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Policies and Measures to Strengthen the Insurance Industry

Implementation of the Financial Sector Masterplan

The Financial Sector Masterplan (FSMP) entered its second year of implementation in 2002. The year saw the completion of a number of new initiatives under the FSMP towards achieving the Bank's long-term strategic vision for the insurance industry. In particular, the initiatives are aimed at further advancing the capabilities of domestic insurers and strengthening the regulatory as well as consumer protection framework. This will provide a strong foundation for a dynamic and stable insurance sector in the increasingly more complex and competitive environment. The key initiatives undertaken in 2002, presented under the key result areas identified in the FSMP, are set out below:-

- **Greater Operational and Management Flexibility**

The ability of insurers to deliver premier services to consumers efficiently and effectively is essential, as consumers now have access to an increasing array of options for financial planning and risk management. To maintain and promote the competitiveness of insurers in this environment, insurers are now given greater operational and management flexibility without compromising prudential safeguards that protect policy owners' interests.

During the year, remaining restrictions on the **outsourcing of non-core activities** by insurers were removed. Insurers are now allowed to engage the services of resident service providers or their group resources located in Malaysia to achieve greater economies of scale and access to advanced technology, resources and expertise that will in turn, facilitate greater operational innovation.

A more flexible policy on the **outsourcing of the management of**

funds by insurers to approved fund managers was also introduced, providing for higher limits on funds that an insurer may outsource. The policy review took into recognition the importance of developing investment capabilities within the insurance industry over the long term, which is critical to the successful conduct of insurance business. Accordingly, the revised policy allows smaller insurers that may lack economies of scale substantially greater flexibility to engage professional fund managers to manage a significant portion of their funds for greater efficiency and improved performance. At the same time, larger insurers are allowed to outsource the management of funds within specified limits for the purpose of performance benchmarking.

To accelerate the development of domestic skills and expertise, the policy on the **employment of expatriates** by insurers was also reviewed during the year. The areas in which insurers may employ expatriates were expanded to include, in addition to the fields of specialised underwriting, actuarial and information technology previously provided for, other areas involving product research and development, risk management and investment. Mechanisms to facilitate more effective transfer of relevant skills and expertise to the domestic insurance industry were simultaneously introduced, including specific requirements for expatriates employed to provide training in various forms to Malaysian personnel during the term of their appointment, and performance reviews to be carried out by insurers to assess the effectiveness of expatriates employed in contributing to the improved performance and development of domestic expertise.

- **Greater Opportunities to Create Business Synergy**

Regulatory initiatives during the year also took into account increasing pressures for

insurers to create business synergies and tap new resources to sustain continued growth and profitability under increasingly challenging business conditions. With this in view, **acquisitions of shares in direct insurers** were allowed to facilitate entry into the insurance market by new domestic institutional shareholders. A rigorous assessment process is applied by the Bank to determine the fitness and propriety of prospective new shareholders, and ensure that only shareholders that are able to demonstrate the capacity and commitment to contribute to the development of insurers are admitted. Together with the encouraging progress achieved to date in the market driven consolidation of the insurance industry which saw the successful completion of 14 mergers and acquisitions involving a total of 27 insurers between 1999 and 2002, the participation of strong domestic institutional shareholders in the insurance industry is expected to further strengthen the underlying foundations for achieving improved performance in the industry going forward.

- **Greater Consumer Protection**

A critical component of the FSMP involves specific measures to enhance consumer protection to ensure the orderly development of the industry in the more competitive and liberalised market. To this end, significant progress was achieved in finalising several key initiatives for implementation in this area.

During the year, the regulatory framework for the **introduction of financial advisers (FAs)** was finalised, paving the way for the advent of a new distribution channel for the sale of life insurance products. FAs that possess the necessary qualifications and expertise will be able to market a wide range of financial products from different institutions, thereby providing consumers with access to more options from a single source. Apart from raising standards of professionalism in the marketing of life insurance products, the development of

FAs is also expected to enhance the level of life insurance market penetration in Malaysia, particularly among up-market consumers, reduce acquisition costs for new business as well as increase productivity in the industry by attracting high performance intermediaries.

