Malaysian Insurance Highlights 2019

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Dr. Schanz, Alms & Company

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For more information about the report, please contact:
Dr. Schanz, Alms & Company
Dufourstrasse 24
CH-8008 Zurich
Switzerland
Telephone: +41 44 256 10 80
info@schanz-alms.com
www.schanz-alms.com

To download a soft copy of the report, please visit:
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Foreword Dr. Schanz, Alms & Company

We are delighted to present the 1st edition of *Malaysian Insurance Highlights (MIH)*, graciously sponsored by Malaysian Re. Based on in-depth interviews with market executives and experts, regional comparisons and a review of relevant academic and non-academic references, MIH offers a deep and broad overview of the current opportunities and challenges Malaysia's general insurance market is facing.

The market place is undergoing a period of transformation. Over the past few years, de-tariffication has been the main driver. Even though it is proceeding in an orderly and phased manner, the country's insurers need to embrace new competitive parameters such as risk-based pricing, tailored services and product innovation. De-tariffication also begs the question as to whether the market is set to see another wave of consolidation as smaller players may struggle to fund the required investments in data and actuarial skills and infrastructures.

At the same time, the under-penetration of the B40 segment of the population remains a major political, societal and commercial challenge. We discuss a few remedial initiatives and the insurers' perspective on these. Also against this backdrop, we devote significant space to Takaful which, due to its mutual features, might be particularly suitable for promoting insurance awareness and take-up in lower-income segments.

Last but not least, we examine the latest trends in insurance and technology. These developments have the potential to reshape the market as we know it today, entailing both painful adjustments and new exciting business opportunities as insurance becomes more affordable, accessible and appealing.

We would like to thank the more than 30 domestic insurance executives and experts who have contributed their insight to this publication. Without their support, it would not have been conceivable.

Dr Kai-Uwe Schanz
Chairman & Partner,
Dr. Schanz, Alms & Company

Henner Alms
Partner,
Dr. Schanz, Alms & Company

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Foreword Malaysian Re

The insurance industry in Malaysia is facing multiple transformative opportunities and challenges, presented by the convergence of digitalization, regulatory reform and changing consumer expectations. Against this backdrop, we are pleased to present the inaugural edition of *Malaysian Insurance Highlights* (MIH). We believe it is timely to put forward an authoritative publication on our nation's insurance markets, combining a rigorous analysis of hard data with in-depth executive and senior professional interviews. This dual approach has yielded a balanced and holistic picture of the opportunities and challenges ahead.

Despite the prevalent notion that digitalization and technology have impacted virtually all elements of the insurance value chain, a staggering majority of MIH interviewees consider an integrated, platform-based ecosystem to be mostly 'talk' at this juncture, with no relevance for day-to-day operations. There also seems to be a gap in technology adoption: While consumers' purchasing behaviour is increasingly driven by digital experience and expectations, many of the executives and practitioners interviewed consider cost-saving as the key rationale for embracing digitalization. The full potential of technology will not be captured unless these perspectives are effectively aligned.

De-tariffication has been another driving force in Malaysia's insurance markets as equitable pricing rewards risk-prudent behaviour, limits cross-subsidization and benefits society at large. Many interviewees, however, describe falling rates and shrinking margins as the main short-term consequences. Nevertheless, the long-term outlook is generally optimistic as risk-based pricing is expected to drive better customer segmentation, optimize distribution strategies, foster product innovation and galvanize effective data mining and analysis capabilities.

Another encouraging MIH finding is the untapped potential of Takaful and its important role in addressing the protection gap for the B40 segment of our country's population. In addition, the rapid progress of digitalization will inevitably spur more cyber solutions from the industry.

Our heartfelt appreciation goes to our partners and friends from the Malaysian insurance & takaful industry for their kind participation and invaluable contribution to the inaugural edition of MIH. We are also indebted to Bank Negara Malaysia and the Malaysian General Insurance Association (PIAM) for their unwavering support of the initiative.

Zainudin Ishak
President & Chief Executive Officer,
Malaysian Reinsurance Berhad

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Methodology

The findings of this report are based on structured interviews with more than 30 executives representing 22 Malaysian insurers, reinsurers, intermediaries and trade associations. The interviews were conducted by Dr. Schanz, Alms & Company, a Zurich-based research, communication and business development consultancy, from June to August 2019.

We would like to thank the following organisations for sharing their insight with us:

AIA General
AIG
AmGeneral Insurance
Axa Affin General Insurance
Etiqa
Etiqa General Takaful
General Insurance Association of Malaysia (PIAM)
Great Eastern General Insurance
Liberty Insurance
Lonpac Insurance
Malaysian Re
MNRB
MSIG Insurance
Pacific Insurance
Progressive Insurance
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Swiss Re
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Executive Summary

Since 2010, Malaysia's economic growth was broadly in line with the average of the ASEAN 5 countries, which is quite an achievement for the most advanced ASEAN 5 economy. The picture looks different for general insurance premium growth. In terms of business expansion, Malaysia's insurance sector has consistently fallen short of the regional average, especially since 2015. As a result, general insurance penetration (premiums as a share of GDP) has eroded in Malaysia whereas for ASEAN as a whole general insurance penetration has remained virtually unchanged. Having said this, Malaysia's general insurance market still boasts a penetration rate that exceeds the regional average by about 50 %.

More recently, based on Malaysia's general insurance premium growth in 2018, the declining trend over the past decade has been reversed, buoyed by robust demand in the motor and fire classes. It remains to be seen whether this trend reversal will be sustainable.

Against this backdrop, we are offering a comprehensive analysis of five major trends, namely de-tariffication, consolidation, B40 strategies, Takaful prospects and InsurTech.

De-tariffication to benefit consumers, insurers and, ultimately, society at large

Today's dominant market challenge is de-tariffication. One of the main policy objectives behind de-tariffication was the desire to align Malaysia's regulatory regime with those of the most advanced economies in the world. Another goal was to introduce more equity to insurance pricing, rewarding those who behave risk-consciously and incentivizing less risky behaviours – with huge potential benefits for society at large.

From the very beginning, Bank Negara Malaysia was committed to prevent de-tariffication from translating into unsustainable pricing, bearing in mind lessons learned from China and India, for example. Therefore, the regulator has opted for a phased approach to liberalisation.

Against this backdrop, we took the pulse of more than 30 Malaysian executives and senior professionals to produce an outlook for the country's motor insurance market. By 2022, 52 % of our expert interviewees expect average motor rates to be below the pre-detariffication level. Premium discounts to low-risk customers are believed to outweigh premium increases for high-risk customers. This assessment, however, is subject to significant uncertainty over BNM's future pace of liberalisation even though virtually all interviewees expect the regulator's phased and managed approach to continue even beyond summer 2020 when the next phase of liberalisation is likely to be launched.

As compared with rates, an even larger majority of 60 % expects technical profitability in the motor segment to trail the level recorded prior to liberalisation. Insurers do not consider themselves able to offset the underlying claims pressure by rate increases. Rising costs for labour and spare parts, in combination with surging bodily injury awards are fuelling claims inflation.

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Assuming a continued managed approach to liberalisation 71 % of interviewees do not expect an increased product variety by 2022. Most executives and professionals do not consider add-ons or riders (such as PA insurance added to flood cover) as genuine product innovation or expansion. New products such as telematics-based motor insurance remain scarce and subject to regulatory approval. In addition, they are met with subdued interest or even reluctance from customers.

80 % of interviewees do not expect de-tariffication *per se* to result in another wave of consolidation in the motor segment, at least not in the medium-term. The market is considered to be already quite concentrated, also in view of the shrinking number of general Takaful operators. However, many executives expect the general trend towards consolidation to continue, but for other reasons such as tighter capital requirements and pressures associated with IFRS 17.

More significant rate reductions in fire insurance

The medium-term pricing outlook for the fire line of business is gloomier than for the motor class. 83 % (compared with 52 % for motor) expect rates to be lower post-de-tariffication. ‹Good› fire risks, especially in the SME segment, have enjoyed significant premium reductions, fully exhausting the leeway offered by the 30 % band.

73 % of interviewees anticipate lower post-detariffication levels of technical profitability in the fire line of business. Some expect residential business, too, to be affected by rate erosions. Also, as liberalisation progresses to the next stages, the band for reductions is believed to expand beyond the current 30 % threshold.

Similar to the motor line of business, the vast majority of interviewees do not expect any increase in product variety post de-tariffication. Many add-ons (such as flood and terrorism cover) that have been introduced to the market are viewed as counter-measures to partially offset the adverse top line effect from rate reductions.

Virtually all interviewees hold a very positive view of the long-term effects of de-tariffication. Shorter-term, customers are believed to be the main beneficiaries through lower prices and a broader availability of innovative products and services. Medium-term, following the completion of liberalisation, insurers are expected to benefit from improved risk segmentation and risk-based pricing. Some players might drop out of the market in view of major investment and adjustment needs. Those who survive, however, are believed to enjoy a more professional and sophisticated operating environment. Longer-term, society at large is widely expected to benefit as risk-based pricing will incentivise less risky behaviours in both the retail and commercial space.

Over the past few decades Malaysia’s general insurance sector has gone through a phase of marked consolidation. Narrowly trailing Singapore, Malaysia boasts the highest average premium per general insurer in the region. Against this backdrop,

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70 % of the interviewees do not see any need for additional consolidation. Some also point to the declining number of general Takaful operators, with only 4 players left, and note decreasing levels of competition and customer choice in that particular field.

In most developing and emerging markets, providing the lower-income segments of the population with insurance protection poses significant political and commercial challenges. Uninsured households are highly vulnerable to financial shocks such as the premature death or critical illness of the family breadwinner which can lead to households quickly descending into poverty. With this in mind, in November 2017, Bank Negara Malaysia launched Perlindungan Tenang, aimed at expanding the insurance and takaful penetration among the B40. A recent example is Skim Perlindungan Nasional B40 (mySalam), a government fund which provides health insurance coverage to the B40 for 36 critical illnesses.

Insurers encourage the Government to broaden its current B40 approach

Almost two thirds of our expert and executive interviewees are skeptical as to whether the B40 programme will make a real difference in terms of boosting insurance penetration in Malaysia. Most respondents believe that despite the various government measures taken B40 insurance will continue to lack a compelling commercial proposition and be viewed as ‹Corporate Social Responsibility›. A number of experts point out that the government should consider measures such as capital relief for those insurers that engage in B40 insurance, ideally as part of a comprehensive B40 insurance strategy that goes beyond healthcare.

When asked about potential alternatives to the current B40 programme, survey participants came up with suggestions such as subsidised compulsory insurance schemes, technology-enabled solutions, capital relief and tax incentives for those insurers that are actively serving the B40, public-private partnerships between insurers and government agencies, dedicated public-private awareness programmes that improve leverage of existing available products and innovative ways of premium payments, e.g. in instalments.

Potential for Takaful not yet exhausted

Over the past few years, General Takaful has outperformed overall market growth and now accounts for 13.7 % of overall gross direct premiums and contributions, up from 12.9 % in 2017. Malaysia's general Takaful penetration (about 14 % of the total general insurance market) compares favourably with Indonesia's 5 %, for example, despite the latter's much higher Muslim population share. This position is largely attributable to a robust regulatory framework, with the country being the first market in the world to implement a risk-based capital (RBC) framework for Takaful. There is also a requirement for companies to disclose their wakalah (agency) fees in their sales documents.

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Financial Strength Rating of 'A-' Excellent (Stable Outlook) by A.M. Best

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Most expert and executive interviewees believe that the potential for Takaful in Malaysia is far from exhausted, not least because of the government's intent to encourage the provision of affordable insurance. These are the most frequently mentioned recommendations as to what it would take to capture the full promise of Takaful. Awareness building and more effective branding rank first. Technology is the second most frequently mentioned lever to pull as Takaful operators rely much less on agents than their conventional counterparts. Product differentiation features third. Many Takaful solutions simply cannibalise conventional business without offering a genuinely new proposition and merely following the conventional sector. A number of interviewees also believe that Takaful should benefit from tax breaks as well as capital relief which would be warranted by lower levels of guarantees.

