

Insurance and Takaful Sector

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Insurance and Takaful Sector

PERFORMANCE OF THE INSURANCE AND TAKAFUL SECTOR

The insurance and takaful sector maintained its growth momentum in 2017. Total premiums and contributions increased by 3.5% to RM63.5 billion (2016: 4.4% to RM61.3 billion), while total insurance and takaful assets increased by 8.1% to RM309.0 billion (2016: 5.0% to RM277.0 billion). The industry remained strongly capitalised, reporting an aggregate capital adequacy ratio of 233.8% as at end-2017, well above the 130% minimum required. Capital in excess of the regulatory minimum totalled RM38.7 billion (2016: RM37.9 billion).

Total premiums and contributions increased by 3.5%, while total insurance and takaful assets grew by 8.1%

There were 55 insurers and takaful operators, including reinsurers and retakaful operators as at end-2017 (Table 3.1 and Table 3.2). During the year, a composite insurer converted into a life insurer. The remaining composite insurers and takaful operators are on track to split their operations into separate life/family and general businesses as required under the Financial Services Act 2013 and Islamic Financial Services Act 2013. The number of approved insurance and takaful brokers and financial advisers increased to 57 (2016: 56). In 2017, 45 loss adjusters (2016: 43) were registered under the Financial Services Act 2013.

Table 3.1

Number of Insurers and Takaful Operators

Categories	Number
Life insurer	11
General insurer	19
Composite insurer	3
Family takaful operator	3
General takaful operator	8

Source: Bank Negara Malaysia

Table 3.2

Number of Reinsurers and Retakaful Operators

Categories	Number
Life reinsurer	1
General reinsurer	5
Composite reinsurer	1
Retakaful operator	4

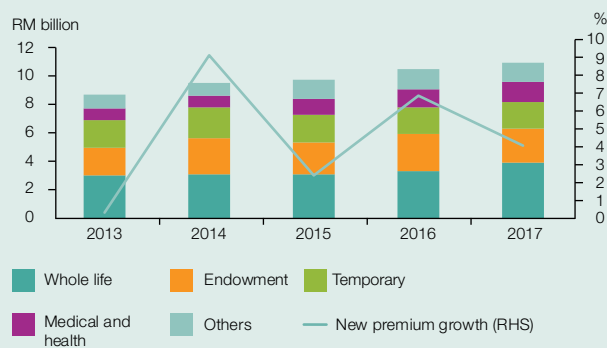
Source: Bank Negara Malaysia

Life insurance and family takaful

Life insurers and family takaful operators continued to record positive growth in new business, with new premiums and contributions increasing by 5.8% to RM15.1 billion in 2017 (2016: 7.5% to RM14.2 billion) (Chart 3.1 and Chart 3.2). The overall product type composition of life insurance and family takaful remained broadly unchanged (Chart 3.3), continuing the trend over the past five years. Whole life, endowment, mortgage-related term insurance and takaful products continued to dominate the share of new premiums/contributions, collectively making up 64.8% of total new premiums/contributions.

Chart 3.1: Life Insurance Sector – New Premium Growth and Breakdown by Product Type

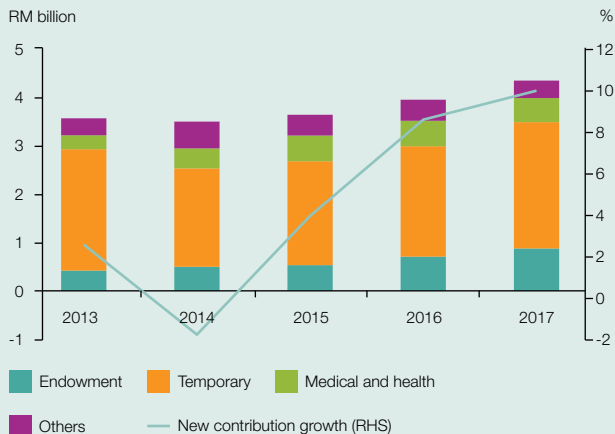
Positive new premium growth recorded for the life insurance sector



Source: Bank Negara Malaysia

Chart 3.2: Family Takaful Sector – New Contribution Growth and Breakdown by Product Type

The family takaful sector continued its growth momentum

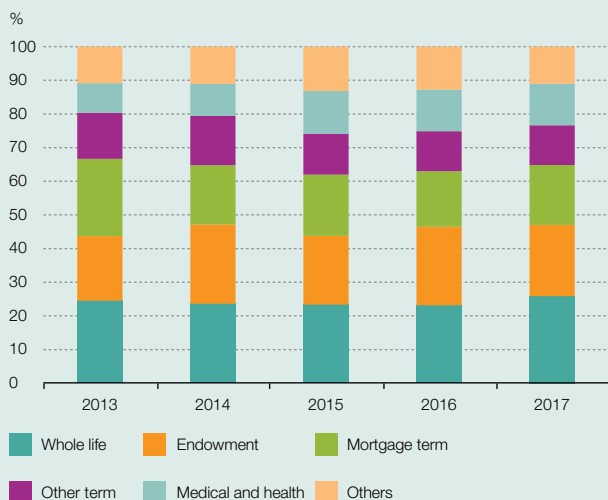


Source: Bank Negara Malaysia

In terms of product class, investment-linked products were a key growth driver in the life insurance sector, accounting for 44.5% of new premiums. Investment-linked insurance new premiums grew 26.3% in 2017, well above the 3.6% annual growth seen between 2013 and 2016, due to a distinct shift in strategic focus from ordinary life participating products

Chart 3.3: Life Insurance and Family Takaful Sector – Composition of New Premium and Contribution by Product Type

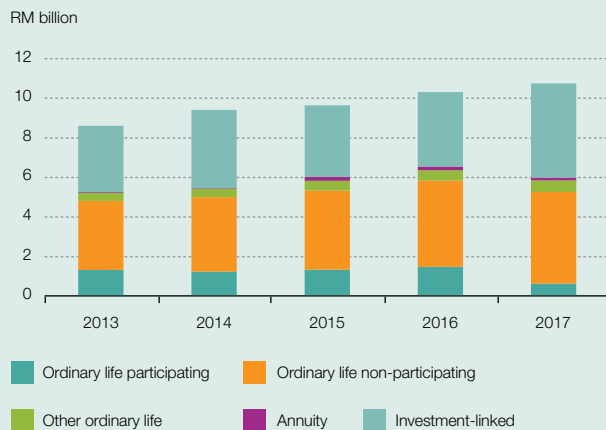
Life insurance and family takaful product composition remained broadly unchanged



Source: Bank Negara Malaysia

Chart 3.4: Life Insurance Sector – New Premium Breakdown by Product Class

Investment-linked products were the key driver for life insurance new premium growth

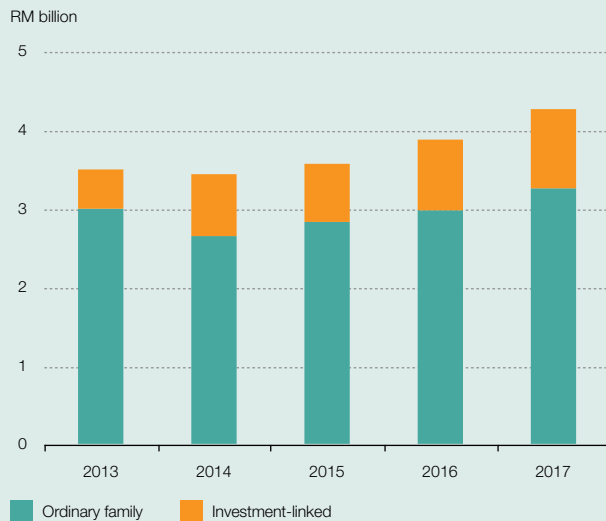


Source: Bank Negara Malaysia

to investment-linked products (Chart 3.4). The decline in new business of ordinary participating products (2017: -58.9%, 2016: 11.7%) was in part due to lower illustrations of returns which were more appropriate to inform purchasing decisions (refer to subsection on ‘Enhancement to sales illustrations for participating policies’). However, as it reduced the perceived

