International Journal of Information System and Innovation Management

Volume 2 Issue 2 December 2024
Page : 49-55

System of Supervision and Control of Syariah Banking

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Submitted: 22 October 2024, Accepted: 10 November 2024, Published: 21 December 2024

ABSTRACT
In Indonesia, the supervision and management of Islamic banking is very important to ensure that the activities of Islamic banks comply with relevant laws. DPS should strictly supervise Islamic banking products given the expansion of this sector and the services offered. DPS is in charge of assessing compliance with sharia law. In addition, effective risk management is key in withstanding challenges and mitigating compliance, liquidity, and credit risks. This system aims to increase public trust in banking, in addition to protecting sharia consumers as a sustainable and ethical financial alternative. Thus, good supervision is expected to encourage stable growth in Indonesia's Islamic banking industry. This study aims to investigate the supervision and management structure of Islamic banking in Indonesia.

Keywords: *Supervision, Control, Islamic Banking.*

1. Introduction

In recent years, Islamic banking has experienced rapid growth, emerging as a significant sector in national financial mechanisms (Baehaqi, 2021). Operating under sharia principles, Islamic banks not only offer products and services that comply with Islamic law but also aim to promote social and economic justice (Mufrih et al., 2020). This unique value proposition has made Islamic banking an attractive alternative for diverse populations, particularly in countries with substantial Muslim demographics (Antonio, 2011).

However, to ensure compliance with Islamic law, Islamic banking requires an effective system of supervision and control (Kurnia, 2022). This system encompasses various components, including oversight by Sharia Supervisory Boards (DPS), strict regulatory enforcement by the Financial Services Authority (OJK), and comprehensive risk management strategies (Noranisa & Ilyas, 2020). DPS ensures that all products and services align with sharia principles, while OJK acts as a regulator overseeing the overall performance of Islamic banks (Wildan & Shalauddin, 2024).

Despite the implementation of such a system, challenges persist, such as integrating sharia compliance into operational practices and aligning it with international banking standards (Haniffa, 2010). Research has shown that inconsistencies in supervision and regulation could potentially hinder the sustainable growth and integrity of Islamic banking institutions (Chapra & Ahmed, 2008). Additionally, the lack of a unified framework for sharia compliance and control mechanisms among Islamic banks globally highlights a critical gap in the current research (Grais & Pellegrini, 2006).

The novelty of this research lies in its exploration of how Islamic banking supervision and control systems can address these challenges while maintaining compliance with both sharia principles and global banking standards (International

Monetary Fund, 2014). Previous studies have largely focused on either the regulatory role of OJK or the sharia oversight of DPS, but few have examined their integration into a cohesive framework for governance and risk management (Yulianti, 2009; Jamaldeen, 2012).

Furthermore, this study aims to provide a detailed analysis of the current supervisory and control systems in Islamic banking, emphasizing their effectiveness, limitations, and areas for improvement (Zuhri, 2006). By addressing these issues, this research seeks to contribute to a deeper understanding of how Islamic banking can achieve operational excellence while upholding its ethical and religious mandates (Sutedi, 2009).

Ultimately, the study aims to fill the research gap by proposing a comprehensive framework that combines regulatory oversight with sharia governance (Yaquby, 2000). This framework is expected to enhance the transparency, accountability, and resilience of Islamic banking institutions, thereby fostering public trust and sustainable growth (Usman, 2004).

In light of these considerations, the primary objective of this research is to evaluate the existing supervision and control systems in Islamic banking, identify their shortcomings, and propose strategies to enhance their effectiveness in aligning with sharia principles and global banking practices (Central Bank of Kuwait, 2016).

2. Literature Review

Sharia banking, as outlined in Article 1 Paragraph (1) of Law Number 21 of 2008, integrates all aspects of Islamic banks and Islamic business entities, encompassing establishment, business activities, and operational procedures (Fitriani et al., 2023). This legal framework defines sharia banks as entities that operate under Islamic principles and outlines the roles of Islamic commercial banks and Sharia People's Financing Banks (BPRS). Central to sharia banking operations are principles derived from fatwas issued by the National Sharia Council (DSN), ensuring compliance with Islamic law while promoting economic justice and sustainable growth.

