

IMPLEMENTATION OF SHARIA-COMPLIANCE IN ISLAMIC BANK PRODUCT INNOVATIONS

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Abstract

The establishment of sharia-compliant financial institutions is an effort by Muslims to live all aspects of their economic life based on the Qur'an and Hadith, and the community's need for interest-free banking. However, the development of Islamic banks around the world and in Indonesia still encounters many obstacles as they emerged amidst of the deep-rooted developments and practices of conventional banking. The success of Islamic banking is the success of implementing Islamic rules in muamalat. Nonetheless, there are still problems in their implementation. Public still doubts Islamic banks are truly Sharia-compliant. Some of the customers of Islamic banks close their accounts because they doubt the consistency of the application of Islamic principles. This is normative legal research in which the results show that Islamic banks without Islamic ethics will be trapped in an unethical Islamic business. The customers are concerned if its operational activities are mere replacement of banking terms. Additionally if it is difficult for the Islamic banks to impose sanctions to their customers as they are interest-free. There is also lack of human resources which comprehensively understand the operational systems of both conventional and Islamic banking. The implementation of a profit-sharing system requires complex calculations, particularly in the small profits shared with the customers and the not-fixed amount of savings. Although Islamic banks are oriented towards lower-income communities, there is a tendency that those who successfully get bona fide projects and credit facilities from Islamic banks are the upper class.

Key Words: *Sharia Compliance, Islamic Banking, Islamic Ethics.*

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A. Introduction

Islam provides comprehensive² and universal³ regulation for human life: the relationship with Allah SWT and with other human. Humans in their vertical relationships are always in contact with their God when worshipping,⁴ while in their horizontal relationships, they are connected to other people in the form of *muamalat*. It is applicable anytime and anywhere throughout the day.

Islam is *rahmatan lil 'alamin*, a religion that brings benefits and welfare for the entire universe, including animals, plants, and human. Thus, humans should not act arbitrarily to other humans and to other creatures created by Allah SWT. This way, the level of nobility of a person can be recognized from the extent to which s/he benefits others. Allah SWT sent down the Islamic teachings (laws) to bring benefits and prevent harms. The specific laws that Allah has set are only for the benefits of human. This religion also provides a comprehensive framework, including Islamic Criminal Law (*jinayah*), Political Law (*siyashah*), Islamic Marriage Law (*munakahah*), Islamic Contract Law (*akad*).⁵ The existence of Islamic law, particularly in terms of private law, is widely implemented in the community's daily life. The aspect of private law is contract law which contains the principles contained in the concept of Islamic Civil Law (*muamalah*)⁶ in accordance with Indonesian culture.⁷

It is increasingly important after the establishment of various Islamic financial and business institutions such as banking, insurance, hard money lenders, bonds, and others. This certainly requires approaching these institutions from the Islamic perspective.⁸ Business activities in Islam are included in the category of *muamalah*, include family matters, politics, law, and economics. In this aspect, the rule applies that, "all *muamalah* activities are basically permissible unless there is evidence or reason that prohibits them." Based on this rule, all forms of economic activities are permissible in Islam.

² Muhammad, *Sistem dan Prosedur Operasional Bank Islam* (1st edn, UII Press 2000) 1-2.

³ *ibid*.

⁴ Holy Quran Surah Az Zariyat verse 56.

⁵ Abdul Ghofur Anshori, *Pokok-Pokok Hukum Perjanjian Islam di Indonesia* (1st edn, Citra Media 2006) 14.

⁶ The principles in *muamalat* include the principle of permissibility, the principle of benefit, the principle of freedom and volunteerism, the principle of refraining from harm and taking advantage, the principle of fairness and balance, the principle of prohibition of harming oneself and others, the principle of obtaining rights due to business, and the principle of property rights, social functions.

⁷ Abdul Ghofur Anshori (n 5) 15.

⁸ Afdawaiza, 'Terbentuknya Akad Dalam Hukum Perjanjian Islam' [2008] *Almawarid* 18, 182.

Economics in Islam is a study of all human behaviors in meeting the life needs to achieve *falah* (peace and prosperity of the world and the hereafter). These human behaviors are related to Islamic principles as a reference of how humans should behave according to their nature. This guarantees the channeling of wealth among humans, so they can maximize their life functions as servants of God to achieve *falah* in the world and the hereafter. In other words, increasing welfare is not only for the benefit of individuals (capitalism), but for human, considering that capitalism is present in almost every sector of life and culture. Unfortunately, criticisms against capitalism unexpectedly strengthen capitalism.⁹

Islamic economic system was born as a form of criticism against economic systems and theories that were built not based on human values (not egalitarian), namely capitalism and socialism. Islamic economic paradigm in fact contradicts capitalism and socialism which adhere to secularism. The Islamic economic paradigm is based on Islamic *Aqidah*, i.e., *tauhid ilahiyyah*. The existence of the Islamic economic system is a result of the Islamic worldview. Humans, whose role is as *khalifah* (leaders), are given an order that to achieve welfare should be based on fairness and balance according to the concept of *tazkiyah* (morality) to achieve *falah*. In meeting the life needs, human behavior should be based on Islamic principles as well as the Qur'an and Hadith; the motive in economic activities is worship.¹⁰

Under this view, economics is inseparable from human life. In addition to achieving material goals, Islam emphasizes that values, human noble characters, social integrity and God's rewards and punishment in the hereafter should be considered. In other words, economic activities are regarded not only as activities to meet material needs, but above all, these activities should be as worship for Allah SWT. This means that economics is a collective activity, instead of individual activity; improving welfare is not only for the benefit of certain individuals as in capitalism, but also for human.

The ideals of Islamic economics are expected to outperform and abolish the conventional system which fails to bring benefits for the community. The main

⁹Choirul Huda, 'Ekonomi Islam dan Kapitalisme: Menurut Benih Kapitalisme Dalam Ekonomi Islam' (2016) VII Jurnal Economica 1, 28.

