ABSTRACT: Delay in debt repayment by bank customers is one of the challenges facing the Islamic banking system in Iran. One solution to this problem can be the stipulation of a delayed payment fine in banking contracts. Since there is a disagreement about the legitimacy of this solution amongst jurists (fuqaha), it is necessary to analyse the jurisprudential (fiqhi) views in this regard, clearly explaining the nature of the delayed payment fine. Making use of an analytical and descriptive approach, this paper makes use of Shi’ah sources to prove the hypothesis that the ‘delayed payment fine’ is punitive in nature and is different from interest or a fine due to late payment which is compensatory in nature. Apart from its similarity to riba (usury), the idea has other juridical and legal problems undermining its practicality in settling the late repayment issue. Proving this hypothesis provides one with the exact definition of the ‘delayed payment fine’ and helps in deducing the most accurate shari’ah decree in this regard.

KEYWORDS: banking, collateral, loans, ta’zir, Iran.
Introduction

Nowadays, customers’ delay in repaying their debts has become one of the major challenges facing banking systems, and this has badly affected Iranian money networks. To come up with a solution to this problem and oblige customers to repay their debts in a timely manner, various methods can be used. Although these methods are approved by the Guardian Council of Iran and acted upon by the banking system and notwithstanding the fact that some laws have been enacted under the rubric of ‘the late payment fine’ in the Civil Procedure Law (Qanun-i Ayin-i Dadrasi-yi Madani) and the Banks’ Debt Collection Practices Act (Qanun-i Chigungi-yi Vusul-i Mutalibat-i Bank-ha), there are numerous debates regarding the legitimacy or illegitimacy of the late payment fine in banking contracts with respect to shari‘ah. To some scholars, this method is unacceptable according to shari‘ah, while others deem it a legitimate and desirable way to resolve the problem.

This research, first and foremost, aims to widen jurisprudential perspectives on the issue of the late payment fine and then to shed light on its nature. It should be noted that prior studies on this subject did not distinguish between the late payment fine and late payment damages; hence, they came up with flawed results in understanding the related jurisprudential issues.

Fundamentally, differentiating between these two concepts, this study goes beyond the nature of the late payment fine and reviews the pros and cons of its legitimacy. In addition, it introduces some jurisprudential challenges which have not yet been discussed in the literature.

First perspective: legitimacy of receiving the late payment fine

In this regard, receiving the delayed payment fine is considered legitimate for two reasons: firstly, the financial penalty clause and secondly, the violator’s financial ta‘żir. We will discuss these two reasons.

First reason: the financial penalty clause
According to this view, banks can insert a clause in their financial contracts with their customers in order to stipulate that if customers do not pay their debts by the due date, they will have to pay a penalty.
This condition implies that the penalty clause compels the customer to be committed to the contents of a contract. In other words, the penalty clause or the delayed payment fine is one of the ways to ensure enforcement of the contract by the parties engaged. According to this clause, each of the parties agrees to pay a predetermined sum, in case he does not meet the terms of a contract (Katuzian 2003).

Hence, the penalty clause is a punishment agreed upon by the parties engaged in a contract according to which, whenever either of them does not follow the terms of the contract, he will have to pay a sum to the other party. It should be noted that the consideration of the penalty clause is not conditional upon the inflicting of damages but will be made mandatory when a party violates any clause of the contract, even if no damage is inflicted upon the stipulator (Taskhiri 2003).

From a jurisprudential point of view, a late payment fine can be categorized under the rubric of the religious rule that ‘the believers must keep their promises’. In addition, one should note that the penalty clause, included in the contract, is necessary only when it has the characteristics of the clauses explained by jurisprudence. In this regard, the insertion of a penalty clause in a banking contract is not contrary to the nature of the said contract and has a logical basis, binding the debtor to the timely payment of his debts. In addition, the definiteness of the sum of the late payment fine prevents the contract from being misinterpreted. Finally, the consideration of a just rate for the penalty solves the problem of the implausibility of the clause. In reality, what blurs the legitimacy of the late payment fine as the financial penalty clause is its similarity to *riba* which, as a clause, is considered invalid according to shari’ah.

Based on the above, most jurisprudential conditions are satisfied, and what matters is whether the penalty clause is in harmony with the Qur’an and the *badīth*, or not. In other words, the most important doubt over inserting the penalty clause in a contract is its similarity with *riba* which invalidates the contract from a jurisprudential viewpoint. Being faced with this challenge, the defenders of the penalty clause state that what differentiates the penalty clause from *riba* is nothing but the violation of the terms of the contract (Taskhiri 2003).

In the penalty clause, through the fine, banks aim at preventing customers from postponing the repayment of bank claims. So, a bank would not demand anything more than the principal from the customer, provided he pays back his debt exactly on the due date. In fact, an
important point as regards *riba* is that the possession acquired as *riba* is part of one side of the contract and there might not be any logical reason for its acquisition (Ja’fari Langarudi 2008). But in the case where the penalty clause is enacted, there is another reason – namely, the breach of the terms of the contract.

What matters is that the penalty clause is only legitimate as a result of the customer’s violation of a term of the contract – paying back his debt on time. So, under the assumption that the customer does not have the financial ability to fulfil his obligations, his delay in repayment will not be a violation of the terms of the contract. In fact, this person does not intend to violate the terms of the contract but due to insolvency, he is forced to postpone the repayment. So, as the insolvent person is not a violator, imposing fines upon him is an unfair act, adding to his problems. This act is forbidden in *shari’ah* because of its being rooted in an unfair principle.

