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A REVIEW OF SHARIAH PRINCIPLE APPLIED FOR
TAKAFUL BENEFITS PROTECTION SCHEME AND ITS
APPLICATION BY MALAYSIAN DEPOSIT INSURANCE
COOPERATION (PIDM)¹

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Abstract

Takaful and Insurance benefits protection scheme is an innovative product introduced by the Malaysian Deposit Insurance Coporation (PIDM) to provide takaful certificate and insurance policy owners with an explicit protection against the loss of part or all of their benefits in the event of an insurer member failure. The main objective of takaful and insurance benefits protection is to promote public confidence in Malaysia's financial system by protecting takaful certificate and insurance policy owners against the loss of their benefits. This paper reviews the possibility of implementing al-kafalah bi al-ajr, or charging fee from or a guarantee from Shari'ah perspective. It also attempts to explore other possible viable alternative instrument in compliance to Shari'ah principles. Any issues and recommendations in this paper are intended to provide positive and constructive improvement for the benefit of the Islamic finance industry.

Key words: *Takaful*, insurance protection, deposit insurance

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1.0 Introduction

The *Takaful* and Insurance Benefits Protection System (TIPS) is a system established by the Malaysian government to protect owners of *takaful* certificates and insurance policies from the loss of their eligible *takaful* or insurance benefits in the event that an insurer member fails and is unable to honour its obligations. *Takaful* operators and insurance companies that are member institutions of PIDM are also referred to as ‘insurer members’². TIPS will also benefit the *takaful* and insurance industry by levelling the playing field with the banking industry, which is already covered by the deposit insurance system.

TIPS covers all *takaful* operators under IFSA 2013 and insurance companies, including locally incorporated subsidiaries. Non-members are reinsurance companies and *takaful* operators, international *takaful* operators, financial guarantee insurers, offshore insurance companies. Exclusions are *takaful* certificates and insurance policies in foreign currency, losses due to acts of dishonesty, damage payable for professional negligence, investment portion of ILP.

The *takaful* and insurance industry is an integral part of the financial system and the introduction of TIPS is consistent with international developments. A number of jurisdictions in Europe and Asia have established insurance compensation schemes in one form or another to protect policy owners, including the United Kingdom, France, Germany, Spain, Korea and Japan. The United States of America and Canada also have similar schemes.

TIPS was designed specifically to meet Malaysian needs. Among the unique features of the system is the coverage of both *takaful* and insurance benefits under the administration of one organisation. In line with its expanded mandate, PIDM will administer both TIPS and the deposit insurance system in an effective and efficient manner to promote public confidence in the financial system. TIPS will also be administered in a manner to promote sound risk management among *takaful* operators and insurance companies.

² <http://www.pidm.gov.my/en/for-public/takaful-and-insurance-benefits-protection-system/what-is-the-takaful-insurance-benefits-protection/>, accessed on September 27, 2018.

2.0 Perbadanan Insurans Deposit Malaysia (PIDM)

PIDM is a Government agency established in 2005 under *Akta Perbadanan Insurans Deposit Malaysia* (PIDM Act) to administer the national deposit insurance system aimed at protecting depositors. From its establishment on 31st December 2010, PIDM's role has been expanded to also administer TIPS to provide protection to owners of *takaful* certificates and insurance policies. PIDM also provides incentives for sound risk management in the financial system and promotes and contributes to the stability of Malaysia's financial system. PIDM is also known internationally as the Malaysia Deposit Insurance Corporation (MDIC).

2.1 Mandate of PIDM

As far as *takaful* is concerned, PIDM's mandate is set out in the PIDM Act :

- a) administer a deposit insurance system and a *takaful* and insurance benefits protection system under the PIDM Act;
- b) provide insurance against the loss of part or all deposits for which a member bank is liable and provide protection against the loss of part or all of *takaful* or insurance benefits for which an insurer member is liable, in the event of a failure of a member institution;
- c) provide incentives for sound risk management in the financial system; and
- d) promote or contribute to the stability of the financial system. In achieving its objects under items (b) and (d), PIDM shall act in such manner as to minimise costs to the financial system.

