Policies and Developments

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Policies and Measures to Strengthen the Insurance Industry

Implementation of the Financial Sector Masterplan

The initiatives undertaken in the first phase of the Financial Sector Masterplan (FSMP) were predominantly directed towards enhancing the capacity and capabilities of domestic insurers to compete more effectively, strengthening the consumer protection framework and raising corporate governance standards. These initiatives were continued in 2004 with further enhancements to the regulatory and supervisory framework to promote greater efficiency, effectiveness and stability within the insurance industry. During the first four years of the implementation of the FSMP, 15 of the 31 FSMP recommendations have been fully implemented. The key initiatives undertaken during the year are set out below:

(i) Strengthening Financial Resilience

To achieve a more efficient utilisation of capital, a risk-based capital (RBC) framework will be adopted to better align the solvency regime with the risk profiles of individual insurers. The framework will allow insurers substantially greater flexibility to implement appropriate investment strategies that would improve performance and at the same time, achieve better asset-liability matching of insurance funds to support the long-term viability of life insurers. The concept paper on the proposed RBC framework for insurers was issued to the industry for comments in December 2004. The concept paper stipulates the capital adequacy and solvency requirements to be adopted by insurers, the formula and methodology to determine them and other related requirements including valuation of assets and liabilities, investment of insurance funds as well as disclosure requirements. The implementation of the framework will be carried out under a two-phased approach. Phase I is focused on implementing the risk charges for assets and liabilities while maintaining the existing valuation basis of assets and life insurance liabilities. Full review of the valuation basis of assets and life liabilities will be undertaken under Phase II. The phased-in approach will allow insurers adequate time to develop the capacity and resources needed for the successful implementation of the proposed framework, while at the same time, enabling Bank Negara Malaysia (the Bank) to take into account current international developments with respect to the solvency assessments of insurers. Phase I of the framework is expected to be finalised in 2006.

A risk-based capital framework will be adopted to better align the solvency regime with the risk profiles of individual insurers.

(ii) Enhanced Corporate Governance Standards

The guidelines on audit committees and internal audit departments for insurance companies were revised in December 2004 to further strengthen the role of the audit committees in assessing the objectivity, independence and performance of appointed external auditors and thus support sound governance structures and processes of insurers. Under the revised guidelines, the audit committee of an insurer is required to review and assess relationships between the external auditor and the insurer, including the fees paid to the external auditor, and to ensure that they do not impair the independence of the external auditor. The audit committee is also required to approve any provision of non-audit services by the insurer's external auditor.

(iii) Strengthening Avenues for Consumer Redress

As part of the efforts to enhance the consumer protection infrastructure and strengthen avenues for consumer redress in the financial sector, the Financial Mediation Bureau (FMB), an integrated dispute resolution centre for financial institutions under the supervision of the Bank, was established in late 2004 and commenced operations in January 2005. The scope of the FMB, which was created through the merger of the Banking Mediation Bureau (BMB) and the Insurance Mediation Bureau (IMB), also covers disputes between consumers and Islamic banks, takaful operators, development financial institutions, selected payment system operators and payment instrument issuers. With the formation of the FMB, the monetary limits on cases falling within the scope of mediation have also been increased. For insurance related claims, the new monetary limits are RM200,000 for motor and fire insurances and RM100,000 for other classes of insurance. In addition, the FMB can also mediate third party property damage claims within the limit of RM5,000. The FMB will complement existing avenues that are already available through the complaints units at insurance companies and the Bank, for consumers to resolve their disputes.

(iv) Consumer Education Programme

The consumer education programme for the insurance and takaful sectors, known as InsuranceInfo, which was launched in August 2003, is a ten-year programme which aims to equip consumers to make well-informed decisions in selecting insurance and takaful products, and to understand their rights and responsibilities under an insurance contract. In addition, it provides yet another channel to address consumer complaints and grievances. During the year, five new information booklets covering topical issues such as protection against insurance fraud, importance of making nomination for life policy, annuities for retirement planning, personal accident takaful and investment-linked takaful, were published in English and Bahasa Melayu, bringing the total number of booklets published to 17. In addition, significant progress was made on other consumer-related information materials that will be made available to the public. These include pocket-sized cards containing important information that could serve as a useful guide for consumers in the event of a road traffic accident and measures to prevent motor vehicle theft.

