RISK MANAGEMENT IN INDONESIA ISLAMIC BANKING

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ABSTRACT

Islamic banks will always be faced with various types of risks with varying complexity and embedded in various business activities. This underlines the importance of implementing risk management in Islamic banking by identifying, measuring, and controlling various risks that will be faced. There are ten types of risks inherent in Islamic banks, credit risk, market risk, operational risk, liquidity risk, compliance risk, legal risk, reputation risk, strategic risk, return risk, and investment risk. The application of risk management in Islamic banks must be adjusted to the objectives, business policies, size, and complexity of the business as well as the bank’s capabilities. Business complexity is the diversity in the types of business network product/service transactions. Meanwhile, bank capabilities include financial capacity, supporting infrastructure, and human resource capabilities.

Keyword: Risk Identification, Risk Management

1. INTRODUCTION

Bank is a financial institution that functions as an intermediary between the surplus and deficit parties. In carrying out this function, of course, banks are faced with various risks in the activities carried out. Islamic banks as intermediary institutions that carry out their business activities with sharia principles and in line with the external and internal banking environment are experiencing rapid development, will always be faced with various types of risks with varying levels of complexity and inherent in their business activities.

In the banking context, risk is a potential event, both predictable and unpredictable and has a negative impact on bank income and capital. These various risks cannot be avoided, but can be managed properly and controlled. Therefore, Islamic banks as banking institutions in general, of course really need a series of procedures and methodologies that can be used in terms of identifying, measuring, monitoring, and controlling risks arising from business activities, or what is commonly referred to as risk management.

The rapid development in the banking world, both in the external and internal banking environment, which is followed by the increasingly complex risk of banking business activities, thereby increasing the need for sound bank governance practices (Good Cooperate Governance) and the application of risk management which includes active supervision of bank management, policies, procedures and determination of risk limits, as well as the internal control system. The great benefits of implementing risk management will have an impact on both banks and bank supervisory authorities. For banks, the benefits of implementing risk management are increasing share holder value, providing an overview to bank managers regarding the possibility of bank losses in the future, improving methods and systematic decision-making processes based on the availability of information, used as a basis for more accurate measurements of bank performance, to assess the risks inherent in relatively complex instruments or bank business activities and to create a robust risk management infrastructure in order to improve bank competitiveness. (Rivai 2013:28)

Islamic banking which is experiencing rapid development of the external and internal environment of Islamic banking has resulted in the risk of sharia banking business activities being increasingly complex. Banks are required to be able to adapt to the environment through the implementation of risk management in accordance with Sharia principles. In its application, the principles of risk management in Islamic banking in Indonesia are directed in line with the standard rules issued by the Islamic Financial Services Board (IFSB). The application of risk management in the Islamic banking environment is adjusted to the size and complexity of the business as well as the Bank’s
capabilities. Bank Indonesia stipulates this risk management rule as a minimum standard that must be met by BUS and UUS so that Islamic banking can develop it according to the needs and challenges faced but still be carried out in a healthy, consistent, and in accordance with Sharia Principles, (Yanuardin: 2020).

The economic crisis that hit in mid-1997 caused the practice of risk management to become a concern in Indonesia. This is the background of the importance of risk management in financial institutions, including Islamic banking. Islamic banks are required to be able to effectively manage the risks they face. With risk management that is managed optimally, it will have an impact on increasing public trust and credibility and the existence of Islamic banks.

2. LITERATURE REVIEW

2.1. Risk Management

Risk is the potential loss due to the occurrence of a certain event. Based on the Circular Letter of Bank Indonesia No. 13 of 2011, risk is an obstacle in achieving a goal. In the banking context, risk in the banking context is a potential event, both predictable and unpredictable, which has a negative impact on bank income and capital.

Risk management in Islamic banking is an effort made by Islamic banks to regulate and monitor risks with the aim of minimizing risk so that the targeted results can be achieved in an effective and efficient manner (Arifin, 2006). As stated in PBI Number 13/23/PBI/2011, risk management is a series of methods and procedures used to measure, identify, and control risks arising from the business activities of Islamic banks. The essence of risk management implementation is the adequacy of risk management procedures and methodologies so that the bank's business activities can still be controlled at acceptable and profitable limits for the bank, but given the differences in market structure conditions, size and complexity of the bank's business, there is no one universal risk management system for all banks. so that each bank must build a risk management system in accordance with the function and organization of risk management at the bank (Yanuardin, 2020).

