Malaysian Takaful Dynamics

A 30th anniversary preview edition

November 2014
A warm welcome to our 30th anniversary commemorative publication which reflects on Malaysia’s takaful journey, from industry performance, market insights and consumer trends to our future directions and outlook.

Malaysia’s three decades of takaful evolution has been characterized by steady growth of market participants, both players and agents, and infrastructure capacity building. The asset base of Malaysia’s takaful industry has grown significantly to an estimated RM21 billion in 2013 from an initial asset base of just RM1.4 million in 1986.

We recognize that Malaysia’s takaful industry is yet to reach its optimal market participation level and the Malaysian Takaful Association as the industry body, has embarked on various efforts to get Malaysian takaful to the top echelons of best practices.

We are also encouraged by Bank Negara Malaysia’s support in creating a conducive environment for takaful to flourish with a resilient and ever-robust regulatory infrastructure - including the development of the Takaful Operational Framework, Risk-based Capital for takaful and the new Islamic Financial Services Act 2013. These wide-ranging reforms will support the long-term sustainable growth of the industry with focus on enhancing operating flexibility, product disclosures, delivery channels and market practices for takaful operators.

In taking Malaysia’s takaful to greater prominence, MTA has organized and participated in a number of strategic events, that encourage sharing of knowledge including, Konvensyen Perunding Takaful, Global Islamic Finance Forum and The Takaful Rendezvous, just to name a few.

My heartiest thanks and gratitude to everyone who has contributed to what Malaysia takaful industry has become today. We hope to garner your continued strong support in the golden years to come.

This special 30th anniversary edition is a preview of the full compendium *Malaysian Takaful Dynamics* planned for release in April 2015.
Message from EY Malaysia’s country managing partner

I am delighted to see MTA celebrate their 30th industry anniversary and to witness the steady growth of Malaysia’s takaful industry over these years.

Malaysia is fast gaining international recognition as a centre for product innovation and operational best practices.

Malaysia’s takaful market, estimated at over US$3.0 billion, has been on a dynamic growth track achieving double-digit growth momentum of about 19%. In addition, Malaysia has a leading position on family takaful with US$1.4 billion in total net contributions.

The takaful industry has vast scope for continual improvement to raise industry performance standards to be on par with the conventional insurance industry and to accelerate the development of creative product innovation.

In today’s highly dynamic and competitive market, the takaful industry must deliver a positive and lasting customer experience. With the growth of more sophisticated customers and their technology savviness, the industry needs to attract more skilled talent to support the financial sector.

Moving forward, the sustainability for Malaysia’s takaful industry will demand the adoption of best practices and rapid adaptation to change in meeting customer needs.

We in EY look forward to continuing to play a key role in the development and growth of the takaful industry in Malaysia and globally in the years to come.

Finally, congratulations to the MTA team for their dedicated enthusiasm to drive takaful industry activities and to be at the forefront of the industry.
Vision, mission and milestones
Malaysian Takaful Association

VISION

Sustainably profitable and growing Takaful industry in Malaysia

An industry that can be trusted and recognized as contributing to society and the economy

An economic and public policy climate conducive to a flourishing industry

A trade body recognised as providing active leadership and an authoritative collective voice for the takaful industry

MISSION

To provide leadership on issues bearing on the industry’s collective strength and image and to shape and influence decisions made by the Government, regulators and other public authorities, locally and internationally, to benefit the industry as a whole.

Objectives

- Promote and represent the interests of members and also the foundation of a sound takaful structure with cooperation.

- Represent the Malaysian takaful industry to government, regulators and policy makers in driving effective public policy and regulation, locally and internationally.

- Institute strategic alliances and cooperation with other similar associations both locally and internationally.

- Advocate high standards of services within the industry and provide useful information to the public about takaful.

- Promote the benefits of takaful to the government, regulators, policymakers and the public.

- Collect, collate and publish statistics and any other relevant information relating to takaful to members.
Key milestones of Malaysia’s takaful industry

1982
- Special Task Force established to explore viability of setting up an Islamic insurance company

1984
- Takaful Act 1984 was gazetted
- Incorporation of Syarikat Takaful Malaysia Bhd. (STMB)

1988
- BNM commences the supervision of the insurance and takaful industry.

