DIGITAL EMERGENCY AND REGULATORY CHANGE IN ISLAMIC MICROFINANCE BETWEEN INDONESIA AND MALAYSIA

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ABSTRACT

The rapid digitalization of Islamic Microfinance Institutions (IMFIs) has generated both opportunities for financial inclusion and new layers of controversy, particularly in relation to Shariah governance, regulatory fragmentation, and consumer trust. This study explores the transformation of Islamic Microfinance Institutions (IMFIs) in response to digital emergencies and shifting regulatory frameworks, focusing on how these changes influence sustainable Shariah compliance. Using a descriptive–explorative qualitative approach, the research examines comparative data from Indonesia and Malaysia through document analysis and digital observation. The findings reveal that regulatory fragmentation, inconsistent fatwa implementation, and limited digital supervision create systemic vulnerabilities that undermine client trust and transparency. Indonesia's decentralized governance structure encourages innovation but weakens regulatory coherence, while Malaysia's centralized model ensures stronger compliance but restricts grassroots flexibility. The study contributes scientifically by framing controversy as a constructive driver of institutional reform, integrating maqāṣid al-sharīʿah ethics with regulatory theory, and proposing an analytical model for harmonizing Shariah governance with positive law in the digital era. However, the research is limited by its qualitative scope, the rapid evolution of fintech policies, and the absence of quantitative validation. Overall, the study advances scholarly understanding of how digitalization, law, and Islamic ethics intersect to foster resilient, inclusive, and ethically sustainable financial ecosystems within the Islamic microfinance sector.

INTRODUCTION

Islamic microfinance institutions (IMFIs) are currently embedded in complex social conditions that extend beyond the immediate effects of the COVID-19 pandemic. One of the most pressing issues is the fragmentation of regulation and Shariah governance, as different jurisdictions adopt heterogeneous standards and Shariah Board practices, which often creates confusion and undermines public trust[1]. This challenge is further compounded by low levels of financial literacy and consumer awareness, where limited understanding of Islamic financial products reduces adoption and confidence, particularly in digitalized services. In many cases, when access to formal IMFIs is constrained, borrowers rely on informal intermediaries, creating patterns of dependency that resemble predatory lending and contradict the social mission of microfinance[2]. Moreover, the complexity of product structures, including multiple contract combinations, contributes to consumer skepticism about the authenticity and benefits of Shariah-compliant offerings. Evidence from recent studies reinforces these concerns: inconsistent governance frameworks remain a fundamental challenge in the Islamic finance industry[3], while empirical work confirms that gaps in financial literacy significantly hinder the acceptance of Islamic fintech[4]. Similarly, research on microcredit highlights how informal intermediation undermines inclusion[5], and comparative analyses show that the complexity and lack of standardization in Islamic finance products fuel consumer doubts[6]. However, previous studies such as Hassan[7] and Mukhibad[8] have primarily addressed governance and literacy dimensions without examining how digital emergency marked by accelerated fintech adoption and regulatory lag reshapes institutional structures and compliance practices in IMFIs. This theoretical gap underscores the novelty of this paper, which reframes controversy not merely as institutional dysfunction but as a potential driver of transformation in Shariah governance. Taken together, these conditions illustrate that the challenges facing IMFIs are not only about external shocks such as the pandemic, but are deeply rooted in structural and social dynamics. They also emphasize the importance of navigating regulatory change and digital transformation under conditions of a "digital emergency," while providing sustainable solutions that enhance Shariah compliance, simplify financial products, and rebuild public trust.

Shariah governance, regulatory adaptation, and technological change as intertwined variables shaping institutional sustainability[9]. Governance fragmentation and regulatory

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[1] Jalalluddin Murad et al., "Untangling the Knots: Navigating the Complexities of Shari'Ah Compliance and Governance in Islamic Finance," *International Journal of Law, Government and Communication* 9, no. 37 (2024): 519–30, https://doi.org/10.35631/ijlgc.937039.

[2] Rabia Batool, "Regulatory Challenges in Sharīʿah Governance in Indonesia," *SSRN Electronic Journal*, 2025, 1–11, https://doi.org/10.2139/ssrn.5258074.

[3] Dewi Fatmawati et al., "Shariah Governance in Islamic Banks: Practices, Practitioners and Praxis," *Global Finance Journal* 51 (2022): 100555, https://doi.org/10.1016/j.gfj.2020.100555.

[4] Muneer M. Alshater et al., "Fintech in Islamic Finance Literature: A Review," *Heliyon* 8, no. 9 (2022): e10385, https://doi.org/10.1016/j.heliyon.2022.e10385.

[5] Beatriz Armendariz de Aghion and Jonathan Morduch, *The Economics of Microfinance, Second Edition*, vol. 1 (The MIT Press, 2010).

[6] Fatmawati et al., "Shariah Governance in Islamic Banks: Practices, Practitioners and Praxis."

[7] M Kabir Hassan et al., "A Survey on Islamic Finance and Accounting Standards," *Borsa Istanbul Review* 19 (2019): S1–13, https://doi.org/10.1016/j.bir.2019.07.006.

[8] Hasan Mukhibad et al., "Open Innovation in Shariah Compliance in Islamic Banks – Does Shariah Supervisory Board Attributes Matter?," *Journal of Open Innovation: Technology, Market, and Complexity* 9, no. 1 (2023): 100014, https://doi.org/https://doi.org/10.1016/j.joitmc.2023.100014.

[9] Muhammad Naveed Aslam, Abdul Rashid, and Abdul Karim Usman, "Evaluating the Governance Framework of Islamic Microfinance Institutions (IMFIs) in Pakistan and Its Compatibility with the Federal Shari'at Court Judgment," *Islamic Banking & Finance Review (IBFR)* 9, no. 2 (2022): 1–18, https://doi.org/10.32350/ibfr.92.04.

uncertainty are associated with controversies over Shariah compliance, where heterogeneous interpretations of Islamic law lead to divergent practices and erode public trust[10]. In contexts of financial inclusion, digital transformation is increasingly framed as both an opportunity and an emergency response to structural limitations of IMFIs, enabling broader outreach but also creating risks of exclusion for digitally marginalized clients[11]. Additionally, literature on Islamic FinTech emphasizes that adoption is conditioned by literacy levels, technology acceptance, and visible Shariah assurance, all of which determine consumer trust in microfinance products[12]. The dynamics of regulatory change further complicate this landscape, as overlapping national and international frameworks constrain standardization and hinder the scalability of IMFIs[13]. However, there remains a gap in the literature that specifically investigates how IMFIs navigate digital emergencies while simultaneously addressing controversies in governance and regulatory transformation. Few studies have positioned IMFIs as critical nodes where Shariah compliance, digitalization, and socio-economic resilience intersect. Therefore, this study contributes to expanding the discourse by situating IMFIs as a field of institutional transformation, where controversy can be reframed into sustainable Shariah-compliant solutions.

This paper aims to examine how Islamic microfinance institutions (IMFIs) navigate the intersection of controversy, regulatory change, and digital emergency not only as operational challenges but also as transformative opportunities to strengthen sustainable Shariah compliance. Generally, this research responds to the limited scholarly attention given to the ways in which IMFIs adapt to fragmented governance systems, rising digitalization pressures, and shifting socio-economic demands in Muslim communities. Specifically, this paper analyzes how regulatory inconsistencies, technological disruptions, and governance debates trigger both latent and explicit forms of institutional tension within IMFIs. The once stable financial architecture of microfinance now experiences a symbolic rupture, as digitalization and regulatory reforms simultaneously open new possibilities while polarizing interpretations of Shariah authenticity. This study also explores how intra-institutional and cross-country differences in Shariah governance frameworks construct new boundaries of compliance, legitimacy, and trust. Thus, this research contributes to offering a new approach to understanding the relationship between controversy, transformation, and sustainability in the evolving landscape of Islamic microfinance.

