

## Application of Promise in Al-Ijarah Thumma Al-Bai' (AITAB) Facility

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**Abstract:** Financing facility is important for most businesses and enterprises. Al-Ijarah Thumma Al-Bai' (AITAB) is among the most popular methods of financing facility in Malaysian financial institutions. One of the important elements in structuring this method of financing is the promise. The application of promise in AITAB must satisfy Shariah rulings to ensure its compliance to Shariah law. The application of promise must also satisfy the relevant civil laws to ensure its enforceability at the court of law. Failure to comply with any of these laws may lead to Shariah or legal issues. Hence, this study aims to analyse the extent to which the application of promise in AITAB facility as practised by Malaysian financial institutions is valid and legally enforceable from the perspective of Islamic law. It is then compared to the position under civil law perspective. This study is limited to the application of promise in AITAB facility and does not include its implementation in other ijarah-based facility such as Musharakah Mutanaqisah and Sukuk Ijarah. This study employed qualitative research methodology and the data were collected by conducting document analysis. The finding of the study shows that the application of promise in AITAB facility is valid and legally enforceable from the perspective of Islamic law. Nevertheless, there is legal issue from the civil law perspective because the promise as practiced in AITAB would not be legally enforceable under Malaysian civil law. Hence, efforts must be undertaken to strengthen local law governing the implementation of promise in AITAB facility.

**Key words:** Promise, Al-Ijarah Thumma Al-Bai' (AITAB), Shariah rulings, civil law, Malaysian financial institutions

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### INTRODUCTION

Financing facility is important for most enterprises and businesses particularly for asset acquisition. Among the most popular methods of asset acquisition facilities offered by Malaysian financial institutions is Al-Ijarah Thumma Al-Bai' (AITAB). AITAB is one form of Ijarah Muntahiyah Bittamlik (Leasing Ending With Ownership). It is an ijarah contract ending with the transfer of the title of the asset to the lessee at the end of the leasing period. Hence, it involves two separate transactions which are leasing and sale contract. At the first stage, both customer and bank enter into a leasing contract through which the customer will lease the asset from the bank for a specified period and an agreed amount of rental payment. At the second stage, a sale contract will be executed that will transfer the ownership of the asset to the lessee. The mechanism of AITAB facility transaction is as follows:

- The customer recognizes the assets that he wants to purchase and obtain all the necessary information of the particular asset from the dealer

- The customer applies for Islamic hire purchase facility from the bank. At this stage, the customer requests the bank to purchase the asset and make a promise to purchase the asset when ijarah period expires
- The bank purchases the asset from the dealer based on the customer's request
- The bank leases the asset to the customer by executing an ijarah contract. At this stage, the possession and benefit of the asset is transferred to the customer at an agreed rental price for a specified period of time
- The bank transferred the title of the leased asset to the customer at nominal price upon the expiry of ijarah contract by executing sale contract

In many cases, AITAB facility involved the application of promise, particularly as a mechanism to transfer the ownership of the asset at the end of the leasing period. The promise in AITAB facility usually takes place in the form of purchase undertaking and/or sale undertaking (Ahmad and Ahmad, 2014). Promise could occur when the hirer undertakes to purchase the

leased asset from the bank upon the expiry of leasing period by signing wa'd document. Promise also would come from the bank in the form of sale undertaking.

Promise plays a significant role in AITAB facility as it ensures its legitimacy. In AITAB, the ownership of the asset is transferred by bank to customer through a sale contract. Nevertheless, the sale contract should not be combined with the lease contract as it may amount to a combination of contract or preconditioned contract which is prohibited by the Shariah (Hasanuzzaman and Ayub, 2007; Irwani, 2010). The application of promise therefore, may ensure the legitimacy of the transaction by avoiding the combination of two contracts in one transaction. The application of promise also may reduce the risk of default. This is because banks need to acquire the ownership of the asset before leasing or selling it to customers to avoid from selling something which is not in one's ownership. Accordingly, banks would face the risk of financial loss if the customer breaches his promise and the bank has to sell the asset to another person at a lower price (Zaini and Isa, 2010). Here, the application of promise can reduce the banks' risk of financial loss by ensuring the parties' commitment to perform the contract. Thus, the application of promise as purchase undertaking may protect the banks' interest where a promise is made by the customer to purchase the leased asset in the event of default and total loss (Ahmad *et al.*, 2012).

