

# Compensation and Penalty Imposed on Debt Settlement of Islamic Products

Mohammad Firdaus Mohammad Hatta (Corresponding author)  
Arshad Ayub Graduate Business School  
Universiti Teknologi MARA, 40450, Shah Alam, Malaysia  
Tel: +6013-3457143 E-mail: firdaus5828@salam.uitm.edu.my

Siti Akmar Abu Samah  
Akademi Pengajian Bahasa  
Universiti Teknologi MARA, 40450, Shah Alam, Malaysia  
Tel: +6016-6396407 E-mail: sitiakma@salam.uitm.edu.my

## Abstract

As the conventional system has been established ever since, the concept of penalty plays an important role in the conventional system at least to secure the financiers from being manipulated by the financees. However, the classical Muslim jurists prohibited such a type of penalty to be imposed on any Islamic debt-based transaction since it would involve an element of usury (*riba*). The purpose of this paper is to extend the examination on debt settlement compensation and penalty, and their compliancy with *shariah* law. The study was then conducted within the ambit of two sacred revelations and the rest of reasoning principles in *usulfiqh* as well as Islamic legal maxims. The findings show that the compensation (*ta'widh*) and penalty (*gharamah*) might be imposed by Islamic financial institutions on early settlement within lock-in period and on delayed payment. In addition, discretionary rebate (*ibra'*) might be given to the early settlement after the lock-in period. The limitation of this study is that it just focuses on compensation and penalty, and concentrates only on Islamic financial system.

**Keywords:** Compensation; Penalty; Delayed Payment; Early Settlement; Lock-in period; *ta'widh*; *gharamah*; *ibra'*

## Introduction

The emergence and development of Islamic finance are globally remarkable, used by Muslims as well as non-Muslim societies. Its development does not only concentrate on Muslim countries, it is now phenomenally extending far to every single region and continent. *Shariah* resolutions and legal opinions (*fatwa*) by Muslim scholars are the essential criteria and considered the prerequisite to the growth of Islamic finance. Many controversial issues arose have been resolved as to Islamic banking and capital products, derivatives as well as Islamic insurance (BNM, 2010).

Islamic banking and finance are moving towards becoming the mainstream of the financing system rather than the conventional competitor in a number of countries, in particular, countries that are dominated by Muslim residents (MIFC, 2014). As the conventional system has been established ever since, followed by the Islamic system about thirty two years ago, the concept of penalty plays important role in the conventional system at least to secure the financiers from being manipulated by the financees. The main benefit of penalty in the conventional banking system is to maintain the financial institution's cash flow planning; the penalty imposed on the loan amount or 'x' months of interest (BNM, 2003). Classical and contemporary scholars as well as Muslim economists have previously discussed on the issue of penalty or

compensation with regard to early settlement, but few studies in particular on the settlement that is within the lock-in period, which imply a significant gap in knowledge.

It is widely documented that compensation and penalty are globally practiced by the Islamic financial institutions (Abd Rahman, 2009) particularly in any default or delay payment made by the customers. The worldwide jurists have viewed the permissibility to impose that compensation as the bank's income or penalty that will then be channelled to charitable purposes. On the other hand, those who are able to make settlement after the lock-in period early settlement might be given rebate according to the banks' discretion (KLRCA i-Arbitration Rules, 2013). The majority of jurists however do not allow the bank to impose any rewardable clause by mentioning the bank's wills to give the rebate as soon as the customer has made any early settlement since it may be equivalent to committing *riba*. But it is a different case as the Malaysian authority has approved the imposition of the said clause for every financial transaction made because it would fulfil fair interest (*maslahah*) for both customer and financial institution (BNM, 2010). Thus, many preceding studies have argued that the rewardable rebate based on the bank's discretion is considered permissible, though they are in dispute with regard to the clause permissibility. Notwithstanding the above matter, no prior studies have incorporated the early settlement within the lock-in period concerned.

As the Islamic finance grows by leaps and bounds, markets are compelled to apply any possible means complying with the *shariah* to respond fair interest to both the customers and Islamic financial institutions. There is a pressing need to examine the critical alternatives that would fulfil the needs of Muslims and at the same time meeting the requirement of the *shariah*. Based on these grounds, the current study is conducted to address the following research questions:

How are the compensation and penalty lawful to be imposed on debtors?