Through this approach, the study not only contributes theoretically to the development of contemporary Islamic microfinance and Shariah governance literature but also supports efforts to strengthen the institutional capacity of IMFIs in navigating regulatory change and

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[10] Hafij Ullah, "Shari'ah Compliance in Islamic Banking: An Empirical Study on Selected Islamic Banks in Bangladesh," *International Journal of Islamic and Middle Eastern Finance and Management* 7, no. 2 (June 2014): 182–99, https://doi.org/10.1108/IMEFM-06-2012-0051; Batool, "Regulatory Challenges in Sharīʿah Governance in Indonesia."

[11] Mustafa Raza Rabbani, Shahnawaz Khan, and Eleftherios I. Thalassinos, "FinTech, Blockchain and Islamic Finance: An Extensive Literature Review," *International Journal of Economics and Business Administration* 8, no. 2 (2020): 65–86, https://doi.org/10.35808/ijeba/444; Florentina Kurniasari et al., "The Role of Financial Technology to Increase Financial Inclusion in Indonesia," *International Journal of Data and Network Science* 5, no. 3 (2021): 391–400, https://doi.org/10.5267/j.ijdns.2021.5.004.

[12] Ayman Abdalmajeed Alsmadi, "Beyond Compliance: Exploring the Synergy of Islamic Fintech and CSR in Fostering Inclusive Financial Adoption," *Future Business Journal* 11, no. 1 (2025): 7, https://doi.org/10.1186/s43093-025-00430-z; Rahmawati Muin et al., "The Evolution of Islamic Finance in the Digital Age: Analyzing Asset Growth Patterns and Stakeholder Attitudes in Emerging Market Economies," *International Journal of Innovative Research and Scientific Studies* 8, no. 2 (2025): 3311–22, https://doi.org/10.53894/ijirss.v8i2.6001.

[13] M. Kabir Hassan and Sirajo Aliyu, "A Contemporary Survey of Islamic Banking Literature," *Journal of Financial Stability* 34 (2018): 12–43, https://doi.org/10.1016/j.jfs.2017.11.006.

digital transformation. By situating controversy as a catalyst for constructive reform, this research enriches the discourse on how fragmented governance can be reframed toward harmonized and sustainable practices. Practically, the findings provide pathways for policymakers, regulators, and practitioners to enhance financial literacy, improve digital inclusivity, and ensure stronger compliance mechanisms within IMFIs. In accordance with the principle of hifz al-māl within the maqāṣid al-sharī'ah framework, the study underscores the protection of wealth and trust as core objectives, thereby offering both conceptual innovation and actionable solutions for safeguarding Muslim communities in the era of digital emergency.

METHODS

This study employs a qualitative approach with a descriptive explorative design to gain an in-depth understanding of the dynamics of controversy, transformation, and compliance in IMFIs. This approach is selected because it is suitable for exploring meanings, governance discourses, and organizational practices that cannot be captured through numerical indicators alone, as emphasized by Creswell and Poth (2018). In this approach, IMFIs are positioned as institutional spaces in which religious values, economic interests, and digital technologies converge, producing layered meanings and contested practices. The goal of this design is to reconstruct how IMFIs transform under pressure, rather than merely describing their surface-level operational adjustments. The rationale for using qualitative methods lies in the complex interplay between religious frameworks, economic policies, and technological infrastructures that define IMFIs. Instead of generalizing across institutions, this study prioritizes contextual and in-depth analysis of case-specific practices and discourses emerging in digital and regulatory spaces.

The research process begins with identifying several cases of digital adaptation and regulatory reforms in IMFIs across Southeast Asia, with a particular focus on Indonesia and Malaysia, where IMFIs are both widespread and heavily regulated. This process continues with mapping institutional discourses, governance structures, and digital initiatives that display signs of controversy or adaptation under pressure. The main focus is to uncover the institutional logics constructed through regulatory texts, Shariah board decisions, and digital innovation practices. This mapping is conducted over one month using document analysis and cyber-observation of IMFIs' digital platforms.

The primary information sources in this research come from three types of data: (1) regulatory documents such as Shariah governance frameworks, central bank regulations, and fatwa guidelines; (2) digital platforms operated by IMFIs, including mobile applications, websites, and social media accounts; and (3) secondary reports such as industry white papers, news articles, and academic publications. In the digital era, online regulatory and institutional data are recognized as valid sources for capturing organizational practices and discourses[14]. Therefore, this study utilizes open-access sources such as official websites, financial reports, and public statements of IMFIs, supplemented with digital traces from social media and mobile platforms. These data reflect both the formal and symbolic dimensions of transformation, recording how IMFIs perform compliance, digital adaptation, and trust-building within their communities.

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[14] Dhiraj Murthy, "Digital Ethnography: An Examination of the Use of New Technologies for Social Research," *Sociology-the Journal of The British Sociological Association - SOCIOLOGY* 42 (October 2008): 837–55, https://doi.org/10.1177/0038038508094565.

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DISCUSSION

Comparative Context: Indonesia and Malaysia in IMFIs' Digital and Regulatory Transformation

Compared with Malaysia, Indonesia's Islamic microfinance landscape reflects a pluralistic, community-based governance model that has struggled to translate rapidly evolving digital delivery into harmonized regulatory oversight. In Indonesia, a large share of IMFIs operate as Baitul Maal wat Tamwil (BMT) or cooperative entities governed by Law No. 1/2013 on Microfinance Institutions and Law No. 17/2012 on Cooperatives, resulting in fragmented supervisory responsibility shared across the Ministry of Cooperatives and SMEs, OJK, and DSN-MUI. This multi-agency architecture has produced regulatory grey zones where many BMTs remain outside full financial-sector supervision, and where digital innovations—such as app-based murābaḥah financing and online savings platforms—often outpace formal oversight[15]. Conversely, Malaysia combines formal integration of microfinance within the regulated Islamic finance sector and a clearer Shariah governance architecture: Bank Negara Malaysia's (BNM) Islamic Financial Services Act 2013 (IFSA) and Shariah Governance Framework 2019 (SGF) require each licensed institution to maintain Shariah Committees endorsed by BNM, supported by a national-level Shariah Advisory Council[16]. Digital innovation in Malaysia—particularly microTakaful and fintech-based zakat platforms—operates within regulatory sandbox environments that balance flexibility with compliance. Comparative data show that Malaysia's centralized model produces stronger Shariah audit trails, higher product disclosure, and greater consumer trust than Indonesia's decentralized cooperative model[17].

The evidence suggests that while Indonesia's model is pluralistic and inclusive, it struggles with harmonization and digital supervision. Meanwhile, Malaysia's model is centralized and compliance-oriented, ensuring legal clarity but sometimes limiting innovation among small, community-based IMFIs. These differences imply that Indonesia could benefit from Malaysia's structured Shariah audit and sandbox mechanisms, while Malaysia might draw from Indonesia's participatory approach to preserve community inclusivity. Integrating these lessons could enhance regional resilience and align digital transformation with maqasid al shariah principles of hifz al-māl (protection of wealth) and 'adl (justice).

Table 1. Comparative Overview of Digital and Regulatory Transformation in IMFIs (Indonesia vs. Malaysia)

Aspect	Indonesia	Malaysia	Comparative Insight

[15] Muhammad Issyam Itam, Rusni bt Hasan, and Syed Musa Alhabshi, "Shariah Governance Framework For Islamic Co-Operatives As An Integral Social Insitution In Malaysia," *Intellectual Discourse* 24 (2016), https://doi.org/https://doi.org/10.31436/id.v24i0.930; Mukhibad et al., "Open Innovation in Shariah Compliance in Islamic Banks – Does Shariah Supervisory Board Attributes Matter?"

