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Policies and Developments

Policies and Measures to Strengthen the Insurance Industry

Implementation of the Financial Sector Masterplan
A significant development in 2001 was the launch of the Financial Sector Masterplan (FSMP) on 1 March 2001 to chart the future direction of the financial system over the next 10 years. The primary aim is to develop a more resilient, competitive and dynamic financial system that is able to support and contribute positively to overall economic growth and stability. As the insurance industry is an important component of the financial system, the FSMP incorporates specific recommendations to build an efficient, effective and stable insurance sector.

Bank Negara Malaysia's (BNM) immediate priority in the implementation of the FSMP is to advance capacity and capability building initiatives as a foundation for the development of the domestic industry. This will be largely achieved by adapting and strengthening the regulatory framework to enhance consumer protection and encourage improved performance, industry consolidation and the adoption of best practices benchmarks. To this end, the following recommendations under Phases I and II of the FSMP were implemented in 2001:-

- the statutory minimum paid-up capital requirement for direct insurers was raised from RM50 million to RM100 million with effect from 30 September 2001 in a move to strengthen the financial resilience of insurers and increase economies of scale needed to compete effectively. As at 1 January 2002, 37 of the 50 direct insurers (excluding two insurers which had executed the transfers of their insurance business to other insurers on 12 December 2001 and 1 January 2002 respectively) had complied with the minimum paid-up capital requirement. Of the remaining 13 insurers, 10 insurers had adopted mergers and acquisitions (M&A) as a strategy to comply with the requirement, which saw further progress made in the consolidation of the industry. Since September 1999, eight M&A involving 16 insurers had been completed. Another seven M&A proposals involving 13 insurers (including the 10 insurers which had adopted M&A as a strategy to comply with the RM100 million minimum paid-up capital requirement) were at various stages of implementation as at end January 2002. Three other companies are finalising steps to raise capital to the required minimum. In the face of mounting competitive pressures, the consolidation of the industry to create a core of financially stronger and economically viable insurers will continue to feature significantly on the regulatory agenda as a key strategy to secure a smooth transition to a liberalised market environment;

- with effect from April 2001, all insurers with the requisite minimum risk management and security systems in place were allowed to offer the full range of life and general insurance products on the internet. As at 31 December 2001, a total of 12 insurers had been given approvals to provide insurance over the internet, including eight insurers which can offer motor insurance policies on-line through an interactive website; and

- since May 2001, approvals were given for a number of insurers to distribute a broader range of personal financial service products to enable them to leverage on their existing distribution networks.

Other recommendations which are being finalised for implementation in 2002 include:-

- the development of a framework for the introduction of independent financial advisers (IFAs) who would be allowed to market a broad range of financial products. Besides providing an alternative distribution channel for the sale of life insurance products, the introduction of IFAs would enable Malaysian consumers to obtain professional independent advice on financial options, including insurance, that would most effectively meet their financial needs;

- the adoption of 'best-advice' practices to enhance the accountability of intermediaries in the marketing of life insurance products. The practices seek to ensure that due diligence is exercised by intermediaries in obtaining sufficient information about a client before rendering advice on a particular insurance product to suit the needs of the client; and

- the removal of restrictions on the outsourcing of non-core business activities to allow greater operational flexibility to insurers to develop their core competencies and effective business strategies. With effect from 1 January 2002, the limits on the amount of funds that insurers may place under the management of approved fund managers were relaxed.

The successful implementation of the FSMP will also require the careful sequencing of measures, taking into account both the progress of domestic players in meeting the sophisticated needs of consumers, to minimise instability during the change process while ensuring progressive and sustainable reform. This will be facilitated by periodic reviews of progress made by the industry under the FSMP in relation to best practice benchmarks. For this purpose, performance measures and benchmarks are being developed to assess the extent to which the objectives of recommendations under each phase of the FSMP have been achieved before subsequent measures are implemented.