It should be noted, however, that the banking system receives the collateral and guaranty from customers in order to secure repayment. Hence, the customers’ insolvency would not be an important issue in the banking system because the bank can get back its claims from the collateral or guaranty. In a nutshell, it can be stated that the proponents of this view rationalize the imposition of late payment fines upon the customers based on the financial penalty clause.

On this point, some Iranian jurisprudents’ perspectives will be presented. Ayatollah Musavi Ardibili says: ‘There is no problem in inserting a penalty clause based on the predetermined contractual terms, whenever the customer violates the terms of a contract’ (Musavian 2008: 225-226). Ayatollah Safi Gulpaygani states: ‘Receiving any mark-up over and above the principal, as a result of the delay in repayment, is not permissible; if it is clearly stated in a binding contract, however, it will be legitimate’ (Musavian 2008: 157).

Elsewhere, Ayatollah Safi Gulpaygani indicates:

If the penalty clause means that the customer has the choice of postponing the repayment and instead of paying twelve percent as fine, the penalty is categorized as *riba* which is not permissible. There will be no problem, however, if the penalty clause is meant to force the customer to pay back his debts exactly on the due date. The penalty clause seems to be
legitimate provided it is specified and inserted as a term in a binding contract. The customer, however, should be capable of paying it and its sum should be definite to some extent. (Gulpaygani 1996: 253).

From this religious edict one understands that the penalty clause is permissible as long as the two terms are met. Firstly, it should be stipulated in a binding contract, and secondly it should be definitive.

What can be inferred from Ayatollah Gulpaygani’s stance is that there is no difference between the simple loan contract and other types because he believes that there is a fundamental difference between the penalty clause and *riba*. In a contract, the financial penalty clause is meant to force the debtor to fulfil his obligations on time and prevent him from postponing the repayment. In his religious edict, twelve percent is the rate passed by the Guardian Council on 17 February 1983.

After all, some jurisprudents (fuqaha) believe that to make sure the financial fine is not considered *riba*, the penalty clause should be stated under a separate binding contract because getting a mark-up for the delay in repayment from a debtor may make it subject to *riba* terms (paying a sum to postpone the time of the repayment). In this regard, Ayatollah Gulpaygani says: ‘The fine is prohibited but if a debtor is forced, in a separate binding contract, to pay something as a fine, provided he does not meet his obligations on time, there will be no problem’ (Gulpaygani 1984: 191). In his opinion, two conditions should be observed to keep it from being considered *riba*. First, the penalty clause should be stated in a separate binding contract, and, second, the debtor must pay the fine freely to the other party.

Ayatollah Makarim Shirazi (2006) says: ‘There is no problem with the penalty clause provided it is stated in a separate binding contract.’ Ayatollah Ardibili also confirms this view, saying: ‘The penalty clause is allowed if it is agreed upon by the two sides but, to be cautious, it should not be stated in the same contract’ (Musavian 2008: 226). According to these views, the creditor, in addition to the main contract, can engage in a very small transaction, like the sale of a commodity where he states that if the debtor does not repay him on time, he will have to pay a sum; for example, six percent, over and above the principal price. As this condition is inserted in a binding sales contract, fulfilling such a condition is obligatory.
According to this view, there is a difference between paying a mark-up for postponing the contract and paying a sum for free as a fine. So, if the fine is given as a tool to delay the contract, it will be forbidden; but if it is given to the creditor as a gift, it will be permissible (Wahdati 2006). One should note that the reason for stating the ‘for free’ condition is that if the fine is given instead of postponing the time of repayment, it will be a case of traditional *riba* whose illegitimacy is evident in jurisprudence.

Finally, it should be noted that the reason for the necessity of stating the payment of the delay fine as a gift in a contract other than the loan contract is to prevent the similarity of the delay fine with the mark-up condition (considered because of the postponement) in the loan contract which is considered *riba* (Wahdati Shubayri 2003a).

**Second reason: financial taʿzir of the violators**

Paying debts on time is one of the shari‘ah rules which is applicable to financial contracts. In other words, every debtor should continually try to pay back his debts and refrain from postponing repayment so long as he has the ability to repay because according to *hadith*, repayment of debts is binding and if it is not done, it is regarded as an unjust act and a sin. The Prophet (S) says: ‘Delaying the repayment of a debt by a debtor with the financial ability [to repay] is a cruel act’ (al-Saduq, 1992: 380). It is related from Imam Rida (A) that the Prophet (S) said: ‘Negligence and postponement on the part of a solvent person in repaying his debts dishonour him and make it legitimate to punish him’ (Burujirdi 2008: 71).

To be dishonoured means it is possible for him to be reprehended and by punishment it means that he is likely to be jailed. In other words, if a person does not pay his debts on time and insists on doing so, the creditor can scold him to some extent. It is even possible for him to be jailed or reprehended. It should be noted that the punishment stated in the said tradition is general and includes financial measures. Finally, it should be noted that although the chains of narration of these two *hadith* are not impeccable (in technical terms, the first being *mursal* and the second being *hasan*), they can be used as legal references because most jurisprudents have accepted them as authentic traditions.

It is related that Imam ‘Ali (A) said to Shurayh:

Watch over the rich people who postpone the repayment of people’s debts and possessions, and those who send their
possessions to the kings. Try to gain the people’s rights from them. If they have houses or properties, sell them and establish their rights. I heard the Prophet saying, ‘Postponing the repayment of Muslims’ debts by a solvent Muslim is a cruel act.’ (Kulayni 1986: 412)

Regarding this tradition, it should be stated that although some scholars have considered one of the narrators in the chain of narration, Salmah ibn Kuhayl, to be a weak narrator, this tradition undoubtedly declares that the postponement of debt repayment is a cruel act. According to this tradition, a solvent person should not unreasonably delay the repayment of debts and if he does so, he would be cruel to other people. Such a debtor’s act will be unlawful; hence, the judge can decide a punishment for him (Rida’i 2001).

