

THE APPLICATION OF WA'D IN ISLAMIC BANKING CONTRACT

Syeliya Md Zaini

*International School of Entrepreneurship
Universiti Kuala Lumpur Business School, Malaysia*

Nosrah Mohd Isa

*Bank Muamalat Malaysia Berhad
Kuala Lumpur, Malaysia*

Abstract

Wa'd means a unilateral promise which connotes an expression of willingness of a person or a group of persons on a particular subject matter. In a commercial transaction, a promise has dual meaning. This is because, in a unilateral contract, the offer of the offeror is known as promise, while in a bilateral contract, the acceptance of the offeree is also known as promise. The application of promise can be seen in several Islamic transaction concepts for example in sale and purchase, murabahah, syirkah mutanaqisah, ijarah, takaful etc. The Malaysian Accounting Standards Board in its amendment to the Financial Reporting Standard i-1 2004 had mentioned about al-wa'd when defining Ijarah Muntahia Bittamleek which reads as follows: Ijarah Muntahia Bittamleek is an Ijarah contract with an undertaking by the lessor to sell the Ijarah asset to the lessee and/or an undertaking by the lessee to purchase the Ijarah asset from the lessor by, or at, the end of the Ijarah period. The sale and purchase is affected by a separate contract. 'Undertaking' is translated from the Arabic word "wa'd". It is inadmissible for the unilateral promise (wa'd) as an alternative to a proscribed contract, such as selling goods that are not in one's possession to be binding. This is because a binding unilateral promise (wa'd) is corresponding to a contract. Any views for making it binding upon both or either parties, explicitly or implicitly, by virtue of a memorandum of understanding, a central agreement, or any other circumvention, are not founded on any legitimate basis. Therefore this paper is aimed to define the concept of al-wa'd in the Islamic law with special reference to the views from the Islamic jurists. It also focuses on the concept of al-wa'd in Islamic financial

contract. Besides, the paper will also highlight the concept of Wa'd in contemporary issues and its application to the current practice.

Keywords: *Wa'd, unilateral promise, contract (aqad), Islamic Financial Institution*

Introduction

Shariah compliant financial institutions are those that do not contravene the proscribed elements in Shariah. All financial instruments and transactions in general must meet a number of criteria in order to be considered halal. At a primary level, all financial instruments and transactions must be free of at least the following five items: (i) riba (usury), (ii) rishwah (corruption), (iii) maysir (gambling), (iv) gharar (unnecessary risk) and (v) jahl (ignorance). However, there are current studies that show that the Islamic banking practices appear to depart gradually from its traditional function as a financial intermediary.¹ For example, in the case of a sale transaction, whereby the bank/seller cannot sell something which it does not own, the bank/seller is required to purchase a commodity after the bank has bought it. However, the bank will face a risk of not being able to dispose the commodity profitably and hence, suffer a financial loss.

Since the commencement of the Islamic Banking in Malaysia in 1983, the word "wa'd" has not been regularly heard in the financial industry market and in effect has rarely been used. In Malaysia, the contract of Bai al-Inah and the principle Bai Bithaman Ajil (BBA) have been widely and complaisantly used since then in Islamic banking industry. However, since early 2005, "wa'd" has been used for banking products when the Islamic Financial Institutions (IFI) introduced banking products which were similar to the Gulf Cooperation Council (GCC) countries' financial products. In fact, the Islamic Financial Services Board (IFSB) has introduced some risk standards on Islamic banking contracts for example Murabahah for Purchase Orderer and Ijarah Muntahiah Biltamleek. The Central Bank of Malaysia (BNM) has also issued a Capital Adequacy Framework for Islamic banks in respect of risk mitigation in Islamic banking products. Thus, the usage of wa'd is appropriate to address and mitigate the risk issues in Islamic banking products in order to show the parties' commitment to perform their contract as mutually attended completely. Most importantly, its ultimate purpose is to ensure continuous Shariah compliancy in every stage of the transaction.

Definition and Concept of Wa'd

Literally, *wa'd* means notification of good or bad news; although *wa'd* is commonly used to give good news, while *wa'id* is to warn about the bad ones. *Muwa'dah* involves two parties exchanging their respective news. Technically, *wa'd* refers to an information leading to good news in the future.

According to Islamic laws, Wa'd means promise. It is a promise which connotes an expression of voluntarily of a person or a group of persons on a particular subject matter.

It is so interrelated with put option and call option but has been inserted with the element of Syara' and it has very much been debated lately. The application of promise can be seen in several Islamic transaction concepts such as sale and purchase, murabahah, ijarah and etc. According to the Malaysian Accounting Standard Board (MASB) in its amendment to the Financial Reporting Standard i-1 2004, wa'd was mentioned when defining Ijarah Muntahiya Bitthamleek which reads as follows:

"Ijarah Muntahia Bitthamleek is an Ijarah contract with an undertaking by the lessor to sell the Ijarah asset to the lessee and/or an undertaking by the lessee to purchase the Ijarah asset from the lessor by, or at, the end of the Ijarah period. The sale and purchase is affected by a separate contract. 'Undertaking' is translated from the Arabic word 'wa'd'".

Looking at the above explanation, it shows that the promise or wa'd has no specific definition of its own. It can be explained as a commitment made by a party to undertake a certain actual or verbal disposal beneficial to the second party or a verbal proposition made by someone to undertake something to the benefit of another person. The difference between wa'd and contract is that contract is legally binding upon the contractual party once it fulfils all the contract requirements needed, while wa'd is an obvious initiation and depends on the acceptance of its applicability. In the traditional concept, wa'd is unilateral in nature, and binds the maker only. As an example, Yussof makes a promise to sell his car to Wahab for RM80,000. This promise is unilateral in nature and does not bind Wahab to accept the offer. It will be binding upon both parties after a sale contract is concluded.