1993
- MNI-Takaful Sdn. Bhd. commenced operations.

1995
- Set-up of ASEAN Takaful Group

1997
- Incorporation of ASEAN Retakaful International (L) Ltd. in the International Offshore Financial Centre, Labuan
- Appointment of members – National Syariah Advisory Council for Islamic Banking and Takaful

1998
- MNI-Takaful changed its name to Takaful Nasional Sdn. Bhd.
- STMB and Takaful Nasional (now known as Etiqa Takaful) jointly developed a Code of Ethics for the industry.

2000
- Establishment of IBFIM
- BNM launch of the Financial Sector Masterplan

2001
- Mayban Takaful Bhd. commenced operations.
- Establishment of the Malaysian Takaful Association
- Malaysia’s Islamic Financial Services Board (IFSB) inaugurated.

2002
- Note: Bhd. stands for Berhad
...celebrating 30 years together

2003
Takaful Ikhas Bhd. commenced operations.

2004
Approval in principal granted to Commerce Asset Holdings Bhd. to conduct takaful business.

2005
Start of operational takaful licences - Sun Life Malaysia Takaful, HSBC Amanah Takaful, MAA Takaful, Hong Leong MSIG Takaful, Prudential BSN Takaful

2006
Establishment of Malaysian International Financial Centre

2008
Establishment of four Retakaful operators: ACR Takaful Bhd, MNRB Retakaful Bhd, Munich Re Retakaful Bhd, Swiss Re Retakaful Bhd

Inter-Takaful Operator Agreement (ITA) was officially signed.

2009
IFSB-8 issued on takaful governance and IFSB-10 issued on Sharia’ governance principles.

Establishment of AIA International Takaful Bhd.

2010
IFSB-11 issued on solvency for takaful

Announcement of four new family takaful licences

Establishment of Great Eastern Takaful Bhd.

2011

AIA AFG Takaful, ING PUBLIC Takaful Ehsan and AmMetLife Takaful began operations.

IFRS convergence in Malaysia, PIDM Act 2011

2012
Enforcement of Takaful Operational Framework and the revised Shariah Governance Framework

2013
The new Islamic Financial Services Act 2013

Merger of AIA AFG Takaful Bhd and ING PUBLIC Takaful Ehsan Bhd (to be known as AIA PUBLIC Takaful Bhd.)

2014
Enforcement of Risk-Based Capital for Takaful

2020
Vision 2020
Landscape

Markets
Quick insights
Business risks
Regulatory
Markets
Global and Malaysia’s takaful markets

Double-digit global growth momentum

With the continued buoyancy in the estimated US$2 trillion global Islamic finance markets, the global takaful market is estimated to continue its double-digit growth momentum of about 14% in 2014. Given a conducive growth landscape, the global takaful industry may reach over US$20 billion in 2017.

However, in the short-term, undifferentiated strategies and wider regulatory compliance efforts have dented the short-term financial dynamics of takaful operators in some markets.

Challenging competition and regulatory scenario

Profitability of takaful operators in most Gulf Cooperation Council (GCC) countries continues to be challenged by intense competition. Consequently, some operators are looking at alternative customer segments and some are even exploring merger options.

Industry players also observe the lack of uniform regulations which can allow them to operate across different takaful models as regional growth impediments.

Malaysia on steady growth traction and continual enhancements

Malaysia’s total net contributions of family takaful reached RM4.5 billion (US$1.4 billion) with steady growth from regular contribution products.

Takaful operators are also reviewing Bank Negara Malaysia’s concept paper on the Life Insurance and Family Takaful Framework (LIFE) which recommends a wide range of enhancements from operating flexibility, product disclosure and delivery channels to market practices.

Chart 1: GDP growth of selected Islamic finance markets (annual %)
Quick insights
Malaysia’s takaful industry

Top 5 reasons to consider takaful

1. Attractive package, 41%
2. Islamic, 29%
3. Good returns, 19%
4. Invest and save, 15%
5. Efficient claim processes, 12%

Events that trigger takaful participation

- “My friend bought takaful and she was telling me about the things it can do if something were to happen to her, so I decided to do the same.”
- “I didn’t intend to buy, but the agent was good. He explained everything and wasn’t pushy, so that helped me decide.”
- “I heard that takaful car insurance gives rebates when you renew it, so that was what made me choose it.”
- “I already have a medical plan at work for myself, but it doesn’t cover my family, so I got one from takaful specially for my family.”
- “I was in hospital and had to pay the cost myself. Someone told me about takaful, so I decided to buy in case it happens again.”