Chart 3.5: Family Takaful Sector – New Contribution Breakdown by Product Class

New contribution growth in the family takaful sector driven by ordinary family products



Source: Bank Negara Malaysia

attractiveness of the products, sales strategies by insurers and agents saw a bigger shift in focus to investment-linked products. For the takaful sector, ordinary family products grew by 9.5% (2016: 5.2%) (Chart 3.5), driven mainly by increased demand for mortgage-related term policies as a result of growth in Islamic financing.

The industry continued to generate surpluses in tandem with overall growth in 2017, contributed by surpluses arising from new business, insurance and investment margins. Excess income over outgo stood at RM18.8 billion (2016: RM13.3 billion).

General insurance and takaful

In the general insurance and takaful sector, gross premiums and contributions declined marginally (2017: -0.4%; 2016: 1.7%) (Chart 3.6). Positive growth in the motor, fire and medical businesses, the three largest contributors to gross premiums and contributions, was offset by the contraction in the offshore-oil segment (2017: -27.7%; 2016: -14.9%) in tandem with lower activity in the oil and gas sector. Excluding the offshore-oil business, the total gross premiums grew marginally by 0.4%. The motor segment grew 3.6% (2016: 0.5%) reflecting higher new car sales. At the industry level, the impact of the liberalisation of the motor tariff is not yet evident, given the short period of liberalisation to date and the overall cautious approach to making significant changes to pricing. Fire products also grew, albeit at a slower pace (2017: 0.9%; 2016: 1.4%),

reflecting a softer market for large and specialised risk premiums due to favourable loss experience and excess capacity in the global property and casualty reinsurance markets. Medical business grew by 6.4% (2016: 20.2%). Excluding reinsurance and retakaful, direct medical business growth was stable at 7.3% (2016: 7.8%), supported by higher demand for group medical cover and higher average premiums and contributions.

The retention ratio of the general insurance and takaful sector remained flat at 76.0% as at end-2017 (Chart 3.7). No significant change was observed for all personal lines (motor, medical and health, and personal accident). Retention levels for marine, aviation and transit risks improved, increasing to 35.7% from 30.6% in 2016, due to the contraction in offshore-oil business, where retention tends to be lower. The proportion of overall premiums and contributions ceded to foreign reinsurers and retakaful operators has been increasing over the past five years (2013: 15.5%; 2017: 24.4%) reflecting the industry's limited appetite to locally retain larger and complex risks. This points to a need to significantly build domestic capacity, both in terms of improving the spread of risks at the industry level and strengthening technical expertise at the company level to underwrite complex risks.

The general insurance and takaful sector remained profitable in 2017, although less so than the past five years. Underwriting and operating profits declined by 24.3% to RM1.4 billion and 21.9% to RM2.7 billion

Chart 3.6: General Insurance and General Takaful Sector – Gross Premium and Contribution Growth and Breakdown by Business Line

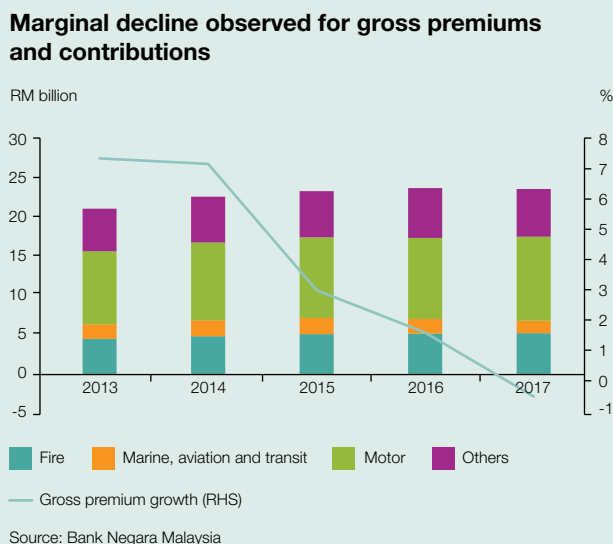


Chart 3.7: General Insurance and General Takaful Sector – Retention Ratio

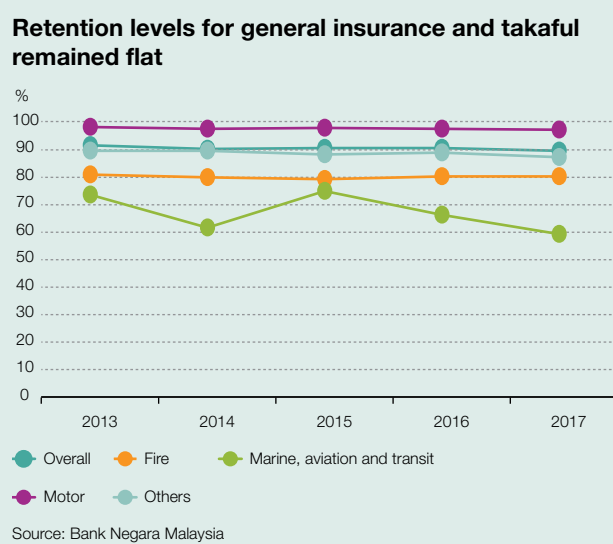
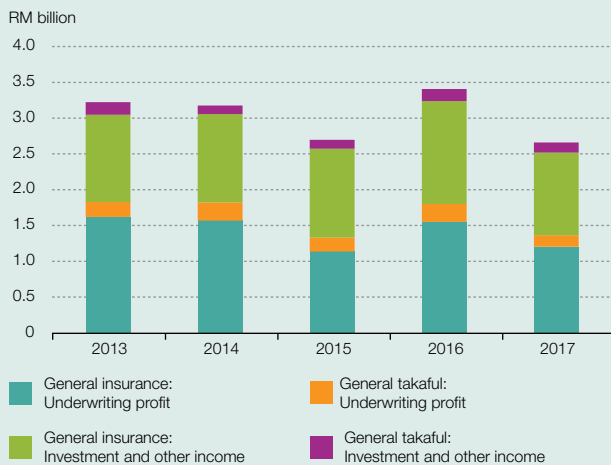


Chart 3.8: General Insurance and General Takaful Sector – Profitability

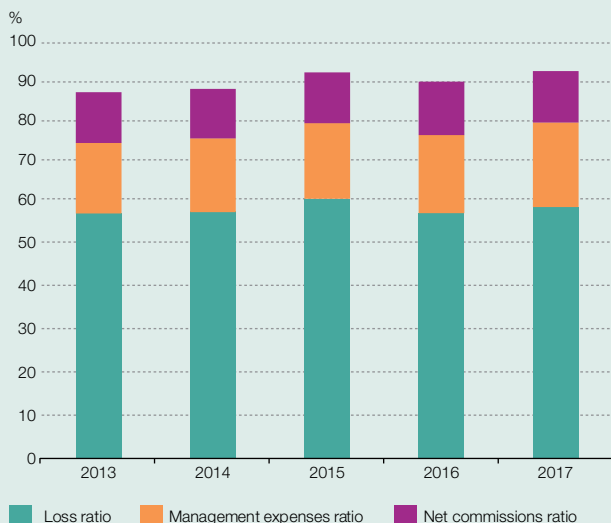
General insurance and takaful sector remained profitable



