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Levying Penalties for Late Payment in Islamic Banking: A Review of the Perspectives of Islamic Scholars

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Abstract

The expansion of the banking industry in the Muslim world, representing both an opportunity and a challenge, has presented a multitude of complex issues for Islamic banking. Among these, the matter of delayed repayment of financing and the imposition of late payment penalties is considered one of the most formidable challenges, primarily due to its perceived resemblance to "Riba" (usury). When a client defaults on their repayment obligations at the scheduled maturity date, the creditor (the bank) incurs financial losses. This loss is compounded by the continuous erosion of the real value of money, a phenomenon exacerbated by macro-economic factors such as geopolitical conflicts and economic instability—as witnessed in nations like Afghanistan—which in turn fuels inflation. In conventional banking systems, repayment delays are managed through the imposition of default interest to compensate the lender. However, in Islamic banking, the utilization of such mechanisms is impermissible due to "Shari'ah" prohibitions against "Riba". Consequently, the management of bank receivables, addressing payment defaults, and determining permissible forms of compensation for such delays remain critical and persistent issues within the Islamic banking framework. This study, therefore, seeks to address several fundamental questions by examining the diverse perspectives of Islamic jurists (*Fuqaha*) and scholars: Can a creditor legally claim compensation from a defaulting debtor for damages arising from currency devaluation and opportunity cost? Is the practice of stipulating and levying late payment penalties in contracts permissible from a "Shari'ah" perspective? Does such a penalty constitute a form of "Riba"? Finally, are the current penalty mechanisms employed by Islamic banks fundamentally sound and effective? This study employs a qualitative methodology, descriptive-analytical in nature, and is based on desk research. Data were collected, analyzed, and synthesized from secondary sources through a systematic review of the relevant literature. The findings reveal that three distinct jurisprudential viewpoints exist among Islamic scholars regarding the permissibility of late payment penalties, stemming from the aforementioned concerns about "Riba". The analysis indicates that the current application of penalties—wherein their compensatory aspect often overshadows their deterrent function—has not proven optimally effective in preventing payment delays. This inefficacy is compounded by persistent "Shari'ah" complexities and the issue of debtor insolvency ("I'sar"). Consequently, there is a compelling need for the development and implementation of supplementary mechanisms to address this challenge effectively.

Keywords: *Islamic Banking; Late Payment; Late Payment Penalty; Insolvency; Penalty; Compensation*

Introduction

The fundamental activity of banks, including Islamic banks, is to provide financing and offer services to individuals and legal entities through credit contracts and instruments, and the provision of facilities. The primary incentive driving all banking operations is the pursuit of profit, a prerequisite for which is the client's commitment to settle their debt by the stipulated due date. As financing is inherently time-bound, payment delays disrupt banking operations and, in some cases, may lead to insolvency.

Conventional banks utilize interest-bearing loans as the basis for providing capital to applicants, where any delay in repayment incurs a cost that is compensated through default interest. In contrast, most Islamic banks, to achieve the same objective, employ deferred-payment transactions, such as installment sales (*Murabaha*), for clients who issue a purchase order. The surplus amount in the former method constitutes *Riba al-Nasi'ah* (the Riba of delay), which is prohibited (*haram*), whereas the surplus in the latter method is considered permissible profit.

This raises the central question of whether the imposition of a late payment penalty by banks—stipulated as a condition in the contract with the client to compensate for damages arising from the depreciation of currency value and the loss of potential profit (*lucrum cessans*) by a debtor who defaults on payment—is permissible (*ja'iz*) or not. Furthermore, is the late payment penalty, as a remedial mechanism, functionally equivalent to *Riba*? These are the inquiries that this paper will examine and evaluate from the perspective of Islamic jurisprudence (*fiqh*).

A. The Perspective of Muslim Jurists and Scholars on Damages for Delayed Settlement

One of the mechanisms addressed in non-usurious banking laws in some countries (e.g., Iran) is the concept of penalties and damages for delayed settlement. Due to its apparent similarity to *Riba*, this topic has been the subject of extensive debate among jurists and scholars (both Shi'a and Sunni) from various angles. Different viewpoints exist regarding the late payment penalty. Before articulating these perspectives, several preliminary points must be clarified:

First Point: In its literal sense, the word "damages" (*khasarah*) means "loss," "harm," or "compensation." In legal terminology, "damages for delayed settlement" is a general title applicable to various cases. Consequently, some have defined it as follows:

> "Damages for delayed settlement" refers to the loss incurred by the creditor due to the debtor's failure to pay a debt by the prescribed deadline. The term "damages" here encompasses both demonstrable, tangible losses (*damnum emergens*) and the loss of utilized benefits (*lucrum cessans*). In other words, "damages for delayed settlement" is the loss of realized benefits or the incurrence of material loss to the creditor's assets resulting from the debtor's delay in payment (Bojnourdi, 1382: 19).

Second Point: The issue of damages for delayed settlement arises in both commutative contracts (*'uqud mu'awadati*), such as a sale (*bay'*), and non-commutative contracts (*'uqud ghayr mu'awadati*), such as loans and bank financing. Therefore, its rulings depend on the type of contract (*'aqd*) and its substance. Wherever a contract is discussed, obligation and commitment are its inherent requirements, as a contract has also been defined as a reinforced covenant (*'ahd mu'akkad*) (ibid.).

Third Point: A debtor may sometimes face poverty and financial hardship (*'usrah*) due to various circumstances, rendering them unable to repay their debt. In this situation, God Almighty clarifies the ruling for the parties in the Qur'an, Surah Al-Baqarah, verse 280:

"وَإِن كَانَ ذُو عُسْرَةٍ فَنَظِرَةٌ إِلَى مَيسَرَةٍ وَأَن تَصَدَّقُوا خَيرٌ لَكُمْ إِن كُنْتُمْ تَعْلَمُونَ"

"And if someone is in hardship, then [let there be] a postponement until a time of ease. But if you give [from your right] as charity, it is better for you, if you only knew" (Jawadi Amuli, 1398: 12/578).

The phrase "*fanazirah ila maysarah*" (a postponement until a time of ease) implies that if the debtor is in hardship and unable to repay the debt, granting them respite is obligatory (*wajib*). However, granting respite to a solvent debtor is not obligatory. The purpose of this respite is to provide an opportunity to settle the principal debt, not to enable the debtor to earn income from which to pay it (ibid., pp. 280-281). The phrase "*wa in kana dhu 'usrah*" (and if someone is in hardship) is general and encompasses all forms of debt, not exclusively usurious debt or loans (Hashemi, 1382: 12/256). Three scholarly opinions exist regarding the obligation to grant respite to an insolvent debtor:

1. It is obligatory for all types of loans and debts, as narrated from Imam al-Baqir (a.s.) and Imam al-Sadiq (a.s.): "It is obligatory for every debt" (Al-Tabarsi, *Majma' al-Bayan*, n.d.: 1-2/676).
2. It is obligatory only for usurious debts.
3. It is obligatory for usurious debts and any similar type of debt (ibid.).

The creditor has two duties:

1. It is commendable for the creditor to forgive the principal debt as an act of charity (*sadaqah*), which is better for them than collecting the debt: "*wa an tasaddaqu khayrun lakum*" (and if you give as charity, it is better for you) (Jawadi Amuli, 1398: 12/282).
2. If the creditor is unwilling to forgive the debt, it is obligatory to grant respite to the impoverished debtor. Pressuring or coercing them is prohibited (*haram*), just as it is prohibited for the debtor to be negligent in repaying their debt (ibid.).

The narrations (*riwayat*) also provide mechanisms to safeguard the rights of both parties. For instance, Imam al-Rida (a.s.) quotes the Prophet of Islam (s.a.w.): "*Layy al-wajid bi-l-dayn yuhillu 'irdahu wa 'uqubatahu...*" (Hurr al-Amili, 1414 AH: 18/333 & 319). The term "*layy*" in this hadith means procrastination. According to this narration, procrastination by a solvent debtor in repaying a debt permits [damage to] his honor and his punishment, making it permissible to file a complaint against him and potentially imprison him (Jawadi Amuli, 1398: 12/279-280). In cases of bankruptcy and insolvency, the relevant laws are applied. Therefore, regulations concerning late payment penalties are specified (*takhsis*) by bankruptcy and insolvency laws and do not apply to individuals or legal entities who are bankrupt or unable to pay for various reasons (Mousavian, 1384: 4/24). Thus, the discussion of late payment penalties does not include such individuals, who must be treated according to their specific legal frameworks.

Fourth Point: One of the clearest manifestations of *Riba* is the practice of increasing the debt principal in exchange for extending the maturity period. Most exegetes, in their interpretation of the verses on *Riba*, identify this practice—increasing the amount in return for an extension—as one of the prevalent forms of *Riba* in the Arabian Peninsula that the Holy Qur'an (2:279) condemned (Jami'at al-Mudarrisin, 1381: 89-92). This study will therefore investigate whether the penalty that banks collect from defaulting clients for delays constitutes an increase in the principal for an extension of term, thereby falling under the category of the pre-Islamic *Riba* (*Riba al-Jahiliyyah*).

1) The Views and Theories of Sunni Thinkers

Regarding the validity and invalidity of the late payment penalty, various jurisprudential (*fiqhī*) viewpoints and discussions have been presented by Muslim thinkers in different Islamic countries. The existence of Islamic banks in various nations, both Muslim and non-Muslim, has prompted Shi'a and

Sunni jurists and thinkers to express their opinions on this matter. Here, we will first refer to some of the views of Sunni scholars.

