Chapter 35
Takaful in Malaysia: Emergence, Growth, and Prospects

Monther Eldaia
Universiti Sains Islam Malaysia, Malaysia

Mustafa Bin Mohd Hanefah
Universiti Sains Islam Malaysia, Malaysia

Ainulashikin Binti Marzuki
Universiti Sains Islam Malaysia, Malaysia

Saddam Shatnawi
Universiti Sains Islam Malaysia, Malaysia

ABSTRACT

Takaful is an Islamic insurance contract introduced to substitute the conventional insurance which has been precluded by nearly all Muslim scholars as it encompasses the components of gharar (uncertainty), maysir (gambling), and riba (usury). Its feasibility is evidenced after numerous Fatwas were issued by Fiqh academies and Ulama in its support. Takaful is founded on the basis of cooperation and mutual aid as it is broadly used in the commercial sector. The Takaful business operation is regulated by the codes of Shari'ah and by other laws. Many models such as the Wakalah model, Mudharabah model, and the amalgamation of Mudharabah and Wakalah models have been applied in the Takaful corporate operation. This chapter explicates the existing implications and future prospects of the Takaful industry in Malaysia. It offers a review on Takaful industry in Malaysia and emphasizes issues and challenges, opportunities, and recommendations.

DOI: 10.4018/978-1-7998-0218-1.ch035

INTRODUCTION

Insurance protection is a financial necessity of life because every day people are more susceptible to a variety of risks and uncertainties in their environments. Death, disability, injury, sickness, or damage of property because of misfortunes can occur to anybody at any time. It is obvious that insurance cannot stop these misfortunes from occurrence, but it can offer financial support to minimize the weight of the losses emanating from such eventualities (Abdul Rahman *et al*., 2009; Salleh *et al*., 2018). Insurance coverage is inevitable because of the multifaceted nature of business dealings and human lifestyles.

Conversely, the existence of forbidden features in the conventional insurance along with non-*Shari'ah* compliant nature has motivated Muslim scholars to propose *Takaful* as a substitute for conventional insurance. *Takaful* merchandises are meant to meet the needs of people, including non-Muslims. The significance and impact of *Takaful* have attracted the attention of Muslim societies in modern time (Saleh, 2016). *Takaful* is viewed as a substitute to orthodox insurance because of its strong base of Islamic codes, which are based upon the concept of unity, mutual support, and harmony. It has become a swift increasing and developing the industry with the tremendous prospect and has positively advanced into a broad system which reduces non-*Shari'ah* compliant characteristics including *Riba* (interest), *gharar* (uncertainty) and *maysir* (gambling) that exist in the traditional insurance (Salman & Htay, 2013; Nordin, 2018).

Conventional insurance exists shoulder to shoulder in Malaysia with *Takaful* as its complementary, which the Islamic financial insurance is built on mutual agreement and *Shari'ah* code (i.e. Islamic law). *Takaful* is principally founded on religious contexts to complement the introduction of Islamic banking, has in the last decade displayed its potential as an innovative financial system (Thanasegaran, 2008; Nazarov & Dhiraj, 2019). Thus, this chapter traces the history, background of the *Takaful* industry in Malaysia, regulations, guidelines and how related framework *Takaful* industry is organized in Malaysia is reviewed. It also explicates how the government and the private sector operate together to safeguard the success of *Takaful* in Malaysia. The objectives of this chapter are:

- To describe the concept and history of the *Takaful* industry in Malaysia.
- To illustrate the *Takaful* models and product in Malaysia.
- To discuss the challenges facing *Takaful* industry in Malaysia.
- To predict the future of the *Takaful* industry in Malaysia.

Takaful Industry Background in Malaysia

Takaful industry plays a key role in plummeting risks and global basic economic growth, predominantly in the financial sector (Sherif & Azlina Shaairi, 2013; Arifin *et al*., 2018). Between the mid-1960s and 1970s, about 93% of the global insurance market was retained in the countries in Europe and Northern America.

The late 1970s oil price shocks along with the subsequent inflationary pressure had a deteriorating impact on the percentage of global insurance market of these nations which raised up to 56% in 2012 (Swiss Re, 2013). In contrast, during this period the share of emerging Asian economies improved from 3.8% in the 1960s to 30% in 2012. It was anticipated that emerging economies of Asian countries will enable growth with a rate of 8% which is more than triple of developed countries growth rate of 2.6% (Swiss Re, 2013).

However, Malaysia *Takaful* industry grew radically in 2010 with total assets of 6.8 million RM (Malaysian *Takaful* Association, 2010). In 2017, the total assets of *Takaful* were peg at 29.3 billion RM (Malaysian *Takaful* Association, 2017). This is expected to grow by 18% in 2019 (Husin, & Rahman, 2019).

There is a belief among the Muslim majority that conventional insurance is forbidden with regards to legality because of the existence of numerous forbids, for instance, *Riba* (interest), *Maysir* (gambling), and *Gharar* (uncertainty). Consequently, there is a need for a substitute form of insurance that meet the demands and needs of Muslims who want to do financial transactions that are harmonious with Islamic *Shari'ah* (El-Gamal, 2001; Akhter, 2010).

In June 15, 1972, the life insurance was first declared when the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia issued a religious fatwa declaring that this form of life insurance is *haram* (proscribed) as it opposes Islamic *Shari'ah* and rules. In 1975, this verdict was affirmed by a similar decree released by the Council of Islamic *Fiqh* Scholars that conventional insurance is prohibited and unacceptable based on Islamic law.

