Transforming the insurance landscape

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As the global economy shifts, financial markets across the world are constantly introducing new policies and changes to its systems to ensure that the financial cogwheels continue to turn.

The same can be said for Malaysia as the whole financial sector is currently undergoing several changes to its regulations, system and its sub-segments, including its insurance industry.

Undoubtedly, the insurance sector is one of the most important growth driver of Malaysia's overall financial services sector.

Based on Bank Negara Malaysia's (BNM) 2016 annual insurance statistics, Malaysia's total insurance fund assets in 2016, amounted to 5.2 per cent of the nation's financial system.

The insurance sector also contributes about 20.9 per cent to Malaysia's total gross national income (GNI) in 2016.

According to BNM, Malaysia's insurance industry is now going through one of its most significant transformation, possibly since the early 1990s when the insurance regulatory system in Malaysia was overhauled.

This transition comes in place at a time when the insurance industry is said to be at its 'down time', remaining stagnant for the last few years after several years of positive earnings growth.

BNM highlighted this phenomenon last year, at the 6th Malaysian Insurance Summit, as it pointed out that Malaysia's insurance sector is following an 'S-curve' trajectory.

"Growth in both the life and general insurance markets would significantly outpace the economy, ascending the steep slope up the 'S-curve'.

“Since then, total assets of the insurance and takaful sector have expanded at an annual rate of 13.3 per cent, more than tripling in value from RM52 billion in 2000 to RM181 billion in 2010,” BNM’s Governor Datuk Muhammad Ibrahim said in his keynote address for the 6th Malaysian Insurance Summit.

In more recent years however, this growth has started to plateau, he pointed out.

The life insurance penetration has remained stagnant at 55 per cent for the past few years, while in the general insurance sector, domestic capacity for larger and more specialised risks appears to be reaching its limits.

“This in turn has contributed towards sustained reinsurance outflows which have an impact on the country’s long term current account balances.

“Based on our observations, the industry appears to be approaching the point of inflection in the ‘S-curve’.

“Yet we know that its growth potential remains significant, with Malaysia still a long way from being a saturated market. This suggests that the industry is ripe for transformation to a new growth trajectory. The industry in essence has not delivered the required results,” he highlighted.

With that, BNM and members of the insurance industry have already started taking steps that are critical to revamp its system, to ride out the industry’s current dormant state.

In March last year, BNM had introduced the phased liberalisation of the motor and fire tariffs before transitioning to a fully liberalised market.

To note, the motor and fire insurance represent more than 60 per cent of the total general insurance market.

Previously, according to the General Insurance Association Malaysia (PIAM), for the past three decades, the premiums which insurance companies can charge consumers have been regulated by a tariff structure. This has resulted in a growing gap between premiums collected and claims paid out by motor insurers as well as volatility in the Motor Third Party business.

It is hoped that with the introduction of this new phased liberalisation of the motor and fire insurance, consumers and businesses would be able to enjoy wider options for their insurance coverage.

At the same time, insurers could benefit by introducing more packages to better fit the consumers’ risk profile, and different income and age groups while a liberalised market could encourage healthy competition amongst insurance companies.

“The implications of the reform are much wider than just an adjustment to premium levels. It will pave the way for a new wave of product innovation, significantly expanding choices for consumers.

“It will improve incentives for safe driving behaviours and better risk management practices by both risk owners and insurers. And it will address market distortions which have threatened access to motor insurance, particularly for higher risks.

“This is also a time when businesses and households are facing rising costs and more uncertain conditions which can adversely affect discretionary spending on insurance.

“At the same time, the exposures of households and businesses which insurance is designed to protect, have actually increased as evidenced by more frequent and severe incidents of natural and man-made disasters,” said BNM assistant Governor Jessica Chew in her keynote address at the General Insurance Agents Convention – ‘Distribution in a Liberalised Environment’.

From July 1, 2017, the second phase of the liberalisation of motor and fire insurance tariffs have started and it involves the gradual adjustments of tariffs, with emphasis on third party insurance products.

With that, BizHive Weekly takes a closer look at how this change will affect consumers, businesses as well as insurance companies:

Consumers at the forefront

One of the main focus of the liberalisation of motor and fire insurance tariffs is the consumers and how they can benefit more from being better protected by their insurance companies.

The de-tariffication of motor and fire insurance is aimed to give consumers more control over insurance products that can tailor to their needs and lifestyle.

The new policy also introduces a risk-based assessment pricing system which could encourage consumers to be more careful, in order to improve or maintain their risk profile.

