

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Management of Participating Life Policy Business

Concept Paper

Issued on: 7 November 2014

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BNM/RH/032-3	Prudential Financial Policy Department	Concept Paper on Management of Participating Life Policy Business

This concept paper (CP) sets out the proposed standards on the management of participating life policy business. The proposed standards aim to promote effective governance, which pays due consideration to the interests of policyholders. All existing requirements by the Bank, where relevant, have been consolidated in the CP, to which further enhancements have been made.

The CP provides more elaboration on the Bank's expectations in relation to the determination of cohorts and cross-subsidisation, the use of the estate, Policy Owners' Reasonable Expectations, as well as the bonus supportability assessment. The CP also proposes enhancements to disclosure requirements, in order to increase the quality of communication between insurers and their stakeholders.

The Bank invites written feedback on this CP, including responses to specific questions set out in this CP. To facilitate the Bank's assessment, please support each feedback with a clear rationale, with accompanying assessments, as appropriate.

Responses and must be submitted to the Bank by 15 December 2014:

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PART A OVERVIEW

1. Policy objective

1.1 This policy document on the management of participating life policy business aims to:

(a) promote effective governance and fair management of the participating life policy business to ensure the protection of policy owners' interests; and

(b) clarify and consolidate the Bank's expectations on the management of participating life policy business, particularly on areas that provide for discretion to be applied.

Scope of policy

1.2 This policy document sets out:

(a) the roles and responsibilities of the board, senior management and appointed actuary in respect of a licensed insurer's participating life policy business;

(b) requirements on the management of participating life policy business;

(c) requirements on bonus revisions; and

(d) requirements on transparency and disclosure.

2. Applicability

2.1 This policy document is applicable to all licensed insurers under the Financial Services Act 2013 (FSA) which carry on participating life policy business.

3. Legal provisions

3.1 The requirements in this policy document are specified pursuant to section 47(1) of the FSA.

4. Effective date

4.1 This policy document shall come into effect upon issuance of the final document.

5. Interpretation

5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA unless otherwise defined in this document.

5.2 For the purposes of this policy document-

"S" denotes a standard, requirement or specification that must be complied with. Failure to comply may result in one or more enforcement actions.

"G" denotes guidance, which may consist of such information, advice or recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted.

"board" means the board of directors of the licensed insurer, or a committee of the board to whom the responsibilities of the board set out in this policy document have been delegated; and

"senior management" means the chief executive officer and senior officers

of the licensed insurer.

6. Policy documents superseded

6.1 The policy documents listed in **Appendix 1** are superseded.

PART B GOVERNANCE AND OVERSIGHT

7. Duties of board, senior management and appointed actuary

S 7.1. The board must ensure that the licensed insurer's participating life policy business is properly managed, taking into account sustainability of the participating life policy fund and the licensed insurer's duty to treat policy owners fairly. In doing so, the board must:

(a) review and approve the policy for the licensed insurer's management of its participating life business (MPB policy), which addresses and is consistent with the requirements in Part C of this policy document;

(b) review and approve bonus rates annually, including any revision of bonus rates and specific actions to be taken to implement the revisions;

(c) provide oversight on the implementation of the MPB policy and the licensed insurer's management of its participating life policy business by senior management;

(d) ensure that independent reviews are carried out at least annually by an independent party with sufficient expertise and relevant experience, to validate that the actual practices in the management of the participating life policy business are in line with the MPB policy; and

(e) ensure that policy owners' interests are properly protected and taken into account in any actions taken by the licensed insurer.

S 7.2. In relation to paragraph 7.1(a), the board must also approve the circumstances which may result in changes to the MPB policy as well as any actual changes.

S 7.3. The senior management must:

(a) develop and ensure that the MPB policy is clearly communicated to the relevant stakeholders;

(b) ensure that all elements of the MPB policy, as approved by the Board, are appropriately translated, implemented effectively and observed at all times;

(c) ensure that the MPB policy and all other aspects of the management of participating life policy business are clearly documented. The documentation must include:

(i) guiding principles for the management of the participating life policy fund; and

(ii) explanations of how the guiding principles translate to practices; and

(d) advise the board on developments having an impact on the management of the participating life policy business and recommend any changes to the MPB policy that may be required in response to such developments.

G 7.4. In relation to paragraph 7.3(d) examples of developments include:

(a) regulatory changes;

(b) changes in social and economic factors, including the financial landscape; and

(c) circumstances which may lead to the closing or merging of funds.

S 7.5. As part of the duties of the appointed actuary specified in paragraphs 9.1(c) and 9.7 of the Policy Document on Appointed Actuary: Appointment and Duties, the appointed actuary must:

(a) take into account Policy Owners' Reasonable Expectations' (PRE) and principles of fair treatment of policy owners, as well as adhere to the MPB policy in his recommendations;

(b) conduct a bonus supportability study annually and recommend to the board the bonus rates to be declared;

(c) ensure that any recommendations for a transfer of the shareholders' portion of the declared bonus out of the participating fund is in

compliance with the requirements in the Policy Document on Management of Insurance Funds and the licensed insurer's MPB policy; and

(d) assess the use of the estate by the company and include his opinion on this matter in his Financial Condition Report (FCR), as set out in paragraph 13.5.

