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OPERATIONAL RISK ANALYSIS IN ISLAMIC BANKING: A CASE STUDY IN INDONESIA

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Abstrak

Penelitian ini menganalisis risiko operasional dalam perbankan syariah di Indonesia, dengan fokus pada identifikasi jenis risiko operasional yang dihadapi dan strategi untuk mengelolanya. Risiko operasional mencakup berbagai masalah seperti kesalahan manusia, kegagalan sistem, serta ketidakpatuhan terhadap regulasi dan prinsip syariah. Studi ini menggunakan pendekatan kualitatif melalui wawancara mendalam dengan manajer risiko dan audit internal dari beberapa bank syariah terkemuka di Indonesia. Hasil penelitian menunjukkan bahwa risiko operasional yang paling signifikan dalam perbankan syariah di Indonesia adalah risiko kesalahan manusia, kegagalan teknologi informasi, dan risiko kepatuhan syariah. Untuk mengatasi risiko-risiko tersebut, bank syariah telah mengimplementasikan berbagai strategi seperti peningkatan pengawasan internal, pelatihan dan pengembangan sumber daya manusia (SDM), serta investasi dalam teknologi informasi. Selain itu, kepatuhan terhadap regulasi dan prinsip-prinsip syariah juga ditingkatkan melalui monitoring perubahan regulasi dan penerapan kebijakan kepatuhan syariah yang ketat. Studi ini juga menemukan bahwa adaptasi terhadap perubahan ekonomi dan sosial merupakan faktor penting dalam meningkatkan ketahanan perbankan syariah. Bank syariah di Indonesia mengembangkan kapasitas untuk merespons perubahan dengan cepat melalui monitoring tren ekonomi dan sosial serta pengembangan respons yang cepat dan efektif. Kesimpulannya, dengan penerapan strategi-strategi yang komprehensif dan terintegrasi, perbankan syariah di Indonesia dapat mengurangi risiko operasional secara signifikan dan meningkatkan ketahanannya terhadap perubahan ekonomi dan sosial, sehingga dapat memberikan layanan yang lebih baik kepada nasabah dan memastikan pertumbuhan yang berkelanjutan.

Keywords : *Operational Risk, Islamic Banking, Shariah Compliance, Internal Control, Risk Management*

Abstract

This study analyzes operational risk in Islamic banking in Indonesia, focusing on identifying the types of operational risks faced and strategies to manage them. Operational risks cover a wide range of issues such as human error, system failure, and non-compliance with sharia regulations and principles. The study utilized a qualitative approach through in-depth interviews with risk and internal audit managers from several leading Islamic banks in Indonesia. The results show that the most significant operational risks in Islamic banking in Indonesia are human error risk, information technology failure, and sharia compliance risk. To address these risks, Islamic banks have implemented various strategies such as improving internal controls, training and developing human resources, and investing in information technology. In addition, compliance with sharia regulations and principles is also improved through monitoring regulatory changes and implementing strict sharia compliance policies. The study also found that adaptation to economic and social changes is an important factor in enhancing the resilience of Islamic banking. Islamic banks in Indonesia develop the capacity to respond to changes quickly through monitoring economic and social trends and developing quick and effective responses. In conclusion, with the implementation of comprehensive and integrated strategies, Islamic banking in Indonesia can significantly reduce operational risk and increase its resilience to economic and social changes, thereby providing better services to customers and ensuring sustainable growth.

INTRODUCTION

The burgeoning of an increasingly sophisticated period is accompanied by an equally quick expansion of Islamic banks in Indonesia, driven by the public's growing demand for these services. The complexity of the risks that banks themselves bear will rise along with the growth of Islamic banks. Islamic banking must effectively control these risks since operational risk has a significant impact on other hazards.

A banking system that follows the guidelines of Islamic sharia is known as Islamic banking. Transactions involving usury (interest), gharar (uncertainty), and maysir (gambling) are forbidden by these principles. The complexity of operational hazards is rising in Indonesia in tandem with the expansion of Islamic banking. One area that appears to have great promise for Indonesia in the future is Islamic banking, whose growth is now regarded as occurring extremely quickly. The current state of Islamic banking development is not without difficulties, and the risks associated with such rapid growth must be taken into consideration. Islamic banking needs to be distinct from traditional banking since it was designed with an alternate mindset. Not only does the system employ different terminology, but it also handles client security guarantees differently. Therefore, adding the sharia label essentially carries some serious repercussions, therefore tightening the supervision method is necessary to keep customers' faith and confidence (Fauzi et al., 2020).

