

Towards a More Effective and Efficient Motor Cover Framework

Challenges facing the insurance and takaful industry in motor underwriting and impact on motor vehicle owners

Under the Malaysian road transport legislation, it is a mandatory requirement for all Malaysian motor vehicle owners to purchase an insurance policy or takaful certificate (collectively referred to as insurance policies) to cover against liabilities arising from bodily injury including death, to any third party. This is to provide for compensation to members of the public who suffer injury or loss of life arising from a road accident caused by a vehicle owner.

In Malaysia, motor insurance premiums (including contributions in the context of takaful) and the scope of coverage under motor insurance policies are determined by the Malaysian motor tariff (Tariff). The Tariff has not been revised since 1978 to take into account the changing profile of risks associated with motor insurance and takaful coverage (subsequent reference to insurance cover includes takaful cover), including the increased frequency and escalating costs of motor accidents.

Among the motor accident-related expenses borne by the insurers and takaful operators, costs relating to bodily injury and death constitute the largest component. Over the years, the claims experience of the Third Party Bodily Injury and Death component of motor insurance policies has progressively deteriorated with claims ratios exceeding 200% since 2006. In 2010, for every ringgit of Third Party Bodily Injury and Death premiums received, insurers and takaful operators paid out RM2.82 and RM2.25 respectively in claims, before factoring in other related costs such as management and acquisition expenses.

The growing gap between premiums collected and claims paid out by the industry has contributed to the displacement of Third Party motor insurance covers as more insurers and takaful operators are not able to sustain such business on a financially viable basis. As a result, some motor vehicle owners have had to purchase their motor policies from the Malaysian Motor Insurance Pool (MMIP), which was originally set up by the general insurance industry in 1992 to act as an insurer of last resort for high motor risks such as buses as well as vehicles carrying hazardous materials. This led to a sharp increase in the number of motor policies issued by the MMIP which increased from 5,897 in 2007 to 128,058 in 2009. Policies insured by the MMIP are subject to additional premium surcharges and stricter underwriting rules to reflect the higher risk of the policies covered. The increased displacement of motor policies into the MMIP has, however, disproportionately affected these vehicle owners through substantially increased insurance-related costs and reduced access to motor insurance protection. While the vehicles underwritten by MMIP account for only 2% of the total number of vehicles insured in Malaysia, immediate review of the rules of MMIP will be undertaken to ensure that these motor vehicle owners that are not deemed as high risk will have greater access to motor protection at a lower premium.

Holistic review of the motor cover framework

Recognising the difficulties faced by vehicle owners with respect to motor insurance, the Bank initiated a holistic review of the motor insurance framework with the primary aim of addressing the issue of access to affordable motor insurance protection. The goal is to ensure that the public is afforded easy access to adequate insurance and takaful protection at a reasonable premium at all times, and that such protection is provided in a commercially sustainable manner over the longer term. In undertaking the review, the Bank was mindful that while a review in the premium rates would address the pricing misalignment in the short term, this must be accompanied by more fundamental structural adjustments to the entire motor claims value chain to arrest the continuing trend of escalating claims costs in the longer term. The resulting proposed new motor cover framework therefore significantly improves on the existing tort-based unlimited liability system through pervasive efficiency enhancements to contain the cost of claims that result from leakages, misaligned incentives and claims fraud.

Feedback from public engagements

Engagements with key stakeholder groups and the public at large have indicated broad support for motor insurance protection to continue to be provided by the existing insurers and takaful operators due to the

ease of access and better service levels that would be promoted as a result of competition. The majority of respondents also supported maintaining the existing scope of coverage for various types of bodily injury claims with a reasonable overall limit on compensation paid out. Feedback received further suggested a high degree of acceptance by the public to a reasonable and gradual premium adjustment to address the pricing misalignment in view that the Tariff has not been revised for more than 30 years. However, the expectation was for this to be accompanied by a significantly more efficient claims settlement process that would also effectively control cost leakages along the entire claims settlement chain. Preserving the role of the court system as an avenue for redress was also favoured to ensure the adequate protection of claimants' interests.

Towards a new motor cover framework

Taking into consideration the feedback obtained from the public engagement process, the new framework focuses on two areas, namely enhancing efficiency in the claims settlement process and the introduction of a gradual premium adjustment to bring premiums more in line with the general motor claims experience.

