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The Evolution of Islamic Banking Operations in Algeria "From Theorization to Legal Implementation"

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Abstract:

This study aims to analyze the legal and regulatory framework for Islamic banking operations in Algeria and examine their practical implementation since the issuance of Regulation No. 2002 and Instruction No. 20-03 in 2020. The study addresses the Sharia and economic foundations underlying these operations and analyzes the types of Islamic banking transactions permitted in Algeria, such as Murabaha, Mudaraba, Ijara, Salam, and Istisna'a. The study also reviews the supervision and oversight mechanisms applied to ensure compliance with Sharia controls, and the challenges facing this sector at technical, human, and organizational levels. The study concludes that Islamic banking operations in Algeria have witnessed promising gradual development, but their success requires further efforts in technical development, human capacity building, and community awareness, with the need to strengthen cooperation among various stakeholders in the banking system to serve sustainable economic development.

Keywords: Islamic Banking; Islamic Banking Operations; Algerian Banking System; Legal and Regulatory; Sharia Supervision

Introduction:

The Islamic banking industry is experiencing accelerated growth on a global scale, having successfully established its position as a banking alternative built on solid Sharia-compliant and economic foundations. In this context, numerous Arab and Islamic countries have turned toward developing their banking systems to incorporate Islamic banking services, responding to the increasing demand from individuals and institutions seeking to conduct transactions in accordance with Islamic Sharia principles.

Algeria is among the countries that recognized the importance of this direction, particularly given the significant percentage of citizens who prefer banking transactions that comply with Islamic Sharia. This need constituted a strong motivation for Algerian authorities to establish a comprehensive legal and regulatory framework, leading to the issuance of Regulation No. 20-02

dated March 15, 2020, and Instruction No. 20-03 dated April 2, 2020, which form the legal foundation for Islamic banking in the country.

The study of the development of Islamic banking operations in Algeria acquires special significance as it represents a transformation from the theoretical phase to practical implementation, carrying within it substantial potential for enhancing financial inclusion and diversifying banking services.

Research Problem:

In light of recent developments in the Algerian banking system and the introduction of Islamic banking operations, a fundamental problematic emerges centered on:

How has Algeria succeeded in transforming the theoretical dream of Islamic banking into a tangible legal reality, and what are the challenges and opportunities facing the practical implementation of these operations in the Algerian banking market?

Sub-questions: To answer this inquiry, we pose the following sub-questions:

- What are the legal and Sharia foundations upon which the Islamic banking system in Algeria is based?
- How was the transition accomplished from theoretical studies and jurisprudential interpretations to establishing a binding legal framework?
- What are the factors and motivations that contributed to accelerating the transition process from theorization to legal implementation?
- What are the most prominent challenges that faced the transformation process from theory to practical implementation?

Research Hypotheses:

To answer these questions, we propose the following hypotheses:

- **First Hypothesis:** Islamic banking operations in Algeria witnessed gradual and systematic development from the stage of theoretical studies and jurisprudential interpretations to establishing a comprehensive legal framework;
- **Second Hypothesis:** Societal needs and economic pressures contributed to accelerating the transition process from theorization to legal implementation of Islamic banking;
- **Third Hypothesis:** The transformation process from theory to implementation faced technical and legal challenges that required innovative solutions to ensure compatibility with both Islamic Sharia and the conventional banking system.

Research Objectives:

This study seeks to achieve a set of objectives, including:

- Tracing the historical development of Islamic banking operations in Algeria from the theorization stage to legal implementation;

- Analyzing the legal and regulatory framework for Islamic banking operations in Algeria and evaluating the extent of its suitability for practical implementation requirements;
- Assessing how challenges facing the transformation process from theory to practical implementation were addressed;

Research Significance:

This study derives its importance from documenting a unique experience in transforming theoretical interpretations in the field of Islamic banking into legal and institutional reality, providing a model suitable for study and benefit by countries seeking to implement similar banking systems. It also contributes to enriching literature related to institutional transformation processes in the Islamic banking sector.

Research Methodology:

To address the research problematic, an analytical-historical approach will be adopted based on tracing the temporal development of Islamic banking in Algeria, in addition to a comparative analytical approach to study transformations from theory to implementation. The study will rely on diverse sources including legal documents, specialized academic studies, and official reports.

Previous Studies:

Among previous studies that addressed this topic, we find:

- **Study by Ben Azzouz Mohammed, 2021, titled "Islamic Banking in Algeria: Reality and Challenges":** The study addressed the problem of the gap between theory and practice in Algerian Islamic banking and the challenges facing its development. It aimed to analyze the reality of Islamic banking in Algeria and identify the most important challenges preventing its growth. It concluded that Islamic banking in Algeria faces significant challenges in practical implementation, including lack of specialized human resources and weak regulatory framework, requiring redoubled efforts to develop this sector;

- **Study by Belabbas Ahmed, 2022, titled "Transparency in Islamic Banking Operations: A Study of the Algerian Experience":** It addressed the problem of weak transparency in Islamic banking operations and its impact on customer confidence and sustainable sector growth. It aimed to evaluate the level of transparency in Algerian Islamic banks and propose mechanisms for improvement. It concluded that the level of transparency in Islamic banking operations needs significant improvement, especially in disclosing the nature of operations and associated risks;

- **Study by Zarhouni Omar, 2020, titled "Economic Foundations for Adopting Islamic Banking in Algeria":** It addressed the problem of the need for strong economic justification for adopting Islamic banking in the Algerian banking system. It aimed to analyze the economic foundations and justifications calling for developing Islamic banking in Algeria. It concluded that there are strong economic justifications for adopting Islamic banking, including enhancing financial

inclusion and diversifying financing sources, also confirming the potential contribution of this sector to achieving sustainable economic development.