Sunni scholars have made a distinction between two issues: the collection of a penalty (*gharāmah*) and the receipt of compensation for damages (*ta'wīḍ*).

- ***Gharāmah* (Penalty):** A penalty is usually imposed by the state on individuals who transgress and violate laws and regulations (Al-Qaradaghi, 1431: 92).
- ***Ta'wīḍ* (Compensation):** Compensation is, in fact, the replacement for or indemnification of the financial loss that an individual has inflicted upon the lender by failing to pay and delaying the settlement of debts on the specified due date (ibid.).

Based on this distinction, the views of Sunni jurists and thinkers regarding penalties (*gharāmah*) and compensation (*ta'wīḍ*) are explained as follows:

1.1. The View of Contemporary Sunni Jurists Regarding the Late Payment Penalty

Generally, two viewpoints exist in this domain:

The First View: The collection of a late payment penalty (*gharāmah*) is absolutely not permissible (*jā'iz*), because it is a manifestation of *Riba*. *Riba* is among the definitively and indisputably prohibited matters in Islam. Among the proponents of this view are Nazih Hammad and Muhammad Sa'id Ramadan al-Bouti (Al-Sayyid al-'Awadi, 1430: 2/324).

The Second View: It is permissible to take a late payment penalty from a person who is solvent (*mūsir*) and procrastinates (*mumāṭalah*) in the payment of their debt. However, the lender does not take ownership of it; it must be spent on the poor and for charitable causes. Yet, an insolvent individual (*mu'sir*) must be treated according to the rule of insolvency (*i'sār*), and based on the noble Qur'anic verse, they must be granted respite until they acquire financial capacity and ability.

Proponents of permissibility cite the following three proofs for their claim:

a) The Prophet (pbuh) said: "*Maṭl al-ghaniyy ẓulm*" (Procrastination by the solvent is an injustice) (Al-Qaradaghi, 1431: 77).
b) His (pbuh) saying: "*Layy al-wājid yuḥillu 'irḍahu wa 'uqūbatahu*" (Procrastination by one who is able [to pay] makes his honor and his punishment permissible) (ibid.).
c) His (pbuh) saying: "*Lā ḍarar wa lā ḍirār*" (There shall be no harm and no reciprocating of harm) (ibid.).

From the first two hadiths, the unjust nature [of the act] and the financial punishment of the defaulting individual are inferred. The third hadith explicitly indicates the prohibition of harm. That is, an individual who, despite having the ability and financial solvency, delays the payment of their debt has committed an injustice against the lender (the bank) and has inflicted a clear and great loss upon them. Therefore, they are deserving of a financial penalty (Al-Qaradaghi, 2007: 8/102-104).

1.2. The View of Contemporary Sunni Jurists Regarding Compensation (*Ta'wīḍ*)

Regarding whether banks can stipulate compensation to prevent repayment delays, either in the same contract or in another contract, two viewpoints exist:

The First Viewpoint: The Permissibility of Stipulating Compensation

Some Sunni thinkers, such as Sheikh Mustapha Ahmad al-Zarqa, Sheikh Muhammad al-Siddiq al-Darir, Sheikh Abdullah ibn Mani', and some fatwa committees in certain banks like the Egypt International Bank and the Jordan Islamic Bank, hold the view that stipulating compensation is permissible.

1. **Mustapha Ahmad al-Zarqa states**:
   It is not permissible for an agreement to be made between the debtor and creditor on the amount to be paid for the damage of delay; in other words, they can stipulate the financial substitute and indemnification (compensation) in the contract, but they must not specify or determine the amount, as this would actualize *Riba*. Only a judge can rule for the payment of a penalty, because:
   a) The procrastinator (the debtor who has not paid the debt) has inflicted harm upon the creditor.
   b) The procrastinator is an oppressor (*ẓālim*) and deserving of punishment.
   c) The way to compensate for loss and damage is to pay its equivalent.
   d) Delaying the settlement of a right is similar to the usurpation (*ghasb*) of usufruct, and the usurper is liable for the benefits of the asset in addition to being liable for the principal asset itself.
   He says: The penalty that the judge determines is not *Riba*; rather, it is compensation for damages and is for the purpose of removing harm and establishing justice. Furthermore, *Riba* is determined between the creditor and debtor from the beginning, whereas compensation for damages is determined at the end (ibid.: 120-122; and Rezaei, 1381: 6/25-42).
2. **Muhammad al-Siddiq al-Darir** holds that:
   The bank cannot agree with the client on a specific amount or a percentage of the debt in case of delay. They can only agree that the client will compensate for the actual damage inflicted upon the bank, provided the client is capable of settling the debt (ibid.).

The Second Viewpoint: The Impermissibility of Stipulating Compensation

Some Sunni thinkers, such as Nazih Hammad, Zaki al-Din Sha'ban, 'Abd al-Nasir al-'Attar, Shabeer [Ahmad Usmani], Rafiq al-Masri, and Ramadan al-Bouti, hold the view of the impermissibility of stipulating compensation (ibid.: 128). Among them:

1. **Nazih Hammad** says:
   The legitimate (*shar'ī*) path in this matter, in order, consists of a threat of punishment in the Hereafter, then a judge's ruling to pay the debt, imprisonment, discretionary punishment (*ta'zīr*), and the sale of the debtor's assets to pay the creditor. In his view, a delay in debt repayment is not governed by the ruling of usurpation (*ghasb*), because liability for benefits applies only where the usurped property has the capacity to be leased, whereas money does not have the capacity for rent or actual, realized benefits (*manāfi' bi-l-fi'l*) (Rezaei, 1381: 6/25-42).
2. **Zaki al-Din Sha'ban** deems compensation for "extraordinary damages" permissible, and this matter has also been accepted in the civil code of Kuwait (ibid.).
3. **Ramadan al-Bouti** holds the view of the impermissibility of financial punishment (ibid.).
4. **Zaki 'Abd al-Barr** believes in compensation and indemnification for damage that has been realized (*tahaqquq yāfteh*).
   The reasoning for the opinion of Zaki al-Din Sha'ban and Zaki 'Abd al-Barr is that the term "punishment" in the Prophetic hadith, "*Layy al-wājid ẓulmun yuḥillu 'irḍahu wa 'uqūbatahu*" (Al-Hindi, 1401: 6/222), is absolute (*mutlaq*) and also includes financial punishment. However, the payment must be in exchange for a definite loss and a depleted asset, not a potential or probable loss (ibid.).

5. **Nejatullah Siddiqi** and **Ali al-Salus** hold that the late payment penalty must be deposited into a special financial fund or a charity, and its solution is through a judicial and penal path (Rezaei, 1381: 6/25-42).
6. In the opinion of **Anas al-Zarqa** and **Muhammad Ali al-Qari**, the procrastinator must provide a benevolent loan (*qard al-hasanah*) to the creditor for a period equivalent to the delay, in order to remedy their loss through this method (ibid.).

The fundamental point in these theories is the permissibility of financial punishment based on the Prophetic hadith, "*Layy al-wājid...*", or the liability for the benefits of usurped property and the notion that money possesses benefit. Each of these contributes to this discussion, and most of them hold the view of the impermissibility of compensating for damages through its initial determination (ibid.: 32).

2) Damages for Delayed Settlement from the Perspective of Shi'a Jurists and Legal Scholars

In relation to the collection of a late payment penalty, three viewpoints exist among Shi'a jurists and legal scholars.

2.1. Proponents of Claiming Damages for Delayed Settlement

Among the individuals who are proponents of claiming damages for delayed settlement, figures such as Mr. Mousavi Bojnourdi, Dr. Naser Katouzian, and some jurists can be named. This group of jurists and legal scholars maintains that:

> If, at the stipulated time, the obligor (*mut'ahhid*) does not proceed to pay their debt, they must be subject to paying damages for the delay of their debt, which has been inflicted upon the obligee (*mut'ahhid lah*) and has caused a reduction and loss of a portion of the obligee's purchasing power. They must pay the equivalent of this reduction in purchasing power as damages to them, so that the obligor's liability (*dhimmah*) may be discharged.

Seyed Mohammad Hassan Bojnourdi articulates the matter of damages for delay well from both a jurisprudential and a legal perspective, stating:

There is a debate among jurists and legal scholars as to whether loss (*ḍarar*) is an existential matter or a privative one. In the terminology of logicians, is the opposition between loss and benefit one of privation and possession (*'adam wa malakah*) or one of contrariety (*taḍādd*)? Most eminent scholars believe the opposition between loss and the absence of profit is one of privation and possession. Loss consists of the absence of profit in a situation where profit is attainable; the very fact that a person does not gain, they have incurred a loss. In other words, the absence of profit (*'adam al-naf'*) is the same as damage.