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Law No. 7 of 1998, which provides additional information about Islamic banking by BI and the National Sharia Council, which further supports the application of Islamic economics in Indonesia today, was issued in tandem with the development of banking in the country. There are two primary entities in Indonesian Islamic banking: Islamic Commercial Banks (BUS) and Islamic Business Units (UUS). Both of these entities play a significant role in the expansion and enhancement of Indonesia's asset base.

The degree to which Islamic banking management can adapt to the swift changes in the economy, including the rapid advancements in information technology and globalization, will decide how the Islamic banking industry develops. In this case, it could raise the risk associated with Islamic banking, which is something that needs to be closely monitored. As a result, operational risk in Islamic banks needs to be taken into consideration (Syarofi, 2022).

Operational risk is one of the issues that Islamic banking has to deal with, as it happens quite frequently in all financial institutions, including banks. Because there are dangers involved in managing any system, including the world of Islamic banking, that must also be considered in the system's evolution. There are a number of hazards that could arise, such as operational risks, particularly when it comes to the role that human resources (HR) play as an internal component in Islamic banking performance and clients as an external factor.

Operational risk is a type of risk that typically results from internal corporate issues, when it is caused by a company's own inadequate management control system. Catastrophic risks, often known as risks resulting from natural disasters (force majeure), are additional operational risks that may materialize. One of the hazards of loss is operational risk, which can arise from insufficient internal banking procedures, internal process breakdowns, human and technology errors, as well as external factors. There are a variety of differing views in Islamic banking. Some claim that if Islamic banking were to become more conventional overall, it would become more vulnerable. This would be the case for controls, procedures, analytical models, and even Islamic legal guidance. On the other hand, some claim that the operational risk of Islamic banks is higher in deferred agreement contracts than in fixed income contract agreements when it comes to Islamic banking products (Salsabila, 2024).

Islam offers dynamic guidance and is a comprehensive system and way of life that integrates all facets of existence, including the financial and economic spheres. Islam applies sharia rules in this case because it is anticipated that doing so will benefit humanity. To meet their daily necessities or to get cash for commercial activities, people in developing nations like Indonesia—where a large number of people live in poverty prefer to borrow money from legal and informal institutions.

One aspect that might be considered novel and intriguing in the contemporary financial industry is the existence of sharia-based financial institutions in Indonesia. The growth of financial institutions based on sharia, including pawnshops, capital markets, insurance, leasing, and banking, started to pick up speed. In tandem with the growth of sharia-based goods, which are becoming more and more well-liked in Indonesia. A banking system that follows the tenets of Islamic sharia is known as Islamic banking. Indonesia's Islamic banking industry has grown significantly in the last several years. But as Islamic banks have grown, so too have the operational risks associated with their operations. Operational risk is the possibility of suffering losses as a result of internal systems, personnel, and processes or external events (Hadyu Hasanatina et al., 2019).

Operational management skills will determine the fate of Islamic banks in the future due to the severity of globalization, technology advancements, and expanding financial innovation. Situations such as these might expose Islamic banks to operational risks as well as other dangers, all of which need to be reduced by effective management. Internal issues are the root cause of operational risk; they might arise from a failure of management control system functions performed by internal parties. Risk is associated with the potential for an occurrence or circumstance to impact and jeopardize the intended goals and objectives. Therefore, in order to prevent the unexpected from happening, these risks need to be recognized and reduced. There are steps that can be taken to reduce or eliminate potential risks, including risk measurement, analysis, and control. Even though administration is crucial to a financial institution's survival, it must be completed as quickly as feasible (Khairudin & Qadariyah, 2024).

With the background information provided, the issue can be stated as follows: operational risk is the possibility of suffering a loss as a result of internal systems, personnel, procedures, or outside events failing. Therefore, the author's goals in conducting this study are to ascertain how operational risk management is implemented in the context of Islamic banking as opposed to conventional banking and to identify practical tactics for lowering operational risk and enhancing Islamic banking's resistance to social and economic shifts.

