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Current and Savings Deposits in Conventional and Islamic Retail Banking in the EU

1. Introduction

In recent decades, the 15,000,000 Muslims in the European Union have become more and more interested in managing their finances by using financial services that are in conformity with Sharia—Islamic law. Today there are more than 350 Islamic financial institutions, all over the world, in some 75 countries^{*1}, and the turnover of Islamic financial services has been estimated as increasing some 10–15^{*2} or even 20% a year.^{*3} We can conclude from the numbers that the development of Islamic financial services deserves every attention, in view of, *inter alia*, the possibility that Islamic financial services may soon be available in Estonia (e.g., by means of exercise of the freedom of establishment and the freedom to provide services within the framework of EU rules for financial services).

This article's aim is to compare the essence of current and savings accounts in conventional banks, of which some Estonian credit institutions are taken as examples, and Islamic banks, in which connection the services provided by the Islamic Bank of Britain have been studied. Although the comparison here may sometimes indicate that the differences between the services provided by conventional and Islamic banking differ in their details but not in their principles, it is essential to keep in mind the very basic principles of Islamic banking as well as the Islamic moral economy as a whole. The Quran prohibits interest (*riba*)^{*4} as usury, which is condemned.^{*5} As a consequence of condemning interest, the Islamic moral economy also prohibits a fixed return generated by interest. Therefore, capital cannot gain any fixed return by itself without any risks being borne. *Vice versa*, according to the Islamic moral economy, capital can increase by means of economic activity and participation in the real economy rather than in the financial industry only. The Islamic moral economy involves the position that money does not have any inherent value and that it is important that the resources, real activity, and risk-bearing are involved in any generation of any new resources. Thus, the principle of profit- and loss-sharing between the parties, the participatory nature of

¹ M. El Qorchi. Islamic Finance Gears Up. – International Monetary Fund Finance & Development December 2005 (42) 4. Available at <http://www.imf.org/external/pubs/ft/fandd/2005/12/qorchi.htm> (31.3.2010).

² FSA encourages growth of Islamic finance in the UK, 28 November 2007. Available at <http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/121.shtml> (31.3.2010).

³ T. Wülfing. Rechtliche Aspekte des islamischen Bankwesens & Scharia-konformer Investments, p. 4. Available at http://www.competence-site.de/downloads/od/2b/i_file_43534/Vorlesung_Islamic_Banking-Skript_deutsch.pdf (31.3.2010).

⁴ رِبَا, “riba”, interest, usurious interest, usury: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 375.

⁵ Quran, Suura 2:275.

economic and business activities, is the crucial element of Islamic financial instruments, which are aimed, *inter alia*, at avoiding concentration of the wealth in the hands of a small circle of persons and *expressis verbis* prohibiting enrichment by means of anything that is prohibited in Islam (alcohol, gambling, pork, etc.). Hence, although the religion prohibits interest, trading is allowed (the prophet Mohammed was a merchant himself) and profit as a return from business activities is allowed. The structures of partnerships in the Islamic financial structures provide that if a joint venture is successful, everybody involved will be entitled to a share in the profit, according to the pre-agreed ratio. At the same time, where a joint venture is not successful, both parties bear the loss. Thus the differences between profit and (forbidden) interest can be depicted as follows⁶:

Interest	Profit
return on capital	return on a project
interest guaranteed	risk of loss involved
fixed return	variable return
return on deposit	return on joint ventures

The background of Islamic financial services dates back to the times of Mohammed. However, they consider that some Islamic financial services (e.g., *murabaha*⁷—a transaction whereby an item will be resold and there will be added to the price a share from the profit as agreed beforehand as well as a fee for the service—and *musharaka*⁸, flexible partnership, wherein all parties contribute capital for financing a project and share the profit as agreed beforehand, with any loss to be covered by all of the partners in proportion to the capital they contributed to the project⁹) date back to pre-Islamic times.

Although it was in the 1920s when the early Islamic banking services began to provide pilgrims from Dutch Indonesia with money exchange services in Jeddah¹⁰, the development of modern Islamic banking services and of providers of such services has been connected mainly with the increase in use of oil products in the latter part of the 20th century.¹¹ It was in 2004 when the first Islamic bank—the Islamic Bank of Britain—was licensed in the EU, in the United Kingdom. The above distinction between interest and profit within the concept of a deposit was an essential factor for prolonging the licensing procedure to nearly 24 months—much longer than was usual for licensing procedures¹² and almost twice as long as is set forth for the licensing period in EU Directive 2000/12 on the establishment and pursuit of banking activities (up to 12 months).¹³ Pursuant to the principle of sharing profit as well as loss, it is quite acceptable that a depositor of an Islamic deposit will not get the deposited money back to the full extent, since an Islamic deposit is composed of the money contributed by one party and the business management of the other party. Thus the returns from the deposit will be shared between the depositor of the money and the party who provided the business management of the deposited resources. On the other hand, if the business management is not successful and there is no profit, the loss would be borne by the contributor of the capital—the depositor—and the bank will lose the resources (of know-how and administration costs) it invested in the management of the deposit. The UK Financial Services Authority did not accept such a concept for a deposit, and in the course of its licensing procedure, the Islamic Bank of Britain agreed to the concept of a deposit entitling the depositor to a full refund of the deposit. However, the Islamic Bank of Britain's deposit contract accommodates both the EU requirements for deposits and the Sharia-compliant provisions. The term added by the

⁶ M. Asutay. Islamic Banking and Finance and Its Role in the GCC-EU Relationship: Principles, Developments and the Bridge Role of Islamic Finance. Gulf Research Centre 2010, p. 7.

