The Establishment of OJK Syariah from The Perspective of Legal Institutionalization Theory

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Abstract. This research focuses on the weaknesses of the Financial Services Authority (OJK) in supervising the Islamic financial industry in Indonesia from the perspective of legal institutionalization theory. The purpose of this study is to analyze the urgency of establishing OJK Syariah as a supervisory institution that is more effective in maintaining compliance with Shariah principles. The research uses a doctrinal method with data collection techniques through a literature review. The data analysis technique is qualitative, and the results of the study show that the current institutional design of the OJK, through the unified supervisory model, suffers from weaknesses in specialization and response to the complexity of the financial sector. These weaknesses include a heavy workload, slow regulation, and the inability to supervise the Islamic sector. The main recommendation of this study is the establishment of OJK Syariah as a separate entity that can address the specific challenges of the Islamic finance industry and strengthen Shariah-based supervision in Indonesia.

Keywords: OJK Syariah, Institutionalization Theory, Unified Supervisory, Islamic Financial Institutions

1 Introduction

The purpose of this study is motivated by the recommendation of the national committee for sharia economics to review the design and model for the establishment of the Sharia Financial Services Authority (OJK), which is important to study because it is related to supervision, which is relevant to the rapid development of the Islamic financial industry in the digital era. Financial digitization has changed the financial landscape in Indonesia, with an increase in online transactions, easy access to financial services, and financial inclusion. Therefore, the regulation of Islamic finance, which is based on Islamic principles, such as the prohibition of usury and sharia- based dispute resolution, requires special and different supervision than conventional finance does.[1] Research on a model for establishing an Islamic Financial Services Authority (OJK) is relevant in the context of Indonesia's legal system for the sustainability and compliance of the Islamic financial sector and to encourage innovation and consumer protection (Mujib 2023 [2]. Moreover, studies are needed to determine challenges such as compliance complexity and institutional limitations of the conventional Financial Services Authority (OJK) (Arifah, Susanto, and Dewi 2021) [3] Institutional institutionalization theory can be used to examine the effectiveness of the Islamic finance industry in the context of the global economy. [4] On the basis of the findings of Sabillah et al. (2023) [5]. the Sharia Financial Services Authority (OJK) plays a key role in strengthening Islamic banking infrastructure in Indonesia. This is evidenced by the

ICLSSE 2024, October 17, Singaraja, Indonesia

DOI 10.4108/eai.17-10-2024.2353750

increased solvency of Islamic financial institutions, which are closely monitored by the Financial Services Authority (OJK), maintaining capital stability during the pandemic crisis. The Financial Services Authority's (OJK) regulations on Islamic financial institutions encourage an increase in innovative products that expand public access to Islamic banking services. Another finding is the increase in public trust in Islamic banks, as evidenced by the increasing number of customers after OJK strengthened consumer protection regulations and transparency of Islamic financial products [6].

When viewed from the institutional structure of the conventional Financial Services Authority (OJK) from the perspective of legal institutionalization theory, its characteristics show coercive isomorphism pressure because through formal regulations, the government urges the Financial Services Authority (OJK) to regulate the Islamic financial industry by referring to sharia principles. Empiricallyreported that 24% of respondents did not know that the Financial Services Authority (OJK) had implemented sharia contract regulations. The characteristics of isomorphism are also seen in normative isomorphism, with the Financial Services Authority (OJK) standardizing the rules in accordance with the fatwa of the DSN-MUI; the institution authorized to issue fatwas related to sharia. The data show that 38.8% of the respondents are aware of the role of DSN-MUI in regulating sharia principles in the capital market. This fact indicates that there is pressure from religious and government authorities that influences the structure and operation of the Financial Services Authority (OJK) to gain legitimacy in a highly normatively standardized environment [7] On the basis of the above description, the focus of this research is to analyze the design and institutional model of the Sharia Financial Services Authority (OJK) from the perspective of legal institutionalization in the constitutional system in Indonesia. The results of this research are expected to serve as a reference for the National Committee for Sharia Economics (KNEKS).

