

DEVELOPMENT OF BANCASSURANCE IN MALAYSIA

Introduction

Bancassurance broadly refers to the collaboration between banks and insurers to distribute insurance products to bank customers. Bancassurance strategies have enjoyed considerable success in Europe for some time, where an estimated two-third of life insurance and pensions business is transacted by banks in the leading markets of Spain, Portugal and France.

In contrast, bancassurance in Asia has been a relatively recent phenomenon, drawing increasing attention as a rapidly growing distribution channel for insurance only since 2002. Notwithstanding its short history, bancassurance penetration in the region has increased tangibly to capture market shares in excess of 20% of life premiums in the more developed bancassurance markets within Asia. A similar trend across the wider region is set to emerge as broad-based regulatory reforms and financial deregulation pave the way for banks and insurers to strike strategic partnerships which were formerly restricted by regulation.

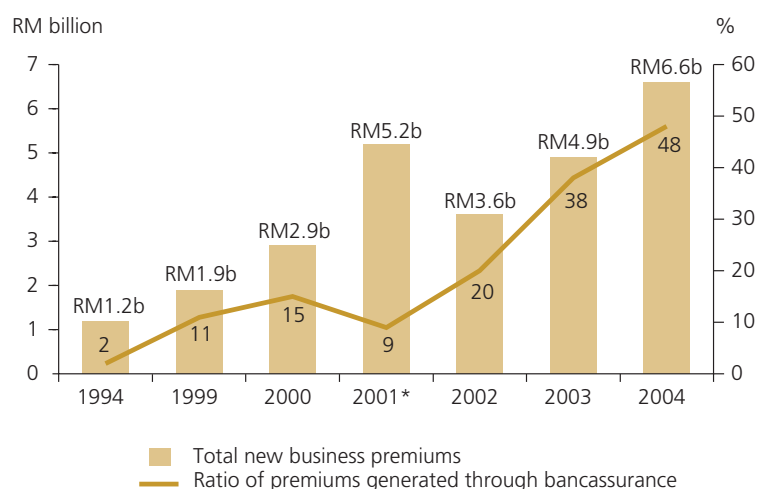
These developments are set to substantially alter the financial landscape in Asia. Against that backdrop, this article provides an overview of bancassurance trends in Malaysia, major regulatory initiatives and its future prospects.

Key Trends and Drivers

The first bancassurance arrangement in Malaysia was approved by Bank Negara Malaysia (the Bank) in late 1993. In 1994, premiums generated through bancassurance represented less than 2% of new premiums in the life sector. Since then, bancassurance penetration in the life sector has achieved remarkable growth, ushering in a more diversified distribution system from one largely dominated by the agency force in the past.

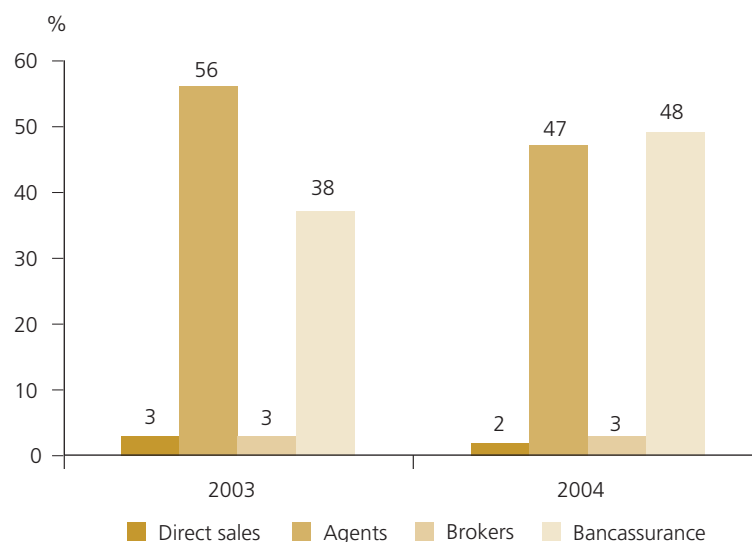
As at end of 2004, bancassurance has evolved into a primary distribution channel for life insurance, capturing 48% of new life premiums written in the industry (Charts 1 and 2).