The application of promise in AITAB facility must comply with Shariah rulings on promise in order for the operations to comply with the Shariah. Failure to comply may lead to Shariah non-compliance risk. Apart from compliance with Shariah law, its application must also comply with civil law in order to be enforceable at the court of law. Failure to comply with civil law may render the promise to be void and unenforceable. This may jeopardize the rights of the parties in AITAB facility because a party may not be able to enforce his right upon breach of promise. Any failure to comply with these frameworks would lead to Shariah and legal issues. Therefore, this study aims to discuss the implementation of promise in AITAB facility as practiced by Malaysian financial institutions. The focus of the study is on the extent to which its implementation is valid and enforceable from both Shariah and civil law perspectives.

## **MATERIALS AND METHODS**

This study employs qualitative method of study that comprises of document analysis. The banks' actual practice of promise in AITAB facility is assessed by analyzing the legal documentation of Islamic hire purchase facility of four banks in Malaysia. The banks'

actual practice on the implementation of promise is then analyzed in the context of both Shariah and civil law to determine its validity and enforceability from both Shariah and civil law perspectives.

**The concept of promise:** Promise is translated from the Arabic root word of Wa'ada. According to al-Fayyumi, literally wa'd or 'iddah is referred to promises to do good or bad (Ahmad *et al.*, 2008). Therefore, its literal meaning covers both notifications to perform a good and bad act (Irwani, 2010; Shabana and Marjan, 2011). Based on Wa'd Exposure Draft, literally, wa'd (promise) connotes the meaning of promise or undertaking and is referred to as commitment to perform a future action which is expressed by one party to another. This definition indicates that wa'd is a promise made unilaterally by one party and it is to be carried out in the future.

The technical meaning of wa'd can refer to the definition given by Ibn 'Arafah, a Maliki jurist and al-Aini, a Hanafi jurist who indicate that wa'd is a declaration made by one person to perform a good act in the future. According to Faruk and Asmak (2015) wa'd is limited to a good promise only and argues that generally, a promise to carry out a bad act is prohibited in Islam. Therefore, technically, wa'd is referred to as a declaration made by one person to perform good act and that particular act must be executed in the future and not at the time of when the promise is made (Faruk and Asmak, 2015; Muhammad, 2014; Irwani, 2010).

In traditional concept, wa'd is unilateral in nature and binding on the promisor only (Irwani, 2010). It is made only by one party either orally or in writing. There will be no acceptance from the other party in returning the promise made by the promisor. The acceptance from the promisee may only constitute an approval and does not amount to an acceptance of contract.

Promise in the context of Islamic finance also refers to the concepts of wa'dan and muwa'adah. Wa'dan refers to two unilateral promises, independently made by two parties pertaining to performance of a certain act in the future (Ahmad and Ahmad, 2014). Both promises are not related to each other and the implementation of promise is subjected to two different conditions (Abdullah and Rahman, 2015a). Moreover, according to Ahmad and Ahmad (2014) and Shamsiah and Rusnah (2010), the application of promises will only satisfy the characteristics of wa'dan if both promises contain two different effects. Muwa'adah refers to a declaration made by two persons that manifest their willingness to perform a certain action in the future and both promises have the same effect on both parties.

According to Aznan, “muwa’adah is two promises given in bilateral by the two parties, one to another, whether the promise was made with conditions or not”. Therefore, muwa’adah differs from wa’dan whereby in muwa’adah, both promises are connected between each other while wa’dan contains two promises which are independent from each other (Abdullah and Rahman, 2015b).

