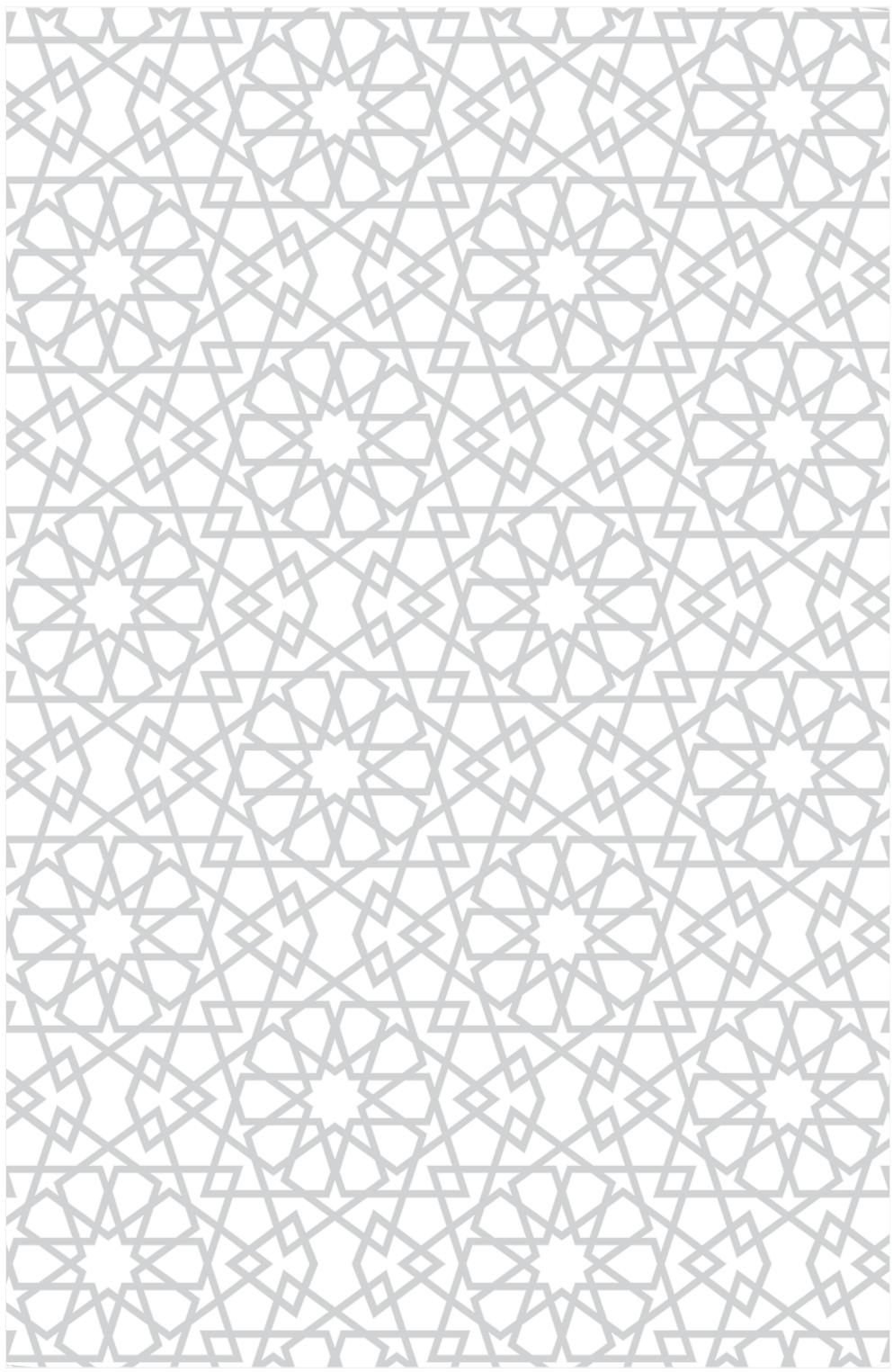


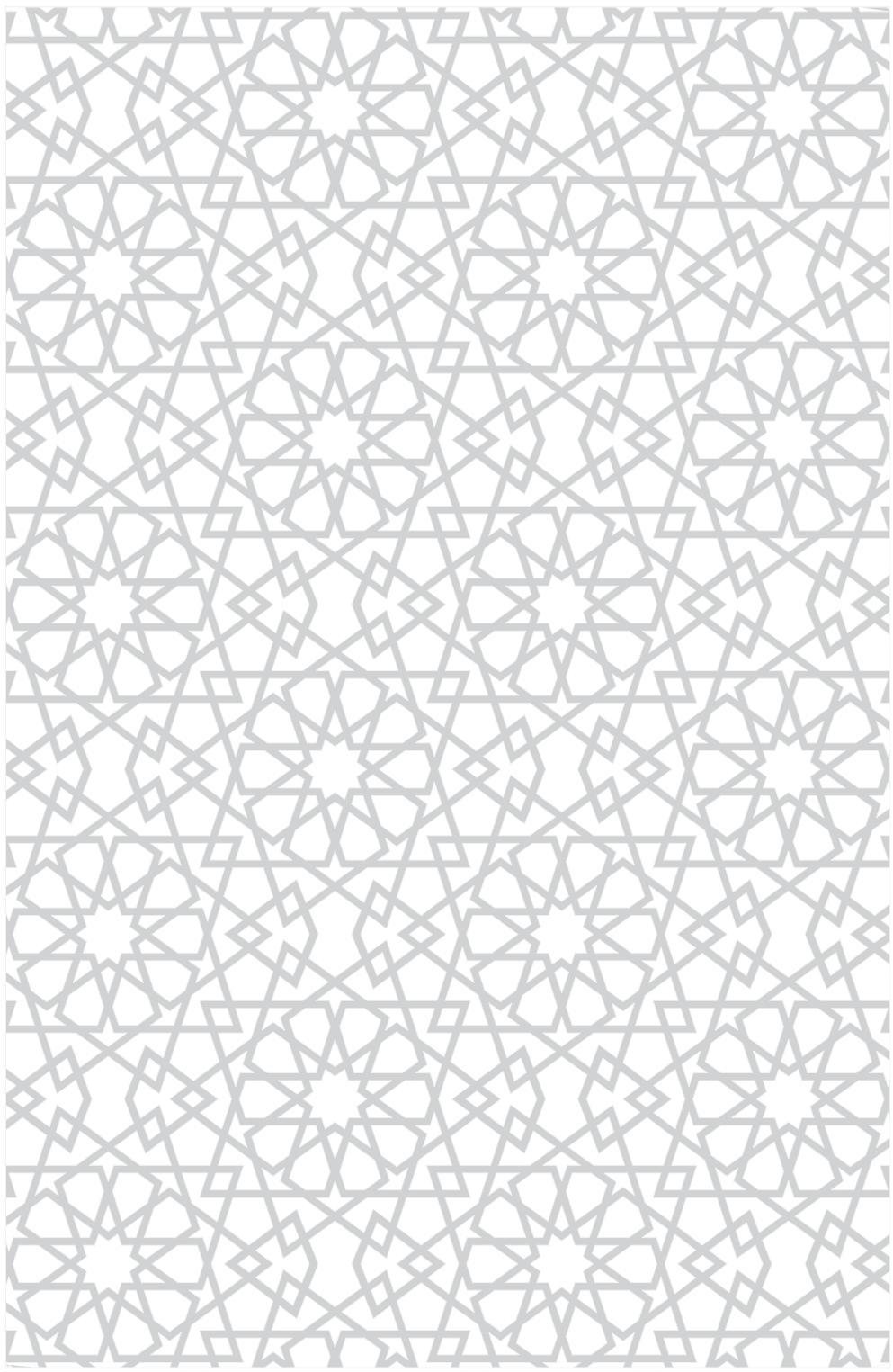
Shari'ah Standard No. (3)

Procrastinating Debtor
(Revised Standard)



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IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

Preface

The purpose of this standard is to explain the Shari'ah rulings applicable to the transactions of Islamic financial Institutions⁽¹⁾ relating to solvent debtors and/or guarantors procrastinating in settling their obligations and contractors delaying in fulfilment of their obligations, which invokes penalty stipulated in the contract.