Other projects in the pipeline under the FSMP to provide for greater consumer protection include raising the **entry requirements and introducing additional compulsory examinations** as part of continuing education programmes for agents, the introduction of specific **guidelines dealing with unfair practices** in insurance business and the expansion of the role of the **Insurance Mediation Bureau**. In addition to the measures to strengthen consumer protection under the FSMP, the Bank, jointly with the industry, will also be launching a Consumer Education Programme in 2003. In this respect, a taskforce comprising representatives from the Bank, Life Insurance Association of Malaysia (LIAM), Persatuan Insuran Am Malaysia (PIAM), the Malaysian Insurance Institute (MII), the Islamic Banking and Finance Institute Malaysia and takaful operators has been established to plan and continuously monitor the educational initiatives to ensure that the programme effectively meets its objectives.

- **Effective Enforcement**

To further strengthen the Bank's supervision of the industry through the institution of a timely and consistent intervention process where called for, the **Informal Enforcement Actions Framework (IEAF)** for insurers was introduced during the year. The primary objective of the framework is to establish a structured and systematic approach towards the enforcement of pre-emptive and corrective measures. These measures are aimed at addressing deficiencies and imprudent practices, identified by the Bank through its ongoing monitoring and surveillance of insurers and takaful operators, that have an impact on the soundness of these institutions. Under the framework, the Bank may require

insurers and takaful operators to take prompt corrective actions under a Board Commitment, Board Resolution or Letter of Undertaking. The specific actions required by the Bank will depend on the severity of the deficiencies identified.

- **Greater Competition**

As part of efforts to gradually introduce greater competition in the domestic market, the Bank approved the **phased removal of voluntary cessions to Malaysian National Reinsurance Berhad** (MNRB) to enhance competition in the reinsurance sector. Taking into account the increased capacity of insurers to assume risks, especially the smaller and less complicated risks, the level of voluntary cessions which insurers are required to cede to MNRB was significantly reduced from cessions of up to 25% to only 5% of each class of general reinsurance business with effect from 1 January 2003. This will be followed by further reductions in the level of cessions at an appropriate time.

- **Tracking Progress**

The Bank continuously reviews the effectiveness of measures implemented under the FSMP towards meeting their desired results. To facilitate this process, the Bank initiated a **benchmarking programme** for the insurance industry with the threefold purpose of gauging the industry's response to the measures implemented, assessing their results in an objective and quantifiable manner, and identifying areas for further improvements to be made. Activities undertaken in 2002 in support of this initiative included:-

- (i) a seminar organised for the board of directors and chief executive officers of insurers and takaful operators focusing on benchmarking as a powerful tool to drive improvements in the areas of performance management, operational efficiency, corporate governance, risk management, distribution, and customer service;
- (ii) the development of benchmark

indicators on financial resilience, performance and productivity that will facilitate regular self-assessments by insurers of their relative performance against the industry's top performers and average industry ratios; and

- (iii) dialogues with individual insurers to discuss their performance results, initiatives and progress towards achieving the objectives of the FSMP, and areas for improvement highlighted through the benchmarking exercise.

The benchmarking exercise has yielded positive results, as evidenced by efforts to develop alternative distribution channels including the internet and bancassurance, emergence of more strategic alliances through mergers and acquisitions and specific commitments made towards improving core competencies and the professionalism of the agency force. However, based on performance indicators, there is substantial scope for improvements by domestic insurers, particularly in terms of achieving greater diversification of business portfolios for more stable growth, more effective control over management expenses, and increased productivity. Investment performance and business persistency were also identified as key areas for improvement within the life sector specifically.

Other Policies and Measures Implemented to Strengthen the Insurance Industry

In addition to the policies implemented under the FSMP, the year 2002 saw various other measures being undertaken to promote the orderly development of the insurance industry, with a particular focus on enhancing consumer awareness and understanding of insurance issues. Among the measures taken were:-

- **Anti-Money Laundering Measures**

In line with the effort to preserve the integrity and stability of the insurance sector, pursuant to section 14(b) of the Anti-Money Laundering Act 2001 (AML Act), with effect from 15 April 2002,

direct insurers, professional reinsurers and insurance brokers are required to report all suspicious transactions to the Bank. In addition, efforts were focused at enhancing the level of awareness and understanding on the provisions of the AML Act and the Guidelines on Anti-Money Laundering Measures for the insurance industry to ensure the effective implementation of anti-money laundering measures.

