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Special Issue on Islamic Banking: Stability and Governance

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Islamic banking has experienced very rapid growth in the last three decades and the global financial crisis of 2007-2009 has contributed to accelerate such a development not only in Islamic countries but also in the rest of the world. Such trends will presumably move further upwards with the Covid-19 pandemic crisis with the rising uncertainty worldwide. Although the share of Islamic assets in total world assets is still relatively low, Islamic finance principles have attracted the attention of more and more researchers and policy-makers from the East and from the West and from the South and from the North. This is because there's an increasing need to consider financial contracts that guarantee better financial stability and resilience based on sound governance mechanisms. This explains the increasing number of studies on the comparison of Islamic and conventional banks in the literature. In this special issue, which gathers seven articles, three main themes in Islamic banking & finance are emphasized: Stability, Governance Structure and Investment Portfolio.

Stability

The articles in this subset cover the following topics: financial resilience, income diversification, interest rate sensitivity and capital and liquidity requirements.

Ghaffari (2020), in this special issue, explores the resilience of Islamic and conventional banks in the MENA region during the 2002-2014 period. The study uses hyperbolic distance function

techniques to examine business risk. The results reveal that conventional banks are more vulnerable to an abrupt fall in their lending business; however, Islamic banks' sensitivity to a substantial decline in business does not vary across lending and non-lending activities. The findings also indicate that large banks are more resilient than small banks.

Paltrinieri et al. (2020) investigate the impact of income diversification on risk and profitability of Islamic banks vis-à-vis conventional banks. They study 67 Islamic and 154 conventional banks in 11 countries during the 2007-2016 period. The analysis shows that there is no significant relationship between income diversification and stability for both Islamic and conventional banks. However, the share of non-interest income activities in total income is positively associated with profitability of both Islamic and conventional banks.

Caporale et al. (2020) examine the bank lending channel of monetary policy in Malaysia. Using a two-regime threshold vector auto-regression model applied on data from January 1994 to June 2015, they find that Islamic credit is less responsive than conventional credit to interest rate shocks in both high and low-growth regimes. Further analysis shows that the sensitivity of Islamic credit and conventional credit to interest rate shocks converges after 2002. In addition, the study reveals that Islamic credit enhances growth in the low-growth period.

Bitar, Pukthuanthong and Walker (2020) address the Basel III requirements for holding more capital and liquidity to create a more stable banking system and study its impact on banks' efficiency. They examine Islamic and conventional banks in 28 countries during the 2005-2012 period. They use data envelop analysis to compute efficiency scores and conditional quantile regressions for their estimations. They show that banks with more capital and liquidity tend to be more efficient even during the global financial crisis of 2007-2009. However, they find that this relationship is weaker for Islamic banks.

Governance Structure

There are two studies on this theme.

The first study investigates disclosure practices under different corporate governance structures. Elamer et al. (2020) explore the relationship between the governance structure of Islamic banks and operational risk disclosure practices. They examine 63 listed Islamic banks operating in the MENA region over the 2006-2013 period. They find that having *sharia* supervisory board, block ownership and board independence are associated with higher operational risk disclosure. The findings have implications for policies aiming at promoting transparency and disclosure.

The second article (Ooi, Setiawan and Hooy, 2020), contributes to the literature on religiosity and risk-taking behavior. The authors study the riskiness of a bank's activities when a Muslim is appointed as the CEO. They examine 39 listed Indonesian banks operating from 2010 to 2017. They find that state-owned banks with a Muslim CEO follow a less risky strategy. For foreign-owned banks, the negative relationship holds when the board is Muslim-dominated. The results show no significant relationship for family-owned banks.

Investment Portfolio

There is one article on this theme. Dharani, Hassan and Paltrinieri (2020) examine the performance of *sharia*-compliant investment portfolios. They juxtapose return and risk of *sharia*-compliant investment portfolios with stock portfolios which are not classified as *sharia*-compliant. They construct the two samples using data on stocks included in the S&P BSE 200 index over the timespan 2001:01-2017:08. The study shows that the *sharia*-compliant portfolio has a higher return but a lower level of risk than the non-*sharia*-compliant portfolio. Further analysis indicates that the *sharia*-compliant portfolio has a lower volatility during the global financial crisis of 2007-2009.

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