[16] Bank Negara Malaysia, "Shariah Governance Licensed," 2019; Murat Yaş, *Legal and Regulatory Issues of Islamic Finance in Turkey: A Qualitative Discussion*, *Journal of Central Banking Law and Institutions*, vol. 2, 2023, https://doi.org/10.21098/jcli.v2i3.169.

[17] Andi Marwah, Nasrullah, and Abdul Syatar, "Integrating Maqashid Al-Shariah into Islamic Economic Practices: A Contemporary Analytical Framework and Its Applications," *El-Kahfi: Journal Of Islamics Economics* 06, no. 01 (2025): 37–44, https://doi.org/0.58958/elkahfi.v6i01.456; Nur Laili Ab Ghani, Noraini Mohd Ariffin, and Abdul Rahim Abdul Rahman, "The Extent of Mandatory and Voluntary Shariah Compliance Disclosure: Evidence from Malaysian Islamic Financial Institutions," *Journal of Islamic Accounting and Business Research* 15, no. 3 (March 2023): 443–65, https://doi.org/10.1108/JIABR-10-2021-0282.

Legal Framework	Law No. 1/2013 on Microfinance; Law No. 17/2012 on Cooperatives	Islamic Financial Services Act (IFSA) 2013; BNM Shariah Governance Framework (SGF) 2019	Malaysia's framework integrates Islamic microfinance under central supervision; Indonesia's legal base remains fragmented between cooperative and financial laws.
Supervisory Authority	Ministry of Cooperatives, OJK, DSN-MUI (overlapping)	Bank Negara Malaysia (centralized) and National Shariah Advisory Council	Centralized oversight in Malaysia enhances accountability; Indonesia's multi-agency approach causes jurisdictional ambiguity.
Shariah Governance	Local SSBs guided by DSN-MUI, with capacity disparities	Institutional Shariah Committees under BNM's oversight	Malaysia enforces harmonized fatwa interpretation; Indonesia shows variable local application.
Digital Regulation / Sandbox	Limited pilot projects under OJK innovation hub	Established regulatory sandbox for Islamic fintech and microTakaful	Malaysia offers structured experimentation space; Indonesia lacks comprehensive digital testing mechanisms.
Disclosure and Transparency	Uneven cost disclosure, hybrid contract ambiguity [18]	Mandatory contract clarity and digital disclosure standards [19]	Malaysia enforces transparency through IFSA; Indonesia's cooperative model relies on voluntary standards.
Consumer Trust & Inclusion	Community trust-driven; vulnerable to digital confusion and low literacy	Institutional trust supported by audit and supervision	Malaysia leads in consumer confidence; Indonesia excels in grassroots participation and outreach.

[18] Mukhibad et al., "Open Innovation in Shariah Compliance in Islamic Banks – Does Shariah Supervisory Board Attributes Matter?"

[19] Malaysia, "Shariah Governance Licensed."

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The comparative overview in Table 1 illustrates the divergent regulatory and digital development of Islamic Microfinance Institutions (IMFIs) in Indonesia and Malaysia. In terms of the legal framework, Indonesia's Islamic microfinance sector operates under fragmented laws—Law No. 1/2013 on Microfinance and Law No. 17/2012 on Cooperatives—which separate cooperative management from financial oversight. Malaysia, by contrast, enforces an integrated legal framework through the Islamic Financial Services Act (IFSA) 2013 and the Shariah Governance Framework (SGF) 2019 issued by Bank Negara Malaysia (BNM). This harmonized approach facilitates consistent regulatory supervision, while Indonesia's dual structure often results in overlapping jurisdictions and limited enforcement[20].

Regarding the supervisory authority, Indonesia's oversight involves multiple agencies, including the Otoritas Jasa Keuangan (OJK), the Ministry of Cooperatives, and the Dewan Syariah Nasional–Majelis Ulama Indonesia (DSN-MUI), leading to coordination challenges and jurisdictional ambiguity. Malaysia maintains centralized regulation under BNM and the National Shariah Advisory Council (NSAC), ensuring unified standards for Islamic finance operations[21]. The contrast highlights how Malaysia's centralized governance enhances institutional accountability, while Indonesia's fragmented structure limits effective regulatory monitoring.

In the area of Shariah governance, Indonesia's IMFIs rely on local Shariah Supervisory Boards (SSBs) that follow DSN-MUI guidance but vary in capability and interpretation, whereas Malaysia mandates institutional Shariah Committees under BNM's supervision, promoting standardized compliance[22]. This consistency has allowed Malaysia to sustain uniformity in Shariah compliance across financial entities, unlike Indonesia, where local contextualization may create inconsistency in fatwa application.

With respect to digital regulation and innovation, Malaysia exhibits stronger structural support through a regulatory sandbox framework designed for Islamic fintech and micro-Takaful experimentation. In contrast, Indonesia's OJK has piloted limited innovation hubs but without a specific sandbox for Islamic digital finance[23]. Malaysia's proactive digital ecosystem enables controlled innovation, better risk assessment, and increased investor confidence in Islamic fintech ventures (Muneeza et al., 2022).

In terms of disclosure and transparency, Indonesia shows uneven contract clarity and non-standardized cost disclosure, particularly in hybrid contracts that mix conventional and Islamic principles[24]. Malaysia enforces clear digital disclosure and consumer protection standards through IFSA 2013 and SGF 2019, ensuring higher market confidence and institutional trust[25]. Finally, the consumer trust and inclusion dimension reveals Indonesia's

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[20] Istianah Zainal Asyiqin, "Legal Framework Synergy : Indonesia and Malaysia ' s Role in Advancing Islamic Fintech Regulations," *Indonesian Comparative Law Review* 7, no. 2 (2025): 102–15, https://doi.org/10.18196/iclr.v7i2.25451.

[21] Aulia Arifatu Diniyya, Mahdiah Aulia, and Rofiul Wahyudi, "Financial Technology Regulation in Malaysia And Indonesia : A Comparative Study," *Journal of Islamic Economics,Finance,And Banking*, 2020, 67–87, https://doi.org/10.12928/ijiefb.v3i2.2703 Financial.

[22] Ibraheem Musa Tijani, Rusni Hassan, and Wan Amir Shafiq bin abi Ab Nasir, "Shariah Governance for Islamic Microfinance Industry Tadbir Urus Bagi Industri Kewangan Mikro Islam," *Journal of Islam in Asia* 17, no. 2 (2020): 2–21, https://doi.org/10.31436/jia.v17i2.957.

[23] Dwi Fidhayanti, "Regulatory Frameworks In Islamic Fintech : Comparative Insights From Indonesia And," *Jambura Law Review* 7, no. 02 (2025): 664–95, https://doi.org/10.33756/jlr.v7i2.30447.

[24] Mukhibad et al., "Open Innovation in Shariah Compliance in Islamic Banks – Does Shariah Supervisory Board Attributes Matter?"

[25] Asyiqin, "Legal Framework Synergy : Indonesia and Malaysia ' s Role in Advancing Islamic Fintech Regulations."

grassroots strength—community-based trust and outreach—but also vulnerability due to low digital literacy and limited protection mechanisms. Malaysia, on the other hand, benefits from institutional credibility supported by regulatory audits and consistent supervision, promoting higher digital financial inclusion[26].