The next section reviews the literature relevant to the research topic, which has propelled the issue to be researched.

## **Riba**

By referring to the *shariah* law, any surplus imposed on the capital loaned or inequality of the values is considered as interest (*riba*). Interest (*riba*) literally means excess, expansion, increase, addition or growth, whereas technically it means the 'unlawful gain derived from the quantitative inequality of the counter-values in any transaction purporting to affect the exchange of two or more species which belong to the same genus (category) and are governed by the same efficient cause. Deferred completion of exchange of such species may also amount to interest (*riba*) whether or not the deferment accompanied by an increase in any one of the exchanged counter-value' (ISRA, 2011). As Allah (s.w.t) pronounces in the Quran:

*'While God has made buying and selling lawful and usury unlawful'.* (Al-Quran 2: 275)

Interest or usury (*riba*) is not only involved in loan or borrowing transaction due to deferment of time of payment, but it also happens in any unjustified excess above and over the capital, either in loans (between creditor and debtor) or in trade (with similar commodities). The primary *hadith* with regard to comprehensive meaning of interest or usury is as what was pronounced by the Prophet Muhammad (pbuh):

*'Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, like for like, equal for equal and hand to hand, if the commodities differ, then you may sell as you wish provided that the exchange is hand to hand'.* (Hadith no. 1584) *Sahih Muslim*, (No'man, 2009).

This *hadith* shows two categories of usurious items, which are currency and foodstuff. Gold and silver are classified under the category of currency while the other four items, wheat, barley, dates and salt are considered to be foodstuff. Furthermore, the usurious items are not restricted to the items mentioned in the previous *hadith*, as they might be extended to other family of currencies, for instance the British Pound Sterling (£) and Ringgit Malaysia (RM), and family of foodstuff such as rice and oat.

### **Ribaas a penalty**

According to the Islamic business transaction, interest or usury (*riba*) can be classified into two, namely ‘waiting interest (*ribaal-nasihah*)’ and ‘surplus interest (*ribafadl*)’. The former is the excess due to the delay in the exchange of the usurious items or the delay in payment, whereas the latter is the additional or surplus quantity or inequality in the exchange of usurious items from the same categories and types. It means that if wheat (one of foodstuff) is exchanged for another quality of wheat, their quantity must be equal for equal but if not, regardless of the quality, the inferior for the superior, the transaction is considered as *riba*. This transaction is also known ‘*riba al-sunnah*’, since it is originated from the *sunnah* of the Prophet Muhammad (pbuh) (Usmani, 2005).

Taqi Usmani (2005) also mentions another form other than *fadl* namely *riba al-nasihah* as given by a number of exegetes of the Al-Quran such as Ibn Jarir, Al-Suyuti, Al-Jassas, Ibn Abi Hatim and Abu Hayyan. This form of *riba* would involve the practice of increase on every single contract of loan, the increase in exchange of further time given to the borrower and lastly the increase of sale price in every additional time given to the buyer; considered as penalty.

### *Compensation and penalty on late payment*

Dusuki (2009) opines that the Islamic banks have the right to manage and mitigate the default risk up to a certain limit by incorporating a penalty clause in the contract, but the banks are not allowed to ask the lessee, for instance to incur the risk of asset loss. It is then supported by the resolution of the Bank Negara Malaysia (BNM) through their *shariah* advisory council which has released the permissibility to charge compensation (*ta'widh*) and penalty or fine (*gharamah*) on late repayments especially on exchange and loan contracts (IFN, 2010). On the other hand, the AAOIFI standard (2010) only addresses the obligation on the debtor to donate an amount or the percentage of the payment to charitable courses via the bank's *shariah* supervisory board without covering the compensation charge.

