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Takaful Unveiled: Tracing Its Roots, Rise and Roadblocks in South East Asia and the Gulf Cooperation Council

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ABSTRACT

This paper examines the historical evolution, operational principles, and contemporary development of takaful as an Islamic alternative to conventional insurance. It highlights how the pre-Islamic Arab practices and customs contribute to the modern institutionalisation of takaful. The paper reviews the foundational principles of ta'awun (mutual assistance) and tabarru' (voluntary contribution) and analyses the main operational models, including mudharabah and wakalah. Focusing on South East Asia (SEA) and the Gulf Cooperation Council (GCC), it outlines regional trajectories and disparities in market maturity. The study further identifies key challenges, including limited Shariah-compliant investment options, regulatory fragmentation, governance conflicts, and low public awareness, that constrain industry growth. It adopts a qualitative comparative analysis to examine the history, development, and challenges of the takaful industry in SEA and the GCC. The study concludes by emphasising the need for model refinement, strengthened regulatory frameworks, and enhanced financial literacy to advance the sustainability and competitiveness of the global takaful sector.

Keywords: Takaful, Islamic Finance, Conventional Insurance, History, Challenges

1. INTRODUCTION

Unfortunate events and perils are, for the most part, unpredictable and unknown until they materialise. Due to the risks and uncertainties, insurance coverage is sought to ease the burden and offer peace of mind. The insurance mechanism primarily operates on risk management and protection principles. Insurance companies offer protection against financial loss which is caused by unexpected events (Maf'ula & Mi'raj,

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2022). To enable the insurance companies to provide the protection, individuals or business enterprises (i.e. insured or policyholders) pay out contributions (i.e. premiums) and transfer the risks to the insurance companies (i.e. insurer) who will compensate the insured in the event of loss from peril using the pool of contributions from a large number of policyholders (Qureshi, 2011). This indicates that the insurance contract is an exchange of money now for money payable in the future, contingent on the occurrence of certain events or risks (Nahar, 2015). Furthermore, the amount of contribution paid by policyholders is very small compared to the amount of protection offered by insurance companies (Qureshi, 2011).

The concept of protection embedded in insurance by itself is not something which is against Islamic principles, as shown in the hadith of Prophet Muhammad (s.a.w), in which he told a Bedouin Arab who intentionally left his camel untied to the will of Allah (s.w.t), “Tie the camel and then leave it to the will of Allah”. This implies that Islam encourages its believers to protect themselves as well as their assets. Yet, the mechanism used in conventional insurance to provide protection is clearly prohibited in Islam due to the presence of *riba* (interest), *gharar* (uncertainty), and *maysir* (ambiguity) in the contract (Ansari, 2022). Thus, this paved the way for the introduction and development of Islamic insurance, known as takaful, an alternative to conventional insurance.

This paper aims to unveil the history and principles of takaful, discuss available takaful models, and examine its development, focusing on two regions: South East Asia (SEA) and the Gulf Cooperation Council (GCC). In addition, this paper explores the obstacles in the takaful industry which hinder its growth and success. The organisation of this paper is as follows: the subsequent section presents a literature review of the history, principles, models, and development of takaful in the SEA and GCC. This is followed by a research methodology section, a discussion of obstacles in the takaful industry, and, finally, the conclusion section.

2. LITERATURE REVIEW

2.1 History and Principles of Takaful

Takaful is derived from the Arabic word ‘*kafl*’, which means guarantee (Maf’ula & Mi’raj, 2022). The history of takaful can be traced back to the old Arab tradition known as *aqilah*, where an individual or a group of people contributed money (i.e. *diyyah*) to compensate the tribe for unintentional injury or death of a member by paying a sum of money to the victim’s family (Muhamat & McIver, 2019). The takaful system can also be linked to the pre-Islamic Arab tribal practices in risk-sharing during dangerous trade journeys, *hilf* (confederation) and *daman al tarik* (surety); social insurance such as *diyyah, aqilah*, and *fidyah* (ransom for prisoners of war); as well as *dawania*, which refers to mutual indemnification among officers working in the same department during the rule of Umar Ibn Al Khattab, the second caliph (Qureshi, 2011). Thus, takaful is not a newfound concept in Islam, and this is not surprising because one of the primary objectives of Islamic law or shariah is to ensure all individuals have access to certain types of protection and benefits which will help in their well-being, safety, and avoidance of harm (Alam et al., 2023).

There are several verses in the Holy Qur'an and hadith of the Prophet Muhammad (s.a.w.) that lay the foundation for takaful (Nazir & Noor, 2018). It is stated in the Qur'an, "...and cooperate (*ta'awun*) in righteousness (*birr*) and piety (*taqwa*), but do not cooperate in sin and aggression. And fear Allah; indeed, Allah is severe in penalty (Al-Maidah [5]:2). In another verse "The believers are but brothers, so make settlement between your brothers. And fear Allah that you may receive mercy" (Hujurat [49]:10). Meanwhile, in the hadith of the Prophet Muhammad (s.a.w), he said "A Muslim should be strong financially so that when he dies, his family will fulfil their needs from his wealth instead of leaving them in poverty to beg for alms from people". The above verses from the Qur'an and hadith emphasise cooperation, brotherhood, and financial protection.