Main takaful customers are aged

30-50 years old
Takaful customers are satisfied with services provided.

<table>
<thead>
<tr>
<th>Gap findings</th>
<th>RM</th>
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<tbody>
<tr>
<td>Average gap per working person</td>
<td>200,000</td>
</tr>
<tr>
<td>Average sum assured for takaful policy</td>
<td>50,000</td>
</tr>
<tr>
<td>Age group with largest aggregate gap</td>
<td>Below 30 years old and/or those earning less than RM1,000 a month</td>
</tr>
</tbody>
</table>

Sources:
- *Environment Scan on Takaful Awareness of Malaysian Youth*, Metrix Research, September 2014
Business risks
Addressing new and evolving business risks

The top three business risks for Malaysian-based takaful operators include:
- Evolving regulations
- Addressing competition
- Business transformation

The ever-changing regulatory environment in Malaysia with the implementation of the Financial Services Act 2013 and Islamic Financial Services Act 2013; the enforcement of Risk-Based Capital for Takaful (RBCT) and other regulations; and the need for operators to comply with them accordingly were cited as the top business risks.

In addressing the new challenges and opportunities catalysed by technological challenges, Malaysian takaful operators are also reviewing their business models and are working out their business transformation strategies.

Chart 2: Top six takaful business risks in Malaysia

<table>
<thead>
<tr>
<th>Business risk</th>
<th>Ranking 2014</th>
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<tbody>
<tr>
<td>Evolving regulations</td>
<td>1</td>
</tr>
<tr>
<td>Competition</td>
<td>2</td>
</tr>
<tr>
<td>Business transformation</td>
<td>3</td>
</tr>
<tr>
<td>Inability to achieve underwriting profit</td>
<td>4</td>
</tr>
<tr>
<td>Global economic weakness</td>
<td>5</td>
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<tr>
<td>Lack of financial flexibility</td>
<td>6</td>
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<table>
<thead>
<tr>
<th>Business risk</th>
<th>Ranking 2014</th>
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<tr>
<td>Ineffective enterprise risk management</td>
<td>7</td>
</tr>
<tr>
<td>High-risk investment portfolios</td>
<td>8</td>
</tr>
<tr>
<td>Misaligned cost base</td>
<td>9</td>
</tr>
<tr>
<td>Rated retakaful shortage</td>
<td>10 &amp; 11</td>
</tr>
<tr>
<td>Political risks and implications</td>
<td>12</td>
</tr>
<tr>
<td>Hostile M&amp;A activity</td>
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Regulatory
Life insurance and family takaful framework

Background

Bank Negara Malaysia's (BNM) concept paper on the life insurance and family takaful framework sets out proposals that will support the long-term sustainable growth and development of the industry with increased value propositions to consumers.

Scope

The proposals cover a wide range of areas:
- Operating flexibility
- Product disclosures
- Delivery channels, and
- Market practices

The initiatives, once finalized, will be reflected in the relevant documents to be issued under the Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA).

Applicability

This proposed framework will be applicable to:
- Life insurers licensed under the FSA
- Family takaful operators licensed under the IFSA
- Financial advisers and Islamic financial advisers approved under the FSA and IFSA

Future landscape

The framework has been introduced to transition the life insurance and family takaful industry into a new environment with the aim of achieving a higher insurance and takaful penetration rate of 75% (2013: 54%) while at the same time ensuring that consumers continue to receive proper advice. This entails having in place several initiatives broadly summarized as follows:

- Allow greater operational flexibility to promote product innovation while preserving policy/certificate value
- Diversified distribution channels to widen outreach
- Strengthen market conduct to enhance consumer protection
The framework promulgates a two-phase approach to ensure orderly implementation of the proposed recommendations.

