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# THE EFFECTIVENESS OF THE ISLAMIC ARBITRATION INSTITUTION IN SETTLING BANKING DISPUTES IN INDONESIA

*by Elza Syarief*

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**THE EFFECTIVENESS OF THE ISLAMIC ARBITRATION INSTITUTION IN SETTLING BANKING DISPUTES IN INDONESIA**

ELZA SYARIEF,<sup>1</sup> RINA SHAHRIYANI SHAHRULLAH<sup>2</sup> AND WINDA FITRI<sup>3</sup>

**ABSTRACT**

The Indonesian government has determined<sup>17</sup> that the Islamic banking disputes can be settled either by the Religious Court or the National Sharia Arbitration Board (*Badan Syariah Nasional/BASYARNAS*). The existence of BASYARNAS is based on Law No.30 of 1999 on Arbitration and Alternative Dispute Resolution, and Law No.21 of 2008 on Islamic (Sharia) Banking. This research questions whether this<sup>18</sup> Islamic arbitral institution can conduct its functions effectively. To answer this question, this research utilises the Effectiveness of Law Theory by Soerjono Soekanto to analyse BASYARNAS and the laws relating to arbitration in Indonesia. Based on the analysis, it was found that laws have supported Islamic arbitration. However, BASYARNAS cannot improve its functions in settling the Islamic banking disputes effectively. This is because Indonesian society (i.e. Islamic bank customers) is not familiar with BASYARNAS as an Islamic arbitration, so they prefer to use courts to settle their disputes. **Keywords:** Islamic arbitration, Islamic banking, BASYARNAS, Indonesia.

**INTRODUCTION**

One of the efforts the Indonesian government is making to develop its national economy is to establish<sup>32</sup> economic system based on Islamic principles, known as the Sharia Economy. The Islamic economic system is based on the values of justice, certainty, benefit, balance and universality. They are embedded in Islamic banking (Elucidation of Law No.21 of 2008 concerning Islamic Banking). One of the principles of Islamic banking is the prohibition of usury. It also adopts the principle of profit sharing and potential risks to create a balance of interests between banks and their customers. Unlike conventional banks which impose 'interest', Islamic banks are prohibited from imposing 'interest',<sup>15</sup> since it is considered as 'usury', which is prohibited by Islamic principles (Elucidation of Law No.21 of 2008 concerning Islamic Banking).

Although the establishment of Islamic banking in Indonesia was preceded<sup>21</sup> by its establishment in the Philippines, Denmark, Luxemburg and the US, the existence of Islamic banking in Indonesia has become stronger due to several factors, namely:

1. A growing awareness among the public about the benefits of Islamic banking and financial institutions;
2. The certainty of banking law in Indonesia that protects Islamic banking;
3. Political support or political will from the government to develop Islamic banking (Pradja, 2015).

Data from the Sharia Banking Statistics of the Financial Services Authority (*Statistik Perbankan Syariah, Otoritas Jasa Keuangan*) from May 2018 records that Indonesia has 13 Sharia Commercial Banks, 21 Sharia Business Units, and 168 Sharia People's Financing Banks (Otoritas Jasa Keuangan, 2018). Although Islamic banking disputes should be avoided as much as possible by banks and their customers, it is necessary to anticipate a dispute resolution mechanism in case a dispute arises. A number of dispute resolution mechanisms can be selected

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by the disputing parties to resolve their disputes, namely negotiation, mediation, conciliation, arbitration and court (Sufriadi, 2011).

Arbitration as one of the dispute settlement mechanisms is governed by Law No.30 of 1999 concerning Alternative Dispute Resolution and Arbitration (Indonesian Arbitration Law). In order to facilitate Islamic economic dispute settlement by arbitration, an Islamic arbitration institution named the National Sharia Arbitration Board (*Badan Arbitrase Syariah Nasional* /BASYARNAS) was established. BASYARNAS constitutes an arbitration institution which is governed by Article 1(8) of the Indonesian Arbitration Law. The article stipulates that 'Arbitration Institution shall mean as a body designated by the parties in dispute to render an award with regard to a particular dispute. This institution may also give a binding opinion concerning a particular legal relationship where a dispute has not yet arisen'.

