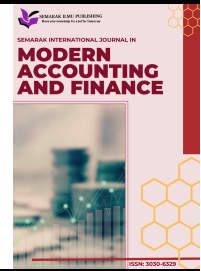




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# A Comparative Study of Islamic Banking in Malaysia and Ethical Banking in Western Countries

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### ABSTRACT

This study is to provide a comparative analysis of Islamic banking in Malaysia and ethical banking in Western countries, with a focus on their founding values, governance frameworks, investment principles, transparency mechanisms, as well as the social and environmental impacts. Islamic banking, which is rooted in Shariah principles, emphasizes justice, risk-sharing, and the prohibition of interest (riba). Ethical banking is guided by environmental, social, and governance (ESG) considerations, as well as the accountability of stakeholders. Using document analysis, policy review, and secondary data, this research explores how both systems result in ethical finance and how they respond to regulatory, societal, and market demands. The key findings highlight the fact that while Islamic banking ensures theological legitimacy through Shariah governance structures, it faces challenges in the areas of transparency and stakeholder engagement. Ethical banks, on the other hand, excel in participatory governance and sustainability disclosure, although they operate within secular legal systems. The study concludes that despite their distinct origins, both models have the shared goal of promoting socially responsible finance. The study recommends cross-learning opportunities, especially in enhancing transparency, inclusivity, and regulatory innovation to create a more ethical and resilient financial system.

## 1. Introduction

### 1.1 Research Background

In recent years, the global financial landscape has undergone profound changes, driven by increased awareness of environmental degradation, social inequality, and the need for ethical conduct in business practices. This transformation has catalysed the development of banking models that prioritize not only profitability but also social and environmental responsibility. These values-based models of finance have emerged in response to the shortcomings of traditional banking, particularly in the aftermath of the 2008 global financial crisis, which exposed systemic issues related to risk-taking, lack of transparency, and unethical behaviour [1].

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Among the leading paradigms of values-based finance are Islamic banking and ethical banking. Islamic banking is based on the principles of Shariah law, which prohibit interest (riba), excessive uncertainty (gharar), and unethical investments such as those involving alcohol, gambling, or pork-related businesses. Instead, it promotes profit-and-loss sharing, asset-backed financing, and investments aligned with Islamic ethical values. Malaysia has been a forerunner in the institutionalization of Islamic finance, with the establishment of Bank Islam Malaysia Berhad in 1983 and a comprehensive regulatory framework that includes the Islamic Financial Services Act (IFSA) 2013, the Shariah Governance Framework, and the guidance of the Shariah Advisory Council (SAC) under Bank Negara Malaysia (BNM) [2].

Ethical banking, meanwhile, has gained prominence particularly in Europe and parts of North America. Unlike Islamic banking, it is not based on religious doctrines but emphasizes transparency, accountability, environmental sustainability, and social equity. Ethical banks actively screen their investments to avoid sectors such as fossil fuels, arms manufacturing, and companies with poor labor practices. Instead, they channel funds into areas like renewable energy, affordable housing, healthcare, and education [3]. Key players include Triodos Bank (Netherlands), GLS Bank (Germany), and The Co-operative Bank (UK), which operate under publicly available ethical guidelines and ESG frameworks.

While Islamic and ethical banking have different philosophical foundations, religious ethics versus secular ethics they converge on the goal of promoting socially responsible finance. Both aim to restore trust in financial institutions, serve the real economy, and foster long-term value creation for society. For instance, both models emphasize avoiding harm (either through Shariah prohibitions or ESG exclusions), engaging in responsible lending, and ensuring that financial practices do not exacerbate inequality or environmental harm [4].

Malaysia's Islamic banking sector has flourished due to its dual-banking model, where Islamic and conventional banks coexist and are subject to parallel regulatory oversight. As of 2023, Islamic banking assets constituted over 45% of the total banking assets in Malaysia, underscoring its significance in the national economy [5]. In comparison, ethical banks in Europe remain niche players in terms of market share but have exerted considerable influence in shaping discourse around sustainable finance, particularly within the context of the European Green Deal and the UN Sustainable Development Goals (SDGs) [6].

This study aims to conduct a rigorous comparative analysis of Islamic banking in Malaysia and ethical banking in other countries. It explores their ethical principles, operational models, governance mechanisms, financial performance, and social and environmental impacts. By identifying both commonalities and divergences, the study seeks to inform regulators, financial practitioners, and scholars on the potential for cross-learning and hybridization between these two systems. Such understanding is essential in the current era of climate change, economic inequality, and geopolitical uncertainty, where the need for a more ethical and resilient financial system has never been more urgent.

## *1.2 Literature Review*

### *1.2.1 Islamic banking: Foundations and development*

Islamic banking operates on the principles of Shariah law, which governs not only religious practices but also commercial and financial transactions. A key tenet of Islamic finance is the prohibition of riba (interest), which is considered exploitative and unjust. Instead, Islamic banks promote risk-sharing between parties, aligning incentives and fostering equitable financial

relationships. Other prohibitions include gharar (excessive uncertainty) and maysir (speculation or gambling), which are seen as destabilizing and ethically problematic [7].

To facilitate compliant financial transactions, Islamic banks use contract-based instruments. Among the most common are:

**Murabahah:** A cost-plus sale where the bank buys an asset and sells it to the client at a profit, with the markup disclosed upfront.

**Mudarabah:** A profit-sharing partnership where the bank provides capital, and the entrepreneur provides expertise. Profits are shared as agreed, while losses are borne by the capital provider.

**Musharakah:** A joint venture in which both parties contribute capital and share profits and losses proportionately.

**Ijarah:** A leasing agreement like conventional leasing but structured to comply with Shariah.

**Istisna':** A contract for manufacturing goods and commodities, often used in construction and project finance.

These instruments are not merely technical substitutes for interest-based products but are embedded in a moral economy that values justice, social welfare, and ethical conduct [8]. The Maqasid al-Shariah, or the objectives of Islamic law, are central to this moral underpinning. These include the protection and enhancement of five essentials: faith (din), life (nafs), intellect ('aql), lineage (nasl), and wealth (mal). Modern Islamic economists and scholars increasingly advocate that Islamic finance must not only avoid prohibited elements but also actively promote the Maqasid by contributing to socio-economic development, poverty alleviation, and financial inclusion [9].

In Malaysia, the evolution of Islamic banking has been supported by a strong legal and regulatory foundation. The sector's development began with the Islamic Banking Act 1983, which allowed for the creation of Islamic banks parallel to conventional banks. The establishment of Bank Islam Malaysia Berhad in the same year marked a milestone in institutionalizing Islamic finance. In subsequent decades, Malaysia has positioned itself as a global leader in Islamic finance through a dual banking system, enabling Islamic and conventional banks to operate simultaneously under clear legal segregation.

The current regulatory environment is governed by the Islamic Financial Services Act (IFSA) 2013, which provides a comprehensive legal framework for all Islamic financial institutions, including banks, insurers, and capital market entities. One of the critical aspects of IFSA is its emphasis on Shariah governance. The Shariah Governance Framework (SGF) introduced by Bank Negara Malaysia (BNM) in 2010 and updated in 2019 requires Islamic financial institutions to establish a dedicated Shariah Committee, appoint a Chief Shariah Officer, and conduct periodic Shariah audits [10]. Malaysia also benefits from a robust institutional support system, including:

- 1) The Shariah Advisory Council (SAC) of BNM, the highest Shariah authority in the country's Islamic finance industry.
- 2) International Shariah Research Academy for Islamic Finance (ISRA), which contributes to scholarship and standard setting.
- 3) Malaysia International Islamic Financial Centre (MIFC), promoting Malaysia as a global Islamic finance hub.

