

## Islamic Personal Risk Management from Islamic Perspective

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**Abstract:** The rising of health care and cost of living in Malaysia has caused financial difficulties to the general public. In fact, medical expenses are one of the reasons why Malaysian become bankrupt today. Thus, the need for individual to manage personal risk. Therefore, the main aims of this study are twofolds: i) to investigate how individual should mitigate risk and ii) to examine a personal risk management from Islamic perspective. A thorough review of literature were undertaken to achieve the research objective. The study suggest that individual should take into consideration maqasid al-shari'ah when managing personal risk. The framework for an Islamic personal risk management should include the concept of maqasid al-shari'ah, Islamic hierarchy of needs, Islamic legal maxim and risk management process. The study enhances the literature in Islamic risk management which is very scarce. The personal risk management framework is very pragmatic for an individual to manage personal risk.

**Key words:** Risk management • Personal risk management • Maqasid al-shari'ah • Islamic legal maxim

### INTRODUCTION

Risks management is a process that involve identifying risk, analyzing risk, finding alternative techniques to mitigate risk, implementing the chosen technique(s) to manage risk and risk monitoring. For an individual, risk management is a process of identifying, assessing and controlling potential exposure that could lead to losses. The threats or risk could come from various sources such as financial uncertainty, legal liabilities, premature death and accidents. *"Risk is accepted as part and parcel of our daily lives and Islamic history shows how risk was managed during the time of Prophets. Risk management is important from the Islamic perspective for the betterment of social well-being" [1].*

In everyday life, individuals are always expose to risks. For example exposure to premature death, accident, illness and property damages. A recent fire in a religious school killed 23 people, one of the worst in the history of religious education. Statistics for fire losses are on the rising trend [2]. Motor vehicles accidents almost every day lead to death and injuries.

The aging population in Malaysia are also on the increasing trend [3]. This is due to better quality of life and health care. However, the growing trend of aging population lead to increasing medical expenses to individuals. Thus, lead to financial difficulties for some people.

All the above discussions signal the need for individuals to manage risk systematically. Hence, the need for personal risk management.

Most of the current literature focus on corporate risk management, risk management practices and effectiveness of risk management. The main aims of this develop a personal risk management approach which could narrow down the literature gap.

**Problem Statement:** First, health care costs are increasingly expensive. These costs cover the cost of consulting doctors, nurses, medicines, medical equipment and buildings. The increase in medical technology requires a very high amount of funds. Costs such as medical research, development of new medical and pharmaceutical equipment and government

approvals spend up to billions of ringgit. Medical costs are expected to continue to rise in the future due to inflation.

Second, the number of cases about high chronic disease. Although medical technology is progressing, the number of sufferers for chronic diseases has also increased. Chronic diseases include cancer, kidneys, heart disease, paralysis, chronic liver disease, HIV, encephalitis and others. The medical cost for the disease is high because it involves a constant and consistent treatment.

Third, the weaker family bonding structure. In the past, family relationship in the majority of the population was very strong with the assumption that the child would care for older parents. However, this culture has changed over time. Older parents' needs and expenses are no longer a concern for children. Children will be more comfortable with their own personal lives.

Fourth is the increase in population age. In one study it is concluded that by 2020, Malaysia will face an increasingly elderly population due to improved living standards and advances in medicine and healthcare [4]. The life expectancy of Malaysians is expected to increase for both women and men from 75 years and 70 years in 2000 to 79 years and 75 years by 2020. With increased life expectancy and declining birth rates, the percentage of people aged 55 years and above is expected to increase to 14 per cent in 2020 compared to nine per cent in 2000. Health levels in the elderly will decline and this directly affects the need for increased health care.

