



## Legal Analysis of Types of Takaful Contracts in Malaysia and Iran

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### ABSTRACT

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#### Background

One of the most crucial insurance models is Takaful, based on Islamic jurisprudence, which has acquired a proper position within Islamic nations' insurance markets despite its shortage.

#### Materials and Methods

The research is in the method library that with the analysis of content and analysis and description while finding the necessary research and responding to the points and issues rose in work, the article was completed.

#### Ethical Considerations

Honesty and fidelity in writing the text have been observed.

#### Findings

Takaful and insurance have been compared long ago by many scholars worldwide. We want to focus on the concept and theoretical nature of Takaful. Since Takaful is a product for which Islamic contracts are used to shape its structure, it is inevitable to study its structure and respect stakeholders' interests to guarantee this product's sustainability in the insurance market. Concerning the importance of Takaful companies in Islamic insurances, the present paper attempts to expound some Takaful models (models of endowment and attorney), based on Shiite jurisprudential and Iranian legal principles types of Takaful models.

#### Conclusion

Takaful is a product of modern Islamic financial practice, and it is mostly a phenomenon of the traditional financial transactions that have developed over time.

#### Key words

Types of Takaful Insurance Models, Types of Takaful Companies, Attorney Model, Endowment Model, Pathology.

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## INTRODUCTION

### A. Motivation of Research

Set appropriate behavior and discipline in the insurance industry would create competition among insurers so that the importance of this issue is motivation research. So on the one hand in chosen because it can be said that because of the lack of competition among insurers and lack of new portfolios and by Iran in the areas of domestic and international business, and on the other one the obligations of legal regulations, rules and general principles be given a motive for choice.

### B. The Importance and Objectives of the Research

The passage of time and the insurance industry, and the overall development of societies in human progress in all areas of business, and acceptance of many business requirements like security in transactions are causing changes in the insurance portfolio. Developments in the insurance portfolio and patterns create the impression that there is a profound failure in the insurance industry of this country that the rules relating to it should change itself with the social transformation, especially in trade, and harmonize the needs of the modern insurance industry. Analytical understanding of the legal system and the Takaful according to Iranian Law and searching its principles, basics, and solutions that can meet modern societies' needs among the study's objectives were causing importance.

### C. Research Question

According to the subject of the article and in its pursuit of goals, answer the following question is the main research question will be: Takaful institutions (models of endowment and attorney) to what extent are the principles of Shiite jurisprudence and legal rules consistent in Iran?

### D. Hypothesis

Acceptance of Takaful in the Shiite jurisprudence based on the validity principle and the Iranian law system because of the conflict with *jus cogens* and Article 10 of the Civil Code and the validity principle in all contracts.

## MATERIALS AND METHODS

The research is in the method library that with the analysis of content and analysis and description while finding the necessary research and responding to the points and issues rose in work, the article was completed

## DISCUSSION

### A. Takaful Insurance in the Contemporary Age

As a model to cover risks, Takaful raised 30 years ago. In a period broad efforts were made in Islamic nations for an Islamic economy – second half of the 20<sup>th</sup> century – in financial economy area, insurance was highly paid attention after banking. Sunni jurists' jurisprudential ambiguities and

deficiencies on the common insurance model led to the introduction of a new model: Takaful [1].

In the 1960s and 1970s, insurance was the topic of many conferences and seminars. In this way, many Islamic insurance companies (Takaful) were established in the 1980s and 1990s in different Islamic nations and are now working successfully [2].

In Sudan, the Takaful industry was shaped in the end-1970s. Similar companies started their operation in the same period in the Middle East. In the same years, Islamic Arabian Insurance Company (IAAI) and Islamic Insurance Company were founded in UAE and Sudan. However, more time was needed to develop this model seriously [3].

In 1984, as a pioneer country, Malaysia devised and approved the first legal framework for Takaful. This Law created a proper ground for the Takaful model success in Malaysia and other Asian southeastern nations. The first official company started its operation in the Takaful field in 1985 [4].

In Pakistan, Takaful law was executed in 2005, and Kuwait – Pakistan Takaful Company started its operation in the same year. Currently, five Takaful companies are working in Pakistan. Laws on Takaful is also adopted in some Persian Gulf littoral states such as Bahrain and KSA.

Currently, hundreds of Takaful companies and reinsurance Takaful companies work in the Muslim world. Takaful insurance is

welcomed not only in Islamic nations but also in the USA, Australia, China, Russia, and several European countries.

