Chapter Three

Development and Main Features of Life Insurance Industry in Malaysia

3.1 Background of Life Insurance Industry in Malaysia

After independence in 1957 conscious efforts were made to introduce domestic insurance companies. The early 1960s witnessed the growth of quite a few life insurance companies, which wound up soon after, because of their unsound operations and inadequate technical background.

Although legislation did exist as far back as 1948 and 1949 for life and general insurance business respectively, the industry was relatively free from restraints except self-impose ones in respect of individual companies until the coming into force of the 1961 Insurance Legislation.

In that year there was a considerable expansion of all kinds of insurance business. A large number of small companies were formed to insure the lives of aged people with flat rates of premium applicable to all ages at entry. These companies brought disrepute to the industry. In order to control these "mushroom" companies and to protect the interest of the public, the Government introduced legislation in April 1961 to ensure that any new companies formed must have a minimum paid up capital of RM1 million.

Later legislations provide that companies could not issue new policies after 4 December 1961 unless it could satisfy the Minister of Finance that its business would be conducted in accordance with sound insurance principles.

In January 1962, legislation was enacted for the compulsory liquidation of the "mushroom" companies.[6] All these eventually cleaned up the industry of the "mushroom" companies. The services of an insurance expert from Australia were obtained under the Colombo Plan to serve as the first Insurance Commissioner and comprehensive insurance legislation in the form of the Insurance Act, 1963 covering both life and general was introduced on 21 January 1963.

The principal authority empowered to regulate the insurance industry in Malaysia since 1963 is known by different names at different times of the period, which is Insurance Commissioner, Director General of Insurance (DGI), and Central Bank of Malaysia. There are at present two Takaful and 18 life insurers operating in Malaysia. Out of the 18 life insurers, 14 are domestic and 4 are constituted outside Malaysia in 1999.

3.2 Insurance Legislation

Insurance companies are regarded as trustees of the insuring public. For this reason the Government has to ensure that the authority exercising supervision over the insurance industry is strong and equipped with all the powers necessary in effective legislation and through the implementation of Government policies governing the activities and conduct of all concerned in the industry. In this regard the Government has played a very important role in the protection of the policyholder so that his insurance company will always be able to meet its liabilities in accordance with the policy contract and provide him a satisfactory service at all times. Besides that, the maintenance of a climate in which the insurance industry also will continue to flourish and make its contribution to the national economy.

The primary objective of insurance regulation and supervision is to protect the policyholders' interests and the general public (See Chart 3.1). This responsibility is carried out in two ways; first, to determine that policyholders and beneficiaries are given fair and reasonable treatment by insurers and insurance agents; and second, to ensure the financial soundness of insurance carriers and the capital, reserves and invested assets held for the distribution of benefits. In Malaysia, the regulation of insurance business is achieved through the administration and enforcement of the Insurance Act, 1963 by the DGI.[7]

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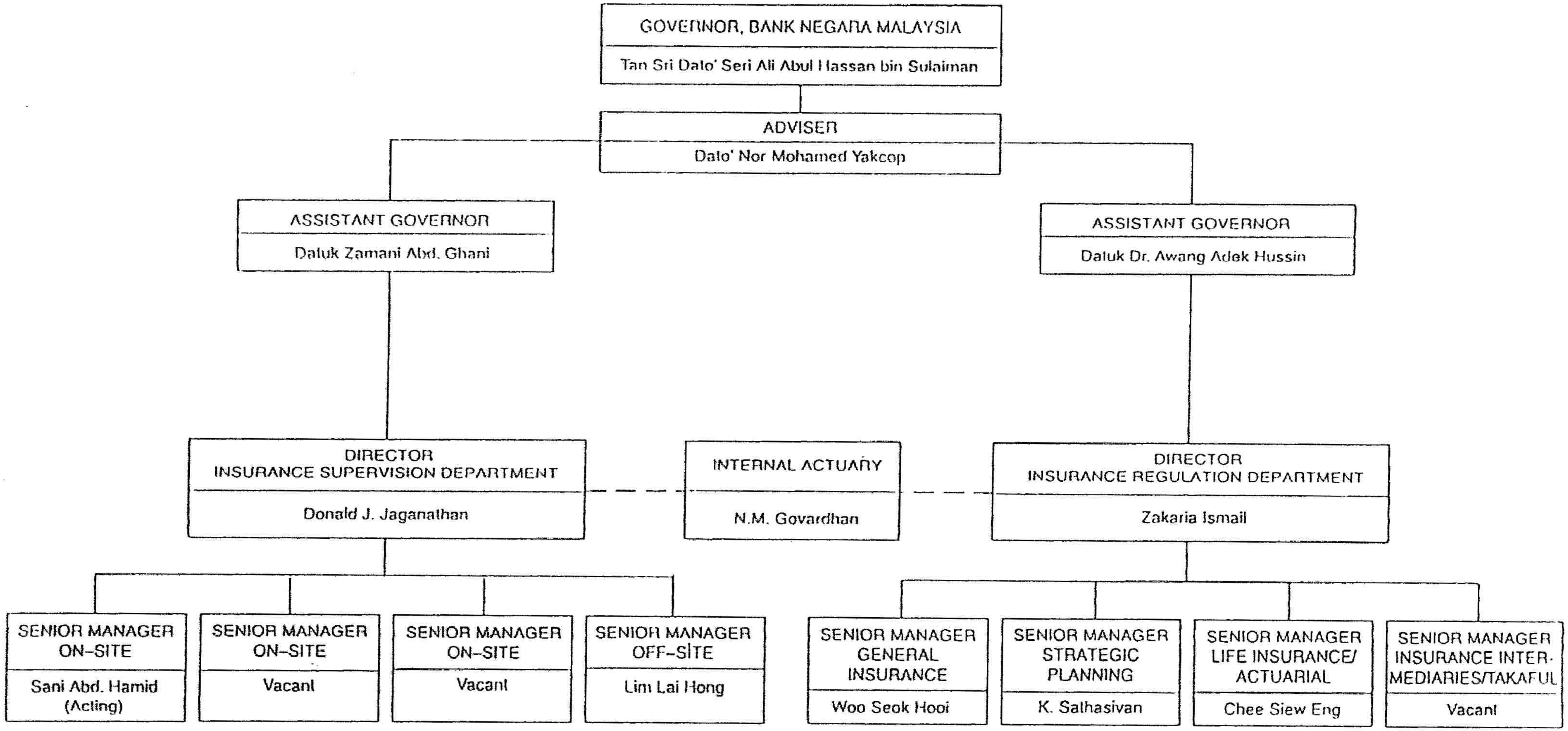
[6] Life Assurance (Compulsory Liquidation) Act 1962.
[7] S.W. Caffin, report upon Insurance Legislation for the Federation of Malaya, Canberra, Common wealth Government Printer, 1960.

Chart 3.1: Insurance Regulation and Supervision Department as at 31 December 1999



Functions of Insurance Supervision Department

Responsible for the financial health of individual insurers/reinsurers/takaful operators.

On-site Supervision

- examination of financial condition, market conduct and actuarial valuation.

Off-site Supervision

- prudential monitoring and surveillance of individual insurance companies.

Functions of Insurance Regulation Department

Responsible for the overall health and development of the insurance industry including :

- formulation and implementation of policies and guidelines;
- administration and enforcement of the Insurance Act 1996 and the Takaful Act 1984; and
- processing of regulatory applications.

Source: Annual Reports of the Director General Insurance, 1999.

