

APPRAISAL

(i) The Legal Environment

The legislation in Malaya is described as a half-way house between minimum controls backed by the publicity of an informed financial press, as in England, and detailed supervision by government inspectors of all aspects of a company's business. The latter method is typified by legislation in North America and India.

The chief areas of control are in the areas of, first, the insurance fund maintenance which should be solvent to meet its expected liabilities which are to be examined by a qualified actuary. Secondly the investment policy of the companies is slightly attuned to certain stable assets and 55% of these assets should be invested in the stipulated authorised assets. Thirdly any literature that is published should not be misleading. Finally, there is wide powers of the Insurance Commissioner whose approval is of great significance in matters like premium rates, commissions, the incorporation of a new company and who is at liberty to clarify or amplify certain information which appears doubtful to him.

In this particular service industry which rests upon principles like "utmost good faith", "public interest," is of great or supreme importance. Government intervention becomes necessary. For instance, the abuse of the mushroom companies would never have been eradicated had it not been for the introduction of legislation. Nonetheless, too stringent a legislation is unhealthy for free enterprise.

The atmosphere prevalent in Malaysia is conducive for the growth of the industry. This can be evidenced by the numerous foreign incorporated insurance companies operating in Malaya. Legislation is necessary only to ensure that good insurance principles are adopted. Thus the legal environment does not retard the possibilities of growth of the insurance industry in Malaya.

(ii) Problems of the Insurance Industry

Though there is scope for development in the industry, there are numerous problems confronting it. What exactly are the various problems that exist in this country? For our purpose again it would preferable to discuss under the two broad categories of (a) general insurance (b) life insurance.

(a) General Insurance: The problems for general insurance can be listed under the following headings:

- (i) Intense competition in a relatively narrow market, thereby leading to high costs and sometimes the temporary slackening of sound standards.
- (ii) Excessive commissions which encourage or condone rebating or discounting.
- (iii) Credit used as a weapon in competition leading to loss of interest and bad debts.
- (iv) Insufficient detailed and accurate data on which to base a realistic tariff for Malaya.
- (v) Shortage of skilled staff.

There are of course other problems which may not be mentioned whether they may be of greater or lesser degree. Nevertheless these five outlined are the basic problems the companies encounter.

- (1) Intense Competition and the Small Market:- When referring to intense competition we look into the total premium income for the whole of Malaya. It can be found that the figure is not in excess of \$100 million. This figure may sound enormous and quite useful but it should not be forgotten that there are eighty-two companies carrying out general business; fighting for their share. (1) It should be realised that about one half of that figure represents motor vehicles insurance and leaving the other half for competition among the other types of insurance. It is quite obvious that a company cannot stay in business unless it earns profits. A loss in one year must be recovered from profits in the earlier or later favourable years. There can be no profit unless premium income exceed claims, commissions and expenses.

This problem has affected the formulation of the policies of the general insurance companies. For instance, in the premium computation, the re-insurance policy to ensure security and so forth.

- (11) Rebating:- Rebating of part of the commissions to a client is almost universal in this country and few premiums paid are actually the rated premiums. Because of this rebating there is a temptation to keep an edging up the commissions paid in order to allow a larger rebate to secure the business. This has affected the practices of the insurance companies.

Commissions for all general insurance in 1963 averaged 34.47% and underwriting profit only 0.18%.

- (1) See the figures in Chapter I under "Classification of insurance".

However the 1964 figure is slightly improved, that is 32.26% for average commission and 5.5% for underwriting profit for all general insurers.

To the general public this cutting of net premiums may look like free enterprise at its best, but when one realises that the client is only buying a promise to pay, one should be equally concerned with the ability of the insurer to pay. Competition to the extent of serious loss can be carried too far under circumstances. This has been held in some countries (but not quite so in Malaya) to be the justification for tight control of premiums, commissions and expense rates.

(111) Credit as a weapon of competition: Companies bow to the demand for extended credit in order to either secure or retain their business. From an examination of the underwriting experience of the companies it is obvious, the extent each company relies on uncollected or "outstanding" premiums as an asset of its insurance funds. From the companies point of view it is also serious because no interest can be earned on premiums which have not been received and bad debts are likely to be more numerous than when credit is strictly controlled. For example one company's credit policy was costing it about 7½% of gross premiums written. (2) This problem influences the investment policy of the insurance company and its practices in a big way.

