

Ta'widh & Gharamah in Islamic Finance: Revisiting the Foundations and Contemporary Industry Expectations

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FOUNDATIONS

Concepts: Ta'widh and Gharamah

Two distinct mechanisms in Islamic finance, each with a different purpose and Shariah basis

Ta'widh (تعويض)

Compensation for Actual Loss



Meaning

Compensation for actual loss suffered due to a customer's delay in payment.



Shariah Basis

- Based on the principle of **removing harm** (raf' al-darar).
- Permissible only where an **actual and quantifiable loss** has occurred.
- Intended to restore the creditor's position, **not to generate profit**.



Key Objective

To compensate genuine losses and restore the institution to the position it would have been in, had the default not occurred.

Gharamah (غرامة)

Financial Penalty for Misconduct



Meaning

A financial penalty imposed on a wilfully defaulting debtor as a deterrent against unjustified delay.



Shariah Basis

- Derived from the obligation to fulfil contracts and the prohibition of oppression by solvent debtors.
- Intended to **promote payment discipline** rather than compensate the financier.
- Amount collected is generally **channelled to charitable purposes** and should not become the financier's income.



Key Objective

To deter misconduct, encourage timely payment, and uphold contractual obligations.

Fundamental Distinction

Key differences between Ta'widh and Gharamah

Aspect	Ta'widh (تعويض)	Gharamah (غرامة)
 Nature	Compensatory	Punitive (deterrent)
 Basis	Based on actual and quantifiable loss	Based on misconduct (e.g. unjustified delay)
 Objective	Removes harm and restores the creditor's position	Deters the debtor and promotes payment discipline
 Condition for Permissibility	Permissible only where an actual loss has occurred	Applicable in cases of wilful default or unjustified delay
 Treatment	May be recognised as income subject to regulatory requirements	Generally not recognised as income and directed to charitable purposes



Complementary Mechanisms for a Fair and Ethical Financial System

Both Ta'widh and Gharamah play an important role in promoting a disciplined, just and sustainable Islamic finance industry.

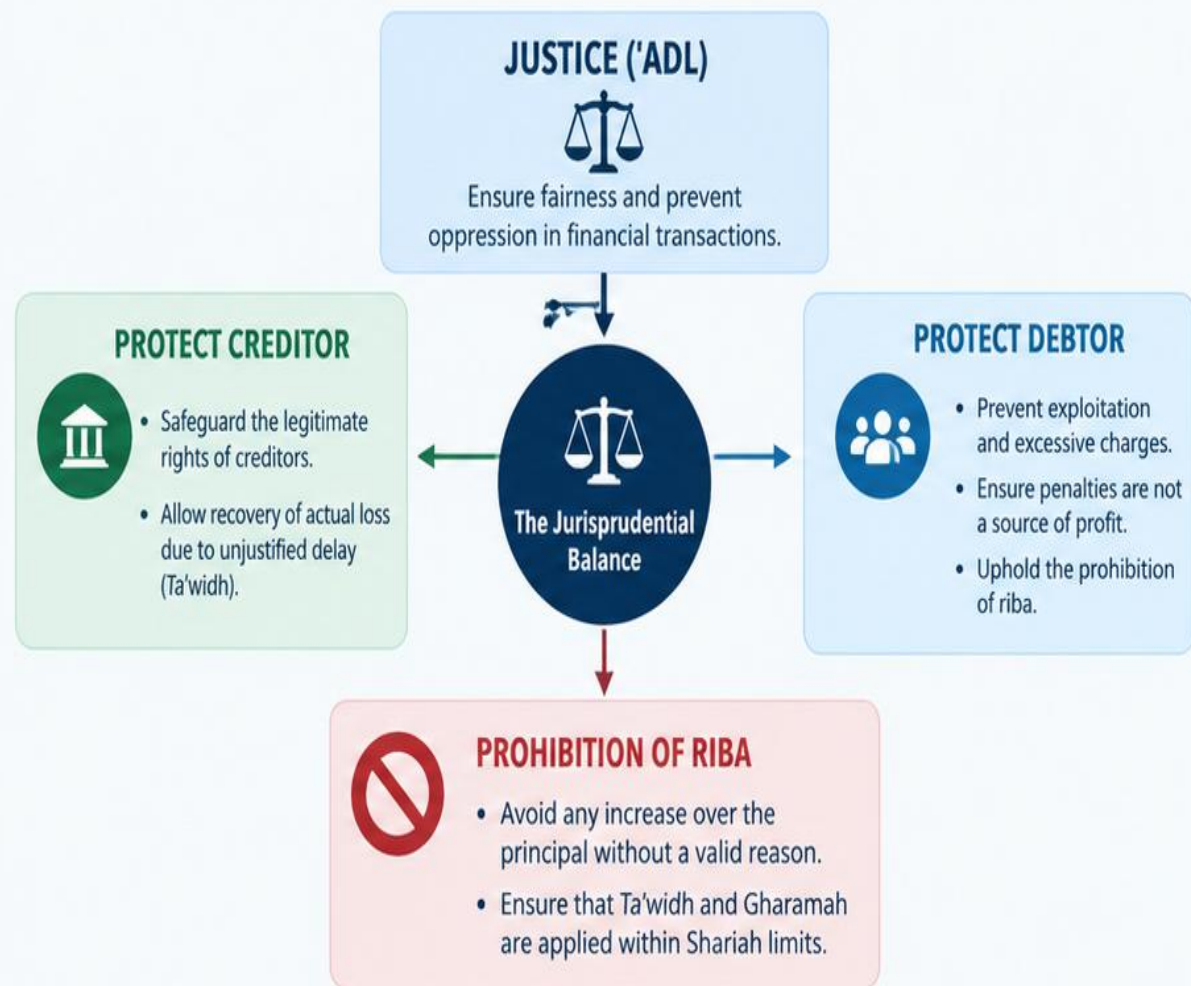
The Evolution of the Debate

From early questions to contemporary governance



The Jurisprudential Foundation of Ta'widh & Gharamah

Protecting the rights of creditors without violating the prohibition of riba



Two important Shariah objectives — both can be achieved through a balanced, well-governed approach to Ta'widh and Gharamah.

The Four Governing Shariah Principles

A balanced foundation for Ta'widh and Gharamah in Islamic finance

1



Protection of Wealth (*Hifz al-Mal*)

- Islam protects legitimate property rights.
- Creditors have the right to recover debts without suffering unjust loss.

Maqāṣid: Preserve wealth and contractual certainty.

2



Justice (*‘Adl*)

- A debtor who is able to pay should not deliberately delay payment.

