

EFFECTIVENESS OF RISK MANAGEMENT POLICIES IN ISLAMIC BANKS: A QUALITATIVE ANALYSIS OF PRACTICES IN INDONESIA

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Abstract: Risk management is a key element of banking, including the sharia-based financial system. The challenges faced by Islamic banking include not only general risks such as liquidity and credit, but also risks related to compliance with sharia principles. This gives the characteristics of risk management in Islamic banks different from conventional banks. The purpose of this study is to analyze the effectiveness of Islamic bank risk management policies through a qualitative approach. By exploring the challenges and best practices in this field, it is hoped that this study can provide relevant recommendations to policy makers and practitioners of Islamic banking in Indonesia. This study uses a literature study research methodology that focuses on collecting, processing and analyzing data from various literature and secondary sources. Risk management in Islamic banking is very different from conventional banking. A comprehensive approach that incorporates the values of Maqasid al-Sharia will help Islamic banking gain a global competitive advantage while maintaining public trust in the sharia-based financial system.

Keywords: Risk Management, Management, Islamic Banking, Conventional Banking, Finance.

Introduction

Risk management is a key element of banking, including the sharia-based financial system. The challenges faced by sharia banking include not only general risks such as liquidity and credit, but also risks related to compliance with sharia principles. This gives the characteristics of risk management in sharia banks different from conventional banks. Risk management in sharia banks not only aims to reduce financial losses but also maintains the integrity of sharia principles which are the fundamental basis of its operations. Therefore, the effectiveness of risk management policies plays an important role in ensuring the stability and public trust in the system (Siregar & Wahyuni, 2020).

As a country with the largest Muslim population in the world, Indonesia has great potential to become a global Islamic financial center. However, the Indonesian Islamic banking industry still faces many challenges, one of which is the high level of non-performing financing (NPF) which is often higher than the conventional banking industry. One of the main reasons is that the profit-sharing financing model is riskier than the fixed interest rate system. According to Chalimi (2024), the strategy for mitigating the risk of non-performing financing in Islamic banks needs to be continuously adjusted and improved to be more effective in reducing the NPF level.

In addition, the success of Islamic banking risk management is also influenced by the regulations implemented by the Indonesian Banking and Financial Services Authority (OJK). Although these regulations provide basic guidelines, their implementation in the field

is often not fully appropriate due to a number of factors, including limited human resources and lack of technical understanding among Islamic banking staff. A study conducted by Nastiti and Cupian (2024) shows that integration between regulations and business practices is still a major challenge for many Islamic banks in Indonesia. This reflects the need for a more comprehensive approach to assessing risk management policies.

In addition, organizational culture and sharia-based governance also play an important role in determining the effectiveness of Islamic bank risk management policies. According to Syarifuddin (2010), the success of implementing risk management often depends on the extent to which Islamic values are internalized in the organizational culture. In addition, the lack of internal accountability and weak risk governance are significant obstacles. Therefore, in-depth research is needed to understand the extent to which organizational culture influences the implementation of these policies in this area.

The purpose of this study is to analyze the effectiveness of Islamic bank risk management policies through a qualitative approach. By exploring the challenges and best practices in this field, it is hoped that this study can provide relevant recommendations to policy makers and Islamic banking practitioners in Indonesia. In addition, the results of this study are expected to be a reference for regulators to develop a more adaptive framework that is in line with industry needs.

Literature Review

Risk Management Concept

Risk management includes a series of actions that need to be taken to emphasize risks that reduce the adverse effects that may arise in a business. Actions that can be taken to manage these risks are carried out by:

1. Risk Determination

The risk determination process involves identifying all potential risks that may arise in an activity or business. Risk determination is the first step in risk management and is crucial to be carried out carefully so that the risks detected can be anticipated and avoided. Some steps in risk determination are as follows:

- a. Determine the elements related to the activities or efforts being carried out
- b. Identifying risks that may arise in each element
- c. Knowing the sources of risk that can arise both from within and outside
- d. Measure the level of risk for each possibility by conducting an evaluation.

2. Risk evaluation

The risk evaluation step is the process of assessing previously identified risks. Several steps in risk evaluation are as follows:

- a. Identify the potential effects that may occur from each identified risk.
- b. Determining the chance of the effect occurring
- c. Measuring the level of risk by means of
- d. multiplying the potential effects and the probability of occurrence
- e. Establish risk priorities based on the level of risk and potential impacts that exist.