Takaful evolved from a merely customary practice to a form of essential protection and became commercially driven in the early nineteenth century, and Ibn Abidin, a scholar of the Hanafi school of thought, is regarded as the pioneer in deliberating the main aspects of takaful, including the legal identity of takaful operators and the relevant contracts (Muhamat & McIver, 2019). The recognition of a form of insurance that complies with Islamic principles and is based on mutual protection was again emphasised in 1976 during the first international conference on Islamic economics in Makkah, Saudi Arabia (Sadeghi, 2010). This was followed by the establishment of Sudan's first takaful company in 1979 (Al-Amri & Hossain, 2017). Later, in 1985, the Grand Council of Islamic intellectuals in Makkah, Saudi Arabia, approved the takaful structure as a substitute for conventional insurance, a system based on cooperation and mutual assistance (Saeed, 2019). It is also believed that the emergence of Islamic revivalism, which refers to efforts to return Islam to its original, pure form, has played a part in igniting the development and expansion of Islamic economics, including Islamic banking, Islamic insurance, and the Islamic capital market (Nahar, 2015).

The National Shariah Council of the Indonesian Ulama Council (MUI) explains that Islamic insurance comes from the Arabic words *ta'min*, takaful and *tadhamun*, which implies an effort to protect and help each other through the investment of assets or *tabarru'*, which will provide returns that will be used to face certain risks that are stated in a shariah-compliant contract (Maf'ula & Mi'raj, 2022). According to Hassan et al. (2020), the Malaysian Takaful Act,1984 (Part 1, Section 2) provides the first juridical definition of takaful, which is "a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby participants mutually agree to contribute for that purpose". Another globally accepted definition of takaful is given in Shariah Standards by Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI, 2015, p.678) as "a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable. A process, thus initiated, involves payment of contributions as donations and leads to the establishment of an insurance fund that enjoys the status of a legal entity and has independent financial liability."

Takaful is therefore based on the principles of mutual assistance (*ta'awun*) and voluntary contribution or donation (*tabarru'*), where the risk is voluntarily assumed by the group collectively (Hemrit, 2020). Both concepts of *ta'awun* and *tabarru'* symbolise the Islamic social relationship among participants in takaful, who voluntarily relinquish individual rights over the contributions paid to help and guarantee each other for the mutual benefit of all participants (Nahar, 2015). *Tabarru'* is an important element in takaful, which refers to a paid contribution in favour of helping other participants who suffer losses and, thus, promotes

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joint guarantee (Maf'ula & Mi'raj, 2022). In addition, *tabarru'* essentially differentiates takaful from conventional insurance as the latter operates on a risk transfer basis, while the former encourages risk sharing (Muhamat & McIver, 2019). This is indeed one of the major distinctions between takaful and conventional insurance. As a substitute for conventional insurance, takaful promotes moral virtue by supporting those in need or having difficulties (Nazir & Noor, 2018). In the takaful system, individual risk exposures are pooled on an indemnity basis, without predetermined rates of interest (*riba*) or profit margins, except for the ex-ante profit sharing of surplus arising from pooled contributions, which is agreed upon between shareholders and policyholders (Kader et al., 2010). At least three aspects of mutuality are represented in takaful: helping one another, protecting each other from loss, and taking responsibility for each other (Dahnoun & Alqudwa, 2018).

Takaful signifies the combination of a shariah-compliant mutual structure for participants (i.e., policyholders) with shariah-compliant business management by takaful operators (Archer et al., 2012). The operators are responsible for managing the premiums, which are segregated into participants' and t*abarru'* accounts, and investing the funds to earn a profit. They also compensate participants in the event of unfortunate events, as provided in the contracts (Ha et al., 2018). Most importantly, to eliminate the forbidden elements of interest, uncertainty, and ambiguity, Islamic law offers an alternative to the risk-transfer mechanism in conventional insurance by sharing risk among policyholders in takaful and restricting investment to only shariah-compliant businesses (Ansari, 2022). The investment fund consists of the retained reserves, accumulated surplus, and provisions, which the shareholders manage on behalf of the policyholders (Hemrit, 2020).

