IMPACT OF GLOBAL FINANCIAL CRISES ON GLOBAL FINANCIAL STABILITY AND NEED FOR AN ALTERNATIVE FINANCIAL SYSTEM*

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Summary

The main objective of this paper is to highlight the importance of the financial stability of the global financial system particularly after the recent global financial crisis of 2008-09. The major causes of different financial crises possess the same pattern of greed among investors, inefficiency of government regulators, central banks and other stakeholders. They have miserably failed to fix the structural problems such as control of excessive debt lending, enforcement of effective regulations, prohibition of speculative business activities and unethical business practices in the global financial system. Islamic financial system, whose size of global assets crossed the mark of US$ 2.1 trillion by the end of 2015, which is relatively very small as compared to the conventional financial system, is rapidly growing as an alternative system. It prohibits unethical economic activities such as speculative derivative trading, uncontrolled excessive debt lending and promotes an interest-free financial system based on profit, loss and risk sharing principles. This paper concludes that global financial stability could only be achieved if proper corrective actions were taken. It also shows that the Islamic financial system was less affected by the recent global financial crisis compared to the conventional financial system because it imposes strict rules and prohibits investments in toxic assets.

Key words: financial stability, financial crisis, Great depression, Islamic financial system, interest-free banking system.

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1. INTRODUCTION

A stable financial system plays an important role in the social and economic development of societies. Financial crises took place in different parts of the world but their impact was not only limited to that particular country. We have seen the ripple effect in the form of higher levels of unemployment, slowdown of global economy and increased financial instability. The implications of the recent global financial crisis have national, regional and international relevance. This paper aims to understand the influence and consequences of this crisis on global financial stability because it has caused distress around the world. This paper aims to present the Islamic financial system as an alternative financial system because this system was less prone to financial crises compared to the conventional one. It is expected that the findings of this paper will help industry regulators, academia, financial institutions and other stakeholders to better understand the importance of financial stability.

The remainder of this paper is structured as follows: Section 2 explains the importance of financial stability and Section 3 provides an overview of past financial and economic crises. Section 4 outlines the basic principles, features and characteristics of the Islamic financial system, and discusses the comparison between the Islamic and the conventional financial system. In Section 5, four main instruments and contracts of Islamic banking and finance are briefly explained. Section 6 provides a discussion on the impact of financial crises on Islamic banking and finance and the conventional financial system. Finally, Section 7 concludes this paper.

2. IMPORTANCE OF FINANCIAL STABILITY

A financial system is composed of different elements such as financial intermediaries commonly known as banks, non-banking institutions and financial markets. However, the contemporary financial system has a broader perspective and a wide range of entities are part of it, such as banks, non-bank financial institutes, asset management companies, insurance companies, credit rating agencies, mutual funds, stock markets, central banks and different credit instructions (Mirakhor & Krichene, 2009). The main purpose of a financial intermediary is to provide excessive savings to investors so that they could be invested in the economy, which in turn rotates the wheels of the economy. Investments create jobs which improve the living standard of individuals and the society. There is a direct relationship between financial stability and intermediaries. The fundamental question here is what is the proper definition of financial stability and why is it so important nowadays? Financial stability is highly important because in case of instability, the entire financial and economic system cannot function properly. This situation leads to trouble for all participants. For instance, financial institutions will not be able to address the financial needs of individuals and businesses. This could be non-payments and, on the other hand, businesses cannot borrow, hence economic activity becomes low and the whole financial system comes to a halt. Financial system is considered a backbone of a well-functioning economy because it provides much needed funding. For instance, companies cannot buy raw materials from other countries with-
out guarantees from banks. If banks have liquidity shortages, then they cannot finance consumption needs of individuals. There is no comprehensive definition of financial stability and several researchers have attempted to define it in the context of financial stability and instability. Mishkin (1999) states that “financial instability occurs when shocks to the financial system interfere with information flow so that the financial system can no longer do its job of channelling funds to those with productive investment opportunities.”

Devis (2001:92) argues that financial instability is caused due to systemic risk and financial crises. A systemic risk is a situation when a financial system is poised with a major threat and it cannot function normally. He further defines financial crisis as “a major collapse of the financial system, entailing inability to provide payment services or to allocate credit to productive investment opportunities.” In case of a major collapse of a financial system, stability of the overall economy and related financial institutions and individuals is threatened.

