Current Advanced Research on Sharia Finance and Economic Worldwide
https://ojs.transpublika.com/index.php/CASHFLOW
Online ISSN 2809-8226 | Print ISSN 2809-848X

https://doi.org/10.55047/cashflow.v5i3.2360

Original Article

Default Amount Determination in Islamic and Conventional Banking: Evidence from Banking Disputes

Witrofoledy Saladin[1], Marhanum Che Mohd Salleh[2*], Ahmad Khaliq[3]

[1]Department of Business Administration, Kulliyyah of Economics & Management Sciences, International Islamic University Malaysia, Kuala Lumpur, Malaysia
[2,3]Department of Finance, Kulliyyah of Economics & Management Sciences, International Islamic University Malaysia, Kuala Lumpur, Malaysia
Email: [1] witra62@gmail.com.my, [2] marhanum@iium.edu.my, [3] ahmadkhaliq@iium.edu.my

Received : 23 July- 2026
Accepted : 01 September - 2026
Published online : 02 September - 2026

Abstract

The determination of claim amounts in financing default remains a critical issue, particularly in Islamic banking, where default claim calculations must comply with both legal and Shariah requirements. Despite the growing development of Islamic finance, limited studies have examined whether the methods used to determine claim amounts differ from those applied in conventional banking. This study aims to comparatively analyze the calculation of claim amounts in Islamic and conventional banking disputes. Using a qualitative approach, this study adopts document review and case analysis methods involving eleven Islamic financing cases and ten conventional banking cases adjudicated by Malaysian courts. The analysis focuses on the approaches adopted by financial institutions and the courts in determining the amounts claimed in financing recovery disputes. The findings reveal that the amounts claimed by Islamic banks in default cases are significantly higher compared to conventional banks. The difference is attributed to variations in contractual structures, financing mechanisms, and methodologies applied in calculating outstanding obligations. The study highlights the need for greater transparency and consistency in claim calculation practices, particularly within Islamic banking to ensure alignment with Shariah principles and legal expectations. This research contributes to the understanding of Islamic banking default case resolution by providing comparative insights into claim determination practices and offers implications for Islamic financial institutions, regulators, legal practitioners, and policymakers.

Keywords: Conventional Bank, Default Cost, Islamic Bank, Islamic Financing, Malaysia.

1. Introduction

The longest verse in the Quran, verse 282 of Surah Al-Baqarah, is not on salah, fasting or hajj, but about debt. The verse outlines the seriousness of debt in Islam, detailing how a debt transaction is to be conducted, such as documenting the transaction, having witnesses to the contract and ensuring all parties clearly understand the content of the contract. It stressed the principle of justice, accountability and transparency in financial dealings.

From the Shariah point of view, loans should only be taken when it is necessary and with the intention of repaying the debt as soon the debtor has the capacity to do so, as mentioned in the hadiths of the prophet narrated by Abu Hurairah

> *"Whoever takes the money of the people with the intention of repaying it, Allah will repay it on his behalf, and whoever takes it in order to spoil it, then Allah will spoil him,"* (Sahih al-Bukhari: 2387).

In the event of default, the Quran suggested that the lender be lenient to the debtor in accordance with Surah Al-Baqarah verse 280, which said,

> *"And if the debtor is in hardship, then allow him time until ease. But if you forgive it as charity, it is better for you…"* (Quran 2:280).

This is where the practice of banks providing Islamic financing facilities appears not to be in line with the Shariah, as the cost of default for Islamic financing is significantly higher than that of a conventional loan.

Since Islamic banking was first introduced in 1983, it has been emulating the products and services of conventional banking in order to provide alternative banking to Muslims that is in line with the Shariah. Thus, the introduction of variable rate products, imposition of penalty on late payment and incorporation of an undertaking to provide rebate in their legal documents. However, the improvements were only made in the area where Islamic bankers were of the view that the practices were to their disadvantage. Imposition of penalty on late payment, for example, was considered as *riba'* and thus non-shariah compliance before BNM's Shariah Advisory Council resolved its permissibility in 1998. However, in terms of the calculation of the cost of default, the existing method is argued by critics to be in favor of the Islamic banks; thus, there is no effort by Islamic banking practitioners to improve it. The current method of calculating the cost of default for Islamic financing is seen to be more oppressive than its conventional counterpart by customers, Islamic consumer associations and even judges. The introduction of variable-rate financing in 2003 inflated the cost of default for Islamic financing further, as the selling prices were calculated using a significantly higher profit rate.