As for the general principle, the scholars are in agreement when promise must be fulfilled for religious reasons only and it is a question of morality. This is because wa'd is part of a voluntarily contract (aqd tabarru'at). Therefore, the judge has no way of such enforcement, because the second party has nothing more than a moral right.

Comparison of Wa'd, Wa'dan, Muwa'dah and Akad (Contract)

In discussing the comparison among the three (3), their basic definition is as follows:²

1. Wa'd: as mentioned earlier, is a unilateral promise which binds the promisor to do certain acts for the promise in future for example, promise to buy or promise to purchase.
2. Wa'dan: means two (2) unilateral promises of one party to another party, or verse versa and the two (2) promises are unrelated to each other and the enforcement depends on two (2) separate conditions.
3. Muwa'dah: means bilateral promise between two (2) parties. It can be conditional promise or unconditional promise. Example of the unconditional Muwa'dah is Abu promises to sell a car to Ali at a certain time and Ali also promises to buy the car from Ali at the same time. The conditional promise happens when Ali promises to buy the car from Abu upon occurrence of a situation and Abu promises to sell the car to Ali upon the occurrence of such situation.

4. Akad (Contract): means a declaration of offer and acceptance made at the same time. A contract in Islamic law consists of an agreement between two (2) or more parties and the basic elements are similar to those of the English common law.³

Wa'd

Generally, traditional jurists have different opinions whether the wa'd is binding or otherwise. However, majority of the jurists opined that fulfilling a promise is recommended and it is not binding and enforceable in law. Looking at the temporary scholars' views, they have reached the consensus that wa'd is enforceable by law until and unless the promisor is not in position to fulfil it in account of any force majeure. If non fulfilment is due to any wilful act of the promisor, he has to make good the loss to the promisee. For example, A promises to sell a house next month to B for RM100,000.00, but subsequently he sells the house to C before the month elapses. A would be liable to make up for any loss incurred by B, since B might have made arrangements to lease the house or to sell it or use it for accommodation for B's staff and thus incurred costs.⁴

Wa'dan

There is no wide discussion on the application of wa'dan. However, the application has been used in Islamic structured products by Deutsche Bank (DB).⁵ The structured product can be illustrated as per the diagram below:

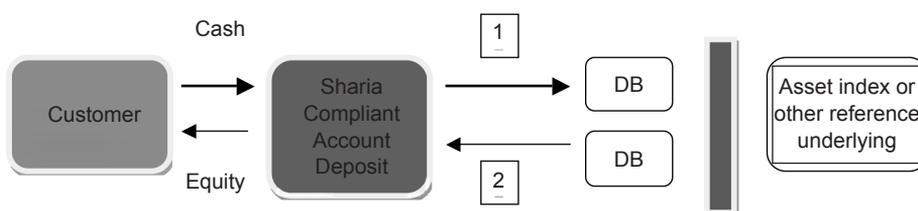


Illustration:

1. The Customer shall give al-wa'd bi al-bay' (promise to sell) to DB to sell the Shariah compliant deposit securities at a certain price, say "x price", in the event the securities' price is higher than the x price.
2. At the same time, DB shall give al-wa'd bi al-shira (promise to purchase) to the Customer to purchase the securities at the x price, in the event the securities' price is lower than the x price.

At the day of transaction, the following two scenarios will happen:

1. If the market price of the securities is higher than the x price, the Customer will not be keen to sell the securities at the x price. However, due to the al-wa'd bi al-bay' (promise to sell) by the Customer, DB will request the Customer honours his promise.

2. If the market price of the securities is lower than the x price, the DB will not be keen to purchase the securities at the x price. However, due to the al-wa'd bi al-sira' (promise to purchase) by the Customer, the Customer will request DB to honour its promise.

In these scenarios, there will be sale and purchase of the securities at the x price.⁶

Al-Muwa'dah

As defined earlier, al-Muwa'dah is a bilateral contract, whereby a person promises to sell and the other person promises to buy. Jurists are of the view that al-Muwa'dah is allowed so long as it is not binding to each other. If it is binding, then it does not differ from a contract. The discussion on binding al-Muwa'dah was discussed in Majma' al-Fiqh al-Islami three times.⁷ Two resolutions approved the application of al-Muwa'dah. One of the resolutions is as follows:

“Al-Muwa'dah is allowed in Murabahah transaction provided that khiyar is allowed to both parties who have given Muwa'dah. Khiyar can be given to only one or both parties. If khiyar is not given, hence al-Muwa'dah is not allowed as the application of al Muwa'dah without khiyar in Murabahah is similar to a buy and sale transaction, where as the seller must own the asset that he wants to sell in order to follow the Rasulullah (s.a.w.)'s hadith which disallows a person to sell something he does not own”.

Contract (Aqad)

Contracts are drawn to ensure the existence of clearly recognised guidelines for all parties involved. The essential elements of a contract are as follows:

- i. Offer and Acceptance. An offer is a proposal to make a deal whereas the acceptance is the acknowledgement made by the person to whom the offer is made to and the offer is accepted.
- ii. Subject Matter. The conditions of the subject matter of the contract are the object must be lawful and permissible. It must be in existence and legally owned by the party of the contract. It must be deliverable and known to the parties (determination).
- iii. Consideration. The consideration in the Islamic contract may consist of money, goods and services. It must be something which is capable of being given and in the case of service, should be capable of being performed.
- iv. Capacity of the Parties to Contract. The parties entering into a contract must be competent to enter into a contract.
- v. Islamic law does not enforce contracts of illegal activities and which are not permissible under Shariah.

