

Repositioning the Insurance and Takaful Industry to Support the Changing Socio-economic Landscape

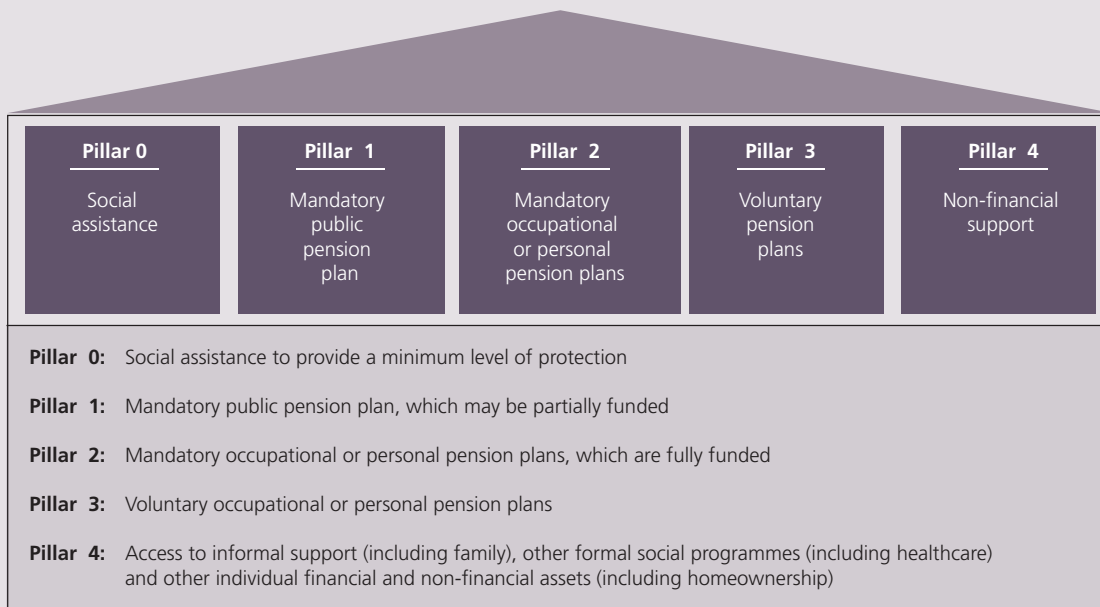
The insurance and takaful industry have made significant strides to become an important component of the financial system and a vital pillar to support the economic and social development of Malaysia. The evolution of the socio-economic landscape in Malaysia over the years has been instrumental in shaping the scope of business of insurers and takaful operators to provide traditional financial protection products to include a broad range of financial planning options such as wealth creation. Two significant areas are in the development of retirement financing and healthcare financing.

Enhanced focus on retirement financing

There has been significant global recognition of the importance of pension systems in the economic stability of countries and the security of an ageing population. Cognisant of the core objectives of pension systems, which are old-age poverty alleviation and smoothing consumption from work life into retirement, the World Bank has adopted a multi-pillar approach towards pension system design to address the needs of target population segments.

The World Bank multi-pillar pension framework provides a structured approach in efforts to evaluate the comprehensiveness and effectiveness of Malaysia’s pension system design. A multi-pillar pension system would better address the differing needs of target population segments by diversifying the types and sources of retirement income across the pillars. By promoting the sharing of risks and responsibilities between the individual, the Government and the private sector in the provision of pension benefits, the pension system of any given country would be more sustainable in the pursuit of a more equitable form of pension structure that suits country-specific needs.

Chart 1
World Bank Multi-Pillar Pension Framework¹



¹ Adapted from Holzmann, Hinz and Dorfman (2008) "Pension Systems and Reform Conceptual Framework" World Bank

Malaysia's pension system is primarily underpinned by Pillar 2 which is the occupational retirement income schemes operated by the Employees Provident Fund, Public Service Department of Malaysia and Armed Forces Fund Board. These schemes are complemented by various welfare assistance programmes, including those operated by the Social Welfare Department of Malaysia, which serve to alleviate poverty. However, there is still much capacity and scope for the enhancement of Malaysia's pension system, in particular in the promotion of pension products provided by the private sector.