¹⁰Ika Prastyaningsih, Mohammad Ghozali and Andi Triyawan, 'Paradigma Ekonomi Syariah Dalam Faham Hegemoni Kapitalisme dan Sosialisme: Sebuah Solusi Pola Hidup Muslim' (2017) 3 Islamic Economic Journal 2, 197.

characteristics that distinguish Islamic and conventional economic systems are the objectives and functions of Islamic economics are based on Islamic teachings.¹¹

The informal development of the Islamic financial industry had started even before the formal legal framework as the basis for banking operations in Indonesia was established. Some non-bank financing business entities established before 1992 have implemented the concept of profit sharing in their operational activities. This implies the community's need for the existence of financial institutions providing Sharia-compliant financial services. For example, the existence of *baitul mal wa al-tamwil* and its development into a financial system that is quite reliable in the middle east region.¹²

The main objective of establishing Islamic financial institutions was as an effort by Muslims to make the Quran and Hadith the bases of all the aspects of economic life.¹³ In addition, sharia-compliant banking was established due to the needs of the community, especially Indonesian Muslims, for interest-free banks; the establishment of Islamic banks in Indonesia with an interest-free system has brought a significant effect on the Indonesian banking system.¹⁴

The basic principle that distinguishes conventional banks and Islamic banks is in the aspect of returns and profit sharing provided by customers to financial institutions and/or provided by financial institutions to customers.¹⁵

In terms of the substantive legal perspective, conventional banking is based on the principle of setting interests as implemented in the capitalism, with the philosophy of the "time value of money," while Islamic banking law has a different philosophy from that of the conventional banking principles. Islam views money only as a medium of exchange that does not have "time value." This way, interest is prohibited regardless of the interest rate.¹⁶ This is what primarily distinguishes between conventional and Islamic banks.¹⁷

The application of Islamic law to all banking, finance or other modern economic activities is not a simple task. Studies on the legal issues of Islamic banking or Islamic

¹¹ Andi Soemitra, *Bank dan Lembaga Keuangan Syariah* (Fajar Interpratama Mandiri 2017) 21.

¹² Nurul Huda, *Lembaga Keuangan Islam Tinjauan Teoritis dan Praktis* (3rd edn, Kencana 2015) 25.

¹³ Muhammad Syafi'i Antonio, *Bank Syariah Dari Teori Ke Praktik* (1st edn, Gema Insani Press 2001) 18.

¹⁴ Sri Eti Faturoh, *Kegiatan Bank Syariah Mandiri (BSM) Dalam Pemberian Kredit Mudharabah, Tinjauan Aspek Yuridis* (Thesis, 2006).

¹⁵ Ema Rindawati, *Analisis Perbandingan Kinerja Keuangan Perbankan Syariah Dengan Perbankan Konvensional* (Thesis, 2007); Muhammad, *Manajemen Bank* (Ekonosia 2005).

¹⁶ Holy Quran Surah Al-Baqarah verse 275.

¹⁷ Muhammad Budi Setiawan, 'Tinjauan Politik Hukum Perbankan Syariah di Indonesia' (*Cakwawan*, 11 November 2007) <<http://cakwawan.wordpress.com/2007/11/10/tinjauan-politik-hukum-perbankan-syariah-di-indonesia/>> accessed on 19 July 2021.

finance law are interesting yet challenging for the legal field in Indonesia, because the positive law applicable in Indonesia differs from Islamic law. Thus, the Islamic law cannot be automatically applicable in social life because Indonesia is not an Islamic state. The application of Islamic law must go through a process known as the "positivization" of Islamic law. In this case, Islamic law is accepted by the state in positive laws and regulations that are applicable on a national level. Therefore, Islamic banks established in countries of which the legal systems are derived from the western laws, as in Indonesia, must follow not only Islamic law, but also all other national laws that directly or indirectly regulate Islamic banks.

The "cooperation" between national law and Islamic law has made this legal framework very interesting to study and explore. Islamic law, which has been widely applied in the legal system in Indonesia, is slowly yet surely balancing the dominance of the western law as a source of the national laws. Today we are challenged to see Islamic law as one of the main sources of laws in creating one of the most important laws, i.e., Islamic banking and finance law. The success of the development of Islamic banking and finance law will determine the success of the development of other Islamic legal sciences.¹⁸

The rapid development of both national and international economies faces challenges that are increasingly widespread, so it is necessary to anticipate and accommodate the aspirations and needs of the community to perform business activities based on Islamic principles.

Law Number 21 of 2008 on Islamic Banking eliminates limitations on the definition and conventional banking activities which are more restrictive compared to Islamic banking activities, especially in terms of investment and trade. Both Islamic and conventional bank customers will have a higher level of confidence in conducting Islamic banking business activities. There is a great expectation for Islamic Banking Law to deal with and respond to various issues related to the authority and coordination between institutions that have the authority to regulate and supervise Islamic banking. It is very crucial to clarify such authority to create a conducive situation for the development of Islamic banking, and to encourage the establishment of an institutional and legal structure that is in line with national economic, political, and legal conditions. The Islamic Banking

¹⁸ Dian Ediana Rae, 'Arah Perkembangan Hukum Perbankan Syariah' (2008) 6 Buletin Hukum Perbankan Dan Kebanksentralan 1, 10.

Law is beneficial, providing clear guideline and direction in terms of dispute resolution inside and outside the court.

It is necessary to improve the intensity, quantity, and quality of in-depth and comprehensive studies on the direction of the development of Islamic economics, so the development of Islamic economic activities will be more in line with and provide more support to the development of Islamic banking legal infrastructure. It is a must to design laws that encourage the development of Islamic banking, not hindering the progress and development of Islamic banking activities.

Muslims and the Indonesian citizens in general should be grateful and proud of the efforts to establish Islamic banks. The success of Islamic banking can serve as an example of the success of implementing Islamic rules in *muamalah*. Nonetheless, there are still problems encountered by Islamic financial institutions in their implementation. The public still doubts the Sharia compliance of Islamic banks. Some of the customers who have used the services provided by Islamic banks tend to close their bank accounts because they doubt the consistency of the application of Islamic principles. The Sharia compliance of these Islamic banks is often questioned by customers.

This implicitly indicates that the practices of Islamic banks have so far not fully paid attention to Islamic principles, affecting the reputation, public trust, and public loyalty to Islamic banks. This dissatisfaction is based on customers' experiences when transacting with several Islamic banks that in fact have not fully and consistently implemented Islamic principles. There is an ambivalence between Islamic principles and the operational activities in the field. There is a nonconformity of the predetermined Islamic principles.¹⁹ This consequently decreases the trust of the customers or prospective customers.

