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The Ability of Islamic Banks in Algeria to Adopt Basel III Standards: A Case Study of Al Salam Bank

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Abstract
This study aims to address the issue of risk management in Islamic banks in accordance with the supervisory standards issued by the Basel Committee, together with the amendments and guidelines introduced by the Islamic Financial Services Board (IFSB). It also seeks to explain the method of calculating the Capital Adequacy Ratio (CAR), which enables Islamic banks to cover the risks arising from their business activities.
The study is structured around three main sections. The first section explains risk management according to the Basel Committee standards and the approaches it established for managing banking risks. The second section discusses the guidelines issued by the Islamic Financial Services Board to enable Islamic banks to comply with international standards in risk management. The third section presents the experience of Al Salam Bank in managing risks and evaluates its ability to comply with Basel standards in this field.
Keywords: Islamic banks; risk management; capital adequacy.

Introduction
The development of banking supervision and risk management techniques has attracted considerable attention from banks in recent years, particularly in light of successive financial and banking crises that have significantly affected the global economic system. These crises have mainly been attributed to the growing level of banking risks, banks' inability to manage them effectively, weaknesses in both internal and external supervision, and the failure of banks to adequately disclose the nature and magnitude of the risks they face and the methods adopted to manage them.
Consequently, efforts began to unify cooperation among central banks worldwide with the aim of establishing common standards for banking risk management and supervisory practices, while reducing the effects of unfair competition among banks, particularly international ones. The first step in this direction was taken in 1974, when the governors of the central banks of the Group of Ten (G10) industrialized countries established the Basel Committee on Banking

Supervision (BCBS), named after the city of Basel, Switzerland, under the auspices of the Bank for International Settlements (BIS).

The Committee issued the Basel I Accord in 1988, focusing primarily on the Capital Adequacy Ratio (CAR) and credit risk. In 1996, the Committee introduced an amendment addressing market risk, requiring banks to allocate additional capital to cover market risks alongside credit risks.

In 2004, the Committee introduced the Basel II Accord, which expanded the scope of risk management by incorporating operational risk in addition to credit and market risks. Basel II was based on three pillars. The first pillar concerned minimum capital requirements to cover credit, market, and operational risks. The second pillar focused on the supervisory review process, through which supervisory authorities assess whether banks maintain sufficient capital to cover all material risks. The third pillar emphasized market discipline by strengthening disclosure requirements and enhancing transparency in the publication of financial information to improve the effectiveness of risk management.

Following the global financial crisis of 2007, the Committee issued the Basel III Accord at the end of 2010. Basel III placed particular emphasis on liquidity risk management, recognizing that the 2007 crisis was essentially a liquidity crisis. It also increased the minimum capital adequacy requirement to 10.5%, compared with the 8% required under Basel I and Basel II. This change was driven by the rapid growth of off-balance-sheet exposures, such as financial derivatives, coupled with a decline in the level of banks' own funds available to absorb risks. Banks were granted a transition period from 2012 to 2019 to fully implement Basel III standards.

Since the introduction of Basel III, the Basel Committee has continued reviewing and strengthening its regulatory framework with the objective of enhancing the resilience and stability of the global financial system and increasing banks' capacity to withstand financial risks and crises. These ongoing developments have paved the way for what has become known as Basel IV.

Most experts in the Islamic finance industry believe that Islamic banks have achieved remarkable progress within a relatively short period. Nevertheless, they continue to face numerous challenges, including the implementation of Basel Committee standards. It is well known that Basel standards were originally designed for conventional commercial banks without taking into account the specific nature and operational characteristics of Islamic banks. Despite these differences, the fundamental principles and objectives of risk management remain largely similar. In this context, the Islamic Financial Services Board (IFSB) was established in Malaysia in 2005 with the objective of aligning Basel standards with the requirements of the Islamic banking industry through appropriate modifications, while preserving the same objectives concerning risk management and capital adequacy.

First: Research Problem

Based on the foregoing discussion, the main research problem addressed in this study can be formulated as follows:

What is the current position of Islamic banks under the Basel Committee's banking supervision standards? What challenges do they face in implementing the Basel prudential requirements, and how do these challenges affect their performance?

Second: Research Hypotheses

In light of the research problem, the following hypotheses are proposed:

Islamic banks are exposed to the same major risks faced by conventional banks.

Islamic banks encounter significant challenges in adapting to the international supervisory standards issued by the Basel Committee.

Third: Significance of the Study

The importance of this study stems from the following considerations:

Basel Committee standards represent one of the most important modern frameworks for banking risk management, and compliance with these standards is essential to ensure the stability and soundness of the banking and financial system.