Literature Review

Institutional theory is rooted in the understanding that, to survive, a financial supervisory institution must gain legitimacy from the public. Legal institutionalization theory is relevant in the context of the decision to establish a new financial supervisory institution because the theory helps us understand how organizations adapt to external and social expectations, including factors such as societal expectations and environmental conditions. The process of institutionalization involves organizational adaptation to external expectations, leading to isomorphism, where financial institutions tend to imitate other financial institutions that have successfully gained legitimacy.

There are three types of institutional pressures that play a role in this process: pressures from the government or regulatory agencies that require organizations to comply with certain regulations. This is referred to as coercive pressure. The pressure resulting from the norms and values developed in society encourage organizations to meet societal expectations. This pressure is referred to as normative pressure.[8] With mimetic pressure, institutions adopt best practices from other institutions in the face of uncertainty. The purpose of legal institutionalization as a perspective in reading the formation of the Sharia Financial Services Authority (OJK) theoretically requires a financial supervisory institution that is more legitimate and efficient in carrying out its duties. By adopting practices that have proven effective in other countries, the financial institution gains public support but also increases its credibility. The tendency to standardize uniform financial supervisory practices will theoretically strengthen the position of the financial institution in the national financial system.

Overall, institutional theory provides a framework for understanding how financial supervisory institutions are formed and operate within a broader social and environmental context and how legitimacy is an important element in the survival of such organizations.6 The legal forms and meanings as well as social norms, organizational culture, and belief systems contribute significantly to the institutionalization of the Islamic Financial Services Authority (OJK). First, the Financial Services Authority (OJK) regulations are based on DSN-MUI fatwas, creating legal and social legitimacy and making Islamic investments not only legal but also ethical. Second, compliance with sharia principles, such as the prohibition of usury, strengthens public trust and creates a sense of security among investors. Third, the structure of norms, such as the prohibition of usury practices, reflects norms that uphold prudence and transparency, thus requiring a special, independent institution. Fourth, the Sharia Financial Services Authority (OJK) not only regulates investment practices but also encourages an ethical and responsible investment culture, strengthening the function of law in shaping and maintaining social norms.7

The opportunities and challenges of establishing a Sharia Financial Services Authority (OJK) in Indonesia reflect the dynamics in the Islamic finance industry, especially as it faces the impact of the COVID-19 pandemic. Although the Financial Services Authority (OJK) has established a Qaradh fund that helps Islamic life insurance companies such as PT Sharia Life Insurance Mitra Abadi and PT BNI Life Syariah meet minimum solvency levels, data show that the supervision of the Financial Services Authority (OJK) still has weaknesses. In 2020, Islamic insurance assets declined by 3.30%, reflecting weak investment returns and a lack of quick response to the crisis. Some companies, such as PT Al Amin, faced liquidity difficulties, with ratios below the safe threshold. The decline in the investment portfolio and stunted development point to the need for strengthened regulation and supervision from the Financial Services Authority (OJK) to ensure the resilience and sustainable growth of the Islamic finance industry in the future.[9]

Despite the increase in Islamic finance assets, the Financial Services Authority's (OJK) supervision of full compliance with the prohibition of riba, gharar and maisir is still weak. This weakness indicates that the law has not been fully institutionalized in the practice of Islamic finance, as there is still a gap between regulation and implementation in the field. In addition, there are no indicators of the internalization of sharia values as a whole by those applied to financial institutions.[10]

Research by Sapitri and Irawan (2023) [11]proves that the capital adequacy ratio (CAR) has a significant effect on return on assets (ROA), but the ethics of implementing mudharabahs as a standard face the challenge of profitability uncertainty. This means that there is a gap in regulation to manage risk effectively. This proves that there is a need for stronger legal institutionalization, not only regulating capital but also overseeing the risk management of the Islamic principle-based financial industry. The urgency of this research lies in the perspective of legal institutionalization used as a model for designing Sharia Financial Services Authority (OJK) regulations that are able to create flexible but structured legal instruments in the face of market uncertainty.

