

**DIMINISHING MUSHARAKA:  
IT'S IMPLEMENTATION AND CURRENT STATUS IN PAKISTAN**

705271

BY

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## **Dedication**

This thesis is dedicated to my parents and my husband, whose helps, support and motivation help me in every hour of my life

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## **Abstract**

In the present world everyone is in the need of the finance because of taxes, inflation, rising property prices and currency devaluation. It has become difficult for the faith based muslims to fulfill their dreams without being indulging in interest based modes. Like owing a home or car or business is not possible for a person with ordinary income because of the shortage of finance and for that purpose most of the persons go to the conventional banks which indulge them in conventional mortgage in which interest prevails which is strongly prohibited in shariah.

Conventional banks are offering variety of products for the attraction of customers but now thanks to the Islamic banks, which is growing on with rapid pace and offering alternatives to the muslims to keep them away from interest based products specially conventional mortgages. Islamic Banks in Pakistan are offering different modes of Islamic finance one of which is diminishing musharaka.

Diminishing musharaka is one of the best alternatives of conventional mortgage. It is a form of Musharaka, which is one of the most desired form of shariah. But unfortunately this mode of Islamic finance despite its importance in the eyes of sharaiah lacks its proper place in the Islamic banking sector of Pakistan. It is the need of the day that government must adopt effective measures for the promotion of Musharaka institution. As far as diminishing musharaka is concerned it is getting quite popular these days because of its potentialities. It is pertinent to mention here that like musharaka it is also lacking its due statutory position in Pakistan. There is no separate law or exact definition of diminishing

musharaka in Pakistani law. That's why I chose this topic for research because this mode of Islamic finance has very potential in it which is required to be highlighted.

### **Methodology of research:**

My thesis would be divided in three chapters.

In the first chapter I tried to present the basic preview of the musharaka upon which diminishing musharaka is based. In this chapter there would be 5 sections. In 1<sup>st</sup> section there would be analyses of the definitions of Musharaka provided by four schools of thoughts and at the end my own comparison of these definition and what is its definition in Pakistani law. Then in the 2<sup>nd</sup> section I will present the analysis that why despite being the most desirable from in the eyes of shariah it is not much popular among financial institutions and the investors and at the end I will present my conclusion also. In the 3<sup>rd</sup> and 4<sup>th</sup> section will come the legitimacy of musharaka and its scholar's classification. In the last section I will discuss the modern classification of musharaka under which comes the diminishing musharaka. After that I will present the basic concept of diminishing musharaka and its different forms in the eyes of scholars. Then how Pakistani Islamic banks define this mode and after that I will present my own observations regarding the differences between these definitions. And at the end there will be discussion regarding the permissibility of diminishing musharaka and fatwas of eminent scholars in favor of it and against it.

In the second chapter I would discuss the differences of diminishing musharaka with other modes of Islamic mortgage that is Ijara and Murabaha. Then will come the three modern forms of diminishing musharaka: diminishing musharaka for home financing, auto financing and trade financing. I will discuss these three modes under three sub-sections. I will describe what steps should be involved in the practice of diminishing musharaka and in what sequence. Then what condition must be fulfilled, etc. and in the 3<sup>rd</sup> section I will elaborate the differences between diminishing musharaka and conventional mortgage and which one is nearer to shariah.

Third chapter of my thesis is totally linked to the practical point of view. In this chapter I will discuss in the first section what type of documentation is needed for diminishing musharaka then how Pakistani Islamic banks are using this mode and what type of strategy they are using to secure themselves from any loss along with the conformity of the principles of shariaah. Here I will give the example of three leading Islamic banks (Meezan Bank, Al-Falah and Dubai Islamic Bank). The procedure of these three banks regarding diminishing musharaka will be discussed in detail.

# Chapter No.1

## BASIC CONCEPT OF MUSHARAKA AND DIMINISHING MUSHARAKA

### SECTION 1

#### MUSHARAKA

##### 1.1: LITERAL MEANING OF MUSHARAKA

It is derived from the Arabic root word 'shirka' the meaning of which is to 'jointly participate'. OR

The word shirka is used in the literal sense to mean "mixing or mingling". It implies the idea of mixing shares in such a way that one cannot be distinguished from the other.<sup>1</sup>

The word Shirka is however a generic term that really means participation of any type.<sup>2</sup>

##### 1.2: TECHNICAL MEANING OF MUSHARAKA

The four schools of thoughts have defined Musharaka in different ways keeping in view its important features:

###### 1.2.1: HANAFI DEFINITION

Hanafi defines Musharaka as:

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<sup>1</sup>Wahaba Zuhili, Al-Fiqh-al-Islami w' adila to ho, ( Dar-ul-Fikr, Dar-ul-Fikr-Almuasir), Vol.5,3875, [hereinafter Zuhili Al-Fiqh-al-Islami w' adila to ho]; Ibn al-Humam, Fath al-Qadir, vol. 5, 6.

<sup>2</sup>Imran Ahsan Khan Niaze, Islamic Law of Business Organization Corporations, (Islamabad: International Institute of Islamic Thought & Islamic Research Institute, 1998), 19. [hereinafter Niazee 1998]

It is a contract between two or more persons who launch upon a capital for the sake of profit.<sup>3</sup>

### 1.2.2: MALIKI DEFINITION

Maliki defines Musharaka as:

A permission from each of the partners to the other for appropriation and disposition of a common thing while retaining the right to transact personally.<sup>4</sup>

### 1.2.3: SHAFI DEFINITION

Shafi school of thought defines Musharaka as:

It is the establishment of right in a single thing, which is held in common between two or more persons.<sup>5</sup>

### 1.2.4: HANBLI DEFINITION

Hanbli school of thought defines Musharaka as:

The participation of two or more persons in the entitlement or disposition of a thing is called sharika.<sup>6</sup>

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<sup>3</sup>Al-Imam Ala-ud-Din Abi Bakr Bin Masood-al-Kasani, Badai-ul-Sanai Fi Tarteeb-ul-Sharai, (Beirut, Dar-ul-Kutb-ul-Ilmiya, 1986), Vol. 6, 66

<sup>4</sup>Muhammad Inn Ahmad Ibn Rushd, Bidayah al-Mujtahid, (Lahore: Mattabah al-Ilmiyyah), Vol 2. 215

<sup>5</sup>Shams-ud-Din Muhammad Bin Abi Abbas, Nihayatal Muhtaj-ila-Shar-al-Minhaj, (Al- Maktaba Al-Islamia), Vol. 5, 2.

<sup>6</sup>Ibn Qudamah, Al-Mughni, (Maktaba-al-Riaz-al-Hadisia, Al-Riaz), Vol. 5, 3 [hereinafter Ibn Qudamah, Al-Mughni]; Mansoor Bin Yunas Bin Idrees Al-Bahuti, Sharh Munthai-al-Iradat, (Dar-ul-Fikhr) Vol. 2, 319 [hereinafter Al-Bahuti].

## COMPARISION: CONCLUSION

Regarding the above all four definitions it may be said that Hanfi definition is the most comprehensive and developed as compared to the other three school of thoughts.

- ✓ As far as Maliki and Shafi are concerned they have considerably restricted the forms of partnership law and their view is very rigid.
- ✓ Hanbli school of thought is lenient and their definition more resembles to Hanfies and is free of rigidities.
- ✓ Hanafi definition is comprehensive and developed one in the current scenario because it covers all the necessary ingredients of a partnership, which are agreement, business, investment from the partners and sharing of expected profit.

### 1.3: LEGAL DEFINITION OF MUSHARAKA IN PAKISTANI LAW:

Partnership known as Musharaka in Islam has been known since mankind has existed on earth. This is because musharaka is based on co-operation and man has always needed help from the fellow men<sup>7</sup>. But unfortunately this type of partnership, which was permitted by holy prophet (PBUH) and was agreed upon by all muslim schools about thousands of years ago, had almost disappeared from the Islamic world before the establishment of Islamic banking in the last century. And after the introduction of Islamic finance in the muslim world musharaka is again gaining its due position.<sup>8</sup>

Efforts being made presently to cleanse up the banking system of interest, are mainly in two directions. In some countries of Middle East and Europe some banks have been established to be run on the interest free system totally, whereas, the entire banking sector in those

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<sup>7</sup>Ahmed Al- Suwaidi, Financing of International Trade in the Gulf, (Brill, Graham & Trotman , 1994)

<sup>8</sup>Mabid Ali Al-Jarhi and Munawar Iqbal, Islamic Banking: Answers to some frequently asked questions, (Islamic Development Bank, 2001) 13.

countries is based on interest-bearing system. In Pakistan and Iran, instead of setting up a separate interest free banking institutions, efforts have been made to take the entire banking system of the country from interest bearing system to the non-interest banking system gradually.<sup>9</sup>

The process of Islamization of banking and financial system in Pakistan started in 1977-78, and in that connection in 1977, the government had appointed the Council of Islamic Ideology (CII) with the responsibility of preparing a blueprint of an interest free economic system in the light of Islamic teaching. The CII presented its final report on 15<sup>th</sup> June 1980, in which it emphasized that, the ideal Islamic techniques to replace interest in the banking and financial fields are profit, loss sharing and Qard-Hasan. However, it gave due recognition to difficulties that may arise in changing the whole system to profit and loss sharing in one step, it endorsed that certain other methods like leasing, hire-purchase, Bai Mu'jjal, investment auctioning and financing on the basis of normal rate of return with a clear provision for adjustment on the basis of actual operating results may also be used in interest free banking operations.<sup>10</sup>

But after the passage of three whole decades Pakistan is still lacking even one single legal definition of Musharaka and no specific law has so far been enacted in the country of Pakistan to regulate the conduct of this important mode of Islamic finance.

Musharaka agreement is included in the 12 modes advised to the banks. However, no specified definition or framework was provided to govern the conduct of Musharaka. Moreover Musharaka contracts are not documented in the form of a negotiable instrument. There is not yet any specific legal/statutory definition of Musharaka available in the law books of Pakistan because there is no specific law has so far been enacted in Pakistan to

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<sup>9</sup> Abdul Jabbar Khan, Non Interest Banking in Pakistan, Concept, Practice and Evaluation, (Royal Book Company, Karachi, 1991), 1.

<sup>10</sup> Council of Islamic Ideology, Pakistan Islamabad, Elimination Of Riba From The Economy & Islamic Modes of Financing, 2<sup>nd</sup> Revised & Enlarged Edition, xv

govern the conduct of Musharaka. That's the reason that, no legal definition of Musharaka in Pakistani law can be provided here.<sup>11</sup>

Whereas Modaraba Companies and Modaraba (Floatation & Control) Ordinance 1980 was promulgated in Pakistan which defines Modaraba in the following words:

“Modaraba means a business in which a person participates with his money and another with his efforts or skill or both his efforts and skill and shall include Unit Trust and Mutual Funds by whatever name called”.

Since Modaraba and Musharaka are the variants of the same principle of profit and loss sharing so Musharaka can be defined in these words:

“Musharaka as a mode of business sharing /financing may be defined as an arrangement based on the principle of profit and loss sharing in which parties to the contract participate with their money or efforts or skills or a combination of them as may be provided for in the Musharaka Investment Agreement”<sup>12</sup>.

State Bank of Pakistan approves the 12 modes of Islamic financing vide their BCD circular 13 dated June 20, 1984<sup>13</sup> and according to that circular it provides the basic concept of Musharaka in these words:

Musharaka means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. It is an agreement under which the Islamic bank provides funds, which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions.<sup>14</sup>

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<sup>11</sup>Muhammad Ayub, Islamic Banking and Finance, Theory and Practice, (Research Department, State Bank of Pakistan, Karachi, 2002), 275.

<sup>12</sup>Nawazish Ali Zaidi, Musharaka Financing for Working Capital, UBL, Economic Journal, Vol5, No.6, Pakistan, p 11; Islamic modes of financing available at <http://www.islamic-financing.org/#c>, last visited 20-4-2007

<sup>13</sup>Permissible modes of financing- State Bank of Pakistan, Banking Control Department, Central Directorate, Karachi, Bcd circular No.13, 20<sup>th</sup> June 1984, regarding: “Elimination of Riba from the Banking System”

<sup>14</sup>ibid



## CONCLUSION:

After the completion of three whole decades since the initiation of Islamization in the banking sector of Pakistan still we do not have any statutory law to govern the most important mode of Islamic finance that is Musaharaka. Council of Islamic ideology also admitted it in its report that the most desirable form of Islamic finance is Profit and loss sharing which represent the true spirit of shariah but unfortunately government is still not paying due attention to this mode of finance. It is the need of the day to present a complete comprehensive statute to govern Musharaka Finance.

## SECTION: 2

### MAJOR OBSTACLES FOR BANKS IN PAKISTAN TO PROMOTE MUSHARAKA INSTITUTION

In Pakistan, the new system which has replaced interest based system is called non-interest banking system and not “Islamic Banking” system as some of the modes of financing used and the way they are used may not perhaps meet the tenets of Shariah when applied very strictly. The first drawback is due to the promotion of Buy-back<sup>15</sup> arrangements and the negligence of musharaka institution, which represents the most desirable form of Islamic financing arrangements. It is the most desired form in the eyes of shariah. All the essential elements, which are approved by shariah, exist in the Musharaka contract like:

- ✓ The absence of interest
- ✓ The presence of risk
- ✓ The spirit of sharing profits and losses

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<sup>15</sup>Under buy-back arrangement clients sell some movable or immovable goods to bank and immediately buy-back the same at a higher price( with mark-up) payable at a future date [Mabid Ali Al-Jarhi and Munawar Iqbal, Islamic Banking: Answers to some frequently asked questions, (Islamic Development Bank, 2001), 49].

- ✓ The direct link between capital investment and underlying assets based transactions<sup>16</sup>

There is immense scope of expansion of business organizations individual activities based on partnership in the modern industrial world and especially in the under developed countries. Because in under developed countries (like in Pakistan) there is scarcity of capital and this form of Islamic investment enable such countries not only to mobilize their internal resources but also to stand on their own feet in matters of finance.<sup>17</sup>

In spite of having all the characteristics of a true Islamic financial mode of financing musharaka is not that much popular among Islamic banks and investors as it should be due to lot of issues. Like sometimes it is criticized as being an old instrument which cannot be applied in the modern world and cannot meet the needs of the day. But this is an unjustified criticism. Islam never ever prescribed a specific form of Musharaka rather it has some rules and broad principles in the light of which new forms can be introduced, no new form can be rejected only on that base that it has no precedent in the past instead of that every that form is acceptable which comes in conformity with the principles of shariah.<sup>18</sup>

A commission for the Islamization of economy (CIE) in Pakistan was appointed in accordance the Enforcement of Shariah Act, 1991<sup>19</sup>. It submitted its report on June 1992 and in its report it raised two important points regarding Musharaka, these are:

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<sup>16</sup>Sufyan Ghulam Ismail, Islamic Finance Explained, available at <http://www.1stethical.com/IslamicFinanceExplained.pdf>, last visited 5-5-2007

<sup>17</sup>Afzal-Ur-Rahman, Economic Doctrines of Islam Vol. 1, (Lahore: Islamic Publications Ltd.), 241.

<sup>18</sup>Hussain G.Rammal, Financing Through Musharaka: Principles And Application, available at <http://www.wesrga.edu/~bquest/2004/musharaka.html>, last visited 5-6-2007, [hereinafter G.Rammal at <http://www.wesrga.edu/~bquest/2004/musharaka.html>]

<sup>19</sup>Government maintaining its theoretical commitment to the process of Islamization promulgated a law entitled "the enforcement of SHARIAH Act 1991".

- ✓ Commission presented its observation that almost the entire commercial banking operations in Pakistan are being conducted on the basis of mark-up<sup>20</sup> and that too under buy-back arrangements<sup>21</sup>. This is not in conformity with the objectives of shariah.
- ✓ It also observed that some of the deposit mobilization schemes of banks and financial institutions are not based on profit and loss sharing in the real sense of shariah.

The commission gave its recommendation that musharaka financing should be given greater importance and the mark-up system should be done away with.<sup>22</sup>

But unfortunately evaluating the present banking system in Pakistan in terms of its Islamicity it transpires that more than 80% of the financing is being provided by the banks under the Buy-Back Agreement with mark-up in price<sup>23</sup>

Major obstacles for the implementation of profit and loss sharing system in Pakistan can be summarized under two categories:

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<sup>20</sup>The term mark-up has been coined from the trade based mode Bai Muajal which referred to sale on deferred payment basis. The C.I.I had legalized bai muajal subject to fulfillment of certain operational conditions. In this sale margin of the profit is agreed upon between the seller and the buyer. This payment of the sale price + profit may be immediate or deferred. [Dr S M Hasanuzamman, 'Islamization of The Financial System in Pakistan', Encyclopedia Of Islamic Banking And Insurance, ( London: Institute of Islamic Banking And Insurance, 1995), 239]. All muslim jurists are agreed on the legality of bai muajjal in shariah but there is no agreement among the jurists on the mark-up in bai muajjal. It means that there is no consensus of opinion whether a seller can increase a price of commodity on deffered payment or not. A group of jurists allow it because it is increase against the commodity and not the money they argue that increase against money in riba not against commodity. But some other scholars raise doubts against its validity. [Mansuri. 2001, 223-224.]

<sup>21</sup>Under buy-back arrangement clients sell some movable or immovable goods to bank and immediately buy-back the same at a higher price (with mark-up) payable at a future date.

<sup>22</sup>Shahid Hasan Siddiqui, Islamic Banking, (Karachi: Royal Book Company, 1994) 80-83 [Hereinafter Siddiqui,1994].

<sup>23</sup>Zaidi, Nawazish Ali, Elimination of interest from commercial Banks and Financial Institutions In Pakistan. Paper presented in National Workshop 15-16 June 1991 Islamabad. Institute of Islamic Economics, International Islamic University.

- i. Problems from the bank's perspective:
- ii. Problems from the investor's perspective<sup>24</sup>

### 1.2.1 FROM THE BANK'S PERSPECTIVE

- ✓ Unlimited discretion is available both to the banks and the public to use any of the twelve modes of financing<sup>25</sup> which is prescribed by the state bank of Pakistan for the interest free financing. That is why the banks and the public do not have sufficient motivation to prefer Musharaka over other modes of investment.<sup>26</sup>
- ✓ Dishonesty is another factor that takes the bank away from Musharaka institution. There is great apprehension that dishonest client may exploit the instrument of Musharaka by not paying any return to the bank. It is not difficult for them to show that business did not earn any profit along with that they can also claim that it had suffered a loss.<sup>27</sup> Experience is that clients can "cook the books" so that the business appears to make no profit.
- ✓ A proper legal framework for strengthening the institution of Musharaka has been missing.<sup>28</sup>

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<sup>24</sup>Islamic finance and structured commodity finance techniques: where the Twain can meet, available at: <http://www.unctad.org/Templates/Download.asp?docid>, last visited 02-06-07 hereinafter [www.unctad.org/templates](http://www.unctad.org/templates)

<sup>25</sup>In June 1984, State Bank of Pakistan issued directives for the elimination of interest according to which banks were allowed to finance on the following modes which were considered by them to be Islamic:

1)-finance by lending which includes a)-loans with service charges. b)- qard hasan.  
 2)-trade related modes of finance: a)-purchase and sale of goods on mark-up basis b)-purchase of trade bills c)- purchase of property with buy-back agreement d)-leasing e)-hire-purchase f)-financing for development of property 3)-investment modes of finance: a)-musharaka or profit and loss sharing b)-equity participation c)- purchase of PTC'S or modaraba certificates d)-rent-sharing. [Siddiqui, 1994, 77]

<sup>26</sup>Dr S M Hasanuzamman, 'Islamization of the Financial System in Pakistan', Encyclopedia of Islamic Banking and Insurance, London: Institute of Islamic Banking And Insurance, 1995), 243.