The occurrence of numerous financial crises has largely been attributed to the absence of effective risk management practices in banks and the failure to adopt modern methods and techniques for managing banking risks.

Reasons for Choosing the Research Topic

Islamic banks are considered the most suitable model within the framework of the Islamic economic system, which has increasingly found practical application.

Islamic banks, which started on a modest scale in the early 1970s, have achieved remarkable progress over the past decades. Research has demonstrated that Islamic banks are characterized by efficiency and effectiveness due to their adherence to the principle of linking the financial economy with the real economy.

In recent years, major conventional banks have begun offering Islamic financial products, while several countries have issued Sukuk (Islamic bonds) to attract investments from Islamic countries.

To examine the extent to which the Basel Committee standards are suitable for Islamic banking operations.

Fourth: Research Objectives

This research aims to:

Understand and analyze the Basel Committee on Banking Supervision (BCBS) standards and assess their impact on banks in general and Islamic banks in particular.

Examine the methods used to measure capital adequacy in banks under the Basel Accords and identify the reasons for the differences in capital adequacy measurement for Islamic banks in light of their unique operational characteristics.

Identify banking risks and their impact on Islamic banks and on capital adequacy.

Develop an understanding of the method for calculating capital adequacy in Islamic banks in accordance with the Basel Committee standards and the amendments introduced by the Islamic Financial Services Board (IFSB).

Fifth: Research Methodology

This study adopts the descriptive-analytical approach by collecting data and information related to the Basel Committee's prudential supervisory standards, as well as data concerning Islamic banks and the nature of their activities. These data are then processed and analyzed. The subject is examined from an economic perspective, with the objective of reaching conclusions regarding the adoption of the Basel Committee standards by Islamic banks.

Sixth: Previous Studies

Most previous studies in this field have focused on conventional banks, as the Basel Committee standards were originally designed for these institutions. The application of these standards is not considered problematic in itself, provided that banks comply with all Basel requirements. However, the main challenge concerns Islamic banks due to the differences between the nature of their operations and those of conventional banks. Consequently, compliance with the Basel standards represents a significant challenge for Islamic banks. Among the most important previous studies are:

Najjar Hayat, "Basel III Agreement and Its Potential Effects on the Algerian Banking System," PhD Dissertation, University of Sétif, 2013.

Hamza Taybi, "Enhancing Supervision of Banking Activities According to the International Standards of the Basel Committee," PhD Dissertation, University of Algiers 3, 2012–2013.

Habbar Abdel Razak, "Compliance with Basel Committee Requirements as an Approach to Establishing Governance in the Banking Sector: The Case of Algeria," PhD Dissertation, University of Algiers 3, 2010–2011.

Mousa Omar Abu Humaimid, "Risks of Islamic Finance and Their Relationship to the Capital Adequacy Standard in Islamic Banks under Basel II," PhD Dissertation, Arab Academy for Banking and Financial Sciences, 2008.

Seventh: Research Structure

The research is divided into three main chapters:

Chapter One: Risk Management under the Basel Committee Framework.

Chapter Two: Guidelines of the Islamic Financial Services Board (IFSB) Regarding the Implementation of the Basel Standards in Islamic Banks.

Chapter Three: A Practical Case Study of Al Salam Bank on Risk Management and Its Ability to Adopt the Basel Committee's Banking Supervision Standards.

Axis One: Risk Management According to the Basel Committee Accords

The Basel Committee's banking supervision accords are considered among the most significant initiatives aimed at harmonizing supervisory systems and risk management practices across banks.

First: The Concept of Risk Management under Basel I and Basel II

Risk management can be summarized as the set of policies and procedures implemented by a bank's management to protect the institution against the various risks surrounding its operations.

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This is achieved by identifying the causes of risks, measuring them, managing them, and maintaining control over them through a comprehensive risk management system. [i]
According to the Basel Committee, the main risks that a bank may face in the course of its activities are as follows:

1. Credit Risk
Credit risk refers to the risk arising from a borrower's failure to repay its debt obligations. [ii]This type of risk was addressed under the Basel I Accord.