(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Statement of the Standard

1. Scope of the Standard

This standard covers cases of default on the part of a solvent debtor or a solvent guarantor, and the case of a contractor or concessionaire who is late in completing work and thus becomes a debtor by virtue of a penalty clause.

The standard does not cover debtors who are insolvent or bankrupt, or debtors who delay payment for an established Shari'ah reason.

2. Shari'ah Ruling

2/1 Default in payment by a debtor

2/1/1 Default in payment by a debtor who is capable of paying the debt is *Haram* (prohibited).

2/1/2 It is not permitted to stipulate any financial compensation, either in cash or in other consideration, as a penalty clause in respect of a delay by a debtor in settling his debt, whether or not the amount of such compensation is pre-determined; this applies both to compensation in respect of loss of income (opportunity loss) and in respect of a loss due to a change in the value of the currency of the debt.

2/1/3 It is not permitted to make a judicial demand on a debtor in default to pay financial compensation, in the form either of cash or of other consideration, for a delay in settling his debt.

2/1/4 The procrastinating debtor is liable for legal and other expenses incurred by the creditor in order to recover his debt.

2/1/5 The creditor is entitled to apply for the sale of any asset mortgaged as collateral for the debt, for the liquidation of the debt. He is equally entitled to stipulate that the debtor must give a mandate

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to the creditor to sell the mortgaged asset without recourse to the courts.

2/1/6 Unless failure to pay was caused by force majeure, it is permissible to stipulate that all outstanding instalments become due once the procrastinating debtor fails to pay an instalment. It is preferable that this clause is implemented only after notifying the debtor and after the lapse of a reasonable period of time. [see Shari'ah Standard No. (5) on Guarantees (item 5/1)]

2/1/7 In the case of a Murabahah sale, if the asset that was sold is still available in the condition in which it was sold, and the buyer has defaulted in the settlement of the price and has later become bankrupt, then the seller (the Institution) is entitled to repossess the asset instead of initiating procedures to obtain a bankruptcy order.

2/1/8 It is permissible in contracts involving indebtedness (such as Murabahah) to stipulate an undertaking by the debtor, that in case of procrastinating in payment, the latter will donate an amount or a percentage of the debt to be spent for charitable causes through the Institution.

2/2 Guarantor

- a) It is permissible for a creditor to demand that a debt be settled by the debtor or the guarantor of the debtor, unless the guarantor stipulated that the settlement must first be sought from the debtor.
- b) All rulings applicable to debtors in default are equally applicable to guarantors in default.

2/3 Contractor

It is permissible to include penalty clauses in contracts for construction, Istisna'a and supply contracts. In case of a refusal to pay the amount due under a penalty clause, the rulings relating to default by a debtor would be applicable. It is permitted to deduct the amount from outstanding amounts due to the contractor.

2/4 Non-material punishments for default in payment

The Institution is entitled to include the name of a debtor in default in a list of undesirable customers (black list) and to send a warning admonition to other companies about the defaulting debtor, either when there is an inquiry from other companies about the debtor or when such 'black lists' are exchanged between companies directly.

2/5 General rulings

2/5/1 The Institution is entitled to [monitor and] investigate [the financial status and activities] of a defaulting debtor through all permissible and legitimate means.

2/5/2 The Institution may accept a payment from a debtor who is in default that is in excess of the amount of the debt, provided there is no contractual condition whether written or verbal, or custom or mutual agreement relating to this additional amount.