Since the first Takaful Company's operation, this industry has experienced extraordinary growth. In the mid-2000s, a Takaful industry occurred by increasing new small and big players into the Takaful market. In 2003 and 2004, a study was conducted on Takaful industry size, and industry size was forecasted in 2015 based on received premiums and contributions. In 2002, the estimation of received premiums (or contributions) worldwide except that Iran was US\$1.3 billion. Total Takaful contributions in 2005 were over US\$2 billion. This industry has experienced 20% growth in past years, showing its high growth potentiality in the future [5].

According to World Takaful Report (2014), the Takaful industry is getting close to US\$12 billion by 19% of the growth rate. In this vein, the share of Persian Gulf littoral states and Eastern Asia nations are US\$6 billion and US\$2 billion, respectively. Among Persian Gulf littoral states and Eastern Asian countries, KSA and Malaysia have the highest Takaful product sales ranks. Big countries like Egypt, Libya, Bangladesh, and Brunei are adhering Takaful market [6].

Currently, over 150 Takaful companies are working in 40 countries. Likewise, ten reinsurance Takaful companies have ensured Takaful companies' success. Also, six

reinsurance companies in the world provide Islamic services to Takaful companies.

Two issues are emphasized as the most important reasons for Takaful insurance's rapid development. The first one is high demand by Sunnis insured for Takaful products. The second reason is the successful development of Islamic financial institutes and banks, which supply financial tools for capital and financial assets management. They play a vital strategic role in distributing and selling Takaful products [6].

Among the significant Takaful markets, one can point out five: Malaysia, Indonesia, KSA, UAE, and Bahrain as the best performers. These five countries have provided a good situation on Takaful insurance in market development and lawmaking [7].

### **1- Malaysia**

In 2007, the total premium – including Takaful – was estimated at US\$1.2 billion. In 2008, the life insurance market grew extraordinarily, and in 2007, premiums were growing 5.9%, which was more than the average of the past three years. The annual growth of Takaful premiums was 17% between 1998 through 2008. Malaysian Takaful market achieved over US\$3.024 billion in 2014 [8].

### **2- Indonesia**

In 2007, the total premium – including Takaful – was estimated at US\$6.9 billion. In early 2008, three exclusive Takaful agents and 32 insurers provided Takaful products in Indonesia. The volume of the Takaful market doubled to US\$150 million in 2007 from US\$56 million in 2006 and US\$964 million in 2014. It is expected to increase to US\$1.3 billion in 2017 [9].

### **3- Kingdom of Saudi Arabia (KSA)**

In 2007, the total premium – including Takaful – was estimated at US\$2.291 million, and Takaful constituted almost 20% of the market while this figure was only 4% for life insurance. KSA Takaful market achieved over US\$ 6.809 billion in 2015 [9].

### **4- UAE**

UAE insurance market is the biggest and most complicated one in the Middle East. Takaful is estimated as 2% of UAE total market, and it is expected that Takaful premiums achieve US\$ 2 billion in 2017 by starting the operation of more Takaful Companies and entrance of others to Takaful Market. It means annual 21% growth on average [10].

### **5- Bahrain**

Bahrain has the smallest economy among Persian Gulf littoral states. Based on initial statistics, total premiums in 2007 were US\$36.1 million. In recent years, premiums have increased 12% annually, particularly from 2015 till 2016 [11], and it is expected

that Takaful growth to US\$200 million in 2017. Such statistics show 15% annual growth and 15% annual growth and 15% annual growth, and 30% of the Takaful insurance market.

Based on the above points, Takaful has a great potentiality in Islamic nations. However, the future of Takaful will be influenced by external factors and variables such as the existence of more assets adaptable to religion and the high capacity of reinsurance Takaful [12].

## **B. Types of Takaful Companies**

Takaful companies are working in three ways throughout the world, as explained in summary below: TO, WTO and Bancatakaful.

### **1- Takaful Operators (TO)**

These are real Takaful Companies that work on Takaful exclusively. They are Takaful operators and are Takaful Funds with legal personality. In article 2 of Malaysian Law, Takaful operator introduces all companies and institute, and it is essential for Takaful operators due to their legal personality. Perhaps, this is due to companies' special laws that if they have natural personality, Malaysian Central Insurance or Negara Bank cannot monitor them [13].

In Iran, one can say that only stock companies and stock cooperatives have the right to perform insurance activities.