What Distinguishes the Current Research from Previous Studies:

This study is distinguished by its focus on the historical and evolutionary dimension of Islamic banking in Algeria, emphasizing the transformation process from theorization to implementation as a central axis of the study. It also provides specialized analysis of the mechanisms and processes that enabled the translation of theoretical frameworks into legal and institutional reality, which previous studies did not address with this detail and depth.

I. The Theoretical Framework of Islamic Banking Operations in Algeria

The theoretical framework of Islamic banking operations constitutes the intellectual and philosophical foundation upon which this industry is based in Algeria. The Algerian legislator was keen to build this framework according to a precise scientific methodology that takes into account local specificities and international standards simultaneously. This chapter will review the basic concepts, types of operations, and foundations upon which Islamic banking is based in Algeria.

1. Concept and Characteristics of Islamic Banking Operations in Algerian Legislation

The Algerian banking sector witnessed important development with the introduction of Islamic banking products and services, in response to the growing need of a broad segment of society seeking to deal with banks according to Islamic Sharia provisions. Understanding the nature of these operations and their essential characteristics is considered a basic starting point, especially as they are based on a different philosophy from the conventional banking system. The Algerian legislator was careful to establish a tight legal framework to regulate these operations through Regulation No. 20-02 and its subsequent implementing texts. Hence, the need arises to study the concept and characteristics of these Islamic banking operations as organized by Algerian legislation.

1.1 Legal Definition of Islamic Banking Operations

Islamic banking operations are defined in Algerian legislation as a set of financial and banking transactions that are practiced according to the provisions of Islamic Sharia, which are based on a fundamental principle of prohibiting usury (riba) in all its forms and manifestations.¹

Regulation No. 20-02 dated March 15, 2020, established a precise definition of these operations, stating in its first article that banking operations related to Islamic banking are

¹ Ben Azzouz Mohammed, "Islamic Banking in Algeria: Reality and Challenges," Journal of Islamic Economics, No. 15, 2021, p. 78.

"operations based on Islamic Sharia principles and characterized by the absence of usurious interest."¹

This legal definition carries deep dimensions that transcend the technical aspect of banking transactions, as it confirms the special nature of these operations that stem from an economic philosophy different from the conventional banking system. While the conventional banking system is based on the principle of lending and borrowing in exchange for predetermined interest, Islamic banking operations are based on the principles of partnership, murabaha, and leasing, creating a type of justice in the distribution of risks and returns between the bank and the client.

1.2 Essential Characteristics of Islamic Banking Operations

Islamic banking operations in the Algerian system are characterized by several fundamental characteristics, the most important of which are the prohibition of riba, gharar (excessive uncertainty), and transactions prohibited by Sharia; the adoption of the principle of profit and loss sharing; and connection to real assets in the economy.² These characteristics distinguish Islamic banking operations from their conventional counterparts and give them a special character that requires a deep understanding of their nature and operational mechanisms.

Regarding the prohibition of riba, this principle is not limited to preventing traditional banking interest only, but extends to include any increase conditionally predetermined in financial transactions without a real equivalent. This means that Islamic banking operations rely on different mechanisms to achieve returns, such as profit sharing, sales margins in murabaha operations, or rent in ijara operations.

As for the prohibition of gharar, this principle aims to eliminate ambiguity and ignorance in financial contracts, requiring complete clarity in all terms and conditions of Islamic banking operations. This includes determining the nature of the good or service subject to contract, its price, delivery date, and all other relevant conditions. It also includes prohibiting transactions that involve excessive risk or unstudied speculation.

1.3 Transparency Controls and Sharia Governance

These operations are also characterized by the obligation to comply with Sharia controls established by competent authorities, which was confirmed by the Algerian legislator by requiring banks and financial institutions practicing these operations to establish an internal Sharia supervisory board to ensure compliance of all operations with Islamic Sharia provisions.³ This

¹ Article 01: Regulation No. 20-02 dated March 15, 2020, relating to banking operations associated with Islamic banking, People's Democratic Republic of Algeria.

² Boudyaf Abdelkader, "Basic Principles of Islamic Banking in Algerian Legislation," Journal of Law and Economics, University of Algeria, No. 23, 2020, p. 156.

³ People's Democratic Republic of Algeria, Regulation No. 20-02, Article 08.

board consists of scholars specialized in Islamic jurisprudence and economics, and undertakes reviewing products and services before their market launch.

The Algerian legislator paid special attention to the issue of transparency in providing these services, requiring banks to clearly disclose to customers the nature of Islamic banking operations and their characteristics, as well as their pricing mechanisms and methods of calculating returns.¹ This transparency commitment aims to protect the banking consumer and ensure their complete understanding of the nature of products they deal with, especially since there is a fundamental difference between the operational mechanisms of Islamic and conventional banking.

Transparency requirements include the necessity to clarify the difference between expected and guaranteed returns, explain risks associated with each product, clarify profit and loss distribution mechanisms, and explain the nature of the contractual relationship between the bank and client in each type of Islamic banking operation.

