Liberalisation of the Motor and Fire Tariffs

The Bank will be gradually liberalising the Motor and Fire Tariffs with the first phase commencing in 2016. In the new environment, the insurance and takaful industry will have the flexibility to offer motor and fire products with new features or differentiated scope of cover, at market-based prices. This flexibility is expected to spur product innovation, while the application of risk-based pricing will incentivise good risk management behaviour among consumers. The healthy competition generated will also benefit consumers who will gain access to a wider array of motor and fire products, along with higher quality services provided by professional intermediaries. To facilitate an orderly transition both for risk owners and the industry to the new operating environment, a liberalisation roadmap has been developed by the Bank. The roadmap sets out the phases under which existing tariff requirements relating to product features, coverage limits and product pricing will be gradually withdrawn. It also importantly provides for the implementation of strengthened prudential and market conduct requirements necessary to ensure that insurers and takaful operators continue to operate in a safe and sound manner and treat consumers fairly. This article elaborates on the implementation roadmap and the specific objectives behind the phased liberalisation approach.

Phased Liberalisation to Support an Orderly Transition

The liberalisation roadmap provides for the removal of tariff requirements in phases (Diagram 1). This allows gradual adjustments to be made by both the industry and consumers which is important since motor and fire products are widely required by vehicle and property owners, either by law or to protect assets under financing. Motor and fire are also the two largest classes of business for general insurers and takaful operators, accounting for approximately 65% of total industry premiums (including contributions in the context of takaful) on average over the past five years.

During the first year of implementation, the industry will be allowed to offer new products or extensions to the scope of coverage of existing products under the tariffs. The prices of these new products and additional covers will be determined by the market. This will provide an early opportunity for industry players to develop and refine their product and pricing strategies as well as upgrade distribution and operational capabilities. The expected supply of a wider variety of motor and fire products by the industry will also provide additional choice for consumers to purchase insurance or takaful protection that suit their individual needs.

In the second year of implementation, premium rates for Motor Comprehensive and Motor Third Party Fire and Theft (TPFT) products will be determined by the market. Current rates in these product lines are assessed to be reasonably close to their technical levels (based on average loss experience), thus mitigating the risk of sharp adjustments which may cause a disproportionate impact on consumers. Accompanying this change will be enhancements to consumer protection requirements to ensure proper governance over product design and pricing as well as the fair treatment of consumers. Insurers and takaful operators are expected to enhance existing procedures and internal capabilities to enable risks to be properly assessed and prices to be set appropriately and consistently. The standard of disclosure will also be increased, particularly in terms of the pricing components and scope of coverage, to facilitate comparison and enable consumers to make informed purchasing decisions.

Premium rates for Motor Third Party products will continue to be regulated with gradual adjustments to more closely reflect the loss experience of these products. At present, some rates remain substantially below technical levels which are not sustainable over the long term. Based on a recent study, the total premiums collected annually on Motor Third Party products were approximately RM520 million, while incurred claims and expenses have increased to almost RM680 million. This means that for every ringgit of premium received for a Motor Third Party product, insurers and takaful operators paid out an average of RM1.30 in claims and related costs, with some vehicle classes incurring up to RM2.90. Given the sizeable pricing gap relative to risk, an immediate deregulation of rates is likely to result in steep premium increases and thus, affecting large numbers of consumers. In view of this, a more measured approach is necessary to provide time for ongoing initiatives to narrow the pricing gap to take effect, including initiatives aimed at checking the inflation of claims costs and addressing leakages and fraud. These initiatives will be complemented by efforts to inculcate responsible driving habits and adoption of road safety measures. The phased approach will also facilitate the collection of higher quality data at a more granular level by insurers and takaful operators to better inform pricing decisions.

