ANALYSIS OF MARKET RISK MANAGEMENT STRATEGY IN ISLAMIC BANK

(Case Study at Bank Mega Syariah Indonesia)

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Abstract

Market risk is one of the risks in Islamic banking that cannot be avoided. If Islamic banking cannot manage market risk properly, it will have an impact on bank profitability or even lead to other risks. Therefore, Islamic banking must create a market risk management strategy to achieve sustainable business growth. This research made Bank Mega Syariah the locus of research. The research method used is qualitative research using the main data source, namely Bank Mega Syariah's 2023 annual report as well as the December 2023 risk exposure and capital report. The results of the research show that Bank Mega Syariah manages market risk based on its fund distribution portfolio, the majority of which is in the form of financing and partly in the form of sukuk securities as a liquidity reserve, does not carry out over the counter trading activities for proprietary trading so market risk exposure is relatively low. The focus is on changing behavior and maintaining customer trust when market benchmark interest rates increase, adjusted to the majority of financing which has a fixed margin.

Keywords: Market Risk, Risk Management, Islamic Banking

Introduction

The development of Islamic banks is inseparable from risks that can disrupt the continuity of the bank's business. Risk in the context of banking is a potential event, both predictable and unpredictable, and has a negative impact on the bank's income and capital. These risks cannot be avoided but can be managed and controlled (Syafii & Siregar, 2020). Islamic banks have more complex risks compared to conventional banks and companies engaged in other sectors because they involve customers and the wider community as well as conditions of economic stability and compliance with sharia principles (C, Eril, Abdullah, & Awaluddin, 2022).

One of the major risks that disrupted the stability of the banking world was the global financial crisis in 2008-2009 where none of the banks were spared from these market risks. The existence of a global financial crisis that disrupted the stability of the banking world required banks to develop more comprehensive risk management. Even though they are still in their infancy, Islamic banks take on current market risks. Islamic banks were consequently impacted, although due to their involvement in Shariah-compliant operations, Islamic banks were discovered to be more stable than conventional banks. When comparing Islamic banks to conventional banks, the majority of studies assessing bank performance during the financial crisis reveal that Islamic banks fared better (Nelly, Siregar, & Sugianto, 2022).

Bank Mega Syariah as one of the Islamic banks in Indonesia certainly conducts risk management in order to maintain the bank's sustainable business growth. Not only implementing management on 8 risks as carried out by banks operating conventionally, Bank Mega Syariah implements 10 types of risk management, namely credit risk, operational risk, market risk, liquidity risk, strategic risk, legal risk, reputation risk, compliance risk, and an additional 2 special risks for Islamic banks, namely yield risk and investment risk. In January 2024, Bank Mega Syariah won the prestigious The *Best Indonesia Enterprises Risk Management Award (IERMA VI-2024)* from *Economic Review* Media. This award is based on the jury's assessment of *risk management* performance, *finance* from company data, namely the *2022 Annual Report* obtained from the Bank Mega Syariah website (Opi, 2024).

Based on the above background, the author is interested in analyzing how risk management is implemented at Bank Mega Syariah, especially in managing market risk because this risk is one type of systematic risk that is quite calculated in banking.

Literature Review

Market Risk

Market risk is the risk of loss due to a decrease in market prices, which occurs due to changes in market factors that are beyond the bank's control and have the potential to harm the bank's portfolio position. The market factors in question are interest rates, exchange rates, stock prices, and commodity prices (Ikatan Bankir Indonesia & Banker Association for Risk Management, 2015). Market factors change beyond the bank's control. Banks can only react accordingly when market factors change, so that the impact of losses can be minimized (Andrianto & Firmansyah, 2022). Islamic bank market risk is inseparable from the four standard market risk factors as conventional banking because Islamic banking uses Islamic financial products with several forms of contracts. The absence of interest rate risk in Islamic banking does not mean that Islamic banks are not exposed to interest risk (Harjoni & Rahmawati, 2020).