2. Types of Islamic Banking Operations Regulated in Algeria

Regulation No. 20-02 and Instruction No. 20-03 dated April 2, 2020, specified the different types of Islamic banking operations permitted for practice in Algeria, and these operations include a wide spectrum of financial products covering most needs of individual and institutional clients.² The legislator was careful to diversify these products to ensure meeting the different needs of the banking market while maintaining commitment to Sharia controls.

These operations are divided into two main categories: financing operations and deposit acceptance operations, with each category comprising several types of banking products. This division reflects the comprehensive nature of Islamic banking that seeks to provide integrated financial solutions meeting customer needs at different stages of their economic lives.

2.1 Islamic Financing Operations

Islamic financing operations form the beating heart of Islamic banking, offering diverse Sharia-compliant alternatives to conventional financing through contracts that comply with Islamic Sharia provisions and achieve justice in the distribution of risks and returns.

2.1.1 Murabaha Contract as Financing Based on Deferred Sale

¹ Belabbas Ahmed, "Transparency in Islamic Banking Operations: A Study of the Algerian Experience," Journal of Economic Research, No. 18, 2022, p. 134.

² Instruction No. 20-03 dated April 2, 2020, defining products related to Islamic banking, and specifying procedures and technical characteristics for their implementation by banks and financial institutions.

In the field of financing operations, the murabaha contract comes at the forefront as one of the most important Islamic banking products regulated in Algeria.¹ Murabaha is based on the bank selling to the client a commodity or service at cost price plus an agreed-upon profit, and it is used to finance the purchase of goods, equipment, and real estate. This contract is characterized by clarity of cost and profit, achieving the required transparency in Islamic financial transactions.

The implementation of murabaha contract in Algerian banks requires observing several Sharia conditions, including the necessity for the bank to own the commodity before selling it to the client, the bank's bearing of ownership risks during the ownership period, and that the sale be at a determined and known deferred price. The sold commodity must also be lawful and beneficial, and must be accurately described to avoid gharar.

2.1.2 Mudaraba Contract

Mudaraba contract is considered one of the important operations based on partnership between the bank (capital owner) and the client (mudareb), where the former provides capital and the latter provides work and expertise, with profits distributed according to predetermined agreed proportions.² This contract embodies the principle of justice in risk and return distribution, where the bank bears capital loss in case of loss not resulting from mudareb's negligence, while the mudareb loses their effort and time.

Mudaraba is applied in Algerian banks in several areas, including financing commercial and industrial projects, managing investment portfolios, and financing agricultural activities. This contract requires precise determination of profit distribution ratios, designation of the work field permitted for the mudareb, and establishment of supervision and follow-up mechanisms to ensure proper money management.

2.1.3 Ijara Contract (Financing through Leasing)

Ijara contract represents one of the forms of long-term financing, where the bank purchases a specific asset then leases it to the client for a specified rent for an agreed period, with the possibility of transferring asset ownership to the client at the end of the ijara period.³ This type of financing is particularly suitable for financing heavy machinery, equipment, and commercial real estate.

Ijara contract in Algerian banking application is divided into two main types: operational ijara that does not end with transferring the asset to the lessee, and ijara ending in ownership that

¹ Khalidi Mahmoud, "Murabaha Contract in the Algerian Banking System: A Jurisprudential and Legal Study," *Journal of Sharia and Law*, No. 45, 2021, p. 89.

² Abdelrahman Said, "Mudaraba as a Financing Tool in Algerian Islamic Banks," *Journal of Financial and Banking Studies*, No. 12, 2022, p. 67.

³ Mersli Abdelhak, "Ijara Muntahia Biltamlik in Algerian Banking Application," *Journal of Islamic Economics*, No. 19, 2023, p. 112.

includes a binding promise to transfer asset ownership to the lessee at the end of the contract term. This contract requires precise determination of the leased asset, designation of the ijara period, and determination of rent and its payment method.

2.1.4 Salam Contract (Deferred Production Financing)

Salam contract is used in financing agricultural and industrial activities, where the bank pays the commodity price in advance in exchange for its delivery at a predetermined later date.¹ This contract is particularly useful for farmers and manufacturers who need financing for their projects before harvesting crops or completing production.

Salam contract requires that the commodity be known in specifications, that the delivery date be determined in the future, and that the price be paid at the contract session. The commodity must also be among things whose specifications can be controlled, and must be normally available in the market at the specified delivery time.

2.1.5 Istisna Contract (Construction Project Financing)

Istisna contract is applied in financing construction and industrial projects, where the bank requests a contractor to manufacture or build a specific asset according to specified specifications, then sell it to the client who needs it. This contract combines characteristics of sale and ijara, requiring precise determination of specifications and execution timeline.

2.2 Islamic Deposit Acceptance Operations

Deposit acceptance mechanisms in Islamic banks vary to provide customers with multiple options ranging from current accounts that guarantee money preservation to investment accounts that allow profit participation according to clear Sharia principles.

2.2.1 Current Deposit Accounts

In the field of deposit acceptance operations, Algerian legislation regulated current deposit accounts that carry no interest but guarantee capital return.² These accounts are based on the principle of benevolent loan (qard hasan), where the client lends the bank their money without compensation, retaining the right to retrieve it at any time. The bank, for its part, benefits from these funds in its lawful investment activities.

2.2.2 Restricted and Unrestricted Investment Accounts

And restricted and unrestricted investment accounts based on mudaraba between the bank and depositor. In unrestricted investment accounts, the depositor gives the bank complete freedom to invest funds in any lawful activity, while in restricted investment accounts, the depositor specifies the type of activity or sector in which they wish to invest their funds.