<sup>27</sup>Mualana Taqi Usmani, An Introduction to Islamic Finance, Some Objections On Musharaka Financing, (Idaratul Maarif, Karachi), 1998, 74.

<sup>28</sup> Siddiqui, 1994, 81-82

- ✓ A separate law which governs the institution of Musharaka like partnership act or the Modaraba Law is urgently needed. In these days Musharaka financing is governed like an ordinary contract under the contract act. No law has been introduced to define modes of participatory financing that is Musharaka. It is presumed that whenever there is a conflict between the Islamic banking framework and the existing law, the latter will prevail.<sup>29</sup>
- ✓ Promotion of Musharaka system is also affected due to interest based government borrowing schemes and the interest based deposit mobilization practices.
- ✓ There has been lack of any strong affirmative policy action in favor of profit sharing modes of financing as against other modes of finance which based on fixed rate of return.<sup>30</sup>
- ✓ It is often difficult to distinguish the transactions which are part of the Musharaka from the general business of the investor.<sup>31</sup>

### 1.2.2 FROM THE INVESTOR'S PERSPECTIVE

- ✓ There is great apprehension that bank may intervene too much in day to day operations or management.<sup>32</sup>
- ✓ The risk associated in Musharaka to share loss is another reason that it is not as popular as the other modes. The depositors, being constantly exposed to the risk of loss, will not want to deposit their money in the banks and financial

<sup>29</sup>A.L.M.Abdul.Gafoor, Islamic Banking, available at [http://users.bar.nl/~abdul/chap4.html #4.3Problems in implementing the PLS scheme](http://users.bar.nl/~abdul/chap4.html#4.3Problems in implementing the PLS scheme), last visited 2-6-2007. [hereinafter A.L.M.Gafoor at [http://users.bar.nl/~abdul/chap4.html #4.3Problems in implementing the PLS scheme](http://users.bar.nl/~abdul/chap4.html#4.3Problems in implementing the PLS scheme)].

<sup>30</sup>Dr S M Hasanuzamman, 'Islamisation of The Financial System in Pakistan', Encyclopedia Of Islamic Banking And Insurance, ( London: Institute of Islamic Banking And Insurance, 1995), 244.

<sup>31</sup>[www.unctad.org/templates](http://www.unctad.org/templates)

<sup>32</sup>[www.unctad.org/templates](http://www.unctad.org/templates)

institutions in this mode of finance.<sup>33</sup> To make the product more appealing to the customer, some financial institutions have started guaranteeing profits in Musharaka. By doing so, these institutions are contradicting the basic law of Islamic finance that requires linking profits to risks.<sup>34</sup>

- ✓ Apprehension exists in disclosing accounts and profit to bank that it may share it with tax authorities and in consequence of that client' s tax liability may increase.<sup>35</sup>
- ✓ Many times it is observed that clients does not want to share their profit with bank because they think that bank has nothing to do with the management or business then why should they share the fruit of their labor with the bank who has no role except the fund provider.<sup>36</sup>
- ✓ There is also apprehension that will bank really share in any loss of a business?<sup>37</sup>
- ✓ The perception that Musharaka system is full of complexity makes the people away from adopting Musharaka. This perception is based only on the lack of correct information about this system.<sup>38</sup>

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<sup>33</sup>Usmani, *An Introduction To Islamic Finance*, 1998, 75.

<sup>34</sup>Hussain G.Rammal, *Financing Through Musharaka: Principles And Application*, available at <http://www.wesrga.edu/~bquest/2004/musharaka.html>, last visited 5-6-2007

<sup>35</sup>A.L.M.Gafoor at <http://users.bar.nl/~abdul/chap4.html> #4.3Problems in implementing the PLS scheme

<sup>36</sup>Usmani, 1998, 75

<sup>37</sup>[www.unctad.org/templates](http://www.unctad.org/templates)

<sup>38</sup>Siddiqui, 1994, 82

## CONCLUSION:

At the end of this discussion it can be concluded that Musharaka institution must be duly promoted in the banking sector of Pakistan and apprehensions, which exists in this regard, both with the investors as well as the financial institutions must be clarified. Government should adopt effective measures and must made modifications to bring the banking system in Pakistan nearer to shariah parameters. It must introduce a separate law to govern that mode so that lots of ambiguities regarding that mode can be removed. Musharaka institution needs a lot of attention so that mark-up and buy back system can be done away with.

## SECTION 3:

### LEGITIMACY OF MUSHARAKA

Musharaka is encouraged and permitted in Islam. Islamic jurists point out that the legality and permissibility of Musharaka is based on the injunctions of the:

- ❖ Quran
- ❖ Sunnah and
- ❖ Ijma (consensus) of the scholars.<sup>39</sup>

#### 1.3.1 QURAN

The Quran says:

“Verily many are the partners in business who wrong one other except those who believe and work deeds of righteousness and how few are they”<sup>40</sup>

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<sup>39</sup>Dr. Muhammad Tahir Mansuri, *Islamic Law of Contracts and Business Transactions*, (Islamabad: Shariah Academy International Islamic University, 2001) 243.

<sup>40</sup>Surah Sad, Ayah 24

### 1.3.2 SUNNAH

- ✓ Hadith of Al Sa'ib Ibn Abi Al Sa'ib Al Makhzumi who was a partner of the prophet peace be upon him in business at the beginning of Islam. On the day the Prophet peace be upon him conquered Mecca the Prophet said when he met Sa'ib: Welcome my brother and my partner. He jokes not (i.e he is serious in business) and does not argue (unnecessarily) <sup>41</sup>
- ✓ Prophet Muhammad (PBUH) said: "Allah the Supreme said ' I am the third of the two partners as long as one of them does not betray his companion. If he betrayed, I would withdraw from them".<sup>42</sup>
- ✓ The Holy Prophet (PBUH) also said: "Allah Almighty is with the two partners unless they defraud each other".<sup>43</sup>

### 1.3.3 Ijma'aa (Consensus)

Partnerships are one of the main transactions at all times since the advent of Islam. This constitutes, therefore, a practical consensus for the permissibility and validity of partnerships.

## SECTION 4

### SCHOLARS CLASSIFICATION OF MUSHARAKA

The Muslim jurists have distinguished following main types of Musharaka:

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<sup>41</sup>Al-Hakim 2/61

<sup>42</sup>Abu Dawud al- sijistani, Sulayman, Al- sunnah, Kitab al Bauyu Bab ul- Sharikah, ( Cairo: Ihya al- Sunnah al Nabawiyah, 1975).

<sup>43</sup>Ibn Qudamah, Al-Mughni, (Maktaba-al-Riaz-al-Hadisiah, Al-Riaz), Vol:5,3.



There are two basic types of Musharaka:

- i. Sharikat al-Milk
- ii. Sharikat al-Aqd<sup>44</sup>

#### 1.4.1 Sharikat al-Milk

This kind 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”.<sup>45</sup>

This type of joint ownership may come into existence by two different ways:

- Optional ownership: comes into existence by the act of both the parties like joint purchase.
- Compulsory ownership: come into existence without any action on the part of the partners like inheritance.<sup>46</sup>

#### 1.4.2 Sharikat al-Aqd:

Sharikat al-aqd is the second type of Musharaka which comes into existence by a mutual agreement between two or more persons in order to share the capital and its profit.<sup>47</sup>

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<sup>44</sup>Ibn Qudamah, Vol. 5, 3; Kasani, 1986, Vol. 5, 56; Zuhili, Vol. 5, 3877; Musharaka & Mudarabah by Mulana Taqi Usmani, available at <http://www.Darululoomkhi.edu.pk/fiqh/islamicfinance/dm.html#concept>, last visited 18-5-2007.

[hereinafter, usmani at [www.darululoomkhi.edu.pk/fiqh/islamicfinance](http://www.darululoomkhi.edu.pk/fiqh/islamicfinance)

<sup>45</sup>Majallah, Article 1045.

<sup>46</sup>Dr. Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions*, (Islamabad: Shariah Academy international Islamic university Islamabad, 2001), 244. [hereinafter Mansuri, 2001]; Usmani at [www.darululoomkhi.edu.pk/fiqh/islamicfinance](http://www.darululoomkhi.edu.pk/fiqh/islamicfinance); Zuhili, Vol. 5, 3877.

<sup>47</sup>Majallah, article 1329; Zuhili, Vol.5, 3877;

## Rules of Shirka al-Aqd

Common conditions are three which are as follows:

- a) The existence of Muta'aqideen (Partners)
- b) Capability of Partners: Must be sane & mature and be able of entering into a contract. The contract must take place with free consent of the parties without any fraud or misrepresentation.
- c) The presence of the commodity: This means the price and commodity itself.<sup>48</sup>

### Difference between Shirkat al-Milk and Shirkat al-Aqd: Conclusion

Shirkat al-Milk is the partnership based on joint ownership, which can be voluntary or involuntary. While, Shirkat-al-Aqd always came into existence with a contract. It is a contractual relationship as it can be seen from its name "Aqd" the meaning of which is contract in Arabic.

Shirkat al-Milk can be compulsory or optional while no compulsion must exist at the time of Shirkat al-Aqd otherwise it will become null and void. Capability of partners also shows the difference; in shirkat-al aqd partners must be sane and mature such condition exists in shirkat al milk because it can be voluntary or involuntary.

#### 1.4.3 Distribution of Shirkat-al Aqd:

The four schools of thought differ in their opinion regarding the kinds of sharikat al-aqd.<sup>49</sup>

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<sup>48</sup>Dr. Muhammad Imran Ashraf Usmani, Meezanbank's guide to Islamic Banking, (Karachi: Darul- Ishaat, 2002,90).

<sup>49</sup>Nyazee, 1998, 27; Mansuri, 2001, 246.

## HANBLI DISTRIBUTION

Hanbli jurists divide sharikat al-Aqd into five kinds:-<sup>50</sup>

- ✓ Sharikat al-inan
- ✓ Sharikat al-Amal
- ✓ Sharikat al-Mufawadah
- ✓ Sharikat al-Wajuh
- ✓ Sharikat al-Mudarabah<sup>51</sup>

## MALIKI AND SHAFI DISTRIBUTION

Maliki and shafi jurists divide sharikat al-Aqd into four kinds:-

- ✓ Sharikat al-Inan
- ✓ Sharikat al-Wajuh
- ✓ Sharikat al-Amal
- ✓ Sharikat al-Mufawadah<sup>52</sup>

## HANFI DISTRIBUTION

Hanfi jurists divide sharikat al-aqd into six kinds:-

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<sup>50</sup>Al-Bihuni, Vol. 2, 319;

<sup>51</sup>Ibn Qudamah, Vol. 5, 3; Zuhili, Vol. 5, 3878

<sup>52</sup>Shams-ud-Din Muhammad Bin Abi Abbas, Nihayatal Muhtaj-ila-Shar-al-Minhaj, (Al-Maktaba Al-Islamia), Vol. 5, 3-4; Zuhili, Vol. 5, 3878.

- ✓ Sharikat al-Amwal by way of mufawadah
- ✓ Sharikat al-Amwal by way of inan
- ✓ Sharikat al-Amal by way of mufawadah
- ✓ Sharikat al Amal by way of inan
- ✓ Sharikat al-Wajuh by way of mufawadah
- ✓ Sharikat al wajah by way of inan<sup>53</sup>

### Definitions of the different kinds of Sharikat al-Aqd according to Majority Schools:

Here I will present the brief definitions of these kinds in the eyes of Majority school of thoughts, these are:

#### Shirkat al-Inan: Restricted authority and obligation

Ibn Qudamah defines Sharikat al-Inan: It is a partnership in which two persons participate with their wealth and work on the condition that the generated profits will be shared by them.<sup>54</sup>

It is limited partnership with unequal capital contributions. It is not necessary that partners must share equal responsibility. Partners must share equally the loss & profit according to their share in the and capital in the viewpoint of majority schools of thought but Hanafa's says profit can be share according to the agreement. It is a contract between two or more persons to work in any particular trade with determined capital and to share profit and loss with determined rates. All the Muslim jurists are unanimous on its validity.<sup>55</sup>

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<sup>53</sup>Kasani, 1986, 56; Zuhili, Vol. 5,3878.

<sup>54</sup>Ibn Qudamah, Al-Mughni, (Maktaba-al-Riaz-al-Hadisia, Al-Riaz), Vol. 5.

<sup>55</sup>ibid

## Sharikat al-Amal: Work Partnership

It is a partnership in which the partners contribute investment in the form of labor and skill. It is also called Sharikat al-abdan because the partners perform manual labor. It is also called Sharikat al-sanai their capital is their skill.<sup>56</sup>

## Sharikat al-Mufawadah: Full authority and obligation

Mufawadah is participation in each thing.<sup>57</sup> It is the partnership in which each partner confers upon his colleague full authority to dispose of their joint capital in any manner intended to benefit their association.<sup>58</sup> This is where two partners share in all the types of companies like a combination between the companies of 'Inan, Abdan, Mudarabah and Wujooh.<sup>59</sup>

## Sharikat al-Mudarabah

It is the partnership of a body with property. It means that one pays his property to another person so as to trade with it for him and the resulting profit is divided amongst them according to what they stipulated.<sup>60</sup>

## Sharikat al-Wajuh: Good will/Credit worthiness

It is defined as the purchase on credit by two persons of something whose profits they share on the condition of half or third or like as agreed. It is a partnership of two people without capital upon the condition that they will buy on credit and sell for cash.<sup>61</sup>

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<sup>56</sup> Abu Bakr Mohammad Ibn Ahmad Al-Sarakhasi, Al-Mabsut (Beirut: Dar al-Ma'arifah), 1978.

<sup>57</sup> Al-Behutni

<sup>58</sup> Ibn Rushd, Al Qawanin al-Fiqhiyyah, 2083

<sup>59</sup> Shaikh Taqiuddin an-Nabhani, Nidham al-Iqtisaadi fil Islam (The Economic System in Islam), 1953.

<sup>60</sup> ibid

<sup>61</sup> Sarakhsi, Al-Mabsut, Vol 11, 152 ; Mansoor Ibn Yunus al-Bahuti, Kashshaf al-Qina ala Matna al-Iqna.u Matba'ah Ansar al-Sunnah-al- Muhammadiyyah, Vol.3, 526.

## Distribution of Sharikat al-Aqd by Hanfi Jurists:

First of all Hanfi jurists divide Sharikat al-Aqd into three kinds:

- ✓ Sharaiaht al Amwal
- ✓ Shariaht al-Amal
- ✓ Sharikat al-Wajuh

Then these three kinds are further divided into Inan and mufawadah.

### Saharikat al Amwal by way of Inan:

It is a contract between two or more persons to work in any particular trade with determined capital and to share profit and loss with determined rates.<sup>62</sup>

### Sharikat al Amwal by way of Mufawadah:

It is a contract of participation between two or more persons, with the condition of complete equality with respect to capital, profit and status, for working with their own wealth, or with their labour in mother's wealth, or on the basis of their credit-worthiness, so that each partner is a surety for the other.<sup>63</sup>

### Sharikat-al-Amal by way of Mufawadah

This type of partnership requires equal share of liability undertaken by each partner, and equal share of profit and loss. The compensation received for the work is shared equally by

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<sup>62</sup>Zuhali, Al-Fiqh-al-Islami wa Addillatuhu, Vol 4, 414

<sup>63</sup>Marghinani, Al-Hidayah, Vol3, 3,.

all the partners, irrespective of the fact that the work is done in the partnership or outside the business.<sup>64</sup>

### Sharaikat al-Amal by way of Inan

Inan work partnership is base on the concept of agency and not on suretyship. Thus each partner is liable only for the obligation personally incurred by himself.<sup>65</sup>

### Sharikat al-Wajuh by way of Inan

According to Hanfi jurists the conditions for Sharikat al-Wajuh by way of Inan are these:

- ✓ Specified share in the goods purchased
- ✓ Entitlement to profit based upon liability
- ✓ Unequal ownership in the purchased goods
- ✓ Stipulation of profit contrary to ownership
- ✓ Excess work<sup>66</sup>

### Sharikat al-Wajuh by way of Mufawadah

According to Hanfi jurists conditions for Sharikat al-Wajuh by way of Mufawadah are following:

- ✓ Not necessary to specify the share of a partner in the goods purchased on credit
- ✓ Any partner can be sued for the goods purchased

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<sup>64</sup>ibid

<sup>65</sup>Sarakhasi, Al-Mabsut, Vol 11, 151; Majallah, Article 1387

<sup>66</sup>Imran Ahsan Khan Nyazee, Islamic Law of Business Organization Corporations, (Islamabad: International Institute of Islamic Thought & Islamic Research Institute, 1998), 19.  
[Hereinafter Nyazee, 1998]

- ✓ Each thing purchased on credit by a partner for business purposes is bought for the joint business.<sup>67</sup>

## SECTION 5:

### MODERN CLASSIFICATION OF MUSHARAKA

There is another division of the forms of Musharaka according to modern scholars and Islamic banks which divide Musharaka into two main types for their financial activities these are:

- ✓ Permanent Musharaka
- ✓ Diminishing Musharaka<sup>68</sup>

#### 1.5.1 PERMANENT MUSHARAKA

In this case, the Islamic bank participates in the equity share and receives an annual share of the profit on a pro rata basis. The period of termination of the contract is not specified, so it can continue as long as the parties concerned wish it to continue. So it can continue so long as the parties concerned wish it to continue.<sup>69</sup>

#### 1.5.2 DIMINISHING MUSHARAKA

Various terms are being used by scholars for the concept of diminishing Musharaka like, digressive Musharaka,<sup>70</sup> Musharaka mutanaqisha, Musharaka at tanazolia, declining

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<sup>67</sup>ibid

<sup>68</sup>Dr. Ausaf Ahmed, The Evolution of Islamic Banking, available in Encyclopedia of Islamic Banking and Insurance, (London: Institute of Islamic Banking and Insurance, 1995), 26; Glossary of Financial Terms, available at <http://www.islaminconferences.com/glossary.htm>, last visited, 20-5-2007.

<sup>69</sup>What is musharaka. Available at: [http://www.islamic-banking.com/shariah/sr\\_musharaka.php](http://www.islamic-banking.com/shariah/sr_musharaka.php), last visited 20-5-2007; <http://www.financeinislam.com/articles>, last visited 20-5-2007.