The insurance industry has been proactive in the implementation of the FSMP. Following the release of the FSMP, the Life Insurance Association of Malaysia (LIAM) and Persatuan Insuran Am Malaysia (PIAM) organised separate focus sessions on the FSMP for the chief executive officers and senior management of insurers in August 2001. The sessions served to identify priorities and offered broad strategies and action plans for the industry to move forward in preparing to meet the challenges of a more competitive market.

Response to the Impact of September 11 Events

The events of September 11 in the United States were the largest insured losses event to occur in the history of the industry. Although the repercussions of the tragedy in terms of cost and impact on international market capacity have not been fully established, the domestic market capacity sustained immediate spillover effects as a result of premium rate increases and the reduction and withdrawal of covers for certain risks following the hardening of the international reinsurance market.

To alleviate the immediate problem of inadequate insurance cover available to the domestic airline and shipping industries, the Malaysian Government finalised an interim agreement in September 2001 to indemnify Malaysian Airlines System for claims in excess of USD50 million up to a limit of USD2 billion per aircraft in respect of third party legal liability arising from war. Pending the restoration of adequate insurance protection from the international insurance market, BNM is working closely with the relevant Ministries in the Government and the industry to explore several alternatives through which assistance could be provided to ensure the continued availability of insurance coverage at a reasonable cost for vessels transporting export commodities to war zone areas. While terrorism cover has been excluded from all general insurance policies (following the withdrawal of reinsurance cover for such risks) with effect from January 2002, BNM has ensured that terrorism cover is available for risk owners as a separate cover. BNM is also working with the industry to develop a long-term solution to provide the coverage locally at a more reasonable rate.

Although any direct financial impact of the September 11 events on domestic insurers has not been significant, insurers have been directed to review their reinsurance programmes and continuously evaluate the financial soundness of their reinsurers. BNM will continue to monitor any financial impact on the domestic industry from changes in the overall loss estimations associated with the attacks and will take necessary remedial measures in cooperation with the industry to mitigate and manage any repercussion on the industry.

Other Policies and Measures Implemented to Strengthen the Insurance Industry
During the year, BNM also implemented various other measures to promote the orderly development of the insurance industry and greater transparency in financial reporting and in the conduct of insurance business. These include:-

- **Anti-Money Laundering Measures**
  BNM continued to focus on the integrity of the insurance system so that it is not in any way compromised by criminal activities. In this connection, BNM issued the "Guidelines on Anti-Money Laundering Measures for the Insurance Industry" on 25 April 2001 to facilitate the prevention and detection of money laundering in the insurance system. It is imperative that the insurance industry is not used as a conduit to launder proceeds from criminal activities in order to safeguard against legal and reputational risks. The Guidelines set out an anti-money laundering framework (AML framework) as a guide to insurance licensees in the implementation of policies, procedures and controls to counter money laundering. The AML framework emphasises the duty of vigilance on insurance licensees, including proper identification of persons they are dealing with, keeping of records, recognition and reporting of suspicious customers or transactions as well as adequate training of relevant personnel. A significant step forward in combating money laundering is the enactment of the Anti-Money Laundering Act 2001 (AML Act). The AML Act came into force on 15 January 2002 and the Minister of Finance has appointed BNM as the Competent Authority with effect from the same date. The AML Act empowers the competent authority to implement measures for the prevention and detection of money laundering.

- **Model Accounts for Insurers**
  The model accounts issued by BNM in 1995 to harmonise the reporting format for financial reports of insurers were reviewed and updated in 2001 to incorporate requirements of the new accounting standards issued by the Malaysian Accounting Standards Board (MASB). The review, which was undertaken by a working group comprising representatives from the Malaysian Association of Certified Public Accountants, BNM, MASB and insurers, would also ensure that disclosures in the financial statements of insurers are brought in line with international standards. The revised model accounts are being finalised by the working group for adoption in 2002.