PART C REQUIREMENTS ON THE MANAGEMENT OF THE BUSINESS

8. Benefit payout

S 8.1 In determining the benefit payout under a participating life policy, the licensed insurer must consider PRE as set out under paragraph 9.

S 8.2 The senior management must ensure that the MPB policy sets out the licensed insurer's principles and practices for the benefit payout, including on:

(a) the categorisation of cohorts of policies (cohorts);

(b) the determination of asset share, including:

(i) the methods to establish the parameters in the asset share calculation, including those used for investment performance, expenses and claims experience;

(ii) where actual experience is not available, the methods to establish the main assumptions and the limitations of the assumptions;

(iii) the degree of approximations allowed for assumptions across different cohorts;

(iv) the circumstances under which parameters and assumptions may be changed, and the internal process and required documentation for such changes;

(v) any non-standard additions and deductions in the asset share formula and any limits for these additions and deductions;

(vi) the methodology for the adjustment of the asset share to take into account profits from riders and surrenders, as well as to reflect the market value of the participating life fund[1]; and

(vii) the treatment of tax in the calculation of the asset share;

(c) bonus declarations[2] and adjustments[3], including:

[1] excluding the estate

[2] This includes cash, regular (including reversionary), terminal and special (one-off) bonuses and dividends.

(i) the approach used to determine the level of the bonus declaration, including any interim bonus declarations;

(ii) thresholds which trigger bonus adjustments at the cohort level; and

(iii) the process to determine the level and order of bonus adjustments for different types of bonuses and different cohorts;

(d) the smoothing of benefits[4], including:

(i) the methodology and parameters used for smoothing, and the rationale for the application of smoothing;

(ii) any differences in smoothing approaches for different cohorts; and

(iii) the methodology[5] to track the difference between the asset shares with and without smoothing; and

(e) transfers to and from the shareholders' fund, including:

(i) the approach and basis used for the transfer to shareholders;

(ii) the circumstances under which the transfer to shareholders will be reduced or withheld; and

(iii) the circumstances under which shareholders will transfer money into the participating life policy fund to support the bonuses and/or any short-term tactical deviations.

S 8.3 In relation to paragraph 8.2(a):

(a) the categorisation of cohorts by the licensed insurer must be determined in a manner that ensures equity among the different groups of participating life policy owners. At minimum, they must be determined based on inception period and product features, including contractual terms, level of guarantees, risk-return profiles, policy term and duration; and

(b) the cohorts determined by the licensed insurers must be observed for the purposes of the assessment of bonus supportability and the

[3] upwards and downwards
[4] where target benefit payout differs from the asset share computed
` such as use of the smoothing reserve

determination of the benefit payout, including revision of bonus. There must not be cross-subsidy between different cohorts.

Question 1

The minimum bases for the determination of cohorts (8.3(a)) and the restriction on cross-subsidy between different cohorts (8.3(b)) were introduced in line with the objective to ensure equity in the distribution of benefits to policy owners. The non-guaranteed benefits, in particular, should be determined in a way that adequately reflects the experience of policy owners belonging to different cohorts.

In relation to these requirements:

(a) Please provide views on whether the minimum bases for the determination of cohorts adequately balances the need to ensure equity in the distribution of benefits to policy owners and the pooling of risk.

(b) Please provide details of any constraints or limitations that may be faced by your company in meeting the requirements, as well measures that could be taken to address them.

(c) Do you foresee any significant implications for specific cohorts? Please provide details including suggestions for alternative approaches that may be considered to meet the intended objectives of the requirements.

G 8.4 In relation to paragraph 8.3(a), the licensed insurer should determine cohorts based on more granular factors if it is of the view that this would enhance equitability.

S 8.5 In relation to paragraph 8.2(b)(vi), profits from riders must be allocated to the participating life policies which the riders are attached to.

S 8.6 In determining the amounts payable under a participating life policy, the

licensed insurer must ensure that-

(a) for death and maturity benefits, the higher of 100% of the asset share or guaranteed benefits must be paid out;

(b) the cash surrender values for the early years are at least 90% of the asset share on aggregate for each cohort in the expected main age range, with an allowance for deviation of 3% for other ages within each cohort. However, the payment of at least 100% of the asset share must be observed from the 15th policy year onwards for whole life policies which are participating and after the mid-term of the policy for all other life plans which are participating; and

(c) the amount of cash and reversionary bonuses paid can be sustained by the participating life policy fund in the long term.

S 8.7 In determining the cash surrender value, the licensed insurer must ensure that any balance of unpaid asset share created by paying less than 100% asset share for each cohort in any year must be rolled over to next year's asset share and should be taken into account in the determination of the cash surrender value for that particular year in accordance with the methodology in paragraph 8.6(b) above. In any event, any balance of unpaid asset share for each cohort must be completely distributed by maturity.

S 8.8 Participating life policies designed and sold prior to 1 July 2005, as per the phased-in approach[6] for the implementation of the asset share requirement, may be exempted by the Bank from the requirements in paragraph 8.6(b) and 8.7 if the design of such policies does not support the payment of the asset share as the total cash surrender value, subject to adequate justification from the licensed insurer. For such policies, the licensed insurer must ensure that

[6] The asset share requirement is applicable to all new products from 1 April 2005 onwards. For products introduced prior to 1 April 2005, companies had to ensure that at least 50% of new business from these existing participating products was in compliance with the requirement by 1 May 2005, with full compliance by 1 July 2005.

the full asset share for each cohort is completely distributed by maturity.