<sup>70</sup>Islamic financial modes and financial instruments available at <http://www.islamibankbd.com/page/ideology.html>, last visited 20-5-2007



Musharika,<sup>71</sup> Musharaka Muntahi Bit-Tamleek,<sup>72</sup> etc. The technique of diminishing Musharaka is getting quite popular these days in Islamic banks because of its potentialities. It is a recent innovation and its popularity depends on the fact that permanent or classical Musharaka aims to involve Islamic banks as permanent partner in the Musharaka which may not be a desirable form for a financial institution because financial institutions prefer to invest in those projects where there is more chance of liquidation or at least a definite maturity of their investments should exist in those projects, which diminishing Musharaka provides.<sup>73</sup>

Under this mode of financing, the financier and the buyer jointly purchase a property. The ownership is then divided into equal Musharaka units and each party will own a number of units commensurate with its investment. The buyer will pay the cost for the use of the property with respect to the units owned by the financier.<sup>74</sup> And it ends up with the transfer of complete ownership to the buyer who purchases the share of the financier in that project by a redeeming mechanism<sup>75</sup> agreed between both of them.<sup>76</sup>

There is no exact definition of diminishing Musharaka exits in the law books of Pakistan. But State Bank of Pakistan approved this newly emerged Islamic financial mode of financing through its State Bank of Pakistan Shariah Board and that board gives concept of diminishing Musharaka in these words:

It 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

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<sup>71</sup>Abdual Awwal Sarker, Islamic Business Contracts, Agency Problems and the Theory of the Islamic Firm available at <http://islamicfinance.net/journals/journal2/art2.pdf>, last visited 22-5-2007

<sup>72</sup>Dr. Muhammad AL-Ameen Mustafa Abu Al-Sanqeetee, Darasata Shariah Leaham AL- AQUD AL Malia-tal-Mustahadisa, (Makataba al-Ulum wa -Hikm, Al Madina Munawara, 1992) 387

<sup>73</sup>Mohammad Obaidullah, Islamic Financial Services, available at, <http://islamiccenter.kau.edu.sa/english/publications/obaidullah/ifs/parttwo>, last visited 22-5-2007

<sup>74</sup>Sohail Jaffer, Islamic Retail Banking and Finance, Global Challenges and Opportunities [Euro money Books, London, United Kingdom, 2005], 69.

<sup>75</sup>Redeemable mechanism is such type of arrangement in which the partner replaces the bank gradually under the provisions of agreement and the nature of the project financed.

<sup>76</sup>Safeer Reza Naqvi, History of Banking and Islamic Laws, [Hayat Academy Karachi, 1993] 133; diminishing musharaka available at [http://www.alislami.co.ae/en/reaestate\\_musharaka.htm](http://www.alislami.co.ae/en/reaestate_musharaka.htm), last visited 13-5-2007

installments the proportionate share of the other co-owner until the title to such tangible asset is completely transferred to the purchasing co-owner.<sup>77</sup>

#### 1.5.2.1 Different forms of Diminishing Musharaka:

In the first Conference of the Islamic Banks in Dubai, the conferees studied the topic of Diminishing Musharaka which ends up with the transfer of complete ownership (decreasing partnership) and in that they decided that this type of business relationship may take one of the following forms.

**The First Form:** In this form, the bank agrees with the customer on the share of capital and both decide the conditions of partnership. The Conference decided the first form that the bank should sell its shares to the customer after the completion of the partnership. Furthermore, they determined that the selling of the banks interest to the partner should be done under an independent contract.

**The Second Form:** In this form, the bank participates in financing all or part of the capital requirements in exchange for sharing in the prospective earnings. In addition, the bank gains the right to retain the remainder of the income for the purpose of applying it towards the capital provided by the bank.

**The Third Form:** In this form, the bank and partner's ownership is determined by stocks comprising the total value of the asset (real estate). Each partner, (the bank and the customer) gets its proportionate share of the profit accrued from the real property. On an annual basis, the partner may purchase a prescribed number of the bank's shares until such time that the partner becomes the sole owner of the real property.<sup>78</sup>

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<sup>77</sup>Drafts instructions and guidelines for shariah compliance in Islamic banking institutions available at <http://www.sbp.org.pk/ibd/2007/DRAFT-SHARIAH-GUIDELINES.pdf>, last visited 13-5-2007.

<sup>78</sup>Muhammad AL-Amin Mustafa Abu Al-Naqiti, *Drasata Sharia Le-Aham Al Uqud Al-Malia Al-Mutahadisa*, [Maktaba Al-Uloom wa Hikm, Al-Madina Munawara, 1992], 389-390; *Concept and ideology :: Islamic Financial Modes and Financial Instruments*, available at <http://www.islamibankbd.com/page/ideology.htm>, last visited 28-05-2007

### 1.5.2.2 HOW PAKISTANI ISLAMIC BANKS DEFINES DIMINISHING MUSHARAKA

Here it is better to present definition of diminishing Musharaka which different Islamic banks in Pakistan are using for their financial activities through diminishing Musharaka.

#### HOW AL-MEEZAN BANK DEFINES DIMINISHING MUSHARAKA

Pakistan's first retail Islamic housing finance facility was made available by Meezan Bank in December 2003. It is a comprehensive product based on the concept of Diminishing Musharaka.<sup>79</sup> The glossary of Al-Meezan bank defines diminishing Musharaka as:

“Another form of Musharaka (a financing mode) developed in recent years. According to this concept, a financier and his client participates either in the joint ownership of a property or equipment, or in a joint commercial enterprise. The share of the financier is further divided into a number of units and it is understood that the client will purchase the units of the share of the financier one by one periodically, thus increasing his own share until all the units of the financier are purchased by him so as to make him the sole owner of the property, or the commercial enterprise, as the case may be”.<sup>80</sup>

#### HOW DUBAI ISLAMIC BANK DEFINES DIMINISHING MUSHARAKA

Dubai Islamic Bank defines diminishing Musharaka in these words:

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<sup>79</sup>Sohail Jaffer, *Islamic Retail Banking and Finance, Global Challenges and Opportunities* [Euro money Books, London, United Kingdom, 2005], 67.

<sup>80</sup>[http://www.meezanbank.com/en/Glossory\\_D.aspx](http://www.meezanbank.com/en/Glossory_D.aspx), last visited 13-5-2007

Diminishing Musharaka is a form of partnership, which ends with the complete ownership of a partner who purchases the share of another partner in that project by a redeeming mechanism agreed between both of them.<sup>81</sup>

## HOW BANK AL-BARAKA DEFINES DIMINISHING MUSHARAKA

Bank Al-Baraka defines the concept of diminishing Musharaka in these words:

“Diminishing Musharaka allows equity participation and sharing of profit on a pro rata basis but also provides a method through which the equity of the bank keeps on reducing its equity in the project and ultimately transfers the ownership of the asset on of the participants. The contract provides for a payment over and above the bank share in the profit for the equity of the project held by the bank. That is the bank gets a dividend on its equity. At the same time the entrepreneur purchases some of its equity. Thus, the equity held by the bank is progressively reduced. After a certain time the equity held by the bank shall come to zero and it shall cease to be a partner”.<sup>82</sup>

Is their any difference exists between these definitions: CONCLUSION

Meezan Bank is pioneer in Pakistan in the field of introducing Diminishing Musharaka for Islamic home financing. It provides the concept of diminishing Musharaka and other banks like Dubai Islamic bank Bank AlBaraka, Bank ALfalah etc follow the identical model.

Following is the brief analysis of these definitions in my viewpoint and in the preceding chapters I will present in detail the models of these banks. Important points of these definitions are as:

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<sup>81</sup>[http://www.alislami.co.ae/en/realestate\\_musharaka.htm](http://www.alislami.co.ae/en/realestate_musharaka.htm) ,last visited 13-5-207

<sup>82</sup><http://www.albaraka.com.pk/glossory/index.html>

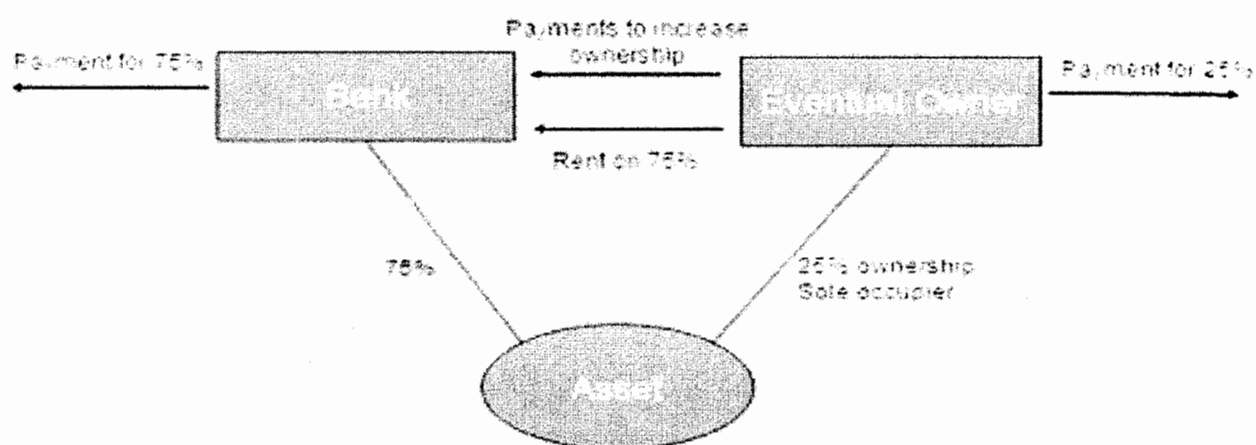
- ✓ All the three banks presents that it is a form of partnership and Meezan bank further clearly specify that it is a joint ownership.
- ✓ Meezan bank says that joint ownership can be in Property or equipment or in a joint commercial enterprise. So through this it specify these three special forms while no such specification exists in the definitions of the other two banks. Both only say the ‘partnership in project’.
- ✓ All the three definitions provide the basic procedure of diminishing musharaka that the client will purchase the entire units of the financier periodically which will give him the sole right of ownership. This also predicts the undertaking by the client to purchase the financier share in the property. Dubai Islamic bank mentioned the word redeeming mechanism, which also means the same procedure.
- ✓ Bank Al-Baraka also gives the concept of profit in its definition and says that ‘contract provides for a payment over and above the bank share in the profit for the equity of the project held by the bank’. While no such reference was given in the other two definitions.
- ✓ Bank Al-Baraka use the technical words in its definition while the definition of Dubai Islamic Bank is very briefly but as far as Al –Meezan bank’s definition is concerned it is very much simple and comprehensive and easy to understand.

### 1.5.2.3 EXAMPLE OF THE CONCEPT OF DIMINISHING MUSHARAKA

Diminishing shared ownership is usually implemented when a person which would become the eventual owner has sufficient funds to purchase say 25% of the asset but need finance for the other 75%. In that situation if he will get conventional loan then in that case he would

borrow 75% of the total cost of the asset from the bank and have 100% beneficial ownership of the asset from the start, although legal title to the asset would be held by the bank as a security.<sup>83</sup> But the procedure is different in diminishing musharaka. In diminishing shared ownership the client and the bank purchase the property jointly, although in it also the bank for security holds the legal title of the asset. But the client enjoys the sole occupancy rights and pays rent to the bank on that part of the asset which he does not own and then he acquires the remain of the asset which he does not own.<sup>84</sup>

The concept of diminishing musharaka can be best explained with the help of an example:



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Diminishing Musharaka agreement consists on two parts.<sup>86</sup>

First the customer enter into agreement with the bank under the joint ownership agreement that is Sharikat-al-Milk and puts its share in the asset like 25% and the bank puts its share of 75%. Then in the second part bank lease its share in the asset to the customer and charges rent from him.

<sup>83</sup>Mohammed Amin, *Diminishing Shared Ownership for Property Acquisition with Islamic finance*, available at [http://pwc.blogs.com/mohammed\\_amin/](http://pwc.blogs.com/mohammed_amin/); Permissible Financing Methods available at [http://www.islamic-world.net/economocs/permissible\\_financing\\_methods.htm#](http://www.islamic-world.net/economocs/permissible_financing_methods.htm#)

<sup>84</sup>ibid; Dr. Zainal Azam B Abd.Rahman available at <http://www.ikim.gov.my/v5/index.php/imagesweb/ikim/index.php>; Muhammad Ashraf, *Shariah- Compliant Financial Products* available at <http://www.accountancy.com.pk/articles.asp>

<sup>85</sup>diagram taken from the article of Muhammad Amin, *UK Taxation of Islamic Finance-Where are They Now*, available at [http://pwc.blogs.com/mohammed\\_amin/2006/11/tax\\_treatment\\_0.html](http://pwc.blogs.com/mohammed_amin/2006/11/tax_treatment_0.html)

<sup>86</sup>Muhammad Ayub, *Islamic Banking & Finance, Theory and Practice*, [Research Department, State Bank of Pakistan, Karachi], 75.

In the diminishing Musharaka contract customer gives the promise to the bank that he will purchase the banks shares in then asset by gradual payment. Shares are divided in the asset in units and customer purchase these units one by one and at the end he become the sole owner of the asset and complete ownership of the asset transfers to him.

This is the mechanism of diminishing Musharaka.<sup>87</sup>

#### 1.5.2.4 Rules to enter into DIMINISHING MUSHARAKA Contract

The general rules for partnerships apply to a diminishing partnership, especially the rules for Sharikat Al Inan. Therefore, it is not permitted that the contract of a diminishing partnership includes any clause that gives any of the parties to the Musharaka a right to withdraw his share in the capital.<sup>88</sup>

The detailed rules to govern the contract of diminishing which each and every Islamic bank in Pakistan have to follow are those which state bank of Pakistan present in its Draft Instructions and Guidelines for Shariah compliance in Islamic Banking Institution. I extract some important rules from it these are following:

- ⇒ It can be created only in tangible assets.
- ⇒ This agreement would consist of following three steps, i.e.
  - ✓ Creation of joint ownership between the co-owners.

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<sup>87</sup>Sohail Jaffer, Islamic Retail Banking and Finance, Global Challenges and Opportunities [Euromoney Books, London, United Kingdom, 2005],69; Mohammad Najetullah Siddiq, Riba, Bank Interest and the Rationale of its Prohibition, available at [http://www.globalwebpost.com/faqooqm/study\\_res/I\\_econ\\_fin/nejatullahahs\\_riba.pdf](http://www.globalwebpost.com/faqooqm/study_res/I_econ_fin/nejatullahahs_riba.pdf), last visited 12-5-2007; Mohammad Asharaf, Shariah Complaint Financial Products , available at <http://www.accountancy.com.pk/articles.asp>, last visited 14-5-2007; Tariq Hameed, Does the diminishing musharaka reflect the spirit of sharaiah, available at <http://www.mfgoonline.co.uk/magazine>, last visited 14-5-2007; The LARIBA Lease Purchase Model available at <http://americanfinance.com/TheLARIBALeasePurchaseModel.htm>, last visited 12-5-2007.

<sup>88</sup> Sharika(Musharaka) And Modern Companies available at <http://www.bisbonline.com/English/islamic-sheets-1-en.html>, last visited 13-5-2007.

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- ✓ Renting out by one co-owner the undivided share in the asset owned by him to the other co-owner; and
- ✓ Selling in periodic installments by one co-owner his share to the other co-owner(s)<sup>89</sup>
  
- ✓ All other terms and conditions are as essential to co-ownership, Ijarah and sale shall be fulfilled in respect of different stages in the process of DM arrangement.
  
- ✓ Proportionate share of each co-owner must be known and defined in terms of investment.
  
- ✓ The amount of periodic payment would go on decreasing with purchase of ownership units by the purchasing co-owner.
  
- ✓ Each periodic payment shall constitute a separate transaction of Sale.
  
- ✓ Separate agreements/contracts shall be entered into at different times in such manner and in such sequence so that each agreement/contract is independent of the other in order to ensure that each agreement is a separate transaction.<sup>90</sup>

### 1.5.2.5 FATWAS ON DIMINISHING MUSHARAKA

Diminishing Musharaka is a new type of contract suggested by contemporary jurists keeping in view the problems of the current muslim world.<sup>91</sup> But besides that we see that where a lot

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<sup>89</sup>Muhammad Ayub, Islamic Banking & Finance, Theory and Practice, [Research Department, State Bank of Pakistan, Karachi], 75.  
<sup>90</sup>Sohail Jaffer, Retail Banking and Finance, Global Islamic Challenges and Opportunities [Euro money Books, London, United Kingdom, 2005],69;Drafts instructions and guidelines for shariah compliance in Islamic banking institutions available at <http://www.sbp.org.pk/ibd/2007/DRAFT-SHARIAH-GUIDELINES.pdf>, last visited 13-5-2007.  
<sup>91</sup>Muhammad Ayub, Islamic Banking & Finance, Theory and Practice, [Research Department, State Bank of Pakistan, Karachi], 75.



of scholars permit this new type of Musharaka some others raise their concern regarding diminishing Musharaka. In the preceding paragraphs I will present both views:

### Opponents of Diminishing Musharaka:

Opponents of Diminishing Musharaka raise the following objections on its permissibility:

- ✓ First objection is that majority of Islamic schools of thought do not allow the combining of more than one agreement into a single contract.
- ✓ 2<sup>nd</sup> a promise is not equal to a contract their view.<sup>92</sup>
- ✓ They raised the objection that what is the difference between rent and interest, and term it only a window dressing.<sup>93</sup>

### Scholars defending Diminishing Musharaka:

- ✓ The first step involved in diminishing Musharaka is to create joint ownership in a property and joint ownership is permissible by all school of thoughts.<sup>94</sup> Therefore no objection can be raised against creating this joint ownership.<sup>95</sup>
- ✓ The second step involved in diminishing Musharaka is that bank leases his share in the property to client which is in compliance of shariah principles. All Muslim Jurists agree on the permissibility of the Financier leasing his share in property to client and charging him rent i.e. the permissibility of leasing one's share to his partner.<sup>96</sup> There is no difference of opinion among the Muslim jurists in the permissibility of leasing one's undivided share in a

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<sup>92</sup>Sohail Jaffer, Retail Banking and Finance, Global Islamic Challenges and Opportunities, 2005, 77.

<sup>93</sup>Islam has an Economic System, available at [http://www.irfi.org/all\\_articles.htm](http://www.irfi.org/all_articles.htm), last visited 25-9-2007

<sup>94</sup>Najmul Hassan, Islamic Financial Instruments, available at <http://www.icap.org.pk/Downloadss/IslamicFinance.ppt>, last visited 13-5-2007

hereinafter Najmul Hassan at <http://www.icap.org.pk>; Shari'aa Opinions & Methodology available at <http://www.laraiba.com/fatwas/model.htm> .

<sup>95</sup>Usmani at <http://www.darulloomkhi.edu.pk>

<sup>96</sup>The Institute of Islamic Banking & Insurance, Shariah Rulings, Islamic Mortgages, available at [http://www.islamic-banking.com/shariah/sr\\_mortgages.php](http://www.islamic-banking.com/shariah/sr_mortgages.php). hereinafter islamic mortgages available at [http://www.islamic-banking.com/shariah/sr\\_mortgages.php](http://www.islamic-banking.com/shariah/sr_mortgages.php) ; Shari'aa Opinions & Methodology available at <http://www.laraiba.com/fatwas/model.htm> .

property to his partner.<sup>97</sup> While there exists difference opinion regarding lease of un-divided share to a third party.<sup>98</sup> But as far as diminishing Musharaka is concerned financier leases his share in the property to the customer and it is permissible by the unanimity of scholars.

- ✓ The third step involved in diminishing Musharaka is that the client purchases the different units of the undivided shares of the bank (financier). All the Muslim school of thoughts also allows this transaction. But here again come contention that whether these shares can be sold to a third party or not? The answer is same as above one.<sup>99</sup>

Now after the permissibility of thesis three steps per se the question comes that whether these three transactions can be combined in a single contract? As the objection raised by the opponents of diminishing Musharaka mentioned above that more than one contract cannot be combined into one single contract. The answer to this question is that these transactions can be combined in one contract only by taking a promise from both sides of the parties. But these cannot be combined by making each one of them a condition to the other, as it is against the rules of shariah. Because it is a well established rule of shariah that one transaction cannot made a pre condition for the other transaction.<sup>100</sup> Because when the condition is expressly mentioned at the time of sale, it means that the sale will be valid only if the condition is fulfilled, meaning that if the condition is not fulfilled in future, the present sale will become

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<sup>97</sup>Usmani at <http://www.darulloomkhi.edu.pk>

<sup>98</sup>There can be two situations in the lease of joint ownership property: the first situation is that where one partner leases his share in the property to other partner and charges rent from him. This transaction is permissible by all muslim scholars while in the other situation the property is leased out to a third party, this type of lease is a point of contradiction between muslim scholars. Imam Abu Hanifa is of the view that undivided share cannot be leased out to a third party, while Maliki and Shafi are of the view that undivided share can be leased out to a third party.[ Islamic mortgages available at [http://www.islamic-banking.com/shariah/sr\\_mortgages.php](http://www.islamic-banking.com/shariah/sr_mortgages.php) ; Dr. Muhammad Ashraf Usmani, Meezanbank's guide to Islamic Banking, 2002, 118].

