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Re-evaluating Islamic Banking Fatwas in Indonesia: Governance, Legal Certainty, and Global Harmonization in Contemporary Sharia Finance

Muhammad Majdy Amiruddin[1*], Ulfa Hidayati[2], Nur Fitriani Rasyid[3], Arwin[4], Besse Faradiba[5]

[1]Universiti Sains Islam Malaysia, Malaysia. E-mail: 232648@raudah.usim.edu.my
[2]Universitas Hasanuddin, Indonesia. E-mail: ulfahidayati@iainpare.ac.id
[3]Universitas Hasanuddin, Indonesia. E-mail: nurfitriani@iainpare.ac.id
[4]Universitas Hasanuddin, Indonesia. E-mail: arwin@iainpare.ac.id
[5]Institut Agama Islam Islam Negeri Parepare, Indonesia. E-mail: bessefaradiba@iainpare.ac.id

[*]Corresponding Author
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Abstract: The rapid expansion of Islamic finance has intensified scrutiny of how religious authority is institutionalized within modern regulatory systems, particularly in Indonesia where fatwas issued by the Dewan Syariah Nasional – Majelis Ulama Indonesia (National Sharia Board - Indonesian Council of Ulama) become binding only after incorporation into regulations issued by the Otoritas Jasa Keuangan (OJK) or Financial Services Authority. This study aims to re-evaluate Indonesia's Islamic banking fatwa framework by examining its institutional translation mechanisms, degree of alignment with international standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Financial Services Board, and its impact on substantive maqasid realization. Using a qualitative institutional-regulatory design, the research analyzes 42 DSN-MUI fatwas, 27 OJK regulations, 18 AAOIFI standards, 12 IFSB standards, and Islamic banking portfolio data from 2015 to 2024. The findings indicate that Indonesia's hybrid model ensures procedural legal certainty and structured fatwa-to-regulation incorporation but exhibits only partial global harmonization and a persistent dominance of debt-based contracts, reflecting a gap between formal compliance and outcome-based governance. Theoretically, the study introduces the concept of regulatory theology to explain how religious interpretation becomes embedded within the regulatory state, extending norm diffusion theory by incorporating epistemic sovereignty as a mediating variable. Practically, the research recommends stronger institutional independence, clearer codification, measurable maqasid performance indicators, and phased harmonization strategies. The originality of this study lies in reframing Islamic banking fatwa analysis from doctrinal validity toward governance-centered institutional performance grounded in empirical regulatory and portfolio evidence.

Introduction

Islamic finance has evolved into a multi-trillion-dollar industry operating across diverse legal and political systems. However, the rapid globalization of Islamic banking has produced a fragmented regulatory landscape characterized by divergent Sharia interpretations, inconsistent fatwa standards, and competing governance models. This fragmentation creates uncertainty for cross-border transactions and complicates the harmonization of prudential regulation. In particular, the institutional role of fatwa has transformed from classical jurisprudential opinion into a critical governance instrument embedded within national regulatory frameworks. Yet the extent to which this transformation ensures legal certainty and substantive compliance remains contested. This paper critically re-examines the evolving role of fatwas within Indonesia's Islamic banking sector, analyzing their impact on governance, legal certainty, and the prospects for global harmonization amidst an increasingly algorithm-driven financial landscape (Perdana et al., 2025). This analysis will delve into how Indonesia's regulatory environment, particularly the Central Bank's strategies, addresses the ethical and governance challenges posed by algorithmic systems in finance (Perdana et al., 2025).

Indonesia offers a distinctive institutional configuration. Islamic banking fatwas are issued by the Dewan Syariah Nasional – Majelis Ulama Indonesia, but they become legally binding only after incorporation into regulatory instruments issued by the OJK. This dual structure combines religious authority with state enforcement. Unlike centralized models such as Malaysia or market-driven Gulf systems, Indonesia's model reflects a semi-autonomous collaboration between religious scholars and financial regulators. While this structure enhances procedural legitimacy, its implications for governance independence, global harmonization, and *maqasid* realization require systematic evaluation. This paper endeavors to bridge this gap by examining the efficacy of this hybrid approach in fostering a robust, globally integrated, and ethically sound Islamic financial ecosystem, particularly in light of emerging technologies like Artificial Intelligence (W. Setyowati & Rahayu, 2023). Specifically, it will investigate how the Indonesian framework balances the imperative for Sharia compliance with the demands for financial innovation and stability in an increasingly digitalized global economy. The paper will also explore the challenges associated with the uneven application of Sharia principles across various regions, particularly concerning financial innovation and the imperative for standardized governance reforms within the Islamic finance industry (Widiastuti et al., 2025).

The previous research has largely focused on the theoretical aspects of Islamic finance or specific national contexts, often overlooking the complex interplay between traditional fatwa issuance and modern regulatory frameworks, especially concerning technological advancements like artificial intelligence and distributed ledger technologies (R. Setyowati et al., 2019). This paper aims to fill this void by providing an in-depth analysis of the Indonesian dual fatwa issuance and regulatory integration model, assessing its effectiveness in navigating these complexities while promoting both legal certainty and global harmonization. This research will also examine how the Indonesian model can contribute to the development of a more unified and resilient global Islamic financial system, particularly through its approach to Sharia accounting standards and regulatory frameworks (Menne et al., 2023; Rashid & Ghazi, 2021). Furthermore, this study will investigate the implications of incorporating artificial intelligence into sharia advisory roles within the Indonesian context, assessing how such technological integration impacts legal certainty and the global harmonization of Islamic financial practices (R. Setyowati et al., 2019).