3.2.1 Review of Insurance Legislation

The urgent need for proper and comprehensive legislation on the insurance industry led to the passing of the Insurance Act, 1962, which was extended to Sabah and Sarawak in 1965. Under the Act, insurance business are divided into two classes, that is life and general. For each class of business to be registered, an insurance fund relating to policies written in Malaysia must be maintained and a deposit of RM 300,000 or in lieu of that, a bank covenant of the same amount must be lodged with the Akauntan Negara, Malaysia. Perhaps the most important of the qualifications for entry is being able to meet the minimum capital requirement.[8] It was RM1 million initially for either life or general insurance business and RM1.5 million for both classes of business. Mushroom life insurance companies were unable to meet these requirements and as a result 38 of them had to close down. Since the passing of the Insurance Act in 1963, there has been no case of institutional failure in the insurance industry. Public confidence has been restored since 1963 in the insurance industry.

The Caffin-pioneered piece of comprehensive legislation, the Insurance Act 1963, became law governing all insurance activities from 1963. At short intervals during the next 33 years, amendments were made to this Act, many extending significantly the scope and direction of regulation. In mid-April 1996, the Act and all its amendments have been tidied up, rewritten, augmented, rearranged, liberalized in some aspects, tightened up in others and presented anew as the Insurance Bill 1996. To make for better claims

[8] Life Assurance Companies (Amendment) Act 1961

reserving practices, two sets of guidelines have been issued by the regulator to all insurers.[9]

In the light of experience gained from the administration of the Insurance Act, 1963, it became necessary to introduce many new provisions and amendments to provide for more progressive legislation reflective of contemporary conditions and practices. These new provisions have been designed to safeguard further the interests of the insured as well as to gear the insurance industry to conduct and identify itself with national interests as insurance industry to conduct and identify itself with national interests as insurance has a direct impact on the economic and social welfare of the community as a whole.

A major development concerning the insurance industry therefore was the coming into force with effect from 1 June 1975, the Insurance (Amendment) Act, 1975.[10] The Insurance (Amendment) Act sets new standards of financial soundness for insurance companies and imposes new obligations on them. These standards and requirements enhance public confidence in the industry and are helping to create a better image. The considerable improvements to the Act no doubt provide a balance between regulation and freedom and facilitate the growth of a sound, progressive and healthy Malaysian insurance industry.

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[9] These are "Guidelines on Accounting for insurance Business" (JPI/GPI 3) and "Guidelines on Mathematical Estimation off IBNR Claims Provision" (JPI/GPI 12).
[10] Briefing to the Malaysian Institute of Management at 2.15 p.m. on Thursday, March 25th, 1976 at the Equatorial Hotel Ballroom, Kuala Lumpur.

Today, the insurance industry is governed by the Insurance Act 1996 which came into force on 1 January 1997. The subsidiary legislation, the Insurance Regulation 1996 (Regulations) saw several changes in 1999. The changes to the Regulations were undertaken in line with the economic recovery experienced during the year. The changes, which have been approved by the Minister of Finance and brought into force in 1999. The Regulations were amended in 1998 primarily to reduce the impact of the economic downturn on insurers. The requirements for minimum paid-up capital and margin of solvency were then revised downward from RM50 million to RM35 million and RM30 million respectively. In view of the positive signals of economic recovery in 1999, the Regulation was amended to reinstate the original financial requirements by 1 January 2001.

Regulators, which review policy contracts to see that they are understandable, fair to the buyer, and consistent with review policyholder rights set forth in the law, first protect the insurance buying public. Agents must be licensed by the DGI. Regulation also defined certain elements of the sales illustrations they use to show the costs of the policy, and the DGI often publish buyers' guides to allow consumers to compare insurance costs among companies. Insurance departments periodically review the market conduct of companies in Malaysia, to be sure that agents are treating policyholders fairly and in conformance with the laws.

The other element of consumer protection relates to regulation of the insurance companies, with emphasis on their financial condition. Use of standard mortality tables, requirements for adequate reserves, valuation and nonforfeiture laws, review of policy forms, submission of financial statements, periodic financial examinations and a myriad of related measures are all designed to maintain the solvency and claim-paying ability of the insurer. Where such measures are failed, and insolvency occurs, DGI guarantee funds have been established to satisfy policy claims if assets are insufficient.

The Act empowers Bank Negara Malaysia (BNM) to specify matters pursuant to provisions of the Act and Regulations. In 1999, specifications continued to be made to provide greater flexibility to insurers in the investment of insurance funds while strengthening the admitted asset base of insurers. In addition, specification was also made in the area of accounting standards to enhance financial statements in the insurance industry. All the developments over the past 36 years have contributed to the building up of a regulatory framework for the insurance industry that today has touched on almost all the important aspects of insurance operations.

3.2.2 Registration of Insurers

There were 145 insurers operating in Malaysia as at 31 December 1999. Of the 145 registered insurers, 38 were registered to transact only general insurance business, seven were registered to transact only life insurance business, 11 insurers were registered to transact both life and general insurance business, 10 insurers were registered to transact general reinsurance business, and one insurer were registered to transact life reinsurance business.

At the end of 1999, the total number of licensees under the Act stood at 145, comprising 67 insurers, 37 insurance brokers and 41 adjusters as shown in Table 3.1.

Table 3.1: Types of Registered Insurers

As at end of December	1998	1999
Direct Insurers	58	56
Life	7	7
General	40	38
Life and General	11	11
Professional reinsurers	10	11
Life	1	1
General	9	10
Insurance brokers	37	37
Adjusters	42	41
Total	**147**	**145**

Notes:
DGI issued 37 insurance brokers were licensed under section 20B(3) of the Act.
DGI issued 41 loss adjusters were licensed under section 20C(4) of the Act.
Source:
Annual Reports of the Director General of Insurance, 1999.

3.3 The Role of Life Insurance Industry in the Economy

Life insurance companies provide long-term funds by marshalling small savings and investing these monies thus contributing towards economic development and creation of employment. At the same time they serve a useful social function of encouraging the populace to provide for death or old age.

3.3.1 Overview of the Industry

The widespread economic recovery benefited world trade and enabled the Malaysia economy to achieve a creditable real growth of 5.8 per cent in 1999 after two years of negative growth. In line with this favorable development, the Malaysian financial system in general and the insurance industry in particular showed significant improvement. After experiencing the difficult period of economic crisis in the previous two years, the insurance industry rebounded strongly to register impressive growth in premiums and profit margins in 1999.

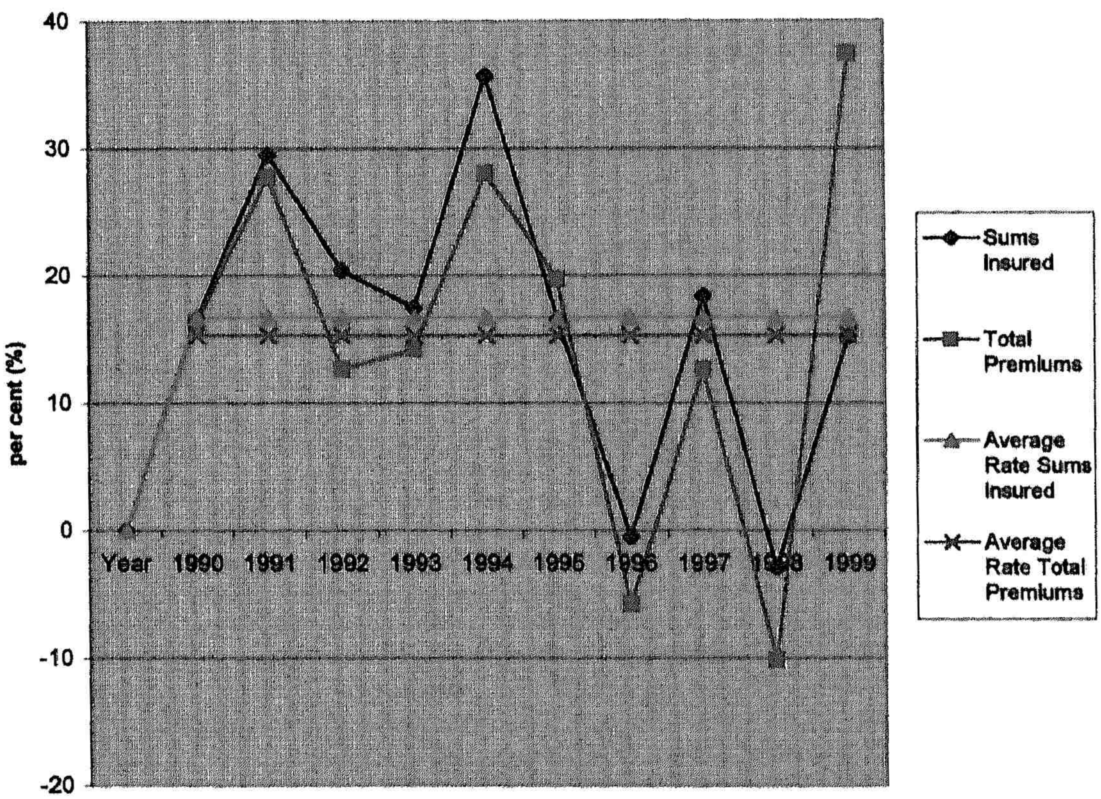
With the economic recovery, measures were set in motion to overcome these weaknesses and accelerate the future development of the industry. In particular, the focus is on preparing the industry players to meet the challenges of a more liberalized market in the future.

