

Insurance and Takaful Sector

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Insurance and Takaful Sector

PERFORMANCE OF THE INSURANCE AND TAKAFUL SECTOR

The insurance and takaful sector continued to show positive growth in 2016. Total premiums and contributions increased by 4.4% to RM61.3 billion (2015: +4% to RM58.7 billion), while combined insurance and takaful assets expanded by 5% to RM277 billion (2015: +5.7% to RM263.8 billion). Growth has continued to be supported by strong overall capitalisation. The industry's aggregate capital adequacy ratio (CAR) stood at 243.9% as at end-2016, with surplus capital above the regulatory minimum of 130% increasing further to RM37.9 billion (2015: RM36.4 billion).

Total premiums and contributions of the insurance and takaful sector increased by 4.4% while assets expanded by 5%

There were 55 insurers and takaful operators, including reinsurers and retakaful operators, in the industry as at end-2016 (Table 3.1 and Table 3.2). Over the past five years, this number has reduced from 60 as a result of mergers and acquisitions, mostly among general insurers, to improve resilience and gain efficiencies in scale. The total number of

Table 3.1

Number of Insurers and Takaful Operators	
Categories	Number
Life insurer	10
General insurer	19
Composite insurer	4
Family takaful operator	3
Composite 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

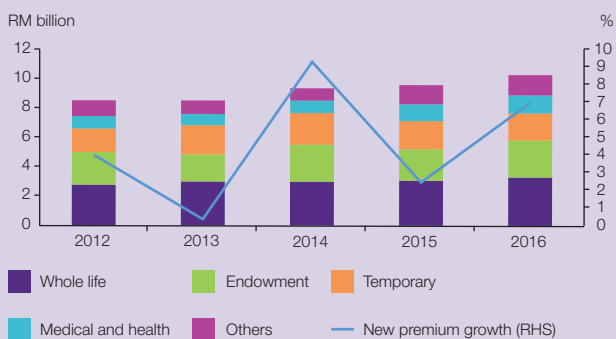
approved insurance and takaful brokers and financial advisers stood at 56. A further 54 loss adjusters are registered under the Financial Services Act 2013, mainly active in assessments of motor and fire-related claims.

Premiums and contributions

Drivers of growth continue to be different for the life insurance and family takaful sectors (Chart 3.1 and Chart 3.2). In the life insurance sector, new business growth has been mainly supported by higher growth in regular premium endowment policies that combine protection with savings and investments. In contrast, new business in the family takaful sector

Chart 3.1

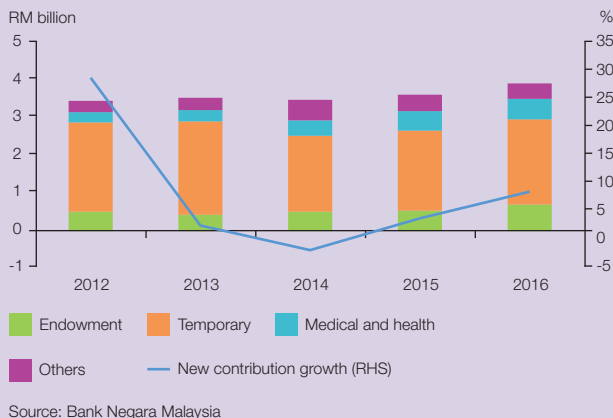
Life Insurance Sector: New Premium Growth and Product Composition



Source: Bank Negara Malaysia

Chart 3.2

Family Takaful Sector: New Contribution Growth and Product Composition



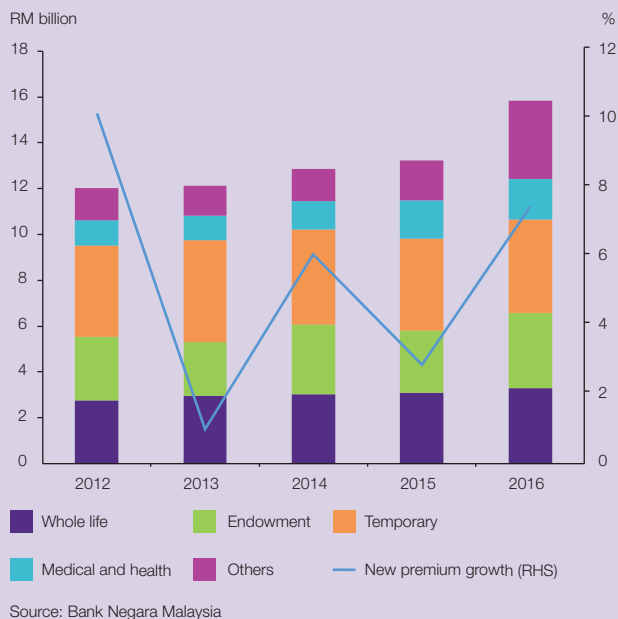
remains largely driven by group term policies, including credit-related term policies, which provide relatively higher protection benefits but do not include any savings or investment component.

The share of medical and health insurance/takaful business has increased, mainly reflecting higher group employee benefits

Since 2006, a significant share of new business growth has been attributed to investment-linked insurance and takaful policies. Greater flexibility, provided under such policies for policyholders to adjust their premiums in response to changes in investment appetite or financial circumstances, has made such policies particularly attractive for those with higher variability in income or seeking to take advantage of investment opportunities. Between 2012 and 2016, investment-linked business increased at an average rate of 8.1% to account for 32.9% of total life insurance and family takaful business. More volatile financial markets over the past two years, however, have had a dampening effect on growth in this segment given its higher sensitivity to changes in market conditions as noted above. The composition of life insurance and family takaful business has remained broadly unchanged, with the notable exception of medical and health insurance/takaful business which increased as a share of total business from 8.7% to 12.4% in the last four years (Chart 3.3). Much of this growth has been associated with the higher group employee benefits provided by corporations in line with rising health financing costs.