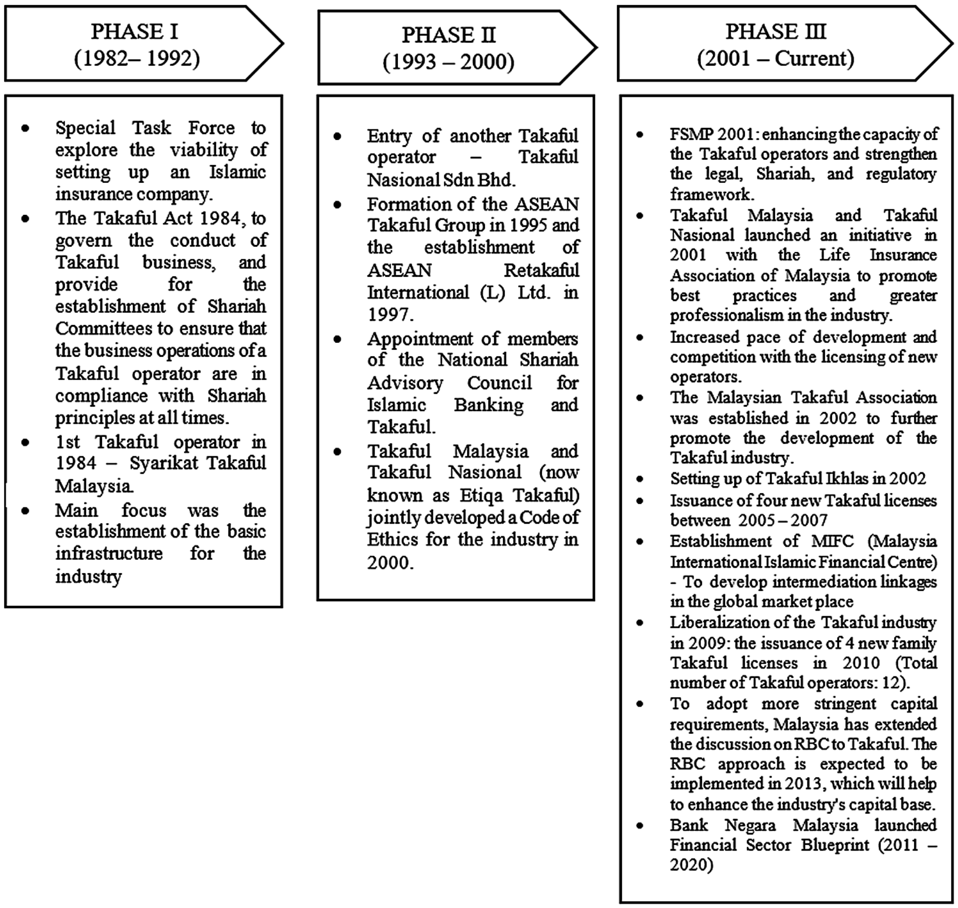
The major purpose for establishing the Islamic insurance scheme in Malaysia was to adhere to Islamic code and to regress from the three prohibited components (*Riba, Maysir, and Gharar*) based on Islamic law and rules. The key objective was to develop and innovate an Islamic alternative to conventional insurance, which is preferred by Muslims in Malaysia.

Malaysian *Takaful* industry created in 1984 was expounded based on the master plan of Central Bank of Malaysia in three phases (Bank Negara Malaysia, 2005). The first phase (1982-1992) was when the infrastructure of the *Takaful* industry in Malaysia was set up. The second phase (1993-2000) was when the regional cooperation between the operators of *Takaful* was reinforced. The third and final stage (2001-current) financial Sector Master plan (FSMP) to reinforce the legal, *Shari'ah* and regulatory framework and improve the capability of the operators of *Takaful*. *Takaful* industry in Malaysia has become a vital prime hub in the Malaysian economy to support Malaysia as a global Islamic financial center.

The Governor of BNM is the Director-General of *Takaful*, explained that the purpose of establishing the *Takaful* industry in Malaysia is to form progressive world-class *Takaful* operators that are capable to positively place themselves as frontrunners in the area of *Takaful* and thus positioning the growth of Malaysia as the global Islamic business center (Bank Negara Malaysia, 2005, p. 9). Consistent with the goal of strengthening Malaysia as an Islamic financial center, competition in the *Takaful* market has been increasing in the last decades, with the addition of three novel *Takaful* companies in 2006. There are eleven *Takaful* companies in the Malaysian market. Despite the intense competition between these two types of insurance, the performance and achievement of the *Takaful* industry in Malaysia have made it a strong competitor to traditional insurance. (Sherif & Shaairi, 2013).

Presently, the *Takaful* industry in the Malaysian market confronts substantial rivalry from the traditional insurance industry in many fields. The absence of a secondary market, the organizational infrastructure of Islamic law and the lack of research on the main issues of *Takaful*, hindered the development of Islamic products in *Takaful* effectively. The Islamic insurance companies also face the lack of Islamic products that comply with *Shari'ah.* With the increasing number of companies in the *Takaful* market, there is a need to create many products to compete in the market, and the industry still needs more research to develop *Takaful* product in Malaysia. There are many studies such as (Johnes *et al*., 2009) recommending an increase in research in evaluating the performance of *Takaful* companies using financial ratios so that *Takaful* companies are evaluated compared to traditional insurance companies (Abdou, Ali, & Lister, 2014).

Figure 1.



THE SIGNIFICANCES AND MOTIVATIONS OF THIS CHAPTER

Malaysia and the Gulf Cooperation Council (GCC) countries are considered as the foremost fundamental actors in the global *Takaful* market as they have served as prolific grounds for the growth of the *Takaful* industry. This indicates the degree to which both Malaysia and the Arab Gulf Nations become the fertile bases for the extension of the *Takaful* industry(Abu Hussin, *et al*., 2014). Malaysia remains the leader in the *Takaful* industry about regulations, which is the first market in the globe to execute a risk-based capital (RBC) structure for *Takaful*. There is also a condition for corporations to disclose their *Wakalah* fees in its sales representatives for openness (Ismail, Jaffer, Unwin, & Jamil, 2017).

Malaysia remains the largest *Takaful* with 62% market share within South East Asia, subsequently Indonesia with 33% in 2015 (Ismail *et al*., 2017). The structure of *Takaful* and its performance are important in view of the current financial framework (Ismail, 2013; Karbhari *et al*., 2018). As a result of a considerable number of firms' failure such as Lehman Brothers, Citibank, and Freddie Mac, AIG, and Fannie May has triggered further worries on the economic stability of the *Takaful* industry in Malaysia (IFSB, 2016, 2017). Without the involvement of this system, it will not be possible to establish the *Takaful* industry, because the industry requires professionals with experiences to be able to be successful.

Thus, the selection, screening, and election of all various structures and committees strongly depend on their competencies, characteristics, qualifications, experiences, and skills in *Shari'ah* jurisdictions (Heradhyaksa & Markom, 2018; Waris *et al*., 2018).

