World Economics & Finance Bulletin (WEFB)
Available Online at: https://www.scholarexpress.net
Vol. 20, March 2023
ISSN: 2749-3628,

THE ROLE OF THE CAPITAL ADEQUACY INDEX OF THE CAMELS STANDARD IN ACHIEVING THE REQUIREMENTS OF BANKING GOVERNANCE, A STUDY OF A SAMPLE OF IRAQI COMMERCIAL BANKS

Assist. Prof AkeelDakheel Kareem(1)
aqeel2017@mu.edu.iq
https://orcid.org/0000-0002-3151-6830
RuselGhalibUhmedy(2)
resl.ghalb.fin.msc@mu.edu.iq
Al-Muthanna University, College of Administration and Economics(1,2)

Article history:

Received: 4th January 2023
Accepted: 4th February 2023
Published: 8th March 2023

Abstract:

Purpose: The research aims to define the capital adequacy index and the standard ratio determined by the Central Bank of Iraq based on and in line with the decisions of Basel 3, and the role of this indicator in protecting depositors' money as well as evaluating the performance of banks with the capital adequacy index and indicating its impact on achieving the requirements of banking governance.

Theoretical Framework: Researching the role played by the capital adequacy index of the CAMELS standard in measuring the ability of banks to achieve the requirements of banking governance. It should not be less than 12%, which leads to disable part of the own funds that banks seek to invest.

Design/Methodology/Approach: The inductive method was relied upon in defining the research problem by asking the following questions: Is the use of the capital adequacy ratio indicator of the CAMELS standard consistent with the objectives of the banks? Does the use of the capital adequacy ratio indicator of the CAMELS standard fulfill the requirements of banking governance To convert from the general to the private as well as relying on the deductive method in order to convert from the private to the general by stating the role played by the capital adequacy index of the CAMELS standard in measuring the ability of banks to achieve the requirements of banking governance.

Hypothesis: Banking governance systems constitute one of the basic tools that help commercial banks build the right start for them in the work, as this study focused on knowing the use of the capital adequacy ratio according to the indicators of the CAMELS standard and the extent of its contribution to achieving the requirements of banking governance .

Research Practical & Social implication: With the possibility of commercial banks being exposed to liquidity risks, the need to adopt the CAMELS evaluation standard and banking governance by the study sample banks through the formation of a committee from within the bank that evaluates the bank on an annual basis and finds standard ratios targeted according to the components of the standard and adherence to the principles of banking governance, and for the purpose of determining The most important and most prominent weaknesses that the bank suffers from, and work to take corrective measures that will reduce these points, as well as identifying the strengths that are the positives that characterize the bank and then work to strengthen and sustain them in the future .

Implications/Originality/Value: The CAMELS evaluation criterion is one of the comprehensive criteria that assess banks from all financial and administrative aspects, especially the quality and quantity of them, predicting

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Vol. 20, March 2023
ISSN: 2749-3628,

risks before they occur, and the possibility of using it to evaluate banks on an annual basis or for several years

Keywords: CAMELS standard, capital adequacy, banking governance, banking risks.

INTRODUCTION

The rapid progress and tremendous development witnessed by banking systems around the world led to the emergence and spread of various problems produced by the banking business as a whole. Banking is the globalization of financial markets and the emergence of many financial products that have led to limiting the effectiveness of traditional tools aimed at ensuring and stabilizing the banking system, (Cargill, 2017). Measures and activities aimed at controlling risks and ensuring that management implements the necessary internal control procedures to overcome these risks, as the effective governance of institutions and banks emphasizes ensuring the accuracy of financial reports and the effectiveness of internal control procedures through a set of foundations and measures that are used to manage the institution or bank from The inside. The interest in banking governance has increased in many developed and emerging economies during the period For the past few decades, as a result of economic collapses, (Abd, Kareem, & Kadhim, 2019) therefore, banking governance finds increasing interest due to its importance in sparing institutions and banks the risks of stumbling and administrative and financial failure through the CAMELS standard capital adequacy index that is capable of detecting cases of manipulation, corruption and mismanagement, in addition to the essential role represented in Avoiding banks falling into accounting problems that lead to subsequent collapses, (Rozzani, 2013).