This study examines three principal research questions: How are Islamic banking fatwas translated into enforceable financial regulations in Indonesia? To what degree do Indonesian fatwas conform to international benchmarks, such as those promulgated by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Financial Services Board? Does the prevailing fatwa-regulation framework sufficiently achieve *maqasid*-oriented governance beyond mere procedural adherence? Furthermore, this research will analyze the intricate interplay between financial innovation and Sharia compliance within the Indonesian context, assessing how new financial products and services are integrated into the existing regulatory and ethical frameworks (Jan et al., 2021; Menne et al., 2022). The study will also consider the implications of these dynamics for competitive financial reporting and operational efficiency within Sharia business entities, especially SMEs.

This article contributes by reframing fatwa analysis from doctrinal jurisprudence to governance theory. It introduces the concept of regulatory theology to explain how religious interpretation becomes embedded within regulatory state mechanisms. It also proposes a harmonization framework grounded in legal certainty and *maqasid*-based governance. Moreover, it investigates how the Indonesian dual-governance model influences the adoption and ethical implementation of advanced technologies such as Artificial Intelligence within Islamic financial institutions (Oriji et al., 2023) This research also provides a novel perspective on how financial innovation can lead to a more competitive Sharia accounting model, offering rapid and accurate financial statement preparation and presentation, thereby improving the operational efficiency of Islamic business entities, particularly small and medium-sized enterprises (Menne et al., 2023). Such an advanced model is critical given the current fragmented state of Islamic accounting research, which often explores isolated aspects without offering a holistic view, necessitating integrated frameworks that can accommodate financial innovation while adhering to Sharia principles (Alamad, 2023; Menne et al., 2022).

Literature Review

Regulatory Theology

The transformation of fatwa from classical juristic opinion into a regulatory instrument represents one of the most significant institutional shifts in contemporary Islamic finance. In modern financial systems, religious interpretation no longer operates solely within theological discourse but increasingly functions within state regulatory frameworks. The concept of regulatory theology emerges to conceptualize this transformation. Regulatory theology refers to the institutionalization of religious authority within formal governance structures, where fatwa becomes embedded in supervisory regimes and financial regulation. This framework situates fatwa within the broader theory of the regulatory state, recognizing that religious norms interact with administrative law, prudential supervision, and institutional accountability. This dynamic requires a nuanced understanding of how theological principles are translated into enforceable legal and ethical guidelines, particularly within the context of rapidly evolving financial technologies and global economic integration. This transformation necessitates a critical examination of how Sharia accounting models are developed and integrated with financial innovations, ensuring both adherence to Islamic principles and the practical application of cutting-edge technologies to achieve transparency and accountability (Alamad, 2023).

Beyond compliance, regulatory theology acknowledges that Islamic finance operates as a value-laden system. As argued by Alamad (2023), accounting within Islamic finance reflects not merely technical reporting standards but a spiritual-ethical commitment that mediates between economic rationality and religious submission. This perspective suggests that Islamic financial governance cannot be fully understood through conventional regulatory theory alone; it requires an integrated socio-legal approach that bridges jurisprudence and institutional design. This integrated approach is particularly crucial for addressing the complexities arising from the interaction between evolving Sharia accounting models and financial innovations, especially considering the inherent tension between religious values and secular imperatives within financial institutions (Alamad, 2023; Menne et al., 2022) This framework highlights how religious values, such as transparency and fairness, are continuously reshaped and redefined in conjunction with secular economic considerations, viewing accounting as a flexible instrument within theological doctrine to maintain alignment with an organization's religious values (Menne et al., 2022).

Existing scholarship on Islamic finance governance largely falls into three streams. First, jurisprudential studies analyze the doctrinal validity of financial contracts and fatwa reasoning. Second, governance literature examines Sharia Supervisory Boards and institutional accountability structures. Third, regulatory analyses compare centralized and decentralized Sharia governance models across jurisdictions. This article, however, expands beyond these existing classifications by introducing regulatory theology as a lens to analyze the systemic integration of religious interpretation into the state's regulatory apparatus, particularly in the context of emerging financial technologies and accounting practices. This new perspective underscores the imperative for Sharia accounting to evolve dynamically, embracing innovative models that not only ensure regulatory compliance but also enhance transparency and user-friendliness, aligning with the ethical dimensions inherent in Islamic FinTech (Heidari et al., 2024; Heidari & Roubaud, 2024). This approach recognizes that Islamic accounting, through its value-based conceptualization, bridges the spiritual accountability of material resources with the guardianship role of accountants, contributing to an authentic self and a value-based body of knowledge.

However, these studies often treat fatwa either as theological doctrine or as a technical compliance requirement. The institutional transformation of fatwa into quasi-legislative regulatory instruments remains under-theorized. Research tends to emphasize legitimacy and permissibility rather than structural incorporation into the regulatory state. This gap in the literature necessitates a deeper examination of how regulatory theology shapes the implementation of Sharia accounting models, particularly in integrating financial innovations (Menne et al., 2022). This includes understanding how accounting, despite its secular function, is reinterpreted within a religious worldview to serve the sacred objectives of Islamic institutions without being perceived as a threat to their core values (Alamad, 2023). This calls for a re-evaluation of how such models can leverage technological advancements like FinTech, blockchain, and AI to enhance operational efficiency, financial reporting accuracy, and Sharia compliance while maintaining their value-based foundations (Abrahams et al., 2024; Haidari & Roubaud, 2024)

A critical synthesis reveals a conceptual fragmentation. Jurisprudential research prioritizes textual validity but overlooks institutional translation mechanisms. Governance research discusses supervisory independence but rarely interrogates how fatwa functions within regulatory hierarchies. Meanwhile, regulatory state theory seldom incorporates religious authority as a formal governance variable. The missing analytical bridge lies in conceptualizing fatwa as both theological interpretation and regulatory instrument simultaneously. Without this bridge, scholarship cannot adequately explain how religious norms acquire binding force within financial markets or how they shape organizational behavior beyond symbolic compliance. Therefore, a robust framework is required to reconcile the normative underpinnings of Sharia with the practical demands of modern financial regulation, especially concerning the development and implementation of Sharia accounting models that integrate emerging financial innovations (Menne et al., 2023).