Despite Malaysia being a largely Muslim country with *Shari'ah* codes of practice in place, the *Takaful* sector is hitherto making a significant influence compared to the traditional insurance system (Nordin, 2018). This can be because of the uninspired setback in financial performance witnessed around the world particularly the Islamic Financial Institutions of Islamic countries in addition to weak Corporate Governance structures in the *Takaful* industry.

This issue is still very fresh in Malaysia nowadays (Alhabshi, 2017). *Takaful* corporates encompass smaller part of the overall insurance companies in Malaysia, based on financial performance; they represent 8.2% of the collective gross contributions of the insurance industry (Salleh *et al*., 2018; Samad & Shafii, 2018). This suggests that the *Takaful* sector required many events to be in place to overcome the conventional insurance industry in Malaysia (Akhter *et al*., 2017). Several *Takaful* operators currently have an average growth rate of only 20% per annum (Daud *et al*., 2018; Mustafa & Rahman, 2018). The industry has enormous potential to be a focus due to its contribution to the Malaysia GDP (Laldin & Furqani, 2018; Nordin, 2018).

The *Takaful* industry in Malaysia is presently in front with a gigantic competition from conventional insurance in several regions because numerous conventional gainful investment prospects are not allowable under the divine Islamic laws. Conversely, it is possible to overcome this issue by increasing research to produce substitute investment prospects that are harmonious with Islamic *Shari'ah.* Accordingly, the *Takaful* industry still requires more studies in order to improve the Malaysian market (Mondaq News, 04 July 2011). Moreover, it is vital to compare conventional insurance and *Takaful* with respect to financial ratios (Abdou *et al*., 2014).

Concept of *Takaful*

Takaful or Islamic insurance system are originated from the ancient Arab tribes, The concept is well known and used among *Ansar* of Medina and *Muhajirin* of Mecca for centuries, as a result of *Hijra* of the Prophet Muhammad *(May peace be upon him)* over 1400 years ago (Anwar, 2008). *Takaful* is derived from the concepts of the "*Aqilah* and *Diyah*", in which a member of a tribe is aided to fulfill the liability that resulted in the unanticipated, for instance, compensation for a person killed was originated *diyah* (Manjoo, 2007; Nazarov & Dhiraj, 2019). Subsequently, this concept was protracted to include various aspects of individual life, maritime trade, and to help any individual or group that has faced a disaster or loss of maritime work. *Takaful* is originated from its Arabic root '*Kafalah'*, which literally means 'to aid one another', or 'mutual guarantee' all products or transactions must completely conform to "Islamic law" (Jaffer *et al*., 2010).

The practice of insurance was first founded in the early second epoch of the Islamic era in Asia, during the time when Muslim Arabs began to enlarge their trade to India, the Malay Archipelago, and other Asian countries (Sadeghi, 2010). Owing to the long distance involved, the dangers inherent in the journey, and the losses arising from mishaps and misfortunes or robberies, the Muslim Arab traders got together and mutually agreed to contribute to a fund that would be used to recompense anybody in the assembly who suffered losses (Thanasegaran, 2008; Abu-Hussin *et al*., 2014).

Takaful is described based on Malaysia Code as

A scheme based on brotherhood, solidarity, and mutual assistance which provide for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose. (Takaful Act, 1984)

This description characterizes the Islamic standard of *Takaful* whereby an assembly of members consents to equally promise each other against a specific loss or harm. Likewise, the Islamic Financial Services Act 2013 (IFSB), in its published guidelines entitled 'Guiding Principles on Governance for *Takaful* Undertakings', describes *Takaful* as follows: "*Takaful* is the Islamic counterpart of conventional insurance, and exists in both Family (and "Life") and General forms" (Bank Negara Malaysia, 2013)

As Islamic protection, consistence with *Shari'ah* standards and standards is the foundation; as it is without a doubt the particular trademark that reflects the Islamic character of *Takaful* business (Bank Negara Malaysia, 2010). *Takaful* has encountered unparalleled development particularly in the course of the most recent decade. Global *Takaful* extended generously between the period 2004 and 2007 from a commitment of 2.1 billion US dollar to 3.4 billion US dollar, the same to a compound of yearly development rate (CAGR) around 30%, with the biggest markets being Saudi Arabia and Malaysia. Territorially, the ASEAN area has been described as the greatest market for the period 2005-2008. In 2008-2010, balanced for international expansion, the division developed at 28% as against the ordinary market which remained at 5% in the respective Muslim nations and 8% in the MENA districts amid a similar period (Ernst & Young, 2015).

RETAKAFUL

ReTakaful concept as an arrangement in which a company, the *ReTakaful* Company, agrees to indemnify a *Takaful* Operator, the ceding company, against a portion of the primary risks underwritten by the ceding company. Re*Takaful*, however, does not discharge the ceding company from its liability to participant.

The Malaysian *Takaful* Act 1984 does not define the term per se but imposes a requirement that 'an operator shall have arrangements consistent with sound *Takaful* principles for *ReTakaful* of liabilities in respect of risks undertaken or to be undertaken by the operator in the course of his carrying on *Takaful* business' (Bank Negara Malaysia, 2012)

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) refers to 'Islamic reinsurance' (re*Takaful*) as "the agreement among insurance companies, on behalf of the insurance funds under their management, to devise a mechanism for avoidance of part of the risks which the insurance funds may encounter. Based on such agreement a reinsurance fund which has a distinct legal personality and independent financial liability is formed up through making contributions out of the insurance funds paid by the insurance clients based on donation. The reinsurance fund, thus formed, assumes the task of covering part of the risks encountered by the insurance funds" (AAOFI, 2012).

Yusuf (2011) dictates the main objectives of *reTakaful* into three. The first objective is to safeguard the operators against the possibility of insolvency and to engage the operators in *Shari'ah* compliant investment. Second objective is to provide adaptable underwriting practice for the operators and the last objective, to prohibit interest in the reserves of *reTakaful* fund. Those three objectives clearly show that even conventional reinsurance and *reTakaful* share the same functions, but the objectives have put both the risk mitigating tools into a different set of games and aims altogether.

