

# Monthly Tips

## CONVENTIONAL vs. ISLAMIC BANKING

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# CONVENTIONAL vs. ISLAMIC BANKING

## Four core principles of Islamic banking

Islamic banks and other financial institutions must comply with a variety of principles besides evading interest. Islamic finance is based on four core principles:

1. Prohibiting usury (Interest)
2. Avoiding speculation
3. Avoid gambling
4. Investing ethically

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## Relationship definition between the bank and its clients/customers

### Conventional Banking

The relationship between the bank and its clients/customers are like a creditor to a debtor; the bank has a responsibility to pay back the money with or without interest according to the account contract. Similarly, the roles reverse when the bank provides a loan.

### Islamic Banking

The relationship between the bank and its client/customer is called “Mudarrabah” or a partnership. It is based on the agreed contract between the bank and the client/customer.

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## Concepts of money and the basis of transactions

- ❖ Islamic banking does not charge interest as compared to conventional banking.
- ❖ Islamic banking promotes and encourages Shariah principles consistent with the Islamic law while Conventional banking is based on the principle that money generates money.
- ❖ Islamic banking is based on the Islamic commercial law called 'Fiqh Muamalat' while conventional banking must follow the financial laws based on the country in which they operate.

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## Investments in Conventional and Islamic Banking

### Conventional Banking

The investments are based on the capital sum and earning a fixed amounts of income. For example, a customer deposits RM10K in a 6-month term deposit. After 6 months, the bank is liable to pay back the customer the capital sum plus the interest rate charged for 6 months. Even if the customer keeps the money with the investment bank, the bank is still liable to pay.

### Islamic Banking

The concept of investment is different. Although the customer deposits the money in order to earn extra income for his/her savings, the capital sum and returns aren't guaranteed. Suppose the Islamic bank loses money because of an unexpected business failure - in this case, the bank isn't liable to pay the money to its customer.

**(Note:** The failure of an investment in Islamic banking isn't very common in Islamic banks because the banks are very concerned about their customers and make their investment choices very wisely. If they didn't, they soon would have no customers at all!)

