

ISLAMIC BANKS: STABILITY AND SURVIVAL DURING FINANCIAL CRISIS

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Abstract

Islamic banks are deemed to be less likely affected by the financial crisis. Islamic banks with their unique characteristics may react differently than their conventional counterparts during banking and financial crisis. Inflexibility of Islamic banks in fund raising through financial markets promotes conservatives decision in term of risk management and thus provides greater stability. The creation of Islamic liquidity instruments and Islamic deposit insurance appears to be necessary for Islamic banks. This paper discusses relevant policy issues pertaining to Islamic banking survival during the financial crisis. It includes the requirement of proper regulatory and Basel II application in line with existing Islamic regulatory bodies such as AAOIFI and IFSB.

JEL Classifications: G01, G21, G28

Keywords: Islamic banks, Financial Crisis, Liquidity

1. Introduction

Banks are different with other institutions in term of their nature of operations and thus lead to the requirements of special regulation. Financial institutions and banks particularly receive special treatment by the government in avoiding systemic impacts of financial instability. This is partly true in some countries. For instance, in developed countries, the government provides drastic action to aid insolvent financial institutions. This decision without careful examination on the real needs of such rescue may burden the taxpayers in supporting hollow financial institutions. Therefore one of the best ways in securing financial stability while ensuring meaningful value of the taxpayers' money is to promote soundness and stability of the banks. The needs become vital during the financial crisis when banks' financial activities are more fragile and sensitive.

Islamic banks are created under Shari'ah principles following Quran and Sunnah with the main objectives in protecting human being from any misconduct. Thus Islamic banks are committed to the stake of equitable and fair distributions of fund and resources. Islamic economy believes in the capability of generating economic growth while being fair to their customers. The principles later build up customers' confidence in term of banks investment and fund management. This kind of relief is very important predominantly during banking and financial crisis, where loss of confidence may contribute to panics phenomenon, bank runs and followed by systemic risks.

Financial crisis associated with banking panics and it contributes to the bank runs and followed by bank closure. Bank runs source from sudden withdrawals of bank deposits and the systemic effects may cause to banking panics and pressure on banks liquidity. Due to insufficient liquidity these banks become insolvent and are forced to closure. The most recent major financial crises are the Asian Financial Crisis occurred in 1997 and the Global Finance Crisis occurred in 2007.

The risks involved in banking activities include operational risk, credit risk, market risk and liquidity risk. Indeed, managing of these risks is becoming complicated when they are mutually linked to or between each other. Thus, in managing these risks, regulations and standard of banking firms is outlined with the essence of financial stability in banking sector. Two ways in promoting this idea, are through the creation of deposit insurance and central bank as lender of last resort. Other than that, money market and stock market are also used as means to protect bank liquidity shortage.

In order to avoid further disruption in banking industry, government may come out with rescue plan and bail-out policy. This decision, however, is very costly to the taxpayers as central banks provide funds to selected banks and yet it is not necessarily ensures banks and economics recovery. On the other hand, many other banks are forced to liquidation during the financial crisis due to financial instability. This paper aims to explore the financial stability and survival level of Islamic banks in dealing with their unique operation and risks.

2. Literature Review

2.1 The Financial Crisis

Financial crisis causes deterioration of banks' assets and thus leads banks to financial distress. It may be resulted from varying factors such as stock market crash, currency crisis and sovereign defaults. With its significant impact towards economy, there are flood of studies in identifying and mitigating banking and financial crisis but there is no consensus on the issue.

Non-performing loan (NPL) as a source to bank failure is one major agenda in banking literature. Less prudent and diligent assessment adds the amount of NPLs and become costly for the banks. Consistent phenomenon of growing NPLs may cause financial distress for banks and leads to bank closure. Lauridsen (1998) figures out that increase of current account and careless lending are the sources of NPLs. Other than that, 'relationship banking' (between bank and preference customer) as highlight by Hanazaki and Horiuchi (2003) also contributes to the accumulation of NPLs and produces more fragile banking sector. The amount of NPLs continuously ascends with the effort of hidden loss. Niinimäki (2009) identifies roll over method (extended the maturity period of default loan) and refinancing method (granting new loan to repay original loan) as two ways for hidden loan losses.

Capital requirement is another important insolvency issue where insufficient capital may cause financial instability and bank failure. Bank's capital requirement is very different with other business as it relies more on deposits and thus considered to be relatively highly-leveraged. Regulators address the stability problem by increasing the capital requirements but it is not the most effective ways to mitigate the problem in banking sector (Wagner, 2007). Indeed, liquidity management endows with greater impact in ensuring banking stability.

Banks are vulnerable to the financial crisis and very sensitive to the systemic impact. Bank closure may occur as a result of systemic impact which cause to bank runs and financial distress due to insufficient liquidity. Other than insolvency problem, poor liquidity management becomes another contributing factor of bank liquidation. Conversely, Wagner (2007) argues that bank instability is caused by increased liquidity due to additional new risk in exploiting the incentive of liquidity risk reduction.

A unique criterion of banking institutions is in term of their assets and liabilities structure where the compositions often end up with asset-liability mismatch. In order to manage cost, banks are willing to accept more risk in having larger amount of cheaper short-term deposits than long-term fund. Banks will intentionally choose illiquid asset-liability and eager to acknowledge the risk if the probability of bank run is sufficiently small (R. Chang & Velasco, 2000).

Apart from cash, banks hold certain amount of securities as liquid assets. These liquid securities are mean to be readily convertible to known value of cash. During liquidity shock, banks actively trade in financial market and choose to sell these securities to facilitate higher cash position in their account (Sawada, 2010). Franck and Krausz (2007) in examining the sources of liquidity find out bank prefer to exploit securities market rather than lender of last resort.

Concentration and competition are among popular discussion among researchers in finding the sources of bank failure and financial crisis. However there are contradicting findings regarding this issue. There are many alternative market power model in measuring concentration and competition such as Bresnahan model, Panzar-Rosse model, Structure-Conduct-Performance model and Cournot model¹.

The classical thought on concentration hypothesis on banking stability resulted from greater market power that enhances profits and lower monitoring costs. Among others studies, (Beck, Demirgüç-Kunt, & Levine, 2006; E. J. Chang, Guerra, Lima, & Tabak, 2008) researchers find evidence of banks are financially more stable in a more concentrated market. Evrensel (2008)'s findings conform the hypothesis where higher concentration in banking sector increases the survival time especially in developed countries. However, the author finds although with higher concentration, banks in developing countries faces higher hazard rate and more fragile to the banking crisis.

