

# REGULATIONS RELATED TO THE ESTABLISHMENT AND DEVELOPMENT OF SHARIA FINANCIAL INSTITUTIONS IN INDONESIA

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## ABSTRACT

*One of the basic principles of sharia economy is the value of social justice. The treasure must be spread to various circles of society and should not be gathered only to a handful of people. The distribution of this wealth must be implemented in policy both in the form of a fatwa of the National Sharia Council of the Indonesian Ulema Council which is the institution authorized to issue fatwas related to sharia economy as well as in the form of legislation that becomes the domain of the legislative institution which is then implemented by the executive institution. Implementation of the principle of social justice in sharia economy in Indonesia is an important part in realizing the ideals of the Indonesian nation in realizing social justice for all Indonesian people as stated in the Preamble of the 1945 Constitution.*

**Keywords:** Social Justice, Sharia Economics, Financial Institutions.

## INTRODUCTION

One of the most important precepts highlighted in recent times is the issue of social justice, where the distance between those who are wealthy and those who lack the need to be so far is not the ideal condition to be achieved by the Indonesian people. In the preamble of the 1945 Constitution mentioned about the national goal of the Indonesian nation that is protecting the whole Indonesian nation and the entire blood of Indonesia, promoting the general welfare, the intellectual life of the nation, and involved in world peace based on freedom, eternal peace, and social justice. These principles are the principal rules that build Islamic economic structures or frameworks. Islamic economics is an integral part of Islam. Islamic economics follows the teachings of Islam in its various aspects, including the doctrine of justice (Chapra, 1993). Islamic economics is defined as a branch of science that seeks to see, analyse, and ultimately solve economic problems in Islamic ways. Islamic ways here are understood as ways based on Islamic teachings of the Qur'an and the *Sunnah* of the Prophet. Manan (1986) mentioned that Islamic economics is a social science studying people's economic issues inspired by Islamic values. Muhammad Akram Khan (1994) mentioned that Islamic economics aims the study of the human well-being achieved by organizing the resources of the earth on the basis of cooperation and participation.

Meanwhile, Ash-Shiddiqy (1992) mentioned that Islamic economics is the thinkers' response to the economic challenges of their time. In this endeavour they were aided by the Qur'an and the *Sunnah* as well as by reason and experience. Khan (1994) stressed the principle of cooperation and participation while Ash-Shiddiqy (1992) emphasized the response of Muslim

thinkers based on the Qur'an and the *Sunnah*. Particularly in Indonesia, Pancasila based on MPR Decree No. XVIII of 1998 is the basis of the State which must be obeyed by all the people of Indonesia. The formulation of the precepts contained in Pancasila is the result of the thought of the Founders of the Nation that is influenced by three important values, namely religious values, customs values, and the values of the great ideologies that were very influential at the time (Ghofur et al., 2017; Wicaksono, 2018). The influence of religion is reflected in the five precepts, from the concept of divinity, humanity, unity, democracy, and social justice. The divine principle animates all other precepts. In the Explanation of Law No. 3 of 2006 Article 49 letter I mentioned the meaning of sharia economy is an act or business activity which is carried out according to sharia principles. The principle of sharia itself is a principle that is in accordance with Islamic law with its main reference of the Qur'an and Al-Hadith. Islamic economic activity in Indonesia as mentioned in the Elucidation of Law No. 3 of 2006 on Religious Courts include Sharia banks, Islamic microfinance institutions, Sharia insurance, Islamic reinsurance, Shariah mutual funds, Islamic bonds and Sharia pawnshops (Husain, 2006).

### **Sharia Banking**

Historically, the idea of the need for a financial institution in the form of banking based on Islamic principles in Indonesia has developed long before the establishment of Islamic banking institutions in Indonesia as well as in the world (Huda and Heykal, 2010; Warman et al., 2018). K.H. Mas Mansur who is a Muhammadiyah figure and served as Chairman of the Muhammadiyah Executive of the period 1937-1944 has explained the reasons why it is still possible to use conventional banking due to forced conditions where Muslims do not have their own banks that are free from usury. At a special National Congress of Muhammadiyah in 1968 in Sidoarjo, the theme of bank law was one of the discussions. In the hearing it was affirmed that *riba* (interest) is illicit based on the Qur'anic and *Sunnah* texts; banks with interest is illegal and conversely, bank without interest shall be lawful; interest granted by state-owned banks to its customers in in *mutashabihat* category; suggested to Central Leadership of Muhammadiyah to work to realize the concept of economic system, especially banking institution in accordance with Islamic norms (Dewi, 2006).

