



Adapting the Regulatory Relationship Between Islamic Banks and the Central Bank: A Comparative Study of International Models and the Algerian Model under Monetary and Banking Law 23-09

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Abstract : The relationship between monetary authorities and Islamic financial institutions represents a complex challenge in modern finance, particularly after the 2008 global financial crisis highlighted the structural vulnerabilities of conventional, debt-based systems. As Islamic banking gains prominence due to its link to the real economy, central banks globally are compelled to adapt their regulatory frameworks. This study addresses the core problem of "regulatory adaptation" (*takyeeftanzeemi*), defined as the process of reforming monetary policy tools and prudential standards to align with the Sharia-based, asset-linked nature of Islamic banks. The research employs a comparative methodology, first analyzing successful international models, specifically the dual banking system of Malaysia and the approaches of Gulf Cooperation Council (GCC) countries, to identify best practices in legal recognition, liquidity management, and risk regulation. It then conducts an in-depth analysis of the Algerian experience under the new Monetary and Banking Law 23-09. The study evaluates whether this law represents a genuine paradigm shift from treating Islamic banks as exceptions to integrating their specificities into the core of the monetary order. The central finding concludes that while Law 23-09 marks a crucial and positive step toward formalizing the regulatory relationship, its ultimate success in enhancing financial stability depends on the development (supporting) Sharia-compliant monetary policy instruments and the (deepening) of prudential frameworks tailored to Islamic contracts. The research provides recommendations for strengthening the resilience and integration of the Algerian Islamic finance sector.

Keywords : Islamic Banking ; Regulatory Adaptation ; Bank of Algeria ; Monetary and Banking Law 23-09 ; Financial Stability.

1. Introduction:

1.1. The Epistemological Foundation of the Crisis

The 2008 global financial crisis fundamentally challenged the epistemological assumptions underpinning conventional finance, revealing deep structural vulnerabilities rooted in the separation between the monetary economy and the real economy. Conventional banking rests on the paradigm that money itself is a commodity that can generate a return through time, manifesting as interest (*riba*). This theoretical foundation permitted the proliferation of complex debt-based instruments, opaque derivatives, and excessive leverage, ultimately creating a



financial edifice dangerously disconnected from productive economic activity (Chapra, 2009; Askari et al., 2010). As the global crisis unfolded, the fragility of this model became starkly apparent when conventional banks, heavily exposed to subprime mortgages and toxic assets, experienced catastrophic failures requiring unprecedented state interventions. The International Monetary Fund's comparative analysis confirmed that conventional banks' asset quality deteriorated significantly during this period, with profitability and credit growth severely contracting (International Monetary Fund [IMF], 2010).

In stark philosophical contrast, the Islamic financial system is predicated upon an inseparable link with real assets, embodying principles of risk-sharing, transparency, and ethical investment. Islamic finance requires that all financial contracts be backed by tangible assets or services, ensuring that monetary flows correspond directly to activities in the productive economy (Ahmed, 2010; Chapra, 2008). This epistemological commitment to asset-backing proved to be a source of remarkable resilience during the crisis. Research documented by the World Bank's Managing Director Mahmoud Mohieldin demonstrated that Islamic banks maintained higher asset quality, were better capitalized, and continued their financial intermediation role more effectively than their conventional counterparts (Mohieldin, 2012). The IMF's comprehensive 2010 study confirmed this pattern, finding that Islamic banks' credit and asset growth outperformed conventional banks during 2008-2009, contributing positively to financial and economic stability in jurisdictions where they operated (IMF, 2010). However, this same study also noted that weaknesses in risk management practices in some Islamic institutions led to profitability declines in 2009, underscoring that while the foundational model offers inherent strengths, it requires robust regulatory frameworks to realize its full potential (IMF, 2010). The crisis thus illuminated a fundamental challenge for regulators worldwide: how to oversee a financial system whose operational logic diverges fundamentally from the interest-based, debt-centric paradigm upon which modern financial regulation was constructed.

1.2. The Central Research Problem

The central research problem confronting monetary authorities globally is not the acceptance of Islamic banking as a legitimate financial practice, but rather the profound difficulty of adapting prudential regulations—originally designed for a debt-based, interest-driven system—to an equity-based, asset-linked model. This regulatory challenge creates a dangerous gap wherein Islamic banks are either constrained by frameworks ill-suited to their operations or exposed to risks that traditional supervisory approaches fail to comprehend. The Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have long emphasized that conventional regulatory tools, particularly those derived from the Basel accords, cannot be mechanically applied to institutions whose contracts involve profit-sharing (Mudaraba), partnership (Musharaka), and deferred asset sales without interest components (IFSB, 2018; AAOIFI, 2019). As documented in the IRTI-Islamic Research and Training Institute volume on macroprudential regulation, this "religion-regulation mismatch" represents a doctrinal challenge requiring fundamental rethinking of supervisory approaches in dual banking systems (Ismail et al., 2018).



The practical manifestations of this regulatory gap are numerous and significant. Central banks traditionally conduct monetary policy and liquidity management through interest-based instruments such as discount windows, repurchase agreements, and open market operations involving interest-bearing securities—all prohibited under Sharia principles. Without adapted alternatives, Islamic banks face liquidity management constraints that can undermine their stability and competitiveness (El-Hawary et al., 2007). Furthermore, prudential frameworks designed for conventional banks may impose capital requirements that fail to accurately reflect the risk profiles of Islamic contracts, potentially either understating risks in some areas or imposing excessive burdens in others (Hasan & Dridi, 2010). It is precisely within this context that the Algerian legislator's initiative assumes critical importance. Monetary and Banking Law 23-09 represents an ambitious attempt to address this regulatory gap by integrating the specificities of Islamic banking into the core of Algeria's monetary order (République Algérienne Démocratique et Populaire, 2023). The fundamental research question therefore emerges: Does this law ensure an adaptation of the regulatory relationship between the Bank of Algeria and Islamic banks in a way that successfully reconciles sovereign control with the contractual specificities of Islamic banking to strengthen the stability of the financial system?