Overall, Malaysia presents a centralized, digitally progressive, and Shariah-consistent model for Islamic microfinance transformation, while Indonesia emphasizes community inclusion and social participation but faces persistent issues in digital readiness and regulatory harmonization. These findings align with regional trends identified by Hadiyan And Azman[27] and Asyiqin[28], who note that Malaysia's integrated governance accelerates Islamic financial digitalization, while Indonesia's cooperative model requires structural consolidation to improve compliance and consumer confidence.

Shariah Perspective on Controversy in IMFIs

Studies on Shariah governance (SG), institutional legitimacy, and digital transformation in Islamic finance reveal an evolving conceptual discourse in contemporary scholarship. Since the introduction of Shariah governance frameworks by the International Financial Services Board (IFSB)[29], academic approaches have expanded into variables of Shariah Supervisory Board (SSB) characteristics, internal Shariah review and audit mechanisms**,** and disclosure or transparency dimensions[30]. In the context of Islamic Microfinance Institutions (IMFIs), digitalization has magnified these variables by forcing institutions to adapt contracts, pricing, and compliance processes into digital platforms. This has generated both opportunities for transparency and new controversies around hybrid contracts, fragmented fatwas, and client confusion. On the other hand, the digital mediation of Shariah governance introduces new forms of institutional accountability where compliance is no longer monitored only by regulators and SSBs, but also by digitally literate clients in social media spaces[31].

Comparative dimension: Indonesia vs Malaysia

When viewed through a comparative lens, the Shariah governance challenges and opportunities in Indonesia and Malaysia take on differentiated contours. In Malaysia, institutions operate within a relatively mature shariah governance architecture: a two-tier model of institutional-level SSBs under central oversight, designated Shariah control

[26] Nur Hazirah Binti Hamdan and Salina Hj Kassim, "The Effects Of Islamic Microfinancing, Human Capital And Ict Usage On Women Micro-Entrepreneurs' Performance In Malaysia," *Journal of Islamic Monetary Economics and Finance* 8 (2022): 125–152, https://doi.org/10.21098/jimf.v8i0.1421.

[27] Nik Hadiyan and Nik Azman, "Sharī ʿ Ah-Compliant Fintech Usage Among Microentrepreneurs In Malaysia : An Extension Of Utaut Model" 8, no. 2 (2022): 305–24, https://doi.org/10.21098/jimf.v8i2.1417.

[28] Asyiqin, "Legal Framework Synergy : Indonesia and Malaysia ' s Role in Advancing Islamic Fintech Regulations."

[29] IFSB, "Revised Standard on Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services (IFSB-22)," *IFSB Standards*, 2018.

[30] Iwan Fakhruddin and Mohd Abdullah Jusoh, "Influence of Sharia Supervisory Board Characteristics on the Shariah Compliance," in *5th International Conference on Community Development*, vol. 231, 2018, 355–57, https://doi.org/10.2991/amca-18.2018.97; Naji Mansour Nomran and Razali Haron, "A Systematic Literature Review on Sharī'ah Governance Mechanism and Firm Performance in Islamic Banking," *Islamic Economic Studies* 27, no. 2 (February 2020): 91–123, https://doi.org/10.1108/IES-06-2019-0013; Rifqi Muhammad et al., "The Influence of the SSB's Characteristics toward Sharia Compliance of Islamic Banks," ed. Collins G Ntim, *Cogent Business & Management* 8, no. 1 (January 2021): 1929033, https://doi.org/10.1080/23311975.2021.1929033.

[31] Muchammad Ichsan et al., "Digitalization of Islamic Banking in Indonesia: Justification and Compliance to Sharia Principles," *Jurnal Media Hukum* 31, no. 2 (2024): 244–61, https://doi.org/10.18196/jmh.v31i2.22485.

functions, and established non-compliance risk management protocols. For example, one comparative study observes that Malaysian Islamic financial institutions require dedicated Shariah control functions and robust non-compliance risk management, whereas in Indonesia such structures are less consistently enforced[32].

In Indonesia, many IMFIs (especially BMTs) remain rooted in cooperative or community-based models, with decentralised governance and less formalised Shariah audit trails. For instance, a study on Indonesian IMFIs found that digital accounting information systems still struggle to integrate maqasid al shari'ah metrics, indicating weaker alignment of digital operations with Shariah objectives[33].

These structural differences manifest in three major trends in the literature:

a. SSB characteristics — The expertise, size, independence, and diligence of SSBs remain central to compliance quality. Malaysian institutions tend to exhibit more formally structured SSBs under regulatory guidance; Indonesian IMFIs often rely on local or cooperative-based boards with variable capacity.
b. Disclosure and transparency — Digital platforms have increased the demand for clear cost breakdowns, contract clarity, and audit trails. In Malaysia, regulatory mandates under the Shariah governance framework support higher levels of disclosure; in Indonesia, disclosure remains inconsistent, especially among smaller BMTs.
c. Adaptation to digital transformation — As IMFIs expand their digital footprint, issues such as hybrid contract design (e.g., murābaḥah and ujrah), fragmented fatwa interpretations, and ambiguous digital service terms have emerged. In forums comparing Indonesia and Malaysia, studies highlight that Malaysia's regulatory sandbox and governance standards facilitate better adaptation; Indonesia's evolving digital BMT ecosystem still faces infrastructural and governance lag[34].

The findings indicate that the rapid digitization of Islamic Microfinance Institutions (IMFIs), initially envisioned as an inclusive financial innovation, has instead triggered new layers of Shariah-related controversy and trust fragmentation. Digital platforms such as mobile loan apps and online financing dashboards social media were first designed to expand accessibility and financial inclusion. However, in practice they have become spaces of regulatory ambiguity where hybrid contracts, opaque cost disclosures, and conflicting fatwas reproduce client confusion and institutional inconsistency. In Indonesia, for example, the acceleration of fintech adoption by BMTs has outpaced the formalisation of Shariah audit and governance infrastructure (evidenced by studies showing digital accounting systems alignment still in development). In Malaysia, while digital adoption is more supported by structured governance, issues remain around talent shortages and balancing innovation with compliance[35].

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32 Muhammad Nazmi et al., "Shariah Governance in Islamic Financial Institutions in Indonesia and Malaysia : A Comparative Analysis," *Journal of Islamic Finance* 9, no. 2 (2020): 146–54, https://doi.org/10.31436/jif.v9i2.492.

33 Provita Wijayanti et al., "The Integration of Maqasid Sharia Principles on Digital Accounting Information System in Indonesian Islamic Microfinance," *Journal of Islamic Accounting and Finance Research* 7, no. 1 (2025): 107–26, https://doi.org/10.21580/jiafr.2025.7.1.25345.

34 Cucu Susilawati et al., "Comparative Study On The Regulation Of Sharia Financial Technology In Indonesia And Malaysia," *Jurisdictie: Jurnal Hukum Dan Syariah* 12, no. 1 (2021): 1–19, https://doi.org/10.18860/j.v12i1.12213.

35 Asyiqin, "Legal Framework Synergy : Indonesia and Malaysia ' s Role in Advancing Islamic Fintech Regulations."

Rather than reducing barriers, digitalization has surfaced a symbolic and operational crisis around what constitutes authentic Shariah compliance in IMFIs. The comparison between Indonesia and Malaysia highlights that institution-level variations in governance architecture and digital readiness significantly influence how controversies emerge and how trust is built or eroded.