Source: Bank Negara Malaysia

Chart 3.9: General Insurance and General Takaful Sector – Combined Ratio

Overall loss ratio for the general insurance and takaful sector impacted by rising motor and medical claims

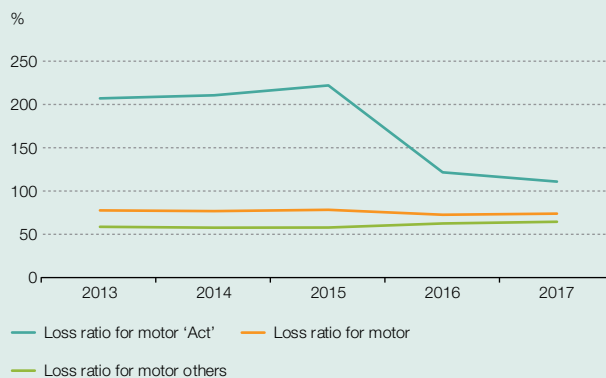


Source: Bank Negara Malaysia

respectively (Chart 3.8). The overall loss ratio for the sector increased to 58.3% from 55.9% in 2016 largely due to rising motor and medical claims (Chart 3.9). In contrast to the life and family sector however, investment income grew marginally to RM790.7 million (2016: RM775.3 million) for general insurance and RM99.9 million (2016: RM96.1 million) for general

Chart 3.10: General Insurance and General Takaful Sector – Loss Ratio of Motor Business Class

Loss ratio for motor business class increased



Source: Bank Negara Malaysia

takaful, reflecting the more conservative asset composition of the general sector which is invested largely in cash and fixed income assets.

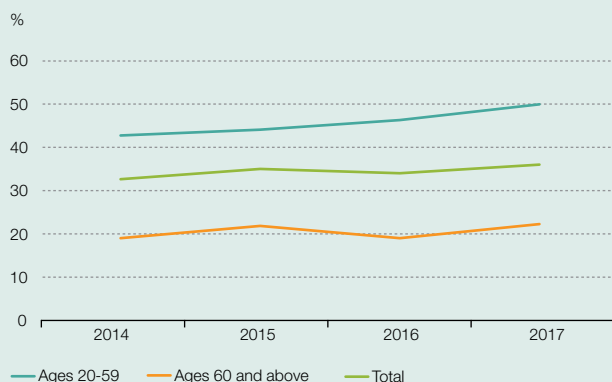
While the motor and medical segments posted relatively stronger premium growth, claims experience in both lines worsened. The overall loss ratio for motor products increased to 69.6% (2016: 66.0%) (Chart 3.10) due to higher frequency and severity of private car own damage claims, where severity was driven up by rising parts prices. The Malaysian Motor Insurance Pool (MMIP) is no longer a key contributor to motor losses, having posted underwriting and operating profits of RM54.0 million (2016: RM41.3 million) and RM122.5 million (2016: RM100.3 million), respectively, due to a better claims experience. The improved claims experience arose from more efficient claims management practices, which resulted in faster claims and a higher number of out-of-court settlements and therefore lower-than-expected claims settlement. Medical business as a whole experienced a sharply higher loss ratio of 83.2% (2016: 69.9%). However, excluding reinsurance and retakaful and focusing on direct business within Malaysia only, loss ratios remained stable at 71.0% (2016: 70.0%).

UPTAKE OF LIFE INSURANCE AND FAMILY TAKAFUL

Life insurance and family takaful uptake among Malaysians continued to see a gradual increase. The penetration rate of life insurance and family takaful, measured as a percentage of Malaysians who own at least one individual life insurance or family takaful policy

Chart 3.11: National Life Insurance/Family Takaful Penetration Rate by Age Bands

National life insurance and family takaful penetration rate grew marginally



Source: Bank Negara Malaysia

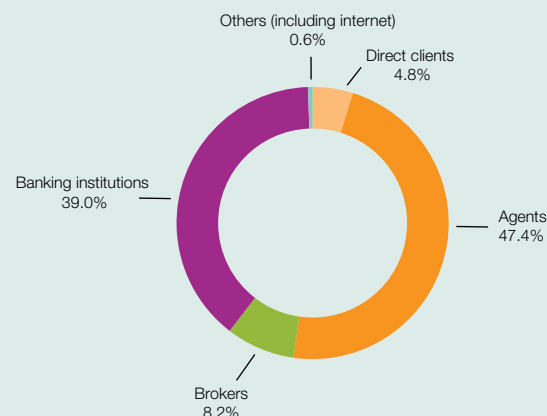
stood at 36.5% as at end-2017, compared to 34.5% in 2016 (Chart 3.11). The penetration rate is highest among those of working age (20 to 59 years old), the key segment of policy owners and participants. It also grew the fastest, reaching 50.4% at end-2017, up 3.6% from 2016 (46.8%). However, national-level growth over the past four years has been muted overall. Between 2014 and 2017, penetration grew by only 1.1 percentage points a year. This highlights the urgency for the industry to step up efforts to enhance their product offerings and business models towards meeting the needs and preferences of consumers.

Life insurance and family takaful penetration grew by only 1.1 percentage points over the past four years, highlighting the urgency for the industry to step up efforts to enhance their product offerings and business models

The agency and bancassurance channels continue to be the main drivers of new business constituting over 80% of the total new premiums of the life insurance sector (Chart 3.12). The online distribution channel, on the other hand, is still fairly new, with a small market share relative to other distribution channels. However, as the Bank continues to drive efforts to diversify distribution channels it is expected that the non-traditional channels will gain traction and contribute to a greater proportion of new business. Since July 2017, all life insurers and family

Chart 3.12: Life Insurance Sector – New Premiums Market Share by Distribution Channel

Agency force and bancassurance continue to be leading channels



Source: Bank Negara Malaysia

takaful operators have been required to offer pure protection term products through direct distribution channels. Insurers and takaful operators are expected to fully leverage on the outreach potential of multiple channels and innovate their products to more closely match the needs of the various consumer segments, ultimately increasing insurance uptake.

REGULATORY AND SUPERVISORY POLICIES AND DEVELOPMENTS

The Bank continued to embark on regulatory and supervisory initiatives towards strengthening business conduct, preserving financial stability and widening the outreach of insurance and takaful. Key development milestones over the year include the rollout of Phase II of the liberalisation of motor and fire tariffs; the introduction of direct distribution channels and improvements to incentive structures under the Life Insurance and Family Takaful (LIFE) Framework; and the *Perlindungan Tenang* initiative. Focus was also accorded on implementing International Financial Reporting Standard 17: Insurance Contracts (IFRS 17), stress testing, and measures to strengthen the professionalism of insurance and takaful intermediaries.

Phased liberalisation of motor and fire tariffs

The liberalisation of the motor and fire tariffs entered its second phase in 2017. Phase II of the reforms, which commenced on 1 July, allows insurers and takaful operators to individually set pricing for two existing

tariffed product lines based on the risk profiles of drivers and vehicles:

- (i) 'Comprehensive' products, which provide coverage for third party losses and loss or damage to an insured's own vehicle due to fire, theft or any road accident; and
- (ii) 'Third Party, Fire and Theft' (TPFT) products, which provide coverage for third party losses and loss or damage to an insured's own vehicle due to fire or theft only.

