



## The Issues of Second Layer Charging Fee in Wakalah Takaful Model Practices

Mohamad Yazid Isa<sup>1</sup>, Ahmad Khilmy Abd. Rahim<sup>2</sup>, Asmadi Mohamed Naim<sup>3</sup>,  
Muhammad Zarunnaim Haji Wahab<sup>4\*</sup>

<sup>1</sup>Islamic Business School, College of Business, Universiti Utara Malaysia, 06010 Sintok, Kedah Darul Aman, Malaysia, <sup>2</sup>Islamic Business School, College of Business, Universiti Utara Malaysia, 06010 Sintok, Kedah Darul Aman, Malaysia, <sup>3</sup>Islamic Business School, College of Business, Universiti Utara Malaysia, 06010 Sintok, Kedah Darul Aman, Malaysia, <sup>4</sup>Islamic Business School, College of Business, Universiti Utara Malaysia, 06010 Sintok, Kedah Darul Aman, Malaysia. \*Email: [zarunnaim@yahoo.com](mailto:zarunnaim@yahoo.com)

### ABSTRACT

This paper aims to examine the issues of second layer of charging fee in the Wakalah Takaful models practices in Malaysia. Hence, to make sure all the objectives are answered progressively, qualitative research methodology is advocated. The main data were collected from the interview session among scholars and expertise in Takaful field. Then, the data has been analysed based on certain coding and themes. In overcome the second layer of charging fee issue, Takaful operator (TO) should provide a clear contract that been used in their operations. Besides, another approach is by providing concrete decision from the authority body such as from Shariah Advisory Council (SAC). The issue also can be mitigate through a good Shariah framework from TO itself. This study can be expanded by focusing on the issue of customers' preferences in the selection of takaful products. Besides, the future research can also examine whether these issues attributed to its low market penetration in Malaysia.

**Keywords:** Business Administrative, Wakalah Takaful Model, Issue in Wakalah Model

**JEL Classifications:** G22, M1

### 1. INTRODUCTION

Takaful industry has been expended rapidly in the entire world nowadays. It is not only famous in Malaysia, but also booming in the Gulf Cooperation Council (GCC) countries like Bahrain, Qatar, Saudi Arabia (Best's Special Report, July 11, 2011). Moreover, the growth of takaful industry has also escalated in the non-Muslim countries especially in the European and Western such as the United Kingdom, United State and Canada. Therefore, not been surprise when the records in 2012 have shown that the takaful industry continues growth around 15% annually since 2007 (Kumar, 2014).

Based on statistics, Malaysia's takaful industry grew at 24% while the GCC achieved 16% growth in 2011. According to ranked, Saudi Arabia is the largest takaful market shares which is contributed US\$4.3 billion, followed by Malaysia which contributed US\$1.4 billion and United Arab Emirates contributed

US\$818 million (Nazneem, 2012). Thus, it is clearly shown that GCC's takaful segment dominates the world takaful market.

The main reason for the growth and development of takaful industry is due to the opportunity provided for its clients to subscribe an Islamic and Shari'ah compliant over the conventional insurance. The idea of having a Shar'iah based insurance system was inspired by the request of the Muslims to conduct their day-to-day affairs in accordance to the Islamic teachings and within the Islamic law framework. Takaful industry has come out with one concept that people will help other members during peril and harm.

This concept is amplified by Allah Subhanahu Wa Ta'ala (S.W.T) in the Holy Quran and hadith Prophet Muhammad Peace Be Upon Him. There are numerous references about the concept of takaful in the Quran especially in the context of co-operation and solidarity for the good of society. One widely quoted reference is from Surah al-Maidah verse 2, Allah S.W.T says:

“And help one another in righteousness and piety and do not help one another in evil deeds and enmity. And fear Allah; indeed, Allah is severe in penalty.” (Al Quran, Al Maidah: 2).

With regards to this Surah, it is explicitly stated that takaful transaction is permissible as one of the concept in helping others. Allah S.W.T also encourages people to help each other in doing righteousness and avoid from committing sinful deeds.