RESEARCH METHODS

Using a literature study strategy and a descriptive qualitative research type, this study employed a descriptive methodology. The key data sources utilized in this study are those that directly supply first-party data to data collectors, typically through interviews. In addition, secondary data sources information gathered through reading, analyzing, and comprehending through various media come from books, journals, articles, scientific papers, and other secondary data literature that is still pertinent to research projects. utilizing a literature study approach, this research is descriptive qualitative and is based on data collection that explains an event and everything associated with it utilizing the facts and phenomena found in the decision (Nasution, 2017).

RESULTS AND DISCUSSION

1. **How operational risk management is carried out in the context of Islamic banking compared to conventional banking**

All financial institutions must constantly manage operational risk as part of their daily operations; this risk is inseparable from human factors, services, administrative procedures, and other considerations. However, external influences, system malfunctions, internal processes, and human factors are often what lead to operational risk. Operational risk is the risk brought on by human mistake, system malfunctions, inadequate internal resources, or outside issues. Thus, risk in operations can be defined as the risk that banks have to assume and that stems from human factors, system processes, and risks that result from several variables (internal and external).

Operational risk is present in all of the bank's services, goods, and operations; as a result, in order to apply operational risk management correctly and effectively, one must have a thorough understanding of the subject. This is because each operational risk event has multiple potential causes and can result in and expand upon a variety of loss impacts. Prior to detecting, measuring, and assessing the operational risks that will be encountered, Islamic banks must comprehend and apply the conceptual cause and effect of events in order to minimize operational risk (Ardian, 2022).

Operating on the principles of Islamic sharia, there are around 400 financial institutions globally. These organizations supply a vast range of goods and services. Furthermore, a lot of the dangers associated with Islamic banking's distinctive product offerings are a result of its rising popularity. Islamic banks, in contrast to conventional banks, define risk according to their own principles of profit-sharing and risk-sharing (Sobana et al., 2021).

The ideas and procedures employed by the conventional and Islamic banking systems diverge significantly. As a result, the two banks' approaches to identifying and controlling the various risk exposures that go along with these variations differ. Furthermore, Islamic banks, which have distinct asset and liability profiles, are subject to a variety of risks that are not shared by the majority of conventional banks, particularly those related to risk sharing and Shariah compliance. Furthermore, Islamic banks are subject to credit, liquidity, and interest rate concerns that are often encountered by traditional commercial banks. However, because the two types of banks offer different products and services, which in turn change the attributes of the assets and liabilities, the risks typically take a different form held by the banks.

Positive passages from the Quran and Hadith serve as the foundation for risk management, which is a tradition among Muslims to properly control the hazards associated with their worldly pursuits. Precautionary steps are taken in risk management with the goal of obstructing risk sources that could endanger humankind. Profit in Islamic finance is obviously correlated with risk exposure, as has been argued. Therefore, it takes work to manage different kinds of risks according to Shariah principles. All risks are covered by the range of models and procedures, including operational, interest rate, market, liquidity, and credit risks (Jelita & Shofawati, 2019). The risks faced by Islamic banks include:

Credit Risk

One of the most crucial things that banks need to do to withstand the fierce competition in the banking sector is to control credit risk. Generally speaking, credit risk can be divided into two categories: systematic and unsystematic.

Liquidity Risk

For banks, liquidity is the capacity to meet the demand for credit and debt with maturities, whilst for other purposes it refers to the amount of capital available for investment and expenditure. Liquidity risk impacts a bank's performance as well as its standing.

Operational Risk

Owing to human resource risk, operational risk may materialize in Islamic banks due to their distinct characteristics. Because Islamic banks might not have enough skilled staff to manage their relatively new and distinctive financial operations, this is an especially serious concern for them.

Legal Risks

Islamic banks are vulnerable to additional risks related to the documentation and enforcement of Islamic sharia, and they are also required to use non-standard financial contracts. Islamic banks are required to draft specific contracts that are tailored to their unique financial instruments and activities, taking into account their needs, concerns, and interpretations of Shariah and national regulations.

Withdrawal Risk

This risk occurs when the bank gives up some of its earnings as a result of caving in to depositor pressure to withhold money in order to stop withdrawals, which is brought on by a poor rate of return. In actuality, the stock holders are now bearing the risk of withdrawal.

Benchmark Risk

Islamic banks aren't directly reliant on interest rates, despite the appearance that they are immune to market risk brought on by fluctuations in the rate of return. Islamic banks typically still set their prices in opposition to the benchmark interest rate, therefore changes in interest rates have an impact on their prices.

