

A Sharia'h Perspective of Minimum Account Balance Requirement in Islamic Banking

- Dr. Mufti Muhammad Mushtaq Ahmad
- Dr. Muhammad Farooq
- Niaz Muhammad
- Shakir Ullah

ABSTRACT:

Banks charge fee on saving and current accounts or downgrade them when the balance drops below a threshold point. This could be justified in conventional banking on pure business grounds; however, it is an issue of concern in Islamic banking because of the underlying Shari'a (Islamic Law) issues in this practice. While some Islamic banks charge incidental fees, as practiced by conventional banks, on accounts with low balances, others simply stop paying profits on such savings accounts and some even downgrade them by stopping some of the free services. This conceptual paper addresses the Shari'a aspect of such practices in Islamic banking. The paper first presents a broader picture of Islamic banks' practices in relation to this issue and then explores relevant Shari'a principles. The current market practices are then analyzed in light of Shari'a principles. The findings reveal that imposing restrictions/ charges on low-balance savings and current accounts are against the basic tenets of

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- Muhammad Mushtaq, Shari'a Research Officer at the Islamic Banking Group of the Bank of Khyber, Peshawar, Pakistan.
 - Assistant Professor of Economics, Shaykh Zayed Islamic Centre, University of Peshawar.
 - Niaz Muhammad, Assistant Professor and Chairman of the Centre of Religious Studies, Kohat University of Science and Technology Kohat Pakistan.
 - PhD Scholar and part-time lecturer at University of Southampton, UK.

Shari'a principles. The implications of the paper are twofold. Firstly, it opens up a whole new dimension of literature in the field of Islamic banking by instigating an important untouched area. Secondly, it strongly recommends that Islamic banks reconsider their practices in this regard in order to stay viable in the long run. The paper also gives alternative recommendations for addressing the problem in a Shari'a compliant way.

Key words: Islamic Banking, Minimum Balance Requirement, Levy on Accounts, Shari'a, Deposits

Introduction:

Conventional banks normally require savings account holders to maintain a minimum balance so that the interest earnings for the banks on the balances, at least, offset the basic service costs. When the account balance drops below a threshold- a point where service costs supersede the interest earned on the balance, the banks start charging a fee on those accounts. Some banks treat such accounts as current accounts and do not pay any profit to account holders. Normally current account holders are exempted from maintaining minimum balance as banks earn more on current accounts when the balances are above the minimum, which is often the case. Thus, banks are happy to provide free services to current account holders even when the balance sometimes drops below the minimum threshold. However, this is not a normal treatment of current

accounts. A number of banks penalize even current account holders for not maintaining a minimum balance.

Saving account holders are typically entitled to a bunch of free services e.g. free fund transfers, online banking, monthly statements etc. However, when the balance in the accounts drops below the minimum required level, banks stop providing some or all of the free services instead of imposing monthly charges. Thus, the accounts are downgraded to an inferior level. Banks charge fees on low balance accounts with the justification that such accounts may be misused for criminal activities in addition to being an operational burden on the banks. Thus the accounts are closed after the balance becomes zero.

Some Islamic banks also require their customers to maintain sufficient balance in their accounts. However, they face resistance from Shari'a scholars- the guardians of Shari'a principles in Islamic banks.¹ It is also worth mentioning that Islamic banking is guided by Islamic law (Shari'a). In particular, Islamic law prohibits *Riba* (usury) - the collection and payment of interest- Shari'a not only requires banking transactions to be interest-free but also based on profit and loss sharing mechanism leading a fair distribution of wealth.

Based on the profit and loss sharing proposition, this paper investigates the charging of fees or downgrading of low balance accounts from a Shari'a perspective. The next section summarizes the current practices of Islamic banks in this regard, especially in Middle East, Malaysia and Pakistan. Section 3 explores this issue in the light of Shari'a principles and Islamic banking literature. Section 4 then analyzes the current market practices in the light of Shari'a principles. The next section gives suggestions and recommendations for addressing this

problem in a Shari'a-compliant way. The last section concludes the paper.