The implementation of risk management reflects the assessment of the adequacy of the risk control system, which determines the effectiveness of the implementation of bank risk management against the principles of implementing rim management. The adequacy of the risk control system. The objectives of risk management according to Karim (2013:225) are:

a) Provide information about risks to regulators;

b) Ensuring that the bank does not suffer an unacceptable loss;

c) Minimizing losses from various uncontrolled risks;

d) Measuring risk exposure and concentration;

e) Allocating capital and limiting risk

According to Bank Indonesia based on PBI Number 13/23/PBI/2011, policies in risk management are as follows:

a) Determination of Risks related to banking products and transactions;

b) Determination of the use of measurement methods and Risk Management information systems;

c) Determination of limits and determination of Risk tolerance;

d) Determination of Risk rating assessment;

e) Preparation of contingency plans in the worst conditions;

f) Determination of the internal control system in the application of risk management

2.2. Characteristics of risk management in Islamic banking

Islamic banks have a very significant difference when compared to conventional banks. Law Number 7 of 1992 concerning Banking has other alternative forms besides conventional banks which are known to the public as banks based on the principle of profit sharing. Law Number 7 of 1992 concerning Banking does not explicitly use the term Islamic bank at all. But still using the term "principle of profit sharing". There are no clearer provisions regarding banks conducting business activities based on sharia principles. since July 16, 2008 with the promulgation of Law Number 21 of 2008 concerning Banking, the existence of new sharia banking has gained a strong foundation, hereinafter referred to as the Sharia Banking Law.

In general, the risks faced by Islamic banking are relatively the same as those faced by conventional
b) The management process is seen in accounting operational systems and procedures and chart of accounts (CoA), information technology operational systems and procedures, book closing operational procedures systems, and product development operational systems and procedures;

b) Human Resources;

c) Technology is seen in the business requirement specifications for profit-sharing-based financing and business requirements specifications for third party funds;

d) The external environment can be seen in the existence of a dual regulatory body, namely Bank Indonesia and the National Sharia Supervisory Board.

2) Risk assessment looks at the relationship between probability and impact, or what is known as the Qualitative Approach.

3) Risk Anticipation, including:

a) Preventive, namely Islamic banks require DPS approval to prevent mistakes in transaction processing from the sharia aspect. Islamic banks also require an opinion and even a DSN fatwa if Bank Indonesia views the DPS as inadequate or outside its authority;

b) Detective, namely supervision covering banking aspects by Bank Indonesia and sharia aspects by DPS;

c) Recovery, namely correction of an error involving Bank Indonesia for the banking aspect and DSN for the sharia aspect;

d) Risk Monitoring does not only cover the management of Islamic banks but also the sharia supervisory board.

2.3. Types of Risks in Islamic Banking

There are 10 (ten) risks that must be managed by Sharia Commercial Banks and Sharia Business Units in the Implementation of Risk Management. These types of risks are credit risk, market risk, operational risk, liquidity risk, compliance risk, legal risk, reputation risk, strategic risk, return risk, and investment risk (Bank Indonesia Regulation No. 13/23/PBI/2011 concerning the Implementation of Risk Management for Islamic Commercial Banks and Sharia Business Units).

2.3.1. Financing/Credit Risk Management

The Financial Services Authority (Otoritas Jasa Keuangan) still uses the term credit risk related to the implementation of risk management for Islamic Commercial Banks and Sharia Business Units. The application can be found in POJK No.65/POJK.3/2016 regarding the Implementation of Risk Management for Islamic Commercial Banks and Sharia Business Units. In its business activities, Islamic banking cannot be separated from risks that can disrupt the continuity of the bank. To manage these risks, banks are of course required to implement risk management both individually and in a consolidated manner. Based on the characteristics of products and services in the Islamic banking industry, the functions of identification, measurement, monitoring, and risk control are required in accordance with sharia banking business activities.