While in term of property damages, Fire and Rescue Department of Malaysia (FRDM) attended to 33,640 fires in 2013 over the country or an average of 92 cases per day. This figure was the highest annual figure recorded, continuing the generally upward trend since 2007, Figure 1. Compared to 29848 fires in 2012, there was an 11% increase with the statistics remains stable from 2009 to 2012. A sharp increase of fire incidents in 2012 had killed 72 civilians but this was the lowest number of fatalities for the last seven years. Note that the death statistics referred to instant death at the place of occurrence and the actual number of death as a result of fire is undoubtedly higher. Generally, the death statistics due to fire outbreaks are stable although the incident of these cases were more frequent occurred. Also, 165 and 152 injuries were sustained in fire in 2013 and 2012, respectively, doubling the total injuries due to fire in 2011. While considering 2013 alone, these figures account only 0.21% and 0.49% of death and injuries, respectively, from the total fire cases reported. In other words, two civilian was killed and five were injuries in every thousand cases. Therefore, these

figures are deemed significant as fire investigation as well as the safety and prevention steps should be implemented in the country. This fire breakout can sometime cause the small entrepreneur to close their business or bankrupt due to no takaful taken.

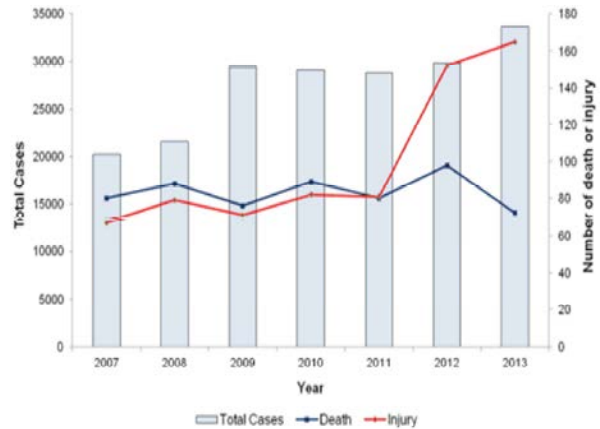


Fig. 1: Statistics on fire breakouts in Malaysia, 2007-2013 [2]

Based on the above factors, individual has to know how to manage these risks. Failing to address these risks, individuals would face financial difficulties leading to bankruptcy. Therefore, there is a need to manage personal risks. Current studies in these field focus on risk management implementation and effectiveness [5-7]. Much of these studies were in developed countries involve big companies. Studies on Islamic risk management is very scarce. Thus, this particular study will fill literature gap and provide a much needed risk management approach.

### Literature Review

**Risk Management:** Risk management is said to have received increasing attention in both corporate practice and literature. Risk as the lifeblood of every company and functional managers deal with risk decisively wherever it appears [8]. Risk management as a systematic process for the identification and evaluation of pure loss exposure faced by an organization or an individual and the selection and implementation of the most appropriate techniques to treat such exposure [9]. Risk management is also described as the performance of activities designed to minimize the negative impact (cost) of uncertainty (risk) regarding possible losses [10]. The objectives of risk management include to minimize foreign exchange losses, to reduce the volatility of cash flows, to protect earnings fluctuations, to increase profitability and to ensure survival of the firm. Risk management is

intended to help an organization meet its objectives which, in the case of proprietary insurers, may be to maximize shareholder value [11]. Risk management has become an integral part of the operations of every organization and its underlining goal is to facilitate all other management activities in order to achieve the firm's stated objectives efficiently.

**Risk Management Framework (ISO 31000:2009):**

The global financial crisis in 2008 demonstrated the importance of adequate risk management. Since that time, new risk management standards have been published, including the international standard, ISO 31000 'Risk management – Principles and guidelines'. This guide draws together these developments to provide a structured approach to implementing enterprise risk management (ERM).

For all types of organisations, there is a need to understand the risks being taken when seeking to achieve objectives and attain the desired level of reward. Organisations need to understand the overall level of risk embedded within their processes and activities. It is important for organisations to recognise and prioritise significant risks and identify the weakest critical controls. When setting out to improve risk management performance, the expected benefits of the risk management initiative should be established in advance. The outputs from successful risk management include compliance, assurance and enhanced decision-making. These outputs will provide benefits by way of improvements in the efficiency of operations, effectiveness of tactics (change projects) and the efficacy of the strategy of the organisation.

