Abstract: Islamic banks face several kinds of risks; credit risk is one of them. Since they are established to operate according to Shariah principles, all their operations including credit risk management techniques should be Shariah compliant. Until today, two methods have been used as credit risk management techniques to compensate for banks' losses occurring from late payments. However, these methods are still under discussion in terms of Shariah and efficient risk management aspects. In order to solve this issue, a new effective Shariah based risk management method is needed by banks. In the present paper, a new credit risk management method is offered. This method is based on the reciprocity principle (Qaidah Muqabalah bil-mithl: قاعدة مقابلة بالمثل) which is one of the most important fiqh principles in Islamic law. In the following pages, this principle will be further elaborated in terms of credit risk management.

I. Introduction:

One of the most important issues of today’s Corporate Governance studies is risk management which is needed by all organizations including financial institutions (FIs). Risk is defined as “the variability or volatility of unexpected outcomes”\(^1\). It refers to a situation in which two or more outcomes are possible\(^2\). In other words, risk is the probability of an event happening whose occurrence is uncertain. For example, the likelihood of loss in trade is a risk\(^3\).

The basic function of FIs, whether conventional or Islamic, is financial intermediation. FIs collect surplus funds from saver groups and supply them to deficit groups that want them. Funds supplied to the FIs are generally for short periods whereas the fund users want them for longer periods. In a conventional economic

\(^*\) This is a revised paper which is presented at 4th International Conference on Islamic Banking & Finance: Risk Management, Regulation & Supervision, 4th-6th April 2010, Khartoum, Sudan.

** Istanbul University.


system, the fund transferring process is based on interest-based-credit, whereas in an Islamic economic system, it is based on profit and loss sharing. This is because, conventional banks perform their intermediary function by borrowing from the saver groups and then lending to the deficit groups. Islamic banks, on the other hand, perform this function by accepting capital on the basis of *mudarabah* from the savers and then employing these funds in ways that are in the nature of participation or trading, such as *mudarabah, musharakah, murabaha, ijarah, istisna and salam*.

Since all banking operations are vulnerable to several kinds of risks, the economic prosperity, efficiency and stability of a financial system depend on proper handling of these risks. This is done by risk management which refers to the process/techniques employed in reducing the risks faced in an investment. It generally involves three broad steps: (i) identifying the source and type of risks (ii) measuring the degree or extent of the risk and (iii) determining the appropriate response or methods to be used⁴.

The risks faced by conventional banks in their operations are of many types: market risk, interest rate risk, credit risk, liquidity risk, exchange rate risk, legal risk, and political risk etc. Since the nature of Islamic banks is different from that of conventional interest-based ones, mainly due to the profit-sharing features and modes of financing used, the kind of risks that these institutions face also change. In addition to the risks faced by conventional banks, Islamic banks face rate of return risk, displaced commercial risk, fiduciary risk, and *Shariah* risk. For the purpose of managing these kinds of risk, several risk management techniques have been developed.

Our purpose is to examine how the reciprocity principle (*Qaidah muqabalah bil-mithl*) can be applied to the credit risk management process by IFIs. Therefore, in this study, we shall only focus on the credit risk management process in an Islamic banking system.

Credit risk (also called default or late payment risk) is defined as *the risk that counterparty fails to meet its obligations timely and fully in accordance with the agreed terms*⁵. Credit risk is related to the ability of a debtor to repay at the time appointed for repayment and in accordance with the conditions stipulated in the contract. If the debtor fails to abide by his obligations, it leads to a loss for the creditor and, therefore, becomes a risk for the bank. This risk may also trigger liquidity risk, rate of return risk displaced commercial risk, fiduciary risk and also *Shariah* risk. For this reason it is important for Islamic banks to manage credit risk.