Current Practices of Islamic Banks:

Holding unproductive low balance accounts is in fact a financial burden not only on conventional but also on Islamic banks. For example banks have to maintain such accounts on their books, service ATM cards, provide online and telephone banking facilities etc. while not getting enough in return. Therefore, charging fees on low-balance accounts or downgrading them is a reasonable penalty from a pure business angle. Islamic banks in Middle East, Pakistan, Malaysia and across the globe have adopted similar practices to deal with this issue. For example, Dubai Islamic Bank, Pakistan, which is considered as one of the premier Islamic banks in the country requires foreign currency account holders to maintain a minimum balance of \$500 US in order to be eligible for a share in the bank's profit.² Any account holder who does not maintain the required balance is deprived from a share in profit of the bank. Local currency accounts (Saving Accounts), however, are exempted from this requirement. Excluding local currency accounts from the charges is a rather soft strategy of the bank but the minimum balance requirement on foreign currency accounts is, however, a debatable issue. On the other hand, Standard Chartered Saadiq- an Islamic banking subsidiary of Standard Chartered Bank, charges a flat rate of 50 Pakistani Rupees (PKR) on all local and foreign currency accounts when the balance drops below the minimum required level.³ Similarly, Barkat Islamic Bank- a subsidiary of Faysal Bank- charges PKR 100 on all low balance savings accounts.⁴

Islamic banks in other countries also follow pretty much similar pattern for penalizing low-balance account holders. For example, Al Tijari-al-Islami, UAE charges 25 UAE Dirham (AED) when balance drops below AED 5,000. Foreign currency accounts are charged with similar amounts in the respective currencies.⁵ On the contrary, May bank Islamic, Malaysia, levy half yearly charges of 10 Malaysian Ringgits (RM) on current accounts when average balance in such accounts is below RM 1,000. However, the bank does not levy any charges on savings accounts.⁶ Abu Dhabi Islamic Bank imposes charges of AED 25 on low balance current accounts. Savings accounts are deprived of their share in profits in case the balance falls below AED 5,000 but no charges are levied.⁷ Thus, savings accounts are downgraded for not maintaining minimum balances.

The current practices of Islamic banks regarding minimum balance requirement have been summarized in Table 1 below.

Table 1: Minimum Balance Requirements of Islamic Banks

S. No	Name of Organization	Practice Regarding Current Accounts	Practice Regarding Saving Accounts
1	Dubai Islamic Bank Pakistan	No Minimum Balance Required	Minimum balance required for eligibility in profit share on foreign currency accounts
2.	Standard Chartered (Saadiq) Pakistan	PKR 50 per month charged on low balance accounts	PKR 50 per month charged on low balance accounts
3.	Faysal Islamic Bank Pakistan	No Minimum Balance Required	PKR 100 per month charged on low balance accounts
4.	Al-Tijari-al-Islami UAE	AED 25 per month charged on low balance accounts	AED 25 per month charged on low balance accounts
5.	May Bank Islamic Malaysia	RM10 per six months charged on low balance accounts	No Minimum Balance Required
6.	Abu Dhabi Islamic Bank UAE	25 AED per month charged on low balance accounts	Minimum Balance Required for Eligibility of Share in Profits

Shari'a Aspects of Islamic Banking Deposits:

Islamic deposit accounts can be divided into two categories from Shari'a point of view i.e. *Qarḍ-e-Hasana* based (current accounts) and *Mushārahah or Muḍārahah* based accounts (profit and loss sharing savings).⁸ The Shari'a intricacies of these accounts are discussed below.

Current Accounts:

Current accounts in Islamic banking are based on *Qarḍ-ḥasana*. The word '*Qarḍ*' is derived from the Arabic word '*Qirāḍ*' which means 'to cut'.⁹ It cuts a certain portion of the lender's property by giving loan to a borrower. The word '*Hasana*' originates from '*Ihsān*' which means kindness to others. It is defined as providing money or goods to someone for his/her immediate benefit who returns an equal value at a later date.¹⁰ There are some conditions associated with *Qarḍ-e-ḥasana*. Firstly, no additional money/benefit can be taken against it as "every *Qarḍ-e-ḥasana* which attracts any type of benefit is Riba".¹¹ Furthermore, the borrower is bound to return the borrowed amount in full and in the same form in which it was lent. Accounting and Auditing Organization of Islamic Financial Institute (AAOIFI) Shari'a Standards impose the same restrictions on current accounts. AAOIFI makes it "binding on the bank to return a similar amount on demand for the current deposits".¹² Resolutions of the Islamic Fiqh Academy also resonates a similar message. Resolution number 86/3/95 of the academy puts it in these words, "Current accounts are considered as loan, from Shari'a perspective, since the bank taking delivery of these deposits is answerable for their safety and is bound Shari'a-wise to returning them on call".¹³ This opinion is held by the Hanafi, Shafii and Hanbaly

schools of thoughts. These jurists consider *Qarḍ-e- Hasana* as *Duyūn-ḥālah* (demand loan/deposit). Imam Abu Hanifa, in particular, is of the view that any *Qarḍ* can be called back by the lender any time. Ibn-Hazm has the same view on this issue.¹⁴

