

Legal Protection of Islamic Banks Against Problematic Murabahah Financing Associated with the Use of Notary Covernote

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Abstract: This research delves into the legal intricacies surrounding the use of notary covernotes in the disbursement of murabahah financing within Islamic banking. A covernote is a certificate issued by a notary when a customer has yet to meet all the prerequisites for financing, such as incomplete collateral checks or unsecured land ownership certificates. Although lacking legal enforceability, covernotes guide Islamic banks in financing disbursement, with notaries responsible for completing the collateral process until a Deed of Granting Mortgage is issued. Despite the authority to create authentic deeds, covernotes are not recognized as such, leading to potential legal vulnerabilities. This study explores a specific case where the failure to convert a covernote into a formal mortgage deed led to non-performing loans, emphasizing the need for legal protections against notarial negligence. Employing empirical juridical research methods, this analysis observes real-world legal practices and evaluates the actions of legal institutions in addressing these issues to enhance legal certainty. The findings highlight that the quality of financing, indicating the customer's ability to meet contractual obligations, is a crucial metric for assessing the financial health and risk of Islamic banks. The paper argues for improved monitoring and management of financing to mitigate risks, maintain financial stability, and ensure the ongoing viability of banking operations.

Keywords: *Legal Protection, Murabahah Financing, Sharia Banking, Notary Covernote*

INTRODUCTION

Notaries play an important role as public officials in facilitating the creation of legal documents, ensuring the validity of transactions, and safeguarding the rights of individuals and the public interest. The existence of notaries has a significant impact on stability and trust in the legal system. In accordance with Article 1 paragraph (1) of the Notary Position Law (UUJN), a notary in the service sector is an official who is given official authority by the state to provide services to the public in a civil context, especially in the process of making authentic deeds. As a limitation so that his position does not conflict with other positions, the authority of a notary is regulated in Article 15 paragraph (1) of Law Number 2 of 2004 Concerning Amendments to Law Number 30 of 2004 Concerning the Position of Notary.

Authentic deeds, made by notaries as legal products, have an important role as very strong and comprehensive evidence in various legal relationships in society. Along with the increasing demand for legal certainty, the demand for written evidence in the form of authentic deeds is growing in various contexts of business, banking, property, and social environments, among others. Through an authentic deed that clearly determines rights and obligations, guarantees legal certainty, and at the same time is expected to avoid disputes. In the process of dispute resolution, authentic deeds - which are the strongest and most complete written evidence - are very helpful in achieving cheap and fast case settlement.¹

The relationship between notaries and Islamic banking is very close because notaries have a very vital role in the world of Islamic banking.² Notaries can support the creation of good governance for Islamic banks, namely formulating the will of Islamic banks and customers in financing contracts into authentic deeds³. Islamic banks as financial institutions almost mostly or entirely need notaries, especially in terms of making contracts or deeds in Islamic banking activities such as conducting various collaborations, financial transactions, required in relation to customers (Islamic banking products), and binding collateral. In addition, notaries also have an important role in making murabaha financing deeds in Islamic banking. Although the relationship between notaries and Islamic banks is not a contractual relationship, notaries must still pay

¹ Maureen Turangan, "Tanggungjawab Hukum Pejabat Notaris Terhadap Akta Yang Ditertibkan," *Lex Privatum* 3, no. 3 (2015): 98, <https://ejournal.unsrat.ac.id/index.php/lexprivatum/article/view/8992>.

² Feisal Khan, "How 'Islamic' Is Islamic Banking?," *Journal of Economic Behavior & Organization* 76, no. 3 (December 2010): 805-20, <https://doi.org/10.1016/j.jebo.2010.09.015>.

³ Ina Faturohmah, "Peran Notaris Dalam Menegakkan Good Corporate Governance Pada Perbankan Syariah," *Jurnal Lex Renaissance* 3, no. 1 (January 29, 2018): 231, <https://doi.org/10.20885/JLR.vol3.iss1.art10>.



attention to their professional code of ethics and uphold their professionalism and independence⁴.

In the world of Islamic banking, murabaha financing is one of the legal products closest to the notary. This financing is arranged by both parties, namely the Islamic bank who has a claim and the customer as the party who has a debt. This murabahah financing also includes an agreement on the rights and obligations of both, especially with regard to providing and using murabahah financing available by Islamic banks. OJK noted that the performance of the conventional or sharia rural bank (BPR) industry has been marked by an increasing trend in *non-performing loans (NPL)* in the last three years, according to OJK, as of August 2022, the BPR rate reached 7.98 percent, continuing to rise from 7.22 percent in 2021 and 6.81 percent in 2020. This figure is far above the average NPL of the national banking industry of 2.88 per year. To get around this, most BPRs and BPRSs choose the alternative route of *merging* (Merger) 10 BPRs in Eastern Indonesia that want to merge. Namely, PT BPR Modern Express, PT BPR Irian Sentosa, PT BPR Palu Lokadana Utama, PT BPR Modern Express Central Java, PT BPR Modern Express NTT, PT BPR Modern Express Southeast Sulawesi, PT BPR Modern Express South Sulawesi, PT BPR Modern Express West Papua, PT BPR Modern Express North Maluku, and PT BPR Modern Express North Sulawesi. The ten BPRs are spread across 10 different provinces⁵