The regulatory architecture and institutional ecosystem have resulted in a well-developed Islamic finance industry. As of 2023, Islamic banking assets in Malaysia accounted for nearly 45.7% of total banking sector assets, supported by innovation in financial products, takaful (Islamic insurance), sukuk (Islamic bonds), and digital banking platforms [5].

Despite these achievements, challenges remain. Critics argue that many Islamic financial products mimic conventional ones too closely, leading to legal form over substance issues. Others call for greater alignment with environmental, social, and governance (ESG) criteria and for Islamic banks to

broaden their impact metrics beyond Shariah compliance [11]. In response, several Malaysian Islamic banks have begun to integrate Maqasid-based performance indicators and adopt frameworks such as value-based intermediation (VBI) to measure their socio-economic contributions.

BNM in collaboration with the Islamic finance industry in 2017 released a Strategy Paper on Value-based Intermediation (VBI). This paper articulates strategies to strengthen the roles and impact of Islamic banking institutions (IBIs) towards a sustainable financial ecosystem. The strategies promote the application of VBI practices which will lead to an improved suite of products and services offered by IBIs for better facilitation of entrepreneurship, community well-being, sustainable environment and economic growth, without compromising on shareholders' returns. The intended outcomes of VBI are broadly similar to the objectives set by frameworks such as the Environmental, Social and Corporate Governance (ESG), Sustainable, Responsible, Impact Investing (SRI) and ethical finance. However, VBI is rooted in Shariah, which determines its underlying values, moral compass and priorities. With the adoption of VBI, practitioners will need to consider the impact of their activities and actions not only to financial consumers, but a wider range of stakeholders. These strategies are expected to be adopted and implemented based on each IBI's readiness [12].

In sum, Islamic banking in Malaysia is a dynamic, regulated, and ethically grounded financial system. Its emphasis on Shariah compliance and social justice positions it well within the global movement toward sustainable and responsible finance.

### *1.2.2 Ethical banking: Principles and practice*

Ethical banking, also referred to as sustainable or social banking, encompasses financial institutions that prioritize environmental sustainability, social justice, and economic responsibility. Unlike Islamic banking, which is underpinned by divine commandments derived from Shariah law, ethical banking is a secular movement driven by humanistic, environmental, and corporate governance values. The overarching objective is not merely financial return but also creating positive societal impact through conscientious financial intermediation [1].

Ethical banks often subscribe to Environmental, Social, and Governance (ESG) frameworks and impact investing principles, selecting clients and investments based on rigorous screening processes. They perform both negative screening (excluding harmful industries like fossil fuels, tobacco, weapons, or exploitative labour practices) and positive screening (favouring initiatives that promote renewable energy, social inclusion, and responsible agriculture) [13]. Some of the foundational principles of ethical banking include:

**Transparency:** Ethical banks disclose detailed information about their operations, projects financed, and criteria for decision-making.

**Sustainability:** Their business models support long-term environmental and economic viability, often aligned with the United Nations Sustainable Development Goals (SDGs).

**Democratic governance:** Many ethical banks operate as cooperatives or mutual institutions where clients and depositors have a say in the bank's direction.

**Client-centred orientation:** Instead of maximizing shareholder profit, these institutions emphasize the well-being of clients, communities, and future generations.

### Prominent Examples of Ethical Banking:

**Triodos Bank (Netherlands):** Founded in 1980, Triodos is a global leader in ethical banking. It provides full transparency by publishing a list of every loan it disburses. It funds projects in organic farming, renewable energy, culture, and microfinance. This bank is an unlisted public company [14].

**GLS Bank (Germany):** Founded in 1974, GLS stands for “Gemeinschaftsbank für Leihen und Schenken” (Community Bank for Loans and Gifts). It finances only projects with clear social and environmental benefits, including inclusive education, ecological housing, and green technologies [15].

**The Co-operative Bank (UK):** Operating since 1872, the bank introduced an Ethical Policy in 1992 that has evolved through regular customer consultations. It excludes investments in fossil fuels, arms trade, and companies that violate human rights. In recent years, it has expanded lending to renewable energy and social enterprises [16].

Other noteworthy institutions include Banca Etica (Italy), Ekobanken (Sweden), and Alternative Bank Schweiz (Switzerland). Many of these institutions are members of the Global Alliance for Banking on Values (GABV), a network of over 70 banks committed to advancing values-based banking.

Recent literature underscores the importance of ethical banking in the transition toward green economies and inclusive finance. According to Kolbel *et al.*, [17] customers increasingly seek financial institutions aligned with their ethical beliefs, leading to a measurable rise in deposits and customer loyalty for ethical banks. Similarly, Weber and Feltmate [1] emphasize that ethical banks tend to exhibit greater financial resilience during economic crises, thanks to their conservative lending and risk assessment practices.

From a regulatory standpoint, ethical banks often go beyond mere compliance, proactively engaging in public policy dialogues related to climate finance, social impact, and regulatory transparency. Many ethical banks are adopting fintech innovations such as open banking, digital sustainability tracking, and blockchain for traceable donations, further enhancing their credibility and outreach [18].

In conclusion, ethical banking offers a transformative model of financial intermediation that balances profitability with people, planet, and purpose. While smaller in scale compared to mainstream commercial banks, their influence on financial ethics and responsible investing continues to grow globally.

#### 1.2.3 Comparative studies and conceptual overlaps

A growing body of interdisciplinary literature highlights the conceptual and operational intersections between Islamic banking and ethical banking. Both systems, despite emerging from distinct ontological and ideological foundations, share a commitment to responsible finance, social justice, environmental stewardship, and stakeholder engagement [19]. They often prioritize positive screening (e.g., investing in socially beneficial projects) and negative screening (e.g., avoiding tobacco, arms, gambling, or environmentally harmful industries).

Islamic banking is primarily rooted in religious ethics derived from the Qur’an, Hadith, and Islamic jurisprudence (fiqh). Its moral imperatives stem from divine revelation, and compliance is overseen by Shariah Supervisory Boards. In contrast, ethical banking is largely secular and humanistic, grounded in civil society values, legal norms, and corporate ethics codes. Nevertheless, the operational principles of both often align closely [20]. For example, both Islamic and ethical banks:

- 1) Emphasize transparency and accountability in financial dealings.
- 2) Avoid investments in harmful or exploitative sectors.
- 3) Support local economies, small and medium enterprises (SMEs), and socially impactful ventures.
- 4) Promote financial inclusion and community-oriented banking.

Scholars like Khan [21] contend that Islamic banking can be considered a subset of ethical banking, albeit with jurisprudential constraints that add specificity and formalism. For instance, the prohibition of *riba* is non-negotiable in Islamic finance, while ethical banks may permit interest if it is not exploitative. Moreover, Islamic finance mandates asset-backing and risk-sharing, whereas ethical banks may focus more on environmental or social governance criteria.