- **Medical and Health Insurance**
The Underwriting Guidelines on Medical and Health Insurance developed by LIAM and PIAM together with the Bank, had been implemented in March 2003. In addition to the Guidelines, which were developed to set minimum standards and controls on the underwriting of medical and health insurance for all insurers, LIAM and PIAM in consultation with the Association of Private Hospitals of Malaysia, have also introduced on 1 April 2002, a standardised Discharged Medical Report Form for the purpose of processing insurance claims.
- **Simplification of Policy Wordings**
In order to facilitate a better understanding and transparency of insurance contracts by policy owners, LIAM and PIAM introduced simplified policy wordings. The simplification of policy wordings for term assurance was completed and issued to the life insurance industry in September 2002, while the simplification of policy wordings for the motorcycle and 'Act' policies is in the final stages of drafting.
- **Translation of Policy Documents into Bahasa Melayu**
Life and retail fire insurance policy documents have been made available in Bahasa Melayu from 1 January 2002 and 1 July 2002, respectively. The Bahasa Melayu policy documents not only promote the use of the national language, but also supplement the industry's initiative to promote a better understanding of policy documents by policy owners.

Life Insurance

In addition to the measures taken to enhance consumer awareness, specific developments in the life insurance sector in 2002 continued to focus on enhancing agency professionalism. The measures undertaken for the year include the following:-

- **Revision to the Guidelines on Pinching of Agents**
The Guidelines on Pinching of Agents were revised in 2002. Initially issued in 1991 with the objective of regulating the movement of agents from one company to another, the Guidelines were revised in order to promote an orderly development of the agency force through higher levels of discipline and self-regulation among LIAM members. Effective 1 January 2002, the Guidelines emphasise training and quality recruitment as a way to build up an agency force and specify among other things, circumstances that would constitute a breach of the Guidelines and the corresponding penalties applicable.
- **Publication of an Educational Series on Life Insurance**
In an effort to enhance public awareness and appreciation of life insurance, LIAM contributed a series of articles on life insurance to three local dailies: Utusan Malaysia, the New Sunday Times and Nanyang Siang Pau. Published articles are also accessible on LIAM's website at www.liam.org.my covering topics that include understanding of cash bonuses, making life insurance claims, medical and health insurance, investment-linked life insurance and annuity. In addition, the articles on understanding cash bonuses and life insurance claims were compiled into booklets which were officially launched on 27 February 2002. Each booklet contains articles in three languages, namely English, Bahasa Melayu and Mandarin.
- **Registered Financial Planner**
Officially launched by the Governor of the Bank on 5 November 2002, the Registered Financial Planner (RFP) programme is designed to prepare life

insurance agents to move towards the trend of the establishment of one-stop financial service providers, which will offer consumers a broad range of savings and investments options. As an integrated financial planning programme jointly developed by LIAM, MII and the National Association of Malaysian Life Insurance and Financial Advisors, all insurance-based financial planners will be required to attend this programme. Upon completion of the seven-module programme, successful individuals who meet the requisite professional conduct and ethical standards will be conferred the RFP designation by the Malaysian Financial Planning Council (MFPC). As the national body for financial planning professionals in the insurance industry, the MFPC will conduct dialogues with other organisations currently offering financial planning courses with a view of integrating the different qualifications under one umbrella organisation.

General Insurance

To continuously improve market practices and underwriting skills in the general insurance sector, the following initiatives were implemented:-

- **Motor Insurance**

To improve market practices in the motor insurance industry, PIAM implemented the following with support from the Bank:-

- (i) **Centralised Database for Motor Repairs Estimation**

The centralised database for motor repairs estimation was introduced on 1 October 2001 to reduce subjectivity in motor repairs estimation. The usage level of the database by the insurance industry had improved significantly from 11% in January 2002 to 38% in December 2002. The Bank will continue to monitor the usage level of insurers to reduce subjectivity in motor claims assessments. The

database will be expanded further in 2003 to include non-franchise parts prices for new models of private cars as well as other categories of motor vehicles, including commercial vehicles and motorcycles. With these improvements, the industry is expected to maximise utilisation of the database in 2003.

- (ii) **Reporting of Non-compliance with Statutory Cash Before Cover Requirements**

The Insurance Regulations 1996 relating to Cash Before Cover (CBC) stipulate that a licensed general insurer is not permitted to assume any risk in respect of motor policies unless the premium payable is received by the insurer. Where the premiums are collected by agents or brokers on behalf of an insurer, the premiums must be remitted to the insurer within seven days. In order to enhance market discipline and compliance with the CBC requirements, insurers are required to report to the Bank, on a quarterly basis, all instances of CBC non-compliance for motor business underwritten with effect from 1 January 2003. The reports will enable the Bank to monitor and enforce the CBC requirements more effectively.

