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Beyond Shariah Compliance: Operational Governance and the Realization of Maqāṣid al-Sharīʿah in Contemporary Takaful Models

ABSTRACT

Takaful has emerged as an Islamic alternative to conventional insurance, founded on mutual cooperation, shared responsibility and collective protection against financial risks. Its operational models seek to translate these principles into institutional practice. However, their implementation raises important questions concerning the distribution of underwriting surplus, operator remuneration, deficit financing, transparency and the protection of participants' interests. This study critically examines four widely discussed Takaful arrangements: Muḍārabah, Wakālah, the hybrid Wakālah–Muḍārabah model and the Waqf-based model. It evaluates their operational structures and institutional challenges in the light of the objectives of Islamic law, particularly justice (ʿadl), protection of wealth (ḥifẓ al-māl), mutual cooperation (taʿāwun), trustworthiness (amānah) and prevention of harm (dafʿ al-ḍarar). Employing a qualitative, doctrinal and analytical methodology based on classical Islamic legal principles, contemporary scholarly literature and authoritative industry standards, the study argues that the Shariah legitimacy of a contractual model cannot be assessed solely through its formal structure; its actual operation and economic consequences must also be examined. The study recommends transparent fund management, fair remuneration, clear surplus and deficit policies, effective Shariah supervision and stronger protection of participants' rights. It concludes that the long-term credibility of Takaful depends on aligning institutional incentives with its cooperative and ethical foundations.

Keywords: *Takaful, Muḍārabah, Wakālah, Waqf, Shariah Governance, Maqāṣid al-Sharīʿah, Risk Sharing.*

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1. Introduction

Islamic economic teachings encourage cooperation, mutual assistance, justice and the protection of wealth. These principles provide the ethical foundation for Takaful, an arrangement through which participants contribute to a common fund to assist one another against specified risks. In its standard contemporary form, Takaful is based on mutual assistance and participants' donation (tabarruʿ), rather than a conventional insurer's sale of risk coverage as a commercial exchange. The International Islamic Fiqh Academy has recognized cooperative insurance, founded on donation and cooperation, as the Shariah-compliant alternative to commercial insurance.[1]

The Qur'an commands believers to cooperate in righteousness and piety [2]. The Prophetic tradition also emphasizes collective responsibility and mutual support. The Prophet ﷺ compared the believers, in their mutual affection and compassion, to one body whose members share one another's pain[3]. These teachings provide an important ethical basis for a cooperative system of financial protection.

Modern Takaful institutions operate within commercial and regulatory environments that require sustainable management, professional administration and adequate financial resources. Consequently, different operational models have been developed to define the relationships among participants, the Takaful fund and the operator. Commonly discussed arrangements include Muḍārabah, Wakālah, the hybrid Wakālah–Muḍārabah model and Waqf-based structures[4] .The Waqf arrangement is not implemented identically in every jurisdiction and may be combined with Wakālah or investment-management arrangements.

Although these models have been developed to meet Shariah requirements, their practical implementation raises questions about the distribution of surplus, the operator's remuneration, the allocation of expenses and the treatment of deficits. A further concern is whether the interests of shareholders and participants remain balanced. These issues are not merely administrative matters; they directly affect the ethical identity and social purpose of Takaful. Recent research has likewise identified wakālah fees, ownership of returns and underwriting surplus as matters that can weaken the mutuality of Takaful if they are not properly governed.

This study therefore examines the principal operational models and their challenges through the framework of Maqāṣid al-Sharīʿah. It uses a qualitative doctrinal and analytical approach, examining relevant Qur'anic and Prophetic principles, classical concepts of Islamic commercial law, contemporary academic literature and standards issued by AAOIFI and the IFSB. Its central argument is that the effectiveness of Takaful must be assessed not only by the validity of its contracts but also by its ability to realize justice, cooperation, transparency and genuine financial protection.

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[1] International Islamic Fiqh Academy [IIFA], 1985, Resolution No. 9 [9/2]
Accounting and Auditing Organization for Islamic Financial Institutions [AAOIFI], 2015, Shariah Standard No. 26

[2] Qur'an 5:2

[3] Ṣaḥīḥ Muslim, Hadith 2586a

[4] Wahab et al., 2007; Noor, 2013; IFSB, 2009

2. Conceptual and Shariah Foundations of Takaful

The term Takaful is associated with mutual guarantee and collective responsibility. In contemporary Islamic finance, it refers to an arrangement in which participants contribute to a common fund for the purpose of providing financial assistance to members who suffer specified losses. AAOIFI describes Islamic insurance as an agreement among a group of persons to address specified risks through contributions made as donations, with the resulting fund having its own financial liability. [5]

Mutual cooperation (Taʿāwun): Participants contribute to a common arrangement to assist one another. This reflects the Qur'anic instruction to cooperate in righteousness and piety.