2 Methods

This research uses a normative juridical approach by using the perspective of legal institutionalization theory as a theoretical lens to interpret relevant legal data, including analyzing legal concepts to explain and design the institutional model of the Sharia Financial Services Authority (OJK) according to the Indonesian legal system. The data used are primary data in the form of a set of relevant regulations and legal products such as Law Number 21 of 2008 concerning Islamic banking and its derivative rules. The secondary data are in the form of findings in the relevant literature and legal research literature. Data triangulation was conducted by determining the relevance of the data on the basis of the focus of the problem and the perspective of legal institutionalization theory. [12]

Data analysis was conducted from the perspective of legal institutionalization theory, whose basic assumption refers to the interaction of isomorphism and the legal structure. These two perspectives are operationalized into propositions to understand the ideal institutional construction of the Sharia Financial Services Authority (OJK) in the positiv legal system in Indonesia.[13] The legal proposition from the theory of legal institutionalization that is the reference in this research is that legal institutions are not only regulators but also drivers of industrial transformation.[14]

3 Results and Discussion

The institutional design of the Financial Services Authority (OJK) in Indonesia follows the Unified Supervisory Model, where the Financial Services Authority (OJK) is the sole authority. From the perspective of coercive isomorphism, which is the basic assumption of legal institutionalization theory. First, the model has fundamental weaknesses, namely, a very large workload, given the complexity of each sector, such as banking, capital markets, and insurance. Second, the lack of specialization within each sector may lead to suboptimal supervision, especially in sectors that have special characteristics such as Islamic financial institutions.[15]

The diversity of financial institutions poses challenges for the Financial Services Authority (OJK) in overseeing diverse sectors with different regulatory needs. In addition, the establishment of comprehensive regulations often takes a long time, which hinders a quick response to financial market changes, such as crises or regulatory violations (Eliya et al. 2021). Legal complexity in Indonesia also adds to the challenges for the Financial Services Authority (OJK), as uncertainty in regulatory interpretation can be exploited by financial institutions to avoid liability. This points to the need for more adaptive and flexible supervision. Therefore, there are three fundamental weaknesses in the current system of the Financial Services

Authority (OJK): lack of specialization, inability to respond to diverse financial sector challenges, and lack of overall supervisory effectiveness.

In terms of a coercive isomorphism perspective, the weakness of the Financial Services Authority (OJK) in supervising the Islamic financial industry can be seen through various interacting legal elements.[16] The legal subject in this context is the Financial Services Authority (OJK), which, despite having the authority to regulate and supervise Islamic banks, faces legal conditions that are full of structural pressures and limited resources. The supervised legal objects are Islamic banks and other financial institutions, which report information that may not be fully accurate due to potential conflicts of interest.

Legal events include the financial services authority's (OJK) reliance on such internal reports, leading to a lack of effective supervision. The regulatory uncertainty and complexity faced by industry players further add to the challenges of sharia compliance. In this situation, the Financial Services Authority (OJK) is trapped in a condition where the expectation to act as an independent watchdog is hindered by the existing structure, creating a gap that can be utilized for the establishment of a Sharia Financial Services Authority (OJK) that is more responsive and effective in maintaining compliance with sharia values.

The weakness of the Financial Services Authority (OJK) in overseeing the Islamic finance industry can be understood as a result of the structural pressures faced by this institution. Coercive isomorphism refers to the process by which organizations are forced to follow rules or practices set by a more powerful entity, such as a government or regulator. In the context of the Financial Services Authority (OJK), although it has the authority to regulate and supervise Islamic banks, there are significant pressures related to resource and capacity constraints that make it difficult to implement effective supervision. The Otoritas Jasa Keuangan's (OJK) reliance on internal reports from Islamic banks and other financial institutions creates a risk that the information provided may not be entirely accurate, given the potential for conflicts of interest.

The complexity of the regulations faced by industry players can lead to confusion, which in turn hinders compliance with sharia principles. In this situation, the Financial Services Authority (OJK) is trapped in a condition where it is expected to act as an independent supervisor; they remain influenced by existing structures and practices, resulting in a lack of effectiveness in ensuring that the entire Islamic financial industry operates in accordance with other institutions in the Islamic financial ecosystem to achieve better supervision.

The Financial Services Authority (OJK), as an institution that regulates and supervises Islamic banks and Islamic business units (USs), has the authority to grant business licenses and monitor compliance with sharia principles. However, business license procedures that may be too bureaucratic can be an obstacle for financial institutions that want to perform sharia compliance. This authority also requires the Financial Services Authority (OJK) to ensure that operating institutions meet sharia standards, but the absence of a clear mechanism for periodic evaluation may lead to sharia institutions operating without adequate supervision after obtaining a license.