The other thought documents more concentration and less competition encouraging larger loans and excessive risk taking activities, then leads to possibility of bank failure. The scenario creates moral hazards problem in banking and less prudent in loan and risk assessment. Furthermore, the issue of 'Too Big to Fail' associates with highly concentrated financial institutions provides implicit guarantee and safeguard for these banks to involve in risky investment (Panageas, 2010). Due to this reason, highly concentrated banking sector endorses risk taking activities and may induce financial instability and bank failure.

Other than that, deposit insurance policy may also cause moral hazard problem in the banking industry. Although the initial motivation of deposit insurance is to promote financial stability and development, its existence comes out with mixed effects. Ng, Lim, and Tan (2010) find there is no excessive risk taking of Malaysian banks after the introduction of deposit insurance scheme. In addition, Sawada (2010) in his study documents Japanese banking sector is potentially exposed to financial instability and bank runs when depositors are insufficiently protected. On the other hand, Önder and Özyildirim (2008) affirm that deposit insurance may not be an effective tool to improve market confidence in Turkish banking sector. Besides it is not capable in eliminating banking crisis as market reacts with the moral hazard behavior of banks.

2.2 Liquidity Risk

As the financial intermediaries, banks differ from other firms in that the balance sheet account does not present similar maturity for its assets and liabilities. Deposits account represents as major funding for banks and it is in a form of short-term funding but the lending is generally long-term in nature. The mismatching in banks' accounts cause liquidity problem during bank run and may cause bank insolvency more than ever during the financial crisis. Liquidity mismatch is not supposed to be the main problem which directly caused by the financial crisis, instead the problem is triggered with the contagion effect of the market panic in the banking sector. This implies the situations that banks with high liquidity risks may face bank run followed by becoming insolvent. Due to this reason, optimal liquidity management is essential in banking industry and possible resolutions for liquidity risk are necessary.

Major parts of banks' assets consist of bank loans, cash and securities. Cash is the most liquid assets but it does not contribute to earnings assets. Securities assets can also be categorised as very liquid with the market availability and flexibility to transform the assets into cash without further varying amount of the assets value. This is especially true with the government securities or bonds with very active market that leads to highly liquid securities. On the other hand, loans are considered to be relatively illiquid with difficulties to generate cash in short-term period. Sawada (2010) finds banks chooses to be more active in buying and selling securities in order to be flexible in their cash holding and liquidity.

The bottom line of lender of last resort is providing funds to illiquid but solvent banks. Nevertheless banks cannot fully rely on the last resort as they should have early precaution against liquidity shortage. The traditional ways is through extra liquidity in the assets side to cater any unexpected withdrawal. Though this measure does provide comfort to banks liquidity position, it does not indicate the optimum liquidity level. It is true when banks hold many idle cash with zero return on investment. Thus in modern conventional banking, securities markets and money market become an alternative in liquidity management. Franck and Krausz (2007) determine that securities market play more important role in banks liquidity management rather than the lender of last resort.

Stock market and money market instruments facilitate the transfer of risk from banks and offer certain amount of returns. This allows banks to maintain high liquidity level contains other than cash as an asset. The motivation of improving liquidity leads to the financial innovation and financial engineering. The creation of these derivative instruments carries certain level of risk. Although the liquidity level had improved, banks are prone to the financial crisis as they are sharing risks with other banks. Furthermore these instruments encourage excessive risk-taking activities and banks have fewer cautions on the potential risks. The situation differs in Islamic banking perspective as the Shari'ah principles prohibit these kinds of risks and activities.

The remaining of the paper will discuss on the case and lesson of Islamic banks failure and evidence of success story of Islamic banks, particularly during the financial and banking crisis. Major issues on risk controls mechanism in Islamic banking is highlighted in the following sections.

3. Islamic Bank Failure: A Case of Ihlas Finans in Turkey

By principles, mainly the profit and loss sharing (PLS), Islamic bank are expected to be less likely affected by the banking and financial crisis. Based on Shari'ah law, banks' conduct and decision must be of the customers' interest and thus it should be prudent and diligence. The situation is on the other way round for Ihlas Finans in Turkey that failed during financial crisis in 2001.

As Islamic banks in Turkey are categorized by the name of special finance house (SFH), Ihlas Finans was established in 1994 under the Ihlas Holdings to operate based on interest-free and PLS principle. Many factors contribute to the bank closure that includes macro and micro factors. While other SFHs in Turkey survive the financial crisis, the issue should focus more on the internal predicament of Ihlas Finans.

The closure of Ihlas Finans resulted from the domino effect of banking panics and bank run as the main problem is unlikely because of insolvency but more on the liquidity problems. Referring to Figure 1¹, liquidity ratios for Ihlas Finans fluctuate since it began operation and dropped dramatically in 1999. Comparing to other SFHs in Turkey, liquidity position of Ihlas Finans is far behind its competitors Kuwait Turkish Participation Bank Inc-Kuveyt Turk Katilim Bankasi A.S. (refer to Figure 2a and 2b). This means Ihlas Finans are exposed to the liquidity risk and asset-liability mismatch which may direct them to the difficulties in fulfilling bank runs and become insolvent. It also explains the main factors of Ihlas Finans failure while other SFHs survive during the crisis.