“Delay in payment by a wealthy debtor is oppression.” (Sahih al-Bukhari)

- Deliberate default violates justice and creditors deserve protection.

3



Mercy (Rahmah)

- Islam distinguishes between:
 - **Mu’sir** (genuine financial hardship)
 - **Mumatil** (deliberate delay despite ability)

- Allah commands:

“...If the debtor is in hardship, then grant him respite...”
(Qur’an 2:280)

- Financial difficulty should never be punished.

4



Prohibition of Riba

- Islam absolutely prohibits

“Any increase over debt merely because of time.”

- Therefore, any late-payment mechanism must avoid:
 - interest,
 - disguised interest, or
 - profit from delay.

Together, these principles enable a fair, just and resilient Islamic financial system.

JURISTIC & REGULATORY DEVELOPMENT

Classical & Contemporary Juristic Opinions



Why Scholars Differ

- The disagreement is **not over justice**.
- The disagreement is **whether financial compensation itself becomes a prohibited increase over debt**.

1

Opinion 1 Absolute Prohibition

- Any additional amount due to delay is considered **riba**, regardless of intent or actual loss.
- Based on a strict reading of the prohibition of any increase over debt.

Key Concern:

Preventing any form of interest.

2

Opinion 2 Conditional Permissibility

- **Ta'widh** (compensation) is permissible only for **actual**, quantifiable loss.
- **Gharamah** (penalty) is permissible as a **deterrent**, with conditions and safeguards.
- Seeks to balance justice with the prohibition of **riba**.

Key Concern:

Allowing fairness while avoiding **riba**.

3

Opinion 3 Malaysian Regulatory Approach

- Recognises **Ta'widh** for actual loss (may be treated as income subject to regulatory requirements).
- Allows **Gharamah** as a deterrent, generally not recognised as income and channelled to charitable purposes.
- Provides practical guidelines to ensure Shariah compliance.

Key Concern:

A workable and consistent framework for modern Islamic finance.

Opinion 1: Absolute Prohibition



Representative

Justice Mufti Muhammad **Taqi Usmani**



Position

No monetary increase over debt is permissible.



Evidence

Relied upon
"Delay by a wealthy debtor makes
punishment permissible."



He argues

- ✓ punishment does **not** mean monetary compensation
- ✓ punishment should be imposed by a judge
- ✓ any contractual financial increase resembles **Riba al-Jahiliyyah**

Underlying Juristic Principle



Sadd al-Dhara'i

(Blocking every avenue leading
to *riba*)

The aim is to prevent *riba* and uphold justice in financial dealings.

Classical Juristic Opinions on Ta'widh and Gharamah

Different approaches, a shared concern for justice and the prohibition of *riba*

School	Position	Juristic Basis	Representative Scholar	Classical Consensus
Hanafi	Prohibited any contractual increase over debt due to delay.	An increase linked to deferment constitutes <i>riba al-nasī'ah</i> . A debtor may be compelled to pay or imprisoned, but no additional monetary amount is payable.	Ibn 'Ābidīn (Hanafi)	 Debt cannot generate an additional return because of time.
Maliki	Prohibited financial increase over debt but recognised judicial measures against a wilfully defaulting debtor.	Distinguished between legal enforcement and financial gain. Delay may attract judicial sanctions, but not compensation to the creditor.	Ibn al-'Arabī (Maliki)	 Wilful delay is sinful.
Shafi'i	Prohibited any stipulated increase arising from delayed repayment.	A debt remains fixed (<i>thābit</i>) and cannot increase merely because payment is deferred.	Al-Nawawī (Shafi'i)	 The Qadi may compel payment or imprison a solvent debtor.
Hanbali	Prohibited contractual monetary penalties while allowing coercive measures against solvent defaulters.	Based on the Hadith that delay by a wealthy debtor is oppression, permitting enforcement but not additional payment.	Ibn Qudāmah (Hanbali)	 The creditor cannot profit from delay.

While jurists differed on specific rulings, they shared a common objective: to uphold justice and prevent *riba*.

Opinion 2: Conditional Permissibility

Financial compensation is permissible provided strict safeguards exist.



Supported by

- OIC Fiqh Academy
- Mustafa al-Zarqa
- Abdullah al-Mani'
- Abdul Sattar Abu Ghuddah
- Zaharuddin Abd Rahman
- Many contemporary jurists



Position

Financial compensation is permissible provided strict safeguards exist.



Juristic Basis

La Darar wa La Dirar

Harm should neither be inflicted nor reciprocated.

Therefore, where delay causes actual financial harm, that harm may legitimately be compensated.

Conditions for Permissibility

1



Actual loss
(documented)

2



Solvent debtor
(able to pay)

3



No compounding
(no interest)

4



No unjust
enrichment

5



No exploitation
(fair and reasonable)

A balanced approach that upholds justice while avoiding *riba*.

Opinion 3: Malaysian Regulatory Approach

Reconciling classical juristic concerns with the practical realities of modern banking.



Ta'widh

(Compensation for delayed payment)

Based on actual compensatory loss
Recognised within BNM's framework



Gharamah

(Penalty for wilful default)

Imposed to deter wilful default
Transferred to charity



Not recognised as bank income

Cannot be treated as revenue
and must be channelled to charity



Ensures fairness

Avoids unjust enrichment and
prevents profit from delay



Underlying Shariah Principles

- **Justice ('Adl)** – protect the rights of creditors and prevent oppression.
- **Prohibition of Riba** – no increase over debt merely because of time.
- **Mercy (Rahmah)** – hardship should be given respite (Qur'an 2:280).
- **Protection of Wealth (Hifz al-Mal)** – preserve wealth and contractual certainty.

SAC Position on Ta'widh & Gharamah

- 1 **Ta'widh** – Compensation for delayed payment; may be recognised as income within BNM-approved parameters.
- 2 **Gharamah** – Penalty to deter wilful default; cannot be recognised as income and must be channelled to charity.
- 3 **Mu'sir** – Genuine financial hardship → respite should be granted.
- 4 **Mumatil** – Able to pay but deliberately delays → late-payment mechanism may apply.

Operationalisation of Ta'widh in Malaysia

- 1 The court may impose the late-payment rate prescribed under court rules.
- 2 Islamic financial institutions may retain only the Ta'widh component representing actual loss.
- 3 SAC adopted the weighted average overnight rate of the Islamic money market as the reference for determining Ta'widh.
- 4 Where the court-imposed amount exceeds the permissible Ta'widh, the balance must be channelled to charity.
- 5 Total compensation must not exceed the principal debt.



