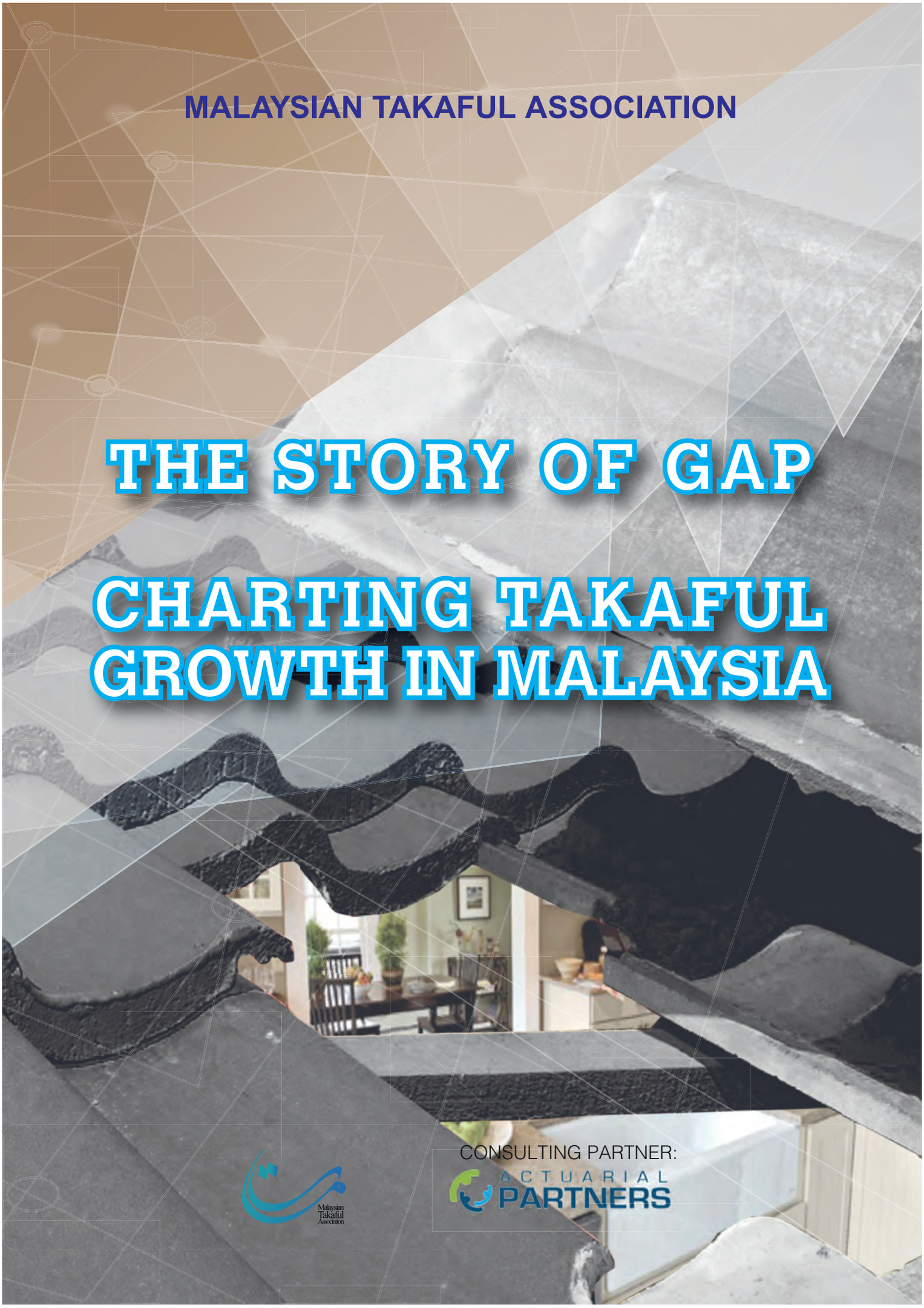
MALAYSIAN TAKAFUL ASSOCIATION

THE STORY OF GAP

CHARTING TAKAFUL GROWTH IN MALAYSIA



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The report is subject to the terms and conditions described in the letter of engagement and statement of work between Actuarial Partners Consulting Sdn Bhd and Malaysian Takaful Association dated 18 December 2013 and reliances and limitations summarised in Section 2 of the report.

MALAYSIAN TAKAFUL ASSOCIATION

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EXECUTIVE SUMMARY

01

EXECUTIVE SUMMARY

The Approach

1.1 Malaysian Takaful Association ("MTA") In collaboration with Actuarial Partners Consulting Sdn Bhd have estimated the protection gap ("the gap") in Malaysia as at 2012. The three key components considered in the study are:

> The estimated protection gap in Malaysia, by market segments.

> Key reasons underlying the protection gap.

> Potential strategies to minimise the protection gap.

1.2 The protection gap is estimated for working adults in Malaysia against the financial consequences of death, critical illness and disability. The study only takes into account the financial needs up to retirement age. The financial needs beyond retirement age

(e.g. long term care, pensions) and any potential savings gap are excluded from this study. In addition, medical protection and the protection provided by general takaful or general insurance business (e.g. Personal Accident plans) are excluded.

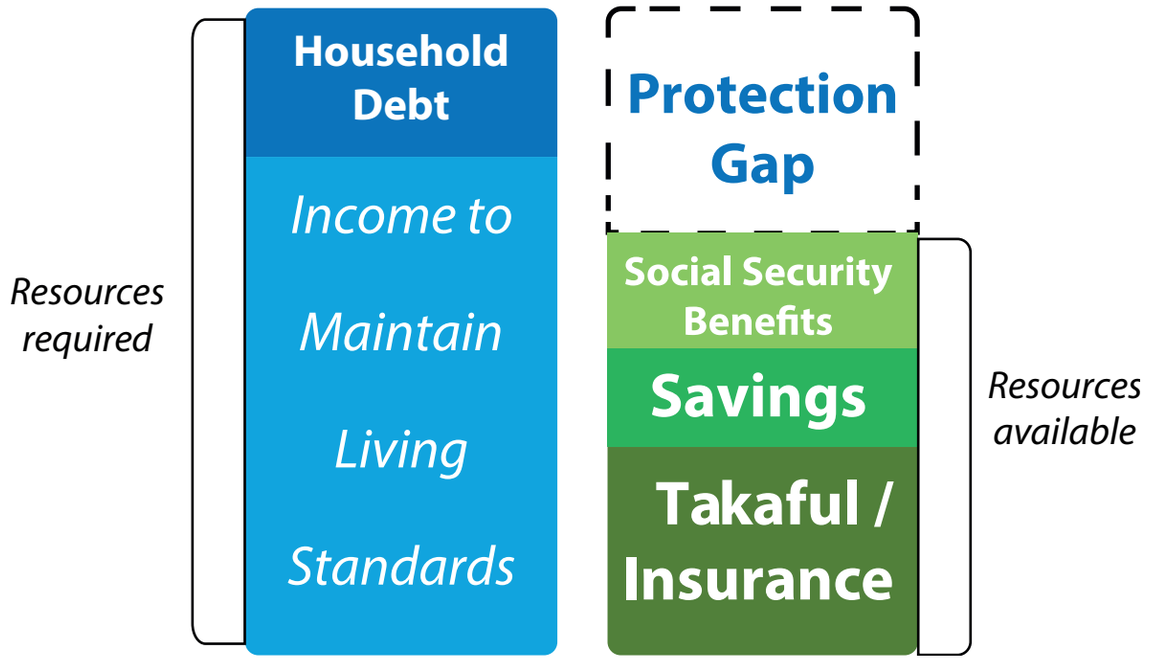
1.3 The protection gap takes into account all working adults, with and without dependents. The methodology does not consider the number of dependents for each individual. Given that the protection gap takes into account both mortality and morbidity risk, each individual will require its own protection cover, regardless whether the individual has a dependent or otherwise. The number of working adults without dependents can be approximated by the number of working population who has never been married, which is small and comprise about 30% of the working population. However, it is noted that although this market segment do not have children, a significant proportion is likely to have (older) parents which may be their dependents given the nature of the society in Malaysia.

1.4 The methodology assumes that the current annual salary is expected to be sufficient to meet current needs.

1.5 The protection gap study was performed based on data as at year-end 2012, which is the latest publicly available data for the purpose of the study.

1.6 The protection gap[1] is defined below:

Protection gap = Resources required – Resources available



[1] It is noted that the methodology adopted in the report does not constitute an exclusive nor exhaustive set of methodology to estimate the protection gap, as described further in section 2.

1.7 The resources required is made up of the following components:

> The income required to maintain the current standard of living is determined as the present value of future income, and it is expressed as a multiple of annual income varying by age. Please refer to Appendix A2 for the derivation of multiplier. It is assumed that the current income level is sufficient to meet daily living needs up to retirement age. Income replacement is partial at two-thirds of the current annual income. However, it is assumed that a minimum income of RM1,000 per month is required for survival, based on the current poverty income line in Malaysia. A minimum income of RM1,500 per month is assumed for Klang Valley and Penang.

> Meeting household debt obligations, such as payment for mortgages, car loans, personal loans and credit card loans.

1.8 The resources available is made up of the following components:

> Life insurance and takaful coverage, including group insurance and takaful insurance provided by employers.

> The savings available, including the savings in the Employees' Provident Fund ("EPF").

> The social security benefits available to civil servants, members of Social Security Organisation ("SOCSO") and EPF.

1.9 Further details on the methodology and assumptions adopted to estimate the protection gap, including the limitations of the methodology, are summarised in Section 4 and Appendix A2.

1.10 In addition, the study has considered the products currently available in the market to identify if there are any potential product gaps between the industry's existing product offerings and current consumer needs and demands.

1.11 To identify the key reasons underlying the gap, and to determine the potential strategies to minimise the gap, the following was performed :

> The study requested the management of takaful operators to complete the survey questionnaire. This is to obtain input from the viewpoint of the takaful operators.

> The study interviewed the head of distribution channels of all the takaful operators. Most of them have previously worked in the conventional insurance market and therefore their views are based on both the conventional insurance and takaful market experience. This is to obtain input from the viewpoint of the sellers (e.g. agents, etc.) and the consumers.

1.12 A summary of the reliances and limitations of this study is described in Section 2.

1.13 A summary of the key data sources considered is described in Appendix A1.

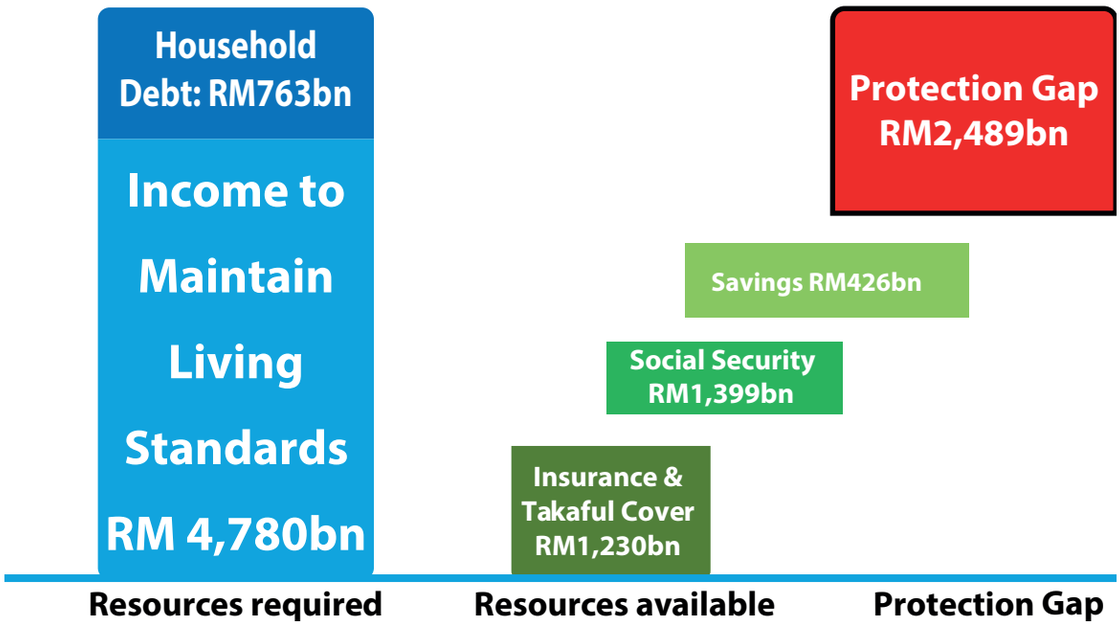
1.14 This report must be read in its entirety together with the Appendices to be understood and must remain together with the Appendices at all times.

This report is subject to the terms and conditions described in the letter of engagement and statement of work between Actuarial Partners Consulting Sdn. Bhd and MTA dated 18th December 2013 and the reliances and limitation summarised in section 2 of this report

Summary of Key Results

The Estimated Protection Gap

1.15 The protection gap in Malaysia is estimated to be RM2,489 billion, as at 2012, and this translates to an average protection gap of 8.7 times of the average annual income. The gap is made up of the following components:



1.16 The study has estimated the protection gap for the following market segments:

> By age group.

> By income group.

> By geographical area (i.e. states in Malaysia).

> By gender.

> By marital status.

1.17 The key observations from the protection gap study by key market segments are summarised below.

> The younger working population in the age group 30 years old and below is observed to have the largest aggregated protection gap, with a total protection gap of RM 1,065 billion, or an average of 17 times of the annual income. This is consistent with the observations highlighted by the majority of the head of distribution channels that were interviewed who noted challenges in selling insurance and takaful products to this age group. This is due to the preferences of the younger generation to spend their disposable income on lifestyle and entertainment items such as mobile phones. In addition, this age group makes up the biggest proportion of the working population in Malaysia, which contributes to the large protection gap in absolute terms.

> The lowest income group (i.e. those with a monthly income of RM1,000 and below), has the largest aggregated gap, with a total protection gap of RM 916 billion or on average 17.5 times of the average annual income. The gap is largest for this market segment due to two key reasons. Firstly, this income group represents one of the largest segments of the working population in Malaysia (at around 35% - 40% of the working population) and therefore contributes to the large protection gap in aggregate. Secondly, to determine the protection gap, the study assumed a minimum income of RM1,000 per month is required for survival despite current earnings may be lower than this threshold (or RM1,500 for those living in Klang Valley and Penang). As a result, the protection gap as a percentage of annual income for this market segment is significantly higher than the annual average of 8.7 times the annual income.

> The aggregate gap is largest for those living in Klang Valley, Johor, Sabah, Sarawak and Penang, due to the higher number of working population residing in these areas. The average gap for these areas is 6 times, 9 times, 15 times, 11 times and 11 times of annual income respectively. The average gap is greater for Johor, Sabah, Sarawak and Penang compared to Klang Valley, and this can be partially explained by the higher cost of living in these areas relative to other areas combined with lower level of income compared to Klang Valley. In Sabah, the gap is significantly higher compared to the national average due to the low level of earnings and high cost of living, as well as the low insurance penetration rate observed in East Malaysia due to challenges in product distribution in these areas.

> Single people have a higher aggregated protection gap at 17 times of annual income compared to those who are married at 5 times of annual income. This is due to the significantly lower annual income of those who are single. This group also consists largely of the younger population and would have only recently joined the workforce and therefore would have minimal savings and insurance or takaful policies.

> The protection gap between males and females are largely similar in aggregate. However, on an average, the average protection gap is larger for females due to the lower proportion of females in the working population, as well as lower savings and existing insurance and takaful coverage.

1.18 Based on the above analysis, it is noted that the key market segment with a large protection gap is attributed to those below age 30 years old who are largely single and are in the lower income group given that they would have only recently entered the workforce and would receive entry-level pay. This is consistent with the observations highlighted by the head of distribution channels of various takaful operators interviewed in this study, whereby the younger generation are often reluctant and would delay purchasing insurance or takaful protection cover.

1.19 SOCSO plays a significant role in reducing the protection gap for those who are employed and are in the income group of RM3,000 per month and below.

1.20 In the analysis of potential product gaps between the industry's existing product offerings and current consumer needs and demands, a summary of our key findings are shown below:

> Most sellers (i.e. agents, banca channel) believe that there is a sufficient range of product offerings in the market.

> Based on the survey questionnaires to the management to takaful operators, micro-takaful products were identified as lacking in Malaysia. Other products identified as not available in Malaysia include annuities and long-term care products but given that these products relate to retirement benefits, these products are excluded from the scope of the study.

> In addition, it is noted that income protection product is currently not available in the market. However, given the low level of financial sophistication in the Malaysian market, some sellers believe that this product will not add value and will give rise to mis-selling given the natural low benefits payout rate and the complex nature of the product.

1.21 Further details on the key findings on the estimated protection gap by various market segments are summarised in Section 5 of the report.

Potential Reasons For The Gap

1.22 Based on the interviews with the head of distribution channels of takaful operators, the following market segments were identified to be underserved by insurance and takaful:

Market Segment	Reasons cited
Those below age 30	Insurance is not viewed as urgent as the younger generation is more interested to spend on lifestyle accessories (e.g. cars, gadgets, phones, gym membership, Astro, etc.).
Those above age 50	Limitations due to maximum age of entry and underwriting requirements
East Malaysia	Challenges in product distribution
Lower income group	Lack of disposable income after meeting daily living needs

1.23 Based on the survey questionnaires completed by the management of takaful operators, the interviews with the head of distribution channels of takaful operators, and the discussion held with MTA members at the workshop session[2] , the key reasons identified as the drivers of the protection gap in Malaysia are summarised below:

> Although consumers are aware that insurance is important, most consumers would often delay the purchase of insurance.

> There is a lack of the awareness on the importance of financial planning.

> Insurance/takaful is viewed as taboo in some societies.

> In some cases, lack of funds is cited as the reason but this is largely applicable to low income groups only (i.e. monthly income below RM2,000).

> The lack of appropriate distribution channels, particularly for rural places where the number of agents/branches are limited.

> In the banca channel, there is challenge in terms of competing bank products vs insurance products, as bank staff would typically push bank/investment products since these products are easier to sell.

> The lack of suitably trained full time agents. Poorly trained agents typically results in product pushing, or with agents being driven by commission level (i.e. selling products with the higher commissions), which would negatively impact on the quality and persistency of the business sold.

1.24 The most popular product currently sold by the takaful market is investment-linked product as sellers find the product flexible in terms of being able to customize the product to meet consumers' requests.

1.25 Consumers typically view insurance/takaful as a savings or investment vehicle rather than a pure protection vehicle. Consumers are keen to enjoy the benefits of insurance/ takaful during their lifetime.

1.26 Given customers' viewpoint above, therefore the surplus sharing feature of takaful should be highlighted during the sales process as this would increase the value proposition of takaful, given consumers preference for a product with a potential return.

1.27 Further details on the key findings and recommendations on the underlying reasons for the protection gap are summarised in Section 6 of the report.