A majority of 58 % sees a strong case for Takaful to play a major role in delivering B40 insurance initiatives. Reasons given include the relative high share of Muslims among the B40 and the perceived superior effectiveness of Takaful (compared with conventional insurance) in building awareness of the benefits of risk pooling and sharing.

Long-term effects of digitization to slowly reshape Malaysia's insurance industry

As technology transforms insurance and impacts virtually all elements of the value chain, there has been much debate among industry practitioners on how business models may evolve, for example from payer only to a more integrated and comprehensive partner model which draws on platform-based ecosystems. In addition, the long-term potential of digital distribution and aggregator technology are being vividly discussed.

Against this backdrop, we have probed the interviewees for their perception of insurance ecosystems' impact so far. The vast majority of 84 % consider such ecosystems still irrelevant and many believe that «there is talk only». Having said this, most experts and executives think that such ecosystems «will rise, but slowly». Consumers are not seen as being ready yet for such digital solutions. In addition, even the longer-term potential of digital insurance ecosystems is expected to be limited to the segment of low and easily affordable premiums which can be viewed as a plus from the perspective of financial inclusion.

By 2022, will digitization have reshaped today's business models in Malaysia's general insurance industry? 58 % of the experts and executives polled are skeptical. They believe that claims will remain at the core of the insurance value proposition. In addition, the dominance of agency distribution makes insurers wary of channel conflicts and inclined to play it safe by maintaining, or at most, digitizing the status quo.

Most experts and executives polled look at InsurTech through the lens of operating expenses. Capturing cost synergies and efficiencies is seen as the ‹lowest hanging› fruit of InsurTech by many. Distribution benefits in terms of increased effectiveness and efficiency of existing and new channels are the second most frequently mentioned benefit. New business generation, primarily on the back of improved access to existing and prospective customers ranks third. Product innovation, based on personalized added-value services, comes in fourth.

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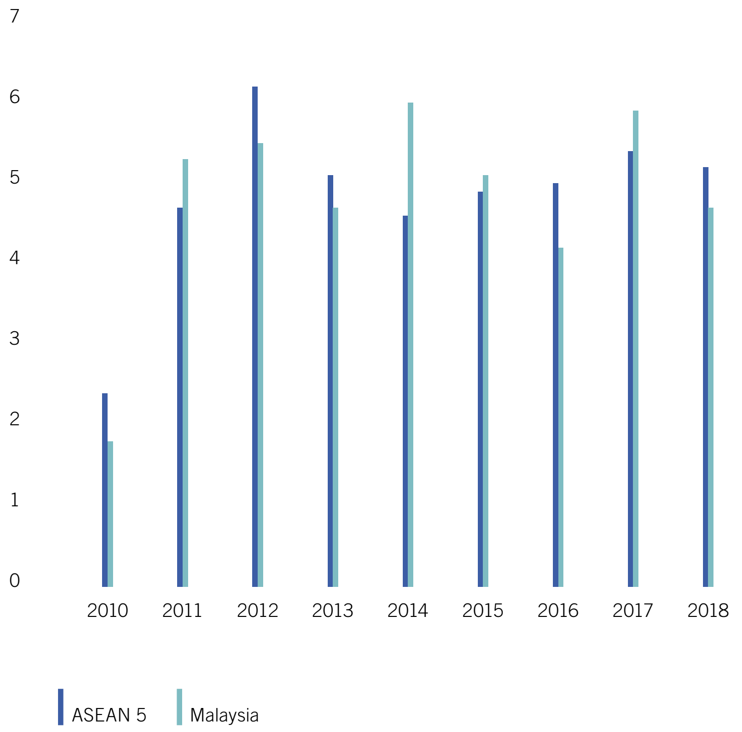
Malaysia in comparison with ASEAN: Key insurance metrics

Economic growth is widely considered the single most important determinant of insurance premium growth. Figure 1 presents Malaysia's economic growth performance over the past few years against the ASEAN average. Years with relative underperformance are broadly matched by those with relative outperformance, which is quite an achievement for Malaysia as the most advanced ASEAN 5 economy.

Figure 1: Real GDP growth (Malaysia versus ASEAN 5, 2010–2018, in %)



Source: IMF, World Economic Outlook (April 2019), *ASEAN 5 as per the IMF's classification (Indonesia, Malaysia, Philippines, Thailand, Vietnam)

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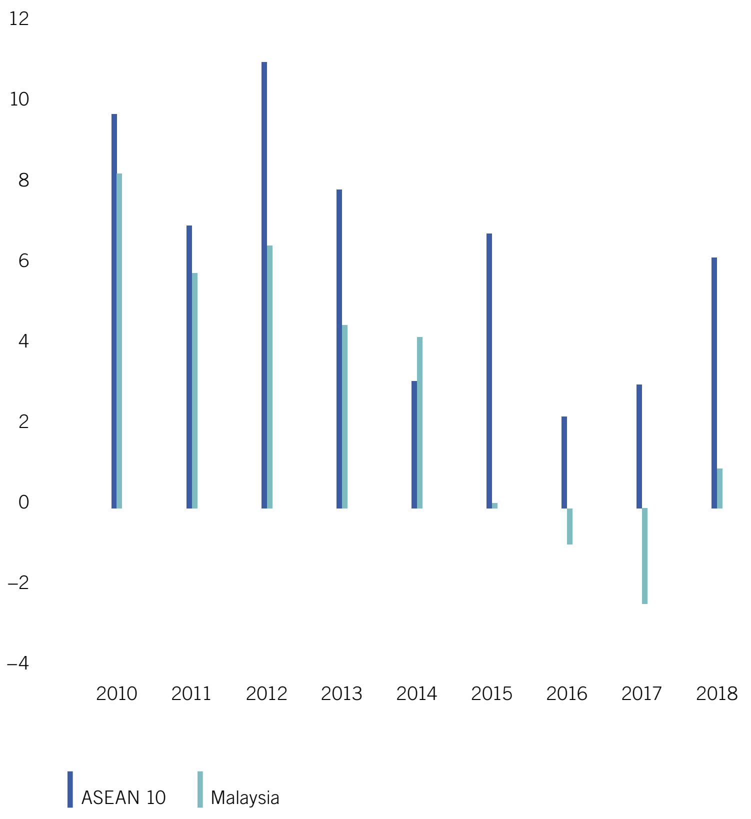
The picture looks different for non-life or general (including health) insurance premium growth. In terms of growth, Malaysia's insurance sector has consistently fallen short of the ASEAN 10 average. As from 2015, the pace of expansion has reduced sharply (see figure 2).

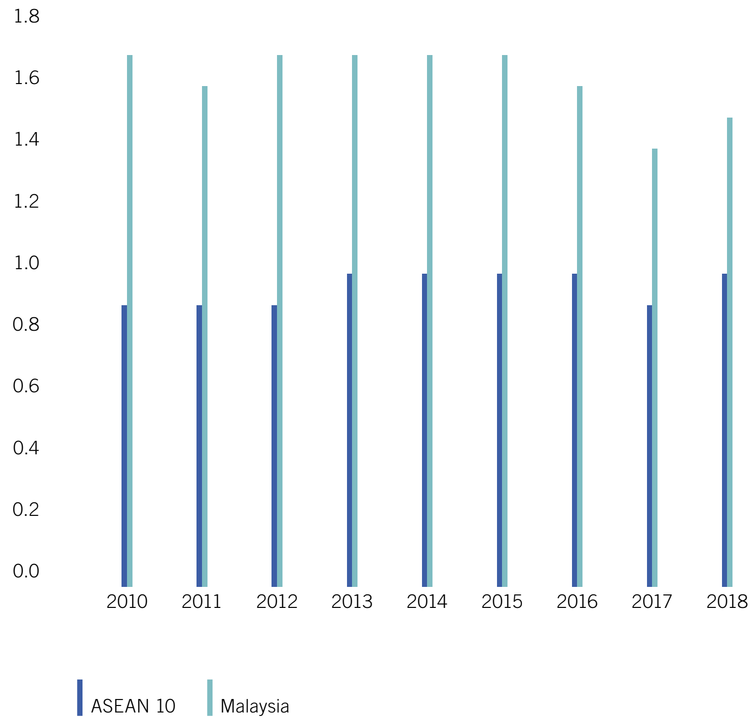
Figure 2: Real general (conventional and Takaful) insurance premium growth (Malaysia versus ASEAN 10, 2010–2018, in %)



Source: Swiss Re sigma database, all rights reserved; Dr. Schanz, Alms & Company (Malaysia 2018)

As a result, general insurance penetration (premiums as a share of GDP) has slightly eroded in Malaysia. For ASEAN 10 as a whole general insurance penetration has remained virtually unchanged. Having said this, Malaysia's general insurance market still boasts a penetration rate that exceeds the regional average by about 50 % (see figure 3).

Figure 3: General insurance penetration (Malaysia versus ASEAN 10, 2010–2018, in %)



Source: Swiss Re sigma database, all rights reserved

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Figure 4: General Gross Direct Premiums (in RM million) and nominal growth (in %) (2012–2018)

Source: ISM, Statistical Yearbook 2018

Figure 4 presents the growth performance of Malaysia's general insurance industry in nominal and local currency terms. The sector grew by a modest 1.8 % to RM 17.6 billion in 2018. While this rate of expansion remains well below GDP growth, the declining growth trend over the past decade has been reversed. The market's growth was supported by robust sales in the motor (plus 1.9 %) and fire (plus 3.3 %) classes which account for more than two thirds of Malaysia's general insurance market. Motor premiums benefited from favorable vehicle sales, buoyed by tax breaks during the year. Overall, the phased approach to rate liberalisation pursued by Bank Negara has, so far, translated into broadly stable market conditions. It remains to be seen whether this trend reversal is sustainable.

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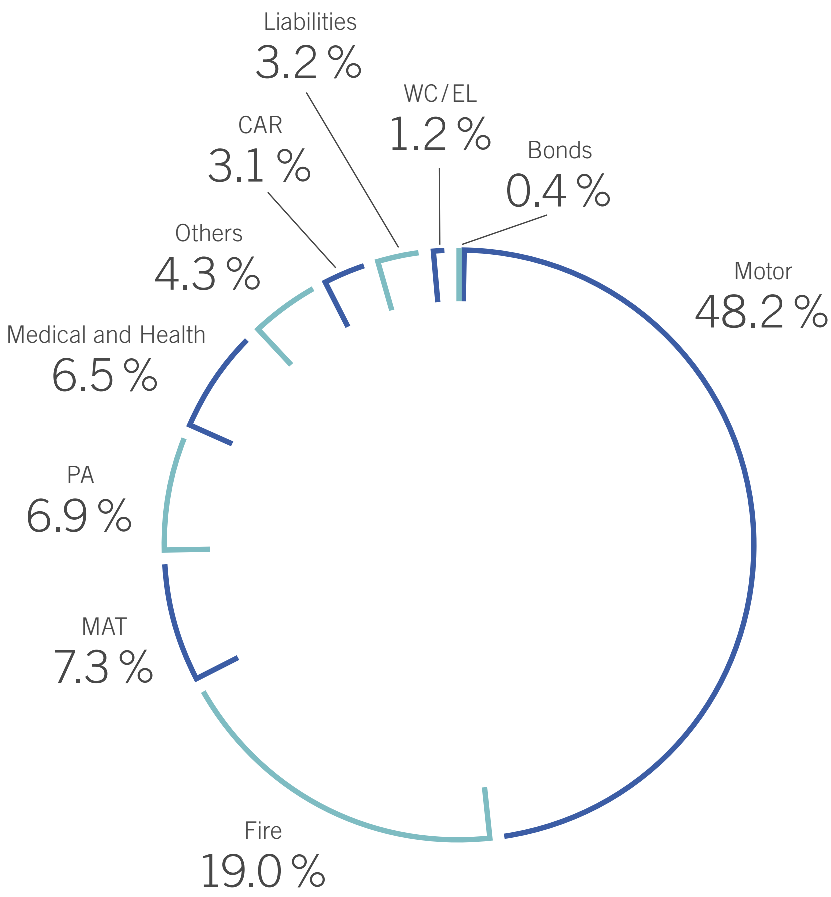
Figure 5: Breakdown by line of business (2018)



