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Avoiding Investment Risks and its Role in the Problem of Excess liquidity in Islamic banks

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Abstract

Islamic banks have significant cash surpluses due to the relatively high volume of deposits compared to traditional banks, and this is due to several reasons, the most important of which is the religious incentive for members of the Arab and Islamic community that drives them to move away from interest (Reba), in addition to the failure of Islamic banks to take advantage of the central bank as a last resort for liquidity to adopt This is interest-bearing lending, which causes Islamic banks to maintain a large amount of liquidity as an alternative guarantee to the central bank. However, these high deposits have become a huge burden on the management of Islamic banks in light of their endeavors to keep pace with traditional banking in the formulas of financing and try to reduce the risks of financing to below the legal minimum, in addition to the absence of a secondary financial market in which these surpluses are invested, and as a result there were a problem with liquidity with Islamic banks, and this research will provide a perception about avoiding risks and its role in the emergence of a liquidity problem in Islamic banks.

INTRODUCTION

Basic concepts about investment risk and liquidity.

First: The concept of risk in banking and related terms.

Risks means the probability of negativity in the event at all, and in the field of investment, it is defined as the probability that the realized (actual) return will be different from the expected return.[1]

It is the condition that included the possibility of deviation from the expected return.

3 .Terms related to risk

Uncertainty: It is a situation in which the information of the decision maker is not available to enable him to identify possibilities for the recurrence of a particular event in the future, which means that the decision in this case will depend on personal assessment.

Certainty: It is called the state of complete information, a situation in which decision-making leads to one known result, that is, that means the cash inflows and outflows known exactly have [1].

4 .The relationship between risk and return

There is a tradeoff relationship between the expected return and the degree of risk in the investment process. The higher the risk, the greater the required return to compensate for that risk. Therefore, the required return on the low-risk investment is less than the required return on the high-risk investment, that is, there is a positive relationship between the degree of the risk and return required.

Second: Investment risks and liquidity

The financials showed that one of the objectives of financial management is to maximize the present value of the institution, which links between the expected return and the degree of risk in a positive relationship as an indication of the success of the money management within the institution and with considering the inverse relationship between profitability and liquidity, there is an adverse relationship also arises between investment risks and liquidity.[2]

When institutions follow an aggressive approach by investing a lot of money in order to achieve a high return, they will use a large part of their liquidity, but they will bear higher risks. But when they follow a conservative approach by employing a lesser part of their assets in order to reduce risk, they exposure to increase in liquidity more than necessary which means disabling these assets. Hence, the strong relationship between investment risks and the size of liquidity is evident.

Third: Types of risks in investment contracts in Islamic banks

Investment risks vary according to the contracts. There are contracting contracts (such as Murabahah, Ejara, Salam, and Istisna'a), and there are partnership contracts (such as participation and Modaraba). The research will show the types of risks for each type of contract separately, as follows [3]:

1. Risks in the Murabaha contract: The principal risk that make the contract is acceptance from the point of shariaha view, is the risks considered by traders, such as: depression of the commodity and changing markets (consumer preferences), as well as a guarantee of storage (loss before delivery), And the consequent risk, the possibility of loss in the sale, as well as the guarantee by returning by a hidden defect, where the seller guarantees the commodity in case of hidden defect appear in it after the sale[4] [5].

"The theory of risk provides an accurate explanation for bearing the dependency on sales in exchange for the expected profit, as the wisdom of the legislation explains forbidding certain sales, as it is based on the dismantling of the correlation between the spoils and the penalties, while the correct sale is based on the transfer of these two syndromes from the seller to the buyer, and the risk in this sense It is a legal safety standard"[6].

