

## *A unique banking technique in the service of ethics and sustainability: the “public benefit account”*

**Motto:** : “O, you who believe, do not consume *riba*, doubled and multiplied, but fear Allah.” (Qur’an 3:130)

**Összefoglalás:** A Saría, mint tradicionális iszlám jog, amely a Korán előírásaira és a Szunnákból levonható tanulságokra épül, egyértelműen tiltja kamat (*riba*) kikötését. A speciálisan Saria-kompatibilis eljárásrenddel rendelkező iszlám pénzügyi intézmények ezért alakították ki a “Public Benefit Account” (közhasznú/jótekonysági számla) lehetőséget, annak érdekében, hogy a Saría által tilalmazott (*non-halal*) tranzakciókból származó és a kamatalapú bevételeket oly módon tisztítsa meg, purifikálja, hogy azokat közhasznú, jótekonny célokra adományozza. Ez a joggyakorlat nagyban járul hozzá az iszlám bankszektor társadalmi szempontú fenntarthatóságához.

**Kulcsszavak:** Saría; iszlám bank; „Public Benefit Account”; kamat; társadalmi fenntarthatóság.

**Abstract:** Sharia, as a traditional Islamic law based on the Quran and the Sunnah, clearly prohibits the charging of interest (*riba*). Islamic financial institutions with specially designed Sharia-compliant procedures have therefore developed the “Public Benefit Account” option to purify interest-based income from transactions prohibited by Sharia (*non-halal*) and to donate it to charitable purposes. This good practice greatly contributes to the social sustainability of the Islamic banking sector.

**Keywords:** Sharia; Islamic bank; “Public Benefit Account”; interest; social sustainability.

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## Introduction

The operation of the Islamic Banking transactions has to be compliant with *Shariah*, the traditional Islamic Law. Islamic financial institutions have to prohibit *Riba* (interest), because it is *Haram* /forbidden by Allah/ [1]. Innovative products and services of Islamic Banking had been widely reported. The products include *Mudarabah* that is profit and loss sharing. Profit and loss sharing /PLS/ is the method utilized in Islamic banking to comply with the prohibition of interest. The Islamic solution, commonly referred to as PLS [2], suggests an equitable sharing of risks and profits between the parties involved in a financial transaction. In the PLS method banking business, there are so three parties. The customers are treated as partners who invest either labor or an equal portion of capital [3, 4]. The most distinguishing features of an Islamic bank, which differentiates it from a conventional bank, is to be free of the most deadly forbidden elements of over usury /*Riba*/, uncertainty /*Gharar*/ and gambling /*Maysir*/, also to avoid conducting other unlawful trading methods. Ensuring effective Shariah compliance, however, is not a straightforward matter. As financial markets are frequently becoming sophisticated, intensified product innovations and engineering in Islamic finance entail the genuine concern over the need to strengthen Shariah compliance throughout the product life cycle. Indeed, failure to comply with Shariah not only invokes financial risk but also may eventually expose the Islamic bank to the risk of breaking the trust and confidence of investors and depositors [5].

If we accept that two of the key pillars of sustainability are the long-term sustainability of economic and social development [6], then we can see that the values - including primarily charity as a means of eradicating poverty and hunger and eliminating social inequalities - conveyed by Islamic banks can play significant role in the development of such a financial sustainability strategy.

## The Public Benefit Account

Shariah compliance is a fundamental requirement of Islamic Financial Institutions (IFIs). Under the current practices of IFIs, it is the duty of Shariah departments along with the Shariah Supervisory Board (SSB) to monitor, audit, check, certify and approve financial products and services offered according to the requirements of Islamic financial laws [7]. When a financial transaction is found to be in violation of the Shariah, the SSB will accordingly need to decide whether the financial transaction is void; or needs to be rectified; or its cost shall be borne by the IFI and/or the profit earned represents Shariah non-compliant (SNC) earnings [8].

In Islamic banking thus a Shariah Governance Framework is operating. Illegal funds are kept in an independent account which is open in the bank's books called the Charity Account (or Public Benefit Account) [9]. Unstandardised practice is also reflected in the lack of a common name for the account within the industry. There are several terms used in the literature to name the account in which funds are pooled and transferred by the IFI for such charitable contributions. These are: Charity Funds [10], Public Benefit/Charity Account [11] and Welfare Account [12]. For the purpose of this article, the term charity account is preferred as it is believed that this term reflects the most accurate definition of it.