One of the cases that today gives rise to civil liability—that is, it brings about involuntary liability (*ḍamān qahrī*)—is this very issue of the absence of profit, or damages. According to the judgment of reason (*'aql*) and religious law (*shar'*), if you cause damage and loss to someone, you must compensate for it. For example, if I did not pay my debt to a natural or legal person on the due date, then I have caused them a loss. I must compensate for this loss. For this reason, this act is not right. According to the saying of the Prophet (pbuh), the root of interest-bearing loans (*Ribā al-qarḍī*) goes back to this point when he stated: "*Kullu qarḍin jarra manfa'atan fahuwa Ribā*" (Every loan that brings a benefit is *Riba*) (Boroujerdi, 1386: 23/780). This means a loan that entails a profit, pulls profit with it, and the lender stipulates a condition of profit when giving the loan, such that the borrower, at the due date, gives the

lender a sum of profit in addition to the amount they received. This matter is *Riba* in every sense of the word (Bojnourdi, 1376: 33).

Bojnourdi distinguishes between the following three jurisprudential theories regarding the permissibility of the late payment penalty and its distinction from *Riba*:

a) The Distinction Between Profit and the Absence of Profit

In the first theory, which is founded upon the distinction between profit and the absence of profit (*'adam al-naf'*), it is stated: We must investigate and determine whether interest-bearing loans (*Ribā al-qarḍī*) apply to damages for delayed settlement. That is, did the bank, as the lender (*muqriḍ*), stipulate a condition of profit with the natural person who is the borrower (*muqtariḍ*), or did it state that if you do not pay your debt at the specified time, the bank will suffer a loss? Because the bank works with this money, and you have impeded the bank's benefits and caused an absence of profit. In other words, you have inflicted a loss (*ḍarar*) on the bank and caused it damage (*khasārah*), and therefore you must provide compensation for the damage. Thus, one of the ways to validate damages for delayed settlement, by which we can say it is not *Riba*, is the non-applicability of the *Riba* of loans to it, as this issue is of the nature of civil liability and involuntary liability (*ḍamān qahrī*) (ibid.). In response to this theory, he [the author] says:

Firstly, the explicit meaning of this theory is that the bank is telling the client that if you had paid your debt to the bank on time, the bank could have utilized it and made a profit. So now that you have prevented the bank from earning a profit by delaying the payment, you must pay that profit as a late payment penalty. Therefore, this theory has no reality other than the payment of an excess amount in exchange for time, which is the very essence of *Riba* (ibid.). However, with a little scrutiny, it can be understood that the bank's objective in such a stipulation is not to take an additional amount in exchange for time, but rather its goal is to compel the client to pay their debt to the bank on the appointed date.

Secondly, if this theory were correct, one could also justify the principle of *Riba* itself. Someone who lends money to another is, in fact, foregoing their own benefits, because they could have worked with that money and earned a profit instead of lending it. Thus, according to this theory, they can claim that by taking the loan, you have prevented my gain and caused my absence of profit. Therefore, since you have caused me a loss, you must now compensate for that loss and damage and pay an additional amount (Mousavian, 1384: 4).

It seems this statement would be acceptable if such a request were made by the bank before the due date. However, after the due date and the client's delay in settling the debt, the bank, like any other natural or legal person, will not take action against itself. And based on the principles of *Lā Ḍarar* (no harm) and *Itlāf* (destruction of property), it can claim damages.

b) Governmental Discretionary Punishment (*Ta'zīr*)

In this theory, which is based on "the criminality of delaying payment," it is said:

> "Failure to pay a financial obligation at the appointed time is procrastination (*mumāṭalah*) and is prohibited (*harām*). If you made a commitment to someone and did not honor it, you are a violator of your covenant and have committed a prohibited act. Here, the government can subject the violator of the commitment to a governmental discretionary punishment (*ta'zīr*), just as many governmental discretionary punishments in countries are now legal, and the law explicitly states that whoever crosses a red light must pay a certain amount as a governmental *ta'zīr*... Here, too, whoever does not pay their

> debt to the bank on the appointed day must pay a certain amount to the bank. Therefore, we can also consider 'damages for delayed settlement' as a type of governmental discretionary punishment" (Bojnourdi, 1376: 34).

Some scholars find the above view flawed in several respects:

Firstly, in many cases of delay, no crime or prohibited act has occurred. For example, individuals who take loans from the bank to procure consumer durables and then, due to life's difficulties, become unable to pay on time; or producers and merchants who take loans and credit for productive and commercial affairs but, due to changes in economic conditions or changes in policies and regulations (which in many cases are made by the government), cannot launch their factory or sell their goods according to their initial plans. In all these cases, although there is a delay in payment and procrastination, a crime or a prohibited act has certainly not taken place. These are the very cases in which God has explicitly commanded in the Qur'an to grant respite (Al-Baqarah 2:280).

Of course, it should not be forgotten that if the client is unable to pay their debt for the reasons mentioned, they fall under the rule of insolvency (*i'sār*), in which case they must be granted respite—not as the esteemed critic states—and the assumption is that the aforementioned problems have not occurred for the client and they, despite being solvent, have refrained from paying their debt to the bank. In this situation, they can be subjected to governmental *ta'zīr*.

Secondly, in cases where the debtor, despite being able, refuses to pay the debt, although they have violated a covenant and are a transgressor, in most cases, according to Islamic jurisprudence, every crime has its own punishment and *ta'zīr*. In this case, after a warning, the ruler detains the violator and, by selling their assets, pays the creditors' rights (Mousavian, 1384: 4). In any case, this individual has been subjected to *ta'zīr*.

Thirdly, even if we accept that the offender can be punished in this case, the penalty amount must be deposited into the public treasury (*bayt al-māl*). But if it is paid to the bank as compensation for the bank's loss and damage, it becomes the former theory, the invalidity of which has already been discussed (ibid.).

Of course, it should not be forgotten that some jurists, based on the principle of "*Al-mu'minūn 'inda shurūṭihim*" (The believers are bound by their conditions) (Kulayni, 1363: 5/404), do not accept this invalidation.

c) Compensation for the Reduction of Purchasing Power

In this theory, which is based on not considering the compensation for the depreciation of money due to inflation as *Riba*, it is argued as follows:

The payment of the amount for damages for delayed settlement compensates for the reduction of purchasing power. Of course, the amount determined for damages for delayed settlement will be less than the reduction in purchasing power.

In reality, the money that the bank takes from the defaulting individual is the difference in the reduction of purchasing power that has arisen due to procrastination and non-payment of the debt, and this is not profit. The issue of the *Riba* of loans is based on "*yajurru al-manfa'ah*" (it brings a benefit). No benefit accrues to the bank from taking damages for delay. This same meaning must be observed when

individuals deposit funds in banks. In truth, individuals are lending to the bank, and at maturity, banks are obligated to compensate for the amount of the reduction in purchasing power (Bojnourdi, 1376: 34).

This theory also faces some objections:

Firstly, this theory is predicated on not considering the payment of a surplus equivalent to the rate of inflation—for the purpose of compensating for the reduction in the purchasing power of money—as *Riba*. And this issue, although a subject of debate among jurists, is considered *Riba* by the majority of them. It is on this basis that it is not practiced in the banking system; because otherwise, it would be necessary for banks to pay interest equivalent to the inflation rate on the balances of current and savings accounts, which are given to the bank as loans.

Secondly, even if we accept this theory, the bank has not taken any penalty or damages from the client for the delay, but has only confined itself to taking its right, whereas the philosophy of instituting a late payment penalty was to prevent the misuse by clients and to ensure the proper circulation of the flow of money in the bank.

Thirdly, this theory is justifiable only under inflationary conditions. But in non-inflationary conditions or with inflation rates of two or three percent, taking a penalty of two or three percent for a one-year delay is not only not a penalty but an incentive for misuse. Because the client sees that if they pay their debt to the bank and proceed to take out a new credit facility, they will certainly gain a profit many times greater than the late payment penalty. This situation is currently prevalent in non-usurious banking. For example, a merchant who takes a banking facility under a *Muḍārabah* contract with an expected profit of 26 percent and, according to the bank's practice, must pay that same 26 percent as the actual profit at the end of the period, observes that if they can somehow avoid timely payment, they will only pay 12 percent as a late payment penalty, and this matter is considerably to their advantage (Mousavian, 1384: 4).

Some scholars believe that "...assuming the creditor's demand and the debtor's ability to pay their debt and their refusal to settle the debt at the appointed time, in the event of a severe depreciation in the value of money, this person has caused a loss to them. Consequently, according to the principle of *Lā Ḍarar*, they must compensate for their loss" (Wahdati Shabiri, 1382: 12/100-101).

Some, although they have considered late payment damages to be *Riba* and prohibited, believe that: if the time interval and inflation are very high, such that paying the said amount is not customarily (*'urfan*) considered settlement of the debt, they must pay according to today's value or reach a settlement (*muṣālaḥah*) (Makarem Shirazi, 1389: 150-151).

There are also jurists who have ruled on the necessity of compensating for the depreciation of money but have deemed settlement (*muṣālaḥah*) desirable or necessary, either as a precaution or as a fatwa (Behjat, 1379: No. 5690 / Ardebili, 1377: Istifta'at).

Shahid al-Sadr also accepts that in the current situation where the value of money is continuously declining, such that after a few years, money loses its real value, today's money can no longer be considered "equivalent" (*mithl*) to the money of a few years ago. Therefore, if the bank, upon settling its debt, pays the real value of the money it had previously taken, it would not be *Riba* or prohibited (Sadr, 1399 AH: 19-20).

