



**UNIVERSITI KUALA LUMPUR
BUSINESS SCHOOL**

**FINAL EXAMINATION
MARCH 2025 SEMESTER**

COURSE CODE : EBB20603

COURSE NAME : RISK MANAGEMENT IN ISLAMIC FINANCIAL INSTITUTIONS

PROGRAMME NAME : BACHELOR IN ISLAMIC FINANCE WITH HONOURS

DATE : 24 JUNE 2025

TIME : 2.00 PM – 5.00 PM

DURATION : 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. Please **CAREFULLY** read the instructions given in the question paper.
 2. This question paper has information printed on both sides of the paper.
 3. This question paper consists of **TWO (2) Sections; Section A and Section B.**
 4. Answer **ALL** questions in **Section A and Section B.**
 5. Please write your answers on the OMR answer sheet and answer booklet provided.
 6. All questions must be answered in **English** (any other language is not allowed).
 7. This question paper must not be removed from the examination hall.
-

THERE ARE THIRTEEN (13) PAGES OF QUESTIONS, INCLUDING THIS PAGE.

SECTION A (Total :40 marks)**INSTRUCTION: Answer ALL questions.****Please use the objective answer sheet provided.**

1. What is the definition of risk?
 - A) Certainty of profit
 - B) Probability of loss
 - C) Possibility of gain
 - D) Control over future
2. Risk management is primarily about:
 - A) Eliminating all risks
 - B) Identifying and managing risks
 - C) Taking all risks possible
 - D) Ignoring possible losses
3. In risk management, risk is considered a combination of:
 - A) Danger and opportunity
 - B) Loss and profit
 - C) Security and loss
 - D) Insurance and failure
4. Which of the following is NOT a step in risk management?
 - A) Identify risks
 - B) Analyze risks
 - C) Evaluate risks
 - D) Predict future profits
5. What is the objective of risk management?
 - A) Remove all risks
 - B) Minimize unnecessary risks
 - C) Avoid all investments
 - D) Guarantee profits
6. What is the principle of "Al-Ghorm Bil Ghonm" in Islamic finance?
 - A. No reward without risk
 - B. Zero risk, zero profit
 - C. Gambling is allowed
 - D. Only profit is considered

7. In Islam, a return without assuming liability is considered:
- A. Permissible
 - B. Not permissible
 - C. Recommended
 - D. Obligatory
8. Risk with zero profit, like in Wadiah Yad Dhamanah, is:
- A. Permissible
 - B. Prohibited
 - C. Recommended
 - D. Mandatory
9. Which of the following involves excessive risk (Gharar Fahish)?
- A. Mudarabah contract
 - B. Sale of an inexistent thing
 - C. Musharakah financing
 - D. Salam sale
10. What type of risk is NOT permissible in Islamic finance?
- A. Essential risk
 - B. Manageable risk
 - C. Gharar Fahish
 - D. Business risk
11. Which of the below statement is FALSE regarding Islamic banks' practice?
- A. Islamic Bank's operation is guided under the shariah principle and must follow international banking regulations and standards.
 - B. Sound and effective banking supervision are necessary to foster and promote the effective function of Islamic bank operations.
 - C. Islamic Bank did not require additional services or products for having liquidity excess.
 - D. All risk management policies and guidelines for Islamic Bank are governed by the central bank or regulatory authority.
12. The risk accrued for Islamic banks due to the commercial pressure of having to pay a rate of return equivalent to a competitive rate of return and absorb a portion of losses which normally would have been borne by investment account holders in order to prevent massive withdrawal of funds. This statement is known as _____.
- A. equity investment risk
 - B. shariah non-compliance risk
 - C. rate of return risk
 - D. displaced commercial risk