1. **Risks in the Ejara contract:** One of the rules established by the jurists is that the leased property is the responsibility of its owner, based on this, the Judicial Judges Magazine stated:

"The tenancy is a trust in the hands of the tenant if the lease contract is valid or not." Thus, the lessee does not guarantee the leased property except in the event of infringement or default, and that this guarantee falls first to the owner of the property, and the entitlement to the fare is to bear the guarantee, This is due to the fact that the leased property is a trust in the hands of the tenant, but if it is guaranteed by the tenant (in whole or in part), then the rent is not permissible for the landlord, according to the jurisprudence rule stipulating that "the remuneration and security do not mix." [7]

3. Risks in the Salam and Istisna'a Contract: The Salam and Istisna'a contracts are based on the sale of a commodity that is not present in the contract council (a sale in which the price is accelerated, and the appraiser is postponed). By assuming these risks, the profit is accepted by shariaha for him. Thus, the Salam contract includes the risk of fluctuating prices, so that the market price can deviate from the time of the contract at the time of delivery, as well as the risk of the being unable to deliver it at the end of the term [1].

As for the Istisna'a contract, the most important risk it faces is that the manufacturer (the commodity to be manufactured) is in violation of the agreed specifications, here the bank can refuse the commodity if it comes in violation of the specifications previously agreed upon, and thus the risk is not great for the bank, and since the bank determines the specifications of the commodity In advance, in that the specifications do not match, the manufacturer bears the consequences of that, just as the customer does not have to refuse the commodity if conformity occurs, and the commodity is mortgaged to the bank, so there is no risk the bank faces in this contract [1].

4. **Risks in the participation contracts (Musharakah and Modaraba):**

The risks are clear in these contracts, as the parties to the contract offer work or money or both pending the achievement of profit, they risk their work as a Modareb, or with their money as a capital in Modaraba or a partner in the company, and by this it is permissible They have a profit from this participation, and it is noted here that the sharing of losses is based on the amount of the guarantee It is the subject of an agreement, and the profit sharing according to the agreement is disputed due to the difference in work between the partners.

ways to avoiding investment risks in Islamic banks.

First: avoiding the risks of investing in netting contracts (Murabaha, Ejara, Salam, Istisna'a)

1. **Avoiding the risks of investing in the murabaha contract for the ordering of the purchase**: "The profit of the murabaha at the merchant justifies the possibility of the situation and it is not the case for the bank that took care of itself with the binding promise and did not buy the commodity except after the customer's specification. As a result of this process, it does not bear any commercial risks other than the risk of loss before Delivery and restitution is a hidden defect and may also hedge them by stipulating insurance and stipulating the seller to respond with a hidden defect, so stripping the contract of the risk.

Hence, it is clear that Islamic banks in this formula deviate risks from this contract, which is a reason for acceptance profit, and they are accounted for profit, and for this we find Islamic banks use this formula very significantly as they constitute more than 90% of their total investments, and by this we find that Islamic banks have avoiding the risks through the binding promise, in addition to entering the transaction in the context of profit unless it guarantees and sells what it does not possess [6].

2. Avoiding the investment risks in the Ejara contract ending in ownership (financial leasing): In the financial lease contract of the Jordan Islamic Bank in its eighth clause: the responsibility of the tenant for the leased property: The second party (the lessee) is responsible for the safety of the immovable property, or any other risks from the moment it was actually received by it, unless the rent was lost due to force majeure or an external cause that has no hand in it. "

With this condition, the bank expressly refers to transferring all the risks to the leased property to the lessee, and This violates the terms of jurisprudence lease,

Its ninth item states: Repair, maintenance and inspection: The second party (the lessee) is obligated to use the leased property for the purpose for which it was allocated, and to maintain the necessary periodic and operational maintenance and any maintenance that it needs, and at its expense, and the first party or whoever he designates has the right to do a periodic check The leased property shall throughout the rental period to verify its proper use and that the necessary regular and periodic maintenance is performed on it, and the second party shall be bound by all expenses and expenses related to any faults that occur on the water, sewage and electricity network and any other malfunctions.

And by looking at these texts, it becomes clear that the bank has avoiding all the risks that may arise from this contract and transfer them to the tenant, by transferring the maintenance burden to the tenant.

