el-Uqud: Jurnal Kajian Hukum Ekonomi Syariah, 3 (1), 2025: 23-39
ISSN: 2986-7185, E-ISSN: 2987-3452
DOI: 10.24090/eluqud.v3i1.13288

BRIDGING INSTITUTIONAL AND REGULATORY GAPS: ENHANCING SHARIA COMPLIANCE IN ISLAMIC FINANCIAL INSTITUTIONS IN INDONESIA

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Article history: Received: March 4, 2025, accepted: April 21, 2025, published: April 24, 2025

Abstract: The compliance of Islamic Financial Institutions (LKS) with Islamic economic regulations is crucial for maintaining the stability and competitiveness of Indonesia's Islamic finance industry. Key regulations—such as Law No. 21 of 2008, OJK regulations, and DSN-MUI fatwas—are designed to ensure that LKS operations adhere to Sharia principles. However, the implementation of these regulations faces several challenges, including regulatory harmonization, infrastructure readiness, and low levels of public Islamic financial literacy. This study employs a descriptive qualitative approach by analyzing the regulations and their implementation through legal document reviews, regulatory reports, and academic research. The findings indicate that the effectiveness of LKS compliance depends heavily on the role of the Sharia Supervisory Board (DPS), which often encounters issues of independence and competence. Furthermore, both employees' and customers' understanding of Islamic finance emerges as a key factor influencing regulatory adherence. Based on these results, this study recommends enhanced synergy among regulators, the industry, and the public to strengthen Sharia governance, boost DPS competence, and improve Islamic financial literacy. Such efforts are necessary to optimize regulatory compliance and enable the sustainable development of the Islamic finance industry.
Keywords*:* Sharia Compliance, Islamic Financial Institutions, Sharia Governance, Sharia Supervisory Board (DPS), Islamic Financial Literacy.

Abstrak: *Kepatuhan Lembaga Keuangan Syariah (LKS) terhadap regulasi ekonomi Islam sangat penting untuk menjaga stabilitas dan daya saing sektor keuangan syariah Indonesia. Regulasi seperti Undang-Undang No. 21 Tahun 2008, peraturan OJK, dan fatwa DSN-MUI bertujuan untuk memastikan kepatuhan Syariah. Namun, tantangan tetap ada, termasuk harmonisasi regulasi, kesiapan infrastruktur, dan rendahnya literasi keuangan syariah masyarakat. Penelitian kualitatif ini menganalisis regulasi dan implementasinya melalui tinjauan dokumen hukum, laporan regulator, dan penelitian akademik. Temuan menunjukkan bahwa peran Dewan Pengawas Syariah (DPS) sangat penting, serta pemahaman pegawai dan nasabah terhadap keuangan syariah menjadi faktor kunci dalam kepatuhan terhadap regulasi. Penelitian ini merekomendasikan sinergi yang lebih kuat antara regulator, industri, dan masyarakat untuk memperkuat tata kelola syariah, meningkatkan kompetensi DPS, dan literasi keuangan syariah guna memastikan perkembangan industri yang berkelanjutan.*
Kata Kunci**:** *Kepatuhan Syariah, Lembaga Keuangan Syariah (LKS), Tata Kelola Syariah, Dewan Pengawas Syariah (DPS), Literasi Keuangan Syariah.*

Introduction

The compliance of Islamic Financial Institutions (LKS) with Islamic economic regulations is a critical factor in maintaining stability, transparency, and credibility, positioning it as a potential driver for high profitability and as a benchmark for other banks to enhance their performance.[1] The establishment of Law No. 21 of 2008 on Islamic Banking, the Compilation of Islamic Economic Law (KHES), the Financial Services Authority Regulations (POJK), and fatwas issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI) are intended to provide legal certainty for Islamic financial institutions in Indonesia.[2] However, in practice, the implementation of these regulations encounters complex challenges, arising from both internal institutional issues and external factors, such as regulatory harmonization, infrastructure readiness, and the level of Islamic financial literacy within society.

Various studies have underscored the importance of Sharia compliance in the Islamic financial system as a key factor in ensuring the sustainability and competitiveness of LKS. A study by H. Ullah and Ruma Khanam found that robust Sharia compliance fosters internal strengths and external opportunities, which ultimately enhance financial performance in Islamic banks. Indonesia has been recognized as a country with best practices in Sharia compliance, an achievement that warrants further recognition.[3] In this context, the Sharia Supervisory Board (DPS) plays a strategic role in ensuring that LKS operational policies align with Sharia principles. The DPS is responsible for overseeing that LKS policies and operational practices adhere to Sharia principles by conducting field visits to cooperatives, assessing contracts, verifying transaction objects and documentation, and ensuring that Standard Operating Procedures (SOP) comply with Islamic guidelines.[4] Nevertheless, the effectiveness of the DPS in fulfilling its duties is often hindered by challenges related to independence, competence, and involvement in strategic decision-making within LKS.

Several studies have indicated that the DPS often lacks sufficient authority to enforce Sharia principles effectively within LKS, creating opportunities for regulatory violations. Research by A. Pratama found that the supervisory activities of the DPS at KSPPS BMT Sri Sejahtera in East Java remain suboptimal, with direct monitoring through reports from management being ineffective.[5] Another study by N. S. Imaniyati et al. revealed that the role and responsibilities of the DPS in overseeing Sharia compliance in Islamic banks are still not optimal due to issues surrounding integrity and competence.[6] These findings support the conclusion drawn by Listari Mauludimah Tari et al., which asserts that the credibility of the DPS—concerning performance, independence, and competence—directly impacts the credibility of Islamic banks.[7]

In addition to the Sharia governance aspect, Islamic financial literacy plays a pivotal role in ensuring the effective implementation of Islamic economic regulations. According to Nadya Dwi Rahmanita et al., Islamic financial literacy significantly determines the extent to

[1] "Sharia Compliance and Profitability in Financial Performance Islamic Banks in Indonesia," *Futurity Economics&Law*, May 4, 2024, 112–30, https://doi.org/10.57125/FEL.2024.06.25.07.

