Advanced International Journal of Banking, Accounting, and Finance
AIJBAF
EISSN: 2682-8537
Volume: 8 Issue: 25 (September 2026) PP. 27-41

ADVANCED INTERNATIONAL JOURNAL OF BANKING, ACCOUNTING AND FINANCE (AIJBAF)
www.gaexcellence.com/aijbaf

GLOBAL ACADEMIC EXCELLENCE

SUSTAINING THE TAKAFUL INDUSTRY IN MALAYSIA: CRITICAL FACTORS AND STRATEGIES

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Article Info:

Article history:
Received date: 09.07.2026
Revised date: 28.07.2026
Accepted date: 23.08.2026
Published date: 09.09.2026

To cite this document:

Wahab, M. Z., Sobry, S. C., & Sadek, D. M. (2026). Sustaining The Takaful Industry in Malaysia: Critical Factors and Strategies. *Advanced International Journal of Banking, Accounting and Finance, 8*(25), 27-41.

Abstract:

This paper aims to outline the future direction of Malaysia's takaful industry by highlighting several crucial aspects that takaful operators should focus on to ensure long-term sustainability. To accurately address the research objectives, a qualitative research methodology was employed. Primary data was collected through in-depth interviews with four informants who possessed expertise in various fields related to takaful. The analysis identified six critical areas that require attention for the sustenance of the Malaysian takaful industry: increasing the number of retakaful companies, introducing Sharia parameters, establishing a clear insolvency framework, ensuring transparency in the legal and operational framework, enhancing the knowledge and trustworthiness of agents, and conducting comprehensive research. This study has several limitations. Firstly, the focus on the perspectives of takaful operators (TOs) in Malaysia may limit the generalizability of the findings to TOs in other countries. Secondly, the small number of informants interviewed may not fully capture the diversity of opinions and experiences in the industry. Future research could address these limitations by expanding the scope to include multiple countries and increasing the sample size of informants. The findings provide valuable insights for takaful operators, guiding them in developing future business targets and directions. These results are significant for the industry, offering strategies to increase market share and deliver better quality products and services to customers.

Advanced International Journal of Banking, Accounting, and Finance
EISSN: 2682-8537
AIJBAF
Volume: 8 Issue: 25 (September 2026) PP. 27-41
DOI: 10.35631/AIJBAF.825002
Keywords:
Challenges, Issues, Malaysia, Sustainability, Takaful Industry.

Introduction

As an important component of Islamic Financial System (IFS), takaful industry has witnessed a tremendous growth in recent years. Generally, takaful can be described as a form of protection provided to its participants based on Sharia compliance (Abd. Rahim et al., 2017; Rifas et al., 2023). Thus, it is not surprising when the Islamic financial services industry, comprising of Islamic banking, takaful and the Islamic capital market are areas that has grown to become an increasingly substantial segment within the global financial market.

According to a Statista Report (2020), the global takaful industry's total contributions were estimated at US$27.07 billion by the end of 2019, with an expected growth rate of 13% in the forecast period of 2021-2026 to reach USD49 billion by 2026. The takaful market is concentrated in the Gulf Cooperation Council (GCC) and Southeast Asia regions, with Saudi Arabia and Malaysia dominating these markets. Malaysia has established a significant takaful market, with family takaful accounting for 38% of the domestic life insurance market in the first half of 2020, compared with 34% in 2019, while general takaful maintained a 16% share of the overall general insurance market (Fitch Ratings, 2021). Despite the Covid-19 pandemic situation, the takaful industry is growing robustly all over the world, including Malaysia. However, the researcher argues that there is an underserved area in the takaful industry that needs to be explored to maintain the industry's growth and sustainability, as takaful operators in Malaysia are more focused on offering family and general products (Fikri et al., 2022).

