

Risk Management Practices in Islamic Banks in Kuwait

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Abstract

The purpose of this paper is to explore via a qualitative study, risk management practices in Islamic banks in Kuwait through addressing risk management processes, type of risks, and measuring and mitigating risks. An in-depth interview was carried out with five informants using the convenience sampling method. After the transcription of the interview data and detailed analysis using the thematic technique, the finding indicated that the practices of risk in Islamic banks in Kuwait is almost similar to the practices of used by conventional bank in Kuwait in term of risk management process, tools that measure the risks and the techniques adopted to mitigate risks.

Keyword: Islamic banks, Kuwait, Qualitative research, Risk management

1. Introduction

Today, the banking environment has experienced many global contemporary changes, the most significant of which are the liberalization of service trade, major progress in the technological aspect, and a rise in competition whether it is within the bank or between banks and other institutions.

In the light of these changes, evolution within banking itself has to come along too in order to keep pace with such contemporary developments, making it a must to pay attention on revealing and clarifying the various risks that banks may encounter, in addition to providing a method for assessing such risks and managing them, while also suggesting means through which risks and their impacts can be curbed (Khalid & Amjad, 2012).

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Due to a state of bankruptcy inflicted upon some of the most prominent and well-established banks in the U.S., with the subsequent bankruptcy of other banks across the globe, questions have been raised to enquire on the effectiveness of risk management practices applied in those bankrupt banks. The findings reached by several studies have actually proved the failure of risk management departments to effectively perform their duties. Risk management experts, practitioners, academics and others, acknowledge that the presence of effective risk management departments is the cornerstone for the management of economic and financial institutions, including banks (Abu Hussain & Al-Ajmi, 2012).

This global financial crisis has not only revealed the poor level of risk management practices in the series of collapsed banks, but has also showed at the same time the importance and strength of Islamic banking. Islamic banks at the beginning were a strange and an unusual, inapplicable concept, i.e. "just a dream" where few were familiar with the concept and role of Islamic banking (Abdullah, Shahimi, & Ismail, 2011). Now, Islamic banks have attracted the attention and confidence of many people as they have proven their worthiness and ability to operate successfully after being able to overcome the series of financial and economic crises suffered by the world economy.

At present, there are more than 500 Islamic financial institutions worldwide with estimated assets of about \$1 trillion. They offer a wide range of products and services. In fact, the increased demand for Islamic banking and funding has urged many countries to grant more licenses for the establishment of Islamic financial institutions in more than 75 Muslim and non-Muslim countries (Khalid & Amjad, 2012).

2. Islamic Banking Industry

The Islam banking system offers more ethical and efficient alternative to the interest-based conventional financial system. Islamic banking emerged in the Middle Eastern financial markets in early 1970s, based on models developed by Islamic economists over the past decades. Other Muslim countries also followed the suit and launched their own Islamic banking institutions. Three Muslim countries that include Iran, Pakistan and Sudan embarked upon the project of adopting the Islamic banking order at the state level.

In many countries, Islamic banks coexist with conventional commercial banks. This coexistence does not pass without facing key challenges in competing between the two, especially on the global stage, making it imperative upon Islamic banks to deal with risks faced by their peers the conventional banks, while also conforming to international standards (Abdullah, Shahimi, & Ismail, 2011). There is a pressure to apply the same regulation for both types of banks, and thus a common legal framework is generally developed. No separate regulatory laws have yet been set to govern the operations of Islamic banks. It is common for Islamic banks to operate under the laws governing commercial banks (Abdullah, Shahimi, & Ismail, 2011)

The fundamental difference between Islamic and conventional banks appears in the main idea thereof. That is, the idea in an Islamic bank is to adopt Islamic modes in funding instead of the system of trading in debts and profiting from the difference in interest rates between deposits and loans in a conventional bank.

Therefore, The goals of Islamic banks go further to include, besides maximizing shareholders' wealth, maximizing depositors' wealth as being partners with the bank, not to mention the main goal represented in fighting usury and monopoly and achieving economic and social development for Islamic societies. With respect to the relationship with depositors, Islamic banks are not committed to return investment deposits or guarantee a certain interest for the depositor. Moreover, depositors bear loss and receive profit without the participation of the bank.

Hence, there are fundamental differences in the nature of work and goals between an Islamic bank and a conventional bank, which necessarily entails difference in the nature and size of risks faced by each of them.

It is worth noting here that risks are a natural element in business and community life. A risk involves a possibility to suffer loss or gain profit from potential incidents that can be manipulated, and it is a necessity for the success of financial institutions. However, there must be efficient risk management departments within institutions (i.e. banks) which practice their work effectively to help banks deal optimally with such risks and reduce the damage and loss when exposed thereto.

3. Islamic Banks in Kuwait

In Kuwait, the Islamic banks offer Sharia-compliant banking products and services have increased as well as the number of Islamic banks in Kuwait increased from one to five Islamic banks in last five years. These are: Kuwait Finance House, Kuwait International Bank, Warba Bank, Bubyar Bank, and Ahli United Bank. According to KFH report, the growth of the assets in Islamic banks in Kuwait registers around 39% of total assets of all banks in Kuwait in 2012.