⁷ مرابحة, "murabaha", resale with the specification of gain, resale with advance (Isl. Law): H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 371.

⁸ مشاركة, "musharaka", partnership, participation, co-operation: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Edition Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 548.

⁹ Bank of London and Middle East, glossary. Available at <http://www.blme.com/glossary.php#letterm> (31.3.2010).

¹⁰ R. Wilson. Islamic Finance in Europe. RSCAS Policy Papers 2004/02 MUSMINE – Muslim Minorities in Europe. European University Institute, Florence, Robert Schuman Centre for Advanced Studies Policy Papers 2007/02, p. 2.

¹¹ M. Lewis, L. M. Algaoud. Islamic Banking. MPG Books Ltd, Bodmin Cornwall 2001, p. 4, 11–12.

¹² Islamic Finance in the UK: Regulation and Challenges, November 2007, p. 14.

¹³ Directive 2000/12/EC of the European Parliament and, of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, Article 10. – OJ L 126, 25.6.2000, p. 1.

Islamic Bank of Britain does not prevent providers of Islamic banking services from complying with their obligation under EU directives^{*14} to take part in a deposit guarantee scheme.

This paper will deal with some characteristic features of Islamic banking services, examining current and savings accounts in comparison with similar services in conventional banking. The article does not claim to be an exhaustive analysis of the issues; attention has been paid first and foremost to the issues that deserve to be addressed in a situation where Islamic banking is still a relatively unfamiliar phenomenon but at the same time has undergone essential developments in recent years.

2. The practice for interest in current and savings accounts in conventional (Estonian) retail banking versus the counterparts of interest in Islamic retail banking

Since the ban on interest is one of the main characteristic features among the principles of Islamic finance, it is proper to explore what opportunities exist for Islamic depositors to gain revenues from their deposits. The basic banking services in conventional banks are current account and term deposits, whereby the depositor is entitled to receive interest. In the Islamic banking system, one can define three basic types of deposit accounts: current accounts (*Amanah*^{*15} accounts), savings accounts, and investment accounts.^{*16}

Current account are used mainly for daily needs. The resources on such accounts will be payable on demand, whereby neither interest nor profit may be paid on them in Islamic banking. The money deposited in the bank by the client will be regarded as a benevolent loan, *al-qard al hasan*^{*17}, with the account-holder being a lender and the bank being a borrower and distributor of the resources. The term *al-qard al-hasan* refers to a beneficial, benevolent, or gratuitous loan^{*18}, whereby the lender will not be entitled to more than was initially given. AAOIFI^{*19} Sharia Standard No. 19, 'Qard' (Loan), describes *qard* as a transfer of ownership in fungible wealth to a person who will be obliged to return wealth similar to the original. It is strictly forbidden to agree upon anything in addition to the return of the original loan: AAOIFI states that the stipulation of an excess for the lender is prohibited and it is considered to be *riba* regardless of whether the excess be in terms of quality or quantity or whether the excess be a tangible asset or a benefit, whether the excess were stipulated upon the conclusion of the contract, or whether the stipulation were in writing or part of customary practice.^{*20}

It is possible for some banks even to apply charges for current account service; however, others do not, provided that a minimum balance will be maintained on the account.^{*21} In the above-mentioned oldest Islamic bank in the EU, the Islamic Bank of Britain^{*22}, waiver of the fee will be applicable if the average balance of the current account was at least £1,500 for the previous month or the total average balance across all savings accounts was more than £5,000 for the previous month. In the event that the resources on the account(s) have remained below the above-mentioned thresholds, there will be applicable a fee of £2 per

¹⁴ Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay. – OJ L 68, 13.3.2009, pp. 3–7.

¹⁵ أمانة, "amana", deposition in trust: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 36.

¹⁶ S. Tamer. The Islamic Financial System. A Critical Analysis and Suggestions for Improving its Efficiency. – European University Studies. Series V. Economics and Management. Peter Lang Europäischer Verlag der Wissenschaften, p. 75.

¹⁷ قرض حسن, "qard hasan", interest-free loan with unstipulated due date: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 886.

¹⁸ S. Atan. The Concept of Al-Qard Ul-Hasan, p. 1. Available at <http://www.scribd.com/doc/22013726/Qard-Hassan> (9.8.2011).

¹⁹ Accounting and Auditing Organization for Islamic Financial Institutions. Available at www.aoifi.org (16.8.2011).

²⁰ AAOIFI, Shari'a Standard No. 19 Qard (Loan) adopted by Shari'a Board on 15–19 May 2004.

²¹ S. Tamer. The Islamic Financial System. A Critical Analysis and Suggestions for Improving its Efficiency. – European University Studies. Europäische Hochschulschriften. Series V. Economics and Management. Peter Lang Europäischer Verlag der Wissenschaften 2003, p. 75.