2. Market Risk
The Basel Committee defines market risk as the risk of losses resulting from fluctuations in market prices that may affect both on-balance-sheet and off-balance-sheet items. Market price fluctuations include changes in interest rates, securities values, exchange rates, options, and commodity prices. The Committee addressed this issue in the January 1996 Amendment to the Basel Accord. [iii]

3. Operational Risk
The Basel Committee defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events. This definition includes legal risk but excludes strategic risk and reputational risk. Operational risk was introduced under the Basel II Accord. (4)
Accordingly, in order for banks to cope with these risks, they are required to maintain 8% of eligible regulatory capital to cover these risks, in accordance with the following formula: [iv]
Capital Adequacy Ratio $\geq$ 8%
= Regulatory Capital ÷ (Risk-Weighted Assets + Market Risk Capital Requirement × 12.5 + Operational Risk Capital Requirement × 12.5)
Basel I classifies the regulatory capital of lending institutions into three tiers: [v]

Tier 1: Core Capital (Capital de Base)
Tier 1 Capital consists of:
Share capital (ordinary/common shares).
Disclosed or published reserves reported in the balance sheet.
Tier 1 Capital is the primary and most important component of regulatory capital because it is the most stable source of funding and enables banks to absorb losses effectively.

Tier 2: Supplementary Capital (Fonds Propres Complémentaires)
Tier 2 Capital consists of the following components:
Undisclosed reserves (Réserves non exprimées): These include retained earnings for the financial period and must be acceptable to the supervisory authorities.
Revaluation reserves (Provision pour plus-value): Some supervisory authorities permit banks to periodically revalue their assets according to market prices.
General provisions for loan losses (Les provisions générales pour pertes sur prêts).

Hybrid capital instruments (Les instruments hybrides): These are financial instruments that combine the characteristics of equity and debt, such as preferred shares. They are capable of absorbing losses without forcing the bank into insolvency and are subject to a number of regulatory conditions and requirements. [vi]

Long-term subordinated debt: These are debt instruments with a minimum original maturity of five years and must not exceed 50% of Tier 1 Capital.

Tier 3: Short-Term Subordinated Debt

Tier 3 Capital consists of short-term subordinated debt intended to cover market risk. It was introduced by the 1996 Amendment, which required banks to maintain a portion of their regulatory capital to absorb market risk. [vii]

Short-term subordinated debt must satisfy the following conditions:

It must not exceed 250% of Tier 1 Capital and may only be used to cover market risk.

It must have an original maturity of at least two years.

It may not be repaid before its maturity date without the approval of the supervisory authorities, as early repayment could reduce the minimum regulatory capital requirements.

Basel I also specified the items that must be deducted from regulatory capital, namely:

Goodwill: This is deducted from Tier 1 capital, as it cannot absorb losses when a bank experiences financial distress and therefore cannot serve as effective capital support.

Investments and equity participations in subsidiary banks and financial institutions whose financial statements are not consolidated: These are deducted because the capital adequacy ratio is calculated on the basis of the consolidated financial statements of the banking group as a whole. This measure is intended to prevent the double counting of capital across different entities and branches.

In addition to the first pillar, which concerns minimum capital requirements, Basel II introduced the second pillar, relating to the supervisory review process for capital adequacy. Under this pillar, bank management is responsible for ensuring that sufficient own funds are maintained to cover all material risks. Accordingly, Basel II established a number of supervisory principles to guide this process. It also introduced a third pillar, namely market discipline, by strengthening banks' disclosure requirements as a means of enhancing market transparency and discipline.

Second: Liquidity Risk and Basel III

The financial crises, particularly the 2007 global financial crisis, constituted the primary reason for the Basel Committee's issuance of a new regulatory framework in 2010, commonly known as Basel III. The objective was to establish prudential banking rules that would strengthen banks' resilience against future financial crises, which are primarily characterized by liquidity shortages. In this context, the Basel Committee introduced several regulatory ratios that banks are required to comply with:

1. Leverage Ratio

The leverage ratio aims to limit excessive expansion in bank lending and to ensure a prudent level of leverage. It is expressed as follows: [viii]

Leverage Ratio ≥ 3%

2. Liquidity Ratios

Liquidity requirements represent one of the most significant reforms introduced under Basel III. Their purpose is to ensure that banks maintain sufficient liquidity to withstand periods of financial stress and liquidity shortages while assisting supervisors in monitoring and preserving banks' liquidity positions. These requirements consist of two main ratios:

a. Liquidity Coverage Ratio (LCR)

The Liquidity Coverage Ratio (LCR) represents the minimum amount of high-quality liquid assets that a bank must hold to meet its short-term liquidity needs. It is calculated as follows: [ix]

Liquidity Coverage Ratio (LCR) ≥ 100%

b. Net Stable Funding Ratio (NSFR)

The Net Stable Funding Ratio (NSFR) measures the amount of available stable funding relative to the amount of required stable funding and is calculated as follows: [x]

Net Stable Funding Ratio (NSFR) ≥ 100%

Where:

Available Stable Funding (ASF) refers to all sources of funding available to the bank that are expected to remain reliable for one year or more.

Required Stable Funding (RSF) refers to the total amount of stable funding required to support the bank's on-balance-sheet and off-balance-sheet assets.