With the liberalisation of the tariff means, insurance companies also can now charge premiums that correspond to the risk profile group of the consumers.

In other words, unlike before, where premiums are charged based on damages or losses inflicted on the property or automotive, insurance companies can now offer premiums based on consumers' behaviours and their attitude towards minimising damages or losses.

Typically, drivers with good driving records can enjoy a higher percentage of NCD up to 55 per cent.

According to the General Insurance Association Malaysia (PIAM), this also implies that different insurance companies can charge different rates for the same risk profile group based on their business risks models and strategies.

In this new environment, the insurance and takaful industry will have the flexibility to offer motor and fire products with new features at market-based pricing which is based on the risk profile, it added.

"The mechanics behind liberalisation is not only freeing the market price application but for consumers to be more aware of what they are purchasing and how they can get the best for the price they want to pay.

"In a liberalised environment, consumers will become more empowered as they will be able to pick and choose what they want to serve their needs. Liberalisation will also introduce many online distribution channels where shopping for products will be made much easier," PIAM chief executive officer Mark Lim shared with BizHive Weekly.

What should consumers be aware about?

As a consumer, PIAM noted that you can expect a wider range of motor and fire insurance products to cater for your lifestyle needs, along with preferred channels to purchase motor and fire insurance protection and higher quality of services provided by agents.

It also pointed out that premium charged on products will also vary from one insurance company to another based on their business risks models and strategies.

“Over time, it is expected that premium rates for both motor and fire insurance will adjust and align to the underlying risk, thus allowing vehicle owners and property owners with low risk profiles to be charged lower premium rates,” it said on its website.

However, PIAM also stressed that consumers should look beyond the pricing of their motor or fire protection plans.

“Consumer should not be looking at pricing as the only factor when purchasing a motor insurance protection plan.

“They should also look for what the policy covers, innovative features and customer service standards. Consumers should shop around to make informed purchasing decisions.

“As each insurance company is expected to be guided by its own identified risk factors in order to determine the premiums, the price of a motor policy would differ from one insurer to another,” Lim advised.

He added, under the phased liberalised environment, more factors will be taken into account in determining the premiums.

“Other than the sum insured, cubic capacity of the vehicle, age of the vehicle and age of the driver, premiums may also be based on the safety and security features of the vehicles, duration that the vehicle is on the road, geographical location of the vehicle and traffic offences on record,” he noted.

PIAM also advised that consumers should shop around and compare for appropriate covers and premium rates, and this should be done early before the policy expires.

More than just a product

Overall, a major challenge in implementing this new system is creating awareness and educating the public on the liberalisation of motor and fire insurance tariffs and how it will affect them.

In a quick survey, BizHive Weekly discovered that most consumers generally believe that when they renew their road tax, all they need to do is purchase a motor insurance to renew their road tax.

PIAM echoed this observation and noted that this goes the same for the fire protection policy, whereby consumers are only aware that they need to purchase an insurance plan to take up the re-payment loan.

However, now, it goes beyond that as insurance companies now offer more comprehensive packages while the risk-based assessment also factors the price consumers have to pay for.

"It is important for every citizen to know what is insurance and how it protects and help them in their times of need," Lim pointed out.

Earlier this year, a National Consumer Education Campaign (NCEC) was launched to create awareness and educate the public not just on liberalisation but also on the benefits of insurance protection as a whole.

"The NCEC is also a campaign that runs parallel with the government's initiative under the Economic Transformation Plan (ETP) to transform the country into a high-income nation and increase insurance market penetration.

"Market penetration will also result in financial inclusion which is important at all levels to ensure consumers are adequately protected and will be compensated for their losses," Lim explained.

Aside from that, he also noted that with the liberalisation of motor and fire insurance tariffs, it is hoped that the change would make consumers better drivers or better property owners.

"Recent statistics indicate that the total number of accidents recorded in 2016 increased to 521,466 from 489,606 in 2015. This on average is a seven per cent increase. Total deaths caused by road accidents also increased by seven per cent to 7,152 in 2016 compared to 6,706 in 2015," he said.

He added, "The association has continuously promoted road safety through its various campaigns held during the General Insurance Day and other public events. The consumers need to know that safe driving will be one of the factors that can help to lower their risk profiles and therefore benefit them in a de-tariffed market."

PIAM will also be collaborating with the Malaysian Institute of Road Safety Research (MIROS) and has recently signed a Memorandum of Understanding to combine their efforts in promoting road safety.

A steady shift in the insurance industry

As we enter the next phase of this liberalisation, how prepared are insurers in terms of setting up this new policy and how will they benefit from this liberalisation?