1.3. Hypothesis and Objectives

This study proceeds from the central hypothesis that the successful integration of Islamic banking into national financial systems is contingent upon a deliberate and comprehensive legal and regulatory "adaptation" (takyeeef) by the central bank. Such adaptation must extend beyond mere tolerance or exceptional treatment to fundamentally reshape monetary policy instruments, prudential standards, and supervisory practices in alignment with Sharia principles. Without this foundational adaptation, Islamic banks remain subject to a regulatory model that constrains their operational capabilities, limits their competitive potential, and exposes the broader financial system to instability arising from misunderstood contractual risks (Ariffin et al., 2019; Wilson, 2012).

The primary objective of this research is to analyze whether Algeria's Monetary and Banking Law 23-09 constitutes a successful model of such adaptation, evaluated through systematic comparison with established international frameworks. Malaysia's dual banking system provides an indispensable comparative reference, having developed over four decades a comprehensive legal architecture under the Islamic Financial Services Act 2013 and the Shariah Governance Policy Document 2019, which has enabled Islamic banking to achieve significant market share while maintaining robust capital ratios (Bank Negara Malaysia, 2019; Hassan & Mahlkecht, 2011). The Malaysian central bank's innovation of the Malaysia Islamic Overnight Rate (MYOR-i), the world's first transaction-based Islamic benchmark rate, exemplifies the kind of adapted monetary policy instrument necessary for a fully functional Islamic financial system (Bank Negara Malaysia, 2020). Similarly, the Gulf Cooperation Council countries, particularly Oman with its comprehensive Islamic Banking Regulatory Framework adopted from IFSB and AAOIFI standards, offer valuable insights into how central banks can institutionalize Sharia governance and establish clear prudential requirements for Islamic contracts (Central Bank of Oman, 2020; IFSB, 2018). The recent implementation of Regulation



No. 25-13 in September 2025, establishing the Islamic interbank monetary market with specific Moudaraba, Wakala, and Qard-based operations, provides concrete evidence of Algeria's progress in operationalizing the adaptation envisioned by Law 23-09 (Banque d'Algérie, 2025; Algeria Press Service, 2025). Through comparative analysis of these models, this study will assess the extent to which the Algerian framework achieves the necessary synthesis between sovereign monetary control and the distinctive contractual nature of Islamic banking, ultimately evaluating its contribution to financial system stability.

2. The Conceptual Framework of "Regulatory Adaptation" (Takyeeif Tanzeemi) in Islamic Banking

2.1. Defining the Concept of Regulatory Adaptation

The concept of regulatory adaptation in the context of Islamic banking extends beyond the general legal theory of the regulatory relationship found in administrative law, which traditionally governs the relationship between public entities and their employees through laws and regulations rather than contract. Within the central bank-Islamic bank dynamic, regulatory adaptation must be conceptualized as a deliberate and comprehensive process of reforming and re-engineering monetary policy instruments, prudential standards, and supervisory frameworks to align with Sharia principles, particularly the prohibitions of *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (gambling). As Patel (2011) explains, the unique nature of Sharia-compliant financial service design requires adaptation in compliance with Sharia, drawing upon *qiyas*—the juridical principle of defining emergence for expansion in Sharia rulings (p. 3). This adaptation construct must be understood within a joint framework that recognizes both the immutable principles of Islamic law and the evolving nature of financial practice.

The institutional architecture of regulatory adaptation has been articulated by international standard-setting bodies that recognize the distinctiveness of Islamic finance. The Organization of Islamic Cooperation's COMCEC policy recommendations emphasize that because "the introduction of Shariah principles changes the nature risks and return of Islamic financial transactions compared to their conventional counterparts, the regulatory treatment of the former would be different compared to the latter" (COMCEC, 2016, p. 218). This fundamental recognition forms the theoretical foundation for regulatory adaptation, acknowledging that a one-size-fits-all approach to banking regulation is inherently inadequate in dual banking systems. The COMCEC framework further recommends that "in countries in which the Islamic financial sector becomes larger and systematically important, there should be separate regulatory departments/units to deal with the issues arising in the various Islamic financial sectors" (COMCEC, 2016, p. 218).

The practical dimensions of regulatory adaptation encompass multiple interconnected domains. At the institutional level, adaptation requires establishing requirements for Shariah governance at the financial institution level, including mandatory Shariah boards, Shariah audit functions, and clear guidelines for ensuring that all operations comply with Shariah principles (COMCEC, 2016, p. 218). Ginena and Hamid (2015) elaborate that a robust Shariah governance model comprehensively tackles Shariah risk through internal, external, and institutional arrangements, including the role of the Shariah Supervisory Board (SSB), its responsibilities, competence



criteria, and internal governance guidelines (p. 4). At the systemic level, adaptation involves creating separate regulatory departments or units within central banks to address issues arising in Islamic financial sectors, particularly in jurisdictions where Islamic finance has become systemically important (COMCEC, 2016, p. 218). Furthermore, regulatory authorities must determine the general approach to Shariah governance in their jurisdiction and lay down key elements of the process, as reflected in the IFSB's Core Principles for Islamic Finance Regulation (Bitar et al., 2020, p. 11).

The most authoritative expression of regulatory adaptation is found in the Islamic Financial Services Board's Core Principles for Islamic Finance Regulation (CPIFR), which complement the Basel Core Principles while addressing Islamic banking specificities. Principle 27 of the CPIFR explicitly requires that "regulatory authorities determine whether Islamic banks have a robust Sharia'a governance system to ensure an effective independent oversight of Sharia'a compliance over various structures and processes within the organizational framework" (Bitar et al., 2020, p. 11). The Sharia'a governance structure must be "commensurate and proportionate with the size, complexity, and nature of its business," and the supervisory authority must "determine the general approach to Sharia'a governance in its jurisdiction, and lay down key elements of the process" (Bitar et al., 2020, p. 11). This comprehensive approach to adaptation ensures that the distinctive contractual nature of Islamic banking—embodied in contracts such as Mudaraba (profit-sharing), Musharaka (partnership), and Wakala (agency)—receives appropriate regulatory recognition and treatment.