This follows from Phase I which took effect on 1 July 2016 where premiums for new motor and fire products outside the scope of the tariff were allowed to reflect market rates.

Starting from 2018, gradual tariff rate adjustments will be made to the remaining products under the tariffs, which are fire and motor third party products. An evaluation will be conducted in 2019 to pave the way for further liberalisation, taking into account market developments observed under the first two phases. The Bank will continue to monitor the impact of the liberalisation to ensure the orderly functioning of the insurance and takaful market in the public's interests.

A key objective of the phased liberalisation is to encourage innovation. This has been more pronounced in the fire and motor insurance businesses, where new motor products or extension covers were introduced by insurers (Chart 3.13). Notable examples include:

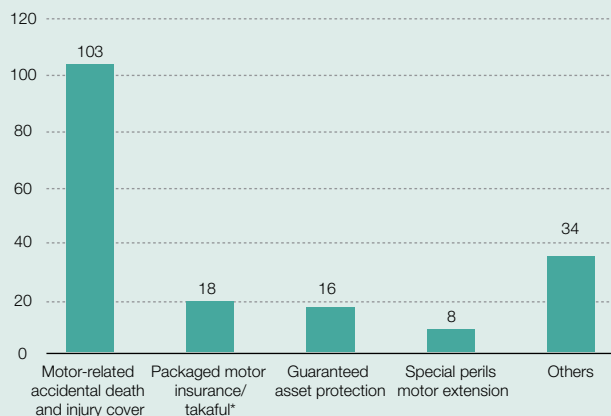
- (i) Guaranteed Asset Protection (GAP) coverage on the difference between the outstanding loan amount or invoice value of the vehicle and the market value of vehicle in the event of a Total Loss due to fire, theft and accidental damage;
- (ii) Limited special perils cover which provides more flexible cover for selected perils such as flood, storm and/or tempest. This type of cover was previously available only as a standardised packaged under the Motor Tariff;
- (iii) E-hailing extension cover which extends private car insurance coverage during the use of the vehicle for e-hailing services; and
- (iv) Usage-based insurance policies that compute premiums based on actual usage of vehicles as measured by telematics devices. This allows drivers who use their vehicles less often or practise safer driving to benefit from lower premiums.

Effects on pricing have also been observed across specific risk groups as insurers and takaful operators have begun to differentiate between lower and higher risks, consistent with more equitable pricing. Overall, average premiums per policy for 'Comprehensive' products remained broadly unchanged over the quarters of 2017. Premiums below the minimum motor tariff rates were, however observed across a range of vehicle makes and models. Where there were premium increases above the maximum motor tariff rates, these were for higher risk groups, particularly those more susceptible to theft. Moving forward, the Bank expects to observe greater differentiation in pricing as insurers and takaful operators increasingly adopt a wider set of risk factors in setting premiums, including vehicle security features, driving experience and behaviour, and the duration the vehicle is on the road.

The Bank is closely monitoring this transition. Premium revisions beyond a defined threshold are reviewed by the Bank and must be supported by empirical evidence. The Bank also increased its thematic reviews to evaluate compliance by insurers and takaful operators with stronger prudential and market conduct requirements. These include stronger governance over product development and pricing practices which should reflect a risk-informed approach and be consistent with the company's financial strength and risk appetite. Greater scrutiny by the board and senior management is also expected to ensure the suitability of products for identified target markets.

Chart 3.13: New Motor Products as at end-2017

New motor products are emerging from liberalisation of motor and fire tariffs



*Basic comprehensive coverage which is packaged with ancillary covers such as road assistance and personal accident insurance/takaful

Source: Bank Negara Malaysia

With more product options available, it is crucial that customers are able to make informed decisions when purchasing and renewing motor coverage. This is supported by a sustained public education and awareness campaign to educate the public on motor liberalisation. Beginning 2018, the Bank also regularly publishes information on premium developments on the Bank's website. In addition, tools made available by industry associations for comparing and selecting products provide a convenient means for customers to assess product information from multiple companies. The Bank continues to pursue broader reforms to increase the transparency and efficiency of motor claims management. This includes enhancing market infrastructure to provide more granular and reliable data for claims assessments, simplifying the claims process and addressing fraud.

In tandem with better customer experience at the point of sale, the Bank continues to pursue broader reforms to increase the transparency and efficiency of motor claims management

Life Insurance and Family Takaful Framework

Reform of the life insurance and family takaful sector continued to advance in 2017 and early 2018, with the issuance of the policy document on Direct Distribution Channels for Pure Protection Products, and revisions to the Guidelines on Operating Cost Controls for Life Insurance and Family Takaful Business to implement the Balanced Scorecard (BSC) framework.

(i) Implementation of Balanced Scorecard framework

Agency distribution continues to be an important channel for the life insurance and family takaful industry, contributing 47.4% of total new premiums in 2017. However, industry data suggests that overall productivity is low. Over half (65.2%) of life insurance and family takaful agents operate on a part-time basis and up to 64% of agents sell less than one policy per month. Three in four agents do not complete a comprehensive fact-find process for more than 80% of their customers, which increases the risks of unsuitable products being sold to policyholders. The BSC framework for agents, which took effect on 1 January 2018 aims therefore, to increase the level of professionalism of intermediaries. Under the BSC framework, 25%

of total commissions to the intermediary will be subjected to meeting key performance indicators (KPIs) on productivity, persistency, customer fact-find, continuing professional development hours and complaints. This will better align incentives with higher standards of professionalism and productivity for insurance and takaful intermediaries.

The Balanced Scorecard framework will drive insurance and takaful intermediaries towards higher standards of professionalism and productivity

The KPIs and corresponding performance thresholds under the BSC were developed in consultation with the industry, including the National Association of Malaysian Life Insurance and Family Takaful Advisors (NAMLIFA), and piloted over one and a half years in 2016 and 2017. Expectations are for higher overall remuneration to the agency channel, lifted by more productive agents. The share of more productive agents is also expected to trend higher as the impact of poor performance on remuneration becomes increasingly felt. Importantly, the BSC also ensures higher standards are met in terms of product suitability assessments and service quality. The Bank has set expectations for the industry to ensure that agents who underperform are provided with the necessary remedial training. To this end, the industry is collaborating with the Financial Accreditation Agency to introduce individual accreditations for the agency force to raise professional and ethical standards and identify specific interventions for agents that do not meet the required standards. Over the longer run as alternative distributions, including direct and online channels evolve, agents are expected to move towards higher value activities that involve advice, sales and customer support for more complex products.

(ii) Availability of products through direct distribution channels

As part of the policy objective to promote diversification of distribution channels, the Bank issued the policy document on Direct Distribution Channels for Pure Protection Products in June 2017. Beginning 1 July 2017, insurers and takaful operators were required to offer pure protection term life insurance and family takaful products directly to consumers. The Bank is currently finalising the specifications for direct offerings of critical illness, and medical and health products to be issued in 2018.