Donation (Tabarruʿ): Contributions to the risk fund are structured on the basis of donation, subject to the rules governing the Takaful arrangement. This is a central feature distinguishing the cooperative basis of Takaful from a conventional commercial insurance contract. [6]

Justice (ʿAdl): The rights and obligations of participants and operators must be clearly defined. Neither party should unjustly benefit at the expense of the other. Fair treatment and balanced stakeholder interests are also emphasized in the IFSB's governance principles.

Protection of wealth (Ḥifẓ al-Māl): The Takaful fund must be managed responsibly, and participants' contributions should be protected from unjustified deductions, mismanagement and undisclosed risks. Protection of wealth is one of the five essential objectives commonly identified in classical Maqāṣid literature.

Trustworthiness and transparency (Amānah and Bayān): Operators manage funds entrusted to them. Their remuneration, expenses, investment activities and surplus policies should therefore be disclosed clearly. AAOIFI requires the operator's management fee to be specified in the agreement, while IFSB standards emphasize disclosure of relevant fund and surplus policies.[7]

These principles indicate that Takaful is not simply an insurance product with Islamic terminology. Its institutional structure should preserve the spirit of mutual assistance and protect the interests of participants. The IIFA has also called attention to operational, legal and supervisory problems that require an integrated framework for cooperative insurance. [8]

3. Major Operational Models of Takaful

Major operational models of takaful are the following:

3.1 Muḍārabah Model

Under the Muḍārabah model, participants provide the investment capital while the operator performs the role of Muḍārib, managing investment activity in return for an agreed share of investment profit. The model draws upon the established Islamic commercial contract of Muḍārabah. In practice, the relationship between the operator and participants' fund may be structured differently for underwriting management and investment management; AAOIFI

[5] AAOIFI, 2015, Shariah Standard No. 26, paras. 2–3
[6] IIFA, 1985; AAOIFI, 2015
[7] AAOIFI, 2015, para. 10/1; IFSB, 2009
[8] IIFA, 2012, Resolution No. 187 [2/20]).

recognizes Wakālah for management and Muḍārabah or investment agency for investment activity. [9]

A significant issue arises when investment profit and underwriting surplus are treated as though they were the same category. Investment profit results from investing fund assets, whereas underwriting surplus is the excess remaining in the risk fund after claims, expenses, provisions and relevant liabilities have been accounted for. Their legal and financial treatment should therefore be clearly distinguished. AAOIFI states that the policyholders' fund is entitled to contributions, their returns, reserves and insurance surplus, and bears the direct expenses of insurance operations. [10]

Where an operator claims a share in underwriting surplus, the arrangement requires a clear and independently defensible Shariah basis; an entitlement to investment profit does not, by itself, establish an entitlement to underwriting surplus. The IFSB notes that the Wakālah–Muḍārabah model separates underwriting management from investment management and records a juristic position that underwriting surplus is not investment profit. Scholarly research also identifies surplus-sharing and operator incentives as contested matters in Takaful practice[11].From the perspective of Maqāṣid al-Sharīʿah, the model should ensure protection of participants' wealth, fairness in the distribution of financial benefits and transparency in the calculation of surplus.

3.2 Wakālah Model

Under the Wakālah model, the operator acts as an agent responsible for managing Takaful operations in return for an agreed agency fee. The model offers a relatively clear distinction between the participants' fund and the operator's remuneration. AAOIFI requires the management fee to be specified in the agreement so that participants can approve it.

Nevertheless, practical implementation raises several concerns. An excessively high or insufficiently disclosed Wakālah fee may reduce the resources available for risk protection. Where the fee is calculated as a proportion of gross contributions, the operator may have an incentive to increase business volume even where underwriting quality is weak. IFSB-29 expressly identifies this potential conflict and explains that poor underwriting and inappropriate pricing may increase the operator's fee while producing a deficit in the participants' risk fund.[12]

Another important issue is the use of Qard to finance deficits in the participants' fund. Qard is an interest-free loan and may serve as a financing mechanism when a fund lacks sufficient assets to meet its obligations. However, recurrent deficits require examination of pricing, expenses, underwriting practices and the long-term financial sustainability of the fund. IFSB-29 requires clear policies for Qard, fair and transparent treatment, and corrective action where persistent deficits result from mismanagement or excessive fees[13].A Maqāṣid-based assessment therefore requires that the agency fee be reasonable, transparent and properly disclosed, while the causes and repayment arrangements of Qard should be clearly explained.