The Practical Industry Tension

- Ta'widh compensates the institution but is constrained by the principle of actual loss.
- Gharamah strengthens deterrence but cannot become bank income.
- This creates a tension between effective default deterrence, recovery of genuine loss, and prevention of profit from delay.
- The challenge is to design a commercially workable mechanism without compromising Shariah principles.

A balanced regulatory approach that upholds justice, prevents exploitation, and supports a stable Islamic finance industry.

Why Do Islamic Banks Need Ta'widh & Gharamah?

A Shariah-compliant response to credit risk and payment default

The Challenge



- Islamic banks face greater challenges because they **cannot rely on interest-based late payment charges**.



Other Risk Mitigation Tools (Already Used)



Collateral
(Rahn)



Guarantees
(Kafalah)



Credit
assessment
(CCRIS)



Pricing
according
to risk



Takaful



Restructuring
and recovery
processes

When a Payment Becomes Due

Debtor delays payment



Genuine Financial Hardship (Mu'sir)

Unable to pay despite genuine difficulty.



Respite / Restructuring

- Payment should be given time.
- No punishment.



Wilful / Strategic Default (Mumāṭil)

Able to pay but deliberately delays.



Ta'widh

Compensate actual loss

- Covers proven financial loss.
- Recognised within Shariah and regulatory framework.
- Must not exceed the actual loss or principal debt.



Gharamah

Deter deliberate default

- Penalty for wilful default.
- Cannot be treated as bank income.
- Must be channelled to charity.
- Acts as a deterrent.



Protect Depositors' Funds



Preserve Financial Discipline



Manage Credit Risk

Ta'widh and Gharamah should be viewed as one component of a broader Shariah-compliant credit risk management framework rather than the primary solution.

From Shariah Principle to Practice: Ta'widh

Lessons from Malaysian Case Law

01

CIMB Islamic Bank v LCL Corp [2012]

Regulatory + contractual alignment matters.



Issue

Ta'widh calculation challenged, including alleged compounding.



Court held

Bank's calculation upheld as consistent with the applicable BNM guideline and contractual terms.



Lesson

Regulatory + contractual alignment matters.

02

Maybank Islamic v M-IO Builders [2017]

Ta'widh must be demonstrable and properly substantiated.



Issue

Basis and calculation of Ta'widh were challenged.



Court

Claim was allowed where the calculation was supported by evidence.



Lesson

Ta'widh must be demonstrable and properly substantiated.

03

MK Associates v Bank Islam [2015]

Permissibility does not create automatic entitlement.



Issue

Ta'widh was not provided for in the original 1994 financing documentation; later imposition was disputed.



Court held

Bank was not entitled to the Ta'widh claimed on that basis.



Lesson

Permissibility does not create automatic contractual entitlement.

04

Pan Northern Air Services v Maybank Islamic [2021]

Regulatory permission does not override contractual safeguards.



Issue

Contract stipulated 1% p.a., but a higher IIMM-related Ta'widh rate was applied without the required notice.



Court

1% contractual rate prevailed; adjustment/refund was required.



Lesson

Regulatory permission does not override contractual safeguards.



Key Takeaway from the Cases

The issue is no longer simply:

"Is Ta'widh permissible?"



The Real Question Now

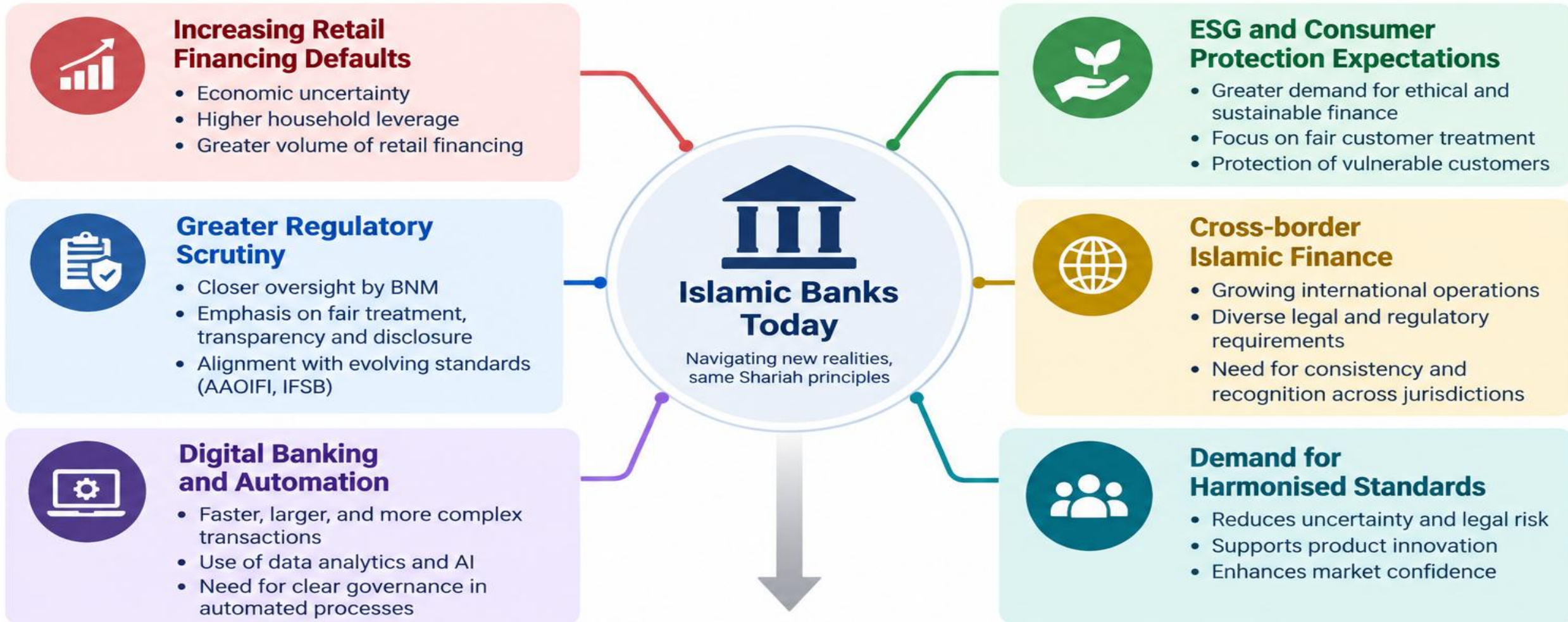
It is: Was the Ta'widh contractually authorised, correctly calculated, properly disclosed and Shariah-compliantly implemented?

