

DISPUTE RESOLUTIONS FOR ISLAMIC BANKS IN
INDONESIA

BY

ATHARYANSHAH PUNERI

A dissertation submitted in fulfilment of the requirement for
the degree of Master of Science (Islamic Banking and
Finance)

IIUM Institute of Islamic Banking and Finance
International Islamic University Malaysia

FEBRUARY 2020

ABSTRACT

The rapid growth of Islamic banking and finance industry demanded an improvement in term of standards, frameworks, policy, technologies, resources, and guidelines in order to go beyond without compromising the core values of Islam itself. In the context of legal framework of Islamic banking and finance, it is most likely this industry needs to be highly regulated in order to avoid manipulation and abuse by the irresponsible parties. One of the crucial issue in the area of Islamic Banks in Indonesia is regarding about the dispute resolution mechanism for Islamic Banks. Based on Indonesian positive law, there are two alternative dispute resolution mechanisms that can be exercised by parties to settle disputes in cases involving Islamic Financial Institutions (IFIs) namely through litigation or non-litigation. Litigation comes under the jurisdiction of the Religious Court. Researcher in this study will discover more deeper into the dispute resolution mechanism for Islamic Banks in Indonesia, as well as going through some decided cases. And based on the study done, it was found that the presence of an alternative dispute resolution mechanism is more effective to resolve Islamic Banks dispute rather than litigation. In the future, researchers may conduct more research to examine deeper about the dispute resolution mechanism for the whole Islamic Economics and Finance in Indonesia. Moreover, researchers need to look at the regulators' and legislators' perception towards dispute resolution and legal environment.

خلاصة البحث

يتطلب النمو السريع لصناعة المصرفية والمالية الإسلامية تحسناً من حيث المعايير والأطر والسياسات والتقنيات والموارد والمبادئ التوجيهية، وذلك من أجل المضي قدماً دون المساس بالقيم الأساسية للإسلام. في سياق الإطار القانوني للمصارف والتمويل الإسلامي، فمن المرجح أن تكون هذه الصناعة بحاجة إلى تنظيم متطور من أجل تجنب الإساءات والتلاعب من قبل الأطراف الغير المسؤولة. أحد أهم القضايا الحاسمة في مجال المصارف الإسلامية في إندونيسيا، هي قضية آلية حل النزاعات للمصارف الإسلامية. واستناداً إلى القانون الوضعي الإندونيسي، هناك آليتان بديلتان لتسوية المنازعات والذي يمكن للأطراف المتنازعة استخدامها لتسوية النزاعات في القضايا التي تتعلق بمؤسسات المالية الإسلامية (IFIs)، أي من خلال المقاضاة أو عدم المقاضاة. وتخضع المقاضاة ضمن اختصاص المحكمة الشرعية (الدينية). يناقش الباحث في هذه الدراسة بشكل أعمق آلية حل النزاعات الخاصة بالمصارف الإسلامية في إندونيسيا، كما يدرس بعض القضايا التي تم البت فيها. وبناءً على الدراسة التي تم إجراؤها، تبين أن وجود آلية بديلة لتسوية المنازعات أكثر فعالية لحل النزاعات في المصارف الإسلامية من التقاضي. مستقبلاً، يمكن للباحثين إجراء المزيد من الأبحاث لدراسة أعمق حول آلية تسوية المنازعات للاقتصاد والمالية الإسلامية بأكملها في إندونيسيا. وعلاوة على ذلك، يتعين على الباحثين الأخذ بعين الاعتبار وجهات نظر المنظمين والمشرعين تجاه حل النزاعات والبيئة القانونية.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science (Islamic Banking and Finance).

.....
Rusni Hassan
Supervisor

I certify that I have read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science (Islamic Banking and Finance).

.....
Nor Razinah Mohd Zain
Internal Examiner

This dissertation was submitted to the IIUM Institute of Islamic Banking and Finance and is accepted as a fulfilment of the requirement for the degree of Master of Science (Islamic Banking and Finance).

