Musharakah
Mutanaqisah
Home Financing
This case study was developed by the Asian Institute of Finance (AIF).

AIF focuses on developing human capital across the financial services industry in Asia. Established by the Central Bank of Malaysia (Bank Negara Malaysia) and the Securities Commission Malaysia to lead capacity building and standards setting for the financial services industry (FSI), AIF is committed to elevating Malaysia’s role as a premier provider of comprehensive solutions for the financial sector across the region.
Musharakah Mutanaqisah (MM) or Diminishing Partnership was relatively new but started to gain popularity amongst Islamic financial institutions. It was generally argued that MM was closer to the spirit and objectives of Shariah and should therefore be used more often by Islamic financial institutions. The MM model could be easily implemented for various financing purposes, including: housing projects, car financing, financing of working materials and equipment, financing business projects, etc.

MM practices differed across Malaysian banks in terms of: documentation, approaches to default, early settlement, abandonment of the project, etc. These different approaches created unresolved issues of Shariah that scholars were still debating. The question customers faced was, which was the best approach? For the banks, according to Shariah requirements, they had to resolve whether they had taken enough measures to ensure the risk was entirely the customer’s?

Musharakah Mutanaqisah

According to Accounting and Auditing Organization for Islamic Financial Institutions’ (AAOIFI) Shariah Standards, diminishing musharakah was “a form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. This transaction starts with the formation of a partnership, after which buying and selling of the equity take place between the two partners. It is therefore necessary that this buying and selling should not be stipulated in the partnership contract. In other words, the buying partner is allowed to give only a promise to buy. This promise should be independent of the partnership contract. In addition, the buying
and selling agreement must be independent of the partnership contract. It is not permitted that one contract be entered into as a condition for concluding the other”1.

**MM Home Financing**

MM was a hybrid product in home financing, consisting of three contracts: *musharakah* (partnership), *ijarah* (leasing) and *bay‘* (sale). Basic steps involved in the MM home financing structure included:

1. **First Stage**
   a. The customer identifies the property that s/he wants to purchase and s/he approaches the bank for financing.
   b. The customer and the bank will enter into a MM arrangement where the purpose is to acquire a property.
   c. The initial down payment or deposit made by the customer will be his/her contribution towards the MM Venture while the bank’s contribution will equal the financing amount.

2. **Second Stage**
   a. The bank subsequently leases the acquired property to the customer.
   b. The rental paid by the customer will be distributed among partners in accordance to the shareholding at the point the rental is paid/ received.
   c. In practice, the bank’s portion of the rental income mirrors the interest rate charged by its conventional counterpart in the similar product offering.

3. **Third Stage**
   a. Throughout the lease tenure, based on agreed time intervals, the customer purchases the bank’s equity of the jointly acquired property. Over the financing tenure, therefore, the bank’s shares are redeemed and reduced by the purchase made by the customer.

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1 AAOIFI, 2008, Shariah Standard No.12, 5/1, p.217
b. At the end of the financing agreement, once the equity portion of the bank has been fully redeemed, the ownership title will eventually be transferred to the customer. The partnership is then effectively terminated.

Figure 1 summarises a typical MM home financing structure and operation:

1. The customer selects the house and applies for financing from Bank.
2. The bank approves application and enters into a *musharakah* agreement with the customer to jointly purchase and own the house. [e.g. 90:10 ratio]
3. The customer leases the bank’s share in the house (*ijarah*) & makes periodic rental payments.
4. The customer buys portions of ownership in the house from the bank until gradually the bank sells all its shares in the house to the customer who then fully owns the house.
5. Some banks will ask the customer to give it a binding promise (*wa’d*) to purchase the Musharakah asset.
Shariah Rulings and Governing Principles

The Shariah validity of the underlying contracts in MM, Musharakah, Ijarah and Bay', were found in the Quran, the Prophet's Sunnah and Consensus of the Muslim scholars (Ijma). Muslim jurists were unanimous in approving these individual contracts. When combined into a product structure, however, there were certain conditions and rulings that needed to be fulfilled for Shariah compliance. The Islamic Fiqh Academy of OIC issued a resolution in 2004 that stated that MM was a permissible product structure “if it is practiced according to its actual parameter”\(^2\).