Well-documented, fair and transparent implementation of Ta'widh is essential for legal enforceability, Shariah compliance and financial stability.

CONTEMPORARY GOVERNANCE CHALLENGES

Why Does This Matter Today?

Evolving risks. Greater scrutiny. Higher expectations.



These developments require governance frameworks that are practical, transparent and Shariah-compliant.

Effective use of Ta'widh and Gharamah is part of a broader response to these contemporary challenges.

Contemporary Governance Challenges

Key Questions in the Application of Ta'widh in Islamic Finance

1 Is Ta'widh Truly "Actual Loss" or an Opportunity Cost?



- Can funding costs be recovered?
- Are collection costs actual loss?
- Are administrative expenses already priced into financing?
- Does a fixed percentage reflect real loss?

2 Who Should Pay?



Mu'sir (Unable)
Respite (Q2:280)

Genuine hardship – may be given time (respite).



Mumatil (Able but delays)
Penalty

Deliberate delay – may be subject to penalty (Gharamah).

3 Should Ta'widh Be Compoundable? Can Ta'widh be on Ta'widh?



Should Ta'widh be recognised as income, or merely as reimbursement of verified losses?

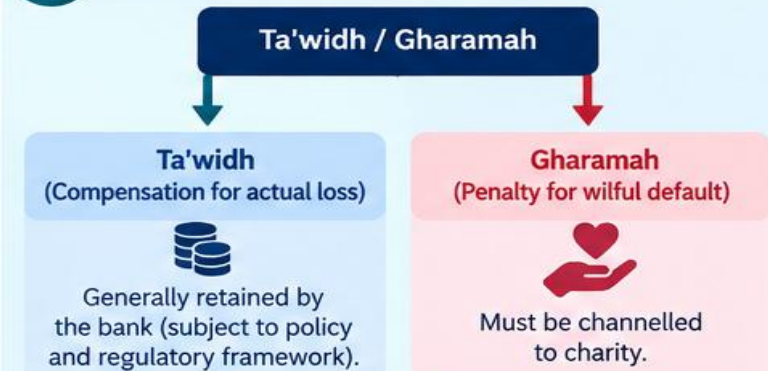


If Ta'widh / Gharamah is based on a binding charitable undertaking (iltizām bi al-tabarru'), does the bank have the legal or Shariah authority to waive it after the obligation has crystallised, or is it merely a trustee administering funds?

4 Are Common Recovery Costs "Actual Loss"?

Item	Actual Cost?	Recoverable as Ta'widh?	Notes
Reminder letters (RM150)	✓	Generally Yes	Direct, reasonable cost
Legal notice (RM1,200)	✓	Yes	Direct, reasonable cost
Court filing fees (RM2,500)	✓	Yes	Direct, reasonable cost
Collection agency fees (RM3,000)	✓	Subject to policy	Must be reasonable and actual
Additional administrative costs	⚠	Depends	May already be priced into financing
Profit that could have been earned if funds had been reinvested	✗	Opportunity Cost	Generally not recoverable
Expected financing return for the delayed period	✗	May resemble Riba	Not regarded as actual loss

5 Where Should Ta'widh & Gharamah Be Channelled?



6 The Bigger Question

Should ordinary recovery costs be regarded as an inherent commercial risk that Islamic financial institutions are expected to bear?



Recovery Costs in Islamic Finance

Actual Loss or Normal Business Cost?

1

Is Every Recovery Cost an "Actual Cost"?

Should every recovery-related expense be passed on to the customer?



The Shariah Concern

Banks establish from the outset:

- Recovery Department
- Credit Risk Department
- Collection Unit
- Legal Unit
- Monitoring Systems
- Staff Salaries
- Collection Infrastructure

These are **ordinary business operations**, regardless of whether a particular customer defaults.



Are these costs
**actual loss caused
by the customer?**

or

**Normal business
overhead that the
bank should bear?**

2

A Practical Distinction

Which costs can be recovered as Ta'widh, and which should be borne by the bank?

Recoverable as Ta'widh (actual loss)	Should be borne by the Bank (normal business cost)
 Court filing fees directly attributable to the case	 Salaries of recovery staff
 External legal fees for that customer	 Recovery department overhead
 Bailiff or enforcement fees	 Office rent and utilities
 Third-party recovery expenses	 IT systems and collections platform
 Direct expenses solely arising from the default	 General operational costs

3

Why This Distinction Matters



Practical Reality

Recovery officers handle hundreds or thousands of default cases simultaneously.



Shared Resources

Legal departments work on multiple files. IT systems, reminder platforms, and collection infrastructure are shared resources.



Fixed Overheads

Staff salaries and office costs are fixed overheads that cannot be allocated to a single customer with precision.



Opportunity Cost

Opportunity costs (e.g. expected financing return) cannot be objectively isolated for a single customer and may resemble riba.



Key Takeaway

Not all recovery-related expenses are actual loss. Islamic financial institutions should only recover costs that are directly caused by the customer's default, while normal business overheads remain the bank's responsibility.



Practical.
Transparent.
Shariah-compliant.

The “Actual Cost” Dilemma

Can the amount be objectively determined for each customer?



Example 1: Recovery Officer

Manages 500 default accounts



Monthly salary:
RM 8,000



Question:

How much of that salary belongs to Customer A?

- RM5?
- RM25?
- RM100?

There is no objective method.



Example 2: Legal Department

Handles 300 recovery cases



Annual operating cost:
RM 2 million



Question:

How much is attributable to one defaulting customer?

Again, there is no precise answer.

Shared
resources
and
overheads



The Governance Challenge

If the amount cannot be objectively determined, can it still be called

“Actual Loss”?

Or is it merely
an allocated business cost?



Key Implication

If a bank cannot objectively calculate the actual loss attributable to an individual customer, can the amount genuinely be described as “**Ta’widh**”, or should it instead be **recognised** as part of the **inherent commercial risk** of operating a financial institution?

This dilemma highlights the need for clear principles and practical guidelines in applying Ta’widh in Islamic finance.

The Mu'sir–Mumatil Dilemma

Different Circumstances, Different Shariah Responses



Mr Ahmad

Lost his job.

- No income for six months.
- Provides evidence of unemployment.
- Cannot meet monthly instalments.

Classification:



Mu'sir

(Genuine financial hardship)



Shariah Response

- ✓ Restructure financing
- ✓ Grant extension
- ✓ Consider rescheduling
- ✓ Possible zakat or social finance support
- ✓ No punitive treatment



Mr Lim

Monthly income RM45,000.