[2] Tarmidzi et al., "The Pursuit of Legal Harmony in the Integration of Sharia Economic Law Compilation, OJK Regulations, and DSN-MUI Fatwas," *Hikmatuna : Journal for Integrative Islamic Studies* 10, no. 1 (August 1, 2024): 121–39, https://doi.org/10.28918/hikmatuna.v10i1.7342.

[3] "Does Sharia Compliance Affect Islamic Banks Performance? Evidence from Islamic Banks in Indonesia," *Journal of Emerging Economies and Islamic Research*, September 30, 2019, https://doi.org/10.24191/jeeir.v7i3.6203.

[4] Nahara Eriyanti, Tiara Salsabila, and Muhadi Khalidi, "THE ROLE OF THE SHARIA SUPERVISORY BOARD IN MURABAHAH FINANCING: In The Mitra Niaga Sejahtera," *Al-Iqtishadiah: Jurnal Hukum Ekonomi Syariah* 5, no. 1 (June 30, 2024): 101–16, https://doi.org/10.22373/iqtishadiah.v5i1.5251.

[5] Agustina Sintya Putri Pratama, "Analisis Kinerja Operasional Dewan Pengawas Syariah (DPS) Pada KSPPS BMT Sri Sejahtera Jawa Timur," *Jurnal Ekonomika Dan Bisnis Islam* 3, no. 2 (2020): 106–27.

[6] Neni Sri Imaniyati, Harits Numan, and Lina Jamilah, "Analysis of the Role and Responsibility of Sharia Supervisory Board (DPS) on Sharia Compliance Supervision in Islamic Banks in Indonesia," *J. Legal Ethical & Regul. Isses* 22 (2019): 1.

[7] Listari Mauludimah Tari et al., "Role and Responsibilities of the Sharia Supervisory Council (DPS) at Sharia People's Finance Bank (BPRS) in Depok City," *ITQAN: Journal of Islamic Economics, Management, and Finance* 2, no. 2 (July 22, 2023): 49–55, https://doi.org/10.57053/itqan.v2i2.19.

which an individual can implement financial planning based on Sharia principles.[8] Moreover, customers' understanding of the differences between Islamic and conventional financial systems also influences market compliance with Sharia principles. Customers who are well-informed about the characteristics of Islamic finance tend to be more selective in choosing financial products that align with Sharia principles, which encourages Islamic Financial Institutions (LKS) to be more consistent in applying Sharia regulations.[9] Therefore, education and socialization regarding Islamic finance are essential to creating a more inclusive and sustainable Islamic financial ecosystem.

This article aims to provide a deeper understanding of the compliance model of LKS with Islamic economic regulations in Indonesia. It explores various factors influencing compliance levels, challenges in regulatory implementation, and opportunities to enhance compliance effectiveness in this sector. The study utilizes a qualitative descriptive approach, analyzing the regulations governing LKS and examining their operational implementation through legal document analysis, regulatory reports, and related academic studies. The findings of this study are expected to contribute both academically and practically to strengthening regulatory compliance in Indonesia's Islamic financial industry and to offer strategic recommendations for stakeholders to improve the effectiveness of a more adaptive and sustainable compliance system.

The compliance of Sharia Financial Institutions (LKS) with Islamic economic regulations directly affects the sustainability of their operations and serves as a key indicator in assessing the effectiveness of their governance. Although Indonesia has strong regulations in this area, the implementation of these rules in practice shows significant gaps, particularly with respect to internal supervision by the Sharia Supervisory Board (DPS), which is often challenged by issues related to independence and competence. Therefore, strengthening the role of DPS and improving the quality of public Islamic financial literacy are critical to ensuring more optimal compliance and supporting the development of a more inclusive and sustainable Islamic financial industry. The primary focus of this article is to explore in greater depth the challenges faced in implementing Sharia regulations and to propose applicable solutions based on existing empirical analysis, with an emphasis on strengthening the competence and independence of DPS and enhancing Islamic financial education for the community.

Results and Discussion

Regulatory and Supervisory Framework in the Islamic Economy

Islamic economic regulations in Indonesia have developed significantly over the past decades, which aligns with the increasing role of LKS in the national financial system.[10] Law No. 21 of 2008 on Islamic Banking serves as the primary legal foundation governing the operations of Islamic banks, ensuring that all economic activities comply with Sharia

[8] Nadya Dwi Rahmanita, Kusnendi Kusnendi, and Suci Aprilliani Utami, "Moderating Effect Of Personality Traits On The Influence Of Islamic Financial Literacy On The Implementation Of Islamic Financial Planning," *The International Journal of Business Review (The Jobs Review)* 3, no. 1 (August 2, 2020): 37–46, https://doi.org/10.17509/tjr.v3i1.26568.

[9] Khofifah Khofifah and Dwiyani Sudaryanti, "The Influence Of Students'knowledge About Riba & Profit Sharing On Interest In Saving In Sharia Bank," *El-Aswaq* 5, no. 02 (2024), https://doi.org/10.31106/laswq.v5i02.25801.

[10] Wiwin Sutoyo, Luthfi Hamidi, and Nurinawati Kurnianingsih, "The Development of Sharia Economic Law In The Constellation of Indonesian National Law," *Journal Equitable* 9, no. 1 (2024): 87–102, https://doi.org/10.37859/jeq.v9i1.6459.

principles.[11] Additionally, other regulations, such as POJK, have strengthened the legal infrastructure to support a more stable and transparent Islamic financial industry, which has proven effective in minimizing problematic financing in Islamic banking, thus contributing to customer economic growth.[12]

Various authorities, including the OJK, supervise Sharia compliance in LKS. OJK regulates and oversees Islamic banking operations, ensuring that banks and other financial institutions adhere to Sharia principles.[13] Meanwhile, BI plays a crucial role in formulating monetary policies and financial instruments that align with the Islamic economic system, including implementing *riba*-free instruments within the national financial framework.[14] With the involvement of these two institutions, the supervision of the Islamic financial industry has become more comprehensive, covering both regulatory aspects and macroeconomic policies.

