AWARENESS OF OPERATIONAL RISK MANAGEMENT PROCEDURES IN ISLAMIC BANKS

Khaldoun M. Al-Qaisi

Associate Professor, Faculty of Business, Amman Arab University, Jordan. Email: (Khaldoun_21@yahoo.com)

Information of Article	ABSTRACT
	Non-financial risk management in Islamic banks is considered very important. The source of non-financial risk is varied in Islamic banks. This paper aims to investigate the extent of awareness of Islamic banks staff about the non-financial risk of different aspects. To accomplish this aim, a questionnaire was designed composed of two parts. The first part concerned demographic characteristics, while the second part concerned the awareness of eight constraints of managing non-financial risk in Islamic banks. The results showed that the general understanding of non-financial risk in Islamic banks is moderate in all its aspects. It was recommended to improve the awareness through the training and applying risk management systems modified to meet the banks' requirements. JEL Codes: G20, G23, G32.

1.   Introduction

Operation risk management in banks became very crucial. The awareness of operational risk management has increased among banks' boards (Basle Committee on Banking Supervision, 1998). Success banks used to build operational risk measures and harmonize them with international ones. In Islamic banks, the low financial risk resulting from applying the Islamic financial procedures raised the other side the care of the non-financial risk management in these banks. The non-financial risk in the Islamic banks could extend from opening new branches, misinforming customers, technology-wise, sharia risk, and withdrawals (Van Greuning and Iqbal, 2008). Abdel-Rahman (2015) classified the sources of non-financial risk in Islamic banks differently. The origins of non-financial risks have been classified internally and externally. The internal risks include fraud, products, system failures, assets damages, and business practices. Whereas the external risks are related to customers and business disruption and others (Archer and Haron, 2007; Fiennes (2007); Sundarjan (2005) Chapra and Khan (2000) used other classifications of risk related to operational, legal, and fiduciary. The comprehensive management procedure for risk should include identifying, measuring, monitoring, reporting, controlling and mitigation (Guide Principles of Risk Management for Institutions, 2005). These control systems are related directly to human resources professionals. Human resources are considered important in managing and dealing with non-financial risks in Islamic banks (Mariutha et al., 2009). The training of the staff is considered one of the elements that contribute to managing and controlling the financial risk in Islamic banks. Abdul-Rahman and Yazid (2015) find that the training is crucial to train the staff about the systems that can control non-financial risk management. The activity of the team would increase the awareness and experience to manage. This paper aims to study the awareness of the Islamic bank staff about the different causes and the training as a tool to manage the risk.

2.   Methodology

This research aims to examine employees' awareness of the implementation of operational risk management in Islamic banks. This research will investigate non-financial operational risk management (NFORM). Quantitative research is followed as a method of data collection (Robson, 2002). The questionnaire was used as a tool for data collection. Different personal characteristics were used to measure the perspectives of banks' staff of NFORM. Age, gender, education, experience in risk management, and work position were the major characteristics used to evaluate the employees' perspectives of NFORM in banks. The second part of the questionnaire was designed to answer many questions: What is the employees' awareness of NFORM in Islamic banks? What is the level of understanding of non-financial risk management? To answer these two questions, eight major variables were introduced as follow:

V1: The realization of the source of risks in bank
V2: The ability to classify the NFORM in banks
V3: Realizing risk management model used in banks
V4: Management of NFORM
V5: Realizing operational control and mitigation plans of NFORM
V6: Reviewing operational risk controls of banks
V7: Impact of using standardized models to manage NFORM
V8: Training and awareness of staff for NFORM

Five scale answers were used to measure employees' understanding of the NFORM. Strongly agree took the rank five, while strongly disagree took rank one. The second part of the questionnaire measured the awareness of employees' for NFORM in banks. A pilot sample was taken to test the questionnaire. The results of the pilot sample were used to modify and correct the language of the questionnaire and to measure the reliability of the data collection tool. The collected data was entered into SPSS (Ver. 22). Descriptive statistics are used to measure the distribution of demographic characteristics of respondents, and it is used to measure the trends of employees for the implementation of INFORM parameters in banks.