The future growth of the takaful industry hinges on the quality of services provided by takaful operators (TOs) and their ability to meet customers' expectations and preferences, which is key to enhancing their perception of the industry (Remli & Wan Daud, 2020). Although there has been an increase in the number of participants in takaful products and services in Malaysia, the majority of potential customers remain unconvinced due to various reasons such as lack of awareness and knowledge, scepticism, and perception that takaful products are more costly than conventional insurance products (Hassan et al., 2018; Bhatti & Md Husin, 2020; Mohammad Sopian & Azmin, 2021). Additionally, the perception of the industry plays a critical role in its sustainability and growth (Wahab, 2018).

Moreover, despite its rapid growth, the takaful industry has encountered several challenges and issues, including in Malaysia. These include regulatory concerns, competition from conventional insurance companies, limited awareness and understanding of takaful among potential customers, and inadequate Sharia governance (Lubaba et al., 2022; Ullah et al., 2023;

Abu Al-Haija & Houcine, 2023). Additionally, after more than three decades since the implementation of the takaful industry in Malaysia, there are still criticisms regarding the existing takaful models and their operations (Abd. Rahim et al., 2017; Isa et al., 2017).

Therefore, it is crucial to address these issues and explore ways to strengthen the takaful industry, especially in Malaysia, to ensure sustained growth in the future. This study aims to identify key issues that takaful operators need to focus on to improve the industry.

The rest of the paper is organized as follows. Section 2 provides a review of the literature, including an overview of the development of the takaful industry in Malaysia and the issues associated with it. Section 3 describes the research methodology used in this study. Section 4 presents the results and findings of the study based on the interviews conducted. Finally, Section 5 concludes the paper, offers recommendations, and highlights the limitations and scope for future research.

Literature Review

Overview of Takaful and its Development in Malaysia

The main reason that conventional insurance is considered haram (unacceptable and impermissible) in Islamic thought is due to its operations consist of three elements which are *Gharar* (uncertainty), *Maisir* (gambling) and *Riba* (usury) (Shofawati, 2020; Mustafa & Rahman, 2023). React from that matter, the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia on 25th June 1972 and the Council of Islamic Fiqh Scholars in 1975 issued a fatwa that conventional life insurance contradicts the Sharia or Islamic rules. *Gharar* in conventional insurance refers to the uncertainty related to the amount of compensation to be paid and how the amount is derived. *Maisir* refers to the element of gambling arising from the transaction of *gharar* whereas *riba* refers to the interest paid in money lending activities. Besides, it also occurred in investment activities when the invested money generates return from *riba*-based financial instruments (Rifas et al., 2023). Thus, it has become the motivation to abolish the three elements that are not allowed in Islam by introducing the Islamic insurance system in Malaysia.

In Malaysia, the history of the takaful industry began on 25 October 1982 when a Special Task Force was created. The committee has appointed to study the possibility of establishing Islamic insurance companies in Malaysia. The study was conducted by taking into account opinions and views from Islamic scholars and industry experts. The committee also conducted work visits to several countries that have implemented Islamic insurance as well as considered the experience and development of existing insurance companies in the country. At the end of the study, the committee concluded that, the key values of takaful industry must be operated based on Sharia law (Mohd Fauzi et al., 2016; Mohammad Sopian & Azmin, 2021).

As an outcome of the above committee's recommendations, the establishment of takaful industry in Malaysia started in 1985 when Takaful Act 1984 came into force for the regulation. Starting from this, the takaful industry in Malaysia has growth from only one takaful operator which is Takaful Malaysia Berhad in 1985 to eleven takaful operators in 2017 (Bank Negara Malaysia, n.d.). Today, takaful industry in Malaysia is governed by a new effective act which

Advanced International Journal of Banking, Accounting, and Finance
AIJBAF
EISSN: 2682-8537
Volume: 8 Issue: 25 (September 2026) PP. 27-41

is Islamic Finance and Services Act (IFSA) 2013. In 2023, the takaful industry in Malaysia celebrates its 38th anniversary.