Islamic banks face credit risk in most of the modes of financing that they use. It is well known that *murabahah, istisna, and installment sale (bay’al-mua’jjal) are*

---

⁴ Bacha, Obiyathullah, “Value Preservation through Risk Management - A Shariah Compliant Proposal for Equity Risk Management”, *MPRA Munich Personal RePEc Archive*, p.5. (http://mpra.ub.uni-muenchen.de/12632/)

⁵ Khan &Ahmad, p. 29.
sales which involve delayed payment thus generating debts in the accounts of the banks. The fundamental form of risk in all these contracts is credit risk. Salam gives rise to a commodity debt rather than a cash debt, but it also involves this kind of delivery risk. Mudarabah and musharakah, on the other hand, are contracts of participation, and the funds given by the bank to entrepreneurs are not liabilities. Nevertheless these two forms also bear a defaulted & late payment risk in two ways. First, in the case of tort or negligence, the entrepreneur is liable to guarantee the capital which means a debt liability. Second, when the capital of mudarabah or musharakah is employed in a deferred sale by entrepreneurs, which is what takes place in most murabaha contracts, the bank which is the owner of the capital (rabb al-mal) bears an indirect repayment risk.6

To mitigate credit risk, several techniques have been developed and are currently used in the conventional banking system. However, these are generally based on imposing interest, using derivatives which are mostly speculative instruments, and debt selling which is used to transfer the risk from the debtor to a third party. Due to some of these techniques that are prohibited in Islamic Law (such as charging interest and debt selling) and the others that are debatable among Islamic scholars (such as derivatives), Islamic banks can not apply them as risk mitigation tools. In contrast, many Shariah based/compliant classical (such as collateral, lien, mortgage, third party guaranty) and modern techniques have been proposed7 to Islamic banks for mitigating their credit risks (particularly late/defaulted payment risk). However, due to certain fiqhi, practical, and legal reasons8, it can be said that, in the Islamic banking system the credit risk issue has not been solved yet; it is still under discussion among financial engineers, practitioners and Shariah scholars.

One of the proposed credit risk mitigation techniques is compensation which refers to the punishment of the delinquent debtor by imposing a penalty for his/her defaulted/delayed payments. Actually, the classical Muslim fuqaha unanimously agreed that the delinquent debtor is to be reminded of the punishment in the hereafter, dishonored, defamed, or imprisoned (habs) if he shows delinquency and contempt of the court. The Maliki, Shafii and Hanafi schools are in favor of imprisonment for debt. If, however, such a debtor refuses to comply to pay the due debt, he may be beaten as a deterrent (zhajr), and lastly, his property may be sold through the court. Although early Muslim fuqaha9 devoted great attention to the non payment of debt by financially capable and delinquent debtors, they concentrated their attention on physical punishment solely rather than on financial punishment when they discussed the liability (mas’uliyah) of the delinquent debtor.9

---

6 el-Gari, p. 9.
8 Khan & Ahmad, p. 27, 28.
As Zarqa has mentioned, since classical fuqahas’ opinions cannot meet modern Islamic financial institutions’ needs\(^{10}\), contemporary fuqahas have attempted to find new and applicable penalty modes and they have focused on a late payment penalty as a compensation for the banks’ losses. Penalty application by Islamic Banks for late payments has been the main fiqhi issue among contemporary Muslim scholars for approximately the last fifty years the period in which Islamic banks emerged and developed and it is still a controversial issue. The debate is conducted on various levels. International Shariah bodies such as the AAOIFI, Islamic Fiqh Academy and the Grand Shariah Scholars’ Council, different Islamic Banks’ Shariah advisory boards, and numerous independent scholars and financial engineers have studied to find solution modes for this issue; finally some of them proposed the imposition of a penalty.

It should be pointed that the principle of penalizing a defaulter who is capable/delinquent of payment is universally accepted by contemporary scholars. However the modes of penalizing are debatable. According to the majority of contemporary scholars, a penalty can be implemented -with some conditions- as a compensation for the banks’ losses as well as a credit risk management tool. On the other hand, according to a large number of Shariah scholars, this method cannot be accepted and implemented by Islamic banks which are established to operate according to Shariah principles. However, both groups concentrated their attention on the issue from the point of Shariah rather than from a risk management angle.

According to Islamic criminal law, equivalence is the essential principle of penalties, including material ones. With regard to material penalties, the reciprocity principle (Qaidah Muqabalah bil-mithl: قاعدة مقابلة بالمثل) is accepted in classical Islamic fiqh sources as one of the main fiqhi principles: in the Qur’an and the Hadith literature there are several verses and traditions which confirm this principle. In the Islamic Banking system, in our opinions, it can be benefited from this principle/qaidah as a credit risk management method. When this new credit risk management method is applied, the losses emerging from delayed payments can be compensated for without using debatable penalty modes, and it will not trigger new risks.

