

# STRATEGY AND IMPLEMENTATION OF RISK MANAGEMENT IN ISLAMIC BANKING IN A SHARIA APPROACH TO FINANCIAL STABILITY

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**Abstract:** This study discusses the strategy and implementation of risk management in Islamic banking with a sharia approach to achieve financial stability. Risk management in Islamic banking has special characteristics that are different from conventional banking, especially in terms of compliance with sharia principles that avoid haram elements such as usury, gharar, and maysir. This study identifies various types of risks faced by Islamic banks, including credit, liquidity, market, operational, and legal risks, as well as mitigation strategies applied to reduce their impacts. The main focus of this study is the analysis of how the application of sharia principles can be the basis for formulating effective and sustainable risk management policies. This study also examines the relationship between the application of sharia-based risk management and financial stability, both at the individual bank level and the banking system as a whole. The results of the study indicate that the integration of sharia-based risk management not only improves the performance of Islamic banks but also contributes to the stability of the wider financial system, by maintaining a balance between economic benefits and social sustainability.

**Keywords:** Manajemen Risiko, Perbankan Syariah, Stabilitas Keuangan, Prinsip Syariah, Risiko.

## INTRODUCTION

Islamic banking is one of the sectors that is growing rapidly in Indonesia, along with the increasing public awareness of the importance of transactions in accordance with sharia principles. Islamic banking does not only focus on achieving economic profit, but also on the application of ethical and moral values contained in Islamic teachings, such as justice, transparency, and sustainability. Therefore, in managing banking operations and products, Islamic banks must comply with the provisions stipulated in sharia, such as the prohibition of usury (interest), gharar (uncertainty), and maysir (gambling), which makes risk management in Islamic banking have different characteristics from conventional banking.

Risk management is a very important aspect in banking operations, including in Islamic banking. Every financial institution, including Islamic banks, faces various types of risks that can threaten operational continuity and financial stability. The risks faced by Islamic banks include credit risk, liquidity risk, market risk, operational risk, and legal risks related to non-

compliance with sharia principles. Therefore, it is important for Islamic banks to have the right strategy in managing and mitigating these risks, so as not to have a negative impact on the performance and reputation of the bank and the stability of the financial system as a whole.

In addition, the sharia approach to risk management presents its own challenges. Islamic banks must ensure that every decision and policy taken not only prioritizes the economic aspect, but also complies with Islamic law that governs every transaction and banking activity. This requires a deep understanding of sharia principles and their application in risk management activities that can face external and internal risk challenges, both under normal conditions and during economic crises.

Financial stability created through effective risk management is very important, not only for the sustainability of the Islamic bank itself, but also for the stability of the national financial system. In this context, Islamic banking has a very strategic role in maintaining a balance between financial benefits and social sustainability, which ultimately contributes to broader economic stability.

This study aims to analyze the strategy and implementation of risk management in Islamic banking with a sharia approach, and how it can contribute to financial stability. By delving deeper into the challenges, strategies, and risk management practices implemented by Islamic banks, it is hoped that this study can provide useful recommendations for the development and improvement of risk management performance in the Islamic banking sector in Indonesia.

### **Types of Risks Faced by Islamic Banking**

Islamic banking faces various types of risks that can affect operations and financial stability, which are different from conventional banking. One of the main risks faced is credit risk, which arises when the debtor fails to fulfill payment obligations for the financing provided, such as mudharabah, musyarakah, or murabahah. This risk requires careful management in assessing the feasibility of financing and monitoring the performance of the debtor. In addition, liquidity risk is also a concern, where Islamic banks must ensure that they have sufficient funds to meet short-term obligations without sacrificing Islamic principles, such as the prohibition of usury transactions. Operational risk is related to disruptions that can occur in the operational process, such as human error, system failure, or fraud. Islamic banks also face market risk, which arises from fluctuations in market prices, currency exchange rates, or interest rates that can affect the value of assets and liabilities. In Islamic banking, market risk must be carefully managed to remain in accordance with Islamic principles that avoid speculation or high-risk transactions. In addition, legal risks are also a challenge, especially related to non-compliance with sharia provisions or changes in regulations governing the sharia banking industry, which can affect the sustainability of bank operations. Therefore, sharia banks need to have an effective risk management strategy to address these risks in order to maintain financial stability and comply with sharia principles.