The main objective of this research is to understand the current method of calculating the cost of default for Islamic financing and to study whether the method used in determining the amount to be claimed by Islamic banking differs from that of conventional banks.

2. Literature Review

2.1. Debt in Islam

Islam provides guidelines on how to conduct a loan transaction and how the borrower and the creditors to conduct themselves. In Surah Al Baqarah, verse 282, the Quran said,

> *"O you who have believed, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice."*

And the hadith of the Prophet, which said:

> *"Allah's Messenger bought some foodstuff (barley) from a Jew on credit and mortgaged his iron armour to him,"* (Sahih al-Bukhari (2251) and Sahih Muslim (1603).

Although borrowing is permissible, Islam discourages it and advises Muslims to avoid it as much as possible, as evidenced by the hadith of the Prophet which was narrated from `Aishah (may Allah be pleased with her) that the Prophet (peace and blessings of Allah be upon him) used to say in his prayer:

> *"O Allah, I seek refuge with You from sin and debt."* Someone said to him, *"How often do you seek refuge from debt?" He said: "When a man gets into debt, he speaks and tells lies, and he makes a promise and breaks it."* (Al-Bukhari, 832 and Muslim, 589).

From Shariah perspective, debt is an obligation that needs to be fulfilled and taken seriously. Debt should only be taken when it is necessary and repaid generously, i.e. more than the amount owed, as soon as the borrower has the capacity to do so, as evidenced by a hadith narrated by Abu Huraira in which Allah's Messenger said,

> *"Procrastination (delay) in repaying debts by a wealthy person is injustice,"* (Sahih al-Bukhari: 2400)

and the hadith narrated by Jabir bin Abdullah which says:

> "*I went to the Prophet while he was in the Mosque. After the Prophet told me to pray two raka'at, he repaid me the debt he owed me and gave me an extra amount"* (Al-Bukhari: 2394).

The seriousness of paying debt is so severe to the extent that the Prophet refused to lead the funeral prayer of a man who died leaving unpaid debt (Al-Bukhari: 2295). Although the creditors have the right to demand the amount owed by the debtor, the Shariah encourages the creditors to postpone the payment of debt if the debtor is in financial difficulty until his difficulty has passed (Al-Quran, Al-Baqarah: 280).

2.2. Default in Islamic Banking

Default is the inability of the borrower to meet their payment obligation when the payment is due. Hassan et al. (2021) said that default happens when customers are unwilling or unable to pay their debt. It is a credit risk faced by banks regardless of whether it is conventional or Islamic banks.

In line with Bank Negara Malaysia's guidelines, accounts will be classified as impaired if the monthly instalments are unpaid for three months or more. The impaired financing position for Malaysia's banking system as of 31/7/2024 was RM34.56 billion, out of which RM13.54 billion, or 39.17%, is impaired financing for the Islamic banking system. Compared to the impaired financing position as of 31/7/2021, the impaired financing position for conventional banks has dropped by RM1.90 billion. However, the impaired financing position for Islamic banking has increased by RM2.94 billion (BNM, 2024).

From the Shariah point of view, debt is a contract and obligation that must be fulfilled. In a hadith narrated by Abu Huraira:

> *"Allah's Apostle said, 'Procrastination (delay) in repaying debts by a wealthy person is injustice.'"* (Sahih Al-Bukhari, Volume 3, Book 41, Number 585).