Ferguson (2003) used a different approach to discuss the concept of financial instability. He defined it as “a situation characterized by …three basic criteria: i) some important set of financial asset prices seem to have diverged sharply from fundamentals; and/or ii) market functioning and credit availability, domestically and perhaps internationally, have been significantly distorted; with the result that, iii) aggregate spending deviates (or is likely to deviate) significantly, either above or below, from the economy’s ability to produce.” This definition refers to two important aspects of financial instability such as ‘distortion of asset prices’ and change in ‘aggregate spending’.

After discussing the importance of financial stability, the following section provides a discussion on different financial crises.

3. HISTORY OF FINANCIAL CRISIS

The issue of financial instability and financial crises is not new to the world. The world has seen such events even when the financial system was not as highly developed as it is today. For instance, mishandling of economic policies and poor management by the Mamluk government in the early fifteenth-century Egypt resulted in the fulus currency crisis (Ali & Izhar, 2015). History has witnessed multiple crises again and again.

This world has seen a number of crises during the 1980s such as Latin American debt crisis, Black Monday and U.S. savings and loan crisis. And during the 1990s the world witnessed the Japanese asset bubble collapse, Mexican Peso crisis, Asian financial crisis, Russian Ruble crisis and the Dot-Com bubble. One of the most important outcomes of these crises has been instability of the global financial system which affected the overall global economy.

Table 1 shows a list of top 11 financial crises between 1929 and 2015 and the trigger of these crises.
Table 1: Top 11 Financial Crisis, 1929-2015

<table>
<thead>
<tr>
<th>Year Crisis Began</th>
<th>Crisis Name</th>
<th>Crisis Trigger</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 1929</td>
<td>Wall Street Crash of 1929 and Great Depression</td>
<td>Stock market crash</td>
</tr>
<tr>
<td>2 1973</td>
<td>Oil crisis</td>
<td>Oil price shock</td>
</tr>
<tr>
<td>3 1982</td>
<td>Latin American debt crisis</td>
<td>Debt default</td>
</tr>
<tr>
<td>4 1987</td>
<td>Black Monday</td>
<td>Stock market shock</td>
</tr>
<tr>
<td>5 1989</td>
<td>U.S. savings &amp; loan crisis</td>
<td>S&amp;L failures</td>
</tr>
<tr>
<td>6 1990</td>
<td>Japanese asset bubble</td>
<td>Real estate bubble</td>
</tr>
<tr>
<td>7 1994</td>
<td>Mexican peso crisis</td>
<td>Currency crisis</td>
</tr>
<tr>
<td>8 1997</td>
<td>Asian financial crisis</td>
<td>Currency crisis</td>
</tr>
<tr>
<td>9 1998</td>
<td>Russian financial crisis</td>
<td>Currency crisis</td>
</tr>
<tr>
<td>10 2000</td>
<td>Dot-com bubble</td>
<td>Stock market bubble</td>
</tr>
<tr>
<td>11 2008</td>
<td>U.S. Sub-prime debt mortgage crisis</td>
<td>Housing market bubble</td>
</tr>
</tbody>
</table>

Source: Author's own depiction with addition based on Alrifai (2015:23-50)

The recent financial crisis which is commonly known as the U.S. sub-prime debt mortgage crisis as shown in Table 1, started in U.S. in 2008 and engulfed the rest of the world economies in short time, including Europe. The crisis trigger was the housing market bubble. In order to save financial institutions from the trickle-down effect, many governments around the world came with bailout packages. According to Alrifai (2015:51-86), the U.S. government issued more than $700 billion as a bailout package to save financially distressed institutions. In Europe, the European Commission proposed a €200 billion European stimulus plan. If we look at a few individual countries in Europe, the United Kingdom (UK) government gave a £500 billion bailout package. Germany, a leading European economy decided to provide a €112 billion bailout to Hypo Real Estate.

Table 2 shows a list of top 10 bank failures in the U.S. during the financial crisis between 2008 and 2009. The financial crisis forced more than 10 banks to shut down and the asset size of these institutions ranged from $11.2 billion to $307 billion.

