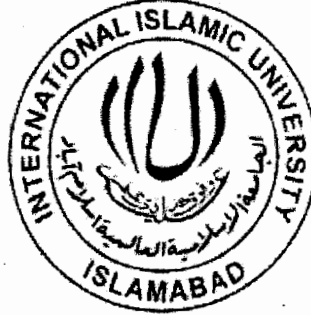


**HOUSE FINANCING IN
PAKISTAN & UNITED KINGDOM:
AN ANALYTICAL STUDY IN
SHARIAH PERSPECTIVE**

T7006



A dissertation Submitted in partial fulfillment
of the requirements for the degree of
LL.M (Islamic Commercial Law)
(Faculty of Shariah and Law)
in the International Islamic University, Islamabad
1431 A.H./2010 A.D.

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**INTERNATIONAL ISLAMIC UNIVERSITY,
ISLAMABAD
2010**



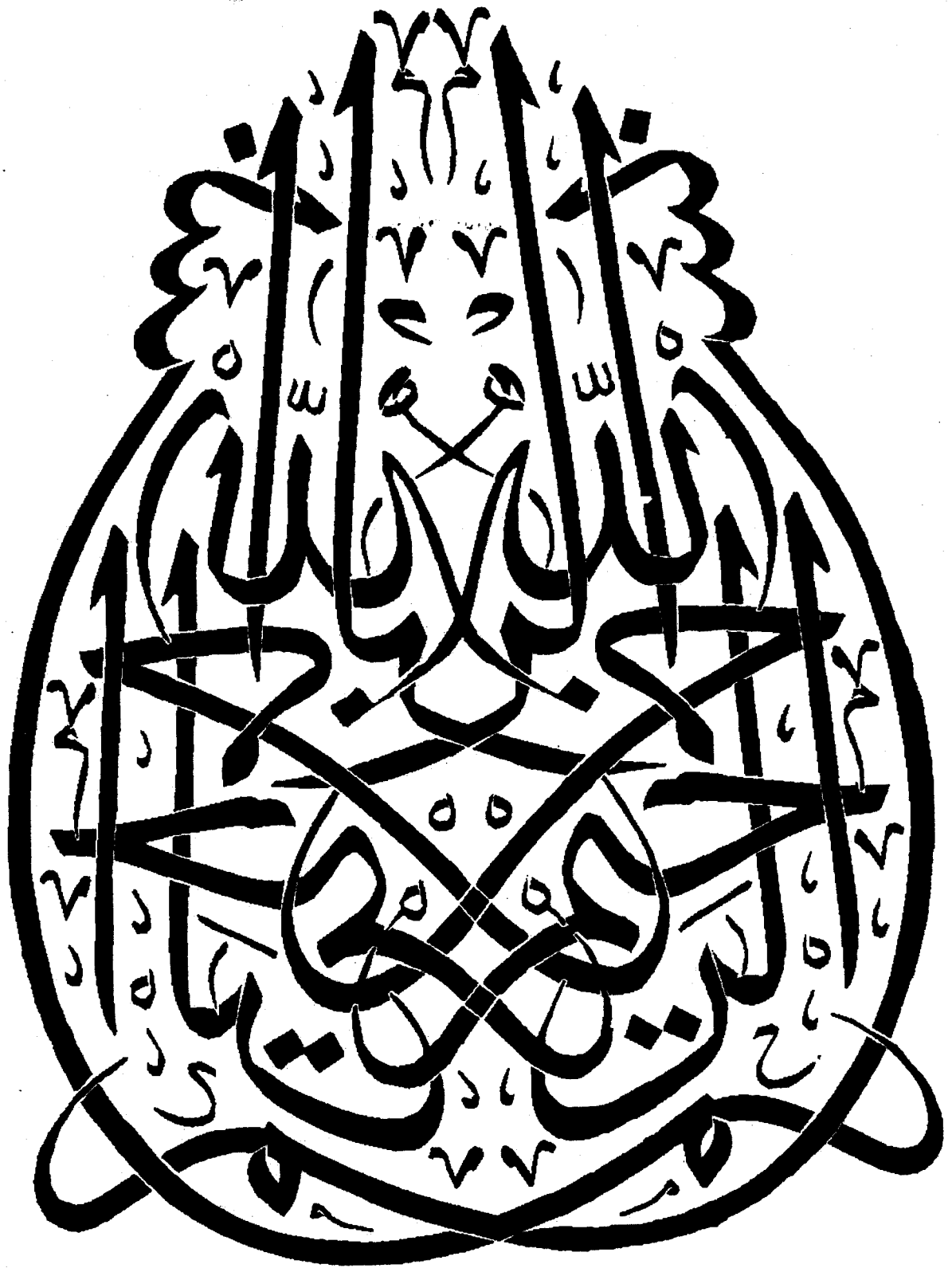
Accession No TH 7006

MS

346-07

SHH

- 1- Housing - Pakistan - Finance .
- 2- Finance - Religious aspects - Islam .
- 3- Commercial law (Islamic law)



CERTIFICATE

The thesis entitled "**House financing in Pakistan & United Kingdom: An analytical study in Shariah Perspective**" submitted by **Shazia Kiyani** in partial fulfillment of LLM degree with specialization in **Islamic Commercial Law** has been completed under my guidance and supervision. I am satisfied with the quality of student's research work and allow her to submit this thesis for further process as per IIU rules and regulations.

Professor Dr.
Muhammad Tahir Mansoori

March, 2010

DECLARATION

INTERNATIONAL ISLAMIC UNIVERSITY, ISLAMABAD STATEMENT OF UNDERSTANDING

I, Shazia Kiyani bearing the university registration number 29-FSL/LLMICL/F07, declare in the name of Allah that my thesis entitled:

“House financing in Pakistan & United Kingdom:

An analytical study in Shariah Perspective”

Submitted to the Department of Shariah, Faculty of Shariah and Law, is a genuine work of mine originally conceived and written down by me under the supervision of Professor. Dr. Muhammad Tahir Mansoori, by Allah’s will and approbation.

I do, hereby, understand the consequences that may follow, if the above declaration be found contradicted and/or violated, both in this world and in the hereafter.

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(Acceptance by Viva Voce Committee)

Title of the thesis:

**“House financing in Pakistan & United Kingdom:
An analytical study in Shariah Perspective”**

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Dated: 30th August 2010

DEDICATION

Dedicated to:

My Parents

ACKNOWLEDGEMENTS

Indeed it is the blessing of the merciful and compassionate Allah Almighty that I have accomplished this task. I would like to acknowledge my debt of gratitude to my supervisor Professor Dr. Muhammad Tahir Mansoori who spared of his precious time to guide me throughout the project.

I am also indebted to my teachers Professor Dr. Muhammad Zia'ul Haq, Professor Dr. Tahir Hakim and Professor Dr. Abdullah Rizk for their invaluable support, guidance and encouraging behavior which made this project possible to be accomplished within specified time period.

I would like to thank my family: my parents for giving me life in the first place, for educating me and for their unconditional support and encouragement throughout to pursue my interests. I am grateful to my brother also who took extra pains in typing and composing the manuscript for me and provided me with the latest information regarding books and articles on my topic.

I also offer my warm regards to all of those who supported me in any respect during the completion of this work. May Allah reward them all in this world and the hereafter.

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INTRODUCTION

i) SIGNIFICANCE AND IMPORTANCE OF THE SUBJECT:

All praise is to Almighty Allah, the undisputed lord and the creator of this magnificent universe and all that exists in it. May His peace and blessings shower on his chosen and final messenger, the best of His creation Muhammad (peace be upon him), his family, companions and all those who follow the path of guidance to the end of the time.

In the present world everyone is in the need of the finance because of taxes, inflation, rising property prices and currency depreciation, it has become difficult for the Muslims to fulfill their dreams without being indulged in interest based modes. Like owning a home or car or business is not possible for a person with ordinary income because of the scarcity of finance and for this purpose most of the persons go to the conventional banks which indulge them in conventional mortgage in which interest exists which is strongly prohibited in Shariah.

Islamic banks are growing on with rapid speed and offering alternatives to the Muslims to keep them away from interest based products specially conventional mortgages. Islamic banks are offering variety of house financing products for the attraction of customers. Diminishing Musharakah is one of the best alternatives of conventional mortgage and one of the most desired form of Shariah.

This study would therefore significantly contribute for investigating strengths and weaknesses of prevalent modes of house financing provided by Islamic banks. It would

also provide some guidelines for formulating recommendations for development of Islamic financial institutions.

This study would also be helpful for the students of the Islamic banking. It would also throw light on the contemporary practices of house financing which would be of great benefit for the customers and for those who want to make an analytical overview of the conventional and the Islamic modes of house financing.

This study would also contribute in the development of Islamic modes of house financing.

This study would also lead towards paving the path for further research in the field of modes of house financing.

ii) RESEARCH METHADODOLOGY:

This is an analytical oriented research work in which methods of descriptive research have been used. In the first chapter I have explained that mainly there are two important modes of house financing in Pakistan. These are governmental institutions like House Building Finance Corporation (HBFC), and non governmental institutions such as Banks (including Conventional and Islamic Banks).

I have described the procedure and documentation of three institutions of Pakistan i-e HBFC, Meezan bank and United Bank Limited. HBFC and Meezan bank provide housing finance on Diminishing Musharakah basis ,whereas UBL , being a conventional bank provides interest based financing.

In the second chapter the concept of Diminishing Musharakah and Ijarah are discussed in the light of Shariah. In this chapter some of the Shariah issues involved in Diminishing Musharakah of Islamic Banks are also discussed and analyzed, to see whether the current interest-free banking is shariah compliant or otherwise.

The third and last chapter is about house financing procedure in United Kingdom. Islamic Bank of Britain's procedure and documentation of Diminishing Musharakah in IBB also discussed here.

iii) LITERATURE REVIEW:

Although there are a lot of excellent classical books available for the study of Musharakah, but as far as the interest based house financing is concerned there are only a few books available in this regard. I have also got few books in Urdu language which posses a pretty good analytical material. Some journals have also been of great help to me. Some of the important writings in this connection are introduced here:

1. "Al Sharhul Kabir" by Shams-Uddin Ibi Al-Farj Abdul Rehman Bin Muhammad Bin Ahmad Ibn-Qadamah Al Muqadasi. This book is based upon the Maliki school of thought. It defines and describes the issues relating to Musharakah.
2. "Al Tijarah Wa Al iqtisad Al Muasir Fi Du Al Islam" by Muhammad Taqi Usmani. The analysis of the contemporary Islamic financial instruments in the light of shariah is made in this book. The conditions which can make a contract of Musharakah and Ijarah in conformity with shariah are described in this book.

3. "Al-fiqh-ul-islami wa adila to ho" by Wahbah Zuhili This book illustrates some important features of Musharakah. All types, ingredients and legal consequences of Musharakah are discussed in this book in detail. This book also combines the opinions of the scholars from prominent schools of thought.
4. "An introduction to Islamic finance" by Mufti Taqi Usmani. In this book Mufti Taqi Usmani has described that how contract of Diminishing Musharakah is practiced by Islamic banks.
5. "Badai-Ul-Sanai Fi Tarteeb-Ul-Sharai" by Al-Imam Ala-ud-Din Abi Bakar Masood-Al-Kasani. This book is based upon the Hanafi school of thought. It defines and describes the issues relating to Musharakah.
6. "Encyclopedia of Islamic Banking and insurance". This encyclopedia contains the history and current practices of Islamic banking. Related terms and terminologies are also discussed in this encyclopedia.
7. "Islami Bankari ka aik Taaruf" by Muhammad Imran Ashraf Usmani. This book does not cover only the definition and ingredients of the Islamic banking but it also gives the introduction of the Islamic financial products. Some objectionable issues related to Islamic banking are discussed in detail in this book.
8. "Islamic Law of Business Organization (partnerships)" by Imran Ahsan Khan Nyazee. This book provides the details of the Islamic law on partnership. The nature, form and legal status of partnership in Islam is discussed in this book.
9. "Islamic Law of Business Organizations" by Imran Ahsan Khan Nyazee, in his book the writer has discussed various types of partnerships in detail.

10. "Islamic law of contracts and business transactions" by Dr. Muhammad Tahir Mansoori. This book contains not only all important types of contracts but also deals with other related things, like conditions and combination of contracts.
11. "Muajam Al- Fiqh-ul Hanbli Mustakhlis Min Kitab-Al Mughni Li Ibn-e-Qadamah" by Abdul Satar, Alashkar, Muhammad, Sulaiman Abu Ghadah. This book is based upon the Hanbli school of thought. It defines and describes the issues relating to Musharakah.
12. "Murawwaja Islami Bankary" by Muhammad Yousaf. This book describes the ingredients of the Islamic banking and analysis of issues related to Islamic banking.
13. "Nihayatyl-Muhtaj-Ila-Shar-Al-Minhaj" by Shams-Uddin Muhammad Bin Abbi Abbas. This book is based upon the Shafi school of thought. It defines and describes the issues relating to Musharakah.
14. Ghair Soudi Bankari by Mufti Taqi Usmani. This book answers many objection on Islamic banking and Diminishing Musharakah.
15. Islami Bankari by Ijaz Ahmed Samdani. This book also elaborates how Islamic banks can cope up with different challenges faced to them.
16. Islamic banking modes for house building financing, Islamic development bank. (Jedah: Islamic Research and Training Institute). This book illustrate some other modes of house financing also besides Diminishing Musharakah.
17. "Shariah Standards. Accounting and Auditing Organization for Islamic Financial Institutions", AAOIFI. Shariah standards cover many Islamic financial

instruments including Musharakah and Ijarah. Principles governing Musharakah and Ijarah are discussed in detail in this standard. Diminishing Musharakah is also discussed in this standard.

18. The Article “Measures Taken in the Constitutional Arena to Introduce Islamic Provisions” by Mehboob Ul-Hassan in Journal of Islamic Banking & Finance, evaluates the process of islamization of economy in Pakistan from the constitutional provisions to the practical steps taken for the islamization of economy are discussed in this book.
19. The Article “The Constitutional, Legal and current status of Islamic Banking & Finance in Pakistan” by Shahad Iqbal Sham in Journal “The Islamic Culture” discusses the Islamic banking in Constitutional, Legal and Contemporary practical spheres.
20. The Article “Islamic Investment Products Available in the United Kingdom.” by Rodney Wilson in Journal of Islamic Banking & Finance, throws light on the prevalent Islamic banking system in the United Kingdom. Some latest facts and figures are also given in this regard.
21. The Article “Housing under-served by bank credit.” In Dawn Economic and Business Review, 21-27 December, 2009, shows the status of house financing institutions like HBFC and Islamic banks in Pakistan. The efforts made by these institutions and the outcome is also discussed in this article.
22. The Article “Islamic Banking in Pakistan from Account Holders Perspective.” by Mehbood Hassan in Journal of Islamic Banking & Finance is a Case Study on Meezan Islamic Bank which contains some issues related to the account holder.

iv) STATEMENT OF THE RESEARCH PROBLEM/THESI STATEMENT:

- What is house financing?
- What are the modes of house financing in Pakistan?
- What are the modes of house financing adopted by Islamic Banks in Pakistan?
- What are the modes and procedures of house financing in United Kingdom?
- What are the views of classical Muslim Jurist about house financing?
- To what extent the modes and procedures of house financing in Pakistan are compatible or incompatible with the views of Muslim Jurist?

v) Objectives of Research:

This research is aimed to:

- 1) Examine the modes and procedures of house financing in Pakistan and United Kingdom. All related financial institutions in Pakistan and United Kingdom regarding house financing will also be discussed, along with the Shariah rulings on the topic.
- 2) Analyze the modes and procedures of house financing in Pakistan and United Kingdom and to make a comparison between the arguments of Muslim Jurist about house financing and contemporary procedures in both countries.

In the end all possible modifications and proposals are recommended in order to bring the procedures and modes of house financing in conformity with the Shariah rulings.

Chapter 1: House Financing In Pakistan:

Section 1.1 House Financing definition and modes:

House Financing means to provide monetary resources, by a government or any other corporate body, to the person in need, in order to build a house or a shelter to live within.¹

To seek protection is one of the basic rights of human beings. No one can lead a life peacefully unless he is protected. Home or a house is a necessary element towards attainment of a smooth life.

Man started his life on earth in a very simple way by taking shelter in caves, than with the passage of time the living standard of man changed. Today man can not earn and spend his earnings to improve his life style unless he owns a house. A house not only provides privacy but it is also a source to enhance life style.

The significance of housing finance in a modern society is a fact that can hardly encounter dispute. The importance of shelter as a basic human need, the rapid growth of urban centres and the continuously increasing cost of housing are often cited among factors that bring this issue into focus.²

People urge to get some financial assistance in order to acquire their own houses. Like other countries of the world in Pakistan too, people look to have some financial

¹ K.J.Aiyer's, Manual of Law Terms and Phrases. (Allah Abad: Law book co, 2000), 358

² Islamic banking modes for house building financing, Islamic development bank. (Jedah: Islamic Research and Training Institute, 1995), 15

recourses, specially those who are from middle or lower income groups require more financial assistance.³

Mainly there are two important modes of house financing in Pakistan. These are:

- (a) Financing by governmental institutions, and
- (b) Financing by non governmental institutions such as Banks (including Conventional and Islamic Banks).

The Conventional banks usually, and specialized financial institutions, mostly, provide housing finance by interest-based financing techniques. Most of the Muslim countries like Iran, Pakistan, Egypt and Sudan are endeavoring to establish their own financial systems based on Islamic Shariah, by following the techniques of Islam that prohibit dealing in interest an important principle that determines the operations of such institutions while lending and borrowing, interest based financing is also prevalent in all Muslim countries.⁴

Section 1.2 Financing by governmental institutions:

1.2.1 House Building Finance Corporation (HBFC)

The House Building Finance Corporation (HBFC) was established in the year 1952 as a Statutory Federal Body. The basic purpose of the corporation was to provide financial aid for purchase and construction of houses to the people of Pakistan in city and rural localities. The notion of institutionalized housing finance was introduced for the first time

³ Iqbal, Munawar. A Guide to Islamic Finance. (Islamabad: Laurie Donaldson, 2007), 6

⁴ Akhtar, Muhammad Ramzan "Practice and Performance of Islamic Banks." Hawliat Al-Jamiah Al-Islamiyyah, Al Alamiyya, iiu, (Volume 1:1, 1993), 38.

in Pakistan with the establishment of HBFC, with the purpose of providing long term finance for house building.⁵

Being the major housing finance organization of the country, its aim is to offer inexpensive housing finances to middle and low income population by stirring new constructions in Small & Medium Housing (SMH) sector.⁶

1.2.2 Housing finance schemes by HBFC Ltd

According to the “**HBFC Act 2001**” HBFC has adopted the Islamic model of house financing. HBFC replaced its conventional Riba Based financing methods and opted Musharakah products after a judgment passed by the Supreme Court of Pakistan against Riba based Transactions.

HBFC Ltd has following two housing finance schemes in practice at present based upon Musharakah Financing:

1. “Ghar Aasan Scheme” for building, purchase and renovation of houses and flat. This Scheme was Started in 2002.
- 2 “Short-term Construction Loan Facility for Small Builders.This Scheme was Started In 2007.⁷

⁵ Khalid Mehmood Khan, HBFC Ltd General Manager .An introduction of HBF Ltd,page 5.