In Malaysia context, the establishment of takaful started in 1984 when the first Takaful Act was introduced. The first Malaysian takaful was established in 1985 known as Takaful Malaysia Berhad. Until 2014, 11 takaful companies have been registered in Malaysia. Through this statistics, it is proven that takaful industry now has become one of the biggest demand transactions in their scope. Hence, it is not surprising nowadays when many countries start to explore and introduce takaful industry in their country.

Nowadays, two major products are being derived from takaful. These are family takaful and general takaful. Family takaful was formulated as an alternative to the life insurance policy as obtainable in the conventional insurance system whereas general takaful is to cover tangible items and properties like motorcars, motorcycles, houses and others. In developing these products, three different types of models were utilized. These are mudarabah takaful model, wakalah model and modified mudarabah model or also known as hybrid model (Rahman et al., 2011).

Although many of achievement that already obtained after more than 30 years the establishment in Malaysia, takaful industry is still faced problems in their operations. Takaful industry is struggling to penetrate the new market shares as well as to compete with the conventional insurances. Besides, this industry is also faced criticisms from some scholars and expertise.

### 1.1. Problem Statement

Takaful industry in Malaysia today encounters problems, challenges and issues that threaten its expansion and development. Although it is hardly surprising that the takaful industry is undergoing a period of rapid growth, it cannot be denied that the development faces a lot of issues and challenges (Ali, 2010; Frenz and Soualhi, 2010; Frenz 2009; Soualhi, 2008; Scott, 2006). The existing models of takaful have met certain criticism in terms of their takaful operations that are not sufficiently covering the needs of the participants.

In order to overcome these challenges and to accomplish additional expansion and development, existing issues pertaining to takaful operations need to be addressed and resolved. This problem is clearly supported by Htay and Salman (2013) who suggest that the regulator, Shari’ah advisors and industry players should revisit issues arisen in takaful industry. The issues need to be resolved immediately in order to avoid reputational risk, Shari’ah compliant risk and other risks that are harmful for the industry’s development.

Some of the issues that been continuously discussed among scholars and expertise in takaful industry is about second layer of charging fee in wakalah takaful model. Htay and Zaharin (2011) stated that fees imposed on the participants are too much and too many layers in generated profit. Hence, she said the currently adopted models are at the disadvantages to participants. Moreover, Rahman and Redzuan (2009) also believe that the wakalah fee is charged 2 times. Hence, this research is conducted to have an in-depth study on issues arisen in wakalah takaful model industries nowadays and to seek possible alternatives to mitigate and eliminate them.

### 1.2. Research Questions

The research aims to answer the following questions:

1. What are the issue of second layer charging fee in wakalah takaful model practices?
2. How can these issue be mitigated?

### 1.3. Research Objectives

This research aims to address the following key research objectives:

1. To examine the issue of second layer charging fee in wakalah takaful model practices
2. To identify alternatives to mitigate issue arisen.

### 1.4. Significant/Limitation of Research

The outcome of this research provides a great impact to researcher, academicians and also industry. This study proposes suggestions and recommendations for the issue of second layer charging fee in wakalah takaful model practices in Malaysia. Consequently, researcher and academician can expand this study to find insights whether the issues contribute significant impact on the public’s confidence towards takaful. Constraints and limitations were encountered while conducting this study. Firstly, the research focuses only on Wakalah models. Dominant issues in this model are analysed respectively to probe some suggestions and recommendations to improve the service.

## 2. LITERATURE REVIEW

### 2.1. Overview of Takaful

Takaful is an Arabic word derived from the word ‘kafala’ which means to take care of one’s need (Ali, 2006). It basically means joint guarantee, solidarity and protect. The essence of Takaful (Islamic insurance) in financial transaction is a mutual cooperation between two parties to protect one of them from unexpected future risk (Billah, 2007). This definition is supported by Islamic Financial Services Board (IFSB) International Association of Insurance Supervisors (2006), which states that takaful is a group of participants who have unanimously agreed to support one another jointly against a defined loss. Besides, the IFSB (2009) also stated, takaful can be defined as an Islamic counterpart of conventional insurance, and are comprising of two accounts namely family (or “Life”) and General Takaful accounts.