Shari'a also appreciates giving time to debtors in case they have hard times and lack resources for repayment. Islam even encourages lenders to grant the lent amount to such borrowers as charity. Quran mentions it in these words "and if the debtor is in a hard time [has no money], then grant him time till it is easy for him to repay, but if you remit it by way of charity, that is better for you".¹⁵

However, *Shari'a* (Islamic Law) termed it cruelty and injustice if the debtor has sources for repayment and still refrains from meeting his/her obligations. Prophet Muhammad (PBUH) said that "protraction of rich is injustice".¹⁶ Prophet Muhammad (PBUH) is also reported to have said that a person who has enough resources for repayment and still does not return the borrowed items, the creditors has the right to claim the debt in other forms such as personal property. Such property, however, should be kept in government custody till the clearance of the debt.¹⁷

Profit and Loss Sharing (PLS) Accounts:

PLS accounts constitute a major percentage of Islamic banks deposits. These deposits are accepted by Islamic banks on *Mushārah* or *Muḍārah* basis.

Mushārah and Muḍārah:

'*Mushārah*' is a word of Arabic origin which literally means sharing. In the context of business and trade it means a joint enterprise in which all the partners share the profit or loss of the joint venture.¹⁸

Mushārah deposits in Islamic banks are based on partnership between the banks and depositors.

'*Muḍārahah*' is also an Arabic term which is derived from the word '*Ḍarb*'. The '*Ḍarb*' means to walk or travel in the land and *mudarib* also travel from one place to another to get profit for the business.¹⁹ *Muḍārahah* is form of business in which one person gives capital to another person for business and both of them share profits in mutually agreed proportions. The supplier of capital is called the "*Rabb-ul-Māl*" (Fund Provider) and the user of capital or fund manager is called *Muḍārib*.²⁰ Thus, '*Muḍārahah*' is a contractual relationship executed between two parties, one supplying the capital and the other supplying the labor and skill, for business.

In present Islamic banking system, PLS account holders are either partners (*Shareek*) of the bank (in case of *Mushārah* based deposit system) or Fund Provider (*Rabb-ul-Māl*) (in case of *Muḍārahah* based deposit system) and the banks acts as partners or fund managers depending upon the deposit mechanism of the bank.²¹ Banks are bound to pay profit to every *Shareek/Rabb-ul-Maal* according to the pre-agreed ratio or proportional to their respective contributions in the *Mushārah/Muḍārahah* pool.²² The profit distribution ratio should be determined and agreed upon at the time of entering into the contract. By placing the burden of loss solely on one or a few partners makes the partnership invalid. However, loss is distributed exactly according to the ratio of investment and the profit is divided according to the agreement of the partners. Any condition contrary to this principle shall render the contract invalid.²³

It is also not permitted to include any condition or modes of profit allocation in partnership contracts that may result in the probable violation of the principle of sharing profit.²⁴ Profit and loss in transactions are recognized at the time of actual or constructive liquidation.²⁵ Constructive liquidation for Islamic banks deposits is the month end.

Analysis of Current Market Practices from Shari'a Perspective:

After discussing different current practices regarding minimum balance requirements in Islamic banking around the world and the related Shari'a aspects/principles behind the deposits mechanisms of Islamic banking system, this section analyzes these practices in the light of Islamic rules/principles laid down by the *Shari'a*.

Sharing of profit is a Shari'a-granted right of every partner in *Mushārah* and *Muḍārah* based deposit accounts. Therefore, the deprivation of any account holder from a share in profit is against Shari'a principles which could render the contract void.²⁶ Some banks justify this practice by claiming that such accounts are automatically converted to current accounts as soon as the balance falls below a minimum threshold. This rationalization creates a number of ambiguities from Shari'a point of view. Firstly, the profit distribution mechanism of Islamic banking system is generally based on daily average balances, which is the average amount that exists in an account over a period of time. The number is calculated by adding the daily balances over a period of time and dividing by the total number of days in that period.²⁷ It means that profits are allocated to every account holder at the end of the month. In this case it is very obvious that actual amount in account is

realized after completion of tenure of the pool (Month). Consequently, the agreement between banks and account holders will be in doubts till maturity of the pool or till the month end. This would create an uncertainty as account holders would not know exactly what their agreement with the bank would be. For example, would it be a partnership or *Qarḍ-e-Hasana* agreement? Such vagueness introduces *Gharar* (risk/uncertainty) which is clearly Haram (prohibited) in Shari'a.²⁸ Though the literal meaning of *Gharar* is 'deception' but the term is used quite widely in practice encompassing uncertainty, risk, hazard and deceit. It has been defined as something with a pleasant appearance and unpleasant outcome. *Gharar* can be divided into two categories; *Tadlīs* (cheating in business) and *Ghabn* (to deceive), as noted by the Encyclopedia of Jurisprudence.²⁹ Because all business transactions involve some level of risk, *Gharar* is a relative concept when it comes to uncertainty, risk and hazard. Thus, a certain level of uncertainty is acceptable in business. However, when it comes to deceit or fraud, *Gharar* becomes an absolute *ḥarām* (prohibited) concept. The current practices of Islamic banks regarding treating low-balance current accounts probably fall into definition of deceit.