According to AAOIFI Shariah Standards, it was permissible in Shariah to combine more than one contract in one set, without imposing one contract as a condition on the other, and provided that each contract was permitted on its own. This type of contract combination was acceptable unless it fell foul of a Shariah restriction that led to it being banned on an exceptional basis\(^3\).

AAOIFI standards further stated that “to acquire the shares at their original or face value is not allowed to be stipulated (i.e. predetermined), since this would guarantee the value of the shares of one partner by the other partner and this is against Shariah”\(^4\). In practice, this ruling was by-passed by IFIs by using a binding unilateral promise (wa’\(d\)) where the price could be agreed and predetermined.

Bank Negara Malaysia in its draft of Shariah parameters\(^5\) stated that, “An IFI may request its customer to give a binding promise (wa’\(d\)) to the IFI to purchase the Musharakah asset or IFI’s share either on a lump sum basis or gradually over an agreed period of time at market value or at a fair value or at any price to be agreed by the parties.”

ISSUES IN MM PRACTICE

MM practices differed across Malaysian banks in terms of: documentation, approaches to default, early settlement, abandonment of the project, etc.

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\(^2\) Resolution No. 136 (2/15), 2004, p. 645  
\(^3\) AAOIFI, 1429/2008, p. 452  
\(^4\) AAOIFI, 2004, pp. 214-25  
\(^5\) 2010, p. 17
**Documentation**

Different types of Malaysian banks used a range of documentation relating to MM. The differences are shown in Table 1.

<table>
<thead>
<tr>
<th>Fully Fledged Islamic Bank (FFIB)</th>
<th>Foreign Bank (FB)</th>
<th>Local Islamic Bank (LB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Letter of Offer</td>
<td>Letter of Offer</td>
<td>Letter of Offer</td>
</tr>
<tr>
<td>MM Facility Agreement(^a)</td>
<td>Facility Agreement(^b)</td>
<td>MM Co-ownership Agreement(^c)</td>
</tr>
<tr>
<td>Undertaking from the Customer(^d)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplemental S&amp;P agreement(^e)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Ijarah (Lease) Agreement(^f)</td>
<td>Property Ijarah Agreement(^g)</td>
<td></td>
</tr>
<tr>
<td>Trust Deed in Favour of the Bank(^h)</td>
<td>Deed of Promise(^i)</td>
<td>Legal Charge/Deed of Assignment(^j)</td>
</tr>
<tr>
<td>Power of Attorney(^k)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- a. Contained all the terms and conditions agreed between the two contracting parties
- b. The promise from the customer to buy the bank’s share in the property and to make the bank the trustee and hold the property solely in the name of the bank
- c. Detailed the sale and purchase of the property, the responsibilities of the contracting parties i.e. the vendor, the bank and the customer
- d. Terms and conditions of Ijarah agreement between the bank and the customer
- e. Customer agreement to make the bank the trustee and the beneficial owner of the property
- f. Explaining the offer and other terms and conditions of the offer
- g. Similar to FFIB
- h. Similar to FFIB
- i. The customer promises to buy the share of the bank within the agreed time at pre-agreed terms and conditions
- j. Authorisation from the customer creating a charge in favour of the bank
- k. Similar to facility agreement of FFIB and FB but it covered the Ijarah terms and conditions in this document rather than having a separate Ijarah document
- l. Same as FB
The main difference between the FB and FFIB was that FFIB was the legal owner and trustee of the property, whereas for FB, the bank was the legal owner of the property but the customer was appointed as the trustee of the property. The key difference between the others and LB, other than considerably less documentation, was that the customer was appointed as the legal and beneficial owner of the property and the charge was created in favour of the bank, as it was the main contributor in the property. Refer to Appendix 1 for a summary and explanation of the documentations used by each of the three banks for their MM home financing products.

**Registration of Property**

All banks other than FFIB registered the customer as the legal title owner, holding the property as a trust for the benefit of both parties. One reason was that the typical customer’s perception was influenced by conventional banking practice where the customer was always the registered owner. Naming the bank as the owner instead may not have been viewed favourably in the market.