Existing Issues and Challenges in Takaful Industry

The development of the takaful industry has faced a lot of issues and challenges globally, including in Malaysia (Mohd Fauzi et al., 2016; Saeed, 2019; Md Husin, 2019; Lubaba et al., 2022). There are criticisms by some takaful experts, such as the common practice in takaful, where participants make contributions as *tabarruq*, which means donation. However, in the Sharia ruling, the donation practice is similar to those concerning gifts and charity. It means that once the donation has been made, the donor loses any right to it and is prohibited from recalling or receiving back any portion of it (Ali et al, 2014; Salman, 2014; Abozaid, 2016). Hence, if the contributions are referred to as *tabarruq* concept, in cases of losses, the participants would be unable to make a claim and receive compensation.

Some scholars have criticized the Mudarabah takaful model as more suitable for short-term rather than long-term products, such as yearly renewable takaful motor products, where surplus sharing can occur earlier than in long-term products (Wahab et al., 2017). Another issue is that takaful operators are facing direct exposure to investments in the Mudarabah model. They are vulnerable to the ups and downs of businesses because the nature of the business is profit-sharing based (Jaffer et al., 2010; Ahmed & Haron, 2018).

Another major challenge faced by TOs is the lack of standardization in takaful products and practices. This has resulted in confusion among customers and inconsistency in the quality of services offered by different TOs (Saeed, 2019). The lack of standardization also makes it difficult to regulate the industry and ensure compliance with Sharia principles (GolzareNabi, & Rahman, 2019).

On the other hand, takaful industry also facing with the lack of qualified personnel and expertise. According to a study by Islam and Sultana (2018), the shortage of qualified personnel in takaful companies hinders their ability to offer innovative products and services. Furthermore, a lack of expertise in Islamic finance and Sharia principles can result in non-compliance and reputational risks for the TOs.

Risk management is also a significant issue for takaful operators. The absence of effective risk management practices and inadequate internal control systems have been identified as major causes of financial crises in TOs (Trokic, 2017). TOs need to develop and implement robust risk management frameworks to protect the takaful fund, maximize investment returns, and ensure sufficient funds to pay claims.

Lastly, low awareness and understanding of takaful among potential customers have been identified as a major issue. Despite the increasing number of participants in takaful products and services, a majority of Muslims still do not subscribe to the system (Lubaba et al, 2022). Lack of awareness and understanding of takaful among potential customers has been attributed to insufficient marketing and educational campaigns.

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EISSN: 2682-8537
AIJBAF
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In conclusion, the takaful industry has grown rapidly in recent years, but it still faces several challenges and issues that need to be addressed. These include standardization of products and practices, shortage of qualified personnel and expertise, effective risk management practices, the suitability of existing takaful models, and low awareness and understanding of takaful among potential customers. Addressing these issues will be crucial to the continued growth and sustainability of the takaful industry.

Methodology

The present study employed a qualitative research method to address its research objectives. As stated by Silverman (2020), this method allows researchers to gather various forms of data, such as facts, information, statements, comments, assumptions, meanings, concepts, specifications, symbols, perceptions, metaphors, and feelings, from a range of sources, including manuscripts, newspapers, diaries, pictures, official and personal letters, artifacts, certain individuals via interviews, and by engaging in ethnography to analyze situations. Accordingly, the study relied on primary data to address its research objectives, specifically in-depth interviews with takaful informants.

The study was conducted in two stages to achieve its objectives. In the first stage, the researcher conducted a review of relevant literature, including research studies, books, journals, and online resources. Additionally, the researcher participated in industry talks to deepen their understanding of the subject matter. In the second stage, the researcher conducted face-to-face interviews with four informants selected through a combination of snowball and purposive sampling techniques based on their relevant knowledge and expertise in the subject matter. The number of interviews was not predetermined, as the study design was flexible. The interviews were approximately 30 minutes long and were recorded and transcribed for analysis. The interview guide used in the study was based on Sekaran and Bougie's (2016) interview guide tip, which included topics and questions notified to participants in advance. The study's primary objective was to examine suggestions from experts on how to improve the takaful industry in Malaysia.