2.3 Membership of *Takaful* and Insurance Benefits Protection Scheme

All *takaful* operators licensed under the *Takaful* Act to conduct family solidarity and/or general *takaful* business in Malaysia, as well as insurance companies licensed under the Insurance Act to conduct life and/or general insurance business in Malaysia are member institutions of PIDM. Membership in PIDM is compulsory as provided under the PIDM Act.

Non-member institutions are reinsurance companies and

re-*takaful* operators, international *takaful* operators licensed under the *Takaful Act 1984*, captive insurers and specialist insurers, *Danajamin Nasional Berhad*, offshore insurance companies and other players in the insurance industry, such as insurance brokers, insurance adjusters and insurance agents or financial advisers.

2.4 Coverage for the Takaful and Insurance Benefits Protection Scheme³

All types of insurers, whether groups or individuals policies either in life or general *takaful* or insurance benefits, are protected. The maximum limit of coverage is up to RM500, 000 per insurer policy holder per member institution. To be eligible for protection under TIPS, the *takaful* certificate or insurance policy must be issued in Malaysia by an insurer member and be denominated in Malaysian *ringgit*. The Malaysian deposit insurance system provides separate coverage for conventional and Islamic deposits. For more elaborative and further understanding refers to the below provided table.

It is submitted that *takaful* is the alternative to conventional insurance, the question arises since PIDM aims at protecting the payment of the *takaful* benefits to the participants or their relative, why should at the end of the process for the purpose of *takaful* benefits protection, they are covered by conventional insurance structure of PIDM.

3.0 *Shari'ah* Compliance Status of PIDM

The Council of *Shari'ah* Advisory Board of Bank Negara Malaysia (Central Bank) in its 26th meeting held on 26th June 2002 / 15th *Rabiul Akhir* 1423, resolved that the deposit insurance scheme in Islamic banking is permissible based on the concept of mutual guarantee among the Islamic financial institutions as participants in the scheme. The implementation of the deposit insurance scheme does not contradict with the *Shari'ah* principles since its objective is to protect public interest, especially the depositors and the banking industry as a whole. Nevertheless, there is a need to separate the funds in the

³ <http://www.pidm.gov.my/en/for-public/takaful-and-insurance-benefits-protection-system/coverage-for-tips/>, accessed on September 27, 2018.

operation of the deposit insurance scheme for Islamic banking to ensure that the funds of Islamic deposit insurance scheme are invested in *Shari'ah* compliant instruments⁴.

3.1 Latest Resolution of *Shari'ah* Advisory Council BNM

The *Shari'ah* Advisory Council of BNM in its 54th meeting held on 27th October 2005 / 23rd *Ramadan* 1426, and in its 55th meeting held on 29th December 2005 / 27th *Zulkaedah* 1426, resolved that the above Islamic guarantee (by charging a guarantee fee) mechanism provided by the credit guarantee company to the Islamic financial institutions offering Islamic financing products to customers is permissible.

Nevertheless, the SAC of BNM in the 80th meeting, dated 7th January 2009, resolved that PIDM operation in managing insurance for Islamic deposits can be operated based on the principle of *kafalah bi al-ajr*. The premiums paid by the member institutions to PIDM are regarded as *ujrah* or fee, for service and as such shall belong to PIDM. Since it is a compensation for the service (protection), PIDM can structure the charges either as a lump sum payment, or by instalments⁵.

4.0 Revisiting *Shari'ah* Issue of *al-Kafalah bi ajr* (Charging Fees for Guarantee)

The application of *al-kafalah bi al-ajr* (guarantee with fee) as an underlying principle has been questioned and criticised since it is not consistent with *takaful* mutual *tabarru'* principle. Among the legal consequences is that all the premiums paid by the member institutions will be treated as considerations for the protection and guarantee of the deposits. In other words, the fees paid by the members are actually compensations against the guarantee. As such, all the accumulated premium paid belong to PIDM. The *Shari'ah* basis for this is *kafalah bi al-ajr*.

⁴ Resolutions of Shariah Advisory Council of Bank Negara Malaysia, BNM/RH/GL/012-2, 22

⁵ Bank Negara Malaysia, *Resolusi Shariah Dalam Kewangan Islam*, (2010), 175.