- Travels overseas regularly.
- Purchases luxury goods.
- Chooses not to repay financing.

Classification:



Mumatil

(Deliberate default)



Shariah Response

- ✓ Ta'widh (compensation for actual loss)
- ✓ Gharamah (penalty)
- ✓ Legal action
- ✓ Enforcement



Ms Sarah

Income reduced by 40%.

- Still employed.
- Supports elderly parents.
- Medical expenses increasing.
- Can pay — but only partially.

Is she:



Mu'sir?

Mumatil?

Something in between?



Key Considerations



Assess intent and ability to pay



Use risk- and affordability-based assessment



Consider partial restructuring



Explore social support mechanisms



Key Question

Should Islamic finance move from a binary classification to a risk- and affordability-based assessment?



Core Principle

A balanced approach ensures fairness, protects the rights of creditors, and remains faithful to Shariah principles.

The Ta'widh Compounding Dilemma

Should Ta'widh be calculated on the original overdue amount or the new balance?

Case Example



Murabahah
Outstanding Debt
RM100,000



Customer Defaults
Fails to make payment



Ta'widh Imposed
RM1,000



**Customer Still
Does Not Pay**

Option A

Calculate on the **original
overdue amount (RM100,000)**



Maintains the
compensatory nature
of Ta'widh



Avoids compounding



Consistent with
preventing **Riba**

**Ta'widh = Compensation
for actual loss,**
not an additional return
on an increased balance.

Option B

Calculate on the **new
balance (RM101,000)**



Compensation on
compensation
(compounding)



May resemble a
time-based increase
in debt



Risks resembling
Riba al-Jahiliyyah

**Not consistent with
the objectives of Ta'widh
and the prohibition of Riba.**

Key Principles



Ta'widh should **never
be compounded.**



It should be calculated only
on the **original overdue
obligation.**



Never be imposed on
previously accrued Ta'widh
or Gharamah.



Not be **capitalised** into
the financing balance.



Cease once the verified
compensable loss has
been recovered.



Conclusion

Ta'widh is a compensation mechanism, not a profit-generating charge.
It should be based on the original overdue amount, with no compounding,
to remain faithful to Shariah principles.

The Ta'widh Management Dilemma

When does compensation become profit?

1

When Does Compensation Become Profit?



The key question is whether the amount collected as Ta'widh remains a genuine compensation for actual loss, or becomes an additional source of income (profit).

2

The Current Practice



Islamic financial institutions recognise Ta'widh as compensation for losses arising from delayed payment.

3

The Governance Question



How can the bank be certain that the Ta'widh collected does not exceed the actual loss suffered?

Illustrative Example

Ta'widh collected exceeds verified recoverable loss



Verified Recoverable Direct Loss
(e.g. collection agency fees, legal fees, etc.)

RM 8,000

+



Ta'widh Collected from Customers
(for delayed payment)

RM 12,000



Excess Collection
(beyond verified loss)

RM 4,000



Should the bank
retain it as
income?



Should it be
refunded to
customers?



Should it be
transferred
to charity?



Or adjusted
against future
recoverable
losses?

Key Consideration



If Ta'widh exceeds the bank's verified loss, can it still be regarded as compensation, or has it become an additional source of income?

Principles to Uphold



Based on actual, verifiable loss



No compounding



Not imposed on previously accrued Ta'widh or Gharamah



Not capitalised into the financing balance



Cease once the verified loss has been recovered



Key Takeaway

Ta'widh must remain a genuine compensation for actual loss, with robust governance to ensure it does not become a source of profit for the bank.



The Charity Utilisation Dilemma

When Ta'widh is also channelled to charity, should it definitely be classified as Gharamah?

Fairness
Accountability
Social Impact

There are instances in which even Ta'widh is also channelled to charity. However, if it is Gharamah, it should be definitely channelled to charity.
Can it be considered as Islamic social finance funds?

1 Who Should Receive the Funds?



- Poor and needy (fuqara' and masakin)
- Education
- Healthcare
- Disaster relief
- Waqf projects
- Zakat institutions
- Public welfare

2 Who Has the Authority to Decide?



- Management
- Board of Directors
- Shariah Committee
- Independent Charity Committee
- Regulator

3 Can the Bank Benefit Indirectly?



Can the funds be used for:

- CSR programmes promoting the bank?
- Marketing or sponsorship?
- Staff welfare?
- Community projects bearing the bank's branding?



Should not create reputational or commercial benefit for the bank.

4 Should Customers Have a Choice?



If Gharamah originates from the customer's undertaking to donate,

- should the customer be allowed to nominate the charitable purpose? or
- Should the institution decide?

5 When Should the Disbursement Obligation End?



If Gharamah is collected for charitable purposes, when should the institution's responsibility end?

- Immediately upon collection?
- Upon transfer to a charitable organisation?
- Upon confirmation that the funds have reached the intended beneficiaries?
- Or only after verifying that the funds have been utilised for the approved Shariah-compliant purpose?



Key Principle

If the funds are **Gharamah**, they should be channelled to charity and managed **transparently**, without creating any direct or indirect benefit for the **bank**.

Clear governance, transparency and Shariah oversight are essential to ensure the proper utilisation of such funds.



The Gharamah Disbursement Duration Dilemma

Can Islamic Financial Institutions sit on *Gharamah* funds?

The Current Position



Customers pay Gharamah

Collected from customers due to delayed payment.



Held by the Islamic financial institution

Not recognised as the bank's income.



Intended for charity

Should be channelled to eligible charitable purposes.



The Dilemma



If **Gharamah** remains undistributed for an extended period:

- Is the bank merely safeguarding the funds?
- Or is it delaying the fulfilment of a charitable obligation?



Key Question

Should there be a prescribed timeline within which **Gharamah** funds must be distributed, or may institutions retain them indefinitely until a suitable charitable purpose is identified?



Governance Concerns



Delayed benefit to eligible beneficiaries.



Accumulation of idle charitable funds.



Weak accountability over timing of disbursement.



Risk of commingling with institutional funds.



Reduced public confidence in the management of charitable monies.



Key Takeaway

Gharamah funds should be managed **transparently** and disbursed within a **reasonable timeframe** to eligible charitable causes, in line with **Shariah principles** and public trust.

Other Emerging Governance Dilemmas – Ta’widh & Gharamah

Key questions to ensure fair, transparent and Shariah-compliant application



Key Takeaway

Robust governance, clear policies, transparency and independent oversight are essential to ensure that **Ta’widh** and **Gharamah** are applied and managed in a manner that is **practical, fair and fully Shariah-compliant**.