Figure 1
Liquidity ratios of Ihlas Finans

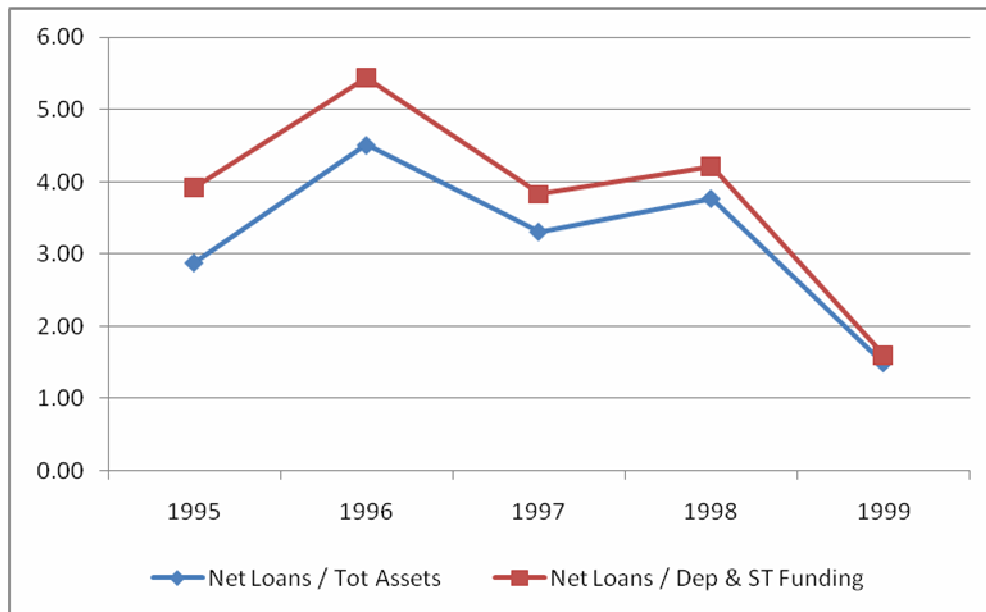


Figure 2a
Net loans to total assets

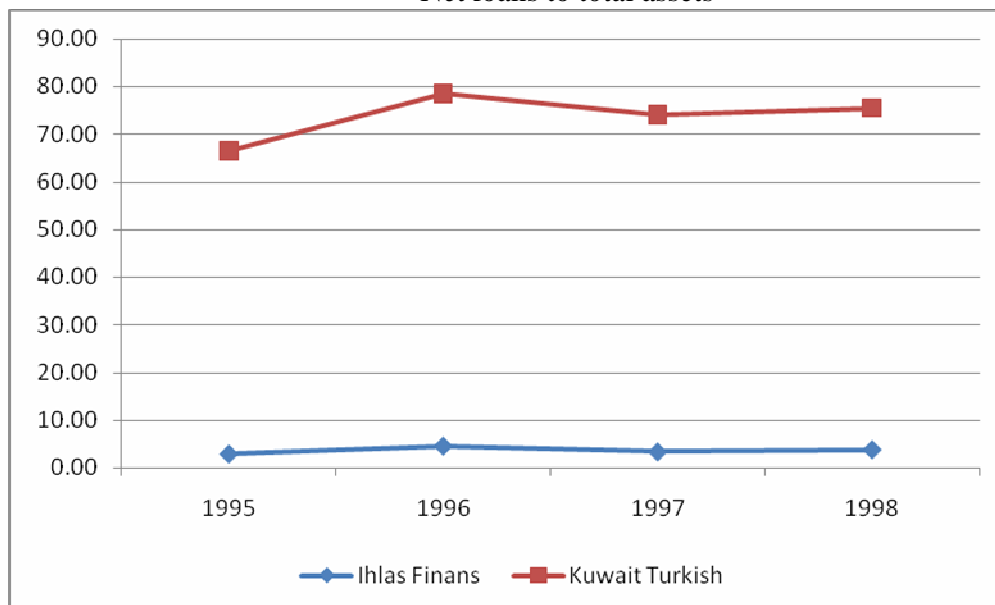
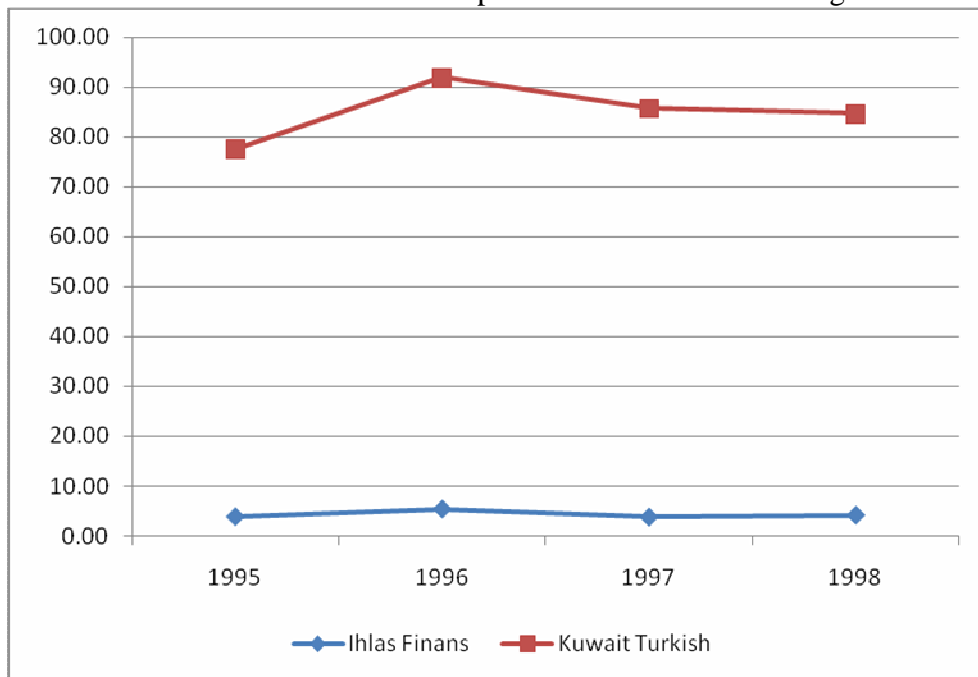


Figure 2b
Net loans to deposits and short-term funding



The lack of proper action by Bank Regulation and Supervision Agency (BRSA) to come out with resolution also contribute to the bank closure. Among other factors, internal issue such as weak management team, reckless financing decision and poor crisis management strategy are also part of integral explanation of financial distress and Ihlas Finans closure. Furthermore, growing Islamic banks are normally more exposed to macro-level shock and banks should be ready with comprehensive crisis management and contingency plan which the evidence was not found in Ihlas Finans¹.

4. Success Story of Islamic Bank: Bank Islam Malaysia Berhad (BIMB)

With many similarities between Islamic and conventional banks, there are still major icon that differentiates Islamic and conventional banking operation and management. The statement reflects Islamic banks in term of risk associates with their operation and management decision. Ahmad and Luo (2010) emphasise on the excessive risk taking activities by banks that contributes to the banking crisis and the effects towards Islamic banks could be less severe with the prohibition of speculation and highly risky investments.

Malaysia is the best example that comes out with excellent operation in Islamic banking and finance. The success story of Malaysian Islamic finance began with the establishment of Pilgrims Fund Board in 1963 followed by the first Islamic Banks, Bank Islam Malaysia Berhad (BIMB) in 1983. To date, BIMB remains loyal to the Shari'ah principles and it is capable to operate alongside with the long existence conventional counterparts. BIMB shows remarkable growth in its loan, assets and deposits since it began with average growth of 16 percent, 17 percent and 17.5 percent respectively.