In general, credit risk and financing risk are not much different. One of the differences is the interest system in conventional financial institutions, and profit sharing in Islamic financial institutions. Financing risk is the risk due to the failure of customers or other parties to fulfill their obligations to financial institutions in accordance with the agreed agreement. One of those included in the financing risk group is the risk that arises due to the concentrated provision of funds to one party or group of industry, sector and certain geographic areas that has the potential to cause substantial losses and can threaten the business continuity of financial institutions. The main cause of credit risk is that it is too easy for banks to provide loans or make investments because they are too required to take advantage of excess liquidity, so that credit assessments are less accurate in anticipating various possible business risks being financed (Arifin, 2009: 263).
According to Arifin (2013:263), credit risk can be reduced by limiting the credit decision authority for each loan, based on its capability (authorize limit) and limit on the amount of credit that can be given to certain businesses or companies (credit line limit), as well as diversifying. To minimize the possibility of financing losses according to Rianto (2013:109), the following techniques are needed:

- Rating model for individual financing;
- Management of the financing portfolio;
- Collateral;
- Cash flow monitoring;
- Recovery management;
- Insurance

In the practice of Islamic banking, there are various types of transactions that take place in the financing contract. Some of these transactions are buying and selling transactions that are applied in murabahah contracts and profit sharing transactions that are applied in musyarakah contracts and mudharabah contracts.

In a murabahah contract, the Bank buys goods and then resells them to the customer at the cost of goods that will be added to the agreed margin. Especially for murabahah transactions with binding orders, the risks faced by Islamic banks are almost the same as the risks that can occur in conventional banks. Whereas in murabahah transactions without orders or with orders that are not binding on customers to buy, these transactions can cause the bank to face two risks. The first risk is that there is no guarantee for Islamic banks if the buyer cancels the transaction. The second risk is that Islamic banks can experience the risk of loss due to a decrease in the value of goods caused by defects or damage during the storage period.

In a musharaka contract, there is a transaction for the placement of funds from two or more owners of funds and/or goods to run a certain business in accordance with sharia principles with the distribution of operating results between the two parties based on an agreed ratio, while the distribution of losses is based on the proportion of each capital. Musyarakah business is held jointly where all parties contribute their capital and expertise. The profits are divided according to the agreement and the losses are divided according to the share of their respective capital.

Risks that may be faced by Islamic banks in musharaka contracts are the possibility of losses from the results of the business / project being financed and dishonesty from business partners. The risk that can occur in musyarakah financing is relatively smaller than mudharabah financing. This is because the bank as a partner can participate in managing the business in addition to carrying out more strict supervision of the business. However, the obstacle that is usually faced is the limited availability of quality and quantity of human resources owned by Islamic banking.

The mudharabah contract is a business cooperation contract between 2 (two) parties in which the first party provides all of the financing capital (shahibul mal), while the other party becomes the fund manager (mudharib). Mudharabah business profits can be divided according to the agreement stated in the previous contract, while if there is a loss, the loss will be borne by the shahibul mal (capital owner) as long as it is not due to the negligence of the mudharib. Meanwhile, the operational costs for managing the business are borne by the mudharib.

In the mudharabah contract, the mudharib, i.e. the customer as the fund manager, has no obligation to bear the risk of losses that may arise. The loss burden can only be charged to the mudharib if the loss is caused by negligence and fraud committed. To deal with possible financing risks, Islamic banks are allowed to request collateral from the fund manager (mudharib). Islamic banking can carry out supervision both actively and passively. Active supervision is carried out by conducting direct checks on operations and customer files, while passive supervision can be carried out by receiving reports from customers. By knowing the risk characteristics of each type of financing, Islamic banks can take steps to identify, measure, monitor, and control risks that may arise.

### 2.3.2. Market Risk Management

Another risk that can be faced by the Islamic banking industry is market risk. Market risk is the risk of loss that occurs in the portfolio owned by the bank due to the movement of market variables (adverse movement) in the form of interest rates and exchange rates. This risk includes interest rate risk, foreign exchange risk, and liquidity risk (Arifin, 2015: 62). Market risk in Islamic banks and UUS according to BI regulations is the risk in
the balance sheet and off-balance sheet positions due to changes in market prices, which include risk in the form of changes in the value of assets that can be traded or leased (Yusmad, 2018:102).

