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ISLAMIC FINANCE

Concept, Principles & Application of
Wa`ad (Promise/Undertaking)

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Presentation Outline

• Concept of Wa'd
• Fulfillment of Promise
  – Wa'd is Binding
  – Wa'd is not Binding
• Legal Status of Wa`d
• Concept of Promise in Common Law
• Application of Wa`d
Introduction

• *Shari’ah* requires bank to engage directly in the transaction in many instances.
• In a sale, bank must purchase a commodity before selling it to the customer.
• If customer does not purchase it, bank will suffer from a financial loss.
• *Wa’d* requires customer to make a unilateral promise to buy before bank makes the purchase from the supplier.
Introduction

- Earliest ruling - murabahah sale to purchase orderer facility.
- *Wa’d* is necessary to show the parties’ commitment to perform contracts as mutually intended completely.
- Most importantly, to ensure continuous Shari’ah-compliance particularly to avoid two contracts in one or pre-conditioned contract (conditional contract).
# Introduction

## ISSUE:

- whether this promise is **legally binding and enforceable**; and

- whether the bank has the right to seek **legal enforcement of the promise** in the court of law?
**Concept of Wa’d**

- **wa’d** = a unilateral promise given by one party to another to perform an obligation. E.g.
  - a customer’s promise to buy the leased asset upon expiry of the leasing (ijarah) period in the al-ijarah thumma al-bay’ (Islamic hire-purchase) transaction.
  - Other usage of unilateral promise in the form of sale or purchase undertaking can also be found in musharakah mutanaqisah (diminishing partnership), murabahah sale to purchase orderer and sukuk structures.
Concept of Wa’d

- **Wa’dan** = 2 unilateral promises given by 2 different parties which are independents from each other and subject to different independent conditions. E.g.
  - in certain Islamic-structured product, a customer promises to sell securities to a bank for an agreed settlement price with certain conditions.
  - At the same time, the bank also undertakes to buy the securities for certain price with another different conditions.
Concept of Wa’d

- **Muwa’adah** = bilateral promises that can be conditional or unconditional with or without consideration.
  - **Unconditional bilateral promise** occurs when one party undertakes to sell an asset during a particular time, while the other party undertakes to buy it during the same time.
  - **Conditional bilateral promises** happen when one party promises to sell an asset and another party promises to buy the same asset if certain condition X occurs.
1. *wa’d* is unilateral in nature, and binds the maker only. It will only be binding upon both parties after a sale contract is concluded.

   - For example, Ahmad makes a promise to sell his car to Abdul for RM60,000. This promise is unilateral in nature and does not bind Abdul to accept the offer.

2. *contract* is legally binding upon the contracting parties once it fulfills all the requirements needed, 

   - promise depends on the acceptance of its applicability and to the opinion of jurists whether they are legally or religiously binding or both or it is a mere a question of morality.
Legal Status of *Wa’d*

- A promise **without any intention** of fulfilling it, is not permissible (haram)
  - deemed to be a liar and pretentious (munafiq) person who are seriously condemned by the religion.

- If the same promisor takes an **oath** to convince the promissee
  - will be subject to Allah’s condemnation
  - a fine or compensation (*kaffarah*) to relieve him from his false oath.
Legal Status of *Wa’d* (2)

- If a promise with an intention of fulfilling it, the jurists are divided whether its fulfillment is **obligatory** or **recommended**.
- Those who opine the fulfilling a promise is **obligatory** are further divided as to whether it is **binding by religion** (*mulzim diyanatan*) or **enforceable by the court** (*mulzim qada-an*).
- Islamic jurists have different views with regard to the liability imposed to the parties of the promise.
Legal Status of *Waʿd* (3)

**VIEW 1:**

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

- promise must be fulfilled for religious reason only and it is a question of morality
- al-Zarqa’- a promise does not initially bind the person who makes it (promisor), and it does not give any right to the promissee.
- The Shafi’i, Hanbali and Zahiri Schools recommend the fulfillment of a promise, even if it is subject to certain condition.
Legal Status of *Wa’d* (4)

**VIEW 2:**

Fulfilling a promise is **obligatory by religion**; otherwise the promisor is deemed to be sinful. Its non-fulfiment will **not be enforced** by the court.

- **Hanafi, Shafi’i, Hanbali,** and a few from **Maliki** schools - a promise made by a person to the other is religiously binding (*mulzim diyanatan*) but not a legal duty (*mulzim qadha-an*). 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.

