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ORGANIZATION AND MANAGEMENT OF CREDIT RISK IN THE ISLAMIC BANKING SECTOR

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This article describes the concept and the risk of bank credit in the Islamic banking sector.

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Banking sector (Commercial Islamic) plays an important role in the financing of a modern economy, as intensive development of the countries and the presence of major projects at local and global levels are noted, which makes it impossible for the interaction of savers and investors with owners of adverse budget to carry out their economic activities. Therefore, the financial and economic institutions have appeared led by the banking sector, insurance, investment and financing, and all other necessary measures. The main role is played by those who mediate between savers and investors. These financial institutions are taking money from savers and lend it to investors. At the same time, the more efficient the financial intermediary (the banking sector), the more efficient the financial inflow from the credit as income, derived from it, is the main item of income of any financial institution, regardless of the number and diversity of other sources of income. Without it, the bank loses its basic function of financial intermediation in the economy, but at the same time, investments are subject to risks, for various reasons, kinds and types of financing, outstanding loans and debts. Therefore, banks are now subject to the issue of competition, beginning to take a global nature, which is caused by a number of changes in the international arena, such as the orientation towards free international trade, services, and information technology, market economy with political openness and the removal of restrictions on the conduct of commercial activities and the provision of services, as well as the removal of financial and economic constraints. Therefore, various governments ordered local banks to keep abreast of the latest developments and always work on the training and retraining of human resources, use modern management system and develop a system of accounting and financial reporting, risk management, quality, liquidity, and, in particular, the technological infrastructure and the search for possible means to reduce banking costs and achieve the highest profits for the banks (financial - social). Such measures will lead to the need to draw attention to the credit function of banks on the grounds that the financial position of any bank is under the influence of variable financial and investment

portfolios, especially the one occupying an important place in the financial position. Portfolio security and its growth lead to higher banks profitability at the lowest possible level of credit risk associated with decisions on granting loans, which are mainly dependent on the credit analysis methods as an important tool to achieve accuracy in making credit decisions and, thus, confront problems encountered in losses reduction, which is very undesired, and risk optimisation, which banks may be exposed to when conducting operations on granting loans and requests for loans from banks to identify the positive aspects and to strengthen them, as well as flaws and means of their elimination, making suggestions and recommendations to avoid them, thus contributing to the optimisation of sales of futures, financing, investment, and banking credit operations, followed by process management and organisation reducing the associated risks, that is, reducing their levels to a minimum, which includes the report items:

First: the Concept of Bank Credit and Risk.

Islamic banks transactions are carried out in accordance with the provisions of the Islamic Shariah. Avoid transactions that focus on interest rates, so credit is given as bank services and contributions provided to customers and investors as Islamic formulas such as Murabaha, participation, leasing, and other various formulas. This is the main type of tapping funds in accordance with these various formulas and indirect engagement in the form of letters of credit and letters of guarantee, so knowledge of Islamic banking experts provide the ability to borrow and buy goods in Exchange for a promise of future payments and therefore expose them to a number of credit risks in its relations with the surrounding possible financiers, such as loss of income as a result of delayed payments by debtors within the allotted time, partially or in full or the inability of the debtor to pay in time for the debt, or the presence of delays in carrying out the terms of the contract, with all the attendant from the consequences in relation to Islamic financing formulas.

Second: Types of Credit Risks in the Islamic Banking Sector.

(Risk focused on one formula). For the Bank to meet the needs of different customers, it must focus on the different financing formulas and be able to measure the risks using the proposed standards, such as used formulas and formulas' relative weight compared to the total amount of financing.

(Financing costs) Cost of financing is not used in all formulas in Islamic banks. Some formulas depend on participation in the profit and loss account. The customer does not pay for the cost of financing, as this is accounting profit rather than cost. The evidence of presence of financing actions is important to ensure that there are grounds for granting financing and the availability of periodic monitoring of authorised limits of financing that are provided to customers, as well as the presence of the effectiveness evaluation of the credit portfolio and work on avoiding risks before they happen, which can be determined by financing costs measuring system, financing system, and periodic monitoring.