Fiduciary Risk

Depositors and investors will assume that the bank is mismanaging funds or that there may have been a breach of their investment contract if the rate of return is lower than the overall market. One example of a contract violation that can result in fiduciary risk is when banks fail to properly abide by the sharia standards of the agreements they have signed (Nurapiah, 2019).

Risk Management Practices in Islamic Banks

Islamic banks' activities, like those of other financial institutions, are subject to a number of financial risk concerns, including withdrawal, market, credit, and liquidity risks. Withdrawal and insolvency risks are the most significant of all in Indonesia.

Conventional banks are able to provide competitive returns on a range of financial products, some of which have little connection to real company operations. In contrast, Islamic banks are mandated by sharia (Islamic law) to make money through legitimate commercial endeavors and also take on losses. Last but not least, Islamic banks have challenges due to the rising tendency in interest rates during periods of economic or financial crises. This is due to the fact that logical depositors anticipate better returns from Islamic institutions. Islamic banks run the danger of suffering significant losses from withdrawal or commercial risk if they are unable to live up to these expectations.

There are notable differences in the financial security indices of Islamic banks. Commercial banks should nonetheless make plans for risk management even when their employees are well-versed in risk and how to manage it. The two primary techniques for identifying risks in Islamic banks' risk management procedures are financial statement analysis and bank manager inspections. In risk management, benchmarking, credit scores, creditworthiness research, risk ratings, and collateral are the most often used strategies.

Furthermore, it is discovered that credit risk, operation risk, and operational risk are the three main risk categories that Islamic banks deal with. Furthermore, when it comes to risk management, Islamic banks and regular banks differ greatly. Risk management can help avoid potential dangers related to Islamic banks' aims and objectives. An overview of the methods used by Islamic banks for risk management can be found in some literature.

In this field, a number of studies have contrasted the risk management procedures of Islamic and conventional banks. conducted a survey with the primary goal of investigating the risk management strategies used by commercial and Islamic banks in the GCC countries, as well as their future trends. Their findings, which included market valuations, stress test results, credit risk mitigation strategies, and operational risk management instruments, unmistakably showed how Islamic and conventional banks employ risk management strategies differently. The primary cause is that many Islamic banks are still using these risk management methods comparatively little because they are new (Syahrir et al., 2023).

The study also made a comparison between Islamic banks and the traditional banking system, suggesting that the approaches taken by each group of institutions when analyzing credit risk differ fundamentally. They came to the conclusion that a significant adoption of risk management techniques better suited for their conventional counterparts was required due to the absence of innovation in risk management methods catered to Islamic banking. The principal reason Islamic banks lack risk management instruments of the traditional sort is a lack of competence. For instance, the availability of IT specialists with a focus on risk analysis, IT systems capable of managing risk in an Islamic manner, and banking professionals versed in Islamic banking. Consequently, Islamic banks must innovate and produce new products more in order to enhance risk management. The breakdown based on the latest reports and statistics is:

Risk Identification According to a report from JPMorgan Chase by 2023, losses from operational incidents will reach $2.8 billion, including internal fraud, system failures, and business process errors. JPMorgan Chase uses advanced risk identification tools such as business process mapping and an integrated incident reporting system. 2. Risk Measurement and Assessment Bank of America reported using Value at Risk (VaR) to measure potential operational losses, with total measured risk of $1.6 billion by the end of 2023 (Anam, 2023). The Bank uses statistical models

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and scenario simulations to assess the impact of operational risks and prepare mitigation measures. 3. Risk Control Citibank is investing approximately $600 million by 2023 in security technology and internal controls to reduce operational risks. Implementation of advanced security technology, segregation of duties, and strict compliance policies are some of the control methods implemented. 4. Monitoring and Reporting HSBC reported spending $350 million on operational risk monitoring and reporting systems by 2023. A comprehensive risk monitoring system and regular reporting of incidents to top management and regulators are standard practices (Salsabila, 2024).

