



Contesting the Boundaries of Sharia Compliance: Legalizing Income Smoothing in Indonesian Islamic Banking

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Abstract

Economic pressures have prompted Islamic banks to implement income smoothing techniques when distributing returns on third-party funds, raising questions about the legitimacy of these practices from an Islamic legal perspective. This paper aims to examine the income smoothing guidelines issued by the National Sharia Council of the Indonesian Ulema Council and their impact on the distribution of third-party fund returns by Islamic banks. The primary data source for this research is a fatwa from the National Sharia Council, accessible on its official website. Employing Islamic legal discourse, this study finds that the income smoothing method for distributing third-party fund returns is approved by the National Sharia Council as a form of *hīlah* (a legal stratagem used to provide solutions and alleviate difficulties) to regulate profit recognition and reporting. This approval is grounded in *istihsān* (legal preference), which considers customary law (*al-urf*) and public interest (*maṣlaḥah*) as key justifications. Practically, this approval enables Islamic banks to remain competitive with conventional banks while also raising public awareness that there is little difference between Islamic and conventional banking.

Keywords

Income Smoothing;
National Sharia
Council; Islamic
Banking; Indonesian
Context

Introduction

Market forces have compelled Islamic banks to adopt the income smoothing method for distributing returns on third-party funds as a risk management strategy.¹ This approach is used to prevent customer funds from being transferred to conventional banks when the equivalent rate of return is lower than the deposit interest offered by those banks.² Regulation of this practice began in 2011 with Bank Indonesia's issuance of Regulation Number 13/23/PBB/2011, which addresses

¹ Zairy Zainol and Salina Hj. Kassim, "A Critical Review of the Literature on the Rate of Return Risk in Islamic Banks," *Journal of Islamic Accounting and Business Research* 3, no. 2 (September 21, 2012): 121–37; Shifa Mohamed Saeed et al., "Dependency of Islamic Bank Rates on Conventional Rates in a Dual Banking System: A Trade-off between Religious and Economic Fundamentals," *International Review of Economics & Finance* 86 (2023): 1003–21; Ahmet Sekreter et al., "Parallelism between Interest Rate and Profit Rate: Comparison of Islamic Banking and Conventional Banking," *Journal of Business* 1, no. 2 (2012): 15–24; Kaouther Toumi, Jean-Laurent Viviani, and Zeinab Chayeh, "Measurement of the Displaced Commercial Risk in Islamic Banks," *The Quarterly Review of Economics and Finance* 74 (November 2019): 18–31; Marwene Rouetbi, Zied Ftiti, and Abdelwahed Omri, "The Impact of Displaced Commercial Risk on the Performance of Islamic Banks," *Pacific-Basin Finance Journal* 79 (June 2023): 102022.

² Rouetbi, Ftiti, and Omri, "The Impact of Displaced Commercial Risk on the Performance of Islamic Banks"; Toumi, Viviani, and Chayeh, "Measurement of the Displaced Commercial Risk in Islamic Banks"; Sugiyarti Fatma Laela and Abdul Latif, "Income Smoothing, Displaced Commercial Risk and Bankruptcy in Indonesian Islamic Banks During the COVID-19 Pandemic," *JASF: Journal of Accounting and Strategic Finance* 6, no. 2 (2023): 383–403.



the implementation of risk management for Sharia Commercial Banks and Sharia Business Units. This regulation was subsequently endorsed by the National Sharia Council of the Indonesian Ulama Council through Fatwa No. 87/DSN-MUIXII/2012, which specifically addresses the income smoothing method for third-party funds. In 2023, the requirement to implement the income smoothing method as a means of controlling policy return risk was further reinforced by the Financial Services Authority of the Republic of Indonesia's Circular Letter No. 25/SEOJK.03/2023 concerning risk management implementation for Sharia Commercial Banks and Sharia Business Units.

The Financial Services Authority has also released data demonstrating the apparent ease with which Islamic banks provide returns on third-party funds. In 2022, the equivalent rate for 1-month *muḍārabah* deposits ranged from 2.86% to 3.79%.³ In 2023, this rate increased, ranging from 3.89% to 4.80%.⁴ Additionally, in 2023, the Financial Services Authority issued Circular Letter No. 25/SEOJK.03/2023 concerning the Implementation of Risk Management for Sharia Commercial Banks and Sharia Business Units. This circular mandate that Islamic banks implement the income smoothing method as a means of controlling yield risk. However, the use of this method does not reflect the actual profit-sharing system stipulated in the *muḍārabah* contract. By applying income smoothing, banks can reduce high profits in prosperous years and increase low profits in lean years, thereby generating stable, smoother profits over time and mitigating the volatility of the company's financial condition.⁵

On this basis, this paper aims to address a gap in the existing literature by examining the arguments presented by the National Sharia Board of the Indonesian Ulama Council in approving the use of income smoothing. While income smoothing serves to meet market demands and maintain the stability of financial statements, it also poses a risk of leading Islamic banks into practices that conflict with Sharia principles. Accordingly, the research questions were formulated to analyze the issue regarding the rules regarding income smoothing of third-party funds as permitted by the National Sharia Board of the Indonesian Ulama Council and what its impact discussing their arguments in approving the use of income smoothing. These research objectives serve as the foundation for guiding the entire discussion in this article.

Literature Review

A review of the existing literature reveals that studies on income smoothing of third-party funds in Islamic banks can be categorized into four main areas. First, research on the factors influencing income smoothing practices in Islamic banks.⁶ Second, investigations into the impact of income

³ Otoritas Jasa Keuangan, "Statistik Perbankan Syariah, Desember 2022," <https://www.ojk.go.id/id/kanal/syariah/data-dan-statistik/statistik-perbankan-syariah/Pages/Statistik>, March 14, 2023.