⁶ <http://www.hbfc.com.pk/index.asp>.Last Visited 02-06-09

⁷ Khalid Mehmood Khan, HBFC Ltd General Manager .An introduction of HBF Ltd,page 5.

1.2.3 Ghar Aasan:

1.2.3.1 Procedure:

This product is based on the concept of Diminishing Musharakah. It has four forms i.e. purchase of a residential property, construction of residential property, renovation of an existing residential property and replacement of an existing housing finance (Balance Transfer Facility).⁸

In Ghar Aasan scheme financing facility for purchase, construction/Balance Transfer facility is up to Rs.10 million. It is subject to the customer's eligibility and location of house/flat. Maximum financing limit for renovation is up to Rs.2.5 million. The investment is to be paid back in installments over a maximum period of 20 years subject to the customer's age and repayment ability. The customer gives all basic information about his income and the amount he needs, he attaches all required documents along with the application form. Some documents are required to be attached with the Application Form as a proof to the Income Information.⁹

When the HBFC is satisfied with the information provided by the customer it sends the final report for verification and legal opinion. House financing agreement and all other Financing Documents are signed by the customer when he satisfactorily fulfils all the procedural and practical requirements.

After the lock out period, ¹⁰early unit purchase option is also offered to the customer.

After lock-out period the customer can purchase as many units as he wishes, once in a

⁸ Khalid Mehmood Khan, HBFC Ltd General Manager .An introduction of HBF Ltd, page, 6.

⁹ Ibid,page8

¹⁰ Lock out period means first 3 years during which advance units purchase to the customer is prohibited.

year subject to prepayment charges and other requirements. The customer can get adjust and reduced his monthly installment on lower side or he can decrease the period of lending the loan by making advance payment. Equitable/registered mortgage is the security for HBFC.¹¹

For Purchase of a residential property HBFC offers financing only in urban areas with one-go financing. Construction sector of HBFC covers 93% of its total business. For construction of a residential property either the construction is done on Applicant's owned land or on applicant's owned house.¹²

1.2.3.2 Eligibility Criteria

All citizens of Pakistan, Northern Areas and Azad Kashmir are eligible to apply for HBFC's housing finance. The Age of applicant and co-applicant/guarantor must be between 18 to 60 years. But, maximum age allowed for self employed persons is 65 years. Along with the applicant three co-applicants/guarantors are allowable. Guarantor must be a family member of the customer who should have inheritance rights in the property which is to be mortgaged with HBFC Ltd.¹³

There are some exceptions to this general rule in deserving cases i.e.; cases of issueless couples and unmarried women aged 30 and above, divorcees, widows, the guarantees of other blood relatives, who do not have inheritable rights in the property, such as brothers, sisters, other adult children (niece and nephew), son-in-law, daughter-in-law etc. may also be accepted. The customer can be employed / self-employed and have adequate

¹¹ Khalid Mehmood Khan, HBFC Ltd General Manager .An introduction of HBF Ltd, page, 6.

¹² Ibid, page7.

¹³ Ibid.

repayment capability to meet the investment responsibility. Affidavit, Salary and tax returns are to be presented as proof of income.¹⁴

Section 1.3

Documentation: Ghar Aasan:

The most important document of House Financing contract by Ghar Aasan at HBFC Ltd is the Mortgage Deed. The Salient Features of the Mortgage Deed are:

1.3.1 Mortgage Deed

i) Parties to the Mortgage Deed:

The deed of Mortgage made between the customer who is "Mortgagor" (which expression means and includes his legal heirs, executors, administrators, successors in interests and assigns) of the one part and House Building Finance Company Ltd who is the "Mortgagee" (which expression means and includes its successor and assigns) of the other part.¹⁵

ii) The Mortgage:

The Mortgagor mortgages the Mortgaged property unto the Mortgagee to hold the same until the payment/repayment of all moneys due under The Financing Documents, or otherwise or any and all profit, costs, charges, expenses and liquidated damages, if any, payable to or incurred by the Mortgagee.¹⁶

¹⁴ Khalid Mehmood Khan, HBFC Ltd General Manager .An introduction of HBF Ltd, page. 9.

¹⁵ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.8

¹⁶ Ibid.

The Mortgagor undertakes to pay to the Mortgagee above mentioned sum of rupees within the period and with profit and other charges, dues, damages etc. as mentioned in The Financing documents. For brevity sake the terms and conditions of The Financing documents are treated as part of this Mortgage deed.¹⁷

This Mortgage is a continuing security and it is security for the payment made to the Mortgagor and is also a security for any amount ultimately due to the Mortgagee from the Mortgagor/Customer on any account whatsoever. On payment of all outstanding dues payable by the Customer/Mortgagor, the Mortgagee shall at the cost of the Mortgagor redeem the Mortgaged Property free of all obligations arising under this deed or financing documents.¹⁸

iii) Insurance of the Mortgaged Property:

The Mortgage deed also states that the Mortgagor during the continuance of the mortgage, shall keep the Mortgaged Property comprehensively/adequately insured with an insurance company approved by the Mortgagee against damage by fire and such other risks as the Mortgagee may require from time to time, with the Mortgagee stipulated therein as the loss payee and the Mortgagor shall pay the premia as and when due and shall pass on all receipts therefore to the Mortgagee, in case the Mortgagor fails or omits to pay such premia, the Mortgagee may pay the same on behalf of the Mortgagor and the Mortgagee shall be entitled to recover from the Mortgagor the amount so spent plus an

¹⁷ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.8

¹⁸ Ibid, p.9.

addition of 20%) thereof as liquidated damages all of which shall stand secured hereunder.¹⁹

iv) The Mortgaged Property:

This is the duty of the Mortgagor to assure that the Mortgaged Property is free from all claims, liens, encumbrances and charges of whatsoever nature and the Mortgagor shall not in any way allow or permit any thing to be done in respect of the Mortgaged Property so as to make their rights therein liable to be extinguished or in any way be impaired.²⁰

The Mortgagee, on the happening of any of the events appearing hereinafter, and after giving notice in writing to the Mortgagor shall have the right to sell the Mortgaged Property or any part thereof either by public auction or by private treaty, with or without the intervention of court including the right to purchase the Mortgaged Property or any part thereof for itself that is to say;

- i) If the amount due is not paid /repaid in terms of The Financing Documents and any agreements entered into in respect of the facilities;
- ii) In case of breach of any of the terms of The Financing Documents by the Mortgagee.
- iii) If the Mortgaged Property is damaged or diminishes in value so as to impair the security;

¹⁹ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.9

²⁰ Ibid

iv) The mortgagor shall not lease, transfer or alienate the Mortgaged Property or create any third party interest in any way whatsoever without obtaining the prior written consent of the Mortgagee.²¹

v) **In the event of default:**

In the event of default under The Financing Documents the Mortgagee may take action under the provision of Financial Institutions (Recovery of Finances) Ordinance, 2001, including appointment of any person, as it may seem well, to receive the rent / profit of the Mortgaged Property or any part thereof with power to realize its income and to discharge there from all amounts outstanding due and payable to the Mortgagee in respect of the facilities. Any notice to the Mortgagor on the address given to the Mortgage or as in the title of these presents, shall be deemed sufficient for all purpose and shall be deemed to have been served, if sent by post or left at the address given under proper acknowledgment.²²

vi) **Examination of the property:**

In this clause it is mentioned that the Mortgagor shall allow the Mortgagee and its authorized agents at all reasonable times to enter upon the Mortgaged Property or any part thereof and to inspect and examine the condition thereof; The Mortgagee may as it may deem fit without reference or notice to the Mortgagor and without obtaining its consent at all the times without prejudice to this mortgage and without discharging or in any way affecting the Mortgagor's liability hereunder grant time or other indulgence to or

²¹ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.10.

²² Ibid, p.10

accept or make any composition or arrangement with the Mortgagor/Customer and also vary/renew/extend the facilities from time to time.²³

Section 1.4 Small Builder Scheme:

An enormous number of Small Builders are engaged throughout the country in building and selling individual houses on small scale, in order to give them confidence, HBFCL has initiated "Finance Facility for Small Builders". Its motive is also to crush the shortage of houses in the country and it would at the same time be helpful in enhancing up national economy as a whole.²⁴

1.4.1 Procedure:

Musharakah is the Mode of Financing for Small Builder Scheme at HBFC. Its Financing Limit is PKR 10 Million with Facility Tenor of 12-15-18 Months (optional) which can be extendable for further 03 months. The Builder is required to complete and sale house(s) / flat(s) within one of above agreed or extended tenure of investment. Extension shall be granted by the respective Provincial Chiefs on receipt of such request for extention in writing from the builder one month before the expiry of agreed tenor.²⁵

The Builder's qualifying age is at least 25 years and not more than 65 years at the time of the maturity of Musharakah. HBFCL's Equity for House is 50% cost of the house as assessed by the Corporation and for Flat Project it is 50% cost of project or the estimated cost of construction whichever is less. HBFC's profit is 18% p.a. (in form of utilization cost of number of Musharakah unit(s)).Corporation's Finance Facility is divided into Musharakah unit(s) according to the number of houses/flats. The Builder purchases such

²³Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.12.

²⁴ Ibid.

²⁵ Ibid.

unit/unit(s) at its/their face value within the agreed or extended tenure of Musharakah. The builder is required to submit separate post-dated cheque(s) for the profit as well as for the amount finance facility, in advance.

The Builder is required to purchase the Musharakah Unit/Units within the agreed tenure or shall submit before the expiry of agreed/extended tenor, application(s) from the intending buyer(s) for transfer of Corporation's Finance Facility.²⁶

The Builder can avail upto two finance facilities at a time, subject to maximum of Rs. 10 Million. The Builder is required to submit personal information along with supporting documents only once and the same will not be demanded again if he initiates another project and apply for another facility. However, it will be the responsibility of the builder to immediately intimate any change in future about his particulars provided to HBFCL earlier.²⁷

The admissibility of finance facility is to be worked out on the basis of statement through affirmation of sufficient repayment capacity by the builder as an applicant/guarantor as the case may be, which shall, invariably, be verified/certified by the concerned Zonal Head.²⁸

The non-refundable processing fee shall be deposited by the builder in any authorized HBL branch at the time of submission of application for investment. The Builder is provided life insurance coverage against payment of insurance premium in advance for the agreed as well as extended tenor of investment. The assured sum will be the amount

²⁶ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.12.

²⁷ Ibid,p.14.

²⁸ Ibid,p.15.

of finance facility disbursed. The property insurance is also to be arranged by the Corporation.²⁹

All costs and expenses are to be borne by the Builder. Plot(s) on which house(s)/flat(s) are to be constructed should preferably be in the personal ownership of the builder. Where the plot(s) is/are in the ownership of the builder's spouse or children they can apply for grant of this facility in their own name on the guarantee of their father/husband (builder) or vice versa. 3rd party ownership of the plot shall not qualify for this facility.³⁰

Section 1.5

Documentation: Small Builder Scheme:

1.5.1 Deed of Assignment

The most important document of House Financing contract by Small Builder Scheme at HBFC Ltd is the Deed of Assignment. The Salient Features of the Deed of Assignment are:³¹

i) Parties to the Deed of Assignment:

The deed of Assignment is made between the customer who is the "Assignor" (which expression means and includes his legal heirs, executors, administrators, successors in interests and assigns) of the One Part and House Building Finance Company Ltd who is the "Assignee" (which expression means and includes its successor and assigns) of the Other Part.³²

²⁹ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC), p.16

³⁰ Ibid.

³¹ Ibid.

³² Ibid.

ii) Construction of the property:

According to the deed of Assignment, Construction of the Property is to be completed under the direct supervision of the Assignor who is responsible for ensuring that it is strictly in accordance with the approved plans, design and specifications approved by the competent authority and the quality and workmanship are in accordance with the accepted Standards.

The house shall be completed and sold by the Assignor with the prior permission in writing of the assignee, within the opted/extended period, hereinafter referred to as 'Agreed Period', counted from the first of the month following the month in which this Deed of Assignment has been executed. No part of the finance facility provided by the Assignee can be expended by the Assignor for any purpose other than for which the finance facility has been approved.³³

No addition, alteration or modification in the plan, design or specification of the Property can be made by the Assignor or otherwise without the prior approval of the competent authority and prior consent of the Assignee in writing.³⁴

The said property assigned with the Assignee in consideration of its finance facility is to be kept in proper condition and order by the Assignor and is required to be open to inspection by an authorized representative of the Assignee deputed for this purpose. No part of the building, structure or fixtures of the house assigned with the Assignee can be sold or transferred in any manner or demolished or removed without the prior permission

³³ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.29.

³⁴ Ibid.

in writing of the Assignee or allowed to suffer any damage by the Assignor. The Assignor is solely responsible and shall bear all expenses, if any, to remove any defects in the construction of the house.³⁵

All taxes, dues and charges relating to the said property and cost of maintenance and repairs thereof are to be borne by the Assignor. The cost of land, cost of construction, the total estimated cost of said property determined by the Assignee are to be considered as final and binding on the Assignee and the Assignor.³⁶

iii) Security to be continuing:

This Assignment is a continuing security and it is not to be discharged except by a duly registered Deed of Redemption. This Assignment shall secure payment of any amount ultimately due from the Assignor to the Assignee whether in its Housing Finance Account or in any other account whatsoever hereby secured and costs charges and expenses notwithstanding that any time hereafter there may not be any amount due and owing by the Assignor to the Assignee.³⁷

iv) Default:

In case the Assignor fails to sell the said property and repay Assignee's finance with agreed profit within the agreed period or fails to complete the construction in time deliberately or commit breach of any of the term of this Deed of Assignment, the Assignee shall be at liberty to take over the physical possession of the Said Property and

³⁵ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.30.

³⁶ Ibid.

³⁷ Ibid.

after sale recover its finance with profit along with the legal expenses on the basis of documents executed by the Assignor in favour of the Assignee (HBFC).³⁸

The Assignor fully understands and agrees that in the event of default, the Assignee reserves the right to institute Legal proceedings and sale said property and recover its dues under the provision of HBFC Act, 1952, the Financial Institutions (Recovery of Finances) Ordinance 2001, or under any other law for the time being in force.

The Assignor agrees that in the eventuality as specified before, he will hand over vacant possession of the house to the Assignee within 30 days after service of notice upon him.

In the case of sale of the house the Assignee will adjust from the sale proceeds the due amount of Musharakah Unit(s) and all other dues upto the date of sale of the house(s)/flat(s) including expenses of sale and the Assignee may, at its sale prudence give up its share in the capital gain, if any, in surplus of the agreed value of its unit(s) on the date of sale of the house. In case the sale proceeds are deficient to adjust the outstanding finance facility, the loss shall be shared between the Assignor and the Assignee in the ratio of their finance outstanding on the date of the sale. If the loss is occurred due to breach of any clause of this Deed of Assignment, or any willful default/negligence on the part of the Assignor in the construction of said property, the Assignee will not share any such loss.³⁹

It is also mentioned that all sums payable to the Assignee shall be paid by the Assignor in any of the authorized branches of the bank(s) specified by the Assignee.⁴⁰

³⁸ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.38.

³⁹ Ibid.

⁴⁰ Ibid.

v) Group Life insurance:

The Group Insurance coverage is available to the life of the customer or his guarantor(s) on whose income the finance facility is accepted by the corporation.⁴¹

During the currency of Musharakah Agreement, if the customer or his guarantor(s) dies or becomes totally or permanently disabled as the case may be, the insurance company shall pay to HBFC an amount equal to the Balance of Finance Facility outstanding on that date and on which due premiums have been paid to the Insurance Company. The customer shall pay insurance premium @ Rs.0.38 per thousand per month for the entire agreed period of finance facility in advance through pay order drawn in favour of HBFC. In case of extension in the agreed period, the customer shall submit another pay order at the above rate on account of insurance premium for the extended period.⁴²

vi) Fire Takaful policy:

Similarly, the customer makes Takaful contribution @ Rs.0.031 per thousand per month of the original amount of finance facility towards Takaful coverage of the residential property in the event of loss and/or damage by Fire & Allied Perils mentioned in "Fire Takaful Policy" obtained from M/s. Takaful Pakistan Ltd. The above contribution is made for the entire agreed period of the finance facility in advance through pay order drawn in favour of HBfC. In case of extension in the agreed period, the customer submits another pay order, at the above rate, on account of Takaful coverage.⁴³

The group Insurance coverage is available to the life of the Assignor on whose income the application for finance facility is approved by the Assignee. The assured sum will be

⁴¹ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p,43.

⁴² Ibid.

⁴³ Ibid.

the original amount of the finance disbursed by the Assignee and profit thereon and the claim if any received in excess of the outstanding balance of total dues from the insurance company, it will be refunded to the legal heirs of the Assignor. The Assignor pays the insurance premium for the entire agreed period of finance facility in advance as required by the Assignee.

The Assignee arranges insurance of property against all relevant insurable risks such as loss, damage or destruction. Such insurance shall be in the name of Assignee as the loss payee thereof and shall remain valid and effective for the entire period of agreed tenor. In the event a claim is being lodged, the proceeds thereof shall be shared between the Assignee and the Assignor in accordance with their respective finances. All costs and expenses incurred in respect of insurance shall be borne by the Assignor.⁴⁴

vii) General Provisions:

The Assignee is not responsible for any loss or damage to the Assignor on account of delay in approval of the request for financial facility or in payment of the amount thereof. The Assignee is also not responsible or liable for any loss or damage whatsoever caused on account of any defect in the construction of the house.⁴⁵

The liability of the Assignee in the losses caused by natural disasters, war or civil disorder shall be determined by the Assignee on the basis of its share of investment at the time the loss crops up and shall not go beyond the outstanding amount of investment.⁴⁶

The Assignor has the option to purchase the Musharakah Unit(s) of the Assignee

⁴⁴ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.45.

⁴⁵ Ibid.

⁴⁶ Ibid.

within agreed tenor from the date of execution of this deed of Assignment on lump-sum payment of profit in the manner approved by the Assignee. Stamp duty, registration fee and any other charges and fees payable on the execution and registration of documents required to be executed in connection with the investment shall be paid by the Assignor.⁴⁷

Section 1.6

Financing by non governmental institutions such as Banks (including Conventional and Islamic):

1.6.1 House Financing by Conventional Banks in Pakistan:

Some Famous Types of conventional Mortgages:

Conventional banks and other financial institutions are providing a number of Mortgages all over the world. Some of the famous types are as follow;

1. Tracker rate mortgages.
2. Fixed rate mortgages.
3. Discounted rate mortgages.⁴⁸

1.6.2 Tracker rate mortgages:

The Tracker rate mortgage is presented for a fixed period of a time. The most common tracker rate period is two years, however many mortgage lenders now offer three, five or ten year track rate mortgages.⁴⁹

⁴⁷ Diminishing Musharakah Manual of The House Building Finance Corporation (HBFC),p.49.

⁴⁸

<http://www.cooperativebank.co.uk/servlet/Satellite/1193206374614,CFSweb/Page/BankMortgagesMortgages>.Last Visited:04-10-09.

⁴⁹ <http://www.godirect.co.uk/mortgage-application.php>.Last Visited:05-10-09.

