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APPLICATION OF THE *WADĪ'AH* CONCEPT IN TRADITIONAL FAMILY *TAKĀFUL* PRODUCTS

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ABSTRACT

Most life (family) takāful products today are structured on the form of unit-linked or investment-linked models. This essentially means that there is a clear segregation between the investment fund and the takāful or tabarru' fund. Indeed, the concept of takāful, which is premised on the principle of tabarru', makes it convenient for family takāful operators to adopt the investment-linked conventional life insurance model. However, when it comes to traditional conventional life insurance products, family takāful seems to be lagging behind. This is due to some inherent features of traditional life insurance that cannot be replicated in family takāful product design, such as the various guaranteed benefits, in the form of cash values, besides the normal contingency benefits (i.e., benefits linked to misfortunes of the participants such as death, disability, sickness, etc.) that are structured in traditional life insurance products. The paper studies how family takāful can be competitively structured in a manner that allows various competitive product features demanded by the public to be offered, features that resemble those of traditional life insurance, without in any way violating Shari'ah

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♣ The views and opinions expressed in this article are those of the authors and do not necessarily reflect the official policy or position of the organizations they work.

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principles. In particular, the wadī'ah concept is proposed to be adopted in family takāful product design, as it will allow various forms of guaranteed benefits (non-participating benefits) to be offered to participants in a manner similar to their conventional counterparts. The paper argues that the cash values in the wadī'ah fund are similar to the non-forfeiture benefit in a traditional life plan. However, it is important to note that there is a fundamental difference between these products, i.e. takāful and conventional life insurance. Whilst the latter is based on a purchase-and-sale arrangement, the former is based on the principle of tabarru', by which participants cooperate to help and indemnify one another on the basis of charitable spirit.

Keyword : *takāful, wadī'ah, tabarru', Participants' Investment Fund, Participants' Risk Fund, Participants' Wadī'ah Fund, survival benefits*

1. INTRODUCTION

It has been widely accepted today that Islamic insurance (*takāful*), unlike its conventional counterpart, is based on the fundamental principles of mutual cooperation (*ta'āwun*) and donation (*tabarru'*). Under the Islamic laws of transactions (*fiqh mu'amalat*), the existence of *gharar* (ambiguity) and *jahalah* (ignorance), which normally nullify an exchange contract (*mu'āwadah*), are tolerated in a contract of donation (*tabarru'*).

This is mainly due to the fact that the parties who enter into a *tabarru'* contract do not aim to make a profit out of the contributed sum, and hence the potential dispute which normally arises in a profit-making transaction is deemed negligible in a transaction based on a gratuitous donation. Furthermore, the issue of uncertainty is irrelevant since the contributor voluntarily gives away his property or right to the recipient without any consideration.

In contrast, conventional insurance, which is based on the principle of *mu'āwadah* (exchange) and aims at making a profit out of the insurance operations, is prohibited from a Sharī'ah viewpoint since it contains substantial *gharar* (ambiguity). This is particularly true since a person who pays the premium (insurance price) for the insurance policy has actually paid for 'peace of mind' that the company will indemnify him should any mishap occur in the future. Being free from uncertainties is never possible in the insurance industry because uncertainties are integral to both the premium/contribution and the claim/compensation.

On the other hand, the Islamic alternative to conventional insurance, also known as *takāful*, reflects a reciprocal relationship and agreement of mutual help between participating members who undertake to mutually guarantee and indemnify one another in case of a particular defined event. The act of guaranteeing one another implies mutual help and mutual indemnity on the basis of brotherhood, deeply rooted in the *tabarru'* principle, which tolerates the presence of *gharar*.

These basic principles and philosophies underlying the *takāful* contract have been widely used to structure various products that can replicate conventional insurance, either for general insurance or life insurance products. Notwithstanding the various innovations in developing *takāful* products that replicate their conventional counterparts, the fact remains that not all features and characteristics of conventional insurance can be easily replicated without violating Shari'ah principles. In particular, one fundamental aspect of traditional life insurance that cannot be offered by a family *takāful* plan is the non-forfeiture benefit, i.e., the guaranteed cash values of the policy.

Against this backdrop, the present study focuses on the life (family) *takāful* product. Specifically, the paper sets out to achieve the following objectives:

- to analyze Shari'ah, operational and commercial issues in structuring family *takāful* products.
- to propose an alternative model based on the *wadī'ah* concept in the family *takāful* product design that will allow various forms of guaranteed benefits (non-participating benefits) to be offered to participants in a manner similar to their conventional counterparts.

The paper is organized according to the following structure: the next section gives an overview of a common conventional life insurance product structure, namely the investment linked, universal life and traditional participating and non-participating life insurance. The section also discusses the value propositions attached to various conventional traditional life insurance products. The third section then analyses Shari'ah issues related to the conventional life insurance products along with their various benefits. Section four proposes an alternative structure to conventional traditional life insurance. In particular, a model which is built on the concept of *wadī'ah* is introduced. A brief discussion of the *wadī'ah* concept is elaborated to give a better perspective on its appropriateness for use in the proposed new product design. Section five highlights some Shari'ah parameters and operational issues in implementing the product, and the conclusion is presented in the final section.

2. AN OVERVIEW OF LIFE INSURANCE

The life insurance industry has been in existence for more than 300 years globally. Life insurance can be defined as “an economic device through which the risk of premature death is transferred from the individual to the group.”¹ The fundamentals of life insurance have been developed over this period of time, but the basic structure of the product has been in place and well understood by practitioners. Consumers, too, understand it to a certain extent. Conventional life insurance products can be broadly classified into two main categories, namely (1) unit linked (investment linked)/universal life) and (2) traditional life. Each of these categories is briefly explained below.

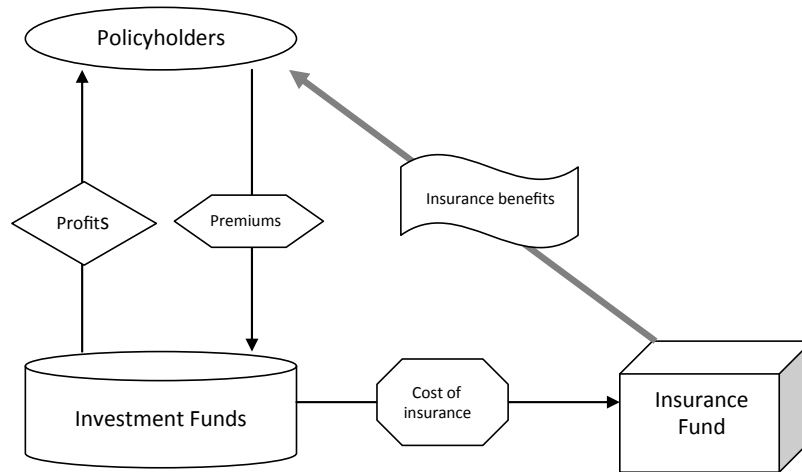
2.1 Categorization of Life Insurance

(a) Unit Linked/Investment Linked/Universal Life Insurance

Unit-linked, also popularly known in the life insurance industry as either investment-linked or universal life, has grown in popularity over the last few decades, with more and more life insurance companies offering such a product to various clients. The basic structure of the product is, to a large extent, premised upon the principle of transferring the investment risk to the policyholders. Consequently, there is a clear segregation between the investment fund and the insurance fund, with the risks associated with the investments being borne by the policyholders, while the risks associated with the insurance being borne by the life insurance companies. This resembles closely the features of unit trust investment with the added coverage of life insurance. Exhibit 1 illustrates the basic structure of unit-linked life insurance.

¹ T. Vaughan & E. Vaughan, *Fundamentals of Risk and Insurance*, (US: John Wiley & Sons, 10th edition, 2008), 231.

Exhibit 1: Basic Structure of Unit-Linked Insurance



(b) Traditional Life Insurance

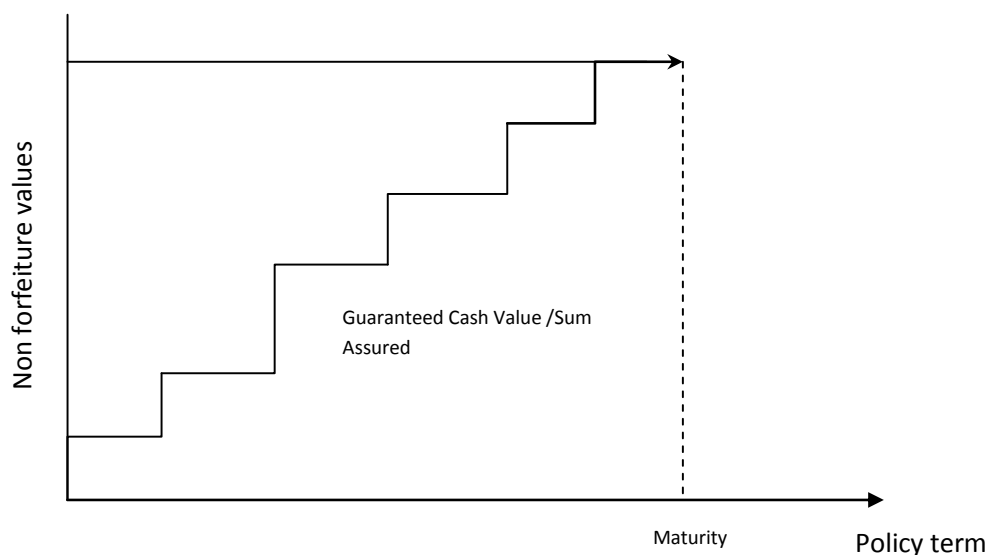
Unlike the unit-linked life insurance product, which mainly focuses on investment but is coupled with an insurance policy, the traditional life insurance product is a long-term savings scheme tied to insurance protection. In contrast to the unit-linked or ILP product above, there is no segregation of funds between the investment and insurance portions. Instead, all paid premiums by policyholders are pooled into a life insurance fund owned by the insurance company. This means the risks associated with the life fund, with regards to both the investments and insurance, are solely borne by the life insurance company. One distinguishing feature of a traditional life insurance product is the existence of non-forfeiture values inherent in all products, whether participating or non-participating.

