

HISTORY AND DEVELOPMENT OF SHARIA BANKING IN INDONESIA

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Abstract: This research aims to understand the history and development of Islamic banking in Indonesia. This research is important because Islamic banking in its history and development has become a benchmark for the success and existence of Islamic economics in Indonesia, where the majority of the population is Muslim. This research is qualitative with a descriptive approach. The data collection technique uses the literature study method, which involves reviewing books, journal articles, laws and regulations, and various reports relevant to the history of Islamic banking. The research data were analyzed qualitatively through data reduction, data presentation, and conclusion drawing. This research answers several questions related to the purpose of establishment, legal basis, principles and functions of Islamic banks, as well as the differences between Islamic banks and conventional banks. This study found that the purpose of establishing Islamic banking is to introduce and develop the application of Islamic principles, sharia, and its traditions into financial, banking, and business transactions. Then, the prohibition of usury, focus on the public interest, accelerate growth, achieve a prosperous economy, the establishment of social and economic justice, and balanced income distribution. Islamic banking in Indonesia is regulated by Law No. 7/1992 on Banking, Law No. 10/1998 on Amendments to Law No. 7/1992 on Banking, and Law No. 21/2008 on Islamic Banking. The basic principles of Islamic banking are the principles of free *maghrib* (*maysir*, *gharar*, *haram*, *riba*, and *batil*), trust and prudence in the management of Islamic banking activities, and principles based on contracts, while the functions of Islamic banks are to collect funds, channel funds to people in need, and provide services in the form of Islamic banking services. The difference between Islamic banks and conventional banks is in the principle of implementation, Islamic banks are banks that adhere to sharia/Islamic principles, while conventional banks are generally based on regulations or mutual agreements.

Keywords: history of Islamic banking; Islamic banks; Islamic economics; sharia principles

Abstrak: Penelitian ini bertujuan untuk memahami sejarah dan perkembangan perbankan syariah di Indonesia. Penelitian ini penting dilakukan karena perbankan syariah dalam sejarah dan perkembangannya telah menjadi tolak ukur keberhasilan dan eksistensi ekonomi syariah di Indonesia yang mayoritas penduduknya beragama Islam. Penelitian ini bersifat kualitatif dengan pendekatan deskriptif. Teknik pengumpulan data menggunakan metode studi literatur, yang melibatkan penelaahan buku, artikel jurnal, peraturan perundang-undangan, dan berbagai laporan yang relevan sejarah perbankan syariah. Data penelitian dianalisis secara kualitatif melalui reduksi data, penyajian data, dan penarikan kesimpulan. Penelitian ini menjawab beberapa pertanyaan terkait tujuan pendirian, landasan hukum, prinsip dan fungsi bank syariah, serta perbedaan bank syariah dan bank konvensional. Penelitian ini menemukan bahwa tujuan didirikannya perbankan syariah adalah untuk mengenalkan dan mengembangkan penerapan prinsip-prinsip Islam, syariah, dan tradisinya kedalam transaksi keuangan, perbankan, dan bisnis. Kemudian, pelarangan *riba*, fokus pada kepentingan publik, mempercepat pertumbuhan, mencapai ekonomi yang sejahtera, pembentukan keadilan sosial dan ekonomi, serta distribusi pendapatan yang seimbang. Perbankan syariah di Indonesia diatur oleh UU No. 7/1992 tentang Perbankan, UU No. 10/1998 tentang Perubahan atas UU No. 7/1992 tentang Perbankan, dan UU No. 21/2008 tentang Perbankan Syariah. Prinsip dasar perbankan syariah adalah prinsip bebas *maghrib* (*maysir, gharar, haram, riba, dan batil*), kepercayaan dan kehati-hatian dalam pengelolaan kegiatan perbankan syariah, dan prinsip yang didasarkan pada akad, sedangkan fungsi bank syariah adalah menghimpun dana, menyalurkan dana kepada masyarakat yang membutuhkan, dan memberikan pelayanan dalam bentuk jasa perbankan syariah. Perbedaan bank syariah dan bank konvensional terdapat pada prinsip pelaksanaannya, bank syariah adalah bank yang menganut prinsip syariah/Islam, sedangkan bank konvensional umumnya didasarkan pada peraturan atau kesepakatan bersama.

