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The Regulation of Syariah Principles in the Syariah Banking in Indonesia

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Abstract
This paper results from a research conducted to analyze critically the *syariah* principles within the *syariah* banking law in Indonesia, namely Law No. 21/2008 on *Syariah* Banking. This research is focused on analyzing the law, which prescribes a collateral for *mudharabah* financing and the inconsistencies of norms within laws on *syariah* banking in Indonesia.The results show that in the *syariah* banking operation, *mudharabah* financing cannot be implemented purely as its definition based on *syariah* principles. This is because *mudharabah* financing contains high risks. To moderate the risks, adequate collateral is absolutely required as a warranty for settling the repayment of the financing when the *mudharib* is unable to settle his/her debt. On the other hand, collateral in the *mudharabah* financing is definitely required for *maslahah* of public, namely it is intended to secure the depositors. Contradiction in the norms were found because substantively there is different formulations (in prescribing the collateral) between the *fatwa* of National *Syariah* Council (DSN) No. 7/DSN-MUI/IV/2000 on *Mudharabah* Financing (*Qiradh*) and the Article 23 (2) of Law No. 21/2008 on *Syariah* Banking. As a consequence, the interpretation of the Article 19 (point c) is not in line with Article 23 (2). This could result in law uncertainty.
Keywords: Syariah principles, mudharabah, syariah banking.

1. Introduction

The majority of Indonesians are Moslems and yet a number of them are still doubtful about the law on bank interest.This doubtfulness has affected their behaviour of not wanting to make a deal with banks. They would only do business with a bank in urgent matters. They prefer to keep their funds at home or in the form of goods or assets, leading to an unproductive accumulation of goods/assets. With such unproductive accumulation of savings, the sources for the financing of development from public sources could not be optimally achieved. Hence the urgent need for banks to run their businesses based on the Islamic syariah principles.

Islamic banking in Indonesia could operate officially only in 1992, following the promulgation of Law Number 7 Year 1992 on Banking and the application of Government Regulation Number 72 Year 1992 on Profit/Production Sharing-based Banking. The permissibility of bank operating based on profit/production sharing basically was an expansion of banking services to meet the demand and desire of the community who preferred compensation/profit not based on bank interest system, but based on profit/production sharing principles outlined under Shari'a. With banks permitted to operate under such profit/production sharing principles, it was expected that the effort to mobilize the entire potential of the community to support national development could be optimized.

With banks permitted to operate under the profit/production sharing principles, Indonesia has applied a dual banking system in the national banking system, namely banks based on interest system (hereinafter referred to as conventional bank) and banks based on the Shari'a principles.

The presence of profit/production sharing-based banks then did not catch optimum attention within the national banking industry, and its journey had not indicated significant progress attributed to the fragile legal basis due to uncertain regulations that could open the opportunity for the operation of shari'a banks. Under Law Number 7 Year 1992 on Banking it was stated that banks applying the shari'a system were only categorized as banks with profit/production sharing and types of businesses allowed thereunder.

In it progress, the term of bank based on profit/production sharing was judicially coined as Shari'a Principle-based Banks.. This was evident under Article 1 number 3 of Law Number 7 Year 1992 on Banking which was amended with Law Number 10 Year 1998 which stated that: Public Bank is a bank operating its business in a conventional manner and/or based on Shari'a Principles which in its operation delivers services in the interchange of payments. Shari'a Principles meant hereunder was regulations based on the Islamic Law.

The arrangements of Shari'a Banking under Law Number 7 Year 1992 on Banking which was amended with Law Number 10 Year 1998 was viewed as not specifically regulating and accomodating the shari'a banking operational characteristics and required more adequate regulations in line with its characteristics. Based on such urgency, Law Number 21 Year 2008 on Shari'a Banking was promulgated, to provide legal certainty for stakeholders and at the same time the confidence of the community in using shari'a banking products and services.