B. Problems Formulation

The problem of this study is formulated as follows: how is the implementation of Sharia compliance in Islamic bank product innovations?

C. Methodology

This study used a qualitative approach, the data processing and analysis is done by an in-depth study by examining the problem under study. The research used a normative

¹⁹ Nurkholis, 'Kajian terhadap Kepatuhan Syariah dalam Praktik Pembiayaan di BMT Sleman, Yogyakarta' (2007) 5 Fenomena 2, 124.

legal approach by using the provisions of the applicable legislations or a doctrinal legal approach, i.e., legal theories and expert opinions.

D. Results and Discussion

1. Implementation of Sharia Compliance in Islamic Bank Product Innovations

Article 29 (2) of the 1945 Constitution provides freedom of belief, and its implementation must be regarded as the freedom for the Islamic community to perform their civil activities based on the Islamic law that they uphold.

There are many interpretations of Article 29 (2). For Indonesia, whose predominant population is Muslim, the implementation of such a provision is, as expected by Muslims, certainly to implement Islamic provisions in its legal provisions (formal law), neglecting the fact that Indonesia was established based on a social contract and that Indonesia still adheres to, embracing pluralism although most of its citizens follow Islam.

The state provides for the right to freedom of religion, positioning the state as a facilitator. The implementation of the provision depends on the applicable mechanism for formulating legislation in Indonesia. In fact, Indonesia is a democratic country, so democratic principles are also considered in all the political activities. This way, anything issued, including laws and decisions, does not take sides or harm a particular group.

The existence of the rule of law in a country is an important requirement to implement the life of the state and society and to create order and peace. The law must contain values that can be applied by the local community.

The regulation of Islamic banking embodies the government's awareness and policy in determining the regulations to be applicable, i.e., determining that Islamic banking is legally equivalent with other conventional banking. The Islamic Banking Law is the government's response to the existence of Islamic banking, and Islamic banking is no longer seen as a mere new banking system, but it is more than that, i.e., it has the opportunity to compete with or even outperform conventional banking.²⁰

The politics of Islamic economics is related to the development of law concerning Islamic economic financial institutions in Indonesia. The role of politics can be seen in the positivization process of Islamic economic regulations in Indonesia, where the

²⁰ Muhammad Ramadhan, 'Politik Hukum Perbankan Syariah Di Indonesia' (2016) XI Jurnal Hukum MIQOT 2, 273.

government has set directions, methods, and policies in formalizing Islamic economics-related laws in Indonesia. The government plays its political role by formulating regulations as checks and balances, such as making policies that can support economic activities and Islamic economic growth, both institutionally and systematically, to ensure they follow the right direction. The government's political will could accelerate the realization of an Islamic economic structure as a fair economic system that is based on Islamic principles, thus creating a good-growth atmosphere. The indicator of the achievement of the political role of Islamic economics can be seen by an increasing number of Islamic financial institutions in Indonesia.²¹

There are three (3) ways to establish an Islamic bank in Indonesia: *first*, directly establish an Islamic bank which applies a full Islamic system; *second*, convert from a conventional bank to an Islamic bank; and *third*, establish an Islamic division which is usually done by a conventional bank that intends to conduct sharia-compliant transactions. This is done by establishing an Islamic division using the Dual Banking System.²²

Islamic banking in Indonesia has developed to attract the interest of the Muslim community in the banking sector. They believe that Islamic banks are conventional banks which use Islamic banking terms, of which the opening of the contract starts with *Bismillahirrahmaanirrahiim* (re: in the name of Allah, the Most Merciful, the Benefolent), and their employees wear uniforms that meet Islamic clothing requirement and say Islamic greetings. However, the contracts of these Islamic banks still contain some aspects prohibited by the religion. In fact, the public's skepticism about Islamic banking is unavoidable because banking has always been perceived to be separate from Islamic principles. Thus, at the beginning of the establishment of Islamic banking, many people were not optimistic that Islamic economists would successfully integrate Islamic principles into banking institutions.²³

²¹Mul Irawan, 'Politik Hukum Ekonomi Syariah dalam Perkembangan Lembaga Keuangan Syariah di Indonesia' (2018) 25 Jurnal Media Hukum 1, 20.

²² Dual banking system is the implementation of two banking systems (conventional and Islamic banking systems) of which the implementation is regulated in various applicable laws and regulations as quoted in Khotibul Umam, *Hukum Ekonomi Islam; Dinamika dan Perkembangan di Indonesia* (Instan Libs Indonesia 2009) 16 from Abdul Ghofur Anshori, *Perbankan Syariah di Indonesia* (Gama Press 2007), 33; Burhanuddin Susanto, *Hukum Perbankan Syariah di Indonesia* (1st edn, UII Press 2008) 151-152.

²³ Bagya Agung Prabowo, 'Konsep Akad Murabahah pada Perbankan Syariah: Analisa Kritis terhadap Aplikasi Konsep Akad Murabahah di Indonesia dan Malaysia' (2009) 16 Ius Quia Iustum 1, 107-108.

The main principles upheld in the operational activities of Islamic financial institutions include being free from *maisir*, *gharar*, and *usury*, conducting business and trading activities based on what is permissible according to Islamic law.²⁴ The basic principles of Islamic banking are according to the Quran and Hadith. The basic philosophy of the operational activities and transactions of Islamic banks is based on three principles, namely efficiency, fairness, and togetherness. Efficiency refers to the principle of helping each other synergistically to obtain as much profit as possible. Fairness refers to the relationship that is sincere and voluntary, does not contain fraudulence, with appropriate agreement on the proportion of inputs and outputs. Togetherness refers to the principle of offering each other help and advice to increase each other's productivity.²⁵

Abdul Ghofur added that,²⁶ the characteristics of Islamic Financial Institutions include: *first*, receiving deposits and investments, Islamic financial institutions must comply with the *fatwa* of the sharia supervisory board; *second*, the relationship among investors (those that deposit funds), fund users and Islamic financial institutions as intermediary institutions is a partnership, instead of a debtor-creditor relationship; *third*, the activities of Islamic financial institutions are not only profit oriented, but also *falah*-oriented, i.e., welfare and happiness in the world and in the hereafter; *fourth*, the transactions in Islamic financial institutions are based on the principle of profit-sharing, sales and purchase, or leasing for commercial transactions, and lending and borrowing (*qardh/credit*) for social transactions; and *fifth*, Islamic Financial Institutions only make *halal* (lawful) investments and neither cause losses nor harm Islamic symbols.

