

## DUAL AGENCY PRACTICES IN ISLAMIC FINANCIAL INSTITUTIONS: A FIQH PERSPECTIVE

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### Abstract

*Bay al-tawarruq is increasingly adopted by Malaysian Islamic financial institutions (IFIs) in creating both deposit and financing products. The contract involves sequences of trading between three parties namely client, IFIs and brokers. However, in order to simplify the operation and to minimize client's involvement, the actual trading are conducted between IFI and brokers only. IFI will act on behalf of the client and execute all trading transactions. The practice triggers fiqh issue because the IFI (as agent of client) will sell and purchase commodity to himself. The present article discusses the issue by assessing Muslim jurists' view pertaining to dual agency practices. The article adopts juristic analysis method in which classical and contemporary scholars arguments are analysed before a preferred opinion (tarjih) is concluded. Understanding the issue is vital to avoid misunderstanding about the legality of Islamic financial products particularly products that used the organized bay' al-tawarruq as the underlying contract.*

**Keywords:** *Islamic banking, Shariah issues, dual agency*

### INTRODUCTION

Commodity *murabahah/musawwamah* (CM), which is guided by the concept of *bay' al-tawarruq* contract, is considered as the most common Shariah contract used by Islamic financial institutions (IFIs). In Malaysian Islamic banks for instance, *bay' al-tawarruq* represent 80 percent of the underlying contract of banking products offered. *Bay' al-tawarruq* contract would normally involve three different transactions of which the IFIs needs to ensure that the sequences are properly followed. In a normal *bay' al-tawarruq* contract

practised by IFIs, the trading sequence for financing product would be as follows:

- a. In the beginning, the IFIs would purchase the commodity from the supplier. The ownership of the commodity should be transferred to the IFIs and evidenced accordingly through time stamps and audit trails.
- b. The second leg, which is the transaction between the IFIs and client; the transfer of ownership to the client should also be evidenced and recorded properly regardless of whether it is based on *murabahah* or *musawwamah* contract.
- c. In the final leg, the commodity will be sold to a third party, whereby the third party must be someone other than the original owner. This is important to prevent the transaction from being regarded as *bay' al-inah* (buy and sell back).

On the other hand, for deposit-based product, the sequence would be slightly different where the first leg would be client as a first commodity buyer. Subsequently, the client will sell the commodity to IFIs on either *murabahah* or *musawwamah* basis. After that, IFIs will sell the commodity to broker to complete the transaction.

However, there is a development in the *bay' al-tawarruq* transaction where it is to simplify the process and to minimize the client's involvement. The process is simplified by allowing the IFI to act as an agent on behalf of the client to execute all trading transactions. The appointment of wakeel (agent) will be done on one-time basis which would be during the application stage. By having this one-time appointment as an agent, it may trigger a contentious issue in Shariah which is the sale of goods by wakeel to himself. Such a transaction is called dual agency and had been the subject of disagreement among classical Muslim jurists over its permissibility.

Hence, the present article analyses both classical and modern Muslims jurists' legal opinions on dual agency issue. It also explains the application of dual agency in IFIs. The discussion is organized into four sub-sections. Section one is the introductory section which explains the background of *bay' al-tawarruq* application in IFIs and how the issue of dual agency arises. Then, section two describes the operations of dual agency in both deposit and financing products. Section three analyses the justifications of classical and contemporary scholars who opposed and allowed the practice. In this section, both scholars' arguments are assessed, and a preferred opinion is supported. Section four concludes the proceeding discussions.