Sharia banking utilizes profit-and-loss sharing (PLS) schemes, such as mudharabah and musyarakah contracts, which promote equitable financial partnerships (Lukmanul Hakim, 2023). Unlike conventional banks, sharia banks adhere to prohibitions against riba (interest), gharar (uncertainty), and maysir (gambling), ensuring that transactions align with ethical and moral values. These principles help Islamic banks gain public trust by offering ethical alternatives to conventional banking (Haniffa, 2010).

The primary functions of Islamic banks include fund collection through contracts like al-mudharabah and al-wadiah, fund distribution via murabahah, musyarakah, and istishna contracts, and provision of essential banking services such as fund transfers and remittances (Andrianto & Anang, 2019). These activities contribute to inclusive economic development and improved societal welfare (Noranisa & Ilyas, 2020).

Islamic commercial banks (BUS), guided by Article 19 of the Sharia Banking Law, are authorized to engage in activities such as collecting deposits, offering profit-sharing investment schemes, and providing financing solutions through sharia-compliant contracts. These banks are also involved in securities transactions and other sharia-compliant financial services (Wildan & Shalauddin, 2024).

Sharia Business Units (UUS) extend similar services, including fund collection and distribution, as well as providing sharia-compliant financial instruments and services to meet customer needs. UUS plays a pivotal role in enhancing financial inclusion and supporting sharia-compliant business operations (Yaquby, 2000).

The Sharia People's Credit Banks (BPRS) focus on fund collection and distribution for small-scale enterprises and communities. Operating under contracts like mudharabah and qardh, BPRS provides financing solutions tailored to the needs of local populations, contributing significantly to grassroots economic development (Usman, 2004).

In summary, sharia banking serves as a cornerstone of the financial system by adhering to Islamic principles and supporting economic activities that promote justice and sustainability. The legal and regulatory framework, combined with sharia governance mechanisms, ensures the integrity of Islamic financial operations while fostering trust and inclusivity (Antonio, 2011). This positions Islamic banks as vital agents of economic and social development in an increasingly competitive global market (Chapra & Ahmed, 2008).

3. Research Method

This study employs a qualitative literature review methodology to comprehensively examine the supervision and control system of Islamic banking. The research involves systematically collecting, analyzing, and synthesizing information from a range of scholarly sources, including peer-reviewed journals, books, and scientific reports that focus on the governance, regulatory, and operational aspects of Islamic banking. Data were sourced from both national and international publications to ensure a balanced and inclusive perspective. The inclusion criteria prioritize materials published within the last 10 years, ensuring relevance to contemporary issues in Islamic banking, and focus specifically on themes related to supervision and control. Exclusion criteria include non-scholarly sources such as opinion articles or materials with insufficient relevance to the study objectives.

The data collection process used advanced search techniques on reputable academic databases such as Scopus, Web of Science, Google Scholar, and ProQuest, employing keywords like “Islamic banking supervision,” “sharia compliance governance,” and “control systems in Islamic finance.” Abstracts were reviewed to determine relevance, and selected materials underwent a detailed examination. Sources included legislation like Law Number 21 of 2008 on Islamic Banking in Indonesia to contextualize findings within the legal framework.

The analysis utilized a thematic approach, categorizing literature into key themes, including supervisory frameworks, compliance mechanisms, and challenges in the current system. This allowed the study to draw insights, identify patterns, and highlight best practices. Supervisory frameworks focused on the roles of the Sharia Supervisory Boards (DPS) and regulatory authorities like the Financial Services Authority (OJK). Compliance mechanisms explored the processes for ensuring adherence to sharia principles, including fatwa implementation and risk management. Meanwhile, challenges and innovations identified gaps in the existing system and proposed recommendations for improvement.

To ensure accuracy and ethical integrity, all sources were cited and managed using reference management software such as Mendeley. The study strictly adheres to ethical standards, with proper acknowledgment of authorship and avoidance of plagiarism. Information gathered was synthesized and rewritten to present a comprehensive and coherent narrative that reflects the findings and perspectives from the reviewed literature.