Such arrangements in reality was that in its operation Shari'a Banking could meet its shari'a compliance

and to be able to maintain the existence and principles of Islamic banking. The underlying message in which Shari'a Banking could commit its operation based on Shari'a Principles was oulined under Article 2 Law Number 21 Year 1998 on Shari'a Banking, as follows: "In its operation Shari'a Banking conducts its business based on the Shari'a Principles....". The Shari'a Principles is as referred to under Article 1 Number 12, namely Islamic law principles in banking activities based on fatwa or edict issued by the institution in charge of stipulating fatwa in the shari'a sector. Banking activities based on Shari'a Principles on the other hand, are business activities exclusive of *riba* or usury, *maisir* or gambling, *gharar* or lack of transparency, *haram* or illicit, and *zalim* or unjust. To implement the mandate under Article 1 number 12, the National Shari'a Council of the Indonesian Ulema Board (MUI) issued several *fatwa*s as reference for banks in running their businesses.

In line with the progress of Shari'a Bank, some circles doubted the existence of the Shari'a Bank. Some Moslem scholars even criticized that in running their transactions Islamic banks contradicted the concepts. Sutan Remy Sjahdeini, stated that observation and research made by several Moslem scholars indicated that in running their business activities Islamic Banks did not eliminate interest and share risks, but maintained the practice of imposing interests, or in other words avoiding risks in a devious way *(1:Sjahdeini, 1999)*

This view was not far off judging from the practice of Shari'a Bank thus far. In the contract for *mudharabah* financing (loan and management) for instance, the Bank (*shahib mal*) is not allowed to call for collateral/guarantee from the client (*mudharib*) because this *mudharabah* contract is actually a contract of trust between *shahib mal* and *mudharib*, not a loan in nature but a capital cooperation based on trust between the bank and client where each party has a share of profit and loss). By asking collateral/guarantee from *mudharib* it means that *sahib mal* no longer trusts the *mudharib*. The consequence of this *shahibul mal's* distrust against *mudharib* makes the *mudharabah* contract void and non-binding.

The demand for collateral in the financing of *mudharabah* by Shari'a Bank in its practice was a deviation which should not have been made. But is is more toward legal obligation that every bank must exercise prudential principle in distributing its funds as regulated under Article 23 Law Number 21 Year 2008 on Shari'a Banking.

The focus of the issue to be discussed in this research is; first, to analyze stipulations under the shari'a banking law which requires collateral in the financing of *mudharabah. S*econd, to analyze inconsistencies of norms existing under shari'a banking law in Indonesia. To analyze the issues above, this research uses the normative juridical approach using the "Legal System" according to Sudikno Mertokusumo and from Lawrence M.Friedman, "Benefit" theory according to Islamic Law and "Utility" theory from Jeremy Bentham.

2. Research Method

a. Type of Research

In line with the purpose and objective desired in this research, a legal assessment was exercised conceptualized as positive norms within the nasional legislative system, although such legislation only sets out Shari'a principles. Starting from the above purpose and objective, this research is categorized under the normative legal type. Through this normative legal research, an in-depth study of the shari'a banking statutes will be conducted.

b. Approach

In line with the type of research applied and the issues proposed under this research, to solve or answer the issues proposed, the statutes approach or yuridical method is used meaning research on legal products and in this case legal products associated with Shari'a Banking arrangements.

c. Legal/Law Materials

This research uses three information sources, namely Primary legal material, secondary legal material, and tertiary legal material, as follows:

1) Primary legal material:
   Al-Qur'an, Al-Hadits, and laws regulating Banking in Indonesia, particularly shari'a banking.
2) Secondary legal materials are legal entities from the analysis of experts available in literary books and scientific articles to be used to assist the analysis and understanding of primary legal/law materials.
3) Tertiary legal materials are legal entities which among others are found in law dictionary, ensyclopedia or similar materials relevant to this research.

d. Analysis

Analysis starts with the grouping of legal entities and the same information based on their aspects and thereafter interpreted to give meanings toward every aspect and relations against each other. This is to be followed by analysis and interpretation of the entire aspect of the main research issue conducted inductively to give a complete picture. Based on the above, the analysis technique used is content analysis, namely analysis based on the content of legal materials. The consideration is that legal materials available are descriptive in nature.