1.6.2.1 Pros and Cons of Tracker rate mortgages:

Pros:

- i. Tracker mortgages are uncomplicated and transparent, and some people like them because the mortgage lender cannot manipulate the rate once its margin is set.⁵⁰
- ii. They offer lower interest rate in the first few years than the lenders standard variable.⁵¹
- iii. The rate which the client pays fluctuates directly in line with the Bank Rate, rather than being attached to the lender's own Standard Variable Rate, which it can modify whenever it chooses for commercial purposes.⁵²
- iv. The client will get advantage from all decreases in the Bank's base rate.⁵³
- v. Tracker mortgages can be simple products for lenders to intend, they have a propensity to come with lower fees than fixed, capped or discounted rates.⁵⁴

⁵⁰ http://www.yourmortgage.co.uk/mortgage_basics/tracker_mortgages, Last Visited:07-10-09.

⁵¹ <http://www.godirect.co.uk/mortgage-application.php>, Last Visited:15-10-09.

⁵² http://www.yourmortgage.co.uk/mortgage_basics/tracker_mortgages, Last Visited:15-10-09.

⁵³ <http://www.godirect.co.uk/mortgage-application.php>, Last Visited:25-10-09.

⁵⁴ http://www.yourmortgage.co.uk/mortgage_basics/tracker_mortgagesLast Visited:05-11-09.

Cons:

- i. Early redemption penalty can be troublesome and costly.
- ii. If the Bank's base rate increases client's monthly payments will also increase in line with it.
- iii. It is not convenient to plan as the interest rate might fluctuate.⁵⁵

1.6.3 Fixed rates Mortgages:

A fixed rate mortgage makes it easy to plan ahead, because as the name shows, the interest rate on mortgage continues to be fixed. This means that the interest rate on mortgage remains constant over a predetermined period of time.

This makes the financial plan easier, because the client can plan in advance knowing exactly how much his monthly repayment will be.

'Asa Ghaffar' writes in an article on 11th December, 2008:

"Over the past decade mortgage interest rates have varied widely. The fact remains that times are uncertain so fixed rate mortgages are popular as a means of keeping mortgage interest rates at an affordable level and creating certainty. Data provided by the Council of Mortgage Lenders shows that fixed rate mortgages account for 70% of all mortgages in use in Britain at the same time as 2-year fixed rate deals are presently the most common, 5- and 10-year fixed rate mortgages are growing in attractiveness".⁵⁶

⁵⁵ http://www.yourmortgage.co.uk/mortgage_basics/tracker_mortgages Last Visited:05-11-09.

⁵⁶ http://home-mortgages.suite101.com/article.cfm/fixed_rate_mortgages_pros_and_cons, Last Visited:07-11-09.

1.6.3.1 Pros and Cons of Fixed Rate Mortgages:

Pros:

- i. Enormous moves back and forth in mortgage repayments can be very disturbing, especially for first time buyers and those on fixed incomes.
- ii. Fixed rate mortgages are excellent for those requiring financial assurance.⁵⁷
- iii. For the period of increasing inflation, interest rates have been known to go above 10%. While nobody forecasts the direction of mortgage interest rates exactly every time, steady affordability can be a cost worth paying.
- iv. The confidence of knowing accurately what monthly mortgage payments will be, makes it considerably easier when an economic planning is done.
- v. In spite of what happens in the economy and how the base rate moves, the interest rate charged is guaranteed to stay the same for the duration of client's initial deal period.⁵⁸

Cons:

- i. Initiating fixed rate mortgages frequently involve paying application fees.
- ii. High risk borrowers, such as those who cannot prove their earnings, are far less possible to be eligible for fixed rate mortgages.⁵⁹
- iii. There is a propensity for people to be in panic and lock into a rate that has been rising just before it comes down.

⁵⁷ http://home-mortgages.suite101.com/article.cfm/fixed_rate_mortgages_pros_and_cons, Last Visited: 07-11-09.

⁵⁸ http://www.yourmortgage.co.uk/mortgage_basics/fixed_rate_mortgages#fixed%20rate%20mortgages, Last Visited: 11-11-09.

⁵⁹ http://home-mortgages.suite101.com/article.cfm/fixed_rate_mortgages_pros_and_cons, Last Visited: 10-11-09.

- iv. Time and again lenders charge a higher premium for guaranteeing a fixed level of interest. Frequently fixed rate deals work out more costly than variable rate mortgages.⁶⁰
- v. Fixed Rate mortgages can also be connected with a discount rate. This is when the bank gives a discounted rate, but this is usually just for first 6 or 12 months.⁶¹

1.6.4 Discounted rate Mortgages:

'Asa Ghaffar' writes in an article on 11th December, 2008:

"Discount rate mortgages are a way of attracting and aiding first time buyers. The rate of interest offered is discounted meaning that, if the Standard Variable rate (SVR) is 5%. a mortgage discount of 1% for 2 years would mean that a borrower only pays 4% interest. Discount rate mortgages can be a useful method for a first time buyer to get on to the property ladder, particularly if incomes are expected to grow in a couple of years time. It is important to always be financially prepared for interest rates increasing after the discounted period elapses. Failing to do so may result in financial difficulties".⁶²

⁶⁰ http://www.mortgageguideuk.co.uk/mortgages/fixed_rate_mortgage.html, Last Visited: 12-11-09.

⁶¹ Ibid.

⁶² http://home-mortgages.suite101.com/article.cfm/discount_rate_mortgages_pros_and_cons, Last Visited: 13-11-09.

1.6.4.1 Pros and cons of Discount Rate Mortgages:

Pros:

- i. The client has to pay a rate of interest that is usually lower.
- ii. A larger decrease for just 12 months can be useful to first time buyers who want to use the extra money for buying new stuff for the home. The longer the discount lasts, the smaller the decrease will be.
- iii. If the Bank reduces its base rates, these are likely to be transferred to the borrower.⁶³

Cons:

- i. Monthly mortgage repayments will be affected by the changes to bank's basic interest rates.
- ii. On the more favourable discounted mortgages it is probable that a borrower will be involved in for longer than the agreement lasts for. If the borrower needs to move mortgage prior to the end of the fixed period, a redemption penalty will be applied on him.
- iii. The discount period usually only lasts for 1-2 years. Once it ends, it is essential to be able to have enough money for the new repayments that come in consequence.⁶⁴

⁶³http://home-mortgages.suite101.com/article.cfm/discount_rate_mortgages_pros_and_cons, Last Visited: 13-11-09.

⁶⁴ Ibid.

Section 1.7

House Financing in United Bank Limited

UBL has assets of more than Rs.550 billion and a successful record of fifty years. Moreover its 1112 branches are serving all over the country. UBL was established on November 7, 1959.⁶⁵

United Bank Limited offers a variety of products and pricing options that are acquiescent. All product options are amortized and range over a tenor of 3 - 20 years. UBL has named its housing finance as "UBL Address".⁶⁶

UBL presents housing finance in following four ways:

1. Buying a Home
2. Construction/ Building a Home
3. Land plus Construction
4. Home Equity/Renovation. Loan to Value 30% of the appraised value.⁶⁷

1.7.1 Eligibility Criteria:

Minimum net income as low as Pak rupees 50,000/- per month. (i:e Rs. 50.000 net salary for salaried individuals or Rs. 100.000 average balance for business individuals) is required to be eligible. The borrower's age must be between 23 to 65 years for Primary Borrower & 18 to 70 years for Co borrower.⁶⁸

⁶⁵ <https://www.ubl.com.pk/aboutus/>. Last visited:20-08-09

⁶⁶ Brusher of UBL Address United Bank Pakistan Ltd.

⁶⁷ Ibid.

⁶⁸ Ibid.

Only Pakistani Resident are eligible. Self-employed businessman/professional or salaried individual working for more than three years are also eligible. The Minimum loan size is Rs. 500,000 & Maximum loan size is up to Rs. 30 MM.⁶⁹

1.7.2 Documents Required:

(a). For Salaried Individuals:

A Salaried Individual is required to submit the following documents:

- i. His Employment Certificate confirming last 12 months work experience.
- ii. His Last 3 Salary Slips & Employment Certificate.
- iii. Bank Statement for the last 12 months.
- iv. Property documents and an approved Map for which loan is required.
- v. Processing, Legal & Appraisal Charges.
- vi. Copy of his CNIC.
- vii. Four recent Photographs of primary as well as co-borrowers are also required.
- viii. A completely Signed application.

Markup: 16.12 for Salaried Individual Subject to change every month.⁷⁰

(b).For SEB/SEP

- i. Last 3 years Tax Documents or Registered Partnership Deed.
- ii. Bank Statement for the last 12 months.
- iii. Income Estimation Report.

⁶⁹ Brusher of UBL Address, United Bank Pakistan Ltd.

⁷⁰Ibid.

- iv. Property documents and an approved Map for which loan is required.
- v. Processing, Legal & Appraisal Charges.
- vi. Copy of CNIC.
- vii. Four recent Photographs each of primary as well as co-borrowers.
- viii. Signed application.

Markup: 17.29 for SEB/SEP Subject to change every month.⁷¹

1.7.3 Unapproved Profession:

These are some of the Unapproved Professions i-e belonging to which an individual can not be eligible to seek a loan for house financing from UBL: Politicians, Lawyers/Legal Advisors, Judicial Magistrates, Judiciary Officials, Police and Law Enforcement Staff, Landlords/Farmers/Cultivators, Stock brokers, Showbiz related Personalities, Journalists, Real Estate Agents, ISP (other than large established companies), Builders/Constructors, Money Changers except Government License, Overseas Employment Agencies, Immigration Consultants, NGO's except approved Multilateral & other NGO's, Low profile Government Contractors.⁷²

⁷¹ <https://www.ubl.com.pk/aboutus/>. Last visited: 20-08-09

⁷² Murtaza Mubasshir, Assistant Product Manager, UBL Address, United Bank Pakistan Ltd.

Section 1.8

Islamic Banking sector in Pakistan:

“Islamic banking is a system of banking or banking organization that is in accordance with the philosophy of Shariah (Islamic law) and its practical application through the expansion of Islamic economics”.⁷³

Islamic Shariah considers that all wealth is possessed solely by Allah and is held in trust by man acting as His vicegerent. Man's assumption of this role requires him to fulfill certain stipulations in the way of spending money.⁷⁴

Shariah disallows the payment of fees (Riba, usury) for the renting of money for specific conditions. It also forbids people to invest in businesses that provide goods or services that are contrary to its principles i.e. Haram or forbidden. Islamic banks, as economic and social institutions, have certain traits prescribed by their specific nature, drawing their principles and rules from Shariah. In the late 20th century a number of Islamic banks were created to apply the principles of Shariah to private or semi-private commercial institutions within the Muslim community.⁷⁵

1.8.1 Modern Islamic banking

In the Egyptian town of Mit Ghamr, the first modern experimentation with Islamic banking was carried out in 1963, the pioneering effort to it was led by Ahmad Elnaggar.⁷⁶

⁷³ Ayub, Muhammad, *Understanding Islamic Finance* (John Wiley and Sons, Ltd,2007), 10

⁷⁴ Ibid

⁷⁵ Haron,Sudin. “A Comparative Study of Islamic Banking Practices.”*Journal of King Abul Aziz University Islamic Economics* (Volume 10,1998),40

⁷⁶ Anwar Muhammad. “Reorganization of Islamic Banking, A New Proposal.”*The American Journal of Islamic Social Sciences*, (Volume 4: 2 1987),16

Section 1.9

The Islamization of the Economy and the Development of Islamic Banking in Pakistan:

1.9.1 Introduction of Islamic provisions in the constitutional arena:

For a long time Islamic activists have made a great effort to introduce Islamic principles in the state affairs and to abolish interest from the financial system. But their efforts could not become fruitful due by Pakistan's political system. The first Constituent Assembly was created under the Indian Independence Act of 1947. This Assembly adopted the Objective Resolution on March 12th, 1949. The Objective Resolution stated clearly that "Pakistan will be a state wherein the Muslims of Pakistan shall be enabled to order their lives in accordance with the teachings and requirements of Islam". The Constitution of 1956 and 1962, made it mandatory for the government to eradicate interest from the country as early as possible. Moreover, Article 2 of the 1973 Constitution stated that Islam is the state religion of Pakistan and Articles 2A, 31, 37, 38(F), 227 of the constitution made it compulsory for the government to take steps to facilitate the Muslims of Pakistan to lead their lives in accordance with the teachings of Islam. Therefore, it was expected that living in Pakistan would be in accordance with the teachings and strategies of Islam.⁷⁷

1.9.1.1 Judgments of the Supreme Court on Banking Practices

Since July 1985 the procedure introduced by banks was mainly based on mark up techniques with or without buy back arrangement, but it was declared unislamic by the Federal Shariah Court (FSC) in a judgment in 1991. An appeal was made by the

⁷⁷ Anwar Muhammad. "Reorganization of Islamic Banking, A New Proposal." The American Journal of Islamic Social Sciences, (Volume 4: 2 1987),17

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government against the Federal Shariah Court's judgment to the shariah appellate Bench (SAB) of the Supreme Court of Pakistan. On December 23rd, 1999 The Supreme Court also rejected the government's appeals and the government was asked to abolish all laws involving interest before June 30th, 2001. Many of the practices and prescribed modes of investment and funding either designed by SBP or other commercial banks were declared unIslamic by the Supreme Court.⁷⁸

The judgment of the court accomplished that:

“All prevailing forms of interest, either in banking transactions or in private transactions fall within the definition of Riba. Any interest stipulated in government borrowings acquired from domestic or foreign sources are Riba. The present financial system based on interest, is against the injunctions of Islam as laid down by the Holly Quran and Sunnah.”⁷⁹

The government was ordered by the court to establish a commission for conversion of financial system (CTFS) and two task forces to be launched to arrange and execute the process of this conversion. Thus in January 2000 the SBP constituted CTFS.⁸⁰

⁷⁸ Hassan, Mehbood. “Islamic Banking in Pakistan from Account Holders Perspective (Case Study on Meezan Islamic Bank).” *Journal of Islamic Banking & Finance*, Volume 25, (Jan-March 2008), 79.

⁷⁹ Billah, Mohd. Ma'sum. “Islamic Model of Home Financing.” *Journal of Islamic Banking & Finance*, Volume 25, (Jan-March 2008), 21.

⁸⁰ [SAB Supreme Court of Pakistan 2000:468]

1.9.1.2 The State Bank of Pakistan's Guidelines for Islamic modes of finance:

In the light of the recommendations given by the different stakeholders in the Essentials of Islamic Modes of Financing the Shariah Board of the State Bank of Pakistan approved and incorporated some of the recommendations to ensure observance with minimum Shariah standards by banks carrying out Islamic banking in Pakistan.⁸¹

These Essentials are proposed to be enforced as Prudential Regulations for Islamic banks in due course. Similarly, in order to facilitate the existing Islamic banks and the potential market players to develop Islamic banking products in particular and to create awareness about Islamic banking products in general, Model Agreements for the following modes have also been updated in the light of stakeholder's comments by the SBP Shariah Board.⁸²

- i. Murabaha Facility Agreement.
- ii. Musawamah Facility Agreement.
- iii. Lease Agreement.
- iv. Salam Agreement.
- v. Musharakah Investment Agreement.
- vi. Istisna Agreement.
- vii. Agreement for Interest free Loan.
- viii. Mudaraba Financing Agreement.
- ix. Syndication Mudaraba Agreement.⁸³

⁸¹ <http://www.sbp.org.pk/press/Essentials/Essentials-Mod-Agreement.htm>. Last visited: 05-12-09

⁸² Ibid.

⁸³ Islamic banking modes for house building finance, Islamic development bank. (Jeddah: Islamic Research and training institute, 1995) 86

These are the model agreements, which can be modified, according to the products designed by the banks conducting Islamic banking business, with the approval of banks Shariah Adviser to ensure that such changes are consistent with the principles of Shariah.⁸⁴

1.9.1.3 Essentials of Musharakah according to SBP:

According to the State Bank of Pakistan Essentials of Musharakah are following:

- i) Musharakah means relationship established under a contract by the mutual consent of the parties for sharing of profits and losses arising from a joint enterprise or venture.
- ii) Investments come from all partners/shareholders hereinafter referred to as partners.
- iii) Profits shall be distributed in the proportion mutually agreed in the contract.
- iv) If one or more partners choose to become non-working or silent partners, the ratio of their profit cannot exceed the ratio which their capital investment bears to the total capital investment in Musharakah.
- v) If Mudarib in a Shirkah arrangement also contributes his own capital to the business, he will be entitled to share the profit in proportion to his own capital in addition to his share as Mudarib according to the agreed proportion.

⁸⁴Islamic banking modes for house building finance, Islamic development bank.(Jeddah: Islamic Research and training institute,1995)86

- vi) It is not allowed to fix a lump sum amount for any of the partners, or any rate of profit tied up with his capital. A management fee however, can be paid to the partner managing the Musharakah provided the agreement for the payment of such fee is independent of the Musharakah agreement.
- vii) Losses are shared by all partners in proportion to their capital.
- viii) All assets of Musharakah are jointly owned in proportion to the capital of each partner.
- viii) All partners must contribute their capital in terms of money or species at an agreed valuation.⁸⁵

Section 1.10

House Financing in Meezan Bank Pakistan Limited

Meezan Bank Limited is the first scheduled bank in Pakistan, which has been certified by the State Bank of Pakistan to function as an Islamic Commercial Bank.⁸⁶

Meezan Bank Limited was incorporated on January 27, 1997 and started business as an investment bank in August that year. In January, 2002 Meezan Bank was granted the nations first full-fledged commercial banking license as a committed Islamic Bank, by the State Bank of Pakistan.⁸⁷

1.10.1 House Financing on a Diminishing Musharakah basis:

House financing by Meezan Bank Limited is the First complete Islamic house finance facility in Pakistan which is said to be totally Shariah-compliant home finance facility.

⁸⁵ <http://www.sbp.org.pk/press/Essentials/Essentials%20of%20Islamic.htm>. Last visited: 01-07-2009.

⁸⁶ Brusher of Meezan Easy Home, Meezan Bank Pakistan Ltd.

⁸⁷ <http://www.meezanbank.com/easyhome.aspx>. Last visited: 22-12-09

The idea behind this product is to abstain from interest based financing and provide the absolute inner satisfaction and peace of mind.⁸⁸

In "Easy Home scheme" the client contributes with Meezan Bank in a joint ownership of the property, where the Bank and the client both provide a certain amount of financing. The client agrees to a monthly payment to the Bank for the use of the home, and his equity share. In fact, the total monthly payment decreases on a regular basis as his share in the property grows up. When the client makes the full payments which had been agreed upon, he becomes the exclusive owner with a free title to the property.⁸⁹

1.10.2 Procedure of House Financing at Meezan Bank Limited:

At the first step a Meeting called as "Credit Meeting" is held between the customer and the MBL. In this meeting the MBL provides the customer with all the information he needs about MBL Home Finance. The customer also gives all basic information about his income and the amount he needs. The main purpose of this meeting is to evaluate the customer.⁹⁰

Following documents the are required to be attached with the application form as the personal information of the customer; copy of NIC of the customer, copy of co-applicants NIC (if applicable), 2 passport-sized colored photographs of applicant / co-applicant, copy of rental documents (if applicable) ,copy of last paid utility bills (Electricity/Gas/Telephone) ,borrowers basic fact sheet ,bank statement - last 6 months ,copy of recent credit card bills and copy of recent CNIC/B form of legal heirs.