.....
Salina Hj. Kassim
Dean, IIUM Institute of Islamic
Banking and Finance

DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Atharyanshah Puneri

Signature

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION OF
FAIR USE OF UNPUBLISHED RESEARCH**

**DISPUTE RESOLUTIONS FOR ISLAMIC BANKS IN
INDONESIA**

I declare that the copyright holders of this dissertation are jointly owned by the student and IIUM.

Copyright © 2020 Atharyanshah Puneri and International Islamic University Malaysia. All rights reserved.

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below

1. Any material contained in or derived from this unpublished research may only be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieved system and supply copies of this unpublished research if requested by other universities and research libraries.

By signing this form, I acknowledged that I have read and understand the IIUM Intellectual Property Right and Commercialization policy.

Affirmed by Atharyanshah Puneri

.....
Signature

.....
Date

*This humble research is dedicated to my family and my special one
For their unconditional love, care, trust, encouragement, continuous support,
sacrifice and constant prayers.*

ACKNOWLEDGEMENTS

In the Name of Allah, Most Gracious, Most Merciful

From the depth of my heart, I thank the Almighty for the blessings He has bestowed upon me to complete this research. Peace and blessings be upon our beloved Prophet Muhammad (S.A.W), his family and his companions.

My heartfelt appreciation to my beloved parents who were constant sources of unwavering support. I pray that Almighty Allah will reward them with long life, good health and deeds. In addition, the love and support extended by my dearest brother, loved one, family, friends and relatives.

I would like to convey my sincere gratitude to my supervisor, Assoc. Prof. Dr Rusni Hassan, who has supported me throughout my research with his patience, encouragement, guidance, kindheartedness, helpful behavior and effort.

I have huge appreciation towards everyone who helps me in the process of making this research, especially to Head of Religious Chamber in Indonesia Supreme Court, Dr. H. Amran Suadi, SH, MH, MM.

Also, my deepest appreciation to many others who supported and assisted me to reach Malaysia to pursue this master's degree. You have been important sources of positive support during times of difficulty faced on this academic journey.

I also have my deepest appreciation to all of my colleagues in MODP FL 4 Bank Muamalat Indonesia who also encourage me in this journey.

May Allah bless all who contributed to the success of this research with increased wisdom and good health in addition to rendering this research a positive contribution for the advancement of the Ummah.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page.....	iv
Declaration	v
Copyright Page.....	vi
Dedication	vii
Acknowledgements	viii
List of Tables	xi
List of Figures	xii
CHAPTER ONE: INTRODUCTION	1
1.1 Introduction.....	1
1.2 Background Of Study	1
1.3 Problem Statement.....	6
1.4 Research Objectives.....	7
1.5 Research Question	8
1.6 Significance Of The Study.....	8
1.7 Scope Of The Study.....	9
1.8 The Organization Of The Study	9
CHAPTER TWO: LITERATURE REVIEW.....	11
2.1 Introduction.....	11
2.2 Islamic Banks In Indonesia.....	11
2.2.1 Definition Of Islamic Banks	11
2.2.2 History Of Islamic Banks In Indonesia.....	13
2.2.3 Development Of Legislation For Islamic Bank In Indonesia	17
2.3 Dispute Resolution In Islamic Perspective	26
2.3.1 Al-Qada (Adjudication)	27
2.3.2 Alternative Dispute Resolution In Islamic Perspective	28
2.4 Importance Of Religious Court In Indonesia.....	31
2.5 Chapter Summary	33
CHAPTER THREE: RESEARCH METHODOLOGY	35
3.1 Introduction.....	35
3.2 Type Of Study.....	35
3.3 Data Collection	36
3.4 Data Analysis.....	37
3.5 Justification For The Methodology	37
3.6 Chapter Summary	38
CHAPTER FOUR: ANALYSIS AND DISCUSSION	39
4.1 Introduction.....	39
4.2 Islamic Banking Disputes	39
4.2.1 Types Of Islamic Banking Disputes In Indonesia	40
4.2.2 Factors That Cause Islamic Banking Disputes	41

