



Islamic Banking in Algeria New funding mechanisms and legal and regulatory challenges

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Abstract:

Islamic banking is widely known as a new mechanism for financing investment, Algeria has recently been involved in adopting this formula in support of financing methods and stimulating the investment movement, and we try in this research paper to identify the financing formulas adopted by these banks, and to identify the most important legal and regulatory challenges and obstacles that collide with it, especially in its relationship with the Central Bank, to put forward some solutions and proposals that will overcome these difficulties

Keywords: Islamic Banking, Bank, Formula, Financing, Challenges, Legal..

Introduction:

Banks are considered one of the most significant pillars of financing in the economy of any country, serving as a cornerstone for investment through their provision of various functions such as money deposits, different financing operations, and other diverse banking activities. The second half of the twentieth century witnessed the emergence of a new banking model focused on financing operations that adhere to Islamic law (Sharia), represented by Islamic banks. These institutions fundamentally rely on the concept of financing through partnership and entirely eschew interest-based lending, a financing mechanism characteristic of conventional banks. Several countries, both Islamic and global, have adopted this banking model due to its proven efficiency in financing, its ability to build trust and creditworthiness, and its achievements in commercial and investment domains. Given the economic significance that Islamic banks have attained, the Algerian government recently sought to adopt Islamic banking. This began with granting licenses to some Islamic banks, such as Al Baraka Bank and Al Salam Bank, while also attempting to launch Islamic banking windows within several traditional banks. However, the government's aspirations faced numerous legal and regulatory challenges within the financial legal system governing banks. These difficulties mirror the challenges faced by various Arab countries that have adopted this banking model, with some variations specific to each context.

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From this perspective, the following problem arises: What are the financing methods employed by Islamic banking? And what are the primary legal and regulatory challenges it faces?

This is what we aim to discuss in this paper, following the outline below:

Introduction

Chapter One: The Nature of Islamic Banks and Their Financing Mechanisms

- Section One: The Concept of Islamic Banks
- Section Two: Mechanisms and Financing Methods in Islamic Banks

Chapter Two: Key Legal and Regulatory Challenges Facing Islamic Banks in Algeria

- Section One: Legal and Regulatory Challenges
- Section Two: Various Obstacles and Challenges

Conclusion

Chapter One: The Nature of Islamic Banks and Their Financing Mechanisms

Islamic banks today hold a significant position in the field of financing and investment, forming a fundamental economic structure in various countries by employing distinctive financing mechanisms.

In this chapter, we will define the concept of Islamic banking and explore its financing mechanisms.

THE FIRST TOPIC The Concept of Islamic Banking

Numerous scholars and jurists in the field of Islamic banking have addressed its definition. In this section, we will present some jurisprudential and legal definitions of Islamic banking.

First Requirement: Jurisprudential Definition of Islamic Banking

Scholars and jurists specializing in banking and financial transactions have contributed to defining Islamic banking, among them:

- Definition by Mohsen Ahmed Al-Khudairi: He defines Islamic banks as "those financial and monetary institutions that work to attract monetary resources from members of society and effectively employ them in a manner that ensures their maximization and growth within the established principles of Islamic Sharia, serving the people of the nation and fostering the development of their economies."¹

- Definition by Sami Hamoud: Sami Hamoud defines Islamic banks as "any institution that provides banking services on a non-usurious basis, engages in opening commercial accounts, and accepts investment deposits for use within prevailing liquidity systems, alongside the bank's financial resources, to finance commercial projects in accordance with Islamic principles."²

- Definition by Ahmed Al-Najjar: Ahmed Al-Najjar defines Islamic banks as "financial and banking institutions that collect and invest funds in a way that contributes to building an integrated Islamic society, achieving distributive justice, and directing money into the Islamic framework."³

This definition is criticized for its generality and for not addressing the essence of Islamic banking, which is the avoidance of dealing with usury in both lending and borrowing.