GOVERNANCE REFORM & FUTURE DIRECTION

The next frontier of Ta'widh and Gharamah is no longer permissibility—it is governance. Future reforms should focus on enhancing transparency, accountability, customer protection, and public trust through robust and harmonised governance frameworks.

The real challenge is not calculating Ta'widh – it is distinguishing genuine hardship from deliberate default.

Genuine Hardship (Mu'sir)



- ✓ Deserves compassion and support
- ✓ May qualify for restructuring, extension or relief
- ✓ Consistent with the objectives of Shariah
- ✓ Reflects true financial distress



That determination lies
at the heart of
Shariah governance
and the **Maqāṣid al-Sharī'ah**.

Deliberate Default (Mumatil)



- ✗ Requires accountability and appropriate action
- ✗ Does not merit hardship concessions
- ✗ May be subject to Ta'widh, legal action or enforcement
- ✗ Undermines fairness and financial discipline

Key Principles



JUSTICE
(ADL)



COMPASSION
(RAḤMAH)



ACCOUNTABILITY
(AMĀNAH)



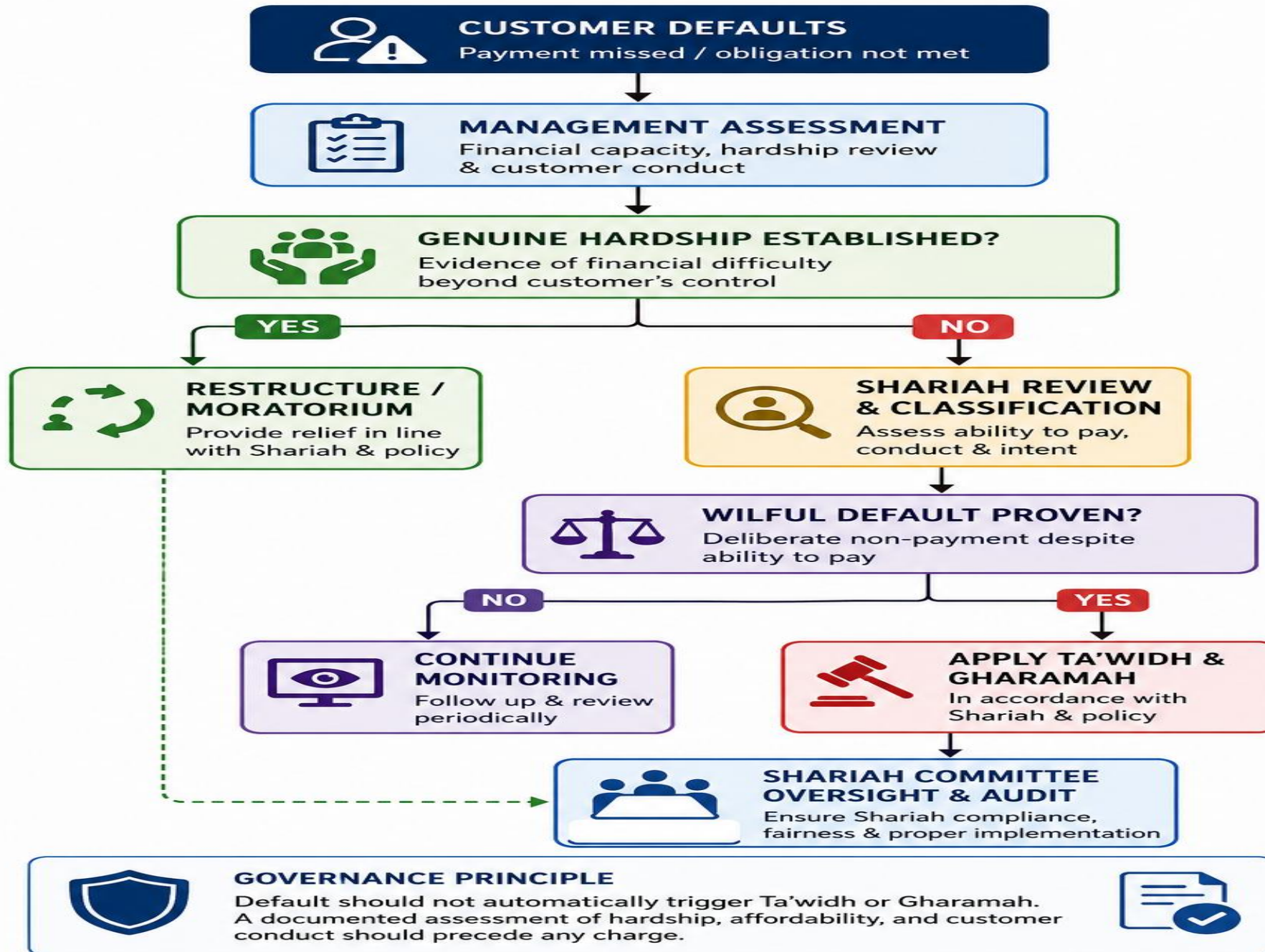
WISDOM
(ḤIKMAH)



UPHOLDING THE
MAQĀṢID AL-SHARĪ'AH

A Shariah-compliant approach to Ta'widh promotes fairness, protects the vulnerable, and maintains the integrity of Islamic finance.

GOVERNANCE FLOW: WHEN A CUSTOMER DEFAULTS



Rethinking “Actual Cost”

A Recoverable Direct Loss Framework (RDLF) for Ta'widh

A fair, objective and customer-specific approach to recovery, aligned with Shariah principles



Key Proposal

Rather than attempting to calculate “actual cost” for every customer, regulators should adopt the concept of a Recoverable Direct Loss (RDL).



Purpose

This is a proposal for discussion rather than an existing regulatory framework.



Objective

To provide a clear, consistent and practical approach to determining recoverable losses in line with Shariah and regulatory expectations.



Definition

Recoverable Direct Loss refers to a customer-specific, incremental, and objectively verifiable financial loss directly caused by a customer’s unjustified default, excluding ordinary operating expenses, business overheads, and opportunity costs.

A loss should qualify as Ta'widh only if it satisfies all three conditions.

1

Direct Causation

Was the loss directly caused by the customer’s default?

Examples:

- ✓ Court filing fee
- ✓ Bailiff fee
- ✓ External lawyer’s invoice

2

Incremental Loss

Would the bank have incurred this expense if the customer had paid on time?

If No

The cost should not be recoverable.

Examples:

- ✗ Recovery department salaries
- ✗ Collection system maintenance
- ✗ Office rent
- ✗ General legal department expenses

3

Objective Verification

Can the amount be independently verified?