Figure 3a, 3b, 4a, 4b, 5a and 5b illustrate total loans, total assets, total deposits and its growth of BIMB for the period of 1995 to 2008.

As it operates under PLS principle, profitability performance of BIMB becomes major concerns to their customers. Apart from financial year 2005 and 2006, BIMB generates sustainable level of return (refer to Figure 6 and Figure 7). The highest profit before/after zakat and taxes achieve in year 2008 when they fully recovered from massive losses in 2005 and 2006. The losses are mainly supply from the NPLs from its Labuan offshore unit after the decision to transform them form subsidiaries into branch. BIMB later comes out with major corrective action plan on the implementation of strategic changes in the management and operation such us loan recovery programme and strategic business expansion.

Figure 3a
Total loans of BIMB (mil MYR)

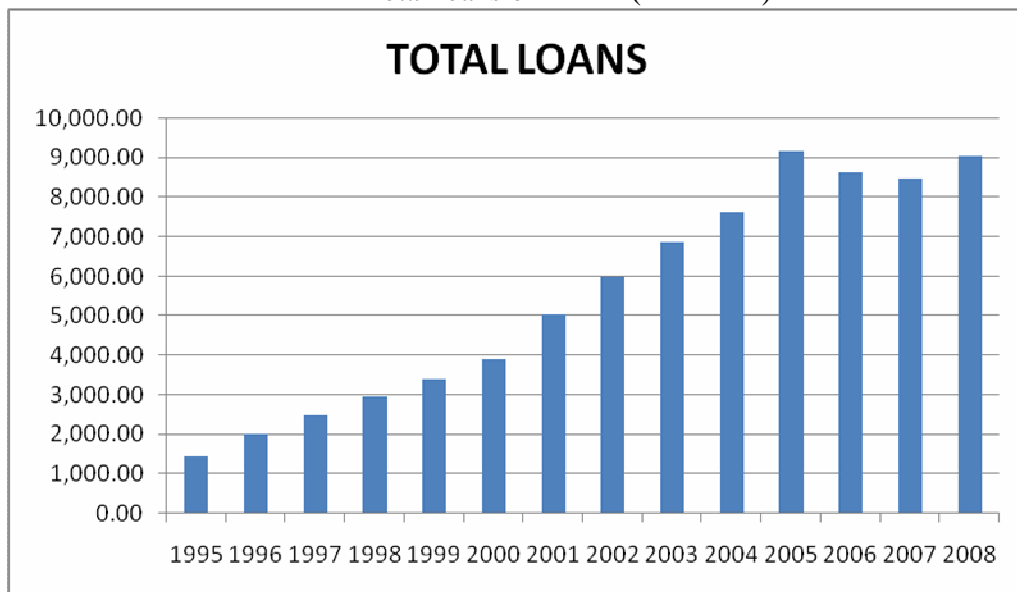


Figure 3b
Loans growth of BIMB (%)

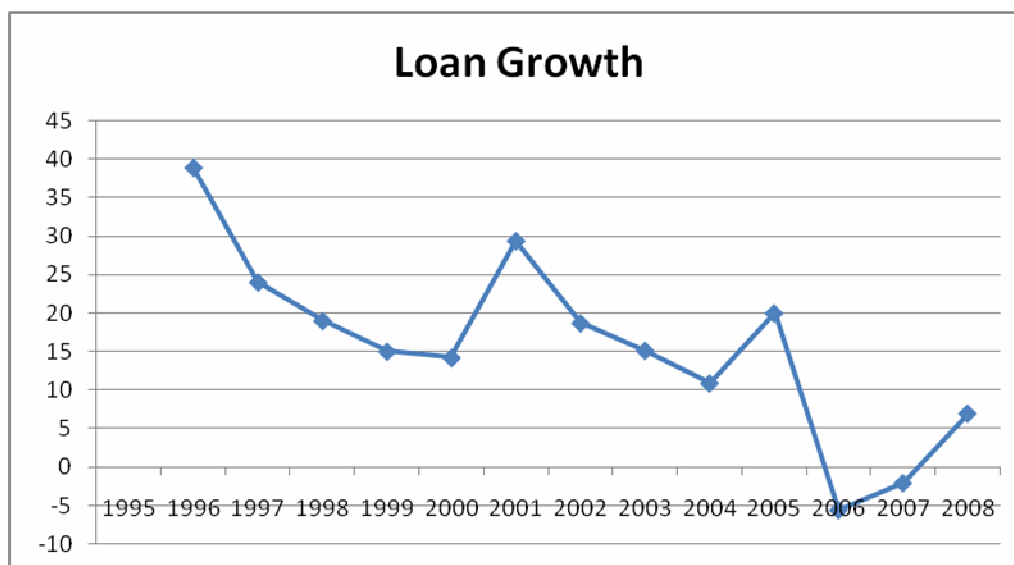


Figure 4a
Total assets of BIMB (mil MYR)