¹ Ben Ali Fatima, "Salam and Istisna Contracts in Economic Activity Financing," Journal of Islamic Finance, No. 8, 2021, p. 145.

² Hammadi Youssef, "Investment Accounts in Algerian Islamic Banks," Journal of Banking and Finance, No. 25, 2022, p. 78.

These accounts allow clients who do not wish to deal with conventional banking interest the opportunity to deposit their funds in banks with the possibility of achieving returns through participating in bank profits from its lawful investments. Profits are distributed according to predetermined agreed ratios, and holders of these accounts bear their share of losses if they occur.

2.2.3 Specialized Savings Products

Additionally, Algerian banks have developed specialized savings products such as Hajj and Umrah savings accounts, education savings accounts, and Islamic retirement accounts. These products meet special customer needs and encourage them to save for specific goals while maintaining their religious principles.

3. Sharia and Economic Foundations for Adopting These Operations in the Algerian Banking System

Algeria's adoption of Islamic banking operations was not merely a response to social or religious pressures, but came as a result of an in-depth study of the Sharia and economic foundations underlying these operations, and the benefits they can achieve for the national economy.¹ This adoption reflects a deep understanding of the nature of Islamic banking as an integrated financial system and not merely a religious alternative to conventional banking.

3.1 Sharia Foundations of Islamic Banking Operations

Islamic banking operations are based on a Sharia framework built on principles derived from the Holy Quran and Prophetic Sunnah that require prohibiting riba, gharar, and monopolistic practices while establishing values of justice and transparency in banking transactions. This framework aims to build a financial system that achieves balance between lawful earning and economic development requirements, while adhering to ethical and social values.

3.1.1 Basic Principles Derived from Sharia Texts

From the Sharia perspective, Islamic banking operations are based on a set of basic principles derived from the Holy Quran and noble Prophetic Sunnah, the most important of which are the prohibition of riba explicitly forbidden in Sharia texts, the prohibition of gharar (ambiguity and uncertainty) in financial contracts, and the prohibition of maysir (gambling) in all its forms.² These principles are not merely formal restrictions, but aim to achieve economic and social justice.

The prohibition of riba aims to prevent exploitation of the needy and ensure distribution justice, as riba leads to wealth accumulation in lenders' hands without real equivalent, increasing social disparity. The prohibition of gharar aims to ensure transparency in transactions and protect dealers

¹ Zarhouni Omar, "Economic Foundations for Adopting Islamic Banking in Algeria," Journal of Economic Policies, No. 14, 2020, p. 201.

² Bouakaz Mohammed Tayyeb, "Sharia Principles in Islamic Banking Transactions," Dar Al-Huda for Printing and Publishing, Algeria, 2021, p. 156.

from ambiguity and deception, while the prohibition of maysir aims to prevent unstudied speculation and excessive risk-taking.

3.1.2 Principle of Justice in Distribution and Shared Responsibility

These operations are also based on the principle of justice in distribution, where all parties bear responsibilities and risks in a balanced manner, which is embodied in the principle of "al-ghurm bil-ghunm" meaning that profit must be matched by risk-bearing.¹ This principle ensures that no party receives profit without bearing appropriate risk, enhancing distribution justice and reducing social disparity.

This principle also includes the necessity of risk-bearing by the party that has control over the asset or activity, encouraging wise management and responsible investment. This principle also requires that returns be proportionate to the size of risk borne, creating an incentive for innovation and development.

3.1.3 Connection to the Real Economy

Additionally, these operations emphasize the importance of connecting financial activity to the real economy, where all operations must be linked to real assets or actual services, contributing to enhancing financial stability. This connection prevents the formation of financial bubbles detached from economic reality, and ensures that financial activity has a positive impact on production and development.

3.2 Economic Foundations for Adopting Islamic Banking

Islamic banking is based on economic foundations aimed at directing financial activity within an Islamic Sharia framework and promoting justice and transparency, away from usurious and monopolistic transactions. It is based on the principle of profit and loss sharing, and from this perspective, Islamic banking represents an economic model through which the Algerian state seeks to achieve balance between freedom of capital movement and economic transactions and establishing foundations of equitable social development.

3.2.1 Expanding the Banking Base and Financial Inclusion

From the economic perspective, adopting Islamic banking operations in Algeria aims to achieve several strategic objectives, the most important of which is expanding the banking base by attracting a broad segment of citizens who refrained from dealing with conventional banks for religious reasons.² Studies indicate that a large percentage of Algerian citizens do not deal with the conventional banking system, depriving the national economy of important benefit from these funds in the economic development process.

¹ Othmani Tarek, "The Principle of Al-Ghurm bil-Ghunm in Islamic Finance," Journal of the Islamic Fiqh Academy, No. 18, 2020, p. 67.

² Algerian Statistics Institute, "Study on Financial Inclusion in Algeria," Annual Report 2023, p. 89.

This objective aligns with international efforts to promote financial inclusion, as integrating broader segments of society into the banking system contributes to enhancing economic growth and reducing poverty. Providing banking products that align with citizens' religious convictions also enhances their confidence in the banking system and encourages them to use official financial services.

3.2.2 Attracting Parallel Economy Funds

Islamic banking is also expected to contribute to attracting funds from the parallel economy to the official banking system, as there are large amounts of money held outside the banking system for religious reasons or lack of trust.¹ Integrating these funds into the official banking system will provide banks with additional financial resources that can be invested in financing development projects and various economic activities.