The prohibition of the delay can be proven in two ways. First, the specific tradition declaring the delay as a cruel act and introducing the possibility of a punishment, and second, the general traditions that open up the possibility for a fine for those who violate shari‘ah rules and regulations. Because of the fact that due repayment of a debt is one of the shari‘ah rules, any delay is an unlawful act justifying consideration for a fine. One type of fine is financial. Based on this, the Islamic government can consider financial fines for those not paying banks’ claims on time, thereby endangering the state’s economy (Musaviyan 2006). It is a general rule regardless of its type. So, it does not matter whether the contract is a loan, one of the trade contracts (like sale on instalment or lease) or one of the participation contracts (like the bailment of capital or share-crop contract). It should be noted that in receiving the delay fine, there is no need to explicitly stipulate the clause in the banking contracts; hence, it is possible to exact the fine from the negligent debtor, even without the contractual insertion of the clause.

The financial punishment of the banks’ negligent customers (being of a criminal nature) can be done in various ways. One way is that the courts may consider a fine according to the amount and time of delay. They collect this fine and give it to the Islamic government (Qura’i ibn ‘Id 2003). Another way is for the government to establish a charitable foundation and then to put the fines gathered by the courts in it. The reserve can then be used to help the needy (Zaftawi 1996). Another approach is to force the negligent person to give an interest-free loan to the bank. In other words, customers who postpone repayment would be
forced to give an interest-free loan to the bank proportionate to the time and amount of the delay. This will reduce the creditor’s (bank’s) losses caused by the delay of repayment to some extent.

The other approach is to regard the banks as representatives of the courts. This way, the government and the courts would consider the banks their representatives; hence, banks could collect the fines. In so doing, the banks would consider punishments for negligent customers proportionate to the amount and time of their delay, separately (Musaviyan 2006). The point here is that in this approach, the severity of the punishment will be separately determined for different customers in a way that the fine for every negligent customer will be determined according to the amount of the debt and the time of the delay in repayment. Some scholars, however, disagree with this method, not allowing courts to declare the banks as their representatives. They believe that the only possible punishment for the negligent person can be in the form of a financial punishment determined by the shari‘ah judge. Some of these scholars’ views are indicated in the next part.

Ayatollah Fadil Lankarani says:

If a debtor has some assets over and above what is excluded in shari‘ah from the debt repayment and he does not mean to pay his debts on time, he has committed a sin and the shari‘ah judge can administer a punishment to him. This punishment can be financial. It is not correct, however, to generalize a rule to all negligent persons, but rather their punishment should be determined one by one. (Musaviyan 2008: 177-178)

Similarly, Ayatollah Nuri Hamadani says:

Administering the financial punishment is one of the duties of the shari‘ah ruler and it is not right to consider a similar punishment for every negligent person; yet, different people deserve different fines. (Musaviyan 2008: 238)

Ayatollah Makarim Shirazi says:
The delay fine is not a right act from the perspective of shari‘ah and it is a kind of riba because solvent people, who have the ability to pay back their debt but do not do so, should be financially punished by the shari‘ah judge and the fines acquired must be possessed by the state; hence, the banks are not allowed to possess these fines.

According to his opinion, it is not possible to consider banks the agents for collecting financial fines, and the shari‘ah judge himself should be the one to collect them. One can say, however, that the government owns banks whose sources are actually those of the government. So, banks can be the representative of the state to collect fines. But the problem still persists with the case of privately-owned banks. So, they cannot receive fines by themselves (Musaviyan 2008: 203-204).

After all, one should claim that this solution is not practical due to the lack of efficiency because banking rules cannot be applied differently to governmental and private banks. In addition, such discrimination will be to the detriment of the private sector as opposed to the governmental (public) sector. It also undermines the capability of the private sector, which in itself is detrimental to the economy.

The nature of the late payment fine

Based on the penalty clause, the delay punishment has a punitive nature. This punishment is either considered by the bank, being one of the parties of the contract, due to the delay in repayment or by shari‘ah due to the fact that the negligent person has violated a shari‘ah rule. When a bank considers a kind of punishment for a customer, the fine will be necessary as he has violated the terms of the contract. Here, the punishment will have a threatening nature; however, it should not be mistaken with the governmental fine as it is possessed by the bank, not by the government. In other words, it is a kind of private fine imposed on the creditor. Finally, it should be noted that the aim of the penalty clause in the contract is to guarantee the fulfilment of the terms of the contract (Katuzian 2004).

When one party to the contract is not sure that the other party will carry out his obligations, he can insert a penalty clause in the contract
to compel the other party to meet his liabilities. So, the payment of a fine, which is a kind of penalty clause indicated in civil law, is meant to punish the negligent person (Ja‘fari Langarudi 2007).

In other words, this clause has mostly a punitive nature and seeks to compel the debtor to meet his obligations on time, being highly significant for institutions like banks to implement their credit plans (Iskini 1992). Based on the second argument, punishing the customer by the shari‘ah judge is a kind of financial fine imposed upon the negligent person. In this case, fines collected shall be put into the government’s treasury as the representative of the Islamic state.

Considering a punitive nature for the penalty clause makes it different from the delay repayment damage because this damage is the one considered for the delay; hence, it should be given by the debtor to the creditor (Musavi Bujnurdi 2003). The exact meaning of the delay repayment damage is that due to the postponement of the repayment, the debtor should pay a sum over and above the principal money to the creditor.