Table 2: Top 10 Bank Failures during the Financial Crisis by Asset Size at Time of Failure

<table>
<thead>
<tr>
<th>Financial Institution</th>
<th>State</th>
<th>Year</th>
<th>Assets at Time of Failure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Washington Mutual</td>
<td>Washington</td>
<td>2008</td>
<td>$307 billion</td>
</tr>
<tr>
<td>Indy Mac</td>
<td>California</td>
<td>2008</td>
<td>$32.0 billion</td>
</tr>
<tr>
<td>Colonial Bank</td>
<td>Alabama</td>
<td>2009</td>
<td>$25.0 billion</td>
</tr>
<tr>
<td>FBOP Corp. banking subsidiaries</td>
<td>Illinois</td>
<td>2009</td>
<td>$18.4 billion</td>
</tr>
<tr>
<td>Guaranty Bank</td>
<td>Texas</td>
<td>2009</td>
<td>$13.0 billion</td>
</tr>
<tr>
<td>Downey Savings and Loan</td>
<td>California</td>
<td>2008</td>
<td>$12.8 billion</td>
</tr>
<tr>
<td>BankUnited FSB</td>
<td>Florida</td>
<td>2009</td>
<td>$12.8 billion</td>
</tr>
<tr>
<td>Am Trust Bank</td>
<td>Ohio</td>
<td>2009</td>
<td>$12 billion</td>
</tr>
<tr>
<td>Western Bank</td>
<td>Puerto Rico</td>
<td>2010</td>
<td>$11.9 billion</td>
</tr>
<tr>
<td>United Commercial Bank</td>
<td>California</td>
<td>2009</td>
<td>$11.2 billion</td>
</tr>
</tbody>
</table>

Source: Adapted from Alrifai (2015:67)
Alrifai (2015:70) conducted a study to find out the reasons for the recent financial crisis and the following findings are adapted from his paper:

- Early signs of the coming crisis were ignored. These signs included:
  - Lending programs aimed at getting less-qualified buyers into homes they could not afford.
  - Wall Street’s innovations, which lead to the development of Credit Default Obligations (CDOs) and Credit Default Swaps (CDSs).
  - Lack of prudent credit and underwriting policies, which lead to widespread fraud by all parties involved, including the home buyers.

- Even as the housing market began to slow and companies started to fail, regulators failed to see the severity of the crisis.

- The lack of regulation and transparency in these complex financial instruments encouraged Wall Street to go off into riskier areas, one of which was allowing naked CDSs, effectively launching a global casino for betting on gains or losses in financial assets.

- CDSs ballooned to more than twice the size of the U.S. stock market in less than a decade. The complexity of these instruments makes them even more dangerous.

- The government bailouts that followed were more about savings Wall Street than Main Street.

- Due to the interconnected nature of the U.S. financial system, the housing crisis turned into a CDO and CDS crisis, which quickly spread across the world. By 2009, the entire developed world was in recession.

Other notable reasons for the recent financial crisis were excessive debt in the global financial system, extensive use of derivatives for speculation and unethical business practices. The question arises as to where there is an alternative financial system which is more stable than the conventional financial system. The following sections explore the answer of this question.

## 4. ISLAMIC FINANCIAL SYSTEM AS AN ALTERNATIVE FINANCIAL SYSTEM

According to Islamicfinance.com (2016), a leading source for Islamic finance data, by the end of 2015 the current size of the Islamic finance market was over $2.1 trillion. The cumulative Gross Domestic Product (GDP) of the Organization of Islamic Countries (OIC) was around $7 trillion. The Islamic financial industry comprised of different sub-sectors including Islamic banks, Sukuk, Islamic funds and Takaful. The cityUK (2015:6-23) report stated that, by the end of 2014, the size of Islamic banking crossed the $1.6 trillion mark and Islamic banking showed a growth of 16% between 2008 and 2014. It is worth mentioning that despite rapid growth, the Islamic banking assets are only equivalent to 1% of the global banking assets. On the other hand, the Sukuk
sector also recorded unprecedented growth of 20% since 2008 and by the end of 2014, the total value of Sukuk bonds issued amounted to $120 billion. The Islamic funds sector is still underdeveloped and by the end of 2014, the assets size was $77 billion. Finally, the total value of assets of the Takaful sector assets was $35 billion in the same period.