In general, murabaha financing is made together with an *assecoir* collateral agreement. Islamic banks usually make the agreements legally before a notary to give them legal force⁶. In principle, notaries as public officials are obliged to carry out their duties with a high level of professionalism when making the deed of murabahah financing for Islamic banks⁷. Islamic banks set requirements that must be met by customers to obtain murabaha financing. One of these requirements is collateral. Collateral, along with the economic condition of the debtor, determines how much credit the bank will give to the debtor. Initially, customers who need financing apply for murabaha financing to Islamic banks.

⁴ Tya Pancawati Hutagalung, Siti Malikhatun Badriyah, and Irawati Irawati, "Kedudukan Perjanjian Kerjasama Notaris Dengan Bank (Ditinjau Dari Undang-Undang Jabatan Notaris Dan Kode Etik Notaris)," *Notarius* 14, no. 1 (May 11, 2021): 358, <https://doi.org/10.14710/nts.v14i1.39002>.

⁵ Ghoida Rahmah, "Jerat Kredit Macet Bank Perkreditan Rakyat," *Tempo*, December 13, 2022, <https://koran.tempo.co/read/ekonomi-dan-bisnis/478805/mengapa-tingkat-kredit-macet-bpr-atau-bprs-tinggi>.

⁶ Nugraha Pratama Septiansyah Gusti, Ahmadlham Alhamdha, and Muchammad Alfieyan, "Peran Covernote Notaris Sebagai Dasar Pencairan Kredit Oleh Bank," *Journal of Education and Development* 11, no. 1 (December 21, 2022): 88, <https://doi.org/10.37081/ed.v11i1.4252>.

⁷ Wirjono Prodjodikoro, *Perbuatan melanggar hukum: dipandang dari sudut hukum perdata* (Bandung: Mandar Maju, 2000), 6.



After the bank approves the application, the debtor and the Islamic bank will enter into a murabahah financing contract which regulates various aspects including collateral in the form of a mortgage.⁸

Furthermore, the Islamic bank binds the Power of Attorney to Enforce Mortgage Rights (SKMHT) to the customer. The Power of Attorney to Impose Mortgage Rights (SKMHT) functions as an instrument that authorizes Islamic banks to impose a mortgage on the customer's land as collateral for the credit provided. After the specified time, the Power of Attorney to Enforce Mortgage Rights (SKMHT) will be upgraded to a Deed of Enforcement of Mortgage Rights (APHT), the customer and the Islamic bank together with a notary carry out the process of making a Deed of Granting Mortgage Rights (APHT). In this process, the details of the mortgage rights that have been agreed upon in the credit agreement are officially recorded in the APHT. After the APHT is completed, the notary will register it at the local land office. This registration process aims to ensure that the mortgage rights are legally recorded and validated. After successful registration, the Islamic bank will become the holder of the mortgage rights and a certificate of mortgage rights is issued in the name of the bank as collateral for the agreed murabaha financing. This whole process creates legal certainty in murabahah financing transactions between customers and Islamic banks.

Murabahah financing is preceded by debt guarantee because of the need for certainty and security for the lender or Islamic bank⁹. Debt collateral is a preventive measure to protect the interests of the lender or Islamic bank, provide certainty of payment, and minimize the risk of loss due to the customer's inability to fulfill debt payment obligations in accordance with the agreed murabahah financing¹⁰. However, the binding of collateral until the emergence of the Mortgage Rights certificate often takes a long time. Consequently, the notary issues a covernote as a form of commitment to complete the collateral binding process.

As a result, the Islamic bank has the right to disburse the murabaha financing facility to the customer based on the covernote. The issuance of a covernote, which is a standard certificate issued by a Notary who also serves as a Land Deed Official (PPAT), is due to work that is still in process or because the Notary has not been able to issue and register a mortgage.

⁸ Zamir Iqbal and Abbas Mirakhor, "Progress and Challenges of Islamic Banking," *Thunderbird International Business Review* 41, no. 4-5 (July 1999): 381-405, <https://doi.org/10.1002/tie.4270410406>.

⁹ SH Gatot Supramono, *Perjanjian Utang Piutang* (Kencana, 2014), 117.

¹⁰ Rachmadi Usman, "Kewenangan Notaris Dalam Membuat Surat Kuasa Membebaskan Hak Tanggungan Dengan Akta," *Jurnal Legislasi Indonesia* 15, no. 3 (2018): 224, <https://doi.org/10.54629/jli.v15i3.222>.



