

## The Effectiveness of Spin off As a Breakthrough in Promoting Islamic Banking in Indonesia

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### Abstract

The Article 68 of Law No. 21 of 2008 on Sharia/Islamic Banking has stipulated the policy of UUS *Splitting* (*Spinoff*) to the Conventional Commercial Bank in Indonesia. This study aimed at determining the effectiveness of this policy based on Friedman's theory of legal system. It is a juridical empirical research with data collection techniques including library research, interview and observation on BNI Syariah and Bukopin Syariah as banks that had been implemented spin off. According to Friedman, three factors to examine the effectiveness of a legal instrument are the structure of law, the substance of law and the legal culture. Based on Friedman's theory the effectiveness of *spinoff* in the context of Indonesia is categorized as less optimal.

**Keywords:** Spin off; Effectiveness; The structure of law; The substance of law and the legal culture.



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### 1.Introduction

The banking system in Islamic finance is based on the concept of profit or loss sharing. The general principle is people who want to earn the profit of the saving shall accept the risk as the same time. Briefly, bank will share its loss if they want the return of capital.

The development of Islamic banking in Indonesia grows significantly after the enactment of the Law No. 21/2008 on Islamic banking. The Article 68 of the law stipulates that the separation of the UUS as one of the efforts to support the development of Islamic banking institution in Indonesia. Article 68 states that:

1. In the event that a Conventional Commercial Bank having UUS, of which its assets value has reached at least 50% (fifty percent) of the total asset value of its Parent Bank or after 15 (fifteen) years since the enactment of this Law, the Conventional Commercial Bank must conduct an UUS Splitting (*spin off*) to turn it into an Islamic Commercial Bank.
2. Further provisions regarding such separation and sanctions for a Conventional Commercial Bank neglecting such Splitting (*spin off*) as considered in paragraph 1 shall be regulated in a Bank Indonesia Regulation.

*Spin off* or splitting is a phenomenon of corporate action conducted by several banks in Indonesia which own Islamic Business Unit or *Unit Usaha Sharia* (UUS). Accordance with Law No. 21 of 2008 on Islamic banking, *Spin off* is an attempt of a bank to split into two or more business entities in accordance with the provisions of laws and regulations. It is one of restructuration methods which opposed the concept of *Merger*. *Merger* is an act to merge two or more business entities into one business entity. *Merger* is usually conducted to strengthen company in terms of capital, assets and others. Meanwhile, *Spin off* is conducted to facilitate the new business entity in order to be reliable in doing a business and to prevent stagnancy of the progress of both Business Unit and Parent Bank if they are in the same legal entity.

The implementation of regulation about UUS *Spinoff* will be initiated by 2023 or 15 years since the enactment of the Islamic Banking Law. It means that the deadline is approaching for the Conventional Commercial Banks to complete the procedure of *spin off* on time. Furthermore, due to the limited time, there is many efforts are done to abide by the law.

However, the efforts are not simple due to some obstacles such as the business unit is not ready to split from its parent bank. In case the UUS Splitting (*spin off*) is implemented, it will potentially lead to the loss of the new Islamic commercial bank, or its incapacity to compete with the parent bank due to imbalance power. Furthermore, there is a provision that the UUS must have at least 50% (fifty percent) of the total asset value of its parent bank, which is also very difficult to be realized because the relation between the parent bank and its UUS in which all the financial reports of UUS is centered in its parent bank so that it is relatively difficult to specifically estimate the asset value of the UUS. In addition, the issue of human resources is also an obstacle for performing *spinoff*.

Inevitably, every policy stipulated by the Law always creates two opposite sides, likewise, the policy regarding with the splitting of Sharia (Islamic) business units (UUS). This policy of *spinoff* must be applied without any exception as there is an indication of several Islamic financial institutions having UUS are unwilling to split their units for various considerations. In the previous study (Yuspin *et al.*, 2017) has succeeded in mapping various forms of UUS *splitting* (*spinoff*) in Indonesia. Furthermore, it assumed that due to the time limit given by the government

to implement the Article 68, this condition potentially leads to frauds or law deviations, including an act called leverage.

The possibility of any law violations in the field is high due to some reasons. Nevertheless, this article aims to reveal the potential deviations against the enactment of Article 68 of the Islamic Banking Law and how to prevent the occurrence of such obstacles.