CAR = Contractor's All Risks & Engineering
MAT = Marine, Aviation and Transit
WC / EL = Workmen's Compensation & Employers' Liability

Source: ISM, Statistical Yearbook 2018

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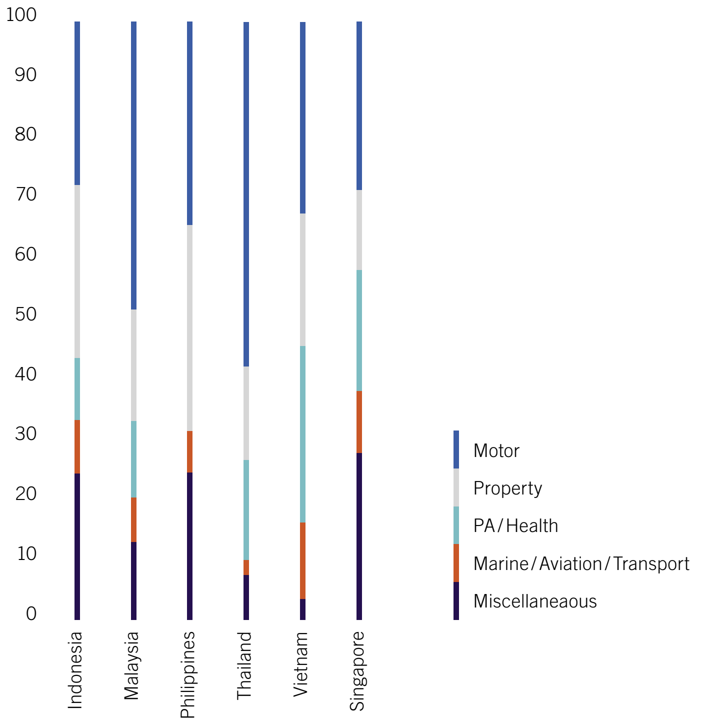
As shown by figure 5, with a share of 48 %, the motor line of business continues to be the dominant segment in Malaysia's general insurance sector. In the ASEAN region, only Thailand exhibits a higher share of motor business (see figure 6). Premiums from the compulsory motor segment (‹Motor Act›) contributed 22 % to the total volume of motor business, up from 17 % in the prior year as insurers increasingly make use of the additional degrees of freedom afforded by de-tariffication. Fire and MAT are the second- and third-largest classes of business, with shares of 19 % and 7 %, respectively.

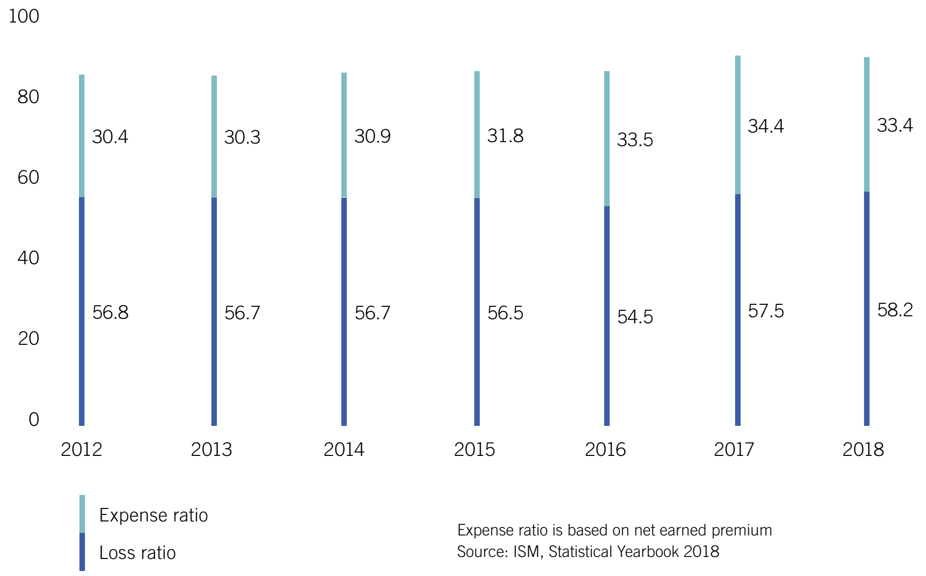
Figure 6: Non-life lines of business split, 2017, in %



Source: Compiled by Dr. Schanz, Alms & Company from national supervisory authorities and insurance associations

The overall general insurance combined ratio improved modestly to 91.6 % in 2018, largely driven by a declining management expense ratio, which came down to 23.5 % in 2018 from 24.3 % in the previous year. The aggregate commission ratio remained stable at about 10 %. The loss ratio slightly deteriorated to 58.2 %, from 57.5 %, spanning all major lines of business, except for motor (see figure 11). Since 2012, the market's combined ratio has crept up by 4.5 percentage points, primarily as a result of rising expense ratios and, to a lesser extent, increased loss ratios (see figure 7).

Figure 7: Underwriting performance (loss and expense ratio, 2014–2018, in %)



Expense ratio is based on net earned premium
Source: ISM, Statistical Yearbook 2018

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Meeting the challenge of de-tariffication

History and rationale

One of the main policy objectives behind de-tariffication was the desire to align Malaysia's regulatory regime with those of the most advanced economies in the world. Another goal was to introduce more equity to insurance pricing, rewarding those who behave risk-consciously and incentivizing less risky behaviours – with huge potential benefits for society at large.

Following three years of preparatory consultations Bank Negara Malaysia (BNM) launched the first phase of the liberalisation of the motor and fire tariff on 1 July 2016. Insurers and Takaful operators were authorized to offer new products and add-on covers beyond the existing regime.

In a second step, from 1 July 2017 onwards, premium rates for motor comprehensive, motor third party, fire and theft products were partially liberalised, with more risk factors permitted to be taken into account for determining rates. In the past, rates were primarily driven by the sum insured, cubic capacity of the vehicle engine, age of vehicle and age of driver. Today, additional relevant risk factors that influence individual pricing include safety and security features of the vehicle, the duration that the vehicle is on the road, the geographical location of the vehicle as well as individual driving behaviour and experience. Currently, the permissible general pricing intervals range from plus/minus 10 % in motor insurance and 30 % in fire insurance. Premium rates for motor third party products, however, continue to be subjected to tariff rates which, despite a gradual increase, remain technically insufficient, with loss ratios reaching up to 300 %.

From the very beginning, BNM was committed to prevent de-tariffication from translating into unsustainable pricing, bearing in mind lessons learned from China and India, for example (see page 21). The regulator has opted for a phased

«For our domestic insurers, there is no alternative to getting ready for a new business paradigm that will prevail once the process of liberalization is completed. A major challenge in this context is to build new technical capabilities in risk-based pricing and tailoring customer propositions, for example. Companies who fail on this account risk being left behind, sooner rather than later.»

Zainudin Ishak, CEO, Malaysian Reinsurance Berhad

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approach to liberalisation, requiring insurers to obtain special approvals if they want to price more aggressively than permitted under the existing ranges. The second «safety mechanism» is Malaysia's well-established Risk Based Capital Framework. It ensures that underwriting reserves are commensurate with the risks assumed and, therefore, disciplines insurers' underwriting activities.

Discussions on phased liberalisation between BNM and the industry started back in 2013, giving insurers sufficient time to prepare for de-tariffication through the adoption of new customer, product and distribution strategies as well as improved data mining and analysis capabilities for the purpose of customer segmentation and risk-based pricing, for example.

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The de-tariffication experience from China and India

When embarking on the deregulation of rates as well as terms and conditions, regulators are most concerned about the impact on the financial viability of insurers. As a late-comer to de-tariffication Malaysia was able to benefit from the lessons learned by other markets. China, for example, has had a very instructive experience in de-tariffication. After joining the World Trade Organization in 2001, the country deregulated motor insurance in 2003. Three years after their abolition, China had to re-introduce tariffs in 2006 to counter-act insurers' mounting underwriting losses, as a result of sharply falling prices, increasing commissions and other expenses. The sharp drop in rates (of close to 50 %) sparked major solvency concerns for the industry, especially for the smaller insurers with a heavy portfolio bias towards motor business. In hindsight, China may not have been fully prepared for de-tariffication in 2003. There was no RBC framework in place and risk management and actuarial controls were still in their infancy. In the meantime, the regulatory regime has advanced substantially, with C-ROSS (China Risk Oriented Solvency System), the country's equivalent to Solvency II, in place. The second attempt to deregulate the motor market was under-taken in 2015, initially limited to selected provinces. The reforms only led to a modest reduction in the annual growth rate of motor premiums, despite increasing costs in acquiring and retaining policyholders and even fiercer price competition in an already competitive environment.

The China Banking and Insurance Regulatory Commission (CBIRC) is keenly monitoring the impact of rising expense ratios on the longer-term viability of the motor insurance market. Therefore, insurers have to disclose the discounts applied to premiums for vehicles, as well as the average acquisition cost. In the meantime, deregulation has taken place across the entire country even though each province remains subject to different pricing limits.

In India, fire and motor (except third-party liability) tariffs were liberalised in 2007 when insurers were allowed to price insurance policies based on their own risk analyses and perceptions. Fire rates started to decline dramatically, resulting in a negative premium growth in the first year of de-tariffication. For more than 10 years now India's general insurance market is characterised by furious price wars and a poor technical performance of the market as a whole. «Automatic stabilisers» such as a risk-based solvency system are not yet in place.

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Findings on motor insurance

Against this backdrop, we took the pulse of more than 30 Malaysian executives and senior professionals to produce an outlook for the country's motor insurance market. By 2022, 52 % of our expert interviewees expect average motor rates to be below the pre-detariffication level. Premium discounts to low-risk customers are believed to outweigh premium increases for high-risk customers. This assessment, however, is subject to significant uncertainty over BNM's future pace of liberalisation even though virtually all interviewees expect the regulator's phased and managed approach to continue even beyond summer 2020 when the next phase of liberalisation is likely to be launched. Even though wider pricing bands are anticipated, unrestricted risk-based and actuarial pricing is not seen as a realistic scenario any time soon. On the one hand, BNM is considered to place market stability over any other consideration. On the other hand, BNM is believed to be determined to protect lower-income customer segments from sharp rate increases as owners of luxury cars, for example, enjoy premium discounts. The lower-income segments of the population generally count as high-risk customers, sometimes for reasons beyond their control.

«Over time, de-tariffication will boost premium growth, especially in personal lines which have been neglected by insurers for too long. The market will benefit from more competition, not just through price but also via new products and services. Having said this, the historically strong profitability of the market is set to erode and converge to more ‹normal› levels seen in other competitive and de-tariffed environments.»

Francis Lai, CEO, Progressive Insurance

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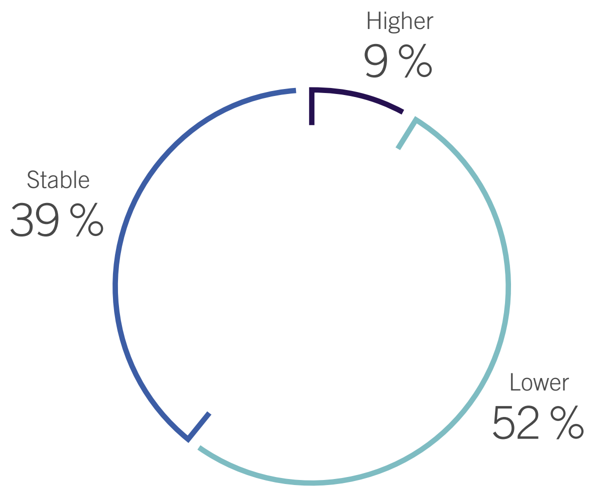
Those 39 % who expect stable rates, point to deteriorating underlying loss trends (see figure 8) which, irrespective of the degrees of freedom afforded by de-tariffication, should require a structural repricing of certain motor risks, at least preventing aggregate rates from eroding. In addition, the prevailing RBC regime and the experience gained from other de-tariffed markets should instill some pricing discipline in the market (see figure 8).

