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Critical Financial Analysis of Islamic Bank in the Philippines: Case Study of Amanah Islamic Bank

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Abstract

The inspiration to delve into the contemporary status of Islamic banking and finance in the Philippines has led this study to analyze the financial condition of Amanah Islamic Bank (AIB) and recommend improvements in its financial performance. This secondary data-based study utilizes library research and content analysis, particularly using the capital, asset, management, earnings, and liquidity parameters. AIB is the rebranded version of Al-Amanah Islamic Investment Bank of the Philippines. At present, AIB has nine branches and is the only authorized bank in the Philippines to offer Islamic banking products and services. Presidential Decree No. 542, which was signed in 1974, directed the AIB to implement an Islamic model of banking and financing, particularly following the "no interest principle" and partnership mechanisms. However, this order was not completely implemented because "conventional banking" dominated the AIB's operation. This study contributes to the continuing effort to convert AIB into a full-fledged Islamic bank and simultaneously contend with the emerging growth of the banking industry.

Keywords: Islamic banking and finance, Amanah Islamic Bank, Philippines, CAMEL

Introduction

"Capital adequacy, Assets quality, Management quality, Earnings ability, and Liquidity (CAMEL) rating has become a concise and indispensable tool for examiners and regulators" (Sandhya, 2014). The CAMEL rating is a beneficial tool for analyzing the safety and soundness of banks, as well as facilitates the mitigation of the potential risks that may lead to bank failures. Banking supervision has been increasing abruptly since the 1980s, thereby prompting the US to introduce the CAMEL model to classify the overall wellness of a bank. The performance of the banking sector is perceived as a replica of the economy given that a healthy banking system serves as the bedrock of economic, social, and industrial growth (Misra & Aspal, 2013).

In general, our appraisal of Amanah Islamic Bank (AIB) is poor. AIB is a government-owned bank and the only recognized Islamic bank in the Philippines; thus, this bank is expected to commit and be resilient to uphold its mandate in uplifting the socioeconomic condition of the people, particularly in the Muslim-dominated

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areas in the country. Harvey (1993) explained that many government banks are often poorly managed and overdependent on government support. Unfortunately, this scenario is present in AIB. The majority of this bank's resources (i.e., approximately 52%) comes from the Bangko Sentral ng Pilipinas (BSP), while approximately 32% are from loans and discounts granted to clients. However, over than 95% of these loans are non-performing based on the asset quality component. Even worse, a significant amount of AIB's income is attributed to other operations and not from the core banking functions. In AIB's effort to become a full-fledged Islamic bank, the deposit liabilities relative to conventional banking are escalating over the years compared with the Islamic deposits. These red flags definitely present the condition of AIB.

The five-year rehabilitation period of AIB was characterized by a fluctuation in its performance, which was in contrast to the expected progressive trend. Thus, AIB requires an extensive re-engineering in various aspects of its operations to hasten the recovery of losses and achieve an efficient, viable, sustainable, and stable banking intermediation. Moreover, external economic factors are considered to complete AIB's development and recovery. The purpose of this study is to analyze the contemporary status of Islamic banking and finance in the Philippines. Furthermore, this research will assess the vital and distinctive concepts and principles of Islamic banking, and particularly focus on the current standing of and issues that AIB is facing, as well as the means to mitigate or even eliminate the existing posterity. The rest of this paper is organized as follows. Section 2 elaborates the CAMEL rating scheme, the vital principles of Islamic banking, and the corresponding 21st century challenges. Section 3 presents the methods employed in this study. Section 4 discusses the findings of this research. Section 5 concludes this study.

Literature review

Amanah Islamic Bank of the Philippines

Islamic bank(s) in the Philippines is governed by a special law (rather than the general banking law) as provided for in Section 71 of Republic Act No. 8791 (An Act Providing for the Regulation of the Organizations and Operations of Banks, Quasi-Banks, Trust Entities and for Other Purposes). This governance covers the organization of an Islamic bank, its ownership and capital requirements, powers, supervision, and the general conduct of business.

