

Comparative Analysis of Risk Management Strategies: Study Between Takaful Operators and Companies Conventional Insurance

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Abstract

This study aims to analyse and compare risk management strategies between takaful operators and conventional insurers from the perspective of operating models, contract structures, as well as approaches to risk. The objective of this study was to identify the key similarities and differences in the risk management mechanisms of the two models as well as to assess the impact of the Shariah framework on the practices of takaful operators. The study uses a qualitative approach through the analysis of the content of documents such as the company's annual report, Bank Negara Malaysia guidelines, and relevant academic literature. The findings show that takaful operators emphasise the concept of risk sharing (ta'awun) and Shariah compliance through the monitoring of the Shariah Committee, while conventional insurers operate on the basis of full transfer of risk to the company with an emphasis on commercial profit. Although both use similar actuarial knowledge and financial instruments, differences in fundamental objectives and operating structures result in different risk management approaches. This study suggests that the takaful model has the potential to offer an ethical and inclusive financial protection system that can be used safely.

Keywords: Takaful, Conventional Insurance, Risk Management, Shariah, Islamic Finance.

Introduction

The insurance industry is an important component in the risk transfer process as well as strengthening the economic resilience of a country. The conventional insurance system serves as a risk transfer instrument that contributes to economic stability through protection against various forms of potential losses (Sufyan & Othman, 2025). Meanwhile, takaful has emerged as an alternative based on Shariah principles which emphasises the concept of risk sharing, mutual help and solidarity among participants (Abdou et.al, 2014). While these two systems share the same goal, which is to manage and reduce risk, takaful also includes Shariah compliance elements such as the prohibition of riba, maysir and gharar, which are not applied in conventional insurance (Abdou et.al, 2014). Overall, conventional insurance operates as a risk transfer contract based on premium payments, while takaful functions as a cooperation

scheme (tabarru') where the surplus or deficit is borne and distributed jointly by the participants.

The existence of dual insurance models, namely conventional insurance and takaful, is very significant in the Malaysian context. Since its introduction in 1984, the takaful industry in the country has shown rapid growth and is now recognized as one of the largest markets globally. Previous studies have shown that the takaful industry has made a positive contribution to the country's socio-economic development through increased employment opportunities, growth in pre-tax profits as well as the contribution of zakat collection (Abdou et.al, 2014). Authorities such as Bank Negara Malaysia have also strengthened the industry's regulatory framework by introducing a risk-based capital (RBC) framework for the conventional insurance sector in 2009, followed by the formulation of specific guidelines for the takaful industry in 2010–2011. For example, takaful operators are required to maintain a minimum capital adequacy ratio of 130% to ensure that takaful funds are always at an adequate level and able to cover the liabilities of participants (Yusof et.al, 2015). From an investment point of view, takaful companies are only allowed to invest in Shariah-compliant instruments; Hence, they are not exposed to interest rate risk. However, they face the risk of margin mark-up stemming from the Shariah-based financing structure. In addition, Shariah compliance requirements including the participation of Shariah advisory boards and compliance with internal standards make risk management in takaful fundamentally different compared to conventional insurance.

Although there are various studies examining the growth and performance of both insurance industries in Malaysia. However, studies comparing risk management strategies across the board are still limited. For example, Salman (2018) emphasises that the risk management aspect related to non-Shariah elements in takaful has not been given much attention in previous research. Existing studies typically focus on financial metrics or operational effectiveness, but lack a comprehensive approach that simultaneously includes operational risk, financial risk, and Shariah compliance. Previous studies have tended to focus on financial metrics or operational effectiveness, but have lacked comprehensive approaches, including operational risk management, financial risk, and Shariah compliance simultaneously.

The objective of this study is to analyse and compare the risk management strategies practiced by takaful operators and conventional insurance companies in Malaysia from the three main perspectives of operational risk, which include the control of internal processes, systems, and corporate governance of financial risk, including capital requirements, investment policies, and liquidity levels; as well as Shariah compliance, including Shariah audit processes and non-Shariah risk control. Through this comprehensive analysis, the study is expected to produce findings that provide practical guidance as well as suggestions for improvement to strengthen the risk management framework of both types of insurance industry in Malaysia.