(v) Promoting Growth of Bancassurance

In a move to promote an effective alternative delivery and distribution channel for insurance products, the regulatory requirements in respect of bancassurance were reviewed in 2004. With lower acquisition costs, consumers will benefit from the efficient cost structures of bancassurance arrangements. The requirement on commission disclosure will also facilitate comparisons of bancassurance products with other savings and investment instruments. With the development of bancassurance, consumers will be able to access integrated financial services from banking institutions in a convenient and cost effective manner. Details of the requirements are outlined in the overview of the development of bancassurance in Malaysia which is presented in the white box on page 20.

(vi) Enhancing Competition in Reinsurance

As part of the efforts to promote a more competitive reinsurance sector, the requirements on voluntary cessions (VC) to Malaysian Reinsurance Berhad will be gradually removed. The levels of VC under

The establishment of the Financial Mediation Bureau was undertaken to further enhance the consumer protection infrastructure and strengthen avenues for consumer redress.

the prevailing market arrangements are subject to regular revisions in view of the increased capacity of insurers to assume risks. The VC levels were revised to 5% for each class of general reinsurance business in 2003 (prior to 1 January 2003, the VC levels ranged from 7.5% to 25%). For the period 1 January 2005 to 31 December 2006, the VC levels for motor, personal accident and hospital and surgical classes will be reduced further to 4% while VC levels for other classes of business remain at 5%.

Other Policies and Measures Implemented to Strengthen the Insurance Industry

In addition to the initiatives implemented under the FSMP, the year 2004 saw various other measures being undertaken to improve market conduct, operational efficiency as well as information technology and product development of the insurance industry. Among the measures taken were:

(i) Guidelines on Outsourcing for Insurers

In December 2004, the Bank issued the guidelines on outsourcing to provide a more comprehensive regulatory framework to strengthen outsourcing governance and risk management among insurers. The guidelines require insurers to have in place, a comprehensive outsourcing policy to guide strategic outsourcing decisions and establish a comprehensive outsourcing risk management programme. In addition, insurers must also ensure that outsourcing arrangements do not diminish their ability to fulfil regulatory obligations and obligations to policy owners, nor impede effective supervision by the Bank. Enhanced reporting requirements introduced under the guidelines will also strengthen the Bank's ability to monitor risks associated with material outsourcing arrangements at both the institutional as well as industry levels.

(ii) Anti-Money Laundering Measures

As part of the efforts to strengthen the integrity of the insurance sector, greater emphasis was placed on enhancing customer due diligence processes adopted by insurers and insurance intermediaries to ensure effective compliance with the Anti-Money Laundering Act 2001 (AMLA). In this regard, the Bank established minimum verification procedures to be adhered to by all insurers, reinsurers and insurance brokers when establishing or conducting business relations to ensure the legitimacy of the insurance transactions being entered into. A risk-based approach to implementing the verification procedures consistent with international best practices was also introduced. Under the risk-based approach, insurers are required to undertake enhanced due diligence for customers or transactions with higher risk profiles, while permitting simplified verification procedures to be carried out for certain types of low-risk insurance applications. During the year, the Bank also continued to hold regular dialogues with compliance officers of insurers and insurance brokers to ensure the effective implementation of anti-money laundering measures.

(iii) Guidelines on Management of Information Technology (IT) Environment

In order to promote a sound IT environment and to mitigate the risks associated with IT operations, guidelines on the management of the IT environment were issued in May 2004. The guidelines outline the minimum responsibilities and requirements for planning and managing, as well as establishing preventive measures which are aimed at preserving the integrity of insurers' critical IT systems and processes. The responsibilities include responsibilities of the management and board of directors of insurers to ensure that appropriate and sound risk management processes are in place to provide a platform for the conduct of safe and sound financial activities, given the rapid changes in new technologies, product innovations and security of financial transactions.