## 2. Literature Review

The action of refusing the imposition of Article 68 of Law No 21 of 2008 basically will not facilitate the advance of the banking industry or otherwise, because the Article encourages even compels the actors of Sharia/Islamic banking to change the conventional commercial banks having UUS to turn the unit into Sharia/Islamic bank in a short time by considering the market of Islamic banks in Indonesia is very promising and quite successful. Some researchers have discussed *spinoff* and its impacts. One of them is M. Nur Riyanto Al Arif who carried out several studies also Khotibul Umam performed research on the improvement of Sharia adherence through the UUS Splitting (Spin off). However, most of previous studies deal with the economic issues, while the legal effectiveness of *spin off* has never been discussed yet.

Winarta and Frans Hendra (2009) states that "In a legal state, law is the most supreme. All problems must be settled by Law instead of by force or even violence". Nevertheless, the law enforcement in Indonesia is still considered very weak. The principal issue of law enforcement lies on the factors that may affect it. These factors are neutral thus the positive or negative impact lies on the substance of these factors.

To assess the effectiveness of legal system, the theory developed by Friedman and Lawrence (1975) is employed. It argues that the effectiveness and success of law enforcement depends on three elements of the legal system, namely the structure of law, the substance of the law and legal culture. The structure of law relates with the law enforcement apparatus, the substance of law is the law itself, and legal culture is the living law adopted in a society.

1. Factor of the structure of law (Law enforcement) is the parties who create or implement the law. The law enforcement is the role model in the society who should have certain abilities in accordance with the aspirations of the society. They should be able to communicate and obtain attention of the society as well as to run or bring a role that can be accepted by them.
2. Factor of the substance of law, in this term is only limited by the law. Law in the broader sense is the written regulation that is accepted by people in general and made by the legitimate central or local authorities
3. Factor of legal culture is the environment in which the law is applied or implemented. From a certain point, the society can influence the law enforcement because the law is the aspiration of the society to achieve peace in life. The legal (system) culture basically includes the values underlying the applicable law, the abstract conceptions of what is considered good (adopted) and what is considered bad (abandoned).

## 3. Objectives

This study aimed at knowing the effectiveness of *spin off* as a breakthrough in promoting Islamic banking or on the contrary, whether it leads to law deviation.

## 4. Methodology

This research is a juridical empirical research using several techniques of data collection, namely library research, interview and observation on two prominent Islamic banks (Bank Bukopin Syariah and Bank BNI Syariah).

## 5. Result

Based on the survey on Islamic banking industries, the majority stated that they support the policy issued by the government. They have anticipated the implementation of leverage on UUS of Conventional Bank that undergoes spin off. It aims to advance the effectiveness of the performance of Islamic bank.

Related to the enforcement of this policy, which has been running for 10 years or two-thirds of the total time allocation provided to implement the spin off, the result of this policy is actually can be estimated by using Friedman's theory of legal system.

Based on the observation, there are 13 Islamic banks in Indonesia. The latest is Bank Aceh Syariah, which converts its conventional commercial bank into Fully Fledged Islamic bank. These 13 Islamic banks are the results of *spinoff* such as BRI Syariah, Bank Jabar Banten Syariah, BNI Syariah, Bank Syariah Bukopin, BCA Syariah, Maybank Syariah, BTPN Syariah, Bank Victoria Syariah, Bank Panin Dubai Syariah, and Bank Aceh Syariah and direct conversion has been implemented since the issuance of Law No. 21/2008. Furthermore, there are more than 20 UUS is expected to perform *spinoff* by 2023.

## 6. Discussion

Related to the theory developed by Friedman, there are three categories:

The first category is substance of Law is related to the regulation of positive law. Even though the provision of spin off has been regulated in Article 68 of Law No. 21 of 2008 and has been implemented by some conventional

commercial banks, the number is still small. In fact, merely one-third of total conventional banks that already conduct *spinoff* whereas just five years left for them to do splitting. Whether they are ready or not, they have to be ready for it. Quantitatively, the number has not represented the success of the program because it is less than the half of the target while the remaining time is three quarters of the provided time allocation.