⁸⁸ Mirza Adeel Baig, Meezan Bank Ltd Assistant Vice President HUB Manager Islamic House Finance The Road Map Easy Home.

⁸⁹Ibid.

⁹⁰ Ibid.

Following documents are required to be attached with the application form as a proof to the Income Information, original or certified copy of recent pay slip, employers certificate including tenure/designation/salary ,bank statement of business - last 6 months (if applicable) ,copy of management accounts (if applicable).⁹¹

A customer other than a salaried one has to show following business/professional information;3 years proof of business (e.g. tax return / bank certificate),partnership Deed (in case of partnership),professional degree / certificate, professional association membership certificate / practice license.

If the client has selected the property to buy or wants financing for construction/re-placement/renovation than he has to present; property title documents (copies at initial stage & original before disbursement) and In the case of a co-applicant, all income related documents will also be required.⁹²

The MBL makes a thorough and comprehensive report which is called “credit or valuation report.”This report consists of the evaluation of property and debt equity ratio. The ratio of the shares contributed by the client and the bank is called as “debt equity ratio”.

Then completely filled & signed application form is to be submitted to MBL along with all required documents.⁹³

The required cheques for processing fee & external agency costs is also to be submitted to MBL’s legal consultant gives his legal opinion on the documents provided and points

⁹¹Mirza Adeel Baig, Meezan Bank Ltd Assistant Vice President HUB Manager Islamic House Finance The Road Map Easy Home.

⁹² Ibid.

⁹³ Mirza Adeel Baig, Meezan Bank Ltd Assistant Vice President HUB Manager Islamic House Finance The Road Map Easy Home.

out his objections, if any. When the file has been thoroughly examined it is sent for further proceedings, at this stage the file is usually named as “credit proposal”. A conditional sanction letter is given to the client when he has satisfactorily fulfilled all Meezan banks credit requirements. Then the approved file is sent to the “credit administration department” for the signatures of the MBL’s housing finance officials.

When the case is finally approved, the client’s account can be opened at Meezan Bank and at this stage the housing finance begins. After that a Meezan bank official and a lawyer along with the seller of the property go to the proper bank or registrar’s office for property transfer. Original property documents are delivered to the lawyer who verifies the documents and gives the pay order to the banker or seller and then completes other legal necessities on the behalf of Meezan bank. In this way house financing begins and the customer starts to pay his installments.⁹⁴

1.10.3 House financing products at MBL:

Buying a home (Easy Buyer) building a home (Easy Builder), renovating home (Easy Renovate) and transferring existing mortgage (Easy Replace) are the main Products offered by MBL.⁹⁵

At MBL financing for buying a home is from PKR 300,000/- to PKR 40 million for salaried, SEP, NRP Customers and from PKR 300,000/- to PKR 5 Million for businessman customer. Financing tenure ranges from 3 years to 20 years. Bank

⁹⁴Mirza Adeel Baig, Meezan Bank Ltd Assistant Vice President HUB Manager Islamic House Finance The Road Map Easy Home.

⁹⁵ Ibid

investment ratio (BIR) for salaried / SEP / NRP customers are up to 70% and for businesspersons it is up to 60 per cent.⁹⁶

For building a home residential construction can be done on applicant's owned land, purchase of land & residential construction and enhancement of an already constructed residential bungalow. At MBL financing for building a home is PKR 300,000/- to PKR 40 million for salaried, SEP, NRP customers and from PKR 300,000/- to PKR 5 Million for businessman customer. Financing tenure ranges from 2 years (excluding construction period of max 12 months) to 20 years. Bank investment ratio (BIR) for salaried / SEP / NRP customers is Up to 70% and for businesspersons it is up to 60 per cent.⁹⁷

At MBL financing for renovation of home is available from PKR 150,000/- or up to 30% of property value. Financing tenure ranges from 2 years up to a maximum of 15 years.

At MBL financing for transferring existing mortgage is available from PKR 300,000/- to PKR 40 million for salaried, SEP, NRP customers and from PKR 300,000/- to PKR 5 Million for businessman customer. Financing tenure ranges from 3 years to 20 years. Bank Investment Ratio (BIR) for Salaried / SEP / NRP customers is Up to 70% and for Businesspersons it is Up to 60%.⁹⁸

⁹⁶<http://www.meezanbank.com/pages.aspx?iPageId=82#builder>. Last visited 12-05-09

⁹⁷ Mirza Adeel Baig, Meezan Bank Ltd Assistant Vice President HUB Manager Islamic House Finance The Road Map Easy Home.

⁹⁸ Ibid.

Section 1.11

Documentation: Home financing by Meezan Bank Limited:

1.11.1 Islamic House Financing Agreement

Salient Features of Islamic House Financing Agreement:

i) Purpose:

This agreement lays down the conditions and circumstances upon which the bank and the customer agree to enter into a Musharakah. It is understood between the parties that regardless of the proportion of each party in the Musharakah, the entire Musharakah property will be occupied and used by the customer against payment of the monthly payments. It is further understood between the parties that the customer shall buy out the banks' shares in the Musharakah from time to time.⁹⁹

ii) Parties to the Islamic House Financing Agreement:

This Islamic "House Financing Agreement" is made between Meezan Bank Limited, (hereinafter referred to as the "Bank" which expression, where the context so permits, means and includes its successors-in-interest and assigns), of the one part; and the client (hereinafter referred to as the "customer" which expression, where the context so permits means and includes its successors in interest and assigns). (Individually referred to as a "party" and collectively as the "parties").¹⁰⁰

⁹⁹ Diminishing Musharakah Manual of Meezan Bank Limited, p.4

¹⁰⁰ Ibid.

iii) Purchase of Musharakah property:¹⁰¹

In this clause it is agreed between the parties that the customer shall purchase the Musharakah property from the seller considering the observance with the conditions precedent specified and agreed upon between the parties. It is also stated that the Bank shall make available the Bank's investment in the Musharakah to the customer or his nominee for the purposes of completing the sale in the name of the customer on behalf of the Musharakah, provided that where the Musharakah property is already in the name of the customer, the Bank shall make available the investment of its Musharakah share by making payment direct to the customer and by virtue of this payment the Bank will acquire the proportionate equity/ownership of the Musharakah property which shall be documented by a sale receipt to be given by the customer to the Bank. The customer is responsible for examining the conditions, situations and all other matters relating to the Musharakah property, including assurance of proper legal, marketable title and ownership to be obtained from the seller. The customer has the exclusive right to use and occupy the Musharakah property including the Bank's share arising in respect of the Musharakah. The customer pays the Bank the monthly payments in accordance with the monthly payments agreement.¹⁰²

¹⁰¹ "Musharakah Property" means the property purchased with the participation of the Bank and the Customer in accordance with the terms of this Agreement.

¹⁰² Diminishing Musharakah Manual of Meezan Bank Limited, p.5

iv) Construction:

In case it has been agreed between the parties that the customer is going to renovate or construct upon the property he shall do so in accordance with building plans approved by the relevant authority. The customer is responsible for execution and completion of all works in respect of the construction and shall ensure that the same is concluded in a timely and efficient manner. The Bank is not responsible for any cost over runs in respect of the construction.¹⁰³

v) Fees and Expenses:

The customer pays all stamp, documentary, registration and other expenses and taxes, or the liabilities which come about in relation with, any agreement, or document accomplished in respect of the attainment of the Musharakah property and the Bank is not liable in any manner in respect of such stamp duty, registration and other duties and taxes and costs associated with fees for services of lawyers, brokers in purchasing the Musharakah property.¹⁰⁴

vi) Payment and Accounts:

Under this agreement the customer is required to make all payments paid on the due dates to the Bank, these payments must not be incomplete or with any condition such as set off or counter claim etc, payments must be free of charge and unambiguous.

¹⁰³ Diminishing Musharakah Manual of Meezan Bank Limited,p.5

¹⁰⁴Ibid,p.7.

If any payment becomes due on a day, which is not a business day, the next following business day will be replaced with such day.¹⁰⁵

If under this agreement an event of default occurs in the payment of any payable sums the customer undertakes to pay at the rate of 1% for each day till the time that default continues a sum and an amount on such outstanding amounts remaining unpaid. The Bank will utilize such extra payments for religious and charitable purposes. The customer assents and authorizes the Bank to such use of the said amount, at its absolute and unconditional discretion.¹⁰⁶

vii) Bank's Representation and warranties:

The Bank warrants and represents that:

- (a) "it is a banking company duly incorporated under the Companies Ordinance, 1984 and licensed to carry on Islamic banking under the laws of Islamic Republic of Pakistan";
- (b) "That it has full legal right, power and authority to enter into, execute and deliver this agreement and to perform the transactions set forth herein";
- (c) "That all requisite corporate approvals and consents have been obtained to enable it to enter into and perform its obligations under this agreement".¹⁰⁷

¹⁰⁵Diminishing Musharakah Manual of Meezan Bank Limited,p.7.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid.

viii) Customer's Representation and warranties:

The customer warrants and represents that the customer has the power to execute, deliver and perform its obligations under this agreement and that this agreement constitutes valid and legally binding obligations of the customer enforceable in accordance with its terms; The execution, delivery and performance of this agreement, the monthly payment agreement and any incidental agreement, instrument or undertaking by the customer will not:

- 1) Commit breach of any existing law, regulations or authorization to which the customer is subject or
- 2) Commit breach of any other agreement to which the customer is a party.¹⁰⁸

Under the laws of the Islamic Republic of Pakistan in force at the date hereof the customer will not be required to make any deduction or withhold any amounts payable by it hereunder. The customer warrants and represents that there are no grounds or proceedings pending, or to the knowledge of the customer threatened, the adverse determination of which may have a material effect on the financial condition of the customer or may impair the ability of the customer to perform any of its obligations or affect the enforceability of this agreement. The customer assures that no legal or

¹⁰⁸ I Diminishing Musharakah Manual of Meezan Bank Limited, p.8.

administrative proceeding are pending against him and no event or circumstance which constitutes or would constitute an event of default has occurred.¹⁰⁹

ix) Undertakings:

The customer also assures that during the term he shall inform the Bank of any event of default or any event, which with the giving of notice or lapse of time or both would constitute an event of defaulting immediately upon becoming aware thereof.

The customer undertakes to provide the Bank with such financial and other information concerning his affairs as the Bank may require reasonably from time to time.¹¹⁰

x) Conditions Precedent:

The customer agrees that the obligation of the Bank to provide the Bank's Musharakah share is subject to the conditions that:

- a. Duly executed versions of this agreement and the security documents to be obtained and such other documents as may be related or incidental to the terms of this financing arrangement have been received by the Bank to the satisfaction of the Bank.
- b. All duties, fees, commissions, expenses required to be paid by the Customer to the Bank in respect of any transaction have been received by the Bank;

¹⁰⁹ Diminishing Musharakah Manual of Meezan Bank Limited, p.10.

¹¹⁰ Ibid.

- c. All such documents, approvals, consents and the like as have been reasonably requested by the Bank in connection with this agreement have been received by the Bank.

The Bank has confirmed in writing that it is satisfied with the nature, type, location, value, title and documentation requirements of the Musharakah property based upon legal opinions, valuation reports obtained by the Bank directly or through the customer.¹¹¹

xi) Events of default:

There shall be an event of default if the customer is unsuccessful to pay any amount due under this agreement when owed ,or, the customer defaults in the due and on time presentation of any other stipulation of this agreement and (if such default is in the opinion of the Bank capable of remedy) such default shall not have been remedied within twenty-one (21) days of the Bank informing the customer of such default, or any representation or assurance made or deemed to be made or repetitive by the customer in or pursuant to this Agreement or in any document delivered under this agreement is or proves to have been incorrect in any material respect.¹¹²

There shall be an event of default if there is initiation of proceedings for insolvency of the customer, or, if the customer discontinues or delays payment of its debts or is incapable or makes a clean breast of incapability to pay its debts as they fall payable or proceedings are commenced in relation to the Customer under any law, regulation or procedure, or, the Musharakah property ceased to be in the occupation of the customer for any reason whatsoever, without the express written consent of the Bank, or, the title of the

¹¹¹Diminishing Musharakah Manual of Meezan Bank Limited,p.15.

¹¹² Ibid.

Musharakah Property and/or the security interest of the Bank is in jeopardy in the reasonable opinion of the Bank. The Bank may, without discrimination to any of its other rights, at any time after the occurrence of an event of default by notice to the customer may end this agreement.¹¹³

xii) Termination upon Death:

If during the term, the customer dies, the legal heirs of the customer shall have the choice to takeover the share of the deceased customer. In such a case the rights, duties and liabilities of the deceased customer under this agreement, the monthly payment agreement and other undertakings and documents shall be transferred to the legal heir(s) as the new customer on the same terms and conditions upon execution of the requisite documentations.

In case the legal heirs of the deceased customer fail to take up the Musharakah share of the deceased customer within a maximum period of three (3) months from the date of expiry of the deceased customer, the Bank shall be entitled to terminate the Agreements. Upon termination the Bank shall enforce the security in respect of interalia the Musharakah property and/or the other assets and recover its proportionate Musharakah share and all other dues outstanding and payable to it under the master agreement and the monthly payment agreement.¹¹⁴

¹¹³ Diminishing Musharakah Manual of Meezan Bank Limited,p.16.

¹¹⁴Ibid.

xii) Indemnities:

The customer shall pay the Bank against disbursement as a result of any default in payment by the customer of any sum under this agreement when due which the Bank shall verify as duly acquired by it.¹¹⁵

xiii) Security:

The customer creates a mortgage as security for the performance of the customer's obligations in accordance with the terms of this agreement. This is done by the deposit of title deeds in respect of the Musharakah property in Bank's favour and a demand promissory note will be executed on the effective date.¹¹⁶

The customer also agrees to accomplish insurance coverage from a company of good reputation offering security under the Islamic concept of Takaful.

The SBP states that: "Until the Islamic concept of Takaful is available the Musharakah property shall be insured with a trustworthy insurance company against all relevant insurable risks such as loss, damage or destruction of the Musharakah property. Such insurance shall be in the name of the Bank as the loss payee thereof and shall remain valid and effective for the entire Term. However it is agreed that in the event of a claim being lodged under the insurance policy, the proceeds thereof shall be shared between the Bank and the customer in accordance their respective shares in the Musharakah. All costs and expenses incurred in respect of such insurance of the Musharakah property

¹¹⁵ Diminishing Musharakah Manual of Meezan Bank Limited,p.18.

¹¹⁶ Ibid.

shall be shared by the Bank and the customer in proportion to their respective shares in the Musharakah.¹¹⁷

xiv) Setoff:

“The Bank is allowed by the customer to apply for any credit balance to which the customer is then entitled in any account of the customer with the Bank at any of its branches in or towards satisfaction of any sum then due and payable from the customer to the Bank under this agreement.”¹¹⁸

xv) Notices and other Matters:

“According to Islamic house financing agreement every notice or other communication under this agreement is made in writing and delivered to the other party personally, or by courier or addressed to the relevant Party at its address stated above or to any telex or telefax number which is published as belonging to it (or such other address or telefax or telex number as is notified by one party to the other under this agreement). Every notice or other communication shall, subject as otherwise provided in this agreement be deemed to have been received in the case of a letter when delivered personally or three (3) days after it has been delivered to a courier company for delivery to the addressee and in the case of a telex at the time of dispatch with confirmed answer back of the addressee appearing at the beginning and end of the transmission or in the case of telefax when the recipient confirms by telex receipt of the transmission (provided that it shall be deemed to have been received at the opening of business on the next such business day)”.

¹¹⁷ Diminishing Musharakah Manual of Meezan Bank Limited, p.19

¹¹⁸ Ibid.

Under this agreement No failure or delay on the part of the Bank to exercise any power, right or remedy shall operate as a waiver, nor shall any single or partial exercise by the Bank of any right, power or remedy prevent any other or further exercise thereof or the exercise of any other right, power or remedy. The remedies provided in this agreement are not exclusive of any remedies given by law.¹¹⁹

xvi) Jurisdiction:

“This agreement is governed by and interpreted in accordance with Pakistan law so far as such law does not go against the Islamic principles of Shariah as determined by the “Shariah Supervisory Board” of the Bank. All competent courts at Islamabad also have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings that arise out of or are in connection with this agreement. Under this agreement, Banking courts may recover the amounts payable by the customer to the bank as mentioned in the financial institutions (Recovery of Finances) Ordinance, 2001”.¹²⁰

1.11.2 Monthly Payment Agreement

Salient Features of Monthly Payment Agreement:

By MBL diminishing Musharakah house financing the Bank and the Customer agree inter alia to participate on the basis of Musharakah in the acquisition of the Musharakah property. The Musharakah property is in the name of the customer and the customer agrees to be bound by the terms of this monthly payment agreement in respect of matters related to the Musharakah property.

¹¹⁹ Diminishing Musharakah Manual of Meezan Bank Limited,p.21

¹²⁰ Ibid.

The parties further agree that the customer shall use and occupy the Musharakah property and to the extent of the Bank's Musharakah share the customer shall pay a monthly payment to the Bank upon the terms and conditions set out.¹²¹

i) Musharakah Property:

Notwithstanding that the Musharakah property is in the name of the customer, the parties agree that in consideration of the Bank's Musharakah share, the customer's rights in respect of the Musharakah property shall be qualified as laid down in this monthly payment agreement and the master agreement.

The customer has the exclusive use and occupation of the Musharakah property for residential purposes only against the monthly payments.

In cases where the Musharakah property is under construction or renovation of any kind by the customer, it shall be deemed to be in the use and occupation of the customer.¹²²

The customer can not assign, transfer, convey, encumber, charge or otherwise alienate any of its rights in respect of the Musharakah property or otherwise part with the possession of the Musharakah property during the term of this agreement.

The customer hereby represents and covenants as follows:

- a) That the customer shall permit the Bank and/or the Bank's representatives and agents to inspect the Musharakah property on the Bank giving to the customer twenty four (24) hours prior notice in writing.
- b) That the customer shall pay all bills for utilities in respect of the Musharakah property, whether for a period prior to or after the effective date.

¹²¹ Diminishing Musharakah Manual of Meezan Bank Limited,p.22

¹²² Ibid.

c) That the customer shall pay all taxes, charges, demands and levies that are imposed in respect of the Musharakah property whenever, including without limitation for any period prior to the effective date, and by whomsoever levied, including without limitation, property tax.¹²³

ii) Obligation to pay monthly payments:¹²⁴

The customer is bound to pay to the Bank the monthly payment in respect of the use and occupation of the Musharakah property to the extent represented by the Bank's share in the property. The customer shall pay to the Bank the monthly payment on the monthly payment dates. The monthly payment schedule applicable for each year, after the first year shall be provided by the Bank to the customer. The customer's obligation to make the Monthly Payments shall continue for the Term.¹²⁵

iii) Variation of monthly payments:

The amount of the monthly payment remains fixed for the first one (1) year period from the effective date hereof, after which the Bank shall vary the monthly payments, to the extent that such variation is required in terms thereof.