The Bank conducts ongoing monitoring and reviews to ensure that the LIFE Framework is implemented smoothly. Thematic reviews on 22 life insurers and family takaful operators were conducted during the year to assess compliance with business conduct requirements and the industry's readiness to implement the BSC framework requirements as planned. Priority was accorded towards ensuring that the appropriate infrastructure is in place to support direct channels, such as simplified underwriting processes and self-directed purchasing guides. Reviews also focused on ensuring adequate measures are taken by life insurers and family takaful operators to prepare agents for the implementation of the BSC framework.

Perlindungan Tenang

In November 2017, the Bank together with the insurance and takaful industry launched *Perlindungan Tenang*. This is an initiative to introduce a range of insurance and takaful products to meet the needs of underserved Malaysians, particularly the Bottom 40% household segment (B40). The introduction of *Perlindungan Tenang* follows from long-held concerns that the majority of existing insurance and takaful products on the market are complex and unaffordable, and thus out of reach of many Malaysians. This is evidenced by the low life insurance and family takaful penetration rate in particular among the B40 income segment.

Products under the *Perlindungan Tenang* banner must be affordable, provide good value, be widely accessible, be easy to understand, and be easy to purchase and claim on. Products meeting these criteria will carry the *Perlindungan Tenang* mark for easy public recognition. The state of insurance and takaful uptake among the B40, and the Bank's vision on how their needs should be met through *Perlindungan Tenang* are elaborated on in the Box Article 'Expanding Insurance and Takaful Solutions for the Underserved Segment'.

As at end-2017, the industry has launched a total of 10 *Perlindungan Tenang* products – six life insurance products, three family takaful products and one general insurance product. These products can be purchased through various distribution channels, including insurer and bank branches, agents, internet, mobile network and selected cooperatives and societies. The list of available products and participating institutions are listed on the respective insurance and takaful

associations' websites. Over 2,000 *Perlindungan Tenang* policies were sold within the first two months. Further traction is expected in 2018 with the planned launch of a national communications campaign to increase public awareness of *Perlindungan Tenang*.

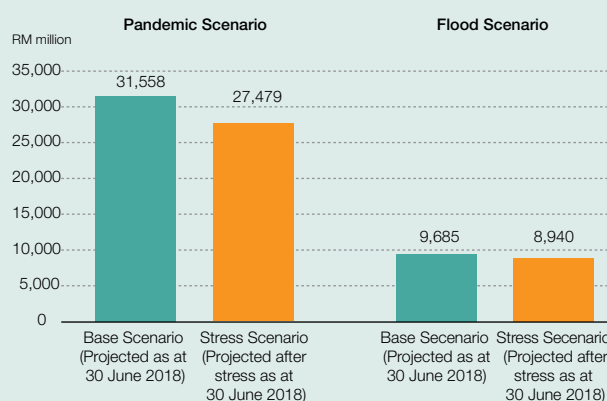
Stress testing of direct insurers and takaful operators

Pursuant to the policy document on Stress Testing issued in mid-2017, the Bank conducted the first insurance and takaful industry-wide stress test to assess resilience of direct insurers and takaful operators against severe but plausible insurance risk events assumed to take place over a one year time horizon. This included a pandemic event and a severe flood scenario.

The results affirm the industry's overall resilience against the tested scenarios. Post-stress, capital ratios will remain at comfortable levels above the regulatory minimum of 130% with surplus capital buffers at RM27.4 billion in the life and family sector and RM9.0 billion in the general sector (Chart 3.14). A significant portion of losses under the flood scenario will be absorbed by the insurers and takaful operators' reinsurance/retakaful arrangements. The Bank intends to repeat these tests annually, alongside regular industry consultations to further refine the scenarios and models.

Chart 3.14: Industry Surplus Capital Above Regulatory Minimum of 130% under Base and Stress Scenarios

Surplus capital buffers remained at comfortable levels under stress scenario



Note: For the purpose of this analysis, "surplus capital" is defined as total surplus capital for all funds within the company
Flood scenario results exclude composite insurers and takaful operators with small general businesses (<5% of total premiums/contributions)

Source: Bank Negara Malaysia

Key Arising Changes from the MFRS 17

1. Measurement of liabilities	Greater consistency with the introduction of a general measurement model <ul style="list-style-type: none"> • Where requirements were previously broad and principles-based, allowing for a variety of valuation approaches, there is now a general measurement model. Simplifications and adjustments to the general measurement model are allowed only under specific circumstances (i.e. the premium allocation approach for short-term contracts and the variable fee approach for direct participating contracts). • The general measurement model aims to ensure that insurance contracts are measured using updated assumptions on cash flows, discount rates and risk, at each reporting date. There is also greater clarity on the cash flows that should be taken into account in measuring the liabilities (i.e. the boundary of the contract).
2. Profit recognition	Profit recognition approach that better reflects provision of services and expectations on profitability <ul style="list-style-type: none"> • Profits can no longer be recognised on day one, but must be systematically recognised over the coverage period of the contract. • Portfolios of contracts have to be further segregated in a way that limits the offsetting of profitable contracts against onerous ones, to provide a clearer picture of profitability trends.
3. Disclosure	Greater clarity and transparency for users of financial statements <p>Key changes include:</p> <ul style="list-style-type: none"> • Greater granularity in the presentation of performance, with the two drivers of profit, namely the insurance service results and the investment results from managing financial assets presented separately. • Alignment of revenue recognition with that of other industries, as revenue will be recognised in line with the expected coverage for the period, rather than when incurred. In line with the separate presentation of investment results from insurance service results, insurance revenue will no longer include the savings component of premiums. • Additional disclosures on the amounts reported, significant judgements made and risks arising from the contracts.

Accounting standards

The issuance of new IFRS 17 by the International Accounting Standards Board in May 2017 marked a fundamental change in the approach to recognition, measurement and presentation of insurance contracts in the financial statements of insurers and takaful operators. IFRS 17, which replaces IFRS 4, introduces more detailed specifications on how insurance contracts must be measured. This creates more consistency and allows better comparison of financial performance between the insurance, takaful and other sectors, as well as across jurisdictions. Following this development, the Malaysian Accounting Standards Board consequently approved the standard as Malaysian Financial Reporting Standards 17 (MFRS 17) for application in Malaysia, effective financial year beginning 1 January 2021.

Two key challenges lie in the uncertainty around the interpretation and implementation of the standards, and increased demands on systems and expert resources.

Interpretive differences between insurers and takaful operators may arise in areas such as the definition of contract boundaries, the application of the variable fee approach, and the determination of discount rates and risk adjustments. The standards also introduce concepts that are new to the industry, such as the approach for profit recognition and the valuation of long-term general insurance/takaful contracts. The Bank will continue to engage the industry and professional associations to address these issues and where appropriate, determine consistent standards for adoption by the industry to promote comparability and alignment with prudential considerations.

Recognising the potential complexities in implementing MFRS 17, the Bank has required insurers and takaful operators to establish clear implementation plans to comply with the standard. Over the coming year, insurers and takaful operators are expected to gain a better grasp of the impact of implementation on their resources,

systems and reported performance. In addition, the Bank will be carrying out a quantitative impact study in 2018, to provide more detailed insights on the regulatory, business and market implications of the new standards. Results from the study will also be used to inform the review of the Bank's existing valuation requirements.