The customer’s share of the beneficial ownership of the property was pledged to the bank, as security against instalment payments. Because the property was registered in the customer’s name, also as a trustee, both beneficiaries agreed to register a charge over the whole property in the bank’s favour. The equitable charge should only have been the customer’s portion of the land. The National Land Code (NLC)\(^6\), however, allowed a charge over the whole, and did not allow “a part only” of any alienated land to be charged in favour of the bank. Therefore the charge was applicable on the whole land\(^7\). As the bank was part beneficial owner of the land, it was argued that the institution could not take a charge over its own beneficial ownership of the land. FFIB held the property in its sole name on trust for the benefit of both, and at all times had custody to the document title of the property\(^8\). At the end of the tenure, after all payments had been made, the title was transferred into the customer’s name.

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\(^6\) S.241(1)(a) National Land Code 1965
\(^7\) Haneef et al, 2011
\(^8\) The trust deed was registered under S.344 of the NLC, Haneef et al, 2011
Combination of Contracts

Combining more than one contract was permitted⁹, provided that (i) each contract itself was permitted in the Shariah, and (ii) each contract stood independently (‘uqud mustailllah). The guidelines and conditions for combining several contracts into one single transaction are shown in Table 2.

### Table 2: Contract Combining Guidelines

<table>
<thead>
<tr>
<th>Condition/Guideline</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Should not include cases explicitly banned by Shariah</td>
<td>Contracts that combined a sale and loan into one contract</td>
</tr>
<tr>
<td>Should not be used as a ploy to commit usury (riba)</td>
<td>An agreement between two parties to practice a sale and buyback transaction (bay al-‘inah) or riba al-fadl¹⁰</td>
</tr>
<tr>
<td>Should not be used as an excuse for practicing riba</td>
<td>Concluding a lending contract that led to some other gain for one of the parties e.g. stipulating in the contract that the borrower should offer accommodation in his house to the lender, or giving the lender a present, or excessive repayments in terms of quantity or quality on the borrower</td>
</tr>
<tr>
<td>Should not reveal disparities or contradictions with regard to underlying rulings and ultimate goals</td>
<td>Examples of contradictory contracts included granting an asset to somebody as a gift and selling/lending it to him simultaneously, or combining mudarabah (profit-sharing contract) with lending the mudarabah capital to the mudarib, or currency exchange with jualah, or salam with jualah in the same contract value, or leasing with selling (i.e. hire-purchase in its traditional form)</td>
</tr>
</tbody>
</table>

Mufti Taqi Usmani suggested having a unilateral (one-sided) promise by the client to lease the bank’s share of the property and pay rental on it and to purchase the bank’s share of the property at different stages¹¹. Illustrated by¹²:

- The joint purchase and the lease contract can be combined in one document where the bank agrees to lease his share, after the joint

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⁹ AAOIFI’s Council of Shariah Advisors, Resolution No. 25
¹⁰ It has been reported that the Prophet (peace be upon him) instructed one of his employees to sell his low-quality dates first and then buy the high-quality dates he wanted, instead of resorting to exchange of a greater quantity of low-quality dates for a lesser quantity of high-quality dates. (Narrated by AbÉ DÉwÉd, al-TirmidhÉ, al-NasÉÊ, Ibn MÉjah, Almad, al-ShÉfiNiÊ and MÉlik)
¹¹ Usmani (2004) pp. 82-90
¹² Smolo and Hassan (2011)
purchase, to the customer. This is allowed because *ijarah* can be affected for a future date

- The customer may sign a unilateral promise to regularly buy each unit of bank’s share; the bank may undertake to agree that each time the customer buys an additional unit of its share, the rent is reduced accordingly
- Each unit’s purchase must be affected by an offer and acceptance of that particular date (e.g. every 3 months)
- Each unit’s purchase price is preferably based on the market value of the property at the time of purchase, however, the parties can agree the price, which is then included in the promise to purchase document

In 2006, the Shariah Advisory Council of BNM resolved that the contracting parties were allowed to (i) combine the *musharakah* and *ijarah* contracts in one agreement, as long as they were concluded separately and clearly not mixed between each other, and (ii) impose a pledge on the shares owned by the customer, recognising the right of beneficial ownership\(^{13}\).