4. 1 *Juristic Opinions on the Rule Regarding Charging Fees for Guarantee*

4.1.1 *First View: Those who allow charging Fee for Guarantee*

The great majority of Islamic jurists have always considered it unlawful to charge a fee for a guarantee. They are the jurists from Hanafites, Shafiites, Malikites and also Hanbalites who claimed that it is unlawful to charge fee against a guarantee⁶. They hold that it is permissible to give guarantee; however, to take any rewards from it is prohibited. There are evidences and justifications that show why such charges are not permissible as follows:

First Evidence: *Al-Kafalah* is a *tabarru'* contract, however if it is associated with a fee imposed by the guarantor, it becomes a contract of commercial exchange (*mu'awadhah*) which is not allowable⁷. The meaning of *tabarru'* is to exchange something not for the purpose of exchange in return for something. For instances a gift, present, and any free offering for which no exchange is taken. Therefore, in the case of guarantee, the party which is guaranteed donates his money to the guarantor, and thus cannot get back what he has given. This case is evidenced in the practices of the prophets' companions Ali bin Abi Talib and Abu Qutadah who guaranteed and paid the debts of a deceased man, their guarantee at that time was for charity and was not for any return⁸.

Second Evidence: The reward or financial compensation is only applicable when it is exchanged against performance of a service or against the exchange of valuable goods. But, as far as guarantee is concerned it is neither performance of an act of service nor an exchange of goods. Therefore, any charge for a guarantee is similar to eating up people's property unjustly or an act of bribery⁹.

⁶ Mansur ibn Yunus ibn Idris Al-Buhuti, *Kashshaf al-qina' an matan al-iqna'*, (Beirut: Dar al-Fikr, 1982), v3, 206; Muhammad Muwafiq al-Din ibn Abdullah Ibn Qudamah, *Al-Mughni*, (Dar al-Fikr: Beirut, 1998), v6, 441; Imam Malik, *Al-Mudawwanah*, (Cairo: Dar al-Hadith, 2005), v5, 283.

⁷ Nazih Hammad, *Mada jawaz akhzi al ujr 'ala al-Kafalat fi al Fiqhi al-Islami, Islamic Economics*, JKAU, 9 (1997), 97.

⁸ *Sahih al-Bukhari*, v5, 56; *Sunan al-Bayhaqi*, v6, 72.

⁹ Samsuddin ibn Muhammad Al-Dusuki, *Hashiyah al-dasuki 'ala sharh kabir*, Isa al-Babi al-Halbi wa al-Syarikah, (Beirut: Dar al-Kutub

Al-Hamawi argues: “Perhaps the reason for the prohibition of charging a fee is the fact that issuing a guarantee is not an act of service which deserves rewards¹⁰. Al-Mawardi argues that the reward is permissible for the exchange of services, but giving guarantee is not a service, hence it does not deserve any rewards¹¹. Al-Dardir also added that the reason for prohibiting taking reward for a guarantee is that when the debtor pays the debt to the creditor, the reward (for the guarantor) is not justified, it is taking people’s money unjustly (*bi al-batil*)¹².

Third Evidence: The condition of charging a fee for a guarantee will amount to uncertainty (*gharar*) which is unlawful¹³.

Fourth Evidence: The guarantor who guarantees the debt of another person for a fee will engage in *riba* by asking the guaranteed person to pay back more than what he owed which is the debt in full plus the fee for the guarantee¹⁴. This is clearly understood through the saying of the Prophet (PBUH), “Any debt that generates benefit is considered *riba*”. According to Ibn Abidin, a guarantor gives loan against the financial obligation, when a consideration is required along with the full amount of debt, it is as if the creditor demands more than the amount of debt, which amounts to injustice and *riba*¹⁵. This is because the additional amount paid is considered as *riba* which is prohibited in Islam. Ibn Qudamah argues: “The guarantor is obligated to honour the payment of debt, when he pays it, it becomes the obligation of the guaranteed person, as such it becomes a debt. Hence, if the guarantor takes fee, it becomes a loan which generates

al-Ilmiyyah,1996), v3, 341.

¹⁰ Ahmad al-Himawi, *Ghamz ‘Uyun al-Basa’ir*, Beirut. (Dar al-Kutub al-Ilmiyyah, 1985), v3, p154.