- **Medical and Health Insurance**
  In the light of the progressively increasing demand for medical and health insurance and its social implications for the society at large, LIAM and PIAM, in consultation with BNM, formulated guidelines on the underwriting of medical and health business by insurers. The guidelines seek to establish the minimum underwriting standards and controls to ensure that the business is underwritten on the basis of sound and prudent insurance principles. To support the future development of the business, PIAM also established a medical and health insurance database that would enable its member companies to track loss ratios by sub-product lines. The database became effectively operational with the submission of full statistics by general insurers from 1 January 2002.

  The insurance associations have also urged their member companies to adopt the standard wordings issued by the associations for hospitalisation and surgical insurance policies to harmonise the description of such items as benefits, definitions, conditions and exclusions of cover across the industry.

- **Sale of Insurance through Multi-level Marketing Organisations**
  In April 2001, following a series of complaints against multi-level marketing (MLM) companies, LIAM and PIAM enforced a prohibition among their member companies against the

distribution of insurance products through MLM organisations which were not agents registered with either one of the associations. The prohibition aimed to secure the protection of consumers by ensuring that only qualified professional intermediaries are involved in promoting or selling insurance on behalf of an insurer.

Life Insurance

In the life sector, further progress was made to raise the standards of professionalism in the marketing of life insurance products, both in response to, and in anticipation of, the changing nature of products and services offered in the market. Among the measures taken in 2001 were:-

- **Certificate Examination in Investment -Linked Life Insurance (CEILLI)**
  To ensure that agents have the proper skills and knowledge to market investment-linked products which were becoming increasingly popular among the insuring public, the CEILLI was introduced as the minimum required qualification for the sale of investment-linked products. The qualification seeks to ensure that prospective policy owners are well informed of the extent and nature of investment risks associated with the product which are borne directly by policy owners. With effect from 1 January 2001, all agents are required to pass the CEILLI conducted by the Malaysian Insurance Institute (MII) before they are allowed to sell investment-linked products.

- **Diploma in Financial Planning**
  In preparation for the introduction of IFAs in the market, a joint working committee comprising representatives from BNM, LIAM, the MII and the National Association of Malaysian Life Insurance and Financial Advisers was tasked to develop a recognised Malaysian-based qualification for the appointment of IFAs by adapting and customising the Diploma in Financial Planning (DFP) programme currently offered by the MII. Qualified individuals will be conferred the title of Malaysian Financial Planners by the MII. The syllabus and course materials for the DFP are being finalised for expected implementation in 2002.

- **Review of Interest Rates of Non-guaranteed Benefits**
  Given the continued low interest rate environment, LIAM revised the maximum interest rate applied in the pricing assumption for non-guaranteed benefits under life insurance policies from 8.5% to 7.5%. The rate applied to determine the bonus reserve valuation was correspondingly reduced to not more than 8%. The adjustments were necessary to reflect the realistic investment earnings of insurers and to ensure that insurers are able to meet their long-term obligations as illustrated to policy owners. Life insurers would start implementing the revised rates from February 2002 for all new products while existing life insurance products would need to be re-priced accordingly.

General Insurance

The year also saw significant developments in the general insurance industry, particularly in the motor insurance sector, many of which were made possible with the increased utilisation of technology in the conduct of general insurance business. These include:-

- **Motor Insurance Initiatives**
  PIAM and BNM undertook the following initiatives aimed at improving market practices in the settlement of motor insurance claims and further strengthening controls against the perpetration of fraud in the industry:-

  (i) Centralised Database for Motor Repairs Estimation
  Effective 1 October 2001, all insurers were required to refer to the centralised database on motor spare parts, prices and labour time developed by Motordata Research Consortium Sdn. Bhd. (MRC) for motor claims estimation. MRC was appointed by PIAM to develop and maintain the centralised database for

its members. The access by relevant market players to a single database is expected to substantially reduce the subjectivity in motor claims assessments, thereby minimising disputes in the industry over claims against insurers for repair costs.