Authorities from the Holy *Qur'an*

God wants us to leave our family ready and in good shape

And those who are taken in death among you and leave wives behind - for their wives is a bequest: maintenance for one year without turning [them] out. But if they leave [of their own accord], then there is no blame upon you for what they do with themselves in an acceptable way. And Allah is exalted in might and wise (AlBkara, 240).

b. Authorities from the *Hadith*

The Prophet advised us to do our part before leaving the result to God: 'When the Holy Prophet asked a Bedouin Arab, who entered the mosque with his camel left outside untied if his camel would run astray, he said: "In shaallah". The Prophet (May peace be upon him) then said: "Tie your camel first, then say In shaallah (narrated by Anas bin Malik, Sahih Bukhari).

TAKAFUL MODELS

Takaful Ta'awuni (Non-Profit Model)

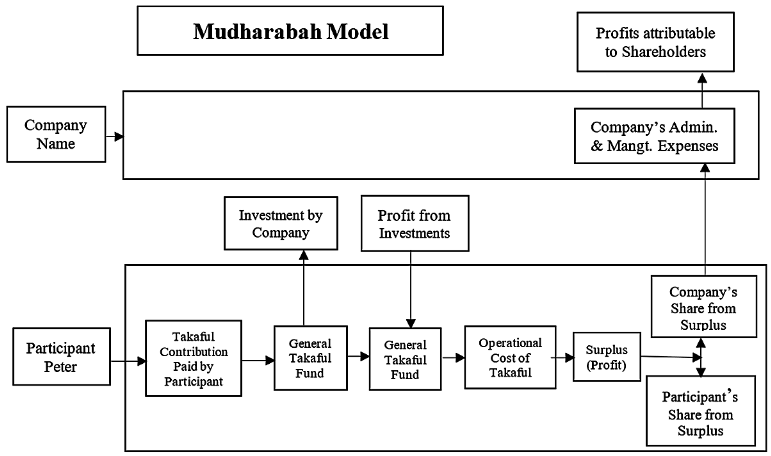
The concept of *Ta'awuni* model is established upon the idea of commonality, collaboration, and brotherhood among the members in this model to help the partaking members in an event of the urgent need for support because of an unexpected accident or a certain tragedy. This form of insurance seeks to realize the wellbeing of the members and society at large. *Takaful* operator can be the custodian on behalf of the customers without considering about making again. Thus, this model is termed a non-profit.

Finally, the excess is allocated in full to all members (Billah, 2004). This model coined in Sudan in 1979 when the first *Takaful* events began. Afterward, insurance firms are compelled to follow the "*tauniuni*" model and adopt the *Takaful* project under the law. The *Ta'awuni* model was adopted and implemented by Bank Aljazira Saudi Arabia when the scholars advocate for Islamic insurance comply with *Shari'ah.* The members contribute to the *Takaful* Fund to pay other members in the event of calamities and afflict. Consequently, the members and operators in *Takaful* are to know their rights and responsibilities to the Fund and the premium in the contribution spread to contributors only (Billah, 2004).

Mudarabah Model (*Tijari*)

Mudarabah is a deal between a capital supplier (*Rab-al-Maal*) and a business individual (*Mudarib*) through which the *Rab-al-Maal* offers wealth to be managed by the *Mudarib* and any profit made from the wealth is divided between the *Rab-al-Maal* and the *Mudarib* in line with mutually consented profit sharing ratio (PSR). In the process, any financial losses are borne by the *Rab-al-Maal* if such losses are not caused by the *Mudarib*'s transgression (*Ta`addi*), carelessness (*Taqsir*) or break of stated terms (*Mukhalafah al-shurut*). This model has practiced in Malaysia for two decades. The *Takaful* Company was the first and largest company in Malaysia in 1985 has demonstrated the success of the *Mudarabah*

Figure 2.



model as profitable for both customers and shareholders. This model is also practiced in Brunei where *Takaful* companies pay 36% gain to their contributors (Saleh, 2016)

Wakalah Model

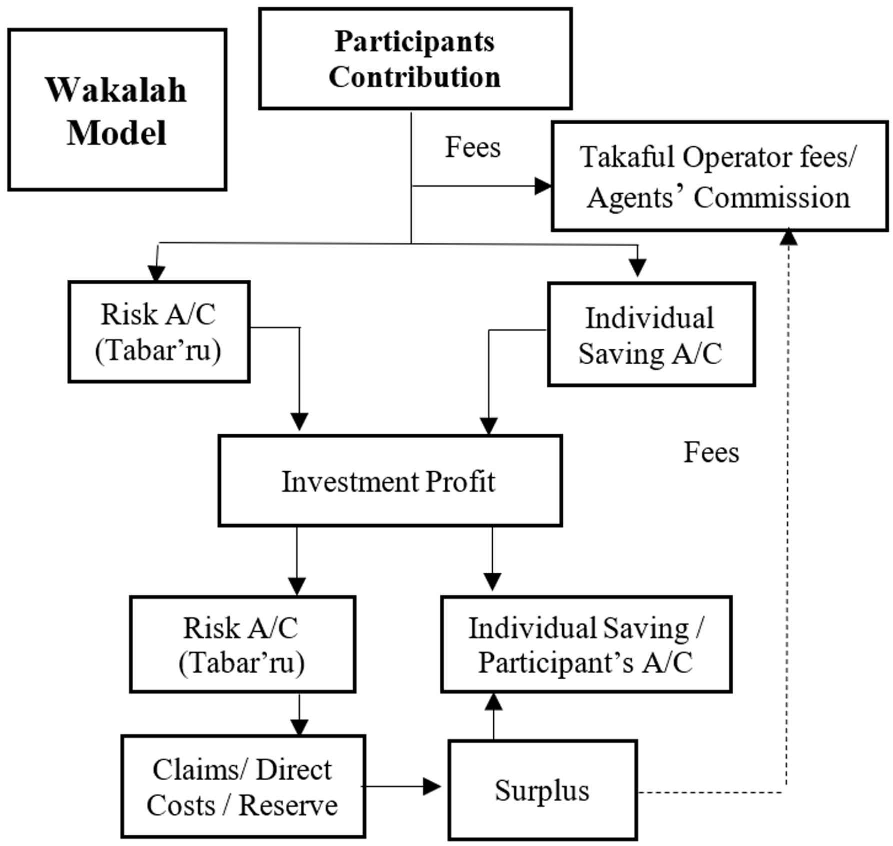
The *Wakalah* model is a remunerated Islamic deal where one party provides funds whereas the other manages the funds. In this, the other party receives fixed payments instead of profit sharing as in the *Mudarabah* deal, to offer his managerial services to prudently invest and manage the funds. Under the *Takaful* contract, members offer wealth in the form of a contribution. The *Takaful* operator manages the capitals and a fixed fee (termed Agency Fees) for the running of its services (Alnemer, 2013). Agency fees must be fair, appropriate, determined, and approved by the *Shari'ah* Supervisory Board (SSB). The model of the agency is more transparent than the speculative model as the fees are fixed and predetermined by both parties. There are no secret charges. Certain *Takaful* operators charge excess surcharges as an incentive to effectively manage funds.