13. Which one of the below falls under systematic risk which deals with regulatory, commodity, regulatory, price, operating, human resources, legal and product risks and it is a law in nature in which its outcome is only known by God with precision and man cannot control.?
- A. Financial risk
B. Credit risk
C. Market risk
D. Business risk
14. _____ arises in the contract of istisna' when the financial institution is not receiving the selling price of the asset from the customer or project sponsor either in pre-agreed stages of completion and/or upon full completion of the manufacturing or construction process.
- A. Price risk
B. Operational risk
C. Credit risk
D. Delivery risk
15. The Shariah risk management function must _____.
- A. establish appropriate risk mitigation measures.
B. report to the board, Shariah committee and senior management on the Shariah non-compliance risk exposures
C. constructively challenge decisions that may give rise to Shariah non-compliance risks
D. All of the above
16. Residual value risk is when _____. This type of risk unique is applicable to _____ contract.
- A. IFI will bear the potential loss due to the fair value of the asset falling below its residual value estimated at lease inception (low fair value), Murabahah
B. IFI will bear the potential loss due to the residual value of the asset falling below its fair value estimated at lease inception (low fair value), Ijarah
C. IFI will bear the potential loss due to the fair value of the asset falling below its residual value estimated at lease inception (low fair value), Ijarah
D. IFI will bear the potential loss due to the residual value of the asset falling below its fair value estimated at lease inception (low fair value), Murabahah

17. Anyone who destroys someone else property, his property should not be destroyed as retaliation, because it could only cause greater injury without any benefit accrued from it. This statement describes the concept of _____
- A. Harm is to be eliminated.
 - B. Harm is repelled as far as possible.
 - C. Repelling of harm is preferred to the attainment of benefit.
 - D. Harm should not be sustained.
18. Which of the following statements is TRUE?
- A. An Islamic Financial Institution must ensure that the oversight and management of the overall Shariah non-compliance risk are structured in a way that the senior officers entrusted with control functions under Shariah governance are able to exercise clear accountability over Shariah non-compliance risk.
 - B. An Islamic Financial Institution shall ensure that the board of directors who perform the review function are qualified to undertake compliance function responsibilities and have a sound understanding of relevant Shariah requirements applicable to Islamic financial business.
 - C. Shariah review refers to a function that provides an independent assessment of the quality and effectiveness of the Islamic Financial Institution's internal control, risk management systems, and governance processes as well as the overall compliance of the Islamic Financial Institution's operations, business, affairs and activities with Shariah.
 - D. None of the above.
19. The common practice for Islamic Banks is by reserving a portion amount of money to absorb the expected losses. However, when such an unexpected occasion happened such default occurs in an exceedingly big amount, and loss of _____ will follows.
- A. Depositors' funds'
 - B. Shareholder's capital
 - C. Investors funds
 - D. All of the above

20. The main responsibility of _____ to validate the policies and procedures, define the risk appetite and establish the risk strategy for the business models adopted.
- A. risk managers
B. shariah auditors
C. board of directors
D. shariah advisory board
21. The income generated from services rendered by Islamic banks in the form of fees or service charges is known as _____.
- A. profit Income.
B. non-financing income.
C. dividend income.
D. return on equity.
22. Generally, when the bank purchases an asset but is unable to sell it above the cost price, the bank suffers a capital loss. This situation best describes as _____.
- A. liquidity risk.
B. market risk.
C. price settlement risk.
D. equity risk.
23. _____ is when the rate of return anticipated is relatively lower than other financial institutions.
- A. Operational Risk
B. Market risk
C. Credit risk
D. Withdrawal risk
24. Business risk is _____.
- A. the potential loss due to the use of a wrong business model which puts capital at risk.
B. the potential loss due to a catastrophic event.
C. the potential loss due to market price volatility.
D. None of the above.
25. _____ gravitate towards investments with extremely high potential return even if the potential for loss is larger.
- A. Risk neutral
B. Risk aversion
C. Risk lover
D. Risk mitigation

26. In a partnership contract, the bank exposes to counterparty risk when _____.
- A. musharakah capital is worth less than its value.
 - B. counterparty loss of the invested asset.
 - C. counterparty withdraws all invested capital.
 - D. musharakah capital is worth higher than its value.
27. _____ are responsible to define the risk appetite acceptable to the business from the business model and strategy adopted as the best function for the bank.
- A. Bank's management committee
 - B. Shariah Risk Committee
 - C. Bank's director
 - D. Bank's depositor
28. In Ijarah, the _____ relishes beneficial ownership, while the ownership risk remains with the _____ throughout the rental tenure.
- A. lessor, lessor
 - B. lessee, lessee
 - C. lessor, lessee
 - D. lessee, lessor
29. Profit rate components levied on financing contracts include of
- A. cost of deposits and inflation risk premium.
 - B. cost of deposits, overheads, and credit risk premium.
 - C. cost of deposits, overheads, inflation risk premium and credit risk premium.
 - D. overheads, inflation risk premium and credit risk premium.
30. Among the objectives of the Shariah, compliance framework is _____.
- A. to prevent all shariah non-compliance risks that arise in banking products, services and activities.
 - B. to facilitate the establishment of the appropriate functional structure to manage risk might expose to shariah issues.
 - C. to establish the process for identifying, measuring, monitoring and controlling of risk.
 - D. to facilitate appropriate shariah asset-liability management approach for income gap mitigation.