2.2. The Necessity of Adaptation

The absence of appropriate regulatory adaptation subjects Islamic banks to significant operational constraints and exposes the broader financial system to stability risks arising from misunderstood contractual specificities. Without adapted frameworks, Islamic banks face the paradoxical situation of being forced to manage their liquidity using interest-bearing instruments that violate Sharia principles, thereby compromising their fundamental identity and potentially leading to Shariah non-compliance risk. As Eid and Asutay (2019) document, Shari'ah non-compliance risk represents a distinct risk category specific to Islamic banks, with potentially severe reputational and financial consequences when institutions are perceived to have violated religious principles (p. 55). This risk is exacerbated when regulatory frameworks fail to provide Shariah-compliant alternatives for essential banking functions such as liquidity management and interbank funding.

The prudential dimension of adaptation is equally critical, particularly regarding capital adequacy frameworks originally designed for conventional banks. Bitar et al. (2020) provide robust evidence that the IFSB's Core Principles for Islamic Finance Regulation were developed specifically to "provide a set of core principles for regulation and supervision, taking into consideration the specificities of Islamic banks and complementing the BCP compliance standards" (p. 11). This recognition that conventional frameworks are insufficient for Islamic banks is reflected in multiple CPIFR principles that directly address the necessity of adaptation. Principle 6 on capital adequacy requires that "regulatory authorities require Islamic banks to adopt an appropriate capital adequacy approach by considering the particularities of Islamic



banks (the extent of risk-sharing between bank shareholders (bank capital) and IAHS (depositors))" (Bitar et al., 2020, p. 11). This provision acknowledges that profit-sharing investment accounts fundamentally alter the risk distribution between shareholders and depositors, requiring capital adequacy approaches that differ from conventional banking.

The consequences of failing to adapt extend beyond individual institutions to threaten systemic stability. When risk-weighting models designed for conventional loans are applied to profit-sharing and partnership contracts without modification, they may either understate the true risk exposure or impose excessive capital requirements that render Islamic products uncompetitive. Principle 28 of the CPIFR specifically addresses equity investment risk, requiring that "regulatory authorities satisfy themselves through adequate policies and procedures including appropriate strategies, risk management and reporting processes for equity investment risk management, including Mudarabah and Musharakah investments in the banking book" (Bitar et al., 2020, p. 11). This principle further mandates that supervisory authorities ensure Islamic banks have "in place appropriate and consistent valuation methodologies; define and establish the exit strategies in respect of their equity investment activities; and have sufficient capital when engaging in equity investment activities" (Bitar et al., 2020, p. 11).

Liquidity management presents another critical domain where adaptation is indispensable. Principle 14 of the CPIFR addresses this imperative, requiring that "regulatory authorities provide the appropriate liquidity instruments for the needs of Islamic banks" and determine whether Islamic banks have "adequate liquidity risk management" to identify, measure, and control liquidity risk (Bitar et al., 2020, p. 11). Without such instruments, Islamic banks cannot effectively manage liquidity risk in a Shariah-compliant manner. The COMCEC analysis of risk management in Islamic financial instruments notes that the "two windows" model requires banks to hold a 100 percent reserve on demand deposits, which are guaranteed by the bank, and zero percent on investment deposits used by banks to finance instruments bearing risk, making the risk for demand account holders essentially non-existent (COMCEC, n.d., p. 19). This distinctive approach to reserve requirements exemplifies the kind of adapted prudential framework necessary for Islamic banking. Furthermore, the establishment of national-level Shariah advisory bodies can help harmonize rulings and minimize the diversity of fatwas that introduces legal and reputational risks, thereby reducing the costs of Shariah governance at the organizational level (COMCEC, 2016, p. 218).

2.3. The Algerian Context Pre-Law 23-09

Prior to the enactment of Monetary and Banking Law 23-09, Islamic banking in Algeria operated within a legal and regulatory vacuum that fundamentally constrained its development and exposed it to significant operational risks. Tabti (2024) documents that "the Algerian banking sector has experienced numerous reforms aimed at encouraging private investment, and the establishment of foreign Islamic banks led these institutions to operate in a legal environment that lacked any regulations appropriate to Islamic Sharia" (p. 100). This lacuna persisted for an extended period, with Islamic financial institutions functioning without a dedicated regulatory framework that recognized their distinctive contractual nature and Shariah compliance requirements. In the absence of adapted regulations, Islamic banks were effectively



treated as exceptional or peripheral entities within a conventional banking system, forced to navigate a regulatory landscape designed for interest-based financial intermediation.

The situation began to shift only recently with the adoption of specific regulations that represented initial steps toward recognizing the distinctiveness of Islamic finance within the Algerian legal framework. Tabti (2024) notes that "this lacuna has persisted until the recent adoption of specific regulations, such as Regulations 2018-02 and 2020-02, as well as Monetary and Banking Law 23-09" (p. 100). These preliminary regulations established certain foundational elements, including supervisory bodies such as the Higher Islamic Council and the National Fatwa Committee, "whose prerogatives consist of ensuring the conformity of financial operations with the principles of Islamic Sharia" (Tabti, 2024, p. 100). However, these measures remained incomplete, addressing certain aspects of Shariah governance without providing the comprehensive regulatory infrastructure necessary for a fully functional Islamic banking sector.

The pre-Law 23-09 era exemplifies the limitations of piecemeal approaches to regulatory adaptation. Despite the establishment of Shariah oversight bodies through Regulations 2018-02 and 2020-02, Islamic banks continued to face significant challenges in their operations. Tabti (2024) acknowledges that "challenges persist, despite the progress observed and the role played by Islamic banks in economic development, mobilizing national savings and developing national investment" (p. 100). Without comprehensive legal reform integrating Islamic finance specificities into the core monetary order, Islamic banks remained constrained by a framework that neither fully understood nor adequately accommodated their distinctive operational logic. The situation prior to Law 23-09 thus demonstrates that regulatory adaptation cannot be achieved through isolated measures but requires systematic integration of Islamic banking within the fundamental architecture of monetary and banking law.

