



An ideal model of supervision of Islamic banks in Indonesia by the financial services authority (FSA)

Hasan^{1*}, Teng Berlianty², Merry Tjoanda², Juanrico Alfalomona Sumarezs Titahelu³

¹ Department of Law, Pattimura University, Ambon, Indonesia

² Professor and Lecturer, Department of Civil Law, Pattimura University, Ambon, Indonesia

³ Professor and Lecturer, Department of Criminal Law, Pattimura University, Ambon, Indonesia

Abstract

Islamic banking supervision in Indonesia still faces challenges in ensuring compliance with sharia principles and applicable regulations. The Financial Services Authority is tasked with maintaining stability, integrity, and public confidence in the sector. The Authority employs a risk-based supervision model and ensures adherence to sharia compliance. From a legal perspective, Bank Indonesia's authority to regulate and supervise banks reflects the central bank's function in an integrated financial system. However, since the enactment of Law No. 21 of 2011 on the Financial Services Authority, the national political legal policy has introduced a new paradigm in implementing a model of regulation and supervision of the financial industry in Indonesia. The focus of supervision ensures legal certainty, supports product innovation, and maintains the stability of the Islamic banking sector so that it can develop sustainably in the midst of global economic changes. Through a solid legal framework, the Financial Services Authority not only ensures the stability and integrity of the Islamic banking system but also opens up opportunities for sustainable product and service innovation, thus supporting the growth of the Islamic financial sector in Indonesia.

Keywords: Supervision, Islamic Bank, financial services authority

Introduction

Indonesia's economic development is a process that cannot be separated from the underlying principles of this state and nation, namely Pancasila and the 1945 Constitution. These philosophical foundations form the framework for sustainable economic development efforts in Indonesia. Article 33 of the 1945 Constitution Amendment IV is the main basis for the implementation of the national economy, which mandates that the economy is organized and managed as a joint work of all the people, based on the principles of justice, efficiency, and economic democracy. This aims to achieve prosperity, welfare, and social justice for all levels of society.

Banks are one form of financial institution that has an important role in various fields in the national economy. This is because in Article 1, number 2, of Law Number 7 of 1992 concerning Banking, as amended by Law Number 10 of 1998, it is stated that a bank is a business entity that collects funds from the public in the form of deposits and distributes them to the public in the form of credit and other forms in order to improve the lives of many people.

Banks function as financial intermediaries with the main business of collecting and channeling public funds and providing other services in payment traffic. As a business entity, the bank will always try to get the maximum profit from the business it runs. On the other hand, as a financial institution, banks have the main obligation to maintain the stability of the value of money, encourage economic activity, and expand employment opportunities.

The reality of society in Indonesia is the majority are Muslim; therefore, it is necessary to establish an Islamic bank to accommodate these interests, which are juridically in accordance with existing legislation in Indonesia, namely Law Number 7 of 1992 concerning Banking, which was accompanied by the birth of Government Regulation

Number 72 of 1992 concerning Banks Based on Profit Sharing Principles. Then the law was amended by Law Number 10 of 1998 concerning banking and then regulated by its own legislation, namely Law Number 21 of 2008 concerning Islamic banking. Islamic banking is also regulated in Bank Indonesia Regulations, the compilation of sharia economic law, and the fatwa of the National Sharia Council.

The function and role of Islamic banks certainly has a significant role in realizing a national economy that grows stably and sustainably, creates broad and equitable employment opportunities in all economic sectors, and provides welfare fairly to all Indonesian people. It is necessary to implement a comprehensive national economic development program.

In order to realize sustainable and stable national economic growth, activities in the financial services sector are required to be organized in an orderly, fair, transparent, and accountable manner. The goal is to create a financial system that can develop in a sustainable and stable manner while still protecting the interests of customers and the general public.

Therefore, it is important to establish a financial services authority that has the function, duty, and authority to regulate and supervise activities in the financial services sector in an integrated, independent, and accountable manner. This is the background for the birth of Law Number 21 of 2011 on the Financial Services Authority.