9. Policy Owners' Reasonable Expectations (PRE)

G 9.1 PRE concerns the policy owners' expectations on how the non-guaranteed benefits of their participating life policies are managed and paid, and can be influenced by factors including communication by, and past practice of the licensed insurer.

S 9.2 In managing PRE, the licensed insurer must:

(a) actively manage bonus rates in line with the level of participating life policy fund returns to avoid the creation of undue PRE with regard to the level of bonus rates; and

(b) ensure that policy owners are aware of the non-guaranteed nature of bonuses as well as its impact on policy benefits, including conditions which could lead to possible future bonus revisions. The licensed insurer must exercise reasonable care to ensure that the content and effect of its communication with policy owners, sales practices and past bonus decisions do not mislead policy owners to form expectations that bonuses and/or the manner in which they are calculated are guaranteed.

G 9.3 In relation to paragraph 9.2(a), examples of situations which may give rise to undue PRE include:

(a) maintaining bonus rates when a bonus revision is necessary and justified, based on the performance of the fund relating to participating life policies over a sustained period; and

(b) declaring a special bonus without clear communication that it is a one-off declaration.

G 9.4 In relation to paragraph 9.2(b), licensed insurers should consider undertaking periodic assessments of policy owners' expectations through focus groups and surveys, and evaluate the need to enhance the content, timing and form of communications with policy owners on bonus payments.

10. Bonus supportability study

S 10.1 The annual bonus supportability study to be conducted by the appointed actuary, as required in paragraph 7.5(b), must include a comparison between the asset share and the gross premium valuation (GPV) reserves for the particular cohort[7]. The study must be carried out separately by the appointed actuary for various types of bonuses, including comparisons with GPV reserves with and without terminal bonuses.

S 10.2 For the computation of the GPV reserves, the appointed actuary must:

(a) take into account both guaranteed and non-guaranteed benefits;

(b) take into account the transfer of the shareholders' portion of the declared bonus out of the participating life policy fund;

(c) ensure consistency of the best estimate assumptions used for the annual bonus supportability study with those in the valuation requirements in Appendix VII of the Risk Based Capital Framework for Insurers; and

(d) in the event that the GPV reserves are negative, which would invalidate the bonus supportability study for the cohort, the licensed insurer must:

(i) assess the reasons for this;

[7] This requirement does not apply to licensed insurers which have received prior approval from the Bank to use an alternative method to the asset share approach for policies issued prior to 1 April 2005.

(ii) assess the expected length of time that the reserves will be negative; and

(iii) consider alternative methods to assess the sustainability of the existing bonus rates[8].

S 10.3 In making the final bonus recommendation, the appointed actuary must take into account the licensed insurer's practices in managing PRE, as described in paragraph 9. In the case where the appointed actuary infers that undue PRE has been formed, the licensed insurer must observe the requirement in paragraph 11.3. The benefit payouts linked to undue PRE must be treated as guaranteed and reserved for appropriately.

S 10.4 As part of the annual bonus supportability study, the licensed insurer must conduct sensitivity and stress testing[9] on the participating life fund in order to assess potential events that could lead to future bonus adjustments. The assessment must take into account the key risk factors[10] affecting the sustainability of the participating fund and clearly show the impact of the stress on individual cohorts.

S 10.5 In conducting the sensitivity test, the licensed insurer must consider at minimum:

(a) a parallel reduction in the gross rate of interest by 0.5% and 1%. This impact must be reflected in the reductions in the expected future investment return;

(b) a decrease in equity value by 40%;

(c) a decrease in property value by 10%;

[8] Such as taking into account projections of future expected asset shares and GPV reserves

[9] Stress testing must be carried out in accordance with the policy document on Stress Testing for Insurers and Takaful Operators

[10] Key risk factors, which can be economic or non-economic, may affect either the actual (asset share) or the expected (GPV) experience of the participating life fund

(d) the reduction to the fund-based yield assumption used to discount liabilities, consistent with items (a) to (c) above; and

(e) any other parameters which the Bank may prescribe.

Question 2

Please comment on whether the scope and level of prescribed sensitivity tests are adequate to analyse the key factors affecting the variability of the results. Please suggest any other important sensitivity tests which you think should be included (e.g. expenses and lapses).

G 10.6 In determining the frequency of conducting the sensitivity and stress tests, the licensed insurer should take into account changes in the external environment. The licensed insurer should also take into consideration its own business and risk profiles in determining the appropriateness of the scenarios used in the tests, subject to the minimum scenarios prescribed by the Bank.

S 10.7 A report providing for the final bonus recommendation must be appended by the appointed actuary to the FCR, and must include the following, with sufficiently detailed descriptions of the various items to enable validation of the results by an independent actuary:

(a) the definition and formula for the asset share, including details of the calculation of each component in the asset share, as well as any smoothing and specific charges applied;

(b) the grouping of participating life policies and data adopted, including a list of plans included and excluded in the study;

(c) assumptions used in the calculation of the asset share and GPV reserves, with supporting justification for the choice of assumptions;

(d) results of the annual bonus supportability study, showing for each group of participating life policies the asset shares over GPV reserves, both with and without the terminal bonus;

(e) results of the sensitivity test showing the key factors affecting the

variability of the results of the annual bonus supportability study; and

(f) the bonus recommendation, with an elaboration of how PRE has been taken into account in the recommendation.