3. Results and Discussion.

a. Mudharabah Principles

Mudharabah is an agreement to participate in taking the advantage of a capital asset from one partner and management expertise from the partner. According to its terminology, *mudharabah* is also called *muqaradhah* or *qiradh*. *(2: Algaoud, 2004)*

Under the principle of *mudharabah,* share of profit should be stated as ratio or part of the total profit. Profit cannot be stated as percentage of the capital invested. This principle is an important requisite from a legitimate agreement Any deviation from such principle or from condition coming from uncertainties under this agreement, will make this agreement unimplementable.

Accroding to Muhammad Syafi'i Antonio, *Mudharabah* is business cooperation agreement between two parties, where the first party (*shahibul mal*) provides the whole capital, while the other (*mudharib*) becomes the business manager. Business profit under *mudharabah* is shared based on agreement outlined in the contract. In case of a loss, such loss will be borne by capital owner as long as the loss is not due to the negligence of manager. If such loss is attributed to fraudulence or negligence in part of the manager, the manager will be accountable for such loss. *(3:Antonio, 2001)*

According to the *fatwa* or edict of the National Shari'a Counsel (DSN) Indonesia Ulema Board Number 07/DSN-MUI/IV/2000 on Mudharabah Financing (*Qiradh*), meant by *mudharabah* fnancing is financing distributed by Shari'a Finance Institute (LKS) to a certain party for a productive business. Under this financing scheme, the Shari'a Financing Institute (LKS) as *shahibul maal* (capital owner) will finance 100% of the requirement of a (business) project while the business (client) will act as *mudharib* or business manager. The amount of fund must be clearly stated in cash and not as receiveable. As fund provider, LSK will assume all losses *mudharabah* except when *mudharib* (client) commits to a willful misconduct, negligent or violating agreement.

The *fatwa* also states that: "In principle, there is no collateral in th financing of *mudharabah,* but in order for the *mudharib* client) not to violate, LKS may ask for a collateral from *mudharib* or a third party. This collateral/guarantee can only be cashed in if it has been proven that *mudharib* has violated stipulations agreed upon under contract/agreement."

According to the compilation of Shari'a Econmic Law (KHES) Article Pasal 20 (4) the cooperation between fund owner or investor and capital manager is to enter into a certain business with profit sharing based on *nisbah* or ratio.

Under Law Number 21 Year 2008 on Shari'a Banking, *mudharabah* agreement/contract is clarified under Clarification of Article 19 letter c which states that:

> "*mudharabah* agreement in financing is a buisness cooperation agreement between the first party (*malik*, *shahibul maal* or shari'a bank) which provides the whole capital and the second party (*'amil*, *mudharib*, or client) which acts as fund manager by sharing profit in accordance with the agreement outlined under contract, while loss will be borne entirely by shari'a bank except when second party commits to a willfull misconduct, negligent or violating agreement".

The *mudharabah* shari'a foundation is depicted the Letter of Al-Muzammil of the Al-Qur'an Surat Al-Muzammil Verse 20, and Letter of Al-Jumuah of the Al-Quran Verse 10 and under the Hadiths.

Al-Muzammil Verse 20 of the Al-Quran:

"… And those who walk on the face of the earth to seek for Allah's bounty....."

Al-Jumuah Verse 10 of the Al-Quran:

"If prayer has been fulfilled, speard onto the earth and seek for Allah's bounty"

Hadith of Muhammad the Prophet:

"The Prophet Muhammad said that there are three things that bear blessings, formidable buying and selling, *muqaradhah* (*mudharabah*), and blend wheat and flour for household purposes, not for sale." (HR. Ibnu Majjah)

In legal terms, *mudharabah* is a business cooperation seeking for profit. This cooperation is entered between capital owner (*shahibul mal*) and business player. It is termed as business cooperation because the capital owner and business player is a partner which directly needs each other.

Capital owner directly needs a business player to run the capital it owns for a business activity to gain profit. On the other hand, a business player having the skill/expertise, opportunity and ability to run a business activity, directly needs capital for the business it runs. This direct mutual interest is what is accomodated *mudharabah*. *(4:Siddiqi, 1985)*

As a form of cooperation, it is important for *mudharabah* to be understood as basis or foundation of thinking. If *mudharabah* is not clearly understood as a form of cooperation, it may create issue on injustice/unfairness.