According to Rianto (2013: 139), Islamic banks must establish a sound and comprehensive market risk management process and information system that contains, among others, the following:

a. A conceptual framework to encourage identification of underlying market risks;

b. Guidelines for managing risk-taking activities on different portfolios in limited investment and market risk limits;

c. Appropriate pricing, valuation and revenue recognition frameworks;

d. Strong management information system (MIS) for controlling, monitoring, and reporting market risk exposure and performance of senior management management

2.3.3. Operational Risk Management

One of the risks that can be faced by Islamic banking is related to operational risk which unexpectedly often occurs in every financial institution, both banking and other institutions. Operational risk is the risk caused by insufficient or malfunctioning internal processes, human error, system failure or affecting the operations of a bank. According to Karim (2013: 275), there are three factors that can be the main cause of this risk, namely: Infrastructure such as technology, policy, environment, security, disputes, processes and resources.

There are differences of opinion that say Islamic banking is more vulnerable, if in Islamic banking the operational risks are in controls, procedures and also analytical models or even Islamic legal views but there are also those who say that the operational risks of Islamic banks are lower in risk in fixed income contract agreements and higher in deferred agreements in Islamic banking products. In Islamic banking, operational risk can occur because Islamic banks have special forms of agreement and a general environment, and this particular aspect of Islamic banks can increase operational risk, one of which is the cancellation of one of the contract contracts, the inability to comply with internal controls, maintenance on the supply of commodities in the market because it is not liquid.

Aspects that can increase operational risk in Islamic banks according to Yulianti (2009:6) are:

a. Risk of delay in non-binding agreements, murabaha and istisna

b. Failure of the internal control system to detect and manage possible problems in operational processes and technical risks

c. The difficulty of forcing Islamic treaties into the larger official sphere

d. The need to maintain and manage commodity inventories in the illiquid market

e. Costs and risks in monitoring capital type agreements and legal risks.

2.3.4. Liquidity Risk Management

One of the most important roles of any financial system is in providing liquidity. Therefore, financial intermediaries always try to manage the liquidity position. Liquidity management is especially important for some financial intermediaries than others. Banks should be able to plan their liquidity positions very carefully and assess their liquidity risk regularly. Bank liquidity risk can arise from a mismatch between the demand and supply of funds. The difference between supply and demand for funds is referred to as "the net liquidity position", which banks must manage carefully to reduce their liquidity risk (Rose & Hudgins, 2013).

Based on PBI Number 13/23/PBI/2011, liquidity risk is a risk due to the inability of banks to meet maturing liabilities from cash flow funding sources and or high quality liquid assets that can be magnified, without disrupting bank activities and finances.

The character of Islamic banks that use sharia transactions as liquidity management is more limited. Islamic banks cannot invest in short term financial instruments that are not sharia compliant such as securities, as they carry interest income which is prohibited in Islam. Islamic banks also cannot borrow from other banks or financial institutions, as that option requires payment of interest on the loan which is also prohibited for Islamic banks. The limitations of Islamic banks to conduct transactions outside of sharia provisions force Islamic banks to rely more on internal sources of liquidity by holding higher levels of cash assets and leaving many profitable investment opportunities to reduce liquidity risk.
According to Rianto (2013: 248). Several factors cause Islamic banks to also face liquidity risk, among others;

a. Decreased customer confidence in the banking system, particularly sharia banking;
b. Reliance on a group of depositors;
c. Limited financial instruments for liquidity solutions;
d. Mismatching between short-term and long-term funds;
e. Profit sharing between banks is less attractive because the financial settlement must wait for the completion of the calculation of the bank's cash income basis, which usually only takes place at the end of the month.
f. In the mudhorobah contract, it allows customers to withdraw their funds at any time without prior notice

In order to carry out the function of controlling liquidity risk, banks must be able to implement the function of assets and liability management (ALMA) (Arifin, 2013: 245). Bank Liquidity Management is a program for controlling liquid assets that are easy to fulfill in an effort to fulfill all bank obligations that must be paid immediately. Bank liquidity is also referred to as liquid assets or reserve requirements, or in other words, money deposits at Bank Indonesia in the form of Demand Deposits in a specified amount, which is also known as Statutory Reserves (GWM). Therefore, a sharia bank can be said to be liquid if:

a. May maintain Statutory Reserves at Bank Indonesia in accordance with applicable regulations.
b. Can maintain Demand Deposits at Correspondent Banks whose minimum balance is set.
c. Able to maintain a sufficient amount of cash to meet cash withdrawals.