Recent comparative research has delved deeper into this convergence. Hassan and Aliyu [22] argue that Islamic banks, particularly in countries like Malaysia and Indonesia, are increasingly adopting ESG and sustainability frameworks to broaden their appeal and impact. Similarly, Naifar et al., [7] find empirical support for the idea that both banking models tend to outperform conventional banks in terms of resilience during crises and long-term profitability, largely due to their conservative risk profiles and stakeholder-centred approach [23].

However, divergences remain significant. Ethical banks often take a bottom-up, activist-driven approach, emerging from grassroots movements (e.g., GLS Bank in Germany or Triodos Bank in the Netherlands). They typically publish impact reports and are often cooperative or member-owned institutions. Islamic banks, conversely, are usually commercially structured and operate under national religious guidelines or government-linked bodies. Furthermore, while ethical banks actively champion environmental causes, not all Islamic banks systematically integrate green finance or climate risk into their strategies [24].

Innovations in hybrid models are beginning to bridge these gaps. Malaysian Islamic banks such as Bank Muamalat and Bank Islam have adopted Value-Based Intermediation (VBI), which aligns *Maqasid al-Shariah* with sustainability goals. Similarly, European ethical banks are exploring partnerships with Islamic finance actors to diversify their portfolios and extend outreach into Muslim-majority markets [25].

In summary, while the normative origins of Islamic and ethical banking differ, divine versus secular ethics, their functional overlap is considerable. As the global financial system increasingly embraces sustainability, ethics, and inclusivity, both banking models offer complementary pathways to rethinking finance beyond shareholder profit maximization.

#### *1.2.4 Gaps in the literature*

Despite a growing body of literature on Islamic and ethical banking, significant gaps remain, particularly in the comparative analysis between these two paradigms. Most existing research has focused on comparing Islamic banking with conventional banking, often emphasizing financial performance, compliance mechanisms, or customer satisfaction. However, few studies offer a systematic comparison of Islamic and ethical banks based on operational structures, governance frameworks, and social impact outcomes across different regulatory and cultural contexts [26].

A primary gap lies in the lack of cross-country empirical studies. While Islamic banking is extensively studied in Muslim-majority countries such as Malaysia, Indonesia, and the Gulf States, ethical banking research tends to centre around Western Europe, particularly institutions like Triodos Bank, GLS Bank, and The Co-operative Bank. These studies are often confined within their own

regulatory and cultural contexts, which limits the generalizability of findings and fails to provide insights into how each model performs in comparable environments [1].

Additionally, there is limited research on customer behaviour and expectations in dual-banking systems where both Islamic and ethical banks coexist or where consumers have access to multiple ethical financial alternatives. This is especially relevant in multicultural societies such as the UK, Malaysia, or South Africa, where consumers may select financial products not only based on profitability but also on moral, religious, or environmental considerations [27].

Another overlooked area is the assessment of social and environmental outcomes of Islamic banking. While ethical banks often report on ESG impact, carbon footprints, or social justice initiatives, Islamic banks tend to focus on Shariah compliance and financial performance, with limited integration of broader sustainability metrics. This creates a methodological challenge for comparing the two sectors on equal terms [28]. Furthermore, regulatory and institutional support mechanisms differ vastly. Ethical banks benefit from frameworks like the EU Sustainable Finance Action Plan, the UN Principles for Responsible Banking, and country-specific ESG reporting mandates. In contrast, Islamic banks are bound by religious edicts, with regulatory environments varying widely by country. These differences have not been adequately examined in comparative studies.

Finally, much of the literature relies on qualitative or theoretical analysis, with few quantitative models that measure the relative efficiency, impact, or stability of Islamic versus ethical banks. This limitation hampers policy makers and investors who seek data-driven insights to support inclusive and sustainable finance.

This article seeks to fill these gaps by conducting a detailed cross-country comparison of Islamic and ethical banks, focusing on operational models, regulatory compliance, governance structures, and socio-environmental outcomes. By analysing case studies from Malaysia (Islamic banking) and leading ethical banks in Europe, this research aims to bridge the empirical divide and offer policy-relevant recommendations for the integration of ethical and religious finance.

## **2. Methodology**

### *2.1 Research Design*

This research adopts a qualitative comparative case study approach to investigate the operational principles, governance mechanisms, and social outcomes of Islamic and ethical banking systems. A qualitative design allows for a nuanced exploration of institutional structures and the interpretive frameworks through which these banks define and measure ethical performance. As suggested by Yin [29], the case study approach is particularly appropriate when examining contemporary phenomena within real-life contexts, especially where the boundaries between context and subject are blurred.

The qualitative comparative method offers flexibility in understanding not just what institutions claim to do, but how they do it and why. The research utilizes documentary analysis, thematic coding, and qualitative synthesis as core tools. These tools allow for pattern recognition, thematic categorization, and critical reflection across diverse data sources, including reports, speeches, and regulatory texts. This approach mirrors the methodological recommendations of Eisenhardt [30] for building theory from case study research and Flick [31] for conducting rigorous qualitative analysis.

### *2.2 Selection of Case Studies*

The study strategically selects six banking institutions three Islamic banks in Malaysia and three ethical banks in Europe as the basis for comparative analysis:

**Islamic Banks** (Malaysia): Bank Islam Malaysia Berhad, Maybank Islamic, CIMB Islamic  
**Ethical Banks** (Europe): Triodos Bank (Netherlands), GLS Bank (Germany), Co-operative Bank (United Kingdom)

The selection criteria were based on institutional maturity, public reputation, regulatory standing, and data availability. These banks are widely recognized as leaders in their respective sectors, have extensive documentation in the public domain, and represent geographic diversity across Muslim-majority and secular contexts. The Malaysian Islamic banks were chosen for their adherence to the Shariah Governance Framework (SGF) issued by Bank Negara Malaysia (BNM), while the European ethical banks were selected due to their affiliation with the Global Alliance for Banking on Values (GABV), ESG certification, and reputation for financial transparency [32].

### 2.3 Data Sources

The data collection process triangulates multiple primary and secondary sources to ensure comprehensiveness, validity, and contextual richness. Data includes:

- Annual and Sustainability Reports (2019–2024): These reports offer insights into each bank’s ethical policies, financial performance, governance practices, and community impact.
- Regulatory Frameworks and Guidelines: Including BNM’s Shariah Governance Policy Document (2019), the Islamic Financial Services Act (2013), and international guidelines like the Equator Principles and UN Sustainable Development Goals.
- Shariah Pronouncements and Fatwas: Issued by Shariah Advisory Councils to govern financial contracts and investment practices.
- Academic Literature and Peer-reviewed Journals: To provide context, interpretative frameworks, and past comparative findings [33].
- Public Interviews, Webinars, and Speeches: Given by bank executives, Shariah scholars, and ethics officers that elaborate on mission alignment, strategic goals, and future outlooks.

Where available, the study incorporates secondary interview transcripts and qualitative datasets archived in regulatory and academic repositories. Document triangulation strengthens internal validity and enables the study to identify convergence or divergence across banks [34].

### 2.4 Analytical Framework

The core of the research methodology lies in a thematic content analysis that allows for both inductive and deductive coding. The study draws upon the five dimensions identified below to build a structured yet flexible comparative framework:

**Table 1**  
 Comparative framework

	<b>Islamic Banks</b>	<b>Ethical Banks</b>
<b>Ethical Principles and Foundational Values</b>	Rooted in Maqasid al-Shariah, focusing on justice, equity, prohibition of harm (e.g., riba, gharar, maysir); finance seen as a moral and spiritual obligation.	Based on ESG values, human rights, and climate justice; finance as a tool for social transformation and ecological sustainability.