- (iii) **Windscreen and Windows Sandblasting Scheme**

As a measure to combat the theft of motor vehicles, a scheme was introduced by PIAM in April 2002 to provide passenger cars with comprehensive and third party fire and theft motor insurance covers with free sandblasting of vehicle registration numbers on the front and rear windscreens and quarter-glass of their motor vehicles. Recognised by the Police as a deterrent of vehicle theft and as a useful feature to assist in the discovery and recovery of stolen vehicles, the free sandblasting service would be provided to policy

owners at the discretion of insurers participating in the scheme. To enjoy the benefit, selected policy owners would have to utilise the services of workshops authorised by their insurers from the PIAM Approved Repairers Scheme.

- **Protocol 5 on the ASEAN Scheme of Compulsory Motor Vehicle Insurance**

As a first step towards the implementation of a harmonised scheme of compulsory motor vehicle insurance within ASEAN, the ASEAN Finance Ministers signed Protocol 5 on the ASEAN Scheme of Compulsory Motor Vehicle Insurance on 8 April 2001 in Kuala Lumpur. In 2002, the implementation of Protocol 5 saw further progress with the signing of the Inter-Bureaux Agreement by the National Bureaux of ASEAN countries in December 2002. The Inter-Bureaux Agreement is intended to ensure the efficient and effective coordination and cooperation among the National Bureaux. Designated as Malaysia's National Bureau (NB) for Protocol 5, PIAM will be responsible for ensuring the smooth functioning of the Protocol in Malaysia. In order to further facilitate cross-border goods transportation in the region, the ASEAN Insurance Training and Research Institute (AITRI) has been commissioned by the ASEAN Insurance Regulators to study the possible approaches or strategies that may be considered by ASEAN countries to harmonise the compulsory motor vehicle insurance laws.

- **Revision of JPI/GPI 14: Guidelines on Claims Settlement Practices**

JPI/GPI 14: Guidelines on Claims Settlement Practices were issued in 1995 to lay down minimum standards for the prompt and fair settlement of claims. The Guidelines were revised in 2002 to incorporate improvement measures and market practices undertaken by both the Bank and the industry as well as to specify the minimum fraud control and risk management measures in claims handling. The revised Guidelines will be implemented in 2003.

- **Development of Underwriting Guidelines**

In 2002, PIAM issued two underwriting guidelines, namely the Risk Management and Underwriting Guidelines on Burglary Insurance and Money Insurance, and the Guidelines for Products Liability Underwriting. The Risk Management and Underwriting Guidelines on Burglary Insurance and Money Insurance were issued in view of the deteriorating claims experience and recommendations from the Police that risk improvement measures be imposed by insurers prior to the acceptance of cover. In addition to these guidelines, aimed at standardising underwriting practices in the industry, standard policy wordings were issued for Products Liability Insurance on 18 September 2002, while standard policy wordings are currently being formulated for the "Directors' and Officers' Liability and Company Reimbursement Insurance" and the "Warehousemen and Carriers Liability Insurance".

- **Regulation of Third Party Call Centres**

In view of the vast potential for the future growth of Third Party Call Centres (TPCCs) as an alternative distribution channel, parameters have been formulated in order to ensure that only professional TPCCs are allowed to conduct telesales activities for general insurance companies. Among other things, a set of minimum criteria was drawn up for the regulation and registration of TPCCs by PIAM. The criteria, as approved by the Bank, will ensure that the TPCCs appointed by insurers are financially strong and technically competent to promote and sell general insurance products.

- **Overseas and/or Local Training Trips as Incentives for General Insurance Agents**

General insurers were previously prohibited from providing overseas training trips for their agents except where the expertise in agents training is not available locally. Following PIAM's proposal, effective 1 May 2002, general insurers are allowed to provide overseas

and/local training trips to qualified agents on the basis that such training will elevate the agents' professionalism, motivate them to higher levels of performance as well as provide global exposure. However, the provision of the incentives by insurers is subject to certain conditions, which among other things, include the compliance of insurers with the management expenses limit and the agents fulfilling certain eligibility criteria for agents.

Insurance Brokers and Adjusters

Insurance Brokers

A number of talks on technical and structural developments in the industry were given by reputable and experienced speakers drawn from various fields to update and continuously upgrade skills of management and staff of insurance broking companies. In addition, individual brokers also took the initiative to continuously upgrade their skills and technical expertise through smart partnerships with selected life insurers.

As an effort to enhance corporate governance in the broking industry, brokers are required to increase the number of directors on their boards to a minimum of three by the end of 2003 and a minimum of five by the end of 2004. The increase in the number of directors is expected to provide brokers with a more effective board which would be able to provide strategic direction in terms of corporate objectives and business strategies.