Based on this definition, the delay repayment damage is connected with the concept of ‘damages’ and will be received to handle the problems faced by banks because of the payment delays. The damages, in this case, are either because of inflation or because of losing the chance to make money from the principal. The financial fine received from a negligent customer, however, is a kind of punishment, regardless of the amount of the damages inflicted on the bank due to the delay.

There are some differences between receiving money stated in the penalty (being practised in the current Iranian banking system) and the delay repayment damages. Some of them are given below:

1. Banks and other financial institutions make use of the penalty clause (based on the criminal financial condition) as a way to punish negligent customers and force them to pay something as a financial fine. This approach has a punitive nature and is connected with the punitive damages aimed at punishing the negligent customer and preventing him from repeating it in the future (Katuzian 2002).

This approach is not based upon the damages inflicted on the banks because of the delay. It is true that the fine received can partly or totally compensate for damages incurred by the bank, but this approach, by its definition, has a punitive nature and is not specifically meant to compensate for the damages inflicted upon the bank because of the delay.
Otherwise, delayed repayment damages are regarded as compensation for damages inflicted upon the banks and other financial institutions because of delayed repayment. The principal basis for their legitimacy is inflation. In other words, if the solvent debtor postpones repayment of a debt to the creditor and if before the settlement of a debt any inflation occurs, the damages to the creditor must be compensated over and above the principal because the debtor has been involved in the damages to the creditor as he has postponed repayment of the debt, forcing the creditor to incur inflation. So, he should add something to the principal debt to compensate the creditor for inflation damages. In addition, three other reasons justify, from the jurisprudential point of view, the receiving of delayed repayment damages including the necessity for full repayment of the debt, the necessity for compensating the damages to the creditor and the necessity for compensating the purchasing power of the money. All these reasons can be traced back to the idea of inflation compensation (Musaviyan 2005).

In fact, when inflation occurs, the purchasing power of the money declines and this will result in the damages to the creditor. So, it is necessary for the debtor to pay for the inflation damages, thereby making the full repayment.

Some scholars have considered the rule ‘not making more money out of the principal’ as a basis for the penalty clause. It means that the creditor could have made money from the principal, if the debtor had paid the debt on time. Considering this fact, one can say that the creditor is faced with specific indirect damages because of the delay (Wahdati Shubayri 2003a). Most of the jurisprudents (fuqaha), however, do not accept this basis for compensation.

2. The insertion of a penalty clause is possible only when it is put in the contract as a term, but the delay damages are receivable only when not indicated in the contract. It means that if we accept the necessity of compensating for the inflation, based on some jurisprudents’ views, and if we take a real approach while facing the matter of inflation and also pay attention to the way the public considers it, the delay damages may not necessarily be indicated in the contract. In fact, even when this term is not explicitly stipulated in the contract, the bank can manage to receive the fine from negligent customers (Wahdati 2006). That is because such customers have violated terms of the contract and have put the bank in
trouble. So, the bank can claim that such customers have failed to meet the repayment date; hence, it can try to get a sum as delay damages.

Based on what is said, if a debtor postpones the payment of a debt while noticeable inflation occurs and at the same time the bank encounters some problems, the public will consider the debtor responsible to compensate for the damages to the bank; otherwise, the public may consider the debt unsettled, even if not indicated in the contract. This is the publicly implied term on which a contract is based, being equal to explicit terms.

3. The severity of the punishment depends on the mutual agreement reached by the two parties to the contract; hence, it can be more or less than the damages inflicted. Yet, the sum of the delay repayment damages depends on the losses inflicted on the creditor and the authority to determine the sum in the court which considers the inflation, the exchange rate, or the gold price to determine the value of the damages.

In fact, since the delay payment fine is not regarded as payment of the damages and their compensation, the amount of the fine can be more or less than the damages. Even if the price does not drastically change, it is possible to get the delay fine for violating the terms of the contract. But in the delay damages approach, the fine received should be exactly equal to the damages inflicted; hence; if the price does not change, there would be no reason to justify the imposition of fines.

All the above-mentioned differences exist between the two bases for a late payment fine including the financial penalty clause and the delay damage, though both of them fall under the civil law for contract fulfilment.

The delay fine can also be received based on another rationale called financial ta’zir (discretionary punishment under shari’ah). There are even some differences between this case and the delay damages, though they are similar in a way that none of them needs to be indicated in the contract. Some of their differences are indicated below:

1. Unlike the delay damages, financial ta’zir of negligent customers has a penal nature and is beyond civil responsibility.

2. Based on financial ta’zir, the shari’ah judge can punish the negligent party according to the fault committed by him and fine him accordingly. So, this basis is a specific way for the ruler; hence; not applicable to the
banking system. As to the delay damages, however, the negligent customer should pay a fine equal to the official inflation rate to the bank or the financial institution.

3. In financial ta’zir, the shari’ah judge should receive the fine and put it in the state treasury, but in the delay damages approach, banks receive the fines because they are the creditors receiving the fine to cover some of the damages they have incurred.

It should be noted that the conspicuous differences amongst different bases for the penalty clause are important when we discuss the legitimacy of the penalty clause because the correct understanding of this concept can help jurisprudents to issue shari’ah-compliant religious edicts.

In fact, it is probable that the religious edicts of a jurisprudent as to the legitimacy of the penalty clause may vary if he considers the financial penalty clause instead of the delay damages (focusing on the idea of inflation compensation). So, it is possible that a jurisprudent may accept the penalty clause due to one reason, but would not accept its permissibility due to the other.