Apart from the role of regulators, the DSN-MUI also has the authority to issue fatwas in Islamic finance, enforce Islamic laws, and ensure the sustainability of Islamic financial institutions.[15] These fatwas provide operational guidelines for LKS, covering various aspects of Islamic financial products and services, including permissible contracts in Islamic banking such as murabahah,[16] ijarah, musyarakah, and mudarabah.[17] The DSN-MUI fatwas aim to enhance the Islamic financial sector in Indonesia by ensuring that financial products comply with Islamic law and establishing long-term sustainability.[18]

In the context of financial innovation, sharia regulations have also evolved to accommodate technological advancements. However, Islamic fintech still requires a stronger legal framework to ensure comprehensive Sharia compliance, maintain customer trust, and strengthen its market presence.[19] The government and regulators must work towards harmonizing existing regulations and adopting new policies that support the development of sharia-based financial technology (fintech) in an accountable, effective, professional, equitable,

[11] Fuji Alia Rahma, Heni Noviarita, and Rita Zaharah, "The Implementation of Law Number 21 of 2008 Concerning Sharia Banking on Sharia Financial Institutions Is Underway Sharia Economic Law Perspective," *ASAS* 16, no. 1 (August 5, 2024), https://doi.org/10.24042/asas.v16i1.18779.

[12] Fatkhur Rohman Albanjari and Catur Kurniawan, "Implementasi Kebijakan Peraturan Otoritas Jasa Keuangan (POJK) No. 11/Pojk. 03/2020 Dalam Menekan Non Performing Financing Pada Perbankan Syariah," *EKSYAR: Ekonomi Syari'ah Dan Bisnis Islam (e-Journal)* 9, no. 1 (2022): 82–92.

[13] Neneng Nurhasanah, "The Internalisation of Hisbah Principles in OJK Regulations on Islamic Banking Compliance Supervision," *Al-Uqud: Journal of Islamic Economics* 5, no. 2 (2021): 275–91, https://doi.org/10.26740/AL-UQUD.V5N2.P275-291.

[14] Adinda Madani and Tika Widiastuti, "The Impact Of Islamic Monetary Operations And Aggregate Financing On Economic Growth In Indonesia (2010-2020)," *Jurnal Ekonomi Dan Bisnis Islam (Journal of Islamic Economics and Business)* 7, no. 2 (November 30, 2021): 185, https://doi.org/10.20473/jebis.v7i2.26085.

[15] Epy Pujiaty, Frilla Gunariah, and Dian Pramayanti, "Development of Fatwa Development of The National Sharia Council of Indonesian Mui Assembly (Dsn-Mui) Related To Practice And Products in Sharia Financial Institutions," in *Proceedings of the 3rd International Conference on Law, Social Science, Economics, and Education, ICLSSEE 2023, 6 May 2023, Salatiga, Central Java, Indonesia* (Proceedings of the 3rd International Conference on Law, Social Science, Economics, and Education, ICLSSEE 2023, 6 May 2023, Salatiga, Central Java, Indonesia, Salatiga, Indonesia: EAI, 2023), https://doi.org/10.4108/eai.6-5-2023.2333543.

[16] Suaidi Suaidi, "Fiqh Muamalah," 2021.

[17] Ulil Amri, Anggita Dwi Hanum, and M Iqbal, "Implementation Of Dsn-Mui Fatwa On Sharia Insurance Products At Pt. Asuransi Takaful Palembang Branch," *JEBI (Jurnal Ekonomi Dan Bisnis Islam)* 7, no. 2 (December 8, 2022): 12, https://doi.org/10.15548/jebi.v7i2.267. The definitions of these terms can be read in detail both from the meaning of the language and the essence of these contracts; S Suaidi, *Ekonomi Islam Dalam Al-Qur'an*, vol. 98 (Duta Media Publishing, 2019).

[18] Pujiaty, Gunariah, and Pramayanti, "Development of Fatwa Development of The National Sharia Council of Indonesian Mui Assembly (Dsn-Mui) Related To Practice And Products in Sharia Financial Institutions."

[19] Ishak Ishak, Ilham Ilham, and Akbar Sabani, "Shari'a Compliance Principles In Financial Technology," *JCH (Jurnal Cendekia Hukum)* 8, no. 1 (September 30, 2022): 47, https://doi.org/10.33760/jch.v8i1.542.

and progressive manner.[20] Collaboration between Sharia regulators and technology developers is essential to ensuring that fintech products in Indonesia adhere to Sharia principles while simultaneously creating opportunities for inclusive financial innovation.[21]

With the continuous growth of the Islamic financial industry in Indonesia, regulation and supervision have become crucial factors in ensuring the sustainability and competitiveness of the sector. A comprehensive regulatory framework must ensure compliance with Sharia principles while adapting to economic and technological developments. Effective supervision should ensure administrative compliance and evaluate how well Islamic financial practices reflect maqāsid al-sharīʻah, particularly regarding justice and economic welfare. The main challenges include low levels of Islamic financial literacy, unequal access to financial services, and competition with conventional financial systems. Therefore, synergy between regulators, industry players, and society is essential to developing more inclusive and technology-driven financial instruments. Without progressive strategic measures, Islamic finance risks losing its essence and merely becoming an alternative version of the conventional system without delivering meaningful social impact.

The narrative of the above ideas reveals the concrete challenges faced in implementing Islamic economic regulations, particularly in the operational context of technology-based Islamic financial institutions. For instance, many Sharia fintech platforms still face legal ambiguities due to the lack of regulatory instruments capable of accommodating digital dynamics in real-time.[22] Cases, such as the misalignment between contract structures in peer-to-peer financing applications and DSN-MUI fatwas, highlight the need for a more adaptive digital Sharia audit mechanism. Theoretically, integrating the *maqāṣid al-sharīʻah* approach with contemporary governance principles such as accountability and transparency becomes essential in formulating a compliance framework that is not only formalistic but also substantively impactful. Therefore, this paper recommends the establishment of a digital Sharia regulatory task force involving financial authorities, DSN-MUI, and fintech associations to develop responsive regulations rooted in Sharia principles. In addition, there is a need to create a digital Sharia literacy curriculum for both the public and industry actors to enhance their understanding of risks and Sharia mechanisms in digital financial services. These initiatives aim to ensure that the Islamic financial industry not only grows quantitatively but also contributes meaningfully to social justice and economic transformation based on Islamic values.[23]

