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RISK IN ISLAMIC BANKING AND COMPARATIVE ANALYSIS

Abstract

The study focuses on the analysis of the Risks in Islamic Banking. I identify specific risks, which are inherent to the Islamic Banking. In Islamic banking, an important principle is the distribution of profits and losses on transactions, as well as the prevention of interest (or usury). The deeper understanding and study of the topic of risk assessment and risk management in Islamic banking is required. Risk assessment is considered as a part of the overall risk management procedure. I employed quantitative methodology to determine the magnitude of the risks for each of the component of the Islamic banking system. There is also an attempt to provide a general framework for risk identification, assessment and management in Islamic banking. A conceptual model for risk management is proposed. The amount of risk associated with each of the common contracts in this banking system is discussed. An attempt is made to include a general structure for risk assessment and management in Islamic banking. The method of weighing assets risk may be the most appropriate or perhaps the only standard solution for classifying the contracts used by an Islamic bank. The nature and type of risk in Islamic banking resulting from the use of Islamic contracts is different from the Conventional banking. Islamic banks have a double risk, because the winner-loser relationship is not acceptable. The parties are jointly share the benefits and are jointly reliable for potential losses. I propose the methods to assess the risks in Islamic Banking and solutions for the risks avoidance and minimization. I challenge the existing way of risk assessment and management in Islamic Banking.

Keywords: Islamic Banking, Risk Management, Credit Risk, Liquidity Risk, Market Risk, Operational Risk.

Introduction

Attracting resources is one of the key, fundamental and strategic goals of banks and credit financial institutions. It plays a special role in providing banking services and is an important indicator for assessing the success of the Banks under consideration. In general, in economies whose financial system is Bank-based, Banks play a major role in supplying and allocating of the financial resources. The Banks have respective facilities and the funds attracted for example through deposits. For example, it is typical for the Iran economy. From this perspective, changes in the amount of bank deposits, as well as identifying the factors influencing the degree to which they are formed as a result of the above two roles, are of particular interest to savers, banking system managers, and economic policymakers. Islamic Banking (IB) pursues the same goals as the conventional banking, with the difference that in IB – the banking operations are based on Islamic jurisprudence. The most important principles in IB are that the profits and losses from the transaction are splited between the Bank and the customer and the avoidance of usury or paying of the interest. Sharia Islam has only forbidden usury (interest), but has not banned other capital gains. In other words, any precondition for the benefit of capital and debt have been banned. According to Islamic principles, the method of implementation and use of capital in a project and job creation cases from it is of special importance. IB is based on risk sharing, physical trade of goods, and direct involvement in trade and labor, rent and construction contracts using various sharia contracts. Risk sharing and its management is one of the goals to achieve the rule of participation and cooperation in carrying out projects Islamic banking. A comprehensive framework of risk management can be equally common in conventional banking and IB can be implemented.

To this end, a general framework for risk identification and management was developed, which is this technique it could be implemented in different situations, products and companies for Islamic Banks having an inclusive framework for risk management crucial. It is crucial for Islamic banks to recognize and evaluate the overlapping nature and transformation of the risks that exist between and among the categories of the risks. A strong risk management framework can help Islamic banks to reduce risk exposure and improve their ability to compete in the market. Reducing risk exposure in any element can help reduce risk throughout the system. The present article refers to the classic scientific papers on the topic, the Internet sites, containing data, authentic and existing articles and tries to introduce the types of risks existing in the IB system and the possibility of risk management in the system. The important question here is: which banking method to use to avoid or minimize the risk? That means less risk for the shareholders and depositors.

A review of the literature on the subject

Risk

Risk is what threatens the present or future of an asset or the ability to earn a company or organization. The risk of an asset can also be called a possible future change in the return on that asset, risk of possible loss, degree of probability of loss, this indicates the probability of loss. Risk in the sense of the possibility of the dander or damage; damage of loss or the reduction of income.