<b>Governance and Compliance Structures</b>	Supervised by Shariah Supervisory Boards (SSBs); follows IFSA 2013 and AAOIFI/IFSB standards; periodic Shariah audits.	Oversight by Ethical or ESG Committees; follows CSR, EU Taxonomy, GRI Standards; subject to ESG-based auditing and stakeholder consultation.
<b>Investment and Financing Policies</b>	It employs risk-sharing contracts such as Mudarabah, Musharakah, and Ijarah; screens industries based on Shariah prohibitions.	Practices negative screening (e.g., no fossil fuels, arms, tobacco); uses positive screening for green and social investments.
<b>Transparency and Stakeholder Engagement</b>	Disclosure focused on Shariah compliance and financial reports; stakeholder involvement is limited but guided by religious ethics.	Encourages active stakeholder dialogue, community ownership models; publishes detailed impact and sustainability reports.
<b>Social and Environmental Impact</b>	Oriented toward charitable giving (zakat), microfinance, and poverty alleviation; increasingly adopting green sukuk and sustainable waqf models.	Focused on renewable energy finance, social housing, and ethical entrepreneurship; measures outcomes through ESG ratings and KPIs.

To support the analytical rigor, NVivo software is used for coding and organizing qualitative data. The software facilitates inter-theme connections and supports pattern recognition through query functions and data visualization tools [35]. Where necessary, thematic findings are validated through member checks and peer debriefing sessions with academic experts and professionals in the banking sector.

### 3. Results

#### 3.1 Ethical Principles and Foundational Values

The comparative analysis reveals both convergence and divergence in the ethical foundations of Islamic and ethical banks. While all six institutions, three Islamic banks in Malaysia (Bank Islam Malaysia Berhad, Maybank Islamic, CIMB Islamic) and three ethical banks in Europe (Triodos Bank, GLS Bank, Co-operative Bank) adhere to explicitly stated ethical missions, the philosophical underpinnings and implementation mechanisms diverge significantly.

Islamic banks are grounded in divine injunctions, with their financial principles extracted from Shariah law, particularly the Maqasid al-Shariah (objectives of Islamic law), which aim to promote justice, prevent harm, and ensure the well-being of society. For example, Bank Islam Malaysia Berhad’s mission is to “advocate financial solutions that preserve wealth, promote fairness, and uphold social justice” in alignment with Maqasid al-Shariah [36]. Key terminologies that repeatedly appear in their vision and policy statements include "riba-free," "halal financing," and "risk-sharing." These terminologies reflect a legally structured moral system where ethical compliance is ensured by Shariah boards and validated through periodic Shariah audits [37].

On the other hand, ethical banks like Triodos Bank explicitly embrace humanistic and sustainability-centred ethics. Their mission is to "make money work for positive social, environmental, and cultural change," and their values are operationalized through a strong commitment to the ESG (Environmental, Social, and Governance) agenda and stakeholder well-being [14]. The Co-operative Bank's Ethical Policy, which is based on stakeholder consultations, excludes lending to fossil fuel projects, arms trade, and companies with records of labour rights violations [16].

A thematic content analysis of mission and vision statements across all six institutions reveals a consistent pattern: Islamic banks emphasize religious terminology and prohibitions (e.g., riba, gharar,

maysir), while ethical banks emphasize forward-looking secular ideals such as sustainability, inclusivity, and transparency.

**Table 2**  
 Comparative ethical frameworks of selected banks

Bank	Ethical Basis	Key Terms Used	Screening Criteria
<b>Bank Islam Malaysia Berhad</b>	Shariah Law (Maqasid al-Shariah)	Riba-free, Halal finance, Justice, Ethical stewardship	Excludes interest-based finance, pork, gambling, alcohol
<b>Maybank Islamic</b>	Shariah-compliance	Partnership, Risk-sharing, Halal returns	Sectoral prohibitions + risk-sharing contracts
<b>CIMB Islamic</b>	Shariah and IFSB Guidelines	Shariah advisory, Islamic contracts, Inclusive growth	Sector-specific exclusion + social justice metrics
<b>Triodos Bank (Netherlands)</b>	Humanistic Sustainability	Social impact, Cultural finance, Climate action	Excludes fossil fuels, animal cruelty, arms trade
<b>GLS Bank (Germany)</b>	Ecological-Social Economy	Climate responsibility, Transparency, Renewable energy	Strict ESG screening; focuses on green technologies
<b>Co-operative Bank (UK)</b>	Stakeholder-driven Ethics	Fairness, Inclusion, Anti-discrimination, Climate justice	Stakeholder-led policy; annual updates on impact performance

These ethical principles fundamentally influence how each bank approaches financing. Islamic banks rely heavily on asset-backed transactions and risk-sharing instruments (e.g., Mudarabah, Musharakah) as a religiously approved alternative to interest-bearing loans. Ethical banks, conversely, prioritize the impact of their funding and implement ESG filters to ensure environmental and social benefits from financed projects. Interestingly, although the origins of these frameworks differ, divine revelation versus stakeholder consensus, their practical outcomes often converge. Both types of banks consistently avoid financing industries that cause social harm and both prioritize real economy transactions over speculative financial instruments. These alignments are not accidental but reflect a shared concern for long-term well-being, sustainable growth, and stakeholder value over shareholder value [33].

However, critical differences emerge in terms of institutional flexibility and ethical authority. Islamic banks must defer to Shariah boards, whose religious rulings carry binding weight, which sometimes results in conservative approaches to product innovation. Ethical banks, on the other hand, often use flexible ethical charters, updated through periodic consultations with stakeholders and civil society [38]. This allows them to be more agile in responding to emergent ethical concerns such as gender diversity or carbon emissions.

Moreover, the activist stance of ethical banks is notable. Triodos Bank and GLS Bank regularly participate in public discourse on climate justice, fair trade, and social equity, actively shaping regulatory frameworks. Islamic banks, while morally aligned with social justice principles, tend to focus more inwardly on compliance and religious legitimacy rather than external advocacy [39].

**Table 3**  
 Comparative analysis on ethical foundations of Islamic vs ethical banks

	<b>Islamic Banking</b>	<b>Ethical Banking</b>
<b>Philosophical Foundation</b>	Divine Origin; based on Shariah Law	Humanistic Philosophy; based on ESG and CSR frameworks
<b>Prohibited Activities</b>	Riba (interest), Gharar (uncertainty), Maysir (gambling)	Fossil fuels, arms trade, animal testing
<b>Governance Structure</b>	Shariah Compliance Boards	Stakeholder committees; ESG reports and ethical audits
<b>Financial Model</b>	Risk-sharing contracts (e.g., Murabaha, Mudarabah)	Impact-first lending; social return over profit
<b>Core Orientation</b>	Faith-based objectives (e.g., Maqasid al-Shariah)	Outcome-focused (e.g., climate action, inclusion)

### 3.2 Governance and Compliance Structures

Governance in financial institutions is not only central to maintaining regulatory compliance but also reflects the ethical and operational integrity of the bank. Islamic and ethical banks differ in their foundational ideologies but converge on the need for specialized oversight structures that ensure alignment with their principles. This section analyses these structures, drawing from bank reports, regulatory frameworks, and academic literature over the past decade.