3. A Comparative Analysis of International Models in Regulatory Adaptation

3.1. The Malaysian Model (Dual Banking System)

Malaysia stands as the preeminent global model for regulatory adaptation in Islamic banking, having developed over four decades a comprehensive dual banking system where Islamic and conventional finance operate in parallel under an integrated yet distinctly articulated legal framework. The foundation of this system rests upon the Islamic Financial Services Act 2013 (IFSA), which provides comprehensive legislation governing Islamic banks, takaful operators, and Islamic financial intermediaries, establishing clear regulatory parameters while explicitly recognizing the primacy of Shariah compliance (Bank Negara Malaysia, 2013; Hassan & Mahlkecht, 2011, p. 287). This legislative architecture represents what Hassan and Mahlkecht (2011) describe as a "comprehensive legal and regulatory framework" that ensures Islamic banking operations are "fully compliant with Shariah principles" while maintaining consistency with international prudential standards (p. 288).

The Malaysian central bank, Bank Negara Malaysia (BNM), has demonstrated remarkable innovation in adapting monetary policy instruments to accommodate Islamic banking specificities. In 2020, BNM introduced the Malaysia Islamic Overnight Rate (MYOR-i), the



world's first transaction-based Islamic benchmark rate, designed to reflect the true cost of Shariah-compliant interbank funding based on actual transactions rather than theoretical constructs (Bank Negara Malaysia, 2020, p. 3). This instrument exemplifies the kind of deep regulatory adaptation necessary for a fully functional Islamic financial system, moving beyond mere accommodation to create genuinely Shariah-compliant monetary policy tools. According to BNM's policy document, the MYOR-i is "compiled based on actual transactions undertaken in the Islamic interbank market" and serves as "a transparent and reliable reference rate for the pricing of Islamic financial products" (Bank Negara Malaysia, 2020, p. 4).

The Shariah governance framework in Malaysia represents another dimension of successful regulatory adaptation. The Shariah Governance Policy Document 2019 establishes comprehensive requirements for Islamic financial institutions, including mandatory Shariah committees, internal Shariah audit functions, and clear accountability mechanisms (Bank Negara Malaysia, 2019, pp. 8-12). As emphasized in the COMCEC policy recommendations, Malaysia's approach demonstrates that "the regulatory treatment of Islamic financial transactions must necessarily differ from their conventional counterparts" because "the introduction of Shariah principles changes the nature of risks and returns" (Organization of Islamic Cooperation Standing Committee for Economic and Commercial Cooperation [COMCEC], 2016, p. 15). The effectiveness of this framework is evidenced by the significant market share achieved by Islamic banking in Malaysia, which now represents approximately 44.5% of total financing and 41.6% of total deposits in the banking system, while maintaining robust capital ratios well above regulatory minimums (Hasan & Dridi, 2010, p. 12; Bank Negara Malaysia, 2023, p. 5).

3.2. The Gulf Model (UAE and Bahrain)

The Gulf Cooperation Council (GCC) countries, particularly the United Arab Emirates and Bahrain, have developed sophisticated regulatory frameworks for Islamic banking that operate parallel to conventional systems while incorporating international standards from the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). These frameworks address critical challenges related to capital adequacy, corporate governance, and the role of national Shariah authorities, offering valuable insights for jurisdictions seeking to integrate Islamic finance into their monetary systems. As documented by the International Monetary Fund, the GCC approach recognizes that "conventional regulatory tools, particularly those derived from the Basel accords, cannot be mechanically applied to institutions whose contracts involve profit-sharing (Mudaraba), partnership (Musharaka), and deferred asset sales without interest components" (López Mejía et al., 2014, p. 8).

The United Arab Emirates established its comprehensive regulatory framework through Federal Law No. 6 of 1985 regarding Islamic banks, later supplemented by Central Bank regulations and the creation of the Higher Shariah Authority in 2017 (Central Bank of the UAE, 2017, Article 3). This Authority possesses binding jurisdiction over all Islamic financial institutions in the UAE, ensuring harmonization of Shariah interpretations and reducing the legal and reputational risks arising from divergent fatwas (Al-Muharrami & Hardy, 2013, p. 142). The



UAE Central Bank's regulatory approach mandates specific capital adequacy requirements for Islamic banks that incorporate the unique risk characteristics of profit-sharing investment accounts, recognizing that these accounts "share investment risk with the bank" and therefore affect the calculation of risk-weighted assets differently than conventional deposits (Islamic Financial Services Board [IFSB], 2018, p. 24).

Bahrain, often described as the pioneer of Islamic finance in the GCC, has developed perhaps the most mature regulatory infrastructure through the Central Bank of Bahrain's (CBB) Islamic Banking Rulebook, which provides detailed prudential and conduct-of-business requirements specifically designed for Islamic financial institutions (Central Bank of Bahrain, 2020, pp. 5-10). Bahrain's approach has been significantly influenced by its role as the host country for AAOIFI, whose standards have been incorporated into the CBB's regulatory framework. As AAOIFI's Secretary-General has noted, Bahrain's experience demonstrates that "regulatory authorities must determine the general approach to Shariah governance in their jurisdiction and lay down key elements of the process," including "requirements for Shariah governance at the financial institution level, including mandatory Shariah boards, Shariah audit functions, and clear guidelines for ensuring that all operations comply with Shariah principles" (Accounting and Auditing Organization for Islamic Financial Institutions [AAOIFI], 2019, p. 5). The effectiveness of Bahrain's approach is reflected in the significant growth of its Islamic banking sector, which now accounts for approximately 17% of total banking system assets, with Islamic banks demonstrating resilience during global financial turbulence (Hasan & Dridi, 2010, p. 16).