Risk management

Risk management refers to the systematic application of management policies, procedures and processes, and the analysis, assessment and control of risk. Risk management is the process of documenting the final decisions made and identifying and applying criteria. That they can be used to minimize the risk to an acceptable level. Risk management is a relatively new phenomenon that has made significant progress in recent decades created in the world of banking science. But in IB there is not much effort for the potential risks facing these banks have not been managed and addressed. There are several reasons for this backwardness, most of which are the state-owned Islamic banks some countries, lack of sufficient knowledge of Islamic principles, new science of risk management and the like. In any case, the occurrence of risk in IB or traditional banking of any form, it reduces the bank's profitability. This reduction in power can take three forms: one is lower profitability than expected, the second is the loss of all projected profits, and the third is damage. Obviously, the third form is the most destructive form of risk that can be eliminated by all or part of the bank's capital, or even part of the deposits (in its very acute form - all deposits), threaten a bank and endanger the bank's existence.

Types of risks

Liquidity risk: Liquidity management is one of the biggest challenges facing the banking system. The main reason for this challenge is that most of the banks' resources come from short-term deposits become financial. In addition, bank lending facilities are used to invest in assets with relatively low liquidity.

Credit Risk: The probability of non-return of the main subsidiary property of the provided object os usually called arising from the deterioration of the financial condition or bankruptcy of the recipient of the object. This risk is the inability of the customer to fulfill part or all of its obligations under the contract, during which some of the bank's assets are reduced in value and devalued. Given that banks' capital is less than the total value of their assets. Even if a small percentage of the loans are not repayable, the bank runs the risk of bankruptcy. It can also be said that credit risk is the risk of losing income (loss), which the result is a delay in payment or non-payment of obligations on time as agreed in the contract is located.

To manage and control credit risk, it is necessary to pay attention to the following items:

– Develop the necessary regulations and instructions in order to organize the process of granting facilities.

– Determining the ceiling of facilities that can be granted to the customer and the necessary guarantees.

Market risk: Market risks can be systematic or non-systematic, these risks are related to losses on the bank's assets that are caused by changes and fluctuations in market factors such as exchange rates, interest rates and stock prices. Market risk management to some extent feasible through financial derivatives that includes futures, options and swaps (exchange contracts).

Operational risk: Operational risk, the direct or indirect risk of losing results: inadequate or incorrect processes within the organization such as human errors or technical incidents and errors or the effect of external events. Operational risks may lead to credit and market risks. Operational risk can be managed and controlled in the following ways: upgrading computer systems and continuously controlling and monitoring them; improving the internal control system; staff training; employing the necessary expertise commensurate with the complexity of banking.

Legal risk: This risk is particularly significant for Islamic banks because of its unique nature. To begin with, many countries have adopted customary or civil law, but their legal structures lack legislation to cover Islamic financial transactions. For example, while Islamic banks' main activities are Murabaha trading and investment, participation, and Mudaraba, the current ban on these activities makes it difficult for them to expand. The second explanation is that non-standard contracts will make transactions more complex and expensive in the negotiating process. Financial institutions have no way of anticipating or protecting themselves from risk. The use of standard contracts makes the transaction easier to track and execute finally, the absence of Islamic courts can increase the legal risk of Islamic contracts. This means that the risk arises when a transaction is not legally enforceable.

Risk management in Islamic financial contracts

Islamic banks with two categories of risk, common to the conventional banking system and specific to banking they face Islam. Many operational risks fall into the category of partnership risks that practice have similar management. The main challenge in risk management in IB goes back to the unique dimensions of this system, which is mainly due to the nature of Islamic contracts. Risk in styles the variety of Islamic investment is complex and extensive Table 1. The sensitivity of the few Islamic banks in relation to the risks of different investment style show According to the table below, a study conducted by the Islamic Development Bank of Pakistan aimed to identify aspects of different risks and their management in Islamic banks, as well as the degree of risk associated with contracts. For this reason, 68 Islamic banks and institutions from 28 countries were questioned. Only 15 of these institutes responded, and only 15 of them were considered trustworthy by the research team.