The formulation of efficiency enhancement measures has been achieved in close consultation and collaboration with the relevant government agencies as well as selected private institutions involved in the claims settlement chain. These include the Royal Malaysian Police, the Ministry of Health (hospitals), the Judiciary, the Attorney General's Chambers, the Malaysian Bar Council, and the insurance and takaful industry, which have provided their commitment to support the realisation of more efficient, fair and transparent claims settlements that most importantly safeguard the interests of motor vehicle accident victims. The identified efficiency initiatives include:

- the establishment of a call centre to provide immediate support assistance to road accident victims;
- enabling hospitals to assist road accident victims in submitting claims notifications to insurers;
- shorter timelines to produce police and medical reports to facilitate early processing of claims;
- a more simplified claims notification process; and
- a review of lawyers' fees for bodily injury and death cases.

Steps by various parties to implement the identified efficiency measures will commence immediately. The effective implementation of these measures is expected to reduce the time taken to settle motor insurance and takaful claims significantly from the current average duration of one to five years to six to 18 months moving forward. The improvement measures are overseen by a joint working committee chaired by Bank Negara Malaysia, and comprising representatives from the Ministry of Finance, the Ministry of Health, the Judiciary, the Attorney General's Chambers, the Malaysian Bar Council, the Royal Malaysian Police, the insurance and takaful industry and the consumer and transport associations. The committee's mandate is to drive and ensure the successful implementation of the various efficiency enhancement measures which the relevant agencies and private institutions have committed to undertake. The first meeting of the committee will be held in April 2011.

In parallel with the efficiency improvement measures, reasonable premium adjustments will be introduced gradually over a period of four years beginning 1 January 2012. The premium adjustments are guided by the following key principles:

- The adjustment will be gradually phased in to mitigate its impact and coincide with enhancements to the Malaysian transportation system;
- The premium adjustment will not have a material impact on the lower income group; and
- Premium adjustments will be more closely aligned with the risk profile of vehicle categories, so that those with good claims experience will benefit from a lower adjustment or a premium reduction consistent with risk-based pricing.

The new motor cover framework strives to converge the long-term interests of both the insuring public and the insurance and takaful industry as well as promote a good and safe driving culture. Its effective and timely implementation is critical to secure the long-term availability of reasonably priced motor insurance protection offered by insurers and takaful operators, with competitive and efficient service levels that will deliver better outcomes for consumers.

Introduction of Takaful and Insurance Benefits Protection System in Malaysia

The recent financial crisis has prompted regulators around the world to reassess the robustness and adequacy of the safety net arrangements in their own countries to safeguard the public when failures of financial institutions occur. The initiatives taken include a review of the scope and level of coverage of existing arrangements as well as the consideration of new arrangements to provide effective protection for the broad range of financial consumers.

In Malaysia, the safety net arrangement within the financial sector was further strengthened with the introduction of the Takaful and Insurance Benefits Protection System (TIPS) by the Malaysia Deposit Insurance Corporation (PIDM) on 31 December 2010, to complement the existing deposit insurance system (DIS) introduced in 2005 for the banking system. TIPS, which replaces the existing Insurance Guarantee Scheme Fund (IGSF) administered pursuant to the Insurance Act 1996, operates as an **explicit compensation scheme** to protect consumers of the insurance and takaful industry in the event of a failure of an insurer or takaful operator (hereinafter collectively referred to as institutions). By alleviating the potential financial loss to policyholders (including participants in the context of takaful) in the unlikely event of the failure of an institution, TIPS will further strengthen the consumer protection framework in Malaysia, thereby promoting public confidence in the industry.

Mandate of PIDM

The Malaysia Deposit Insurance Corporation Act 2011 provides that PIDM's mandate shall include administering TIPS. This will further enhance PIDM's role as an important component of the financial safety net, while leveraging on PIDM's capacity, competencies and institutional framework which have been developed and strengthened to manage financial sector resolutions. Similar to the DIS, PIDM is required to carry out its mandates under TIPS in a manner that minimises cost to the financial system.

Public policy objectives of TIPS

The primary objective of TIPS is to protect the interests of policyholders and preserve public confidence in the insurance and takaful industry. Most individual and small policyholders would find it difficult to ascertain the financial soundness of institutions given the significant information asymmetries that exist between policyholders and institutions. This is further compounded by the technical complexity and long term nature of insurance and takaful business. The vast majority of policyholders would have neither the resources nor incentives to monitor the performance of institutions and exercise informed consumer choices. Under these circumstances, the reasonable protection of policyholders serves not only to safeguard the interests of policyholders of an institution that may become insolvent, but it is also important to avert a widespread erosion of confidence in the industry at large which could have detrimental consequences for economic activity, individual welfare and the development of the industry.

