ISLAMIC BANKING IN EUROPEAN UNION COUNTRIES: CHALLENGES AND OPPORTUNITIES

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Abstract: *Islamic banking is a relative young industry, with a high rate of growth, which in the last years became a highly discussed subject, due to the challenges and opportunities that it brings. Due to the fact, that in the last decade, the Islamic banking made its presence in the European Union market, too, in this paper we try to describe the main features of the Islamic banking transactions and to identify the challenges and opportunities that its brings.*

Keywords: Islamic banking, European Union, regulation, Islamic banking products and services
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INTRODUCTION

The Islamic banking is a financial industry with a very high growth rate, nowadays. It is a relatively young, the first bank, functioning on the base of the ShariahLaw, was founded in 1963 in Egypt – the "MitGhamr Savings Bank", renamed afterwards in "Nasser Social Bank", but the first Islamic banks were the "Dubai Islamiquebanque", "Kuwait Finance House" and "Bahrain Islamic Bank".

The factors which prompted the evolution of the Islamic banking were: financial deregulations and innovations, which allowed the development of the pure Islamic banking products and services;the presence of the "visionnaires" - persons with deep knowledge of banking and Islamic doctrine and oil shocks from the first decade of '70s, which support the accumulation of the great amount of the petrodollars in the Arabic countries.

Nowadays there exist more than 300 Islamic banks over the world. The main centres of Islamic banks, are still, mainly situated in the Middle East and Gulf region: Iran, Kuwait, Malaysia, Saudi Arabia and the United Arab Emirates. The total amount of assets, controled by these banks is considered to be about 200-500 mld.$, with a growth rate of 10-15% per year, according to the statistics provided on the web-site of the Financial Services Authority of United Kingdom.

Following the Asian banker rankings, the largest Islamic banks by assets are: Al Rajhi (28,053 mln USD), Kuwait Finance House (21,724 mln USD), Bank Of Islam Malaysia (4,136 mln USD), Dubai Islamic bank (9,799 mln USD), Qatar Islamic Bank (4,072 mln USD), Boubyan Bank (504 mln USD), Abu Dhbi Islamic Bank (9,799 mln USD) etc..

In the last decade, many Islamic banks entered the European Union market and in this context have arised many questions: what are the challenges and opportunities for the Islamic bank on the European Market and what are the benefits and drawbacks for the resident countries of these kind of banks, which will be treated in the next sections.

1. THE MAIN FEATURES OF THE ISLAMIC BANKING

The main principles of the Islamic banking are:

- *Mutual trust and transparency of all transactions*
- *Partnership between the bank and its clients – "profit and loss sharing"*
- *The priority of the ownership - "don't sell what you don't know"*

Comparing to commercial banks, the Islamic banks are prohibited for:

- *Speculative transactions (masir)* - according to the Sharia Law, the investments in speculative transactions, such as derivatives, are considered to be illegal;
- *Prohibition of interest (riba)* – the charging and the receiving of interest is strictly forbiden by Islamic laws. According to these laws, money cannot be considered as a commodity and can be used exclusively as a medium of exchange and store of value;
- *Economic purpose* – while the main purpose of the conventional banks is profitable investments of their assets, the Islamic banking is more oriented on business partnership and financing of trading activities or industrial projects;
- *Sanctity of the contract* – before approving any banking transaction, both counterparts should make sure that this transaction is in compliance with Islamic laws;
- *Risk sharing* –unlike the traditional banks, the Islamic banks apply the "profit and loss sharing" principle, which assumes, that the bank will not just charge a fixed procent of reward, but it will share both the profits and losses of its business partners;
- *Uncertainty about the terms of contract (gharar)* – that Shariah law requires a complete transparency of the contract terms. Any uncertainty about price, delivery issues and other terms are prohibided.

Over the time, the complexity of the products offered by the Islamic banks increased a lot. If, back in the '70s Islamic banking started with commercial banking activities, at present we can see that they offer a more diversified range of products and services tailored to the needs of clients: liquidity management tools, asset management, project finance etc.

The main products and services offered by Islamic banks can be described as follows:

- ✓ *Mudaraba* – is a partnership contract where one or several investors (Rabbul Mal), provide capital to an entrepreneur (Mudarib), for investment in a commercial enterprise. The Mudaraba can be restricted if Rabbul Mall specify the business in which to invest, if not, the contract is considered to be unrestricted.
- ✓ *Musharaka*(active partnership) – is an agreement between two or more parties to finance a project. Losses and profits from the projects are shared proportionally to the amount of investment. These types of contracts are usually performed on a long-term basis.
- ✓ *Ijarawaiktinaa*(financial leasing) – is a medium and long-term financial leasing contract, where a bank buys an asset, which further is leased out for a specific period. The lessee has the possibility to buyout the asset.
- ✓ *Morabaha* – is a contract for the selling of goods, at a price equal to the cost of the product to which is added a profit or a mark-up which is known to the buyer. This type of contract can involve only two parts (buyer and seller), or also an intermediary bank which performs the deal between parts for a specific commission.
- ✓ *Bai al salarm* - contract under which the buyer pays the seller at a bargain price for the goods which are further delivered in installments.
- ✓ *Istisna'a* - is a contract under which a bank is financing the working capital of a company. Here are included especially those goods that cannot be financed by leasing.
- ✓ *Sukuk*– are bonds, issued by a bank for the financing of a specific medium- or long-term project, which can be implemented by both public and private companies.
- ✓ *Quardhassan* – are loans offered by the bank or deposits attracted, zero interest rate being charged.

