

*Review*

## **The scope and application of *Wa'ad*, *Muwa'adah* and *Wa'dan* in Islamic finance**

**Shafi'i Abdul Azeez Bello<sup>\*1</sup> and RusniBt Hassan<sup>2</sup>**

<sup>1</sup>Bachelor in Islamic Law (*Shari'ah*), Master in Comparative Laws, Ph.D. candidate at Ahmad Ibrahim Kulliyah of Laws IIUM. (Specialized on Islamic Banking and security)

<sup>2</sup>Associate Professor, Bachelor in Islamic Law (*Shari'ah*), Bachelor in Law, Master in Comparative Laws, PhD in Laws: (Institute of Islamic Banking and Finance, Department of Islamic Law IIUM)

Accepted April 28, 2013

Islamic laws cover all aspects of human behaviours and govern the Muslims ways of life. It is wider than the Western understanding of laws and they regulate Islamic transactions. Therefore, this paper demonstrates scope and application of *Wa'ad* (promise), *Muwa'adah* (promisor) and *Wa'adan* (two promises) in Islamic finance. Brief discussion on the definitions and legal principles of *Wa'ad*, *Muwa'adah* and *Wa'adan* from perspectives of Islamic law as well as the concept of *wa'ad* under common law were reported in the paper. Furthermore, the paper critically analyses the rules of *wa'ad*, *muwa'adah* and *wa'adan* in Islamic transaction (sales and purchase). Similarly, the concept and practice of *wa'ad* in Islamic banking system in Malaysia were also discussed. The applications of *wa'ad* also explain in Islamic banking products such as, use of *wa'ad* for foreign exchange option, Islamic financial market and foreign exchange option for a Multination bank. The paper ended with some illustrations about the use of *wa'ad* for short selling in Islamic finance.

**Keywords:** *Wa'd*, *Muwa'adah* and *Wa'dan*

### **INTRODUCTION**

Promises are special in our society especially in Islamic societies, because there is a societal or moral convention that allows a promisor to be treated as bound to his promise, promises here including behaviour making others believe that one has promised, as well as the more obvious overt statements such as 'I promise to buy you a car'. Although promise is morally and religiously binding according to the tenets of the *shari'ah*, it was considered neither mandatory nor enforceable according to the majority of the classical jurists, probably because it was

not considered a customary contract.<sup>1</sup> Liability / right were considered to be created only after a regular offer and acceptance.<sup>2</sup>

*Al- Wa'ad* is a term used currently which according to Islamic transaction means 'promise'. It is so inter-related with put option and call option but had been inserted with the element of Shari'ah and it is very much debated

<sup>1</sup>Sweet Child, (2009) *Islam and Finance From My Perspective*, Retrieved from <<http://myviewpoint2u.blogspot.com/2009/08/waad-versus-muwaadah.html>> visited on 26/3/2012.

<sup>2</sup>Ibid.

lately.<sup>3</sup> The application of promise can be seen in several Islamic transaction concepts for example, in sale and purchase contract, *murabahah*, *shirkahmutanaqisah*, *ijarah*, *takaful* etc.<sup>4</sup>

### Definition of *Wa'ad*, *Muwa'ad* and *Wa'adan*

Literally, *Al-Wa'ad* means notification of good or bad news; although *wa'ad* is commonly used to give notice a good news, while *wa'id* is to warn about the bad ones *Muwa'adah* involves two parties exchanging their respective news.

Technically, *wa'ad* refers to information leading to good news in the future.<sup>5</sup>

According to Islamic law, *Al-Wa'ad* means promise. It is a 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 a 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 known as promise as well.<sup>6</sup>

In traditional concept, *wa'ad* is unilateral in nature, and binds the maker only. 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. It will only be binding upon both parties after a sale contract is concluded.<sup>7</sup> On the other hand, *muwa'adah* is defined as a mutual promise between two parties with the intention to conclude a contract in the future.<sup>8</sup>

*Wa'dan*, two unilateral promises given by two different parties which are independents from each other and subject to different independent conditions. For instance, 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.<sup>9</sup>

### The legal principle of *Wa'ad* from perspectives of Islamic law

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 pretentious (*munafiq*) person who are seriously condemned by the religion. What more if the same promisor takes an oath to convince the promisee to act upon his promise. The promisor in the latter case will not only be subject to Allah's condemnation, also a fine or compensation (*Kaffarah*) to relieve him from his false oath.<sup>10</sup> However, if a promise is coupled with an intention of fulfilling it, the jurists are divided whether its fulfillment is obligatory or recommended. Those who opined that fulfilling a promise is obligatory are further divided as to whether it is binding by religion (*mulzimdiyatan*) or enforceable by the court (*mulzimqada-an*). Islamic jurists have different views with regards to the liability imposed on the parties of the promise.

#### View 1

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

(a) As for general principle, promise must be fulfilled for religious reason only and it is a question of morality and the scholars are in agreement on this point.

(b) 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.

(c) The Shafi'i, Hanbali and Zahiri Schools recommend the fulfillment of a promise, even if it is subject to certain condition.

#### 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-fulfillment will not be enforced by the court.

(a) The majority scholars from Hanafi, Shafi'i and Hanbali school, and a few from the Maliki school opined that a promise is religiously binding (*mulzim diyatan*) but not

<sup>3</sup>Nor Adilabt.Mohd NoorMohd Ashraf b. Aripin, Mechanism of al-Wa'ad (Promise): Theory and Application in Islamic Banking in Malaysia, *journals.vaggi.org search Open Access SoSci e-Journals*. 14/7/2010 at. 81.

<sup>4</sup>Ibid.

<sup>5</sup>Summarised from Al-Mausuah Al-Fiqhiyyah, Wizarah al-Auqafwa al-Shu'un al-Islamiyyah, Kuwait Retrieved from, <<http://isra.my/www.islam.gov.kuwait>> visited on 1/4/2012

<sup>6</sup>SitiSalwaniRazali, (2008) The Concept of Wa'ad in Islamic Financial Contract, *Presented paper at Islamic Banking, Accounting and Finance ConferencelBAF*, at. 2.

<sup>7</sup>Nurdianawatilrwan Abdullah, (2010) Status and implications of promise (wa'd) in contemporary Islamic banking, *Humanomics*, Vol. 26 Iss: 2, at.84 – 98 Retrieved from <<http://www.emeraldinsight.com/journals.htm?articleid=1875997&show=html>> visited on 27/3/2012.

<sup>8</sup>Id., 1.

