MALAYSIA
LIFE INSURANCE AND FAMILY TAKAFUL NEWSLETTER

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We are pleased to present the first edition of Milliman's Malaysia Life Insurance and Family Takaful Newsletter. This edition summarises recent developments, including market performance and news, regulatory activities, and other industry developments in Malaysia during the period of 1 July 2016 to 31 December 2016.

In addition, the newsletter includes a white paper on International Financial Reporting Standards (IFRS) 17, which outlines the implementation approach for the new reporting framework.

We hope you find this newsletter informative. Please do not hesitate to reach out to Farzana Ismail, Richard Holloway, or your usual Milliman consultant if you have any questions.

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Market performance

LIFE INSURANCE AND FAMILY TAKAFUL INDUSTRY PERFORMANCE

According to the Life Insurance Association Malaysia (LIAM), the life insurance industry continued to achieve strong growth in the first three quarters of 2016, with 18.3% growth in new business weighted premium or annualised premium equivalent (i.e., 100% of regular premiums plus 10% of single premiums) compared with the same period in 2015. Highlights include:

- Investment-linked business continues to dominate, with a market share of 54.9% in terms of new business annualised premium income (APE), while the remaining 45.1% is made up of traditional life insurance business.
- Traditional business grew by 27.0% in terms of new business APE, which outpaced the growth of investment-linked business of 12.0%.
- In terms of gross sum assured, investment-linked business grew faster compared with traditional business, i.e., at 24.7% and 7.2% respectively.
- The total gross sum assured for all new individual policies hit MYR 82.0 billion, compared with MYR 68.0 billion achieved in the same period in 2015.
- Benefit payments increased by 7.7%. This was within expectations and is in line with the growth in the industry.

According to Fitch Ratings, the takaful sector continued to record higher growth than the conventional sector:

- The family takaful industry grew by 9.8% in the first half of 2016, compared with 8.2% growth in conventional life insurance.
- Family takaful represents around two-thirds of the country's takaful segment, and contributes to around 30% of the overall life market, based on new business contributions in the first half of 2016.
- There is a positive growth outlook for the family takaful industry, driven by a low base, stable domestic consumption, increasing consumer awareness, and regulatory pressure, which will drive consolidation in the near future.

The strong performance of the life insurance and family takaful sector augurs well for the industry, as it is currently undergoing a transformation process following the implementation of the Life Insurance and Family Takaful Framework ("LIFE Framework"), which came into force on 23 November 2015.

Market news

A. MERGERS AND ACQUISITIONS

- MAA Takaful Berhad became part of Zurich Insurance Group effective 1 July 2016, and was renamed as Zurich Takaful Malaysia Berhad. The acquisition enables Zurich to penetrate the takaful market in Malaysia.
- Canada's Sun Life Financial Inc. and Malaysian sovereign wealth fund Khazanah Nasional were in talks from June 2016 to acquire the insurance business of Hong Leong Financial Group Bhd (HLFG), which includes a 70% stake in Hong Leong Assurance Berhad and 65% in Hong Leong MSIG Takaful Berhad. The deal was reported to be valued at about MYR 3 billion. However, an announcement was made on 4 November 2016 that the parties involved could not reach an acceptable commercial agreement and have mutually agreed to cease negotiations.
- Allianz Malaysia Bhd commenced negotiations to acquire the entire equity stake of HSBC Amanah Takaful (Malaysia), following approval from Bank Negara Malaysia (BNM) on 26 October 2016. The approval is subject to all parties concluding negotiations within six months. The deal is reported to be worth MYR 240 million to MYR 300 million and is likely to involve a bancatakaful agreement with HSBC Bank.

B. KEY COMPANY NEWS

Life insurance

- AIA Bhd launched AIA Vitality, a science-backed health and wellness programme, on 3 June 2016.
- Since June 2016, Zurich Insurance Malaysia Berhad has expanded its foreign funds portfolio. The Zurich Health Care Fund is the first of its kind within the Malaysian market to allow customers to invest in the global healthcare industry.
- Prudential Assurance Malaysia Berhad launched 'PRUlife partner,' a first-in-the-market investment-linked life insurance policy which covers two lives under one policy, in November 2016.
- Etiqa Group (for both insurance and takaful, including general business) registered a 20% increase in its online business for the first half of 2016. Etiqa will continue to increase its range of online services with new products.