Islamic banking and finance is part of the Islamic economic system, which is governed according to the Shari’ah principles. Shari’ah principles are mentioned in the fundamental sources such as Quran, the holy book of Muslims and Sunnah, collection of sayings, deeds and endorsements of Prophet Muhammad (Iqbal & Mirakhor, 2011:63). Warde (2000:5) defined Islamic banking and finance: “Islamic financial institutions are those that are based, in their objectives and operations, on Quran’s principles (principles of the Muslims’ holy book).” These principles are broadly discussed in Quran and hence the interpretation of Quran is in the form of Sunnah, practical teachings, traditions and way of life of Prophet Muhammad.

In order to gain insights about Islamic banking and finance, a brief understanding of the following prominent principles and characteristics of the Islamic financial system is important:

1. Prohibition of Riba (usury or interest) is one of the most important differentiating principles compared to conventional finance (Krim, 2001:178). The word Riba is an Arabic word which means the excess, increase, addition or growth but practically it refers the amount charged by financial institutions and individuals on a loan (Al-Amine, 2008:316). Quran has clearly mentioned the prohibition of Riba as following verses show:

   • “That which you give as interest to increase the peoples’ wealth increases not with God; but that which you give in charity, seeking the goodwill of God, multiplies manifold” (Surah Rome, Verse 39, Quran).

   • “Believers! Do not swallow Riba, doubled and redoubled, and be mindful of Allah so that you may attain true success” (Al Imran, Ayat 130, Quran).

   • “And for their taking interest even though it was forbidden for them, and their wrongful appropriation of other peoples money, and We have prepared for those among them who reject faith a grievous punishment ” (Surah al-Nisa’, Verse 161, Quran).

2. Prohibition of Gharar is another important feature of the Islamic financial system. The literal meaning of the word Gharar is deception, danger, risk and uncertainty (Al-Amine, 2008:310). In simple words, Gharar means exposure to excessive risk in a business transaction due to uncertainty related to price of the product, quality, quantity, delivery date or inability of the parties to meet the obligations involved in transactions. Islamic institutions should avoid those contracts and dealings which involve uncertainty and risk such as highly speculative derivative instruments.

3. Prohibition of Maysir (gambling) is another important principle and Islam prohibits any gains which are made through gambling because in such situations people intentionally involve in risky activities (Obaidullah, 2005:11). Gambling includes all games of chance including lotteries.
4. Prohibition of dealing with Haram Products (non-permissible) means Islamic financial institutions must not finance those products and services which are prohibited by Islam such as alcohol, pornography, tobacco and drugs (Alrifai, 2015:117).

5. Profit and Loss Sharing (PLS) is another very important principle and feature of Islamic banking and finance. Islam encourages its believers to take part in economic activities. However, it defines certain rules of business - to share profit, but also parties to business should also take part in the case of loss and share their due part of the risk (Lewis, 2009:12).

6. Obligation of payment of Zakat is compulsory for all Muslims who possess enough resources (IFSB, 2015: X). Zakat means to clear, to grow or to increase and it is among the five basic pillars of Islam (other fours are declaration of faith, pray, fasting and Hajj- pilgrimage to Mecca and Medina). If the wealth exceeds a specific limit prescribed in Islam, then excess wealth is subject to Zakat. For example, 2.5% Zakat on annual savings, gold and other resources. The payment of Zakat by the rich Muslims provides resources to the government for the well-being of the poor segments of society. It should be noted that individuals can either gave Zakat money to the government for distribution to the needy or can also pay Zakat directly to them.

7. Islamic financial institutions are also obliged to follow ethical principles in business dealings such as risk sharing, prohibition of short-selling, productive investments and transparency in financial practices (Alrifai, 2016:119-120).

After discussing briefly the important principles and characteristics of Islamic banking and finance, Figure 1 depicts the differences between Islamic banking and the conventional banking system.