3. Results and Discussion

3.1 Descriptive Analysis

The demographic characteristics of the personnel responsible for NFORM reflect the bank readiness to deal and manage non-financial risk. This section introduces details about the selected sample concerning age, gender, banking experience, working Sector/Department, education. The age groups used were 20-29 years, 30-39 years, 40-49 years, 50–59 years and >60. Figure (1) represents the percentage of age distribution. The highest occurrence was for the age group (40-49) years representing a percentage of 49.6%, the second group (30-39) representing a percentage of 35.0% while the smallest group of participants was the (20-29) years with the percentage of 15.3%. The second demographic characteristic of the sample is gender. Figure (1) shows that males represent the percentage of 73.7 (98 participants) of the sample, while the female is 26.3 per cent with (39 participants). The educational level (Figure 1) was highest for bachelor's and master holders, representing the majority of the participants with 52.6% and 37.2% and 62 & 56 participants, respectively. In comparison, the PhD/Doctorate holders represent 7.3% with ten participants, high school and diploma holders represent the smallest group of the participants with less than five and four participants. Concerning experience, most of the sample falls in three groups (5-10,11-15 years, and 16-20 years) with percentages of 14.6, 35.8 and 27.7 respectively, with (20), (49) and (38) participants respectively, while the rest of the groups represent percentages of 12.4 and 9.5.
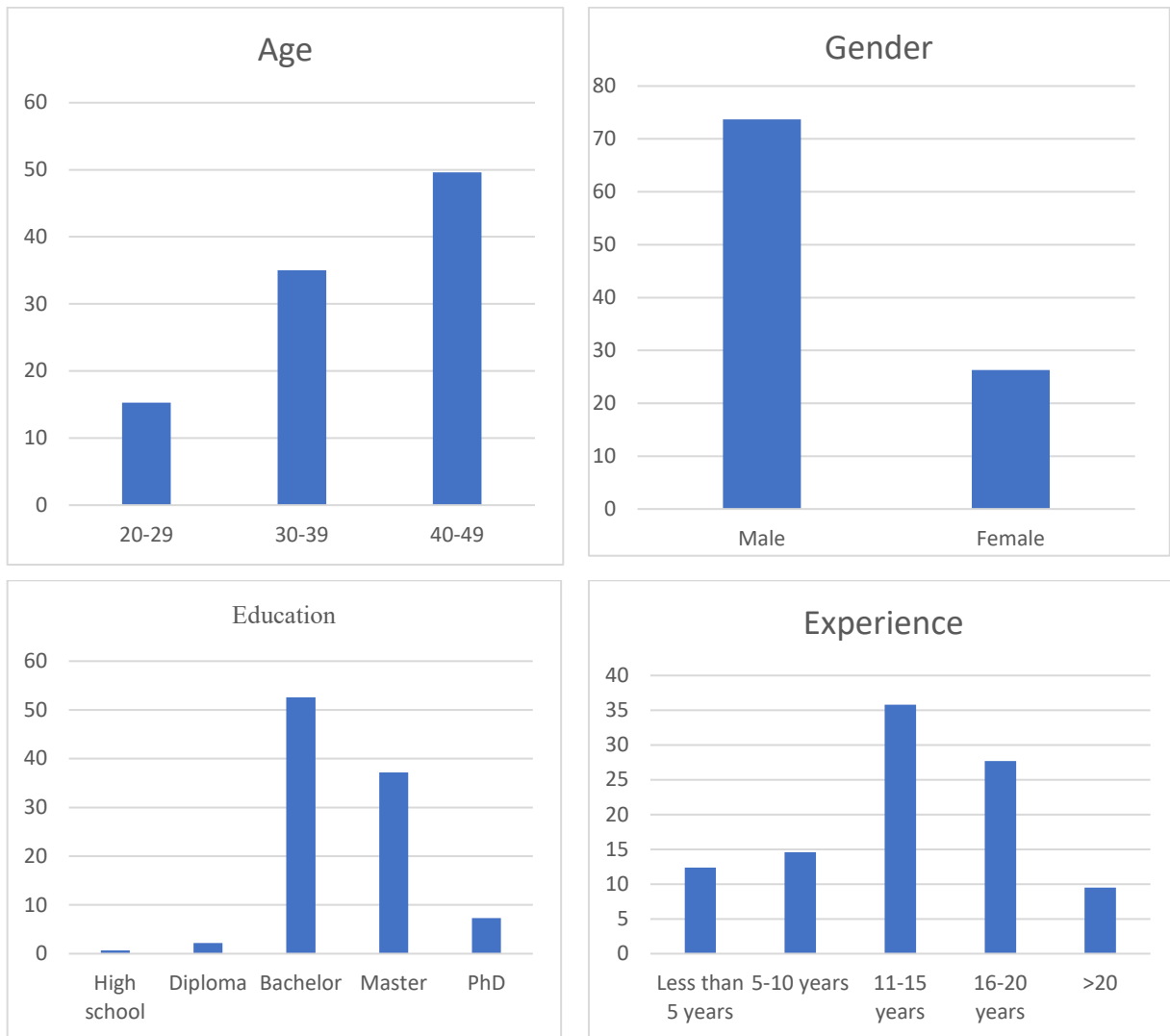