2/5/3 It is permissible for the Institution to stipulate in a contract dealing with indebtedness that, if the debtor is late in making payment, the Institution is entitled to recoup the amount due from any of the accounts of the customer with the Institution, whether current accounts or investment accounts. This may be done without getting any further consent of the debtor provided the balance in the account is of the same currency as that of the debt. If, however, the currency is different, then the rate of exchange to be used must be the then prevailing rate of exchange.

2/6 Establishment of default in payment

Default in payment is established when, following a normal demand for payment, a debtor who has not proved that he is insolvent fails to settle the debt on its due date.

3. Date of Issuance of the Standard

The Standard was issued on 27 Safar 1421 A.H., corresponding to 31 May 2000 A.D.

Adoption of the Standard

The Shari'ah Standard on Procrastinating Debtor was adopted by the Shari'ah Board in its meeting No. (4) held on 25-27 Safar 1421 A.H., corresponding to 29-31 May 2000 A.D.

Appendix (A)

Brief History of

the Preparation of the Standard

In its meeting No. (1) held in Bahrain on Saturday 11 Dhul-Qa'dah 1419 A.H., corresponding to 27 February 1998 A.D., the Shari'ah Board decided to give priority to the preparation of a Shari'ah standard on procrastinating debtor.

On Saturday 11 Dhul-Qa'dah 1419 A.H., corresponding to 27 February 1999 A.D., a Shari'ah consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 13-16 Rabi' I, 1420 A.H., corresponding to 27-30 June 1999 A.D., the Shari'ah Studies Committee discussed the juristic study and introduced certain amendments to it. The Committee further discussed the exposure draft of the standard in its meeting No. (3) held in Bahrain on 9-11 Rajab 1420 A.H., corresponding to 18-20 October 1999 A.D., and asked the consultant to make additional amendments to reflect the comments made by the members.

The revised exposure draft of the standard was presented to the Shari'ah Board in its meeting No. (2) held in Mecca on 10-15 Ramadan 1420 A.H., corresponding to 18-22 December 1999 A.D. The Shari'ah Board made further amendments to the exposure draft of the standard, and decided that the amended exposure draft should be distributed to specialists and interested parties to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29–30 Dhul-Hajjah 1421 A.H., corresponding to 4-5 April 2000 A.D. The public hearing was attended by more than 30 participants representing central banks, Institutions, accounting firms, Shari'ah scholars, academics and others who are interested

in this field. Members of the Shari'ah Studies Committee responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'ah Studies Committee held its meeting No. (5) on 22-24 Muharram 1421 A.H., corresponding to 26-28 April 2000 A.D., to discuss the comments made about the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing, and the written comments that were received.

The Shari'ah Board in its meeting No. (4) held on 25–27 Safar 1421 A.H., corresponding to 26-28 May 2000 A.D., in Al-Madinah Al-Munawwarah discussed the amendments made by the Shari'ah Studies Committee, and made the necessary amendments, which deemed necessary. Some paragraphs of the standard were adopted by the unanimous vote of the members of the Shari'ah Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'ah Board.

The Shari'ah Standards Review Committee reviewed the standard in its meeting held in Muharram 1433 A.H., corresponding to November 2011 A.D., in the State of Qatar, and proposed after deliberation a set of amendments (additions, deletions, and rephrasing) as deemed necessary, and then submitted the proposed amendments to the Shari'ah Board for approval as it deemed necessary.

In its meeting No. (38) held in Al-Madinah Al-Munawwarah, Kingdom of Saudi Arabia on 28 Sha'ban - 1 Ramadan 1435 A.H., corresponding to 26-28 June 2014 A.D., the Shari'ah Board discussed the proposed amendments submitted by the Shari'ah Standards Review Committee. After deliberation, the Shari'ah Board approved the necessary amendments, and the standard was adopted in its current amended version.