3.2.3 Enhancing Financial Stability and Reducing Systemic Risks

Moreover, Islamic banking operations are characterized by their close connection to the real economy, contributing to reducing financial speculation and limiting systemic risks that may threaten financial stability. This connection to real assets reduces the likelihood of forming financial bubbles, and the principle of profit and loss sharing distributes risks more fairly among depositors, investors, and banks.

The nature of Islamic banking operations based on specific and understood contracts also reduces financial complexity and derivative financial instruments that may increase systemic risks. This makes the Islamic banking system more transparent and easier to supervise and oversee.

3.2.4 Supporting Sustainable Economic Development

On another front, Islamic banking operations contribute to supporting sustainable economic development by focusing on productive activities and long-term investments. Instead of focusing on short-term profits, these operations encourage investment in projects that achieve real added value to the economy.

Islamic banking principles also encourage socially and environmentally responsible investment, as they prohibit investment in activities harmful to society or the environment. This aligns with global trends toward sustainable development and responsible investment.

II. Practical Implementation and Legal Regulation of Islamic Banking Operations

The practical implementation of Islamic banking operations constitutes the real challenge facing any banking system seeking to integrate these financial instruments within its organizational structure. Algeria faced this challenge by establishing a comprehensive regulatory framework and

¹ Ben Said Adel, "Integration of Parallel Economy into the Official Banking System," Journal of Algerian Economy, No. 31, 2022, p. 123.

advanced supervisory mechanisms, while working to ensure proper implementation of these operations in practical reality. This chapter will review the practical and regulatory aspects of implementing Islamic banking in Algeria.

1. Regulatory Framework Governing the Implementation of Islamic Banking Operations

The existence of a tight and integrated regulatory framework is considered the basic condition for the success of any Islamic banking system, especially in countries that adopt the Islamic windows model within conventional banks. The Algerian authorities realized this fact from the beginning, so they worked to establish a comprehensive legal and regulatory framework that ensures the safety of implementation and maintains the Sharia character of Islamic banking operations.

1.1 Historical Development of Legal Foundations for Islamic Banking in Algeria

Algeria witnessed gradual development in the legal foundations of Islamic banking, starting with attempts to integrate some Islamic financing formulas within the framework of the conventional banking system. With the increasing societal demand for banking alternatives compatible with Sharia, the legislator moved toward enacting clearer regulatory texts.

1.1.1 Early Legal Framework with the Monetary and Credit Law 90-10

The first beginnings of Islamic banking in Algeria were with the Monetary and Credit Law No. 90-10,¹ which opened the door to establishing specialized Islamic banks. This law laid the first foundations for banking pluralism in Algeria and allowed the emergence of banks operating according to Islamic Sharia provisions, even though it did not explicitly stipulate details of Islamic banking operations.

1.1.2 Development and Modernization with Order No. 11-03

The issuance of Order No. 11-03 dated August 26, 2003, relating to money and credit,² constituted an important stage in developing the legal framework of the Algerian banking system. This order, which repealed Law 90-10, came in response to local and international developments in the banking sector, and sought to modernize the Algerian banking system to keep pace with international standards.

Order No. 11-03 included general provisions allowing the development of new forms of financing and investment, providing the legal basis for developing Islamic banking within the general banking system framework. It also introduced new concepts in the field of banking supervision and oversight, and strengthened the role of the Bank of Algeria as a monetary and banking authority.

¹ Order No. 90-10 dated 19 Ramadan 1410 corresponding to April 14, 1990, relating to money and credit, amended and supplemented.

² Order No. 03-11 dated 27 Jumada al-Thani 1424 corresponding to August 26, 2003, relating to money and credit, amended and supplemented by Order No. 10-04 dated August 26, 2010.

Among the most important achievements of this law was that it laid the foundations for a more flexible banking system capable of adapting to developments, which later helped develop regulatory tools specific to Islamic banking.

1.1.3 The New Monetary and Banking Law No. 23-09

The issuance of Law No. 23-09 dated June 12, 2023, containing the Monetary and Banking Law,¹ is considered a historic turning point in the path of Islamic banking in Algeria. This new law came to give full legislative power to the provisions that governed Islamic banking operations through regulations and instructions. It included basic themes that we summarize as follows:

a. Explicit Recognition of Islamic Banking: For the first time in the history of Algerian banking legislation, the Monetary and Banking Law includes explicit texts about Islamic banking, where it established this concept as an integral part of the national banking system. This legislative recognition gives full legal legitimacy to this type of banking transactions.

b. Compatibility with Regulation No. 20-02: The new law aims to give legislative force to the provisions issued by Regulation No. 20-02 defining banking operations related to Islamic banking and rules for their practice,² meaning that these operations are no longer based only on Bank of Algeria regulations, but have become established by a law issued by the legislative authority.

c. Strengthening the Institutional Framework: The law seeks to strengthen the institutional framework for Islamic banking by establishing solid legal foundations for developing this sector, including improving supervision and oversight mechanisms, developing Islamic financing tools, and ensuring compliance with Sharia standards.

1.2 Graduated Legal Structure for Islamic Banking

The regulatory framework for Islamic banking operations in Algeria is based on a graduated legal structure starting with the Monetary and Banking Law No. 23-09 as a basic legislative foundation, and developing through regulations and instructions issued by the Bank of Algeria. This graduation ensures coherence and harmony between different regulatory levels, and provides the necessary flexibility to develop technical details without needing to amend basic laws, embodied on three levels:

- Legislative Level:** Represented by the Monetary and Banking Law No. 23-09 which established general foundations and basic principles for Islamic banking, and defined the general framework for these institutions' work within the national banking system.