Amanah Islamic Investment Bank of the Philippines (AIIBP), the forerunner of AIB, is the only bank in the Philippines authorized to offer Islamic banking products and services that adhere to the principles of *Shari'ah*. AIIBP was first established as Philippine Amanah Bank by virtue of Presidential Decree No. 264, which requires this bank to invest 75% of its loan funds to provide reasonable medium and long-term credit facilities, among others, to people from Muslim-dominated provinces in the southern region of the country. At present, this bank has nine branches, eight of which are located in Mindanao. Of the eight branches, those branches located in Cagayan de Oro City, Cotabato City, General Santos City, Jolo, Zamboanga, and Makati have been refurbished.

In 1974, AAIIBP was directed to implement the Islamic model of banking and financing, which follows the "no interest principle" and partnership mechanisms. In 1990, AAIIBP became a primarily Islamic bank with the signing of Republic Act No. 6848, otherwise known as the Charter of AAIIBP. Subsequently, AAIIBP was rebranded as AIB. The mandate of AIB is to promote and accelerate the socioeconomic development of the Autonomous Region in Muslim Mindanao (ARMM) through banking, financing, and investment operations, as well as to establish and participate in agricultural, commercial, and industrial ventures based on the Islamic concept of banking. In 1989, AIB

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was re-chartered and re-capitalized pursuant to Republic Act No. 6848, with a capital of one billion pesos. The Philippine government attempted to privatize AIB in 2000 after it began incurring losses in the mid-1990s. As of 2005, the bank's liabilities ranged from Php400 to Php500 million while its assets were valued at up to Php115 million. AIB has liquid assets of Php43.377 million, while its non-performing loans (NPL) account for 97% of its loan portfolio.

The Development Bank of the Philippines (DBP), a government-owned and controlled corporation, intended to acquire AIB to assist its initiative for micro, small, and medium entrepreneurs in Mindanao, as well as to serve as the main remittance outlet for Muslims and Mindanao-based overseas Filipinos in 2008. Thereafter, BSP had given its final approval for DBP's plan to obtain full control of AIB, which had been previously held by other government institutions, including the Social Security System (SSS) and Government Service Insurance System (GSIS). In 2009, the Monetary Board of the Philippines approved AIB's five-year Rehabilitation Plan, which focused on four corporate strategies (4Rs): *recapitalization*, capital infusions from DBP and domestic and foreign investors that aimed to cover the expenses of AIB's rehabilitation; *restoration of financial viability*, which focused on aggressive marketing effort to introduce AIB's new products and services, liquidation of non-performing assets, and sourcing of contingent funds; *reorganization*, which centered on building institutional capacity, particularly with regard to Shari'ah compliance, and involved organizational structuring, relocation, refurbishing of bank offices, expansion, and automation; and *reforms institutionalization,* which entailed the strengthening of corporate culture and governance, monitoring system, risk management and audit system, and review of product and operating manuals. Particular emphasis was given to the recapitalization strategy, which would have provided the funds needed for the three other points of the rehabilitation (Development Bank of the Philippines, March 2009). In 2012, DBP infused Php1.0 billion capital to AIB, thereby marking the partial completion of the primary strategy (Dimapunong, 2006).

The notes in AIB's 2012 financial statements indicated that the bank will be completely converted into an Islamic bank by the end of its rehabilitation period. However, such conversion is complicated by the difficulty in increasing the assets or deposits, let alone achieving sufficient scale to reach profitability. This situation led the bank to continuously rely on its conventional banking business, thereby preventing it from expanding its Islamic banking business. The macro backdrop of the struggles of AIB is not substantially disheartening. Although the GDP growth in Northern Mindanao slowed down to 5.6% in 2013 compared with the 7.2% pace in 2012, the growth in the banking sector accelerated from 9% to 10.8%.

