CHAPTER V

POLICIES AND PRACTICES OF LIFE INSURANCE COMPANIES

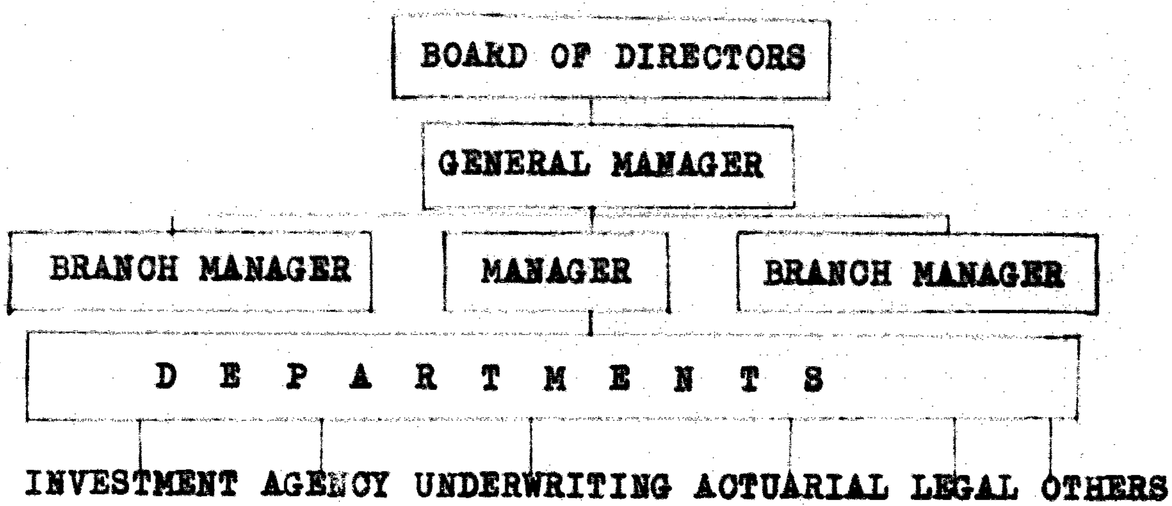
The policies and practices of the insurance companies are varied and diverse in this country. It would be quite difficult and inappropriate to examine the policies and practices of individual insurance companies. Nevertheless, there are certain tendencies on the part of insurance companies toward certain policies and pratices. These can be generalised to present a broad picture of the policies and practices of the insurance companies in Malaya. In this chapter the policies and practices of important aspects of the insurance business would be discussed. It attempts to examine the policies of the companies and how they practice or operate the business. It also tries to relate the former to the latter or examine their relationships.

(1) Organisation of Life Insurance Companies

The organisation of the life insurance companies in Malaya can be divided into two clear-cut categories. They are firstly, the "Home Office" and secondly the "Field" Organizations. This is practised by any life insurance company.

Home Office Organisation. Principally the organisation of the Home Office of life insurance companies follows that of any business organisation. Each company can adopt any policy in setting up its organisation. The policies which the companies can adopt vary from the simple "line" organisation to the "line and staff", the "functionalised" or the"committee" organisational structures. The policy of an insurance company on this would depend upon the extent of development of the company. Suppose the company has been in business for a long time and is quite developed and stable probably it would have a complex organisational chart. Thus insurance companies differ in their policies on the choice of the organisational structures. Once a company has chosen a policy; then in practice they would closely adhere to that policy.

The Home Office can be referred to as the head-quarters of the insurance company. In it can be found the "general manager" or the operating head of the business and the "company secretary" who is the person responsible for correspondence, the issuance of policies (contracts) and the keeping of records of Board of Director's and committee meetings. In the case of foreign companies which have only branches in Malaya, the companies are managed by a "Divisional Officer" "Branch Manager" or "General Manager" (whichever name the company chooses to adopt but whose functions are the same). Under the general managers are the managers and the branch managers (if the insurance company has branch offices) who are in charge of office administration. In the headquarters' office administration are the various departments with their respective heads and work subordinates. These can be represented in a chart.



Differences from this chart are only natural in the practices of the insurance companies but the differences are a natter of degree rather than kind.

Field Organisation. The more important aspect is the field organisation which is the main body that procures the business for the company. This is essentially a sales organisation which performs three primary functions namely :-

(a) the selling of new business (the most emphasized aspect).
(b) the maintenance of the old business in force and
(c) the provision of service to policy-holders.

Every insurance company in practice should possess this organisation. From the above functions it is obvious that the operations of the company depend on it. It secures a sufficient number of policy contracts or policy-holders to make it possible for the practice of the probability principle or in insurance jargon to "yield average experience". The field force is spread over the country so that policies sold are widespread. Hence if local conditions in some areas, like epidemics for instance would not disrupt the insurance companies mortality estimations or experience. In other words it prevents the possible creation of disproportionate deviations from average mortality. Furthermore this organisation provides the flow of premiums into the company to be constant and thus undermines the success of the business.