Therefore, all companies cannot operate Takaful in insurance industry.

### **2- The Window of Takaful Operators (WTO)**

Concerning Takaful companies, one can say that based on an article of Pakistani Takaful law Takaful Company is a registered insurer who is allowed to conduct Takaful commercial activities and traditional insurance ones. Although this item is only adopted in Pakistani Law, it exists in other countries with such insurance types. These companies are only a window toward Takaful, and one of their activities is Takaful. However, their difference with Bancatakaful is that in the latter, the main operation is banking, while in these kinds of companies, the main operation is insurance. In Iran, all insurance companies can use the potentiality of such operations. Out of total 308 Takaful companies, 93 are Takaful windows. However, these Takaful windows own only 2.5% of the total Takaful assets [11].

### **3- Bancatakaful**

As mentioned, these companies operate in banking activities, and due to their similarity with sharing contract managers, they go toward such operations. There are two reasons for their insurance permission: (1) in countries like Malaysia where insurance activities are covered by banking operations, the entrance of banks to such operations is expectable, (2) lower possibility of

borrowing Fund Donation from Takaful Company [14].

According to Takaful players, these activities are fruitful for four reasons: (1) convenience and easiness since for starting Takaful, relevant players should go to a particular bank and endorse there; (2) investment and high experiences and low risk in Takaful Fund; (3) more transparency in these companies than Type 1 and Type 2 companies and more monitor on them; (4) players' trust to banks. These companies are divided into three parts: (a) Bancatakaful with special meaning, (b) commission; (c) agent. In the first kind, the bank starts Takaful, which is real Bancatakaful. In the second kind, the bank is a mediator between Takaful Company, and this company does not want players to inform its existence while the bank provides its products in Takaful while the bank offers Takaful policies on its name. We know these Takaful companies are not so valid. In the third kind, the Takaful Company belongs to the bank and offers Takaful policies on its name [15].

### **C. Establishing Takaful Company**

To conclude the Takaful contract, a Takaful company should be established, and according to article 4 of Malaysian Takaful Law, it should be a commercial company (according to Law of companies in 1965) or a cooperative. It seems that, as mentioned before, in Iran, only stock and cooperative companies can obtain such licenses from the government and operates in the Takaful

field. Takaful's only problem is divided into two parts: (1) family Takaful (2) general commercial Takaful. By some arguments, one may be able to consider the latter as a commercial one. In contrast, family Takaful which looks for aims such as preparing sums for children's training, preparing sums for the early death of mortgagor and supporting job interests against the death of critical employees and so on, one can consider it as commercial operations. On the other hand, based on article 2(9) of commerce law, marine and non-marine insurance is considered as commercial and if we accept a broad description of this article, Takaful insurance can be also seen as commercial and any activity under Takaful insurance should also be seen as commercial; however, jurists do not accept such description of article 2(9) of commerce laws and see it as absolute since articles 2(3) and 2(7) have used generic preposition while the legislator doesn't use any generic preposition in article 2(9) and it's supposed absolute; Therefore any insurance activity that has no interest or is constituted based on noninterest goals is out of the article inclusion. It seems that family Takaful, translated by some as life insurance, is out of this article's subject. However, this reason is invalid because commercial or noncommercial belongs to the company, and the insurance company is commercial in our law system as mentioned before; Furthermore, the Malaysian legislator supposed them as commercial insurance according to article 3(1). So any Takaful company's activity is commercial.

This issue is seen in article 2(10) of Iranian commerce law. According to most jurists, by article 220 of commercial Law, those who have made profit-sharing contracts and have not registered should accept that they are commercial. We know that the profit-sharing act is one of two essential conditions in Takaful activities. Another point is that a Takaful company can perform both family Takaful and general commercial [16].

#### **D. Some of the Takaful Models**

##### **1- Endowment Model**

Pakistan Islamic Council represented this model in its report in 1992. In 2003, insurance and jurisprudence experts established another Takaful model named attorney-endowment. Finally, in 2005 the regulatory framework for this type of Takaful was approved in the shape of "Takaful Rules-2005" by the Securities and Exchange Commission of Pakistan (SECP). Naturally, to resolve ownership and other Islamic issues, the endowment was introduced in Pakistan as a legal entity that could own funds and enter into legal contracts. The basic description of this model of Takaful is that the direct relationship between participation and the company personality is breaking off [17].