Chart 3.3

Life Insurance and Family Takaful Sector: New Premium and Contribution Growth and Product Composition



Insurance take-up expanded but the penetration rate has been stagnant over the last five years and a significant protection gap remains

Insurance penetration rate, measured by the ratio of total number of life insurance and family takaful policies in force to the total population, has remained fairly static within the range of 54% to 56% over the last five years. However, this has been against higher total sums insured which rose to RM1,964.8 billion in 2016 (2015: RM1,852 billion). This is still believed to be inadequate even for the insured population, with industry studies¹ estimating an average protection gap² in Malaysia of between RM553,000 for families whose primary wage earner has some form of life insurance, to RM723,000 for families without any form of life insurance taken by the primary wage earner. Affordability and access required to service policies in underserved market segments remain key barriers to higher levels of penetration. Several important initiatives taken in recent years to improve transparency, encourage product

¹ 2012 Underinsurance Study in Malaysia by Life Insurance Association of Malaysia and Universiti Kebangsaan Malaysia.

² A measure of the extent to which families are underinsured following the death of primary wage earner.

innovations and expand channels for delivering insurance and takaful products and services (further elaborated in this Chapter) are expected to reduce these barriers and improve prospects for achieving the 75% penetration target set under the Economic Transformation Programme.

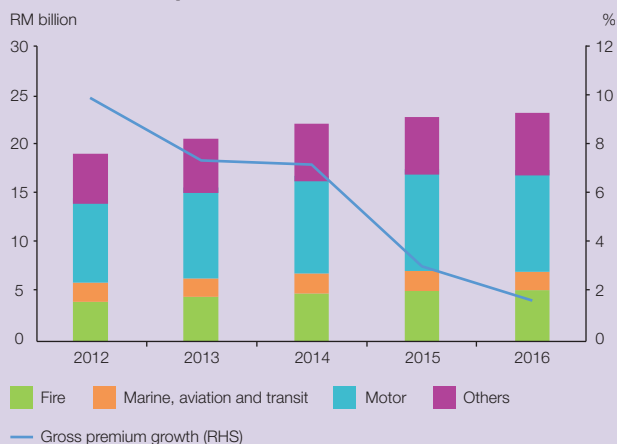
General insurance and takaful growth was supported by fire business, offsetting the impact from slower motor vehicle sales and vessel charter utilisation

In the general insurance and takaful sector, gross premiums and contributions moderated in line with economic conditions (Chart 3.4). Slower sales of motor vehicles impacted the motor insurance and takaful segment which continues to represent a dominant (43.4%) share of general insurance and takaful business. Lower oil prices and vessel charter utilisation also posed a drag on business growth with sharply lower premiums recorded in the offshore oil-related (-14.9%) and marine hull (-12.6%) business segments. Growth, however, continued to be supported by sustained demand for fire insurance and takaful, both by businesses and individual property owners. Overall, gross premium and contribution growth remained marginally positive at 1.7% (2015: +3.1%).

About 90.4% of insurance premiums and takaful contributions underwritten domestically are retained in the country, broadly unchanged over the past 10 years

Chart 3.4

General Insurance and General Takaful Sector: Gross Premium and Contribution Growth and Business Composition



Source: Bank Negara Malaysia

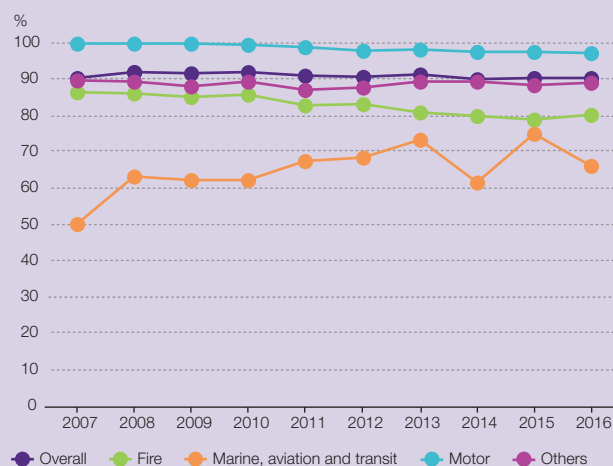
(Chart 3.5). The relatively high retention level is largely influenced by the dominant share of personal business lines (motor, medical and health, and personal accident insurance/takaful) which have smaller exposures per policy and less complex policy features. Domestic insurers and takaful operators have also been able to underwrite and retain a majority of risks in some corporate lines, such as workmen’s compensation and employers’ liability insurance/takaful, which exhibit lower volatility in loss experience and are supported by reasonably diversified risk pools. Domestic capacity to underwrite and retain larger and more complex risks, however, remains underdeveloped resulting in such risks being largely insured abroad. This is more pronounced in the marine, aviation, liabilities, performance bonds and energy segments of business where retention levels have generally remained below 75% over the last five years. This accounted for the bulk of reinsurance premium outflows which amounted to RM1.9 billion for all risks combined in 2016. In line with the development of the economy and its changing structure, it is important for the industry to strengthen its capacity to support more complex and non-traditional risks, both at a technical as well as financial level.

Profitability

Profitability improved for the year. In the life insurance and family takaful sector, excess income over outgo increased by 10.3% to RM13.3 billion (Chart 3.6). This was mainly driven by higher growth in premium and contribution income. The surplus

Chart 3.5

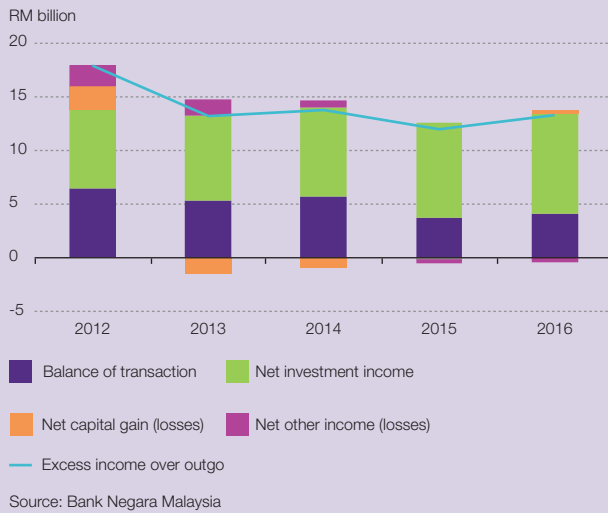
General Insurance and General Takaful Sector: Retention Ratio