### **Risk Management Strategies Implemented by Islamic Banks**

Islamic banks implement various risk management strategies to manage potential risks faced in their operations, while adhering to sharia principles. One of the main strategies is diversification of the financing portfolio, which aims to spread risk by providing financing to various sectors or types of businesses, so that banks do not rely on one type of financing that is vulnerable to risk. To manage liquidity risk, Islamic banks ensure adequate funds by

carefully managing cash and liquidity reserves, and using sharia money market instruments and sukuk as alternatives to maintain cash stability. In dealing with operational risks, Islamic banks implement a strong internal control system, including the use of technology to minimize human error, and conduct regular training for employees to ensure that every operational process runs according to established standards. To manage market risk, Islamic banks avoid speculative transactions that are not in accordance with sharia principles, and focus on products that are based on productive and real activities. In addition, sharia supervision by the Sharia Supervisory Board (DPS) is also an important strategy to ensure that all transactions and products offered by the bank always comply with applicable sharia provisions. By implementing these strategies, Islamic banks strive to mitigate existing risks, maintain financial stability, and ensure the sustainability of bank operations in the long term.

### **Implementation of Sharia Principles in Risk Management for Financial Stability**

The implementation of sharia principles in risk management can significantly improve the financial stability of Islamic banks and the financial system as a whole in several ways. First, sharia principles require Islamic banks to avoid transactions that contain elements of *riba* (interest), *gharar* (uncertainty), and *maysir* (gambling). By avoiding these elements, Islamic banks reduce their exposure to speculative risks that can cause uncertainty and high volatility in the financial market. This makes Islamic banking more stable and less vulnerable to financial crises caused by speculation or extreme market fluctuations.

Second, sharia principles that emphasize fairness and balance in transactions encourage Islamic banks to manage risk in a more careful manner and based on productive financing. Financing provided by Islamic banks is not only oriented towards financial profit alone, but also towards sustainability and positive social impacts. Therefore, Islamic banks are more likely to provide financing to projects that can provide added value to the real economy, so that credit risk can be better managed.

In addition, sharia principles also require Islamic banks to maintain transparency and honesty in every transaction, which contributes to operational risk management. By ensuring that every transaction is carried out openly and in accordance with clear rules, Islamic banks can reduce legal and operational risks arising from non-compliance with regulations or errors in the transaction process. Supervision by the Sharia Supervisory Board (DPS) also plays an important role in maintaining compliance with sharia principles, so that Islamic banks avoid legal problems that can damage their reputation and stability. By implementing sharia-based risk management, Islamic banks contribute to the stability of the financial system as a whole. Because Islamic banks avoid speculative transactions and focus more on productive financing based on real assets, Islamic banking has greater resilience to market fluctuations and global financial crises. This not only increases the stability of Islamic banks themselves, but also supports the stability of the wider national financial system, by creating a more sustainable and ethical financial ecosystem. Thus, the application of sharia principles in risk management not only improves the financial stability of Islamic banks, but also strengthens the stability of the financial system as a whole.

### **Challenges in Implementing Sharia-based Risk Management**

Islamic banking faces several significant challenges in implementing sharia-based risk management. One of the biggest challenges is the limited financial instruments that can be used to manage risk, especially market and liquidity risk, because Islamic banks cannot use conventional derivative instruments that contain speculative elements. To overcome this,

Islamic banks can develop sharia financial instruments such as sukuk and use the sharia money market to maintain liquidity. Another challenge is the limited human resources who have dual competencies in sharia and risk management. The solution is to provide continuous training for employees and strengthen the role of the Sharia Supervisory Board (DPS). In addition, Islamic banking also faces the challenge of changes in regulations and government policies that can affect risk management. For this reason, Islamic banks must monitor existing policies and adapt to changes that occur. The challenges of technology and information systems are also quite large, because the adoption of technology that is in accordance with risk management needs often requires large investments. To overcome this, Islamic banks need to implement efficient technology-based systems and collaborate with sharia fintech. Finally, public perception of the security and stability of Islamic banks is also an obstacle. Therefore, Islamic banks need to improve public literacy and education about the Islamic banking system and its advantages in managing risk. Thus, Islamic banks can overcome these challenges and implement effective risk management to support long-term financial stability.

Risk management in Islamic banking plays an important role in ensuring financial sustainability and stability, not only for the bank itself, but also for the financial system as a whole. Along with the rapid development of the Islamic banking industry, the strategy and implementation of sharia-based risk management are key to maintaining stability and avoiding losses that can damage the integrity of Islamic banks. One of the main aspects of Islamic banking risk management is the application of sharia principles that require banks to avoid transactions that contain elements of *riba* (interest), *gharar* (uncertainty), and *maysir* (gambling), which can increase the potential for losses and instability in the financial system. Islamic banks face various risks that require special attention, such as credit risk, liquidity risk, operational risk, market risk, and legal risk. Credit risk in Islamic banking is more related to the quality of the financing provided, because Islamic banks must ensure that financing in the form of *mudharabah*, *musyarakah*, or *murabahah* can be fulfilled by debtors in accordance with their obligations. Therefore, Islamic banks apply strict prudential principles in assessing the feasibility of financing and monitoring customer developments so that the risk of default can be minimized. Liquidity risk is also a major concern, because Islamic banks must maintain a balance between short-term and long-term obligations, and ensure that there are sufficient funds to meet customer demand without sacrificing sharia principles. In dealing with this risk, Islamic banks utilize sharia money market instruments and sukuk to maintain adequate liquidity.