Islamic banks have three main functions, namely collecting funds from the public in the form of savings and investments, channeling the funds to people who need funds from banks and providing services in the form of Islamic banking services.²⁷ Islam sees that financial and banking activities are a vehicle for the community to bring them to the implementation of Islamic teachings. This is the core principle of Islamic banking.

²⁴ Abdul Ghofur, *Pengantar Ekonomi Syariah: Konsep Dasar, Paradigma, Pengembangan Ekonomi Syariah* (Raja Grafindo Persada 2017) 128.

²⁵ Edy Wibowo and others, *Mengapa Memilih Bank Syariah?* (1st edn, Ghalia Indonesia 2005) 33.

²⁶ Abdul Ghofur (n 24) 136.

²⁷ Ismail, *Perbankan Syariah* (2nd edn, Kencana Prenada Media Group 2013) 23.

The principles of Islamic banking include, *first*, the *at ta'awun* principle, i.e., the principle to help each other and cooperate.²⁸ Allah SWT has ordered humans to help each other in acts of piety and righteousness. On the other hand, Allah SWT forbids humans from helping others in acts of sinfulness and transgression, as stated in QS. Al-Maidah verse 2.

Second, the principle of avoiding *al-ikhtinaz*. This principle is in accordance with the function of money, i.e., that it should be used in transactions that are beneficial to the public and not be left idle. Islam views money that is used as a flow concept, so it must be used to stimulate the economy. The faster the money is circulated in the economy, the higher the income level of the community as a whole and the better the economy.²⁹ This principle is in line with the words of Allah SWT in QS. An-Nisaa' verse 29.

The paradigms of Islamic banks include, *first*, the paradigm of the relationship of a bank with its customers.³⁰ The relationship between the bank and the customer is a contractual agreement or a contract between the investor who owns the funds or *shahibul maal* and the investor who manages the funds or *mudharib* who work together to carry out a productive business and share profits fairly (a mutual investment relationship). With the presence of such investment partnerships, it basically creates a harmonious business relationship because it is based on the principle of fairness and both parties obtain proportionally agreed benefits.

Second, the paradigm of the prohibition of business activities by Islamic banks³¹ which aims to create productive, fair, and ethical economic activities. Islamic banks create productivity because they abolish the concept of the "time-value of money" and prohibit speculative transactions. Being in line with the Islamic concept of property and natural resources, the existing property and natural resources should be utilized and explored productively for the welfare of the society. The concept of utilizing property and natural resources clearly opposes the non-productive accumulation of property,

²⁸ Danang Wahyu Muhammad, 'Penerapan Prinsip Syariah dalam Permodalan Bank Syariah' (2014) 21 Jurnal Media Hukum 1, 46.

²⁹ Veithzal Rivai and Arviyan Arifin, *Islamic Banking: Sebuah Teori, Konsep dan Aplikasi* (Bumi Aksara 2010) 299; Adiwarmanto A. Karim, *Ekonomi Makro Islam* (Islamic Macro Economy) (RajaGrafindo Persada 2007) 88.

³⁰ Dhani Gunawan, 'Perbankan Syariah Indonesia Menuju Millenium Baru; Suatu Tinjauan Pengembangan, Pengawasan, dan Prospek' *Buletin Ekonomi Moneter dan Perbankan* (December 1999).

³¹ *ibid.*

land, or natural resources that are held by a small part of the community, including the flow of funds in banks without any real investment.

Third, the paradigm of Islamic banks engaging in more diverse business activities than conventional banks³², because Islamic banks are based not only on a profit-sharing system but also on a system of purchases and sales, leasing, and providing other services adhering to Islamic principles. Although there are some questions from experts regarding the institutional functions of Islamic banks, whether they serve as "banks" or "investment companies," in practice, there is no doubt that the diversity of the business activities of Islamic banks has fostered various aspects of economic transactions throughout society, making the Islamic banks have a high adaptability to the needs of the business world.

The Islamic economic system, particularly Islamic banking, emphasizes the concept of benefits in each economic activity at a broader level, not only the benefits at the completion of each activity. Each transaction must always refer to the concept of benefits and uphold the principles of fairness.³³ In addition, the principles are intended to emphasize that economic actors must always uphold ethics and legal norms in economic activities. This way, the realization of the Islamic concepts, in this case in Islamic banking, is upholding the principle of fairness, avoiding prohibited activities, and paying attention to the beneficial interests.³⁴

The implementation of the contract principles in the business or operational activities of Islamic banking is as follows:³⁵ *first*, fundraising activities. Fundraising activities can be carried out by banks through various mechanisms including savings, current accounts, and time deposits. Particularly for Islamic banking, there are two types of savings and current accounts, namely savings and current accounts based on a *wadiah* contract, and savings and current accounts based on a *mudharabah* contract. Meanwhile, time deposits can only be carried out based on a *mudharabah* contract because deposits are intended as investments.

Second, fund channeling activities. Channeling funds to the public (lending) can be carried out by banks in the form of *murabahah*, *mudharabah*, *musyarakah*, or *qard*.

³² *ibid.*

³³ Zainuddin Ali, *Hukum Perbankan Syariah* (1st edn, Sinar Grafika 2008) 20.

³⁴ *ibid.*

³⁵ Yusman Alim Djasmin Maku, 'Penerapan Prinsip-Prinsip Tentang Perbankan Syariah Hubungannya Dengan Otoritas Jasa Keuangan' (2007) VI Jurnal Lex Crimen 1, 41.

Banks as fund providers will obtain rewards in the form of profit margins for *murabaha*, profit sharing for *mudharabah* and *musyarakah*, as well as administrative fees for *qard*. *Third*, Bank Services. Business activities carried out by banks as service providers can be in the form of providing bank guarantees (*kafalah*), Letters of Credit (L/C), *Hiwalah*, *Wakalah*, and buying and selling foreign currencies.