Figure 8: Expected 2022 aggregate level of motor rates (compared with pre-detariffication)



«Malaysia's road accident record is relatively poor by international standards. Therefore, one of the most important societal benefits from de-tariffication is risk-based pricing. As we have seen from other countries, pricing is set to change behavior, to the benefit of individuals and society at large. From an insurance point of view, de-tariffication is expected to boost general awareness of insurance, potentially prompting customers to consider non-motor types of cover such as home insurance where protection gaps are massive.»

Antony Lee, CEO, AIG Malaysia and Chairman PIAM

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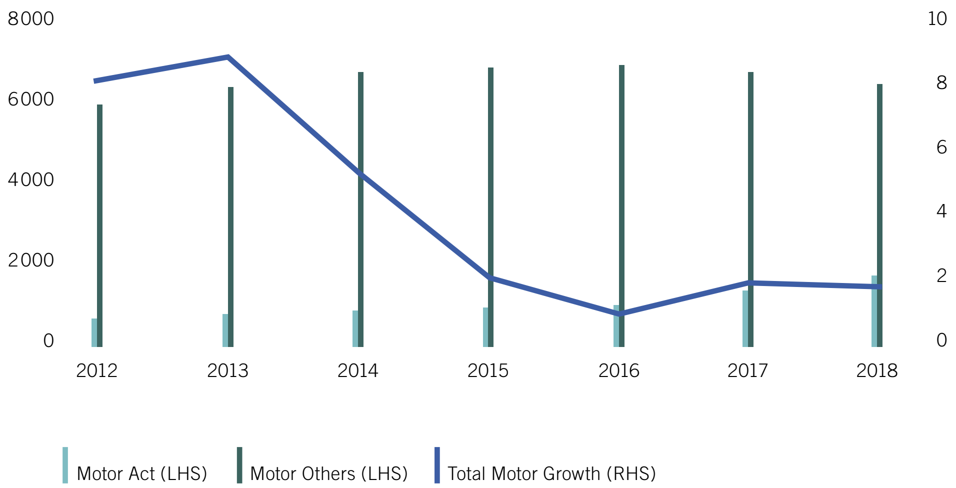
Figure 9 shows that the first phase of de-tariffication has not had any disruptive effects on motor premium growth. In 2018, premiums increased by 1.9 % to RM 8.5 billion on the back of higher car sales, encouraged by tax benefits. In addition, new products and add-on covers to existing offerings have supported the sector's continued albeit subdued growth. In the wake of slowing economic growth motor premiums have moved to a trajectory of slower expansion long before de-tariffication set in.

Figure 9: Motor insurance: Gross Direct Premiums (in RM million) and growth (in %) (2012–2018)



Source: ISM, Statistical Yearbook 2018

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As compared with rates, an even larger majority of 60 % expects technical profitability in the motor segment to trail the largely unprofitable levels recorded prior to liberalisation. Insurers do not consider themselves able to offset the underlying claims pressure by rate increases. Rising costs for labour and spare parts, in combination with surging bodily injury awards are fuelling claims inflation. This pressure comes on top of traditionally high accident and fatality rates on Malaysia's roads which insurers hope to influence positively through risk-based pricing and the expected changes in driving behaviour. A significant minority of 40 % do expect technical profitability to be resilient, supported by more leeway for risk-based pricing and the possibility of outperforming on the back of advanced analytics (see figure 10).

Figure 10: Expected 2022 aggregate level of motor technical profitability (compared with pre-detariffication)

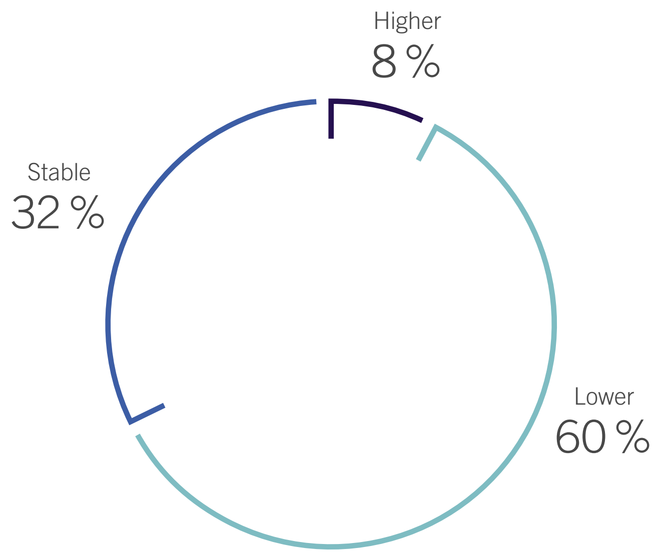
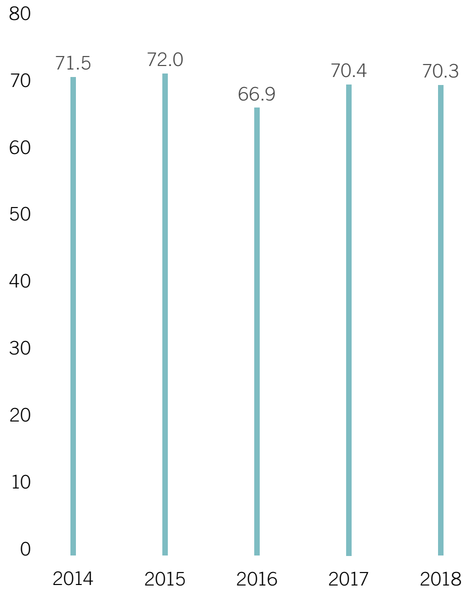


Figure 11 demonstrates the hitherto muted impact of liberalisation of motor loss ratios. At 70.3 % the 2018 motor loss ratio remained virtually unchanged compared with the previous year. Even though 2017 saw an increase in the loss ratio of about 350 basis points, current motor loss ratios are broadly consistent with the pre-detariffication level.

Figure 11: Motor insurance loss ratio (2014–2018, in %)



Source: ISM, Statistical Yearbook 2018

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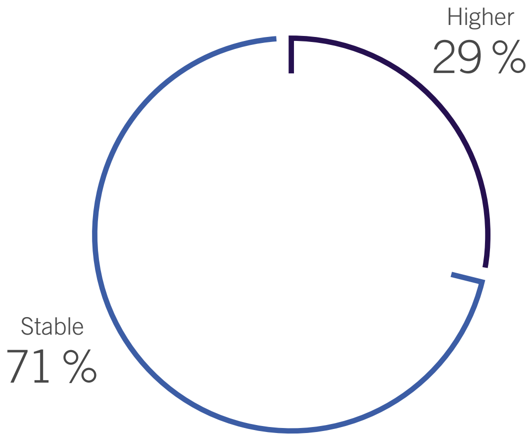
Assuming a continued managed approach to liberalisation 71 % of interviewees do not expect an increased product variety by 2022. Most executives and professionals do not consider add-ons or riders (such as PA insurance added to flood cover) as genuine product innovation or expansion. New products such as telematics-based motor insurance remain scarce and subject to regulatory approval. In addition, they are met with subdued interest or even reluctance from customers. Generally speaking, most interviewees believe that insurers will continue to focus on pricing as long as full (product) liberalisation remains a remote scenario (see figure 12).

Figure 12: Expected 2022 aggregate level of motor product variety (compared with pre-detariffication)



«Since the start of the de-tariffication in the motor line of business in Malaysia, the focus is first and foremost on pricing. Only once rates have stabilized we will be in a position to introduce real innovations to the market such as telematics.»

Tan Sek Kee, CEO, Berjaya Sompo Insurance

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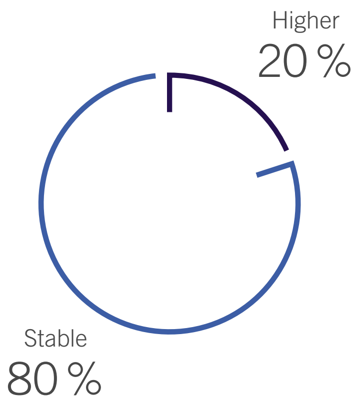
80 % of interviewees do not expect de-tariffication *per se* to result in another wave of consolidation in the motor segment, at least not in the medium-term. The market is considered to be already quite concentrated, also in view of the shrinking number of general Takaful operators. However, many executives expect the general trend towards consolidation to continue, but for other reasons such as tighter capital requirements and pressures associated with IFRS 17.

Those 20 % who see a positive medium-term relationship between motor de-tariffication and consolidation point to massive investment needs in the area of technology (e.g. in predictive analytics) in order to cope with much higher requirements in pricing and product development. More scope for rate differentiation adds to the importance of data-driven strategies, risk segmentation and the underlying analytical capabilities. Those using less sophisticated pricing tools are seen to be facing a heightened risk of adverse selection (i.e. a higher share of high-risk customers) and gradual portfolio deterioration.

Generally speaking, there is a broad consensus that, longer-term, de-tariffication will boost both insurance demand and supply, translating into a heightened level of market competition and sophistication, also driven by changes to the distribution landscape. Many interviewees expect to see some shifts in favour of «provider agnostic» channels such as independent intermediaries and banks or those which cater to segmentation strategies such as affinity and worksite marketing (see figure 13).

Figure 13: Expected 2022 degree of motor market consolidation (compared with pre-detariffication)



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Findings on fire insurance

The medium-term pricing outlook for the fire line of business is gloomier than for the motor class. 83 % (compared with 52 % for motor) expect rates to be lower post-de-tariffication. ‹Good› fire risks, especially in the SME segment, have enjoyed significant premium reductions, fully exhausting the leeway offered by the 30 % band. The role of brokers in the commercial space and their contribution to enhancing transparency and competition are adding to the pressure on rates. The impact on residential fire risks (primarily sold in conjunction with mortgages through bancassurance channels where competition tends to be limited due to strategic partnerships) and large commercial risks with sums insured of more than RM 50 million (largely de-tariffed as early as in the 1990s) was less pronounced.

Even though fire insurance is still considered the market's ‹cash cow› many interviewees believe there is a limit to further rate decreases as profits from the fire line of business are still relied upon for cross-subsidising losses from motor insurance where high-risk customers cannot yet be charged risk-based rates. Having said this, the reduced scope for funding cross-subsidies through sizeable fire margins is expected to result in more insurance products to be sustainably priced on an individual basis (see figure 14).

Figure 14: Expected 2022 aggregate level of fire rates (compared with pre-detariffication)

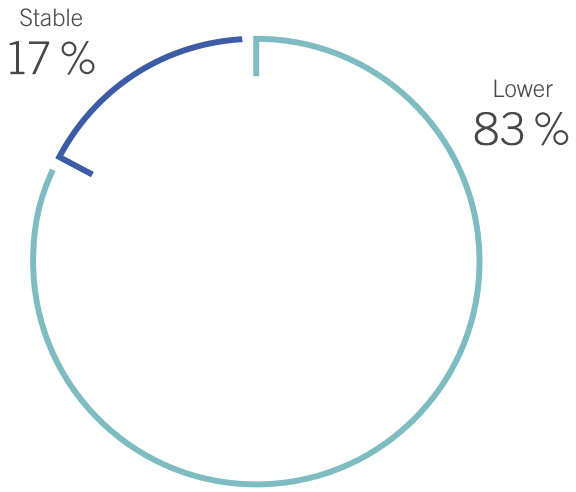

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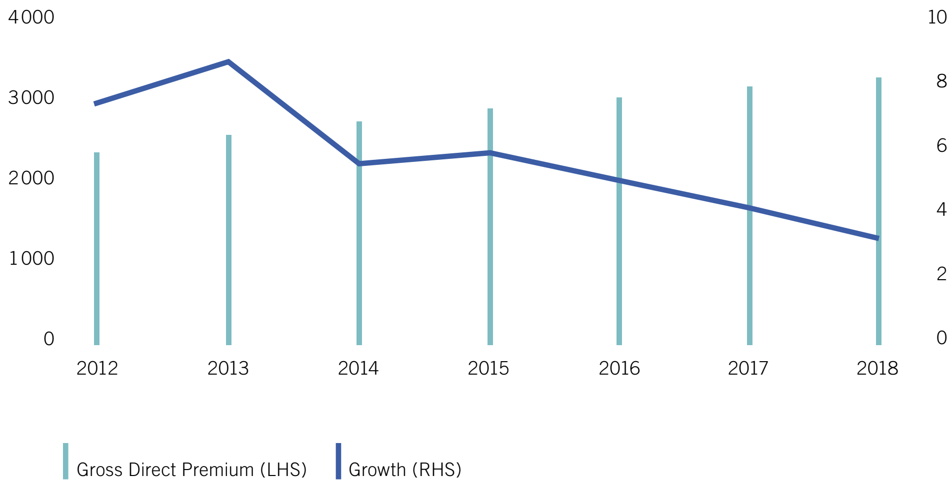
Figure 15 shows that despite massive premium discounts de-tariffication in 2016 has only led to a relatively moderate slowing of premium growth, with the pace of expansion more than halving to 3.3 % in 2018. The fire line of business remains more buoyant than the motor class, reflecting strong fundamentals such as continued economic growth and a very low insurance penetration in the residential space.