Some legal scholars, while differentiating between *Riba* and damages for delayed settlement and noting that the two main pillars [of *Riba*] (1- The acquired property being one of the two considerations of

the transaction or its accessory, and a separate and independent cause for ownership cannot be assumed; 2- Something in excess of what was given; which is a condition in *Riba*) are not present in damages for delayed settlement (Katouzian, 1383: 4/270-271), have expressed their opinion on the legitimacy and permissibility of taking damages for delayed settlement as follows:

What is taken on account of damages for delayed settlement is not an additional consideration in exchange for the debt; it is a separate obligation whose cause is the debtor's fault (*taqṣīr*) and which falls under the category of involuntary liabilities (*ḍamān qahrī*). In other words, damages for delayed settlement have their own specific and legitimate cause and are not an excess substitute for the principal, so as to be (unjust enrichment - *akl māl bi-l-bāṭil*). Furthermore, the current paper and fiduciary money, in reality, represents a certain amount of "purchasing power." There should be no doubt that the debtor's delay causes the loss of a portion of the money's value and the possibility of using its resources.

This value and benefit must either be given to the creditor or be considered the debtor's. And the ethical question that may be raised in this regard is: which one has a greater qualification for its ownership? The one who has lost this value and benefit due to a breach of covenant, or the one who has delayed the fulfillment of the covenant and has profited from it?

In other words, is securing the debtor's benefit more important, or compensating for the creditor's loss and damage? Just as justice (*'adl*) and fairness (*inṣāf*) dictate that it is better to grant a period of grace to a destitute debtor with good faith, justice also requires refraining from encouraging a transgressing and covenant-breaking debtor and giving them the opportunity for misuse. The motive to prevent the consumption of *Riba* should not give the debtor the opportunity for "unjust enrichment" (*akl māl bi-l-bāṭil*) (ibid.: 272-273).

The advantages of accepting this theory are that, firstly, it necessitates the debtor's commitment to paying their debt on the appointed date. Secondly, accepting this theory encourages individuals to lend, because when the owner of capital is certain that the value of their capital will be preserved, they will readily and with peace of mind place their capital at the disposal of the needy.

Arguments of the Proponents of Claiming Damages for Delayed Settlement

This group, to substantiate their theory, refers to the jurisprudential principles (*qawā'id fiqhiyyah*) of *Itlāf* (destruction of property) and *Lā Ḍarar* (no harm). They believe that the intention and purpose of the obligee (*mut'ahhid lah*) from the outset was not to receive profit, and this surplus amount received is in exchange for the loss of a portion of the obligee's purchasing power (Mohammad Behmand, & Mahmoud Bahmani, 1379: 87).

The question is, if a person gives a sum of money as a benevolent loan (*qard al-hasanah*) to another, and its repayment date is several months or years later, if an agreement has been made on the repayment date, but due to refusal to perform the obligation, they pay a debt that should have been paid, for example, two years later, four years later instead, what amount is upon the debtor's liability (*dhimmah*) at the stipulated time of repayment?

In response to this question, it must be said that the value and monetary worth (*māliyat*) of some assets are intrinsic (*dhātī*). Because such assets, like rice and meat, etc., themselves satisfy human needs, and their desirability is intrinsic, and without the imputation of monetary value to them, they possess the characteristics of property, i.e., being desirable and needed. However, banknotes do not have intrinsic economic value and monetary worth, as they do not satisfy needs and necessities *per se*. The holder of a banknote is the owner of a "specific purchasing power" and can, with such power, proceed to meet their needs to the extent of that purchasing ability (Bojnourdi, 1382: 19).

Thus, the entire essence of a banknote consists of purchasing power and the ability to meet needs, in addition to the preservation of value. Therefore, the holder of a banknote, as the holder of a contractual and fiduciary asset, will possess a specific purchasing power, and the banknote represents and indicates a specific and determined power that has been imputed to the banknote itself. Consequently, the reality of a banknote is not merely the imputation of monetary value; rather, it is the imputation of value and monetary worth in the form of purchasing power, such that a debt of one million Tomans is a debt to the extent of the purchasing power manifested in the sum of one million Tomans. In reality, concerning the loan of banknotes, it must be said that a loan is: "*tamlīk māl al-ākhir bi-l-ḍamān bi-an yakūn 'alā 'uhdatihi wa adā'ihi fī al-waqt al-mu'ayyan*" (the transfer of ownership of another's property against a guarantee, such that it is upon their liability to perform its settlement at the specified time) (Golpayegani, 1393 AH: 2/147). Given the reality of the banknote, which has no physical corpus (*'ayn*) and its identity is its purchasing power, the loan of a banknote will be the transfer of ownership of a specific amount of purchasing power, in exchange for which the same amount of purchasing power must be returned (Bojnourdi, 1382: 19).

Therefore, when two million Afghanis are borrowed, in reality, a purchasing power equivalent to two million Afghanis has been borrowed, and at the time of settling the debt, the same amount of purchasing power must be paid, even if a larger sum of banknotes is paid. Otherwise, they have not settled their debt. The transfer of ownership of a banknote is in no case gratuitous; rather, it is the transfer of ownership in exchange for its real counter-value (*'iwaḍ wāqi'ī*). Of course, if we consider the reality of the banknote to be merely purchasing power, it would be considered a fiduciary entity, and the term "corpus" (*'ayn*) would fundamentally not apply to it so as to fall under the definition of a loan. But if the reality of a loan is "the transfer of ownership of another's property for its real counter-value," it will also include the loan of banknotes, because the legislator has imputed monetary value to the banknote (ibid.).

It is noteworthy that the banknote itself is not purchasing power; rather, it is merely indicative of purchasing power. Therefore, purchasing power is a natural universal (*kullī ṭabī'ī*) that has multiple existences in the external world through the multiplicity of its individuals. This means that the natural universal is the very existence of the individual, and there is a generic unity (*waḥdah sinkhiyyah*) among banknotes, a unity that does not contradict numerical multiplicity (*kathrah 'adadiyyah*). That is, purchasing power is loaned, and by virtue of the loan contract, a specific amount of purchasing power is transferred to the borrower, and the banknote itself has no role in this nature; it only gives such an imputation a concrete and external realization and existence. Thus, the obligor will not be obligated merely to pay the same amount of banknotes received, because otherwise, they have not paid the real counter-value and have not discharged their liability (in return, the borrower will be obligated and liable). This is especially true in the current situation where the value of money has decreased and the inflation rate, considering fluctuations in commodity prices and purchasing power in the market, will be feasible without usury (*Ribā*) having taken place. This is because in such a contract or situation, no benefit (*manfa'ah*) has been obtained to be a manifestation of *Riba*, even though it has increased in terms of the number of banknotes (ibid.). But if the borrower, at the time of settling the debt, pays the lender the same number of banknotes received, despite its value and monetary worth having decreased due to inflation, they have paid less than what they received. Therefore, their liability is not discharged, and the rational principle of the equality of considerations (*tasāwī al-'iwaḍayn*) has not been observed.

Therefore, the value paid by the borrower, as that which was received (the counter-value), must be increased by the rate of inflation. Ultimately, if we consider the identity of the banknote to be indicative of what it represents, i.e., its purchasing power, we cannot prevent the application of the rule of *Itlāf* (destruction) to it. Because purchasing power is destructible, and by destroying the indicator (the banknote), what it indicates (purchasing power) is also destroyed. And based on the principle that "whoever destroys the property of another is liable for it" (*man atlafa māl al-ghayr fahuwa lahu ḍāmin*), the destroyer of the banknote is liable to compensate for it. And since the reality of the banknote is

purchasing power, the person who caused the destruction must compensate for the same amount of monetary value that they destroyed. This is a solution that, without conflicting with jurisprudential principles, provides for the compensation of the damage inflicted upon the aggrieved party, is also compatible with general legal principles, derives its legitimacy from the rule "*Al-mu'minūn 'inda shurūṭihim*" (The believers are bound by their conditions), and necessitates the commitment of the obligor and debtor to fulfilling their obligation at the appointed time (ibid.).

Sahib al-Jawahir, in his statements regarding damages for delayed settlement, says: If the benefit obtained in damages for delayed settlement arises from an ancillary binding contract (*'aqd khārij lāzem*), since the said contract, according to the principle of the dissolution of contracts, is a separate contract from the loan, therefore, if a benefit is obtained from this source, it has not originated from the loan contract itself but has come into existence from outside of it. Thus, the benefit obtained cannot be considered as a benefit in the loan, because a condition of benefit was not made, but rather a condition of an act was made, which has taken the form of an ancillary binding contract. In other words, since the benefit obtained did not originate from the loan contract itself, it has no prohibition. This meaning applies if we consider the condition a stipulation and not a part of it; otherwise, if it is considered part of the contract, then the benefit obtained originates from the contract itself, and thus it will be *Riba*. And if we consider the condition of damages like an implicit condition, collateral, respite, mortgage, ..., the discussion of a condition of benefit in a loan will be negated, because such a condition is merely a restriction on the return of the loaned property and the restoration of the right, and compels the lender [debtor] to pay the debt (Najafi, 1314 AH: 25/5).

2.2. Absolute Opponents of Collecting Damages for Delayed Settlement

The debt that a debtor refrains from paying, for which the creditor claims damages for delay, sometimes originates from a loan contract and sometimes stems from other contracts. The difference between these two lies in the narrations that have been transmitted specifically regarding loans, which declare any condition that benefits the lender to be prohibited (*harām*) (Hurr al-Amili, 1403 AH: 18/356).