By examining the economic rules contained in the Qur'an and Hadith, Islam has really regulated the economic system carefully and clearly through its universal values, that each economic transaction (*muamalah*) should be based on the principles of honesty, fairness, tolerance, and kindness, and these principles should be applicable to trade, cooperation, or all other aspects of the economy.³⁶ Islam has also allowed for the widest possible degree of freedom in carrying out all economic transactions (as long as these transactions do not violate the universal values of Islam) and has even ordered its believers to keep being dynamic in facilitating transactions through its financial instruments so as to always keep up to date with the changing times and place differences.³⁷

The main Islamic principles that serve as the philosophical basis for Islamic banking are, *first*, honesty. This principle is something that every human must uphold in various aspects of life, including *muamalah*. Honesty proves a commitment to the importance of the right words, so they become a guide and provide benefits for any parties engaged in an agreement and for the community and the surrounding environment. Therefore, in the management and operation of Islamic banking, honesty must always be upheld to get the blessing of Allah SWT. *Second*, fairness and truth. Each agreement made by Islamic banking must prioritize fairness and truth to avoid unfairness (*dzalim*). *Third*, Parallel or equality. The presence of mutual trusts in an agreement is the success factor of each of the parties related to their rights and obligations, preventing them from experiencing losses. Another success factor is measured by willingness to help others and to cooperate.

³⁶ The indication can be seen from the fact that the barter system (materials and benefits) is permissible, through sale and purchase, leasing, pawning, cooperation and others.

³⁷ This can be seen from the fact that there is neither specialization nor limitation on certain instruments. What the Prophet and his Companions had applied at that time was only the compatibility of the times and their knowledge of these instruments and products, where only the instruments/products were known by them and used at that time. That is, there is no need for future generations to use the instruments and products as long as the universal values are maintained.

The fact that Islamic banks are mushrooming has caused criticism. In fact, the criticism comes from Islamic scholars. They argue that the Sharia-compliant transactions carried out by Islamic banks contain some aspects that are in contrary to Islamic principles.³⁸

In carrying out their business activities, it is known that Islamic banks are not interest-free and risk-sharing. Instead, they still charge interest, but they use different terms, and they avoid risks in a dishonest way.³⁹

Islamic ethics-based business should be not only a discourse and slogan displayed in the corners of Islamic bank offices but should also be applicable in reality, particularly by Islamic bank marketers. Without Islamic ethics, Islamic banks will be trapped in unethical Islamic business practices. Therefore, not only are Islamic banking institutions considered to have no integrity in the community's eyes, but Islam as a religion is also considered to have no correct system.

Islamic banks, in their business operations, must comply with Islamic principles. Non-conformity with Islamic principles will cause reputational damage to the Islamic banks. This can decrease public trust in Islamic banks, causing customers to withdraw their funds.⁴⁰

Therefore, Sharia compliance⁴¹ is a must for Islamic banks in Indonesia to improve reputation and trust in Islamic banks as well as protect the interests of stakeholders to create a healthy and reliable Islamic banking system.

One example is the marketing staff of Islamic banks who always interact directly with the community (customers) to market and offer Islamic banking products. The marketing efforts carried out by these staffs are often considered to be one of the causes why the public (customers) are not interested in Islamic banks. They think that the

³⁸ Sutan Remy Sjahdeini, *Perbankan Islam dan Kedudukannya dalam Tata Hukum Perbankan di Indonesia* (2nd edn, Pustaka Utama Grafiti 2005) 117.

³⁹ *ibid.*

⁴⁰ Enzelita Wahyuningsih, *Pengaruh Sharia Compliance & Islamic Corporate Governance Terhadap Fraud Pada Bank Umum Syariah* (Thesis, Undergraduate Study Program of Accounting, Faculty of Economics, Universitas Negeri Jakarta, 2021) 3. Muhammad Ainun Najib, 'Legal Policy of Formalization of Islamic Sharia in Indonesia' (2020) 2 *Prophetic Law Review* 159.

⁴¹ Sharia compliance is an absolute requirement that must be met by financial institutions that carry out business activities based on sharia principles, *see* Hasanah Endraswati, 'Konsep Awal Islamic Corporate Governance: Peluang Penelitian yang Akan Datang', (2015) 6 *Muqtasid* 2, 92; Sharia compliance is one of the fundamental aspects that distinguishes Islamic banking from the conventional ones, *see* Aldira Maradita, 'Karakteristik Good Corporate Governance pada Bank Syariah dan Bank Konvensional' (2014) 29 *Jurnal Yuridika* 2, 202.

marketing staff do not show any Islamic ethics and the way they provide information related to the banking products does not meet the values of Islamic banking.

To maintain the rights of businesses and avoid violations when making transactions with customers, Islamic bank marketers need business rules and ethics that can be used as a reference in carrying out marketing activities. Ethics are always upheld to understand Islamic business ethics and applied when carrying out marketing activities. This is manifested in honesty, cooperation, commitment, discipline, and responsibility.

In carrying out their activities, marketing staff should always uphold the principles of fairness, honesty, cooperation, commitment, discipline, responsibility, and sincerity. This aims to provide an understanding of Islamic business ethics and to develop Islamic banking. A decision to become the customer of an Islamic bank can be influenced by marketing staff who show Islamic ethics. Therefore, Islamic banks prioritize customer satisfaction which is manifested in the form of guaranteed quality of products and services. In addition, Islamic bank marketing staff should have transparency, instead of committing fraud or dishonesty. They usually refer to religious concepts or religious elements, so they carry out their marketing activities carefully.

The core values of Islamic banking marketing are honesty, integrity, and transparency so the marketing staffs of Islamic banks must not lie, allowing people to buy their products because they meet their needs and desires. This activity directs the process of creating, offering, and changing the value from an initiator to stakeholders, of which the entire processes are in accordance with the contract and principles of Islamic business ethics. In other words, in Islamic marketing, the process of creating, offering, and exchange of value should not violate the contract and principles of Islamic business ethics.

Another example is related to the products offered by Islamic banks, one of which is *murabahah*. *Murabahah* is a purchase and sale transaction between seller (bank) and customer where the bank basically purchases the goods needed by the customer (the goods purchased must meet the specifications as requested by the customer), then sells them to the customer at a selling price of the purchase price plus a profit margin as agreed upon by both parties. From such transactions, the bank earns a profit margin as agreed upon by the bank and the customer.