⁴ Otoritas Jasa Keuangan, "Statistik Perbankan Syariah, Desember 2023," <https://www.ojk.go.id/id/kanal/syariah/data-dan-statistik/statistik-perbankan-syariah/Pages/Statistik>, February 22, 2024.

⁵ Fadhilah Hanum Lubis, Sigid Eko Pramono, and Saiful Anwar, "Income Smoothing Use Financing Loss Provision in Indonesia and Malaysia's Islamic Banks," *International Journal of Science, Technology & Management* 2, no. 1 (2021); Peterson K Ozili, "Bank Income Smoothing, Institutions and Corruption," *Research in International Business and Finance* 49 (2019): 82–99.

⁶ Syawal Harianto, Haris Al Amin, and Yumika Indah, "Pengaruh Ukuran Perusahaan, Dan Leverage Terhadap Praktik Income Smoothing Pada Bank Syariah," *Jurnal Emt Kita* 4, no. 1 (2020): 80-88; Amina Malik et al., "Impact of Earnings Variability and Regulatory Measures on Income Smoothing in Islamic Banks: Evidence from an Emerging Market," *Public Finance Quarterly* 65, no. 3 (2020): 397-410; Clarissa Nathania and Vidyarto Nugroho,

smoothing on profit quality.⁷ Third, studies examining income smoothing practices through the use of Financing Loss Provision (FLP) in Islamic banks.⁸ Fourth, reviews of income smoothing practices from the perspective of Islamic business ethics.⁹ However, no study has yet analyzed the arguments developed by the National Sharia Council of the Indonesian Ulama Council in approving income smoothing practices, particularly through the lens of *uṣūl al-fiqh* (Islamic legal methodology), with a focus on the theories of *istiḥsān* and *ḥilah*.

Despite the existence of research on fatwa income smoothing, the study's methodology does not align with the *uṣūl al-fiqh* approach employed by Dede Abdul Fatah et al. that examined this issue and others using the theory of hybrid contracts.¹⁰ A study has been conducted on the use of *istiḥsān* in the fatwa of the National Sharia Council-Indonesian Ulama Council; however, this study is not related to the income smoothing method. The study determined the utilization of *istiḥsān bi al-ʿurf* in fatwa number 119/DSN-MUI/2018 concerning ultra-micro financing in accordance with Sharia principles. Concurrently, the study on the utilization of *ḥilah* in the fatwa of the National Sharia Council-Indonesian Ulama Council places greater emphasis on the application of hybrid contracts.¹¹ Consequently, studies addressing the use of *ḥilah* in regulating income smoothing have not been conducted. The objective of the present study is to address this lacuna in the extant literature.

Method

This study employs a qualitative approach to examine Fatwa No. 87/DSN-MUI/XII/2012, issued by the National Sharia Board of the Indonesian Ulama Council, which serves as the legal foundation for the income smoothing method in Islamic banks. The fatwa was obtained from the official DSN-MUI website (<https://dsnemui.or.id/>). Primary data consist of the fatwa itself, while secondary data include scholarly articles, books on income smoothing, and banking statistics from the Financial Services Authority. Data analysis involves three steps: (1) editing – rewriting and simplifying legal materials, including fatwas and related literature; (2) systematic organization – logically classifying and organizing the data; and (3) description – presenting the research findings for legal analysis.¹²

The data were analyzed using the *uṣūl al-fiqh* (Islamic jurisprudence methodology) approach, particularly employing the theories of *istiḥsān* and *ḥilah*. This means that the arguments, evidence,

“Pengaruh Ukuran Perusahaan, Profitabilitas, Leverage, dan Komite Audit terhadap Income Smoothing,” *Jurnal Paradigma Akuntansi* 5, no. 1 (2023): 1-11.

⁷ Amy Kurniasari, Mohamad Adam, and Umar Hamdan, “The Effects of Profit Volatility, Income Smoothing, Good Corporate Governance and Non-Performing Financing on Profit Quality of Sharia Commercial Banks,” *Accounting* 9, no. 1 (2023): 9–16.

⁸ Fadhillah Hanum Lubis, Sigid Eko Pramono, and Saiful Anwar, “Income Smoothing Use Financing Loss Provision in Indonesia and Malaysia’s Islamic Banks.”

⁹ Rizkiana Iskandar et al., “Income Smoothing Practices at Sharia Banks: An Overview in Islamic Business Ethics,” *Journal of Business and Management Review* 3, no. 3 (2022): 191–207; Siti Normala Sheikh Obid and Lofti Demikha, “Earnings Management: Islamic Perspective,” *Asia Pacific Journal of Accounting and Finance* 2, no. 1 (2011): 77-89; Rediyanto Putra and Inneke Putri Widyani, “Highlighting Earning Management from Islam Perspective,” *Journal of Accounting and Investment* 20, no. 3 (2019): 251-266; Trie Nadilla, “The Earnings Management in Islamic Perspective,” *Jurnal Ekonomi Syariah, Akuntansi dan Perbankan (JESKaPe)* 6, no. 1 (2022): 1-12.

¹⁰ Dede Abdul Fatah et al., “Akad Murokab on the DSN-MUI Fatwa and Its Effect on Islamic Bank Funding Products,” *Al-Iqtishad: Jurnal Ilmu Ekonomi Syariah* 14, no. 1 (June 20, 2022): 155-172.

¹¹ Agus Fakhрина, *Hiyal dalam Inovasi Keuangan Syariah*, ed. Heriyanto (Pekalongan: SCIENTIST Publishing IAIN Pekalongan, 2022).