- Definition by Awf Mahmoud Al-Kafrawi: He describes Islamic banks as "those financial institutions that conduct banking financial transactions, as well as other financial and commercial transactions and investment activities, in accordance with the provisions of Islamic Sharia. They refrain from dealing with usury in both lending and borrowing, aiming to uphold Islamic values and ethics, purify banking activities from corruption, and achieve the highest possible economic and social returns to foster economic development."⁴



– Definition by Wahbah Al-Zuhayli: Wahbah Al-Zuhayli defines Islamic banks as "modern financial institutions that adhere to the provisions and principles of Islamic Sharia in financial transactions, particularly concerning money. They rely on collecting funds through legitimate means and investing and developing them using lawful tools and methods for the benefit of participants. Their goal is to rebuild the Muslim community, achieve economic and social development, and fulfill the requirements of Islamic cooperation in accordance with Sharia principles."⁵

This definition appears to be the most comprehensive in addressing the concept of Islamic banks, as it is founded on the principle of avoiding interest-based transactions while also emphasizing the adoption of legitimate tools and methods for investment and economic and social development. This aligns with the objectives of Islamic cooperation and integration. Due to the unique nature of Islamic banking, it has been referred to by various names, such as "participation banks," "alternative financing banks," and "ethical financing banks."⁶

Second Requirement: The Legal Definition of Islamic Banking

Several countries and unions have enacted laws addressing banks in general and Islamic banks in particular. For instance, the Agreement on the Establishment of the International Association of Islamic Banks, issued in 1977, defined Islamic banks in Article 15 as:

"Those banks or institutions whose founding laws and bylaws explicitly mandate adherence to Sharia principles and prohibit dealing in interest, whether in lending or borrowing."⁷

The UAE Federal Law No. (6) of 1985, concerning Islamic banks, financial institutions, and investment companies, defines Islamic banks in its first article as: "Institutions whose founding contracts and bylaws commit to applying the provisions of Islamic Sharia and conducting their activities in accordance with these provisions."

This definition highlights two elements: formal and substantive. Formally, Islamic banks and institutions must explicitly state in their foundational documents their commitment to adhering to the provisions of Islamic Sharia. For instance, their founding contracts might state: "The company (or bank) undertakes to apply the provisions of Islamic Sharia in all its operations and conduct its activities in accordance with these provisions." Additionally, the company or bank is authorized to carry out all activities, including banking, investment, commercial, and service-related operations, as long as they comply with Sharia principles. Failure to include such a clause in the foundational documents would prevent the issuance of authorization from relevant authorities. This formal requirement often mandates the explicit labeling of the bank as "Islamic," as in the cases of Faisal Islamic Bank and Dubai Islamic Bank.⁸

Similarly, Article 1 of the Palestinian Banking Law No. 2 of 2002 defines an Islamic bank as: "Any public joint-stock company aiming to collect savings from natural or legal persons to use them in financing and investment activities for the benefit of individuals and communities in accordance with Islamic Sharia provisions."

The Syrian Legislative Decree No. 35 of 2005, concerning the establishment of Islamic banks in Syria, defines an Islamic bank in its first article as:

"A bank whose founding contract and bylaws commit to practicing permitted banking activities on a non-interest basis, whether in lending or borrowing, and in accordance with banking transactions that comply with the provisions of Islamic Sharia. This includes accepting deposits, providing other banking services, and conducting financing and investment activities."⁹



Article 86 of Section on Islamic Banks, under Law No. 30 of 2003, which was added to the Law on Currency, the Central Bank of Kuwait, and the Banking Profession No. 32 of 1968, defines Islamic banks as:

"Banks that conduct banking activities in accordance with the provisions of Islamic Sharia, habitually accepting deposits of various types, whether as current accounts, savings accounts, or financing operations of varying terms, utilizing Sharia-compliant contracts such as cost-plus financing, joint venture partnerships, and profit-sharing arrangements."

The Law on the Establishment of Islamic Banks in Lebanon, No. 575 of 2004, defines an Islamic bank in Article 1 as:

"Banks whose bylaws include a commitment to not contravene Islamic Sharia in their operations, particularly by refraining from dealing with interest, whether in lending or borrowing."