- **Imam Nawawi** - when a person promises another something (provided it is not illegal) he should fulfill his promise.

- **Al-Qarafi** - promise is not binding at all
Legal Status of *Wa’d* (5)

**VIEW 3:**

Fulfilling a promise is **obligatory by religion** and can be **enforceable by the court**

- **Ibn Al-‘Arabi** - The promise is absolutely binding & must be fulfilled by all means unless if its fulfillment is impossible.

- **Ibn Shubramah** made the fulfillment of promise as compulsory.

> "أن كل وعد بالالتزام لا يُحل حراماً ولا يحرم حالاً، يكون وعداً ملزماً قضاء وديانةً"

(Meaning: every concluded promise which does not allow prohibited thing, and not prohibit permissible thing, is binding legally and religiously)

> "الوعد كله لازم ويقضى به على الواعد ويجبر"

(Meaning; all promises are binding, and the promisor is compellable in fulfilling it)
VIEW 4:
Where a promise is subject to certain **conditions**, its fulfillment is **obligatory** and **enforceable** although the promissee has not acted upon the promise yet.

- **Hanafi School** - distinguished between absolute promise and conditional promise.
- The latter is binding in contract of exchange to avoid *ghurar* (unknown element) in the subject matter of promise.
- This rule is very similar to the concept of guarantee established by *kafalah* contract.
**Legal Status of *Wa’d* (7)**

**VIEW 5:**
Where a promise is subject to *conditions*, its fulfillment is *obligatory* and *enforceable* only if the promissee *has indeed acted* on the basis of the promise & incurred *loss*.

- **Ibn Al-‘Arabi** - if the promise results in particular consequence, its fulfillment 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 promisee in reliance to the promise. As such, fulfilling the promise is obligatory, or the promisee will suffer loss or difficulties as a result of the non-fulfillment. This is a preferred opinion in the **Maliki** School which was expounded by Malik, Ibn Al-Qasim and Sahnun.
### FULFILMENT OF PROMISE

#### Recommended
1. The Shafi’i School
2. Abu Hanifah
3. Some Maliki jurists
4. Al-Qarafi (Maliki)

اذا وعد أحدكم أخاه ومن نيته أن يفي ولم يجي للميعاد فلا شيء عليه

A man asked the Prophet (S.A.W.), “Can I lie to my wife”. The Prophet said, “There is no good in lying.” The man said, “Shall I make her a promise and tell her?” The Prophet said, “It will not be held against you

promise (wa’d) is like a gift (hibah) which is not binding on its promisor except after delivery has taken place

#### Obligatory
1. Majority of Maliki jurists
   - Ibn Al-‘Arabi: absolutely
   - Malik, Ibn Al-Qasim and Sahnun:
     - obligatory, or the promisee will suffer loss or difficulties
2. Ibn Shubramah

يا أيها الَّذين آمنوا لَم تَفْعَلُونَ ما لا تَفْعَلونَ

وَكَبَرَ مَقَاتًا عَنْهُ أن تَفْعَلْوهَا ما لا تَفْعَلونَ

يُرِيدُ اللَّهُ بِكُمْ أَلْيَسْرٍ وَلَا يُرِيدُ بِكُمْ أَعْسَرٍ

وَمَا جَعَلْ عَلَيْكُمْ فِى أَلْدَىٰن مِّن حَرْجٍ

آية المنافقين ثلاث: إذا حدث كذب وإذا وعد أخلف وإذا انتقم خان

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International Shariah Research Academy for Islamic Finance (ISRA)
Overview of Classical Juristic Opinions

- **a promise per se** (without any condition attached to it) is binding
  - its non-fulfillment amounts to lying and non-obedience which is sinful to Allah.
  - is **binding by religion**.

- If the **promise is conditional** upon fulfilling certain condition, the opinion of Maliki School is well-justified.
  - If the non-fulfillment causes **difficulty or loss to the promisor**, then the promise become **binding judicially** and thus, is enforceable against the promisor.
Overview of Contemporary Juristic Opinion

Contemporary jurists have been posed with many issues in financial products which require them to exercise an ijtihad and produce a new ruling (ifta’) to such effect.
Sheikh Badr Al-Mutawalli Abdul Basit, Shari’ah advisor of KFH

Every unilateral promise that neither permit unlawful thing nor prohibit lawful thing is binding judicially and by religion \( \text{mulzim qada-an wa diyanatan} \).

