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The Notion of *'Wakalah'* in Pre-Modern Islamic Jurisprudence and Its Applications in Modern Islamic Financial Institutions: A Critical Analysis

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Abstract

This research paper expounds the concept, legitimacy and standards of the notion of Wakalah in pre-modern Islamic jurisprudence and examines its practices in the contemporary Islamic finance industry. Wakalah plays an important role in the current financial institutions as almost all the contracts of Islamic banking and finance are revolving around Wakalah such as Murabaha, Mudharabah, Diminishing Musharakah, Ijarah, Salam, Istisna, and Tawarruq Financing etc. It can be claimed that the current Islamic banks cannot fulfil their daily activities without the involvement of Wakalah. However, on the other hand, it is presumed by many that the contemporary practices of Wakalah does not fulfill the requirements of the notion of wakalah enunciated in the classical Islamic jurisprudence because sometimes, the transactions seem like mere subterfuges and stratagems (hiyal) to circumvent the prohibitions prescribed by Shariah, hence, there's an immense need to critically evaluate these practices in the light of well-established principles. This paper is aimed to fill this research gap in the existing literature on the subject of wakalah. The paper is based on the qualitative research methodology i.e. descriptive, analytical and critical. The paper is concluded with concrete recommendations for

further improvement in the practices of wakalah in current Islamic financial institutions to meet the requirements of Shariah.

Key words: Wakalah, Fiqh, Islamic Finance, Shari'ah, AAOIFI

Introduction

Islam regulates every aspect of human lives, both individually and collectively. Economics is one of the most important aspects among them and *Shari'ah* provides a better pathway towards an economic system. In banking sector, the number of Islamic banks has dramatically expanded globally over the past three decades. As per the Global Islamic Finance Report (2010), more than six hundred Islamic banks are operating in almost fifty countries. Islamic finance has turned into a sort of banking that can never be ignored. In Western countries, the conventional banks try to establish Islamic banks in order to get the savings of Muslims and to attract their sovereign funds issued from oil overflows of Gulf countries.[1] Matthews Robin pointed out the potential of the Islamic mortgage market in the United Kingdom, as London is aspiring to become the first Islamic financial centre in Europe. France is also trying to develop its position itself in this field.[2]

The basic objective of Islamic finance is to fulfil all the injunctions of the Holy Quran. As like conventional banks, Islamic banks do not provide direct financial loans, they participate in real business in order to generate *Shari'ah* compliant profit. For this purpose, they generally depend upon agency relationship. Usually, an Islamic bank appoints its agent to take part directly in real businesses and provide services to the bank's customers on behalf of bank. In classical *fiqh*, the term *wakeel* is being used for agent while *wakalah* for agency. These concepts are discussed very briefly in classical books of Islamic Jurisprudence. The IFIs offer *wakalah* contracts in different forms like letter of credit, Islamic monetary certificate,[3] *sukuk*,[4] term deposits[5] and *takaful* etc.[6] The *wakalah* contract has been strongly criticized by the researchers because of the conflict of interest. Whenever there is a question arises about the conflict of interest, it generally leads towards *tuhma* and accusation,[7] especially where the agent acts against the interests of his principal *(muakkil*. Such type of problem is known as agency problem. It occurs when the owner's and agent's objectives and interests are not same and

coincide.[8] AAOIFI *Shari'ah* Standard regarding *murabaha* to the purchase orderer recommends IFIs to nominate third party as an agent but also declares it permissible that IFIs can appoint their client as its agent, although third party is preferable.[9] The IFIs are getting benefits from the declaration of permissibility by appointing their clients as agents and, hence, the observer seems that the agent play a role in dual capacity. Sometimes, a real transaction adopts the shape of a mere subterfuge and artificial transaction.

Tawarruq practices of the Islamic banks are objectionable where the agent plays in dual capacity.[10] These practices generally lead towards the conflict of interests. Similarly, the agent cannot be a guarantor *(kafil)* according to the *Hanafi* School[11] but the IFIs declare him as *kafil* while concluding the contract of *salam* and *istisna'*. The IFIs appoint the *muslam ilaih* or seller as their agent for selling the commodity further in the market and compel him to provide guarantee as well.

This study is an attempt to look at the concept of *wakalah* from the perspective of classical Islamic *fiqh* and also to evaluate the current practices of *wakalah* prevalent in the IB&F industry from the lens of Islamic *Shari'ah* so that a more permissible and preferable form of *wakalah* can be introduced in the Islamic banking and finance industry.

Wakalah in Pre-Modern Islamic Jurisprudence

The practice of *wakalah* existed during the early period of Islam. The Prophet Muhammad (S.A.W) himself was directly or indirectly involved and He encouraged this kind of relationship or contract. Studying the Prophetic traditions, one may find that the scope of the *wakalah* is unlimited. The jurists permit the practice of *wakalah* in all personal actions which are usually carried on directly by the person himself. Some of them went so far as to permit deputation in some deeds of worship. The rationale is that the jurists wish to accommodate facilities for the people and satisfy their needs to carry out all matters by themselves. The importance of *wakalah* can be illustrated by the concept of co-operation. An agent may act in some activities on behalf of his principal in the situation where the principal does not perform the task by himself, either because he cannot, or because he chooses to find somebody else more capable in skill and experience than himself, or for some other

reasons. The concept of co-operation in society is very much encouraged in Islam.