The Bank will continue to engage the industry and professional associations to address concerns faced in the implementation of MFRS 17

Review of capital frameworks for insurers and takaful operators

During the year, the Bank initiated a review of the Risk-Based Capital Framework for Insurers (RBC) and the Risk-Based Capital Framework for Takaful Operators (RBCT) to ensure that the standards continue to remain fit for purpose. The review intends to reflect changes in the domestic insurance and takaful industry landscape, including how the range of insurance and takaful product offerings have evolved since the initial issuance of the standards in 2009 and 2014 respectively. It also aims to account for developments in global regulatory and accounting standards. These include the Risk-Based Global Insurance Capital Standard (ICS) by the International Association of Insurance Supervisors (IAIS) and new accounting standards on Insurance Contracts (MFRS 17) and Financial Instruments (MFRS 9). The review will be conducted in phases over the next few years starting from 2018. The first phase will focus on reviewing existing prudential limits on assets and counterparty exposures, with the aim of minimising the risks of pro-cyclical investment behaviour and further strengthen the prudent management of investment risks by insurers and takaful operators. This will be followed by the review of the standards for the valuation of liabilities and capital adequacy components.

Enhancement to sales illustrations for participating policies

New requirements on sales illustrations for participating life products were introduced by the Bank on 1 January 2017 to enhance how costs, benefits and risks are presented to consumers. An insurer must provide a summary page that

explains the key elements of a product, in addition to a comparison against a term life plan to enable consumers to assess how well it meets their protection and savings needs. The objective is to better guide consumers towards making prudent decisions taking into account their individual circumstances and risk appetites. To ensure that sales illustrations are more focused on helping consumers understand potential variability in outcomes rather than create undue expectations on future investment returns, the rates used to project scenarios of future benefits have been standardised. These rates were lower than what was generally illustrated and resulted in the industry shifting away from participating business. This indicates that purchasing decisions remain disproportionately driven by expectations of future returns, which the Bank aims to address going forward. In addition, the Bank will continue to monitor the impact of these requirements to ensure that the requirements achieve their intended effect.

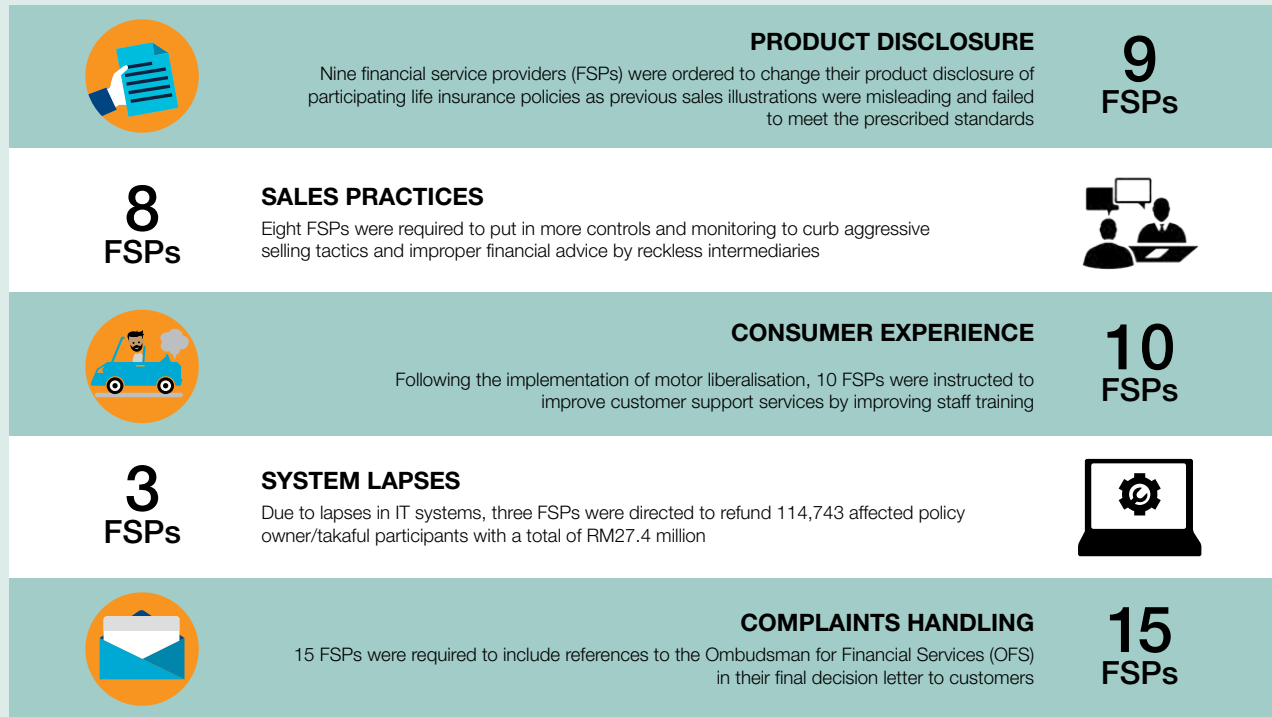
Business conduct supervision and enforcement activities

The Bank continued to accord high priority to improving the professional conduct of insurers, takaful operators and intermediaries. Supervisory activities carried out during the year were focused on proper advice and ethical selling practices. While improvements have been observed, particularly in the quality and investments in the training of intermediaries, there is further scope for achieving higher professional standards in the industry as outlined earlier in this chapter (refer to subsection on 'Implementation of Balanced Scorecard framework'). Observations of improper sales practices and unprofessional conduct were met with supervisory and enforcement actions (Diagram 3.1).

In 2018, the Bank will also be issuing standards to elevate the professional integrity and ethical behaviour of the insurance and takaful intermediaries. These standards will require shareholders of insurance and takaful brokers, and financial advisers to be persons of integrity and good reputation, and persons involved in providing advice to be suitably qualified. In improving the quality of motor claims management process, standards will also be issued to strengthen expectations on the provision of transparent and independent claims assessments by loss adjusters.

Diagram 3.1

Supervisory and Enforcement Actions in 2017



Source: Bank Negara Malaysia

REGIONAL AND INTERNATIONAL COOPERATION

The Bank continued to participate actively in the development of international standards for insurance activities through its membership in the IAIS. In particular, the Bank is represented at the Policy Development and Implementation and Assessment committees, contributing in areas such as the ongoing enhancements to the Insurance Core Principles, in addition to the development of the ICS. This is important given the global nature of insurance activities and Malaysia's interests to expand domestic insurance market capacity to support the economy, while ensuring its resilience. The Bank hosted the IAIS Annual Conference 2017 and meetings in Sasana Kijang in November 2017. The discussions that took place delivered a pivotal agreement among IAIS members on a path to convergence of the ICS for internationally active insurance groups. The Kuala Lumpur agreement marked a significant step forward towards the ultimate goal of a single capital adequacy measure

that achieves comparable outcomes across jurisdictions. The next iteration of the ICS (ICS 2.0) is expected to be released in 2019 for a five-year monitoring period. The Bank will continue to monitor developments on the ICS through the Bank's involvement in the IAIS committees, and the Capital, Solvency and Field Testing Working Group. The Bank also hosted the Roundtable Discussion on Takaful, on the side of the IAIS events where the Bank shared Malaysia's experience in developing the takaful sector.

On the regional front, the Bank and the Office of Insurance Commission of Thailand (OIC) signed a memorandum of understanding (MoU) to enhance cooperation for mutually beneficial insurance sector development in December 2017. The MoU encompasses arrangements in the areas of mutual assistance, information exchange, and cooperation in capacity building and technical assistance between the Bank and the OIC. The MoU further strengthens regional cross-border regulatory collaboration between ASEAN insurance regulators to support ongoing efforts to deepen regional insurance integration.