In addition, Basel III increased the minimum capital adequacy ratio to 10.5%, which may rise to 13% when the countercyclical capital buffer is added to protect banks against periods of economic fluctuations.

Section Two: Guidelines of the Islamic Financial Services Board (IFSB)

This section discusses the guidelines issued by the Islamic Financial Services Board (IFSB) to assist Islamic banks in adopting and implementing the Basel Committee standards, taking into account the specific nature of their sources of funds and the utilization of these resources. [xi]

First: Capital Requirements for Different Types of Islamic Financing

1. Credit Risk and Market Risk

The IFSB recommends applying the Basel I risk-weighting approach to all assets arising from Islamic financing modes, including:

Murabaha and Murabaha to the Purchase Orderer;

Salam;

Istisna';

Ijarah and Ijarah Muntahia Bittamleek (Lease Ending with Ownership);

Musharakah and Diminishing Musharakah;

Mudarabah.

Murabaha and Murabaha to the Purchase Orderer

The capital requirements relating to credit risk concern the possibility that the counterparty may fail to pay the purchase price owed to the bank for the commodity acquired from it. Regarding market risk, the capital requirements relate to changes in the value of assets held by the bank and available for sale.

(A) Credit Risk

Credit risk is measured based on Murabaha receivables, which are recorded at the cash amount expected to be collected, i.e., the amount due from the customer less any allowance for doubtful debts.

The receivables arising from a Murabaha sale are assigned a risk weight according to the obligor's credit rating as determined by an external credit rating agency. Where the obligor is unrated, a 100% risk weight is applied.

(B) Market Risk

Where the bank holds assets under a Murabaha transaction that were acquired specifically for resale to a customer based on a non-binding promise (i.e., the customer may cancel the transaction), such assets are treated as the bank's inventory and are assigned a 187.5% risk weight, corresponding to a 15% capital charge.

Salam

Capital requirements are intended to cover both credit risk and market risk arising from Salam contracts. The Islamic bank is exposed to the counterparty's credit risk resulting from the seller's failure to deliver the purchased commodity, as well as market (price) risk from the date the contract is concluded.

(A) Credit Risk

Receivables arising from the purchase of a commodity under a Salam contract are assigned a risk weight based on the seller's credit rating. If the seller is unrated, a 100% risk weight is applied.

(B) Market Risk

Under the simplified approach, the capital charge is fixed at 15%, which is equivalent to a 187.5% risk weight.

Istisna'

The risks associated with Istisna' include credit risk, arising from the possibility that the bank may fail to recover the sale price of the manufactured asset from the customer, as well as market (price) risk, which exists from the commencement of the manufacturing process until the asset is delivered. These risks require coverage through appropriate capital requirements.

(A) Credit Risk

Receivables arising from the sale of an asset under an Istisna' contract are assigned a risk weight according to the customer's credit rating. If the customer is unrated, a 100% risk weight is applied.

(B) Market Risk

A distinction should be made between two cases:

Istisna' with Parallel Istisna'.

In this case, the bank entrusts the manufacturing of the asset to another party for a predetermined amount. Once the manufactured asset is delivered to the bank, it is subsequently handed over to the customer. Accordingly, the bank does not bear the risk arising from price fluctuations.

Istisna' without Parallel Istisna':

A 20% risk weight is applied to the value of the remaining work in progress required to manufacture the requested asset, in addition to the applicable credit risk weight.

Ijarah and Ijarah Muntahia Bittamleek (Lease Ending with Ownership)

Under an Ijarah contract (whether an operating lease or a lease ending with ownership), the bank, acting as the lessor, retains ownership of the leased asset, while the lessee acquires the right to use it. In this context, capital requirements are intended to cover the risks associated with the lessee's credit risk, as the counterparty responsible for paying lease installments, as well as market (price) risk related to the residual value of the leased asset, either at the end of the lease term or upon repossession if the lessee defaults on payment. This refers to the potential financial loss incurred when the leased asset is resold.

a) Credit Risk

A risk weight is applied according to the obligor's credit rating. If the obligor is unrated, a 100% risk weight is applied to the lease receivables from the time the bank acquires the leased asset and throughout the period during which the lessee uses the asset.

b) Market Risk

A distinction should be made between the following:

Operating Ijarah

When the bank acquires the leased asset, a 187.5% risk weight is applied. During the lease period, while the asset is being used by the lessee, a 100% risk weight is applied. At the end of the operating lease, ownership of the asset reverts to the bank; therefore, a 100% risk weight is applied to the value of the asset.