Non-Forfeiture Values

Non-forfeiture values are guaranteed benefits structured together with all traditional life insurance products.² These benefits are in the form of cash values accumulated by the policy as it progresses throughout the tenure. Put simply, cash values are the amount of money that the insurance company guarantees will be owned by the policyholder as he continues to pay the premium. These are built up into the life fund. In some ways, this can be seen as part of the insurance benefit purchased by the policyholder, since he will get this increasing benefit as the policy grows towards maturity. Exhibit 2 depicts the non-forfeiture values in conventional life insurance.

² See <http://www.investopedia.com/terms/n/nonforfeiture-clause.asp#axzz1wc38AGYv>

Exhibit 2: Non-Forfeiture Values in Conventional Life Insurance

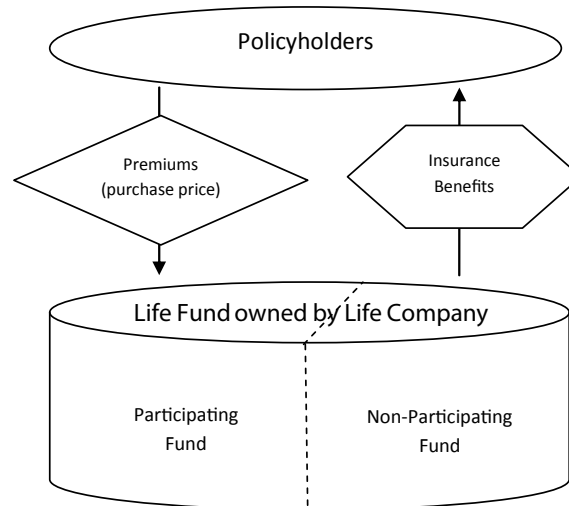


In the event that a policyholder wishes to exercise any of the options made available under a non-forfeiture option, he may use the cash value to exercise that option. Normally, these options can be in any of the following forms:

- (1) Cash surrender option: when the policyholder terminates his policy by surrendering it and getting cash in return;
- (2) Extended term insurance: when the policyholder converts the existing policy into a pure term insurance cover without any more cash values;
- (3) Reduced paid-up policy: when the policyholder stops paying premiums for the remainder of the policy's tenure and converts the existing policy into a lower sum assured with the same period of insurance coverage;
- (4) Automatic premium loan: when the policyholder uses the accumulated cash values in the form of a loan based on a certain agreed policy. In this kind of facility, the insurance company normally charges interest on the loan facility granted.

Traditional life insurance products can be further classified into two main types, namely (1) participating traditional life insurance and (2) non-participating traditional life insurance. Exhibit 3 illustrates the classification of traditional life insurance.

Exhibit 3: Categorization of Traditional Life Insurance



A participating life insurance product refers to the policyholders' participation in the profit/surplus of the life insurance company, payable in the forms of bonuses or dividends. The nature of these bonuses and dividends is that they are not guaranteed, and they are normally declared and allocated to policyholders annually. Types of bonuses/dividends declared can be in the forms of cash or reversionary bonuses. In addition to these, the life insurance company may pay extra dividends or bonuses upon maturity, death claim (terminal bonuses/dividends) or surrender.

On the other hand, a non-participating life insurance product means that the policyholders do not participate in the life insurance company's profit/surplus. This product normally offers policyholders a protection benefit with some guaranteed savings benefits but without any share in the investment profits earned by the life insurance company. In other words, no dividends or bonuses are paid to non-participating life policyholders.

Both participating and non-participating life policies normally offer some level of guaranteed benefits payable on the survival of the policyholders throughout the period of the policy. This survival benefit can be in the form of cash paid periodically or cash surrender value.

The concepts of participating and non-participating funds were traditionally the bedrock of life insurance products before the innovation of investment-linked and universal life products were introduced in the 90s. Until today, traditional participating and non-participating products still play significant roles in the life insurance industry despite the growing popularity of investment-linked and universal life plans.

2.2 The Emergence of Life *Takāful*

In general, the objective of the life insurance product, which is mainly to assist those who are afflicted with various forms of calamities, is also shared by the *takāful* industry. Consequently, Sharī'ah-compliant *takāful* instruments to protect participants against various misfortunes, such as death, disability and sickness, are being structured and introduced as the demand grows for an alternative to conventional life insurance.

In Malaysia, most of the life *takāful* products (also known as family *takāful*) are structured in the form of unit-linked or investment-linked policies. This essentially means that the investment risks are borne entirely by the policyholders (participants). A certain portion of their *takāful* contribution is allocated to the risk (*tabarru'*) fund for the purpose of *takāful* protection against unfortunate events such as death, disability or sickness. There is a close resemblance, in terms of product structure, between conventional life investment-linked insurance and family *takāful* products since both have basically “transferred” the investment risks to policyholders/participants and, by doing so, have clearly segregated the cost of providing protection, either in the form of *tabarru'* or the cost of insurance.

The fundamental principle of *takāful*, i.e., *tabarru'*, makes it convenient for the family *takāful* operator (hereafter TO) to adopt the investment-linked life insurance model. Unlike conventional insurance, which is structured on the basis of *mu'āwadah*, i.e., a contract of exchange between policyholders and life insurance companies in the form of buying and selling insurance coverage, *takāful* reflects a reciprocal relationship and agreement of mutual help between participating members, who undertake to mutually guarantee and indemnify each other in a particular defined event. The act of guaranteeing each other implies mutual help and mutual indemnity on the basis of brotherhood deeply rooted in the *tabarru'* principle, which tolerates the presence of *gharar* (uncertainty).

Changing the contract of life insurance to family *takāful* leads to a fundamental difference in ownership of the funds, particularly the risk fund. In conventional life insurance, the risk fund belongs to the life insurance company. This is because the exchange contract executed between the company and the policyholders effectively means that each policyholder has transferred his right over the premium paid (insurance price) to the insurance company against a consideration of an insurance policy that has been sold by the company, which will indemnify him should any mishap occur in the future.

On the other hand, in *takāful*, the risk fund is exclusively and collectively owned by the participants, who have been contributing into the charitable pool (*tabarru'*) for mutual help and indemnification. In most *takāful* models, a contract of agency (*wakālah*) is used to reflect the relationship between the participants and the TO; the latter acts as an agent to manage the *takāful* fund on behalf of the former in return for a fee. In terms of the prudential requirements for managing this fund, they are similar to those for a conventional risk fund.

Operationally, it is more convenient for family TOs to adopt the life insurance investment-linked model; first, because segregation between the investment fund and the risk fund works very well with the concept of *takāful* as described earlier. Second, the existing system development, operational procedures, risk management, regulations and other relevant areas that have already been put in practice, and with which practitioners are familiar, can be easily adopted by TOs. This explains why almost all family *takāful* products in the market today adopt the investment-linked concept.

2.3 Market Challenges in Offering Family *Takāful*

The preceding section acknowledged that the family *takāful* investment-linked product structure is very similar to conventional investment-linked life insurance in terms of its basic features, charges, *takāful* benefits as well as investment funds. This reflects the current market trend in the family *takāful* industry, which is predominantly structured based on the investment-linked model.

However, when it comes to traditional conventional life insurance products, family *takāful* seems to be lagging behind. This is due to some inherent features of traditional life insurance that cannot be replicated in family *takāful* product design, such as:

- guaranteed survival benefits in the forms of cash dividend payouts, cash surrender value, and maturity values
- guaranteed investment returns
- guaranteed capital/refund of contributions

It should be noted that the above factors are significant selling points when it comes to marketing a life insurance product on the basis of guaranteed long-term savings coupled with insurance protection. However, various forms of guaranteed benefits mentioned above may not be readily available for family *takāful* since, structurally,

the only possible guaranteed benefits are in the form of the contingency benefits (except for survival), i.e., benefits linked to misfortunes of the participants, be it death, disability, or sickness-related. This is due to the fundamental concept of *takāful*, i.e., helping one another. The guaranteed benefits that are contingent upon the survival of the participants cannot be offered by the TOs in a way that is totally acceptable from a Sharī‘ah standpoint, unless it is taken from the shareholders’ fund. Despite some attempts by family *takāful* products in the market today to offer guaranteed survival benefits, doubts have been cast upon the validity and permissibility of such structures from a Sharī‘ah viewpoint. The following section deals with the issue in detail.

Besides the above issues, the family *takāful* product, being in its infancy stage in the market, faces other challenging issues, such as:

- being perceived as more expensive than the equivalent conventional products
- being perceived as giving lower returns than the conventional products
- its inability to offer minimum guaranteed returns as its conventional equivalent does.

This paper is not intended to address the above issues as they are very much related to individual companies’ financial strategies in terms of pricing as well as their investment management strategies. The present study is more concerned with how family *takāful* can be competitively structured in a manner that allows various forms of benefits to be offered that resemble those of traditional life insurance without in any way violating Sharī‘ah principles.