The field organisation in a life insurance company is under the supervision of the agency in the Home Office Organisation. The Home Office can either adopt one of two systems to maintain the Field Organisation:-
(a) General Agency System
(b) Branch Office System
These two are entirely different in their set up and more so in their relations with the insurance company. In theory there can be a pure general agency or branch office system but in practice especially so in Malaya, all the companies adopt a mixture of the above two systems. This is so chiefly because different localities require different treatment to achieve higher sales of policies. Moreover the under developed nature of the insurance business in our country makes it rather difficult to pursue a single system because of the inherent advantages in each. Thus to tap the advantages in the two, a combination is usually employed in Malaya by the insurance companies. General Agency System :- It would be appropriate to outline the practice of this system and that of the branch office, together with their advantages and disadvantages.

Under the theoretical pure general agency system the company signs a contract with an individual giving him exclusive rights to represent and solicit new business in a specified area for the company. Within the contract is the condition of a fixed scale of commission payments together with a collection fee. The general agent is then at liberty to employ sub-agents (they are not responsible to the company). These sub-agents are paid commissions by the general agent. Thus the general agent gets the 'overriding commission' which is the gross commissions received from the company less that amount paid to the sub-agents.

The insurance company is not responsible for the cost of establishing the agency or of operating it or of developing the business in that territory. Thusthe general agent is an independent operator. For instance the Great Life Insurance Company has Banks and financial agents throughout Malaysia. These perform the functions of the general agent.

Branch Office System:- In this case the company establishes branches throughout the country and places a Branch Office Manager in charge of that district.

His powers are limited as compared to the general agent. The branch manager is under direct control from the Home Office. The manager then, is responsible for the recruitment of agents to work for him. The branch manager is a salaried employee of the company. He receives commissions too on business he produces and a bonnus for producing a good volume of business.

Under this system the company bears the expanses of the operation, training of the agents and other facilities afforded. The agents used are not salaried but receive commissions on a fixed scale. This is the pure branch office system.

Comparison of the two systems : - The primary advantage of the general agency system is the lower initial cost because no part of the financial burden of operation expenses and so on are borne by the company. Secondly, business flows in faster immediately after the establishment because agents hope to receive their commissions early. Thirdly, the flexibility of the system, which takes into consideration local conditions. Agents work in their own territories and are better suited to their localities. Furthermore the company can avoid the problem of training, supervision and motivation of the agents.

Nonetheless there are disadvantages in the above system (and these are incidentally advantages to the Branch Office System). Firstly, the company completely has no control over its field forces. There is no question of choice of agents training and so forth. But still the company is liable to the actions of the agent. This is not so in the branch office system. Moreover the company's sales policy may be in conflict with that of the general agent. Finally the general agency may limit the financing of new agents. Some general agents may not be able to provide financial help in the early half ofthe agent's struggle to acquire business.

The advantages of the Branch Office System are, firstly, the company has more control over its field force. The company can select capable agents. This ensures faithfulness on the part of the agents and with capable agents more business or sales can be acquired. Secondly, there can be more understanding of the company's policies by the agents especially with contracts with the branch as compared to general agents who are not part of the company and, therefore, ignore this duty. Finally, this system can provide aid to capable agents who are not financially stable in the early stages of their career.

However the branch office system has disadvantages too. There is the expense of running and maintaining the branch office. The lack of knowledge of local conditions on the part of the branch manager and especially so when decisions are made by the Home Office which is ignorant of the local situation. Finally, the company has to keep track or supervise the operations of the branches. This again involves expenses and necessitates a more efficient Home Office organisation.

In Malaya the policy of most insurance companies is to employ both these two systems so as to gain from the advantages in-here-nt in both. For instance, in a small town like Telok Anson in Perak it would be unwise to set up a branch office. The expenses incurred would outweigh the revenue. As such, companies would choose the policy of setting up a general agent to transact the business. This is not only practical but cheaper. Therefore the policy of most insurance companies in the choice of an agent or branch office is to match the feasibility of establishing a branch and the volume of business to be gained from it.

For instance Great Eastern Life Assurance Companies policy is to éstablish branches in only state capitals in Malaysia and employ general agents in small towns. Thus we find that this company has branch offices in Alor Star, Penang, Ipoh, Seremban, Kuala Lumpur, Malacca, Johore Bahru, Kluang, Kuantan, Kota Bahru and Jesselton. For general agents they employ the services of banks and financial agents.

ii) Commissions

Commissions are renumerations paid to an agent for the business obtained for the insurance company concerned. The agents are not salaried employees of the company. Their renumerations depend solely on the volume of business they can obtain for the insurance company. Usually commissions are calculated as a percentage of the premium.

These commissions vary with the type of life insurance contract sold. For instance they may range from 50% of the first annual premiums on ordinary life contracts to as little as 15% to 20% on short term endownment contracts, and 2% or 3% on single premium policies. If higher commissions are paid by the insurance companies to the agents then policy-holders would stand to loose by way of premiums paid. This is because premium payments are calculated on the basis of certain factors (1) and commissions paid is one of them.