However, Kuwaiti Islamic banks operate with many products that do not exist in conventional banks and suffer from increasing risks, therefore, the situation is unpredictable for this reason, and therefore, the efficient risk management is extremely necessary as mentioned early. Moreover, although Kuwait central bank issues instructions for applying risk management through the internal controls which both commercial and Islamic banks are supposed to follow, and despite the presence of Shariah boards that regulate the work of Islamic banks to ensure that their practices and activities are in compliance with the Islamic Shariah, banks may not apply those instructions, requirements and regulations properly or optimally, either for the lack of necessary resources or difficult application. Therefore, the opportunity of occurring risks is remarkable. The researcher will explore and identify level of risk management practices in Islamic banks in Kuwait, through answering the main question of current study "What are the risk management practices in Islamic banks in Kuwait?"

Therefore, the objective of this study is to identify the extent level of Islamic banks in Kuwait use the effective risk management practices RMPs, identify the types of risk that Islamic banks face in Kuwait, identify tools that measures risks and the approaches that Islamic banks in Kuwait use to mitigate risks, identify the difficulties that Islamic banks in Kuwait face in the practices of risk management, if any, and finally, which banks are facing greater risks Islamic or conventional.

Based on the statements mentioned above, the current study raises the following questions:

1. To what extent the Islamic banks in Kuwait use the effective practices risk management RMPs?
2. What are the risks that Islamic bank in Kuwait facing?
3. How do Islamic banks in Kuwait measure and mitigate risks?
4. Which are facing more risks conventional or Islamic banks? And why?

4. Literature Review

4.1. Risk Management Practices

Risk in the economic field is: "to expect differences in the expected and actual rate of returns." Risk is defined as "a future possibility that a bank may suffer unexpected and unplanned loss which may affect the achievement of the bank's objectives and the successful fulfillment thereof, and may lead, in the event of failing to control such loss, to cause the bank to go bankrupt." (Hennie, 2008).

Risk management is an integrated process that aims to reach specific means to control risks and reduce the frequency thereof, and reduce the size of loss using the best means and lowest cost by identifying, analyzing, and assessing risks and identifying the means to address them, by selecting the best among them to achieve the desired goal (Taher, 2004). The risk management theory describes the term 'risk management' as "a method through which decisions are made; a process conducted on two steps: (1) to identify the origin and causes of risks, and (2) to develop ways to assess risks by means of mathematical models" (Khalid & Amjad, 2012).

Risk management is an ongoing process which depends directly on changes in the internal and external environments of banks; namely, the changes that require constant attention to identify and control risks (Abu Hussain & Al-Ajmi, 2012). The risk management process has four basic elements: risk identification, risk assessment, risk mitigation, and risk monitoring and reporting (Tafri, Abdul-Rahman & Omar, 2011).

The Basel Committee on Banking Supervision (BCBS) (2001) defines financial risk management as a four-process sequence: "the identification of events into one or more broad categories of market, credit, operational and other risks (and then into specific sub-categories); the assessment of risks using data and a risk model; the monitoring and reporting of the risk assessments on a timely basis; and the control of these risks by senior management." (Alexander, 2004)

In conclusion, risk management is a set of departments or bodies concerned with identifying, assessing, mitigating, and monitoring and reporting risks in Islamic banks of the study.

4.2. Risk Management Based on AL Quran

Qur'an has presented stories of the previous prophets so that Muslims can take the lessons from their experiences. The story of the prophet Joseph (verses 43 to 49), for instance, tells us about risk management. The King of Egypt had seen a dream, and the King's assistants failed to interpret it. So they sent the Prophet Joseph (PBUH) to inquire about such a dream. Allah the Almighty says: "O Yûsuf (Joseph), the man of truth! Explain to us (the dream) of seven fat cows whom seven lean ones were devouring, and of seven green ears of corn, and (seven) others dry, that I may return to the people, and that they may know." (Holy Qur'an 12:46)

4.2.1: Identifying, Understanding, and Analyzing the risk from Prophet Joseph Story

The Prophet Joseph (PBUH) identified, understood and analyzed the risk. He could interpret the dream. Almighty Allah says: [(Yûsuf (Joseph)] said: "For seven consecutive years, you shall sow as usual and that (the harvest) which you reap you shall leave it in the ears, (all) except a little of it which you may eat. Then will come after that, seven hard (years), which will devour what you have laid by in advance for them, (all) except a little of that which you have guarded (stored). Then thereafter will come a year in which people will have abundant rain and in which they will press (wine and oil)." (Holy Qur'an 12:47-49). Therefore, Prophet Joseph (PBUH) gave solutions to avoid such risks.

4.2.2: Monitoring the Risk Based on the Prophet Joseph Story

To complete the process of risk management, the Prophet Joseph (PBUH) asked the king to give him control over the store houses to monitor the implementation of the plan he set before with a view to avoid the risk of famine. '[Yûsuf (Joseph)] said: "Set me over the store-houses of the land; I will indeed guard them with full knowledge" (as a minister of finance in Egypt)' (Holy Qur'an 12:55). By doing so, Prophet Joseph (PBUH) managed to avoid the risk of famine very safely.

4.3. Risks Type, Measuring, and Mitigating

In his study, Kumaran (2012) concluded that liberalization of financial markets is associated with the increase of risk level as well as financial instability.