Question 3

In addition to the items in paragraph 10.7, please comment on whether there will be a situation where the parameters used in the asset share computation and the figures used in the statutory returns are irreconcilable, and the possible reasons for this.

11. Allocation of expenses

S 11.1 The licensed insurer must include the following in its overall policy on the allocation of expenses:

(a) the types of expenses, including expenses incurred for any outsourcing arrangements, which are directly attributed or which can be allocated to the participating life policy fund;

(b) the method used to allocate the common expenses between the participating life policy fund, other insurance funds and the shareholders' fund;

(c) the method used to apportion expenses charged to the participating life policy fund to the different cohorts and individual participating life policies within the fund; and

(d) the internal process and controls to monitor, report and approve any deviation from the overall policy.

S 11.2 The licensed insurer must only charge costs to a participating life policy fund which have been, or will be, incurred in the ongoing management of that participating life policy fund.

S 11.3 The licensed insurer must ensure that all costs of compensation is borne by the shareholders' fund and not charged to the participating life policy fund. The costs of compensation include, but are not limited to costs associated with:

(a) actions to provide restitution or redress to policy owners arising from errors[11]; and

(b) actions to meet any undue PRE which is deemed to have been formed, as set out in paragraph 10.3, including due to inappropriate management of the participating life policy fund.

G 11.4 With reference to paragraph 11.3, an example of the inappropriate management of the participating life policy fund is taking excessive investment risk to increase competitiveness.

S 11.5 The licensed insurer must ensure that all costs of promotional gifts must be borne by the shareholders' fund and must not be charged to the participating life policy fund.

12. Investment and risk management

S 12.1 The licensed insurer's investment and risk management practices for participating life policy business must be in accordance with the requirements in paragraph 22 of the Risk-Based Capital Framework for Insurers (Version 3.0) and the Policy Document on Risk Governance. The investment strategy must also be in line with any communication to policy owners.

[11] Such as system errors in the computation of any benefit payouts.

13. Estate

13.1 The licensed insurer may have built up estate from:

(a) benefit payouts under participating life policies issued before the implementation of the asset share rule on 1 April 2005 being less than the corresponding asset shares;

(b) retention of the shareholders' share of bonuses declared in the past;

(c) past injections of capital from shareholders;

(d) miscellaneous profits not allocated to the asset share, including surrender and rider profits; and

(e) investment returns on the estate.

S 13.2 The senior management must ensure that the MPB policy contains principles and practices on estate management, which include:

(a) how the estate is, and may be used in the licensed insurer's management of its participating life policy business;

(b) the investment strategy for the estate with an explicit recognition of how the strategy may differ from the rest of the participating life policy fund;

(c) circumstances under which the uses for estate may be changed and the process for approval and documentation for such changes;

(d) how fairness to different groups of policy owners is taken into account in the management and use of the estate; and

(e) any segregation or division of the estate between the different cohorts under the participating life policy fund, and the basis for this.

S 13.3 The value of the estate must be calculated as the difference between:

(a) the market value of the total assets allocated to the participating life policy fund net of "other liabilities"; and

(b) the higher of the aggregate asset share of the participating life policies

and the participating life reserve for guaranteed benefits.

For this purpose, the present value of the guaranteed benefits must be calculated based on the GPV reserves discounted at MGS rates, as prescribed in paragraph 3.2 of Appendix VII of the Risk-Based Capital Framework for Insurers (Version 3.0).

Question 4

Please comment on whether the estimation of liabilities set out in paragraph 13.3(b) captures the cost of guaranteed benefits to date appropriately and adequately. If not, please provide reasons and propose any alternative methods to calculate the value of the estate.

S 13.4 The licensed insurer must not use the estate in a manner that creates an unfair competitive advantage and/or leads to adverse effects on the interests of the existing participating life policy owners, including:

(a) to support aggressive pricing of policies that are inconsistent with technical pricing levels and declarations of special bonuses to enhance marketability;

(b) to subsidise new business with unsupported guarantees, or to support new business strain of participating life policies which cannot be recovered from the profits arising from that portfolio of business;

(c) to support a greater level of risk than would be the case had there been no estate, including relying on the estate to support excessive levels of asset liability mismatch to increase returns;

(d) to pay compensation costs arising from mis-selling and consumer redress, negligence or mismanagement of the licensed insurer; and

(e) for any other purposes determined by the Bank as having an adverse effect on the interests of existing policy owners based on the Bank's examination of the practices of individual licensed insurers.

S 13.5 In relation to paragraph 7.5(d), the appointed actuary's opinion on the estate must include the following:

(a) an assessment on the purposes of the use of the estate, taking into consideration the prohibitions set out in paragraph 13.4;

(b) the amount of estate used for each purpose, its proportion of the total estate and a general assessment of the equitability of the uses; and

(c) the amount of subsidy recovered from the new business supported by the estate.

