

MANAGING RISK IN THE MODERN ERA: RISK MANAGEMENT PRACTICES IN ISLAMIC BANKING

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Abstract: This literature study aims to analyze the risk management practices of Islamic banking in this modern era. This is discussed in the context of data taken from books, scientific journals, research reports, and recent articles that reveal that Islamic banking faces all kinds of unique risks, including Shariah compliance, operational, liquidity, and technological risks. The modern, digital and global era has also given rise to new threats in cybersecurity and a constantly changing regulatory environment. Therefore, a holistic and innovative risk management approach is needed that will integrate Shariah principles with the help of artificial intelligence and blockchain technology. Furthermore, effective management integration of all operational units of Islamic banking is needed to ensure stability and sustainability in an environment characterized by changing dynamics.

Keywords: Islamic Banking, Risk Management, Modern Era

A. Introduction

The modern era is marked by technological developments, globalization, and the complexity of increasingly dynamic economic systems. Against this backdrop, risk has become an unavoidable factor in various industries, including the banking industry. Digital transformation, product innovation and the interconnection of the global financial system have brought new opportunities and challenges to the banking industry. Islamic banks, as part of a financial system based on Islamic principles, face pressure to remain relevant and competitive amidst rapid change. Therefore, risk management is one aspect in Russia; maintaining the stability, sustainability and operational compliance of Islamic banking operations.

Islamic banks face various complex risks in their operations. Between 1992 and 1998, there was only one Islamic bank in Indonesia. This number increased to three in 1999 and six units in 2000, including Islamic business units owned by conventional banks. Public awareness of the usury-free system encouraged the growth of Islamic banking. Conventional and Islamic banks have similar products, but differ in their systems. Conventional banks use interest, while Islamic banks apply profit sharing through products such as mudharabah and musyarakah.

As institution finance , Islamic banks face increasingly complex operational risks along with the development of industry . Banks need to manage risk in a way as a whole , including

risk child company , to adapt to change operational environment . Management risk must consistent with Sharia principles to ensure operational continuity.

Risk management in sharia banking it has characteristics unique which distinguishes it from conventional banking . This is due to the implementation of sharia principles that forbid usury (interest), gharar (uncertainty), and action immoral . In contrast , Islamic banks use instrument finance based on partnership, sell buy , and rent use business , which own complexity risk In practice , Islamic banking is faced with various type risks , including financing , liquidity risk , operational risk , and risk Sharia compliance . Managing these risks requires an approach that not only integrates Sharia principles but also leverages modern technology and data analytics.

In addition, the modern era also brings changes in regulations and stakeholder expectations towards the banking industry. Financial authorities in various countries have increased supervision of risk management in financial institutions, including Islamic banking. This challenge is exacerbated by the global pandemic and economic crisis that require financial institutions to be more resilient in managing uncertainty. In the context of Islamic banking, this challenge requires a proactive, innovative, and sharia-compliant risk management approach.

B. Literature Review

In the framework of this research, a literature review was compiled based on the theories that are the basis of this research. In addition, this research also involves interviews, and literature review is carried out through research journals, both national and international.

Risk Management Concept

Risk management is a systematic process aimed at identifying, evaluating, and managing risks that can affect the achievement of organizational goals. This process includes risk identification, impact assessment, selection of mitigation measures, and evaluation of the effectiveness of risk management. In Islamic banking, risk management does not only focus on economic aspects, but must also be in accordance with sharia principles such as fairness, transparency, and adherence to Islamic values. Good risk management implementation involves various parties, including management, employees, and even regulators to ensure that all potential risks can be minimized. Risk management in banks involves several main stages:

- 1. Risk Identification** : Assess and identify various types of risks that may affect bank activities, such as credit, market, liquidity, operational, as well as legal and reputational risks.
- 2. Risk Assessment and Analysis** : After the risks are identified, the next step is to analyze the level of potential loss and impact of each risk.
- 3. Risk Control** : Implementing mitigation strategies to reduce or avoid these risks, either through internal controls, use of derivative instruments, or establishment of appropriate policies.
- 4. Monitoring and Evaluation** : Continuously monitor emerging risks and evaluate the effectiveness of the mitigation measures that have been implemented.