Progress also continued to be made towards finalising the ASEAN Insurance Integration Framework (AIIF) guiding principles and roadmap which will shape the parameters for the implementation of the AIIF. In relation to the ASEAN Framework Agreement on Services, several regulations were gazetted to effect

Malaysia's commitment to liberalise the cross-border supply of marine, aviation and transit insurance and insurance broking services enshrined in the Seventh Package of Commitments. This is expected to facilitate intra-ASEAN trade and investment, in line with the vision of the ASEAN Economic Community.

Expanding Insurance and Takaful Solutions for the Underserved Segment

By Chiew Hui Lin

Introduction

This box article analyses the low uptake of insurance and takaful among underserved segments in Malaysia, focusing in particular on the bottom 40% households by income (B40). New directions for product design and delivery are proposed to improve insurance and takaful penetration within the B40 segment.

B40 are Under-Protected Relative to National Population

A breakdown of the Malaysian life insurance and family takaful penetration rate¹ (2017: 36.5%) reveals that the uptake of insurance and takaful among the B40 is disproportionately low relative to the national population (Diagram 1). Out of the working population, meaning those aged 20 to 59 years old who are most likely to be in employment and to have dependents, the B40 penetration rate² stood at 30.3% at end-2016, compared with the national working population penetration rate of 50.4% (2017). There is also a clear disparity between the B40 and non-B40 penetration rates across all states, where the gap is particularly wide in states with large urban centres. In urban areas such as Kuala Lumpur, 88% of non-B40 between ages of 20 and 59 have insurance and takaful coverage, compared to 30% among the B40. In the less urban states such as Sabah, a similar pattern is observed, with 30% of non-B40 having insurance and takaful relative to 19% among the B40.

The low penetration rate of insurance and takaful among the working-age B40 segment is a critical issue. B40 households are highly vulnerable to financial shocks as they often have low levels of savings. When a financial shock occurs, such as the death or illness of the family breadwinner, the household not only loses its source of income, but also lacks the funds to pay for the unexpected expense. In such situations, insurance and takaful can act as a safety net with insurance and takaful payouts providing temporary relief and enabling households to weather financial emergencies.

Reasons Impeding B40 Access to Insurance and Takaful

In last year's FSPSR box article 'Evolution of Life Insurance and Family Takaful Distribution Channels'³, a few factors impeding the affordability and accessibility of insurance and takaful were identified. These include the low productivity and limited geographical reach of the agency network, in addition to the focus of bancassurance channels on products targeted at affluent customers. In this article, we examine two other developments that have further contributed to the low take-up of insurance and takaful products by the B40 segment.

1) Industry focus on products with savings and investment elements that are complex and unaffordable

The current dominance of insurance and takaful products with savings and investment elements, which are often costly and complex, has crowded out products that are more suited for the B40 segment. In its simplest form, an insurance or takaful product provides protection such that a guaranteed benefit is paid out on a specified event for a given amount of premium paid. However, over the years, products have evolved to increasingly include savings and investment elements. The inclusion of these benefits inevitably increases the base cost of such products. Products also become more complex due to features that introduce greater uncertainty into the product plan. An example of this is investment-linked (IL) products, which form 54% of insurers and takaful operators' new regular premiums or contributions today due to its inherent capital-efficiency. Under an IL product, premiums paid by the policy owner are channelled to a unit fund, from which deductions are made to fund the insurance protection element. The policyholder bears the entire investment risk while

¹ Defined as the percentage of Malaysian citizens who own an individual life insurance policy or family takaful certificate, after eliminating duplicates from multiple policies.

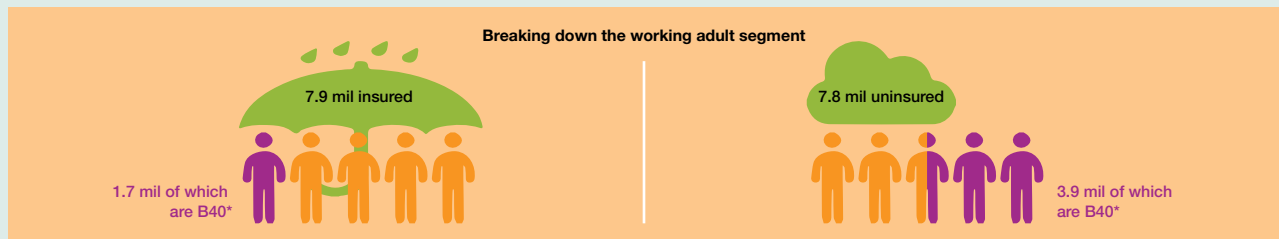
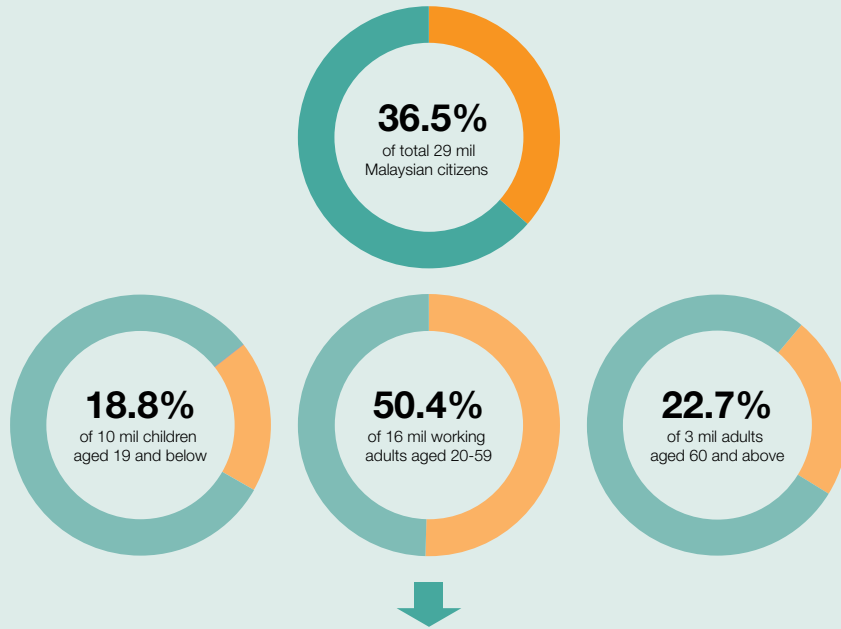
² The Bantuan Rakyat 1Malaysia (BR1M) recipient segment is used as a proxy for the B40 segment.

³ 'Evolution of Life Insurance and Family Takaful Distribution Channels', Financial Stability and Payment Systems Report 2016, Pages 79-83.

Diagram 1

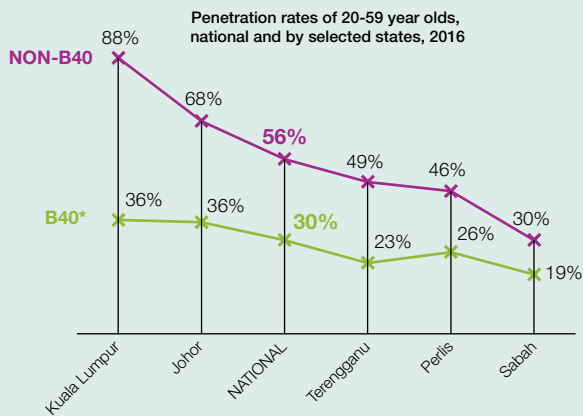
B40 Life Insurance Uptake and Other Characteristics

What percentage of Malaysian citizens own a life insurance or family takaful policy?