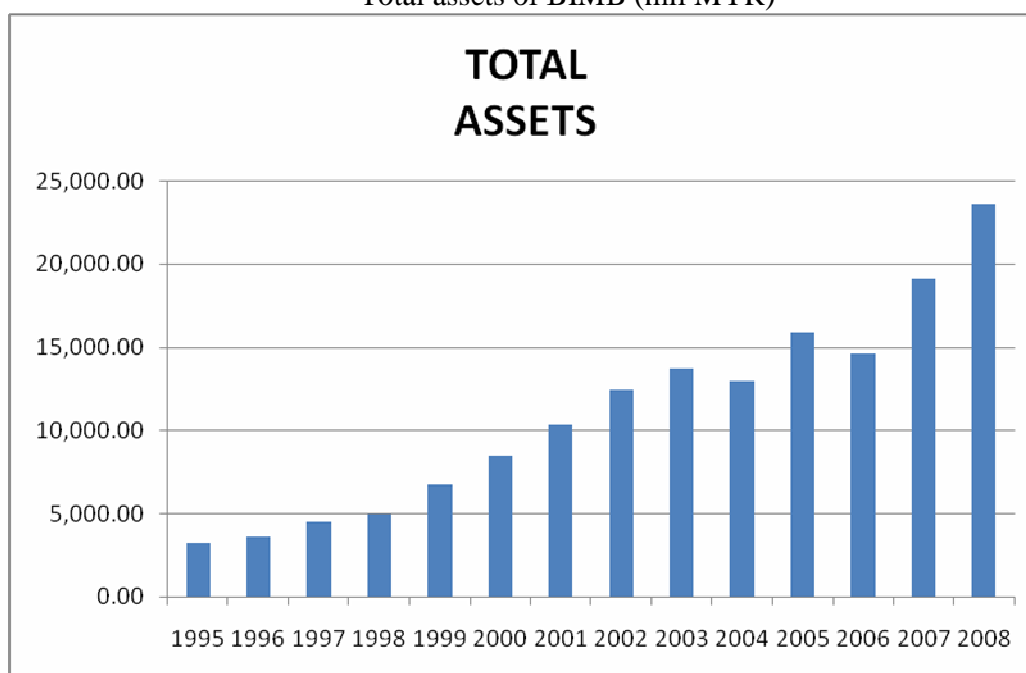


Figure 4b
Assets growth of BIMB (%)

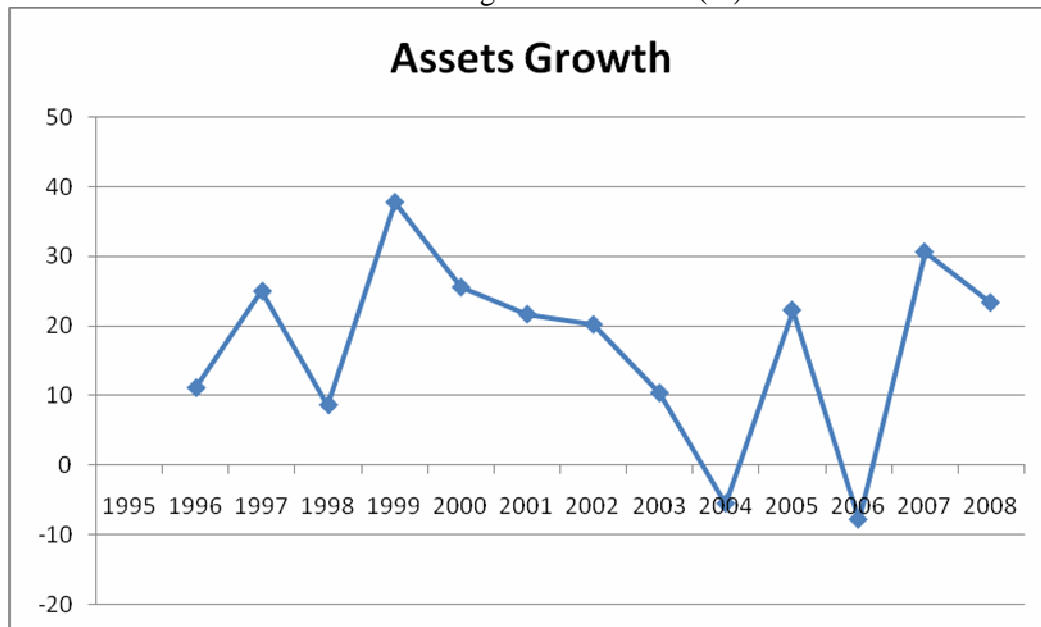


Figure 5a
Total deposits and short-term funding of BIMB (mil MYR)

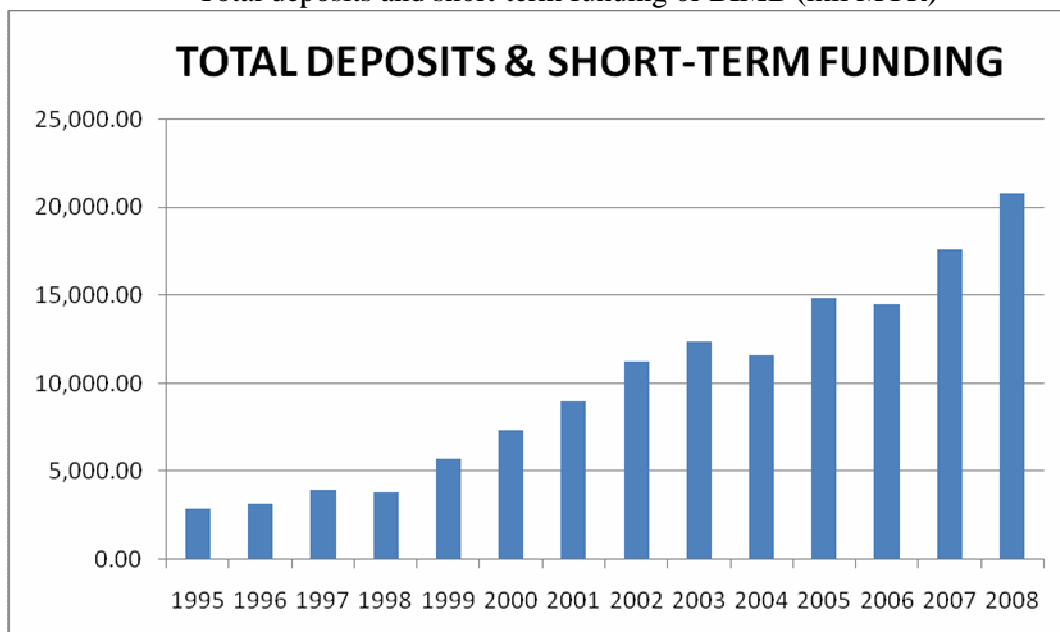
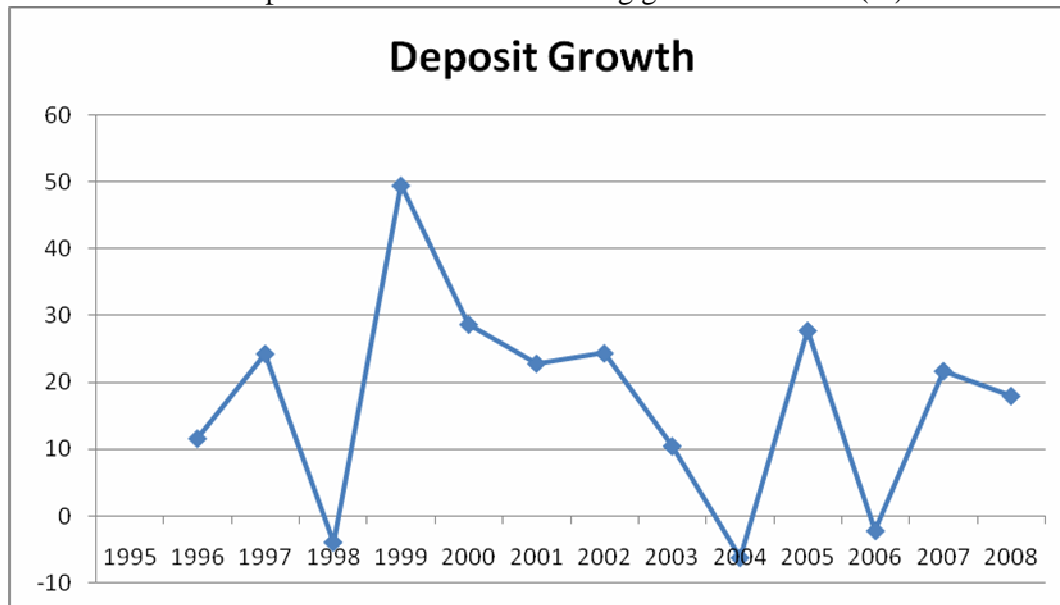


