CENTRAL BANK LOAN TO ISLAMIC BANK (LIQUDITY CASE STUDY)

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Abstract: *Purpose of writing this articleiadalahito analyze Liquidity Risk Management in Islamic Banking. This type of research includes library research. Furthermore, it is analyzed using the content analysis method. The data sources used are journals, as primary data sources and other supporting books related to the object of research as secondary data sources. The results showed that the liquidity risk of Islamic banks is the same as other financial services. Liquidity risk is the risk resulting from the Bank's inability to fulfill maturing obligations from high-quality cash flow sources and/or liquid instruments that can be used as collateral, without disrupting the Bank's activities and financial condition. Therefore, estimating liquidity needs is complex. Banks must estimate liquidity needs and find ways to meet all funding needs in times of need. Bank liquidity needs come from two needs. Liquidity risk itself can be interpreted as the risk of the bank's inability to provide immediate liquidation at a fair price.*

Keywords: *Liquidity Risk, Islamic Bank*

Introduction

Liquidity risk is the risk caused by the inability of Islamic banks to fulfill total bonds rather than high-quality sources of cash flow financing and/or usable liquid assets, without disrupting the activities and conditions of the bank. Therefore, liquidity risk is the risk arising from the inability of Islamic banks to meet their obligations at a predetermined time for customers. The inability to obtain sources of cash flow funds that pose liquidity risks can be caused, among others (Azizah & Farid, 2021: 27):

a. Inability to generate the flow of funds, both from product assets and the sale of assets including liquid assets.
b. Inability to produce cash flows from fund collection, transactions between Islamic banks, and loans received.

Liquidity risk is often interpreted as potential losses derived from a bank's inability to meet expirations, either financing assets already owned or financing the growth of bank assets without incurring costs or incurring losses that exceed the bank's tolerance. Credit and liquidity risk are the most fundamental risks in the banking industry. It is mentioned the main thing because it is the

main trigger of the crash experienced by the bank therefore if the bank cannot overcome the problem that is the tree. It is certain that banks will lose their source of funds.

Declaring liquor is essential for Islamic banks in conducting their business activities, addressing urgent needs, meeting customer demand for loans, and providing flexibility in seizing attractive and possible investment opportunities. The available liquidity must be sufficient, it cannot be too small to impact the daily operating requirements, but it also cannot be too large because it will be down and have an impact on low profit levels. Therefore, if the bank can manage liquidity, then customers will feel satisfied which will affect the increase in new customers and advance the Islamic bank. (Winanti, 2019)

Liquidity risk is a measurement of the risk faced by a bank if it fails to meet its obligations to depositors with its liquid assets Rose and Hudgins: 2008 stated that banks face the threat of liquidity risk, namely the absence of funds used to cover customer deposit withdrawals and credit requests submitted by customers. The calculation used to measure credit risk is the Loan to Deposit Ratio (LDR). Loan to Deposit Ratio (LDR) compares credit with third-party funds. Loan to Deposit Ratio (LDR) is widely used to measure the level of liquidity of banks, the higher the level of this ratio, the smaller the level of liquidity, because the amount of funds needed to finance credit is increasing. (Fitrianto &; Mawardi, 2006) Liquidity risk generally comes from third party funds, assets and liabilities to counter-parties. The most significant off-balance sheet component in a bank's liquidity and funding fulfillment is customer commitment. Therefore, banks manage liquidity risk in order to fulfill every agreed financial obligation in a timely manner, and can maintain an adequate and optimal level of liquidity The size of liquidity risk is determined by several indicators, namely:

a. Accuracy of cash flow planning or fund flow based on financing predictions and fund growth predictions, including observing the level of fund volatility (volatility of funds).
b. Accuracy in managing fund structure, including adequacy of non-PLS (profit and loss sharing) funds.
c. Availability of assets that are ready to be converted into cash.
d. Ability to create access to the interbank market or other sources of funds, including lender of last resort facilities

The concept of liquidity according to Oliver G. Wood, Jr. which was interpreted by Dahlan Siamat (2005) that a bank is considered liquid if the bank meets the following categories:

a. Holding a number of liquid instruments, cash assets, consisting of cash, accounts at the Central Bank and accounts at other banks equal to the amount of estimated liquidity requirements.
b. Holding less than the amount of liquid instruments, however, banks have high-quality securities that can be exchanged or transferred into money without loss either before maturity or at time after maturity.
c. Have the ability to obtain liquid instruments through debt creation, for example the use of discount facilities, call money, sales of securities with repurchase agreements (repo). (Handayani, 2017)