Definition of *Wakalah:*

"Wakalah" is an *Arabic* term which is built on the root *'wakala'.* Literally it has several meanings including looking after, delegation, authorization, preservation and performing a task on behalf of other. According to *Al-Kasani,* the linguistic meaning of *wakalah* is "protection, preservation and caring something". In support of his argument, he presented some verses from the Holy Quran.[12]

Despite those differing meanings, they are all used to indicate *"a representation of a person on behalf of another person in certain dispositions".*[13] According to the *Hanafi* jurists, *wakalah* is defined as:

"الوكالة: هى أن يقيم شخص غيره مقام نفسه فى تصرف جائز معلوم على أن يكون المؤكل (بكسر الكاف) ممن يملك التصرف"

"a representation of another person to act in a permissible (ja'iz) and known (ma'lum) disposition provided that the principal (al muwakkil) is legally permitted to do so".[14]

In the Ottoman codification of *Hanafi* law, The *Majallah* explains *wakalah* in article 1449 as:

"الوكالة تفويض أحد أمره إلى آخر وإقامته مقامه ويقال لذلك الشخص موكل ولمن أقامه مقامه وكيل ولذلك الأمر موكل به".[15]

"Agency consists of one person empowering some other person to perform some act for him, whereby the latter stands in the stead of the former in regard to such act".[16]

Although this definition has been criticized by *al 'Aini* for containing some weak points such as unnecessary repetition and the used of inappropriate terms.[17]

The *Maliki* jurists describe *wakalah* as: *"a representation of one person by another person to dispose over his rights and possessions without restricting a deputation after his death".*[18]

The *Shafi'i* jurists defined *wakalah* as *"the authorisation of one person by another person to dispose of something during his lifetime provided that he has the right to do so and that such things are liable to be represented"*.[19]
The *Hanbali* jurists suggest the following definition:
"A deputation of a person who is legally competent by a person of the same qualification in matters embodied under the concept of deputation".[20]
AAOIFI *Shari'ah* Standard No. 23 defines *wakalah* as:
"The act of one party delegating the other to act on its behalf in what can be a subject matter of delegation".[21]
In English law, Fridman offers a tentative and brief description of what agency involves as follows:
"Agency is a relationship that exists between two persons when one called the agent, is considered in law to represent the other, called the principal, in such a way as to be able to effect the principal's legal position in respect of strangers to the relationship by the making of contracts or the disposition of property".[22]

The Legitimacy of *Wakalah:*

Muslim jurists of every school unanimously agree that the practice of *wakalah* is permissible and lawful. Its legitimacy can be derived from the Holy Quran, the *Sunnah* and the *Ijma'*. The scholars derived the permissibility of agency contract from many verses of the Holy Quran, especially from the following verse of *Sura Al Kahaf*:

فَابْعَثُوْٓا اَحَدَكُمْ بِوَرِقِكُمْ هٰذِهٖٓ اِلَى الْمَدِيْنَةِ فَلْيَنْظُرْ اَيُّهَآ اَزْكٰى طَعَامًا فَلْيَأْتِكُمْ بِرِزْقٍ مِّنْهُ۔[23]

"Now send one of you with this your silver coin unto the city, and let him see what food is purest there and bring you a supply thereof".[24]
Here the word *'ib'athu'* means 'send' or 'appoint' or 'authorize'. In this context, the "Companions of the Cave" *(ashab al kahf)* have appointed a person among themselves to go to the city to buy food with their silver coin. *Imam Qurtubi* suggests in his exegesis and interpretation that this verse is a valid proof for the legitimacy of *wakalah,* so appointing someone as an agent is permissible according to this *Ayah*.[25]

There are various *ahadith* which show the permissibility and legality of *wakalah*. It is reported in a *hadith* that when *Jabir bin Abdullah (R.A)* intended to go to Khyber, the Holy Prophet (S.A.W) addressed him: "If you meet my agent, take or ask from him fifteen *wasaq* (a unit of weight measurement)".[26] This *hadith* expressly supports the legality of *wakalah*. The Holy Prophet Muhammad (S.A.W) many times appointed his agents for a variety of objectives. Additionally, it is also reported that the Prophet (S.A.W) sent his assistants for collecting *zakat*.[27] So, those assistants acted as an agent on behalf of the Holy Prophet (S.A.W).

The Muslim scholars have established the consensus on the permissibility of *wakalah* based on evidence from the Quran and the *Sunnah* of the Prophet Muhammad (S.A.W). The jurists agreed upon its permissibility on the basis of the concept of helping each other.[28] There is unanimity among the Muslim jurists that agency is a lawful contract and has been since the early stage of Islam.[29]

Types of *Wakalah:*

The contract of agency, concerning the subject matter of agency and for the purpose of determining the authority of any particular one, can be divided into two types: general agency and special agency.

General Agency (الوكالة العامة):

General agency refers to a general delegation of power to the agent. He has absolute permission and authorization to act in all the principal's affairs without exception, whether it causes harm to the principal or not.[30] For instance, the principal may say: "you are my agent in all affairs". With such authorization, the agent may freely dispose of the principal's property and possessions, sell and purchase, distribute and receive gifts, divorce, accept a marriage and so on, without considering any harm he may cause. According to the opinion of *Shafi'i, Hanbali, Zahiri,* and *Zaidi* school, the general agency is null and void. Some of the *Imami* jurists also having this opinion.[31] Because the general authorization bears several meanings unless the subject matters of agency are clearly classified. In addition, deception or delusion *(gharar)* may occur in general agency and this might endanger the principal and his property.[32]