Due to this model, Takaful Company creates an endowment personality by establishing endowment funds and participating in the Takaful contract with the endowment personality. In this contract, Takaful Company is the endowment fund

administrator. The endowment entity becomes the owner of all contributions and has the right to act as a legal entity as per its terms for investment, compensations, and dealing with surplus amounts [18].

One crucial question is why experts tried to create a new Takaful model while other kinds of Takaful models have their sellers? We think there are two arguments;

1- The Takaful Company creates the endowment fund because it wants to be that fund administrator based on Islamic endowment rules.

2- Some jurisprudence experts do not accept a gratuitous intention without any contracting form. There is no contracting form for participation's gratuitous intention in other Takaful models. The Takaful important principal is gratuitously intended, but there is no contracting form. When the intention of any participation is gratuitous act generally, it is illogical to obligate him/her to pay the premium installments. In this model, the intention of any participation is an endowment .

Based on this model, the participation shows his satisfaction to pay premiums. To this end, Takaful Company has to allocate a part of funds as called "seed money" or "ceding money" [19]. Based on articles 75 and 84 of Iranian civil Law, the donor may reserve to himself the administration, to say, the management of the property's affairs, either for his lifetime or for some specified period. Also, it is permissible for the donor to make

provision for a portion of the estates' profits to be devoted to the administrator's remuneration. Info remuneration for the administrator has been specified. The administrator is entitled to fair remuneration.

However, there are criticisms against the endowment of Takaful Companies' assets:

1. There are legal and jurisprudential doubts about the licensee endowment of the properties belonged to legal persons in the current laws, and its explanation does not fit in this space, and recent discussions in the Iranian Parliament are toward resolving this problem.

2. Assuming that endowment license is for legal persons' assets, the endowment is allowed when based on Statute; legal persons have the authority to acquire such assets. So to resolving this problem, only the legislator can allow it.

3. Takaful companies are commercial companies, and the endowment is a noncommercial practice incompatible with their nature. To resolve this problem, we can say that Joint Stock Company is commercial and can do noncommercial activities.

The aims of devising such models are:

- (1) Expanding financial synergy to the participation in a time of losses
- (2) Direct distribution of interests to members by endowment letter

(3) Granting some to charity funds by the approval of the jurisprudential committee of Takaful Company

The administrator (Takaful Company) can withdraw from fund endowment all expenses relating to issuing insurance policy and administrative activities. As Operator, the Takaful Company performs all functions necessary for the operations of the endowment against a commission to be deducted from the contributions of Participants and as sharing contract manager of the fund (entrepreneur), the Takaful Company manages the investment of excess funds into Islamic rules compliant investment avenues and has a right to the profit of the fund's investments at a fixed ratio. It can use the endowment fund assets in commercial activities in the form of a bailment contract.

It is famous in Takaful insurance after deducting the fees of the agent, Claims, Re-Takaful Contributions, Contingency Reserves, and Charities etc. the remaining amount in the pool is to be distributed among participants [20]; it does not go to shareholders; but as mentioned before, an endowment fund has legal personality, and any surplus is for it and must be distributed based on endowment deed. In Pakistan, it is stated in the Takaful Rules 2005 that any surplus should only be distributed amongst the policyholders. Under 10(2), it is stated that "the income of the shareholder's Fund shall not be determined concerning the surplus in the Takaful Fund." Furthermore,

under 14(5), the participants' exclusive entitlement towards the surplus is affirmed [21].

Nevertheless, Takaful Company may not be prevented from taking the surplus to recover the amount of the Islamic loan, a benevolent loan facility, in the case of a deficit. The former may also hold a portion of the surplus as a contingency reserve over and above the technical provisions. They may also invest the surplus (with the participants' permission) and, in exchange, may earn additional income either in the form of a percentage of the investment profit or a fixed fee [22].

## **2- Attorney in General Takaful**

The contracts involved in the Takaful models can generally be categorized into six, namely, al-Mudarabah, Musyarakah, Wadi'ahYadDhamanah, al- Wakalah, Waqf, and Ju'alah. However, only al- Wakalah (attorney) and al-Mudarabah (profit sharing contract) are the only two models that have been implemented so far in Malaysia [23]. Insurance companies act as organizational factors under the attorney model, namely insured. The attorney model is similar to Cooperative Fund, in which the executive player does not receive a predetermined salary from the insured's shares.