Source: Bank Negara Malaysia

Chart 3.6

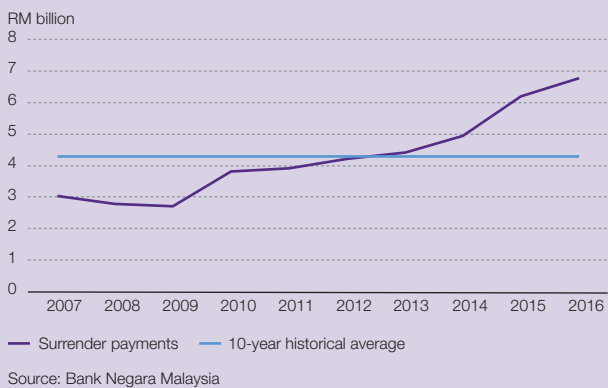
**Life Insurance and Family Takaful Sector:
Composition of Excess Income over Outgo**



arising³ for combined life insurance and family takaful funds was, however, lower on account of adjustments to policy liabilities to reflect the extended period of lower yields that continued to prevail. This offset a deceleration in payments of net policy benefits following lower maturity payouts in 2016. Surrender payments over the past four years have remained higher than historical average (Chart 3.7), rising sharply since 2014. This is a concern given the loss of value to and protection for policyholders. The Bank has increased its

Chart 3.7

**Life Insurance and Family Takaful Sector:
Surrender Payments**



³ After payment of interim bonus but excluding surplus brought forward from the preceding year and transfers from shareholders.

Chart 3.8

**General Insurance and General Takaful Sector:
Profitability**

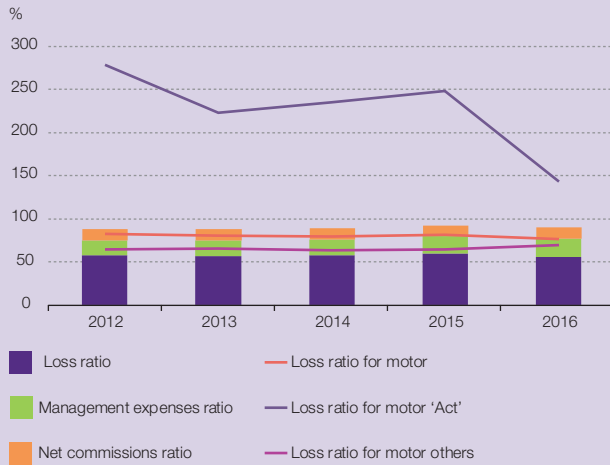


scrutiny of sales practices by life insurers and family takaful operators and directed them to strengthen measures to conserve policies. Such measures have included providing options for policyholders to convert their policies into fully paid-up policies with adjusted sums insured and reviewing incentive systems for agents and intermediaries.

General insurers and takaful operators posted significantly stronger results compared to the previous year, with operating profits increasing 26.4% in 2016 (2015: -15.1%) (Chart 3.8). This was largely attributed to improved underwriting results for motor business following a release of claims reserves, including reserves held against risks underwritten through the Malaysian Motor Insurance Pool (MMIP), due to more stable claims development patterns. This was further supported by lower vehicle theft losses which have fallen steadily to almost half of its peak in 2013. These conditions, however, only partially mitigated losses on motor Third Party Bodily Injury and Death claims (Chart 3.9) which have continued to exceed premium levels by a significant margin, underlining the importance of persevering with broader reforms that are being implemented in the motor sector. This is to achieve pricing that is more aligned to risk and drive improvements required to stabilise and reduce losses. The reforms will also promote more equitable pricing, thereby reducing the need for cross-subsidies between lines of business or customer segments.

Chart 3.9

General Insurance and General Takaful Sector: Combined Ratio and Loss Ratio of Selected Business Classes



Source: Bank Negara Malaysia

While operating profits for general insurance and takaful improved, motor business continued to suffer significant losses in Third Party Bodily Injury and Death

Over the years, insurers and takaful operators have progressively shifted into higher yielding corporate bonds to improve risk-adjusted returns

on capital (Chart 3.10). Most of this substitution has been from holdings of cash and deposits and government securities. The industry's share of assets in government securities has declined over the past 10 years to 11% in 2016 (2007: 16.6%), while the share of assets in corporate bonds has correspondingly increased to 42.8% (2007: 33.8%). Insurers and takaful operators' appetite for credit risk remains generally conservative, with most firms maintaining a target portfolio minimum credit rating of AA and above. In an extended low yield environment, further adjustments in asset allocations are expected, particularly among life insurers and family takaful operators, to improve diversification and achieve more efficient asset-liability matching. This will likely continue to be balanced with strategies that improve resilience to greater credit volatility in the current economic climate.

REGULATORY AND SUPERVISORY POLICIES AND DEVELOPMENTS

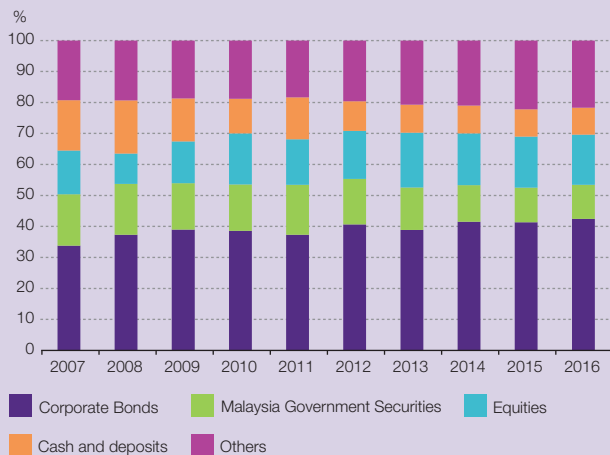
Policies and initiatives implemented in 2016 continued to build on and further strengthen foundations for the development of a more resilient, competitive and inclusive insurance and takaful industry. In line with the Bank's mandate to promote the fair treatment of financial consumers, regulatory and supervisory activities were also directed at managing key conduct risks assessed by the Bank and to reinforce high standards of professional conduct and fair dealings in the industry.

Phased liberalisation of motor and fire tariffs

As foreshadowed by measures under the New Motor Cover Framework to improve efficiency in motor claims settlements and gradually bring tariff premiums closer to sustainable levels, the industry moved into the first phase of liberalisation of the motor and fire tariffs beginning 1 July 2016. The phased liberalisation will provide flexibility for more equitable pricing of risk which will incentivise better risk management in the form of responsible driving habits and adoption of road safety measures. The healthy competition generated will also be a catalyst for a wider array of motor and fire products, along with improved levels of service. The industry is well-placed to make this transition, with stronger financial and risk management capacity underpinning the transition.