31. Which statement is FALSE regarding Basel III?

- A. The introduction of new liquidity requirements.
- B. The purpose of the Basel III introduction is to heighten capital requirements for derivative products.
- C. The capital requirement for common equity remains at 4.5%
- D. The minimum total capital requirement ratio remained at 8%.

32. Which following statement is TRUE regarding Bank Negara Malaysia's key plan for risk management focus area 2020?

- A. The management team of critical functions such as treasury operations, currency management and payment systems must be given priority to perform without any major disruption to ensure business continuity.
- B. Bank Negara Malaysia inculcate cyber security awareness to improve and strengthen information security controls for remote access and information sharing to manage risks associated with working from home.
- C. Bank Negara Malaysia focused on stakeholder management and communication strategies to manage the risks arising from the policies to assist individuals and businesses affected by the pandemic.
- D. All of the above.

33. The major contribution of profit and loss earning for Islamic bank operations is dependent on economic health. Moreover, given a signal of expansion and contraction of economic scenarios Islamic banks also expose to ___ for bank capital management.

- | | |
|-------------------|------------------|
| A. market risk | C. business risk |
| B. financial risk | D. credit risk |

34. Which of the following statement is TRUE implies a negative income gap:

- A. The income gap is negative when Variable Rate Asset (VRA) is lower than Variable Rate Liability (VRL).
- B. The income gap is negative when Variable Rate Liability (VRL) is lower than Variable Rate Asset (VRA).
- C. The income gap is negative when Total Assets (TA) is lower than Variable Rate Asset (VRA).
- D. The income gap is negative when Total Liabilities (TL) is lower than Variable Rate Asset (VRA).

35. The Basel Core Principles document laid out details and proper supervision for banking and financial sectors. The key elements are stated as follows EXCEPT:

- A. An efficient and independent judiciary, and well-regulated accounting, auditing and legal professions
- B. Well-defined rules of governing, and adequate supervision of, other financial and non-financial markets and, where appropriate, their participants
- C. A proper system of business laws which is consistently enforced and provides a mechanism for the fair resolution of disputes
- D. A form of legal entity for investment funds that provides an alternative to the use of a mudarabah contract with a separate legal entity for funds managed by an Islamic bank.

36. In Malaysia, Islamic Financial Institutions (IFI's) need to maintain minimum capital requirements, If the capital adequacy ratio falls below the minimum requirement:

- A. Bank Negara Malaysia may intervene to modify IFI's risk profile or raise new capital for their institutions.
- B. Bank Negara Malaysia may not intervene to modify the IFI's risk profile or raise new capital for their institutions
- C. Bank Negara Malaysia may not intervene if the IFI's risk profile is under control.
- D. Bank Negara Malaysia will always intervene regardless of any situation.

37. Credit risks can be evaluated qualitatively and quantitatively. For Islamic Banks, evaluating customers through the 5Cs of Credit is necessary before granting financing facilities:
- A. Capacity, Character, Collateral, Capital and Condition.
 - B. Capacity, Character, Cash, Cost of fund and Condition.
 - C. Capacity, Character, Collateral, Cost of fund and Condition.
 - D. None of the above
38. Which of the below statement is TRUE?
- A. A high liquidity coverage ratio (LCR) refers to the proportion of illiquid assets held by the Islamic Bank to ensure the ability to meet short-term and long-term obligations.
 - B. Islamic banks need to be sensitive to the amount of Fixed Rate Asset (FRA), Variable Rate Asset (VRA), Fixed Rate Liabilities (FRL) and Variable Rate Liabilities (VRL) they hold.
 - C. A credit risk report uses the Value at Risk (VaR) indicator to measure the impact of the changes in interest rates on a bank's profit.
 - D. A low financing-deposit ratio usually means excess liquidity as opposed to a high financing-deposit ratio.
39. The difference between Islamic credit financing and interest-bearing credit loan is _____.
- A. the former is generated based on the bank's earnings while the latter is generated based on the bank's assets.
 - B. the former is generated from loan-based lending while the latter is generated from asset-based credit financing.
 - C. the former is generated from asset-based credit financing while the latter is generated from loan-based lending.
 - D. None of the above.