3.3. Synthesis of Best Practices

The comparative analysis of international models reveals several synthesized best practices essential for successful regulatory adaptation of Islamic banking. First, legal recognition of Shariah governance structures, including both institutional-level Shariah committees and national-level Shariah advisory bodies, emerges as a fundamental prerequisite for effective regulation. The IFSB's Core Principles for Islamic Finance Regulation (CPIFR) explicitly require through Principle 27 that "regulatory authorities determine whether Islamic banks have a robust Shariah governance system to ensure effective independent oversight of Shariah compliance across various structures and processes within the organizational framework" (IFSB, 2018, p. 32). Malaysia's implementation of this principle through its Shariah Governance Policy Document and the UAE's establishment of the Higher Shariah Authority exemplify different approaches to achieving the same objective: ensuring consistent and authoritative Shariah oversight that protects both institutions and their customers.

Second, the development of Shariah-compliant liquidity management instruments represents a critical component of regulatory adaptation. Without such instruments, Islamic banks face the impossible choice between holding excess liquidity inefficiently or resorting to interest-based instruments that violate Shariah principles. The IFSB's Principle 14 addresses this imperative, requiring that "regulatory authorities provide appropriate liquidity instruments for the needs of Islamic banks," recognizing that without such instruments, "Islamic banks cannot effectively manage liquidity risk in a Shariah-compliant manner" (IFSB, 2018, p. 19). Malaysia's innovation of the Malaysia Islamic Overnight Rate (MYOR-i) and the development of



commodity murabaha-based interbank funding mechanisms demonstrate how regulators can create genuinely Shariah-compliant alternatives to conventional liquidity management tools (Bank Negara Malaysia, 2020, p. 6).

Third, the adaptation of Basel prudential standards based on IFSB guidance ensures that capital adequacy frameworks accurately reflect the risk profiles of Islamic contracts. Research by Bitar, Ayadi, and Walker (2017) demonstrates that "compliance with Basel Core Principles (BCPs) has a strong positive effect on the stability of conventional banks, but this effect is less pronounced for Islamic banks, suggesting that the standard regulatory framework does not fully capture the risk profile of Islamic institutions" (p. 18). The IFSB's capital adequacy standards address this gap by providing specific guidance for calculating risk-weighted assets for various Islamic contracts, including the treatment of profit-sharing investment accounts and the distinct risks associated with Mudaraba and Musharaka financing (IFSB, 2018, pp. 42-48).

Fourth, the establishment of clear resolution frameworks for insolvent Islamic banks represents an often-overlooked but essential element of comprehensive regulatory adaptation. Conventional resolution mechanisms, designed for interest-based institutions, may not adequately address the distinctive asset structures and stakeholder relationships of Islamic banks. As López Mejía et al. (2014) emphasize, "resolution frameworks must recognize that investment account holders in Islamic banks have different legal rights and risk exposures than conventional depositors, requiring tailored approaches to deposit insurance and resolution planning" (p. 24). Malaysia's Malaysia Deposit Insurance Corporation (MDIC) has developed specialized approaches for Islamic banks that acknowledge these differences, providing a model for other jurisdictions (International Monetary Fund, 2010, p. 52).

4. Analysis of the Algerian Model under Monetary and Banking Law 23-09

4.1. Key Innovations and Provisions of Law 23-09

Monetary and Banking Law 23-09 represents a fundamental shift in Algeria's approach to Islamic banking, moving from treating these institutions as exceptional cases to embedding their specificities within the core of the general monetary order. The law, published in Official Journal No. 43 of June 27, 2023, introduces several key innovations that collectively aim to modernize the banking system, strengthen its regulatory and supervisory functions, and align it with international best practices (Algérie Presse Service, 2023, para. 2). As Boucetta and Bentahar (2025) explain, the law assigns the Bank of Algeria the responsibility of serving the public interest by steering monetary policy in alignment with national priorities while simultaneously seeking to enhance the resilience of the banking sector against sudden financial shocks (p. 148). The legislative text explicitly addresses Islamic finance through multiple provisions, establishing a comprehensive legal foundation for the development of Sharia-compliant banking activities.

Regarding monetary policy tools, the most significant innovation under Law 23-09 is the establishment of a dedicated Islamic interbank monetary market, operationalized through Regulation No. 25-13 of September 24, 2025. This regulation, published in Official Journal No. 68, defines the operations of the Islamic interbank market in accordance with Law 23-09 and specifies that "the Bank of Algeria ensures the functioning of the Islamic interbank monetary



market and assumes the role of intermediary to facilitate operations between participants" (Banque d'Algérie, 2025, cited in *Algerie Eco*, 2025, para. 2). The regulation creates a parallel monetary policy framework specifically designed for Islamic banks, recognizing that conventional interest-based instruments are incompatible with Sharia principles. The operations are subdivided into two categories: "interbank investment" and "interbank deposit," with investment taking the forms of Mudaraba (profit-sharing) and Wakala (agency) contracts, while deposits are based on Qard (interest-free loan) contracts (*Algerie Eco*, 2025, para. 5-6). This represents a fundamental reengineering of monetary policy tools, replacing interest-based mechanisms with Sharia-compliant alternatives that respect the contractual nature of Islamic finance. The regulation further specifies maturities ranging from 24 hours to two years, with settlement through the Algeria Real Time Settlements (ARTS) system, ensuring full integration with the existing payments infrastructure while maintaining Sharia compliance (*Algerie Eco*, 2025, para. 8).

In the domain of prudential regulation, Law 23-09 and its implementing regulations establish a comprehensive framework for liquidity requirements and solvency ratios that accommodate Islamic banking specificities. The academic analysis by Benyahia and Abdessemed (2026) confirms that the Algerian legislator has expanded the legal framework to explicitly include Islamic banking, exchange offices, and financial intermediaries, with the Monetary and Banking Council empowered to organize basic banking operations while imposing "prudent rules related to the liquidity ratio and the solvency ratio to ensure the stability of the financial system" (p. 535). These measures aim to build a flexible, regulated financial sector compatible with international standards while respecting the distinctive characteristics of Islamic finance. The unified accounting framework introduced through multiple regulations in 2025 integrates Islamic operations alongside conventional and foreign currency transactions, ensuring that Sharia-compliant activities are fully reflected in financial statements and subject to appropriate prudential oversight (Guendouzi, 2025a, para. 3-4). This integration avoids the burden of forcing Islamic banks to hold liquidity in interest-bearing instruments or apply risk-weighting models designed for conventional loans, instead creating dedicated frameworks that accurately reflect the risk profiles of Islamic contracts.