The categorizing of *mudharabah* as a form of cooperation starts from islamic economic principle which

considers capital and work (business professionalism) not as a distinct factor, but as a mutually benefitting basic unit. Nejatullah said: *"Islam does not regard capital and entrepreneurship as distinct factors with a sparate basis foreward, rather as copartners wih a uniform basis on return"*

Based on this principle, capital has an equal position and on the same level as business professionalism. This same and equal position must abe actualized under stipulations regulating rights and obligations between capital owner and business professionalism. If under *mudharabah* agreement there are stipulations contradictory to basic equation between capital and business professionalism creating injustice/unfairness, it can be disputed into a legal suit..

A business player making a loan to a bank cannot be said as cooperation, but rather as lending and borrowing or debt and credit. Lending and borrowing or debt and credit places capital owner and business player in an unequal position, but in an subornatitive position. The relationship of the two parties is categorized as relationship between creditor and debtor. Therefore, the normative contruction established from such relationship is not a form of cooperation law but of a legal relationship between creditor and debtor. .

The rights and obligations that can be constructed by law against the relationship between creditor and debtor will be defferent from the rights and obligations in a cooperation. Therefore, the applicable normative stipulations under lending and borrowing or debt and credit relationship cannot be applied in *mudharabah* cooperation relationship.

Mudharabah agreement is based on trust between capital owner and business player. A capital owner in search of profit will not give its money as business capital which right to manage is in the hands of business player if mutual trust is not evident. Because under the *mudharabah* agreement or contract the capital owner is not permitted to participate in the management. Business management is in the hands of business player.

Under *mudharabah*, a capital owner can demand certain terms for the capital invested to be effective and efficient. The terms demanded by capital owner can be in the form of compulsion for the capital to be used in certain economic business sector, or terms on the business period or other requirements mutually agreed.

Under *mudharabah* agreement/contract, in addition to terms allowed under such *mudharabah*, the professionalism of business player is an important factor that must be considered under *mudharabah*. A capital owner who do not have the slighest information on the professionalism of business player will carry a big risk against the funds invested. Under the *mudharabah* agreement/contract, a busines player must be honest/sincere and possesses integrity as *mudharib* is the representative of *shohibul mal* in running the agreed business, or in other words a *mudharib* must have an *al-amin* attitude or character.

Mudharabah cooperation is always based on profit generating, and therefore, profit is the issue and that its method of distribution/sharing must be clealrly defined. Legally, *mudharabah* agreement/contract should regulate the issue on profit. If it turns out that the business financed by capital owner suffers a loss, the loss in finacial terms, namely the reduced capital must be borne by capital owner. Business player cannot be charged with financial loss because it already bear losses in the form of time, efforts and expertise. Nevertheless, if such loss is attributed to a mistake, or negligence in its part, then business player should be accountable for the financial loss and capital owner cannot be saddled with such a loss.

b. Financing of *Mudharabah* at Shari'a Bank

1) Shari'a Principles in Shari'a Banking Law

The exclusive and seggregated disposition of Shari'a Banking from banking laws is expected to provide legal certainty to stakeholders and confidence to the community in using the shari'a bank products and services. And in the effort to encourage shari'a bank to obide to shari'a statutes in running its business activities, the shari'a banking regulation will also regulate shari'a compliance.

How a shari'a bank can comply with shari'a principles in the financing of *mudharabah* can be seen under Article 1 number 12; Article 2; Clarification of Article 3; Article 19 letter c; Article 23 section (2) and Clarification; Aticle 24 section (1) a and Section (2) a; Article 26 section (1) and (2); Article 55; Article 56 of Law Number 21 Year 2008 on Shari'a Banking..

Article 12 number 12 of Law Number 21 Year 2008 on Shari'a Banking regulates shari'a principles. Under this stipulation, meant by shari'a principles is the Principles of Islamic Law in banking activities based on *fatwa* or edict released by the institution in charge of decreeing the *fatwa* in the shari'a sector. If the stipulation under this article is associated with Article 26 Section (2), it is obvious that the institution having the authority to release such *fatwa* is the Indonesian Ulema Assembly/Majlis (in this case the executing body is the National Shari'a Council).

