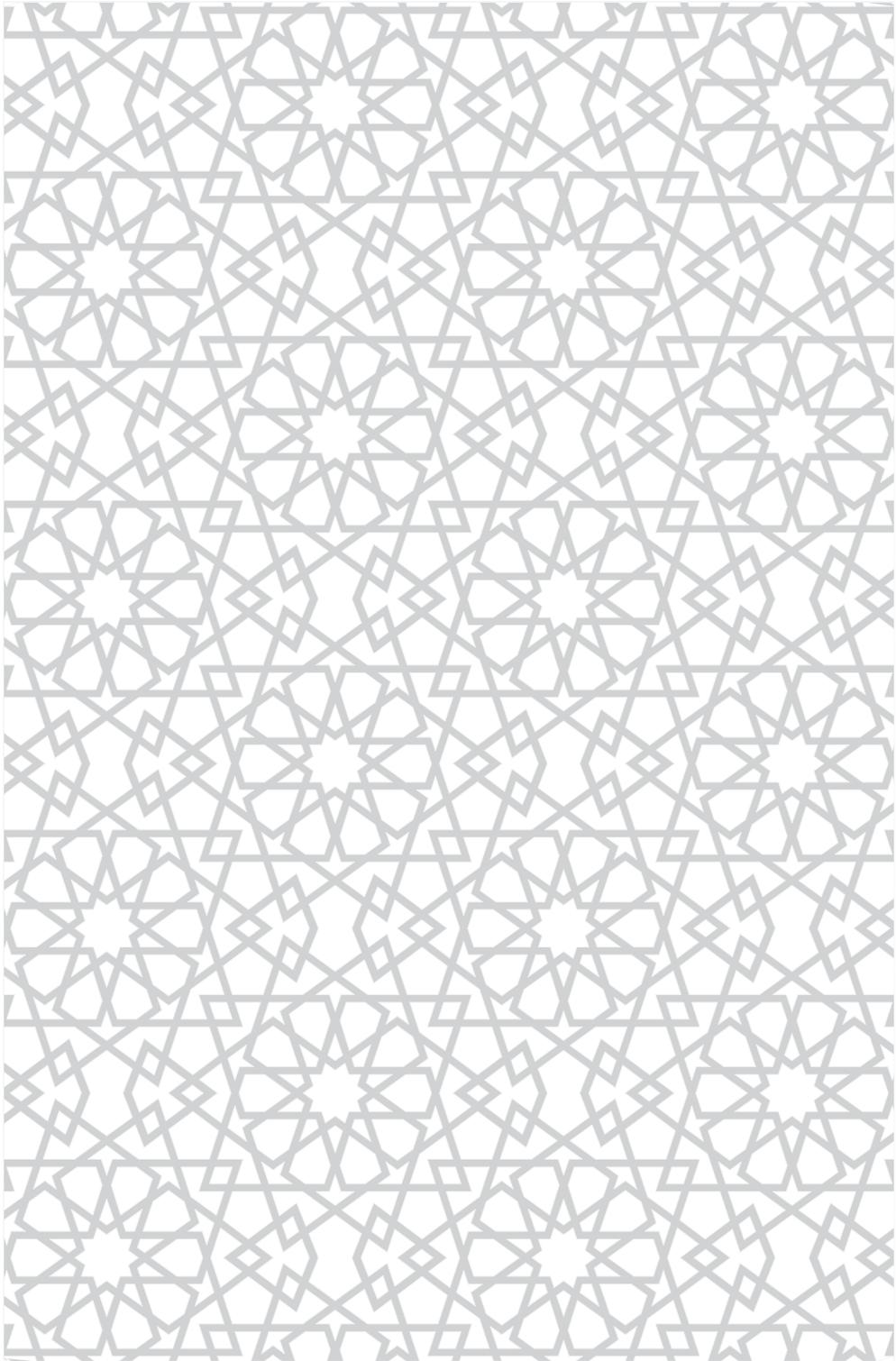


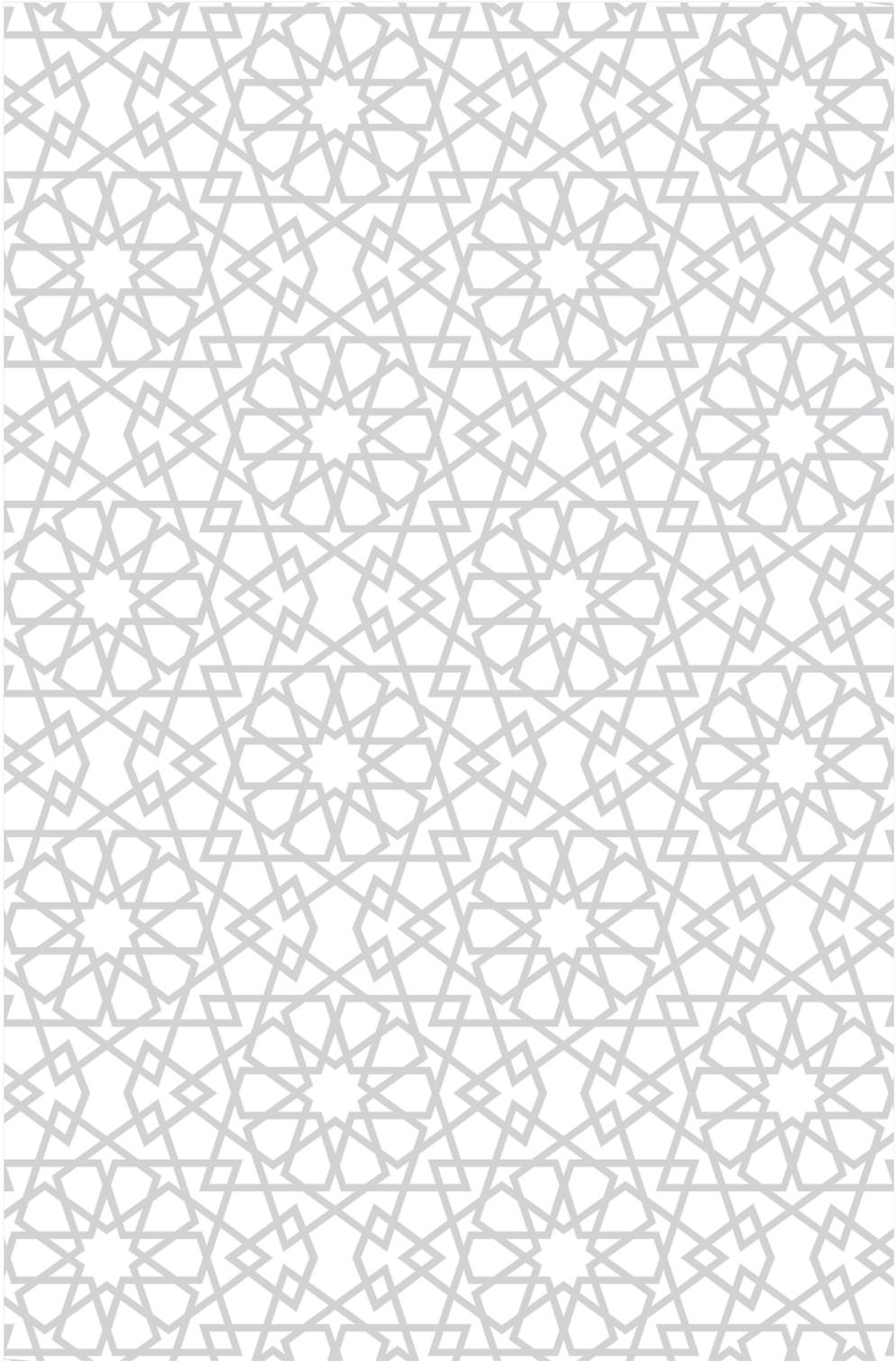
**Shari'ah Standard No. (46)**

**Al-Wakalah Bi Al-Istithmar  
(Investment Agency)**



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*IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL*  
All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

## **Preface**

This Standard aims to explain the rules of Investment Agency applicable to Islamic financial institutions,<sup>(1)</sup> the conditions for its validity, its types, its implications and its contemporary applications.