**Phase 1: Partial liberalization for better preparedness pending further liberalization**

<table>
<thead>
<tr>
<th>Partial removal of operating limits</th>
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<tbody>
<tr>
<td>• Operating cost limits of investment-linked products in the form of commissions, management expenses and agency related expenses will be removed immediately.</td>
</tr>
<tr>
<td>• To preserve policyholder’s value, a certain percentage of the premium/contribution payable must be allocated to the policyholder’s/ participant’s unit fund before any deduction of charges.</td>
</tr>
<tr>
<td>• Commission limits for pure protection products (pure term, medical and health insurance takaful, and critical illnesses) to be removed, subject to insurers and takaful operators offering those products via direct channels.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Diversification of distribution channels</th>
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<tr>
<td>• Bancassurance/Bancatakaful commission limits will be aligned with corporate agents.</td>
</tr>
<tr>
<td>• Incentivizing growth of financial advisers through:</td>
</tr>
<tr>
<td>• Reduction in paid-up capital from RM100,000 to RM50,000</td>
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<tr>
<td>• Expansion of list of qualifications to become financial advisers</td>
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<tr>
<td>• Requirement for insurers and takaful operators to offer entire range of products for financial advisers to sell</td>
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<table>
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<tr>
<th>Strengthening market conduct practices to enhance customer protection</th>
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<tbody>
<tr>
<td>• Intermediaries, remuneration based on a balanced scorecard</td>
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<tr>
<td>• Enhanced disclosure standards for greater consumer empowerment and awareness</td>
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<tr>
<td>• Introduce product aggregator to assist product comparison</td>
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<tr>
<td>• Introduce online insurance/ takaful account to promote awareness of policy status</td>
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<td>• Removal of agency financing scheme limits</td>
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**Key KPIs to be achieved**

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<tr>
<th>Premium/contribution level of products liberalized to commensurate with benefits to policyholders/participants</th>
</tr>
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<tbody>
<tr>
<td>Availability of pure protection products via direct channels</td>
</tr>
<tr>
<td>Market share of regular premiums for non-agent channels to be 30% (current = 14%) with higher persistency</td>
</tr>
<tr>
<td>Banca penetration target of 10% of banking population (current = 5%)</td>
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**Phase 2: Full/managed liberalisation subject to achievement of KPIs and BNM’s assessment**

<table>
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<th>Continuous consumer education efforts</th>
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<tr>
<td>Scorecard for intermediaries’ rating</td>
</tr>
<tr>
<td>Number of full-time agents to be 50%</td>
</tr>
</tbody>
</table>

Sources:
- Life Insurance & Family Takaful Framework: Concept Paper, BNM
- EY analysis
Performance
Industry performance
Takaful growth powers steadily at double-digit mode

Over six consecutive years, double-digit net contributions income growth:
15.7% CAGR for family takaful
15.2% CAGR for general takaful

Growth magnitude:
2.4 X's for family takaful
2.3 X's for general takaful

Double-digit CAGR, six consecutive years
15.6% CAGR for takaful net contributions income
15.6% CAGR for takaful fund assets

Family takaful assets growth rate is 1.7 times that of the life insurance industry, albeit from a low base.
18.8% CAGR for takaful's fund assets (vs. 10.9% for life insurance)

Note: Family takaful's fund asset is RM18b as at December 2013.
The takaful industry's market penetration rate* of 13.9% compared to the overall insurance and takaful industry rate of 52.8% reflecting significant untapped potential. The target of the Financial Sector Blueprint in 2020 is 75%.

**Below optimal market penetration rates**

- Conventional insurance: 38.9%
- Takaful: 13.9%
- Long-term target penetration rate: 75%**

*The total number of life insurance policies or family takaful certificates divided by the total Malaysian population.

**This long-term target penetration rate is for conventional insurance and takaful.

- From 2009 to 2013, the take-up of new individual ordinary family takaful certificates rose by 11.7% per annum whilst group ordinary family takaful tapered by about 1% per annum (CAGR 0.98%).
- Exponential growth is recorded in investment-linked takaful certificates which experienced 17.6% growth.

Source:
- Data on Malaysian Takaful Industry, Malaysian Takaful Association
Financial dynamics

Despite competitive challenges, Malaysian takaful operators achieved healthy financial results.

The average profit margin is about 7.5%.

Half (50%) of the respondents indicate that their average profit margin is between 5% to 10%.