There are various reasons why customers default. The most common reasons are the unwillingness to pay their debt, diversion of funds, wilful negligence, and improper assessment by the bank when processing the applications (Hassan et al., 2021). As per A. Hasan et al. (2017), defaulters fall into three general classifications: solvent, insolvent, and habitual. Hassan et al. (2021) observed that default within Islamic banking is distinct from conventional banking default, as the underlying products differ fundamentally. In conventional systems, default arises from a creditor-debtor relationship, whereas Islamic banking relationships are contract-dependent, manifesting as debtor-creditor for sale contracts (BBA, Salam, *Inah*, *Istisna'*, *Tawarruq*), lessor-lessee for *Ijarah*, partnership for *Mudharabah* and *Musyarakah*, and agency for *Kafalah* and *Wakalah*.

Both customers and Islamic banks have duties and responsibilities in managing impaired financing accounts to avoid recovery action being initiated by the banks against the customers. Customers have the responsibility to inform the Islamic banks if they realize that they are having difficulties in meeting the payment obligation under the financing agreement, so that they may consider rescheduling or restructuring the account, while the Islamic bank will have to develop a strategy to recover their money in the event the customers fail to renegotiate the payment arrangement of defaulted accounts (Kamaruzaman & Hassan, 2023).

2.3. Previous Studies

Several studies have examined the legal and regulatory dimensions of Islamic banking disputes and rebate practices in Malaysia. Z. Hasan and Asutay (2011) analyzed how Malaysian courts have decided Islamic finance disputes, providing case-based insight into judicial treatment of Islamic financing contracts. Sherin (2017) examined the limitations of Bank Negara Malaysia's Guideline on *Ibra'* for Sale-Based Financing, noting that while the guideline clarifies whether a defaulting customer is entitled to a rebate and how it should be calculated, the guideline's scope remains limited in application, and prior case law had been inconsistent on this issue. Similarly, Mohamad and Trakic (2015) examined the application and development of *Ibra'* in Islamic banking in Malaysia, including whether the granting of a rebate by Islamic banks is a matter of discretion or an obligation. On the empirical side, Manaf et al. (2021) conducted an empirical analysis of the determinants of credit risk among Islamic and conventional banks in Malaysia, using factors such as return on assets, return on equity, and bank inefficiency.

Collectively, these studies establish that the treatment of default and rebate in Islamic banking has long been an unsettled area both judicially and regulatorily, and that credit risk differs between the two banking systems. However, none of these studies directly examines how the actual amount claimed by a bank at the point of default is calculated, or whether this calculation method differs between Islamic and conventional banks, which is the specific gap the present study addresses.

3. Methods

Research philosophy or research paradigm is a framework or worldview that is being used as guidance on how the research is to be conducted (Collis & Hussey, 2013). This research adopted constructivist paradigms based on the belief that there are multiple realities to be discovered from the findings of this research. The data collected will have to be critically analyzed to understand the current phenomenon and thereafter to explore another method of deriving the cost of default for Islamic banking so that it would reflect the actual amount owed by the customers at the point the facilities were terminated, and the amount claimed should not be seen as more oppressive than that of conventional banks.

A qualitative research design guided the collection and analysis of data in this investigation. Qualitative inquiry is understood as the examination of phenomena in their intrinsic nature, encompassing their quality, diverse expressions, contextual settings, and interpretative perspectives, while deliberately excluding considerations of range, frequency, or position within an objectively established causal sequence (Busetto et al., 2020). Secondary data is data that already exists and is collected by other parties (Daas et al., 2012). These data have been used by previous researchers in their research and may have been published. The secondary data for this research includes legislation, reported court cases on Islamic financing and conventional loans, Bank Negara guidelines, and Syariah Advisory Council Resolution.

The eleven Islamic financing cases and ten conventional banking cases analyzed in this study were extracted from Malaysia's Law Journal, comprising reported cases adjudicated by Malaysian courts. The Islamic financing cases span from 1994 to 2025, allowing the analysis to capture how the calculation of the default claim amount has been applied by the courts across different periods, including before and after the introduction of variable-rate financing in 2003 and the issuance of Bank Negara Malaysia's Guidelines on *Ibra'* (Rebate) for Sale-Based Financing in 2013.

The secondary data were analyzed using thematic and content analysis technique. Comparative and strategic analysis were used to understand and compare the existing recovery practices of the two banking systems to identify their similarities and differences, with the intention of developing an alternative method of calculating the default cost for Islamic financing products.

