

# THE UNDERSTANDING AND APPLICATION OF *TAKAFUL* AMONG THE CONTRACTORS OF THE MALAYSIAN CONSTRUCTION INDUSTRY

Puteri Nur Farah Naadia Mohd Fauzi<sup>1a\*</sup> and Khairuddin Abd Rashid PhD<sup>2b</sup>

1,2 International Islamic University Malaysia (IIUM), Kuliyyah of Architecture & Environmental Design (KAED),  
Department of Quantity Surveying, Selangor, Malaysia.

<sup>a</sup>puterinurfarahnaadia@gmail.com and <sup>b</sup>khairuddin@iium.edu.my

**Abstract** – *Takaful has been introduced in Malaysia since 1984 and has experienced a positive increment in demand each year. However, based on statistics issued by the Central Bank of Malaysia, the market penetration growth for conventional insurance is still relatively higher than Takaful. One of the major reasons is the lack of understanding on Takaful by the contractors in the construction industry. Therefore, this paper reports on a study on assessing the understanding and application of Takaful among the contractors of the Malaysian construction industry. The paper is presented in four parts which are literature reviews on Takaful and its application in Malaysia, methodology applied in conducting this study, results and findings of the study and conclusion. This paper is expected to provide information and better understanding on Takaful and its application in the Malaysian construction industry.*

**Keywords** – Takaful, construction, insurance

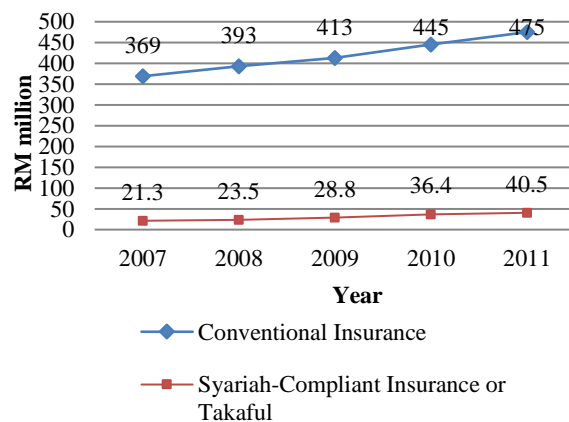
## INTRODUCTION

*Takaful* is an Islamic insurance. The term '*Takaful*' is derived from the Arabic word '*Kafaala*' means guaranteeing [2]. The approximate of *Syariah* equivalent word for insurance in Arabic is '*Ta'mein*'. It means to reassure, safeguard and guarantee through indemnity losses. Guarantee in this context consist fidelity, loyalty, confidence and trust [3]. An alternative to *Takaful* is conventional insurance. However, in 1972, the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia has issued a decree that the conventional insurance is prohibited or *haram* under the Islamic Law or *Syariah* as the conventional insurance consists the existence elements of uncertainty or *gharar*, the involvement of interest and usury or *riba*' and the presence of gambling or *maisir* [4]. A consistent decree has also been issued in 2009 with a better justification. Thus, *Takaful* which prohibits the element of usury, uncertainties, and gambling was introduced in Malaysia in 1984. Refer to the decision of the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia discussion to 80<sup>th</sup> time sitting in February 2008; the current implementation of *Takaful* in Malaysia is in line with

the Islamic Law or *Syariah* [5]. After the issuance of the *fatwa*, the *Takaful* Act 1984 was enacted by the Malaysian Parliament. The first *Takaful* Company was 'Syarikat Takaful Malaysia', now known as *Takaful* Malaysia was formed under the *Takaful* Act [6].

In general *Takaful*, the insurance of works is categorized under Contractor's All Risks (CAR) *Takaful* policy. CAR *Takaful* Policy is one of the general *Takaful* schemes which specifically designed to meet the needs for protection of both the contractor and the client as an individual or corporate business entity [7]. The CAR *Takaful* protects any loss or damages resulting from a catastrophe or disaster inflicted upon properties and works of *Takaful* participants [7,8].