Islamic Banking: An Overview

The CAMEL rating is a concise and indispensable tool for examiners and regulators (Sandhya, 2014). This tool is beneficial for examining the safety and soundness of banks, as well as facilitates the mitigation of the potential risks that may lead to bank failures. The abrupt increase in banking supervision since the 1980s has inspired the US to develop the CAMEL model to classify the overall wellness of banks. The performance of the banking sector is perceived as the replica of the economy given that a healthy banking system serves as the bedrock of economic, social, and industrial growth (Misra & Aspal, 2013).

Islamic banking and finance goes beyond the interest-free system to promote entrepreneurship, safeguard property rights, and honor contractual obligations and transparent transactions. This system is not the type of financing that caters merely to the needs of the Muslim community. This banking activity is consistent with Islamic principles and assumes a pivotal role worldwide.

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Since its inception in the 1970s, Islamic banking has emerged from being a niche to offering to become part of the mainstream financial services landscape. The latest World Islamic Banking Competitiveness report of Ernst and Young (E&Y) shows that the assets of Islamic banks increased annually at an average rate of 17% between 2008 and 2012. In spite of this positive growth, Islamic banks are not free from the many challenges that may cause the deterioration of their performance.

Islamic Banking: Unveiling the Truth

Given a plethora of varying perspectives, Islamic banking is defined as a banking system that operates in consonance with Islamic teachings. Islam in all its aspects is the underpinning of the Islamic financial system. Ahmad (2000) identified what constitutes Islamic banking as a foundational concept. Accordingly, the Islamic monetary system is the fundamental and sole measure of value, measure of exchange, and standard for deferred payment. This characteristic is what separates the Islamic monetary system from the ethos of conventional fiscal scheme, in which money is not regarded as a commodity in itself, to be sought, sold, and used to beget money. In the Islamic framework, money has to operate through certain real economic activity. Accordingly, money is a tool toward the value-added, production, and promotion of creative entrepreneurship through the physical expansion of the economy. That is, real economic progress and development comprises the expansion of the physical and human aggregates of the economy by way of the creation of assets, products, and services, and not merely in the form of fiduciary expansion. Ahmad further stressed that "Wealth does not create islands of affluence in an ocean of poverty and deprivation. Money never becomes the objective, the hero of the cast. It remains an intermediary and an instrument for real productive effort, for asset creation, for value-added and for expansion of physical economic activity in a manner that benefits all sectors and which participates in the economy as a whole."

The preceding statements lead us to the essential theoretical premise of Islamic banking that *riba* (i.e., usury, which is generally defined as interest or excessive interest) is strictly prohibited in Islam in all its forms. Ahmad (2009) reviewed and assessed the present state of Islamic banking in both in its theoretical and practical aspects. Consequently, Muslim economists have accentuated that it was a historical accident that brought interest as the kingpin of modern banking. The practice of interest has been seized by the foremost thinkers in human society and by all Biblical religions. He further cited that the description of Aristotle as "birth of money from money" triggered the barren nature of money and vehemently condemned the institution of interest. Ahmad also mentioned the case of Judaism, in which the Israelites were forbidden to demand any increase on the principal amount of the sum lent in transactions among themselves, even though interest could be charged in dealings between the Israelites and gentiles. Many scholars of Judaism explained that no law at that time among the gentiles prohibited the practice of interest. Moreover, allowing Jews to recover interest from people who charged interest from them was not regarded as unfair. He also added that the words attributed to Jesus Christ to "lend freely, hoping nothing thereby" (Luke 6:35) is taken by many commentators as a condemnation of interest. However, the Church has gradually altered its doctrine on the subject of interest. Thus, Islam is not alone in prohibiting the institution of interest. Furthermore, Muslim scholars recognize the significant role that banks play in the economy of countries in modern times. The attitude of Islam to all known innovations is that nothing should stand in the way of their adoption if they are beneficial for human society and are not in conflict with the fundamental teachings of the Qur'an and *Sunnah*. Given that banks perform a beneficial service of financial intermediation, these institutions are completely acceptable in Muslim society. However, What is not acceptable from the *Shari'ah* point of view is the use of the interest rate mechanism in the

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process of financial intermediation (Ahmad, 2009).