As commercial entities, some may view the business operations of takaful companies as a common business area that differs little from conventional insurance (Alshammari & Altarturi, 2021). Prudence and meticulous consideration should be exercised here, as the two entities differ in significant ways. The first major difference is the conceptual basis of takaful, which does not involve exchanging or trading risks for a fee (Alam et al., 2023). In takaful, the premiums paid by the participants are regarded as voluntary contributions (*tabarru'*), which will be pooled and utilised later to compensate any participant who suffers losses due to unfortunate events according to the agreement. In this regard, the takaful company neither sells the risk nor takes it on itself; rather, it acts as the manager of the *tabarru'* fund on behalf of the participants, and the risk is indeed distributed among the participants themselves (Alam et al., 2023). On the other hand, in conventional insurance, the risk is transferred from the insured to the insurance company (Nazarov & Dhiraj, 2019). The difference is clearly elaborated below by Khan (2015):

> "… conventional insurance is primarily a contract of risk transfer as it transfers the risk of loss insured from the policyholder to an insurance company against an agreed amount of premium. The insurance company owns the premiums written and any surplus or deficit generated by the insurance operation. Policyholders have the right to claim only under the conditions specified in the insurance policy. Islamic insurance, on the other hand, is a contract of risk sharing among policyholders. The insurance company, referred to as the takaful operator (TO), merely manages the business's affairs in exchange for various financial incentives. Premiums collected by the TOs are, therefore, in principle, owned by the policyholders as a group, and so is any surplus or deficit from the insurance operation. Participants, in this case, insure one another on a non-profit

basis and make contributions to the takaful on the basis of *tabarru'* (conditional and irrevocable donation), which is a noncommutative contract." (p.135)

Second, according to Alhalboni et al. (2022), IFIs, such as Islamic banks, sukuk (Islamic bonds), and Islamic mutual funds, employ organisational structures similar to those of their conventional counterparts. However, takaful differs significantly from conventional insurance in its institutional form, as it incorporates a mutual structure due to the prohibition on *gharar* (uncertainty) in transactions. *Gharar* contaminates conventional insurance in four forms, according to Ismail (1997). The uncertainty could be linked to the outcome, the existence, the results from the exchange, and the contract period itself. Nazir & Noor (2018) also claim that the terms in insurance contracts involve uncertainty because there is no certainty as to when the loss will occur or how much will be payable to the insured if it does. In takaful, the uncertainty level is reduced to an acceptable level according to Islamic law due to the fact that the participants' contributions are donations (*tabarru'*) and not a binding commitment to alleviate the loss suffered by any participant.

Third, in addition to *gharar*, conventional insurance also involves *riba* (interest) and *maysir* (ambiguity). Therefore, it is essential to ensure that Islamic insurance, as offered in takaful, eliminates all impermissible elements by providing an alternative to the traditional risk-transfer mechanism, in which the risk is shared among policyholders rather than transferred to the insurance company. Takaful companies should consider only shariah-compliant investments (Ansari, 2022). Nahar (2015) states that *riba* in insurance exists in various forms and situations, such as *riba al-buyu'*, which is in trade or sales contract; *riba al-fadl'*, which refers to uneven exchange value related to a small premium paid in return for a bigger coverage value; *riba al-nasiah*, which occurs because the claim payments are deferred only to when the risks occur; and riba in interest-bearing investment instruments such as conventional bonds and non-Islamic deposits. Meanwhile, *maysir* (ambiguity), or essentially gambling, exists in conventional insurance and is closely related to the element of *gharar*, as the profitability of insurance companies largely depends on the claims level, which is definitely beyond their control (Nahar, 2015).

Fourth, another notable conceptual difference is that in takaful, there are at least four Islamic concepts which exist, namely *ta'awun* (mutual help), *tabarru'at* (willingly relinquishing individual rights over the contributions paid for collective benefits), *mudharabah* (profit sharing), and *wakalah* (agency) (Nahar, 2015). These concepts are not present in conventional insurance. Finally, the spirit of brotherhood in takaful means that participants pay contributions to help and care for one another in the event of losses. In this regard, the participants will share any profit and loss, which should not affect the takaful operators (Nazir & Noor, 2018). On the contrary, conventional insurance bets on the premiums collected from the policyholders because if the expected loss never occurs, the policyholders lose the amount paid. On the other hand, if the expected loss occurs, the insurance company incurs a substantial loss, typically exceeding the premium collected (Nazir & Noor, 2018).

2.2 Takaful Models

According to Kader et al. (2010), three main takaful models are commonly used: *mudharabah*, *wakalah*, and *musharakah*. Other models mentioned include hybrid models, which combine two or more takaful variants (Muhamat & McIver, 2019; Orlando & Bace, 2021), and *waqf* models (Nazir & Noor, 2018; Muhamat & McIver, 2019; Orlando & Bace, 2021). The *mudharabah* model, at its essence, is a basis

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for sharing profit and loss between the takaful operator and the policyholders (Qureshi, 2011). In IFSB 8, the *mudharabah* model is defined by IFSB (2009) as:

> "a contract between the capital provider and a skilled entrepreneur whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur as the *mudharib* (or labour provider). Profits generated by that enterprise or activity are shared in accordance with the terms of the *mudharabah* agreement, while losses are to be borne solely by the capital provider unless they are due to the *mudharib*'s misconduct, negligence or breach of contracted terms" (p.26).