BASYARNAS is an autonomous and independent arbitration institution. Its establishment was initiated by the Indonesian Ulema Council (MUI) to respond to the development and progress of Islamic economics and banking in Indonesia. The existence of BASYARNAS is also approved by Law No. 21 of 2008 concerning Islamic Banking (Sharia Banking).

In addition to arbitration, Islamic banking disputes can be settled by Religious Court. The jurisdiction of the Religious Court to settle Islamic economic disputes is established by Law No.3 of 2006 concerning Religious Judicature. This Law amended Law No. 7 of 1989 which was subsequently amended by Law No. 50 of 2009. Article 49 letter (a) of Law No.3 of 2006 asserts that the Religious Court has the authority to handle Islamic economic disputes. Article 5 paragraph (1) of Law No. 21 of 2008 concerning Sharia Banking further emphasises that the Religious Court can settle Islamic banking disputes. The decision of the Constitutional Court No.93 / PUUX / 2012 confirms that the Religious Court is the only judicial authority to resolve Islamic economic disputes. Article 1 number 4 of the Supreme Court Regulation No. 14 / 2016 concerning Procedures for the Settlement of Sharia Economic Cases re-confirms the decision of the Constitutional Court No.93 / PUUX / 2012 by declaring that Islamic banking falls within the scope of the Islamic economy; consequently the Religious Court has the authority to settle Islamic banking disputes.

It is obvious that parties to Islamic banking disputes may select either the Religious Court or arbitration, i.e. BASYARNAS, as their dispute resolution mechanism. Statistics on BASYARNAS from 2010–2015 reveal that there were 23 cases submitted to BASYARNAS. This number is slightly higher than those submitted to the Religious Courts (20 cases) (Irfan, Faizin and Muslim, 2017). However, the Secretary of BASYARNAS reported that in the period 2015–2017, no cases were submitted to BASYARNAS. Meanwhile, at the same period, the Religious Court handled six cases relating to Islamic banking (Interview, Secretary of BASYARNAS, 2018). This data leads to the question of why BASYARNAS is not popular among Islamic banks. It brings up the issue of BASYARNAS' effectiveness in settling Islamic banking disputes.

## LEGISLATIVE AND THEORETICAL FRAMEWORK

### Legal sources of Islamic arbitration

Arbitration in Indonesia is governed by various legislation, namely:

1. Article 1 (1) of Law No. 1999 concerning by Law No.30 of 1999 concerning Alternative Dispute Resolution and Arbitration which states that 'Arbitration is a mechanism of settling civil disputes outside the general courts based upon an arbitration agreement entered into in writing by the disputing parties'.
2. Article 59 of Law No. 48 of 2009 concerning Judicial Power which states that 'arbitration is a way of resolving a civil dispute outside the court based on an arbitration agreement made in writing by the disputing parties'.

Indonesia has an arbitration institution which specifically deals with Islamic economic disputes, including Islamic banking, named BASYARNAS. The name is mentioned by the Elucidation of Article 55(2) under Law No.21 of 2008 concerning Islamic Banking (Sharia Banking). It states that 'settlement of dispute is done according to an *Akad* content' and is conducted by the following efforts:

- a. deliberation,
- b. banking mediation,
- c. through the National Sharia Arbitration Board (BASYARNAS) or other arbitration institution, and/or
- d. through a court.

### 18 e Effectiveness of Law Theory

This research utilises the Effectiveness of Law Theory by Soerjono Soekanto because it is relevant to the evaluation of the effectiveness of legal instruments when they are implemented in society. Soekanto (2008) advances five factors as a means to measure the effective implementation of law. Briefly, the question of whether a legal instrument is effective or not in its implementation is influenced by five factors, namely:

1. The legal substance which must contain justice, certainty and utility;
2. Law enforcers who implement the law must be professional and ethical;
3. Legal facilities and means for the implementation of law must be well supported by good organisation, equipment and adequate finance.
4. The society in which the law is implemented must act to achieve harmony among its members;
5. The legal culture of society must contain the society's common values. For example values of morality, sustainability, security and order.