S 13.6 In relation to paragraph 13.4(e), the Bank may direct the licensed insurer to take specific actions to address the Bank's concerns.

S 13.7 Where the Bank has directed the licensed insurer to take specific actions to address the Bank's concerns under paragraph 13.6, the licensed insurer must comply with the Bank's direction.

14. New business

S 14.1 The senior management must ensure that the MPB policy contains principles and practices relating to new business, which address:

(a) the circumstances, including specific trigger points and thresholds, that will result in the participating life policy fund being closed to new business for a particular product type and for the overall participating life policy business;

(b) the actions that the licensed insurer would take if the participating life policy fund ceases to take on new business; and

(c) the conditions, including pricing assumptions, for effecting new contracts in an existing participating life policy fund so as to avoid or minimise any material adverse effect on the interests of the existing policy owners.

S 14.2 In relation to paragraph 14.1(c), if the new policies are priced assuming transfers to shareholders being less than that allowed under the limit as specified in paragraph 12.10 in the Policy Document on the Management of Insurance Funds, future actual transfers to shareholders must not exceed the limit assumed in the pricing of the new contracts. A board resolution must be sought to evidence the shareholders' commitment to undertake less profit than allowed under the specified limit.

S 14.3 If the licensed insurer intends to close the participating life policy fund to new business, whether temporarily or permanently, the licensed insurer must submit a detailed report to the Bank, including, at least the following:

(a) the reasons and period of the closure;

(b) changes in the investment strategy and bonus distribution;

(c) management of expenses, in particular the impact of closure to the expense allocation to the participating life policy fund; and

(d) management of PRE, including communication to policy owners.

PART D SPECIFIC REQUIREMENTS ON BONUS REVISIONS

15. Proposal to board on bonus revision

S 15.1 Any bonus revision must be proposed formally by the senior management to the board for its approval.

S 15.2 The senior management's proposal for a bonus revision must include at least the following, for the board's consideration:

(a) a recommendation on the type and magnitude of the bonus revision by the appointed actuary;

(b) details on all previous bonus revisions including the dates of the bonus revisions, type of bonus and products affected, the quantum and rationale of the bonus revisions and number of affected policy owners;

(c) the annual bonus supportability study as at the last financial year end to demonstrate the appropriateness of the current bonus rates for the various policies, in line with the requirements under paragraph 10;

(d) legal opinion on whether there are any legal constraints which can impact the licensed insurer's ability to make the bonus revision, as set out in paragraph 16.1;

(e) results from a comprehensive risk assessment of the impact of the bonus adjustments to different stakeholders and plans to manage the risks;

(f) communication to the affected policy owners on the bonus reduction as required under paragraph 18; and

(g) considerations relating to PRE which the board should be aware of or which may require further deliberation at the board level.

16. Legal basis

16.1 The senior management must ensure that legal opinion referred to in paragraph 15.2(d) at minimum takes into account the following:

(a) all relevant sales and marketing material;

(b) participating life policy-related documents;

(c) agency training material used in the past for the promotion of the products; and

(d) any other communication, expressed or implied, to the policy owners that may have formed the PRE**.** This includes any communication made during the actual sales.

S 16.2 The board must ascertain, on the basis of the legal opinion, that the licensed insurer's legal right to undertake any bonus revisions has been clearly established before such a decision is made.

17. Notification to the Bank on bonus revision

S 17.1 The licensed insurer must lodge the board's decision to approve any bonus revision with the Bank one month before the implementation of the bonus revision. This lodgment must be accompanied by all the relevant documentation pertaining to the board's approval of the bonus revision and copies of all forms of communication to affected stakeholders.

18. Communication to stakeholders

18.1 The licensed insurer must ensure that the communication strategies are developed and appropriately tailored to manage specific expectations of different groups of stakeholders[12]. The licensed insurer must ensure that all communication to stakeholders is in line with the Bank's disclosure principles in the Policy Document on Product Transparency and Disclosure, and the requirements contained therein of Part E of this policy document.

S 18.2 Where a bonus revision is to be implemented, the licensed insurer must duly inform affected policy owners of the bonus revision, including the types of bonuses affected, the extent of the revision and the impact to their participating life policies.

Question 5

The Bank is considering the inclusion of more detailed requirements on the timing and nature of forewarning to be given to policy owners in advance of a potential bonus reduction being contemplated by the insurer. This should be consistent with expectations set out in this policy document on the management of PRE.

To inform the Bank's consideration, please elaborate on your company's practices in relation to the following:

(a) timelines and the scope of information provided to the policy owners; and
(b) any observations of adverse implications arising from forewarning.

[12] such as policy owners, the distribution force, press and media, as well as the general public

PART E TRANSPARENCY AND DISCLOSURE REQUIREMENTS

19. Marketing material

S 19.1 The licensed insurer must ensure that its marketing material for participating life policies complies with the general requirements as set out in the Code of Good Practice for Life Insurance Business and the Policy Document on Product Transparency and Disclosure.

S 19.2 The licensed insurer must ensure that its printed marketing material for a participating life policy includes at least the following information:

(a) a brief description of the nature of bonuses (i.e. whether cash, reversionary or terminal);

(b) the deferment period, if applicable;

(c) events upon which each type of bonus is payable;

(d) a statement to explain that the face value of the reversionary bonus is not payable on early termination or conversion of the policy; and

(e) a statement to direct policy owners to refer to the sales illustration for further information and understanding of the product.