In the context of *murabahah* transactions, Islamic banks are profit-sharing banks, not truly interest-free banks. Around 40% of Islamic Public Financing Banks (BPRS) and several conventional banks offering Islamic banking transactions do not comply with the *murabahah* principles because they suspectedly carry out *murabahah* by using a scheme equivalent to conventional banking.⁴²

If Islamic procedures are not properly implemented, it means that the scheme uses conventional procedures. This is because the bank intends to avoid double taxation (for cases before the abolition of double taxation) or save operational costs which currently still take place in Islamic banking. However, this is not a pure *murabahah* scheme, but it is similar to a money lending scheme that includes interest.⁴³

Profit sharing and interest is a persistent concern to the customers, especially in terms of the differences and implementation in *murabahah*. In the operational activities, Islamic banks are still allowed to charge administrative fees for services provided to customers, but the amount of the administrative fees must be listed before signing the contract, allowing customers to know about these fees before the *murabahah* transaction is carried out. In addition, the amount of the administrative fees must always be the same for all *murabahah* transactions regardless of the price of the goods requested by the customers. For other costs arising when purchasing goods, the banks are allowed to show them to the customers honestly and transparently when delivering the goods.

The foundation of the operations of Islamic banking is the interest-free as well as profit- and risk-sharing principles. Many Islamic scholars have explained that interest is prohibited because it can cause injustice in the community's economy. On the other hand, Islamic banking conceptually follows the principles of cooperation based on equality, fairness, transparency, and seeking only *halal* profits. In addition, at a macro level, its mission is to carry out education process (*tarbiyah*), i.e., fostering financial administration to the public, create healthy competition, strengthen zakat institutions, and build *ukhuwah* (networking) with other Islamic financial institutions at the national and international levels.⁴⁴

⁴² Achmad Setiyaji, 'Perbankan Syariah Kian Menjamur di Nusantara' *Pikiran Rakyat* (18 June 2004).

⁴³ Agus Triyanta, *Hukum Perbankan Syariah* (Setara Press 2016) 68.

⁴⁴ Fathurrahman Djamil, 'Kontrak Keuangan pada Bank Syariah' (Paper, Seminar Perbankan Syariah in Padang, 29 May-3 June 2004) 2-3.

Philosophically, Islamic banking implements Islamic principles. These principles include the prohibition of interest (*usury*) in any economic transactions including banking, and the *halal* status of any products offered by banks. This Islamic principle results in a banking principle which prioritizes the real sector and the principle of a mutually beneficial cooperation (*ta'awun*) between Islamic banks and customers.

Regarding profit margins that keep increasing over time, it is crucial for the banks to reflect on the principles that Islamic banks are prohibited from charging percentage-based administrative fees for debt or savings that automatically multiplies the debt or savings over time. Therefore, profit margins must be determined immediately after the bank purchases the goods and ready to sell them to the customer. Profit margins must be included in the contract, so both the bank and the customer agree and are willing to accept the terms, preventing any losses to any party. For the date on which debt payment is due, the researcher recommends that Islamic banks set a debt payment period of no more than one year, preventing the banks from experiencing any cash flow problems. However, if financing is agreed upon for a period of more than one year, then the profit margins predetermined at the beginning of the contract may not be changed later and may not be increased when there is a change in the debt payment period.⁴⁵

In relation to the purchase of goods, banks are basically not institutions that carry out purchase and sale transactions. On the other hand, banks are a fund-channeling institution so the bank's activities in procuring the goods ordered by customers under a *murabahah* contract do not violate the rules. In order for the process of purchasing and selling goods to run smoothly, banks should only purchase goods when a customer orders it. Both the customer and the bank's representative should go together when purchasing the goods requested by the customer, preventing a customer from cancelling the contract. If this effort is done, it is not possible to say that the bank has violated the DSN-MUI Fatwa, as often criticized by various mass media and the public.

Similarly in 2013, Bank Negara Indonesia Syariah (BNI Syariah) disclosed non-halal income. According to Circular Letter of Bank Indonesia No. 12/13/DPbS dated April 30, 2010, concerning the Implementation of Good Corporate Governance for Islamic Commercial Banks and Islamic Business Units, BNI Syariah was required to

⁴⁵ Dodik Setiawan Nur Heriyanto, 'Public Contract in Indonesia: Is it merely Contractual Obligation?' [2005] 1 PEME XI. Ph.D. – Konferencia 41, 42-44.

disclose non-halal income and its use in Islamic banks through an annual report on the implementation of Good Corporate Governance (GCG).⁴⁶

The non-*halal* funds at BNI Syariah were obtained from penalties, interest, etc. BNI Syariah also disclosed the use of these non-halal funds. The non-halal funds were channeled for education, health, natural disasters, and *da'wah*. In addition, employee zakat, corporate zakat, and *infaq* were channeled for social activities. BNI Syariah disclosed this fact although the funds obtained were categorized as non-*halal* funds. This is in line with one of the Islamic principles, honesty, where BNI Syariah made full disclosures by disclosing all necessary information about their activities although the information disclosed disadvantaged them.⁴⁷

The actions of BNI Syariah has implemented the principle of honesty by reporting the non-halal funds it has obtained. The non-halal funds stated in the financial statements of BNI Syariah were obtained from interest, a type of income prohibited by Islamic teachings.

Another example is related to Islamic banking products, namely *musharaka*. In a *musharaka* contract, both the bank and the customer contribute to a business. There are some things drawing complaints and criticism from the customers in relation to the *musharakah* contracts, such as lack of information that this contract tends to use the principle of loan as in conventional banks due to the presence of "ability to pay" analysis, collateral, and penalties.

In principle, there is no security interest in *musharaka* financing. However, to prevent violations, Islamic Financial Institutions may ask for collateral. The collateral is solely to protect the contract and prevent losses from defaults.

In addition, analysis of creditworthiness is a concrete measure taken by Islamic banks as the holder of funds trusted by the customer association. This way, it is only understandable that before making a *musharaka* contract, a bank first assesses the ability to pay of the customer who is applying for such contract to safely manage the funds as mandated. Regarding penalties, the bank should not include them in the contract because penalties are an addition to the loan which violate the Islamic principles.