Table 2. Comparison of Patterns of Shariah Controversy in IMFIs: Indonesia and Malaysia

Dimension	Indonesia	Malaysia
Nature of Controversy	Operational misapplication of contracts (murabahah, mudharabah), resembling interest-like returns; inconsistency between fatwa and product execution.	Procedural / documentation errors rather than doctrinal issues; centralized regulator oversight limits product-level deviation.
Regulatory Fragmentation	Dual supervision (Ministry of Cooperatives and DSN-MUI) causes unclear dispute resolution channels; SSB independence often limited.	Unified structure under BNM; SAC decisions legally binding on courts and IFIs.
Digital-Related Shariah Issues	Issues over aqad validity via digital signatures, unclear consent mechanisms, and dynamic pricing algorithms.	Mostly technical—system outage, late disclosure, or mislabeling of digital contracts.
Disclosure and Transparency	Weak disclosure, accusations of gharar and tadlis (uncertainty/deception).	Disclosure regulated; minor lapses handled through remediation plans.
Public Trust and Reputation	High sensitivity due to community-based networks; small controversies can quickly damage local legitimacy.	Centralized regulation and media management reduce reputational contagion.
Dispute Resolution Mechanism	Multi-layer: internal SSB, DSN-MUI, OJK or Ministry of Cooperatives,sometimes civil court.	Hierarchical: internal Shariah Committee, BNM, Shariah Advisory Council, court (if needed).

Nature of Controversy

From comparison table 2, In Indonesia, controversies in IMFIs (including BMTs and KSPPS) often revolve around operational misapplication of contracts (such as murābahah, muḍārabah) that in practice begin to resemble conventional interest-bearing returns, or at least deviate from the normative Shariah structure. One study highlights how the Dewan Syariah Nasional-Majelis Ulama Indonesia (DSN-MUI) fatwas provide clear guidelines for murābahah financing, yet actual practice in Sharia banking shows "challenges in harmonizing

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the provisions of the fatwa and existing regulations"[36]. Another review of murābahah financing in BMTs notes internal and external factors in problematic murābahah financing (e.g., lax procedure, lack of human resources, resemblance to debt financing) in the Indonesian context[37]. This suggests that the core doctrinal contract form is in question: whether what is labelled murābahah or muḍārabah is in fact operating like riba-based or interest-type returns.

By contrast, in Malaysia the controversies tend not to majorly call into question the doctrinal form of the contract (i.e., whether murābahah is permissible), but rather focus on procedural/documentation errors or implementation deviations (for example in Shariah governance and audit). For instance, a Malaysian study on Shariah audit practices indicates that the issues are in implementing Shariah audit in various sectors (including cooperatives), rather than fundamental doctrinal mis-structures[38]. Likewise, studies note gaps between regulation and practice (e.g. in musyarakah mutanāqisah for home financing) in Malaysian Islamic banks, reflecting implementation issues rather than fundamental contract invalidity [39]. Hence in Malaysia the controversy is less about the nature of the contract and more about how it is executed, documented or governed.

Regulatory Fragmentation

In Indonesia the regulatory-governance environment for IMFIs (such as BMTs/KSPPS) suffers from dual supervision: on one hand cooperatives regulation (Ministry of Cooperatives) and on the other Shariah advisory/fatwa oversight (DSN-MUI) and also oversight by the Otoritas Jasa Keuangan (OJK) when applicable. This fragmentation means that dispute channels and governance lines can be unclear, and the independence of internal Shariah supervisory boards (DPS) often limited. The broader literature on Shariah legitimacy in Indonesia notes that DSN-MUI has an accommodative stance and the regulatory ecosystem is uneasy, which may allow conventional-banking-like practices to creep into Islamic banking and finance[40]. In other words, for Indonesian IMFIs there is an overlap and sometimes lack of clarity among cooperative law, micro-finance regulation, Shariah fatwas and banking oversight.

In Malaysia, by contrast, the structure is more unified: the central regulator Bank Negara Malaysia (BNM) oversees Islamic banks and microfinance operations under one framework; the Shariah Advisory Council (SAC) of BNM issues legally-binding guidance; governance is more consolidated. Though cooperatives have their own regulation, the overall system for Islamic financial institutions is more integrated. This means fewer structural fault-lines in oversight and thus less fragmentation in dispute resolution or regulatory ambiguity[41].

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[36] Abdul Muiz, "Tinjauan Yuridis Terhadap Implementasi Fatwa DSN-MUI Mengenai Pembiayaan Murabahan Dalam Praktik Perbankan Syariah Di Indonesia," *Journal of Islamic Finance and Syariah Banking* 2, no. 1 (2024), https://doi.org/10.63321/jifsb.v2i1.54.

[37] Azhar Alam et al., "The Problem of Murabaha Financing of Islamic Microfinance Institution and The Handling Strategies in Indonesia: A Literature Review," *Al Muzara'ah; Jurnal of Islamic Economics* 2023, no. 1 (2023): 17–30, https://doi.org/10.29244/jam.11.1.17-30.

[38] Muhammad Iqmal et al., "Issues and Challenges in Shariah Audit Practices in Malaysian Shariah-Based Sectors," *The Journal of Muamalat and Islamic Finance Research* 21, no. 1 (2024): 82–100, https://doi.org/10.33102/jmifr.564.

[39] Audia Syafa et al., "Gap Analysis Between BNM Regulation and Application of Musharakah Mutanaqisah in Islamic Banking," *Journal of Islamic Finance* 7, no. 1 (2018): 38–50, https://doi.org/10.31436/jif.v7i1.214.

[40] Agus Fakhrina and Abdul Hamid, "The Role of DSN – MUI in the Legal- Economic Legitimacy of Islamic Banking in Indonesia," *Ahkam; Jurnal Ilmu Syariah* 25, no. 1 (2025): 125–42, https://doi.org/10.15408/ajis.v25i1.40879.

[41] Malaysia, "Shariah Governance Licensed."

Regulatory Fragmentation

In Indonesia, the adoption of fintech and digital channels by IMFIs has introduced novel Shariah-controversies: issues around the validity of aqād (contracts) executed via digital signatures or platforms, unclear consent mechanisms, dynamic pricing or algorithmic profit sharing, and uncertainty around contract transparency/gharar in the digital domain. A recent Indonesian study on digitalisation of Islamic finance noted three DSN-MUI fatwas (No. 116/IX/2017; 117/II/2018; 140/VIII/2021) addressing e-money, digital financing and crowdfunding—but implementation remains uneven [42]. Moreover, literature on Indonesian IMFIs notes that adoption of fintech by BMTs has grown rapidly yet the risk of Shariah non-conformity and governance lapses is high[43].

In Malaysia, digital-related Shariah issues tend to be more technical (e.g., system outages, late disclosures, mislabelling digital contracts) rather than deep doctrinal objections over contract form. While Shariah governance in digital platforms remains a concern, the governance framework is relatively more mature and documented. For example, Shariah audit and governance studies in Malaysia note challenges but do not typically highlight large scale doctrinal crises specific to fintech micro-finance[44]. Thus Malaysian IMFIs have fewer controversies about whether the digital contract is Sharia-compliant, and more about how well the digital service is governed, documented and audited.

Disclosure and Transparency

For Indonesian IMFIs the disclosure dimension is a frequent source of controversy: weak disclosure of contract terms, profit-sharing mechanisms, or risk exposures leads to accusations of gharar (excessive uncertainty) and tadlīs (deception). Some BMTs have been flagged for not clearly communicating cost structures or switching contracts in practice. the broader literature on Shariah legitimacy in Indonesia shows how fast growth and regulatory gaps generate public trust gaps[45].

In Malaysia the disclosure-and-transparency regime is better regulated: Islamic microfinance and cooperatives are subject to more stringent regulatory disclosures, Shariah audit and governance frameworks, and remediation plans when minor disclosure lapses occur. Studies on Malaysian Islamic cooperatives indicate that Shariah governance issues often relate to audit practices and disclosure—but the framework for correction and remediation is in place[46].

