

Participating Life Insurance Business in Malaysia

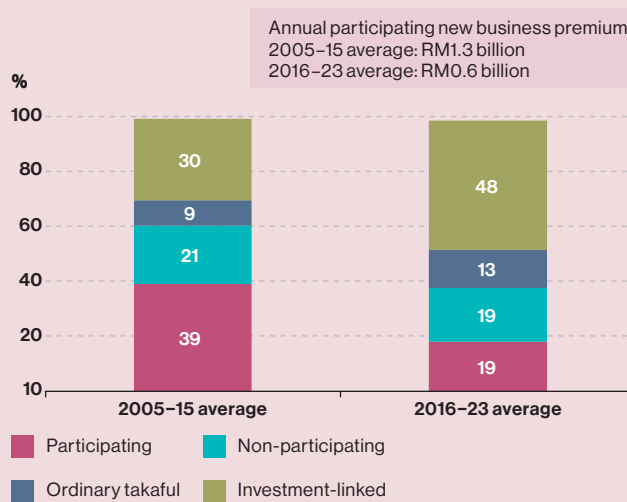
A participating life insurance policy is a type of insurance product that provides policyholders with the opportunity to participate in the profits of the insurance fund, in addition to receiving guaranteed benefits upon claims for insured events such as death or total and permanent disability. The profits of the participating life insurance fund may be distributed as non-guaranteed benefits¹ on a regular basis and/or upon termination, as determined by the policy terms. Participating life insurance policies typically include a savings element, where policyholders expect to receive maturity payouts upon termination or at the end of the policy term. In some markets, a participating life insurance policy is also referred to as a with-profit insurance policy.

This article reviews the developments in the participating life insurance business in Malaysia, provides insights into the factors driving the recent trends in the industry, and assesses the implications for the insurance sector.

Current developments in the participating life insurance business in Malaysia

In the recent decade, participating life insurance policies have seen a significant decline in their share of net premium in the life insurance and family takaful sector (Chart 1). This has been attributed to a prolonged reduction in participating life insurance new business premium, coupled with lower renewal premium arising from the termination and maturity of participating life insurance policies over time.

Chart 1: Life Insurance and Family Takaful Sector – Net Premium by Product Composition



Source: Bank Negara Malaysia

Factors driving the decline in participating life insurance business

The trend of declining participating life insurance policies is not unique to Malaysia. Some markets in Asia and Europe² are also facing similar situations. Several common challenges faced by insurers across Asia³ include the historically prolonged low-interest rate environment that has put pressure on investment returns, stronger regulatory requirements including changes to risk-based capital frameworks, and the availability of more attractive alternative policy offerings.

¹ Benefits can take the form of bonuses and/or dividends payouts, in addition to guaranteed benefits.

² Based on Milliman’s article dated 17 March 2021, titled ‘The with-profits end-game: A consideration of the potential approaches to winding up with-profits fund’.

³ Based on a survey conducted by Milliman in the second quarter of 2023 amongst 76 life insurers across Asia including Malaysia, China, Hong Kong, India, Indonesia, Philippines, Singapore, Sri Lanka, Thailand, and Vietnam (Participating business in Asia 2023 (milliman.com)).

Life insurers in Malaysia face similar challenges. In a survey conducted by Bank Negara Malaysia (BNM),⁴ more than half of the insurers surveyed cited the shift in consumer preferences towards insurance policies that provide greater protection against life uncertainties as a key contributing factor to the decline of participating life insurance policies. This preference partly reflects the heightened awareness and demand among Malaysians for financial protection to meet medical and health expenses, which are typically not covered under participating life insurance policies. Participating life insurance policies generally provide coverage for events such as death or total and permanent disability, which may not align with the current preferences of potential policyholders who are looking for coverage that addresses a broader range of financial needs.

Participating life insurance policies are also perceived to be less flexible compared to other life insurance policies. They typically have fixed premiums, with a guaranteed minimum coverage that is pre-determined at inception. In contrast, other life insurance policies such as investment-linked (IL) policies⁵ allow policyholders to make partial withdrawals or additional payments to their unit fund corresponding to their financial circumstances, as well as to choose and switch unit fund investments according to their risk tolerance and financial objectives.

