

Does Dual Banking System in Indonesia Differentiate Investment Account Requirement?

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Abstract. *This paper aims to propose a model of investment account based on Islamic Financial Services Board guiding principles. The research figures out some factors affecting the process of deploying investment account, the proposed model, cost - benefit analysis as well as the steps to be taken by Islamic banking stakeholders to install the model in the future. Having reviewed many literatures related to irregular deposit, investment account as well as the institutional theory, the study found that the adoption of investment account heavily relies on the political factor applied by Bank Indonesia. Law No. 21 Year 2008 that regulates Indonesian Islamic Banking clause 35 stated that Bank Indonesia has coercive power to drive the accounting and governance standard for the Indonesian Islamic banking. Other actors such as Financial Services Authority, National Sharia Board, and Indonesia Deposit Insurance Corporation also do affect the regulation on Investment Account. This paper informs the policy makers to set different regulation on investment account within the practice of dual banking system.*

Keywords: *Islamic Banking, Investment Account, Irregular Deposit*

Abstrak. *Tulisan ini bertujuan untuk mengusulkan model dan produk Investment Account sesuai dengan pedoman yang diberikan oleh Islamic Financial Service Board (IFSB). Penelitian ini berusaha menyajikan faktor yang mempengaruhi implementasi Investment Account, model bisnis, analisa biaya-manfaat serta apa saja yang perlu dilakukan oleh pemangku kepentingan di bank syariah. Setelah menelaah lebih lanjut literatur terkait dengan Irregular Deposit, Investment Account dan teori Institusional, penelitian ini menemukan bahwa proses adopsi produk investment account sangat bergantung dengan Bank Indonesia seperti yang tercantum pada pasal 35 Undang-undang Perbankan Syariah No. 21 yang nantinya akan mendorong badan terkait lainnya seperti OJK, Dewan Syariah Nasional, serta Lembaga Penjaminan Simpanan. Penelitian ini pada akhirnya menginformasikan regulator, beberapa saran terkait peraturan yang dapat diimplementasikan pada sistem dual banking di Indonesia.*

Kata kunci: *Bank Syariah, Investment Account, Irregular Deposit*

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Introduction

The Islamic Banks (IBs) in Indonesia has been introduced 25 years ago since the formation of the first Islamic bank, Bank Muamalat Indonesia (Ismal, 2014; Ismal, 2010; Mukhlisin *et al.*, 2015). Behind the fast development, the history of Islamic banking in Indonesia has been recorded in several phases. The first phase is the introduction phase that occurred in the era of 1992-1998 by the approval of the law number 7-1992 and the government policy number 72-1992 regarding the bank that operated under profit sharing system. Government via finance minister has allowed the bank to give 'zero percent' interest for its financing activities (Anshori, 2008; Ascarya and Yumanita, 2005). The second phase is called as "recognition phase" in the period of 1998-2008 by the endorsement of the law No. 10-1998 (amendment of law No. 7 1992) (Anshori, 2008). In this context, the government recognizes the Islamic bank by redefining the definition of commercial bank and rural bank from not only doing banking operation in conventional but also in Islamic way (Ascarya and Yumanita, 2005). The third phase is called the "purification phase" by the enforcement of the law number 21-2008 regarding Islamic bank (Anshori, 2008).

The establishment of Islamic bank cannot be separated from conventional counterpart. Both of the banking systems have some differences in terms of their philosophy and economic roles (Wan Ibrahim and Ismail, 2015). On the grassroots, the Islamic and conventional banks are operated in the same way (Hanif, 2011). For example, the implementation theory of deposit that genuinely should be treated as a mere custody (Bagus and Howden, 2012). Unfortunately, the epistemological error happens and the banks are now using the theory of irregular deposit rather than regular deposit (Bagus, Gabriel and Howden, 2015; Bagus, Gabriel and Howden, 2016; Barnett II and Block, 2009; Nair, 2013; De Soto, 1998; Syamlan, 2016). The fallacy of the deposit theory not only happens in conventional banks but also in Islamic bank. The delusion

ensues on the pronouncement of the *wadiah yad dhamanah* instead of promoting *wadiah yad amanah* in Islamic bank daily operation (Farooq, 2011). Furthermore, the Islamic banks are also offering deposit product under a contract of *mudhārabah* (investment contract). Again the legal definition of deposit is not in line with the operational side of *mudhārabah* since it offers “capital certainty” (Archer and Karim, 2009).

Islamic Financial Service Board (IFSB) has seen those issues as major problems in the Islamic bank. Hence IFSB standard on liquidity risk management as well as the government’s is in place to at least reduce the solvency risk of Islamic bank as well as the risk of non compliance to sharia. IFSB realizes that in the nature, Islamic bank has two major funding products which are investment account and non-investment account (IFSB, 2005; IFSB, 2007; IFSB, 2006). The investment account is based on a *tijāri’* (business) contract of *mudhārabah* which has the main feature of profit and loss sharing and has no “capital guarantee” feature. The non-investment account is based on *tabarru’* (social) *aqad* of *wadiah* (trusteeship) and *qardhul hasan* (loan) (IFSB, 2012). Indonesia has joined IFSB since years ago and contributed their idea with other members in the form of standard. However, Indonesian Islamic banking industry somehow leaves the IFSB standard in its business operation. The funding products that offered to the customer are different than IFSB stipulation. The non-investment products are offered under a contract of *wadiah* and *mudhārabah* while the investment products are mainly based on *mudhārabah* (Ismal, 2011). Both types of funding products in Indonesia are guaranteed by Indonesia Deposit Insurance (LPS) and contravened with the IFSB Guidelines.