Kata kunci: sejarah perbankan syariah; bank syariah; ekonomi syariah; prinsip syariah

Introduction

The country's economy is supported by two financial institutions: bank and non-bank financial institutions (Aldasoro et al., 2020; Leon et al., 2020; Mokodenseho & Puspitaningrum, 2022). Bank financial institutions have capabilities in various forms and main activities in the financial sector (Ahmed et al., 2020; Laplante & Kshetri, 2021; Judijanto et al., 2024). Non-bank financial institutions can only conduct one financial activity (Trapanese, 2021; Eren & Wooldridge, 2021). Even so, financial institutions continue to contribute to the country's economy.

Sharia banks are banking financial institutions whose operational activities are based on sharia principles, namely the Koran and Hadith (Nugroho, 2021; Awaluddin et al., 2020; Choiriyah et al., 2021). Sharia banks emerged because of the basic needs of Muslims, where in practice they are free from the practice of usury (*riba*) (Arifin, 2021; Ariss, 2010; Abduh & Azmi Omar, 2012; Judijanto et al., 2024). The formation of sharia banks was initiated by prohibiting usury in the Samawi religion. Since the 1930s in Egypt, the Muslim Brotherhood, through their movement, began to voice criticism of the interest-based financial system, including criticism that came from various parts of the Muslim world (Saeed, 2004). Thoughts about banks using a profit sharing system as a substitute for usury emerged, marked by the thoughts of Muslim scientists such as Anwar Qureshi (1946), Naiem Siddiqi (1948), and Mahmud Ahmad (1952) (Susanto, 2009).

Ryandono (2020) stated that usurious activities exploit the needs of weak people by hoarding excess wealth on weak economic capital. In Sharia banking, there is no interest but profit sharing, where the two are different when looking at the contracts in sharia banking (Miah & Suzuki, 2020; Istan & Fahlevi, 2020).

In the context of sharia banking in Indonesia, its development is a manifestation of public demand that requires an alternative banking system that not only provides sound banking or financial services but also fulfills sharia principles (Marlina et al., 2021).

Method

This research is qualitative with a descriptive approach (Bungin, 2011). The data collection technique used the literature study method. Literature study is a data collection technique that involves reviewing books, literature, notes, laws and regulations, and various reports related to the problem you want to solve. Research data sources were taken from various literature related to the history of Sharia banking. This research data was analyzed qualitatively through three stages, namely data reduction, data display, and drawing conclusions or verification.

Results and Discussion

Sharia Banking in Historical Trajectory

Sharia banking first appeared in Egypt without using Islamic labels because of fears that the regime in power at that time would see it as a fundamentalist movement (Kıçmari, 2022). A savings bank founded in Mit Ghamr in 1963 was founded on profit sharing. This experiment lasted until 1967 when nine banks with a similar concept were established in Egypt. These banks, which neither charge nor receive interest, mostly invest in trading businesses. In 1971, Nasser Social Bank was founded in Egypt and declared itself an interest-free commercial bank (Al Masry et al., 2015). Although in its deeds, there is no reference to religion or Islamic law. In 1974, the Islamic Development Bank was founded, sponsored by countries that are members of the Organization of the Islamic Conference, although it is primarily an intergovernmental bank that aims to provide funds for development projects in its member countries (Egresi & Belge, 2015). The Islamic Development Bank provides fee-based and profit-sharing lending services to these countries and explicitly states that it is based on Islamic sharia. In the 1970s, Islamic-based banks emerged in the United Arab Emirates that operated without interest, such as Dubai Islamic Bank in 1975 (Kadiwala & Prajapati, 2019) dan Kuwait Finance House in 1977 (Al-Noumani et al., 2019). In 1978, Islamic banks such as Faisal Islamic Bank were re-established (Kaplan, 2020).

In Cyprus in 1983, Faisal Islamic Bank of Kibris was established (İnal-Cavlan & Dana, 2022). In 1983, in Malaysia, a Sharia bank was established

called Bank Islam Malaysia Berhad (Kitamura, 2020), and Bank Bumiputera Muamalah in 1999 (Asni, 2019). In Iran, the Islamic banking system began to apply nationally in 1983, starting with the publication of Islamic Banking Law (Parveen et al., 2015). In Turkey, Islamic banking was born in 1984 in the presence of Daar al-Maal al-Islami (Kammarti, 2022) and the Faisal Finance Institution, and operations began in 1985 (Yas et al., 2018).