Islamic banking operates under a dual-layered governance framework: conventional financial regulation and Shariah compliance oversight. The Islamic Financial Services Act 2013 (IFSA) mandates each Islamic financial institution (IFI) in Malaysia to establish an independent Shariah Committee. These committees are composed of scholars proficient in Islamic jurisprudence (Fiqh al-Muamalat), finance, and economics.

Each decision or product innovation must be reviewed and endorsed through a Fatwa (juridical ruling) issued by the bank's internal Shariah Committee (SC). In a few cases, verified by Bank Negara Malaysia's Shariah Advisory Council (SAC) which was established in May 1997 as the highest Shariah authority for Islamic financial institutions in Malaysia. The Central Bank of Malaysia Act 2009 (CBMA) reinforces the roles and functions of SAC as the authority for the ascertainment of Islamic law for the purposes of Islamic financial business which are supervised and regulated by the Central Bank of Malaysia (CBM) (S51 CBMA 2009)

The governance and compliance structures of Islamic and ethical banks demonstrate both distinct regulatory paradigms and emerging areas of convergence. In the Islamic banking sector, the governance model is deeply rooted in religious jurisprudence and is formalized through institutions like the Shariah Supervisory Boards (SSBs). In Malaysia, this structure has been significantly strengthened with the implementation of the Shariah Governance Policy Document 2019 by Bank Negara Malaysia (BNM) [40]. This framework mandates a clear functional segregation between management and Shariah oversight, requiring that the Shariah function operates independently to ensure unbiased religious compliance. It also introduces robust internal Shariah audits, comprehensive risk management systems, and annual Shariah compliance reviews and public disclosures. These mechanisms are designed not only to ensure theologically sound operations but also to enhance the credibility and transparency of the Islamic financial sector. This Shariah

Governance Policy Document (SGPD) 2019 (which takes effect on 1 April 2020) which superseded SGF 2010 in short aimed at strengthening Shariah governance in Islamic financial institutions (IFIs) enhancing board oversight, clarifying Shariah Committee responsibilities and promoting Shariah compliance culture [40].

However, despite these advancements, the Shariah governance system is not without its criticisms. Scholars such as Archer and Karim [41] have highlighted concerns that Shariah Supervisory Boards (SSB) or in Malaysia is known as Shariah Committee (SC) may sometimes function with limited transparency and may be influenced by the commercial interests of the institutions they oversee. This has raised questions about the extent of their independence and objectivity. Nonetheless, Malaysia remains at the forefront of Shariah governance innovation. The efforts of BNM to institutionalize and standardize governance practices through both regulatory mandates and the Islamic Financial Services Act 2013 (IFSA) have contributed significantly to improving both consistency and accountability across the Islamic banking industry [42].

In contrast, ethical banking institutions rely on governance systems built around Environmental, Social, and Governance (ESG) principles rather than religious doctrine. These institutions typically establish Ethical Review Committees or Sustainability Boards to oversee compliance with their ethical mandates. Governance is further reinforced by third-party audits, conducted by organizations such as Sustainalytics, to ensure objective assessment of a bank’s adherence to ESG commitments. Ethical banks also align with global sustainability standards and international policy frameworks, such as the United Nations Principles for Responsible Banking [43] and the Global Reporting Initiative (GRI) Standards [43]. These frameworks provide structured guidance on transparency, stakeholder inclusiveness, and accountability in financial practices.

Unlike Islamic banks, which derive legitimacy from religious compliance, ethical banks derive their credibility from stakeholder engagement, regulatory transparency, and adherence to globally recognized sustainability benchmarks [45]. While Islamic banks emphasize faith-based compliance and theological validation, ethical banks emphasize environmental sustainability, social justice, and good corporate governance as essential components of their operational philosophy. Despite their differences in foundation, both models have evolved to incorporate more rigorous compliance systems, often blending elements from each other in response to growing expectations for transparency and accountability in the global financial landscape [46].

For instance, Triodos Bank and GLS Bank have board-level sustainability units and publicly disclose every investment. Triodos publishes "Know Where Your Money Goes" portals, enabling customer tracking of capital deployment [14]. Furthermore, ethical banks undergo periodic ESG impact assessments and align their operations with SDG targets and EU Taxonomy for sustainable activities. The secular structure enhances transparency and stakeholder accountability. Yet the absence of a single global ethical standard (unlike Shariah in Islamic finance) leads to variability in ethical criteria across institutions [47]. This pluralism offers flexibility but can also lead to inconsistency in ESG enforcement.

**Table 4**  
 Comparative analysis of governance and compliance structures

	Islamic Banking	Ethical Banking
<b>Philosophical Foundation</b>	Divine Origin; based on Shariah Law	Humanistic Philosophy; based on ESG and CSR frameworks

<b>Prohibited Activities</b>	Riba (interest), Gharar (uncertainty), Maysir (gambling)	Fossil fuels, arms trade, animal testing
<b>Governance Structure</b>	Shariah Compliance Boards	Stakeholder committees; ESG reports and ethical audits
<b>Financial Model</b>	Risk-sharing contracts (e.g., Murabaha, Mudarabah)	Impact-first lending; social return over profit
<b>Core Orientation</b>	Faith-based objectives (e.g., Maqasid al-Shariah)	Outcome-focused (e.g., climate action, inclusion)

Both systems strive for accountability but approach it from fundamentally different worldviews. While Islamic banking's strength lies in religious legitimacy and codified jurisprudence, ethical banking benefits from dynamic, secular, and externally audited frameworks. A notable distinction is transparency as ethical banks outperform Islamic banks in real-time reporting, participatory decision-making, and accessibility of investment data [48]. However, Islamic banks tend to demonstrate stronger internal audit mechanisms, a reflection of their compliance with divine mandates. Additionally, ethical banks are more embedded within international sustainable finance ecosystems enabling cross-border alignment whereas Islamic banks remain largely regionalized despite standardization efforts by bodies like AAOIFI and IIFM.

### 3.3 Investment and Financing Policies

Investment and financing policies form a crucial axis of comparison between Islamic banking and ethical banking models. While both models aim to achieve socially beneficial outcomes, the underlying principles, instruments, and sectoral priorities diverge significantly. Islamic banking is governed by Shariah-compliant finance principles, which prohibit riba (interest), gharar (excessive uncertainty), and maysir (speculation/gambling). Instead of conventional lending, Islamic banks employ asset-backed contracts and profit-loss sharing arrangements. The most common financial instruments include:

**Murabahah:** A cost-plus sale contract commonly used for trade and asset financing.

**Mudarabah:** A profit-sharing arrangement where the bank provides capital, and the entrepreneur contributes expertise.

**Musharakah:** A partnership where both parties contribute capital and share profit/loss.

**Ijarah:** A leasing arrangement where the bank retains ownership of the asset while leasing it to the customer.

These instruments reflect the Islamic ethical emphasis on risk-sharing, real economic activity, and financial justice [9]. Notably, Shariah-compliant banks exclude investment in non-halal sectors, such as alcohol, gambling, pork-related industries, and conventional financial services. This exclusion list is governed by fatwas and Shariah Board rulings, which can have variances across jurisdictions.