In English, *covernote* means cover note because the word "cover" means cover and "note" means "note". In a notarial context, *Covernote* refers to a certificate, which is a document issued by a notary that relies on his signature, stamp and seal. This document aims to provide assurance on the validity of the deed made by the notary¹¹. The notary *covernote* is an important tool in notarial practice. It is used as evidence of the creation of a notarial deed, which is often a very important legal transaction, such as the purchase of property, the formation of a company, or other legal agreements. *Covernote* is one of the notary's works, although it is not included in the category of authentic deeds in accordance with the regulations of the Notary Law. Its function is to record detailed information about the transaction, date, and parties involved in a legal event.

The *covernote* refers to a certificate provided by a notary as a formal requirement for the disbursement of murabaha financing, especially when the customer has not fulfilled all the requirements, such as the length of the collateral inspection process that has not been completed or the possibility that murabaha financing will be granted by the Islamic bank. Some requirements relating to the land to be pledged may still be in the process of changing the name or the certificate is still a letter c and has not been upgraded to a certificate of ownership (SHM). In the subject matter, the *covernote* functions as a support and guideline for Islamic banks in the process of disbursing murabahah financing given to customers, checking the object collateral is being carried out, and the Notary has the responsibility to complete the checking process, so that the Deed of Granting Mortgage Rights (APHT) can be issued and a certificate of mortgage rights issued on behalf of the holder of the mortgage rights¹².

Although the notary's authority to make authentic deeds and deeds under the hand, the *covernote* is a notarial legal product that is neither an authentic deed nor a deed under the hand. In the process of making a deed under hand, each party is required to make special provisions written in their own hand by the signatory of the deed. Therefore, each party must directly write and sign the deed. If this requirement is not met. *Covernote* can only be considered as an ordinary letter containing a statement or an undertaking by the notary to explain that the notary's work is still unfinished. Since *Covernote* is not regulated by law, it has no legal force¹³.

¹¹ Syafran Sofyan, "Majalah Berita Bulanan Notaris, PPAT, Pertanahan & Hukum, RENVOL, Jembatan Informasi Rekan," 2014, 76.

¹² Gusti, Alhamdha, and Alfieyan, "Peran *Covernote* Notaris Sebagai Dasar Pencairan Kredit Oleh Bank," 88.

¹³ I Gede Arya Wijaya, "Kekuatan Hukum *Covernote* Notaris Sebagai Produk Hukum Notaris," *Acta Comitatus* 4, no. 1 (April 30, 2019): 96, <https://doi.org/10.24843/AC.2019.v04.i01.p08>.



Covernote is not included in the category of legal products produced by a notary. Covernote functions as a certificate made by a notary, covernote is used as a tool to complete files that have not been obtained during the process of applying for agency permits and to obtain credit. For example, Supreme Court Decision Number 2404 K/Pdt/2014. The verdict confirms that cover notes are used as collateral in credit disbursement. Covernote is not a legal product of a notary according to the law. Instead, the covernote is used to disburse murabaha financing. A covernote, which contains a certificate that a document that will become a Mortgage in a credit agreement, has not been completed, is issued by a Land Deed Official (PPAT).

The use of cover notes in murabaha financing is part of the bank's function. Due to concerns that customers will move to other banks, banks often practice with less caution. In providing fixed financing, Islamic banks need to ensure that steps are taken to avoid potential problems. This principle is in accordance with, which requires Islamic banks to use an approach that is not detrimental to either the Islamic bank or the interests of the customers who submit funds to them when providing credit or financing based on Islamic principles.

The making of SKMHT by Notary/PPAT is carried out after the debtor signs the murabahah financing. However, there is a problem if the land used as collateral for murabahah financing is still in the process of being split or roya, or if the certificate has not been issued at the time of financing distribution, so that Islamic banks cannot accept the collateral. In practice, Islamic banks still disburse loan applications using the notary covernote requirement. The covernote issued by the agency in need is not a complete file, but a guarantee that the files needed by the agency or client are really in process, at least there is trust built between the parties.

In the supposedly smooth flow of murabaha financing, the customer enters the process by entering into a murabaha financing contract. Next, the bank checks the documents, including the Power of Attorney to Enforce Mortgage Rights (SKMHT) and the Deed of Assignment of Mortgage Rights (APHT). After verification is complete, the murabaha financing is then disbursed and the customer makes regular payments until it is paid off, marking the end of the murabaha financing process. After the payment is complete, the bank then gives the customer a sign of recognition or roya. However, when facing a bad murabaha financing situation, problems arise when the notary does not make important documents such as SKMHT/APHT. Nevertheless, the bank still disburses the murabaha financing because the notary has previously issued a covernote. The flow of problematic financing starts when the customer enters the murabahah financing agreement and proceeds with the document inspection. The notary makes a covernote, but does not make SKMHT/APHT as required. The bank, unfortunately did not do adequate follow-up.