<sup>99</sup>What do different Islamic schools of thought say? available at [http://www.glasgowfinancialservices.com/islamic\\_mortgages.htm](http://www.glasgowfinancialservices.com/islamic_mortgages.htm).

<sup>100</sup>What do different Islamic schools of thought say? Available at [http://www.glasgowfinancialservices.com/islamic\\_mortgages.htm](http://www.glasgowfinancialservices.com/islamic_mortgages.htm); Usmani at <http://www.darulloomkhi.edu.pk>; Islamic mortgages available at [http://www.islamicbanking.com/shariah/sr\\_mortgages.php](http://www.islamicbanking.com/shariah/sr_mortgages.php)

void. It means that the condition in future may or may not occur which leads to Gharar which is totally prohibited in shariaah.

But there exist a solution for this objection that client can give an undertaking to purchase the financier share in the property that stands as a promise. And there is a big difference between putting a condition in the contract and making a separate promise. And the promise can also be enforced by the court of law according to a number of muslim jurists. They hold the view that court can compel the people to fulfill their promises especially in case of commercial activities.

And as far as the last objection is concerned there is big difference between rent and interest. Rent is the money charged on commodities. These commodities which are leased out remain intact and do not have to be recreated when they are required back. Same is the case in diminishing Mushraka in which partner leased out his share to the other partner and receives rent on it.<sup>101</sup> While interest is charged on the money which is borrowed, that money used up and does not remain intact; it is consumed on whatever purpose it was borrowed for. In order to return, the borrowed money it needs to be recreated or reproduced and some more money over and above the borrowed amount too needs to be produced to pay back as interest.<sup>102</sup> And at the end interest is clearly prohibited in Islam while rent is permitted.

## CONCLUSION:

Musharaka is one of the most authentic forms of shariaah approved as Islamic mode of finance whose legality is based on the injunctions of Quran, Sunnah and Ijma. Musharaka is the desired form of Islamic financing in which all the essential elements exists like absence of interest, presence of risk, spirit of sharing profit and losses, etc. but still this important mode is lacking its proper place in the financial world, specially in Pakistan. By the grace of

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<sup>101</sup>[http://www.hsbcamanah.com/1/PA\\_1\\_1\\_S5/content/amanah/assets/html/hsbc\\_amanah\\_faqs.pdf](http://www.hsbcamanah.com/1/PA_1_1_S5/content/amanah/assets/html/hsbc_amanah_faqs.pdf).

<sup>102</sup>[Islam has an Economic System](http://www.irfi.org/all_articles.htm), available at [http://www.irfi.org/all\\_articles.htm](http://www.irfi.org/all_articles.htm), last visited 25-9-2007

god Pakistan has been able to discard the old system of interest from its banking sector successfully without giving any jolt to the economy. Shifting from interest-based system to non-interest banking system has been very smooth; so smooth that some people have not even felt the change. But unfortunately there are some flaws in the new Islamic banking system of Pakistan like it is giving more importance to Bai-Mojjal and Mark-up system which is strongly criticized within and outside the country. It is need of the day that Pakistani banking system should move to the mechanism of Musharaka or profit and loss sharing system.

Although the banks and the clients both are free to do financing under Mushraka arrangement, but these are not adopting this mode so long they have the other option of mark-up. Government must adopt effective measures to remove this other option and besides legal framework other practical measures are also needed. Awareness among the banks and the clients is also needed. There is not yet even an independent law has been introduced to govern Musharaka and it is the need of the day to promote Mushraka institution with its due weight-age.

Scholars classify the Musharaka in two main kinds: Shirakat-al-Milk and Shirakat-al-Aqd. Different scholars further classify shirakat-Aqd into different kinds.

There is another classification of Mushraka by modern Islamic scholars, which classify the Musharaka into two kinds, that is permanent Musharaka and diminishing Musharaka. In permanent Musharaka period of the termination of Musharaka is not specified and Islamic financial institution share the profit on a pro rate basis. While in diminishing Musharaka the contracts ends with the transfer of complete ownership to one partner who gradually purchases the units of other partner in the asset. Diminishing Musharaka is getting quite popular in these days because of its potentialities. Like Musharaka there is not a specific definition of this new innovation exists in Pakistani law. Different Islamic banks are defining it differently according to their own financial operations and conditions. State bank of Pakistan approved this new form of Islamic finance and present the basic rules, which each bank in Pakistan must have to follow.

Diminishing Musharaka is permissible by Islamic scholars and the fatwas of eminent Islamic scholars of the recent time exists on it like Mulana Taqi Usmani. And its permissibility is also shown by the fact that lot of Islamic banks within and outside of the country is using this technique for Islamic financing especially for home finance.

## Chapter No.2

### MODERN FORMS OF DIMINISHING MUSHARAKA AND DIMINISHING MUSHARAKA VS CONVENTIONAL MORTGAGE

Diminishing Musharaka as discussed in the previous chapter is a popular form of Musharaka which developed in the near past and growing on with rapid pace because of its potentialities. Recent time has witnessed a great shift away from other means of Islamic mortgages to diminishing Musharaka.

#### SECTION 1

#### DIFFERENCES OF DIMINISHING MUSHARAKA WITH OTHER MODES OF ISLAMIC MORTGAGES:

##### 2.1.1 DIMINISHING MUSHARAKA:

This method allows the customer and financier to jointly acquire and own a property either movable or immovable. The share of the finance provider divided into a number of units and financier then leases their share of the property to the customer. The customer, as part owner and part tenant, then buys the financier's share in the property periodically until he is the sole owner of the property. The customer pays installments for a fixed period of years to the financier, contributing towards both the rental and increasing their share in the property. Upon full payment of installments the customer purchases the full share of the financier and becomes the sole owner of the property and at that time the transaction (partnership) ends.<sup>103</sup>

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<sup>103</sup> Muhammad Ayub, Islamic Banking and Finance, Theory and Practice, [Muhammad Ayub, Senior Research Economist, Research Economist, research Department, State bank of Pakistan. Karachi 2002, 74]; Cultural Diversity Bulletin Personal Finance Education available at <http://www.pfeg.org.document/EandA/bulletins/CDBulletin2.pdf>, last visited 10-8-2007.

It 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.<sup>104</sup>

### 2.1.2 Murabaha:

Murabaha is that mode of Islamic finance in which financial institution purchase the goods for its customer and resell them on a deferred basis at a higher price which is known as agreed profit margin or mark up of price. The customer then pays the agreed price of the goods including profit either in installments or on lump sum basis at the end of agreed period.<sup>105</sup>

Murabaha includes the basic price plus profit so it means sale for an agreed upon profit. Murabaha is the most popular form of finance and this form can be used to finance a variety of purchases. For example it is widely used in house finance where the buyer agrees the sale price with the seller and approaches the bank. Bank purchase that house at that price and resell it to the buyer at a higher price on deferred payment.<sup>106</sup>

### EXAMPLE:

In Murabaha bank buys the property supposes for A at the closing and assumes the risk of loss. Then bank immediately sells the property to A for a fixed price i.e. the purchase price which the bank paid plus the bank's profit for risk assuming. A then pay this total price to the bank in an initial down payment and in fixed installments over an agreed upon period of

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<sup>104</sup>Drafts instructions and guidelines for shariah compliance in Islamic banking institutions available at <http://www.sbp.org.pk/ibd/2007/DRAFT-SHARIAH-GUIDELINES.pdf>, last visited 13-5-2007; Navinne Hassan & Stuart Carruthers Islamic financial services: overview & prospects for the Canadian marketplace, available at <http://www.stikeman.com/cps/rde/xchg/se-n>, last visited 11-10-2007

<sup>105</sup>M.Shaghil, Islamic Economics A Global Perspective, 106

<sup>106</sup>Jeremy Hetherington-Gore, Islamic Finance-An Alternative Alternative, available at <http://www.investorofshore.com/html/specials/specials>, last visited 10-8-2007.

time. All payments are scheduled at the beginning of the transaction and do not change. A gain full ownership of the property at the closing of all payments.<sup>107</sup>

## DIFFERENCES BETWEEN BOTH MODES: CONCLUSION

Murabaha defers from the diminishing Musharaka in this context that in diminishing Musharaka bank and the customer acquire the asset jointly and create a joint ownership (shirka-til-milk). It means that both are partners in diminishing Musharaka contract while in murabaha bank purchase the asset for the client and then resell it to the client at a higher price that is agreed margin over cost and mortgage the property to the bank in order to secure the installments that are due. Both diminishing Musharaka and the Murabaha exists on deferred payment basis but the techniques are different. In murabaha bank receives the mark up on the original price while in diminishing Musharaka it receives rent on the property because it leased out his share in the asset to the partner.

### 2.1.3 IJARA:

It is also known as lease or hire contract. In this contract bank buys an asset on the request of the customer and then lease it to the customer for an agreed period and during that period of the lease the buyer (lessee) is required to pay a form of rent which is predetermined for the prescribed period. This rent is deemed by the bank to be reflective of the risk it is taking as part of the transaction.<sup>108</sup> In this financial mode of finance title to the asset remains with the bank and at no time it neither passes to the lessee nor is it expected to pass. If the lessee wishes to purchase the asset at a later date a separate agreement is drawn up.<sup>109</sup> According to that agreement the bank (lessor) and the client (lessee) exchange the letters that obliges the

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<sup>107</sup>[www.auburnmountain.com/thepractice/islamicfinance.aspx](http://www.auburnmountain.com/thepractice/islamicfinance.aspx), last visited 9-11-2007

<sup>108</sup>IIIIE' s BLUEPRINT OF ISLAMIC FINANCIAL SYSTEM including strategy for Elimination of Riba, Report of the IIIIE Workshop on Islamization of the Financial System (May-June 1997), (Islamabad: International Institute of Islamic Economics, 1999). [hereinafter IIIIE's Blueprint of Islamic Financial System, 1999]; Mukhtar Zaman, Banking and Finance Islamic Concept, [International Association of Islamic Banks, Karachi], 1993, 175.

<sup>109</sup>Mohammad Ashraf, Shariah Compliant Financial Products, available at <http://www.accountancy.com.pk/articles.asp>, last visited 10-8-2007. [hereinafter Mohammad Ashraf at <http://www.accountancy.com.pk>



bank to sell the asset while at the same time obliges the customer to purchase it.<sup>110</sup> This contract is known as Ijara wa Iqtina (Hire Purchase).<sup>111</sup>

## DIFFERENCES BETWEEN BOTH MODES: CONCLUSION

As far as ijara wa iqtina and diminishing Musharaka are concerned both have lot of similarities due to which it is difficult to distinguish one from the other. But the techniques of both transactions are different. Ijara wa iqtina is a contract under which the Islamic bank finances equipment, a building or other facility for the client against an agreed rental together with an undertaking from the client to purchase the equipment or the facility at the end of the lease period. The rental as well as the purchase price is fixed in such a manner that the bank gets back its principal sum along with some profit which is usually determined in advance. Diminishing Musharaka differs from ijara wa iqtina in such a manner that it originated from the partnership of bank and the customer while no such partnership exists in lease. And after the creation of partnership, in an independent contract client gives the promise to bank to purchase the financier share in the property. At the end of both transactions that is lease and partnership client becomes the sole owner of the property.

Although the payments made in diminishing Musharaka and ijara wa iqtina are very similar because in both transactions client pays rent as well as extra payment to purchase financier share in the property, but the arrangements of both diminishing Musharaka and ijara wa iqtina are different. Although lease is a part of diminishing Musharaka contract but it differs from diminishing Musharaka as an independent mode of Islamic finance.

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<sup>110</sup> Islamic Home Finance Methods available at <http://www.ijaraloans.com/IslamicFinance.htm#IJARA-Leasetoown> , last visited 10-8-2007. [hereinafter Islamic home finance methods at <http://www.ijaraloans.com>]

<sup>111</sup> Fuad Al-Omar & Mohammed Abdel-Haq, Islamic Banking Theory, Practice & Challenges, (London & New Jersey: Zed Books, 1996), 15.[hereinafter Faud AL-Omar, 1996]; Simon Archer and Rifaat Ahmed Abdel Karim, Islamic Finance Innovation and Growth, [Euro money Books, London, 2002] 99.

## SECTION 2:

### MODERN FORMS OF DIMINISHING MUSHARAKA:

The Diminishing Musharaka has taken these three mostly used different shapes in recent times:

2.2.1-Diminishing Musharaka for house financing

2.2.2-Diminishing Musharaka for trade

2.2.3 Diminishing Musharaka for auto financing

#### 2.2.1 DIMINISHING MUSHARAKA FOR HOUSE FINANCING:

Home is the basic necessity for human life; it provides a shelter to everyone for rest, sleep and comfort. It is the place where a family lives together with comfort and peace of mind. Owning a home is one of the most important desires of everyman's life and his most important achievement. It is indeed one of the great blessings of god, so everyone wants to have their own home but

- ✓ Rising property prices
- ✓ Taxes
- ✓ Inflation, &
- ✓ Currency devaluation

are only few of the many reasons which usually makes the purchase of the house only a dream.<sup>112</sup>

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<sup>112</sup>Islamic mortgage, available at <http://www.thetruthaboutmortgage.com/islamic-mortgage>, last visited 2-12-2007

But now in these days when demand for home purchase is increasing Islamic banks and other Islamic financial institutions are trying to introduce new means of Islamic finance<sup>113</sup> which can help the people to own their own home the dominant of which are diminishing Musharaka and Al-Bay Bithaman contracts. Bay Bithaman Ajil contracts based on buy and sell principle whereas Diminishing Musharaka contract based on partnership. Scholars are on consensus on the permissibility of the diminishing Musharaka agreement while there is no such consensus exists on the permissibility of the bay bithaman contract. Middle Eastern scholars disapprove this form of home finance while it is popular in countries like Malaysia, Indonesia and Brunei. Middle Eastern scholars disapprove this form of home finance because they see it as similar to conventional loan.<sup>114</sup> This contract refers to the sale of goods on a deferred payment basis. Equipment or goods requested by the client are bought by the bank which subsequently sells the goods to the client an agreed price which includes the bank's mark-up (profit). The client may be allowed to settle payment by installments within a pre-agreed period, or in a lump sum, similar to a Murabaha contract, but with payment on a deferred basis.<sup>115</sup>

In Pakistan Islamic home finance is generally based on diminishing Musharaka. It allows the bank to participate in equity type finance and then rent out his share in the property to the client and client undertakes to buy the shares of the bank by monthly payments.<sup>116</sup>

#### 2.2.1.1- STEPS WITH SEQUENCING IN DIMINISHING MUSHARAKA:

Diminishing Musharaka is the most complex but most widely accepted form of Islamic home finance.<sup>117</sup>

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<sup>113</sup> murabaha, ijara, ijara wa iqtina Istisna are some of these.

<sup>114</sup> Ahamed Kameel Mydin Meera and Dzuljastri Abdul Razak, Islamic Home Financing through Musharakah Mutanaqisah and al-Bay' Bithaman Ajil Contracts: A Comparative Analysis, available at <http://ahamedkameel.com/MMPPaper.pdf>, last visited 14-8-2007

<sup>115</sup> <http://www.islamicconferences.com/glossary.htm>, last visited 14-8-2007.

<sup>116</sup> Defining Direction First Pakistan Islamic Banking & Money Market Conference held on September 14-8-2007, available at <http://www.iifm.net/download/pakistan%20conference%20report.pdf>, last visited 15-8-2007.

<sup>117</sup> THE HALAL NEWS, Institute of Halal Investing Newsletter, Volume 1, issue 5, January 2007, available at <http://www.instituteofhalalinvesting.com/news/materials/Vol1Issue5June07.pdf>, last visited 15-8-2007.

Following are the main steps involved in a Diminishing Musharaka for home finance:<sup>118</sup>

### STEP 1 – Seller sells the property directly to the financier:

The vendor of the property sells the property directly to the financier (bank), in whom the legal title to the property is vested.<sup>119</sup> The financier pays the full purchase price of the property to the vendor and gets legal title to the asset which is usually held by the financial institution as security. Although in diminishing musharaka the eventual owner and the financial institution purchase the property jointly, but for security purposes the legal title is likely to be held entirely by the financial institution.<sup>120</sup>

### STEP 2 – Joint ownership of the property:

The financier and the customer enter in to a partnership to jointly own a property under sharikat-al-milk. It is in contrast to the leasing model, where ownership of the financed item remains with the lessor for the entire lease period, ownership in a diminishing partnership is explicitly shared between the customer and the Islamic financial institution) which is legally called sharikat-al-milk.<sup>121</sup> Sharikat-al-milk may come into existence by two different ways:-

- ✓ Compulsory ownership: come into existence without any action on the part of the partners like inheritance
- ✓ Optional ownership: comes into existence by the act of both the parties like joint purchase. Diminishing Musharaka comes under this concept of optional ownership.<sup>122</sup>

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<sup>118</sup>Tariq Hameed, Does the Diminishing Musharaka reflect the spirit of Sharia?, available at <http://www.mfgonline.co.uk>, last visited 16-8-2007.

<sup>119</sup> Ibid

<sup>120</sup>Mohammed Amin, Diminishing Shared Ownership for property acquisitions with Islamic finance, available at [http://pwc.blogs.com/mohammed\\_amin/2007/2/diminishing\\_sha.html](http://pwc.blogs.com/mohammed_amin/2007/2/diminishing_sha.html), last visited 14-8-2007

<sup>121</sup>Permissible Financing Methods available at [http://www.islamic-world.net/economics/permissible\\_financing\\_methods.htm#](http://www.islamic-world.net/economics/permissible_financing_methods.htm#), last visited 16-8-2007

<sup>122</sup>Dr. Muhammad Tahir Mansuri, Islamic Law of Contract and Business Transactions, (Islamabad: Shariah Academy international Islamic university Islamabad, 2001), 244. [Hereinafter Mansuri, 2001]; Usmani at [www.darululoomkhi.edu.pk/fiqh/islamicfinance](http://www.darululoomkhi.edu.pk/fiqh/islamicfinance); Zuhuli, Vol. 5, 3877.