For this reason, most Shi'a jurists are absolutely opposed to the payment of damages for delayed settlement by the debtor and have deemed any payment in excess of the principal debt under any title—such as the depreciation of money's value, the reduction of purchasing power, or damages for delay at the stipulated due date, and the like—to be forbidden and illegitimate (*ghayr mashrū'*) (Wahdati Shabiri, 1382: 101).

This group adheres to the principle of "*'adam al-naf' laysa bi-ḍarar*" (the absence of profit is not a loss) and believes that if, at the appointed time, the debtor does not proceed to fulfill their obligation, no loss has been inflicted upon the obligee, and the term "destruction of property" (*talaf māl*) does not apply to it, so that the general laws of *Itlāf* (destruction) and *Tasbīb* (causation) would be applicable. Likewise, the rule of liability of possession (*ḍamān al-yad*) does not apply to lost profit. This group does not consider the absence of profit to be a loss (Mir Fattah, 1417 AH: 1/310 / Naraqi, 1375: 50).

In other words, the disagreement mostly arises from the fact that this group does not consider the damages that arise from delayed settlement to be a loss and believes that: "*'adam al-naf' laysa bi-l-ḍarar*" so as to be compensable (Isfahani, 1419 AH: 363). Below, we examine the opinions and arguments of this group:

Imam Khomeini (ra), in response to a question about a person who, within a loan contract, stipulated a guarantee regarding purchasing power, wrote:

The mentioned condition is not effective (*nāfidh*), and he is liable for the same amount that he borrowed, and the purchasing power of money has no effect in this matter (Khomeini, 1392: 2/290).

And elsewhere, in response to the question that if, for example, the cost of living index at the time of receiving a loan in the year 1352 was 100 and at the time of repaying the loan in the year 1354 was 150, is it correct for the debtor to pay the difference that has resulted from the depreciation of the creditor's money's value due to inflation, as the price? He responded:

The *Riba*-taker must return the amount of *Riba* they have taken, and the increase or decrease in the value of money has no effect.

Likewise, in his *Kitab al-Bay'* (Book of Sale), he says:

The surplus discussed in *Riba* includes any kind of conditional financial surplus whose benefit accrues to the lender or someone else. Therefore, if in a loan, one stipulates a condition to help a needy person, or to spend money for a mosque or for mourning ceremonies, or to repair a mosque, these cases are a condition of surplus and are *Riba*. Only a non-financial matter, or a financial matter that was obligatory for the borrower without the condition, can be mentioned as a condition in a loan, such as "I lend to you on the condition that you pay your *zakat* or perform your prayers or pray for me." If in a loan, one stipulates a condition to sell their goods cheaper or to rent out their house cheaper, this is a financial surplus and is *Riba* (Khomeini, 1390 AH: 1/535 / Khoei, 1410: 2/48).

Ayatollah Golpayegani, in response to a question about bank penalties, writes:

A condition of surplus, even if under the title of a service fee and the other matters mentioned in the question, is *Riba* and is prohibited. The penalty is also prohibited. But if the debtor, in a legitimate manner within an ancillary binding contract, has committed that if they delay past the specified date, they will give a certain amount gratuitously (*majjānan*), there is no problem (Golpayegani, 1413 AH: 2/91).

Ayatollah Seyed Mohammad Kazem Yazdi (ra), the author of *'Urwah*, believes that the depreciation of money's value before and after the due date is not under the debtor's liability, even if they were capable of paying and the creditor had also demanded the debt. In response to a question regarding a severe depreciation of money's value, he says:

Whenever that debt is deferred and the price decline occurs before the maturity of the term, the loss is on the creditor... So in the case of a price decline, it has come from the creditor's pocket; just as they say in the case of usurpation (*ghasb*)... (Shabiri, 1382: 12/100).

As was indicated, most jurists consider the determination of a rate for the repayment of a loan to be "Riba," and regarding the collection of a late payment penalty by banks, the overwhelming majority of the Maraji' (sources of emulation) emphasize that it is *Riba*. Thus, Grand Ayatollahs Makarem Shirazi, Nouri Hamedani, Sistani, and Ja'far Sobhani, from the Grand Maraji' of the Shi'a, are in unanimous agreement in response to a request for a fatwa on this matter and consider the collection of late payment penalties on bank installments to be religiously problematic (Rasa News Agency, 1383).

Ayatollah Makarem Shirazi, emphasizing the impermissibility of collecting these penalties, stated:

We have repeatedly written and said in response to such questions that the collection of late payment penalties on installments by banks is not permissible (ibid.).

Ayatollah Nouri Hamedani, in response to the question, "What is the ruling on collecting late payment penalties on bank loan installments?" emphasized:

In response to the question that was raised, we have written many times and have even declared in meetings with respected bank officials that these penalties collected in exchange for the delay of bank installments have the ruling of "Riba" and are definitively prohibited, and we hope that our banks will be cleansed and purified of the prohibited (ibid.).

Ayatollah Sistani:

As long as the money has not completely lost its value, the standard for liabilities and debts is the same amount of money that existed previously, and the decrease in value does not cause an increase in the liability and debt (ibid.).

Ayatollah Tabrizi:

If a person owes another a sum of the current money on account of a loan or otherwise, the creditor can only claim that same amount and does not have the right to claim more than that. The decrease or increase in the purchasing power of money does not affect the aforementioned ruling. And God knows best (Judiciary, Center for Fiqhi Research, 1381: 1/98).

Ayatollah Fazel Lankarani:

No, none of the mentioned proofs authorize compensation for the depreciation of money's value (because in his view, money is fungible - *mithlī*), and the recipient is liable for the same as what they took, not for purchasing power or anything else. In response to a question ("Currently, as the value and purchasing power of banknotes decrease daily, please state your opinion on the quality of settling a debt or a liability"), he writes: In cases where a person's liability (*dhimmah*) is occupied with a fungible good, they are indebted and liable for that same fungible good. And in cases where a non-fungible good (*qīmī*) is attached to the liability, they are liable for its value. The decrease or increase of purchasing power or becoming more or less expensive does not change the obligation and liability. Of course, in the case of non-fungible goods, it is necessary to pay the value on the day of settlement (Lankarani, 1383: 1/304).

Ayatollah Sobhani:

The money with which goods are purchased is of two types: sometimes the money itself has the ruling of a commodity and, in terminology, has real value and is considered a commodity itself, like gold and silver. In this case, such money has the ruling of a commodity. Whenever a person is indebted for the corpus of gold and silver for any reason, their liability is discharged by paying the thing itself, and they have acted according to the law of "like for like." Sometimes money is not considered a commodity, but has fiduciary value, not intrinsic and real value, and has acquired value through the support of banking guarantees, carrying out the function of buying and selling. And if its imputed value is stripped from it, it is nothing more than a worthless piece of paper. This type of money is a fiduciary fungible (*mithlī i'tibārī*) and stands in contrast to gold and silver, which are real fungibles (*mithlī ḥaqīqī*). In situations where a sum of money or something else is given to another as a benevolent loan and its repayment date is several years later, they can only take its equivalent, whether it be a commodity—including currency or other goods that have intrinsic value—or banknotes that have fiduciary value. And if they take more than what they paid under the title of inflation and the depreciation of money, it will be *Riba* (Sobhani, 1372: 6/89-90).

The Guardian Council, in response to a letter from the Supreme Judicial Council regarding damages for delayed settlement (12/4/64), declared:

"The claiming of a surplus over the debt from debtors as damages for delayed settlement, as the Imam explicitly declared with this phrase: 'What is taken on account of the delay in payment of a debt is *Riba* and is prohibited,' is not permissible, and rulings issued on this basis are not legitimate" (Mousavian, 1384: 4/15). Of course, this council later deemed the taking of a penalty in the form of a condition within a contract to be permissible.

2.3. Conditional Proponents of Collecting Damages for Delayed Settlement

A number of jurists and scholars accept the collection of damages for delayed settlement conditionally. They believe that if damages for delayed settlement are included as a condition within the contract (*shart ḍimn al-'aqd*) between the obligor (*mut'ahhid*) and the obligee (*mut'ahhid lah*), then on this basis, if the obligor does not proceed to pay their debts at the appointed time, a sum will be attached to their liability (*dhimmah*) as damages.

This group of jurists states that there is no obstacle to placing such a condition within the contract, and to prove their theory, they refer to the jurisprudential principle of "*Al-Mu'minūn 'inda shurūṭihim*" (The believers are bound by their conditions) (Taskhiri, 1382: 35/65). Therefore, they believe that this penalty constitutes damages for delayed settlement and is not *Riba*; it is a damage that the defaulter must pay due to the breach of a condition within the contract. That is, in reality, the intention of the condition within the contract is to compel the borrower to pay the debt at the appointed time, not to take *Riba* in exchange for granting a respite and extending the time.

Ayatollah Safi Golpayegani, distinguishing between commodities and banknotes, says regarding banknotes:

> "...If someone unjustly withholds someone's banknote, check, or deed, causing its monetary value to decrease, they will be liable (*ḍāmin*) for the decrease in monetary value and the loss inflicted upon the owner of the banknote... because in a banknote, where its entire اعتبار (*i'tibār*) and monetary worth (*māliyat*) lie in its purchasing power, and the primary intended purpose of it is as a means to purchase and acquire ownership of things, therefore, the decrease in its monetary value is like [damage to] the corpus (*'ayn*) of a commodity. Because the external benefit of it, aside from this fiduciary monetary value, is not intended, and thus its decrease is customarily (*'urfan*) a loss, and if it occurs unjustly, it gives rise to liability. This applies whether it is a liability in *dhimmah* or an external [asset]. And this is contrary to the case where a banknote held as a liability decreases in price during the stipulated period or with the permission of the creditor for a delay, because in this case, it has appreciated or depreciated while in their own ownership and under their own possession, and no one is liable for its loss..." (Yousefi, 1381: 269-270).