4. Results and Discussion

4.1. Recovery Process

Adopting the comparative analysis, the similarities and differences of the recovery process of the Islamic and conventional banking are summarized as per the table 1 and 2 below.

Table 1. Comparison of similarities in the recovery process between Islamic and conventional banking

Action	Islamic Financing	Conventional Loan
Classification of accounts as non-performing	Upon three months of non-payment of the instalment.	Upon three months of non-payment of the instalment.
Rehabilitation initiated	Upon accounts showing signs of deterioration.	Upon accounts showing signs of deterioration.
Legal action initiation	1. Customers are non-responsive to rehabilitation initiatives. 2. Customer ignores notices and reminders sent. 3. Customers failed to comply with the rehabilitation terms and conditions.	1. Customers are non-responsive to rehabilitation initiatives. 2. Customer ignores notices and reminders sent. 3. Customers failed to comply with the rehabilitation terms and conditions.

Source: Authors' own

Table 2. Comparison of differences in the recovery process between Islamic and conventional banking

Action	Islamic Financing	Conventional Loan
Amount claimed upon default	Outstanding balance	Balance of selling price
Components of the amount claimed	Outstanding principal plus accrued interest until the recovery process is initiated.	Outstanding principal plus accrued profit until the recovery process is initiated, plus future profit for the unexpired duration of the facility.
Early settlement amount	Balance of selling price less profit for the unexpired duration of the facility	Principal outstanding plus profit up to the date of settlement
Settlement after initiation of the recovery action but before the date of maturity	Balance of selling price, less profit for the unexpired duration of the facility, plus accrued profit until the date of settlement	Outstanding principal plus accrued profit until the date of full settlement
Judgment sum	Balance of selling price plus profit at the Interbank	Outstanding principal plus accrued profit until the date of

Action	Islamic Financing	Conventional Loan
	Islamic Money Market rate (IIMR)	judgment, plus penalty at the rate determined by the court

Note: BBA refers to Bay Bithaman Ajil, a sale-based Islamic financing contract; IIMR refers to the Interbank Islamic Money Market rate.

Source: Authors' own

The application of strategic analysis enabled the identification of merits and deficiencies in the existing default cost calculation method for Islamic banking, toward the objective of developing a novel derivation framework. Among the issues with the current method of calculating the cost of default are that the cost of default in Islamic banking is extremely high compared to conventional banks, that it does not reflect the actual amount owed by the customer at the point of default, that the method, although it complies with Bank Negara Malaysia's Shariah Advisory Council resolution, does not seem to be in line with the *Maqasid* of *Shariah*, and that Islamic banking may lose its competitive edge if the method of deriving the cost of default is made known to customers at the point of entering the contract.

4.2. Amount of Claim for Default Cases

Eleven Islamic financing cases and ten conventional banking cases were reviewed, and the findings are summarized in Table 3 for Islamic financing cases and Table 4 for conventional banking cases. The Islamic financing cases range from 1994 to 2025.

Table 3. Comparison of Islamic bank legal action cases and amounts claimed, extracted from Malaysia's Law Journal

No.	Case Name	Year	Contract	Purchase Price (RM)	Selling Price (RM)	Default After	Amount Claimed (RM)
1.	Bank Islam Malaysia Berhad v Adnan bin Omar	1994	BBA	265,000.00	583,000.00	8 years	583,000.00
2.	Affin Bank Berhad v Zulkifli Bin Abdullah	2003	BBA	394,172.00	992,363.00	1.5 years	958,998.00
3.	Bank Muamalat Malaysia Berhad v Kong Sun Enterprise Sdn Bhd	2006	Ijarah	22,000,000.00	38,540,747.00	Not available	36,200,000.00
4.	Malayan Banking Bhd v Marilyn Ho Siok Lin	2006	BBA	500,000.00	995,205.64	3 years	928,589.12
5.	Malayan Banking Berhad v Ya'kop Oje	2007	BBA	80,094.00	184,094.00	3 years	167,797.00
6.	Bank Islam Malaysia Bhd v Azhar bin Osman	2009	BBA	177,960.00	451,895.04	Not available	391,634.66
7.	Bank Islam Malaysia Berhad v Lim Kok Hoe and Koh Hsia Ping	2009	BBA	145,800.00	450,954.00	7 years	370,425.05