According to some of the *Hanafi* and the *Imami* jurists, general agency is valid. An agent may have absolute authority to act in all of his principals' matters, even in a matter related to the social contracts *(tabarru')*, divorce and other rights possessed by the principal.[33]

The *Hanafi,* the *Maliki* and some of the *Imami* jurists claim that general agency is valid.[34] However, that generality is not absolute as the *Hanafi* jurists exclude some dispositions such as gifts, repudiation *(talaq)*, the releasing of a slave *('itāq)* and endowment *(waqf)*.[35] *Imam Muhammad* only excludes repudiation and keeps gifts and releasing the slaves under general agency. The opinion of *Imam Abu Hanifah* is decisive and considered as a legal opinion *(fatwa)* of the *madhhab*.[36]

AAOIFI *Shari'ah* Standard No 23 [4/1/1] says that general agency covers all means of disposing of assets provided that the principal's interest and the customary practices are well observed.[37]

Specific Agency (الوكالة الخاصة):

It is a kind of agency when the principle gives the agent the authority to carry out a certain duty on his behalf. For instance, someone might assign a representative to sell his car at a specific price. The agent's authority in this situation is restricted to selling that specific car for the specified amount. It is a basic principle that an agency may be special.[38] The agent must only dispose of items that fall under the parameters of the specific disposal for which he has been appointed. He is not permitted to go beyond the restrictions set by the principle.[39]

For instance, if an agent is nominated for buying or selling a specific car, he is not allowed to buy or sell another car.[40] Although the principal sometimes uses general expressions to authorize the agent, it remains a specific agency in a real sense. The agent must act within these limits of authorization and at no time act against the principal's order.[41]

However, this does not mean that the agent cannot or should not exceed the given authority at all. Consequently, in situations where the agent exceeds his authority in a way which appears to him to be for the benefit of the principal the agency is valid and acceptable. In addition, the principal may not only be satisfied with these kinds of dispositions, but he also receives extra

advantages. For example, if the principal authorized an agent to buy a car with the condition of it being for a certain amount, and he then bought the same car for a lower price, the disposition is valid.

The *Majallah,* article 1494, states:

"للوكيل بالبيع مطلقا أن يبيع مال موكله بالثمن الذى رآه مناسبا، قليلا كان أو كثيرا"۔[42]

"An agent who has been granted absolute power to conclude contracts of sale may sell his principal's property at any price he thinks fit, whether great or small".

Article 1495 states:

"ليس للوكيل أن يبيع بأنقص مما عينه الموكل، يعنى إذا كان الموكل قد عين ثمنا، فليس للوكيل آن يبيع بأنقص من ذالک، وإذا باع فينعقد البيع موقوفا على إجازة موكله..."۔[43]

"However, if the principal has instructed the agent to sell for a fixed price, the agent may not sell for less than this price. If he does so, the sale is concluded subject to ratification by the principal".

However according to the article 1497, *"If he sells for more than the value of the property, then the sale is valid".*[44]

Wakalah has more types according to different considerations, for example, with regards to the characteristics of the agency, it can be divided into absolute and restricted agency, while with regards to the time factor, it can be classified into provisional or temporary agency and non-provisional or permanent agency. The jurists have explained all these types in details.

The Integral Parts of *Wakalah (Arkan)*

The *wakalah* contract has some essential elements *(arkan).* These elements are necessary for the existence of *wakalah* contract. According to the majority of jurists, the formation *(sighah),* the offer and acceptance *(ijab & qubul),* the principal *(muwakkil),* the agent *(wakil),* and the subject matter *(muwakkal bihi)* are the key components of *wakalah.*

i) The Formation and Offer and Acceptance (صیغہ/ایجاب وقبول)

An agency relationship cannot be established without *sighah.* It is crucial to focus on the parties' explicit intents or core goals rather than any concealed ones. The intention and approval of the parties will remain hidden without the *sighah* and hence the contract cannot be created. *Sighah* is a verbal or written expression, and it has two primary components, which are offer *(ijab)*

and acceptance *(qubul).* Both must be found in the parties' meeting which is termed as '*majils al'aqd'.*

Offer is the very initial statement made in first place by one of the parties while acceptance is the statement made in the second place by another party. The offer and acceptance must be clear and transparent. Both can be expressed verbally or by other means of expression. For example, "I accept the agency" or "I will perform your order" or "I will represent you" etc. These expressions may be in the form of *'ta'ati'.*

ii) Contracting parties: the principal and the agent

A *wakalah* contract has two parties: the principal and the agent. The basic condition for both parties is to have a legal capacity to enter a contract.

The Principal *(Muwakkil):*

In an agency relationship, the principle is the party who has agreed to pay someone else to represent him. He must be an independent and legal doer. Ali Haydar Efendi (Efendi 1935) stated:

"وشرط جوازه كون الموكل أهل تصرف"[45]

"The principal should possess legal capacity to enter into a contract".

The *Majallah* stated that *"the principal must be able to perform the act which is the subject matter of the agency".* So, he must be capable of representing himself in court. It is possible to think of that competency as the requirement the principal must meet in order for the agency contract to be valid. The principal may only ratify the agency contract if he is legally capable.