This study introduces regulatory theology as an integrative framework that connects Islamic jurisprudence, legal sociology, and regulatory state theory. By situating Indonesian fatwas within institutional translation processes, the research extends beyond doctrinal analysis and reframes fatwa as a governance technology. This reconceptualization allows for systematic evaluation of legal certainty, supervisory independence, and substantive compliance within Islamic banking systems. Specifically, this framework will analyze how attributes of Sharia boards and ownership structures influence the economic, social, and environmental sustainability performance of Islamic financial institutions (Jan et al., 2021). This is particularly relevant given that the attributes of Sharia supervisory boards, such as member expertise and cross-membership, have been shown to positively impact Sharia compliance, especially in unlisted Islamic banks (Mukhibad et al., 2023).

Legal Certainty and Institutional Diffusion

Legal certainty constitutes a foundational principle of financial regulation. In Islamic banking, legal certainty requires predictability of contract enforcement, clarity of supervisory standards, and coherence between religious rulings and statutory regulation. Without institutional coherence, divergent fatwas can generate uncertainty that undermines market stability and cross-border transactions. Norm diffusion theory provides a theoretical lens to understand how global Islamic finance standards influence domestic frameworks. International organizations such as the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Financial Services Board produce standardized guidelines intended to harmonize governance practices (Bassens et al., 2010). Yet diffusion does not imply uniform adoption. Domestic legal systems adapt, reinterpret, and selectively incorporate global norms. This adaptive process often leads to hybrid regulatory frameworks where global best practices are integrated with local legal traditions and religious interpretations, thereby necessitating a deeper analysis of how these interplays influence legal certainty and operational coherence in Islamic financial institutions (Alamad, 2023).

Prior studies on Islamic finance harmonization focus primarily on the divergence between AAOIFI standards and national fatwa bodies. Some scholars argue for strict standardization to enhance cross-border integration (Ercanbrack, 2019), while others defend contextual jurisprudence rooted in local fiqh traditions (Devi & Hamid, 2024). Research on norm diffusion highlights the role of institutional legitimacy and political economy in shaping adoption patterns (Poon et al., 2018). However, much of this literature treats Islamic finance harmonization as a technical regulatory issue rather than as an interaction between religious authority and state sovereignty. This study, therefore, examines how the Indonesian Ulema Council actively engages in a process of regulatory negotiation, selectively incorporating and adapting global Islamic finance standards to align with national legal frameworks and local religious interpretations. This approach provides a nuanced understanding of how global harmonization efforts intersect with the unique institutional qualities and legal systems of individual nations, particularly concerning the development and enforcement of Islamic financial regulations (Mawardi et al., 2024). This framework extends to analyzing how harmonized global halal standards, despite their importance in streamlining trade and enhancing supply chain integrity, face challenges due to inconsistencies in certification criteria and limited cross-border collaboration (Ali et al., 2021).

A critical gap emerges in understanding how legal certainty is constructed through institutional translation. Existing literature insufficiently analyzes the procedural mechanisms through which domestic regulators incorporate or modify international Sharia standards. Moreover, the tension between sovereign interpretive authority and global harmonization remains theoretically underdeveloped. There is limited empirical mapping of how fatwas become codified into enforceable regulation and how this process affects predictability and investor confidence. As a result, the relationship between norm diffusion and regulatory theology remains unexplored. This study endeavors to bridge this gap by examining how Indonesian regulatory theology mediates the adoption of international Islamic finance norms, particularly focusing on the role of fatwas in shaping legal certainty and fostering institutional diffusion within the country's unique regulatory landscape. Specifically, it will investigate how the Indonesian Ulema Council navigates the complexities of global Islamic financial standards while simultaneously upholding domestic jurisprudential considerations, thereby offering a more granular understanding of the dynamics at play in regulatory localization. Furthermore, this analysis will extend to how the Indonesian government's role in improving the Halal Supply Chain through mandatory Halal Certificates on various products highlights the interplay between religious decrees and state enforcement, further emphasizing the need for comprehensive legal frameworks that ensure consistent application and international recognition of these standards (Surjandari et al., 2021)

This study advances the debate by linking norm diffusion theory with regulatory theology. It analyzes not only whether Indonesian fatwas align with global standards, but how alignment is mediated through state regulatory incorporation. By conceptualizing legal certainty as an outcome of institutional translation rather than mere doctrinal clarity, the research offers a governance-based explanation of harmonization dynamics. This approach permits an in-depth examination of how religious authority, mediated by state mechanisms, influences the convergence or divergence of Islamic financial practices from international benchmarks (Rashid & Ghazi, 2021). This perspective is crucial for understanding the evolving landscape of Islamic finance, where the integration of global standards with local jurisprudence is critical for sustainable growth and ensuring adherence to Sharia principles (Akhtar et al., 2023). Further, this research will investigate how the interplay between national regulatory bodies and Sharia boards influences the operationalization of these principles, ultimately impacting the traceability and compliance within the halal supply chain and wider Islamic financial products (Ali et al., 2021). It will also explore how the adoption of artificial intelligence and blockchain technologies can further enhance compliance, transparency, and efficiency within these systems, addressing the complexities of modern financial transactions while upholding Islamic ethical principles.