LITERATURE REVIEW:

First: The emergence and development of the Camels standard: The United States of America is one of the first countries to use the CAMELS standard, due to the banking crises it was exposed to in 1933, according to which more than 4,000 local banks were declared bankrupt, and this was one of the reasons for the establishment of the Bank Deposit Guarantee Corporation, as The entire banking system was exposed to a crisis of loss of confidence, which made the public withdraw their deposits from the banks, then a similar collapse occurred in 1988 that led to the collapse of 221 banks , (Prefontaine, 2013).and Iraq, like other countries, faced difficult situations, especially with regard to the system The Iraqi banker, therefore, was in dire need of a banking evaluation system similar to other countries, so the period that followed 2003 witnessed important developments in the banking system as a result of the great changes that prevailed in the country and the transformation of the Iraqi economy from a central economy to a market economy, and the banking system had to keep pace with this development, (Ali, Abd, & Kareem, 2020) Hence the need for the Central Bank of Iraq to adopt the most important regulatory and supervisory standards recognized regionally and internationally, which is the CAMELS banking evaluation standard to achieve banking safety, and the Central Bank of Iraq designed this The standard and began to apply its standards as of 2007, but it excluded the index (sensitivity to market risks) according to the conditions of the country, and dealt with other indicators so that (CAMEL) five indicators are the weighted criteria in evaluating and classifying Iraqi banks, and the Central Bank of Iraq applied this standard in two stages , (Merciful, 2014)

The first stage : related to the creation of a banking the legal environment through the instructions and publications issued by the Central Bank of Iraq, especially with the decisions and recommendations of the Basel I Committee regarding capital adequacy, as it obligated private banks to work to raise their capital, as the Central Bank deliberated by holding seminars and circulating publications to Creating banking awareness , (Penikas, 2015)

The second stage: here the indicators of the evaluation standard (CAMEL) were entered into actual application for the first time in Iraq by the Central Bank of Iraq and it began to apply its indicators to private banks officially as of 2007, (Abbas, Abd, & Kareem, 2020)as all private banks were subject to evaluation and classification in that year, and the bank The Central Bank of Iraq has actually applied CAMEL indicators to all private banks for the years, (Johansson, 2012)

Second: The concept of the CAMELS standard: The CAMELS standard is one of the early warning standards for banking crises in cases where the banking system is at risk. It leads to the collapse of the bank if the Central Bank does not intervene to save it ,and he defined it as a set of indicators through which the financial position of any bank is analyzed and the degree of its classification is determined. regulators in America to take the results of CAMELS and rely on them in decision-making, (Harzi, 2011) This criterion contains six indicators that can be mentioned as follows:

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Table (1) Indicators of the CAMELS standard

Symbol	Meaning of symbol in English
C	Capital Adequacy
A	Asset Quality
M	Management
E	Earnings
L	Liquidity
S	Sensitivity to Marketer

Source: Prepared by the researcher based on (Mohammad, 2014: 342)

Third : The concept of capital adequacy: The bank's capital adequacy is defined as the amount of capital that secures the bank from various risks, and the extent of its ability to face crises in a way that does not expose the financial position to the line, and is part of the liquidity to face losses that may occur in the future, thus providing protection for the bank. Capital adequacy reflects the bank's ability to achieve its safety and financial stability, in other words, to provide the volume of liquidity required to face events that may occur in the future, (Jenkins, 2018) The Central Bank of Iraq has developed a mechanism for calculating the capital adequacy ratio. Money, after making a change in the ratios based on the reality of the Iraqi banking system, and it is applied to the assets items inside and outside the bank's budget for the purpose of weighting their amount and accessing the risk-weighted assets that depend on calculating the capital adequacy ratio by keeping a ratio of not less than 15%, (Dreca, 2013). which It was later reduced to 12% of the risk-weighted assets, and it is calculated on the basis of the consolidated budget for each of the general administration and branches of the bank inside and outside Iraq, and the financial institutions affiliated to the bank, provided that the amount of private funds is not less than For the amount of capital specified under the Banking Law, (Cargill F. T., 2017) with the right of the Central Bank of Iraq to impose a higher capital adequacy ratio for any bank if necessary ,

Fourth: The concept of banking governance: Banking governance is one of the most important modern topics in the financial and accounting field, and this is at the micro-economic level, (Kadhim , Abd, & Kareem, 2020). and given that banks represent an essential element for the development of the national economy, it must be developed and preserved from collapse based on guaranteeing the interests and objectives of all parties dealing with and with them, (Delahaye, 2011)The concept of banking governance in general refers to the standards and rules that define the relationship between the management of banks on the one hand, and stakeholders and shareholders or related parties (bondholders, workers, suppliers, creditors and consumers, (Hopt, 2020)

MATERIAL AND METHODOLOGY

The capital adequacy ratio (CAR) of the study sample banks can be calculated and analyzed by dividing the total capital in the banks by the total risk-weighted assets according to the following equation:

$CAR = TC/(RWA) \times 100\%$

Since:
CAR: capital adequacy ratio
TC: total capital
RWA: Risk Weighted Total Assets

The CAMELS standard has classified capital adequacy by placing different weights ranging from (2-10%), which are as follows:

