

## SHARIA COMPLIANCE IN THE CAPITAL MARKET: REGULATION, IMPLEMENTATION, AND CHALLENGES

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### *Abstract*

*A lack of awareness of the benefits and potential profits of Sharia investment can hinder the growth of the Sharia capital market. Efforts are needed to harmonize sharia regulations and clarify the standards that must be complied with by capital market participants. The purpose of this study is to analyze the regulations, implementation, and challenges of Sharia compliance in the capital market. The research method used is qualitative descriptive. The data collection techniques used are observation and documentation with interpretive data analysis. The results of the study show that clear, comprehensive, and responsive regulations to market developments can be a strong foundation for business and investment practices that are in accordance with Sharia principles. The implementation of Sharia principles in business and investment practices requires a strong commitment from all stakeholders. Challenges in maintaining Sharia compliance in the capital market include the complexity of financial instruments, different understandings of Sharia principles, transparency and reporting that still need to be improved, as well as the challenges of effective supervision and law enforcement. Awareness and education of Sharia principles among stakeholders is essential to increase understanding, transparency, and compliance. Ongoing education on sharia compliance can help address some of the challenges faced.*

**Keywords:** Sharia, Capital, Regulation, Challenges.

### INTRODUCTION

The background on sharia compliance in the capital market refers to the importance of ensuring that business practices and investments carried out in the capital market are by Islamic sharia principles. This involves aspects of regulation, implementation, and challenges that must be faced.

Sharia regulation in the capital market refers to rules and policies that are set to ensure that investments and activities in the capital market are by Sharia principles (Eijk, 2012). These include prohibitions on usury, excessive speculation, and investments in industries that are considered haram. The implementation of sharia principles in the capital market involves the development of financial instruments that are by Islamic law, such as sharia bonds, sharia stocks, and sharia mutual funds (Ostien & Dekker, 2012). It also includes sharia audits to ensure that companies and investment products comply with sharia principles (Köndgen, 2012).

Sometimes it is difficult to determine the extent to which an investment or business activity is by sharia principles with certainty. The limited number of Sharia-compliant financial instruments can be an obstacle to diversifying investment portfolios (Atikah & Sayudin, 2024). Legal uncertainty and differing interpretations of sharia principles can make it difficult for companies and investors to adhere to consistent sharia standards. By understanding this background, regulators, companies, and investors can work together to address existing challenges and improve sharia compliance in the capital markets, thereby creating an investment environment that is more in line with Islamic sharia values.

Problems that are often faced in sharia compliance in the capital market include aspects of regulation, implementation, and challenges that need to be overcome. Sharia regulations can be interpreted in different ways by different Sharia institutions and experts, causing uncertainty and difficulty in understanding the limits of permissible investments. The lack of clear standards in sharia regulations can hinder efforts to develop investment instruments that are consistent with sharia principles.

There are limitations in the available Sharia investment instruments, especially in terms of optimal portfolio diversification. Sharia investment instruments are often illiquid, making it difficult for investors to buy and sell easily. Sharia auditing requires specialized knowledge and skills that are not always widely available, especially in the growing capital market. Ensuring transparency and accurate reporting regarding Sharia compliance can be a technical challenge, especially for companies that are not familiar with these standards.

Uncertainty in sharia law and conflicts between secular and sharia law can make investors hesitant to invest in sharia instruments. Unexpected or inconsistent policy changes from governments or regulatory authorities can create unforeseen uncertainty for investors (Ayadi & de Groen, 2024). Investors often lack an understanding of Sharia principles and the importance of Sharia compliance in their investments. A lack of awareness of the benefits and potential profits of Sharia investment can hinder the growth of the Sharia capital market. Efforts are needed to harmonize sharia regulations and clarify the standards that must be complied with by capital market participants. It is necessary to improve the development of diverse and liquid Sharia investment instruments to increase choices for investors.

Investors' awareness and understanding of Sharia principles and the benefits of Sharia investment need to be increased through effective education programs. Close collaboration between regulators, financial institutions, and sharia experts is needed to effectively address technical challenges and sharia compliance. By overcoming these problems, it is hoped that the sharia capital market can develop better and attract investors who are looking for investments that are in accordance with Islamic sharia principles.

Several previous studies that have been conducted on sharia compliance in the capital market, focus on regulatory aspects, implementation, and challenges faced. Al-Swidi et al's research highlights the importance of clear and consistent regulations to facilitate the development of the sharia capital market. Discuss challenges in the implementation of sharia principles in the capital market, especially related to sharia audits and accurate reporting. In addition, research by Al-Jafari and Kassim (2015), examines the effectiveness of sharia regulations in promoting sharia compliance in the capital market. Analyze best practices in the implementation of Sharia principles, including the development of Sharia-compliant financial instruments.

Overall, previous research has provided valuable insights into the complexities and challenges of achieving sharia compliance in the capital market. These findings can be the basis for formulating more effective strategies and policies in supporting inclusive and sustainable growth of the Islamic capital market.