Therefore, the *mudharabah*-based takaful contract is an Islamic financial partnership contract in which the investor provides funds to be invested by the fund manager and shares the profits with the manager (mudharib). However, only the investor (*rab-al-mal* or capital provider) bears the risk (Orlando & Bace, 2021). The profit-sharing ratio must be determined ex ante with the investor (Kader et al., 2010). In determining the ratio, the risk borne solely by the takaful participants must be taken into consideration. Once the ratio is agreed upon, no one can change it without prior notice (Hemrit, 2020). As takaful operators have significant responsibilities under the *mudharabah* model, it is crucial that they adhere to the requirements and invest wisely to avoid unsafe and risky business practices (Nazir & Noor, 2018). In this model, the aspects of governance and corporate accountability are of utmost importance as the contract clearly indicates that all risks and actual losses will be borne solely by the takaful participants who entrust the management of their funds to the takaful operators. Yet, from the takaful operators' perspective, they are also pressured to ensure that the costs incurred in managing the takaful funds are less than the profit and/or underwriting surplus they receive.

Another model is *wakalah*, which is more popular in GCC (Ansari, 2022). In this model, the mechanism operates similarly to an agency contract, whereby the policyholder delegates the right to a venture to the agent, who is remunerated based on their knowledge, skills, and abilities (Ansari, 2022). IFSB (2009, p.27) defines *wakalah* as "an agency contract where the takaful participants (as principal) appoint the takaful operator (as agent) to carry out the underwriting and investment activities on their behalf". Therefore, the agent (takaful operator) acts on behalf of all takaful participants (principals) and assumes responsibility for decisions regarding investments, cash flows, and assets (Hemrit, 2020). Here, a clear principal-agent relationship exists between the takaful participants and the takaful operator as *wakeel.* Similar to the *mudharabah* model, the takaful operators in the *wakalah* model will not directly share the risk borne by the takaful fund. They will also not receive any share of investment profit or surplus, except for a performance-related fee as an additional incentive (IFSB, 2009). This is an important mechanism that will encourage takaful operators to manage funds effectively and ultimately align the interests of both the principal and the agent closely. On the other hand, the *musharakah* model typically refers to a financing mode that allows a capital user to enter into an agreement with a secondary capital supplier (e.g., a reinsurer) and share profits or losses based on their capital contributions (Kader et al., 2010).

The hybrid model normally combines the *mudharabah* and the *wakalah* models. In this hybrid model, underwriting activities will adopt the *wakalah* contract, while investment activities will employ the *mudharabah* contract (IFSB, 2009). Thus, the takaful operators are entitled to investment profits based on the agreed profit-sharing ratio and *wakalah* fee. There is also a combination of the *wakalah* model with the *waqf* fund. This is an attempt to address concerns with the original *wakalah* model and to redistribute wealth among Muslims (Ansari, 2022).

2.3 Development of Takaful in the Gulf Cooperative Council (GCC) and South East Asia (SEA)

The takaful market has shown impressive growth not only in the Muslims dominated countries but also in countries with Muslim minorities. According to the Takaful Global Market Report 2024, the market is also expected to continue growing at a steady rate of 11.8% to reach $51.75 billion by 2028 (The Business Research Company, 2024). The report also elaborates on the factors contributing to the development of the takaful market, which include the expansion of Islamic finance, improved awareness towards Islamic insurance, support from the government and effective regulation, partnerships with Islamic banks, as well as increasing ethical and social responsibilities (The Business Research Company, 2024). Other contributory factors mentioned in the report are the development and diversification of takaful products, financial planning strategies, the increase in wealth of the Muslim population, and the focus on standardisation efforts through international collaboration. In addition, the interest shown by the main players in the conventional insurance sector towards takaful sparks the international growth of the Islamic alternative to insurance, whereby conventional insurers and reinsurers begin to introduce takaful subsidiaries or takaful windows (Alokla et al., 2022).

The increasing importance and growth of the takaful sector are also evident in the development of takaful-related standards. For example, of the six latest standards issued by IFSB, four are dedicated to takaful, namely IFSB 25: Disclosures to Promote Transparency and Market Discipline for Takaful / Retakaful Undertakings (adopted December 2020); IFSB 27: Core Principles for Islamic Finance Regulation [Takaful Segment] (adopted December 2022); IFSB 28: Revised Solvency Requirements for Takaful / Retakaful Undertakings (adopted December 2022); and IFSB 29: Conduct of Business Supervision for Takaful Undertakings (adopted December 2023). The first standard issued by the IFSB solely for takaful was in 2009, specifically IFSB 8: Guiding Principles on Governance for Takaful (Islamic Insurance) Undertakings. Interestingly, IFSB decided that governance would be the first concern it needed to address for the takaful sector, implying both its importance and, perhaps, the most critical issue for the takaful sector at the time. Previously, in 2006, IFSB already issued IFSB 3: Guiding Principles on Corporate Governance for Institutions offering only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds). However, the uniqueness and distinct characteristics of takaful companies are believed to be very significant, which led to the issuance of IFSB 8, which specifically covers their governance.