Appendix (B)

The Shari'ah Basis for the Standard

Default on the Part of a Debtor

The debtor must settle his debt when it is due. Default in payment by a debtor who is able to settle the debt is prohibited. The Prophet (peace be upon him) says: *“Default in payment on the part of a solvent debtor is unjust.”*⁽²⁾ He (peace be upon him) also says: *“Delay in payment by a solvent debtor would be a legal ground for his being publicly dishonoured and punished.”*⁽³⁾ Moreover, he (peace be upon him) approved the statement of Salman Al-Farisi to Abu Al-Darda` saying: *“Give everyone his right.”*⁽⁴⁾ Muslim scholars have agreed on the permissibility of a debtor being punished in such circumstances.⁽⁵⁾ However, an insolvent debtor should be granted a grace period.

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- (2) Related by Al-Bukhari in his “*Sahih*” [2: 999], Dar Al-Qalam edition, Damascus, 1401 A.H./1981 A.D.; Muslim in his “*Sahih*” [10: 288], Al-Maktabah Al-Misriyyah edition with the commentary of Al-Nawawi, Cairo, 1349 A.H./1930 A.D.; and Ahmad in his “*Musnad*” [2: 71 and 345], Al-Maktab Al-Islami edition, Damascus.
- (3) Related by Ahmad in his “*Musnad*” [4: 388-399], and all relators of Hadith except Al-Tirmidhi, Al-Bayhaqi, Al-Hakim and Ibn Hibban who deemed it authentic. Al-Bukhari deemed it ‘suspended’. In his “*Fath Al-Bari*”, Ibn Hajar has said: “Its chain of transmission is good”: “*Nayl Al-Awtar*” [5: 240], Mustafa Al-Babi Al-Halabi edition, Cairo, 1378 A.H./1951 A.D.; and “*Fayd Al-Qadir*” [5: 400], Mustafa Muhammad edition, Cairo, 1371 A.H./1938 A.D.
- (4) Related by Al-Tirmidhi from Abu Juhayfah quoting the statement of Salman (may Allah be pleased with him) which the Prophet (peace be upon him) approved when mentioned to him saying: *“Salman has said the truth.”* Al-Tirmidhi said: “It is an authentic Hadith”: “*Sunan Al-Tirmidhi*” [2: 66], Bulaq Edition.
- (5) “*Bada` i` Al-Sana` i`*” [7: 173], Dar Al-Kitab Al-Arabi, Beirut, 1982 A.D.; “*Al-Muhadhdhab*” [3: 245], Dar Al-Qalam edition, Damascus, 1417 A.H./1996 A.D.; “*Al-Mughni*” [4: 501], Maktabat Riyad Al-Hadithah, Riyadh; “*Hashiyat Qalyubi*” [2: 288], Dar Al-Fikr edition, Beirut, no date; “*Mu`jam Al-Mustalahat Al-Iqtisadiyyah*”, (P. 314); The International Institute of Islamic Thought edition, Virginia, USA, 1415 A.H./1995 A.D.; and “*Dalil Al-Mustalahat Al-Fiqhiyyah Al-Iqtisadiyyah*”, (P. 274), Kuwait Finance House edition, Kuwait, 1412 A.H./1992A.D.

Stipulation of, or Legal Claim for, Compensation for Late Payment of the Debt

It is not permitted to stipulate as a condition of a contract involving indebtedness that in case of default the debtor should pay compensation, or to have a legal claim for compensation against a defaulting debtor, whether such arrangements are made at the beginning of the contract or on its maturity, since this would constitute Riba and any such stipulation or arrangement is null and void. This is because the Prophet (peace be upon him) says: "*Muslims are bound by their contractual conditions, except those that render impermissible what is permissible or render permissible what is impermissible.*"⁽⁶⁾ There is also the reason that, during the pre-Islamic period, lenders who charged interest used to say to their debtors: "Do you want to settle now or to pay an additional amount for a further period of credit?". The prohibition of any loan which requires a payment in excess of the amount lent has also been reported on the authority of many companions from the Prophet (peace be upon him). On this basis, a decision was reached by the International Islamic Fiqh Academy which reads as follows: "It is impermissible from the Shari'ah perspective to stipulate a condition of compensation in the case of delay in the settlement of a debt".⁽⁷⁾