3. Risk management strategy design

The risk management strategy design step is the process of determining the right approach to reduce, move, or avoid what has been identified. Some steps in the risk management strategy design are as follows:

- a. Set risk priorities based on the level of risk and potential impact.
- b. Determine the goals and targets to be achieved in risk management

- c. Develop risk management strategies that are appropriate to the risk characteristics and available resources.
 - d. Develop an action plan for each risk to be controlled, reduced, or transferred.
 - e. Implement risk management methods and evaluate the effectiveness of each method.
4. Strategy implementation
- The process of implementing a risk management strategy includes steps to carry out the chosen strategy to reduce, divert, or avoid risks that have been identified and evaluated. Some steps in implementing a risk management strategy are as follows:
- a. Identifying the resources needed to implement risk management strategies
 - b. Distribute available resources to each required action
 - c. Carry out the steps that have been prepared in the action plan for each risk
 - d. Monitor and evaluate the activities of the actions that have been carried out
 - e. Adjust the steps taken if necessary to achieve the goals and objectives that have been set.
5. Monitoring and Evaluation
- The monitoring and evaluation steps in risk management are a process to ensure that the strategies that have been implemented are successful in reducing, diverting, or avoiding risks that have been identified and assessed. Some steps in monitoring and evaluating risks are as follows:
- a. Monitor the performance results of the risk management strategies that have been implemented.
 - b. Collecting data on new risks and updating risk assessments
 - c. Determine whether risks that have been addressed still require further action or if there are new risks that must be addressed.
 - d. Determine whether there have been changes in the external environment
 - e. Re-evaluate the risk management strategy and update it if necessary.

Risk Management in Sharia Perspective

Risk management in the perspective of sharia focuses on risk management in accordance with the principles of Islamic law, which include justice, transparency, and social responsibility. In this context, concepts such as *gharar* (uncertainty), *maysir* (gambling), and *riba* (interest) are avoided in business transactions and risk management. Uncertain or excessive risks, such as in transactions that contain speculation or ambiguity, are considered invalid in Islam. Therefore, sharia risk management seeks to ensure that any risks faced can be accepted in a fair manner and do not harm other parties. The emphasis on clarity in every business contract is key to avoiding uncertainty that can cause unfair losses to one party (Abdullah & Hossain, 2020).

In addition, in sharia risk management, the implementation of the *takaful* system (sharia insurance) is one of the main mechanisms in risk mitigation. *Takaful* operates based on the principle of mutual assistance among participants, which distinguishes it from conventional insurance that contains elements of *gharar* and usury. In *takaful*, participants agree to provide protection to each other against risks faced, such as natural disasters or accidents, with funds collected together. The emphasis on the principle of mutual assistance is in line with social values in Islam that emphasize shared welfare. Thus, *takaful* is one of the risk management models that is in line with sharia principles (Hassan & Ali, 2018).

Risk management from a sharia perspective also includes attention to broader objectives, namely achieving *maqasid al-shariah* (the objectives of sharia), which include protection of religion, life, mind, descendants, and property. In this case, sharia risk management not only aims to minimize financial losses, but also to maintain the welfare of

the community and maintain socio-economic sustainability. This approach leads to a more holistic risk management, where every decision taken must consider the long-term impact on society and the environment. Therefore, companies that operate according to sharia principles are expected to not only focus on economic profit alone, but also on making a positive contribution to the welfare of humanity (Khan & Bhatti, 2021).

Sharia Banking Regulatory Policy

The Islamic banking regulatory policy in Indonesia is designed to ensure that Islamic banking operations are in accordance with Islamic principles and support the stability of the national financial system. The main legal basis governing Islamic banking is Law No. 21 of 2008 concerning Islamic Banking, which regulates the establishment, management, and supervision of Islamic banks in Indonesia. In addition, this regulation regulates Islamic banking products that must comply with principles such as the prohibition of *riba* (interest), *gharar* (uncertainty), and *maysir* (gambling). To ensure that these principles are implemented, Bank Indonesia and the Financial Services Authority (OJK) play a role in issuing various detailed regulations and guidelines.

At the operational level, Islamic banks in Indonesia are required to have a Sharia Supervisory Board (DPS) which functions to supervise and ensure that all banking activities carried out by the bank do not conflict with sharia principles. DPS has a very important role, including providing fatwas and recommendations related to products and services offered by Islamic banks. OJK also has the task of strict supervision of Islamic banks, both in terms of sharia compliance and financial performance. OJK issues various regulations such as OJK Regulations (POJK) to maintain the smoothness and integrity of the Islamic banking industry.

In addition to product regulation and supervision of sharia compliance, sharia banking policy also covers aspects of development and innovation. The Indonesian government through Bank Indonesia and OJK encourages the development of more inclusive sharia banking services, for example by facilitating the implementation of sharia financial technology (fintech) and expanding public access to sharia-based financial services. The goal is to create a more modern, efficient, and accessible sharia banking ecosystem for all levels of society. This policy is not only to meet the financial needs of Muslims, but also to strengthen the Indonesian financial sector as a whole by utilizing sharia principles that can support sustainable economic development. To obtain relevant journal references related to sharia banking regulatory policies in Indonesia, here are some journals that can be used as sources:

Practical Challenges in Risk Management Implementation

Risk management is an important framework in organizations to identify, analyze, and manage risks that can affect the achievement of strategic objectives. However, its implementation often faces various practical challenges. One of the main challenges is the lack of understanding and awareness of the importance of risk management at all levels of the organization. Many employees or managers see risk management as an additional task, so they do not give it full attention or adequate resources. In fact, successful implementation requires cross-functional collaboration and full support from top management.