In Islamic banks, risk management must also include compliance with sharia principles, which prohibit practices that are contrary to Islamic law, such as gharar, riba, and maysir. Therefore, risk management in Islamic banks is more complex, because it involves financial risks and sharia compliance risks that must be managed carefully. With the rapid development of technology and globalization, risk management in banking must now also consider risks related to cyber security and rapid regulatory changes. This increasingly requires a holistic and innovative approach to ensure that banks can survive in an increasingly dynamic and challenging environment.

Differences between Conventional and Sharia Banking Systems

Conventional banks and Islamic banks have fundamental differences in their basic operational principles. Conventional banks operate with an interest system, where profits are obtained from interest charged on loans and deposits. In contrast, Islamic banks operate based on sharia principles that prohibit usury (interest), and prioritize the concept of profit and loss sharing. Products offered by Islamic banks such as mudhrabah and musyarakah reflect this principle, which focuses on a fairer risk sharing between the bank and the customer.

In terms of risk management, conventional banks rely more on derivative instruments and insurance to manage interest rate and credit risks. On the other hand, Islamic banks face additional risks such as sharia compliance risks, in addition to financial risks. However, due to the profit-sharing principle, risk sharing is more balanced between banks and customers, which can provide greater resilience to economic turmoil. With the challenges of globalization and digitalization in the modern era, both conventional and Islamic banks need to adapt a more innovative risk management approach to maintain financial and operational stability.

Operational Risk in Islamic Banks

Operational risk is one of the main challenges faced by Islamic banks, including the risk of compliance with sharia principles. Operational risk covers various aspects, such as human error, system failure, and legal risk. Managing operational risk requires the implementation of strong internal controls, regular employee training, and regular evaluation of operational compliance with sharia principles. Unlike financial risk, which is related to market, credit and liquidity risks, operational risk is more related to internal management and factors that affect the bank's day-to-day performance.

In addition, Islamic banks also face challenges in managing efficient operational systems and processes, as well as ensuring protection of customer data and the information technology systems used. External events such as natural disasters or regulatory changes can also affect the smooth operation of banks. Effective operational risk management in Islamic banks requires strict supervision of sharia compliance, strengthening internal systems, and readiness to face external risks and threats of digitalization. In Islamic banks, operational risks can arise from several aspects, including:

- 1. Compliance with Sharia Principles** : One of the main challenges of Islamic banks is to ensure that all operational activities and products offered are always in accordance with

sharia principles. Sharia compliance risks include errors in the implementation of sharia contracts, products that are not in accordance with Islamic law, or non-compliance with fatwas from sharia supervisory institutions.

2. **Human Resources** : Islamic banks also face operational risks that arise from human factors, including procedural errors, lack of adequate training, or failure to manage human resources consistently. Errors in transactions involving Islamic financing or products can cause losses.
3. **Internal Processes and Systems** : Inefficient or failure-prone operational systems and processes in IT systems that handle transactions or payments can put you at risk of financial and reputational loss. Good risk management should include close oversight of internal systems and procedures.
4. **External Events** : Operational risk can also be triggered by external events, such as natural disasters, regulatory changes, or political instability. Although these factors are often beyond the bank's control, Islamic banks need to prepare contingency plans to mitigate the impact of unforeseen events.

With the development of digital technology and increasing threats to information systems, Islamic banks also need to focus on managing operational risks related to cyber security and protecting customers' personal data.

Risk Management in the Modern Era

The modern era brings new challenges in risk management, such as technology risks and data security. The digitalization of banking services creates new opportunities and risks, such as cyber security threats and customer data leaks. Islamic banks need to adopt the latest technology, such as the use of artificial intelligence and blockchain, to improve the effectiveness of risk management while strengthening customer trust.

Islamic banking, in particular, faces challenges in ensuring that all operations remain in accordance with sharia principles amidst the ever-evolving market dynamics. In this case, risk management is not only concerned with managing financial risks, but also with ensuring that all products and services offered are in accordance with Islamic law. In the digital era, Islamic banking also needs to strengthen its technological infrastructure and manage risks related to information systems, such as data leaks and cyber attacks. Therefore, Islamic banking must integrate a holistic and innovative approach to risk management to remain relevant and sustainable amidst these rapid changes.