No.	Case Name	Year	Contract	Purchase Price (RM)	Selling Price (RM)	Default After	Amount Claimed (RM)
8.	Bank Muamalat Malaysia Berhad and others v Redha Resources Sdn Bhd and others	2015	Istisna' Inah	87,400,000.00 38,400,000.00	214,100,000.00 148,690,000.00	7 years	326,667,000.00
9.	AmBank Islamic Berhad v Seacera Group Berhad	2020	Tawarruq	1,260,000.00 5,000,000.00 4,820,300.00	1,877,523.00 6,800,000.00 4,889,252.00	3 years	1,877,526.00 6,141,410.00 4,889,842.00
10.	Bank Islam Malaysia Berhad v Lim Soo Kok	2020	Tawarruq	6,039,030.42	Not available	6 years	11,190,144.25
11.	MBSB Bank Bhd v Hiew Yee Sin & Anor	2025	Tawarruq	816,941.70	3,214,848.00	4 years	2,967,659.23

Note: BBA refers to Bay Bithaman Ajil, a sale-based Islamic financing contract.

Source: Authors' findings

Table 3 above shows that from as early as 1994, in Bank Islam Malaysia Berhad v Adnan Bin Omar, until 2025, in MBSB Bank Bhd v Hiew Yee Sin & Anor, in the event of default, banks have been claiming for the balance of the selling price for Islamic financing facilities, and the courts have granted judgment for the amount claimed.

On a few occasions, the court had declined an Islamic bank's application to demand the full selling price when initiating legal action against customers who had defaulted on their monthly payments. The most notable one was Affin Bank Berhad v Zulkifli bin Abdullah in 2005, presided over by Justice Abdul Wahab Patail. The judge awarded a sum of RM582,626.80 against Affin Bank's claim of RM958,997.20. Similarly, Justice David Wong, in deciding Malayan Banking Bhd's claim against Marilyn Ho Siok (2006), awarded a sum of RM598,689.10 against a claim of RM928,589.12 by Malayan Banking Berhad.

Table 4. Comparison of conventional bank legal action cases and amounts claimed, taken from Malaysia's Law Journal

No.	Case Name	Year	Contract	Loan Amount (RM)	Default After	Amount Claimed (RM)
1.	Citibank NA v Ibrahim Bin Othman	1990	Loan	224,000.00	2 years	239,659.00
2.	Perwira Affin Bank Berhad v Tan Tien Ser	1994	Loan	205,000.00	Not available	250,754.00
3.	Phileoallied Bank Berhad v Bhupinder Singh & Anor	1995	Loan	359,000.00	2 years	376,190.00
4.	RHB Bank Bhd v Zalifah Bte Juan & Anor	2006	Loan	90,000.00	3 years	90,477.00
5.	Alliance Bank Malaysia Berhad v Lim Vincent	2010	Loan	357,700.00	7 years	444,298.72

No.	Case Name	Year	Contract	Loan Amount (RM)	Default After	Amount Claimed (RM)
	[2010] MLJU 1385					
6.	CIMB Bank Berhad v Sivadevi Sivalingam	2019	Loan	185,320.00	15 years	549,245.60
7.	Bank Pertanian Malaysia Berhad v Abdul Razak Bin Ali	2020	Loan	600,000.00	13 years	795,189.89
8.	Malayan Banking Berhad v Rosiah Binti Ahmad	2021	Loan	1,000,000.00	8 years	383,290.08
9.	CIMB Bank Bhd v Yap Wee Leong	2021	Loan	2,040,000.00	1 year	2,023,571.41
10.	Standard Chartered Bank Malaysia Bhd v Joyce Hayati Tan	2024	Loan	2,205,000.00	6 years	2,131,558.15

Source: Authors' findings

Table 4 lists conventional banking cases from 1990 until 2024. The findings indicate that the amount claimed by conventional banks is not much higher than the original loan amount. This reflects that the longer the default continues, the bigger the amount claimed, due to interest accumulation over the period of default.