The growth and increasing interest in the takaful industry are also evident in the GCC. The GCC is viewed as a niche region in the Middle East, operating under a dual system that allows both conventional and Islamic insurance, except in Saudi Arabia, where only Islamic insurance is permitted (Alshammari & Altarturi, 2021). Alokla et al. (2022) suggest that the positive trends in the GCC are linked to the economic growth of oil-exporting countries, particularly following the recovery in oil prices and the initiation of large-scale infrastructure projects in many GCC countries. They also believe that the potential takaful market exists in the GCC due to the large Muslim populations, including expatriate communities. The insurance industry regulations in GCC, including takaful, are under the direct authority and supervision of

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the respective countries' regulatory authorities, namely the Central Bank of the UAE, the Central Bank of Saudi Arabia, Qatar Central Bank, Central Bank of Bahrain, Insurance Regulatory Unit of Kuwait, and the Capital Market Authority of Oman (Alshammari & Altarturi, 2021).

Moreover, Alshammari and Altarturi (2021) report that regulators in countries such as Oman, Qatar, and Bahrain give special consideration to the specific nature of takaful business and provide specific requirements for operators, except in Saudi Arabia, which does not have a dual system. The authors provide examples of the specific requirements imposed by Oman, Qatar, and Bahrain, such as that only licensed providers may use the terms "takaful" and "Islamic insurance", prospective clients should be made aware of the distinctions between takaful and conventional insurance, and marketing materials or new takaful products should be approved by the Shariah Board before being made public.

According to Nazir & Noor (2018), the first takaful company in Saudi Arabia was Weqaya Takaful Insurance and Reinsurance Company, which was established in 1979. This is the second takaful company in the world, following the establishment of the first one in Sudan. The history of insurance in the kingdom dates back to before 1974, when foreign companies began operating. The first insurance company in Saudi Arabia was established in 1974, named the Red Sea (Alshammari et al., 2018). In this regard, it is noticeable that the takaful market in Saudi Arabia did not take long to launch after the introduction of conventional insurance. This is because in 1977, a fatwa was issued on the permissibility of cooperative insurance based on the *tabarru'* concept rather than conventional insurance, marking a significant development in Saudi Arabia's insurance industry (Alshammari et al., 2018). In 2015, it was reported that Saudi takaful companies contributed to 55 per cent of global gross takaful contributions, while other GCC countries accounted for around 10 per cent (Kantakji et al., 2020). Until now, only Islamic insurance companies and cooperatives have been allowed to operate in Saudi Arabia, making the country the largest takaful market globally. Two government entities are responsible for regulating takaful in the country: the Central Bank of Saudi Arabia, also known as the Saudi Arabian Monetary Authority (SAMA), and the Capital Market Authority of Saudi Arabia (CMA) (Orlando & Bace, 2021).

The takaful market in Oman is relatively new, as the country's earliest two takaful companies, Al Madina Takaful and Takaful Oman, began their operations only in 2014. In 2015, takaful contributions accounted for only 9 per cent of the overall insurance market (Alshammari et al., 2018). Meanwhile, the first insurance company in the country, the American Life Insurance Company (ALICO), a foreign company, began operations in 1971 (Alshammari et al., 2018). This shows that the awareness of Islamic insurance in Oman was minimal until recently. ALICO is also the first insurance company in Qatar, having entered the market in 1962, two years before Qatar Insurance Company was established in 1964. Meanwhile, the first takaful company, Qatar Islamic Insurance Company, did not appear until 1995 (Alshammari et al., 2018). It takes 33 years for a takaful company to be introduced to the Qatar insurance market, while in Oman, the waiting period is 43 years. This indicates that awareness of Islamic insurance at the time was limited, despite takaful companies having operated in the region for decades.

In the United Arab Emirates (UAE), the gross subscription of takaful recorded a growth of 0.51 per cent in 2021, amounting to $1.18 billion, which was contributed mainly by health insurance (43.6 per cent) as well as assets and liability insurance (38.3 per cent) (The Business Research Company, 2024). The takaful market in the UAE was also strengthened following the merger of two major players in July 2022, namely National Takaful Company and Dar Al Takaful, which facilitated technological advancements and product offerings (The Business Research Company, 2024). The insurance industry in the country, however, started as early as 1959, with the introduction of an Indian company, Oriental Insurance, followed by New India Insurance in 1962 (Alshammari et al., 2018). The insurance industry in the UAE underwent a transformation with the introduction of the Insurance Authority, established under Federal Law No. 6 of 2007, a legal entity with financial and administrative independence. This is believed to be one of the reasons supporting the growth of the insurance market in the UAE, which is expected to become one of the largest globally (Alshammari et al., 2018).