40. The purpose of shariah governance outline policy _____.
- A. to monitor credit assessment from granting facility to disbursement preventing shariah non-compliance risk
 - B. to reinforce sound decision-making processes and robustness of internal control functions for effective management of Shariah non-compliance risks
 - C. to reinforce robust capital adequacy requirements for Islamic financial institution management
 - D. All of the above.

(TOTAL : 40 MARKS)

SECTION B (TOTAL: 60 MARKS)

INSTRUCTIONS: ANSWER ALL QUESTIONS.

Please use the answer booklet provided.

Question 1:

Aira has recently been appointed as the Risk Officer at Nasrul Islamic Bank. To carry out her role effectively, she must understand the different types of risks associated with Shariah-compliant financing.

Discuss the major risks associated with Murabahah and Salam contracts. Explain how these risks arise and describe appropriate mitigation strategies with examples for each contract to help Aira understand the scope of risk in Islamic banking.

[20 Marks]

Question 2:

Airin Islamic bank has the following on its balance sheet:

- Fixed Rate Assets (FRA): RM600 million
- Flexible Rate Assets (RSA): RM80 million
- Fixed Rate Liabilities (FRL): RM250 million
- Variable Rate Liabilities (RSL): RM520 million

a) Calculate the GAP between RSA and RSL.

[2 Marks]

b) If the profit rate increases by 1.5%, calculate the expected change in net income.

[2 Marks]

c) Briefly explain whether this is a positive or negative GAP and what it implies.

[2 Marks]

Value at Risk (**VAR**) is a statistical measure used to estimate the potential loss of a portfolio or investment over a specific time frame, given a certain confidence level. It is widely used in financial risk management to quantify and control the level of risk exposure.

- d) From your point of view, explain **THREE (3)** key components of VAR and **THREE (3)** applications in Islamic Risk Management. [6 Marks]
- e) Define market risk and explain why it is significant in Islamic financial institutions. [4 Marks]
- f) Identify and briefly describe two types of market risk that Islamic banks face, along with an example of a contract affected by each. [4 Marks]
- [20 Marks]

Question 3:

Hajar Islamic Bank Statement of financial position as of 31 December 2024

Assets / Liabilities and Equity	2024 ('000)	2023 ('000)
Cash	2,000	2,800
Treasury placements	260,000	390,000
Home purchase plan	1,250,000	1,210,000
Commercial property finance	710,000	590,000
Investment securities	130,000	180,000
Property and equipment	8,000	10,000
Intangible assets	4,500	5,200
Deferred tax assets	8,000	6,000
Other assets	6,000	5,500
TOTAL ASSETS	2,378,500	2,399,500

Liabilities and Equity	2024 ('000)	2023 ('000)
Deposits from banks	100,000	40,000
Deposits from customers	2,000,000	2,000,000
Subordinated funding	30,000	30,000
Sukuk funding	0	150,000
Other liabilities	18,000	15,000
TOTAL LIABILITIES	2,148,000	2,235,000
Share capital	125,000	125,000

Contingent investment	3,500	3,500
Share premium	0	55,000
Revaluation reserve	-1,000	800
Retained earnings	98,000	-29,000
Profit stabilisation reserve	100	100
TOTAL EQUITY	225,600	155,400
TOTAL LIABILITIES & EQUITY	2,378,500	2,399,500

Assume that 85% of the Commercial Property Plan is in the form of Murabahah Tawarruq financing portfolio with 30 years' tenor. The Probability of Default (PD) for Murabahah Tawarruq financing is estimated at 28%. Given total balance outstanding for Commercial Property Plan is 75% at the end of year 2024.

Based on Hajar Islamic Bank's financial statement 2024, answer the following:

a) Calculate the Exposure at Given Default (EAD) for each year (2023 and 2024).

[4 marks]

b) Calculate the Collateral Value (Recovery Amount) and the Loss Given Default (LGD) for each year (2023 and 2024), given that the collateral value is only 35% of the outstanding amount at default. Show your working step by step.

[4 marks]

c) Calculate the Expected Loss (EL), Unexpected Loss (UL), and Total Loss (TL) for each year (2023 and 2024).

[12 marks]

[20 Marks]

Total = 60 marks

END OF EXAMINATION PAPER