Table 1

Classification according to the importance of risk

Classification	Credit risk	Market risk	Liquidity risk	Operational risk
Interest	8.01	8.19	8.08	8.1
Speculation	9.91	9.90	8.91	8.38
Participation	9.10	9.01	9.1	9.1
Rent	8.00	9.01	9.0	8.3
Istisna'a	9.09	8.19	9.1	9.83
Loans	9.81	9.89	9.8	9.89
Share Tadleel	9.09	9.9	9.09	9.01

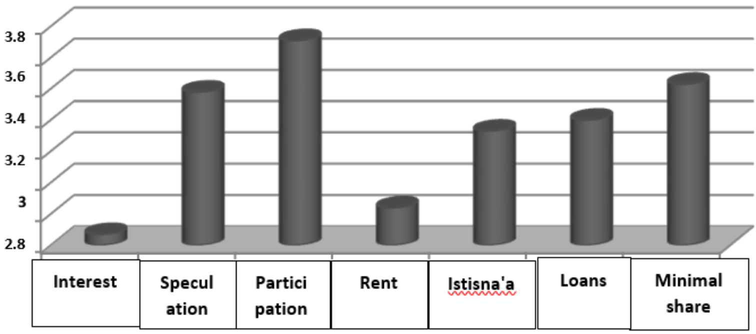

Fig. 1. Risk level scale

As it can be seen, in credit risk participation is the most risky and Murabaha has the lowest risk.

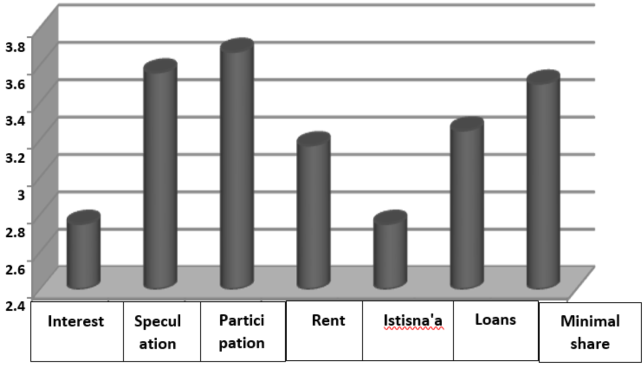

Fig. 2. The degree of market participation risk for Islamic contracts

Risk management system in Islamic banking

Due to the complex nature of the risks faced by Islamic banks, it is difficult to reduce them. Table 2 shows the risk management system in 17 Islamic banks each bank has been asked about various aspects of the risk management system, 6 questions about establish a proper risk management system and 9 questions about establishing a proper system Risk assessment and 5 questions about proper internal monitoring. The data inside the table show that Islamic banks are practicing risk management policies and use better practices, limiting and reducing the risks.

Table 2

Risk management components

Risk management components	Total score	Percentage
Establish a proper risk management system	84(1.3)	82,4
Establish a proper risk assessment system	106(153)	69,3
Proper internal monitoring	65(85)	76,5

Conceptual model for risk management

The relationship between risk management activities and four facets of the mechanism is examined here. Risk assessment encompasses risk perception and management, as well as risk recognition, risk analysis, and risk monitoring and tracking. The following are some risk control techniques.

RMP = f(URM, RI, RAA, RM)
RMP =Risk management practices
URM = Risk perception and risk management
RI = Risk diagnosis
RAA =Risk analysis and assessment
RM=Risk monitoring

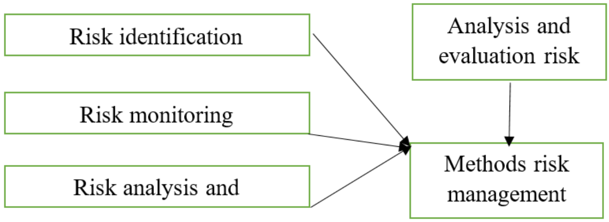

Fig. 3. The conceptual framework indicates a positive relationship between risk management practices and various aspects of the risk management process