4.3 Dispute Resolution For Islamic Banks In Indonesia	43
4.3.1 Dispute Resolution For Islamic Banks Through Litigation	45
4.3.2 Dispute Resolution Through Arbitration	59
4.3.3 Dispute Resolution Through Mediation.....	65
4.4 Possible Overlapping Issues	72
4.4.1. Overlapping Between Religious Court And Constitutional Court	72
4.4.2 Overlapping Decisions Of Litigation And Alternative Dispute Resolutions	73
4.5 Chapter Summary	74
CHAPTER FIVE: CONCLUSION AND RECOMMENDATION.....	79
5.1 Conclusion	79
5.2 Recommendation	80
REFERENCES.....	82
APPENDIX A – List of Interview Questions.....	88

LIST OF TABLES

Table 1.1	The development of Islamic Banks in Indonesia according to the laws and regulations applied	3
Table 2.1	List of Islamic Commercial Banks in Indonesia	16
Table 2.2	List of Islamic Business Unit in Indonesia	16
Table 3.1	List of Interview Respondents	36
Table 4.1	Differences between Litigation, Arbitration and Mediation in handling Islamic Banks' disputes	76

LIST OF FIGURES

Figure 2.1	Court Structure in Indonesia	31
Figure 4.1	The process in Religious Court	48
Figure 4.2	The process of Arbitration in BANI/BASYARNAS	63
Figure 4.3	Process of Mediation inside the Court in Examining Islamic Banking Disputes	69

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Based on the law that are exist and eonforced in Indonesia, there are two alternative dispute resolution mechanisms that can be exercised by parties to settle disputes in cases involving Islamic Financial Institutions (IFIs) namely through litigation or non-litigation. Litigation comes under the jurisdiction of the Religious Court. This is based on Article 49 Act No. 3 of 2006 following amendments to the law that applies to the court. In term of non-litigation, it can be handled in two ways, (i) arbitration (under *Badan Arbitrase Syari'ah Nasional Indonesia/BASYARNAS* or any other arbitration body, such as *Badan Arbitrase Nasional Indonesia/BANI*) or (ii) using another alternative dispute resolution mechanism such as mediation. Non-litigation is covered by Article 55 Paragraph (2) and (3) Islamic Banking Act No. 21 of 2008.

1.2 BACKGROUND OF STUDY

The global Muslim population has been growing very fast and has long been underserved in terms of Shariah finance. A lot of Islamic banks and financial institutions have been set up in Muslim countries in the GCC and MENA region as well as in countries like Malaysia, Oman, Qatar, the UAE, Pakistan, Saudi Arabia and Indonesia. The last decade has seen a sharp rise in Islamic banking services, offering a real and attractive alternative to conventional financial services. Across the Middle East, Africa, and Asia, Islamic Banks has grown to become a prominent feature of

financial systems, and have sparked interest from various parties including from Western countries.

Islamic banking has fast gained prominence across the world a decade after the global financial crisis (GFC) 2008-2010. Some people think that Islamic Finance (IF) especially Islamic Banks can provide alternative forms of financing that is more ethical, discourage speculation and less crisis-prone. At the end of 2016, the asset of the global IF industry stood at US\$2.293 trillion. This shows a growth by almost triple from its size in 2008 which stood as US\$ 822 billion (Edbiz Group, 2017). This highlights the rapid growth of the IF industry, especially after the global financial crisis in 2008. Islamic Banks still makes up the substantial portion of the industry, with assets in 2016 at US\$ 1.493.40 trillion.

In actual fact the development of Islamic Banks has been more dynamic than the total asset suggests. Islamic Banks market share increased 18% and remained constant or decreased only marginally in 13 jurisdictions. The average net profit margin of the sector has sustained its ROA and ROE in the past two years with different levels across different jurisdictions. The ratio of liquid assets to short-term liabilities has varied across jurisdictions from 100% and more to 20% and less (Islamic Financial Services Board, 2017).

