

The Ethical Standards of Islamic Financial Transactions Between the AAOIFI and the Algerian Monetary and Banking Act of 2023

Abderrezzak BOUAITA^{1*}, Abdelhak BOUDJELIDA²

¹ University Mohamed El Bachir El Ibrahimi (Algeria), abderrezzak.bouaita@univ-bba.dz

² University Mohamed El Bachir El Ibrahimi, LEZINRU Laboratory (Algeria),
abdelhak.boudjelida_2@univ-bba.dz

Received: 27-10-2023

Accepted: 24-03-2024

Published: 31-03-2024

Abstract:

In the Islamic financial industry, all stakeholders seek to enhance their integrity by adhering to ethical requirements. This study aims to assess the extent to which the Algerian Monetary and Banking Act of 2023 adopts ethical standards for Islamic financial transactions as issued by AAOIFI, by relying on the descriptive approach to present the study's variables and on the analytical approach in analysing various concepts and legal legislation. The findings of this research revealed the absence of Islamic ethical standards in the Algerian Monetary and Banking Act 2023, with no indication of the adoption of AAOIFI's ethical standards. Lastly, the study recommends setting up a committee made up of Islamic financial industry experts who will be responsible for developing standards to fit the Algerian Islamic banking environment. Issuing a code of ethics that governs professional conduct in Islamic banks and financial institutions following Islamic Shari'ah principles.

Keywords: *Monetary and Banking Act of 2023, AAOIFI, Ethical standards, Islamic banking.*

Jel Classification Codes: *G21, G28, K20.*

* *Corresponding author*

1. INTRODUCTION:

Islamic finance has seen tremendous advancements and fast expansion in recent years. To maintain stability and sustainability, Islamic financial institutions (IFIs) must nevertheless follow the rules and principles of Sharī'ah (Islamic law) in the face of growing competition. In order to do this, one of the well-known worldwide organisations assisting the Islamic financial industry, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), was founded. Its objective is to improve these institutions' governance, ethics, and auditing practises by releasing a range of Islamic standards that are based on Sharī'ah's moral precepts (AAOIFI, 2023).

Algeria embraced Islamic banking by issuing Regulation no. 20-02 and started putting it into practice in compliance with local legislation. The marketing of Islamic banking products through the adoption of Islamic windows by numerous conventional banks made it imperative to make sure that these financial transactions complied with Sharī'ah. This was carried out in an effort to prevent manipulations and improve credibility and confidence among investors, customers, and banks.

In 2021, The Bank of Algeria and AAOIFI inked a collaboration agreement to boost Islamic finance industry in Algeria (AAOFI, 2022). Furthermore, the Monetary and Banking Act, which was released in 2023, amended the legal framework governing Islamic banking as a response to the most recent issues. Numerous changes were brought about by this act, which had an effect on the Islamic banking sector.

Research problematic: Islamic banks (IBs) that lack ethics in their financial transactions are exactly like conventional banks. In light of the aforementioned, the following research question can be posed: **To what extent does the Algerian Monetary and Banking Act issued in 2023 adopt ethical standards for Islamic financial transactions in comparison to the standards issued by AAOIFI?**

To cover all aspects of the study, the following sub-questions were asked:

- What are the ethical standards issued by AAOIFI?
- What are the amendments introduced by the Algerian Monetary and Banking Act 2023 in regulating Islamic banking compared to Regulation no. 20-02?
- What are the primary provisions of the Algerian Monetary and Banking Act of 2023 pertaining to the regulation of the ethical aspects of Islamic financial transactions?
- What are the key aspects not addressed by the Algerian Monetary and Banking Act in the adoption of ethical standards for financial transactions?

Research hypotheses: To answer the questions raised, the following hypotheses were proposed:

- AAOIFI has issued three (3) ethical standards: the Code of Ethics for Professionals in the field of Islamic Finance, the Code of Ethics for Accountants and External Auditors

of Islamic Financial Institutions, and the Code of Ethics for Employees of Islamic Financial Institutions.

- The possibility of establishing exclusive IBs instead of opening Islamic windows within conventional banks.
- The Algerian Monetary and Banking Act of 2023 did not address the ethical aspect of Islamic financial transactions.
- The absence of both the Islamic Professional Code of Ethics and the texts governing the adoption and implementation of AAOIFI standards.

Research objectives: This study aims to achieve a set of important points that can be summarised as follows:

- Identifying the ethical standards issued by AAOIFI.
- To draw attention to the amendments made to the Algerian Monetary and Banking Act of 2023 with regard to Islamic banking.
- To assess the extent to which the Algerian Monetary and Banking Act of 2023 adopts ethical standards for Islamic financial transactions.