According to (Permatasari, 2018) Liquidity is the ability of banks to fund asset increases and meet maturing obligations (BCBS, 2000). (Doni et al., 2022). Therefore, liquidity is very important for the sustainability of the bank's business. Liquidity management is one of the most important activities undertaken by banks. Bank imbalances in asset and liability management can expose banks to liquidity risk

Literature Review

A. Definition

Challenges of Liquidity Risk Management in Banking. The following are the challenges banks face in managing liquidity risk:

a. Liquidity is the ability to fund an increase in assets and meet liabilities when they mature. The implied meaning of this definition is that obligations can be fulfilled "at reasonable costs." Liquidity risk management seeks to ensure the bank's ability to continuously fulfill these obligations. This includes the fulfillment of uncertain cash flow obligations, which depend on external events and the behavior of other agents.
b. Effective risk management estimates future cash flow needs, both under normal conditions and under stress conditions. This poses a challenge for banks even under normal market conditions, as they need the ability to draw information from various bank operations and assess the effect of external events on the availability of funding liquidity. This challenge will increase when pressure conditions occur, because the underlying assumptions of liquidity risk may change, especially changes in partner behavior and market conditions that may affect the liquidity of financial instruments and the availability of funding.
c. Financial innovations and global market developments have changed the nature of liquidity risk in recent years. Some banks' funding has shifted to a greater reliance on capital markets, which are a more volatile source of funding than funding from regular deposits.
d. The complexity of financial instruments has also increased. This has led to an increase in demand for underwriting; increased uncertainty over future margin call liquidity pressures; as well as a lack of transparency that can lead to asset market contraction in times of pressure. Along with these market developments, the increasing nature of real-time payment and settlement systems, as well as increased interdependence between different systems have increased the importance of intraday liquidity management. (Doni et al., 2022)

B. Principles in Liquidity Risk Management

The liquidity risk management framework issued by Bank Indonesia has incorporated the principles of liquidity risk management assessment from the Basel Committee on Banking Supervision. The following are assessment principles for risk management for banking institutions:

1. Develop a liquidity management structure. Every bank should have a mutually agreed upon strategy for day-to-day liquidity management. The bank's board of directors and commissioners must approve important strategies and policies related to liquidity management. The board must also ensure that top management has taken the necessary steps to monitor and control liquidity risk.
2. Measure and monitor funding needs. Each bank should establish a process for continuous measurement and monitoring of net funding needs. In addition, banks must analyze liquidity using various "if" scenarios.

3. Manage market access. Periodically, the bank must review its efforts to build and maintain its relationships with creditors, to maintain debt diversification, and to ensure its ability to sell assets.
4. Planning contingencies. Banks should have a contingency plan that shows strategies for handling liquidity crises and includes procedures to overcome cash shortages in emergency situations.
5. Foreign exchange liquidity management. The bank must have a system of measuring, monitoring and controlling its liquidity position in the active major currencies.
6. Internal control for liquidity risk management. Banks must have an adequate internal control system over their liquidity risk management processes. The basic components of its internal control system include regular independent reviews and evaluations of the effectiveness of the system and, where necessary, ensuring that improvements have been made to the internal controls.
7. The role of public disclosure in increasing liquidity. Banks should have a mechanism in place to ensure that there is an adequate level of disclosure of information about them to manage public perception of their institutional and soundness.
8. The role of regulatory agencies. The supervisor shall conduct an independent evaluation of strategies, policies, procedures, and practices related to liquidity management. Supervisors require banks to have an effective system of measuring, monitoring, and controlling liquidity risk. The supervisor shall obtain adequate and timely information from each bank to evaluate the level of liquidity risk and ensure that it has an adequate liquidity contingency plan in place. (Doni et al., 2022)

C. Method

This type of research includes library research. Furthermore, it is analyzed using the content analysis method. The data sources used are journals, as primary data sources and other supporting books related to the object of research as secondary data sources.

D. Result and Discussion

Implementation of Liquidity Risk Management

Based on Bank Indonesia Circular Letter No. 11/16/DPNP concerning the Application of Risk Management for Liquidity Risk, the effective implementation of liquidity risk management at least includes: (1) active supervision of the Board of Commissioners and Board of Directors, (2) adequacy of risk management policies, procedures, and limits, (3) adequacy of risk identification, measurement, monitoring, and control processes as well as risk management information systems, and (4) a comprehensive internal control system. In implementing liquidity risk management, banks need to evaluate their liquidity risk profile as they are tied to capital requirements. The effectiveness of liquidity risk management will improve the stability of the banking system as a whole Basically, the process of measuring liquidity requires four measuring instruments :

1. Cash flow projection, which is a projection of all cash inflows and cash outflows including funding needs to meet commitments and contingencies in administrative account transactions.
2. Liquidity ratio, which describes the ability of the bank to meet its short-term obligations.