A successful enterprise risk management (ERM) initiative can affect the likelihood and consequences of risks materialising, as well as deliver benefits related to better informed strategic decisions, successful delivery of change and increased operational efficiency. Other benefits reduced cost of capital, more accurate financial reporting, competitive advantage, improved perception of the organisation, better marketplace presence and, in the case of public service organisations, enhanced political and community support. This guide provides a brief commentary on ISO31000 as well as setting out advice on the implementation of an ERM initiative. The purpose of the guide is to: i) describe the principles and processes of risk management, ii) provide a brief overview of the requirements of ISO 31000, iii) give practical guidance on designing a suitable framework, vi) give practical advice on implementing enterprise risk management.

According to ISO 31000, risk management framework is defined as a set of components. The diagram below is taken from AS/NZS ISO 31000:2009 that shows the relationship between the principles of risk management, the risk management framework and the risk management process.

**Maqasid Al-Shariah:** MaqasidShariah or objectives of shariah is the foundation for shariah rules and regulations. These shariah injunctions are source of reference and guidelines for muslim in managing their daily life. MaqasidShariah is literally translated as the objectives of Islamic law. MaqasidShariah of the Islamic law are the objectives/ purposes/ intents/ ends/ principles behind the Islamic rulings [12]. Maqasid al-Shariah explains wisdom and comprises of all the benefits and advantages for the mankind, which simultaneously wards off evil and other form of harms from the society. MaqasidShariah is vitally necessary to be delineated so as to provide an understanding on the rationale of the shariah guidelines for the mankind to live in this world according to the Islamic way of life. Indeed, MaqasidShariah enables a better appreciation of Islam as well as a comprehensive appreciation of the Almighty s rules and regulation.

MaqasidShariah is classified according to different dimensions: the traditional classification of MaqasidShariah is according to the levels of necessity, scope of the rulings with the aim to achieve the purpose, scope of people included in the purpose and level of universality of the purpose. The modern or contemporary scholars classify MaqasidShariah according to general objectives, specific objectives and partial maqasid [13].

The traditional scholars including al-Shatibi classify the general objectives into three sub-categories according to the hierarchy of needs, or levels of necessity: the essentials or necessities, the needs and the luxuries [14]. Those risk related to essentials to one life need to be given more attention. Islamic scholars like Al-Ghazali, Ibn al- Hajib and al-Shatibi defined essentials need as the preservation and safeguarding of five fundamentals in one life that includes protection of religion, protection of life, protection of intellect, protection of wealth and protection of lineage [15]. These are regarded the essential needs that a man requires for his well-being in this world and the hereafter. None of these essential needs can be ignored, for it will create a disorder in this world and man will not be able to fulfil his requirement as a caliphin this world and achieve success in the world hereafter [16]. This classification shows the wide-range of

dimensions and varieties of Maqasid Shariah which aim to provide ease and eliminate or reduce hardship to the Ummah.

**Maqasid Al-Shariah and Risk:** Life is full of risks. We can try to avoid them or reduce their consequences, but we cannot eliminate them. The broad perspective on risk and its management are embodied in the objective of Shari'ah which is to protect the wellbeing of mankind. Al-Ghazali in defining Maqasid al-Shari'ah as "promotion of the wellbeing of the people, which lies in safeguarding their faith (din), their self (nafs), their intellect ('aql), their lineage (nasl) and their wealth (mal)".

There are many supportive arguments and evidences in Islamic heritage showing the importance and necessity of risk management in all aspects of life. The significance of risk management according to Qur'an and Sunnah (prophetic tradition) will be discussed in the following section. More importantly, the Maqasid Shariah initiatives are to conform to Shariah rules and guidelines as it is the most prominent issue in risk management. Conforming to Shariah principles is the major concern in the management of risk that it has to achieve the objectives of Shariah, precisely the protection of life, protection of wealth and protection of dignity.