**Shariah rulings on promise:** As a general rule, Islamic scholars unanimously agreed that a promise only imposes a promisor with a moral duty and the performance of the promise is not compelled by Shariah law (Kharofa, 2000). However, there are different opinions among the classical jurists on the legal enforceability of a promise to perform permissible or recommended matters (Mohamad, 2014). The view of classical jurists can be divided as follows.

**View 1:** Performance of promise is recommended but not compulsory. Therefore, a breach of promise is makruh (discouraged) but not a sin (Mohamad, 2014; Irwani, 2010). This is the opinion of the majority of scholars including Shafi’is, the Hanafis and the Hanbalis.

**View 2:** Wa’d is religiously binding but not legally binding. Therefore, performing a promise is obligatory by religion and a person who breaches his promise is committing a sinful act but there is no legal duty to perform the promise. This is the consensual opinion of the majority of Muslim scholars including Imam Abu Hanifah, Imam al-Shafii, Imam Ahmad, the Zahiris and some Malikis (Irwani, 2010).

**View 3:** The promise is legally and religiously binding. According to this view, a promise is enforceable through a court of law and the promisor is under moral as well as legal obligation to fulfill his promise (Qazi, 2012). This is the opinion of a minority of scholars that includes Ibn Syabramah, an opinion of the Malikis, Umar bin Abd al-Aziz, Hasan al-Basri, Samurah bin Jundub and Ishak bin Ibrahim.

**View 4:** Performance of promise is legally binding and enforceable if the promise is tied with certain conditions though no action has been taken by the promisee in pursuant to promisor’s promise. This is the opinion of the Hanafi School.

**View 5:** Performance of a promise is binding and enforceable by court if the promise is tied to conditions and the promisee has acted in relation to the promise. Hence, the promisor is obliged to perform the promise,

otherwise it will cause the other party to bear loss and difficulties. This is the preferred opinion of the Maliki school that includes Imam Malik, Ibn al-Qasim and Shahnun (Faruk and Asmak, 2015; Irwani, 2010). Ibn Al-Arabi of Maliki School viewed that performance of a promise is compulsory if it results to certain implications.

### **Contemporary opinion on the status and bindingness of promise**

**Unilateral promise (wa’d):** According to OIC Islamic Fiqh Academy in its 5th meeting in 1988, unilateral promise is religiously binding on the promisor unless there is a valid excuse. It is, however, legally binding if it is attached to a condition and the promisee in relation to such promise has acted to his detriment. Similarly, the AAOIFI in Shariah Standard No.9 on Leases and Rental Ending in Transfer of ownership held that a promise made by one party to transfer the ownership is binding.

Based on Wa’d Exposure Draft, a wa’d (promise) shall have a binding effect if it is linked to a specific cause and the breach of promise has caused detriment to the promise. Furthermore, according to the Concept Paper on Ijarah, the lessor may require the lessee to give a binding unilateral promise (wa’d mulzim) to purchase the leased asset in the event of default or breach of contract.

Qazi (2012) agrees that wa’d has a binding effect, particularly in its application in commercial activities. He argues that the issue of binding status of wa’d is within the flexible sphere of Shariah which is subject to modification in order to suit the change of time and place. Therefore, a comprehensive local law governing the enforceability of a wa’d in commercial activities should be enacted.

Ahmad and Ahmad (2014) conclude that a promise is binding if it is attached to a condition and the binding status becomes stronger if the promisee has acted or incurred expenses in pursuant to the promise. Similarly, Faruk and Asmak (2015) view that from the perspective of Islamic law, generally all promises are binding on the promisor unless there exist valid reasons or mitigating circumstances.

However, Mohamad (2014) views that wa’d is not binding for it would make it similar to contract while in actual fact, wa’d and contract are different from each other and both are subjected to different rulings. Similarly, Masri (2002) views that wa’d is not legally binding.