In order to carry out its functions and objectives in general as a regulatory and supervisory authority, the Financial Services Authority uses methods in bank supervision, including Islamic banking, including regulation, indirect supervision (off-site supervision), direct supervision/examination (on-site supervision), regular contact and communication with banks, not remedial and/or

application of sanctions, and building cooperation with other bank supervisory authorities.

The reality is that in the implementation of the functions and objectives of the Financial Services Authority Institution, there are still obstacles because the regulations used by Islamic banking are not only subject to the rules of national law but also other regulations issued by religious institutions. So that the author raises the problem, namely, what is the ideal supervision model for Islamic banks in Indonesia by the Financial Services Authority Institution?

Research Method

The research method used is normative juridical, using a statutory approach and conceptual approach, which is supported by primary legal materials such as banking laws and regulations, secondary legal materials in the form of literature and research results, and scientific journals traced in libraries and also online.

Result and Discussion

1. Concept of Supervision

Supervision is basically to ensure that the implementation of activities runs in accordance with what has been planned effectively. There are two terms in English related to supervision, namely "control" and "supervision."

The term control, which is given the meaning

1. to exercise power or influence over: the judge controlled the proceedings,
2. to regulate or govern: by law, the budget office controls expenditures,
3. to have a controlling interest in: the five shareholders controlled the company.

Firman Umar defines supervision as an activity that is very important so that the work and tasks assigned to the implementing apparatus are carried out in accordance with the established plan. Also Sondang P. Siagian, who states that supervision is a process of observing the implementation of all organizational activities to ensure that all work being carried out is in accordance with a predetermined plan.

The same thing is also defined by Suryansya Murhaini: supervision is an assessment that is a process of measurement and verification of a series of processes that have been carried out on an ongoing basis. According to Sujamto, supervision is all efforts or activities to find out and assess the actual reality regarding the implementation of tasks or activities, whether according to what should be or not.

Referring to the description of the meaning of supervision according to these experts, it can be understood that supervision is a very important activity in maintaining that the implementation of organizational tasks and activities runs according to a predetermined plan. This involves the process of observation, evaluation, and verification of the implementation of tasks and activities to ensure that they are in accordance with the desired goals and avoid deviations.

Supervision is seen as a systematic effort that involves assessment, improvement, and adjustment so that the results achieved remain in accordance with the plans that have been made. This confirms the importance of supervision as an instrument to achieve effectiveness and efficiency in various aspects of organization and governance.

2. Concept and development of islamic banking in indonesia

The March 2006 edition of the Indonesian Banking Booklet explains the definition of Islamic banks as financial institutions whose main business is to provide credit and other services in payment traffic and money circulation that operate according to sharia principles. While the same thing is the definition of Islamic banks according to M. Amin Aziz, explaining that what is meant by sharia banks is banking institutions that use systems and operations based on Islamic Sharia.

In line with that, in the process of regulation of Islamic banking in Indonesia based on the pressure of various opinions of scholars with consideration of meeting the needs of Muslims in Indonesia, Islamic banks were promulgated in Law Number 7 of 1992 concerning Banking as revealed to be given the opportunity to carry out sharia-oriented rural bank operations. The same thing is also revealed in Law Number 10 of 1998 concerning Amendments to Law Number 7 of 1992 concerning Banking. The explanation of Islamic banking in the two laws is more likely to provide an understanding, as in Article 1, Paragraph 13, as follows:

"Sharia principles are the rules of agreement based on Islamic law between banks and other parties for the deposit of funds and/or financing of business activities or other activities that are stated to be in accordance with sharia, including financing based on the principle of profit sharing (mudharabah), financing based on the principle of equity participation (musyarakah), the principle of sale and purchase with profit (murabahah), or financing of capital goods based on pure lease without option (ijarah) or with the option of transferring ownership of goods leased from the bank by other parties (ijarah wa iqtina)."

Whereas in Law Number 21 of 2008 concerning Islamic Banking, it has been explained in detail about the meaning of Islamic banking, as explained in Article 1, Paragraph 1, as follows:

"Islamic Banking is everything that concerns Islamic Banks and Islamic Business Units, including institutions, business activities, as well as ways and processes in carrying out their business activities."