<sup>9</sup>AsyrafWajdiDusuki, FN 6023 ISLAMIC FINANCE Concept, Principle & Application of wa'ad (promise/undrrtaking) Retrieved from <[www.kantakji.com/fiqh/Files/Finance/N422.pdf](http://www.kantakji.com/fiqh/Files/Finance/N422.pdf)>

<sup>10</sup>Abdullah Yusuf Ali translation of the Qur'an. (Q,2: 225)

a legal duty (*mulzim qadha-an*). This is because *wa'd* is part of a voluntarily contract (*'aqdtabarru'at*). Therefore, the judge has no way of such enforcement, because the second party has nothing more than amoral right.

(b) Imam Nawawi said when a person promises (provided it is not illegal) he should fulfill his promise.

(c) The promise is not binding at all. This is a view of *Al-Qarafi*.

### View 3

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

(a) The promise is absolutely binding. Ibn al-'Arabi is among the proponent of this view, stating that the promise must be fulfilled by all means unless in certain exceptional situation in which its fulfillment is impossible

(b) Ibn *Shubramah* made the fulfillment of promise as compulsory. He said: every concluded promise which does not allow prohibited thing, and not prohibit permissible thing, is binding legally and religiously, <sup>11</sup>all promises are binding, and the promisor is compellable in fulfilling it.<sup>12</sup>

### View 4

In a specific case where a promise is subject to certain conditions, its fulfillment is obligatory and enforceable although the promisee has not acted upon the promise yet. The ruling is affirmed by the Hanafi School whom 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 *kafalah* contract.

### View 5

In the similar instance where a promise is subject to conditions, the promisor is obliged to fulfill it and can be enforced by the court only if the promisee has indeed acted based on the promise. Thus, non-fulfillment of such a promise will cause losses to the promisee.

(a) According to Ibn al-'Arabi, the Maliki School viewed that if the promise results in a particular consequence then its fulfillment are obligatory; but if it is a promise per se without any consequential effect, fulfilling it is not made obligatory

(b) 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 the preferred opinion in the Maliki School which was expounded by Malik, *Ibn Al-Qasim* and *Sahnun*. For example, a person wants to buy a slave if somebody willingly lends him 1000 dirham. If that somebody says "I will give you a favor by giving you 1000 dirham, therefore, buy yourself a slave", this kind of promise is binding (*lazim*) upon the second person.<sup>13</sup>

Those who view that fulfilling a promise as binding and enforceable rely on the following authorities:

(a) Allah says:

O ye who believe! Why say ye that which ye do not? It is most hateful in the sight of Allah that ye say that which ye do not.<sup>14</sup>

The verses generally prescribe to a person (*mukmin*) to do or fulfill what he said or promised; otherwise the non-fulfillment will amount to a serious sin which is clearly not allowed by Islam.

(a) Allah says:

Allah desireth for you ease; He desireth not hardship for you.<sup>15</sup>

(c) Allah says:

He hath not laid upon you in religion any hardship.<sup>16</sup>

(d) Allah says:

And fulfill the commitment, for the commitment will be inquired into on the day of Reckoning.<sup>17</sup>

(e) Allah says:

O ye who believe! Fulfill (all) obligation.<sup>18</sup>

Fulfill the covenant of Allah when you have entered into it...<sup>19</sup>

The above verses stress that *Shari'ah* should not cause difficulty to the people; instead it is capable to solve all problems and issues in all walks of life without affecting its objective (*maqasid*) and principles.

(f) From *Abi Hurairah* (R.A.): the Prophet (S.A.W.) said: "Sign of a munafiq (pretentious person); when he talks he lies; when he promises he breaks it; and when he is given a trust he betrays it".<sup>20</sup>

The hadith describes a person who does not fulfill 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.

<sup>13</sup>Id., 3, at. 82

<sup>14</sup>Qur'an 61:2-3

<sup>15</sup>Qur'an 2:185

<sup>16</sup>Qur'an 22:78

<sup>17</sup>Qur'an 17: 34

<sup>18</sup>Qur'an 5:1

<sup>19</sup>Qur'an 16:91

<sup>20</sup>Sahih Al-Bukhari; 1/21. Hadith no. 33

<sup>11</sup>Al-Qardawi Yusuf, (1986) *Bay' Al-Murabah Lil-Amri Bi- Ashira'* (3<sup>rd</sup> Edn.,) Kuwait: Dar al-Qolam, at 36.

<sup>12</sup>Ibid.

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 fulfillment of a promise is merely recommended, not obligatory. Al-Qarafi stated some of the 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 fulfill it; then the thing promised is not brought forward (promise is not fulfilled), so it is not held responsible (onto you)".<sup>21</sup>

(b) By Imam Malik in *Muwatta'*: 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."<sup>22</sup> However, this hadith is not acceptable to justify the issue of non-fulfillment of *wa'ad* since it is concerned with the issue of whether a husband who lied to his wife is sinful or not.

(c) The other justification is that a promise (*wa'ad*) is like a gift (*hibah*) which is not binding on its promisor except after delivery has taken place. It is observed from the above classical juristic rulings that a promise per se (without any condition attached to it) is binding, and thus, its non-fulfillment amounts to lying and non-obedience which is sinful to Allah. This type of promise is binding by religion. If the promise is provisional upon fulfilling certain condition, the opinion of the Maliki School is well-justified. If the non-fulfillment causes difficulty or loss to the promisee, then the promise becomes binding judicially and thus, is enforceable against the promisor.<sup>23</sup>

### Hukumal-Wa'ad Bil Bay' and al-Wa'ad Bis-Shira'

There is no clear record about the views of the jurists discussing the *hukum* promise in sale and purchase. *Maliki* school of thought differentiates between promises which are used in a transaction with a promise in fixing profit rate. If it is merely for a sale transaction, it is permissible. However, the *hukum* is vice versa if it is for fixing the profit rate. It is totally prohibited. On the other hand, *Hanafi* and *Shafi'i's* scholars permit promise to sell and buy and the *hukum* is permissible as (*mubah*).<sup>24</sup> This is the view of contemporary scholars who do not permit promise in sale and purchase. They refused of this

concept is because they consider it as similar as *Bay' al-'inah*. *Bay' al-'inah* is prohibited by the Muslim scholars because there is a consensus between the buyer and seller.

The ruling (*fatwa*) by *Sheikh Abdul Aziz bin Baz*, a Saudi Arabia *mufti* decided that *al-wa'ad bil bay'* is permissible if the subject matter promised is belonged to the promisor. The conditional sale and purchase contract which requires re-sale and re-purchase of the subject matter is not a valid contract. However, both parties to contract can make a promise to buy or to sell back the asset. If one of them breaks the promise, the other side can claim for damages and the contract is still a valid one.