(ii) Amendment to the Knock-for-Knock (KfK) Agreement

With effect from 1 June 2001, an amendment was made to the KfK Agreement to provide a vehicle owner involved in an accident that is evidently not his fault with the option of either making a claim against the insurer of the party at fault or directly against his own insurer without affecting his No-Claim-Discount (NCD) entitlement. Besides expediting payments for vehicle repairs to the benefit of vehicle owners, the arrangement would also enable insurers to obtain access to earlier information on the damage to the vehicles insured by them, and exercise better control over the claims settlement process. Vehicle owners can direct claims to their own insurers by completing the normal claim form and providing the necessary documents including copies of the police report, insurance policy and driving licence.

(iii) On-line Submission of Motor Cover Notes to the Road Transport Department (RTD)

The electronic link-up between insurers and the RTD for on-line submission of motor insurance cover notes by insurers to the RTD for the purpose of road tax issuance was launched in the Klang Valley in the second half of 2001. The link-up is expected to address the problem of forged cover notes in the industry and hence, uninsured vehicles on the road, besides facilitating the more efficient and timely exchange of relevant information between the RTD and insurers. Once the link-up is extended nationwide, only electronic cover notes submitted by insurers will be accepted by the RTD as valid insurance cover for road tax purposes.

(iv) PIAM Approved Repairers Scheme (PARS)

In February 2001, PIAM completed a review of the PARS to improve the selection criteria applied for the inclusion of workshops in the panels of insurers. Under the revised criteria, greater emphasis is placed on equipment standards, the level of manpower experience, suitability of the premises and security in an effort to enhance the quality, integrity and standard of service provided by workshops. To promote greater professionalism in the motor repair trade, a 6-month warranty for repair work undertaken by the approved workshops was also incorporated in the scheme. As at 27 November 2001, the revised PARS included 345 workshops in various locations across the country.

(v) Guidelines for Contract Repairs of Accident Vehicles

In principle, the cost of motor repairs should be itemised based on the cost of spare parts and labour. In certain circumstances, this process is not adhered to and the cost of repairs is determined arbitrarily based on negotiation between the insurer and the motor workshop. The waiver of itemised repair is known as contract repairs. However, the practice of contract repairs by insurers has resulted in shoddy repair work and dissatisfied claimants. To protect policy owners, PIAM has issued guidelines on contract repairs of accident-damaged vehicles in May 2001 after consultation with BNM. The guidelines were intended to address weaknesses observed in contract repairs carried out, particularly with respect to the quality of the repairs carried out and the eventual road-worthiness of the vehicles repaired under contract repair terms. Under the guidelines, contract repairs can only be undertaken with the consent of policy owners.

- **Protocol 5 on the ASEAN Scheme of Compulsory Motor Vehicle Insurance**
  Protocol 5 on the ASEAN Scheme of Compulsory Motor Vehicle Insurance was signed by the ASEAN Finance Ministers on 8 April 2001 at the Kuala Lumpur Meeting of ASEAN Finance Ministers. The Protocol is one of nine protocols under the ASEAN Framework Agreement on the Facilitation of Goods- in-Transit which was signed by member countries in 1998 to facilitate the movement of goods in transit between ASEAN countries. In its current form, the Protocol, which is expected to be ready for implementation in 2002, would not affect the present system of cross-border motor insurance operations. However, it represents an important first step towards the implementation of a harmonised scheme of compulsory motor vehicle insurance within ASEAN which would pave the way for the free flow of goods-in-transit in the region.

- **Development of Agriculture Insurance**
  In supporting the Third National Agriculture Policy (NAP3) objectives, BNM continued to facilitate the insurance industry in identifying, and ensuring the availability of insurance coverage and services required for the successful implementation of the NAP3. This initiative is also in line with the FSMP's recommendation to diversify the range of insurance products to cater for the unique features of the various subsectors within the agriculture sector. A consortium of insurers was formed in 2001 to undertake the provision of agriculture insurance on a pooling basis which would be made available in 2002. Initially, the insurance scheme would cover natural perils and diseases for prioritised agricultural sectors comprising crops, livestock and aquaculture. The scheme will subsequently be extended to include risks related to yield and price fluctuations after further study by the consortium.