Sampling

The research study involved selecting four experts to participate as informants in the interview session. Although the number of informants was relatively small, the selection was based on the relevance, depth, and diversity of their expertise rather than numerical representativeness. This approach was considered appropriate because the study sought specialised and information-rich insights into the takaful industry rather than statistical generalisation. The informants comprised one takaful practitioner, one academician specialising in Islamic finance and takaful, and two Shariah advisory members, thereby incorporating industry, academic, and Shariah perspectives.

The selection of informants was guided by several criteria: (i) relevant professional or academic expertise in takaful, Islamic finance, or Shariah; (ii) direct experience or involvement in the takaful industry or related advisory activities; (iii) sufficient knowledge of the issues concerning the sustainability and future development of the takaful industry; and (iv) willingness to participate and provide detailed perspectives. The inclusion of informants from different professional backgrounds also enabled the study to obtain complementary perspectives and strengthen the richness of the qualitative evidence.

Informant A, a practitioner with significant experience and expertise in the takaful industry, was selected due to his extensive knowledge of laws and regulations in Malaysia. He holds a professional qualification from Chartered Islamic Finance Professional (CIFP). Informant B is an academician who holds a PhD in takaful from INCEIF and currently works as a lecturer in a public university in Malaysia. Informants C and D are members of the Shariah committee in a takaful company. To maintain the confidentiality of the informants' backgrounds, they were later labelled as Informant A, B, C, and D in the analysis phase.

Data collection and analysis were conducted iteratively to assess data saturation. Saturation was considered to have been achieved when the interviews generated recurring themes and perspectives, with the later interviews providing no substantially new themes relevant to the research objectives. Despite the small sample size, the consistency of key themes across informants with different areas of expertise provided sufficient information to address the objectives of this exploratory qualitative study. Nevertheless, the findings should be interpreted within the Malaysian takaful context and are not intended to be statistically generalised to the broader population of takaful stakeholders.

Data Analysis

In this study, the data collected from the in-depth interviews was interpreted through the transcripts obtained. The researchers listened to the recorded tape of interview data several times during the data interpretation process. The data was transcribed in written form and reviewed. It was then organized based on the questions to identify similarities and differences in the responses of all participants. The researchers coded the data and categorized the answers according to the themes. Finally, the researchers identified patterns and connections among the interviewees' answers to relate an analysis to the objectives.

Finding and Discussion

After conducting a series of interview sessions, it has become evident that there are several critical issues that must be addressed in the takaful industry in Malaysia. These issues require focused attention and improvements to ensure the industry's sustainability in the future.

Increased Retakaful Company

According to the analysis of interview sessions, a critical factor that needs improvement and focus in the takaful industry in Malaysia is the establishment of more retakaful companies. The limited number of retakaful companies currently available exposes TOs to potential financial risks that could compromise the security of their funds. This issue must be resolved urgently and effectively to ensure the long-term sustainability of TOs. The viewpoints expressed by the informants highlight the significance of retakaful companies as a crucial concern within the industry. This point has agreed in all informants that said as follows:

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"....retakaful operators are crucial for the survival and sustainability of takaful industries. Otherwise, TOs will have to rely on reinsurance companies, and the reinsurance sector will become larger, making it difficult to compete with conventional insurance".

"*Currently, the most critical problem in takaful is finding retakaful companies. There are not many retakaful companies in the industry, and fewer of them are getting licenses to operate"*

"The main problem now is that takaful companies need to mitigate risk by getting retakaful coverage, but there are no (less) players in the retakaful market. As a result, they have to turn to conventional reinsurance. In practice, most TOs use reinsurance companies".

"*There are not many retakaful companies willing to participate in the industry. Even if TOs use retakaful, they will use retro-insurance as a last resort".*

Informant C pointed out that the shortage of retakaful companies is attributed to the low profitability of the business portfolio, which poses a risk for potential investors.

".... this is a very risky business. The amount needs to be very big in retakaful whereby the income may not be very attractive."