¹² Bachtiar, *Metode Penelitian Hukum* (Tangerang Selatan: UNPAM PRESS, 2019).



and considerations of the National Sharia Board–Indonesian Ulema Council were examined through the lens of these two theories. *Istihsān* involves preferring *qiyās khafī* (subtle analogy) over *qiyās jallī* (apparent analogy) based on a specific postulate, or excluding particular (*juz'īyyah*) issues from the general (*kullī*) rule according to the postulates of *khāṣṣ* (exception) that require such exclusion.¹³ *Istihsān* plays a crucial role in the formulation of sharia law by ensuring the continuity of benefits. The legitimacy of this exception depends on its substantiation by sharia sources. For example, *salam* (forward sales) represents a specific legal ruling that introduces a concept not originally present in the general law, as this contract provides certain benefits to society.¹⁴

Ḥiyal (the plural form of *ḥilah*) refers to the cleverness in handling situations by applying common sense to find a way to achieve a specific goal. In *ḥilah*, the chosen path is one that is prescribed or permitted by Sharia as an effort to avoid what is prohibited. This approach is undertaken without abandoning *qiyās* (analogical reasoning) and without disregarding the *maqṣad* (objective) of the means (*wasīlah*) employed. In such cases, a method is considered invalid if it does not comply with the legal stipulations of a contract. For example, if an Islamic bank uses an *ijārah* (lease) contract as a *ḥilah* to finance housing but transfers all ownership obligations to the client (tenant), the *ijārah* contract will be deemed invalid. In contrast, *istihsān* (juristic preference) demonstrates a different approach.

Result

Return Risk Control Policy

Unlike conventional banks, Islamic banks operate according to Islamic principles. One such principle used to collect third-party funds is profit-sharing, implemented through the *muḍārabah* contract. This contract affects the risk and variability of returns. Depositors may transfer their funds to conventional banks if the returns from Islamic banks are lower than the interest rates offered by conventional banks.¹⁵ This occurs because Islamic banks do not pay interest on savings products; instead, they share profits based on the *muḍārabah* contract. Consequently, the effective rate of return on Islamic bank deposits can be equal to, lower than, or higher than conventional bank interest rates.¹⁶ If the return on Islamic deposits is equal to or exceeds that of conventional banks, customers are likely to maintain their deposits with Islamic banks. However, if the return is lower due to suboptimal income from financing activities, customers may move their funds to conventional banks offering higher returns, a phenomenon known as displaced commercial risk.¹⁷

In 2011, Bank Indonesia issued Regulation Number 13/23/PBI/2011 on the Implementation of Risk Management for Sharia Commercial Banks and Sharia Business Units. Among other

¹³ Wahbah Al-Zuhailī, *Uṣūl Al-Fiqh al-Islāmī*, vol. 2 (Damaskus: Dār al-Fikr, 1986), vol. 2, 739; Muhammad Shahrul Ifwat Ishak and Syairazi Muhammad Husni Mohd Sharoni, “The Role of Istihsan in Applying Maslahah in Islamic Finance,” *Journal of Islamic Finance* 11, no. 1 (June 30, 2022): 113–120.

¹⁴ Ishak and Mohd Sharoni, “The Role of Istihsan in Applying Maslahah in Islamic Finance.”

¹⁵ Zainol and Hj. Kassim, “A Critical Review of the Literature on the Rate of Return Risk in Islamic Banks”; Ahmad Khaliq et al., “Interest Rate Risk Management and Islamic Banking: Evidence from Malaysia,” *Journal of Islamic Finance* 6, no. 1 (May 10, 2017): 16–30; Saeed et al., “Dependency of Islamic Bank Rates on Conventional Rates in a Dual Banking System: A Trade-off between Religious and Economic Fundamentals.”

¹⁶ Toumi, Viviani, and Chayeh, “Measurement of the Displaced Commercial Risk in Islamic Banks.”

¹⁷ Rouetbi, Ftiti, and Omri, “The Impact of Displaced Commercial Risk on the Performance of Islamic Banks”; Agus Widarjono, Suharto, and Diana Wijayanti, “Do Islamic Banks Bear Displaced Commercial Risk? Evidence from Indonesia,” *Banks and Bank Systems* 17, no. 3 (September 13, 2022): 102–115; Toumi, Viviani, and Chayeh, “Measurement of the Displaced Commercial Risk in Islamic Banks.”

provisions, this regulation requires Islamic banks to implement yield risk control. Yield risk arises from fluctuations in the rate of return that the bank pays to customers, which result from changes in the rate of return the bank earns from fund distribution. This risk can influence the behavior of the bank's third-party fund customers. There are two methods to control yield risk: the income smoothing method with mitigation and the income smoothing method without mitigation.¹⁸ The income smoothing method with mitigation employs the Profit Equalization Reserve (PER) model. Under this model, Islamic banks may only establish internal reserves from the portion of their profits that exceed the competitive rate of return. Conversely, the income smoothing method without mitigation permits Islamic banks to reduce the portion of profits distributed to customers as grants or gifts, thereby maintaining a competitive rate of return.¹⁹

The National Sharia Board of the Indonesian Ulama Council, in 2012, responded to this issue by reinforcing and legitimizing the policy. According to Ma'ruf Amin, Islamic banks advocate for the immediate recognition of the legitimacy of using reserve funds as part of the income smoothing method. Reserve funds are utilized to maintain the competitiveness of returns in Islamic banking and can be deployed when profit sharing decreases. This approach helps preserve depositor interest by compensating for reduced profit sharing through reserve funds.²⁰ Consequently, Fatwa No. 87/DSN-MUI/XII/2012, concerning the income smoothing method for third-party funds, was issued on December 21, 2012. With this fatwa, the National Sharia Board of the Indonesian Ulama Council approved income smoothing by Islamic banks, whether implemented with or without reserve funds.