Public Trust and Reputation

Indonesian IMFIs (especially BMTs/KSPPS) are often embedded within community-based networks, their legitimacy depends heavily on social trust, local reputation and social relationships. A single Shariah controversy (say over a misapplied murābahah contract) can quickly damage local legitimacy, given that many customers are community members rather than anonymous bank clients. The literature on the legitimacy of Shariah finance in Indonesia

[42] Tri Hidayati et al., "Digitalization of Islamic Finance : Epistemological Study of the National Sharia Board-Indonesian Council of Ulama ' s Fatwa Introduction That Demands Time , Cost , and Energy Efficiency in Various Aspects of Life , along Are Relatively New (Contemporary," *Al Ahkam Jurnal Pemikiran Hukum Islam* 33, no. 2 (2023): 255–78, https://doi.org/10.21580/ahkam.2023.33.2.17324.

[43] Ahmad Mukri Aji, Harisah, and Syarifah Gustiawati Mukri, "Revitalization of Fintech Era 4.0 in the Development of Islamic Microfinance Institutions (IMFs)," *Al -Iqtishad; Journal of Islamic Economics* 12, no. 1 (2020): 149–64, https://doi.org/10.15408/aiq.v12i1.15072.

[44] Iqmal et al., "Issues and Challenges in Shariah Audit Practices in Malaysian Shariah-Based Sectors."

[45] Fakhrina and Hamid, "The Role of DSN – MUI in the Legal- Economic Legitimacy of Islamic Banking in Indonesia."

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Jurnal Hukum dan Peradilan Vol. 15, no. 2 (2026), pp. 365-390
ISSN: 2303-3274 (p), 2528-1100 (e)
DOI: https://doi.org/10.25216/jhp.15.2.2026.365-390

emphasises that when institutional growth is rapid and normative distinctiveness is blurred, public trust becomes fragile[47]. In effect, controversies in Indonesia can quickly lead to reputational contagion within the local community-based model.

In Malaysia, the reputation risk remains but the structure (centralised regulation, large institutional scale, regulate disclosure) tends to mitigate reputational contagion. Because major Islamic banks and microfinance providers are regulated under BNM, and public trust is supported by formal audit/gov frameworks, scandals tend to be caught earlier or handled more systematically, reducing the speed/scale of reputational damage. Studies on Malaysian Islamic cooperatives and audit practices note that public trust is influenced by Shariah governance but the systems for addressing the issues are more robust[48].

Dispute Resolution Mechanism

In Indonesia, given the fragmented regulatory and supervisory environment, there is a multi-layered dispute resolution mechanism: internal SSB (Shariah Supervisory Board) the institution level appeal to DSN-MUI (for fatwa/guidance), oversight via OJK or Ministry of Cooperatives depending on institutional form, sometimes recourse to civil courts. The literature on BMTs points out that the ambiguity in whom the depositor/member should approach, and limited independence of SSB, complicates dispute resolution. For instance, the analysis of Indonesian Shariah-finance legitimacy emphasises ambiguity of authority between fatwa, regulator and practice[49].

By contrast, in Malaysia the mechanism is more hierarchical and streamlined: internal Shariah Committee to regulator BNM's Shariah Advisory Council (SAC) then to formal adjudication via courts if required[50]. The governance and oversight system is embedded in regulatory law (e.g., the Islamic Financial Services Act 2013) which ensures clearer lines of dispute recourse.

The collected data reveal that digital practices within IMFIs, intended to enhance financial inclusion and efficiency, are instead creating new zones of Shariah controversy. Across platforms like mobile apps, social media promotions, and article about fatwa dissemination clients consistently encounter ambiguity in contracts, opacity in pricing, and divergent fatwa interpretations. Rather than strengthening trust, these digital adaptations are **a**mplifying uncertainty and generating visible debates over authenticity and compliance.

From a Shariah governance perspective, these patterns indicate fragmented application of fiqh muʿāmalah in the digital sphere. The bundling of fees and profit margins risks violating the principle of *bayān* (clarity), and the inconsistent disclosure of contracts invites *gharar* (excessive uncertainty). The parallel existence of conflicting fatwas reflects weak harmonization mechanisms within Shariah Supervisory Boards (SSBs). Consequently, clients experience trust stratification: they gravitate toward IMFIs perceived as more transparent or whose fatwas align with their personal or community orientation, deepening interpretive.

The findings indicate that digital practices within IMFIs, though intended to expand inclusion, are increasingly marked by Shariah-related controversies rooted in fragmented governance structures. Mobile apps that bundle *murabaha* profit margins with *ujrah* fees, savings platforms that emphasize "halal branding" without contract disclosure, and using non-standard *qard hasan* mechanisms illustrate how weak transparency and inconsistent fatwa references create confusion and erode trust. From a Shariah governance perspective, these

[47] Fakhrina and Hamid, "The Role of DSN – MUI in the Legal- Economic Legitimacy of Islamic Banking in Indonesia."
[48] Iqmal et al., "Issues and Challenges in Shariah Audit Practices in Malaysian Shariah-Based Sectors."
[49] Fakhrina and Hamid, "The Role of DSN – MUI in the Legal- Economic Legitimacy of Islamic Banking in Indonesia."
[50] Malaysia, "Shariah Governance Licensed."

patterns highlight gaps across core variables identified in the literature. Studies confirm that Shariah Supervisory Board (SSB) attributes particularly expertise, independence, and diligence are critical to ensuring consistency in fatwa interpretation, yet rapid digital adaptation often outpaces the boards' capacity to harmonize rulings[51]. Similarly, Shariah-related disclosure is shown to enhance legitimacy and reduce *gharar*, but IMFIs' reliance on symbolic marketing over transparent contractual explanation undermines this function[52]. The absence of robust Shariah audit and review mechanisms in digital workflows further exacerbates regulatory fragmentation, leaving IMFIs vulnerable to reputational risk[53]. As a result, controversies not only reflect doctrinal disagreement but also expose structural weaknesses in governance variables that mediate digital transformation. The implications are significant: without stronger disclosure standards, harmonized fatwa communication, and digitally embedded Shariah audit trails, IMFIs risk deepening client vulnerability, eroding institutional trust, and contradicting the maqasid al-shariah principle of hifz al-mal (protection of wealth).

Conceptual Model: From Controversy to Transformation in Digital IMFIs

The policy and practical implications of these findings point to the urgent need for harmonized regulatory frameworks and institutional reforms in IMFIs. At the regulatory level, central authorities and standard-setting bodies such as the IFSB and AAOIFI must develop digital-specific Shariah governance guidelines that clarify contract disclosure, fee structures, and online fatwa dissemination to prevent interpretive silos across institutions. For IMFIs, strengthening the capacity and independence of Shariah Supervisory Boards is critical, not only by increasing expertise in digital finance but also by embedding Shariah audits within technological platforms to ensure real-time compliance monitoring. At the operational level, institutions should prioritize transparent digital disclosures**,** including simplified contract explanations and breakdowns of costs, to enhance financial literacy and restore trust among low-income clients. From a client perspective, targeted financial and digital literacy programs are necessary to reduce vulnerability to ambiguous contracts and foster informed participation in digital financial ecosystems. Collectively, these measures would transform controversy from a source of distrust into an impetus for institutional learning and reform, aligning IMFIs more closely with the maqasid al-shariah framework of Hifz al-mal and ensuring that digital innovation strengthens rather than undermines Shariah compliance and financial inclusion.

