



Dar Al Istithmar

دارالإستثمار

The Global Leader in Islamic Financial Innovation

Defaults In Islamic Finance: *A Shari'a Perspective*

1 December 2009

Presented by:

Asim Khan

Executive Director

Intelligent

Islamic Finance Advisory: Creating Innovative
Solutions for a Dynamic World

- Islamic Finance transactions are based on three main components:
 - Commercial viability
 - Shari'a compliance
 - Legal enforcement

- Shari'a compliance considerations restricts:
 - Riba (includes interest)
 - Maisir (includes speculation)
 - Gharar (i.e. Uncertainty)
 - Muharramat (refers to certain business activities)

Qur'an

“If the debtor is in a difficulty, grant him time until it is easy for him to repay. But if ye remit it by way of charity, that is the best for your if you only know”
(Chapter 2: Verse 280)

“O ye who believe! when ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing..... And get two witnesses.....Disdain not to reduce to writing (your contract) for a future period, whether it be small or big: it is just in the sight of Allah, more suitable as evidence, and more convenient to prevent doubts among yourselves...take witnesses whenever ye make a commercial contract.....”
(Extract from Chapter 2: Verse 282)

The Prophet (PBUH) said:

“the hand continues to remain under an obligation until it returns what it has taken”

“deliberate delay on the part of a financially capable debtor is a form of oppression (dhulm)”

Contract	Nature	Type of Obligation	Default Rights
Murabaha/ Musawama Mu'ajjal	Deferred Payment Sale	Sale proceeds are considered debt	Full amount due, can be accelerated upon default
Ijarah	Lease	Ownership of usufruct/ assets. Lease Rentals accrued are considered debt	Only lease rentals are debt Right to cancel lease contract and sell assets
Wakala bil Istithmar	Investment Agency	Equity in investment assets	Trace and liquidate assets as specified in the contract, subject to other investor's rights, also see below
Mudaraba	Investment Management	Equity in investment assets (after payment of all debts/obligations)	Sue manager for negligent/fraudulent misconduct
Musharaka	Equity Partnership	Equity in investment assets (after payment of all debts/obligations)	Sue manager for negligent/fraudulent misconduct

- Default by debtor capable of paying is *haram* (prohibited).
- No additional financial compensation allowed upon default.
- Legal and other recovery expenses claimable
- Asset can be pledged and asset can be sold without recourse to courts
- Acceleration of payments allowed, subject to notice and grace period.
- Charity penalty provision permissible and exercisable
- Asset tracing permissible
- Excess payment permissible so long as not contractually stipulated.

- Under Shari'a, an obligation remains due and payable until settled or forgiven, totally or partially, by the financier.
- No increase in the amount of obligation is allowed due to delay in the repayment.
- If the obligor is in genuine difficulty, and subject to the financier's convenience, Shari'a requires that additional time should be provided to the obligor to work his way through the financial difficulty.
- It is accepted that upon a default, a financier can make the obligor bankrupt .
- Not all contracts result in clear determinable rights for investors
- It is sometimes preferable to engage in restructuring talks then to exercise rights which may lead to uncertain legal outcomes.

Any queries, please feel free to contact

Asim Khan

Executive Director, Dar Al Istithmar

E: asim.khan@daralistithmar.com

M: + 44 (0) 75157 33455

3 George Street

Oxford, OX1 2AT

United Kingdom

T: +44 (0) 186 524 6357

This document is the sole property of Dar Al Istithmar Ltd. No unauthorised reproduction, copying, translation or other similar act is permitted without the explicit written consent of Dar Al Istithmar Ltd. Any such permission may only be granted upon receipt of written request for the same.

This document contains general discussions and in no way should be considered as a Fatwa on the issues discussed. DI does not recommend structuring and marketing any product based on the information contained in this document without obtaining relevant prior legal documents conforming Sharia approval and before DI has at least issued provisional Sharia approval from its Sharia Supervisory Board.

The information contained in this document is based on material we believe to be reliable; however, we do not represent that it is accurate, current, complete, or error free. Assumptions, estimates and opinions contained in this document constitute our judgment as of the date of the document and are subject to change without notice. Any projections are based on a number of assumptions as to market conditions and there can be no guarantee that any projected results will be achieved. Past performance is not a guarantee of future results.

DI SPECIFICALLY DISCLAIMS ALL LIABILITY FOR ANY DIRECT, INDIRECT, CONSEQUENTIAL OR OTHER LOSSES OR DAMAGES INCLUDING LOSS OF PROFITS INCURRED BY YOU OR ANY THIRD PARTY THAT MAY ARISE FROM ANY RELIANCE ON THIS DOCUMENT OR FOR THE RELIABILITY, ACCURACY, COMPLETENESS OR TIMELINESS THEREOF.

Copyright© 2009 Dar Al Istithmar Limited