Maliki's view which says that promise is not binding and cannot be enforced by the court except if the party to whom the promise had been broken (the victim) suffers loss, then the party who breaks the promise must pay damages for the detriment or hardship arise from it.<sup>25</sup>

The ruling ruled in the first 1981 convention of '*Nawaz al-Baraka' in Madinah al-Munawarah* stated that if a promise of transaction *mulzim* in nature to the parties of promise, it will be falls within prohibited promise because it involves *bay al-kali' bil-kali'* which is not permissible.<sup>26</sup> The first proponent who instituted the practice of the binding promise in commutative contracts was probably *Sheikh Mustafa Al-Zarqa* in his Introduction to Jurisprudence.<sup>27</sup> That stance filtered into his book on Insurance,<sup>28</sup> where he adopted the position that if it was admissible, for some jurists, for the *wa'ad* to be binding in donations, then, in his view, it was even more justifiable for the unilateral promise (*wa'ad*) to be binding in commutative contracts. Later this view was adopted by *Yusuf Al-Qardawi* in his book on Resale Contracts<sup>29</sup> and *Hassan Al-Shazli* in The Academy Journal.<sup>30</sup>

### Hukum Muwa'adah

*Shari'ah* Bodies (Lembaga) of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), an accounting and auditing standards setting body in Bahrain held that *wa'ad* which is '*mulzim*' in nature by both parties is just similar as a contract or '*aqad*', *Majma' fiqh Islami* in its 5th meeting which was held in 10-15 December 1988 differentiating between a promise made by one parties and the promise made by two parties as follows:

<sup>21</sup> Sunan Abi Dawud; 268/5. Hadith no. 4995

<sup>22</sup> Al-Muwatta, "Book of Speech in the heading „Truthfulness and Lying”.

<sup>23</sup> Nurdianawati Irawani Abdullah, *The Status of Promise (Wa'ad) And Its Implication In contemporary Islamic Banking*, ISRA Islamic Finance Seminar (IIFS) 11 November 2008, at. 2 Retrieved from <<http://www.scribd.com/doc/50755396/IIFS-Status-of-Wa-ad>> accessed on 25/3/2012.

<sup>24</sup> Nor Adilabt. Mohd Noor Mohd Ashraf b. Aripin, *Mechanism of al-Wa'ad (Promise): Theory and Application in Islamic Banking in Malaysia*, at. 83

<sup>25</sup> Ibid

<sup>26</sup> (Majmu'ah Dallah Barakah, 1997, at. 28)

<sup>27</sup> Mustafa Al-Zarqa, (2003) *Al-Madkhal Al-Fiqhi Al-Amu*, Damascus: Dar al-Qolam, Vol. II, at. 1032.

<sup>28</sup> Nizam Al-Ta'min, at. 58 and 131.

<sup>29</sup> Yusuf Al-Qardawi, (1987) *Bay' al-Murabahah*, Damascus: Maktaba Wahbat, at. 85

<sup>30</sup> Majallat Al-Majma, Vol. V, Part IV, at. 2720.

First, if promise made by one party, then the promise will be considered as '*mulzimdiyatan*' upon the promisor. In the ruling perspective, the promisor has to carry out his promise if such promise related with a specific reason, and there is commitment from the promisee.

Second, promise made by both parties i.e. *al-muwa'adahis* permissible but it does not '*mulzimah*' in nature upon both parties because if the '*muwa'adahis*' is *mulzimah* in nature, it will be just the same as '*aqad*'.

Though, the latest ruling by *Majma'FiqhIslami* in its 17th meeting stated that:

First, *Mulzim* promise made by both parties is originally *mulzimdiyatan* or religiously binding and not '*mulzimqadhaan*' or legally binding.

Second, *Mulzim* promise by both parties in a contract is a '*hilah* of *riba* (interest) like '*inah* and promise in *salaf* transaction. It is prohibited by *syara*'.

Third, in situation where a sale and purchase transaction cannot be performed because the seller do not have the selling item, but there is public need to ensure that both parties perform the contract in the future based on provision of law or common practice of trade of the state such as providing 'documentary credit' to import, therefore, binding promise from both parties is allowed whether through provision of law or by mutual consent of both parties.

Fourth, promise by both parties as mentioned in paragraph iii does not consider the future transaction therefore the ownership of the subject matter will not transfer to the buyer thus create no debt. The sale and purchase will only be executed at the time agreed by both parties after the completion of *ijab* and *qabul*.

Fifth, for the situation mentioned in paragraph iii, if one of the parties breaks the promise, thus he is legally bound to perform the contract or to remove the hardship which is borne by both parties due to the breach of the contract. The ruling laid down by Jordan Islamic Bank was that if the *muwa'adahis* *mulzim* in nature upon both parties, therefore, the transaction will fall under the general prohibition ('*umuma- nahyi*'), *bay' alkali'bil- kali* (sale the debt with debt). However, if '*muwa'adahmulzimah*' only binds one party, therefore, the transaction is permissible.<sup>31</sup>

*Rafi' al Misri* mentioned that *bay' al- murabahah li al- Amirbil-shiraw* which is practice in most of Islamic banking in present applies *al- wa'ad* principle. In practice, some banks practicing *wa'ad* which is *mulzim* upon both parties and some other banks only upon one party. With regard to this issue, *Rafi' al- Misri* of the view that *wa'admulzim* upon both parties is not permissible. There is no specific opinion from traditional jurists who discuss about *wa'admulzim* from both parties similar as '*aqad*'; it is almost a consensual among them. This can be proven

by the ruling and writing of modern jurists of *fiqh*.<sup>32</sup>

The difference of opinion among jurists on the plain *wa'ad* should not be extrapolated to the *wa'ad* that substitutes for the contract, since in this case the *wa'ad* may not be binding under any circumstances. Hence, divergence is inadmissible thereon and must be given up altogether in favor of non-binding as one consistent position. Due to the prevalent controversy among modern jurists on unilateral promises (*wa'ad*), the decision of the Islamic Fiqh Academy of 1409H reflected the tension of the debate, thus expressing the ebb and flow between the two camps on both sides of the divide. The Academy decided that:

1. A *wa'ad* (which is issued unilaterally by either the ordered or the client) is by religion binding upon the promisor except where otherwise justified. It is also judicially binding if it is made contingent upon a reason and if the *wa'ad* entails a cost for the *wa'ad*. In such cases, the consequences of the binding character of the *wa'ad* are determined by either the fulfillment of the *wa'ad* or by reparation for losses actually incurred as a result of the non-fulfillment of the *wa'ad* without justification.