The study indicates that Islamic financial institutions face two categories of risks; the first of which includes credit risk, market risk, liquidity risk and operational risk – which they have in common with traditional banks. However, and due to compliance with the provisions of the Islamic Sharia, the nature of these risks changes. The second one is a new and unique risk that Islamic banks face as a result of their unique assets and liability structure. These are Murabaha, Mudaraba, Musharaka, Ijarah, Istisna'a and Salam.

Khan and Ahmed (2001) are in the view that Islamic banks do not only face the same risks that conventional banks face, they however have to deal with the new and unique risk stemming from their unique assets and liability structure. According to them, this new risk exists due to compliance with Sharia requirements. Most of Islamic financial institutions' activities are based on profit and loss sharing; which indicates that such transactions pose lower risks. However, contracts based on profit and loss sharing expose Islamic financial institutions to a specific risk depending on the type of each contract.

As Islamic banks' operations differ from that of conventional bank; its risk exposure is also different. Basel II identifies three types of risk exposures for conventional banks: credit risk, market risk and operational risk (BCBS, 2006). However, according to Chapra and Khan (2000), at least four different types of risks for the Sharia compliant products are not included in Basel II.

Credit and operational risks can be handled in the similar way in both conventional and Islamic banks but the market risk needs a special attention.

Arunkumar and Kotreshwar (2005) revealed that credit risk constitutes 70% of the total risk in banks, while the remaining 30% is shared by market and operational risk. Khan (2003) indicates that credit risk is the most important source of banking instability and capital is widely recognized as an effective security against the insolvency of banks. Basel Committee, the international banking supervisory body also claims that the key source of critical banking problems is the credit risk, the risk of customer default. Credit Risk is defined as risk that the value of portfolio may change due to the unexpected changes in the credit quality of issuer or trading partner.

Hull (2007) and Arunkumar and Kotreshwar (2005) defined credit risk as the possibility of the borrower, bond issuers or counter parties to default or be unable to meet the contractual obligation and repay the promised amount. In Islamic banks, each type of contract results in a different credit risk on the banks' profit. IFSB 2 (2005), credit risk exposures in Islamic financing arise in connection with accounts receivable in Mudarabah contract, counterparty risk in Salam contract, account receivable and counterparty risk in Istisna', contract and lease payment receivable in Ijara contract and Sukuk held to maturity in the banking book.

Market risk is the risk that a bank may encounter due to unfavorable movements of market price (Greuning & Iqbal, 2008) and it arises from the change in the price of equity instruments, commodities, fixed income securities and currencies. According to IFSB 1 (2005), market risk is defined as the risk of losses in on and off-balance sheet positions stemming from movements in the market prices, namely fluctuations in values in marketable, tradable, or leasable assets (including Sukuk) and in off-balance sheet individual portfolios (such as restricted investment accounts). There is a connection between the risks and the current and future volatility of market values of specific assets, such as the market value of a Sukuk, the commodity price of a Salam asset, the market value of Murabaha assets purchased and are expected to be delivered over a specific period, and of foreign exchange rates.

Operational risk has to do with the loss resulting from "inadequate or failed internal processes, people and system, or from external events, including losses resulting from non-compliance with the provisions of the Islamic Sharia and the failure in fiduciary responsibilities" (IFSB, 2005a: 26).

It is understood that the definition of operational risk in Islamic banks includes legal risk (Archer and Haron, 2007; Cihak and Hesse, 2008; Djojosingito, 2008, Fiennes, 2007; Khan and Ahmed, 2001; Sundararajan, 2005), and also reputational risk (Fiennes, 2007; Akkizidis and Kumar, 2008; Standard & Poor's, 2008). The main feature of this definition, as compared to the definition by Basel 2, is the inclusion of Sharia non-compliance risk and fiduciary risk. In fact, Sharia non-compliance risk stands for a significant portion of the operational risk (IFSB, 2007b: 6). Sharia non-compliance risk arises from Islamic banks' failure to comply with the Sharia rules and principles determined by the Fatwa and Sharia Supervisory Board (FSSB) or the relevant body where the Islamic bank operates in (IFSB, 2005a). Failure to comply with the Sharia provisions will result in the transaction being cancelled, and hence the income or loss cannot be recognized.

Moreover, fiduciary risk arises from Islamic banks' failure to perform in accordance with the explicit and implicit standards applicable to their fiduciary responsibilities (IFSB, 2005a). Therefore, failure to maintain fiduciary responsibilities will damage the Islamic banks' reputation (Hamidi, 2006). A reputational damage could eventually lead to withdrawal of funds which would in turn result in a liquidity crisis. It could also induce customers to abstain from requesting financing facilities from Islamic banks, leading finally to a plunge in profitability. To maintain good reputation, Islamic banks need to do two things: 1) to ensure that their financial products are Sharia compliant (Greuning and Iqbal, 2008; Iqbal and Mirakhor, 2007); and 2) to effectively maintain their fiduciary roles (Muljawan, 2005).

In addition, Islamic banks are exposed to a unique type of operational risk or Sharia non-compliance risk. Islamic banks' operations are free of interest, but interest rate risk is present to a certain extent because of the use of LIBOR (London Interbank Offering Rate) as the benchmark in pricing. Therefore, a change in the reference rate is likely to affect the rate of return that the bank expects to realize on its use of funds and pay to its depositors. This rate is called rate of return risk (IFSB, 2005).

