إدارة المخاطر التجارية ومعدل العائد في البنوك الإسلامية

THE MANAGEMENT COMMERCIAL RISK AND RATE OF RETURN IN ISLAMIC BANKING

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ملخص

تتعرض البنوك الإسلامية لمخاطر مختلفة عن البنوك التقليدية بسبب القيود التي تفرضها على نفسها والطبيعة المحددة لأساليب إدارتها. لمواجهة هذه المخاطر ، يجب عليهم تطوير أساليب مناسبة لإدارة المخاطر. وعلى هذا النحو فإن البنوك الإسلامية أصبحت تواجه، بالإظافة إلى جميع أنواع المخاطر التي تتعرض لها البنوك التقليدية، أنواع أخرى من المخاطر أكثر حدة. وفي هذا الإطار فإن الهدف الرئيسي لهذا العمل هو بسط و تحليل مختلف الطرق و الأساليب المعتمدة قصد تدبير المخاطر الخاصة بالبنوك الاسلامية. و من أجل تحقيق هذا الغرض سنقوم بجرد مختلف المخاطر التي تعترض عمل هذه البنوك و كذا أساليب تطبيق مخرجات و اتفاقيات لجنة بازل 3 المرتبطة بنشاط الأبناك الاسلامية قصد تحليل منهج إدارة هذه المخاطر من خلال تقديم نموذج "بنك البركة" في كيفية إدارته للمخاطر التجارية المتداولة و كذا لمخاطر معدلات العائد.

الكلمات المفتاح

. إدارة المخاطر ، المخاطر التجارية المتداولة ، مخاطر معدل العائد ، البنوك الإسلامية ، بنك البركة.

Abstract:

Islamic banks works according to a certain ethic. Islamic banks are exposed to risks that are different from conventional banks due to the constraints they impose on themselves and the specific nature of their management methods. To address these risks, they must develop appropriate risk management methods. Thus, the purpose of this paper is to analyze these specific risk management methods within Islamic banks. First of all, it is necessary to identify the main risks, then to treat the modalities of application of the Basel agreements to Islamic banks, and finally to analyze the management approach of these risks through example of "Al Baraka Bank" in its management of traded commercial risk and the rate of return risk.

Keywords:

Risk Management, Traded commercial risk, Rate of return risk, bank islamic, Al baraka bank

Introduction

Risk management has become a central and transversal function in financial institutions, including Islamic ones. Banks face diversified risks that require optimal and intelligent management. The 2008 financial crisis reinforced this orientation towards increased vigilance and monitoring, or even more prudential and regulatory measures. All financial institutions need to improve their risk detection and management practices. Islamic financial institutions (IFI), which support a variety of risks, must make risk management their priority in order to win the battle and meet the challenges of a rapidly changing international financial system. IFIs face not only traditional banking risks, but also specific risks due to their particular way of operating.

Thus, IFIs incur two types of risks. The first type, shared with traditional banks as financial intermediaries, concerns credit risks, market risks, liquidity risks and operational risks. But with regard to the rule of Sharia compliance, the nature of these risks is changing. The second type concerns the new and unique risks that Islamic banks will face because of their specific asset and liability structures. Therefore, due to their unique nature, Islamic institutions are called upon to develop more rigorous systems for risk identification and management.

That said, the main objective of this paper is to try to answer the following central question: How can specific risks within Islamic banks be assessed and managed, including translated commercial risk and rate of return risk?

To do this, we will try to provide the answers to the following sub-questions:

- What are the specific risks to Islamic finance and in particular the translated commercial risk and the rate of return risk?
- What risk management techniques are currently being used and what other modalities should be explored?

In order to answer the question asked, to find elements of a solution to the problem raised, we will adopt a descriptive analysis likely to identify the main risks related to Islamic finance and then seek, subsequently, its management modalities.

To do this, it is first of all necessary to make an overview of the risks facing Islamic banking institutions; i.e. to identify the common risks between conventional banks and the specific risks to Islamic finance, while emphasizing on the two principles; the translated commercial risk and the rate of return risk (I). The second point will be devoted to the approach of managing specific risks, considering the example of "Al Baraka Banking Group" in its management of translated commercial risk and the risk of the rate of return (II).