This study is an attempt to apply the reciprocity principle (قاعدة مقابلة بالمثل) as a modern Islamic Banks’ credit risk management method. In this article, firstly, the Islamic Banks’ financial penalty application and the Shariah scholars’ opinions, regarding this issue, will be presented; secondly, the meaning of the reciprocity principle (قاعدة مقابلة بالمثل) and its fiqhi sources will also be discussed from the credit risk management angle. Finally, we will try to elaborate with evidence how the reciprocity principle can be applied as an alternative method in credit risk management in Islamic finance.

II. Two Proposed Methods and Their Shortcomings

There are two main groups of Shariah scholars that can be examined under this title. The first group consists of scholars who accept penalty application for delayed payment with some conditions, and the second group consist of those who do not accept penalty application. In the following pages we shall present both these groups’ opinions in brief:

1) The First Group

This group constitutes the committees and scholars who accept that the credit risk problem which results from defaulted payments can be solved by imposing a penalty on the delinquent defaulter debtor. According to those holding these views, the amount of the penalty can either be a sum of money determined by the court or experts or can be a percentage of the defaulted debt. In making this proposal they forward some justifications and also conditions for their solution. The AAOIFI\(^{11}\), the Malaysian Central Bank of Shariah Advisory Council (SAC)\(^{12}\), the National Shariah Council of Indonesian Council of Ulema (DSN-MUI)\(^{13}\), the Al-Barakah\(^{14}\) and KFH Shariah Boards\(^{15}\), Mustafa A. az-Zarqa\(^{16}\), M. Siddiq ad-Darîr\(^{17}\), Suleyman al-Manî'\(^{18}\), Zeki Abdulberr\(^{19}\), and some other Shariah bodies and scholars may be included in this group. The main arguments forwarded by this group as the basis for imposing a penalty on debt payment delaying-delinquent-clients are as follows:

1. From the Qur’an:
   a) "يَا أَيُّهَا الَّذِينَ آمَنُواْ أَوْفُواْ بِالْعُقُودِ": “O you who believe, fulfill the contracts”.

This verse makes fulfillment of the agreement made by the two parties obligatory.
b) “(Success is attained) by those who honestly look after their trusts and covenant”.

c) “Surely, Allah commands you to deliver trusts to those entitled to them”.

These three verses stress the importance of respecting a trusteeship. Here, in the case of a relationship between an Islamic bank and its clients, the clients (debtors) should respect the trusteeship given by the bank, and not do anything that could cause loss to the bank.

d) “Do not eat up each other’s property by false means”.

e) “O you who believe, do not devour each other’s property by false means, unless it is trade conducted with your mutual consent”.

According to most jurists, the word al-mal means not only property, but also utility. Thus, impeding someone from utilizing his property for no legal reason comes within the scope of “eating” on another person’s property by illegal ways.

2. From the Sunnah

a) “There should be neither harming nor reciprocating harm.”

b) “Delaying the payment of debt by a well-to-do person is injustice (zulm)”.

c) “Deferring payment by one who has the means to pay legalizes his punishment and his dishonour”.

3. From the principles of Fiqh:

The above verses relate to the principles of fiqh, among others:

» أن الأمر التشريعي يفيد الواجب ما لم تقم قرونة أو دليل يتصرف له الواجب

Imperative form refers requirement, except there is no clue that prevents it.

If this principle is linked with al-Maidah, ayah 5/1 concerning the promise of

22 an-Nisa, 4/58.
23 al-Baqarah, 2/188.
24 an-Nisa, 4/29.
fulfillment, it will be concluded that violating an agreement is considered as violating an obligation. Therefore, it is legal to impose a penalty.

Also “Damage remains” is one of the fiqhi qaidah which is derived from the hadith “لاضرر ولا ضرار.

According to these scholars, since deferring the payment of a dept form of loss and can harm other peoples such as the banks’ shareholders and investment account holders, thus it must be accounted and compensated for. To eliminate this loss, it is legal to impose a penalty in the form of actual/material loss compensation.