2.3.5. Compliance Risk Management

In principle, the business activities carried out by Islamic banks are not much different from the business activities carried out by conventional banks, but these activities must not conflict with sharia principles. Compliance risk is the risk that the bank does not comply with and/or does not implement the applicable laws and regulations, as well as sharia principles. The compliance function is an ex-ante (preventive) action and step, namely to ensure that the policies, provisions, systems and procedures, as well as business activities carried out by Islamic banking are in accordance with Bank Indonesia regulations, DSN fatwas, and applicable laws and regulations.

The establishment of the Sharia Supervisory Board (DPS) is one way of managing compliance risk in sharia banking. The formation of this DPS is regulated in Article 32 of the Sharia Banking Law which is mandatory for every Sharia Bank and UUS. DPS has a function to provide advice and suggestions to the board of directors as well as oversee the activities of Islamic banks and UUS in accordance with sharia principles. In terms of its function, the DPS completes the supervisory duties assigned by the commissioners. In addition, banks are required to have one Compliance Director based on Bank Indonesia Regulation Number 11/3/PBI/2009 concerning Sharia Commercial Banks.

Duties of the compliance director include:

a. Determine the steps needed to ensure that the bank has complied with all Bank Indonesia regulations and other applicable laws and regulations in the context of implementing the prudential principle;
b. Monitor and maintain that the bank's business activities do not deviate from the applicable provisions;
c. Monitor and maintain bank compliance with all agreements and commitments made by banks to Bank Indonesia.

The certainty that Islamic banks carry out their business activities based on sharia principles is very important to maintain public trust in the existence of Islamic banks. Failure in compliance risk management can lead to massive withdrawals of third party funds, liquidity problems, bank closures by the authorities, and even bankruptcy. Therefore, the main objective of compliance risk management is to ensure that the risk management process can minimize the possible negative impact of Islamic bank behavior that violates generally accepted standards, provisions, and/or applicable laws and regulations (Rianto, 2013: 233).

2.3.6. Legal Risk Management

Legal risk is a risk caused by the weakness of the juridical aspects, such as: the existence of lawsuits,
the absence of supporting legislation or the weakness of the agreement such as not fulfilling the conditions for the validity of a contract or binding collateral that is not perfect (Rianto, 2013: 213).

The main objective of legal risk management is to ensure that the risk management process can minimize the possible negative impact of the weakness of the juridical aspect, its absence, and/or changes to laws and regulations. According to Karim (2013: 278) in relation to this legal risk, the things that need to be considered are:

a. Must have written policies and procedures;

b. Must carry out legal aspect analysis procedures for new products and activities;

c. The requirement to have a work unit that functions as a 'legal watch', not only against positive law but also against DSN fatwas and other provisions.

d. Must assess the impact of changes in provisions/regulations on legal risks;

e. The need to apply sanctions consistently.

f. The need to conduct periodic reviews of bank contracts, contracts, and agreements with other parties in terms of effectiveness and enforceability.

The application of risk management, especially legal risk in Islamic banks that must be carried out, includes the following:

a. Active supervision of the board of commissioners, directors, and DPS in the supervision of the three boards, they must also be able to understand the legal risks faced and provide clear directions, namely to actively supervise, mitigate and develop a risk management culture in Islamic banks.

b. Policy procedures, and setting limits. Implementation of risk management must be supported by a framework that includes policies that are clearly defined in line with the vision, mission and strategy of the Sharia tire business. The formulation of risk management policies and procedures is carried out by taking into account the type of complexity of business activities, risk profile, and the level of risk to be taken as well as regulations set by the authorities and sound banking practices. In addition, the application of risk management policies and procedures owned by banks must be supported by adequate capital and quality of human resources (HR).

c. Policy on identification, measurement, monitoring, and control of risk and legal risk management information system system

2.3.7. Strategic Risk Management

Strategic risk is a risk that is caused, among others, by the implementation and implementation of inappropriate bank strategies, inappropriate business decision making or banks not complying with/not implementing changes to laws and other applicable provisions. Indications in strategic risk can be seen from the existence of strategic risks. failure to achieve business targets that have been set, both financial and non-financial targets (Karim, 2013: 277).