Conversely, certain *Takaful* operators receive supplementary fees as a spur for their efficacy in running finance and their profit achievement. This model is practiced in *Takaful* Berhad and *Takaful* Ikhlas Sdn Bhd. The Government of Bahrain has also started to enforce a mandatory model on *Takaful* and re-*Takaful* businesses in all its operations. This model has enjoyed acceptance around the globe due to the benefits such as transparency and the purpose of fixed fees. This brings about an upsurge in the company's impact to work better and increase the profits of the stakeholders. Furthermore, there are less *Shari'ah* related issues associated with this model that might create conflicts of interests among *Shari'ah* scholars of different schools of thoughts (Razimi *et al*., 2017).

Mixed Model

The mixed model is a fusion of *Wakalah* and *Mudarabah* model where *Mudarabah* deal is implemented for investment accomplishments whereas *Wakalah* deal is applied for underwriting agreement (Tolefat, 2006; Djafri *et al*., 2018). Regarding this, the stakeholders act as the *wakeel* (agent) on behalf of con-

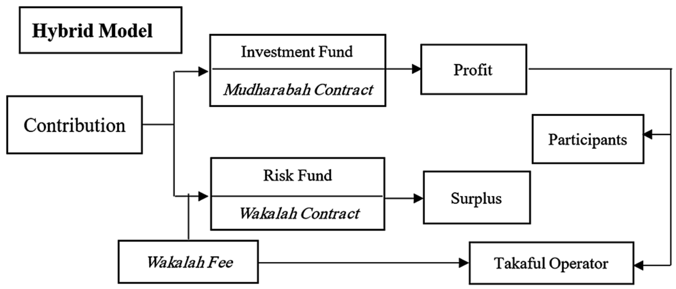
Figure 3.



tributors to manage their capitals whereby the *Takaful* company (stakeholders) gets a contribution, pay claims, arrange re-*Takaful* and all other obligatory activities related to *Takaful* business. The company charges each contributor a fee recognized as a *Wakalah* fee, which is commonly a percentage of the contribution paid by each contributor in exchange for execution these tasks. With regards to investment, the company invests the extra contributions in *Shari'ah* -based devices based upon Al-*Mudarabah* deal, where the company acts as *Mudarib* on behalf of contributors (*Rab-al-Maal* or capital providers).

Nevertheless, in order to fulfill the *Shari'ah* condition for Al-*Mudarabah* deal, the ratio of profit is set and contracted between the two parties, at the start of the deal. Adherents of this model assert that a *Mudarabah* procedure is better suitable for management and investment of *Takaful* finance (Obaidullah, 2005; Almulhim, 2019) and offers a reason to *Takaful* operator to boost its return by sharing profit. The *Wakalah* model is possibly better appropriate than the *Mudarabah* for running the *Takaful* business for the agency fee (cost of insurance). It is more transparent and freer from the contentious indicting of expenses (including marketing commissions) to the *Takaful* fund. These measures need to be deemed as an aspect of attempts to seek for the best model of *Takaful* and to create concord among existing *Takaful* models (Akhter, 2009).

Figure 4.
Source: (Ali, 2016)



Certain financial regulators and international organizations (e.g. Accounting and Auditing Organization for IFI, AAOIFI) advocate the mixed model as it leverages the strengths of the *Wakalah* and *Mudarabah* models. Implementing the *Mudarabah* model to investment events assist lessen principal-agent issues, while the usage of the *Wakalah* model permits the operator to convalesce the administrative expenses of underwriting (Swiss Re, 2008). This model is widely practiced in the Middle East market and worldwide in *Takaful* companies. In Malaysia, Maybank *Takaful* Berhad (MTB) and *Takaful* Nasional Berhad practice it. A supporter of this model argues this model combines the benefits of *Mudarabah* and *Wakalah* model (Obaidullah, 2005). Therefore, it may help to build a standardized model to be used around the world.

The implementation of a particular model of *Takaful* makes the issue of CG controversial in terms of the rights of contributors to *Takaful* firms. The concern of *Takaful* employees was to maximize the profits of the stakeholders while ignoring the rights of the participants, even though the employees are acting as agents, trustees, and managers of the invested funds that receive their profits in the form of *Mudarabah* and the Agency fees. In the absence of a good CG practice, the BODs is not held accountable and their decisions are not properly monitored for the participants and the community as a whole, because the participants have no positions in the BODs, so they do not have the right to question the BODs. (Abdel Karim & Archer, 2002).

PRODUCTS OF *TAKAFUL*

General *Takaful*

General *Takaful* products are typically designed to provide a form of *Shari'ah* -compliant risk-sharing and risk management mechanisms on an annual renewal basis. In this scheme, the relationship among the participants is based on *Ta'awuni* and *Tabarru'*; whereas the relationship between *Takaful* operator and participants, is based on *Mudarabah, Wakalah*, or *Waqf* (Yasin & Ramly, 2011; Abu Hussin, *et al*., 2014).

Some examples of general *Takaful* products are:

I. Motor *Takaful*: This type of policy protects the participant against any losses or damages to the insured vehicle due to theft, accident, fire or third-party property damage or bodily injury.
II. Fire *Takaful*: This type of policy protects the participant against any losses or damages caused by fire, lightning, or explosion to their properties. It includes but not limited to buildings, machinery,

plant, furniture, and accessories. The fire *Takaful* scheme usually excludes damages caused by earthquake, volcanic eruption, or typhoon scheme.

III. Engineering *Takaful*: This type of policy protects the contractor's interest against any losses, damages, or liability due to different causes to the construction of bridges, buildings, dams, and towers.

IV. Marine *Takaful*: This type of policy protects the participant against any perils or damages to the property while it is in transit. It includes sea peril, collision, stranding, fire, and severe weather. Such coverage may be provided to marine transport or road and aviation. Moreover, it can also be a combination of all (Marifa Academy Team, 2014; Yasin & Ramly, 2011).