## THE APPLICATION OF DUAL AGENCY IN DEPOSIT AND FINANCING PRODUCTS

As mentioned earlier, *bay' al-tawarruq* concept may be applied in financing based product as well as in deposit based product. The issue of sale of goods by wakeel to himself is best described in the following diagram:

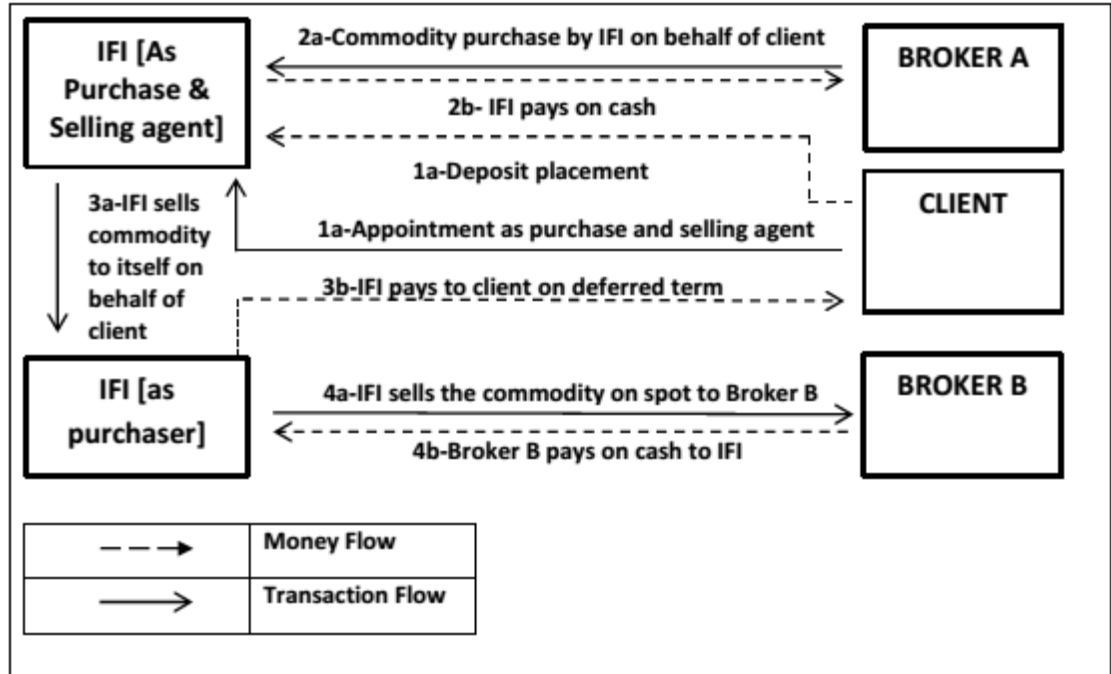
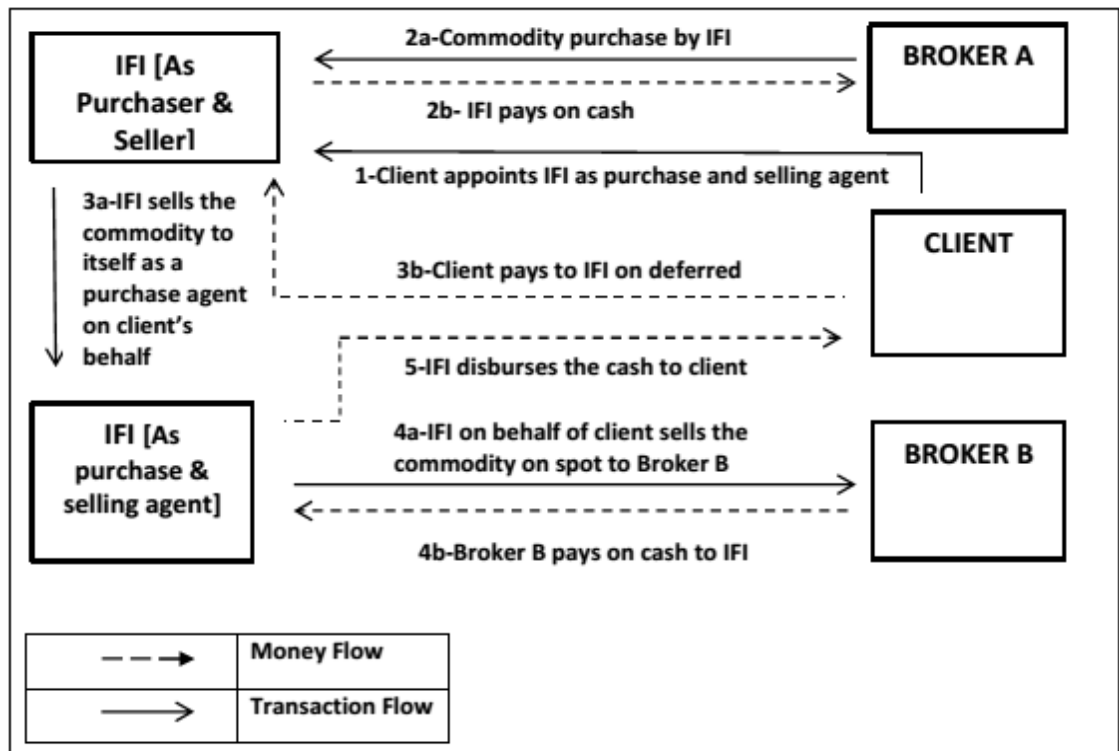