3. SHARĪ‘AH APPRAISAL OF GUARANTEED BENEFIT

As mentioned earlier, many traditional life insurance products offer additional benefits in the form of non-forfeiture values, which are actually guaranteed cash values. Table 1 below illustrates an example of how a non-participating plan with guaranteed survival benefit is calculated and offered to participants.

Table 1: Non-Participating Plan with Guaranteed Cash Values

Example of Conventional Plan

Non-Participating Illustration Plan (simple endowment)

Annual Premium : 11,585

Sum Assured : 70,000

Plan Type : Endowment Non-Par

End of Policy Year	GUARANTEED					NON-GUARANTEED	
	Basic Premium Paid at beginning of year	Basic Cash Value	Rider(s) Cash Value	Basic Death Benefit	Rider(s) Death Benefit	Total Surrender Value	Total Death Benefit
	(a)	(b)	(c)	(d)	(e)	(g) = (b) + (c)	(h) = (d) + (b) + (c)
1	11,585	0	0	70,000	0	0	70,000
2	11,585	5,040	0	70,000	0	5,040	75,040
3	11,585	14,210	0	70,000	0	14,210	84,210
4	11,585	17,430	0	70,000	0	17,430	87,430
5	11,585	24,780	0	70,000	0	24,780	94,780
6	11,585	32,060	0	70,000	0	32,060	102,060
7	11,585	40,950	0	70,000	0	40,950	110,950
8	11,585	45,780	0	70,000	0	45,780	115,780
9	11,585	55,370	0	70,000	0	55,370	125,370
10	11,585	60,900	0	70,000	0	60,900	130,900

In order to be competitive with their conventional counterparts, TOs tend to design products that offer similar features. Based on observation of market trends, the guaranteed survival benefits in family *takāful* products may be offered in three possible ways:

- a guaranteed maturity value
- a guaranteed series of cash payouts throughout the certificate term
- a guaranteed refund of the contributions

In conventional traditional non-participating life insurance, the above guaranteed benefits are normally taken from a single pool, the risk fund pool, since there is no investment pool available as there is in the case of the investment-linked product. However, this approach invokes Sharī'ah issues as *takāful* is structured on the premise of *tabarru'*, which makes the otherwise prohibited elements in a normal exchange contract, such as *ribā*, *gharar* and *maysir*, tolerated. The concept of *tabarru'* is explained in detail below.

3.1 Issues Related to the Concept of *Tabarru'*

Tabarru' is derived from the verb *tabarra'a* and carries the meaning of contribution, gift, donation or charity without expecting any compensation in return.³ In *fiqh* terms, *tabarru'* is a unilateral declaration of intent, and this contract has a particular nature in Islamic commercial law. Its purpose is to give a favour to the recipient without any specific consideration in return.

This type of contract is valid and enforceable in Islamic commercial law for no consideration, in contrast to an exchange contract, in which both parties must give something in return for what they receive. The Sharī'ah Advisory Council (SAC) of Bank Negara Malaysia defines *tabarru'* as a contract of gratuity or charity, i.e., to relinquish a portion of the contribution as a donation to fulfill the obligation of mutual help by allowing it to be used to pay claims submitted by eligible claimants.⁴ Based on this definition, *tabarru'* is a contribution which entails no return but, rather, a reward from Allah alone.

Hibah (gift) is a form of *tabarru'* in which the donor unilaterally relinquishes his right of ownership over the gifted object to the recipient (donee). There are two important pillars of *tabarru'*: the absence of counter-value and the intention to perform a charitable act. In the absence of either, the act is no longer considered *tabarru'*. If a donor stipulates a benefit for his contribution, it will change the reality of the transaction from a gift to an exchange contract. This is consistent with the legal maxim, "In contracts, consideration is given to intention and meaning rather than words and forms."⁵ This issue is known in classical jurisprudence as *hibah bi thawāb* (a gift with

³ See al-Jurjānī, *al-Ta'rifāt*, 1:256, Qal'aji, *Mu'jam Lughat al-Fuqahā'*, 1:120, Muṣṭafā, *al-Mu'jam al-Wasīṭ*, 1:50.

⁴ Bank Negara Malaysia, *Resolusi Syariah dalam Kewangan Islam*, (Kuala Lumpur: BNM, second edition, 2010), 62.

⁵ See Wizārat al-Awqāf wa al-Shu'ūn al-Islāmiyah, *al-Mawsū'ah al-Fiqhiyyah*, (Kuwait: Dār al-Salāsīl, 1427 AH), 15:62. Ibn al-Qayyim, *Zād al-Ma'ād*, (Beirut: Mu'assasat al-Risālah, 1415 AH, 27th edition), 5:110,

expected compensation), according to the Mālikī School,⁶ or *hibah bi shart al-ʿiwad* (a gift with stipulated counter-value), according to the Shāfiʿī and Ḥanbalī Schools.⁷ Whatever they call it, jurists agree that when the gift and compensation have been exchanged, *hibah bi shart al-ʿiwad* is no longer a charitable (*tabarruʿ*) contract; rather, it becomes a *muʿāwadah* (exchange) contract. Some of them consider it an exchange contract from the time of the offer and acceptance.⁸

In the *takāful* context, the gift is the contribution and the *thawāb* is the indemnification by the risk fund. If that is the case, the ruling of *hibah bi thawāb* will take the ruling of an exchange contract. If *takāful* is considered an exchange contract, all the issues of *ribā*, *gharar* and *jahālah* will reemerge.

Therefore it is not possible for TOs to design products that pay any form of cash or survival benefits out of the risk fund (*tabarruʿ* fund). It is not sufficient to argue that all participants in the risk fund agree to pay for the survival benefits and consider them as a form of “*takāful* benefit” in addition to the normal *takāful* benefits, which are only payable when a misfortune occurs to a participant. Paying survival benefits out of the risk fund to the participants in the *tabarruʿ* fund invokes the issue of *ribā al-faḍl* (the exchange of money for money at unequal amounts). This is because the stipulated condition of getting benefits out of the donated amount changes the nature of the original *tabarruʿ* into a *muʿāwadah* (exchange) contract. It may also trigger the issue of *ribā al-nasīʾah* in that the exchange of money is not done on the spot; it is deferred.

5:813; Ibn Nujaym, *al-Ashbāh wa al-Nazāʾir*, (Beirut: Dār al-Fikr, 2005), 18-19, al-Zarkashī, *al-Manthūr fī al-Qawāʾid*, (Kuwait: Ministry of Awqāf, 1982), 2:371; Aḥmad ibn Idrīs al-Qarāfī, *al-Dhakhīrah fī al-Fiqh*, (Morocco, Dār al-Gharb al-Islāmī, 1994), 1:243-244, 6:336.

⁶ Al-Jazīrī, *al-Fiqh ʿalā al-Madhāhib al-Arbaʿah*, (Beirut: Dār al-Kutub al-ʿIlmiyyah, 2003), 3:273.

⁷ Ibid, 3:276.

⁸ See W. Zuhaili, *al-Fiqh al-Islāmī wa Adillatuh*, (Damascus: Dār al-Fikr, 1997), 5:4007-4008. Also refer to the discussion of the four Schools in al-Jazīrī, *al-Fiqh ʿalā al-Madhāhib al-Arbaʿah*, 3:273.

الشافعية – قالوا: الهبة بشرط العوض ويقال له الثواب صحيحة بشرط أن يكون العوض معلوماً، وفي هذه الحالة تكون بيعاً لها حكم البيع.

الحنابلة – قالوا: الهبة بشرط العوض تصح إن كان العوض معلوماً أما إن كان العوض مجهولاً فإن الهبة لم تصح أصلاً؛ ويكون حكمها في هذه الحالة حكم البيع الفاسد.

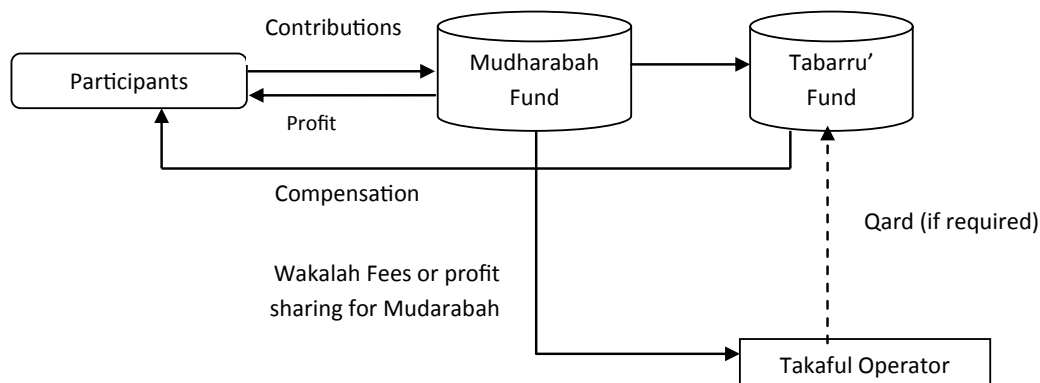
المالكية – قالوا: للواهب أن يشترط العوض المالي على هبته، ويعبر عن العوض بالثواب، ويقال للهبة (هبة الثواب).

الحنفية – قالوا: الهبة بشرط العوض جائزة ويصح عقد الهبة.