Family *Takaful*

Family *Takaful* products are usually designed to offer protection against the risks of death or permanent disability. Under this system, the participant may benefit from long-term savings and investment returns based on a pre-agreed ratio consistent with *Mudarabah.* In addition, the participants in a family *Takaful* scheme entrust their money to the *Takaful* operator and conduct a *Wakalah* contract which permits the operator to act as their agent. The participants' aid in the form of a contribution to the *Takaful* fund is deposited in Participants' Special Account (PSA).

The funds are used to compensate claimant's family in case of the claimant's demise or permanent disability. The contribution in the form of savings is deposited in Participants' Account (PA) for investment in *Shari'ah* -compliant businesses. The *Takaful* operator is responsible for distributing the surplus based on participants' contribution to the fund. There are several types of family *Takaful* products offered by various operators which are primarily divided into two categories; 1) Individual family *Takaful*: In this type of product, the member of the fund has policy protection against any defined risks, including mortgage, education, or health. 2) Group family *Takaful*: In this type of product, the members have policy protection for themselves and their families against any defined risks, including mortgage, group health, and education. Their families are entitled to receive financial benefits in case of illness, death or permanent disability (Marifa Academy Team, 2014; Yasin & Ramly, 2011; Nazarov & Dhiraj, 2019).

CONCEPTUAL AND OPERATIONAL DIFFERENCES BETWEEN *TAKAFUL* AND TRADITIONAL INSURANCE

Takaful insurance companies and traditional insurance companies differ concerning their basic concept models (Kwon, 2007; Kwon, 2010; Lee *et al*., 2010; Hussain and Pasha, 2011; Maysami and Kwon, 2011; Matsawali, *et al*., 2012). Traditional insurance includes an undertaking from an insurance company in event of payment either to the insured or to another in the event of a certain event. *Takaful* is an Islamic substitute for traditional insurance and is built upon the concept of "social solidarity, cooperation and joint compensation for loss of members".

In fact, there are some similarities and differences between those two types of insurance. The similarities are the following:

1. The two forms of insurances require payment from the insured to the insurer; in traditional, it is termed premium while under *Takaful*, it is termed contributions in the form of endowment (*Tabarru'*).
2. The value insured is returned to the insurer when particular events happen.

3. The two forms of insurances have a substantial investment or savings components developed in them.

The following table summarizes the main differences between both systems.

Malaysia's *Takaful* Industry Bodies

Malaysia is one of the forerunners of Islamic finance and banking industry and well famous for having the most established and effectual *Takaful* market in the globe. This is because, through the decades, Malaysia has advanced and well-regulated Islamic financial industry i.e. well supported with the essential regulatory contexts and conventional physical structures (Abu Hussin, *et al*., 2014; Remli & Rosman, 2018). The *Takaful* Act (1984) and the Islamic Financial Services Act 2013 were introduced to advance the industry towards realizing a tremendous amount of growth and development in the conventional insur-

Table 1. Main differences between Takaful and Conventional

Item	*Takaful*	Conventional
Benefits	Paid from the related participants' funds under mutual assistance.	Paid from the company reserves.
Investments	The funds shall be invested in any interest-free *Shari'ah* approved assets and also meet any required national insurance regulations and laws.	The funds may be invested in any assets so long as they meet required national insurance regulations and laws.
Operations	Operational mechanisms shall be in line with the *Shari'ah* rules.	Operational mechanisms shall be in line with national insurance regulations and laws.
Profit	Underwriting profit is distributed to the policyholders. Stakeholders' profit is generated from the return on the investments of the shareholder capital and expenses paid to the stakeholders by the policyholders for (i) managing the company on behalf of the policyholders; and (ii) managing the policyholders' investment funds on behalf of the policyholders.	Policyholders do not get any share of the underwriting profit (except in mutual companies); stakeholders' profit is generated from the company's underwriting profit plus any investment returns.
Premiums	Paid premium is treated as both donations (*Tabarru'*) and saving (*Mudarabah)*.	Paid premium creates an obligation against the insurer on a sale and purchase relation.
Company	Company is better known as an operator, which acts as a trustee, manager and also an entrepreneur.	Relationship between the company and the policyholders is on one to one basis.
Shari'ah	*Takaful* practices are free from the elements of *Riba* and other prohibited elements and are evolved around the elements of *Mudarabah, Tabarru*, and other *Shari'ah* -justified elements	Conventional insurance (including mutual insurers) may involve *Riba* and some other elements, which may not be justified by *Shari'ah* principles
Policyholder Fund	The policyholder fund belongs to the policyholders on a collective basis and is managed by the stakeholders.	All (both policyholder and shareholder) funds belong to the company, though separation of assets may be maintained between stakeholders and policyholders for specific insurances (e.g. with profits).
Regulations	The operational mechanisms and products must be *Shari'ah* -compliant and be in accordance with the required national laws and insurance regulations.	Operational mechanisms and products have to be in accordance with the required national laws and insurance regulations.

Sourse: (Khan, 2005, p142)

ance industry of Malaysia and global. Furthermore, the amounts of regulators that are vigorously backing the whole value chain of Islamic finance have assisted the industry to expand optimally in the country.

Additionally, many of committed regulators are keenly supporting the complete value chain of Islamic finance which have also assisted the industry to develop. Further, amounts of ideas have been presented to bring Islamic insurance into the majority of Malaysia insurance industry (Cuyper, 2012). This is discussed under the following headings:

The Malaysia International Islamic Financial Centre (MIFC)

A cooperative network started for the country's financial segment regulators in 2006, for instance Bank Negara Malaysia (Central Bank of Malaysia), Securities Commission Malaysia, Labuan Financial Services Authority, Bursa Malaysia (Kuala Lumpur Stock Exchange), Government ministries and other financial agencies and institutions offering bank services, *Takaful*, re-*Takaful*, capital market, human capital development and proficient auxiliary services.

International *Takaful* Operators (ITO)

The financial institutions licensed to carry out a broad range of *Takaful* and re-*Takaful* (Islamic reinsurance) business with foreign currencies.

International Currency Business Unit (ICBU)

It is a platform for firms to carry out dealings comprising foreign denominated currencies. It is a scheme that provides opportunities for undertaking international currencies trade in offshore markets and a network by which the accessible technical proficiency and expertise in Islamic finance in Malaysia are being predisposed and exported.