Diagram 1: Dual Agency in Deposit Product:

In this structure, client approaches the IFI to deposit their money and appoint IFI as purchase and selling agent. Subsequently, the IFI, on behalf of the client will purchase the commodity as stated in the agreement from a broker A. The IFI will then sell the commodity to itself as a purchaser which will in turn be paid to the client in deferred terms (cost plus profit). In this situation, the issue of sale of agent to himself (*bai' wakeel linafsih*) is triggered when the IFI act as an agent for the client and sell the commodity to itself. After that, IFI as owner will sell the commodity to broker on spot and complete the transaction.

Meanwhile, in the financing product, the same issue arises and it is illustrated in the diagram 2 below:

Diagram 1: Tawarruq with Dual Agency



In this structure, client approaches the IFI for financing purposes. The IFI buys a commodity from a broker and subsequently sells it to the client. The IFI, on behalf of the client will then sell the commodity to another broker. The proceeds received will be credited to client's account which in turn will be paid back to the IFI in deferred terms (cost plus profit). Since the IFI will act as an agent to facilitate all transactions, after buying the commodity, the IFI will then sell the commodity to itself (in wakeel form). This is considered as sale of agent to himself (*bai' wakeel linafsih*).

### JURISTIC DISAGREEMENT OVER DUAL AGENCY PRACTICES

The permissibility of dual agency practices has been subject of disagreement among Muslim jurists. The argument was basically on whether or not this practice will reflect a true and pure sale contract since it may raise suspicion because there is only one party who will execute the contract of sale and purchase which is the agent (*wakil*) himself. Apart from that, the argument was also centred around the issue of consent by the principal for agent to execute sale and purchase transaction on his behalf.

Most of the Shafiis and some of the Hanbalis jurists ruled that a selling agent may not sell to himself or his underage child (Zuhaily, 2007). They viewed that a selling and buying agent is not permitted to sell to himself, since it would raise suspicion. Moreover, since a selling agent is the official

seller in the sales contract, he cannot also be the buyer, let there be only one party to the sales contract (Juzairy, 2004).

In addition, this particular act of agent may contradict with the very objective of a wakalah contract. This is because the objective of the buyer (*wakil*) is to buy at a cheaper price, while for the seller (*muwakkil*) is to sell at higher price in order obtain more profit (al-Qaradaghi, n.d.). How the two contradictory objectives is achieved when the transaction is conducted by the same party?

Al-Musili from Hanafi school stated in his book:

و إن وكله بشراء شيء بعينه ليس له أن يشتريه لنفسه

*"If he has been instructed to purchase a specific goods for the muwakkil then it is not permitted for the agent to purchase the goods that he bought for muwakkil for himself".*

This is because he has been instructed to purchase a specific goods for the muwakkil and it is assumed that the wakeel is cheating when he bought back the goods for himself (al-Musili, 2006).