**Life Protection:** In term of protection of life, it is clear that the concept of takaful, namely joint guarantee and mutual help are well within the Maqasid Shariah framework to provide protection to the participants against any misfortune through mutual assistance and mutual sharing of risk. In the spirit of mutual assistance, it is the right and duties of individuals to help others, also known the concept of social obligation that puts responsibility on those who are capable or better off to assist those who are not capable or worse off. It is an obligation that connotes compulsory which means not optional. This implicates mutual dependency among society and therefore, mutual cooperation and social responsibility is needed. Human beings are expected to cooperate among themselves to properly perform the task and mission of khilafah.

**Wealth Protection:** Islam provides detailed instructions to manage various types of risks in a broader sense amongst others are criminal assault risk, illness risk, investment risk, business risk and etc. Islam also commands the adherents to manage spiritual types of risks such as to avoid fornication, idolatry, apostasy and other types of sins. Protection of wealth according to the

Muslim jurists is achieved through the safeguarding of ownership; through the acquisition and development; from damage; through circulation; and through protection of its values [17]. Safeguarding of wealth is significant as men are created with lust and desire to have possession of things in the world, including women and children and gold and silver; as noted in the holy Quran: fair in the eyes of men is the love of things they covet: women and sons; heaped-up hoards of gold and silver and the Almighty prohibits any acquisition of wealth through illegitimate means. Hoarding of wealth is also prohibited; therefore, wealth has to be circulated for the benefit of the community. Indeed, wealth has to be protected to provide justice to individuals, or the parties involved. Hence, the importance of managing risk related to properties.

Specifically, from the Islamic approach to managing risk, protection of wealth is achievable through the elimination of the prohibited elements such as riba, maysir and gharar; wealth circulation; and good code of conducts. Avoiding such prohibited elements will help the industry to grow healthily, mainly as it is blessed by the Almighty for adhering to the Shariah principles. In other words, these elements are known to cause unjust and are harmful for any society; it will lead to societal disorder and economic turmoil. The intended objectives of Islamic risk management that are Shariah compliant ensure that adherence to Shariah principles is not only in the concept and objectives, but also in all of its economic activities such as the underlying contracts of risk management that have to be Shariah compliant. The broad perspective on risk and its management are embodied in the objective of Shari'ah which is to protect the wellbeing of mankind.

#### **Islamic Legal Maxim**

**Legal Maxim 1 – Harm is to be Eliminated:** The basis for this maxim is the prophet saying: "Harm may neither be inflicted nor reciprocated in Islam." The scholars differ over what is meant by the words inflicted and reciprocated. Some scholars stated that inflicted harm is harm caused by one individual, while reciprocated harm refers to two individuals causing harm to each other [18]. Another view is that inflicted harm entails that the person inflicting the harm is benefiting in some way and reciprocated harm entails that the person inflicting harm is not benefiting from the harm caused.

This maxim enters into numerous sections of fiqh and has various sub-divisions: i) necessity makes the unlawful lawful, such as eating animal unslaughtered; ii) necessity is measured in accordance with its true proportions, such

as only eating from animal unslaughtered the amount needed to keep oneself alive; iii) harm must be eliminated but not by means of another harm, such as when a person eats the food of another to satiate his own hunger; iv) a greater harm is eliminated by means of a lesser harm. This axiom is derived from the incident of the desert Arab who urinated in the mosque and the Prophet (may Allah bless him and give him peace) ordered the companions to leave the desert Arab as he was in order to eliminate a greater harm.

**Legal Maxim 2 – Averting Harm Takes Precedence Over Achieving Benefit:** This maxim is a subsidiary of the leading maxim “Harm should be eliminated”. When a certain act will result in both beneficial and harmful effects, the magnitude of the effects should be analysed. If the benefit outweighs the harm, achieving the benefit takes precedence. When the benefit and harm are of the same magnitude, the Shariah gives precedence to preventing harm.

Many acts have both positive and negative consequences. An example of conflicting benefit and harm in which the benefits outweigh the harm was the truce of Hudaibiyah. Certain conditions in this treaty were apparently harmful to Muslims. For example, they were unable to complete the *umrah* which they had set out to perform that year. This maxim applies when the harmful consequences of an act outweigh the beneficial consequences or when they are evenly balanced. In such cases, priority must be given to preventing the harm over achieving the benefits i.e. the act must be avoided.