3. Avoiding the risks of investing in the Salam and Istisna'a contracts: As previously indicated, the Salam and Istisna'a contracts are among the contracting contracts in which the seller bears the risks of providing the required commodity through its production, purchase, or manufacture at a known price for a known period, and thus the merchants bear the risks of price changes, The commodity is damaged before delivery, and so on.

As for Islamic banks, other forms have been developed (Parallel Salam and Parallel Istisna'a) and it is in this formula that it sells a commodity to the customer Salam, which he previously bought ladder from the supplier, and if the bank received the commodity from the provider, it delivered it to the buyer, even if not received from The supplier, it bought it from the market and delivered it to the buyer, and by this the bank does not sell a commodity but rather sells a commodity described in its prescription that matches its description with the description of the commodity that he bought Salam, as well as parallel Istisna'a, and in these formulas we find that the bank has avoiding a portion of its risks, which is what makes sense Risk management is accepted [8].

Second: Avoiding the risks of investing in partnership contracts (Musharakah and Modaraba).

The risks in the participation contracts are considered necessary from their supplies so that the risks from these contracts cannot be removed, and for this we find that Islamic banks avoiding these risks by get away from the application of these formulas except in a narrow framework to the extreme, so that these financing formulas do not exceed 5% Of the total granted by Islamic banks.

Avoiding the investment risks and its role in creating the liquidity problem.

First: Avoiding investment risks and its role in disrupting funds.

It was evident from the above that Islamic banks avoiding investment risks, either by transferring them to the financier as in contracting contracts, or by narrowing the size of the financing method as in the sharing contracts, and given the Islamic banks 'endeavor to reduce investment risks in an inappropriate way from the legal point of view, they do so Borrowing in narrow limits, which are the limits with less risk and are of an administrative mentality in traditional banks that are based on excluding risks and monopolizing profit, which is the basic principle for which interest is forbidden in this regard.

While traditional banks can invest their surplus funds (due to their risk avoiding) as deposits in the central bank or in foreign banks, Islamic banks are unable to do so because there is no secondary market for them, and thus the funds are disrupted, and the problem of excess liquidity appears in Islamic banks.

Second: Avoiding the risks and its role in reducing the volume of investment and the emergence of the liquidity problem.

Islamic banks tend in their dealings in the same direction that traditional banks do in terms of granting credit in terms of guarantees, as they adopt the principle of financial efficiency (financial solvency) which is the It is the ability of the financial customer to pay that result from granting credit, which is personal guarantee or mortgage on property, which It would reduce the credit risk to the maximum, and in the absence of this financial solvency with the customer, he would not get the credit.

Through the adoption of Islamic banks with the same method in terms of granting credit, with each differing in the way of work, through the ability of traditional banks to invest surpluses as deposits with interest, Islamic banks are unable to make such investment, the amount of investment in them will decrease and with the presence of very large deposits In Islamic banks as a result of the religious fear of members of society, the problem of excess liquidity arises in Islamic banks.

Practical proposals to treat the liquidity problem in Islamic banks.

First: Finding a secondary market for Islamic banks

The liquidity problem in Islamic banks is considered one of the most important challenges facing Islamic banks, as this problem leads to The presence of defective cash surpluses that are disrupted from investment, which leads to a decline in the profitability of banks, whether in terms of return on deposits or return on the rights of shareholders, because not investing these deposits leads to a decline Islamic banks in the banking market. And from here it is necessary to find a way through which to invest these surpluses, and from these methods to find a compromise formula between Islamic banks by creating a secondary market for Islamic banks through which the surpluses of Islamic banks can be invested. Including that the central banks manage the investment for Islamic banks by depositing cash surpluses in Islamic banks in the central bank, and the central bank manages these funds as a proxy for projects of a legal nature, the result of which is the Islamic bank in return for a commission obtained by the central bank [9].

Second: Adopting investment criteria based on economic efficiency, not financial efficiency.