Ijarah Muntahia Bittamleek (Lease Ending with Ownership)

When the bank acquires the asset, a 187.5% risk weight is applied. Throughout the lease period until its maturity, no risk weight is applied to the value of the asset, since the lessee is expected to acquire ownership of it at the end of the contract.

Musharakah and Diminishing Musharakah

Capital requirements are intended to cover the risk of loss of funds invested through Musharakah contracts. Three cases may arise:

a) Musharakah in Commercial Ventures Involving Foreign Exchange, Equities, and Commodities

In this case, the bank is exposed to market risk. Financial positions are calculated for each category of assets and each commodity and are treated in the manner previously explained under market risk.

b) Musharakah in Other Commercial Ventures

A 400% risk weight is applied to the bank's contribution to the project, or alternatively, according to the applicable rating-based approach.

Musharakah in Assets Intended for Resale through Murabaha or Leasing through Ijarah

In this case, the risk weight is determined based on the customer's credit rating (the lessee or purchaser). If the customer is unrated, a 100% risk weight is applied. As for market risk, it is treated in the same manner discussed under Murabaha and Ijarah.

Mudarabah

Capital requirements are intended to cover the risk of loss of funds invested under Mudarabah arrangements. Three cases may arise:

a) Mudarabah in Commercial Ventures Involving Foreign Exchange, Equities, and Commodities

In this case, the bank is exposed to market risk, which is treated as previously explained in the section on market risk.

b) Mudarabah in Other Commercial Ventures

A 400% risk weight is applied to the amount invested in the project, or according to the applicable rating-based approach.

c) Mudarabah Investments for Financing a Project

When the Mudarabah funds are disbursed to the customer, the applicable risk weight is determined based on the customer's credit rating. If the customer is unrated, a 400% risk weight is applied.

Sukuk

Sukuk are defined as proportional ownership certificates representing a share of capital allocated to finance a specific project or transaction in accordance with one of the recognized Islamic financing modes.

The capital is divided into a specified number of Sukuk certificates. There are several types of Sukuk depending on the financing structure, including:

Murabaha Sukuk
Salam Sukuk
Istisna' Sukuk
Ijarah Sukuk
Musharakah Sukuk
Mudarabah Sukuk

An Islamic bank may hold a portfolio consisting of different types of Sukuk as part of its assets. Consequently, it is required to maintain a portion of its capital to cover the risks associated with these Sukuk. The treatment is as follows:

a) Sukuk rated by external credit rating agencies:

A risk weight is applied to the value of the Sukuk held by the bank according to their assigned credit rating.

b) Unrated Sukuk:

The applicable risk weights are determined based on the financing mode corresponding to the type of Sukuk, whether for credit risk or market risk.

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1. Operational Risk

The Board adopts the same approaches established by the Basel Committee for calculating the capital requirements necessary to cover operational risk.

2. Calculation of Capital Requirements to Cover All Risks

The Board specifies the Capital Adequacy Ratio (CAR) for Islamic banks as follows:

CAR ≥ 8%

[\frac{\text{Eligible Capital}} {\left(\text{Risk-Weighted Assets financed by shareholders' funds (Credit Risk + Market Risk)}\right) + \left(\text{Capital Requirement for Operational Risk} \times 12.5\right)}]

Where a proportion of the assets financed by Unrestricted Investment Accounts (UIAs) is required to be supported by the bank's capital in order to strengthen the returns to investment account holders and reduce withdrawals, the formula becomes:

[\frac{\text{Eligible Capital}} {\left(\text{Capital Requirement for Operational Risk} \times 12.5\right) -\left(\text{Risk-Weighted Assets financed by Restricted Investment Accounts (Credit Risk + Market Risk)}\right) -(\alpha-1)\times\left(\text{Risk-Weighted Assets financed by Unrestricted Investment Accounts (Credit Risk + Market Risk)}\right) - \beta\times\left(\text{Risk-Weighted Assets financed by the Investment Risk Reserve related to Unrestricted Investment Accounts (Credit Risk + Market Risk)}\right)}]

Eligible capital consists of the following: [xii]

Tier 1 Capital:

Issued and fully paid-up capital.
Disclosed reserves.
Minority interests in subsidiaries.
Investments in insurance companies.
The following item is deducted from Tier 1 Capital:
Goodwill.

Tier 2 Capital:

Revaluation reserves of fixed assets.

Secondly: Supervisory Review

Based on the Supervisory Review Pillar established by the Basel Committee, the Islamic Financial Services Board (IFSB) has developed a set of standards that Islamic banks are expected to observe, as well as supervisory practices that supervisory authorities are expected to implement. The IFSB has introduced additional requirements that are compatible with the nature of Islamic banking, particularly regarding the extent to which banks comply with Shariah principles in conducting their transactions.