Comparing Table 3 and Table 4 shows that the amount claimed by Islamic banks is significantly higher than that of conventional banks. On a different note, Justice Hamid Sultan Abu Backer, in Malayan Banking Bhd (plaintiff) v Yakup Oje and Anor (defendants) (2007), directed the plaintiff to submit, among other things, an undertaking to grant a substantial rebate to the defendant before granting the amount claimed by the plaintiff. In that case, the plaintiff had granted a financing facility of RM80,094 to acquire a property under the Islamic concept of Bay Bithaman Ajil (BBA) to the defendants. In line with the plaintiff's procedure, both parties had executed the property purchase agreement and property sale agreement, which stipulated that, at the defendant's request, the plaintiff agreed to purchase the property at the financing amount of RM80,094.00 and immediately resell it back to the defendants at a selling price of RM184,094, payable over a period of 26 years. The defendants defaulted on the repayment after paying RM16,947.62, and the plaintiff initiated legal action claiming the balance of the selling price of RM167,797.10.

Justice Hamid Sultan Abu Backer JC stated in his judgment that, in the interest of a just resolution and to avoid dismissing the originating summons, he would permit the plaintiff to establish equitable conduct through an affidavit specifying a rebate to be given upon recovery of the sale proceeds, which rebate must be substantial, non-nominal, and consistent with prevailing banking market practices and the meaningful decisions in Affin Bank Bhd and Malayan Banking Bhd (supra). He further noted that satisfaction with the proposed rebate would result in an order in the plaintiff's favor subject to the affidavit's terms, whereas dissatisfaction could lead to denial of the order or an alternative ruling as the case demanded, guided by the thoughtful proposition in Century Land Resources Sdn Bhd.

On 18 July 2008, Justice Abdul Wahab Patail delivered a common judgment on twelve Islamic banking cases that sent shock waves to the Islamic banking industry. In his ruling, the judge divided the cases into two categories: those with a novation agreement and those without one. For cases without a novation agreement, the judge ruled that the agreement was a loan agreement, and since interest is prohibited in Islam, the plaintiff was only allowed to claim the principal amount, in line with section 66 of the Contract Act 1950.

The judge further divided the cases with a novation agreement into those whose tenor had expired and those whose tenor had not expired. For those whose tenor had expired, the plaintiff was allowed to claim the full selling price, while for those whose tenor had not expired, the plaintiff was allowed to claim principal outstanding plus profit calculated up until the facilities were terminated, similar to his ruling in Affin Bank Berhad v Zulkifli Abdullah.

The Court of Appeal, upon appeal by BIMB as the adversely affected party, overturned the High Court's decision on 26 August 2009 and granted BIMB's appeal. Islamic banks thus persist in claiming the remaining selling price when taking legal action against customers in payment default. Among the most vigorously disputed matters in Islamic banking jurisprudence is the quantum sought by Islamic banks upon default, a point evidenced by numerous judicial decisions, including Affin Bank v Zulkifli Abdullah, Malayan Banking Berhad v Yakop Oje, and Malayan Banking Berhad v Marilyn Ho Siok Lin. One issue that previous case law has inconsistently addressed is whether customers who default on their financing repayment are entitled to be given *Ibra'* when the facility is terminated (Sherin, 2017).

Despite significant criticism that the amounts claimed by Islamic banks are considerably higher than those of conventional banks and constitute an un-Islamic and burdensome practice, the recovery of the outstanding selling price by Islamic banks in default cases continues to fall within the boundaries approved by Bank Negara Malaysia and the resolutions of its Shariah Advisory Council, as codified in the 2013 Guidelines on *Ibra'* (Rebate) for Sale-Based Financing.