Figure: 1 The percentage of demographic constraints

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The working sector/department within the bank represents the last classification characteristic of the sample. Table (1) elaborates a few facts about the sample, such as the Corporate Finance department was the major contributor (respondents) to the study with 40.9 56 participants. The second rank was the operation department, with 24 respondents with 17.5.

Table: 1 The distribution of samples according to their working section in Islamic banks

Working Section	Frequency	Percentage
Administration support	9	6.6
Branches	4	2.9
Corporate Finance	61	44.5
Credit	1	.7
Customer Service	1	.7
Deposits	5	3.6
Financial Audit	4	2.9
HR	17	12.4
Internal Audit	1	.7
IT	5	3.6
Operations	24	17.5
Personal Finance	5	3.6
Total	137	100.0

3.2 The Trend of Realizing NFR in Islamic bank of Study Variables

3.2.1 Evaluation of Overall Understanding of NFR in Islamic Banks

As it is clear from the table (7), the overall mean is 3.8564, which indicates that the Islamic banks in Jordan are ready to implement any international standards of NFORM. However, further analysis is required to validate this result, which will be in the coming sections.

Table 2: Mean and std dev. of the evaluation of understanding of NFROM in Islamic Banks in Jordan

	N	Mean	Std. Deviation
T_All	137	3.8564	.22357
Valid N (listwise)	137		

3.2.2 Evaluation of Trends of Study Constraints

As part of the analysis, calculating the means for the dependent variables to find out, which is the most variable has the highest trend, which is for variable number eight with (3.9069) and SD of (0.26604), table 8 shows the means for each theme of the study.

Table: 3 The sample trends for the study variables using means and standard deviation

	N	Mean	Std. Deviation
V1	137	3.5706	.47215
V2	137	3.8777	.36395
V3	137	3.8234	.34816
V4	137	3.8684	.22858
V5	137	3.8858	.27217
V6	137	3.8942	.28929
V7	137	3.9015	.28977
V8	137	3.9069	.26604
Valid N (listwise)	137		

All variables' mean is greater than 3.5, which indicates that the Islamic banks in Jordan are ready to implement international standards of NFORM, which is in line with the overall findings.

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3.3 Correlation Analysis

The researcher performed a correlation test between the themes, including the overall (T_All) table 4-10. The following table 4-10 summarize the output of the correlation test.