Second view: the delayed payment fine is not legitimate

As already stated, although some scholars believe that the consideration of delayed payment fine is legitimate based on the financial penalty clause, some others think that there are important jurisprudential issues undermining its legitimacy. Next, we will consider some of these problems.

First challenge: the delayed payment fine is regarded as riba

Based on this viewpoint, the consideration of a delayed payment fine in financial contracts allows banks to receive a sum over and above the principal of the loan, because of the delay in repayment. In this regard, upon receiving this fine, banks allow receivers of the fund to postpone the repayment of the loan, and accept payment of a sum other than the principal by a new deadline. This banking procedure, being a common trend these days in the Iranian banking system, is a new version of the repayment period extension by means of increasing the sum of the debt and is regarded as a kind of riba; hence, it is illegitimate. This specific kind of riba, which is known as ‘traditional riba’, was prevalent before Islam.
In this kind of *riba*, when the creditor demanded money from the debtor, the creditor would require him, by the deadline of loan repayment, to either totally pay the debt or to postpone it to a future time, but with a sum in addition to the principal debt. The debtor, on the other hand, was either solvent paying the debt or insolvent postponing the repayment with an additional sum added to the principal (Jawahiri 1984).

There is a consensus amongst all jurisprudents over this kind of *riba*, deeming it illegitimate. *Jawahir al-Kalam* says: ‘There is no disagreement over the fact that the postponement of the repayment via paying a sum additional to the principal is not permissible, as it could be inferred from the Holy Book, tradition and the consensus of jurisprudents’ (Najafi 1994: 121). This kind of *riba* can be seen in trade, settlement, contract of reward, or other types of contracts. Even if it is indicated as a term of contract, it is invalid, not legitimizing *riba*.

Shaikh Ansari also writes in *Makasib* that:

There is no disagreement over the fact that postponement of a repayment by means of paying a sum additional to the principal is *riba* and not permissible. It is also the same case in all debts. In addition, the reality of a *riba* loan is the payment of an additional sum by means of postponement of the repayment deadline. In fact, this extra sum is a result of the extension of their payment deadline, being regarded as *riba*. Also, the public does not differentiate between the case where an extra sum is indicated from the beginning in the contract and where it is conditional on their payment postponement that happens at the end of the contract. Both these types are regarded as *riba* in the public’s perspective. (Ansari 1994: 221-223)

As for the case of the banking system, it seems as if banks and financial institutions add a sum to the principal by means of allowing the debtor to postpone the repayment. In this regard, they receive an additional sum as a fine. By inserting a term in the contract, they force the debtor to pay this fine. As it was already indicated, this act is deemed as *riba* and is illegitimate.

Based on what was stated above, it is apparent that the penalty clause is invalid because of its contradiction with the Holy Book and the Sunnah because the act of receiving a sum over and above the principal
debt falls under the traditional definition of *riba*. In fact, such a term is invalid for the specific prohibition indicated in the religious sayings. It is regarded as a specific kind of *riba* that is a postponement of the deadline by adding an extra sum to the principal. It should be noted that such a kind of *riba* is not exclusive to the loan contract; in fact, it is a general type covering all contracts (trade-based or participation-based).

The insertion of the delayed payment clause in a loan contract is conditional upon the gain condition because according to religious sayings, receiving any extra sum in a loan contract is considered *riba*; hence, it is not permissible. So, the insertion of a clause as the delay penalty is not correct. Considering this, jurisprudents have regarded the gain condition in a loan contract impermissible. They also believe that in a loan contract, an extra payment clause is invalid. This means that it is not correct to lend some money on the condition that the debtor agrees to repay the principal plus an additional sum (Khomeini 1986).

If banks put a condition in their loan contracts indicating that the customer must pay a fine provided he does not pay the principal on time, it will be a type of gain condition in the loan contract which is, for sure, illegitimate because the delay fine is a sum extra to the principal. In fact, the fine payment clause is invalid because it contradicts the Holy Book and Prophetic tradition. In addition, it is based on the religious rule that ‘religious people must satisfy the conditions they accept’. So, the insertion of such a condition in the loan contract is not correct and is actually considered a *riba* loan. If the delayed payment, however, is referred to in other contracts other than the loan contract, it will be a type of traditional *riba* which is the case of the extension of the deadline by adding to the principal debt.

Some defenders of the delayed payment fine, nevertheless, have rejected the idea that the fine is a kind of *riba*. They argue that the bank does not receive the fine for the postponement of the repayment. Yet, in case of the postponement, the negligent customer should immediately pay the principal in addition to the fine (Ridwani 1993).

This argument, however, is questioned for the fact that although some scholars like Shaikh Ansari and the author of *Jawahir al-Kalam* emphasized the issue of postponement in their views, it is not a fundamental matter. It means that *riba* is not just based on the idea of postponement. In other words, it is not possible to infer that *riba* will not be the case when there is no postponement.
To explain the issue more thoroughly, one can say when postponement is the only reason for *riba*, it is possible to say that when there is no postponement, *riba* has not occurred. If such is the case, there will be no case of *riba*. Yet, the reality is quite different. In fact, from the sayings of jurisprudents it can be inferred that, if postponement happens, *riba* will be for sure the case. Yet, it does not prove the fact that the only reason for *riba* is postponement. In addition, reasons implying *riba* assert that any sum extra to the principal is not permissible, regardless of the postponement being the case or not. In all verses of the Holy Book, *riba* is announced as quite impermissible, not conditional upon any clauses and conditions. The same thing can be seen in traditions (*hadith*). In the following section, we review some of these sayings:

1. Imam al-Sadiq is quoted as saying: ‘*Riba* is to lend someone some money while putting the condition in the contract that the debtor should pay a sum extra to the principal. This is actually the case of the prohibited *riba*’ (Hurr al-‘Amili 1988: 161).