Maqasid-Based Governance

While permissibility (halal) forms the foundation of Islamic banking, contemporary debates increasingly emphasize maqasid al-shariah as a broader evaluative framework. Maqasid-based governance moves beyond formal contract validation toward assessing socio-economic outcomes, distributive justice, and sustainability. This shift reflects growing concerns that Islamic banking risks replicating conventional financial structures under Islamic nomenclature. Maqasid inte gration requires measurable indicators. Risk-sharing ratios, financial inclusion metrics, and sustainability disclosures become essential tools for evaluating substantive compliance (Dusuki & Bouheraoua, 2011). Governance, therefore, must extend beyond product approval to performance assessment. Scholarship on maqasid in Islamic finance has expanded significantly in recent years (Kiranawati et al., 2023). Many studies critique the dominance of debt-based instruments such as murabaha and advocate greater emphasis on mudaraba and musharaka contracts (Djumadi et al., 2025) Others propose maqasid-based performance indices to measure socio-economic contribution.

However, most maqasid studies remain conceptual or theoretical. Empirical linkage between regulatory structure and portfolio outcomes remains limited. Research frequently calls for reform but rarely analyzes whether existing governance models structurally constrain risk-sharing growth. The literature reveals a disconnect between normative maqasid discourse and institutional regulatory design. Scholars advocate maqasid integration but seldom examine whether supervisory frameworks embed measurable impact assessment mechanisms. Consequently, maqasid often remains aspirational rather than operational. This study aims to bridge this gap by exploring how regulatory frameworks in Indonesia can be enhanced to incorporate Maqasid-based performance indicators, moving beyond mere Sharia compliance to evaluate the broader socio-economic impact and ethical alignment of Islamic financial institutions (Jan et al., 2021).

There is a need for governance-based analysis that evaluates how regulatory theology and legal certainty structures influence substantive financial outcomes. Without this integration, maqasid remains detached from institutional enforcement. This study bridges maqasid theory with institutional regulatory analysis. It evaluates whether Indonesia's hybrid fatwa-regulation model facilitates or constrains risk-sharing expansion and socio-economic objectives. By combining normative alignment analysis with portfolio data examination, the research operationalizes maqasid governance within a measurable regulatory framework. This integration represents a novel contribution to Islamic finance scholarship, shifting maqasid discourse from ethical rhetoric toward institutional performance evaluation. This approach directly addresses the critique of "Sharīʿah arbitrage" by emphasizing substance over form in product offerings, thereby enhancing the credibility and societal alignment of Islamic banks (Kader, 2021).

Methods

This study adopts a qualitative institutional–regulatory research design grounded in structured document comparison. The central objective is to analyze how Islamic banking fatwas in Indonesia are translated into binding financial regulation and to evaluate the degree to which this translation aligns with global Sharia governance standards. Rather than treating fatwa as purely doctrinal legal opinions, this research situates them within the regulatory state framework, examining their transformation into enforceable supervisory instruments. The design integrates four complementary analytical components. First, normative document analysis is employed to extract legal reasoning, contractual structure, and governance provisions embedded within fatwas and regulations. Second, institutional mapping is conducted to trace the procedural pathway through which fatwas issued by the Dewan Syariah Nasional – Majelis Ulama Indonesia become incorporated into regulatory instruments issued by the Otoritas Jasa Keuangan. Third, comparative regulatory analysis is undertaken to evaluate alignment between Indonesian instruments and international standards. Fourth, substantive compliance assessment examines whether regulatory structures translate into measurable shifts in Islamic banking portfolio composition, particularly regarding risk-sharing instruments. The unit of analysis consists of Islamic banking governance instruments issued between 2008 and 2024, a period covering the institutional transition from Bank Indonesia's Sharia supervisory authority to OJK's consolidated financial regulatory framework

This study relies exclusively on qualitative documentary data drawn from three principal categories. First, primary normative data consist of legally authoritative documents governing Islamic banking in Indonesia. These include fatwas issued by the Dewan Syariah Nasional – Majelis Ulama Indonesia concerning major Islamic banking contracts, including *murabaha*, *mudaraba*, *musharaka*, *wakalah*, *ijarah*, and hybrid contractual arrangements. They also include financial regulations issued by the Otoritas Jasa Keuangan that formally incorporate DSN-MUI fatwas into binding supervisory rules. For the period prior to OJK's establishment, Bank Indonesia's Sharia banking regulations between 2008 and 2013 are analyzed to capture institutional continuity and transition. Second, international regulatory standards are used as comparative benchmarks. These include Sharia standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and governance as well as prudential standards published by the Islamic Financial Services Board. Third, institutional and financial data are employed to assess substantive implementation. These data consist of Islamic banking statistical reports published by OJK between 2015 and 2024, annual reports of three major Islamic banks—Bank Syariah Indonesia, BCA Syariah, and Bank Muamalat Indonesia—and publicly available governance disclosures concerning the composition and affiliation of Sharia Supervisory Boards. These materials allow the study to move beyond textual comparison toward institutional and portfolio-level analysis.

The empirical corpus analyzed in this study is extensive and structured. It includes 42 DSN-MUI fatwas directly related to Islamic financial contracts and governance mechanisms. It further examines 27 OJK regulations that explicitly reference or incorporate DSN-MUI fatwas into binding supervisory frameworks. For comparative purposes, 18 AAOIFI Sharia standards and 12 IFSB governance and prudential standards are systematically reviewed. In addition, Islamic banking portfolio data covering the period 2015 to 2024 are analyzed to evaluate long-term trends in contract composition, particularly the proportion of debt-based versus risk-sharing instruments. This broad documentary scope ensures that the analysis captures not only normative alignment but also institutional implementation and financial outcomes across more than a decade of regulatory development.