(iv) Medical and Health Insurance (MHI)

To improve market practices in MHI

business, the insurance industry implemented the following measures:

- reviewed the Hospital and Surgical Insurance (HSI) Underwriting Guide, which serves as a best practice guide for the underwriting of HSI policies, to promote the more equitable treatment of policy owners while ensuring prudent underwriting practices. The revised Guide, among other things, provides greater flexibility for insurers with the necessary capacity to offer more favourable terms and conditions to consumers in a competitive market;
- introduced co-insurance and deductibles which enables insurers to offer plans with lower premiums while promoting individual responsibility in health spending by creating an incentive for consumers to be more discerning when considering medical treatment; and
- engaged in discusssions with private hospitals and related service providers to address issues surrounding the escalating cost of medical services and treatment.

(v) Graduate Training Scheme
In support of the Government's efforts to equip the unemployed graduates with the necessary skills to enhance their marketability, the Life Insurance Association of Malaysia (LIAM) and Persatuan Insuran Am Malaysia (PIAM) in collaboration with the Malaysian Insurance Institute (MII), launched insurance training and development programmes for unemployed graduates in 2004. A total of 36 unemployed graduates were sponsored by 18 insurers to undergo a four-six month training programme. The training and development programmes for unemployed graduates were aimed at improving their communication and analytical skills as well as providing relevant exposure in the insurance sector.

Life Insurance

During the year, several measures were initiated mainly to strengthen consumer protection as well as promote the orderly development of the life insurance industry. The specific measures initiated were as follows:

(i) Fair Treatment of Policy Owners
Due to the unfavourable investment conditions, some insurers had to revise the bonus rates for participating life insurance plans. To ensure equitable treatment of policy owners, the Bank issued a circular on 'Appointed Actuary's Report to the Board on Recommendation for a Reduction in Bonus Rates for Participating Life Products' in October 2004. The circular requires insurers proposing to undertake a bonus revision exercise to submit an Appointed Actuary's report to the board of directors (Board) for consideration before such a decision is made. The report includes an assessment of insurers' legal rights to reduce bonus, and the use of asset share methodology to determine bonus revision and the cash value of the policy. The asset share methodology will ensure that a fair share of the accumulated funds is returned to the policy owners upon surrender or maturity after allowing for deductions for expenses by insurers. The report, as endorsed by the Board, is to be submitted to the Bank three months prior to the implementation of the revision. Insurers are also required to ensure there is proper communication with affected policy owners on bonus revisions. Further information on the fair treatment of policy owners is presented in the white box on page 61.

(ii) Guidelines on Dynamic Solvency Testing (DST)
To enable life insurers to take early pre-emptive actions and allow them to react in a timely manner to changes in financial conditions, the Bank requires life insurers to conduct DST as part of the annual financial condition report of the insurer. The guidelines on DST which were issued in October 2004, streamline the methodology for a proper assessment

of the medium to long-term financial and solvency position of the insurers. The DST requires the insurer to project its financial position into the future, with allowances for variations in the external economic and financial environment as well as changes in the mortality rates, investment returns and new business experience of the insurer. It is envisaged that the DST will serve as an effective tool for the Board and management of life insurers in determining strategic business decisions with respect to their available resources.

The Guidelines on Dynamic Solvency Testing were issued to enhance proper assessment of the financial and solvency position of life insurers.

(iii) Replacement of Life Insurance Policies
In an effort to improve market practices relating to life insurance sales, the Bank required life insurers to put in place a number of measures to detect and curb replacement of life insurance policies. These measures include establishing an effective control mechanism to detect replacement of policies and the inclusion of relevant questions in the proposal form on replacement of policies. In addition, life insurers are required to set up a conservation unit with a designated policy conservation officer within the company to follow-up and advise policy owners on the disadvantages of replacing an insurance policy and the alternative options available. Insurers are required to conduct regular internal audits to ensure proper enforcement of the control procedures on policy replacement.