I. Risks in Islamic banks

Islamic banks face the same risks as conventional banks and are sometimes exposed more actually as capital investors. First, we will present the different risks specific to Islamic banks such as stock risks, risk of abandonment financing operations, concentration risk, sharia arbitrage risk (sharia arbitration). The second point will be devoted to the two main risks: the translated commercial risk and the rate of return risk

I.1 Specific risks in Islamic bank

The risks specific to Islamic banks are of various types, ranging from stock risk, risk of abandonment of operations, concentration risk, sharia risk, etc,

I.1.1 Stock risks

This risk stems from the specific nature of the Islamic banks' financing method, which is based on purchase/sale operations in the form of a Murabaha, or leasing in the form of an Ijara, in order to make profits, whereas any surplus or gain from a traditional loan operation is considered as Riba. This implies the creation of a stock of goods for banks, which will then be used for Murabaha's operations for sale, or Ijara for rent. The constitution of this stock will obviously be accompanied by a management risk, a risk of loss of the stored products, a delivery risk for customers, or even a risk of non-compliance with the needs initially expressed by the customer[2].

I.1.2. Risk of abandonment of financing operations

The risk of abandonment financing operations is another example of the specificities of the financing method of Participating banks, particularly via Murabaha and Ijara products. Indeed, these banks, in order to reduce other risks in particular those related to stock, favour the purchase of the property to be financed at the customer's request. However, if the customer decides to abandon the transaction after the property is purchased by the bank, the bank will have to find another buyer for the property, at the risk of selling it at a price below its cost.

I.1.3. Concentration risk

The concentration risk in the case of Islamic banks is specific in that, for the time being, the banking jobs intended to manage liquidity are not very varied. So, only few large companies admitted for investment meet Islamic criteria. In addition, on the liabilities side, the number of institutional counter-parties is not very high. These elements leave Islamic banks dependent on low use of their resources.

In order to ensure the stability of the banking system, which is at the heart of contemporary economic activity, international bodies have been created with the main role of establishing rules and recommendations in the field of banking supervision, including defining the main financial risks and mechanisms to protect against them. The most well known organization in the world of finance is the Basel Committee.

I.1.4. Sharia arbitration risk (sharia arbitration)

The multiplicity, difference and standardization of financial contracts used by Islamic banks impede the proper functioning of this Islamic financial system. Thus each Islamic bank defines, independently of the others, its own instruments according to its own understanding of Sharia law, its internal regulations, and its needs.

Conventional banks are characterized by two types of competition: one on the assets side and the other on the liabilities side. In addition to them, in the Islamic banks, there is a competition in the application of religious principles. One bank can claim to be "more Islamic" than another. In this case, the incentives for innovation are low. In addition, the lack of standardised contracts, the absence of a legal system to intervene in the event of a dispute, and the lack of monitoring of the proper functioning of the system increase the legal risk associated with Islamic contracts.

Finally, there is a need for standardization of standards and practices, a necessary prerequisite for the globalization of this growing industry.

I.2 Translated commercial risk and rate of return risk

In this paragraph, the main focus will be on the two main risks that will be the subject of our analysis through an example, namely the translated commercial risk and the rate of return risk.

1.2.1. Translated business risk

Displaced or translated commercial risk is a new term in the banking risk literature. It results mainly from the risk incurred by Islamic banks on the liability side. As a result of the mobilization of deposits that is on the basis of the Moudaraba contract. Islamic Financial Services Board (IFSB, 2005) in its report on Islamic financial institutions defined translated commercial risk as: ' the risk arising from assets managed on behalf of investment Account Holders which is effectively transferred to the Islamic Financial Institutions own capital because the institution forgoes part or all of its mudarib's share (profit) of a such fund, when it considers this necessary as a result of commercial pressure in order to increase the return that would otherwise be payable to Investment Account Holders 5". This risk arises when an Islamic bank is under pressure to pay its investor-depositor, with a higher rate of return than what should be payable under the actual term of the investment contract.