## RESEARCH AIMS AND METHODS

### Research question and objective

The Indonesian Ulema Council Decree No.09 / MUI / XII / 2003 on 24 December 2003 concerning the National Sharia Arbitration Board states that BASYARNAS is the only Sharia arbitration institution in Indonesia that has the authority to examine and decide *muamalah* disputes arising in trade, finance, industry, services, and others'. Although BASYARNAS is privileged as the only arbitration institution to resolve Islamic economic disputes, including Islamic banking disputes, it is not popular among Islamic banks since they still tend to choose the Religious Court to settle their disputes. Hence, this research poses a question regarding the effectiveness of BASYARNAS in performing its functions as the only Islamic arbitration institution in Indonesia. The objective of this research is to evaluate the performance of BASYARNAS in settling banking disputes by utilising the Effectiveness of Law Theory as a tool of analysis.

### 6 Research methods

This research adopts a socio-legal method. Socio-legal research uses secondary data as its initial data, followed by primary data (Zainal and Asikin, 2004). Secondary data includes official documents (legislation), books, and research reports, which are collected through a literature study (Zainal and Asikin, 2004). The secondary data used by this research consists of:

1. Primary legal materials which constitute binding legal materials such as laws and regulations (Marzuki, 2005). They are:
  - a. Law No. 30 of 1999 concerning Alternative Dispute Resolution and Arbitration;
  - b. Law No. 23 of 2008 concerning Islamic Banking (Sharia Banking);
  - c. Law No. 48 of 2009 concerning Judicial Power.



2. Secondary legal materials are those which support and strengthen the primary legal materials by providing an explanation of the existing primary legal materials (Marzuki, 2005). They are legal articles in journals, books, and legal research reports.

Primary data in this research was collected by using the interview method of directly asking structured questions of key respondents (Ashofa, 2001). The respondents are determined via purposive sampling approach, targeting the most competent persons on the topic (Sumardjono, 2001). They are the Secretary of BASYARNAS, Central Jakarta; the Arbitrator of BASYARNAS, Central Jakarta; the Judge of the Central Jakarta Religious Court; and an expert on Islamic economics (Islamic banking). In addition, three Islamic banks were also interviewed. Table 1 shows the questions for the Islamic banks in Jakarta.

**Table 1: Structured questions for Islamic banks**

No.	Respondents
1	How are Islamic banking disputes usually settled?
2	Is BASYARNAS the most appropriate dispute settlement institution to deal with Islamic banking disputes? Why?
3	Which is more efficient in resolving Islamic banking disputes, BASYARNAS or the Religious Court?
4	What are the advantages of using BASYARNAS?
5	What are the disadvantages of using BASYARNAS?
6	What should be done to strengthen BASYARNAS?

Source: Irfan, Faizin, Muslim (2017)

Both primary and secondary data were analysed based on their content (content analysis) by using a qualitative approach to provide a comprehensive picture of the legal aspects relating to the research questions (Amiruddin, 2012).

## RESEARCH FINDINGS AND DISCUSSIONS

### The authority of BASYARNAS in settling Islamic banking disputes

Although BASYARNAS is the only Islamic arbitration institution in Indonesia, as is stated by the Indonesian Ulema Council Decree No. 09 / MUI / XII / 2003, its authority settle Islamic banking disputes stems from the disputing parties' agreement to arbitrate. Article 7 of the Indonesian Arbitration Law stipulates that 'the parties may agree that a dispute which arises, or which may arise, between them shall be resolved by arbitration'. The agreement must be in written form, as is mandated by Article 1(1) and Article 4(2) of the Indonesian Arbitration Law. Briefly, it can be submitted that in the absence of an arbitration clause or agreement, BASYARNAS does not have the authority to resolve Islamic banking disputes. Article 55 paragraph 2 of Law Number 21 of 2008 concerning Islamic banking also emphasises that disputing parties have to enter into an agreement to arbitrate.

An arbitration clause or agreement binds the disputing parties based on the principle of *Pacta Sunt Servanda*. Article 1338 of the Indonesia Civil Code clearly states that:

- Each agreement is binding on the parties;
- The power of binding is similar to the power of law; and
- It can only be revoked by mutual agreement of the parties.