Table 3 above illustrates that Bank Negara Malaysia's 31 January 2013 Guidelines on *Ibra'* (Rebate) for Sale-Based Financing seem to have had negligible effect on how Islamic financing default costs are computed, given that banks continue to demand the balance of the selling price, as evidenced by Bank Muamalat Malaysia Berhad and others v Redha Resources Sdn Bhd and others (2015), AmBank Islamic Berhad v Seacera Group Berhad (2020), Bank Islam Malaysia Berhad v Lim Soo Kok (2020), and MBSB Bank Bhd v Hiew Yee Sin & Anor (2025).

Islamic banks, as the findings reveal, calculate the cost of default using a method distinct from that of conventional banks, yielding a consequential difference in claim amounts. Yet the magnitude of this discrepancy between Islamic and conventional default costs has drawn critical commentary from borrowers, consumer advocacy groups, and judicial officers alike. The conventional bank's method of calculating the cost of default is straightforward and easy to comprehend. Conventional banks claim only the amount due to them, which consists of outstanding principal and accrued interest. Accrued interest is defined as interest already earned on the account but not yet received. The default cost for Islamic banks is represented by the balance of the selling price, which includes the principal outstanding, accrued profit, and future profit attributable to the unexpired financing period. This formulation means that a longer remaining facility term produces a correspondingly larger differential between Islamic and conventional default costs.

Technically, the future profit is not yet due, and the whole profit for the sale transaction is only due at the end of the financing period. Thus, if Islamic financial institutions insist on claiming the balance of the selling price, they should do so only at the end of the financing period. Even then, under this approach, the quantum demanded would be reduced relative to existing practice, since Islamic banks would need to apply *Ibra'* each month to the spread between the cap rate and the effective rate. The divergence in default costs across Islamic and conventional banking is presented in Table 5.

Table 5. Comparison of the cost of default between Islamic and conventional banks

	Islamic (RM)	Conventional (RM)
Selling price	2,379,728.40	Not applicable
Monthly instalment	2,835.28	2,835.28
Number of instalments paid	116	116
Total instalment paid (2,835.28 x 116)	328,892.48	328,892.48
Date of first default	01/12/2023	01/12/2023
Date recovery action initiated	31/03/2024	31/03/2024
Amount claimed (Selling Price - Total Payment)	2,050,835.92	551,616.75

Source: Authors' findings

Based on the results, a number of limitations should be acknowledged. The comparative analysis is based on a small, non-random sample of twenty-one reported cases (eleven Islamic financing cases and ten conventional loan cases) extracted from Malaysia's Law Journal. As the sample is limited to reported, published court decisions, it does not capture unpublished settlements or cases resolved outside formal litigation, which may not follow the same pattern in the amounts claimed. These limitations should be taken into account in interpreting the generalizability of the findings.

5. Conclusion

This study set out to understand the current method of calculating the cost of default for Islamic financing and to examine whether this method differs from that applied by conventional banks. The findings confirm that it does: Islamic banks' default claims are consistently and substantially higher than those of conventional banks across the cases reviewed. The current method of calculating the amount to be claimed in the event of default has been criticized as un-Islamic and more burdensome to customers than the practices of *riba'*-laden conventional banks. Some customers are unable to make full settlements once they default, and legal action proceeds until they are made bankrupt. One suggestion for improving the method of calculating the cost of default is to prorate the profit at the point the contract is terminated and legal action is initiated against the customer. This would result in the amount claimed being almost similar to that of conventional banks.

In the event of default, the amount claimed by Islamic banks is significantly higher than the amount claimed by conventional banks. This confirms the difference in claim calculation methods anticipated at the outset of this study. The difference in the amount claimed is mainly due to the different factors considered by the two banking systems, such as the nature of transactions, the relationship between the banks and customers, and the legal documents used by the banks.

Previous research indicated that the relationship between Islamic banks and their customers varies depending on the contract used. The relationship could be that of creditor and debtor if a sale-based contract is used, that of lessor and lessee if the contract is *Ijarah*, and that of partners if the contract is based on *Musyarakah* or *Mudharabah*. However, Islamic bankers stress that, in total, the actual amount customers have to pay under Islamic financing is similar to conventional financing if customers diligently pay the monthly instalment until the facility is fully settled, or if customers settle the financing before the expiry date of the facility, as Islamic banks will give *ibra'*, or rebate, equivalent to the profit of the unexpired tenor even after legal action and judgment have been obtained.