This methodology provides a robust foundation for understanding the supervision and control system in Islamic banking, identifying existing gaps, and offering actionable recommendations for regulators, financial institutions, and other stakeholders. Through this approach, the study seeks to contribute meaningful insights that can enhance the integrity, compliance, and sustainability of Islamic banking practices.

4. Results and Discussion

Sharia Banking Supervision

The most important component of the management function plan is supervision or control, which is closely related to planning. Similar to this, in everyday life, every business strives to achieve its goals in an efficient and successful way. To ensure that the planned activities are aligned with the results achieved, supervision is necessary it will be difficult to implement a plan for the life of the organization without effective supervision (Baehaqi 2021).

In principle, there are two types of supervision in Islamic banking supervision, In particular: financial supervision, compliance with standard banking regulations, and prudent banking concepts; Second, bank operational supervision in accordance with sharia principles. Therefore, the external supervision system is one of the systems that form the Islamic banking supervision framework, mainly focused on the interests of the public and customers, and the internal supervision system, which regulates the internal part in such a way that the supervision mechanism and system are administrative (Abrahaham et al., 2024).

1. Internal Surveillance System
   The internal control system is defined as the supervision of the management system in the implementation of its executive role, which is carried out by organizations that are part of the bank's operational framework. The Board of Directors, the Board of Commissioners, and, especially for Islamic banking, the Sharia Supervisory Board are responsible for this internal supervision.
   a. Board of Commissioners
      The board of commissioners supervises the bank internally to ensure that all its policies do not violate the laws and regulations or internal policies set out in the Articles of Association and GMS, as such may have a negative impact on the bank's health.
   b. Board of Directors
      Supervision by the Board of Directors is primarily aimed at ensuring that management policies are adhered to. The level of safety, fairness, and compliance is evaluated by the Board of Directors. The level of safety, fairness, and conformity needs to be monitored. Thus, obtaining certainty that all policies and regulations have been implemented correctly and that the business can be protected from all dangers is one of the objectives of monitoring financial risks, corporate image and legal risks.
   c. Sharia Supervisory Board
      DPS was formed to supervise the operations of Islamic banks so that they always adhere to the principles of Islamic muamalah and do not contradict Islamic law. At the proposal of the Indonesian Ulema Council, the Annual General Meeting of Shareholders appointed the Sharia Supervisory Board. DSN is given the authority to limit DPS by the MUI itself, which is in charge of supervising the operational activities of Islamic banks, which it established as a separate body under the supervision of DSN in financial institutions and Islamic banks. Every member of the Sharia community must be a member of the DPS. Maumalah also has expertise in the financial industry. Bank Syariah has notified this to DPS members, and they will be contacted In accordance with the

results of the general meeting of shareholders and the board of directors, DPS is obliged to comply with the DSN fatwa issued by the highest authority regarding the compliance of banking products and services with Sharia laws and principles in carrying out its activities. The primary responsibility of the DPS is to oversee the bank's operations to ensure that they comply with Sharia legal rules and guidelines. (Sri Dewi, 2014).

