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Malaysia: Life Insurance & Family Takaful Framework Concept Paper

With the stated aims of achieving higher levels of insurance and Takaful penetration in Malaysia, increasing the professionalism of intermediaries and enhancing the transparency around the provision of products and services to consumers, on 7 November 2013 Bank Negara Malaysia (BNM) issued a concept paper, *Life Insurance and Family Takaful Framework* (Framework), for public consultation. This e-Alert summarises the changes proposed by BNM.

A two-phased approach has been suggested, with Phase 1 introducing initiatives (summarized below) that would gradually prepare the industry for further liberalisation (Phase 2). The success of the Phase 1 initiatives will be monitored and measured by BNM against a set of key performance indicators (KPIs) before Phase 2 begins. The Framework does not discuss the likely content of Phase 2.

1. Partial removal of operating cost control limits

The guidelines to operating cost control (OCC guidelines) of life insurance business were introduced in 1996. They provide the maximum limits of operating cost within which life insurers and family Takaful operators must apply to their agency channels. This includes the specification of limits on agency commissions, agency-related expenses, other expenses of management and agency structure. Commission limits for the bancassurance/bancatakaful channel are prescribed under separate guidelines on bancassurance which were established in 2009.

The new Framework proposes the following changes to the OCC guidelines:

- For investment linked products (ILP), limits on commission and agency-related expenses are to be removed immediately. Instead, the allocation rates for such policies will be regulated, with minimum allocation rates applicable to both annual premium (varying by policy year) and single premium policies.
- For non-ILP products that are sold as pure protection products without any savings component, namely term policy, critical illness and medical and health, limits on commission are also removed provided that the insurer also offers similar pure protection products via the direct channel with zero commission.
- For all non-ILP products, the limits on management expenses as set out by the OCC guidelines will be removed.

2. Diversification of distribution channels

To promote diversification of distribution channels, the Framework provides incentives for industry players to expand their distribution network beyond the agency force through a variety of initiatives including:

- Commission limits payable to bancassurance/bancatakaful will be aligned with that of corporate agents for all products apart from ILP and pure protection products, where commission limits have been removed as outlined above. Commission limits for bancassurance/bancatakaful are currently lower in aggregate compared to those for agency.
- A requirement to set up a direct channel selling pure protection products free of commission (as outlined above).
- Enhancing the framework for financial advisers (FAs) and Islamic financial advisers (IFAs) by:
    - Reducing the paid-up capital requirement from RM 100,000 to RM 50,000
    - Reviewing and expanding the qualification standards for FAs and IFAs
    - Permitting FAs and IFAs to sell the entire range of products offered by all insurers and Takaful operators

3. Strengthening Market Conduct

The Framework sets out the following proposals to “safeguard and facilitate the liberalisation of the industry”:

- Balanced scorecard system:
  Intermediaries are to be remunerated based on a balanced scorecard system that includes elements of training, certification and conduct as areas of performance assessment. The Framework has put the responsibility of implementation onto Boards of Directors

- Enhanced product disclosures:
  A revised format for the sales/marketing illustration is proposed which aims “to provide clear and adequate information for prospective policyholders/Takaful participants to make informed decisions”.

- Availability of online facilities:
  In addition to enhancing the existing *insuranceinfo* website to include an online product aggregator for the comparison of at least pure protection products, life insurers and family Takaful operators are also required to develop online insurance and Takaful accounts for their customers.

- Removal of agency financing limits:
  The Framework proposes the removal of the existing limit imposed on agent financing, with such financing facilities to be made available from the shareholders' fund and subject to existing capital requirements.

- Initiatives on consumer awareness:
  BNM will continue to provide consumers with financial education through various initiatives aimed at helping consumers make informed financial decisions

Observations/Implications

1. Distribution landscape

The proposed Framework, with the various incentives to help develop bancassurance/bancatakaful, FAs and direct channels, has the clear objective of enhancing the growth and significance of such channels to complement the traditional agency channel.

While bancassurance/bancatakaful has been growing steadily and is a channel that attracts a lot of interest (as is evidenced by the fierce competition for recent bancassurance-related transactions), there is a widespread view that it has not reached its full potential. The relaxation of bancassurance/bancatakaful channel commission restrictions should be an important catalyst for future growth. Independent FA and direct channels are also still in their infancy. The proposed changes could therefore see the start of a shift in the distribution landscape and mix in the coming years, with non-agency channels gaining a larger share of the market.

Although market statistics by channel are not published in Malaysia (a change that should perhaps follow through this initiative) it is worth noting that in Singapore the market share of independent FAs has increased from 11% in 2008 to 17% in 1H 2013 (measures in terms of new business APE). At the same time, in Thailand, the market share of bancassurance has grown to around 46% of new business APE, which will far exceed the proportion of bancassurance/bancatakaful business in Malaysia.

2. Cheaper products and greater transparency

The Framework proposes the provision of better value products for consumers by providing a basis for comparison (using the online aggregator), as well as the availability of commission-free pure protection products via direct channels. In addition, the proposed enhancements to product disclosures are aimed at providing more transparent information to consumers, allowing them to have a better understanding of the product and services being offered.

3. Products

It is not clear how the removal of commission limits, accompanied with caps on allocation charges, will impact ILP business and in particular the underlying margins. It is likely that the business will have to be re-priced, with commission scales adjusted to reflect these new allocation caps that have been put in place.

The focus on liberalising pure protection products is not a surprise as BNM aims to close the "protection gap", an initiative that has also been initiated by the Monetary Authority of Singapore. Rising medical costs could see a greater demand for pure protection products such as accident and health and medical policies, which could subsequently lead to product innovation from industry players who have expertise in this space. The online product aggregator, if implemented successfully, could potentially lead to margin squeeze for protection products as consumers could more easily compare prices and product features between insurers/Takaful operators.

Currently, the maximum aggregate basic commission for savings products (non-ILP) sold through agency is much higher (110%) than that for bancassurance (65%). Aligning the commission rates for bancassurance/bancatakaful with agency could see the proportion of such products sold through bancassurers/bancatakaful operators increasing.

Conclusions

It will be interesting to see how the industry reacts to the proposed Framework, with public feedback required by 9 December 2013. Given the proposed changes, it is not surprising to see reports of strong opposition from agency sales forces in the media.

With the introduction of the Framework at a time when there have been several new entrants to the market, as well as other on-going merger and acquisition activity, the market is certainly poised for some interesting changes. Growth in the life insurance sector in Malaysia has been somewhat disappointing in recent years (with new business APE growth of only 5% and 2% for the years 2011 and 2012, respectively), which many attribute to the number of transactions that have taken place and the related level of uncertainty within the companies that have been affected. If BNM is successful with its aim of expanding the level of insurance penetration coverage, the industry could see a return to a pattern of strong growth in the coming years, particularly as the level of transaction activity subsides.

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