From a quick observation on major banks and insurance agencies in Malaysia, since early July this year, a few major insurance agencies have started holding campaigns to build the awareness of this change in the insurance industry.

According to PIAM, with effect from July 1, 2016, insurers are allowed to introduce new products for both the motor and fire classes.

It also noted that proper vetting and clearance by PIAM on the policy wordings is necessary so as not to create any confusion amongst consumers, especially on the coverage and benefits provided.

In this regard, the association set up an Industry Product Review Board (IPREB) in August 2016 with the objective to review these new product offerings by insurers and to ensure they are in line with the requirements issued by BNM.

“As at to-date PIAM has reviewed the wordings of 45 new Motor products and 21 new Fire products.

“Insurance companies who have had their products approved are launching them based on their targeted launch dates,” Lim revealed.

How will insurers benefit from this liberalisation?

However, after more than 30 years of using the old system, the bigger question here is, why now and how will insurance companies and agents benefit from a de-tariffed motor and fire insurance system?

PIAM answers, as Malaysia progresses towards a developed nation status, the insurance industry has to catch up too by opening up its market to allow a more equitable approach to the charging of premium.

“Any progressive nation has to have an open market to allow competition. Companies should be given an opportunity to compete in the market if they want to grow or progress.

“In addition to providing companies with these opportunities, it also gives consumers an opportunity to sample and purchase products that are unique or special and are customised to suit their needs,” said Lim.

In a liberalised environment, a good risk should be rewarded whilst a bad risk recognised.

“This will result in insured with good risks such as being a good and careful driver paying lesser premium compared to another driver who is in a class that is more likely to experience many accidents.

“If bad drivers reduce their risks they will be rewarded with reductions in their motor premiums,” Lim disclosed.

He also pointed out that improvement in the quality of service is also expected due to greater competition amongst insurers.

Meanwhile, analysts generally viewed that the detarrification of motor and fire insurance is crucial for the insurance industry as it promotes healthy competition amongst insurance players.

While there is a general belief that an open market could entail a destructive price war and the irregular pricing opens up questions on how the products are fairly priced, analysts pointed out that the prices are still monitored and it has to be in line with the capital framework issued by BNM.

In a report earlier this year, Kenanga Investment Bank Bhd’s research team (Kenange Research) opined, “From the pricing perspective, we gather that the new pricing of the new insurance products with more than 10 per cent deviation from the current tariffs are required to go for filing as governed by BNM.

“Subsequent to that, even if pricing deviation more than 10 per cent is technically justifiable, BNM may not approve if this affects the orderly development of detariffication, hence, providing another secure layer in preventing a price war.”

In a separate note, MIDF Amanah Investment Bank Bhd’s research arm (MIDF Research) in a report last year, noted that the pricing of insurance products is still required to fall within the risk based capital framework issued by BNM.

“Thus, it is immensely important for an insurer to invest in technology to build sophisticated pricing mechanisms and to improve its operational capabilities.

“Those lacking in capital to invest to improve their pricing models are likely to face an adverse impact from under-pricing for risk of insurance policies underwritten,” it warned.

Kenanga Research also viewed, for the insurers, while the general view is that the liberalisation may intensify competition, the risk-based capital framework in place coupled with the phased implementation should minimise the impact.

En route to a liberalised market

In the first phase of the liberalisation of motor and fire insurance tariffs, insurance companies are expected to progressively offer new products to the consumers and market price while existing motor third party product and motor comprehensive and motor third party fire and Theft product will continue to be made available.

In the second phase of the detarrification, starting July 1, 2017, premium rates for motor comprehensive and motor third party fire and theft product will be liberalised while for fire class insurance, will continue to be regulated under the tariff with gradual downward adjustments until a review is made in 2019.

In the final phase of the liberalisation of motor and fire insurance tariffs, BNM will evaluate the progress and impact of the phased liberalisation of the motor and fire tariff to determine the readiness of consumer and the industry for further liberalisation.

Before this final stage, BizHive Weekly asks, what changes can we expect to see?

PIAM’s Lim noted that there would be on-going preparations for this transition.