The policy of insurance companies is to pay as low

(1) These factors would be discussed under "Premiums" later in the Chapter.

a commission rate as possible so that the policy-holder's would benefit from lower premiums charged by the company. It is also the poloiy of the insurance companies to adjust their commission payments and gear it to the level that is followed by leading insurance companies. However, smaller companies would adopt a policy to pay slightly higher commission rates to gain business. This policy has to he made by smaller companies which face keen competition from larger and more stable companies. (2)

In practice it can be seen that the insurance companies pay about 50% to 55% of the first premium income in commissions. This cantradicts the policy to maintain lower commission rates paid to agents. An analysis of the percentage of commissions paid from the acquisition expenditure will reflect that commissions paid are high and the practices of the insurance companies are not in conformity with the policies (See Table IV).

Apart from 'initial commissions' agents, in practice, as get paid by insurance companies by way of renewal commissions. Renewal commissions are paid on the second

TABLE IV AOQUISITION EXPENDITURE PERCENTAGES

COMPANIES	COMMISSIONS	SALARIES	OTHER EXPENSES
Malayan Co-op. Insurance Society.	56.5%	15.6%	27.9%
Great Eastern.	56.0%	8.2%	35.8%
Life Insurance Corporation of India.	19.3%	42.2%	38.5%
American International.	55.6%	14.3%	30.1%
Prudential.	35.9%	28.2%	35.9%
United Malayan.	47.8%	21.7%	30.5%
Safety.	80.5%	13.9%	5.6%

to the seventh annual premiums. For instance The American International (AIA) pays for a twenty year endowment policy ~~are~~ 50% for the first year premium, 15% on the second annual premium and 5% for the third to the seventh annual premium. The Life Insurance Corporation

(2) See TABLE V, the Schedule of Commission of the Great Eastern Life Assurance Company.

of India follows roughly the same pattern as the Great Eastern Assurance and the American International Assurance Companies.

From the table (IV) we can observe that Safety Insurance Company spends 80.5% on commission expenses. This is quite high. This high acquisition cost can be attributable to the heavy competition faced by this company from the more stable companies. Though insurance companies are free to formulate their policies regarding commissions, the amount paid should not be too high (which means less efficient operations). If its too high the Insurance Commissioner would question the company involved.

(ii) Management Expenses

The policy of insurance companies on management expenses is to keep it low. Despite the prevailance of this policy the management expenses are high. "Management expenses are excessive in Malaya".(3) This can be proved by examining the expenses (apart from Commissions) in Table IV. The approximate percentage of management expenses averages about 30% of the three items. For Great Eastern its 35.8%, AIA 30.1%, Life Insurance Corporation of India 38.5% and Safety Insurance Company 5.6%. (4)

An examination of the figures of other expenses for Great Eastern Life Assurance Company would show the actual amount incurred. For the year 1965 $2.5 million was spent on management expenses. (See Table VI)

---

(3) Quoted from an interview with the Insurance Commissioner.

TABLE V SCHEDULE OF COMMISSION

POLICY PLANS	ON FIRST YEAR PREMIUMS PARTICIPATING		ON RENEWAL PREMIUMS. ON THE SECOND POLICY YEAR			ON THE THIRD TO 6th POLICY YEARS.
	CASES PAYABLE MONTHLY OR QUARTERLY IF UNDER $5,000	ALL OTHER	AA	BB	CC	DD
A. LIFE:						
Ordinary and 20, 25, 30 payments & low premium endowment:-	45%	50%	20%	15%	10%	5%
15 payment:-	45%	50%	15%	12½%	10%	5%
10 payment:-	35%	40%	10%	7½%	5%	5%
B. ENDOWMENT ASSURANCE WITH ANNUAL PREMIUMS PAYABLE THROUGH-OUT ENDOWMENT PERIOD.						
25 years or longer.	50%	55%	20%	15%	10%	5%
20 to 24 years inclusive.	45%	50%	20%	15%	10%	5%
18 to 19 years inclusive.	40%	45%	20%	15%	10%	5%
13 to 17 years inclusive.	35%	40%	15%	10%	5%	5%
10 to 12 years inclusive.	20%	25%	10%	7½%	5%	3%
C. ONE:TWO:FOUR.	As Above Less 5%	As Above 5%	As Above	As Above	As Above	As Above
D. TERM ASSURANCE BY ANNUAL PREMIUMS	-	25%	-	-	-	-
E. Educational Annuities childs Deferred Assurances, Special Child's endowments and all kind of bonds Calling for the payment of 10 or more annual Premiums.	10%	15%	7½%	5%	5%	3%
F. SINGLE PREMIUM:						
Annuities:-	-	2%	-	-	-	-
Life and Endowment Policies:-	-	3%	-	-	-	-
Mortgage Decreasing Policies.	-	5%	-	-	-	-

TABLE VI EXPENSES OF GREAT EASTERN LIFE ASSURANCE COMPANY

		1965	1964
(i)	Management and Sales Expenses:		
	Commissions and Agent's Salaries and Travelling Expenses.........	$3,587,776	$3,174,195
(ii)	Medical fees:...............	$ 46,103	$ 43,461
(iii)	Expenses of Management Head Office and Agencies:...................	$1,626,687	$1,497,754
(iv)	Other expenses:-		
	(1) Directors' fees.........	$ 70,000	$ 70,000
	(2) Depreciation............	$ 754,058	$ 502,572
		$2,496,848	$2,113,787

Source: Annual Report 1965 of Great Life Assurance Company.