Chart 1
Bancassurance Penetration



* Due to enlarged new business arising from the EPF annuity scheme, which was mainly generated through the agency force.

Chart 2
New Life Business Premiums by Distribution Channels



Consistent with observations in most other bancassurance markets, bancassurance penetration is significantly lower in the general insurance sector, with only 7% of the industry's gross premiums sourced through bancassurance in 2004.

The key drivers behind the significant growth of bancassurance in Malaysia stem from the new business opportunities and competitive leverage that it presents to both banks and insurers seeking to maintain or expand their market shares in an increasingly dynamic environment.

The long-term nature of life insurance adds favourably to income stability, thereby improving the banks' prospects for more sustainable performance and profitability. With the more competitive pricing of banking products as a result of increased competition, more banks are seeking to supplement their core earnings with commissions and fee-based income through bancassurance opportunities.

Banks can also expand their traditional product offerings to include complementary insurance products in order to meet the more diverse needs of their customers. This increases customer retention by enabling banks to provide comprehensive wealth management services tailored to the life-cycle of customers, as well as to reach new markets. Another major attraction of bancassurance for banks is the ability to make more productive use of their extensive customer database and established branch network to substantially increase income at relatively lower incremental costs on infrastructure.

For insurers, bancassurance offers a significant opportunity to expand their customer base. With the penetration of banking services estimated at 98% of the population aged between 18 and 64, and close to 2,300 bank branches located throughout the country, the banks' ability to mine the customer database constitutes a significant market potential for insurers. This potential is further enhanced by the fact that less than 8% of Malaysians that use banking services are estimated to have relationships with their banks that include insurance products and services.

The quality and organisation of customer information maintained by banks is also generally considered to be superior and dynamic, rendering it particularly suitable in enabling insurers to

segmentise markets into more refined strata groups according to differing customer profiles. This, in turn, enables insurers to design products that can be customised to specific target markets, and achieves more focussed sales efforts. The resulting effects are substantially higher rates of successful sales, lower unit distribution costs, increased productivity and ultimately, higher profitability for insurers.

Bancassurance Opportunities	
For Banks	For Insurers
• Greater income stability • Expand product offerings • More productive use of customer database and branch network	• Expand customer base • Enhance ability to segmentise markets to support more effective product design and marketing efforts • Lower distribution costs

Bancassurance also offers benefits to consumers in the form of convenient access to a wide range of integrated financial services from a single provider, and more competitively priced insurance products as a result of insurers passing on cost savings arising from lower distribution costs. The more effective use of technology and higher investments in the development of human resource competencies by banks and insurers to support the increased customer focus that is central to an effective bancassurance strategy, is also favourable to consumers. Over time, this is expected to lead to significantly improved services to consumers and thereby, a higher overall level of consumer satisfaction.

Products

Bancassurance products in Malaysia may be broadly categorised into credit-related and non-credit related products.

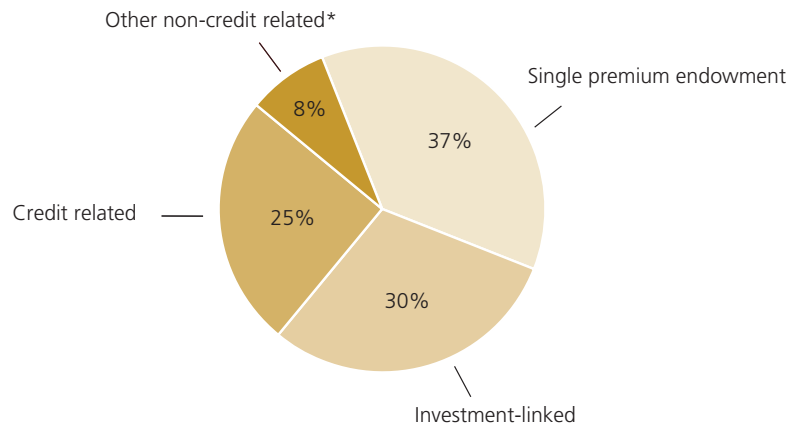
In the life insurance sector, credit-related insurance products accounted for 25% of new life business premiums generated from bancassurance in 2004. The most common credit-related products are consumer credit insurance products purchased by borrowers in connection with mortgages, vehicle loans and overdraft facilities provided by banks.