No penalty clause may be applied in the case of a delay in settling a debt, as any increase in the amount of the debt is Riba; this is in contrast to the application of a penalty clause to other cases of delay, such as delay in fulfilling construction or Istisna'a contracts. As the judgement on this issue by the court is binding, it is therefore not permitted to stipulate such a condition directly in the contract creating a debt or to enforce it subsequently by recourse to the judiciary.

(6) This Hadith has been narrated by a number of the companions and it was related by Ahmad in his "Musnad" [1: 312]; Ibn Majah through a good chain of transmission [2: 783], Mustafa Al-Babi Al-Halabi edition, Cairo, 1372 A.H./1952 A.D.; Al-Hakim in his "Mustadrak", Hyderabad edition, India, 1355 A.H.); Al-Bayhaqi in his "Sunan" [6: 70 and 156] and [1: 133], Hyderabad edition, India, 1355 A.H.; and Al-Darqutni in his "Sunan" [4: 228] and [3: 77], Dar Al-Mahasin Lil-Tiba'ah edition, Cairo, 1372 A.H./1952 A.D.

(7) International Islamic Fiqh Academy Resolution No. (51); and "Majallat Majma' Al-Fiqh Al-Islami", No. 6 [1: 193]; and No. 6 [2: 9].

Litigation Expenses

A defaulting debtor must bear the litigation expenses and other expenses relating to his default in payment as he is the cause of the expenses.⁽⁸⁾

Disposal of a Mortgaged Asset

It is permissible for the creditor to demand the selling of a mortgaged asset and other properties belonging to a debtor which are in his possession for the purpose of liquidation and recovery of the debt. Furthermore, it is permissible for the creditor to obtain a mandate from the debtor to sell the mortgaged assets or other properties of the debtor, because such disposal is permissible for the creditor, and such a practice would speed up the procedures for disposing of the charged asset.⁽⁹⁾

Maturity of Instalments in the Case of Instalment Credit

It is permissible for the creditor to impose the condition that, if the debtor is late in paying one instalment, all the instalments become due. To this effect, there is a decision by the International Islamic Academy of Fiqh, the text of which reads as follows: "It is permissible for a seller on deferred credit terms sale to impose the condition that instalments become due before their original due date in case of the delay of the debtor in paying some of the instalments, so long as the debtor consented to this condition when the contract was agreed".⁽¹⁰⁾ Such a condition would be valid, as there is no Shari'ah text to the contrary, and it serves a lawful interest of the creditor.⁽¹¹⁾ Giving prior notice to the debtor before giving effect to such

(8) Some of the jurists have stated this such as Ibn Taymiyyah in "Al-Ikhtiyarat" and in "Mukhtasar Al-Fatawa" (P. 346), Al-Mawardi in "Al-Insaf" and Sheikh Muhammad Ibn Ibrahim Al Al-Shaykh (see: Paper by Sheikh Ibn Mani' in the Fourth Fiqh Conference (pp. 226-227), organized by Kuwait Finance House 1416 A.H./1995 A.D.

(9) "Al-Rawd Al-Murbi'", (P. 74), 2nd edition, Dar Al-Turath, Cairo.

(10) International Islamic Fiqh Academy Resolution No. (51); "Majallat Majma' Al-Fiqh Al-Islami" No. 6 [1: 193] and No. 7 [2: 9]. This has been reinforced by the Resolution No. 64 (2/7); see: "Majallat Jami'at Al-Malik 'Abd Al-'Aziz", Al-Iqtisad Al-Islami, (P. 89).