Islamic banks are also faced with pricing risks for financing products. This is directly related to interest rates in the market. The risks are in the form of *director competitor market* (profit sharing rate of Islamic commercial banks), *indirect competitor market* (interest rate in conventional commercial banks), and *expected competitive return for investors (*competitive investment return expected by investors). Therefore, Islamic banks have yield risk. This risk occurs when expected returns are not met due to movements in market conditions, such as inflation. This risk includes periodic profit expectations, such as *Murabaha* installment payments, profits from *salam* and *istishna* transactions, and *ijarah* leases (Harjoni & Rahmawati, 2020).

Market risk can occur in both the *banking book* and *trading book*. In the *trading book*, the impact of market risk directly affects profit loss. Meanwhile, in the *banking book, the impact of* market risk indirectly affects the acquisition of NII (*Net Interest Income*) and EVE (*Economic Value of Equity*) (Ikatan Bankir Indonesia & Banker Association for Risk Management, 2015). *A banking book* is all activities in banking such as the transformation of deposits into loans/financing. While, the trading book is a tool used for the buying and selling of non-financial assets, financial assets, and commodities. While only financial assets and instruments held to maturity for personal use are included in the banking book, the trading book records all commodities and financial instruments for transaction purposes ('Faktor Risiko Pasar', n.d.).

Islamic Bank Risk Management

Risk management is a series of procedures and methods used to identify, monitor, measure, and control risks arising from the bank's business activities (C et al., 2022). 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 in Sharia. In other words, the fundamental difference between Islamic banks and conventional banks lies not in *how to measure*, but in what *to measure* (Fasa, 2016).

Islamic banking is not solely an intermediary institution but also a customer partner so Islamic banking must protect the interests of customers it must uphold the principle of prudence so that Islamic banking as a trustee is in a controlled, *liquid*, *solvent,* and *profitable* condition (C et al., 2022). The objectives of risk management in banking are: (1) Provide information about risk to regulators; (2) Ensure the bank does not experience *unacceptable* losses; (3) Minimize losses from various *uncontrolled* risks; (4) Measure exposure and risk concentration; (5) Allocate capital and limit risk (Fasa, 2016).

There is no single, universal risk management system that works for all banks due to variations in the market conditions, business structures, sizes, and levels of complexity of each bank. To achieve sustainable business growth, each bank must thus design its risk management system following the function and complexity of the bank and provide a risk management organization system at the bank as needed (Ikatan Bankir Indonesia & Banker Association for Risk Management, 2015). The implementation of good risk management is a belief in generating healthy bank performance, maintaining its sustainability consistently, and generating high trust from all stakeholders.

Market Risk Management

Market risk management has the main objective of minimizing the possibility of negative impacts due to changes in market conditions on the assets and capital of the bank. Through this system, the bank can keep the market risk taken, the bank is within tolerable limits, and the bank has sufficient capital to cover market risk (Harjoni & Rahmawati, 2020). Banks are required to provide a certain amount of capital to cover market risk on portfolio exposures. Market risks that must be taken into account by banks individually and/or on a consolidated basis with subsidiaries are interest rate risk and/or exchange rate risk (Andrianto & Firmansyah, 2022).

The Bank must have a well-developed market risk management system that is implemented with integrity. Market risk management is built with a risk control system and obtained a very adequate predicate. The bank implements market risk management that allows the bank to identify, measure, monitor, and control market risk following the characteristics and complexity of the bank's market risk exposure and has been implemented consistently. Banks must have valuation policies and procedures based on prudential principles for market risk exposures, including having an adequate valuation process control management information system that is integrated with market risk management (Andrianto & Firmansyah, 2022).

Research Methods

This research uses a qualitative approach that produces descriptive data in the form of written sentences on the topic under study to answer the objectives of the research, namely to find out the market risk management strategy at Islamic Banks. The Sharia Bank which is the locus of this research is Bank Mega Syariah. The research data used is in the form of the Risk Management Implementation Report obtained from the Annual Report of Bank Mega Syariah in 2023 and the Risk Exposure and Capital Report December 2023 which is accessed on the website www.megasyariah.co.id. This research also uses supporting data from books, journals, and trusted websites.

Finding and Analysis

Bank Mega Syariah Profile

Before being acquired by PT Mega Corpora (formerly Para Group) through PT Mega Corpora (formerly PT Para Global Investindo) and PT Para Rekan Investama in 2001, Bank Mega Syariah was known as PT Bank Umum Tugu (Bank Tugu), a commercial bank that was founded on July 14, 1990. Following this acquisition, on July 27, 2004, the bank's business operations were converted from conventional to Islamic, operating under the name PT Bank Syariah Mega Indonesia (BSMI). In order to enhance the bank's reputation as a reliable Islamic financial institution, it also changed its logo (Bank Mega Syariah, n.d.-b).

