

## 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.

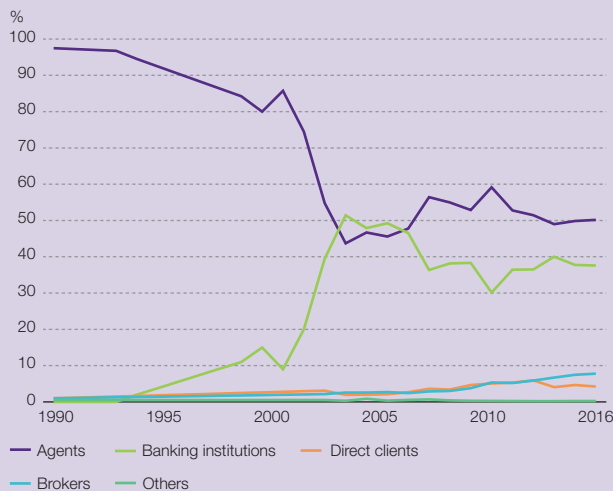
### From an Agency-Dominated System to a Dual-Channel System

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%<sup>1</sup> 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 markets<sup>2</sup>.

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

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

<sup>2</sup> 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.

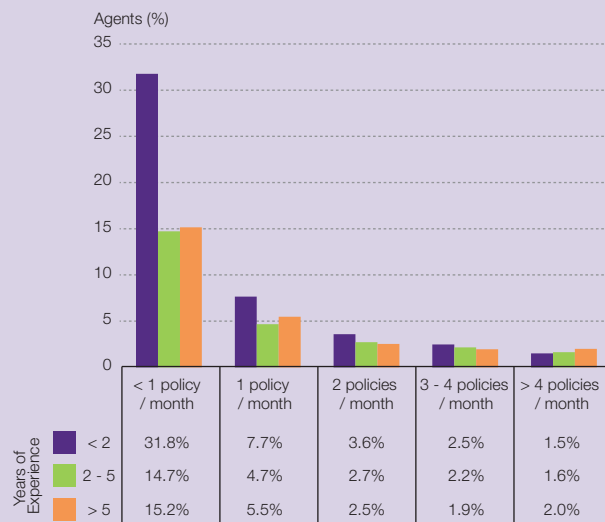
The plateauing insurance penetration rate and low take-up by the underserved population may be explained by several factors:

- **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 policies<sup>3</sup>. 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

<sup>3</sup> 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

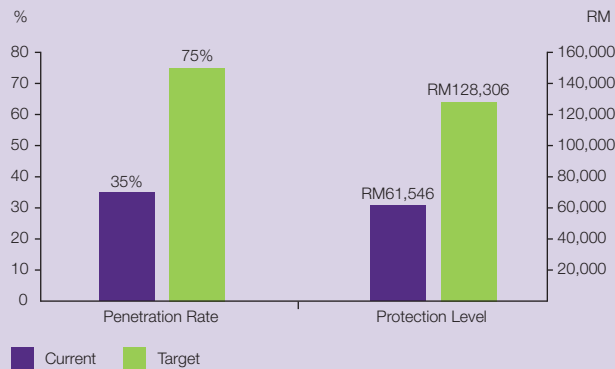


Source: Bank Negara Malaysia

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 Level<sup>4</sup>



<sup>4</sup> 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.