

JUSTIFICATIONS OF AVOIDING RIBA (PART III): CARE FOR THE DEFAULTERS

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Features

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Have you ever defaulted on your loans? How does it feel like when you are a defaulter? For MABROOR MAHMOOD, he was fortunate not to have had this experience so far but many people had this pain in the recent past and he explores this further in this article.

In the US, the 2008 financial crisis was caused by the mass default of people on housing loans which they could not afford to repay. So they had to leave their houses for which they paid mortgage payments for years, and at the end, had to leave their possessions in favor of the banks just because they could not repay the outstanding loans.

The pain of default on loans becomes acute when the outstanding dues keep mounting over time. According to conventional banking wisdom, money has time value and as time passes, if the outstanding dues are not paid off, the value of money decreases and as a result, the banks have to be properly compensated by the borrower to mitigate the loss. This additional compensation is called 'default interest' and it keeps increasing as the borrower delays the repayment.

For example, Jason buys a house with a 20% down payment and the remaining amount is in the form of a mortgage loan from a bank. The loan carries a 6% interest rate and it has to be repaid in quarterly installments in 20 years. During the inception of the loan, Jason had a good job with a good salary that gave him enough confidence that he would be able to repay the loan on time.

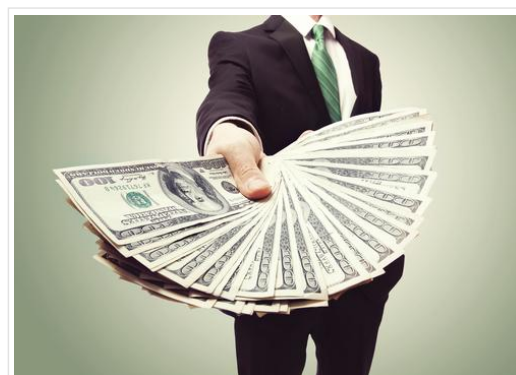
But a crisis starts when there is a downturn in the economy. People start losing jobs right and left, and inevitably, the company that Jason works for announces a mass lay-off, with Jason among the unfortunate.

Now with no job and no additional income, Jason and his family of two children and wife fall into deep debt. They not only have the housing loan but they also have the car loan and a huge amount of credit card debt falling due every month. Jason could never predict that he would fall into debt trouble and lose his job so soon. So he did not keep a cash buffer or emergency funds in his account.

Now that Jason has lost his job, his repayment dates for all loans are falling due next week. He has to pay the housing loan installment, the car loan payment and also the credit card installment. He knows very well that if he delays payment, the outstanding dues will accumulate further with default interest and as time passes, this default interest will keep mounting.

So even if Jason can get a suitable job within the next six months, he will have to bear all these additional default interest to the bank that will cost him a lot. If he keeps delaying repayment, at one point, he will lose his house, his car and also the credit score that will make his life miserable in the future.

Jason's predicament is a classic case of the aftermath of a borrower in a conventional banking system where money is exchanged with a higher amount of money and money is considered to have a time value. This concept is absent in Islam.



Islam treats money with money transactions as illegal and does not allow putting a borrower under pressure when he is in deep trouble.

There are eight verses in the Holy **Quran** where God Almighty mentions the term **Riba**. These are found in Sura Baqara (verses 275, 276, 278-280), Al-Imran (130), An-Nisa (161) and Sura Ar-Rum (39). In two of these eight verses, God Almighty gives specific commands to the lenders. Verse 3:130 says: "O you who have believed, do not consume usury, doubled and multiplied, but fear God that you may be successful." Here God commands the lenders not to charge a high amount of interest that will distress the borrowers. The solution to the lender is provided in verse 2:280 where God encourages the lenders, saying: "And if someone is in hardship, then [let there be] postponement until [a time of] ease. But if you give [from your right as] charity, then it is better for you, if you only knew."

This is the reason why increasing the amount of debt in case of a default is not permissible in Islamic banking. If a beneficiary defaults, the outstanding amount remains the same no matter how much the delay in repayment is. If the financier charges any additional amount, it will be considered **Riba** and thus unlawful.

However, the present Islamic banking model is still not able to follow the instructions under verse 2:280 since according to contemporary banking wisdom, if the lender forgives the outstanding amount as charity, it will cause moral hazard problems as borrowers will tend to default deliberately en masse.

Now the question is, did God make any mistake or we are not able to comprehend the wisdom of God?

(To be continued)

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