This situation poses a significant challenge for takaful operators as they rely on reinsurance companies when unable to secure the appropriate retakaful company. Consequently, this may lead to the growth of reinsurance companies at the expense of retakaful companies. This scenario has significant implications for the takaful industry, as the insufficient support for retakaful companies may lead to their inability to compete with reinsurance companies in the long run.

Introduce Sharia Parameters

One potential solution to the challenges facing the takaful industry is for regulators to introduce Sharia parameters for TOs. Specifically, the *tabarruq* concept parameter is of particular importance, as it examines the extent to which TOs prioritize this core aspect of takaful. However, some experts have noted that many TOs today appear to prioritize profit maximization over the *tabarruq* concept. Therefore, by introducing and enforcing clear Sharia parameters, regulators can help ensure that TOs prioritize the fundamental principles of takaful and maintain a sustainable business model. The informant D said:

"In my view, the best way to mitigate this issue is through a legal Sharia framework. The highest authorities can provide a specific framework for the TOs, so they will have guidelines to follow when conducting their operations."

Besides, another informant B said:

" I don't think there are any problems with the models that TOs are currently using. However, what's most important is the level of implementation of the tabarruq concept."

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The implementation of Sharia parameters to TOs is a crucial movement that needs to be taken to ensure the sustainability of takaful industries. Among the important concepts in takaful is the *tabarruq* parameter, which assesses the level of *tabarruq* concept implemented by TOs.

However, most TOs focus more on generating maximum profits rather than the nature of takaful. To enforce this parameter, the Sharia Advisory Council (SAC) under the Bank Negara Malaysia (BNM) is considered the best authority body. The implementation of this parameter by the highest body will standardize the operation, harmonize the business operation, and reduce operational costs. The TOs can follow the rules and improve their services based on the benchmark, which will ultimately enhance the efficiency of services in the takaful industry in the future.

Endorsed Insolvency Framework

The third imperative is for BNM to institute a comprehensive framework for TOs in the event of insolvency. At present, there is no explicit framework concerning the winding up of TOs. It is vital to provide a transparent outline of the parties responsible for covering losses if the company becomes insolvent. Informant A said:

“In winding up, what percentage of the participants have the right to claim back their investment from TO and what are the rules and regulations applied?"

In addition, Informant C emphasized,

"In any circumstances, TOs must fulfill the rights of the participants and protect their interests. Therefore, what would happen in the event of TOs' insolvency?"

Therefore, the establishment of a winding up framework is crucial to address this issue and ensure that all parties involved are treated fairly in the event of insolvency. This is particularly important for takaful operators as they are required to comply with Sharia principles, which may not be reflected in conventional winding up practices. It is imperative that BNM provides clear guidelines and regulations to ensure that the winding up process adheres to Sharia principles and all parties receive their rightful compensation.

Introduce Legal Operational Framework

The fourth movement emphasizes the importance of transparency and accountability on the part of TOs. TOs must be willing to exhibit a clear and transparent legal framework and provide a strong rationale for choosing a particular model. Additionally, they should be forthcoming in disclosing all aspects of their business operation to participants, thereby instilling a sense of trust and confidence in their services. For example, one of the informants during the interview session said,

"TOs should disclose all the profits generated and where they go. TOs must also show good efforts to help the participants and not only focus on generating profits."

"To improve the existing takaful model, the legal framework should be clearer and more transparent," supported by informant A.

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Informant D argued about the transparency of TOs by asking,

"The question is whether TOs are ready to disclose everything to the participants, or do they prefer to hide the facts? This is also related to the trust between customers and TOs."

The sustainability of takaful companies depends on the participants' perception and adherence to good governance practices. Failure to maintain and improve business operations could lead to difficulties for the TO. Therefore, the disclosure of clear and transparent legal frameworks is essential in building trust and loyalty among customers. However, in practice, many TOs are unwilling to be transparent in their operations. It is therefore imperative for the regulatory body to mandate TOs to establish a clear framework for their business operations.