The Legal Status of Wa'd from the Perspectives of Shariah

If the promisor takes an oath to convince the promisee to act upon his promise, the promisor in the later case will not only be subjected to Allah's condemnation but also a

fine or compensation (kaffarah) to relieve him from his false oath.⁸ The Islamic jurists have unanimously agreed that when a person promises something without any intention of fulfilling his promise, such act is not permissible (haram) because the promisor will be deemed to be a liar and a pretentious (munafiq) person who is seriously condemned by the religion.

Indeed, the Islamic jurists have different views with regards to the liability imposed on the parties of the promise as follows:

View 1: Fulfilling a promise is recommended (mandub), not obligatory; otherwise the promisor will be condemned (makruh).

- As for the general principle, promise must be fulfilled for religious reasons only and it is a question of morality.
- The Shafi'i, Hanbali and Zahiri schools recommend the fulfilment of a promise, even if it is subjected to certain conditions.
- According to al-Zarqa, a promise does not initially bind the person who makes it (promisor), and it does not give any right to the promisee.

View 2: Fulfilling a promise is obligatory by religion because in the context of divine sin and reward, fulfilling a promise is a must. If a promise is not fulfilled, the promisor is deemed to be sinful. However, its non-fulfilment will not be enforced by the court.

- The majority scholars from Hanafi, Shafi'i and Hanbali Schools, and a few from the Maliki School opined that a promise is religiously binding but not a legal duty. This is because wa'd is part of a voluntarily contract. Therefore, the judge has no way of such enforcement, because the second party has nothing more than a moral right.
- Imam Nawawi said when a person promises (provided it is not illegal) he should fulfil his promise.
- Al-Qarafi views a promise as not binding at all.

View 3: Fulfilling a promise is obligatory by religion and can be enforceable by the court.

- The promise is absolutely binding. Ibn Al-Arabi is among the proponents of this view, stating that the promise must be fulfilled by all means unless in certain exceptional situations in which its fulfilment is impossible.
- Quoted by Ibn Shubramah, the fulfilment of a promise is compulsory. He said '*Every concluded promise which does not allow prohibited things, and does not prohibit permissible things, is binding legally and religiously*'.

View 4: In a specific case where a promise is subjected to certain conditions, its fulfilment is obligatory and enforceable although the promisor has not acted upon the promise yet.

- This ruling is affirmed by the Hanafi School which distinguished between absolute promise and conditional promise. The latter becomes binding in the contract of exchange to avoid gharar (unknown element) in the subject matter of promise. This rule is very similar to the concept of guarantee established by the kafalah contract.

View 5: In the similar instance where a promise is subjected to conditions, the promisor is obliged to fulfil it and can be enforced by the court only if the promisee has indeed acted based on the promise. Thus, non-fulfilment of such a promise will cause a loss to the promisee.

- According to Ibn Al-Arabi, the Maliki School viewed that if the promise results in a particular consequence, then its fulfilment is obligatory; but if it is a promise per se without any consequential effect, fulfilling it is not made obligatory.
- The enforceability of a binding promise judicially can be upheld if it entails to the performance of promise in reliance to the promise. As such, fulfilling the promise is obligatory, or the promise will suffer loss or difficulties as a result of the non-fulfilment. This is the preferred opinion in the Maliki School which was expounded by Malik, Ibn Al-Qasim and Sahnun.

Those who view fulfilling a promise as binding and enforceable rely on the authorities and the hadith describes a person who does not fulfil his promise as a munafiq or pretentious, who is sinful and his honesty is questionable and cannot be relied upon. As such, fulfilling a promise is compulsory. Otherwise the promisor is deemed to be a dishonest and untrustworthy person.

On the other hand, there is no strong justification for those who disagree with the former view, despite being the common opinion. In fact, they are more inclined to unanimously rule that the fulfilment of a promise is merely recommended, not obligatory. Al-Qarafi stated some justifications as follows:

- a. Reported by Zaid bin Arqam (r.a) that the Prophet (s.a.w.) said; "If you promised something to your brother with an intention to fulfil it; then the thing promised is not brought forward (promise is not fulfilled), so it is not held responsible (onto you)."⁹
- b. The other justification is that a promise (wa'd) is like a gift (hibah) which is not binding on its promisor except after delivery has taken place.

As for the *Islamic Fiqh Academy* (generally accepted view), fulfilling a promise is accepted if the following conditions take place:

- a. The promise should be unilateral (one-sided)
- b. The promise incurs a loss or expense in an effort to meet the promise
- c. The actual sale is completed.

Contemporary Ifta' and Ijtihad on the Legality of Wa'd

Contemporary jurists have been posed with many issues in financial products which require them to exercise ijtihad and new ruling (ifta') due to that. Some of the significant rulings are as follows:

- a. A fatwa relating to Murabahah sale to purchase orderer (by Sheikh Badr Al-Mutawalli Abdul Basit, Shariah Advisor of Kuwait Finance House, 1979) similar to Ibn Shubrimah's opinion, 'every unilateral promise that neither permits an unlawful

thing nor prohibits a lawful thing is deemed to be a binding promise judicially and by religion'. This opinion appears to benefit the parties involved and makes the transaction well-governed.

- b. The legality of Wa'd in Murabahah sale to purchase orderer, which contains a unilateral promise (wa'd) from the customer to buy the goods according to an agreed term; and also a promise from the bank to sell the goods based on the agreed conditions. Each promise is judicially binding on both parties according to the Maliki School; while other schools view such a promise as binding by religion. Fulfilling such promise may become judicially obligatory in the event of necessity, for example, if the non-fulfilment of the promise entails difficulties or losses to the promisee.
- c. Promise to sell is permissible provided that the goods that have been pledged are owned by those who made the promise (Sheikh Abdul Aziz bin Baz, Mufti of Saudi Arabia).
- d. The legality of a bilateral promise (muwa'dah) sale to purchase orderer must be as follows:¹⁰
 - The bank owns the goods
 - The goods are in the bank's possession
 - The bank sells the goods to the purchase orderer with an agreed specification of profit
 - The bank must bear the ownership risk until the goods are delivered
 - The bank must accept the redelivery if there is hidden defect in the goods.

