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The urgency of sharia division in Indonesian and Malaysian Islamic bank

Amin Wahyudi[1], Binti Nur Asiyah[2], Husnul Haq[3]

[1]Department Islamic Economic, Faculty of Islamic Business and Economics, Institut Agama Islam Negeri Ponorogo, Indonesia.
[2]Department Islamic Economic, Faculty of Islamic Business and Economics, Universitas Islam Negeri Sayyid Ali Rahmatullah Tulungagung, Indonesia.
[3]Department Fiqh and Ushul Fiqh, International Islamic University Malaysia, Malaysia.

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Abstract

This paper aims to investigate the significance of having a sharia division in Indonesian and Malaysian Islamic banks. This paper is a qualitative study based on a review of official documents from the Indonesian Central Bank and the Indonesian Sharia Council. Interviews with Sharia Advisers were conducted to conduct an interpretive, critical, and descriptive study of the issue. The interpretive analysis was carried out by interpreting each issued regulation, and the analysis was deepened by presenting a description of the sharia division's implementation in Malaysian Islamic banks. Efforts to analyze the results are carried out by reducing the information obtained, presenting the data and concluding. According to the research findings, there are numerous deviations in non-compliance with Sharia implementation in disbursed financing. According to the findings, Islamic banks must have a Sharia division in their organisational structure. The Sharia division ensures that Sharia bank operations follow Sharia principles, beginning with input, processing, and output. This study's theoretical implication is a study of sharia implementation by providing a sharia division in the organisational structure of Islamic banks. This is a more extensive study involving more sharia banks on their willingness and the internal awareness of the presence of the sharia division. Any country that wishes to establish sharia banks must research the presence of sharia divisions to ensure sharia compliance in their operations.

*Corresponding author: aminwahyudi@iainponorogo.ac.id
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Introduction

The implementation of sharia in sharia banks is still much doubted by some people. Studies done by (Hosen et al., 2019; Nawaz & Bardai, 2017; P, 2018; Sonko, 2020), to name a few, have discussed customer perceptions and the implementation of sharia. The public still considers sharia banks the same as conventional banks(Isnawi, 2016; Hikmah, 2017). Sharia banks must answer this doubt by implementing their operations following sharia principles. (Hosen et al., 2019; Nawaz & Bardai, 2017; P, 2018; Sonko, 2020)In conducting their business, sharia banking must be professionally managed to ensure that sharia is applied and that the profit generated is guaranteed to be halal. The Sharia Supervisory Board of Islamic banks across countries from the Middle East, North Africa, and Southeast Asia influences the risk of financing portfolios channelled by Islamic banks (Alman, 2012).

Sharia banks must be run with the principle of Amanah (trust). According to (Barus, 2016; Kheirabadi, 2004; Mamadolimova et al., 2011), Islam gives meaning to Amanah as an effort to settle obligations in accordance with Islamic principles. Islam gives mercy and compassion to humans. Implementation of Islamic rules and faith in Allah is beneficial for the attainment of falah, in this world and the hereafter. Falah achievements in the economic field are obtained through achieving economic progress in the field of sharia implementation in Islamic banks. The principle of sharia, referred to by (Jan, 2018), is the acquisition of istihsan based on sharia, maṣlaḥah (benefits), raf'al ḥaraj (removing difficulties), and ḍarūriyyāt (primary needs).

Islamic banks ensure that customer deposits are managed according to sharia. The disbursed financing experienced a bottleneck because the customer did not understand the financing received according to the sharia contractIt is contradictory in Amanah as one of the sharia principles implemented in such banks is expected to prevent them from experiencing fund congestion to realise their stability (Hafnida & Maamor, 2016). If not dealt with properly, such congestion will eventually affect the banks' income and the profit sharing for saving customers and shareholders.