3.3.2 Performance of the Life Insurance Business

a) New Businesses

Preliminary figure for 1998 showed a decline in life insurance sales after a period of high growth. Total new premiums declined by 10.2 per cent to RM1,438.9 million and total new sums insured by 2.9 per cent to RM87,464.4 million. This was very largely influenced by the performance of a specific company as a result of measures it took to reorganize and trim down its large agency force. The result was also affected by other factors. A general slow-down in business condition in the economy also had a bearing to some extent, as this would affect people's willingness or ability to purchase life insurance protection. Despite this the overall performance over the 10 years was still healthy. From 1990 to 1999, life insurance sales increased by an average rate of 16.7 per cent in total new sums insured and 15.3 per cent in total new premiums (See Figure 3.1).

Figure 3.1: New Business



Source: Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

In line with the sustained buoyant growth in the economy and the consequential better demand for insurance, business volume in the insurance industry recovered to register strong growth in 1999. The total new premiums of the life sectors rose by 37.4 per cent to RM1,977.6 million and total new sums insured also rose by 15.2 per cent to RM100,769.3 million (See Table 3.2). Compared to the developed countries, there is still substantial room for further growth of life insurance as Malaysia achieves further economic growth. However, to improve their performance in new business, life insurers should review their present operations, plan and organize themselves to be more effective and innovative in meeting the needs of the public. They must continue to improve their agency systems and strive for quality and professionalism in their life agents.

Table 3.2: New Businesses

Year	No. of Policies		Sums Insured		Total Premiums	
	Units	% change	RM million	% change	RM million	% change
1990	498,338	5.7	24,805.0	16.6	573.1	16.3
1991	633,133	27.0	32,117.1	29.5	731.7	27.7
1992	710,964	12.3	38,661.7	20.4	823.6	12.6
1993	806,642	13.5	45,520.8	17.5	939.8	14.2
1994	944,746	17.1	61,781.1	35.7	1,202.5	28.0
1995	1,034,523	9.2	76,436.7	16.6	1,510.5	19.7
1996	908,196	-12.2	76,045.5	-0.5	1,422.8	-5.8
1997	1,111,999	22.4	90,051.5	18.4	1,602.6	12.6
1998	1,123,472	1.0	87,464.4	-2.9	1,438.9	-10.2
1999	1,452,287	29.3	100,769.3	15.2	1,977.6	37.4

Source: Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

b) Active Businesses

In 1999, total active business was affected by higher life insurance sales and reduced terminations. So, the phenomenal growth in total active business in 1998 was sustained in 1999, the life insurance sales show the phenomenal growth achieved in 1999. Total active business continued to grow at a healthy pace with annual premiums increasing by 9.9 per cent to RM6,859.4 million and sums insured by 8.7 per cent to RM368,979.1 million (See Table 3.3).

Table 3.3: Active Businesses

Year	No. of Policies		Sums Insured		Total Premiums	
	Units	% change	RM million	% change	RM million	% change
1990	2,388,585	8.3	86,678.0	18.7	1,576.7	21.3
1991	2,802,053	17.3	105,666.5	21.9	1,986.4	26.0
1992	3,242,183	15.7	127,496.6	20.6	2,431.9	22.4
1993	3,736,775	15.3	157,305.8	23.4	2,973.8	22.3
1994	4,331,627	15.7	197,268.4	25.4	3,697.1	24.3
1995	4,977,203	14.3	246,228.2	21.8	4,612.8	23.6
1996	5,358,028	7.7	282,605.0	14.8	5,259.4	14.0
1997	5,926,324	10.6	321,979.5	13.9	5,967.2	13.5
1998	6,318,992	6.6	339,598.9	5.5	6,240.0	4.6
1999	7,038,691	11.4	368,979.1	8.7	6,859.4	9.9

Source: Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

c) Distribution of Annual Premiums in Force

All classes of business registered was record growth rates in terms of annual premiums in force (See Table 3.4), especially for temporary policies which turned around to record a positive growth of 2.0 per cent after experiencing a negative growth 18.8 per cent in 1997. In 1999, temporary policies increased by a faster rate of 11.3 per cent to RM373.8 million. This is because temporary insurance provides the maximum protection at the cheapest cost. It is purely for protection without any savings element. Annual premiums in force for whole life policies grew by 8.6 per cent (1998: 4.6 %) to RM3,069.1 million in 1999, while endowment policies grew by 9.0 per cent (1998: 4.8%) to reach RM2,125.7 million in 1999. In 1999, the type of other insurance policies grew by 5.8 per cent to RM1,182.9 million.

Table 3.4: Distribution of Annual Premiums in Force

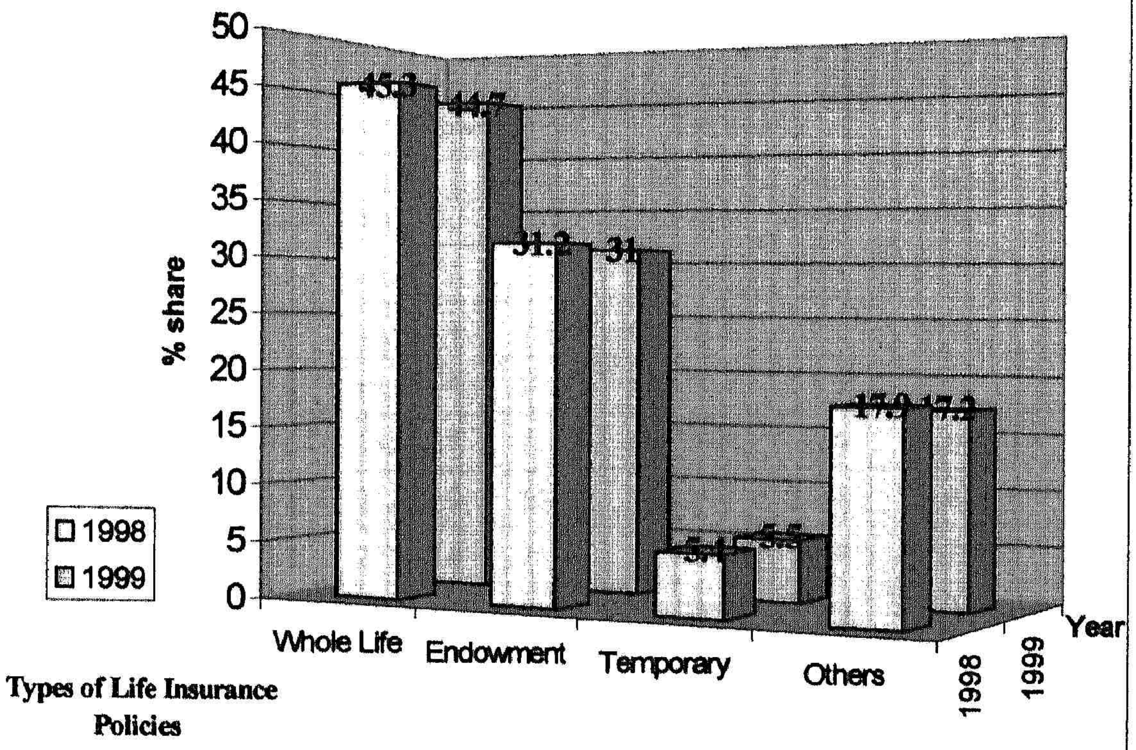
Year	Whole Life		Endowment		Temporary		Others	
	RM million	% change	RM million	% change	RM million	% change	RM million	% change
1990	736.2	20.8	617.9	28.0	102.5	48.9	120.1	-13.5
1991	868.9	18.0	756.6	22.4	120.1	17.2	240.7	100.4
1992	1,100.6	26.7	867.1	14.6	171.8	43.1	291.9	21.3
1993	1,387.9	26.1	996.7	15.0	198.4	15.5	390.8	33.8
1994	1,745.1	25.7	1,180.8	18.5	242.8	22.4	528.4	35.2
1995	2,119.4	21.4	1,481.9	22.7	306.4	24.0	705.0	32.3
1996	2,397.8	13.1	1,660.2	12.0	405.6	32.4	795.7	12.9
1997	2,702.8	12.7	1,861.8	12.1	329.2	-18.8	1,064.0	33.7
1998	2,826.1	4.6	1,950.4	4.8	335.8	2.0	1,117.8	5.1
1999	3,069.1	8.6	2,125.7	9.0	373.8	11.3	1,182.9	5.8