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(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

## Statement of the Standard

### 1. Scope of the Standard

This Standard covers Investment Agency in various fields, or parts thereof, and the powers and responsibilities of the principal and the investment agent. It does not cover Agency in general or the acts of Uncommissioned Agent (Fodooli) as they are covered by Shari'ah Standard No. (23) on Agency and the Acts of an Uncommissioned Agent (Fodooli).

### 2. Definition of Investment Agency and Its Permissibility

2/1 Investment Agency means appointing another person to invest and grow one's wealth, with or without a fee.

2/2 Investment Agency is permissible subject to the relevant Shari'ah rules.

### 3. Investment Agency: Integral Parts (Arkan) and Its Key Types

3/1 The integral parts (Arkan) of a valid investment agency are offer and acceptance, the subject matter of the contract, and the two contracting parties (the principal and the agent). [see Shari'ah Standard No. (23) for the conditions that are required for a valid agency and the rules relating to the acts of the uncommissioned agent (Fodooli)]

3/2 It is permissible to make the appointment of an agent contingent agency upon the fulfillment of certain conditions or to cause to take effect on a specified future date. It is also permissible to stipulate conditions/restrictions that are compliant with Shari'ah. For further details, see Shari'ah Standard No. (23).

3/3 It is permissible for the investment agency to be restricted to a particular kind of investment, or a specific place or be subject to other restrictions. It is also permissible that it be unrestricted, in which case it would still be restricted by customary practice and that the agent acts in the principal's best interests.

- 3/4 It is not permissible for any one of the parties to unilaterally amend the restrictions in the agency contract. [see Shari'ah Standard No. (23) for the types of agency]

#### **4. Characteristics of Investment Agency**

- 4/1 Investment agency contracts, whether remunerated or unremunerated, are binding on institutions because they are invariably fixed term contracts in which both parties agree not to terminate within a specified period.
- 4/2 Where the parties agreed to terminate for a specified period, it is permissible for the contract to stipulate the right of one of the parties to terminate the contract unilaterally in specific circumstances.
- 4/3 When the term of an agency expires, the agent is required not to enter into new investment activities, but may not liquidate ongoing existing investments.

#### **5. Agency Fee**

- 5/1 If the agency is remunerated, the agent's fee should either be a fixed amount or a percentage of the amount invested. It is also permissible to link the fee to an established index/benchmark that is known to both parties and is referred to before every investment period after the fee of the first period has been determined. It should, however, be capped and floored (by assigning it maximum and minimum limits).
- 5/2 If the fee was not specified in the contract and the agent customarily charges a fee as is normal practice in institutions then the agent will be entitled to a fee which is prevalent in the relevant markets. This also applies when the agent does not complete the task required after starting and realizing returns that are beneficial to the principal.
- 5/3 The principal is required to pay the investment agent's fees in accordance with stipulated time and manner.
- 5/4 It is permissible to stipulate that the agent, in addition to his fee, is entitled to all or part of any amount over and above the expected profit as a performance incentive.