Figure 5b
Deposits and short-term funding growth of BIMB (%)



Nowadays BIMB does not only serve Muslim customers but half of its deposits are contributed by non-Muslim. Unique behavior of these non-Muslim in choosing Islamic bank over conventional banks provides signals of Islamic banking competitiveness in the industry. The ideas and evidence on survival level of Islamic banks enhanced market confidence with Islamic banking operation and management. Samad & Hassan (1999) study the performance of BIMB and reveal from its financial ratios that BIMB is relatively more liquid and less risky as compared to conventional banks in Malaysia.

Figure 6

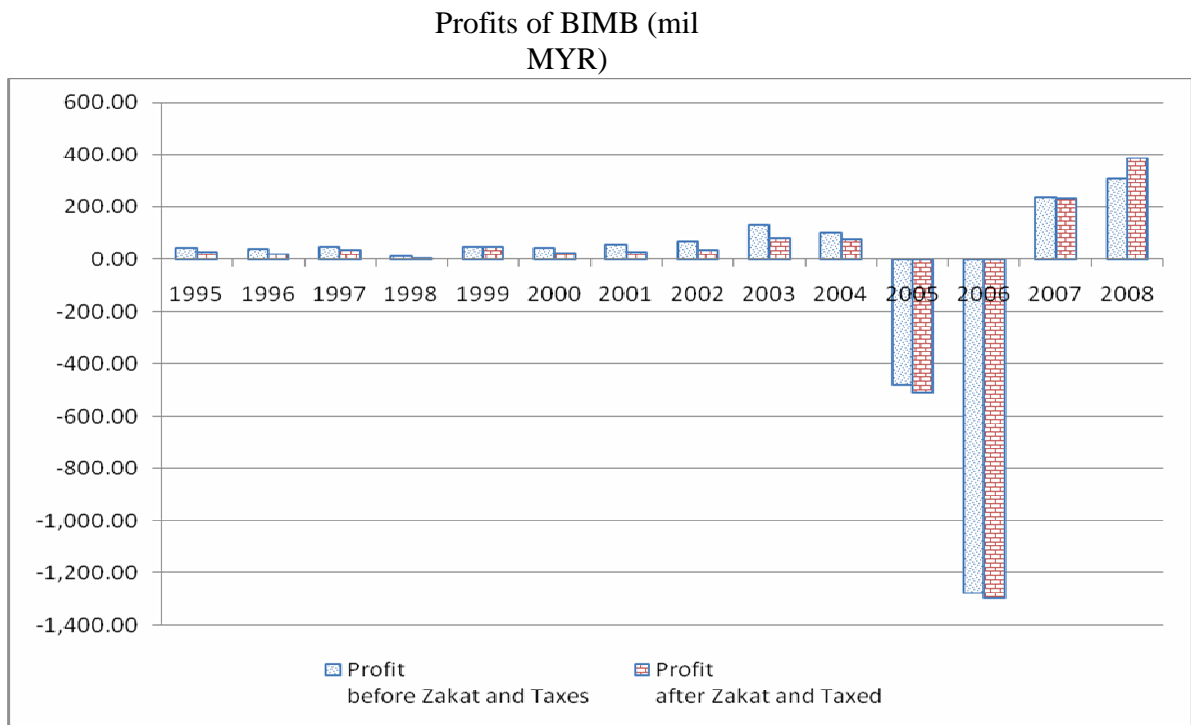
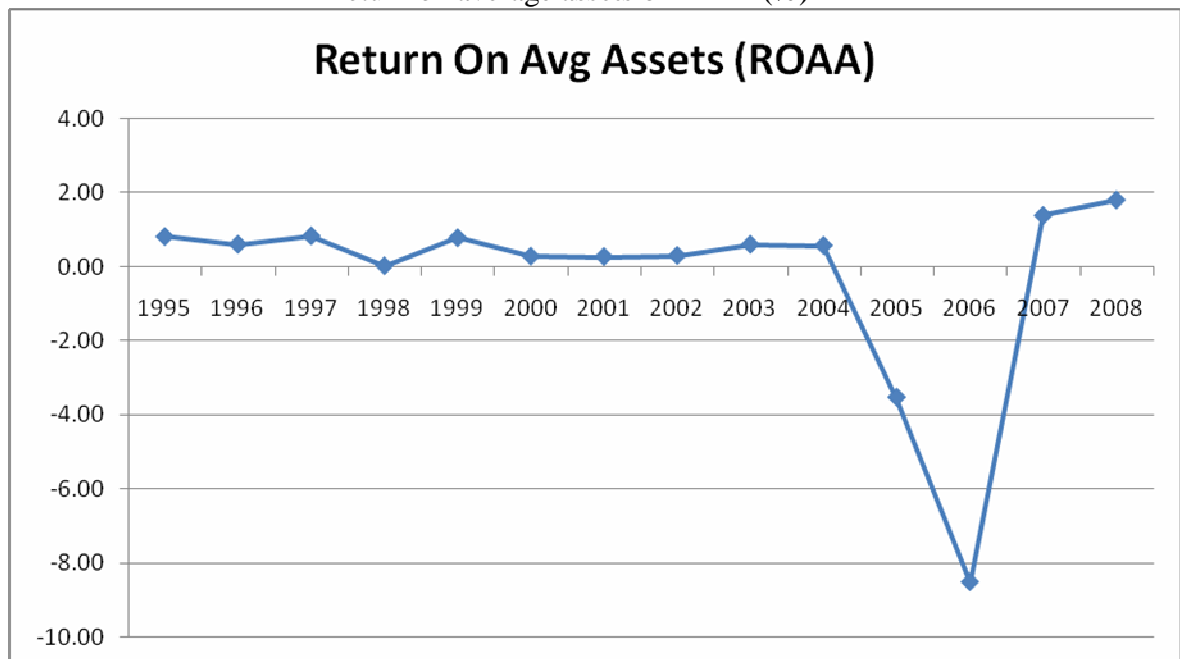


