Journal of Financial Stability 25 (2016) 47–57

Contents lists available at ScienceDirect

Journal of Financial Stability

journal homepage: www.elsevier.com/locate/jfstabil

A net stable funding ratio for Islamic banks and its impact on financial stability: An international investigation

Dawood Ashraf[a,*], Muhammad Suhail Rizwan[b], Barbara L'Huillier[c]

[a] Islamic Research & Training Institute (A member of Islamic Development Bank Group), 8111 King Khalid Street, Jeddah 22332-2444, Kingdom of Saudi Arabia
[b] NUST Business School, National University of Sciences and Technology (NUST), Islamabad, Pakistan
[c] College of Business Administration, Prince Mohammad Bin Fahd University, Al Khobar 31952, Kingdom of Saudi Arabia

ARTICLE INFO

Article history:
Received 25 November 2015
Received in revised form 21 June 2016
Accepted 29 June 2016
Available online 4 July 2016

Keywords:
Islamic banks
Net stable funding ratio
Financial stability
Regulatory framework
IFSB

ABSTRACT

The Islamic Financial Services Board (IFSB) is the standard setting body for the Islamic banking industry. The IFSB, while endorsing the Basel III accord, modified the criteria to calculate the Net Stable Funding Ratio (NSFR) to cater for the unique aspects of the Islamic banking industry. In this paper, we calculated the modified NSFR of 136 Islamic banks from 30 jurisdictions between 2000 and 2013 and explored the potential impact the requirements of this ratio has on the financial stability of Islamic banks after controlling for bank, country, and market-specific variables. The empirical findings suggest that the modified NSFR has a positive impact on the financial stability of Islamic banks during the sample period. However, the marginal impact of the NSFR on stability diminishes as the size of the bank increases. The results remained robust after applying an alternative measure of stability and using an alternative estimation model based on an instrumental variable approach. These results validate the use of the IFSB's modified NSFR for Islamic banks as a regulatory measure.

© 2016 Elsevier B.V. All rights reserved.

1. Introduction

The 2007–2009 global financial crisis highlighted weaknesses in the conventional banking system and drew attention to the success of the Islamic banking model (Hasan and Dridi, 2010). The Islamic banking sector grew at an exceptional compound annual growth rate of 17% during the period 2008–2013. It now accounts for more than a quarter of the total banking assets of 10 countries where the majority of the population is Muslim including five of the oil-rich members of the Gulf Cooperative Council (GCC)[1] (Islamic Financial Services Board, 2015a).

In response to weaknesses in the global financial system, the Basel Committee on Banking Supervision (BCBS) introduced two new regulatory measures in the Basel III regulatory framework. One is a liquidity coverage ratio (LCR) that focuses on the short-term liquidity of banks and the other is a net stable funding ratio (NSFR) that aims to monitor the long-term funding stability of banks.

Although adoption of the Basel III accord is being phased in, it is expected that by 2019 all requirements will be fully implemented. The full impact of these new regulatory requirements on the banking industry is still unknown. However, there is already a growing literature assessing the potential impact these new regulatory measures will have on the stability of conventional banks. This literature capitalizes on the argument that the newly introduced regulatory measures (NSFR and LCR) can be calculated using existing data and their 'potential' impact on banks can be explored retrospectively. Yan et al. (2012), using data from a sample of 11 UK banks for the period 1997–2010, found that higher regulatory capital requirements not only reduce the probability of a banking crisis but also reduce the economic loss from a banking crisis. Similarly Jiraporn et al. (2014), using data from a sample of 68 banks from 11 East Asian countries for the period 2005–2009, reported an inverse relationship between the NSFR and risk-taking behavior of banks. King (2013), using data from a sample of banks from 15 countries, suggested that the implementation of the NSFR has adverse consequences for the economy due to the shrinking of banks' balance sheets, changes in the composition of assets or maturity thereof.

The business model for Islamic banks is quite different from that of conventional banks in terms of their asset-liability structure and product offering. The International Monetary Fund (IMF) (2011) suggested that the business model on which banks base their

* Corresponding author.
E-mail addresses: dashraf@isdb.org (D. Ashraf), suhail.rizwan@nbs.nust.edu.pk (M.S. Rizwan), blhuillier@pmu.edu.sa (B. L'Huillier).

[1] GCC member countries include Saudi Arabia, Kuwait, Qatar, UAE, Bahrain, and Oman.

http://dx.doi.org/10.1016/j.jfs.2016.06.010
1572-3089/© 2016 Elsevier B.V. All rights reserved.