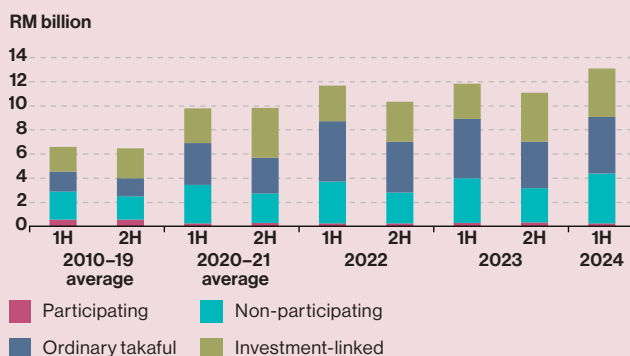
Furthermore, participating life insurance policies may be more difficult for policyholders to fully understand or appreciate due to the way in which profits are shared with policyholders. For example, the actual investment performance of a participating life insurance fund is not directly reflected in the declared bonuses due to smoothing practices.⁶ This contrasts with IL policies, where the return from an IL fund is directly reflected in the unit fund's value, with investment risks fully borne by the policyholders.

From the supply perspective, life insurers face heightened challenges in meeting expected investment returns of insurance funds in an uncertain macroeconomic environment. Life insurers are also factoring in enhanced regulatory requirements⁷ in their long-term strategies for participating life insurance business. These considerations have seen some insurers gradually scale back their offering of participating life insurance policies.

Impact on the insurance sector

The longer-term decline in the volume of new participating life insurance policies has led to a persistent trend of underwriting losses recorded for participating life insurance funds. However, the financial impact on the sector remains limited. Excluding the participating life insurance funds, the sector continues to record positive net underwriting performance, driven by other life insurance policies. Overall, total new business premium, including savings-based policies, continues to experience positive growth. This is supported by the sustained growth in alternative insurance policies, reflecting strong substitution effects associated with new business premium shifting from participating policies to IL and non-participating policies (Chart 2). Such effects have continued to support overall earnings performance.

Chart 2: Life Insurance and Family Takaful Sector – New Business Premium by Product Composition



Source: Bank Negara Malaysia

⁴ The survey was conducted by BNM in April 2024 on 11 life insurers in Malaysia writing participating life insurance policies.
⁵ A policy that combines life insurance coverages with investment components, where the investment risks are borne by policyholders.
⁶ Smoothing is a unique feature of participating life insurance policies, whereby life insurers may withhold some returns during periods of strong fund performance to maintain bonuses during periods of poor fund performance.
⁷ Refer to BNM policy document on Management of Participating Life Business issued on 10 July 2023 (<https://www.bnm.gov.my/documents/20124/948107/pd-Participating-Life-Business-Mgmt-July2023.pdf>).

Despite the shrinking participating life insurance funds, life insurers have allocated sufficient reserves to fund payouts for participating life insurance policies. Guaranteed benefits for policyholders are well covered by ample buffers, with a coverage ratio of 166% in June 2024.⁸ As of June 2024, the total surplus arising⁹ from participating life insurance funds remained positive at RM2.4 billion, adding to the overall capital buffers of ITOs.

Outlook

Insights from the BNM survey indicate that growth in new participating life insurance business will likely remain low in the foreseeable future.

For some insurers, the persistent decline of participating life insurance funds could reduce economies of scale for risk and expense pooling to an unsustainable level. Under the policy document on the Management of Participating Life Business issued by BNM in July 2023, insurers must observe specific requirements for managing small¹⁰ and shrinking participating life insurance funds to preserve the safety and soundness of the funds and safeguard policyholders' interests. These include requirements for insurers to take appropriate remedial or mitigation actions to address risks emanating from the decline of participating life insurance funds, including revisions to bonus management strategies, timely and proper communications with policyholders and increasing reserves, to ensure that payouts are commensurate with policyholders' reasonable expectations.

⁸ Ratio of participating life insurance funds total benefit reserves relative to guaranteed benefit reserves.

⁹ Surplus arising refers to the amount of change or increase in unappropriated surplus (excess of assets over liabilities, including reserves). The surplus can be used to support the capital requirement of the insurance funds.

¹⁰ Based on BNM policy document on Management of Participating Life Business, a participating life insurance fund is deemed small if (i) the size of the participating life insurance fund is less than RM2 billion; (ii) the number of in-force policies is less than 200,000; and (iii) the annual office premium is less than RM200 million.