This research focuses mainly to analyze some factors which affect the Indonesian Islamic Banks (IBs) to adapt the IFSB. Moreover, this paper will also cover the future model of IBs based on the theories of deposit and investment account, the cost and the benefit, and what the stakeholder should do if Indonesia adopt it.

Literature Review

The Irregular Deposit and the Reserve Banking System

First of all, it is important to know that the ontology of deposit contract in the reserve banking system is divided into three, which are (1) *Commodatum* contract which is rooted from latin word refers to a real contract that made to divine faith whenever one person (the goods owners) entrusts his goods to other to be used for free in a certain stipulated time. At the end of the contract, the goods must be returned to the owner (Yeager, 2010; De Soto, 1998). In Islam, this contract is referred to *qardhul hasan* (Farooq, 2011). (2) *The Mutuum* contract on the other hand, refers to a contract that done by owners and borrowers which the owners lent out a certain quantity of their fungible to the borrowers. Moreover, borrowers at the end of the contract must return it back to an equal quantity as well as its quality (Lewis, 2007; Selgin, 2012; Yeager, 2010; Michael and Rozeff, 2010; De Soto, 1998). A daily life example of them is the monetary loan contract. For example, if Mr. Fulan has \$1.000 and Mrs. Fulanah, his colleague, wants to make a loan, it means the loan contract happened. The \$1.000 is now transferred to Mrs. Fulanah and should be paid back in the future for instance a month later. During the one month period, Mrs. Fulanah has full right to consume the money in a way that she wants. When the pay back time is due, Mrs. Fulanah has to fulfil her obligations of \$1.000 to Mr. Fulan. To make it clear, there is an exchange of “present” goods for “future” goods or in simple words, for instance Mr. Fulan gave \$1.000 with 10 pieces of \$100 with have serial numbers 1,2,3,4,5,.....,10. A month later, Mr. Fulanah might not pay back the amount with the same exact serial number since she has done consumption with the money. She pays the money back with a different serial number of the money that amounted \$1.000. In Islamic banking context, we call it as *wadiyah yad dhamanah* (Farooq, 2011). (3) *Depositum* contract, while the *commodatum* and *mutuum* require the transfer of availability as well as the benefit of the good, *depositum* contract or deposit contract in contrast entails the availability of the good and its benefit not to be transferred. Deposit contract is a contract made

by both depositor and depositary to move the good for the depositary to be protected guarded, and return it at any time that depositor may ask (Michael and Rozeff, 2010; Bagus and Howden, 2012; White, 2003; Yeager, 2010; De Soto, 1998). Its purpose is for custody or safe keeping and the good should remain in favour of depositors. From the depositors' point of view, they may ask a charge to guard the good or the deposit may free of charge. In Islamic context, we call it as *wadiah* (Farooq, 2011). The ontology of the deposit mentioned also act as the bases of the reserve banking system. The irregular deposit which stated above is the tools of the fractional reserve banking system (FRBS) which according to Meera and Larbani (2009), it is contravened to the *maqasid* sharia since it's triggered the money creation without any underlying business.

The concept of deposit in banking system is basically in line with the *depositum* contract and it has been practiced since the time of Roman Emperor (Ochaita, 2010). Furthermore, the goldsmith banking system changed the nature of the contract to be *mutuum* and started to make money by issuing the cheque/receipt to the depositors who placed their money. Banks then realized that not all depositors withdrew their money every day, thus it triggered them to utilize the fund for the purposes of gaining profit. That was the origin of fractional reserve banking (Mallett, 2015; Quinn, 1997; King, 2012).

Additionally, the legal suit has been happened in Spain and France in early 19th century whenever depositors sue the bank subsequently after failing to repay the depositors obligations. Regarding the case, at that time the court charged the Bank of Barcelona and Bank in Paris with a reason of breaching the commercial practices that recognized by Spanish jurisprudence and failed to maintain the fund possession at the moment the depositors should claim it (De Soto, 1998; De Soto, 1995a; Javaid, 2015). In South East Asia, the crisis was also triggered by the practice of fractional reserve banking system. The deposit from the depositors was used to fund the creditors and at the time of crisis when banks failed to serve the withdrawal (Radelet and Sachs, 2000; García *et al.*, 2004).

Fractional reserve banking system has been commented negatively by some economist from Austrian School of Economic. It is a risky behaviour that has been done by banks and considered as unethical behaviour (Bagus and Howden, 2012; Bagus and Howden, 2009; Bagus and Howden, 2011; Bagus, Gabriel and Howden, 2016; Bagus and Howden, 2010). Fractional reserve banking system treats money as a commodity rather than the medium of exchange (Hulsmann, 2003; Hulsmann, 2004). As a result of non-neutrality of money, banks starts to exploit the depositor's fund and at the end might result severe shock like "bank run" (De Soto, 1995a; De Soto, 2006; De Soto, 1998).