Similarly, Article 1 of the Jordanian Banking Law No. 28 of 2000 defines an Islamic bank as: "A company licensed to conduct banking activities that comply with the provisions and principles of Islamic Sharia, as well as any other activities and operations in accordance with the provisions of this law."¹⁰

These are some legislations that attempted to define Islamic banking or finance, given that they recognized Islamic finance at an early stage and sought to incorporate related concepts into their frameworks. However, the Algerian legal system did not provide a definition for Islamic banking, nor did it formally recognize it, until recently through the Monetary and Banking Law 23-09, which repealed the Monetary and Credit Law 03/11. Article 71 of Law 23-09 considers any banking operation conducted by Islamic banks or Islamic windows, in compliance with Islamic Sharia, as an Islamic banking operation. Nonetheless, this adoption of the concept came significantly late compared to the legislation of other Arab and Islamic countries, as previously mentioned.

The Algerian legislator had made some earlier attempts to define Islamic banking in texts preceding the aforementioned law. The first reference to this form of banking appeared in the Bank of Algeria Regulation No. 18-02, which used the term "participatory banking," suggesting certain aspects of Islamic banking without explicitly defining or clarifying it. The broader concept of Islamic banking was later introduced in the Bank of Algeria Regulation No. 20-02, dated March 15, 2020. Article 2 of this regulation states:

"Every banking operation that does not involve the accrual or payment of interest, and such operations must comply with the provisions outlined in Articles 66 to 69 of Order 03-11, dated 27 Jumada Al-Thani 1424, corresponding to August 26, 2003, concerning monetary and credit regulations, as amended and supplemented."

Based on these definitions, it can be concluded that the Algerian legislator established Islamic banking on two fundamental principles:

- Avoiding interest-based transactions, specifically interest-bearing loans.
- Adopting the participation model in its broad sense, while ensuring compliance with the provisions of Islamic Sharia and the relevant monetary and banking laws under Law 23-09 governing banking operations.¹¹

THE SECOND TOPIC: Mechanisms and Financing Methods in Islamic Banks

What distinguishes Islamic banks from conventional banks is the nature of their financing methods, as they fundamentally avoid the concept of loans typically employed by conventional banks. The core principle upon which these banks operate is reflected in two primary factors:

- Complete avoidance of loans as a financing method.



– Adoption of financing models based primarily on two approaches: sales-based models and partnership-based models.

These methods will be explained in the following subsections:

Subsection One: Sales-Based Models as a Financing Mechanism in Islamic Banks

Sales-based models in Islamic finance take several well-established forms within Islamic jurisprudence and commercial practice. These include:

First Requirement: Cost-Plus Financing (Murabaha)

This is one of the most widely practiced forms of sales in Islamic finance. Linguistically, *Murabaha* originates from the term *rabaha* (profit), and technically, it refers to the sale of an item at its original cost plus an agreed-upon profit margin. *Murabaha* falls under the category of *trust sales*, which can be divided into:

- Bargaining sales: Where knowledge of the original price of the item is not required.
- Trust sales: Where the original cost of the item must be disclosed.

Cost-plus sale financing is deemed permissible by Islamic jurists, based on the Quranic verse:

"Allah has permitted trade and forbidden usury " (Quran 2:275).¹²

Islamic banks rely on cost-plus sale financing through two methods:¹³

– Standard Cost-Plus Sale Financing: This method involves two parties: the seller and the buyer. The seller purchases a product without relying on a prior promise to buy it and then offers it for sale on a cost-plus basis, agreeing on a price and profit margin in advance. This approach is common among merchants but is generally unsuitable for the nature of banking operations. Consequently, researchers have developed an alternative model that aligns better with banking activities: cost-plus sale financing based on a purchase order.¹⁴

– Banking Cost-Plus Sale Financing (Cost-Plus Sale Based on a Purchase Order): In this method, the bank purchases the product at the request of a buyer, based on a promise from the buyer to purchase the product on a cost-plus basis. The bank then sells the product to the buyer at a predetermined profit margin, disclosing the original cost of the product and arranging for the payment in specific installments.

This type of financing involves the following agreements:

- A promise to purchase issued by the buyer (customer) to purchase the product from the initial seller at an agreed cost-plus price, contingent on specified conditions and terms.
- A purchase contract between the initial seller and the Islamic bank.
- A sale contract between the customer (buyer) and the Islamic bank.