According to Tafri, Abdul-Rahman and Omar (2011), the risk measurement process covers the utilization of the appropriate risk indicators to measure the size of risk and its impact on the bank and its business activities.

At present, there are different measurements, methods, and systems for different kinds of risk and those are motivated by the ability of the bank to allocate capital among their expanding. These techniques of measuring and mitigating risks include: gap analysis and the duration gap analysis to measure interest rate risk; VaR to access market risks and credit risks separately; earnings at risk (EaR), risk adjusted rate of return; and stress-testing. According to Archer, Ariffin and Karim (2008), Islamic banks use the same risk management techniques as compared with conventional banks for managing risks, such as collateral arrangements and guarantees, which are the most widely used by Islamic banks.

5. Research Methodology

This qualitative study aims at exploring and identifying the risk management practices in Islamic banks in Kuwait. To explore the applicability of the various questions set forth in the introduction; this study adopted a realist ontological position. Realist ontology is a system that is based on the belief that a reality exists out there. According to Guba (1990), the realist ontology position assumes that, nature cannot be seen as it "really is" except through a value window. Thus, in order to avoid the choice of a particular value to dominate the other, critical theorist adopts a subjectivist epistemology so as to facilitate intimacy between inquiry act and value of the inquirer.

The research method adopted in this study is a qualitative research approach in the form of semi-structured, face-to-face and in-depth interview. Semi structured interview is a qualitative data collection strategy whereby the researcher asks the Respondents a series of predetermined but open ended questions, (Given L., 2008). According to Horton and Struyven (2004), semi structured interview reveals more facts by allowing the interviewee certain degree of freedom to explain their thought and allow certain response to be questioned in-depth due to its flexibility. The interviews were recorded, transcribed coded and analyzed.

Five Respondent interviews were conducted with risk managers in Kuwait Islamic banks. Two of them from Warba Bank (WB), one from Kuwait Finance House (KFH), one from Kuwait International Bank (KIB), and one from Boubyan Bank (BB). The minimum working experience in the risk management was 5 years and the maximum working experience was 15 years.

Standard, semi-structured interview was used not only for the purpose of answering the study questions, but also to explore other additional and related information that may help meet the objective of this study. All interviews were conducted in person. They lasted 15-25 minutes, with an average duration of 19 minutes. Respondents were asked to identify the risk management process in Islamic banks in Kuwait and what types of risks that Islamic banks faced and how they measure and mitigate the risks and which banks are facing more risks; conventional or Islamic.

6. Discussion and Findings

Following the literatures reviewed for this study, the thematic analysis method is adopted in this study. Thematic analysis focuses on identifying themes. Moreover, it is stated that idea can be better understood through thematic analysis. According to Strauss and Corbing, (2000), thematic analysis can be applied if the goal of the research project is not for the establishment of theory. This study therefore uses thematic analysis method. In fact, five themes have been identified from interviews. A summary of those themes is shown and further discussed in the Table 1 below:

Table 1: Summary of Findings

Themes	Risk management practices	Represented by
Theme 1	Four Risk management process	"we follow Basel 2" "Same processes of conventional banks"
Theme 2	Types of risk in Islamic banks	"Our bank has three main risks: Credit Risk, market risk, and operational risk" "Risks are the same in all banks. A key risk is compliance risks(Corporate Governance Risks)"
Theme 3	Risk Measures	"There is software such as Moody's that is used in credit risk" "In respect of market risk is measured Value at Risk"
Theme 4	Risk Mitigations	"The bank applies the guarantees policy, collaterals and assignment of dues, and the bank adopts the insurance policy"
Theme 5	Risk Greater Islamic or Conventional Banks	"Conventional banks have more risks than Islamic banks because Bank remains in comfort zone" "Risk is dependent on bank's size and how the bank is willing to allocate assets"

6.1. Themes of Risk Management Practices in Islamic Banks

6.1.1: Theme 1: Risk Management Processes

In line with the definition provided by the Basel Committee on Banking Supervision (Alexander, 2004), and that mentioned by Tafri, Abdul-Rahman and Omar (2011) on the issue of the risk management processes, there are four risk processes. These are: 1) to identify and understand the risk which is a common understanding of risk and risk management, which gives an indication about the ability of these Islamic banks to manage risk efficiently in the future course of action.

2) To assess the risk, which is the tool used to analyze risk, to assess the cost and benefits of addressing risk, and to prioritize the risk. 3) To monitor the risk, which is to facilitate efficient and effective management of such risks and report risk indicators to committee and management periodically. 4) The controls, which means to avoid recurrences and keep track of activities and assess lest the probability of a similar case arising in the future.

Furthermore, all Respondents indicated that these processes are the same as those applied in conventional banks, and apply Basel II based on the instructions of the Kuwait Central Bank. The only difference is that Islamic banks use sharia rules in addition to KCB regulation. This view is supported by Respondent 1 who stated that:

The concepts and processes are the same and apply according to Basel II instructions. The difference is that Islamic banks use Sharia rules that ensure all products and services are approved by the banks Fatwa and Sharia Supervisory Board, and all deals are real assets that generate value to the economy. (Respondent 1)

The view of the second Respondent is supported the above statement:

Risk management processes in conventional and Islamic banks are slightly different. They both receive regulations and instructions from the Central Bank of Kuwait. With regard to Islamic banks, the Central Bank of Kuwait takes certain instructions and recommendations from IFSB and applies the same to Kuwait Islamic banks. There are variances in risk management in Islamic and conventional banks due to different products, such as Murabaha, Ijara, Mudaraba, and Musharaka. Islamic banks should follow Sharia provisions. However, these variances will not affect risk management processes in Islamic and conventional banks. (Respondent 2).