Additionally, it is also necessary that the parties must be rationale and they understand the nature of the acts. However, if a person becomes incapable of exercising his legal rights, then he is declared as *mahjur* (interdicted person). Mental capability or sound mind *('aql),* puberty, prudence *(rushd),* insolvency *('iflas),* death sickness *(marad al-maut),* and duress *(ikrah)* are the requirements and significant cases of interdiction.

iii) The Agent *(Wakil)*

An agent is a person who has the authority to affect the legal position of the principal. So, he has the capacity of execution and understanding the nature of the transaction that he concludes on behalf of the principal. Efendi states:

"كون الوكيل يعقله"

The agent must be wise and sensible. Therefore, an insane and a minor (who does not know about the work) cannot enter a contract of *wakalah* due to the absence of legal capacity.[46]However, according to Hanafi jurists, a wise minor *(Sabi Mumayyez)* may appoint an agent to carry out actions that could result in a loss for that minor. An indiscriminating minor *(sabi ghair mummayyez)* cannot be chosen to serve as an agent.

Both parties in an agency arrangement must be familiar with one another. However, it is not necessary for them to know by name. It would be sufficient for an agency agreement to be legal if the principal can identify the agent by name, by his physical attributes, or by other means.

iv) The Subject Matter *(Muwakkal bihi)*

An agent's performance of a delegated duty or responsibility on behalf of a principal is referred to as the subject matter of a *wakalah* contract. It is not permitted to assign someone to carry out unspecified.[47] The genuineness, sort, quality, and other essential characteristics of the product to be purchased should be indicated if the contract is intended to be a purchase agreement. The subject matter should be known and clear to the agent. If the *wakalah* contract is for purchasing something, then the quality, quantity, kind, and other necessary attributes should be identified and known. Similarly, the subject matter of *wakalah* must be something which is eligible for delegation and authorization such as financial dealings, sale and purchase, borrowing and lending and making gifts etc. The contract of *wakalah* is not permissible for pure acts of *Ibadah* such as prayer, fasting and oath taking etc.[48]

The agency must also be a legal activity that can be concluded through *wakalah*. It should not involve in any non-*Shari'ah* compliance practice such as trading prohibited commodities or prohibited acts or stealing, usurpation of property, or operating a riba-based business. AAOIFI *Shari'ah* Standard No 23 [3/3/3] also states: *"It should not involve a Shari'ah-banned practice, like trading in impermissible commodities or committing usurious lending".*[49]

Right and Obligation of the Contracts Executed by the Agent

According to the general rule of agency, a contract is formed when an agent acts on behalf of a principal after receiving permission from that principal to do so. Therefore, it is first essential to demonstrate that a contractual relationship between the principal and agent has developed; in most cases, this is determined by the agreement between the principal and agent. Through this special connection, the agent is granted specific rights against his principal and is subject to specific duties toward that principle.

An agency contract has two distinct sets of contractual connections. The first is the relation between the principal and the agent. This relationship is similar to many other contracts in which the express and implied provisions of the agreement govern the rights and obligations of the parties collectively. The second one is the relation between the principle and a third party comes. The agent's withdrawal from the transaction after negotiating the agreement between the principal and the third-party results in this relationship.

Duties of the Agent

Once the relationship of principal and agent is established, a number of duties are imposed upon the agent, for example:

a. Fulfilling the Work with Ordinary Skill and Diligence
b. Preservation of the Principal's Interests
c. Proper Accountancy of All Transactions
d. Avoiding Bribes or Secret Profit
e. Trustworthiness
f. Avoiding Personal Benefits without principal's permission

The Rights of the Agent

Beside the duties the agent owes to the principal, he also has several rights. Normally, Muslim jurists discuss this matter along with other general obligations of the contract of agency. He has the right of remunerations against his services. Besides this, he can reimburse all his expenses.[50]

Commercial Agent

A commercial agent can be defined as a *Dallal* or *Simsar* who normally acts as a mediator between the buyer and the seller in order to facilitate the sale.[51] In the present day the commercial agent is widely known as a broker or intermediary in the sale of goods and commodities. He is "an independent individual or legal entity, contractually controlled by the principal, assigned to promote, sell and distribute products and provide services in the name and on behalf of the principal for remuneration that generally takes the form of commission". He is in a position of trust toward the principal since he is dealing with a product without having title to it. Hence, he must render an account of the outcome and the proceeds of sale to the principal.[52]

An Unauthorized Agent *(Fuduli)*

One of the general principles of the *Shari'ah is* that no person may deal with the property of another person unless by his permission or acting as his trustee. Muslim jurists are not agreed on the validity of the acts of an unauthorized agent. Some of the jurist, including *Imam Shafi'i,* hold that such acts are invalid even though accepted by the owner of the property.[53] The majority of jurists said that the act of an unauthorized agent is dependent upon the ratification of the owner of the property.[54]

Plurality of Agent *(Ta'addud al Wukala)*

All Muslim jurists agree that the plurality of the agent is legitimate. However, in the standard agency relationship only one person may act as agent. It appears that in certain circumstances two or more agents might be needed. This sometimes depends on the workload as well as on time and place factors. In certain dispositions agents need to collaborate and exchange their experience and expertise. According to the Maliki jurists' point of view, there must be only one agent in litigation. However, more than one agent can be appointed in the disputation and litigation provided that the litigant party is satisfied with this.[55]

If more than one agent is nominated in a single contract, they are not permitted to act independently without the principal's permission. However, if the action they were asked to take does not require for mutual consultation

or if it is not practicable for all agents to be there, they may act individually, such as in the case of litigation and prosecution in court.[56]

The Appointment of Sub-Agent

The fundamental rule is that an agent can only work in the best interests of his principal and is not permitted to appoint subagents. When this is not practicable or when it would be difficult for an agent to accomplish his obligations alone, there is an exception to this rule. There is a difference of opinion among the jurists regarding the permissibility of appointing sub-agent. In *Hanafi* School, an absolute *wakil* can appoint someone else to be his sub-agent. *Maliki* School does not allow it, except if that *wakalah* is not suitable for his personality. *Shafi'i* and *Hanbali* schools allow it with the permission of the principal as far as he is capable of carrying out the delegated task.[57]

Logically, people are not the same in terms of opinions, ideas and expertise as well as degree of trust *(amanah)* and personal qualification. Therefore, the agent is supposed to perform the agreed task or disposition himself and not to ask somebody else to do so.[58] Nevertheless, in the situation where the appointed agent is unable to perform the agreed action, he might need somebody else to replace him. The basic rule is that the agent cannot delegate his authority without the explicit or implicit consent of his principal.