In diminishing Musharaka the customer (eventual owner) and the financier agree at the start of the contract their respective share in the property shall be pro-rata,<sup>123</sup> depending on their contribution to the purchase price paid to the vendor of the property.<sup>124</sup>

### STEP 3-lease of the financier share to client:

The diminishing Musharaka agreement involves the use of **two written contracts**, being Ijara agreement and a diminishing ownership agreement (Musharaka).<sup>125</sup>

In the diminishing Musharaka agreement customer enters into two agreements at the same time, the first one is the diminishing ownership agreement while at the same both customer and the financier enters into the agreement of lease under which the financier leases his share in the property to the customer which gives the right to customer to use the financier share in it.<sup>126</sup> This lease agreement runs concurrent with the diminishing ownership agreement.<sup>127</sup> In other words it can be said that Diminishing Muaharaka agreement consists on two portions:

- ✓ Diminishing Musharaka agreement
- ✓ Lease agreement<sup>128</sup>

This Diminishing Musharaka and lease agreement runs parallel to each other. The lease is effective for as long as the financier has a share in the property. When client purchase all the

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<sup>123</sup>Pro-rata is an adverb or adjective, meaning in proportion [Farlex's The Free Dictionary, available at <http://encyclopedia.farlex.com/pro+rata>, last visited 2-12-2007]. Here it is used in the context that "Each of several partners "is liable for his own share or proportion only, they are said to be bound *pro rata*." [Pro-Rata available at <http://en.wikipedia.org/wiki/pro-rata>, last visited 4-12-2007]

<sup>124</sup> Dr. Ausaf Ahmed, The Evolution of Islamic Banking, available in Encyclopedia of Islamic Banking and Insurance, (London: Institute of Islamic Banking and Insurance, 1995), 26

<sup>125</sup>Muhammad Ashraf, Shariah-compliant Financial Products, available at <http://www.accountancy.com.pk/articles>, last visited 16-8-2007; <http://www.islamic-bank.com/islamicbanklive/diminishingmusharakawithijara/1/home>, last visited 5-9-2007

<sup>126</sup>[http://www.black-stone.co.uk/shariah/shariah\\_commercial\\_property\\_finance.html](http://www.black-stone.co.uk/shariah/shariah_commercial_property_finance.html), last visited 7-9-2007

<sup>127</sup>Mohammad Ashraf at <http://www.accountancy.com.pk>

<sup>128</sup>Ahamed Kameel Mydin Meera and Dzuljastri Abdul Razak Islamic Home Financing through Musharakah Mutanaqisah and al-Bay' Bithaman Ajil Contracts: A Comparative Analysis available at <http://ahamedkameel.com/MMPPaper.pdf>, last visited 28-9-2007

remaining shares of the financier and the legal title goes to him the lease also automatically terminates.

## DIFFERENCE OF OPINION:

All the muslim school of thoughts are agreed on the permissibility of leasing out one partner shares to the other partner. There is unanimity on this point; however there is difference of opinion on leasing out undivided share to a third partner.<sup>129</sup>

Imam Abu Hanifa and Imam Zufar are of the view that the undivided share cannot be leased out to a third party, while Imam Malik and Imam ShafiT, Abu Yusuf and Muhammad Ibn Hassan hold that the undivided share can be leased out to any person. **But so far as the property is leased to the partner himself, all of them are unanimous on the validity** of this leasing transaction that eventually results in full ownership.<sup>130</sup> So leasing in diminishing Musharaka is permissible by all muslim scholars through which any of the partners can lease the share of the other partner for a fixed amount (that is rent) and for whatever duration which is agreed between the partners.<sup>131</sup>

## STEP 4– Unilateral promise to purchase financier share in the property:

Next step involved in diminishing Musharaka is one sided promise<sup>132</sup> by the client to purchase financier share in the property, in this arrangement parties agree that during the course of their partnership, which has an agreed date of termination, the customer (owner-tenant) will purchase the financier's share in the property in installments (usually monthly

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<sup>129</sup> Islamic Mortgages And Home Financing, available at <http://forum.mpacuk.org>, last visited 21-8-2007

<sup>130</sup> What do different Islamic schools of thought say?, available at [http://www.glasgowfinancialservices.com/islamic\\_mortgages.htm](http://www.glasgowfinancialservices.com/islamic_mortgages.htm), last visited 7-9-2007

<sup>131</sup> Bahrain Islamic bank available at <http://www.bisonline.com/English>, last visited 29-8-2007

<sup>132</sup> Promise is described as a verbal proposition made by one party to undertake something to the benefit of the other. The main difference between a promise and a contract is absence of an explicit ijaab and qabool. in other words promise is a one-sided commitment as opposed to a contract which typically requires two sides. That's the reason that contracts are binding legally as well as morally while muslim jurists differs on the enforceability on promises through court. Imam Abu Hanifah, Imam Shafi'e and Imam Ahmad says that promises implies only a moral duty, while Hasan al-Basri, Sa'id bin al-Ashwa, Imam Bukhari, Ibn al-'Arabi, al-Ghazali held the view that promises are legally binding in certain circumstances. [Kharofa, Ala' Eddin. Transactions in Islamic Law. 2nd ed. Kuala Lumpur: A.S. Noordeen, 2000. 20-23]

payments) and for the price that the financier had paid for such share on the initial date of acquisition.<sup>133</sup>

In Diminishing Musharaka customer gives the unilateral promise which means one sided promise in the terms of law. Diminishing Musharaka extracts a morally binding promise from the client to purchase financier share in the property in future.<sup>134</sup>

It is generally believed that a promise to do something creates only a moral obligation on the promisor which cannot be enforced through courts of law. But, there are a number of Muslim jurists who opine that promises are enforceable, and the court of law can compel the promisor to fulfill his promise, especially, in the context of commercial activities<sup>135</sup> with the respect of following conditions:

1. It should be a one-sided promise;
2. The promise must have caused the promisor to incur some liability;
3. If the promise is to purchase something, the actual sale must take place at the appointed time by the exchange of offer and acceptance; and
4. If the promisor backs out of his promise, the court may force him either to purchase the commodity or pay actual damages to the seller.<sup>136</sup>

Difference between the promise and putting a condition in the contract:

- ✓ Some jurists raised the objection against Diminishing Musharaka that promise from the client is like putting a condition in the contract. But in fact there is a big difference between putting a condition in the sale and making a separate

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<sup>133</sup> <http://www.lariba.com/knowledge-centre/scholars-faqs.htm>, last visited 15-10-2007

<sup>134</sup> Shirley Chiu and Robin Newberger, *Islamic Finance : Meeting Financial Needs with Faith Based Products*, available at [http://www.chicagofed.org/community\\_development/files/02\\_2006\\_islamic\\_finance.pdf](http://www.chicagofed.org/community_development/files/02_2006_islamic_finance.pdf), last visited 10-9-2007

<sup>135</sup> Maulana Taqi Usmani, *Diminishing Musharaka, Musharakah & Mudarabah* By Maulana Taqi Usmani, available at <http://www.darulloomkhi.edu.pk-fiqh/islamicfinance/dm.html#house>, last visited 10-9-2007 [hereinafter usmani at <http://www.darulloomkhi.edu.pk>]-

<sup>136</sup> Junaid Mirza, *difference between a promise and a contract*, <http://cief.wordpress.com/2006/1/17/difference-between-a-promise-and-a-contract/>, last visited 12-9-2007

promise without making it a condition. If the condition is explicitly mentioned at the time of sale, it means that the sale will be valid only if the condition is fulfilled, meaning thereby that if the condition is not fulfilled in the future; the present sale will become void. This makes the transaction of sale contingent on a future event which may or may not occur. It leads to uncertainty (gharar)<sup>137</sup> in the transaction which is totally prohibited in Shariah.<sup>138</sup>

- ✓ While promise is totally different thing as explained earlier. It is made separately from the sale, and sale or contract does not depend on it. It will take effect irrespective of whether or not the promisor fulfils his promise. Even if the promisor backs out of his promise, the sale will remain effective. This is the big difference between putting a condition in the contract and making a separate promise.

#### STEP 5-Monthly payments made by the client:

The amount of the monthly payment of the client is determined at the time of purchase, based on several factors including

- ✓ The price of the home,
- ✓ Credit rating,
- ✓ The amount of initial payment,
- ✓ The term of the contract, and

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<sup>137</sup>Literally gharaa means risk or hazard. "Taghreer" being the verbal noun of gharar is to unknowingly expose oneself or one's property to jeopardy. While as far as jurisprudential definition is concerned it can be summarized under three headings: first: it applies exclusively to cases of doubtfulness or uncertainty, as in the case of not knowing whether something will take place or not. Second, gharar applies only to unknown, to the exclusion of doubtful. Third, it is combination of the two categories of above; gharar covers both the unknown and the doubtful. [Siddiq Mohammad Al-Ameen Al-Dhareer, Al-Gharar in contracts and its effects on contemporary transactions Islamic research and training institute, Islamic development bank, Jeddah, Kingdom of Saudi Arabia, 1997, 9-11]

<sup>138</sup>[http://www.glasgowfinancialservices.com/islamic\\_mortgages.htm](http://www.glasgowfinancialservices.com/islamic_mortgages.htm),



- ✓ The current fair market value of similar homes and their rents in the community where the client buys the home.<sup>139</sup>

When first payment is made most of the money goes towards use of the house that is known as rent because financier leases his share in the house to the customer so he receives rent on it. And the remaining balance goes toward increasing customer share in the house. As each month goes by, a little less of the payment is applied to the use of the property and a little more towards increasing equity because with each purchase of the unit client share in the equity increases and the financier share decreases so the amount of the rent which the financier receives. In Diminishing Musharaka total monthly payment reallocated regularly to reflect growing number of shares of the client in the home purchase as far as client shares increases financier shares decreases in the property.<sup>140</sup>

Both the amounts which are paid under the diminishing ownership agreement and the amount paid under the lease agreement are amalgamated and used to calculate how much of the financier's share of the property has been purchased per month by the customer. As the financier's share in the property decreases so does the amount paid under the lease agreement.<sup>141</sup> Financier equity in the property reduced as the customer makes capital payments over and above the agreed rental or lease payments. It means that finances share decreases and the customer's increases over time till the transfer of complete ownership to the customer.<sup>142</sup>

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<sup>139</sup>Musharaka- Declining Balance Co ownership, available at <http://www.ijaraloans.com/islamicfinance.htm#Musharaka-DecliningBalanceCoownership> , last visited 22-8-2007.

<sup>140</sup>Types of Islamic Mortgage, available at <http://www.fancymortgage.co.uk/islamicmortgages/mortgagetypes.asp>, last visited 16-10-2007

<sup>141</sup>Jeremy Hetherington-Gore, Islamic Finance- An Alternative Alternative, available at <http://www.investoroffshore.com>, last visited 25-8-2007; Muhammad Ashraf, Shariah-compliant Financial Products, available at <http://www.accountancy.com.pk/articles>, last visited 16-8-2007.

<sup>142</sup>Jeremy Hetherington-Gore, Islamic Finance- An Alternative Alternative, available at <http://www.investoroffshore.com>, last visited 25-8-2007

## CONCLUSION:

At the end of this discussion I conclude that all the steps involved in diminishing Musharaka for home financing are in good sequence and in conformity with the principles of shariah. These steps best answer the objections raised by the opponents of diminishing Musharaka and offer the satisfactory reply. But along with that while practicing this Islamic mode of mortgage lot of care and full knowledge of the principles of shariah is needed to ensure that it must not go against the principles of shariah otherwise it will also become un-Islamic and will assume the shape of conventional mortgage. Like if we put any condition in it then it is not permitted, likewise we can't combine two or more contracts in one single contract, etc. For this purpose deep research is needed and separate law must also be promulgate to govern this mode of Islamic mortgage.

### 2.2.1.2- Conditions of Diminishing Musharaka for home purchase:

Diminishing Musharaka for home purchase may be subject to the following conditions:

All terms and conditions as are essential to co-ownership, Ijarah and sale shall be fulfilled in respect of different stages in the process of diminishing Musharaka arrangement.<sup>143</sup> Conditions of these contracts shall also apply on diminishing Musharaka because it involves all the three contracts.

Normally the objection raised against diminishing Musharaka is that it combines two or more contracts into one transaction which is not allowed in shariah. It is prohibited in shariah to make one contract condition to the other it is a well settled rule of shariah that combination of two or more contracts by making one precondition to the other is prohibited in Islamic legal system.<sup>144</sup>

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<sup>143</sup> Drafts instructions and guidelines for shariah compliance in Islamic banking institutions available at <http://www.sbp.org.pk/ibd/2007/DRAFT-SHARIAH-GUIDELINES.pdf>, last visited 13-5-2007.

<sup>144</sup> Muhammad ibn Adam al-Kawthari, Islamic alternatives for an interest-based mortgage: interest-based transactions in disguise, available at <http://qa.sunnipath.com>, last visited 2-9-2007.

**So another condition of the diminishing Musharaka is that the agreement of joint purchase, leasing and selling different units of the share of the financier should not be tied up together in one single contract and no contract should make a pre condition for the other contract.**<sup>145</sup>

The proposed solution for this condition which Islamic banks are following these days is that the joint purchase and the contract of lease may be joined in one single document in which financier agrees to lease his share to the client after joint purchase. This is permitted in Islam because lease can be affected for a future date.

- ✓ And on the other hand the client may sign a one-sided promise (not a condition) firstly to take financier share on lease and to pay agreed rent on it and, secondly purchase different units of the share of the financier periodically.
  
- ✓ At the time of the purchase of each unit, sale must be affected by the exchange of an offer and acceptance at that particular date. It is preferable that the purchase of different units by the client be affected on the basis of the market value of the house as prevalent on the date of purchase of that unit. It is also permissible that a particular price is agreed in the promise of purchase signed by the client.<sup>146</sup>

### 2.2.1.3- Example of Diminishing Musharaka for home purchase:

The application of Diminishing Musharaka can best be explained with the help of example which LARIBA bank in USA gives and follows:<sup>147</sup>

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<sup>145</sup> hereinafter usmani at <http://www.darulloomkhi.edu.pk>

<sup>146</sup> ISLAMIC MORTGAGES, [http://www.glasgowfinancialservices.com/islamic\\_mortgages.htm](http://www.glasgowfinancialservices.com/islamic_mortgages.htm),

<sup>147</sup> <http://www.lariba.com/home-financing.htm#>, lat visited 5-8-2007

## ASSUMPTIONS:

- ✓ Cost of home \$ 150,000
- ✓ Down payment available from client \$30,000
- ✓ Period of financing-15 years

Determination of return on capital (that is rent) and repayment of capital (RofC):

The next step for both parties would be to determine the fair rental value for the property. Determination of the rental value for both the client and financial institution can be done by the survey to market to obtain estimates for similar properties in the same neighborhood and negotiate an agreement. This fair rental value will remain constant over the life of the agreement. For this example, we will assume \$1,000 per month as the rental value.

A rental value of \$1,000 means that the client will pay \$800 as rent for the 80 per cent share the financial institution holds. The two parties then agree on the period of financing. In this example we will assume that the financing period is 15 years (180 months). Based on the rental value and the financing period, the financial institution then determines the fixed monthly payments the client would have to make to own the house.

### **Total monthly payments:**

Using the

- ⇒ Fair Rental Value,
- ⇒ Amount contributed by each party, and
- ⇒ the financing period

#### 2.2.1.4-Current practices of Diminishing MUSHARAKA home ownership schemes in Pakistan:

Home ownership through Diminishing Musharaka is getting quite popular these days and now a lot of Islamic and conventional banks in Pakistan are offering this technique. Following is the list of some of these banks:

##### ISLAMIC BANKS:

- ✓ **Meezan Bank:** it offers easy home which is based on the technique of diminishing musharaka <sup>149</sup>
- ✓ **Al-Baraka Islamic Bank:** Al-Baraka Islamic Bank is a Bahrain based Islamic bank operating in Pakistan as a scheduled commercial bank and it offers Islamic home ownership through “Maskan Home Musharaka” on the basis of diminishing Musharaka. <sup>150</sup>
- ✓ **Dubai Islamic Bank:** it is Dubai based bank started its operation in Pakistan as a scheduled bank since March 2007. Its Islamic homeownership service is termed as real estate finance based on diminishing Musharaka arrangement. <sup>151</sup>
- ✓ **Emirates Global Islamic Bank Ltd:** it is Incorporated in Pakistan and sponsored by leading investors from the United Arab Emirates and Saudi Arabia. It is an Islamic Commercial Bank, commenced operations in February 2007. It provides Islamic home finance through its AL-BAIT program which is based on diminishing Musharaka concept. <sup>152</sup>

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<sup>149</sup>Meezan bank easy home available at <http://www.meezanbank.com/en/EasyHomeRoadMap.aspx>, last visited 28-11-2007

<sup>150</sup>Maskan Home Musharaka available at <http://www.albaraka.com.pk/services/maskan.html>, last visited 28-11-2007

<sup>151</sup>Real finance, available at <http://www.alislami.ae/en/realestate.htm>, last visited 28-11-2007

<sup>152</sup>Home Financing AL-BAIT, available at <http://www.egibl.com/al-bait.html>, last visited 28-11-2007

## PRIVATE SCHEDULED BANKS:

- ✓ **Bank Alfalah:** Bank Alfalah Limited is a private bank in Pakistan owned by the Abu Dhabi Group. It offers diminishing musharaka home ownership through its programme 'Alfalah Musharaka Homes'.<sup>153</sup>
- ✓ **Muslim Commercial Bank:** MCB is one of the largest commercial bank in Pakistan and in these days its upcoming product is diminishing Musharaka for housing finance.<sup>154</sup>

## FOREIGN BANKS:

- ✓ **Standard Chartered:** Standard Chartered is the largest international Bank in Pakistan. The Bank has been operating in Pakistan for over 140 years when it first established its operations in 1863 in Karachi. It offers its diminishing musharaka home finance product through its scheme called 'Sadiq home financing' which is based on joint ownership of the property.<sup>155</sup>
- ✓ **ABN AMRO:** it has its roots in the Netherlands going back to 1824 while it is committed to Pakistan since 1948. ABN AMRO Islamic Banking Home Finance uses the Islamic mode of Diminishing Musharakah to offer services for Islamic home finance.<sup>156</sup>

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<sup>153</sup>Alfalah Musharaka Homes available at [http://www.bankalfalah.com/islamic/consumer\\_banking.asp](http://www.bankalfalah.com/islamic/consumer_banking.asp), last visited 28-11-2007

<sup>154</sup>[http://www.mcb.com.pk/islamic\\_banking/upcoming\\_products.asp](http://www.mcb.com.pk/islamic_banking/upcoming_products.asp), last visited 28-11-2007

<sup>155</sup>Sadiq Home Financing available at [http://www.standardchartered.com/pk/ib/home\\_finance.html](http://www.standardchartered.com/pk/ib/home_finance.html), last visited 28-11-2007

<sup>156</sup><http://www.abnamro.com.pk/pakistan/islamicbank/homefinancehtm>, last visited 28-11-2007

## CONCLUSION:

New competitors are coming in the field to practice this mode and it is in full swing these days and in Pakistan lot of banks is adopting this technique of Islamic mortgage. New players are coming in the field and are trying to explore this new mode of Islamic mortgage and are seeing whether this can serve as an alternate system to the conventional mortgage, which has a lot of flaws. Everyone can see the free competition, which is increasing with the passage of each day.

