UNIVERSITI TEKNOLOGI MARA

BANKING RISKS: GLOBAL EVIDENCE FROM ISLAMIC FINANCIAL INSTITUTIONS

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ABSTRACT

Banks are the skeletal structure in a country that plays a vital role as intermediaries in circulating the money in the economy. They involve numerous types of risks in day-to-day banking business activities. The risks are uncertain event inducing negative impacts to the financial system of a country. Although the risks are inevitable, they can still be mitigated. Therefore, the regulators and banks are responsible to mitigate the risks in the banking system. The reason is to avoid severe risks spill-out which could harm the money circulating in the economy. If this happens, it can decelerate the banking business activities and in the worst case, lead to the malfunction of the banking system in a country hence, alarming the country's growth. In response to the abovementioned issue, this study is motivated to investigate the possible factors influencing major banking risks that are: credit risk, liquidity risk and capital risk from the Islamic banking perspective. Furthermore, the study includes additional factors of Sharia compliancy (SC) and moral hazard (MH) in addition to CAMEL approach (C-capital adequacy, A-asset quality, M-management quality, E-earnings and L-liquidity). The study covers from the year 1999 to 2015 equivalent to seventeen (17) years, unbalanced panel data. The study focuses on the nine (9) major market players of Islamic banks that include Bahrain, Indonesia, Kuwait, Malaysia, Pakistan, Qatar, Saudi Arabia, Turkey and United Arab Emirates. The study employs Instrumental Variable Two-Stage Least Squares (IV2SLS) for the multiple regressions. The findings reveal traditional CAMEL approach influences the three (3) major risks differently. There are evidences that liquidity risk is influenced by the Sharia compliancy however, it does not have any influence on the other two (2) risks; credit risk and liquidity risks of Islamic banks. Interestingly, the Islamic banks are less likely to face moral hazard issue of too-big-to-fail (TBTF). Both of the control variables that are, economy and financial crisis influence the liquidity risk. However, the economy only influence capital risk whilst the financial crisis only influence the credit risk. The research findings benefit the market players of banking and finance industry that are banks, regulators, economists, investors, researchers and consumers.

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