**Mutual promise (muwa’adah):** Majority of scholars disallow a binding muwa’adah because they view a binding muwa’adah is similar to a forward contract (Faruk and Asmak, 2015). The OIC Islamic Fiqh Academy’s decision in its 17th meeting stated that originally, muwa’adah is

religiously binding for both parties and not legally binding. Binding muwa'adah in a contract is a "hilah" of riba (interest) like 'inah and promise in 'salaf" transaction which is prohibited by Islamic law. However, binding muwa'adah is permissible whether through provision of law or parties' mutual consent if there is public need.

The AAOIFI Shariah Standard No. (9) on Leases and Rental Ending in Transfer of Ownership (Ijarah Muntahiyah bi al-Tamlik) also indicates that a promise must not be made binding on both parties to avoid a bilateral contract. It states:

"A promise to transfer ownership by one of the means mentioned in clause 8/1 is binding upon the one who gives it. It is obligatory that the binding promise be limited to one of the two parties. The other party will have the option to cancel. This is to avoid a binding bilateral contract which is prohibited, for it makes the promises equivalent to a contract, making it subject to the same rules:

According to Masri (2002), there is no legitimate ground to support the view that wa'd has a binding effect and therefore any view that holds promise as binding on both or either party, whether implicitly or expressly is not permissible. Hence, binding muwa'adah is not permissible. However, some studies differentiate between binding muwa'adah and contract and held that binding muwa'adah is permissible. This view is supported by studies conducted by Khairun.

**Two unilateral promise (wa'dan):** Based on literature, many scholars view that wa'dan is permissible if both promises contain two different conditions and it leads to two different effects. According to Ahmad and Ahmad (2014), wa'dan is similar to wa'd because in wa'dan, only one condition will be performed. Faruk and Asmak (2015) argue that wa'dan is not similar to muwa'adah because it contains two separate wa'd and only one wa'd will be implemented at one time while in muwa'adah, both promises will take effect at one time. According to Ahmad and Ahmad (2014) wa'dan is not a contract because wa'dan has a future effect while a contract has an immediate effect.

**Legal status of promise in the Malaysian civil law:** Based on the Federal Constitution, matters of banking and finance are within the jurisdiction of the civil court. Therefore, the operation of Islamic banking and finance must comply with the relevant civil law to be legally enforceable. The relevant civil law governing the implementation of promise is the Contracts Act 1950. Section 2(b) of the Act defines promise as:

"An agreement which is enforceable by law at the option of one or more of the parties there to but not at the option of the other or others is a voidable contract"

This shows that a proposal made by the promisor becomes a promise when it is accepted by the promisee. If the promise is not accepted, it will only amount to an offer. Section 2(a) defines offer as:

"When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to the act or abstinence, he is said to make a proposal"

This implies that an offer is the promisor's readiness to perform or abstain from doing something upon the consent of the promisee. Offer is an essential element of a binding contract. Nevertheless, an offer will only constitute a promise if it is accepted by the party to whom it is made. Hence, legal relationship between promisor and promise is created when the promise is accepted. Moreover, based on Section 26 of the Act, generally, a promise made in the absence of consideration is void. Section 2(d) of the contract defines consideration as:

"When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstain doing, or promises to do or to abstain from doing, something such act or abstinence or promise is called a consideration for the promise"

This shows that consideration must be made in pursuant of the promisor's request. The Contracts Act only enforces a promise if there is consideration in exchange of the promisor's promise. A promise without consideration is categorized as gratuitous promise which is usually not legally enforceable (Siti Salwani, 2008). Furthermore, Section 2(i) of the Act states:

"An agreement which is enforceable by law at the option of one or more of the parties thereto but not at the option of the other or others is a voidable contract"

This shows that according to the Act, an agreement is void if the promise is only binding on one party. The application of promise can also be referred to the doctrine of promissory estoppel. Promissory estoppel is a doctrine of equity applicable to the law of contract as a mechanism to enforce unilateral promise. Promissory estoppel was defined in the case of *Combe v Combe* 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 promisee 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 and even though it is not legally supported by any consideration but only his word