[2] Workshop with MTA members held on 17 February 2014

The Potential Strategies To Minimise The Gap

1.29 Based on the survey questionnaires completed by the management of takaful operators, the interviews with the head of distribution channels of takaful operators, and the discussion held with MTA members at the workshop session, the key potential strategies identified to minimise the protection gap in Malaysia are summarised below:

> **Providing education on the importance of financial planning and the importance of having insurance/takaful protection.** This should begin at the younger ages (e.g. as part of school curriculum at secondary or tertiary level). Currently knowledge on financial planning is lacking in Malaysia. In addition, further education about takaful should be provided to certain segments of the society who may not be aware that Takaful is Sharia-compliant.

> **Developing a fair and suitable tax incentive to increase the insurance/takaful penetration rates**. This includes the separation of the tax-free allocation between insurance premiums and EPF (currently RM6,000 for the combined EPF and insurance premiums). However it is noted such tax relief is only beneficial to those who pay tax. Therefore, tax incentives should be developed for the lower income group (e.g. dollar-to-dollar subsidy) to encourage this group to purchase insurance and takaful protection. Given that the purpose is to minimise the protection gap, the tax incentives and subsidies can be structured towards pure protection products only to prevent those taking advantage of the relief for investment purposes. In addition, the study recommends a level playing field to be developed between takaful and insurance products relative to other pure savings and investment vehicles. For example, currently there are tax advantages in investing in unit trusts compared to an investment-linked insurance/takaful product. Therefore the study proposes that these two products to be subjected to a similar tax structure to encourage the growth of the insurance and takaful industry.

> **Increasing the awareness of the consumers on the importance of insurance/ takaful cover and financial planning through road-shows, talks at universities, etc**. The awareness program should be developed coherently by the industry as a whole to maximise its effectiveness.

> **Providing better training for the agents.** There is a need to develop suitably trained agents to sell on needs-based selling to consumers, using financial planning tools. This will increase the quality of business sold, with better persistency rates if consumers understand the importance of insurance and takaful cover and choose affordable products. Agents should also be trained to do emotion-based selling to highlight the urgency of insurance/takaful protection, particularly to the younger market segment who would typically delay insurance purchases until they are much older.

> **Reviewing the agency force structure in Malaysia.** Several head of distribution channels in the market highlighted that there are too many part-time agents in the market which impacts on the quality and amount of sales. A potential solution is to adopt the agency force structure in Singapore, whereby the number of agents is limited from a best practice viewpoint, to improve the quality of the agents and the amount of sales performed. Therefore the study recommends that the number of part-time agents is minimized and a concerted effort is made to increase the number of full-time agents. This is in line with the KPIs outlined in the “Life Insurance and Family Takaful Framework: Concept Paper” by Bank Negara Malaysia, to increase the number of full time agents to be more than 50% of the total agency force.

> **Developing a more suitable and extensive distribution channel to reach a wider consumer group such as those in East Malaysia and those in the rural areas.** Several potential solutions would be to tie up with existing infrastructures such as Pos Malaysia. Other existing infrastructures include mobile phones and through the small retailers. The product range for these alternative distribution channels is likely to be limited to simple pure protection products. In addition, the study recommends that industry/MTA branches are developed whereby these facilities are shared by all takaful operators in East Malaysia and the infrastructure cost can be shared between the participating MTA members. This will enable takaful players to minimise the expense level and yet continue to expand its distribution reach.

> **Developing products that are appropriate to the target market.** For consumers with a lack of regular disposable income, a single premium protection product is more appropriate compared to the regular premium product to minimise the lapse risk. This market segment would typically have a lower level of disposable income, and therefore product offerings to this market should be based on simple and cheap products. For banca products, insurance products that complement and are packaged or embedded with banking products are critical for successful sales. There is also a suggestion to develop a national pure protection takaful product to be sold via the internet. Developing an online infrastructure is expensive and takaful operators may not be willing to invest in products with a low average premium. Therefore the study recommends that a national protection takaful product is developed such that the distribution, infrastructure and marketing costs are shared amongst all participating MTA members. Given that takaful products share its underwriting surplus, it can be argued that the initial contribution rate is not the same for all Takaful operators as the surplus distribution will vary by company and as such would not constitute a monopoly.

> The industry providing further assistance in increasing the penetration rate, such as providing assistance in highlighting the key target markets that are currently underserved or under-insured and developing national products.

1.29 The study also sought opinions from the Head of Distribution Channels of Takaful Operators on their views on the recent 'Life Insurance and Family Takaful Framework: Concept Paper', which was issued by the regulator, Bank Negara Malaysia ("BNM"), in November 2013. The key findings are summarised below:

> Direct sales channels (e.g. online, telemarketing) are only appropriate for simple products such as term and for certain market segments (e.g. internet-savvy and financial-savvy individuals).

> Most of the head of distribution channels interviewed had the opinion that the optimal approach to sell insurance/takaful in Malaysia remains to be via the agency force as insurance/takaful is 'sold not bought' and human interaction is deemed to be essential in the sale process.

> There were conflicting views on whether applying higher commissions will increase sales or otherwise. Some viewed that sales will only increase temporarily as a result of higher commissions.

1.30 Further details on the key findings and recommendations on the potential strategies to minimise the protection gap are summarised in Section 7 of the report.

Conclusions

1.31 The large protection gap indicates that there is a big opportunity for insurers and takaful operators to offer good value insurance and takaful products in Malaysia. The proportion of protection provided by the takaful market has been increasing in the recent years.

1.32 The study recommends that the following key principles and objectives are met in developing strategies to minimise the protection gap in Malaysia:

> Empowering consumers with knowledge and decision to purchase insurance.

> Developing financial incentives to encourage consumers to purchase insurance.

> Developing appropriate products to meet the consumer needs in various market segments.

> Developing a suitable approach and channel for product distribution purposes, taking into account the various market segments.

> Developing partnership strategies to minimise cost while targeting a higher penetration rate.

1.33 The study showed the employed populations have a lower protection gap as compared to the self-employed as the employed populations are members of SOCSO and the EPF. An immediate and effective solution to address this disparity for the self-employed, particularly among the lower income segment of the population which is currently underserved by the Takaful/insurance industry, is to find ways of extending SOCSO cover to the self-employed.

1.34 The study recommends that the overall strategy adopted to minimise the protection gap should be considered holistically by all industry players and the regulators such that all efforts are well-placed and coordinated to maximise its effectiveness.

SCOPE, RELIANCES AND LIMITATIONS

02

SCOPE, RELIANCES AND LIMITATIONS

BACKGROUND

2.1 Malaysian Takaful Assocation ("MTA") together with Actuarial Partners Consulting Sdn Bhd ("AP") have embarked on a protection gap study ("the gap") in Malaysia for economically active adults due to mortality and morbidity risks only, as at 2012.

2.2 The MTA members are listed below:

> ACR Retakaful Berhad

> AIA PUBLIC Takaful Berhad

> AmFamily Takaful Berhad

> Sun Life Malaysia Takaful Berhad

> Etiqa Takaful Berhad

> Great Eastern Takaful Berhad

> Hong Leong MSIG Takaful Berhad

> HSBC Amanah Takaful (Malaysia) Sdn. Bhd.

> MAA Takaful Berhad

> MNRB Retakaful Berhad

> Munich Re Retakaful Berhad

> Prudential BSN Takaful Berhad

> Swiss Re Retakaful

> Syarikat Takaful Malaysia Berhad

> Takaful Ikhlas Berhad

OBJECTIVE

2.3 The aim of the study is to estimate the protection gap in Malaysia as at year-end 2012 by key market segments. This is to assist takaful operators to identify the existing gaps, understand the potential reasons underlying this gap and to determine potential solutions to increase the penetration rate in the market. The results from the protection gap study will enable takaful operators to take actions appropriately to grow the takaful business in Malaysia.

SCOPE OF WORK

2.4 In summary, the scope of the protection gap study is to assess the following:

> To estimate the protection gap by key market segments.

> To explore the potential reasons on why the gap exists.

> To identify the potential strategies to minimise the gap.

2.5 The protection gap is considered for those who are economically active (i.e. the working labour force) in Malaysia only. Those who are unemployed and those who are already above the retirement age of 60 are excluded from the study. The retirement age of 60 is assumed based on the current retirement age in Malaysia.

2.6 The study determined the protection gap based on the financial needs of the individuals up to retirement age, to maintain the current living standard. The financial needs at retirement and any considerations of the savings gap for retirement purposes are excluded from the study.

2.7 The study considers both the conventional insurance and takaful market in Malaysia. The scope of work is restricted to the protection provided by the life insurance and family takaful business only. The protection provided by general insurance and general takaful business is excluded from the scope of work (e.g. Personal Accident covers).

2.8 The type of risks considered in the study includes mortality and morbidity (including critical illness and disability) risks. Retirement and health products (e.g. annuities, long term care, and medical protection) are excluded from the scope of work.

2.9 The study takes into account the benefits provided to SOCSO members, civil servants and EPF members in the event of death or disability. However, the study has not taken any allowance for the potential protection provided by the new BR1M protection. The study notes that the sums covered under the BR1M protection for natural death cover is small. Excluding BR1M is expected to overstate the protection gap. However, given the low sums covered under BR1M for other than accidental death, the extent of the overstatement due to the exclusion of the protection provided by BR1M is not expected to be material.

2.10 The study also performed a comparison of the protection gap in Malaysia relative to several other countries, based on existing reports that are publicly available on the other markets. It is noted that the methodology underlying the protection gap study in other markets may be different. However, given that only a high-level comparison was performed, the impact of the differences in methodology will not be significant given the overall objective of this study.

2.11 The study identified the product gaps in the market by cross-referencing products that are available in the market relative to the products required based on consumer needs identified in the typical life cycle.

2.12 To identify the potential reasons of the gap and to determine the potential strategies to minimise the gap, the study has performed the following:

> Conducted a survey to obtain the viewpoint of the management of takaful operators.

> Conducted interviews with Head of Distribution Channels of takaful operators.

> Held a discussion workshop with MTA members.

2.13 The study has also considered the strategies and practices adopted in other markets for comparison purposes.

2.14 The study briefly considered the impact of the Life Insurance and Family Takaful Framework: Concept Paper", issued by Bank Negara Malaysia ("BNM"), based on the opinions of market participants obtained during the interview sessions.

2.15 The protection gap study is performed based on data as at 2012, which is the latest publicly available data at the date of this report.

LIMITATIONS

2.16 In order to comprehend this report fully, any user should be advised by an actuary with a substantial level of expertise in areas relevant to this analysis to appreciate the significance of the analysis. This report must be read in its entirety together with the Appendices to be understood and must remain together with the Appendices at all times. Draft versions of this report should not be relied upon for any purpose.

2.17 In addition, the key analyses and findings presented in this report is based on a set of methodology and assumptions, which is one of the market-accepted practice in estimating the protection gap and is deemed to be suitable and appropriate for the required purposes. They do not constitute an exclusive and exhaustive set of methodologies and assumptions.

2.18 The work have been performed as assigned and the report was prepored in conformitywith its intended utilisation by persons technically familiar with the areas addressed and for the stated purposes only. Judgment as to the appropriateness of data, methods and assumptions contained in this report should be made only after studying the report in its entirety, as conclusions reached by a review of a section or sections in isolation may be misleading if taken out of context.

2.19 A summary of the limitations in the methodology and assumptions adopted to estimate the protection gap is described in Appendix A2.

2.20 Utilisation of this report and any application from the findings of this study is subject to the users own risk and responsibility, and Actuarial Partners Consulting Sdn Bhd bears no liabilities due to this report from any parties.

DATA RELIANCES

2.21 The study has received various data items and information supplied by MTA and its members, both orally and in writing, which the study have taken to be accurate and reliable in the analysis prepared in this report. The study has relied on this data and information, and made no independent verification of the provided items as this was outside the scope of our work. The review of the methodology and assumptions as discussed in this report depends on the substantial accuracy of the information provided. The principal materials which are relied upon include but are not limited to, are summarised in Appendix A1.

2.22 The study has not audited or independently verified the information derived from MTA internal sources and its members or obtained from the external sources identified in this report, except as stated explicitly as part of the study review. Although the study has no reason to suspect the integrity of the underlying data, to the extent the data is materially flawed, the results of the study analysis may be materially affected.

REPORT STRUCTURE

03

REPORT STRUCTURE

3.1 The main body of this report summarises the major areas considered in our review and our conclusions:

> Section 1 provides the executive summary of our key findings.

> Section 2 provides the background, objective and scope of the work and sets out the reliances and limitations of our work and this report.

> Section 3 introduces the overall structure of the report.

> Section 4 summarises our key methodology and assumptions to estimate the protection gap in Malaysia.

> Section 5 summarises the key results of the estimated protection gap.

> Section 6 identifies the potential reasons for the protection gap.

> Section 7 highlights the potential strategies to minimise the gap.

> Section 8 summarises the key conclusions and recommendations from the study.

3.2 Background information on the areas considered and findings on which our conclusions are based are provided in the Appendices. Consequently, these Appendices should be read in full in order to understand the analyses conducted in forming our conclusions.

> Appendix A1 summarises the key sources of data including those the study has received from MTA members, which the study has relied upon during the review.

> Appendix A2 summarises the methodology and assumptions, including its limitations.

> Appendix A3 provides a summary of the takaful survey.

> Appendix A4 summarises the key components underlying the gap analysis.

> Appendix A5 summarises the recent regulatory changes in product distribution in various countries.

KEY METHODOLOGY AND ASSUMPTIONS

04

KEY METHODOLOGY AND ASSUMPTIONS

4.1 This section provides a high level overview of the methodology and assumptions adopted in the protection gap study. This is described separately for each of the following components:

> Estimation of the protection gap by market segments and product offerings.

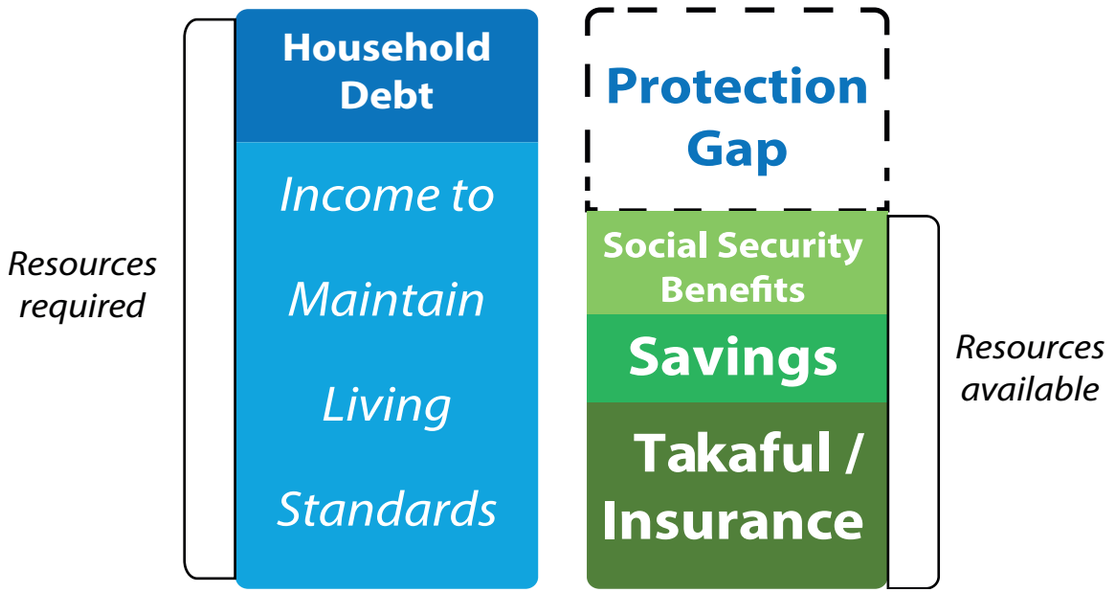
> Identification of the potential reasons of the gap.

> Developing the potential strategies to minimise the gap.

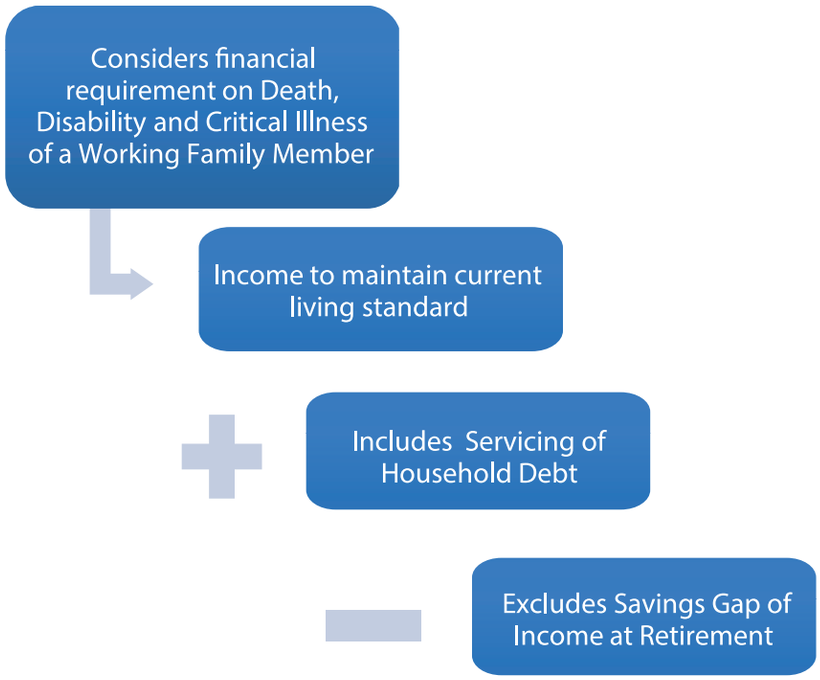
4.2 Further details on the methodology and assumptions, as well as the limitations, are described in Appendix A2.

METHODOLOGY TO ESTIMATE THE PROTECTION GAP

4.3 The study has adopted the following methodology to estimate the aggregate protection gap in Malaysia. The estimated protection gap is determined based on the difference between the resources required and the resources available to meet these needs.