Factors Influencing LKS Compliance with Sharia Regulations

The compliance of LKS with Sharia regulations is a fundamental aspect of maintaining public trust and ensuring the sustainability of the Islamic financial industry.[24] Sharia regulations in Indonesia, such as Law No. 21 of 2008 on Islamic Banking, DSN-MUI fatwas, and various regulations issued by the OJK and BI, are designed to safeguard the integrity of the Islamic

[20] Suaidi Suaidi, Ali Sodiqin, and Abdur Rozaki, "A Critique of Contemporary Economic Justice and Sharia Economic Law on The Tompangan Tradition," *Jurnal Hukum Islam* 22, no. 2 (2024): 249–80.
[21] Suaidi Suaidi and Akhmad Farid Mawardi Sufyan, "Contemporary Fiqh Construction For Progressive Islamic Business Ethics In The Society 5.0 Era:: Methods, Challenges, And Opportunities," *ALFIQH Islamic Law Review Journal* 2, no. 3 (2023): 135–52.
[22] Rudy Haryanto, "Branding the Role of the District Baznas in Madura Through Online-Based Digitalization in Efforts of Community Economic Empowerment," *Iqtishadia Jurnal Ekonomi & Perbankan Syariah* 10, no. 1 (2023): 84–99.
[23] Suaidi Suaidi, "Resolusi Konflik Dalam Islamic Studies: Perspektif Harmonisasi Antar Umat Beragama Richard C. Martin," *Living Islam: Journal of Islamic Discourses* 7, no. 2 (n.d.), https://doi.org/10.14421/lijid.v7i2.5546.
[24] "Sharia Compliance and Profitability in Financial Performance Islamic Banks in Indonesia."

financial system and ensure its adherence to Islamic principles.[25] However, in practice, various internal and external factors influence the level of LKS compliance with these regulations.

Internal Factors: Establishing a Sharia-Based Culture in LKS

1. Sharia Governance

Sharia governance is fundamental in ensuring LKS compliance with Islamic economic principles.[26] When implemented proportionally, Sharia governance has been found to influence sustainability reporting significantly in conventional banks in Indonesia.[27] Without an effective governance system, the risk of non-compliance with Sharia principles increases, especially given that Islamic financial institutions in Indonesia operate under a dual legal system. Sharia governance can mitigate this risk through contract standardization and resolving disputes through Islamic legal mechanisms rather than conventional courts, which could otherwise compromise the integrity and public trust in the Islamic financial industry.[28]

One of the key aspects of Sharia governance is the supervisory mechanism, which involves multiple stakeholders, including DPS at the institutional level and external regulatory authorities such as OJK and BI. According to Muryanto et al., weak supervision and low levels of Sharia compliance remain major challenges in implementing Islamic fintech, and a well-established ecosystem requires comprehensive regulations, policies, Sharia Supervisory Boards, and standardized governance frameworks for Islamic fintech.[29] Therefore, DPS plays a crucial role in overseeing all products and services offered by LKS, ensuring that they align with the sharia principles set by DSN-MUI.

On the other hand, employees' understanding of Islamic financial principles also plays a significant role in successfully implementing Sharia governance.[30] For instance, managers in Islamic financial institutions that fully comply with Sharia significantly influence decisions related to leverage, dividend policies, and working capital, following a distinct financial style compared to those in non-Sharia-compliant companies.[31] Therefore, regular training and education are essential to ensure all staff know Sharia

[25] Rahma, Noviarita, and Zaharah, "The Implementation of Law Number 21 of 2008 Concerning Sharia Banking on Sharia Financial Institutions Is Underway Sharia Economic Law Perspective." Lucky Omega Hasan, "Dewan Syariah Nasional – Majelis Ulama Indonesia Under Construction Sharia Economic Supervision System In Indonesia," *Asian Journal of Engineering, Social and Health* 3, no. 1 (January 22, 2024): 134–46, https://doi.org/10.46799/ajesh.v3i1.228.Nurhasanah, "The Internalisation of Hisbah Principles in OJK Regulations on Islamic Banking Compliance Supervision."Andrew Shandy Utama, "Sejarah Dan Perkembangan Regulasi Mengenai Perbankan Syariah Dalam Sistem Hukum Nasional Di Indonesia," *Jurnal Wawasan Yuridika* 2, no. 2 (October 1, 2018): 187, https://doi.org/10.25072/jwy.v2i2.180.

[26] Annisa Adha Minaryanti and Muhammad Iman Sastra Mihajat, "A Systematic Literature Review on the Role of Sharia Governance in Improving Financial Performance in Sharia Banking," *Journal of Islamic Accounting and Business Research* 15, no. 4 (March 29, 2024): 553–68, https://doi.org/10.1108/JIABR-08-2022-0192.

[27] Falikhatun Falikhatun et al., "Sharia Governance and Sustainability Reporting: The Mediating Role of Financial Performance," *Al-Uqud : Journal of Islamic Economics* 4, no. 2 (July 1, 2020): 218, https://doi.org/10.26740/al-uqud.v4n2.p218-234.

[28] Iffah Karimah, "Between Legal Risk And Sharia Risk In Islamic Banking: How Shariah Governance Address The Problem," *Diponegoro Law Review* 7, no. 1 (April 28, 2022): 88–105, https://doi.org/10.14710/dilrev.7.1.2022.88-105.

[29] Yudho Taruno Muryanto, "The Urgency of Sharia Compliance Regulations for Islamic Fintechs: A Comparative Study of Indonesia, Malaysia and the United Kingdom," *Journal of Financial Crime* 30, no. 5 (November 30, 2023): 1264–78, https://doi.org/10.1108/JFC-05-2022-0099.

[30] Aan Zainul Anwar and Mohammad Yunies Edward, "Analisis Syariah Compliance Pembiayaan Murabahah Pada Gabungan Koperasi BMT Mitra Se-Kabupaten Jepara," 2016, 2407–9189.