²² Hereinafter the mostly the Islamic Bank of Britain is referred to, the only full Islamic bank in the UK providing retail banking services.

visit (i.e., for using the services of a branch counter, for services such as depositing cash or cheques, making withdrawals of cash, or transferring money to another account—within the Islamic Bank of Britain or some other bank). However, the client will be charged for no more than one visit per day: any further visits on the same day will be free, and there will be no limit to the number of transactions one may perform at the branch counter in any visit. When one further compares the price lists of the Islamic bank and Estonian credit institutions, it is worth mentioning that cash-machine withdrawals from Islamic Bank of Britain and other UK cash machines are free of charge (unless extra charges are applicable for withdrawals via some cash machines, with prior notification), while most Estonian credit institutions apply fees for cash withdrawals with debit cards from the cash machines of other credit institutions.^{*23} Estonian credit institutions also pay interest on the resources on current accounts, but the banks providing Islamic current account services state *expressis verbis* that no credit or debit interest will be paid for such an account.^{*24}

The resources that remain after daily activities can be deposited on savings accounts. The main difference between deposit accounts in conventional banking and Islamic banking is that in Islamic banking it is not possible to agree about the revenues entailed by the deposited resources beforehand—in contrast to conventional banking, wherein interest rates are displayed as guaranteed. A deposit account in Islamic banking is treated as a contractual agency for the purpose of protecting wealth (*al-wadiah*^{*25}) whereby the depositor has authorised the financial institution to use the resources, provided that the depositor will be entitled to regain the resources to their full extent and also participate in the division of profits with the institution. The Islamic Bank of Britain offers a variety of savings accounts. The On Demand Savings Account^{*26} is most comparable with the operating deposit offered by AS Eesti Krediidipank^{*27}, from the angle that no notice is required for making a withdrawal from the On Demand Savings Account of the Islamic Bank of Britain and just one day's notice is required for making a free withdrawal from the operating deposit with AS Eesti Krediidipank.^{*28} Additionally, there are no limits to the number of withdrawals that can be made in any given month, provided that there are sufficient resources on the account. On the other hand, there are no requirements regarding the amount for opening an operating account with AS Eesti Krediidipank, but in order to open an On Demand Savings Account, one has to make a minimum initial deposit of £500 or set up an order mandate for at least £50 a month, to ensure regular deposits into the On Demand Savings Account.^{*29}

Once the funds are available on the account to be invested by an institution providing Islamic financial services, the institution and the depositor will agree with respect to the calculation period being a period equivalent to a calendar month. The Islamic financial institution will use the deposited sum as a contribution to the pool of funds during the agreed calculation period. From the gross income—i.e., all revenue generated by the pool of funds during the calculation period—deductions will be made to cover the administrative and other costs of the investment. The Islamic Bank of Britain states that the maximum annual percentage for such costs will not exceed 1.5% of the average balance of the pool of funds during the calculation period. After that, the bank shall deduct its share of the profit (50% in the case of the Islamic Bank of Britain) from the net income. Then the depositor's final share of the profit will be calculated through

²³ Complete price list of Swedbank services for private and corporate clients <https://www.swedbank.ee/private/home/more/pricesrates?language=EST> (9.8.2011) (in Estonian); SEB rates and interest rates <http://www.seb.ee/hinnakiri> (9.8.2011) (in Estonian); Banking Service Charges: Sampo Pank, p. 5.1, 5.2. Available at http://www.sampopank.ee/public/price_list/Pangateenuste_hinnakiri_EST.pdf (9.8.2011) (in Estonian).

²⁴ General Terms and Conditions Current Accounts terms and Conditions Savings Accounts Terms and Conditions, HSCB Amanah bank account p. 8.2. Available at <http://www.hsbc.co.uk/1/2/personal/travel-international/hsbc-amanah/amanah-bank-account> (9.8.2011).

²⁵ *وَضِيْعَةٌ*, “wadiah”, entrusted to custody, deposit, trust: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author. Spoken Language Services, Inc., Urbana, IL, US 1994, p. 1263.

²⁶ On Demand Savings Account, Islamic Bank of Britain. Available at <http://islamic-bank.com/personal-banking/savings-products/demand-savings-account/> (4.8.2011).

²⁷ Terms of the Operating Deposit, AS Eesti Krediidipank. Available at <http://www.krediidipank.ee/era/hoiused/kasutushoius/index.html> (9.8.2011) (in Estonian).

²⁸ The operating accounts available in other Estonian credit institutions provide for longer notice periods for withdrawals, e.g., three days in SEB Bank: see Contract Terms of the Operating Deposit of SEB Bank (available at <http://www.seb.ee/hoiused-ja-investeerimine/hoiused/kasutushoius> (9.8.2011) (in Estonian)) and 10 banking days in Sampo Pank: see Contract Terms of Growth Deposit (available at http://www.sampopank.ee/public/agreement/Kasvuhoiuse_tingimused_EST.pdf (9.8.2011) (in Estonian)).

²⁹ On Demand Savings Account, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/demand-savings-account> (9.8.2011).

deduction of a contribution to a profit stabilisation reserve, with the latter amount limited to 20% of the depositor's gross share of the profit.^{*30}

Thus, in calculation of the depositor's share of the profit, the profit payable to the depositor passes through several stages: a) gross income, b) net income; c) gross share of profit, d) the deduction of the share of the profit for the provider of the Islamic banking services, and finally e) deduction of the profit stabilisation reserve contribution. Roughly speaking, the crediting of the account of the depositor is the sixth step in the overall arrangement.