Based on the Islamic Financial Services Act 2013 of Malaysia, takaful is defined as a scheme that is based on brotherhood, solidarity and mutual assistance which provides mutual financial

aid and assistance to participants in case of needs whereby the participants mutually agree to contribute for that purpose. Takaful is also defined as a shariah compliant insurance. Takaful is a business which its aims and operations have not involved any elements that are disapproved by the shariah. According to Kwan (2007), takaful is based on the principles of mutual cooperation and shared responsibility for the protection of members should any losses happen. It means that, under the takaful practice, members or participants of the society unanimously agree to contribute some amount of money to support group members to cater specific needs.

Most of Muslim jurists agreed that the operation of conventional insurance does not conform to the rules and requirements of the shariah whereby conventional insurance involves elements of uncertainty (Gharar) in the contract of insurance, gambling (Maysir) as the consequence of the presence of uncertainty and interest (Riba) in the investment activities of the conventional insurance companies which contravene the rules of the shariah (Hamid and Rahman, 2011). Hence, takaful can be regarded as an alternative over conventional insurance especially for Muslims today. This is due to the fact that takaful that exists today in the Islamic Finance Market has combined all the principles, rules and law of Islam which are in compliance with the Shariah.

## 2.2. Development of Takaful Industry

The origin of takaful can be traced from several practices of ancient Arab tribal custom and the companions of the Prophet. For example, under the concept of "Al-Aqilah", it is a mutual agreement among the tribes that if a person is killed unintentionally by a person of a different tribe, the accuser's paternal relatives will take the responsibility to make mutual contribution for the purpose of paying the blood money to the victim's relatives. This practice of having a fund that pools contributions from a group of people to assist others in need was further encouraged in the early Islamic period (Rabiah and Scott 2008).

Takaful is claimed to have its first emergence in Sudan in 1979 and has made its way throughout the world. (Farooq et al., 2010; Wahab et al., 2007; Taylor, 2005; Islamic Fiqh Academy, 2000; and Maysami and Kwon, 1999). After that, more commercial takaful models were implemented in other countries such as Malaysia and Saudi Arabia. Now, takaful is practised by over 60 companies in 23 countries and has evolved into a rapid growing industry (IFSB, 2009).

In 1979, takaful was reintroduced by Sudan when the Muslim scholars realized that the conventional insurance does not fulfil the shari'ah compliance concept and Muslim ethics (Farooq et al., 2010; Wahab et al., 2007; Taylor, 2006; Islamic Fiqh Academy, 2000; and Maysami and Kwon, 1999). The scholars confirm that the conventional insurance is fasid because it contains the elements of gharar, maysir and riba.

In Malaysia, on 15 June 1972, the Fatwa Committee of the National Council for Islamic Religious Affairs issued a fatwa that conventional life insurance is contradicting the shariah or Islamic rules (Bank Negara Malaysia (BNM), 2008). A similar decree that rules the conventional insurance as haram or unacceptable

was made by the Council of Islamic Fiqh Scholars in 1975. Thus, more than 10 years later, the first Takaful Act was set in force. The establishment of takaful industry in Malaysia started in 1985 when Takaful Act 1984 for regulation came into force. Ever since, takaful industry in Malaysia has grown rapidly into one unified Takaful operator (TO) and in 1985 Takaful Malaysia Berhad was established and later in 2010, it opened up to eleven TO (BNM, 2008).

## 2.3. Issue the Second Layer of Charging Fee in Wakalah Model

In wakalah takaful model, TO acts as a Wakil (an agent) for the participants. Then, wakil will manage the fund into specific investment account. Under wakalah the participants remain the actual owner of takaful funds and surplus will be invested in Shariah compliant activities (Selim, 2013). Nowadays, wakalah model seems to have become the most widely applied arrangement for takaful industries (Archer et al., 2009).

According to Ayub (2003), wakalah model is applied when the TO provides service on fee basis which is pre-agreed and there is no share in profit of the business. The operator fee can only be deducted the net contribution and remain party can be put in participant risk account (PSA). However, to minimize shariah issues in wakalah model, scholars have set up a separate waqf entity between participants and TO (Pasha and Hussain, 2013).