### **Rebate on early payment**

The concept of rebate or *ibra* in Arabic is known as waiving the ownership of money or any valuable item, partially or totally, that belongs to or is owned by someone (Muhammad, 2010). According to him, the unilateral contract granted to the Islamic financial institutions is considered unjust compared to the conventional ones. Hence, bilateral contract in rewarding rebate is considered justifiable in complying with the Islamic rulings and fulfilling the objectives of the *shariah*. In addition to the bilateral contract, it is further argued by Mohamad and Trakic (2013) that the existing rebate is typically given in cases of early settlement but is not applicable to default cases. It is suggested that a new guideline for granting rebate needs to be structured as to first, the rebate is not only granted to the customers who make an early settlement or early redemption, but also the settlement by customers in case of default. Secondly, the granting of rebate cannot remain to be at the discretion of the Islamic financial institutions only. This is in order for the Islamic financial institutions to still remain competitive with the conventional ones.

## Methodology

Discussion of compensation and penalty status from the perspective of the *shariah* law would require the use of the *shariah* principles, mainly of the Quran and *sunnah* (Prophetic traditions), and the rest of Islamic jurisprudence principles, *interalia*, *qiyas* (analogical deduction) and *maslahah* (public interest), and its general principles namely *al-qawaid al-fiqhiyyah* (Islamic legal maxims) as supporting tools. In addition to that, the research also applies the concept of *riba* (interest) and *gharar* (uncertainty) to get clearer picture of the compensation and penalty concepts.

*Qiyas* is, according to Kamali (2003) the extension of the *shariah* ruling from the original case or in Arabic known as *asl* to the new case known as *far* ' since the new case has the same effective cause (*'illah*) as the original. The elements of *qiyas* consist of four, the three as mentioned and the fourth is *hukm* or the established rule for the new case. Nyazee (2000) and Kamali (2005) have quoted a number of *maslahah* definitions given by different scholars by which it is concluded as a consideration of public interest that would fit the objectives of the Lawgiver, securing benefits and preventing harm; the texts, the Quran and *sunnah* have never mentioned as to its validity or otherwise. Meanwhile, *al-qawaid al-fiqhiyyah* (Islamic legal maxims) according to Mustafa al-Zarqa as translated by Laldin is the 'general *fiqh* principles which are presented in a simple format consisting of the general rules of *shariah* in a particular field related to it' (Laldin, 2006; Ismail and Habibur Rahman, 2013). The majority of these general principles of *fiqh* consist of a few words but at the same time would be able to cover the comprehensive meanings that can be applied to various issues of *fiqh*.

## Results and Discussion

This paper contributes to the existing body of knowledge in terms of narrowing the research

gap by examining the penalty and compensation imposed on three areas of the Islamic financing system, namely early settlement after the lock-in period, delayed payment, and early settlement within the lock-in period. The novelty of this study is that it provides a holistic perspective of the critical view of every single compensable and penalizable factors/area arise in the Islamic financing system, examined from the perspective of the Islamic juristical view.

### *Early settlement after the lock-in period*

According to the conventional system, any early settlement made by the customers, the bank will waive certain amount of unearned interest that should be paid by the customers which is known as 'rebate' (Securities Commission, 2009). Similar to the Islamic banking system, any customer who has settled his financing earlier than maturity date might be granted certain amount of money, warded off based on the discretion of banks. The concept of *ibra* ' as mentioned earlier (Kuwait Ministry of Waqf and Islamic Affairs, 1993) represents the waiver as an individual has claimed his right which lies as an obligation (*zimmah*) to another individual which is due to him. Meanwhile, from the perspective of the Islamic finance, it has been defined by the BNM (2010) as a rebate granted by one person or institution to another party in any Islamic financial transaction or known as *mua'malah*.

By referring to the resolution made by the BNM, the *Shariah* Advisory Council (SAC) has resolved that Islamic financial institutions to grant rebate (*ibra* ' ) to their customers who have cleared their debt obligation of sale contract earlier than the agreed settlement period. In addition to that, the BNM has required the institutions to mention the 'rebate' in their terms and conditions in order to remove any uncertainty (*gharar*) that might arise in the near future (BNM, 2010).