Article 2 of Law Number 21 Year 2008 on Shari'a Banking regulates the operational aspects

of shari'a banking, which in its clarification it is definitively mentioned that business activities based on shari'a principles are businesses that do not contain the elements of *riba, maisir, gharar, haram* and *zalim*.

Clarification of Article 3 Law Number 21 Year 2008 on Shari'a Banking gives the clarification that in achieving to objective of supporting the implementation of national development, shari'a banking continues to stick to shari'a principles in its entirety (*kaffah)* and consistently (*istiqamah).* This means that in implementing its activities shari'a bank shall be subject to shari'a principles as mandated by the National Shari'a Council (DSN-MUI). There should be no deviation especially from the substance of such *fatwa* released by DSN-MUI.

Article 19 letter c of Law Number 21 Year 2008 on Shari'a Banking gives the explanation on one of the activities of Shari'a Public Bank, which is to distribute the financing of profit/production sharing based *mudharabah* agreement, *musyarakah* (partnership) agreement, or other agreements which do not contardict the shari'a principles.

Article 23 Section (2) of Law Number 21 Year 2008 on Shari'a Banking and its clarification, in general regulate the feasibility of fund distribution in shari'a bank. Under the stipulation on the feasibility of fund distribution, a shari'a bank must have the confidence to the willingness and capability of financing facility prospective recipient to pay back or return all of its obligations in due time. To come to that confidence, a shari'a bank must exercise a thorough assessment against the character, capability, capital, collateral and business prospects of such prospective financing facility recipient client. Therefore, it can be said that in providing financing a shari'a bank should also make thorough assessment against collateral to be provided by prospective financing recipient client. In other words, in dispensing financing, a shari'a bank requires collateral.

Article 24 of Law Number 21 Year 2008 on Shari'a Banking in general regulates prohibited activities for shari'a banks and Shari'a Business Units (UUS), among others is the prohibition to conduct business activities contradictory against shari'a principles as regulated under Section (1) a and Section (2) a.

Article 26 Section (1) and Section (2) of Law Number 21 Year 2008 on Shari'a Banking is basically a stipulation which emphasizes that all business activities or products and services conducted by shari'a bank are subject to shari'a principles. In addition, it underlines that what is meant by shari'a principles are shari'a pinciples as mandated (*fatwa*-ed) by the National Shari'a Counsil (DSN-MUI).

Article 55 of Law Number 21 Year 2008 on Shari'a Banking regulates settlement of dispute. Settement of dispute in Shari'a Banking is done through the court within the religious affairs court environment. If the disputing parties have agreed to settle their disputes outside the Religious Court, such as through deliberations, banking mediation, Arbritrary Body, and dispute settlement through the Public Court environment, then such dispute settlement will be made in line with the content of agreement/contract, and the execution must not contradict shari'a principles.

Article 56 of Law Number 21 Year 2008 on Shari'a Banking constitutes sanctions against shari'a bank or UUS, members of the board of commissioners, members of Shari'a Supervisory Board, board of directors, shari'a bank employees for obscuring or not implementing shari'a principles in carrying out their business activities or duties. The sanction is in the form of administrative sanctions stipulated by Bank Indonesia. .

From the aforementioned regulations, it is expected that in running its operation a shari'a bank should really comply with shari'a principles, so that shari'a compliance can be manifested as mandated by shari'a banking law.

2). Issues in Applying *Mudharabah* Wholly

Following the understanding of *mudharabah* as proposed by clasic Islamic Law experts/scholars as previously mentioned, the application of *mudharabah* in the context of current banking will be faced with various difficulties that makes it impossible to *mudharabah* in all its entirety.