The analytical process unfolds in four structured stages. First, textual extraction is conducted to identify normative clauses relating to contract structure, ownership requirements, risk allocation, governance obligations, and disclosure provisions within DSN fatwas and corresponding OJK regulations. Second, incorporation mapping traces the procedural and textual pathways through which fatwas are translated into binding regulation.

This stage identifies whether incorporation is direct, adaptive, partial, or merely advisory. Third, an alignment matrix comparison is developed to evaluate the degree of convergence or divergence between Indonesian instruments and standards issued by AAOIFI and IFSB. This matrix systematically compares contract permissibility, governance structures, supervisory independence, and disclosure requirements. Fourth, substantive portfolio analysis examines Islamic banking statistical data to assess whether regulatory structures correlate with measurable trends in risk-sharing instruments such as *mudaraba* and *musharaka* relative to debt-based contracts such as *murabaha*. To enhance analytical rigor, the study applies structured coding across all documents. Coding categories include contract structure, governance requirements, risk allocation mechanisms, disclosure provisions, and *maqasid*-related language. This systematic coding allows for cross-document comparison and minimizes interpretive bias, ensuring that findings emerge from patterned evidence rather than selective textual citation.

Result and Discussion

Results

The analysis reveals that DSN fatwas function as normative templates that acquire binding force only after formal adoption by OJK regulations. However, incorporation varies in depth and textual fidelity. Specifically, direct incorporation often involves verbatim reproduction of fatwa provisions, while adaptive incorporation entails rephrasing or contextualizing fatwa principles to fit existing regulatory frameworks or address specific market conditions.

Table 1. Institutional Translation of Fatwa into Regulation

Fatwa No.	Subject	OJK Regulation Incorporating It	Type of Incorporation	Source Documents
DSN 04/2000	*Murabaha*	POJK No. 24/POJK.03/2015	Direct textual reference	DSN archive; OJK 2015
DSN 07/2000	Mudaraba	POJK No. 16/POJK.03/2014	Substantive adaptation	DSN; OJK regulation
DSN 08/2000	*Musharaka*	POJK No. 36/POJK.03/2017	Partial reference	DSN; OJK
DSN 117/2018	Hybrid contracts	No direct codification	Advisory only	DSN 2018

Most classical contracts are fully codified. Hybrid contracts remain partially advisory, creating legal grey areas. This lack of comprehensive codification for innovative financial products may impede the growth of Islamic fintech, which relies on clear regulatory guidance to foster new AI- and blockchain-based services and ensure Sharia compliance. Furthermore, the absence of codified regulations for emerging financial instruments could hinder open innovation within Islamic finance, potentially limiting job creation opportunities that arise from the development and deployment of novel Sharia-compliant products and services. Alignment analysis indicates partial convergence with AAOIFI standards but divergence in contract structuring details.

Table 2. Comparative Alignment Matrix

Issue	DSN-MUI Position	AAOIFI Standard	Alignment Level	Data Source
Murabaha asset ownership	Permissible after constructive possession	Requires clear asset transfer	High	DSN 04/2000; AAOIFI Std. 8
Tawarruq	Permitted under conditions	Restricted in organized form	Medium-Low	DSN 82/2011; AAOIFI Std. 30
Hybrid contracts	Permissible if no contradiction	Conditional	Medium	DSN 117/2018; AAOIFI
Governance disclosure	General obligation	Detailed governance disclosure	Medium	POJK 2015; IFSB 10

Indonesia aligns structurally but allows more flexibility in certain organized financing models. This approach suggests a pragmatic balance between adherence to global Sharia principles and accommodation of local market practices, particularly regarding instruments like *tawarruq* (cash procurement through commodity sale). Moreover, this nuanced regulatory stance, while fostering market growth, simultaneously introduces complexities in achieving full global harmonization, potentially affecting cross-border investment and product standardization. Analysis of governance disclosures from three Islamic banks reveals overlapping membership between DSN and Sharia Supervisory Boards.

Table 3. Governance Overlap Analysis

Bank	Number of Sharia Supervisory Members	DSN Affiliation	Dual Role Presence	Source
Bank Syariah Indonesia	3	2 affiliated	Yes	BSI Annual Report 2023
Bank Muamalat	2	1 affiliated	Yes	Annual Report 2023
BCA Syariah	2	1 affiliated	Yes	Annual Report 2023

Governance overlap may affect perceived independence though legally permissible. Portfolio data indicates heavy concentration in debt-based instruments. Risk-sharing contracts decline proportionally, indicating substantive *maqasid* gap.

Table 4. Islamic Banking Portfolio Composition 2015–2024

Year	Murabaha (%)	Mudaraba (%)	Musharaka (%)	Ijarah (%)	Source
2015	58%	7%	15%	12%	OJK Statistics 2015
2018	60%	6%	14%	11%	OJK
2021	63%	5%	13%	10%	OJK
2024	65%	4%	12%	9%	OJK

Discussion

Localization vs Global Integration

The findings demonstrate that Indonesia's Islamic banking governance model embodies a form of sovereign contextualization in which religious interpretation retains institutional authority within a state regulatory framework. Fatwas issued by the Dewan Syariah Nasional – Majelis Ulama Indonesia are selectively incorporated into binding regulations promulgated by the Otoritas Jasa Keuangan, producing a hybrid architecture that merges religious legitimacy with administrative enforceability. Comparative analysis, however, reveals only partial alignment with global standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Financial Services Board, particularly in relation to organized *tawarruq* and hybrid contractual structures. This divergence underscores a tension between localized jurisprudential interpretations and the imperative for global harmonization, potentially impacting the interoperability and international competitiveness of Indonesian Islamic financial products.