From the arguments above, the first group concluded that debt payment delaying-action can impede an Islamic bank from utilizing its own capital. That delaying action can be categorized as an abuse of trusteeship and a despotic action, because it can harm other people. Therefore, if such an action is left without penalty, it will then become a custom. As one of the maqasid al-shari’ah which talks about amanah and khiyanah, or the just and the unfair, it is therefore necessary to impose a penalty on debt payment delaying-capable-clients explicitly and proportionally.

Concerning the form of penalty there are analogies with ghusb. According to the first group, the analogy between the legal status of debt payment delaying-capable-clients and ghusb is permitted. Earlier Muslim scholars have also made such an analogy. For example, in the case of a found animal (luqatah), the finder has the right to hold the animal as guarantee until the owner compensates the finder for the cost of caring for it. In this way, a pawning legal status is given to the luqatah. Thus, referring to the legal status of ghusb, debt payment delaying-capable clients must be responsible for their actions and compensate material loss because they have inflicted financial loss on the bank. Therefore, there is no fiqhi problem concerning the legal status of the penalty imposed on debt payment delaying capable clients, as long as it is handled correctly and based on Shariah principles.

Despite the fact that this group accepts imposing a penalty, they lay down certain conditions for determining the compensation process. According to them, two alternatives can be used to determine the amount of compensation for material loss, i.e. (1) decided in advance or (2) decided through the legal courts after harm has occurred. According to Darir, the method used for determining compensation can be decided by the bank and the client in advance whereas according to Zarqa it cannot. He worries about the first alternative as it can lead to riba. Here, we need assurance that material loss compensation does not come under riba, because riba, which has been agreed in advance in debit and credit, is a des-

28 al-Majallah, Article no, 20.
30 See ad-Darir, “al-Ittifaq…”, p. 118.
potic way to obtain profit. In contrast, loss compensation is a means to uphold the law for those oppressed because of their losing the right to use their own property. Thus, the best alternative to determine the amount of loss compensation is through the courts or other authorized legal bodies (such as Shariah Supervisory Bodies). In determining material loss compensation, according to them, the legal courts should consider the following:

1. The legal courts should ensure that delaying-clients truly have no legal reason (uzr Shari') to delay their debt payment.

2. The legal courts should limit the loss compensation, by estimating the minimum income usually earned by the debtor with legal efforts such as mudarabah, mu'ara'ah, etc. Here, the legal courts may ask experts' opinions in related fields. With regard to point one, the legal courts should ensure that the delaying-clients truly have no legal reason (uzr Shari') to delay their debt payment, such as force majeure or economic trouble reasons. If the reason of delaying-clients is economic trouble, then according to them, the clients should not be given a penalty and should be given sometime to pay the debts when they are relieved from this trouble.

Zarqa proposes six principles that must be observed by an Islamic bank when handling debt payment delaying action:

1. Delaying action will be assumed to have been done if the clients cannot pay installments three times, or are late to pay until a half period after the time limit for debt payment has passed (in case of payment that is not paid in installments), and the bank has to be able to show evidence stating the delaying action.

2. It is prohibited to demand additional payment in the form of loss compensation if there was provision made for delaying action when the transaction was being made.

3. If a client delays installment payment over nine days after the time limit, the bank will be allowed to continue giving loans with domanah or mortgage agreements.

4. If the bank decide that delaying-capable-clients must pay compensation, the compensation may not exceed 10% from of the debt counted per month.

5. The bank should maintain the objectives of imposing a penalty, by making special counting arrangements (separate account) and transferring compensation into the bank's head office cash.

6. Funds originating from material loss compensation should be utilized for social objectives, such as social funds.

From Zarqa's argument, at least two problems emerge in ascertaining that material loss compensation does not contain elements of riba:

31 az-Zarqa, p. 110-112.
The first, Zarqa’s argument, states that the loss compensation penalty imposed on delaying-capable-clients must be decided through the legal courts, to avoid inefficiency and ineffectiveness. In general, the legal court process tends to be complicated and requires considerable time and costs. Therefore, the legal court process should be taken as the last resort when there is a dispute between the bank and the client. Every effort should be made to establish general regulations that can be used as a manual for Islamic banks in handling debt payment delaying problem. Furthermore it is the DPS’ duty to supervise the implementation of such regulations by an Islamic bank. It would be better here if general regulations were formalized in an act regulating Islamic banking, so that they have binding legal power.