Applying *mudharabah* wholly on simple cases as defined under *musaqah* agreement will not be an issue, such as in agriculture land cultivation profit sharing practice common to the community in Indonesia thus far. In land cultivation cooperation, land owners hand over agricultural land to farmers to be planted with certain crop(s) where the entire financing is borne by land owners under profit sharing agreement between land owners and busines player (farmers). In this simple case, the land is still under the control of land owner so that in this case the asset is in secure position. Therefore, in this simple *mudharabah* collateral is not necessary, it is only based on trust. In the case of crop failure, land owner will only bear the loss of capital expenses incurred, while business player will not gain the amount of income as expected.

It will be otherwise if *mudharabah* is applied in the practice of financing in banking. A

shari'a bank will face difficulties, among others:

a. Integrity of business players, related to the bookkeeping of business players which are often not proper and manipulative and thus not in accordance with the real facts.
b. Sincerety in the use of funds received from the bank. Based on the agreement it should be utilized for productive purposes in line with the proposal submitted, but most often the fund is used for consumptive purposes.
c. Difficulty for the bank to determine profit margin: bank must gain profit in its operation. In renumerating its profit, the bank will include several components, such as operational cost, overhead cost, inflation and other costs that will influence the extent of margin, and these profits will be charged to the client. As inflation may influence the extent of margin, in determining the extent an assumption is used taking the referrence of the analysis of conventional bank interest rate, so that the extent of profit sharing ratio is not different from the interest rate applied in conventional banking. *(5:Gafoor, 1995)*
d. Long term financing will bind the capital in an extended time resulting in an extended time of capital return. Capital return within an extended time will be faced with the consequence of uncertainty and high risk. This is quite contrary to credit provided by conventional bank, albeit in long term the capital return will be in line with the start of the initial installment, so that the level of uncertainty and risks is not as high as the uncertainty and risks under *mudharabah* financing.

The extent of risk that must be faced by a shari'a bank in this *mudharabah* financing has resulted in the various innovations in part of shari'a bank in distributing funds through the *mudharabah* financing scheme *(6:Hirsanuddin, 2008)* in order to reduce the existing financing cost. Among those innovations, the first is by engaging third party to serve as managing body. In this financing scheme, the third party assumes several functions, namely;

a. Extend supervision to business players receiving financing.
b. Control and supervision on returning financing received by business players to shari'a bank. .
c. Management control of business players.
d. Reporting on business progress from business players to shari'a bank. .
e. In the event of business failure due to the negligence of business players, the consultent reserves the right and to take over the business management until the financing has been fully paid/returned.

The second innovation is that shari'a bank build partnership with cooperative employees. Employee cooperative was selected as partner under *mudharabah* financing because:

a. Income of cooperative employees is relatively stable.
b. Guarantee from cooperative management on the good and honest character of cooperative employees.
c. The cooperative guarantees repayment of financing if cooperative employees are negligent or ended up in failure in the business financed under the *mudharabah* scheme.

Therefore, in this partnership, employee cooperative acts as guarantor of employees to be recieveing such financing. Employee cooperative also collects payment from cooperative employees and desposits such payment to shari'a bank. In this partnership, employee cooperative receives management fee from shari'a bank.

From the elaboration above it can be concluded that the practice of *mudharabah* financing in banking is difficult to implement due to several aspects, either from moral, technical, operational cost, and risk factors to be faced by shari'a bank. Therefore, in distributing *mudharabah* financing, shari'a bank perfers to build partnership with cooperatives or use a consultant to serve as managing body for security reasons.

3) Collateral Requirements in *Mudharabah* Financing at Shari'a Bank

As mentioned earlier, the law requires collateral in *mudharabah* financing at shari'a bank. Such collateral will be used to secure return payment from respective shari'a bank when the recipient of financing facility cannot settle its obligation. This is in accordance with stipulation under Article 23 Section (1) and (2) of Law Number 21 Year 2008 on Shari'a Banking and its Clarification.

In terms of the required collateral under this *mudharabah* financing, in the Bank Mandiri Syariah *mudharabah* agreement/contract there is a clause regulating such collateral which reads as follows:

"To ensure return payment/settlement of Financing in due time and in the amount agreed by both parties under this Agreement, CLIENT hereby declares and binds itself to surrender collateral and establishes a binding guarantee to BANK in accordance with prevailing rules and

regulations, which is an inseparable part of this Agreement."