Chart 3.10

Insurance and Takaful Sector: Asset Composition



Source: Bank Negara Malaysia

The progressive liberalisation of tariff rates will take place over a three-year period to allow for orderly market adjustments. Under Phase I of the liberalisation, new motor and fire products may be offered at market-based prices while existing motor products under the tariff will continue to be available to the public at prevailing tariff rates. Under Phase II, which will commence on 1 July 2017, tariffs will be removed for all existing motor products except for motor third party products where tariff rates will be gradually adjusted. Further liberalisation of the tariff for motor third party products will be reviewed in 2019, taking into account market developments observed under Phases I and II.

Beginning 1 July 2017, existing motor tariffs will be removed except for motor third party products

To allow room for insurers and takaful operators to moderate any motor premium increases, particularly where large numbers of policies are affected, premium rates for existing fire products will continue to be regulated with gradual adjustment. A review of the fire tariff will be undertaken together with remaining tariff for motor third party products as a clearer picture of the transitioning process emerges over the next three years.

A number of risks require attention. A disorderly price war among firms to maintain or gain market share may lead to the inadequate pricing of risks, in turn exposing the industry to significant losses and a retrenchment of underwriting capacity in the future. In addition to capital risk charges that are in place to counteract a race to the bottom in rates, insurers and takaful operators are required to submit rates that fall below specified thresholds for the Bank's review to mitigate this risk. Risks of motor insurance and takaful policies becoming unaffordable for some segments under market-based pricing are also being managed through appropriate transitioning arrangements by ensuring adequate transparency and educating vehicle owners on ways to improve their risk profile. It is additionally important to minimise public confusion regarding terms of cover as more varied products are introduced in the market. While these risks warrant close attention, they do not diminish the need for reform in the longer-term interests of ensuring a sustainable and more equitable motor insurance and takaful market, and strengthening incentives that will improve risk management and road safety.

As an important precondition for subsequent phases of liberalisation, work continues to progress on improving the availability of adequate and reliable data for the assessment of risks and claims. This includes improving the quality of data submissions by insurers and takaful operators to the Insurance Services Malaysia Berhad (ISM) which maintains a database and provides analytical support for the effective implementation of the phased liberalisation of the tariffs. This shared database is expected to complement product development, pricing and reserving activities by individual insurers and takaful operators through the pooling of industry data. ISM is also expected to roll out a fraud intelligence system in the second half of 2017 which will enable the identification of fraud patterns based on data collated from insurers and takaful operators on suspected fraudulent claims.

Measures are also being taken to enhance the coverage and granularity of reference data maintained by Motordata Research Consortium Sdn. Bhd. (MRC) which are used by insurers and takaful operators for claims assessments. This is further supported by the implementation of higher qualification and professional standards that will be introduced for loss adjusters.

Life Insurance and Family Takaful Framework (Framework)

The Framework, issued in November 2015, sets out a three-pronged strategy aimed at encouraging greater innovation in the life insurance and family takaful sector to meet the protection needs of the Malaysian population. The Framework introduces greater flexibility for insurers and takaful operators to control distribution and management costs, promotes the development of alternative distribution channels and strengthens incentives for improving the quality of service provided by intermediaries. Key developments in the implementation of the Framework in 2016 are described below.

(i) Implementation of a balanced scorecard for life insurance and family takaful intermediaries

An over-emphasis on premium growth without adequate regard to policyholders' interests has led to more than a few instances in which firms were called out by the Bank for mis-selling products that were ill-suited to a policyholder's needs and financial circumstances. As noted earlier, this has also resulted in higher surrenders of policies in more recent years. The balanced scorecard (BSC) will introduce changes to the remuneration structures of intermediaries effective from 2018 with the view to better align

rewards with the overall quality of service and policies sold. The changes will improve incentives for intermediaries to observe higher standards of professionalism and service in providing advice and product recommendations, as well as ongoing customer support to policyholders throughout the duration of a policy. With over 95% of insurance and takaful business currently acquired through agents and intermediaries, this is expected to enhance the level of trust and confidence of financial consumers in the industry. To complement the BSC, life insurers and family takaful operators have also been required to provide all customers with a service guide detailing the areas of advice and service that customers can expect from insurance and takaful intermediaries.

Industry members have agreed on the key performance indicators (KPIs) under the BSC based on principles laid out by the Bank in the Framework. A pilot run of the BSC is currently in progress prior to its effective implementation in 2018.

Basic pure protection products will be available on direct distribution channels, starting with term products in 2017 followed by critical illness and medical and health products in 2018

(ii) Availability of products through non-advisory direct distribution channels

In October 2016, the Bank finalised requirements for all life insurers and family takaful operators to make basic pure protection products available, commission-free, on a non-advisory direct distribution channel. This will first begin with term products in 2017, followed by critical illness and medical and health products in 2018. Direct distribution channels include distribution through the premises of an insurer/takaful operator or an online platform. Customers will also be provided with tools to facilitate self-assessments of the suitability and affordability of a product to support informed, non-advised decisions. This is expected to increase the take-up of insurance, while reducing the cost of basic protection products.

(iii) Introduction of online accounts for policyholders

As part of measures under the Framework to improve the persistency of life insurance and family takaful policies, most life insurers and family takaful operators have, since July 2016, started providing policyholders with information on their policy details online. This

includes information on the status of policies and premiums to enable policyholders to keep track of and maintain their policies. Documents for filing claims and changes to details of the policyholder or nominations under the policy are also accessible online. From 2017 onwards, these online accounts will be extended to include information on investment-linked plans, policy loan balances, surrender values, bonuses for participating policies and details on trustees, assignees and nominees. This initiative will provide a practical and convenient means for policyholders to better manage their policies and ensure that they will continue to enjoy the intended protection accorded under the policies.

Microinsurance and microtakaful

Among lower income groups, only 4% of households currently have some form of life insurance or family takaful cover. In line with the Bank's mandate to promote an inclusive financial system, encouraging broader microinsurance and microtakaful product offerings has therefore been an important priority of the Bank to address this protection gap. Focus has mainly been directed at lowering distribution costs and simplifying product design and delivery, while ensuring meaningful protection for policyholders.