Thirdly: Market Discipline

The standards issued by the Basel Committee concerning the Market Discipline Pillar remain applicable to Islamic banks, particularly with respect to disclosure requirements as a key mechanism for ensuring market discipline. These include disclosures related to the bank's capital structure and investment accounts. The Islamic Financial Services Board has introduced certain modifications to these standards to reflect the specific nature of Islamic banking activities.

Third Axis: An Applied Model of Al Salam Bank

In this section, we will examine the extent to which Al Salam Bank complies with the Basel Committee standards within the framework of the amendments introduced by the Islamic Financial Services Board [xiii]

Introduction to the Bank

The establishment of Al Salam Bank – Algeria was officially announced on 8 June 2006. It is a commercial bank incorporated under Algerian law with an initial share capital of DZD 7.2 billion, which was increased in 2009 to DZD 10 billion.

In 2020, the bank's capital was further increased to DZD 15 billion in compliance with Bank of Algeria Regulation No. 18-03 of 4 November 2018, concerning the minimum capital requirements for banks and financial institutions operating in Algeria.

The bank officially commenced its operations on 20 October 2008. Its branch network currently consists of 18 branches distributed across the national territory.

Financial Statements for 2020

Balance Sheet (in thousands of Algerian Dinars)

Assets			**Liabilities**		
Assets		**2022**	**Liabilities**		**2022**
Cash, Central Bank, Treasury, and Postal Checking Center		74638050	Central Bank liabilities		
Financial assets held for trading			Deposits from financial institutions		74504
Available-for-sale financial assets			Customer deposits		154117422
Financing to financial institutions		3911553	Investment certificates		62585556
Customer financing		174534597	Current tax liabilities		766590
Financial assets held to maturity			Deferred tax liabilities		

Current tax assets		40043	Other liabilities		9534840
Deferred tax assets		42405	Settlement accounts		4650378
Other assets		487121	Provisions for risks and charges		514730
Settlement accounts			Capital grants and other investment grants		
Investments in subsidiaries, joint ventures, or associates		881205	Funds for covering general banking risks		2136675
Investment property		12000	Subordinated debt		
Tangible fixed assets		1373178	Share capital		20000000
Intangible fixed assets		5552310	Share premium		
Goodwill		220876	Reserves		2920035
Total Assets	**261693338**		Valuation reserve		
			Revaluation reserve		
			Retained earnings (+/–)		
			Net Income for the Financial Year (+/–)		4392508
			Total Liabilities and Equity	**261693338**	

Off-Balance Sheet

Assets		**2022**
A. Commitments Granted		
Financing commitments granted to financial institutions.		612757
Financing commitments granted to customers.		76135652

Guarantee commitments issued on behalf of financial institutions.		
Guarantee commitments issued on behalf of customers.		14400039
Other commitments granted.		
B. Commitments Received		
Financing commitments received from financial institutions.		
Guarantee commitments received from financial institutions.		7940509
Other commitments received.		462954338

Risk Management Framework

The main risks to which the Bank is exposed are classified as follows:

-Credit Risk.

-Liquidity Risk.

-Operational Risk.

During 2022, Al Salam Bank Algeria implemented a set of policies governing risk management, defining the organizational structures concerned and specifying their respective responsibilities. The Bank also submits to the Board of Directors an annual Risk Matrix, which summarizes the various risks facing the Bank, measures the relevant risk exposure indicators, and compares them with the internal standards established by the Bank.

Credit Risk

Credit risk arises from the inability of a customer, or a group of customers considered as a single customer, to fulfill their financial obligations toward the Bank. Credit risk is managed in accordance with the Credit Risk Policy adopted in 2022, as well as the procedures governing financing management and the Internal Corporate Rating System.

In general, Al Salam Bank Algeria's credit risk management policy is based on the following principles:

• Credit Risk Acceptance Criteria

Customers applying for financing are classified into five categories: individuals, corporate entities, government institutions, banks, and financial institutions.

Each financing application received by the Bank must be accompanied by a complete set of administrative and financial documents, in addition to the information and documentation related to the proposed collateral intended to secure the requested financing.

Financing applications are assessed and evaluated based on seven key criteria related to the customer's financial solvency, financial capacity, the availability and adequacy of the proposed collateral, and the prevailing economic conditions.

• Internal Credit Risk Rating System

The Bank has established an internal rating system for corporate financing applicants. This system is based on a combination of qualitative and quantitative criteria. The qualitative criteria include the legal form of the company, the quality of its management, the sector in which it operates, its relationship with banks, and the sources from which it intends to repay the requested financing. These qualitative factors account for 60% of the overall rating.