The translated commercial risk then arises from the fact that the Islamic bank, under the effect of investment competition particularly from traditional banks with Islamic windows and other Islamic banks, strives to offer competitive rates of return to its depositors at the expense of its shareholders whose profits will be punished. In other words, displaced commercial risk refers to the risk of loss that is absorbed by Islamic banks to ensure that investment account holders (investment deposit) are paid the same price offered by conventional banks. Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI, 1999) considers this risk as a rate of return equivalent to the volatility of the rate of return, and the rate of counterparty risk that is generated by financial assets, investment accounts.

The displaced commercial risk, caused by income volatility, is to be borne by the shareholders or the Islamic bank itself (IFSB, 2011). This is, in fact, the profit transferred from the shareholders and/or the bank in the form of a donation to the holders of the investment accounts, with the aim of increasing the profits generated by these accounts in the event of strong competition with conventional banks.

I.2.2. Return rate risk

This risk is associated with an adverse change in market factors affecting the rate of return on the Islamic Bank's assets Return on Assets (ROA), compared to the rate of return expected by investment account holders. The latter is the result of the agreement between shareholders and investment account holders.

To build investor customer loyalty, Islamic banks could adopt three techniques to address inappropriate business risk and return risk. The revealed objective is to improve the return on investment of investment accounts while making them more attractive than what traditional banks offer.

-The first technique is called the profit smoothing reserve, or Profit Equalization Reserve (PER) which consists of setting aside a portion of the profits generated by investment projects. The remaining income will be allocated between the holders of the investment accounts and the bank's shareholders. PER aims to improve the rate of return on investment accounts.

The second technique is called the Investment Risk Reserve or provisions for investment-related risks (IRR), when the investment accounts record losses, IRR replenishes the investment accounts by drawing part of the reserves from past profits;

-The third technique is a simple donation (hiba) of a portion of the bank's and shareholders profits to the benefit of investment account holders for the purpose of improving the rate of return on investment accounts.

However, on the basis of the principle of loss and profit sharing of PPPs, the capital invested in these investment accounts should not be guaranteed by the Islamic bank. In reality, and in case of a loss, all those involved in the investment will have to bear the consequences.

II. Translated business risk and rate of return management

Even if Islamic banks are not yet of systemic size, they also concentrate on a number of risks and their probability of default that must be limited, otherwise such a situation would certainly disrupt the financing of the economy and the functioning of the payment system. In the next section, we will try to calculate the translated commercial risk and the rate of return risk, using the database of the Al Baraka Banking Group annual report, over the period from 2011 to 2014.

II.1 Risk management in Islamic banks

In the banking system, risk management is of particular importance. This importance is further accentuated by the interdependence between the different financial institutions. The failure of even a small bank could affect the stability of the entire payment system. Hence the importance of effective risk management control in the banking system. Achieving this objective requires the development of a risk management culture by regulators and supervisors, but also an understanding of the nature of these risks and the promotion of their effective management through the internal controls of financial institutions.

II.1.1.1. Regulation and supervision of Islamic banks

There can be no opposition to the idea that Islamic banks' risk management systems must meet the requirements of international standards. However, we have seen that Islamic banks face even greater risks than their traditional counterparts. As a result, some standards are exclusively intended for Islamic banks.

Thus, adequate supervision of Islamic banks requires a prior study of the risks faced by Islamic banks, before formulating guidelines for appropriate supervision of Islamic financial institutions. Several authors have attempted to propose procedures for the regulation and supervision of Islamic financial institutions, in particular Islamic banks. Chapra and Khan (2000), among others, have conducted studies on the issue and proposed relevant recommendations for good risk management in Islamic banks.