3.2 The Inherent Impediments in the Existing Model

Besides the issue of *tabarru'* as discussed above, the inherent impediments of the existing *takāful* model also restrict TOs from providing guaranteed benefits to participants. This is particularly true as the existing models of *takāful*, which are based on *wakālah*, or *muḍārabah*, or a hybrid, do not allow any form of guarantee. In the *wakālah* (agency) model, the TO acts as the fund administrator, managing it in trust on behalf of the participants. In return, the TO is paid a fee for services rendered. However, any loss incurred is still borne by the participants since *wakālah* is merely a contract of trust. Similarly, under the *muḍārabah* model, the contracting parties have the right to share profit, while loss is borne by the participants. Exhibit 4 depicts the common structure of the *wakālah* and *muḍārabah* models of family *takāful*.

Exhibit 4: The Wakalah/Mudarabah Model



In practice, for family *takāful*, funds are normally further segregated into the participants' risk fund (representing the *tabarru'* fund) and the participants' investment fund (representing the *muḍārabah* fund). To have a guaranteed benefit scheme, even out of the participants' investment fund, would be tantamount to a violation of the Shari'ah.

The majority of jurists agreed that the entrepreneur (*muḍārib*) is a trustee (*amīn*). The *muḍārib* receives the capital with the consent of the capital provider (*rabb al-māl*), and hence, he is not liable to guarantee it except in case of negligence (*taqṣīr*), misconduct (*ta'addī*) or violation of stipulated conditions (*mukhālafat al-shurūṭ*). Al-Bājī explains this fact as follows:

أن عقد القراض لا يقتضي ضمان العامل، وإنما يقتضي الأمانة ولا خلاف في ذلك. فلذلك إذا شرط نقل الضمان عن محله بإجماع اقتضى ذلك فساد العقد والشرط

“The *qirāḍ* (*muḍārabah*) contract does not require the entrepreneur to guarantee; it only requires trusteeship. There is no dispute concerning this matter. Thus, stipulation of a condition that transfers the obligation of guarantee from the party that should, according to scholarly consensus, bear it renders the contract and the condition void.”⁹

Stipulation of a guarantee in any form would change the *muḍārabah* contract into a *qarḍ* (loan), and the legal status of the entrepreneur as an agent (*wakīl*) and a trustee (*amīn*) would change into a debtor who guarantees the principal. The strict rules of *qarḍ* would not allow any form of benefit to be associated with the loan, for that would be deemed as *ribā*. Therefore, any form of guaranteed benefits would render the transaction *ribā* should these benefits be derived from the fund that is structured on the principle of *muḍārabah* or *wakālah*.

4. APPLICATION OF WADĪ'AH YAD ḌAMĀNAH AS A NON-PARTICIPATING FUND

Based on the preceding discussion, it is apparent that TOs cannot offer various forms of guaranteed benefits, such as cash dividend payouts, cash surrender value, survival value and others, in a way that is acceptable from the Sharī'ah standpoint due to the inherent impediments in the existing structure related to the *tabarru'*, *muḍārabah* and *wakālah* principles governing various funds in family *takāful* models. Therefore, this paper proposes a concept based on *wadī'ah yad ḍamānah* (guaranteed safe custodianship) to be structured together with other types of contracts in order to allow such benefits to be offered to *takāful* participants. This section begins by delineating the concept of *wadī'ah* in order to pave the way for a better understanding of the proposed *wadī'ah* model for traditional family *takāful* products.

⁹ See al-Bājī, *al-Muntaqā: Sharḥ al-Muwaṭṭa'*, (Cairo: Dār al-Kitāb al-Islāmī, 1322 AH), 5:153.

4.1 Revisiting the Concept of *Wadī'ah*

4.1.1 The Definition of *Wadī'ah*

Wadī'ah literally means a trust for safekeeping.¹⁰ Different schools of thought have provided various technical definitions of *wadī'ah*. The Ḥanafī and Mālikī Schools defined *wadī'ah* as property given to another party for safekeeping.¹¹ The Shāfi'ī School defined it as property that is turned over to another party for safekeeping on the owner's behalf, but they focused further definition on the nature of the property, allowing *wadī'ah* whether the property is recognized by the Sharī'ah or not, as long as it can be used and is a person's exclusive right; for example, a useful impure substance.¹² The Ḥanbalīs defined *wadī'ah* as property given to a person for safekeeping without any consideration.¹³

4.1.2 The Legitimacy of *Wadī'ah*

The *wadī'ah* contract is legitimated by the Sharī'ah based on authentic evidence from the Qur'ān, the Sunnah, *ijmā'* (consensus) and logic (*'aql*).¹⁴ Verses of the Qur'ān that support the legality of *wadī'ah* include:

إِنَّ اللَّهَ يَأْمُرُكُمْ أَنْ تُؤَدُّوا الْأَمَانَاتِ إِلَىٰ أَهْلِهَا

“Allah commands you to return trusts to those to whom they are due.”¹⁵

The above verse was a specific divine command to return back the key of the Ka'bah to 'Uthmān ibn Ṭalḥah.¹⁶ However, the verse indicates the importance of fulfilling all types of trusts in general, including *wadī'ah*,¹⁷ on the basis of the hermeneutic rule that consideration is given to the general wording not the specific occasion of revelation (*al-‘ibrah bi ‘umūm al-laḥẓ, lā bi khuṣūṣ al-sabab*).¹⁸

¹⁰ Q. al-Rūmī, *Anīs al-Fuqahā' fī Ta'rīf al-Alfāz al-Mutadāwalah Bayn al-Fuqahā'*, (Beirut: Dār al-Kutub al-‘Ilmiyyah, 2004), 1:92.

¹¹ Al-Nawawī in Nazīh Ḥammād, *‘Aqd al-Wadī'ah fī al-Sharī'ah al-Islāmiyah*, (Damascus: Dār al-Qalam, 1993), 8.

¹² Ibn Ḥajar al-Haytamī, *Tuḥfat al-Muḥtāj fī Sharḥ al-Minhāj*, Beirut: Dār Iḥyā' al-Turāth al-‘Arabī, 1983), 7:98.

¹³ Ḥammād, *‘Aqd al-Wadī'ah*, 8.

¹⁴ *Al-Mughnī*, 9:256, *al-Muḥadhdhab*, 1:366.

¹⁵ Sūrah al-Nisā'(4):58.

¹⁶ Ḥammād, *‘Aqd al-Wadī'ah*, 17.

¹⁷ Ibn ‘Ābidīn, *Radd al-Muḥtār ‘alā al-Durr al-Mukhtār*, (Beirut: Dār al-Fikr), 5:662.

¹⁸ Ibid.

وَتَعَاوَنُوا عَلَى الْبِرِّ وَالتَّقْوَى

“Help one another in righteousness and piety.”¹⁹

This is a command from God for mutual assistance in righteousness and piety.²⁰ It includes *wadī'ah* as it is a benevolent contract designed to help others based on trust.

Several authentic *hadīths* provide further evidence of its legality. They include:

أَدِّ الْأَمَانَةَ إِلَى مَنِ اتَّيَمَّنَكَ وَلَا تَخُنْ مَنْ خَانَكَ

“Return a trust to the one who entrusted you, but do not betray the one who betrayed you.”²¹

عَنْ عَائِشَةَ فِي هِجْرَةِ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَالَتْ: وَأَمَرَ، تَغْنِي رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ، عَلِيًّا رَضِيَ اللَّهُ عَنْهُ أَنْ يَتَخَلَّفَ عَنْهُ بِمَكَّةَ حَتَّى يُؤَدِّيَ عَنْ رَسُولِ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ الْوَدَائِعَ الَّتِي كَانَتْ عِنْدَهُ لِلنَّاسِ.

‘Ā’ishah mentioned, regarding the Hijrah of the Prophet (peace be upon him), that he ordered ‘Alī (may Allah be pleased with him) to remain behind in Makkah in order to return the items that people had entrusted for safekeeping with Allah's Messenger(peace be upon him) back to their owners.²²

In addition to the recommendations of the Qur’an and Sunnah to honor the concepts of *amanah* and *wadī'ah*, jurists of both the past and present have consistently supported the legality of *wadī'ah*. The logical justification for it is that people have need of others to assist them in keeping their property safe,²³ as not everyone has the ability to protect and safeguard his property at all times by himself.²⁴

¹⁹ Sūrah al-Māidah (5):2.

²⁰ Ḥammād, *‘Aqd al-Wadī'ah*, 17.

²¹ *Sunan Abū Dāwūd*, 2:260, *Sunan al-Tirmidhī*, in *‘Āridhat al-Aḥwadhī*, 5:268, *Sunan al-Dārimī*, 2:264, and *Musnad Ahmad*, 3:414.

²² Al-Bayhaqī, *al-Sunan al-Kubrā*, (Beirut: Dār al-Kutub al-‘Ilmiyyah, 3rd edition, 2003), 6:472.

²³ Ibn Qudāmah in al-Zuhaylī, *al-Fiqh al-Islāmī wa Adillatuh*, (Damascus: Dār al-Fikr, 2004), 5:4018.

²⁴ Markaz Dirāsah Fiqhiyah wa Iqtisādiyyah, *Mawsū‘at Fatāwā al-Mu‘āmalah al-Māliyah*, (Cairo: Dār Salam, 2010), 13:73.