First Conference of Islamic Banking in Dubai (May 1979)

Fulfilling such promise may become judicially obligatory in the event of necessity, eg. if the non-fulfillment of promise entails difficulties or loss to the promisee.

Sheikh Abdul Aziz bin Baz, Mufti of Saudi Arabia

Promises to sell are permissible provided that the goods that have been pledged are owned by those who made the promise.

2nd Conference of Islamic Banking in Kuwait (21-23 March 1983)

- Approved bilateral promise \( \text{muwa’adah} \) provided that: bank owns the goods & put in possession, Bank sells goods to purchase orderer with an agreed profit, Bank must bear ownership risk until the goods are delivered, Bank must accept redelivery if there is hidden defect in the goods
- Also resolved - unilateral promise becomes binding to the promisor - subject to the approval of Shari’ah supervisory committee

Islamic Fiqh Academy in resolution no. 40-41

Fulfilling a promise is allowed subject to certain conditions as enumerated in the next slides.
Islamic Fiqh Academy Position on Promise

- 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 fulfillment of an obligation, and
  - the promissee has already incurred **expenses** on the basis of such a promise.
Islamic Fiqh Academy Position on Promise (2)

- **binding effect** means such promise must be fulfilled,
  - otherwise a compensation must be paid for damages caused due to the unjustifiable non-fulfilling of the promise.

- **Mutual promise** (muwa’adah) is also permissible provided that the **option** is given to one or both parties.
  - Otherwise, it is not permissible, since mutual and binding promise is like a sale contract which requires the seller to be in full possession of the goods to be sold.
CONCEPT OF PROMISE IN COMMON LAW

• A promise - a kind of communication usable everyday life either in formal or informal functions.

• It depends on the usage of the promise itself to determine the status of promise or whether some legal obligations should be imposed on it or not.

• A promise is more than the truthfulness in reporting the intention of parties to a contract, for the party is free to change their mind.

• In fact, a contract is formed by promises when both parties give their proposals and the others accepted it in the same contractual setting.

• S. 2 of the Contracts Act 1950 provides:

  “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.

If one of them breaches the promise, the innocent party can sue the other party since this kind of promise is enforceable in the courts of law.

This rule is also known as consideration doctrine; where the law will not enforce unilateral promises, but promises exchanged for something of value become legally binding contracts.

**S. 2(d) of the Contracts Act 1950;**

“when, at the desire of the promisor, the promissee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise”.
The promise made by the contracting parties can be made through express or implied as it is recognized in S. 9 of the Contracts Act 1950;

“So far as the proposal or acceptance of any promise is made in words, the promise is said to be express. So far as the proposal or acceptance is made otherwise than in words, the promise is said to be implied.”

Breach or violation of promise in a contract = promisor does not perform his obligation as promised

In common law, if one promisor has refused to perform his promise, the other contracting party has the right to end the contract. S. 40 of the Contracts Act 1950;

“when a party to a contract has refused to perform, or disabled himself from performing, his promise in its entirely, the promise may put an end to the contract, unless he has signified, by words or conduct, his consent to continue with the contract”.
CONCEPT OF PROMISE IN COMMON LAW(4)

• Any promise contained in a contract must be performed by the promisor.
• Promisor may also employ a competent person to perform the promise.
• 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. S. 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.”
• If one party violates the promise containing 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.
The Equitable Doctrine of Promissory Estoppel

• What about a purely unilateral promise?

• To compensate innocent party who acted merely on a promise, the equitable doctrine of promissory estoppel was introduced to prevent promisor from denying that that he has made such promise which was relied and then acted upon by the promissee.

• The court in *Combe v. Combe* defined the principle of promissory estoppel as follows:
  – Where one party had made a promise (orally or by conduct) to the other
  – with intention to affect legal relations between them and to be acted accordingly
  – once the promissee has taken him by his word and acted on it
  – the promisor cannot afterwards deny such promise given earlier
  – but the promisor must accept their legal relations
  – even though it is not legally supported by any consideration, but only his word.
The Equitable Doctrine of Promissory Estoppel (2)