Implementation of sharia in Islamic banks in Indonesia is in accordance with the obligations of directors of Islamic banks, and there is no special person in charge. Supervision of sharia compliance is the task of the Sharia Supervisory Board (DPS). (SSB). Their duties, according to Article 32 paragraph 3 of the Law of the Republic of Indonesia No. 21 of 2008 concerning Islamic Banking, are in the form of sharia supervision of Islamic bank operations and to contribute in providing input to the directors (GoI, 2008a). Referring to the Bank of Indonesia's Circular Letter No. 15/22/ DPbS, compliance with sharia principles means all efforts related to savings, distribution of funds, no usury in operations, maysir (gambling), gharār (cheating), ḥarām (haram), and ẓālim (wickedness) (BI, 2013). However, the SSC's advice and suggestions are non-binding; therefore, they may or may not be followed. At Bank Islam Malaysia, sharia principles are implemented by the sharia committee and supervised by the sharia supervisory board (Amin et al., 2021; BNM-SGDP, 2019).

According to articles 5 and 6 of the Regulation of the Indonesian Financial Services Authority 24 Number, that implementation of compliance with sharia principles, policies and procedures for product risk management and new activities of sharia banks must be evaluated by the SSB (K. D. K. OJK, 2015). SSB members are appointed by bank commissioners when fund owners hold a general meeting. This can jeopardize the independence of the management because they no longer position themselves as arbiters of sharia-based business but as business partners.

Various cases arise exercise of sharia in the operations of sharia banks such as the case of Bank Syariah Mandiri (BSM), which distributed fictitious financing to its Bogor branch amounting to IDR (Indonesian Rupiahs) 102 billion for 197 fictitious customers (Najib & Rini, 2016). Then, there were complaints from customers of Bank Rakyat Indonesia (BRI) Syariah and Bank Mega Syariah or being disadvantaged by sharia gold pawn products. The Dubai

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Islamic Bank also announced a loss of approximately US$ 300 billion due to incorrect financial reports. Khan (2019) states that limited business conducted by sharia banks leads some to run fictitious financing to meet consumers' consumptive needs. Such cases show the portrait of sharia banks' prudence that does not run with sharia principles. Ascarya et al. (2016) stated that Bank Negara Indonesia (BNI) Syariah, Bank Syariah Mandiri, and BRI Syariah are more Islamic compared to shariah banks in other countries. This means that there are other sharia banks which operate in fewer sharia manners than those banks.

The SSC holds a meeting once a month which usually only takes a few hours. This becomes another cause of the arising of various cases. Guaranteeing the implementation of sharia include every signing of new financing document, murabahah (a kind of leasing) contracts, and obligations that the bank and customers must do should be scrutinised by the sharia division. The legal function within the sharia bank often does them. Due to their limited frequency, such meetings usually refrain from discussing problematic matters related to sharia nor making the one-by-one correction. However, every document has elements of sharia. Only some of them are adequately scrutinised by the SSC. Therefore, it increases the possibility of violating the sharia. Every branch office of any public sharia bank must have an officer in charge of sharia compliance. According to (Hosen et al., 2019), sharia compliance conducted by a sharia bank is an important service that affects customer perceptions. To realise such a situation, it is essential or the banks to employ special officers working in the bank's sharia division who ensure the implementation of sharia compliance. This research aims at analysing the possibility of having sharia divisions in the structure of sharia banks and their management.

Literature Review

Sharia compliance in banking is a strength for Islamic banks. Asiyah et al. (2019) paper show that the construct of Islamic prudential banking in its ideas can reduce the NPF level because sharia prudence raises awareness for customers of the obligations that must be carried out. This sharia prudence is a manifestation of sharia banks complying with sharia elements. Sharia compliance is defined as the process of taking into account Shariah-compliant business practices when planning, financing, procuring and developing resources in such a way that human resources, business, product, link to each other information, finance and record flow on operations based on sharia principles (Annabi et al., 2017).

Sharia prudence and compliance is a study in Islamic banking. *Prudential banking is interpreted by* Hulster and Montes-Negret (2015) as the operational basis of Islamic banks that provide security and full vigilance. This method is technically beneficial so that Islamic banks have stability, avoiding all elements of banking risk and systemic risk. Microprudential arrangement, stated to Wall (2015), can be used to maintain and protect healthy Islamic banks and avoid failures in financial system management. Vallascas and Keasey (2012) stated that Islamic banking can be managed stably if risks can be minimized and limited. Meanwhile, stated to Williams (2014), Islamic banks are able to avoid risks if the government makes a real contribution. In this case, the government's duty in encouraging Islamic rules to be implemented in Islamic banks through the role of the Majeli Ulama Indonesia from each of its fatwas is implemented in Islamic banks.