Cooperative risk-sharing occurs among participants, whereas the Takaful Operator earns a fee for services (Agent). The

Operator earns an upfront deductible fee and shares the profit of investments without sharing in underwriting results. However, in certain territories, Operators can share in surplus as an incentive for prudent underwriting [24].

Based on Constitution Law principles and basics, all percentages of dividing dividends, salaries, and installments of two profit-sharing contract and attorney models are determined at the beginning of concluding the contracts. Therefore, transparency exists for both parties. Participants pay premiums to Takaful Company, and these are based on donation and in this model, Takaful Company acts as an attorney. Now, whether Takaful Company is the attorney of each of participation or not? Takaful Fund has a legal personality, and Takaful Company is its attorney [24].

It has been found out that most Takaful operators prefer the Hybrid attorney or Modified attorney (principal-agent) model. The main reason is that the Central Bank of Malaysia sets the rule that Takaful operators can charge attorney fees (agent fees and administrative expenses) upfront to the participants (certificate holders) in the attorney contract. Moreover, an upper limit attorney fee is 40%, and hence, it is favorable to Takaful operators [23].

## **3- Attorney Model in Family Takaful**

In the family Takaful, the same attorney fee is paid to the insurance company for fund management.

In this model, the same points on Takaful Fund in general Takaful model. The difference is that the participants invest without donation for some of the payment, and therefore the Takaful Company is obliged to pay a percentage agreed by both parties. Donation Fund is called PSA, and Investment Fund is called PA. In the case of death or loss of participation, the total share is paid by PSA to his/her family [25].

This is the pure attorney model that the investment or savings portion will be credited to the PA account, and the donation will be credited into the PSA. Here, all the underwriting surplus and investment profits belong to the participant. The Takaful operator in the attorney model earns their income from the attorney fee. They do not share in the underwriting surplus. Interestingly, the attorney fee is charged two times. There are actually (1) attorney fees on contribution and (2) attorney fees on the investment value [25].

On the other hand, Bank Negara Malaysia (2010) mentions that a fixed upfront fee can be charged on the contributions based on the attorney contract for products based on contractual terms entered with the participants. The attorney fee covers commissions and management expenses incurred in Takaful funds management. It does not explicitly explain anything against charging the attorney fee more than once [23].

According to Iranian Law, this model is a hybrid of attorney and profit-sharing contracts. However, most of the papers emphasize that in the hybrid of attorney and sharing contract manager, modified the profit-sharing contract model by sharing the net underwriting surplus modified the profit-sharing contract model by sharing the net underwriting surplus, which means that the PSA is channeled to the participants and distributed to the Takaful operators as well. Any net underwriting surplus will be returned to the participants [26]. PSA Fund has a legal personality, and any surplus is for it and ought not to distribute among participations or Takaful Operator.

## **CONCLUSION**

As mentioned in the Takaful, we examined two contracts with our jurisprudence system and Iranian Law and concluded that some Takaful contracts, including endowment, may not be consistent with Iran's endowment provisions. However, according to the principle of necessity and validity of contracts, the other can be considered valid. So Takaful industry is increasing due to adaptability with public jurisprudence (for Sunnis) on the one hand and as a part of growing Islamic financial system on the other hand so that in addition to Islamic countries (Sunnis), other countries, including European and American ones are witnessing the establishment of various companies which provide Takaful products. For the same reason, it is has become too important in recent years to study this model

theoretically and functionally, and it has been less neglected in scientific forums in Islamic financial management and economy.

The most critical trait of Takaful insurance is its adaptability with both Shiite and Sunni attitudes. Takaful means a commitment for subsistence by both parties. Takaful insurance is used in six forms: profit-sharing contract, attorney, endowment, a mixture of attorney and profit-sharing contract (nameless contract), and a mixture of attorney and endowment and deposit contract. In an attorney contract, the insured should pay a premium as an attorney fee to the insurer to compensate. In this way, the insurer takes its fees from the premium, and the condition of not removing or insured is correct and be seen as well in the case of insured death. In an endowment, the insured pays a premium to a dedicated fund with legal person identity, and the incumbent takes its fees and pays compensations to one donor.

### **ETHICAL CONSIDERATION**

Authenticity of the texts, honesty and fidelity has been observed.

### **AUTHOR CONTRIBUTIONS**

Planning and writing of the manuscript was done solely by the author.

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### **CONFLICT OF INTEREST**

No conflict of interest was reported by the author.

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