[31] Iram Naz, Syed Muhammad Amir Shah, and Ali M. Kutan, "Do Managers of Sharia-Compliant Firms Have Distinctive Financial Styles?," *Journal of International Financial Markets, Institutions and Money* 46 (January 2017): 174–87, https://doi.org/10.1016/j.intfin.2016.05.005.

principles adequately. This, in turn, helps minimize operational errors that could lead to regulatory non-compliance.

Considering the complexity of Sharia governance in the Islamic financial industry, a more comprehensive and sustainable approach is required to ensure compliance that is not only formal but also substantive. Strict regulations without enhanced human resource capacity and a supportive ecosystem will only lead to administrative compliance without a tangible impact on the industry's sustainability. Thus, synergy among regulators, DPS, industry players, and academics is essential in building a more adaptive and responsive Sharia governance system. Islamic finance is about being free from *riba* and promoting justice, transparency, and sustainability. Without a strong commitment from all stakeholders, Islamic finance risks losing its essence and becoming merely a replica of the conventional financial system under a different label. Strengthening Sharia governance is not just a regulatory requirement but a fundamental pillar in maintaining public trust and ensuring that the Islamic financial industry truly benefits society.

2. The Role of the Sharia Supervisory Board (DPS)

The Sharia Supervisory Board (DPS) plays a crucial role in maintaining the integrity of LKS by ensuring that policies, products, and services comply with Sharia principles.[32] As part of the internal supervisory structure, DPS is responsible for monitoring the implementation of Sharia regulations and provides recommendations and guidance to management in aligning business strategies with Sharia requirements.[33] The presence of DPS in every LKS aims to ensure that all institutional operations remain within the framework of Islamic law and are free from practices that contradict Sharia, such as *riba*, *gharar*, and *maysir*.[34]

DPS's effectiveness largely depends on its members' level of independence and competence.[35] A highly independent DPS can carry out its supervisory functions without pressure from management or capital owners, ensuring that decisions are made purely based on sharia considerations. Another essential aspect of DPS is competence, which ensures LKS compliance with Sharia regulations. For instance, DPS members must be proficient in fiqh muamalah theory, financial statement analysis, applicable laws, and developing the Islamic financial industry at national and global levels.[36] Without adequate competence, DPS risks failing to provide effective supervision, which could ultimately lead to non-compliance with sharia principles in products and services.

As the frontline authority in ensuring Sharia compliance within Islamic Financial Institutions, DPS is a supervisory body and a key pillar in maintaining credibility and public trust in this industry. Strong independence and competence are not merely expectations but essential prerequisites for DPS to function optimally without external interference that could compromise Sharia principles. In an increasingly complex and dynamic financial landscape, the role of DPS must continue to evolve by adopting a more proactive approach, not only in supervision but also in encouraging product innovation

[32] Aam, "Sharia Supervisory Board: A Review and Some Finding," *Review on Islamic Accounting* 1, no. 1 (December 31, 2021), https://doi.org/10.58968/ria.v1i1.69.

[33] Rizka Rahmatillah Zidna, Sayyidah Syafiqoh, and Bakhrul Huda, "Analisis Fatwa DSN MUI No. 140 Tahun 2021 Terhadap Regulasi Dewan Pengawas Syariah Pada Produk Securities Crowdfunding," *El-Mal: Jurnal Kajian Ekonomi & Bisnis Islam* 5, no. 10 (October 3, 2024), https://doi.org/10.47467/elmal.v5i10.3035.

[34] Achmad Lubabul Chadziq, "Mengenal Investasi Dalam Dunia Syariah," *AKADEMIKA* 10, no. 1 (June 30, 2016): 1–12, https://doi.org/10.30736/akademika.v10i1.50.

[35] Arnita Septiani Panjaitan and Nurul Jannah, "Peran Dewan Pengawas Syariah Dalam Pengawasan Di Bank Syariah (Studi Kasus Bank Sumut Syariah Kecamatan Tebing Tinggi)," *Regress: Journal of Economics & Management* 2, no. 1 (October 18, 2022): 131–43, https://doi.org/10.57251/reg.v2i1.304.

[36] H. Rahman Ambo Masse, "Dewan Pengawas Syariah Dan Profesionalisme Sumber Daya Manusia," *DIKTUM: Jurnal Syariah Dan Hukum* 16, no. 2 (December 5, 2018): 147–70, https://doi.org/10.35905/diktum.v16i2.616.

while remaining anchored in Islamic values. Without a strong and credible DPS, the Islamic financial industry risks losing its direction and merely mirroring the conventional system under a different label. Therefore, strengthening the role of DPS through capacity building, supportive regulations, and transparency in decision-making is a non-negotiable step toward achieving a more sustainable and just Islamic financial system.

3. Employee Awareness and Understanding of Sharia Principles

Employee awareness and understanding of Sharia principles are fundamental to ensuring that LKS complies with applicable regulations. Employees with a deep understanding of Islamic financial concepts are better equipped to perform their duties by Sharia principles, whether in product management, customer service, or business decision-making. Conversely, low awareness and understanding among employees regarding Sharia principles may lead to unintentional regulatory violations, potentially diminishing public trust and the credibility of LKS.[37]

Violations of Islamic financial principles are often not due to intentional misconduct but rather a lack of knowledge or inadequate socialization regarding sharia-based operational standards. In many cases, LKS employees who previously worked in conventional banking or finance struggle to adapt to the fundamentally different concepts of Islamic finance.[38] For example, some employees often do not fully understand the difference between interest (*riba*) in conventional banking and the profit-sharing concept in Islamic banking. Therefore, LKS must ensure that all employees, especially those in strategic positions, understand Islamic financial rules and practices comprehensively.

Regular training and education programs must be integral to LKS compliance strategies to enhance this understanding.[39] These training sessions should cover theoretical aspects of Islamic financial principles, applicable regulations, and case studies on implementing Sharia rules in banking operations. Additionally, training should be conducted in a practical format, such as simulations of Sharia-compliant transactions, to provide employees with a concrete understanding of Sharia principles in practice. Through continuous training, LKS employees will develop better skills in identifying and mitigating risks that may hinder compliance with Sharia regulations.