Novelty in research on sharia compliance in the capital market includes new ideas, innovative approaches, or discoveries that have not been widely known before. By

developing and implementing innovative elements such as those mentioned above, research on sharia compliance in the capital market can make a significant contribution to advancing financial practices that are sustainable, inclusive, and by Islamic sharia values.

## **METHOD**

The research method used in this study is qualitative descriptive (Creswell, 2009; Sugiono, 2015). This method aims to describe the observed phenomenon or event in detail and depth. This method focuses on a deep understanding of the characteristics, properties, and context of a phenomenon, without making significant statistical generalizations or inferences.

The data collection in this study is observation and documentation. Observation is carried out to observe phenomena or events directly to gain a deep understanding. Review relevant documents (e.g., reports, notes, policy documents) for supporting information. Meanwhile, the data analysis carried out is interpretation. Interpretive analysis is carried out in depth on the data that has been analyzed, relating the findings to a broader context. With this method, it is very useful in describing complex phenomena or events, exploring individual experiences, and understanding the context that affects a situation.

## **RESULTS AND DISCUSSION**

### ***Sharia Compliance Regulations in the Capital Market***

Sharia compliance regulations in the capital market refer to a set of rules, policies, and guidelines set by the government or regulatory authority to ensure that business practices and investments conducted in the capital market are by Islamic sharia principles (Fitri, 2023) (Ihsan, 2022). It covers a wide range of aspects, including regulations on sharia investment instruments, sharia audits, financial reporting, and investor protection.

It is important to ensure that regulations regarding Sharia investment instruments, such as Sharia stocks, Sharia bonds, and Sharia mutual funds, regulate the requirements, criteria, and procedures to ensure that these instruments are by sharia principles. The regulation also establishes standards and procedures for Sharia audits, which aim to ensure that companies or financial institutions involved in Sharia capital market activities have complied with Sharia principles in their operations and finances.

Regulations regarding financial reporting for Sharia entities establish specific reporting requirements and ensure that the information submitted accurately reflects financial conditions and sharia compliance (Suadi, 2018). The regulation also regulates investor protection in the context of the Islamic capital market, including information transparency, understanding of Islamic investment risks, and fair and transparent dispute resolution mechanisms (Fathoni, 2020). Regulatory authorities usually work closely with Sharia institutions, such as ulema councils or Sharia committees, to ensure that the interpretation and application of sharia principles are consistent and by the views of ulama. The regulation also includes sanctions and enforcement mechanisms for violations of sharia compliance, which aims to encourage compliance and maintain the integrity of the sharia capital market (Aggarwal & Chow, 2010).

Sharia compliance regulations in the capital market can vary between countries that have different legal and financial systems. However, in general, this regulation aims to create a capital market environment that is in accordance with sharia principles, transparent, and fair for all stakeholders. The analysis of Sharia compliance regulations in the capital market involves an in-depth evaluation of the effectiveness, clarity, and conformity of the regulation with Islamic Sharia principles and the objectives of the capital market in general (Gultom dkk., 2022).

How clear are the regulations regarding Sharia principles that must be complied with in capital market activities, such as the prohibition of usury, the prohibition of investment in haram industries, and the principle of fairness in sharing risks and profits (a) Consistency of Interpretation The level of consistency in the interpretation of sharia principles between regulatory authorities, ulama councils, and other relevant sharia institutions. (b) Effectiveness of the implementation of the suitability of investment instruments. The extent to which Sharia investment instruments available in the capital market comply with Sharia principles and provide suitable investment alternatives for Sharia investors. (c) Sharia Audit. The effectiveness of sharia audits in ensuring companies' compliance with sharia principles in their business and financial practices. This analysis aims to identify the advantages, shortcomings, and potential improvements in Sharia compliance regulations in the capital market so that it can help in improving the integrity, transparency, and investor trust in the Sharia capital market as a whole.

### ***Implementation of Sharia Compliance in the Capital Market***

Sharia compliance in the capital market refers to obedience or compliance with Islamic sharia principles in business activities, investments, and transactions that occur in the capital market. This includes various aspects that reflect the commitment to carry out business practices by sharia values, such as the prohibition of riba (interest), the prohibition of investment in illegal industries (e.g. alcohol, gambling, tobacco), and the principle of fair sharing of risks and benefits.

Compliance with the prohibition of usury, which is the practice of giving or receiving interest or profits from money loans. In the context of the capital market, this leads to the avoidance of financial instruments that contain elements of interest or usury. In addition, compliance with the prohibition of investment in industries that are considered haram according to Sharia principles, such as the liquor industry, gambling, pornography, and other sectors that are contrary to Islamic moral values. The principle of sharing risks and benefits fairly between parties involved in an investment or transaction, so that neither party gets an unfair advantage or harms the other party.

Sharia compliance in the Capital Market is not only related to legal or regulatory aspects, but also includes ethical and moral commitments to conduct business practices that are fair, transparent, and by Islamic sharia principles (Badruzaman dkk., 2020). It aims to create a responsible and sustainable investment environment for Muslims who want to invest by their religious beliefs and values.