On the other hand, the other reserve banking system, the 100% Reserve Banking System (100%RBS), has instituted on the basis that money is only as a medium of exchange. So, the demand deposit which put at bank account is more like warehouse receipt. It means that the money which is deposited under demand deposit cannot be channeled into financing credit (Cochran and Call, 1998).

In this perspective, the neutrality of money in Islam is almost the same with the 100% RBS principle. Islam protects the money to neutral in every time by introducing the concept of *riba* (Hasan, 2011). Islam also treats money as actual capital instead of potential capital. When money becomes potential capital it refers to what has been done in fractional reserve banking system as well as irregular deposit whereas the money in demand deposit is used to fund a project or to make more profit for the benefit of IBs. Otherwise, the actual capital is akin to 100% RBS since the demand deposit will be idled and available at any time to serve the need of the depositors. In Islam, money is basically actual capital, a mere supporting transaction. If someone desires to generate more wealth with his money, he has to invest in a business or project or trading so that he bears a risk and gets the lawful profit. (Iqbal and Mirakhor, 2013)

The 100% RBS concept is flourished with an aim to omit the irregular deposit and fixed it so that in the future it will called as the regular deposit (Yeager, 2010; Hulsmann, 2004; Cochran and Call, 1998; De Soto, 1995a). At the

end, if the regular deposit is implemented the mismatch problem between the deposit and loan then it can be reduced accordingly (Bagus and Howden, 2016; Bagus, Gabriel and Howden, 2015; Bagus and Howden, 2009).

The Islamic banks (IBs) have their unique feature compared to conventional banks. Indonesia as the moslem majority country also has its unique Islamic bank model along with its product. Indonesian IBs basically use two contracts for third party deposit which are (1) *Wadiah* based deposit: the *wadiah* genuinely is *depositum* contract. Islamic Bank in this context acting as a warehouse and should not transfer the benefit of the good fund for the sake of making a profit (Farooq, 2011). Deplorably, Islamic bank that operates in the dual banking system faced through competition from conventional bank and at the end, forming a new type of *wadiah* in the contract of *wadiah yad dhamanah*. It fundamentally commingles two contracts which is *wadiah* (trusteeship) and *dhamanah* (guarantee), then it makes the *aqad* somehow akin to *qard* (Sahroni and Karim, 2015). The irregular deposit has happened due to the change of *wadiah* (*depositum*) to *wadiah yad dhamanah* which based on *mutuum* contract. In the context of Indonesian Islamic banking, it is used as the current account as well as saving account (Ismal, 2011; Ismal, 2014). The main feature is saving without any return to the customer. However, banks could give a bonus to its depositors based on their discretionary. Herewith, Islamic banks guarantee the money to be withdrawn any time. In the context of IFSB, this type of deposit also called non-investment account. (2) *Mudhārabah* based deposit: the relationship between customer and the banks is the investor-investee relationship whereby Islamic bank admits the fund as a deposit to be used for financing a project. Then the Islamic bank manages the money by investing it to earn a revenue or profit to be distributed to depositors. In the *mudhārabah* contract, the investment amount (deposit amount) might lessen due to the non-performance of the financing activities. Bank gives no guarantee to depositors since its status of investment account (Anuar *et al.*, 2014; Gilani, 2015). Nevertheless, there is independent body - deposit insurance - who gives

guarantee so that the depositor's trust is increased to invest the money under this contract (Ebrahim, 2008). The irregular deposit happened also in *mudhārabah* saving in terms of deposit. Again, as the *depositum* contract, *mudhārabah* could not give some certainty in terms of profit and the capital. It also arises governance issues since it is an equity partnership contract that Islamic banks have.

The unique feature of Islamic bank in terms of mobilizing funds adds more governance and sharia issue. As noted before, based on *mudhārabah* contract, bank has new stakeholder which is Investment Account Holders (IAHs). The treatment of the IAHs will raise a new issue whether should or not give a right to oversight their investment in the bank. In this section, the elaboration will both touch governance and sharia issues (Archer and Karim, 2009; Hamza and Saadaoui, 2013). So, now the question is, does Indonesian Islamic bank practice the irregular deposit as well? The irregular deposit is now actually exist due to the 50% - 70% of IBs liabilities mostly the 1 month roll over *mudhārabah* deposit, which used for the long term project financing asset. The Indonesian IBs usually used the Bank Indonesia *Wadiah* Certificate to fulfil the depositor's withdrawal. The irregular deposit also exist in Indonesian IBs due to the bigger liquidity gap, on the other hand the IBs short term asset basically couldn't afford the short term liquidity (Ismal, 2008; Ismal, 2010; Ismal, 2011).