The Financial Services Authority (OJK) is authorized to file for bankruptcy or suspension of debt payment obligations against financial institutions, including Islamic banks. While this gives Otoritas Jasa Keuangan (OJK) the power to resolve problems faced by financial institutions, the lengthy and complex legal process can hinder a quick response in a crisis situation, potentially leading to greater systemic impact.

The provision that conventional banks can only operate on the basis of sharia principles with the permission of the Financial Services Authority (OJK). This gives the Financial Services Authority (OJK) control but also creates a potential conflict of interest if there is insufficient transparency. The lack of clarity in the relationship between conventional and sharia financial institutions can make effective supervision difficult, given the possibility of parties having undesirable influence.[17]

The establishment of the Sharia Financial Services Authority (OJK) is a strategic response to the weaknesses of the existing structure of the Financial Services Authority (OJK), which focuses on the legal objects of Islamic financial institutions in the midst of uncertain legal conditions. In this context, pressures from international regulations and public guidance become legal conditions that encourage the need for adaptation of the Financial Services Authority (OJK). This uncertainty creates a gap that is utilized by the Financial Services Authority (OJK) to respond by forming a new entity that has special authority, namely, the Sharia Financial Services Authority (OJK), as a legal event aimed at supervising and enforcing compliance with sharia principles.[18]

In addition, changes in government policy that encourage financial inclusion are important factors that trigger the Financial Services Authority (OJK) to expand its duties and authorities, with a focus on the Islamic finance sector. Therefore, the establishment of the Sharia Financial Services Authority (OJK) aims not only to strengthen supervision but also to increase public confidence in the integrity and transparency of the Islamic finance industry in Indonesia.[8]

Table 1. The Process of Financial Service Authority

Aspects	Input	Process	Output
Dependence on the Global Economy	The Financial Services Authority (OJK) dependence on global economic conditions for the stability of Indonesia's financial system.	Financial Services Authority (OJK) regulations in mitigating external risks have not been effective; lack of risk mitigation mechanisms from global volatility.	Internal financial instability due to the inability of the Financial Services Authority (OJK) to cope with global economic uncertainty.
Limitations of Crisis Detection	Use of the Financial System Stability Index (FSIS) with crisis-sensitive change point analysis.	The Financial Services Authority's (OJK) supervisory system lacks accuracy and responsiveness in detecting threats to financial stability.	The need for more sophisticated and adaptive surveillance systems to detect market changes.
Sources of Internal Instability	Weak macroeconomic conditions and nonrobust funding structures in the financial system.	Financial Services Authority (OJK) regulation and supervision of internal factors are still weak.	The system has not been able to significantly reduce internal pressures, leading to financial instability.

Failure to Maintain Macroeconomic Conditions	The need to strengthen macroeconomic conditions and funding structure.	Lack of stronger and coordinated policies in support of fiscal and monetary policies for financial system stability.	Weaker policies make it difficult to maintain financial stability.
The Need for More Precise Regulation	Recommendations to improve policies such as increasing the savings rate and evaluating international trade barriers.	Identify gaps in policies that could have been coordinated.	The need for a stronger coordinating role of the Financial Services Authority (OJK) in financial stability policy, to ensure system resilience to external threats.

The following is a classification table that follows the input-process-output pattern on the basis of the description given:

This table summarizes the key issues and potential solutions related to the weaknesses of the Financial Services Authority (OJK) in managing financial stability in Indonesia, according to the input-process-output pattern.

Overall, the data reveal that despite the financial services authority, there are still weaknesses in its supervisory capabilities regarding global and internal risks, as well as in the implementation of policies that are adaptive to changing economic conditions.