Sharia compliance with Islamic banks provides benefits in real terms and convinces Islamic banks in the future. As stated by Welfens (2008), prudence in Islamic banks is carried out on the consideration of maintaining business competition and shareholder assets, product renewal is needed. Innovation, in this case, is the development of sharia banks by always ensuring sharia as a reference in the operations of sharia banks. Sharia on banks in financing includes prudence carried out by upholding the principles of 5 C (Character, Capacity, Capital, Collateral and Condition), not strictly sharia being the basis of the part that becomes prudential.

These rules in the Sharia Banking Law stated Sharia Banks and Sharia Business Units must believe that prospective customers are willing, aware, and able to pay in full for their responsibilities to Islamic banks in a timely manner when the financing has not been disbursed. This is done by considering the character of the customer, the ability of the customer's capital, collateral and business prospects of prospective financing customers (GoI, 2008b, article 23)

Sorkhou (2006) argues that conventional banking in extending loans is carried out by always considering the credit risk in each unit, the inherent credit risk, the credit rating that occurs and the importance of credit being monitored in terms of process and results. That is what has been done by Islamic banks in running the business. If sharia is not expressly contained in prudential rules, then sharia derivatives must be carried out by the sharia division so that it is implemented. The Sharia that is implemented concerns the products that are distributed. While process inputs and outputs are not a point of pressure so that regulations are not found, the sharia division needs to ensure that all 5C are sharia-based in its operations. Efforts to prevent sharia non-compliance in sharia banking, according to (Lahsasna, 2014), require sharia administrators, sharia advisory boards, sharia reviews and sharia audits.

Methodology

This paper is qualitative research employing a descriptive approach. This paper is analyzed by carrying out data reduction according to research questions, data is presented so that it is easy to understand, and ends by concluding answers according to the discussion in the discussion. In-depth interviews with the Sharia Supervisory Board of some sharia banks were done to strengthen the data to enhance the research quality. In-depth interviews with the Sharia Supervisory Board in Malaysia, namely Muhammad Mahbubi Ali, and the Sharia Supervisory Board in Indonesia Sa'dullah Syarofi. The value built in this study is based on the thought of (Glaser & Strauss, 2006). The acquisition of qualitative research can be concluded to a broader population; applicable definitions determine the understanding values that emerge from interpretive studies and work with the perspective of the research subject.

Results and Discussion

This paper finds that the management of sharia banks employs prudence. According to (Syarofi, 2019),

…The Sharia Supervisory Board has done a sampling test everywhere. Fraud is still happening in a place where I often do pick-and-drop tests. If it is just a test, sharia violations will continue. So it is ceremonial. The picking test is still carried out, only reports. I have spoken openly to the financial services authority, I have not done a pick-me-up, but I am looking for everything."

According to (Abdullah et al., 2013), the expertise of the Sharia Supervisory Board (SSB) of Islamic Banks in Malaysia in the areas of accounting, banking, economics or finance encourages the disclosure of supervision carried out by SSB. In Indonesia, according to Mukhibad & Setiawan (2022), busy life, educational background (economics/finance and Islamic law), and experience of SSB of the Sharia Supervisory Board of Islamic Banks harm risk in Islamic banks. Meanwhile, the SSB education level encourages directors to take risks. This will encourage management to improve education for Sharia Supervisory Board because it will further contribute to efforts to minimise losses in Islamic banks. (Wan Abdullah et al., 2013).

Sharia-based operations management in Indonesia becomes the bank's directors' task and responsibility, whereas the Sharia Supervisory Board carries out the supervision through their opinions related to sharia. The Bank of Indonesia (BI, 2009) and the Indonesian Financial Service Authority (O. J. K. OJK, 2017) outline this matter in the underneath chart:

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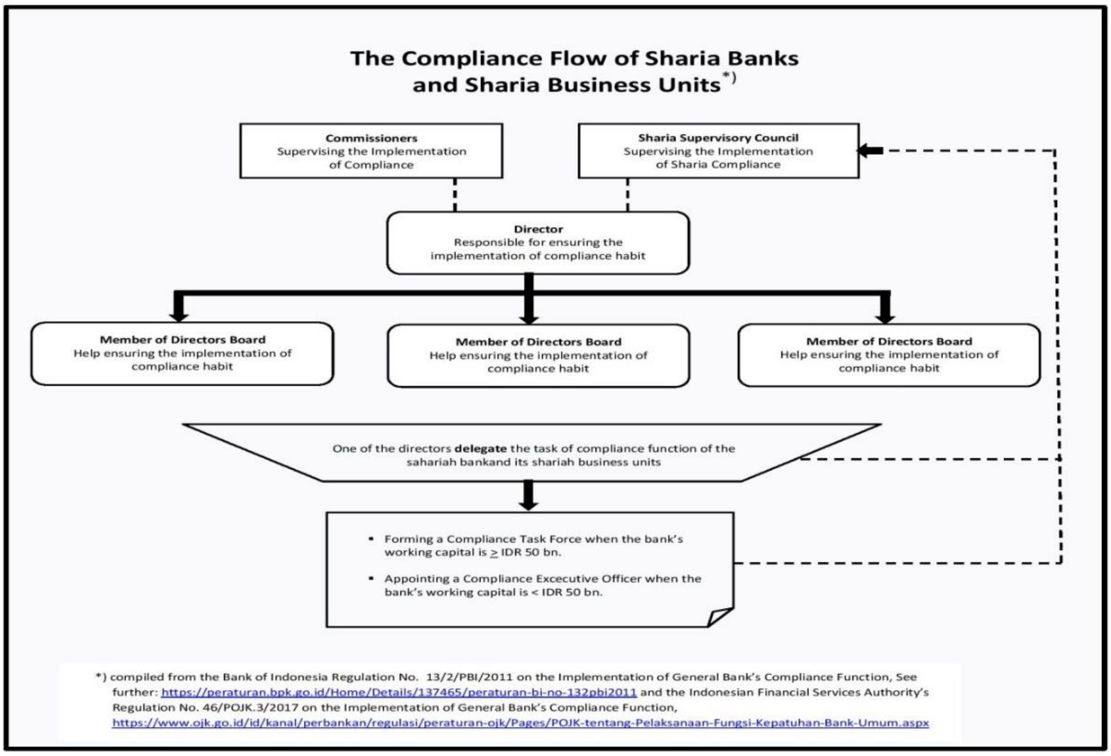

Chart 1: Sharia Compliance Structure of Sharia Banks and Sharia Business Units in Indonesia

Chart 1 shows no organisational structure under the directors mandated explicitly to ensure the implementation of sharia principles. It is different from the management of Islamic banks in Indonesia and Malaysia. Malaysian Islamic Bank provides a sharia committee to implement sharia principles. The following is the structure of the sharia division in the management element and the Sharia Supervisory Board in the supervisory function the following chart:

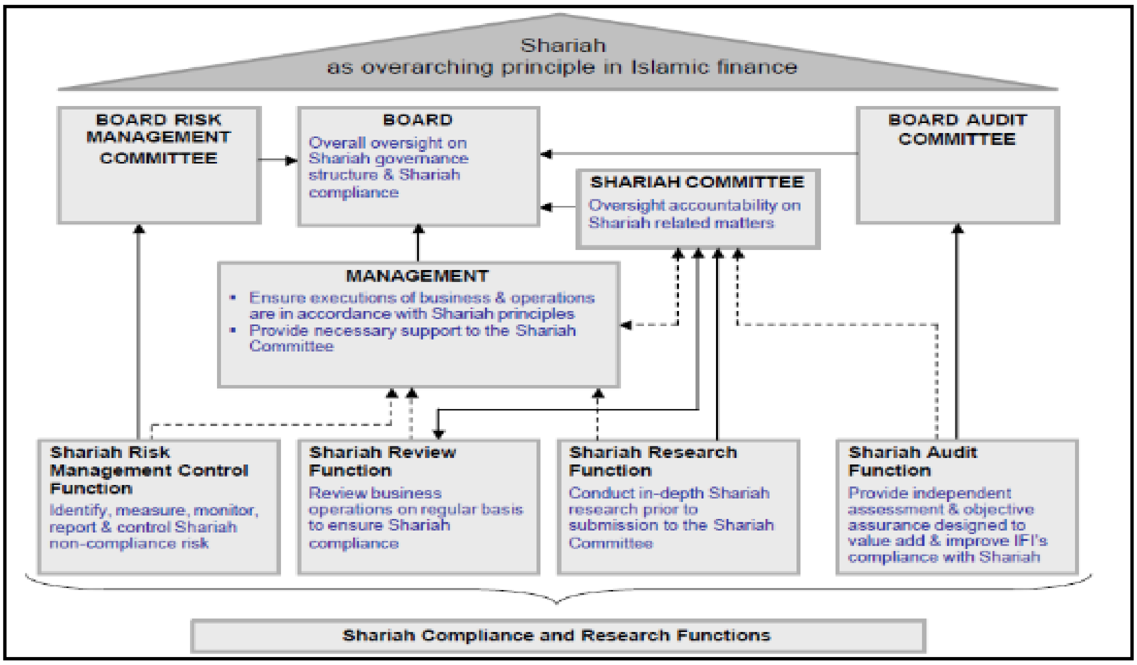

Chart 2: Sharia Implementation in Bank Negara Malaysia
(Source :Rama, 2015)

According to (Ali, 2020), in Malaysia, there is a sharia division which also serves as the secretary of the sharia committee. The sharia division is appointed by the Board of Directors, while the commissioner appoints the sharia committee. The sharia principles in Malaysia's Islamic banks are implemented by the sharia committee, while the Sharia Supervisory Board carries out the supervision. That is what distinguishes Islamic banks in Indonesia. The existence of the sharia division is responsible for the implementation of sharia compliance. The sharia division has an essential role in the implementation of sharia in sharia banking; therefore, it is involved in the policy-making process in the principle of discussion, as explained by (Zain et al., 2015).

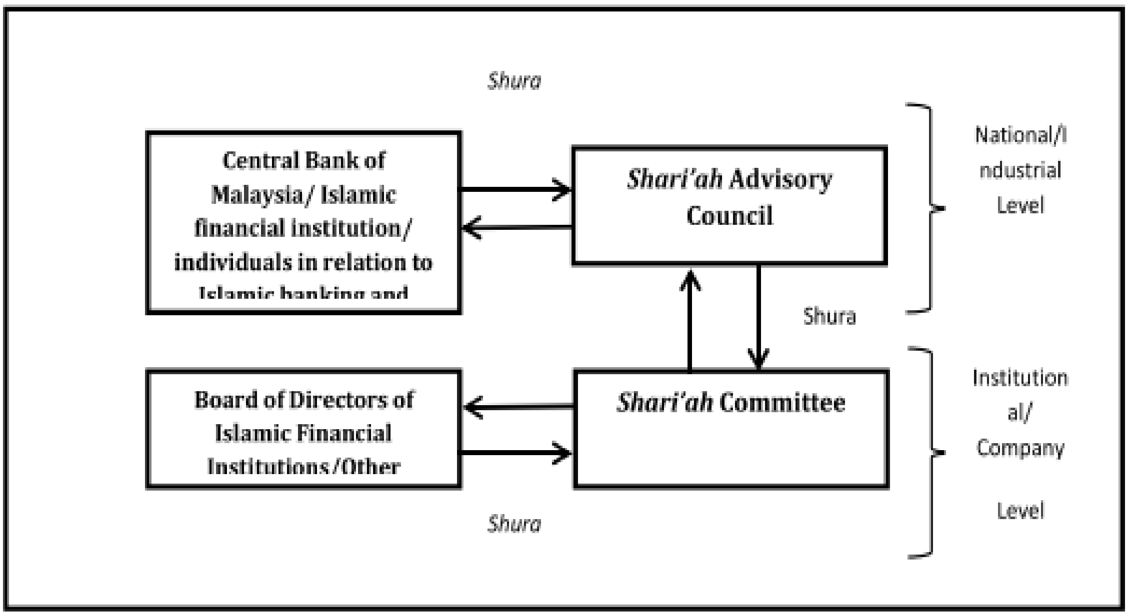

Chart 3: Sharia Committee Engagement in Sharia Banks
(Source: Zain, Zulkarnain & Hassan, 2015)