Principles of Islamic Banking

Alwosabi (n.d) explained that Islamic financial institutions (including Islamic banks) should follow a few basic principles. The first principle is the business framework. In this aspect, the Islamic banking system is based on *Shari'ah* law, thereby ensuring strict adherence to Islamic law, which aims to provide guidance to all financial transactions. The second principle is the prohibition of interest (*riba*). All banking activities must avoid interest in all its forms. "Money does not create surplus value by itself" (Presley & Sessions, 1994, p. 586). The third principle is the prohibition of illicit activities/ commodities. *Shari'ah* controls the engagement of investment companies in activities that are tolerable and consistent with its law. Thus, this situation prevents activities forbidden by Islam, such as liquor manufacturing, gambling, pork producing enterprises, and other related businesses. The fourth principle is uncertainty (*gharar*). Any contract based on future uncertain events that can be avoided, such as hedging and dealing with derivatives, is prohibited. These uncertainties can be avoided but people opt not to. Hence, this situation can result in one party earning at the expense of another. The fifth principle is participation and risk-sharing. Islamic financial institutions offer investors/ depositors participation in risk-sharing packages rather than the fixed interest on deposits. Any risk-bearing instrument that reflects real asset and earning a variable rate of return tied to the performance of the asset is considered consistent with Islamic law. The sixth principle is the contribution to the socioeconomic goal of the Islamic society. The Islamic financial system strives to contribute in achieving the major socioeconomic goals of society. This system stresses the ethical, social, and moral dimensions of wealth creation that enhances equality and fairness for society. The seventh principle is adherence to accounting standards. Islamic financial institutions abide by the accounting standards of the Accounting and Auditing Organizations for Islamic Financial Institutions (AAOIFI). AAOIF was formed in 1988 in Bahrain. The eight principle is the governance of the *Shari'ah* Supervisory Board (SSB). SSB supervises Islamic banks in conducting their financial transactions in accordance with *Shari'ah* law (Alwosabi, n.d.).

Challenges of the Islamic Banking Industry in the 21st Century

Over the past three decades, the Islamic banking industry continues to gradually gain momentum, and rapidly emerges and evolves as a reality of contemporary times. The latest World Islamic Banking Competitiveness report shows that the assets of Islamic banks increased annualy at an average rate of 17% between 2008 and 2012 (Ernst and Young). However, in spite of this positive growth, Islamic banks are not free from the many challenges that may cause the deterioration of their performance. Hence, these issues should be addressed for a positive development with a promising outlook for the future. Karimi (2014) articulated a few of the most important bottlenecks that confront the Islamic banking industry.

Political will

Islamic law provides the legal support through its own framework for the execution of commercial and financial contracts and transactions. The commercial, banking company laws contains that are narrowly defined and prohibit the scope of Islamic banking activities within conventional limits. Accordingly, special laws for the introduction and practice of Islamic banking should be implemented. This legal framework of Islamic banking and finance may contain the following components. *Islamic banking courts*: Disputed cases of Islamic banks are subject to the same legal system and are dealt with the same court and judge as the conventional one, even with the the comletely different nature of the legal system of Islam. To ensure a proper, immediate, and

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supportive Islamic legal system, amendments in the existing laws, which are repugnant to the injunctions of Islam, are required to promulgate *Shari'ah* compliant laws for the resolution of disputes through special courts. *Amendment of existing laws*: Given that Islamic banking has a few resemblance with universal banking, laws and regulations have to be amended accordingly. *Islamic banking law*: In the absence of Islamic banking laws, the enforcement of agreements in courts may require additional effort and costs. Therefore, banking and company laws in several countries require suitable modifications to provide a level-playing field for Islamic banks. Furthermore, the international acceptance of Islamic financial contracts requires them to be *Shari'ah*-compliant and acceptable under major legal regimes, such as the common law and civil law systems.