Table (2) shows the capital adequacy weights according to the CAMELS standard

Classification degree	CAR capital adequacy	Classification description
1	15 % ≤ greater than or equal to	Good and strong capital
2	Greater or equal to 12-14.99%	sufficient capital
3	Less than 8-11.99%	Insufficient capital
4	7.99% less than 7-	Significantly insufficient capital
5	Less ≥ 6.99%	Critically insufficient capital

Source: Prepared by the researcher based on (Dreca, 2013: 12)

Table (1)below:
First :it appears from
* The capital adequacy ratio (CAR) in the study sample banks: varies from one year to another, due to the variation in the total capital, as well as the decrease or increase in risk-weighted assets relative to the total capital, so this ratio shows the extent of the banks' ability to The use of the total capital to face the losses that the bank may be exposed to as a result of dealing with risky assets. The risks to which investment and credit activities are exposed through the decrease in the ability of the total capital to cover the risks, and vice

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Vol. 20, March 2023
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versa when the ratio rises, the banking risks decrease, and there is a direct relationship between the increase in capital adequacy and the increase in the total capital.
* The capital adequacy ratio: It was different at the level of one bank: the capital adequacy ratio in the Bank of Baghdad reached (232%) as a maximum during 2018 and (94%) as a minimum during 2016, with an annual average value of (160%) , which is higher than the standard ratio set by the Central Bank of Iraq by about (148%), issued in the year (2004), as it determined it by no less than (12%) of the total value of the specified assets and on the basis of risk considerations, and also higher than the standard ratio set by the Committee Basel is about (150%), which stipulates the need for banks to maintain a percentage of not less than (10.5%) of the total assets weighted by risk weights, and that the capital adequacy ratio covers risky assets in all years of the study by more than the specified ratio for capital adequacy, as well as The standard of the Central Bank of Iraq and the standard of the Basel Committee, but maintaining a percentage that exceeds the required rate has adverse effects on the amount of profits achieved, which is the freezing of large funds in exchange for low-risk assets.
* And that the Middle East Bank, the capital adequacy ratio was growing regularly during the study period during the period from (2016) to (2021), due to the continuous growth in the total capital for the aforementioned period, as the capital adequacy ratio reached a higher limit (96%) during In 2017 and (61%) as a minimum during 2016, with an annual average of (85%), which is higher than the standard percentage set by the Central Bank by about (73%), and also higher than the percentage set by the Basel Committee on Banking Supervision by about (75%), and to evaluate these ratios, they are all good because the capital adequacy ratio covers risky assets in all years of study by more than the specified ratio for capital adequacy and avoiding risky investments.

Table (1) Comparison of the results of calculating the capital adequacy ratio (CAR) (million dinars)

sequences	Year / value	RWA(2)	TC(1)	CAR(2/1)(3)
	Baghdad Bank			
1	2016	304033	286724	%94
2	2017	265614	282736	%106
3	2018	231823	536677	%232
4	2019	258947	276358	%107
5	2020	134502	288469	%214
6	2021	154440	317420	%206
average				%160
sequences	Year / value	RWA(2)	TC(1)	CAR(2/1)(3)
Middle East Bank				
1	2016	378825	275989	%73
2	2017	286758	274205	%96
3	2018	326421	270660	%83
4	2019	319638	270007	%84
5	2020	311319	268262	%86
6	2021	307503	266622	%87
average				%85

Source: prepared by the researcher based on the study sample

Second: For the purposes of assessing capital adequacy in the banks of the study sample: the general average of the capital adequacy ratio in the Bank of Baghdad, with an average rate of (160%). and financial risks, followed by the Middle East Bank with the lowest average percentage compared to other banks during the study period, as the average percentage for the bank was (85%). Table (2) below shows this:

Table (2) Classification of the capital adequacy ratio for the study sample banks

Classification degree	Bank place from Category	achieved percentage	CAR capital adequacy	Classification description
1	Baghdad Bank Middle East Bank	160 % 85%	greater than or equal to 15%	Good and strong capital

Source: prepared by the researcher based on the study sample

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CONCLUSIONS

The Bank of Baghdad and the Middle East Bank fall within the first (strong) classification in terms of the degree of classification for the capital adequacy ratio, as the Bank of Baghdad achieved a ratio of 160% and the Middle East Bank a ratio of 85%, which is a percentage that exceeds the specified percentage of 15% according to the CAMELS standard. Strong capital in relation to the total risk of the bank. A bank within this level is characterized by good management, high levels of growth, capital levels exceeding all regulatory requirements, strong profit performance, increased specialization, and management's ability to analyze and measure the risks associated with its activities and determine capital levels. appropriate and achieves reasonable profits in addition to the ability to raise new capital, and through the foregoing, it can be said that the Commercial Bank of Iraq, according to the ratio of capital adequacy, has fulfilled the requirements of banking governance.

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