Hence, Muhammadiyah explicitly declared the new bank interest law in 2006, (Muhammadiyah, 2006) where the Majelis Tarjih Muhammadiyah at the Muhammadiyah Supreme Deliberation in Yogyakarta issued a fatwa on 8 of 2006 which states that the interest of the bank is usury, and clear unlawful (Huda and Heykal, 2010). Thus, it will take a long time for Muhammadiyah to determine the interest of the bank with various forms. Meanwhile, Nahdlatul Ulama (NU) as the largest Islamic society organization in Indonesia has been discussing bank interest problem since 1937 through NU 12th Congress of 1937. At the hearing, it was stipulated that the law put money in Conventional Bank for security purposes only and not sure the money not used for something that is forbidden by religion. This bank interest issue always arose in the deliberations conducted by NU, as in the NU's Great Conference which was held on 19 March 1957 in Surabaya, in the National Conference of Islamic Scholars and the Great Conference of NU in 1982 in Bandar Lampung. The problem of bank interest law for NU is not one; however National Congress of the organization mandates the establishment of Islamic banks with interest less system. NU'S views on banks are diverse. First, the problems of conventional banks, there

are NU circles who hold the view that the interest of banks *riba* is absolutely unlawful (Antonio, 2001).

Meanwhile, the other party stated that bank interest is not necessarily the same as usury, so it is allowed. Second, where the interest issues categorized as consumptive and productive interest, the NU holds that the productive interest of law is *halal* while the consumptive interest of the law is *haram*. In 1988 the government issued a policy package known as the October 1988 Policy Package “(*Paket Kebijakan 27, Oktober 1988/Pakto, 1988*)”. *Pakto, 1988* is a policy package that regulates the deregulation of the banking industry in Indonesia. With the release of the 1988 *pakto* Muslims who have difficulty in establishing Islamic Bank because of the absence of legal foundation began to seek to realize the establishment of Islamic banks. The first institution to obtain sharia bank permits was the Sharia Rural Credit Bank (BPRS) of Berkah Amal Sejahtera and SRB Dana Mardhatillah dated August 19, 1991, and BPRS Amanah Rabaniah on October 24, 1991. All BPRSs operate in Bandung. Meanwhile in Aceh BPRS Hareukat stands on November 10, 1991 (Dewi, 2006). The establishment of BPRS is a representation of the will of the Muslim community in realizing interest-free banks.

Thus, the establishment of sharia banking in Indonesia is more a button-up in which the community as a pioneer and not an active role of government. On November 1, 1991, it is signed the deed of establishment of PT Bank Muamalat Indonesia. The accumulated capital as a paid-up capital commitment for PT Bank Muamalat is IDR 106 billion. Furthermore, on May 1, 1992 Bank Muamalat Indonesia began operating. After the reform of 1998 came sharia-based banks, namely Bank Sharia Mandiri, Bank Mega Sharia in 2004 and other banks (Prayogo, 2018). Legal support for the development of sharia banking in Indonesia is not as strong as expected by sharia economic community. This is evident from the slow pace of sharia banking regulation independently. Since the establishment of Bank Muamalat Indonesia in 1991, the new sharia banking has a special law related to sharia banking in 2008 with the issuance of Law No. 21 of 2008. The Banking Act of 1992 mentions a bit about banking with profit-sharing system, as stated in Article 13 point (c) stating that one of the Rural Banks (BPR) businesses provides financing for customers based on the principle of profit sharing. The provisions are in accordance with Government Regulation (PP) No. 72 of 1992 concerning Bank based on profit sharing principle. In Article 6 of Government Regulation No. 72 of 1992 mentioned: 1. Commercial Banks or Rural Banks whose business activities are solely based on profit sharing principles, shall not engage in business activities that are not based on profit sharing principles. 2. Commercial Bank or Rural Bank whose business activities are not based on profit sharing principles are allowed to conduct business activities based on the principle of profit sharing (Hakim, 2017). Based on Law No. 7 of 1992, sharia banking performs its role by referring to the translation issued by Bank Indonesia through Bank Indonesia Circular Letter No. 25/4/BPPP dated 29 February 1993 which in essence is: (1). Whereas banks based on profit sharing principles are Commercial Banks and Rural Banks which are conducted based solely on the principle of profit sharing; (2) The principle of intended profit sharing is the principle of profit sharing based on sharia; (3) Banks based on profit sharing principles shall have Sharia Supervisory Board (DPS); (4) Commercial Banks or Rural Banks whose business activities are solely based on profit sharing principles are not allowed to conduct business activities that are not based on the principle of profit sharing.