According to Annual Insurance and *Takaful* Statistics 2011, the market penetration growth for both general insurances has experienced well increment each year [9,10,11]. However, a comparison statistic of both insurances demonstrates the market penetration growth for general *Takaful* based on net contributions income is far low than general conventional insurance based on net premium income (refer to Figure 1).



**Figure 1:** Comparison of the market penetration growth for general conventional insurance and general *Takaful* in Malaysia [9,10,11]

Many reasons have contributed and led to the general *Takaful* low growth phenomenon as illustrated in Figure 1 above. Critically, *Takaful* has been covered less in the literature on Islamic Finance, and its working are not fully understand [12]. The low penetration of *Takaful* business compared to conventional insurance

business has been attributed to factors such as poor marketing and general lack of understanding of the available *Takaful* product in the market [13]. The knowledge on the understanding of *Takaful* is important in the development of appropriate insurance service channels as well as future product.

However, little is known on the subject of *Takaful* as its application in the construction industry. Consequently, a study, to be reported herein, the key objectives are 1) to establish understanding of *Syariah-compliant insurance (Takaful)* as an alternative to works insurance, 2) to compare and contrast between conventional insurance and *Syariah-Compliant Insurance (Takaful)* and 3) to ascertain the understanding, acceptance and application among the contractors of the Malaysian construction industry in adopting *Takaful*.

## 1. LITERATURE REVIEWS

### a. Conventional Insurance

Redja [14] states that the Commission on Insurance Terminology of the American Risk and Insurance Association has defined insurance as:

*"Insurance is the pooling of fortuitous losses by transfer of such risks to insurers who agree to indemnify insured peoples for such losses, to provide other pecuniary benefits on their occurrence, or to render services connected with the risk."*

Insurance can be defined as a financial arrangement between the parties that distributes the costs of unexpected damages and losses [15]. The transfer of risks by a person or an entity to the insurance company is called insurance. Insurance means a scheme which provides security to a person or his belongings in the occurrence of risks.

In Malaysia, the contract of insurance is governed under Insurance Act 1996. Insurance contract requires two parties entered into a financial agreement whereby one party agreed to compensate the other party if it results from the occurrence of specified events [16]. The system of insurance in construction building is practiced when a contractor transfer the burden of risks to an approved insurance company as the insurer, for an agreed financial consideration called the 'premium' [17]. Premium is the amount to be paid for an insurance contract or policy and could be regarded as the transferring of some or all of the risks of loss and damage. After the payment of such amount, the insurance company or insurer is assumed to provide the insured with insurance contract or policy.

In the practice of insurance of works in the Malaysian construction industry, a contractor will pay premium for the exchange of insurance policy to an approved insurance company. The insurance policy is an agreement setting out the risks covered and the

circumstances, the allocation of payment if such risks or loss occurs, and the duration or period of the insurance contract.

### b. Syariah-Compliant Insurance or Takaful

Section 2 of *Takaful Act 1984* [18] interprets the word '*Takaful*' as:

*"A scheme based on brotherhood, solidarity, and mutual assistance which provides for mutual financial aid and assistance to the participant in case of need whereby the participants mutually agree to contribute for that purpose."*

*Takaful* refers to the concept of permissible Islamic insurance or '*Halal*' insurance which provides a principle of a person protecting him against loss or misfortune [19]. *Takaful* is defined as a mutual agreement between parties in which they agree to provide material assistance to one another or a group, in time of a misfortune [20]. *Takaful* is an Arabic word refers as 'joint guarantee' whereby a group of people agree to jointly guarantee themselves against any defined loss which may occur by a specific event.

The concept of *Takaful* insurance is an agreement or contract between two parties on a particular subject matter, which is binding upon both parties of the contract [21]. Allah commands the believers to fulfill their contract requirements and to co-operate among Muslims in the Holy Quran [1] in *Surah Al-Maidah*; verse 1 and 2:

*"O ye who believe! Fulfill the contractual obligations...and co-operate you one another in righteousness and piety..." (Surah Al-Maidah; verse 1-2)*

Even though the concept and scope of *Takaful* is flexible, there are certain elements that Allah prohibits in any Islamic business transaction in order to ensure the purity and principles of Islamic ethics are fulfilled. The elements are usury (*Riba'*), uncertainty (*Gharar*), and gambling (*Maisir*).

