

## 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](http://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.