As the second problem, there is an inconsistency in Zarqa’s opinion when he asserts that funds originating from material loss compensation should not be given to the bank, but donated as social funds. Whereas he stated that the reason for imposing a penalty on a delaying-capable-client is to give material loss compensation if funds originating from material loss compensation are donated, the purpose of imposing the penalty will not be fulfilled. Moreover, Zarqa himself has asserted previously that material loss compensation is not similar to riba, only a measure implemented to prevent an Islamic bank from incurring material loss caused by clients ignoring their obligation.

2) The Second Group

Despite the first group of scholars accepting the imposition of a material loss compensation penalty on delaying-capable-clients, there are some other Sharia committees –such as the Islamic Fiqh Academy, the Grand Shariah Scholars’ Council, and some scholars –such as Nezih Kamal Hammad, Zekiyyuddin Sha’ban, and Refiq Yunus al-Misri- who oppose this position. Their arguments are as follows:

a) The prohibition of imposing a material loss compensation penalty has been stated in al-Baqarah, verse 2/275. This verse does not differentiate whether the man on whom extra payments (ziyadah) are imposed is capable or not. Based on this verse, most Muslim scholars have prohibited all extra payments (ziyadah) irrespective of whether they are requested in advance or executed as custom. It is this reason that explains why Muslim scholars do not consider material loss compensation in a specific manner.

34 See al-Mani’, p. 409-412.
36 Sha’ban, p. 215-219.
b) Analogizing the legal status of debt payment delaying action with *ghasb* is unacceptable. The reason is that, according to scholars’ agreement, *nuqud* can not be rented / a rent, and therefore requesting payment (*ujrah*) for the delaying time, as has been determined on *ghasb*, is illegal.

c) The analogy of material loss compensation is invalid because of the verse prohibiting extra payments as has been mentioned above.

d) Judgment (*fatwa*) on the imposition of such a penalty will only bring disadvantages (*mafsadah*) rather than benefits (*maslahah*), because of the elements of *riba* contained in the compensation.

Regarding this issue, in its twelfth session held in Riyadh (Kingdom of Saudi Arabia) during the period from the 25th of Jumad Thani to the 1st of Rajab 1421H (23-28/9/2000), The Council of the Islamic Fiqh Academy of the Organization of the Islamic Conference, declared that “When the purchaser delays payment of due installments no additional charge should be imposed on him whether by virtue of a predetermined condition or otherwise. Such a practice amounts to commitment of prohibited usury.”

As is stated above, neither the penalty application supporters’ nor the oppositions’ opinions have solved the issue; it is still under discussion. The second group’s opinion was not accepted, in particular, by banks’ risk management teams because it does not contain any compensation. From the risk management perspective, according to bankers, it cannot be used as a risk management tool. The first opinion was also not accepted, since it is not considered an ideal appropriate fiqhi resolution. This is because, in this method, interest and compensation cannot be differentiated clearly. Banks’ staffs cannot explain these differences to their clients and account holders. This situation causes fiduciary and Shariah risks which are more dangerous than credit risk for Islamic banks. Using this method, determining the net losses that banks are exposed to from defaulted debts is difficult. Special treatment by courts to Islamic banks is not allowed by many countries’ banking laws. Supposing that an imposing penalty is accepted, but with this method, the banks’ losses cannot be compensated, because the bank is not permitted to benefit from this sum by registering it as a source of income, since according to most Shariah boards it should be donated in charity. In addition this approach also contains a contradiction in itself. If the penalty application is allowed (halal), why should banks give it to charity? If it is halal they could benefit from this amount. If it is used for penalizing defaulter debtors, the application of the punishment should not be the banks’ task, it should be implemented by related official bodies. Furthermore, since the amount of penalty is generally fixed, this method is open to abuse.

---


40
by malicious customers. In short, due to many reasons, the two above-mentioned methods have not been accepted an ideal solution for the late payment problem and also as a credit risk management technique in the Islamic banking system.