¹¹ Al-Mawardi, *Al-Hawi al Kabir*, (Beirut: Dar al-Kutub al-Ilmiyyah, 1994), v8, 121.

¹² Al-Dardir, *Al-Sharh al-Soghir*, (UAE: Ministry of Religious Affairs, 1989), v3, 442.

¹³ Nazih Hamad, “*Mada jawaz akhzi al ujr ‘ala al-Kafalat fi al Fiqhi al-Islami*, op. cit., 114.

¹⁴ Al-Buhuti, *Kashshaf al-qina’ an matan al-iqna’*, op.cit.,v3, 306.

¹⁵ Ibn Abidin, *Minhatul al-Khaliq a’la al Bahri ar Raiq*, (Dar al-Kutub al-Ilmiyyah al-Kubra, accessed from <http://waqfeya.com/book.php?bid=5011.2010>), v6, 242.

profit to the creditor”¹⁶. In the same vein, Al-Dusuqi of the Malikites argues: “The guarantor when he pays the debt to the lender, he will ask the debtor (under his guarantee) the same amount with addition to the fee. This is not allowable as it is a loan with extra payment”¹⁷.

Fifth Evidence: Islam encourages good deeds such as guarantee of others and giving loans to those in financial difficulties. Such deeds are only done for the pleasure of Allah and will be rewarded by Allah. These good deeds are considered one of the ways that strengthen the relationship between the people. On the other hand, charging fee for good deeds such as guarantee is considered as exploitation of people who are in need and thus prohibited¹⁸. It is narrated from Al-Abhari in the book of “*al-Taj wa al-Iqlil*” that imposing charges for guarantee is not allowable because giving guarantee is an act of a good deed. It is submitted that it is prohibited to take a fee from acts of good deeds like praying and fasting which are performed not for the worldly rewards¹⁹.

4.2.2 Second View: Those who Allow Charging Fee for Guarantee

Among the contemporary scholars who allow charging fee for guarantee are Sheikh Yusuf al-Qaradawi, Sheikh Nazih Hamad, Sheikh Abdullah Mani‘ and the stance of Malaysian scholars at SAC Bank Negara Malaysia. The following are among their evidences:

First Evidence: concerns the possibility of converting a *tabarru’* contract to *mu‘awadhat*. According to Sheikh Nazih Hamad²⁰, it is permissible to convert a *tabarru’* (donation based contract) to a *mu‘awadhah* based contract (commercial exchange contract) with the consent of the contracting parties. According to him, a guarantor deserves a good reward from the guaranteed person similar to his contribution for the guaranteed person, or even more. This is for his commitment as long as the debt is settled immediately. Sheikh Hammad also makes analogy with *hibah* (a gift) when it is

¹⁶ Ibn Qudamah, *al-Mughni*, op. cit., v6, 441.

¹⁷ Al-Dusuqi, *Hashiyat al-Dusuqi ‘ala al-Sharh al-Kabir*, op. cit., v3, 341.

¹⁸ Al-Dardir, *Al-Sharh al-Soghir*, op. cit., v3, 442.

¹⁹ Muhammad ibn Yusuf Al-Qasim Al-Abhari, *Al -Taj wa al-Iqlil li mukhtasar al-Khalil*, (Beirut: Dar al-Fikr, 1398H), v5, 111.

²⁰ Most of the arguments are derived from Nazih Hamad, *Mada jawaz akhz al-ajr ala al-kafalah fi al-fiqh al-Islami*, op. cit.

associated with the expectation of a reward, i.e *hibah al-thawab* or *bi shart al-thawab*. Similarly, a lending contract associated with a consideration will convert it to *ijarah*. The same is true with *wakalah*, which can be converted to *wakalah bi al-ajr*²¹. However, the above mentioned argument can be refuted that those contracts when associated with considerations (such as *kafalah* with a fee) are considered to be another different contract in which have different legal nature and consequence. Therefore, "*hibah al-thawab* is not a real *hibah*, as the confusion lies in its terminology by calling it "*hibah*" (because it is actually a *muawadhah* contract), and it is not regarded as an act of *tabarru'* (donation). As per *ijarah* converted from *'ariyyah* (lending), it is argued that if the lending is associated with a consideration it is regarded as a hire from the very beginning. The same is true with agency contract and agency with fee where they should not be treated as a conversion of the former to the latter²². This reasoning can also be refuted by the fact that all those example of conversions of the contracts from *tabarru'* to *mu'awadah* are actually the established and known contracts which are recognized by *Shari'ah*. But what is the result of converting a guarantee to a debt from *tabarru'* to *mu'awadah*? It becomes lending or giving a loan with a fee. Charging a fee for a loan is nothing but *riba*²³.