## **6. Amount, Term and Profit of the Investment**

- 6/1 The amount and term of the investment should be determined, irrespective of whether the amount is paid as a lump sum or in installments.
- 6/2 The principal is responsible for any expenses related to the investment such as transportation, storage, taxes, maintenance and insurance. It is not permissible to require the agent to pay them from the agent's own funds, or to defer any reimbursement due to the agent where he has paid them on behalf of the principal or to make such reimbursement subject to the yield of the investment. And the investment agent is liable, as a legal entity, for any expenses related to its employees or equipment.
- 6/3 The agent may start investment activity before receiving the funds (from the principal), and with the principal's permission, by:
- 6/3/1 Incurring a debt on behalf of the principal by purchasing on credit;
  - 6/3/2 Advancing a loan to the principal by purchasing something on his behalf.
- 6/4 Any loan advanced by the agent is construed as an interest free loan which may not bring any benefit to the agent as creditor. The agent is entitled to its fee and performance incentive, without consideration to the loan advanced.
- 6/5 The profit in its entirety is the right of the principal unless it is stipulated that the agent shall be entitled to all or part of any excess above the expected profit as a performance incentive in addition to its fixed fee.
- 6/6 It is permissible for the agent, with the principal's consent, to set aside a portion of the profit to create a profit equalisation reserve for the benefit of the principal.
- 6/7 Upon liquidation, the balance of the profit equalisation reserve is returned to the principal without affecting the agent's entitlement to the fixed fee or performance incentive for the period in which the reserve was set aside.

## **7. Liability of an Investment Agent**

- 7/1 The agent acts in a fiduciary capacity in relation to the investment and therefore is not liable for any loss in cases other than willful misconduct, negligence, or breach of contract unless the breach happens to be advantageous to the principal such as selling an asset for a price higher than the price required by the principal. In situations where the agent is held liable for loss of capital, such liability is limited to the capital amount and the agent is not liable for loss of expected profit whether the capital was invested immediately or delayed or not invested at all.
- 7/2 If the investment results in profit or capital gain in case of a breach that is advantageous to the principal, then such profit or capital increase belongs to the principal without affecting the agent's right to its performance incentive.

## **8. Rights and Obligations of the Contracts Executed by the Agent**

The results of the contract (like transfer of ownership and entitlement to the fee) belong to the principal. However, the rights and obligations (like pursuit of payment or delivery including litigation) belong to the agent.

## **9. Appointment of a Sub-Agent**

- 9/1 The investment agent is not permitted to appoint a sub-agent for the prescribed investment activities except for activities outside its area of expertise, or what is normally outside the capacity of the agent or its employees or where the principal grants the agent permission to subcontract.
- 9/2 The sub-agent appointed by the agent with the consent of the principal cannot be dismissed by the agent but can only be dismissed by the principal. However, if the principal authorizes the agent to appoint any sub-agent at his will, the agent is entitled to dismiss the sub-agent.

## **10. Restrictions Stipulated in Investment Agency**

- 10/1 The investment agent must adhere to a restriction requiring it to consult the principal before any investment and if any breach by the agent results in loss, the agent shall bear it.

10/2 If the Investment Agency is restricted to activities that yield a minimum specified profit margin and the agent does not find such an investment, then it should seek the principal's consent before investment. If it invests in lower-yielding transactions, it is liable to compensate the principal for the difference between the profit earned and the average profit prevalent in the market (if it is less than the stipulated amount/percentage). It is not liable for the minimum profit margin specified for the investment by the principal. [see Shari'ah Standard No. (23) on Agency and the Acts of an Uncommissioned Agent (Fodooli), item 6/3/2]

### **11. Rules of Investment Agency**

If the agent co-mingles his own funds with the principal's funds or with the funds that he manages, he may not then purchase, for his own account any assets from the assets owned by the co-mingled funds without giving notice on each occasion. This is to establish the transfer of ownership and liability for the asset from the co-mingled funds to the agent's account. This requirement is impracticable in relation to investment accounts (and therefore this requirement may be waived). [see items 7/1/2 and 7/1/3]

See also Shari'ah Standard No. (23) on Agency and the Acts of an Uncommissioned Agent (Fodooli).

### **12. Contemporary Applications of Investment Agency**

12/1 Co-mingling the funds of an unrestricted agency with Mudarabah funds or with the agent's funds.