This pattern suggests that harmonization in Indonesia operates through adaptive translation rather than wholesale standard adoption. While this approach reinforces domestic legitimacy and preserves interpretive sovereignty, it may generate transactional friction in cross-border Islamic finance. Indonesia has thus succeeded in constructing internal regulatory stability, yet its global competitiveness remains contingent upon deeper structural convergence. This is further complicated by the fact that Indonesia's Islamic banking sector, despite positive growth trends and increasing community acceptance, still exhibits a relatively small share and capitalization of assets compared to conventional banking, suggesting that the current regulatory approach might not fully optimize its global potential (Hafidh, 2021). Moreover, the current emphasis on debt-based products, as highlighted in the portfolio composition, signifies a departure from the aspirational equity-based, profit-and-loss sharing models central to the Islamic moral economy, which are crucial for achieving holistic human well-being and mitigating systemic risks (Ghosh, 2023; Kader, 2021).

Within the broader academic debate, these findings complicate the binary opposition between global standardization and local jurisprudential pluralism. Rather than representing mutually exclusive trajectories, harmonization and contextual sovereignty appear as negotiated institutional positions along a spectrum of regulatory integration. The Indonesian case illustrates that Sharia governance cannot be reduced to either strict uniformity or unrestricted diversity; it is instead shaped by the institutional mediation of religious authority within national legal systems. This dynamic process of mediation often involves strategic interpretations that prioritize national economic development and financial stability while maintaining a semblance of adherence to foundational Sharia principles (Badrudin et al., 2025). This nuanced approach to regulatory development often creates internal inconsistencies and potential conflicts with established international best practices, thereby necessitating a re-evaluation of current fatwa applications to ensure greater legal certainty and coherence within the Islamic finance landscape.

Theoretically, this expands norm diffusion theory by introducing regulatory theology as a mediating mechanism through which global standards are filtered, reinterpreted, and domesticated. Harmonization is therefore not a purely technical regulatory process but an epistemic negotiation involving religious authority, state sovereignty, and market integration. Practically, the findings suggest the need for a phased harmonization roadmap focusing on areas with high cross-border impact, thereby enhancing investor confidence without undermining domestic legitimacy. This roadmap could prioritize the alignment of Indonesian fatwas with global consensus on instruments like Sukuk to facilitate broader international market participation and enhance liquidity (Narayan et al., 2022; Trabelsi et al., 2023). Furthermore, adopting advanced technologies, such as blockchain for supply chain integrity and compliance in halal certification, could significantly bolster Indonesia's position in the global Islamic economy (Ali et al., 2021)

The strength of this analysis lies in its institutional mapping of fatwa-to-regulation pathways combined with systematic comparison against international benchmarks. Its novelty resides in reframing harmonization as a theological-regulatory negotiation rather than a compliance exercise. Nonetheless, the study is limited by its documentary focus and does not incorporate interviews with regulators, Sharia scholars, or international investors. Future research could investigate how market actors perceive harmonization gaps and whether such perceptions materially influence capital flows. Additionally, further empirical investigation into the decision-making processes of Indonesian millennial ulamas in utilizing online Islamic knowledge for fatwa generation could offer insights into evolving interpretive methodologies and their impact on regulatory development (Rusli & Nurdin, 2021). Another promising avenue involves exploring the potential of Sharia accounting models, particularly those leveraging financial innovation, to enhance the competitiveness and operational efficiency of Islamic financial institutions, especially small and medium-sized enterprises in Indonesia (Menne et al., 2022).

From Formalism to Governance Reform

The empirical evidence indicates that although Islamic banking fatwas in Indonesia are formally integrated into binding regulations, substantive transformation toward risk-sharing remains limited. The continued dominance of debt-based contracts, particularly *murabaha*, demonstrates that compliance with Sharia form does not necessarily translate into the realization of *maqasid*-oriented outcomes. Institutional design appears to privilege procedural conformity over measurable socio-economic impact. This observation suggests a critical need for a deeper examination of the mechanisms through which Sharia principles are translated into actionable financial products, moving beyond mere formal adherence to a more substantive alignment with the ethical objectives of Islamic finance. This re-evaluation necessitates a shift from a purely formalistic interpretation of Sharia compliance to a governance reform framework that prioritizes the spirit and ethical intent of Islamic law in product development and operational practices.

This suggests that Indonesia's model operates primarily within a compliance-based paradigm of Sharia governance. Fatwa functions effectively as a legitimacy-granting instrument, yet its regulatory embedding has not structurally incentivized greater adoption of equity-based financing modes. The persistence of debt concentration therefore reflects not merely market preference but also regulatory architecture. This necessitates a comprehensive re-evaluation of existing governance structures to foster a more robust integration of *maqasid al-Sharia* into the core operational frameworks of Islamic financial institutions (Jan et al., 2021). Such a re-evaluation should also consider the potential of innovative Sharia accounting models to enhance both compliance and operational efficiency, particularly for SMEs that often face limitations in accessing advanced financial information technology (Menne et al., 2023). This could involve implementing robust Good Amil Governance principles to professionalize zakat management, thereby contributing to increased economic growth and financial inclusion within the broader Sharia economy, especially for underserved populations (Menne et al., 2022; Widiastuti et al., 2025).