Figure 7
Return on average assets of BIMB (%)



During recent 2007-2008 Global Financial Crisis, none of Malaysian Islamic banks particularly BIMB, have been hit by the U.S. subprime crunch. The reason behind that is in term of the structure of Islamic banks itself which are less flexible in its investments. Islamic banks are prohibited to involve in highly risky business and

investment in security market must be based on real underlying assets. Speculation and interest bearing activities are totally forbidden under Shari'ah law. In order to facilitate liquidity management and fund transfer for Islamic banks, Islamic money market instrument and Sukuk market were introduced. Malaysia has first introduced Islamic interbank money market to enhance liquidity management of Islamic banks.

5. Issues On Risk Control Mechanism In Islamic Banking

5.1 Liquidity Management in Islamic Banking

Islamic banks hold on to the Shari'ah principles in its operation and basically they are not allowed to involve in unacceptable risky investment. The motivation behind these rules is for consumer protection as the profits from Islamic banking activities should depends on actual business rather than speculative activities from the underlying assets. With these unique operations and risks, Islamic banks are expected to be more stable and less affected by the financial crisis.

In term of liquidity position, Islamic banks generally maintain higher liquidity level than the conventional ones. In previous study, it is found that Islamic financial institutions are 50 percent more liquid than the conventional banks (Majid, 2003). This is mainly caused by less flexible funds raising activities through securities and money markets. Unlike conventional banks, Islamic banks must maintain sufficient liquidity in term of cash as the reliance of derivative instruments is almost forbidden. Table 1 shows the comparison on types of assets for Islamic and conventional banks in Malaysia as the mean value of proportion of total assets. It indicates that Islamic banks hold more proportion of non-earning assets as compared to conventional banks and lower proportion of loans than conventional banks. Apart from that, being risk averse in relative to conventional banks, Islamic banks invest more on the government bonds and securities. Government securities carry low risks and it has active traded market that enhance the liquidity management of Islamic banks as this type of assets is considered to be very liquid with low variation in value.

Table 1
Mean value of assets classification in proportion of total assets (%)
for Malaysian banks

	TOTAL LOANS	TOTAL OTHER EARNING ASSETS	FIXED ASSETS	TOTAL NON- EARNING ASSETS	PERIOD
Islamic Banks	49.35	26.04	0.92	23.70	1995 - 2009
Commercial Banks	51.08	26.99	0.69	21.24	1993 - 2009

5.2 Islamic Liquidity Instruments

Recently, Islamic money market has been developed to enable Islamic banks to invest and at the same time to support the liquidity management. The establishment of International Islamic Financial Market (IIFM) in 2001 that promotes active secondary market with Shari'ah compatible instruments should be able to facilitate liquidity management of Islamic banks and other financial institutions. The effort to create harmonization among Islamic countries in dealing with different Shari'ah school of thought and interpretation can be achieved through IIFM. IIFM involves the agreement between the President of the Islamic Development Bank with other major countries that practice Islamic banking and financial market such as Malaysia, Bahrain, Indonesia and Sudan.

In this section, we will discuss on Islamic liquidity instruments adopted by Islamic banks in Malaysia. It includes of Commodity Murabaha, Malaysia Islamic Interbank Money Market and Sukuk. In any structures of each instrument, although some of it has been adapted from conventional market, the basis of Islamic instruments must comply with Shari'ah law in every level of transaction.

Commodity Murabaha is the most common and popular short-term investment practice of Islamic banks to ease liquidity management. It is based on Murabaha contract and used for the buying and selling commodities in international market at agreed mark-up price. Basis of Murabaha is the banks buys certain tangible assets or commodity and sell it at mark-up price for deferred payment. Although it assists in liquidity improvement for Islamic banks, this instrument does not promise high return for the investment. An example of Commodity Murabaha contract is palm oil contracts launched by Malaysia's Commodity Murabaha House (CMH) in June 2009 in providing underlying assets to the market for Islamic liquidity management scheme.

Malaysia Islamic Interbank Money Market (IIMM) was set up in 1994 to fulfill the formation of comprehensive Islamic financial market in Malaysia. The activities includes buying and selling of Islamic financial instruments among market players, interbank investment activities and Islamic clearing and settlement system. This instrument makes available of means to transfer surplus fund to the deficit needs in Islamic financial markets. Islamic securities traded in IIMM are ABS (Islamic Bonds), Cagamas BAIS, Corporate Bond (Islamic), Government Investment Issues, Islamic Commercial Papers, Islamic Medium Term Notes, Malaysian Islamic Treasury Bills and Sukuk Bank Negara Malaysia Ijarah.

Islamic bond or better known by Sukuk differs from conventional types of bond in term of its structure, product design, product offering and rating methodology. The first Sukuk issuance to be rated in Malaysia by Rating Agency Malaysia (RAM) initiates in 1994 for Petronas Dagangan Sukuk (Ayob). The most commonly used Sukuk contract under the provision of Accounting and Auditing Organisation for Islamic Financial Institution (AAOIFI) includes Mudharaba, Musharaka, Istisna'a, Ijarah, Salam and Murabaha. Currently, there are four broad categories of Sukuk; debt-based Sukuk, asset-based Sukuk, project-based Sukuk and asset-backed Sukuk.

Debt-based Sukuk securitise on Islamic receivables and it must be originate from Islamic approved contracts that create future receivables. Conversely, asset-based Sukuk are based on the underlying assets used to facilitate the issuance of Sukuk. The new innovation of Sukuk, project-based Sukuk seems to be better in mitigating financial crisis as compared to the earlier two Sukuk. Project-based Sukuk is a PLS arrangement and the pay-off relies on the performance of underlying projects. Sukuk investors need to consider the risk of investment on the asset quality and quality of cash flows of the project before embarks to the investment. In this Sukuk arrangement, there is no guarantee of profit payment or principal redemption to the investors. Finally, asset-backed Sukuk represent the real form of securitisation and Sukuk investors are exposed to the real value and risk of the underlying asset. Asset-backed Sukuk is non-recourse Sukuk with the underlying assets forming the sole source of profit and principal payments.