Only 4% of lower income households are protected by life insurance or family takaful

In 2016, the Bank issued a discussion paper outlining regulatory parameters that are adjusted for lower risks inherent in microinsurance and microtakaful products. This is intended to encourage insurers and takaful operators to offer such products more widely. At the same time, increased efforts were made by the Bank and industry to educate the public on the importance of insurance and takaful protection, particularly among the underserved segments.

Since the publication of the discussion paper, a number of insurers and takaful operators have indicated their interest to introduce simple and affordable products targeted at lower income groups which will leverage on alternative delivery channels including the postal system, agent banking, government agencies and non-governmental organisations. Lessons learnt from these early movers are expected to increase traction from more firms in the industry to offer microinsurance and microtakaful products going forward.

Insurance contract accounting standards

After many years in development, the International Accounting Standards Board (IASB) has announced that the revised International Financial Reporting Standards for insurance contracts (IFRS 17) will be published in 2017 with the full implementation of the standards coming into effect on 1 January 2021. The standards, which aim to improve the comparability and transparency of financial reporting for insurance contracts, will be adopted under the Malaysian Financial Reporting Standards, thus making them applicable to all licensed insurers and takaful operators. As it is expected to introduce fundamental changes to current valuation practices, the Bank will be reviewing current prudential settings and the extent of variability in insurance contracts that are prevalent in the industry in order to identify issues on which additional regulatory guidance may be required. This may also entail changes to current regulatory prescriptions to align prudential and accounting requirements. In the first phase of review, expected to be completed in 2017, focus will be given to the requirements that relate to the determination of fulfilment cash flows (cash flows needed to fulfil obligations of an insurance contract), the grouping of insurance contracts and the valuation of current service margins (expected accounting profits in an insurance contract).

Global insurance capital standard

The International Association of Insurance Supervisors (IAIS) is developing a Risk-Based Global Insurance Capital Standard (ICS), which aims to establish a common methodology for supervisors across different jurisdictions to assess the capital adequacy of internationally-active insurance groups (IAIGs). An initial version of the ICS which will be used as a basis for confidential reporting is expected to be issued in the second half of 2017. This will inform further refinements to the ICS before its finalisation for adoption in 2019. While the ICS will be applicable at the group level, group-wide changes in valuation and capital management practices will inevitably impact individual entities within the group that are present in Malaysia. This development is timely, given the Bank's own plans to review the Risk-Based Capital Frameworks for Insurers and Takaful Operators to ensure that they remain relevant and effective in promoting the industry's resilience. The Bank is

currently working to develop a quantitative survey of valuation methodologies in the industry and their impact on capital and the measurement of risks under ICS. Where relevant, these assessments will be coordinated with the assessment of IFRS 17 requirements.

Life insurance and family takaful policy surrenders

As noted earlier, surrenders of life insurance and family takaful policies have increased in recent years. A survey by the Bank showed that a common reason for policy lapses which is wholly avoidable, is the omission by policyholders to make regular premium payments. The introduction of online insurance and takaful accounts, coupled with stronger incentives under the BSC for intermediaries to continue servicing policies over their duration, are expected to reduce such lapses.

Surrender payments have increased in recent years

Other key reasons identified for surrenders were financial pressures faced by policyholders which affect the affordability of insurance and takaful. This is further compounded by high pressure sales practices that induce policyholders to replace their policies, or to buy policies that they are unlikely to maintain given their financial circumstances and needs. These reasons have led the Bank to maintain a strong focus on addressing mis-selling risks in the industry.

With increasing intensity of the Bank's supervisory activities over the years and reforms introduced under the Framework gathering pace, the Bank has observed greater attention accorded by the board and senior management of insurers and takaful operators to the effective supervision of the conduct of agents. However, reviews of intermediary sales practices by the Bank continued to reveal weaknesses among some firms which increased the risk of unsuitable product recommendations being made to prospective customers.

During the year, the Bank directed several insurers and takaful operators to strengthen the administration of the customer fact find process and improve the quality of agency training. In addition, supervisory actions were taken against 11 insurers and five takaful

operators for various non-compliance with conduct requirements issued by the Bank, as set out below:

- Seven insurers and four takaful operators were directed to modify and improve the level of disclosures in product marketing materials;
- One insurer and one takaful operator were directed to refund premiums and contributions (including interest where applicable) amounting to RM1 million to 152 affected policyholders, for mis-selling life insurance and family takaful products to the policyholders;
- Three insurers and one takaful operator were directed to provide restitution amounting to RM6.6 million to 9,752 affected policyholders due to failures to properly supervise their agents, resulting in fraudulent activities; and
- Two insurers were directed to refund/transfer a total of RM10.9 million to 13,899 affected policyholders to rectify computational errors resulting in incorrect payments to and charges levied on policyholders.

Supervisory actions were taken against several insurers and takaful operators for various non-compliance with conduct requirements

Repricing of medical and health insurance/takaful (MHIT) products

Escalating healthcare costs have contributed to increased repricing activity for MHIT products by insurers and takaful operators. To ensure that this is managed with due regard to the reasonable protection of policyholders, the Bank took steps during the year to promote greater discipline and transparency in policies and practices around repricing. Insurers and takaful operators were required to clearly address the frequency of repricing, level of cross-subsidisation and appropriate communications to policyholders within their repricing policies. In addition, they must provide options for policyholders to continue receiving MHIT protection by offering options to switch plans, reduce room and board limits or upgrade to enhanced features without additional medical underwriting. At the same time, the Bank is also in discussions with the Ministry of Health and other stakeholders on broader measures to address medical inflation, in particular among private healthcare providers. Further developments on this front will be communicated by the Government.

Revisions in bonuses for participating life insurance products

The policy document on Management of Participating Life Business, issued by the Bank in 2015, came into effect on 1 July 2016. It promotes more equitable outcomes for policyholders when insurers undertake bonus revisions by setting standards that must be observed by insurers in assessing the sustainability of insurance funds. Insurers are also required to take reasonable steps to manage policyholders' expectations and provide support to customers affected by bonus revisions.

In line with the strengthened expectations under the policy document, insurers have taken a more gradual approach to bonus revisions in order to moderate the immediate impact on affected policyholders. In addition, insurers have also improved their communications of bonus revisions to affected policyholders, with clear explanations of reasons for the revisions and the impact on policy benefits. In the current volatile financial market environment, the Bank will continue to closely review industry practices in determining bonus revisions to ensure revisions made are equitable and justified.