Depending on the sum deposited and the success of the investment of the pool of funds, the share of profit payable to the depositor may be equal to the interest payable to a depositor with a conventional bank. As the share of profit payable to a depositor with a provider of Islamic banking services is, the interest payable to a depositor with a conventional bank will be dependent on the following two variables, in the main: 1) the sum deposited (which is at the same time a loan to the provider of banking services) and 2) the calculation period. These two factors are common to Islamic and conventional deposits. The third variable influencing the return from a conventional deposit comprises a number of variables, including the expected inflation rate for the calculation period, the risk of default payments, general need for a loan, etc.^{*31} With respect to the revenues from an operating account with AS Eesti Krediidipank, they will be calculated on the basis of the monthly average balance in accordance with the interest rate disclosed beforehand. The returns from the On Demand Savings Account could also be estimated on the basis of the target profit rates disclosed on the Web site of the bank; however, there is a disclaimer that such rates may be subject to change due to potential volatility in Commodity Murabaha markets and the bank will notify clients of the changes as soon as possible.

Higher profit rates are available for sums that have been deposited in Direct Savings Accounts of Islamic banks, which have some features in common with the term deposits and operating accounts of conventional banks. With the Islamic Bank of Britain, a minimum deposit of £1,000 is required for opening a Direct Savings Account. The sum shall be deposited within 14 days of opening of the account, and it is obligatory to maintain a minimum balance of £1,000. It is worth mentioning that payments into the Direct Savings Account cannot be made in cash; only electronic means, sending a cheque to the bank, or other means are allowed. Neither can the money be withdrawn in cash; one must perform an online transfer to another account or instruct the bank to make a payment on behalf of a third party.^{*32}

The revenues from Direct Savings Accounts will be calculated according to a formula similar to that applicable for the On Demand Savings Account. However, there are also some diverging factors. As with regard to the On Demand Savings Account, first the gross income will be calculated and after that the net income will be determined through deduction of direct costs, fees, and expenses incurred in the investment of the pooled funds (such costs, fees, and expenses shall not exceed 1.5% of the average pooled funds for the calculation period). The third step constitutes the first crucial difference in the schemes for calculating the revenues that are due to the depositor—calculation of the distributable profit. In the calculation of the share of profit due to a depositor in an On Demand Savings Account, the third step is deduction of the bank's share of the profit from the net income, while the third step of calculation with the Direct Savings Account is calculation of the distributable profit from the net income via deduction of a stabilisation reserve contribution (up to 20%). After that, the bank's share of the profit (up to 40%) from the distributable profit will be calculated and the share of profit of the depositor will be credited to the account of the depositor. Withdrawals from the Direct Savings Account in any given month will not be limited, provided that a minimum balance of £1,000 is retained.

The calculation of revenues from the on-demand savings and direct savings has much in common with the calculation of revenues for the Young Person's Savings Account, which can be opened in a child's name by a guardian (parent, sibling, grandparent, aunt or uncle, or legal guardian) as a trustee to the account. The account can be opened with £20, and the minimum continuing account balance is £1. Withdrawals from the account on the child's behalf will be authorised until the child reaches 14 years of age; however, the guardian must always act in the best interest of the child. After the child reaches age 14 (becoming what

³⁰ On Demand Savings Account Special Conditions; Islamic Bank of Britain, p. 5.2. Available at <http://www.islamic-bank.com/personal-banking/savings-products/demand-savings-account> (9.8.2011).

³¹ N. E. Sheppard, D. C. Baillie. *Compound Interest*. University of Toronto Press, Canada 1973, pp. 3–4.

³² Direct Savings Account Special Conditions; Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/direct-savings-account/> (6.8.2011).

is hereinafter referred to as a young person), a conditional access letter will be signed by the guardian and the young person and returned to the bank; thereby, the young person is entitled to make withdrawals from the account of up to £100 a day while the adult retains the right to make withdrawals from the account. At the age of 16, the funds on the Young Person's Savings Account will be made available to the young person in other forms—the bank will inform of the possibilities for continuing the relationship with the young person.^{*33}

In the same way as other resources managed by Islamic banks, the sums deposited on the Young Person's Savings Account will be invested in the pooled funds in a Sharia-compliant way. On the calculation date—i.e., the last working day of each month—the bank will calculate the gross income and then calculate the net income by deducting the costs, fees, and expenses of the investment of the pooled funds (in total, up to 1.5% of the average pooled funds during the calculation period). After that, up to 20% will be allocated to the profit stabilisation reserve, then up to 50% will be the share of the profit for the bank. Finally, there remains the young person's share of profit, which will be credited to the bank account.^{*34} On 5 August 2011, the 'Indicative Expected Profit Rate' (gross per annum) for a Young Person's Savings Account was 0.1%.