The adoption of traditional investment criteria in Islamic banks is incorrect due to the different nature of each of them, and accordingly, investment criteria that are in line with the nature of Islamic banking work should be considered based on its mission, and based on this we must talk about some of the criteria that must It is based on the decision to invest in Islamic banks, as follows:

1. Economic feasibility: This is through the bank's financing of projects that are economically feasible, through conducting feasibility studies for the projects to be funded, and this extends the base of beneficiaries of financing in Islamic banks, so that the Islamic bank can operate a large part of its money in projects achieved good profitability in addition to achieving economic development, which is one of the tasks of Islamic banks.

2. Good reputation: This is by financing the owners of projects who have a good reputation in terms of skill in work, integrity and experience, so its guarantee will be that it does not violate its obligations with the bank after the financing, and this standard is considered a method of risk management in investing in Islamic banks, because many From bank contracts you need trust from customers, especially Musharakah and Modaraba contracts, in addition to other contracts.

3. Using investment formulas that achieve these standards appropriately: by activating the system of Modaraba and participation that is based on economic efficiency and not only financial efficiency, they are contracts in which the feature of economic efficiency is reflected as a criterion for evaluating projects that can be funded, and that would broaden the investment base for funds The Islamic bank because other contracts have been extensively built on financial efficiency, and it is economically self-evident that the economic efficiency circle is much larger than the financial efficiency circle, and accordingly a large part of the problem of excess liquidity in Islamic banks will disappear.

Second: Activating the investment methods that serve the majority of economically viable entrepreneurs

It was evident from the above that banks have deviated from the path in which they were theorized, as Islamic banks built their idea on the basis of Modaraba, but the application of Modaraba is at the bottom of the investment formulas applied in Islamic banks, due to their match with traditional banks by extending the work in the form of murabaha to the order to purchase This is what contributed to the emergence of the problem of excess liquidity, because it relies on the principle of financial efficiency in granting financing. To remedy this problem, it is necessary to refer to the Modaraba in the financing formula for the following reasons:

1. Broadening the base of the beneficiaries of bank financing: to include craftsmen who are not financially full, due to their dependence on the principle of skill, not financial competence.

2. Dependence on the use of resources to establish investment projects: This will achieve an increase in economic growth by supporting small business owners in the community.

3. Its ability to motivate investors to invest by raising the marginal efficiency of the capital: This is because investment according to the speculative formula achieves higher profits due to the presence of the partnership between the investor and the bank, upon which the bank is based on studying the investment operations well and choosing the most appropriate ones.

4. Participation of investors in bearing the expected risks of these investments: This is considered an incentive for investors to make investment contrary to the traditional financing formula in which the bank does not bear the slightest risk [10].

5. Limiting the process of deriving money and contributing to inflation: This is because Modaraba is not based on the idea of lending, and the money that is taken is not re-deposited with the bank or any other bank, but rather is invested and developed [10].

Third: Adopting risk management methods that are compatible with Islamic investment formulas

Risk management is defined as means that are used to maximize returns, reduce risks and reduce their effects, and not eliminate or avoidinge them. Accordingly, when Islamic banks adopt Islamic financing formulas on the basis of which Islamic banks are built and in which they adopt criteria that are different from traditional financing standards, there must be new ways of managing their risks that are different from those in conventional banks, and this may be done through the following methods:

1. In compensation contracts (murabaha and financial leasing): the Islamic bank in these contracts can adopt the principle of the financial efficiency of the customer and ensure his ability to pay, in addition to taking something from personal or in-kind guarantees, and from an operational point of view it may use the condition option when purchasing the commodity (which It reduces the risks of not buying (instead of the binding promise (which avoiding these risks) because the binding promise neutralizes the risks and does not manage them, and economic efficiency standards must be adopted when financing small traders in the absence of financial efficiency for them in order to expand the base of beneficiaries of bank financing.