IFSB Guidelines on Investment Account

Islamic Financial Service Board (IFSB), Malaysian based organization, has made the standard regarding the risk management framework for Islamic financial institution including bank. Among the standards, two standards will be used for the purpose of this paper which are IFSB Guidelines No. 1 - 2005 regarding the Principles of Risk Management for Institutions other than Insurance (later stated as IFSB 1), IFSB No. 3 - 2006 regarding the Governance for Islamic Financial Institution (later stated as IFSB 3), IFSB No. 4 - 2007 regarding Disclosure to Promote Transparency and Market Discipline (later

stated as IFSB 4). According to IFSB 1 there are 9 risks associated with IBs which is Credit Risk, Equity Investment Risk, Market Risk, Rate of Return Risk, Operational Risk, Displaced Commercial Risk, *Sharia* Non Compliance Risk, Fiduciary Risk and Liquidity Risk.

For purposes of this paper, it will only focus on the liquidity risk, potential loss arising from their inability to fulfil the obligations either to depositors or to the debtor. IFSB in this case aware that Islamic banks have two major types of fund which are (1) Islamic demand deposit or the current account holder or those who hold current account and/or saving account. Islamic bank should guarantee the amount and should repay the fund to the depositor at any time. (2) The Investment Account-IA, which is served by *mudhārabah*, is divided into two types which are (a) Unrestricted Investment Account Holders (UIAHs), is the one who pose the investment account. The salient different of this type of account is that the UIAHs might bear the risk of capital loss if the investment is underperforming. However, IBs are doing “fund pooling” with comingling all of the UIAHs’ funds to various halal financing to give return to them. (b) Restricted Investment Account Holders (RIAHs). This type of account is operated under the *mudhārabah muqayyadah* principle whereas IBs only acting as the brokers to match the need of surplus unit and deficit unit. Consequently, IBs only take a small portion of underwriting fee. In this context, the *shāhibul māl* (surplus unit) is the one who is in charge to control the *mudhārib* (deficit unit) by stating certain business. The main difference between the IA and the demand deposit is sharing the profit as well as the losses.

While the IA needs special treatment according to IFSB 3 and 4. The IA itself raises some governance issues, such as (1) Accountability whereas the IBs are accountable to the IAH in term of how they use the IAH fund. Especially in restricted *mudhārabah* whereby the depositor state some restriction on the investment and Islamic bank must strictly engage with the restriction. (2) Transparency; IBs must be transparent and disclose the income smoothing to

the investment Account Holders (IAHs). They are also must be transparent on the kind of investment policy, make report on the usage of IAH's money and ensure it is based on economic reality, not on "window dressing" to make them happy. (3) Communication; Banks and the IAHs must have intense communication with the management of the investment. They must be provided information by information on their investment. It does not mean that they are given a bulk of information. Banks must be given timely information and only on the essential information like the investment policy and the usage of fund (4) Duty Care and Diligence; In managing the IAHs' fund, the person who is in charge ought to manage the money based on duty care and diligence by carefully investigate the investment opportunities and risk, so he can give considerable rate of profit to the IAHs. In terms of purchasing securities they have to disclose the material information to IAHs like price, transaction party, fee, agent fee earned, etc.

The vicarious monitoring which suggested by Archer and Karim (2009), is the same with the guideline on the IAHs which made by the IFSB. IFSB has come with guiding principles on corporate governance for institutions which offer Islamic financial services. These guidelines encourage IBs to establish a comprehensive governance policy framework which empowers each organ of corporate governance for balancing the IFI accountabilities to various stakeholders. The IFSB 4 guideline comes with an interesting idea, which is an establishment of the governance committee. If we compare its function with the audit committee, the governance committee monitors the performance of board and management from the stand point of the IAHs interest, while audit committee monitors primarily from the standpoint of shareholders. This committee will oversee and monitor the implementation of the governance policy framework by working together with management, audit committee and the SSB (Archer and Karim, 2009).

Archer and Karim (2009) also said that according to sharia jurisprudence, Islamic bank does not guarantee the value of the investment

accounts based on *mudhārabah*. The implication is, IAHs has no power like creditor who has the right of various control, which the creditor obtained by firms default. The right of the creditor includes interfering in the major decision of the firm. The claim of IAHs on the earnings or assets is similar to the claim of the shareholder in the bank earning or assets. Moreover, the *mudhārabah* contract is neither a debt, a conventional equity instrument nor a type of conventional hybrid instrument comprising debt and equity characteristics. Generally speaking, IAHs as *rabbul māl* has no right to involve in day to day investment decision. It is because when they do it, the contract of *mudhārabah* will be void. When concluding the contract of *mudhārabah* for the first time, all the money and the right to control are transferred to *mudhārib*. *Mudhārib*, has the prerogative right to use the fund. He can re-invest it to other business and commingle with his own money to run the business. Otherwise, *mudhārib* should strictly follow the requirements of *rabbul mal* in restricted *mudhārabah* and separate the funds with the shareholder funds particularly (Ameer *et al.*, 2012).

