The Use of Waad in Islamic Finance Structures

By Davide Barzilai

The Shariah compliant debt markets rely heavily on the use of the Waad. A Waad is used for Ijarah-based structures (such as Sukuk Ijarah), the more controversial quasi-equity based structures (such as Sukuk Musharakah), the Murabahah-based structures used to enable Shariah compliant hedging transactions, and diminishing Musharakah structures used in home financing. In this article, I will go through a basic Shariah and legal analysis of a typical Waad.

Waad (also referred to as Ahd) in legal terms means a promise and can come in the form of a unilateral undertaking or commitment to do something made by one person (the promisor) for the benefit of another (the promisee). The action that the promisor undertakes to do upon a trigger event might be the purchase of an asset or the entry into a Murabahah transaction at a price that is pre-determined in accordance with a formula set out in the promise.

This price might be fixed on the day of executing the promise or it might be determined at the time the promisee exercises its rights under the promise. An important requirement as to the validity of a promise under Shariah is that the promisee should not make a direct payment to receive the benefit of the promise. Otherwise, it can be categorized as a bilateral contract.

In the recent past, there have been some interesting debates as to the nature of a promise under Shariah but recent debates have their roots in discussions that took place among the classical Islamic jurists.

The key issue is whether or not a promise is legally binding under Shariah or if it is simply a gratuitous gift which would be a morally binding commitment. Dr Nuridanawati Irawani Abdullah of the International Islamic University Malaysia has usefully categorized five key views from the classical jurists as to the status of a promise under Shariah.

- Fulfilling a promise is recommended but not obligatory. It is a moral/religious matter which does not give the promisee any rights.
- Fulfilling a promise is obligatory from a religious perspective but the promise cannot be enforced by the courts. The promisor has a religious obligation to fulfill his or her promise but the promisee only has a moral right which the courts cannot enforce.
- Where a promise is subject to certain conditions, its fulfillment is obligatory and can be enforced even if the promisee has not relied upon the promise.
- Fulfilling a promise is obligatory from a religious perspective and can be enforced by the courts.

Contemporary Islamic jurists have analyzed the modern day use of the promise and have generally concluded that since a promise is conditional and the promisee relies on it (to the extent that if it is not performed, the promisee will make a loss), it is therefore binding on the promisor and can be enforced in a Shariah court. There is another argument that maintains that the promise is not binding, but the promisee is able to claim for losses caused as a result of the breach.

There is therefore sufficient consensus among the classical and contemporary Islamic jurists to conclude that a Waad is binding and enforceable under Shariah, although it is important to note that there are alternative views which some parties may choose to adopt.

In order for a promise to be of any material use in the modern financial system within which Islamic finance operates, a promise must be enforceable in a court of law. Assuming that a secular legal system governs the promise and a secular court has jurisdiction over the promise, then it will be the secular legal system that one has to consider when analyzing the promise.

In English law, there is a principle that there cannot be a legally binding contract where there is no intention by the parties to be legally bound. There could be a potential argument that the promisor did not intend to be legally bound by the promise (such as the promise was like a gift). This argument would be supported by the Shariah view that a promise is only a morally binding obligation and is not capable of being legally enforced under Shariah.

Clearly, taking this argument involves ignoring the majority of contemporary Islamic jurists as well as important classical jurists. Another available argument is that no consideration for the promise is given by the promisee. Consideration is one of the English law requirements for a contract. However, when reviewing commercial contracts, an English court can deduce intention to create legal relations from the fact that there is valid consideration.

This line of argument may not be available as, under Shariah, a promisor should not receive direct consideration in return for granting the promise. In English law, it would be possible to look at the transaction as a whole and imply consideration in an indirect way which would not conflict with the Shariah view.

Even if these arguments were to be accepted, there are other aspects of English law which will give the promisee protection from such a claim. In commercial agreements (including unilateral contracts), there is established case law that provides a strong presumption that the parties intend to be legally bound. In order for this presumption to be rebutted, the agreement would have to be vague, uncertain or not seriously meant. This is not the case with the typical promise which is documented as part of a sophisticated set of finance documents.

Finally, the concept of a deed will solve any consideration issues. In English law, a deed can be distinguished from other forms of written contracts by certain execution formalities. The key difference between a deed and a contract signed under hand is that a deed is enforceable despite a lack of consideration. Having established that a promise is on the face of it binding and enforceable in a court, one needs to look at the content of the promise to ensure that each term is in fact binding.

From a Shariah perspective, one key consequence of an agreement being classified as a Waad as opposed to a contract (Aqd) is that the terms of a Waad do not have to meet the same Shariah criteria of uncertainty (Gharar) as would be needed in a contract. The concept continued...
of certainty of terms under English law differs from the concept of certainty under Shariah.

From a Shariah perspective, the concept refers to excessive uncertainty regarding the subject matter or the price to be paid under the contract. This means that one cannot sell something which does not exist at the time of the sale or is not owned by the seller at such time. It also means that delivery and payment terms must be fixed at the time of the sale.

From an English law perspective, provided that the terms are sufficiently clear to determine the object of the sale, the price and delivery terms then would be considered sufficiently clear. This means that selling something for a price based on the performance of an index—such as a retail price index, the London Interbank Offered Rate or a stock exchange index—would be valid and not be considered uncertain.

However, English law will not recognize agreements to agree. An agreement to agree would be considered unenforceable where an essential term of a contract is subject to further agreement and there is no mechanism available to determine how that term is to be agreed.

Since a Waad cannot contain the actual agreement to sell or buy something (otherwise it would be considered a contract and would be subject to all the rules of Gharar) it is usual for a Waad to be drafted so that the promisor will agree to enter into an agreement to buy or sell something in the future. From an English law perspective, it is therefore essential to ensure that the mechanism for determining the future agreement is certain. Careful drafting is therefore required to ensure that a Waad, which may be binding under Shariah, is also binding under English law.

In conclusion, there are some within the Islamic finance community who are concerned that the industry has focused on ensuring that documentation is Shariah compliant without concern to the essence or spirit of Shariah, in the way that the otherwise Shariah compliant documentation is used in a commercial setting. While I have shown that a Waad from an English and Shariah perspective can be binding and enforceable, the debate as to how it is used still remains a valid and important discussion which the industry will continue to debate.