The function of the sharia committee, which is actively involved in the implementation of sharia, is to strengthen sharia compliance in sharia banking. The implementation of sharia governance is beneficial for the effectiveness and credibility of sharia banks (Hamza, 2013). This is so since there is only one side of sharia supervision, whereas the implementation needs to be ensured. The implementation of sharia may be manageable. This is as stated by (Maulana, 2014) that such a condition happens due to the indirect supervision carried out by the SSC, namely by reviewing financial reports. As (Triyanta, 2019) explained, the product of regulations on prudential and sharia in Islamic banks is still separate. Therefore it needs to be integrated to avoid problems. Through such integration, it is hoped that there is a demand for a sharia division. This sharia division will carry out integrated sharia principles in every operational activity of the sharia bank. The presence of the sharia division will certainly add to the costs of sharia operations. However, on the other hand, this is a sharia bank's business core, so other organs need to be made efficient to avoid sharia non-compliance (Lahsasna, 2014). SSB has a significant role in preparing reports about the compliance level with Sharia (Hussainey, 2016)

Sharia compliance is expected to be carried out by all employees, while supervision is carried out by SSB. As appointed to the shareholder's general meeting by the commissioners and shareholders, its duty to evaluate sharia principles regulated by the Sharia Financial Service Authority is not maximal, so it does not change financing performance effectively. According to the BI Circular mail number of 15 regarding the Guidelines and Duties of the SSB on Sharia-

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based Public Financing Banks, the exercise of supervising sharia principles is carried out by the SSB at least once a month (BI). During a relatively short time, the SSB can only supervise financing operations within the sample limit. Such a condition opens up possibilities for big deviations to take place.

OJK issued compliance regulations and the importance of supervision by the government as stated in OJK regulation number 46 of 2017 that requires early risk management efforts before these risks occur in Islamic banks. (O. J. K. OJK, 2017). Attention to risk in Islamic banks needs to be minimized because the problems of Islamic banks will continue to increase as products continue to develop, as well as BUS which continues to grow. Compliance with sharia is contained in the following articles:

> "Ensuring that the policies, regulations, systems, and procedures, as well as business activities carried out by the bank, are following the provisions of the Financial Services Authority and statutory provisions, including sharia principles for the sharia commercial banks and sharia business units" (O. J. K. OJK, 2017).

The meaning and attitude towards sharia in Islamic banks is different for each employee of an Islamic bank because there are no specific sharia rules that must be implemented. As is the case with buying and selling financing, there is no detailed reference to this product being carried out according to the product being sold. Products sold have different varieties and consequences. This requires that the contract process takes place and is stated in it so that in detail the customer can understand the consequences of the sale and purchase contract that was signed. Products sold are understood by employees, explained to employees so that employees understand in detail.

According to (Khan & Bhatti, 2008), the expansion of sharia banks in Asia is shown by regulators' great interest and attitude towards sharia banks. Detailed rules for Islamic banks are regulated in the law on Islamic Banking, Financial Services Authority regulations, and related circulars. These rules are used by the government to get healthy, safe Islamic banks. Sharia compliance needs to be maintained, as explained by (Acharya, 2013), first, the importance of maintaining customer trust because the source of customer funds as a financial source is carried out for the intermediation function of Islamic banks. Islamic bank microprudential regulations are part of the governance of Islamic banks. The authorities monitor the tendency for errors in managing customer funds. Second, the tendency of the authorities to limit risk is also caused so that the government does not spend more funds to take part in saving Islamic banks from the risks they face. Third, in most developing countries, banks are owned by the state to secure the country's economy. A culture of obedience to rules is expected to keep Islamic banks growing properly and healthily. Compliance culture has values, norms, attitudes and steps to encourage compliance with laws and regulations, the authority to carry out sharia in Islamic banks.

Islamic commercial banks carry out the mandate of depositors' customers with the principle of deposit and profit sharing. The offer of a sizable deposit of funds requires a large and steady income. This causes the management of Islamic banks to have difficulty adjusting between the real income received and the income obligations that must be paid to customers, so managers must have confidence that this is not in accordance with sharia, and does not reflect justice. Profits in Islamic banks are regulated through margin, profit sharing or ujroh. This needs to be fully implemented so as not to equate it with interest or the equivalent of interest.