Provided Enough Knowledge and Trustworthiness of Agent

The adequate knowledge of TOs agents in explaining the concept of takaful to potential customers is crucial in the takaful industry. However, incorrect or incomplete explanations by agents have become a significant issue that can lead to various negative consequences for TOs. This problem could result in a poor reputation of the TOs and a misunderstanding of the takaful concept by the public. To mitigate this issue, it is suggested that TOs provide their agents with adequate knowledge and training to ensure they can provide clear and comprehensive explanations to potential customers. Most of the informants said:

"The problem is that the agents appointed by TOs do not have enough knowledge to provide a clear explanation to potential customers. The effect is that in the long run, if this problem continues to happen, the reputation of the TOs will be negatively impacted in the eyes of society. Or maybe the society will misunderstand takaful."

Thus, one of the informants suggested that:

"TOs should provide their agents with enough knowledge. In my observation, the agents appointed sometimes were not clear about what they were promoting. They just told people that this product is sharia-compliant without further explanation."

Another issue related to agents is their level of trustworthiness. In some cases, agents appointed by TOs were found to be dishonest in fulfilling their responsibilities. For example, some agents collected contributions from customers but did not put them into takaful funds. This can lead to issues when customers make claims, and TOs discover they have not received the contributions from the agent. One of the informants during giving the real example said:

"*For example, an agent has already collected the contribution from his participant, however the agent did not put the contributions of the customers into takaful funds. A few issues happened when customers make the claims to TO, then TO said they have not received their contribution for the long time, then when rechecked, the problem came from agent. The agent did not submit the contribution of participant to the company.”*

This issue not only poses a risk to the reputation and perception of the industry but also involves the Sharia risk. Therefore, TOs must be careful in the selection process of agents and continuously monitor their actions to ensure compliance with Sharia principles.

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EISSN: 2682-8537
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Generated More Research

The fifth movement emphasizes the need for more research to be conducted in the takaful sector, as currently most research in finance is focused solely on the banking industry. This sentiment is echoed by one of the informants who notes that the slower growth of the takaful industry may be attributed to several factors, including the lack of awareness among society and a lack of research in the field. It is in line with one of the informants who said:

"Firstly, it is important to acknowledge that the growth of the takaful industry is not as rapid as the banking sector. Secondly, the challenges faced by the takaful industry are more complex than those of the banking sector. This is due to the perception of the society that takaful is not necessary at the moment. However, the slow growth cannot be solely attributed to the TOs, as there may be several factors contributing to it, such as the lack of awareness among society and insufficient research."

The takaful industry is an important aspect of the Islamic finance sector and should not be overlooked in research. In fact, there is a need for high-impact research to be conducted in this sector. However, currently, the takaful industry faces limited sources of research as compared to the banking sector. To address this issue, it is important to allocate more funds towards research in the takaful industry to enable it to flourish and contribute to the wider Islamic finance sector.

Thus, based on the discussion of the findings, the aspects that require focused attention and improvements to ensure the sustainability of the Takaful industry can be summarized as shown in Figure 1.