In South East Asia, it is apparent that Malaysia is leading the takaful market in the region. In fact, Malaysia is the third-largest takaful market in the world, with a thriving Islamic finance ecosystem from the Islamic banks, shariah-compliant businesses, and halal industries that rely on takaful products (Alias et al., 2023). The special report, titled Malaysia Takaful Dashboard 2024, states that increasing awareness of medical and weather-event coverage in the country will propel takaful growth (Fitch Ratings, 2024). The takaful industry in Malaysia is also fully supported by the government, as it has been regulated since 1984. Until recently, Malaysia was the only country with takaful-specific legislation, introduced through the Takaful Act 1984 (Alokla et al., 2022). This was further enhanced by the enactment of the Islamic Financial Services Act 2013 (IFSA 2013) (Wan Daud et al., 2017) and the issuance of the Risk-based Capital Takaful framework in 2014 by the Central Bank of Malaysia to create an effective risk management framework according to the size and the degree of risk, promote innovation, increase competitiveness, and enhance transparency (Dahlan & Palil, 2018).

The growth of takaful in Malaysia is largely attributed to family takaful. For instance, it was reported that family takaful grew by 46.7 per cent in the first half of 2021, amid the COVID-19 pandemic, compared with only 7.8 per cent in 2020 (Alias et al., 2023). Meanwhile, general takaful also showed a promising increase of 13.5 per cent in the same period, compared to only 4.61 per cent in the previous year. Regarding the takaful model, the Central Bank of Malaysia grants takaful operators leeway to choose the appropriate model from *mudharabah*, *wakalah, waqf*, or a hybrid (Alias et al., 2023). This flexibility allows the operators to determine the best model for their business objectives and operations.

In the neighbouring country, Indonesia, the takaful industry began in 1994 with the establishment of PT Asuransi Takaful Indonesia on 25 August 1994, following the founding of the first Islamic bank in the country, Bank Muamalat Indonesia, in 1992 (Maf'ula & Mi'raj, 2022). With the country's largest Muslim population, takaful offers a promising future and growth in the Indonesian market. Yet, Maksum (2011) previously reported that the takaful industry in Indonesia faced severe challenges from a regulatory perspective, as it failed to address the distinct characteristics of takaful due to a shallow understanding among regulators, takaful companies, and even the Shariah Board. This, however, is partly resolved with the introduction of Act No. 40, 2014. Although this act encompasses both conventional and Islamic insurance, it introduces significant changes to Islamic insurance in particular, as there was no specific law governing Islamic insurance in Indonesia prior to this (Maf'ula & Mi'raj, 2022). There is also active participation from the National Shariah Board of Indonesia and the Ulama Council, although their involvement is limited due to the absence of legal enforcement of the council's fatawa (Maf'ula & Mi'raj, 2022).

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In summary, the literature highlights that takaful is firmly rooted in the Islamic principles of mutual assistance (*ta'awun*) and voluntary contribution or donation (*tabarru'*), which distinguish it fundamentally from conventional insurance. The evolution of three main models of takaful, namely *mudharabah, wakalah*, and *musharakah*, to include other models such as hybrid and *waqf* models, reflects the ongoing efforts by various players to strengthen the industry. The development of the takaful industry in the GCC and SEA further demonstrates how regulatory frameworks, market maturity, and socio-economic factors influence it. However, it also reveals inherent tensions between Islamic principles and operational realities, thereby setting the stage for a critical examination of the key obstacles and challenges that continue to constrain the takaful industry's future.

3. RESEARCH METHODOLOGY

This study adopts a qualitative comparative analysis to examine the history, development and challenges of the takaful industry in SEA and the GCC. The comparative method is appropriate for identifying regional similarities and differences in historical evolution, regulatory frameworks, and operational challenges. This provides a holistic understanding of the takaful industry in these two prominent Islamic financial hubs and offers valuable insights into the obstacles in different Islamic finance jurisdictions.

4. FINDINGS AND DISCUSSION: OBSTACLES IN TAKAFUL INDUSTRY

The takaful industry faces many challenges worldwide. Kader et al. (2010) enumerate several obstacles in the industry, including the lack of Islamic investment opportunities and market liquidity for Islamic securities, limited reinsurance capacity, and deficiencies in financial regulation and corporate governance in Islamic jurisdictions. Prior research has documented that takaful companies are less efficient than their conventional counterparts (Ismail et al., 2011; Kader et al., 2014; Karbhari et al., 2018). Using a sample of 19 takaful companies in Malaysia from 2004 to 2009, Ismail et al. (2011) found that takaful companies were less technically and scale-efficient than conventional insurance companies. In addition to technical and scale inefficiencies, Karbhari et al. (2018) also identified operational inefficiencies in their sample of 137 takaful companies across 21 countries, spanning the period from 2002 to 2013. This was previously noted by Kader et al. (2014), who identified cost inefficiencies, in addition to operational inefficiencies, in non-life takaful companies. Therefore, based on prior studies, takaful companies are struggling with technical, scale, operational, and cost inefficiencies, which could distort their development and future success. Several reasons are offered by the researchers that cause the inefficiencies, which include organisational constraints, managerial lethargy, operational lack of concern on low economies of scale and scope, ineffectiveness in managing agency issues such as political issues, as well as poor investment performance due to weak portfolio structure (Alhalboni et al., 2022).