In the academic discourse on *maqasid al-shariah*, scholars frequently critique the structural mimicry of conventional finance within Islamic banking systems. However, few studies empirically connect portfolio composition trends to institutional governance design. The present findings contribute to this discussion by demonstrating that regulatory frameworks can indirectly shape financial behavior and product concentration patterns. This highlights the imperative for Islamic corporate governance frameworks to evolve beyond mere compliance, focusing on tangible sustainability performance and the effective integration of sharia economic development within national economic strategies (Jan et al., 2021). This further underscores the necessity of developing robust Islamic corporate governance frameworks that not only ensure financial stability but also promote sustainable development and ethical objectives within Islamic financial institutions (Jan et al., 2021). Such frameworks should emphasize ethical and responsible resource utilization, ensuring investments are directed toward productive and socially beneficial sectors, aligning with the core tenets of Islamic finance (Heidari et al., 2024).

Theoretically, this shifts *maqasid* discourse from normative aspiration to institutional determinism. *Maqasid*-based governance cannot rely solely on ethical exhortation; it requires embedded supervisory indicators and measurable performance metrics within regulatory frameworks. Without structural incentives and disclosure mechanisms, *maqasid* remains aspirational rather than operational. This calls for the development of an Islamic corporate governance framework that extends beyond traditional metrics to incorporate sustainability performance and social impact, thereby ensuring that Islamic financial institutions contribute meaningfully to broader developmental goals (Jan et al., 2021). This entails a re-evaluation of current sustainability evaluation practices to ensure that Islamic corporate governance aligns with the holistic objectives of sustainable development, encompassing economic, social, and environmental dimensions (Jan et al., 2021). This involves designing regulatory frameworks that encourage the adoption of Sharia-compliant financial instruments that genuinely promote risk-sharing and ethical investment, moving beyond mere formal compliance.

From a policy perspective, reform should prioritize clearer codification of fatwa, strengthened institutional independence between fatwa issuance and supervisory roles, and the integration of *maqasid* performance indicators within prudential reporting standards. Embedding measurable benchmarks for risk-sharing and financial inclusion could align regulatory design with substantive Islamic economic objectives. Such a multi-faceted approach could foster a more robust and ethically grounded Islamic finance sector, moving beyond superficial adherence to genuinely embodying the principles of justice, equity, and sustainability in its operations. This might involve developing an Islamic well-being index as a tool for policymakers, fostering national and regional cooperation, especially among OIC member countries (Kader, 2021). Additionally, the development of robust, Sharia-compliant accounting standards is crucial to accurately reflect the socio-economic and religious events and transactions inherent to Islamic finance, distinguishing them from conventional economic reporting (Alamad, 2023).

The principal strength of this finding lies in integrating normative analysis with portfolio-level statistical trends. Its novelty emerges from linking governance architecture to observable financial outcomes. Nevertheless, the study does not employ econometric modeling to establish causal relationships between regulatory design and portfolio composition. Future research could apply quantitative techniques to test whether regulatory reforms correlate with shifts in financing structures over time. Further empirical studies are warranted to explore the impact of specific regulatory interventions on the prevalence of equity-based financing, using methodologies such as difference-in-differences or regression discontinuity designs to isolate causal effects. Moreover, future research should also investigate the influence of interest rate changes and nuanced regulatory practices on the technical efficiency of Islamic banks, recognizing their distinct business models that prioritize risk-sharing and interest prohibition (Akdeniz et al., 2023). This would provide a more comprehensive understanding of the factors affecting their operational performance and their ability to fulfill their socio-economic objectives (Akdeniz et al., 2023).

Toward Harmonized Regulatory Theology

The analysis indicates that Indonesia possesses the institutional capacity to develop a harmonized regulatory theology—one that preserves local jurisprudential legitimacy while enhancing compatibility with global standards. Partial convergence with AAOIFI and IFSB standards suggests that the existing hybrid model can evolve without abandoning its contextual foundations. Indonesia is therefore positioned not merely as a norm recipient but as a potential mediator between global standardization and localized Sharia interpretation. This strategic positioning allows Indonesia to champion a nuanced approach to Islamic finance regulation, one that respects the diversity of Fiqh traditions while promoting greater transparency, stability, and interoperability across jurisdictions. This unique role could facilitate the development of a “harmonized regulatory theology” that balances global best practices with the specific socio-economic and religious contexts of various Muslim-majority nations, fostering a more inclusive and resilient global Islamic financial system (Alamad, 2023).

This development implies that harmonization does not necessitate uniformity. A harmonized regulatory theology would maintain epistemic sovereignty while ensuring procedural compatibility in areas critical to financial stability and cross-border integration. Such a model could offer an alternative to fully centralized systems or fragmented decentralized regimes. This approach would involve leveraging Indonesia's growing influence in global Islamic finance to advocate for a framework that accommodates diverse interpretations of Sharia while promoting universal principles of good governance and risk management (Akdeniz et al., 2023). Furthermore, a harmonized theological framework could mitigate regulatory arbitrage and foster greater investor confidence by providing a consistent, albeit flexible, interpretative lens for Sharia compliance across different jurisdictions. This dynamic approach would allow for the integration of innovative financial technologies into the Islamic finance ecosystem, thereby enhancing financial inclusion and promoting economic empowerment (Heidari & Roubaud, 2024).

Within global Islamic finance scholarship, states are often categorized as either norm takers or norm makers. The Indonesian case suggests a third role: norm mediator. Through selective incorporation and adaptive codification, Indonesia may contribute to shaping evolving global governance standards rather than passively adopting them. This mediating role is particularly significant given Indonesia's substantial and growing Islamic finance market, as evidenced by its robust Islamic securities growth (Ledhem & Mékidiche, 2021), which positions it as a key influencer in developing ethical, socially responsible, and transparent financial instruments globally (Akhtar et al., 2023). This active participation in norm development could lead to a more inclusive and resilient global Islamic financial system, fostering economic growth and financial inclusion, particularly in developing nations (Manawar et al., 2023). This strategic positioning allows Indonesia to champion a nuanced approach to Islamic finance regulation, one that respects the diversity of Fiqh traditions while promoting greater transparency, stability, and interoperability across jurisdictions (Ledhem & Mékidiche, 2021).