Nevertheless, the doctrine is only applicable as a defence and not as an independent cause of action. The limited application of promissory estoppel was explained in the case of *Amalgamated Investment and Property Co. Ltd. v. Texas Commerce International Bank Ltd.*

**Banks' actual practice :** The actual practice of promise in AITAB facility is assessed by analyzing its legal documentation. In bank A, the practice of promise is adopted in its document of sale undertaking which reads as follows:

"We refer to the above mentioned agreement. All terms defined in the agreement shall have the same meaning in this sale undertaking when used or referred to: Upon your exercise of your rights pursuant to and in accordance with Clause 11 of the agreement at the sale price stated in Clause 11.1 or Clause 11.2, as the case may be; Upon your exercise of your rights pursuant to and in accordance with Clause 14.1 of the agreement at the sale price of Ringgit Malaysia One (RM1.00) only; And upon full payment of which we shall transfer all our rights, benefit and interest in the goods to you"

Here, the bank as the owner undertakes to transfer all their rights, benefit and interest in the leased asset to the customer upon the performance of the specified condition. The application of promise can be implied from the term "we shall transfer". In bank B, the practice of promise is inserted in AITAB agreement which reads as follows:

"In consideration of the owner's agreement to enter into this Agreement, the Hirer hereby grants an irrevocable and unconditional right to the owner but not the obligation to ask the Hirer to purchase the vehicle in the event of termination by the Hirer and an event of default leading to termination by the owner,

whose when implemented, the Hirer hereby undertakes and will be considered for buying vehicles from the owner at a price calculated as the amount of termination which without demand, will be due and payable immediately when the option is exercised by the owner" (Translated from bank's IHP agreement)

"In consideration of the Hirer agreement to enter into this Agreement, Owner hereby grants an irrevocable and unconditional right to the hirer but not the obligation to ask the owner to sell the vehicle either during the conclusion of this agreement or during the rental period on any installment payment date by giving thirty (30) days prior notice to owner in writing by fully pay the Termination Amount on the condition the Hirer has complied with the terms and conditions of this Agreement and no event of default has occurred and continuing, whose when implemented the Hirer will be considered for buying vehicles from the owner at a price calculated as the amount of termination which without demand, will be due and payable immediately when the option is exercised by the hirer" (Translated from bank's IHP agreement)

The above example contains two different promises. Both promises contain two separate conditions that lead to two different effects. The customer's promise will be performed at the time when the customer terminates the agreement or upon an event of default while the bank's promise will be performed when the hirer has complied with the terms and conditions of the agreement and no event of default has occurred and is continuing. Here, the application of promise can be implied from the term 'hereby grants an irrevocable and unconditional right' and the term 'hereby undertakes'. In bank C, the practice of promise is adopted in a notice of sale document which reads as follows:

"Pursuant to the Hire Purchase (HP-i) Agreement dated the day of made between us on the one part and yourself on the other part ("the agreement") and the Aqad dated the day of, where we have agreed to make available to you an Islamic"

"Hire Purchase facility of RM (xxx) there under and upon payment of all sums of money stipulated in the agreement, we hereby agree to sell to you the goods on the terms and subject to the conditions as set out in the Agreement"

This shows that the bank promises the customer to sell the leased asset to him on the condition that all sums of money as agreed in the agreement have been paid. Here, the application of promise is indicated by the term 'we hereby agree to sell'. In bank D, implementation of promise in AITAB facility is adopted in the notice of acknowledgement document which reads as follows:

"Provided that you have complied with all the terms and conditions of the Hire purchase-i agreement and no event of default has occurred and is continuing, we hereby give you notice that upon payment of the final installment or balance due by you to the bank for the bank's own account, it shall be deemed that you have thereby purchased from the bank the goods as particularly described in the hire purchase-i agreement pursuant to the Shariah principle of Bai' Al-Mu'atah. Upon such purchase, all the rights, benefits, titles and ownership to the goods shall be deemed to have transferred to you"

This clause indicates that the bank undertakes to sell the asset to the customer pursuant to the Shariah principle of Bai' Al-Mu'atah on the condition that the hirer has complied with all the terms and conditions of the agreement and no event of default has occurred and is continuing. Here, the application of promise can be implied from the term "we hereby give you notice... you have thereby purchased from the bank".