The quantitative criteria account for the remaining 40% of the rating and relate to the company's financial structure, liquidity position, and profitability.

The rating system classifies companies into ten risk categories according to their overall risk score.

The rating of companies with existing financing obligations is reviewed annually or whenever they submit a new financing application.

Risk Diversification:

Risk diversification consists of avoiding the concentration of financing granted by the Bank to a single customer, a group of customers, a single economic sector, a group of sectors, or a single type of financing.

Al Salam Bank Algeria ensures compliance with the regulatory standards established by the Bank of Algeria in this regard. These standards stipulate that the Bank's exposure to a single customer must not exceed 25% of the Bank's own funds, and that the aggregate amount of large exposures exceeding 10% of the Bank's own funds must not exceed eight times the Bank's own funds.

The Bank has also established a set of internal standards aimed at diversifying its exposure to credit risk, mainly including the following:

Diversifying the financing portfolio between investment financing and operating financing.

Diversifying the financing portfolio between individual customers and corporate customers.

Diversifying the corporate financing portfolio among the various financing instruments.

Diversifying the financing portfolio across different economic sectors.

Collateral Collection:

The collection of collateral is one of the methods used to mitigate credit risk. However, it does not replace compliance with the conditions required for obtaining financing or the assessment of the creditworthiness of the customer applying for financing.

The Bank obtains various forms of collateral, including real collateral such as real estate mortgages and equipment pledges, personal guarantees such as joint guarantees and insurance coverage provided by guarantee funds, in addition to cash collateral.

The collateral obtained must cover a specified percentage of the financing granted by the Bank. These coverage ratios are determined in accordance with the Bank's Credit Risk Policy.

Collateral is valued either by the Bank's internal expert or by an independent expert accredited by the Bank. The collateral is revalued periodically or whenever exceptional circumstances relating to the collateral itself or to market conditions make revaluation necessary, in order to ensure that it continues to adequately cover the outstanding obligations.

Credit Risk Classification:

Credit risks are classified and impairment provisions are recognized in accordance with the requirements of Bank of Algeria Regulation No. 14-03. The classification of customer receivables and the determination of impairment provision levels are decided by the Provisions Committee, which meets quarterly to assess the quality of receivables.

Non-performing receivables are monitored daily by the Monitoring and Recovery Unit and are presented weekly to the Recovery Committee.

Liquidity Risk:

Liquidity risk is closely linked to the nature of banking activities, which are based on the intermediation and transfer of funds within the economic system. The Bank serves as an intermediary among various market participants. In this context, it uses the resources it collects (demand and term deposits) to finance its assets and financing operations (both demand and term).

This maturity transformation, which constitutes the core of the Bank's business and the source of its profitability, may result in long-term financing being funded by short-term resources. In such cases, the Bank must be able to repay a portion of its liabilities upon maturity by utilizing its assets.

Accordingly, the Bank's inability to repay its liabilities and meet its financial obligations exposes it to what is known as liquidity risk.

Liquidity risk at Al Salam Bank Algeria is managed in accordance with the Liquidity Risk Policy adopted in 2022.

The Bank ensures compliance with the liquidity risk standards established by the Bank of Algeria, particularly the Short-Term Liquidity Ratio and the Own Funds and Stable Resources Ratio. In addition, the Bank's internal policy sets out several key prudential standards, including:

Maintaining liquid assets equivalent to at least 25% of total assets.

Maintaining the ratio of financing to deposits at less than 90%.

Maintaining Liquidity Ratios

Maintaining short-term and three-month liquidity ratios at no less than 120% (while the mandatory minimum ratio is 100%).

Maintaining the deposit concentration ratio, whereby the total value of the ten largest deposits must not exceed 30% of total customer deposits.

Maintaining a long-term liquidity ratio exceeding 60%.

The Treasury and Financial Operations Department monitors the Bank's liquidity position on a daily basis to ensure optimal liquidity management, enabling the Bank to avoid liquidity shortages while also preventing the maintenance of excessively high liquidity levels that could result in the loss of potential returns from investment opportunities.

Liquidity risk is also monitored through the Liquidity Monitoring Committee, which meets monthly, and the Assets and Liabilities Committee (ALCO), which meets quarterly. Their primary responsibilities include monitoring and analyzing the development of the Bank's funding sources and asset utilization in order to determine liquidity management objectives and the preventive measures necessary to ensure compliance with the applicable regulatory requirements while maintaining an optimal level of liquidity.

Operational Risk

Operational risk arises from inadequate or failed internal processes, personnel, and systems, or from external events, including risks resulting from internal or external fraud.

Operational risk at Al Salam Bank Algeria is managed in accordance with the Operational Risk Policy adopted in 2022. This policy defines the overall operational risk framework, the organizational structure for its management, and the responsibilities of the various departments concerned.