Family Takaful

- Syarikat Takaful Malaysia Bhd hopes to maintain its leadership in the family takaful business, focusing on products with lower premium bases. (June 2016)
- Great Eastern Takaful Berhad aims for a double-digit growth in 2016, with the plan to specifically target the Malay Muslim community by employing more agents. It also expects to expand to sell its products online in early 2018. (July 2016)
- Manulife Holdings Bhd is keen to tap into the takaful industry in Malaysia, according to its CEO. (August 2016)
- Etiqa Takaful Bhd formed a strategic partnership with Pos Malaysia Bhd to offer a family takaful plan, Pos Khairat Takaful, at Pos Malaysia branches nationwide. (December 2016)

C. KEY APPOINTMENTS

- Ng Sim Kheng was appointed as the chief financial officer (CFO) in Prudential Assurance Malaysia Berhad in 2016.
- Joseph Gross was appointed as CEO of Allianz Life Insurance Malaysia Berhad, effective 20 April 2016.
- In June 2016, Tim Oommen Thomas became the CEO of Gibraltar BSN, Lee Kok Wah the CFO, and Chua Kim Soon the chief operations officer (COO).
- MCIS Insurance Berhad appointed a new CEO, Kobus Vlok, who took office effective 1 October 2016.
- In 2016, Mark Steven O'Dell served as Manulife's CEO, and Justin Helferich as the CFO.

Regulatory developments

MANAGEMENT OF PARTICIPATING LIFE BUSINESS

- The policy document was issued on 15 July 2015 and became effective from 1 July 2016 onwards.
- It sets out:
  - BNM's expectations regarding the management of participating life business.
  - Roles and responsibilities of various key stakeholders (the board, senior management, and appointed actuary) in the management of the participating life business.
  - Key requirements in bonus revisions, transparency, and disclosure.
- The new regulation is expected to have a material impact on the way insurance companies manage their participating life business going forward. In particular, participating business now needs to be managed at a cohort level, taking into account the product type, features, and year of inception. As a result, bonus revisions are also likely to occur for some companies.
- From 1 January 2017, insurers are required to comply with the new sales illustration format for participating life policies as outlined in this policy document. In particular, the illustrative rates of returns are now lower, at 2% and 5% for a low and high scenario respectively (compared with investment-linked business at 5% and 7%).

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP) FOR TAKAFUL OPERATORS

- The policy document was issued on 15 April 2016 and came into effect on 1 January 2017. The new regulations for takaful operators are in line with the ICAAP requirements that have already been in place for insurance companies since September 2012, with specific considerations for takaful and the additional overlay for Shariah considerations for takaful companies.
- It requires takaful operators to actively manage their capital adequacy, taking into account their business strategies, risk profiles, and overall financial resilience.
- The takaful operators will need to have the following in place:
  - An individual target capital level (ITCL) that reflects the takaful operators' risk profile and risk management practices.
  - A capital management plan (CMP) that takes into account business strategies and environment.
  - The processes involved for monitoring and ensuring the maintenance of adequate capital above ITCL at all times, commensurate with the risk profile.
- To determine the ITCL, the takaful operator needs to determine the impact of the stress tests on the participants' risk fund (PRF), including the possibility of the PRF being in deficit, the ability of the PRF to repay a qard (loan), and the financial impact if a qard is irrecoverable.
- The ITCL needs to be linked to the availability of the surplus within each PRF to absorb losses. The operator needs to identify the minimum level of surplus in the PRF, which, if it is breached, will require a review of the ITCL.
- Takaful operators need to consider the interlinkage between the participants' investment fund (PIF) and PRF in the stress tests.
- The stress tests conducted for the capital planning process must cover a projection period of at least three years.

STRESS TESTING FOR ALL INSURERS AND TAKAFUL OPERATORS

- The policy document was issued on 30 June 2016 and came into effect on 1 September 2016.
- The purpose of the stress tests is to enable companies to set individual target capital levels (ITCLs), assess overall capital adequacy, identify potential threats to financial conditions, and the potential impact of risk mitigation measures, as an integral part of the insurer's risk management framework.
- The board of directors has the ultimate responsibility for the overall stress testing programme.
- It requires at least three stress scenarios to be internally developed, in addition to the scenarios specified by BNM on an annual basis. The projection needs to be conducted for each fund separately.
- The projection period for multi-period stress testing must be sufficiently long to capture the full impact of the stress scenario (e.g., five to six years for life insurance or family takaful, and three to four years for general insurance and takaful business).