- **Simplification of Policy Wordings for Motor Insurance Covers**
  The simplification of policy wordings for motor insurance policies and related endorsements for commercial vehicles and the motor trade was completed for adoption by member companies of PIAM. The remaining documents to be simplified under this initiative are the motorcycle and 'Act' policies and their related endorsements as well as the motor tariff regulations.

- **Establishment of Databases**
  During the year, two databases were additionally developed by PIAM to provide statistical support to its member companies in the conduct of general insurance business. **The Crime Loss Database** collates statistics on crime-related losses in the various classes of insurance, other than fire, motor and marine, for the determination of burning costs for crime losses. The database will also enable the industry to identify regions, goods and risks which have a high incidence of crime losses, and provide a platform for the exchange of information to facilitate cooperation between the industry and relevant government and non-government agencies to reduce the incidence of crime. **The Marine Hull Database** was established to promote the more scientific underwriting and competitive pricing of marine insurance business.

Insurance Brokers and Adjusters

Insurance Brokers

In line with the increasingly demanding role of brokers as professional advisers in the areas of financial planning and risk management, the Insurance Brokers Association of Malaysia (IBAM) implemented "Guidelines for Brokers in the Marketing of Individual Life Policies" with effect from 1 September 2001. The Guidelines provide a framework for the development of insurance brokers as a viable alternative distribution system to the agency force for life insurance business. The Guidelines, which were drawn up in close consultation with LIAM, address various administrative issues relating to training, products and commission structures to ensure that high professional standards are observed by insurance brokers in the marketing of life insurance products. These requirements will be incorporated in the memorandum of agreement between IBAM and LIAM which is being finalised to specify the minimum requirements for the procurement of life insurance business by insurance brokers. By paving the way for insurance brokers to diversify their product offerings to include individual life policies, these developments are expected to enable insurance brokers to play a more meaningful role in the development of the domestic life insurance market.

During the year, IBAM also continued with its efforts to raise the qualification standards of insurance brokers in the industry. In this regard, IBAM continued to work closely with the MII to formulate the syllabus for the Advance Certificate Course in Insurance Broking. Supporting technical programmes were also developed to assist individuals enrolled in IBAM's certificate courses in making the transition from the basic to the intermediate levels.

Adjusters

Developments in the loss adjusting sector continued to focus on human resource development. Through a collaborative effort between the Association of Malaysian Loss Adjusters (AMLA) and the MII, a training programme to prepare adjusters for the examination for admission to the Society of Claims Technicians (SCT) which is affiliated to the Chartered Institute of Loss Adjusters (UK) (CILA), was introduced for the first time in Malaysia in January 2002. The SCT examination is conducted by the MII, in collaboration with CILA, to promote excellence in claims handling through the adoption of technical and ethical good practices by claims practitioners. AMLA and the MII also successfully negotiated concessionary examination and membership fees for Malaysians to encourage more adjusters to obtain the qualification and participate as members of the society. During the year, AMLA, in collaboration with the MII, CILA and National Insurance Claims Society, organised a regional loss adjusting and claims conference in May 2001 in Kuala Lumpur which was attended by loss adjusting representatives from Asia, Europe, Canada, U.S.A and Australia.

On the business front, the consolidation of the adjusting sector is set to emerge as an imminent development in the wake of mergers and acquisitions (M&A) among insurers in the industry which will effectively reduce the number of potential clients for individual adjusters. Accordingly, adjusters have been urged to re-examine their business strategies and consider appropriate measures and their evolving role to ensure their continued viability in the changing competitive environment.

Other Related Matters

The Malaysian Insurance Institute

Established in 1968, the MII is the main provider of educational and training support for the Malaysian insurance industry. Through established links with internationally recognised insurance bodies including the Chartered Insurance Institute (U.K.), the Life Underwriters Training Council (U.S.A.) and the American Society of Actuaries, the MII is committed to delivering educational and training programmes that are able to meet the increasing technical and professional demands of the industry.