Thus, the unilateral promise becomes binding to the promisor. This safeguards the transaction and protect the interest of both the bank and the customer.

- e. The Council of the Islamic Fiqh Academy in resolution no. 40-41¹¹ resolved the permissibility of promise on goods already in the physical possession of the seller, provided he carries the risk of loss before delivery or consequences of returned goods because of concealed defects or other reasons justifying the return. In this situation, a promise (wa'd) which is made unilaterally by the purchase orderer or the seller is morally binding on the promisor, unless there is a valid excuse. It becomes legally binding if:
 - It is made conditional upon the fulfilment of an obligation, and
 - The promise has already incurred expenses on the basis of such a promise.

Therefore, when a promise has the binding effect, it means that such a promise must be fulfilled. Otherwise, a compensation must be paid for the damages caused due to the unjustifiable non-fulfilling of the promise.

The Benefits of Wa'd in Islamic Finance Institutions

Commonly, a binding unilateral promise has been applied in many Islamic banking products which are based on sale (bay), lease (ijarah) and partnership (shirkah) contracts. The promise or wa'd in this context performs the following functions:

a. Parties' Commitment

Wa'd to show *parties' commitment* to complete the transaction according to their ultimate intention. For example, in Murabahah sale to purchase orderer, the customer will give his undertaking to purchase the asset which he requested the bank to purchase. To ensure the fulfilment of such promise, the bank usually asks for a security deposit or hamish al-jiddyiah. If the customer does not fulfil his promise, i.e. cancels the purchase, the deposit will turn as a remedy to any loss suffered by the bank.

b. As an alternative to put option and call option.

Wa'd as an *alternative to put option and call option*. In Islamic financing documents, the wa'd concept is applied in a supplementary document to the master agreement, or is commonly known as purchase undertaking (an alternative to put option). There is also a sale undertaking¹² (or called option) by the bank although it is rarely used in Islamic banking transactions. For example, in Al-Ijarah Thumma al-bay' (AITAB), the customer undertakes to purchase the asset at the end of the Ijarah (leasing) term for an agreed nominal price.

c. Risk Mitigation

Wa'd as a *risk mitigation* technique in the event of default or total loss. A binding promise becomes necessary to manage and mitigate a bank's risk in the event of customer's default or total loss of the asset. For example, a customer promises to allow the bank to restructure the facility in the event of a 'major' default. Similarly, consecutive defaults in AITAB will entail repossession and then sale of asset in the public auction. In order to prevent a bank from facing losses, a customer's promise becomes necessary, i.e. he undertakes to:

- Pay any incidental costs of repossession;
- Pay the indebtedness if upon deducting the proceeds from the auction, the customer remains indebted.

Besides the stated above said points, wa'd is also widely adopted in the Islamic capital market products as a tool for liquidity payment, as an exit mechanism i.e. to redeem a Sukuk at maturity, and also for risk management and hedging purposes.

The Application of Wa'd in Islamic Banking Products

Sale Contract of Murabahah Sale by Purchase Orderer

Murabahah is selling a commodity with a defined and agreed profit mark-up. In addition to the ordinary Murabahah, this transaction is concluded with a customer's promise to purchase the item from the institution. It is different from the ordinary type of Murabahah in the sense that the latter does not include such promise. It is called a "banking Murabahah" or Murabahah to the purchase orderer which is usually offered by the institution in the form of a Murabahah credit facility.

This transaction involves a sale of an item by the institution to a customer (the purchase order) for a pre-agreed selling price which includes a pre-agreed profit mark-up over its

cost price. These matters are specified in the customer's promise to purchase. Indeed, Murabahah is one of the trust-based contracts (Bay' Al-Amanah) that depend on the transparency in relation to the actual purchase price or cost price, in addition to the general expenses. This type of Murabahah is also known as Murabahah to the Purchase orderer without an obligation.¹³ At this point, the concept of promise has been developed on *murabahah* financing mode in order to achieve stability in this particular financial transaction. The shariah feature of this transaction requires the bank to buy and own the commodity whether directly or through the agent; the ownership of the commodity puts the whole business transaction in substantial risk in case of the withdrawal of the buyer. The initial transaction is based on the request of the client who wants to engage in such a transaction to secure the commodity to his interest. If the client is not bound to purchase the commodity after the engagement of the bank into this business transaction by buying the subject matter of the contract from the supplier, the bank will face a huge loss, and the bridge of the contract will affect the stability of the business transaction in the market. In order to overcome this issue and avoid a dispute, the agreement should be bound to both parties, and the promise to purchase the commodity from the financier must be compulsory by signing the promise to purchase. The nature of this engagement from the client is based on a one-sided promise; however, the fulfilling of the promise can be enforced by the shariah base on the legal shariah's opinion which allows the promise to be compulsory. From the Islamic point of view, it is highly appreciated for the promise to be fulfilled though it is not mandatory in the business transaction in general, but in some cases it has to be mandatory depending on the nature of the transaction especially if that particular transaction may cause serious business damages and a huge loss. Below is the illustration of the Murabahah sale to purchase orderer.