Likewise, in the agreement for *mudharabah* financing at Bank Muamalat Indonesia there is a clause regulating collateral that reads as follows:

"…As collateral for the fulfillment of client's obligation to Bank and part of profit sharing revenue occurring based on this Agreement, client herewith provides collateral in the form of ....."

The clauses mentioned above shows that the *mudharabah* financing requires collateral. In other words, the (*mudharib*) or client has the obligation to provide collateral to guarantee settlement of financing received when the client (*mudharib*) fails to fulfill its obligation to the bank.

Legally, collateral is required in *mudharabah* financing, to provide certainty to capital security invested by bank to the client *mudharib*. On the other side, the requisition of collateral is to protect larger interest namely the interest of other depositors which number is overwhelming.

When confronted with the shari'a principles, such stipulations are contradictory and violate the shari'a principles. In *mudharabah* financing, the bank must comply with the principles found in *mudahrabah*.

According to the principles under *mudharabah* agreement, *shahib mal* is not allowed to demand collateral from *mudharib* because this *mudharabah* agreement basically is a mutual trust agreement between *shahib mal* and *mudharib*. On the other hand, *mudharabah* is a joint-capital and expertise cooperation, where the position between capital and business expertise is the same or equal, so that the position of the capital owner and business player is the same or equal.

Hence under such equal position, Islamic Law experts or scholars stipulate the prohibition for capital owner to demand collateral from business player. Because by requiring collateral under such *mudharabah,* the capital owner places the business player in an unequal position with capital owner. This is clealy a deviation from the phylosophy of *mudharabah* itself. *(7:Saeed, 1966)*

In regard to this collateral, scholars and jurists do not agree with collateral being put *mudharabah* agreement, becuase basically *mudharabah* is a mutual trust agreement and in the event of a loss both parties should suffer such loss. Therefore, collateral should be eliminated. According to Imam Malik and Imam Syafi'i, if *shahib maal* insisted a collateral from *mudharib* and designates it as part of the contract, then the contract will be invalid. *(8:Rusdy)* This is also underlined by Latifa Algaoud and Mervyn Lewis, that under *mudharabah*, *shahib mal* cannot demand any collateral whatsoever from *mudharib* to return the capital or capital plus profit, because the relationship between *shahib mal* and *mudharib* is trust and *mudharib* should be a trustworthy person. Under such circumstances, the bank cannot have any guarantee at all from business player as capital security against the possibioity *mudharib* suffering a loss. This condition leads to the cancellation and invalidity of *mudharabah.*

In Islam, this collateral issue is not prohibited under the al-Qur'an and Hadith. However, this relates to debts and credits or lending and borrowing, where the position of creditor and debtor is not equal. This unequality is the reason for the permissiveness of collateral under creditor and debtor or lending and borrowing agreement, because the relationship between creditor and debtor is not a cooperation and as such collateral is allowed. *(9:Harun, 2000)*

Therefore, the demand for collateral by shari'a bank against *mudharib* in *mudharabah* financing is an unavoidable situation because the bank must comply with stipulations regulating prudent principle in the granting of credit or provision of financing facility. On the other hand, DSN-MUI's *fatwa* provides the window for shari'a bank to require collateral in the provision of *mudharabah* fnancing facility.

Another alternative for requiring collateral that a bank can do to secure financing distributed to the community is by protecting such financing through insurance. Protecting financing distributed to the community through insurance is not impossible. This has been done by shari'a bank in distributing financing, it is just that the implementation is the same as what has been practiced by conventional banks.

4) Inconsitency of *Mudharabah* Principles Regulation under Shari'a Banking Law.

The regulation of *mudharabah* principles under the shari'a banking law is not consitent. The inconsistency of such regulation is evident from the official reading of Article 3 Law Number 21 Year 2008 on Shari'a Banking which states that "In achieving the objective of supporting national development, shari'a banking conitnues to uphold shari'a principles in its entirety *(kaffah)* and consitently *(istiqomah.* This clarification mandates that every shari'a banking activity should always uphold the shari'a principles in its entirety and consistently, meaning that there should be no deviation from the sharia'a principles, either substantially or technically.