The reasons to explain why in practice the insurance companies in-cur heavy management expenses are two-fold:-

(a) The underdeveloped nature of the insurance industry and as such many insurance companies have not established ~~established~~ themselves well as yet.

(b) The competitive nature in the market. Promotion used to combat competitors involves expenses. Acquisition of better abled personnel to operate the business efficiently would also cause expenses by way of salaries. The present policy of the insurance companies is to try and secure business and with this they have to be quite liberal in expenses paid for management.

(iv) Premiums:

Definition: Premiums are the "monetary considerations paid by the insured to the insurers for the insurance granted by the policy". (5) There are two considerations in the premium charged;

(a) Cost.
(b) type of policies (contracts)

---

(4) The comparatively low figure for Safety Insurance Company is because of the poor premises under which the company operates its business and the poor facilities thereOf

Cost in life Insurance: There is cost involved in selling insurance and this cost would principally govern the premiums charged by the companies. The chief factors which contribute to cost are mortality which leads to claims ultimately and secondly, expenses which cover commissions to agents, and other expenses involved in carrying out the business.

In practice, the premium rates of any insurance company in Malaya (and in foreign countries) are determined by an Actuary. The Actuary should be either a Fellow of the Institute of Actuaries in England or a Fellow of the Faculty of Actuaries in Scotland or a Fellow of the Society of Actuaries in America. (6) The Actuary determines for the company the rates to be charged. It would be proper, although not in detail, to know the tools that are used by the Actuary to determine premium rates.
Mortality table: The foremost step in computing the premium for any type of insurance or annuity contract is to tabulate the amount of expected future claims. The absolute necessity of a mortality table is undeniable. Apart from this very important task, it is also valuable for the valuation of reserve liabilities and for the calculation of non forfeiture values. To illustrate its use we have an example. How much should be charged (excluding expenses and interest which would be dealt with later) for a one year term policy issued at age, 35 years. Adopting the CSO mortality table (1941) (7), we find that if 906,554 individuals were insured at age 35; 4,161 would probably die before they reached 36 years of age. If each of these individuals were insured for $1,000, the expected claims would amount to $4,161,000. The proportionate share of these claims to be borne by each policy-holder would be $4.59 ($4,161,000/906,554). Thus each policy-holder has to pay $4.59 and assuming that the law of averages will operate (the principle underlying insurance). This simple illustration only helps to explain the principle behind it but it is not that simple. It involves more complex calculations.
Expenses: This item is a necessity for every company even for a non-profit company. The addition of expense in the computation of the premium rates is commonly known as "loading". This loading is spread over all the policies. Also included in the loading are (a) an allowance for taxes and (b) for the creation of various contingency funds to meet wide fluctuations in mortality and interest earnings. In the computation of premiums ~~are~~ we find that if the two factors, mortality and interest, are only taken we arrive at "net" premium rates. Once loading is included we arrive at "gross" premium rates. These latter premium rates are the

---

(5) Dinsdale, W.A, "Op. cit" Pg. 176
(6) Insurance Act 1963 "Op. cit" Pg. 38

premiums quoted in the rate books of insurance companies.

It is possible to discern three methods whereby expenses are added:- (a) add a constant amount to each policy that has a certain amount of face value
(b) add to the net premiums a certain percentage of that prēmium, and
(c) add to the net premium a loading which is computed from a combination of the above two methods.

Interest: The question of interest arises mainly because of two assumptions, namely; premiums will be paid at the beginning of the year while claims will be paid at the end of the year. Following these assumptions, the insurance companies have the use of the premiums paid for at least a year. This a source of fund which can be invested to earn interest. Therefore in rate computation interest is taken into account.

Types of policies: The premium rates also vary with the types of policies sold. This is obvious because each affords a different kind of protection to the policy-holder.

It is the policy of every insurance company to leave the computation of the premium rates of the company to a qualified actuary after the Valuation, actuarially, of the company. The 'mushroom' companies ignored the computation of premium rates along the above lines. They arbitrarily stated the premium rates. But now the legislation is powerful and the insurance companies follow the above policy of using a qualified actuary in compliance with the legal requirements.

Despite the above policy the rates charged by the various companies only differ a little. Any difference that exists is so small that it is very insignificant. For instance, for the most popular policy contract sold-the participating endowment policy. The rates for a ten year endowment policy at $1,000 for the age of 20, of the different insurance companies can be examined from the few examples below:-

(a) Great Eastern Life Assurance Company $110.35 p.a.
(b) American International Assurance $109.50 p.a.
(c) Life Insurance Corporation of India $108.00 p.a.