[9] AAOIFI, 2015, paras. 4/2 and 10/1; IFSB, 2009
[10] AAOIFI, 2015, para. 3/2
[11] Khan, 2015; Mohamed Naim et al., 2018
[12] IFSB, 2023, paras. 79–80
[13] IFSB, 2023, paras. 81–85

3.3 Hybrid Wakālah–Muḍārabah Model

The hybrid model combines Wakālah for the management of underwriting activities with Muḍārabah for investment management. It seeks to distinguish operational management from investment activity and to provide a framework for remunerating the operator. This division is recognised in the IFSB's description of the Wakālah–Muḍārabah arrangement.

Despite its potential advantages, the combination of contractual relationships can make the structure difficult for participants to understand. The operator may receive an agency fee for managing the fund and a share of investment profit for investment management. If these entitlements, expenses and surplus arrangements are not clearly separated, participants may find it difficult to determine how their contributions are being used. The principal concern is therefore not the mere combination of contracts, but the possibility of contractual complexity, inadequate disclosure and unclear allocation of financial rights.

The model should maintain a clear distinction between the participants' risk fund, participants' investment fund where applicable, shareholders' fund, investment returns, management fees and underwriting surplus. IFSB governance principles require clear disclosure of product design, fund separation, surplus allocation and the treatment of Qard. In Maqāṣid terms, clarity strengthens bayān, fair allocation promotes ʿadl, and transparent management protects amānah.

3.4 Waqf-Based Takaful Model

The Waqf-based model establishes a Waqf arrangement through which contributions are dedicated to a fund for mutual assistance. The operator or administrator manages the fund according to the governing rules and the conditions of the Waqf. In some formulations, Waqf is combined with Wakālah and investment-management arrangements; it should therefore not be treated as a single uniform model across all jurisdictions. [14]

Conceptually, this model has a strong connection with social solidarity and collective welfare. It can provide a clearer distinction between the participants' mutual fund and the commercial interests of shareholders. However, the legal consequences depend on the governing documents and the applicable law. The model faces practical challenges concerning legal recognition, the status and ownership of the Waqf fund, trusteeship, governance, accountability and the relationship between the Waqf and the operator.

The Waqf-based model has potential for strengthening the social dimension of Takaful, particularly where its structure is designed to serve mutual protection rather than merely commercial expansion. Its suitability must nevertheless be assessed in light of local Waqf law, regulatory requirements and clear rules governing the fund.

4. Operational and Governance Challenges

4.1 Conflict of Interest between Participants and Shareholders

A fundamental challenge arises from the different interests of participants and shareholders. Participants expect affordable protection and fair treatment, whereas shareholders seek sustainable returns on their investment. This difference is not necessarily problematic; it becomes a governance concern when institutional arrangements systematically priorities

[14] Wahab et al., 2007; Noor, 2013

shareholder income over participants' rights. IFSB-29 requires Takaful providers to identify, manage and disclose actual or potential conflicts of interest and to explain the measures taken to protect consumers. [15]

The issue is particularly relevant to agency fees, expense allocation, surplus distribution and deficit financing. A sound governance framework must ensure that the operator's commercial interests do not undermine the cooperative purpose of the Takaful fund.

4.2 Transparency in Fees and Surplus Distribution

Participants should be able to understand the amount deducted from their contributions, the purpose of each deduction, the method of calculating surplus and the conditions governing its distribution. Unclear fee structures and undisclosed deductions weaken informed consent and may result in unfair treatment. AAOIFI requires the management fee to be stated in the agreement, while IFSB-8 requires disclosure of policies relating to reserving, surplus sharing, deficit mitigation and distribution of underwriting surplus or investment profits[16].The distinction between investment profit, underwriting surplus, reserves and operator remuneration is particularly important. Each category should be accounted for separately and disclosed in accessible language.

4.3 Deficit Financing through Qard

Qard may be used to support a Takaful fund when its assets are insufficient to meet liabilities. However, repeated dependence on Qard may indicate problems in pricing, claims management, expense control or risk assessment. IFSB-29 explains that excessive management fees and mismanagement can contribute to persistent deficits and quasi-permanent Qard; it therefore calls for written Qard policies, transparent repayment arrangements and corrective action where the operator is responsible for the deficit[17].The operator and regulator should examine the underlying causes rather than treating repeated Qard financing as a permanent substitute for sound fund management.