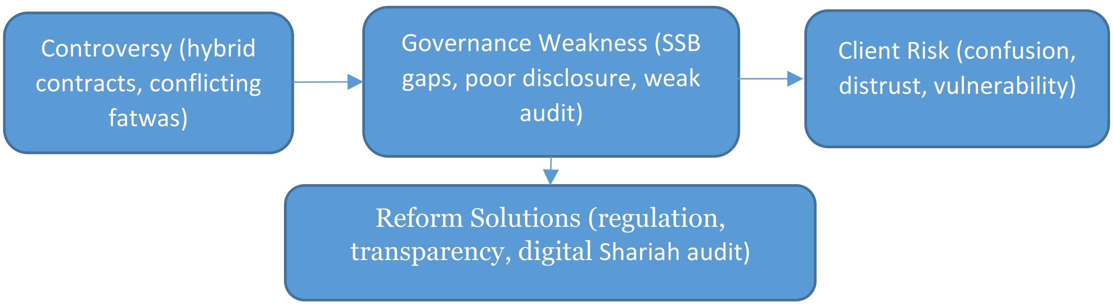

Figure 1. Conceptual Model: From Controversy to Reform in Digital IMFIs

[51] Mukhibad et al., "Open Innovation in Shariah Compliance in Islamic Banks – Does Shariah Supervisory Board Attributes Matter?"

[52] Ab Ghani, Mohd Ariffin, and Abdul Rahman, "The Extent of Mandatory and Voluntary Shariah Compliance Disclosure: Evidence from Malaysian Islamic Financial Institutions."

[53] Nomran and Haron, "A Systematic Literature Review on Sharīʿah Governance Mechanism and Firm Performance in Islamic Banking."

Jurnal Hukum dan Peradilan Vol. 15, no. 2 (2026), pp. 365-390
ISSN: 2303-3274 (p), 2528-1100 (e)
DOI: https://doi.org/10.25216/jhp.15.2.2026.365-390

This model illustrates how digital adaptation in Islamic Microfinance Institutions (IMFIs) produces controversy through hybrid contracts, bundled costs, and conflicting fatwas, which in turn expose weaknesses in Shariah governance variables such as Supervisory Board (SSB) effectiveness, disclosure practices, and audit mechanisms. These weaknesses heighten client risks in the form of confusion, distrust, and financial vulnerability. The model further highlights reform pathways, including harmonized regulations, transparent disclosures, and embedded digital Shariah audits, as solutions aligned with maqasid al-shariah principles of hifz al-mal (protection of wealth).

Regulatory and Positive Law Perspective

Studies on financial regulation, legal pluralism, and the evolution of positive law in Islamic finance demonstrate a complex conceptual trajectory in contemporary academic discourse. Since the introduction of the dual banking system and legal frameworks for Islamic finance **i**n the early 1990s (e.g., Malaysia's Islamic Banking Act 1983; Indonesia's Law No. 21/2008), approaches to regulation have expanded into the domains of consumer protection, dispute resolution, and digital governance[54]. Within the context of Islamic Microfinance Institutions (IMFIs), regulatory frameworks that were originally designed to ensure inclusion and compliance with Shariah principles are now challenged by digital innovation, cross-border operations, and financial technology integration. This shift reveals a tension between positive law, which emphasizes standardization and enforcement, and Shariah law, which allows interpretive plurality through fatwas and juristic reasoning. Digital platforms intensify this tension by exposing inconsistencies in contract validity, pricing transparency, and dispute settlement mechanisms in real time[55].

Three major trends can be identified in the literature: first, the evolution of regulatory frameworks for IMFIs from informal community-based models to state-supervised institutions under positive law**;** second, the emergence of legal fragmentation caused by the coexistence of multiple sources of authority (state law, fatwas, and transnational standards); and third, the challenges of embedding consumer protection, dispute resolution, and accountability mechanisms into digital financial ecosystems.

The trend highlights how IMFIs' regulatory environment has shifted from reliance on community trust and informal dispute settlement toward incorporation into national legal systems. In Indonesia, for instance, the enactment of Law No. 1/2013 on Microfinance Institutions and Law No. 21/2008 on Islamic Banking reflects the formalization of IMFIs under state jurisdiction**.** However, this legal embedding is often partial, as many IMFIs remain registered under cooperative law rather than financial law, creating a regulatory grey zone[56]. This tension is amplified in digital contexts, where informal practices such as app-based murabaha financing interact with formal regulatory demands, leading to enforcement

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[54] Mohamed Ben Mimoun, Daghbagi Hamrouni, and Asma Raies, "Islamic Banking Finance and Private Sector Investment in Dual Banking Systems: The Impact of Institutional Quality," *International Journal of Islamic and Middle Eastern Finance and Management* 18, no. 1 (November 2024): 201–23, https://doi.org/10.1108/IMEFM-01-2024-0034; Mohammed Nafisah et al., "Does Efficiency Matter for Competition ? A Case of Dual Banking Industry," *Journal Ekonomi Malaysia* 53, no. 3 (2019): 163–77, https://doi.org/10.17576/JEM-2019-5303-13.

[55] Afdawairza, Riduan Mas'ud, and Shahid Q Manulandong, "Islamic Banks in the Digital Age : Balancing Innovation with Sharia Principles," *Ikonomika; Jurnal Ekonomi Dan Bisnis Islam* 9, no. 1 (2024): 33–50, https://doi.org/10.24042/ijebi.v9i1.24912; Alshater et al., "Fintech in Islamic Finance Literature: A Review."

[56] Rosa M Lastra, "Do We Need a World Financial Organization?," *Journal of International Economic Law* 17, no. 4 (December 2014): 787–805, https://doi.org/10.1093/jiel/jgu041; Itam, Hasan, and Alhabshi, "Shariah Governance Framework For Islamic Co-Operatives As An Integral Social Insitution In Malaysia."

challenges. As Hassan et al. (2022) argue, positive law frameworks must balance between protecting consumers from financial harm and respecting Shariah pluralism, but IMFIs' rapid digital adaptation exposes the gap between law on paper and law in practice.

The findings reveal that the digitization of Islamic Microfinance Institutions (IMFIs), though aimed at expanding inclusion, has exposed significant regulatory and Shariah governance ambiguities. Practices such as mobile murabaha loan apps, digital savings platforms, and article about fatwa dissemination consistently show patterns of contractual opacity, fee bundling, and legal pluralism. These issues point not only to Shariah compliance gaps but also to contradictions between positive law requirements (e.g., consumer protection law, cooperative law, financial supervision statutes) and the flexible nature of fiqh muʿāmalah as interpreted by Shariah Supervisory Boards (SSB).

The implications of these findings extend beyond operational shortcomings to structural weaknesses in regulatory governance. The fragmentation of authority—between cooperative law, consumer law, financial regulators, and Shariah bodies has created a fertile ground for controversy, eroding institutional trust and exposing clients to exploitation. In practice, IMFIs risk regulatory arbitrage, where institutions selectively apply rules to maintain symbolic Shariah legitimacy while sidestepping stricter state regulations. This not only undermines financial inclusion but also contradicts the maqasid al-shariah principle of hifz al-mal (protection of wealth).

These dynamics suggest that controversy in IMFIs is not merely theological but regulatory and structural. Without reforms, digitalization will continue to magnify inconsistencies, fostering distrust and fragmenting authority. Conversely, coordinated action by regulators (OJK, DSN-MUI, AAOIFI) can transform these challenges into opportunities for institutional learning and reform. Transparent disclosure standards, harmonized fatwa rulings, and digital Shariah audits would not only mitigate disputes but also reposition IMFIs as resilient, trustworthy, and aligned with both positive law and Shariah principles.