Furthermore, due to the incompleteness of the collateral documents in this case SKMHT/APHT, the Mortgage Rights (HT) cannot be executed because they have not been bound. In the overall flow of problematic financing, the lack of proper document creation by the notary and the lack of follow-up by the Islamic bank causes the financing to be mismanaged. This can result in serious consequences if the murabaha financing goes bad and then the inability to execute the Mortgage Rights. If there are cases of misuse of notarial *covernotes* that are not addressed, this can damage the integrity of the notary profession and raise doubts about the validity of documents issued by notaries. For business transactions such as financing between banks as creditors and customers as debtors, a notarial *covernote* is often used as a substitute for the original deed. However, Article 10 of the Mortgage Law states that the enforcement of a mortgage right must be based on an authentic deed, creating legal uncertainty when this situation occurs. Therefore, the use of notarial *covernotes* as evidence of the encumbrance of mortgage rights in murabahah financing transactions in Islamic banking cannot be the basis for the disbursement of murabahah financing and has the potential to cause adverse legal consequences for the parties involved.

Departing from the results of the pre-survey, the author connects the presence of Bank Syariah Indonesia (BSI) Palembang Area as research subject to the center of attention. The involvement of this Islamic financial institution allows the research to gain a closer insight into the impact of the use of notarial *covernotes* on customers at the local level. More than just data, this research seeks to weave a narrative that reflects the daily realities and challenges faced by customers and Islamic financial institutions in Palembang city, with its distinctive legal and environmental context, providing an interesting backdrop to analyze the legal protection of non-performing loans. Involving the city in the research also allows the researcher to understand the local legal dynamics that may influence policies and practices in the Islamic banking industry.

The decision to choose Palembang also reflects an effort to maintain regional relevance. As a major city in South Sumatra, this research is expected to provide a broader view of the challenges and opportunities in the legal protection of non-performing loans at the regional level. Thus, the selection of the research site is not merely a location, but rather a strategic step to provide a more contextual and in-depth contribution to the understanding of non-performing loan issues within the framework of the Islamic banking industry at the local and regional levels.

In this context, this research is important to understand the law governing notarial *covernotes*, examine the urgency of legal protection for banks due to notaries who do not carry out their responsibilities of making authentic deeds, and analyze the legal remedies that can be taken by banks against problematic loans due to notaries not fulfilling their obligations in *covernotes*. The results of



this study will provide the necessary insights to improve the integrity of the notary system and protect the interests of parties involved in legal transactions involving notarial cover notes.

To enhance the efficacy and reliability of notarial covernotes in Islamic banking, several strategies can be implemented. These include standardizing covernote formats to reduce inconsistencies and facilitate quicker verification processes, and providing enhanced education and training for notaries and banking professionals to ensure they understand their legal and ethical responsibilities. Improved oversight and accountability mechanisms can be established to uphold higher standards of practice, while integrating technology could automate and monitor the covernote process, reducing errors and increasing efficiency. Additionally, launching legal awareness campaigns for customers can help them understand their rights and the implications of financial agreements. Finally, developing alternative risk mitigation tools, such as different forms of collateral or insurance products, could provide more options for securing murabahah financing, thereby reducing reliance on covernotes.

Indicators of murabaha financing at Islamic banks that can be categorized as problematic financing at Bank Syariah Indonesia (BSI) Palembang Area.

To minimize the risks that occur in Islamic banks, every financing provided must go through a rigorous analysis process in accordance with the procedures that apply in bank financial institutions.¹⁴ Money financing analysis is used in the financing contract process, in the course of the financing contract and after the financing contract occurs. Accuracy and thoroughness in analyzing financing is the principle of prudence of Islamic banks in managing customer funds. The financing analysis carried out is:¹⁵

- 1) Before the Financing Agreement¹⁶.

At this stage, prospective customers must fulfill the required administrative requirements such as: Including a financing proposal that makes about the general description of the mudharib business, business plans/prospects, details and use of funds, the nominal amount of the need, it is expected that prospective customers explain in detail and clearly so that they can convince the bank. If there is a discrepancy

¹⁴ Namira Albabana, "Pertanggungjawaban Hukum Bank Atas Kelalaian Pegawainya Terhadap Debitur Yang Terkena Bi Checking," *Esensi Hukum* 2, no. 1 (August 10, 2020): 49-63, <https://doi.org/10.35586/esensihukum.v2i1.24>.

¹⁵ Ikit, S. E., M.E.I, *Dasar-Dasar Perbankan Syariah* (Yogyakarta: Penerbit Gava Media, 2023).

¹⁶ Ismail, *Perbankan syariah* (Jakarta, Indonesia: Kencana, 2011), 120.



between the proposal and reality, the bank will refuse.¹⁷ Prospective customers fill in the financing application form provided by the bank which is accompanied by a stamp duty of Rp. 10,000. Furthermore, business legitimacy such as NPWP, SIUP, TDP, legal entity establishment deed, AD/ART, and others¹⁸

2) Furthermore, to strengthen confidence in prospective customers, Islamic banks conduct in-depth analysis of:

a. Character. Character analysis to see and describe the character and personality of prospective customers. Character analysis with the aim of knowing that prospective customers have good intentions to fulfill their obligation to pay in full. Bank confidence in the willingness of prospective customers to fulfill their obligations in accordance with the agreed period. The ways that banks use to find out the character of prospective customers are:

(1) BI Checking is a customer's loan history so that it can be seen whether he has ever defaulted on credit / financing or not. Information contained in BI Checking such as the identity of the debtor, the size of the collateral, the owner, the management, the guarantor, the facility for providing funds, as well as the collectibility that is in it. BI Checking can be used by banks to clearly know their prospective customers, both the quality of the prospective customer's financing if they have become debtors/customers at other banks. With this BI Checking information, it can provide confidence for banks to provide financing.