Four-fifths (80%) of the respondents state that their average commission ratio is between 16% and 25%.

Two-fifths (40%) of the respondents state that their average combined operating ratio is between 61% to 70%.

Source:
- Global takaful online survey 2014, EY
Outlook
Demographic shifts and regulatory developments in rapid-growth markets (RGMs) are driving global insurers to re-assess which RGMs present highly attractive investment options. EY’s recent global insurance study, Waves of change has identified Malaysia as a market with an attractive mix of demographics, strong economic growth and a strategic base for the development of takaful. Malaysia was ranked alongside China as a country with higher opportunities and moderate risks.

Industry regulatory initiatives led by Bank Negara Malaysia to encourage the industry’s adoption of best practices and initiatives by the Malaysian Takaful Association are steps in the right directions towards accelerating the internationalization of Malaysia’s takaful industry.

With Malaysia’s high potential to take the lead in the internationalization of takaful, there is urgency for Malaysia to realize this aspiration by growing strong domestic players to become regional champions and winning opportunities in Asia’s diverse and dynamic markets.

Chart 11: Matrix of opportunity and risk for insurance investments

Source:
- Waves of change: The shifting insurance landscape in rapid growth markets, EY, August 2014
Malaysia takaful: growth forecasts

In tandem with its takaful peers across the world, prospects for the Malaysian takaful industry continue to ride on the growth of the Islamic banking and finance sector.

Over the last five years, Malaysia’s takaful industry achieved admirable CAGR growth of 24%.

Industry estimates indicate that given a conducive economic climate and its young demographics, Malaysia’s takaful industry may be able to continue its double-digit growth path.

Across the world, it is pertinent to note that despite takaful’s strong growth in key ASEAN and GCC markets, the insurance penetration rates in Islamic finance key markets are comparatively low and present significant untapped potential.

In the medium to long term, takaful operators in markets with stable domestic economies, good macro management and sizeable young Muslim populace can look towards capturing profitable opportunities in niche market segments.

Source:
- Global Takaful Insights 2014, EY, 2014
Long-term growth factors

Moving forward, the key forces of change that will drive and shape the future of the Malaysian takaful industry include:

**Customer’s technology adoption**
Aside from market demographics, the rise of social media and their influence on the buying attitudes of youths and even businesses provide both opportunities and risks to takaful players.

**Market conditions**
The state of innovation and communication of Sharia’ compliant products, and the level of participation of institutions in promoting takaful products can drive the market participation of takaful.

**Facilitative regulatory changes**
Continued efforts to strengthen Malaysia’s regulatory infrastructure such as the introduction of Risk-based Capital for Takaful provides better consumer protection and confidence to encourage takaful take-up. In addition, fiscal tax incentives for takaful products and welfare schemes (e.g. i-BRIM) can facilitate wider takaful participation.

**Taking 6 actions**
To ride through market challenges and realize takaful’s market potential, operators need to:

1. Attune strategies to potential regulatory changes and develop plans before new rules take effect
2. Closely track consumer behaviours and rapid technological change in specific markets
3. Follow and anticipate changing government attitudes
4. Consider how macroeconomic trends can affect market(s)
5. Identify circumstances where shared service options can be applied
6. Acknowledge that local culture matters across markets

Source:
- Waves of change: The shifting insurance landscape in rapid-growth markets, EY, August 2014
References
Malaysian Takaful Association references

Publications

The Story of Gap: Charting Takaful Growth in Malaysia

Environment Scan on Takaful Awareness in Malaysia

Annual Report 2013

MTA’s online library

Consumer Education Series

- Motor takaful
- Family takaful
- Investment-linked takaful

Guidelines

- Code of ethics for takaful agents
- Guidelines on Replacement of Family Takaful Certificates (ROC) - inter takaful operator procedures
- Guidelines on the Continuing Professional Development (CPD) hours
EY thought leadership

2014 Global insurance outlook
Waves of change: the shifting insurance landscape in rapid-growth markets
Rapid-growth markets: EY rapid-growth markets forecast

Global Takaful Insights 2013: Finding growth markets
Take 5: Financial Services Act 2013 and Islamic Financial Services Act 2013
World Islamic Banking Competitiveness Report 2013-14: the transition begins

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