Al-Rahaibani from Hanbalis emphasized:

و لا يصح بيع وكيل لنفسه ; (بأن يشتري ما وكل في بيعه من نفسه لنفسه. هذا المذهب، وعليه الجمهور، وجزم به في "الوجيز" وغيره، وصححه في المذهب وغيره

*"It is not permitted for wakeel to buy back the goods for himself and this is the opinion of Mazhab (Hanbali) as well as the majority of Islamic scholars). This opinion is concurred in al-Wajiz and others and verified in the mazhab and others (al-Rahaibani, 1961).*

In addition to this, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) indicated their rules with regard to dual agency in its Shariah Standard of Murabaha to the Purchase Orderer:

*3/1/3: The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for the institution to carry out the purchase by authorizing an agent, other than the purchase orderer, to make the purchase; and the client (the purchase orderer) should not be appointed to act as an agent except in a situation of dire need. Furthermore, the agent must not sell the item to himself (AAOIFI, 2010).*

AAOIFI also mentioned in its Shariah Standard no 23 (Agency):

*6/1/2: An agent should not conduct deals with his own self or with his son/daughter who is still under his guardianship, or with his partner (Shareek) in the same contract (AAOIFI, 2010).*

Furthermore, the dual agency issue was also discussed in Albaraka Banking Group Symposium in 2008. During the symposium a resolution was issued as followed:

“... It is not permitted for a client to take charge of the two sides of the agency contract, whereby he purchases the commodity for the IFI and in turn sells it to himself, on behalf of the IFI (Mannea, 2008).”

After reviewing the opinions of those who disallowed the practices of dual agency, it can be inferred that their basis of reasoning is to safeguard the interest of the principal (in this case is the customer of bank). It is afraid that the agent (bank) who executes both roles as buyer and seller at the same time could manipulate the transaction for its own benefits. This is because logically in a sale contract, a person who sells will want to maximize his profit. In contrast, a person who purchases will most probably want to minimize the selling price. Therefore, when a same person executes both purchase and sell transactions, this contradictory objectives might not be realized. Furthermore, a person who has the capacity to sell on behalf of his principal will potentially abuse the right by selling a lower price to himself.

However, some Muslim jurists opined that the prohibition of sales of goods by agent to himself is only related to unrestricted wakalah (wakalah mutlaqah). However, in the case of restricted wakalah (wakalah muqayyadah) where the principal gives his consent to sell the goods to his agent with certain conditions, the agent is allowed to sell the goods to himself provided that he had met with all conditions requested by the principal. For example, Ahmad appoints Salim to sell his car and specifies that the selling price must be not lower than RM20,000 and payment must be in cash. According to Malikis and Hanbalis jurists, Salim is allowed to sell the car to himself provided he meets with all conditions stipulated by Ahmad.

The Malikis jurists also added two other conditions for the validity of agent selling to himself which are the presence of principal during the sale session and the price must be explicitly stated during that session (Zuhaily, 2007). The rule is mentioned by al-Dasuki as followed:

فَإِنْ اشْتَرَى الْوَكِيلُ لِنَفْسِهِ بَعْدَ تَنَاهِي الرَّغَبَاتِ أَوْ أَذِنَهُ الْمُؤَكَّلُ فِي شِرَائِهِ لِنَفْسِهِ جَازَ شِرَاؤُهُ

“If the agent bought the goods for himself after the requirements had been fulfilled or the principal has given his consent for agent to purchase the goods for himself, hence, the sale is permissible (al-Dusuki, n.d).”

Meanwhile the Hanbalis emphasized the consent of principal before the agent could sell goods for himself. The rule is mentioned in al-Bahuti’s work (1993):

إِلَّا إِنْ أَذِنَ مُؤَكَّلٌ لَوْكَيْلِهِ فَيَبِيعُهُ لِنَفْسِهِ....

“...except if the principal gives his consent, (the agent) could sell for himself”.

It is clear from Hanbalis jurists view that dual agency is permitted should the principal approves it and the principal has ownership over the goods. The permissibility of dual agency was also cited by al-Juzairy (2004). He said the Malikis jurists allowed the agent to purchase for himself in a

situation where there is no interest from peoples to purchase the goods. However, the jurists stressed that the price must be determined in advanced.