Elsewhere, he says:

Riba occurs in the case where the lender, with the said condition, authorizes the borrower to delay in exchange for the payment of a sum of money. But if their intention is to compel the borrower to settle the debt at maturity, and in terminology, a "penalty clause" (*wajh al-iltizām*), it will be without issue. For example, the lender stipulates that if the debt is not paid at the specified maturity, 12 percent of the principal debt per year will be added to their liability. Such a thing will not be included in the narrations prohibiting *Riba* (Seyed Abbas Mousavian, 1384: 4/25).

What is noteworthy in this fatwa is the distinction between *Riba* and a penalty clause, which is sometimes referred to as a "penal clause" (*shart-i kayfarī*). *Riba* is an amount in addition to the principal debt in exchange for granting a respite, whereas the lender in the discussed scenario wants nothing other than the principal debt at maturity. And if they stipulate an amount in the event of a delay, it is for the purpose of compelling the borrower to pay the loan at the end of the term. For this reason, the jurists of the Guardian Council, as will be mentioned, have accepted damages for delayed settlement in the form of a condition within the contract.

Ayatollah Khamenei, in response to a question in this regard, has written:

Damages arising from the delay of a debt, if it is proven that they are attributable to the delayed settlement, are under the debtor's liability and do not have the ruling of *Riba* (Ettela'at Newspaper: 2/2/1378).

In this view, without using the mechanism of a condition within the contract, damages for the delayed settlement of cash are accepted and are considered outside the ruling of *Riba*. However, it does not provide an explanation regarding the scope of said damages and how they are to be attributed to the delayed settlement. For example, it is not clear whether the claimable damages also include lost profits or only cover the reduction in purchasing power. Likewise, it is not specified whether the said damages are claimable in the case of a severe reduction or if a reduction to a conventional extent is also under the debtor's liability, although it is not unlikely that the absolute wording of the statement encompasses all these scenarios (Wahdati Shabiri, http://hagh1345.blogfa.com).

Elsewhere, regarding this, they state:

> "You must state and explain this issue to the person separately from the contract. At the time of signing, they must understand and accept that according to this contract, for every day they delay in paying the debt, they must pay this amount."

Ayatollah Makarem Shirazi, in this regard, states:

> "We understand that we are now at a crossroads, where whichever path we choose, we face a problem. On the one hand, if we want to say there is no penalty whatsoever, this will cause people to delay. Debtors will not pay attention to paying their debts. When a bank places its capital at the disposal of debtors who are indifferent to paying their debts, the fabric of that bank will fall apart. On the other hand, we also understand that if someone, for any reason, delays the payment of their debt by one hour or one day, if we take a profit from them according to the banking system for this one day, this also creates a problem with our jurisprudential standards" (Rasa News Agency, 1383).

Elsewhere, he states:

> "If inflation in a short period and of a normal amount occurs, it is not calculated, because changes in goods and the purchasing power of money have always occurred and continue to occur, and the practice (*sīrah*) of the Muslims and jurists has been not to calculate minor changes. But if the inflation is severe and the fall in the value of money is great, to the extent that in custom (*'urf*), paying that amount is not considered settlement of the debt (*adā' al-dayn*), it must be calculated based on the present situation. And in this matter, there is no difference between dower (*mahriyah*) and other debts. For example, in one of the requests for a fatwa, it was mentioned that a person had not paid a builder's wage thirty years ago, while the builder had worked for him for ten days and the builder's wage on that day was 18 Tomans (180 Rials). Certainly, if someone wants to pay the builder's wage at the price of that day, i.e., 18 Tomans per day, in no custom is it considered settlement of the debt. And likewise, in the case of the

destruction of non-fungible goods (*qīmiyyāt*), if one were to pay the previous price, no custom would consider it compensation for damages.Therefore, neither in debts nor in other damages is paying the previous price in such situations a manifestation of settling a debt or compensating for damages, and for this reason, it must be calculated at the daily rate... The conclusion is that in cases where price changes in the short or long term are small, custom considers it a manifestation of settling the debt and accepts it, but severe and egregious differences are not acceptable and are not considered settlement of the debt" (Yousefi, 1381: 314-315).

According to this Marja' (source of emulation), the settlement of a debt is a customary matter, and in an inflationary situation, especially when inflation is very high and severe, custom does not consider the payment of the nominal amount of the debt as settlement of the debt.

Ayatollah Mousavi Ardebili also says in this regard:

Regarding damages for delayed settlement, the bank makes a condition within the contract and an initial condition, which I consider religiously authoritative (*hujjat*), that if you do not pay the money on time, you must pay this much as a penalty. However, the way those contracts are drafted, stating that if you do not pay, you must pay this much monthly, will cause misunderstanding for some. Of course, I consider both to be correct, because it might be a monthly [rate]; they might say, if there is a one-month delay, it is this way; a two-month delay, this amount, and so on. Now, if a percentage is also specified, in this case it is also correct, because the debtors are different from each other; one is one million and another is more or less, so in this case, it is also correct.

Of course, it must be stated in the text that this amount is a penalty, it is not for the delay, and the issue that has caused the ambiguity—you must say, if you did not pay, give a certain amount as a penalty (Mohammad Behmand & Mahmoud Bahmani, 1379: 87).

The only difference between the first theory and this theory is that the jurists in the first theory did not consider the mention of damages for delayed settlement within the contract to be necessary, but the proponents of the third theory consider the mention of this phrase to be a condition for collecting and claiming these damages.

The acceptance of this theory creates a balance between the previous two theories, because on the one hand, it includes the advantages of the first theory, i.e., compensating the obligee's loss, and on the other hand, it is immune from the attacks and objections of the second theory, because the debtor, based on the hadith "*ūfū bi-l-'uqūd*" (Fulfill the contracts), must honor their covenant and settle their debt at the appointed time so as not to be subjected to paying damages.

Ayatollah Sane'i, in response to the question, "Do banks have the right to take a late payment fee for a loan?" states:

If it is stipulated in the text of the contract, by the ruling of the condition, there is no obstacle (Sane'i, 1384: 2/341).

Ayatollah Seyed Kazem Haeri:

"If the delay in settlement was intentional and caused damage, like a usurper who has consumed someone's property and then repented and wants to settle, or like debts where the time for settlement has arrived and he is capable of settling but disobediently does not, [he is liable]. And if the delay in settlement was with the agreement of both parties or was due to '*naẓirah ilā maysarah*' (postponement

until a time of ease), there is no proof for liability for the depreciation, and the debtor in this case is a trustee (*amīn*) and there is no liability for him" (ibid., 317-318).

The jurists of the **Guardian Council**, in an official letter (dated 28/11/1361), agreed that banks, based on a condition they include within the contract, can receive a percentage as a late payment penalty from defaulting debtors.

Ayatollah Rezvani, one of the jurists of the Guardian Council, in a jurisprudential explanation of this theory, says:

The late payment penalty is not *Riba*. Rather, the bank says: you must pay your installment at the end of the month. If you do not bring it, at that same time, you must pay a certain amount as a penalty; not that you pay the penalty so that the amount (the installment) can remain with you for another month. Therefore, delayed settlement [penalty] is not *Riba*. Now that it is not *Riba*, if it has been stipulated within the contract or loan, it has the ruling of "*Al-Mu'minūn 'inda shurūṭihim*," and no issue arises" (Rezvani, 1372: 33-34).

2.4. The Jurisprudential Proof for the Permissibility of Stipulating a Late Payment Penalty within the Contract

Some, in their jurisprudential explanation of the view of the Guardian Council and those jurists who permit the collection of a late payment penalty in the form of a condition within the contract (*shart ḍimn al-'aqd*) and a penalty clause (*wajh al-iltizām*), have stated:

According to the principle of "*Al-Mu'minūn 'inda shurūṭihim*" (The believers are bound by their conditions), which is an accepted and established matter among jurists, if a condition is placed by the two contracting parties within a valid and binding contract, and firstly, it is not contrary to the nature (*muqtaḍā*) of the contract; secondly, it is not contrary to the Qur'an and Sunnah; thirdly, it is agreed upon by both parties; and fourthly, the commitment to the condition is included in the contract, this condition is valid and, like the contract itself, is obligatory to fulfill (*lāzim al-wafā*). Because just as the fulfillment of a binding contract is obligatory, the fulfillment of the condition included within it is also a religious obligation and duty (*taklīf shar'ī*) (Taskhiri, 1384: 44/75-79).

In the subject of our discussion, it is assumed that banking contracts are valid and binding contracts. It is clear that the condition of a penalty in case of a breach of obligation and delay in settling the debt is not contrary to the nature of banking contracts such as the benevolent loan (*qard al-hasanah*), installment sale (*bay' al-mu'ajjal*), lease-to-own (*ijārah wa iqtinā'*), forward sale (*salaf*), profit-sharing (*muḍārabah*), etc. On the other hand, it is agreed upon and signed by both parties to the contract.