II.1.2. Applicability of international standards to Islamic banks

The Basel Committee's Core Principles underline the prerequisites for effective banking supervision. In addition to these preconditions, other specific conditions have been set for the proper supervision of Islamic banks. Some of these preconditions must be met by the regulatory

and supervisory bodies of banks, including the creation of an environment conducive to fair competition, licensing, the lender of last resort mechanism compatible with the specificity of Islamic banks, a favorable legal framework, a legal audit of Sharia law, etc. The other part of the preconditions must be fulfilled by the Islamic banks themselves. They also include the development of an interbank market with sharia-compliant instruments, the processing of a number of Fiqh issues, the development of internal control and risk management systems, etc.

Regarding the fundamental principles required for proper banking supervision, disclosure and transparency requirements; they also apply to Islamic banks. Due to their profit-sharing, Islamic banks need to develop much more effective control and transparency systems.
The difficulty in applying international standards to Islamic banks lies in the application of capital adequacy standards. First, because of the profit-sharing system, Islamic banks need much more equity capital than their capitalist rivals. Secondly, the need to adapt international standards to Islamic banks is accelerating efforts to establish the Supervisory Board for Islamic Financial Services.

Finally, risk assessment systems such as CAMELS of a great interest to Islamic banks because they can be adapted without great difficulty.

A number of advantages of the Banking Risk Management IRB approach could be useful for good risk management within Islamic banks. First, the approach highlights the risk profile of each asset individually. Given that Islamic financing methods are diversified, the IRB approach is much better suited to these modes than the standard approach. Second, the IRB approach links banks' current risk exposure with capital requirements and is therefore perfectly applicable to Islamic banks. Third, the IRB approach aims to encourage banks to develop a risk management culture, which helps to reduce risks in the banking industry and strengthen the stability and efficiency of the financial system. Fourth, it is clear that this approach will make it possible to manage reliable information while strengthening transparency and market discipline. Fifth, by using the external evaluation of appropriations as a reference, it really gains more internal and external reliability. This is very important, as an external credit assessment may not have the right information as collected by the internal rating system, while the latter may lack the objectivity demonstrated by the external rating bodies. This fact, used in harmony with incentives for rigorous risk management, can be valuable in the process of controlling moral hazard and capital arbitrage.

II.2 The risk management approach according to Al Baraka Bank Group

Al Baraka Bank is located in more than 15 countries, in Pakistan, Tunisia, Bahrain, Algeria, Lebanon, South Africa, etc.

In Morocco, Al Baraka Banking Group in Bahrain, in partnership with the Moroccan Foreign Trade Bank (BMCE), created the participating bank, Bank Al Tamwil wal Inmaa. In the following, we will focus on risk management within this major Islamic financial institution[9].

II.2.1. Al Baraka Banking Group and its risk management approach

The Al Baraka Bank group is committed to internationally recognized principles and policies in risk management. In particular, the Group fully subscribes to the risk management guidelines adopted by the Islamic Financial Services Council established by the Islamic Financial Services Commission (IFS).
The Head of Credit and Risk Management is responsible for formulating and monitoring the Group's policies on all aspects of risk, developing the framework for risk measurement and ensuring coordination with the Group's subsidiaries, implementing all necessary measures to comply with Basel II and Basel III requirements, etc. It is also responsible for the introduction and implementation of risk measurement software, monitoring to measure the group's compliance with risk measurement standards and reporting to management on the rate of return based on the level of risk associated with the group's capital.
The objectives of the Group's risk management are:

- To enable the group to calculate the risk-adjusted return on capital;
- To establish a professional risk management culture throughout the group with a disciplined and prudent approach based on the global approach;
- To have qualified professional teams and to adopt a policy of recurrent continuous training;
- To invest in technology and systems that enable the ownership and integration of best practices in the field of risk management;
- To comply with all sharia standards; legal and regulatory requirements etc.

II.2.2.2. Changes in the financial indicators of Al Baraka Banking Group ABG

The table below shows the main financial indicators of Al Baraka Banking Group (ABG) from 2010 to 2014:

Table 1: Financial indicators of Al Baraka Banking Group (ABG)

Value in USD Millions	2010	2011	2012	2013	2014
Total assets	1347	1598	1418	1631	1835
Financing and investment	883	1035	1041	1008	1339
Total deposits	1135	1284	1216	1416	1592
Total capital	183,95	178,83	168,76	164,80	169,88
Annual profit	4,6	2,6	-10,6	0,9	2,1
Price to earnings ratio (PER)	3,79	2,12	-8,67	0,7	1,7

Source: Done by us on the basis of ABG's annual reports (2010, 2011, 2012, 2013 and 2014).