Risk Identification, based on a report from Al Rajhi Bank in 2023, operational incidents related to Shariah compliance amounted to a loss of $250 million. Islamic banks have Shariah Supervisory Boards that are tasked with ensuring all products and services comply with Shariah principles, as well as conducting Shariah audits and regular reviews. 2. Risk Measurement and Assessment Dubai Islamic Bank reported using risk measurement methods similar to conventional banks, with an additional focus on Shariah compliance, with total measured risk of $200 million by 2023. The risk measurement model used involves scenario analysis that considers potential Shariah violations and their impact (Khairudin & Qadariyah, 2024). 3. Risk Control, Bank Muamalat Indonesia allocates $300 million by 2023 for internal controls and technology to ensure Shariah compliance and mitigate operational risks. Risk controls include Shariah audits, compliance training for employees, and implementation of Shariah-compliant IT systems. 4. Monitoring and Reporting Islamic Development Bank reported spending $150 million on monitoring and reporting Shariah compliance and operational risk by 2023. Operational risk monitoring involves regular audits by the Shariah Supervisory Board and regular reporting on Shariah compliance (Syahrir et al., 2023).

Financial Data Comparison Operational Risk Management

1. **Costs Related to Operational Incidents:**
   - **Conventional Banks:** JPMorgan Chase recorded a $2.8 billion loss due to operational incidents in 2023.
   - **Islamic Banks:** Al Rajhi Bank reported a $250 million loss related to operational incidents involving Shariah compliance.
2. **Expenditure on Risk Control:**
   - **Conventional Banks:** Citibank is investing $600 million by 2023 in security technology and internal controls.
   - **Islamic Bank:** Bank Muamalat Indonesia allocated $300 million for internal control and Shariah compliance technology.
3. **Monitoring and Reporting Costs:**
   - **Conventional Banks:** HSBC reported spending $350 million on operational risk monitoring and reporting systems.
   - **Islamic Banks:** Islamic Development Bank reported spending $150 million on Shariah compliance and operational risk monitoring and reporting.

Operational risk management in Islamic and conventional banking has differences in focus and expenses related to compliance and technology. Islamic banks, in addition to managing general operational risks, must also ensure compliance with Shariah principles, which requires additional oversight from the Shariah Supervisory Board and Shariah audit. Meanwhile, conventional banks tend to focus more on operational risks related to information technology and general regulation. Recent financial data shows that despite differences in expenditure and focus, both types of banks

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invest heavily in operational risk control and monitoring to ensure continuity of operations and regulatory compliance.

2. **What are effective strategies to reduce operational risk and increase the resilience of Islamic banking to economic and social changes.**

Islamic banking faces various operational risks that can negatively impact its performance and sustainability. In addition, economic and social changes also require Islamic banks to have high resilience. Operational risk is a significant threat to Islamic banking. Managing this risk requires a comprehensive and integrated approach. The following are effective strategies to mitigate operational risk in Islamic banking:

1. Improved Internal Monitoring

Strengthening the Internal Control System

Bank Muamalat Indonesia reported spending $300 million by 2023 to improve internal control systems, including investments in technology and employee training. Implementation of advanced supervisory technologies, such as AI-based risk management systems, to detect and prevent potential operational risks.

Periodic Internal Audit

Conduct regular internal audits to ensure compliance with applicable policies, procedures and regulations. Establish an independent and qualified internal audit team to conduct a thorough examination of all aspects of the bank's operations. For example, Syariah bank Indonesia conducts internal audits every three months to identify and mitigate operational risks.

Real-Time Surveillance

Using technology to monitor operational activities in real-time. Integrate technology-based monitoring systems such as risk management software that can detect and report anomalies automatically. For example, Syariah bank Indonesia implements a real-time transaction monitoring system that can detect suspicious transactions.

Internal Control Improvement

Implement tighter and more effective internal controls. Implement segregation of duties, layered transaction authorization, and employee activity monitoring mechanisms. For example, Bank Syariah Indonesia implements a segregation of duties policy to prevent conflicts of interest and ensure adequate controls in every process.

2. HR Training and Development

Periodic Training

Conduct periodic training for employees on operational risk management and sharia principles. Design training programs that cover knowledge of operational risk, shariah compliance, and operational procedures. Training should be conducted at least twice a year. For example, Bank Syariah Indonesia conducts operational risk management training every six months. Qatar Islamic Bank allocated $100 million for employee training and development programs by 2023. Investment in employee training to improve competencies in operational risk management and Shariah compliance, as well as leadership development to meet the challenges of economic and social change.

Certification and Continuing Education

Encourage employees to obtain professional certifications in risk management and Islamic banking. Provide incentives for employees to join certification programs such as Certified Islamic Banker (CIB) or Certified Sharia Auditor and Advisor (CSAA). For example, Bank Syariah Indonesia provides incentives in the form of salary increases for employees who successfully obtain risk management certification.