Estonian banks too make services available for saving money for children. The two largest banks provide investment accounts for raising funds for children, but in some credit institutions there are also children's deposits (e.g., in the Estonian branch of Nordea Bank and at AS Eesti Krediidipank). Unlike the Young Person's Savings Account, a child's account at AS Eesti Krediidipank can be opened by the legal guardian of the child only, but contributions can be made to the account by other persons as well. The interest rate on the children's deposit account with Nordea Bank is 1.2%^{*35}, and for Eesti Krediidipank it is 4%.^{*36} The latter bank states that if the children's deposit account holds over 150,000 EUR, the bank will not pay any interest on the amount in excess of 150,000 EUR. The bank expects regular payments to the children's deposit account—at least 72 EUR a year. After the conclusion of the contract, the bank will contribute premium interest in the amount of 50 EUR on the child's account. In cases where the account's value is at least 30,000 EUR, the legal guardian does not have to continue regular payments to the child's deposit account. A legal guardian can apply for withdrawal from the deposit account only in the month when the child reaches seven, 10, or 15 years of age, provided that the contract has been in force for at least three years and the withdrawal is necessary to cover the daily needs of the child. The bank is entitled to limit the maximum amount in a child's deposit account. Once the child reaches 18 years of age, the resources on the deposit account will be made available for the child on his or her own account.^{*37}

We can conclude that the children's deposit in Estonian banking and the Young Person's Savings Account of the Islamic Bank of Britain have a common aim—to start raising funds for the young person from an early age. The children's deposits provided for in the Estonian banks largely target the needs of a child who is coming of age, while the resources contributed to the Young Person's Savings Account are available far more readily in the time when the child is growing up. That explains the significant difference between the expected revenues from the child's account in Estonia (4% from Eesti Krediidipank and 1.2% from Nordea) and the Indicative Expected Profit Rate for a Young Person's Savings Account—0.1% gross per annum.

Thus it is that in cases where the projects in which the pool of funds is involved are successful, those depositors with an On Demand Savings Account, Direct Savings Account, or Young Person's Savings Account will be entitled to a share of profit that could in certain circumstances be comparable with the interest due from a deposit of the same size in conventional banking. On the other hand, according to the principles of Sharia all financial arrangements that are operated on the basis of profit-sharing also involve the risk that the invested capital could suffer loss if the pool of funds returns a loss. However, the Islamic banks in the United Kingdom have taken measures to address such occasions and reduce the depositors' potential losses. That is, there is applicable a rule by which the Islamic bank forgoes some of the deductions

³³ Young Person's Savings Account Special Conditions, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/young-persons-savings-account/> (9.8.2011).

³⁴ Young Person's Savings Account Islamic Bank of Britain, p. 5.4.

³⁵ Child Deposit, Estonian branch of Nordea Bank AB. Available at <http://www.nordea.ee/Teenused+erakliendile/Hoiused/Lastehoius/60542.html> (9.8.2011) (in Estonian).

³⁶ Child Deposit, Interest, AS Eesti Krediidipank. Available at <http://www.krediidipank.ee/intressid/index.html> (9.8.2011) (in Estonian).

³⁷ General Terms of the Child Deposit, AS Eesti Krediidipank 1.1.2011, especially pp. 2.4–2.6, 3.2, 5.1.3, 5.2. Available at http://www.krediidipank.ee/pank/tingimused/lastehoiuse_tingimused_01.01.2011_eeesti.pdf (9.8.2011) (in Estonian).

from the investments with the pool of funds and the profit stabilisation reserve account will be administered so as to compensate for any capital losses of the depositor. It is even possible that the deposit—i.e., the invested resources—will suffer from such a loss that the funds invested are fully exhausted. In such a case, the Islamic financial institution would not earn anything either and its loss also includes the expenditures for expertise and administration costs etc. involved in the arrangement. According to the EU principles of deposit guarantee^{*38}, all deposits with banks incorporated in the EU are guaranteed by means of deposit guarantee schemes, which are mainly maintained by the banks. Accordingly, those banks providing Islamic banking services and that attract deposits first and foremost in the EU also have to make contributions to a guarantee scheme and the relevant information is disclosed in the terms of contract for the deposits. However, such a deposit guarantee scheme is not a Sharia-compliant system. The deposit contracts also comprise a section stating that if the pool of funds returns a loss, the bank will, in line with the UK banking regulations and policy, offer to make good the depositor's loss and the depositor will be entitled to the deposited resources to their full extent. Nevertheless, the depositor is entitled to refuse this offer, and the Sharia boards of Islamic banks also advise that a depositor who accepts the offer by the Islamic bank to redress any shortfall is not acting in a Sharia-compliant way.

Islamic banks in the UK also provide further rules with regard to the application of deposit guarantee scheme arrangements in relation to loss of resources deposited with the Islamic financial institution and being part of the pool of funds. If the provider of Islamic banking services will not be able to return the amount deposited, the depositor is entitled to apply to the UK Financial Services Compensation Scheme in order to receive compensation. However, if the depositor has suffered loss and refused the offer of payment by the provider of Islamic banking services, the depositor will not be able to apply to the Financial Services Compensation Scheme for payment. It is worth reiterating here that all banks operating in the EU are bound by the obligation to participate in the deposit compensation schemes; therefore, all banks providing Islamic banking services under a banking licence of the EU are subject to the same obligation—making payments to the deposit compensation schemes in order to redress any losses of the deposits for depositors whose bank has failed. The regular payments by the banks to the deposit guarantee scheme are a financial obligation and especially burdensome to a bank whose practices in general do not approve the means of deposit guarantee schemes and whose customers have been constantly advised accordingly that applying for compensation from a deposit guarantee scheme is not a Sharia-compliant behaviour. *Inter alia*, it is not Sharia-compliant since most funds in the deposit guarantee schemes have been raised by conventional banks that do not pay attention to what is permissible or impermissible from the point of view of Sharia scholars: paying and receiving interest and/or earning from the alcohol, gambling, and pork industries; even music-related industries are regarded as *haram* (forbidden) from the point of view of several Sharia scholars.