Source: Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

Temporary policies contributed shares of annual premiums in force of 5.5 per cent in 1999. On the other hand, the shares of whole life and endowment policies remained dominant comprising 44.7 per cent and 31.0 per cent of premiums in force respectively. The share of other types of policies had declined to 17.2 per cent in 1999 (See Figure 3.2).

In order to gain wider market penetration, insurers need to diversify from traditional policies into more innovative 'savings' type products. To achieve this, insurers have to enhance product research and development, as well as to improve their investment management especially for investment-linked policies. Given the recent tax relief of RM3000 announced by the Government for education and medical products, active promotion of these products should enhance market access and growth beyond the traditional boundaries.

Figure 3.2 Distribution Market Share of Annual Premiums in Force for the Year 1998 and 1999



Source: Annual Reports of the Director General of Insurance, 2000.

d) Distribution of Sums Insured in Force

The distribution of sums insured in force by type of policy does not exhibit the same trend as the distribution of the annual premiums in force (See Table 3.5). In 1999, saw whole life policies in force increased by 10.8 per cent to RM135,464.8 million while temporary policies grew by 16.1 per cent to reach RM133,032.2 million. Endowment policies, which grew at a moderate pace of 8.2 per cent to RM43,628.1 million. On the

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other hand, the type of other insurance policies recorded a reduction of 14.1 per cent to RM53,479.9 million.

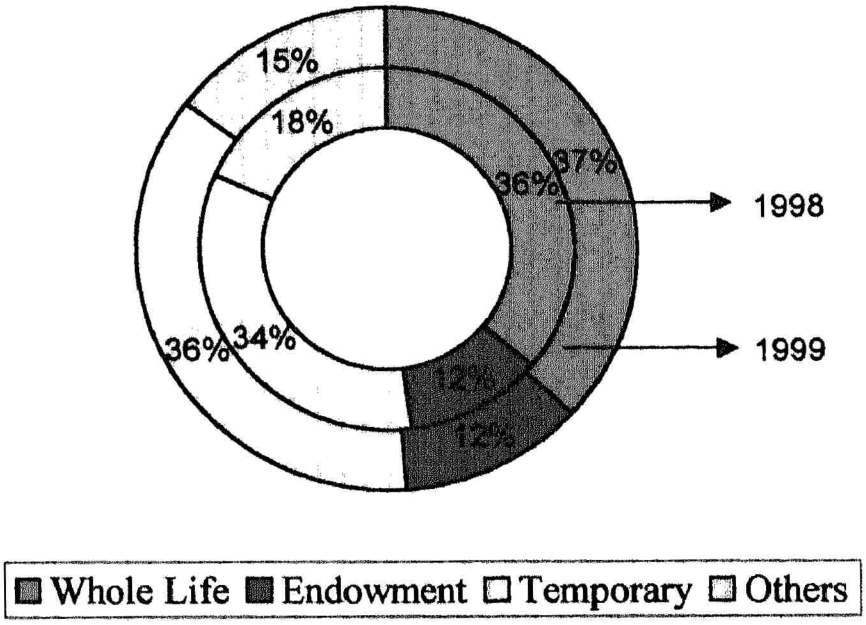
Table 3.5: Distribution of Sums Insured in Force

Year	Whole Life		Endowment		Temporary		Others	
	RM million	% change	RM million	% change	RM million	% change	RM million	% change
1990	30,984.7	19.5	11,699.7	23.6	40,423.3	26.3	3,570.3	-36.6
1991	36,201.1	16.8	13,917.3	19.0	46,786.6	15.7	8,761.5	145.4
1992	48,500.0	34.0	15,843.0	13.8	54,429.8	16.3	8,723.8	-0.4
1993	62,980.1	29.9	18,148.7	14.6	63,009.6	15.8	13,167.4	50.9
1994	79,650.2	26.5	21,471.9	18.3	76,126.3	20.8	20,020.0	52.0
1995	94,726.9	18.4	27,547.8	24.4	93,846.6	17.9	30,107.0	47.1
1996	105,141.9	11.0	31,279.7	13.5	108,735.7	15.9	37,447.7	24.4
1997	117,672.6	11.9	37,698.6	20.5	103,244.4	-5.1	63,250.7	68.9
1998	122,233.6	3.9	40,329.6	7.0	114,578.7	11.0	62,247.3	-1.6
1999	135,464.8	10.8	43.628.1	8.2	133,032.2	16.1	53,479.9	-14.1

Source: Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

In terms of sums insured in force, the industry sustained a strong growth rate of 8.7 per cent (1998: 5.4%), attributable mainly to the rapid pace of increase of temporary and whole life policies. The trend towards temporary insurance coverage continued in 1999. Temporary insurance further increased its share of total sums insured to 36.1 per cent share while the shares of whole life policies accounted for 36.7 per cent of all term insurance business. Annual premium in force for the endowment and other of insurances continued to decline to 11.8 per cent and 14.5 per cent respectively (See Figure 3.3).

Figure 3.3: Distribution of Market Share of Sums Insured in Force for the Year 1998 and 1999



Source: Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

Compared to the developed countries, there is still considerable scope for further growth of life insurance in Malaysia. A notable characteristic of life insurance development worldwide is that highly industrialized countries are also the ones showing the highest level of life insurance development measured in terms of per capital life insurance premiums or life premiums as a proportion of gross national product. On both scores, Malaysia is quiet far behind the developed countries, indicating sample potential for life insurance development.

3.3.3 Socio-economic Indicators

3.3.3 Socio-economic Indicators

Life insurance can provide consumers with both a form of protection and a mode of saving. In addition to its primary function of providing protection for financial consequences of death, life insurance can also be an effective vehicle for harnessing household savings. This function has important benefits for an economy in the creation of a pool of investment capital.

Others indicators on the performance of the life insurance industry in relation to the economy are provided in Table 3.6. Sums insured in force as a ratio of GNP at market prices deteriorated to 131.9 per cent in 1999 from 126.2 per cent in 1998 and 120.7 per cent in 1997. On the other hand, the demand for life insurance coverage, measured in terms of aggregate premium income of the industry, also increase at an impressive rate of 4.1 per cent in 1998, as against 15.0 per cent in 1999 while the annual premium income as a ratio of GNP at market prices remained at around 2.6 per cent. This was the highest rate of increase in premium income recorded by the industry during the 10 year period from 1990 to 1999.