Non-credit related insurance products feature far more prominently in bancassurance arrangements in the life sector. Such products accounted for 75% of new bancassurance business generated in 2004. Of this, investment-linked and short-term endowment policies were the two most dominant products, constituting 67% of the new life business premiums generated from bancassurance (Chart 3).

These are largely simple, single premium products that incorporate guaranteed returns at maturity, with a substantial savings content and a low level of insurance cover. The products are typically designed to require minimal underwriting in order to simplify the sales effort by bank staff.

Other non-credit related bancassurance products consist primarily of education, traditional whole life and medical insurance policies, but these tend to be far less prevalent given their more complex features and corresponding need of consumers for more intensive advice to understand them.

Chart 3
Distribution of Life Products Through Bancassurance



* Including education, whole life and medical policies

In the general insurance sector, bancassurance products are predominantly credit-related personal-line products including residential fire and motor insurance policies. In addition, non-credit related products in the form of personal accident policies are also widely available through bancassurance.

Business Models

The three predominant bancassurance models currently found in Malaysia are referral arrangements, distribution agreements and integrated services. Their main features are summarised below:

	Referrals	Distribution Agreements	Integrated Services
Description	Insurer is placed on the panel of a bank for the provision of certain insurance covers (typically credit-related) to the bank's customers.	An agreement (which may or may not be exclusive) between a bank and an insurer under which the bank agrees, for a commission or fee, to actively promote the insurance products of its bancassurance partner to its customers.	- Integrated front and back-end operations between a bank and an insurer to deliver banking and insurance products to customers in a seamless manner. - Underlying such arrangements is usually an equity relationship between the bank and its insurance partner.
Degree of bank's involvement in insurance sales effort or delivery of after-sales insurance services	Minimal involvement as insurance is consequential and closely tied to financing arrangement.	- Ranges from relatively low involvement, e.g. where the bank merely agrees to distribute promotional insurance material to pre-selected bank customers and is paid commission for each successful sale closed, to a high level of involvement by the bank staff in offering insurance products to prospective insurance customers identified as 'warm leads'. - Bank staff may also be involved in the provision of after-sales service, although this is more often undertaken by the insurer.	- High degree of bank involvement, ranging from prospecting of potential clients, closing of insurance sales to claims servicing. - Fully integrated operations and systems between the bank and the insurer, as well as the common branding of banking and insurance products, usually support the integrated model.

	Referrals	Distribution Agreements	Integrated Services
Product offerings	• Credit-related products. • Common products are mortgage reducing term assurance, houseowner's and fire insurance.	• Includes non-credit related products. • Usually simple insurance products, including single premium endowment and investment-linked products with minimal insurance cover.	• Insurance is offered as part of a broad range of financial product offerings. • Common products include education and investment-linked policies. • Fully integrated products that include both banking and insurance components may also be available (e.g. fixed deposits where interest accrued is used to purchase units in investment-linked funds managed by the insurer).

At present, bancassurance strategies in Malaysia are primarily focussed on the distribution agreement model, which accounted for 96% of all bancassurance arrangements (excluding referral arrangements) in the market as at end January 2005. Also common in the market, albeit less prominent, are referral arrangements, as banks are required by regulation to include a minimum of four insurers on their panel for credit-related insurance referrals in order to preserve the right of consumer choice.

Integrated services models are much less common, with only one such arrangement currently operating in the market. However, such arrangements are drawing increasing interest among financial service providers, with two financial service groups already establishing a bancassurance strategy modelled on the basis of integrated operations.

Prospects

The penetration level, product range and organisational models featured in the Malaysian market are indicative of a relatively advanced stage of development of bancassurance. More specifically, the current status of bancassurance as a primary distribution channel for insurance products, high proportion of non-credit related business featured in bancassurance arrangements, and growing emergence of fully integrated bancassurance tie-ups are consistent with observations in the more developed bancassurance markets. Although the industry remains some way from achieving the level of sophistication seen in Europe, these elements will nevertheless stand the industry in good stead to support the continued future growth of bancassurance.