According to AAOIFI *Shari'ah* Standard (Standard No 23, para 6/4):

"The agent has no right to appoint a sub-agent except with the permission of the principal. Once a sub-agent is appointed, his termination does not spontaneously follow the termination of the first agent, but the principal can terminate him".[59]

Termination of *Wakalah*

Wakalah can be terminated through mutual consent or through the resignation of agent. According to *Hanafi* School, he has to inform the principal about his resignation. However, it is not necessary according *Shafi'i* School. The principal can also remove the agent at any time. In this scenario, the *Hanafi* School seems two conditions necessary that the principal must inform him about his removal. The *Shafi'i* and *Hanbali* schools don't see it

necessary. Secondly, the agency contract does not interfere with other person's right. If *wakil* or *muwakkil* becomes insane, or he fells in the sickness of death or he is declared as *mahjur*, then the *wakalah* contract could be terminated. Similarly, the *wakalah* is also terminated through the destruction of the subject matter. For example, the subject matter is sold out or someone has hired it.[60]

Applications of *Wakalah* in Contemporary Islamic Finance

Wakalah contract is also used by IFIs in respect of many Islamic modern financial products like *mudharabah, salam, istisna", ijarah, diminishing musharakah* and many other activities like the letter of credit, payment and collection of bills, fund management and securitization. In this section, some *wakalah* based products will be discussed.

I. Murabaha:

Murabaha is a particular kind of sale where the seller discloses its cost and profit charged thereon. *Murabaha* can be a credit or a spot payment sale. The price in credit sale may be recovered in single payment or in tranches. The product of *murabaha* that is used in Islamic banking as a 'mode of financing' is slightly different from the *murabaha* used in normal trade. This transaction is concluded with a prior promise to buy from the person interested in acquiring goods through the institution. It is a contract wherein the institution, upon request by the customer, purchases an asset from a vender and resells the same to the customer against immediate or deferred payment basis. This is called *murabaha* to the purchase orderer.

It is an intermediary sale which means this sale is done between vender, Islamic bank and customer. Therefore, it is executed through various stages and uses a bunch of contracts completed in steps. The sequence of their execution is extremely important to make the transaction *Shari'ah* compliant. In *murabaha*, the Islamic bank is the seller, and the client is buyer. If the institution can make direct purchases from the supplier, then agency agreement is not a necessary condition for *murabaha* but usually the financial institution does not have the expertise to identify the goods and negotiate an efficient price. The customer, however, being in the industry, can do this. The

institution, therefore, appoints him as its agent in the first step of the transaction, to identify and procure the goods on institution's behalf. This is done by execution of agency agreement between the institution and the customer. However according to *Shari'ah* perspective it is preferable to appoint the agent other than customer. If goods are acquired from third party, the execution of agency agreement will be between the institution and the third party.

In principle, Islamic banks cannot give money in cash to the customers or organizations as a loan. They can provide funds through *murabaha* financing, namely the sale of goods at the original price with the added advantage that has been agreed.[61]

2. *Mudharabah:*

Wakalah is also used in partnership-based contracts like *mudharabah* and *musharakah*. In *mudharabah*, the principal *(rabb al maal)* provides the capital to the *mudharib* (manager) for doing business. The principal is not working as active partner. Only *mudharib* is doing business. Both of them are getting share from the profit as per the agreed terms and conditions, however, in case of loss, all the loss will be borne by the principal alone.

Mudharib has different capacities for which rules are different. He can be *ameen* (trustee), *wakil, shareek, zamin* (liable) *and ajeer* (employee). He will be treated as per his capacity according to *Shari'ah* law.

3. Diminishing *Musharakah*:

Diminishing *Musharakah* is a kind of partnership, and the Islamic banks widely use this product in an engineered form for fulfilling the needs of their customers. Itis a type of *shirkah* where one partner purchases the other partner's share gradually. It is basically a bunch of contracts like *wakalah*, *ijarah* and sale agreement. The Islamic bank, in the first phase, nominates someone as an agent for purchasing the product as per the need of the customer. The bank and the customer purchase an asset through *shirkah.* Islamic bank, in second phase, makes a contact of *Ijarah* with the customer and rents out its own share to him. The customer uses the product and pays its rent to the bank. In the meanwhile, the customer, gradually, purchases the share of the bank in units, which have an ultimate effect on monthly rent, as

the share of the customer increases and the share of the bank decreases. At the end, the customer becomes the sole owner of the product.

4. *Ijarah*:

Ijarah is transferring of usufruct and benefit of something non consumable to a person against compensation and the ownership remained with the owner. Consumable things cannot be leased out. The lessee holds the assets as trustee therefore he is liable to compensate the lessor for loss caused by his misuse or negligence. All liabilities of ownership are borne by lessor and the leased asset shall remain in the risk of the lessor throughout the lease period.