2. It is related that Ishaq ibn ‘Ammar asked Imam Musa ibn Ja‘far (A): ‘I asked him about an individual who lends the other some money to do business with and pay the lender a sum as a profit, because of the fact that if he does not pay him any profits, he might get the money back. However, there may not be any contractual conditions predetermined for this profit.’ The Imam said: ‘If there is no precondition determined in this regard, there will be no problem’ (Kulayni 1986: 103). This saying emphasizes the fact that the gain is regarded as *riba* only when it is indicated in the contract.

3. ‘Ali ibn Ja‘far narrates in his book from his brother, Musa ibn Ja‘far (A), that one day he asked his brother whether it would be permissible if a person lends someone 100 *dirham* to do business, on the condition that he will pay the lender five percent extra in addition to the principal. The Imam said: ‘This is *riba*’ (Arizi 1988: 126). This saying emphasizes the impermissibility of the addition of any sum extra to the principal in the loan contract.

4. Imam Muhammad al-Baqir (A) is quoted as saying: ‘When a person lends another person some *dirhams*, he should not make it conditional for the debtor upon paying a sum extra to the principal. If the debtor himself pays an extra sum, it will be legitimate. Do not insert conditions in your loan contracts such as riding an animal or borrowing something
from the debtor in a way that he is obliged to pay something extra to the loan’ (Tusi 1986: 203). The source of this religious saying is reliable, and all the narrators are Shi'a. It strictly prohibits laying down a condition in contracts to pay a sum in addition to the principal.

5. It is related by Shaykh al-Saduq that Imam al-Baqir (A) was asked about a person who is in debt and the creditor comes to him saying, ‘Pay something in cash right now, and I will forgive the rest, or pay a sum and I will postpone the deadline.’ The Imam said: ‘There will be no problem when no sum is added to the principal because Allah says, “Just your principal is for you; do not oppress anyone and no one should oppress you”’ (Kulayni 1986: 159). This saying is reliable as it is narrated by Aban ibn ‘Uthman and Muhammad ibn Muslim. After all, this is a proof shared between Shaikh al-Saduq and Aban inserted at the end of Shaikh al-Saduq’s book. This proof emphasizes the impermissibility of receiving anything extra to the principal in loan contracts.

The idea of ‘just your principal is for you; do not oppress anyone and no one should oppress you’ implies that the basic rule in all contracts is justice. In addition, the term ‘do not oppress’ prohibits the receiving of any sum extra to the principal because this is an act of cruelty (Tabataba’i 2007). So, receiving a sum extra to the principal loan, under the rubric of a fine, is cruel, falling into the prohibited area.

This tradition is applicable to the case where the debtor postpones the repayment upon the creditor’s agreement and even when he disagrees with the postponement. According to a tradition, the creditor should not get any sum extra to the principal whether he agrees or disagrees with the postponement (Wahdati Shubayri 2003b).

Considering all that is mentioned above, we can infer that laying down a condition in a contract according to which the debtor is obliged to pay a sum extra to the principal is strictly prohibited and unconditional on the postponement. So, the fact that the Imam differentiates the case where the postponement is indicated as a condition from the one not indicated as such shows that it is strictly prohibited. This generalization is not specified by those historical facts that limit traditional riba to the case where the debt increases as a result of the postponement. It is a proven case in the principles of jurisprudence. As a matter of fact, one can say that the extra sum is prohibited, no matter whether it is caused by the postponement or not.

The explanation rejects the idea that the banking fine is not regarded as riba as it is not a result of some postponement of loan repayment.
Nevertheless, the authors believe that the banking practice is nowadays surely a kind of traditional riba as it is a result of postponement in loan repayment. It can be interpreted that banks give the choice to debtors to either pay the debt on time or postpone it to a future date but pay an extra sum in return. It means that banks give the chance to debtors to pay later but more. It is exactly the case of postponement and also a kind of traditional riba.

It should be noted that what matters in a contract are the aims of the parties to the contract and not their final incentives. In fact, by laying down the fine condition in the contracts, banks allow the customers to choose between repaying on time or postponing the repayment and paying a sum extra to the principal. So, this claim cannot be acceptable for the banks to lay down the fine condition to make customers repay on time. What matter in financial contracts, however, are the aims and not the final incentives of the parties engaged. These aims form the subject of the contract.

The current practice of the Islamic banking system in Iran has some shortcomings. In trade contracts such as sale on instalments where the relation between banks and customers is of the debtor-creditor type and it finally becomes a debt contract, by postponing the time of repayment, banks add six percent to the interest rate as a fine (Musaviyan 2006: 122-123). The extra sum is exactly of the nature of riba and the six percent interest cannot force the debtor to pay on time, yet it can stimulate him to postpone repayment. So, if the fine condition is laid down in the contract at a very low rate, it will be contrary to the nature of the contract.

It seems that many negligent customers prefer to postpone the repayment and pay a small fine. In this case, it seems as if the customer has two options of paying on time with no fine or paying later with a fine.

In banking participation agreements, on the other hand, because they are temporary and banks do not continue their participation, they turn into debts after the due date. So, it is not permissible to receive such a fine, even in these kinds of contracts.

In fact, in participation agreements, banks do not care for the profit and loss and when the deadline comes, the fine will be enforced regardless of whether the project is ended or not, or whether there is a profit or loss included. This is not a decent act by the banks.