Figure 15: Fire insurance Gross Direct Premiums (in RM million) and growth (in %) (2012–2018)



Source: ISM, Statistical Yearbook 2018

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73 % of interviewees anticipate lower post-detariffication levels of technical profitability in the fire line of business. Some expect residential business, too, to be affected by rate erosions. Also, as liberalisation progresses to the next stages, the band for reductions is believed to expand beyond the current 30 % threshold.

A minority of 8 % expect technical profitability to be higher post-detariffication, pointing to more degrees of freedom and technological advances in risk selection and underwriting (see figure 16).

Figure 16: Expected 2022 level of fire technical profitability (compared with pre-detariffication)

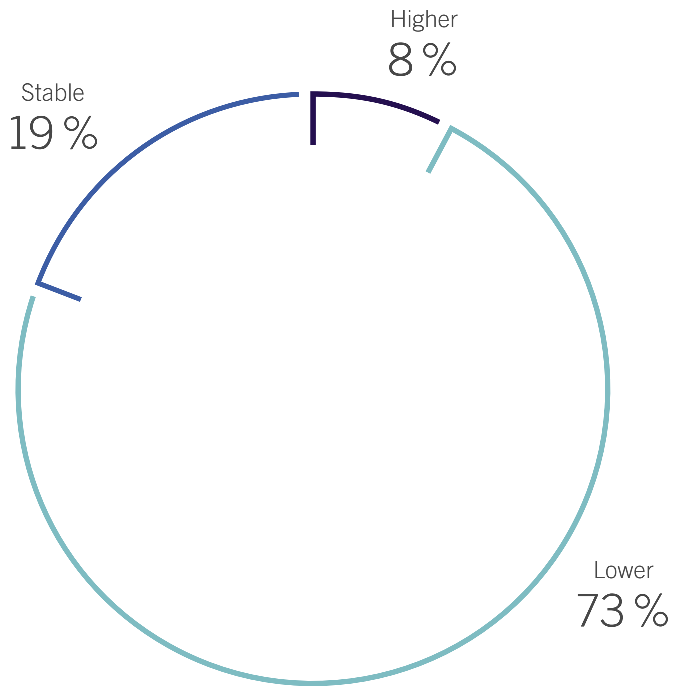
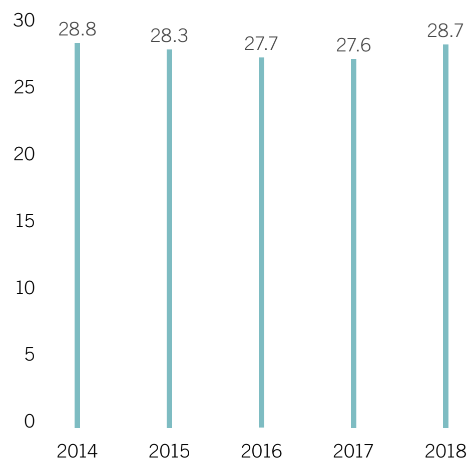


Figure 17 demonstrates the resilience of fire loss ratios to the first phase of liberalisation which does not seem to have had any noticeable impact, suggesting that rate reductions were not granted across the board and have been offset by improvements in risk selection and underwriting.

Figure 17: Fire insurance loss ratio (2014–2018, in %)



Source: ISM, Statistical Yearbook 2018

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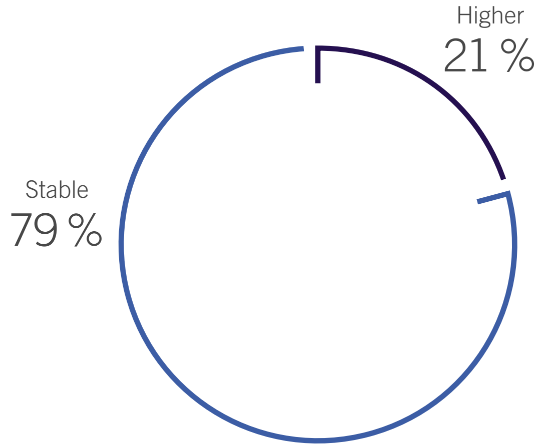
Similar to the motor line of business, the vast majority of interviewees do not expect any increase in product variety post de-tariffication. Many add-ons (such as flood and terrorism cover) that have been introduced to the market are viewed as counter-measures to partially offset the adverse top line effect from rate reductions.

Also, in residential fire insurance, customer appetite for innovative products is limited as the cover is typically viewed as a corollary to mortgages (see figure 18).

Figure 18: Expected 2022 level of fire product variety (compared with pre-detariffication)



«Bank Negara has deliberately opted for a cautious and gradual approach to de-tariffication. As experience from other countries has taught us, some guidance is needed to avoid market disruption. As in other countries before, liberalization is expected to initially translate into an erosion of rates which, in turn, should accelerate market consolidation. Once the transition to full liberalization is completed, we are expecting to see a more competitive, equitable and innovative market place where low risks no longer subsidize high risk individuals.»

Marcel Omar Papp, Head Reinsurance Malaysia (Conventional & Retakaful), Swiss Re

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Virtually all interviewees hold a very positive view of the long-term effects of de-tariffication. Shorter-term, customers are believed to be the main beneficiaries through lower prices and a broader availability of innovative products and services.

Medium-term, following the completion of liberalisation, insurers are expected to benefit from improved risk segmentation and risk-based pricing. Some players might drop out of the market in view of major investment and adjustment needs. Those who survive, however, are believed to enjoy a more professional and sophisticated operating environment.

Longer-term, society at large is widely expected to benefit as risk-based pricing will incentivise less risky behaviours in both the retail and commercial space. Fewer road traffic fatalities were mentioned most frequently in this context. In a liberalised environment, insurers also have an incentive to collect and analyse more information about loss exposures, since the more precisely they measure the cost of risk, the more they can expand profitably. As a result, the insurance market generates price signals to the entire economy, helping to allocate resources to more productive uses that more accurately reflect risk-return correlations.

The potential downside to liberalisation in terms of risks to financial stability seems to be manageable, given Malaysia's long experience with RBC frameworks and their beneficial role as effective ‹checks and balances› on any form of excessive competition.

«We expect the de-tariffication or market liberalization to be an advantage for both consumers and insurers – ultimately the entire industry. The de-tariffication will benefit the more competitive players which will be able to strengthen their position. That will improve the overall security and competitiveness of the market. Furthermore, risk based pricing, which will be the consequence of the market liberalization, will eventually lead to lower prices at better service, which will be a plus for consumers.»

Shu Yin Kong, Managing Director & CEO, RHB Insurance

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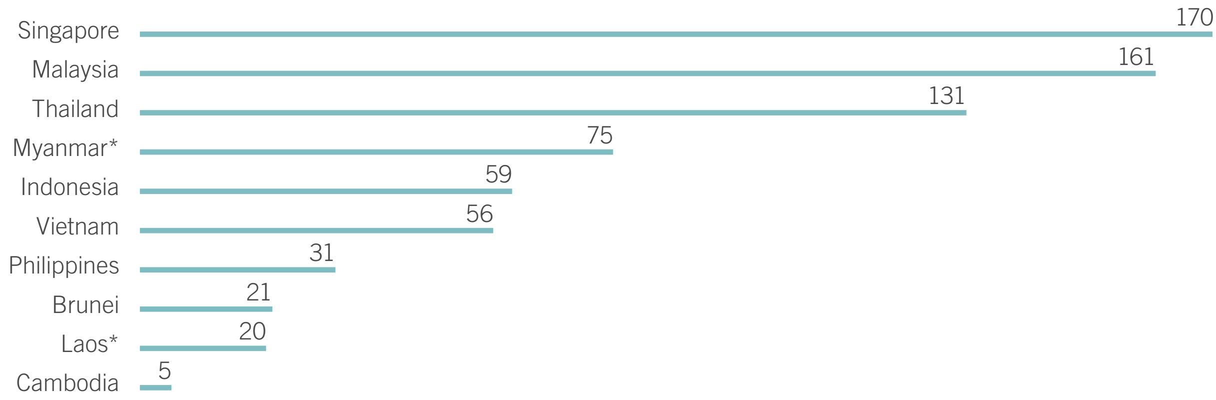
Supply side dynamics

Over the past few decades Malaysia's general insurance sector has gone through a phase of marked consolidation. The number of licensed general insurers has dropped from 36 in 2000 to its current level of 21, serving the country's 32.6 million population. Figure 19 illustrates Malaysia's progress towards general insurance consolidation compared with other ASEAN countries. Narrowly trailing Singapore, Malaysia boasts the highest average premium per general insurer in the region.

BNM has used various tools to encourage consolidation such as the early adoption of a modern RBC framework or offering foreign insurers an equity participation above 70 percent, if beneficial to industry consolidation and rationalisation.

BNM continues to push for further consolidation and still deems the industry «too fragmented». It would like to see even stronger players on the back of «synergistic partnerships» enabling scale and competitive edge which it hopes will contribute to increasing the national insurance penetration rate to 75 % of the population which compares with 56 % in 2016 and a mere 25 % in 1996.[1]

Figure 19: Average size of non-life insurance companies in the ASEAN markets (in US$ million)



*by AIC estimation

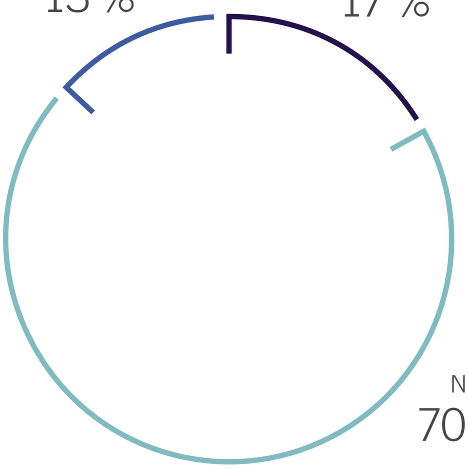
Source: Calculations by Dr. Schanz, Alms and Company based on Thai General Insurance Association, Insurance Directory of Asia 2018, Asia Insurance Review, Swiss Re, Sigma No.3/2017 and AIC 2017 ASEAN Insurance Statistical Report

1 https://themalaysianreserve.com/2018/10/15/insurance-sectors-consolidation-is-not-easy/

The case for consolidation is intuitively clear. However, as Lim (2015) shows, between 2000 and 2012, and contrary to economic theory, increasing market concentration in Malaysia's general insurance industry did not affect the sector's financial performance.[2] Lim attributes this outcome to the fact that the general insurance industry has been subject to a strict tariff system, limiting the scope for entrepreneurial decisions and for reaping the efficiency gains associated with economies of scale. With de-tariffication gaining momentum, we may see a positive correlation emerging between market consolidation and financial performance going forward.

Against this backdrop, 70 % of the interviewees do not see any need for additional consolidation. Some also point to the declining number of general Takaful operators, with only 4 players left, and note decreasing levels of competition and customer choice in that particular segment.

Figure 20: Should BNM push for more consolidation?