**Wa’d (Unilateral Promise)**

The MM product in most Islamic banking practice incorporated a Deed of Promise, which was essentially a *wa’d* or unilateral promise from the purchaser to buy the shares of the Bank. The issue was whether this promise was legally binding and enforceable\(^ {14}\); and whether the bank had the right to seek legal enforcement of the promise in the court of law. There was a fine line to draw between a *wa’d* and a contract, however. If the *wa’d* was immediately enforceable, it was no longer a promise. Instead it was a contract, which rendered the MM partnership in conflict with the *Shariah*\(^ {15}\)\(^ {16}\). Until challenged in court, the issue of *wa’d* remained contentious. The International Fiqh Academy\(^ {17}\) under OIC decided that the promise was legally binding based on certain conditions.

**Nature of Partnership: Sharikat al-milk vs Sharikat al-aqd**

From the perspective of *Shariah*, substance was more important than form; hence, it was important to be able to define the nature of the MM partnership. Broadly, the debate was whether MM was either a *sharikat al-milk* (co-ownership) or *sharikat al-aqd* (contractual partnership).

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\(^{13}\) SAC resolution in its 56th meeting held on 6th February 2006 / 7th Muharram 1427

\(^{14}\) Abdullah (2008)

\(^{15}\) Inferring from Laldin (2009)

\(^{16}\) To keep a promise is certainly a virtuous act (Quran: 53:37, 18:54), but it does not imply enforceability, rather it implies nobility

\(^{17}\) International Fiqh Academy (1988)
Under the Sharikat al-‘aqd, partners pooled capital and/or resources for a commercial purpose, agreeing on a pre-determined profit sharing ratio. Partners were agents of each other and one partner could not guarantee capital or profit of the other. Sharikat al-milk was a co-ownership that was not created via ‘aqd and the purpose of the partnership was not to make profits. The co-owners used the property jointly or individually. In such a partnership, guarantee of capital by one partner to the other was not an issue since the venture was not for profit.

The MM was arguably in the form of shirkat al-aqd if the intention of at least one of the parties was to earn returns. The Malaysian banking practice, however, considered MM to be shirkat al-milk from the commencement of the contract until the end of its tenure18

Although the MM is claimed to be shirkat al-milk, the features of this type of shirkah is only fully met in the initial stages of the product rather than permanently19. This is because, in fact, both parties consequently agree to invest in the property to be leased (to the customer or others), hence transforming the partnership into a contractual one. Mustafa al-Zarqa20 explained that where a shirkat al-milk is “subject to a condition that there is no contract jointly benefiting it in profitable means, or to jointly invest it in business or leasing and etc from any commercial activities.” This meant that any guarantee of capital or profit was not permitted.

**Risk Sharing Issues**

As well as differences in MM structures in different countries due to differences in regulatory systems and laws of the land, there were also differences in practices by institutions within the same country, illustrated by FFIB, FB and LB examples.

**Abandonment of Project**

Peninsular Malaysia had a chronic problem with developers not completing housing projects. In most developed countries housing was sold under “build then sell (BTS)”. In Malaysia, the practice was still “sell then build (STB)”. Despite the huge social problems it caused, developers and bankers were reluctant to move from STB to BTS. Under the BTS the project financiers were fully exposed to the project risk, whereas with STB, purchasers financed up

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to 90% of the project and took the greater share of the project risk. When projects failed, customers were still liable to the bank for the amounts of money already distributed under the progress payment scheme. Islamic Banks took exactly the same approach as conventional banks in shielding themselves from the project risk. Differences between the banks are shown in Table 3.