When the yield of investment is positive, the shares of profit are allocated among the parties of the contract, IAHs and the bank, according to the proportionate share. Bank also entitled to any profit earned from investing the funds provided by current accounts as well as a contractual *mudhārib* share of profit allocated to the IAHs as its fee for managing their funds. Again, the bank's profit is generated both from shareholder and other fund investment portfolio that does not participate in profit sharing. Hence the shareholders receive the entire profit from this source and IAHs cannot claim any profit share from them. On the other hand, if the earning of investment is negative, according to the *mudhārabah* contract, the loss should be borne by IAHs and shareholders based on their investments. Like the shareholders, the liability of IAHs is limited to the amount of their investment and no more. In the case of a negative return, in addition to the shareholder's proportion of loss that is determined, a bank in the capacity of *mudhārib* receive no profit sharing fee on

behalf of shareholders. However if the loss is because of misconduct or negligence of the bank, then they should bear the loss (Ameer *et al.*, 2012; Archer and Karim, 2009; Archer and Karim, 2012; Hamza and Saadaoui, 2013).

The Institutional Theory

A standard is created to promote some efficiencies in the business operation which resulted a trust between the stakeholders (Meeks *et al.*, 2009). In the recent Islamic banking practice in Indonesia, some standards have been in place to govern the business operation and to ensure the fulfilment to its stakeholders. Beyond that, Indonesia is also included in the board member of Islamic Financial Service Board (IFSB), Malaysian based institution that concern on the risk as well as governance of Islamic bank (IFSB, 2012; IFSB, 2005; IFSB, 2006; IFSB, 2007). This paper elaborates why Indonesia Islamic banking has not adopted the IFSB standard especially the one that governs market transparency as well as the governance requirement of maintaining investment account. Using the theory that formed by DiMaggio and Powell (1983) regarding the Institutional Theory of Isomorphism, this problem is defined as the pressure that will be faced by an organization to set the rules. The isomorphism comprises three forms of pressure namely (1) coercive, (2) mimetic and (3) normative (DiMaggio and Powell, 1983; Mukhlisin *et al.*, 2015). Coercive means the political pressure that impacts to the organization conforming to some standards while mimetic might be explained as a benchmark that might be used as a role model in the process of compliance with some standards and the normative isomorphism is the pressure that fit in to set the rules from the professional groups (Ekanayake and Perera, 2014; DiMaggio and Powell, 1983).

The Factors Affecting the Adoption to IFSB Standards

Nowadays, in the context of the adoption to IFSB standards of market disclosure and the investment account, there is no legal or political pressure

that has been done by the regulator. The Islamic banking in Indonesia, has been operated under the law No. 21 the year 2008 (Mukhlisin *et al.*, 2015). If we scrutinize that particular law especially on the accounting standard that will be used in the industry, according to the clause 35 verse 2 which stated “*The Islamic Bank is obliged to disclose to BI all material information according to the relevant standard that has been govern with the BI Decree*” (Ministry of Law, 2008).

To some extent, this clause shows how powerful the BI in determining which accounting as well as governance standard that should be used by industry. Thus, BI issues BI Decree No. 14/14/PBI/2012 about Islamic Banking in Indonesia pertaining the transparency and disclosure of the financial statement. On that particular decree, BI coercively asks the Islamic bank to make additional report such as the zakat report, the *qard* funding report and the *mudhārabah muqayadah* report twice a year. Nevertheless, BI does not control the investment account separately to be in line with the IFSB 3 and 4 (BI, 2012). Interestingly, in 2015, Indonesia Financial Authority revised the decree that has been made by BI with OJK Decree No. 6/POJK.05/2015 regarding Transparency and Publications of Financial Statement and still the idea of making a separate disclosure for deposit based on *mudhārabah* is not included in that particular decree (OJK, 2015).

Moving on to the mimetic isomorphism, Indonesia needs a benchmark from other countries which have the same culture as well as social environment who has adopted the IFSB 3 and 4. In this case, in the South East Asia, Malaysia is the only country that has adopted this standard since 2015 by the enactment of the Islamic Financial Service Act 2013 (IFSA 2013). Malaysia established the IFSA in 2013 and gave the Islamic banking to adapt this new standard for 2 years (Hasan, 2014; Rosman *et al.*, 2015; Kunhibava, 2015). The Malaysian case of IFSB 3 and 4, can be used to minimize the uncertainty of compelling the new standard. This mimetic isomorphism will scrutinize deeper on the last section of the research which will discuss the action that to be taken by stakeholders.

Last, the institutional theory also touches on the normative isomorphism whereas in this case, no professional body which is related to Indonesian Islamic banking pushed the industry conforming to the IFSB 3 and 4 in terms of research publications or more practical recommendation like some proposal for deploying the standards (this research might be the first). Finally, based on above explanation, the most influential factor that hinders the adoption of IFSB 3 and 4 is the political factor or in other words, Bank Indonesia has the power to change the industry by making the specific decree for promoting market disclosure and the governance aspect of investment account.

Method

This research operated under the qualitative research with mixed method. This paper is using the critical perspective in the beginning to evaluate and censure the recent Islamic banking practices that still used the *mudhārabah* deposit as the venue of investment and also use the interpretative to give such directions for stakeholders for adopting the model. Moreover, this paper will only use the literature from journal that indexed in DOAJ, accredited journal according to Indonesian Higher Education, EBESCO, SCOPUS, as well as the ABS Journal that contain the topics of irregular deposit, investment account.

This paper also use some standard that has been published by IFSB and AAOIFI regarding the market discipline and investment account. Originality: This paper tries to construct proposed model for Indonesian Islamic Banking to operate under IFSB guidelines.