Plain language insurance and takaful policies

Following the issuance of the Guidelines on Product Transparency and Disclosure in early 2011, insurers and takaful operators have started to draft standard terms in insurance and takaful policies in plain and intelligible language. The shift to plain language aims to help consumers better understand the benefits, exclusions and obligations under policies that they have purchased and compare products. A key function of plain language documents is also to prompt important actions and behaviours by policyholders, such as notification of changes in health status or a claim event, or factors that should be considered in determining if a product will meet their specific needs.

The shift to plain language for insurance and takaful policies aims to help consumers better understand policy benefits, exclusions and obligations

About one-third of personal line insurance and takaful policies issued in 2016 used plain language policies, spanning a wide range of products including motor, houseowner and householder, personal accident and critical illness policies. With the full adoption of

plain language for private car and motorcycle policies issued beginning 1 November 2016, more than three quarters of personal line policies are expected to be presented in plain language in 2017. The Bank will be undertaking more intensive reviews of sample policies used by insurers and takaful operators to ensure that the plain language objectives are being effectively met.

REGIONAL AND INTERNATIONAL CO-OPERATION

The Bank continued to participate actively in regional and international forums that promote supervisory co-operation across borders and global standards for sound insurance markets.

The Bank is a member of the Financial Stability and Technical Committee as well as the Capital Solvency and Field Testing Working Group of the IAIS, through which it contributes to international standard setting, including the ICS which will serve as a minimum measure of capital adequacy for IAIGs and global systemically important insurers. The Bank will also be hosting the 24th IAIS Annual Conference in November 2017 with the theme 'Insurance Supervision: Looking Beyond'. This will be the first time in 14 years that the IAIS Annual Conference is being held in an ASEAN country, with around 500 participants expected from 140 jurisdictions that make up the membership of IAIS.

On the regional front, the Bank participates in advancing co-operation and coordination through the Asian Forum of Insurance Regulators (AFIR) and the ASEAN Insurance Regulators' Meeting (AIRM). AFIR achieved significant progress as a platform for supervisory co-operation with the endorsement of AFIR's key action plans for

information exchange, regional co-operation and capacity building at the 11th Annual Conference of AFIR held in Taipei in April 2016.

The AIRM meanwhile serves as an important platform for dialogue and co-operation on developments and issues affecting ASEAN insurance markets. Improving insurance penetration and enhancing supervisory capacity continued to be key priority areas for member countries. The ASEAN Insurance Training and Research Institute (AITRI) which was established by the ASEAN member states in 2000, continued to play an important role in capacity building for ASEAN insurance regulators. During the year, four regulator training programmes were conducted in the areas of inclusive insurance, corporate governance and enterprise risk management, reinsurance supervision as well as supervisory co-operation, cross-border collaboration and crisis management. AITRI is also envisaged to play a greater role towards enhancing the readiness of ASEAN Member States for regional insurance integration. The year also witnessed the inaugural meeting of the ASEAN Insurance Forum (AIFo), which brought together ASEAN insurance regulators and trade negotiators to develop a roadmap for regional insurance integration to support trade, investment and economic linkages in line with the objectives of the ASEAN Economic Community. Regional insurance integration progressed a step further during the year with the conclusion of the Seventh Package of Commitments under the ASEAN Framework Agreement on Services. Under the Seventh Package, Malaysia has committed to liberalise the cross-border supply of marine, aviation and transit insurance and insurance broking services with effect from 20 December 2016.

Evolution of Life Insurance and Family Takaful Distribution Channels

By Tang Khai Sheng

Effective and professional distribution channels are important to ensure that all segments of the population have access to life insurance and family takaful products and are able to make informed decisions for their financial protection needs. This box article explores the changes in the distribution channel landscape of the life insurance and family takaful industry and the deeper transformation needed for the industry to achieve this vision.

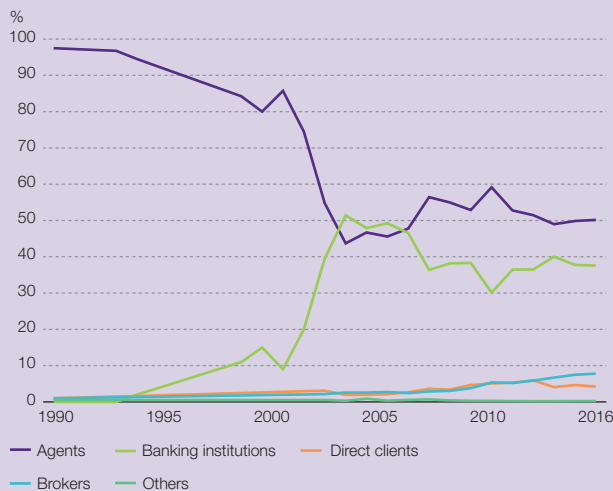
From an Agency-Dominated System to a Dual-Channel System

During the early decades, the agency channel acted as the main driver of growth for the life insurance and family takaful industry as the population was still largely uninsured. Personal contacts and relationships were key strengths that were used very effectively by the agency channel to increase access to insurance and takaful products at a time when financial literacy was still low. As rising household incomes increased demand for financial services, the industry evolved into a dual-channel system during the 1990s, with the introduction of bancassurance to leverage on the branch networks and customer base of banks. From the first bancassurance arrangement in 1994, bancassurance sales have charted impressive growth, achieving more than half the market share of life insurance at its peak in 2004 (Chart 1). This transition to a dual-channel system was accompanied by a higher level of insurance take-up as evidenced by the average annual new business growth of 16% and increase in the insurance and takaful penetration rate from 13% to 51%¹ from 1990 to 2010 (Chart 2).

While new channels have subsequently been introduced to the market, in particular internet insurance in 2000 and financial advisers in 2001, their share remains small. These channels have not gained traction as companies have continued to prioritise the agency and bancassurance channels over investments to develop these new channels. This is in part out of concern for channel conflict. To date, direct and online distribution accounts for only 5% of life insurance and family takaful sales, compared with significantly higher shares of up to 25% observed in advanced markets².