Evidence may include:

- ✓ Court receipts
- ✓ Third-party invoices
- ✓ Enforcement charges
- ✓ External professional fees



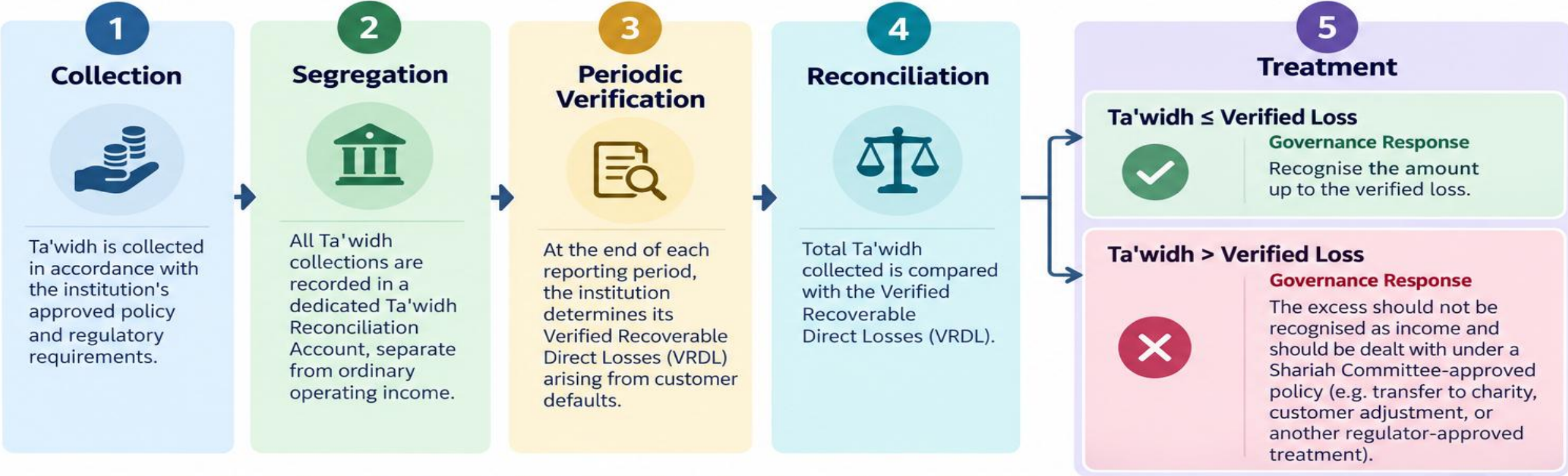
Towards a Fairer and More Sustainable Islamic Finance Industry

Objective | Transparent | Consistent | Shariah-Compliant

A Ta'widh Reconciliation Framework

Restoring the institution to the financial position it would have occupied, without creating a better position

Ta'widh should restore the institution to the financial position it would have occupied had the unjustified default not occurred — but should never place it in a better financial position.



Key Principles

Fair and Just

Transparent and Accountable

Regulatory Compliant

Shariah Aligned

A more resilient and trustworthy Islamic financial industry

For Gharamah: From a Penalty Framework to a Governance Framework

A fair, transparent and accountable approach for a sustainable Islamic finance industry

1

Standardise the Determination of Wilful Default



- Develop objective criteria to distinguish Mu'sir (genuine hardship) from Mumatil (wilful default) before imposing Gharamah.
- Future need: a harmonised hardship assessment framework across Islamic financial institutions.

2

Clarify the Legal Nature of Gharamah



- Regulators should determine whether Gharamah is:
 - a contractual penalty;
 - a regulatory sanction; or
 - a binding charitable undertaking (*Ittizām bi al-tabarru'*).
- This clarification determines whether the bank has authority to waive, amend, or enforce Gharamah.

3

Strengthen Governance of Charity Funds



- Move beyond merely requiring Gharamah to be channelled to charity.
- Introduce governance standards covering:
 - eligible beneficiaries;
 - approval authority;
 - segregation of funds;
 - distribution timelines;
 - transparency and disclosure; and
 - Shariah audit.

4

Introduce End-to-End Fiduciary Accountability



- The bank's responsibility should not end simply by transferring Gharamah to a charity.
- It should extend until there is reasonable assurance that the funds have been utilised for approved Shariah-compliant charitable purposes.
- Regulators should prescribe a maximum timeframe within which Gharamah funds must be disbursed.

5

Develop International Shariah Standards



- AAOIFI, IFSB and national regulators should work towards greater harmonisation on:
 - imposition criteria;
 - waiver policy;
 - governance of charity funds;
 - reporting requirements;
 - audit standards.

From Penalty to Governance

A holistic framework that ensures fairness to customers, accountability in the management of charitable funds, and full alignment with the *Maqāṣid al-Sharī'ah*.