(2) Information from other parties. Furthermore, to find out the character of prospective customers, banks can seek information from other parties such as neighbors, work friends, direct superiors, and business partners, and from other financial institutions. Furthermore, to find out the character of prospective customers, banks can see their hobbies and habits whether the customer is wasteful or not.

b. Capacity. Capacity analysis is shown to determine the financial ability of prospective customers to fulfill their obligations according to the

¹⁷ Berke Oral et al., "Information Extraction from Text Intensive and Visually Rich Banking Documents," *Information Processing & Management* 57, no. 6 (November 2020): 102361, <https://doi.org/10.1016/j.ipm.2020.102361>.

¹⁸ M Sankari, M Benazir, and R Bremananth, "Verification of Bank Cheque Images Using Hamming Measures," in *2010 11th International Conference on Control Automation Robotics & Vision (ICARCV 2010)*, Singapore, Singapore: IEEE, 2010), 2531-36, <https://doi.org/10.1109/ICARCV.2010.5707819>.



financing period¹⁹. Some of the ways that can be taken in knowing the financial capabilities of prospective customers include:

- (1) Looking at the financial report. In the financial statements of prospective customers, the source of funds will be known, by looking at the cash flow statement. In the cash flow statement as a whole, the cash financial condition of the prospective customer can be seen, by comparing the sources of funds obtained and the use of funds.
 - (2) Other information. Capacity analysis can be done by requesting information such as salary slips, PDAM payments, electricity payments and others. Another way that can be taken by Islamic banks, if the prospective customer is an employee, the bank can ask for a photocopy of the last three months' salary slip and supported by a savings account for at least the last three months. From the salary slip data and photocopies of savings accounts, it will be able to analyze the source of funds and the use of prospective customer funds. Financial data is used as a basic assumption about the financial condition of prospective customers after obtaining financing from Islamic banks.
 - (3) Survey to the prospective customer's business location. This survey is needed to find out the prospective customer's business by making direct observations.
- c. Capital. Capital that needs to be included in the object of financing needs to be analyzed more deeply. Capital is the amount of capital owned by prospective customers or the amount of funds that will be included in the project being financed. Capital analysis included in the object of financing needs to be analyzed more deeply.²⁰ The greater the capital owned and included by prospective customers in the object of financing, the more convincing the bank will be of the seriousness of prospective customers in applying for financing and repayment. The ways taken by the bank to find out capital include:
- (1) Financial statements of prospective customers. In the event that the prospective customer is a company, the capital structure is important to assess the level of debt to equity ratio. The company is considered strong in the face of various risks if

¹⁹ Ryan R. Mullins *et al.*, "Know Your Customer: How Salesperson Perceptions of Customer Relationship Quality Form and Influence Account Profitability," *Journal of Marketing* 78, no. 6 (November 2014): 38-58, <https://doi.org/10.1509/jm.13.0300>.

²⁰ M. Gill, "Preventing Money Laundering or Obstructing Business?: Financial Companies' Perspectives on 'Know Your Customer' Procedures," *British Journal of Criminology* 44, no. 4 (July 1, 2004): 582-94, <https://doi.org/10.1093/bjc/azh019>.



the amount of own capital owned is large enough. Financial ratio analysis can be done by the bank to find out the company's capital. This financial ratio analysis is carried out if the prospective customer is a company.

(2) Down payment paid in obtaining financing. In the event that the prospective customer is an individual, and the purpose of use is clear, for example financing for the purchase of a house, then the capital analysis can be interpreted as the amount of down payment paid by the prospective customer to the developer or down payment that has been prepared. The larger the down payment paid by the prospective customer to buy a house, the more convincing it is for the Islamic bank that the financing to be channeled is likely to be smooth.

d. Collateral. Collateral analysis is an analysis applied by the bank regarding the collateral / guarantee provided by prospective customers for the proposed financing. Collateral is an additional guarantee, both in the form of movable and immovable objects submitted by the owner of the collateral to the Islamic bank and / or UUS, to guarantee the repayment of the obligations of the customer receiving the facility²¹. The bank will not provide financing that exceeds the value of the collateral, except for certain financing guaranteed by certain parties. In analyzing collateral, a very important factor that must be considered is the post-sale of the collateral submitted to the bank. Islamic banks need to know the market interest in the collateral submitted by prospective customers.²² If the collateral is an item that is in demand by many people (marketable), then the bank believes that the collateral submitted by prospective customers is easy to sell. Financing that is covered by collateral with good after-sales, the risk is low. Furthermore, if the customer cannot pay the installments, the Islamic bank can sell the collateral.²³ The proceeds from the sale of collateral are used as a second source of payment to pay off the financing.²⁴

²¹ Republik Indonesia, *Undang -Undang Nomor 21 Tahun 2008 Tentang Perbankan Syariah*, 2008.