20. Sales illustration

S 20.1 The licensed insurer must provide to all prospective policy owners an illustration of premiums and benefits applicable to a specific proposal for a participating life policy at the point of sale.

S 20.2 The licensed insurer must ensure that the sales illustration for a participating life policy observes paragraph 8 of the Guidelines on Product Transparency and Disclosure.

S 20.3 The licensed insurer's sales illustration must conform to the format prescribed in **Appendix 2**. In the event that the licensed insurer is of the opinion that the prescribed format is inappropriate for a specific participating life product and would like to deviate from the format, it must ensure that the proposed format does not reduce the extent of the disclosure required under this section and highlight to the Bank the proposed alternative format during the submission of product documentation.

S 20.4 The licensed insurer must include in the sales illustration the following:

(a) a description of the general features of the particular participating life policy;

(b) an explanation of the different types of bonuses payable under such a policy; and

(c) a general explanation of how the bonuses are determined.

S 20.5 The licensed insurer must illustrate in the sales illustration the following values as at the end of each policy year for policy years 1 to 20 and every 5 years thereafter until maturity or the age of 70 years, whichever is later:

(a) premiums paid;

(b) guaranteed survival benefits;

(c) guaranteed death benefits;

(d) guaranteed surrender value; and

(e) non-guaranteed benefits, identifying the component separately for reversionary, cash and terminal bonuses.

S 20.6 The licensed insurer's illustration for premiums payable must not suggest that premium payment is not or may not be required for any point of time during the duration of the participating life policy, including in situations where premiums payable are financed through the guaranteed and non-guaranteed cash values of the policy.

S 20.7 The illustration for benefit payout must:

(a) clearly separate non-guaranteed and guaranteed benefits;

(b) clearly state that the non-guaranteed values illustrated are not guaranteed with potential of decrease or increase in the quantum declared in future;

(c) show non-guaranteed benefits under two hypothetical scenarios based on the two prescribed return rates, 2% and 5%. This is to demonstrate the variability of non-guaranteed benefits under the different investment scenarios;

(d) highlight that the returns in 20.7(c) are hypothetical and do not reflect the past or expected future participating life fund return. It must also highlight that policy owners should refer to the annual bonus statement for information on actual past returns for the participating life fund and future outlook of the participating life fund; and

(e) in the case of a collateral policy where the benefit payout at maturity is for loan settlement and dependent on non-guaranteed benefits, indicate that the actual maturity payout may not be sufficient to cover the outstanding loan amount.

Question 6

Please comment on whether illustrating based on two hypothetical investment scenarios is sufficient to show variability of non-guaranteed benefits and/or manage PRE with regard to the determination of non-guaranteed benefits. Please provide any suggestions that you may have on how the expectations of non-guaranteed benefits can be better managed at the point of sale.

S 20.8 A clear distinction must be made between the costs and benefits attributable to the participating life policy and any extensions respectively, unless the participating life policy is marketed as a packaged product[13].

S 20.9 The sales illustration must disclose the participating life policy fund's returns over the past five years. In doing so, a statement must be included to inform policy owners of the limitations on the information of the past performance, including a prominent statement to indicate that past performance is not an indicator of future performance.

21. Annual bonus statement

S 21.1 The licensed insurer must provide information to each participating life policy owner on his participating life policy annually, in the form of the annual bonus statement and ensure that the statement contains the information set out in paragraphs 21.2 and 21.3.

S 21.2 The annual bonus statement must contain the following qualitative information:

(a) the status of the participating life policy;

(b) whether the policy has been assigned or has a nominee and if so, the name and address of the person; and

(c) caveats on the non-guaranteed nature of bonuses.

S 21.3 The annual bonus statement must contain the following quantitative information:

(a) any bonus declared for the current and preceding 5 years;

[13] subject to Schedule 7 of the Financial Services Act 2013

(b) the sum assured, the vested bonus and other vested non-guaranteed benefits as at the date of the statement;

(c) the total accumulated reversionary bonus declared until the previous year;

(d) any bonus or other non-guaranteed benefit which has vested since the date of the last statement;

(e) the guaranteed cash value;

(f) the total cash surrender value; and

(g) the balance of the loan amount, accrued interest and the policy loan rate at the date of the statement, in the case of a loan taken from the licensed insurer on the security of the policy.

S 21.4 The licensed insurer must also provide an updated description of the investment performance of the relevant participating life policy fund and take reasonable steps to ensure the accuracy of the description. The description must include:

(a) quantitative information on the fund's performance over the past 5 years and a qualitative description of the performance of the fund over the previous accounting period;

(b) key factors affecting bonuses to be allocated in this accounting period such as investment performance or operating experience;

(c) the future outlook of the participating life policy fund, in particular the changes in the outlook on the key factors affecting non-guaranteed bonuses. This description must have a balanced view of both upside and downside risk to avoid undue PRE; and

(d) an explanation of how past experience and future outlook of the participating life policy fund will impact the future bonus allocation and reserves for future bonuses.