The absence of comprehensive personal data protection in Indonesia points to weaknesses in the legal framework that can directly affect consumer privacy. Without a strong foundation, the Financial Services Authority (OJK) struggles to protect private rights and oversee financial services that potentially violate consumer rights. In addition, the lack of a legal culture of consumer protection means that consumer rights are often ignored, signaling the weakness of the Financial Services Authority (OJK) in building awareness and encouraging the compliance of the Islamic finance industry with consumer protection. Supervision of fintech loan contracts also remains weak, leaving consumers vulnerable to injustice in digital transactions. The establishment of an alternative dispute resolution body (LAPS) is necessary so that consumers have adequate access to fair dispute resolution. In addition, coordination between the Financial Services Authority (OJK) and the Central Information Commission (KIP) for the enactment of a personal data protection law is important to strengthen the protection of privacy rights, especially in the rapidly growing fintech era.[19]

Table 2. process, and output patterns

Aspect	Input	Process	Output
Autonomy and Ineffectiveness in Supervision	Independent mandate from the Financial Services Authority (OJK) to conduct supervision.	External influences that undermine the autonomy of the Financial Services Authority (OJK).	Low supervisory effectiveness in maintaining market efficiency.
Leadership and Selection Mechanism	Transparent and accountable election mechanism.	Potential political or industry influence in leadership selection.	Supervisory decisions that may not reflect the best interests of the market.

Dependence on Fees and Funding	Financial Services Authority (OJK) funding that relies on fees from the industry sectors it supervises.	Potential conflict of interest due to funding dependency.	Effectiveness and independence of supervision declines.
Budget Utilization and Transparency	Financial Services Authority (OJK) budget utilization regulations.	Lack of transparency in budget management.	Impaired supervisory effectiveness, reduced market efficiency.
Data on Violations and Law Enforcement	Data on violations and sanctions in the Islamic Financial Industry.	Process for recording violations and applying sanctions.	Numerous violations indicating a lack of industry compliance.

This table makes it easier to analyze the factors that influence the effectiveness and autonomy of the Financial Services Authority (OJK) in carrying out its supervisory duties.

Data for 2022 show that OJK received 20,628 complaints with a settlement rate of 89.44% through the Internal Dispute Resolution process by financial services business actors (PUJK), and there were 2,435 complaints or 10.56% in the settlement process. This figure continues to increase, considering that the financial literacy index of the Indonesian people was 38.03% in 2019. This figure shows that out of 100 residents, only approximately 38 people have a good understanding of financial institutions and financial services products. The high number of violations shows that OJK's inability to strictly enforce the law negatively impacts market confidence and, ultimately, market efficiency.

According to legal institutionalization theory, the data above illustrate OJK's weakness in maintaining economic justice, especially in law enforcement in the financial and economic sectors. Moreover, special cases, especially in the financial sector, are often trapped in complicated legal bureaucracy and do not result in quick justice for the affected community or investors.

Legal institutionalization theory shows that OJK has weaknesses in maintaining economic justice, especially regarding law enforcement in the financial sector. Cases in this sector are often trapped in a complicated bureaucracy, hindering justice for the public or investors. One example, such as PT Cipaganti Citra Graha Tbk, shows that although OJK has authority in the capital market, decisive action to protect small investors is still suboptimal. In addition, OJK faces structural weaknesses and relies on other institutions, such as the prosecutor's office and the police, which complicates the legal process. Corporate bankruptcy cases, such as PT Citra Maharlika Nusantara Corpora Tbk, demonstrate financial system stability (OJK) failure to prevent economically harmful practices. Overall, consumer and investor protection remains a major challenge for OJK in maintaining economic justice.[20]

On the basis of the data, one of the strong motivations for companies to cross-list is that they can expand their financial market to reach the international level. In the context of financial system stability (OJK), Syariah is relevant because it is also trying to integrate Islamic financial markets both domestically and internationally by encouraging Islamic financial institutions to follow global standards and practices. Empirical data support that firms belonging to business groups have a greater probability of cross-listing, and firms listed on foreign exchanges can improve the efficiency of their access to international capital. Probit analysis shows that cross-listed firms have a significant reduction in financial constraints, suggesting that involvement in global markets improves firms' access to larger and cheaper capital.[16]

In the case of financial system stability (OJK) Syariah, this suggests that the adoption of global financial standards and engagement in international cooperation can strengthen the capacity of Islamic financial institutions in terms of capital access efficiency, similar to the positive effects experienced by firms in the data above. This also supports the argument that market integration is an important element in building financial system stability (OJK) Syariah's institutional model, where engagement with international standards and principles (as seen in the Basel Accord or cooperation with the IMF and World Bank) will strengthen Islamic finance institutions and increase competitiveness and global investor confidence in the sector.