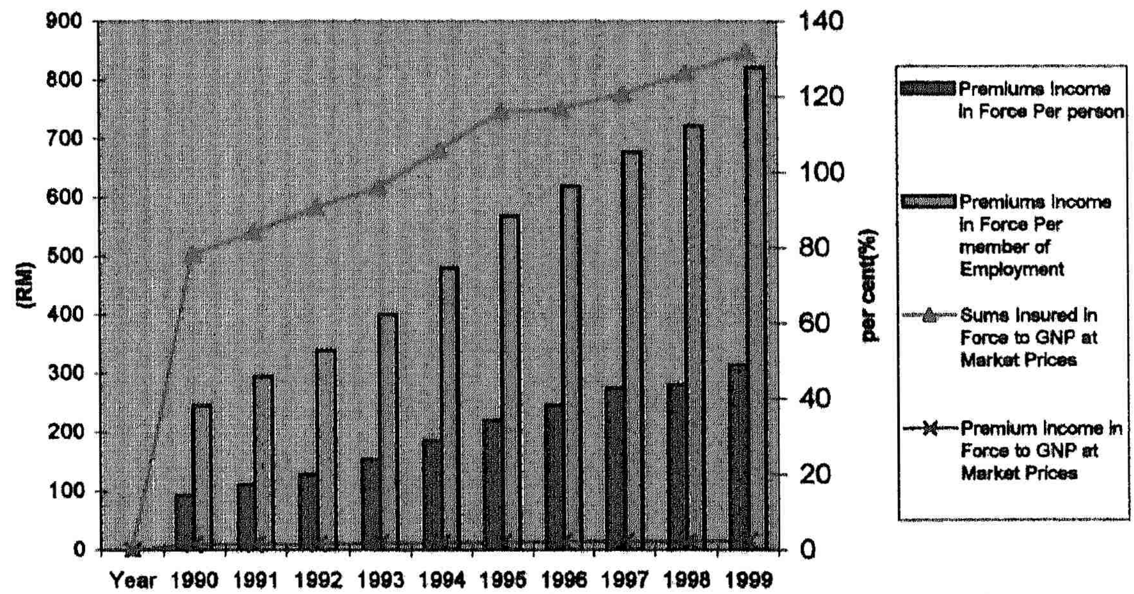
Table 3.6: Life Insurance Growth and Socio-Economic Indicators

Year	Total Sums Insured in Force	Premium Income*	Gross National Product at Market Prices	Population	Employ-ment	Per Capita Income	Sums Insured in Force to GNP at Market Prices	Total Sums Insured in Force Per capita	Premium Income in Force to GNP at Market Prices	Premium Income in Force Per person	Premium Income in Force Per member of Employ-Ment
	(RM million)			(million per son)		(RM)	(%)	(RM)	(%)	(RM)	(RM)
1990	86,678.0	1,643.1	110,637	17.8	6.7	6,229	78.3	4,880	1.5	92	246
1991	105,666.5	2,030.3	125,581	18.3	6.9	6,688	84.1	5,765	1.6	111	295
1992	127,496.6	2,408.6	140,531	18.8	7.1	7,394	90.7	6,795	1.7	128	339
1993	157,305.8	2,957.4	163,928	19.2	7.4	7,993	96.0	8,190	1.8	154	400
1994	197,268.4	3,653.7	186,049	19.6	7.6	8,975	106.0	10,039	2.0	186	480
1995	246,228.2	4,549.9	212,096	20.7	8.0	10,068	116.1	11,895	2.1	220	569
1996	282,605.0	5,209.2	241,931	21.2	8.4	11,228	116.8	13,330	2.2	246	620
1997	321,979.5	5,970.7	266,700	21.7	8.8	12,051	120.7	14,838	2.2	275	678
1998	339,598.9	6,217.2	269,136	22.2	8.6	12,135	126.2	15,297	2.3	280	723
1999	368,979.1	7,152.7	279,842	22.7	8.7	12,305	131.9	16,255	2.6	315	822

Note:
* Refer to 'A Glossary of Life Insurance Terms'.
Source:
Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.
Economic Report of Ministry of Finance.

In 1999, total sums insured in force per capita in Malaysia rose in value by 6.3 per cent from RM15,297 in 1998 to RM16,255 million. Similarly, in line with the more extensive coverage, the premium income in force per person rose at a faster rate by 12.5 per cent from RM280 in 1998 to RM315 in 1999. In terms of the population with disposable income and capacity to purchase, the ratio of the employed population covered by life insurance increased by 13.7 per cent from RM723 to RM822 in 1999. These indicated that, while the life insurance industry in Malaysia had achieved commendable growth in the past few years (See Figure 3.4), further efforts are evidently necessary to enable the industry to harness the growth potential arising from the fast transforming economy and rising levels of per capita income.

Figure 3.4: Growth of Life Insurance and Population Insured



Source:
Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

The assets position of life funds from 1990-1999 is shown in Table 3.7. In line with the overall improvement in business performance, life insurance assets grew by 20.5 per cent to reach RM 31,707 million while life funds constituted 11.3 per cent of the Gross National Product (GNP) to RM 279,842 million in 1999, reflecting a slight increase, compared with 9.8 per cent recorded in 1998 (1997: + 8.7%, 1996: + 8.6%, 1995: + 8.2%).

Table 3.7: Assets Growth of Life Insurance Fund

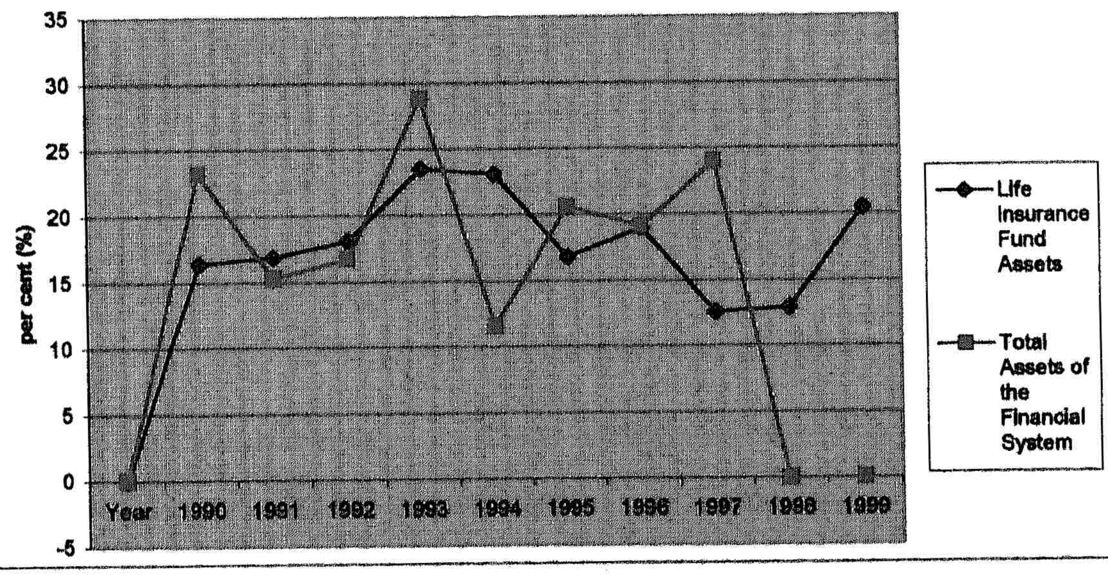
As at end of December	Life Insurance Fund Assets (RM million)	GNP Market Price (RM million)	Total Assets of the Financial System (RM billion)	% of GNP	% of Total Assets of the Financial System
1990	7,097.2	110,637	327.5	6.4	2.1
1991	8,323.3	125,581	377.5	6.6	2.2
1992	9,793.8	140,531	440.6	7.0	2.2
1993	12,118.7	163,928	567.5	7.4	2.1
1994	14,862.2	186,049	633.5	8.0	2.3
1995	17,358.1	212,096	764.0	8.2	2.2
1996	20,729.4	241,931	909.6	8.6	2.2
1997	23,306.7	266,700	1127.7	8.7	2.1
1998	26,314.9	269,136	1092.3	9.8	2.4
1999	31,707.0	279,842	1164.0	11.3	2.7

Source:
Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.
Economic Report of Ministry of Finance.