¹ Law No. 23-09 dated 3 Dhu al-Hijjah 1444 corresponding to June 21, 2023, containing the Monetary and Banking Law, Official Gazette of the Algerian Republic, No. 43, 2023.

² Bank of Algeria, "Annual Report on Islamic Banking Development," 2021, p. 34.

- **Regulatory Level:** Including Regulation No. 20-02 dated March 15, 2020,¹ which constituted an important turning point in this field, as it repealed the previous Regulation No. 18-02 which was not practically implemented, and came with clearer and more detailed regulation of Islamic banking operations. This new regulation established the necessary legal foundations for practicing these operations, and defined conditions and controls that banks and financial institutions must respect when providing these services.

The reform brought by the new regulation was not limited to the formal aspect, but included substantial improvements in content, where procedures were simplified, concepts were clarified, and supervision and oversight mechanisms were strengthened. International experiences in this field were also taken into account and best practices were utilized.

- **Implementation Level:** Represented by Instruction No. 20-03 dated April 2, 2020² which provides technical details on how to practically implement Islamic banking operations.

1.3 Basic Themes of Islamic Banking Regulation

The regulatory provisions contained in Regulation No. 20-02, now supported by Law No. 23-09, include several basic themes, including defining types of permitted operations, conditions for their practice, and supervision and oversight mechanisms. These themes cover all aspects of Islamic banking work, from licensing and operation to supervision and financial reporting. Regarding types of permitted operations, the regulation defined a comprehensive list including most internationally recognized Islamic financing tools,³ with the possibility of adding new tools after regulatory authority approval. Practice conditions include capital, experience, technical systems, and qualified human resources requirements.

1.4 Sharia Governance and Internal Supervision

The regulation also included special provisions for Sharia governance, which now received full legislative support through Law No. 23-09, where it required banks and financial institutions wishing to practice Islamic banking operations to establish an internal Sharia supervisory board consisting of scholars specialized in Islamic jurisprudence and Islamic economics.⁴ This board undertakes the task of reviewing all Islamic banking products and services to ensure their compliance with Islamic Sharia provisions before offering them to customers.

Sharia supervisory board responsibilities include reviewing new product documents, conducting periodic reviews of ongoing operations, issuing fatwas on emerging issues, and training

¹ Articles 03 to 07, Regulation No. 20-02.

² Articles 05 to 15, Instruction No. 20-03.

³ Belkasem Nour Eddine, "Arbitration in Islamic Banking Disputes," Journal of Justice, No. 56, 2021, p. 178.

⁴ Rahmani Abdelkarim, "Supervision of Islamic Banks: The Algerian Experience," Journal of Banking Supervision, No. 11, 2022, p. 145.

employees on Sharia aspects of Islamic banking operations. The board also prepares periodic reports on the level of compliance with Sharia controls.

1.5 Technical and Implementation Details

In addition to the basic regulation, Instruction No. 20-03 dated April 2, 2020 was issued to provide more technical details on how to implement Islamic banking operations.¹ This instruction precisely defines each type of Islamic banking operation, determines technical procedures for their implementation, as well as accounting and financial reporting methods specific to them. The instruction also sets strict controls to ensure accounting separation between conventional banking activities and Islamic banking activities within the same bank, which is necessary to maintain the Sharia nature of these operations. This separation includes financial accounts, accounting records, information systems, and financial reports.

1.6 Dispute Resolution Mechanisms

Among the important aspects in the Algerian regulatory framework, which is now strengthened by the new law, is establishing mechanisms for dealing with disputes that may arise regarding Islamic banking operations, where the possibility of resorting to Sharia arbitration in case of disputes related to interpreting provisions of Islamic banking contracts was approved.² This procedure aims to ensure dispute resolution according to Sharia principles governing these operations, and enhances confidence in the system and encourages more customers to use these services.

2. Supervision and Oversight Mechanisms for Islamic Banking Operations

Supervision and oversight of Islamic banking operations are considered among the most important challenges facing monetary authorities, given the special nature of these operations that require a different type of supervision combining traditional financial supervision and Sharia supervision. This complexity stems from the necessity of understanding Sharia, technical, and economic dimensions of Islamic banking operations, requiring the development of specialized supervisory tools and methodologies.

2.1 Central Role of Bank of Algeria in Supervision Under Legislative Development

The Bank of Algeria undertakes the primary role in supervising and overseeing Islamic banking operations in Algeria, through several advanced supervisory mechanisms and means. These mechanisms were specifically developed to suit the nature and distinctive characteristics of Islamic banking operations.

¹ Bank of Algeria, "Supervision Guide for Islamic Banking Operations," First Edition, 2021, p. 67.

² Boushaib Amine, "Accounting in Islamic Banks: Standards and Practices," Dar Al-Khaldounia Publishing, Algeria, 2022, p. 234.

The Bank of Algeria benefited from accumulated experience since Order No. 11-03 in developing its supervisory capabilities, where it worked to build specialized expertise in Islamic banking.¹ This expertise accumulated over the years and was strengthened with the issuance of the new Law No. 23-09 which provided a stronger legislative basis for exercising supervision.

