JULY 2024 | 17TH EDITION

# NEWSLETTER

Shariah Newsletter of GA Skylight Berhad

GA SKYLIGHT

**5th July 2024**

The seventeenth edition of Compliance and Shariah Newsletter

## DIFFERENCES BETWEEN CONVENTIONAL BANK AND ISLAMIC BANK

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Assalammualaikum everyone and Hi! We meet again in another topic of Shariah Newsletter. Last month we shared about advantages and disadvantages of Islamic Finance. So, this month, we will talk about differences between Conventional Bank and Islamic Bank. Islamic finance and conventional finance are two distinct systems with differing principles, practices, and objectives. Here are the key differences:

### 1. Foundational Principles

| Islamic Finance | Conventional Finance |
|---|---|
| Shariah Compliance: All financial transactions must comply with Islamic law (Shariah). This prohibits activities involving interest (riba), excessive uncertainty (gharar), and investments in businesses considered haram (forbidden) such as alcohol, gambling, and pork. | Secular Basis: Operates under secular legal systems without religious restrictions. |
| Profit and Loss Sharing: Emphasizes risk-sharing. Profit and loss are shared between the lender and the borrower. | Interest-Based Transactions: Interest (riba) is a fundamental component, with profits primarily generated through interest on loans. |

### 2. Key Financial Instrument

| Islamic Finance | Conventional Finance |
|---|---|
| • Murabaha: A cost-plus financing structure where the seller discloses the cost and profit margin.<br>• Mudarabah: A profit-sharing arrangement where one party provides the capital, and the other provides expertise. | • Loans: Money lent at interest to be repaid over time.<br>• Bonds: Debt securities issued by entities to raise capital, with periodic interest payments |
| • Musharakah: A joint venture where all partners contribute capital and share profits and losses.<br>• Ijara: Leasing agreements where the financier buys and leases out an asset to the client.<br>• Sukuk: Islamic bonds that represent ownership in a tangible asset or business venture. | • Equities: Stocks representing ownership in a company.<br>• Derivatives: Financial contracts whose value is derived from underlying assets, including futures, options, and swaps. |

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## 3. Banking Operations

| Islamic Finance | Conventional Finance |
|---|---|
| • Shariah Compliance: Banks and financial institutions must ensure all operations comply with Sharia principles.<br>• Sharia Boards: Islamic banks have Sharia boards to oversee and ensure compliance with Islamic law.<br>• Profit and Loss Sharing: Banks share in the profits and losses of the businesses they finance. | • Regulatory Compliance: Operations are governed by financial regulations and standards, with no religious oversight.<br>• No Sharia Boards: There is no requirement for religious boards to oversee operations.<br>• Fixed Interest Returns: Banks earn a fixed interest on the loans they provide, irrespective of the borrower's business performance. |

## 4.Objectives and Outcome

| Islamic Finance | Conventional Finance |
|---|---|
| • Social Justice: Emphasizes fair distribution of wealth and social justice.<br>• Economic Welfare: Aims for the economic well-being of the community.<br>• Ethical Investments: Promotes socially responsible and ethical investing. | • Profit Maximization: Primary focus is on maximizing profits for shareholders.<br>• Market Efficiency: Seeks to ensure efficient allocation of resources.<br>• Investment Freedom: No restrictions on the types of investments made, as long as they are legal. |

## 5. Contracts and Agreement.

| Islamic Finance | Conventional Finance |
|---|---|
| • Transparency: Requires full disclosure and transparency in all transactions.<br>• Prohibition of Gharar: Transactions with excessive uncertainty or ambiguity are not permitted.<br>• Real Economic Activity: Financial transactions must be linked to real economic activity or tangible assets. | • Varied Disclosure Standards: Disclosure requirements vary by jurisdiction and regulatory body.<br>• Acceptance of Speculative Investments: Transactions involving high risk and uncertainty, such as derivatives, are common.<br>• Separation from Real Assets: Many financial transactions do not require backing by tangible assets. |

- These differences underscore the unique nature of Islamic finance, which blends religious principles with financial practices, contrasting with the profit-driven approach of conventional finance.