Resources Required

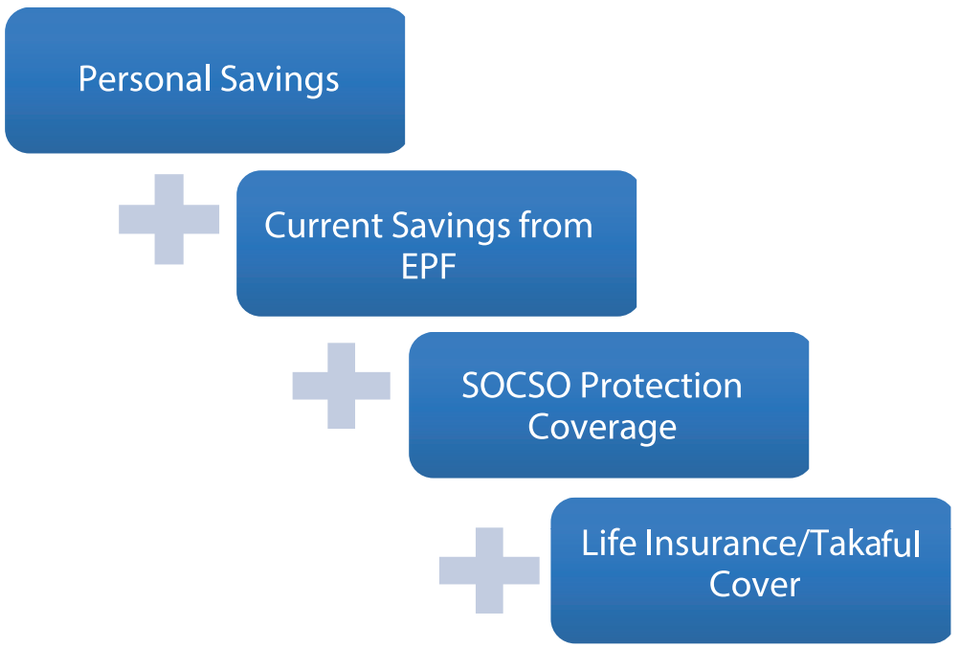


4.4 The resources required comprises:

> The income required to maintain current living standards up to retirement age of 60. This is assumed to be two-thirds of the current income level, subject to a minimum monthly income of RM1,000. A minimum income of RM1,500 per month is assumed for Klang Valley and Penang. The study assumed that the current level of income is sufficient to meet the needs of daily living and the income is assumed to increase with annual inflation. This is expressed as a multiple of current income level, and the derivation of the multiplier is described in Appendix A2.

> Household debt, including mortgages, car loans, personal loans and credit card debts.

Available Resources to meet Protection Needs



4.5 The resources available comprises:

> Personal savings and the savings in the Employee Provident Fund ("EPF"). Only 50% of the savings is taken to be resources available to generate a supporting income.

> The insurance and takaful coverage. This includes credit-related insurance and takaful business (e.g. mortgage reducing term assurance or takaful or MRTA/MRTT).

> The present value of social security benefits, such as those provided by the government to civil servants, SOCSO benefits and EPF benefits upon death.

4.6 Further details on the methodology and assumptions to determine protection gap, as well as the key limitations underlying the methodology, are summarised in Appendix A2.

METHODOLOGY TO IDENTIFY THE POTENTIAL REASONS FOR THE GAP

4.7 The following was performed to identify the potential reasons for the existing protection gap in Malaysia:

> Interviews with the head of distribution channels of the takaful operators.

> Survey forms to the management of takaful operators.

> Discussion workshop with representatives of MTA members.

4.8 Around twenty Head of Distribution Channels (HODC) in the market were interviewed. At least one of the Head of the Distribution Channels from all the takaful operators was represented in the survey. The distribution channels covered include:

> Agency force

> Banca

> Direct business

> Corporate and Group business

4.9 The purpose of the interview with the HODC is to obtain input from the seller's perspective as well as the viewpoint of the consumers. The study believes that the sellers would understand the viewpoint of the consumers given their regular contact with the consumers in the market.

4.10 It is noted that only HODCs of takaful companies were interviewed as conventional insurance companies are not participating in this study. However, given that most HODCs have extensive experience in both the conventional and takaful market, their views are applicable to the whole Malaysian market in general.

4.11 In addition, the study conducted a survey by sending out a questionnaire form to the management of the takaful operators to obtain the input and viewpoint of the takaful operators. A summary of the key findings from the survey is described in Appendix A3.

4.12 The study has also conducted a discussion workshop with the MTA members on 17th February 2014 to share draft key results and findings and to obtain further input from the industry.

4.13 In addition to the above, we have also performed the assessment taking into account our knowledge of the industry.

METHODOLOGY TO IDENTIFY POTENTIAL STRATEGIES TO MINIMISE THE GAP

4.14 To identify the potential strategies to minimise the gap, the study has adopted a similar methodology as described in Para 4.7 to 4.13 above. We have also provided recommendations based on our knowledge of the industry.

4.15 The study briefly considered the 'Life Insurance and Family Takaful Concept Paper' issued by BNM in November 2013, by obtaining the opinion of the head of distribution channels during our interviews.

4.16 In addition, the study considered the strategies and practices adopted in other markets to manage the distribution of insurance products.

THE ESTIMATED PROTECTION GAP

05

THE ESTIMATED PROTECTION GAP

5.1 This section summarises the estimated protection gap in Malaysia, determined based on the methodology and assumptions outlined in Section 4 and Appendix A2.

5.2 The estimated protection gap in 2012 is summarised for the following market segments:

> Aggregate gap.

> By age group.

> By income group.

> By geographical area (i.e. states in Malaysia).

> By gender.

> By marital status.

5.3 The study indicated the illustrative average protection gap based on various scenarios of individuals living in Malaysia in the key market segments.

5.4 In addition, a summary of the estimated protection gap in Malaysia relative to other countries is described below.

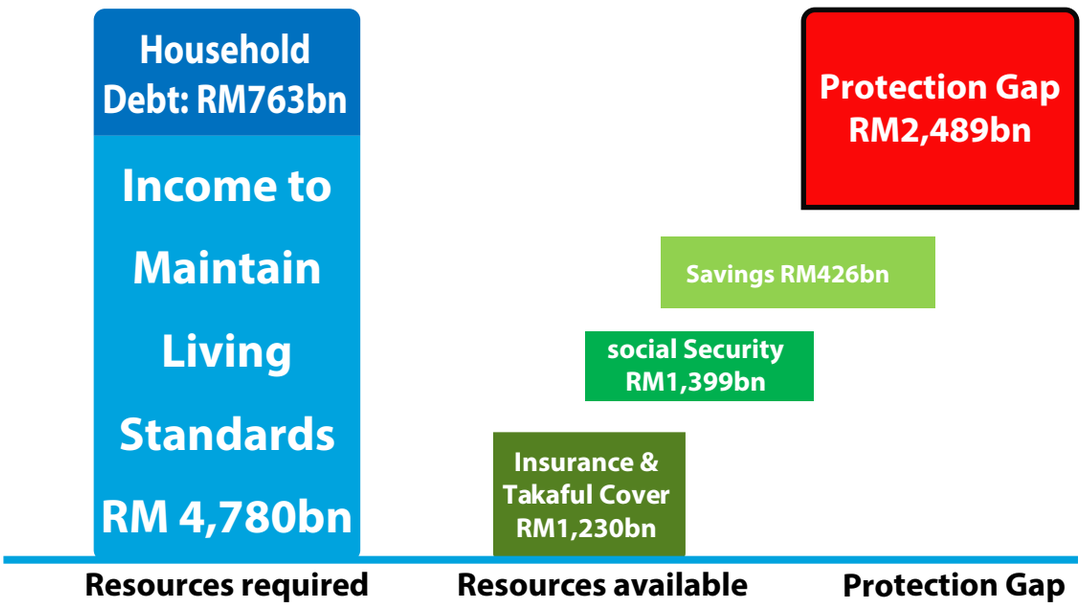
5.5 The product gaps in the Malaysian market are also highlighted in this section.

ESTIMATED GAP IN MALAYSIA

Aggregate Gap

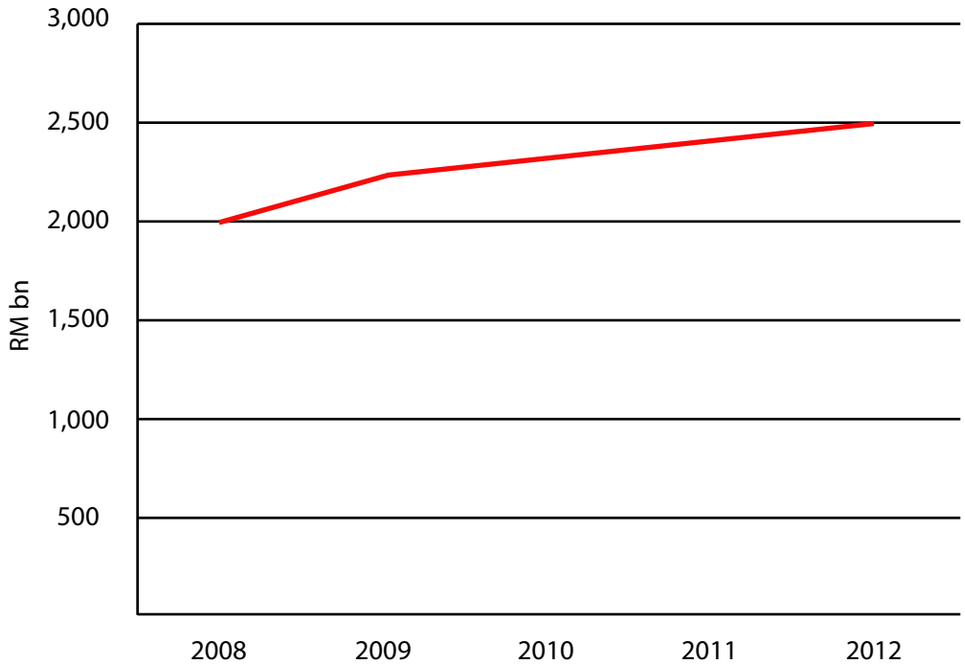
5.6 The estimated total protection gap in absolute amounts as at 2012 is RM2,489 billion. This translates to about 8.7 times of annual salary.

5.7 A summary of the key components making up the protection gap is summarised below:



5.8 The historical estimated aggregate protection gap has been increasing as shown below, with an average increase of 6% p.a.

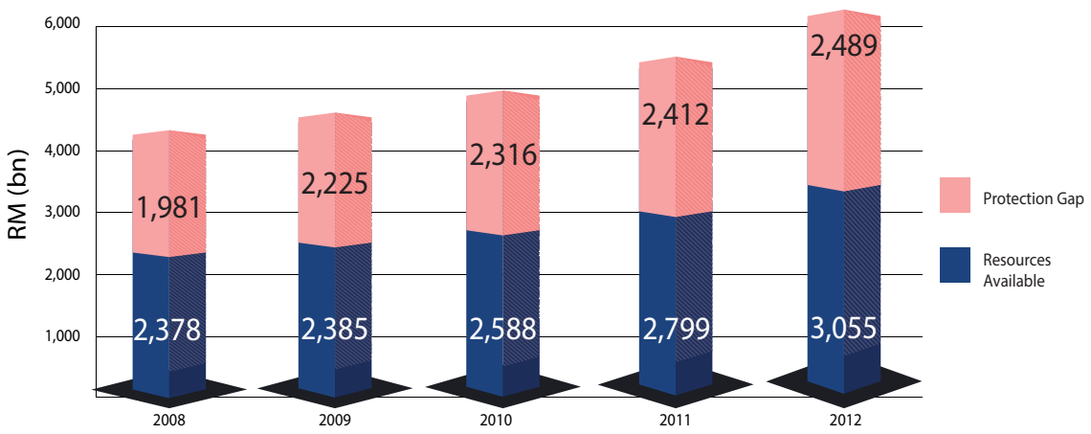
Figure 5.1: Historical aggregate protection gap in Malaysia



Year	2008	2009	2010	2011	2012
Working population (million)	10.7	10.9	11.9	12.3	12.7

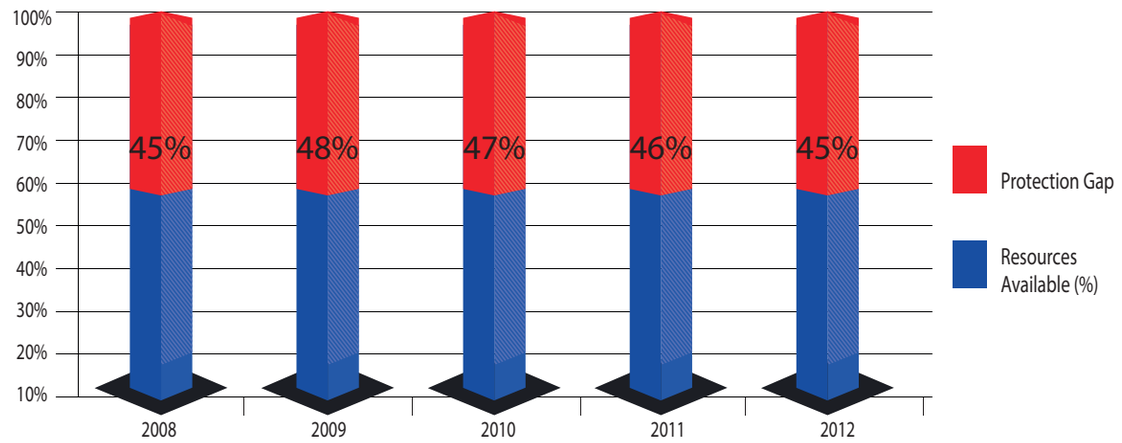
5.9 A summary of the protection gap relative to resources available is shown below.

Figure 5.2: Historical protection gap and resources available



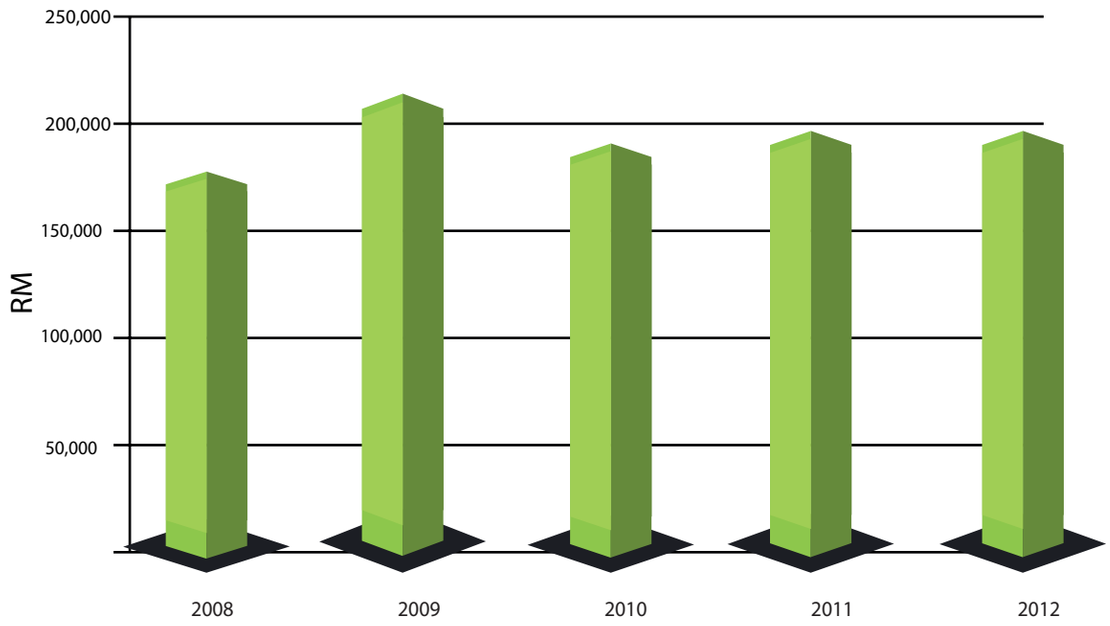
5.10 Although the protection gap has been increasing in absolute amounts, the ratio of the protection gap relative to protection needed has been decreasing slightly over the years as shown in the graph below. This indicates that the savings amount and the life insurance and takaful coverage have outgrown the economy.

Figure 5.3: Historical ratio of protection gap / protection required



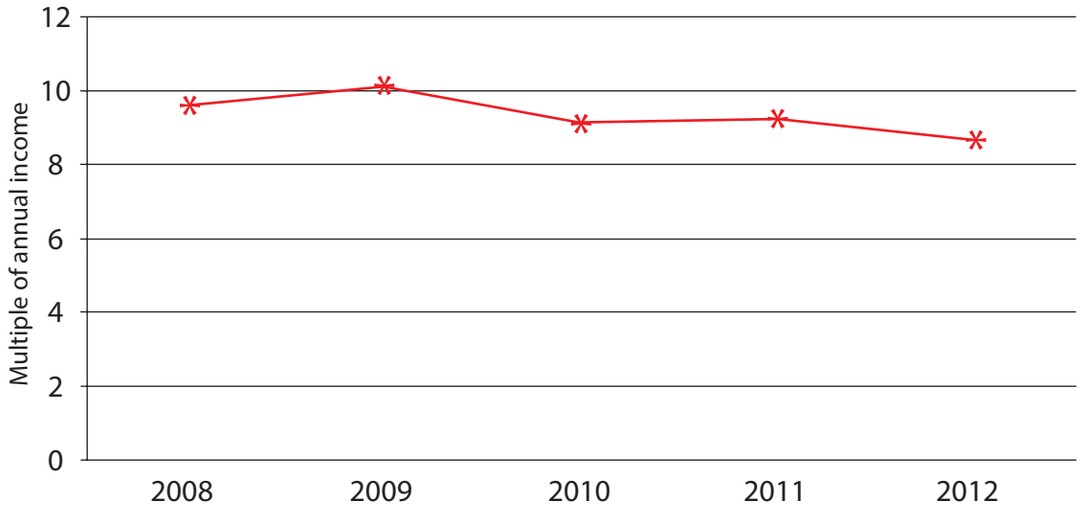
5.11 However the average gap per working person has been largely unchanged. This is explained by the high growth rate of the working population, combined with the growth in the life insurance and takaful coverage relative to the growth of the economy.

Figure 5.4: Historical average gap per working person



5.12 Similarly, the average protection gap as a multiple of average annual income has also been decreasing, as shown in the graph below.

Figure 5.5: Historical gap as a multiple of average annual income

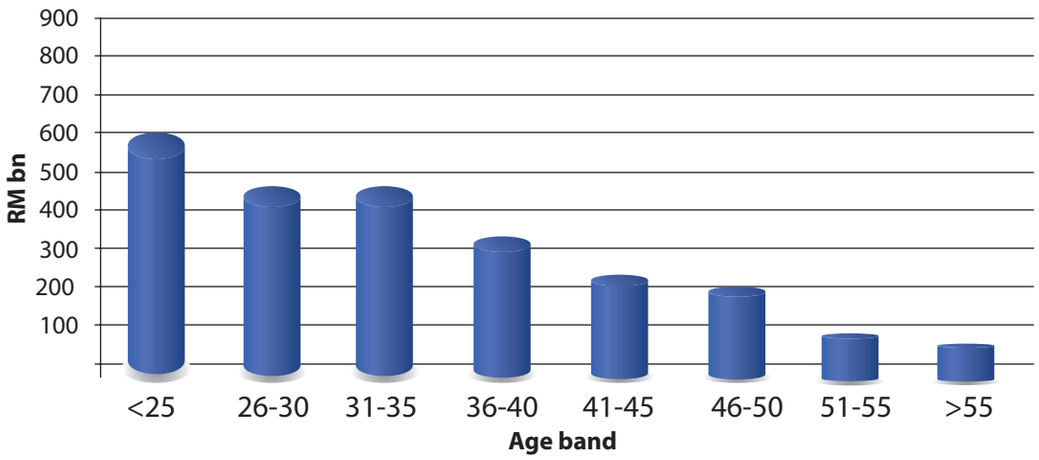


5.13 It is important to note that a decrease in the ratio of the protection gap relative to the protection needed, and a static level of the average gap per working person does not imply a decrease in protection gap in absolute terms. The economic growth has led to the expansion of the life insurance and takaful market. The protection gap in absolute terms continues to increase along with the economic growth which indicates a huge potential for life insurance and takaful business.