In addition to that, a statement from Respondent 4 supports the statements of Respondents 1 and 2, adding that after changing from being a conventional bank to an Islamic one, products had been changed and sharia scholars had been hired to review transactions and contracts of the bank. The following was stated:

I would like to indicate that risk management processes after the bank's conversion into Islamic banking are similar to the relevant activities which were in place before conversion (conventional bank).

The divisions existed in the bank before conversion into Islamic banking are still the same after conversion. After conversion, all products have been changed and Sharia scholars have been hired as advisors to review the contracts and products and ensure that there is no interest or loans, and apply new concepts like profits, finance, Murabaha, investment and all other common products offered by Islamic banks. (Respondent 4)

Moreover, Respondents 3 and 5 concluded with the same results of Respondent 1, 2, and 4 by mentioning these brief statements:

We use the same procedures based on Basel II and Central Bank of Kuwait's instructions. (Respondent 3). There is no difference in processes as we follow the instruction of the Central Bank of Kuwait. (Respondent 5)

To summarize the aforementioned responses, all of the Respondents mentioned that the risk management process is the same as conventional banks and follow Basel II based on the instructions of the Kuwait Central Bank.

6.1.2: Theme 2: Types of risk in Islamic banks in Kuwait

In this theme, it is observed that all of the Respondents indicated there are many types of risks that Islamic banks are facing. Some of those risks observed are in conformity with the risks mentioned in the works of Kumaran (2012), and Khan and Ahmed (2001), taking into consideration the unique risks faced by Islamic banks when compared to conventional banks. According to the view of Respondent 1 whose view is in support of the literature review:

There are three main types of risk: 1) Credit risk; which occurs when customer fails to pay back or defaults. Warba Bank is a newly established bank and tries to create business and in the same time to clean its portfolio from any bad debts. Therefore, credit risk is highest risk in faced by Warba Bank. 2) Market risk; it occurs when there is huge reduction in value of investment, currency, and stocks. 3) Operational risk, which covers people, processes, and systems that constitute whole banks interlink with market and credit risks. Operational risk is about what the bank dose based on the policy and procedures, if the bank does not have policy and procedures, the risk will be high. (Respondent 1)

As indicated in the above statement, the respondent identifies three major types of risks which are: credit risk, meaning when the client is unable to pay his obligation, while market risk refers to when there is a huge reduction in the value of investment, currency, and stocks since the market is so volatile, and finally operational risk, which covers people, processes, and systems that constitute the whole bank's interlink with market and credit risks. The credit risk is the most critical one in Islamic banks in terms of affecting its performance.

Another Respondent also stated:

We have four types of risks as follows: 1) Market risks: i.e., the bank invests in equity markets or funds, but the market has a volatile condition. Low prices impose risks on the investment portfolio. 2) Credit risks: i.e., customer's inability to repay. 3) Operational risks: they are divided into 4 sections according to Basel II: A. Human risks; i.e., ethical and behavioral risks, B. Employees' safety risks, and risks of staff disputes. C. Process risks: which stem from a defect in the procedures in force as a result of a gap in the control systems and procedures, or incompliance with the applicable procedures. D. System risks: any defect in systems as a result of their incompliance with the work needs; i.e., purchasing a system that does not meet the nature of the work. 4) External risks: risk beyond the control of the bank; i.e., economic crises and nature catastrophes. (Respondent 5)

This is in line with the previous statement by Respondent 1, yet explaining in further detail about market, credit, and operational risk and adding one more additional risk, which are external risks that occur beyond the bank's control such as natural disasters.

Another Respondent also indicated more risks faced by Islamic banks, which is in line with Khan and Ahmed (2001), mentioning the unique risks faced by Islamic banks when compared to conventional banks. Respondent 2 supported that, saying:

There are many risks faced by the bank and such risks are similar to those faced by conventional banks such as credit risk, market risk, liquidity risk, operational risk, strategy risk, reputation risk, legal risk, IT risk and compliance risk. There is a slight difference in measuring risks in Islamic banks. For example, when applying certain weight on treasury products different from conventional products.

The credit risk is the key risk in Warba Bank because the bank is newly established and has a large portfolio of investments. (Respondent 2)

In the above statement, the respondent goes beyond the three major risks and identifies other types of risk that relate to sharia rules when a bank does not follow them. Some risks will be explored such as the compliance risk that is related to corporate governance risk, and reputation as when the bank is not following instructions of sharia rules. This also leads to the creation of another risk called withdrawal risk which propels clients to withdraw their deposits from the bank. In addition, liquidity risk refers to a group that will be unable to meet its financial liabilities when they become due.

Respondent 3 stressed the same as the previous Respondents and explained further about compliance risk that relates to corporate governance risk, by governing the relationship between shareholders and the board of directors, and that between the board of directors and the executive managers.