To enhance its capabilities in this field, the Bank of Algeria established a specialized unit for supervising Islamic banking operations, comprising experts in banking law, Islamic jurisprudence, and economics. Specialized training programs were also developed for employees responsible for supervising these operations.² These units received additional strengthening in their authorities with the new law.

The Bank of Algeria, under the new legislative framework, works to ensure supervisory mechanisms comply with international standards related to Islamic banking, especially standards of the Islamic Financial Services Board (IFSB) and standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

2.2 Two Main Levels of Supervision in the New Framework

Supervision mechanisms for Islamic banking operations in Algeria, under the new law, are divided into two main levels: external supervision exercised by the Bank of Algeria, and internal supervision exercised by banks and financial institutions themselves. This division ensures comprehensive coverage of all aspects of Islamic banking operations and reduces operational and Sharia risks.

2.2.1 External Supervision and Its Developed Means

At the external supervision level, the Bank of Algeria, based on enhanced authorities in Law No. 23-09, monitors banks' compliance with regulatory provisions stipulated in Regulation No. 20-02 and Instruction No. 20-03, and ensures the correctness of practical implementation of these operations according to Sharia and regulatory controls. External supervision means include:

- **Developed Periodic Reports:** Including detailed data on volumes and types of Islamic banking operations, risk ratios, profitability rates, and level of compliance with Sharia controls. These reports were developed to align with new law requirements.
- **Specialized Field Inspection:** Including periodic visits to banks to review procedures and operations and ensure implementation correctness. This inspection is conducted by specialized teams with Islamic banking expertise.
- **Advanced Sharia Review:** A new mechanism developed to review Sharia aspects of banking operations in a specialized manner.

¹ Bank of Algeria, "Statistical Report on Islamic Banking," 2024, p. 12.

² Association of Algerian Banks and Financial Institutions, "Guide to Islamic Banking Products," Second Edition, 2023, p. 145

2.2.2 Internal Supervision and Its Updated Components

At the internal supervision level, Regulation No. 20-02, now supported by Law No. 23-09, required banks and financial institutions practicing Islamic banking operations to establish an internal Sharia supervisory board, which reviews all products and operations to ensure their compliance with Islamic Sharia provisions.¹ Internal supervision components include:

- **Sharia Supervisory Board:** Consisting of scholars specialized in Islamic jurisprudence and Islamic economics, undertaking several tasks including studying and approving new products before launch, reviewing contracts and legal documents, conducting periodic reviews of ongoing operations, and issuing Sharia fatwas on emerging issues.
- **Specialized Internal Audit Units:** Working to review operations from technical and procedural aspects.
- **Advanced Risk Management:** Undertaking identification, measurement, and monitoring of risks specific to Islamic banking operations.
- **Developed Compliance Management:** Ensuring compliance with all regulatory and Sharia requirements.

2.3 Specialized Accounting Systems and Financial Reporting Under New Legislation

Internal supervision mechanisms, supported by the new legislative framework, also include developing special accounting systems for Islamic banking operations, ensuring transparency and accuracy in recording and reporting these operations to regulatory authorities.² These accounting systems take into account the special nature of Islamic banking operations, such as absence of traditional interest, existence of profit and loss sharing operations, and necessity of linking financial operations to real assets. To develop accounting systems requires:

- **Specialized Chart of Accounts:** Considering the specificity of Islamic banking operations and complying with international accounting standards for Islamic financial institutions.
- **Accounting Recording Procedures:** Ensuring accurate recording of operations according to their Sharia and economic nature.
- **Financial Report Templates:** Honestly and clearly reflecting the financial position of Islamic banking activities.
- **Specialized Performance Indicators:** Including profitability ratios, growth rates, risk ratios, customer satisfaction levels, and degrees of compliance with Sharia controls.

3. Evaluating the Level of Implementation of Islamic Banking Operations in Algerian Banks

¹. Maamri Saleh, "Technical and Human Challenges in Algerian Islamic Banking," Journal of Banking Development, No. 17, 2023, p. 89

² Ibid., p. 89.

After more than five years since the issuance of Regulation No. 20-02, and after its strengthening with the new Monetary and Banking Law No. 23-09, it has become necessary to conduct an objective and comprehensive evaluation of the level of practical implementation of Islamic banking operations in Algeria. This evaluation helps understand strengths and weaknesses in the Algerian experience, and provides a scientific basis for developing future policies and strategies in this field.

3.1 Quantitative Indicators of Growth and Development Under Legislative Development

The level of practical implementation of Islamic banking operations in Algeria can be evaluated through several indicators and criteria, especially under the legislative strengthening brought by Law No. 23-09.

3.1.1 Quantitative Growth Since Order 11-03

Quantitatively, and considering the gradual development since Order No. 11-03, the sector witnessed gradual growth in the number of banks providing Islamic banking services, where several public and private banks joined the specialized Islamic banks that had been operating in the market for decades. This expansion in the Islamic banking network contributed to improving access to these services and expanding the customer base benefiting from them.

3.1.2 Positive Impact of Legislative Development

With the issuance of the new Law No. 23-09, the sector witnessed a strong boost in terms of institutional confidence, where the existence of a strong legislative foundation encouraged more banks to enter this field, and enhanced customer confidence in these products. Statistics indicate steady growth in volumes of Islamic deposits and financing,¹ although they still represent a limited percentage of total banking activity in the country.