The Malaysian *Takaful* Association (MTA)

It is an organization founded to offer training, research, and education through institutions such as the International Centre for Education in Islamic Finance (INCEIF) and Islamic Banking and Finance Institute Malaysia (IBFIM). Known the dissemination of the Islamic financial industry in Malaysia, especially the *Takaful* industry, some professionals are of the opinion that the *Takaful* industry in Indonesia, Brunei, and Singapore as a Southeast Asia might threefold that of the Middle East by 2015 (Ismail *et al*., 2011).

OPPORTUNITIES AND FUTURE CHALLENGES

Takaful industry in Malaysia is anticipated to grow, provided the following opportunities:

1. Ongoing government support to propagate the *Takaful* segment by executing strong regulations, intensify public awareness and providing adequate assets for investments.
2. Business players mounting advance *Takaful* products (e.g., universal life products).

3. Opportunity in the sequestration savings space.

Yet, the *Takaful* industry is also anticipated to encounter the following challenges:

Key Issues and Challenges

Lack of Consumer Awareness

Despite the *Takaful* primer, there is still to be understood the rise in the anticipated rate of dissemination. Several clients are still unaware of *Takaful* as a replacement, while others regard *Takaful* as marketing traditional insurance into the Islamic world and discard the notion that it is a *Shari'ah* -compliant tool. Also, in the Middle East, several people tend to modulate the importance of this scheme. *Takaful* penetration, like traditional insurance, is generally an offer that needs to be sold to clients (instead of one that clients buy). In order to enhance client understanding, there is a need to address mainly instructional problems involving *Takaful* and individual risk management among Muslim communities. Many of the current *Takaful* education is among the professionals and investors concerned or linked, and very restricted awareness campaigns are regarded for the target individuals.

Insurance and *Shari'ah* Expertise Shortages of Human Capital

The current small group of specialists with appropriate *Takaful* expertise in areas such as law, sales, and actuarial services can hinder future development. With traditional insurance experience, most *Takaful* companies would frequently use human resources. These resources would generally tend to know *Takaful*'s *Shari'ah* characteristics and familiarize their previous knowledge with integrating *Shari'ah* compliance laws into their fresh responsibilities. Therefore, standard opinions and resolutions tend to determine the attitude of many carriers and, consequently, creative thoughtfulness in the sector has been limited. Several *Takaful* classes have been provided recently, and one provided by the Chartered Insurance Institute (CII), helping with both insurance and *Shari'ah* skills in the growth and training of human resources.

Shortage of *Shari'ah* Scholars With Enough Practical Experience

Each *Takaful* company must have a *Shari'ah* Supervisory Committee whose members are not less than three *Shari'ah* scholars to supervise the company's business. *Takaful* companies face significant regional challenges, so they are required to build confidence in their target markets. Therefore, they must rely on the preferred *Shari'ah* scholars and those have practical experience in the *Takaful* markets. *Shari'ah* scholars should be experienced in financial fields not only in *Shari'ah* issues, but especially in private financial transactions in *Takaful*. This is the main task of the members of the *Shari'ah* Committee to implement and control the work of the *Shari'ah* transaction and to ensure compliance with *Shari'ah.*

By contrast, the amount of *Shari'ah* academics with expertise in both Islamic jurisdiction and insurance is restricted; definitely, these academics are currently sitting on multiple boards that can generate interesting encounters and negotiate counseling quality. The scarcity of academics on fresh rivals continues a short-term barrier and speeds up the cost of developing *Shari'ah* board.

Lack of Standardization in the Industry as a Result of *Shari'ah* Explanation

Since the *Takaful* sector is only lately recognized, there is a broad series of problems presently being deliberated amongst technocrats and *Shari'ah* scholars, mainly those inclosing the descriptions and practices that are considered suitable and *Shari'ah* -compliant.

Different Legislative Approaches and Absence of Centralized Rules

The *Takaful* sector relies on *Shari'ah* Committee, which apply the provisions of Islamic *Shari'ah,* subjected to any local legislative constraints, in the non-existence of standardization of a worldwide *Takaful* regulatory scheme. When it comes to coping with *Takaful*, local authorities have implemented a variety of techniques.

Solvency and Capital Requirements

Numerous regulatory contexts, specifically those implemented a 'level playing field', In *Takaful* companies, liquidity and principal are a major obstacle same as conventional insurance companies, Conversely, the following challenges, which are particular to *Takaful* companies, need to be resolved:

- Present governing systems have not given suitable attention in treating *Qard-e-Hasana* in resolving the solvency necessities for *Takaful* operator (i.e., the *Qard-e-Hasana* may be a probably added capital base for the *Takaful* endowment)
- The concern of whether the 'level playing field' is justifiable at long run for *Takaful*
- The concern of the excess dissemination and likelihood reserve techniques that can result in a lesser capital requirement for *Takaful* bodies.
- Concern about mutual conduct under Solvency II whether the same technique can be appropriate to *Takaful* businesses
- Concern about the treatment and technique used by rating agencies towards *Takaful* bodies.

Corporate Governance

The present correlation between the *Takaful* operator's Board of Directors and *Shari'ah* Supervisory Board is usually one of enormous trust and integrity. Conversely, setting a clear written standard on the *Shari'ah* board's scope and duties is still essential. Compliance with *Shari'ah* must include all operational characteristics, the implemented *Takaful* model, products introduce, investments, fee structures, contract contents, and marketing expression. There are currently no compliance guidelines and normal reference conditions for *Shari'ah* boards in the sector. There are other problems concerning the *Shari'ah* board function and potential conflicts of interest among *Shari'ah* academics.

The risk may be from the focus of the *Shari'ah* board on jurisprudential issues related to *Shari'ah* and not equally focusing on major technical issues, for example underwriting, actuarial, and wider risk management. Alternatively, the management's concern is to maximize the value of shareholders, which can create additional prospective encounters from a portion of *Shari'ah* compliance. There are also issues in the concentration of assets invested in related businesses with interest and risk management (Jaffer *et al*., 2010).