Significantly, the approach to computing default claims adopted by Islamic banks remains compliant with Bank Negara Malaysia's guidelines and the resolutions of its Shariah Advisory Council. The guidelines permit banks to pursue the entire selling price balance despite early settlement, and the decision to award *ibra'* is vested solely in the Islamic financial institution's discretion. This indicates that the disparity identified in this study is not a matter of non-compliance, but a limitation embedded in the regulatory framework itself, a distinction with direct implications for policymakers.

The contribution of this research can be presented in three dimensions. Firstly, at the theoretical level, an understanding is thereby advanced regarding the existing approach to default cost calculation in both Islamic and conventional banking, and the considerable disparity in sums demanded by the respective systems in default scenarios. Secondly, at the level of practice and policy, the research contributes to the body of knowledge of Islamic banking, as research in the area of calculating the cost of default in Islamic banking is still lacking; most research in Islamic banking covers the areas of risk management, sustainability performance, and Islamic banking products. The findings offer Islamic financial institutions and regulators a basis for reconsidering the current claim calculation method, such as the proration approach suggested above, so that the amount claimed better reflects the actual amount owed at the point of default.

Given that this study is based on a qualitative review of a small, non-random sample of reported cases, future research could quantitatively test the proposed proration method against the current practice to assess its financial impact on both banks and customers, and could extend the sample beyond reported, published cases to capture a broader range of default outcomes.

6. References

Busetto, L., Wick, W., & Gumbinger, C. (2020). How to use and assess qualitative research methods. *Neurological Research and Practice*, *2*(1), 14. https://doi.org/10.1186/s42466-020-00059-z

Collis, J., & Hussey, R. (2013). *Business Research: A Practical Guide for Undergraduate and Postgraduate Students*. Bloomsbury Academic.

Daas, P. J. H., Arends-Tóth, J., Schouten, B., & Kuivenhoven, L. (2012). Proposal for a Quality Framework for the Evaluation of Administrative and Survey Data. *ES-SNET (European Statistical System Network) Vienna*. https://www.slideshare.net/slideshow/es-snet-viennapresentation/14571504

Hasan, A., Haron, M. N., Mohamed, M. F., & Mana, B. (2017). Classification of defaulters in the payment of debt in Islamic banking practices. *Al-Shajarah*, *2017*(Special Issue), 85–103. https://doi.org/10.31436/shajarah.v0i0.610

Hasan, Z., & Asutay, M. (2011). An Analysis of the Courts' Decisions on Islamic Finance Disputes. *ISRA International Journal of Islamic Finance*, *3*(2), 41–71. https://doi.org/10.55188/ijif.v3i2.131

Hassan, M. K., Muneeza, A., & Mustapha, Z. (2021). Mechanisms to Handle Default Cases in Islamic Banking: The Malaysian Approach. *International Journal of New Political Economy*, *2*(1), 97–115. https://doi.org/10.29252/jep.2.1.97

Kamaruzaman, N. H., & Hassan, R. (2023). Responsibilities of Customers and Islamic Banks to Manage and Recover Non-Performing Financing. *International Journal of Islamic Economics and Finance Research*, *1*(Special Issue), 91–102. https://doi.org/10.53840/ijiefer117

Manaf, S. M. A., Yusri, Y. M., & Ismail, F. (2021). Analysis of Credit Risk on Islamic and Commercial Banks in Malaysia. In *Journal of Academia* (Vol. 9, Issue 2, pp. 93–101). https://journal.uitm.edu.my/index.php/JOA/article/view/5258

Mohamad, T. A. H., & Trakic, A. (2015). The reception of English law in Malaysia and development of the Malaysian common law. *Common Law World Review*, *44*(2), 123–144. https://doi.org/10.1177/1473779515584731

Sherin, K. (2017). Limitations To Bank Negara's Ibra Guideline. *Global Journal Al Thaqafah*, *7*(1), 39–47. https://doi.org/10.7187/gjat12520170701