Let say, upon early termination, the bank will calculate a selling price for a customer to clear

the payment. The customer may be given rebate on the outstanding payment balance. The following formula may be applied:

$$\begin{aligned} &\text{Where,} \\ X &= \text{remaining tenure (in month)} \\ Y &= \text{whole tenure (in month)} \\ TP &= \text{total profit} \end{aligned}$$

The agreed period of the contract is 5 years (60 months) and the total profit that the bank would gain is RM 400,000. As soon as the customer paid the selling price for 3 years (36 months), he wishes to settle the account and provides adequate and advanced notice to the bank. Based on the rebate clause in the agreement, the customer is entitled:

$$\begin{aligned} \text{Rebate (ibra')} &= \\ &= \text{RM } 65,573.77 \end{aligned}$$

Therefore, if the cost price is RM 1,000,000, the selling price is RM 1,400,000, the payment having been made after 3 years (36 months) is RM 840,024, then the remaining that should be paid is RM 559,976 – RM 65,573.77 = RM 494,402.23.

The permissibility of that rebate imposed on any early settlement is based on the prophetic text as narrated by al-Hakim (2008) that allows warding off of the right to claim a portion or total amount of debt existing during the time period of the Prophet Muhammad (pbuh) which reads:

*'The Prophet Muhammad (pbuh) once ordered the people of Bani Nadhir to leave Madinah, then he received delegates from the people who said: Oh Rasulullah! You ordered us to leave Madinah while we have outstanding debts that must be settled by the local people. Then Rasulullah (pbuh) replied: Give discount and accelerate the settlement'.(Hadith no. 2325) Al-Hakim.*

However, some Muslim scholars do not allow such practice as their view is actually based

on any increment in the value of debt causing the extension of repayment time period is considered as committing usury. Similar to the reduction of value of debt due to the settlement before the maturity date is also regarded as usury (Al-Baihaqi, 1994; Ibn Rushd, 1975; Ibn Qayyim, 1975).

Moreover, some other Muslim scholars viewed that the concept of 'giving discount and accelerating the settlement' is not permissible since it creates uncertainty (*gharar*) in the selling price. The reason they viewed so because the transaction seems to have two contracts in one that fulfils the characteristic of '*bay'tain fi bay'ah*' that has been forbidden by the Islamic law (Al-Atram, 2008).

Perhaps, some scholars considered 'giving discount and accelerating the settlement' as committing usury since two value differentials arise between the pre-agreement and the time of repayment regardless of the value being more or less than the pre-agreed one with the modification of time period. In contract, the reason such scholars opined equating discount with usury might not be appropriate since the essence or substance of both subjects are different (Ibn Rushd, 1975). The former (giving discount and accelerating the settlement) is actually, the financier, not intending to have something extra as a return on top of the capital advanced but in order for them to be able to get back the original capital. Whereas, the increment in value after some extension given is clearly indicating the financier's intention to have some return or time value of money having been advanced.

In order for the parties involved to get rid of any *riba*-led contract, a condition imposed by the majority of scholars is by prohibiting any incorporation of the term 'rebate' or the like in the agreement. This is because the incorporation as a sort of conditions might constitute a characteristic of usury, and it is similar to the ruling on giving loan with benefit which is prohibited if it is made as conditional.

However, the BNM has required to incorporate the ‘rebate’ in the financing agreement in order to eliminate uncertainty with regard to the customer’s right to get the rebate. This is because staying away from uncertainty (*gharar*); one of the prohibited elements in the *shariah* law is an obligation for every single contract. In addition, the incorporation of the term, perhaps, would accord fully with the interest (*maslahah*) of both parties; the customer and financial institution. Meaning to say, a written agreement becomes more concrete evidence in comparison with verbal agreement, as recommended by Allah(s.w.t) while dealing with debt obligation:

*‘O you who have believed, when you contract a debt for a specified term, write it down.’*  
 (Al Quran 2: 282)

The verse proves the importance of putting it down in writing though it is juristically just a recommendation according to the majority of jurists. What has been stated by Allah (s.w.t) here is at the same time mentioning the requirement of giving fair treat and mutual interest to all parties involved.

#### *Delayed payment*

Any debtor who delays their debt payment or settlement will be imposed penalty or traditionally known as interest. The interest-based penalty in the conventional financial system in Islamic law is considered as *riba*, which is regarded as non-permissible. Hence, any surplus charged on top of debt-based

financing or loan is definitely not allowed, it is considered one of the great sins in Islamic law.