2. LITERATURE REVIEW:

2.1 The Islamic Code of Ethics of AAOIFI:

In order to uphold the spirit of Sharī‘ah, including its values, behaviours, and legal principles, AAOIFI issued, through its Technical Board for Governance and Ethics, the Code of Ethics for Professionals in Islamic Finance. This new code replaced two previous ethical standards: the Code of Ethics for Auditors and External Auditors of Islamic Financial Institutions (issued in 1999) and the Code of Ethics for Employees of Islamic Financial Institutions (issued in 2001). Furthermore, a recent public hearing session discussed the draft governance standard for the institutional framework of ethics application, with the goal of institutionalising ethics within the Islamic finance industry (AAOIFI, 2023).

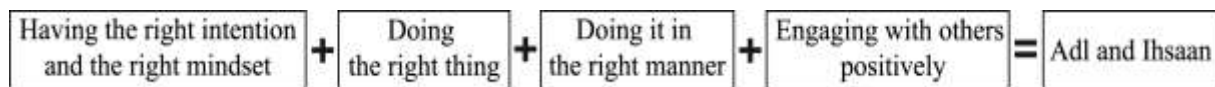
The Code of Ethics for Islamic Finance Professionals aims to achieve several objectives, which include (AAOIFI Code of Ethics, 2019, p. 10):

- Ensuring that the Islamic financial industry and Islamic finance professionals are in compliance with maqāṣid al-Sharī‘ah (objectives of Islamic law).
- Providing guidance and support to Islamic finance professionals in comprehending and applying ethical standards.
- Encouraging Islamic finance professionals to voluntarily adopt moral attitudes, advocate for truth, and serve as ethical role models for others.
- Minimising operational risks for IFIs, particularly by reducing risks linked to non-compliance with Sharī‘ah.

- Building public trust and enhancing the confidence of various stakeholders in the Islamic financial industry.

The ethical model proposed by the AAOIFI Code of Ethics is an equation that includes both Adl (justice) and Ihsaan (benevolence) (AAOIFI Code of Ethics, 2019, p. 12). Professionals in Islamic finance must always pursue justice in their work operations. In order to consistently attain and uphold justice, the professional must first prioritise Ihsaan in all circumstances. Islamic finance professionals can contribute to the creation of a more equitable and moral financial system by adhering to all four of the equation's main components, as shown in **Figure 1** below .

Fig.1. AAOIFI’s Adl and Ihsaan equation



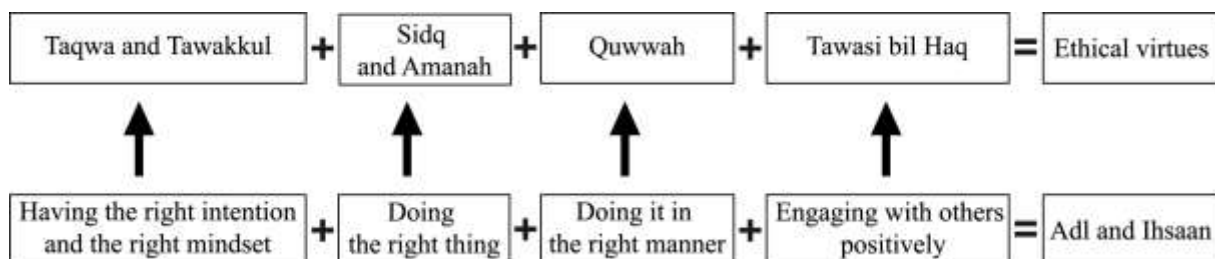
Source: AAOIFI Code of Ethics, 2019, p. 13

Ethics are defined as a set of moral standards held by an individual that are reflected in their behaviours and interactions with society. These ethical standards govern how individuals conduct their actions and distinguish between what is right or wrong, good or bad. Without ethical foundations and rules governing society, individuals and companies cannot function. (Ibrahim & Falikhatun, 2023, p. 6)

Islam places a strong emphasis on ethics in various aspects of life. Every action performed by a Muslim should adhere to the requirements of Sharī‘ah. Islamic ethics derive their moral values from the Qur’ān and the Sunnah of Prophet Muhammad (SAW), serving as a guide for what is considered right and wrong for individuals (Setiawan & As Sahara, 2022, p. 35).

Islamic finance professionals are required to uphold the following six (6) ethical virtues, which are in accordance with the four elements of the equation of Adl and Ihsaan. **Figure 2** illustrates the interaction between the equation of justice, benevolence, and moral virtues (AAOIFI Code of Ethics, 2019, p. 13).