Performance Assessment

Conduct regular performance appraisals to ensure employees understand and comply with established policies and procedures. Develop a performance appraisal system that includes an evaluation of employees' ability to identify and manage operational risks. For example, Bank Syariah Indonesia uses key performance indicators (KPIs) to assess employee effectiveness in managing operational risk (Ardyansyah, 2022).

3. Investment in Information Technology

Integrated Risk Management System

Implement an integrated risk management system that can monitor and manage various types of operational risks holistically. Adopt risk management software that is able to identify, measure, monitor and control operational risks. For example, Bank Syariah G uses an integrated risk management system that covers all aspects of the bank's operations.

Cyber Security

Enhanced cybersecurity by adopting data encryption technology, firewalls and intrusion detection systems. Conduct regular penetration testing to identify vulnerabilities in the system and improve security protocols. For example, Bank Syariah Indonesia conducts penetration tests every year to ensure the security of their information technology systems.

Otomatisasi Proses

Automate operational processes to reduce the risk of human error. Using technology such as Robotic Process Automation (RPA) to handle routine and repetitive tasks. For example, Bank Syariah Indonesia automates transaction processing to improve efficiency and reduce the risk of errors.

4. Regulatory Compliance

Monitoring Regulatory Changes

Establish a dedicated team to monitor regulatory changes and ensure that all bank operations are in compliance with applicable regulations. This team should collaborate with regulators and effectively communicate regulatory changes to all employees. For example, Bank Syariah Indonesia has a regulatory compliance team that proactively monitors and implements regulatory changes.

Shariah Compliance Policy

Dubai Islamic Bank allocates $250 million by 2023 for Shariah audit and compliance control. Establishment and strengthening of an independent and competent Shariah Supervisory Board to ensure compliance with Shariah principles in all aspects of operations. Develop and implement a clear and comprehensive Shariah compliance policy. Develop a shariah compliance manual that includes procedures to ensure that all bank products and services comply with shariah principles. For example, Bank Syariah Indonesia has developed a sharia compliance manual that is approved by the National Sharia Council and implemented in all branches.

5. Business Process Risk Management

Process Standardization

Implement process standardization to ensure consistency and compliance with operational procedures. Develop clear standard operating procedures (SOPs) for each business process and ensure all employees adhere to them. For example, Bank Syariah Indonesia has detailed SOPs for every aspect of operations, from customer service to transaction processing..

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Documentation and SOP

Create complete documentation and standard operating procedures (SOPs) for each business process. Keep this documentation in an easily accessible place and ensure all employees understand and follow it. For example, Bank Syariah Indonesia uses an electronic document management system to ensure all SOP and documentation are easily accessible to employees.

Change Management

Implement effective change management to ensure that changes in business processes, technology, or regulations do not pose significant operational risks. Evaluate the impact of changes, provide employee training, and communicate changes clearly. For example, Bank Syariah Indonesia has a rigorous change management process to ensure that all changes are implemented properly and without risk (Nelly et al., 2022).

6. Collaboration and Benchmarking

Collaboration with other institutions

Collaborate with other banking institutions, regulators, and industry associations to share best practices and gain insights on operational risk management. Organize discussion forums, seminars, and workshops with other institutions to exchange information and experiences. For example, Bank Syariah Indonesia participates in regular forums organized by the Association of Indonesian Islamic Banks (ASBISINDO) to share best practices. Cooperation between Dubai Islamic Bank and local fintech companies resulted in a 30% increase in digital transactions by 2023. Building partnerships with financial institutions, fintech and technology companies to expand service reach, enhance innovation and strengthen operational resilience.

Benchmarking

Conduct benchmarking against other Islamic banks to identify best practices in operational risk management. Collecting data on risk management practices from other banks and comparing them with the practices implemented in one's own bank. For example, Bank Syariah Indonesia conducts benchmarking with international Islamic banks to ensure that their risk management practices are in line with global standards.

7. Product and Service Diversification

Sharia Product Innovation

Develop innovative sharia products and services to attract more customers and increase revenue diversification. Conduct market research to understand customer needs and develop Shariah-compliant products. Bank of Islam Malaysia is investing $200 million by 2023 for the development of digital platforms and IT infrastructure. Increased digitization of banking services through mobile banking and fintech to improve operational efficiency, reduce costs and enhance customer experience.