Beyond internal training, LKS must also establish collaborations with educational institutions and relevant authorities to enhance the quality of employees' knowledge.[40] For example, partnerships with universities or Islamic financial training institutions can provide in-depth academic-based training. Similarly, the involvement of the DPS in guiding and evaluating employee Performance related to Sharia compliance can further strengthen compliance mechanisms. With a comprehensive and systematic approach, efforts to enhance employee awareness of sharia principles can be implemented more effectively. By improving employees' understanding of sharia regulations, LKS will enhance compliance with applicable rules and increase the institution's competitiveness in the Islamic financial industry. Employees who are well-versed in Sharia principles can provide more professional services to customers, thereby strengthening public trust in LKS. Therefore, investment in employee education and training should be a top priority

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[37] Anwar and Edward, "Analisis Syariah Compliance Pembiayaan Murabahah Pada Gabungan Koperasi BMT Mitra Se-Kabupaten Jepara."

[38] Avita Puji Ilahi and Arif Afendi, "Factors To Influence Employee Performance In Bank Tabungan Negara Sharia Semarang," *AL-ARBAH: Journal of Islamic Finance and Banking* 1, no. 1 (December 31, 2019): 1, https://doi.org/10.21580/al-arbah.v1i1.4108.

[39] Fardinant Adhitama et al., "Unrevaling Sharia Comliance," *Akuntabilitas* 16, no. 2 (August 7, 2022): 257–78, https://doi.org/10.29259/ja.v16i2.17337.

[40] Siti Nur Aisyah, "Synergizing the Sustainable Islamic Finance Ecosystem in Indonesia The Management Collaboration Line," *Jurnal Bisnisman : Riset Bisnis Dan Manajemen* 6, no. 1 (May 28, 2024): 28–44, https://doi.org/10.52005/bisnisman.v6i1.208.

for every LKS to ensure that all operational aspects align with Sharia principles.

4. Customer Awareness and Understanding

Customer understanding of Islamic financial principles is crucial in ensuring LKS compliance with applicable regulations. For instance, customers' knowledge of Islamic financial planning significantly relates to their satisfaction with Islamic credit card services.[41] Educating customers about Sharia principles influences their decision-making when choosing financial products and encourages LKS to remain committed to the established Sharia standards. However, many customers still do not understand the fundamental differences between Islamic and conventional financial systems. Understanding *riba*, product knowledge, and attitudes toward Islamic banking greatly influences the likelihood of customers choosing Islamic banking services.[42] This lack of knowledge often leads to misconceptions, where customers focus more on financial returns without considering Sharia compliance in their transactions.

One of the main challenges in customer education is their tendency to compare Islamic financial products directly with conventional products. Many customers evaluate the quality of services and economic returns in Islamic finance based on interest rates or return on investment (ROI) in conventional banking. However, the Islamic financial system operates on principles of profit-sharing, sales contracts, or partnership schemes, which fundamentally differ from interest-based banking. This lack of understanding can result in a lack of trust in Islamic financial products, especially if customers feel that the economic benefits are not comparable to conventional alternatives.

To address this knowledge gap, LKS must be proactive in customer education and outreach programs.[43] A strategic approach involves providing comprehensive Islamic financial literacy programs through seminars, workshops, and digital platforms such as Islamic banking applications and online educational content. These programs should give customers a deeper understanding of fundamental Islamic financial principles, such as the prohibition of *riba*, *gharar*, and *maysir*, as well as the economic and social benefits of sharia-based financial systems.[44] With improved understanding, customers will gain confidence in using Islamic financial products without making direct comparisons to conventional systems.[45]

Enhancing customer awareness of Islamic finance will directly contribute to LKS's compliance with Sharia regulations. When customers fully understand Sharia principles, they will be more selective in choosing financial products that align with Islamic values, motivating LKS to adhere strictly to regulations. Indonesia's Islamic financial ecosystem can grow healthier and more sustainably through a synergy of customer education, product transparency, and LKS's commitment to Sharia compliance.

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[41] Azwan Abdullah Et.al, "Does Customer Knowledge on Islamic Financial Planning Is Crucial for Islamic Credit Cards Users?," *Turkish Journal of Computer and Mathematics Education (TURCOMAT)* 12, no. 3 (April 11, 2021): 2592–96, https://doi.org/10.17762/turcomat.v12i3.1260.

[42] Indri Yuliafitri and Ressy Siti Lathifah, "Understanding Riba, Product Knowledge, and Attitudes: Influences on Intentions to Become Sharia Bank Customers," *Li Falah: Jurnal Studi Ekonomi Dan Bisnis Islam* 7, no. 1 (June 30, 2022): 102, https://doi.org/10.31332/lifalah.v7i1.5500.

[43] Salwa Afronisa Aulia et al., "Sosialisasi Literasi Dan Lembaga Keuangan Syariah Pada Masyarakat Desa Sukabungah," *Al-Ihsan: Journal of Community Development in Islamic Studies* 3, no. 1 (May 24, 2024): 57–67, https://doi.org/10.33558/alihsan.v3i1.9546.

[44] Zainul Mun'im et al., "Revisioning Official Islam in Indonesia: The Role of Women Ulama Congress in Reproducing Female Authority in Islamic Law," *AHKAM: Jurnal Ilmu Syariah* 24, no. 1 (2024).

[45] Ahmed Tahiri Jouti, "What Policy for Islamic Financial Literacy?," *Turkish Journal of Islamic Economics* 8, no. 2 (August 15, 2021): 531–51, https://doi.org/10.26414/A148.

External Factors Influencing LKS Compliance

Besides internal factors, Islamic Financial Institutions' (LKS) compliance with Sharia regulations is also significantly influenced by external factors, including global regulations, regulatory authority oversight, and technological advancements in the Islamic financial industry.

1. The Role of Regulators and Supervisory Authorities

   The role of regulators and supervisory authorities in the Islamic financial industry is crucial in determining the effectiveness of LKS compliance with applicable regulations. LKS must adhere to Sharia principles and the national regulatory system set by various supervisory institutions. In Indonesia, three key institutions play a crucial role in overseeing and regulating Islamic finance: the OJK, BI, and the DSN-MUI. These institutions have different yet interconnected authorities, ensuring that LKS operations remain within Sharia compliance and national financial regulations.