⁴⁶ Muhammad Wahyuddin Abdullah and Nurul Ainun, 'Implementasi Nilai-nilai Islam dalam Manajemen Laba Efisien Perbankan Syariah di Indonesia' (2017) 17 Jurnal Al-Ulum 1, 76.

⁴⁷ Muhammad Bassam Maali, Peter Casson and Christopher Napier, 'Social Reporting by Islamic Banks' (2006) 42 Abacus 2, 266-289; Muhammad Wahyuddin Abdullah, n 45, 76.

Another problem is lack of oversight of Islamic banking, especially in relation to the practices in Islamic bank products. There are a limited number of the members of Sharia Advisory Board (DPS) who are responsible for overseeing sharia-compliant operations and many DPS members working in Islamic banks find it difficult to focus because they hold many positions. In addition, there is lack of quality improvement of DPS members in Islamic Financial Institutions.⁴⁸

There is a violation to the quality and capability of Islamic banks, i.e., the board of directors has business interests focusing on profit. At the GMS, the profits become the main indicator in developing and improving the business, so the company or institution is oriented to the interests of the company shareholders, instead of carrying out the institution's function as intermediary finance and the interests of stakeholders.⁴⁹

Sharia compliance is the fulfilment of all Islamic principles in all of the activities of Islamic banks. This means that, in making product innovations, Islamic banks must also comply with Islamic principles. The aspect of Sharia compliance for Islamic banking is important because it can be used in risk mitigation and fraud prevention.⁵⁰ In this case, product development is of no exception where Islamic banking must also refer to Islamic standards, Islamic governance, and international standards. Product development efforts should not harm the community and must pay attention to the conformity of the product contracts developed in compliance with Islamic standards.⁵¹

Problems related to the product innovation of Islamic banks have also emerged along with the development of Islamic banks. The development and innovation of Islamic banking products have neither answered market needs nor had high competitiveness. For example, a *rahn* product (gold pawns) is offered by Islamic banks, making it similar to the instruments of Islamic pawnshops. Bank Indonesia has given a warning on the existence and function of Islamic banks.⁵²

One of the instruments that is rapidly developing in Islamic capital markets is *sukuk* (sharia bond). This instrument has considerable prospects and potential if

⁴⁸ Budi Sukardi, 'Kepatuhan Syariah (Shariah Compliance) dan Inovasi Produk Bank Syariah di Indonesia' (2012) 17 Jurnal Akademika 2, 241.

⁴⁹ *ibid*, 242.

⁵⁰ Lia Kian, 'Syariah Compliance Untuk Pengembangan Inovasi Produk Perbankan Syariah Di Indonesia' (Research Gate, 2016) <https://www.researchgate.net/publication/321197350_Syariah_Compliance_Untuk_Inovasi_Produk_Bank_Syariah> accessed on 1 October 2021.

⁵¹ Hani Werdi Apriyanti, 'Model Inovasi Produk Perbankan Syariah di Indonesia' (2018) 9 *Economica: Jurnal Ekonomi Islam* 1, 95.

⁵² Budi Sukardi (n 47) 242.

developed properly. To date, the general assumption is that the main information needed to make investment decisions is about risk characteristics and higher returns on the investment instrument to be selected. More specifically, the main consideration only focuses on the extent of the possible risks and profits to gain. In fact, conformity of sukuk with Islamic principles certainly serves as an additional consideration in selecting sukuk. However, the aspect of sharia compliance of sukuk is often not considered important.⁵³

Issuance of sukuk in Indonesia is not without problems. In addition to regulatory issues, there are some problems with its practices. Sukuk in Indonesia has not been Sharia compliant. There are some aspects considered to have met sharia compliance, but there are some other aspects considered not to meet sharia compliance. There are several factors why sukuk in Indonesia has not met sharia compliance: human resources⁵⁴, human nature⁵⁵, and government initiatives.⁵⁶

In terms of ideal Sharia compliance of sukuk, there are several points to be prioritized, namely, a strong Islamic foundation on sukuk regulation, the existence of continuous supervision, and the fulfilment of *maqashid* sharia.⁵⁷

Regarding the fact that any *muamalah* activity is basically permissible (unless there is an argument that forbids it), then the Shariah compliance in Islamic banking brings benefits, does not cause disadvantages for individuals and community, brings fairness, and avoids injustice. Economic rules, which are taught by the Quran and hadith, aim to provide balance in the entire aspects of human life, including physical and mental balance, material and spiritual balance, individual and social balance, present and future balance, as well as the world and the hereafter balance. Physical and

⁵³ Sri Nurul Komariyah, 'Persepsi Akademisi Terhadap Risiko Kepatuhan Syariah Sukuk di Indonesia' (2014) 3 Jurnal Ilmiah Mahasiswa FEB 2, 2.

⁵⁴ Lack of understanding of the existing human resources about Sharia-compliant bonds becomes one of the main factors that causes the financial certificates in Indonesia to not meet sharia compliance. Lack of understanding of the ideal sharia rules and how to implement these rules in the field is one of the existing shortcomings in terms of the quality of human resources. There are indeed some people who already understand Sharia rules, but the number of these knowledgeable persons are very small compared to the total number of existing human resources.

⁵⁵ In economic life, this characteristic can be manifested as profit-oriented. This characteristic, which is only concerned with profit, will consciously or unconsciously influence the way of doing business in which a person can justify any means even if s/he has to violate business ethics and sharia rules.

⁵⁶ The government's commitment to the development of the Islamic financial system in Indonesia is still very minimal. The government's role is so far still less than optimal in supporting the development of Islamic finance, in this case sharia-compliant bonds. This can be seen from the funds allocated by the government to the Islamic finance industry which is still minimal compared to the funds allocated to other sectors. In addition, more initiatives are so far from the private sector instead of the government.