Many Islamic banks provide a commodity to the client through *Ijarah*. This product also revolves around *wakalah*. In the very beginning, the Islamic bank nominates someone as an agent for purchasing the commodity, and then provides that commodity to its customer through *Ijarah*. The customer pays the monthly rent for a specific tenure and after completion of the duration, the Islamic bank sells out the commodity to the customer.

5. *Salam:*

Salam is a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot. Here the price is cash, but the supply of the purchased goods is deferred. The buyer is called *"rabb-us-salam",* the seller *"muslam ilaih",* the cash price is *"ra's-ul-mal"* and the purchased commodity is termed as *"muslam fih". Salam* in Islamic banking may also be defined as:

"A type of sale in which the seller undertakes to supply goods at a future date, against an advanced spot price, paid fully in cash".

It is the alternate of future contracts. Islam allows *Salam* with certain conditions as discussed in the books of classical *fiqh*. Islamic banks use *salam* in agricultural products and industrial products, where the customer is in need of cash, so he can buy his agricultural products or industrial products in advance.

After delivery of the *salam* goods, the Islamic bank nominates someone as an agent for selling those goods in the market in order to get its money back

along with some profit. It is mostly used for agriculture financing, working capital financing, commercial and industrial financing, export financing and operations and capital cost financing. If the bank has no expertise to sell the commodities received under Salam contract, then the bank can appoint the customer as its agent to sell the commodity to any third party, subject to Salam agreement and agency agreement are separate from each other. A price must be determined in agency agreement on which the agent will sell the commodity but if the price is increased, the benefit can be given to the agent.

6. *Istisna':*

Istisna' is a sale transaction where a commodity is transacted before it is manufactured. It is an order to a manufacturer to manufacture a specific commodity for a purchaser. *Istisna'* can be used for house financing, financing high technology industries such as aircraft industry, locomotive and ship building industries. It can be used in working capital and export financing.

Under *istisna'* financing transaction, the client manufactures goods for the bank and upon delivery of the goods to the bank, someone is appointed as agent of the bank to sell those goods in the market. Normally, the banks appoint the manufacturer as its agent for selling those goods.[62]

7. *Wakalah* in *Tawarruq* Financing:

Tawarruq means "to buy on credit and sell at spot value." This transaction is nowadays being used by many Islamic banks for liquidity management and as a mode of financing especially for personal financing and credit cards. In fact, *tawarruq* is an arrangement whereby a person, in need of liquidity, purchases a commodity from a seller on credit at a higher price. The person who acquires commodity in this way is called '*mutawarriq*'. The difference between *bai' 'inah* and *tawarruq* is that "*mutawarriq*" sells the commodity to a third party, while in *bai' 'inah* the buyer resells it to the same seller from whom he had bought the commodity.[63]

Tawarruq is defined by the *Fiqh* Academy as buying a commodity from a seller who possesses it at a deferred price, and then the buyer sells the

commodity to a third person, in order to obtain liquidity. According to majority of the scholars, *tawarruq* is legally permissible, based on that the origin of things is permissibility and Allah says, *"Allah has allowed trade and has prohibited riba".* Usually, the contract of *tawarruq* is supported with the agency contract. In practice, the customers normally enter into the contract of agency and appoint the bank as their agent to sell the commodity to a third party.

In fact, the appointment of the bank as the client's agent to sell back the commodity to the market is not a matter of consensus among modern jurists. Whilst some jurists believe that the appointment of anybody, including the bank, to sell the commodity back in the market wouldn't affect the validity of *tawarruq*. Some jurists believe that the appointment of the bank as an agent shows that the intention of the client is not to own the commodity, but to only use the commodity as the conduit to get cash. Hence, they propose that there shall be no appointment of the bank as the client's agent to sell the commodity back to the market.[64]

Critical Analysis of *Wakalah* Practices in Modern IFIs:

As mentioned above that *wakalah* is a very important tool and the Islamic financial institutions cannot overlook it. In this section, those practices will be examined in the light of classical *fiqh*.

Dual Practices of *Wakeel:*

AAOIFI *Shari'ah* Standard No. 8 (*Murabaha* to the Purchase Orderer)[65] recommendsIslamic financial institutions to nominate third party as an agent while concluding *murabaha* but also declares it permissible that IFIs can appoint their client as its agent, but third party is preferable. This preference is because of blocking means *(sadd al zari'ah)*, as there is a possibility of involvement in *riba* based activity. There is also a possibility, if the client, who is actually an agent of the bank at first phase, buys the goods with the intention that I am buying it for myself, then it will have an impact on the contract of *wakalah* and hence, the commodity will be in the ownership of client (agent) rather than the bank. As a result, the whole contract will

become void, and it will become a pure *riba* based loan like conventional banking.

Al Marghainani states:

"وإن وكله بشراء عبد بغير عينه: فاشترى عبدا فهو للوكيل، إلا أن يقول نويت الشراء للموكل أو يشتريه بمال الموكل. هذه المسئلة على وجوه:----وإن أضافه إلى دراهم مطلقة، فإن نواها للآمر فهو للآمر، وإن نواها لنفسه فلنفسه".

If an agent is nominated for buying an unidentified slave, then he bought a salve, he will be for the agent himself, unless he says that I intend to buy for my principal, or he buys him with the amount given by principal. This issue has many aspects…. If the *wakil* dedicates the purchase towards general *dirhams,* then his intention will be considered. If he bought for the principal, it will be for him and if he bought for himself, then it would be for him.[66]

So, there should be a third party for doing agency-based activities. By doing so the cost of IFIs will increase a little bit but the contracts will become transparent.