One of the countries that has been the main pioneer in implementing the sharia banking system nationally is Pakistan. The Pakistani government converted the entire banking system in the country into a Sharia bank (Zafar & Sulaiman, 2020). In 1979, several of the largest financial institutions in Pakistan had abolished the interest system, while the government promoted interest-free loans, especially to farmers and fishermen (Kasmir, 2008).

The presence of sharia-based banks in Indonesia is still relatively new. In 1990, the Indonesian Ulema Council formed a working group to establish an Islamic Bank in Indonesia. On August 18–20, 1990, the Indonesian Ulema Council held a bank interest and banking workshop in Cisarua, Bogor, West Java (Basyirah et al., 2022). The results of the workshop were then discussed in more depth at the IV National Conference of the Indonesian Ulema Council in Jakarta on August 22–25, 1990, which resulted in a mandate for the formation of a working group for the establishment of Islamic banks in Indonesia (Isretno, 2020). The working group in question is called the Indonesian Ulema Council Banking Team and is given the task of approaching and consulting all related parties. Because of the work of the Indonesian Ulema Council Banking Team, the first sharia bank was established in Indonesia, namely Bank Muamalat Indonesia, which, according to its deed of establishment, was established on November 1, 1991. With support from the government and the community, since May 1, 1992, Bank Muamalat Indonesia officially operated. with initial capital of IDR 106,126,382,000,- (Perwangsa, 2016). The establishment of Bank Muamalat Indonesia was not immediately followed by the establishment of other sharia banks, so the development of sharia banking was stable until 1998 (Abdullah, 2017).

Against the background of the economic and monetary crisis in 1998 and the issuance of Law Number 10 of 1998 concerning Amendments to

Law Number 7 of 1992 concerning Banking, which regulates sharia business opportunities for conventional banks, sharia banking began to experience development with the establishment of Bank Syariah Mandiri in 1999 and the BNI Sharia Business Unit in 2000, as well as sharia banks and other Sharia Business Units in the following years. Ten years after the issuance of Law Number 10 of 1998, the government, together with the House of Representatives of the Republic of Indonesia, issued Law Number 20 concerning Sukuk and Law Number 21 concerning Sharia Banking in 2008. This law encouraged the development of sharia banking in Indonesia. According to data from the Infobank Research Bureau as quoted by Ash-Shiddiqy (2023), the number of sharia banks in Indonesia in 2023 will reach 13 banks, 20 Sharia Business Units and 165 Sharia People's Financing Banks with good development.

Development of Sharia Banks in Indonesia

Sharia banking entities in Indonesia started in 1983 with the release of the December 1983 Package (Pakdes 83), which contained some regulations in the banking sector, one of which allowed banks to provide credit with 0% interest (zero interest) (Baiti et al., 2021). These developments were followed by a series of banking sector policies by the Minister of Finance Radius Prawiro, which were contained in the October 1988 Package (Pakto 88) (Choiriyah et al., 2021). Pakto 88 was essentially banking deregulation that made it easier to establish new banks, so that the banking industry at that time experienced very rapid growth. Only in 1991 was Bank Muamalat Indonesia established as the only commercial bank that performs business activities based on the principle of profit sharing (Bayinah et al., 2021).

The formal existence of sharia banks in Indonesia began in 1992 with the enactment of Law Number 7 of 1992 concerning Banking (Atsani, 2022). However, it must be acknowledged that this law does not provide a strong legal basis for the development of sharia banks because it does not explicitly include the words "sharia principles" in its business activities, only using the term profit-sharing bank. The definition of a profit-sharing bank as intended in the law is not in accordance with the scope of the definition of a sharia bank, which is relatively broader than a profit-sharing bank. Due to the

absence of articles in the law that regulate sharia banks, until 1998 there were no operational provisions that specifically regulated the business activities of sharia banks. The amendment to Law Number 7 of 1992, which then gave birth to Law Number 10 of 1998, explicitly stipulates that banks can operate based on sharia principles (Tahir, 2017).

In the era of Law Number 10 of 1998, banking legal policy in Indonesia adopted a dual banking system. This policy essentially provided an opportunity for conventional commercial banks to provide sharia services through an Islamic window mechanism by first establishing a Sharia Business Unit. As a result, after this law, many conventional banks took part in providing sharia services to their customers. Then, Law Number 23 of 1999 concerning Bank Indonesia was passed in 1999. This law stipulates that Bank Indonesia can carry out monetary control based on sharia principles.