**Table 3: Project Abandonment Treatment**

<table>
<thead>
<tr>
<th>FFIB</th>
<th>FB</th>
<th>LB</th>
</tr>
</thead>
<tbody>
<tr>
<td>No explicit clause but likely falls under events of total loss,</td>
<td>Customer acts as an independent contractor to procure the</td>
<td>Project abandonment recognised as one of the possible events of</td>
</tr>
<tr>
<td>recognised in the customer’s purchase undertaking</td>
<td>construction and delivery, in accordance with a separate</td>
<td>default, where it stated that in the event that the Property</td>
</tr>
<tr>
<td></td>
<td>agreement between the customer and the bank. A contract of</td>
<td>be incomplete or abandoned during the course of construction</td>
</tr>
<tr>
<td></td>
<td><em>Ijarah Mawsufah fi Dhimmah</em> takes effect.</td>
<td>for any reason, then the customer is required to buy the bank’s</td>
</tr>
<tr>
<td></td>
<td>If customer fails to procure/ deliver the construction, he will</td>
<td>interest in the property for the equivalent of the outstanding</td>
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<tr>
<td></td>
<td>be deemed in breach of his contractual obligations, regardless</td>
<td>financing balance and any other amount due and payable to the</td>
</tr>
<tr>
<td></td>
<td>of the failure reason. The following occurs:</td>
<td>bank.</td>
</tr>
<tr>
<td></td>
<td>1) The bank returns to the customer all amounts paid as</td>
<td></td>
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<td></td>
<td>Advance Lease Rentals, since the <em>Ijarah</em> agreement cannot take</td>
<td></td>
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<tr>
<td></td>
<td>place; and</td>
<td></td>
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<tr>
<td></td>
<td>2) The customer, as the procurement party, shall compensate the</td>
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<tr>
<td></td>
<td>Musharakah parties the sum of:</td>
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<tr>
<td></td>
<td>• The amount of capital extended by the bank to the date of</td>
<td></td>
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<tr>
<td></td>
<td>non-completion event; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• The aggregate of all Advance Lease Rentals paid by the</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Customer, in his capacity as the lessee, during the</td>
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<tr>
<td></td>
<td>construction period, which is to be off-set with the refund by</td>
<td></td>
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<tr>
<td></td>
<td>the bank of the same.</td>
<td></td>
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<tr>
<td></td>
<td>The documents also record the customer’s intention to</td>
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<tr>
<td></td>
<td>waive his entitlement to compensation, as a Musharakah Party,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>for losses incurred due to project non-completion.</td>
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</tbody>
</table>

**Event of Default**

The termination of the MM in the event of default could take place by either of two approaches\(^\text{22}\) (i) without promise, and (ii) with promise (purchase undertaking).

(i) Without Promise: where MM was structured without the use of purchase undertaking, in the event of default the MM was terminated and the jointly owned property sold in the market. Sale proceeds were shared between the partners as profit from MM venture, after outstanding

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\(^{21}\) Kuwait Finance House Malaysia Berhad Musharakah Mutanaqisah Property Financing-i Facility Agreement

\(^{22}\) See BNM Financial Stability and Payment Systems Report (2007); Smolo and Hassan (2011)
rental and legal fees were deducted according to the latest ownership share ratio or profit-sharing ratio. If sale proceeds were short from gross deductibles, realised loss was shared between the bank and the customer as per a loss-sharing ratio. The bank was not, therefore, guaranteed an amount equal to its outstanding share of the property. FFIB, for example, reserved the right to use the alternative trust arrangement to protect its interests in adverse times. FFIB acted as manager and trustee to the *Musharakah Mutanaqisah* with rights to manage and to hold the assets of the *Musharakah Mutanaqisah*.

(ii) With Promise (Purchase Undertaking): alternatively, the MM arrangement might have incorporate a purchase undertaking, whereby the customer promised to buy the bank’s outstanding share of ownership should certain events of default occur such as non-payment, breach of facility’s terms and conditions, and bankruptcy. Here, the MM was terminated and the customer was legally obliged to buy the bank’s entire outstanding share of ownership and pay the settlement amount in full. The settlement amount included the amount owing to outstanding bank’s share, outstanding rental and other fees. If the customer failed to honour his purchase undertaking, the bank could sell the property to any third party at auction. Sale proceeds would be used to pay the bank for any fees or charges incurred during the course of legal action and property disposal and all amounts due with regards to monthly rental payment and outstanding facility amount. Any deficiency in the sale proceeds were to be cleared by additional funds by the customer; securing the bank’s outstanding amount. Any surplus would be paid to the customer. FB and LB adopted this approach in the event of default.

