

Islamic banking: sources and uses of funds term paper sample

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Summary

of

Chapter 3. Islamic Banking: Sources and Uses of Funds

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Summary: Islamic Banking: Sources and Uses of Funds

Islamic Banking has become a fast-growing system in the global finance environment. Its demand is rising quite fast in numerous countries of the world- which has led to creation of numerous Shari'a-compliant products since the inception of Islamic banking in 1960s. Unlike conventional banking, Islamic banks are not allowed to charge or provide interest, as under Islamic law, making money from money (riba or interest) is strongly forbidden. Instead Islamic banking transactions are based on the principles of sharing, trading (buying and selling), and leasing.

As sources of funds, Islamic banks use shareholder investments, savings account, current account, and investment account. Under Islamic banking, depositors seek safe custody of funds, but they are not a guaranteed to earn a profit on their deposits. Islamic banks may provide hibah (gift) at banks' discretion or share in profit of banks based on type of deposit.

In application of fund, profit and loss sharing is major feature in Islamic banking products. Also the products must avoid gharar (uncertainty, risk or speculation) and invest in halal (religiously permissible) business activities.

Products can be classified under 3 categories: 1) Equity Financing and Profit Sharing, 2) Credit Purchase, 3) Leasing. Islamic Banks provide numerous financing structures, but not all of these structures are acceptable to all Muslim investors, as there controversy among different school of thoughts and interpretations.

Despite some controversy with interpretation of some Islamic banking products, it cannot be denied that Islamic banking assets is on the rise and expected to cross \$1 trillion in banking assets by 2010. According to Asian Banking Journal, asset growth of top 100 Islamic banks was higher than that of top 100 conventional banks in 2006. Given such potential, Islamic banking's coverage will surely increase, through participation of popular financial institutions such as including HSBC, Citibank, Standard Chartered Bank, and others.