Based on the results of the study, T_all (overall) is strongly related to T1, T2, T3, T4, T5, T6, T7 & T8 with $r1 = .256$, $r2 = 710$, $r3 = .789$, $r4 = .550$, $r5 = .721$, $r6 = .324$, $r7 = .245$, and $r8 = .621$, $p < .01$

<center>Table: 4 Correlations of different study constraints</center>

		V1	V2	V3	V4	V5	V6	V7	V8	V
V1	Pearson Correlation	1	-.124	.258**	.126	.025	.036	.320**	.104	.256**
	Sig. (2-tailed)		.148	.002	.143	.776	.679	.000	.227	.003
	N	137	137	137	137	137	137	137	137	137
V2	Pearson Correlation	-.124	1	.748**	.547**	.671**	.225**	.016	.522**	.710**
	Sig. (2-tailed)	.148		.000	.000	.000	.008	.856	.000	.000
	N	137	137	137	137	137	137	137	137	137
V3	Pearson Correlation	.258**	.748**	1	.453**	.602**	.232**	.052	.571**	.780**
	Sig. (2-tailed)	.002	.000		.000	.000	.006	.545	.000	.000
	N	137	137	137	137	137	137	137	137	137
V4	Pearson Correlation	.126	.547**	.453**	1	.548**	.050	.115	.397**	.550**
	Sig. (2-tailed)	.143	.000	.000		.000	.562	.182	.000	.000
	N	137	137	137	137	137	137	137	137	137
V5	Pearson Correlation	.025	.671**	.602**	.548**	1	.337**	.080	.522**	.721**
	Sig. (2-tailed)	.776	.000	.000	.000		.000	.353	.000	.000
	N	137	137	137	137	137	137	137	137	137
V6	Pearson Correlation	.036	.225**	.232**	.050	.337**	1	.043	.054	.324**
	Sig. (2-tailed)	.679	.008	.006	.562	.000		.620	.529	.000
	N	137	137	137	137	137	137	137	137	137
V7	Pearson Correlation	.320**	.016	.052	.115	.080	.043	1	.202*	.245**
	Sig. (2-tailed)	.000	.856	.545	.182	.353	.620		.018	.004
	N	137	137	137	137	137	137	137	137	137
V8	Pearson Correlation	.104	.522**	.571**	.397**	.522**	.054	.202*	1	.621**
	Sig. (2-tailed)	.227	.000	.000	.000	.000	.529	.018		.000
	N	137	137	137	137	137	137	137	137	137
V_All	Pearson Correlation	.256**	.710**	.780**	.550**	.721**	.324**	.245**	.621**	1
	Sig. (2-tailed)	.003	.000	.000	.000	.000	.000	.004	.000	
	N	137	137	137	137	137	137	137	137	137

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

3.4 Awareness of NFORM in Each Constraint

Understanding NFR Sources: Figure 2 shows the awareness of NFROM sources in the bank. The items have scored 3.53, 3.49 and 3.61for questions one to three, respectively. This indicates that the banks are in the mid-range of the scale (between three and four), which means that the banks need more efforts to define the sub-categories for their NFROM to better understand NFROM sources the same for the integration between risks.
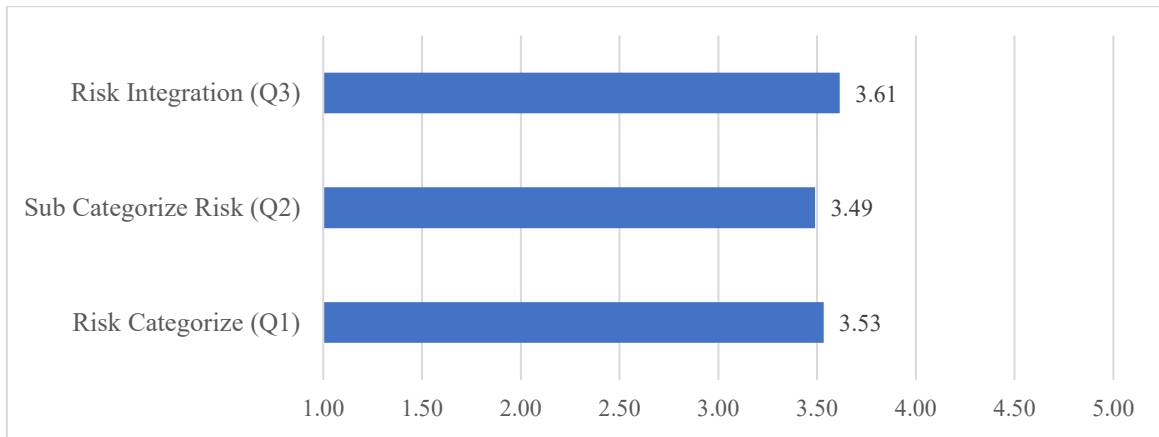
Figure: 2 Awareness of NFROM sources