**Termination**

The bank had recourse to the customer through either a purchase undertaking or trust deed, in the following termination events:

- If the customer failed to buy the bank’s entire share of ownership in the property when the MM agreement was due to terminate
- If the customer was unable to make commercial transactions as prescribed by *Shariah*, or if the customer died, or was declared to be of unsound mind

**Early Settlement**

FFIB allowed customers to ask the bank if they could purchase the remaining share of ownership at any time during the agreement’s tenure, with 30 days advance notice to the Bank.
FB allowed customers to settle the MM if they gave the Bank one month’s notice in advance and paid the Settlement Amount. Then the *Musharakah Mutanaqisah* Arrangement was dissolved. The Settlement Amount varied, for example, if the customer intended to settle prior to the lock-up period, he was required to pay an additional amount equivalent to 3.0% of the full Facility Amount or RM5,000.00, whichever was higher.

LB allowed the customer to settle the facility early by paying the equivalent of the outstanding financing balance and any other amount due and payable to the bank.

**Force Majeure**

If the property was destroyed or suffered damage beyond economic repair, whether in part or entirety, due to any reason beyond the control of the MM parties, the three banks took different approaches.

FFiB - *Musharakah Mutanaqisah* was terminated and the bank had the right to follow similar termination procedures as with default.

FB - the customer notified the bank about the damage as soon as was practical. MM was terminated immediately and the customer had to make a claim for the damage to the Takaful operator. No settlement was to be concluded without the prior written consent of the bank. In his capacity as procurement agent, the customer undertook to hold any amounts advanced by the Takaful operator on behalf of the partnership and use the funds to repair, rebuild or restore the property so far as the Takaful proceeds permitted. If, however, the damage was beyond repair, the Takaful proceeds were used to pay the bank the amounts outstanding and due as per the distribution of sale proceeds in the event of default. Where such damage was not covered by takaful or takaful proceeds were deficient due to the customer’s negligence or misconduct, the customer would have to quickly indemnify the bank as a negligent *Musharakah* partner.

**Tortuous claims**

Another reason for the property to be legally tied to the customer related to its ownership liability, which protected the bank in the event of any tortuous claim. If there was huge damage to the property where someone is badly injured, for example, the bank would potentially be liable as the registered owner of the property.
In an *ijarah* arrangement, any risks and liabilities associated with ownership were the lessor’s. Those associated with its use were the lessee’s. Defects were at the expense of the lessor to restore the asset to its intended use, unless the defect was wilfully caused by the lessee or was due to his/her negligence. Scholars permitted the financier to factor in the expenses in the rental price. The issue was that because the property in the MM was jointly borne, risks and responsibility should also been jointly borne according to their respective shares.

Under normal practice, homebuyers (of whatever financing arrangement) bore all insurance/takaful. A mortgage reducing term assurance (MRTA) or the MRTT (its takaful equivalent) was signed with the financing contract, in case the homebuyer defaulted on repayments due to disability or death. The customer was also obliged to undertake annual fire insurance. The same was applied to the MM financing arrangements. This complete transfer of risk and liabilities to the customer did not reflect an equitable share of the risk by the bank. No additional charge attributable to takaful could be imposed on the lessee\(^\text{23}\) once the *ijarah* contract was signed.

In practice, where the customer was the sole legal owner, a clause was included to the affect that takaful coverage must not be less than the outstanding buyout amount, or for an amount that would be acceptable to the bank. Worse still, the customer had to continuously assign all rights to the takaful proceeds to the bank. There was also a clause on payment of taxes and outgoings in the MM co-ownership agreement, indicating that the customer paid 100% of all taxes due related to the property, as well as stamp duty costs. Additional provisions such as “the customer having the exclusive right to occupy, possess, use and enjoy the property” may not have served its true spirit.\(^\text{24}\)

**Determination of Rental and Share Prices**

The majority of Muslim scholars considered that the price of shares as well of rental prices should be left to market forces, reflective of the true value. This meant adjusting the payment amounts at every instalment to reflect the market condition at that particular time.