Result and Discussion

Future Model and The Cost and Benefit

The Islamic Bank funding products now exist under the *mudhārabah* and *wadiah* contract. For the customers who are placed their money under *mudhārabah* contract or in the Indonesian case it is *Mudhārabah* Term Deposit, the return will be higher than the *wadiah* (Ismal, 2011). However, the

mudhārabah is equity partnership contract and not similar to the deposit contract (Archer and Karim, 2012; Archer and Karim, 2009). In this context, IFSB has come up with an interesting solution by defining the nature of Islamic Banking funding product into current account and investment account (IFSB, 2005). Furthermore, IFSB subsequently has made the guidelines to operate the investment account under IFSB 3 and 4 which is basically focused on the market transparency and governance of investment account management to protect the interest of Investment Account Holders (IAHs) (IFSB, 2006; IFSB, 2007). The IAHs in the investment account framework basically is *shāhibul māl* (those who place the fund) and Islamic bank act as *mudhārib* (those who possess the project). In this case, IAHs is not the shareholders. Thus, they can't put their representative to oversee the fund. In these circumstances, the situation of asymmetric information will happen in the future (Ameer *et al.*, 2012). To cater the problem, especially when the IBs adopt the IFSB standards, it needs to construct the model first. Below is the proposed model if Indonesian IBs agree to operate under IFSB 1, 3, and 4:

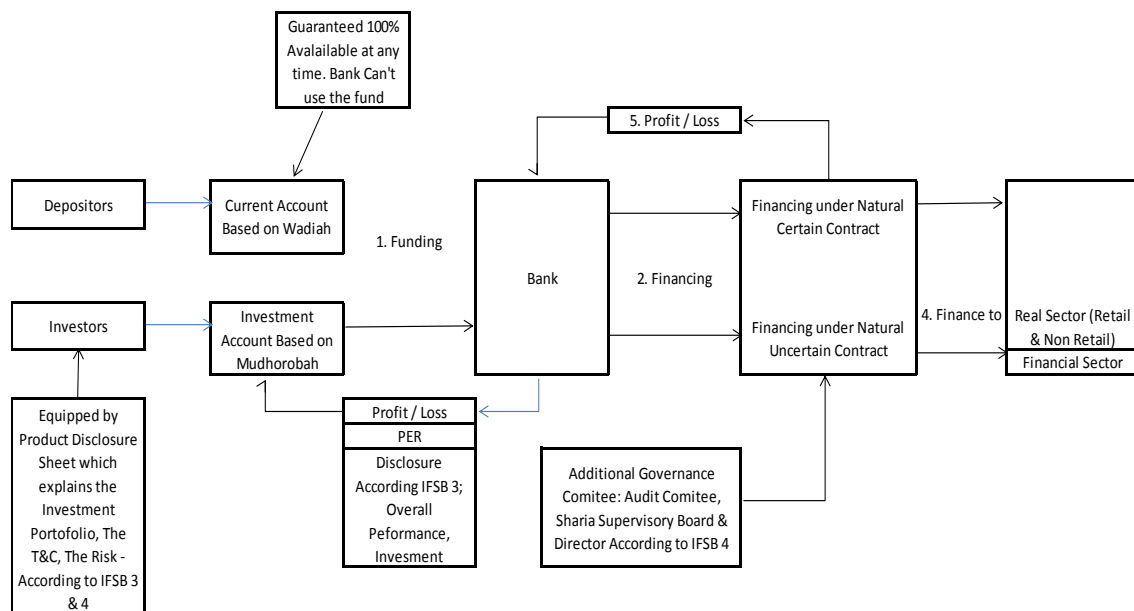


Figure 1. The Proposed Model

Source: Ismal, 2011; IFSB, 2005; IFSB, 2007; IFSB, 2006

From the figure 1, the proposed model is basically taken from the work of Ismal (2011) and then modified with the framework of IFSB 1, 3, and 4 as

well as the theory of deposit. In the first step, the IBs here need to identify the motivation of the customer. IBs might advise the customer to take the deposit product when they only intended to save the money in the bank for saving or transaction purpose to be the depositors. However, if the customer expected more return and risky product or on the other hand want to invest the money, IBs recommend the customer to change the investment account into the Investment Account Holders (IAHs). Here the IAHs is given adequate information before placing the money as well as the fund performance report quarterly. The second step after taking the funds for both depositors and IAHs, IBs in this case will separate the demand deposit with the investment account due to its different nature. Subsequently move to the third step which is channelling the investment account to finance the project with equity partnership contract, buy and sale contract as well as the purchase hire contract. The financing itself, should be aimed at the real sector as the main focus. The bank might invest the money to the financial sector merely for managing the liquidity. The fourth step, IBs might collect the profit or loss from the pool of fund to be shared only to the IAHs. In the fifth step, whether the fund resulting profit or loss, it will be shared. For example, they will share the loss if the funding is underperformed. In this case, IBs might have more weapons to maintain the depositors as well as the investors by deploying the profit equalization reserve (PER) and investment reserve requirement (IRR). Both weapons should be declared in the quarterly report to prevent the displaced commercial risk (DCR).