The only point that remains regarding the validity of the condition is its opposition to the Qur'an and Sunnah, or to put it more clearly, the usurious nature (*Ribāwī*) of the condition, as was also inferred from the fatwas of the opponents of the penalty condition. That is, they were of the belief that: damages for delayed settlement, even if they take the form of a condition within a loan contract, are still prohibited (*harām*) and illegitimate, because the content of this condition contingently returns a benefit to the lender (Mousavian, 1384: 4/26).

However, in the opinion of some, such a condition is natural and conventional, because a delay usually causes a loss (*ḍarar*) for the lender. Although the aspect of causing harm is not a restrictive condition (*ḥaythiyyat al-iḍrār, ḥaythiyyat taqyīdiyyah nīst*), and even if the breach of the condition does not cause a loss, the stipulator can still claim compensation based on the breach of the condition,

according to the principle of "*Al-Mu'minūn 'inda shurūṭihim*." This is because, based on customary (*'urfī*) views and habits, a breach often causes loss; therefore, they consider the condition of a financial penalty to be valid (Taskhiri, 1384: 44/88-89). Given what has been stated, it is clear that transactional *Riba* (*Ribā al-mu'āmalī*) does not apply to such a condition, and consequently, it does not require much examination. However, there is the possibility of the applicability of the *Riba* of loans (*Ribā al-qarḍī*), the increase of a debt in exchange for an extension of the term (*Riba* of the pre-Islamic era - *Ribā al-Jāhilī*), and also the possibility of it being a subterfuge for *Riba* (*ḥīlah al-Ribā*) (Mousavian, 1384: 4/27). We will examine these in the following:

The Possibility of the Applicability of the *Riba* of Loans:

According to the definition derived from authentic and explicit narrations regarding prohibited *Riba*, which jurists have also acted upon, a loan contract becomes afflicted with *Riba* when a condition of surplus is made in it. If there is no such condition, even if the borrower, at the time of payment, pays more or better than what they borrowed, it will not be prohibited *Riba*. "*'An Abī 'Abdillāh (a.s.) qāl: idhā aqraḍta al-darāhim thumma jā'aka bi-khayrin minhā falā ba's idhā lam yakun baynakumā sharṭ*" (From Abu Abdullah (a.s.) who said: If you lend dirhams and then he brings you better than them, there is no harm, as long as there was no condition between you) ('Amili, 1387: 18/360). al-Sadiq (a.s.), in defining prohibited *Riba* of loans, states: "*Wa ammā al-Ribā al-harām fahuwa al-rajul yuqriḍu qarḍan wa yashtariṭu an yarudda akthara mimmā akhadhahu fahādhā huwa al-harām*" (As for the prohibited *Riba*, it is when a man gives a loan and stipulates that[the borrower] return more than what he took; this is what is prohibited)(ibid.:160-161).

Imam Khomeini also, in explaining the dimensions of the *Riba* of loans, states:

In a loan contract, a condition of surplus is not permissible, in the sense that one lends property on the condition that the borrower pays more than what they borrowed (Khomeini, 1408 AH: 2/653).

Now, in the issue of the "late payment penalty" that is discussed in banks, firstly, the penalty condition is not always in a loan contract to become an usurious loan. Rather, most banking facilities are based on various contracts such as installment sales, lease-to-own, forward sales, *ju'ālah*, purchase of debt, *muḍārabah*, *muzāra'ah*, *musāqāt*, and civil partnership. The loan contract constitutes only 5 to 10 percent of banking facilities.

Secondly, in the condition of a late payment penalty, the lender does not stipulate that the borrower, at maturity, should pay something more than what they borrowed. Rather, just as the lender sometimes demands a guarantor, sometimes collateral, and sometimes a surety to ensure the settlement of the debt, this time, instead of or in addition to them, to compel the borrower to settle the debt at the stipulated maturity, they [the borrower] commit that in case of a breach of covenant and default on timely payment, they will pay a sum as a penalty (Mousavian, 1384: 4/27).
If the lender's goal (for example, the bank's) is to take a sum as a penalty at maturity, or if their intention was for the borrower to be authorized to delay payment in exchange for paying the penalty, or if both parties intended for a delay and the payment of a penalty, the title of "a loan with a condition of surplus" would apply to it, and it would fall under the *Riba* of loans (Wahdati Shabiri, 1382: 12/102).

As has been stated, the condition of a late payment penalty is a mechanism to compel the debtor to pay the debt on time. And institutions like banks, if they have evidence of non-payment, are not willing to grant facilities, even with the knowledge that the client will pay the late payment penalty. The conclusion is that: such a loan does not fall under the description of a loan with a condition of surplus, and if there is a condition, it is of the nature of a condition of guarantee or collateral (Mousavian, 1384: 4/28).

The Possibility of the Applicability of Extending the Term in Exchange for Increasing the Debt: One of the manifestations of *Riba* is extending the payment term in exchange for increasing the debt, and this type of *Riba* is not exclusive to loan contracts and includes all deferred-payment contracts. According to the writings of exegetes (Jami'at al-Mudarrisin, 1381: 89-90), when the pre-Islamic Arabs had a claim on someone, when the payment maturity arrived, they would say to him: "*ta'ḍī aw turbī*" (pay, or increase [the debt]) (Taskhiri, 1382: 35/63-71). Meaning, will you pay your debt, or will you add to its amount so that its maturity is extended? If the debtor had the means, they would pay, and if not, they would add to the amount of the debt and postpone the maturity, until the verses on *Riba* were revealed and deemed such an act prohibited (Jami'at al-Mudarrisin, 1381: 89-90 & 92).

It is clear that the content of this type of *Riba* reverts to an agreement between the two parties for the continuation of the debt in exchange for a larger sum (Iqbal Qureshi, 1361: 41), and this case of "*ta'ḍī aw turbī*," which is based on *Riba* from the outset, is different from the content of the condition of a late payment penalty (Taskhiri, 1382: 35/63-71). This is because in the condition of a late payment penalty, the creditor's objective in including such a condition is to compel the debtor to pay on time and to provide a mechanism to prevent the continuation of the debt.

In practice, an amount is taken as a penalty only when a breach of covenant and a default occur. If the debtor fulfills the covenant at maturity, no surplus is taken. Banks and reputable financial institutions prefer that debtors pay their debts at the stipulated maturities so that they can advance their objectives according to a specific plan. Delays in debt payments cause disruptions to plans and a loss of credibility for banks, and it is clear that no bank or institution would enter into such a risk for the allure of a penalty (Seyed Abbas Mousavian, 1384: 4/28).

Therefore, there is an essential difference between a late payment penalty and increasing the debt in exchange for extending the term. Another point that differentiates the discussion of a penalty condition from the manifestation of *Riba* of the pre-Islamic era is the title of "default" (*takhalluf*), which actualizes the subject of the condition (Taskhiri, 1382: 35/63-71).

The Late Payment Penalty as a Subterfuge for Receiving *Riba*:

Among the subterfuges (*ḥiyal*) that some European usurers devised against the Church was taking *Riba* in the form of a late payment penalty. The lender would give their property as an interest-free loan for a short period, even one day, but at the time of the contract, they would stipulate that if the borrower did not pay at the appointed time (sometimes they set the payment date so short, for example, one day, that the borrower could not pay their debt), they must pay a certain specified amount as a penalty for each day or month of delay. Gradually, this method turned into a mechanism for receiving *Riba* (Jami'at al-Mudarrisin, 1381: 58).

It is clear that such a penalty, although it may not fall under the title of *Riba* in appearance, will in reality be *Riba* and prohibited (Seyed Abbas Mousavian, 1384: 4/29). This is because in the *Riba* of loans, the lender gives the loan for the purpose of earning profit and benefit, but in the case of damages for delayed settlement, for the bank, receiving installments at maturity is more profitable than receiving damages. In other words, the lending was done from the beginning with the allure of that surplus to the other party, contrary to the late payment penalty in Islamic banks, where the main goal of the bank is to compel the client to pay the debt at the stipulated maturity.

Although in banking contracts there is a concern that banks might grant interest-free loans or banking facilities for a specific period and, in that contract, use the penalty condition as a cover for receiving *Riba*, in the opinion of some, an examination of the various aspects of Iranian banking contracts shows the contrary, because:

Firstly, banking contracts, in proportion to the subject of the contract, are concluded for a suitable period of time, such that ordinary individuals can pay their debt in that time. Benevolent loan facilities are for three to five years, installment sales for one to fifteen years, civil partnerships for two to several years, and even six-month *muḍārabah* contracts are designed in such a way that the recipient of the facility can achieve their goals and have the ability to pay. The performance of the past several years of the banks also indicates that more than 90% of the users of banking facilities can pay their debt according to the bank's schedule and do not incur any penalty (Seyed Abbas Mousavian, 1384: 4/28).

Secondly, a maximum of 10 percent of the facilities granted by banks are through interest-free loan contracts, where the bank might use the late payment penalty condition as a cover for receiving *Riba*. More than 90 percent of bank facilities are based on other contracts, especially installment sales, where the bank can propose a higher price from the very beginning in proportion to the amount and the payment period, and there is no need for a penalty condition to cover for *Riba*. For example, a good that the bank was supposed to sell for five million with two-year installments, it sells for six million with four-year installments. Therefore, in the majority of banking contracts, there is no scope for a subterfuge for *Riba* through a penalty condition (ibid.).