While the general ruling for the *wadī'ah* contract is permissibility, jurists are of different views with regard to giving and taking property as a deposit. The Ḥanafī School is of the opinion that being a custodian is recommended, based on various verses and ḥadīths enjoining mutual assistance. The Ḥanbalī and Shāfi'ī Schools agree with the Ḥanafīs on the condition that the custodian is trustworthy and has the full capacity to safeguard the deposit. According to the Mālikī School, the original ruling of *wadī'ah* is permissibility. However, it becomes obligatory if a person cannot protect his property and the person he asks to safeguard it has the ability. On the contrary, it becomes prohibited if the property is acquired from unlawful activities.²⁵

4.1.3 Essentials of *Wadī'ah*

While the Ḥanafī School stipulated only one pillar for the validity of *wadī'ah*, i.e., offer and acceptance, the majority of jurists enumerated four essential pillars:²⁶

- (1) Depositor
- (2) Custodian
- (3) Property to be deposited
- (4) Offer and acceptance

Jurists have stipulated several conditions to be fulfilled for each pillar. The contracting parties (depositor and custodian) must be legally eligible to execute the contract, i.e., they must be sane and of the age of majority. The subject matter of the deposit should be an asset recognized as wealth by the Sharī'ah—according to the Ḥanafī and Mālikī Schools; however, according to the Shafīī and Ḥanbalī Schools, even wealth that is not recognized by the Sharī'ah is eligible if it is useful and the depositor has an exclusive right to it. The subject matter should also be a movable asset. However, the Ḥanafī and Shāfi'ī Schools allow immovable assets to be the subject matter. The offer and acceptance may be either verbal or implicit through physical receipt even if nothing is said. The latter is considered valid by analogy with a sale by direct exchange (*mu'āṭāh*), for which verbal acceptance is not required.²⁷

²⁵ See Ḥammād, *'Aqd al-Wadī'ah*, 19-20.

²⁶ Wabbah al-Zuhayli, *al-Fiqh al-Islāmī wa Adillatuh*, 5:4018.

²⁷ See Ḥammād, *'Aqd al-Wadī'ah*, 28-43.

4.1.4 Characteristics of Wadī'ah

The majority of jurists consider *wadī'ah* as a form of agency contract. It, therefore, has three characteristics: First, *wadī'ah* is a non-binding and revocable contract. Each party may terminate and cancel the contract at any time he wishes, as in a *wakālah* contract. It is stated in *Majallat al-Ahkām al-'Adliyyah* (774): “The person making the deposit for safekeeping and the person so receiving it may either of them cancel the contract of deposit for safekeeping at any time they wish.”²⁸ Second, *wadī'ah* is a trust-based contract. The custodian is a trustee to safeguard the deposit. Hence, he is not liable to indemnify the property for any damages or losses except in case of negligence or misconduct (*al-taqṣīr wa al-ta'addī*).²⁹ Rasūlullah (peace be upon him) said:

مَنْ أُودِعَ وَدِيعَةً فَلَا ضَمَانَ عَلَيْهِ

“Whoever accepts property for safekeeping, there is no guarantee due on him.”³⁰

Third, *wadī'ah* is a form of *tabarru'* (benevolent) contract legislated by the Sharī'ah on the basis of mutual assistance, eliminating harm, and fulfilling people's needs. Hence, it is basically inappropriate for the custodian to require any compensation as it is unlike a commercial contract, which has been legislated to establish an exchange of financial rights and responsibilities.³¹

4.1.5 From Trust (Amānah) to Guarantee (Damānah)

As indicated earlier, the nature of *wadī'ah* is a trust (*amānah*) in the hand of custodian. Therefore, according to the majority of jurists, if the depositor stipulates that the custodian must guarantee the deposit, and the custodian agrees, and subsequently the deposit is damaged or stolen without any negligence or misconduct on his part, he is still not liable to indemnify it. That is because the condition is void as it contravenes the inherent nature and implication of the contract (*muqtaḍā al-'aqd*). Al-Zurqānī says, “The stipulation of guarantee violates the essence and ruling of the *wadī'ah*

²⁸ Ibid, 22-23.

²⁹ *Al-Muhadhdhab*, 1:366; Ibn Nujaym *Al-Baḥr al-Rā'iq*, 7:273; al-Shāfi'ī, *al-Umm*, 4:62, Ibn Ḥazm, *al-Muḥallā*, 8:277.

³⁰ Ibn Mājah, *Sunan Ibn Mājah*, (Dār Iḥyā' al-Kutub al-'Arabiyyah), 2:802.

³¹ Ḥammād, *Aqd al-Wadī'ah*, 25.

contract.”³² However, jurists unanimously agreed that the nature of the trust will change to a guarantee (*ḍamānah*) if the custodian is proven to have exhibited negligence and misconduct. Examples of such behavior include:³³

- (1) The custodian does not protect and safeguard the deposit as required.
- (2) Entrusting the deposit to third party.
- (3) Utilizing the deposit
- (4) Travelling with the deposit
- (5) Commingling the deposit with other properties
- (6) Violating the depositor's conditions.

With regard to the status and legal implication of the contract, when the custodian is ruled negligent or the depositor authorizes the custodian to utilize the property, the ruling of *wadī'ah* will change to the ruling of a guaranteed gratuitous loan (*‘āriyah maḍmūnah*).³⁴ However, if the deposited property is in the form of currency, the ruling of *‘āriyah* will change to the ruling of *qarḍ* (loan to be repaid in kind).³⁵ Al-Samarqandī said:

وَكُلُّ مَا لَا يُمَكِّنُ الْإِنْتِفَاعُ بِهِ إِلَّا بِاسْتِهْلَاكِهِ فَهُوَ قَرْضٌ حَقِيقَةٌ، وَلَكِنَّهُ يُسَمَّى
عَارِيَةً بَحَارًا

“When it is impossible to use something without consuming it, borrowing it is actually a *qarḍ* (a loan to be repaid in kind) even though it may be called *‘āriyah* metaphorically.”

Based on al-Samarqandī's statement, al-Kāsānī opined that dinars and dirhams can only be borrowed on the principle of *qarḍ* and not *i‘ārah*.³⁶

³² *Al-Mawsū'ah al-Fiqhiyyah*, 43:24-25.

³³ See al-Zuhayli, *al-Fiqh al-Islāmī wa Adillatuh*, 5:4024-4028.

³⁴ Al-Buhūtī, *Kashshāf al-Qinā'*, 4:167.

³⁵ Ibid

³⁶ Al-Kāsānī, *Badā'i' al-Ṣanā'i'* (Dār al-Kutub al-‘Ilmiyyah, 1986, 2nd edition), 6:215.

In the current Islamic financial context, Shaykh 'Uthaymīn pointed out that it is inappropriate to apply the *wadī'ah* contract to bank deposits because the bank never leaves the deposited funds idle; rather, it utilizes them for financing and investment. The deposit is actually a *qard*, not a *wadī'ah*.³⁷ The Islamic Fiqh Academy of the OIC (1995) resolved that deposits in current accounts, both in Islamic banks and conventional banks, are ruled as a loan (*qard*) from the *fiqh* perspective since the banks are obliged to guarantee the principal and must return the deposit when requested.

This arrangement and understanding has a precedent in Muslim history. The most significant example is the safekeeping service offered by the Companion, Zubayr ibn al-ʿAwwām. Because of his honesty and competence, people would give Zubayr their money and valuable items for safekeeping. Because the amounts of money were large, Zubayr was concerned about bearing the responsibility of protecting and safeguarding the money from loss without being able to use it. He decided to ask depositors permission to use their money and consider it as a loan. Thus, whenever a depositor came to ask for safekeeping, he would refuse and say:

لَا، وَلَكِنْ هُوَ سَلَفٌ؛ إِنِّي أَخْشَى عَلَيْهِ الضَّيْعَةَ

“No, but make it a loan; I fear it may be lost”³⁸

By this stipulation, Zubayr converted the *wadī'ah* (which was legislated to keep people's entrusted property safe without utilizing it) into a loan, which enabled him to use and invest the borrowed money and assume liability for its safe return.

4.2 Structuring Family Traditional Non-Participating *Takāful* Based on *Wadī'ah*

The preceding section elaborates the features and characteristics of *wadī'ah yad ḍamānah* (guaranteed safe custodianship). The nature of *wadī'ah yad ḍamānah* means that the custodian of the fund provides a total guarantee of the savings, while the ownership of the fund belongs entirely to the participants or depositors. Moreover, by virtue of its ruling, which is similar to a loan in characteristics and principles, participants are not entitled to any returns from the fund except on the discretion of the custodian, who

³⁷ Muḥammad ibn Ṣāliḥ Āl 'Uthaymīn, *Sharḥ Mumtī' alā Zād al-Mustaḥṣin*, Dār Ibn al-Jawzī, 1428 AH), 10:286.

³⁸ Al-Bayhaqī, *al-Sunan al-Kubrā*, 6:467; al-Nawawī, *Riyāḍ al-Ṣāliḥīn*, (Dār al-Rayyān), 1:77.

can utilize and invest it as long as he provides a guarantee of the fund. The concept of *wadī'ah* is deemed to be a suitable structure for use in structuring a family traditional non-participating (non-par) fund.