To transform the Indonesian IBs operation to comply with IFSB 1, 3, and 4, the cost and benefit analysis should be performed. The benefits of IFSB 1, 3, 4 for Indonesian Islamic bank are: First, preventing the occurrence of asymmetric information. Herewith, the appointment of a member of governance committee will become another important point to be explained regarding the asymmetric information. The empowerment of governance committee is to ensure that IAHs right of monitoring the performance of their

investment and associated risks are exercised. The IAHs right to monitor their investment should not be misinterpreted as a right to intervene the managements. The only thing that governance committee should do which is also the need of IAHs is the disclosure of their policies and practices in respect of their investment account. The committee also has a duty to monitor the practice of smoothing return to preserve the transparency in any investing activities done by management as well as ensuring the transparency of financial reporting of the investment accounts. The expectancy of IAHs should be appreciated by conducting a sound investment strategy.

They duty also extend to ensure that the matter of sharia compliancy is really applied. (Archer and Karim, 2009). The member would be preferable for the independent non-executive director which possess skills not only the ability to read and to understand financial statements, but also able to coordinated and to link the complementary roles and functions of the governance committee and audit committee. It will be necessary to put a member of SSB (Sharia Supervisory Board) for the purpose handling sharia- related governance issues if any. Another member, it will be a good addition to have a member which has expertise on legal to cultivate a good corporate governance structure (Archer and Karim, 2009).

Second, preventing the Irregular *Mudhārabah*. Deposit to be more sharia compliance. Again, the nature of *mudhārabah* is purely investment and far from the concept of deposit. In this case, the investment account concept under the contract of *mudhārabah* will omit the irregular deposit since there is no guarantee to repay the principal back as well as paying the profit (Hulsmann, 2004; De Soto, 1995b; De Soto, 1998; Archer and Karim, 2012; Archer and Karim, 2009). Moreover, by shifting the demand deposit product to the *wadiah* contract, it will stabilize the economy since it is fully ready for the customer withdrawal every time.

Third, better education program for the customer as well as educating the customer to understand the sharia investment in the end might increase the

market share by the increase of disclosure of investment account. In this context we can refer to the IFSB 4 regarding market transparency (IFSB, 2007). In IFSB 4 stated that there should be qualitative and quantitative disclosure. The qualitative disclosure mainly focus on the product range, the suitable investors that suit to the product, the experience of the investment managers, the governance arrangement of IAHS funds by declaring the committee, the disclosure that IAHS' Fund is invested in accordance with sharia, the allocation of asset, profit, expenses and the policies regarding the calculation of allocation as well as the profit distribution. On the contrary, the IBs should also give some quantitative information such as the Return on Asset (ROA), the Return on Equity (ROE), the ratio of profit distributed to IA, the total amount of PER and IRR compares to the total of the fund.

On the other hand, the costs of operating the IFSB 1, 3, 4 are as follows: *First*, the new committee should be formed. It is according to IFSB 3, whereas a new committee namely governance committee should be in place to oversee the IAHS' Fund. In this case, the bank should pay the expenses of the new committee. *Second*, new disclosure regime should be operated. IBs should be prepared with the rigorous reporting. This painstaking regime needs more resources like IT as well as the human resources (the investment manager who at the end makes the report). *Third*, Displaced Commercial Risk (DCR). This risk is faced by the bank because of the competition with conventional banks in the dual banking system. It asserted the IBs shareholders to make provision so that they can do income smoothing to prevent *mudhārabah* funding customer migration from IBs to CBs due to the decrease of return. (IFSB, 2005; Hamza and Saadaoui, 2013; Abdullah *et al.*, 2011). In this case, to prevent the DCR the establishment of PER and IRR are urgently needed. However, PER and IRR will strive the bank to maintain their Capital Adequacy Ratio (CAR) (Archer and Karim, 2012). *Forth*, the problem of accounting recognition. Investment account has its unique features. Genuinely, it is not fit if IBs classify it as liabilities since *mudhārabah* is the equity partnership (Rosman *et al.*, 2015). *Fifth*, no guarantee

provided by LPS for the investment account (Archer and Karim, 2012; Archer and Karim, 2009). *Sixth*, the restoration cost will be high, since the recent model of banking will be restructured to the new model and it will incur big cost both for the bank and the regulator (Syamlan, 2016).

Stakeholders Support to Comply with IFSB Standards

Bank Indonesia (BI)

As per above section, BI plays a big role in the development of Islamic banking. In this case, to implement IFSB 1, 3, and 4 BI should make at least circular letter regarding this matter. It is in order to empower the coercive pressure to the industry. BI in this case also should revise the Decree (PBI) to have the investment account in place. The decrees are: PBI No. 10/16/PBI/2008 regarding the revision of PBI No. 9/19/PBI/2007 pertaining to the sharia principle in the funding and service (Anshori, 2008); and PBI No. 10/17/PBI/2008 regarding the funding product for Islamic bank (Anshori, 2008).