(iv) Investment Return Assumption for Non-Guaranteed Benefits
As a result of lower investment earnings by life insurers, LIAM revised the maximum interest rate for pricing of non-guaranteed benefits of participating life policies from 7.5% to 7%. Correspondingly, the interest rate assumption used in the bonus reserve valuation was revised from 8% to 7% to be in line with revision of the pricing of life products. This periodic review is necessary to ensure that the illustration of non-guaranteed bonus to policy owners is realistic and insurers are able to meet policy owners' reasonable expectations of policy benefits.

(v) Tax Incentive under Budget 2005
The Budget 2005 provided an enhanced tax incentive to individuals to encourage savings in insurance and takaful products. With effect from the year of assessment 2005, the individual income tax relief on contributions to the Employees Provident Fund, life insurance premiums and takaful was increased from RM5,000 to RM6,000.

(vi) Memorandum of Understanding (MoU) between LIAM and the Insurance Brokers Association of Malaysia (IBAM)
In an effort to further enhance the role of insurance brokers in the selling of life insurance products, a MoU between LIAM and IBAM was signed on 24 May 2004. The MoU sets out the rules on payment of commission, procedures on collection of premiums, compliance with the professional code of ethics and marketing conduct as well as uniform terms of appointment of brokers.

General Insurance

Several measures were implemented in 2004 to continuously improve market practices in the general insurance sector. These initiatives include:

(i) Motor Insurance Initiatives
To increase operational efficiency and improve market practices in the motor insurance industry, the following measures were undertaken during the year:

(a) On-line Submission of Motor Cover Notes to Road Transport Department (RTD)
As part of the e-Government

initiatives, the JPJ eINSURANS, which facilitates electronic straight-through transmission of motor insurance details to the RTD for the purpose of road tax renewal, was implemented on 2 January 2005. The implementation of electronic cover notes for newly registered vehicles and renewal of road tax constitutes a significant move towards eliminating the incidence of forged cover notes that have resulted in premium leakages and a significant proportion of uninsured vehicles on the road. Insurers are required to be electronically linked to their agents for transmission of cover notes information to the RTD, as well as to take all the necessary measures to manage the enquiries and issues raised by their policy owners. Insurers are also encouraged to assist their agents by providing the required infrastructure for e-linkage and as an incentive, the Bank had agreed to exempt certain expenses incurred by insurers for this purpose from the requirements stipulated in JPI/GPI 2: Guidelines to Control Operating Costs of General Insurance Business. With the implementation of the system, physical cover notes would no longer be issued to policy owners.

JPJ eINSURANS facilitates electronic transmission of motor insurance details to Road Transport Department for road tax renewal.

(b) Action Framework for Non-compliance with Statutory Cash-Before-Cover (CBC) Requirements

The Insurance Regulations 1996 relating to CBC stipulates that a licensed general insurer is not permitted to assume any risk in respect of motor policies unless the premium payable is received by the insurer. To instil greater market discipline and enhance compliance with CBC requirements, the Bank introduced a new action framework for CBC non-compliance in October 2004. Under the framework, insurers will be compounded for any non-compliance of CBC requirement in respect of the issuance of motor covers for their direct clients. To encourage better control over the premium collection from agents by insurers, the action framework allows insurers to treat only motor premiums outstanding for less than 14 calendar days (from the date of cover note issuance by agents) as admitted assets for solvency compliance purposes. Insurers are required to make provision for motor premiums outstanding for more than 30 days from their agents. In addition, PIAM is required to blacklist agents that were deregistered for poor remittance record, thereby ensuring global deregistration of these agents in the country.

(c) Measures to Reduce Motor Vehicle Thefts

The insurance industry has formulated a strategic motor vehicle anti-theft campaign to check the rising incidence of motor vehicle thefts and educate vehicle owners. The strategies will focus on reducing professional or opportunistic vehicle thefts and enhancing co-operation between relevant parties to ensure effective implementation of these theft reduction measures. Vehicle manufacturers and assemblers have been encouraged to actively support the installation of effective anti-theft devices in new vehicles, including the installation of electronic immobilisers and tracking systems that meet international standards. The industry continues to work closely with Polis Diraja Malaysia to reduce vehicle theft and enhance the recovery rate of stolen vehicles domestically or from overseas. The industry has also established a fund for motor vehicle theft prevention and recovery activities.