Fairness
for Customers



Accountability
and Transparency



Regulatory Certainty
and Consistency

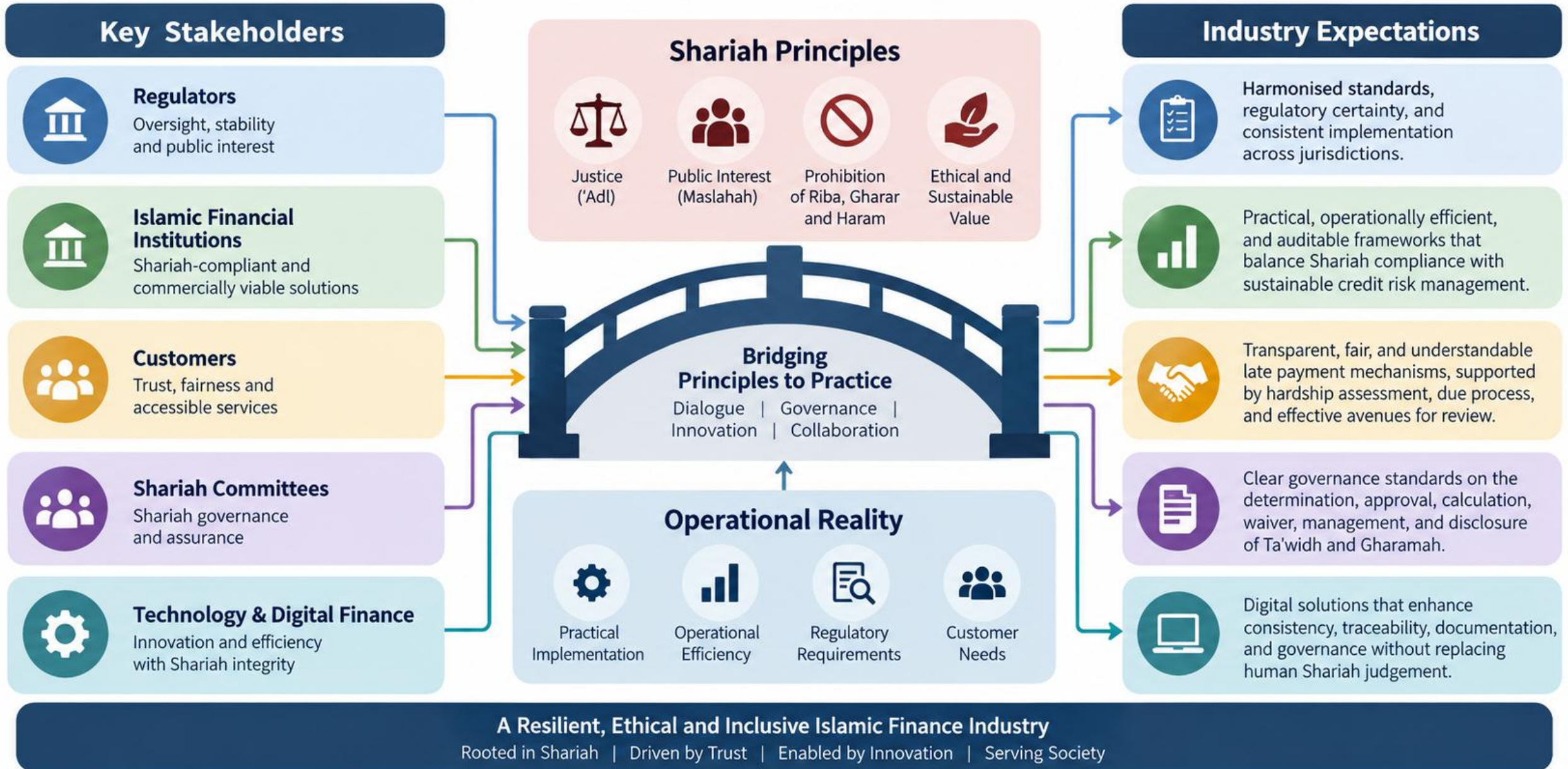


A Sustainable
Islamic Finance Industry

CONTEMPORARY INDUSTRY EXPECTATIONS

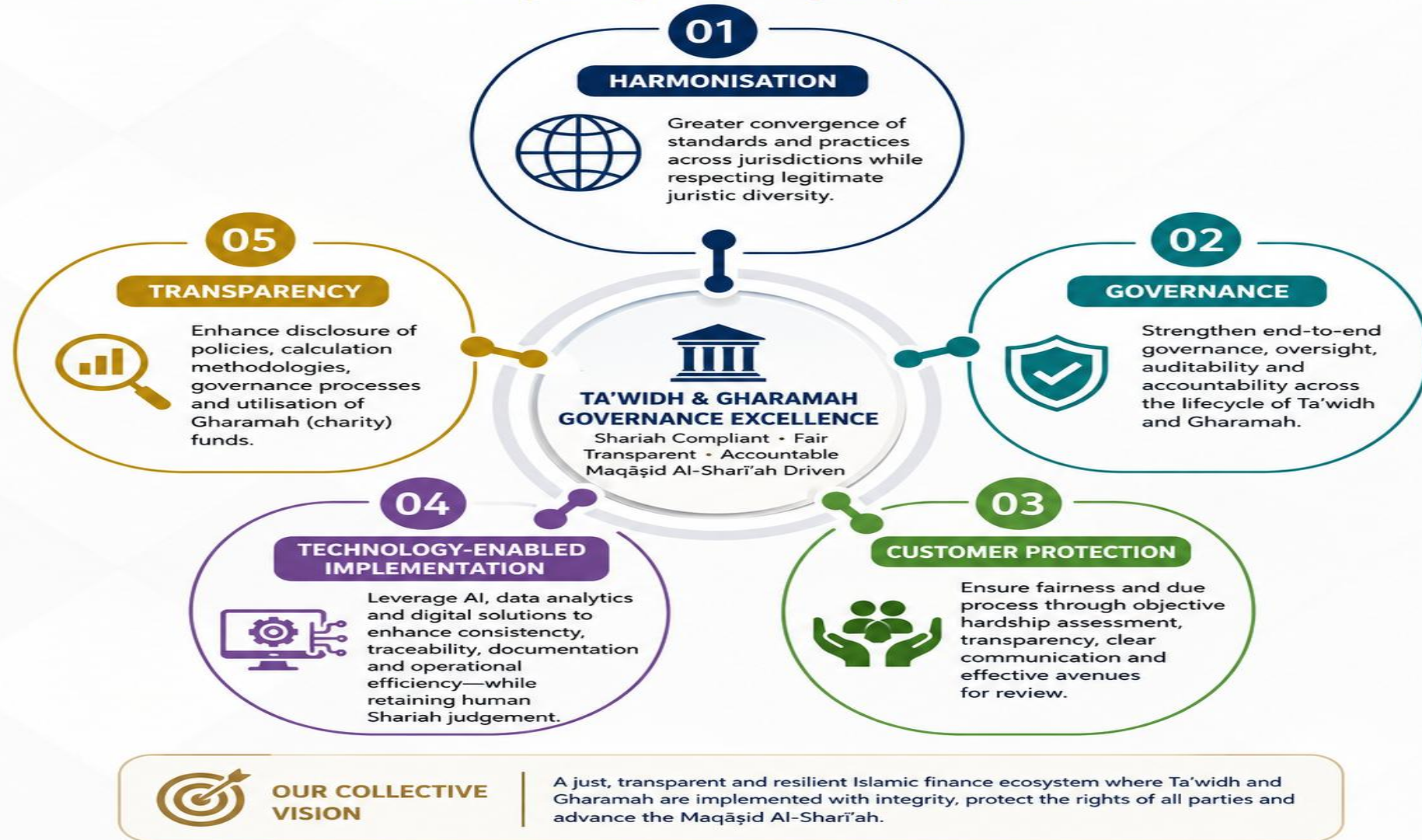
Bridging Shariah Principles with Operational Reality

Aligning values, stakeholders and solutions for a sustainable Islamic finance ecosystem



THE FIVE FUTURE PILLARS

Contemporary Industry Expectations



The future of Ta'widh and Gharamah will be defined not by new penalties, but by better governance—governance that protects rights, preserves justice, and advances the Maqāṣid al-Sharī'ah.



Thank You