Fig.2. The interaction between the Adl and Ihsaan equation and ethical virtues



Source: AAOIFI Code of Ethics, 2019, p. 14

- **Taqwa (Allah consciousness):** awareness of Allah's presence and remembrance, leading to obedience to Him and repentance immediately if one deviates or disobeys.

- **Tawakkul (Trust in Allah):** trust in Allah's will and decree, and being content with the outcome after taking all possible means.
- **Sidq (integrity):** defending and conforming to the truth while preserving coherence and consistency in one's intentions, words, deeds, and beliefs.
- **Amanah (Trustworthiness):** respecting and performing the duties, authorities, and responsibilities associated with an individual's role, rank, position, and status, including the care and protection of entrusted resources as a trust.
- **Quwwah (Strength):** possessing the intellectual, psychological, physical, ability, and competence at the required level to fulfil a responsibility or carry out a task.
- **Tawasi bil Haq (Enjoining Good):** encouraging others to do good and avoid evil in a positive, wise, and thoughtful manner.

2.2 The Importance of Ethics in Banks and Financial Institutions:

The adherence of IBs and IFIs to ethical standards holds significant importance because it helps to ensure that these institutions operate in a way that is consistent with Shari'ah principles. Abraham and Falikhatun (2023) list the following as some of the main advantages of this commitment:

- Ensuring that management acts follow the guidelines of Shari'ah.
- Building trust in the bank's operations.
- Enhancing the governance of banks and financial institutions.
- Restricting creative accounting practices.
- Enhancing the value of Islamic bank shares in the financial market.
- Gaining a competitive advantage through increased trust and transparency.
- Providing assurance to shareholders that their interests are protected.

2.3. The Islamic Banking Provisions in the 2023 Monetary and Banking Act:

The Algerian Monetary and Banking Act was issued through Law No. 23-09, dated June 21, 2023. This law consists of one hundred and sixty-seven (167) articles distributed across nine (9) sections, encompassing significant amendments within the framework of restructuring and reforming the banking and financial sector in response to major economic and financial transformations and technological challenges. (Monetary and Banking Act, 2023)

The Monetary and Banking Act of 2023 introduced a series of new amendments and provisions related to the regulation of Islamic banking, which can be summarised as follows:

2.3.1 Emergency Liquidity Assistance:

The process of borrowing from the Bank of Algeria involves interest (Adem, B. & Hichem G.M, 2022, p. 212), which is contrary to the principles of Islamic banking that prohibit *riba* (usury). Nevertheless, IBs occasionally encounter financial challenges that make it difficult for them to find solutions within the framework of the previous monetary law that comply with *Sharī'ah* principles.

Article 47 of the Monetary and Banking Act of 2023 provides a lifeline for solvent banks that are experiencing a temporary liquidity crisis. The Central Bank of Algeria can provide emergency liquidity to these banks, but only if they meet certain conditions. The bank must be solvent, provide appropriate guarantees, and submit a work plan to restore its liquidity and repay the emergency liquidity.

2.3.2 Exclusive Islamic Banks and Financial Institutions:

The Monetary and Banking Act of 2023 opens the door for the establishment of exclusive IBs and IFIs that are fully dedicated to Islamic banking operations. It also allows conventional banks to offer Islamic banking products and services through Islamic windows, provided that these windows are financially, accounting, and administratively independent from the rest of the bank.

2.3.3 Scope of Islamic Banking Operations:

According to Article 68 of the Banking and Monetary Act, banking operations include "receiving public funds (...) and banking operations related to Islamic finance" (Monetary and Banking Act 2023, 2023, p. 13). This article does not explicitly specify which banking operations IBs and IFIs can engage in.

Furthermore, Article 71 of the same law defines banking operations related to Islamic finance as "any operation conducted by banks or Islamic windows that comply with *Sharī'ah* principles" (Monetary and Banking Act 2023, 2023, p. 13). This expands the range of marketable Islamic financial products and the freedom to conduct any banking operation, provided it is *Sharī'ah*-compliant, as opposed to the previous system (Regulation no. 20-02, 2020), which restricted the scope to just eight products and required them to be free from *riba* (Tawfiq & Assia, 2022, p. 74). The expansion of the scope of Islamic banking operations is expected to lead to the emergence of new Islamic financial instruments and operations.

2.3.4 Financing the Banking Deposit Guarantee Fund:

Article 134 of the Banking and Monetary Act has provided IBs and Islamic windows with a special privilege when it comes to financing the Banking Deposit Guarantee Fund. The fund has a dedicated separate account for them. Additionally, the calculation and payment of premiums for Islamic banking deposits are handled separately from conventional banks, which is in line with the requirements of *Sharī'ah*.