3. Term deposits

The Islamic savings accounts touched upon above entitle the depositor to easy access to the resources deposited, enabling the depositors to take care of their daily financial needs as well as earn some profit from the deposited money. Higher profit rates are available for term deposits both in conventional banks and in Islamic banks. The Islamic Bank of Britain makes available fixed-term deposits of three, six, 12, 18, and 24 months. With Estonian banks, it is possible to deposit money for 1–12, 24, 36, 48, or 60 months. In cases of larger sums, it is also possible to deposit money for shorter terms with Estonian banks: two days or 1–3 weeks.^{*39}

Both the Islamic Bank of Britain and Estonian credit institutions apply the requirement of a minimum deposit for term deposits. With regard to the minimum sums in Estonian banks, this is 100–200 EUR at most Estonian credit institutions^{*40} and 350 EUR at Marfin Bank.^{*41} In Estonian banks, the minimum

³⁸ Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay. – OJ L 68, 13.3.2009, pp. 3–7.

³⁹ Interest rates of deposits, Swedbank. Available at <https://www.swedbank.ee/private/investor/deposits/my/interests> (in Estonian); Deposit interest rates, Sampo Pank. Available at <http://www.sampopank.ee/en/25489.html> (6.8.2011).

⁴⁰ Interest rates of deposits, Swedbank. Available at <https://www.swedbank.ee/private/investor/deposits/my/interests>; Interest rates, term deposits SEB Bank. Available at <http://www.seb.ee/en/investments-and-deposits/deposits/term-deposit#interest-rates> (4.8.2011).

⁴¹ Interest rate, Marfin Bank. Available at <http://www.marfinbank.ee/?id=4549e113> (4.8.2011).

amount that can be deposited also may vary, depending on whether the money is deposited at the bank office, via phone services of the bank, or via Internet banking facilities. Usually the thresholds for the minimum amount are higher when the deposit contract will be concluded in the bank office or via phone services and lower in cases wherein the contract will be concluded by means of Internet banking—the minimum amounts at AS Sampo Pank being 300 EUR for deposit contracts concluded in the bank office or via Sampo Telephone Bank and 65 EUR (or the equivalent in other currencies) if the money will be deposited via Sampo Internet Bank.^{*42} The Islamic Bank of Britain requires that at least £1,000 be deposited, and only pounds sterling will be acceptable.

With regard to the revenue from the deposits, in the Islamic Bank of Britain the profits for three-, six-, and 12-month term deposits will be calculated and paid on maturity, but in the case of an 18- or 24-month deposit, the depositor can choose whether the profits will be paid quarterly or retained on the depositor's account to be reinvested along with the deposited amount, with the full amount paid on maturity. The idea in the Islamic Bank of Britain under which the 18- and 24-month deposits' profits can be paid quarterly may seem unusual in that it diverges from the practice of several Estonian credit institutions.^{*43} At the same time, it is understandable from the perspective of Islamic economic principles—the Fixed Term Deposit Account is a joint venture of the bank acting as an agent and the depositor, so if the joint venture is successful, it is fair to distribute profits already in the course of the venture. However, as a rule, the client cannot terminate the Fixed Term Deposit Account, nor may he or she withdraw funds from it (or add them) before the arrival of the maturity date.

The Fixed Term Deposit Account is operated on the 'wakala principle'^{*44}; that is, the deposited money will be invested by the bank in Sharia-compliant transactions. The bank will calculate the profit generated on the deposit and credit the account of the depositor on the basis of accrual as of the payment date—i.e., upon the deadline set in the contract coming to pass. Unlike in the cases of the other accounts discussed above, the scheme for calculating the share of profit has not been specified for this account; in the Special Conditions, in paragraph 2.6.4, the Islamic Bank of Britain indicates only that 'we will endeavour to achieve the expected profit rate'^{*45}. For the Fixed Term Deposit Account, the bank will be entitled to an agency fee (*wakala* fee) of £1 and any profit generated through investment of the deposit amount that exceeds the expected profit as an incentive. If only the expected profit rate is achieved, the bank will be entitled to only the *wakala* fee.

Before one enters into a contract, it is always advisable to study the expectations of the bank regarding the possible revenue. The expected profit rate for the latter fixed-term deposits range from 0.1% gross per annum for three-month deposits to 4% gross per annum for two-year deposits. Although the presentation of the Indicative Expected Profit Rates (gross per annum) of banks providing Islamic banking services looks very similar to the presentation of interest by banks engaged in conventional banking, it is nevertheless different, since the Islamic Bank of Britain indicates in its special conditions for various accounts that the bank will not be liable for any shortfall of the actual profit paid for the deposit on the payment date from the profit expected in view of the published expected profit rate.^{*46}

The fees and profits will be calculated according to the same system in the case of a 60 Day Notice Account—the *wakala* fee is £1, and the bank will be entitled to any profit generated by investment of the deposit amount that exceeds profit at the expected profit rate. The expected profit rate for a 60 Day Notice Account is 1%. This is most comparable to the expected profit rate for a Fixed Term Deposit Account for six months, which is 1.25%. As the name of the 60 Day Notice Account indicates, 60 days-notice will be necessary for making a withdrawal from the account. The 60-day notice to make a withdrawal is a term of

⁴² Deposit interest rates, Sampo Pank. Available at: <http://www.sampopank.ee/en/25489.html> (7.8.2011).

