

**BUILDING DUAL BANKING ECOSYSTEMS: REGULATORY ARCHITECTURE  
AND INTEGRATION MODELS OF ISLAMIC AND CONVENTIONAL FINANCE IN  
EMERGING MARKETS**

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**Abstract**

The expansion of finance has led to the development of dual banking systems in many emerging economies. This article examines the architecture and integration models of dual banking ecosystems through a comparative study of Malaysia, Gulf Cooperation Council (GCC) countries, Turkey and Kazakhstan. The methodology involves analyzing regulatory documents, official reports and academic literature. The article proposes a regulatory framework emphasizing transparency, centralized Shariah governance, regulatory parity, capacity building and consumer protection.

**Keywords:** banking, Islamic finance, regulatory architecture, Shariah governance, emerging markets, civil law, Uzbekistan.

**1. Introduction**

Global finance has changed significantly in years. Emerging markets are playing a role in the global economy. One notable development is the growth of finance. Islamic finance follows Shariah principles that prohibit interest, excessive uncertainty and speculative risk-taking. Instead it promotes risk-sharing, asset-backed investments and ethical practices.

As Islamic finance expands more countries are adopting dual banking systems. In a dual banking system conventional financial institutions operate together. This article examines the architecture and integration models of dual banking ecosystems in emerging markets. It aims to identify challenges and propose an optimal framework to support the growth of these systems.

A dual banking system can promote inclusion and expand consumer choice. However it also introduces challenges. Legally it can be complex to recognize and accommodate contracts within conventional banking laws. Regulators may face a shortage of professionals with expertise in Shariah finance. Establishing Shariah governance frameworks can be complex. Culturally limited public familiarity with finance principles may lead to misconceptions.

The coexistence of two banking systems requires careful rule-setting and consistency in standards. This is especially important in emerging markets, where the financial sector can drive growth but also pose risks.

This article closely examines the design of dual banking systems. It compares approaches across Malaysia GCC countries, Turkey and Kazakhstan. It provides attention to Shariah governance and explores the challenges faced by civil law countries, such as Uzbekistan.

**2. Theoretical Foundations of Dual Banking Systems**

**2.1 Definition and Rationale**

A dual banking system refers to the coexistence of conventional banks operating under the same financial sector. This arrangement meets growing demand for Shariah- financial services and fosters financial inclusion. It provides a range of financial products and enhances competition and innovation.

The dual banking model extends to principles and concerns. It poses questions regarding parity, systemic risk, consumer protection and how two distinct systems can coexist and complement each other. Effective dual banking depends on regulators capacity to create an enabling environment and a level playing field.

### **2.2 Key Conceptual Models**

There are two conceptual models within dual banking: the segregated model and the integrated model.

#### **Segregated Model**

Islamic institutions are independently licensed, supervised and regulated. This approach allows for customization of Shariah governance, prudential requirements and product regulation. However it often results in compliance costs and regulatory complexity.

#### **Integrated Model**

Both conventional and Islamic financial institutions are operated under a legal and regulatory framework with added layers for Shariah compliance. This model fosters harmonization and ease of cross-sectoral supervision. It streamlines supervision. Can enhance overall market stability.

A significant issue in modeling is achieving regulatory parity. The legal system and regulatory capacity of the market have an impact on how the dual banking system operates. Policymakers must weigh the potential for oversight and product harmonization against the likely resistance from industry actors who value institutional autonomy, for Shariah-based product development.

### **3. Global Models of Dual Banking**

#### **3.1 Malaysia: A Leader in Dual Banking**

Malaysia is a world leader in developing a dual banking system. The Central Bank of Malaysia oversees the framework for banking. This framework provides a regulatory environment for both Islamic and conventional financial institutions. Islamic banking institutions are regulated under the Islamic Financial Services Act 2013. Conventional banking institutions are regulated under the Financial Services Act 2013. Malaysia has a Shariah Advisory Council. This council ensures that Shariah principles are interpreted in the way across all Islamic finance players. This helps Malaysias dual banking system succeed.

#### **3.2 GCC Countries: Regulatory Approaches**

In GCC countries regulatory approaches to dual banking vary. Bahrain and the UAE have an approach to licensing and supervising conventional and Islamic banks. Saudi Arabia has an universal banking license. This license permits both Islamic activities. The adoption of AAOIFI standards has made the Islamic finance sector more credible. However regulatory harmonization remains a challenge in GCC markets.

#### **3.3 Turkey: Participation Banking**

In Turkey participation banks operate within the supervisory framework as conventional banks. The Banking Regulation and Supervision Agency regulates both. The principle of parity ensures that both conventional and Islamic banks operate on the same level. A national Shariah board ensures consistency in Shariah opinions among institutions. However there are concerns about the lack of product diversity and transparency in frameworks governing Islamic banking.

#### **3.4 Kazakhstan: A Developing Market**

Kazakhstan is developing its dual banking system. The country has adopted legislation and received technical assistance from international organizations. A dedicated regulatory framework for banking and a central Shariah council have been established. However market growth is slow due to vagueness in documentation and poor consumer awareness.

#### **4. Regulatory Systems: Comparative Study**

##### **4.1 Licensing, Supervision and Prudential Standards**

Malaysia has a licensing framework. This framework offers licenses for Islamic and conventional institutions. This reduces ambiguity about operations. GCC countries have approaches. Some have licenses for each institution. Others have a license under a single regulatory authority. Prudential requirements broadly align with the Basel framework. Are tailored to Islamic contracts and practices.