Usury or *riba'* is a business dealing when money of independent labour or effort, is transformed into capital which is invested usuriously. Usury can be gained from the benefits of others money or the increase of the capital sum realizes is acquired at the expense of the wealth of others [3]. Uncertainty or *gharar* refers to the liability of any parties of contract is uncertain or contingent [23]. The element of uncertainty takes place when a policy holder is not informed on the amount of the compensation that the insurance company would pay to him. The presence of uncertainty or *gharar* in a *Takaful* contract resulted in the existence of gambling or *maisir* [24]. Gambling is an activity that involves betting whereby one party who is the winner will take everything while the other party who is the loser will lose everything [19]. The element of gambling in insurance is attributed to the act of purchasing the insurance contract with the intention of getting more indemnity in the case of risks occurrence.

As an alternative, *Takaful* is a permissible insurance which prohibits the elements of usury, uncertainties and gambling. *Takaful* is based on mutual and joint guarantee whereby all the participants agreed to help each other upon any unexpected risks or events [12,19]. In the practice of a *Takaful* scheme, *Takaful* participants or policy holders agree to pay a sum of voluntary payment or donation (*Tabarru'*) and the *Takaful* operator guarantee to pay for compensation upon any losses or damages occur due to a specific events or risk [23].

*Takaful* insurance represents the concept of insurance based on mutual co-operation and solidarity of people by participating in a *Takaful* scheme [20]. The principles of *Takaful* are based on mutual cooperation (*Ta'awun*) and donation (*Tabarru'*). These principles applied when the *Takaful* participants or policyholders agree between themselves to share the risk of a potential loss to any of them by making a donation, of all or part of their contribution, which is used to compensate the loss suffered by any participant of the *Takaful* scheme.

In *Takaful*, the premium must be paid on the basis of 'donation with condition of compensation' or *tabarru'* [20]. This means that the participants agree that their donation can be used to help other participants according to the terms of the *Takaful* contract. A *Tabarru'* contract requires each policy-holder to willingly relinquish a portion of his or her paid contribution to other policyholders who may need the financial assistance [23]. With the intention of *tabarru'* the insurance transaction becomes valid and permissible from the point of view of *Syariah*.

There are two contracting parties under a *Takaful* scheme which are the *Takaful* operator and the *Takaful* participant. The *Takaful* operator is appointed by the *Takaful* participants to manage the *Takaful* scheme for them [20]. The promise made by the *Takaful* operator is with the consideration of contributions or *tabarru'* paid by the *Takaful* participants [22]. *Takaful* participants are also known as the *Takaful* policyholders who act as the capital provider for a *Takaful* fund [22]. The *Takaful* participants are a group of people who subsequently becomes the insured against a defined risk by paying regular contributions or *Tabarru'* to a *Takaful* company or operator. The payment of contributions or *Tabarru'* by *Takaful* participants is for the purpose of future security and protection.

The requirements of *Takaful* are related to the Islamic contracts that must be applied by the contracting parties which are the profit-sharing contract (*Mudharabah*), agency contract (*Wakalah*), guarantee contract (*Kafalah*) and manufacturing and sale contract (*Istisna'* and *Salam*). *Mudharabah* contract is an