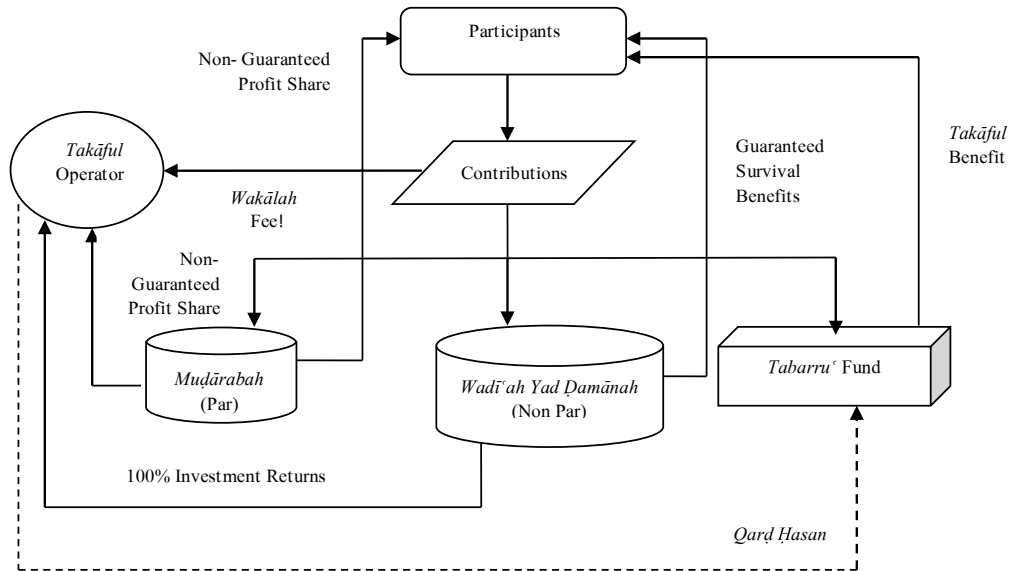
If we revisit the fundamental understanding of a non-par life fund, it shares the same philosophy as *wadī'ah*, which is based on trust. The function of a non-par fund is to provide the insurance guarantee, be it on the insurance benefits or survival benefits. The only different is that the non-par fund belongs to the life insurance company, which is the opposite of the *wadī'ah* fund. This may entail further analysis from practitioners regarding the responsibility of ensuring the safety of the fund in the event the *takāful* company goes out of business, since the money belongs to the participants, similar to their savings in a bank.

It is also important to understand that life insurance is a risk-transfer mechanism between policyholders and a life insurance company and that the risk is guaranteed via the non-par fund. On the contrary, in *takāful*, protection is conceived of as a risk-sharing mechanism, which is the underlying spirit of the *tabarru'* fund. However, with regard to the guaranteed savings part using *wadī'ah yad lam'Énah*, it is, basically, a risk-transfer mechanism since the fund custodian has full responsibility to manage the fund, which belongs to the participants, and to guarantee its solvency at any point of time. In other words, the fund custodian, i.e., the *takāful* operator, guarantees the fund against underlying risks.

4.3 The Modus Operandi of the Wadī'ah-Based Family Takāful Model

Exhibit 5 below depicts the proposed model of traditional family *takāful* based upon the *wadī'ah* concept together with other established contracts and principles, including *tabarru'*, *wakālah* and *muḍārabah*.

Exhibit 5: Hybrid Family Takāful Model



As depicted in Exhibit 5 above, the model works similarly to the existing *takāful* model applied by most TOs these days, except that the *wadī'ah* fund has been added to the model alongside the *muḍārabah* and *tabarru'* funds. Interestingly, it can be argued that the whole model resembles a combination of participating and non-participating funds under one roof. The participating fund is the *muḍārabah* fund, as TOs share the profits of the investments of the fund, whilst the non-participating funds are the *wadī'ah* and the *tabarru'* funds as both provide the guaranteed benefits. The former is on the concept of *qarḍ*, and the latter is on the concept of risk sharing. The *wadī'ah* fund functions to provide the guaranteed survival benefits (non-forfeiture benefits), similar to conventional life insurance.

It is important to note that the dripping process of contribution to the *tabarru'* fund can be done in any of the following manners:

- (1) Up-front allocation to the *tabarru'* fund out of contributions (after deducting the *wakālah* fee);
- (2) Dripping from the *muḍārabah* (participant's investment fund)
- (3) Dripping from the *wadī'ah* (participant's savings fund)

In addition, since the *wadī'ah yad ḍamānah* contract is similar to a qard contract, it will allow the TOs to utilize and invest the fund as long as they fully guarantee it. Any returns generated from the investment activities are exclusively earned by the TOs. The TOs are not obliged to share any returns generated out of this fund with the participants. However, on a yearly basis, should the TOs at their own discretion decide to distribute a portion of the realized returns, they can do so in the form of voluntary hibah. However, this should not become customary; otherwise it will be deemed as a contractual obligation and invoke the Sharī'ah issue of *ribā*.

Nevertheless, the operational model of a *takāful* operator may prevent this issue from cropping up. As mentioned earlier, most TOs operate with a non-guaranteed savings fund in the form of *muḍārabah* (equivalent to the par fund in a life insurance company). This makes it convenient for the operator to transfer the investment returns to the *muḍārabah* account (par fund), should they wish to give away part of the returns to the participants. This will essentially avoid the issue of customer expectation for investment returns from the *wadī'ah* fund.

It is also proposed that the calculation of the guaranteed survival benefits or non-forfeiture benefits under *wadī'ah yad ḍamānah* apply actuarial methodology, either using the discounting technique or the asset-share method. The non-forfeiture values generated need to be disclosed to all participants, however, as they enter the *takāful* contract with the TOs. Table 2 illustrates the operation of non-par traditional family *takāful* based on the *wadī'ah* concept.

Apparently, in Table 2 above, the columns of *wadī'ah* savings (as depicted in Columns B and C), imply that the *wadī'ah* functions almost exactly the same as the non-par plan illustrated previously in Table 1. The *wadī'ah* portion (see Column B) is calculated up-front by the TO similar to the way the conventional life plan calculates its cash values, and it is allocated on a yearly basis. It will then accumulate and give the annual accumulated cash values in a way similar to a conventional life plan. At any point in time, if a participant decides to surrender his certificate, he will get the accumulated cash value as per Column C.

Table 2: Illustration of a Non-Participating Plan Using The *Wadī'ah* Concept

Annual Contribution : 11,585
Sum Covered : 70,000

Plan Type : Endowment Non-Par

End of Cert. Year	GUARANTEED						NON-GUARANTEED			
	Basic Contribution Paid at beginning of year	Participant's Account (Muḍārabah)	Wadī'ah Savings	Accumulated <i>Wadī'ah</i> (same as original basic cash value)	Rider(s) Cash Value	Basic Death Benefit	Rider(s) Death Benefit	Accumulated <i>Muḍārabah</i> *	Total Surrender Value	Total Death Benefit
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i) = (b) + (c) + (g)	(j) = (f) + (g) + (d) + (h)
1	11,585	11,585	0	0	0	70,000	0	11,585	11,585	81,585
2	11,585	6,545	5,040	5,040	0	70,000	0	18,130	23,170	88,130
3	11,585	2,415	9,170	14,210	0	70,000	0	20,545	34,755	90,545
4	11,585	8,365	3,220	17,430	0	70,000	0	28,910	46,340	98,910
5	11,585	4,235	7,350	24,780	0	70,000	0	33,145	57,925	103,145
6	11,585	4,305	7,280	32,060	0	70,000	0	37,450	69,510	107,450
7	11,585	2,695	8,890	40,950	0	70,000	0	40,145	81,095	110,145
8	11,585	6,755	4,830	45,780	0	70,000	0	46,900	92,680	116,900
9	11,585	1,995	9,590	55,370	0	70,000	0	48,895	104,265	118,895
10	11,585	6,055	5,530	60,900	0	70,000	0	54,950	115,850	124,950

(This illustration is intended to illustrate how *wadī'ah yad ḍamānah* works, full workings will ultimately depend on the product design)

It assumes contribution is net of *wakālah* fee that has been taken upfront)

* *Muḍārabah* portion is not inclusive of investment returns.

Needless to say, the above illustration is merely meant to show how *wadī'ah* works to provide for the non-forfeiture benefits. It assumes that the *wakālah* fee has been taken up front. In a real situation of product development, the TO would need to carefully study the proportions that would go into each part below:

- (1) up-front *wakālah* fees for management expenses and commissions
- (2) *muḍārabah* investments
- (3) *wadī'ah* savings
- (4) *tabarru'* charges

These items may give a different complexion to the final arrangement. However, one can draw an example from the conventional traditional plan to replicate the same benefit as we can see that the application of the normal life fund is now being split into four different parts to form the traditional life *takāful* plan.

As explained above, the non-forfeiture option is a benefit built into the traditional par and non-par traditional life products. A policy would have acquired cash values as the policy progresses towards maturity, which normally can be used for different options in the event the policyholders can no longer pay the premiums till the end of the policy.

It was argued above that the cash values in the *wadī'ah* fund are similar to the non-forfeiture benefit in a traditional life plan. However, it is important to note that there is a fundamental difference between these products, i.e. *takāful* and conventional life insurance. Whilst the latter is based on a purchase-and-sale arrangement, the former is not. The *wadī'ah* fund, which is entirely owned by the *takāful* participants, will not allow for such arrangement for the above facilities, i.e., the non-forfeiture options. Though it is proposed that the calculations of cash values in the *wadī'ah* fund may use the same methodology as conventional life insurance, the option, as available in the traditional life insurance above, cannot be offered due to the difference in the underlying contracts.

5. SHARĪ'AH PARAMETERS IN IMPLEMENTATION OF THE WADĪ'AH MODEL

5.1 The Combination of Various Contracts Should Be Executed Independently

The proposed traditional life *takāful* product applying the *wadī'ah* concept coupled with *muḍārabah* and *wakālah* contracts may trigger a possible Sharī'ah issue on combining contracts in one deal.

The majority of jurists are of the view that the original ruling of any financial transaction is permissibility as long as no clear evidence indicates otherwise.³⁹ Ibn Taymiyyah stated that everyone is at liberty to enter into any contract they consider necessary and to have added value as long as no explicit divine text prohibits it.⁴⁰ The Qur'anic command to "fulfill your contracts"⁴¹ implies the legitimacy of employing any contract that the Lawgiver has not specifically banned.