²² David Limehouse, "Know Your Customer," *Work Study* 48, no. 3 (June 1, 1999): 100-102, <https://doi.org/10.1108/00438029910262518>.

²³ Prakash Chandra Mondal, Rupam Deb, and Mohammad Nurul Huda, "Know Your Customer (KYC) Based Authentication Method for Financial Services through the Internet," in *2016 19th International Conference on Computer and Information Technology (ICCIT) (2016 19th International Conference on Computer and Information Technology (ICCIT), Dhaka, Bangladesh: IEEE, 2016)*, 535-40, <https://doi.org/10.1109/ICCITECHN.2016.7860255>.

²⁴ Irfam Fahmi, *Manajemen Perkreditan* (Bandung: Alfabeta, 2014), 18.



- e. Condition of Economy. An analysis of economic conditions both at home and abroad. Banks need to analyze the impact of economic conditions on prospective customers' businesses in the future, to determine the effect of economic conditions on prospective customers' businesses.
- f. Sharia. Analysis of sharia principles is based on the principles of Islamic law in banking activities based on fatwas issued by institutions that have the authority to determine fatwas in sharia²⁵. This assessment is carried out to confirm that the business to be financed is really a business that does not violate sharia in accordance with the DSN fatwa, the manager must not violate Islamic sharia law in his actions related to murabahah.

3) In the course of the Financing Agreement

After the process is carried out, both parties determine what contract will be carried out. The signing of the contract between the bank and the prospective customer (stamped with Rp. 10,000) and the presence of witnesses. After the contract is signed, there are rights and obligations attached to both parties. Furthermore, the bank disburses funds according to customer needs in the form of cash or goods (in accordance with the initial agreement).

4) After the Financing Agreement Occurs

After the financing process has been realized, what the bank must do includes supervision or monitoring of the customer's business, profit sharing (if the contract is profit sharing), return of capital (if the contract is profit sharing).

Indicators of problematic financing in Islamic banks

Financing according to Law Number 7 of 1992 is the provision of money or bills that are equated with it based on an agreement or agreement between a bank and another party that requires the financed party to return the loan / bill after a certain period of time in return or profit sharing. In providing financing, banks must have confidence based on in-depth analysis or the intention and ability and ability of customers to pay off their debts or return the financing in accordance with the agreement. Sometimes the analysis has been done well, but in practice there are still problematic financing.

In a hypothetical case involving "Bank Amanah" and "Company XYZ," the bank provided murabahah financing for industrial equipment purchases, secured by a mortgage on the company's property. Due to registration delays, a notary issued a covernote as a temporary measure. However, when Company

²⁵ Republik Indonesia, *Undang -Undang Nomor 21 Tahun 2008 Tentang Perbankan Syariah*.
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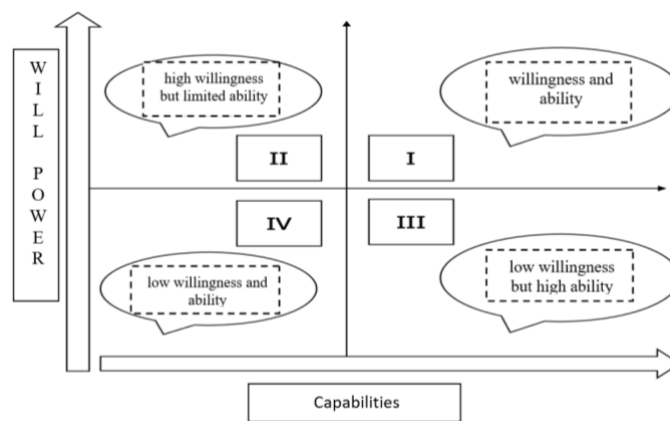


XYZ defaulted, the covernote proved insufficient for Bank Amanah to enforce the mortgage rights, leaving the bank unable to recover the funds. The primary legal challenge is determining the validity of the covernote as collateral security under Islamic finance laws, alongside assessing the notary's adherence to legal and ethical standards and the bank's due diligence in accepting the covernote.

The situation could prompt legal actions against the company and the notary, potentially leading to significant consequences. If found legally insufficient, the covernote's failure could expose the notary to liability for professional breaches and the bank to criticism for inadequate security measures. This case highlights the need for stricter regulations on covernotes, enhanced notarial standards, and more thorough bank protocols to ensure the robustness of security interests in Islamic financing, underlining the critical role of documentation and procedural compliance in safeguarding financial transactions within the legal frameworks of Islamic banking.