### 2.2.2- Diminishing MUSHARAKA for trade:

Diminishing Musharaka is also in practice in trade although it is not as much popular as it is in home financing but it is in practice. Diminishing partnership differs from the permanent partnership only in terms of continuity. In this mode, the Islamic bank has all the rights and obligation of the ordinary partner. From the very beginning, the bank does not intend to remain associated with the business, in which it has invested, indefinitely. Instead the Islamic bank gives its partner the right to repurchase its share in the capital of the partnership in accordance with the agreement. Banks participate in the trade with a given income forecast. An agreement is signed by the partner and the bank, which stipulates each party's share of the profits. However, the agreement also provides an amount of extra and above payment over the profit which constitutes as repayment financed by the bank. The partner is entitled to keep the rest. In this way, the bank's share of the equity is progressively reduced and the partner eventually becomes the full owner. When the bank enters into a Diminishing Musharaka its intention is not to stay in the partnership until the business is dissolved. In this type of partnership, the bank agrees to accept payment on an installment basis or in one lump sum, an amount necessary to buy the bank's partnership interest. In this way, as the bank receives payments over and above its share in partnership profits, its partnership interest reduces until it is completely bought out of the partnership.<sup>157</sup>

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<sup>157</sup>Decreasing partner, available at <http://www.barakaonline.com/products/decreasing.htm>, last visited

## EXAMPLE:

'A' wishes to start the business of import-export but lacks the required funds for that business. 'B'(here the bank) agrees to participate with him for a specified period, say seven years. 30% of the investment is contributed by 'A' and 70% by 'B'. Both start the business on the basis of Musharaka (joint ownership). The proportion of profit is expressly agreed upon by both the parties at the start of the partnership. But at the same time 'B's share in the business is divided say into fourteen equal units and 'A' keeps purchasing these units on gradual basis until after the end of seven years 'A' becomes the sole owner of the business and 'B' comes out of the business, leaving its exclusive ownership to 'A'. During that partnership B earned the periodical profits and along with that he gets back the price of the units of the share which he invested in the partnership.<sup>158</sup>

### 2.2.2.1-Conditions for diminishing MUSHARAKA in trade:

- ✓ Each partner should contribute part of the capital, whether in the form of cash or tangible assets such as a piece of land for the building or equipment required for the operation of the partnership.
- ✓ Loss, if any, shall be borne by the co-owners in the proportion of their respective
- ✓ Investments as the equity stake of one partner increases the others decrease.
- ✓ The percentage of profit that each partner (the Bank and customer) is entitled to should be clearly determined at the time of partnership. It is permissible for the partners to agree on a ratio of profit sharing which is not proportionate to

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<sup>158</sup>Badr-El-Din A. Ibrahim, The Role of Home Based Enterprises (HBE's) in Alleviating Sudanese Urban Poverty and the Effectiveness of Policies and Programmes to Promote HBE's, available at <http://www.iwim.uni-bremen.de/publikationen/pdf/SERG34%20.pdf>.



the ratio of equity ownership, and should apply even if the ratio of equity shares has changed. It is also permissible to conclude an agreement between the two parties on amending the ratio of profit sharing in accordance with the change in the ratio of equity shares. However, they must ensure that the principle of allocating losses in accordance with the ratio of equity share of ownership is maintained at all times.

- ✓ It is permissible for one of the partners to give a binding promise that entitles the other partner to acquire, on the basis of a sale contract, his equity share gradually, according to the market value or a price agreed at the time of acquisition. However, it is not permitted to stipulate that the equity share be acquired at their original nominal value, as this would constitute a guarantee of the value of the equity shares of the Bank by the other partner, which is prohibited by Sharia'a. Therefore, financier should agree to sell the units on the basis of valuation of the business at the time of the purchase of each unit. If the value of the business has increased, the price will be higher and if it has decreased the price will be less. Such valuation may be carried out in accordance with the recognized principles through the experts, whose identity may be agreed upon between the parties when the promise is signed.<sup>159</sup>

### 2.2.3-Diminishing MUSHARAKA for auto financing:

The market for Islamic auto financing products has grown dramatically during the past decade.<sup>160</sup> Under the concept of diminishing Musharaka in car financing, bank and the client enter into partnership in the joint purchase of the car or any other vehicle. In the joint purchase bank may provide the larger share of the purchase and then lease his share in the automobile to the client for a certain period of time. During that period bank receives

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<sup>159</sup>usmani at <http://www.darululoomkhi.edu.pk>; Sharika(Musharaka) And Modern Companies, available at <http://www.bisbonline.com>, last visited; Drafts instructions and guidelines for shariah compliance in Islamic banking institutions available at <http://www.sbp.org.pk/ibd/2007/DRAFT-SHARIAH-GUIDELINES.pdf>, last visited 13-5-2007.

<sup>160</sup>Ibrahim A.Mardam, Recent Developments in Islamic Auto Finance Products, Islamic Retail Banking And Finance, 2005, 107.

monthly regular payments from the client for the use of bank's share in car. Client also makes regular scheduled investments in the partnership which increases client share and decreases the banks share. And after due payments client becomes the complete owner of the car and gets the total of his automobile.<sup>161</sup> The procedure and conditions are same as it is in home financing.

### Steps involved in diminishing Musharaka Auto financing:

Steps, which involved in Diminishing Musharaka car financing, are exactly in the same sequence as it lies in Diminishing Musharaka for home financing. These are:

- ⇒ Seller sells the property directly to the financier
- ⇒ Joint purchase of the car
- ⇒ Lease of the financier share in the car to the client
- ⇒ Unilateral promise by the client to purchase financier share in the car
- ⇒ Monthly payments made by the client

### ISLAMIC VERSUS CONVENTIONAL AUTO FINANCE:

The differences between conventional and Islamic auto finance are not easily understandable but very important. Some of these differences are mentioned below:

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<sup>161</sup>Sadiq Auto Financing, available at [http://www.standardchartered.com/pk/ib/auto\\_finance.html](http://www.standardchartered.com/pk/ib/auto_finance.html), last visited 8-1-2008; Easy Home Products, available at [http://www.meezanbank.com/en/Easy\\_Home\\_Products.asp](http://www.meezanbank.com/en/Easy_Home_Products.asp), last visited 8-1-2008

- ✓ Shariah principles require that a car under Islamic finance must be owned by the Islamic bank for the duration of the transaction. While no such condition exists in conventional auto finance.
- ✓ It is not permitted that a financial institution offer Islamic auto finance but uses traditional banking methods to finance the car , that's why bank can't the customer a conventional interest rate. It is prohibited in sharaiah to charge interest rate while whole conventional banking based on interest.
- ✓ In case of late payments under Islamic auto finance special treatment is needed and bank can't charge interest. While procedure is simple in conventional auto finance it charge the interest in case of late payment.
- ✓ That's the reason that Islamic auto finance involves more risk factor as compared to conventional finance.

### SECTION 3:

#### DIMINISHING MUSHARAKA VS CONVENTIONAL MORTGAGES:

Two points of views:

- ✓ A group of people who says that there is no difference between a diminishing Musharaka and conventional mortgage if one is permitted then other should also be
- ✓ Other says that great differences exists between a diminishing Musharaka and conventional mortgage and first one is permitted while the later is prohibited

### 2.3.1 Argument of those who says that Diminishing MUSHARAKA and conventional mortgages<sup>162</sup> both are same:

Muslims have been raising their concerns and doubts with regards to Shariah-compliant alternatives for conventional mortgages. Their basic argument has been the fact that these Islamic mortgage schemes (diminishing Musharaka, ijara and murabaha) are nothing but interest-based transactions in disguise. It is merely another way of involving one's self into an interest based transaction so according to them it makes no difference whether one holds one's ear from the front side or from behind. Thus, these so called "Islamic" mortgages, according to their understanding, are nothing but conventional mortgages under a new name and a new banner<sup>163</sup>.

There argument is that client owe the debt from the mortgagee is documented as a loan but so as the Islamic mortgages so what is the difference. The procedure for conventional mortgage is usually following:

- ✓ Client pays the down payment
- ✓ The mortgagee pays the balance of the home price, which is equal to mortgage amount.
- ✓ Both the payments are combined to pay the home seller.
- ✓ Property Title is transfered in client name,mortgagee take a lien on the property.
- ✓ So client signed a"mortgage loan" documents, documenting the debt to the bank for the balance of the home price.

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<sup>162</sup>Mortgage is defined as "A mortgage is a device used to create a lien on real estate by contract. It is used as a method by which individuals or businesses can buy residential or commercial property without paying the full value upfront. The borrower (also called the mortgagor) uses a mortgage to pledge real property to the lender (also called the mortgagee) as security against the debt for the rest of the value of the property. ..."  
[en.wikipedia.org/wiki/Mortgage, last visited 19-9-2007]

<sup>163</sup>Muhammad ibn Adam, Darul Iftaa, Leicester , UK, [If an Islamic Mortgage Costs too Much, Can I Take a Conventional Mortgage?](http://www.daruliftaa.com/), available at <http://www.daruliftaa.com/>; <http://www.islamicmortgages.co.uk>, last visited 19-9-2007

## Interest or Riba, which is prohibited?

Some people tend to argue that it is riba which has been prohibited by Islam and that riba is not equivalent to interest.<sup>164</sup> They give their argument that there was no banking system of the type that exists today when the verses prohibiting the riba were revealed in the holy book and therefore the prohibition does not apply to the bank interest as it is known today.<sup>165</sup>

## No convincing difference between rent and interest:

People justify the charging of interest by saying that it is money charged for the amount lent and it is just like the rent of a commodity or a house. In other words, they argue that just as a person pays rent for using a house, he pays rent for using money borrowed and this rent for money borrowed is interest. Thus if charging rent is allowed, then interest should also be allowed in their point of view.<sup>166</sup> And charging of rent in Diminishing Musharaka is exactly like the charging of interest. The best example which shows this view is the words which UK legislation used for the diminishing Musharaka arrangement. Under the UK legislation, a diminishing Musharaka arrangement is characterized as a loan, and the payment (the rent) is re-characterized as interest for tax purpose.<sup>167</sup>

## Islamic bank protect himself from any loss so as the conventional bank:

In Diminishing Musharaka price and timing of the share purchases is usually fixed at the outset of the contract. This fixation of the share price is not allowed in Islam because it is the rule of Shariah that partners in a contractual investment (in this case, a rental property) must share any losses on their investments in proportion to their capital contribution. But if one partner forces another to buy his shares at a predetermined price, he may effectively be able to protect himself against loss, which breaks the principle of loss sharing that must apply in

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<sup>164</sup>Dr. Umer Chapra, Prohibition of Interest? Does it make sense, (Islamic Dawa Movement Durban, South Africa, 2001)

<sup>165</sup>Abdul Jabbar Khan, Non Interest Banking in Pakistan, Concept, Practice and Evaluation, Royal Book Company, Karachi, 1991.

<sup>166</sup>Islam has an Economic System, available at [http://www.irfi.org/all\\_articles.htm](http://www.irfi.org/all_articles.htm), last visited 25-9-2007

<sup>167</sup>Treatment of Islamic Financial Instruments under the UN Mode, available at <http://secint24.un.org/esa/ffd/Taxation/EC18-2007-9-adv.pdf>, last visited 26-10-2007

an Islamic partnership. Thus diminishing musharaka protect the bank from any loss by various means.<sup>168</sup>

### Conventional mortgages cost much less than islamic mortgages:

According to another group of people conventional mortgages cost much less than islamioc mortgeges so it is more wiseable to get a cheapest conventional mortgage and pays it off as quickly as possible, in such situation there would be less interest and less sin. Islamic mortgages get tens of thousands of interest by another name.<sup>169</sup>

2.3.2 Arguments of those who say that diminishing MUSHARAKA differs from conventional mortgage, first one is permitted in Islam while the other is haram:

A conventional financier will see a number of parallels between a conventional mortgage and a Diminishing Musharaka product. For example, the acquisition of the financier's share at a fixed cost would appear to be a repayment of the financier's capital. The rent payable by the customer under the lease would appear to be the interest on the financier's capital. But whatever the arguments people gives in favor of the conventional mortgages and even say that both are exactly the same so both should be allowed only one verse of Holy Quran can answer to their arguments:

"Trade is just like riba but Allah has made trade halal and riba haram."<sup>170</sup>

Another example can also answer to the arguments of those who says that conventional mortgage and Diminishing Musharaka are identical, etc.

The analogy of one chicken which has been slaughtered according to Shari'ah and another similar chicken which has been slaughtered while pronouncing the name of a false deity.

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<sup>168</sup> Sheikh Haitham al-Haddad, The Islamic Mortgage: Paradigm Shift or Trojan Horse?, available at <http://cambridgeforecast.wordpress.com/2006/11/25/islamic-mortgages/>, last visited 16-10-2007

<sup>169</sup> Sheikh Muhammad Ibn Adam al-Kawthari, available at <http://www.sunnipath.com/resources/Questions/qa>, last visited

<sup>170</sup> Qur'an 2:27

Even if these two chickens are cooked by the same chef in an identical manner and their final cost is the same, one chicken remains halal and the other remains haram.<sup>171</sup>

However along with this clear cut evidence of difference, below is a selection of the main differences between a Diminishing Musharaka product and a conventional mortgage.

Conventional mortgages are interest based which is prohibited in shariah while DM is interest free:

Under a conventional mortgage a bank will charge interest on money advanced for the purchase of a property, either at a fixed, capped or floating rate, and client make regular payments to the bank over a fixed period of time. These payments usually combine an element of interest and principal. Conventional mortgages are interest based which is in conflict with Shariah Law and therefore Haram (prohibited) by Shariah. The word used in the Holy Quran for interest is riba and it is prohibited in Quran. The Qur'an has prohibited it in four different revelations.<sup>172</sup> The last of these revelations came near the end of the Prophet's (SAWS) life and stated that those who took riba were declaring war on Allah (SWT) and the Prophet (SAWS). In conventional mortgage client borrow the money from the financial institution to buy for example a house and then pay the money back with interest on it over a number of years which is clearly in contravention of shariah because it is riba which is prohibited in Islam.<sup>173</sup>

### Difference of relationship between parties

The relationship between parties in conventional mortgage is lender-borrower in which financier lend some money to the client for a future repayment with an interest on it which is prohibited in sharaiah. While this relationship is entirely different in diminishing musharaka

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<sup>171</sup>Dr. A. Hussain, *Islamic Home Financing and Mortgages*, available at <http://www.islamicmortgages.co.uk>, last visited

<sup>172</sup> 30:39, 4:161, 3:130-2 and 2:275-81. Quran

<sup>173</sup> What's the difference between a conventional mortgage and an Islamic home-buying facility?, available at <http://www.islamic-bank.com/islamicbanklive/FAQs/home/2>, last visited 12-9-2007; <http://www.emiratesislamicbank.ae/eib/faqs/>, last visited 14-9-2007.

in which both parties are co-owners of the asset means partnership exists between parties in Diminishing Musharaka. The initial financing provided by financier is for the acquisition of share in the property and not to provide a loan. The customer's monthly Acquisition and Profit Payments are applied, respectively, to acquire financier's share in the property and for the customer's exclusive use of the whole property. These payments do not constitute a repayment of a loan with interest. This transaction does not involve an exchange of cash for a greater amount of future cash, which would give rise to riba.<sup>174</sup>

## Difference between rent and interest

Analogy which the people drawn between rent and interest is not correct.

- ✓ Rent is the money charged on commodities. These commodities which are leased out remain intact and do not have to be recreated when they are required back. Same is the case in diminishing Musharaka in which partner leased out his share to the other partner and receives rent on it.<sup>175</sup>
- ✓ While interest is charged on the money which is borrowed, that money used up and does not remain intact; it is consumed on whatever purpose it was borrowed for. In order to return, the borrowed money it needs to be recreated or reproduced and some more money over and above the borrowed amount too needs to be produced to pay back as interest.<sup>176</sup>

Under an interest mortgage, the bank lends the client cash which he uses. And upon it bank takes interest which is prohibited in Islam because "Any amount, big or small, over the principal, in a contract of loan or debt is "riba" prohibited by the Quran, regardless of whether the loan is taken for the purpose of consumption or for some production activity."<sup>177</sup>

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<sup>174</sup>The Declining Balance Co-ownership Programe An Overview, available at [http://www.guidancefinancial.com/pdf/Customer\\_White\\_Paper-DBCP-.pdf](http://www.guidancefinancial.com/pdf/Customer_White_Paper-DBCP-.pdf), last visited 14-8-2007

<sup>175</sup>[http://www.hsbcamanah.com/1/PA\\_1\\_1\\_S5/content/amanah/assets/html/hsbc\\_amanah\\_faqs.pdf](http://www.hsbcamanah.com/1/PA_1_1_S5/content/amanah/assets/html/hsbc_amanah_faqs.pdf).

<sup>176</sup>Islam has an Economic System, available at [http://www.irfi.org/all\\_articles.htm](http://www.irfi.org/all_articles.htm), last visited 25-9-2007

<sup>177</sup>M. Umer Chapra, TOWARDS A JUST MONETARY SYSTEM, (1985: The Islamic Foundation) p.34



For as long as he owes the bank the cash he will be charged interest. Lending money and charging for its use is considered Haram, as scholars say that money has no value in itself and just represents the value of something else (after all, a 5 rupees note is just a piece of paper). If money has no value itself then how can banks make a charge for its use? While charging rent on the use of property for example is halal because property has its own value and it is used by one of the partner in diminishing Musharaka.<sup>178</sup>

**Lender in conventional mortgage never owns the property:**

In conventional mortgage lender never owns the property to secure him from any loss. While in Diminishing Musharaka financier owns the property as co-owner and put itself in higher risk of loss.<sup>179</sup>

**Riba and interest both are prohibited:**

It is a misgiving which weak faith based muslims are spreading that riba was prohibited by shariah and not the interest because it was not present at that time. It is not true. Because banking in the sense of money holding, money lending and money changing is as old as history. At the advent of Islam a system of banking was being practiced. Although it lacked refinements and adequate documentation, as they exist today, banking in its nascent form was fairly well developed and transactions were based on a system of interest. Since no exception was made about the legitimacy of the interest, all forms of interest can therefore be taken as repugnant to Islam. Riba is clearly and harshly prohibited by Quran and Sunnah both and it is difficult to believe that how some people are trying to justify it. Excess in all form is prohibited.<sup>180</sup>

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<sup>178</sup> Rent or interest - what's the difference?, available at [http://www.glasgowfinancialservices.com/islamic\\_mortgages.htm](http://www.glasgowfinancialservices.com/islamic_mortgages.htm), last visited

<sup>179</sup> Issam Tlemsani and Robin Matthews, Ethical Banking Islamic House Financing in The United Kingdom: A Comparative Study, available at <http://business.king.ac.uk/research/intbus/ebih.pdf>, last visited 14-9-2007

<sup>180</sup> Dr.Umer Chapra, Prohibition of Interest? Does it make sense, (Islamic Dawa Movement Durban, South Africa, 2001; Abdul Jabbar Khan, Non Interest Banking in Pakistan, Concept, Practice and Evaluation, Royal Book Company, Karachi, 1991.

## CONCLUSION AND SUGGESTION:

Promoters of conventional mortgage give arguments in favor of it and say that there is no difference between conventional and Islamic mortgage. They said that only names are changed while procedure in both transactions is similar so if one is permitted then we cant prohibit the other they term it only a window dressing. But faith-based muslims gave their argument with this clear cut verse of Holy Quran which says that 'trade is just like riba but it is hilal and riba is haram'. Like that Islamic mortgage is halal while conventional mortgage is haram because it involves interest in it. And when a muslim has the option to conduct an affair in a halal manner or a haram manner it is obligatory upon him to chose the halal option. And it is needed that we must give full awareness to our fellow muslims that conventional mortgage is not the answer to our requirements and it brings us far from our religion.

## CONCLUSION:

The practice of diminishing Musharaka is growing on with rapid pace because of its potentialities. Although Diminishing Musharaka, Ijara, and Murabaha all these are means of Islamic mortgages but techniques are different from each other. Ijara is an ingredient of diminishing Musharaka but it is also a separate mode of Islamic mortgage. In Diminishing Musharaka customer and the financier both jointly acquire the property or any other asset, and then financier leases his share to the customer, and customer as part owner part tenant then buys the financier's share in the property and becomes the sole owner.