Second Evidence: It is allowable to charge a fee for a guarantee by comparing it with taking rewards for making other commitments which are permissible by *Shari'ah*. Among the classic examples, according to the Malikites, it is allowable for a wife to take a promise from her husband not to practice polygamy where it is pursued against a consideration. Similarly, the husband can buy a promise from his wife not to get married if he passes away. However, when he wants to get married again with the second wife, he can

²¹ Nazih Hamad, *Mada jawaz akhz al-ajr ala al-kafalah fi al-fiqh al-Islami*, op. cit., 99.

²² Sheikh Mukhtar Sallami. Comments on Sheikh Nazih Hamad paper "*Mada jawaz akhz al-ajr ala al-kafalah fi al-fiqh al-Islami*" *Islamic Economics*, JKAU. 9, (1997),126.

²³ Al-Sadiq Al-Darir. Comments on Sheikh Nazih Hamad's paper "*Mada jawaz akhz al-ajr ala al-kafalah fi al-fiqh al-Islami*", *Islamic Economics*, JKAU. 9, (1997), 97.

compensate his commitment i.e. promise which is the right of the first wife with a financial consideration²⁴. However, this can be argued by the fact that, in the case of the promise not get married without the consent of the first wife, it is about a compensation for dropping the right, or “*isqat al-haq*”, where a husband pays money to break his promise and it is not for making a commitment. The wife can also get married again if her husband passes away²⁵.

Third Evidence: It is allowable to charge a fee for a guarantee by comparing it to the permissibility of taking rewards for some of the good deeds, such as teaching *Al-Qur’an*, the remuneration of an *Imam* and *Muazzein*. This is also supported with some events such as the companion who took a reward for “*ruqyah*” healing by using *Al-Qur’an*, which was approved by the Prophet PBUH²⁶.

5.0 Analysis

It is observed that the existing structure of PIDM is similar to the conventional insurance. The insured will buy a protection from the insurer and the insurer will own the payment of all the accumulated premiums and surplus. This is because the transaction is based on sale and purchase where the ownership is mutually exchanged and transferred. As far as Shariah compliance is concerned, the subject matter of the *aqd* or contract must be well defined and known to the contracting parties. Major uncertainty renders a contract void. In the conventional insurance, uncertainty is obvious since the counter value is not known. The unfortunate event is also a matter of gambling. It also involves *riba al-fadl* as it is an exchange of money with money (cash with cash). Such cash exchange must be at par, but it is clear in the case of fees charged by PIDM as compared to the sum insured that the counter values vary. This is among the reasons why conventional insurance has been declared impermissible (*haram*) by the *Fiqh* Academy and the majority of Muslims scholars²⁷.

²⁴ Nazih Hamad., op. cit.

²⁵ Sheikh Mukhtar Sallami, op. cit.

²⁶ *Sahih* Al-Bukhari, no.1670.

²⁷ Resolution 9: 9/2, (December 1985); *Majallah al-Majma’ Fiqh al-Islami*, v2, 545.

It is suggested that the concept and structures of *takaful* should be studied as an alternative to *al-kafala bi al-ajr* to be the underlying contract of PIDM. It would be a paradox if a *takaful* concept and structure can be used, but still the conventional insurance model is preferred and adapted for the purpose of the protection of the *takaful* benefits. Ironically, *takaful* operators are backed by conventional structure. Why not adopt a similar *takaful* model? Otherwise it will certainly raise criticisms from the public and the global community.