Recent developments in Islamic finance, particularly in countries like Malaysia, Indonesia, and the GCC, have seen increased focus on green sukuk (Islamic bonds) and Islamic microfinance, reflecting convergence with sustainable finance goals [48]. In contrast, ethical banking institutions structure

their financing activities around social and environmental impact metrics rather than religious prohibitions.

A distinctive feature of ethical banking is its prioritization of "impact-first" financing, where investment decisions are made based on the positive societal or environmental outcomes, even if financial returns are moderate. Banks such as Triodos Bank (Netherlands) and GLS Bank (Germany) implement strict lending criteria aligned with the UN Sustainable Development Goals (SDGs). Financing is directed towards renewable energy, organic agriculture, social housing, and cooperatives [49]. Moreover, ethical banks often use negative and positive screening techniques in their due diligence processes. Negative screening eliminates industries misaligned with ethical values, while positive screening prioritizes businesses with demonstrable social/environmental benefits [13].

**Table 5**  
 Comparative analysis of investment and financing policies

	<b>Islamic Banking</b>	<b>Ethical Banking</b>
<b>Underlying Principles</b>	Shariah law; prohibition of riba, gharar, maysir	ESG standards; alignment with SDGs
<b>Financial Instruments</b>	Murabaha, Mudarabah, Musharakah, Ijarah, Sukuk	Ethical loans, community bonds, green loans, social investment funds
<b>Risk Allocation</b>	Risk-sharing (Mudarabah, Musharakah)	Impact-weighted risk management
<b>Prohibited Sectors</b>	Alcohol, gambling, pork, conventional banking, adult entertainment	Fossil fuels, weapons, animal testing, tobacco, unethical labor
<b>Screening Mechanisms</b>	Shariah screening via board decisions and fatwas	ESG screening, third-party audits (e.g., Sustainalytics, MSCI ESG)
<b>Social Investment Focus</b>	Zakat, waqf-based microfinance, Islamic social finance instruments	Community finance, education, renewable energy, social enterprise funding
<b>Transparency Tools</b>	Shariah disclosures, annual Shariah compliance reports	Impact reports, sustainability disclosures, stakeholder consultations
<b>Innovative Instruments</b>	Green Sukuk, Islamic microfinance, Islamic fintech	SDG-linked bonds, climate risk funds, cooperative banking

While both models advocate ethical financial practices, their differences lie in intent, process, and methodology. Islamic finance embeds ethics through divine commandments and jurisprudential compliance, which sometimes limits its adaptability to fast-evolving sustainability frameworks. On the other hand, ethical banks are more flexible and continuously adapt to emerging global challenges, such as climate change, inequality, and responsible consumption. Nonetheless, recent trends indicate a growing intersection between the two paradigms. Islamic banks are increasingly adopting ESG reporting, while ethical banks have begun incorporating faith-based investment products to

reach a diverse clientele [50]. Both systems share common ground in risk aversion, exclusionary investment criteria, and community development goals. These convergences suggest potential for cross-learning and collaboration in creating a more just and sustainable financial future.

### *3.4 Transparency and Stakeholder Engagement*

Transparency and stakeholder engagement are core pillars of ethical and Islamic financial systems. Both models emphasize accountability, but they operationalize transparency differently, guided by either religious doctrine or socially driven governance frameworks. While Islamic banking prioritizes Shariah-based disclosures and theological oversight, ethical banks lean on participatory governance and structured stakeholder inclusion.

In Islamic banking, transparency is primarily enforced through Shariah governance frameworks. Institutions are required to disclose Shariah compliance reports, fatwas, and internal Shariah audit findings. These disclosures aim to reassure stakeholders that financial products and operations align with Islamic legal and ethical norms. The Shariah Governance Framework 2020 [51], introduced by Bank Negara Malaysia, has significantly enhanced transparency within the Islamic banking sector by establishing stricter disclosure and oversight requirements. One of its key provisions is the mandatory publication of annual Shariah compliance reports, which provide a comprehensive review of how financial institutions align their operations with Islamic legal principles. These reports serve to inform stakeholders, including regulators, investors, and the public, about the institution's commitment to Shariah compliance.

In addition, the framework requires the public disclosure of Shariah rulings, or fatwas, issued by the bank's Shariah Committee. This step ensures that the religious basis of each financial product is made transparent and accessible, promoting greater trust and understanding among customers. SGF 2020 also mandates the establishment of internal Shariah audit and risk management functions that operate independently of conventional audit systems. These internal mechanisms are designed to monitor compliance proactively and continuously, thereby strengthening internal accountability and reducing the risk of Shariah non-compliance. Collectively, these measures aim to institutionalize a culture of ethical transparency while reinforcing the theological legitimacy of Islamic financial operations in Malaysia.

These mechanisms are intended to uphold theological legitimacy, but critics argue that Islamic banks sometimes lack clarity and consistency in disclosures. For example, differences in Shariah interpretations across jurisdictions may lead to varied product approvals, reducing comparability and market confidence [50].

Additionally, the influence of internal Shariah Boards, while rooted in religious scholarship, may result in limited stakeholder input. Boards are appointed by bank management, and there are few channels for customers or civil society to participate directly in governance processes [52]. However, Islamic banks in Malaysia, Indonesia, and the UAE have begun adopting more public-facing compliance summaries, reflecting a positive trend toward improved disclosure and stakeholder inclusion.

Ethical banking, in contrast to Islamic banking, positions transparency and stakeholder engagement as fundamental pillars of its governance philosophy. Rather than relying solely on internal compliance mechanisms, ethical banks adopt structures that are participatory, impact-driven, and externally validated. Central to this approach is the concept of participatory transparency, where a broad range of stakeholders including customers, employees, civil society organizations, and local communities are actively involved in shaping the bank's policies and operational decisions. This

inclusive model not only democratizes financial governance but also enhances accountability and social legitimacy.

One of the key instruments of transparency in ethical banking is the annual publication of sustainability and impact reports, which detail the bank's environmental and social contributions, lending practices, and carbon footprint. For instance, Triodos Bank consistently publishes such reports to highlight how its capital allocation aligns with its ethical mission. Ethical banks also maintain open governance structures, incorporating stakeholder councils and advisory panels that provide feedback and guidance on strategic matters. These structures ensure that decisions are not solely dictated by executives or shareholders but reflect the broader ethical and social concerns of the community.

Moreover, ethical banks frequently undergo third-party ESG audits and certifications from organizations such as B Corporation, or the Fair Finance Guide, adding an additional layer of accountability and transparency. Another hallmark of ethical banking is the use of public exclusion lists, which clearly disclose sectors and industries the bank refuses to fund. These lists help ensure that customers are fully informed about how their deposits are used, reinforcing trust and ethical consistency. Collectively, these practices exemplify how ethical banks operationalize their values through robust transparency and inclusive governance mechanisms.

Ethical banks often publish loan-level transparency data, allowing depositors and investors to know exactly where their money is going. For instance, GLS Bank in Germany provides a database of all funded projects, categorized by social sector and environmental impact.

In addition, ethical banks typically participate in global sustainability initiatives that reinforce their commitment to transparency, accountability, and sustainable finance. These frameworks serve not only as guiding principles but also as benchmarks for performance and disclosure. Among the most prominent initiatives is the Global Reporting Initiative (GRI), which provides standardized guidelines for sustainability reporting. Through GRI compliance, ethical banks are required to disclose detailed information about their environmental, social, and economic impacts, thereby enhancing the credibility and comparability of their disclosures [44].