By Age Group

5.14 A summary of the estimated protection gap by age groups is shown below.

Figure 5.6: Estimated protection gap by age groups in 2012



Age	<25	26-30	31-35	36-40	41-45	46-50	51-55	>55
% working population	17%	18%	15%	13%	11%	10%	8%	8%

5.15 As shown in the graph above, the protection gap is largest for the younger age group (i.e. age 30 and below), due to the following factors:

> This age group comprises the largest proportion of the working population. This is consistent with the demographic profile of Malaysia, whereby there is growth in the working population largely due to the younger population entering the workforce for the first time.

> The younger age group has a greater outstanding working lifespan compared to those in the older ages. For example, for a 25 year old, the number of future working years is 35 before retiring at 60 years old. Therefore the loss of expected future income is greater in the event of sudden death or disability, in comparison to a 50 year old earning the same salary with only 10 years of outstanding working lifespan before retirement.

> This age group would largely be earning entry-level pay given that they would have recently entered the workforce. Nearly 60% of those in this age group (i.e. below age 30) would be earning less than RM3,000 per month and are members of SOCSO, and about 25% of those in this age group who are employed would be earning less than RM1,000 a month.

> The insurance and takaful coverage for this age group is lower compared to other age groups.

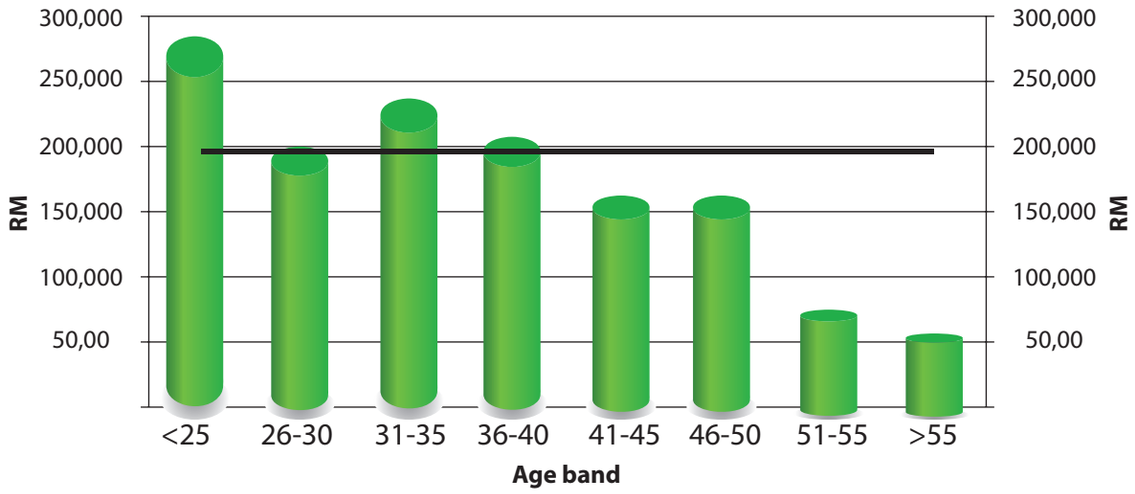
> The savings amount in this age group is also lower for this age group, given that they have only entered employment recently and therefore is at the beginning of the wealth accumulation phase.

> A proportion of this age group may have only recently purchased a car and a property which means that they are likely to be at the initial period of the debt repayment period and there is a substantial outstanding debt, particularly if a MRTA/MRTT policy was not purchased.

> This is further exacerbated with the recent trends of individuals at the younger ages who tend to have high expenditures on lifestyle accessories (such as mobile phone and gadgets), which contributes to the lower savings rate and higher debt amount relative to their salary.

5.16 The estimated average gap per working person is shown below. As seen from the graph, the largest gap remains to be for the younger age group (i.e. age 25 and below), with an average gap of around RM280,000 per person. The large gap is partially explained by the typical characteristics of the individuals in this age group who are usually single, in the lower income group as they would be receiving entry-level salary and are likely to have minimal savings and insurance or takaful coverage.

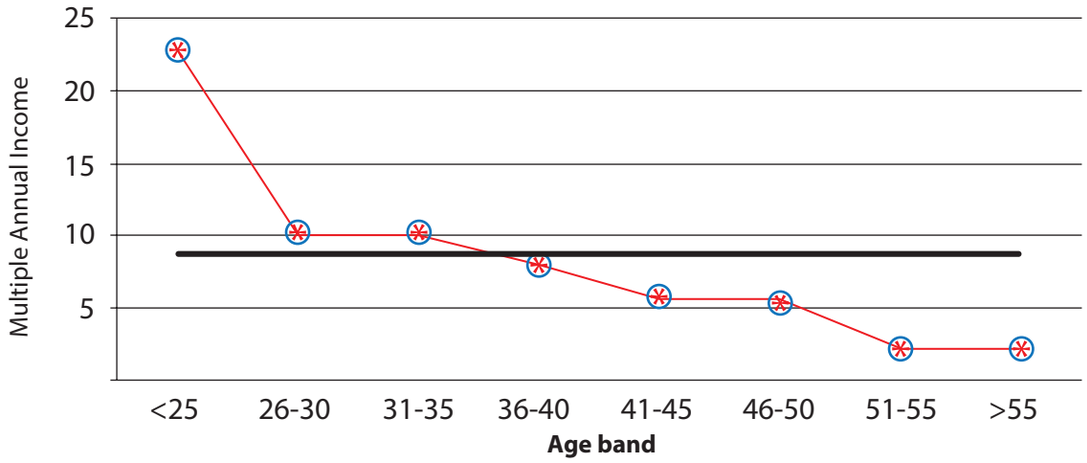
Figure 5.7: Estimated average protection gap per working person by age in 2012



5.17 The national average gap is shown as the black line in the graph. As shown above in the green columns, the average gap per working person is higher than the national average for those below age 40, as these groups of individuals are currently in the wealth accumulation phase and would typically own a large outstanding debt relating to mortgages and car loans.

5.18 The estimated average gap as a multiple of the average annual income is shown below. The largest gap remains to be for the younger age group below age 30 years old, with an average gap as high as 23 times the average annual income at the youngest age group.

Figure 5.8: Estimated average protection gap as a multiple of average annual income by age in 2012

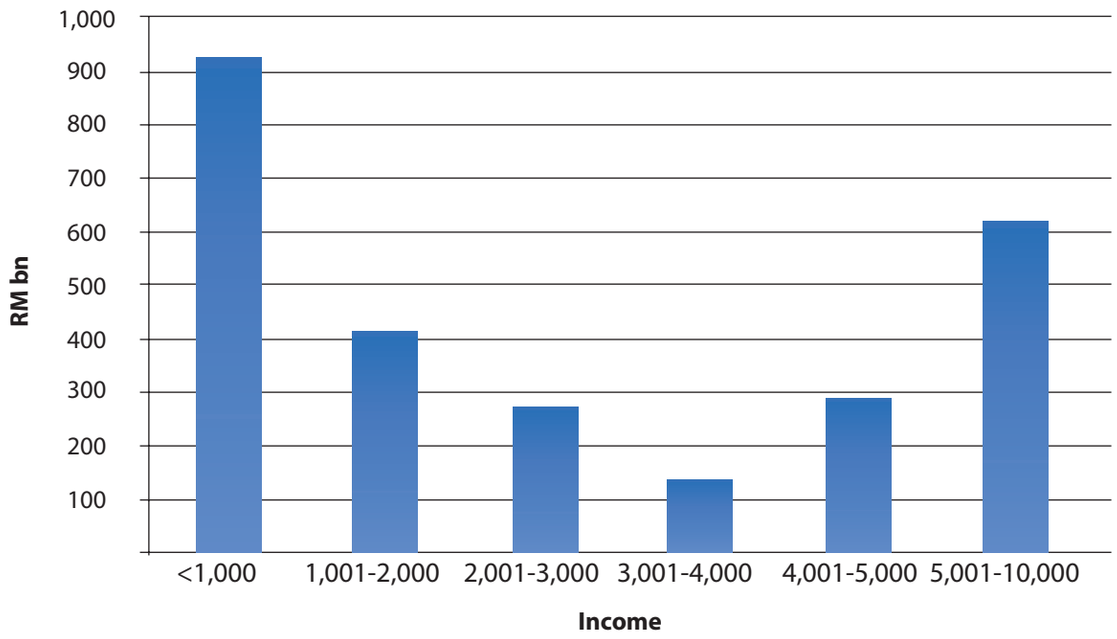


5.19 The national average gap is shown as the black line in the graph. Based on the multiple of average annual income, the multiples are higher than the national average for age groups 35 and below, and are at a similar level to the national average for age group 36-40 years old. The decreasing trend indicates a lower protection gap combined with an increasing level of annual income for the older ages. The gap is highest for age group below 25 years old and about 50% of the workers in this age group are in the low income group earning around RM1,000 a month on average.

By Income Group

5.20 The estimated protection gap by income group is shown below. It is noted that there is no gap in aggregate for the income group above RM10,000. This is partly due to the older average age of those in this earning group and the cross-subsidies within the income group above RM10,000.

Figure 5.9: Estimated protection gap by income group (per month) in 2012



RM per month	<1,000	1,001-2,000	2,001-3,000	3,001-4,000	4,001-5,000	5001 - 10,000	>10,000
% working population	38%	28%	15%	6%	6%	6%	2%

5.21 As shown in the graph above, the largest aggregate protection gap is for the lowest income group (i.e. those earning RM1,000 per month and below). This is due to the following factors:

> This income group comprise the largest group in the working population (at 35%-40% of the working population based on EPF and SOCSO data).

> About 60% of this lower income group is below age 30. This is consistent with the observed demographic profile of Malaysia, whereby there is growth in the working population largely due to the younger population entering the workforce for the first time.

> A minimum income of RM1,000 per month is assumed to be required for survival in line with the national poverty line in Malaysia (a minimum of RM1,500 per month is assumed for Klang Valley and Penang).

5.22 The aggregate protection gap is high for those in the income group earning RM5,000 per month and above. The key reason for this trend is described below:

> The higher average salary or income level, which therefore translates to a higher income required to maintain the current standards of living.

> The higher proportion of debt relative to income level, relative to other income groups.

> In addition, only a small proportion of individuals from this income group are SOCSO members and/or civil servants who will be entitled to receive benefits from SOCSO and the government, upon death or disability. This further reduces the protection available to this income group.

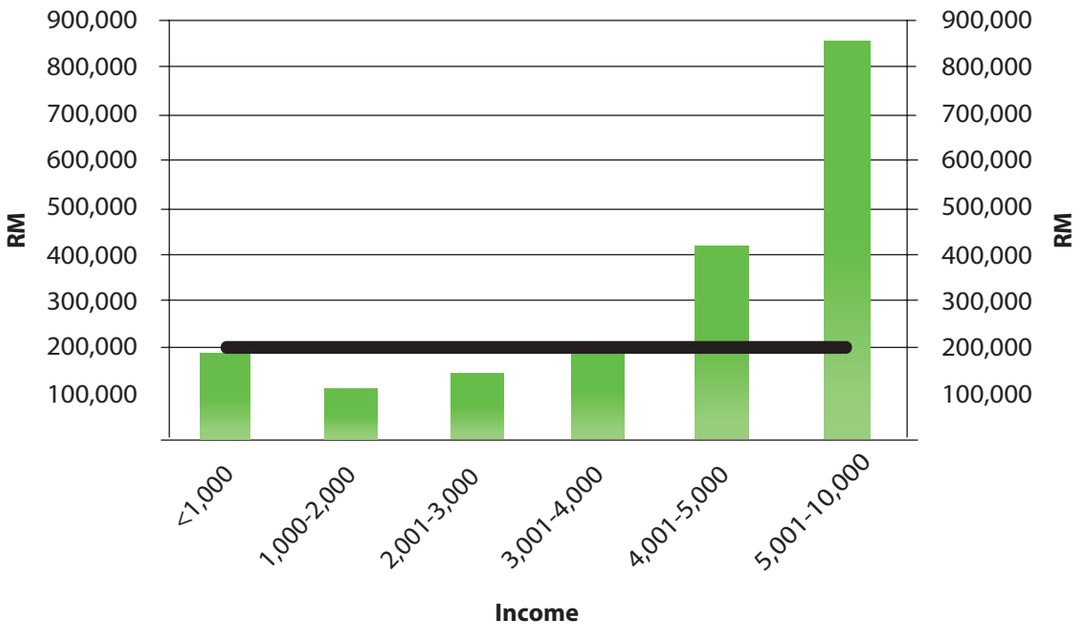
> The lower insurance penetration rate in absolute terms for this income group. Based on BNM statistics, the average premium for this income group is similar to the average premium spent by the adjacent lower income group (i.e. income of RM4,000 to RM5,000 per month). This indicates that the average protection purchased for this income group is lower relative to the higher income and higher debt amount.

5.23 The aggregate protection gap is low for the mass market (i.e. income group RM2,000 to RM5,000 per month). This is because a majority of the individuals in this income group (approximately 60%) are SOCSO members and therefore are entitled to SOCSO benefits. SOCSO benefits contribute significantly to reduce the protection gap. In addition, a large proportion of civil servants is also within this income group and would benefit from the protection benefits provided under the Civil Service Pension Scheme.

5.24 The aggregate protection gap decreases from the lowest income group to income group RM3,000 – RM4,000 per month before increasing again. The gap is lowest for income group RM3,000 to RM4,000 per month to reflect the combined effect of benefits received under SOCSO and the higher insurance penetration rate for this income group (relative to the lower income group). The subsequent increasing trend in the protection gap reflects the reducing number SOCSO members and civil servants as the income level increases.

5.25 The estimated average gap per working person by income group is summarised below. The national average gap is shown as the black line in the graph.

Figure 5.10: Estimated average protection gap per working person by per month income group in 2012

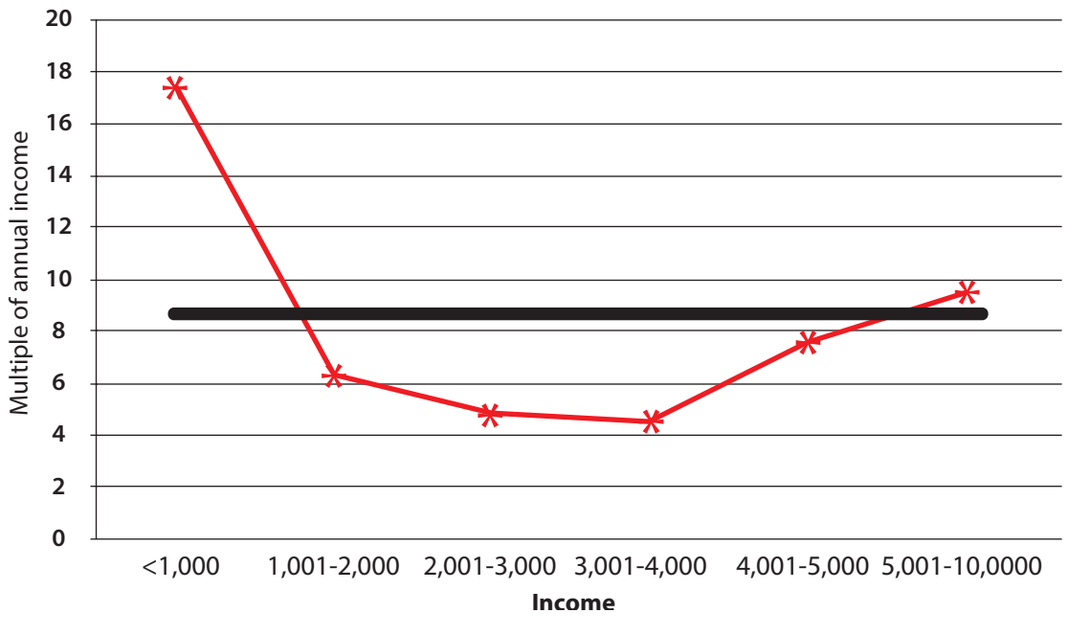


5.25 Correspondingly, as shown in the graph above, the average gap per working person is largest for the income level RM5,000 to RM10,000 per month, due to the large income amount per person, the higher proportion of debt relative to income level, the lower insurance penetration rate and the limited access to social security benefits, as described in Para 5.22.

5.26 Despite having the largest aggregate gap, the average gap per working person for the lowest income group is small to reflect the small income amount per person and the effectiveness of social security benefits available to the lower income group.

5.27 The estimated protection gap expressed as a multiple of average annual income is summarised below. The national average gap is shown as the black line in the graph.

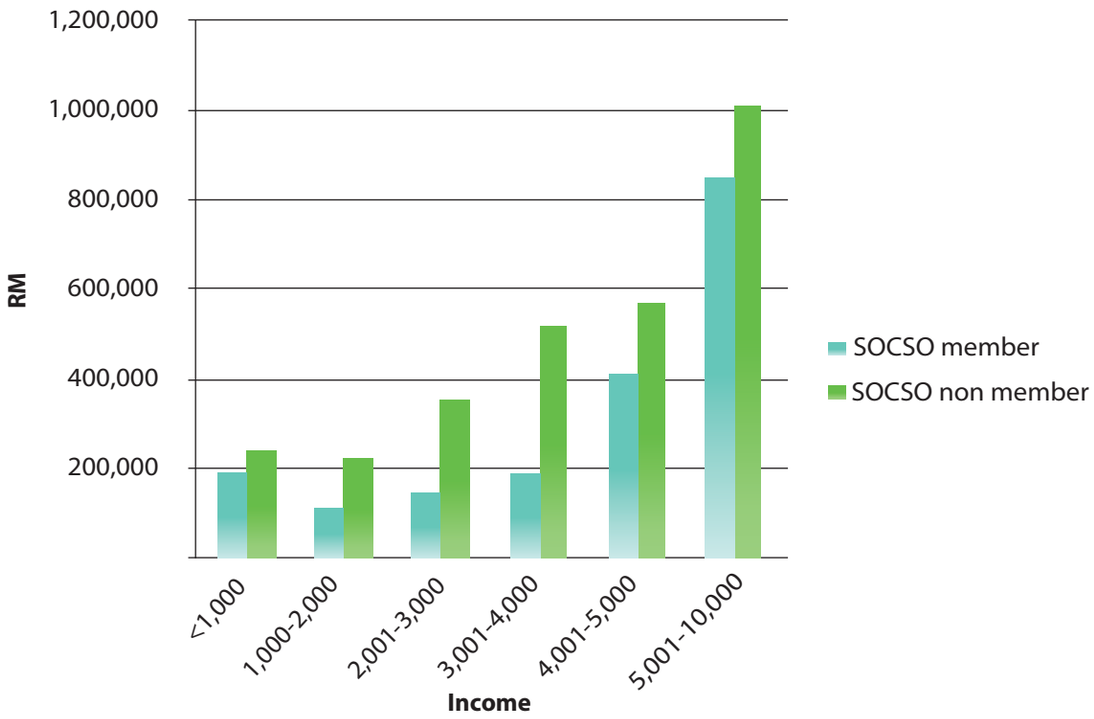
Figure 5.11: Estimated protection gap expressed as a multiple of annual income by income group in 2012



5.28 Given that the analysis is subject to a minimum monthly income of RM1,000 to meet basic daily living needs in Malaysia, the average gap as a multiple of income is biggest for the lowest income group (i.e. income level of RM1,000 and below), at around 17.5 times of the average income level.