Risks are the same in all banks. A key risk is Compliance risks (corporate governance risks). The regulations that govern the relationship between the shareholders and the Board of Directors from the one hand, the Board of Directors and the Executive Management from the other hand by means of forming special committees. And, the most important risks faced by the bank are the credit and liquidity risks... (Respondent 3)

In summary, Islamic banks have different types of risk, such as credit risk, marketing risk, operational risk, liquidity risk, and so forth. According to Arunkumar and Kotreshwar (2005), it was revealed that credit risk constitutes 70% of the total risk in banks, while the remaining 30% is shared by market and operational risk, and Khan (2003) indicates that credit risk is the most important source of banking instability, while capital is widely recognized as an effective security against the insolvency of banks.

6.1.3: Theme 3: Risk Measures

In this theme, according to Tafri, Abdul-Rahman and Omar (2011), it is indicated that many tools can be used to measure different types of risks. In their study, they provided examples of those tools which are in line with the respondents, as it showed that many tools can be used to measure different types of risk, with those tools being either internal or external, as required by central banks. However, some tools that are mentioned in the interview are different from what was stated by Tafri, Abdul-Rahman and Omar (2011), albeit those tools have the same objective, which is the measuring of risks. This can be seen in the following Respondents' statements regarding how to measure different types of risks:

In regard to Credit risk, at the present time, we use different tools to measure risks internally, and use software balance sheet spreading to evaluate your balances in order to do credit analysis and credit review. We are in the process of implementing internal rating of risks, probability of default, and loss arising from default. However, there are external measures required by central banks which are risk weight, capital adequacy ratio, stress testing which ensure that capital is adequate to absorb any losses that might occur. Moreover, in respect of market risk is measured by Value at Risk (VaR) as recommended by the Central Bank of Kuwait and operational risk, at the present moment, the bank uses excel based to record loss have been occurred with bank and put defined control to identify low, medium, and high risk. After that, bank defines the frequency of loss occurrence and have map to score the risk. Finally, other risks: For other types of risk, bank uses a lot of subjective measurers such as experiences and market situation that assist in identifying and measuring risks. (Respondent 2)

In the above statement, the Respondent highlighted some tools that assist in measuring risk. In terms of credit risk, there is an internal rating of risks, probability of default and loss arising from default, that can assess, evaluate, and analyze risk.

Other external measures applied are stress testing, namely an analysis or simulation designed to test the ability to give a financial instrument to deal with financial crises and to ensure that the capital is adequate to absorb any losses that might occur, while market risk measured by value at risk (VaR) refers to a quintile measure of the worst expected loss over a given horizon under normal market conditions at a given level of confidence. This tool is required by the Central Bank of Kuwait.

Further, in terms of operational risk, banks use excel sheet to define control in order to identify low, medium, and high risk, followed by frequency of loss and map risk. However, some other types of risks use a large extent of subjective measures such as experience and market situation.

Another response statement from Respondent 1 was as the following:

Credit risk: There is software such as Moody's that is used in credit risk. In order to mitigate the risk, the bank implements the policy of collateral and looks at the company's name, balance sheet, and cash flow. Market risk is measured by Sendero – UK Company Package – which is used by most of the banks. Also, Value at Risk (VaR) which is recommended by Central Bank of Kuwait, and to mitigate market risks, bank has the option to borrow and lend. Operational risk: Initially, the bank uses the Excel sheet spreading. However, in the future, the bank will use risk register that keeps record of all incidents that happen in bank, and the key risk indicators, key performance indicators, and control self-assessment which are linked to each other to identify and measure risks. In respect to mitigating the risk, the bank transfers the risk mainly by having insurance policies, for the staff medical issues and against fire, fraud or any disaster. (Respondent 1)

In line with the statement of Respondent 2, the first Respondent added Moody's software that is used to measure credit risk and Sendero UK company package to identify and assess market risk, in addition to value as a risk tool. In term of operational risk, the bank uses risk register that keeps record of all incidents that occur in the bank, and the key risk indicators, key performance indicators, and control self-assessment which are linked to each other to identify and measure risks.

Another Respondent mentioned the same as the aforementioned, identifying measures related to liquidity risk based on periodic reports submitted to the Kuwait Central Bank. The response is below:

Many applications are used to measure and evaluate the risks. Liquidity risks are measured through periodic reports submitted to the Central Bank of Kuwait on maturity ladder: 1- Excel Model; 2- Value at Risk (VaR). As for credit risks, they are measured through the policies and procedures approved by Kuwait Finance House, giving more attention to the optimal application of the internal control systems on customers and credit portfolios, the segregation of duties by means of studying the financial position and analyzing balance sheets and documents with emphasize on the credit portfolio through the following: 1- Credit analysis; 2- Ensure following the required policy; 3- Follow up on the credit decision and put the same into action; and 4- Review the policies and procedures and follow up with the customer. (Respondent 3)

Regarding to market risk measures, Respondent 4 reckoned the use of two tools: 1) Reuters software that assists in identifying and measuring risk, and 2) market research. The below statement was the response of Respondent 4:

The system that we deal with market risks depends on Reuters, so that we are usually connected with Reuters via the internet. In addition we follow market researches as well as the researchers conducted by the Central Bank of Kuwait or Kuwait Banking Association's relevant committee. (Respondent 4)

Also, Respondent 5 expressed his experiences and explained in details the tools that are used in measuring credit risk and operational risk, which are the same tools expressed by Respondents 1, 2, 3 and 4. The following citation reveals further details:

For credit risks, there are more than one tool that is used to measure credit risks; for example, Moody's rating system that is used to measure default probability, Loss Given Default (LGD), Value at Risk (VaR) that is used to measure liquidity, and finally Liquidity Gap Risk Analysis.