On the other hand, a Commercial Bank or a Rural Bank conducting business not on the basis of profit sharing (conventional) is allowed to conduct business activities based on profit sharing principle. Law No. 7 of 1992 then revised with the birth of Law No. 10 of 1998 concerning Banking. The existence of sharia banking is accommodated by the Act. In Article 1 paragraph (3) of Law No. 10 of 1998 mentioned:

*"Commercial Bank is a bank conducting business in a conventional and or based on Sharia Principles which in its activities provide services in payment traffic".*

Then in paragraph (4) it says:

*"Rural Bank is a bank conducting conventional business activities or based on Sharia Principles which in its activities do not provide services in the payment traffic".*

Thus, it is very clear that banking businessmen can establish banks either in conventional form or in forms based on sharia principles. Bank Indonesia in 1999 issued Decree of Bank Indonesia's Board of Directors. 32/34/KEP/DIR concerning commercial banks based on Sharia Principles and Decree of the Board of Directors of BI No.32/36/KEP/DIR concerning Rural Banks Based on Sharia Principles. Then the second decree was replaced by Bank Indonesia Regulation (PBI) No. 6/24/PBI/2004 dated October 14, 2004 concerning Commercial Banks conducting Business Based on Sharia Principles No. PBI No. 7/35/PBI/2005 dated 25 September 2005 concerning Amendment to PBI No. 6/24/PBI/2004 concerning Commercial Banks conducting Business Based on Sharia Principles and Bank Indonesia Regulation (PBI) No. 6/17/PBI/2004 dated 1 July 2004 concerning Rural Banks Based on Sharia Principles. Sharia banking is legally increasingly solidified by the issuance of Law No. 21 of 2008 concerning Sharia Banking. This Act consists of 13 Chapters and 70 Articles. Article 2 of the Sharia Banking Law states:

*"Islamic Banking in conducting its business activities based on Sharia Principles, economic democracy and prudential principles".*

Meanwhile, the legal entity form of Sharia Bank is a Limited Liability Company as stated in Article 3 of Sharia Banking Law. The founder and/or owner of a Sharia Bank consists of Indonesian citizens and/or Indonesian legal entities; Indonesian citizens and/or Indonesian legal entities with foreign citizens and/or foreign legal entities in partnership; or local government. Meanwhile Sharia Financing Bank may only be established and/or owned by Indonesian citizens and/or Indonesian legal entities with all owners of Indonesian citizens; local government; or two or more parties mentioned before. Sharia Commercial Bank by the law is prohibited from doing some activities, such as to conduct business activities contrary to sharia principles (Sabiq, 2009); conduct stock buying and selling activities directly in the capital market; conduct capital participation, except as referred to in Article 20 paragraph (1); and conducting insurance business activities, except as marketing agent of takaful products. Moreover, the Sharia Rural Bank is prohibited to conduct business activities that are contrary to Sharia Principles; receive deposits in the form of demand deposits and participate in payment traffic; conduct business activities in foreign currency, except for foreign currency exchange with a license from Bank

Indonesia; conduct insurance business activities, except as marketing agent of takaful products; to engage in capital participation, except on institutions established to tackle the liquidity difficulties of the Sharia Rural Bank; and conduct other business outside the business activities as intended in Article 21 (Djumardin & Isnaini, 2018).

## **Sharia Insurance**

The establishment of sharia insurance companies is not far from the establishment of Islamic banks in the world. In Indonesia, the establishment of sharia insurance was initiated by Association of Indonesian Islamic Scholars (Ikatan Cendekiawan Muslim Indonesia/ICMI) through Yayasan Abdi Bangsa with Bank Muamalat Indonesia and Tugu Mandiri Company. The three institutions agreed to establish Takaful Insurance by compiling the Indonesian Takaful Insurance Formation Team (TEPATI) on July 23, 1993. TEPATI has conducted the establishment of PT Syarikat Takaful Indonesia as a holding company and two subsidiaries of PT. Family Takaful Insurance (Life Insurance) which was established in 1994 and PT. General Takaful Insurance (Takaful Insurance Losses) which was established on 5 May 1994. In 2014, it is regulated Law No. 40 of 2014 About Insurance includes the regulation on Takaful insurance. Prior to the issuance of the insurance law, the implementation of sharia insurance still underlies to the laws and regulations concerning the conventional insurance in Indonesia contained in the Civil Code, the Commercial Code and the Law No. 2 of 1992 concerning Insurance Business and Government Regulation No. 63 of 1999 concerning Amendment to Government Regulation No. 73 of 1992 on the Implementation of Insurance Business. In the regulation there is no special arrangement on Takaful insurance (Muhaimin, 2018).