المالكية قالو يجوز له شراؤها إذا أذنه موكله بذلك أو انتهت رغبات الناس في هذه الساعة الى ثمن معين

*“Malikis said it is permissible for an agent to purchase goods for himself with consent from the principal in which no other peoples want to purchase the goods and the price is determined”.*

Contemporary Muslims scholars discussed the issue of dual agency in their efforts to provide solutions for Islamic banking institutions. The Shariah advisory committee of Kuwait Finance House (KFH) has issued a fatwa regarding the issue of dual role of agent-buyer:

*“It is permissible to appoint someone as an agent, to purchase and receive, as well as to sell. However, it is not permissible for the person (agent) to sell the identified goods to himself, until specification of the selling price is concluded with the principal.” (i-Fikr, 2015).*

Hence, according to KFH Shariah advisory committee the dual role of agent-buyer is permissible provided that the price is determined and the sale is concluded with the consent from principal.

The Accounting Auditing of Islamic Financial Institutions (AAOIFI) also explains the dual agency issue in its Shariah Standard related to wakalah contract. According to AAOIFI, it is allowed for an agent to purchase for himself provided the sale and wakalah contracts are treated independently:

*“An agent may purchase what he has bought for the principal, by way of offer and acceptance. The deal should be concluded in such a way that the guarantees stemming from the agency contract and the sale contract are kept separate. After the completion the conclusion of the sale contract, the commodity becomes under the guarantee of the purchaser/agent” (AAOIFI, 2010).*

Bank Negara Malaysia through its Tawarruq Standard issued on 17th of Nov 2015 has permitted the implementation of dual agency in Islamic banking products. In addition to that, Shariah Advisory Council (SAC) of Bank Negara Malaysia (BNM) has in its 138th meeting in 2013, approved an enhanced resolution on Tawarruq which stipulates the essential Shariah conditions relating to the application of dual-agency arrangement in Tawarruq based deposit products. SAC of Bank Negara Malaysia defined the dual-agency as a person or an institution who acts as an agent to purchase an asset on behalf of the other contracting parties; and subsequently acts as an agent to sell the asset on behalf of the same contracting parties to himself (BNM, 2013). SAC of Bank.

As stated in the Tawarruq standard of Bank Negara Malaysia a dual-agency may involve the following:

a) An action of one of the contracting parties who acts as an agent to purchase an asset on behalf of the other contracting party; and subsequently

acts as an agent to sell the asset on behalf of the same contracting party to himself; or

b) An action of one of the contracting parties who acts as an agent to purchase an asset from himself on behalf of the other contracting parties; and subsequently acts as an agent to sell the asset on behalf of the same contracting party to a third party.

However, SAC of Bank Negara Malaysia also put certain conditions for a dual agency to be practised by Islamic banks. Firstly all essential criteria or specification of the authorised task, such as price, tenure and asset specification, shall be mutually agreed by the contracting parties. Secondly, the transaction conducted in the bay' tawarruq contract shall be in a proper sequence and supported by proper evidence (BNM, 2013).

## DISCUSSION OF PREFERRED OPINION

After we have presented both opinions of those who prohibited as well as permitted the practice of dual agency, in this section we will try to assess them to arrive at a preferred opinion. If we observed the argument and justification by the classical jurists, we can conclude that the subject of disagreement (*mahal al-khilaf*) lies on the issue of safeguarding the interest of principal. Jurists who prohibited the dual agency are afraid of the abuse of right by agent. This is because agent who is given the right to sell and purchase for himself might conduct the transactions for his own benefit at the expense of principal's interest. An agent, being the purchaser and seller at the same time may take an advantage over the price or the goods and indirectly, speculate the market. This is a valid concern since Shariah always uphold the principle of justice (*adl*) in any commercial transaction for all contracting parties. Dispute between principal and agent could occur if the issue is not clearly specified.

Based on this premise, we notice that the Malikis jurists ruled certain conditions before a dual agency practice can be legalized. The conditions aimed at removing the earlier concern and suspicion. For this reason, the Malikis jurists emphasized on obtaining the consent of principal before an agent could sell and purchase for himself. Consent from principal is required because principal should be aware of the risk of allowing his agent to conduct the dual roles. It is also indicated in the Malikis's jurisprudence that dual agency is not a common practice but more of last business decision to be taken by an agent. When a principal asked an agent to sell his goods, normally the instruction is to sell the goods to other peoples. However, in the case where there is no buyer who is interested to purchase the goods, only then an agent could sell the goods to himself. Besides, the price must be determined upfront and agreed by the principal. It is for the same reason, we found that the Malikis jurists required the principal to be present during the



dual agency transaction. The point which is to be highlighted here is that all conditions and requirements are to ensure that the agent could not manipulate his position as seller and purchaser at the same time for his own benefits.