3.5 Identification of FROM

Figure 2 shows the results of the awareness of identification of NFROM in Islamic banks. Impact matrix risk registers have scored 3.78, 3.93, 3.91 and 3.85 for questions four to seven, respectively. By subjecting the scores to NFR Readiness Scale, the banks are in the mid-range of the scale (between three and four), which means that the banks need to review their current practices for NFR assessments and their related tools (for example, the PIM).
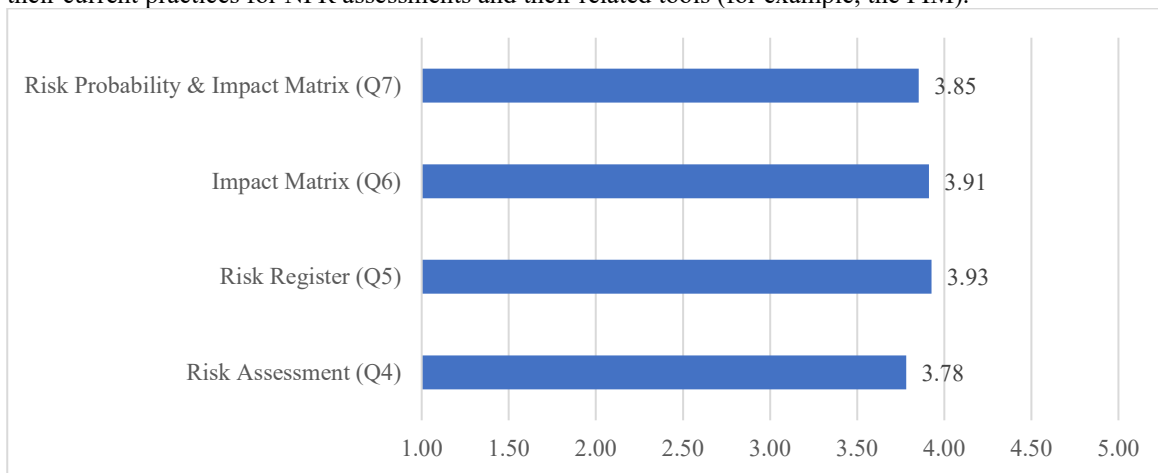
Figure: 3 Awareness of identification of NFROM in Islamic banks

3.6 Current Risk Management System(s), Models and Framework(s) Implemented

Figure 4 shows the awareness of the current risk management system and models and frameworks implemented. The components have scored 3.91, 3.77, 3.71, 3.43 and 3.82 for questions eight to twelve, respectively. By subjecting the scores to NFR Readiness Scale, the banks are in the mid-range of the scale (between three and four), which means that the banks have an ERM in place, but the scores showed a lack of utilization and integration with banks processes. It is recommended to review the ERM modules and enhance them to be aligned with standard requirements.
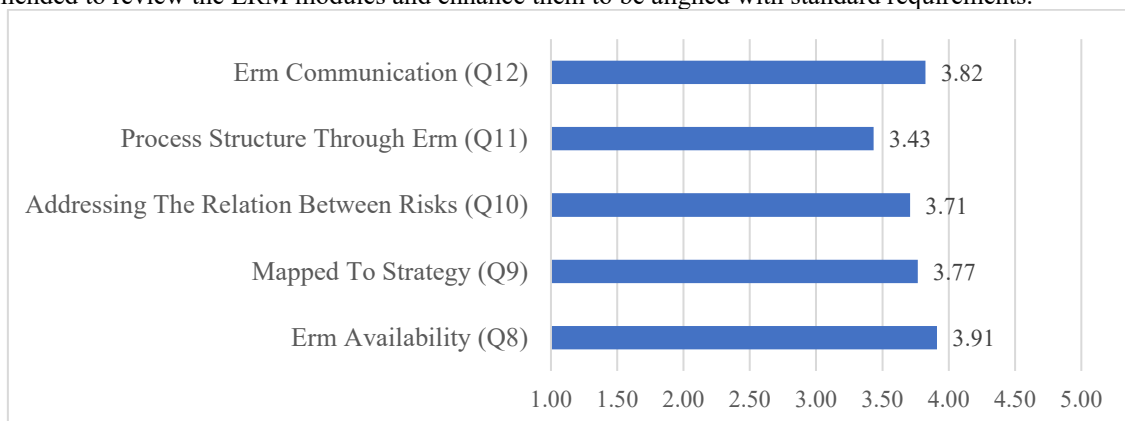