Chart 1

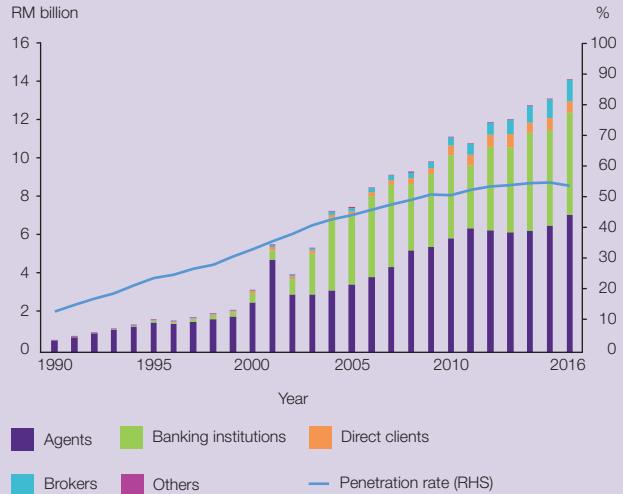
Life Insurance and Family Takaful Sector: New Premium and Contribution Market Share by Distribution Channel



Source: Bank Negara Malaysia

Chart 2

Life Insurance and Family Takaful Sector: New Premium and Contribution by Distribution Channel and Penetration Rate



Source: Bank Negara Malaysia

¹ Defined as the ratio of total number of life insurance and family takaful policies in force to the total population.

² Swiss Re *sigma* No.2/2014 'Digital Distribution in Insurance: A Quiet Revolution' Report.

Overall Growth Moderated while Certain Segments Remain Underserved

In the past five years, the incremental impact of the predominant agency and bancassurance channels appears to be diminishing. Similarly, growth of the life insurance and family takaful industry has moderated significantly compared with previous decades, with new business growth averaging 5.5% per annum between 2011 and 2016. Life insurance and family takaful penetration hovered at about 55% over the past five years (Chart 2). Eliminating multiple ownership of policies by the same policyholder, the proportion of the population that owns at least one life insurance or family takaful policy is only 35% (2015). Among the bottom 40% household income group, only 4% have some form of life insurance or family takaful cover according to the Financial Capability and Inclusion Demand Side Survey conducted by the Bank in 2015.

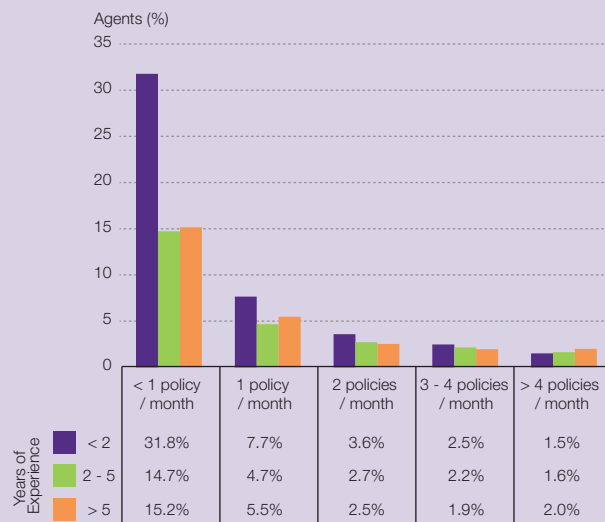
The plateauing insurance penetration rate and low take-up by the underserved population may be explained by several factors:

- **Agency productivity has been declining**

The number of policies generated per agent has been declining. 80% of agents today sell less than two policies per month and even among the more experienced agents, more than half sell less than one policy per month (Chart 3). A significant factor to note is that 60% of agents operate on a part-time basis, mainly to supplement other forms of employment. This constrains efforts to professionalise the agency force, which in turn makes it less attractive as a career of choice, thereby reinforcing a vicious cycle. There have been challenges faced in attracting and retaining agents and the number of agents has been declining since 2012, with only three out of 10 remaining in the industry after three years.

Chart 3

Life Insurance Sector: Composition of Agents by Level of Productivity and Experience



Source: Life Insurance Association of Malaysia

- **Products have become less affordable to the mass market**

The average premium per policy has accelerated at an annual rate of 8% in the recent five years, compared with an average of 3% over the last 10 years. Unaffordability had also been cited by consumers as the main reason for not purchasing or lapsing life insurance/family takaful policies³. This trend coincides with a discernible shift towards more investment-linked products sold by agents. Such products account for two-thirds of new business generated by agents and typically have higher premiums due to a higher investment element. Consumers searching for yield

³ 2015 Financial Capability and Inclusion Demand Side Survey.

in a low interest rate environment have bolstered demand for investment-linked products, which offer an upside potential on returns during periods of more buoyant financial markets. On the supply side, the lower levels of guarantees inherent in investment-linked products have also made them relatively more capital efficient for insurers and takaful operators to underwrite. This is evidenced by the change in overall product composition, with investment-linked products comprising 33% of new business market share in 2016 (2009: 25%). In addition, products have increased in complexity, with more product features leading to higher premiums. The confluence of these factors, combined with a commission-based remuneration structure that incentivises the agency channel to focus on products with larger premium sizes and more affluent consumers, have further contributed to lower affordability.

- **Bancassurance channels have focused on investment-linked and credit-related products**

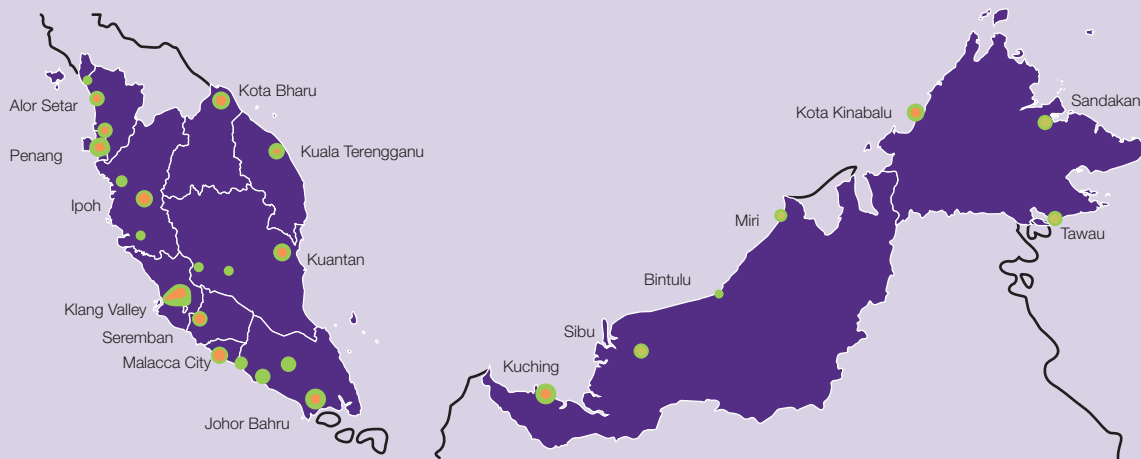
The growth of the bancassurance channel has been centred mostly on single premium credit-related and investment-linked products that are more familiar to sales staff at banks and banking customers. Significant fees paid by insurers and takaful operators to banks under exclusive bancassurance agreements have also driven the preference for higher premium products and more affluent customer segments. As a result, insurance penetration among banking customers is significantly below the industry penetration level, at only 5% as at 2014, with low-income customer segments generally under-represented.