As for the financial leasing, the bank must bear part of the risks that it must legally assume, which are the original maintenance expenses for the rental as defined by the jurists, and not to transfer them to the customer. In practical terms, the bank must periodically check the rental asset as a kind of guarantee for the lack of bad use by the customer in order to reduce the risk of rented asset damage.

2. In contracts for Salam and Istisna'a: The adoption of a parallel scale and Istisna'a parallel formula in Islamic banks will reduce the risks that may arise from these contracts, through which the Islamic bank reserves the creation of another contract in exchange for the contract it established with its client that is parallel to it in terms of value and Time, and in this way, manages the risks of such contracts, which we have previously demonstrated as important as an Islamic financing formula, and by expanding in such formulas it would make greater use of financial resources at the Islamic Bank as a step in the way of overcoming the problem of high liquidity.

3. In the contracts of shares and Modarabas: risk management is evident in these contracts because it is based on sharing the result of the funded projects, and accordingly the Islamic bank must study the projects to be created by its customers well, through the economic feasibility studies of these projects as well as the technical aspects. And the customer's skill that reflects his ability to manage such projects, because the bank will bear the result of these projects with a profit or a loss, and by activating these formulas the investment operations in Islamic banks will expand greatly because there are a large number of beneficiaries who can obtain financial resources through these formulas, which leads to the treatment of the liquidity problem extensively in Islamic banks, and care must be taken here when studying projects to invest in them well and ensure that there are sufficient experiences of human resources in Islamic banks that are able to study such projects. And judging it in terms of economic feasibility, and using these formulas, Islamic banks will achieve their goals in the field of treating the liquidity problem in addition to achieving economic development in society that is one of the objectives of Islamic banks.

Fourth: Rehabilitation of administrative and executive cadres in Islamic banks

One of the most important problems facing Islamic banking is the lack of legal rehabilitation of human cadres, as most of the cadres have experience in traditional banks, especially the owners of senior management who have central decisions in the methods of investment and financing, and from here we find that they accept the financing formulas that are based on debts, and do not accept the formulas Participatory list, as well as for the risk management method, Islamic banks using conventional methods are used for the same previous reason.

On the operational side, the implementation of Islamic banking transactions requires legally qualified cadres to carry out these tasks, and from here it is necessary to rehabilitate the human cadres in Islamic banks at all levels, in order to improve financing and investment methods in Islamic banks as a step to overcome the liquidity problem.

RESULTS AND RECOMMENDATIONS

First: Results:

1. The problem of excess liquidity arises as a result of the large deposits in Islamic banks due to the religious inconsistency of society.
2. Islamic banks maintain a large amount of deposits for reserves because they are unable to borrow from the central bank when they need to rely on usurious interest.
3. The absence of a secondary market in which Islamic banks can invest cash surpluses.
4. Avoiding of investment risks narrows the investment circle in Islamic banks, as a result of the traditional banking rows of banking, by relying on debts rather than partnerships.
5. Adopting financial efficiency as a criterion for managing risks instead of economic efficiency with a broader circle in terms of investment, leads to reducing the size of beneficiaries and then increasing liquidity with Islamic banks.
6. All of the above led to the disruption of a large part of the financial resources in Islamic banks, which led to the emergence of the problem of excess liquidity and the prevailing profitability.

Second: Recommendations

1. Find a compromise formula between the central bank and Islamic banks that ensure Islamic banks to get liquidity when needed in a legitimate form.
2. Find an Islamic secondary market for Islamic banks, under the supervision of the Islamic Development Bank.
3. Finding a formula for cooperation between Islamic banks and the central bank in the framework of managing Islamic bank funds in the central bank in legitimate projects in exchange for commission on the basis of the agency.
4. Adopting economic efficiency instead of financial efficiency as a criterion for managing investment risks, because it is broader than the financial efficiency, which leads to increasing the volume of investment and reducing the problem of excess liquidity.
5. Widening the activation of the financing formulas based on partnerships and Modarabas, which would increase the circle of beneficiaries of bank financing.

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