As consumers become more sophisticated and with the growing convergence of financial products in the financial market, the competition among different financial providers becomes more acute. In term of contribution to total assets of financial market in the economy, the life insurance assets constituted 2.7 per cent (1998: + 2.4 per cent) of the total assets in the financial system in 1999 (See Table 3.7).

The growth at an average annual rate over the past 10 years of life insurance fund assets was slightly faster than the increase in total assets of the financial system. From 1990 to 1999, life insurance fund increased by an average rate of 17.8 per cent, 15.9 per cent in total assets in the financial system (See Figure 3.5). In order to ensure that the life insurance market will be in an advantageous position to better compete for a bigger share in the financial market, life insurers should be more professional and efficient.

Figure 3.5: Growth of Life insurance Fund Assets Against Total Assets of the Financial System



Source:
Annual Reports of the Director General of Insurance, 1995.
Annual Reports of the Director General of Insurance, 2000.

The life industry has the potential to play a much more meaningful role in the mobilization of domestic savings, and become a major contributor to capital formation for the nation's development, if strategic measures are undertaken to improve operational and technical efficiency, including enhancing product value to consumers, upgrading quality of service and reducing operating costs.

3.4 Economic Bases of Life Insurance

A human life is possessed of many values, most of them irreplaceable and not susceptible of measurement. Such values, however, are not the subject matter of life insurance. Life insurance is concerned with the economic value of a human life, which is derived from its earning capacity and the financial dependence of other lives on that earning capacity. If an individual is without dependence and no other person or organization stands to profit through his living, either now or in the future, then his life, for all practical purposes, has no monetary value that needs to be perpetuated. Such an individual is rare. Most income producers either have dependents or can expect to acquire them in the normal course of events. In either case, a basis exists for insurance.

By means of life insurance, an individual can assure himself that his family will receive the monetary value of those income-producing qualities that lie within his physical being, whether he lives or dies. By capitalizing his life value, he can leave his family in the same economic position that they would have enjoyed had he lived. The objective is to determine the present value of the income flow to the family if the family head survives to the end of his income-producing period, since ideally the insurance should be sufficient to permit the family to enjoy the same standard of living that it would have enjoyed had the breadwinner not died.

3.4.1 Diminishing Nature of the Economic Value

It must be apparent that from any given point, the economic value of a producer will have a tendency to diminish with the passage of time. His earnings level may continue to increase for a certain period or indefinitely; but with each passing year, the remaining period of productivity becomes shorter. Each year of income that is realized, the less that remains to be earned. Since the economic value of a man is nothing more than the unrealized earning capacity represented by his native ability and acquired skills, his value must diminish as potential income is converted into actual income. This principle is illustrated diagrammatically in Figure 3.6.

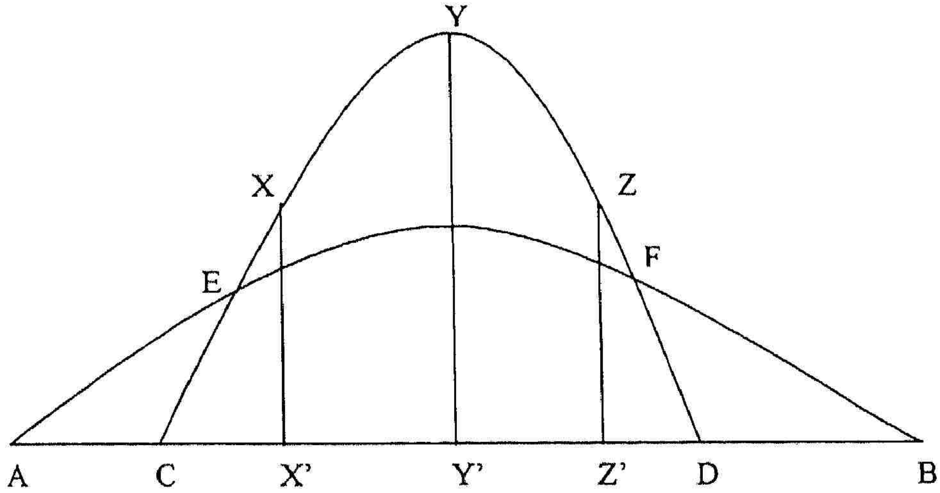


Figure 3.6: Hypothetical Illustration of Economic Value of a Human Life

The chord *AB* represents the lifetime of an individual born at point *A* and dying at point *B*. The arc *AB* represents his cost of maintenance and, during his productive years, his income tax liability. The arc *CD* represents earning capacity. During the period *A* to *C*, there are no earning, but there are costs of maintenance represented by the triangle *AEC*. Earnings commence at *C* and may represent part-time work or sums earned for running errands. The area of arc *CD* time that extends above arc *AB* represents earning in excess of taxes and the cost of self-maintenance. Point *D* marks the age of retirement; and the area *DFB* symbolizes the second major period in the individual's life, during which the cost of self-maintenance exceeds his income.

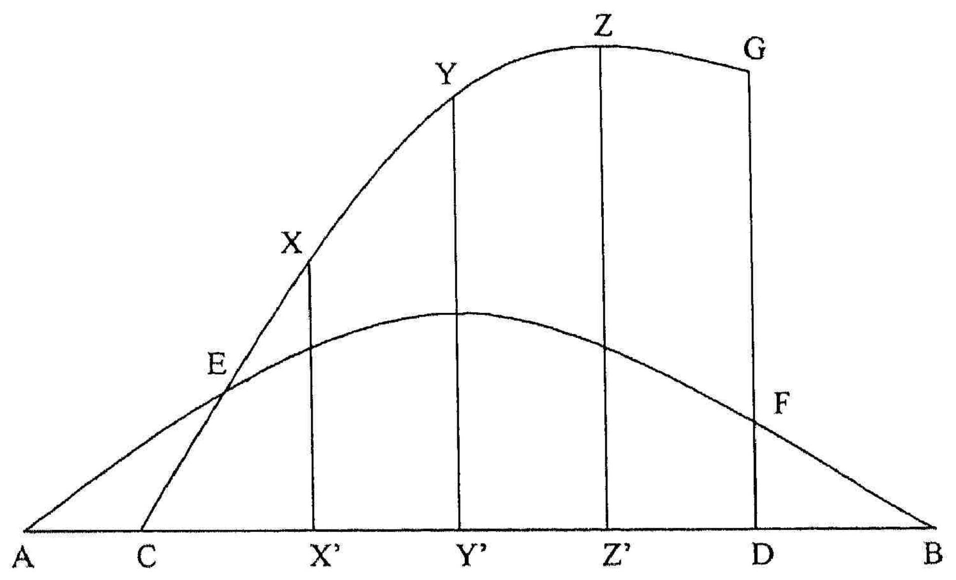


Figure 3.7: Typical Pattern of Earnings

The monetary value of the individual is at its peak at point *E*, since net earnings are just commencing. At the point where *XX'* intersects the arcs, the earnings rate has increased, but potential future earnings have declined. The earnings potential shows further decreases at *YY'* and *ZZ'*; and at point *F*, it has shrunk to zero.

Figure 3.6 is diagrammatic and obviously unrealistic. Neither earnings nor maintenance expenses follow a symmetrical curve. For example, the childhood period starts with a highly unsymmetrical outlay for maternity costs. Income is likely to commence earlier than at point *C*, particularly among lower income groups, and under no circumstances is it likely to decline so gradually to the age of retirement. In most occupations, earnings reach their maximum in the forties and decline only slightly to retirement, when they terminate abruptly. Figure 3.7 shows a fairly typical pattern of earnings among clerical and professional groups.