2. External surveillance system
   Monitoring of the management system in the exercise of its executive responsibilities by parties outside the bank's operational system is known as external supervision. Bank Indonesia is in charge of supervising international banking in Indonesia. Law Number 23 of 1999 states that Bank Indonesia is tasked with making regulations, supervising banks, and developing them. The goal is to be a model for the use of sound banking practices. The Financial Services Authority is part of the external supervision framework of Islamic banks. To fulfill their responsibilities towards Islamic banks, OJK banking supervisors must have the required Sharia expertise and understanding. At the same time, being an auditor is a component of the external supervision system, as specified in ASIFI No. 4 on "Testing Compliance with Sharia Rules and Principles by External Auditors" and Sharia Bank Audit Guidelines, which mandates that external auditors obtain a Sharia compliance statement from DPS before conducting an audit. Baehaqi, Ahamad (2014).
   As previously stated, the OJK will take over the regulation and starting from December 31, 2013, the Financial Services Authority will begin to conduct financial supervision from Bank Indonesia. The Financial Services Authority is tasked with carrying out regulatory and supervisory duties in accordance with Article 6 of the OJK Law which states that financial services are very important for the economy and can be divided into several main sectors. First, in the banking sector, financial services include various services provided by banks, such as deposits, loans, fund transfers, and other financial services that support the daily activities of people and businesses. Banks serve as a bridge between people who have extra money and people who don't need financing, thus creating efficiency in resource allocation. Furthermore, the capital market sector provides a platform for companies to raise funds through the issuance of stocks and bonds, allowing investors to participate in economic growth and earn returns on their investments. In this context, the capital market plays an important role in increasing liquidity and providing access to companies to obtain the capital necessary for expansion and innovation.
   In addition, financial services also include insurance, companies provide financial protection against risks faced by individuals and businesses, while pension funds aim to ensure the financial well-being of participants after entering retirement. Other financial institutions, such as finance companies and microfinance institutions, also contribute Thus, the financial services sector as a whole supports economic growth, financial stability, and people's well-being. The supervision of Islamic financial institutions is the result of changes in the discussion of the regulations of each financial institution that are applied in various types of teachings, then discussing contracts that are often used in financial institutions, then verbally aligning with the concept of Sharia law in accordance with the concept of Islamic fiqh. globally it is narrowed by the emergence of certain Mahzab. Then, the emergence of the concept of halal for certain mahzab and a response that is consistent with the remnants of other mahzab, then a fatwa related to matters for Sharia compliance, which is related to the problems that arise and explanations related to the management of financial institutions, was born. The existence of Sharia supervision is basically an obligation, because Sharia financial

supervision institutions reflect the obligation to enforce Sharia law in accordance with Sharia principles of supervision (Lukman Hakim, 2023).

Sharia Banking Control

In financial institutions, the problem of asymmetrical information is quite strong. Customers and owners become clients and management becomes agents when using the PA theory method. Regulations are needed to align the management of measures with interests (Fitriani et al., 2023):

1. Controlling *management actions*;
2. Restriction of authority (Otherwise, this will create gambling problems with other eople's funds.
3. Create the right gift

An important part of bank governance and safe and secure banking operations is an efficient internal control system (ISC) which can improve bank compliance with regulations, ensure the availability of reliable financial and management data, support bank management in complying with legal requirements, and reduce the risk of failure, irregularities, and violations of regulations.

The implementation of an effective and efficient internal system of the bank is a responsibility for the bank's management and employees. In addition, bank management is necessary to improve the effectiveness of the risk structure within the bank and ensure that it is present at all levels of the organization. A bank's internal control system is necessary because one of the factors that contribute to business failure There are several shortcomings in the implementation of a bank's internal control system, including:

a) Inadequate oversight procedures, unclear management responsibilities, and failure to establish a culture of internal control at all levels of the organization;
b) Implementation of inadequate identification and assessment of risks resulting from bank operations;
c) There is no meaningful control over the bank's operations, including separation of authority and duties and review of performance risks;
d) Lack of information and communication at all levels of the bank's organization, especially at the decision-making level regarding the deterioration of the quality of risk exposure and the implementation of corrective measures, internal audit programs and other inadequate or ineffective monitoring initiatives;
e) Lack of dedication of bank management to implement internal control measures and enforce severe penalties for violations of relevant regulations, guidelines and procedures set by the bank.

5. Conclusions

The integrity and continuity of this industry is greatly aided by the framework of supervision and control of the Indonesian Islamic banking system. Islamic banks can ensure that all their offerings comply with Sharia laws and principles by enlisting the assistance of the OJK and DPS in place. The success of the supervision and control system not only strengthens public trust in the Islamic banking system, but also contributes to the stability of the national financial system as a whole. As challenges evolve, the application of best practices in supervision and control is becoming increasingly important to drive sustainable and ethical growth in the Islamic banking sector in Indonesia.

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