This fatwa represents a form of legitimacy or approval granted by the National Sharia Board of the Indonesian Ulama Council for the income smoothing method employed by Islamic banks and regulated by Bank Indonesia. The fatwa serves to reinforce the effectiveness of this method. The Financial Services Authority issued Regulation Number 65/POJK.03/2016 concerning the Implementation of Risk Management for Sharia Commercial Banks and Sharia Business Units. In 2023, this was followed by Circular Letter Number 25/SEOJK.03/2023, which addresses the Implementation of Risk Management for Sharia Commercial Banks and Sharia Business Units. The circular mandates that Islamic banks implement the income smoothing method to manage yield risk. It provides more detailed regulations on how Islamic banks should conduct yield risk management, including the requirement to benchmark their rates against those of their competitors (conventional banks). Additionally, the yield risk management information system must supply data necessary for calculating the benchmark rate to determine the bank's return level.

Interest Rate as a Benchmark

The endorsement by the National Sharia Board of the Indonesian Ulama Council for the use of the income smoothing method, as previously mentioned, further supports the Financial Services Authority in enhancing its return risk control policies. In 2023, the Financial Services Authority issued Circular Letter No. 25/SEOJK.03/2023, which requires Islamic banks to incorporate

¹⁸ Laela and Latif, "Income Smoothing, Displaced Commercial Risk and Bankruptcy in Indonesian Islamic Banks During the COVID-19 Pandemic."

¹⁹ Islamic Financial Services Board, "Guidance Note on the Practice of Smoothing the Profits Payout to Investment Account Holders," https://www.ifsb.org/wp-content/uploads/2023/10/FAQs-for-GN-3_En.pdf, n.d.

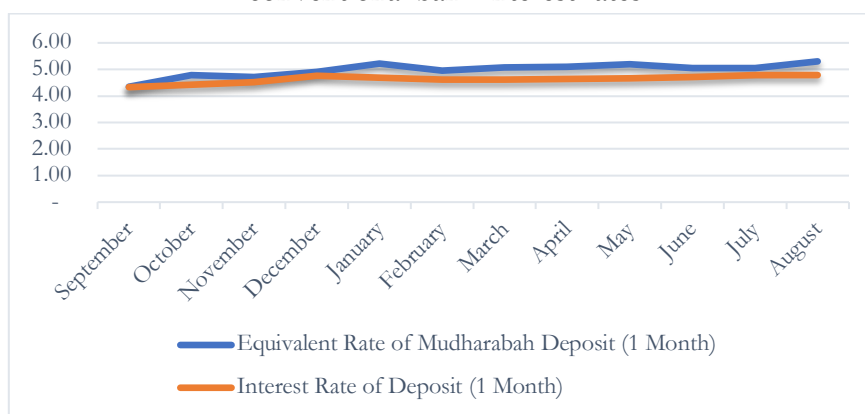
²⁰ Nur Aini, "Dana Cadangan Bank Syariah Dibahas DSN-MUI," <https://republika.co.id/berita/syariah/keuangan/12/04/04/lzgyxg-dana-cadangan-bank-syariah-dibahas-dsnmui>, February 16, 2012.



benchmark rates into their profit-sharing risk management information systems. This directive aims to facilitate the determination of the banks' return levels. Although Islamic banking prohibits interest, risk-control policies for returns effectively use market interest rates as benchmarks for pricing financial products. Changes in benchmark rates are likely to influence the rates of return that Islamic banks expect to earn on their funds and pay to their depositors. A substantial body of research has shown that, despite the prohibition of interest in Islamic banking transactions, fluctuations in interest rates significantly impact the performance of Islamic banks.²¹

As a result, it is common for Islamic banks to promote their deposit products by also presenting the projected profit-sharing rates or equivalent yields associated with these products. Most Islamic banks employ yield projections in their product promotions. Examples can be found on official websites such as <https://www.megasyariah.co.id>; <https://www.cimbniaga.co.id>; <https://www.maybank.co.id>; and <https://www.btpnsyariah.com>. Therefore, it is typical for Islamic banks to advertise their deposit products alongside a projected yield or equivalent rate. Kusuma et al., in their study, found that when setting the profit-sharing rates for their deposit products, Islamic banks tend to mimic the interest rates offered by conventional banks. They acknowledge using benchmarking to determine the pricing of their *muḍārabah* deposit products, aiming to align these rates with prevailing interest rates in conventional banking institutions. Similarly, in setting the profit-sharing ratios for their savings products, they imitate the interest rates of conventional savings accounts.²² Data on the equivalent rates of Islamic bank *muḍārabah* deposits, published by the Financial Services Authority for the period September 2023 to August 2024 (see Figure 1), also appears to follow conventional bank deposit rates to remain competitive.²³

Figure 1. Graph of the *muḍārabah* deposit equivalent rate and conventional bank interest rates



Source: Compiled by the authors

This graph illustrates how Islamic banks maintain the rewards given to depositors within a stable range—avoiding excessive volatility—while remaining competitive with the interest rates offered by conventional banks. This suggests that the National Sharia Board of the Indonesian

²¹ Zainol and Hj. Kassim, “A Critical Review of the Literature on the Rate of Return Risk in Islamic Banks.”

²² Kumara Adji Kusuma et al., “Profit Sharing Ratio Determination of Mudharabah Contract in Indonesia Islamic Banks,” *Opcion* 34, no. 85 (2018): 2804–2813.

²³ Otoritas Jasa Keuangan, “Statistik Perbankan Syariah-Agustus 2024,” <https://www.ojk.go.id/id/kanal/syariah/data-dan-statistik/statistik-perbankan-syariah/Pages/Statistik-Perbankan-Syariah---Agustus-2024.aspx>, n.d.; Otoritas Jasa Keuangan, “Statistik Perbankan Indonesia Agustus 2024,” <https://www.ojk.go.id/id/kanal/perbankan/data-dan-statistik/statistik-perbankan-indonesia/Pages/Statistik-Perbankan-Indonesia---Agustus-2024.aspx>, October 24, 2024.