5.29 SOCSO members benefit from the dependent pensions available under the scheme. As such, the chart below breaks down the protection gap according to SOCSO and non SOCSO members.

Figure 5.12: Estimated average protection gap per working person for SOCSO and non SOCSO member

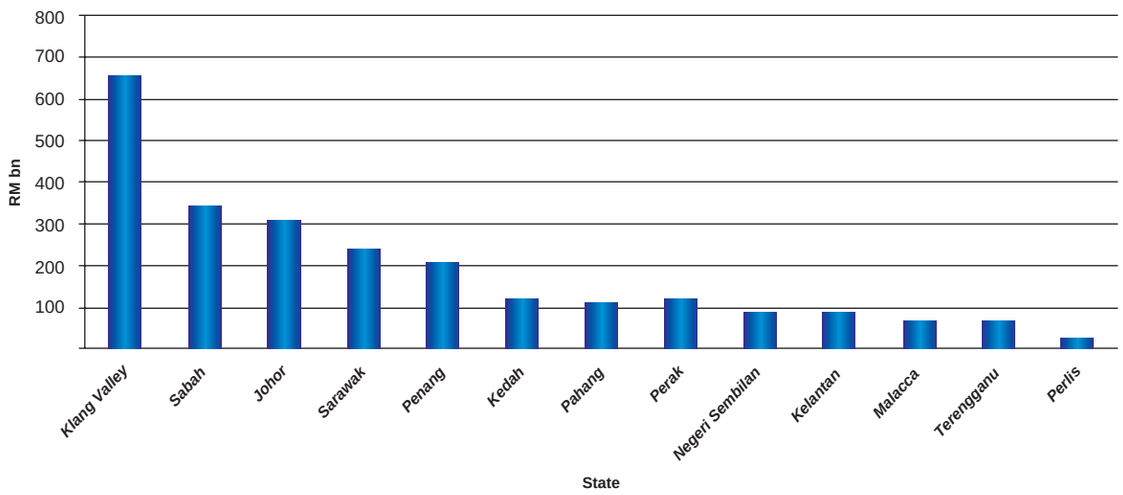


5.30 At monthly salaries below RM1,000, the SOCSO dependents pension is insufficient to provide the minimum dependent's income of RM1,000 per month while at the higher income group, the cap on benefits means the impact of SOCSO benefits is not as significant as for those earning RM4,000 and less.

By Geographical Area

5.31 The estimated protection gap by geographical areas is summarised below.

Figure 5.13: Estimated protection gap by geographical areas in 2012

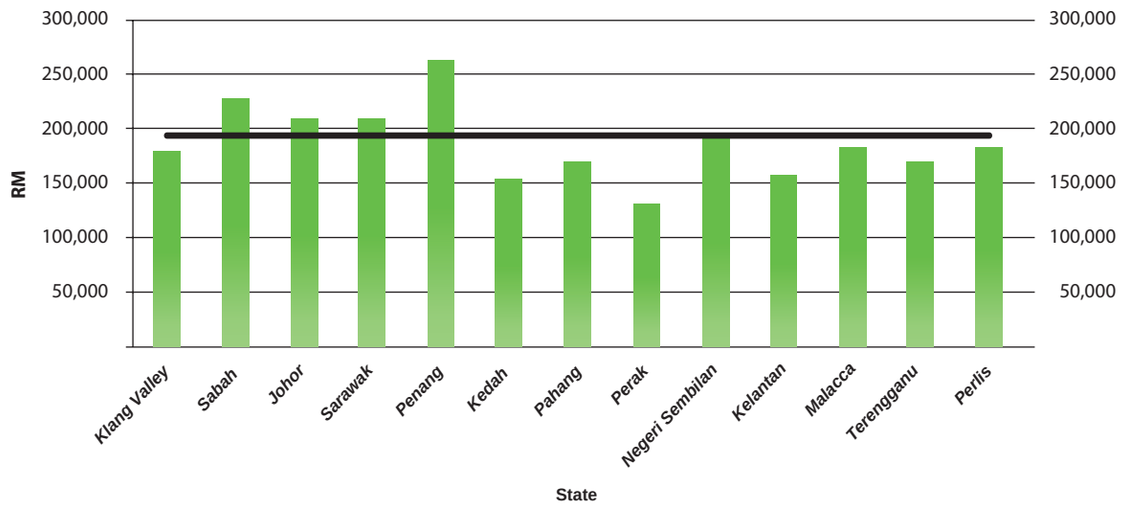


	Klang Valley	Sabah	Johor	Sarawak	Penang	Kedah	Pahang	Perak	Negeri Sembilan	Kelantan	Malacca	Terengganu
% working population	29%	12%	12%	9%	6%	6%	5%	7%	3%	5%	3%	3%

5.32 The aggregate gap is largest for Klang Valley, followed by Sabah, Johor, Sarawak and Penang. This is partially explained by the higher cost of living in these areas.

5.33 The estimated average gap per working person by states is shown below. The national average gap is shown as the black line in the graph.

Figure 5.14: Estimated average protection gap per working person by geographical areas in 2012



5.34 The graph above shows that the average gap per working person is largest for Penang. It is interesting to note that the aggregate gap is largest for Klang Valley as shown in Figure 5.13, whereas the average gap per working person is greatest for Penang as shown in Figure 5.14. This is explained by the following key factors:

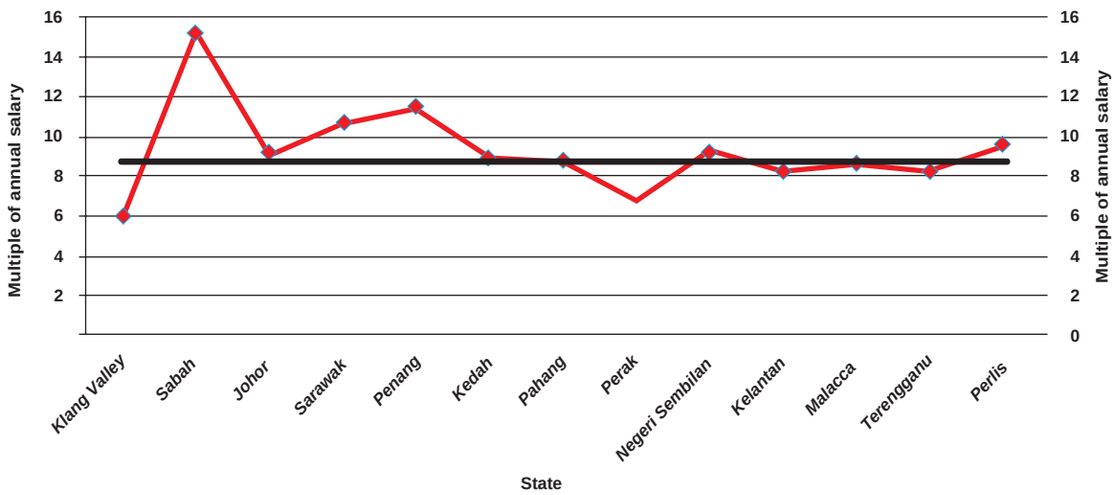
> The average salaries in Penang is about 30%-40% lower than Klang Valley

> The higher cost of living in Penang compared to Klang Valley[3] .

5.35 The average gap is higher than the national average (shown as the black line) for Penang, Sabah, Johor and Sarawak. This reflects the higher cost of living in these areas, combined with a lower insurance penetration rate in these areas relative to Klang Valley.

5.36 The estimated average gap expressed as a multiple of average annual income by geographical areas is shown in the graph below. The national average gap is shown as the black line in the graph.

Figure 5.15: Estimated protection gap as a multiple of average annual income by geographical areas in 2012

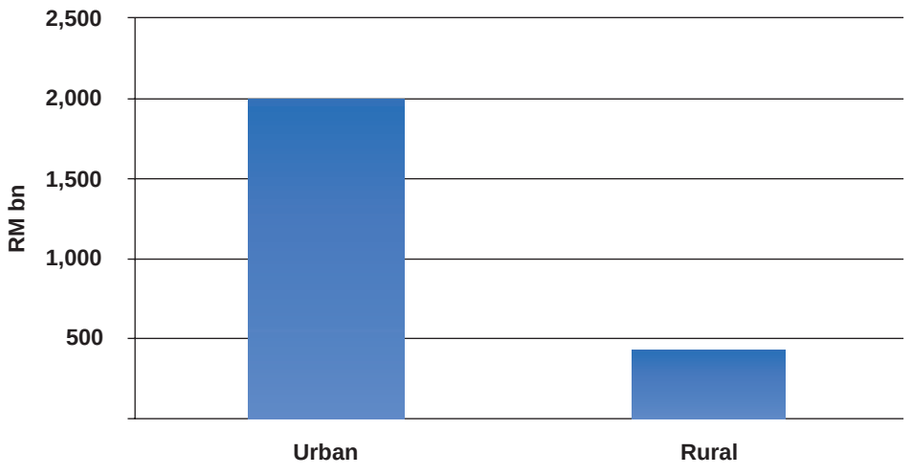


5.37 As shown in the graph, it is also observed that the gap as a multiple of annual income is above the national average, particularly for Sabah, Sarawak and Penang. The gap as a multiple of average annual income is largest for Sabah. This is explained by the higher cost of living and the lower income level in Sabah relative to the national average. The insurance penetration rate for Sabah is also significantly lower compared to other states in West Malaysia. The issue of lower penetration rate in Sabah and Sarawak is largely due to the lack of suitable and effective distribution channel to reach the market here, as described in Para 6.4, Para 6.22(ix) and Para 6.22(x).

[3]The Malaysian Insider, "When even RM12,000 a month isn't enough to get by in Malaysia" 29 December 2013. http://www.themalaysianinsider.com/malaysia/article/when-even-rm12000-a-month-isnt-enough-to-get-by-in-malaysia

5.38 It is also expected that there will be differences in the protection gap for those living in the urban and rural areas. The gap is significantly lower at the rural areas. The aggregate gap at urban areas is approximately 4 times those in the rural areas. The estimated protection gap is shown below.

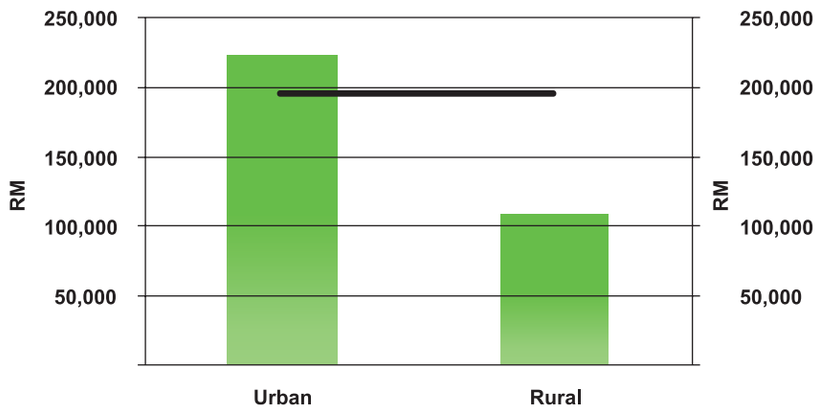
Figure 5.16: Estimated protection gap by urban and rural areas in 2012



	Urban	Non-Urban
% working population	70%	30%

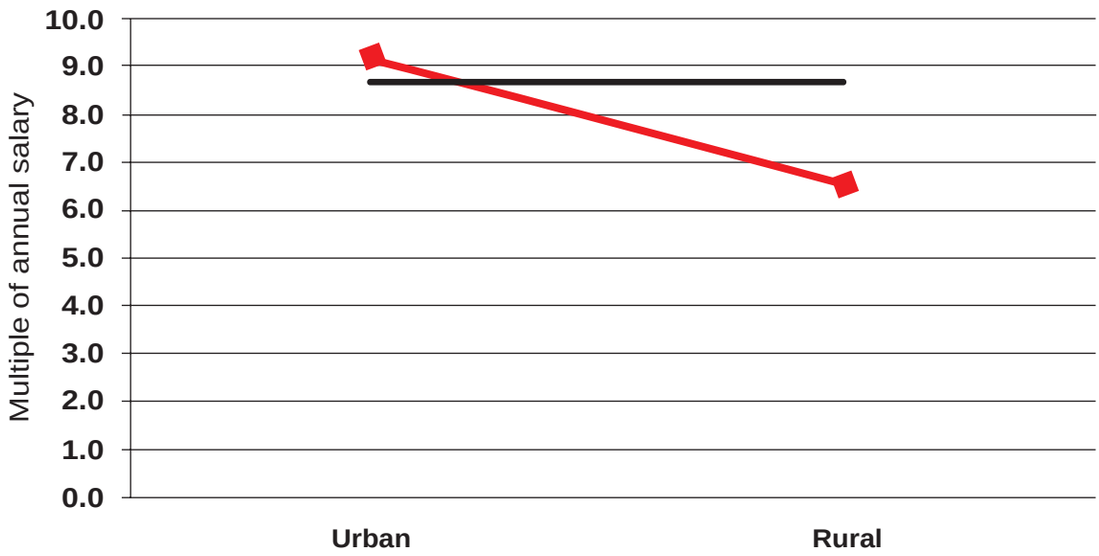
5.39 The estimated average gap per working person is twice as high in urban areas compared to rural areas, due to the higher cost of living in urban areas.

Figure 5.17: Estimated average protection gap per working person by areas in 2012



5.40 Correspondingly, the gap expressed as a multiple of income is about a third higher in urban areas.

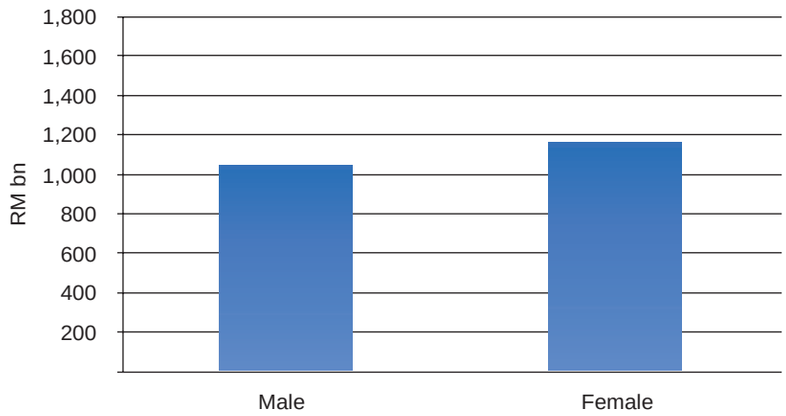
Figure 5.18: Estimated average protection gap per working person as a multiple of annual income by areas in 2012



By Gender

5.41 The estimated aggregated protection gap is largely similar for males and females in Malaysia, despite the lower proportion of females in the working population. It is noted that estimated aggregate savings amount and the insurance penetration rate are lower for females.

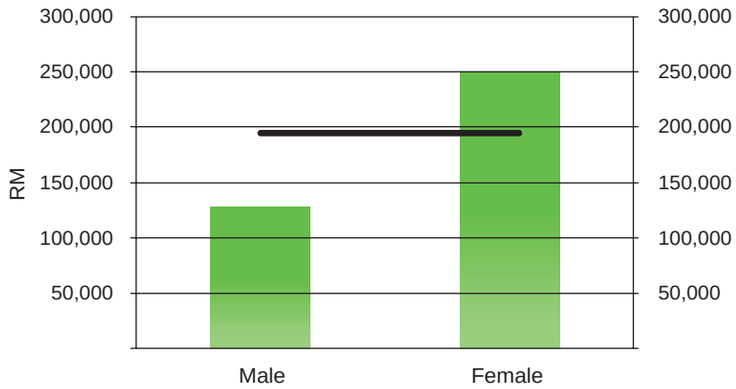
Figure 5.19: Estimated protection gap by gender in 2012



	Male	Female
% working population	64%	36%

5.42 However, the estimated average gap per working person and the gap expressed as multiples of annual income is higher for females (females is about three times higher), due to the lower number of working females and the lower savings and takaful/insurance coverage relative to males (e.g. out of all SOCSO members, only 40% are females). About 20% of females are in the lower income group of less than RM1000 per month compared to only 13% of males in the same category. About 10% of the females have an income of less than RM1000 per month and are below the age of 30.