4.4 Effectiveness of Shariah Governance

Takaful institutions require both corporate governance and Shariah supervision. The Shariah Supervisory Board should not be limited to approving contractual documents before a product is launched. It should also have access to relevant operational information and review whether approved arrangements are implemented in practice. The IFSB's governance principles address the need for effective oversight, appropriate control functions and fair treatment of stakeholders. The IFSB's later conduct-of-business standard further emphasises the supervision of conflicts of interest and consumer protection.

Effective Shariah governance requires independence, competent supervision, proper documentation, periodic review and transparent reporting. Its purpose is to ensure that the institution's actual conduct remains consistent with its Shariah commitments.

[15] IFSB, 2023, paras. 73–76
[16] AAOIFI, 2015, para. 10/1; IFSB, 2009
[17] IFSB, 2023, paras. 81–85

4.5 Operational Efficiency and Accountability

High administrative expenses, weak risk assessment and inefficient management may reduce the value of participants' contributions. Although Takaful institutions may incur costs associated with Shariah governance and fund management, such costs should be justified, proportionate and transparent. The operator should be accountable for the proper use of the funds entrusted to it. This responsibility follows from the principle of amānah and the obligation to prevent avoidable harm. IFSB-29 specifically recognises that management fees, underwriting quality and expenses can affect the financial position of participants' funds.

5. Assessment of Takaful Models in the Light of Maqāṣid al-Sharīʿah

The objectives of Shariah provide a framework for assessing whether Takaful institutions fulfil their ethical and social purposes. Classical jurists, particularly al-Ghazālī, identified the preservation of religion, life, intellect, lineage and wealth among the essential objectives of Shariah; contemporary Maqāṣid scholarship has further developed the use of these objectives in institutional analysis.

First, ḥifẓ al-māl requires the protection of participants' contributions and financial entitlements. Excessive or unclear fees, improper fund management and unjustified deductions may undermine this objective.

Second, ʿadl requires fairness in the relationship between participants and operators. The allocation of financial benefits and responsibilities should be based on clear contractual rights rather than institutional bargaining power.

Third, taʿāwun requires that the cooperative purpose remain central to the Takaful arrangement. If the participants' fund becomes merely a source of predictable commercial income for the operator, the spirit of mutual assistance may be weakened.

Fourth, amānah and bayān require trustworthy management and adequate disclosure. Participants should understand the contractual structure, the operator's remuneration and the financial risks associated with the fund.

Finally, dafʿ al-ḍarar requires institutions to prevent avoidable financial harm. This includes addressing repeated deficits, misleading disclosures, conflicts of interest and inefficient management. These criteria are consistent with the IFSB's emphasis on fair treatment, disclosure and the protection of participants' interests.

It follows that no model should be declared superior solely because of its contractual label. The actual legal arrangements, financial practices and outcomes must be examined. A model that is theoretically sound may produce unsatisfactory results if its governance and implementation are weak. This approach also reflects the broader Maqāṣid perspective that legal and institutional arrangements should be assessed in terms of their purposes and consequences.

6. Recommendations

Clear contractual separation: The participants' risk fund, participants' investment fund where applicable, shareholders' fund, investment returns, underwriting surplus and management expenses should be clearly distinguished.

Transparent remuneration: Wakālah fees and other operator entitlements should be reasonable, justified and disclosed before participation. Fee structures should not create incentives for imprudent underwriting.

Fair surplus policies: The method of calculating and distributing underwriting surplus should be defined in advance and applied consistently, while ensuring that adequate reserves and liabilities are provided for.

Responsible Qard management: Institutions should disclose the causes, amount and repayment mechanism of Qard and address recurring deficits through improved risk and expense management. Where deficits result from operator negligence or mismanagement, the operator should bear the responsibility required by the applicable Shariah and regulatory framework.

Independent Shariah supervision: Shariah boards should review actual operations and not merely approve contractual documents. Their oversight should include fund separation, fees, surplus allocation, investments and Qard arrangements.

Participant protection: Institutions should establish accessible complaint mechanisms and provide participants with understandable information about their rights, charges and fund performance.

Strengthening Waqf-based arrangements: Regulators and practitioners should explore legally sound Waqf structures that can enhance social solidarity and inclusive protection, with clear rules on ownership, trusteeship and accountability.

Maqāṣid-based performance review: Takaful institutions should periodically assess whether their practices promote fairness, protection of wealth, transparency and mutual assistance.

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