agreement between a capital provider and an entrepreneur. In a profit-sharing model, the *Takaful* operator acts as an entrepreneur or *Mudharib* and the *Takaful* participants or policy holders act as capital providers or called *Rabul Mal* [25]. The *Takaful* operator who manages the *Takaful* fund will receive a fee, or share of the investment profit as a reward. *Mudharabah* specifies the concept of investment profit or surplus from the *Takaful* scheme are to be shared between the *Takaful* operator and *Takaful* participants or policy holders. The *Takaful* operator acts as an agent or a representative on behalf of the *Takaful* policy holders under *Wakalah*. The *Takaful* operator runs the *Takaful* fund by ensuring all risks are borne by the fund and any operating surpluses are belong exclusively to the *Takaful* policy holders [25]. The guaranty contract is involved in a *Takaful* scheme when the *Takaful* policy holders pay their contribution or donation to the *Takaful* fund to reduce the effect of losses incurred by other *Takaful* policy holders. In sale or *Salam* contract, the *Takaful* operator undertakes to supply a certain amount of compensation upon any loss or damages due to a specific risk to the *Takaful* participants or policy holders at a future date in exchange of advance payment or donation (*tabarru'*). Based on the *Takaful* formation of contract, the existence of donation or *Tabarru'* and other related contracts in *Takaful* make the insurance transaction permissible and valid according to Islamic Law.

#### c. Comparison between *Takaful* & Conventional Insurance

Under conventional insurance, the risk is transferred to an individual or entity in the exchange of premium [26]. In contrast, in *Takaful*, there is no transfer of risks by an individual or entity [19]. In *Takaful*, risks are shared among the *Takaful* policy holders [26]. A *Takaful* operator acts as an agent for the *Takaful* participants to manage the *Takaful* scheme. The *Takaful* operator will ensure that each of the *Takaful* participants pay an equitable *Tabarru'* or contribution and get equitable compensation for any losses and damages that they suffered as well. A comparison is made in Table 1 to highlight the salient differences between conventional insurance and *Takaful*.

**Table 1:** Salient differences between *Takaful* and Conventional Insurance [6,15,19,27]

Items	<i>Takaful</i>	Conventional Insurance
Contract relationship	A combination of <i>tabarru'</i> contract (donation) and agency or profit sharing contract - mutual agreement	An exchange contract between the insurer and insured person – sale and purchase
Risk	Within the group itself. The group member agreed to help those among them who incur any loss and share	Transferred to one party

	the reminder if any	
Right and responsibilities	Participants make their ownership right of the amount of the donation to help protect one another against the impact of unpredicted risk	Policyholders pay premiums to protect themselves or their interests
Prohibited elements	Free from Usury ( <i>Riba</i> ), Uncertainty ( <i>Gharar</i> ), and Gambling ( <i>Maisir</i> ) but operate based on the principle of profit sharing contract ( <i>Mudharabah</i> )	Contains the Usury ( <i>Riba</i> ), Uncertainty ( <i>Gharar</i> ), and Gambling ( <i>Maisir</i> )
Benefits & Liability	The benefits will be specified and paid by the Takaful administrator from the Takaful funds upon any unexpected event.	Depends on outcome of future events that is unknown at the time of signing the contract.
Policy	Fixed and definite term or period of maturity	The term or period of a policy varies on the type of policy.

## 2. METHODOLOGY

The primary data collection applied for this research is semi-structured interview i.e. to ascertain the understanding and application of *Takaful* in construction works by the contractors of the Malaysian construction industry. Due to time and costs constraints, the author has decided to choose contractors registered for Grade 7 under CIDB specifically in Kuala Lumpur and Selangor areas as the targeted respondents for this study. The contractors are the best respondents to give more accurate data, feedback and comments on the understanding and application of *Takaful* for construction works insurance as they are authorized party to choose and decide on what type of insurance to be procured. Besides, it is compulsory for all contractors in Malaysia to register with CIDB in order for them to enter any construction projects. It is assumed that big contractors deal with a lot of projects and therefore should have full experiences and understanding on insurance contract in construction. Thus, the author decided to survey the highest group of contractor registered for grade (7) under CIDB as the targeted respondent.