Nevertheless, the contemporary Muslim scholars, since Muslims are living in conventionally economic and financial framework, have come out with a resolution that would overcome the issue of default or delayed payment from the customers. As revealed by the BNM, any Islamic financial institution facing such issue is allowed to impose compensation (*ta’widh*) or penalty (*gharamah*) subject to certain conditions listed down by the Bank Negara Malaysia.

The former, compensation, defined as any ‘claim for compensation arising from actual loss suffered by the financier due to the delayed in payment of financing or debt amount by the customer’, whereas the latter refers to ‘penalty charges imposed for delayed in financing or debt settlement, without the need to prove the actual loss suffered’ (BNM, 2010). However, these methods are, as mentioned previously, subject to certain conditions, otherwise they are considered as non-permissible. Among them are, compensation is chargeable on any late payment of the exchange contracts such as sale and lease, as well as loan contract (*qard*). Secondly, it may be charged after the settlement date is over, and thirdly the compensation could be recognised as the financial institutions’ income since it is equivalent to the actual loss incurred. On the other hand, the penalty imposed cannot become a sort of income to the financial institutions, instead it must be channelled to the charitable purposes.

Product name	BBA Home Financing-i
Bank’s principal	RM100,000
Bank’s selling price	RM158,520
Monthly instalment	RM1,321
Payment due date	4 <sup>th</sup> of the month
Financing profit rate	10%p.a.
Late payment charge (C)	AFR
<i>Ta’widh</i> (compensation) (T)	1%
<i>Gharamah</i> (penalty) (G)	G = (C-T)

The illustration of late payment charges exemplified by the BNM (2013) is as follows:

The formula for the late payment charge (combination between compensation and penalty) is as follows:

$$\text{Overdue installment(s)} \times \text{Combined rate} \times \text{RM1,321} \times 9.50\% \times = \underline{\text{RM10.31}}$$

Compensation:

$$\text{Overdue installment(s)} \times \text{Compensation rate} \times \text{RM1,321} \times 1.00\% \times = \underline{\text{RM1.90}}$$

$$\begin{aligned} \text{Penalty} &= (C - T) \\ &= \text{RM10.31} - \text{RM1.90} \\ &= \underline{\text{RM9.22}} \end{aligned}$$

The permissibility of the compensation and penalty is based on a *hadith* pronounced by the Prophet Muhammad (pbuh):

*'Delay by a solvent or rich person (in payment of debt) is a tyranny'. (Hadith no. 486) Sahih Al-Bukhari.*

The *hadith* clearly mentionsthat the solvent people who delay the payment of debt are considered as committing tyranny as narrated by al-Bukhari (1982). It shows the Prophet Muhammad (pbuh) reveals an intrinsic message saying there is a possibility of punishment that might be imposed by the authority on those people though none of the punishment has been reported in the *hadith*. It is supported by the Quranic verses asreported:

*'And those who have wronged will be afflicted by the evil punishment of what they earned'. (Al-Quran 39: 51)*

And in the Chapter of An-Nahl:

*'So they were struck by the evil punishment of what they did and were enveloped by what they used to ridicule'. (Al-Quran 16: 34)*

The abovementioned Quranic verses clearly mention about the evil punishment and perhaps may endorse the compensation and the penalty imposed on those who have breached and

made unfair contract with others. The sin of doing wrong to people is then forgiven by the Almighty Allah provided that the wrong doer has repented to Allah (s.w.t) and has fulfilled back the fair treat that supposed to be between the two parties involved. As the Prophet Muhammad (pbuh) mentioned for those who have committed tyranny against people either having taken people's wealth or damaged people's dignity, they have to get themselves released from those sins by giving back allof the people's right. Hence, compensation imposed is sort of a financial institution's right that must be delivered by the wrong doers. This is important since the *shariah* only endorses any fair treat without any harm to all the parties involved as Prophet Muhammad (pbuh) said '*neither harming nor reciprocating harm in Islam*' (Hadith no. 32) *Al-Arba'un An-Nawawiyah* (Badi, 2002).