Therefore, the existence of banking is not far from the development of trade, because the banking world is increasingly recognized along with the growth of trade. The colonization of the Dutch East Indies made Indonesian banking more popular. By the time of Indonesian independence, there were ten banks, although during the colonial period there were only four.

In the mid-1970s, the idea of establishing an Islamic bank in Indonesia had already emerged. International seminars organized by the Institute for the Study of Social Sciences (LSIK) and the Bhineka Tunggal Ika Foundation in 1974 and 1976 discussed this issue. However, there were several reasons that prevented the idea of an Islamic bank:

1. The operation of Islamic banks that apply the principle of profit sharing is not regulated because it is not in line with the prevailing Basic Banking Law.
2. The concept of Islamic banks from an ideological perspective was part of or related to the concept of an Islamic state, so the government did not want it.
3. The establishment of new banks from the Middle East is still delayed due to some rules that limit foreign banks that want to have offices in Indonesia. In

addition, it was still being questioned who would invest in this venture.

In 1988, the government issued the October Policy Package, which aimed to liberalize the banking industry, and finally the idea of an Islamic bank resurfaced. The ulama attempted to establish an interest-free bank, but there was no legislation to support it. The ulama workshop on bank interest and banking in Cisarua, Bogor, on August 19-22, 1990, made a recommendation that banks could set interest at 0%. This idea was then further discussed at the National Conference IV of the Indonesian Ulema Council (MUI) at Sahid Jaya Hotel, Jakarta.

Islamic banking in Indonesia has experienced significant development in the last ten years. This period includes a fundamental transformation in the structure and regulation of Islamic banking, along with the government's efforts to encourage financial inclusiveness and sustainable economic development. Essentially, Islamic banking in Indonesia incorporates Islamic economic principles in its banking activities, which include the prohibition of interest and financial practices deemed incompatible with Islamic values.

Since 2013, Islamic banking in Indonesia has grown rapidly, driven by various factors. One of the main factors is the increasing public awareness of sharia principles in financial activities, which creates a growing demand for Islamic banking products and services. The Indonesian government has also been instrumental in supporting the development of Islamic banking through various policies and incentives. In recent years, the government's focus has shifted from simply promoting Islamic banking towards creating a broader Islamic financial ecosystem.

3. The financial services authority institution performs microprudential functions

The establishment of the Financial Services Authority Institution is based on the fact that the Financial Services Authority must be part of a system of organizing state affairs that is well integrated with other state and government institutions in achieving the goals and ideals of Indonesian independence as stated in the constitution of the Republic of Indonesia. Then the philosophical, sociological, and historical basis for the establishment of the financial supervisory institution of the Financial Services Authority, among others:

- a. That in order to realize a national economy that is able to grow in a sustainable and stable manner, it is necessary for activities in the financial services sector to be organized in an orderly, fair, transparent, and accountable manner, and to be able to realize a financial system that grows in a sustainable and stable manner and is able to protect the interests of consumers and the public;
- b. That based on the considerations as referred to, a financial services authority is required that has the function, duty, and authority to regulate and supervise activities in the financial services sector in an integrated, independent, and accountable manner;
- c. That based on the considerations referred to, it is necessary to establish a law on the Financial Services Authority.

Supervision of the banking, capital markets, and non-bank financial industries needs to be conducted separately due to the different characteristics of each of these financial services industries. So as to achieve specialization in supervision and development of appropriate supervision methods and reduce the breadth of supervisory span of control so that the decision-making process and the implementation of these decisions become more efficient and effective.

Microprudential regulation of the entire financial services industry is carried out by the Financial Services Authority Institution to ensure that, in terms of institutions, business processes, governance, capital, liquidity, and reporting systems have been regulated completely and thoroughly. This microprudential regulation is required as a guideline for each financial service institution to conduct its business activities in Indonesia. Thus, the microprudential regulation carried out by the Financial Services Authority Institution must refer to international best practices.