Thirdly, in most banking contracts, the rate of the late payment penalty is set at a level such that the recipient of the facility does not see it as a suitable mechanism for extending and continuing the contract. For example, in the current contracts of Iranian banks, the rate of the late payment penalty is six percent more than the rate of conventional facilities, and this causes that, under normal conditions, no facility recipient would see the penalty condition as a substitute for increasing the debt amount to continue the contract (ibid.).

B. The Distinction Between Damages for Delayed Settlement and *Riba*

Some experts, citing a narration from Imam al-Sadiq (a.s.) who stated: "*Kullu qarḍin jarra al-manfa'ah fahuwa harām*" (Every loan that brings a benefit is prohibited), claim that damages for delayed settlement are, in fact, a benefit in a loan and are therefore prohibited and constitute *Riba*. In response to this view, it must be stated that in the taking of *Riba*, the profit and surplus are intended *per se*. That is, in commutative transactions or in the *Riba* of loans, the excess (*faḍl*), surplus, and benefit are the intended objective of the usurer from the beginning of the contract (Mahmoud Bahmani, 1384: 272-273; and Taskhiri, 1383: 35/...). For example, in the *Riba* of loans, the lender gives the loan for the purpose of earning profit and benefit, whereas in damages for delayed settlement, for the bank, receiving installments at maturity is more profitable than receiving damages.

In other words, if the bank receives the installments back on time, given its resource management, it can utilize them in other economic sectors and enjoy a greater profit (Mousavian, ibid., p. 30).

Some believe that damages for delayed settlement are completely different from "profit" (*ribḥ*) or "*Riba*," and these two should not be confused, because in "*Riba*," two main pillars exist that determine its nature and essence:

1. The acquired property is one of the two considerations of the transaction or its accessory, and a separate and independent cause for ownership cannot be assumed.
2. Something more is taken than what was given. What is mentioned in the Civil Procedure Code (of Iran) under the title "damages for delayed settlement" has neither of those two main pillars (Katouzian, 1383: 4/270-271), because:
    1) It is not an additional amount paid to the lender in excess of the principal amount, but rather the minimum damage that the creditor has borne as a result of being deprived of

their capital at the appointed time. This indemnity is also a composite of the two main pillars of damages: one part arising from lost profit (*lucrum cessans*) and the other part arising from conventional losses (*damnum emergens*), including the erosion of the money's purchasing power.

2) These losses arise from the debtor's breach of covenant, and they must, according to the rules of involuntary liability (*ḍamān qahrī*), compensate for the loss that they have caused (ibid.).

Since in Iranian law, damages are typically paid in money, in lawsuits where the subject matter is "cash," if property of the same kind and in excess of the claim is paid to the plaintiff, this action is considered similar to usury. However, from an analytical perspective, the taking of the second sum of money is not an agreement between the two parties for an excess in exchange for deferring a due debt. Rather, its cause is the fault (*taqṣīr*) that the debtor has committed in settling the debt, thereby inflicting damage on the creditor. Consequently, what is taken on account of damages for delay is not an additional consideration in exchange for the debt; it is a separate obligation whose cause is the debtor's fault and which falls under the category of involuntary liabilities (ibid.).

Some believe that if the bank's objective in instituting a late payment penalty and collecting damages for delayed settlement is to generate income for the bank, in this case, the suspicion of *Riba* exists, and it is considered a manifestation of *Riba* and is definitively prohibited. However, if the bank's objective is to compel the client and the applicant for facilities to pay the debt and installments on the stipulated due date, in this case, the late payment penalty and damages for delayed settlement are not a manifestation of prohibited *Riba*, and the rulings of *Riba* do not apply to them (Interview with Dr. Mohammad Javad Mohaghegh Nia, Professor of Economics, Member of the Fiqhi Council of Bank Refah Kargaran).

Some believe that neither transactional *Riba* nor the *Riba* of loans includes the late payment penalty and have stated the difference between a late payment penalty and damages for delayed settlement with "*Riba*" in the following order (Mousavian, 1384: 4/30):

1) Transactional *Riba* (*Ribā al-mu'āmalī*), meaning the exchange of two commodities of the same kind with a surplus, does not include the condition of a late payment penalty.
2) The *Riba* of loans (*Ribā al-qarḍī*), meaning the condition of a surplus in a loan contract (i.e., both the contract is a loan contract and a condition of surplus has been made), this matter does not include the condition of a late payment penalty.
3) *Riba* of the pre-Islamic era (*Ribā al-Jāhilī*), meaning an agreement to increase the amount of the debt in exchange for extending the payment term, and this statement does not include a late payment penalty.
4) What is taken on account of damages for delay is not an additional consideration in exchange for the debt; it is a separate obligation whose cause is the debtor's fault and which falls under the category of involuntary liabilities.

Damages for Delayed Settlement from the Perspective of Shi'a Jurists and Legal Scholars

A. Conditional Proponents: The Collection of Damages for Delayed Settlement as a Stipulation within a Contract (*Shart Ḍimn al-'Aqd*)

1. The Jurists of the Guardian Council (*Fuqahā-ye Shourā-ye Negahbān*)
2. Ayatollah Safi Golpayegani
3. Ayatollah Ali Khamenei

4. Ayatollah Makarem Shirazi
5. Ayatollah Yousef Sane'i

B. Absolute Opponents of Collecting Damages for Delayed Settlement (The Majority View - *Qawl al-Mashhūr*)

1. Imam Ruhollah Khomeini
2. Ayatollah Mohammad-Reza Golpayegani
3. Ayatollah Seyed Mohammad Kazem Yazdi
4. Ayatollah Makarem Shirazi
5. Ayatollah Ali al-Sistani
6. Ayatollah Sheikh Javad Tabrizi
7. Ayatollah Fazel Lankarani

C. Proponents of Claiming Damages for Delayed Settlement

1. Seyed Mohammad Hassan Mousavi Bojnourdi
2. Dr. Naser Katouzian

Damages for Delayed Settlement from the Perspective of Selected Sunni Scholars
A. The Collection of a Late Payment Penalty (*Gharāmah*)

1. The Collection of a Late Payment Penalty is Absolutely Impermissible
1.1. Nazih Hammad
1.2. Muhammad Sa'id
1.3. Ramadan al-Bouti

2. Permissible to Collect from a Solvent and Willfully Procrastinating Debtor (*Mūsir wa Mumāṭil*)
2.1. Al-Qaradaghi
2.2. Ahmad al-Zarqa

B. The Collection of a Penalty as a Stipulation within a Contract (*Shart Ḍimn al-'Aqd*)

1. Permissible
1.1. Ahmad al-Zarqa
1.2. Muhammad al-Siddiq al-Darir
1.3. Abdullah ibn Mani'

2. Impermissible
2.1. Nazih Hammad
2.2. Zaki al-Din Sha'ban
2.3. Ramadan al-Bouti
2.4. 'Abd al-Nasir al-'Attar
2.5. Rafiq al-Masri

Conclusion

In this research, due to the usurious semblance (*shubhah*) of the late payment penalty, its legitimacy as a mechanism to prevent delayed settlement in Islamic banks was scrutinized and analyzed from the perspective of jurists (*fuqahā*), legal scholars, and Islamic thinkers. The findings of the study in this regard can be enumerated as follows:

1. Diverse viewpoints exist among jurists and scholars (both Shi'a and Sunni) regarding the late payment penalty, owing to its similarity to the concept of *Riba*.

2. Three primary viewpoints can be identified among Muslim jurists and legal scholars regarding the collection of a late payment penalty:

   a) One group considers the absence of profit (*'adam al-naf'*) to be a form of loss (*ḍarar*) and argues for its compensation by the defaulting party. They base this on principles such as "*Lā Ḍarar wa Itlāf*" (No Harm and Destruction), "*Al-Mu'minūn 'inda Shurūṭihim*" (The Believers are Bound by their Conditions), and the hadith "*Maṭl al-Ghaniyy Ẓulm*" (Procrastination by the Solvent is an Injustice). They classify the damages arising from the debtor's fault as an obligation under the rules of involuntary liability (*ḍamān qahrī*).
   b) The majority of jurists (*al-qawl al-mashhūr*) are absolutely opposed to the payment of damages for delayed settlement by the debtor. They prohibit any payment in excess of the principal debt under any title, such as compensation for currency depreciation, loss of purchasing power, or a late payment fee at maturity.
   c. Some jurists and scholars conditionally permit the collection of damages for delayed settlement as a penalty clause (*wajh al-iltizām*), based on the jurisprudential principle of "*Al-Mu'minūn 'inda Shurūṭihim*." They hold that if damages are stipulated as a condition within the contract (*shart ḍimn al-'aqd*)—whereby a sum becomes due upon the obligor's liability (*dhimmah*) for failure to pay on time—it is permissible and does not possess a usurious nature.
3. A fundamental distinction exists between damages for delayed settlement and *Riba*. In *Riba*, the collection of profit and surplus is the intrinsic objective (*maqṣūd bi-l-dhāt*) and is intended from the inception of the contract. In contrast, the amount collected for delayed settlement is not an additional counter-value for the debt but a separate obligation caused by the debtor, which falls under the category of involuntary liabilities (*ḍamān qahrī*). Consequently, compensation for damages is considered legitimate. However, the dispute among jurists regarding the dubious nature (*shubhah*) of the late payment penalty has diminished its significance as an efficient and effective mechanism.

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