What do we know of the Bottom 40% household segment?

Consistently lower penetration rate than non-B40 segment



- 76% of B40* are working-age
- Median income of RM3,000
Mean income of RM2,848
- 1.5 mil urban and 890,000 rural households earn <RM4,000
- 49.3% have home internet
95.2% have a mobile phone

*Estimated by using 2016 BR1M recipients as a proxy for the B40 segment

Source: Bank Negara Malaysia, Department of Statistics Malaysia, Implementation Coordination Unit (2017)

insurers have full discretion to review insurance charges, which affects the amount of these deductions. While offering a degree of flexibility to policy owners to manage their protection levels and investment exposures, such products are usually designed for mass affluent segments and are generally not well understood by consumers from the lower-income groups. This ultimately reduces their suitability, affordability and accessibility to the B40 segment.

2) Proliferation of products packaged with add-on benefits that may not provide meaningful protection

In the pursuit of product differentiation to remain competitive, insurance and takaful benefits are increasingly offered as add-on benefits purchased with basic policies. For example, some personal accident products come with add-ons such as cover for flood-related injuries. This is a highly specific event, often involving lengthy claims documentation and verification processes before claims are paid. Products become more expensive and also more complex, without providing significant additional protection. The value of such benefits is questionable for B40 households, who would typically need such payments to be immediate in their hour of need due to the lack of savings. Based on a survey of 23 life insurers and family takaful operators conducted by the Bank in early 2017, only eight offered any life and family takaful products with monthly premiums below approximately RM15 per month, the level considered to be reasonably affordable for the B40 segment.

Perlindungan Tenang Initiative

The lack of insurance and takaful products for B40 households is a good example of market failure to provide protection for the underserved segment. Market failure necessitates an intervention by the regulator. Given these apparent market gaps and growing challenges associated with income distributional effects which further increase the vulnerability of B40 households, the Bank, on 24 November 2017, launched *Perlindungan Tenang* to expand insurance and takaful solutions targeted at the B40 segment. These products, which can be identified by a distinct logo (Diagram 2), are also intended to be suitable for the general public who are not currently covered by any form of insurance or takaful protection.

Diagram 2

Logo for *Perlindungan Tenang*



Source: Bank Negara Malaysia

The initiative aims to galvanise a broader movement among insurers and takaful operators to offer products that meet five parameters: (1) affordable pricing; (2) provides good value; (3) widely accessible; (4) easy to understand; and (5) easy to purchase and claim. Through an iterative feedback process and close monitoring of take-up by the B40, the industry is expected to go beyond incremental enhancements to embrace new business models and processes that will support expanded product offerings for the underserved segments.

Such products will be evaluated against the following characteristics:

Affordable

Premiums should be set at an affordable level, which is defined as the amount that consumers are willing and able to spend on purchasing insurance or takaful protection. Premium levels must therefore take into account the circumstances of households in the target market, including disposable income, occupation, household size and

access to other coping mechanisms such as emergency savings or social safety nets. While such factors will vary substantially between individual households, the Bank is setting a target of monthly premiums not exceeding RM15. This target will be refined further as the industry gains more experience and understanding of the B40 households' expenditure patterns.

Good value

In order for products to offer good value to the B40 segment, they should cover risks that are most important for such households and maximise the proportion of the premium paid that is allocated to the protection benefits. As a measure of value, projected benefit payouts are generally expected to exceed at least half of premiums generated, with greater use of technology and alternative lower-cost access channels to minimise expenses and distribution costs. Agency channels, as currently structured, are unlikely to deliver affordable premiums at the level of value envisioned by the *Perlindungan Tenang* initiative. Innovation in distribution models is therefore imperative to optimise costs and outreach. This will require a longer view of investment decisions, including the potential for collective investments in supporting market infrastructure, in order to achieve a required critical mass.

Accessible

Coverage under *Perlindungan Tenang* products and distribution channels should be inclusive of the specific circumstances (such as location, occupation or dwelling types) that are typical of the B40 population. Products and services should be made available at access points that are convenient, such as public hospitals, urban and rural transformation centres (UTC/RTC), and smaller retail outlets. The smart use of technology should also be reflected in consideration of the specific needs and lifestyles of the targeted segments, rather than what is more familiar to the current market segments of insurers and takaful operators. For example, while internet distribution could offer cost savings and outreach beyond urban centres, only half of B40 homes are connected to the internet.

Easy to understand

Product benefits, terms and conditions should be designed to be self-explanatory to a consumer with relatively limited understanding of insurance and takaful. Insurers should minimise uncertainty in the product design, including those associated with underwriting disclosures, and the repudiation of or inadequate limits on claims. Marketing materials should present information in an intuitive manner to help consumers make informed choices, focusing on the protection they need and can afford.

Easy to buy and claim

The entire journey of a customer, from the first contact with the distribution channel to the point of claims payment, needs to be frictionless. Currently, a customer's experience is often riddled with many pain points. The process of making claims, in particular, including the supporting documents required, should be simplified to minimise anxieties at the point of making a claim. For example, while insurance or takaful offerings might be available online, claims need to be submitted at the branches of the insurer or takaful operator, often located at a considerable distance from the policyholder or beneficiary. In some incidences, a claim may require up to nine separate documents (for example, a claim for some death benefits). Hospital income benefits that reimburse the policyholder up to a month after being discharged from hospital do not meet the needs of a daily wage earner with low savings. To reduce these frictions, the Bank has required claims on *Perlindungan Tenang* products to be paid out within five working days from the receipt of complete, simplified documentation. Other improvements that are being prioritised to achieve a frictionless experience include:

- Nominations captured at the point of sale for more efficient claims payment;
- Simplified underwriting process and immediate policy issuance;
- Responsive and well-trained call centre staff for post-sale care; and
- Leveraging on open application interfaces (API) to further simplify the underwriting and claims process.

Early Signs of Innovation Among Providers of *Perlindungan Tenang* Products

As at end-2017, 10 *Perlindungan Tenang* products have been rolled out by 10 participating companies comprising six life insurers, three family takaful operators and one general insurer. More are expected to participate in 2018.

Innovations that address some of the common pain points have included:

- Basic life and family takaful products focusing only on death benefits that come with simple disclosure and claims processes. One product allows electronic submission of claims documents through mobile applications such as WhatsApp.
- A fire product that relies on confirmation from the village head or district officer as substitute proof of residence for policyholders (staying in longhouses) that are unable to provide customary documentation.
- Acceptance of postal submissions of claims documents certified by the village head, school principal or police officer in lieu of in-person submission at the insurer or takaful operator's branch.
- A funeral benefit product with a 24-hour pay out timeline. Key features of this simple product fit on a brochure that is the size of a name card. Burial permits are accepted as an alternative to the death certificate, thereby removing uncertainties in the timing of claims payouts where a death certificate is required.

Conclusion

The Bank expects that further product innovations and improvements in delivery inspired by the *Perlindungan Tenang* initiative will increase overall insurance and takaful penetration, particularly among the B40 segment, as more experience is gained in meeting the needs in this segment. On its part, the Bank will continue to engage the industry on developing fit-for-purpose regulations, and intensify collaborations with the industry and other stakeholders to raise the financial capability of B40 consumers. More broadly, the efforts under *Perlindungan Tenang* to expand insurance and takaful coverage for those currently without protection, are also expected to generate positive spillovers for the insurance and takaful market as whole — through a renewed focus on improving customer value, access and experience.