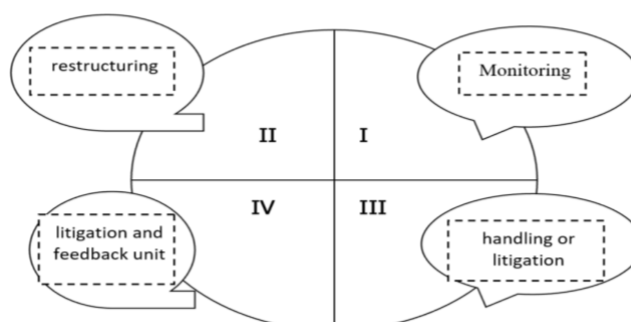
Islamic banks qualify customers according to quadrants, an approach used to classify customers based on their financial behavioral characteristics. This approach allows banks to understand the credit risk profile of customers in greater detail and design appropriate handling strategies. This method often refers to the quadrant concept, where customers are grouped based on their level of financial capability and willingness to fulfill financial obligations. The quadrant is often divided into four categories:

Figure 1: Customer qualification according to quadrant



Source: processed by the author

Figure 2: Customer handling based on quadrant



Source: processed by the author

- I. Quadrant I: High Will and Ability. Customers in this quadrant have a high willingness and ability to fulfill their financial obligations. They tend to be reliable and dependable customers for Islamic banks. Qualifications of customers in this quadrant include:
 - a. High Willpower: They have a strong motivation to fulfill their financial obligations.
 - b. High Capability: They have sufficient financial capability to pay their obligations on time.
- II. Quadrant II: High Capability but Limited Ability. Customers in this quadrant have high financial capability, but may experience certain limitations or challenges that affect their ability to meet their financial obligations. Qualifications of customers in this quadrant include:
 - a. High Capability: They have sufficient financial resources to fulfill their financial obligations.
 - b. Limited Capability: Despite having high financial capability, they may face certain constraints such as liquidity issues or the need for financial restructuring.
- III. Quadrant III: Low Will but High Ability. Customers in this quadrant have high financial capability, but lack the willingness or motivation to fulfill their financial obligations. Qualifications of customers in this quadrant include:
 - a. High Capability: They have sufficient financial resources to fulfill their financial obligations.
 - b. Low Willpower: Despite having sufficient financial means, they may lack care or seriousness in fulfilling their financial obligations.
- IV. Quadrant IV: Low Will and Ability. Customers in this quadrant have low financial willingness and ability to fulfill their financial obligations. Qualifications of customers in this quadrant include:
 - a. Low Willpower: They do not have enough motivation or desire to fulfill their financial obligations.
 - b. Low Capability: They also have financial limitations that make it difficult for them to pay their obligations on time or in full.

Each quadrant has its own characteristics and traits that reflect customer behavior and financial capability. For example, customers in Quadrant I tend to



have high financial capability and strong motivation to meet their financial obligations. Meanwhile, customers in Quadrant IV may have financial limitations and lack motivation to pay their obligations. The use of these quadrants allows banks to take measures to address each group of customers accordingly. For example, for customers in Quadrant II who have high but limited financial capability, banks can offer restructuring or rescheduling programs to help them better manage their financial obligations. This approach is linked to the concept of credit risk management and customer handling strategies. Empirical studies are also often conducted to evaluate the effectiveness of this approach in managing credit risk and improving the performance of financing portfolios in Islamic banks.

Non-performing financing, which is often referred to as Non-Performing Financing, is financing whose quality is in the substandard (class III), doubtful (class IV), and non-performing (class V) categories. In channeling financing and conducting other business activities, Islamic banks are required to take methods that are not detrimental to Islamic banks. In general, the definition of non-performing financing is financing caused by customers who do not meet the installment payment schedule and do not meet the requirements stated in the contract. There are 5 (five) types of financing quality in banking, namely: Current, Special Attention, Substandard, Doubtful, and Bad Debt.

- (1) Current financing. Financing is classified as current if it meets the following criteria: (a) payment of principal plus profit installments on time; (b) has an active account mutation; (c) part of the financing is secured by cash collateral.
- (2) Financing under special mention. Financing is classified as special mention financing if it meets the following criteria: (a) there are arrears of principal and profit-sharing installments that have not exceeded ninety days; (b) active account mutations; (c) rare violations of the agreed contract; or supported by new loans.
- (3) Substandard financing. Financing is classified into substandard financing if it meets the criteria (a) there are arrears in principal installments and / or profit sharing; (b) the frequency of account mutations is relatively low; (c) there is a violation of the agreed contract for more than ninety days; (d) weak loan documentation.
- (4) Doubtful financing. Payments are classified into doubtful financing if they meet the following criteria: (a) there are arrears in principal installments and / or profits; (b) there are defaults of more than 180 days; (c) there are defaults of more than 180 days; (d) weak legal documentation for both the financing agreement and the binding of collateral.
- (5) Bad financing (loss). Financing that is classified as non-performing financing if it meets the criteria: (a) there are arrears in principal



installments and / or plus profits; (b) operating losses are covered by new loans; (c) from a legal point of view or market conditions, collateral cannot be disbursed at fair value.