12/1/1 It is permissible to co-mingle funds on the basis of Investment Agency with funds from Mudarabah investment accounts. Such funds are treated as if they were extra funds provided by a capital provider in a Mudarabah investment or shareholder funds when they are co-mingled with funds in Mudarabah investment accounts. Allocation of profits is calculated by the standard prorated method (usually daily weighted

average method) for funds invested in Mudarabah which takes into account each investor's amount and the tenor of the investment. All the profits of the invested funds in Murabahah belong to the principals and the agent is entitled to his fee and any performance incentive stipulated. The agent is not entitled to any profits generated from the Mudarabah accounts he invested.

12/2 Investment agency for the financing of working capital<sup>(2)</sup>

Investment agency can be used as a substitute for an overdraft. The amount provided to the client is regarded as the institution's undivided share in the working capital of the client. It is permissible for the client to use the withdrawn amount to settle the client's liabilities relating to his activities or his employees' salaries. The client is entitled to a fee for his service and profit from his portion of the working capital and losses occurring after the agency, if any, are borne by both parties on a pro-rata basis. If the client has any interest-bearing deposits or loans, the institution should stipulate that the client is solely responsible for them.

When the client does not require financing anymore, then the relationship may be terminated on the basis of Takharuj which means that either the joint account is distributed between them pro-rata or one party will purchase the share of the other at a price agreed upon at that time.

12/3 Appointing conventional banks by the institutions as their investment agents and vice versa

12/3/1 It is permissible for institutions to appoint a conventional bank as an investment agent, provided that the relevant contracts are compliant with Shari'ah approved by the institution's Shari'ah Supervisory Board, and that the conventional banks have among their activities Shari'ah-compliant modes of financing and investment with proper Shari'ah supervision

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(2) As an alternative to an overdraft, its application requires precise accounting treatment.

and Shari'ah audit without violating the requirements of the regulatory authorities.

12/3/2 It is permissible for the institution to accept funds based on Wakalah from conventional banks and invest them in its activities which have been approved by its Shari'ah Supervisory Board, provided that the contract is free from conditions and restrictions that are prohibited by the Shari'ah.

12/4 Expiry of the investment agency term before collecting amounts receivable

If the agency expires and the receivables are yet to be collected, and the agency is not mutually renewed, the investment agent is required to collect the receivables and take necessary actions against the debtors or other counter-parties delaying their payments.

The agent is not entitled to any fee for such collection unless agreed otherwise. It is not permissible for the agent to use such funds received for his personal use or to re-invest them. The agent is not required to pay to the principal such receivables from his own personal funds, or to seek financing like Tawarruq for this purpose.

12/5 In the event of early termination of the agency either by mutual agreement, or by one party unilaterally exercising its right to terminate or by early settlement of the amounts due (from the obligors), it is permissible (if mutually agreed upon) to reduce the performance incentive stipulated for the agent, if any, in proportion to the tenor of the investment.

### **13. Date of Issuance of the Standard**

This Standard was issued on 26 Jumada II, 1432 A.H., corresponding to 29 May 2011 A.D.

## **Adoption of the Standard**

The Shari'ah Board adopted this Standard in its 30th meeting held in the Kingdom of Bahrain during the period of 24-26 Jumada II, 1432 A.H., corresponding to 27-29 May 2011 A.D.

## **Appendix (A)**

### **Brief History of the Preparation of the Standard**

On 23 Muharram 1430 A.H., corresponding to 20 January 2009 A.D., the General Secretariat decided to commission a Shari'ah consultant to prepare a juristic study on Investment Agency.

In its meeting held in Kuwait, on 6 Rabi' I, 1431 A.H., corresponding to 20 February 2010 A.D., the Shari'ah Standards Committee discussed the draft of a Shari'ah Standard on Investment Agency and made necessary amendments.

