

The Role of The Sharia Supervisory Board in Risk Mitigation in Islamic Financial Institutions

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Abstract

The Sharia Supervisory Board (SSB) plays a critical role in ensuring the compliance of Islamic financial institutions with Sharia principles. Beyond its function as a compliance authority, the SSB also contributes significantly to risk mitigation within Islamic financial institutions. This study explores the strategic role of the SSB in identifying, assessing, and minimizing Sharia-related and operational risks. The presence of the SSB ensures that all financial products, services, and operations adhere strictly to Islamic law, thereby preventing reputational and legal risks. Additionally, the SSB's involvement in governance, product structuring, and continuous auditing enhances transparency and promotes stakeholder trust. The findings highlight that an active and competent Sharia Supervisory Board not only strengthens the ethical foundation of Islamic finance but also enhances overall risk management and organizational resilience.

Keywords: Sharia Supervisory Board (SSB), Islamic Financial Institutions, Sharia Auditing



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INTRODUCTION

The Islamic finance industry has experienced significant growth in recent decades, not only in Muslim-majority countries but also in other parts of the world. This growth is driven by increasing public awareness of the importance of sharia principles in economic and financial activities, as well as the need for a fairer and more sustainable alternative financial system. However, along with this rapid expansion, Islamic financial institutions face various complex challenges and risks, ranging from credit risk, operational risk, market risk, to the most crucial, the risk of sharia non-compliance. In the context of Islamic financial institutions, the risk of sharia non-compliance has a unique and different dimension from conventional financial institutions. This risk not only impacts the financial aspect, but can also damage the reputation and credibility of the institution in the eyes of customers and the Muslim community as a whole. Therefore, the existence of an effective sharia supervisory mechanism is an absolute necessity for Islamic financial institutions to ensure that all operations and products offered are in accordance with sharia principles.

The Sharia Supervisory Board (SSB) is present as a vital organ in the governance structure of Islamic financial institutions that is tasked with supervising and ensuring compliance with sharia principles in every aspect of the institution's operations. The role of the SSB is not only limited to the post-implementation supervisory function, but also includes a preventive function in risk mitigation through product review, fatwa issuance, and ongoing supervision of the business practices of Islamic financial institutions. The complexity of the SSB's role in risk mitigation is increasing along with the development of innovations in Islamic financial products and the dynamics of ever-changing regulations. The SSB is not only required to have a deep understanding of fiqh muamalah, but must also be able to understand the technical aspects of modern finance, risk management, and applicable regulations. This raises questions about the extent to which the SSB's role is effective in risk mitigation and

how optimization of this function can be carried out to support the stability and sustainable growth of the Islamic financial industry. Research on the role of the SSB in risk mitigation in Islamic financial institutions is very relevant considering the importance of understanding effective sharia supervision mechanisms in maintaining the integrity and sustainability of the Islamic financial industry. This study is expected to contribute to the development of a better governance framework for Islamic financial institutions, especially in the aspect of risk management integrated with Islamic principles. Try again Claude may have made a mistake. Double check each response.

Literatur Review

The Role of the Sharia Supervisory Board in Risk Mitigation in Islamic Financial Institutions The Concept of the Sharia Supervisory Board The Sharia Supervisory Board (SSB) is an independent body tasked with supervising the business activities of Islamic financial institutions to ensure they are in accordance with sharia principles. According to Grais and Pellegrini (2006), the SSB functions as a sharia governance mechanism that ensures compliance with Islamic law in all operations of Islamic banks. This concept is reinforced by research by Nomran et al. (2018) which states that the SSB acts as an internal supervisor who has the authority to provide fatwas and sharia guidance to the management of Islamic financial institutions. Hamza (2013) in his study explained that the existence of the SSB is not only to fulfill regulations, but also as a form of accountability to Muslim stakeholders who need assurance of sharia compliance. This is in line with the views of Mollah and Zaman (2015) who emphasized that the SSB has a dual responsibility, namely ensuring sharia compliance while contributing to the management of operational risks of Islamic financial institutions.