If the clarification of Article 3 above is associated with the Clarification of Article 19 letter c, where it elaborates the meaning "*Akad Mudharabah*" or "*Mudharabah Agreement/Contract",*

which is a business cooperation contract between the first party (*Shahibul mal*/Shari'a Bank) which provide the total capital and the second party (*mudharib*/client) which acts as business manager by distributing business profit in accordance with the agreement set forth in the contract. The loss, if any, will be fully borne by the Shari'a Bank, excpet when the second party committed a willful misconduct, negligent, or violates the agreement. In principle, the two clarifications should not be an issue because there is a coherency between the two. The clarification of Article 3 underlines the fact that a shari'a bank should comply with the stipulation and shari'a principles in running its business activities, while clarification of Article 19 letter c provides the clarification on the understanding of *mudharabah* contract in line with the understanding provided by shari'a principles.

But when the Clarification of Article 3 and the Clarification of Article 19 letter c are associated with Article 23 Section (2) and its clarification, the inconsistency of the regulation is evident. It can be concluded as such because the norms under Article 23 Section (2) and its clarification is contradictory to what has been defined under Clarification of Article 3 and Clarification of Article 19 letter c.

Article 23 Section (2) of Law Number 21 Year 2008 on Shari'a Banking states:

"To acquire the conviction as referred to under section (1), Shari'a Bank and/or USS is obligated to conduct a thorough assessment against the character, capital capability, Collateral, and business Prospect of prospective Facility Recipient Client."

Clarification of Article 23 Section (2) of Law Number 21 Year 2008 on Shari'a Banking states that:

"...In assessing Collateral, Sharai'a Bank and/or USS should assess, goods, project of right to claim funded under the respective Financing and other goods, securities or risk guarantee added as Collateral supplement, whether they are adequate and if in the future such Facility Recipient Client cannot fulfill its obligations, such Colllateral can be used to shoulder Financing back payment from respective Shari'a Bank and/or USS..."

From the reading of Article 23 Section (2) Law Number 21 Year 2008 it can be concluded that every *mudharabah* contract requires adequate collateral *mudharib* as guarantee when such *mudharib* cannot fulfill its obligations. This means that *mudharabah* contract has gone through a a shift of mean9ng, not the meaning defined under the Islamic Law.

Article 23 Section (2) and its Clarification calls for the existence of guarantee or collateral in the implementation of *mudharabah* contract, while the Clarification of Article 19 letter c provides the understanding of *mudharabah* based on shari'a principles which basically do not require guarantee or collateral, and this clarification is in line with the clarification of Article 3 which mandated that shari'a bank should alway comply with shari'a principles in running its business activities. As such, between Article 23 Section (2) and its Clarification is not consistent with with the Clarification of Article 19 letter c and Clarification of Article 3.

4. Conclusions

The requirement of collateral in the mudharabah financing according to the banking law basically does not contradict the shari'a principles, because collateral is used to anticipate moral hazard mudharib or character that emerges, not meant as financial risk as practiced in conventional banking scheme. On the other hand, mudharabah is difficult to be applied due to its high risk.

The requirement of collateral under mudharabah financing is taken to provide protection to depositors which number is overwhelming. Therefore, collateral requirement is based on a larger interest, namely to manifest public welfare.

The regulations on the principle of mudharabah financing under Law Number 21 Year 2008 on Shari'a Banking, as it turns out, find that there are inconsitent stipulations, that is between the norms found under the Clarification of Article 3 and Clarification of Article 19 letter c with the norms found under the Clarification of Article 23 letter c. Inconsistency in regulations will lead to legal uncertainty and the effort to establish shari'a compliance as mandated under the shari'a banking law difficult to be implemented.

5. Recomendations

The regulations on the principles of mudharabah financing under the shari'a banking law need to be revamped. Revamping is done by revising the formulation of norms under the inconsistent articles. The first is to refine the clarification of Article 19 letter c and the second is to reformulate the clarification of Article 23 section (2) to make them both consistent.

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