Ibn al Hummam states:

"والأصل أن الواحد لا يتولى طرفى العقد فى الرهن ولا البيع"

Principally, one person cannot play dual role in a contract of *rahan* (mortgage) and *bai'* (sale).[67]

The *Majallah* states in article 1496:

"إذا اشترى الوكيل بالبيع مال موكله لنفسه فلا يصح".

It is not legal for an agent for selling *(wakil bil bai')* to buy the subject matter of principal for himself.[68]

A major objection raised upon the Islamic banking practices is that these heavily relies on *hiyal* and subterfuges to circumvent certain *Shari'ah* prohibitions. Many scholars, in this regard, especially discussed the examples of *murabaha* and *ijarah,* and declared that these are merely *hiyal* that cannot be the alternatives to conventional banking. This stance has a little bit reality but not at all.[69] So, the IFIs should avoid such type of duality while practicing the *wakalah* based transactions.

Tawarruq in *Shari'ah* Perspective**:**

The classical *fiqh* discussed the issue of *tawarruq*. *Imam Ahmad bin Hanbal* declared it as "disliked" *(makrooh)* in one of his statements while permitted

in the other statement.[70] *Mardawi* clearly mentioned that the Hanbali opinion regarding *tawarruq* is of permissibility and majority of the Hanbali scholars have this viewpoint.[71]

Imam Shafi'i discussed the permissibility of *"bai 'inah"* with detailed arguments and did not declare it as disliked sale.[72]The classical jurists of *Shafi'i* School of thought also declared its permissibility and they didn't see any disliked issue in the buy back.[73] Later on, some *Shafi'i* jurists declared buy back as disliked sale. *Qazi Zakariyya Ansari, Khateeb Sharbini* and *Ramli* considered *bai' 'inah* among the disliked sale contracts.[74] *Al-Sharbini* and *Al-Ramli* didn't discuss *tawarruq,* however *Imam Shafi'i* discussed it under the chapter of *"bai' 'inah"* by saying that those jurists who don't see buy back as permissible contract, all of us are unanimously agreed on the permissibility of *tawarruq*.[75]

The Maliki jurists discuss *"bai' 'inah*" under *"Buyu' al Aajaal"*. They are very strict regarding *'inah* and declared it prohibited. As far as the *tawarruq* is concerned, it is evident from the statements of *Maliki* jurists that they don't see any issue in it.[76]

Most of the *Hanafi* jurists explain *tawarruq* with the title of *bai' 'inah*. *Imam Muhammad* declared it *makrooh* while *Imam Abu Yusuf* permitted it. *Al Haskafi* defines *bai' 'inah* as selling something with profit but on deferred basis, so that the borrower sells it further at lower price for paying off his debt. It is the invention of usurers which is disliked and reprehensible in *Shari'ah*.[77] *Ibn Abideen Shami* elaborated the statement of *Al Haskafi* as:

"قولہ: وھو مکروہ أی عند محمد وبہ جزم فی الھدایۃ، قال فی الفتح: وقال أبو یوسف، لا یکرہ ھذا البیع، لأنہ فعلہ کثیر من الصحابۃ وحمدوا علی ذلک، ولم یعدوہ من الربا، حتی لو باع کاغذۃ بألف یجوز، ولا یکرہ، وقال محمد: ھذا البیع فی قلبی کأمثال الجبال ذمیم اخترعہ أکلۃ الربا"۔

Imam Haskafi claim means that it is *makrooh* according to *Imam Muhammad,* which is confirmed by *Al Hidayah. Fath al Qadeer* narrated on the authority of *Imam Abu Yusuf* that this type of sale contract is not *makrooh*, because many of the companions of the Prophet (S.A.W) practiced and admired it. They didn't count it in *riba* based transactions, even if he sells a paper against one thousand, it is permissible, and it is not *makrooh. Imam*

Muhammad states that this type of sale's condemnation, in my opinion, is equal to a mountain and it is the invention of usurers.[78] *Ibn Hummam* justifies both the sayings of permissibility and abomination by declaring that *tawarruq* is permissible and buy back *(bai' 'inah)* is disliked and abominated.[79] *Ibn Hummam* statement is very valid, and most of the *Hanafi* jurists adopted it and gave fatwa accordingly.[80]

To sum up the above discussion, it should be noted that majority of the *Hanbali* jurists have preferred the permissibility of *tawarruq*, except *Ibn Taimiyyah* and *Ibn al Qayyim.* They declared it impermissible. The *Shafi'i* jurists have allowed *bai' 'inah*, and therefore it seems that they don't see any kind of impermissibility in *tawarruq.* The *Maliki* jurists are very strict about *'inah,* but they do not see any problem in *tawarruq* as it is observed from their literature. Some *Hanafi* jurists have held that *tawarruq* is *'inah* and hence declared it *makrooh* but majority of the Hanfi jurists have preferred the view of Ibn al Humam that *'inah* is restricted to the situation where the commodity comes back to the original seller but where the commodity is sold in the market, the transaction is valid and permissible. Thus, the preferred view in all the famous four schools of thought is that *tawarruq* is permissible. However, lending without interest is more advisable.