In 2001, the MII conducted a total of 175 training programmes, both in the technical aspects of insurance as well as soft skills. It is also the accreditation body for the MII Diploma/ Certificate (DMII/CIP) and Associate (AMII) qualifications in insurance. As at 31 December 2001, a total of 524 personnel in the insurance industry have qualified for the DMII/CIP, while another 381 have qualified for the AMII. Since 2000, the institute has also been conducting a postgraduate Masters of Business Administration (Insurance/Financial Services) in collaboration with Universiti Putra Malaysia. Four training programmes which drew 64 participants from six ASEAN countries (including Malaysia) were also conducted under the ASEAN Insurance Training Fund (AITF) in 2001. The AITF, jointly-funded by the Malaysian insurance industry and the Malaysian Government and managed by the MII, was established to promote the development of insurance professionalism and expertise in the ASEAN market.

Further progress was made in 2001 with respect to the establishment of the ASEAN Insurance Training and Research Institute (AITRI) with the finalisation of a memorandum of understanding which is expected to be signed by ASEAN member countries in 2002. AITRI also organised its first training programme on global trends and developments and important supervisory principles for ASEAN insurance regulators in July/August 2001 in Bangkok, Thailand. To take its activities forward, ASEAN member countries have identified priority training needs, agreed on the focus of research, and committed financial resources for AITRI's projects in 2002. AITRI's evolution over time as the ASEAN network centre for insurance education and research is expected to produce a valuable pool of knowledged and skilled human resources that are crucial to sustain the long-term development of the insurance industry within ASEAN.

International and Regional Cooperation

BNM continued to take an active role both in promoting and supporting international and regional cooperation in insurance in 2001. On 17-18 January 2001, BNM organised the Second OECD/IAIS Conference on Insurance Regulation and Supervision in Asia in cooperation with the Organisation for Economic Cooperation and Development (OECD) and the International Association of Insurance Supervisors (IAIS) in Kuala Lumpur. Attended by a total of 122 Government officials and industry experts representing 41 countries and six international organisations both within and outside Asia, the Conference provided an important platform for the exchange of dialogue on several key issues and developments confronting the industry, including the progress of regulatory reforms in Asia following the Asian financial crisis, issues related to the assessment of observance of financial sector standards under the Financial Sector Assessment Programme (FSAP), new approaches to regulatory risk assessment, and developments in private pensions and private health insurance. The Conference also explored avenues for future cooperation between Asian Governments, the IAIS and the OECD in a joint effort to promote stability in the insurance system.

BNM also participated in the following other regional and international fora on insurance during the year:-

- **Fourth Meeting of the ASEAN Insurance Regulators and Second Joint Meeting between the ASEAN Insurance Council and the ASEAN Insurance Regulators**
  The Fourth Meeting of the ASEAN Insurance Regulators and the Second Joint Meeting between the ASEAN Insurance Council (an association of private insurance practitioners in ASEAN) and the ASEAN Insurance Regulators were held in Singapore from 28 to 30 August 2001. The meetings saw further progress made in the area of insurance cooperation at the ASEAN level with several important commitments made by member countries towards actively supporting the activities of AITRI, strengthening supervisory systems through observance of the Insurance Core Principles promulgated by the IAIS and the establishment of the necessary administrative bodies within member countries to facilitate the implementation of the Protocol to establish the ASEAN Scheme of Compulsory Motor Vehicle Insurance.

- **Eighth Annual Conference of the International Association of Insurance Supervisors**
  The Eighth Annual Conference of the International Association of Insurance Supervisors (IAIS) was held in Bonn, Germany in September 2001. Five new papers were approved in principle for adoption by the IAIS at its annual general meeting held in conjunction with the annual conference. They were the Supervisory Standard on the Evaluation of Reinsurance Cover of Primary Insurers and the Security of their Reinsurers; the Supervisory Standard on Exchange of Information; Principles on Capital Adequacy and Solvency; a Guidance Paper on Public Disclosure by Insurers; and Anti-Money Laundering Guidance Notes.