3.4.2 Bases for Life Insurance

The foregoing diagrams illustrate in rough fashion the economic foundation of three broad categories of life insurance. The first is represented by the area AEC. The needs of the individual are met during this period by the parents or other persons responsible for the welfare of the child. If the child should die before becoming a producer, the investment in his maintenance and education is sacrificed. While most parents regard such expenditures as one of the duties and privileges of parenthood and justifiably shrink from labeling them as an investment, to be recovered, if practicable, in the event of the child's death, they do create a substantial value which can logically serve as one of the bases for juvenile insurance, which a rapidly growing segment of the life insurance business.

Another type of insurance need is portrayed by the area in arc CD lying above arc AB. The surplus earnings represented by this area are the source of support for the individual's dependents and a broad measure of the economic loss to the family if the producer should die. A portion of such earnings will have to go into insurance premiums, and another portion should be set aside for the old-age needs of the producer and his wife; but the share that is destined for the care and maintenance of the family should be capitalized and preserved for the family through the medium of life insurance. Thus, endowment and term policy is needed in this situation, because endowment policy is an investment scheme combined with protection & savings where the sum assured will be paid out upon death, total & permanent disability or upon maturity. Beside that, term policy provides protection for a specific term. His family will be well protected in the event of an untimely death or permanent disability.

Finally, the retirement needs of the individual, represented by the area DFB, should be met, at least in part, therefore the most realistic source of the additional income needed is the whole life policy. Besides, it provides his family with a lifetime protection. It is also a value builder. Therefore, more and more insured can purchase this kind of policy to protect their family during the child-raising period, with the specific objective of using the cash values for their child's education or retirement income.

3.5 Concept of Life Insurance

Life insurance is a contract between an individual and a life insurance company. The individual agrees to pay a premium and in return, the insurance company promises to pay a predetermined amount of money to:

- The insured, in the event he becomes disabled or when some specified event takes place, and/or;
- A beneficiary or beneficiaries if the insured dies.

In order for the insurer to have enough money available to pay death benefits when they become due, insurance companies use a pricing system known as the legal reserve system. This system is based upon several premises:

- The amount of the death benefit promised in the insurance policy should be calculable in advance of the insured's death;
- The money needed to pay the benefits should be collected in advance, so that funds will be available to pay claims and expenses as they occur;
- The premium an individual pays for an insurance policy should be directly related to the amount of risk the insurer assumes for that person.

3.5.1 The Need for Life Insurance

The insurance industry which exists primarily to provide the public with a means of protection against financial losses arising from unexpected events offers in addition a wide range of services which is broking, adjusting, risk management including inspection of plant and building and loss prevention advice. Life insurance offers an ever-increasing range of savings and investment contracts, besides protection.

Life insurance is a means whereby a person can make financial provision for his retirement by contributing regularly to a pension funded by a life insurance company. Consequently, the management of pension funds is a very important function for life insurance companies. For those concerned about having money to spend after they retire may want to look into endowment plans that are designed to pay out sum of money after a period of your choice. This way, they can be sure of a nest egg at the end of the day.

Under the education category, life insurance companies have plans that serve parents who wish to plan for their children's education. With this plan, parents can have the peace of mind that their children will have a sum of money that will enable them to pursue their education when the time comes.

Income Protection products are aimed at protecting the standard of living and ensuring the family has a source of funds should the inevitable happens to income earner. Under this category, insurance plans for accidents resulting in total and permanent disabilities are also included.

Most people are not prepared for the time that they need to be hospitalized and do not have an idea how much that can cost, depending on which private hospital. With the cost of medical care on the rise, seeking treatment at hospitals may also result in long waits because of the constant long queues. With the health plans of the life insurance companies, the burden of hospital room and boards as well as medical and surgical costs are taken care of.

The greatest killer of them all is stroke and cancer in this country. Critical illness plans have been designed to cover up to thirty-six types of diseases. Life insurance companies may not able to prevent illness from taking place but these companies can help to make the road to recovery easier.

The life insurance agent is concerned with the financial consequences of death to those that survive the deceased. Through his financial services he also minimizes the emotional and legal consequences of death, at the same time serving the needs of future income and old age as well. The use of life insurance as a means of meeting these expenses helps people not only to anticipate and plan for the future but also provides peace of mind and financial independence making possible a fuller present.

3.5.2 Main Types of Life Insurance Policies

There are three basic types of life insurance policies: temporary, endowment, and whole life. The function is to create a principal sum or estate, either through the death of the insured or through the accumulation of funds set aside for investment purposes. All policies sold by life insurers in Malaysia are a variation or combination of these three basic types.

3.5.2.1 Temporary Life Insurance

Temporary (or Term) insurance provides life insurance protection for a limited period only, the face of the policy being payable if death should occur during the specified period, and nothing being paid in the event of survival.

This popular form of ordinary insurance differs in major respects from whole life, primarily because it is offered for a specified number of years, usually one year. During the specified time, the premium is unchanged, based on the attained age of the insured. At younger ages, the premium likelihood of death increases on average. Because temporary insurance is the least expensive form of coverage, it appeals largely to younger adults and those with lower incomes.

Temporary insurance is regarded as term insurance (as opposed to permanent insurance like whole life), and as such, it does not provide any surrender values, paid-up values, loan values or any of the non-forfeiture privileges.

3.5.2.2 Whole Life Insurance

In contrast with temporary insurance, which pays benefits only if the insured dies during a specified period of years, whole life insurance provides for the payment of the face amount upon the death of the insured, regardless of when it may occur.

Sometimes known as permanent insurance or cash-value life insurance, traditional whole life insurance is based on a level-premium method of payment, whereby the policyholder pays an unchanging periodic amount for entire life of the contract, normally until the death of the insured. If the insured dies, the sum assured less any outstanding policy loans are payable to beneficiary. Sometimes the sum assured will be payable when the insured reaches a certain age such as 85, 90 or 99 years.

This is a permanent insurance policy and hence, there are surrender values available and they typically carry a policy loan privilege. If the premiums are to be paid throughout the duration of the insured, the insurance is known as ordinary life; if premium are to be paid only during a specified period, the insurance is designated limited-payment life.

a) Ordinary Whole Life Insurance

Ordinary whole life insurance is one where the premiums are payable throughout the lifetime of the life assured. If the life assured dies, the contract provides various settlement options to be payable to the beneficiaries.

After the first few policy years (normally the third), the policy will have accumulated surrender value. The policyholder may then apply for a policy loan (against the surrender value) to meet his financial needs. Furthermore, the policy can be converted to a reduced paid-up policy.

b) Limited Payment Whole Life Insurance

Limited payment whole life insurance is one in which the premiums are payable for a limited number of years (usually ten, fifteen, twenty, twenty-five, or thirty years). Sometimes, the policy is designed in such a way that premiums payment is not required from his retirement date (no matter whether he did retire) onward. After the premium-paying period, the policy becomes paid-up for its full amount and no further premiums are required.

The purpose of this limited payment is to enable the policyholder to pay up the policy during his working lifetime so that after the completion of the specified period, the policy may remain in force without imposing further financial obligations on the policyholder.

3.5.2.3 Endowment Insurance

Term and whole life insurance provide for payment of the face amount of the policy only in the event of death. Endowment insurance, on the other hand, provide not only for payment of the face of the policy in the event of the insured's death during a specified period of years, but also for payment of the full face amount at the of such period if the insured is still living.

Endowment insurance policies may be classified in various ways; but with respect to the manner in which the maturity date is expressed, they may be subdivided into those that mature at a specified ages, such as fifty-five, sixty, or sixty-five; and those that mature at the end of a specified of number of years, such as ten, fifteen, twenty-five, thirty, or more years.