Equality of Islamic Prudential Regulations and Islamic Banks

At present, the lack of effective prudential regulation is one of the weaknesses of the Islamic banking industry. For example, the leasing prudential regulations are applied to *ijara*, where the nature of both is different, such as taking advances. The bank is the owner in *ijara*; thus, taking advances will render the contract of *ijara* (leasing) for conversion into *musharakah* (partnership) illegal, even though the rules of *ijara* are applied to it. A few Islamic banks use the term of security, thereby making the *ijara* contract non-*Shari'ah* compliant. The reason is that using the deposited sum under the heading of *ijara* security (*rahn*) is nothing but *riba,* which is strictly prohibited by Islam.

Difference in the Nature of Risk in Islamic and Conventional Banking

Precautionary actions must be taken separately for the Islamic and conventional banking systems, such as special prudential, accounting, and auditing standards. Moreover, taking the conventional interest-based benchmarks (LIBOR) as the base of pricing, an Islamic financial product places Islamic banks at the mercy of their conventional peers. A negative perception with no prudent difference in Islamic bank products is created because the products are also using the same interest-based benchmark. Furthermore, *Shari'ah*-based products offered by different Islamic institutions may have different features and subject to different rules. Thus, the lack of standard financial contracts and products can cause ambiguity and can be a source of cost dispute. In addition, the lack of a common understanding on certain basic foundations will hinder the further development of banking products. Moreover, the nature of Islamic banking should be enhanced to facilitate the implementation of real banking activities, such as promoting risk sharing through equity type facilities on the asset side and profit sharing investment accounts on the funding side. Liquidity risk also causes hesitance in entering into long-term transactions due to the lack of liquidation availability through the secondary market. Liquidity support is present in the lender of the last resort facility. However, what is lacking is a proper mechanism for transparency and disclosure to the public to ensure consumer protection as provided by the *Shari'ah*.

Islamic future exchange

In the conventional system, long-term financing is provided through long-term bonds and equities. Apart from the general public, banks, mutual funds, insurance companies, and pension funds are the most important sources of these investments. Islamic banks do not deal with interest-bearing bonds, therefore, they have a considerably high equity market need . Moreover, most of the products in Islamic banks are based on goods and commodities, while prices and currency rates frequently go up and down, This situation creates a huge risk for them, particularly in realty as in the case of *Salam* and *Istisna*. To hedge the risk, they need derivative products and consequently of a future exchange or future market.

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Methodology

This study used the purposive sampling method and focused on AIB as the specific sample. A case study approach was selected to critically analyze the financial condition of AIB and to provide recommendations to improve its financial performance. Research data collected for a five-year period (2009–2013) was deemed sufficient to provide a systematic period of observation and analysis.

This study used secondary data-based research by utilizing library research and content analysis, particularly the CAMEL approach, and converged its objectives of rekindling essential concepts, as well as the current operation of AIB through qualitative and quantitative approaches. The information was gathered and collated from various secondary sources, including journal articles, speeches, books, various websites, and annual reports of AIB.

Results & Discusion

Capital Adequacy Measures

The capital adequacy measures of the bank capital amount is expressed as its risk weighted credit exposure percentage (Sebe-yeboah & Mensah, 2014). It comprises of the capital adequacy ratio (CAR) and equity to asset ratio (EAR). CAR is principally used to determine the strength of a bank to withstand balance sheet shocks. Therefore, CAR is a way to ensure whether the bank is able to absorb reasonable loss level before becoming insolvent.

Table 1 shows the decreasing trend of CAR and EAR over the five-year period, thereby indicating the adverse stability and efficiency of AIB. Hence, AIB will be facing difficulty to absorb losses in the future, and will unlikely be able to protect the depositors.