Then, on August 25, 2004, BSMI began conducting business. On November 7, 2007, nearly three years later, the shareholders decided to update the BSMI logo to better reflect its affiliation with the Mega Corpora group. PT Bank Mega Syariah is the name under which the bank has been known since November 2, 2010. Bank Mega Syariah has been authorized to conduct business as a foreign exchange bank as of October 16, 2008. The bank can carry out foreign exchange transactions and participate in international trade with this status. This means that the status has also expanded the bank's business reach so that it not only reaches the domestic realm but also the international realm. The market expansion strategy and foreign exchange bank status finally solidified Bank Mega Syariah's position as one of the leading Islamic commercial banks in Indonesia (Bank Mega Syariah, n.d.-b).

Bank Mega Syariah Amrket Risk Exposure

Market risk in Bank Mega Syariah is the risk on the balance sheet and administrative accounts due to changes in market prices, including changes in the value of assets that can be traded or leased. This risk consists of exchange rate risk and sukuk price movement risk, which are categorized as fair value. The following is the disclosure of market risk using the standard method in Bank Mega Syariah December 2023:

Figure 1. Bank Mega Syariah Market Risk December 2023

(dalam jutaan rupiah

No.	Jenis Risiko	31 Desember 2023				31 Desember 2022			
		Bank		Konsolidasi		Bank		Konsolidasi	
		Beban Modal	ATMR	Beban Modal	ATMR	Beban Modal	ATMR	Beban Modal	ATMR
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1	Risiko Suku Bunga								
	a. Risiko Spesifik	-	-	-	-	-	-	-	-
	b. Risiko Umum	94,437	1,180,457	-	-	64,018	800,226	-	-
2	Risiko Nilai Tukar	12,918	161,471	-	-	3,482	43,531	-	-
3	Risiko Ekuitas *)	-	-	-	-	-	-	-	-
4	Risiko Komoditas *)	-	-	-	-	-	-	-	-
5	Risiko Option	-	-	-	-	8	97	-	-
6	CVA		26,935				73		-
	Total	107,354	1,368,863	-	-	67,508	843,927	-	-

Source: Bank Mega Syariah

The figure above shows the comparison of market risk exposure in Bank Mega Syariah as of December 2022 and 2023. The large capital charge to *cover* market risk indicates that Islamic banking faces significant risks in its operational activities, especially for positions that contain interest rate risk and currency exchange rate risk. Meanwhile, Risk Weighted Assets (RWA) are used to determine the minimum amount of capital a bank should hold about the risk profile of its lending activities and other assets. This is done to reduce the risk of bankruptcy and protect depositors. The greater the risk a bank has, the greater the capital it needs (Tuovila, 2023).

Based on the figure above, the capital expense at Bank Mega Syariah in December 2023 increased compared to December 2022, both interest rate risk, exchange rate risk, and credit valuation adjustment (CVA) risk. Because the capital expense increased, the RWA value at Bank Mega Syariah also increased from 2022 843,927 to 1,368,863 in 2023. However, in 2023 Bank Mega Syariah did not have a capital expense and RWA on option risk, unlike in 2022 which had a capital expense of 8 million and RWA of 97 million. Therefore, the market risk profile of Bank Mega Syariah in 2023 compositely increased from the previous year which was ranked 1 (*low*) to 2 (*low to moderate*). This is because, in 2023, Bank Mega Syariah also considered potential future risks in the risk profile assessment, so several types of risks were considered to have an increase in risk level.

Bank Mega Syariah Market Risk Management

The implementation of market risk management in Bank Mega Syariah is based on risk management policy in general by referring to 5 main pillars, namely (1) Organization and human resources pillar; (2) Adequacy of policies, procedures, and limit setting pillar; (3) Adequacy of risk management process pillar; (4) Comprehensive internal control governance pillar, and (5) Risk management pillar through capital. Bank Mega Syariah established 4 committees that play a major role in the risk management of Bank Mega Syariah, namely ALCO (*Asset and Liability Committee*) which focuses on managing the Bank's liquidity and profitability, Risk Management Committee which focuses on assessing the Bank's risk position/profile against 10 types of risk exposure, *Financing* Policy Committee that focuses on standardizing provisions related to the financing process, and *Financing Approval Committee that* is related to the provision of funds to customers (Bank Mega Syariah, 2023).