Furthermore, the results from cross-listing also show that institutions with foreign ownership or businesses with international access are more efficient and have lower market frictions, which is relevant in the context of financial system stability (OJK) Syariah facilitating the integration of domestic markets with international markets. This suggests that financial system stability (OJK) Syariah can play a role in supporting Islamic financial firms in becoming more involved in global markets and complying with international regulations to improve access to foreign capital and strengthen the domestic market's global position.

Table 3. Institutionalization Category

Institutionalization Category	**Description**
Mimetic	Companies cross-list on foreign exchanges to expand access to international financial markets, following global practices that are considered successful. OJK Syariah encourages Islamic financial institutions to follow global standards, such as those of international institutions (IMF, World Bank).
Coercive	Adoption of international standards such as the Basel Accord, which is a must for Islamic financial institutions to remain competitive and comply with global regulations. Compliance with global and national regulations governing the integration of Islamic financial markets, such as those of the IMF and other international institutions.
Normative	Promote the integration of Islamic financial markets through the adoption of international norms and practices that improve efficiency of access to capital and global competitiveness. Involvement of OJK Syariah in international cooperation and adoption of sharia principles in line with international standards to enhance trust.

The table above shows that the Financial Services Authority (OJK) Syariah is designed to integrate domestic and international markets with the adoption of global standards so that financial efficiency and the growth of a more competitive Islamic market can be achieved.

The relevance of the data in explaining the institutional model of the Financial Services Authority (OJK) Syariah from the perspective of state institutional institutionalization theory can be seen through a focus on the role of information technology (IT) in strengthening domestic and international linkages and how user decisions are influenced by the development of IT-based services. According to the data, users of IT services, such as the internet for e-banking and e- shopping, exhibit behavioral dynamics that are influenced by different factors at each stage of use, including technology expectations and trust in the system. This is relevant in the context of the establishment of the Islamic Financial Services Authority (OJK), where appropriate technology adoption can help overcome users' hesitancy toward Islamic financial services.

The Financial Services Authority (OJK) Syariah, as an institutionalized institution, needs to understand these dynamics to formulate IT-based policies that are more responsive to the needs of the community, both at the domestic and international levels. By utilizing IT, financial system stability (OJK) Syariah can increase user trust and participation in the Islamic financial system, as well as facilitate greater transparency and accountability. This is in line with institutionalization theory, which emphasizes the importance of technology adoption and adaptation to environmental changes in building strong and credible institutions.

The data presented in the research results above highlight the importance of financial system stability, including supporting the Sharia financial system stability (OJK) institutional model in Indonesia from the perspective of state institutional institutionalization theory.

4 Conclusion

On the basis of the above description, this study concludes that theoretically, the design and model of the Sharia Financial Services Authority (OJK), as an implementation of optimal and effective supervision in the era of financial digitization, is to adopt the best practices of the Financial Services Authority (OJK) model of ASEAN countries such as Malaysia. From a coercive perspective, structural pressure from both domestic and international regulations is a formal legal basis for promoting the establishment of the Shariah Financial Services Authority (OJK). This is due to the limited resources and capacity of the OJK to supervise various financial sectors, including those operating on the basis of Sharia principles. Normatively, the establishment of the Sharia Financial Services Authority (OJK) is an effort to overcome legal uncertainty and compliance with Sharia principles in the practice of financial institutions.

The practical purpose of this research is to highlight the importance of different types of supervision between Islamic and conventional finance and to pay attention to findings that show that the Financial Services Authority (OJK) plays an important role in strengthening Islamic banking infrastructure and increasing public confidence in Islamic financial institutions. The establishment of the Sharia Financial Services Authority (OJK) in the supervision of Islamic financial institutions in Indonesia involves increasing legal compliance through coercive mechanisms, adopting best practices from the global Islamic financial system (mimetic), and strengthening social legitimacy through the harmonization of MUI fatwas and national regulations (normative). This strengthens the credibility and efficiency of the supervision of Islamic financial institutions.

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