Based on these general principles, the original ruling of combining various contracts is, therefore, permissibility. The Shāfi'ī jurists generally allow the application of hybrid contracts in financial transactions, such as the combination of leasing and sale, as these contracts are valid when executed separately.⁴² More specifically, al-Kāsānī allowed the combination of *muḍārabah* and *wadī'ah* contracts in one deal,⁴³ and al-Sarakhsī permitted the combination of *muḍārabah* and *qarḍ* contracts.⁴⁴ AAOIFI, in its Sharī'ah Standards, clearly mentioned that the combination of contracts in a single deal is permissible provided that each combined contract is legitimated by the Sharī'ah and there is no stipulation making entry into one contract conditional upon entry into another.⁴⁵ AAOIFI set out the following parameters for applying hybrid contracts:⁴⁶

³⁹ A. al-Imrānī, *al-Uqūd al-Māliyah al-Murakkabah, Dirāsah Fiqhiyyah Ta'şīliyyah wa Taṭbīqiyyah*, Riyadh: Dār Kunūz Ishbīliyyah li al-Nashr wa al-Tawzī', 2006), 69.

⁴⁰ Ibn Taymiyyah, *Majmū' al-Fatāwā*, compiled by Maḥmūd Qāsim, (Riyadh: 1398 AH), 132.

⁴¹ Sūrah al-Mā'idah, (5):1.

⁴² M.B. Arbouna, The Combination of Contracts in Sharī'ah: A Possible Mechanism for Product Development in Islamic Banking and Finance, *Thunderbird International Business Review*, Vol. 49 (3) 341-369, May-June 2007, p. 348

⁴³ Al-Kāsānī, *Badā'i' al-Şanā'i'*, (Dār al-Kutub al-Ilmiyyah, 1986), 6:84.

⁴⁴ Al-Sarakhsī, *al-Mabsūṭ*, (Beirut: Dār al-Ma'rifah, 1993), 22:136.

⁴⁵ AAOIFI, *Sharī'ah Standards for Islamic Financial Institution*, (Bahrain: AAOIFI, 2010), 446.

⁴⁶ Ibid.

- (1) The process does not include cases that are clearly prohibited by the Sharī'ah.
- (2) It is not designed as a trick or excuse to practice *ribā*.
- (3) It does not involve contracts that are contradictory in their rules and objectives.

To ensure that the application of various contracts in the proposed model is in adherence with Sharī'ah principles and guidelines, the various contracts must be executed separately and independently. The *wadī'ah* contract is applied to manage the non-par fund (known hereafter as the Participants' Wadī'ah Fund [PWF]) for the guaranteed survival benefit, and the *muḍārabah* contract is used to manage the Participants' Investment Fund (PIF), while the *wakālah* contract is solely employed for underwriting the Participants Risk Fund (PRF).

5.1.1 The Funds Should Be Clearly Segregated

TOs should establish clear segregation between the assets of the *takāful* funds and the assets of the *takāful* operators. The Participants' Risk Fund (PRF) and Participants' Investment Fund (PIF) must also be segregated from each other. This is to avoid the commingling of funds and to recognize the different purposes, ownerships and risks associated with each fund. It is also important to establish the Participants' Wadī'ah Fund (PWF) along with the PIF and the PRF. Since the PWF belongs to the participants individually, there must be a clear distinction and demarcation for each fund so that any rights and liabilities pertaining to each fund is acknowledged and monitored accordingly.

However, TOs may commingle the Participants' Investment Fund (PIF) and the Participants' Wadī'ah Fund (PWF). This is based on the opinion of some jurists from the Ḥanafī Schools (e.g. al-Kāsanī and al-Sarakhsī) who did not require segregation of *muḍārabah* funds and *wadī'ah* funds. Al-Sarkhasī said:

وَإِذَا دَفَعَ الرَّجُلُ إِلَى الرَّجُلِ أَلْفَ دِرْهَمٍ فَقَالَ: نِصْفُهَا قَرْضٌ عَلَيْكَ وَنِصْفُهَا
مَعَكَ مُضَارَبَةً بِالنِّصْفِ فَأَخَذَهَا الْمُضَارِبُ فَهُوَ جَائِزٌ عَلَى مَا سُمِّيَ؛ أَمَّا فِي
حِصَّةِ الْمُضَارَبَةِ فَعَيَّرَ مُشْكِلٌ؛ لِأَنَّ الشُّيُوعَ لَا يَمْنَعُ صِحَّةَ الْمُضَارَبَةِ، فَإِنْ
شَرَطَهَا كَوْنُ رَأْسِ الْمَالِ أَمَانَةً فِي يَدِ الْمُضَارِبِ، وَذَلِكَ فِي الْجُزْءِ الشَّائِعِ يَتَحَقَّقُ،

وَأَمَّا الْقَرْضُ فَلِأَنَّهُ تَمْلِكُ بِعَوَضٍ، وَالشُّيُوعُ لَا يَمْنَعُ صِحَّتَهُ كَالْبَيْعِ

When one man gives another 1000 dirhams and says, “Half of it is a loan to you, and half of it is for you to use in *muḍārabah*,” and the *muḍārib* accepts it, it is permissible as stipulated. As for the portion assigned for *muḍārabah*, there is no difficulty because commingled capital ownership does not invalidate the *muḍārabah* contract. That is because its essential condition is that the capital is a trust in the hand of *muḍārib*, and that [condition] is realized in the commingled portion. As for the loan, it is a transfer of ownership with an exchange [of the same at a later date], and commingling does not prevent it from being valid, as in a sale.⁴⁷

Notwithstanding to the above opinion, operationally it would be suggested that the investments of these two funds are carried out separately since the returns from both funds have different ownership status.

5.2 Transparency in the Dripping Process

As mentioned earlier, the dripping process of the funds for the Participants’ Risk Fund (PRF) can be done either from Participants’ Investment Fund (PIF) or even the Participants’ Wadī’ah Fund (PWF). It can also be dripped directly from the contributions paid up-front after netting off the *wakālah* fee. However, the whole dripping process must be done in a transparent manner, and the participants must give their clear consent to it.

For example, if a TO decides to drip from the *muḍārabah* (PIF) fund into the *tabarru’* (PRF) fund, the dripped amount for PRF should be transparent. From the Sharī’ah viewpoint, obtaining prior consent, at the outset of contractual execution, from each participant is essential since it effectively means that the participants have agreed to waive their rights and entitlements with regards to the funds and returns generated in the PIF for the purpose of *tabarru’* and mutuality. This practice is in line with the *fiqh* concept of *tanāzul* (waiver of entitlement to a claim) or *isqāṭ al-ḥaqq* (waiving one’s right). The same requirements of transparency and consent apply to any amount dripped from the PWF for *tabarru’* purposes since the PWF is exclusively owned by the participants as individuals.

⁴⁷ Ibid.

5.3. Guaranteed Cash Surrender Benefits Can Only Be Taken From the PWF

Any form of guaranteed survival benefits to be introduced by TOs can only be structured in the form of the Wadī'ah Fund (PWF). However, it is important to note, in applying the concept of *wadī'ah* in *takāful*, the need to understand the Sharī'ah's limits on guarantees. In order to make it comply with the Sharī'ah, the level of guarantee cannot exceed the total contributions paid (after netting off the *wakālah* fees earned by the operator). This means that the guarantee is limited to the amount of money that is deposited into the Wadī'ah Fund.

Any amount of guarantee provided by TOs in excess of the Wadī'ah Fund (PWF) would be tantamount to *ribā*. This is particularly true, since the rules for *wadī'ah yad ḍamānah* (guaranteed safekeeping) are based on the principle of *qarḍ* (loan). One of the fundamental requirements for the validity of *qarḍ*, from a Sharī'ah viewpoint, is the absence of any extra benefit beyond the principal amount. *Qarḍ* is a charitable contract designed for assistance and helping the other party. It is, therefore, impermissible to stipulate any condition that will give benefit to the lender,⁴⁸ as it will depart from the nature of *qarḍ*, turning it from a charitable contract to a commercial contract. Prophet Muḥammad (peace be upon him) said:

كُلُّ قَرْضٍ جَرَّ مَنْفَعَةً فَهُوَ وَجْهٌ مِنْ وُجُوهِ الرِّبَا

“Any loan that results in some benefit for the lender is a kind of *ribā*.”⁴⁹

5.4 Clear Justification for Charges and Sources of Income

Takāful operators are remunerated through fees, charges and shares of profit/surplus. The remunerations should be specific, appropriate, reasonable, and justifiable as being for particular works and services. In this proposed model, the TO's remunerations may be derived from various sources as follows:

⁴⁸ *Al-Mawsū'ah al-Fiqhiyyah*, 39:106.

⁴⁹ *Al-Bayhaqī, al-Sunan al-Kubrā*, 5:573.

5.4.1 Charge for Managing the Wadī'ah Fund

Jurists held different views in regard to the permissibility of stipulating compensation as a reward for the custodian's effort to safeguard the deposit. According to the Ḥanbalī School, it is impermissible to request a fee for safekeeping. A fee, according to them, is warranted in an *ijārah* contract but not in a *wadī'ah* contract. However, Shāfi'ī and Ḥanafī jurists allow the custodian to require a fee in a *wadī'ah* contract, and it is deemed a valid and binding condition. It is stated in *Murshid al-Ḥayrān*:

لَيْسَ لِلْمُسْتَوْدَعِ أَنْ يَأْخُذَ أَجْرَهُ عَلَى حِفْظِ الْوَدِيعَةِ مَا لَمْ يُشْتَرَطْ ذَلِكَ فِي الْعَقْدِ

“A custodian is not entitled to a fee for safekeeping a deposit if it is not stipulated in the contract.”⁵⁰

Meanwhile, the Mālikī School distinguished between a storage fee and safekeeping fee. While they permitted charging for the former, they disallowed taking a fee for the latter unless it becomes a customary practice or is stipulated in the contract.⁵¹

However, it is important to note that this proposed model has changed the ruling of *wadī'ah* to the ruling of *qard* since the participants authorize the TO to utilize the Wadī'ah Non-Par Fund. Therefore, the ruling of charging a fee should also follow the ruling of *qard*.