Table 1. Trend of Capital Adequacy Measures

Ratio	2009	2010	2011	2012	2013
Equity to Asset Ratio	0.65	0.48	0.63	0.62	0.58
Capital Adequacy Ratio	8.73	4.79	2.32	2.04	1.32

Assets Quality Measures

Asset quality remains as one of the key performance indicators of bank assessment. Loans and advances are expected to provide a high percentage of a bank's earnings; therefore, its quality is important to the profitability and survival of a bank (Sebe-yeboah & Mensah, 2014). This parameter evaluates a bank's ability to recover the outstanding loans and advances made in due time.

Furthermore, the percentage of the classified loan to the total loan granted is contemplated as the main ratio for assessing the quality of the assets. Accordingly, this index discloses NPLs to determine the credit risk associated with particular assets. Loans are classified as NPLs when its principal and interest is overdue and unpaid for six months or above from the first day of default (BNM/GP3). Thus, a bank is more vulnerable to bankruptcy with a higher ratio.

Table 2 shows that AIB performs in an extremely negative position. We excluded 2009 because the bank did not extend loans to its clients. However, 2010 to 2013 still reflected it's the bank's difficulty to withstand losses due to NPLs. These trends relayed AIB's incompetence in the industry, its inability to maximize its potential as the only recognized Islamic bank in the Philippines, and the likely failure to transform into a full-fledged Islamic bank.

Even in its NPLs to Equity, AIB also led an increasing trend that affected the quality of the loan and its profitability. The approved five-year rehabilitation plan expected that AIB should have a gradual progressive performance to achieve its mandate. However, it experienced a considerably gradual recovery to resist in the banking industry.

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Table 2. Trend of Asset Quality Measures

Ratio	2009	2010	2011	2012	2013
NPL to Total Loans	0%	100%	99.45%	96.03%	99.82%
NPL to Total Equity	0%	9.85%	32.21%	27.64%	54.87%

Management Efficiency Measures

Management efficiency analysis evaluates the ability of the management to utilize the assets and resources of the bank to achieve profitability and bring up public trust and confidence from its good reputation. Accordingly, a favourable result from a sound management performance rating in all aspects apart from profitability, signals a healthy condition to the stakeholder. However, an unfavorable outcome means a critical situation.

The Php1 Billion cash infusion of DBP in 2009, growth computation to assess management efficiency becomes impractical. However, this huge amount can tremendously affect our analysis. Nevertheless, we will combine the concept of efficiency using the PELARI model, which considers collating and evaluating the bank expenses relative to profitability. Unfortunately, AIB fails to pose a viable operation primarily due to the five-year period losses. Hence, the ratio of net loss to personal services shows that AIB fails to maximize the staff productivity that was expected to contribute to the bank efficiency. This result further led to a domino effect as far as total cost to net loss is concerned.

Table 3. Trend of Management Efficiency Measures

Ratio	2009	2010	2011	2012	2013
Net Income (Loss) to Personal Services	−34%	−74%	−65%	−119%	−77%
Cost to Net Income (Loss) Ration	−110%	−176%	−158%	−237%	−152%

Earnings Performance

Table 4: Summary of Earnings Performance

Ratio	2009	2010	2011	2012	2013
Return on assets	−7	−3	−7	−4	−7
Return on equity	−11	−7	−11	−7	−13
Return on loans	0	−7	−6	−11	−8
Net interest margin	0.03	0	1	2	2
Other operating income to assets	1	3	3	4	1

Profitability in the retained earnings is typically one of the key sources of capital generation. A sound banking system is built on profitable and adequately capitalized banks. Profitability is a revealing indicator of a competitive position in banking markets and of the quality of management. This indicator enables a bank to maintain a certain risk profile and provides cushion against short-term problems. Thus, profitability is the first line of defense against banking loss risks, as well as other losses resulting from credit, interest rate, liquidity, and currency risks.

Furthermore, banks need to make profit like other business entities. At least three main reasons can be identified for the bank profit motive: to provide an appropriate return to the shareholders, to give confidence to depositors that the business is soundly and competently managed, and to maintain and expand the bank capital base. These reasons will satisfy the prudential criteria and facilitate business growth in real terms.