Secondly, the initial agreement signed between the bank and the account holder is *Mushārahah/ Muḍārabah* which could not be converted into a different type of agreement (*Qarḍ-e-ḥasana*) automatically.³⁰ Any such conversion will require a new agreement between the two parties at the time of such conversions.

Some banks, though, do not deprive account holders from a share in profits on the excuse of low balance, they charge a fee on such accounts directly deducted from the balances each month. This is an

exact copy of conventional banks practices. Shari'a does not allow any such fees/charges/deductions from a partner/capital-provider's investment.³¹ Deductions from saving accounts are only legitimate in Shari'a when the banks incur genuine operational losses in which case all partners have to bear them proportional to their investments. Any deduction on grounds other than this is against the essence of *Musharakah/ Muḍārabah* and can render the contracts as void.

The issue of charging a levy on current accounts on the excuse of low-balance is similar to that of saving accounts. Current deposits are *Qarḍ-e-Hasana* with the banks the return of which is guaranteed without any deduction even upon the borrower's operational losses.³² Thus, any deduction or levy for not maintaining minimum required balance in current accounts of IFIs is a deceit/fraud and is against Shari'a.

A big step forward in this regard is a recent circular of the State Bank of Pakistan in which it barred all banks in Pakistan from charging any service fees for opening and maintenance of regular saving accounts with effect from July 1, 2011. In this regard, the Banking Policy and Regulations Department (BPRD) of the State Bank of Pakistan issued circular stating that "the services rendered by banks for the opening and maintenance of regular saving accounts shall be free of charge. There shall be no condition of maintaining a minimum balance for these accounts. These instructions are applicable equally to all existing and new accounts. Similarly, no charges shall be recovered by banks at the time of closing an account." It further says that, "banks shall pay profit invariably on 'Profit and Loss Sharing (PLS)' accounts without any condition of minimum balance".³³ This circular is a milestone step

towards better Shari'a compliance of Islamic banks even though it is not only limited to Islamic banks.

Suggestions and recommendations:

Instead of charging levy on low-balance accounts or depriving PLS accounts from a share in profits, we suggest two alternatives. Firstly, Islamic banks can attract more customers to maintain minimum balances by assigning higher weightages to accounts that meet the minimum balance requirements. PLS accounts can thus be divided into different weightage categories based on the average balance. In this regard different categories of profit and loss sharing accounts may be formed. For example accounts with an average monthly balance of \$500 US may be given higher weightage than those with lower balances. Banks may announce categories of different PLS accounts on the basis of average monthly balance which will attract more customers to maintain at least minimum balances in their accounts. This will make the current practices Shari'a compliant. However, we strongly recommend Shari'a scholars' approval for the allocation of any such weightages as managers could manufacture weightage structures yielding similar results as current practices. Secondly, Islamic banks may give additional incentives to account holders with sufficient balance rather than downgrading the services of low balance accounts. Presently some Islamic banks give incentives to all account holders except those who do not maintain minimum balance in their accounts. For example some banks give facilities of free online cash/clearing/transfer transactions for customers who maintain minimum balance requirement. What we suggest is that account holders should not be deprived from basic free services or a share in profit because of low balance. Rather those with sufficient

balances should be rewarded additionally by providing them additional free services. Again, this suggestion could be used very subjectively by managers and therefore, we recommend Shari'a scholars' approval of what constitutes basic necessary services.

Conclusion:

The extant practices of Islamic banks regarding minimum balance requirements have significant Shari'a concerns. Given the sophisticated modern banking businesses, Islamic bankers and Shari'a scholars have to be focused on applying the pure Islamic banking model according to the rules and regulations given in Islamic Law. The minimum balance requirement of Islamic bank appears to be contradictory to the established rules of classical Islamic jurisprudence. As a result of these and other such dubious practices, some jurists as well as public masses regularly raise objections on Islamic banking and blame it to be no different than its conventional counterparts. It is therefore recommended that the present system of Islamic banking industry regarding minimum balance requirement be thoroughly re-examined by the by Shari'a scholars as well as central Shari'a boards, if any, in order to make the industry Shari'a compliant at minimum. We also recommend further academic research on the profit sharing mechanism between the banks and their depositors.

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