⁴³ In Sampo Pank the interests will be paid on maturity, see: Term Deposit. Overview. Available at <http://www.sampopank.ee/et/10435.html> (09.08.2011) (in Estonian). In Swedbank there are monthly interest payments available for term depositors, in such cases lower interest rates will be applicable, e.g., for a 24-month deposit of EUR 2000 with the interest payable upon maturity the interest rate of 2.5 will be applicable, but in case of monthly interest payments, the interest rate of 2.00% will be applicable. Interest rates of deposits; Swedbank. Available at <https://www.swedbank.ee/private/investor/deposits/my/interests> (6.8.2011).

⁴⁴ لَوَّكُو, "wakala", entrust, assign, put in charge: H. Wehr. A Dictionary of Modern Written Arabic. J. Milton Cowan (ed.). 4th ed. Considerably enl. and amended by the author, Spoken Language Services, Inc., Urbana, IL, US 1994, p. 1283.

⁴⁵ Special Conditions, Fixed Term Deposit Account p. 7.4, Islamic Bank of Britain, 6.8.2011.

⁴⁶ Target Profit Rates, Savings and Term Deposit Profit Rates, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/target-profit-rates/> (6.8.2011).

contract with utmost bindingness—the Special Conditions of the 60 Day Notice Account (paragraph 4.6) state that in the case where the client has declared upon giving the 60-day withdrawal notice that the money will be collected in person and the withdrawal has not been made within 21 days, the bank shall deem the notice to have expired and a further 60-day term of notice will be applicable.

The consequences of cancellation of a term deposit differ significantly between Islamic banking and the Estonian credit institutions we have taken as examples of conventional banking. Estonian banks state in their contract terms that if a client initiates the cancellation of a term deposit, the client will be entitled to only the amount of the deposit and not to the interest.^{*47} Furthermore, in some cases, a contractual penalty will be applicable.^{*48} If the Islamic Bank of Britain agrees to an early withdrawal from a 60 Day Notice Account, the bank will return the sum for whose early withdrawal the client applied from the account (up to the full deposit amount—the minimum opening balance for a 60 Day Notice Account is £250; the amount in the deposit account may later fall to below £250, though the bank is entitled to close the account on the basis of available funds only if there is a zero balance for three consecutive months^{*49}) and an amount of expected profit that is equal to the minimum profit expected from the savings account funds available in the bank. The expected profit rate for 60 Day Notice Accounts is 1% gross per annum, and the lowest Indicative Expected Profit Rate (gross) per annum was 0.05% for an On Demand Savings Account as of 5 August 2011. Therefore, if the client applied for an early withdrawal from a 60 Day Notice Account, the client will have the amount required from the account (up to the full deposit amount) and instead of the expected profit rate applicable to a 60 Day Notice account, the client will be entitled to profit at 0.05% gross per annum. We can conclude from the above comparison that in some respects—namely, elements of early withdrawal—term deposit contracts with the Islamic Bank of Britain are more favourable to the client than are term deposit contracts in the Estonian banks, where the client will lose the interest and in some cases even the deposited amount will be reduced by a contractual penalty.

With regard to protection of the interests of depositors, clients will be notified if there are changes in the expected profit rates. In case the deposit amount is at risk due to unforeseen circumstances, the bank goes beyond this information procedure by terminating the deposit contract immediately and returning the full amount deposited, along with the profit accrued up to the date of termination.^{*50} Unlike those for the accounts discussed earlier in this article, the contracts for the Fixed Term Deposit Account and 60 Day Notice Account do not give any special advice^{*51} on deposit guarantee schemes, which are compulsory according to EU directives on deposit guarantees. However, the outlined Special Conditions for the Fixed Term Deposit Account (paragraph 2.5.6) and the Special Conditions of the 60 Day Notice Account (paragraph 2.6.5), in fact, could be regarded as more favourable for the depositor than is the EU deposit guarantee mechanism, since in paragraph 2.5.6 the bank commits itself to returning the deposit and accrued profits to their full extent in the event of unexpected failure, for a maximum deposit of £100,000 for a 24-month fixed-term deposit. Thus the maximum deposit guaranteed by the Islamic Bank of Britain is greater than the guarantee provided for in Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19 on deposit guarantee schemes where the coverage level and pay-out delay are concerned, with Article 1 (3) stating that from 31 December 2010 on, the coverage for all aggregate deposits of each depositor will be 100,000 EUR in the event of deposits being unavailable.^{*52} Since on 5 August 2011 the euro–sterling exchange rate was 1 EUR = 0.86905 GBP^{*53}, one cannot deny that the guarantee given by the Islamic Bank of Britain to depositors under the contract for a Fixed Term Deposit Account or 60 Day Notice Account could in some circumstances be more favourable than the relevant arrangements provided for in the EU directive.

⁴⁷ Term Deposit. Terms and Conditions, SEB, p. 3.5, 3.6. Available at http://www.seb.ee/files/tingimused/tahtajalise_hoiuse_tingimused_est.pdf (9.8.2011) (in Estonian).