*Early settlement within the lock-in period*

The early settlement, as discussed, the stipulated amount will be waived that is supposed to be paid by the customer; the method used is known as rebate or *ibra*'. The rebate might be given discretionally by the Islamic financial institutions based on the agreement made at the beginning of the transaction. However, should the customer breaches by making early settlement as not what has been stipulated or required by the agreement, for example the customer has settled the debt financing or loan within the lock-in period, the BNM has resolved with a general legal opinion that the financial institution is not allowed to claim the compensation (BNM, 2010). The general legal opinion connotes that the prohibition does not take into account the period of early settlement. As long as the customer made that early settlement, the ruling is prohibited to impose extra charges. Therefore, the researcher inferred that the BNM legal opinion perhaps covers all types of early settlements without taking into account the stipulated time agreed and the actual loss the financial institution may be facing later on.

The reason of prohibition is, according to the BNM, not consistent with the objectives of the *shariah* and the religion of Islam itself encourages all debtors to settle any kind of debt as soon as possible. The opinion is by referring to one *hadith* of any solvent debtor, as discussed, who delays in debt payment is considered committing tyranny. In addition, the financial institution does not face any problem of lacking liquidity for investment since all debts have been settled before the maturity date. Perhaps, there is no reason for financial institution to impose compensation since both parties have fulfilled the validity parameters outlined by the *shariah* law as both parties have received the benefits and met their interests. As the Al-Quran reported:

*'So that it will not be a perpetual distribution among the rich from among you'.* (Al-Quran 7: 59)

None of them are treated unfairly and unjustly though the one has made early settlement to the other before the maturity date.

However, the BNM opinion of prohibition might actually not guarantee the existence of the objectives of the *shariah* since non-compensation would lead to unfair treat to one of the parties involved, in this case is the Islamic financial institutions. The purpose of sale and purchase contract is to gain an extra profit or return. So, how an Islamic financial institution is not allowed to receive any return resulting from their customers having breached the contract, which is the financial institution has incurred actual costs relating to the financing products. Again, the prohibition of compensation would deny the interest of one party over the other and the objectives of the *shariah* might not be achieved then.

If one party makes the early termination in order to favour himself, but not the other by breaching the contract, in the researcher's opinion he may have an illegal intention via illegal means, and may considered as a sign of hypocrisy. This is

parallel to a *hadith* mentioned by the Prophet Muhammad (pbuh) as narrated by al-Bukhari:

*'The signs of hypocrite are three: when he speaks he lies, when he promises he breaks and when he is entrusted he betrays the trust'.* (Hadith no. 6095) *Sahih Al-Bukhari*

And in another hadith the Prophet Muhammad (pbuh) said:

*'Four traits whoever possesses them is a hypocrite and whoever possesses some of them has an element of hypocrisy until he leaves it: the one who when he speaks he lies, when he promises he breaks his promise, when he disputes he transgresses and when he makes an agreement he violates it'.* (Hadith no. 34) *Sahih Al-Bukhari*

Any person who is characterised with all that evil signs is judged by the two *hadith* as a hypocrite and any who is attributed to one or some, has to leave those attributes. Perhaps, in order to deter from that being rampantly happening, the authority has the right to impose many kinds of punishment that fall under *ta'zir* (discretionary punishment) which is administered at the discretion of the authority since it is not fixed in the *shariah* law; the Al-Quran and *Sunnah*. The punishment of *ta'zir* is based on the practice of Prophet Muhammad (pbuh):

*'The Prophet Muhammad (pbuh) has ever imprisoned a man who made an accusation without any proof'.* (Hadith no. 1417) *Jami' At-Tirmidhi*, (Hadith no. 3630) *Sunan Abi Dawud*, (Hadith no. 4876) *Sunan An-Nasa'i*.

And again the Prophet pronounced:

*'The Prophet imposed the maximum of any punishment other than hudud is up to ten times stroke only'.* (Hadith no. 6850) *Sahih Al-Bukhari*.

Meaning to say, any punishment having been



fixed by the *shariah* law is ten times of stroke and below. It is then supported by a Quranic verse saying: *'Do not imagine that those who are joyful with what they have done and love to be praised for that which they did not do – do not imagine them to be safe from punishment, and theirs is a painful punishment'* (Al-Quran 3: 188). So, any compensation is allowed to be imposed by the authority since it meets the Prophetic *hadith* and fits with the Quranic verse.