The purchase undertaking (*wa‘d*) granted the bank the right to force the customer to purchase the bank’s share portion on credit or to purchase the

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\(^{23}\) AAOIFI, 2004, p.142-143

\(^{24}\) Refer to Musharakah Mutanaqisah facility agreements of KFH, HSBCA and local bank
customer’s share at a pre-determined price. AAOIFI standards\textsuperscript{25} prohibited the sale of shares in an MM contract at a pre-fixed price\textsuperscript{26}. By doing this, the bank was able to protect itself from the depreciation in value of the property. If there were a significant fall in value the bank would hold negative equity. Hence, if the contract stipulated conditions that protected one party from capital loss and protected the principal, it was deemed equivalent to an interest-bearing loan. This prohibition held for sharikat al ‘aqd. Usmani\textsuperscript{27}, however, considered it was allowable to fix the purchase price under the sharikat al-milk contract of the home financing product.

BNM’s Shariah Advisory Council allowed the customer to give the wa’d to the bank to purchase the bank’s share, “either on a lump sum basis or gradually over an agreed period of time at market value or at a fair value or at any price to be agreed by the parties.” It did not mention the issue of pre-agreed price.

Meera and Dzuljastri\textsuperscript{28} suggested using a form of Rental Index or House Price Index to determine the rental price. The rental could therefore be periodically reviewed (either annually or semi-annually) to reflect market conditions.

**MM and the Entire Banking Eco-System**

In applying the *maqasid* considerations, the entire banking eco-system needed to be taken into account. This included the depositors of the money (for safe-keeping or for investment), and the customer (who required financing), with the bank acting either as a seller, a partner, or as investor depending on the form of the contractual relationship.

In the specific case of the MM home financing, the bank and the customer joined together as equity partners in the acquisition of a property. In addition the customer was also a lessee, leasing from the bank (lessor), its portion of ownership and there was also a buyer-seller relationship. Each relationship was enshrined in a contract together with the rights and obligations of each party.

Given the different approaches taken by the different banks, the question customers faced was which was the best approach? For the banks, according to Shariah requirements, had they taken enough measures to ensure the risk was entirely the customer’s?

\textsuperscript{25} AAOIFI 2004, p. 214
\textsuperscript{26} Smolo and Hassan, 2011
\textsuperscript{27} Usmani, 2005, p.90
\textsuperscript{28} Meera & Dzuljastri 2005, 2009
<table>
<thead>
<tr>
<th>Fully-Fledged Bank Documents</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Letter of Offer (The first document from the bank to the customer)</td>
<td>A short letter to explain the main terms and conditions of the financing arrangement that the Bank is prepared to enter into with the client. It is the first document to be issued and if the client agrees to the offer, then the actual contracting process begins (this is the same for all three banks). The most important aspect of the offer letter is the durations of the offer e.g. 30 days</td>
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<td>2. MM Facility Agreement (Main document of the agreement)</td>
<td>This is the agreement that spells out extensively the exact nature of the relationships that the bank and the client will enter into, including all the terms and conditions; and in the event of any conflict or discrepancy between the terms and conditions in the Letter of Offer and the provisions of this Agreement, the provisions of this Agreement are binding over the Letter of Offer</td>
</tr>
<tr>
<td>3. MM Promise (Promise from the customer to bank)</td>
<td>The two promises in this agreement between the customer and the bank is that (i) the customer will purchase the bank’s share in the property and agree to follow all the terms and conditions laid down in the Facility Agreement, and (ii) to make the bank a trustee and hold the property in the sole name of the bank until either the MM is dissolved or the bank recovers full outstanding amounts from the customer in the case of default or other situations.</td>
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| 4. MM Supplemental S&P (Supplemental sales and purchase contract to the facility agreement) | This is the supplementary document containing the details of:  
• The bank buying the property from the vendor  
• Rights and/or obligations existing or accruing immediately prior to the effective date  
• Indemnity from the customer to indemnify the bank against any harm  
• Bank to act as a trustee of the property  
• The capital contribution from the customer  
• The bank to obtain the state government’s consent for the transaction  
• Representations and warranties of the customer and vendor and other miscellaneous clauses as agreed by the bank and the customer |
| 5. MM Property Ijarah Lease Agreement (This document is signed once the above agreements are entered in to) | This agreement comes after the signing of the facility agreement and supplemental S&P Here, the bank proposes to lease out its share of ownership to the client at agreed terms and conditions and the customer agrees to the terms and conditions laid down by the bank in this document e.g. the amount of instalments, period of lease, calculation of lease rental and other such conditions |
| 6. MM Trust Deed | The bank, being the principal capital contributor, becomes the trustee and manager of the property and holds the legal title of the property. The title is transferred to the customer upon successful payment of all dues payable by the customer to the bank and the customer is responsible for payment of all the applicable charges for the property |
### Summary of Documents Used by the Three Different Banks for their MM Home Financing Products