The competitive forces described earlier behind the growth of bancassurance to date are expected to continue to drive the development of bancassurance going forward. In addition, prospects for its further growth and development also remain strong on account of the following:

- the low penetration rate of life insurance at 37.9%, coupled with the increasing sophistication of consumers, point towards a large untapped market potential;
- single product relationships, mainly in the form of savings or current accounts, continue to dominate retail banking in Malaysia, underscoring the scope that still exists for banks to more effectively leverage on banking relationships with their customers by offering an expanded product range, including insurance products and services;
- personal visits to bank branches are still common (averaging at more than two visits per month) among Malaysians, indicating valuable opportunities for banks to have access to face-to-face contact with customers that are already pre-disposed to considering insurance solutions to meet their diverse financial needs; and
- the high level of confidence and trust generally placed by the public in banks make them

particularly well-positioned to attract consumers to purchase life products from their distribution outlets. The strong preference among consumers for insurance products with a high savings content further enhances the complementary effects between life insurance and banking products, rendering life policies a natural extension of the product range offered by banks.

Despite its promising prospects, the majority of financial service groups with cross-holdings in banks and insurers have yet to fully tap the enormous potential of bancassurance opportunities.

Regulatory Initiatives

The development of bancassurance is being undertaken within the context of efforts to promote a more efficient financial system in Malaysia by improving the delivery and distribution systems for financial services. With this in view, regulatory measures in respect of bancassurance are aimed at achieving a cost-effective alternative channel for the distribution of insurance products to complement banking products in meeting the wealth management needs of consumers. This, in turn, is expected to contribute towards the more diversified and efficient allocation of savings across the financial sector.

Specific regulatory measures implemented by the Bank to promote the orderly development of bancassurance include the following:

- the introduction of a more flexible commission structure for the sale of life insurance products through bancassurance, previously limited to fixed commission limits in the first three policy years not exceeding 50% in aggregate of corresponding annual premiums. Under revised guidelines issued by the Bank in December 2004, insurers are permitted to structure the commission levels based on negotiations with their bank partners, subject only to a minimum commission spread (explained below) and a maximum overall limit in present value terms to ensure that insurance products remain competitive in terms of returns to consumers relative to other savings-type products available;
- a requirement for insurers to spread the payment of commissions meaningfully over a minimum period of up to 10 years for annual premium life policies. The requirement serves to avoid high front-end loaded commissions in the first years of the policy and ultimately, provides incentives for banks to continue servicing customers effectively after the close of a sale;
- for new life insurance products introduced after 15 December 2004 with a savings component, insurers will be required to reflect any savings from lower distribution costs arising from bancassurance arrangements in lower premiums or better benefits to consumers;
- for such products, banks will also be required to disclose charges borne by consumers in order to facilitate comparison with other savings and investment alternatives. Disclosure of commissions which are imputed in the premiums paid by consumers, as well as other charges not included in the premium must be made. Such disclosures must also be presented in clear terms in the sales and marketing material used by banks, and explained by the banks' staff to prospective consumers; and
- in tandem with higher qualification requirements introduced for insurance agents in 2004, and to ensure consistent standards of professionalism and market conduct among insurance intermediaries, staff of banks involved in the marketing of insurance products are also required to comply with the same minimum qualification and continuous professional development requirements, as well as the code of conduct and ethics, applicable to insurance agents.

Creating Conducive Environment for Bancassurance Development

The Bank will continue to provide an enabling environment for the orderly growth and development of bancassurance through an appropriate balance between encouraging

competition and innovation, while maintaining stability. In particular, the Bank will maintain the necessary degree of regulation with regard to bancassurance to maintain confidence in the insurance and banking systems. This includes appropriate regulations to protect the confidentiality of customer information as well as the right of consumer choice to a wide range of products, service providers and distribution channels.

Fundamentally, the development of bancassurance will further contribute to the modernisation of Malaysia's financial system by:

- promoting a more competitive environment through the evolution of a multi-channel distribution system for insurance products; and
- facilitating product and service innovation in the delivery of financial services by combining the best of the expertise and key business strengths of banks and insurers.