Regarding the banking sector regulation, it will refer to the provisions issued by the Basel Committee on Banking Supervision; insurance provisions will refer to the International Association of Insurance Supervisors (IAIS); capital market provisions will refer to the International Organization of Securities Commissions (IOSCO); and Islamic financial services industry provisions will refer to the Islamic Financial Services Board (IFSB).

Accordingly, the Financial Services Authority is responsible for the supervision and regulation of the financial sector in Indonesia. OJK's microprudential function relates to the individual supervision of financial institutions, such as banks, insurance companies, and other financial institutions, with the aim of ensuring that these institutions operate in a safe, sound, and compliant manner.

The microprudential functions carried out by the Financial Services Authority Institution include

1. Business Eligibility Supervision.
2. Licensing and Shareholder Eligibility Assessment.
3. Continuous Monitoring and Supervision.
4. Enforcement of Standards and Regulations.
5. Crisis Management.

Based on the microprudential function performed by the Financial Services Authority Institution, it can be described as follows:

- a. The Financial Services Authority monitors the business feasibility of financial institutions, including assessment of risk management, asset quality, liquidity, and capital resilience.
- b. The Financial Services Authority is responsible for granting operating licenses to financial institutions and assessing major shareholders to ensure integrity and legal compliance.
- c. The Financial Services Authority conducts ongoing monitoring of financial institutions to identify potential problems or risks and provide corrective action if necessary.
- d. It enforces standards and regulations set for the financial sector to ensure consumer protection, transparency, and compliance with good governance principles.
- e. Financial Services Authority institutions have a role in financial crisis management where necessary, including

the provision of liquidity assistance, recapitalization, or takeover of financial institutions in distress.

By carrying out these microprudential functions, the Financial Services Authority can ensure the stability and security of Indonesia's financial sector and protect the interests of stakeholders, including customers, investors, and the general public.

4. Ideal Model of Supervision of Islamic Banks by the Financial Services Authority

The supervisory authority over the banking sector as one of the financial services sectors was originally vested in Bank Indonesia as stipulated in Article 8 of the Law on Bank Indonesia, which stipulates that the regulation and supervision of banks is one of the duties of Bank Indonesia. However, since the existence of Law Number 21 of 2011 concerning the Financial Services Authority on November 22, 2011, the national legal political policy has introduced a new paradigm in applying the regulatory and supervisory model to the financial industry in Indonesia.

As for the regulatory and supervisory functions, the Financial Services Authority Institution functions to organize an integrated regulatory and supervisory system for all activities in the financial services sector. In addition, the function of the Financial Services Authority Institution is to oversee the provisions that have been carried out from the financial stability forum, maintain financial system stability, conduct non-bank supervision in the same structure as now and bank supervision out of the authority of Bank Indonesia as the central bank and held by a new institution, namely the Financial Services Authority.

This is reinforced by Article 6, Law Number 21 of 2011 concerning the financial services authority, namely:

The Financial Services Authority (OJK) carries out the task of regulating and supervising:

- a. financial services activities in the banking sector;
- b. financial services activities in the capital market sector; and
- c. financial services activities in the insurance sector, pension funds, financing institutions, and other financial services institutions.

So it can be understood that the authority of the Financial Services Authority in carrying out supervisory duties shows the strategic role of the Financial Services Authority in maintaining the stability and integrity of the financial services sector in Indonesia. The Financial Services Authority has broad authority, ranging from establishing operational supervisory policies to granting and revoking business licenses and individual licenses in the financial services sector. It also has the right to conduct examinations, investigations, and consumer protection to ensure compliance of financial services institutions with applicable regulations.

The authority to appoint a statutory manager and impose administrative sanctions demonstrates the authority of the financial services authority in dealing with troubled financial institutions. With this broad scope of authority, the financial services authority is expected to be able to create a healthy, stable, and competitive financial system while providing maximum protection to consumers and the public.

The leadership structure of the Financial Services Authority, led by the Board of Commissioners with a collective and collegial system, shows a democratic and deliberation-based leadership approach in decision-making. The nine-member Board of Commissioners, with various areas of supervision such as banking, capital markets, and other financial services sectors, reflects the comprehensive scope of supervision of the financial industry.