These three companies' figures reveal that there is not much variation in practice. "The pattern of the premium rates of all the companies is the same" (8) Numerous rates exist for different ages and the variety of types of policies sold. Neverthelèss it can be safely concluded that the basic pattern is in practice quite similar for all the companies operating in Malaya.

---

(7) "CSO" refers to the "Commissioners Standard Ordinary Mortality Table 1941 of the U.S.A.

Premiums can be paid in different methods by policy-holders. They may choose a single premium, an annual premium method or a half yearly or quarterly payment method. All the insurance companies in Malaya allow premiums to be paid in the above methods. However, single premiums are very rare. For instance in 1964, out of the new policies issued by seventeen companies only three; The Great Eastern Life Assurance Company, the Overseas Assurance Company and the Prudential Assurance have in their premium income payments, single premiums. The chief reason why single premiums are not common in Malaya is that the money or capital can be invested elsewhere where the returns are higher. Secondly, it can also be that the ability on the part of policy-holders to pay in one lump sum is limited, as their means do not ordinarily permit this practice.

Although the insurance companies allow policy-holders to pay premiums half-yearly or quarterly, they do charge, in practice, a little extra than what would have been paid by an annual payment basis. The extra is necessary to meet the loss of interest earnings and the additional costs of collection. The Great Eastern Life Assurance Company, for instance, charges 2% extra on tha annual premiums for semi-annual payments and 3% for quarterly payments. AIA on the other hand uses a multiplying factor 0.51 of annual premiums for semi-annual and 0.26 for quarterly, plus an additional 20 cents in both. The practice of charging may vary only slightly in different companies.

In the earlier discussion on premium rate computation certain factors such as mortality, expenses and interest are involved. Except for mortality these could be controlled by the company. The main item is expenses. - the loading factor. It is the policy of every insurance company to see to it that the expenses especially commissions and management (discussed earlier in the chapter) are kept to a minimum. There is a concensus among the various general managers interviewed (even the Insurance Commissioner) that that commissions paid to agents and management expenses are high for all the insurance companies in Malaya. This would be reflected in the premium rate charged. When compared to the American premium rate it is estimated that Malayan rates are approximately 7% higher than the American counterpart. The companies realise this and they have tried to attune their policies to reducing it if possible. But the practice, however, still does not depict in any way that this objective is aimed at. The premium rates charged by the insurance companies rarely follow the trend of reduction.

(8) Quoted from an interview with the Divisional Manager of Life Incorporation of India.

Various reason could be given to explain this inability on the part of insurance companies to reduce premium rates by controlling the variables. The very competitive nature of the market makes it difficult to introduce marked changes and there is the policy of following the crowd in real practice. Secondly, insurance agents are not licensed and they always look for higher commission rates. As such, companies which offer lower remunerations would suffer losses in premium income. There is, therefore, the tendency to maintain the standard. Perhaps with further legislation (which is quite unlikely, according to the Insurance Commissioner) of insurance agents and commissions paid by insurance companies, there can be control over this factor. It is therefore obvious that the policy of the insurance companies in Malaya, though concrete yet it is not achieved in real practice in this particular aspect.

However control is possible over management expenses. The policy of insurance companies of the moment is that of expansion to achieve a fair share of the insurance market. With this policy still prevailing (in Malaya), it is not surprising to see that management expenses are quite high. When the companies have set their roots securely, there could be greater control over this area and the companies may fulfil the policy of reducing the rates a little. But by far commissions paid to agents, remains the more important factor of the two and a little control over it would produce greater results than one over management expenses.

(v) Investments

The investment portfolios constitute the great bulk of the assets or asset structure of the insurance companies as contrasted with commercial and industrial companies whose assets are primarily made up of land, equipment, merchandise and receivables. On the other hand insurance companies invest in bonds, mortgages, policy loans and so forth. The importance of the investment portfolio in the asset structure of the insurance companies is unique. Before examining the policies of insurance companies on their investments it would be appropriate to analyse the factors that would influence the investment pattern and policies of the companies.

Legal restriction: The law, as evidenced in the Insurance Act 1963 governs the investment policy of the insurance companies primarily inthe field of the authorised class of investment and the condition that 55% of the insurance fund should be invested in the authorised Malayan assets locally. From the Second Schedule in the Insurance Act 1963.,(9) are listed the

(9) Insurance Act 1963. Op. Cit. Pg. 42.

Federation Assets authorised for deposits and insurance funds. They are:

(i) Securities of which the principal or interest is charged directly or by way of guarantee on the Consolidated Fund.

(ii) Debentures or other loans issued under the authority of any written law by authority or body established by any written law to discharge, otherwise than with a view to profit, any functions of a public nature (including the provision of public utility and similar services).

(iii) Shares in, or debentures or other securities of, a body incorporated in the Federation which are listed by the Malayan Stock Exchange.

(iv) Shares in, or debentures or other securities of, a society registered under the Co-operative Societies Ordinance 1948.

(v) Estates or interests in land in the Federation, and up to the value of that security, loans secured on any such estate or interest.