<table>
<thead>
<tr>
<th>Foreign Bank</th>
<th>Details</th>
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| 1. Letter of Offer | The acknowledgement from the Bank to the Customer, that it agrees to enter an Islamic Musharakah Mutanaqisah contract, provided the terms in the offer letter agreed to by the customer. These terms include and specifies:  
  - The facility  
  - Its purpose and utilization  
  - Its tenure  
  - The monthly repayment and method of calculation  
  - Compensation and late payment charges  
  - Bank charges and other charges  
  - What happens in the event of default  
  - Maintenance and takaful obligations  
  - Conditions preceding disbursement  
  - Covenants, representations and warranties  
  - Amendments and / or additional terms and conditions  
  - Appendix and annexures that contain the details of the above conditions  
  - Additional conditions, such as evidence required of the customer to demonstrate financial ability to enter into the partnership  
  - The available period of the facility after which, if not drawn down, it will be revoked  
  - Miscellaneous fees |
| 2. MM Facility Agreement | The agreement comes after the Letter of Offer has been signed and acknowledges that:  
  - The customer has entered into a Sale and Purchase agreement with a “Vendor” for the purchase of a specific property  
  - That the Customer then has applied to the Bank for an Islamic Facility pursuant to a Shariah contract of MM, requesting the bank to form a Musharakah together with the customer in acquiring the property from the bank, and the customer providing a promise to acquire the Bank’s undivided shares in the Musharakah progressively  
  - This agreement contains the rights and obligations of the parties in the course of the partnership |
| 3. Property Ijarah Agreement | This agreement comes after the signing of the Facility Agreement. It is the Agreement in which the bank agrees to lease its share of the property to the customer and the customer agrees to accept the lease based on the conditions stipulated in the agreement |
| 4. Deed of Promise | This agreement comes after the signing of the Facility Agreement. It is the Agreement in which the customer promises and undertakes to purchase the Bank’s shares in the MM in accordance with the terms and conditions that are stipulated in this document |
| 5. Power of Attorney | This agreement is a condition precedent, that although it is signed after signing the Letter of Offer and Facility Agreement, the Facility Agreement is subject to the donor (Customer):  
  - Creating a charge in favour of the Bank by executing the Power of Attorney  
  - The Power of Attorney is not a contract but an authorisation letter |

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<tr>
<th>Local Bank</th>
<th>Details</th>
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<td>1. Letter of Offer</td>
<td>In this legal document the bank approves the facility with the specific terms and conditions related to method of financing, purpose and facility amount/bank’s commitment amount, customer’s initial contribution, description of the property, tenor and margin of profit, mode of payment, securities i.e. whether 1st party or 3rd party charge or pending deed of assignment over the property, compensation charges and other conditions related to processing fees/admin fees and validity of the offer</td>
</tr>
</tbody>
</table>
| 2. MM Co-ownership Agreement  
(This document includes all the terms related to MM and Ijarah. No separate Ijarah Agreement is entered in to between the bank and the customer) | This is the main Agreement, which states the customer is to be the legal and/or beneficial owner of the Property and he intends to refinance the Property. The Bank agrees to acquire the rights, interest and benefits in the Property from the customer for the consideration of up to the Bank’s Commitment Amount and customer agrees and acknowledges that he has entered into the Sale and Purchase Agreement as the nominee of the Bank in relation to the Bank’s rights, interest and benefits in the Property. It also includes the Ijarah terms and conditions as part of main agreement. All the other terms and conditions like early settlement, event of default, force majeure are also embedded in this agreement |
| 3. Legal Charge/Deed of Assignment | The legal charge is created by the bank on the property until the customer settles all dues to the bank |
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