The implementation of sharia compliance in the capital market involves a series of steps and practices undertaken by financial institutions, companies, and other stakeholders to ensure that their business and investment activities are in accordance with Islamic sharia principles (Supriatna dkk., 2020). Financial institutions and companies in the capital market develop sharia investment instruments, such as sharia stocks, sharia bonds, and sharia mutual funds, which are by sharia principles and provide alternative investment for sharia investors.

It is very important to conduct regular sharia audits to ensure that the company's operational and financial activities are by sharia principles, including in terms of fund management, investments, and financial transactions (Wulpiah, 2017). In addition, applying sharia principles in investment management, such as the prohibition of usury, the prohibition of investment in haram industries, the principle of justice in sharing risks and profits, and the selection of socially and environmentally responsible investments (ESG) (Lutfiyah dkk., 2022).

The analysis of the implementation of sharia compliance in the capital market in the field involves a direct evaluation of the practices carried out by financial institutions, companies, and other stakeholders in carrying out capital market operations by Islamic sharia principles. (a) Sharia Investment Portfolio. Review the sharia investment portfolio owned by financial institutions or investors and identify the sharia investment instruments adopted (sharia stocks, sharia bonds, sharia mutual funds, etc.). Evaluate the suitability of the portfolio with sharia principles, such as the prohibition of usury, the prohibition of investment in haram industries, and the principle of risk and profit sharing. (b) Investment Management Practices. Observe investment management practices implemented by companies or financial institutions, including the investment selection process, sharia risk management, socially and environmentally responsible investment decision-making, and periodic evaluation of portfolio performance. (c) Sharia Audit. Review the results of sharia audits conducted by internal or external parties, and evaluate the company's compliance with sharia principles in their operational, financial, and investment activities (Mardian, 2019). Pay attention to the findings and recommendations of sharia audits for improvement and increased compliance.

### ***Challenges of Sharia Compliance in the Capital Market***

The challenges faced in maintaining sharia compliance in the capital market can come from various aspects, ranging from legal and regulatory issues to different understandings of sharia principles. Here are some of the main challenges in maintaining sharia compliance in the capital market:

1. The complexity of financial instruments. Modern financial instruments are often complex and can cause confusion when it comes to sharia compliance. For example, derivative instruments or structural products that may have elements that are difficult to understand from a sharia point of view (Putri & Mandayanti, 2021).
2. Supervision and Law Enforcement. Supervision and enforcement of sharia compliance in the capital market requires a strong infrastructure, including supervisory institutions that

- have a deep understanding of sharia principles and the ability to handle violations or non-compliance.
3. **Limitations of Understanding.** Different understandings of sharia principles can be challenging, especially if stakeholders, including investors, fund managers, and financial institutions, have different interpretations of the application of these principles in business and investment practices.
  4. **Transparency and Reporting.** Challenges related to transparency and reporting related to sharia compliance can also arise. For example, it is difficult to get clear and transparent information about how funds or investments are carried out in accordance with sharia principles.
  5. **Difficulty Finding the Right Investment.** For investors who want to follow sharia principles, it can sometimes be difficult to find investments that are fully compliant with these principles. Limited investment options that are in accordance with sharia can be an obstacle.
  6. **Changes in Regulations and Interpretation.** Changes in regulation or interpretation of sharia principles can also be challenging. This can affect existing investment strategies and business practices, as well as create confusion or uncertainty in the market.
  7. **Awareness and Education.** Challenges related to awareness and education of sharia principles also need to be considered. Lack of understanding or lack of awareness of sharia principles can hinder efforts to maintain compliance in the capital market.
  8. **Collaboration between parties.** Less effective collaboration between regulators, financial institutions, ulema councils, and other stakeholders can also be an obstacle in maintaining sharia compliance.

These challenges show that maintaining sharia compliance in the capital market requires commitment, cooperation, and deep understanding from various related parties. Joint efforts are needed to overcome these challenges to build a stronger, more transparent, and sustainable sharia capital market.

## CONCLUSION

Adequate regulation is very important in maintaining Sharia compliance in the capital market. Clear, comprehensive, and responsive regulation of market developments can be a strong foundation for business and investment practices that are by sharia principles. The implementation of Sharia principles in business and investment practices requires a strong commitment from all stakeholders. The Sharia audit process, education and training, and consultation with Sharia experts are important factors in maintaining compliance. Challenges in maintaining Sharia compliance in the capital market include the complexity of financial instruments, different understandings of Sharia principles, transparency and reporting that still need to be improved, as well as the challenges of effective supervision and law enforcement. Awareness and education of Sharia principles among stakeholders is essential to increase understanding, transparency, and compliance. Ongoing education on sharia compliance can help address some of the challenges faced. Strong collaboration between regulators, financial institutions, ulema councils, investors, and other stakeholders

is key in maintaining Sharia compliance in the capital market. Effective collaboration can help overcome challenges and create a more sustainable Sharia capital market environment.

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