Indonesia, as the country with the largest Muslim population in the world is seeing growth in Islamic Banks. Initially the Indonesian Banking Act No. 14 of 1967, did not provide any provision for the establishment of Islamic Banks in Indonesia. However, in 1992 the Act was amended by Indonesian Banking Act No. 7 of 1992. Islamic Banks were formally established in Indonesia under the enactment of the same Act. The first Islamic Bank established in Indonesia was Bank Muamalat Indonesia, established on 1st May 1992. Although the amendment allowed Islamic Banks to be

established, there were still no detailed rules in term of Shariah principles for banking, for example, the amendment recognized that banks operate under the “profit-sharing principle” (Masykur, 2017).

Further impetus and support for Islamic Banks was via the Amendments of Banking Act No. 10 of 1998. Finally, in 2008, the Indonesian Government established a dedicated law for Islamic Banking, the Islamic Banking Act No. 21 of 2008. According to Article 4 Paragraph 1 of the Act, Indonesia has a dual banking system. This means that the country has two banking systems running, the conventional and Islamic banking system. It is interesting to note that in the Indonesian context, the term used to refer to Islamic Banking is Shariah Banking. However, for the ease of discussion in this research, the general terminology used is Islamic Banking. Table 1.1 shows the development of Islamic Banks in Indonesia according to the banking laws applicable in Indonesia.

Table 1.1 The development of Islamic Banks in Indonesia according to the laws and regulations applied

	Regulation about Islamic Banks
Banking Act No. 14 of 1967	Did not allow banks to be operated under Islamic principles. Only conventional banks (bank with interest) can operate
Banking Act No. 7 of 1992	Dual banking system allowed in Indonesia. Still use the term “profit-sharing principle” instead of “Islamic Banks”
Banking Act No. 10 of 1998	For the first time Indonesian Government acknowledged the term “Islamic Banks”.
Islamic Banking Act No. 21 of 2008	First time Indonesian Government established a dedicated regulation for Islamic Banks

Source: Author’s own

Islamic Banks have been growing rapidly in Indonesia since the first Islamic Banks was established in 1992. As of September 2019, there are 14 Shariah Commercial Banks, 20 Shariah Business Units and 244 Shariah Rural Banks established as per data from Otoritas Jasa Keuangan (OJK). In terms of assets, as of Sept 2019, Islamic Banks assets in Indonesia stood at Rp 490.415 trillion, an increase of RP 33.493 trillion from Sept 2018. In terms of market share, Islamic Banks share stood at 6.01% assets shares compared to 93.99% held by conventional banks. In term of structure, Shariah Commercial Banks still dominate in term of share of asset by 66.28%, followed by Shariah Business Units with 31.23% and Shariah Rural Banks with 2.49% (Otoritas Jasa Keuangan, 2019).

For the growth of Islamic Banks in Indonesia, the Indonesian Government has set up a target for Islamic Banks to reach 10.9% market shares in 2019 (Badan Perencanaan Pembangunan Nasional, 2015). However, as of Sept 2019, Islamic Banks in Indonesia have only managed to reach 6.01% market shares (Nordiansyah, 2019). Otoritas Jasa Keuangan (2015) stated that some issues faced by Islamic Banks are such as:

1. Misalignment in the vision and lack of coordination between the government, the authorities and the stakeholders in the development of Islamic Banks
2. Inadequate capital, low level of industry scale and inefficiencies of Islamic Banks
3. High cost of funds which leads to limited financing segment
4. Lack of variety in products and service not up to the peoples' expectation

5. Inadequate quality and quantity of human resources as well as underdeveloped Information Technology infrastructure to support the development of Islamic Banks products and services.
6. Low level of peoples' understanding and awareness of Islamic Banks

The growth of Islamic Banks in Indonesia has created new opportunities as well as new challenges. Minka (2013) stated that there are at least five challenges facing Islamic Banks, namely:

1. Not many qualified Islamic Banks experts in Indonesia who are also qualified in modern economics as well as expert in Shariah at the same time
2. The credibility of Islamic Economics and Finance has not been tested
3. No adequate regulatory, policies and legal tools for Islamic Banks in Indonesia
4. Limited number of educational institutions e.g. colleges that offer quality Islamic Finance education
5. The government's role still needs to be improved in order to help Islamic Banks to develop further in Indonesia.