Another challenge is limited resources, whether in terms of finance, time, or manpower. Organizations often struggle to allocate budget for training, technology, or software that supports the risk management process. In addition, the lack of quality data and adequate analytical tools can hinder effective risk identification and mitigation. In some cases, organizations also face resistance to changing work cultures to be more proactive in managing risk, especially if there are no clear incentives or short-term benefits.

External factors such as regulatory changes, dynamic market conditions, and global economic uncertainty also pose significant challenges. Organizations must continually adapt to these changes in the external environment, which are often difficult to predict. This requires flexibility in the risk management framework, but many organizations do not have a system that is responsive enough. This combination of internal and external challenges requires a holistic and innovative approach to implementing risk management to ensure business continuity and the achievement of organizational goals.

Qualitative Approach in Risk Management Evaluation

Qualitative approaches in risk management evaluation are often used to understand the complexities and dynamics involved in identifying, assessing, and mitigating risks in organizations. This approach focuses more on collecting descriptive data, which allows researchers or practitioners to explore the factors that influence risk management decisions and actions. According to Wiegmann et al. (2007), qualitative approaches allow for in-depth analysis of decision-making processes in the context of uncertainty and complexity, and provide richer insights into how individuals and groups within an organization understand and manage risk. This approach is also useful in exploring subjective perspectives that may not be revealed through quantitative approaches.

In risk management evaluation, qualitative approaches can be conducted through in-depth interviews, focus group discussions, and direct observation. This method allows researchers to gain a more holistic understanding of individual perceptions and experiences related to the risks faced by the organization. Research by Soini et al. (2011) shows that in-depth interviews with stakeholders in the organization can reveal various types of risks that may not be visible through quantitative data, such as reputational risk or operational risk arising from internal policies. This approach provides the flexibility to explore broader nuances in risk management that cannot always be mapped numerically.

However, although the qualitative approach has the advantage of providing in-depth and contextual insights, it also has some limitations, especially in terms of generalizability of the findings. According to Creswell (2014), qualitative analysis often relies on subjective interpretations of researchers, which can lead to bias or limitations in the validity of the findings. Therefore, in risk management evaluations, qualitative approaches are often combined with quantitative approaches to ensure stronger validity and reliability of the findings. This mixed approach allows researchers to leverage the strengths of both approaches in providing a more comprehensive picture of risk management within the organization.

Method

This study uses a literature study research methodology that focuses on collecting, processing and analyzing data from various literature and secondary sources. The purpose of this method is to evaluate the effectiveness of risk management policies based on theories, regulations and past research findings. This study is based on primary sources such as official policy documents of the Financial Supervisory Agency (OJK), fatwas of the Indonesian National Sharia Council and the Indonesian Ulema Council (DSN-MUI), and annual reports of Indonesian Islamic banking . In addition, secondary sources such as academic journals, books, articles, and reports from academic databases are also analyzed to obtain a comprehensive understanding of the status of risk management practices.

Results and Discussion

Results

Characteristics of Sharia Risk Management

- Aims not only to reduce financial losses but also to support compliance with Sharia principles such as avoiding Gharar (uncertainty), Maysir (gambling) and riba (interest).
- Integration of Maqasid al-Syariah values, including protection of religion, life, descendants and property.

Internal and external problems

- High levels of non-performing financing (NPF), especially in the profit distribution system.
- Human resources, technical knowledge, and data and analysis tools are limited.
- Corporate cultural resistance to the changes necessary to implement risk management.

Relationship with regulation

- The regulations implemented by the OJK and the Sharia Supervisory Board still face obstacles in their integration into business practices.
- The role of Takaful as a Sharia-based risk mitigation solution that emphasizes the principle of mutual assistance.

Evaluation methods

- A qualitative approach based on a review of literature and policy documents will be used to analyze the effectiveness of the intervention.

Discussion

Risk management in Islamic banking is very different from conventional banking. The general norm is to interpret the occurrence of risk in accordance with the nature and value system of Islam. The main step towards implementation is risk identification, which involves steps in which internal and external sources of risk are identified, their relevance is considered, and mitigation measures are developed to address them.

The approach in OJK regulation, for example, the requirement to have a Sharia Supervisory Board (DPS), has been quite good in setting its basis. However, the implementation still faces challenges due to the lack of expertise of vicious circle staff and allocation of all kinds of resources. This basically means continuous learning and technological innovation.

On the other hand, the Takaful system is an important risk reduction solution as an alternative to traditional insurance. However, the success of its implementation is highly dependent on the internalization of Shariah values in a strong organizational and management culture.

Qualitative approaches such as in-depth interviews and observations show that risks such as reputational or operational risks are often not visible due to quantitative data. To conduct a more comprehensive analysis, a combination of quantitative and qualitative methods is needed.

Conclusion

Risk management in Islamic banking is not only an effort to control financial risks but also to ensure compliance with Islamic principles. Key challenges such as high levels of non-performing funds, resource constraints, and lack of organizational awareness require an innovative and comprehensive approach.

The integration of regulation and business practices should be strengthened through training, Shariah-based governance, and technological innovation to support effective risk management. A comprehensive approach that incorporates the values of Maqasid al-Sharia will help Islamic banking gain a global competitive advantage while maintaining public trust in the Shariah-based financial system..

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