Bank Mega Syariah also established a risk management organizational structure consisting of a Board of Commissioners, Board of Directors, Risk Management Working Unit (SKMR), Operational Units (Risk *Taking* Unit), Independent Risk Monitoring and Control Unit, Risk Monitoring Committee, and Risk Management Committee. These seven instruments carry out their respective duties and responsibilities in carrying out risk management functions, starting from identifying risks, measuring risks, assessing risk profiles, monitoring risks, reviewing new product processes/activities from a risk and mitigation perspective, and reporting on the implementation of risk management strategies (Bank Mega Syariah, 2023).

The market risk faced by Bank Mega Syariah is managed based on the majority of the fund disbursement portfolio in the form of financing and partly in the form of sukuk securities as a liquidity reserve. It does not conduct *over-the-counter* trading activities for *proprietary trading*, thus market risk exposure is low. The focus is on behavioral change and maintaining customer trust during the increase of the market benchmark interest rate, adjusted to the majority of financing that has a fixed *margin* (Bank Mega Syariah, 2023).

In managing market risk, Bank Mega Syariah implements a risk management process in general, which consists of risk identification, risk measurement, risk monitoring, and risk control, as follows (Bank Mega Syariah, 2023):

1. Risk Identification

   Risk identification involves analysis of financial data presented by the *accounting/finance* working unit that reflects the performance achievement and quality of Bank Mega Syariah as a whole, in each distribution office, as well as per product or service. The risk identification process in Bank Mega Syariah also involves the results of internal *control* and internal audit checks, opinions from risk management and compliance working units, as well as discussions in inter-departmental and divisional meetings.
2. Risk Measurement

   The process of risk measurement and assessment takes place simultaneously by identifying and using the same sources. Bank Mega Syariah regularly evaluates risk measurement assumptions and data sources used, as well as reviews information on similar banking industries and recent regulatory changes. Every year, Bank Mega Syariah refines the parameters and risk measurement system, especially if there are significant changes in business activities or product portfolio that may affect the Bank's performance and financial condition.
3. Risk Monitoring

   At Bank Mega Syariah, risk monitoring is formally carried out during monthly Risk Management Committee meetings through the submission of Risk Profile and Risk Limit evaluations. These are subsequently reviewed daily and revisited during the subsequent month's meeting.
4. Risk Control

   Bank Mega Syariah has established *Business Continuity Plan and Disaster Recovery Plan* policies and procedures to face the worst possibilities beyond the bank's control. This includes *Business Impact Analysis, Risk Assessment*, and identification of crucial *Critical Business Processes*. In addition, *worst-case scenario* trials are also conducted routinely every year to ensure bank operations continue to run and services to the community are fulfilled in emergencies.

Conclusions and Recommendations

Bank Mega Syariah one of the Islamic banks in Indonesia conducts risk management to maintain the bank's sustainable business growth. Bank Mega Syariah implements 10 types of risk management, namely credit risk, operational risk, market risk, liquidity risk, strategic risk, legal risk, reputation risk, compliance risk, and 2 special risks, namely yield risk and investment risk. Based on the risk exposure and capital report, the capital expense owned by Bank Mega Syariah in December 2023 market risk has increased from December 2023 so it also affects the RWA value which has increased. The difference seen in the December 2022-2023 market risk exposure of Bank

Mega Syariah is that in 2023 Bank Mega Syariah did not have a capital expense for option risk, while in 2022 Bank Mega Syariah had a capital expense for option risk. Bank Mega Syariah manages market risk based on the majority of fund disbursement portfolios in the form of financing and partly in the form of sukuk securities as liquidity reserves, not conducting *over-the-counter* trading activities for *proprietary trading*. The focus is on behavioral changes and maintaining customer confidence during the increase in market benchmark interest rates, adjusted to the majority of financing that has a fixed *margin*.

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