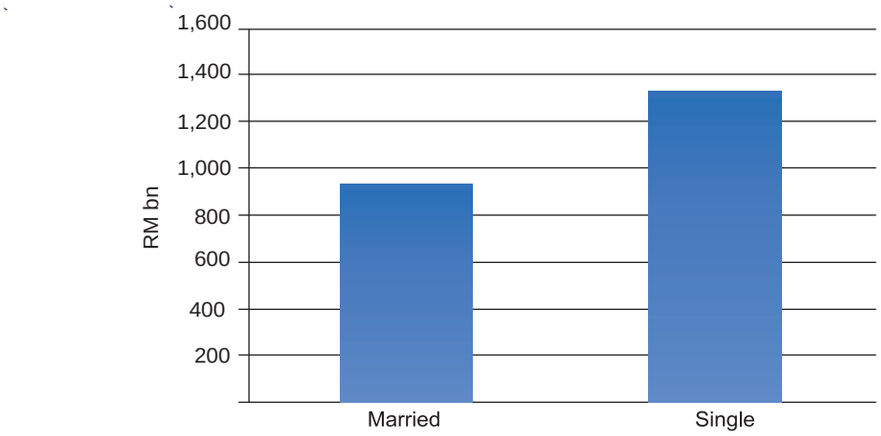
Figure 5.20: Estimated average protection gap per working person by gender in 2012



By Marital Status

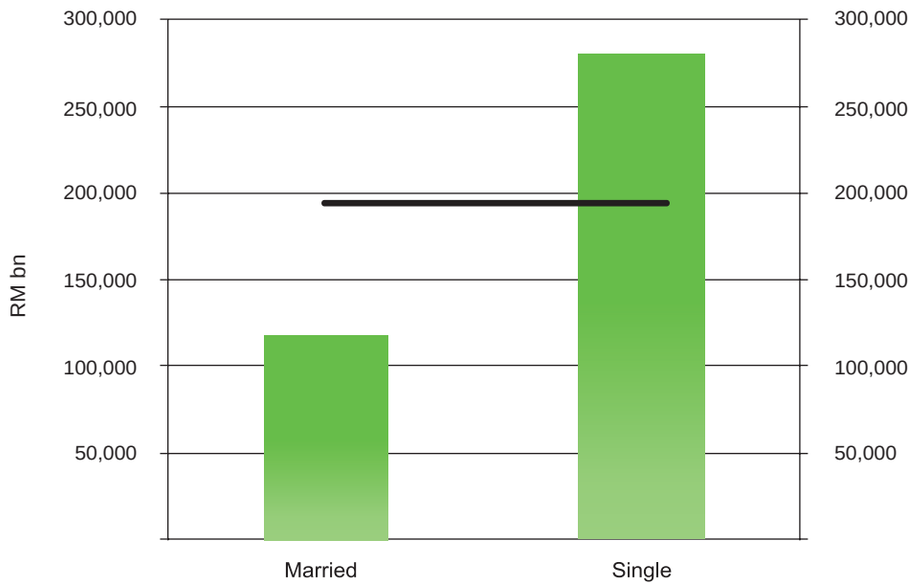
5.43 The estimated protection gap by marital status is shown below. As shown in the graph below, the gap is about 50% larger for single individuals due to the lower insurance penetration in this market segment.

Figure 5.21: Estimated protection gap by marital status in 2012



5.44 The gap for single individuals is estimated to be approximately 17 times of annual income level with an average gap per working person of around RM280,000.

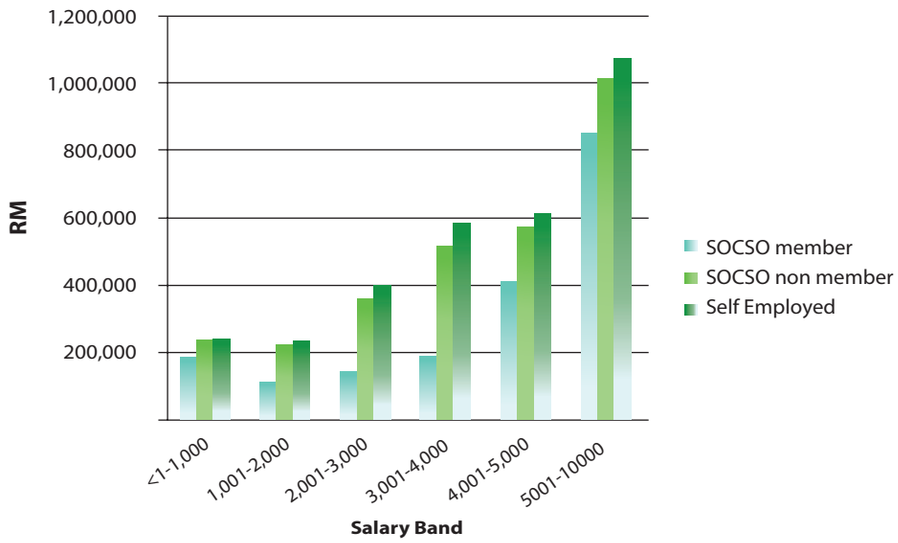
Figure 5.22: Estimated average protection gap per working person by marital status in 2012



By Employment Status

5.45 The analysis is extended to illustrate the protection gap between the employed and self-employed. It is noted that that the gap is on average three times larger for the self-employed due to lower protection provided in this market segment. In particular, the self-employed are not members of the EPF or SOCSO, and therefore will not benefit from the compulsory EPF savings and the protection benefits from EPF, SOCSO or the government.

Figure 5.23: Estimated average protection gap per working person for SOCSO, non-SOCSO and self-employed in 2012 (salary per month)



5.46 Based on the graph above, it can be observed that SOCSO plays a vital role in providing protection to a large proportion of the working population. The protection gap increases significantly without SOCSO protection. However it is noted that many individuals may not be aware of the benefits provided under SOCSO. Approximately 60% of the working population is covered by SOCSO, largely covering the younger population as these would receive low entry-level pay (as membership is automatic for the employed population with monthly income of RM3,000 and below, and membership is for life despite any increase in future salary). The distribution in each age group for the working population covered by SOCSO is summarised below:

Age	<25	26-30	31-35	36-40	41-45	46-50	51-55	>55
% working population in SOCSO in each age group	66%	49%	45%	44%	41%	37%	35%	33%

5.47 Further details on the estimated resources required and resources available to meet the protection needs against mortality and morbidity risks are described in Appendix A4.

ILLUSTRATIVE SCENARIOS

5.48 The study also determined the average protection gap based on various illustrative scenarios of individuals in Malaysia. It is noted that the gap calculated in this section is for illustrative purposes only and are straw cases. It is not intended to be tied back to the top-down study in the report.

5.49 The illustrative average protection gap is determined for the following individuals, based on the following assumed profile. An example of the protection gap calculation is shown below.

Figure 5.24: Illustrative profile of individuals

Individual	Age	Income per month	Employment	SOCSO member	Multiplier	Debt (RM)	50% of available savings (RM)	Takaful/ Insurance/ Social Security Benefits (RM)	Protection Gap (RM)
A	25	RM1,000	Employed	Yes	30	9,780	2,880	202,858	164,042
B	25	RM1,000	Self-employed	No	30	8,400	-	-	368,400
C	35	RM1,000	Employed	Yes	24	55,494	17,280	156,841	169,373
D	35	RM1,000	Self-employed	No	24	47,904	-	-	335,904
E	25	RM3,000	Employed	Yes	20	50,000	9,286	603,575	157,139
F	25	RM3,000	Employed	No	20	50,000	9,374	110,500	650,126
G	25	RM3,000	Self-employed	No	20	50,000	2,685	-	767,315
H	35	RM3,000	Employed	Yes	16	576,707	51,840	715,522	385,345
I	35	RM3,000	Employed	No	16	575,732	51,840	360,500	739,392
J	35	RM3,000	Self-employed	No	16	554,278	-	250,000	880,278

Example:

For individual A, aged 25 has a monthly income of RM1,000 and is employed. He is therefore a member of SOCSO. He has a debt of RM9,780 and 50% of his available savings (including EPF) totals up to RM2,880. He has takaful coverage and present value of SOCSO benefits worth RM202,858.

For his income level, he needs to protect 100% of his salary as it is assumed that a minimum RM1,000 monthly income is required for survival based on the average poverty line in Malaysia in 2012. Hence, based on his age and his income level, to protect 100% of his income, the resources required for individual A against mortality and morbidity risk is estimated to be 30 times his annual salary.

The estimated protection gap due to mortality and morbidity risk for individual A is calculated as:

Resources required for individual A – Resources available for individual A

=(annual income x multiplier + debt outstanding) – (50% of savings + coverage available)

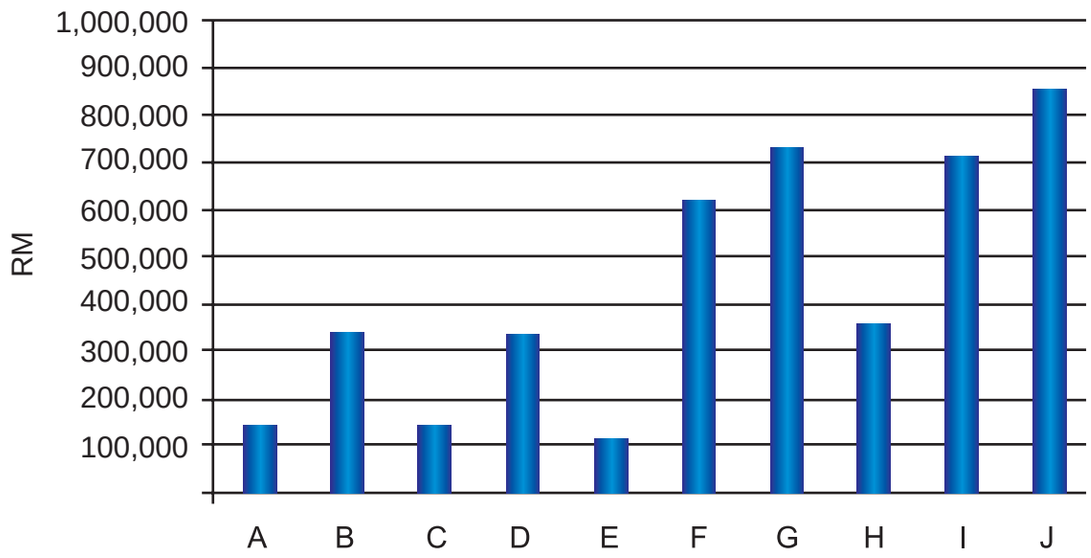
= (RM1,000 x 12 x 30 + RM9,780) - (RM2,880 + RM202,858)

= RM 164,042

For individual E who is also 25 years old, given that his income level is above RM1,000, the calculation is the same except that it is assumed that he will only require two-thirds of his annual income as resources required against the risk of sudden death or disability. Hence, based on his age and his income level, to protect two-thirds of his income, the resources required for individual E against mortality and morbidity risk is estimated at 20 times his annual salary.

5.50 The illustrative average protection gap for each of these individuals is shown in the graph below. The protection gap is estimated to be significantly higher for those who are self-employed and those who are not members of SOCSO. Ignoring debt level, the study would expect the gap to be higher for individuals at younger ages (e.g. age 25) relative to those at age 35. However in the illustrations below, it is assumed that the debt level to be significantly higher at age 35 relative to age 25 and thus, the protection gap is greater at age 35 compared to age 25.

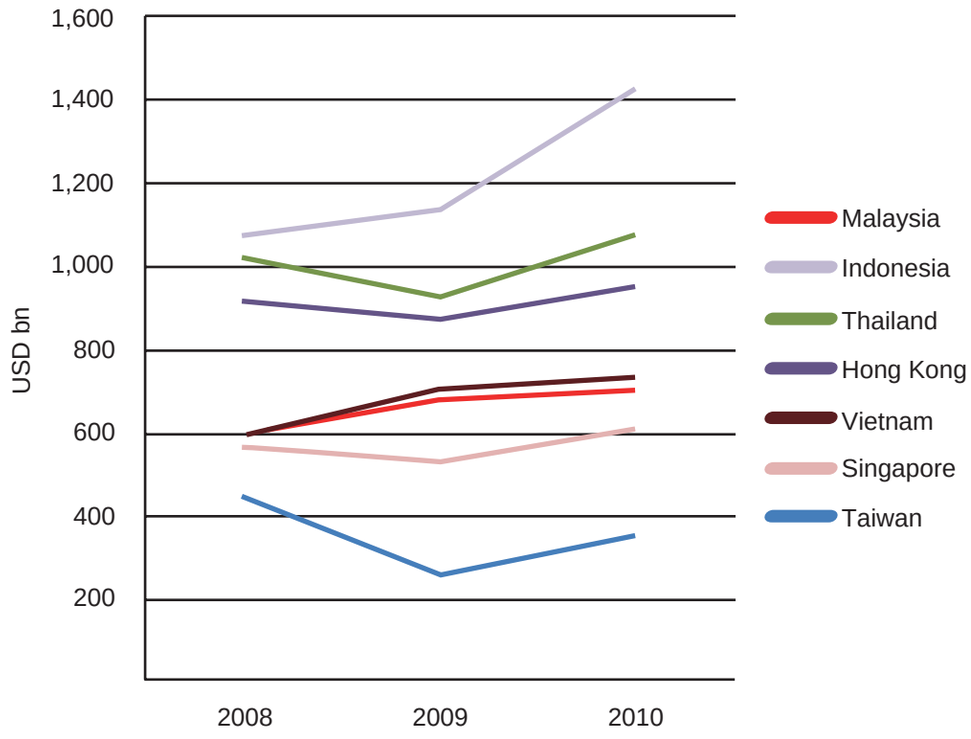
Figure 5.25: Illustrative average protection gap for individuals



GAP COMPARISON WITH OTHER COUNTRIES

5.51 A comparison of the aggregate protection gap observed in Malaysia relative to other countries is shown below. The estimated protection gap for other countries is sourced from the Swiss Re's report[4] , and it is noted that the methodology to determine the gap is different and is on a more simplified basis compared to the methodology adopted in this report for Malaysia. The study have adjusted the figures from the Swiss Re report in an attempt to calibrate the two methodologies to enable the comparison. Therefore, the study believe the analysis below is appropriate for the purpose of a high level comparison.

Figure 5.26: Estimated aggregate protection gap in various countries

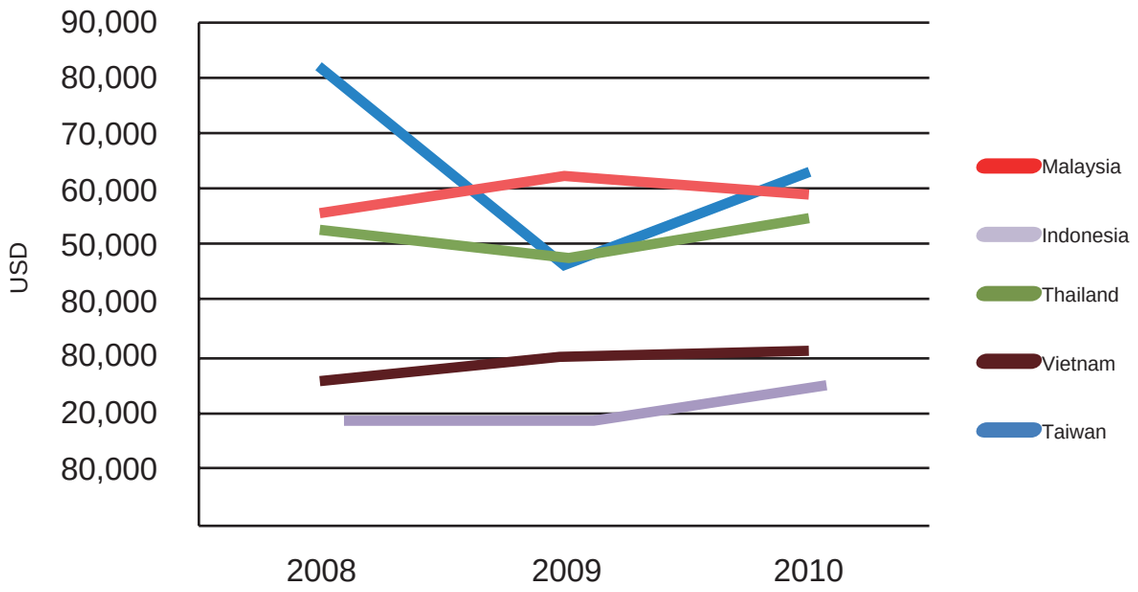


Source: Actuarial Partners analysis and recalibration of Swiss Re's Mortality Protection Gap analysis[5]

[4] "Mortality Protection Gap: Asia-Pacific 2011" Swiss Re
[5] "Mortality Protection Gap: Asia-Pacific 2011" Swiss Re

5.52 The average gap per working person for Malaysia is higher relative to other countries as shown in the graph below.

Figure 5.27: Estimated aggregate protection gap per working person in various countries



Source: Actuarial Partners analysis and recalibration of Swiss Re's Mortality Protection Gap analysis [6]

5.53 Although the aggregate gap is at similar levels for Malaysia, Hong Kong and Singapore as shown in Figure 5.26, the average gap per person for Hong Kong and Singapore are significantly higher, at approximately 7 to 8 times higher relative to Malaysia (not shown in the graph above as the gap levels for these countries are significantly above the level for other countries). This can be partially explained by the higher cost of living and the lower number of working population in those countries.

[6] "Mortality Protection Gap: Asia-Pacific 2011" Swiss Re

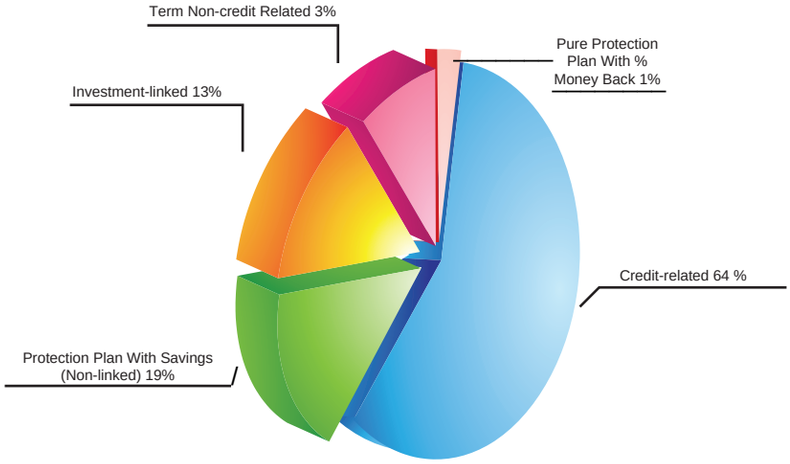
PRODUCT GAPS

5.54 The study considered the products that are currently being offered in the Malaysian market and the key findings are summarised below.

Figure 5.28: Product offerings in Malaysia

5.55 Based on the information provided by the takaful players in the survey form, the products that are currently sold in the takaful market largely relates to credit-related products. In addition, there is an increasing proportion of investment-linked product being sold in the market. A summary of the takaful product distribution in terms of sums covered is shown below.