Return on Assets and Return on Equity

These ratios, which are often described as the primary ratios, relate the income earned by the bank to the resources and equity employed to generate income. They also enable us to assess the managerial performance, profitability extent, and measure for the planning and control of AIB. Unfortunately, the weak AIB performance did not generate any return but incurred operation loss over the five-year period. Accordingly, both ratios followed the same fluctuation trends.

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Return on Loans

Loans are the important earning asset banks. The ratio of the interest and fees earned on loans to the total loans is a significant measure of the management ability to price its loan and achieve an optimum loan mix. This asset is a net interest income parameter extended to loans and finances. AIB exhibited a fluctuating trend during the five-year period; however, this result is still insufficient to cope with its requirement, thereby necessitating additional strategies to improve its performance.

Net Interest Margin

This ratio measures the net interest income as a percentage of the average total assets, and indicates the interest income that the bank generates from its earning assets. Fortunately, the increasing AIB trend resulted into a positive outcome. However, this result is still below the standard criterion of at least 4.5%.

Other Operating Income to Total Assets

This ratio relates the other operating incomes to the average total assets, and shows the dependence on the income rather than the (operating) interest earnings on loans. Apparently, the AIB income statements reveal its reliance to other operating incomes, thereby necessitating the enhancement of its status particularly to the main banking operation and not being dependent with auxiliary undertakings.

Table 5: Summary of Liquidity Measures

Ratio	2009	2010	2011	2012	2013
Cash position indicator	0.96	0.91	0.75	0.77	0.64
Capacity ratio	0	0.05	0.2	0.18	0.32
Total deposit ratio	0.17	0.49	0.32	0.32	0.36
Loan to deposit ratio	0	0.1	0.65	0.57	0.88
Reserve Ratio	5.31	1.82	2.27	2.27	1.62

Liquidity Measures

Liquidity is the lifeblood of all business processes (Abdullah, 2010). However, financial institutions, such as AIB, analyze its liquidity ratio (particularly current ratio) differently from other businesses, such as manufacturing and merchandising. One of the essential issues in liquidity management is identifying assets that should be held as a liquidity reserve and can be loaned out.

Asset liquidity measures

Assets liquidity measures facilitate the liquid and non-liquid assets identification in different categories to the total asset volume. These include the cash position indicator (CPI) and the capacity ratio (CR).

CPI is used to compare cash and demand deposits in other banks, including the central bank, to the total asset base of AIB. Results ranged from 0 to 1. Accordingly, the higher index resulted in a considerably strong position to handle cash requirement. AIB showed a relatively favorable result of 0.96 in 2009, but gradually decreased to 0.64 in 2013 primarily due to the significant decrease of the BSP account that covered that period.

CR is stressed as the negative liquidity indicator. This indicator includes liquid assets from the loans granted to clients that cannot be extended to meet financial flexibility and financial obligations (e.g., respond to unexpected opportunities and payment to creditors). Furthermore, CR indicates the extent to which AIB has loaned out its funds. Inversely related to liquidity, a higher CR means lower bank liquidity.

The increasing AIB CR trend from 0 in 2009 to 0.32 in 2013 shows a gradual decrease in the liquidity condition. However, the favorable result in 2009 was not due to efficient loan management but to the start of the rehabilitation plan to transform it into a full-fledged Islamic

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bank, where they did not extend loans to its clients.

Liability liquidity measure

Liability liquidity measure refers to the ease with which AIB can obtain a new debt to acquire cash assets at reasonably low cost. With everything else being equal, raising debt from commercial banks will be considerably easy provided that the bank does not already have most of its transactions financed with short-term commercial borrowing or the so-called purchased funds. For AIB, the purchased fund computation is irrelevant, and a lacking portion of the commercial short-term borrowing is highly sensitive to interest rates and perceived as a credit risk that affects liquidity risk.