Another important initiative is the United Nations Principles for Responsible Banking (UNPRB), launched in 2019 [43]. By adhering to these principles, banks commit to aligning their business strategies with the Sustainable Development Goals (SDGs) and the Paris Climate Agreement. Signatory banks must publish regular reports on how their activities contribute to global sustainability targets, along with third-party verified data. This creates a culture of performance-based accountability, where ethical banks must demonstrate that their commitments translate into measurable impact [43].

Ethical banks also often adopt the Equator Principles, a risk management framework for assessing and managing environmental and social risks in project finance. Compliance with these principles ensures that banks fund only those projects that meet stringent environmental and social criteria [45]. Additionally, membership in the Net-Zero Banking Alliance, launched by the United Nations in 2021, reflects a commitment to achieving carbon neutrality in investment and lending portfolios, with clear interim targets and timelines [43]. Collectively, participation in these initiatives signifies that ethical banks are not only transparent about their operations but are also actively shaping and responding to global sustainability standards, thereby reinforcing their ethical identity in a measurable and credible way.

**Table 6**  
 Comparative transparency and stakeholder engagement

	<b>Islamic Banking</b>	<b>Ethical Banking</b>
<b>Transparency Mechanism</b>	Shariah compliance reports, fatwa disclosure, internal audits	Public ESG reports, sustainability disclosures, third-party verifications
<b>Stakeholder Involvement</b>	Primarily internal (management Shariah Board axis)	Participatory: stakeholders involved via councils, surveys, governance roles
<b>Regulatory Oversight</b>	Guided by central banks and Shariah governance standards (e.g., BNM SGF 2020)	Adheres to international frameworks: GRI, UNPRB, Equator Principles
<b>Disclosure Frequency</b>	Annual or as required by law; varies by jurisdiction	Quarterly/Annual, often voluntary but standardized
<b>Public Access to Data</b>	Limited (compliance summaries and fatwa disclosures)	High (loan-level databases, exclusion lists, funding breakdowns)
<b>Accountability Instruments</b>	Internal Shariah audits, Shariah Board reviews	Third-party audits, sustainability indices, public voting mechanisms
<b>Customer Influence</b>	Minimal direct input; influence through complaints or feedback channels	Strong: customers may vote, suggest funding areas, or participate in assemblies
<b>Criticism</b>	Opaque board appointments; inconsistent fatwa disclosures	Greenwashing risk; challenges in verifying impact of all projects

While both systems prioritize ethics, ethical banking offers greater procedural transparency and broader stakeholder access. Islamic banks, constrained by jurisprudential rigidity and jurisdictional diversity, often fall short in providing actionable transparency. Their disclosures tend to focus more on theological compliance than on quantifiable environmental or social outcomes. However, efforts are underway to bridge this gap. Islamic banks in Malaysia and the GCC have started issuing Sustainability Sukuk with ESG-linked disclosures, suggesting that the gap is narrowing. Also, the emergence of Islamic social finance platforms and digital disclosure tools may improve public engagement and data openness [53].

Conversely, ethical banks, while more transparent, are not without criticism. Concerns over greenwashing and overstated ESG impact persist, especially when reporting standards are self-set or voluntary [47]. Nevertheless, ethical banks consistently outperform mainstream banks in disclosure practices, particularly in the EU and Nordic regions. In sum, ethical banking currently leads in participatory transparency and multi-stakeholder engagement, while Islamic banking continues to evolve through regulatory reforms and sustainability integration.

### *3.5 Social and Environmental Impact*

The social and environmental contributions of financial institutions are increasingly becoming central to the assessment of their legitimacy and long-term value. Both Islamic banking and ethical banking systems incorporate social responsibility into their operational philosophies, albeit from different ontological foundations and with varying degrees of implementation.

Islamic banking derives its social orientation from the *Maqasid al-Shariah*, which emphasizes the preservation of faith, life, intellect, lineage, and wealth. In practice, this translates into financial inclusivity, equitable distribution of resources, and support for vulnerable segments of society [54]. One of the most distinctive social instruments within Islamic finance is *zakat*, a mandatory almsgiving mechanism that redistributes wealth within the community. In Malaysia, for example, Islamic banks collaborate with *zakat* institutions to streamline the collection and disbursement process, contributing to poverty alleviation and social safety nets [55].

Beyond *zakat*, *waqf* (endowments) and Islamic microfinance are used to support long-term community development. Several Islamic banks in Malaysia have established *waqf*-based funds to provide education, healthcare, and housing for underserved populations. Islamic microfinance institutions, guided by principles of profit-and-loss sharing (e.g., *Mudarabah* and *Musharakah*), offer low-income entrepreneurs access to capital without exploitative interest, which fosters sustainable livelihoods [56]. Furthermore, the Value-Based Intermediation (VBI) initiative launched by Bank Negara Malaysia in 2017 has encouraged Islamic banks to enhance their role in generating positive social and environmental outcomes. Under VBI, banks are encouraged to integrate social impact indicators into their performance frameworks, such as access to affordable housing, financing for renewable energy, and SME empowerment [57].

Nonetheless, critics argue that while Islamic banking has made theoretical and partial practical strides in social finance, its environmental impact remains underdeveloped. Green finance is still at a nascent stage in most Islamic financial institutions, with few systematic policies addressing carbon emissions, biodiversity, or ecological risks [58]. There is also an observable gap in standardized metrics for assessing and reporting environmental outcomes, which impedes comparisons across jurisdictions and institutions.

In contrast, ethical banks have embedded environmental and social objectives as foundational pillars of their operations. These institutions actively avoid financing activities that harm the environment or violate human rights. For example, banks such as Triodos Bank and GLS Bank maintain public exclusion lists that clearly state industries they refuse to fund, such as fossil fuels, arms manufacturing, and large-scale industrial agriculture [14,15]. Instead, they direct capital toward renewable energy projects, organic agriculture, social housing, and educational initiatives.

One of the hallmarks of ethical banking is the practice of impact reporting. Institutions provide data on how client funds are allocated, often down to the project level. For example, GLS Bank maintains a digital database listing every loan issued, categorized by sector and assessed for its social return. Ethical banks also publish annual sustainability and impact reports that quantify greenhouse gas reductions, jobs created, or communities served, reinforcing their commitment to transparency and stakeholder accountability [59].

Moreover, ethical banks actively participate in environmental partnerships and global sustainability alliances. Many are signatories to the UN Principles for Responsible Banking, Net-Zero Banking Alliance, and B Corp Certification, which require concrete action on climate change and inequality [60]. Ethical banks often outperform their conventional peers in green lending ratios and carbon disclosure metrics, suggesting that their model offers more tangible progress on climate goals [61].

Nevertheless, challenges persist. Ethical banks operate within relatively small market shares and often face capital constraints, regulatory ambiguities, and limited public awareness. Their social and environmental contributions, while significant per unit of capital, remain constrained by scale and mainstream financial dominance.