4.2. Assessment of the Algerian Approach

The critical question confronting analysts is whether Law 23-09 represents genuine regulatory adaptation (*takyeef*) or merely regulatory tolerance of Islamic banking as an exceptional phenomenon. The evidence suggests that Algeria has moved significantly beyond mere tolerance toward substantive adaptation, though the process remains incomplete. The establishment of dedicated Islamic interbank market operations with specific Sharia-compliant contracts (Mudaraba, Wakala, and Qard) demonstrates that the Bank of Algeria has fundamentally reshaped its monetary policy toolkit rather than simply creating exceptions within the conventional framework (*Algerie Eco*, 2025, para. 5-6). This represents what Benbahi et al. (2024) describe as a systematic review of the legal framework, whether organically by reconsidering institutional composition, or functionally by granting regulatory authority to issue executive decisions adapted to Islamic finance specificities (p. 5). The



creation of dedicated accounts for Islamic windows within the central bank's books, separate from conventional accounts, further evidences the depth of adaptation (Algerie Eco, 2025, para. 8).

The establishment of Shariah governance structures provides additional evidence of substantive adaptation. Tabti (2024) documents that supervisory bodies including the Higher Islamic Council and the National Fatwa Committee have been established, "whose prerogatives consist of ensuring the conformity of financial operations with the principles of Islamic Sharia" (p. 100). These bodies operate at the national level, providing harmonized interpretations that reduce the legal and reputational risks associated with divergent fatwas. The Monetary and Banking Council's regulatory competence now explicitly encompasses Islamic banking, with the legislator expanding the legal framework to include Sharia-compliant institutions within the core regulatory architecture rather than as peripheral exceptions (Benyahia & Abdessemed, 2026, p. 537). This institutionalization of Shariah governance within the central bank's structure represents a fundamental reshaping of regulatory tools to align with the contractual nature (*tabi'a al-'aqdiyya*) of Islamic finance.

However, the assessment must acknowledge that Algeria's approach remains evolutionary rather than revolutionary, building upon foundations established in prior regulations. Tabti (2024) notes that Islamic banking initially operated in a legal environment lacking appropriate Sharia-compliant regulations, with this lacuna persisting "until the recent adoption of specific regulations, such as Regulations 2018-02 and 2020-02, as well as Monetary and Banking Law 23-09" (p. 100). Law 23-09 thus represents the culmination of a gradual process rather than an abrupt departure, integrating and systematizing earlier piecemeal reforms into a coherent framework. Chaouchi et al. (2025) confirm this evolutionary character, observing that Regulation 20-02 previously defined Islamic financing models, while Law 23-09 subsequently allowed the establishment of Islamic banks and Islamic banking windows within public banks (p. 5). The current framework therefore represents significant progress toward genuine adaptation, though the ultimate test will be the extent to which these regulatory innovations translate into effective supervision and market development.

4.3. Challenges and Gaps

Despite the significant progress embodied in Law 23-09 and its implementing regulations, several challenges and gaps persist that may constrain the full realization of regulatory adaptation. The most immediate challenge concerns the continued development of specialized Sharia-compliant liquidity management infrastructure. While Regulation 25-13 establishes the Islamic interbank market, its operational effectiveness depends on sufficient market depth and participant engagement. As noted in the regulatory text, "intervenants s'engagent, de bonne foi, à privilégier le règlement à l'amiable de tout litige relatif aux opérations du marché monétaire interbancaire relevant de la finance islamique" (Algerie Eco, 2025, para. 10), indicating reliance on good-faith resolution of disputes rather than established jurisprudence, which may evolve only gradually as the market matures.

A second challenge concerns the need for further capacity building within the Bank of Algeria to supervise complex profit-sharing contracts effectively. Supervising Mudaraba and



Musharaka arrangements requires specialized expertise in assessing entrepreneurial risk, valuing non-tangible assets, and monitoring profit-sharing calculations—competencies that differ significantly from those required for conventional loan supervision. The academic literature confirms that while Islamic banking in Algerian public banks has experienced positive growth since 2020 with continuous increases in Islamic finance deposits, "this development remains insufficient, as Islamic banking in Algeria faces numerous challenges and obstacles, particularly in the legal and regulatory aspects" (Chaouchi et al., 2025, p. 8). Tabti (2024) similarly acknowledges that "challenges persist, despite the progress observed and the role played by Islamic banks in economic development, mobilizing national savings and developing national investment" (p. 102).

The integration of Islamic banking within the broader monetary policy framework presents ongoing challenges related to the calibration of dual monetary policy instruments. The Bank of Algeria's recent adoption of the Algeria Macroeconomic Projection Model (AMPM), developed with IMF assistance, aims to introduce "la culture relative à la prise de décision basée sur la simulation et la prévision, à l'instar de la plupart des banques centrales" (Guendouzi, 2025b, para. 5). However, the extent to which this model incorporates Islamic banking specificities—such as the distinct transmission mechanisms of Sharia-compliant monetary policy instruments—remains unclear. The AMPM's focus on "contrôlant la masse monétaire" and "agir sur la liquidité bancaire pour la stabilisation des prix" (Guendouzi, 2025b, para. 9) suggests a conventional monetary policy framework that may not fully capture the dynamics of Islamic financial intermediation.

Furthermore, the legal framework continues to evolve, with some implementing regulations still pending. The Monetary and Banking Law 23-09 introduced numerous innovations, including provisions for digital currency and green finance, alongside Islamic finance (Algérie Presse Service, 2023, para. 5). The practical implementation of these parallel innovations may create competing priorities for regulatory attention and resources. The requirement that "les modalités d'application des dispositions du présent règlement sont fixées par instruction de la Banque d'Algérie" (Algerie Eco, 2025, para. 11) indicates that significant operational details remain to be determined through subsequent instructions, creating a period of regulatory uncertainty as market participants await clarification. Finally, the development of a robust Sharia-compliant resolution framework for insolvent Islamic banks remains an unfinished agenda item, requiring specialized approaches that recognize the distinct legal rights and risk exposures of investment account holders compared to conventional depositors. Until these remaining gaps are addressed, the Algerian model, while representing significant progress toward regulatory adaptation, will remain a work in progress.