• The modern development of promissory estoppel began with the case of *Central London property Trust Ltd v. High trees House Ltd*
  – In each case the court held the promise to be binding on the party making it,
  – even though under the old common law it might be difficult to find any consideration for it.
  – The courts have not gone so far as to give a cause of action in damages for the breach of such a promise,
  – but they have refused to allow the party making it to act inconsistently with it.
  – It is in that sense, and that sense only, that such a promise gives rise to an estoppel.
• The court in this case also observed that a promise to accept a smaller sum in discharge of a larger sum, if acted upon, is binding notwithstanding the absence of consideration.
The Equitable Doctrine of Promissory Estoppel (3)

• To apply this principle, 4 conditions must be observed:
  1. The promise must be clear and unequivocal to avoid any doubt about it and prevent the promisor from arguing against its formation.
  2. There is a pre-existing legal relationship between the parties, but not necessarily contractual.

  *Cheng Hang Guan v. Perumahan Farlim & Ors,*
  - both plaintiffs and defendants who had no contractual relationship claimed possession of the same land.
  - The court found out that plaintiffs’ possession of the land was protected by promissory estoppel,
  - because the registered proprietor had promised to them that as long as they continued paying the rent, they could stay on the land as long as they wanted.
The Equitable Doctrine of Promissory Estoppel (4)

3. It must be **inequitable (unfair)** for the promisor to go back on his promise.
   * E.g., Abu borrowed RM500 from Chong,
   * then during repayment he offered RM300 stating that Chong should take it or get nothing.
   * Chong who was in a financial difficulty accepted RM300 in full settlement.
   * If Chong sued for the balance, Abu cannot be protected by Chong’s promise earlier (to accept the smaller sum in discharging the larger sum).
   * It will be unfair to Chong because the settlement seemed to be involuntarily made due to his financial condition.

4. The promissee must **have acted in reliance on the promise made to him**.
   * If the promisor does not fulfill his promise, the promissee may likely suffer from certain loss.
Limitation of Promissory Estoppel

- Promissory estoppel can only be used as a defence, not as an independent cause of action.
  - It is a doctrine that enables a person to use it as a shield, not as a sword.
  - In *Combe v. Combe* the spouses were at divorce. The husband promised to give £100 per annum as permanent allowance. When the husband failed to pay, the wife sued on the husband’s promise. The court held that the wife was not entitled to rely on promissory estoppel as the doctrine could be used only as a defence and not as a cause of action itself.
- To protect a person (particularly the promissee) from other’s claim, either the promisor or third party.
- Thus, cannot be simply used as an action against the promisor, for example to compel him to fulfil his promise.
- May be applied if the promissee suffered loss or faced with the third party’s claim because of the non-fulfillment of promise by the promisor.
Promissory Estoppel as a Cause of Action?

- Revolutionary step by Malaysian Court following Australian & English
- Flexible application of Promissory estoppel
- Promissory estoppel can also be used as a cause of action.
- Thus, can be used as an action against the promisor, for example to compel him to fulfil his promise.

*Hong Leong Leasing v. Tan Kim Cheong (1994)*

- Viewed that the Walton Stores (1988) case had added a new dimension to the issue
- The court may consider such ruling in the future case after hearing full arguments on the issue


Promissory Estoppel as a Cause of Action?

- Justice is done acc. to c’tances- flexibility of promissory estoppel’s principle
- Estoppel may be used to achieve justice- to enforce a cause of action to prevent the promisor from denying the existence of some fact relied upon by the promissee.

Gopal Sri Ram:
- It is time to recognise the doctrine as a flexible principle
- Which justice is done acc. to circumstances of the case
- The scope in which the doctrine may operate is endless

- Applying this principle, a promise can be enforced legally in the court
- But the court must be more vigilance in applying this equitable doctrine to achieve justice
Application Of Wa’d In Islamic Banking Products

1. *Wa’d* in Sale Contract - Murabahah sale by Purchase Orderer
2. *Wa’d* in Ijarah Contract: Lease ending with ownership (Ijarah Muntahiyah Bittamlik)
3. *Wa’d* in Shirkah Contract: Diminishing Partnership (Musharakah Mutanaqisah)
Sukuk

• Generally, an entity gives an undertaking to sukuk holders to purchase their sukuk usually for a nominal price.
• In certain sukuk structures, *wa’d* is used as a guarantee to sukuk holders to receive an amount equal to their initial investment when the sukuk are redeemed.
• There are two issues that may invoke Shari’ah consideration in the purchase and sale undertaking, namely:
  ❖ *Are the sale and purchase undertakings considered as bilateral promises (muwa’adah)*?
  ❖ *What is the effect of the undertakings; does it guarantee principal and return?*
Deutsche Bank Wa’d’d Structure

1. DB enters into an unconditionally and irrevocably Purchase Undertaking (wa’d 1) to promise the mudarib to purchase the Islamic assets at the following sale price upon maturity.

