



Merging share capital with investment account funds in Islamic law: A scrutiny

Muhammad Abdurrahman Sadique¹, Ahmad Ibrahim Kulliyah¹, Mohammed Waseem²

¹ International Islamic University, Malaysia

² Faculty of Management Sciences, International Islamic University, Islamabad, Pakistan

Abstract

Where several parties invest with a single fund manager, such investment should take place on a single occasion, so that the tenure of investment could commence with regard to all deposits at the same time. Where the fund manager accepts investments from different individuals through individual contracts, the majority of schools of Islamic law require that the business of each capital be managed separately. The restriction is due to fundamental anomalies that may result from mixing different capitals. However, jurists of the Hanafi school appear to have allowed the fund manager to mix funds of different investors together with the permission of the investors. This could indicate permission for mixing funds invested at different stages when overall permission had been obtained. Similarly, mixing investment funds with funds of the fund manager could be valid according to the majority of schools with the express permission of investors. Thus the Hanafi position appears to uphold the validity of mixing funds belonging to different investors who had invested at varying points of time, as practised in investment accounts.

Keywords: mudarabah, capital, investment accounts, multiple investors

Introduction

In funds invested with Islamic financial institutions on mudarabah, involvement of funds in business operations is often carried out in common with the institution's capital. A portion of the share capital or other funds available with the institution is invested along with the mudarabah capital. It would be relevant to examine whether this process affects the nature of the mudarabah contract in any manner, due to the fact that investment always comes from one of the contracting parties in a mudarabah contract. Some jurists have recognised such mixing of funds by the mudarib only when the financier expresses his consent to it. If the mudarib mixes mudarabah capital with his own funds without such permission, he becomes liable for the capital. This could indicate that such unauthorised mingling of mudarabah funds with his own is counted as an act of transgression that abolishes the mudarib's immunity from bearing liability. As explained by the Hanbali jurist Ibn Qudamah, this is because mudarabah capital is considered to be *amanah*, i.e. funds given on trust, similar to a deposit for safekeeping (*wadi'ah*), which he is expected to manage separately. However, if the investor had authorised the mudarib to manage the funds based on his own discretion, this has been considered sufficient by way of permission according to the majority of schools, as the mudarib may require such mixing in the course of operations. Shafi'i jurists do not regard such general authority sufficient for mixing capitals, and rule that the mudarib becomes liable for the funds in this event. Even where the investor expressly allows mixing, another Shafi'i principle becomes relevant, viz. that where there is investment from both contractors, profit sharing should necessarily be on the ratio of capital. The labour component ceases to play a role in entitlement to profits, when the capital is common. However, it appears from some Shafi'i texts that when the capital is mixed with funds of the mudarib, if there happens to be a separate shirkah contract in part of the investor's capital, where, evidently, profit is

proportionate to capitals, while the remainder of the investor's capital is on mudarabah, the arrangement is valid. At the same time, with regard to common capital jointly owned by two partners, i.e. on shirkah al-milk, Shafi'i jurists have allowed one of them to enter into a mudarabah with the other in his own share, provided the labour rests with the mudarib only. In this instance, the mudarib would be entitled to the profit of his portion of the capital, while sharing the profit of the other as agreed. Thus, the Shafi'i position in this regard seems to be that where the mudarib mixes the mudarabah capital with his own funds with the approval of the investor for joint investment in business, profit sharing should necessarily be on the ratio of capitals. Otherwise, the mudarib should enter into a shirkah contract in part of his capital where the above guideline is observed, while contracting a mudarabah in the rest on any ratio as wished. Maliki jurists have allowed mixing even without the permission of the investor, provided any condition that necessitates such mixing is not stipulated. The Hanafi position on the issue was mentioned above, according to which the mudarib is permitted to mix the mudarabah funds with his own or with that of another when the investor had granted him overall permission to transact using the mudarabah funds as he wishes. Thus, mixing of mudarabah funds with the funds of the mudarib could be valid according to all schools other than the Shafi'i when the investor grants express permission to the fund manager to do so.

It is evident from the above that where the investors in a joint mudarabah fund allow the institution (i.e. mudarib) to mix its own funds with mudarabah capital, it cannot be held contrary to the norms of mudarabah according to the majority of schools. Such mixing would alter the relationship of the institution to the investors slightly, which, however, would not be of any material importance. Subsequent to the admixture of funds, its relationship with the mudarabah investors would also reflect an element of

shirkah, in view its own capital invested in the pool. Thus, the institution as a joint partner or *sharīk* would claim an amount of profit proportionate to its capital involvement in the pool, while also being entitled to a part of the proportion of profit accruing to the mudārabah capital, due to its role of fund manager (mudārib). The AAOIFI Shari'a standards have upheld the same position, stating that the mudārib in the event of such mingling of funds becomes a partner in respect of his funds and a mudārib in respect of the funds of the capital provider.