**Figure 1: Major differences between Islamic Banking and Conventional Banking System**

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Islamic banking system</th>
<th>Conventional banking system</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Framework</td>
<td>Based on Shariah laws – Shariah scholars ensure adherence to Islamic laws and provide guidance.</td>
<td>Not based on religious laws or guidelines – only secular banking laws.</td>
</tr>
<tr>
<td>Balance Between Moral and Material Requirement</td>
<td>The requirement to finance physical assets which banks usually take ownership of before resale reduces over extension of credit.</td>
<td>Excessive use of credit and debt financing can lead to financial problems.</td>
</tr>
<tr>
<td>Equity Financing with Risk to Capital</td>
<td>Available. Enables several parties, including the Islamic Bank, to provide equity capital to a project or venture. Losses are shared on the basis of equity participation while profits are shared on a pre-agreed ratio. Management of the enterprise can be in one of several forms depending on whether the financing is through Mudarabah, Musharakah, etc.</td>
<td>Not generally available through commercial banks, but through venture capital companies and investment banks, which typically take equity stakes and management control of an enterprise for providing start-up finance.</td>
</tr>
<tr>
<td>Penalty/Late Payment</td>
<td>Penalties on late payments are prohibited. If penalties are levied, they must be re-channeled to charities.</td>
<td>Fees are typically charged for late payments.</td>
</tr>
<tr>
<td>Ethical Transaction</td>
<td>Transactions and activities that involve engagement with unlawful business sectors such as gambling and brewery are not allowed.</td>
<td>Besides money laundering and the financing of criminal activities, how customers utilize borrowed funds is typically unrestricted.</td>
</tr>
</tbody>
</table>

Source: Djennas et al. (2015:89)
5. IMPORTANT ISLAMIC FINANCIAL INSTRUMENTS AND CONTRACTS

Islamic financial system like the conventional financial system operates as a financial intermediary between those who have excess savings such as households and those who are seeking financing such as investors for investments. The list of Islamic financial instruments and contracts is very long. However, in the follow section a few major instruments and contracts are briefly explained.

5.1 Musharakah (Equity Partnership)

The meaning of the word Musharakah is sharing and it is one of the most prominent PLS instruments in Islamic finance. In contemporary finance, it is also known as private equity and venture capital (Alrifai, 2015:129). According to Iqbal and Molyneux (2005:20), the Musharakah financial contract can be defined as “an arrangement where two or more parties establish a joint commercial enterprise and all contribute capital as well as labour and management as a general rule”.

In Musharakah profit is distributed among all parties in a pre-agreed ratio whereas loss is borne according to the capital contribution (Iqbal & Mirakhor, 2011:87). Both partners contribute financial resources for a business. In case of profit, it is shared according to an agreed ratio. However, loss sharing ratio is based on the actual capital contribution by both partners. According to Iqbal and Mirakhor (2011:88), the Musharakah instrument is being frequently used in mortgage financing. On the other hand, Kettell (2011:82) states that Musharakah is also used in domestic trade, commerce, and agriculture.

5.2 Mudarabah (Investment Partnership)

According to Alrifai (2015:125) Mudarabah is known as trust financing and it is “one of the simplest financing structures in Islamic finance.” In this contract one partner provides capital for the business known as Rabb-ul-maal whereas the other partner Mudarib contributes his intellectual skills for the management of business. The profit is distributed between Rabb-ul-maal and the Mudarib in an agreed ratio which is decided at the start of the contract. However, financial loss is to be borne by the capital provider only i.e., Rabb-ul-maal. But Mudarib will lose his employment and management rights associated in the business if he failes to make profit and the business is forced to shut down (Abu-Alkheil 2012:12).

Islamic banks widely use this instrument as a financing tool and a contract is made between the bank and the customer (BankIslami Pakistan Limited, 2006:79). However, in case of loss, the bank can either pass it to the depositors or adjust it against own income depending on the specific situation.
5.3 \textit{Ijarah} (Leasing)

Conventional finance leasing is a similar concept to \textit{Ijarah}. \textit{Ijarah} is an Arabic word which means \textit{to give something on rent}. (Lewis, 2009: 17). In simple words, it is the transfer of rights of use imbedded in a specific property/item to another person for a rent claimed from him. However, the difference between sale and \textit{Ijarah} is the right to use the property and ownership title. For instance, in case of \textit{Ijarah} the ownership right remains with the bank. However, the right to use the property and any other item is transferred to the customer who agreed to pay rent on an instalment basis. On completion of a specific number of instalments, the bank transfers the ownership title to the customer.

According to Iqbal and Mirakhor (2011:82), \textit{Ijarah} contract can be used to fulfil the financing needs of entrepreneurs and investors in the Islamic financial industry. On the other hand, Visser (2009:59) states that the \textit{Ijarah} contract is suitable for the transport sector. Moreover, \textit{Ijarah} is also applied for mortgaging financing but is usually applicable in longer duration of projects.