2 Lim, E.S. (2015), The Relationship between Market Concentration and Performance: Evidence from Malaysian General Insurance Industry, Conference Paper, August 2015: https://www.researchgate.net/publication/305638760_The_Relationship_between_Market_Concentration_and_Performance_Evidence_from_Malaysian_General_Insurance_Industry

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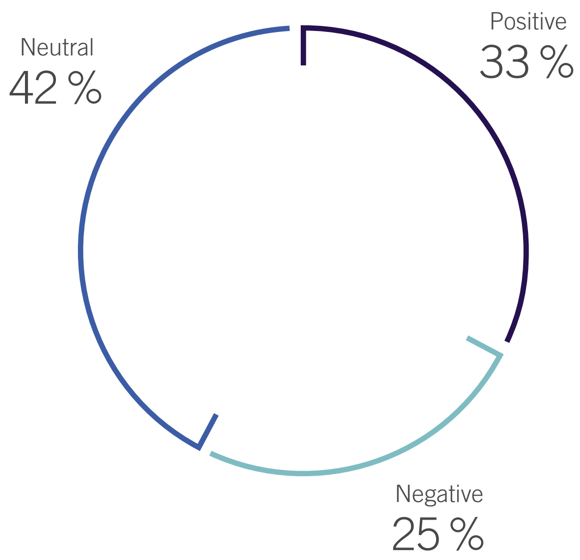
Interviewees were also probed about their views on the Labuan-domiciled re/insurers. One in four interviewees highlight negative implications for the domestic general insurance market. The Labuan companies are considered enjoying problematic privileges, for example in the area of RBC calculations, adding to competitive pressures through aggressively priced offshore capacity. Those with a positive view mainly represent reinsurance purchasing managers who benefit from competitive markets. Others are bearish as to the prospects for Labuan re/insurers as tax benefits are under review and onshore reinsurance capacity for large risks is abundant (see figure 21).

Figure 21: The impact of Labuan-domiciled re/insurers on the domestic market



«We expect some but not significant further consolidation in Malaysia's non-life insurance market. However, pressure remains high in particular on the smaller players in the market. Malaysia's ongoing de-tariffication requires significant investments in products, knowhow and human resources, which may force those with less muscle to look for investors.»

Ng Hang Ming, CEO, Tokio Marine Insurans (Malaysia) Berhad

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Serving the B40 customer segment

In most developing and emerging markets, providing the lower-income segments of the population with insurance protection poses significant political and commercial challenges. Malaysia is no exception. As pointed out by Chiew (2018), the uptake of life insurance and Family takaful among the B40 is disproportionately low relative to the national average. Out of the working population, meaning those aged 20 to 59 years old, the B40 insurance penetration rate stood at 30.3 %, compared with the national average penetration rate of 50.4 % (2017). The gap between the B40 and the non-B40 is particularly pronounced in states with large urban centres. In Kuala Lumpur, for example, 88 % of non-B40 aged 20 to 59 are covered by insurance, compared with a mere 30 % among the B40. In more rural states such as Sabah, the gap is narrower, with 30 % of non-B40 having insurance and takaful protection against 19 % among the B40.[3]

From a social policy point of view, the under-penetration of the B40 is a serious challenge. Uninsured households are highly vulnerable to financial shocks such as the premature death or critical illness of the family breadwinner which can lead to households quickly descending into poverty.

BNM considers this situation as an example of market failure to provide protection for the underserved segment, requiring regulatory intervention. With this in mind, in November 2017, BNM launched Perlindungan Tenang, aimed at expanding the insurance and takaful penetration among the B40. Insurers were asked to develop and deliver products that are affordable, provide «good value», are easy to understand and easy to purchase and claim.

A recent example is Skim Perlindungan Nasional B40 (mySalam), a government fund which provides health insurance coverage to the B40 for 36 critical illnesses, including cancer, heart attack and Alzheimer's. Recipients will benefit from a one-off payment of RM 8000 as well as some daily income replacement if they are diagnosed with one of the illnesses. The scheme is currently being managed by Great Eastern Life Malaysia which provided the initial funding of RM 2 billion, with the additional benefit of being exempted from the minimum local shareholding threshold of 30 % set by the government. The RM 2 billion are expected to cover an annual breakeven premium of RM 112 over five years for 3.69 million eligible Malaysians within the B40 income group.

Almost two thirds of our expert and executive interviewees are skeptical as to whether the B40 programme will make a real difference in terms of boosting insurance penetration in Malaysia. Most respondents believe that despite the various government measures taken, B40 insurance will continue to lack a compelling commercial proposition and be viewed as ‹Corporate Social Responsibility›. A number of experts point out that the government should consider measures such as capital relief for

3 H.L. Chiew (2018), Expanding insurance and Takaful solutions for the underserved segment, Bank Negara Malaysia

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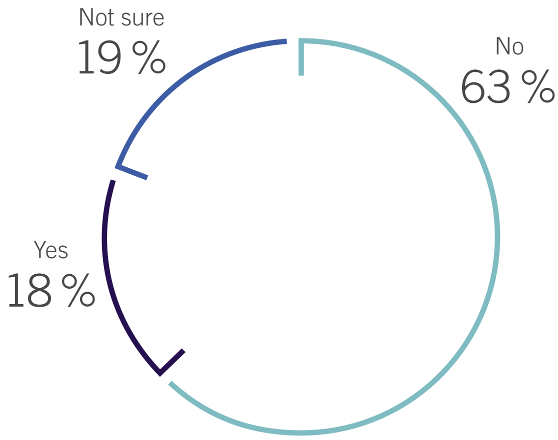
those insurers that engage in B40 insurance, ideally as part of a comprehensive B40 insurance strategy that goes beyond healthcare. In addition, another fundamental obstacle needs to be tackled: The lacking interest among the dominant distribution channels (i.e. agents) to sell small-volume policies to the B40. Other critical voices maintain that the benefits under mySalam are insufficient and, more generally, insurance is not suitable for solving deep-rooted social challenges such as rural poverty.

Having said this, most interviewees acknowledge that the B40 measures can help create awareness of the need for protection and the fundamental contribution insurance can make to it (see figure 22).

Figure 22: Will the B40 initiative make a real difference?



«One may argue that the B40 classification is too broad for designing and implementing effective public and private initiatives to tackle the underlying issue of severe protection gaps, for example in the area of critical illnesses. Narrowing down the focus on those who are the neediest may facilitate targeted measures, jointly driven by the public sector and the private insurance industry in Malaysia.»

Zainudin Ishak, CEO, Malaysian Reinsurance Berhad

When asked about potential alternatives to the current B40 programme, survey participants came up with the following suggestions:

- Subsidised compulsory insurance schemes, with agricultural insurance in China and India highlighted as success stories;
- Technology-enabled product design, distribution and claims settlement, with e-wallets given as an example that could boost the prospects of microinsurance;
- Increase the number of insurers servicing the B40 segment, for instance through capital relief or tax incentives;
- Public-private partnerships between insurers and government agencies that can help reach out to the B40;
- Dedicated public-private awareness programmes that improve leverage of existing available products;
- Innovative ways of premium payments, e.g. in instalments.

«Designing and transacting commercially viable insurance solutions for the B40 remains a challenge for Malaysian insurers. Many of them consider their related activities CSR rather than business. Again, technology could be a game changer when looking at the positive experience abroad, with mobile microinsurance or parametric cover, for example.»

Dato Majid Mohamad, Board Member, Maybank Ageas Holdings and Chairman, Etiqa General Takaful

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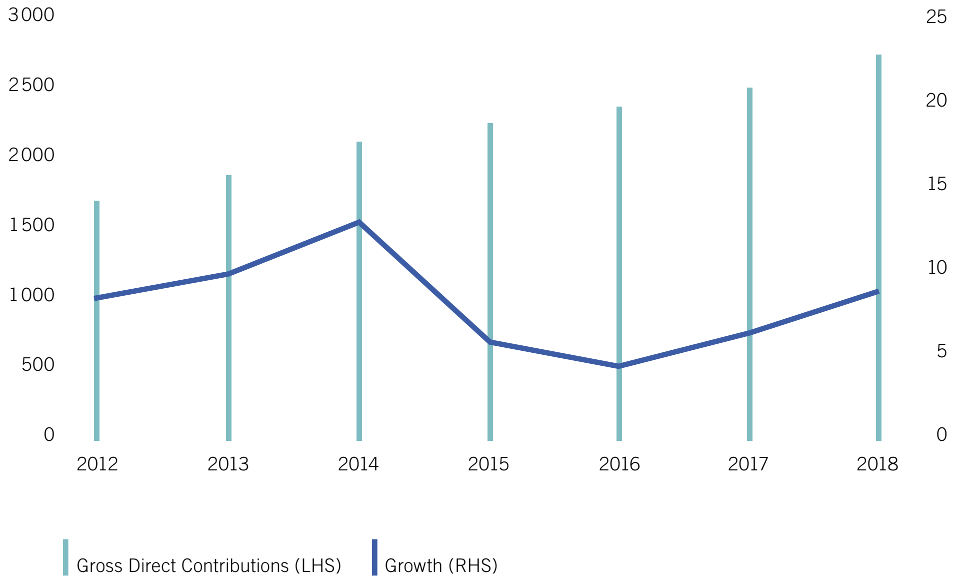
The prospects of General Takaful

In 2018, the general takaful sector expanded by a nominal 8.9 % to RM 2.79 billion, maintaining its growth outperformance over its conventional counterpart which grew by a mere 1.8 % (see figure 23). As a result, general takaful continued to gain market share in the domestic insurance market, accounting for 13.7 % of overall gross direct premiums and contributions (GDC), up from 12.9 % a year ago.

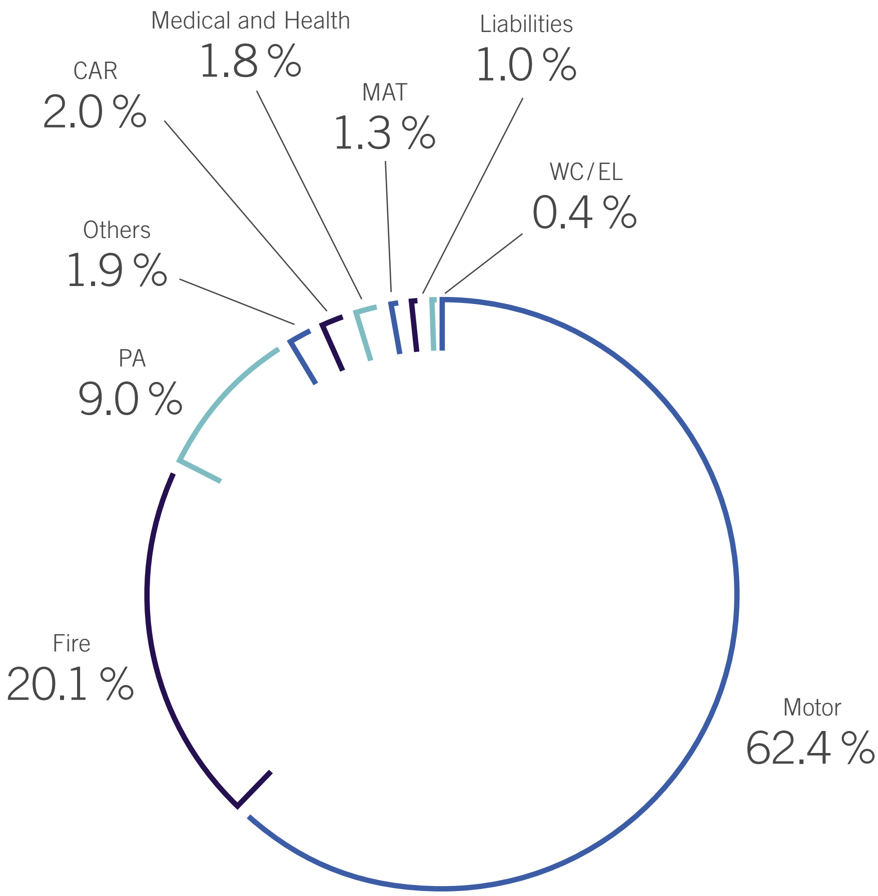
Figure 23: Gross Written General Takaful Contributions (in RM million) and growth (in %) (2012–2018)



Source: ISM, Statistical Yearbook 2018

Motor contributions accounted for 62 % of the total in 2018, followed by fire contributions with a share of 20 % (see figure 24). With a combined share of 82 %, the dominance of these two lines is even more pronounced than in the conventional general insurance market (67 %).

