial contracts are governed and the treatment of various accounts and services offered in the UK market. Information related to capital adequacy and governance is also reviewed to find areas of similarities and differences among Islamic financial services providers when it comes to the implementation of financial markets' rules.

Finally, the reports published by the Financial Services Authority in relation to the overseeing of Islamic financial contracts are also examined to find about the steps taken by this regulatory body in maintaining the protection of the different stakeholders who have a direct or indirect link to the Islamic financial services industry.