The International Islamic Fiqh Academy has approved the cost-plus sale based on a purchase order under certain conditions, including:

- The product must be owned by the Islamic bank and come into its possession before being sold to the customer.
- The bank bears responsibility for any damage to the product before its delivery, as well as liability for hidden defects or other issues that may justify the customer's return of the product after delivery.
- All conditions of a valid sale contract under Sharia must be fulfilled.¹⁵

The Algerian legislator referred to this model in Bank of Algeria Regulation No. 20-02, specifically in Article 5 and Article 9 of Instruction No. 03-2003.

Second Requirement: Forward Sale Financing (Salam)

This form of financing is traditionally associated with farmers, as it provides them with the necessary financial resources and materials before initiating their activities. Some Islamic jurists refer to it as "the sale of necessities."



Forward Sale Financing (Salam): Linguistically, the term "Salam" refers to giving, lending, or prepayment, with "Salam" and "Salf" being synonymous in Arabic. However, "Salam" was traditionally used by the people of Hijaz, whereas "Salf" was used by the people of Iraq, as noted by Al-Mawardi.¹⁶

Technically, Forward Sale Financing is defined as a sale of a specified item described in the seller's liability,¹⁷ with the payment made upfront. It essentially means a forward sale where the purchased item is to be delivered at a specified future date, while the buyer makes full payment at the time of contract formation. The legitimacy of this contract is established in the Quran, Sunnah, and the consensus of Islamic scholars.¹⁸

The Forward Sale Financing contract is a highly efficient financing instrument in Islamic economics and a flexible tool used by Islamic banks to address various financing needs. It stimulates production and contributes to optimizing production costs by creating a margin between the sale price and production costs. In a Forward Sale Financing transaction, the sale price is predetermined before production begins. Therefore, for the seller to achieve a reasonable profit, they must focus on minimizing production costs, which inherently promotes the efficient use of resources and cost reduction.¹⁹

The Algerian legislator incorporated the Forward Sale Financing model in Bank of Algeria Regulation No. 20-02, specifically in Article 9, as well as in Articles 36 and 37 of Instruction No. 03-2003.

Third Requirement: Manufacturing Contract Financing (Istisna Financing)

This financing method is considered medium-term and meets the manufacturing-related financial needs. It has gained prominence recently in various Islamic banks, particularly in the context of industrial progress and development. Linguistically, Manufacturing Contract Financing means "request for manufacture," while in technical terms, it refers to a contract based on purchasing an item to be manufactured according to specific requirements or requesting the production of goods from manufacturers, with the price agreed upon in advance. The buyer or requester retains the right to reject the manufactured product if it does not conform to the agreed-upon specifications.²⁰

Therefore, Manufacturing Contract Financing is a contract under which the bank commits to producing a specific item based on agreed-upon specifications. This commitment includes all stages of manufacturing, as well as specifying the price and delivery date. This is referred to as regular Manufacturing Contract Financing. Alternatively, the bank may assign all or part of the manufacturing process to another party under its supervision and responsibility through two separate contracts: one with the client requesting the goods and the other with the capable manufacturer, such as a contractor. This arrangement is known as parallel Manufacturing Contract Financing.

The Algerian Banking Regulation 20-02 defines the Manufacturing Contract Financing model²¹ in Article 10 and in Articles 44 and 45 of its Instruction No. 3-2003.

Fourth Requirement: Leasing-Based Financing (Ijarah Financing)

Islamic banks utilize Leasing (Ijarah) as a significant financing method. Through this approach, banks acquire assets and properties to make them available for use in exchange for a rental fee. These transactions involve the sale of the asset's benefit (usufruct) rather than the asset itself or its ownership.

The term "ijarah" originates from the Arabic root "ajara," meaning "to provide compensation or a reward for work."

First: Definition and Concept:



In technical terms, Leasing (Ijarah) is a contract for a known and lawful benefit of an asset provided in exchange for a specified payment made incrementally. Alternatively, it can be defined as a contractual agreement between two parties whereby the lessor grants the lessee the right to use an asset owned by the lessor for a specific period and in exchange for a predetermined rental fee, as agreed upon.