(d) PIAM Approved Repairers Scheme (PARS)
To ensure that all motor repairers under PARS maintain a quality level of service, periodic surprise checks are being carried out on approved workshops, in addition to an annual routine inspection. The first exercise was carried out in July 2004. In a move to upgrade the service quality and integrity of PARS, with effect from 1 July 2004, a repairer applying for PARS status must be a private limited company with a minimum paid-up capital of RM50,000.

(e) Road Safety Campaign
To complement the Government's initiatives to curb the relatively high number of motor accidents, the industry launched a three-month campaign with the theme 'Think Safety, Drive Safely', in conjunction with the annual Insurance Day in July 2004. The campaign aims to educate and instil an understanding of the importance of road safety among Malaysians.

(ii) Strengthening General Insurance Reserves
As part of ongoing efforts to enhance the capital adequacy requirements for the insurance industry, the Bank made significant progress towards strengthening the reserving framework for general insurance business. The proposed guidelines on reserving for general insurance business aim to provide a consistent level of statistical confidence at the 75th percentile level in relation to the adequacy of reserves and make it a requirement for the valuation of general insurance liabilities to be certified by a qualified actuary. The proposed guidelines will also serve to provide a reserving framework that is compatible with the risk-based capital framework. A test exercise is currently being carried out by the industry to validate the framework and to carry out impact analyses prior to full implementation of the guidelines.

(iii) Insurance Guarantee for Foreign Workers
In April 2004, the Ministry of Home Affairs allowed the Immigration Department to accept insurance guarantees to support the application of work permits for foreign workers. Prior to this, only bank guarantees were accepted. In June 2004, the Bank allowed insurers to increase the maximum limit for bonds on foreign workers from RM50,000 to RM250,000 per employer, subject to compliance with prudent underwriting standards established under the revised bond underwriting guidelines issued in 2000. The higher limit would also enable insurers to compete effectively with other financial institutions in view of the increased demand for insurance guarantees for foreign workers.

Insurance Brokers and Adjusters

Insurance Brokers

The insurance broking industry continued to organise talks on technical aspects and structural developments with the objective of enhancing the capabilities and professionalism of its players. In addition, IBAM together with the MII, undertook the initiative to revise the syllabus of the Basic Certificate Course in Insurance Broking to ensure the continued relevance and quality of its content.

On the international front, IBAM had successfully organised the Twelfth Council of International Insurance Brokers' Association (CIIBA) meeting in July 2004. CIIBA, which comprises 12 international brokers associations, provides an international platform for strategic discussions and the promotion of the role and profession of insurance broking globally. The meeting in Kuala Lumpur focused on two key areas, namely, the regulatory environment and education needs of insurance brokers. In conjunction with this meeting, IBAM had also organised the First ASEAN Insurance Brokers' Conference, which was well attended by 150 local and foreign participants.

Adjusters
The loss adjusting sector continued its effort in increasing the number of qualified loss adjusters, in line with the initiative to enhance skills development and competency levels in the field of loss adjusting. Efforts are also underway for joint education and training arrangements between the MII, Chartered Institute of Loss Adjusters (CILA) of the United Kingdom and Australian Institute of Chartered Loss Adjusters (AICLA). Such arrangements have elevated the profile of the Malaysian adjusting sector which has the largest number of chartered loss adjusters in the Asian region. The adjusting sector also received international recognition when the Chairman of AMLA was elected as the Vice President of the International Federation of Adjusting Associations (IFAA) for 2004/2005.