5.4 \textit{Murabahah} (Cost Plus Sale)

According to Iqbal and Mirakhor (2011:83) \textit{Murabahah} is one of the popular instruments in Islamic finance that is used for purchasing commodities and other products on credit. \textit{Murabahah}, which is also known as cost plus sale or mark-up sale, is the case when the client requests from a financial institution to buy a specific item for his need. The bank buys it from a supplier and then resells it to the client on instalment payment basis with a predetermined profit margin commonly known as mark-up price, which includes compensation for the services provided by the bank.

Alrifai (2015:127) states that its simple structure and ease of use makes \textit{Murabahah} one of the widely used instruments in Islamic finance. According to Shanmugam and Zahari (2009:32) \textit{Murabahah} is used to finance raw materials, manufacturing equipment, and consumer goods.

6. GLOBAL FINANCIAL CRISIS IMPACT ON ISLAMIC BANKING AND FINANCE

As far as the impact of the global financial crisis on Islamic financial institution is concerned, a study of recent literature shows mixed views about it. Clearly two views emerged. Some studies conclude that Islamic banks performed very well against the financial crisis as compared to conventional banks but other studies show that there is no substantial difference and Islamic banks operated like conventional banks (Masoud, 2015). According to Belouafi \textit{et al.} (2015) Islamic financial institutions have shown resilience against the first wave of the recent global financial crisis. However, some financial institutions have suffered negative consequences during the second wave when the overall economy of most countries went into recession. The fundamental difference
between Islamic financial institutions and conventional financial institutions was the involvement in ‘very toxic assets’. Due to their inherent model, Islamic financial institutions avoided making huge speculative investments in derivatives, unlike conventional counterparts around the world especially in the U.S. and Europe. The fact that Islamic finance is not as developed as a large-scale global financial system and the fact that its growth and development are limited in certain jurisdictions, may have saved the Islamic financial institutions from the crisis. The inherent model of Islamic finance encourages financial institutions to function on the basis of asset-backed financing principle. This means that banks should have adequate assets to cover any potential loss.

The study conducted by Hassan and Dridi (2010:6) investigated the behaviour of Islamic and conventional banks with regard to the recent global financial crisis by studying a sample of 120 Islamic and conventional banks in eight countries such as Bahrain, Jordan, Kuwait, Malaysia, Qatar, Saudi Arabia, Turkey and UAE. This study found that the financial crisis had less impact on Islamic banks compared to conventional banks. Furthermore, the paper shows that Islamic banks have clearly performed better in asset and growth during the financial crisis than conventional banks. This study also reveals that Islamic banks enjoyed higher profitability before the start of the global financial crisis when compared to their counterparts. Results after the crisis also exhibit a similar trend.

Beck et al. (2013) investigated the difference between Islamic and conventional banking models and impact of the global financial crisis from 1995 to 2009 by selecting a large sample of 510 banks from 22 countries. This paper found three interesting insights. Firstly, on the basis of capitalization and asset quality, Islamic banks showed better performance than conventional banks. Secondly, the business model of Islamic banks is similar to that of conventional banks. Islamic banking model is based on the tenets of being interest-free, avoiding speculative activities and functioning within the domain of core instruments such as Musharakah, Mudarabah and Sukuk. Thirdly, conventional banks are more efficient than Islamic banks. However, on the contrary to the already mentioned studies, Kassim and Abd.Majid (2015) employed the Value at Risk technique as opposed to the traditional measurement approaches to determine the consequences of the global financial crisis on Islamic and conventional banks in Malaysia. This study found that neither Islamic banks nor conventional banks remained unaffected by the global financial crisis.

According to Ali (2013:63), it is not the case that Islamic financial institutions are immune to the financial crisis. He stated that in 2001, bank liquidity crisis in Turkey also affected Islamic banks and Ihlas Finans went bankrupt. However, conventional banks were more prone to the financial crisis that started in 2007 and a few Islamic wholesale and investment banks suffered.