   OJK plays a primary role in overseeing the stability and compliance of the Islamic banking industry. As the institution responsible for regulating and supervising the financial services sector, OJK ensures that LKS not only operates under Sharia principles but also complies with macroprudential policies set by the government. OJK supervises compliance with POJK regulations on Islamic banking, risk management standards, and Islamic financial governance. Through strict supervision, OJK aims to establish a healthy, stable, and highly competitive Islamic economic system, allowing it to compete effectively with the conventional financial system.[46]

   BI plays a key role in designing sharia monetary policies and ensuring that financial instruments used by LKS comply with sharia principles. As the central bank, BI formulates policies related to interest rates, liquidity, and the payment system in the Islamic financial industry. One of BI's crucial functions is the development of sharia-based monetary instruments, such as Bank Indonesia Sharia Certificates (SBIS) and Sukuk BI, which allow LKS to manage liquidity while adhering to Sharia principles. Through appropriate regulations, BI strives to create monetary policies that support the growth of the Islamic financial industry while maintaining overall financial system stability.[47]

   DSN-MUI has the authority to issue fatwas related to Islamic financial products and services. These fatwas are a primary reference for regulators and LKS when formulating and implementing Islamic financial instruments. DSN-MUI's decisions are critical in ensuring that financial products offered by LKS align with Sharia principles and do not deviate from Islamic teachings. Therefore, coordination between DSN-MUI and financial authorities such as OJK and BI is crucial to ensuring that regulations are aligned with the national economic system and uphold the Islamic principles governing LKS operations.[48]

   The effectiveness of LKS compliance with Sharia regulations largely depends on how well regulators and the industry coordinate. Regulatory misalignment between financial authorities and DSN-MUI often hinders the consistent implementation of Sharia principles. For example, in some cases, policies introduced by OJK or BI may not be fully aligned with DSN-MUI fatwas, confusing LKS in implementing regulations. Therefore, a more effective coordination mechanism among regulators, financial authorities, and the

[46] Salwatun Aslamia et al., "Regulation, Supervision, And Implementation Of Sharia Principles In Banking By Ojk (Analysis Of Legal Aspects And Challenges)," *Indonesian Journal of Multidisciplinary Sciences (IJoMS)* 2, no. 2 (December 31, 2023): 264–74, https://doi.org/10.59066/ijoms.v2i2.344.

[47] Madani and Widiastuti, "The Impact Of Islamic Monetary Operations And Aggregate Financing On Economic Growth In Indonesia (2010-2020)."

[48] Rizka Rahmatillah Zidna, Sayyidah Syafiqoh, and Bakhrul Huda, "Analisis Fatwa DSN MUI No. 140 Tahun 2021 Terhadap Regulasi Dewan Pengawas Syariah Pada Produk Securities Crowdfunding."

industry is needed to ensure that Sharia regulations are implemented optimally and in line with the primary objectives of the Islamic economic system in Indonesia.

2. The Development of Digital Technology in Islamic Finance

Technology is increasingly crucial in enhancing LKS compliance with sharia regulations in the digital era.[49] Digitalization is an administrative tool that ensures transparency, efficiency, and accountability in Islamic financial operations. With more advanced systems, LKS can reduce regulatory non-compliance risks, enhance public trust, and identify, monitor, control, and mitigate compliance risks. This, in turn, helps Islamic banks achieve sharia compliance, permissible profitability, and a strong reputation.[50]

Automation in Sharia Compliance is one of the key innovations that can accelerate supervisory and compliance reporting processes. Digital-based systems allow LKS to record every transaction in a centralized database that is accessible in real-time by compliance teams. This ensures that all financial products and services undergo sharia verification from the initial stages. Additionally, such systems enable early detection of potential sharia violations before transactions are executed, thus minimizing compliance risks.

Pravin says digital document management and process standardization are critical aspects of regulatory compliance.[51] In Islamic finance, every financing contract, investment, or other transaction must have clear legal standing under Sharia principles. By adopting digital systems, contract documents can be standardized based on formats approved by regulators, such as DSN-MUI or OJK. Beyond improving administrative efficiency, this approach reduces the risk of contract misuse or deviations from sharia principles due to inconsistencies in document preparation.

Integration with the National Financial System presents challenges and opportunities for LKS to ensure that its services remain relevant amid the dominance of conventional banking systems. For instance, LKS must uphold its Sharia principles while providing viable alternatives for both Muslim and non-Muslim consumers.[52] Therefore, enhancing competitiveness and regulatory compliance requires ensuring that LKS's technological infrastructure is compatible with national payment systems, including e-commerce platforms and digital financial services. If the Islamic economic system can be widely integrated with the national financial ecosystem, regulatory compliance will be easier due to uniform compliance standards.

Monitoring Compliance through Digital Platforms is another essential aspect.[53] With digital technology, regulators such as OJK, BI, and DPS can access real-time compliance reports, eliminating the need for costly and time-consuming manual inspections. Automated reporting systems implemented by LKS enable real-time monitoring of financial transactions, allowing immediate corrective actions in case of any

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[49] Muthia Hafsari Hasibuan and M. Irwan Padli Nasution, "Mengembangkan Produk Pada Layanan Jasa Informasi Perbankan Dengan Shariah Governance Untuk Pengaplikasian Keuangan Digital Syariah," *Sci-Tech Journal (STJ)* 2, no. 2 (2023): 157–65.

[50] Muhammad Yunas Ali and Farooq Hassan, "The Study of Potential Shariah Non-Compliance Risks in Murabahah Along with Their Risk Management," *Journal of Finance & Economics Research* 4, no. 1 (January 2019): 44–58, https://doi.org/10.20547/jfer1904104.

[51] Pravin Ullagaddi, "Digital Transformation in the Pharmaceutical Industry: Ensuring Data Integrity and Regulatory Compliance," *The International Journal of Business & Management*, May 17, 2024, https://doi.org/10.24940/theijbm/2024/v12/i3/BM2403-013.

[52] Fadia Fitriyanti et al., "The Implementation of Islamic Principles in Sharia Financial Institutions," *Fiat Justisia: Jurnal Ilmu Hukum* 17, no. 2 (April 12, 2023): 153–62, https://doi.org/10.25041/fiatjustisia.v17no2.2849.