Item 2/1/3 of the AAOIFI's Shariah Standards (2008) provides a guideline on the enforcement of customer's promise:

'The customer's wish to acquire the item does not constitute a promise or commitment except when it has been expressed in due form. It is permissible for

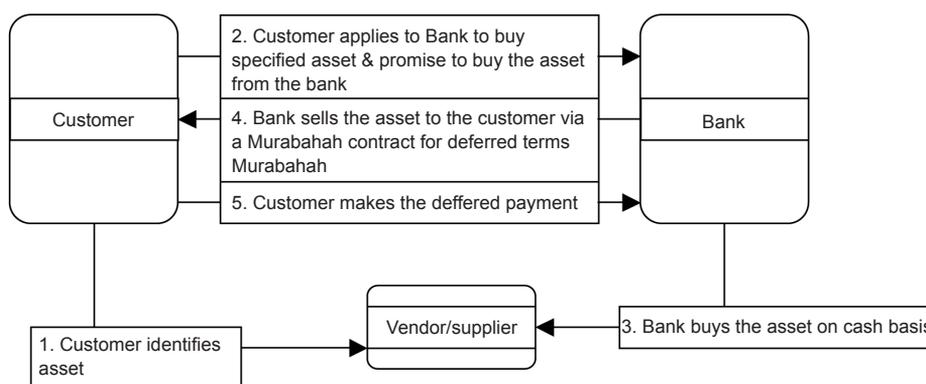


Figure 2: Operation of Murabahah Sale to Purchase Orderer
 Source: CIFP, INCEIF, Shariah Rules in Islamic Finance

the customer to prepare such a document, or it may be a standard application form prepared by the institution to be signed by the customer.'

This above guideline requires the customer's undertaking to be put in a standard document or form which may be provided by the institution.¹⁴ Such a document shall expressly state the customer's wish that the institution should buy a particular asset from a supplier and his promise to buy the asset from the institution. However, to ensure the validity of the whole transaction, this document of promise must examine the following rules:

- a. There is no bilateral promise included that is binding both the institution and customer in the document of promise to buy which is signed by the customer.¹⁵
- b. The customer's promise to purchase and other related undertakings are not integral to the Murabahah transaction. These are merely intended to provide an assurance that the customer will purchase the commodity after it has been acquired by the institution.¹⁶
- c. A bilateral promise between the institution and the customer is permissible only if there is an option to cancel the promise which may be exercised by any of the parties.¹⁷
- d. Both parties shall mutually agree to revise the terms of the promise in respect of the deferment of the payment, the mark-up etc. at any time before the execution of the Murabahah transaction.¹⁸

The IFI's response to the customer's application to buy an asset from a supplier is permissible because such an application or demand does not strictly bind the institution's acquisition. In fact, the institution may acquire the asset from any other supplier provided the asset meets the customer's specification and fits the desired purpose. Opposing this, due to the promise, the customer may be forced to fulfil his promise on the basis of divine requirement imposed by the Quran and the Sunnah.

Furthermore, Shariah prohibits bilateral promise in this type of transaction because it will amount to a conditional contract to the main Murabahah contract.¹⁹ On the other hand, the amendment of terms in the promise is allowed because a promise is not a contract. Hence, any amendment to the profit margin and the duration will not amount to rescheduling of debt which is also prohibited by the Shariah.²⁰

Wa'd in Ijarah Contract (Ijarah Muntahiyyah Bitthamlik)

Another form of Ijarah used by the Islamic financial institutions is Ijarah Muntahiyyah Bitthamlik. It is a promise made by the lessor to transfer the ownership in the leased property to the lessee. A lease which ends with ownership can be in the form of the following:

- a. A lease contract that enables the lessee to benefit from the leased property against a specific rental payment for a specific term, and coupled with a promise from the owner to sell the property at the end of the lease period, at an agreed price by both parties.

- b. A lease contract that is similar to the above and supplemented with a promise to purchase by the lessee in order to become the owner at the end of the contract.
- c. A lease contract that ends by offering the property as a gift (hibah) to the lessee. The latter contract becomes effective at the end of the lease period whereby the lessor promises to give the property as a gift to the lessee after the lease period expires and full payment of rentals is paid.
- d. A lease contract which upon its expiration gives an option to the lessee to own the property at any time he wishes.

From the four types of leasing contracts, the first three forms of lease ending with ownership apply wa'd or undertaking, either by the owner to sell the property at the end of the lease period. The shariah standards No. 9 (9), paragraph 8/1 confirms these methods of transferring ownership in the leased property. A separate document from the Ijarah contract must evidence the transfer by utilising any of the following options:

- a. A promise to sell for a token or other consideration, or by accelerating the payment of the remaining amount of rental, or paying the market value of the leased property.
- b. A promise to give it as a gift without any consideration
- c. A promise to give it as a gift, contingent upon the payment of the remaining instalments.

The ownership transfer document which consists of any of the above promise should be independent and cannot be an essential part of the Ijarah contract.

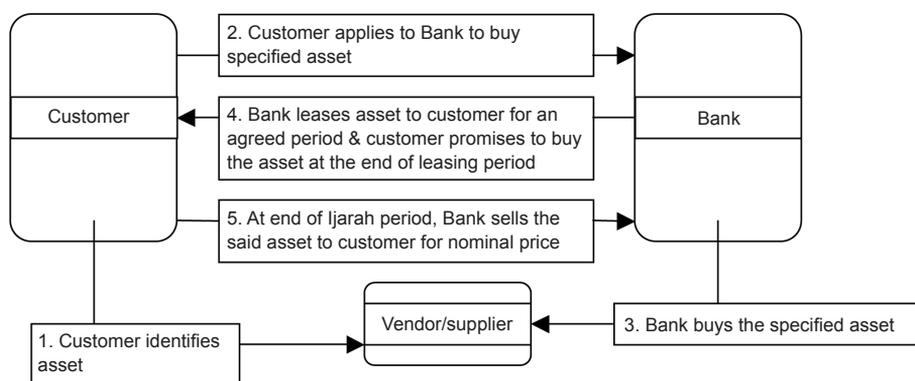


Figure 3: Operation of Ijarah Muntahiyah Bitthamlik

Source: CIFP, INCEIF Shariah Rules in Islamic Finance

It emphasises that the above promise is treated as a binding promise on the promissory only, while the other party (promisee) must have the option of not proceeding (Paragraph 8/2, Shari'ah Standards). This is to avoid a bilateral promise which leads to a formation of contract prior to the actual contract or known as conditional contract. Conditional contract is clearly prohibited in Shariah.