Theoretically, the concept of harmonized regulatory theology extends regulatory state theory by incorporating religious legitimacy as a structural component of governance architecture. In Islamic finance, legal validity is inseparable from theological credibility. Institutional design must therefore integrate both dimensions simultaneously to ensure durable legitimacy. This integration ensures that regulatory frameworks not only adhere to international best practices but also resonate with the foundational ethical and moral principles embedded within Sharia, thereby fostering trust and acceptance within the Muslim community. This dual legitimacy, encompassing both technical regulatory efficacy and Sharia compliance, is critical for the long-term sustainability and widespread adoption of Islamic financial products and services. This approach is particularly crucial for unlocking the full potential of Islamic finance in promoting inclusive welfare and economic development, especially in regions with significant Muslim populations where financial inclusion remains a challenge (Hidalgo, 2021) Moreover, the emphasis on religious legitimacy inherently promotes adherence to ethical and moral considerations, aligning with the broader objectives of sustainable development and social justice, which are central to Islamic finance (Testa et al., 2022).

Practically, Indonesia could institutionalize this approach through the development of an integrated Islamic finance governance code, structured regional fatwa harmonization forums, and the introduction of a regulatory *maqasid* performance index. These initiatives would strengthen Indonesia's standing in the global Islamic finance ecosystem. Such a performance index would enable a quantitative and qualitative assessment of how effectively financial products and services align with the higher objectives (*maqasid*) of Sharia, thereby guiding continuous improvement and innovation within the sector. This integrated approach would further solidify Indonesia's role as a leader in balancing traditional Islamic jurisprudence with modern financial demands, facilitating the integration of innovative technologies like blockchain for enhanced transparency and efficiency (Heidari & Roubaud, 2024). Furthermore, the integration of innovative technologies like AI and other digital tools into the Islamic finance ecosystem, coupled with a collaborative approach between regulators and FinTech companies, could drive financial inclusion and economic empowerment by reaching underserved populations (Oriji et al., 2023).

The strength of this contribution lies in synthesizing legal sociology, Islamic jurisprudence, and global regulatory theory into a unified analytical framework. Its novelty is the articulation of harmonized regulatory theology as a forward-looking governance paradigm. However, the framework remains conceptually driven and requires cross-country empirical validation. Comparative studies involving jurisdictions such as Egypt or Malaysia would test its broader applicability and refine its theoretical robustness. Further research could also explore the specific mechanisms through which Indonesian fatwas influence global Islamic finance standards, considering both formal and informal channels of diffusion. Additionally, investigating the interplay between different institutional logics, including those beyond the theological and regulatory, could offer a more nuanced understanding of the complexities influencing the demands placed upon Islamic financial institutions (Testa et al., 2022). Furthermore, an examination of how digital advancements and evolving regulatory landscapes intersect with Sharia principles would provide crucial insights into developing resilient and adaptable Islamic finance ecosystems (Oyewole et al., 2024).

Conclusion

This study demonstrates that Indonesia's Islamic banking governance model represents a distinctive hybrid architecture in which religious authority and state regulation are structurally intertwined. The incorporation of fatwas issued by the Dewan Syariah Nasional – Majelis Ulama Indonesia into binding regulatory instruments promulgated by the Otoritas Jasa Keuangan provides procedural legal certainty and strengthens enforceability within the national financial system. At the same time, alignment with international standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Financial Services Board remains partial and selective. While institutional translation mechanisms are relatively robust, substantive *maqasid* realization remains limited, as evidenced by the continued dominance of debt-based contracts over equity-based risk-sharing instruments. The findings therefore indicate that Indonesia has achieved formal Sharia integration but has yet to fully operationalize outcome-based governance grounded in measurable socio-economic impact.

The principal strength of this study lies in its integrative analytical framework. By introducing the concept of regulatory theology, the research bridges Islamic jurisprudence, legal sociology, and regulatory state theory, offering a governance-centered lens for understanding how religious norms acquire binding force within modern financial systems. The combination of normative document analysis, institutional mapping, and portfolio-level data examination moves the discussion beyond doctrinal legitimacy toward structural performance evaluation. The study's novelty resides in conceptualizing harmonization not merely as technical standard convergence but as an epistemic negotiation between sovereign interpretive authority and global regulatory integration. In doing so, it repositions Indonesia from a passive norm recipient toward a potential norm mediator within the global Islamic finance architecture.

Nevertheless, several limitations must be acknowledged. The analysis is primarily document-based and does not incorporate interview data from regulators, Sharia scholars, or financial practitioners, which could provide deeper insight into institutional dynamics and decision-making processes. In addition, while portfolio data reveal structural patterns, the study does not employ econometric modeling to establish causal relationships between regulatory design and financing composition. Future research should therefore adopt mixed-method approaches, integrating elite interviews and quantitative modeling to test whether governance reforms produce measurable shifts in risk-sharing behavior. Comparative studies involving other jurisdictions, particularly those with centralized Sharia governance structures, would further validate and refine the theoretical construct of harmonized regulatory theology.

In policy terms, the study recommends strengthening institutional independence between fatwa issuance and supervisory roles, developing a consolidated Islamic finance governance code, embedding measurable maqasid performance indicators within regulatory reporting frameworks, and pursuing phased harmonization strategies in areas critical to cross-border transactions. Through these reforms, Indonesia may consolidate legal certainty domestically while enhancing its global competitiveness and contributing constructively to the evolving governance landscape of Islamic finance.

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