2. ISLAMIC BANKING IN THE EUROPEAN UNION

In the last decade, the European Union became an atractive market for expansion for the Islamic banks, due to its big potential. Following the Statistics provided by the Institute for Islamic banking and Finance, there are about 14 million of the Muslim inhabitants in the European Union, most of them living in United Kingdom, (2.4 mln, about 2.8% of total population), France (5.5 mln, 8% of total population), Germany (4.3 mln, 3.9% of total population). Also, following these statistics, a great percent of Muslims, live mainly in the big cities of the mentioned countries.

Figure 1 - The Islamic Finance across the European Union

Source: Institute for Islamic Banking and Finance

The largest Islamic banks are mainly present in three countries: France, Germany and United Kingdom:

- United Kingdom: the Islamic Bank of Britain (IBB), the European Islamic Investment Bank (EIIB) – first Islamic investment bank from Europe, the Bank of London & the Middle East (BLME), Securities House (UK), the European Finance House (EFH);
- France: National Bank of Kuwait (NBK), Tejerat Bank (TB), Qatar National Bank (QNB) etc.;
- Germany: the Irani Bank Sepah, KuveytTurk.

Challenges and opportunities of Islamic banking for the European Union countries

As I described above, the presence of the Islamic banking in the European Union is higher and higher and have a great potential in order to continue its growth.

But in this context we can ask ourselves, how benefic is this presence for the economy and financial system of the resident countries of the Islamic banks, what challenges and opportunities can be faced by both sides?

Reffering to the European Union countries the main challenge can be considered the proper regulation and supervision of these banks.

The first one is that many Islamic banks combines commercial banking activities with investment banking, making more complicated supervision of this institutions.

Also, the Islamic bank activity imply a higher level of risk comparative to the conventional banks, making some problems for regulatory authorities in the fields of capital adequacy and transparency requirements and customers protection: depositors of these banks participate not just in the bank profits, but losses, too.

Further the Islamic banks apply different resource mobilisation ant investment methods, from that of conventional banks, challenging in this way the regulatory institutions.

But the Islamic Banking may offer great opportunities too, for the financial systems and economies of the resident countries:

First of all, the Islamic banking services can increase the social inclusion of the Muslim minorities, which nowadays represent the biggest minorities in Europe.

Also, the presence of the Islamic banks can be considered as an attraction of the important part of oil wealth from the Gulf region, and as an additional source of liquidity and finance for the national economy.

Besides, the presence of the Islamic banking industry in Western countries can be viewed as bridge for international financial groups, seeking to diversify their investments, to Islamic world.

Nowadays there are activating many conventional banks, which, also offers banking products and services in compliance with the Islamic laws. For example, in Germany such banks are: Commerzbank, Deutsche bank, Dresdner Bank: in France the Credit Agricole, in United Kingdom, many international groups opened divisions, which provide islamic products and services, some of them being: HSBC Group, UBS Group, Barclays and Lloyds.

Challenges and opportunities for Islamic banking

Competition with conventional banking products: the potential Muslim clients can be devided into two segments: muslim customers, who agree to pay, even a higher price, in order to benefit from services, which have a prominent level of compliance with the Shariah Law and Muslim customers, attracted by the competitive rates, too, accepting sometimes services only in part with Shariah Law, but more attractive from the financial point of view. Due to this fact, in order to cope with local competition coming from conventional banking products, the Islamic banks, entering foreign markets, should make their products and services price competitive, too.

Lack of standardisation of the Islamic banking products, which can be a cause of ambiguity, theoretical existence of a wide range of transactions and activities which can be performed by this banks.

Lack of trained Islamic staff with possesion of deep financial and religious knowledge, in order to assure a strict compliance of all performed transaction with Shariah law.

Higer risks - the Islamic banks are exposed to higer risks comparativ to conventional banks: the Islamic banks can make use of less risky instruments, such as derivatives and also, the secondary and interbank markets are in the process of development.

Because the Islamic banks undertake higher risks, they should imobilize a greater amount of resources on the central bank account of the resident countries and corespondent account, making their activity less eficient.

Reffering to the opportunities for the Islamic banking on the European continent, these can be mentioned as follows: new customer base, diversification of their investment portfolios and new business opportunities; new tools for financing banking activities from cooperation with conventional banks, which offers Islamic banking products and services, and also new customer base.

CONCLUSIONS

The Islamic Banking entrance on the European Union market can be seen as an opportunity to attract the additional oil capital from the Middle East countries for the resident countries and as a substantial enlargement of the customer base for the Islamic banks. But there is still a great amount of work to be done, due to the challenges, that can be faced by the both sides, especially in the field of supervion and regulation. The concept of the Islamic banking is relatively new and completely different from that of conventional banking, because of that, the resident countries of this banks should adjust their legislation, and should account for all potential risks that can bring this new financial industry.

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