In Islamic banking unlawful incomes still mistakenly procures through some impermissible means. Illegal funds are created either by unintentional forms such as interest on bank deposits with other banks or by foreseen forms such as delay penalties, but not limited to: interest from open accounts of the bank with the Central Bank, traditional banks or other institutions, as some banking laws require that the depositor be entitled to interest on deposits calculated on the basis of balance and duration; the delay penalties that the debtor bank is required to pay, in accordance with the approved financing contracts and agreements; compensation and surpluses established for the benefit of the bank by the court order for amounts overdue; or the

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profits of the finance and the financial operations in which the violation occurred, after reviewing and verifying the internal audit department or the external legal auditor and after the approval of the Shariah Supervisory Board (SSB). General provisions should be initiated in order to avoid the non-halal incomes: first, the bank must make a profit from graft in all its transactions, and seek not to enter it in any way. In the form of the collection of a Haram reward, it must be avoided in the Public Benefit Account; second, the bank must ensure that all agreements and contracts with other parties are free from prohibited conditions such as Riba-based interest, etc. under any circumstances and under any name. The bank shall take the initiative to dispose of the forbidden funds by distributing them in the good and public interest, and not to annex them to their assets or to benefit from them in any way of utilization; and third, it is not permissible to confuse the accounts of Zakah /donation/ [1], the donations paid by the bank if any, and the Public Benefit Account, but each of them shall have a special account, which shall direct its amounts to its legitimate banks [9]. The bank, however, may not refund Riba-based interest, which may be settled in its account without agreement with other banks, to the party that paid it, and it shall be included in the Public Benefit Account.

Every time a Minutes of Meeting has to be presented at the first meeting of the Shariah Supervisory Board (SSB). The bank shall establish the Committee for the Conduct of Public Benefit, which studies the demands received and determine their priority. This committee also determines the parties to which the funds will be disbursed and the amounts to be utilized for each entity. The committee consists of the General Manager; the Director of Public Control Pole; the Compliance Manager (Rapporteur of the Committee); and the Director of Product Pole and Quality [13].

## The Activities of the Committee for the Conduct of Public Benefit

A majority of its members shall take decisions of the Committee for the Conduct of Public Benefit. The Committee shall consider the requests for assistance received by the bank, as well as decide and confirm its decisions. Building on the above, this Committee discusses the purification of non-halal income from modern sources. According to them, the bank has to purify such income in order to avoid the sins of keeping the unlawful money and preventing them from utilizing it. The bank shall expedite the disbursement of the funds of the Public Benefit Account. However if disbursement from the Public Benefit Account requires certain procedures or approvals, it will be delayed as needed [11; 14].

The bank is also obliged to disburse a certain percentage of the account balance within one year from the date of collection. The allocation of a sum of money from the Public Benefit Account shall be credited to an account with the bank on behalf of a certain entity and approved under this policy. Meanwhile, it is not permissible to invest public benefit funds in an investment account or any other account. If any profit is realized from a provision made to a party, from a Public Benefit Account, it is credited to the concerned party and the bank is not entitled to any of it. A Public Benefit Account may be disbursed to assist those who have a formal license in the activity with a full legal file and for those having activities within one of the following sectors: construction, renovation and furnishing of educational and public; the field of training, training and scientific research that benefits the society provided that the training is for non-employees of the bank who are trained for the general benefit and dissemination of Islamic sciences; charity activities /such as care for orphans, elderly people, disabled persons, etc./; contributing to the launching of micro-projects for the disabled, people in need, orphans, etc.; applications are subject to medical or surgical intervention for those in need; the active bodies in the field of teaching Quran and for khateeb /a person who delivers the sermon; literally: narration/ [15]; and supporting scientific research in the field of Islamic studies [16].