(vi) In relation to any insurer, any loan secured on a life policy of the insurer, but only up to the value of that security (calculated in the prescribed manner) and only if the policy is a Federation policy and the principal and interest of the loan is payable in the currency of the Federation.

(vii) Any currency of the Federation, and any amount payable in that currency which is held on current account or deposit in the Federation within a bank licensed under the Banking Ordinance 1958.

(viii) Such other investments in or connected with the Federation as may be prescribed.

The following table shows the authorised assets of Malayan funds in 1964.

TABLE VII AUTHORISED MALAYAN ASSETS

	As at 31-12-63	%	As at 31-12-64	%
1. Property	$13,609,698	17.49	$21,480,522	22.74
2. Mortgage loans	$ 3,599,712	4.63	$ 4,968,423	5.26
3. Policy loans	$15,311,877	19.68	$18,088,229	19.14
4. Other loans	$ 1,200,382	1.54	$ -	-
5. Government and local government securities	$19,416,523	24.96	$19,431,934	20.57
6. Debentures and Shares	$16,668,850	21.43	$19,777,841	20.93
7. Cash and cash deposits	$ 4,774,196	6.14	$ 7,029,101	7.45
8. Outstanding premiums	$ 241,224	.31	$ 229,460	.24
9. Miscellaneous	$ 2,973,172	3.82	$ 3,464,533	3.67
Total	$77,795,634	100.00	$94,470,043	100.00

Source: Third Annual Report of the Insurance Commissioner 1965. Briefly we find that the investments of the insurance companies in authorised Malaya assets amount to $94,470,043. A major portion of the invesments are in government and local government services (about 20.57%) and Debenture and shares too. These show a sign of security investment which is the purpose of legislation to limit investment in assets of wide fluctuations.

The total investment in the Malayan Fund can be seen below:

TABLE VIII TOTAL ASSETS OF MALAYAN FUND

1. Fixed. Assets	(i) Property.	$22,378,502		15.79%
	(ii) Furniture	$ 473,513		.33%
		$22,852,015		
2. Loans.	(i) Mortgage	$ 5,103,236		3.65%
	(ii) Policies	$19,748,136		13.94%
	(iii) Others	$ 1,241,184		.87%
		$26,152,556		
3. Investments.	(i) Government/ Local government	$47,311,614		33.39%
	(ii) Debentures/ Shares	$26,286,702		18.55%
		$73,598,316		
4. Cash, cash deposit.		$13,666,994		9.65%
5. Outstanding premiums.		$ 230,350		.16%
6. Miscellaneous.		$ 5,204,571		3.67%
		$19,101,915		
		$141,704,802		

Source : Insurance Commissioner's Report 1965 p. ?

Source: Insurance Commissioner's Report [illegible]

The total investments of the Insurance Companies in the Malayan Fund is quite substantial, $141.7 million in 1964. Thus we find that a major portion of the insurance companies' investments fall into the Malayan Fund assets outlined. Their major investment policy is governed to a great degree by this policy namely security or safety. We find that, therefore the overiding objective of the insurance companies is security. This is explained by the nature of the industry that called forth intervention from legislation to maintain security.

In its choice of policy the insurance companies have these factors to consider; namely:

(a) Security.
(b) Adequacy of Returns.
(c) Diversification.
(d) Liquidity.
(e) Socio-economic purposes.

Out of the five factors the policy of most insurance companies in Malaya emphasizes on (in order of importance) security, returns, diversification and socio-economic purposes. Most of the insurance companies' investment policies pay more attention to security and returns. It is also the policy of insurance companies to invest locally as far as possible. The reasons for the choice of security as apposed to speculation, as mentioned earlier is firstly the requirement of legislation and secondly the nature of the business. Returns are also important because an efficient investment policy would mean greater interest rates secured and thus the lower the premium rates to be charged. Thirdly, diversification is introduced, in the investment policy of the insurance companies to enhance the security of the company investments. The final factor, socio-economic purposes, for instance, the granting of mortgage loans, the purchase of houses and so forth, is necessary for the socio-economic needs of the country. These are the policies of the insurance companies in the choice of their investments and is consequently followed in practice.

Liquidity is not an important consideration in the investment policies of life insurance companies for three reasons. (a) Life insurance commitments are long term commitments and assets held are therefore long-term investments.

(b) Since different investments are frequently or everyday they mature at different times rather than all at once. Thus claims arising can be met.

---

(10) Riegel, R., and Miller J.S. Op. cit. P. 89.

(c) Cash receipts arising from premium income and investment earnings continued to grow so that except in an extreme economic emergency, the company has always sufficient cash to meet commitments.

The yield of investment can be briefly seen in the effective rate of interest after deduction of tax. The few companies chosen and their respective rates are given in Table IX.