Figure 24: Breakdown of General Takaful's Gross Direct Contributions in 2018



CAR = Contractor's All Risks & Engineering
MAT = Marine, Aviation and Transit
WC/EL = Workmen's Compensation & Employers' Liability

Source: ISM, Statistical Yearbook 2018

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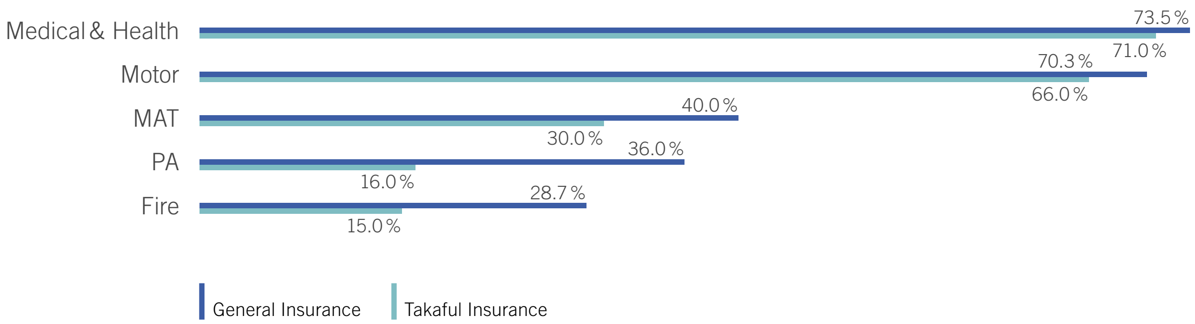
General Takaful loss ratios compare favourably with the conventional sector. The outperformance in 2018 over the dominant motor and fire lines of business amounted to 4 and 14 percentage points, respectively (see figure 25).

Figure 25: General Insurance vs. General Takaful: Loss Ratios by Class of Business 2018



Source: ISM, Statistical Yearbook 2018

Malaysia's general Takaful penetration (with contributions accounting for about 14 % of total general insurance premiums) compares favourably with Indonesia's 5 %, for example, despite the fact that the latter's Muslim population share of about 90 % is well in excess of Malaysia's 60 %. This lead is largely attributable to a robust regulatory framework, with the country being the first market in the world to implement a risk-based capital (RBC) framework for Takaful. There is also a requirement for companies to disclose their wakalah (agency) fees in their sales documents. In addition to providing robust regulations, the government has been offering support in terms of awareness building and providing suitable assets for investment. Also, Takaful players successfully launched innovative solutions such as universal life and accumulation / decumulation retirement products offering financial protection against longevity risk. On the general side, however, product innovation and differentiation relative to conventional counterparts remain limited.

Most expert and executive interviewees believe that the potential for Takaful in Malaysia is far from exhausted, not least because of the government's intent to encourage the provision of affordable insurance.

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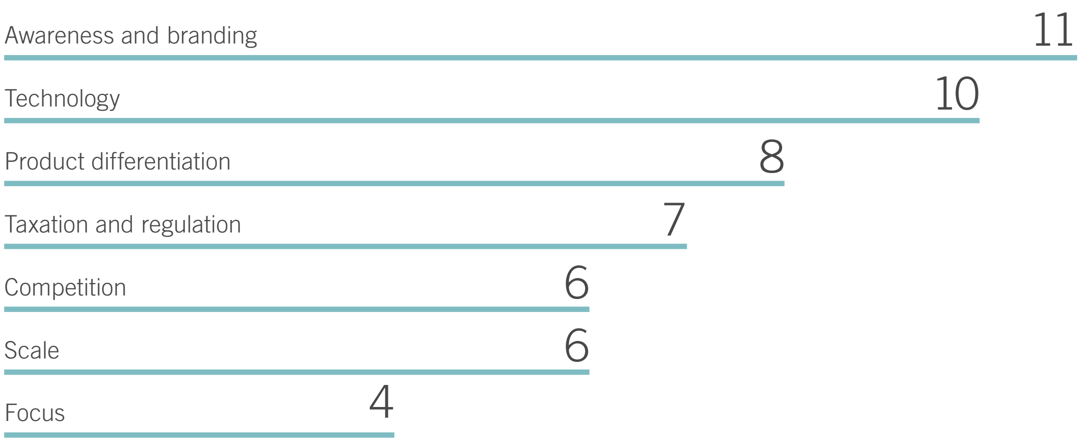
Figure 26 shows the most frequently mentioned recommendations as to what it would take to capture the full promise of Takaful. Awareness building and more effective branding rank first. Fundamental (and distinguishing) features such as profit sharing are still insufficiently understood. Technology is the second most frequently mentioned lever to pull. Takaful operators rely much less on agents than their conventional counterparts. Their bias towards direct distribution could give them an edge in terms of the adoption of technology to enhance the appeal and affordability as well as access to their products. Product differentiation features third. Many Takaful solutions simply cannibalise conventional business without offering a genuinely new proposition and merely following the conventional sector. A number of interviewees also believe that Takaful should benefit from tax breaks as well as capital relief which would be warranted by lower levels of guarantees. Further recommendations include more competition (4 general Takaful players may not be enough)[4], scale (the lack of which is considered a key competitive disadvantage compared with conventional insurers) and focus (Takaful operators are recommended to bundle their efforts towards the B40, rather than fishing in the same pond as their conventional counterparts. The B40 are believed to be particularly susceptible to the concept of risk and profit sharing).

Figure 26: What would it take for Takaful to achieve a significantly larger market share (number of mentions)?



4 By 2018, the previously composite operators (i.e. those selling both family and general Takaful business) were required by BNM to split into separate family and general entities. This requirement, coming with a minimum paid up capital of RM 100 million, led to a reduction of general Takaful operators to a mere 4.

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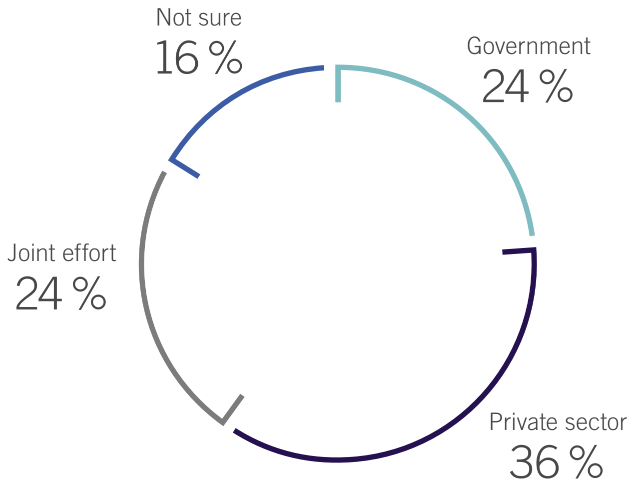
A relative majority of interviewees are of the opinion that the ball is in the private sector's court when it comes to fully capturing the potential of Takaful. Operators should step up their game in terms of product differentiation, pricing, innovation and distribution. In addition, there is believed to be a massive potential for accessing the B40 through digital or even non-smart mobile channels. 24 % contend that the government should be the driving force given its ability to promote awareness and education as well as to provide a more conducive regulatory and tax environment. The same share of respondents believe that the most promising way of further advancing Takaful is a ‹public-private partnership›, based on a comprehensive multi-stakeholder ‹Takaful strategy› (see figure 27).

Figure 27: Who should drive the future development of Takaful?

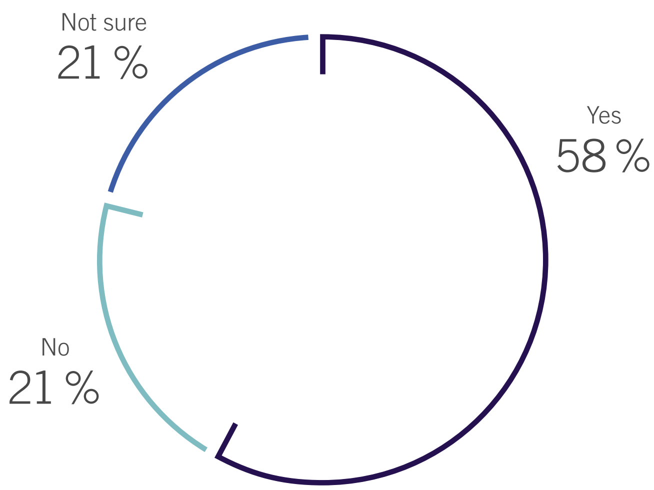


The role of Takaful in promoting financial inclusion and alleviating poverty has been discussed in both political and academic circles. Trokik (2017), for example, references studies that have shown that «individuals living in poverty have a desire to save and safeguard themselves against possible future risk but often lack the opportunity or support to do so. Insurance can provide the poor with coverage, reducing their vulnerability in terms of disease, theft, disability and other threats».[5]

Trokik also argues that the cooperative insurance structure might be best suited to provide insurance to the poor. Takaful, being very similar to cooperative and mutual insurance schemes, can, therefore, be considered a promising approach to alleviating poverty.

A majority of 58 % sees a strong case for Takaful to play a major role in delivering B40 insurance initiatives. Reasons given include the relative high share of Muslims among the B40 and the perceived superior effectiveness of Takaful (compared with conventional insurance) in building awareness of the benefits of risk pooling and sharing. Some of the more skeptical interviewees point to the fact that Takaful is largely irrelevant to the health sector which is at the core the B40 insurance initiative (see figure 28).

Figure 28: Should Takaful play a major role in delivering B40 initiatives?



5 Trokik, A. (2017), An Analysis of Takaful: The Potential and Role in Financial Inclusion and Challenges Ahead

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Embracing InsurTech

As technology transforms insurance and impacts virtually all elements of the value chain, there has been much debate among industry practitioners on how business models may evolve, for example from payer only to a more integrated and comprehensive partner model which draws on platform-based ecosystems. In addition, the long-term potential of digital distribution and aggregator technology are being vividly discussed.

Emerging Asian markets are seen as a particularly fertile ground for such innovative approaches. The region's young populations are very tech savvy. In addition, entrenched legacy systems (e.g. long-established distribution structures) are of lower relevance and regulation is frequently less heavy-handed, as compared with mature economies. Also, many high-growth markets in Asia offer a remarkable combination of high e-commerce and low insurance penetration, especially in general insurance, suggesting a major potential for technology-based insurance propositions.

Customers are expected to be the biggest beneficiaries of InsurTech, benefiting from better services, greater convenience, lower premiums and more personalized solutions. From a societal point of view, incentive-based products could lead to positive shifts in customer behaviours. Even marginal changes in the frequency of motor vehicle accidents, for example, can yield immense benefit to society.

Regulators are increasingly aware of this potential. Back in 2016, the Monetary Authority of Singapore (MAS) established a regulatory sandbox for FinTech, including InsurTech, providing start-ups with the opportunity to test their value propositions in the ‹sanctuary› of a low regulation environment. Shortly thereafter, BNM introduced a similar mechanism, not least against the backdrop of de-tariffication which will put a premium on data analytics capabilities that provide insights across underwriting, pricing, claims management as well as customer acquisition and retention. Similarly, in a liberalised environment, machine learning-based predictive tools and telematics are set to gain in importance for risk-based pricing and customer segmentation.