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The bank shall pay the public benefit amounts according to the priority of the sectors already mentioned. The first three points shall account for 80% of the amounts spent annually from the account, and the remaining 20% shall be spent on the last three sectors. In addition, the disbursement procedures shall be determined from the account for each sector mentioned above in a detailed disbursement manual showing the required documents and the manner of disbursement. Likewise, the beneficiary should send a report on the use of such funds, supported by evidence. Additionally, no payment may be made without the approval of the Committee, and the funds of the account can not be used to put files in retroactively. As for taxes on the funds of the public benefit account, it may be paid from it. Whereas, this shall not apply to taxes levied on the assets of the bank. It is permissible to dispose of the Public Benefit Account for the purchase of a property or movable property and to grant it to a charity. The bank's conduct with these funds and its consequences must be disrupted, because the exit of the bank to the disposal of the charity is achieved by the due disposal of these funds [8].

Consequently, it is not permissible to dispose of the Public Benefit Account with respect to the bank's direct or indirect benefit, or the provision of any expenses, including payment of interest accounts correspondents or taxes incurred by the bank in its work and activities. Moreover, the bank is not allowed to reduce the due performance regarding to the amounts disbursed or for training the bank's staff in particular, or research and studies related to the bank's business. Besides, the Public Benefit Account cannot be used for protection of the real value of bank funds from the effects of currency fluctuations or to deposit amounts that the bank is required to put in the Central Bank or other bank. In addition, it cannot be used in the performance of fees or amounts to which the Bank is committed to contribute to the subscription of its share in the Bank Deposit Guarantee Fund or others or as support for non-performing loans, as well as to write off the deceased or doubtful debts. It is also not permissible to take the Eid / Eid al-Adha, also called the Festival of Sacrifice, is the second of two Islamic holidays celebrated worldwide each year - the other being Eid al-Fitr- and considered the holier of the two/ [17] sacrifice from the account of public benefit because it is a religious rite, in which Muslims draw close to their Lord. Moreover, it is not allowed to lend from the Public Benefit Account, because this is a deliberate delay in paying it, and if the person who is to be lent from it is in need, it should be given instead of lending it [11, 8].



Finally, the bank's staff and its frameworks are not included in the public interest. They are also keen to deepen their knowledge in the field of Islamic banking, as well as providing books, magazines and specialized documents for them in the fields of banking activity and the various social services are not intended for the benefit of the bank's employees. The bank must provide such assistance to its beneficiaries from the budgeted sections. In case of any violation of the above principles or a payment to a party not approved by the SSB and objected thereto, the amounts paid by the bank shall be charged and returned to the General Interest Account [11, 8].

## Conclusion

Islamic banks, while providing surplus to their customers, are competitive with conventional Western banks. Their clients in the 21<sup>st</sup> century are not motivated in their choice primarily by religious fundamentals but rather by the quality of services and the right price-value ratio. However, the functioning of these banks is perceptibly pervaded by moral values, and lay stress on charity as well (Balázs et al, 2019).

Islamic banking as opposed to the conventional Western banking system, is working on the principles of Shariah, the Islamic religious law. It is based on religious and moral foundations, so it has to be free of the most deadly forbidden elements of over usury */Riba/*, uncertainty */Gharar/* and gambling */Maysir/*, also aims to avoid conducting other unlawful trading methods as well. Ensuring effective Shariah compliance, however, is not a straightforward matter. Even Islamic banks can generate a portion of non-halal income through invalidity of contracts that govern certain products, contracts that do not fulfil the pillars and the conditions, unlawful business banking operations and the interest received from conventional banks. The identification of such income is crucial for the purification process, though this is a special moral service that only these banks are able to offer to their clients. The way these banks give the impure income away for charity purposes and their donation process is an example to follow for Western commercial banks as well.

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Since one of the key pillars of sustainability is the long-term sustainability of economic development, we see that the values conveyed by Islamic banks can play a significant role in the development of such a financial sustainability strategy. The Public Benefit Account is one element of the techniques of Islamic banking. In light of this, it is no wonder that IFIs enjoy great popularity worldwide. Taking into account the fact that the Public Benefit Account is suitable for realizing several of the 17 Sustainable Development Goals /SDGs/ of the 2030 Agenda for Sustainable Development of the UN [19], as means of long-term economic and social development, we can conclude that this legal institution of financial law should be studied by the conventional Western banking system as well.