**Legal Maxim 3 – Necessity is To Be Assessed And Treated Proportionally:** This maxim is regarded as a constraint to the maxim “Hardship begets facility” which permits the prohibited act without any restriction as long as ‘necessity’ is present. It also affirms the significance of another maxim which states: “When hardship causes constraint, (the law) becomes permissive, but as circumstances ease, (the law) becomes strict”.

The maxim explains that any act permitted on the ground of extreme necessity should not be extended beyond its bound, rather the necessity that can override a prohibition should be given weight according to its true extent. In this regard, the forbidden act is deemed permissible only at minimum level it takes to remove the dire necessity. Moreover, it is important to note that the permission of the prohibited act is temporary and ends when the necessity that first justified it ends.

There are many texts from Al-Quran and Prophet Saying which constitute the legal basis for this maxim including: “If a person in need eats without taking any fruit out (of the orchard), there is no penalty on him. But if he takes some of it out with him, he must pay double the equivalent in restitution and he is subject to a (discretionary) penalty” [19]. This maxim means that if an Islamic bank is on the verge of collapse due to a liquidity shortage, it is allowed to borrow from a conventional bank if no Shariah compliant source of funds is available, however the amount borrowed should only cover the deficit.

**Islamic Legal Maxim and Risk:** In Islam, risk is defined similarly with additional reference to submit to the Almighty Allah upon making efforts and prayers to achieve goodness in this world and the hereafter as every event in the life of a Muslim is fated and only the Almighty Allah knows best the fate and future of every being. This is evidenced in a number of instances and the famous is as stated in the hadith, Sahih al Bukhari narrated by Anas bin Malik, “When the Holy Prophet (peace be upon him) asked a Bedouin Arab who entered the mosque with his camel left outside untied, if his camel would run astray, he said Insha Allah I put my trust in God. The Prophet (peace be upon him) then said: tie up your camel first then put your trust in God”, [20].

This particular conversation between the Prophet and the Bedouin indicates the significance of making effort of reducing risk or loss prior to accepting fate. Thus, managing risk is vital in Islam which could promote the social and economic well-being of a society. Many Islamic financial institutions are increasing their focus on risk management to sustain competitiveness. The approach to risk management in Islam is not merely about reducing risk but how to manage it effectively using Shariah principles. The management of risk in Islam therefore has to conform to the objectives of Shariah that promotes tranquillity and harmony among its society by means of providing protection and warding off harm and disaster for their well-being in this life and the hereafter.

There are many Qur’anic verses that guide mankind to have risk management in wealth and financial affairs. Those verses precisely show the significance of strategic planning to control and mitigate anticipated risks. The absence of efficient risk management will harm certain parties to the extent that the risk most likely endangers one’s life. It is stated in surah Yusuf: “You will plant for seven years consecutively; and what you harvest leave in its spikes, except a little from which you will eat.

Then will come after that seven difficult [years], which will consume what you saved for them, except a little from which you will store. Then will come after that a year in which the people will be given rain and in which they will press [olives and grapes]" (Qur'an, 12:47-49). In the above verses, prophet Yusuf (peace be upon him) interpreted the dream of the king of Egypt that Egyptian would face seven years of drought after seven years of prosperity. Hence, he advised the king to develop an economic strategy in order to overcome the upcoming catastrophe. To be precise, Egyptians had to implement the proposition by actively planting crops during the first seven years and store much of the proceeds as a preparation to face seven years of drought, as interpreted by prophet Yusuf. As recommendations implemented it resulted in the country surviving the seven years of drought [21]. In the following Qur'anic verse, attestation by contracting parties in a financial transaction is required to manage risk, particularly the credit risk.