This concept is established in Islamic jurisprudence on financial transactions and is supported by both the Quran and the Sunnah.²² Islamic banks apply this framework specifically to the leasing of real estate and movable assets, commonly referred to as leasing-based financing. In essence, it aligns with the concept of leasing in conventional banking, except for specific conditions that distinguish it in Islamic finance, including:

- The bank may not enter into a leasing agreement unless it owns the asset to be leased.
- The Islamic bank is permitted to appoint a third party to procure the asset intended for leasing.
- Rental installments may not be tied to prevailing market interest rates.
- The bank, as the owner of the leased asset, bears the risk of the asset's destruction unless caused by negligence on the part of the lessee.²³

A. Leasing-Based Financing:

Leasing financing takes several forms, the most notable being operational leasing and lease-to-own. The Algerian legislator recognized this financing model under Law 23-09 in Article 70, as well as in Bank of Algeria Regulation 20-02, specifically in Article 08 and Articles 24, 32, and 33 of Instruction 03-2003.

There are, however, some differences between the provisions of Regulation 20-02 of the Bank of Algeria regarding insurance costs and those outlined in Order 96-09, Article 39. This discrepancy necessitates clarification by the legislator to align the lease-to-own model with its Sharia-compliant framework, as defined in Article 02 of Bank of Algeria Regulation 20-02. This alignment should also consider the guidelines mentioned in Articles 72 and 73 of the previously referenced Monetary and Banking Law.

THE THIRD TOPIC: The Partnership Model as a Financing Mechanism in Islamic Banks

The partnership model is particularly prominent in stimulating investment activity and is a distinctive mechanism recognized by Islamic banks.

First Requirement: Partnership-Based Financing (musharakah)

Linguistically, partnership refers to mutual involvement or intermingling. Technically, it is defined as a contract whereby two or more parties agree to contribute shares of capital to a specific project for the purpose of generating profit.

In banking terms, partnership is a financing model in which the bank funds its clients in the commercial, industrial, and agricultural sectors. The bank provides a sum of money, either as a lump sum or in installments, representing its share in the partnership. Similarly, the client contributes a portion of capital as their share in the partnership.

Types of Partnership Models

- Permanent Partnership: This is a partnership tied to the duration of the financed project itself. It remains in effect as long as the project continues. Partners are free to dispose of their shares, whether through sale or other transactions. Profits and losses are distributed among the partners in proportion to their respective contributions.²⁴
- Diminishing Partnership Ending in Ownership: This is a type of partnership between the bank and the client, wherein the client has the right to fully own the project either in a lump sum or



through installments, based on the agreed-upon terms and the nature of the financing arrangement.

Under this model, the bank's share in the partnership gradually decreases as the client makes incremental payments toward the bank's share of the project funding. Once all shares have been repaid, the client (or financing partner) assumes full ownership of the project.²⁵

The various types of partnership models have been adopted by the Algerian legislator under Bank of Algeria Regulation 20-02, as mentioned in Article 06 and Article 14 of Instruction 03-2003.

Second Requirement: profit-sharing partnership (Mudarabah Financing)

Mudarabah, linguistically, derives from the Arabic root "daraba," meaning traveling for trade and earning profit. The term differs based on region: in Iraq, it is referred to as Mudarabah, while in Medina, it is known as Qirad, derived from "qard," meaning "cutting" (symbolizing a share or portion).

Technically, Mudarabah is a profit-sharing partnership contract between two parties. One party, known as the capital provider (Rab al-Mal), provides the capital, while the other party, called the entrepreneur or manager, contributes expertise and effort to manage the venture. The profit earned from the Mudarabah is distributed between them according to the pre-agreed terms, while losses, if not resulting from negligence or misconduct, are borne solely by the capital provider. The entrepreneur incurs no financial loss, bearing only the loss of effort.²⁶

Islamic banks adopt this model to finance various sectors, including industrial and agricultural activities, particularly for large companies and institutions known for their expertise and reputation. Profit-Sharing Partnership in Islamic banks takes two primary forms:

- Unrestricted Mudarabah: In this form, the entrepreneur is not bound by specific conditions set by the capital provider (the bank).
- Restricted Mudarabah: Here, the entrepreneur operates within specific conditions imposed by the capital provider. These conditions do not invalidate the contract as long as they comply with Islamic principles.²⁷

The Algerian legislator has defined the Mudarabah model in Article 07 of Bank of Algeria Regulation 20-02, as well as in Article 19 of Instruction 03-2003.