The Islamic Banks' Practices:

The Islamic banks perform *tawarruq* based activities. The jurist declares the permissibility of only that *tawarruq* where two contracts are separated from each other. In first contract, the seller sells those goods which are in his possession and ownership. He sells them to the *mutawarriq* (who is in need of liquidity) at a deferred price. Secondly, the *mutawarriq* sells those goods to a third party, who doesn't have any relation with the first seller. Many banks and financial institutions mix a third contract, which is agency contract, with the above mentioned both contracts. For example, a person is in need of money, and he wants to do a *tawarruq* contract with a bank. The bank doesn't have its own goods and commodities; the bank uses to buy those goods from market. In so many cases, the bank nominates the client *(mutawarriq)* as its agent for purchasing the goods on behalf of bank. Then

mutawarriq buys those goods from bank on deferred payment and sells to a third party on spot payment. It is also observed that the banks don't pay the price of goods to the actual seller, he pays the price to the *mutawarriq* as an agent for purchasing.

This type of contract becomes similar to interest-based investment because the *mutawarriq* gets less money from the bank and returns more to the bank on maturity. Even though, the *mutawarriq* dealings with the bank were in the capacity of agent, not the borrower, but this subtle difference does not make the matter akin to a usurious investment. Sometimes it makes the contract prohibited and sometimes repugnant. However, if *mutawarriq* buys the goods as an agent of the bank, and then without resorting to bank and without making an independent contract with bank, he buys it for himself, then the contract is void because an agent does have any right to play dual role in a sale contract.[81]

Tawarruq in International Market:

Islamic banks do *tawarruq,* a lot, in international commodity markets. In these markets, thousands of sale contracts are concluded within minutes through computer. The popular way of implementing *tawarruq* in these markets is that the bank contacts an agent for purchasing goods from international market on behalf of bank and whenever the bank demands him to sell those goods, then he sells them to a third party.

Whenever a client comes to the bank for doing *tawarruq* based contract. The bank purchases goods from the international market through its agent on a spot basis and then the bank sells those goods to the *mutawarriq* on deferred basis. After that the bank orders its agent to sell those goods as an agent of *mutawarriq*. As a result, *mutawarriq* gets liquidity.

In the international market, a lot of transactions are artificial, where the commodities are not handed over to the buyer. Only their entries are passed on to the computers. Among these contracts, some belong to future sales, which is prohibited in *Shari'ah,* while in some other contracts, the *Shari'ah* requirements do not fulfill, like the unknown subject matter is traded, the subject matter is not separated from other goods, the subject matter is not in

the possession and ownership of seller. So, keeping in view the above-mentioned reservations, dealings in international commodity market is not allowed whether for *tawarruq* or for any other matter.

If we assume that the international market fulfils all the *Shari'ah* requirements of a valid sale contract, then it will be necessary for *mutawarriq* to take the possession of those goods after purchasing from the bank. The *mutawarriq* can take the possession by himself or by his agent, other than the bank. The bank cannot be his agent for taking possession on behalf of him because the bank is the seller in this matter, so it cannot be the agent for taking possession on behalf of *mutawarriq*.[82]

Declaring Agent as a Guarantor *(Kafil)*:

The agent cannot be a guarantor *(kafil)* at the same time, but it is observed from the IFIs practices while concluding the contract of *Salam* and *Istisna'* that they put an extra responsibility on agent that he will also be the guarantor and will make sure to the buyer that there will be no defect or issue in the subject matter, otherwise he will be responsible for the loss. This type of combination is prohibited according to the jurists and by doing so the *wakalah* contract become void. So, it's better treatment could be the disclosure of agency, i.e. the agent should disclose that he is selling it on behalf of bank, so by doing so he will become *"Rasool"* rather than *wakeel*[83] and there is no *Shari'ah* issue in the combination of *wakalah* with *kafalah.*

Conclusion:

In prevailing practice related to *wakalah* in modern Islamic financial institutions, there are numerous issues that violate the norms enunciated in the classical *fiqh* literature on the subject. These practices must be brought into confirmation with the tenets of Islamic law of business and transactions. The *Shari'ah* boards of the Islamic financial institutions are expected to minimize the quantum of practice of contracts that lead towards subterfuges, duality in practice and disturbance in achieving the higher objectives of Islamic finance. The Islamic financial institutions need to step forward in

order to transform the real Islamic economic spirits from theory to practice. These organizations must not be as money laundering institutions. The principle of blocking means *(sadd al zaray'i)* must be kept in view while innovation of new products. The issues related to *wakalah* pinpointed in the paper must be addressed and amended to avoid un-Islamic practices. This paper also offers the following recommendations for further improvement: There should be an independent *wakalah* contract where third party must be given the responsibility to act as *wakeel,* hence the *wakalah* practice would be more transparent and different from mere subterfuges. Although by doing so, the costs of contract will be increased but it is nothing for achieving the higher objectives and true spirits of *Shar'iah. Tawarruq* practices should be discouraged at all. In case of dire need, *tawarruq* must be practiced without any kind of *Shari'ah* violations. All the involved contracts including agency contract shall be separated and independent from each other. An independent third party must play the role of agency in doing *tawarruq* instead of client. Usually, while concluding *tawarruq* based activity in international commodity market, a lot of *Shari'ah* violations have been observed. The Islamic bank must be aware of them and must avoid such type of practices. The Islamic banks should not declare its client as a guarantor while concluding the contracts of *salam* and *istisna',* because agency and guarantee cannot be combined in a contract. So, the bank is advised to establish agency agreement with a third party rather than its client. If there is no such way of doing so, then the client must be *"rasool",* rather than *wakeel.* In this case, he will be responsible for the damages and defects etc. on behalf of bank.

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