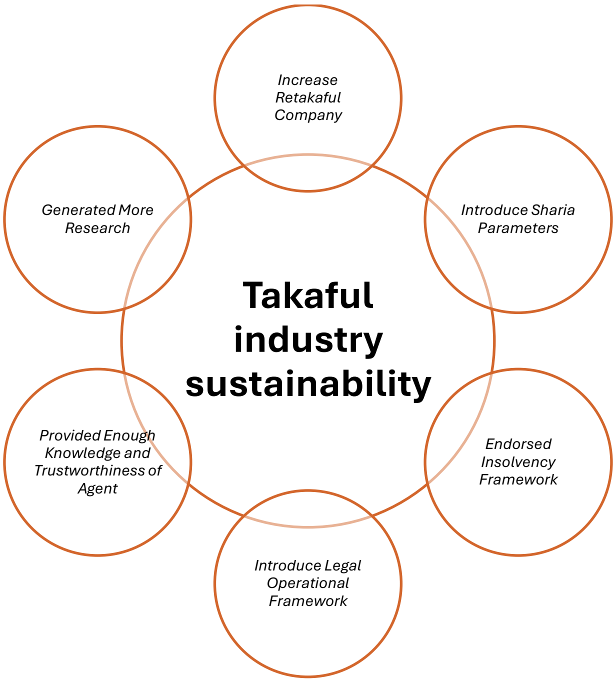

Figure 1: Takaful Industry Sustainability

Source: Self-constructed

Conclusion

According to the analysis, there are six approaches that takaful operators in Malaysia can adopt to ensure the sustainability of their services in the future. These approaches include the creation of more retakaful companies, the introduction of Sharia parameters, the establishment of a clear insolvency framework, transparency in showing the legal operational framework, the provision of adequate knowledge and trustworthiness to agents, and the generation of more research. These measures are expected to enhance customer confidence and trust, as well as to sustain the industry. It is worth noting, however, that this paper does not deny the possibility of other factors that could also contribute to the improvement of the takaful industry in Malaysia.

Implication

This study has significant implications for various groups. Firstly, for the takaful industry, it provides insight into the crucial factors that need to be addressed in order to ensure future sustainability. Failure to address these issues can lead to negative consequences for the industry. The industry can use these findings to formulate effective strategies that cater to the demands and preferences of existing and potential customers.

Secondly, for policymakers, these findings can guide them in establishing new guidelines and standards to strengthen and support the takaful industry in Malaysia. For example, the establishment of Sharia parameters and insolvency frameworks by BNM can assist takaful operators in addressing issues related to Sharia compliance and winding up.

Thirdly, for customers, addressing the issues highlighted in this study can result in better services from takaful operators in the future. This can increase public confidence among existing and potential participants towards takaful services.

Finally, this study can benefit academicians by enriching the existing literature reviews and providing a new direction for future research in the takaful area.

Limitation

In conducting this research, the researcher encountered certain limitations and constraints. Firstly, the scope of the study was limited to improvement factors applicable to takaful operators in Malaysia, and further research could explore improvement factors from a global perspective. Secondly, the study only involved four informants, and future researchers could increase the sample size to obtain a more diverse range of opinions and perspectives.

The outcomes of this research have significant implications for the industry and academicians. The study proposes several suggestions to enhance the service quality of the takaful industry in Malaysia. Further research could empirically investigate how specific improvement factors, such as service quality, digitalisation, product innovation, Shariah governance, transparency, and claims management efficiency, influence public confidence in takaful services. Future studies could also examine customer satisfaction and trust as mediating variables, while takaful awareness, financial literacy, and demographic characteristics could be investigated as potential moderating factors. Such research would provide a more comprehensive understanding of the mechanisms through which operational and governance improvements contribute to customer confidence, loyalty, and continued participation in takaful.

Acknowledgements:	The authors would like to express their sincere gratitude to Universiti Utara Malaysia for providing the necessary resources and support throughout the course of this research. Special appreciation is extended to colleagues and peers who contributed valuable insights and constructive feedback, which greatly enhanced the quality of this paper.
Funding Statement:	No funding was received from any organisation.
Conflict of Interest Statement:	The authors declare that there is no conflict of interest regarding the publication of this paper. All authors have contributed to this work and approved the final version of the manuscript for submission to the Advanced International Journal of Banking, Accounting and Finance (AIJBAF)
Ethics Statement:	This study was conducted in accordance with ethical research standards. Informed consent was obtained from all participants prior to data collection. Participation was voluntary, and respondents were assured of confidentiality and anonymity. The data collected were used solely for academic purposes.
Author Contribution Statement:	All authors contributed significantly to the development of this manuscript. Muhammad Zarunnaim handled data collection, analysis, and interpretation of results. Suheil Che Sobry contributed to the literature review, drafting, and critical revision of the manuscript. Daing Maruak Sadek was responsible for the conceptualization, methodology, and overall supervision of the study. All authors read and approved the final version of the manuscript prior to submission.

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