5.3 Islamic Deposit Insurance

Islamic banks in Malaysia established under the supervision of Bank Negara Malaysia (BNM), the central bank and operate under the advice of Shari'ah Advisory Council. All Islamic banking licenses issued by BNM are in deemed to obey with Malaysia Deposit Insurance Corporation (MIDC) Act 2005. The key objective of the establishment of MIDC is to ensure the stability of the Islamic financial system and to retain public confidence to the banks. The lesson of previous bank failure brings out the importance of risk management in banking and thus it should be seriously taken into account. The establishment of MIDC further strengthens customers' protection in Islamic deposits.

Islamic deposit insurance administered under MIDC must follow the rules in investing only in Shari'ah-compliance instruments and activities. As discuss earlier, the existence of deposit insurance may lead to moral hazards of banks by tolerate with excessive risk. However, the probability of moral hazards in Islamic banking should be very minimal as the pillar of Shari'ah law itself is to conduct ethical business with the main interest to protect customers apart from generating handsome return. Furthermore as evidence in Ng, et al (2010) the existence of deposits insurance in Malaysia demonstrate positive impacts in banking risk management.

Malaysia Islamic Deposits Insurance since its starts has prove its excellent rational towards Islamic banking and finance stability. Other countries that began to starts and strengthen their Islamic financial markets realised the importance of risk controls and believe many things could be learned from MIDC. For instance Nigeria Deposit Insurance Corporation (NDIC) entails the exposure on Islamic deposit insurance and Islamic banking in Malaysia for the preparation of Islamic banking operation in Nigeria (Ekundayo, 2010; Komolafe, 2010).

5.4 Regulatory Framework for Islamic Banks

Regulation is vital in banking industry as it promotes banking soundness and stability. The main agenda of regulation and supervision is to protect the right of every stakeholder in banking sector. As another part of banking business, Islamic banks may need its own

sets of regulation to fits in Islamic banking framework. The need is compulsory seeing that Islamic banks require tailor made regulation for their unique products. Apart from its product, it is crucial for Islamic banks to have proper regulatory framework to guarantee the true security instruments in accordance of Shari'ah principles (Ahmad & Luo, 2010). Other than that, supervisions are necessary in monitoring capital level of Islamic banks from any misconduct and excessive risks; in observing liquidity position to avoid withdrawal run; and in promoting disclosure and transparency in financial reporting.

As Islamic banks operate in parallel to conventional banks locally and internationally, the enactment of special law for Islamic banks may not be possible. Therefore the adaption of existing law and regulation to suit Islamic banking operation is practical. The collaboration of Islamic agency such as AAOIFI and Islamic Financial Standard Board (IFSB) with Basel II would be sensible in ensuring standardisation and at the same time to be recognised internationally (Hassan & Dicle, 2005). Similar to conventional banks, Islamic banks are required to comply with the Basel II of minimum 8 percent capital adequacy requirement.

Capital adequacy requirement provides an opportunity for Islamic banks to strengthen their risk management. Islamic banks should maintain higher capital adequacy to enhance due diligence and discipline in avoiding extreme risk taking in its operation. Brana and Lahet (2009) highlight the needs to properly structure capital requirement as the 1998 Basel capital requirement trigger the 1997 Asian financial crisis and create external common shock. Solvency ratio (BIS) illustrates bank's actual capital as a percentage of its risk-weighted assets. It consists of Tier 1, Tier 2 and Tier 3. Tier 1 represent the core capital consists of equity, reserve and retained earnings; Tier 2 contains preferred shares and debt certificates; and Tier 3 consists of short-term subordinated debts (Bikker & Bos, 2008). Table 2 represents the mean value of funds and equity as percentage of total capital for Malaysian banks. It shows Islamic banks hold higher proportion of equity than conventional banks although deposits and short-term funding is slightly higher than conventional ones. The ratio indicates Islamic banks' ability to withstand losses and signal lower risk exposure with better capital adequacy.

Table 2

Mean value of funds and equity in proportion of total liabilities and equity (%) for Malaysian banks

	TOTAL DEPOSITS & SHORT- TERM FUNDING	TOTAL OTHER FUNDING	TOTAL OTHER (NON- INTEREST BEARING)	TOTAL EQUITY	PERIOD
Islamic Banks	80.50	1.30	2.65	15.53	1995 - 2009
Commercial Banks	79.99	5.03	3.79	11.18	1993 - 2009

Basel II also grants financial stability through the requirement of banks disclosure and transparency. As suggested in the third pillar of Basel II, six categories of financial disclosure and transparency are the financial performance; financial position, risk

management strategies and practices; risk exposure; accounting policies; and basic business, management and corporate government information. Transparency and disclosure provides benefits to customers, banks and the economy. Acceptable disclosures boost up customers and investor confidence through bank accountability. This is guide to discipline in banking practice and thus promote financial market and economic stability.

6. Conclusion

Banking sector and financial crisis have very close relationship in one another. Islamic banks are not excluded with the banking fragility toward systemic risks in banking industry. Thus, the effort in finding resolution should come in advance before the crisis hits the market. Islamic banks however, are presume to be more stable during the banking and financial crisis due to their nature in holding to Shari'ah principles.

Nevertheless, Islamic banks are in needs to be equipped with tools and instrument that can improve their performance and mitigate the adverse effect of financial crisis. Among issues should be taken into consideration are the risk management of liquidity, capital and operation. Islamic banks normally maintain higher liquidity level due to inflexibility in short-term fund raising through money market. The introduction of Islamic liquidity instruments should assist Islamic banks in utilizing the mechanism of fund transfer in Islamic money market. Other than that, Islamic banks need to have sufficient capital requirement as this is to ensure bank solvency and low level of risk.

Appropriate standards and regulation are necessitates in promoting Islamic banking soundness and financial prudent. Currently AAOIFI and IFSB actively monitor and offer guidelines for Islamic banking operation and the collaboration of these bodies with co-existence authority would assist the standardisation and internationalisation of Islamic banks globally. While Islamic banking growth is tremendous, the perseverance of Islamic banks to survive during the financial crisis is importance considering their unique characteristics that distinguish them with the conventional counterparts.

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