Risk management in takaful plays an important role in ensuring financial stability and compliance with Shariah principles. The risks faced include financial, operational, market, as well as the risk of non-compliance with Shariah. In this context, risk management theories provide a basis for understanding how risks can be identified, assessed, and controlled (Jaffry et.al, 2015)

According to Akhter (2010), risks in takaful can be categorised into underwriting risk, operational risk, credit risk, liquidity risk, and market risk. Each category requires a different

management approach to ensure that participant and operator funds are safe. Shariah risks, on the other hand, arise when operations do not comply with Shariah principles, and the Shariah committee plays a critical role in assessing fiqh compliance and fiqh motions to minimize these risks (Yusof, Romli, & Borhan, 2014).

Financially, strong capital management is required to cover underwriting and investment risks. Risk-based capital (RBC) helps to determine the minimum level of capital to maintain financial stability (Puspita, Kolkiewicz, & Tan, 2020). The ruin probability model is used to assess the probability of participants' funds experiencing a deficit, especially in the wakalah-mudharabah hybrid model (Puspita, Kolkiewicz, & Tan, 2020).

The concept of social justice and equity is also the basis for the distribution of takaful surplus. Surpluses need to be distributed fairly between participants and operators to maintain the value of solidarity (ta'awun) and financial effectiveness (Yahdi, 2019).

A study by Akhter (2010) identified different types of risks in takaful operations and proposed an enterprise risk management approach. He also emphasised the use of cooperative hedging and bilateral mutual adjustment as alternatives to conventional derivatives that are not Shariah-compliant. However, this study focuses more on financial risk and does not place a deep emphasis on market and credit risk.

The study of Yusof, Romli, & Borhan (2014) focuses on the role of Shariah committees in managing the risk of non-compliance. The study found that sharia risks mostly arise from potentially Shariah-non-compliant contracts or operations. They emphasised the importance of fiqh expertise in the committee to assess risks and suggested improving the competence of non-Shariah staff to identify risks earlier.

Puspita, Kolkiewicz, & Tan (2020) developed a quantitative model for wakalah-mudharabah hybrid takaful to calculate the probability of "ruin" or bankruptcy of participant funds. This study shows that the use of the qard-hasan mechanism can help cover the deficit. Additionally, contribution rates, return on investment, and investment structure have a significant impact on insolvency risk.

Comparative analysis found that Akhter's (2010) strategic approach differed from the quantitative model of Puspita et al. (2020) and the Shariah risk focus of Yusof et al. (2014). The governance of Shariah committees has proven to be critical in identifying and controlling sharia risks. Financial mechanisms such as qard-hasan can reduce the risk of deficit and maintain the stability of participants' funds. In terms of social justice, the distribution of surpluses needs to be done fairly to maintain the principle of ta'awun (Puspita, Kolkiewicz, & Tan, 2020).

Methods

Research Design

This study applies a qualitative approach through case study design, as this approach provides space to gain a deeper understanding of the context and practices of risk management in Islamic and conventional financial institutions. The qualitative approach was chosen because it provides an opportunity for researchers to examine the risk management context more thoroughly and in depth. In the design of this case study, researchers were able to obtain detailed, rich and in-depth data related to risk management strategies. Through a case study approach, the phenomenon of risk management can be described holistically and help answer the questions of 'when', 'how' and 'why' related to risk management strategies in a company.

Data Sources

The study data was obtained from relevant official documents at the organizational level. This document includes written resources such as risk management policies and Shariah compliance guidelines. According to the definition of a document as a written record, this material becomes an important source of information in the study. Among the main data sources analysed in this study are:

- i. *Risk Management Policies* adopted by such companies, including internally published documents describing risk management frameworks and strategies.
- ii. *Shariah Compliance Guidelines* and related internal manuals, especially from takaful operators, which set out Shariah compliance standards in operations and investments.
- iii. *Other Official Documents* such as regulatory guidelines (e.g. Bank Negara Malaysia documents on RBCs), company policy papers, internal audit guidelines and industry documents related to risk management.

These documents are considered primary materials that provide an official overview of an organization's risk strategy.

Data Collection Method

Data were collected through documentation research methods. The main instrument of the study is the analysis of official documents. Selected documents are obtained secondarily from open sources, including the official websites of companies and regulatory agencies, as well as *google scholar*. The main focus in the material collection and selection process is on content that is directly related to risk management strategies. Documents that discuss Shariah-compliant investments or the use of risk-based capital frameworks (RBCs) are given priority. This method ensures that the analytical material is relevant to the research questions and allows for a thorough comparison between risk management practices in takaful and conventional insurance.