2. A bilateral promise (*muwa'ada*) is admissible in *murabahah* upon the condition that the bilateral promise (*muwa'ada*) is optional for both or either parties. If the bilateral promise (*muwa'ada*) offers no choice, then it is inadmissible because a binding bilateral promise (*muwa'ada*) in *murabahah* is comparable to an ordinary sale where it is required that the seller be in possession of the goods sold in order not to violate the prohibition by the Prophet (PBUH) of the sale by a seller of that which is not in his possession (*bay' al-insan ma laysa'indah*).

In summary, the Academy relied on researches into the *wa'ad* that were carried out separately from the issue of *murabahah*, where the authors ignored the link between the *wa'ad* and the resale contract, even though the provisions governing the plain *wa'ad* are completely different from those governing the *wa'ad* in resale and other commutative transactions.<sup>33</sup>

### **Promise (*al-wa'ad*) in Islamic banking system in Malaysia**

The application of *al- wa'ad* had been recognized by the Central Bank of Malaysia and practiced by many banks such as Bank Islam Malaysia Berhad, Bank Muamalat Malaysia Berhad, Citibank, as well as RHB Bank that run the Islamic Banking Business in their products such as *Murabahah*, *ShirkahMutanaqisah*, *Sukuk*, Foreign

<sup>32</sup>Id., 24, at. 84

<sup>33</sup>SitiSalwaniRazali, (2008) The Concept of *Wa'ad* in Islamic Financial Contract, at.7

<sup>31</sup>Id, 18

Exchange, and *ijarah*.<sup>34</sup> Based on the practice of Islamic Banking system, a promise made is normally binding upon parties because of the follows:

First, banking system is a system which is systematically monitored and any breach of promise is normally affecting the reputation of the financial institution.

Second, all transaction is normally supported by complete documentation as well as on line computer system in order to minimize any mistake which may lead to misunderstanding.

Third, banking transaction involves properties or big amount of money and therefore it is not proper for that kind of transaction to be done merely based on promise which is not binding.

Fourth, breach of promise in banking transaction is normally involves material loss upon the party whose promise had been breached.<sup>35</sup>

According to Malaysian Islamic Fiqh Academy resolution, *al wa'ad* does not bind only one party but upon both parties provided there must be two clauses or terms of promise which derive from both parties. In Bank *Muamalat* Malaysia Berhad, the application of *wa'ad* will be adopted in the agreement such as Deed of Covenant which reads as follows:

First, the customer hereby irrevocably undertakes and promises to purchase from the Bank's Shares pursuant to the *Shari'ah* principle of *Wa'ad Mulzimah* the Sale Price upon the terms and conditions of the *Musharakah Mutanaqisah* House Financing- I Facility Agreement, in particular in accordance with Section 3 thereof. The Sale Price for each portion shall be an independent debt of the customer and shall constitute a separate and several sales from the other portions of the sale of the Bank's Shares.

Second, the parties hereby agree that the sale of the Bank's Share herein shall be pursuant to the *Shari'ah* principle of *Bay' Al- Mu'atoh*. (Purchase of Bank's Shares).

The title to the bank's Share that is to be acquired over time upon the terms and conditions of the *Musarakah Mutanaqisah* House Financing-I Facility Agreement shall pass upon full payment of each portion so acquired. (Transfer of Title, Deed of Covenant).

Here we can see that the word unilaterally had been replaced by the word irrevocably because it involves two different promises i.e. promise to buy the equity in every month from the client and promise to sell the share equity from the financial institution i.e. in this case Bank *Muhamalat*, besides of *syirkah mutanaqisah*, the concept is also being used in foreign exchange (FOREX), *ijarah*, *sukuk*, *murabahah* etc. The term *al-wa'ad* has not been commercialized in Maybank like Bank *Muhamalat* since

Islamic banking is a mere window to this Conventional Banking; instead they rely on the ordinary contract in running their banking business. However the concept of *al-wa'ad* itself is impliedly used in many Maybank products such as Mortgage Reducing Term Takaful (MRTK), *Wakalah*, Overdraft- Cash line Facilities, and *Murabahah* which will be elaborated later on how this concept is actually being practiced in Maybank.

The application is impliedly inserted in their Master Agreement and it is binding upon parties but subject to the clause which confers the bank right to make any changes to it. The same goes to RHB Bank Berhad where the terminology itself is not so familiar among them however the application is there especially in the Islamic products which are about to be launched very soon for example *Musharakah Mutanaqisah*, Equity Home Financing-i, *Mudharabah* Overdraft, etc. The term 'purchase undertaking' used in their contract signifies the application of *al-wa'ad* which they believe that it is basically had been applied in almost all of their products.<sup>36</sup>

#### Application of *al- Wa'ad* in Islamic banking product

A forward contract in the forex market locks in the price at which an entity can buy or sell a currency on a future date. It is also known as "outright forward currency transaction", "forward outright" or "FX forward". As a general principle, Maliki's scholar of thought does not permit promise done in currency transaction except on the spot or immediately. This is in parallel to the hadith of the prophet.

gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, equal for equal, and hand-to-hand (spot); if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand or spot transaction.<sup>37</sup>

In this *hadith* it stated that for the *ribawi* item (interest), including currency which was originated from the gold and silver, it has to be equal in amount and on spot transaction otherwise it will be constituted as *riba*. Imam *Shafi'i* permit promise of sale and purchase of currency as stated in *Kitab al- Umm*, "If two persons promise on currency there is no restriction for them to buy *dirham*, then both of them agree upon one of the price until they execute the sale and purchase agreement". *Ibnu Hazm* permits promise to sell and to buy the currency with the agreed price on that day followed by the real sale and

<sup>34</sup>Ibid.

<sup>35</sup>Id, 31.

<sup>36</sup>Ibid.

<sup>37</sup>Mishkat, on the authority of Bukhari's "Tarik", and Ibn Taymiyyah's "*Al Muntaqa*" translation by M. 'Umer Chapra. See also *Sunnah al-Bayhaqi*, *Kitab al-Buyu'*, translation by 'Umer Chapra.

purchase which is executed together. The parties to promise also can refuse to proceed with the promise by not execute the sale and purchase contract. This is because according to *IbnuHazzam* the promise is revocable because it is not binding.