Ulama Council is yielding to market forces that favor such practices. On one hand, the actions of the National Sharia Board enable the Islamic banking industry to develop and compete effectively with conventional banks. On the other hand, they increase public awareness that Islamic banks and conventional banks are not significantly different. The profit shares received by customers on their savings or deposits closely resemble those of conventional banks, being distributed in a similar manner. The legitimacy granted to income smoothing practices has resulted in profit sharing that appears to be pseudo profit sharing. At this point, it seems necessary to pursue more innovative and Sharia-compliant breakthroughs rather than merely adopting conventional banking methods, in order to foster greater public trust, confidence, and loyalty in Islamic banking products.

Discussion

Legal Stratagems (Hilal) in Profit Recognition and Reporting Arrangements

The National Sharia Board of the Indonesian Ulama Council, in its Fatwa No. 87/DSN-MUI/XII/2012, permits Islamic banks to use income smoothing methods when distributing returns on third-party funds. Islamic banks are allowed to regulate the recognition and reporting of profits or income by withholding a portion of the profit or income in one period and transferring it to another. This practice aims to reduce excessive fluctuations in profit sharing between Islamic financial institutions and depositors (third-party fund holders). The objective is to ensure that the returns provided by Islamic banks align with projected expectations. To achieve this, Islamic banks may establish a Profit Equalization Reserve (PER) or choose not to form such a reserve fund.

In the application of the income smoothing method through the formation of a profit adjustment reserve fund, Islamic banks are permitted to set aside profits exceeding the projected remuneration level before distribution, subject to two conditions. First, the actual profit share must exceed the projected rate of return. Second, this must be done with the customer's consent. Conversely, if the actual profit share is lower than the projected return, the reserve fund should not be formed by reducing the profit share that rightfully belongs to the customer. This fatwa also stipulates that the reserve funds formed are collectively the rights of the customers, while Islamic banks retain the authority to manage the income and customer returns. Regarding the use of the income smoothing method without forming a profit adjustment reserve, Islamic banks are allowed to waive their rights to customers when the distributed business results fall below projections, in order to maintain competitive customer return levels.²⁴

According to the rules outlined in the fatwa, Islamic banks are permitted to set a projected rate of return. This projected yield serves as the basis for calculating the amount of profit to be distributed to customers and the portion to be retained by the bank. Consequently, the returns provided to customers align with the previously projected yield. The yield offered by the bank is not the full profit earned; a portion is withheld when actual profits exceed the projected return, or an additional amount is drawn from previously withheld profits to meet the projected return when actual profits fall short. Even if the Islamic bank does not establish a profit adjustment reserve

²⁴ Muhammad Izzul Syahmi Zulkepli and Mohammad Taqiuddin Mohamad, "Hiyal Analysis in Deposit Product Based on Tawarruq Contract in Malaysian Islamic Banking," *Online Journal of Research in Islamic Studies* 6, no. 1 (March 28, 2019): 43–59; Ehsanullah Agha Syed and Mustafa Omar, "Hiyal in Islamic Finance: A Recognition of Genuine Economic Need or Circumvention of Riba?" *Qualitative Research in Financial Markets* 9, no. 4 (November 6, 2017): 382–90.



fund, it is allowed to waive its rights and distribute lower returns to customers when business results are below projections, ensuring the return remains competitive. This mechanism enables banks to consistently provide a projected rate of return that is stable (not overly volatile) and competitive.²⁵ This type of arrangement or engineering of actions in Islamic legal literature is known as *hilah*. *Hilah* refers to the clever use of common sense to find a way to achieve a specific goal.²⁶ In this context, the National Sharia Board of the Indonesian Ulema Council instructs Islamic banks on *hilah* by establishing guidelines for the recognition and reporting of profits or income. A simple illustration is as follows:

Person A provides capital to Person B in the amount of IDR 100,000,000 under a *muḍārabah* contract with an equal profit-sharing ratio of 50% each. Person B projects that Person A will earn a profit of 10% of the capital in one year, or IDR 10,000,000. At the end of the year, the actual profit earned is IDR 50,000,000. Based on the profit-sharing ratio, Person A should receive IDR 25,000,000. However, to meet the 10% projection, the recognized profit is limited to IDR 20,000,000, with the remaining IDR 30,000,000 recorded as retained earnings. Therefore, Person A's share is 50% of IDR 20,000,000, which equals IDR 10,000,000. Thus, Person A's return is IDR 10,000,000, not IDR 25,000,000, in accordance with the projection. Conversely, if in the following year the profit is only IDR 5,000,000, Person A's share based on the profit-sharing ratio would be IDR 2,500,000. However, to maintain the 10% projection, Person A's return is adjusted to IDR 10,000,000 by taking IDR 2,500,000 from Person B's share and IDR 5,000,000 from the reserve fund.

Al-Masri stated that the use of interest rate tables for project valuation is not prohibited. He considers the interest rate table a technical mathematical tool, and therefore, its use is permissible.²⁷ Meanwhile, Kahf, although he rejects the use of the time value of money when assessing a project, allows its use as a mental exercise.²⁸ Siddique and Memoona Rahim do not object to using the time value of money in capital budgeting. They assert that it is permissible to use discount values to compare projects and decide which to select. However, they maintain that using discount values to calculate actual project returns is prohibited in Islam. The concept of the time value of money applies only when evaluating and comparing projects to choose among them; it should not be used to determine interest rates on loans.²⁹

Thus, using the equivalent rate to calculate the projected yield is not inherently problematic in Islam. However, the issue arises when the yield is entirely allocated to meet the projected return, leading to income smoothing behavior to ensure the projection is achieved. This practice violates the fundamental principles of the *muḍārabah* contract because the business profit sharing is not

²⁵ Muhammad Omer Rafique Et Al., "Analysis Of Hiyal (Legal Stratagems) Cases in Islamic Financial Law," *Russian Law Journal* 11, no. 2 (March 31, 2023): 299-308; Aaron Z. Pitluck, "Sometimes It Looks Fake': *Hiyal* and Contrivances as Tools for Exploring Aspirations for Radical Social Change," *Economic Anthropology* 11, no. 2 (June 2, 2024): 235-45;

²⁶ Satoe Horii, "Reconsideration of Legal Devices (*Hiyal*) In Islamic Jurisprudence: The Hanafis and Their 'Exits' (*Makhārij*)," *Islamic Law and Society* 9, no. 3 (2002): 312-57; Sumayyah Abdul Aziz and Nadhirah Nordin, "An Analysis of the Hiyal Syariyyah Concept Pertaining to Deferred Products in Malaysia," *International Journal of Academic Research in Business and Social Sciences* 9, no. 6 (2019): 259-270.