On reading this table, a number of significant results attract our attention. As a result, Al Baraka Banking recorded an annual profit decline of USD 10.6 million in 2012. Indeed, this situation had as a direct impact on the decrease in the price-earnings ratio of 8.67. This means that in 2012, the Al Barak Group systematically achieved negative results. But, generally over the period 2010-2014, ABG has achieved accelerated growth by focusing on building high quality assets with a stable and well diversified liability base against the volatility of deposits in the market. This remarkable growth was maintained by the Al Baraka group, consolidating its financial position from USD 1347 million at 31 December 2010 to USD 1835 million at 31 December 2014.

II.2.3. Translated commercial risk and rate of return management at Al baraka Bank

To manage the rate of return risk and the translated commercial risk, the Al Baraka Islamic Bank Group of Bahrain uses the reserve technique. We distinguish between two types of reserves: Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR). The following table summarizes the risk management policy pursued by the Al baraka Bank group over the period 2011-2014.

Table 2: Specific risk management policy by Al Baraka Bank

Non-restrictive investment account (CINR)	2011	2012	2013	2014
PER	**524542**	**544632**	**573411**	**574489**
Balance sheet as at 1 January	**965311**	**524542**	**544632**	**573411**
Allocated amount of income attributable to holders of CINRs	**19331**	**20090**	**20738**	**23174**
Amount used during the year Foreign currency	**(460100)**	-	**8041**	**(22096)**
Tier 1 (December 31)	-	-	-	-
Tier 2 (December 31)	**524542**	**544632**	**573411**	**574489**
IRR	**2737120**	**2604947**	**2418610**	**2338207**
Balance sheet as at 1 January	**1156962**	**2737120**	**2604947**	**2418610**
Allocated amount of income attributable to holders of CINRs	**240301**	**214**	**476**	**(1097)**
Amount allocated to/from the provision Exchange rate difference	**1339857**	**(132387)**	**(186813)**	**(79306)**
Tier 1 (December 31)	-	-		-
Tier 2 (December 31)	**2737120**	**2604947**	**2418610**	**2338207**

Source: Table prepared by us on the basis of ABG's annual reports

The Central Bank, like the IFSB and AAOIFI, recognizes the exposure of Islamic banks to translated commercial risk, which makes it mandatory to respect certain prudential reserves. Two types of reserves are used: the first is the Profit Equalization Reserve (PER), which is a reserve for equalizing returns withheld from the bank's gross income before allocating profits between shareholders and investment account holders. This allows a certain level of profit to be maintained for investment accounts. The second is the Investment Risk Reserve (IRR), which is an investment risk reserve to protect investment account holders against possible losses. Based on the above table, only the amount of IRR can be said to have decreased over time, if it is very large. On the other hand, the PER recorded an increase.

Conclusion

Risk exists when an Islamic bank does not provide sufficient profitability to the holders of these accounts. They compare their remuneration with that of competing banks and consequently withdraw their funds. Thus, creating a high liquidity risk for the bank. The literature shows that Islamic banks' practices diverge from theory with regard to investment accounts. Under commercial and/or regulatory pressure, Islamic banks are obliged not to respect the principle of real profit sharing as stipulated in the Mudaraba contract. Thus, smooth the income on the participating investment accounts.

In this paper, we discussed risk management in an Islamic bank. In the empirical study we tried to see the behavior of Bahrain's Al Barak Bank in managing displaced commercial risk and the rate of return by using the RER and IRR type reserves with the aim of improving the rate of return on investment accounts. In Morocco, the participating banks began their activities in 2017 and the legal, regulatory and fiscal arsenal of this young financial industry is being built. These new Moroccan banks have every interest in taking into consideration the experiences of Islamic banks, which started their activities decades ago, in the field of risk management and hedging.

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