Figure: 4Current risk management system(s), models and framework(s) implemented

3.7 Awareness of Managing NFR

Figure 5 shows the results of awareness of managing NFR in Islamic banks. The components have scored 3.91, 3.78, 3.81, 3.79, 3.80, 3.85 and 3.93 for questions 13 to 19 respectively. By subjecting the scores to NFR Readiness Scale, the banks are in the mid-range of the scale (between three and four), which means that the banks need to review their risk amendment processes and add a few controls/components to be aligned with standards requirements.
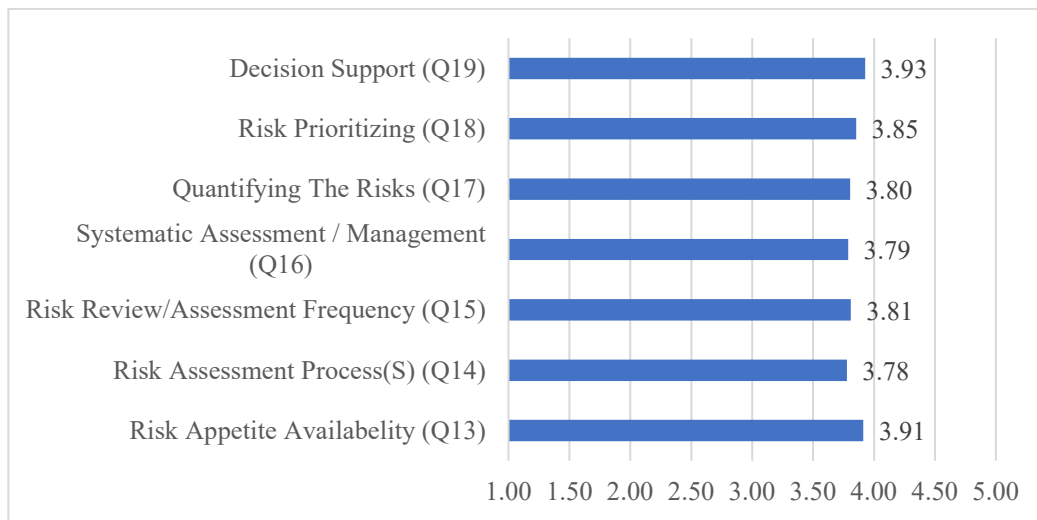