The Indonesian Arbitration Law does not require that an arbitration agreement must be made in the form of a notary deed, yet it must be carefully, clearly and accurately drafted. An unclear arbitration agreement may be challenged or used by one of the disputing parties to move the dispute settlement to the Religious Court (Arifin, 2016). Although the Indonesian Arbitration Law is relied on by BASYARNAS in the process of settling Islamic banking disputes, it also specifically utilises Islamic (Sharia) principles.

### Islamic banking disputes settled by BASYARNAS

As previously mentioned by the Secretary of BASYARNAS, from 1993 to 2017, BASYARNAS handled 27 cases. They consisted of Islamic insurance, capital markets and Islamic banking cases. However, the majority of disputes registered to BASYARNAS pertained to Islamic banking. Two examples of Islamic banking cases are presented in Table 2 below.

**Table 2: Examples of Islamic banking disputes handled by BASYARNAS**

Case Registration Number	Registration Date	Issue	Date of Award	Summary of Award
Perkara Nomor: 02/Tahun 1998/ BASYARNAS / Ka.Jak.	6 August 1998	Financing agreement ' <i>al-bay' bithaman ājil</i> No. 05/1-BDG / BBA-IND / 12/96 dated 5 December 1996. The amount of Rp. 96,386,170	27 March 2000	(1) granting a part of the claimant's (2) declaring guilt on the part of the respondent due to a default against the claimant; (3) declaring all matters that were agreed by the claimant and the respondent in the agreement of <i>al-bay' bithaman ājil</i> to be legal and binding.
Perkara Nomor: 05/tahun 1999/BASYARNAS/Put/Ka. Jak	16 August 1999	The respondent does not perform the obligation to pay loan installments as agreed in the agreement with the bank (Financing agreement ' <i>al-bay' bithaman ājil</i> )	4 November 1999	(1) granting the whole claim; (2) declaring guilt on the part of the respondent due to a default against the claimant; (3) declaring all matters that were agreed by the claimant and the respondent in the agreement of <i>al-bay' bithaman ājil</i> to be legal and binding.

Source: BASYARNAS, 2018

The awards made by the arbitrators of BASYARNAS were mostly honoured by the respondents. However, a small number of awards were not voluntarily implemented by the losing parties. Since BASYARNAS has no executory power, the enforcement of the awards must be conducted by the Religious Court as is mandated by Article 61 of the Indonesian Arbitration Law. The quality of BASYARNAS awards are very much influenced by the competencies of its arbitrators. Today, BASYARNAS has 38 arbitrators who are expert in Islamic economic issues, such as Islamic banking, insurance, trade, investment and securities (interview with the Arbitrator of BASYARNAS, August 2018).

### Islamic banks' responses to the interviews

Interviews with selected Islamic banks in Jakarta reveal that the Religious Court remains the preferred dispute resolution institution for handling Islamic banking disputes, as is shown in Table 3 below.

**Table 3: Islamic banks' responses to the structured questions**

<b>Question 1. How are Islamic banking disputes usually settled?</b>	
Bank Muamalat	If a dispute occurs, it is settled by a consultation. If this fails, it is submitted to BASYARNAS.
Bank Syariah Mandiri	A dispute occurred once regarding a bad credit: it was submitted to the court.
BNI Syariah	In the case of a dispute occurring, it will be submitted to the court, not BASYARNAS.
<b>Question 2. Is BASYARNAS the most appropriate dispute settlement institution for dealing with Islamic banking disputes? Why?</b>	
Bank Muamalat	Consultation is better, but if consensus cannot be reached, the dispute should be submitted to BASYARNAS.
Bank Syariah Mandiri	Settlement of disputes in the court is more secure. If BASYARNAS is used, its awards must be enforced by the court.
BNI Syariah	Theoretically, BASYARNAS is more effective because it is fast and simple. In practice, it is not so because it is quite expensive. <sup>16</sup>
<b>Question 3. Which is more efficient in resolving Islamic banking disputes, BASYARNAS or the Religious Court?</b>	
Bank Muamalat	BASYARNAS is more efficient in settling disputes than the Religious Court.
Bank Syariah Mandiri	BASYARNAS is not the best institution because there is not much information on BASYARNAS. The court is more famous.
BNI Syariah	BASYARNAS cannot be categorised as the best choice in resolving Islamic banking disputes.
<b>Question 4. What are the advantages of using BASYARNAS?</b>	
Bank Muamalat	The award is final and binding, the proceedings are faster and confidential.
Bank Syariah Mandiri	Arbitrators at BASYARNAS are more expert about Islamic banking disputes, the proceedings are not open to public.
BNI Syariah	BASYARNAS' characteristics: confidential, faster, and simple.
<b>Question 5. What are the disadvantages of using BASYARNAS?</b>	
Bank Muamalat	It is more expensive than the Religious Court. BASYARNAS has no bailiff.
Bank Syariah Mandiri	It is more expensive than the Religious Court. BASYARNAS' offices are still limited to big cities.
BNI Syariah	It is more expensive than the Religious Court. BASYARNAS has no executory power.
<b>Question 6. What should be done to strengthen BASYARNAS?</b>	
Bank Muamalat	The enactment of a special law that regulates the absolute authority of BASYARNAS as an institution for the settlement of Sharia economic disputes.