##### **4.2 Legal Underpinnings: Common Law vs. Civil Law**

In law countries like Malaysia the legal system is flexible. This flexibility provides room for finance innovation. In civil law countries like Uzbekistan and Kazakhstan explicit statutory provisions are necessary to support Shariah- contracts.

##### **4.3 Harmonization and Standardization**

Malaysia and GCC markets are adopting standards. These standards are prescribed by bodies like AAOIFI and IFSB. This harmonization promotes consistency and facilitates global interconnectedness of financial markets.

##### **4.4 Consumer Protection**

Consumer protection frameworks differ across jurisdictions. In Malaysia the financial ombudsman scheme provides a platform for dispute resolution. Regulatory mandates require disclosure of terms and risks for both Islamic and conventional financial products. GCC countries have instituted transparency and disclosure standards. Turkey regulates consumer protection through supervision of both participation and conventional banks.

#### **5. Shariah Governance Structure**

##### **5.1 AAOIFI Standards**

AAOIFI provides Shariah governance standards. These standards encompass a Shariah Supervisory Board. The board should be independent and composed of least three individuals knowledgeable in Shariah law.

##### **5.2 National Shariah Boards and Institutional Arrangements**

Malaysias Shariah Supervisory Council resides within the Central Bank of Malaysia. This leads to consistency and standardization of products offered within the market. GCC countries tend to employ institutional Shariah boards. Turkey combines both national Shariah bodies.

##### **5.3 Integration with Risk Management and Corporate Governance**

In dual banking systems Shariah governance is integral to operational risk management and corporate governance. This enables stability and enhances confidence among stakeholders.

##### **5.4 Pressing Challenges and Policy Implications**

The shortage of Shariah scholars and varying interpretations of Shariah principles are obstacles to the development of an effective dual banking system.

#### **6. Challenges to Integration in Civil Law Countries: Case Study on Uzbekistan**

##### **6.1 Legal, Institutional and Cultural Obstacles**

Uzbekistans civil law system lacks provisions for Islamic contracts and profit-sharing arrangements. Limited availability of Shariah scholars and regulatory expertise are challenges. Cultural obstacles include a lack of understanding of Islamic finance.

##### **6.2 Comparative Experiences**

Kazakhstans experience highlights the importance of reforms and capacity building. Turkeys experience demonstrates that targeted education and centralized Shariah governance can enhance acceptance and uptake of Islamic finance products.

#### **7. Towards an Optimum Regulatory Framework**

##### **7.1 Construction of the Policy Framework**

An optimal policy framework for banking in emerging markets should address legal, institutional and governance challenges. The framework should include a legal system that recognizes Islamic contracts. Coordinated regulation and centralized Shariah governance bodies are also necessary.

### **7.2 Suggestions for Emerging Markets**

The development of a dual banking system, in emerging markets should proceed gradually. A phased approach tailored to each country's context is recommended. Pilot initiatives can address challenges before broader implementation. Policymakers should consider context-sensitive steps to operationalize reform.

#### **Legal Reform**

Start by setting up a team to review banking and financial laws to see if they match Islamic principles. Pass new laws that clearly understand Islamic contracts using international best practices and advice from Islamic scholars. Test these laws in a few banks or areas before using them everywhere.

#### **Capacity Building**

Train regulators, supervisors and practitioners on both Islamic and conventional banking rules. Work with groups to create certification programs for Islamic compliance and risk management. Encourage universities to offer courses on finance to increase the number of qualified Islamic scholars and finance professionals.

#### **Shariah Governance**

Set up or strengthen central Shariah councils at the national level following international guidelines. Hold meetings and workshops between regulators, banks and Shariah boards to ensure consistent interpretation and implementation of Islamic principles.

#### **Consumer Education**

Launch nationwide campaigns to teach people about conventional and Islamic banking principles. Create multilingual materials and conduct outreach through local media, schools and community centers to increase consumer understanding and uptake of Shariah-compliant products.

#### **Regulatory Standardization**

Gradually make prudential standards and reporting requirements similar for both banking systems with regular reviews to address potential gaps or overlaps. Test regulatory procedures through sandbox initiatives allowing innovation in product development while maintaining oversight.

Public understanding of finance plays a role in reducing confusion and promoting consumer understanding of both conventional and Islamic banking principles. Emerging markets should learn from mistakes, such as superficial judicial reforms, uncoordinated Shariah governance, excessive copying from foreign banking systems and poor investment in human capital.

### **8. Conclusion**

In summary this study shows that expanding dual banking ecosystems can significantly foster inclusion and innovation in emerging markets. However sustainable progress requires more than replicating existing models. Success depends on developing frameworks and governance structures tailored to national legal and institutional contexts. Uzbekistan's experience shows that overcoming legal, institutional and cultural impediments is crucial for effective dual banking integration.

Although the comparative analysis focused on Malaysia GCC countries, Turkey, Kazakhstan and Uzbekistan the findings emphasize that policy recommendations and optimal practices must be carefully adapted than universally applied. Therefore adopting a dual banking

system is not a one-size-fits-all solution; it demands a context-aware implementation and continuous evaluation.

The proposed flexible regulatory framework provides policymakers and regulators with the tools to reconcile international standards, with local exigencies supporting the evolution of robust inclusive financial systems aligned with sustainable development goals.

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