2.3.5 Adapting Monetary Policy Tools to the Characteristics of Islamic Banking:

Article 44 of the same law stipulates allows the Bank of Algeria to adapt its monetary policy tools to the specificities of Islamic banking operations. This opens up future prospects for investing excess liquidity in IBs and IFIs away from interest rates.

3. RESEARCH METHODOLOGY:

In this study, the descriptive approach was employed to describe the variables of the study, which are the ethical standards for Islamic financial transactions issued by AAOIFI, and the Algerian Monetary and Banking Act. This involved presenting various theoretical concepts related to the subject. Additionally, the analytical approach was utilised in the analytical reading of fundamental concepts, legal texts, and legislation pertaining to the study's issue, followed by an interpretation to reach results.

4. RESULTS AND DISCUSSION:

The provisions mentioned below from the 2023 Monetary and Banking Act address the ethical aspects related to banks and financial institutions in Algeria, with the aim of ensuring integrity and compliance with the code of conduct in the performance and regulation of financial and banking activities.

Article 64 of the Monetary and Banking Act grants the Central Bank of Algeria, as the monetary authority, the powers to intervene in matters related to ethical standards and professional conduct applicable to banks and financial institutions. Similarly, the Banking Committee, acting as a supervisory authority according to Article 116, is responsible for investigating and penalising violations and ensuring compliance with the rules of good professional conduct. Furthermore, banks, financial institutions, and other entities subject to Article 138 must adhere to ethical principles. Managers must ensure that their institution's activities align with professional ethics and its principles. Specific penalties are applied in the event of violations by those subject to ethical standards.

Despite the law's reference to ethical aspects of banking transactions, it is noted that the law did not consider the specificities of IBs and IFIs. It did not address Islamic ethical standards and instead adhered to conventional codes of conduct. Furthermore, the banking system lacks a clear ethical charter that outlines professional conduct rules and procedures.

In addition, the Monetary and Banking Act of Algeria does not explicitly address how IBs and IFIs are to adopt the standards issued by AAOIFI. As a result, to date, there is no clear legal guidance on how to implement these standards in practice. Through an analysis of the Monetary and Banking Act and a comparison with AAOIFI standards, it is evident that the standards have not been entirely or partially incorporated into the law. However, it allows for the use of these standards as guidelines or reference material, and there are no restrictions on their usage. It is worth noting here that the Bank of Algeria has agreed with AAOIFI to develop a plan for the issuance of Islamic Sukuk (Islamic bonds). This development opens up a broad opportunity for the adoption of AAOIFI standards, particularly concerning the ethical aspect.

5. CONCLUSION:

All stakeholders in the Islamic financial industry aim to enhance their integrity by applying ethical requirements. However, despite the signing of a cooperation agreement between the Bank of Algeria and AAOIFI to adopt its standards, in addition to the issuance of the Monetary and Banking Act of 2023, which included several provisions that promote Islamic banking in Algeria, the Monetary and Banking Act did not address or adopt the ethical standards for Islamic financial transactions issued by AAOIFI. Among the key findings of the study are the following:

- The absence of ethical standards for Islamic financial transactions in the Algerian Banking and Monetary Act of 2023.
- The lack of legal texts regulating the adoption and implementation of standards issued by AAOIFI in IBs and IFIs.
- The Algerian government's commitment to promoting Islamic banking by enacting new legal provisions and regulations.
- Adherence to ethical standards in financial transactions has a significant impact on Islamic banks and financial institutions.
- The Algerian banking system lacks a professional code of ethics.
- The absence of a Shari'a supervisory authority for Islamic banks and financial institutions to monitor the compliance of banking operations with the provisions of Islamic law.

Hypotheses Testing: Testing the hypotheses in light of the results obtained:

Hypothesis 1: The possibility of establishing exclusive IBs instead of opening Islamic windows in conventional banks. This hypothesis is valid, as the Monetary and Banking Act authorised this in Article 72.

Hypothesis 2: This hypothesis has been confirmed, as AAOIFI issued the latest standard: the Code of Ethics for Islamic Finance Professionals, which replaced the previous standards, the Code of Ethics for Accountants and External Auditors for Islamic Financial Institutions, and the Code of Ethics for Employees in Islamic Financial Institutions.

Hypothesis 3: The Algerian Monetary and Banking Act of 2023 did not address the ethical aspects of Islamic financial transactions. This hypothesis has been confirmed, as it is observed by the absence of legal texts that consider the ethical aspects of Islamic financial transactions.