The existence of Law Number 10 of 1998 and Law Number 23 of 1999 has mandated Bank Indonesia to prepare provisions and other supporting facilities that support sharia banking operations, thereby providing a stronger legal foundation and wider opportunities for the development of sharia banking in Indonesia. Law Number 10 of 1998 and Law Number 23 of 1999 are the legal basis for the existence of a dual banking system in Indonesia, namely the existence of two banking systems (conventional and sharia) in providing banking services to the public.

Efforts to develop sharia banking in Indonesia are not only a consequence of Law Number 10 of 1998 and Law Number 23 of 1999 but are also part of efforts to revitalize the banking system which aims to increase the resilience of the national economy. The economic crisis that occurred in mid-1997 proved that banks operating with sharia principles could survive among exchange rate volatility and high interest rates. This fact is supported by the operating characteristics of Islamic banks, which prohibit interest (*riba*), non-transparent (*ghabarar*), and speculative (*maysir*) transactions.

In the above context, the development of sharia banking is expected to increase the resilience of the national banking system, which in turn is also expected to increase the resilience of the national economy in the future. Such national economic resilience can create a resilient economy (Zuhriyah et al., 2022), namely an economy whose financial sector growth agrees with real

sector growth (Perdana et al., 2023). To develop sharia banking, Bank Indonesia, as the national banking authority, began to move forward by introducing the first sharia monetary instruments, namely the Bank Indonesia Wadiah Certificate in 1999 and the Inter-bank Money Market based on Sharia principles in 2000. In 2006, the provision of Sharia services was made easier by Bank Indonesia with the introduction of office channeling in Bank Indonesia Regulation Number 8/3/PBI/2006. The essence of office channeling is that to provide sharia services, conventional commercial banks that already have a Sharia Business Unit in their head office no longer need to open new branch offices/sub-brand offices but simply open sharia counters in conventional branch offices/sub-brand offices. This will, of course, save bank finances because it no longer requires new infrastructure such as buildings, office equipment, employees, and information technology.

The sharia banking industry has experienced rapid development and increasingly has an adequate legal basis, namely with the issuance of Law Number 21 of 2008 concerning Sharia Banking. This regulatory support will certainly encourage faster growth of the sharia banking industry, and it is hoped that the role of the sharia banking industry in supporting the national economy will be even more significant (Utama, 2018). However, Rusydiana and Firmansyah (2017) stated that in its development, sharia banking in Indonesia showed results that were not in line with the desired targets. In Indonesian banking statistics as of December 2014, there were no less than 12 Sharia Commercial Banks and 22 Sharia Business Units from conventional banks with a total office network of 2,151 units (Fianto & Gan, 2017). In addition, the total assets of Sharia Commercial Banks reached 272,343 (in billion rupiahs) (Bayuny & Haron, 2017). This amount is small compared with the total national banking assets in general, which reached 5,615,150 (in billion rupiahs). This means that the sharia banking market share is still very small, namely 4.85%. In fact, the target market share for Sharia banking was 15% by the end of 2015 (Jumono et al., 2018). This encourages sharia banking practitioners to immediately look for a more massive sharia banking development strategy.

Purpose of Establishing a Sharia Bank

The existence of sharia banking as part of the Islamic economic system is expected to encourage the economic development of a country. The objectives and functions of sharia banking in the economy are widespread economic prosperity, full employment levels and optimum levels of economic growth, socioeconomic justice and equitable distribution of income and wealth, stability of the value of money, and mobilization and investment of savings that guarantee fair returns and effective service (Nastiti & Kasri, 2019; Sarib et al., 2023).

The aim of establishing sharia banking is to introduce and develop the application of Islamic principles, Sharia, and traditions into financial and banking transactions and other related businesses so that people avoid violations of Islamic law. According to the 2008 Law of the Republic of Indonesia, sharia banking aims to support the implementation of national development to increase justice, togetherness, and equal distribution of people's welfare. Meanwhile, Bidabad (2019) stated that the objectives of sharia banking are to prohibit usury, focus on the interests of the public or wider community, accelerate growth, achieve a prosperous economy, establish social and economic justice, and balance income distribution.