Timeline	Motor Business	Fire Business
Prior to July 1,2016	• All available products are defined in tariffs and are subject to tariff rates • Gradual adjustments to tariff rates for identified risk groups	
Effective from July 1, 2016 onwards	**Flexibility in product offering** • A licensed person shall continue to offer the same products at the same prices that were being offered as at June 30, 2016. Such products shall be offered in accordance with the tariffs • A licensed person may introduce new products at premium or takaful contribution rates as determined by the licensed person (market rates)	
Effective from July 1, 2017 onwards	**Gradual Tariffs adjustments** • The pricing for Third Party products shall be in accordance with the motor tariff and any pricing adjustments which the bank may specify for identified classes of vehicles • The pricing for Comprehensive and Third Party Fire and Theft products will be liberalised. Licensed persons will be able to determine the premium or takaful contribution rates for such products	• The pricing for fire products shall be in accordance with the fire tariff and any pricing adjustments which the bank may specify for identified categories of risks
Effective from 2019 onwards	• The progress and impact of the phased liberalisation will be evaluated to determine the readiness of consumers and the industry for further liberalisation	

(SOURCE: BNM)

“Insurers will be moving over to a new methods of underwriting their motor and fire portfolios with more focus on risk profiles of each insured person/peril and with actuarial computations,” he added.

However, he also pointed out that insurers are ready with their resources and systems. At this stage, it is critical now for consumers to be educated properly and made aware of how these changes are going to impact them.

“Development of options available for better services like online channels will be making a bigger impact.

“However, this does not mean that the traditional channels like marketing through agents will no longer be available.

“Certain consumer sectors still prefer to deal with their own insurance agents who have a wealth of knowledge to advise them what is best for their needs,” he commented.

Meanwhile, in terms of the implications of to the industry, Kenanga Research believed that there could be five outcomes from this liberalisation of motor and fire insurance.

It said, the industry could see differentiated rates to be priced according to risk profiles, wider range of motor and fire products to be introduced, higher efficiency level from insurers, diversified delivery channels as well as expanded role of intermediaries.

“In fact, our channel checks reveal that the insurers have been investing in new systems which aim to improve the group’s operational efficiency as well as enabling for more services rollout (which is claims through internet portal).

“Meanwhile, actuarial team with new systems have also been the area of investment focus which will be the enabler for best pricing and product strategies,” it added.

Regulatory reforms to support insurance industry

On the outlook of the overall insurance industry for 2017, RAM Ratings maintained its stable outlook on the Malaysian insurance and takaful sector in 2017, which is supported by the industry’s strong capital levels and regulatory reforms which augur well for the sector’s development.

Amid expectations of a delicate economic recovery, general insurance gross premiums growth is anticipated to stay below two per cent in 2017.

Market conditions were challenging for general insurers and takaful operators in 2016. It noted that gross premiums in the general insurance segment grew a marginal 0.9 per cent (compared with 2.5 per cent in 2015) to RM17.2 billion due to weaker growth in the motor and fire lines of business – segments which collectively represent more than 60 per cent of the sector’s premiums.

Similarly, it noted that the general takaful gross contributions expanded at a slower rate of 4.7 per cent (compared with six per cent in 2015) to RM2.4 billion.

However, it pointed out that topline growth moderation, the profitability of the general insurance and general takaful sectors strengthened to RM3.4 billion (compared with RM2.8 billion in 2015) on account of better claims experience.

“Looking ahead, tariff liberalisation initiatives in respect of motor and fire products may result in some initial price undercutting, but will spur an improvement in product innovation and risk selection criteria of general insurers and takaful operators,” the ratings agency said.

Similarly, Lim expected that the general insurance sector will continue its moderate growth pace. However, he also believed that the introduction of new products and increased options would lead to better insurance take up rates.

“We foresee more new products to be introduced and increased choices would result in better take up rates.

“Higher growth rates may be seen in the non-motor portfolios like fire and medical and health insurance.

“This will be supported by wider distribution channels and increased demand for medical and health insurance owing to changes in demographics and an ageing population.

“Moving forward, PIAM expects a low growth rate given the ongoing uncertainties in the external environment,” Lim said.

Meanwhile, for the life insurance segment, RAM Ratings believed that subdued consumer sentiment and inflationary pressures will slow the pace of life insurance (LI) gross premiums growth to about five per cent this year.

“We expect the takaful sector’s growth trajectory to remain higher than that of its conventional counterpart, underpinned by growth in the family takaful (FT) segment. The FT penetration rate is substantially lower (15 per cent of the population) relative to life insurance’s 41 per cent.

“On the LI and FT front, regulatory measures to promote greater operational efficiency and increase the focus on direct commission-free distribution channels will lead to more affordable product offerings. These will help address the protection gap in Malaysia and steer the sector towards the target penetration rate of 75 per cent.”

Overall, regulatory reforms are expected to support the industry’s growth prospects, which remain favourable, despite some near-term moderation.