For operational risks, we have more than one tool: 1- Risk and control self-assessment (RCSA) which is about the activity that should be done once a year at least to determine inherent risk and find out how to control it effectively.

2- Loss data collection which is used the control have failed during process and recommend action plan to mitigate, and also to avoid the findings of RCSA. 3- Risk indicator which is the most important for the risk you want to monitor on monthly or weekly basis. 4- Business process mapping which is physical engineering to enhance the control. 5- New product and change process management to introduce new or to change existing product. They have to follow process when they identify risk project and product. (Respondent 5)

In summary, different tools have been used by different banks, but the objective is the same, which is measuring the risks in an efficient way from the perspective of banks.

6.1.4: Theme 4: Risk Mitigation

In this theme, the techniques that Islamic banks used most to mitigate the risks are collateral arrangements and guarantees (Archer, Ariffin & Karim, 2008). This statement is in line with the Respondents' replies. They use the same tools to mitigate the risks which are collaterals in cash, real-estate, stock and others. Moreover, sometimes banks do insurance in order to transfer the risk and secure the position from any uncertain situations. Some representative statements regarding risk mitigation are presented below:

The bank applies the guarantees policy; i.e., cash, financial instruments, real estates, collaterals and assignment of dues. In addition, the bank adopts the insurance policy based on the customer and the credit policy. Insurance is one of the tools used by banks to mitigate credit risks. (Respondent 3)

Also, another Respondent explained his thoughts about how to mitigate each type of risk by requiring guarantees to ensure the seriousness, including cash or assets. As an internal process to mitigate risk, the bank implements periodic reviews to policy and procedure to ensure the appropriation and effectiveness of policy and procedure in the mitigation of risks. This is what Respondent 5 stated in following paragraph:

As for credit risk, we mitigate such risk by requesting the customer to provide cash or in-kind guarantees.

With regard to market risk, it is reduced through imposing daily control on Value at Risk. In term of operational risk, it is reduced through loss monitoring and ongoing review (review risk register).

Finally, external risk, it is measured and reduced by building insurance on the external events like embezzlements, fires and etc (Respondent 5).

Respondent 4 added that his bank is implementing a conservative policy regarding to its clients by requiring personal guarantees of the individual such as account balance for three to six months, or requiring three year audit financial statements if the client is company. The bank also follows a diversifying risk policy since it converted to an Islamic bank in 2007 by diversifying the portfolio from only one real estate to more than one portfolio such as stocks, investment, financing, and real estate.

He further elaborated as the following:

Bank uses risk rating system to system to handle the guarantees, type of facilities, purpose of facilities, and the availability of a real or in-kind guarantor. This is added to the available guarantees that exist in the finance itself, the personal guarantee as an individual or company, and the financial position of the person or the company. The financial position is usually calculated based on the approved balance sheets of three consecutive years. Furthermore, with regard to our case (Kuwait International Bank), we used to be a real estate bank, and then converted into Islamic banking; we faced high risks, so we had to rely on the commercial and retail division. To this end, we have developed the portfolio from the date of conversion till date. Now real estate share of the portfolio constitutes 40% of our portfolio instead of 90% at the very beginning. This also depends on our market share, and studying customers and the economy." (Respondent 4)

According to Respondent 1, he viewed the same expression of mitigation risks, stating that "In regard to mitigating credit risk, bank takes collaterals and personal guarantees to mitigate risk." (Respondent 1)

In respect to mitigating risk particularly in credit and market risk, some Islamic banks are involved in narrow area of doing derivatives (Swap) in a manner that does not conflict with sharia rules.

These banks avoid speculation and gambling that are main factors that affect and damage their compliance with sharia rules. They have debates in terms of using derivatives in Islamic banks.

In addition to mitigate operation risk some banks depend on insurance to transfer risk to a third party, such as insurance against fraud, fire, and any disaster. Respondent 2 elaborated more in this regard and explained so in the following two statements:

In term of mitigating market risk, bank use swap to reduce the risk. In respect to mitigating the risk, the bank transfers the risk mainly by having insurance policies, for the staff medical issues and against fire, fraud or any disaster (Respondent 2). Perusing the responses of the five Respondents, the conclusion is that every bank aims to mitigate its risks in such way that secures and saves it, especially its transactions, in front its clients. Therefore, the more risk mitigation, the more confidence in the bank, leading to having more deposits and the banks building a good reputation.