S 21.5 As part of the requirement in paragraph 7.1(d), the annual bonus statement must be reviewed to ensure that it complies with the disclosure principles in the Guidelines on Product Transparency and Disclosure as well as the requirement outlined in paragraph 9.2(b) of this policy document.

APPENDICES

Appendix 1 Policy documents superseded

1. *Appointed Actuary's Report to the Board on Recommendation for a Reduction in Bonus Rates for Participating Life Products (JPI: 29/2004) issued on 13 October 2004*

2. *Guidance notes on the implementation of the asset share methodology issued on 8 March 2005 (in relation to the Appointed Actuary's Report to the Board on Recommendation for a Reduction in Bonus Rates for Participating Life Products (JPI:29/2004))*

Appendix 2 Format for the sales illustration

A. Summary page

This page provides you with a snapshot of what this policy offers and how much it costs to buy this policy.

Name of Insurer:	[ABC Insurance Berhad]	Client's Name:	[Mr. Customer]
Product Name:	[XYZ policy]	Sex:	[Male/ female]
Type of policy:	[Endowment Participating]	Smoker:	[Yes/ No]
		Age:	[Age of proposer]

What does this policy offer?

- Protection against death and Total and Permanent Disability (TPD)
- Payment of cash periodically

Have you considered term life?

- Term life offers protection against death and TPD with lower premiums
- You can invest the balance in other savings/ investment alternatives

XYZ Policy		Term Life Policy
RM4,360 X 20 years = RM87,200	**Premium payment** *How much will you need to pay*	RM560 X 20 years = RM11,200
20 years	**Coverage period** *How long will you be covered*	20 years
RM7,456	**Total direct commission** *Amount paid to intermediaries from your premium*	RM960
XYZ Policy	**Guaranteed Benefits** *Amount company promises to pay*	**Term Life Policy**
Year 1-8: RM20,000 Year 9-14: RM40,000 Year 15-20: RM60,000	• If you die or suffer permanent disablement	RM60,000
Year 1-8: RM600 Year 9 -14: RM1,200 Year 15-20: RM1,800	• Cash every year	-
RM50,000	• At maturity	-
XYZ Policy	**Non-Guaranteed Benefits** *The company may or may not pay the following amount*	
Scenario X: RM6,265 Scenario Y: RM9,315	• Total cash received	-
Scenario X: RM18,314 Scenario Y: RM29,932	• At maturity	-
XYZ Policy	**Your Annualised Return*** *[Net gain/ loss] if held to maturity*	
-2.28% p.a.	• Guaranteed benefits only	-
Scenario X: 1.24% p.a. Scenario Y: 2.85% p.a.	• Total benefits (inclusive of non-guaranteed payments)	-

* Annualised return (net gain/loss) is the estimated average investment return on the survival/ savings benefits that you will receive over the period of the policy until its maturity with respect to the premium that you paid. However, the actual annualized return of your policy can only be determined when your policy matures.



If you are looking for insurance/ takaful policy with savings element, you may wish to compare the annualised return of this policy with the effective returns of other investment alternatives.



You may only receive the guaranteed amount upon survival/ surrender/ death/ maturity.

 **What you should know**  **What you should consider**  **What you should be aware of**

Issued on: 7 November 2014

B. Sales illustration table

This table shows the amount of premium you will be paying each year and the yearly cash flow on your policy until the end of the policy period.

You May Only Receive the Guaranteed Amount Periodically

How much are you paying?

What can you cash out periodically?

End of Policy Year /Age	Premiums Paid Each Year	Survival Benefits		
		Guaranteed Cash Payments Each Year	Non-Guaranteed Cash Dividend Each Year	
			Scenario X	Scenario Y
1/31	4,360	600	0	0
2/32	4,360	600	1	2
3/33	4,360	600	19	26
4/34	4,360	600	45	60
5/35	4,360	600	74	100
6/36	4,360	600	109	148
7/37	4,360	600	145	198
8/38	4,360	600	187	258
9/39	4,360	1,200	231	321
10/40	4,360	1,200	271	381
11/41	4,360	1,200	312	443
12/42	4,360	1,200	355	510
13/43	4,360	1,200	400	580
14/44	4,360	1,200	446	655
15/45	4,360	1,800	495	734
16/46	4,360	1,800	539	809
17/47	4,360	1,800	585	890
18/48	4,360	1,800	633	975
19/49	4,360	1,800	683	1,065
20/50	4,360	1,800	735	1,160
25/55				
30/60				
35/65				
40/70				
45/75				
50/80				
Cash payment at the end of the policy period (At maturity)		50,000	18,314	29,932

Please refer to the notes in the next page for the assumptions used in the illustration table.

How do the benefits compare against the total premiums paid to date?

You May Only Receive the Guaranteed Amount Upon Surrender/ Death

How much premium you would have paid? | How much is paid to the intermediaries? | How much will you receive if you cancel the policy early? | What is payable upon death?