⁴⁸ Terms and Conditions of Receiving and Serving Term Deposits, Citadele pank, p. 6.4.3. Available at http://www.citadele.ee/common/img/uploaded/doc/ee/term_and_cond_term_dep_private_ee.pdf (in Estonian); Term Deposit, Citadele bank. Available at <http://www.citadele.ee/ee/fees/deposits/term/> (9.8.2011) (in Estonian).

⁴⁹ Special Conditions, p. 1.9 and 1.10, 60 Day Notice Account, Islamic Bank of Britain, 9.8.2011.

⁵⁰ Special Conditions, p. 2.5.6, Fixed Term Deposit Account, Islamic Bank of Britain.

⁵¹ Just a footnote on the last page of the Special Conditions of the Fixed Term Deposit Account and 60 Day Notice Account.

⁵² Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19 on deposit-guarantee schemes as regards the coverage level and the payout delay. – OJ L 68, 13.3.2009, pp. 3–8.

⁵³ Euro exchange rated GBP, European Central Bank. Available at <http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-gbp.en.html> (6.8.2011).

4. Conclusions

From the descriptions above for different Islamic savings products, we can see that, before entering into a contract with the bank, a customer can learn how the expected share of profit will be calculated and thereby also the relevant operation fees and expenses determined, but only in the form of a percentage of the average pooled funds during the calculation period. Likewise, the bank's share of the distributable profit will be provided in terms of a percentage of the distributable profit (which is 50% with the On Demand Savings Account, 50% for a Young Person's Savings Account, and 40% where a Direct Savings Account is concerned). Although banks providing Islamic banking services in the EU also inform their clients of the possibilities within the framework of deposit guarantee schemes, the obligation of which arises from the relevant EU directive, the Islamic Bank of Britain underscores the deduction from the net income from the investment as a contribution to a profit stabilisation reserve (20%).^{*54} The resources in the profit stabilisation reserve account may be used for improving the distributable profits. However, in the event of the bank being subjected to liquidation according to a court order, the resources in the profit stabilisation reserve account will be given to charities, according to the special conditions for the On Demand Savings Account, Direct Savings Account, and Young Person's Saving Account.^{*55} With regard to the variety of percentages pointed out above—deductions from the profit to cover the operation fees and expenses, contributions to the profit stabilisation reserve, and the share of the bank in the profit—the bank highlights that the percentages are maximum figures and the bank may, at its discretion, reduce all of them: its share in the profit, the operation fees and expenses, and the contributions to the profit stabilisation reserve.^{*56}

The above calculations explain how the Islamic counterpart of interest in savings contracts functions. In civil law, interest can be described 1) as a contractual fee for the temporary use of capital or 2) as damages for default payment—a measure of legal protection. In both cases, in conventional financing arrangements there are applicable the principles for calculation of interest in contractual relationships in the EU, adhering therein, *inter alia*, to the interest rate applicable to the main refinancing operations of the European Central Bank, with the relevant Estonian legislation being the Law of Obligations Act^{*57}'s §94. Although said section concentrates on interest and not interest-like measures, to address default payments we do note that in the event of default, the additional rules would be applicable—in the Estonian legislation, the Law of Obligations Act in its §113 (1) states that the interest on delay / penalty for late payment includes the interest rate applicable to the main refinancing operations of the European Central Bank and additionally 7% per year unless an interest rate exceeding the rate provided by law has been agreed upon beforehand.

Therefore, when comparing the returns to the depositor with a provider of Islamic banking services with the interest payable to the depositor with a conventional bank, one should leave the treatment of penalty interest for delay outside the scope of consideration. In Islamic banking, there are different principles for addressing the payment, for fulfilling contractual obligations.^{*58} When depositing resources in a conventional bank, the depositor will know the amount of the return—the return of the transaction that is guaranteed as soon as the amount and period of the deposit have been fixed—beforehand, since the Credit Institutions Act^{*59} (§89 (5)) and also other relevant legal acts in the EU provide that banks have to disclose, among other data, the interest rates. When making a deposit in the Islamic banking system, one can only consult the list of expected returns. The Islamic Bank of Britain meets the requirement for disclosing information on returns through displaying, monthly, the Indicative Expected Profit Rates (gross) under the nomination of target profit rates, with an additional disclaimer stating that the target profit rates may be subject to change due to potential volatility in Commodity Murabaha markets.

We can conclude that, although revenues from Islamic savings deposits may be similar to interest on deposits with conventional banks in certain circumstances, the ideology behind interest in conventional banking and profit in Islamic banking differ. In both cases, the deposited money will be managed so as to generate returns; however, it will be calculated in accordance with different principles.

⁵⁴ Profit Sharing Ratio, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/target-profit-rates/profit-sharing-ratio/> (6.8.2011).

⁵⁵ Special Conditions Direct Savings Account, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/personal-banking/savings-products/direct-savings-account/> (6.8.2011).

⁵⁶ Profit Sharing Ratio, Islamic Bank of Britain. Available at <http://www.islamic-bank.com/target-profit-rates/profit-sharing-ratio/> (6.8.2011).

⁵⁷ Võlaõigusseadus. – RT I 2001, 81, 487; RT I, 8.7.2011, 6 (in Estonian).

⁵⁸ AAOIFI Shari'a Standard No. 3 Default in Payment by a Debtor, 2000.

⁵⁹ Krediidiasutuste seadus. – RT I 1999, 23, 349; RT I, 8.7.2011, 6 (in Estonian).