RESEARCH METHODS

Research Methodology: The Role of the Sharia Supervisory Board in Mitigating Risks in Islamic Financial Institutions Document I have developed a comprehensive research methodology for the topic "The Role of the Sharia Supervisory Board in Mitigating Risks in Islamic Financial Institutions". This methodology is designed with a mixed methods approach that combines quantitative and qualitative analysis. Some key points of this research methodology: The mixed approach allows for more in-depth analysis with quantitative data to measure effectiveness and qualitative data to understand mechanisms and challenges Clear research variables with the SSB as the independent variable and various types of risks as the dependent variables Purposive sampling with appropriate criteria to ensure data quality Validated research instruments with structured questionnaires and interview guides Appropriate statistical analysis including multiple regression and SEM to test relationships between variables Are there any specific parts of this research methodology that you would like to discuss further or need adjustment?

1. Research Approach. This research uses a mixed methods approach with a sequential explanatory method, namely starting with a quantitative analysis to measure the effectiveness of the role of the Sharia Supervisory Board (SSB), then continuing with a qualitative analysis to explore the mechanisms and challenges faced in risk mitigation in Islamic Financial Institutions (LKS).
2. Type of Research. Descriptive-Analytical Research with the following approaches: Descriptive: Describes the actual role of DPS in risk mitigation; Analytical: Analyzes the causal relationship between DPS functions and LKS risk levels.

RESEARCH RESULT AND DISCUSSION

The Role of Supervision of Sharia Compliance

The SSB is tasked with reviewing and issuing fatwas on products, services, and policies implemented by the SSB. By maintaining sharia compliance, the SSB indirectly prevents the emergence of reputational and legal risks that could arise if the SSB violates sharia principles. When public trust, especially Muslim customers, is disrupted due to violations of sharia principles, this can have an impact on the liquidity and sustainability of the institution. (Selasi, 2024)

1. **Reputation Risk Mitigation.** Reputation risk is one of the most significant risks in Islamic financial institutions because it concerns the integrity of the institution towards Islamic teachings. The DPS has an important function in forming a positive public perception of the credibility and Islam of the institution. (Lestari et al., 2019) By issuing sharia decisions transparently and independently, the DPS helps build public trust and protect the institution's reputation from potential losses due to ethical violations.
2. **Involvement in Governance.** The DPS is not only an advisor, but also part of the corporate governance structure. An active and knowledgeable DPS can provide strategic input in making high-risk decisions. Collaboration between the DPS with the risk committee and top management allows early detection of potential sharia and operational risks, as well as formulating appropriate preventive measures. (Kalista et al., 2025)
3. **Sharia Evaluation and Audit.** One of the risk mitigation functions carried out by the DPS is through the implementation of periodic sharia audits. This audit assesses the conformity of operational implementation with sharia principles (Isror & Rahmayati, 2022). From the audit results, DPS can provide recommendations for improvement and ensure that deviations that occur can be immediately corrected before they cause greater risks.
4. **Improving Internal Sharia Literacy.** DPS also has a role in educating and fostering sharia understanding for LKS management and staff. (Mentari et al., 2024) Through training and socialization, DPS helps instill awareness of sharia risks early on throughout the organization, which ultimately creates a work culture that is in line with the principles of prudence and shariacompliance. (Munthe et al., 2019)

CONCLUSION

The Sharia Supervisory Board (SSB) plays a vital and multidimensional role in the risk mitigation process within Islamic financial institutions. By ensuring Sharia compliance, the SSB helps prevent reputational and legal risks, thereby protecting the integrity and trustworthiness of the institution. Its involvement in governance, regular Sharia audits, and internal education promotes ethical practices and enhances overall risk management frameworks. Ultimately, a competent and proactive SSB not only safeguards the institution's adherence to Islamic principles but also strengthens its operational resilience and stakeholder confidence. Therefore, integrating the SSB effectively into institutional decision-making and risk oversight is essential for the sustainable development of Islamic finance.

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