Joint investors in Mudārabah

When the contract of mudārabah comprises more than a single individual on each side, it could be observed that the contract here comprise two types of relationships. The contract of mudārabah occurs between the group of financiers or investors and the fund manager, who too could be an entity comprising several individuals. It would be pertinent to examine the nature of the relationship between the investors themselves. Determining the relationship among the investors would depend to a great extent on whether they had invested jointly through a single contract or through separate contracts. All schools of Islamic law appear to have recognised the validity of several parties jointly investing funds that are commonly owned by them with a single mudārib, through a single contract. The joint investment with the mudārib in this instance could indicate some similarity with shirkah al-'aqd, as funds are invested based on a common contract for earning a return. However, it is pertinent to note here that the investors had not entered into a contractual arrangement among themselves, resulting in agency to deal in the capital shares of each other, as necessary in the case of a proper shirkah al-'aqd. Thus, if the funds invested commonly with the mudārib had belonged to them jointly, the shirkah al-milk that existed would remain even after the investment. The relationship among the investors here being different from a proper shirkah al-'aqd is further endorsed by the fact that even the Hanafi and Hanbali schools have required profit division among the investors here to take place based on the proportion of their capitals, any agreement to the contrary being void.

Where funds are invested by different investors at different points of time with a single mudārib, a relationship could be assumed to result if the mudārib mixes their capitals together for common management. Whether the investors had expressed their consent to such mixing too would be relevant in this regard. Therefore, we shall analyse below the position of Islamic schools of law on the mudārib combining capitals invested by different parties under different contracts.

Mixing capitals invested by Different Investors

From a perusal of Islamic legal texts, it is evident that the Shāfi'i and the Hanbali schools have shown the least acceptance to mingling capitals of different investors together. The restriction on this issue is such that combining capitals invested even by the same party at different occasions is considered unacceptable. This is because, after mobilisation in business, each capital acquires its own profit loss position, which may not be verified until liquidation. As such, fresh capital may not be added to it at this stage. Explaining the issue, the Shāfi'i jurist al-Nawawi states that after investing a sum of capital with the mudārib, if the

same investor forwards another sum, it could be combined with the first sum only if the first sum had remained with the mudārib unutilised thus far. If the first sum had already been involved in trade, the later sum may not be combined with it, as the profit / loss status of the former capital had already become established. Each capital is separately entitled to its own profit or loss. The Hanbali position on the issue is similar, who add that if such combining is stipulated in the second contract, it would become invalid. However, if the first capital, after mobilisation in trade, had been restored to cash, the second amount could be combined with it without any objection, with the permission of the investor. As combining of capitals forwarded by the same investor on different occasions has been considered unacceptable after the former amount had been invested in trade, it follows that capitals of different investors forwarded on different occasions, i.e. through separate contracts, may not be merged. Thus, where the mudārib accepts investments from different individuals through individual contracts at various points of time, he is required to manage the business of each capital separately. If some mistake occurs inadvertently where the assets of different businesses are merged, the mudārib could be held liable for the capitals.

Māliki texts indicate the permissibility of mixing capitals invested by two individuals with a mudārib even when each had invested separately. They consider that this may not result in harm to the interests of either party. Obtaining the permission of both investors for such mixing has not been deemed mandatory. Although not resulting in the liability of mudārib, arbitrary mixing has been deemed to be an offence requiring repentance. However, such mixing is permitted only before one of the two capitals is involved in operations, provided there is an assured benefit in mixing capitals. This indicates that mixing the capitals after involvement in operations is not accepted in the Māliki school. Where mingling of the capitals occurs with the consent of the investors, i.e. before involvement in trading, as well as when their consent is not ascertained, based on the shirkah principle of dividing profits according to capital input, the profit, as well as the loss, should be divided based on the proportion of their respective capitals. Therefore, arbitrary mixing by the mudārib is not materially effective as far as profit division is concerned. Where mixing is done with the consent of the investors, the relationship between the investors could reflect a partial semblance of shirkah al-'aqd.