Bank Syariah Mandiri	Progressive socialisation of BASYARNAS.
BNI Syariah	Opening more branch offices.

Source: Interviews in August 2018

### How effectively does BASYARNAS settle Islamic Banking Disputes?

To answer the question above, the Effectiveness of Law Theory, which identifies five factors to measure the effectiveness of BASYARNAS will be used. The factors are:

#### Factor 1. Legal substances which must contain justice, certainty and utility.

The existence of BASYARNAS is governed by Law No.30 of 1999 concerning Alternative Dispute Resolution (Indonesian Arbitration Law) and Arbitration and Law No. 48 of 2009 concerning Judicial Power. It is also supported by the Indonesian Ulema Council Decree No.09 / MUI / XII / 2003 on 24 December 2003 concerning National Sharia Arbitration. Furthermore, the fact that BASYARNAS' arbitration procedures must be completed within 180 days and its award is final and binding fulfils the requirements of the principle of simple and fast under Law No. 48 of 2009 concerning Judicial Power. Hence, it can be said that the legality, certainty and utility of BASYARNAS is supported by legal instruments in Indonesia to effectively carry out its functions.

#### Factor 2. Law enforcers who implement the law must be professional and ethical.

BASYARNAS has 38 arbitrators who have expertise in various Islamic economic fields, for example Islamic banking, insurance, trade, investment and securities. The criteria of the arbitrators fulfils the requirement of the Indonesian Arbitration Law and the needs of current Islamic economic fields. Hence it can be said that arbitrators of BASYARNAS are professional and ethical, to effectively conduct the arbitration processes.

#### Factor 3. Legal facilities and means for the implementation of law must be well supported by good organisation, equipment and adequate finance.

In an interview with Abdul Rasyid, an expert in Islamic banking (interview on August 2018), he revealed that BASYARNAS has not been effective in resolving Islamic economic disputes, including those on Islamic banking. According to him, BASYARNAS has not run optimally because it experiences funding problems, because there are no fixed funds owned by BASYARNAS. Its operational money is only obtained from the costs of case settlement. In addition, it has inadequate facilities and infrastructure. It does not have its own building. It still occupies the same building as the *Dewan Syariah Nasional-Majelis Ulama Indonesia*. A similar sentiment was advanced by Bank Syariah Mandiri when it stated that the BASYARNAS office is still limited to big cities (interview, August 2018). Hence, it can be said that BASYARNAS lacks of facilities to implement its functions effectively.

#### Factor 4. The society in which the law is implemented must act to achieve harmony among its members.

Abdul Rasyid, the expert on Islamic banking (interview on August 2018) revealed that Indonesian society is not familiar with BASYARNAS as an Islamic arbitration, due to limited information regarding BASYARNAS. This is exacerbated by the fact that it does not have its own website, so it is difficult for society to find information about it. According to Euis Nurhasanah, the Secretary of BASYARNAS, it only has 15 representative offices in Indonesia (interview, February 2018). Although Islamic banks in Indonesia may know about BASYARNAS, according to the interviews with Islamic banks, the majority of banks prefer to submit their disputes to the Religious Court instead of BASYARNAS. Bank Syariah Mandiri, as an Islamic bank, asserts that BASYARNAS is not the best institution to settle Islamic banking disputes because there is not much information on BASYARNAS. It is apparent that not only does Indonesian society not recognise BASYARNAS, but Islamic banking society also does not recognise it when it comes to the selection of a forum for dispute settlement. Due

to these circumstances, it can be submitted that BASYARNAS is not effective in implementing its functions because not only the Indonesian public, but also Islamic banking society still has a different approach to the selection of a forum to settle Islamic banking disputes.