**Table 7**  
 Comparative analysis on social and environmental analysis

	<b>Islamic Banking</b>	<b>Ethical Banking</b>
<b>Foundational Philosophy</b>	Based on <i>Maqasid al-Shariah</i> (preservation of religion, life, intellect, lineage, wealth).	Based on secular ethics: social justice, sustainability, human rights, and climate action.
<b>Social Instruments</b>	Zakat, waqf, Islamic microfinance, profit-and-loss sharing to empower low-income communities.	Loans for social enterprises, affordable housing, education, fair trade projects, and underserved populations.
<b>Environmental Focus</b>	Emerging but underdeveloped; limited structured green finance policies.	Central to operations; actively funds renewable energy, sustainable agriculture, and green innovation.
<b>Impact Measurement</b>	Qualitative; focused more on religious compliance than environmental or social KPIs.	Quantitative; publishes annual impact reports with data on CO <sub>2</sub> savings, social returns, and project-level transparency.
<b>Transparency of Impact</b>	Improving through initiatives like Value-Based Intermediation (VBI), but disclosure is still limited and uneven.	High; publishes exclusion lists, sustainability certifications, loan-level databases, and stakeholder reviews.
<b>Examples of Initiatives</b>	Zakat-linked housing funds, waqf-based education scholarships, VBI scorecards (e.g., Bank Islam Malaysia).	Triodos Bank's renewable energy portfolio, GLS Bank's public loan database, B Corp-certified finance initiatives.
<b>Global Alliances</b>	Some participation in ESG conversations; not yet widely aligned with global sustainability protocols.	Signatory to UN PRB, Equator Principles, Net-Zero Banking Alliance, and GRI Standards.
<b>Challenges</b>	Lack of standardized ESG metrics, jurisdictional Shariah interpretations, low environmental integration.	Small market size, capital limitations, niche visibility despite high impact per asset.

In conclusion, both Islamic and ethical banks demonstrate a commitment to social responsibility, albeit with distinct motivations and methods. Islamic banking is rooted in theological obligations that promote justice, redistribution, and community welfare. Ethical banking is driven by secular ethics

and sustainability frameworks, offering measurable environmental benefits and participatory governance. For future growth, Islamic banks may benefit from deeper integration of environmental metrics and green product innovation, while ethical banks may seek to expand their financial inclusion mandates to achieve a broader developmental impact. Harmonizing these approaches offers the potential for a hybrid model of banking that is both spiritually grounded and environmentally progressive.

#### **4. Conclusion**

This comparative analysis of Islamic and ethical banking has highlighted significant convergence in values but divergence in methods and institutional frameworks. Both models aim to deliver socially responsible financial services, but they are grounded in different paradigms: Islamic banking is rooted in divine jurisprudence, while ethical banking is guided by secular ethics and sustainability standards [50].

Islamic banking, particularly in Malaysia, has evolved significantly under regulatory frameworks such as Bank Negara Malaysia's Shariah Governance Policy Document 2019, which has institutionalized mechanisms for compliance, risk control, and ethical integrity [51]. These include Shariah Committees, fatwa disclosures, and internal Shariah audits. While these efforts reinforce religious legitimacy, critiques remain regarding the lack of stakeholder inclusivity and variability in Shariah interpretations [42]. The adoption of BNM Value-Based Intermediation is a promising step to realign financial services with social and environmental goals, but operational implementation still varies across institutions [57].

Ethical banking, on the other hand, emphasizes stakeholder engagement, transparency, and external audits. Institutions like Triodos Bank and GLS Bank exemplify participatory governance and impact-first financial models, with regular publication of sustainability reports, exclusion lists, and customer-level disclosure of funded projects [14,15]. Ethical banks typically operate within robust international frameworks such as the UN Principles for Responsible Banking, Global Reporting Initiative Standards, and Net-Zero Banking Alliance, enhancing their transparency and global comparability.

This study finds that while Islamic and ethical banking share goals like financial justice, sustainability, and social inclusion, their governance structures, compliance systems, and financing policies differ in both scope and operationalization. Islamic banking focuses on compliance with Shariah principles (e.g., avoiding *riba*, *gharar*, and *maysir*), while ethical banking emphasizes ESG risk mitigation and stakeholder well-being [62].

##### **4.1 Recommendations**

This study reveals significant areas for improvement and cross-learning between Islamic and ethical banking systems. To enhance effectiveness, global competitiveness, and social value delivery, several key recommendations are proposed.

Firstly, greater integration between Islamic financial frameworks and international Environmental, Social, and Governance (ESG) standards is essential. While Islamic banking already incorporates ethical underpinnings through Shariah principles, these are often confined within theological and legalistic boundaries. Integrating globally recognized sustainability frameworks such as the Global Reporting Initiative (GRI) or the United Nations Principles for Responsible Banking (UNPRB) could help Islamic banks benchmark their performance against ethical banks and enhance their credibility with global stakeholders. Malaysia's Value-Based Intermediation (VBI) approach,

introduced by Bank Negara Malaysia in 2018, represents a promising start toward this goal. However, broader alignment with international ESG indicators would not only improve transparency but also allow investors and regulators to better assess the impact and consistency of Islamic finance operations [57].

Secondly, Islamic banks should adopt more robust transparency mechanisms, like those practiced by ethical banks. One of the strengths of ethical banking lies in its participatory and stakeholder-driven governance structures. Ethical banks routinely publish detailed sustainability and impact reports, disclose project-level financing data, and engage a wide array of stakeholders, including civil society, depositors, and employees in decision-making. Islamic banks could benefit greatly from adopting similar practices, especially in enhancing public trust and demonstrating their commitment to ethical outcomes beyond compliance with Shariah rulings. Institutions like GLS Bank and B Corp certified entities have set clear benchmarks in these areas, which Islamic banks can emulate to improve their stakeholder engagement and market positioning [63].

A third recommendation involves standardizing Shariah interpretations across jurisdictions to mitigate inconsistencies in Islamic banking products and practices. One of the persistent challenges in Islamic finance is the divergence of Shariah rulings, which affects the comparability of financial instruments and hampers cross-border investments. Malaysia's centralized model featuring a national-level Shariah Advisory Council under Bank Negara Malaysia offers a workable blueprint for ensuring consistency and enhancing investor confidence. If other countries were to adopt a similar centralized structure, it could pave the way for a more harmonized and globally integrated Islamic finance sector [47].

Another area for development is capacity building around Shariah-compliant ESG financial instruments. While there has been growing interest in Islamic green sukuk and socially responsible investment (SRI) tools, the market remains nascent. Islamic finance institutions should invest more in product innovation that merges ESG goals with Shariah compliance. For instance, developing sukuk structures aligned with the Equator Principles or other green finance frameworks could position Islamic banks as leaders in sustainable finance within Muslim-majority economies [45].

Finally, there is a pressing need for interdisciplinary research and cross-sector dialogue between Islamic and ethical finance practitioners, scholars, and regulators. The lack of engagement between the two paradigms limits innovation and mutual understanding. Collaborative efforts such as joint research projects, regulatory forums, and cross-training programmes could yield hybrid financial models that combine Shariah principles with ESG best practices. Such models would be well-positioned to address contemporary global challenges, from climate change to social inequality, within a faith-conscious yet universally ethical framework.

To sum up, the future of Islamic and ethical banking lies not in isolation, but in synergy. By learning from each other and embracing shared goals of justice, sustainability, and accountability, both sectors can contribute meaningfully to a more inclusive and resilient global financial system. Islamic and ethical banking both offer distinct yet overlapping pathways toward a more equitable, sustainable, and inclusive financial system. By learning from each other and fostering mutual adaptation, they can jointly contribute to the global transformation of finance in line with both moral values and sustainability imperatives.

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