However, the institution is allowed to demand payment of money from the lessee because of a need to confirm the commitment of the promisor. A binding promise undoubtedly has financial implications if the promisor breaches the promise. Thus, payment of a commitment fee²¹ is required to cater for the financial loss that may be suffered by the institution as a result of a breach of the promise. Quoted from the Shariah Standards No. 9, paragraph 2/3, 'It is permissible for the institution to require the lease promissory (i.e. customer) to pay a sum of money to the institution to guarantee the customer's commitment in accepting the lease on the asset and the subsequent obligations.' The standard is also parallel to the Bank Negara Malaysia draft of Shariah parameter in Ijarah Contract (SPR2) paragraph 99. In addition, the Bank Negara Shariah Parameters make a provision whereby 'in a situation where there is no breach of promise, the security deposit may be used to set-off part of the rental payment of the leased asset' (SPR2, paragraph 101).

Wa'd in Shirkah Contract (Diminishing Partnership) Musyarakah Mutanaqisah

Diminishing partnership is one type of partnership contract in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him/her.²² This transaction requires a formation of a partnership contract, followed by a gradual transfer of equity share between the partners. The transfer of ownership must be evidenced in a separate document that is independent from the partnership contract.

If the transfer is made through a sale contract, then the partner who wishes to buy the other partner's share must give an undertaking or promise to buy, in any manner and agreed between them. But such promise must be independent from the main agreement (partnership contract), because a contract can be a condition for concluding the other contract.

Similarly, the partner is allowed to give a binding promise that entitles the other partner to acquire his equity share gradually on the basis of a sale contract based on the market value or price agreed at the time of acquisition (Shariah Standards No. 12, paragraph 5/7).

The transfer of ownership is made gradually on the principle of Ijarah Muntahiyah Bitthamlik (lease end with ownership). There are two contracts to be concluded between the partners (bank and customer) as follows:

- a. Firstly, partnership contract where the customer enters under the concept called the 'shirkat al-milk' (joint ownership) agreement with the bank. In this arrangement, the customer will pay for example 20% as the initial share to co-own the house whilst the bank provides the balance of 80%. The customer will then gradually redeem the bank's share at an agreed portion until the property is fully owned by the customer.
- b. Secondly, the bank leases its share in the property to the customer under the principle of Ijarah in consideration of the rental payment. The customer's share ratio would increase after each rental payment due to the periodic redemption built into the monthly instalment. Eventually the customer will fully own the house.

According to Dr. Osman Syabir, the parties to Shirkah Mutanaqisah are obliged to the obligation pertaining to the sale and purchase company because he is of the opinion that the wa'd elements in share transaction automatically confers obligation of the parties to the promise.

The structure of Musyarakah Mutanaqisah is illustrated in Figure 4.

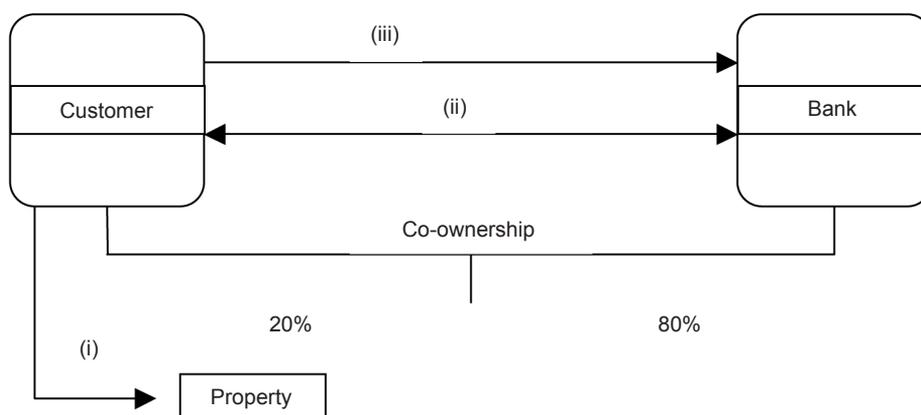


Figure 4: Operation of Musyarakah Mutanaqisah
Source adopted: Musharakah Mutanaqisah as an Islamic
Financing Alternative to BBA by Noreeta Mohd Nor,
Azmi & Associates

- i. The customer identifies the property, with 20% of the purchase price being paid by the customer and 80% by the bank. The customer and the bank therefore own 20% and 80% of the property respectively.
- ii. The customer uses the property as a residence and pays rent to the bank for the use of his share of the property.
- iii. The bank's share of the property is divided into 20 units of 4% each and the customer promises to buy one unit at the end of each year for the next 20 years – at the end of which the customer fully owns the property and the rent is reduced in proportion to the units bought by the customer.

The Concept of Promise from Conventional Perspective

A promise can be described as an assurance that one will or will not undertake a certain action. It is a type of communication usable in everyday life either in formal or informal events. Promise can be made through legal documentation or merely as an ordinary conversation.²³ Promise should be binding but the law only enforces certain types of promise essentially those which involve some form of exchange. A promise in which nothing is given in return is known as a gratuitous promise. This type of promise is not

usually enforceable under the law. Additionally, contract law rarely forces a party to fulfil contractual promises but what it does is to compensate innocent parties who might suffer as a result of the breach of promise.²⁴

In fact, a contract is formed by promises when both parties give their proposals and the other accepts it in the same contractual setting. Section 2 of the Contracts Act 1950 provides the following:

“When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted; a proposal, when accepted, becomes a promise”.