Conclustion

The existence and form of risk that occurs in IB as a result of the use of Islamic contracts differs from traditional banking risks. Since the winner-loser relationship is not appropriate in Islamic economic thinking, Islamic banks face a double risk as compared to traditional banks. The economic behavior of the parties is such that, while sharing the benefits, they jointly accept responsibility for the possible damages. In all Islamic contracts in the IB system, it is not possible to transfer the risk of any of its activities to the other party, and in general, its portfolio has a higher risk. This issue emphasizes the need for prudent management of assets and liabilities and optimal control of higher risk assets. It can be the most appropriate or perhaps the only regular solution to classify the contracts used by an Islamic bank and help it control and manage its collection. Based on the above points, effective risk management in IB requires a dual strategy based on an appropriate regulatory framework as well as optimal expansion of institutions.

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РИСК В ИСЛАМСКОМ БАНКИНГЕ И СРАВНИТЕЛЬНЫЙ АНАЛИЗ

Аннотация

Предметом исследования является анализ рисков в исламском банковском деле. Определяются конкретные риски, присущие исламскому банкингу. В исламском банкинге важным принципом является разделение прибыли и убытков по операциям между, а также недопущение ростовщичества. Требуется более глубокое понимание и изучение темы оценки рисков и управления рисками в исламском банкинге. Оценка рисков рассматривается как часть общей процедуры управления рисками. Был использован количественный метод для определения величины риска для каждого компонента исламской банковской системы. Также предпринимается попытка представить общую основу для выявления рисков, оценки и управления рисками в исламском банкинге. Предлагается концептуальная модель управления рисками. Рассматривается размер риска, связанного с каждым из общих контрактов. Сделана попытка создать общую структуру для оценки рисков и управления ими в исламском банковском деле. Метод взвешивания рисков активов может быть наиболее подходящим решением для оценки контрактов в исламском банкинге. Природа рисков исламского банкинга, возникающих в результате использования исламских контрактов, отличается от традиционного банковского дела. Исламские банки несут двойные риски, так как отношения побудителя и проигравшего здесь не допустимы. Стороны совместно получают выгоду и несут ответственность за возможные убытки. Предлагается метод оценки рисков в исламском банкинге и решения по их предотвращению и минимизации. Оспаривается существующий способ оценки и управления рисками в исламском банкинге.

Keywords: исламский банкинг, управление рисками, кредитный риск, риск ликвидности, рыночный риск, операционный риск.

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A. Khalfa

TRADE WARS AS DISPUTES WITH A SUBSTANCE OF A TENSION

Abstract

This study tries to construct an alternative theory of trade wars to analyze the trade disputes that could not be understood by the existing trade war theories. Taking the US-China trade war as a case study, we found that previous theories of trade wars are unable to provide a comprehensive analysis for the current trade conflict. Therefore, this study proposes another perspective for understanding trade wars. It argues that While previous trade theories took only economic reasons as a cause of trade wars, trade wars could be used as an economic tool caused by political reasons. By applying a process-tracing methodology, we first argue that the economic causes provided by different previous theories do not have a strong explanation power in explaining the main reasons behind the US-China trade dispute, and then we provide a hypothesis which argues that the causes could be mainly political. This paper challenges the dominant understanding of the primacy of economic factors in trade wars and argues that political factors could also be taken as an independent variable. The paper distinguishes between disputes of trade wars due to economic factors and disputes with a substance of a tension in which trade wars are caused by political factors.

Keywords: Trade Theories, China-US Tech war, Trade Wars as disputes with a Substance of a Tension, conflict of power, Middle-Income trap.

Even though free trade can increase global wealth, some protectionist policies can benefit the states to be able to increase their wealth and to create an advanced economy. Countries tend to use some protectionist policy. However, believing in the advantages of protectionism will put countries in the prisoner's dilemma and the world will enter into endless trade wars. Nevertheless, it is not what we are seeing today. With all the trade tensions that happen from time to time, the world maintained