Legal Foundations of Sharia Banking

Kasmir (2010) defines a bank as a financial institution whose business activities include collecting funds from the community, channeling them back to the community, and providing other banking services.

The legal basis for sharia banking cannot be separated from the history of the development of sharia banking in Indonesia. Harahap et al (2010) stated that the development of sharia banking in Indonesia went through several periods as follows:

First, the period before 1992. Before 1992, in Indonesia, there were sharia banks in the form of BPR-Sharia, namely BPRS Mardhatillah, BPRS Berkah Amal Sejahtera, Al Mukaromah where the founders were ITB alumni. During this period, the BPR-Sharia was established in accordance with the banking legislation in force at that time (conventional banks), and there were no provisions governing sharia banks apart from the fact that it was not

possible for people to engage in sharia transactions, so the BPR-Sharia died slowly.

Second, the period from 1992 to 1998. During this period, dozens of BPR-Sharia and one sharia commercial bank, namely Bank Muamalat Indonesia, were established. During this period, sharia banks were established on the basis of Law Number 7 of 1992 concerning Banking. This law does not discuss sharia banks clearly or directly, only in article 6 letter m and article 13 letter c, which regulate Sharia bank business, namely: (a) Commercial Bank Business: "Providing financing for customers based on the principle of results are in accordance with the provisions stipulated in Government Regulations" (article 6 letter m); (b) Rural Bank Business: "Providing financing for customers based on the principle of profit sharing in accordance with the provisions stipulated in Government Regulations" (article 13 letter c).

Based on the provisions in Law Number 7 of 1992 concerning Banking, the government issued two sharia banking provisions, namely: (a) Government Regulation Number 72 of 1992 concerning Banks Based on Profit Sharing. Thus, Law Number 7 of 1992 concerning Banking and Government Regulations is the legal basis for the establishment of Sharia Commercial Banks; (b) Government Regulation Number 73 of 1992 concerning Rural Banks Based on Profit Sharing. Thus, Law Number 7 of 1992 concerning Banking and Government Regulations is the legal basis for establishing Rural Banks in this period.

In this period, there are no other provisions except the provisions mentioned above, such as Bank Indonesia Regulations, provisions regarding accounting and so on. During this period, each Sharia Supervisory Board issued a fatwa, so that the sharia provisions of one BPR Sharia were different from the others, and different from the fatwa issued by the Sharia Supervisory Board of Bank Muamalat Indonesia. In this period, Sharia banks carried out business activities in the sharia sector according to their respective capabilities, based on the fatwa of each relevant Sharia Supervisory Board.

Third, the period from 1998 to 2008. From the experience and studies carried out, it turns out that Islamic banks have different characteristics from conventional banks, so Law Number 7 of 1992 concerning Banking was refined with Law Number 10 of 1998 concerning amendments to Law

Number 7 of 1992 concerning Banking. In Law Number 10 of 1998, the provisions of sharia banking are discussed. For example, Article 1 Number 13 states that Sharia principles are the rules of agreements based on Islamic law between banks and other parties for the storage of funds and/or financing of business activities, or other business activities that are declared in accordance with sharia, among other things, financing based on the principle of profit sharing (*mudharabah*), financing based on the principle of capital participation (*musharakah*), the principle of buying and selling goods at a profit (*murabahah*), or financing of capital goods based on the principle of pure rental without options (*ijarah*), or with the option of transferring ownership of goods rented from the bank by another party (*ijarah wa iqtina*). Then, in Article 6, letter m, it is stated that providing financing and/or conducting other activities based on sharia principles, in accordance with the provisions stipulated by Bank Indonesia. In the explanation of this article, it is stated that "the main provisions stipulated by Bank Indonesia include, among others: (1) business activities and bank products based on sharia principles; (2) the formation and duties of the Sharia Supervisory Board; (3) requirements for opening branch offices that carry out conventional business activities to perform business activities based on sharia principles; (4) there are many other articles that regulate Sharia banking."

Because Law Number 10 of 1998 discussed Islamic banks, the government revoked the two Government Regulations mentioned above with Government Regulation Number 30 of 1998. As implementing regulations, Bank Indonesia, starting in 1999, issued many regulations governing Islamic banks. These provisions are the legal basis for the establishment of Sharia Rural Banks and sharia commercial banks such as Bank Syariah Mandiri and Bank Mega Syariah and several sharia branches of conventional banks such as BRI Syariah, BNI Syariah, BTN Syariah, BJB Syariah, and so on.