²⁷ Rafiq Yunus Al-Masri, *Al-Ribā wa al-Ḥasm al-Zamanī fī al-Iqtisād al-Islāmī* (Damaskus: Dār al-Maktabī, 2009).

²⁸ Monzer Kahf, "Time Value of Money and Discounting in Islamic Perspective: Revisited," *Review of Islamic Economics* 3, no. 2 (1994): 31-38.

²⁹ Muhammad Abubakar Siddique and Memoona Rahim, "The Concepts of Discounting and Time Value of Money in Islamic Capital Budgeting Framework: A Theoretical Study," *Journal of Islamic Banking and Finance, Pakistan* 32, no. 1 (2015): 23-29.

fully distributed; instead, a portion is placed into a reserve fund, or the bank relinquishes part of its profit share to the customer to meet the projected returns. It appears that the National Sharia Board of the Indonesian Ulama Council is encouraging Islamic banks to engage in such practices.

Ḥilāh is categorized into two types: permissible *ḥilāh* and forbidden *ḥilāh*.³⁰ Permissible *ḥilāh* refers to strategies that do not violate the clear legal analogy (*qiyās jallī*) and are intended for beneficial purposes.³¹ Forbidden *ḥilāh*, on the other hand, includes any strategy that violates *qiyās jallī*, even if intended for benefit; or any strategy that does not violate *qiyās jallī* but is intended to cause harm; as well as those that both violate *qiyās jallī* and are intended to cause harm.³² It appears that the *ḥilāh* endorsed by the National Sharia Council of the Indonesian Ulama Council falls into the category of *ḥilāh* that violates *qiyās jallī*. However, since it has become a common practice (*ʿurf*) and serves the interests of Islamic banks, the National Sharia Board of the Indonesian Ulama Council permits its use.

Regarding this particular type of *ḥilāh*, scholars hold divergent opinions. Among Hanafi scholars who advocate *istiḥsān*, there is a tendency to permit this form of *ḥilāh* based on *istiḥsān* when supported by other evidence, such as *ʿurf* (custom) or *maṣlaḥah* (public interest). This is exemplified by the allowance of *bayʿ al-wafāʾ* on the basis of *istiḥsān bi al-ʿurf wa al-maṣlaḥah* by some Hanafi scholars,³³ despite the consensus among the majority of Islamic jurisprudence scholars—including those of the Maliki, Shafiʿi, Hanbali schools, and some Hanafi scholars—that *bayʿ al-wafāʾ* is a defective sale and, in substance, is actually a *rahn* (pledge).³⁴ According to these scholars, *bayʿ al-wafāʾ* constitutes a forbidden *ḥilāh* intended to circumvent the prohibition of *ribā*, rendering the transaction *ḥarām*.³⁵ Specifically, *bayʿ al-wafāʾ* violates certain clear analogical principles (*qiyās jallī*). First, it contravenes the *qiyās jallī* of a contract of sale and purchase: both parties must have the right to perform a legally binding sale, and the buyer does not have the right to resell the item to others. Second, if regarded as a *rahn*, it violates the *qiyās jallī* of *rahn*: the *murtahin* (pledgee) cannot legally possess or benefit from the pledge without the owner's permission. However, these issues are considered acceptable by some due to a special postulate grounded in *ʿurf* and *maṣlaḥah* aimed at avoiding *ribā*.

Legal Preference (Istiḥsān) as the Main Evidence

As mentioned above, the *ḥilāh* taught by the National Sharia Board of the Indonesian Ulama Council violates the fundamental provisions (*qiyās jallī*) of the *muḍārabah* contract. This deviation

³⁰ Mohd Ashrof Zaki Bin Yaakob et al., “Application of Hiyal (Legal Stratagems) on Al-Ijarah-Based Contract in Islamic Financial Institution in Malaysia,” in *Contemporary Issues and Development in the Global Halal Industry* (Singapore: Springer Singapore, 2016), 391–400.

³¹ Muhammad Omer Rafique Et Al., “Analysis Of Hiyal (Legal Stratagems) Cases in Islamic Financial Law”; Fakhriana, *Hiyal Dalam Inovasi Keuangan Syariah*; Yaakob et al., “Application of Hiyal (Legal Stratagems) on Al-Ijarah-Based Contract in Islamic Financial Institution in Malaysia.”

³² Syed and Omar, “Hiyal in Islamic Finance: A Recognition of Genuine Economic Need or Circumvention of Ribā?”; Muhammad Omer Rafique Et Al., “Analysis Of Hiyal (Legal Stratagems) Cases in Islamic Financial Law.”

³³ Ubaidillah Ubaidillah, “Tinjauan Istihsan Terhadap Baiʿ al- Wafaʿ Di Baitul Maal Wa Tamwil Sidogiri Cabang Bondowoso,” *Istidlal: Jurnal Ekonomi Dan Hukum Islam* 2, no. 2 (2018): 149-163; Muklisin Muklisin and Khoiri Khoiri, “Baiʿ Al Wafaʿ dalam Tinjauan Hukum Islam,” *ISTIKHLAF: Jurnal Ekonomi, Perbankan dan Manajemen Syariah* 1, no. 2 (2020): 1-11.