(iv) Statistics and tariff: The rating schedules of the tariff for general insurance premiums contain certain serious anomalies. For instance if on a certain fire risk a discount of 50% or 55% is considered reasonable by several companies and the tariff commission for that particular class happens to be 30% then there is more than a suspicion that the premium rating is too high. (3)

To have an organisation to compute the necessary statistics for a premium rating based on Malayan experience would be fairly costly in terms of the size of the market. Ultimately this must be faced if the industry is to have real information on which to conduct its business by other than intelligent guess work. It should be recollected that the basis of insurance is on the concept of large numbers and no one company's business is of sufficient spread and volume for its own experience to provide for it a reliable enough guide. These two would affect the companies' policies on commission rates and premium rates.

(v) Skilled staff: As this problem also arises in the

(2) Quoted from an interview with the Insurance Commissioner.
(3) See Chapter VI on "premiums"

life insurance section it would be dealt with later.

(b) Life Insurance. The outstanding problems for life insurance can be summed up as follows:-

- (i) Ammarket in which the public has not reached a balanced understanding of the need for life insurance.
- (ii) Inadequate knowledge and ability in a high proportion of the sales force to sell on a basis of the needs of each client.
- (iii) Rebating of premiums.
- (iv) High lapse rates.
- (v) An inadequate supply of skilled personal.
- (vi) The death of local actuaries.

It is particularly true that the public in Malaya have not attained that understanding of the need for life insurance. People sometimes purchase life insurance just because the agent happens to be a friend of theirs. This attitude reveals the poor understanding of the requirement of insurance in life and this attitude can be reflected in the popularity of the fifteen and twenty year endowment policies.

The field organisation (4) is not well trained to provide that aid in the choice of the most appropriate policies for the clientele. The agents themselves are not fully aware of the advantages and disadvantages of different policies, More so their interest lies in the commissions receivable during the sale of a policy.

As is explained while dealing with general insurance rebating is a recurring problem too in life insurance. The above problems combined has serious repercussions in the high lapse rate of policies. In 1964 lapses represented 38.05% of new sums insured and 36.59% of new annual premiums. In this atmosphere of high lapse rates, to boast new business written for the year is very much a delusion and this can be pretty expensive in the long-run.

The similar problem faced here is deficiency in the supply of skilled personnel in the two branches of insurance. This profession has not developed very far in this country and as such few are enterprising to train in this field. Also lacking is the qualified actuaries resident in Malaya. At present there is only one in Malaya! This makes it difficult for the newer companies who need on the spot technical advice. Often an administrative decision can have a technical repercussion unrecognised by management.

(4) See Chapter V on the "Structure and Organisation of the business"

Policies and Practices of Insurance Company :-

The companies' policies, we can observe are moulded and shaped by the problems facing the industry. The need to comply to legislation is another factor. These two factors have a great deal of influence on the policies of the companies operating in Malaya. It should be explained from the outset that this particular type of business enterprise allows only certain areas for the practice of free policy making which in its turn determines the practices and operation of the business. In many areas the policies are made either for conformity to legislation or the general policies adopted by other members of the trade.

Most companies definitely recommend the idea of an efficient field organisation or other officials. But this is hampered by the deficiency of skilled personnel. There can be no question on the failure of the policy when the environment does not furnish the conditions. On the payment of commissions, there are wide deviations from policy in the customary operations of the business. Rebating is high and consequently high commissions paid automatically follow. On this matter policy-decisions are very difficult to be formulated for achieving a more efficient alternative. Although most companies advocate that their policy is to keep their management expenses low, but as a percentage of total premium income it is fairly high. This cannot be charged as inefficiency. Rather the problems overrule efficiency.

There is no clear-cut policy that companies can adopt as regards premium rates. They are, in the life business, dependant upon the actuary's determination together with an eye on the rates for rival companies. To top it all, the approval of the commissioner is needed. On the general side the tariff determines most of the rates charged. If any variations that exist, between companies, they are minor rather than conspicuous.

In areas like reserve policies and surplus policy, loans and surrender values in life business, legislative control limits the scope for much differentiation of policies between the companies. Any policy that can arise has to be fashioned from the results of operations. For example surpluses are dependant upon the operation after valuation, by the actuary. With surpluses from valuation, then only can a dividend policy be made. For general insurance the reserves are also kept in accordance with the Act.

In areas like investments and reinsurance there is

scope for individual policy-making. In their investment policy companies can choose the types of investments within the authorised items up to a percentage of 55%. There is also scope for investment in foreign ventures but the element of speculation should not be the policy of any company. The reinsurances are also adopted by individual companies in accordance with whatever policy they make. For example the retention limit, the choice of the reinsurer and whether the reinsurer should be a local^{or} foreign company. These differ from company to company.

Thus it can be found, the pattern which the insurance companies abide to. The free scope in policy making of the companies are narrowed by certain factors. This is justifiable on the grounds of the nature of the industry.