While in Murabaha financier purchases the goods for its customer on his request and then resell it on deferred basis at a higher price. In Ijara financier purchases the asset/property and leases it to the customer on a pre agreed rental along with an undertaking to purchase the property upon extra payment made by the customer upon lump sum or installments.

Diminishing Musharaka is itself a newly introduced concept and its most commonly used forms are these:

- ✓ DM for house financing
- ✓ DM for trade
- ✓ DM for Auto financing

And steps involved in all these forms are almost same and in sequence like:

- ✓ Seller sells the property to the financier
- ✓ Joint ownership of the property
- ✓ Lease of the financier share to client
- ✓ Unilateral promise to purchase financier share in the property
- ✓ Monthly payments made by the client

These steps provide a role model for the practice of diminishing Musharaka but while using this mode lot of care is needed to make it different from conventional mortgage because only one single flaw can involve the interest factor in it, which is prohibited in shariah.

These days in Pakistan almost all Islamic banks are using this mode of Islamic finance and using identical models with minor modifications. To govern their transactions properly there is need to introduce separate law for diminishing musharaka, so to make it transparent and clear form from all ambiguities.

Some people are trying to justify the conventional mortgage and alleged that Diminishing Musharaka is also like the conventional mortgage and there is no visible difference between theses so if DM is allowed then conventional mortgage should also be allowed in Islam. They give the arguments that there is no convincing difference between rent and interest; conventional bank as well as Islamic bank both protects themselves from any loss; and at the last conventional mortgages cost much less than Islamic mortgages and even go to the extent

that it is not the interest which is practiced by banks these days is prohibited only riba is prohibited by shariah.

But when we talk in the light of shariah we can conclude that a conventional financier can see a lot of similarities between Diminishing Musharaka and conventional mortgage but faith based muslims see a lot of differences between both these. Even there first argument is enough to conclude the discussion that Diminishing Musharaka is Halal while conventional mortgage is Haram in islam because first one is interest free while the latter is interest based. Difference of relationship between parties and difference between rent and interest also matters a lot in the permissibility of Diminishing Musharaka.

At the end I want to conclude that in these days when everyone is in the need of finance diminishing musharaka is the best solution to their needs. They can get the finance under the most desired form of shariah. But what we need is to develop a separate law in this field and let it contribute in the field of mortgage to make it clear for all who are practicing conventional mortgage that diminishing musharaka is more effective than conventional mortgage.

## Chapter No.3

### Legal Documentation and Implementation of diminishing MUSHARAKA in Pakistani Islamic Banks

#### SECTION 1:

##### 3.1.1 Legal Documentation of Diminishing MUSHARAKA:

What is a Legal document?

It is a document that states some contractual relationship or grants some right<sup>181</sup>

##### 3.1.2 Legal Documentation of Diminishing MUSHARAKA:

As the legal documents states the contractual relationship and grants some rights, the legal documentation of Diminishing Musharaka also specify the contractual relationship and rights of the parties, involved in Diminishing Musharaka (here most of the time parties are referred as bank and the customer). Legal Documentation of Diminishing Musharaka consists on the following documents<sup>182</sup>

#### 1-MUSHARAKA AGREEMENT

This is the main agreement that establishes the Bank's share in the Musharaka Property. It is the agreement through which bank and the client both constitutes their joint ownership in the property.

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<sup>181</sup><http://www.thefreedictionary.com/legal+document>, last visited 10-11-2007;  
[wordnet.princeton.edu/perl/webwn](http://wordnet.princeton.edu/perl/webwn), last visited 10-11-2007

<sup>182</sup>Najum Hassan, Islamic Financial Instruments, available at  
<http://www.icap.org.pk/Downloads/IslamicFinance.ppt>.

## COMPONENTS OF MUSHARAKA AGREEMENT:

Legal documents of this musharaka agreement consist on the 'Musharaka property detail' upon which the joint ownership will exist. Here under this agreement both parties share

- Both parties share
- MUSHARAKA Property detail<sup>183</sup>

### 2. Payment Agreement (Rent Agreement)

This agreement is signed after Main Musharaka Agreement. Bank gives its share to the customer through this agreement. Bank gives its share to the customer to use and upon that use customer pays back rent to the bank.

## COMPONENTS OF RENT AGREEMENT:

Legal documentation of this agreement consists on Rent Schedule and Formula of Calculation.

- Rent Schedule
- Formula of calculation<sup>184</sup>

### 3. Undertaking to Purchase MUSHARAKA Units

This is an undertaking by the customer to the bank to purchase Bank's MUSHARAKA units. Through this document customer gives the undertaking that he will purchase the bank's share in the property through installments and at the end will become the sole owner of the property.

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<sup>183</sup>Noman Ahmed, Meezan Bank Ltd Asst.Product Manger Islamic Housing Finance, legal documentation, page-12

<sup>184</sup>All banks follow their own formula of calculation which suits their policy the best

#### Components of this undertaking by the client:

- Normal Sale Price
- Additional Unit Purchase Price<sup>185</sup>

#### 4. Undertaking to Sell MUSHARAKA Units

This is an undertaking by the Bank to sell its Musharaka units from time to time. Through this document bank gives its promise that it will sell its share in the property to the client following agreed schedule.

#### Components of this undertaking by the bank:

- Normal Sale Price
- Additional Unit Purchase Price<sup>186</sup>

This legal documentation of Diminishing MUSHARAKA is exactly in accordance with the sequence provided by the state bank of Pakistan to enter in to Diminishing Musharaka agreement. It states that

“The sequencing of the agreements in a DM shall be as follows:

- a. There shall be an Agreement of co-ownership between the parties.
- b. There shall be an agreement of Lease between the co owners to lease out one’s share in such property to another for an agreed rental in consideration of the use of the former’s share by the latter.

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<sup>185</sup><http://www.icap.org.pk/Downloads/IslamicFinance.ppt>;

<sup>186</sup> ibid

- c. An undertaking by one of the co-owners to the effect to purchase the units of other co owner at a mutually agreed price until the entire ownership of the asset is transferred to the purchasing co-owner. Additionally, an undertaking shall be given by the other owner to the effect that he will sell the units owned by him to the first co-owner in the event the latter desires to purchase the units earlier than the agreed schedule on such price as may be mutually agreed.
- d. The sale of units by one co-owner to the other co-owner as aforesaid shall be documented in such a manner as the parties may mutually agree.”<sup>187</sup>

## SECTION 2:

### 3.2.1 General Requirements to enter into Diminishing Musharaka:

Obtaining financing from an institution logically dictates that one is eligible to do so. Similar to any other credit facility, a financier in diminishing Musharaka needs the comfort that the applicant is capable of entering into such a business transaction and has the ability to maintain his or her responsibilities throughout the tenor. Diminishing Musharaka is a form of Islamic mortgage and in mortgage individual’s creditworthiness plays a vital role. That’s why most institutions will initially assess an application on three main criteria before any decision to proceed is made:

- ✓ Credit
- ✓ Capacity, and
- ✓ Collateral

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<sup>187</sup>Draft Instructions & Guidelines For Shariah Compliance In Islamic Banking Institution, available at <http://www.sbp.org.pk/ibd/2007/DRAFT-SHARIAH-GUIDELINES.pdf>, last visited 10-11-2007



## Credit:

Credit history in most markets is transparent and information is readily available from standard credit bureaus that provide a clear indication of whether the applicant makes due payments on time or not. And any existing default will also be highlighted in this process.

## Capacity:

It refers to the applicant's ability to meet the financial obligations which will arise due to diminishing musharaka contract, like initial equity, monthly installments, plus a number of additional costs pertaining to property and documentation. In this regard monthly income will be assessed through official salary certificate or by certified income estimation agency, as well as any existing debt burden. The aim is to assess that whether the customer is in the position to meet the financial requirements of the contract or not.

## Collateral:

It refers to the current market value of the property. Most financiers cannot finance more than a defined portion of the value, for example 85 per cent.<sup>188</sup>

So it is pertinent to mention here that bank always decides to finance on the basis of Diminishing Musharaka only when it satisfies itself that its client has the ability to meet its payments, and to get that satisfaction every bank lays down some conditions and requirements for its client to enter into Diminishing Musharaka contract. Usually general requirements which all banks follow are these:

- ✓ The first thing which bank will consider is the age of his client, it means that he should not be a minor nor very aged person

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<sup>188</sup>Sohail Jaffer, Islamic Retail Banking and Finance, Global Challenges and Opportunities, [Euromoney Books, London, UK, 2005], 68

- ✓ Then comes the income and expenditure requirements of the client
- ✓ Banks also analyze how the applicant have handled his financial affairs in the past
- ✓ Credit assessment techniques are adopted by the banks which take all personal details of his client and establish his creditworthiness
- ✓ The nature of the property and its condition
- ✓ Citizenship is also seriously considered by the banks<sup>189</sup>

### 3.2.2- Products available through diminishing MUSHARAKA:

Diminishing Musharaka is commonly used for the purpose of financing of fixed assets by various Islamic banks.

- ✓ House financing
- ✓ Buying home
- ✓ Building home
- ✓ Renovating home
- ✓ Replacing the existing conventional mortgage<sup>190</sup>
- ✓ Car Financing
- ✓ Plant and machinery financing
- ✓ Factory/Building financing
- ✓ Agriculture land financing
- ✓ All other fixed Assets <sup>191</sup>

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<sup>189</sup>home finance-eligibility, available at [http://www.alburaq.co.uk/homefinance\\_eligibility.asp](http://www.alburaq.co.uk/homefinance_eligibility.asp), last visited 8-1-2008; Features of Muskan- Islamic Home Financing, available at <http://www.bankislami.com.pk/JSP/en/Muskan/%20Home%20Finance>, last visited 8-1-2008; Home Finance, available at <http://www.abnamro.com.pk/Pakistan/islamicbnk/homefinance.htm>, last visited 9-1-2008; Maskan Home Financing, available at <http://www.albaraka.com.pk/services/maskan.htm>, last visited 9-1-2008.

<sup>190</sup>Saadiq Home Financing available at [http://www.standardchartered.com/pk/ib/home\\_finance.html](http://www.standardchartered.com/pk/ib/home_finance.html), last visited 8-1-2008; Easy Home Products, available at <http://www.meezanbank.com/en/EasyHomeProducts.asp>, last visited 8-1-2008;

## SECTION 3:

### Leading Islamic banks in Pakistan offering Diminishing MUSHARAKA:

Practice of diminishing musharaka in Pakistan is as old as implementation of Islamic banking in the country. Council of Islamic ideology in 1978 had advised that instead of advancing loans on the basis of interest, House Building Finance Corporation (HBFC) should enter into the joint ownership of the house with their client. The client should pay rent to the corporation for utilization of the shares of the corporation in the property. At the same time the client will keep on purchasing different units of the share of the corporation and thus the principle amount invested by the corporation will be gradually restored to the corporation in the form of the price of the purchase, until the full house is ultimately owned by the client and the corporation share is fully purchased by him.<sup>192</sup>

Different Islamic banks in Pakistan are offering the product of Diminishing Musharaka but here I will give the example of three leading banks in detail these are:

- ✓ **Meezan Bank**
- ✓ **Al-Falah Bank**
- ✓ **Dubai Islamic Bank**

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<sup>191</sup><http://www.icap.org.pk/Downloads/IslamicFinance.ppt>.

<sup>192</sup>Muhammad Ayub, Islamic Banking and Finance, Theory and Practice, Research Department, State Bank of Pakistan, Karachi, 2002, 63-64; Islamization of Banking in Pakistan, Research Department, United Bank limited, Karachi, 1984, 13.

### 3.3.1- Meezan Bank Limited:

Meezan Bank Limited is a publicly listed company, which was incorporated on January 27, 1997 and started its operations 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 dedicated Islamic Bank, by the State Bank of Pakistan. Meezan Bank has now clearly established itself as the largest Islamic Bank in Pakistan with a large network of branches in all major cities of the country.<sup>193</sup> Now after the establishment of Meezan bank, banking sector is showing a significant paradigm shift away from traditional means of business to pure Islamic means. It is serving in a great way to familiarize the people with pure Islamic means of finance. Justice (Retd.) Muhammad Taqi Usmani, is its chairman who is a renowned figure in the field of shariah particularly in Islamic finance, not only in Pakistan but through out the world.<sup>194</sup>

Vision statement of Meezan Bank Limited states to

Establish Islamic banking as banking of first choice to facilitate the implementation of an equitable economic system, providing a strong foundation for establishing a fair and just society for mankind.<sup>195</sup>

And its mission statement is

To be a premier Islamic bank, offering a one-stop shop for innovative value added products and services to our customers within the bounds of Shariah, while optimizing the stakeholders value through an organizational culture based on learning, fairness, respect for individual enterprise and performance.<sup>196</sup>

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<sup>193</sup><http://www.meezanbank.com/corporateprofile1.aspx>, last visited 4-2-2008

<sup>194</sup>Justice (Retd) Muhamad Taqi Usmani Chairman, available at [http://www.meezanbank.com/SB\\_Chairman.aspx](http://www.meezanbank.com/SB_Chairman.aspx), last visited 4-2-2008

<sup>195</sup>our vision available at <http://www.meezanbank.com/vision.aspx>, last visited 4-2-2008

<sup>196</sup>our mission available at <http://www.meezanbank.com/vision.aspx>, last visited 4-2-2008

### 3.3.1.1 Meezan Easy Home:

Meezan bank offers its Islamic home financing through Diminishing Musharaka and gives “Meezan Easy Home” title to its product. It says that applying for Islamic housing finance is easy that’s why it gives easy home title to its product. 10 easy steps for its product which Meezan bank provides are these:<sup>197</sup>

#### Step 1- Application form

Submit the filled & signed application form to Meezan Bank and the required cheque for processing Fee and External Agency Costs.

#### Step 2- Required Documents

Meezan Bank required the following documents with the application form

#### Personal Information

- ✓ Copy of NIC
- ✓ 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

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<sup>197</sup>Noman Ahmed, Meezan Bank Ltd Asst. Product Manger Islamic Housing Finance The Road Map Easy Home, page 14; also available on <http://www.meezanbank.com/en/EasyHomeRoadMap.aspx>, last visited 8-1-2008

## Income Information

- ✓ Original or certified copy of recent Pay Slip
- ✓ Employers Certificate including Tenor/Designation/Salary
- ✓ Bank Statement of Business - last 6 months (if applicable)
- ✓ Copy of Management Accounts (if applicable)

## Business/Professional Information

- ✓ 3 years proof of business
- ✓ Partnership Deed (in case of Partnership)
- ✓ Professional Degree / Certificate
- ✓ Professional Association Membership Certificate / Practice License

## Step 3- Address Verification

Meezan Bank will verify residential & office addresses of the applicant and the addresses of references submitted.

## Step 4- Income Estimation

### For Businessman / Self Employed professionals

Meezan Banks External Consultant will contact the applicant to determine his monthly income to help him in obtaining the maximum possible financing from the Bank.

### For Salaried Individuals

Meezan Bank will verify the income with the applicant employer.

### **Step 5- Legal opinion**

Meezan Bank will obtain a legal opinion on the property documents provided by the applicant.

### **Step 6- Property valuation**

Valuation agency appointed by the Meezan bank will evaluate the property to determine its market value.

### **Step 7- Credit Approval and Sanction Letter**

After you have satisfactorily fulfilled all Meezan Banks credit requirements, we will give you a conditional sanction letter.

### **Step 8- Account opening**

After approval of the case, applicant is required to open an account at Meezan Bank and submit a filled Account Opening Form.

### **Step 9- Signing of House finance agreement**

After completion of the above steps and approval of the applicant case, applicant is required to come to Meezan Bank for signing of the Islamic House Finance Agreement and other legal documents.

## Step 10- Transfer of property and disbursement

A Meezan Bank officer & bank's authorized lawyer will accompany the client & the seller of the property to the appropriate Bank or Registrars Office for Property Transfer. Original Property Documents will be handed over to the Lawyer who, after verification of the documents, will hand over the Pay Order to the Banker or Seller and will then complete the legal formalities on Meezan Banks behalf.<sup>198</sup>

### 3.3.1.2- Basic Eligibility Criteria prescribed by Meezan Bank Ltd:

The following parameters define the specific requirements that will constitute an eligible application of Easy Home: Islamic Housing Finance. An eligible customer may opt for any type of Housing Finance category provided by Meezan bank

#### Citizenship:

The citizenship of the applicant must be Pakistani whether resident or non resident

#### Age Limit:

Then comes the age factor for the primary applicant the age must be between 25-65 years, while for co-applicant it can be between 21-70 years. Here 65 and 70 describes the maximum age at the time of maturity of contract.

#### Customer/Applicant

Customer or applicant status can be single that is primary applicant or dual that is co-applicants

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<sup>198</sup>Noman Ahmed, Meezan Bank Ltd Asst. Product Manger Islamic Housing Finance The Road Map Easy Home, page 14; also available on <http://www.meezanbank.com/en/EasyHomeRoadMap.aspx>, last visited 8-1-2008



### Minimum Income:

Minimum income for salaried persons is fixed PKR 20,000 Gross, while for businessman/self employed persons it is PKR 50,000 Gross.

### Working Experience:

For the salaried person it is required at least 2 years and for businessmen it is 3 years.<sup>199</sup>

### 3.3.1.3- Easy Home Products:

Meezan Bank offers following products through its Easy Home Programme:

- ✓ Easy Buy
- ✓ Easy Builder
- ✓ Easy Renovate
- ✓ Easy Replace

### Example of Meezan Bank Ltd:

It is known as Meezan Easy Home Payment Calculator. Here I will give the example of home buying facility of Meezan bank.

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<sup>199</sup>Case Study, Meezan Bank's Easy Home –Islamic Housing Finance- A Success Story, Basic Eligibility, p 12; also available at <http://www.meezanbank.com//en/EasyHomeEligibility.aspx>, last visited 8-1-2008

Suppose a customer A want to purchase property worth Rs.50, 00000. In which he intend to invest Rs.10,00000 from his side and in need of finance of Rs.40,00000 from the bank.

Now the calculations of Meezan Bank will be as follows:

No of Units	60	
MBL Share in the		
Unit Sale Price		60

\*MBL Share in the Property is Divided into Musharakah Units

**Unit Sale Price \*\* (PKR) :** 66,666.67

\*\*Price of Units = Total MBL Share / No. Of Units

**Monthly Rent Per Unit (PKR) :** 916.67

**Total Starting Rent \*\*\* (PKR) :** 55,000.00

\*\*\*Total Starting Rent = Rent Per Unit X numbers of MBL Units outstanding

**Starting Month Payment (PKR) :** 121,666.67

### 3.3.2: Bank ALFALAH Limited

Bank Alfalah Limited is a private bank in Pakistan owned by the Abu Dhabi Group. Bank Alfalah was incorporated on June 21, 1997 as a public limited company under the Companies Ordinance 1984.

Regarding Islamic banking Bank Alfalah Ltd "Mission Statement" states

“To practice Islamic banking in its desired spirit that unfolds its true economic potential resulting in prosperity to our customers and commercial rewards to our sponsors and our employees.”<sup>200</sup>

Bank Al-falah’s Islamic Banking Division (BAL-IBD) started operations in 2003 and at its yearend reflected a modest capital base of Rs.100 million and deposits totaling Rs.113.7m. By following yearend, BAL-IBD’s equity had risen more than 4 times to Rs.569m and the balance sheet footing had swelled to Rs.7,799 million. Deposit size had grown from less than Rs.114m to over Rs.7,229 million.<sup>201</sup> This shows that its Islamic banking division is growing on with a great speed

“Bank Alfalah – Islamic Banking Division (BAL-IBD) – presently a division of Bank Alfalah Limited – is gearing up to become a separate, full-fledged Islamic Banking entity” says the company information.