Table 3 provides an overview of credit ratings of Islamic and global banks as of August 2014. As it is evident, the credit ratings of overall Islamic financial institutions are better than those of the global conventional banks.
Table 3: Credit Ratings of Islamic Banks vs. Global Banks as of August 2014

<table>
<thead>
<tr>
<th>Banks</th>
<th>Fitch</th>
<th>Moody’s</th>
<th>S&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rating</td>
<td>Rating</td>
<td>Rating</td>
</tr>
<tr>
<td>HSBC Plc</td>
<td>AA-</td>
<td>Aa3</td>
<td>A+</td>
</tr>
<tr>
<td>National Bank of Kuwait</td>
<td>AA-</td>
<td>Aa3</td>
<td>A+</td>
</tr>
<tr>
<td>Bank of NY Mellon Corp</td>
<td>AA-</td>
<td>A1</td>
<td>A+</td>
</tr>
<tr>
<td>∂Al Rajhi Bank</td>
<td>A+</td>
<td>A1</td>
<td>A+</td>
</tr>
<tr>
<td>Kuwait Finance House</td>
<td>A+</td>
<td>A1</td>
<td>A-</td>
</tr>
<tr>
<td>UBS AG</td>
<td>A</td>
<td>A2</td>
<td>A-</td>
</tr>
<tr>
<td>Abu Dhabi Islamic Bank</td>
<td>A+</td>
<td>A2</td>
<td>NR</td>
</tr>
<tr>
<td>Ahli United Bank of Kuwait</td>
<td>A+</td>
<td>A2</td>
<td>NR</td>
</tr>
<tr>
<td>Deutsche Bank AG</td>
<td>NR</td>
<td>A3</td>
<td>A-</td>
</tr>
<tr>
<td>Barclays Plc</td>
<td>A</td>
<td>A3</td>
<td>A-</td>
</tr>
<tr>
<td>Qatar International Islamic Bank</td>
<td>A</td>
<td>A3</td>
<td>NR</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>A</td>
<td>Baa1</td>
<td>Stable</td>
</tr>
<tr>
<td>Boubyan Bank</td>
<td>A+</td>
<td>Baa1</td>
<td>Stable</td>
</tr>
<tr>
<td>Gulf Bank</td>
<td>A+</td>
<td>Baa1</td>
<td>Positive</td>
</tr>
<tr>
<td>Dubai Islamic Bank</td>
<td>A</td>
<td>Baa1</td>
<td>Stable</td>
</tr>
<tr>
<td>Bank of America Corp.</td>
<td>A</td>
<td>Baa2</td>
<td>Stable</td>
</tr>
<tr>
<td>Citigroup Inc.</td>
<td>A</td>
<td>Baa2</td>
<td>Stable</td>
</tr>
<tr>
<td>RBS Plc</td>
<td>A</td>
<td>Baa2</td>
<td>Negative</td>
</tr>
</tbody>
</table>

Source: Adapted from Alrifai (2015:169)

7. CONCLUSION

Financial stability is important for the global financial system. This world has seen a number of financial crises since the Great Depression of 1929. However, the recent financial crisis of 2008-09 was the worst since the Great Depression. Many governments around the world had to save financial institutions from further negative consequences by providing bailout packages. The main reasons of the financial crisis were the lack of strong financial and banking regulations, excessive use of financial derivatives, inadequate response from the market regulators and ignoring of early signs of the financial crisis. This paper also found that Islamic banking and finance is a young viable financial system whose current asset size is above $2.1 trillion. This system is based on ethical values and principles, and uncontrolled use of financial derivatives is prohibited. Investors are strongly encouraged to engage in business activities backed by real economic assets. Main instruments of Islamic financial system are Musharakah, Mudarabah, Ijarah and Murabahah. The Islamic financial system also suffered from the financial crisis, albeit indirectly, when the overall global financial system was in distress. The empirical studies also showed that Islamic financial institutions were less affected compared to the conventional financial system and they performed better. Moreover, the credit ratings of large Islamic banks are better than those of their conventional counterparts. Thus, it can be concluded from this paper that the Islamic financial system may prove as an alternative financial system especially after the recent financial crisis.
REFERENCES:


UTJECAJ SVJETSKIH FINANCIJSKIH KRIZA NA SVJETSKU FINANCIJSKU STABILNOST TE POTREBA ZA ALTERNATIVNIM FINANCIJSKIM SUSTAVOM

Muhammad Ashfaq

Sažetak


Ključne riječi: Financijska stabilnost, financijska kriza, Velika depresija, islamski financijski sustav, beskamatni bankarski sustav.

JEL klasifikacija: E32

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