Figure 5.29: Takaful product distribution by sums covered as at 2012

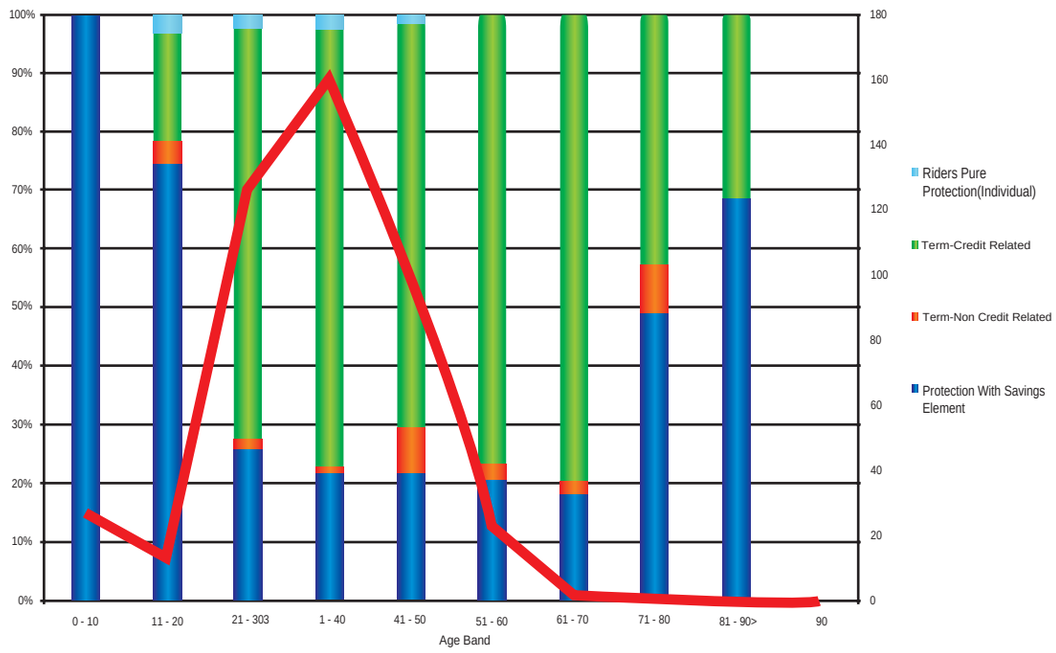


5.56 Investment-linked products and credit-related products are popular in the market as the products are simple to understand and are therefore easy to sell to the consumers. Credit-related takaful products have ridden on the success of the Islamic banking system, and as such, the majority of the takaful business is focused on credit-related products.

5.57 Investment-linked products typically generate a lower capital requirement compared to traditional insurance products under the Risk-Based Capital Framework, which resulted in many companies focusing its sales towards investment-linked products. In addition, investment-linked products are also flexible which makes customisation for each consumer's needs easy for the seller.

5.58 Based on the survey results, the distribution of sums covered by age in the takaful market is shown in the graph below. The left y-axis shows the proportion of the sums covered by product groups and this is represented by the columns in the graph for each age groups. The right y-axis shows the amount of sums covered and is represented by the red line for each age group.

Figure 5.30: Takaful product distribution of sums covered by age groups in 2012



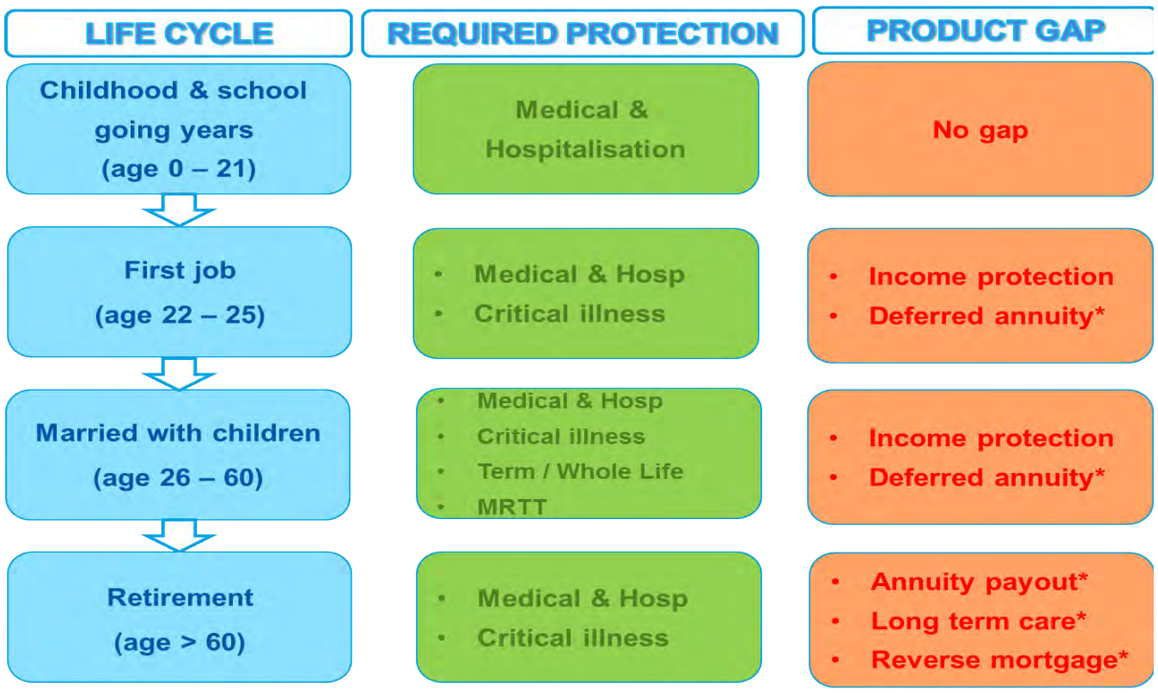
5.59 Based on the graph above, the majority of the sums covered are attributed to credit-related business. Only a very small proportion (at around 3% of total sums covered) of non-credit-related term takaful business is in-force in the market as at 2012.

5.60 The total sums covered is highest for the working age group 20-50 years old, and these are largely attributed to credit-related business such as mortgage reducing term takaful policies (MRTT). The total sums covered drops significantly at older ages. This can be partially explained with a lower outstanding debt, as well as challenges in obtaining further debt and in obtaining takaful coverage due to the underwriting requirements at older ages.

5.61 There are a greater proportion of savings-type policies at the younger ages (i.e. below 20 years old) and above retirement age. The policies at younger ages are typically savings policies for the purpose of education whereas the policies at the older ages are largely for savings for retirement purposes.

5.62 Below is a summary of the product gaps analysis, relative to the typical Malaysian life cycle.

Figure 5.31: Typical life cycle and product gap analysis



Note: Products marked with * relate to retirement products and are excluded from the scope of this study.

5.63 Based on the above analysis, the protection products that are currently not available in the market include:

> Micro-takaful or products targeted to the lower income group.

> Income Protection.

5.64 The key findings on product gaps are described below, based on our interview with the Head of Distribution Channels and the survey amongst takaful operators:

> From a seller's perspective (e.g. agents), the product range currently available in the market is largely sufficient to meet the protection needs of the majority of consumers.

> Although income protection is not available, the product may not necessarily add value to the consumers as it is expensive and can be complex and therefore difficult to explain. The payout rate for income protection products is typically low and therefore may result in mis-selling issues. It is noted that one insurance company in Malaysia had previously sold an income protection product with limited success.

5.65 Based on the product analysis and the estimated gap by key market segments, there is a need to develop products targeted at minimizing the protection gap, particularly for the following market segments:

> The younger generation (i.e. below age 30).

> The low income group (i.e. RM 1,000 a month and below).

> The working population in Klang Valley, Sabah, Sarawak, Johor and Penang.

> The self-employed.

5.66 Although most of the products may already be readily available in the market, these products will need to be re-designed or be packaged strategically to meet the different lifestyle needs in each market. For example, those in the low income group are unlikely to be able to purchase a regular premium product and therefore it may be more appropriate to design a single premium, pure protection product. Affordability is also an issue for this market segment. Considerations towards product distribution are also essential to keep costs low, particularly for products with a low average premium size. This is discussed further as the potential strategies to minimise the gap in Section 7.

POTENTIAL REASONS FOR THE GAP

06

POTENTIAL REASONS FOR THE GAP

6.1 This section highlights the key potential reasons for the gap in Malaysia. This is identified based on the methodology described in Section 4.

6.2 In this section, the study has considered the following:

> The insurance and takaful take-up rates by key market segments.

> An overview of the attitudes of various market players (i.e. consumers, sellers, takaful operators).

> Key drivers of the gap.

INSURANCE AND TAKAFUL TAKE UP RATES

6.3 Based on the feedback provided by the takaful operators in the interview, the take-up rate for insurance and takaful is highest for the following market segments:

> Age group 30 to 45 years old.

> The mass market (i.e. monthly income of RM 3,000 – RM5,000).

> The mass affluent (i.e. approximate monthly income of RM5,000 – RM10,000).

6.4 Based on the interviews with the takaful operators, the following groups are deemed to be underserved in terms of protection coverage. This is consistent with the findings summarised in Section 5, where the largest protection gap is noted for these market segments.

Figure 6.1: Market segments deemed to be underserved by insurance/takaful

Market Segment	Reasons cited by Head of Distribution Channels
Those below age 30	Insurance is not viewed as urgent as the younger generation is more interested to spend on lifestyle accessories (e.g. cars, gadgets, phones, Astro, etc.). Typically these consumers are keener to spend today than save for tomorrow.
Those above age 50	Limitations due to maximum age of entry and underwriting requirements
East Malaysia	Challenges in product distribution
Lower income group	Lack of disposable income after meeting daily living needs.

6.5 The protection gap by key market segment is described in detail in Section 5.

UNDERSTANDING THE MARKET PLAYERS

Consumers' Attitudes

6.6 To understand the potential reasons underlying the gap, the study explored to understand consumers' attitude towards insurance and takaful products in Malaysia, based on the interviews performed with the takaful operators.

6.7 Consumers generally view insurance/takaful product as a savings/investment product, rather than a protection product. Pure protection is challenging to sell due to customers' reliance on large family support network and a strong preference for products that provide returns while the policyholder is still alive. Consumers tend to expect insurance policies to provide some investment returns that can be enjoyed during the lifetime of the policyholder, rather than having the benefits to be fully bequeathed to the dependents. This makes pure protection product less popular compared to a savings-type product.

6.8 Consequently, consumers typically would prefer to pay more for a savings-type product, despite the lower protection provided for an equivalent RM1 premium paid for a pure protection product. This conclusion is often reached even when a comparison of the protection provided under the two types of product is shown to the consumers during the sales process.

6.9 Agents commented that the principle of 'buy term and invest the rest' is likely to be challenging for the mass market as most consumers will not have the discipline to do so and is likely to spend the excess money (after paying for term cover) instead of investing it.

6.10 The consumers' attitude described above results in the low popularity of pure protection products, as these products are perceived to be poor value-for-money, given the lack of investment returns element and low surrender values (if any). There is also a lack of awareness of such products amongst consumers. Both of these factors result in very little demand for pure protection products.

6.11 In addition, consumers typically look at life insurance to cover final/burial expenses instead of income replacement indicating a mismatch in the view of consumers and agents/insurers.

6.12 Although consumers are aware the importance of insurance, the purchase of insurance is often delayed. Consumers do not see the immediate value of insurance and therefore are more likely to purchase items which gives immediate gratification. This is particularly evident for the younger generation who would prefer to spend their disposable income on entertainment and lifestyle items.

Sellers' Attitudes

6.13 The study also considered the typical sellers' attitude towards insurance and takaful products in Malaysia. Sellers in this context refer to those who perform the sale process such as agents, banca staff and telemarketers. This is summarised below.

6.14 Sellers typically have a preference to sell investment-linked policies, due to the following reasons:

> The product is simple and easy to understand by the consumers.

> The product is flexible and can be customised to meet the amount of savings and protection required by each consumer. In addition, there is also the ability to attach various riders to the basic plan to meet the various protection needs of each consumer.

> Therefore, from a seller's viewpoint, an investment-linked product tailored for the policyholder is sufficient for the sellers to meet consumer needs.

6.15 Investment-linked product is categorized as a savings-type product (i.e. with both protection and savings element). The average premium size for a savings-type product is typically higher compared to a pure protection product, for an equivalent sums covered. Consequently, the level of commissions is typically higher for savings-type product in absolute terms, which may further incentivize agents to sell investment-linked products at the expense of protection only products.

6.16 It was highlighted in the interview that sellers' are typically trained to perform needs-based selling and the majority of the sellers will typically do so in the sales process, rather than performing sales being purely driven by the commission level. Takaful operators noted that the element of product remuneration to the seller can also play a significant role in influencing the sales process.

6.17 Nevertheless, it is noted that consumers would typically prefer a product with some savings element, such as investment-linked products, notwithstanding the existing incentive structures available to the sellers. Such preferences would have contributed significantly to the growth of investment-linked policies

6.18 Given the above, it is not surprising for investment-linked product to be one of the highest selling products in the market. As the equity market in Malaysia has been enjoying a period of boom, this has worked well for most consumers. As investment-linked products are investment products rather than savings products, there can be persistency challenges should the equity market demonstrate greater volatility in the future.

Attitudes Of Insurers/Takaful Operators

6.19 In general, insurers and takaful operators would typically prefer to sell products with the following key characteristics:

> Profitable with short breakeven years.

> Low capital requirements.

> Medium to high average premiums.

> Products that can be sold in significant volumes.

> Product design that is not exposed to significant anti-selection and unexpected or volatile insurance risks.

6.20 Being a profit-driven organization, insurance companies and takaful operators are required to monitor cost and expense level. In particular, as takaful operators major source of income are the wakalah fees, the preference would be to minimize claims volatility so as to minimizing the need for a qard to the takaful risk fund. This can result in a high level of retakaful cover for risk type products.

6.21 Although there is a need of insurance coverage in certain market segments, there are challenges for the takaful and insurance industry to meet this demand. For example, it is necessary for products sold to the low income group to be of very low average premiums. As a result the product may be unprofitable given the high expense level to manage the business and the capital investment required to develop a suitable distribution channel to reach and service the policyholders in the rural areas. In addition, the claims experience for this product group may be poorer than the national average which makes the product difficult to price.

KEY DRIVERS OF THE PROTECTION GAP

6.22 Based on the interview with the takaful operators and the analysis performed above, in addition to our knowledge of the industry, the following key reasons were identified as drivers of the protection gap.

i. **LACK OF KNOWLEDGE IN FINANCIAL PLANNING:** In general, consumers are aware of the importance of insurance. However, most consumers will delay the purchase of insurance. This is largely driven by the lack of knowledge and awareness on the need of financial planning. Consequently most consumers are not aware and would typically find it difficult to know what type of insurance to buy and how much coverage is appropriate. Historically it could be argued that a strong family structure compensates for the lacking takaful/insurance protection, however this is becoming less dependable given the trend towards a smaller family unit and continuing urbanisation.

ii. **LACK OF FUNDS:** Although lack of funds and budget constraints are often cited as the reason for the inability to purchase insurance, this is largely true for the lower income groups only.

iii. **PERCEIVED LACK OF FUNDS:** There is a gap in consumers' perception on the cost of insurance. For income groups (at least those above RM3000 and above), typically there are sufficient funds available for the purchase of insurance. However insurance is usually not viewed as a priority item, particularly for the younger generation as described in Para 6.4.

The findings are similar to those observed by Swiss Re[7] in developed markets such as the US and Europe, where budget issues are often cited as the main impediment to buying insurance but in reality, the cost of protection insurance in such countries would cost less than the cost of a daily cup of coffee or monthly internet access.

In Malaysia, it is noted that for a 35-year old male, it is possible to obtain a 20-year sums covered of RM100,000 for just under RM2 per day.

Despite the perception that life insurance is expensive, in a survey carried out by Swiss Re, it was observed that around 40% of survey respondents in Malaysia are willing to pay for term insurance above the market rate, with income and education cited as the main drivers to purchase insurance. Men are also more inclined to pay for term insurance than women due to the more traditional family forms where intra-family support is common and men would generally feel more responsible for the financial well-being of the family[8].

iv. **LIMITED FINANCIAL AND TAX INCENTIVE TO PURCHASE INSURANCE:** The current tax structure provides tax relief up to RM6,000 per annum for life insurance products. However, this is combined with the EPF relief, which is usually fully utilised for employed individuals. In the addition, the tax structure is only beneficial to individuals who pay tax. Therefore those who do not pay tax (who are also more likely to need insurance) are marginalized from the tax benefit.

v. **PREFERENCE FOR SAVINGS-TYPE PRODUCTS:** Based on the consumers' product preference described above, consumers generally prefer to purchase savings-type products rather than a pure protection product. This trade-off implies a lower amount of protection provided under a savings-type product for an equivalent RM1 premium. Consequently, given the limited funds to purchase insurance, consumers are only able to afford a lower amount of coverage as savings-type product is typically more expensive compared to a pure protection product. This results in a protection gap.

vi. **HEAVY RELIANCE ON THE BENEFITS PROVIDED BY EMPLOYERS:** For the employed, consumers would typically rely heavily on the group term cover provided by the employer. However, the group term coverage is typically low in Malaysia, at approximately three to five times of annual income. This is significantly lower compared to the average protection required of 13 times the annual salary, before any allowance for household debt. Depending on the employer to address the protection gap results in consumers to be heavily dependent in continuing employment and insurability.

[7] Swiss Re – The Mortality Protection Gap in the US, August 2012 – pgs 16 and 17.

[8] Swiss Re Economic Research & Consulting based on Survey of Risk Appetites and Insurance: Asia-Pacific 2011 Swiss Re.

vii. **UNDERWRITING REQUIREMENTS:** Although there is a demand for insurance coverage at the older ages, there are limitations in the amount of coverage that can be provided given the underwriting requirements and the maximum age of entry of the products available in the market. However, it is noted that the protection gap for the older ages is small relative to other age groups.

viii. **CONSUMER PERCEPTION AND REPUTATIONAL ISSUES:** In certain market segment, insurance and takaful are viewed as taboo and therefore the understanding of insurance and its importance is limited. Insurance are often associated with negative emotions – frustration, confusion, anxiety and boredom are experienced more often than relief, confidence and satisfaction[9]. In addition, certain market segments may not be aware that takaful is Sharia-compliant and therefore will not consider the purchase of takaful. There is also a negative perception on the insurance and takaful industry in general, which adds to the challenge in increasing the penetration rate.

This is consistent with the findings in other markets. In a recent study, consumers have a neutral or negative view of the industry and its products. Consumers are generally confused, and find insurance products complex and opaque, and often find it difficult to compare with products with others due to fine print embedded in product description[10]. In a LIMRA survey, survey respondents reported that life companies often use confusing language, try to find loopholes from making a payout, offer products that are too complicated and are just after the consumers' money regardless of need[11].