Islamic banks must comply in carrying out all operations of Islamic banks, not only sharia in the new products that appear. New sharia-compliant products are a portrait of Islamic banks, and in the course of Islamic bank products. There are no sharia checks on disbursed financing, there are no rules, but a sampling inspection by DPS, so there is a potential for non-sampling financing documents where sharia elements are not monitored. This fact occurs in Islamic banks in Bangladesh. Stated by (H. Ullah, 2014), there is a vulnerability to sharia compliance in

Bangladesh, the status of sharia compliance varies, and non-compliance is found to occur a lot in investments due to various reasons, namely little knowledge, no seriousness in implementing sharia, sharia auditing is not a concern and lack of steps investigate the sharia that is applied and the weakness of the SSB.

Carefully managed risks and positioning sharia as a written and implemented rule will positively impact healthy banks and reduce troubling financing. Banking institutions' fragility is often caused by the less-than-optimal running of their intermediation functions. Mathur (2002) focuses that appropriate information will encourage smooth financing. Efforts to implement sharia compliance must be fully implemented by employees and ensure that customers are able to invest in the capital provided. Trust is required in any business, including banks and their customers. Nur et al. (2019) Nur correct and appropriate information needs to be instilled so that trust arises with banks and customers, being open to each other about misunderstandings in the course of financing, fulfilling obligations. The importance of stages that are mutually understood in detail will reduce non-compliance with the rules made, obligations are carried out. there is a sense of trust from both parties in the business being carried out for mutual benefit.

Fulfilment of prudence in sharia banking is closely related to fulfilling compliance with sharia principles. As stated by Ashraf et al. (2015), customers decide to choose Islamic banks because of their trust in Islamic banks, both in terms of investment and financing. The personal element is attached to one's trust in the bank, others and also the funds deposited. Trust strengthens unity in Islam in one area of Islamic banking. As stated by Mamadolimova et al. (2011b), the fulfilment of prudence in compliance with sharia principles is conducted by applying a transaction model following the contract. The contract execution follows the DPS' advice and the rules set by OJK.

Ullah et al. (2016) stated that the main role of the bank managers and ulama (Muslim scholars represented by the National Sharia Council or Dewan Syariah Nasional, DSN) is dominant in achieving compliance with sharia principles. Alsaadi et al. (2017) stated that income increased due to the application of sharia principles. Islamic banks comply with Islamic rules in running a business. However, managers and Muslim scholars often do not exercise their control authority to the maximum. This means that when pursuing profit targets takes priority, adherence to sharia principles is less enforced.

The encouragement of compliance with Islamic banks correlates with the needs of all who intersect with Islamic banks. The signaling theory makes it clear that sharia compliance provides a signal for anyone who concentrates on sharia for one purpose related to business in Islamic banks. Eventually, customers will become trustworthy with the trust (Amanah) signal built by Islamic banks. As mentioned by Kabir et al., (2015), who examined financial risk in Islamic and conventional banks, sharia banks have lower non-performing loans than conventional ones. Financing assessments that are only based on financial reports do not provide complete information and result in wrong decisions. because of that, sharia that is well-understood by customers will bring up their awareness to return the financing on time and to fulfil their obligation regarding the financing they receive.

Regulations have a total impact on the implementation of microprudential Islamic banks, Fatwas that have been issued by the DSN, it is not believed that the DSN is implemented by all Islamic banks even though SSB has the expertise requirements to be trained by the DSN. (Abozaid, 2016; De Nicolò et al., 2014; Hermanto, 2018). According to De Nicolò et al. (2014), bank regulations regarding micro-prudential loans give rise to an inverse relationship between bank lending, welfare, and capital requirements. Liquidity requirements reduce borrowing, efficiency, and welfare, as well as observed capital-dependent resolution policies. As revealed by Abozaid (2016), Islamic finance faces internal challenges, namely sharia governance and

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auditing. This becomes anticipation that sharia banks do not lose their Islamic spirit so that they remain unique and preferred by customers when choosing banks for their business financing.