**Factor 5. The legal culture of society must contain the society's common values. For example values of morality, sustainability, security and order.**

In addition to the unpopularity of BASYARNAS because of limited awareness of it in the public, Islamic banks still rely on the Religious Court to settle their disputes. Based on the interview with Dr. Isti'anah, M.H (Judge of Central Jakarta Religious Court), in the past five years the Religious Court of Central Jakarta handled five Islamic banking disputes, namely the disputes between:

1. Bank Muamalat and Sukarto Nugroho regarding the execution of mortgage rights;
2. BNI Syariah and PT. A in the field of Property Development, relating to the finance issue in the *Musharakah* contract;
3. Bank Muamalat and Kristan regarding a bad credit;
4. PT. Al-Ijrah and China Chosen Plastic Factory Industries regarding fiduciary claims;
5. BRI Sharia and Electricity Payment Services regarding bad credit.

The majority of Islamic banks interviewed for this research prefer to select the Religious Court instead of BASYARNAS on the grounds that it has no executory power, so its awards must be enforced by the Religious Court. It is quite expensive and it has no bailiff as well. Hence, it can be submitted that it is more common for Islamic banks to resolve their disputes through the Religious Court. The pro-court approach remains a strong culture among Islamic banks even though they admit that the BASYARNAS arbitrators are more expert on Islamic banking disputes than the Religious Court judges. This culture impedes BASYARNAS from carrying out its functions effectively, as is evidenced by the fact that from 2015 to 2017, no cases were submitted to BASYARNAS. Yet, in the same period, the Religious Court of Central Jakarta alone has dealt with five Islamic banking disputes.

Based on the above analysis, it can be summarised that two factors of the Effectiveness of Law Theory are met by BASYARNAS, but it fails to fulfil the requirements of the remaining three factors, as is shown in Table 4 below.

**Table 4: An evaluation of BASYARNAS based on the Effectiveness of Law Theory**

No.	Factor	Effective	Ineffective
1	Legal Substances	Law No.30 of 1999 concerning Alternative Dispute Resolution and Arbitration, Law No. 48 of 2009 concerning Judicial Power, the Indonesian Ulema Council Decree No.09 / MUI / XII / 2003 on 24 December 2003 concerning the National Sharia Arbitration.	
2	Law Enforcers	38 arbitrators with expertise in Islamic banking, insurance, trade, investment and securities.	
3	Legal Facilities		No fixed funds, no own building, in big cities only (15 representative offices).
4	Society		Limited information, no website.

5	Legal Culture		pro-litigation approach, no executory power, expensive, no bailiff.
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Source: Summarised evaluation by the authors

## CONCLUSIONS AND SUGGESTIONS

Based on the discussion above, it can be concluded that although BASYARNAS is supported by a number of legal instruments and their arbitrators are professional, it remains ineffective in carrying out its functions because of its inadequate facilities which make it unpopular in society. It is also worsened by the pro-court culture of Islamic banking society. It is suggested here that to improve the effectiveness of BASYARNAS, there are several approaches to be taken, namely:

1. The Indonesian government should declare that all Islamic economic disputes should be submitted to the Islamic arbitration institution. The function of the Religious Court is merely to enforce the Islamic arbitration awards, since arbitration has no executory power.
2. The number of arbitrators should be increased by giving special trainings relating to Islamic economic disputes. In this regard, BASYARNAS should conduct the trainings with affordable fees.
3. BASYARNAS should start to apply online arbitration to support its Representative Offices. Its own website needs to be established, providing adequate information and an interactive forum.
4. BASYARNAS should collaborate with all Islamic banks, so they can prioritise the use of Islamic arbitration as recourse for their disputes.

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