- **Limited reach of agency support outside urban centres**

In terms of geographical reach of the agency force, there is significant disparity between locations as more than 60% of agents serve Klang Valley, Johor and Penang. As agents generally depend on branches of insurers and takaful operators for administrative, compliance and training support, the reach of agents is limited to urban centres where branches are mostly located (Diagram 1). This further concentrates the target customer segments of agents to those who are more likely to already have some form of life insurance or family takaful cover, while excluding the lower income and rural population.

Diagram 1

Life Insurance and Family Takaful Sector: Heat Map on Branch Network

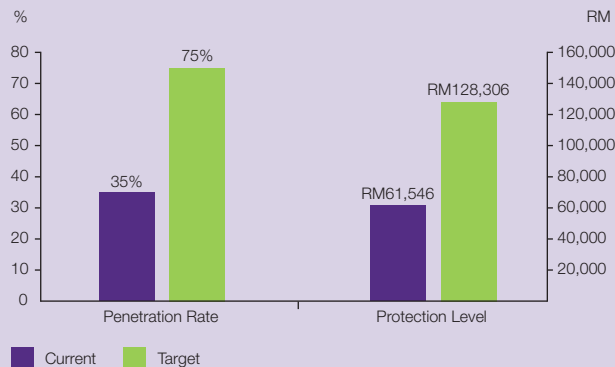


Source: Bank Negara Malaysia

The above factors suggest considerable scope for alternative distribution channels to address underinsurance among a relatively large segment of the population. This gap remains significant, whether viewed in terms of increasing the penetration rate, narrowing the life and medical protection gap or improving the adequacy of cover (Chart 4).

Chart 4

Life Insurance and Family Takaful Sector: Penetration Rate and Protection Level⁴



⁴ Defined as sums insured per capita

Source: Bank Negara Malaysia, Economic Transformation Programme Target (PEMANDU), 2012 Underinsurance Study in Malaysia (Universiti Kebangsaan Malaysia and Life Insurance Association of Malaysia)

The Future Evolution of Distribution Channels

Increasingly complex and unaffordable product offerings have limited the access of insurance/takaful products to large segments of the population. Efforts to reduce complexity and cost will need to go hand-in-hand towards achieving a larger share of simple life insurance and family takaful products that are distributed through alternative delivery channels and include the following strategies:

- **Simplifying and aligning products to deepen penetration**

Simplifying product designs will make insurance and takaful more affordable and accessible to the underserved segments. This is in line with the product principles and features as outlined in the Microinsurance and Microtakaful Discussion Paper issued in April 2016. The Starter Pack initiative as proposed by the industry is a significant step in the right direction, providing basic term cover at low levels of premium with minimal underwriting. The product which is expected to be launched in the second quarter of 2017 will serve as a basis for insurers and takaful operators to proliferate more targeted products catering to the underserved segments.

- **Leveraging technology with online and mobile channels**

The Life Insurance and Family Takaful Framework introduces key elements to spur this transition including requiring pure protection products to be made available through direct channels and introducing online product aggregators to enable consumers to make informed choices. With the high levels of internet and smartphone penetration in Malaysia, combined with advancements in payment technology, online platforms and mobile insurance hold much promise for expansion of outreach to the underserved segments. The large efficiency gains that these channels bring due to process automation open up new possibilities for making products simple and affordable. In particular, mobile insurance that combines simple product designs and efficient payment mechanisms (e.g. deduction of airtime or credit) has greatly increased insurance inclusion in many markets.

- **Increasing consumer touch points through partnerships**

Insurers and takaful operators should also explore partnerships with businesses and organisations with large and established distribution networks including co-operatives, community-based organisations, retail chains and agent banks. These offer a multitude of consumer touch points and many have payment facilities for convenient premium collection.

In-person sales of life insurance and family takaful products with financial advice will continue to be a fundamental pillar for outreach and financial literacy promotion. Agents, bank staff and financial advisers who have direct access to consumers are better positioned to understand the specific needs of consumers and to enhance understanding of how insurance and takaful products work. However, insurers and takaful operators will need to continually assess how these channels can serve consumers better, including through the following:

- **Up-skilling and equipping intermediaries**

Support tools and analytics will help intermediaries to better match product recommendations with the needs of consumers. This needs to be reinforced by raising the standards of professionalism and overall quality of services, including through the continuous training and up-skilling of agents and bank staff.

- **Improving incentive structures**

Insurers and takaful operators need to re-examine how incentive structures affect the behaviour of intermediaries. The balanced scorecard introduced under the Life Insurance and Family Takaful Framework will complement these efforts by aligning the remuneration of intermediaries with a greater emphasis on the suitability of products for prospective customers and overall quality of service. Over time, it is important that these incentives continue to be reviewed to encourage desired behaviours towards closing the protection gap.

- **Deepening engagement through financial advisers**

As household income and wealth increase, so will demand for comprehensive and independent financial advice. To promote financial advisers as a viable distribution channel, the Bank has reduced the minimum paid-up capital from RM100,000 to RM50,000 and rationalised the qualifying requirements to become a financial adviser's representative. This will also support insurance/takaful agents scaling up to become financial advisers. Since the introduction of these measures in 2015, the number of financial adviser's representatives has increased to 574 (2014: 381). It remains important for insurers and takaful operators to have a dedicated product and distribution strategy, supported by adequate operational resources, to further develop the financial advisory channel.