An implementation of prudential principles in sharia banking, a failed sharia bank due to asymmetry requires sharia security and governance (Abdullayeva, 2015; Mathur, 2002; Oz et al., 2016 and Usanti, 2010). Mathur (2002) mentions that information asymmetry factors can cause market failure in financial institutions due to financial instability. In order to create symmetrical information between customers and sharia banks, collateral is applied in financing. Usanti (2010) highlighted several things regarding sharia banking. First, because of fiduciary obligations, sharia banking must maintain customer funds and apply prudential principles to achieve a healthy, liquid, and profitable banking condition. Second, the Holy Qur'an and Hadith obligate Muslims to be cautious in conducting mu‘āmalah transactions, to keep transactions documented, and to have witnesses and collaterals for non-cash transactions. Third, one of the healthy signs of banking implementing prudential principles is when sharia banking activities adhere to sharia compliance. In more detail, according to Abdullayeva (2015), sharia banks must increase transparency.

Furthermore, that sharia banks need to pay due attention to aspects of sharia governance by emphasising the expertise of the sharia supervisory council and understanding the fields of accounting, banking, economics, and finance. Regarding the nature of the risk of non-sharia compliance and its implications for the capital adequacy of sharia banks, Oz et al. (2016) stated that ensuring sharia compliance requires additional costs, so sharia compliance must be carried out effectively and comprehensively. The effectiveness of implementing sharia compliance inherent in business operations requires a sharia division in sharia banks.

Finally, as explained by Suhartanto et al. (2020), business operations implemented following sharia are expected to increase customer loyalty and ensure that the profits obtained meet sharia regulations. Awareness of sharia in conducting transactions must appear as part of the bank manager's responsibility to Al-Khāliq (God, the Creator). This is intended to strengthen the sharia banks' movement to present and 'sell' the uniqueness of sharia banks as their strength and attraction to the public. In so doing, the elements of sharia must be attached to every business operation of a sharia bank which is guaranteed to be implemented by the sharia division.

Conclusion

There is no sharia division in Indonesia, and in Malaysia, there is a sharia committee. The implementation of sharia principles is inherent in the duties of employees. The Sharia Supervisory Board carries out Sharia supervision. The impact is the customer's misunderstanding of Islamic bank products, even though the contract is already in sharia. Employees make deviations because they need to apply the principle of honesty to employees. The existence of a sharia committee in Malaysian Islamic banks increases customer decisions to transact. The sharia division is important to be presented in sharia banks. Unlike Malaysian sharia banks, which have implemented a sharia division in their organisational structure, Indonesian still need to provide a sharia division. The importance of the sharia division guarantees the implementation of every sharia bank's operational process following sharia principles. Additionally, funding and financing documents are corrected daily and ensured to comply with sharia regulations. The sharia rules in sharia banks minimise the risk of contract breach (wanprestatie, Dutch) in the form of lousy financing and wrong procedures and can eventually avoid non-halal profits.

The functions of sharia bank governance and sharia compliance which lie in conventional rules are still general. When the sharia division routinely checks banks' documents and operations employing sharia monitoring, periodic supervision according to the rules can be carried out to strengthen the implementation of the sharia division on the inner side of the company. So, learning from what happened with the Malaysian sharia bank, it is necessary to have a sharia division in Indonesian sharia ones. This is made possible since the sharia compliance officers need to ensure that sharia becomes the basis for banks' operations and emphasise the health level of sharia banks only in terms of risk. Sharia compliance done by sharia banks is supervised by the Sharia Supervisory Board, which in its implementation is limited to advise on their supervision task. A function for implementing sharia compliance is required in managerial elements. The Sharia Supervisory Board members must have sharia and business competence to support product innovation according to sharia (Islamic prudential banking). Sharia banks must be ensured to have regulations for the governance function of sharia banks and a sharia compliance function which differs from conventional banks. These regulations must ensure the existence of Sharia Human Resources and that bank's operations are carried out according to sharia management and sharia marketing. With such conditions, the sharia division can guarantee the implementation of Islamic prudential banking comprehensively on their inputs, processes, and outputs per Islamic principles.

Author's Contribution

Amin Wahyudi: Conceptualization, Methodology.
Binti Nur Asiyah: Writing- Reviewing and Editing
Husnul Haq: Visualization, Investigation

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Declaration of Competing Interest

We declare that we have no conflict of interest.

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