TABLE IX EFFECTIVE INTEREST RATES

1. Malaysian Co-Op. Insurance Society	6.66%
2. Safety Insurance Company.	23.32%
3. United Malayan Insurance Company	5.13%
4. A.I.A.	4.03%
5. Great Eastern Life.	7.76%
6. Life Insurance Corp. of India.	3.53%
7. Prudential Assurance Company.	3.78%

The investment policy of Great Eastern Life Assurance Company can be deduced from examining the class of security that the investments are made (Table X). The security and stability element is present in this investment portfolio. 50% of this portfolio is in very stable investments. There is also a great emphasis on returns since it invests in ordinary stocks and shares. If these are placed on shares of stable companies' then the investment could not be treated as speculative.

TABLE X INVESTMENTS OF GREAT EASTERN LIFE ASSURANCE COMPANY

1.	Government and municipal stocks	24.8%
2.	Ordinary stocks and shares	37.2%
3.	Preference stocks and shares	1.6%
4.	Loans on policies	8.5%
5.	Mortgages	11.5%
6.	Real Estate	8.5%
7.	Debentures and Building Societies Deposit	3.4%
8.	Cash	1.6%
9.	Others	2.9%
		100.0%

(vi) Reinsurance

Definition: Reinsurance can be defind as "an agreement between the insurance company that originally issues a policy (the direct writer) and another insurance company (the reinsurer). The latter agreeing to accept a certain share of the former's potential liability on the policy".(10) Dinsdale defines reinsurance as "an agreement made between the ceding company and the reinsurer, whereby the ceding office agrees to cede and the reinsurer agrees to accept a certain fixed share of a risk upon terms as set out in the agreement".(11) From the two definitions it is obvious that this practice is to safeguard the company from being burdened with too great a risk for its financial capabilities. The portion that is unable to be accepted is passed on to another company which is ~~in~~ the reinsurer.

Kinds of Reinsurance Contracts: According to Dinsdale there are three (a) facultative.
(b) treaties.
(c) pools.

Of the three the first two, facultative and treaties, are the most common in Malaya. Facultative reinsurance is an arrangement made with respect to a particular risk at a particular time. These are non-automatic in nature whereby the company would consider the risk and then ask

(11) Dinsdale, W.A., Op. cit. P.177

for a reisurer. The automatic operation of reinsurance is found in the treaties which, as the name implies, is a contract between two or more companies whereby one agrees in advance to accept a portion of the risk above a certain limit written by the other.

In life insurance business reinsurances are not very substantial because most of the policies sold are not very large risks. For instance the AIA's reinsurance policy is to begin reinsurance after (U.S.) $50,000. Anything below this is retained. The policy of the Malaysia Co-operative Insurance Society is to retain a maximum liability of $5,000 and any policy with liability above that target (that is over and above $5,000) would be reinsured with only one insurer- the "Co-operative Insurance Society of Manchester", and nobody else. Reinsurances in life insurance are not very great because only high risks are reinsured. Thus, in practice the reinsurances, transacted by the insurance companies are small. This is because the retention policy of the companies are high before reinsurance begins. For instance the Life Insurance Corporation of India retains up to 500,000 rupees or $325,000.

The policies of the insurance companies on a specific limit of retention varies between companies. The limit would depend primarily on the financial stability of the company. It is in general insurance business that reinsurances is more popular.

11) <u>Reserves</u>

<u>Definition</u>: The Reserve "measures that amount of assets which the company must have, and which, together with future premiums to be paid and future interest to be earned thereon, will be required to meet all policy obligations as they become payable". (12) Riegel and Miller defines it briefly as "an amount that, together with future premiums will equal future death claims". (13) These reserves are also called "funds".

<u>Practice</u>:- Theoretically premiums should increase annualy with age of the assured life, but in practice the rates would become prohibitive at advanced ages. As a result an average level premium system has been devised whereby more is paid the early years than is required to meet the risk, so, a reserve may be built up to meet the deficit in the premiums in later years, necessary to meet death benefits and dividends. This reserve is deemed to earn interest, which is paid to the policy-holders through the interest basis as a discounting factor in the computation of premiums payable as we discussed earlier. These reserves are so

---

(12) Mehr & Osler. Op. Cit. P. 556.
(13) Riegel & Miller. Op. Cit. P.226.

calculated that the reserves of all life policies of a similar class at any time together withiall the future expected premiums from this particular group will, with interest, be just sufficient to account for the total sums assured that will have to be paid in the form of claims. Legislation usually specifies the minimum amount that must be held.

In Malaya, under the Insurance Act 1963, "~~enemy~~ any Federation insurer registered under the Act shall establish and maintain in accordance with his section and insurance fund in respect of the class of business carried on by the insurer". (14) It further goes on to specify that "these should be paid into an insurance fund all receipts of the insurer properly attributable to the business to which the fund relates (including the income of the fund) and the assets comprised in the fund shall be applicable only to meet such part of the insurer's liabilities and expenses as is properly so attributable". Thus it is required by law that insurance funds (or reserves) whould be established by the life insurance companies and as such in practice the companies just comply to the stipulation. The liabilities and asset of the statutory fund of all the companies can be examined. ~~in the Appendix~~....