3. Maturity profile, which is mapping the position of assets, liabilities, and administrative accounts into a certain period scale based on the remaining period until maturity.
4. Stress testing, which is testing carried out using certain scenarios on the bank's liquidity position in crisis conditions. (Doni et al., 2022)

The application of risk management in Islamic banking is adjusted to the size and complexity of the business and the Bank's capabilities. Bank Indonesia establishes this risk management regulation as a minimum standard that must be met by BUS and UUS so that Islamic banking can develop it in accordance with the needs and challenges faced but still carried out in a healthy, istiqomah, and in accordance with Sharia Principles. In risk management, the first thing to do is to identify all the risks faced, then measure or determine the magnitude of the risk and then a way out can be found to face or deal with that risk. Therefore, the management must develop a strategy to minimize or control the risks it faces. Therefore, every Islamic bank must be able to identify every risk that will be faced in the process of running the Islamic bank. In this study, we will discuss how to manage the risks that will be faced by Islamic banks. Risk management is an important element whose application needs to be considered, especially in the Bank as one of the financial institutions

The development of effective frameworks, structures and tools for monitoring risk using an Enterprise Risk Management (ERM) approach was initiated in 2007. During 2007, major work was completed in identifying risk events and planning scenarios to improve the Bank's effectiveness in its ability to respond to potential or occurring risk events. In general, the risks faced by Islamic banks are relatively the same risks as those faced by conventional banks. But besides that, Islamic banks also face risks that have their own uniqueness, because they must follow sharia principles. Credit risk, market risk, operational risk and liquidity risk must be faced by Islamic banks. This unique risk arises because the contents of Islamic banks' balance sheets are different from conventional banks. In this case, the profit-sharing pattern carried out by shari'ah banks increases the possibility of other risks arising. Such as withdrawal risk, fiduciary risk, and displaced commercial risk are examples of unique risks that Islamic banks must face. (Syafii &; Siregar, 2020)

Effective implementation of Risk Management for Liquidity Risk at least includes: (i) active supervision of the Board of Commissioners and Board of Directors; (ii) adequacy of Risk Management policies, procedures and limits; (iii) adequacy of Risk identification, measurement, monitoring and control processes and Risk Management information systems; (iv) a comprehensive internal control system. (Desda &; Yurasti, 2019)

The implementation of Risk Management as referred to in Article 2 paragraph (1) at least includes:
1. active supervision of the Board of Commissioners, Board of Directors, and Sharia Supervisory Board
2. adequacy of Risk Management policies, procedures, and limits
3. adequacy of Risk identification, measurement, monitoring, and control processes as well as Risk Management information systems; and
4. Comprehensive internal control system. (Rahmany, 2012)

The implementation of Liquidity Risk Management also includes:

1. Supervision by Management and Supervisors

Supervision carried out by management and supervisors by holding regular meetings every month, then the management and supervisors provide input to managers on what to do. If considered important, the management issues a decree as a work guideline to managers and employees in the form of special regulations as a supervisory system carried out by the management in daily cash management in the office The trust of management and supervisors to managers is very high even though the risk of misappropriation is also high. The understanding of management and supervisors on liquidity risk management is still low, especially at the supervisory level, with no active supervision and on the spot control.

2. Policies, Procedures and Limits of Liquidity Risk.

In the implementation of policies, procedures and liquidity limits based on Special Regulation numbered 003/Persus/BMT-AU/I/2014 concerning Cash Management Provisions. This regulation contains Cash Provision, Cash Opname and Bank Cash.