Implementation of Consolidated Risk Management

The implementation of consolidated risk management refers to an integration approach where all bank units or branches, both at individual and group levels, implement uniform and coordinated risk management policies and procedures. In the context of Islamic banking, consolidation of risk management aims to optimize risk management across operations, ensuring that risks are managed in a structured and comprehensive manner, and in accordance with Islamic principles.

In practice, consolidated risk management involves the integration of various types of risks including market, credit, liquidity and operational risks into an integrated management system. In Islamic banks, this also means that sharia compliance risks, such as violations of sharia principles (riba, gharar, maysir), must be managed simultaneously with other financial risks.

Consolidation of risk management provides benefits in the form of more effective monitoring of potential risks across the organization, reduced redundancy in risk management, and greater efficiency in implementing mitigation policies and strategies. In addition, it also allows Islamic banks to be more responsive to changes in market conditions and the external environment that can affect operations and sharia compliance.

In the modern era, with digitalization and increasing reliance on technology, the implementation of consolidated risk management is becoming increasingly important. Integrated information systems and data-based supervision enable faster and more accurate risk management, which is critical to the sustainability of Islamic banking operations amidst ever-changing dynamics.

C. Method

This study uses a literature study approach to analyze risk management practices in Islamic banking in the modern era. Literature studies are conducted by collecting, reviewing, and analyzing various relevant references from books, scientific journals, research reports, and current articles that discuss risk management in Islamic banking and its application in a global context and the challenges faced by Islamic banks in managing risk in the digital era and globalization.

D. Results and Discussion

Risk Management Concept

Management risk is a process for identify , assess , manage , and monitor risks that can occur influence continuity And bank stability . In Islamic banks , management risk No only covers risk financial , but also compliance to principle sharia , such as prohibition usury And gharar . In modern era context , management risk must consider risk new emerging from development technology And globalization , including threat security cyber And change rapid regulation .

Differences between Conventional and Sharia Banking Systems

Conventional banks rely on interest as a source of profit, while Islamic banks operate under Islamic principles that prohibit usury and implement profit sharing. This difference has direct implications for how both types of banks manage risk. Conventional banks are more likely to rely on derivatives and insurance to mitigate risk, while Islamic banks must consider Islamic compliance risks in addition to other financial risks. Therefore, Islamic banks are expected to face additional challenges in ensuring compliance with Islamic principles in every aspect of their operations and products.

Operational Risk in Islamic Banks

Operational risk in Islamic banks refers to potential losses resulting from failures in systems, processes, or human factors that affect bank operations. In addition to the general operational risks faced by banks in general, Islamic banks also face risks related to compliance with sharia principles, such as violations of Islamic law relating to inappropriate products or transactions.

Risk Management in the Modern Era

The modern era brings great challenges to risk management, especially with the advancement of technology and globalization. Islamic banking, in addition to managing traditional financial risks, must also face new challenges such as cyber security, changes in global monetary policy, and systematic risks that can affect banking stability. Therefore, risk management in Islamic banks must be increasingly holistic and adaptive to face these challenges.

Implementation of Consolidated Risk Management

The implementation of consolidated risk management aims to integrate various types of risks into one coordinated management system. This approach allows Islamic banks to monitor and manage risks more efficiently across units and branches. In addition, the implementation of this consolidation also strengthens supervision of sharia compliance, ensuring that all bank operations remain in accordance with Islamic law while facing external challenges, such as regulatory changes and digital threats.

E. Conclusion

Risk management in Islamic banking has unique characteristics because it applies sharia principles that prohibit usury, gharar and unethical activities. With the development of the modern era marked by digitalization and globalization, Islamic banks face new challenges, including cybersecurity threats, data leaks, and regulatory changes. To manage these risks, Islamic banks must adopt a holistic approach that integrates sharia principles with modern technologies, such as artificial intelligence and blockchain.

In addition, the implementation of consolidated risk management, namely the integration of risk management across all bank units, is important to ensure efficiency, sharia compliance, and rapid response to external changes. This also provides an advantage in facing global challenges, including economic crises and pandemics. With a proactive and innovative approach, Islamic banks can ensure sustainability, relevance, and operational stability amidst a dynamic business environment.

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