

## **Financial Stability and Deposit Protection: Strengthening the Framework (Response)**

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It is very clear that the governments' and the financial authorities' intention at the moment is to take more steps in order to strengthen the current regulatory framework. However, there is a new developing sector that has not been considered in the process at the moment, which is the Islamic banking sector. With the fifth Islamic bank joining the market – *Gatehouse* – the needs of Islamic banking seem to be worth considering at this point.

Currently the proposed changes, and especially with regard to the compensation scheme, do not seem to consider the special nature of Islamic banks; and specifically the prohibition of interest. The pre-funding proposal means that the levies of both Islamic and conventional banks will be deposited in the same pool which is not necessarily invested in interest free transactions. Further, one of the proposed changes presented by the consultation document is the exclusion of deposits that have the nature of equity from the scheme. This could raise certain questions regarding investment account deposits, where the depositors share both the losses and the profits. Therefore, the legal status of those should be addressed.

It is worth noting that now could be the ideal time to reform the compensation scheme in order to achieve a more comprehensive scheme which is able to address all the special requirements of Islamic banking. The Malaysian compensation scheme can be a good example where it covers most of problematic issues associated with the subject of Islamic banking.

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