The Bank shall vary the monthly payment on the first day of each year subsequent to the first year and in the event of such a variation an amended schedule of monthly payments for each subsequent year appearing shall be provided to the customer.¹²⁶

¹²³ Diminishing Musharakah Manual of Meezan Bank Limited,p.23

¹²⁴ "Monthly payment" means the amounts to be paid by the customer to the Bank for the right to use and occupy the Musharakah property to the extent of the share of the Bank in the Musharakah Property.

¹²⁵ Diminishing Musharakah Manual of Meezan Bank Limited,p.24

¹²⁶ Ibid.

iv) Payment and accounts:

Under this agreement the customer is required to make all payments paid on the due dates to the Bank, these payments must not be incomplete or with any condition such as set off or counter claim etc, payments must be free of charge and unambiguous.

If at any time the customer is required to make any deduction or withholding in respect of taxes from any payment to the Bank under this monthly payment agreement, it shall promptly deliver to the Bank any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.¹²⁷

Without prejudice to any other rights of the Bank, in the event of a default in the payment of any amounts due under this monthly payment agreement, the customer hereby undertakes to pay a sum and an amount on such outstanding amounts remaining unpaid, at the rate of 1% for each day that such default continues. Such additional amount shall be utilized by the Bank for charitable and religious purposes. The customer hereby consents to such utilization of the said amount by the Bank, at its absolute discretion.¹²⁸

v) Events of default:

A default in payment of any monthly payment in terms of this agreement and/or the occurrence of an event of default under the master agreement, shall constitute a default under this monthly payment agreement as well and the bank shall thereupon become entitled to exercise all rights and remedies as provided in the master agreement upon

¹²⁷Diminishing Musharakah Manual of Meezan Bank Limited,p.26

¹²⁸ Ibid.

occurrence of an event of default. The bank may with out prejudice to any of its other rights at any time after the happening of an event of default by notice to the customer terminate this agreement.¹²⁹

vi) Purchase of Musharakah units upon termination:

The customer agrees and undertakes to purchase all the remaining Musharakah units from the bank immediately upon notification of an event of default. The Musharakah units shall be purchased by the customer at the outstanding buy out price in accordance with the terms of the master agreement.¹³⁰

vii) Security:

As security for the performance of the customer's obligations in accordance with the terms of this monthly payment agreement the customer shall create a mortgage by deposit of title deeds in respect of the Musharakah property in favour of the bank.¹³¹

viii) Setoff:

The customer authorizes the bank to apply any credit balance to which the customer is then entitled in any account of the customer with the bank at any of its branches in or towards satisfaction of any sum then due and payable from the customer to the bank under this monthly payment agreement.¹³²

ix) Notices and other matters:

“Every notice or other communication under this monthly payment agreement shall be in writing delivered personally, or by courier or addressed to the relevant party at its address

¹²⁹ Diminishing Musharakah Manual of Meezan Bank Limited,p.27.

¹³⁰ Ibid.

¹³¹ Ibid.

¹³² Ibid.

stated above or to any telex or telefax number which is published as belonging to it (or such other address or telefax or telex number as is notified by one party to the other under this monthly payment agreement). every notice or other communication shall, subject as otherwise provided in this monthly payment agreement be deemed to have been received in the case of a letter when delivered personally or three (3) days after it has been delivered to a courier company for delivery to the addressee and in the case of a telex at the time of dispatch with confirmed answer back of the addressee appearing at the beginning and end of the transmission or in the case of telefax when the recipient confirms by telex receipt of the transmission (provided that it shall be deemed to have been received at the opening of business on the next such business day)".¹³³

"Under this agreement No failure or delay on the part of the Bank to exercise any power, right or remedy shall operate as a waiver, nor shall any single or partial exercise by the Bank of any right, power or remedy prevent any other or further exercise thereof or the exercise of any other right, power or remedy. The remedies provided in this agreement are not exclusive of any remedies given by law".¹³⁴

x) Jurisdiction:

"This monthly payment agreement is governed by and interpreted in accordance with Pakistan law so far as such law does not go against the Islamic principles of Shariah as determined by the "Shariah Supervisory Board" of the Bank. All competent courts at Islamabad also have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings that arise out of or are in connection with this agreement". "Under

¹³³Diminishing Musharakah Manual of Meezan Bank Limited,p.30.

¹³⁴ Ibid.

this agreement, banking courts may recover the amounts payable by the customer to the bank as mentioned in the financial institutions (Recovery of Finances) Ordinance, 2001".¹³⁵

1.11.3 Undertaking to purchase Musharakah units

The letter of undertaking is to be construed in conjunction with the master agreement and the monthly payment agreement and terms and conditions set out in the master agreement are applicable to this letter of undertaking.

There shall be an event of default if the customer fails to pay any amount due. The bank may, without prejudice to any of its rights at any time after the happening of an event of default by notice to the customer, terminate the master agreement and the monthly payment agreement and this letter of undertaking. Upon a notice of termination being issued by the bank the customer agrees and undertakes to purchase the remaining Musharakah units from the bank immediately.

The outstanding buy out price applicable at the time of the purchase of the remaining Musharakah units are determined by valuation of the Musharakah property by a valuer of repute appointed by the bank.¹³⁶

In the case of failure on the customer's part to immediately purchase the remaining Musharakah units at the applicable outstanding buy out price in accordance with the provisions agreed upon, the bank at its discretion is entitled to proceed to enforce the security interest in the Musharakah property or otherwise for recovery of the amounts due to the bank under this letter of undertaking, the master agreement and the monthly

¹³⁵ Diminishing Musharakah Manual of Meezan Bank Limited, p.32.

¹³⁶ Ibid.

payment agreement including accrued and unpaid monthly payments, if applicable, plus costs, taxes and other dues payable and applicable to the Musharakah property.

upon realization of the security interest the bank may in its sole absolute discretion give to the customer the amounts corresponding to his share in the Musharakah and all dues of the bank under master agreement, monthly payment agreement and this letter of undertaking are received by the bank provided that in the sole opinion of the bank the default of the customer was due to unforeseen reasons such as an act of god, including permanent physical disability or other genuine reasons.¹³⁷

1.11.4 Letter of undertaking to sell Musharakah units

“Letter of undertaking to sell Musharakah units” is the agreement between the customer and MBL which describes that he may purchase the bank’s Musharakah’s share at the applicable outstanding buy out prices, at any time during the term but after the expiry of one year. The customer shall serve upon the bank a notice of at least ten (10) days of his intention to purchase all or any of the remaining Musharakah units.

The customer further undertakes that the outstanding buy out price applicable at the time of the purchase of the remaining Musharakah units shall be determined by valuation of the Musharakah property by a valuer of repute appointed by the bank.¹³⁸

¹³⁷Diminishing Musharakah Manual of Meezan Bank Limited,p.36

¹³⁸ Ibid.

1.11.5 Undertaking and Indemnity

By the document of undertaking and indemnity the customer undertakes to be faithful and to perform in a timely manner comply with requirements of the prudential regulations or other regulations as are from time to time notified by the state bank of Pakistan.¹³⁹

the customer further undertakes to indemnify MBL against all proceedings claims penalties, expenses and liabilities whatsoever which may be taken or made against or imposed upon by the state bank of Pakistan from time to time or are otherwise incurred by MBL by reason of the customer's failure to comply with his undertaking.

the customer further undertakes to indemnify MBL against any and all penalties which may be imposed on MBL by the state bank of Pakistan from time to time in case of any violation of the specific requirements of the said prudential regulations or other directives of the state bank of Pakistan where such violation has taken place by the customer's failure to comply with the requirements of the said prudential regulations.¹⁴⁰

The customer further undertakes that it is his duty to ascertain the current prudential regulations and any changes therein from time to time and ignorance on his part of the said regulations or any changes therein will not in any manner affect his above stated indemnity obligations MBL.¹⁴¹

1.11.6 Memorandum of deposit of title deeds

By the memorandum of deposit of title deeds the customer confirms and records in writing that at his request MBL has agreed to extend to use banking facilities and financial accommodation by way of housing finance from time to time pursuant to a master

¹³⁹ Diminishing Musharakah Manual of Meezan Bank Limited, p.40

¹⁴⁰ Ibid.

¹⁴¹ Ibid.

agreement, a monthly payment agreement, an undertaking to purchase Musharakah units and other agreements, against the security interalia of a mortgage by deposit of title deeds upon the property.¹⁴²

In this memorandum the customer further assures that he has deposited documents listed with the intention of creating a mortgage by deposit of title deeds related to the mortgaged property for the purpose of securing the repayment of the facility along with profits, damages, liquidated damages and all other charges, commissions, costs and expenses and any other payment(s) due to MBL under the facility.¹⁴³

the customer further assures that he is the sole and absolute owner of the mortgaged property with full power and right to transfer and no one else has any right, or title to, or interest in, or encumbrance whatsoever over the mortgaged property or any part of it.

The customer also assures that he will not create any further encumbrance upon or in respect of the mortgaged property with out the prior written consent of MBL.¹⁴⁴

¹⁴² Diminishing Musharakah Manual of Meezan Bank Limited,p.42

¹⁴³ Ibid,p.45

¹⁴⁴ Ibid.

Chapter No.2

Diminishing Musharakah

Section 2.1 Concepts used in Islamic Home and Property Financing:

Islamic home and property financing is not a new issue in today's Muslim world. The Islamic financing products have been emerging as one of the most demanded home and property financing scheme. Its competitive advantages have been recognized worldwide and today, not only Islamic financial institutions are offering these products and schemes but these have also grown rapidly in the Conventional financing institutions.¹

Islamic financing that has been applied by the Islamic banking provides methods or concepts in order to assist consumers to acquire their home or property in a manner consistent with Shariah. Among the popular concepts that are being practiced to acquire the home or property are:

- i) Diminishing Musharakah.²
- ii) Murabahah.
- iii) Bai Bithaman Ajil.
- iv) Ijarah.
- v) Ijarah Thumma AI-Bai.
- vi) Istisna'.³
- vii) Iqtina.

¹ Billah, Mohd. Ma'sum. "Islamic Model of Home Financing." *Journal of Islamic Banking & Finance*, Volume 25, (Jan-March 2008), 21.

² Usmani, Muhammad Taqi, *An Introduction To Islamic Finance*. (Karachi: Idaratul Ma'arif, 1998), 85

³ Billah, Mohd. Ma'sum. "Islamic Model of Home Financing." *Journal of Islamic Banking & Finance*, Volume 25, (Jan-March 2008), 21.

viii) Muqawalah or Istisna.

ix) Bay'ajil.⁴

2.1.1 Definition of Diminishing Musharakah:

It is a partnership between a financier or a bank and his client in which both share the equity capital. They contribute either in the joint ownership of a property or an equipment, or in a joint commercial venture. The share of the bank is further divided into a number of units. The client purchases the units of the bank's share, one by one, periodically and after a specific time period the client becomes the owner of the property.⁵

Islamic methods of financing, even when applied under conditions of underdevelopment financial markets, could provide a flexible portfolio for a financial institution dealing in housing finance.⁶

2.1.2 Background of Diminishing Musharakah in Islamic Fiqh:

In Islamic Fiqh the word "Musharakah" is used to denote the contract of "Sharikah".

"Sharikah" is the root word for "Musharakah".⁷

⁴ Islamic banking modes for house building financing, Islamic development bank.(Jedah:Islamic Research and Training Institute,1995),30

⁵ Anwar Muhammad. "Reorganization of Islamic Banking, A New Proposal."The American Journal of Islamic Social Sciences, (Volume 4: 2, 1987), 303.

⁶ Islamic banking modes for house building financing, Islamic Research and Training Institute(Jedah:Islamic development bank, 1995),65

⁷Usmani,Muhammad Taqi,Al Tijarah Wa Al iqtisad Al Muasir Fi Du Al Islam.Translated by Al arkani,Tahir Sadique.(Karachi:Idarat ul Quran Wal Islamiyah, 1998),133

2.1.3 The literal meaning of “Musharakah”:

The literal meaning of the word “Sharikah” is “sharing”, “jointly participate” or “joining”. It is a contract between partners to earn profit where their money or the capital is mixed in the way that it turns to be a mixture in the form of joint capital.⁸

2.1.4 The Technical meaning of “Musharakah” in Islamic Fiqh:

As far the technical meaning of “Musharakah” is concerned, In Islamic Fiqh the jurists from four major schools of thought differ at the technical meaning or the definition of Musharakah. The definitions from Hanafi, Maliki, Shafi and Hanbli schools are as follow:

i) Hanafi Definition:

The Hanafi school of thought defines Musharakah as:

“It is a contract where two or more than two partners jointly contribute the capital to earn profit.”⁹

ii) Maliki Definition:

The Maliki school of thought defines Musharakah as:

“It is a contract where all the partners give permission to the other for appropriation and disposition of a common thing with the retainment of the right to transact personally they jointly contribute the capital to earn profit.”¹⁰

⁸ Zuhili, Wahbah, *Al-fiqh-ul-islami wa adila to ho.* (Dar-ul-fikr, Dar-ul-fikr-almuasir) Vol.5, 3857. (hereinafter, Zuhili)

⁹ Al-Imam Ala-ud-Din Abi Bakar Masood-Al-Kasani, *Badai-Ul-Sanai Fi Tarteeb-Ul-Sharai.* (Karachi: H.M Saeed Company), 56 [Hereinafter, Kasani]

¹⁰ Ibn-Qadamah Al Muqadasi, *Shams-Uddin Ibi Al-Farj Abdul Rehman Bin Muhammad Bin Ahmad, Al Sharhul Kabir.* (Dar-Ul-Fikar) 14,3

iii) Shafi Definition:

The Shafi school of thought defines Musharakah as:

“It is the establishment of a right in a common object, which is held in common between two or partners.”¹¹

iv) Hanbli Definition:

The Hanbli school of thought defines Musharakah as:

“When two or more persons participate in the entitlement or disposition of a thing, it is called “Sharikah”.”¹²

Section 2.2 Legitimacy of Musharakah in Islamic Fiqh:

Musharakah is permitted in Islam. Its permissibility is proved by;

The Holy Quran, Sunnah of Holy Prophet Muhammad (PBUH) and Ijma or Consensus of the scholars.¹³

2.2.1 The Holy Quran:

“Verily many are the partners in business who wrong each other except those who believe and work deeds of righteousness and how few are they.”¹⁴

2.2.2 Sunnah of Holy Prophet Muhammad (PBUH):

“Allah Almighty is with the two partners unless they defraud each other.”¹⁵

¹¹Shams-Uddin Muhammad Bin Abbi Abbas, Nihayatul-Muhtaj-Ila-Shar-Al-Minhaj. (Dar-UI-Fikar) 5,3 also

Aashour, Ahmad Eesa, ALfiq-ul Muyassar fi Alabadat Wa Almuamalat. (Kahirah: Maktaba Al-Quran), 38

¹²Ibn-Qadamah, Abi Muhammad Abdullah Bin Ahmad Bin Muhammad, Al-Mughni. (Riad: Maktaba Alriad Al-Hadeesa), 5, 1 [Hereinafter, Al-Mughni]

also,

Abu Ghadah, Abdul Satar, Alashkar, Muhammad, Sulaiman, Muajam Al Fiqh-ul Hanbli. (Wazara-tul Auqaf Wa Shauon Al-Islamia), 479

¹³Sabiq, Al Sayed, Fiqh Al Sunnah. Vol.3, 178

¹⁴Al-Qur'an, 38:24

¹⁵Ibn Qadamah, Al-mughni, vol 5, p.3.

2.2.3 Ijma or Consensus of the scholars:

Legitimacy of Musharakah is also proved by the Consensus of the scholars or the Practice of the Muslim community, but there is a difference of opinion among the four major school of thought upon the legitimacy of different types of Musharakah.¹⁶

Section 2.3 The Theory of Musharakah:

The formation of partnership may result from either:

i) “Shirkat ul-ibahah”:

This is the Natural partnership.¹⁷

ii) “Shirkat ul-milk”:

This is the Partnership in ownership by virtue of the law. This type of partnership can be further divided into two types:

a) By the partners choice (Shirkah ul Ikhtiyariah) and

b) Without the partners choice (Shirkah Jabariah)

a) By the partners choice (Shirkah ul Ikhtiyariah):

This is the “Optional ownership” between the parties. It comes into existence by the voluntary act of both the parties. For instance, a person A gifts a car to B and B accepts it so they both enter into a relationship based upon “Optional ownership”.¹⁸

¹⁶Zuhili, 3877.

¹⁷Sabiq, Al Sayed, Fiqh Al Sunnah. Vol.3, 356

¹⁸Ibid.

b) Without the partners choice (Shirkah Jabariah):

This is the “Compulsory ownership”. It comes into existence without the voluntary act of both the parties, like the inheritance is transferred to the heirs even if they do not want to have the property of the person dead.¹⁹

iii) “Shirkat al-aqd”:

This is the Partnership based on a contract amongst two parties.

The contractual partnership is the most relevant type of partnership

In Islamic finance operations.²⁰

2.3.1 Distribution or Types of Shirkat al-aqd in Islamic Fiqh:

2.3.1.1 Hanafi Distribution of Shirkat al-aqd:

Hanafi school of thought divides Shirkat al-aqd into six types:

- i) Shirkahat-amwal by way of Mufawadah
- ii) Shirkahat-amwal by way of Inan.
- iii) Shirkahat-amal by way of Mufawadah
- iv) Shirkahat-amal by way of Inan
- v) Shirkahat-wujuh by way of Mufawadah
- vi) Shirkahat-wujuh by way of Inan²¹

¹⁹ Muhammad Assaf, Ahmad, Al-Ehkaam-ul-Fiqhia Fi Almazahib Al-Islamia Al-Arbaa. (Dar-ul-ahya al-aloom) Vol.5, 166.