Table 1
Islamic bank assets and liabilities and their conventional counterparts. Comparative haircuts given by Basel III for conventional banks and IFSB for Islamic banks are given in the last two columns respectively. These haircuts are based on the authors' understanding of quantitative guidelines for the calculation of the NSFR published by the IFSB (for Islamic banks) and Basel III for conventional banks.

Islamic product	Conventional counterpart	Nature of the contract for Islamic banks	Key features	Haircut under Basel III	Haircut under IFSB
Qard-al-Hassan or wadi'ah	Current account	Debt	Resembles conventional deposits, although non-interest/return bearing. May receive a gift (*wadiah*) from bank capital.	50%	50%
Qard-al-Hassan or wadi'ah	Saving deposits	Debt	Safekeeping and profit sharing of Islamic bank ('deposit') contracts.	50%	50%
Profit-sharing investment accounts (PSIAs)	Saving and term deposits	Equity	Structured as profit/loss sharing partnerships (*mudarbah* or *musharaka*) or agency (*wakalah*) contracts.	95%	–
PSIA (Restricted)	Saving and term deposits	Quasi equity	Funds provided by investors are invested per account holder's instructions and not comingled with banks' own assets and so easier to trace and transfer to account holders. However, assets of all such account holders may be pooled together, so traceability may still be a challenge.	95%	0%
PSIA (Unrestricted)	Saving and term deposits	Hybrid	Account holders give banks' full discretion to invest in any Sharī'ah compliant assets. May be comingled with bank assets or those of other account holders. Traceability to specific account holders may be a challenge.	95%	90–95%
Sukūk	Bonds and securitized loans	Hybrids	Islamic equivalent of conventional bonds. Structured as certificates of participation through securitization of specific assets/pool of assets.	–	100%
Murabahah	Loans and advances	Debt	A sales contract whereby the institution offering Islamic financial services sells to a customer a specified kind of asset that is already in its possession. Selling price is the sum of the original price and an agreed profit margin.	85%	85%
Musharaka	Loans and advances	Equity	A contract between the institution offering Islamic financial services and a customer. Both would contribute capital to an enterprise. Profits generated by that enterprise or real estate assets are shared by the terms of the Musharaka agreement. Losses are shared in proportion to each partner's share of capital.	85%	50%
Ijarah	Mortgages and leases	Equity	An agreement made by an institution offering Islamic financial services to lease an asset to a customer for an agreed period for a specified rental. An Ijarah contract commences with a promise to lease that is binding on the part of the potential lessee before entering the Ijarah contract.	50%–65%	50%
Qard-al-Hassan	Loans and advances	Debt	An interest-free loan is given by a lender to a borrower with the stipulation that the latter pays back the principle only.	85%	0%
Salam and istisna'a	Hybrid	Hybrid	Salam: Agreement to purchase, at a predetermined price a specified kind of commodity not currently available to the seller, to be delivered on a specified future date as per agreed specifications and specified quality. istisna'a: A contract of sale of specified objects to be manufactured or constructed, with an obligation on the part of the manufacturer or builder to deliver the objects to the customer upon completion.	–	85%

operations has serious consequences for the stability of banks and that prior to 2008 the NSFR of investment banks declined more sharply as compared to commercial banks. Furthermore, Mergaerts and Vennet (2016) while examining the impact of bank business models on performance and risk of European banks found that retail banks perform better in terms of profitability and stability and suggested that business model considerations should be more fundamentally integrated in the regulatory and supervisory practices. Beck et al. (2013) observed that Islamic banks are generally better capitalized compared to conventional banks. The equity-based and risk-sharing nature of Islamic contracts helps reduce the maturity mismatch of assets and liabilities and enhances financial stability.

The Islamic Financial Services Board (IFSB) is the standard-setting body for the Islamic banking industry. The IFSB endorsed the Basel III regulatory framework after making some adjustments for the difference in the nature of assets and liabilities of Islamic banks. The IFSB issued Guidance Note No. 12 which provides guidelines for the calculation of the NSFR for Islamic banks.[2]

Why is there a need for a modified NSFR for Islamic banks? Response to this very critical question centers on the treatment of 'risk' under both banking systems. Under the conventional banking system 'risk' transfers from lenders to borrowers while under the Islamic banking system 'risk' is shared between the two (Hasan and Dridi, 2010). Regulatory requirements under the BCBS's framework are based upon the underlying riskiness of banks and are designed

[2] Guidance Note 12 on quantitative measures for liquidity risk management in institutions offering Islamic financial services [excluding Islamic insurance (Takāful) institutions and Islamic collective investment schemes] issued by the Islamic Financial Services Board in 2014. Online: www.ifsb.org.

Download English Version:

https://daneshyari.com/en/article/998799

Download Persian Version:

https://daneshyari.com/article/998799

Daneshyari.com