*Shari'ah* council of AAOIFI had explained that the original *hukum* for currency transaction is permissible, because it includes in the general provision of *shara'* which allow currency transaction. It is one of the sources of income as long as it is not contrary to *Shari'ah*. However, *Shari'ah* council of AAOIFI also decided that the promise in currency exchange which is *mulzim* in nature is prohibited as proclaimed by the consensus opinion of jurists. This is because the promise which is *mulzim* in nature by both parties is just like a formal contract. Should the promise is done by one party; it is permissible though it is *mulzim* in nature. *Nadwah al Barakahin* 1981 stated that the promise of currency exchange transaction which is binding on both parties is prohibited because it involves *bay 'al-kali'bil- kali'*. If the promise is not *mulzim*, it is permissible.<sup>38</sup>

As for those who recognized *al-wa'ad* in currency exchange, the delivery of the exchange can be made within three days after the dealing which is still considered as spot according to the view of Imam Malik, who made an analogy with *Salam* contract. Any time longer than that will amount to *riba* as the principle stated before. Therefore to avoid such thing and having a longer period with the fluctuation of the market price, here *al-wa'ad* will come into the picture where it will take effect from the time the dealing is made without concluding any contract, until the delivery day. Once the delivery is made, then the ordinary contract for currency exchange is concluded. So far in Malaysia, only Bank Islam and Bank *Muamalat* apply and recognize the application of *al-wa'ad* in foreign exchange.<sup>39</sup>

### Use of the *Wa'ad* in the Islamic finance market

In relation to any contract, *Shari'ah* requires (i) knowledge of the price and (ii) possession or ownership of the subject matter, as necessary prerequisites to ensure legitimacy.<sup>40</sup> The attractiveness of the *wa'ad* stems from its unilateral nature, meaning that the above formal requirements of a contract under

*Shari'ah* need not be strictly adhered to. The *wa'ad* has gained a lot of exposure over the last few years due to its inherent flexibility<sup>41</sup> and has proved particularly helpful in developing several Sharia-compliant structures, as discussed below.<sup>42</sup>

### Use of *Wa'ad* for foreign exchange option

The *wa'ad* can be used to structure an FX (i.e. currency) option. In this regard, *Shari'ah* distinguishes between the creation of an option and the trading of an option.

The creation of an option (and the subsequent exercise or cancellation of the same) for genuine trade hedging purposes is broadly viewed as permissible, as it reduces uncertainty (*gharar*) and is therefore regarded as contributing towards the public good (*maslaha*).<sup>43</sup>

However, the trading of an option without any accompanying purchase/sale of underlying tangibles, undertaken solely with the objective of making a speculative gain (akin to gambling – i.e. – *maisir*, which is prohibited under *Shari'ah*), is regarded as impermissible by several *Shari'ah* scholars, as this is looked upon as increasing *gharar*.<sup>44</sup> The currency option is conceptually accepted by many scholars and the promisor may be eligible to receive a fee for facilitating the transaction. The cash-flows under an FX option using a *wa'ad* emulate the cash-flows under a comparable conventional FX option.

### FX option for a multinational bank

This currency exchange structure was approved by the central *Shari'ah* monitoring body of a multinational Bank in 2006. The structure, which is capable of operating either as a put option or as a call option (both in favour of the Bank), is built on a unilateral promise (*wa'ad*) from the Client, without creating any obligations (other than an initial obligation to pay the applicable premium) for the Bank.

Under this structure, (i) the Client promises the Bank to buy/sell a particular amount of a currency (Currency B) against another currency (Currency A) on a pre-

<sup>38</sup> Majmu'ahDallahBarakah., *Fatwa Nadawat al Barakah*, 1981-1997, Jeddah.

<sup>39</sup> Nor Adilabt.Mohd NoorMohd Ashraf b. Aripin, Mechanism of al-Wa'ad (Promise): Theory and Application in Islamic Banking in Malaysia, at.85-86.

<sup>40</sup> Deutsche Bank Academic Paper, *Pioneering Innovative Shari'ah Compliant Solutions*, available at <[http://www.db.com/presse/en/download/White\\_Paper.pdf](http://www.db.com/presse/en/download/White_Paper.pdf)> Retrieved on 28/3/2012.

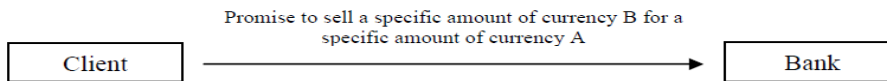
<sup>41</sup> Norfadelizan bin AbdRahman, *Commodity Murabaha: as a basic foundation of Islamic derivative and structured product*, 29 May 2008, available at <[http://www.pacificprospect.com/msp\\_2008/downloads/a/12.pdf](http://www.pacificprospect.com/msp_2008/downloads/a/12.pdf)>; *Is Wa'ad the next star in Islamic banking*, available at <<http://islamicbankers.wordpress.com/focus/is-waad-the-next-star-in-islamic-banking/>> Accessed on 25/3/2012.

<sup>42</sup> Ibid.

<sup>43</sup> Mohammed Obaidullah, *Islamic Financial Options*, available at <<http://vlib.unitarklj1.edu.my/htm/islamfin.htm>>; Sami al Suwailem, *Hedging in Islamic Finance*, available at <[www.irtipms.org/OpenSave.asp?pub=217.pdf](http://www.irtipms.org/OpenSave.asp?pub=217.pdf)> Accessed on 25/3/2012.

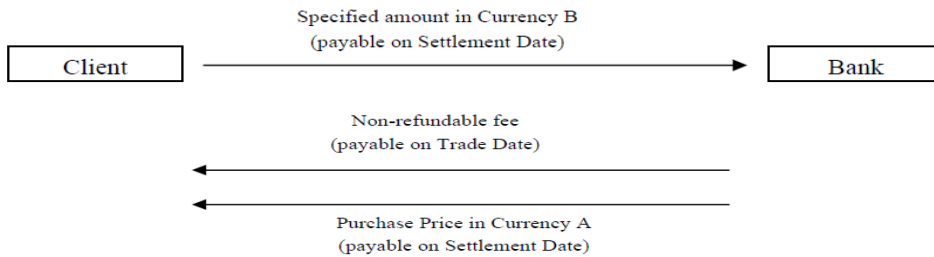
<sup>44</sup> Ibid

*The Promise (illustrating a call option for the Bank)*

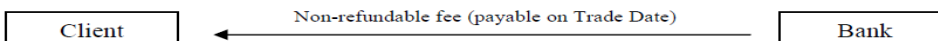


*Cashflows*

**Scenario (A)** If the Bank exercises the option (i.e. if the Bank does not send a cancellation notice to the Client):



**Scenario (B)** If the Bank sends a cancellation notice to the Client and therefore, does not exercise the option:



(Note: In the above example, the Client is the 'Seller' and the Bank is the 'Buyer' of the option).  
46

determined date (Settlement Date) and at a predetermined rate; (ii) the Bank acknowledges the Client's promise but makes no promise to the Client; and (iii) the Bank pays a non-refundable fee (premium) to the Client, regardless of whether the Bank chooses to exercise the put/call option (as the case may be) by enforcing the *wa'ad* (the Bank's decision whether or not to exercise the option being dependent upon whether the option is in-the-money on or about the Settlement Date).