AAOIFI has passed a resolution that Islamic financial institution acting as custodian may charge a service fee for managing loan-based current accounts. It is stated in AAOIFI's *Shari'ah Standards* (2010): “10/1/1. The reality of current accounts is that these are loans and not deposits. Thus, the institution comes to own the amounts, and a liability to repay the amount is established against it. 10/1/2. It is permissible for the institution to demand a fee for services rendered to the holders of the current accounts.”⁵²

It can be concluded from AAOIFI's Shari'ah Standard 10/1/2 that the TO may impose an appropriate and reasonable charge to participants for services provided in managing the *wadī'ah* non-par fund.

⁵⁰ Hammād, *Aqd al-Wadī'ah*, 26.

⁵¹ Ibid.

⁵² AAOIFI, *Shari'ah Standards for Islamic Financial Institution*, 348-349.

5.4.2. Investment Return from Participants' Wadī'ah Fund (PWF)

Jurists agree that the custodian is ruled to have misbehaved, and hence he is held liable, if he invests the deposit fund without the consent of the depositor. Nevertheless, there are diverse views with regard to the profit accumulated from investment activities using a deposit fund, which can be summarized in five opinions:

- (1) The profit exclusively belongs to the depositors as it is generated from the deposit fund where any profit should follow the principal. This view is held by Ibn 'Umar, Nāfi', Abū Qulābah, Ishāq and Aḥmad, in one narration from him.
- (2) The profit should be channeled to the Bayt al-Māl. This opinion is proposed by 'Aṭā and by Aḥmad in one narration.
- (3) The profit should be given to alms or charity on the basis that all income accumulated unlawfully must be channelled to charity. This view is held by Abū Ḥanīfah, Zufar, Muḥammad ibn al-Ḥasan and al-Sha'bī, and is attributed to Aḥmad in one narration.
- (4) The profit is the exclusive right of the custodian as it is the outcome of his effort and work. He is entitled to the profit as compensation for his liability to guarantee the deposit fund. This view is held by Shurayḥ, Ḥasan al-Baṣrī, Imām Mālik, al-Thawrī, Layth ibn Sa'd, Abū Yūsuf and others.
- (5) The profit is shared between the depositor and the custodian, as in a *muḍārabah* contract. This view is reported in one narration from Imām Aḥmad. According to Ibn Taymiyyah, it is the most authentic opinion on the basis that 'Umar bin al-Khattāb issued the same ruling.⁵³

The authors of this paper prefer the fourth view, that the profit belongs exclusively to the custodian on the basis that it is a result of his effort and a compensation of his liability to guarantee the deposit, based on the *ĪdĒth* in which the Prophet said: *الْخَرَجُ بِالْضَمَانِ* ("Profit goes with liability").⁵⁴ Hence, in this proposed model, the authors are of the view that all investment income generated from the *wadī'ah* non-par fund is the exclusive right of the TO. The TOs are not obliged to share the investment profit, bonus or reward with the participants; and any token of appreciation, if given to the participants,

⁵³ See Ḥammād, *'Aqd al-Wadī'ah*, 111-113.

⁵⁴ *Sunan Abū Dāwūd*, Bāb al-Kharāj bi al-Ḍamān, (Beirut: Dār al-Kitāb al-'Arabī), 3:30.

must be on a discretionary, and occasional, basis in order to prevent it from becoming an 'urf (custom) that is prohibited by the Sharī'ah. This is in line with the following maxim.

المعروف عرفا كالمشروط شرطا

“What is known [and expected] by custom is like a stipulated condition.”⁵⁵

5.4.3. A Wakālah Fee for Managing the PRF

Islamic jurists allow *wakālah* contracts with or without a fee.⁵⁶ If a person serves as an agent without stipulating a defined fee, it is considered a form of *ibdā'*.⁵⁷ In contrast, if he imposes a fee for his capacity as an agent, the concept applied is basically *ijārah*.⁵⁸ The proposed model allows TOs to charge a reasonable and justifiable fee in their capacity as agents managing the *tabarru'* fund. The fee can be either a percentage of the contribution or a fixed amount. It is not allowed to impose a fee based on a percentage of the surplus or a percentage of the profit. It is important to emphasize that the *wakālah* fee is imposed solely for managing the PRF and covers management expenses and a commission. TOs should be very careful in determining the *wakālah* fee, especially when the PRF is dripped out from the PIF, to ensure that the fee is prudently calculated purely for managing the PRF; it is not allowed to make part of the *wakālah* fee compensation for managing the *muḍārabah*-based PIF.

5.4.4. Profit Sharing from the Participants' Investment Fund (PIF)

Another income source for TOs in this proposed model is an unguaranteed profit share in their capacity as the investment managers of the *muḍārabah* fund. The share of profit should be a percentage of the profit as agreed up-front and not a lump sum or a percentage of the capital. The profit should not be guaranteed, as the TO are trustees. Any financial loss is borne solely by the participants.

The Sharī'ah has made profit-sharing the basis of compensation for the investment

⁵⁵ Al-Zarqā, *Sharḥ al-Qawā'id al-Fiqhiyyah*, (Dār al-Qalam, 1989), 237.

⁵⁶ Wahbah al-Zuhayli, *al-Fiqh al-Islāmī wa Adillatuh* 5:4058.

⁵⁷ *Ibdā'*: to send money with a trader to do business with it as a favour to the sender. The profit here is due to the owner, and the trader donates his labour. It is a common practice among traders as it serves to cement ties among them. See *ISRA Compendium for Islamic Financial Terms*, (Kuala Lumpur: ISRA, 2010), 30.

⁵⁸ *Majallat al-Aḥkām al-'Adliyyah* (1426 AH).

manager in a *muḍārabah* contract. It is, therefore, inappropriate to charge a management fee for running a *muḍārabah* fund. AAOIFI has resolved that combining a share of the profit and a fee in a *muḍārabah* contract is impermissible. However, if the fee is for other services executed in an independent contract, it is allowed.⁵⁹

5.4.5. Surplus Sharing from PRF

Another potential income source for the TO in this proposed alternative model is sharing the surplus from the PRF. The Takāful Operational Framework (TOF) stipulates that the share of surplus for TOs should not exceed 50% of underwriting surplus. The SAC BNM, in its 62nd meeting, dated 4 October, 2006, resolved that TOs are entitled to share in the surplus from the *tabarru'* fund based on *wakālah* concept as a performance fee on an agreed ratio. The SAC's ruling is premised upon following justifications:⁶⁰

- (1) The *takāful* contract is formed on the basis of *tabarru'*, *ta'āwun* and mutual agreement between the contracting parties. The *tabarru'* principle is the core principle of *takāful* product whereas other contracts such as *wakālah* and *muḍārabah* are applied in managing *takāful* operations.
- (2) The SAC's resolution is based on a performance fee, which is in line with legal maxim:

الأصل رضى المتعاقدين، وَنَتِيجَتُهُ هِيَ مَا التَزَمَاهُ بِالتَّعَاقِدِ

“The fundamental [requirement for the validity] of a contract is the consent of the contracting parties, and its effects are the rights and duties they agree to.”

⁵⁹ AAOIFI, *al-Ma'āyir al-Shar'īyyah*, Standard No. 8/2, p.185.

⁶⁰ BNM, *Sharī'ah Resolution in Islamic Finance*, (2010, 2nd edition), p.79.

6. CONCLUSION

This paper has proposed that the *wadī'ah* concept be embedded in traditional family *takāful* products in order to provide solutions to the ever challenging issue of replicating its conventional counterpart in terms of the guaranteed savings, guaranteed income stream and guaranteed protection that conventional life insurance products can offer. Indeed, operating in a mature market in which traditional life insurance products have been dominant for hundreds of years, it must be acknowledged that offering fully Shari'ah-compliant *takāful* products with guaranteed survival benefits has become a need in the market. Guaranteed survival benefits are becoming critical since this is related to events such as retirement needs, income protection, refund of premium/contribution, etc. This is particularly a concern since family *takāful* products are essentially competing head-on with traditional life insurance savings and retirement products, and this particular benefit often becomes the deciding factor that would win the hearts and minds of distributors as well as customers alike.

Having mentioned the above, there are a number of issues that need to be considered before such a product could be viably introduced into the market. Besides the Shari'ah parameters which this paper has proposed, other important issues that require further deliberation and attention include the regulatory and governance concerns, product design and pricing strategy, infrastructure and system requirements, and prudential requirement such as actuarial reserving. These issues are imperative since the proposed concept is new and has never been introduced in the market.

In the final analysis, it is hoped that this new, innovative structure would serve the needs of the *takāful* industry, particularly family *takāful*, in offering products and services demanded by various clientele. More importantly, the product features and characteristics must always adhere to Shari'ah principles. These principles are expressed not only in structural minutiae, but in the breadth of transactions and the manner they are actually implemented in society. This demands the internalisation of Shari'ah principles on Islamic financial transactions in their form, spirit and substance. Doing so will promote economic and social justice at all levels of society.

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