Table 3. Comparison of Shariah Governance and Positive Law Compliance in IMFIs' Digital Practices

Governance Variable	Shariah Perspective	Positive Law Perspective	Observed Gap in IMFIs' Digital Practices
Contract Disclosure	Contracts must be clearly stated to avoid *gharar* (uncertainty) (fiqh muʿāmalah principle of *bayān*).	Consumer Protection Law No. 8/1999 requires transparency in contract terms and cost breakdown.	Mobile apps and savings platforms use halal branding without disclosing contract type (wakalah vs. mudarabah).
Fee vs. Profit Clarity	Separation of *ujrah* (service fee) and *ribh/margin* (profit) is mandatory to avoid prohibited combinations.	Cooperative Law No. 17/2012 and financial disclosure norms require clear differentiation between service fees & profit.	Bundling murabaha profit with ujrah fees creates opacity and client confusion.

Jurnal Hukum dan Peradilan Vol. 15, no. 2 (2026), pp. 365-390
ISSN: 2303-3274 (p), 2528-1100 (e)
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Fatwa Consistency	Fatwas from DSN-MUI carry national authority; local SSB rulings must align with national standards to avoid divergence.	Regulatory recognition gives DSN-MUI fatwas semi-binding status under Indonesian financial law.	IMFIs selectively cite permissive fatwas, creating legal pluralism and client uncertainty.
Supervisory Board (SSB)	Must ensure independence, expertise, and diligence in approving products[57]	Governance laws require boards to act in fiduciary interest of members and clients.	Digital adaptation often outpaces SSB oversight, weakening harmonization of rulings.
Audit & Monitoring	Shariah audit ensures ongoing compliance with maqāṣid al-sharīʿah, particularly *hifz al-māl* (protection of wealth)	State regulators (OJK, Ministry of Cooperatives) mandate financial audits but lack digital Shariah compliance audits.	Absence of digital Shariah audit trails leaves gaps in real-time monitoring of apps and online groups.
Dispute Resolution	Must follow Islamic arbitration or mediation frameworks (tahkīm, ṣulḥ).	Positive law directs disputes through courts, consumer protection bodies, or OJK mediation.	No clear pathway for disputes in digital IMFIs; clients uncertain whether to approach DSN-MUI or state courts.

This comparison shows that IMFIs' digital practices are caught between two overlapping but weakly integrated systems: Shariah governance and positive law. While both frameworks stress clarity, transparency, and client protection**,** IMFIs often default to symbolic halal branding rather than substantive compliance. The lack of harmonization produces *grey zones* where client trust fractures along lines of religious authority (fatwas) and state regulation.

[57] Nomran and Haron, "A Systematic Literature Review on Sharī'ah Governance Mechanism and Firm Performance in Islamic Banking."

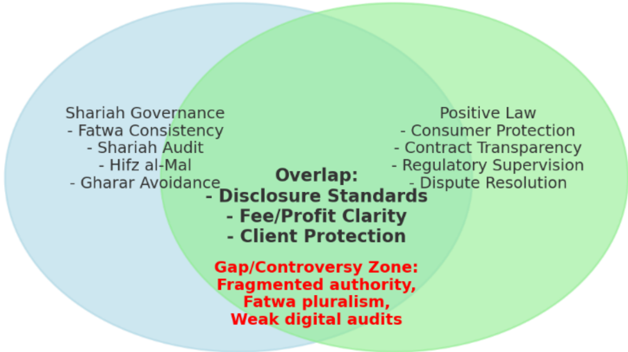

Figure 2. Overlap and Gap between Shariah Governance and Positive Law in IMFIs

Figure 2 illustrates the overlapping and contested relationship between Shariah governance and positive law in Islamic Microfinance Institutions (IMFIs). On one side, Shariah governance emphasizes fatwa consistency, Shariah audits, avoidance of *gharar*, and the maqāṣid al-sharīʿah principle of *hifẓ al-māl* (protection of wealth). On the other side, positive law stresses consumer protection, contract transparency, regulatory supervision, and dispute resolution mechanisms. The overlap zone highlights shared objectives, particularly disclosure standards, fee–profit clarity, and client protection, which in theory should reinforce one another. However, the gap or controversy zone exposes systemic weaknesses: fragmented regulatory authority, pluralism of fatwa interpretations, and the absence of robust digital Shariah audits. These weaknesses undermine both trust and compliance, leaving IMFIs vulnerable to reputational and legal risks. The diagram underscores the urgent need for harmonized governance frameworks that integrate Shariah principles with enforceable positive law standards in order to transform digital controversies into pathways for institutional resilience and sustainable financial inclusion.

CONCLUSION

This study concludes that the transformation of Islamic Microfinance Institutions (IMFIs) amid digital emergencies has generated both opportunities for inclusion and new zones of Shariah controversy. Comparative evidence from Indonesia and Malaysia reveals that fragmented governance structures, regulatory ambiguity, and uneven Shariah supervisory capacity are primary sources of institutional vulnerability. In Indonesia, pluralistic yet decentralized regulation has led to inconsistent fatwa application and weak digital supervision, while Malaysia's centralized model ensures stronger compliance but limits grassroots innovation. Across both contexts, digitalization—intended to expand access—has instead exposed deficiencies in contract disclosure, fee transparency, and audit integration, creating client confusion and trust erosion. These findings highlight the need to harmonize Shariah governance and positive law through integrated digital Shariah audits, standardized fatwa communication, and proportionate regulatory frameworks.

This research makes several significant scientific contributions to the study of Islamic microfinance, Shariah governance, and digital transformation. Conceptually, it advances the discourse by reframing controversy not as institutional dysfunction but as a catalyst for reform and innovation in Islamic financial governance. Methodologically, it introduces a qualitative, descriptive–explorative framework that integrates regulatory analysis, digital ethnography, and maqāṣid al-sharīʿah ethics, offering a multidimensional perspective rarely applied in Islamic finance studies. Empirically, the comparative analysis between Indonesia and Malaysia contributes new insights into how different regulatory architectures and governance models shape digital adaptation and public trust in IMFIs. The study also bridges

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a critical theoretical gap between Shariah governance and positive law, demonstrating how harmonization of these two systems can strengthen transparency, compliance, and consumer protection in the digital era. Ethically, it extends the application of maqāṣid principles—particularly hifz al-māl, ʿadl, and amanah—into the evaluation of digital financial practices, positioning them as measurable indicators of institutional sustainability. Collectively, these contributions enrich the scholarly understanding of Islamic microfinance as a dynamic field where technology, law, and ethics intersect to promote sustainable Shariah compliance and social welfare.

Despite its theoretical and empirical contributions, this study acknowledges several scientific limitations that should guide future research. First, the qualitative and descriptive–explorative design, while effective in revealing institutional dynamics and governance discourses, limits the generalizability of findings across all Islamic Microfinance Institutions (IMFIs) and national contexts. The comparative analysis between Indonesia and Malaysia, though rich in insight, represents only two regulatory environments and may not capture the diversity of Shariah governance practices in other regions. Second, the reliance on document analysis and digital observation means that the study primarily interprets institutional narratives rather than measuring performance outcomes through quantitative indicators such as financial ratios or client impact metrics. Third, the rapid evolution of fintech and digital regulation poses a temporal limitation, as policy frameworks and technological applications may change quickly, potentially altering the relevance of current findings. Lastly, while the study integrates maqāṣid al-sharīʿah ethics into its analytical framework, it does not empirically operationalize these ethical dimensions into measurable indices, leaving room for future studies to develop maqāṣid-based performance models. These limitations underscore the need for longitudinal, mixed-method, and cross-country research to deepen understanding of how digitalization and regulatory harmonization influence sustainable Shariah compliance in IMFIs.

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