6.1.5: Theme 5: The Greater in Risks Conventional or Islamic Bank

According to Khan and Ahmed (2001), it is stated that Islamic banks face greater risk due to their unique products that are non-existent in conventional banks. However, the response to this question from interviews is not in line with Khan and Ahmed (2001). The Respondents came with different answers and with different reasons that expressed their thoughts. Generally, no specific answer has been reached. However, the question opens a wide door of thinking about the difference between conventional banks and Islamic bank based on the perspectives of reality and theory. Feedback of one Respondent stated that conventional banks have more risks than Islamic banks due to the more conservative policy applied by Islamic banks and also due to their investment in real assets that have value. Therefore, Islamic banks always invest in a comfort zone. Respondent 1 expanded his opinion as follows:

Conventional banks have more risks than Islamic banks because Islamic banks are in to certain extent protected by means of taking collaterals and dealing in real assets even when the value of assets depreciates, the bank remains in comfort zone. (Respondent 1)

In line with the above statement, Respondent 4 supports the view of Respondent 1 by stating that Islamic banks have less risks due to the nature of products that they deal with and also being more approachable to their customers by identifying the type of assets that the customer is willing to buy and providing the documents required to complete contracts. Here is the statement of Respondent 4 in which he explained his thoughts:

Islamic banks are less exposed to risks, which is attributable to the nature of their products. In conventional banks, a customer receives the cash and uses it, while in Islamic banks the customer takes no cash in hand as they purchase sellable goods that are pledged to the bank and rented to the customer. In case of investment, the bank must know the commodity, the type of the real estate, or the type of the item that the customer is going to purchase plus obtaining the documents required to complete the investment (Respondent 4).

In term of Respondents 1 and 4, Respondent 5 came with different comments, concluding that the risks in Islamic and conventional are almost the same due to the fact many Islamic products that have a high percentage of risks that are not used in Islamic banks in Kuwait such as Mudharaba and Musharaka. He further elaborated by stating the following below:

Based on the Kuwaiti market, risks are equal as the Islamic banks resemble conventional ones, with Sharia application is the difference between both. In addition, certain Islamic tools are not used like Mudharaba and Musharaka as we are not taking risks (Respondent 5).

The second Respondent and third Respondent have totally different comments from the previous Respondents, as they look at risk from a different perspective regardless whether the bank is Islamic or conventional. They replied that the issue is not related to the issue of being an Islamic or conventional bank; the issue in the level of risks is determined by the size of the banks and the way assets are allocated within the banks. The second Respondent shares his knowledge in question by stating:

The issue is not about which is more risky than the other; Islamic or conventional bank. Risk is dependent on bank's size and how the bank is willing to allocate assets.

For example, if a bank wants to do commercial activity in only one sector, which is high risky, bank needs to diversify risk by investing in more than on area such as corporate, commercial, and retail sectors (Respondent 2).

Moreover, the third Respondent contributed a different idea that risks are determined by the level of knowledge the staff has in risk management. Having highly effective and efficient staff will lead to having more control over risks and more avoidance of risks, which is the difference from a department that has less control or no control at all. Therefore, the following respondent described their view as below:

The practices are the same. However, risks in any bank depend on the individuals of risk management. In case where the bank has highly effective and efficient control departments, the credit and investment risks become lesser that those in banks with no or weak control department. (Respondent 3).

In the end, the response of the fifth theme showed that Respondents have different views and thoughts, with each in support of his argument based on his practical experience in the banking field. Two of the Respondents replied that the conventional banks have more risks than Islamic banks providing justification for their stance. One of the five Respondents saw that there is no difference and both are equal in risks, while also justifying his answers, while the other two Respondents went beyond the question and responded from a different perspective.

7. Conclusion and Recommendation

The main purpose of this study is to explore the risk management practices in Kuwait and identify the practices of Islamic banks in Kuwait by using a qualitative research method. The detailed review of previous literature assisted in the preparation of the interview guide and in conducting interviews with five risk managers in Islamic banks in Kuwait. Following the transcription and analysis of data of the interviews by using thematic approach, the findings of the study conclude that the practices of risk in Islamic banks in Kuwait is almost similar to the practices of used by conventional bank in Kuwait in term of risk management process, tools that measure the risks and the techniques adopted to mitigate risks.

This is due to several reasons: First, Islamic banks in Kuwait are still in an infant stage and need time to apply all Islamic rules. Even the Central Bank of Kuwait (CBK) still does not make any distinction between Islamic banks and convention banks, and as a result imposes almost identical rules and regulation on both types, such as, capital adequacy ratios and others. Secondly, the staff of both the Central Bank of Kuwait and Islamic banks lack experience in Islamic banks' products. This concludes that it is necessary to identify the nature of risks that exist in Islamic products. From researcher observation when he was conducting interviews, researcher found that most of risk managers in Islamic banks have strong back ground experience in conventional banks because they worked first in conventional bank; local banks in Kuwait or oversees banks. Third, the awareness of Islamic banks is very weak in terms of their Islamic products and the activities they do in corporate social responsibility.

Based on the finding of the study, it is recommended that the awareness of Islamic should be increased by addressing the Islamic products. In addition, Central bank of Kuwait and Islamic banks should hire experience staff in Islamic muamalat and should conduct many conferences and training courses for staff and for public to enhance knowledge in Islamic financial institutions.

7.1. Limitation of the Research and Suggestion for Future Research

A thorough review of the literature provide an insight into identifying the risk management practices in Islamic bank in Kuwait that were later explored empirically through a qualitative research by means of semi-structured interview. The main limitation for this study is the small number of risk staff interviewed.

The future research, however, suggest that, such kind of research can be replicated with a larger number of Respondents. More so, this research can be done for the case of Islamic Banking in GCC countries, another future research suggest to study the risk management disclosures in Islamic bank in Kuwait to explore the level of disclosures that Islamic banks practices to conclude that whether the disclosures adequate or not for stakeholders and public as well.

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