Two types of sampling methods applied in this research i.e. cluster (area) and simple random sampling. Refer to CIDB 2009, the total contractor registered by Contractor Registration Grade and State of Registration by end of 2009 in Malaysia is 65,249. Due to the large population number, the author decided to make the sample group smaller by applying cluster (area) random sampling method. The targeted respondents for this study are contractors registered for grade 7 from Wilayah Persekutuan Kuala Lumpur and Selangor. This is because; the Federal Territory Kuala Lumpur and Selangor are the centre areas of cultural, economic and administrative development in Malaysia and it is

assumed that such characteristics of area qualify the sample to represent the Malaysian Construction Industry as a whole.

There are a total of 2,325 contractors registered for grade 7 in Federal Territory of Kuala Lumpur and Selangor respectively which the author believes it is difficult to interview all the respondents within a limited time. Thus, the simple random sampling is applied to reduce the number of targeted respondents. Finally, 60 contractors in Federal Territory Kuala Lumpur and Selangor are chosen as the respondents for this study. 30 respondents are grouped in the targeted respondents list and the other 30 in the reserved list. Table 2 and table 3 show the summaries of the contacted respondents and the participation of respondents respectively.

**Table 2:** Summary of the contacted respondents from both lists

Respondents	Quantity	Percentage (%)
Targeted List	30	50.00
Reserved List	30	50.00
TOTAL	60	100.00

**Table 3:** Summary of the respondents' participation from both lists

Respondents	Quantity	Percentage (%)
Targeted List	20	66.67
Reserved List	10	33.33
TOTAL	30	100.00

This study is limited to 30 contractors which are registered under CIDB Malaysia for Grade 7 (G7). The contractors to be the respondents are picked randomly within Federal Territory Kuala Lumpur and Selangor areas only. Therefore, the results of this research cannot be summarized to represent the contractors of the Malaysian construction industry entirely. Thus, further study with a bigger sample of respondents is recommended to represent the Malaysian construction industry entirely. Besides, the data reported in this study are collected in year 2010 as part of the undergraduate dissertation in Department of Quantity Surveying at IIUM. Hence, further study is also required in order to update the data given the gap in time.

## 3. ANALYSIS OF DATA, RESULTS & FINDINGS

There are four questions all together on the understanding of respondents (contractors) on *Takaful* in the Malaysian construction industry. Table 4 shows the respondents' level of understanding on the definition of *Syariah*. Based on Table 4, 18 respondents

rate understand and fully understand on the term *Syariah*. Thus, all the 18 respondents were asked on their opinion of the most appropriate definition of *Syariah*.

**Table 4:** Level of understanding on the definition of '*Syariah*'

Level of understanding	Muslim		Non-Muslim		Overall	
	Frequency	%	Frequency	%	Frequency	%
Fully understand	7	27	0	0	7	23
Understand	10	39	1	25	11	37
Moderately understand	9	34	1	25	10	34
Somewhat understand	0	0	2	50	2	7
Do not understand at all	0	0	0	0	0	0
TOTAL	26	100	4	100	30	100

Table 5 shows the respondents' opinion on the appropriate definition of *Syariah*.

**Table 5:** Respondents' opinion on the appropriate definition of '*Syariah*'

Definition of <i>Syariah</i>	Muslim		Non-Muslim		Overall	
	Frequency	%	Frequency	%	Frequency	%
Islam	2	11	0	0	2	11
Islamic Law	9	50	0	0	9	50
An Islamic Contract	1	6	0	0	1	6
A direction of life for Muslim	6	33	0	0	6	33
TOTAL	18	100	0	0	18	100

Table 6 shows the respondents' awareness on *Takaful*. All of the total respondents included the non-Muslims are aware that there is an insurance contract under *Syariah* named as *Takaful* which contribute 100% of the total respondents; equal to 30 respondents.

**Table 6:** Awareness of respondents on *Takaful*

Awareness of <i>Takaful</i>	Muslim		Non-Muslim		Overall	
	Frequency	%	Frequency	%	Frequency	%
Yes	30	30	0	0	30	100
No	0	0	0	0	0	0
TOTAL	30	100	0	0	30	100

Table 7 shows respondents' level of understanding on the concepts of *Takaful* in the context of construction. Based on the concepts of *Takaful* explained in the literature review, the respondents are asked to rate their level of understanding and the results show that most of the respondents do not understand the concepts of *Takaful* as their average index is between 4.50 to 5.00. The justifications given by the respondents who rate somewhat understand and do not understand at all on the benefits and liability and the prohibitory

elements concepts respectively were lack of input and knowledge on *Takaful*, never experience in dealing and applying *Takaful*, not sure on the operation and management of *Takaful* operator and administrator in managing the insurance fund and never heard before that some of the concepts in conventional insurance are prohibited in *Syariah*.