The current growth of Islamic Banks in Indonesia poses legal challenges to the current legal system. This includes both laws governing Islamic Banks but also in the terms of dispute resolution for Islamic Banks. Disputes can happen between Islamic Banks and its customers such as defaults in payments or in term of financing facilities. Dispute resolution in Islamic Banks is regulated under Chapter IX Article 55 from Islamic Banking Act No. 21 of 2008. That Act provides that:

1. Settlement of disputes of Sharia (Islamic) Banking is conducted by a court in the Religious Court.

2. In the case that the parties have already agreed the settlement of disputes besides as considered as in paragraph (1), the dispute settlement shall be according to the Akad (contract) content.
3. Settlement of disputes as considered in paragraph (2) may not be contrary to the Sharia Principles.

Article 55 provides two ways to settle disputes in Islamic Banks, through the Religious Court or through other alternative dispute resolution mechanisms as long as they are not contrary to the Sharia Principle. The alternative dispute resolution mechanisms that can be chosen are mutual understanding, mediation, and arbitration.

This study contributes to a better understanding of dispute resolution for Islamic Banks in Indonesia. This study examines the laws and regulations on dispute resolution for Islamic Banks in Indonesia, as well as the issues and challenges faced by Islamic Banks practitioners in this regard. Furthermore, this study will also analyze the trends in dispute resolution by the courts and through alternative dispute resolution for Islamic Banks.

1.3 PROBLEM STATEMENT

Although the Islamic Banking Act No. 21 of 2008 provides that dispute resolution comes under the jurisdiction of the Religious Court, there is lack of trust amongst the people in the court's ability to handle such cases (Fauzi et al., 2014). This could be due to:

- a) Some practitioners think that judges in the Religious Court lack ability to handle Shariah Economics disputes

- b) Islamic Banks often think that if disputes go to the courts, they will be on the losing end
- c) Disharmony in the legal system related to dispute resolution for Shariah Economic disputes

Using alternative dispute resolution also poses some issues. First, any resolution reached via alternative dispute resolution requires the disputing parties to go to the courts to get endorsement to execute the resolution. If the parties choose to use alternative dispute resolution like *BASYARNAS*, they have to agree to this in the Akad. If alternative dispute resolution is not stipulated in their Akad, then all disputes will be handled automatically by the Religious Court (Hasan, 2010).

1.4 RESEARCH OBJECTIVES

This study aims to discuss and explore dispute resolution for Islamic Banks according to Indonesian Law. Specifically, it attempts to:

1. Examine the dispute resolution mechanisms for Islamic Banks in Indonesia
2. Identify issues faced by the Religious Court being the main platform for dispute resolution
3. Provide recommendation for effective implementation of dispute resolution

1.5 RESEARCH QUESTION

1. What are the dispute resolution mechanisms for handling Islamic Banks disputes?
2. What are the issues faced by Religious Court being the main platform for dispute resolution?
3. What are the recommendations that can be given for effective implementation of dispute resolution?

1.6 SIGNIFICANCE OF THE STUDY

This study can benefit regulators, academics and also the public. Regulators can use the findings to help them make informed decision and formulate regulations that can further enhance dispute resolution for Islamic Banks in Indonesia. Academics can use the findings to benchmark, explore and add to literature on dispute resolution for Islamic Banks in Indonesia. The public such as Islamic Banks practitioners, stakeholders as well as customers can use this study to understand and protect their rights and obligation in disputes.

Meanwhile, Islamic Banks can use the findings as a source of information to provide better customer protection. Because by knowing on how to solve the dispute, the Banks can give more protection to their customer and at the end, Islamic Banks can gain more trust from the people in Indonesia. Through this, they can build customer loyalty, instill customer trust and grow their business further.