The Bank, therefore, has a right to accept the promise (and thereby exercise the *wa'ad*-based option) or cancels the promise by sending a cancellation notice.

In the context of a similar *wa'ad*-based FX option developed by another multinational bank, the relevant *Shari'ah* Board stated that the concerned product is "for hedging or cost reduction purposes only and not for speculation".<sup>45</sup>

<sup>45</sup>Kabir Hassan, Michael Mahlknecht, Ed., (2011) *Islamic Capital Markets: Products and Strategies* (UK: John Wiley and Sons,) at.153.

<sup>46</sup>PriyaUberoi, Rahul Chatterji&DanyBidar, (2009) Promises on the Horizon: An Introduction to the Wa'ad J. Documents and Resources for Small Business and Professionals, at.3

**The promise (illustrating a call option for the bank)**

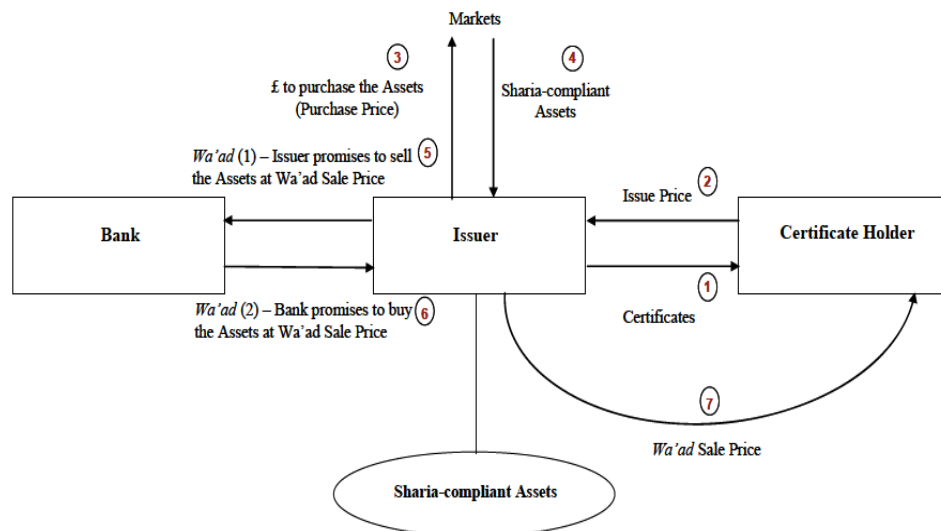
Promise to sell a specific amount of currency B for a specific amount of currency A

**Double promise (Wa'adan) structure**

Under a conventional total return swap, the underlying economic reasons for entering into such a transaction are, (i) that it allows a party to gain exposure to an asset which it does not necessarily need to hold on its balance sheet; and (ii) that pay-offs can be structured so that the other party can hedge against the upside or downside related to that particular asset or class of assets. Under *Shari'ah*, a similar economic profile can be generated by using a double *wa'ad* structure.

The double *wa'ad* structure has been used in a *Shari'ah*-compliant securities program to give the holder of a Certificate exposure to an underlying asset or index (the Underlying). This product was approved by the *Shari'ah* Board of *Dar Al Istithmar* (*Shari'ah* Advisor to Deutsche Bank), comprised of five of the world's leading *Shari'ah* scholars - *Dr, Hussein Hamed Hassan, Dr Ali Al-*

*Structure and Cash-flows:*



Qaradaghi, Dr, Abdul Sattar Abu Ghuddah, Dr, Mohamed Ali Elgari and Dr, Mohamed Daud Bakar.

Under this structure, an SPV Issuer uses the cash proceeds from an issue of Certificates to acquire a pool of Sharia-compliant assets from the market (*Shari'ah-compliant Assets*). These *Shari'ah-compliant Assets* could be shares listed on the Dow Jones Islamic Market Indexes (DJIMI). Exposure to the Underlying is pivoted on two mutually exclusive *wa'ads* between the Issuer and the Bank. Under one *wa'ad* (*Wa'ad 1*), the Issuer promises to sell the *Shari'ah-compliant Assets* to the Bank at a particular price (which is linked to the performance of the Underlying) (*Wa'ad Sale Price*), while under the other *wa'ad* (*Wa'ad 2*), the Bank promises to buy the *Shari'ah-compliant Assets* from the Issuer at the *Wa'ad Sale Price*. The *Wa'ad Sale Price* is linked to the performance of the Underlying. Out of these two *wa'ads*, only one shall ever be enforced.

At maturity, the Bank will calculate how the *Shari'ah-compliant Assets* have performed relative to the Underlying, and (i) if the *Wa'ad Sale Price* is greater than the market value of the *Shari'ah-compliant Assets*, then the Issuer shall enforce *Wa'ad 2* (similar to a conventional put option); and (ii) if the *Wa'ad Sale Price* is less than the market value of the *Shari'ah-compliant Assets*, then the Bank shall enforce *Wa'ad 1* (similar to a conventional call option).