Diagram 1

Phased Liberalisation of Motor and Fire Classes

	Motor Class	Fire Class
Prior to 2016	All available products are defined in the Motor* and Fire Tariffs and are subject to tariff rates Gradual adjustments to tariff rates for identified risk groups	
2016 onwards	New products and new optional add-on covers** can be offered at market rates	
2017 onwards	Disapplication of tariff rates for Motor Comprehensive and Motor Third Party Fire and Theft Gradual adjustments to tariff rates for Motor Third Party for identified vehicle classes	Gradual adjustments to tariff rates for identified risk groups
2019 onwards	Assessment of the state of readiness of the industry and consumers for further liberalisation	

Note:
* More detailed explanation on the types of motor insurance can be found in the Motor Claims Guide on the InsuranceInfo website, http://www.insuranceinfo.com.my/landing_pages/accident_info/download/guide.pdf.
** Refers to a new type of product/cover not defined under the Motor and Fire Tariffs or any variation to or extension of product/cover defined under the Motor and Fire Tariffs.

Source: Bank Negara Malaysia

The liberalisation in motor premium rates will be accompanied by a reduction in fire premium rates for certain risk classes, as part of an overall rebalancing of pricing between these classes of business. Over time, as the pooling of risks becomes more refined, premium rates for the two classes are expected to become more consistent with the underlying risk profiles. The progress of the liberalisation will be reviewed in 2019, with an assessment of the impact of these measures on consumers as well as the industry.

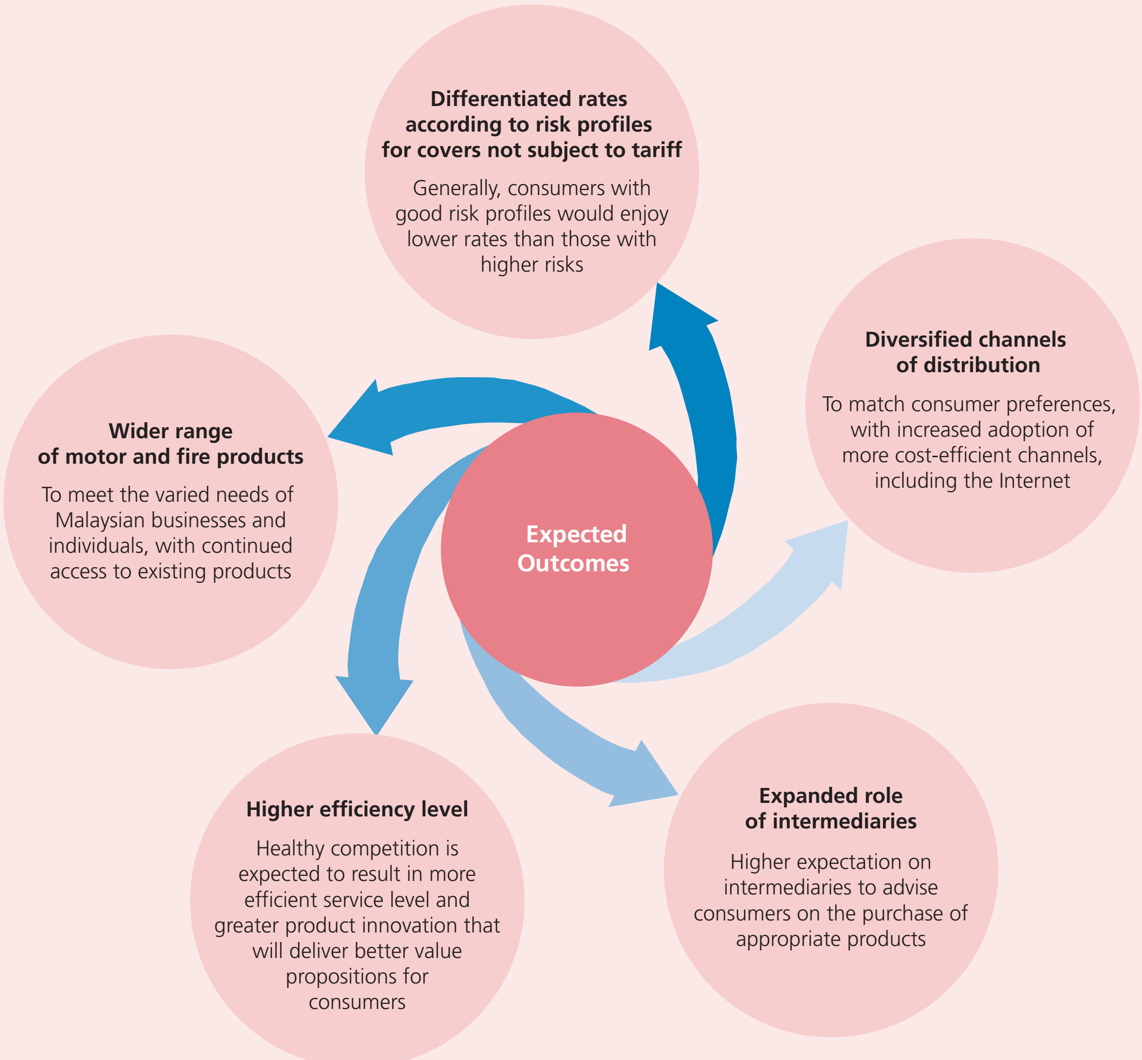
Objectives and Expected Outcomes of Liberalisation