Fourth, the period after 2008. Starting in 2008, sharia banking in Indonesia has its own law, namely Law Number 21 of 2008 concerning Sharia Banking. This law fully states that sharia banks that were established and/or carried out their business activities starting in 2008, of course based on Law Number 21 of 2008, and all its implementing regulations. The provisions

regulated under Law Number 10 of 1998 and its implementing regulations remain valid as long as they do not conflict with the provisions of Law Number 21 of 2008. This is in accordance with the provisions in article 69 "when this law comes into force, all provisions regarding sharia banking as regulated in Law Number 7 of 1992 concerning Banking (State Gazette of the Republic of Indonesia of 1992 Number 31, Supplement to State Gazette of the Republic of Indonesia Number 3472) as amended by Law Number 10 of 1998 (State Gazette of the Republic of Indonesia of 1998 Number 182, Supplement to the State Gazette of the Republic of Indonesia Number 3790) and its implementing regulations are declared to remain in effect as long as they do not conflict with this law."

Referring to Law Number 10 of 1998 concerning Amendments to Law Number 7 of 1992 concerning Banking, the existence of sharia banking in Indonesia has been explicitly recognized. This can be seen in the words "bank based on Sharia principles."

Law Number 10 of 1998 does not yet specifically regulate sharia banking operations; therefore, the government passed Law Number 21 of 2008 concerning Sharia Banking on July 16 2008. Law Number 21 of 2008 is expected to guarantee certainty for interested parties. So, in summary the legal basis for sharia banking, namely: Law Number 7 of 1992, Law Number 10 of 1998, Law Number 23 of 2003, and Law Number 21 of 2008. Then, several Bank Indonesia Regulations regarding Sharia Banking, namely: PBI No.9/19/PBI/2007 concerning Implementation of Sharia Principles in Fund Collection and Fund Distribution Activities as well as Sharia Bank Services; PBI No.7/35/PBI/2005 concerning Amendments to Bank Indonesia Regulation No. 6/24/PBI/2004 concerning Commercial Banks Carrying Out Business Activities based on Sharia Principles; PBI No.6/24/PBI/2004 concerning Commercial Banks Carrying Out Business Activities based on Sharia Principles.

Principles and Functions of Sharia Banks

The limitations of Sharia banks, which must conduct their activities on the basis of Islamic sharia, cause them to have to apply principles that agree with or do not conflict with Islamic sharia (Judijanto et al., 2023). The

principles of sharia banking are: first, the principle of deposit or savings (*al-wadi'ah*), which is a pure deposit from one party to another, whether an individual or a legal entity, which must be safeguarded and returned whenever the depositor wishes. Second, the principle of profit sharing, namely a system that includes procedures for sharing business results between fund providers and fund managers (Gilani, 2015).

In the Islamic accounting paradigm, Islamic banks have functions, namely: first, investment management. Islamic banks can perform this function on the basis of *mudharabah* contracts or representative contracts. Second, investment. Islamic banks invest funds placed in the business world (both capital funds and investment account funds) using investment tools consistent with Sharia law. For example, *al-murabahah*, *al-mudharabah*, *al-musyarakah*, *bai' as-salam*, *bai' al-ishtisna'*, and *al-ijarah*. Third, financial services: Islamic banks can also offer various other financial services based on wages in a representative or rental contract (Miah & Suzuki, 2020).

Differences between Sharia and Conventional Banks

Sharia banking and conventional banking have differences in the systems used. The sharia banking system not only generates as much profit as possible but is also required to implement sharia values in real terms. The Islamic financial and banking system is a subsystem of the Islamic economic system, which has a broad scope (Salman & Nawaz, 2018).

Alam et al (2017) say that in conventional banking there are activities that are prohibited by Islamic law, such as receiving and paying interest (*riba*), financing production and trading activities of prohibited goods (*haram*), activities that are very close to gambling (*maisir*), for certain transactions in foreign exchange transactions, as well as including highly speculative transactions (*gharar*) in investment banking. Meanwhile, the main principles adhered to by sharia banking are as follows: first, the prohibition of usury (interest) in various forms of transactions; second, conducting business and trading activities based on obtaining legal profits according to sharia; and third, developing *zakat*.