Strategic risk can be sourced, among others, from weaknesses in the strategy formulation process and inaccuracies in strategy formulation, inadequate management information systems (MIS), inadequate internal and external environmental analysis results, setting strategic goals that are too aggressive, inaccuracy in strategy implementation, and failure to anticipate change business environment (Rianto, 2013:223).

The failure of strategic risk management can lead to a loss of public confidence which can lead to large withdrawals of third party funds, liquidity problems, bank closures by the authorities, and even bankruptcy. Therefore, the main purpose of implementing strategic risk management is to ensure that the risk management process can minimize the possible negative impact of inappropriate strategic decision making and failure to anticipate changes in the business environment(Rianto, 2013: 223).

2.3.8. Reputational Risk Management

Reputational risk can be caused by negative publications related to bank activities or negative perceptions of the bank. Sharia Banks are financial institutions that are based on sharia principles (sharia principles). So as an institution that adopts Islamic values, Islamic banks must always uphold the spiritual image to the community. This spiritual image is needed so that the
differentiation between Islamic banks and conventional banks can be seen. If people see that Islamic banks are not in accordance with sharia principles, people will argue that Islamic banks are the same as conventional banks. This will undermine the reputation of Islamic banks.

The main objective of reputation risk management is to anticipate and minimize the impact of losses from the reputation risk of Islamic banks. Reputation risk in business can be sourced from various business activities of Islamic banks (Rianto, 2013:245). If management in the view of stakeholders is considered good, the reputation risk will be low, as well as if the company is owned by strong shareholders, the reputation risk will be low. In addition, in terms of service, if the service is not good, the reputation risk becomes high.

In the application of sharia principles, it must be carried out consistently so as not to cause a negative assessment of the implementation of the sharia system which can result in negative publications so that it will increase the level of reputation risk (Karim, 2013: 275).

### 2.3.9. Return Risk

Based on Bank Indonesia Regulation No.12/23/PBI/2011 dated November 2, 2011 concerning the application of Risk Management for Islamic Commercial Banks and Sharia Business Units, return risk is the risk due to changes in the rate of return paid by banks to customers due to changes in the rate of return. Returns received by banks from distributors of funds, which can affect the behavior of third party fund customers. This risk arises due to changes in the behavior of third party fund customers which are influenced by changes in expectations of the level of profit sharing provided by the bank. This change in expectations can be caused by two factors, namely internal and external factors. Internal factors for example a decrease in the value of Islamic bank shares (if it has gone public) or a decrease in the value of the capital adequacy ratio. While examples of external factors such as increased yields offered by other Islamic banks or rising interest rates offered by conventional banks. The yield risk is similar to the interest rate risk found in conventional banks. However, there are differences between yield risk and interest rate risk in conventional banks, namely:

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<thead>
<tr>
<th>Item</th>
<th>Risk Return</th>
<th>Interest Rate Risk</th>
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<tbody>
<tr>
<td>The source of income</td>
<td>Islamic banks is a mix of mark-up-based investments and equity-based investments so that greater uncertainty</td>
<td>Conventional Banks operate on fixed-income securities based on interest-based assets so that the uncertainty of the level of return received on investments held to maturity will be smaller</td>
</tr>
<tr>
<td>Amount of return</td>
<td>The rate of return on deposits in Islamic banks has been anticipated, but not agreed in advance. In addition, the return on investment based on the partnership is not accurate until the end of the investment period.</td>
<td>The rate of return from deposits in conventional banks is predetermined.</td>
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In the application of return risk management, Islamic banks must have the right system to identify and measure factors that can increase the risk of return. As stated by Rianto (2013: 257) Islamic banks must use balance sheet techniques to minimize exposure using the following strategies:

a. Determine the ratio of future earnings compared to expected market conditions;

b. Develop new sharia-compliant instruments;

c. Issuing securitization tranches in accordance with assets permitted under sharia provisions

### 2.3.10. Investment Risk

Investment risk is the risk due to the bank taking part in the loss of the customer's business which is financed in profit sharing based financing. This risk arises when the bank provides profit-sharing-based financing to customers where the bank also bears the risk of the loss of the customer being financed (profit and loss sharing). According to Rianto (2013:260) Investment risk has several features different:

a. The nature of equity investment requires close monitoring to reduce information asymmetry;

b. Mudhorobah and musharaka are profit and loss sharing agreements and face the risk of loss of capital even with adequate supervision. The level of risk is higher than other investments.

c. Equity investments other than stock market investments do not have a
secondary market resulting in large early exit fees. The illiquidity of the investment can cause losses to the bank.