²⁰ Bakar Mohd Daud, Shirkah (Partnership) & Islamic Finance. International institute of Islamic finance (IIF)

²¹ Zuhili, 3878

2.3.1.2 Hanbli Distribution of Shirkat al-aqd:

Hanbli school of thought divides Shirkat al-aqd into five types:

- i) Shirkahat al-inan.
- ii) Shirkahat al-aml.
- iii) Shirkahat al- Mufawadah
- iv) Shirkahat al- wujuh.
- v) Shirkahat al-Mudaraba.²²

2.3.1.3 Maliki and Shafi Distribution of Shirkat al-aqd:

Maliki school of thought divides Shirkat al-aqd into four types:

- i) Shirkahat al-inan.
- ii) Shirkahat al- wujuh.
- iii) Shirkahat al- Mufawadah
- iv) Shirkahat al- abdan²³

Section 2.4 Other Modern Forms of Musharakah applied by the Islamic Banks:

In a declining musharaka, the bank's share in the equity is diminished each year through fractional return of capital. The bank obtains periodic profits based on its condensed equity share that remains invested during the period. The share of the client in the capital gradually increases over time, ultimately resulting in absolute ownership of the enterprise.²⁴

²² Abu Ghadah, Abdul Satar, Alashkar, Muhammad, Sulaiman, Muajam Al- Fiqh-ul Hanbli. Mustakhlas Min Kitab-Al Mughni Li Ibn-e-Qadamah. (Wazara-tul Auqaf Wa Shauon Al-Islamia), 479

²³ Zuhili, 3878

²⁴ Obaidullah, Mohammed, Islamic Financial Services. (Jeddah: Islamic Economics Research Center, 2000), 59

The DM contract combines the prime characteristics of the sale and sharing contracts: it transfers ownership through sale and does so through profit sharing arrangement this fact makes the DM as a special contract. Similarly, because of the sharing feature of the contract the financier's interest in the project is enhanced. This leads to consistency in the objective functions of the two parties.²⁵

i) The Continuous Musharakah:

This is where an Islamic bank enters into a joint venture with a partner (s) for establishing and running an industrial, agricultural and services project, be it on a small, medium or big scale. The intention is to continue running the business as long as it is conforming to their objectives. Musharaka as a model of finance is, indeed, governing the contractual relationship of the parties.²⁶

ii) Musharakah in Working Capital:

Continuous Musharika has not been widely practiced, more so during periods of inflation, where assets ostensibly seem to appreciate and money depreciates. Under these circumstances and perhaps others businessmen prefer to have their own business. They would rather solicit the assistance of banks to provide them with the working capital. In the situation where the business enterprise affords to avail part of the working capital, it may seek the participation of an Islamic bank to provide the other part through

²⁵ Economics of Diminishing Musharakah.(Jeddah:Islamic Research and Training Institute[IRTI]), 49

²⁶ Memon, Noor Ahmed.“Islamic Banking Products Finds Worldwide Acceptability.” Journal of Islamic Banking & Finance, Volume 25, (Jan-March 2008), 49.

Musharakah in the working capital (M.W.C.) the rules governing this type of Musharika are more or less the same as those regulating Continuous Musharakah.²⁷

Section 2.5 House financing on the basis of diminishing Musharakah:

House financing on the basis of diminishing Musharakah comes into form by the following steps:

- i) Joint ownership (Shirkat-ul-Milk) between the parties.
- ii) Lease agreement.
- iii) Promise to purchase Musharakah units by the client.²⁸

i) Joint ownership (Shirkat-ul-Milk) between the parties.

The first step in the house financing on the basis of Diminishing Musharakah is creating a joint ownership in the property which is called 'Shirkat-ul-Milk' (joint ownership).

Shirkat-al-Milk or joint ownership comes into existence in many different ways which includes joint purchase by the parties. This has been specifically allowed in Shariah.

The type of Shirkat-ul-Milk applicable in DM is Optional or Ikhtiari, where two or more persons purchase a property.²⁹

ii) Lease agreement.

In the second step the financier leases his share in the house to the client and charges rent from him. This arrangement is also permitted by all schools of Islamic jurisprudence.³⁰

²⁷Al Abdulla,Ahmed, The Application of Musharakah (Partnership) Mode Of Finance In Islamic Banks(Bank Of Sudan), Journal of Islamic banking and Finance Volume 25, (Jan-March 2008),305

²⁸ Ibid.

²⁹Ibn-e-Abidin,Radd-al-Muhtar aala addar-ul-mukhtarI.(Beirut:Ahya Atara-sul Arabi),3,343

³⁰ Sabiq,Al Sayed,Fiqh Al Sunnah.Vol.3,178

iii) Promise to purchase Musharakah units by the client.

In the third step of house financing on the basis of Diminishing Musharakah the client is allowed to make a promise to purchase different units of the share of the bank.

It is generally believed that promises can not be enforced through courts of law because a promisor has only a moral obligation to fulfill it, but many Muslim jurists are of the opinion that promises can be enforceable, specially in the context of commercial activities as the court of law can compel the promisor to fulfill his promise.

It is obvious now that making a separate promise without making it a condition and putting a condition in the sale are two entirely different things. It is also quite clear that an independent and separate promise to purchase does not make the actual contract conditional.³¹

Section 2.6 Draft Instructions and Guidelines for Shariah Compliance by Institute of Islamic Banking and Insurance (IBI):

Diminishing Musharika (DM) is a form of co-ownership in which two or more persons share the ownership of a tangible asset in an agreed proportion and one of the co-owners undertakes to buy in periodic installments the proportionate share of the other co-owner until the title to such tangible asset is completely transferred to the purchasing co-owner.³²

³¹ Al Abdulla,Ahmed, The Application of Musharakah (Partnership) Mode Of Finance In Islamic Banks(Bank Of Sudan), Journal of Islamic banking and Finance Volume 25, (Jan-March 2008),305

³² Ibid.

- i) Diminishing Musharika is restricted to the specified Assets and not to the whole business. It is created in tangible assets only.³³
- ii) A DM agreement consists of three steps, i.e. creating joint ownership between the owners, renting out one partner's share to the other, and selling the property in periodic installments to the other partner.³⁴
- iii) Ijarah and sale may be fulfilled in respect of different stages in the process of DM arrangement as all other terms and conditions are crucial to co-ownership.³⁵
- iv) It is a compulsion to know and define the Proportionate share of each partner in terms of investment.³⁶
- v) The partners in the proportion of their partnership shall jointly bear the expenses incidental to ownership.³⁷
- vi) The partners shall bear the loss in the proportion of their respective investments.³⁸
- vii) The partners shall also share risk and reward in proportion to their investment.
- viii) As the purchasing partners purchases the ownership units, the amount of periodic payment would go on decreasing.³⁹
- ix) A separate transaction of sale shall be constituted for each periodic payment.

³³<http://www.sbp.org.pk/press/Essentials/Essentials-draftinstructions.htm>. Last visited: 12-12-09

³⁴ Ibid.

³⁵ Ibid.

³⁶ Ibid.

³⁷ Ibid.

³⁸ Ibid.

³⁹ Ibid.

- x) All contracts are to be presented in a way that each contract remains independent of the other in order to make sure that each agreement is a separate deal.⁴⁰

In the sequence of the arrangement of DM contract, first of all there needs to be an agreement of partnership between the parties. Then there shall be a lease agreement where one partner will lease out his share in such property to the other for an agreed rental in consideration.⁴¹

- xi) If a partner becomes unsuccessful to credit his undertaking, with regard to sale of units or the periodic payment and purchase as the case may be, the asset will be sold in the open market and the partner distressed by such breakdown shall be entitled to recuperate.⁴²

2.6.1 Definition of Partnership in Pakistani Law:

The Partnership Act 1932, defines Partnership as:

“A relationship between persons who agree to share the profits of a business carried on by all or any of them acting for all”.⁴³

Section 2.7 The concept of “Ijarah” in shariah prospective:

In Diminishing Musharakah house financing procedure at the second stage of the arrangement, the financier leases his share in the house to his client and charges rent from him. In recent times Interest free banking has appeared as the most powerful method of banking in Pakistan.⁴⁴

⁴⁰ <http://www.sbp.org.pk/press/Essentials/Essentials-draftinstructions.htm>. Last visited: 12-12-09

⁴¹ Ibid.

⁴² Ibid.

⁴³ The Partnership Act 1932

⁴⁴ Memon, Noor Ahmed. “Islamic Banking Products Finds Worldwide Acceptability.” *Journal of Islamic Banking & Finance*, Volume 25, (Jan-March 2008), 49.

2.7.1 The literal meaning of “Ijarah” In Islamic Fiqh:

Ijarah literally means, "To obtain the services of assets (human or physical) in return for rent." In the Islamic jurisprudence, the term Ijarah is used for similar meaning.⁴⁵

2.7.2 The Technical meaning of “Ijarah” In Islamic Fiqh:

The jurists have formulated various definitions of Ijarah having regard to its principle features. The definitions from Hanafi, Maliki, Shafi and Hanbali schools are as follow:

i) Hanafi Definition:

The Hanafi school of thought defines Ijarah as:

“It is contract on usufructs for a known consideration”.⁴⁶

ii) Shafi Definition:

The Shafi school of thought defines Ijarah as:

“It is a contract on a known and permissible benefit in exchange of a known return.”⁴⁷

iii) Maliki Definition:

The Maliki school of thought defines Ijarah as:

“It is an alienation of lawful usufructs for a fixed charge for a fix period”. For the Maliki Ibn Rushd says, “ijarah resembles a sale contract whereby price and use are exchanged.”⁴⁸

⁴⁵ Usmani, Muhammad Taqi, An Introduction To Islamic Finance. (Karachi: Idaratul Ma'arif, 1998), 156

⁴⁶ Kasani. vol.4, 174.

⁴⁷ Shirbini, Mughni al-Muhtaj, vol.2, 332.

⁴⁸ Ibn Qadamah, vol5, 398.

iv) Hanbali Definition:

The Hanbali school of thought defines Ijarah as:

“Ijarah is contract for the lawful and defined use of a lawful and determined corporeal object for a specific period of time. It is also defined as providing a defined work for a fixed price”.⁴⁹

Sectin 2.8 Legitimacy of Ijarah in Islamic Fiqh:

Ijarah is permitted in Islam. Its permissibility is proved by;

The Holly Quran, Sunnah of Holly Prophet Muhammad (PBUH) and Ijma or Consensus of the scholars.

2.8.1 The Holly Quran:

“And if they suckle your (offspring) give them their recompense.”⁵⁰

2.8.2 Sunnah of Holly Prophet Muhammad (PBUH):

“The Holly Prophet (PBUH) Said “Give wages of the person hired before his sweat dries up.”⁵¹

2.8.3 Ijma or Consensus of the scholars:

All the companions of the Holy Prophet (PBUH) unanimously held that ijarah is a lawful contract, They themselves practiced all lawful forms of this contract. In the shariah permissibility of Ijarah has been constructed on Istihsan.⁵²

⁴⁹ Bahuti, al-Rawd al-Murbi, 214.

⁵⁰ Al-Qura, 65:6.

⁵¹ Mansoori, Tahir. Islamic law of contracts and business transactions. (Islamabad: Shariah academy, 2000), 230

⁵² Mansoori, Tahir. Islamic law of contracts and business transactions. (Islamabad: Shariah academy, 2000), 230.

2.8.4 Types of Ijarah in Islamic fiqh:

There are two types of Ijarah in Islamic fiqh, these are:

i) Ijarah Ala Al aamaal:

It means, "to employ services of a person in return for an agreed wage rate." The employer is called "musta'jir" while the employee is called "ajeer".

Examples: if one employs another in his office as a clerk for a monthly salary the transaction between the parties is termed as Ijarah. The person whose services are hired could be a laborer, a physician, a teacher, a lawyer, or any other person who can provide some helpful services.⁵³

ii) Ijarah Ala Al-Manafe:

This type of Ijarah is related to the usufructs of assets and properties, and not to the services of human beings. Ijarah in this sense means, "To transfer the usufruct of a particular property to another person in exchange for rent." In this case, the term Ijarah is similar to the English term "leasing".⁵⁴

Here the lessor is called "Mu'jir" the lessee is called "musta'jir". The rent payable to the lesser is called "ujrah". Ijarah is an influential tool, as it can be a simple monetary activity or a mode of finance.⁵⁵

⁵³ Zuhili, 3803

⁵⁴ Ibid. 3837

⁵⁵ http://www.accountancy.com.pk/docs/islam_ijarah.pdf, Last Visited: 20-12-09
also available on:

<http://www.alhudacibe.com/images/Presentations%20on%20Islamic%20Banking%20and%20Finance/Ijarah/Ijara%20%20by%20Zubair%20Usmani.ppt>, Last Visited: 20-12-09.

2.8.5 Some important principles of ijarah:

- i) The agreement of Ijarah can have an effect for a future date, unlike the contract of sale. Thus, it is different from Murabaha.⁵⁶
- ii) Rent ought to be charged after the delivery of the leased asset to the lessee. If the supplier has delayed the delivery after receiving the full price, the lessee should not be liable for the rent of the period of delay.⁵⁷
- iii) Only recognized, valuable and countable objects can be subject matter of a lease, consumable things cannot be leased out. Anything which cannot be used without consuming cannot be leased out; e.g., wheat, money etc.⁵⁸
Usufruct is to be transferred to another person for an agreed price, at an agreed consideration, not the ownership,⁵⁹
- iv) If the lessor, on the specified date in the ijarah contract, fails to deliver the asset to the lessee, no rental is owed for the period between the contract date and the date of actual delivery, and the rental should be condensed consequently, unless it is agreed that the lease be extended by an corresponding period after its actual termination date.⁶⁰

⁵⁶ Dr. Usmani, Muhammad Zubair. Sharia Advisor
Muslim Commercial Bank Ltd (Karachi: Jamia Darul Uloom)
<http://www.alhudacibe.com/images/Presentations%20on%20Islamic%20Banking%20and%20Finance/Ijarah/Ijarah%20by%20Zubair%20Usmani.ppt>, Last visited: 25-12-09

⁵⁷ Al-Mughni, 454.

⁵⁸ Zuhili, 3809

⁵⁹ Shams-Uddin Muhammad Bin Abbi Abbas, Nihayatyl-Muhtaj-Ila-Shar-Al-Minhaj. (Dar-Ul-Fikar, 1984) 5, 298

⁶⁰ Shariah Standards. Accounting and Auditing Organization for Islamic Financial Institutions, AAOIFI. (Bahrain: Manama), 141

v) The lessor is liable to be compensated for every harm to the leased asset caused by any misuse or carelessness of the lessee.⁶¹

vi) The amount of rent must be determined at the time of contract for the whole period of lease. It is permissible that different amounts of rent are fixed for different phases during the lease period, provided that the amount of rent for each phase is specifically agreed upon at the time of effecting a lease.⁶²

Rental will be charged when the Leased asset is handed over to the lessee.⁶³

vii) If the lessee shatters any term of the agreement, the lessor has a right to end the lease contract unilaterally. If not then it can be terminated through mutual consent only. However, in such a case he cannot charge rentals of remaining period. Further more, the destruction of the asset also terminates the lease. In the event of lessee's death the lease will also be terminated.⁶⁴

viii) In the case of the Ijarah, the lessor assumes the full risk of the whole leased asset. If the asset is damaged during the "Ijarah period", the lessor will suffer the loss. Likewise, if the leased asset loses its usufruct without any exploitation or carelessness on the part of the lessee, the lessor cannot claim the rent. The lessor may take out permissible insurance on the leased asset and such insurance

⁶¹ Shariah Standards. Accounting and Auditing Organization for Islamic Financial Institutions, AAOIFI. (Bahrain: Manama), 141

⁶² Dr. Usmani, Muhammad Zubair. *Sharia Advisor, Muslim Commercial Bank Ltd (Karachi: Jamia Darul Uloom)*

⁶³ Zuhili, 3823

⁶⁴ Ibid.

expenses must be borne by the lessor. The lessor may also bestow to the lessee the task of taking out insurance at the lessor's expense.⁶⁵

Section 2.9 Shariah issues involved in Diminishing Musharika of Islamic Banks:

Some of the people and a group of religious scholars too assert that the present Islamic banking Practices are unIslamic and inconsistent with the principles of shariah. In this section some major objections regarding DM and Islamic banks are discussed and analyzed, to see whether the current interest-free banking is shariah compliant or otherwise.

2.9.1 First Issue:

DM contract of Islamic banks is based upon Sharikat ul- Milk and not on Sharikat ul- Aqd.

Analysis of issue:

The first step in the house financing on the basis of Diminishing Musharakah is creating a joint ownership in the property which is called 'Shirkat-ul-Milk' (joint ownership).

Shirkat-al-Milk or joint ownership comes into existence in many different ways which includes joint purchase by the parties. This has been specifically allowed in Shariah.⁶⁶

Sharikat ul- Aqd is the Partnership based on a contract amongst two parties.

⁶⁵ Shariah Standards. Accounting and Auditing Organization for Islamic Financial Institutions, AAOIFI. (Bahrain: Manama), 142

⁶⁶ Ibn-e-Abidin, Radd-al-Muhtar aala addar-ul-mukhtar. (Beirut: Ahya Atara-sul Arabi), 3, 343

The type of Shirkat-ul-Milk applicable in DM is Optional or Ikhtiari, where two or more persons purchase a property.

Here this relationship has come into existence at their own option, as they themselves elected to purchase the property jointly.

Partnership by joint ownership means joint ownership of two or more persons in a particular property. The partners may not make use of or distribute the money or joint property without the permission of all parties.

Shrikat al-milk is defined by the Majallah as “the existence of a thing in the exclusive joint-ownership of two or more persons due to any reason of ownership or it is the joint claim of two or more persons for a debt that is due from another individual arising from a single cause.

In this type of Sharikah each and everyone has ownership in every smallest part of the capital. The property, which is difficult to divide and distinguish, forms the subject matter of a proprietary partnership.⁶⁷

Some important rules relating to Sharikat ul- Milk;

- i) The partners are not allowed to undertake any act of disposal with respect to the other’s share except with the latter’s permission.
- ii) Each partner can sell his own share without the other partners consent, except in cases where share of one partner can not be distinguished from the other.⁶⁸
- iii) The share of one partner in the possession of another co-owner is governed by the rules of wadiah (Deposit). If one co-onwer further deposits Such property

⁶⁷Mansoori, Tahir. Islamic law of contracts and business transactions.(Islamabad: Shariah academy),2000,244-245.

⁶⁸ Ibid.

with a third party without the permission of his partner, He is liable for compensation (daman) if the property is destroyed.

- iv) Right to demand the recovery of a debt belongs to each con-owner jointly and severally. A debt possessed by one partner is governed by the rules of Sharikat ul –Milk. Further, postponement of the recovery of a debt can not be granted by one co-owner without the permission of the other.

These are some of the attributes which are exclusively related to Sharikat ul- Milk and make it different from Sharikat ul- Aqd, and at the first step of DM arrangement a joint ownership in the property is created between the parties in the form of Shirkat-ul-Milk.⁶⁹

2.9.2 Second Issue:

Another issue raised at the contract of DM is that it is a mixture or combination of two or more contracts which is called “combination of contracts” or Baitan-fi-Bayah .Such type of contracts are prohibited in Shariah.

Analysis of issue:

Firstly, it is important to understand the concept of “combination of contracts” in Islamic Fiqh and than I will describe its implementation in DM contract.

A Hadith of Holly Prophet Muhammad (PBUH) clearly prohobits the combination of two contracts in one contract.Accorind to another Hadith two conditions imposed upon one contract are also prohibited in Shariah.

⁶⁹ Mansoori, Tahir. Islamic law of contracts and business transactions.(Islamabad: Shariah academy),2000,244-245.

If two or more contracts are combined in a way that every contract is conditional upon the other, this is called combination of contracts.⁷⁰

Meaning of two conditions in sale and two transactions in one:

The tradition prohibiting the two conditions and two transactions referred to above has been interpreted by the jurists in a number of ways, "sarakhsi" a Hanafi jurist, commenting on the tradition says.⁷¹

"The description of the two conditions in sale is to say (so much for cash and so much for delay) the contract here is fasid because the buyer did not specify the price at which he has agreed to purchase goods. Thus the case of irregularity of this contract is indeterminacy with regard to price of goods".