Based on the abovementioned issues, one can assert that the condition of a fine regarded as riba is cruel and in contrast with the Holy Book and
Sunnah. According to this, some jurisprudents have not authorized the act of receiving a fine in banking financial contracts. Ayatollah Tabrizi says: ‘Receiving any sum for the delay in repayment is regarded as riba and impermissible, regardless of the fact that there may be a condition in the contract or not’ (Musaviyan 2008).

Imam Khomeini also prohibits receiving anything as a fine. He says: ‘What banks or non-banks receive as a fine for the delay in repayment is riba and impermissible even if both parties agree to it’ (Khomeini 1986: 457). Based on his view, the impermissibility of the delay fine becomes more definite. So, the banking system cannot lay down a condition in financial contracts because the subject of trade and partnership contracts is debt and based on the debt rules, it is not right to receive anything in debt as a fine or in any other similar contracts, because it is certainly a kind of riba. In fact, although the debtor has not paid his debt on time, it is not right to force him to pay riba as a fine.

Second challenge: the delayed payment fine condition is not binding
Inserting the delayed payment fine clause in a contract as the ‘condition of performance’ can be deemed as a condition laid down in the contract based on which the customer is forced to pay a sum as a fine provided that he does not repay on time. This condition is not binding because the pledge needs to be indicated by the Divine law. In other words, there should be a reason for the pledge; for example, we know that if a person’s material possession is destroyed, the Divine law considers this action as a loss to that person; hence, there is a pledge here. But in the banking fine case, if a person does not satisfy his obligations, there will be no reason to consider a pledge.

In other words, in this situation, the only sound reason imaginable for such a condition for a fine is to make the condition a shari’ah judgement. It means that if the customer meets such a condition, he has done an illegitimate act because all Muslims should fulfil the conditions they have already agreed upon in their contracts. Nevertheless, if a solvent customer does not abide by the shari’ah rules and does not pay his debts on time, the bank is not entitled to compensate this by confiscating his belongings because such a condition does not lead to a pledge, but rather the bank demands the customer to be loyal to a shari’ah rule (paying on time). And in case the customer accepts the advice of the bank, it can
refer to the Islamic court and the shari‘ah decree can force him to meet his obligations.

The bank cannot force the customer to pay on time because the condition of a fine is only a shari‘ah decree, and not a right because shari‘ah decrees can be divided into two groups as to the responsibilities of individuals towards each other: initial responsibilities and responsibilities conditional upon legislation.

Initial responsibilities (duties) are those that oblige someone to do something. For example, someone makes a vow to give something to a needy person. Here, this person should fulfil his vow and the needy person has the choice of either accepting the charity or not. It means he can make use of his right to reject it. In this situation, the person who makes a vow is under no obligation to fulfil something. If he does not keep his vow, however, he has committed a sin and God may punish him on the Day of Judgement. Nevertheless, the needy person does not have the right to complain because the other party has followed a religious decree by making a vow. This does not grant any ownership right to the needy person. So the vow only leads to a religious decree.

From another perspective, responsibilities conditional upon legislation produce some rights. For example, a marriage contract requires the husband to pay the expenses of his wife. In the case of banking, when a condition is indicated in a contract pursuant to which the debtor accepts to repay the debt on time, this condition only necessitates timely payment; yet, the contract is valid even when the debtor does not pay on time. It means that although the Divine law has made it necessary for the debtor to pay on time, it is not binding on his part. So, it is not the case that the debtor is forced to pay, unlike the example of vowing. This way, the one who makes a vow should fulfil it, but the needy person is not the owner of what is vowed to be given to him and cannot get it by force because the vow is not binding. So, the aforementioned condition only necessitates what is a kind of initial responsibility. It means that it is necessary for the one who makes the vow to meet the condition; otherwise, he has committed a sin.

It does not mean, however, that one party has the right to force the other to satisfy the condition because such a condition is an initial responsibility, not leading to any ownership right. So, the other party can only advise him to be loyal to the condition (considering the Islamic rule of enjoining what is good and forbidding what is wrong). Here, the
permissibility of advising one to be loyal is not a right but a religious responsibility. One should advise the other party to abide by the religious rules, if he thinks the other party will act upon his advice.

Third challenge: revoking the contract upon violation of the condition

As it was already indicated, the delay fine condition in banking contracts is not binding and the only effect it has is that if the customer does not satisfy the conditions of the contract, the contract will be rendered invalid. It means that the bank has the right to terminate a contract whenever the customer shows that he does not intend to fulfil the conditions of that contract.

The reason for such a right is that the bank has restricted the nature of a contract to the satisfaction of the conditions laid down by the other party. In fact, in each contract, there are two kinds of commitments. The first is the commitment to establish the subject of the contract, which is, for example in the loan contract, the ownership. This commitment resulted from the reasons making the contract necessary.

The second kind of commitment is to remain loyal to the contract over time. This is fulfilled by laying down a condition in the contract. In addition, it is conditional on the satisfaction of the customer. It means that if he does not meet the conditions of the contract, there will be no necessity for the bank to be faithful to the contract. It means that the bank can terminate the contract. In other words, consideration of the revocation right is to indicate that the continuity of the contract is made conditional on the act satisfying the mutually agreed condition. So, if such a condition is not satisfied, it will not be necessary to continue the contract.

In this case, the Qur’anic expression ‘you should abide by the conditions of your contract’ (5:1) implies a contract which is made conditional from the very beginning. It means that a general condition has not been laid down from the beginning, but only a conditional one. So, if the condition is not followed, the commitment will remain unfulfilled.