Theoretically, endowment insurance is made up of a pure endowment insurance and a term insurance. The pure endowment insurance will pay the sum assured if the insured survives to the end of the endowment period. The term insurance will pay the sum assured if the insured dies during the endowment period. Therefore, it can be said that the endowment insurance is a combination of pure endowment insurance and term insurance.

Like whole life policies, endowment policies steadily build up cash values. However, since an endowment policy matures much earlier than a whole life policy, the cash values build up more rapidly. And because of this, the premium payable is higher than that of a whole life policy.

3.5.3 Premium Calculation

The price charged by a life insurance company for an insurance company for an insurance contract is called the premium. The premium may be paid in one sum, in which event it is referred to as a single premium; or it may be paid at periodic intervals, such as annually, semiannually, quarterly, or monthly.

Premiums are computed on the basic of three fundamental assumptions, which is a rate of mortality, a rate of interest, and a rate of expense.

3.5.3.1 The Rate of Mortality

With the introduction of the principle of the Rate of Mortality, it became possible for the insurers to determine the cost of offering life cover to a person for a period of one year. Mortality tables are used when determining the rate of mortality (see Appendix B). These tables are constructed by making observations of past experience, and projecting the trends observed into the future by forecasting the expected number of deaths. Usually different standard tables are prepared for different types of policies; giving recognition to the fact that mortality rates also vary in accordance with the type of policy. This is based on the assumption that the rate of deaths among a group of people of the same age in the future will be similar to that of a known group in the past. Higher mortality means higher premiums will be charged, and vice versa except for riders or plans that continue to pay only when the insured is alive. Examples of the latter are cash dividend and reversionary bonus riders. Many companies, mainly the large ones, construct mortality tables from their own experience and use them, or sometimes with modifications the rates of mortality from Life Insurance Association Malaysia, to calculate their premiums.

3.5.3.2 The Returns of Investment

This is the interest rate the insurer expects to earn on its funds and/or investments. It directly affects the level of premium that will be charged. For example, if the insurer expects to earn high interest on its investment, it will charge a lower premium, and vice versa.

3.5.3.3 The Expenses Factor

These are the expenses that the insurer incurs as a result of issuing the policy. The determination of the expenses that will be incurred is based on the assumption that operating costs will follow some patterns based on past experience, adjusted for inflation. It is obvious that the higher the expenses, the higher the premiums will be, and vice versa. Therefore, all three factors above will be taken into account in calculating the premium.

Usually the premium rate derived is presented in a table or tables and expressed as premium per thousand RM of face amount. Depending on the age of insured and where relevant, the length of period of coverage, a premium rate is extracted from such tables. Sometimes there are separate tables for male and female insured. If not, the premium rate table provided is assumed to be for males and when reading for female rates, a certain number of years are subtracted or added to actual age before being read from the table.

Sometimes, there are separate tables for each face amount band. If not, a fixed amount may be added or subtracted from the table rate depending on whether the face amount is below the lower threshold or greater than the higher threshold, respectively. Furthermore, if the insured is considered to be a medically preferred risk, the premium rate is reduced or increased by a certain amount. Often there is a further reduction for non-smoking insured. Finally, if chosen frequency of payment is not annual, a premium adjustment is applied.

3.6 Consumer Choices and the Purchase of Life Insurance

Consumers considering the purchase of life insurance face a complex, emotionally charged decision. A considered choice requires that the consumer first decide whether he needs savings as well as protection. For pure protection, the choice is relatively simple; the consumer can shop term policies for the least expensive cover. If saving is intended, the consumer must then consider the various policies with some type of savings component, for example, whole life plan, and endowment plan. Here the decision becomes considerably more difficult, especially if the consumer considers purchasing whole life or endowment insurance, because such policies typically do not state a rate of return and the computation is beyond the skill of the ordinary consumer.

In addition, consumers can take out term insurance, but save in other ways. The consumers ought then consider the relative risks, rewards and liquidity of other savings mediums for even a straightforward savings account has comparative disadvantages, such as the lack of a guaranteed rate of interest. To get a guaranteed, and probably higher, rate of interest from a savings account,

Thus, intelligent consumer choice among these various possible investment requires, at a minimum, that consumers be aware both of the various types of investments they might make and, for a given type of investment, the particular features of competing offerings.

3.6.1 The Problem of Choice

Consumers have long had difficulty choosing among these alternatives. While the problem of choosing does not seem to have generated great numbers of complaints, perhaps due to the complex nature of the choices or the lack of a clear focus for complaining. According to DGI research reported that, the average person feels far less self-confident as a buyer of life insurance than of any other major purchase. Indeed, the entire act of purchasing life insurance is fraught with anxiety; people are not confident about their ability to comprehend the pros and cons of alternative plans; there are unsure of how much influence the agent's commission has on his recommendations substantial; and there are unsure about what amount of coverage is adequate or desirable.

Similar problems have been reported in other countries, Canada government comments that the distribution system there does not encourage price comparisons by consumers between the life insurance products offered by different companies. Singapore likewise reports that consumers face particular difficulties in comparing policies with important "savings" components because it is complicated to determine, on a comparable basis, the implicit "cost" of cash surrender values. In Japan, consumers have very little information about choices between different types of policies or between different companies.

3.6.2 Variations on Basic Policy Types

In the Malaysia, for example, the temporary insurance contract may have a clause giving the policyholder the right to renew for a further specified period at the end of the term, irrespective of any changes in the life assured's health (or occupation). Such a policy is styled a "Renewable Term Insurance". It is quite similar in principle to the assured has the option to convert the policy into a whole life or endowment assurance. Such a policy is useful to a young head of household with heavy family commitments and limited income. As his disposable income grows, he can convert the contract to a wider form of cover without evidence of good health.

Another variation in basic temporary insurance is decreasing temporary insurance (also called reducing term, declining term or mortgage term). In this form of temporary insurance, the amount payable in the event o death diminishes each year. This form of policy is typically used in connection with the purchase of a home to insure the declining loan balance.

3.6.3 Distinctive Features of Life Insurance Contracts

With most types of non-life insurance, the cover is intended to give financial protection against is a certainty, for example, death or the expiry of a period of years. This permits life insurance contracts (other than term policies) to offer a number of distinctive features.

3.6.3.1 Level Premium Payments

Actuarial science makes it possible to issue life insurance contracts with the same premium throughout the duration of the policy, including term policies. The amount payable will vary according to the age of the assured at policy inception, but such an increase in risk would invariably have meant higher premiums or the termination of the policy, but limited payment insurance can be arranged, with premiums ceasing at a given age.

3.6.3.2 Surrender Values

In most instances where a life insurance contract is terminated before death or maturity, a surrender value is payable to the policyholder. Surrender values are peculiar to life insurance. The amount paid by way of surrender value may be less than the sum paid by way of premium, and if surrender occurs during the early years of insurance the difference is usually significant. Three main factors contribute to low surrender values in the early years of the policy. These are:

i) payment for the cost of the life insurance cover up to the time of surrender;

ii) initial expenses which are much greater than subsequent annual renewal expenses; and

iii) the high initial rate of commission paid to the agent.

3.6.3.3 Loans

A policy loan is taken out on the security of the policy. It can only be taken out if the policy has a cash value. There is usually a cash value after the policy has been in force for three full years. For this reason, life insurers and others are normally prepared to lend policyholders money on life policies, usually up to 90 per cent of the surrender value.

3.6.3.4 Fully Paid-Up Insurance

If a policyholder wishes to terminate his contract before policy maturity but does not want to accept a surrender values, it is possible to make the policy fully paid-up instead. As its name implies, no further premium are necessary, and the policy will be on the same terms and payable at the same time as the original one except that the sum assured will be reduced. The amount of the new sum assured will depend on the premiums paid up to the point. Such policies are particularly useful when the normal maturity date is near or when the policy will continue to participate in bonus distributions.