Results

Risk management is a key element in conventional takaful and insurance operations (Hanafi & Yaakub, 2021; Khorshid, 2018). While both provide a risk protection mechanism, their methodological approaches, contract structures, and operating philosophies are very different (Hanafi & Yaakub, 2021; Khorshid, 2018). In the context of takaful operators, risk management strategies are not only focused on financial efficiency but need to adhere to Shariah principles that emphasise fairness, transparency, and avoidance of elements of usury, gharar and maysir. This analysis uses a case study approach of two key entities in the industry Malaysia Takaful Malaysia Keluarga Berhad (STMKB) as takaful representatives and AIA Berhad as conventional insurance representatives to examine the similarities, differences and implications of risk management strategies in the context of Shariah.

Business Background

Prudential BSN Takaful Berhad (PruBSN) is the largest family takaful operator in Malaysia with a market share of more than 30% (Bank Negara Malaysia, 2022). Among its main products are PruBSN Warisan, PruBSN Anugerah and PruBSN Anggun. PruBSN

operates using the Wakalah model, where the operator acts as the fund management agent, as well as applying the Tabarru' Fund which consists of donations from the participants. In addition, all its investments are Shariah-compliant (Abdullah & Chee, 2019; Ismail, 2020). The risk fund is also very large as the number of participants has now reached 1.5 million people (Takaful Malaysia, 2022).

Prudential Assurance Malaysia Berhad (PAMB) is a conventional insurance holding company that offers a wide range of products such as life insurance, medical plans and savings-related policies (AIA Malaysia, 2023). In terms of operations, PAMB uses a full risk transfer model, where premiums paid by policyholders are considered as the company's income (Hanafi & Yaakub, 2021). Its investments also include beneficial instruments such as corporate bonds and money markets. The comparison between PAMB and PruBSN clearly shows two different risk approaches within the Prudential group (Hanafi & Yaakub, 2021).

Case Analysis and Risk Management Strategies

Case Study 1: Takaful Malaysia Keluarga Berhad (STMKB)

The risk sharing structure used by STMKB is built on the concept of *tabarru'*, which is the voluntary contribution of participants to the Joint Risk Fund (Risk Fund) which is used collectively to help other participants who experience calamities (Abdullah & Chee, 2019; Takaful Malaysia, 2022). This approach emphasizes shared responsibility without any transfer of risk to the operator, as the operator only acts as a representative (*wakalah*) or manager (*mudharib*). This model also reduces the element of uncertainty (*gharar*) as the role of each party is clearly defined, with participants as risk contributors while operators function as fund managers (Ismail, 2020).

STMKB applies several Shariah-compliant risk management techniques to ensure the stability of funds as well as the protection of participants.

- i. The Shariah-compliant *underwriting* process is strictly implemented through health risk classification, participant lifestyle assessment and compliance with Shariah guidelines to avoid exploitation, thus reducing the risk of *adverse selection* and *moral hazard* (Ismail, 2020).
- ii. Risk *pooling* and diversification methods are used to distribute individual risk in a large group of participants, which in turn increases the stability of funds and reduces the volatility of claims (Abdullah & Chee, 2019).
- iii. For large-scale risks such as mass deaths or natural disasters, STMKB uses *retakaful* to transfer some of the risk to Shariah-compliant retakaful operators, avoid instability of *tabarru' funds*, as well as ensure the safety of participants' funds.
- iv. Surplus management is implemented systematically, where the surplus after deducting claims and savings is distributed back to participants according to the wakalah contract, is not considered as the company's absolute profit, and reflects the Islamic principles of distributive justice (Abdullah & Chee, 2019; Takaful Malaysia, 2022).

STMKB's annual report (2022) shows a significant improvement in *underwriting* performance, a decrease in the *claims ratio*, as well as the growth of *tabarru' funds* as a result of the implementation of a comprehensive risk management strategy. This achievement proves that the Shariah model not only emphasizes ethical and justice aspects, but also enhances the

financial resilience and ability of companies to manage risk more effectively (Takaful Malaysia, 2022).

Case Study 2: Aia Berhad (Conventional Insurance)

The risk structure based on risk transfer in conventional insurance works through a risk sale and purchase contract, where the customer transfers the risk entirely to the insurance company through premium payments (Hanafi & Yaakub, 2021). In this model, the insurance company bears the entire risk taken, thus making the operation more profit-oriented (*profit maximization*). The premiums received are also considered the company's income, in line with the commercial nature of the conventional insurance model.

Conventional insurance companies such as AIA apply a number of different risk management techniques than the takaful approach.