Islamic banking adopts procedures and systems from conventional banking as long as these systems and procedures do not conflict with Islamic principles (Ullah et al., 2018). To avoid irregularities in the implementation of

sharia banking systems and procedures, sharia banks have a Sharia Supervisory Board whose task is to provide input to sharia banking to ensure that sharia banks do not perform activities that are contrary to Islamic principles (Mukhibad, 2019).

Sharia banks and conventional banks can be differentiated in several ways. First, from the aspect of contracts and legality, sharia banks are based on Islamic law and positive law, whereas conventional banks only rely on positive law. Second, in terms of dispute resolution institutions, sharia banks have the National Sharia Arbitration Board (BASYARNAS), whereas conventional banks have the Indonesian National Arbitration Board (BANI). Third, in terms of organizational structure, Islamic banks have a National Sharia Council (DSN) and a Sharia Supervisory Board (DPS), whereas conventional banks do not. Fourth, in terms of operational principles, Islamic banks have principles (profit sharing, buying and selling and renting), whereas conventional banks are interest instruments. Fifth, from an investment perspective, Islamic banks are halal, whereas conventional banks are halal and haram. Sixth, in terms of objectives, Islamic banks are profit and *falab*-oriented, whereas conventional banks are profit-oriented only. In terms of customer relationships, Islamic banks are partnerships, whereas conventional banks are debtors and creditors.

Machmud and Rukmana (2010) stated that the main differences between conventional banking systems and Islamic banking can be briefly seen from four aspects, namely: first, the philosophical aspect. Islamic banks are not based on interest, speculation, and uncertainty, whereas conventional banks are based on interest. Second, the operational aspect. In sharia banks, public funds in the form of deposits and investments will only get results if they are invested in first, whereas in conventional banks, public funds are deposits that must be paid interest at maturity. On the distribution side, Islamic banks channel their funds to halal and profitable business sectors, whereas in conventional banks, the halal aspect is not a main consideration. Third, the social aspect. In Islamic banks, the social aspect is stated explicitly and firmly in the company's vision and mission, whereas in conventional banks, it is not explicitly implied. Fourth, organization. Sharia banks have a Sharia Supervisory Board, whereas conventional banks do not.

A very significant differentiator between Islamic banks and conventional banks is the profit-sharing system in Islamic banks, whereas conventional banks use an interest system. However, quite a few people think that there is no difference between profit sharing and giving/taking interest, so they are of the opinion that Islamic banks and conventional banks are the same, but the terms are different.

Machmud and Rukmana (2010) mentioned five points related to the profit-sharing system. *First*, the determination of profit sharing is made during the agreement on the basis of profit/loss. *Second*, the profit-sharing ratio is based on the amount of profit achieved. *Third*, profit-sharing depends on the results of the project. If the project makes a profit or suffers a loss, the risk is borne by both parties. *Fourth*, the amount of profit given increases according to the increase in profits obtained. *Fifth*, the receipt or distribution of profits is halal. Machmud and Rukmana (2010) also have five points related to the interest system. *First*, interest is determined during the agreement without being based on profit or loss. *Second*, the interest percentage is based on the amount of money (capital) available. *Third*, interest payments remain as agreed upon without consideration of whether the project implemented by the second party makes a profit or a loss. *Fourth*, the number of interest payments does not increase even though the profit doubles. *Fifth*, returns or interest payments are haram.

Conclusion

The purpose of establishing Islamic banking is to introduce and develop the application of Islamic principles, sharia, and its traditions into financial, banking, and business transactions. Then, the prohibition of usury, focus on the public interest, accelerate growth, achieve a prosperous economy, the establishment of social and economic justice, and a balanced distribution of income. Islamic banking in Indonesia is regulated by Law No. 7/1992 on Banking, Law No. 10/1998 on Amendments to Law No. 7/1992 on Banking, and Law No. 21/2008 on Islamic Banking. The basic principles of Islamic banking are the principles of free *maghrib* (*maysir*, *gharar*, *haram*, *riba*, and *batal*), trust and prudence in the management of Islamic banking activities, and principles based on contracts, while the functions of Islamic banks are to collect funds, channel funds to people in need, and provide services in the form of Islamic banking services. The difference between Islamic banks and conventional banks is in the principle of implementation, Islamic banks are

banks that adhere to sharia principles or Islamic principles, while conventional banks are generally based on regulations or mutual agreements.

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