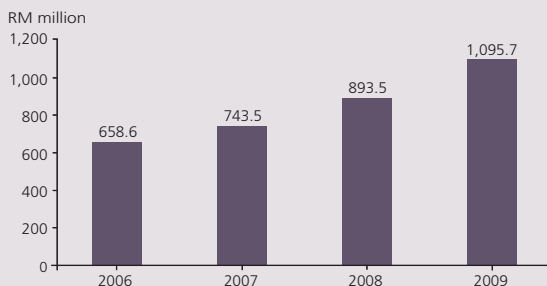
While Malaysia has a relatively comprehensive mandatory occupational pension scheme for employees of the public and private sectors, the present system which has been in existence for more than five decades might not be sustainable in the longer term to effectively support the ageing demographic structure of the Malaysian population. In 1980, the number of Malaysians aged 55 and more comprised 8% of the total population and this is expected to increase to 16% by 2020. With the improved quality of life, the life expectancy of Malaysians has increased from only 56 years in the 1950s to 76 years for females and 71 years for males currently. This is estimated to increase to 79 years and 75 years respectively in 2020. The longevity risk has posed great challenge to the adequacy of savings for retirement, further compounded by premature exhaustion of retirement savings in the early period of retirement, particularly in view of the prevailing practice of lump sum withdrawal at age 55.

Towards enhancing the Malaysian pension system, the Government has embarked on a pension reform initiative, guided by the World Bank's multi-pillar approach. For comprehensiveness, the reform necessitates an integration of the various pension pillars to bridge gaps in the provision of financial safety nets. The insurance and takaful industry in particular, would play a significant role in strengthening the development of a vibrant voluntary private pensions market of Pillar 3 to complement the social pension infrastructure made available by the Government. The offering of pension products such as annuity plans by insurers and takaful operators will enable retirees to benefit from a regular income stream, beyond retirement for a sustainable standard of living. It is key, therefore, to create greater awareness among Malaysians on the importance of retirement planning and making available product lines which accommodate the needs of the ageing population.

Growing significance of medical and health protection

With the changing socio-economic landscape, Medical and Health Insurance (MHI) and Medical and Health Takaful (MHT) are expected to continue to grow strongly. Total MHI gross direct premiums and MHT gross direct contributions increased 22.6% from RM0.9 billion in 2008 to RM1.1 billion in 2009 (Chart 2).

Chart 2
Total Gross Direct Premiums/Contributions of
Medical & Health Insurance and Takaful



Source: Bank Negara Malaysia

This growth is in line with the trend of increasing private expenditure in healthcare (average 17% per annum over the period 2003 to 2008) that reached a total of RM18.9 billion in 2008. The trend is expected to continue as rising cost of healthcare becomes an impetus to seek cost-effective ways to provide for healthcare needs and protection from catastrophic healthcare spending. Furthermore, as Malaysia progresses towards a high-income economy, household expenditure on healthcare is expected to increase especially with a growing middle-class population. A highly-skilled workforce will also demand better

healthcare benefits leading to higher healthcare spending by employers. Insurers and takaful operators are expected to respond to such developments by providing more cost-effective options to consumers. One recent innovation is the introduction of no-claims bonus for MHI plans where consumers with a good claims record will receive cash payments.

As income levels and public awareness of healthcare increases, there will be increasing demand for higher levels of cover and a more comprehensive suite of benefits. For example, some insurers have increased or removed lifetime limits on claims, while others are considering including traditional medicine to the benefits covered. Certain lines of critical illness products now allow consumers to make multiple claims, although for different illnesses each time, in response to an environment where better medical technology increases the likelihood of recovery from critical illnesses. With increased life expectancy, there is also a push towards longer term MHI and MHT, with some products now covering policyholders up to age 100.

It is clear that as the MHI and MHT segment matures and as Malaysia moves towards a high-income economy, the range of products and services will grow to meet the diverse needs of the Malaysian population.

In facing the challenges of an ever-changing socio-economic landscape, the Bank will continue to review and refine the regulatory and supervisory approach for the insurance and takaful industry to ensure that the players remain resilient, responsive and progressive in serving the needs of Malaysians.