In the pure wakalah model, the investment or savings portion will be credited to the PA account and the donation will be credited into the PSA (Frenz and Soualhi, 2010; Archer et al., 2009; Frenz and Soualhi, 2009; Rahman and Redzuan, 2009; Ali, 2008). Here, all the underwriting surplus and investment profits belong to the participant. The TO in wakalah model simply earns their income from the wakalah fee (Rahman and Redzuan, 2009). They do not share in the underwriting surplus.

Rahman and Redzuan (2009) however believe that the wakalah fee is charged two times. There are actually, (1) Wakalah fee on contribution, and (2) Wakalah fee on value of investment. On the other hand, BNM (2010) mentions that for products based on the wakalah contract, a fixed upfront fee can be charged on the contributions based on contractual terms entered with the participants. The wakalah fee is to cover commissions and management expenses incurred in the management of takaful funds. It does not specifically explain anything against charging the wakalah fee more than once.

Htay and Zaharin (2011) stated that fees imposed on the participants are too much and too many layers in charging profit. Hence, she said the currently adopted models are at the disadvantages to participants. Besides that, another criticism is about choosing model that company takaful used only to maximize their profit without considered the ta'awuni spirit. In practises, a certain fee charged in advance as upfront charge when participant pays contribution amount although in wakalah model.

According to actual principle of accounting, TO only will earn wakalah fee at the end of takaful period for a particular year. TO

claim that participant's contribution will be refunded whenever he wants to terminate the contract. Only wakalah fee is deducted from the contribution amount. The issue arises when any participant terminated his contract at the mid of takaful period, has TO have any right on unearned wakalah fee or otherwise. If not, then how should unearned wakalah fee be returned to the participant when TO deducts it in advance and pays to takaful agents as commission (Akhtar, 2010).

### 3. METHODOLOGY

The paper used a qualitative research method to answer the objectives stated earlier. Qualitative research method can be traced via facts, information, statements, comments, assumptions, meanings, concepts, specifications, symbols, perceptions, metaphors and feelings. Sources of data come in many different forms such as manuscript, newspaper, diary, picture, official and personal letter, artefact, selected people through interview and the researcher himself involved in the study directly through ethnography (Berg, 2001). The paper also relies on primary data to attain research objectives. The primary data were collected from in-depth interview with takaful expertise.

#### 3.1. Selection of Data Collection Method

This study is concerned with the issues in wakalah model of Malaysian takaful industry. As such, Malaysia becomes the location for data collection. In-depth interview was the main method for collecting data regarding issues in takaful models that govern the Malaysian Takaful companies. Face to face interviews were conducted using interview guidelines provided by Sekaran (2003) in which the topic and questions were notified in advanced before the actual interview sessions take place.

#### 3.2. Sampling

The interview session involved four informants among them were a practitioner, an academician and Shari'ah advisories. In-depth interviews were conducted to assist the researcher to gather information of takaful models and issues identified in each model.

The first informant is a practitioner who has an expertise in the field of takaful practice. Besides, he received recognition in Chartered Islamic Finance Professional from the International Center for Education in Islamic Finance (INCEIF). He is an expert in laws and regulation of takaful in Malaysia. The second informant is an academician. He is a lecturer at Universiti Sains Islam Malaysia in takaful discipline. He received his PhD from INCEIF in takaful area.

The third informant has been in the takaful industries for a long time and he is one of the Shari'ah committee members for the MAA. This interview is beneficial for the researcher from the Shari'ah perspectives about takaful industries practice nowadays. Finally the fourth informant is also a Shari'ah committee member of Hong Leong MISG Takaful. A lot of invaluable input was gained by the researcher in the area of Shari'ah governance in takaful industries.

#### 3.3. Data Analysis

Data collected were interpreted using interviews method. In the interview data, the researchers listened several times to the recorded interview data. The data were reviewed and transcribed in a written form. At the same time, the data were run through to identify similarities and differences from the responses given by the informants. The responses were coded and categorized thematically. Then, the researchers identified pattern and connections among the interviewees' responses to make the analysis.