(Financing portfolio) The importance of changing the financing portfolio depends on the presence of a system for the allocation of risks among the various internal and external sectors of the economy, as well as on the availability of budget planning in order to achieve a balance between sources of financing and use. They

can be measured by the availability of budget planning and the relative weight of domestic investments against gross domestic and foreign investments and the presence of risk-sharing system.

Third: Principles of Quality Management and Organisation of Credit Risk in the Banking Sector.

Banking institution must examine and determine the nature of credit risks, contained in all kinds of products and financial services, which it provides, and how to manage them, and must not participate in the financing of any new products without defining the nature of their risks and introducing programmes and procedures for management, which include the following:

1 – introduction of the system and relevant programmes to get familiarised with the risks contained in all types of given products and financial activities, analysis and high-quality management;

2 – the bank Board of Directors must be aware of the true nature of risks associated with complex and complicated financial products, such as the financing of certain industries and operations of inheritance and rights-related products for options and other credit products;

3 – bank pays special attention to awareness of the risks of financing new projects, checks understanding of these risks, and the ability to analyse and manage them, as well as develops appropriate policies and procedures, before deciding to participate in them;

4 – verification of sufficient level of productivity and skills of those responsible for the provision of financial products and activities, for conducting research and making recommendations associated with them, in particular, regarding the complex and complicated products, as well as by the risk management by the persons responsible for risk analysis, monitoring, and evaluation.

Fourth: Reasons of Credit Risks in the Islamic Banking Sector.

Currently, Islamic banks are facing problems which constitute a debt and overdue debt payments on most of their assets. Therefore, such institutions are facing relatively higher risks than commercial banks because they lack solutions for debt risks within permissible framework in connection under the provisions of the Islamic Shariah while conducting Islamic financial transactions, but we cannot state that the Islamic banking model should encounter high risk, since debts in this model represent only a small part of the total assets; their investment portfolio contains various sharing types, leasing contracts, and speculation with the opportunities that are available within the permissible framework under the provisions of the Islamic Shariah, which is enough to resist risk sources, for example, for the following reasons:

financing formulas are based on sharing in the profit and loss, and actions according to the formula result to such risks in the absence of security of the customer's financial position, i. e. its inability to perform future obligations to the bank, exposing the bank to credit risk, which diminishes the profit and capital turnover rate in addition to the existing buying and selling operations, and the fact that the other side does not have a well-developed information system and lacks

experience in the field of business, thus endangers the project with greater likelihood of loss risk.

Ban on interest receipt does not allow Islamic banks to restructure the debt on the basis of the discussion of additional interest rates, which encourages customers to stumble and delay repayment, which is known as the inability to increase debt receivables.

Ban on debts trade, i.e. debt selling until the onset of its coverage at a price less than par value, is not recognised in Islamic banking. This shuts the opportunity for debts trading and means that Islamic banks could not take IOUs, because this would lead to riba, the sale of existing debts to any other persons is prohibited as well.

Islamic banks do not have sufficient means and methods that would facilitate risk hedging, since most of them are based on interest rates, such as commercial banks. This means that their ability to deal with credit risk is very limited.

Fifth: Confidentiality of Credit Risks in the Islamic Banking Sector.

Commercial banks are facing credit risks in all its operations, because the relationships between them and their customers are always in effect relationships of the creditor and the debtor (interest loan) regardless of denomination of contracts and transactions. Islamic banks are also facing risks in most of the financing formulas they operate with. It is known that the Murabaha, Istisna'a and selling of contributions are futures selling, that generates debt in the balance sheet. The main risk is a credit risk because, as it raises commodity rather than monetary debts, and also includes credit risk, speculative risk, and sharing. Partnership agreement, on which the bank pays its customers its debts may include credit risk of two variants. In the event of a breach or omission, the customer guarantees the floating capital, which becomes its debt and when the operations speculation and separation are over, the Bank's share becomes guaranteed as debt. All of this involves credit risk. In addition, the second case is the use of speculative funds or sharing in futures sales, which often happens as part of the speculative operations. In such cases, the owner of the funds and the Bank bear indirect credit risk directly associated with the debt extinction ability of the speculating customers.