In regard to the legal status of two transactions in one imam shafi is reported to have stated his opinion in the following words.⁷²

"It carries two interpretations: first I sold you this commodity for two thousand on credit and one thousand in cash and sale is binding and irrevocable at one of the two prices the sale is void because contract is contingent upon an unspecified thing. Second I sell you my house on the condition that you sell your horse to me this is invalid because it involves exploitation of buper who is compelled to purchase a thing. Which he does not

⁷⁰ Siraj, Muhammad Ahmad A. Hadi. Mudharabah, Musharakah and Ijarah Lessons in Islamic Economics,(Islamic research and training institute, Islamic Development Bank), 87 .

⁷¹ Ibid.

⁷² Siraj, Muhammad Ahmad A. Hadi. Mudharabah, Musharakah and Ijarah Lessons in Islamic Economics,(Islamic research and training institute, Islamic Development Bank), 87

want. It also contains gharar because the seller does not know whether the second sale will take place or not”.

This sale is invalid in the Hanbali School as well because of the element of Gharar.⁷³

If the question is whether the combination of sale and lease contract in DM is allowed or not?The answer is that if all these transactions have been combined by making each one of them a condition to the other, then this is not allowed in Shariah, because it is a well settled rule in the Islamic legal system that one transaction cannot be made a pre-condition for another. However,in DM contracts Islamic banks and HBFC use different contracts of lease and sale,they do not combine the contracts in one single contract.⁷⁴

2.9.3 Third Issue:

In DM house financing contract the bank gives the property to the customer on Ijarah,than customer is bound to purchase bank's share one by one. This issue is about Ilzamia tul- wa'ad or the binding nature of the contract in DM, as it is not permissible in Shariah to make a promise for a future contract than what is the status of such a promise in Shariah.

Analysis of issue:

To understand the situation it is important to describe the meaning of some of the related terms which are often misunderstood.

⁷³ Mansoori, Tahir. Islamic law of contracts and business transactions.(Islamabad: Shariah academy,2000),160.

⁷⁴ Ibid.

Contract ('aqd): When a matter comes into existence by performance of the parties it is called Aqd. For example in the contract of sale when the buyer sells his commodity in exchange to the price determined, the ownership is transferred to the seller from the buyer. In the result all rights and liabilities of both parties are to be granted by each other. There is no point of difference among Muslim jurists on such Aqd. Contract ('aqd) is legally binding in Shariah.⁷⁵

Promise (wa'ad): It is generally accepted that a wa'ad means a unilateral promise or "to pledge" or "to firmly intend", in the context of commercial dealings. A promise (wa'ad) is not binding, except in the case of a vow or a promise made under oath before God, however, such a vow or a promise under oath is binding in religion only (and not in law) and even then, the oath may be broken for good. If a person affirms to perform or restrain himself from performance of a certain act it is called a unilateral promise. Failing to undertake a promise is a sin but it would be binding at the moral level only, it is not enforceable by the Islamic courts.

In fact It is this unilateral nature of the wa'ad that potentially makes it a very functional and flexible means in structuring Sharia-compliant transactions.

There are the following three extensive views on the enforceability of the wa'ad. These views are based on different Shariah schools of thought.⁷⁶

- i. According to the first view a wa'ad is not enforceable by law. Fulfilling a

⁷⁵ Iqbal, Munawar. A Guide to Islamic Finance. (Islamabad: Laurie Donaldson, 2007), 6

⁷⁶ Usmani, Muhammad Taqi, Ghair Soudi Bankari. (Karachi: Quranic studies publishers), 157

promise is dignified act but that is not Wajib or obligatory. This view belongs to Imam Abu Hanifah, Imam Al-Shafai', Imam Ahmad and several Maliki jurists.⁷⁷

- ii. According to the second view A wa'ad is legally enforceable as the promisor is under a moral as well as a legal responsibility or obligation to honour his promise. This view is belongs to Samura bin Jundab, Umar bin Abd al-Aziz, Hasan al-Basri, Said bin al-Ashwa, Ishaw bin Rahayawh, Ibn Shubrumah, Imam Bukhari, Ibn al-Shat , Ibn Arabi and al-Ghazzali.⁷⁸
- iii. According to the third view fulfilling a wa'ad is obligatory, if the case requires some difficulties for the unilateral promisee. It means that he utilizes some of his resources which can not be acquired back or he case he incurs a cost. For instance, if the promisor says to the unilateral promisee to get married and promises to give him Rs 10,000 if he does so. If the promisee performs such act on his provocation the promisor is duty-bound to fulfill his unilateral promise (wa'd). This view is the famous view of Imam Malik.⁷⁹

The Islamic fiqh academy has made the promises in commercial dealings binding on the promisor with the condition that: "the promise must have caused the promisee to incur some liability. If the promise is to purchase something, the actual sale must take place at the appointed time by the exchange or offer and acceptance. Mere promise itself should

⁷⁷ Usmani, Muhammad Taqi, Ghair Soudi Bankari. (Karachi: Quranic studies publishers), 157

⁷⁸ Ibid, 160.

⁷⁹ Ibid, 138-139

not be taken as the concluded sale. If the promisor backs out of his promise, the court may force him either to purchase the commodity or pay actual damages.”⁸⁰

2.9.4 Fourth Issue:

Islamic banks also use KIBOR as bench mark like conventional banks as a standard to determine their profit and rent etc, which is an interest based standard.

Analysis of issue: To understand the situation it is important to describe some of the related issues which are often misunderstood.

The State Bank of Pakistan (SBP) and the Pakistan Banks Association (PBA) asked the banks to use Karachi Interbank Offered Rate (KIBOR) of one, three, six month and longer tenures, as made available, as the benchmark rate for all corporate lending in Rupee after 31st January, 2004. The motive behind making it benchmark was to encourage transparency, promote consistency in market based pricing and improve management of the market risk undertaken by banks.⁸¹

KIBOR is “Karachi inter bank offer Rate”, given by specialized institution on daily, weekly, monthly and on 1,2 and 3 yearly basis to all the commercial banks of Pakistan so that they charge interest to their customers on that basis. This rate is inflation adjusted rate and then banks by adding 2 or 3% in KIBOR rate charge their customers for their profit. KIBOR has also been defined as the “Average rate, for the relevant tenure”.⁸²

⁸⁰ Usmani, Muhammad Taqi, Ghair Soudi Bankari. (Karachi: Quranic studies publishers), 140

⁸¹ Yousuf, Muhammad. Murawwaja Islami Bankary. Karachi: Maktaba Bayinaat Jamia al Ullom al Islamiya, 2008.

⁸² <http://www.sbp.org.pk/press/2004/jan-21-04.pdf>, Last Visited: 07-10-0

The answer to this question is that no doubt the use of interest rates to determine the permissible profit and rent is not ideal act for an Islamic bank but if an Islamic bank fulfill all the conditions of permissible sale and Ijarah contract than the interest rate standard does not violate the contract.⁸³

KIBOR is an interest rate standard, taking it as a bench mark makes the transactions of Islamic banks resembling the transaction of a conventional bank. It will be preferable if Islamic bank try to avoid such resemblance too. There is need to understand the background of using interest rate as bench mark for all banks. Banks are basically the companies which differ from each other according to their different financial status. Some banks have more reserves than their need but some banks have to lend some financial help from another banks. A bench mark determines the interbank exchange rate.⁸⁴

The bank with extra reserves lends money to the needy bank with a specific interest rate which is called interbank offered rate. Its abbreviation is KIBOR. In Pakistan Karachi's banks interest rate is used as bench mark that's why it is called KIBOR. Islamic banks need a large Islamic banking market in order to establish their own bench mark.

In Pakistan this market is prospering day by day.⁸⁵

⁸³Yousuf, Muhammad. *Murawwaja Islami Bankary*. (Karachi:Maktaba Bayinaat Jamia al Ullom al Islamiya, 2008),17.

⁸⁴ Ibid.

⁸⁵ Samdani,Ijaz Ahmed, *Islami Bankaari*.(Lahore:Idarah Islamiyat,2007),53

2.9.5 Fifth Issue:

Islamic bank also have a penalty clause provision where a customer on late payment gives sadqah or charity to the charity fund of the Islamic bank, like conventional banks which also charge penalty for default like conventional banks.

Analysis of issue:

A customer in Islamic bank signs the undertaking that if he fails to pay the due installment he will pay Sadqah in the charity fund of the bank.

This is an obvious principle of Shariah that every person can bound himself upon performance of a certain act which is called Nazar in Fiqh. Nazar is a voluntary act of a person no one else can bound him to vow for a Nazar except he himself.⁸⁶

Than here the objection comes that when Islamic banks puts such a condition upon his customer how far this condition can justify with true spirit of Islamic financial system. Another objection raised is that is it compulsory to pay the Sadqah money in the charity fund of the Islamic bank or with the intervene of that bank?⁸⁷

The third objection raised in this regard is that if the customer does not pay that Sadaqah than Islamic bank brings him in the court of law to pursue him to fulfill this obligation.

The answer to first objection is that the payment of sadqah can be made obligatory if the unwanted act or mistake comes within the category of rights of Allah. For example if a person says that he will pay Rupees one thousands as sadqah if he does not offer his Fajar

⁸⁶ Samdani, Ijaz Ahmed, *Islami Bankaari*. (Lahore: Idarah Islamiyat, 2007), 53

⁸⁷ Usmani, Muhammad Taqi, *Ghair Soudi Bankari*. (Karachi: Quranic studies publishers, 2009), 200

Paryer. This type of sadqah is obligatory to be given. If that unwanted act or mistake comes with-in the category of the Rights of people but that mistake involves the harm for another person in this situation the payment of sadqah money is also made obligatory.⁸⁸

In the first situation man has the exclusive right to bound himself or not to vow for the sadqah payment but in the second situation there are many situations when it can be made obligatory for one person to compensate the other for the non performance of a curtain act. For example if a man X requests Y to lend him his car and Y says to X that if he will allow him to drive his car if he drives carefully and in the case of any negligence on X's part he will pay a certain money as compensation or sadqah to Y. now if Y's car gets some damage due to the negligence of X, X is bound to pay that sadqah money to Y because otherwise Y will suffer a loss.⁸⁹

Same is the case of Islamic bank where Islamic bank finances its customers with the depositories of its other customers. If Islamic bank dose not come with a penalty clause than there is an apparent fear that many customers will exploit the bank which will create financial troubles for bank. Without a penalty clause a bank can not make all the customers to fulfill their commitments on due time.⁹⁰

The answer to the second objection is that it is compulsory to pay the Sadqah money in the charity fund of the Islamic bank or with the intervene of that bank because only by this way it can be ascertained that the customer has paid the Sadqah money. This

⁸⁸ Usmani, Muhammad Taqi, Ghair Soudi Bankari. (Karachi: Quranic studies publishers, 2009), 205

⁸⁹ Ibid.

⁹⁰ Samdani, Ijaz Ahmed, Islami Bankaari. (Lahore: Idarah Islamiyat), 46

condition does not contradict the context of the contract so imposition of such condition is permissible.⁹¹

The answer to the third objection which is that if the customer dose not pay that Sadqah than Islamic bank brings him in the court of law to pursue him to fulfill this obligations, is that although according to Hanafi school of thought performance such promise is not obligatory but according to some Maliki jurist this promise is obligatory and Islamic bank can bring such customer in the court of law to fulfill the required obligation.⁹²

2.9.5.1 Draft Instructions and Guidelines for Shariah Compliance by the State Bank of Pakistan:

SBP provides guideline for the Use of Charity Fund that is;

“Every IBI (Islamic Banking Institution) will create a Charity fund in which income of the IBIs from non-Shariah compliant sources or penalties and late payment charges received from clients in default or overdue cases etc will be credited. The amount in this fund will be utilized for charitable and social welfare purposes in accordance with the policy vetted by Shariah Advisor and approved by the Board of Directors, in case of locally incorporated IBIs or management in case of foreign banks having IBBs”.⁹³

2.9.5.2 Compensation for breach of contract where penalty stipulated as described in “The Contract Act, 1872”, Section; 74:

“When a contract has been broken, If a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by the way of

⁹¹ Samdani, Ijaz Ahmed, *Islami Bankaari*. (Lahore: Idarah Islamiyat), 46.

⁹² Usmani, Muhammad Taqi, *Ghair Soudi Bankari*. (Karachi: Quranic studies publishers, 2009), 207.

⁹³ <http://www.sbp.org.pk/ibd/2008/Annex-c2-1.pdf>. Last visited: 07-09-09

penalty, **the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby**, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or as the case may be, the penalty stipulated for”.⁹⁴

2.9.6 Sixth Issue:

In case of Diminishing Musharakah agreement between the bank and the client, the Islamic bank also obtains adequate security from the customer to ensure safety of the capital invested as the conventional bank obtains, whereas in Shariah there is no concept of security in Musharakah based upon the principle “La Kafalah Fi Al-Amanat.”

Analysis of issue:

Partnership is based on both agency and trust. Every partner is an agent when he transacts in the wealth of his partner, and is a trustee in it. A trustee will not be held responsible for a trust unless he is fraudulent or culpably negligent in looking after the trust. Guarantee or surety is the bringing together of the responsibility of the guarantor to that of the guaranteed in honoring a right. Thus, the right will become the responsibility of both. The possessor of the right may therefore seek his due from either. The jurists, moreover, are in agreement that a guarantee will be lawful after a right has come due. According to the Hanafi, Maliki, and Hanbali schools, it will be lawful before becoming due as well.⁹⁵

Based on the above, then, it will be lawful for the Islamic Bank when it enters into a Musharakah with one of its clients, to seek a guarantee against loss resulting from

⁹⁴ “The Contract Act, 1872”, Section ; 74

⁹⁵ Dellorenzo, Yousuf Talal. A Compendium of Legal Opinions on the Operation of Islamic Bank. London: Institute of Islamic banking and Insurance,2001),305

negligence or fraud. It will not, however, be lawful for the Bank to seek a guarantee against loss resulting from other than negligence or fraud because what is lost in that case will not be guaranteed for the partner, and therefore may not be guaranteed by the partner.⁹⁶

With regard to collateral, and its definitions in Islamic law, there are two sorts of collateral: collateral of possession, and collateral of trust. Collateral is the holding of something of value (belonging to someone) for a right that may be collected from him. The difference between collateral of possession and collateral of trust is that the collateral of possession will actually remain in the hand of the pledgee until he collects his due. The collateral of trust will remain in the possession of the pledger, who is free to use it. The pledgee, however, will have the right to go to the debtor and seek recompense through the price of the collateral, even if it passes into the possession of another.

The purpose of a guaranty and both kinds of collateral is one, and that is the cementation of a debt and the assurance that it will be honored.⁹⁷

The Maliki School held that it is lawful to take collateral from a partner against fraud or negligence. Kharashi wrote: "It is a condition that the reason for taking collateral be a debt, rather than a trust."

The Hanbali jurists differentiated between a guarantee and collateral, prohibiting the taking of collateral for other than what is due, but permitting guarantees. The reason they gave for their position was that the taking of collateral is importunity for the pledger

⁹⁶ Dellorenzo, Yousuf Talal. *A Compendium of Legal Opinions on the Operation of Islamic Bank*. London: Institute of Islamic banking and Insurance, 2001, 305.

⁹⁷ *Ibid.*

because the collateral remains in the hands of the pledgee, thus preventing the pledger from putting it to use, which is not the case in a guarantee.⁹⁸

With regard to collateral of trust, however, it will be lawful for a partner to take it. This position is derived from the ruling of the Maliki School, because since they hold it lawful to take collateral of possession, in which the collateral passes into the possession of the pledgee, then if the collateral is to remain in the possession of the pledger, they would be even more likely to consider it lawful. The Hanbali jurists, too, held it lawful, by analogy with a guarantee.⁹⁹

In brief, then, the answer to the question above is that it will be lawful for the Islamic Bank to seek from its client/partner guarantees against loss to the capital of the partnership through either fraud or culpable negligence on the part of the partner. All of this conforms to the positions taken by the jurists of the Hanafi, Maliki, and Hanbali schools. It will likewise be lawful for the bank to seek collateral of trust from its partner/client, in accordance with the Maliki and Hanbali schools, and collateral of possession, in accord with the Maliki School and Allah knows best.¹⁰⁰

In case of Diminishing Musharakah agreement between the Bank and the client, the bank shall in its own right and discretion, obtain adequate security from the party to ensure safety of the capital invested and also for the profit that may be earned as per profit

⁹⁸ Dellorenzo, Yousuf Talal. *A Compendium of Legal Opinions on the Operation of Islamic Bank*. London: Institute of Islamic banking and Insurance, 2001), 307

⁹⁹ Ibid.

¹⁰⁰ Dellorenzo, Yousuf Talal. *A Compendium of Legal Opinions on the Operation of Islamic Bank*. London: Institute of Islamic banking and Insurance, 2001), 307

projection given by the party. This security is for the purpose of performance guarantee.¹⁰¹

Legal status of the pledged property:

According to the view point of the majority of Muslim jurist the pledged property assumes the status of trust in the hands of pledgee thus, if it is destroyed or loss with out negligence, fault or wrongful action on his part he will not be held liable. He will remain entitled to his debt due on the pledger. The Hanafi jurist hold the view that the pledgee after taking the possession of the property becomes responsible in case of its being destroyed in his hands. The responsibility of the pledgee extends to the amount of the debt owing to the pledgee. Thus if a pledged property equivalent to the amount of debt is destroyed in the pledgee's hand. His claim is rendered void and he is deemed to have obtained a complete payment. If on the contrary the value of the pledge exceeds the amount of the debt, the excess is in that case considered as a trust for which the pledgee will not be held responsible in case of its destruction, but if the value be less than the debt, the pledgee forfeits that part of his debt and the pledger will pay the remaining to the pledgee.

In opposition to the above mentioned opinion, the Shafi jurists maintain that the pledge is a trust in the hands of the pledgee. Thus if it is destroyed in his possession, still he does not forfeit his due because it is recorded in the tradition that no pledge shall be distained for debt and the pledger shall be liable for all risks.¹⁰²

¹⁰¹ Chopra, M.Umar. Towards a just monetary system.(London: the Islamic foundation, 1985),55.

¹⁰² Mansoori, Tahir. Islamic law of contracts and business transactions. (Islamabad: Shariah academy),316.

2.9.7 Seventh Issue:

Another issue raised about the transactions made by the Islamic Banks is that they follow “Heela” and there is a difference in “Form” versus “Substance”.

Analysis of issue:

There are three types of Heela in Fiqh.

The first type is prohibited in form and its performance is also prohibited. If some body performs that act then its intended result is also not acquired. For example fat was prohibited for Jews but they start using it by melting it, that’s why Jews were cursed by Allah because their intention was to deceit the required purpose. This type of Heela is Haram.¹⁰³

The second type of Heela is that where the person is sinner for his wrong intention but the act which he has performed itself is not prohibited in shariah. For example if a person gifts something from his property before the completion of one year or Howl in order to escape from payment of Zakaat. Though he can not be compelled to pay zakaat but he is a sinner before Almighty Allah.

The third type of Heela is where Heela is not prohibited or a sin and the intended purpose of the doer is also not disliked by shariah.¹⁰⁴

¹⁰³Mansoori, Tahir. Islamic law of contracts and business transactions. (Islamabad: Shariah academy),316.