The second is structure of Law is examined based on the law enforcement apparatus having authorities to enforce the rule. The law enforcement of *spinoff* has not been conducted because it has not reached the deadline of 2023 or 15 years after the enactment of Law no. 21/2008. Thus, the punishment to the parties that have not implemented *spinoff* cannot be examined. However, based on the role of government, in this context the stakeholders, they currently do not issue any permit to establish UUS. Nevertheless, the UUS is a temporary unit and it will be transformed into Sharia or Islamic bank. Therefore, the government, in this case Bank Indonesia, provides a limitation for it is impossible to apply new UUS submission. If a conventional bank resists submitting a permit for establishing an UUS, it must include a clear road map of when the time design to split and change the UUS into an Islamic commercial bank.

The last is legal culture is examined through the factor of environment and society. The law shows that the society (banking industry) expects the spin off to be a leap for the development of Sharia banks in Indonesia, although it has not demonstrated a significant result. Moreover, there is a discourse of leverage as an alternative of the *spinoff* program. The policy of *spinoff* is opted based on the research that found the capacity of Sharia/Islamic commercial bank to convince the customers/society about the application of Sharia principle and subsequently, to use Islamic bank. It is the background of the policy of *spinoff*. Meanwhile, the Islamic banking industries do not show the same interest hence, the perspective between society and industry is somehow contradictory.

For banking industries, the obligation of *spin off* complicates the development of Islamic bank if the separated UUS has not been prepared well. (Al Arif and Mohammad Nur Rianto, 2014) revealed that only third part funds and interest rate had an impact on the financing growth in spin-off banks. The spin-off policy has an insignificant impact on the financing growth in spin-off banks. Similarly, the study disclosed a result that there is an impact of spin-off policy on the efficiency of spin-off banks. There is an efficiency decrease in spin-off banks after the implementation of *spinoff*. It implies that the policy is not the only strategy. The policy-makers can choose other strategies to enhance the development of Islamic banking industry. Therefore, there is a proposal from the industrial sector to implement leverage instead of the *spinoff*. However, it has not been decided by the government.

Leverage is the distribution of Sharia financing through the branch office of the company. It means that the Sharia/Islamic commercial bank (*bank umum syariah*) will use the branch of conventional bank to offer the Sharia/Islamic products. This system is actually similar to the office channeling that has been applicable currently, despite of its limited on funding. By using leverage model, conventional bank is able to distribute the *Sharia* financing by using *Sharia* contracts and *Sharia* provision.

Leverage is generally can be stipulated in legal rules so that it can be applied in the banking industry, particularly to promote the progress of Sharia banking without the necessity for implementing *spinoff*. Nevertheless, if the implementation of *spinoff* is forced, it will potentially harm the development of Islamic banking in the future. (writer's journal published in Scopus)

Based on the legal effectiveness examined by Friedman's legal system theory, *spinoff* is expected to be a breakthrough in promoting Islamic banking. However, it seems to be less effective in promoting Islamic banking since many difficulties has not been resolved. Even though the rule of law has been regulated, yet the law enforcement cannot be assessed because it has not reached the final deadline. Meanwhile, as an alternative discourse, the concept of leverage is perceived to be capable to substitute the *spinoff*, in which it is more profitable and will support the progress of Sharia banking in Indonesia. However, the main obstacle lies on its absence in a law, hence it cannot be applied in this industry.

## 7. Conclusion

*Spinoff* is an obligation that is regulated in the law. Its implementation is expected to promote the development of Islamic banking in Indonesia and to support its optimal performance. However, some studies found that based on the theory of economy, the establishment of *spinoff* does not help much in improving the effectiveness of Islamic bank. Meanwhile, based on the theory of law effectiveness, the implementation of *spinoff* has not been effective yet. It is based on the three factors in legal system, namely the substance of law, the structure of law and the legal culture, which show that the legal instrument of *spin off* is intended to optimize the development of Islamic banking, yet it cannot be achieved. In accordance with the substance of law, the policy has been running for 10 years, but it has not achieved the target of 50% of UUS Splitting. Meanwhile, based on the structure of law, Bank Indonesia (BI) does not permit any new UUS submission, since it should focus on the implementation of *spinoff* by the conventional banks that have not established it yet. Finally, based on the legal culture, before the deadline of *spinoff* implementation, there is a discourse about the concept of leverage as an alternative to the policy of *spinoff* or the implementation of both *spinoff* and leverage. It means that Islamic bank will be able to use the service provided by conventional bank, both for funding and financing. Nevertheless, the concept of leverage has not been included in the regulation hence it cannot be applied for now.

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