

UNIVERSITI TEKNOLOGI MARA

**ISLAMIC BANK'S FEE INCOME
AND RISK: EVIDENCE FROM
PANEL DATA ANALYSIS BETWEEN
MALAYSIA AND INDONESIA**

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ABSTRACT

Fee income, a component of other operating income in Islamic banks, has become progressively important in raising the bank's earnings to counter declining net incomes due to competition from other financial competitors. However, it is vital for Islamic banks to determine any potential risk that will affect their performance due to this activity since they are channelling their focused toward fee income activities. By employing panel data analysis and quarter data of fourteen Malaysia Islamic banks and six Indonesia Islamic banks from the year 2009 to 2013, this study aims to examine the relationship between Islamic bank's fee income and characteristics with the risk in Malaysia and Indonesia. The empirical results proved that, fee income activities able to reduce Islamic bank's risk with weak significant impact. Besides that, Islamic banks with a larger value of total assets, total equity and total loans can offset the banks' risk. Therefore, for policy implication, the government should set up capital requirement specifically for fee income activities that suit with the Islamic bank's principle and risk to expand further on these activities. Islamic banks also are recommended to increase their assets value to ensure the sustainability of Islamic banking operation. In addition, to facilitate Islamic banking to remain sustainable and be competitive in the banking industry, it is imperative for Islamic banks to improve their risk management capabilities.

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CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

This chapter offers an overview of the background of the study, the problem statement, the research objectives and research questions, the scope of the study, the significance and the limitations of the study. It concludes with a description on how the research is structured.

1.2 BACKGROUND OF THE STUDY

Malaysia's Financial System is structured into two main groups which are the Financial Institutions and Financial Market. Banking System and Non-bank Financial Intermediaries is categorized under the Financial Institutions consist of the. Money and Foreign Exchange Market, Capital Market, Derivatives Market and Offshore Markets is grouped under the Financial Market. Figure 1.1 below depicts the Structure of the Financial System in Malaysia.

Malaysian banking system comprises of Bank Negara Malaysia (BNM), four main types of banking institutions (commercial banks, finance companies, merchant banks and Islamic banks) and a miscellaneous group (discount house and representative offices of foreign banks). The current total assets of the banking system are valued at USD 611,228 at the end of May, 2015 and it is the major component of the financial system (Bank Negara Malaysia, 2015a).

BNM as a statutory body plays an important role as the central bank of Malaysia and established on 26 January 1959 under the Bank Negara Malaysia Act 2009 which replaces the Bank Negara Malaysia Act 1958 (Bank Negara Malaysia, 2014a). It is a new act that continued the existence of the bank as the central bank, extended BNM authority on promoting and advocating monetary and financial stability and provides supervision on payment systems (Bank Negara Malaysia, 2009). BNM has several functions which are upholding monetary stability and ensuring a sound financial structure, issuing currency and keeping reserves to safeguard the