The presence of ex-officio members from Bank Indonesia and the Ministry of Finance also strengthens macroprudential and fiscal policy coordination in maintaining financial system stability. In addition, equal voting rights for each member emphasize the principle of collegiality in decision-making so that there is no domination from one particular party. This reflects the independence and professionalism of the Financial Services Authority in carrying out its duties as the supervisor of the financial services sector in Indonesia.

The transfer of authority from Bank Indonesia to the Financial Services Authority in the banking sector affects the institution that is part of Bank Indonesia, which assists Bank Indonesia in terms of regulation and development of Islamic banking, also transfers from Bank Indonesia to the Financial Services Authority, namely the Islamic Banking Committee (KPS). After the Sharia Banking Committee was transferred to the Financial Services Authority, the Sharia Banking Committee was changed and expanded to become the Sharia Financial Services Development Committee (KPJKS), whose authority not only regulates and supervises Islamic banking but extends to other Islamic financial services sectors.

Coordination between Bank Indonesia and the Financial Services Authority is realized in several ways, namely:

1. The Financial Services Authority coordinates with Bank Indonesia in making supervisory regulations in the banking sector, and then Bank Indonesia and the Financial Services Authority will cooperate in exchanging banking information, and Bank Indonesia, in special conditions, can conduct examinations of banks after coordinating with the Financial Services Authority. In the Joint Decree Number 15/1/KEP.GBI/2013 and Number PRJ-11/D.01/2013 dated October 18, 2013, the scope of cooperation and coordination includes (1) cooperation and coordination in the implementation of duties in accordance with their respective authorities;
2. Exchange of information on financial services institutions as well as management of the reporting system for banks and finance companies by Bank Indonesia and the Financial Services Authority;
3. Use of assets and documents owned and/or used by Bank Indonesia by the Financial Services Authority;
4. Management of Bank Indonesia officials and employees who are transferred or employed at the Financial Services Authority.

Meanwhile, to ensure the fulfillment of sharia principles in sharia banking operations, the Financial Services Authority must coordinate with the National Sharia Council and the Sharia Supervisory Board. The National Sharia Council, as part of the Indonesian Ulema Council, is expected to assist relevant parties such as the Ministry of Finance, Bank Indonesia, and others in formulating regulations or

provisions for Islamic financial institutions, including Islamic banking.

The creation of a coordination relationship between the Financial Services Authority and Bank Indonesia is also determined in the Coordination Protocol as specified in Article 44, Article 45, and Article 46 of Law number 21 of 2011 concerning the Financial Services Authority. In this Coordination Protocol, a forum to bring together the Ministry of Finance, Bank Indonesia, the Financial Services Authority, and the Deposit Insurance Corporation in one coordination forum called the Financial System Stability Coordination Forum. Coordination (FKSSK) in this forum is carried out if it is not possible to handle banking problems by the OJK related to the resolution and handling of a failed bank that is suspected of having a systemic impact.

The Financial System Stability Coordination Forum (FKSSK) has a strong legal basis in the Financial Services Authority Law. This law emphasizes that the institutional relationship between the Financial Services Authority, Bank Indonesia, the Deposit Insurance Corporation, and the Ministry of Finance must be built through effective coordination. This coordination plays a crucial role in ensuring financial system stability, especially in the aspects of banking sector supervision and mitigation of potential financial crises. Without good coordination, the risk of inefficiency in decision-making and crisis management may increase, thus weakening the stability of the national financial system.

Conclusion

Based on the discussion above, it can be concluded that the ideal supervision model for Islamic banks in Indonesia by the Financial Services Authority Institution is to implement a risk-based independent integration supervision model and sharia compliance to encourage the growth of the Islamic banking sector in Indonesia. This approach includes identifying and mitigating risks, ensuring sharia compliance, and increasing public confidence. Through coordination with Bank Indonesia, the Deposit Insurance Corporation, the Sharia Supervisory Board, and the Indonesian Ulama Council, the Financial Services Authority can create an ecosystem that supports the growth of Islamic banking.

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