Figure: 5Awareness of managing NFR in Islamic Banks

3.8 Awareness of the Available Operational Controls and Mitigation Plans (Risk Response)

Figure 6 shows the results of awareness of the available operational controls and mitigation plans in Islamic banks. The components have scored 3.87, 3.94, 3.82, 3.91 and 3.84 for questions 20 to 24, respectively. By subjecting the scores to NFR Readiness Scale, the banks are in the mid-range of the scale (between three and four), which means that the banks need to review and enhance the risk treatment process and develop prioritization matrices.
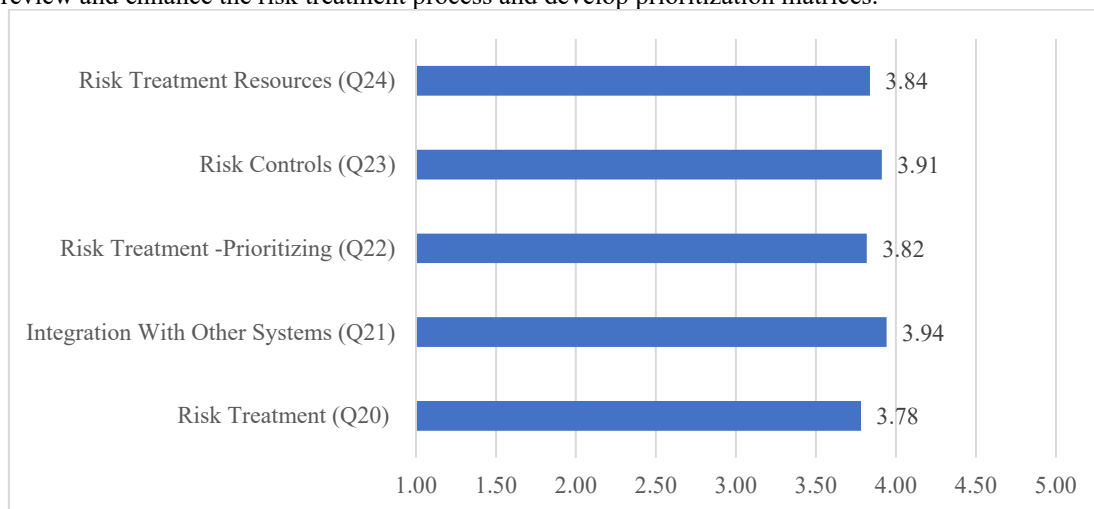

Figure: 6 The available operational controls and mitigation plans (risk response

3.9 Awareness of Reviewing NFR Management Controls and Procedures

Figure 7 shows the awareness of reviewing NFR management controls and procedures. The components have scored 3.94, 3.83 and 3.91 for questions 25 to 27, respectively. By subjecting the scores to NFR Readiness Scale, the banks are in the mid-range of the scale (between three and four), which means that they needs to enhance the methods of risk performance monitoring and risk plans and utilize the learnt lessons more effectively.
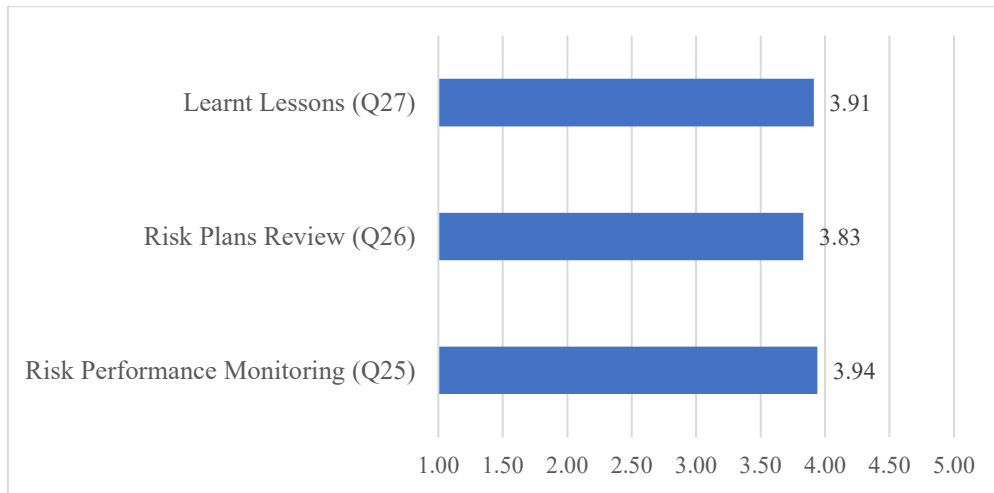
Figure: 7 reviewing NFORs management controls and procedures