³⁴ Dewi Wulan Fasya, “Jual Beli dengan Hak Membeli Kembali (Studi Komparasi antara Kitab Undang-Undang Hukum Perdata dan Fikih Syafiʿi),” *JURISDICTIE* 6, no. 1 (2017): 50-62.

³⁵ Ubaidillah, “Tinjauan Istihsan Terhadap Baiʿ al- Wafaʿ Di Baitul Maal Wa Tamwil Sidogiri Cabang Bondowoso”; Feri Irawan, “Pengembangan Wakaf Berbasis Sukuk dalam Pemberdayaan Tanah Tidak Produktif di Indonesia Perspektif Hukum Islam,” *Muʿamalatuna: Jurnal Ekonomi Syariah* 3, no. 2 (2021): 56-74.



stems from the fact that the income smoothing method has long been practiced by Islamic banks to enhance their competitiveness with conventional banks, thereby minimizing the risk of customers transferring or withdrawing funds due to uncompetitive or unreasonable profit levels (displaced commercial risk). These considerations are outlined in Fatwa No. 87/DSN-MUIXII/2012 concerning the Income Smoothing Method for Third-Party Funds. This indicates that the National Sharia Board of the Indonesian Ulama Council relies primarily on the principle of *istiḥsān bi al-ʿurf wa al-maṣlaḥah* to permit Islamic banks to apply the income smoothing method. *Istiḥsān* involves preferring *qiyās khaṭī* over *qiyās jallī* based on a specific postulate, or the exclusion of particular (*juzʿiyyah*) issues from the general (*kullī*) rule when justified by special postulates (*khāṣṣ*) that require such exclusion.³⁶ In other words, the National Sharia Board of the Indonesian Ulama Council departs from the *qiyās jallī* of the *muḍārabah* contract due to a special postulate grounded in *ʿurf* (custom) and *maṣlaḥah* (public interest).

The National Sharia Board of the Indonesian Ulama Council focuses more on providing legal solutions rather than merely declaring whether the legal issues of a submitted transaction are *ḥarām*, permissible, or otherwise. In responding to legal questions through its fatwas, the Board prioritizes offering solutions that align with Sharia principles.³⁷ Therefore, for every legal issue addressed in a fatwa, the National Sharia Board seeks to find a resolution based on postulates they consider appropriate. Maʿruf Amin stated that the Board consistently applies the rule of *al-taisīr al-manhajī*, which encourages choosing the more lenient opinion while remaining within the established legal framework (*manhaj*). This approach has been the most widely used method by the National Sharia Board to date.³⁸

Table 1. Legal maxim used in fatwa

No.	Islamic legal maxim
1	All forms of <i>muʿāmalah</i> are generally permissible unless there is clear evidence explicitly prohibiting them
2	Where there is benefit, there is the law of Allah
3	People who donate should not be compelled to do so
4	The leader's policy toward his people must consider public interests
5	Seeking to secure an emergency position
6	Wishes do not grant the right to take someone else's property
7	According to Sharia law, a person cannot take another individual's property without a valid reason.

In general, the National Sharia Board of the Indonesian Ulama Council consistently bases its fatwas on verses from the Qur'an, Hadith, *Ijmāʿ* (consensus), legal maxims, scholarly opinions,

³⁶ Ubaidillah, "Tinjauan Istihsan Terhadap Bai' al- Wafa' Di Baitul Maal Wa Tamwil Sidogiri Cabang Bondowoso"; Wardatun Nabilah, Arifki Budia Warman, and Nurul Aini Octavia, "Istihsan dalam Literatur Syafi'iyah (Telaah Istihsan dalam Kitab Al-Mustasfa Al-Ghazali)," *Juris: Jurnal Ilmiah Syariah* 20, no. 1 (2021): 77-89; Muhammad Al Zuhri and Fery Dona, "Penggunaan Alkohol Untuk Kepentingan Medis Tinjauan Istihsan," *Journal of Law, Society, and Islamic Civilization* 9, no. 1 (2021): 40-49; Panji Adam, "Penerapan Metode Istihsan pada Bidang Muāmalah Māliyyah (Hukum Ekonomi Syariah)," *Jurnal Ilmiah Universitas Batanghari Jambi*, no. 1 (2021): 68-79.

³⁷ Maʿruf Amin, *Solusi Hukum Islam (Makharij Fiqhiyyah) Sebagai Pendorong Arus Baru Ekonomi Syariah di Indonesia: Kontribusi Fatwa DSN-MUI Dalam Peraturan Perundang-Undangan RI* (Malang: Universitas Islam Negeri Maulana Malik Ibrahim, 2017).

³⁸ Maʿruf Amin, "Sambutan Wakil Presiden RI pada Acara Pembukaan Pra Ijtima' Sanawi (Annual Meeting) Dewan Pengawas Syariah Se-Indonesia," in *Workshop Pra Ijtima' Sanawi DSN-MUI 12 - 19 Oktober 2020* (Jakarta: DSN-MUI, 2020).

fatwas from other fatwa institutions, and guidelines from the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) to support their arguments. In the fatwa concerning the use of the income smoothing method, the National Sharia Board primarily grounds its legal opinion on fiqh principles, AAOIFI standards, and the views of Hanafi scholars who emphasize *maṣlaḥah* (public interest). Seven legal maxims are referenced, as detailed in the accompanying Table 1.

Numbers 1, 2, 4, and 5 demonstrate that there is flexibility in determining the law with consideration of benefits, while numbers 3, 6, and 7 establish rules or limitations on these leniencies. This indicates that the National Sharia Board of the Indonesian Ulama Council is more oriented toward *maṣlaḥah* in its rulings. To further support their opinions, they referenced the decision of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) No. 12 (numbers 3/1/5/14) and the views of scholars from the Hanafi school. The AAOIFI decision states that a company may withhold profits without distributing them or set aside profits periodically to strengthen the company's performance, form special reserves to mitigate the risk of capital losses, or maintain the stability of profit distribution. Meanwhile, Hanafi scholars permit the inclusion of a condition in which one party to the contract receives a dinar with a specified amount based on business profits exceeding a certain value. This condition is considered valid and does not affect the validity of the *muḍārabah* contract because it does not create uncertainty in profit distribution. The Hanafi school is known for introducing *istiḥsān* (juristic preference) as a legal principle.