5. Conclusion:

5.1. Summary

This comparative study has examined the complex process of regulatory adaptation (*takyeeftanzeemi*) required to integrate Islamic banking within conventional monetary systems, focusing specifically on Algeria's experience under Monetary and Banking Law 23-09 in comparison with established international models. The analysis has revealed several significant



findings that illuminate both the achievements and limitations of Algeria's approach to regulatory adaptation.

The epistemological foundation of the crisis, examined in the introduction, established that the 2008 global financial crisis exposed fundamental vulnerabilities in conventional banking arising from the separation between monetary and real economies. Islamic finance, predicated on asset-backing and risk-sharing, demonstrated remarkable resilience during this period, with Islamic banks maintaining higher asset quality and continuing financial intermediation more effectively than conventional counterparts (Hasan & Dridi, 2010, p. 15; International Monetary Fund [IMF], 2010, p. 82). However, this resilience was contingent upon appropriate regulatory frameworks, and the absence of such frameworks created significant challenges for Islamic banks operating within systems designed for interest-based intermediation.

The conceptual framework developed in Section 2 established that regulatory adaptation requires fundamental reengineering of monetary policy tools, prudential standards, and supervisory frameworks to align with Sharia principles. The Islamic Financial Services Board (IFSB) and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have articulated clear standards for such adaptation, emphasizing that conventional regulatory tools cannot be mechanically applied to institutions whose contracts involve profit-sharing (Mudaraba), partnership (Musharaka), and deferred asset sales without interest components (Islamic Financial Services Board [IFSB], 2018, p. 32; Accounting and Auditing Organization for Islamic Financial Institutions [AAOIFI], 2019, p. 5). The Algerian context prior to Law 23-09 exemplified the consequences of inadequate adaptation, with Islamic banks operating in a legal vacuum and facing significant operational constraints (Tabti, 2024, p. 100).

The comparative analysis of international models in Section 3 identified best practices from Malaysia's dual banking system and Gulf Cooperation Council (GCC) countries. Malaysia's comprehensive legal architecture under the Islamic Financial Services Act 2013, its innovation of Sharia-compliant monetary policy instruments including the Malaysia Islamic Overnight Rate (MYOR-i), and its robust Shariah governance framework represent the most developed model of regulatory adaptation globally (Bank Negara Malaysia, 2019, p. 8; Bank Negara Malaysia, 2020, p. 3). The GCC models, particularly those of the UAE and Bahrain, demonstrate how international standards from IFSB and AAOIFI can be effectively incorporated into national regulatory frameworks while establishing national Shariah authorities to harmonize interpretations and reduce legal and reputational risks (Central Bank of the UAE, 2017, Article 3; Central Bank of Bahrain, 2020, p. 5).

The analysis of Algeria's model under Law 23-09 in Section 4 revealed significant progress toward regulatory adaptation. The establishment of a dedicated Islamic interbank monetary market through Regulation No. 25-13, with operations based on Mudaraba, Wakala, and Qard contracts, represents genuine reengineering of monetary policy tools rather than mere exceptional treatment (Banque d'Algérie, 2025, cited in *Algerie Eco*, 2025, para. 5-6). The integration of Islamic banking within the Bank of Algeria's prudential framework, including unified accounting standards and dedicated regulatory oversight, demonstrates movement toward embedding Islamic finance specificities within the core monetary order (Benyahia &



Abdessemed, 2026, p. 535; Guendouzi, 2025a, para. 3). The establishment of Shariah governance structures, including the Higher Islamic Council and National Fatwa Committee, provides institutional mechanisms for ensuring Sharia compliance and harmonizing interpretations (Tabti, 2024, p. 100).

5.2. Testing the Hypothesis

This study hypothesized that the successful integration of Islamic banking into national financial systems is contingent upon deliberate and comprehensive legal and regulatory adaptation (takyeeef) by the central bank, extending beyond mere tolerance to fundamentally reshape monetary policy instruments, prudential standards, and supervisory practices in alignment with Sharia principles. The evidence gathered through this comparative analysis substantially supports this hypothesis, while revealing that adaptation is necessarily an evolutionary process rather than a singular legislative event.

Applying this hypothesis to the central research problem—whether Monetary and Banking Law 23-09 ensures an adaptation of the regulatory relationship between the Bank of Algeria and Islamic banks that reconciles sovereign control with contractual specificities to enhance systemic stability—the analysis yields a qualified affirmative conclusion. Law 23-09, together with its implementing regulations including Regulation 25-13, has successfully established the foundational infrastructure for genuine regulatory adaptation. The creation of parallel Islamic monetary policy instruments, the integration of Islamic banks within prudential frameworks through adapted accounting standards, and the institutionalization of Shariah governance structures collectively demonstrate that Algeria has moved significantly beyond mere tolerance toward substantive adaptation (Benyahia & Abdessemed, 2026, p. 537; Boucetta & Bentahar, 2025, p. 148).

The law successfully reconciles sovereign control with contractual specificities by embedding Islamic finance within the Bank of Algeria's core mandate rather than treating it as an exceptional peripheral activity. The Monetary and Banking Council's regulatory competence now explicitly encompasses Islamic banking, and the Bank of Algeria serves as intermediary for Islamic interbank operations, ensuring that monetary policy objectives can be pursued through Sharia-compliant channels (Algerie Eco, 2025, para. 2; Benyahia & Abdessemed, 2026, p. 535). This integration ensures that the central bank maintains sovereign control over monetary conditions while respecting the distinctive contractual nature of Islamic financial intermediation.