The total deposit ratio (TDR) incorporates only the less sensitive deposits with respect to the interest rates change or the minor deterioration in the performance of a bank. Accordingly, the higher TDR resulting in the lower attributable liquidity risks is a favorable result. Unfortunately, AIB started with 0.17 in 2009, increasing to 0.49 in 2010, decreasing to 0.32 in 2011 and 2012, and slightly increasing to 0.36 in 2013, thereby resulting as a negative signal on the bank's liquidity position.

Combined asset–liability ratio

From the name itself, it is the combination of the assets and the liability liquidity measures. This ratio tries to draw the assets and liabilities relationship and how they can affect each other to address liquidity management.

The loan-to-deposit ratio (LDR) is the general liquidity measure which many bank analysts consider. Undeniably, loans are the least liquid assets, while deposits are the principal sources of funds. A relatively high ratio indicates the illiquidity arising from the fully-loaned up and stable funding. By contrast, a low ratio suggests a bank with favourable liquidity, extending new loans financed with stable deposits.

Over the five-year period, AIB experienced a gradual unfavorable outcome, from 0 indices in 2009 to 0.88 in 2013. Even if we excluded 2009, AIB still faced a liquidity dilemma due to increasing loan extension trend relative to the received deposit.

Specific liquidity ratio

The reserve ratio (RR), pursuant to Republic Act 7653 or the New Central Bank Act, indicates that all banks are required to maintain a reserve against their deposit liabilities to control the money volume created by the banking system credit operations. This amount is lodged under due from the BSP (also include the cash infusion received from DBP), thereby resulting to a considerably high ratio of 5.31 compared with those of the succeeding years. Hence, AIB encounters a significant fluctuation of reserves.

Conclusion

This study elucidates the different contributing factors that produced the total AIB condition. We primarily collated its latest five-year audited financial statement that covers 2009−2013. Thereafter, we used the CAMEL rating system to measure the key aspects of the Islamic banking practices. We can conclude that AIB experienced a critical performance. The results of the capital adequacy ratio did not reach the minimum standard of 8%, NPLs were extremely huge, expenses were not properly utilized, losses were deliberate throughout the period, and were deficient to meet the obligations. Along with the increasing growth of the Islamic banking and finance literature, the number of developments sparks the light of comprehension, mobilization, and achievement of the Islamic socioeconomic appraisal. These excellent signals are used for competing in the predominance of conventional banking without tarnishing the realm of Islamic financial practices.

Therefore, we propose the following financial-related recommendations. First, AIB, in its quest to transform into a full-fledged Islamic

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bank, should implement accounting standards promulgated by AAOIFI. These standards specifically cater to the unique transaction characteristics that govern Islamic bank operations. We commend the proper application of the financial statement presentation of Islamic financial institutions. Apart from the usual set of financial statements, the AIB must also report the Statement of Sources and Uses of Qard Fund, Statement of Changes in Restricted Investments, and Statement of Sources and Uses of Zakat and Charity Funds. AIB should disclose the extent of its responsibility with regards to zakat. Second, the application of FRS in the Islamic banking practices guarantees that the recording transactions of AIB are comparable with that of similar conventional banking transactions.

Furthermore, we suggest non-financial related recommendations. First, AIB demands intense human resource empowerment and enrichment. Through this action, the pool of *Shari*"ah and the finance of experts with extensive experience can address the poor corporate governance that are rooted with vast risks. Effectively achieving this factor, the other banking competitive advantages follow, such as market positioning to capture the minds of its current and potential clients. Second, government interventions garnered a plausible factor. Apart from the charter that authorized AIB to operate, there should also be a regulatory and supervisory framework particularly designed in the Philippine context.

Future research can proceed to deeper investigations on the following operational issues relating to the Islamic instruments that cater to the needs of its diverse clients: 1) concrete actions to attune the AIB in the attainment of Islamic economy; 2) *Maqasid Al- Shari'ah* of Islamic banking in AIB, featuring equity and debt-based financing; and 3) accounting-related issues, such as profit and loss scheme arrangements.

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