1.7 SCOPE OF THE STUDY

This study focuses on the laws in Indonesia regulating dispute resolution for Islamic Banks. The dispute resolution mechanisms covered in this study are litigation (under Religious Court) and alternative dispute resolution (mutual understanding and arbitration) governed by Article 55 Paragraph 2 and 3 Islamic Banking Act No. 21 of 2008.

This study also focuses on legal studies based on Indonesian regulations applicable to dispute resolution and Islamic Banks in Indonesia. This study also refers to decided cases and interviews.

1.8 THE ORGANIZATION OF THE STUDY

This study consists of five chapters. **Chapter One** introduces the study and consists of Introduction, Background, Problem Statements, Research Objective, Research Questions, Significance of the Study, Scope of the Study and the Organization of the Study.

Chapter Two covers the literature review of the study. It provides an overview of Islamic Banking in Indonesia, the local regulatory framework for Islamic Banks, disputes faced by Indonesian Islamic Banks, dispute resolution from the Islamic perspective as well as dispute resolution for Islamic Banks in Indonesia.

Chapter Three covers the research methodology of the study. This chapter discusses about the research method applied for the study. It also provides the description of the data and the method of analysis.

Chapter Four analyses and discusses the findings. This chapter will provide with the analysis about the dispute resolution for Islamic Banks in Indonesia.

Chapter Five provides overall conclusion and recommendation of the study on dispute resolution for Islamic Banks in Indonesia.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter covers the literature review for this study. Cooper (1998) stated that there are five main function of literature review namely to improve research methodology, to focus more on the research problem, to cater for knowledge based research, to contextualize research findings and to ensure novelty in the research. This chapter consists of three parts namely the history of Islamic Banks in Indonesia, dispute resolution mechanisms in Islam and the importance of the Religious Court in Indonesia.

2.2 ISLAMIC BANKS IN INDONESIA

In this section, it will be describing about the history of Islamic Banks in Indonesia as well as the development of the law that are regulating about Islamic Banks in Indonesia.

2.2.1 Definition of Islamic Banks

Banks are at the core of a country's financial system. Banks as financial institutions allow people, companies and even government institutions to save their excess funds. These excess funds are channeled to others in need of funds and banks also facilitate payments throughout the economy. (Hermansyah, 2005) Black's Law Dictionary defined Banks as:

An institution, usually incorporated, whose business to receive money on deposit, cash, checks or drafts, discount commercial paper, make loans, and issue promissory notes payable to bearer known as bank notes.

Article 1 Paragraph (2) Indonesian Banking Act No. 7 of 1992 as amended by Act No. 10 of 1998 defined Banks as:

A corporate entity mobilizing funds from the public in the forms of Deposits and channeling them to the public in forms of Credit and/or other forms in order to improve the living standards of the common people.

Based on the definition above, the main activities of a bank as a financial intermediary are to move funds in the form of deposits and to channel the funds in the form of credit. Meanwhile, specifically for Islamic Banks, Article 1 Paragraph (7) Islamic Banking Act No. 21 of 2008 defined Islamic Banks as:

A Bank conducting business on the Shariah Principles consisting of Shariah (Islamic) Commercial Bank and Sharia (Islamic) Rural Banks.

Article 1 Paragraph (12) defined Shariah Principle as Islamic law principles applied in the banking business based on fatwas' issued by an institution having the authority to issue fatwas in Sharia matters. This implies that Islamic Banks in Indonesia conduct their business based on the Shariah Principle. The Principle is being issued by authorities such as the *Dewan Syariah Nasional Majelis Ulama Indonesia (DSN-MUI)* or National Sharia Board. Bank Indonesia (2009) in their website states that:

The characteristic of Islamic banking operation is based on partnership and mutual benefits principle provides an alternative banking system with mutual benefits both for the public and the bank. This system will give priorities to aspects related to fairness in transaction and ethical investment by underlining the values of togetherness and partnership in production, and by avoiding any speculative activity in financial transaction. By providing various products and banking services