- i. *Commercial underwriting* is carried out using a commercial actuarial model that assesses risks based on mortality and morbidity data, supported by the use of advanced risk algorithms, thus resulting in a more aggressive pricing strategy (Hanafi & Yaakub, 2021; AIA Malaysia, 2023).
- ii. AIA also uses *reinsurance* by transferring large-scale risk to international *reinsurers*, including entities that invest in interest-based instruments, which are not in line with Shariah principles (AIA Malaysia, 2023).
- iii. In terms of investments, conventional insurance companies manage funds through interest-oriented instruments such as bonds, derivatives, and conventional money market instruments to increase returns, but this approach is contrary to Shariah requirements (Hanafi & Yaakub, 2021; AIA Malaysia, 2023).

AIA's financial report for 2021 to 2023 shows a significant increase in investment income, particularly from interest-based instruments (AIA Malaysia, 2023). Shareholder profits have also increased in tandem with aggressive investment strategies in conventional financial markets. However, this performance also shows a significant reliance on non-Shariah-compliant instruments, thus underscoring the fundamental differences between conventional insurance models and takaful systems in terms of risk management and Shariah compliance.

Risk Management From a Shariah Perspective

From a Shariah perspective, takaful avoids the element of *gharar* because the contractual structure is clear and transparent, including donation intentions (*tabarru'*), funds that are considered as trusts, as well as pre-determined benefit conditions (Abdullah & Chee, 2019; Ismail, 2020). On the other hand, conventional insurance is often criticized by scholars for the existence of uncertainty over the amount of compensation and uncertainty about premium ownership. In addition, Shariah prohibits *usury*, whereas most of the profits of conventional insurance companies are earned through investments in interest bonds and interest-bearing loans (Abdullah & Chee, 2019; Ismail, 2020; Khorshid, 2018). In takaful, all investments must comply with Shariah-compliant instruments, thus contributing to long-term stability. From the point of view of *maysir* (gambling element), conventional insurance is considered to contain an element of betting because the customer 'bets' the premium for compensation while the company 'bets' that the claim will not occur. In the takaful system, *tabarru'* eliminates the betting element because participants contribute donations and funds are jointly owned, not as a risk purchase (Abdullah & Chee, 2019; Ismail, 2020).

Synthesis And Implications Of Sharia On Risk Management Strategies

The analysis of both cases shows that takaful operators adopt a value-driven risk management approach, while conventional insurance prefers a profit-driven approach. While both have the goal of protecting participants/insurers, the Shariah framework provides an additional dimension of ensuring fairness, transparency, and blessings in risk management.

Through STMKB's case study, it is clear that the use of *tabarru'* plays a role in strengthening distributive justice among participants, while the implementation of *retakaful* helps to reduce exposure to large-scale risks and thus increases the resilience of funds. In addition, the implementation of Shariah audits also ensures operational integrity as well as continuous compliance with Shariah principles. On the other hand, AIA's case study shows that conventional insurance approaches offer greater flexibility in terms of investment and risk management, yet this model does not adhere to Islamic ethical values and potentially contains elements that are not in line with Shariah.

This analysis proves that takaful risk management strategies are more in line with Shariah principles (Abdullah & Chee, 2019; Ismail, 2020), for avoiding usury, gharar and maysir, as well as promoting justice and risk sharing. The conventional insurance model, although more commercially mature, does not meet Shariah requirements due to the contractual structure involving gharar risk transfer and usury investment practices.

Industry case studies show that takaful operators are not only safe from a fiqh perspective, but also competitive and stable from an economic perspective. With the increasing awareness of the Muslim community on the importance of Shariah compliance, the takaful model is expected to be a long-term strategic choice in the risk protection sector.

Discussion

Insurans

Generally, insurance is an agreement between the insured person and the insurance company. This agreement is known as a policy. To obtain such coverage, the policyholder has to pay a certain amount known as a premium to the insurance company. (Haron, M. N, 2016). The premiums paid will be invested by the insurance company. However, the policyholder does not have the authority to determine the form or direction of such investments. This situation can cause investors to engage in activities that do not comply with sharia principles, including gambling, usury, as well as high-risk or volatile operations. (Haron, M. N, 2016)

Takaful

Like insurance, Takaful will also invest the money that has been donated. However, only investments in businesses that comply with sharia principles are allowed. Therefore, participants can feel more at peace of mind as their Takaful subscriptions are guaranteed to be sharia-compliant. Like conventional insurance, Takaful also offers various types of plans, including life protection or family Takaful, medical, education, investment and so on. (Nik Asma', 2019). Based on the Takaful contract, the agreement entered into is based on the concept of *ta'awun* (cooperation and help). This means that participants not only protect themselves when faced with calamity, but also help other eligible participants as well as their nominees.