6.0 Defining the Contractual Relationship and the Payment of Premiums to PIDM

There remains a substantial question. Who is in need of the protection of PIDM? The policy holders or the *takaful* operator? Who is accountable to pay the premiums for the protection? If the protection premium is paid by the *Takaful* operator from its own account which is reflected in the balance sheet, this would amount to issuing guarantee. The wakeel should not give any guarantee. This is against the principle of *wakalah* as a wakeel should not be held liable to guarantee any loss except because of his negligence or misconduct. It is submitted that most of *takaful* operators now are using *wakalah* model where the *takaful* operator is a *wakil* (agent) appointed by the participants to manage their risks fund and investment.

It is suggested that the contractual relationship between the participants and *takaful* operator is clearly *mu'awadhah* contract (commercial exchange), but the subject matter is the services rendered in underwriting, managing the fund which includes investment activities and payment of claims. Hence, the subject matter of *mu'awadhah* is not the *takaful* benefits.

6.1 Payments of Premium to PIDM

The *takaful* benefit is actually a mutual guarantee and indemnity made by the participants among themselves. The strength lies in their agreement and promise as stated in the *takaful* contract to provide the financial assistance to the participating members during misfortune. The pool of premiums in the risk fund (*tabarru'* fund) should be treated as an independent entity with separate financial and legal

entity. The cost of the protections for this *tabarru'* should be borne by the fund itself. This should be reflected in its balance sheet as one of its expenses, as premiums to PIDM for the protection, not in the share holders' balance sheet. It should always be clearly stipulated in the *takaful* contract and *takaful* certificate that the *takaful* operator only acts on behalf of the participants through the risks fund for the benefits of the participants. As such, *takaful* operators may issue protection certificates or guarantees but it is on behalf of the participants, not from the shareholders' mandate.

This proposal is also matching with the PIDM policy to take over the responsibility of *takaful* operator in case failure to manage the payment of *takaful* benefit. This is so because the participants in the *takaful* scheme can appoint or hire any operator to manage the scheme. This is because the contractual relationship between the participants and the *takaful* operator is only to manage the fund, conduct a prudent underwriting and payment of claims, not a seller and buyer relation of the protection. In this case it is known to the participants that PIDM will be the successor to replace the insolvent operator.

6.2 Personal Investment Account

It seems that the new PIDM product, i.e. *Takaful* and Insurance Benefits Protection System (TIPS) is not silent about the savings in the personal investment account which is part and partial of most of *takaful* family and *takaful* investment link products. It is worth noting that the *takaful* benefits will lapse if no claim is made because no unfortunate event happens, but the savings and the investment which is totally owned by the participants will never lapse and will become due upon maturity. The maturity value and early surrender value represent the participants' individual investment savings. The former is payable after maturity whereas the latter can be made prior to maturity. The protection for both withdrawals is up to RM 500,000²⁸. The question is again who should bear the cost for the protection? Since the *takaful* operator is only acting as an agent, it is suggested

²⁸ If the maturity value is also taken from other participants' contributions (on the ground of *ta'awun*), apart from the particular individual savings, this should be clearly spelled out in the *takaful* contract to get their consent.

that the cost for the protection should be borne by the investment fund.

7.0 Conclusion

To conclude, the protection of *takaful* benefit is justified for the benefits of the *takaful* participants and for a prudent and robust Islamic financial system. However, as far as *Shari'ah* principle is concerned, the structure of *kafalah bi al-ajr* contract perhaps requires reconsideration since it reflects similarity to the features and models of conventional insurance. The possible alternative is the model used in *takaful* i.e. mutual *tabarru'* and *wakalah* model. This model has also been adopted by re-*takaful*. This will make it more consistent to the *takaful* and re-*takaful* model without neglecting the same purpose and function of PIDM in providing protection. By adopting *takaful wakalah* model, PIDM can generate income by charging fee for the services rendered.

As far as the *Takaful* Benefit Protection scheme is concerned, it is suggested that the premiums payable to PIDM is directly borne by the *Takaful* Risks Fund which represents contributions of all participants for their mutual help and indemnification which is realized through *takaful* benefits. Therefore, the guarantee and protection actually come from the risk fund performed by *takaful* operator on behalf of the fund. The *takaful* contractual relation clearly defines the position of the operator which is only an agent (*wakil*), not a guarantor.

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