The revised draft of the Shari'ah Standard was presented to the Shari'ah Board in its 28th meeting held in the Kingdom of Bahrain, during the period of 12-14 Dhul-Q'adah 1431 A.H., corresponding to 20-22 October 2010 A.D. The amendments that were deemed appropriate were included.

The revised draft of the Shari'ah Standard was presented to the Shari'ah Board in its 29th meeting held in Makkah Al-Mukarramah, during the period of 28-30 Rabi' I, 1432 A.H., corresponding to 3-5 March 2010 A.D. The amendments that were deemed appropriate were included.

The General Secretariat held a public hearing in the Kingdom of Bahrain, on 25 Jumada II, 1432 A.H., corresponding to 28 May 2011 A.D. All the comments made in the public hearing were listened to, and a representative of the Shari'ah Board answered these comments and made commentary on them.

In its meeting No. (30) held in the Kingdom of Bahrain, during the period of 24-26 Jumada II, 1432 A.H., corresponding to 27-29 May 2011 A.D., the Shari'ah Board discussed the amendments proposed by the participants in the public hearing and incorporated the amendments that it deemed appropriate, and adopted the Standard.

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In its meeting held in Al-Madinah Al-Munawwarah, on 30 Sha'ban 1436 A.H., corresponding to 17 June 2015 A.D., the Shari'ah Standards Review Committee reviewed this Standard. After deliberation, the committee approved necessary amendments, and the Standard was adopted in its current amended version.

## Appendix (B)

### The Shari'ah Basis for the Standard

- The basis for the differentiating between investment agency and agency in general is that the former is in order to increase wealth, and it is similar to Mudarabah and Musharakah in this respect. However, the difference between investment agency and Mudarabah and Musharakah is that Investment Agency is a form of Ijarah (hiring), while Mudarabah and Musharakah are forms of partnership. As for the general agency, it is an authorization to perform specific tasks such as payment etc. Even if the authorization is to engage in a sale/purchase, such as the authorization of the client in a Murabahah contract, its main purpose is to acquire ownership for the institution rather than investment on its behalf.
- The basis for the permissibility of investment agency is the Hadith stating: *“Engage in trade with the wealth of orphans so that it will not be consumed by Zakah”*<sup>(3)</sup> as well as numerous Verses of the Qur`an on seeking sustenance, striving and earning.
- The basis for the binding nature of the investment agency is that it is entered into for a specific period; i.e., there is an agreement between the counterparties that neither of them can unilaterally dissolve the contract except in certain circumstances specified in the contract.
- The basis for allocating for the investment agent any profit amount in excess of the expected profit is that it is a type of conditional gift and is an incentive.
- If the agency contract stipulates a certain percentage of profit and the agent invests in lower-yielding transactions, the agent is liable to compensate the principal for the difference between the profit earned and the average

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(3) Related by Al-Tabrani in *“Al-Awsat”* and graded authentic (*sahih*) by Al-'Iraqi. Ibn Hajar graded it as good (*hasan*). *“Fayd Al-Qadir”* [1: 108]. It is found in *“Al-Muwatta`”* as a statement of Umar (may Allah be pleased with him).

profit prevalent in the market (if it is less than the stipulated amount/percentage), because he is in breach of the conditions of the Agency. However, the agent is not liable for the specified percentage stipulated in the contract if it is higher than the prevalent market rate, because it will be tantamount to acquiring another's wealth by illegitimate means.<sup>(4)</sup>

- The basis for the permissibility of employing the agency's funds in the Mudarabah portfolio is that the authorization granted by the investment agency includes such employment when the agency is unrestricted.
- The basis for the principle that the agent, in a situation where the agency's funds are employed in a Mudarabah portfolio, is entitled to the agency commission and not to Mudarabah profit is that his contract with the institution is that of agency and not of Mudarabah. Even if the agent has employed the funds in a Mudarabah portfolio, the profit entitled to the institution is generated from the Mudarabah portfolio and not on the basis of agency.



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(4) See "Al-Mughni", vol. 5, (P. 135).