3. Risk Management Process and Management Information System

a. Risk identification

In raising funds, there are products that can be taken at any time and futures products whose collection is carried out according to the agreement and according to their proud characteristics. Basically, fundraising products are dominated by deposits whose collection is tied to the characteristics of the product.

b. Measurement

Liquidity measurement is only based on members' daily habits in taking their savings and disbursing approved financing. In the event of a lack of liquidity for cash, the branch office notifies the head office to provide liquidity and postpone the disbursement of financing that has been approved for disbursement. Measurement tools commonly used in the banking world, namely based on cash flow projections, based on liquidity ratios, based on maturity profiles and stress testing, are completely unknown to managers and employees and are not the basis of policies by their management.

c. Monitoring

Liquidity monitoring has been carried out daily by the central manager to branch offices by means of intensive communication via telephone, sms and email. However, monitoring to anticipate liquidity in the long term is not carried out, even measurement methods such as early warning indicators known in the banking world are not yet known by management, managers and employees So that if in the long term there is a rush or lack of liquidity, there is no scenario to anticipate it.

d. Control

Control of all transaction processes and other operations is directly handled by the head office with 1 manager and 1 financial administration (accounting) person. At branch offices, transaction control and other operations are carried out by branch managers. If there is a problem, the branch office immediately notifies the head office, the central manager conducts a meeting with the management to make a decision.

E. Conclusion

Internal Control System

Internal control systems can be a suitable strategy to support accounting information systems. Internal control is a process influenced by human resources and information technology systems designed to help organizations achieve certain goals. Internal control serves to direct, supervise and measure the resources of an organization. Internal control systems can help minimize or prevent fraud. Fraud occurs due to lack of supervision over irregularities committed by humans, so that it can make the company lose. This is one of the company's factors to keep an eye on ongoing activities. These activities can now be monitored easily because they use the system. The system is a sophisticated technology and the system makes it easier for companies to control the procedures that have been regulated. This is done in order to maintain the company's assets.

In addition, the definition of the Internal Control System according to Permendagri No. 4 of 2008 Guidelines for the Implementation of Review of Regional Financial Statements Article 1(10) The internal control system is a process influenced by management that is created to provide adequate confidence in the creation of effectiveness, efficiency, compliance with applicable laws and regulations and the reliability of regional financial presentation. Based on the above understanding, it can be stated that the internal control system is a process designed to provide adequate assurance about the achievement of three classes of objectives consisting of the reliability of financial statements, effective and efficient.

Purpose of Internal Control System

According to Hall (2007) in the journal Saifuddin (Saifudin &; Ardani, 2017) various policies, practices and procedures are implemented by companies to achieve four general objectives:

1. Maintain company assets, company assets or assets can be stolen or misappropriation occurs so that an adequate control system is needed.
2. Ensure the accuracy and reliability of accounting records and information, Accuracy and accuracy are necessary to assist management in business activities.
3. Encouraging efficiency in company operations, Internal control system prevents waste and sorting out unnecessary business activities.
4. Measuring conformity with policies and procedures set by management, Internal control assists the company in implementing established policies and procedures so that the company can achieve its objectives.

Internal Control Components

The COSO and AU 319 report, Condiseration of Internal Control in the Financial Statement Audit (SAS 78) in (Kell, Johnson, &; Boynton, 2014) and also cited by (Siwu, 2013) in its journal Doni et al, (Doni et al., 2022) identifies five components of internal control, namely:

1. Control environment The control environment defines the atmosphere of an organization that affects the awareness of control of its people. The control environment is the foundation of all other internal control components that provide discipline and structure. Factors that shape the control environment in an entity include the following:

a. Integration and ethical values
b. Commitment to competence
c. Board of directors and audit committee
d. Management philosophy and operating style
e. Organizational structure
f. Assignment of authority and responsibility
g. Human resource policies and practices

2. Risk assessment Risk assessment is the identification of entities and analysis of risks that are relevant to achieving their objectives and form a basis for determining how risks should be managed.
3. Control activities Control activities are policies and procedures that help ensure that management directives are implemented. In general, control activities consist of the following things.
   a. Adequate authorization of transactions and activities
   b. Separation of duties
   c. Design and use of adequate documents and records
   d. Adequate safeguarding of assets and records

4. Information and Communication Information is data that has been managed that is used for decision making in the context of carrying out the tasks and functions of the organization.
5. Monitoring Supervision is the process of determining the quality of internal control performance over time.

Limitations of Internal Control

According to Bastian (2007) there is no internal control system that can guarantee efficient administration, completeness, and accuracy of records. Every internal control system has limitations such as:

a. Internal control that relies on separation of duties can be avoided by collusion
b. Authority can be ignored by someone who has a certain position or by the manager
c. Personnel misunderstand orders due to negligence, inattention, or fatigue. (Irawati &; Satri, 2017)

The characteristics of a good internal control system according to Bastian. (2007)

a. Independent in processing procedures
b. There must be collusion to get through it
c. Performed by personnel with sufficient seniority
d. Done in a timely manner. (Irawati &; Satri, 2017)

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