

Comments of

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on

**A Design for Islamic Banking Rating System:
An Integrated Approach**

By

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Objectives

The paper aims to formulate a model to assess the soundness of Islamic banks. The model still based on conventional formulae which is based on CAMELS but it tries to accommodate some characteristics of Islamic bank and values and insert to the new model.

Argument:

The paper argues that conventional CAMELS model might be used in assessing the soundness of Islamic bank but the model should accommodate some indicators that reflect the salient characteristic of Islamic bank. The paper tries to identify some differences of CAMELS component between Islamic conventional banks and propose to be included into the new model

Coverage

The paper covers several issues that benefits to understand the different between Islamic and conventional bank assessment in every point of CAMELS element. But it fails to show the real different between the two especially to create a new model. It also fails to show the different between Islamic values and the modern values i.e. Professionalism, responsibility, continuous improvement etc which in my view is also a part of conventional tradition.

The paper does not justify why Islamic bank still can use conventional bank model in assessing Islamic bank soundness. Yet, the philosophy of an Islamic bank is different from conventional bank.

Differences between Islamic Bank and Conventional Bank:

The paper discusses the difference between conventional and Islamic banks but, in my opinion the paper fails to identify clear differences between Islamic bank and conventional bank in a consistent basis especially in the CAMELS model. In some

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paragraph, the paper identifies the difference between the two but is not presented consistently and more over the difference fails to provide the way how the difference affects the new model for assessing the soundness of an Islamic bank. The failure to identify a clear difference between the two in the CAMELS model will affect the measurement aspect which will be used in the Neo-CAMELS to assess the Islamic bank healthiness.

The following quotations from the paper, show how the inconsistency of the differences occurred and fails to focus which element will influence the new CAMELS model:

1. In the abstract the paper argues that the difference between conventional and Islamic banks in CAMELS model are:
 - a. The agency role in the capital assessment
 - b. Value added distribution
 - c. Identification risks
 - d. Incorporation of the Islamic values and norms which emphasis on professionalism, competence, and Shari'ah compliance.
2. In page 8:
 - a. Ethical investment
 - b. Probation of *ribā* (usury) and obligation of *zakāh*
 - c. Non-speculative transaction
 - d. Concept of Shiddiq, fathanah, *amānah*, and tabligh
3. In page 11:
 - a. Compliance to the Shari'ah principles
 - b. Sharing concept
 - c. Islamic norms in management
4. In Exhibit 1: Component of bank rating systems: A comparison, page 12:

| | |
|-----------------------------|---|
| Capital: | Agency role |
| Asset quality: | Variable income |
| Management Quality: | MU Shari'ah value in management; Shari'ah compliance |
| Earning: | BEP Pricing policy; ROE benefit |
| Liquidity: | Short term mismatch; displacement risk |
| Sensitivity to market risk: | Scenario analysis on commercial displacement risk |

There is no formulae to measure the difference and what its effect on CAMELS model.
5. In page 12:
 - a. Financial soundness would be adjusted into the structure of Islamic banking

- b. Islamic objectives: ethical investment, Shari'ah compliance, Islamic values in the banking operation.

6. In page 17:

Management aspect:

Fair value added distribution, brotherhood, social education and service excellent.

7. In page 18:

Quality of risk management:

Cheque and recheck, good administration, realistic planning, continual evaluation, continual improvement, fulfilment to commitment, appropriateness in the risk management.

8. In page 21:

- a. the agency role in the capital assessment
- b. identification of risks which do not appear in conventional bank
- c. the incorporation of the Islamic values and norms which particularly emphasis professionalism, competence, to promote conducive and friendly atmosphere in the organization and other Islamic values like environment orientation beside transactionally Shari'ah compliance

There are 8 places in the paper discussed the differences between the two banks and argues that the CAMELS model should accommodate these component in assessing the soundness of an Islamic bank Those 8 differences are not using a consistent and similar elements and do not clearly define and specify the differences. The paper fails to provide a new CAMELS model based on the Islamic banking spirit. Failure to identify the difference will affect the failure to measure the assessment criteria using in the model.

Assessment System

Even though CAMELS model has used in many countries however the CAMELS model also has limitation in assessing the soundness of a bank especially its subjective judgement. CAMELS uses quantitative as well as qualitative criteria. The latter has been used in assessing management aspect of the bank. Some author argues that the qualitative criteria might be subjective. How ever I agree with the author that using CAMELS model in assessing the soundness of an Islamic bank with some modification.

There are some limitations of proposed model:

- a. subjective component
- b. unclear indicator of Islamic values measurement in every component of CAMELS.

If the argument is valid, the paper will be better off, if it shows the differences between Islamic bank and conventional banks consistently and specify the criteria to measure them and become a part of the Islamic bank based CAMELS model. The paper may proposed a Model not only the argument what to be included in the Model.

Conclusion

The paper has started raising a very important topic in formulating a model in assessing the soundness of Islamic bank operation. We appreciate the work the author has been done to study the topic. The paper has elaborated extensively the possible differences between Islamic bank and conventional bank particularly in assessing the soundness of the bank.

I fully agree with the paper argument on the need for a new model in assessing a soundness of an Islamic bank. I also agree that the conventional based CAMELS should be modified to accommodate the difference between conventional and Islamic bank. I agree also the difference between the two as discussed in the paper.

There are some gray areas in claiming whether the points are Islamic monopoly or also part of conventional spirit e.g. Professionalism, cheque and recheck, good administration, realistic planning, continual evaluation, continual improvement, fulfilment the commitment, appropriateness in the risk management.

In my opinion, the author has succeeded to raise the important of the issues however it fails to distinguish these two banks especially, its affect upon the CAMELS model. The paper identify the difference but fails to measure the element that may affect the CAMELS model in assessing an Islamic bank's soundness.

If the author can show us a clear and objective model to asses the soundness of an Islamic bank. The model will be a invaluable contribution to development of Islamic bank soundness and supervisory tasks.

Recommendation

The argument to use conventional model in assessing the soundness of an Islamic bank operation may be justified. The difficult task is how to identify element that distinguishes CAMELS components between conventional and Islamic bank perspective. The paper may focus on the real difference of CAMELS between the two and propose the measurement of those difference and insert into the Model. From that step, the author may have a formula or a model that may be used to asses the soundness of an Islamic bank. The model may be used by supervisory board, external or internal parties. The tool is very important to maintain the soundness of Islamic bank All in all, the author deserve a high appreciation from academics and practitioner and regulator in raising this important and critical issue.