The Limited Size and Capacity

Despite relatively rapid growth, the industry is still very small compared to the conventional insurance market. In 2006, participants' contributions stood at US$2 billion, accounting for only 1 percent of the US$3.7 trillion global insurance premiums. The *Takaful* assets are estimated to be around US$20 billion, in contrast to the Islamic banking assets of US$500 billion. There is a high capital need for *Takaful* enterprises despite *Takaful* having lower levels of securities, hence making it a challenge to contest with traditional insurances due to lack of economies of scale for various *Takaful* operators (Ismail *et al*., 2017).

Practical Challenges and Difficulties

Furthermore, there are numerous practical problems in *Takaful* sector that may be relevant to the *Takaful* industry's evaluation and risk management. Some of the primary technical problems considered are:

Handling of *Qard-e-Hasana* (Interest-Free Loan)

Qard-e-Hasana or "benevolent loan" is an interest free loan given by the *Takaful* Company in the case of scarcity in *Takaful* finance. *Shari'ah* rules does not obviously dictate this development, but there is an expectation that in the case of a shortage, the operator will introduce the funds. The loan or *Qard* can then be reimbursed for future surplus development. However, the instrument and subtleties of the loan and its consequent payments are highly insecure and absence of precision.

Determining and Allocating Surplus

Since a third party's risk insurance (risk transfer) is prohibited in Islam, any excess or profit gained from the risk share is prohibited by default. There is a distinction of perspective as to the nature and management of *Takaful*'s supporting surplus, as listed below:

Opinion 1: Since insurance risk transfer is prohibited, *Takaful* operators may not take advantage of any surfacing surplus underwriting. These must therefore be disseminated back to the contributors who guarantee each other together.

Opinion 2: The excess surface is the result of the extensive risk management of the *Takaful* operator. A surplus ratio should be distributed as a reward to the operator.

Opinion 3: The underwriting surplus does not benefit either the *Takaful* operator or the contributors as favourable underwriting experience is considered possible by Allah *(Subhanahu wa Taala)*. Therefore, in the real spirit of *Takaful*, all growing surpluses should be provided to charity.

Handling of Emergency Reserves

As an alternative of allocating whole, the underwriting surpluses as explained earlier, often the possibility of retaining a portion of the underwriting surplus is considered to counter the possibility of future demand for capital maintenance (Jaffer, *et al*., 2010).

FUTURE STRATEGIES CAN BE CONSIDERED FOR PLANNING AND IMPLEMENTATION

- There is a strong need to form a more globalized *Takaful* industry through grander connectivity across jurisdictions. *Takaful* operators need to give satisfactory importance on cross-border associations at regional and international levels. This will not only broaden the market but also more significantly bring disclosure to the different challenges to establish strength and competitiveness.
- Attempts towards rigorous branding for *Takaful* must be recruited and developed. Through intensive branding, we could improve the appeal of *Takaful* to the global community. The *Takaful* philosophies of mutuality, transparency, and assistance could be further popularized to lead exclusive products for the global community.
- Globally, *Shari'ah* must be the enabler of higher connections for *Takaful* markets. Research and training in the *Shari'ah* and *Shari'ah* -related problems and fields may be one strategy to proliferate the impact of the *Shari'ah* and *Takaful* in all markets that *Takaful* can serve. The critical shortage of human capacity cannot be overlooked at all.
- *Takaful*, like any business that deals with a huge number of customers, must be well-appointed with infrastructure that can aid accelerate processes and enhance precision to alleviate risks in these regions. It is not limited physical infrastructures such as IT, but also the regulatory framework must be more reinforced.
- *Takaful* should not be viewed simply as a business concern but should also locate areas where socio-economic support is absolutely required. Corporate Social Responsibility could use as a means of reaching out to assist in community development.
- Internationally accepted *Shari'ah* compliance standards
- Training on Islamic finance on a global scale from the core centers of expertise in Islamic finance
- Structure awareness for customer needs in insurance and *Takaful* (e.g. mortality gap, retirement, and pensions, longevity, etc.)
- Micro *Takaful* for the poor aspect of population
- Vigorous in new product development to achieve financial needs of modern days consumers – (innovative products: *Takaful* operators need to offer an exclusive value proposition to compete with conventional offerings)
- Effective dissemination channels – The distribution channels should be diversified to reach a greater segment of the market.
- Build re-*Takaful* capacity, which would cater to the unique principles of *Takaful* products and to provide essential technical capabilities in managing risks
- Develop *Takaful* talents particularly in the advisory and operations level
- Investment in research and development for market divisions, products structuring and differentiation that would advantage to *Takaful* operators in the long run (Hans De Cuyper, 2012).

CONCLUSION

Takaful industry in Malaysia is quite new when compared to other areas of the financial industry but it has experienced strong growth. Conversely, even though the strong growth, the infiltration rate for *Takaful* in Malaysia remained lesser and this shows that there is a momentous prospect for future growth. Malaysia has more experience in developing the *Takaful* industry. One advantage that makes *Takaful* industry in Malaysia to propagate positively is the participation of the Bank Negara Malaysia (the central bank of Malaysia) to offer a discrete regulatory body, completely responsible for the guideline and monitoring the *Takaful* industry. *Takaful* industry witnessed 30% growth in the last decade.

Despite the swiftly growing *Takaful* industry it is, still, encountered by several regulatory and technical challenges in Malaysia. These encounters range from competitive components, business model, and practices, altering customers' requirements and demands for better product selections. These challenges include the low level of awareness regarding the basic spirit and importance of this types of insurance products, low level of suitability of its products, insufficient regulations and ineffectual CG, scarcity of qualified workforces, absence of new products and limited funds undertakings for *Takaful* finances. *Takaful* industry tries to enhance competitiveness and to comply with *Shari'ah* demands, treating consumers, and *Takaful* companies equitably. Therefore, the *Takaful* Industry should comply with new trends in global economics to be competitors worldwide and be the only choice among customers among Muslims and non-Muslims.

Moreover, for the technical challenges, there are also regulatory challenges within the *Takaful* industry. Due to differences in *Shari'ah* interpretations, it is hard to create global standards or regulations in the *Takaful* industry. In the Malaysia context, the government is devoted to promote *Takaful* and to make Malaysia a *Takaful* hub in South-East Asia. This chapter provided a brief on the *Takaful* industry in Malaysia. Therefore, future and in-depth study in this area are required to overview and discussion.

CLASSIFICATIONS

JEL Classification: G22, G52, M41
KAUJIE Classification: E22, I44, L1

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