In this particular operation of the business there is no set policy that can be formulated bythe individual companies. Rather the policy of the insurance companies is one of compliance to the legal requirement in its practices. However most of the conservative companies like Life Insurance Corporation of India and United Malayan Insurance, keep more than the legal standard, but this is seldom the policy.

ii) Surrenders Loans and Claims

Surrenders: The insured may become uninterest in the policy held. This may result in (a) failure of paying premiums and (b) surrendering the policy. If the insured surrenders the policy the insurance company would allow a surrender value on the policy. This practice of allowing a surrender value is possible because of the level premium system and the maintenance of a reserve by the insurance company. It is the practice of insurance companies to pay surrender values after premiums have been paid for three whole years in the case of ordinary policies. This non-forfeiture would not be allowed if thepolicy is surrendered earlier than three years; then, the policy lapses or is forfeited by the company. It is, however, the policy of the companies to try as best as they can to keep the policy in force by features as lowering the amount insured or changing the premium plan or allowing a grace.

(14) Insurance Act 1963. "Op. Cit". P. 9.

The requirement of three years before surrender values are paid is stipulated in the Insurance Act 1963. Legislation provides for the minimum surrender value the companies have to pay to policy-holders.

Loans: Policy-holders are given the opportunity of borrowing from the insurance company. This takes the form of policy-loans. Policy-loans are obtainable after two years' premiums have been paid by the insured. The companies usually offer about 90 to 95% of the surrender value of the policy. For instance Malaysian Co-operative Insurance Society gives 95% while Life Insurance Corporation of India gives about 90%. There is only a very small range in the difference in the policy-loans issued by companies.

Claims: In life insurance, unlike general insurance, payment of claims is a sure practice sooner or later. Before a claim is paid, documentary evidence must be received by the company. The age of life assured and the proof of death for a death claim. The policy forms should also be presented. The amount to be paid is then calculated, that is the sum assured plus any bonuses, deductions of loans or outstanding interest. This brief idea of the procedure that is practised by every company takes some time. It is the policy of the companies usually to pay off claims as early as is permissible.

If claims arise out of maturity, usually the insured are informed beforehand, about a month or two. This is a customary practice. There are also different methods of payment that insurance companies employ. The claims can be paid either in (a) a lump sum
(b) on installment basis or
(c) trusts.

The last mentioned is the least popular method in Malaya.

(ix) Surplus and Dividends

Definition: Surplus is "that amount remaining after all the liabilities of a company are subtracted from the assets of the company. It is the excess of assets of an insurer, determined in accordance with law, over liabilities and capital, similarly determined". (15) Dividends in a mutual or participating company "is the return to the policy-holder out of the earnings of the company. "In a stock or non-participating insurance company it is the division of the profits amongthe stock-holders of the company".(16) Dividend can also be a "refund of part of the premium on a participating life

(15) Davids, L.E., "Dictionary of Insurance". N. Jersey Littlefield, Adams and Co. P. 196

(16) Ibid P. 70
(17) Ibid P. 70

insurance policy. It is a share of the surplus earned apportioned for distribution and reflects the difference between the premium charged and the actual experience" (17)

In Malaya, the surphus of any insurance company is determined by actuarial Valuation as stipulated by law. This is the usual practice of all the insurance companies. From the surphus, the companies can declare dividends. Dividends, from the definitions can be viewed in two aspects:-
(a) payment to policy-holders usually referred to as "bonuses" and
(b) dividends are payments to stock-holders.
To cite one or two examples, the Prudential Assurance Company makes an annual Valuation and a minimum of 90% of the declared profits (or surplus) after provision for contingency funds, is allocated to the holders of "with profits or participating" policies each years, in form of bonus additions to the sum assured- that is an addition payable when the policy becomes a claim by death or maturity. However the policy of the company is that the face value of the bonus is not immediately payable in cash. Accordingly for the years 1954 to 1964 a total "Reversionary Bonus" of $210 per $1,000 sum assured was added to participating policies issued in Malaysia. The future bonuses will depend on the profits earned from time to time.

Similarly the Great Eastern Life Assurance Company follows the policy of distribution of at least 90% of the divisible profits arising from life assurance business to the type of policy issued (under the participating policies alone). This company has also annual valuations and there are two systems of bonus payments viz (a) the Uniform Reversionary Bonus System and (b) The Cash Bonus System. The rate of Reversionary Bonus declsared by the company as a result of the actuarial valuation as at 31st December, 1964 was $32 per $1,000 sum assured, which is easily one of the highest declsared by a Life Assurance Company in Malaya. In addition the company's policy is to pay in 1965 special maturity bonuses equal to 25% of the attaching bonuses for policies of terms fifteen years and above. The Malaysian Co-operative Insurance Society, on the other hand distributes any profits arrived at though valuation to its policy-holders (who are incidentally owners) and these are payable when claims or maturity arises. ~~N/P~~. From these it is obvious that the Dividend policies of the different insurance companies differ depending upon the valuation. But more important is the efficiently of its operations in business and the careful choice and selection of the investment porfolio. These two factors would propagate stability in the company's financial position which directly determines the dividend policy.