Islamic banks must have an adequate strategy, risk management and reporting process in relation to the characteristics of investment risks including mudhorobah and musyarakah investments. Islamic banks must ensure an appropriate and consistent valuation methodology to assess the potential impact of the calculation method and profit allocation. Islamic banks must establish an exit strategy in their capital investment activities with the approval of the DPS (Rianto, 2013: 261).

2.4. Implementation of Risk Management in Islamic Banking

The characteristics of Islamic banking products and services require the functions of identification, measurement, monitoring and risk control in accordance with sharia banking business activities. The steps taken by Islamic banks in mitigating risk must consider compliance with sharia principles but in the management of every functional activity the bank must also be integrated into an accurate and comprehensive risk management system and process.

The future of the Islamic banking industry will largely depend on its ability to respond to changes in the financial world. The phenomenon of globalization and the information technology revolution, has made the scope of Islamic banking as a financial institution has exceeded the statutory limits of a country. The implication is that the financial sector is becoming more dynamic, competitive, and complex. Moreover, there is a growing trend of cross-segment mergers, acquisitions, and financial consolidations that mix the unique risks of each segment of the financial industry (Rahmani, 2009: 151-165).

In order to minimize risks that can cause losses for banks, banks must implement risk management. Risk management is a set of methodologies and procedures used to identify, measure, monitor and control risks arising from all bank business activities.

The implementation of risk management at least includes active supervision of the Board of Commissioners, Board of Directors, and Sharia Supervisory Board; adequacy of risk management policies, procedures and limits; adequacy of risk identification, measurement, monitoring, and control processes as well as risk management information; and a comprehensive internal control system. Where the scope of the application of risk management is adjusted to the objectives, business policies, size, business complexity and capabilities of the bank.

The target of the risk management policy is to identify, measure, monitor, and control the course of bank business activities with a reasonable level of risk in a directed, integrated, and sustainable manner. Thus, risk management functions as a filter or an early warning system for bank business activities.

Risk management in Islamic banking has a different character from conventional banks, mainly because of the types of risks that are unique to banks that operate according to sharia. In other words, the fundamental difference between Islamic banks and conventional banks lies not in how to measure, but in what to measure.

The application of risk management can increase shareholder value, provide an overview to bank managers regarding the possibility of bank losses in the future, improve methods and systematic decision-making processes based on the availability of information, which is used as a basis for more accurate measurements of bank performance, and create infrastructure robust risk management in order to improve bank competitiveness. Therefore, risk management in banks is one thing that is always prioritized and is not underestimated in running an Islamic banking business.

3. CONCLUSION

The target of the risk management policy is to identify, measure, monitor, and control the course of bank business activities with a reasonable level of risk in a directed, integrated, and sustainable manner. Thus, risk management functions as a filter or an early warning system for bank business activities.

Risk management in Islamic banking has a different character from conventional banks, mainly because of the types of risks that are uniquely attached only to banks that operate according to sharia. In other words, the basic difference between Islamic banks and
conventional banks lies not in how to measure, but in what to measure.

Implementation of Risk Management For Islamic Commercial Banks and Sharia Business Units, there are 10 (ten) risks that must be managed by banks. The ten types of risk are credit risk, market risk, operational risk, liquidity risk, compliance risk, legal risk, reputation risk, strategic risk, return risk, and investment risk.

The application of risk management can increase shareholder value, provide an overview to bank managers regarding the possibility of bank losses in the future, improve methods and systematic decision-making processes based on the availability of information, which is used as a basis for more accurate measurements of bank performance, and create a robust risk management infrastructure in order to increase the competitiveness of banks.

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