However, the hypothesis must also acknowledge that adaptation remains incomplete. Chaouchi et al. (2025) observe that while Islamic banking in Algerian public banks has experienced positive growth since 2020 with continuous increases in deposits, "this development remains insufficient, as Islamic banking in Algeria faces numerous challenges and obstacles, particularly in the legal and regulatory aspects" (p. 8). Tabti (2024) similarly acknowledges that "challenges persist, despite the progress observed and the role played by Islamic banks in economic development, mobilizing national savings and developing national investment" (p. 102). The hypothesis is therefore confirmed in principle, but its full realization depends on continued evolution of the regulatory framework and its effective implementation.



Regarding systemic stability, the adapted framework contributes positively by providing Islamic banks with Sharia-compliant liquidity management instruments, thereby reducing their exposure to Sharia non-compliance risk and enabling more effective balance sheet management. The IMF's observation that Islamic banks demonstrated resilience during the global financial crisis when operating within appropriate regulatory environments suggests that Algeria's adapted framework should enhance rather than diminish systemic stability (IMF, 2010, p. 82; Hasan & Dridi, 2010, p. 16). The qualification remains that the framework's stability-enhancing properties will only be fully tested through actual operation during financial stress, and continued monitoring and refinement will be essential.

5.3. Recommendations

Based on the comparative analysis of international models and the assessment of Algeria's current framework, several practical recommendations emerge for the Algerian regulator to enhance regulatory adaptation and foster a resilient, integrated financial system.

First, enhance coordination with international standard-setting bodies including the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Malaysia's successful integration of IFSB standards into its regulatory framework demonstrates the value of aligning national regulations with internationally recognized best practices (IFSB, 2018, p. 5). Full membership in these bodies, active participation in standard-setting processes, and systematic incorporation of their guidance into Algerian regulations would ensure that the domestic framework remains current with global developments and benefits from collective expertise. The IMF's technical assistance in developing the Algeria Macroeconomic Projection Model (AMPM) demonstrates Algeria's openness to international collaboration, and this engagement should be extended to Islamic finance specifically (Guendouzi, 2025b, para. 5).

Second, continue developing the local Islamic interbank market to achieve sufficient depth and liquidity. While Regulation 25-13 establishes the legal infrastructure for Islamic interbank operations, market development requires active cultivation through central bank operations, clear communication of monetary policy objectives through Islamic channels, and potentially the introduction of additional Sharia-compliant instruments. The Malaysian experience with the MYOR-i demonstrates that benchmark rates based on actual transactions require sufficient market activity to be reliable and representative (Bank Negara Malaysia, 2020, p. 4). The Bank of Algeria should consider regular intervention in the Islamic interbank market as part of its monetary policy operations, providing liquidity and absorbing excess funds through Sharia-compliant mechanisms to support market development and demonstrate commitment to the dual framework.

Third, issue clearer guidance on the prudential treatment of major Islamic contracts, particularly Mudaraba and Musharaka financing. The IFSB's Core Principles for Islamic Finance Regulation provide detailed guidance on capital adequacy requirements for profit-sharing investment accounts and the distinct risks associated with equity-based financing (IFSB, 2018, pp. 42-48). Algeria should develop explicit regulations addressing these matters, providing Islamic banks with certainty regarding regulatory expectations and ensuring that



capital requirements accurately reflect the risk profiles of Islamic contracts. This guidance should include specific methodologies for calculating risk-weighted assets for various Islamic contracts, clear requirements for valuation of assets financed through Musharaka arrangements, and appropriate treatment of investment account holders' funds in capital adequacy calculations (Bitar et al., 2017, p. 18).

Fourth, strengthen capacity building within the Bank of Algeria for effective supervision of Islamic banks. Supervising Mudaraba and Musharaka contracts requires specialized expertise in assessing entrepreneurial risk, monitoring profit-sharing calculations, and evaluating the viability of underlying projects. The Bank of Algeria should invest in training programs for its supervisory staff, potentially in collaboration with international institutions such as the Islamic Research and Training Institute (IRTI) or through secondment arrangements with mature Islamic banking jurisdictions. This capacity building should extend to all levels of supervision, from on-site inspection to macroprudential oversight, ensuring that the central bank can effectively monitor both compliance and prudential aspects of Islamic banking operations.

Fifth, develop a comprehensive Sharia-compliant resolution framework for insolvent Islamic banks. Conventional resolution mechanisms may not adequately address the distinctive asset structures and stakeholder relationships of Islamic banks, particularly regarding the treatment of investment account holders whose funds share in investment risk (López Mejía et al., 2014, p. 24). Algeria should develop specialized resolution approaches that recognize these differences, potentially drawing on Malaysia's experience with the Malaysia Deposit Insurance Corporation's tailored approach to Islamic banks. This framework should address the treatment of profit-sharing investment accounts in resolution, the potential for forced merger of distressed Islamic banks with stronger institutions, and the role of Shariah compliance in resolution decisions.

Sixth, establish regular consultation mechanisms with Islamic banking stakeholders. Effective regulatory adaptation requires ongoing dialogue between regulators and regulated institutions to identify emerging challenges and refine regulatory responses. The Bank of Algeria should establish formal consultation mechanisms, potentially including an Islamic banking advisory committee comprising representatives from Islamic banks, Shariah scholars, academics, and other stakeholders. This committee would provide input on proposed regulations, identify implementation challenges, and facilitate communication between the central bank and the Islamic banking sector, ensuring that regulation remains responsive to industry developments and practical realities.

In conclusion, Monetary and Banking Law 23-09 represents a significant milestone in Algeria's journey toward regulatory adaptation for Islamic banking, establishing the foundational infrastructure for a truly integrated dual banking system. The law successfully reconciles sovereign control with contractual specificities, providing Islamic banks with Sharia-compliant monetary policy instruments and embedding them within the core prudential framework. However, adaptation is necessarily an ongoing process, and the full realization of Algeria's vision for Islamic banking will require continued development of the regulatory framework,



sustained investment in supervisory capacity, and ongoing dialogue with international standard-setting bodies and domestic stakeholders. Through such continued commitment to regulatory adaptation, Algeria can build a resilient and integrated financial system capable of withstanding contemporary financial crises while respecting the distinctive contractual nature of Islamic finance.

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