A key feature of TIPS, in comparison with the IGSF, is the explicit level of protection provided under TIPS. The IGSF previously provided compensation up to 90% of the benefits in the event of a failure of an institution. This level in practice has varied between 55% and 70% of the benefits depending on the availability of the fund. In contrast, under TIPS, the maximum level of protection is predetermined to provide greater certainty, assurance and importantly, full protection to the vast majority of insured individuals and small businesses. The explicit protection under TIPS, which has existed under the DIS since 2005, will also provide for the consistent treatment between savings instruments offered in the banking and insurance/takaful industry to reflect the growing convergence of products within the financial sector and provide equivalent protection for depositors and policyholders.

The protection of policyholders will also be further enhanced under TIPS with broad powers provided for PIDM to be able to intervene and resolve troubled institutions which have ceased to be viable or which the Bank considers likely to become non-viable, in the best interest of policyholders. PIDM's intervention and resolution powers include arrangements to transfer policies/certificates to another institution in order to preserve the continuity and value of investments and protection afforded under existing insurance policies and takaful certificates.

A further objective of TIPS is promoting and strengthening incentives for sound risk management by institutions. This will be achieved through the implementation of a differentiated premium structure which will reflect the risks posed by individual institutions to the compensation fund. Under this structure, institutions with strong financial standing and risk management will contribute a lower rate of premium to the fund. This will complement and reinforce the supervisory role of the Bank through strengthened incentives for institutions to adopt and implement sound risk management practices commensurate with their risk profiles. This contrasts with the IGSF where all institutions contribute the same rate of premium to the IGSF regardless of their risk profiles.

Membership

Membership in TIPS is compulsory for insurers licensed under the Insurance Act 1996 and takaful operators registered under the Takaful Act 1984. Reinsurance companies, retakaful operators, international takaful operators, Danajamin Nasional Berhad and intermediaries such as insurance/takaful agents, brokers and adjusters are excluded from membership.

Funding

TIPS will be funded from annual premiums assessed against member institutions based on the level of coverage for each individual institution. PIDM maintains and administers separate funds under TIPS respectively for:

- conventional life policies;
- conventional general policies;
- family takaful certificates; and
- general takaful certificates.

The clear segregation of funds promotes equity, transparency and accountability in the management and usage of the funds, as each fund is built up from premium funded from the respective types of insurance/takaful business for the benefit of its respective policyholders. The segregation between conventional and takaful TIPS funds also ensures compliance with Shariah principles.

Coverage

TIPS provides coverage for ringgit-denominated policies issued in Malaysia. Where a member institution is unable to meet its obligations to its policyholders, PIDM is required to reimburse the policyholders in respect of the covered benefits up to the specified maximum limits provided under TIPS. The maximum coverage limits vary for the different types of protected benefits, ranging from up to RM10,000 per month for disability or annuity income benefits, to an amount of up to RM500,000 on death or property damage claims. Any premiums paid in advance will also be refunded in full. The limits are generally adequate to protect the vast majority of policyholders in full, while retaining sufficient incentives for policyholders of high-value policies with substantial benefit levels to be more vigilant in selecting the institutions from which coverage is obtained. Further details on the coverage provided by TIPS can be accessed at www.pidm.gov.my.

Collaboration and coordination

Bank Negara Malaysia remains responsible for the regulation and supervision of insurers and takaful operators as part of its mandate for maintaining overall stability of the Malaysian financial system, while PIDM administers both the DIS and TIPS in a manner that contributes towards promoting public confidence in the financial system. The close collaboration and coordination between the Bank and PIDM ensures the effectiveness and efficiency of the financial safety net.

This is achieved through a strategic alliance agreement (SAA) between the Bank and PIDM, which was established during the inception of the DIS and which has now been expanded to include TIPS. The SAA clearly sets out how the two organisations will collaborate and coordinate their activities to preserve the integrity of the financial safety net and minimise duplicative regulatory costs and burdens on the industry. In particular, the arrangements provide for the coordination of risk assessments, resolutions of member institutions as well as requirements on regulatory reporting. It also establishes protocols for regular consultation and exchange of information concerning developments in the industry to promote optimal financial stability outcomes.