¹⁰⁴ Usmani, Muhammad Taqi, Ghair Soudi Bankari. (Karachi: Quranic studies publishers),175-177

The above discussion shows that all types of Heela are not prohibited in Fiqh. There is no doubt that no Heela can be regarded as permissible if it allows the commission of a prohibited act.¹⁰⁵

Another objection raised is that Islamic banking is similar to the convention banking because Islamic banks also earn profits. The answer to this objection is that even a single individual can not provide financial services to others without any reward or payment. An Islamic banks is also a corporate body which needs some finances to further help others, if an Islamic bank dose not earn the permissible profit then how can it continue business and provide services.¹⁰⁶

Than comes the issue of insurance. Insurance is not allowed in shariah but Islamic bank insures its transactions like conventional banks. Muslim jurist are agreed upon that if a person is in such a condition that he has to perform one of two evil acts than he is allowed to perform the act with less evil by preferring it upon more evil act. With the condition that he will continuously try to leave the less evil act as well.

This problem can easily be solved by adoption of Takaful.

Section 2.10 Legal opinions on the operation of Musharakah in Islamic Banks:

2.10.1 Fatwa regarding Initial Deposits in Cash:

When the agreement is made between the bank and its client to enter into a musharakah for the purchase and sale of goods and the amount of capital to be invested (by both parties) is determined, this will be the same as a mutual promise to enter into a

¹⁰⁵ Usmani, Muhammad Taqi, Ghair Soudi Bankari. (Karachi: Quranic studies publishers), 175-177.

¹⁰⁶ Samdani, Ijaz Ahmed, Islami Bankaari. (Lahore: Idarah Islamiyat), 18

partnership. A partnership, however, will not be legal until both parties have actually paid their shares of the capital. Thereafter, all accounting for profits and losses will be based on the percentage of the amounts actually invested by each of the partners.¹⁰⁷

2.10.2 Fatwa regarding Musharakah with Interest-based Banks:

There is no legal impediment to entering into a musharakah with an interest-based bank for the purpose of conducting lawful business. The evidence for the legitimacy of this opinion is that the Prophet of Allah himself, upon him be peace, is known to have done business with Jews, and they dealt in interest. Except that the Prophet's dealings with them were confined only to lawful sorts of transactions in which interest was not involved. After him, his companions did the same.¹⁰⁸

2.10.3 Fatwa regarding financing the purchase of Real Estate:

- a) It will be lawful to register the property in the name of the client/partner from the outset. Nor will such a registration in any way nullify the musharakah agreement, especially since the right of the client/partner to freely dispose of the residence will remain conditional until such a time as he/she assumes full ownership. In this matter, it was borne in mind that registration is a form of documentation that is secured by a pledge (or collateral) which formally establishes ownership in accordance with the conditions agreed to with the client/partner.
- b) Placing the responsibility for registration fees, real estate assessment, stamp fees, and other related expenses on the client/partner alone, from the beginning, will

¹⁰⁷ Dellorenzo, Yousuf Talal. A Compendium of Legal Opinions on the Operation of Islamic Bank. London: Institute of Islamic banking and Insurance, 2001. Kuwait Finance House, Fatawa Shariah, Fatwa no 349,336-337

¹⁰⁸ Ibid, Fatwa no 331,322

also be lawful when the two partners agree to the same; especially since the client/partner is the one who will eventually become the sole owner.¹⁰⁹

- c) With regard to insurance, the original assumption would be that both partners pay the premiums because the burden falls on the shared property. For the Bank's part, it may be possible for it to cover its costs in the matter when determining the amount of its share in the lease.
- d) With regard to leasing, the principle to be followed is that the lease will be determined annually in accordance with (the terms of) the (musharakah) agreement.
- e) Likewise, in a partnership of property, there is to be equality in terms of costs and profits, but in proportion to the percentage of ownership. As the legal situation demands that the bank avoids the possibility of loss when finally settling a partnership of possession, there is clearly a need to change the formula, so the procedure will take place in the following order:
 - a) The bank and the client/partner will jointly purchase the residence in accordance with an agreed upon percentage of shares.
 - b) The bank will sell its share to the client/partner on the basis of its sale of the physical property while retaining the rights to usufruct until such a time as the client/partner has completed paying the remainder of the price.¹¹⁰

¹⁰⁹ Dellorenzo, Yousuf Talal. A Compendium of Legal Opinions on the Operation of Islamic Bank. London: Institute of Islamic banking and Insurance, 2001. Kuwait Finance House, Fatawa Shariah, Fatwa no331,322.

- c) The bank will account its earnings from the yearly lease against the usufruct of the property in proportion to amount of the sale price that is actually realized.
- d) If the client/partner should fail to pay the installments he/she owes, the Bank will have the right either to proceed with the sale by realizing its right to the remainder through forceful appropriation of the collateral; or it may nullify the sale and maintain possession of the property if the client/partner agrees to the return of payments. In legal terms, this would amount to an annulment of the transaction from its beginning.¹¹¹

2.10.4 Fatwa regarding building on the Client/Partner's Land:

With regard to the question concerning the legality of the Bank's requesting the client to offer the land as collateral, it must first be explained that collateral is the guarantee of a debt by means of a material possession. In the business described, the bank is not a creditor to the client, such that the client would have to offer the land as collateral against his/her debt to the bank. However, in view of the bank's status as the administrator of the partnership and its carrying out its purposes, the bank has the right to seek the vacancy of the property for its own purposes in consideration of its value being the share of the client/partner since, by vacating the property, the bank may realize its desire for caution

¹¹⁰ Dellorenzo, Yousuf Talal. A Compendium of Legal Opinions on the Operation of Islamic Bank. London: Institute of Islamic banking and Insurance, 2001. Kuwait Finance House, Fatawa Shariah, Fatwa no331,322.

¹¹¹ Ibid, Fatwa no 4,39-43

and protect itself from the client/partner's disposing of the property after entering into the Musharakah with the bank.¹¹²

2.10.5 Fatwa regarding Bearing Expenses:

The legal principle here is that these sorts of expenses, like transport, loading, and unloading, are the responsibility of the partnership and must be borne by both partners. This is (the rule) when a single company is to be managed. But when there are a number of Musharakahs, all managed by the same manager, then an estimation may be made on the basis of what is customary, so that the Musharakahs bear a percentage as close as possible to the actual expenditures".¹¹³

¹¹² Dellorenzo, Yousuf Talal. A Compendium of Legal Opinions on the Operation of Islamic Bank. London: Institute of Islamic banking and Insurance, 2001. Kuwait Finance House, Fatawa Shariah Fatwa no 2,60-61.

¹¹³ Ibid, Fatwa no 345,333-334

Chapter 3

House Financing In United Kingdom:

Section 3.1 Islamic Banking sector in United Kingdom:

There are more than 1.8 million Muslim British Citizen and permanent residents in United Kingdom, besides 500,000 temporary residents which include visitors and students. This Muslim community is racially and linguistically dissimilar and geographically sprinkled. Thus marketing becomes a major challenge for drawing the concentration of the community. The community is noticeably and gradually becoming wealthier, and consists of an increasing number of professionals such as doctors, as well as a significant small business section.¹

Some devoted Muslims avoid dealing with conventional interest based banks, and those who deal like to donate interest earnings to charity in an effort to decontaminate their income, but the majority of the Muslims still use the conventional financing services, because they have a very few options. Like the rest of the population, to have trust in large retail financial institutions to gain acceptance within the community substantial educational and marketing promotion would be needed.²

Islamic financial products are available in the United Kingdom from a number of High Street banks which offer current accounts and mortgages tailored for Muslims. The UK is home to the first wholly Shariah compliant retail bank in the West, Islamic Bank of Britain, which was authorized by the FSA in 2004. The FSA has also authorized the

¹ Wilson, Rodney. "Islamic Investment Products Available in the United Kingdom." *Journal of Islamic Banking & Finance*, Volume 25, (Jan-March 2008), 73.

² Ibid.

European Islamic Investment Bank which is the first such investment bank. In addition, London has become an important financial centre with major international firms and the Middle East's biggest traditional banks offering Islamic products.³

3.1.1 A case study of Islamic Bank of Britain (IBB):

Before the establishment of Islamic Bank of Britain (IBB) Britain's 1.8 million resident Muslims had no access to an Institution providing Islamic banking service separately. Islamic Bank of Britain welcomes Muslims and non-Muslims in a similar way as customers. Its aim is to provide banking services to the community at large. The value of the Islamic mortgage sector in the UK is rising swiftly. The velocity of the Islamic mortgage sector in the UK has increased from £40 million in 2002 to an expected £1.4 billion by 2009.

On 1st July 2008 IBB announced details of its new home purchase plan, the mortgage substitute. It is based on the Islamic financing principles of Diminishing Musharakah (partnership) and Ijarah (leasing).⁴

³ <http://www.fsa.gov.uk/pages/About/Media/notes/bn>. Last Visited : 08-01-09.

⁴ <http://www.fancyamortgage.co.uk/IslamicMortgages/ShariahLaw.asp>. Last Visited : 10-01-09.

Section 3.2 Home Purchase Plan

3.2.1 Products Guide:

With an Islamic Bank of Britain home purchase plan one can:

Purchase home in a Shariah yielding manner, change his existing interest based mortgage into Shariah compliant finance, move existing Shariah compliant finance to Islamic Bank of Britain and elevate additional finance in a Shariah compliant mode.⁵

One can also choose to have assessment and legal fees paid with the fees as property at any time and he can make full payment at any time without any penalty with 100% benefit from any price appreciation in the value of home.⁶

3.2.2 Procedure:

Islamic Bank of Britain's Shariah compliant Home Purchase Plan is based on the Islamic financing principles of Diminishing Musharakah (partnership) and Ijara (leasing) concepts. It can be explained simply that both the client and the Bank put in their shares towards the purchase of the home. For example, the Bank may contribute 60% and the client 40% of the purchased price. Both client and the Bank become partners. Client makes monthly purchase installments over a period of up to 30 years, through which he buys the Bank's share. With each installment paid, the Bank's share in the property decreases while client's share likewise increases.⁷

⁵ <http://www.fancyamortgage.co.uk/IslamicMortgages/ShariahLaw.asp>. Last Visited : 10-01-09.

⁶ <http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home.jsp>, Last Visited: 11-01-09.

⁷ Ibid.

3.2.3 Eligibility:

The preference of client to invest for the property is to be based on his assessment of his capacity to meet the payments. The following factors must be considered by the client while making such a decision:

- i) Client's income and expenses.
- ii) The management of his economic affairs.
- iii) Information received from credit reference agencies.⁸
- iv) Age of the client.
- v) The type of the property and its state.⁹

3.2.4 Buildings Insurance:

Buildings insurance is an obligatory prerequisite of the Islamic Bank of Britain Home Purchase arrangement. This needs to be sustained throughout the term of the home purchase contract. Under the service agency agreement the client is required to arrange this himself. The policy is in joint names between Islamic Bank of Britain and the client.¹⁰

Any changes in the Insurance policy such as altering a source or a change in any of the rules or principles must be notified to Islamic Bank of Britain and related documents must be sent to it. The insurance policy must be for a nonstop time period.¹¹

⁸ <http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home.jsp>, Last Visited: 13-01-09.

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

3.2.5 Costs:

These are the types of expenses that are to be incurred in the purchase or refinance of the property.¹²

i) Administration fee:

This fee is owed when the client completes the debit card details and return with his home purchase plan application to cover the Bank's fee in processing the application.¹³

ii) Valuation fee:

This fee is payable when the client completes the debit card details and go back with his home purchase plan application to cover the cost of a survey and a professional.¹⁴

iii) Stamp Duty:

It is to be paid according to the current rate when the purchase of the property takes place if there is not any exemption.¹⁵

¹² <http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home>. Last Visited:23-02-09.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Ibid.

3.2.6 Detailed Procedure:

3.2.6.1 Initial steps:

The client is required to apply for the agreement in principle. Once the agreement in principle has been accepted, an application form needs to be accomplished, signed, dated and returned to the bank with the necessary documents and fees.

Once the bank is satisfied that the client meets the conditions and has provided the requisite information, the client will receive an offer (the "Offer Letter"). The offer letter will bring the provisions and state of affairs upon which the offer is based and at the same time a draft copy of the Diminishing Musharakah agreement, legal charge, lease agreement and the service agency agreement will also be sent to the client.¹⁶

3.2.6.2 On completion:

The Bank will pay its contribution towards the purchase of the property to the Bank's solicitor. The client will pay the difference between this amount and the real purchase price of the property.

If the client is switching to the Bank from a conventional mortgage or from another Islamic form of finance, the Bank will pay the amount it is prepared to finance to the Bank's solicitor. Any difference between this amount and what is payable on his existing mortgage(s) must be paid by the client. The Bank will plan to collect this difference from the client before completion. The Bank's solicitor will then pay the total amount to the client's existing financier to fully repay the sum due.¹⁷

The client will lease the property from the Bank for an agreed number of years and he will be the registered owner of the leasehold title at the Land Registry.

¹⁶<http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home.jsp>, Last Visited:10-03-09.

¹⁷Ibid.

The first precedence Legal Charge the client grants to the Bank will be registered at the Land Registry against the client's beneficial interest in the property and his leasehold title.¹⁸

The client pays monthly installments (acquisition payments) towards the acquiring of the Bank's share of the property (acquisition cost) as well as Rent for the duration of the payment term. Once the client has paid the acquisition cost and rent due in full, the property will be transferred into his name and his solicitor can then arrange for the record at the land registry to be amended to remove the bank as registered owner and replace the client as the registered lawful owner of the property instead. The legal charge will be removed.¹⁹

Section 3.3 Documentation:

The client will have to enter into legal agreements with the Bank. There are principally five documents "The Agreements" that are to be sent when the client's application has been approved.²⁰

¹⁸ <http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home.jsp>, Last Visited: 10-01-09.

¹⁹ Ibid.

²⁰ Ibid.

i) **“The Offer Letter”:**

This document contains the Bank’s offer for investment, the details of the contracts and the sums involved along with the steps that will be taken by the Bank to purchase client’s preferred property.²¹

The Offer Letter will outline how the Bank will purchase the property. It will be a requirement under the Offer Letter that the client will say his solicitor to include a special condition in the purchase contract (i.e. the contract the client will enter into with the seller of the property) giving way the ability to transfer the property to the Bank by way of a sub-sale. The reason for this requirement is that the Bank will need to complete the purchase of the property rather than the client, although the client will carry on the negotiations with the seller’s solicitor in the usual way. On completion, the Bank will pay its contribution to the purchase price of the property (the Acquisition Cost) to the seller and the client will pay his share.²²

ii) **“The Diminishing Musharaka Agreement”:**

In this agreement, the Bank agrees to sell the property to the client over the payment term (i.e. the number of years over which he wishes to acquire the bank’s share of the property). Every month the client agrees to pay acquirement payments towards the acquisition cost of the property. Once the acquisition cost and all rents have been paid in full, the bank will transfer the property to the client and he will become the registered owner.²³

²¹<http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home.jsp>, Last Visited:20-03-09.

²²Ibid.

²³Ibid.

iii) “The Lease Agreement”:

In this agreement, the Bank agrees to lease the property to the client and in return he will agree to pay monthly rent. Rent is determined according to a number of factors, including bank’s outstanding share in the property under the Diminishing Musharakah Agreement and the profit margin in the transaction.²⁴

iv) The Service Agency Agreement:

In this agreement the bank appoints the client as its service agent. This will state the client’s obligations as a service agent which includes arranging buildings insurance for the duration of the Lease agreement.²⁵

v) The Legal Charge:

As security for the client’s payment obligations under the Diminishing Musharaka agreement and the lease agreement, the client grants the bank a first priority legal charge over the client’s interests in the Diminishing Musharaka agreement and the lease agreement.²⁶

vi) “Additional costs when payments are late”:

There may be times when some customers make their payments late there will be some additional administrative costs as a result of such delay.

Once the costs have been recovered the additional amount will be donated to charity and the Bank will not profit from any extra income received from this penalty.

²⁴ <http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home.jsp>, Last Visited:24-03-09.

²⁵ Ibid.

²⁶ Ibid.

The Bank will not get benefit from any increase in the value of the property although it is the legal owner.²⁷

The Bank will receive the balance of the Acquisition Cost due under the Diminishing Musharaka Agreement paid in purchasing the property as well as the rent due under the Lease Agreement. Any appreciation or depreciation in value of the property will be passed on to the client on completion of the sale of the property under the Diminishing Musharaka Agreement.²⁸

²⁷<http://www.islamic-bank.com/islamicbanklive/HomeFinance/1/Home/1/Home.jsp>, Last Visited: 23-03-09.

²⁸ Ibid.

CONCLUSION

Promotion of savings and capital accretion to finance projects using various modes of finance, financing of international trade and mobilization of capital, and putting them into permissible investments for the benefit of society are the major roles played by the Islamic banking network. Most of the Islamic banks provide housing finance by the mode of Diminishing Musharakah. Conventional banks provide mortgage on interest based financing. Diminishing Musharakah mode of financing is particularly suited to the Muslim communities where capital is insufficient and greater effort is needed on the part of the Muslims themselves. Partnerships will facilitate the Muslim communities not only to mobilize their internal resources but also stand on their own feet in matters of finance and save them from going to conventional financial institutions, where there is a curse in the form of payment of interest.

No doubt there are some of the areas where Islamic banking needs to play an active role, for example Islamic bank use KIBOR as bench mark like conventional banks, as a standard to determine their profit and rent etc, Islamic banks should be able to established their own bench mark other then KIBOR.

A recent World Bank survey shows a backlog of 8.8 million housing units in 2008. This gap is more pronounced in urban centers where people are continuously migrating from rural areas. The current annual requirement is 1.5 million housing units but only 0.6 million are being built. Of these 90 per cent are being provided by private sector and the remaining by public sector. The housing sector is underserved by financial institutions.

The process of the obtaining loan is awkward and expensive in time and money and discourages borrowers. Despite hassles, the housing finance market has showed significant improvement in some recent years, the Rs. 60 billion lending in March 2005 has more than doubled at the end of December 2007 to Rs. 126 billion, up by 112 per cent in almost three years. This growth was probably spurred by greater demand owing to rise in GDP, growth in remittances and competition among banks.

Despite this growth, the mortgage market is still small in both relative and absolute terms. The mortgage loan to GDP ratio in nominal terms rose only from 0.49 per cent since 2003 to its peak at 0.98 per cent in 2006 but again declined to 0.7 per cent. This ratio is very low when compared with other countries e.g. 14 percent in Chile, five percent in china and 28 per cent in Malaysia. A number of factor such as low income levels, legal property issue etc, depress the demand for mortgage loans. This is also demonstrated by the institution wise numbers of loans disbursed. The HBFC share in number of loans disbursed stood at 93 per cent while rest of the institutions share was only 07 per cent. The subsequent increase in growth rate from -8.4 per cent to 6.4 per cent during the quarter of March 2007 is due to the rising participation of three Islamic banks.

It is generally perceived that the worst is over for the economy and various indicators are pointing towards the revival, also evident from the recent activity in the construction sector.

There is vast scope for extension in the forms of different business organizations based on partnership in the modern world. In the formation of partnerships, according to the

true spirit of the Shariah, Muslims will increase their financial position to maintain themselves, their families and others and pay their charitable dues during the journey of this life towards the eternal life of the henceforth.

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