⁵⁷ Sri Nurul Komariyah (n 52) 7-8.

mental balance as well as material and spiritual balance creates welfare for all human races.⁵⁸

In its operations, Islamic banking must carry out its functions properly in accordance with the applicable banking regulations and Islamic principles. To ensure the implementation of Islamic principles in Islamic banking activities, there is one affiliated party, namely the Sharia Supervisory Board as the body that provides services to Islamic banks or Islamic Business Units (UUS). This board is the party responsible for information about the compliance of bank managers with Islamic principles.⁵⁹

DPS plays an important and strategic role in supervising the sharia compliance of Islamic banking. DPS is responsible for ensuring that all the products and procedures of Islamic banks are in accordance with Islamic principles. The function and role of DPS in Islamic banking has a relationship with the management of Islamic banking risks, namely reputation risks which in turn may lead to other risks, such as liquidity. The economic transactions of Islamic banking must follow Islamic principles and not contain any things prohibited by Islam such as usury, gambling, speculation, and others.⁶⁰

Every legal entity with Islamic principle-based operations should have a DPS. A DPS is responsible for ensuring that all the products and procedures of Islamic banks meet Islamic principles. Optimizing the role of DPS is very important to ensure that every transaction does not violate Islamic principles that refer to the Qur'an and Hadith, in this case, the fatwa of the National Sharia Board of the Indonesian Ulema Council. The basic guidelines of the DSN MUI Chapter IV (2) state that the DSN MUI issues a fatwa that binds the DPS in every Islamic financial institution and becomes the basis for the parties to take relevant legal actions, namely based on the fatwa issued by the DSN MUI referred to by the DPS.⁶¹

DPS plays an important role in minimizing and preventing any possible violations from sharia compliance. Through this supervision, DPS is expected to help evaluate and detect the extent to which Sharia compliance has been implemented and the extent

⁵⁸Mursal and Suhadi, 'Implementasi Prinsip Islam Dalam Aktivitas Ekonomi; Alternatif Mewujudkan Keseimbangan Hidup' (2015) 9 Jurnal Penelitian 1, 88.

⁵⁹ Suryani, 'Industri Perbankan Syariah dalam Cerminan Aspek Sharia Governance' (2014) V Jurnal Economica 1, 104.

⁶⁰ Adrian Sutedi, *Pasar Modal Syariah: Sarana Investasi Keuangan Berdasarkan Prinsip Syariah* (Sinar Grafika 2011) 31.

⁶¹ Hirsanuddin, *Hukum Perbankan Syariah di Indonesia: Pembiayaan Bisnis dengan Prinsip Kemitraan* (1st edn, Genta Press 2008) 42.

to which sharia compliance has been violated by Islamic financial industries. It is expected that DPS focus on developing and supervising the Islamic financial industry in terms of both the products offered and the operations, so they always meet Islamic principles.⁶²

DPS is also responsible for ensuring that every transaction is in accordance with Islamic principles. In addition, to support product innovation, banks must develop flexible policies and rules for product innovation. Every policy developed is always under the supervision of the DPS to ensure the implementation of sharia compliance.⁶³

Islamic principles must be upheld by Islamic financial institutions in their operational practices. The application of sharia compliance is a necessity. Apologetic answers that use “under the supervision of the Sharia Supervisory Board” do not guarantee that their operational practices completely adhere to Islamic principles. Therefore, DPS must actively increase its role along with increasingly mushrooming Islamic banking and finance networks.

E. Conclusion

Islamic ethics-based business should not only be a phrase and slogan displayed in the corners of Islamic bank offices, but should also be applicable in real life, particularly the Islamic bank marketers. Without Islamic ethics, Islamic banks will be trapped into an unethical Islamic business. Consequently, not only are Islamic banking institutions considered to have no integrity in the community’s eyes, but Islam as a religion is also considered to have no correct system.

The operational activities of Islamic banks apply the concept of profit sharing and interest-free. Profit sharing and interests always become a concern to the customers, especially in terms of the differences and implementation in Islamic bank products. In carrying out sharia-compliant transactions, Islamic banks intend to avoid charging interests and all the parties should share risks. However, the customers’ concern regarding the operations of Islamic banks is they merely replace the banking terms, instead of implementing interest-free and risk-sharing. In other words, they still charge interests, but they use different terms, and they avoid risks in a dishonest way.

⁶²Luqman Nurhisam, ‘Kepatuhan Syariah (*Sharia Compliance*) dalam Industri Keuangan Syariah’ (206) 23 *Ius Quia Iustum* 1, 92.

⁶³Hani Werdi Apriyanti (n 50) 95.

Another Islamic bank product is *musharakah*. In a *musharakah* contract, both bank and customer contribute to a business. There are criticism or complaints from the customers in relation to *musharakah* contracts, such as lack of information that this contract tends to use the principle of loan as in conventional banks due to the presence of "ability to pay" analysis, collateral, and penalties.

The operational of Islamic banks are based on the same religious emotional bond between the parties. The credibility of all parties is important, if there is a violation which causes losses to one of the parties, especially Islamic banks. When there is a customer who has bad intentions and causes losses to Islamic banks, it is difficult for Islamic banks to impose sanctions to the customer because these banks are interest-free and charge neither late fees nor commitment fee. This then creates problems in administrative management.

There is a lack of experts who comprehensively understand all matters related to the Islamic banking industry. Thus, in practice, violations to the Islamic principles are possibly found in the transaction activities.

In the operational activities, Islamic banks that adhere to Islamic principles are more likely to have a benevolent leaning towards all their customers and assume that everyone making transactions with Islamic banks is honest. Thus, Islamic banks are vulnerable to those with bad intentions. The capabilities and instruments required by Islamic banks are unique and distinctive. In addition to mastering the conventional banking system, they must also master the Islamic system. Besides, the instruments and products of Islamic banks should be sharia-compliant, economic, and strategic.

Profit-sharing system requires complex calculations, particularly in calculating the small profits shared with the customers and the not-fixed amount of savings. This makes it possible for miscalculations to occur. If such miscalculations occur frequently, customers may leave the Islamic banks. In addition, because Islamic banks apply a profit-sharing system, they require extra energy and thoughts than conventional banks.

The practices of Islamic banks abroad show that, although Islamic banks are oriented towards lower-income communities, there is a tendency that ones who successfully get bona fide projects and credit facilities from Islamic banks are those from the upper class.

From the abovementioned description, the sharia compliance in Islamic banks must always supervise all the operational activities and products of Islamic banks. Sharia compliance is an instrument that guarantees conformity with Islamic principles.

Innovation in Islamic banking products fulfill the integrity and quality of Islamic banking human resources as well as conformity of contracts, and it should not cause losses to the public as consumers. This is important to reflect on, if Islamic banks fail to uphold Islamic principles in business and global financial competition, it means that Islamic principles are irrelevant.

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