III. Alternative Method

Actually, this is not a new approach; it can be traced back to the 1980s. According to Darir, this approach was proposed for the first time by Yunus et-Temimi in 1986 and was criticized by Darir\(^41\). The same idea was brought up by Muhammed Anas az-Zarqa and Muhammed Ali al-Qari in an article named “et-Ta’wid an Darari’l-Mumatalah Beyne’l-Fiqhi ve’l-Iqtisad” in 1991\(^42\) and it was also criticized by Darir\(^43\) and Rabi ar-Roubi\(^44\). Abdussattar Abu Ghudde quoted this opinion in his book\(^45\). Lastly, this view was suggested again by Abdulaziz Bayindir with new additional arguments\(^46\). As stated earlier, Darir and Roubi criticized this view; this method, according to them, can not be implemented either in terms of fiqhi nor from an economic aspect. Moving from the later literature, it can be said that the two holders of this opinion-Zarqa and Qari- have not stood behind their views; they have not been consistent in spreading and applying their opinions. Because of this, in our opinion, this important approach has not been introduced and is not known by the majority of contemporary scholars and financial engineers.

This method is based on the reciprocity principle (قاعدة مقابلة بالمثل) which is one of the most important qaidah in Islamic criminal law\(^47\). A total of nine verses\(^48\) can be used as a source for this principle four of which\(^49\) are directly related to this topic.

The related parts of the four verses are:

\[
\text{فَمَنِ اعْتَدَى عَلَيْكُمْ فَاعْتَدُوا عَلَيْهِ بِمِثْلِ مَا اعْتَدَى عَلَيْكُمْ}
\]

“So when anyone commits aggression against you, be aggressive against him in the like manner as he did against you”\(^50\).

\[
\text{وَإِنْ عَاقَبْتُمْ فَعَاقِبُوا بِمِثْلِ مَا عُوقِبْتُمْ بِهِ}
\]


\(^45\) Abu Ghuddeh, al-Bay’ul-mu’ajjal, p. 100-102.

\(^46\) Bayindir, Abdulaziz, Faiz ve Ticaret, Istanbul 2007, p. 289-312.


\(^48\) These verses are, al-Baqarah, 2/194; al-En’am, 6/160; Yunus, 10/27; en-Nahl, 16/126; Hajj, 22/60; en-Neml, 27/90; al-Qasas, 28/84; Shura, 42/40.

\(^49\) al-Baqarah, 2/194; en-Nahl, 16/126; Hajj, 22/60; Shura, 42/40.

\(^50\) al-Baqarah, 2/294.
“And if you were to harm (them) in retaliation, harm them to the measure you were harmed.”

"Having said this, whoever afflicts (someone) with a punishment equal to what he was afflicted with (by the latter), Allah will certainly help him. Indeed, Allah is Most-Pardoning, Most-Forgiving.”

The recompense of evil is evil like it. Then the one who forgives and opts for compromise has his reward undertaken by Allah. Surely, He does not like the unjust.”

These four verses principally talk about punishment in this Dunya not in the Hearafter (akhirah) and teach us that the reciprocity which necessitates equivalence between crime and penalty is the main principle that should be considered in punishments.

When we look at the Hadith books, we can find several narratives which are related to these verses’ interpretation. Some of these include the following:

It is narrated from the prophet (SAW):

"The fine of hiding lost camel is to provide it and also its equivalence.

The prophet of Allah (SAW) was asked about fruit which was bung up and said: If a needy person takes some with his mouth and does not take a supply away in his garment, there is nothing on him, but he who carries any of it is to be fined twice the value and punished, and he who steals any of it after it has been put in the place where dates are dried to have his hand cut off if their value reaches the value of a shield. If he steals a thing less in value than it, he is to be fined twice the value and punished.

These ahadith show us how the Prophet (SAW) interpreted the above-mentioned verses, particularly in the fiscal criminal area. It can be concluded from these narratives that, when punishment is implemented for fiscal crimes, first of all the damaged or destroyed mal or its equivalent amount is taken from the of-

51 an-Nahl, 16/126.
52 al-Hajj, 22/60.
53 Shura, 42/40.
fender as the original right of the victim. In addition to the original amount, the same amount of *mal* is also taken from him as a punishment for his offence. This is because, taking back the victim’s original amount isn’t considered as punishment. However, verses and narrations give us punishment right to offender humans’ properties. According to these verses, forgiveness –if it’s wanted- is also possible.