(11) Ibn Abidin says; "If one says, I have invalidated the deferred period and I have abandoned it, the debt becomes due on the spot": "Hashiyat Ibn Abidin" [5: 157], Dar Al-Fikr edition, Beirut, 1399 A.H./1979 A.D. The Shari'ah Supervisory Council of the Kuwait Finance House has supported this in its Fatwa No. (542). "Al-Fatawa Al-Shariyyah Fi Al-Masa'il Al-Iqtisadiyyah", Kuwait Finance House, [4: 18].

a condition is merely of the nature of a reminder, so as to provide him with reasonable time for payment.

The Right to Repossess a Sold Asset

If an asset sold by Murabahah or another sales contract is still available to the seller, and the purchaser has defaulted in the payment of the price, and subsequently has become bankrupt, then the seller is entitled to repossess the sold asset instead of initiating legal proceedings to obtain a bankruptcy order. This judgement is based on the report of Abu Hurayrah (may Allah be pleased with him) that the Prophet (prayers and peace of Allah be upon him) said: If one party has sold an asset and the other party (the purchaser) has become bankrupt, and the former party has managed to retain the asset, then he is more qualified to take possession of the asset in preference to the other creditors.⁽¹²⁾

A Commitment on the Part of the Debtor to Make a Donation in Case of Default

The permissibility of stipulating a condition, whereby the debtor in case of default is obliged to donate a sum of money (in addition to the amount of the debt) to be spent by the creditor (the Institution) on charitable causes, is because this has been considered as an instance of the commitment to make a donation, which is well established in the Maliki school of law. This is the opinion of Abu Abdullah Ibn Nafi' and Muhammad Ibn Ibrahim Ibn Dinar, two Maliki jurists.⁽¹³⁾

Guarantor

A guarantor is liable for anything for which the debtor whose debt is guaranteed is liable, because standing as a surety adds one obligation to another with respect to the liability. This is in line with the Quranic verse expressing the statement of Prophet Yusuf (peace be upon him) saying: {“... and I will be a guarantor to it”}.⁽¹⁴⁾ Also, the Prophet (peace be upon

(12) This Hadith has been related by Al-Bukhari in his “Sahih” [2: 846]; and Muslim in his “Sahih” [10: 221]. Also, see: “Al-Muhadhdhab” by Al-Shirazi [3: 253], Dar Al-Qalam edition, Damascus 1417 A.H./1996 A.D.

(13) See the book entitled: “Tahrir Al-Kalam Fi Masa'il Al-Iltizam” by Al-Hattab and the legal opinions of the Fourth Fiqh Conference organized by the Kuwait Finance House.

(14) [Yusuf (Joseph): 72].

him) affirmed the suretyship of Abu Qatadah in respect of the debt of a deceased person, when Abu Qatadah said; "I take responsibility as surety for both (two dinars), O Messenger of Allah."⁽¹⁵⁾ It is a principle of law that the demand for payment from either the debtor or guarantor is permissible, as this is the very essence of suretyship, so long as there is no stipulation that the demand be in sequence; that is, it must start with the debtor and once he refuses to pay, payment will be demanded from the guarantor, because this sequence is a valid stipulation and believers are bound by their stipulations.

Contractor or Concessionaire

It is permissible to impose penalty clauses in contracts for constructions, Istisna'a and supply contracts, as such clauses are included in what may be validly stipulated as part of the contract. This does not render the impermissible permissible, or vice versa, and it complies with the Hadith of the Prophet (peace be upon him): "*Muslims are bound by contractual conditions, except those that render impermissible what is permissible or render permissible what is impermissible.*"⁽¹⁶⁾ Also, this is based on the statement of Shurayh (may Allah confer mercy upon him) saying: "Whoever has bound himself by a contractual condition voluntarily without any coercion, is bound by that condition". The International Islamic Fiqh Academy has also issued a decision which states: "It is permissible to include in an Istisna'a contract a penalty clause according to what is agreed upon by the two contracting parties provided that there are no unusual circumstances."⁽¹⁷⁾ In addition, it is a juristic principle in the Hanbali school of law. This is also what has been decided by consensus of the Council of the Eminent Scholars of Saudi Arabia, in the following words: "The council has decided by consensus that a penalty clause that is stipulated in a contract is a valid and enforceable stipulation".⁽¹⁸⁾ It is well known that the stipulation of the penalty clause is permissible only for non-financial obligations.