Besides the inefficiencies mentioned above, the takaful industry also faces solvency issues, which have led to the demise of several companies. High *wakalah* fees, poor investment income, deficits in participants' funds, inefficiencies, and fragmented regulation are among the possible reasons for the collapses (Alokla et al., 2022). Indeed, the deficit in policyholders' funds is becoming more frequent, thereby increasing the accumulated deficit and eventually weakening the financial strength of takaful companies, thereby increasing their riskiness (Alokla et al., 2022).

Moreover, many scholars brought to the surface the conflict of interest in the takaful industry. For example, Sham et al. (2012) highlighted the conflict of interest between shareholders and policyholders arising from the commercialisation of the takaful business and suggested modified models of either *mudharabah* or *wakalah* to ensure reasonable profits are available to benefit shareholders. This conflict was previously highlighted by Vishwanathan and Cummins (2003), who elaborated on two major agency issues due to the coexistence of stock and mutual organisational forms in the insurance industry, which we can relate to takaful. The first conflict of interest is between the company's shareholders and the policyholders, while the second exists between the shareholders and the managers. The former creates a conflict because shareholders always aim to maximise the company's market value, while policyholders aim to reduce their premiums and the risk of unpaid claims (Alhalboni et al., 2022). On the other hand, in the latter, the managers' goal is to maximise their benefits from compensations and perquisites. The conflicts of interest need to be resolved to ensure the survival of takaful companies and to ensure fair benefits not only for policyholders but also for shareholders, managers, and other stakeholders.

Muhamat and McIver (2019) also highlight the conflict faced by takaful operators due to the dual principals of shareholders and takaful participants. As agents, businesses need to serve their shareholders as their sole principal, but takaful operators face conflicting roles in satisfying two different principals with distinct objectives and needs. The takaful operators, as agents, must therefore align their interests with those of the principals while serving them without bias, and at the same time, cannot disregard their social responsibility (Muhamat & McIver, 2019).

Regarding the takaful model, several practical issues and Shariah concerns are highlighted, which are part of the broader challenges in the industry. For example, Wahab et al. (2007) raised the clash of the *tabarru'* or donation concept with profit sharing in the *mudharabah* model. They claimed that takaful is built on the concept of *ta'awun* or cooperation, in which the participants voluntarily contribute to the takaful fund without expecting anything in return. Thus, the donation and profit sharing do not appear to be compatible within the same contract. On the other hand, in the *wakalah* model, there is a Shariah concern regarding donations to the risk fund (Ansari, 2022). Specifically, there are issues of inheritance and zakat related to the fund, as it is the participants' right and must be returned to them if it is not fully utilised. This is where the waqf model is suitable for integration to resolve the issues (Wahab et al., 2007; Rahman & Ahmad, 2011). Additionally, under the *mudharabah* and *wakalah* models, some contributions should be invested in shariah-compliant investments. However, there is doubt whether fund managers actually invest in projects or businesses that fully comply with Shariah principles (Qureshi, 2011).

In Malaysia, the leading takaful market in South East Asia, there are also hurdles to overcome, such as inflation, market volatility, the weakening of the ringgit, and the end of tax exemptions on passenger cars (Fitch Ratings, 2024). In the country, takaful accounted for 32 per cent of the insurance industry in 2023 (Fitch Ratings, 2024), which was significantly larger than the 9.82 per cent reported for the UAE in 2021 (The Business Research Company, 2024). The takaful industry in Malaysia was significantly impacted by the frequent floods in 2023, which increased the general takaful claim ratio to 64.3 per cent, up from 60 per cent in 2022 (Fitch Ratings, 2024). This resulted in underwriting losses for the general

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takaful, while the family takaful suffered a decreasing underwriting margin due to medical inflation. Still, the Fitch Ratings report offers promising prospects for takaful in Malaysia, following the Malaysian Central Bank's efforts to introduce a regulatory framework for digital insurers and takaful operators (DITO) by the end of the first half of 2024.