Bank Indonesia needs to revise both regulations since in the decree; the *mudhārabah* is written as the *mudhārabah* deposit and should be revised to an investment account that is equipped by PER and IRR. Bank Indonesia in this case should mimic what Bank Negara Malaysia (BNM) has been done regarding the IFSB compliance. What BNM has been done are: Issuing the Islamic Financial Act (2013). Herewith, this is a fundamental law which has been changed the definition of investment account that is before categorized as a deposit into real investment. It is written in section 2 (1) of IFSA 2013 (Kunhibava, 2015; Rosman *et al.* 2015); issuing the Prudential Limits and Standards on Investment Account in march 2014 (Rosman *et al.* 2015); and issuing a standard to operate the PER by the ruling of guidelines number BNM/RH/GL 008-12 in 2008.

Indonesia Financial Authority (OJK)

OJK needs to revise the OJK Decree No. 6/POJK.05/2015 which generally discuss the transparency on the financial report. Herewith, by the enactment of BI decree to push IBs to comply with IFSB guidelines, this POJK should be revised because there is an obligation for the Islamic bank to report general qualitative disclosure quarterly. Also there is an obligation for the Islamic bank to report general quantitative disclosure quarterly. Regarding the risk and investment policy that is used by IBs, OJK does not need to make new decree since it has been already covered in POJK number: 1/POJK.07/2013 regarding the protection of financial sector consumer.

National Sharia Board (DSN)

DSN in Indonesia is somehow independent body that issues the economic fatwa case by case. In this context, if BI decides IBs to comply with IFSB standard, there are no major activities that should be done under the two reasons: DSN has governed the profit and loss sharing in the Fatwa No. 14 and 15 the year 2000 regarding the mechanism to share the profit to depositors/investors. Herewith, the fatwa has stipulated that IBs might choose revenue sharing or profit and loss sharing regarding the operation of *mudhārabah* in IBs. And DSN has issued a Fatwa regarding PER numbered 87-2012. Moreover, DSN Has not made the Investment Rate Reserve Fatwa yet.

Indonesia Accountant Board (IAI)

IAI has a big task to solve the problem regarding the compliance to IFSB 1, 3, and 4. According to Rosman *et al.* (2015) these are the main problems of IFSB 1, 3, and 4: *First*, the investment account is no longer classified as the deposit since IBs would not give a guarantee to repay the money back to the customer as well as the profit. This conclusion is based on the definition of financial liabilities in the Malaysian Financial Reporting Standards (MFRS) 132. Alternatively, according to IAI, the case happens since IAI also define financial liabilities similar to what MFRS do. *Second*, AAOIFI has issued Financial

Accounting Standards No. 6 and give some solution by classifying the investment account as Quasi - Equity. Treating as quasi equity will promote risk sharing between bank and IAHs. Rosman *et al.* (2015) also suggests to all countries that will adopt the IFSB 1,3, and 4 to make focused group discussion that should be attended by auditors, accountants, sharia scholars and the academics to resolve this matter.

Indonesia Deposit Insurance Corporation (LPS)

LPS is established since 1998 by the law No. 10 - 1998. LPS is existed as the result of 1998 financial crisis (Anshori, 2008; Nasution, 2000). However, in the context of investment account, referring to Archer and Karim (2009), there should not be a guarantee from any party if IBs want to operate the real *mudhārabah*. In this case, the law 10-1998 governs that all deposit in the banks which have an amount below IDR 2 Billion should be insured by the LPS for both Islamic and conventional bank. Herewith, if the IFSB guidelines are enacted, the investment account would not be guaranteed by the LPS since it is categorized as an investment and not deposit. Then LPS only will protect the current account.

Conclusion

The main factor that affects the adoption of IFSB guidelines is the political factors that played by Bank Indonesia (BI). In the Law No. 21 - 2008 regarding the Islamic Banking of Indonesia clause 35 stated that Bank Indonesia has coercive power to drive the accounting/governance standard for the Indonesian Islamic banking. However, if the model really deployed in Indonesia, the benefit is accepted more by the customer since they will be educated well by the banks regarding the nature of investment account. Moreover, by limiting the demand deposit that only for safekeeping purpose will stabilize the payment system and transaction. Nevertheless, the cost of operating the IFSB guidelines is not favourable to the IBs since the need of big restoration cost and impact directly to the capital structure. Thus if IFSB

guidelines are used by Indonesian IBs, the Bank Indonesia (BI) should make a decree to state that IBs ought to comply to IFSB Guidelines while Indonesia Financial Authority (OJK) should enact a diktat on the matter of governance of Investment Account product. The National Sharia Board (DSN) only needs to make a new fatwa regarding the Investment Reserve Requirement (IRR). Then The Indonesia Accountant Board (IAI) should ensure whether the investment account is considered as liability or equity as well as the accounting entry. Last, the Indonesia Deposit Insurance Company (LPS) should revise their decree to only guarantee the *wadiah* based product rather than the investment account. All of the stakeholder should communicate intensely to make this model happen. They can study how Malaysia forming the investment accounts as benchmark.

For the future research, it should be conducted with different approach such as using the Analytical Network Process (ANP) with using the Benefit, Opportunity, Cost, and Risk (BOCR). After decomposing the BOCR using ANP, the questionnaire should be given to all stakeholders that are stated in this research to see their opinion on the proposed model.

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