Hypothesis 4: The Algerian Monetary and Banking Act of 2023 does not provide guidance on how to adopt and implement the various standards of AAOIFI. This hypothesis was supported by the law's lack of any specific provisions on the adoption and implementation of AAOIFI standards.

Recommendations: Consequently, the following recommendations have been proposed:

- Encouraging and incentivising ethical behaviour within IBs and IFIs.
- Issuing a code of ethics to govern professional conduct in banks and financial institutions, preferably to be issued by the central bank.
- Activating the agreement between the Bank of Algeria and AAOIFI by implementing the AAOIFI's standards in IBs and IFIs. This could be enforced through a legal provision that obliges banks to uphold ethical standards.
- Forming a committee of experts in the Islamic financial industry to develop or modify standards that suit the Algerian Islamic banking environment.
- Establishing a Sharī'ah supervisory authority responsible for overseeing IBs and IFIs' compliance with Sharī'ah principles. This authority should be independent and possess both prior and ongoing supervision under the supervision of the Central Bank.
- The need to open a high institute for Islamic financial transactions in line with modern economic developments under the central bank's purview for the training of professionals that reflect the high certificates awarded.

Future studies should focus on determining the readiness of banks to adopt the ethical standards issued by the AAOIFI, a qualitative study might be a good option for future research.

6. BIBLIOGRAPHY LIST:

- AAOIFI (2019), AAOIFI issues the final standard on Code of ethics for Islamic finance professionals for industry adoption, Accounting and Auditing Organisation for Islamic Financial Institutions, available at: <https://aaoifi.com/announcement/aaoifi-issues-the-final-standard-on-code-of-ethics-for-islamic-finance-professionals-for-industry-adoption/?lang=en> (accessed 25 October 2023)
- AAOIFI (2019), Code of Ethics for Islamic Finance Professionals, Accounting and Auditing Organisation for Islamic Financial Institutions, available at: <https://aaoifi.com/issued-standards-3/?lang=en> (accessed 25 October 2023)
- AAOIFI (2022), AAOIFI and Bank of Algeria sign an MOU for joint collaboration as part of efforts to enhance Islamic Finance industry in Algeria, Accounting and Auditing Organisation for Islamic Financial Institutions, available at: <https://aaoifi.com/announcement/aaoifi-and-bank-of-algeria-sign-an-mou-for-joint-collaboration-as-part-of-efforts-to-enhance-islamic-finance-industry-in-algeria/?lang=en> (accessed 25 October 2023)
- AAOIFI (2023), Public Hearing on the Exposure Draft of the IFSB-AAOIFI Revised Sharī'ah Governance Framework for Institutions Offering Islamic Financial Services, Accounting and Auditing Organisation for Islamic Financial Institutions, available at: <https://aaoifi.com/announcement/public-hearing-on-the-exposure-draft-of-the-ifsb-aaoifi-revised-shariah-governance-framework-for-institutions-offering-islamic-financial-services/?lang=en> (accessed 25 October 2023)
- Adem, B. & Hichem G.M. (2022). The Effect of the 20-02 Regulation on The Algerian Islamic Banking Sector: Study on the Role of The New Regulation in Achieving Financial Inclusion, *Dirassat Journal Economic Issue*, 13(1), 207-223
- Ibrahim, K. & Falikhatun. (2023). THE IMPORTANCE OF COMPLIANCE WITH ACCOUNTING ETHICS STANDARDS ISSUED BY AAOIFI IN ACTIVATING THE GOVERNANCE OF ISLAMIC BANKS: AN ANALYTICAL STUDY. *Berkala Akuntansi dan Keuangan Indonesia*, 08(01), 15-17. doi:10.20473/baki.v8i1.41766

- Monetary and Banking Act 2023, available at: <https://www.joradp.dz/FTP/jo-francais/2023/F2023043.pdf> (accessed 25 October 2023)
- Regulation no. 20-02 of 15 March 2020 defining the banking operations relevant with the Islamic banking and the conditions of practice by the banks and the financial institutions, available at: <https://www.joradp.dz/FTP/jo-francais/2020/F2020016.pdf> (accessed 25 October 2023)
- Setiawan, D. & As Sahara, M. (2022). THE EFFECT OF ETHICAL VALUES ON ISLAMIC BANKING PERFORMANCE. *Corporate & Business Strategy Review*, 3(2), 35-36. doi:10.22495/cbsrv3i2art3
- Tawfiq, K. & Assia, B. (2022). The Reality of the settlement of Islamic Banking in Algeria in the light of the 20-02 System and Instruction 20-03', *Journal of Studies in Economics and Management*, 5(1), 68-90