(15) Related by Al-Bukhari in his "Sahih" [2: 800-803]; Ahmad and others.

(16) This Hadith has been previously explained under Note No. (5).

(17) International Islamic Fiqh Academy Resolution No. 56 (3/7); see also the Journal of the Academy vol. 2, issue No. (7), (p. 223).

(18) Research papers by the Eminent Scholars of the Kingdom of Saudi Arabia, vol. 1, the penalty clause, Maktabat Ibn Khuzaymah edition, Riyadh, 1412 A.H.

Non-Material Penalties Applied to the Debtor in Case of Default

The grounds for such penalties lie in the jurists' decision which is based on their interpretation of the Hadith of the Prophet (peace be upon him): "*Delay in payment by a solvent debtor would be a legal ground for his being publicly criticised and punished*".⁽¹⁹⁾ A public complaint about his default in payment is not a prohibited slander; on the contrary, there is an obligation to warn other companies about his character, as this falls under the category of advice which it is a duty to give.

General Provisions

- a) The monitoring of the affairs of the default debtor, is a kind of pursuing that has been established by the Shari'ah jurists. This pursuit is intended to make recovery from the defaulting debtor out of assets that he may have concealed from the knowledge of the creditor. In the circumstances, such pursuit does not constitute interference in the affairs of others.
- b) The debtor may, entirely at his own discretion without any condition or customary practice, pay an additional amount when settling the debt, and this is part of good settlement following the saying of Allah: {“...No ground (of complaint) can there be against the Muhsinun (good-doers)...”}.⁽²⁰⁾ Also, the prophetic Hadith says: “Verily the best of you is he who is the best in the settlement of debt.”⁽²¹⁾ The Prophet (peace be upon him), occasionally used to pay an additional amount when settling a debt. The permissibility of this practice depends on the discretionary nature of this extra payment and the absence of any stipulation or customary practice of making such a payment, since the existence of such a customary practice would be inconsistent with the condition that the extra payment be entirely discretionary and not stipulated.
- c) It is permissible to accept the extra amount paid by the debtor following the proofs mentioned earlier.

(19) This Hadith has been previously explained under Note No. (3).

(20) [Al-Tawbah (Repentance): 91].

(21) Related by Al-Nasa'i on the authority of Al-'Irbad Ibn Sariyah: “*Fayd Al-Qadir*” [3: 497].

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d) A stipulation by an Institution that it may recover amounts owing to it by a defaulting debtor by right of set-off from accounts of the debtor that are kept by the Institution is valid, since believers are bound by their stipulations. This right of set-off, even though it does not require the consent of the debtor, should preferably be documented in the contract that establishes the indebtedness, in order to shorten the procedures in case of dispute. This right is based on the amicable right of recovery that is based on Shari'ah evidence including the saying of the Prophet (peace be upon him) to the wife of Abu Sufyan: "*Take (from his property) what would suffice you and your child amicably.*"⁽²²⁾

(22) Related by Al-Bukhari and Muslim: "Al-Lu 'lu' Wa Al-Marjan", No. (1115).

Appendix (C)

Definitions

Default in payment

Delay in the settlement of an obligation or in paying an amount due for payment, without any legitimate reason.

Procrastinating debtor

A debtor who is solvent but refuses to pay a debt that is due, without any legitimate reason, after receiving the normal demand for payment.

Penalty clause

An agreement between two parties to a contract stipulating a pre-determined amount of compensation that will be due to the obligee, should the obligor delayed carrying it out.