### *Qiyas*

The prohibition of delayed payment by the *hadith*: 'Delay by a solvent or rich person (in payment of debt) is a tyranny' is because such an act contains unfair treat to one of the parties involved. That is, perhaps, a reason or a cause for the Prophet Muhammad (pbuh) prohibiting and considering the act doer as a tyranny or injustice. Based on the same cause (*'illah*), the ruling of compensation or penalty after the lock-in period may be deduced from the analogy (*qiyas*) since both; delayed payment and after lock-in period, may establish unfair treat to one or some parties involved. Allah (s.w.t) mentioned in *Surah Al-Furqan*:

*'And whoever commits injustice (tyranny) among you, We will make him taste a great punishment.'* (Al-Quran 25: 19)

Should any win-lose situation happen in contracts is a sort of injustice, it is then against the *shariah* law since Allah (s.w.t) imposes:

*'Be just; that is nearer to righteousness.'* (Al-Quran 5: 8)

And:

*'Indeed, Allah commands you to render trusts to whom they are due and when you judge between people to judge with justice'* (Al-Quran 4: 58).

Hence, both parties involved have to observe justice and do offer fair dealings to each other, otherwise the consequences either the contract

be invalid or they undergo punishments.

### *Al-Qawa'id Al-Fiqhiyyah*

Another evidence might support the permissibility of the said compensation is the legal maxim that reads:

*'Whoever hastens the accomplishment of a thing before its time, is punished by being deprived of it'*. (Ramadhan, 2007; Azzam, 2005). Any person who hurries the obtainment of a thing before the time of its legal cause, either through an absolute illegal means or via an apparent legal means yet with an illegal intention, he shall be punished by being deprived thereof or by being treated with the opposite of his bad intention.

And again another legal maxim reads: *'The normative practice among traders is like a binding condition among them'*. (Azzam, 2005) This practice focuses on customary practices relating to a specific group of people i.e. merchant. Whatever commercial transaction that takes place among them or with other people it has to be executed according to the prevailing customary practice unless the custom or the contract violates the principles of *shariah*. As Abdullah bin Masud said:

*'What the Muslims deem to be good is good in the eyes of Allah'*. (Hadith no. 3600) *Musnad Ahmad*.

Meaning to say if a particular customary mode of payment (i.e. payment after the lock-in period) has become dominant and well-known transactions between banks and customers, then it becomes authoritative, approved by the Almighty Allah. In addition, the contract between the parties is a clear stipulation of agreement. According to the general rule, if there is a conflict between the stipulated agreement and the custom, the agreement prevails. In this case, the researcher notices there is no conflict between the custom and the agreement at all, instead both correspond to each other.

The situation is similar to, in case, the customer or debtor applies for refinancing or rescheduling of debt. The customer or debtor must abide by the stipulated agreement made at the beginning of every transaction. Otherwise, the compensation might be imposed by the financier on every payment delayed or the non-compliant early settlement against the agreement.

### Conclusion and Recommendation

This study has advanced knowledge by investigating the issue of compensation and penalty in particular the early settlement within the lock-in period, which has received very little attention to date. This is probably one of the first attempts to find a solution resulting from non-compliant act against the stipulated agreement, that perhaps would offer significant insights for people in the market as well as the academicians.

So, by referring to the arguments, the researcher intends to suggest and recommend the permissibility of compensation and penalty or by imposing 'unilateral promise' on customers, in case they have breached the contract by making early settlement within the lock-in period. The rest (delayed payment and early settlement after the lock-in period), as discussed, will on the other hand, apply as what has been resolved by the authority. It is hoped that the suggestion and recommendation will provide an alternative to the market in particular the Islamic financial institutions on what should be done in order to overcome especially the early settlement within the lock-in period.

From the discussion, the research has answered the question as identified at the beginning, as the financial institutions are legally entitled to impose compensations or penalties for both types of early settlement; within the lock-in period settlement and the delayed payment, and they are also allowed discretionally to give rebate for any early settlement after the lock-in period.

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