### **Challenges in Implementing Sharia-Based Risk Management**

The implementation of sharia-based risk management has a significant positive impact on the sustainability and financial performance of Islamic banks. By adopting sharia principles that avoid speculative transactions, usury, and *gharar*, Islamic banks can reduce exposure to high risks and maintain financial stability in the long term. Effective risk management, such as diversification of financing portfolios and prudent liquidity management, helps Islamic banks avoid potential major losses that could threaten operational continuity. In addition, by maintaining compliance with sharia principles, Islamic banks can strengthen customer trust, which in turn can increase loyalty and attract more investment. The implementation of sharia-based risk management also encourages banks to focus on productive financing and the real sector, which contributes to a more stable and sustainable

economy. This not only improves the financial performance of Islamic banks but also has a positive impact on the financial system as a whole, as Islamic banks tend to avoid risky practices that can cause market instability. Thus, sharia-based risk management plays an important role in strengthening the sustainability of sharia banks and ensuring stable and healthy financial performance.

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Legal risk is also an important concern, because non-compliance with sharia principles or applicable regulations can damage the reputation of Islamic banks. Therefore, strict supervision by the Sharia Supervisory Board (DPS) is very necessary to ensure that every transaction carried out by Islamic banks is in accordance with sharia provisions. In an effort to manage these risks, The risk management strategy implemented by Islamic banks focuses on the principles of prudence, transparency, and diversification. One of the most important strategies is the diversification of the financing portfolio, which helps Islamic banks to reduce dependence on one type of sector or certain type of financing, so that credit risk can be better distributed. Islamic banks also implement a liquidity risk mitigation strategy by managing cash and liquidity reserves carefully and utilizing Islamic market instruments. In addition, Islamic banks also maintain a diversity of financing and investment products that support productive sectors, avoiding sectors that are high risk and not in accordance with Islamic principles. The implementation of this Islamic-based risk

management has a major positive impact on financial stability. By avoiding high-risk transactions that are not in accordance with Islamic principles, Islamic banking contributes to the creation of a more stable and sustainable financial system.

## CONCLUSION

The implementation of sharia-based risk management in Islamic banking plays a very important role in ensuring financial stability both at the bank level itself and in the financial system as a whole. By implementing sharia principles that avoid elements of speculation, usury, and uncertainty, Islamic banks can minimize risks that can threaten the continuity of their operations and maintain a balance between profitability and economic sustainability based on the values of justice. Risk management strategies such as diversification of financing portfolios, careful liquidity management, and strict supervision of operations and transactions in accordance with sharia principles have been proven to have a positive impact on the performance and stability of Islamic banks. Furthermore, stable Islamic banking contributes to the resilience of the global financial system, by creating a more sustainable and ethical economic ecosystem.

However, Islamic banking must also continue to face challenges, such as limited sharia financial instruments, lack of competent human resources, and rapid regulatory changes. Therefore, it is important for Islamic banks to continue to innovate, improve Islamic financial literacy, and collaborate with regulators and related parties to overcome these challenges. Thus, Islamic banking can continue to grow, become more resilient, and play an important role in creating stability and sustainability in the global financial system.

## SUGGESTIONS

Islamic banking needs to continue to improve the quality of human resources (HR) who have competence in the field of sharia and risk management. Continuous training and education programs are very important to ensure that bank staff have a deep understanding of sharia principles and the ability to manage risk effectively. In addition, Islamic banking must innovate in developing more efficient sharia financial instruments, such as sukuk or sharia derivative products, to better manage market and liquidity risks. Strengthening the role of the Sharia Supervisory Board (DPS) is also crucial to ensure that every transaction and product offered is in accordance with sharia principles. In addition, Islamic banks need to be more adaptive to regulatory changes issued by regulators by building closer relationships with authorities to participate in the formation of policies that support the development of this sector. Finally, it is important to expand sharia financial education and literacy to the public so that they better understand the benefits and advantages of sharia banking in creating sustainable economic stability. With these steps, Islamic banking can continue to develop, face existing challenges, and contribute to maintaining the stability of the global financial system.

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