From a regional perspective, JLT (2019) identify the following key trends for InsurTech in Asia: First, an increasing collaboration between traditional (re)insurers and InsurTech start-ups; second, a growing number of digital insurance brokers and digital-only insurers offering both life and non-life products; third, the reduced complexity for obtaining a digital insurance license; fourth, the creation of regulatory FinTech sandboxes throughout Asian countries and, fifth, more insurers «pushing the envelope of distribution channels» by partnering with e-commerce platforms and other non-insurance players.[6]

Against this backdrop, we have probed the interviewees for their perception of insurance ecosystems' impact so far. The vast majority of 84 % consider such ecosystems still irrelevant and many believe that «there is talk only». Having said

6 JLT (2019): Insurance in Asia – InsurTech development

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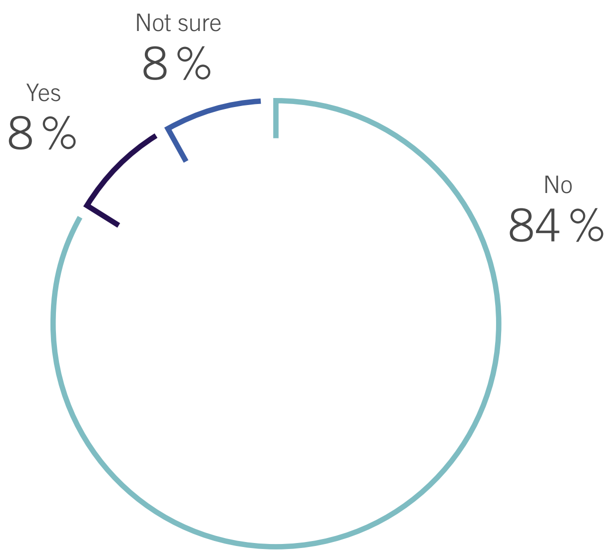
this, most experts and executives think that such ecosystems «will rise, but slowly». Consumers are not seen as being ready yet for such digital solutions. In addition, even the longer-term potential of digital insurance ecosystems is expected to be limited to the more generic low-premium segment which can be viewed as a plus from the perspective of financial inclusion.

Only a small number of interviewees believe that recently launched platform offerings such as apps for insurance have already made themselves felt in the Malaysian insurance market (see figure 29).

Figure 29: Have you seen any tangible impact of insurance-related ecosystems yet?



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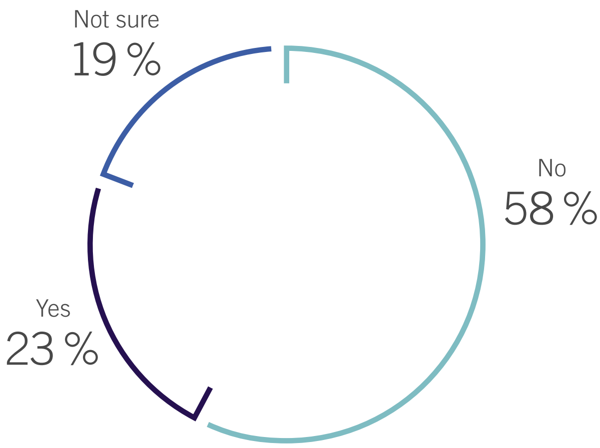
By 2022, will digitization have reshaped today's business models in Malaysia's general insurance industry? 58 % of the experts and executives polled are skeptical. They believe that claims will remain at the core of the insurance value proposition. In addition, the dominance of agency distribution makes insurers wary of channel conflicts and inclined to play it safe by maintaining, or at most, digitizing the status quo.

A significant minority of 23 %, however, expects the fundamental business model of insurance to evolve. While continuing to perform its core role as a reliable payer in the customer's «moment of truth», the insurer of the future is seen as adopting a more holistic approach to customer interaction and risk management. The long-held paying role would be complemented by the dimensions of partnership and risk prevention (see figure 30).

De-tariffication is considered a catalyst for the transition to a broader business model of insurance. It not only adds to the need to embrace technology but also introduces new elements to competition such as personalized services and advisory.

Figure 30: By 2022, do you expect major changes to existing business models in the Malaysian insurance market?



«With the advent of digitalization, human capital management will further grow in strategic importance. On the one hand, automation will require to reskill many employees. On the other hand, insurers need to attract new competencies and skills such as social media management or data science, competing with other industries in a talent market with severe shortages.»

Ng Kok Kheng, CEO, Great Eastern General Insurance

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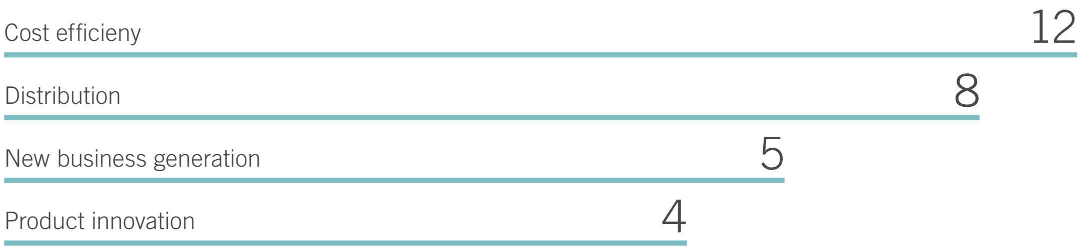
Figure 31 reveals that most experts and executives look at InsurTech through the lens of operating expenses. Capturing cost synergies and efficiencies is seen as the ‹lowest hanging› fruit of InsurTech by many. Distribution benefits in terms of increased effectiveness and efficiency of existing and new channels are the second most frequently mentioned benefit. New business generation, primarily on the back of improved access to existing and prospective customers ranks third. Product innovation, based on personalized added-value services, comes in fourth.

Figure 31: What is the single most important area of InsurTech potential? (number of mentions)



«Mobile technology could be a real game changer for insurers in terms of reaching out to the B40. It enables entirely new ways of designing, marketing, distributing, administering and servicing low-premium policies. In view of these much improved economics of serving the underserved, the insurance industry could achieve real breakthroughs in insurance penetration, in a way that also makes commercial sense.»

Chua Seck Guan, CEO, MSIG Insurance (Malaysia) Bhd

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The dark side of digitization: Cyber risk

As a flipside of digitization and the rapid development of interconnectedness, based on the Internet of Things, artificial intelligence and robotics, cyber risks are growing exponentially. The latest study on the «economic impact of cybercrime» puts the global cost of cybercrime at 0.6 % to 0.8 % of global GDP, or about USD 450 to 600 billion – per annum. This figure includes direct losses from cyber-crime, the cost of securing networks, reputational damage and liability risk for the hacked company, to name just the main cost factors.[7]

Among the major risks covered by cyber insurance are large data breaches and catastrophic events such as the outage of a major cloud service provider or a global spread of malware. A recent study by Lloyd's and AIR identifies cloud providers as a source of large systemic risk and presents economic loss scenarios of up to USD 15 billion, with about 80 % of the losses remaining uninsured.[8]

Against this backdrop, global demand for cyber insurance solutions has grown sharply over the past few years. The stand-alone cyber market is now worth around USD 4.5 billion, of which the US market accounts for 80-90 % of the global total, and the EU for less than 10 %. This market segment is primed for double-digit growth for the next five to ten years and expected to reach around USD 20-25 billion by 2025.[9]

Cyber insurance still faces fundamental constraints. A first challenge to insurability is the lack of predictability of cyber losses which are mostly of criminal nature. As a result, risk pooling hits its limits. Exposures are largely unpredictable not only because of a lack of data (which is set to accumulate over time) but more fundamentally in light of the dynamics of cyber risks and the associated risk of change which complicates risk assessment. A second insurability challenge is accumulation of losses. Cyber is one of the few genuinely global risk exposures, which presents severe quantification challenges. A third hurdle to insurability is asymmetric information. Adverse selection is almost inevitable as organisations that have experienced cyber incidents before are more likely to buy insurance. The lack of loss data impairs the risk classification of policyholders and in turn renders adverse selection even more acute.[10]

7 Mc Afee (2018), The economic impact of cyber crime
8 Lloyd's and AIR (2018), Cloud Down: Impacts on the US economy
9 European Insurance and Occupational Pensions Authority (EIOPA), EU-U.S. INSURANCE DIALOGUE PROJECT – the cyber insurance market.
10 Schanz, K.-U. (2018), The global insurance protection gap – A holistic update, The Geneva Association.

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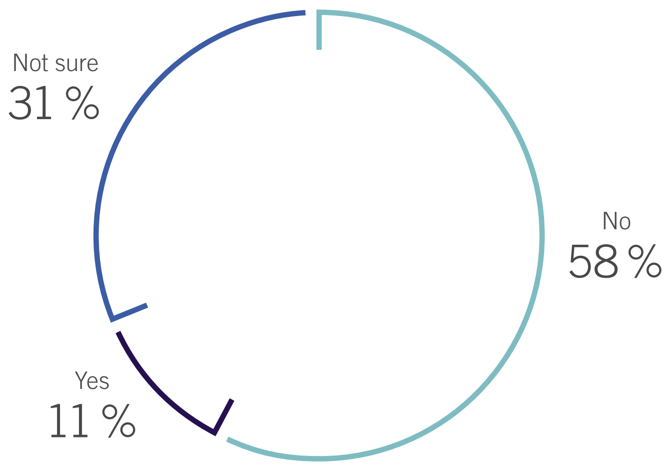
58 % of interviewees do not consider cyber insurance relevant to Malaysian retail or commercial policyholders. Some cover has been purchased by wholesale customers and much fewer by SMEs. As in mature markets, in personal insurance, cyber cover is virtually non-existent. In some instances, cyber is sold bundled with other insurance products. As reasons for this low penetration, interviewees mention prohibitive rates, limited awareness (also due to a relatively low frequency of incidents) and a lack of conducive legal and regulatory frameworks (see figure 32).

Figure 32: Cyber insurance: Is it relevant to retail and wholesale policyholders?



«We see great opportunities in developing those parts of the retail market which are yet untapped. Firstly, there is the lower ticket business, like personal accident, which is still largely underinsured. Secondly, home insurance offers substantial growth potential because thus far it is predominately sold as collateral for housing loans and thirdly, there is the whole SME segments, which is still underserved.»

Emmanuel Nivet, CEO, Axa Affin General Insurance

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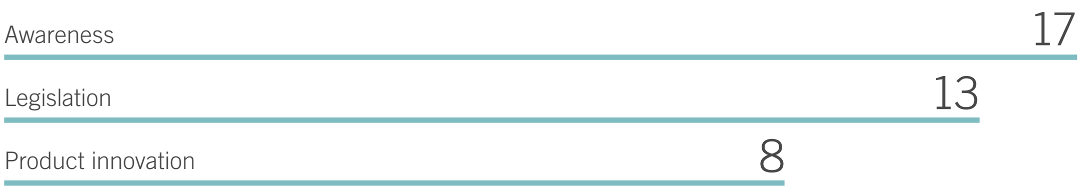
The most frequently mentioned approach to boosting cyber insurance in Malaysia is awareness building, especially with personal and small commercial lines customers. There is still a very limited understanding of the potential scale and scope of cyber disruptions and associated exposures. The role of insurance in mitigating any adverse impacts is equally ill-understood.

Legislation is seen as the second most important stimulus for cyber insurance in Malaysia. Some interviewees refer to the EU's General Data Protection Regulation (GDPR) Directive. Its comprehensive disclosure and remediation requirements for data breaches have led to a marked increase in demand for cyber insurance.

Product innovation ranks third. Examples given include policies that do not only cover business interruption but also contingent business interruption for certain losses incurred as a result of cyber-attacks in the supply chain. Also, cyber insurers could expand their offerings to include services which help to bring down the frequency and severity of cyber breaches. It is often in the advice and technical support that insurers can provide where much of the real value lies, especially from the perspective of smaller, less sophisticated clients such as SMEs (see figure 33).

Figure 33: Cyber insurance: What would it take to spur demand? (number of mentions)



We also enquired about interviewees' estimate or guestimate of the current size of the Malaysian cyber insurance market. Only a handful of respondents felt comfortable providing an indication, ranging from 10 million to 60 million RM of annual premium volume.

«The guiding principle for our investments into our company's digitization is that we want to strengthen our engagement with our clients. We benefit from a strong agent network. And we want to empower this distribution force through digital tools to be even more effective and increase their sales.»

Eric Chang, CEO, AIA General Berhad

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Financial Strength Rating of 'A' Strong (Stable Outlook) by Fitch Ratings

Financial Strength Rating of 'A-' Excellent (Stable Outlook) by A.M. Best

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