In the current practice of Islamic banks especially in Malaysia, dual agency transaction is conducted in *bay' al-tawarruq* based products either for financing or deposit products. In a normal practice of *bay' tawarruq* contract, it will involves sale and purchase transactions executed by three different parties namely customer, bank and broker. However, for Islamic banks to adopt *bay' tawarruq* contract in a massive scale, they have structured the contract whereby the parties involved and the prices of commodity transacted are pre-identified and pre-determined. As all the procedures and processes are pre-arranged, Islamic banks would play two roles (purchaser and seller) on behalf of customers and deal with brokers. For example, when a customer comes to an Islamic bank for financing product, he will be asked to sign a *wakalah* contract and gives consent for bank to act dual roles in *tawarruq* transaction. Given this mandate, the bank then purchases a commodity on behalf of the customer and subsequently sells the commodity to itself. The roles of dual agency is important to ease the whole process of *bay al-tawarruq* transactions. Otherwise, the customer needs to sell the commodity to bank by himself. This will be not practical as customer normally will not come several times in obtaining financing from bank. Thus, to simplify the matter, the bank will sell the commodity to himself and eventually will sell it to broker.

It is worth mentioning that all prices and mark up rate have been agreed between customers and bank in the *bay' tawarruq* transactions. Hence, when a bank sells commodity to himself the bank will sell at the price and mark up rate agreed by customer as the principal in *wakalah* agreement. It is important to highlight at this juncture that the concern over possible manipulation by agent (bank) at the expanse of customer's interest can be avoided. This is because restricted *wakalah* is been practised whereby customer as the principal has mandated bank according to pre-agreed price and mark-up rate. Even though the bank is the only party who conducts the purchase and sell with broker, but all the transactions are completed according the specified terms and conditions. Customer always has the right to contest if the bank performs transactions not according to the agreed terms. In view of this practice, we are of the opinion that the dual agency as practised by Islamic banks do not trigger any Shariah issue. Furthermore, Islamic banks are strictly governed by the Central Bank of Malaysia and are subjected to review and compliance procedures as well as Shariah audit process. With this Shariah governance framework in place, it can be assured that the right of customer is well safeguarded.

## CONCLUSION

*Bay' al-tawarruq* contract has increasingly become the most common contract used by Islamic financial institutions (IFIs) in designing their deposit and financing products. Unlike *bay' al-inah*, trading transactions in *bay' al-tawarruq* contract involve three different parties namely customers, Islamic banks and brokers. In financing product for example, the bank will purchase a commodity and sells it to client. Then, the client will cash the commodity by selling it to a broker. However, to simplify the operation and minimize customer's involvement, the bank will act on behalf of the customer and will execute all trading transactions. This means bank will purchase and sell the commodity to itself. The practice may trigger fiqh issue as most of Hanafis, Shafi'is and Hanbalis jurists prohibited the transaction. However, Malikis jurists were of the opinion that the dual agency practice is allowed. Modern Shariah scholars also have different opinions in this matter. Some of the contemporary scholars view that the dual agency is impermissible. Meanwhile, the Shariah Advisory Council of Bank Negara Malaysia (SAC BNM) approve the transaction. The crux of the issue lies on the concern over the possible manipulation by the bank who conducts the purchase and sell for itself. Those who prohibit the dual agency have a suspicion that the agent may take advantage from his position at the expense of principal's benefit. However, given the sound regulatory framework in which the *bay' tawarruq* transactions are conducted, the preferred opinion concluded in this article is that the dual agency practice does not trigger any Shariah issue. The permissible rule applies to Islamic bank who is required to transact according to pre-determined price and mark-up rate even to itself.

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#### Penafian

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