The Bank has developed a risk map based on business activities, identifying approximately 60 activities, which have been grouped into six major business lines: management, support services, financing commitments, international operations, and information technology. In addition, in 2019, the Bank established a database of operational risk incidents and implemented an operational risk management system.

Conclusion

Islamic banks possess distinctive characteristics that differentiate them from conventional banks. These characteristics stem from the manner in which Islamic banks mobilize their financial resources and from the unique nature of Islamic financing modes. Consequently, these characteristics influence both the types and the nature of the risks faced by Islamic banks.

The international supervisory standards issued by the Basel Committee do not fully take into account the specific characteristics of Islamic banking or the distinct nature of the risks it faces. Therefore, the challenge confronting Islamic banks and their supervisory authorities lies in achieving compliance with international regulatory standards while preserving the fundamental characteristics of Islamic finance through the adaptation and harmonization of these standards to accommodate the unique features of Islamic banking.

This study has led to a number of findings, recommendations, and proposals, summarized as follows:

First: Findings of the Study

Islamic banks are financial institutions that mobilize the savings of individuals and institutions and invest them in various sectors in accordance with Sharia principles and regulations, with the objective of promoting economic and social development.

Islamic banks perform the role of financial intermediation by directly linking savings with investment, thereby achieving a high degree of efficiency in the allocation and utilization of financial resources in a manner that serves the interests of all parties involved in the investment process.

Islamic banks adopt the principle of "gain accompanies risk", which rejects entitlement to profit without the contribution of capital or effort and without assuming risk. This principle strengthens the relationship among investment participants and ensures a fair distribution of both risks and profits.

Financing provided by Islamic banks is characterized by a variety of financing modes, most of which involve tangible assets and are closely linked to the real economy, where profit is earned only through the creation of wealth.

The Basel Committee standards constitute a strategic framework that encourages banks to adopt the best practices in risk management. However, implementing these standards is highly costly, requiring substantial financial and human resources.

The Islamic Financial Services Board (IFSB) has developed a capital adequacy standard specifically for Islamic banks that is broadly consistent with the Basel capital adequacy framework.

Islamic banks are capable of adapting to Basel Committee requirements through the enhancement of their risk management and risk measurement practices.

The major categories of risk identified by the Basel Committee—credit risk, market risk, operational risk, and liquidity risk—are also encountered by Islamic banks, although the nature of these risks sometimes differs from that in conventional banking.

Islamic banks face an additional operational risk associated with potential non-compliance with Sharia principles in the provision of financial products.

There is a considerable degree of similarity between Islamic and conventional banks with regard to capital adequacy ratios, both in terms of the numerator and denominator components.

Most Islamic banks rely on the standardized approach for risk management in order to calculate the capital requirements needed to cover risks. This preference is due to its relative simplicity compared with the Internal Ratings-Based (IRB) approach, which requires sophisticated systems for estimating various types of risk—systems that are generally unavailable in Islamic banks.

Banks operating in Algeria, whether conventional or Islamic, continue to rely primarily on traditional risk management methods and remain relatively behind in adopting the Basel Committee's banking supervisory standards.

Second: Recommendations

The implementation of the new capital adequacy standard requires Islamic banks to maintain substantial levels of regulatory capital to cover the risks inherent in their financing activities, which are based on risk-sharing and the assumption of potential losses.

It is necessary to establish an independent framework for defining and measuring risks in Islamic banks that reflects the nature of their operations while taking into account their unique obligations toward investment account holders.

Supervisory authorities in countries overseeing Islamic banks should recognize the distinctive characteristics of these institutions when requiring compliance with Basel standards.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) should develop the necessary accounting standards to meet the disclosure requirements stipulated under the third pillar of the Basel framework concerning market discipline.

Greater support should be provided to the Islamic Financial Services Board by supervisory authorities overseeing Islamic banks in order to strengthen the institutional development of Islamic financial institutions and enhance their global competitiveness.

Proposals

The rapid growth of Islamic banking, together with its expanding geographical presence, increasing operational volume, and growing asset base, calls for further research into the major challenges confronting the industry in order to strengthen its competitiveness with leading international banks.

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This study of the Basel standards and the extent to which Islamic banks are capable of adopting them raises several issues that deserve further academic investigation, including:
The role of Islamic banks in developing supervisory mechanisms in cooperation with the Islamic Financial Services Board.
The development of financial engineering frameworks that effectively support Islamic banking.
The relationship between Islamic banks and international credit rating agencies.
Islamic banks and the establishment of an Internal Ratings-Based (IRB) system.

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