The commercial significance of this structure lies in the fact that, similar to a conventional total return swap, it offers Islamic investors the opportunity to potentially swap the returns in one basket (as generated from the *Shari'ah-compliant Assets*) with the returns in another basket (the *Wa'ad Sale Price*, as calculated with reference to the Underlying). According to Dr. Hussein Hassan, director in the Middle East structuring team at Deutsche Bank, "Driven by investor demand, the

technique has been instrumental in opening up investment in asset classes that have previously been closed to Islamic investors".<sup>47</sup>

(Numbers in the above diagram denote chronology of events. Either 5 or 6 shall occur (but never both, as explained above).<sup>48</sup>

### Use of the *Wa'ad* for short selling

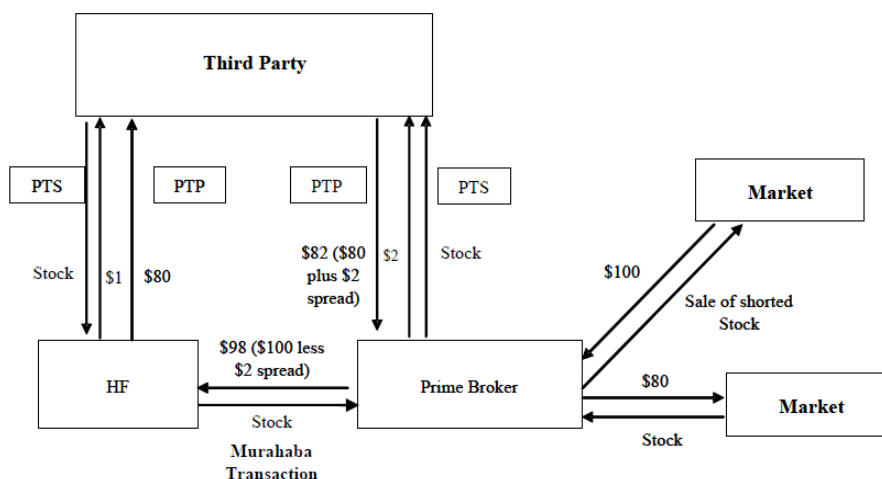
Conventional short selling involves the selling of a security (generally a stock or a share) that the seller does not own. There is, therefore, a separation of ownership and risk in any conventional short-selling mechanism. The short-seller essentially takes a chance on the security in question decreasing in value, which shall enable the short-seller to buy that security back from the market at a later date (for a lower price) and make a speculative gain in the process. Under *Shari'ah*, according to *Hadith* (sacred words and deeds of the Prophet Muhammad), one cannot sell what one does not own<sup>49</sup> and ownership cannot be divorced from risk. Therefore, to replicate the economics of a conventional short-sale in a *Shari'ah-compliant* structure whereby the parties adhere to the *Hadith*, the seller has to actually own the securities which form the basis of the

<sup>47</sup>PriyaUberoi, Rahul Chatterji and DanyBidar, (2009) *The wa'ad on the Street*, available at <<http://www.risk.net/public/showPage.html?page=813157>> retrieved on. 28/3/2012.

<sup>48</sup>SitiSalwaniRazali, (2008) *The Concept of Wa'ad in Islamic Financial Contract*, at. 5

<sup>49</sup>Mahmoud Amin El Gama I(2000). *Prohibitions on riba and gharar*, Retrieved from <[http://www.witness-pioneer.org/vil/Books/MG\\_CIBF/chapter\\_1.htm](http://www.witness-pioneer.org/vil/Books/MG_CIBF/chapter_1.htm)> Visited on 27/3/2012.

## Structure and Cashflows:



**PTP** stands for Promise to Purchase; **PTS** stands for Promise to Sell.

transaction.

Two double *wa'ads* can be used efficiently in combination with a *murabaha*, or deferred payment transaction, to replicate the cash flows under conventional short selling in order to generate a similar economic profile but in a Shari'ah compliant manner. Such a structure might work in the following way. A Prime Broker (PB) purchases the stock from an Islamic Hedge Fund (HF) through a *murabaha* for a particular *murabaha* sale price (\$100 in the illustrative diagram below (ID)) payable on a deferred basis at a future date. PB then on-sells the stock in the market for the prevailing spot price (\$100 in ID), thereby generating a certain cash reserve.

Simultaneously, a third party (Third Party) enters into two double *wa'ads*— (i) one with PB, whereby PB unilaterally promises to sell and the Third Party unilaterally promises to buy the stock for a pre-specified price (\$82 in ID) (Double *Wa'ad* 1), and (ii) one with HF, whereby HF unilaterally promises to buy and the Third Party unilaterally promises to sell the stock for a pre-specified price (\$80 in ID) (Double *Wa'ad* 2). The Third Party is paid (i) a fee (DW1 Fee) by PB (\$2 in ID) for entering into Double *Wa'ad* 1; and (ii) a fee (DW2 Fee) by HF (\$1 in ID) for entering into Double *Wa'ad* 2.

Assuming that the stock price falls to \$80 at any subsequent date, PB (i) uses its cash reserves to buy shares from the market at the spot price of \$80 and (ii) triggers Double *Wa'ad* 1 with the Third Party, whereby PB on-sells the stock to the Third Party for \$82 (\$80 plus PB's \$2 spread). HF then triggers Double *Wa'ad* 2 with the Third Party whereby HF purchases the stock for \$80 from the Third Party. Under the terms of the *murabaha* transaction between HF and PB, PB pays HF \$98 (\$100 minus PB's spread (for the *murabaha* transaction) of \$2).

The returns generated by this structure broadly emulate the returns generated by a comparable

conventional short-selling structure (assuming that the Third Party and HF are related parties, which we consider to be quite likely). However, it could be argued that the risk profiles in this structure are slightly different from those in a conventional structure. Our understanding in this regard is based solely on publicly available materials<sup>50</sup>, however it is not implausible that the below structure incorporates the creation of alpha (new wealth) to ensure that returns are synonymous to a conventional short-sell arrangement.

### Returns for the Hedge fund and prime broker

Similar to conventional short-selling, the above structure produces returns for both the Prime Broker and the Hedge Fund.

#### Prime broker

In the above scenario, PB's return is equal to \$2. This represents the total spread which PB earns on (i) the *murabaha* transaction with HF and (ii) Double *Wa'ad* 1; minus (iii) the DW1 Fee (\$2).

#### Hedge fund

In the above scenario, HF's return is equal to \$17. This

<sup>50</sup>PriyaUberoi, Rahul Chatterji and DanyBidar, *Promises on the Horizon: An introduction to the Wa'ad*, (Alloen&Overy) at. 3-7 Retrieved from <<http://www.sovereign-publications.com/Alt-investmentarticles/272-275%20Amiri%20Capital.pdf>>accessed on 28/3/2012.

<sup>51</sup>Ibid., at.5-7.

represents (i) The amount of money HF receives from PB under the *murabaha* transaction (\$98, i.e. \$100 less PB's \$2 spread), minus (ii) The amount of money HF spends on purchasing the stock from the Third Party under Double *Wa'ad* 2 (i.e. \$80), minus (iii) The DW2 Fee (\$1).