A promise is made when the contracting parties provide their considerations when making a contract. Breach of promise in a contract means that the promisor does not perform his obligation as promised to the other party. If such an event occurs, the other contracting party has the right to end the contract (Section 40, Contract Act 1950). In addition to that, any promise contained in a contract must be performed by the promisor. But in other cases, a promisor may also employ a competent person to perform the promise. But, if the promise is breached under certain circumstances, only the contracting party i.e. the promisor and the promisee can sue or be sued. The promise between the promisee and the third party is not enforceable in the court of law. As stated in Section 42 of the Contracts Act 1950:

“When a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor”.

Therefore, if one party violates the promise in a contract, this contract is enforceable in the court of law in order to protect the interest of the innocent party, unless the innocent party gives his consent to continue with the contract.

In other words, a promise is made to someone; it gives the promisee a right to expect, to call for its performance; and so by implication a promise, to be complete, to count as a promise, and must in some sense be taken up by its beneficiary. If a promise is made to someone, and if he or she fails to keep his or her promise, it is fair that he or she should be made to hand over the equivalent of the promised performance. A promise is something basically communicated to someone – to the promisee in the standard case. A promise is relational; it invokes trust, and so its communication is essential. Although, this might seem a bit of a general way of identification as to the requirement that the promise benefits the promisee, however, it fails to bring out some promises that may propose a benefit to the promisee that the promisee does not want, or does not want from this promisor.

The Issue of Wa'd in the Islamic Financial Institution

Most of the jurists believe that wa'd is binding religiously but not legally since it is a voluntary act. A person who does not fulfil a promise is literally categorised as a hypocrite as it had been described in one of the hadiths of the Prophet s.a.w., and therefore a Muslim who makes a promise of any kind to another person must fulfil the promise even though

it is of a moral obligation and by proving to the other party how trustworthy the promisor is. According to the fatwa of Imam Malik narrated by Ibn Arafah, Wa'd is not binding on any person for a specific item or purpose at present but on what will be in the future.

One of the financial transactions that has links with wa'd is the Wa'd SWAP. It is the promise agreement with which returns from one basket of assets are swapped with returns from another. This mechanism is used to give Shariah compliant investors exposure to returns from haram, or non-shariah compliant assets. However, Shaykh Yusuf Talal DeLorenzo is against this mechanism and its usage in the investment portfolio. This is because wa'd swap uses a LIBOR benchmark which is inappropriate and it has nothing to do with the Muslim investors in LIBOR but it is of concern to the London banks. He further argues that if an investor swaps returns of one basket of performing assets for another, then he or she must insist that the assets in both baskets are halal so as to receive halal returns.

Furthermore, the Muslim jurists have allowed unilateral promises to be enforceable based on the principle that "the promise can be made enforceable at a time of need". Therefore, if the sale is without any condition, but one of the two parties has promised to do something separately, then the sale cannot be held to be contingent or conditional upon fulfilling of the promise. A sale will take effect irrespective of whether or not the promisor fulfils his promise.

In the 22nd meeting of Islamic Banking and Takaful Department, it was resolved that *When Issue* transaction in Islamic securities market is permissible based on the permissibility of promise to sale and promise to buy.

Another issue raised by Rafiq Yunus Al-Masri (2002) is the decision made by the Islamic Fiqh Academy where the decision prohibited the unilateral promise (wa'd) to be binding on both parties but allowed it to be so on one of them. This arbitrariness does not make sense. To his opinion, one should treat the unilateral promise (wa'd) as either binding on both parties or optional for both parties. Making it binding upon one to the exclusion of the other is illogical, unacceptable, and denotes a misinterpretation of some jurisprudential texts, such as *Al-Um* by Imam Al-Shafi'i.

Besides that, he believes that a plain unilateral promise (wa'd) and a bilateral promise (muwa'da) are one and the same thing in that in the unilateral promise (wa'd), a man could not be said to be promising himself, since in both cases two parties are involved; the party making and the party accepting the offer.

Quoted from an article by Deutsche Bank, "Pioneering Innovative Sharia-compliant solutions" there are few shariah related issues that need to be resolved pertaining to Wa'd arrangements such as promises and contracts in Shariah, the permissibility of compensation for failure to fulfil a promise and the validity of promising to sell an asset at a price other than the market price and which is not known at the time of the promise, and the validity of benchmarking.

Conclusion

When exercising *ijtihad* in permitting the application of *wa'd*, contemporary jurists observed it as a necessity for the interest of the contracting parties. According to them, *wa'd* should not be rigidly construed in its limited application. Instead, *wa'd* can become an innovative tool in structuring many forward contracts which require flexibility with full commitment of the parties involved without jeopardising the basic principles and *maqasid* Al-Shari'ah. It is a unanimously-accepted principle that fulfilling a promise is a must for an ethical and religious reason. An absolute promise which is not subjected to a particular reason and neither affects to a loss to the other party, is not legally binding. However, the promisor will be labelled as a liar, thus, sinful in the eye of Allah. On the other hand, conditional promise becomes binding and enforceable because it may affect the other party's interest who may suffer loss if the promise is not fulfilled. A promise to buy goods that the promisor initially ordered from the promisee becomes binding and enforceable in avoidance of *gharar* (unknown element) in the subject matter of promise. In the actual application of promise in Islamic banking products, *Wa'd* is commonly used to show the parties' commitment to complete the contract. Its application and enforcement is somehow subjected to certain guidelines, which include: the promise and other related undertakings are not integral to the main contract; the promise should not include a bilateral promise that is binding on both parties; a bilateral promise is deemed to be permissible only if there is an option to cancel the promise which may be exercised by any of the parties. It is prohibited for the unilateral promise (*wa'd*) as an alternative to an illegal contract, such as selling goods that are not in one's possession to be binding. This is because a binding unilateral promise (*wa'd*) is corresponding to a contract. Any views for making it binding upon both or either parties, explicitly or implicitly, by virtue of a memorandum of understanding, a central agreement, or any other circumvention, are not founded on any legitimate basis.