There are also two financing models that take the form of Mudarabah and are recognized in Islamic jurisprudence as Irrigation Partnership and Sharecropping:

- Irrigation Partnership derives from the Arabic word for irrigation and refers to a type of partnership where the worker undertakes the care and irrigation of fruit-bearing trees. The resulting produce is shared between the parties based on an agreed-upon ratio. Islamic banks use this model to finance land reclamation and agricultural development projects, often incorporating advanced technology for better productivity.²⁸

- Sharecropping involves the landowner providing land to a worker who cultivates it or manages its operations, with the harvest shared between them. It is essentially a partnership contract between the landowner and the worker.

From the foregoing, it is clear that the financing models in Islamic banks take various forms and structures, all of which are directed toward investment while entirely avoiding the loan-based approach adopted by conventional banks, which is fundamentally rooted in interest (usury). However, the question arises: Have Islamic banks, through these diverse financing mechanisms and models, managed to adapt to the realities of financial regulation, laws, and their surrounding environment? This issue can be explored further in the second section.

THE FORTH TOPIC: Key Legal and Regulatory Challenges Facing Islamic Banks



Despite the relatively recent experience of Islamic banks compared to conventional banks and the skepticism surrounding their ability to compete, they have managed to establish themselves firmly in the local and global banking sectors. This success has led many developed countries to adopt Islamic banking models, particularly following the 2008 financial crisis.

Many conventional banks have recently opened Islamic banking windows, including in Algeria. Despite these developments, Islamic banks continue to face numerous challenges and obstacles, which can be categorized into the following two main points:

First Requirement: Regulatory and Legal Challenges

The most significant and critical challenge hindering the development of Islamic banks lies in the regulatory and legal frameworks governing the banking sector. This can be elaborated through the following points:

Second Requirement: Lack of Specific and Adequate Legal Protection

One of the key issues is the absence of legal frameworks that adequately recognize and protect the unique nature of Islamic banking. For instance, in Algeria, the financial and banking systems continue to operate under general laws, such as Law No. 90/10 on Currency and Credit, as amended and supplemented by Order 03/11 and Order 10/04, which do not provide a distinct legal identity for Islamic banks.

Although there is a dedicated legal framework for Islamic banking, such as Bank of Algeria Regulation 20-02 and Instruction 03-2003, and despite the expansion of Islamic banking services through windows introduced by conventional banks like the Algerian National Bank and the External Bank of Algeria, the legal framework remains insufficient. Even with the recent Law No. 23-09 on Monetary and Banking, which explicitly recognizes Islamic banking as a financing mechanism for banks and financial institutions, the regulatory environment still falls short of adequately addressing the specifics of Islamic banking practices and their relationship with the central bank (Bank of Algeria).

The continued subjection of Islamic banking to the general legal framework creates a mismatch, as these laws are not tailored to accommodate financing models that operate on the principle of avoiding interest (usury). This misalignment results in a legal structure that is unsuitable for the commitments and obligations arising from Islamic banking operations.

Third Requirement: Weakness in Modern Digital Technological Capabilities

Many Islamic banks suffer from a lack of advanced digital and technological resources, posing a significant challenge to their development and progress. This deficiency hampers their ability to align with modern organizational, economic, and legal principles, especially in light of the emergence of electronic banks that have integrated advanced technologies into their banking operations.

Fourth Requirement: The Nature of the Regulatory and Legal Relationship Between Islamic Banks and Central Banks

The relationship between Islamic banks and central banks is another major challenge. In Algeria, for instance, Al Baraka Bank and Al Salam Bank, which represent Islamic banking, are fully subject to the regulatory and legal requirements of the central bank, referred to in the Monetary and Banking Law as the Bank of Algeria.