BAL-IBD offers to its customers a broad range of Islamic products under:

- ✓ Personal,
- ✓ Consumer and
- ✓ Corporate banking modes<sup>202</sup>

and under consumer banking it offers to its customers riba free home finance facility that is titled “ALFALAH MUSHARAKA HOMES”.<sup>203</sup>

### 3.3.2.1-Alfalah MUSHARAKA Homes:

In the scheme of Alfalah Musharaka Homes any eligible person can participate with Alfalah Bank Islamic Banking Division for the joint ownership of the property. Following are the ten

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<sup>200</sup>Bank Alfalah Limited, Mission Statement, available at [http://www.bankalfalah.com/islamic/about\\_islamic\\_banking.asp](http://www.bankalfalah.com/islamic/about_islamic_banking.asp), last visited 15-1-2008

<sup>201</sup>Bank Alfalah Limited, Performance, available at [http://www.bankalfalah.com/islamic/about\\_islamic\\_banking.asp](http://www.bankalfalah.com/islamic/about_islamic_banking.asp), last visited 15-1-2008

<sup>202</sup>Islamic banking, available at <http://www.bankalfalah.com/index.asp>, last visited 15-1-2008

<sup>203</sup>consumer banking, Islamic banking available at [http://www.bankalfalah.com/islamic/consumer\\_banking.asp](http://www.bankalfalah.com/islamic/consumer_banking.asp), last visited 15-1-2008

steps of Alfalah musharaka homes provided by Alfalah Bank Ltd which are in accordance with the shariah principles according to this bank:<sup>204</sup>

#### STEP 1:

Bank provides all the information which customer needs about Alfalah Musharaka Homes. This information can be brought through face to face meeting with the relationship officer of the bank or over telephone or through post whichever is convenient to the client.

#### STEP 2:

Then customer gives some basic information about his income and the amount of the family and the amount he needs from the bank so in the light of these information's bank can assess the eligibility of the client in principle.

#### STEP 3:

After the decision of the amount which the client wants to get from the bank, he is required to complete an application form and submit it to the bank along with the following documents:

- ✓ Copy of NIC (New)
- ✓ Copy of co-applicant's NIC–New (if applicable)
- ✓ 3 passport size photographs
- ✓ Copy of salary slip or rental documents whichever is applicable
- ✓ Copy of paid utility bill
- ✓ Borrower's fact sheet

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<sup>204</sup>Brusher of ALFALAH MUSHARAKA HOMES , BANK ALFALAH LIMITED, ISLAMIC BANKING, You are ten steps away from "Alfalah Musharaka Homes", last visited 14-1-2008

- ✓ Copy of recent credit card bill (if applicable)
- ✓ Bank statement for the last six months

**STEP 4:**

Bank conduct some inquiries about the financial circumstances of the client

**STEP 5:**

Then bank carry out a valuation of the property and verification of the client's income

**STEP 6:**

After the completion of all initial processing by the bank, it send to the client an offer through a Facility Offer Letter

**STEP 7:**

Customer signs the Facility Offer Letter and returns it to the bank

**STEP 8:**

Credit Administration Department of the bank will get in touch with the client to complete all the Finance and Security documentation including legal opinion on the title documents of the property



## Income

Gross annual income of the client must be Rs.200,000/- or more, spouse income can also be combined in it

## Maximum Financing

Maximum Financing can be upto Rs.10 M or three times of gross annual income of the main customer plus 1.5 times of gross annual income of the spouse, whichever is less.

## Tenure:

Customer may apply for Bank Alfalah's Musharaka Homes for minimum of 3 years and a maximum period of 20 years subject to the age of the client.

### 3.3.2.3-Products of DM offered by Bank Alfalah Ltd:

Bank Alfalah Ltd practice Diminishing Musharaka through its Alfalah Musharaka Homes facility. This Alfalah Musharaka Homes product can be used in multiple situations giving different solutions to the desired objectives of its clients; it offers the following four services:

- ✓ Alfalah Musharaka Homes- Buyer, that is known as Alfalah Buyer:  
Under this service Alfalah Jointly purchase an already constructed house
- ✓ Alfalah Musharaka Homes- Construction, that is known as Alfalah Builder  
Bank jointly purchases a plot and subsequently construct upon it
- ✓ Alfalah Musharaka Homes Improvement, that is known as Alfalah Renovation

Renovate, extend, restore and enhance already owned housing unit of the customer

- ✓ Alfalah Musharaka Homes- Replacement  
Alfalah also provides the facility to transfer the existing conventional mortgage housing finance facility form another financial institution to our Riba-free-facility<sup>206</sup>

### 3.3.2.3-Ratio of Musharaka Participation between Bank and customer

The ratio of Musharaka participation between the bank and customer is given below:

#### Alfalah Musharaka Homes- Buying:

Bank will provide 80%, while customer will provide 20%

#### Alfalah Musharaka Homes – Construction

Land: Bank 60%: customer 40%

Construction: Bank 70%: customer 30%

#### Alfalah Musharaka Homes- Renovation:

Upto a maximum of 30% of the value of your property or Rs.2.5 million whichever is lower

#### Alfalah Musharaka Homes- Replacement

Bank 70%: Customer 30%<sup>207</sup>

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<sup>206</sup>Brusher of ALFALAH MUSHARAKA HOMES , BANK ALFALAH LIMITED, ISLAMIC BANKING, Which type of Financing Agreements are being used in Alfalah Musharaka Homes?; [http://www.bankalfalah.com/islamic/comsumer\\_banking.asp](http://www.bankalfalah.com/islamic/comsumer_banking.asp), last visited 14-1-2008

<sup>207</sup>Brusher of ALFALAH MUSHARAKA HOMES, BANK ALFALAH LIMITED, What will be the minimum ratio of musharaka participation between the Bank & Customer?



### 3.3.2.4-Determination of Musharaka unit by Bank Alfalah Ltd:

The methodology which bank Alfalah is following for the determination of one Musharaka unit is done by the following formula:

BAL's total Musharaka Investment /Numbers of months allowed= Cost of One Musharaka Unit.<sup>208</sup>

### 3.3.3: Dubai Islamic Bank Pakistan Ltd:

Dubai Islamic Bank Pakistan Ltd. is a subsidiary of Dubai Islamic Bank, launched in 1975. Dubai Islamic Bank has the unique distinction of being the world's first full fledged Islamic bank and a pioneer institution. The distinguishing feature of Dubai Islamic bank is that it always tries to combine the best of traditional Islamic values with modern technology and innovation to become one of the leading Islamic banks.<sup>209</sup>

The mission statement of Dubai Islamic Bank also shows that its main purpose is to serve its customers with the pure Islamic means, as it states

“We are proud to be the first Islamic Bank worldwide that has translated true Islamic economic principals into practice, out of firm belief in the need of mankind for an economic system based on the final Revelation. By partnering with our customers in halal earnings, employing best business practices, the latest financial services technologies and placing our trust in Allah, we are confident of our success.”<sup>210</sup>

And its vision is to be the leading provider of innovative financial services in accordance with the legislation of Allah.<sup>211</sup>

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<sup>208</sup>Brusher of ALFALAH MUSHARAKA HOMES, BANK ALFALAH LIMITED, What is a Musharaka Unit?

<sup>209</sup>Brusher of Dubai Islamic Home Finance, Dubai Islamic Bank Pakistan Ltd

<sup>210</sup>Mission, available at [http://www.dib.ae/en/aboutdib\\_mission.htm](http://www.dib.ae/en/aboutdib_mission.htm), last visited 23-1-2008

<sup>211</sup>Vision, available at [http://www.dib.ae/en/aboutdib\\_vision.htm](http://www.dib.ae/en/aboutdib_vision.htm), last visited 23-1-2008

### 3.3.3.1 Dubai Islamic Home Finance

Dubai Islamic Bank offers Home Finance product through Diminishing Musharaka and in this regard it says that the key to owning a home the Islamic way is here.<sup>212</sup>

Dubai Islamic Bank gives the argument regarding the use of Diminishing Musharaka that using the Musharaka model, you can own a home

- ✓ Quickly
- ✓ Conveniently and
- ✓ In a fully shariah compliant manner.<sup>213</sup>

### 3.3.3.2-Features of Dubai Islamic Bank Pakistan Ltd:

Following are the important features of DIBPL Home Finance which makes it as a best choice for Islamic Home Finance in Bank's view point:

100% Shariah compliance

- ✓ Financing up to Rs.30million
- ✓ Fastest processing time
- ✓ Affordable and competitive monthly payment amount
- ✓ Financing up to 80% of customer property value
- ✓ Early and partial settlement option<sup>214</sup>

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<sup>212</sup>Front page of the brusher of Dubai Islamic Home Finance, Dubai Islamic Bank Pakistan Ltd

<sup>213</sup>DIBPL' s Islamic Home Finance, Brusher of Dubai Islamic Home Finance, Dubai Islamic Bank Pakistan Ltd

<sup>214</sup>What Makes Dubai Islamic Home Finance the Best Choice? Brusher of Dubai Islamic Home Finance, Dubai Islamic Bank Pakistan Ltd

### 3.3.3.3-Products of Dubai Islamic Bank Pakistan Ltd:

Following are the main products which Dubai Islamic bank offers under Islamic Home Finance Scheme

✓ Home Purchase:

With the help of this facility customer can become the owner of a new Home/Apartment through Dubai Islamic Bank Home Purchase Plan.

✓ Purchase of undivided share (Home Renovation).

The Home Renovation Plan gives a new look to the existing homes. Dubai Islamic Bank Pakistan Ltd becomes a partner in the existing property of the customer by purchasing certain undivided share of the customer's property by the bank. Then after the purchase bank will lease its share to you. Through this home renovation customer can get 70% of its value of the property.

✓ Purchase of undivided share of property at other bank (Balance Transfer).

Dubai Islamic Bank Pakistan Ltd also provides the facility to get rid of the interest based mortgage facilities which customer is already availing. Through this balance transfer customer can transfer its interest-based home mortgage loan to interest-free home mortgage of Dubai Islamic Bank, where bank purchases a share in the customer property and lease it to the customer. This option can also be availed for properties financed at Islamic banks.<sup>215</sup>

### 3.3.3.4-Procedure of Dubai Islamic Bank for Home Finance

Dubai Islamic Bank gives its 3 step procedure to own a home, following are the 3 simple steps to own a home the Islamic way:

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<sup>215</sup>3 Home Solutions, Brusher of Dubai Islamic Home Finance, Dubai Islamic Bank Pakistan Ltd, also available at <http://www.dibpak.com/HomeFinance.aspx>, last visited 23-1-2008.

- ✓ Dubai Islamic Bank Pakistan Ltd and the customer will first of all enter into a partnership (Musharaka) for the purchase of property, where both customer and bank will share in the ownership of the property and hence the associated risks and the gains associated with it.
- ✓ Then, bank will lease its share in the property to the customer and will receive agreed rentals. Bank leases its shares as a part of the agreement for a monthly rent.
- ✓ Periodically, customer will purchase a pre-agreed percentage of bank's share in the property, thereby increasing his ownership in the property and reducing bank's share by a similar amount. And at the end of the agreement term the ownership of the entire property will pass to customer upon successful completion of the agreed payments.<sup>216</sup>

#### How it works?

- ✓ Dubai bank's relationship Officer will visit and help the customer to complete the Home Finance application form.
- ✓ When application has been analyzed and approved by the bank customer will receive an offer letter stating the terms of offer and the amount DIBPL is willing to offer to the customer as finance.
- ✓ On completion of these steps, the amount stated in the offer letter which is DIBPL's contribution towards Musharaka will be deposited by DIBPL to Musharaka account.

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<sup>216</sup>How does Musharaka work?, Brusher of Dubai Islamic Home Finance, Dubai Islamic Bank Pakistan Ltd

- ✓ Customer will be registered as the legal owner of the property at the local registrar's office.
- ✓ Customer will then be required to lease DIBPL's undivided share of the property DIBPL for an agreed number of years.
- ✓ After successful completion of Lease, DIBPL will sell its undivided share in the house to the customer for a nominal price and the property will be transferred to the customer name.<sup>217</sup>

### 3.3.3.5 Eligibility Criteria of Dubai Islamic Bank Pakistan Ltd Home Finance:

- 1- Pakistani nationals can only apply for Dubai Islamic Home Finance
- 2- Applicant age should be between 25- 65 years
- 3- Applicant minimum income must not be less than Rs.15,000
- 4- Applicant must be self-employed Businessmen, professional or salaried individual.

#### Property Eligibility criteria:

- ✓ The qualifying property must be located in Cities (Karachi, Lahore, Islamabad, Rawalpindi and Faisalabad) of Pakistan.
- ✓ The minimum value of the property must be greater than Rs.800,000.<sup>218</sup>

### 3.3.3.7-Documents required for Dubai Islamic Bank Home finance:

Documentary proof which is required to apply for Dubai Islamic Bank Home Finance product is mentioned below:

<sup>217</sup>How it works, available at <http://www.dibpak.com/HomeFinance.aspx>, last visited 21-1-2008

<sup>218</sup>Eligibility, available at <http://www.dibpak.com/HomeFinance.aspx>, last visited 23-1-2008

- 1- Copy of primary applicant's CNIC
- 2- In case of co-partners, copy of co-partner's CNIC
- 3- 2 Passport size photographs
- 4- Tax returns
- 5- Copy of utility bill
- 6- Professional degree for self employed professionals only
- 7- Salary certificate for salaried individual's and proof of profession for professionals
- 8- Latest salary slip<sup>219</sup>

#### CONCLUSION:

In this chapter I presented a comprehensive outlook of the practice of Diminishing Musharaka which is practiced by different Islamic banks in Pakistan. Diminishing Musharaka is in practice in the whole world in Islamic financial institutions but here I gave the example of my own country only. First of all I presented that upon what documentation Diminishing Musharaka consists. Legal documentation is that procedure through which any types of rights or liabilities are conferred upon the parties of the contract or agreement. So according to that concept legal documentation of Diminishing Musharaka must consist on four documents these are:

- ✓ Musharaka agreement
- ✓ Payment agreement that is rent agreement
- ✓ Undertaking to purchase Musharaka units by customer
- ✓ Undertaking to sell Musharaka units by the bank or financial institution

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<sup>219</sup>Documents Required, Brusher of Dubai Islamic Home Finance, Dubai Islamic Bank Pakistan Ltd; also available at <http://www.dibpak.com/HomeFinance.aspx>, last visited 23-1-2008

Then comes the general requirements which all banks, no matter where they are, in Pakistan or outside the world, takes into consideration before entering into Diminishing Musharaka contract with its customer. These general requirements are the age factor, citizenship, solvency of the customer, financial affairs handled by the customer in the past and location and condition of the property which customer wants to own. These are the general things which each and every financial institution takes into consideration before entering into Musharaka agreement with its client. Details of these conditions can be different as American Islamic financial institution may demand that its customer must be an American likewise Pakistani bank can laid the condition that customer must be a Pakistani but general thing is that bank gives the importance to the citizenship and format its condition according to that and likewise for other conditions.

Then after that I particularly gave the example of the Pakistani banks and from that I choose three leading Islamic banks offering their services in Pakistan. These are Meezan Bank Limited, Bank Al-Falah Limited and Dubai Islamic Bank Pakistan Limited. All these banks follow their own procedure for the product of Diminishing Musharaka but one thing is common that all these banks use the Diminishing Musharaka for the home finance only. Most of the banks in Pakistan use Diminishing Musharaka mostly for home finance. These banks offer Diminishing Musharaka for home purchase, home renovation and home construction.

All the three banks present their own procedure for their service of Diminishing Musharaka. Although some conditions provided by these banks can vary from case to case but the basic procedure and other conditions remain identical for all the Islamic banks in Pakistan.

Meezan Bank, Al-Falah Bank and Dubai Islamic Bank present their own road maps for their product of Diminishing Musharaka. They present this road map with the help of which their customer can understand this service in detail.

These banks practice Diminishing Musharaka for home purchase, home construction and home renovation. They follow their own formula of calculation for the Diminishing Musharaka which calculates the each unit price, the payment made by the client, the amount of rent he has to pay, and the percentage of bank and customer share in the property.



## **CONCLUSION:**

Partnership known as Musharaka in Islam has been known since mankind has existed on earth. Musharaka is based on co-operation and man has always needed help from the fellow men. But unfortunately this type of partnership which was permitted by holy prophet (PBUH) and Quran and was agreed upon by all muslim school of thoughts about one thousand years ago had almost disappeared from the Islamic world before the establishment of Islamic banking in the last century.

By the grace of God Pakistan has been able to discard the old system of interest from its banking sector successfully without giving any jolt to the economy. Shifting from interest-based system to non-interest banking system has been very smooth; so smooth that some people have not even felt the change. But unfortunately there are some flaws in the new Islamic banking system of Pakistan like it is giving more importance to Bai-Mojjal and Mark-Up system, which is strongly criticized within and outside the country. It is need of the day that Pakistani banking system should move to the mechanism of Musharaka or profit and loss sharing system.

Although the banks and the clients both are free to do financing under Musharaka arrangement, but they are not adopting this mode so long they have the other option of mark-up. Government must implement effective measures to remove this other option and besides legal framework other practical measures are also needed. Awareness among the banks and the clients is also needed. There is not yet even an independent law so far has been introduced to govern Musharaka and it is the need of the day to promote Musharaka institution with its due weight-age. And laws which we have for other modes like “Mudaraba companies and Mudaraba Ordinance 1980” such type of law should be introduced for Musharaka also.

Diminishing Musharaka is a type of Musharaka, which is growing on in Islamic banks with rapid pace because of its potentialities. It is a type of partnership, which ends up at the transfer of complete ownership to the other partner who purchases the shares of the other partner.

Banks are practicing this mode but like Musharaka we don't have any statutory framework for this type also and we can't find the exact legal definition of this mode in the law books of Pakistan. This is a very popular mode and to govern this mode without any ambiguities we must be clear regarding all its aspects under a clear-cut law. Fatwas of eminent scholars exists regarding the permissibility of this mode although some raise objections on it also but if all the conditions are fulfilled then this is a permissible mode of Islamic mortgage.

Modern forms of diminishing Musharaka which Islamic and conventional banks both are offering these days are mainly three, these are diminishing Musharaka for house financing, diminishing Musharaka for trade and diminishing Musharaka for auto financing. Steps involved in all three forms are almost in same sequence. These steps provide a role model, for the practice of diminishing Musharaka, to the banks but while practicing these steps lot of care and knowledge regarding principles of shariah is needed to avoid any type of involvement of interest in it that can make it haram.

Almost all Islamic banks in Pakistan are using this mode of finance with their own models, which are almost identical. To govern their conduct properly there is need to introduce a law to make it transparent and clear from all ambiguities.

Some people are trying to justify the conventional mortgage for their own interest and give the argument that conventional mortgage and diminishing Musharaka both are same so both should be permitted. They also give other arguments also but for faith based muslims only argument is enough that interest is haram while rent is halal and diminishing Musharaka is based on rent so that's why first one is haram while the other is halal.

As far as legal documentation of diminishing Musharaka is concerned it consist on Musharaka agreement, rent agreement, undertaking to purchase Musharaka units and undertaking to sell Musharaka units. These are the documents upon which diminishing Musharaka consists. Leading Pakistani Islamic banks are using identical models with little modifications according to their banking policy but all of them keep in view that shariah principles must be fulfilled.

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