**Table 7:** Level of understanding on the concepts of *Takaful* in construction

No	<i>Takaful</i> concepts	Weighting Scale					Average Index	Rank
		1	2	3	4	5		
1.	Risks	8	7	14	1	0	4.53	1
2.	Subject Matter	5	8	15	2	0	4.93	4
3.	Rights and Responsibilities	8	7	14	0	1	4.60	2
4.	Benefits and Liability	5	8	14	3	0	5.00	5
5.	Prohibitory Elements	5	9	12	1	2	4.87	3

Besides, there were three questions asked pertaining to the acceptance of respondents and the application of respondents on *Takaful*. Table 8 shows the overall respondents' interest on *Takaful* to be applied in the Malaysian construction industry.

**Table 8:** Respondents' interest on *Takaful* to be applied across the Malaysian construction industry

Respondents' interest	Frequency	Percentage (%)
Yes	21	70.00
No	9	30.00
Not Sure	0	0.00
TOTAL	30	100.00

Table 9 shows the respondents experience in procuring *Takaful* for construction works. 11 respondents have no experience in procuring *Takaful* for construction works. Thus, the said respondents are asked on their opinion to consider in procuring *Takaful* for construction works insurance. Table 10 shows that all 11 respondents will consider procuring *Takaful* as the insurance for construction works.

**Table 9:** Respondents' experience in procuring *Takaful*

Experience in procuring <i>Takaful</i>	Muslim		Non-Muslim		Overall	
	Frequency	%	Frequency	%	Frequency	%
Yes	18	69	1	25	19	63
No	8	31	3	75	11	37
TOTAL	26	100	4	100	30	100

The reason quoted given by some Muslim respondents who will consider procuring *Takaful* as the insurance for construction works is because *Takaful* is an Islamic product, so it should be supported by all the Muslims. There are also some Muslim respondents

stated that *Takaful* provides more benefits and profits. Thus, it should be the best insurance product to be procured by a company. However, one respondent who is not sure whether to consider procuring *Takaful* as the insurance for construction works stated the reasons as; lack of knowledge and input on *Takaful* and will consider, only if the cost will not give implication to the insured

**Table 10:** Respondents' consideration in procuring *Takaful* for construction works

Consideration in procuring <i>Takaful</i> for construction	Muslim		Non-Muslim		Overall	
	Frequency	%	Frequency	%	Frequency	%
Yes	8	100	2	67	10	91
No	0	0	0	0	0	0
Not Sure	0	0	1	33	1	9
TOTAL	8	100	3	100	11	100

#### 4. DISCUSSION & CONCLUSION

Based on the results, it can be summarized that only a quarter of the total respondents perceive the meaning of *Syariah* is a direction of a Muslim life which is considered to be the most accurate meaning. All of the respondents claimed that they are aware of *Takaful* in general. Nevertheless, results show that the respondents' understanding on the concept of *Takaful* is deficit as majority of the respondents do not understand on the concepts of *Takaful*. Majority of the respondents are interested to see *Takaful* to be applied across the Malaysian construction industry and will consider procuring *Takaful* for works insurance in construction.

The results focus only on the contractors' understanding of *Takaful* concepts and principles. Thus, the results and findings cannot be generalized to show the level of understanding on *Takaful* as a whole. Therefore, a detail study pertaining to the understanding of *Takaful* in the context of construction insurance is recommended. Besides, it is recommended that programmes and trainings to be conducted in order to create awareness and to educate the Malaysian contractors in the need to procure *Takaful* for their construction works insurance.

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