[53] Anil R. Doshi and William Schmidt, "Soft Governance Across Digital Platforms Using Transparency," *Strategy Science* 9, no. 2 (June 2024): 185–204, https://doi.org/10.1287/stsc.2023.0006.

violations or deviations from Sharia principles. This approach enhances transparency and strengthens a more responsive and accurate supervisory system.

However, the successful adoption of technology to enhance sharia regulatory compliance comes with implementation challenges. High investment costs in digital infrastructure remain a major constraint for many LKS, particularly for institutions still in the early stages of development. Additionally, regulatory gaps concerning technology adoption in Islamic finance necessitate clear and structured policies to integrate digitalization as a compliance tool. Therefore, strong collaboration among the Islamic financial industry, regulators, and other stakeholders is essential in developing a technology-driven Islamic financial ecosystem while maintaining Islamic principles in its operations.

Challenges, Opportunities, and Prospects: An Analytical Study of LKS Compliance with Sharia Regulations

Implementing LKS compliance with sharia regulations in Indonesia faces various complex challenges. One of the main challenges is the lack of competent human resources in Islamic finance, which poses a serious obstacle to ensuring regulatory compliance.[54] Many LKS employees, including management and supervisory staff, still do not understand Islamic economic principles and institutional operations regulations. This issue affects not only internal compliance but also the effectiveness of the DPS in providing guidance and oversight. LKS becomes more vulnerable to non-compliance in its financial products and services without highly qualified personnel.

Another challenge is the limited compliance infrastructure, particularly regarding supervision and regulatory reporting. Many LKS still lack technology-based audit and monitoring systems, which are essential for ensuring their operations' transparency and accountability. The slow adoption of digitalization leads to delays in supervision and increases the risk of data manipulation. Additionally, investment costs for digital compliance systems often constrain LKS with limited capital resources.

Despite these challenges, significant opportunities exist to strengthen regulatory compliance in LKS. The Indonesian government actively promotes Islamic economic growth through various strategic policies and programs, including those led by the National Committee for Islamic Economy and Finance (KNEKS).[55] This support creates a more conducive ecosystem for LKS to enhance regulatory compliance. Additionally, advancements in digital technology in compliance systems provide LKS with opportunities to adopt technology-driven oversight mechanisms, improving transparency and efficiency in regulatory audit processes. Another promising opportunity is to increase the literacy of Islamic finance among the public. As education on Islamic economic principles grows, customers become more aware of Islamic financial products and services.[56] A stronger literacy culture incentivizes

[54] Hendri Hermawan Adinugraha, Muhammad Shulhoni, and Dliya'udin Achmad, "Islamic Social Finance in Indonesia: Opportunities, Challenges, and Its Role in Empowering Society," *Review of Islamic Social Finance and Entrepreneurship*, March 28, 2023, 45–62, https://doi.org/10.20885/RISFE.vol2.iss1.art4.

[55] Efendi Sugianto, "Strategy for Accelerating Development of the National Sharia Economic and Financial Committee (KNEKS) Efforts to Improve Sharia Financial Institutions in Indonesia," *Syarikat: Jurnal Rumpun Ekonomi Syariah* 7, no. 1 (June 30, 2024): 1–13, https://doi.org/10.25299/syarikat.2024.vol7(1).16963.

[56] Mohammed Ali Al-Awlaqi and Ammar Mohamed Aamer, "Islamic Financial Literacy and Islamic Banks Selection: An Exploratory Study Using Multiple Correspondence Analysis on Banks' Small Business Customers," *International Journal of Emerging Markets* 18, no. 12 (December 12, 2023): 6285–99, https://doi.org/10.1108/IJOEM-09-2021-1354.

LKS to comply more strictly with regulations, ensuring competitiveness and customer trust.[57]

Looking ahead, the primary goal in implementing LKS compliance with sharia regulations is to establish a more integrated and adaptive compliance system. Strategies should include harmonizing regulations between financial authorities and fatwa institutions to prevent regulatory inconsistencies that could create confusion within the industry. Additionally, enhancing human resource capacity through training and certification in Islamic finance must be prioritized to ensure that LKS employees gain deeper insights into regulations and sharia principles. Furthermore, accelerating the digitalization of compliance systems is crucial to making audit and supervision processes more efficient and accurate. Leveraging technologies such as blockchain for tamper-proof transaction records and automated monitoring systems for real-time detection of potential Sharia violations can significantly enhance LKS compliance with regulations. If these strategies are implemented effectively, LKS compliance with regulations will not only strengthen but also improve the global competitiveness of Indonesia's Islamic financial industry.

Conclusion

The conclusion of this study emphasizes that the development of Sharia-compliant financial institutions (LKS) with a genuine Islamic character requires a fundamental shift from mere formal compliance to an ethical, reflective, and participatory approach to institutional practice. Sharia governance should not be viewed as a mere administrative control mechanism but as a collaborative space that includes the Sharia Supervisory Board (DPS), management, regulators, and academics, working together to translate Sharia values into adaptive and justice-oriented business strategies. The role of the DPS must evolve from a passive supervisory function to an active strategic partner in product innovation and governance processes. Concurrently, Sharia literacy among employees should be cultivated as part of the institutional culture through the integration of normative knowledge and sustained practical experience. Furthermore, customer education must extend beyond merely explaining the differences between systems, transforming into a co-learning process grounded in dialogue and shared experiences that foster a collective understanding of justice and blessings in financial transactions. The use of digital technology should not only enhance reporting and supervisory efficiency but also serve as a tool to promote real-time ethical transparency and social accountability. Therefore, the success of LKS in adhering to Sharia principles depends not on the perfection of regulatory instruments or audit systems but on the collective determination to position Sharia not as a mere administrative label, but as the foundation for an economic practice that is just, inclusive, and spiritually meaningful.

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[57] Mohamed Albaity and Mahfuzur Rahman, "The Intention to Use Islamic Banking: An Exploratory Study to Measure Islamic Financial Literacy," *International Journal of Emerging Markets* 14, no. 5 (December 2, 2019): 988–1012, https://doi.org/10.1108/IJOEM-05-2018-0218.

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