2. At the same time, the mudarib enters into a similar Purchase Undertaking (wa’d 2) promising DB to sell the shari’ah-compliant assets at the above predefined price upon maturity.

3. However, at maturity, only one of the Purchase Undertaking will be exercised depending on the performance of shari’ah-compliant assets and reference assets which could be an index or a fund (i.e Libor).

4. If the value of Islamic assets is greater than performance of reference assets, wa’d 1 will be exercised and wa’ad 2 if otherwise
Deutsche Bank AG

Islamic Investment Account

SPV (Shari’ah Investment Manager)

Sukuk Holder

Ensure Shari’ah Compliance

Cash

Shari’ah Asset

Market

Dar Al Istithmar Ltd (Shari’ah Monitor)

Source: Understanding the Duetsche Bank Wa’ad Structure, Duetsche Bank Publication
Deutsche Bank Wa’d Structure (2)

1. SPV issue the security to security holders
2. SPV receive the proceed at “par”
3. SPV will credit the account in respect of each structured product with shari’ah-compliant asset, bought from the market of equal value to par, work in capacity of shari’ah investment manager all in accordance with the instruction of the shari’ah monitor
4. SPV will appoint DIL as its shari’ah monitor in accordance with shari’ah monitoring agreement
5. DB to purchase at the Islamic asset at sale price when Islamic asset is higher than reference assets (index or fund)
6. SPV to sell the Islamic asset at Sale Price when Islamic asset is lower than reference assets (index or fund). This agreed sale price guaranteeing return of capital (par) to the investor
7. DB in its capacity as calculation agent, will calculate any profit or loss to the security holders in accordance with the form of the securities and underlying asset
Shari’ah Observation

- Realizing the extensive uncontrollable usage of *wa’d* in equity-based sukuk in particular, AAOIFI pronounced that the purchase undertaking mechanism is not *shariah*-compliant in February 2008. Following to the above pronouncement, it is estimated that 85% of *sukuk* might be *haram* (not *Shariah*-complaint).

- 3 main issues:
  1. ownership of enterprise,
  2. distribution of regular profits and
  3. return of principal guarantee.

- *Wa’d* becomes a Shari’ah issue because in any shari’ah-compliant investment, the return of investor’s capital cannot be guaranteed.
• Shaykh Muhammad Taqi Usmani observed from 3 perspectives:

1) Commitment by a mudharib
   – AAOIFI Standard 13, 7.8, Mudharib is a trust holder, *amin*, should not be made responsible in the case of loss as long as no negligence in his part. The profit must be shared accordance to agreed profit sharing ratio.

2) Commitment by a Sharik
   – unlawful for one partner to guarantee return of capital of other partner because it possibly leads to the interruption the profit sharing ratio.

3) Commitment by an Investment Agent
   – If as *wakeel* to the issuer, it can also be no guarantee to the capital invested except in the case of negligence by the manager and mala fides.

• A guarantee for the principal or for the profits is unlawful regardless the manager is a mudharib, or investment agent or partners.
• Furthermore, combining an agency contract with a guarantee is contrary to the shari’ah as the mechanism will transform the operation into interest-bearing loans.
Shari’ah Observation

- *mudarib* clearly give sukuk holders a guarantee that *musharakah* investment is profitable regardless of actual performance of Islamic asset.
  - If it ever makes a loss, the obligor (DB) will undertake to buy sukuk holder’s share.
  - However, in return for the purchase undertaking, the sukuk holders reciprocate by a *tanazul* or “rebate” of profit in excess of an agreed amount, usually Libor (London interbank offer rate) plus and agreed percentage.
- By this mechanism, sukuk are able to preserve the same characteristic as conventional interest bearing bonds since the mudharib will not return the sukuk holders more than a fixed percentage of the principal, based on interest rates, while guaranteeing the return of principal at maturity.
- Therefore, this type of sukuk structure indirectly violates the principles of profit and loss sharing investments thus defeat its primary objection of being a viable shari’ah-compliant investment alternative.
والله اعلم وشكرًا

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