Notes

- ¹ Nurdianawati Irwani Abdullah (2008), The status of promise (*Wa'd*) and its implication in contemporary Islamic banking.
- ² Pengertian Al-Wa'd, Al-Wa'dan and Al-Mua'adah – Aznan Hassan, Muzakarah Cendekiawan Syariah Nusantara 2008.
- ³ "Islamic Banking – A Practical Perspective" – Kamil Khir et al., page 43.
- ⁴ "Understanding Islamic Finance" – Muhammad Ayub, page 114.
- ⁵ Pengertian Al-Wa'd, Al-Wa'dan and Al-Mua'adah – Aznan Hassan, Muzakarah Cendekiawan Syariah Nusantara 2008.
- ⁶ Deutsche Bank Academic Paper, page 2.
- ⁷ Pengertian Al-Wa'd, Al-Wa'dan and Al-Mua'adah – Aznan Hassan, Muzakarah Cendekiawan Syariah Nusantara 2008.
- ⁸ See Al-Baqarah: 225. Shariah Rules in Financial Transaction, CIFP, INCEIF, 2009.

- ⁹ Sunan Abi Dawud; 268/5. Hadith no. 499, “The Status of promise (Wa’d) and its Implication in Cotemporary, Islamic Banking, Isra Islamic Finance Seminar, 2008.
- ¹⁰ 2nd Conference of Islamic Banking in Kuwait, 1983.
- ¹¹ Resolution of the securities Commission Shariah Advisory Council, adopted from Nurdianawati Irwani Abdullah, ISRA Islamic Finance Seminar (2008).
- ¹² Sale undertaking normally use in the Sukuk market to ensure that the Sukuk holders sell the asset to the obligor at maturity.
- ¹³ Murabahah, Shariah rules in financial transactions, CIFP, AHCene Lahsasna.
- ¹⁴ See Shariah parameters (SPR1) Murabahah, paragraph 72.
- ¹⁵ Item 2/3/1 of the Shariah Standards No. (8), 2008.
- ¹⁶ Item 2/3/2 of the Shariah Standards No. (8), 2008.
- ¹⁷ Item 2/3/3 of the Shariah Standards No. (8), 2008.
- ¹⁸ Item 2/3/4 of the Shariah Standards No. (8), 2008.
- ¹⁹ International Fiqh Academy, resolution No. 41 (3/5).
- ²⁰ Shariah Standards No. (8), 2008.
- ²¹ In Murabahah, commitment fee is known as Hamish Jiddiyah (i.e. security deposit).
- ²² Shariah Standards No. 12, item 5/1, 2008.
- ²³ Contract Act, 1950, section 9.
- ²⁴ Contract Act, 1950.

Bibliography

- Aznan Hasan (2008). “Pengertian Al-Wa’d, Al-Wa’dan dan Al-Muwa’dah, *Muzakarah Cendekiawan Syariah Nusantara*.
- BNM/RH/GL/012-2, Islamic Banking and Takaful Department, Resolutions of Shariah Advisory Council of Bank Negara Malaysia.
- Burhanuddin Lukman (2008). “Penggunaan Wa’d Dalam Kontrak Buyu’, Ijarah dan Syirkah: Adakah Aplikasi Wa’d Boleh Menjejaskan Kontrak Kewangan”, *Muzakarah Cendekiawan Syariah Nusantara*.
- Deutsche Bank Academic Paper, Pioneering Innovative Shari’a Compliant Solutions, available at http://www.db.com/presse/en/downloadWhite_paper.pdf
- Firoozye, Nikan (2009). “Wa’d and the completeness of Islamic Markets”, *Opalesque Islamic Finance Intelligence*, Issue 3.
- Islamic Fiqh Academy (1409H). *Majjalat Al-Majma’*, The Academy, Volume V, Part II, Jeddah.

- Jasani Abdullah and Munawwaruzzaman Mahmud (2008). "Penggunaan Wa'd Dalam Kontrak Buyu', Ijarah Dan Syirkah Dari Perspektif Industri, *Muzakarah Cendekiawan Syariah Nusantara*.
- Kamal Khir, Lokesh Gupta and Bala Shanmugam (2008). *Islamic Banking A practical Perspective*, Longman.
- Lahsasna (2009). *Ahcene Shariah Rules in Financial Transactions*, CIFP, INCEIF.
- Muhammad Ayub (2007). *Understanding Islamic Finance*, Wiley Finance.
- Noreeta M.N., Azmi & Associates (2008). *Musharakah Mutanaqisah as an Islamic Financing Alternative to BBA*, MIF Monthly, September 2008 available at www.mifmonthly.com
- Nurdianawati Irwani Abdullah (2008). "The Status of Promise (Wa'd) and its Implication in Contemporary Islamic Banking", *ISRA Islamic Finance Seminar*.
- Resolution numbers 2 and 3 of the Fifth Conference of the Islamic Fiqh Academy (Kuwait), as cited in Deutsche Bank Academic Paper, *Pioneering. Innovative Shari'a Compliant Solutions*, available at http://www.db.com/presse/en.download/White_Paper.pdf
- Saiful Azhar Rosly (2005). *Islamic Banking and Financial Markers*, Dinamas.
- Shari'a Standards for Islamic Financial Institutions (1429H). *Accounting and Auditing Organization for Islamic Financial Institution*.
- Siti Salwani Razali (2008). "The Concept of Wa'd in Islamic Financial Contract", *Islamic Banking, Accounting and Finance Conference*.