Every time a participant makes a contribution payment for the Takaful plan, a portion of the amount will be channelled into the Tabarru' Fund. These funds are used to compensate participants who make valid claims. The remaining contribution will be deducted as the

Wakakalah Charge, which is a payment to the Takaful operator for performing his duties as a representative in managing the services provided under the plan.

The Concept of Takaful in Addressing the Issue of Riba' in Conventional Insurance

Having understood the reasons for the ban on conventional insurance, this section explains how Islam provides an alternative that serves the same purpose, which is to protect society from calamities. The alternative is known as *takaful* or *ta'min ta'awuni*. (Dusuki & Ali, 2018). Takaful comes from the word *kafala* which means guarantee or indemnity.

Technically, takaful is a form of protection where a group of participants agree to contribute a sum of money (*tabarru'*) to help each other in the event of a disaster such as loss of property, death, injury or permanent disability. According to AAOIFI's sharia standards, takaful is defined as a system where participants donate part or all of their contributions to pay the claims of other participants, while the role of the company is limited to managing and investing the contributions. (Othaman, 2010)

The concept of takaful is based on the principles of *ta'awun* (help-help), *tadhamun* (mutual responsibility) as well as mutual protection and guarantee which belong to the *tabarru'* contract. This principle coincides with the word of Allah which commands people to help one another in goodness and piety and not to cooperate in sin and aggression. It is also supported by the hadith which asserts that whoever eases the difficulties of a believer, Allah will ease his difficulties on the Day of Judgment; and that Allah always helps His servants as long as they help each other.

Conclusion

This study compares risk management strategies between takaful operators and conventional insurers by focusing on operating models, contract structures, financial approaches and Shariah implications. Although both provide protection against risk, the results of the study show that fundamental philosophical differences mean that the risk management approaches practiced are also different.

Takaful is based on the principles of *ta'awun*, *tadhamun* and *tabarru'*, where risk is shared with participants through the *Tabarru'* Fund. The Operator does not bear the risk but acts as a representative or manager of the fund. All operational processes including underwriting, investment and fund management must comply with Shariah principles, thus avoiding elements of usury, *gharar* and *maysir*. Risk management technologies such as risk pooling, *retakaful* and Shariah auditing contribute to financial stability and ensure the integrity of participants' funds. Case studies of STMKB show that this approach is not only Shariah-compliant but also effective in maintaining the resilience of funds as well as increasing long-term value to participants.

On the other hand, conventional insurance uses a risk transfer model entirely to the insurance company. The premium becomes the company's income and the investment is made in commercial instruments without Shariah restrictions. While this strategy increases financial returns and provides greater flexibility in risk management, it involves elements of usury, uncertainty and *maysir*, making it contrary to Islamic principles. The study of AIA showed strong financial performance, but did not meet the requirements of Shariah.

Overall, the study concluded that takaful is superior in terms of ethics, transparency and Shariah security. It offers a more stable and value-based risk management system. The study also suggested that the takaful industry should be empowered through product innovation, Islamic financial education, government policy support and the application of technology to increase competitiveness and expand benefits to society.

The development of the takaful industry requires strong support from various parties, especially the authorities who play an important role in expanding the scale and increasing the competitiveness of the industry, given that takaful's contribution is currently only around 1.1% of the total Islamic financial assets (Dusuki, 2018). Stronger policy support from policymakers, Islamic financial institutions and sharia monitoring bodies will help strengthen takaful's position in the Islamic financial ecosystem. In addition, the implementation of continuous campaigns on the importance of the participation of Muslims in takaful schemes is needed to raise public awareness and prevent them from getting involved in the elements of riba, gharar and maysir found in conventional insurance (Hafizah, 2013).

This campaign needs to be strengthened through community programmes, mass media, educational institutions and religious institutions to ensure that Islamic financial literacy can be improved comprehensively. In addition, takaful companies also need to implement continuous improvements to their products, operations and services, including providing more innovative products, offering competitive pricing and protection features as well as leveraging digital technologies such as mobile applications, paperless claims systems and data analytics to improve the customer experience. To further strengthen the development of this industry, strategic collaboration between takaful companies, Islamic financial institutions and government agencies is also needed to expand marketing networks, increase public access to takaful products and promote the integration of takaful in comprehensive Islamic financial planning (Wahid, F. N. (A 2015).

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