Considering this issue, it can be stated that the revocation and obligation rights to force the customer to meet the conditions of a contract (considering the Islamic rule of enjoining what is good and forbidding what is wrong) are almost the same and one in whose favour a condition is laid down can exercise each of them. In other words, the
bank can make use of them to force the debtor to meet the condition or, if he does not, to refer the case to the court or terminate it (Naraqi 1996).

Some jurisprudents, however, have considered these two rights as mutually exclusive. These scholars have made use of the ‘no damages’ (la darar) rule to prove the revocation right. They believe that if it is possible to compensate for the delay damages (using either ‘forcing the other party’ or ‘terminating the contract’), it will not be right to use or implement it the other way (Mirza-yi Qummi 1996).

Nevertheless, we believe that when the nature of a contract and its necessity are made conditional on the satisfaction of the conditions, in case a condition is not satisfied, the necessity of the contract enforcement will be obviated and the contract will be subject to probable revocation. In this situation, the creditor has the options of either exercising the revocation right or advising the other party to fulfil his commitments. The two options are not in contradiction with each other. The situation is related to the case where the fine condition is considered legitimate.

Nonetheless, we think that putting a fine as a condition is not correct, considering the fact that it is a kind of riba; hence, it is regarded as an invalid condition. In this case, the invalidity of the condition is not to be generalized in other aspects of the contract; that is, it does not cancel the contract as a whole, and instead leaves the contract still in force. The only important point here is that the creditor shall have the right to terminate the contract upon offering the proof that he was ignorant about the invalidity of the condition (Tabrizi 1995).

That is because the revocation right is a religious decree and consequently needs a rationale, but we do not have a rationale here. The revocation right is the option of terminating the contract. So, it is not a right for the creditor but just an option that can be utilized. This also denotes that it is not possible for him to demand something for not exercising such a right. Based on what was already mentioned, we understand that the most important difference between a right and a religious decree is that the latter is a shari‘ah rule and not revocable (Ansari 1989).

A right, however, is a power given to a person by the religious legislator. Jurisprudents believe that the right can be forgivable (Sayfi Mazandarani 1971: 60). So, the judgement belongs to shari‘ah but the right belongs to the person. As regards what was stated, we can say that if
the customer does not meet the conditions of the contract, the bank can only terminate the contract and is not entitled to get anything as a fine.

After all, as is prevalent in the banking system, if a bank receives the collateral from the customer when giving the money, and if the customer does not repay on time, the bank will be authorized to compensate for its debts by selling the collateral on the market; hence, there will be no need for terminating the contract.

Considering the fact that the subjects of such contracts are houses or the like, banks can easily sell the collateral on the market and there will be no need to refer the case to the court. It is noteworthy that what was stated is only tangible when the bank has received the collateral or something like that; otherwise, it can only terminate the contract and it is illegitimate to collect anything as a fine.

Finally, it should be noted that banks usually have other ways and options to punish a negligent customer. For example, they can convert his future instalments of his loan to the present or limit their future services to him.

**Conclusion**

Based on the above discussion, the following conclusions can be drawn. There are two opposing views about the permissibility of receiving the delay fine in the banking system. Some jurisprudents consider it permissible and some others as impermissible. The defenders of the delay fine offer two reasons for that. The first one is the financial criminal condition (financial penalty clause), originating from the rule that ‘the religious people must meet their conditions’, and the second one is the financial *ta’zir* of the negligent customer, i.e. the solvent person not paying his debts on time. Considering these two reasons, the delay fine might have a punitive nature because according to the penalty clause, the fine is a punishment for a customer who postpones a timely repayment. According to the ‘financial *ta’zir*’ justification, the fine is a shari‘ah punishment for a negligent person. The delay fine should be considered different from the delayed payment damages. This difference lies in understanding the shari‘ah decree that defines the appropriate one to receive the fine and its rate. Opponents of the late payment fine believe that it is not right to receive it because of the abovementioned two
reasons. The reason ‘financial ta’zir’ is only applicable to the courts, not in financial institutions and the other reason has other shortcomings. The delay fine condition (clause) inserted in the banking contracts is invalid as it is considered a kind of riba because if the delay fine is mentioned in the loan contract, it shall be an additional impermissible condition and if it is mentioned in other separate contracts, it shall be regarded as a kind of traditional riba. Considering the generality of riba in religious sayings, however, it becomes clear that its impermissibility is not conditional on the delay but is a general issue. Laying down the delay fine as a condition does not make it binding or enforceable for the customer to act upon. It is only a shari‘ah decree and a necessity. If the customer does not act according to such a decree, the bank will only advise him to do that (considering the Islamic injunction to enjoin what is good and forbid what is wrong). This means the bank should follow a necessary decree that advises others to carry out their shari‘ah responsibilities. Finally, if the customer does not accept the bank’s advice, then it will be possible to refer the case to the court. The result of laying down the condition for a fine in a banking contract is that the bank can immediately terminate the contract or use collateral to settle the other party’s debts.

**Table of key transliterated terms**

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Notes

1 Some jurisprudents like Ayatollah Subhani, Ayatollah Sani‘i and Ayatollah Ha’iri have regarded inflation compensation as totally permissible (Subhani 1993; Sani‘i 1998; Ha’iri 1996). Others, including Makarim Shirazi, Nuri Hamadani, and Musavi Ardibili, consider it permissible only when the inflation is high and noticeable. Finally some believe that the two parties to the contract should come to an agreement in this regard. Ayatollah Bahjat and Ayatollah Khamene‘i hold this view (Research Centre of the Iranian Judiciary 2002).

2 The hadith is indicating the words of Allah as a hadith qudsi, not as a Qur’anic citation.