On the international front, the Insurance Brokers Association of Malaysia, as a member of the Council of International Insurance Brokers Associations (CIIBA), attended the Annual Meeting of CIIBA in Northampton, England, in August 2002. Established in 1993, CIIBA provides an international platform for strategic discussions and the promotion of the role and profession of insurance broking on a global basis.

Adjusters

Although the sector is characterised by a large number of small adjusters, the year 2002 saw only one merger in the loss adjusting sector. Nonetheless, an increasingly larger number of

adjusters have entered into strategic alliances with foreign partners to facilitate the acquisition of technical knowledge and expertise. These partnerships have also created broader business opportunities for adjusters to provide other value added services. Going forward, adjusters will need to take steps to build capital and technical expertise in multiple sectors to remain relevant in the increasingly competitive environment.

As a founding member of the International Federation of Adjusting Associations, currently based in London, the Association of Malaysian Loss Adjusters had commenced an initiative to develop a standardised global education benchmark for adjusters in collaboration with the various loss adjusting associations from around the world.

Other Related Matters

The Malaysian Insurance Institute

As the premier insurance education provider in Malaysia, the MII continues to work closely with the insurance industry to provide training and education programmes tailored to meet the evolving needs of the industry. As a non-profit professional body established in 1968, the MII also works closely with internationally recognised insurance institutes, such as the Chartered Insurance Institute (U.K.), the Life Underwriters Training Council (U.S.A.) and the American Society of Actuaries.

In 2002, the MII conducted a total of 99 training programmes touching on technical as well as soft skills. Ranging from basic to advanced levels, the courses were attended by a total of 2,149 participants. As the accreditation body for the MII Diploma/Certificate (DMII/CIP) and Associate (AMII) qualifications, the MII also produced a total of 41 DMII/CIP graduates and 15 AMII graduates, bringing the total number of insurance personnel with DMII/CIP and AMII qualifications as at 31 December 2002 to 565 and 396 respectively. In addition, the MII offers the Graduate Diploma of MII programme, a fast track programme that provides graduates with an in-depth view of the insurance industry. In 2002, a total of 113 students registered for the programme, including 15 students from ASEAN countries.

Five programmes were also conducted under the ASEAN Insurance Training Fund (AITF), which were attended by 109 participants, including participants from various ASEAN countries. As a joint effort between the Malaysian Government and the local insurance industry, the AITF aims to channel resources to assist in insurance expertise development in the ASEAN region.

An important milestone in the year 2002 was the finalisation and adoption of the Memorandum of Understanding (MoU) on the establishment of AITRI at the Fifth Meeting of the ASEAN Insurance Regulators (AIRM) held in Chiang Mai, Thailand in December. The establishment of AITRI as the regional insurance training and research centre signifies the commitment of ASEAN members in training and human resource development cooperation. The MoU outlines the governing structure, management, activities and funding of AITRI. The Memorandum and Articles of Association for the formal establishment of AITRI are being finalised. In 2002, AITRI conducted three programmes for regulators and seven technical courses for insurance practitioners. AITRI has also embarked on two research projects in the areas of harmonisation of ASEAN insurance laws and human resource development needs which are expected to be completed in 2003.

International and Regional Cooperation

The Bank also participated in the following regional and international insurance forums during the year:-

- **Fifth Meeting of the ASEAN Insurance Regulators and Third Joint Meeting between the ASEAN**

Insurance Council and the ASEAN Insurance Regulators

The Fifth AIRM and the Third Joint Meeting between ASEAN Insurance Regulators and the ASEAN Insurance Council, held from 17 to 19 December 2002 in Chiang Mai, Thailand, saw further progress made in the various areas of insurance cooperation at the ASEAN level. In addition to the finalisation and the adoption of the MoU on the establishment of AITRI, the meetings also saw the following developments:-

- (i) endorsement of the revised ASEAN Unified Forms of Statistics and guidance notes which will serve as a template for the compilation of ASEAN insurance statistics to monitor the performance of the insurance sector in the region; and
- (ii) further reiteration of commitments by ASEAN countries to work towards achieving observance of the Insurance Core Principles promulgated by the International Association of Insurance Supervisors (IAIS).

- **Ninth Annual Conference and Annual General Meeting of the International Association of Insurance Supervisors**

The Bank participated in the Ninth Annual Conference and Annual General Meeting of the IAIS which was held in Santiago, Chile in October 2002. One new paper, Principles on Minimum Requirements for Supervision of Reinsurers, was approved by the IAIS at the Annual General Meeting.