Hanafi position on mixing funds of different investors together

According to Hanafi jurists whose position is distinct on this issue, when the investor grants overall permission to the mudārib to transact using the mudārabah funds as he wishes, (lit. by saying "Do as you see fit"), the mudārib is permitted in this event to mix the mudārabah funds with his own or with the funds of another. Others have elucidated that such overall permission is necessary when such mixing is not customary in the land. If such mixing happens to be common among the people of the locality and is not objected to, the mudārib is permitted to mix even when a general permission has not proceeded from the investor.

The above only indicates that the mudārib is allowed to mix mudārabah capital with his own or with that of others,

especially when permission for the purpose had been obtained. However, it is not clear from these texts whether the mixing referred to here takes place while the capital or capitals are still in cash form, or after some of them had been turned into assets after involvement in trade. The Hanafi jurist Ibn 'Ābidīn has provided an interesting reference from the Hanafi work *al-Tātarkhāniyyah*, which indicates that mixing may take place even after the capitals had been mobilised in trade. However, this reference only mentions an instance when the investments are from the same investor. Therefore, the ruling pertaining to mixing capitals of different investors together after some of them had been involved in trade can only be inferred from this, based on the overall recognition of mixing mudārabah capital by Hanafi jurists referred to above. According to Ibn 'Ābidīn's quotation from *al-Tātarkhāniyyah*, if the mudārib arbitrarily mixes mudārabah funds with another investment from the same investor, he would be held liable only if the mixing takes place after the appearance of profit, in which event he would be liable for the capital as well as the profit share of the investor. However, if the arbitrary mixing took place before, the mudārib would not bear any liability. If the mudārib had mixed the capitals with permission from the investor to do so with regard to each, he would not bear any liability irrespective of whether the mixing took place before the appearance of profit or afterwards. This indicates that when the several investments are made by the same investor at different stages, i.e. after the previous investments had been mobilised in business, with individual permission to mix the particular investment with other funds, it is condoned by Hanafi jurists. Although specific reference is lacking, due to the mudārib being allowed by Hanafi jurists to mix funds of different investors together especially with the permission of the investors, it can be inferred from the above that mixing funds of different investors together at any stage of the business could be recognised as valid, when overall permission of the investors had been obtained for the purpose. This could provide a justification for an Islamic bank, in its capacity as mudārib, mixing funds invested by different investors through different contracts, even when some funds had already been involved in trade and given rise to profit, when the consent of the investors had been obtained for the purpose.

When funds invested by several parties with a common mudārib are mingled with the consent of the parties, or when such mingling for earning profit is upheld by custom, according to the Hanafi position, the partnership among such investors could reflect characteristics of a sharikah al-'aqd. However, as explained above, it is questionable whether the relationship could be categorised as a full-fledged shirkah al-'aqd.

It should be noted that when such mingling takes place after the previously invested capital had been involved in operations, at the capital contribution of the late coming investor, the assets of the former investors are not evaluated so as to ascertain the value of their capital. It appears that upon liquidation of the whole venture, the profits would be shared on the basis of the capital contributed by each partner at his joining the pool. Therefore, even when later joining of investors is accepted on the basis of a general permission granted by all the investors, the capital position existing at the entry of each new investor remains unverified. Moreover, since loss division in shirkah is to be done

exactly on the basis of the capitals, allocation of loss may prove problematic. Such anomaly could be a major reason for the rejection of later mixing of capitals after commencement of operations in the other schools of Law.

Based on the above, according to the position adopted by Hanafi and Māiki schools, the relationship between the investors who invest at different times could bear some resemblance to shirkah al-'aqd in some situations. As far as Shāfi'i and Hanbali schools are concerned, investments done at different occasions may not be managed together. Also important is the fact that even where the relationship among the investors bears similarities to shirkah al-'aqd, due to the absence of the right of management and mutual agency to deal in the capital of each other, it may not be construed as shirkah al-'aqd in every respect.

Conclusion

Where several parties invest with a single mudārib, such investment should take place on a single occasion, so that the tenure of mudārabah could commence with regard to all deposits at the same time. Where the mudārib accepts investments from different individuals through individual contracts, the majority of schools require that the business of each capital be managed separately. The restriction is due to fundamental anomalies that may result from mixing different capitals.

However, Hanafi jurists appear to have allowed the mudārib to mix funds of different investors together with the permission of the investors. This could indicate permission for mixing funds invested at different stages when overall permission had been obtained. Similarly, mixing mudārabah funds with funds of the mudārib could be valid according to the majority of schools with express permission of investors. Thus the Hanafi position appears to uphold the validity of mixing funds belonging to different investors who had invested at varying points of time, as practised in investment accounts.

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