3.10 Awareness of the Impact of Using the Standardized Model on Managing NFR

Figure 8 shows the awareness of the impact of using a standardized model on managing NFR. The components have scored 3.96 and 3.96 for questions 28 to 29, respectively. By subjecting the scores to NFR Readiness Scale, the banks are in the mid-range of the scale (between three and four) but near grade four, which means that the banks need little to enhance the integration between the implemented standards.
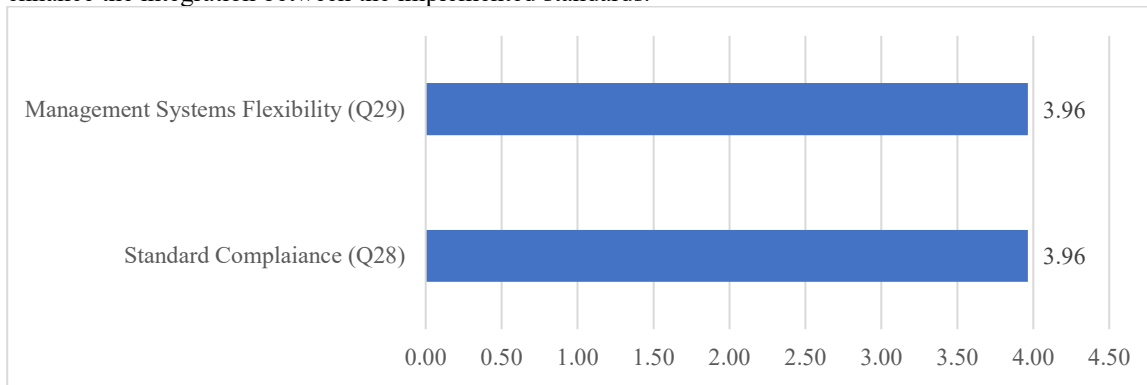

Figure: 8Awareness of the impact of using the standardized model on managing NFR

3.11 Awareness of Training and Awareness of Staff About the NFR Management System

Figure 9 shows the results of training and staff awareness about the NFR management system. The components have scored 3.87, 3.82, 3.78 and 3.94 for questions 30 to 33, respectively. By subjecting the scores to NFR Readiness Scale, the banks are in the mid-range of the scale (between three and four), which means that the banks need to provide more specialized training on risk management, increasing the effectiveness of the internal and external communication about the risks.
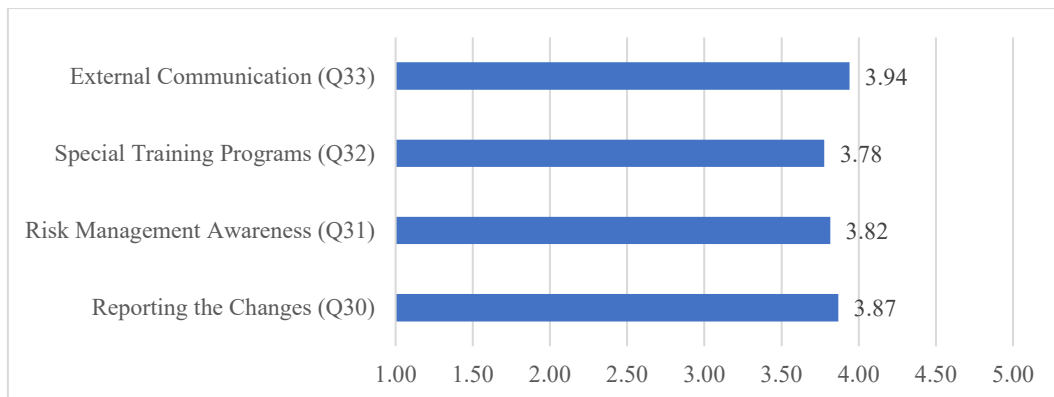

Figure: 9 Awareness of training and awareness of staff about NFR management system

4. Conclusion

This research aims to investigate the realization of non-financial risk in Islamic banks in Jordan. The quantitative research using questionnaire was used as a tool to collect data. The results showed that the banks realized the extent of non-financial risk. The results showed that the grade for the evaluation increased over three, indicating the positive attitudes of Islamic banks employees to understand, deal and manage NFR. The positive attitudes were for the realization of the source of risk in the bank, the ability to classify the NFR in the bank, the management systems of risks, the overall management of NFR, the realization of operational control and mitigation plans NFR. The reviewing of operational control plans of the bank, the impact of using standardized international models to manage NFR and the training and awareness of staff for NFR.

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