The above-stated narrations talk about material punishment in general which is not directly related to our topic. The following two narrations, which are directly related to our topic, are:

b) *مطلق الغني ظلم* “Delaying the payment of debt by a well-to-do person is injustice (zulm)”\(^{56}\).

c) *لم يواجد يحل عرضه وعقوبته* “Deferring payment by one who has the means to pay legalizes his punishment and his dishonour”\(^{57}\).

In the first hadith, the action of delaying payment of debt is considered as a *zulm* by the Prophet (SAW). According to the second hadith, if the financially capable debtor delays his payment, he can be punished. Here, there is an important word which is "عقوبة" that is related to the verses and hadiths. According to Mani and Shaban this word is absolute (mutlaq); it covers physical, material and all kinds of punishments; it cannot be limited only to some types of punishments\(^{58}\). From the word “عقوبة” used both in the Quran and the ahadith which relates the Prophet’s (SAW) implementations, it can be concluded that the Prophet’s interpreted “عقوبة” with above-mentioned meaning.

As we know not only FIs or corporations but also all societies have risk vulnerable values. The maqasid of Shariah, which is derived from the main sources of Islamic religion, aims to protect all these common values from risks. One of the most important common values is property right (Haqqu’l mal). Hence, protecting humankinds’ property is considered under the goals of the Maqasid Shariah. The above-stated verses and narrations can be evaluated from this perspective and it can be said that they are also talking about risk management principles. By doing this, these general principles have been applied to a special area which is financial risk management.

The discussions show us that the present late payment penalty application by Islamic banks which is unsatisfactory to almost all parties, needs to be reviewed and established a new mode which may be welcomed by all stakeholders and can be used as a credit risk management technique. This is because the newly proposed method would be appropriate to Islamic Law and current economic conditions. When this new credit risk management method is applied, the banks’ losses from

\(^{56}\) Buhari, *Sahih*, "Hiwalat", 1, 2.


\(^{58}\) See al-Mani’, p. 397; Sh’aban, p. 217.
delayed payments can be compensated for and they will not be triggered to new Shariah and economic risks.

This solution can be implemented as follows:

Let’s say, A Islamic Bank and its client made a *murabaha* agreement. With this contract, the bank has become a creditor and client has become a debtor. Assume that the amount of debt is $10,000, and the debt is to be settled in 10 months; the debtor will pay $1000 monthly. The debtor pays the first five installments regularly, without any delay, but in the sixth month he delays his sixth payment without any reasonable Shari necessity. After one month, whether by court order or his own initiative, he accepts to pay his debt. The bank takes $2000 from him; the first $1000 is considered for the original amount of debt and the second $1000 is considered as a penalty. However the bank cannot put this money into its account as a source of income, but can use it for one month, which is equivalent to the time which the debtor kept and used the bank’s money. After finishing the stipulated time, the bank puts the money back into the client’s account. If the debtor cannot afford to pay the second $1000 in one payment, with mutual consent, it can be divided into two or more parts. This time, the bank has the right to extend the time of keeping and utilizing this part of the money to two or more months: equal to the time which the client utilized and benefited from it. Hence, by applying this solution neither the bank nor the client is subjected to any harm, and this will be more suitable to the main Shariah sources. Based on this principle, financial engineers can develop many more sophisticated credit risk management techniques.

**IV. CONCLUSION**

In conclusion, the delayed payment issue has been a major problem for Islamic banks since their emergence. It has been discussed for approximately 40 years and is still under discussion by contemporary fuqaha. During this period, fuqaha have concentrated on the Shariah aspect of the issue; the risk management aspect has been ignored by them. Since the above-mentioned two groups’ opinions were not found to be applicable by the related parties, conflicts occurred between Shariah bodies and risk managers. When the third proposal is implemented, neither the Shariah bodies nor risk managers can reject it. This is because, this method is based on the reciprocity principle which is one of the main qaidahs in Islamic law. By applying this method, banks protect themselves against fiduciary and Shariah risks. Since banks can benefit from the income of money taken as a penalty, it may be used as a credit risk management tool. As it is well known, the main objective of risk management is to reduce risk as much as possible, not to eliminate all the losses that banks are exposed to.