3.1.3 Comparison of Development Across Legislative Phases

It is noted that the first phase under Order No. 11-03 witnessed relatively limited growth, while growth accelerated with the issuance of Regulation No. 20-02, and greater acceleration is expected under the new Law No. 23-09. This gradual growth is natural and expected in the early stages of developing any new banking sector, especially with the need to build confidence and increase public awareness.

3.2 Diversity in Products and Services and Impact of Legal Development

Regarding diversity of products offered, Algerian banks, benefiting from the flexibility provided by gradual legislative development from Order 11-03 to Law 23-09, were able to develop a diverse range of Islamic banking products covering most needs of individual and institutional customers. Products were limited and focused on basics under Order 11-03, then witnessed

¹ Ibid., p. 90.

significant expansion in product diversity, and greater product innovation is expected in this phase since the issuance of Law 23-09.

3.2.1 Current Products

These products include various types of Islamic deposit accounts, financing operations based on murabaha, ijara, and mudaraba, as well as remittance services and documentary credits compatible with Islamic Sharia provisions.¹ This product diversity reflects the seriousness of Algerian banks in developing this sector and meeting diverse customer needs.

3.2.2 Product Innovation

Banks also developed innovative products suitable for local conditions and special needs of the Algerian market, such as Islamic housing financing programs, Hajj and Umrah savings accounts, and small and medium enterprise financing programs. This continuous product development indicates sector vitality and its ability to adapt to market requirements, facilitated by flexible and gradual legislative development.

3.3 Challenges Facing Practical Implementation Under Legislative Development

However, there are several challenges facing practical implementation of Islamic banking operations in Algeria, despite important legislative development, including technical challenges related to developing information systems suitable for the nature of these operations, and human challenges related to training and qualifying specialized human resources in this field.

3.3.1 Technical Challenges

Islamic banking operations require complex information systems capable of dealing with their unique characteristics, such as joint investment accounts and profit and loss distribution. These technical challenges require large investments from banks, but the new legislative framework provides necessary confidence for these investments.

3.3.2 Human Resources Challenges

Despite legislative development, there is still a shortage of specialized expertise in Islamic banking, whether at management, operations, or supervision levels. This requires intensive and long-term training programs.

3.3.3 Marketing and Awareness Challenges

Banks also face challenges in marketing and awareness, where awareness level of the nature of Islamic banking products and their advantages remains limited among broad segments of the public. This awareness shortage limits demand for these products and affects their growth rates. Therefore, banks need large investments in awareness and banking education programs.

¹ Ibid., p. 90.

3.3.4 Cost and Profitability Challenges

Other challenges include lack of experience in practical implementation, where most Algerian banks are new to Islamic banking. This requires time to build expertise and develop best practices. The sector also faces challenges in costs, where developing new products and services requires large investments that may not achieve quick returns.

3.4 Evaluating Achievement of Strategic Objectives Under Legislative Development

Evaluating practical performance of Islamic banking operations in Algeria also requires looking at the extent of achieving strategic objectives set when approving this system, which are now strengthened by the new law.

Among the most important of these objectives are expanding financial inclusion by attracting new categories of citizens to the banking system, attracting funds from the parallel economy, diversifying financing sources for economic projects, and developing the Islamic financial market.

While some indicators show gradual improvement in these aspects, especially with new legislative support, the overall impact remains relatively limited compared to hoped-for aspirations.¹ This is partly due to the novelty of the experience, and partly to the challenges mentioned earlier.

Law No. 23-09 is expected to contribute to accelerating achievement of these objectives through:

- **Strengthening Institutional Confidence:** Strong legislative foundation enhances customer and investor confidence
- **Attracting New Investments:** Clear legal framework encourages investment in this sector
- **Product Development:** Legislative flexibility allows innovation of new products
- **Geographic Expansion:** Encouraging opening more Islamic branches and windows
- branches and windows

Conclusion:

Islamic banking operations in Algeria have witnessed remarkable development through the establishment of a tight legal and regulatory framework, based on Regulation No. 20-02 and Instruction No. 20-03, which represented a real turning point in the development path of the Algerian banking sector. This legal framework was able to define the types of Islamic banking operations permitted for practice, and establish the necessary Sharia and regulatory controls to ensure their compliance with Islamic Sharia provisions.

Through this study, it becomes clear that Islamic banking operations in Algeria are based on solid Sharia and economic foundations, aimed at achieving justice in distribution and linking

¹ Algerian Ministry of Finance, "Report on Islamic Banking Sector Development," 2024, p. 56.

financial activity to the real economy. The practical implementation of these operations, despite the challenges it faces, is witnessing gradual development that promises a bright future for this sector. However, the success of this experience requires more efforts in the areas of technical development, human training, community awareness, as well as strengthening supervision and oversight mechanisms to ensure proper implementation of these operations.

The future of Islamic banking operations in Algeria depends on the banking system's ability to overcome current challenges and develop innovative products that meet evolving customer needs, while maintaining strict adherence to Sharia controls. Cooperation between various parties of the banking system, regulatory authorities, and education and research institutions will be a decisive factor in enhancing the role of this sector in serving sustainable economic development in Algeria.

From this perspective, the following recommendations can be presented:

- **Intensify awareness programs:** Utilizing the new legislative framework in comprehensive awareness campaigns
- **Develop human resources:** Specialized training programs supported by the new legal framework
- **Invest in technologies:** Developing advanced information systems aligned with new requirements
- **International cooperation:** Benefiting from international experiences under the flexible legislative framework, where Algeria can benefit from successful international legal experiences in developing an advanced legislative framework for Islamic banking operations.

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