The approval by the National Sharia Board of the Indonesian Ulama Council regarding the use of income smoothing in the distribution of third-party fund returns cannot be separated from the consideration of *urf*, as this has become a common practice, and *maṣlaḥah*, to enable Islamic banks to compete with conventional banks. This aims to prevent the risk of customers withdrawing funds from Islamic banks due to uncompetitive or unreasonable levels of remuneration (displaced commercial risk). However, the *urf* considered by the National Sharia Board appears to conflict with *maqāṣid al-sharī'ah*, which requires transparency in information disclosure, especially concerning profits earned by Islamic banks, to ensure justice. Income smoothing clearly involves elements of fraud and ambiguity. From the perspective of *maqāṣid al-sharī'ah*, there are no provisions permitting any form of profit management that contradicts Islamic law. Regardless of the underlying motivation, such practices are inconsistent with Islamic teachings because they tend to benefit one party at the expense of another, thereby involving elements of fraud.³⁹ Indeed, any *urf* that contradicts the explicit texts (*nuṣūṣ*) of sharia is entirely rejected. For example, the *urf* of lending money (*qarḍ*) with interest is categorically prohibited because it contradicts the sharia texts that forbid usury.

Moreover, the concept of *maṣlaḥah* upheld by the National Sharia Board of the Indonesian Ulama Council appears to be biased, favoring Islamic banks over the broader community. The *maṣlaḥah* in question is based on collective *ijtihād*, which can be subject to misuse, given that *maṣlaḥah* itself is a broad and flexible concept. This underscores the need for further study on the

³⁹ Fadhilah Hanum Lubis, Sigid Eko Pramono, and Saiful Anwar, "Income Smoothing Use Financing Loss Provision in Indonesia and Malaysia's Islamic Banks"; Obid and Demikha, "Earnings Management: Islamic Perspective"; Trie Nadilla, "The Earnings Management in Islamic Perspective"; Putra and Widyani, "Highlighting Earning Management from Islam Perspective"; Iskandar et al., "Income Smoothing Practices at Sharia Banks: An Overview in Islamic Business Ethics."



overall impact of such decisions.⁴⁰ The term *maṣlaḥah* is traditionally associated with the public interest, rather than being limited to specific groups within society, such as Islamic banks. There is a legal maxim stating, “If there is a conflict between the *maṣlaḥah* pursued by a few individuals and that of a larger group, the latter prevails.”⁴¹ Therefore, employing *maṣlaḥah ‘āmmah* (general public interest) as a benchmark and guiding principle in policy-making is essential to prevent the misuse of *maṣlaḥah ‘āmmah* for personal desires, arbitrariness, or the interests of particular groups disguised as public interest. Using *maṣlaḥah ‘āmmah* as a criterion in policy formulation ensures that any established policy does not cause harm or infringe upon the interests of humanity at large. However, it seems that the National Sharia Council of the Indonesian Ulama Council places excessive emphasis on the interests of Islamic banks, neglecting to verify whether these interests align with the public good and whether the *‘urf* (customary practice) commonly adopted by Islamic banks falls within the scope of valid (*ṣaḥīḥ*) or invalid (*fāsid*) customs.

Conclusion

The National Sharia Board of the Indonesian Ulama Council has authorized the use of the income smoothing method for distributing returns on third-party funds. This method constitutes a form of *ḥīlah*, a practice that contradicts the fundamental principles of the *muḍārabah* contract. The approval is based on the concept of *istiḥsān*, specifically *istiḥsān bi al-‘urf wa al-maṣlaḥah*, which permits deviation from the basic provisions (*qiyās jallī*) of the *muḍārabah* contract due to special considerations in the form of *‘urf* (customary law) and *maṣlaḥah* (public interest). This decision aims to strengthen the capacity of Bank Indonesia and the Financial Services Authority to implement yield risk control policies through the income smoothing method. Furthermore, the Financial Services Authority’s circular letter number 25/SEOJK.03/2023 uses interest rates as a benchmark for yield risk control. While this approval may help the Islamic banking industry grow and compete with conventional banks, it also risks creating the perception that Islamic banks are no different from conventional banks. Therefore, there is a need for more innovative and genuinely sharia-compliant breakthroughs beyond merely adopting conventional banking methods to foster greater public trust, confidence, and loyalty in Islamic banking products.

This study focuses exclusively on the National Sharia Board of the Indonesian Ulama Council, which presents several limitations. The primary limitation is that the main data source consists solely of fatwas issued by the National Sharia Board. However, this limitation also creates opportunities for further research, such as investigating public perceptions of the returns generated through the application of income smoothing methods and their expectations of Islamic banks. Given the novel exploration of the National Sharia Board’s arguments in its fatwas, there is significant potential for future research to advance the discipline of Islamic economic law. The evolving direction of Islamic economic law studies now draws not only from traditional fiqh texts but also from fatwas issued by contemporary scholars and current fatwa institutions, reflecting the dynamic nature of the field.

⁴⁰ Suheyib Eldersevi and Razali Haron, “An Analysis of Maṣlaḥah Based Resolutions Issued by Bank Negara Malaysia,” *ISRA International Journal of Islamic Finance* 12, no. 1 (2020): 89-102.

⁴¹ M. Ainur Rifqi and A. Halil Thahir, “Tafsir Maqasidi: Membangun Paradigma Tafsir Berbasis Mashlahah,” *Millah* 18, no. 2 (February 16, 2019): 335–356.

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