Islamic banks face dual constraints: on the one hand, adherence to Shariah-compliant principles that prohibit the acceptance or payment of interest; on the other hand, compliance with the regulations set by the Bank of Algeria, as stipulated in Articles 48, 53, 54, and others of the Monetary and Banking Law.



This dual compliance creates a significant challenge, as the conventional relationship between central banks and traditional banks is often based on interest, whether in formulating monetary policies or in their interactions with various banks. This highlights the difficulty Islamic banks face in adapting to such a regulatory and legal environment.

Some of the key difficulties arising from this relationship include:

–Within the framework of monetary policy and open market operations, the central bank deals with banks, including Islamic banks, based on interest when buying or selling bonds, which puts Islamic banks in violation of Shariah principles.²⁹

–Islamic banks are bound by the instructions issued by the central bank concerning the deposit and withdrawal of foreign currencies.

–Similarly, when the central bank implements its rediscount policy, which is a widely used indirect monetary policy tool, Islamic banks are compelled to engage in interest-based transactions. This contradicts their foundational Shariah principles. Therefore, alternative credit mechanisms need to be developed to uphold the operational integrity of Islamic banks without compromising their principles.³⁰

–Islamic banks are deprived of the refinancing facility offered by the central bank as the lender of last resort, as this facility involves dealing with interest, both in borrowing and lending.³¹

–Penalties and fines imposed for regulatory violations are often calculated as interest rates, which directly conflict with the operational principles of Islamic banks.

–In some cases, the central bank prohibits banks from dealing in fixed and movable assets and restricts them from engaging in agricultural, industrial, commercial, real estate, or service-related activities. This does not align with the models used by Islamic banks, such as Profit-Sharing Partnership, Manufacturing Contract Financing, and Agricultural Partnership, which often involve investment in these types of assets. Such restrictions hinder their operations and limit their investment opportunities, undermining their role as banks focused on business, investment, and development.

–Within the framework of export operations, the central bank grants conventional commercial banks a discount on export transactions based on interest. This practice contradicts the principle adhered to by Islamic banks, thereby depriving them of opportunities to distribute their profits.³²

Fifth Requirement: Additional Challenges and Obstacles

In addition to the regulatory and legal challenges previously highlighted, this section will outline various other practical and real-world challenges faced by Islamic banks, which are as follows:

First: The Abundance and Complexity of Jurisprudential Opinions

It is well known that in matters of Islamic jurisprudence and financial transactions, opinions often vary due to the reliance of Islamic economic thought on fatwas. This has resulted in the emergence of diverse opinions upon which Islamic banks depend, as each Islamic bank has its own Sharia supervisory board. These boards issue binding decisions and fatwas for the financial institution to implement. Some scholars permit certain financing or transactions, while others prohibit them, leaving clients confused. This inconsistency disrupts the implementation of some financial models adopted by these banks.³³

Second: The Focus of Financing Policies on Limited Models

Islamic banks often concentrate their financing policies on specific models, such as cost-plus financing and leasing ending in ownership, which restricts their investment scope. The Islamic Fiqh Academy has recommended expanding financing mechanisms to include partnership and profit-sharing, while reducing reliance on Cost-Plus Financing and Monetization. Diversification



in investment operations and prioritizing long-term projects in financing represent significant challenges for Islamic banking.³⁴

Third: The Challenge of Internal and External Banking Competition

Islamic banks face a significant challenge in the form of internal and external banking competition, particularly following the implementation of banking trade liberalization in 1997. This agreement was one of the notable outcomes of the Uruguay Round, where the application of international legal rules for trade, previously limited to goods, was extended to services, including banking services.

As a result, banks globally shifted towards financial and banking liberalization. Despite the advantages introduced by this agreement, some have criticized its implementation for removing regulations and procedures that curbed competition, thereby creating an uneven playing field between global and local banks, including Islamic banks.³⁵ This challenge is particularly acute for banks that are active and dynamic in exchanges, as opposed to those that remain stagnant and struggle to finance and support domestic investment. Such banks are even less equipped to handle external competition.