### Third party

In the above scenario, the Third Party's return is equal to \$1. This represents (i) The amount of money Third Party receives from HF under the terms of Double *Wa'ad* 2 (\$80), plus (ii) The DW1 Fee (\$2), plus (iii) The DW2 Fee (\$1), minus (iv) the amount of money Third Party pays PB under the terms of Double *Wa'ad* 1 (\$82).<sup>51</sup>

### CONCLUSION

*Al-wa'ad* can be regarded as a *Shari'ah* concept with exciting possibilities and significant market potential. Whether this potential shall be realized, only time shall tell. Till then, market players will be keenly watching *wa'ad* based products to try and determine, whether the *wa'ad* is the next shining star on the horizon of innovative Islamic financing techniques. It is essential to ensure the *Shari'ah*-compliance of new products in the market. On the other hand, it is equally important not only to allow the market to stagnate. In the current Islamic Finance, the market is calling out for even more innovation, and the *wa'ad* has the potential to bring that innovation to the market. Moreover, its frequently referred to as an effort aimed helping Islamic finance to grow and be competitive in the world of finance, *wa'ad* may employing in structuring many Islamic financial instruments including *Murabahah* sale, swap and option.

### REFERENCES

- Al-Qardawi Yusuf (1986). *Bay' Al-Murabah Lil-Amri Bi- Ashira'* (3<sup>rd</sup>Edn.,) Kuwait: Dar al-Qolam.
- AsyrafWajdiDusuki, FN 6023 Islamic Finance Concept, Principle and Application of *wa'ad* (promise/undrrtaking) Retrieved from [www.kantakji.com/fiqh/Files/Finance/N422.pdf](http://www.kantakji.com/fiqh/Files/Finance/N422.pdf) Accessed on 26/3/2012.
- Deutsche Bank Academic Paper, *Pioneering Innovative Shari'ah Compliant Solutions*, available at [http://www.db.com/presse/en/download/White\\_Paper.pdf](http://www.db.com/presse/en/download/White_Paper.pdf)
- Kabir Hassan, Michael Mahlknecht, Ed. (2011). *Islamic Capital Markets: Products and Strategies* (UK: John Wiley and Sons,)
- Mahmoud Amin El Gamal (2000). *Prohibitions on riba and gharar*, Retrieved from [http://www.witness-pioneer.org/vil/Books/MG\\_CIBF/chapter\\_1.htm](http://www.witness-pioneer.org/vil/Books/MG_CIBF/chapter_1.htm).> Visited on 27/3/2012.
- Majallat Al-Majma,, Vol. V, Part IV.
- Majmu'ahDallahBarakah (1997). at.28)
- Majmu'ahDallahBarakah.,*Fatwa Nadawat al Barakah* (1981- 1997). Jeddah.
- Mishkat, on the authority of Bukhari's "Tarik", and Ibn Taymiyyah's "*Al Muntaqa*" translation by M. 'UmerChapra.
- Mohammed Obaidullah, Islamic Financial Options, available at <http://vlib.unitarklj1.edu.my/htm/islamfin.htm>; *Sami al Suwailem, Hedging in Islamic Finance*, available at [www.irtipms.org/OpenSave.asp?pub=217.pdf](http://www.irtipms.org/OpenSave.asp?pub=217.pdf)> Accessed on 25/3/2012.
- Mustafa Al-Zarqa (2003). *Al-Madkhal Al-Fiqhi Al- 'Amu*, Damascus: Dar al-Qolam, Vol. II.
- Nizam Al-Ta'min, at.58 and 131.
- Nor Adilabt.Mohd NoorMohd Ashraf b. Aripin, Mechanism of *al-Wa'ad* (Promise) (2010). Theory and Application in Islamic Banking in Malaysia, J. vaggi.org search Open Access SoSci e-J. 14/7/
- Norfadelizan bin AbdRahman, *Commodity Murabaha: as a basic foundation of Islamic derivative and structured product* (29 May 2008). available at [http://www.pacificprospect.com/msp\\_2008/downloads/a/12.pdf](http://www.pacificprospect.com/msp_2008/downloads/a/12.pdf); *Is Wa'ad the next star in Islamic banking*, available at <http://islamicbankers.wordpress.com/focus/is-waad-the-next-star-in-islamic-banking/>> Accessed on 25/3/2012.
- Nurdianawatilrwani Abdullah (2010). Status and implications of promise (*wa'ad*) in contemporary Islamic banking, *Humanomics*, Vol. 26 Iss: 2, at.84 – 98 Retrieved from <http://www.emeraldinsight.com/journals.htm?articleid=1875997andshow=html>> visited on 27/3/2012.
- Nurdianawatilrwani Abdullah (2012). *The Status of Promise (Wa'ad) and Its Implication Incontemporary Islamic Banking*, ISRA Islamic Finance Seminar (IIFS) 11 November 2008, at. 2Retrieved from <http://www.scribd.com/doc/50755396/IIFS-Status-of-Wa-ad>> accessed on 25/3/
- PriyaUberoi, Rahul Chatterji and DanyBidar (2009). *Thewa'ad on the Street*, available at <http://www.risk.net/public/showPage.html?page=813157>> retrieved on. 28/3/2012.
- PriyaUberoi, Rahul ChatterjiandDanyBidar (2009). Promises on the Horizon: An Introduction to the *Wa'ad*, *Journal of Documents andResources for Small Business and Professionals*. Retrieved from <http://www.sovereign-publications.com/Alt-investmentarticles/272-275%20Amiri%20Capital.pdf>.> accessed on 28/3/2012. retrieved on 28/3/2012.
- Sahih Al-Bukhari; 1/21. Hadith no. 33
- SitiSalwaniRazali (2008). The Concept of *Wa'ad* in Islamic Financial Contract, *Presented paper at Islamic Banking, Accounting and Finance Conference* IBAF.
- Summarised from Al-Mausuah Al-Fiqhiyyah, Wizarah al-Auqafwa al-Shu'un al-Islamiyyah, Kuwait Retrieved from, <http://isra.my>www.islam.gov.kuwait> visited on 1/4/2012.
- SunanAbiDawud; 268/5. Hadith no. 4995
- Sunnah al-Bayhaqi*,Kitab al-Buyu", translation by 'UmerChapra.
- Sweet Child (2009). *Islam and Finance From My Perspective*, Retrieved from <http://myviewpoint2u.blogspot.com/2009/08/waad-versus-muwaadah.html>> visited on 26/3/2012.
- Yusuf Al-Qardawi (1987). *Bay' al-Murabahah*, Damascus: MaktabaWahbat, at. 85