End of Policy Year/ Age	Total Premium Paid To Date [refers to cumulative premium to be paid from policy inception]	Total Direct Commission To Date [refers to cumulative premium to be paid from policy inception]	Surrender Value			Death Benefits		
			Guaranteed	Non-Guaranteed [excluding guaranteed benefits amount and any survival benefits kept with insurer]		Guaranteed	Non-Guaranteed	
				Scenario X	Scenario Y		Scenario X	Scenario Y
1/31	4,360	2,834	0	106	117	20,000	106	117
2/32	8,720	4,578	818	993	1,045	20,000	993	1,045
3/33	13,080	5,712	2,233	1,984	2,113	20,000	1,984	2,113
4/34	17,440	6,584	3,892	3,090	3,341	20,000	3,090	3,341
5/35	21,800	7,020	5,922	4,326	4,748	20,000	4,326	4,748
6/36	26,160	7,456	8,054	5,558	6,205	20,000	5,558	6,205
7/37	30,520	7,456	10,582	6,934	7,870	20,000	6,934	7,870
8/38	34,880	7,456	13,237	8,301	9,592	20,000	8,301	9,592
9/39	39,240	7,456	15,468	9,612	11,330	40,000	9,612	11,330
10/40	43,600	7,456	19,791	9,138	11,350	40,000	9,138	11,350
11/41	47,960	7,456	22,527	10,192	12,968	40,000	10,192	12,968
12/42	52,320	7,456	25,402	11,220	14,637	40,000	11,220	14,637
13/43	56,680	7,456	28,421	12,219	16,355	40,000	12,219	16,355
14/44	61,040		31,593	13,185	18,122	40,000	13,185	18,122
15/45	65,400	7,456	34,300	14,126	19,954	60,000	14,126	19,954
16/46	69,760	7,456	37,141	15,040	21,841	60,000	15,040	21,841
17/47	74,120	7,456	40,124	15,922	23,785	60,000	15,922	23,785
18/48	78,480	7,456	43,256	16,767	25,783	60,000	16,767	25,783
19/49	82,840	7,456	46,545	17,566	27,833	60,000	17,566	27,833
20/50	87,200					60,000	18,314	29,932
25/55								
30/60								
35/65								
40/70								
45/75								

The illustrations of Non-Guaranteed benefits have been prepared on two hypothetical investment scenarios.

a. Scenario X = Assumes the participating fund earns 2% every year
b. Scenario Y = Assumes the participating fund earns 5% every year

The two rates are used purely for illustrative purposes and are NOT GUARANTEED. They do not represent upper and lower limits on the investment performance of the participating fund, and not the returns earned on the actual premiums/ paid for the life insurance product.

The investment return rates earned in the previous five years are as follows:-

Yr 2009:	Yr 2010:	Yr 2011:	Yr 2012:	Yr 2013:

This is strictly the performance of the life insurance fund. Please note that past investment performance of the fund is not an indication of its future performance.

Total direct commission is the amount received by the intermediary for the sale/marketing of this policy and services that the intermediary will provide to you for the duration of your policy.

If you cancel the policy before the maturity period, the amount that you will receive will be much less than the total amount of premium that you have paid.

Important Information regarding your Participating Policy

What is a Participating Policy?

A participating policy enables you to share in the profits of the participating life fund. Profits are shared by adding bonuses to the policy. The actual payment of these bonuses is not guaranteed and can reduce (or increase) to reflect the operating performance of the participating life fund.

What are the different types of bonuses payable on my policy?

- Cash Bonus / Dividends

This is a non-guaranteed bonus which is determined annually by the Company and will be payable to you each year in cash.

- Reversionary Bonus

This is a non-guaranteed bonus which is allocated and added to the sum assured of a participating policy, usually on an annual basis. Once allocated, their values are guaranteed provided you continue to pay the premiums as defined in your policy contract.

However, if you choose to surrender your policy, you may not receive the full amount of the allocated bonuses. The amount of the bonuses payable may be significantly lower compared to those payable if you keep your policy until maturity, or on earlier death.

- Terminal Bonus

This is a non-guaranteed bonus which may be payable when your policy ends - upon death, maturity or if you choose to surrender your policy. The terminal bonus is usually designed to give policy owners a fair share of the profits earned by the participating life fund.

How are the bonuses determined?

These bonuses which are not guaranteed, are determined by the Company based on the participating life fund's actual operating and investment performance. For example, if the investments have performed well over the past year, the Company may be able to pay a higher bonus. If the investments have performed poorly, the Company may pay a lower bonus, or it may not be able to pay a bonus at all.

Please also note that the investment performance is not the only factor that will affect the bonuses that you will receive. Other factors such as expenses incurred to meet the direct distribution cost, agency related expenses and company's expenses, as well as the actual level of death and disability claims on the fund, will also affect the bonuses that you will receive.

In addition to actual operating performance, bonuses may also be adjusted if there is expected persistent deterioration in future investment environment or operating conditions to maintain the long term sustainability of the fund.

The bonuses paid are 'smoothed'. This means that, in years where the Company has experienced good operating and investment results, they may hold back some of the profits and use them to top up bonuses in poorer years. This is a feature unique to participating policies. This means that a Company will try to even out the payout to policy owners when results have not been so favourable. However, smoothing does not give you complete protection against poor results. If poor results continue over several years, the Company may have to reduce bonuses to reflect the poor results.

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You are advised to discuss with your life insurance agent or contact the company directly for more information on your participating policy

Disclaimer

This document is intended for your general information only. It does not contain exhaustive information relating to the subject matter.

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