Fourth: The Problem of Globalization and Its Impact on Islamic Banking

Globalization, as an abstract concept with economic, social, political, and cultural dimensions, manifests through the movement of market forces on a global scale. This phenomenon significantly affects both local and international banks, exposing them to various crises, such as the 2008 financial crisis.

The emergence of the term "banking globalization" refers to the transition of banks from local operations to global horizons by integrating their activities into the global market. This integration can have both positive and negative effects on banks' operations.³⁶

Fifth: Challenges in Adhering to Basel I and II Standards

Islamic banks and financial institutions face challenges in complying with the regulations of the Basel Committee, particularly Basel I and Basel II. The Basel I Accord, established in 1988, set minimum capital requirements. Basel II, introduced in 2001 and implemented in 2005, focuses on capital adequacy standards and emphasizes risk management and mitigation.³⁷ These requirements compel Islamic banks to adapt and align with these international risk management frameworks.

Sixth: Internal Challenges Facing Islamic Banks

Internal challenges are particularly pronounced for newly established Islamic banks, such as those in Algeria, and include the following:

- Limited Awareness of Islamic Banking Practices: Public awareness about Islamic banking is limited, both among the general population and among those responsible for its Sharia compliance.
- Theoretical Gaps in Sharia Research: Although there is a wealth of research on Islamic banking at the level of Sharia supervisory boards, the theoretical framework remains insufficient to keep pace with modernization and compete with global banks and financial institutions.
- Weak Human Resource Development: Islamic banks still rely on scattered efforts to provide their employees with specialized knowledge of Islamic banking. General banking institutes have only recently started incorporating training programs specific to Islamic banking, as seen in countries like Bahrain, Kuwait, Jordan, and the UAE.³⁸ However, these initiatives are still in their infancy.

For countries that have been pioneers in Islamic banking, progress in training and professional development has been slow. In countries where Islamic banking has been introduced recently,



such as Algeria, the development of skilled human resources and expertise in Islamic banking remains underdeveloped and far from achieving the desired level of professionalism.

Conclusion:

Islamic banking operates on a Sharia-based principle rooted in compliance with Islamic law, with its foundation in the Quranic verse: *“And Allah has permitted trade and prohibited usury”* (Al-Baqarah: 275). It functions as a commercial enterprise aimed at fostering economic growth and diversifying investments with stable profits, adhering to the principle of profit and loss sharing.

While Islamic banks have achieved significant success and proven their competence in Asian countries such as Malaysia, Singapore, and Indonesia, where Islamic banking has seen remarkable progress, they remain underdeveloped in countries that adopted the system more recently, such as Algeria. Despite the explicit incorporation of Islamic banking in Algeria's recent Law No. 23-09—an important legislative milestone—the system lacks effectiveness due to the various challenges highlighted earlier.

To advance Islamic banking, several recommendations can be proposed to overcome these obstacles and challenges, thereby enabling Islamic banking to freely contribute to development and investment within a well-regulated framework. The most important of these recommendations are as follows:

- Expedite the enhancement of legal frameworks by introducing regulatory and practical provisions promptly.
- Regulate the relationship between the central bank and Islamic banks in a manner that respects the unique nature of Islamic banking while maintaining legal, regulatory, and supervisory requirements.
- Establish unified Sharia boards to oversee Islamic banking and even mandate compliance by banks with their guidelines.
- Foster engagement with international organizations and banks that possess experience and expertise in Islamic banking.
- Prioritize the training and qualification of human resources in the field of Islamic banking.
- Diversify Islamic banking models to encompass all aspects of financing, such as partnership and profit-sharing, rather than limiting operations to cost-plus financing and leasing.
- Promote Islamic banking by organizing seminars, forums, and conferences.
- Enhance protection and the spirit of credit in transactions with Islamic banks by developing advanced methods for safeguarding, credit assurance, and risk management.
- In the context of financial and economic globalization, Islamic banks must establish large, globally competitive banking entities by pursuing mergers and reassessing certain banking activities that fail to generate returns sufficient to cover the cost of invested capital.

Globalization, as a reality, serves Islamic banking by virtue of its focus on the economy and free trade, providing an opportunity for diverse Islamic banking models to expand and compete effectively.

MARGINS

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