



Difference Between Islamic and Conventional Banking

Systematic differences	
Islamic Banking	Conventional Banking
Islamic Banks work under the socio-religious guidelines that prohibit charging and paying interest and avoid all impermissible transactions like gambling, speculation, short selling & Sale of debts & receivables.	Conventional Bank is not required to adhere to any such requirements or boundaries in its product offering.
Islamic Banks have strong Shariah governing framework in terms of Shariah Board, who approves the transactions and products in the light of the Shariah rulings.	
Islamic bank operates on the basis of profit and loss sharing. In case, the businessman has suffered losses, the bank will share these losses based on the mode of finance used (Mudarabah, Musharakah).	Interest is charged even in case the organization suffers losses by using bank's funds. Therefore, it is not based on profit and loss sharing.
Money is not regarded as a mere commodity, despite its function as a medium of exchange and store of value. As a result, it cannot be traded above its nominal worth or leased out.	Money is seen as both a commodity and a means of exchange and value storage. Thus, it can be sold above its nominal worth and rented out as well.

Asset Side	
Islamic Banking	Conventional Banking
1. The relation between the bank and Customer is one of participation in risks and rewards.	1. The relationship between the bank and customer is that of debtors and creditors
2. The Bank acquires the ownership and all related risks of the asset in all sale based modes of financing	2. The bank does not acquires the ownership and related risks of the asset as it only deals in documents and money
3. Islamic banks do not provide finance by offering cash loans, but through sale, rental or services based modes	3. The conventional banks offer provide finance by offering cash loans.
4. Islamic banking is mainly equity- based.	4. The conventional system is as a whole interest-based.
5. The Islamic system is value- oriented.	5. Conventional system is value-neutral
6. Compensation is always price of asset or rent	6. Compensation is always Interest

## Liability Side

Islamic	Conventional
1. In profit bearing account / certificates there is no pre-agreed fixed return on the funds invested with Habibmetro Sirat and same is the case when banks provide funds.	1. There is pre-agreed fixed return on the funds either provided by the bank or invested by the customer.
2. The saving accounts/Islamic investment certificates in HabibMetro Sirat are based on Mudarabah. Mudarabah is a form of partnership in which one partner (depositor) provides capital and other partner (Bank) renders its services/expertise for investing the funds in Shariah compliant profitable avenues.	2. Conventional Saving accounts/Term Certificates are based on the contract of loan and interest is paid on it as a compensation.
3. The relationship between the bank and the depositor is that of Mudarib (Bank) and Rabb-ul-maal (depositor).	3. The relationship of bank and depositors are of lender and borrower.
4. Islamic Bank invest the deposits/funds in Shariah compliant avenues only.	4. Conventional Bank may use the amount deposited in accounts regardless of Shariah prohibition.
5. Profit (on investment/financing made) is shared with depositor at a pre-agreed profit sharing ratio and assigned weightages.	5. Depositors are paid at a pre agreed interest rate.
6. The loss is borne by the depositors in proportion to their investments except where the loss is due to the negligence of the Bank.	6. Depositors do not bear the loss.

# Basic principles of Islamic banking

- **Contractual Integrity:** Prior to engaging in any Islamic banking transaction, the involved parties must ensure that the transaction complies with the principles of Islamic Shariah, establishing its validity (halal). Consequently, an Islamic bank's transaction should not be deemed invalid or capable of being annulled. An invalid contract refers to a contract that, based on its inherent nature, violates Shariah principles. Conversely, a voidable contract is one that possesses inherent validity, but contains certain invalid elements within an otherwise valid agreement. Unless these invalid elements are rectified within the valid contract, the contract will retain its voidable status



# Basic principles of Islamic banking

- The Islamic legal scholars have derived two fundamental principles from the teachings of Prophet Muhammad (SAW), namely “Alkhiraj Biddamaan” and “Alghunun Bilghurum”. These principles carry similar connotations, asserting that the accrual of profit from an asset or capital can only occur when the recipient assumes the accompanying ownership risks. Therefore, within the context of every Islamic banking transaction, the Islamic financial institution and/or its deposit holders willingly undertake the risks associated with the ownership of tangible assets, provision of real services, or deployment of capital prior to attaining any profitability therefrom.
- Islamic banking inculcates fairness through its operations. Transactions based on dubious terms and conditions cannot become part of Islamic banking. All the terms and conditions embedded in the transactions are properly disclosed in the contract/agreement. This is because Islamic banking is based on the principles of justice and fairness, which are integral to the Islamic faith. The contracts/agreements are designed to ensure that all parties involved in the transaction are treated fairly and equitably.

# Basic principles of Islamic banking

- Islamic banks cannot involve in riba/interest related transactions. They cannot lend money to earn additional amount on it. However, it earns profit by taking risk of tangible assets, real services or capital and passes on this profit/loss to its deposit holders who also take the risk of their capital.
- Every Islamic banking transaction has a certain economic purpose or activity. Moreover, Islamic banking transactions are backed by tangible assets or real services.
- When executing an Islamic banking transaction, it is ensured that no invalid subject matter or activity is financed by the Islamic financial transaction. Some subject matter or activities may be allowed by the law of the land but if the same are not allowed by Shariah, these cannot be financed by an Islamic bank. This is because Islamic banking is based on the principles of justice and fairness, which are integral to the Islamic faith.

# Conventional Banking





# Islamic Banking



*The End*