Other Related Matters

The Malaysian Insurance Institute
As the premier professional insurance education provider in Malaysia, the MII works closely with the insurance industry to ensure the training and education programmes conducted are tailored to meet the evolving needs of the industry. Through its extensive links with established insurance institutions internationally, including the Chartered Insurance Institute (U.K.), the Life Underwriters Training Council (U.S.A.) and the Society of Actuaries (U.S.A.), the MII is committed to providing insurance education that meets international standards. Apart from playing an active role in servicing the needs of the insurance market in Malaysia, the MII intends to establish strategic linkages regionally especially in ASEAN countries, in line with its vision to be recognised as a world-class centre of excellence for education and professional development of insurance and related financial services. In 2004, the MII in collaboration with the ASEAN Insurance Training & Research Institute (AITRI), a non-profit organization formed by the ASEAN insurance regulatory authorities to provide regional research, education and training support in insurance for ASEAN member countries, offered three regional technical training courses. The courses which were on life and health insurance, marine and aviation insurance and reinsurance, were aimed at equipping participants from the region with the necessary technical skills.

During the year, the MII also conducted a total of 137 training programmes for insurers, brokers and adjusters, covering both technical aspects of insurance as well as a range of soft skills. A total of 3,258 participants attended these courses. The MII also conducted training for life and general insurance agents to equip them with the necessary skills to better service their clients. The Pre-Contract Examination for Insurance Agents (PCEIA) will be expanded to incorporate a medical and health insurance syllabus to ensure agents acquire the necessary expertise to sell medical and health insurance policies.

As the accreditation body for the MII Diploma/Certificate (DMII/CIP) and Associate (AMII) qualifications, the MII produced a total of 104 DMII/CIP graduates and 88 AMII graduates in 2004, bringing the total number of insurance personnel with DMII/CIP and AMII qualifications as at 31 December 2004 to 721 and 498 respectively. The Registered Financial Planner (RFP) programme, which has been conducted by MII since early 2004, attracted a total of 2,967 candidates from the industry. With effect from 1 January 2005, life insurance agents will be required to attend module 1 (Fundamentals of Financial Planning) and module 2 (Risk Management and Insurance Planning) of the RFP programme as part of their training under the Continuing Professional Development programme.

International and Regional Cooperation
During the year, the Bank participated in the following regional and international insurance forums:

- **The Seventh ASEAN Insurance Regulators Meeting (AIRM) and Related Joint Meetings**
  The Bank attended the Seventh AIRM which was held in Makati City, the Philippines from 21 to 22 September 2004. The meeting endorsed the constitution of the Management Board of AITRI, comprising Indonesia, the

Philippines, Singapore and Thailand as members, with Malaysia as the chair. The Management Board is responsible for reviewing the proposed projects or activities and annual budget requirements for AITRI. The meeting also reached a consensus for member countries to conduct their self-assessment on observance of the International Association of Insurance Supervisors (IAIS) Insurance Core Principles based on the revised set of 28 (compared with 17 previously) core principles starting from the year 2005. To further enhance the existing cooperation between members and facilitate the sharing of critical information, member countries also agreed to undertake an annual evaluation of key insurance sector trends and risks in their respective jurisdictions on a voluntary basis, the results of which would be shared at the annual AIRM. The Bank also attended the joint meetings held between the ASEAN insurance regulators and ASEAN insurance industry groupings, which were held in conjunction with the AIRM to exchange information on current developments in the insurance industry.

- **The Eleventh Annual Conference and Annual General Meeting of the IAIS**
  The Bank participated in the Eleventh Annual Conference and Annual General Meeting of the IAIS which was held in Amman, Jordan in October 2004. Four papers were approved for adoption by the IAIS at its Annual General Meeting, namely:

  - Standard on Disclosures Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers;
  - Revised Principles on the Supervision of Insurance Activities on the Internet;
  - Guidance Paper on Investment Risk Management; and
  - Revised Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism.

  The Annual General Meeting also saw the release of a new framework for insurance supervision by the IAIS. The new framework underpins the IAIS's past and future standard-setting activities on insurance supervision and proposes the development of cornerstones for the assessment of insurers' solvency. Apart from addressing specific risks associated with insurance business, the framework will promote greater compatibility between international standards on insurance supervision and supervisory standards adopted for other financial sectors with respect to common types of exposures.