### 4. WAKALAH MODELS IN LINE WITH SHARIAH

Based on interviewed, all the informants agreed that wakalah model which have been practised nowadays in Malaysia are parallel with shariah perspectives. Informants have the following to say:

"As long as this products enforce by BNM and IFSA 2013, the product generally parallel with syariah."

Similarly, another respondent said:

"Yes, for me it is shariah compliance as long as the highest authorities such BNM endorsed it. We know, the endorsement of the product is quite difficult. They should investigate in various of process. So I think it is in line with shariah."

Another informant added:

"As long as we know that all of these products has been approved by central bank shariah advisory council, so in general we can say that everything has been endorsed and don't have any issues on the syariah."

This supported by another informant that said:

"I think there are not have any problem with model that TO used nowadays."

Thus, in overall, can be concluded that wakalah takaful model that been practised nowadays is comply with shariah principle. However, a few issues has been worried among the informants such as the level of practises the ta'awani concept and the level of the implementation of the model. Besides, some of them believed there are still have space for improvement. Some of that said:

"But in my opinion, the pure concept of ta'awani was already gone in practised nowadays."

"In my perspective, there are still rooms for improvement for the model."

"But the most important the level of the implementation of that model."

Thus, although in general all the informants agreed that this model are in line with shariah but there are still have space for that model to make improvement for the future.

## 5. THE ISSUE IN WAKALAH MODEL

The issue of wakalah model is about second layer of charging fee. One of the informant said:

“In wakalah, the issues when participants appoint the TO as the operators, TO will charge the fees as a upfront fee, at the same time TO also get a profit portion as the mudharib. Meaning that, the second layer of fee are charged.”

In order to generate clear pictures about this issue, another informant during giving the example of second layer of charging fee stated:

“If let say the TO manage the pool of fund very efficiently, less claims in that year, so the TO can share the profit portion of the surplus. Meaning that, if the profit RM1 million, so the only RM500k, then the balanced will be share. However in the first places when we participate in wakalah takaful model, TO already charge the upfront fee, the issue of second layer existed.”

Thus, from the interviewed, the issue that been highlighted is second layer of charging fee in wakalah takaful model.

## 6. SUGGESTIONS TO SOLVE THE ISSUE

The alternatives to mitigate this issue has been analysed based on interviewed outcomes. One of the informant suggested that TOs must providing a clear contract in their operation, he said:

“TO need to choose a very clear contract that may give them to manage the fund efficiently.”

It is important to ensure the trustworthiness among the participants are always in optimum level. Besides that, less of issue also increased confident level of participant to continuously contribute in takaful.

Another suggestion by informant to mitigate the issue through Shariah Advisory Councils. He stressed:

“Another way to resolving the issue through the serious adverse circumstances (SAC’s) decisions. Meaning that, the higher authority will makes the decisions to resolve the issue.”

Besides, TO should have a concrete framework in order to mitigate the issue. Other informant said:

“TO must have a good shariah governance framework.”

It is important to ensure the business will operate in line with the Shariah principles. The services quality, attitude of staff and agents, good marketing also the items that need to take into consideration to all TOs in their operation.

Based on the analysed, there are three possible methods to overcome the issue of second layer of charging fee in wakalah model. First, TO should use the clear contract that have less of

issue. Second, SAC can take the role as the highest authority to provide clear decision pertaining the issue arise. Moreover, TO itself must have a good shariah governance framework to ensure the issue has been overcome as well as to generate the public confident among participants and potential customers.

## 7. CONCLUSION

In conclusion, second layer of charging fee is one of the issue in wakalah takaful model. Some scholars claim that TO has imposed charging fee in two layers. First layer during the initial contribution and the second layer during the sharing the surplus.

Thus, the continuous effort must be taken to ensure the issue arise can be resolved to avoid the other risk especially the reputation risk. Besides, TO must willing and ready to show the clear legal framework and transparent. They also need to ready to disclose everything to the participants related to their business operation.

Therefore, for future research, researchers such as academicians, regulators, TOs and shariah scholars should look at the unresolved issues in takaful operating model and come out with the most appropriate model which is fair to all parties involved. The researchers also do not reject the possibility of the model that had been used nowadays will be changes in the future.

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