'O you, who have believed, when you contract a debt for a specified term, write it down. And let a scribe write between you in justice. Let no scribe refuse to write as Allah has taught him. So let him write and let the one who has the obligation dictate. And let him fear Allah, his Lord and not leave anything out of it....' (Qur'an, 2:282). Attestation is a basic requirement in Islamic commercial law, whether it is an ordinary documentation at an individual level or an official documentation at an entity level. The core objective of attestation is to mitigate the risk of any party denying what was agreed upon, which may lead to a loss of capital. In case the financial transaction that involves debt is performed during a journey Qur'an allows the creditor to receive collateral as the debt security. This is an example of risk management, i.e. mitigating credit risk due to the failure of the debtor in fulfilling his financial obligations. The aforementioned verse clearly gives an indication that if the trust of the counterparty is not sufficient an effective step must be taken to avoid fraudulence and unreasonable losses [22]. In financial matters and business dealings, there is always a possibility of disputes and differences of opinion over the mutually agreed conditions. There is a need that such kind of transactions involving money, land, rights, ownership, property and other articles of value should be recorded in the form of contract and signed by both parties in the presence of witnesses. A well-documented contract eliminates the risk of default and ensures to secure the rights of all concerned.

**Risk Management In Prophetic Tradition:** The legality of the concept of risk management has its root and basis in the Sunnah (prophet way of life) as well. There is a well-known hadith on tying a camel, which is repeatedly quoted by the proponents of takaful. It was narrated by Anas bin Malik that an Arab Bedouin asked the Prophet (p.b.u.h.) in Medina:

*"O the Messenger of Allah...Should I leave my camel untied and trust in Allah, or should I tie it?" The Holy Prophet (p.b.u.h.) replied: "Tie your camel and then trust in Allah" [15].*

Despite the fact that a Muslim must put his trust to Almighty, the hadith proves that a Muslim should not be passive and fatalistic. The hadith does not only illustrate how a Muslim should deal with his fate, but it also instructs to manage the risk of calamities and losses. It is worth mentioning that risk management is not against the concept of putting trust in Almighty. Putting trust in Almighty is to choose appropriate means toward achieving the goals first, then entrusting Almighty for the better result. It is also narrated by Anas bin Malik that the Prophet (peace be upon him) said:

*"Trade the money of the orphans, so it will not be eaten (decreased) by zakah". The Prophet (peace be upon him) encourages the trustee on behalf of orphans to invest the wealth in a business that will yield a positive return. This is to avoid the risk of decrease in the wealth due to payment of zakah portion. One of the clear examples of risk management could be the business of Abbas ibn Abdul Muttalib (may Allah be pleased with him) as narrated by his son:*

*"Whenever Abbas ibn Abdul Muttalib (may Almighty be pleased with him) handed over his assets [camels] for mudarabah (profit sharing) to his partner, he stipulated that he should not take the assets across the sea, nor take them down to the bottom of a dry river bed, nor trade them for live animals. If he were to do any of these, he would have to bear the compensation. Word of al-Abbas stipulation reached the prophet (peace be upon him) and he allowed it".*

This prophet's saying permits stipulating conditions in *mudarabah* business in order to prevent exposure to undue risks [23]. Apart from that, this prophet's saying

also became as foundation for the ruling of restricted *mudarabah* where capital provider can put forward some restrictions on management where to invest the fund. Risk in economics represents the probable loss of wealth which is not desirable in itself. Nonetheless, risk is essential in economic activities and must be taken to create wealth and value [24]. The presence of higher risk opens a higher opportunity for profit and reward. Though risk management is important, it is also argued that risk should not be eliminated in total by transferring to other contracting parties as it leads to injustice and unfairness. It is argued that obtaining profit without assuming business risk is not allowed. Total elimination of risk in financial transaction, which is 'zero risk' may result any income derived becomes illegitimate.

### CONCLUSION

This study reviews the relevant literature in managing personal risk from Islamic perspective. It begins with the concept and definition of risk management. It continues to discuss risk management standard, Maqasid al-Shariah, Maqasid Shariah and risk, Islamic legal maxim and Islamic legal maxim and risk. According to an Islamic perspective an individual has to categorised risk according to the hierarchy of need and manage risk according to the concept of Maqasid Al-Shariah and Islamic legal maxims. This particular study is very significant in enhancing Islamic risk management literature. Future study is suggested to focus on developing an Islamic risk management framework.

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