Article 3 of Law No. 2 of 1992 point a mentioned about insurance business that is a loss-taking business that provides services in the mitigation of risks for loss, loss of benefits and liability to third parties arising from an uncertain event; a life insurance business that provides services in the management of risks associated with the life or death of a person who is held liable; insurance business that provides services in re-insurance against risks faced by insurance companies and life insurance companies. In 2000, it was the Decree of the Director General of Financial Institutions No. Kep. 4499/LK/2000 concerning the type, assessment and restriction of Insurance companies and Reinsurance companies based on Sharia principles. Then in succession out some regulations issued by the Minister of Finance of the Republic of Indonesia which in essence recognizes the existence of Takaful insurance in addition to conventional insurance. As the operational guideline of Sharia Insurance, the Indonesian Ulama Council has issued a fatwa on Sharia General Insurance Guidelines that are the fatwas from DSN. 21/DSN-MUI/X/2001, No. 30 on Hajj Insurance, No.51 concerning the contracts of mudharaba musytarakah on Sharia Insurance, No. 52 on Wakalah bil Ujrah on Sharia Insurance and Reinsurance Sharia, No. 53 on Tabarru' on Sharia Insurance, No. 81 on Tabarru Refund's for Insurance participants who terminated before the end of the agreement, No. 98 on Guidelines for the Implementation of Sharia Health Social Security, and No. 106 on Waqf of Insurance Benefits and Investment Benefits on Sharia Life Insurance.

## Sharia Capital Market

Sharia Capital Market is a capital market that is run by the principles of sharia, in which every securities trading transaction in the capital market is implemented in accordance with the provisions of Islamic sharia (Huda and Haykal, 2010). Sharia capital market has different instrument principles with conventional capital market. Shares in Islamic capital market are shares that have criteria where the shares are issued companies that do business in accordance with sharia (Manan, 2009). Thus, transactions that are not in accordance with the principles of sharia such as gambling and speculation, usury are rejected in sharia capital markets (Sudarsono, 2007). In the world, historically, Amanah Income Fund is the first financial institution that cares to operationalize its portfolio with sharia portfolio in the capital market (Manan, 2009). It was founded in June of 1986 by members of The North American Islamic Trust based in Indiana, USA.

The idea of a sharia-compliant capital market is gaining significant appreciation from Muslim economists in various parts of the world such as the Middle East, Europe, Asia and the United States. Bahrain Stock in Bahrain, Amman Financial Market in Amman, Muscat securities, Kuwait Stock Exchange in Kuwait, and KL Stock Exchange in Kuala Lumpur Malaysia are proactive countries in welcoming the arrival of Muslim investors and investors who want to take advantage of Shariah-compliant capital markets. In non-Muslim countries the sharia capital market may also flourish. The New York Stock Exchange launched a product called the Dow Jones Islamic Market Index (DJIMI) in February 1999. In Indonesia, the new sharia capital market was inaugurated by Finance Minister Boediono on March 14, 2003. The sharia capital market inauguration plan was actually in early November 2002, but the Capital Market Supervisory Agency (Bapepam) and the National Sharia Board (DSN) felt not ready (Sudarsono, 2007). The sharia capital market instrument itself has been in existence since 1997 with the launching of Danareksa Islam on July 3, 1997 by PT Danareksa Investment Management. Then the Indonesia Stock Exchange in cooperation with PT Danareksa Investment Management launched the Jakarta Islamic Index on July 3, 2000 which aims to guide investors who want to invest funds in accordance with the principles of sharia. In 2002 PT Indosat issued sharia bonds. This instrument is the first instrument which is then followed by other sharia bonds. Of 2004 out of sharia bonds with ijarah agreement and in 2006 emerging instrument Index Fund where index which used as underlying is index JII (Huda and Heykal, 2010). The development of sharia capital market is seen to run slowly not as the development of sharia banking and sharia insurance. In determining the criteria of the components of the Jakarta Islamic Index (now become Indonesia Stock Exchange), the Sharia Supervisory Board and PT DIM have an important role in approving the discharge of the JII component.