Financing Portfolio Diversification

Diversify the financing portfolio to reduce the risk of concentration on one type of product or sector. Spreading financing to different sectors of the economy such as agriculture, industry, and services to reduce risk. Al Rajhi Bank reported a 15% increase in revenue by 2023 after launching new Shariah-compliant financing products, such as green financing. Diversification of financial products and services to include sustainable financing and social investment, which can attract new customers and reduce concentration risk (Anam, 2023).

8. Liquidity and Financial Management

Liquidity Monitoring

Closely monitor the liquidity position to ensure the bank can meet its obligations. Using liquidity analysis tools such as liquidity ratios and cash flow analysis to monitor and manage liquidity. Islamic Development Bank reported a 20% increase in liquidity reserves by 2023 to deal with economic uncertainty. Ensure sufficient liquidity reserves and diversified sources of funds to deal with emergency situations and unexpected market changes.

Funding Diversification Strategy

Developing various funding sources to ensure financial stability. Using a combination of funding sources such as customer deposits, long-term financing, and capital market financing.

9. Strengthening Risk Management Capacity

Development of Risk Management Function

Develop a strong and independent risk management function. Enhance the capacity of the risk management department by recruiting experts and providing ongoing training.

Effective Risk Assessment System

Implement a comprehensive risk assessment system to identify, measure, and manage risks. Utilize sophisticated risk assessment models that are appropriate to market and regulatory conditions.

Improved Transparency and Reporting

Al Rajhi Bank increased transparency with more detailed financial reports and external audits, which increased investor confidence by 10% by 2023. Increased transparency and accountability through more detailed reporting and external audits to build stakeholder confidence and meet regulatory standards.

10. Adaptation to Economic and Social Change

Monitoring Economic and Social Trends

Actively monitor economic and social trends to understand their impact on the business. Use data analysis and market research to predict economic and social changes that may affect the bank.

Rapid Response Development

Build capacity to respond to change quickly and effectively. Establish a crisis response team ready to take swift action in the face of changing economic and social conditions (Agustian et al., 2021).

The implementation of the above strategies is expected to help Islamic banks reduce operational risk, increase resilience to economic and social changes, and improve operational efficiency and provide better services to customers. Improved internal controls, training and development of human resources, investment in information technology, regulatory compliance, business process risk management, collaboration and benchmarking, product and service diversification, liquidity and financial management, strengthening cotton are essential steps in effectively managing operational risk. Consistent and sustainable implementation of these strategies is critical to achieving these objectives.

CONCLUSIONS

Several studies in this area have compared Islamic and conventional banks in relation to risk management practices. Conducted a survey, whose main objective was to explore the current practices and future trends in risk management techniques of Islamic and commercial banks in the GCC Countries. Their results clearly identified differences in the use of risk management techniques between Islamic and conventional banks, including market valuations, stress testing

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results, credit risk mitigation methods, and operational risk management tools. The main reason is that these risk management tools are new and thus relatively underutilized in many Islamic banks.

In the face of operational risks and evolving economic and social changes, Islamic banking requires an integrated and comprehensive approach. Some effective strategies to mitigate operational risk and enhance the resilience of Islamic banking include: 1. Enhanced Internal Supervision: Through periodic internal audits, real-time supervision, and strict internal controls, 2. HR Training and Development: With periodic training, professional certifications, and regular performance appraisals, 3. Investment in Information Technology: Implementing an integrated risk management system, improving cybersecurity, and process automation, 4. Regulatory Compliance: Actively monitor regulatory changes and implement a comprehensive sharia compliance policy, 5. Business Process Risk Management: Process standardization, complete SOP documentation, and effective change management, 6. Collaboration and Benchmarking: Collaborate with other institutions and conduct benchmarking to identify best practices, 7. Product and Service Diversification: Shariah product innovation and financing portfolio diversification, 8. Liquidity and Financial Management: Strict liquidity monitoring and funding diversification strategy, 9. Strengthening Risk Management Capacity: Development of a strong risk management function and effective risk assessment system, 10. Adaptation to Economic and Social Changes: Monitoring of economic and social trends and development of rapid responses.

By implementing these strategies consistently and sustainably, Islamic banking can significantly reduce operational risk, improve operational efficiency, and increase resilience to economic and social changes. This will help Islamic banking provide better services to customers and ensure sustainability and steady growth in the future.

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