Meanwhile, in Indonesia, Maf'ula & Mi'raj (2022) claim that, in addition to the regulation, the biggest challenge in the country is the low takaful market penetration, with an average rate of only 0.103 per cent, despite the Muslim population being the largest. They argue that this low penetration is largely due to shockingly low awareness or literacy rates for takaful, which stood at only 3.99 per cent in 2019, compared with 18.64 per cent for conventional insurance. Therefore, the authors believe that for the takaful market in Indonesia to thrive, the following obstacles must be overcome. First, there are problems that come with a poor regulatory structure. An all-encompassing regulatory structure is necessary to compel the industry's supply and demand. Second, the little market penetration must be addressed with concerted efforts from all parties to increase awareness and understanding. The third concern is the poor growth of takaful products and the Islamisation of conventional insurance products. While Shariah values are important, a financial institution's primary responsibility is to understand customer needs and match them with suitable products. Fourth, there are very few retakaful options in the market, and issues persist with the *qard al-hasan* fund. Indeed, the retakaful scarcity has been mentioned previously by Qureshi (2011), and this issue worsens when scarcity forces takaful companies to opt for conventional reinsurance under the doctrine of necessity. Yet, there is a possibility that conventional reinsurers may not comply with shariah principles, as their Articles of Association do not mandate compliance, despite setting up a shariah reinsurance window to attract takaful companies (Qureshi, 2011).

The poor state of regulation governing the takaful industry is not only affecting Indonesia. In Saudi Arabia, the issue of regulation is primarily centred on regulatory frictions, as the country's regulations were developed in reference to the conventional insurance model (Orlando & Bace, 2021). Many agree that reform in regulations governing takaful is an important factor that could invigorate the industry. This is evident in Malaysia and the UAE, where the takaful industry in both countries has developed rapidly following the adoption of specific takaful regulations (Orlando & Bace, 2021). Although Malaysia and Saudi Arabia are regarded as leaders in takaful, Malaysia is well ahead in terms of regulation, having enacted the Takaful Act in 1984. On the contrary, Saudi Arabia was largely unregulated until it passed the Control of Cooperative Insurance Companies Law on 20 November 2003 (Qureshi, 2011), despite having established its first Islamic insurance company as early as 1979.

5. CONCLUSION

The historical trajectory of takaful demonstrates a continuum of cooperative risk-sharing practices that long preceded the formal institutionalisation of Islamic insurance. Rooted in pre-Islamic Arab customs such as *aqilah, hilf*, and *daman al-tariq*, these traditions evolved into a structured, commercial model in the modern era, culminating in the Grand Council of Islamic scholars' endorsement of takaful in 1985. This evolution reflects both the intellectual influence of Islamic revivalism and the growing demand for a financial system that aligns with Islamic principles. The foundations of takaful, namely *ta'awun* (mutual assistance) and *tabarru'* (voluntary contribution), continue to differentiate it from conventional insurance through its emphasis on risk-sharing, ethical investments and prohibition of *riba* (interest), *gharar* (uncertainty), and *maysir* (ambiguity).

Despite its strong conceptual underpinnings and robust global growth, the takaful industry faces several structural and operational challenges that hinder its full potential. Issues such as limited Islamic investment avenues, inadequate market liquidity, fragmented regulation, and insufficient re-takaful capacity have contributed to inefficiencies and, in some cases, solvency concerns within takaful operators. Conflicts of interest, particularly those arising from the dual principal relationship between shareholders and participants, further complicate governance and raise questions regarding the suitability of prevailing operational models such as *mudharabah* and *wakalah*. The tension between the donation-based *tabarru'* framework and profit-sharing arrangements underscores the need for clearer shariah harmonisation. Additionally, in markets such as Indonesia, extremely low penetration and literacy rates highlight a persistent gap between the conceptual appeal of takaful and public awareness of its value.

Moving forward, the sustainability and competitiveness of the global takaful industry depend on addressing these institutional, regulatory, and market-related barriers. Strengthening regulatory frameworks, particularly by ensuring they are designed specifically for takaful rather than adapted from conventional insurance, remains essential. Enhancing consumer education, improving governance structures, and expanding shariah-compliant investment opportunities will further support the industry's long-term viability. With coherent reforms and continued innovation, takaful can better fulfil its intended purpose as a cooperative, ethical, and financially sound alternative to conventional insurance.

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7. CONFLICT OF INTEREST STATEMENT

The authors agree that this research was conducted in the absence of any self-benefit, commercial, or financial conflicts and declare that there are no conflicts of interest with the funders.

8. AUTHORS' CONTRIBUTIONS

Siti Jeslyn Hasan: Conceptualisation, methodology, formal analysis, writing-original draft and editing; Wan Amalina Wan Abdullah: Conceptualisation, supervision, writing review and validation; Fahru Azwa Mohd Zain: Conceptualisation, supervision, writing review and validation.

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9. DATA AVAILABILITY/ SUPPLEMENTARY MATERIALS

Data sharing is not applicable to this article as no new datasets were generated or analysed during the current study.

10. ETHICS STATEMENT

The authors declare that this research did not involve human or animal subjects.

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