Moreover, sharia capital market instruments can be grouped into three categories. First, asset securities/asset projects (asset securitization) which is evidence of inclusion, both musharakah mapping and mudharabah inclusion. Second, debt securities (debt securitization) or issuance of bonds arising from sale and purchase transactions or is a funding source for the company. Third, securities of capital, these securities are securities emissions by issuers listed in the sharia capital market in the form of shares. These capital securities can also be done by companies whose shares are owned in a limited way by issuing shares or buying shares. Jakarta Islamic Index (JII) is the last index developed by Jakarta Stock Exchange (now BEI) in

cooperation with Danareksa Investment Management. Sharia Index is an index based on Islamic sharia. Sharia-compliant stocks are those whose business activities are not contradictory to Sharia, such as: (1) gambling and gambling business or banned trade; (2) conventional financial business (including interest and usury) including conventional banking and insurance, (3) businesses that produce, distribute and trade food and beverages classified as haram, (4) businesses that produce, distribute and/or supply goods-goods or services that damage morals and are harmful. Shares issued by the four types of companies cannot be included in the category of sharia stock and the issuer cannot enter the Jakarta Islamic Index. Bond is one type of effect. Unlike the stock whose ownership signifies the partial ownership of a company that issues the stock, the bond shows the debt of the issuer. The bondholder has the right and position as the creditor of the bond issuer. Islamic bonds based on the MUI-DSN fatwa Number: 32/DSN-MUI/IX/2002 explains that sharia bonds are a long-term security based on sharia principles that require issuers to pay revenues to sharia bondholders in the form of profit/margin/fees, and repay the bonds at maturity (Manan, 2009). There are several principles in the issuance of Islamic bonds are the principles of mudharaba, musharaka, *ijara*, *ististna*, *salam*, and *murabaha*. In practice, the principles of mudharaba and *ijara* principles are the most widely used principles. Mudharabah sharia bonds are sharia bonds using mudharabah contracts, in which mudharabah contract is a cooperation agreement between the owner of capital (*shahib al-mal*) and the manager (*mudharib*). Meanwhile, *ijara* bonds are sharia bonds based on *ijara* agreement, in which the *ijara* contract is a type of contract to take advantage of by way of replacement. The owner of the property gives the right to exploit the transacted object through temporary mastery or borrowing the object with certain benefits by paying the reward to the owner of the object. Some companies that have issued Islamic bonds in Indonesia include PT Indosat Tbk (2002), PT Bank Muamalat Indonesia (2003), PT Bank Sharia Mandiri (2003), PT Cilandra Perkasa (2003), PTPN VII (2004), PT Matahari Putra Prima (2004), PT Sona Topas Tourism Industri (2004), PT Berlian Laju Tanker (2003 and 2004), PT Indorent (2004), PT Indofood Tbk. (2004). The companies issue sharia bonds in the form of *ijarah* and mudharaba. With the issuance of Law No. 21 of 2011 on the Financial Services Authority, the regulation concerning the Capital Market including Sharia Capital Market shall be the authority of the Financial Services Authority. Article 6 of OJK Law states:

*“OJK performs regulatory and supervisory duties on:*

- 1. Activities of financial services in the banking sector;*
- 2. Financial services activities in Capital Market sector;*
- 3. Financial services activities in the Insurance sector, Pension Funds, Financing Institutions, and other Financial Services Institutions” (Mulyawan, 2018).*

The DSN fatwas associated with the Sharia Capital Market include the DSN fatwa No. 20 concerning Guidelines for the Implementation of Investment for Sharia Mutual Funds, fatwa No. 40 concerning the Capital Market and General Guidelines for the Implementation of Sharia Principles in the Capital Market Sector; 65 regarding Pre-emptive Rights (HMETD) of Sharia, No. 66 on Sharia Warrants, Fatwa No. 80 on the Implementation of Sharia Principles in Equity Securities Trading Mechanism in the Regular Market of Stock Exchange, fatwa No. 69 on State Sharia Securities (SBSN), and other fatwas related to Sharia bonds.

## CONCLUSION

The importance of justice in Islam is well documented in its main sources of reference, namely the Qur'an and al-Hadith as well as in intellectual thought. Similarly, in practical terms Islam has demonstrated the ideal example of how the principles of justice are applied. In economic terms, social justice is an important principle that must be realized. The provisions of the profit-sharing principle show that each party must be prepared with the possibility of profit and the possibility of loss so that the risk of business spread to all parties, not as in usury where one party does not want to take risks against losses suffered by other parties if the loss occurred. The doctrine of social justice in economics is reflected in its principles, its theories and the forms of its transactions. Wealth should not be concentrated on one group alone, because it will cause imbalance and will affect the social situation and politics. Wealth must be spread to various parties through various instruments such as zakat and other productive instruments. Thus, it is expected to create harmonious social conditions that justice. The regulation of Islamic economy in Indonesia is getting better and better. Nevertheless, there is still a need for state involvement to promote the growth of Islamic economies in various forms. Principles of transactions based on the real sector as important capital for the realization of social justice in Indonesia. People and managers of the state must be involved in making it happen. By applying the principles and teachings of Islamic economics by balancing the contemporary context and the Indonesian, it is expected social justice for all the people of Indonesia contained in the five principles of Pancasila can be realized.

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