- Companies are required to consider stress scenarios that have an instantaneous impact as well as those that have a continuous impact throughout the projection period.
- The new guidelines require companies to consider concentration risk and the impact of the correlation among risk factors within stress scenarios. In addition, insurers need to also consider second-round effects from the primary shocks of the stress scenarios that are due to dependencies of risk factors. Where management actions are taken into account, they must be objective, realistic, and take into account the costs and likely secondary impact.
- It needs to be viewed in conjunction with the Risk Based Capital Framework, ICAAP, Risk Governance Framework, and Financial Condition Report (FCR) guidelines and policy documents.

PROHIBITED BUSINESS CONDUCT

- BNM continues to enhance the standards in market conduct, with the issuance of this updated policy document on 15 July 2016.
- It enhances the consumer protection and serves to ensure that financial consumers are not provided with misleading or deceptive information in relation to a financial service or product, which includes insurance and takaful.
- The policy document also prevents business practices that intimidate or exploit financial consumers or restrict the freedom of consumers to choose, and it prevents collusive business practices that may result in unfavourable outcomes to financial consumers.

TRANSFERS OF BUSINESS

- This policy document was issued on 5 August 2016 to ensure that business transfer schemes do not adversely affect the safety and soundness of the insurer or takaful operator. In addition, it is intended to safeguard the rights and interests of those who are likely to be affected by the schemes (e.g., policyholders).
- Business transfer schemes include transfers of insurance or takaful contracts in the context of an exit strategy, whereby prior written approval is required from BNM.
- The supporting documents to be submitted to BNM during the application for approval include details on the proposed business transfer scheme, approval from the board of directors, a report on the assessment made, and relevant mitigation measures to protect the interests of those affected by the scheme, as well as a valuation report on the liabilities to be transferred by the appointed actuary (if applicable).

FINANCIAL TECHNOLOGY REGULATORY SANDBOX FRAMEWORK

- The Regulatory Sandbox Framework was issued on 18 October 2016 to enable the experimentation of financial technology (fintech) solutions in a live environment, subject to appropriate safeguards and regulatory requirements.
- BNM will review the applicants' minimum standards and requirements for participation in the Sandbox and inform them of their eligibility within 15 days of application submission. In reviewing the application and the extent of any regulatory flexibilities that may be accorded while operating in the Sandbox, BNM will take into account the potential benefits of the proposed product, service, solutions, the potential risks and mitigating measures, and the integrity, capability, and track record of the financial institutions.

CONCEPT PAPER ON DIRECT DISTRIBUTION CHANNELS FOR PURE PROTECTION PRODUCTS

- In relation to the initiative to build the presence of direct channels, as outlined in the LIFE Framework, this concept paper was issued on 28 October 2016 with a one-month consultation period.
- Under the LIFE Framework, life insurers and family takaful operators are required to offer commission-free stand-alone pure protection products through at least one direct channel, applicable for pure protection term products in 2017 and pure protection critical illness and medical/health products in 2018.
- This policy document sets out the requirements for the offering of pure protection products through direct distribution channels by life insurers and family takaful operators, including:
  - Minimum product specifications for pure protection term products offered via this channel.
  - Business conduct, infrastructure, and operational requirements regarding the channel.
- Pure protection products shall be offered via one or both of the two following direct channels:
  - The head office and branches.
  - Online platform (internally developed or outsourced).
- Life insurers and family takaful operators must give due regard to the following in developing the direct channel:
  - The scalability, including geographical reach, to facilitate accessibility of consumers to the pure protection products.
  - The capability of the direct channel to contribute towards increasing the share of regular premium products offered through non-agency channels to 30% by 2020.
- Life insurers and family takaful operators are required to offer pure protection term products via the direct channel, with sums assured of up to at least MYR 500,000.

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Special feature: IFRS 17 implementation

- After long preparation, a final IFRS standard on insurance contracts is now being drafted by the International Accounting Standards Board (IASB), with a planned publication in 2017. The IASB foresees a 3.5-year implementation period, with the first application of the new standard to be on 1 January 2021.
- This implies a very short period for implementation, especially considering the need for shadow runs well before 2021. The following article discusses the critical points and suggests the possible first steps towards IFRS 17 implementation: tinyurl.com/z43sxq8.

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