In Bank Indonesia Regulation Number: 10/18/PBI/2008 concerning Financing Restructuring for Sharia Banks and Sharia Business Units. Financing restructuring is an effort made by the bank in order to help customers to settle their obligations, among others through:

- (1) Rescheduling, which is a change in the payment schedule of customer obligations or the time period;
- (2) Reconditioning, which is a change in part or all of the terms of financing, including changes in payment schedule, number of installments, time period, and / or provision of discounts as long as it does not increase the remaining customer obligations that must be paid to the bank;
- (3) Restructuring, namely changes in financing terms not limited to rescheduling or reconditioning, including: 1) additional funds for bank financing facilities; 2) conversion of financing contracts; 3) conversion of financing into medium-term sharia securities; 4) conversion of financing into temporary equity participation in the customer's company.
- (4) Settlement through collateral. Settlement through collateral is the settlement of financing through the sale of goods that become collateral in the framework of debt repayment. Settlement through collateral is carried out on financing that is really according to the LKS cannot be healthy and or customers who are not prospectivedeveloped.

Banks are prohibited from restructuring financing in order to avoid: (a) a decrease in the quality classification of financing; (b) the formation of a larger allowance for possible losses on assets (PPA); (c) the cessation of recognition of margin or ujah income on an accrual basis. Financing restructuring can only be carried out for customers who meet the following criteria: (a) the customer experiences a decline in payment ability as follows; (b) the customer has good business prospects and is able to fulfill obligations after restructuring. Financing restructuring can only be done for financing with substandard, doubtful, and loss quality. And financing restructuring must be supported by adequate analysis and evidence and well documented. Financing restructuring can be carried out a maximum of 3 (three) times within the term of the initial financing contract. Furthermore, the second and third financing restructuring can be carried out no sooner than 6 (six) months after the previous financing restructuring.



Bad financing that later becomes non-performing financing

Bad debt financing and non-performing financing are two different conditions in the context of banking. Here are the differences between the two:

1) Non-Performing Financing:

Bad debt refers to financing or loans that have late payments or are not paid as scheduled. Typically, a financing is considered non-performing if the customer does not make payments on time for a certain period, which is usually 90 days or more. Bad debt financing is still in the collection process, and the bank is making efforts to obtain repayment from the customer.

2) Problematic Financing:

Non-performing financing is financing that has a high risk of not being paid back in full by the customer. Non-performing financing can be more serious than non-performing financing, as it can include financing that has a high risk of default or is unlikely to be recovered. The bank may have identified financing as non-performing if there are structural weaknesses in the transaction, for example, lack of collateral or the inability of the customer to repay the financing even after intensive collection efforts.

Thus, non-performing financing is the initial condition where payments have been late or not paid as scheduled, while non-performing financing is a further condition where there is a high risk that the financing will not be repaid by the customer. There are several factors that can cause financing that initially experiences late payments or bad debts to later become non-performing financing in the context of Islamic banking. Some of these include:

- 1) Lack of Documentation: Complete and appropriate documentation is essential in any financing transaction, including in murabaha financing. The absence or lack of important documents such as the Certificate of Mortgage Rights (SKMHT) or Deed of Granting Mortgage Rights (APHT) can be a key indicator of weaknesses in the financing.
- 2) Notary Responsibilities: The notary has the responsibility to manage the legality of the transaction, including the creation of necessary documents such as SKMHT or APHT. If the notary only makes a covernote or promise to create such documents without actually carrying them out, this can pose legal and financial risks for all parties involved.
- 3) Limitations in Collateral Execution: Lack of documents such as SKMHT or APHT may hinder the bank's ability to execute collateral or recover the defaulted financing through an auction process. Without valid documents, banks may face difficulties in protecting their interests as creditors and recovering their losses from collateral assets.



The impact of lack of documentation in financing is that the bank does not have adequate collateral or strong legal evidence to enforce its rights in the event of default. This can make defaulted financing difficult to recover or fully recover, resulting in financial losses for the bank and worsening their asset quality.

If the financing becomes non-performing and the collateral assets cannot be effectively executed, the bank may face a significant risk of loss. Without sufficient collateral, the bank may not be able to obtain repayment from defaulting customers, which in turn may affect the liquidity and financial health of the bank. In such a situation, Islamic banks should take appropriate steps to address the issue. This could include attempting to obtain the missing documents, negotiating with the customer to find an alternative solution, or even engaging legal proceedings to resolve the conflict. What is clear is that compliance with regulations and proper procedures are crucial in minimizing risks and maintaining the business continuity of Islamic banks.

CONCLUSION

Within Islamic banks, the quality of financing is a key marker in assessing financial stability and risk. This quality is reflected in a number of categories, ranging from current to non-performing financing. Current financing indicates the customer's ability to pay according to the contract on time and without problems, indicating stability without major risks. However, special mention financing indicates potential risks that need to be addressed, such as late payments or changes in the customer's economy. While substandard financing indicates more serious delays in payment, but can still be improved through restructuring. Doubtful financing indicates a customer's inability to fully repay, while loss financing indicates irrecoverability. It is important for banks to closely monitor and manage financing quality to identify risks and take appropriate steps to minimize financial risks and maintain operational continuity.

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