## **RESULTS AND DISCUSION**

**Banks' actual practice of promise from Shariah law perspective:** Generally, from Islamic law perspective, a promise is different from a contract because there is no acceptance to the promise and the action promised must be performed in the future, while in a valid contract, offer and acceptance is compulsory and it takes effect immediately. Scholars' deliberation on the status of promise indicates that unilateral promise (wa'd) is binding and enforceable if it is linked to a condition and the promisee has incurred cost in relying to such promise. Further, promise can be implemented in the form of two unilateral promise (wa'dan), provided that both promises contain two different conditions and it has two different effects. As for mutual promise (muwa'adah), scholars generally agree that a muwa'adah is allowed if it is not binding.

Based on the banks' legal documentation of AITAB facility, the concept of promise is applied in the form of wa'd and wa'dan and there is no application of

muwa'adah. The banks' practices indicate that in many cases, this concept is indirectly applied without the use of the term 'promise' itself. The application of promise can be signified by the term 'undertaking', 'shall transfer' or the term 'hereby agree'. The practice signifies that the bank's and/or the customer's promise is unilateral, where there is no acceptance to the promise. Furthermore, the promise is attached to a condition and it will be performed in the future. Whenever it involves two promises (wa'dan), both promises contain two different conditions and leads to two different effects; however, only one condition will be performed. The practice indicates that the bank's promise to sell the asset will be performed upon maturity period while the customer's promise to purchase the asset will be performed upon triggering the event of default. This shows that the banks' practice on the implementation of promise in AITAB facility is valid and legally enforceable from Shariah perspective.

**Enforceability of promise from malaysian civil law perspective:** By virtue of the Contracts Act 1950, a promise is binding and enforceable if it is accepted by the promisee. This is different with the concept of promise in Shariah law where a promise is enforceable though no acceptance from the promisee. Furthermore, according to the Contracts Act, a promise is enforceable if it has a consideration. This is different with the rulings of promise in Islamic law that does not require the element of consideration to constitute an enforceable promise. Moreover, based on Section 2(i) of the Act, an agreement is voidable if the promise is only binding on one party. This is different with the ruling on binding muwa'adah whereby a majority of scholars view that a binding muwa'adah is not allowed as it may constitute a future contract which is prohibited in Islamic law. Therefore, promise as practiced in AITAB facility is not recognized as legally enforceable in pursuant of the Contracts Act 1950 due to the absence of acceptance and consideration on the part of the promisee. The Act only recognizes an accepted promise and a binding bilateral promise; nevertheless, this may amount to a future contract which is prohibited in Islamic law. The promise would be binding and enforceable under the doctrine of promissory estoppel. By referring to the doctrine of promissory estoppel, the promise would be legally enforceable; however, the doctrine is applicable only as defence and not as an independent cause of action. Hence, the implementation of promise in AITAB facility would not be enforceable from the perspective of civil law. This may pose legal issues because a party who rely on the promise may not be able to enforce their right upon promisor's breach of promise.

## CONCLUSION

Promise is practiced by Malaysian banks in structuring AITAB facility. The application of promise in AITAB facility must satisfy certain Shariah ruling in order to be recognized as valid and legally enforceable. The above discussion shows that the implementation of promise in AITAB facility is valid and legally enforceable from the perspective of Islamic law. Nevertheless, it may lead to legal issue because the promise may not be recognized as legally enforceable from the perspective of civil law. Therefore, this study recommends that effort must be undertaken to strengthen the local law governing the implementation of promise in AITAB facility. It is hoped that a sound legal framework may address the issue of enforceability of promise in AITAB facility.

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