A key objective of the liberalisation initiative is to strengthen incentives for efficiency improvements and sound risk management within the general insurance and takaful sector. Greater flexibility provided for the industry to price motor and fire products will promote competition, in turn driving improvements in underwriting and claims management to deliver the best service and value to consumers. In addition to the need for insurers and takaful operators to upgrade technical capabilities and competencies, it is also expected that broader collaborative efforts, both across the industry and with service providers, will be accelerated to streamline existing practices and minimise leakages and delays in claims settlements. Such efforts include the establishment of the Fraud Intelligence System by the industry to address insurance fraud, upskilling intermediaries to further enhance professionalism and raising the standard of the repair industry to facilitate more efficient claims processing.

Over time, premium rates would be priced fairly and become more aligned to the underlying risks, thus allowing vehicle and property owners with lower risk profiles to be charged lower premium rates. Similarly, those with higher risk profiles will be appropriately incentivised to undertake measures to reduce risk exposure or improve their risk profiles. The resultant changes in risk behaviour may also reduce the overall incidence of accidents and thefts, which can moderate the inflation in claims costs and premium rates as well as ensure the sustainability of the industry over the long term.

Diagram 2

Expected Outcomes under the New Operating Environment



Source: Bank Negara Malaysia

Another important objective of the liberalisation is to encourage greater product innovation that is responsive to the different needs and preferences of vehicle and property owners. This would include the adoption of new technologies in product development that enable insurers and takaful operators to provide incentives for consumers to adopt safer practices, while delivering better value propositions for responsible consumers. Consumers should also be able to access motor and fire products through their preferred distribution channels, including more cost-efficient channels such as the Internet. Aside from having greater product choice, consumers will additionally benefit from the ability to vary coverage limits or purchase optional extensions. This will enable the scope and level of protection as well as the corresponding premium rates to be customised to match individual risk profiles. During the transition however, existing products will continue to be made available to allow time for consumers to review and adjust their purchasing decisions. To facilitate informed decisions by consumers, the disclosure of product features, coverage limits and premium rates will be enhanced. Intermediaries are also expected to take on an expanded role in explaining new product features and options and assisting consumers to optimise their protection purchases.

The industry is well-placed to make a smooth transition towards a more market-based regime. The regulatory and supervisory efforts undertaken by the Bank over the years have substantially strengthened the resilience of the industry and instilled better governance, risk management and market practices. In particular, the prudential requirements relating to risk-based capital and sound risk management are expected to preserve incentives for sustainable pricing practices and ensure that insurers and takaful operators remain financially sound in the more competitive environment.

Greater flexibility in product design and pricing which corresponds to insurers' and takaful operators' respective risk appetites and capital will also promote more equitable pricing of risks. Together with the cost savings derived from other ongoing initiatives to increase operational efficiency, the liberalisation will contribute towards ensuring the sustainability of the industry over the longer term.