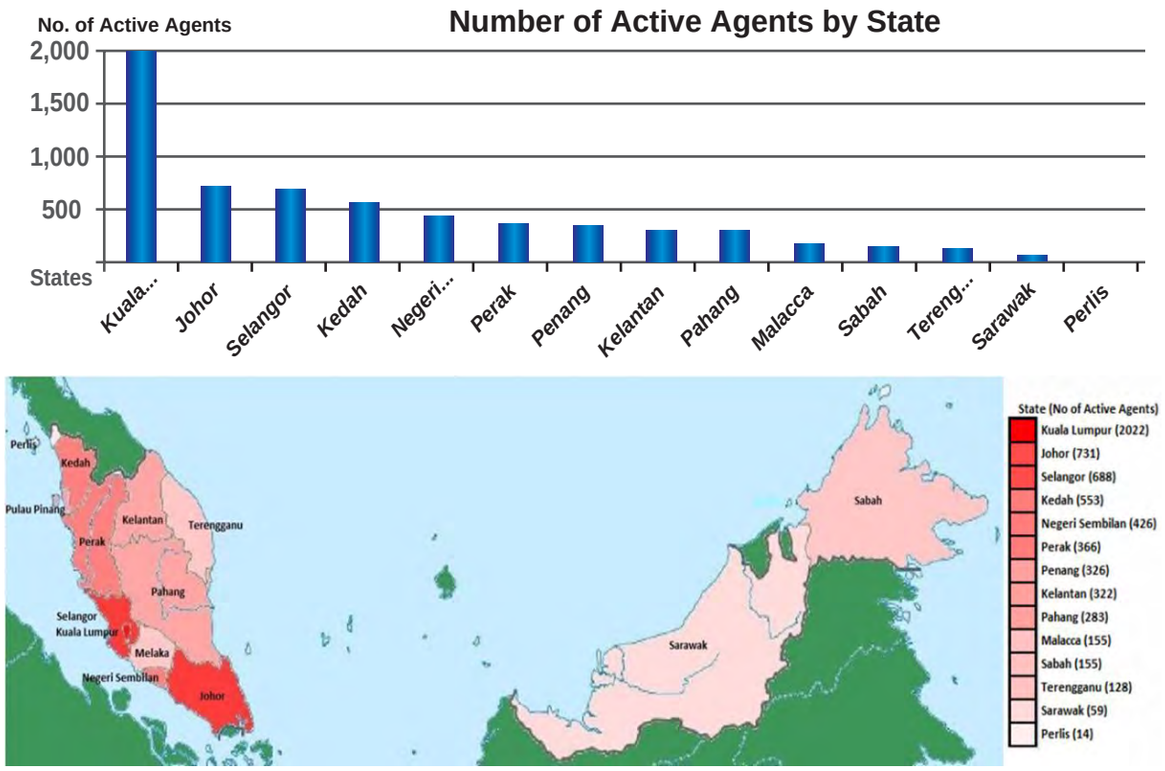
[9] Maddock Douglas – Maria Umbach "You talkin' to me? How Gen Y hears 'insurance'" August 2010 and Maria Umbach, "Interest group awareness of the need for life insurance is flagging, but the industry can take steps…" October 5 2011 (Articles on the Maddock Douglas Community website)

[10] Leveraging Consumer Insight in Insurance, Boston Consulting Group, 2010

[11] Consumer Confidence in Life Insurance Companies, LIMRA 2012

ix. **THE LIMITED REACH OF EXISTING DISTRIBUTION CHANNELS:** Currently the product distribution approach remains to be largely concentrated in the big cities and the presence of insurance and takaful product distributors are limited or non-existent in the rural places. This is illustrated in the agency force distribution for takaful operators in Malaysia, as shown below.

Figure 6.2: Distribution of takaful agents in Malaysia



x. **THE NEED TO MINIMISE COSTS BY INSURERS AND TAKAFUL OPERATORS:** There are challenges in developing an extensive distribution channel, particularly for those living in rural places and in East Malaysia. Takaful operators are faced with the challenge to keep costs down given that many have yet to reach critical size and there are significant costs and efforts in developing an extensive distribution force to these areas. Takaful operators may not be willing to make such investments, particularly since the products to be sold in these areas are typically of low premium sizes and therefore may not justify the high up-front costs.

xi. **THE LACK OF ALTERNATIVE DISTRIBUTION CHANNELS:** For those that are technology-savvy, this market segment may have a preference to purchase insurance and takaful products online. Currently, the number of products that can be purchased online is limited.

xii. **THE LACK OF TRANSPARENCY:** There is a lack of online product aggregators to compare similar products in the market (e.g. term insurance). At present, consumers would typically need to meet an agent to find out about a particular product, which is time consuming.

xiii. **PRODUCT COMPETITION WITHIN BANCA CHANNEL:** For insurance and takaful products sold in the banca channel, there are competing banking products which are also sold by bank staffs. Bank staff would typically prefer to sell banking products, as it is easier to sell and the sale process takes a much shorter period compared to insurance products. In addition, there is a poor take-up rate for pure protection products in the banca channel as the typical mindset of banking consumers largely relates to savings and investments.

xiv. **PART-TIME AGENTS:** It was observed that there are a large number of part-time agents, which may not be as well-trained or serious about selling compared to a full-time agent. Due to the nature of the part-time role, these agents typically have limited time, focus and incentive to further increase the insurance and takaful penetration rate as the role is likely not his/her main source of income.

xv. **QUALITY OF AGENTS:** The lack of trained agents may result in the sales process to be purely commissions driven or may result in product pushing. As a consequence, if the sales process is not driven by the needs of the consumers, then the product is likely to result in a high lapse rate.

xvi. **LIMITED SOPHISTICATION IN THE SALES PROCESS:** There are limited agents that are equipped with the skills of financial planning to assist the consumers in determining the amount of protection required. During the interview, it was identified that only a small proportion of agents apply a more sophisticated approach such as using financial planning techniques to determine the amount of protection required by the consumers (e.g. calculating the present value of the potential future income and taking into account the future needs and expenditures). Typically, most agents will advise consumers to purchase protection cover equivalent to about ten times of the annual salary, without any adjustments by age. In reality, the multiplier is expected to be higher for the younger generation. Without appropriate financial projection techniques, the advice provided by sellers may result in insufficient protection being purchased by the consumers.

xvii. **LIMITED EXPERIENCED AGENTS:** There are limited agents with the required skills to perform emotion-based selling during the sale process of insurance and takaful products. As previously highlighted, a majority of consumers are aware of the importance of insurance but there is a lack of urgency to purchase insurance. In addition to needs-based selling, emotion-based selling is important to convince consumers the importance of purchasing insurance at an early age without further delay.

6.23 Given the above, the potential strategies to minimise the gap is described in the next section.

POTENTIAL STRATEGIES TO MINIMISE THE GAP

07

POTENTIAL STRATEGIES TO MINIMISE THE GAP

7.1 This section identifies the potential strategies to minimise the protection gap in Malaysia, based on the methodology described in Section 4 and Appendix A2.

7.2 The product distribution strategies and recent new guidelines in various countries are also considered in this section.

STRATEGIES AND REGULATIONS IN OTHER MARKETS

7.3 The following product distribution strategy and regulations in various countries were identified in the study, as summarised below. This is relevant to be taken into consideration when developing the potential strategies to minimise the gap in Malaysia as these new regulations would have been developed with the objective to increase market penetration rates of various market segments.

FAIR in Singapore

7.4 Singapore is currently undertaking a review of the guidelines relating to the distribution of life insurance and investment products in Singapore, aimed at increasing the standards and professionalism of the financial advisory industry. The key proposed changes include:

> The launch of a free online aggregator to compare life insurance and endowment products between insurance providers.

> Insurance companies are required to offer basic life insurance products available directly (i.e. direct channels) to consumers instead of via the agency force only.

> First year commissions to be capped at 55%, with the remaining 45% of commissions to be paid out over the remaining premium payment years, up to a maximum of five years.

> Enhanced disclosures, including Disclosure of Trailer Fees for Collective Investment Schemes and Disclosure of Total Expense Ratios of Participating Funds.

> Incorporating a balanced scorecard remuneration framework with non-sales KPIs for financial advisers.

> Higher regulatory requirements for financial advisory (FA) firms, such as the need to set up independent sales audit department, increasing the minimum education requirements of FAs, higher capital requirements for FA firms, a more onerous skill sets requirements for certain FA personnel.

7.5 When FAIR was launched, there was much apprehension in the industry, particularly in relation to the potential removal of the commission-based structure to be replaced with a fee-based model similar to the UK. As a result, this proposal was withdrawn and the commission-based model remains. As such, the agency remuneration will remain largely unchanged even with the introduction of the 55% first-year cap as current first year commission levels are in the range of 49% to 55% of total commissions.

7.6 For consumers, the web aggregator will be a useful tool to compare the basic insurance products available in the market and consumers are likely to enjoy better rates as these channels are expected to have lower distribution costs and commissions. In addition, enhanced disclosure would also help the consumer better understand the insurance products they are buying.

7.7 For insurers, disclosure of the expense ratios may not be favourable, particularly to those with smaller participating funds or have yet to achieve economies of scale. Financial savvy consumers may be incentivised to look for other products with lower expenses, such as unitised with profit products.

Retail Distribution Review (RDR)

7.8 The recommendations resulting from the RDR was introduced in the UK on 1 January 2013, with the following objectives:

> raise professional standards in the industry.

> introduce greater clarity between the different types of service available; and

> provide clarity and transparency on the cost of advice.

7.9 The recommended changes include a ban on insurers' influence on distributor remuneration, whereby commissions are replaced with advisor fees. The advisors have to agree on the fees or charges with customers and the charges must be related to the services provided and not products sold. Ongoing charges are only applicable where ongoing services are provided and customers are able to discontinue advice charges at any time. Trail commissions for products sold pre-RDR have also been banned.

7.10 Other changes include clearer disclosure of advisor status and remuneration, higher conduct standards for independent financial advisors and minimum qualification standards and continuing professional development for all advisors.

7.11 As the recommendations have only been in place for a year, the impact of the RDR is yet to be determined. However, a summary of the key observations by market players are summarised below.

> Under RDR, it is likely that the mass market for financial advice would be largely unattractive to advisors. Therefore, a reduction in the number of mass market IFAs staff, which may create a "guidance gap" for these consumers.

> Direct sales forces may make a comeback to service the lower income and mass market (as they cannot afford to obtain the advice from the IFAs) as the disappearance of the commission-based model created a clear distinction between advice on the one hand and product providers on the other.

> RDR is also likely to have the greatest impact on smaller IFAs, who would not have had the necessary infrastructure to support the requirements. They are also more likely to be affected by consequences of the elimination of trail commissions. Some insurers have indeed assumed a reduction in the member of IFAs in the market.

New Bancassurance Rule in China

7.12 In late 2013, the China Banking Regulatory Commission (CRBC) issued a draft proposal for the sale of insurance policies by banks and postal agencies, placing the focus on protection products. Under the new guidelines, at least 20 percent of the total premiums generated by banks and postal agencies must be from protection-type insurance products. This will be a challenge for most banca channels as currently protection-type premiums represent less than 10 percent of total bancassurance sales. The main products sold through this channel currently are high-returns wealth management products.

7.13 Banks and postal agencies are also required to carry out Know-Your-Customer assessments during the sales process and to avoid excessive financial commissions. Sellers are also required to match customers' incomes to the value of insurance products to be sold.

Proposed Concept Paper in Malaysia

7.14 The regulators in Malaysia have also recently issued the 'Life Insurance and Family Takaful Framework: Concept Paper' ("Concept Paper") in November 2013. The key proposed changes in the Concept Paper are summarised below:

> Partial removal of operating cost control limits: Limits on commissions for investment-linked policies will be removed and minimum allocation rates are introduced instead. Limits on commissions for non-linked protection products will also be removed subject to insurers making these products available in the direct channel. Limits on agency-related expenses for investment-linked business and limits on management expense for non-linked business will also be removed.

> Diversification of distribution channels: Commission limits for banca channel will be increased to be aligned with the commission levels of corporate agents for all products except those that are liberalized as outlined above (i.e. investment-linked and pure protections). There is also a requirement to set up a direct channel selling pure protection products without commissions. The framework for financial advisers is also enhanced.

> Strengthening of market conduct: This includes the introduction of a balanced scorecard system, enhanced product disclosures, the availability of online facilities, removal of agency financing limit and initiatives on consumer awareness.

7.15 The study also sought the opinions of the Head of Distribution Channels of Takaful Operators on their views on the Concept Paper, which are summarised below:

> Direct sales channels (e.g. online, telemarketing) is only appropriate for simple products such as term and for certain market segments (e.g. internet-savvy and financial-savvy individuals).

> Most of the head of distribution channels interviewed were of the opinion that the optimal approach to sell insurance/takaful in Malaysia remains to be via the agency force as insurance/takaful is 'sold not bought' and human interaction is deemed to be essential in the sale process.

> There were conflicting views on whether applying higher commissions will increase sales or otherwise. Most viewed that sales will only increase temporarily as a result of higher commissions.

7.16 It is noted that there is a common recurrent theme in the objectives of the majority of the new guidelines proposed in various countries. This includes:

> Strengthening market conduct, including the professional standards of the advisors, to benefit the consumers.

> Developing greater transparency to empower consumers to make an informed decision.

> Developing a fair remuneration system for each distribution channel based on the value of advice provided to the consumer.

> Encouraging the growth of affordable pure protection products.

> Providing incentives to develop other distribution channels to complement the traditional agency business, with the intention to access all segment of the population and therefore help to increase insurance penetration rates.

7.17 Some other strategies applied in other markets with the intention to minimise the protection gap include:

> In India, there is a requirement for a proportion of the business to be made up of micro-insurance business. This is to encourage the growth of micro-insurance business.

> In Denmark, insurers would send a standardized form to clients once a year on their birthdays, stating how much protection the client has. Similarly, in the US, the government provides a comparable report on the amount of social security benefits available to individuals. Having such report will enable consumers to assess their total level of coverage available and identify unmet protection needs[12]

> In Australia, the life insurance sector has worked collectively to promote greater awareness of the benefits of insurance protection to the general public. The coherent effort combined with the growth of alternative channels, and the sales of protection policies through superannuation funds has significantly increased the protection coverage in Australia[13] .

7.18 Further details on the regulatory updates in relation to product distribution are described in Appendix A5.

[12] Sigma No.4/2004 – Mortality protection: The Core of Life. Swiss Re.
[13] Mortality Protection Gap: Asia-Pacific 2011. Swiss Re.

POTENTIAL STRATEGIES TO MINIMISE THE GAP

7.19 Based on the interviews conducted with the Head of Distribution Channels, the survey results, the analysis performed above and our knowledge of the industry, the following strategies were identified for the purpose of minimising the protection gap in Malaysia:

i. **EDUCATION:** The study recommends that education is provided to the public on the importance of financial planning and the importance of having insurance/takaful protection. This should begin at the younger ages (e.g. as part of school curriculum at secondary or tertiary level). Employers can also play a role by providing financial planning education at the workplace, highlighting the important of protection, the implications of being underinsured at death and disability, understanding how to measure the protection amount required and how it fits into the larger framework of financial planning[14] . Currently knowledge on financial planning is lacking in Malaysia. In addition, further education about takaful to certain segments of the society who may not be aware that Takaful is Sharia-compliant would be beneficial. There should be more efforts made by the takaful operators to differentiate itself from the conventional insurance industry to win over those who remain doubtful about takaful. Providing consumers with the education on financial planning is likely to empower consumers to purchase insurance. If consumers understands the need for insurance products and can see their value, it is likely that they would be more willing to pay for them.

ii. **DEVELOPING A FAIR TAX INCENTIVE FOR ALL MARKET SEGMENTS:** The study recommends that a fair and suitable tax incentive that addresses the needs of various market segments is developed to increase the insurance/takaful penetration rates in Malaysia. This includes the following:

> A separation of the tax-free allocation between insurance premiums and EPF (currently RM6,000 for the combined EPF and insurance premiums). It is noted that the insurance industry (LIAM) has been lobbying for such amendments to the tax relief structure for several years without success so far.

> Given that the current tax relief structure is only beneficial to those who pay tax, tax incentives should be developed to also cater for the lower income group. For example, a dollar-to-dollar subsidy up to a certain maximum amount can be provided to encourage this group to purchase insurance and takaful protection.

> Given that the purpose is to minimise the protection gap, the tax incentives and subsidies can be structured towards pure protection products only to prevent those taking advantage of the relief for investment purposes.

[14] Sigma no.4/2004 – Mortality protection: the core of life

> In addition, the study recommends a level playing field is developed between takaful and insurance products relative to other pure savings and investment vehicles. For example, currently there are tax advantages in investing in unit trusts compared to an investment-linked insurance/takaful product. Therefore the study proposes that these two products are subject to a similar tax structure to encourage the growth of the insurance and takaful industry.

iii. INCREASING AWARENESS ON INSURANCE AND TAKAFUL: The study recommends that an industry-wide awareness program is developed to increasing the awareness of the consumers on the importance of financial planning and insurance/takaful cover. This can be done through road-shows, talks at universities, etc. The awareness program should be developed coherently by the industry as a whole to maximise its effectiveness and allowing the costs to be shared across the industry.

iv. **DEVELOPING THE AGENTS' SKILLS:** There is a need to develop suitably trained agents to develop the following skills:

> To sell on needs-based analysis to consumers using financial planning tools. This will increase the quality of business sold, with better persistency rates if consumers understand the importance of insurance and takaful cover. A recent consumer survey by LIMRA[15] in the US noted that 73% of those who received a needs analysis bought a life insurance policy, compared to a take up rate of 49% who did not have any assistance in the purchase process. According to a study by Genworth[16] , consumers would also prefer to see a calculation based on their individual needs instead of providing a generic rule-of-thumb advice (e.g. multiple of income).

> Agents should also be trained to do emotion-based selling to highlight the urgency of insurance/takaful protection, particularly to the younger market segment who would typically delay insurance purchases until they are much older. This can be as simple as sharing stories of real-life beneficiaries. Death is often a difficult subject and is often considered taboo in our society. Using anecdotal evidence can be a powerful way to show to the consumers that it is the consumers that will benefit from insurance, not the agents or the insurers[17] .

v. **REVIEWING THE AGENCY FORCE STRUCTURE IN MALAYSIA:**
The study recommends that the agency force structure is reviewed such that the number of part-time agents is controlled and the number of full-time agents is increased. This is in line with the recent Concept Paper whereby there is the intention to increase the number of full-time agents in the market in Malaysia. During the interview, several head of distribution channels in the market highlighted that there are too many part-time agents in the market which impacts on the quality and amount of sales. A potential solution is to adopt the agency force structure in Singapore, whereby the number of agents is limited based on best practice guidelines, to improve the quality of the agents and increase the penetration rate.

[15] LIMRA – Trillion Dollar Baby – Growing Up, 2011, pg 10
[16] Genworth Financial, Inc – The LifeJacketSM Study, 2011
[17] Swiss Re – The mortality protection gap study in the US, August 2011, pg 17

vi. **ENCOURAGING A PRO-ACTIVE DISTRIBUTION CHANNEL:**
Insurance purchase is usually triggered by life events such as marriage, birth of a child, purchase of new homes etc. There is a strong correlation between the birth of a child and the purchase of and the amount of term life insurance[18] . Therefore, agents can engage existing customers at relevant lifecycle trigger points and offer cross and up selling opportunities to meet evolving needs. In addition, mortality protection gap can be reduced by revisiting the existing policyholders for a pro-active re-evaluation of older existing policyholders. Insurance policy that was bought ten years ago may no longer be sufficient, and consumers may have undergone various life events that would require different coverage compared to a decade ago[19].

vii. **DEVELOPING A MORE SUITABLE AND EXTENSIVE DISTRIBUTION CHANNEL:** This includes the following:

> In order to reach to the wider consumer group in East Malaysia and those in the rural areas, one potential solution would be to tie up with existing infrastructures such as Pos Malaysia.

> Other existing infrastructures which can be utilized include insurance sales via mobile phones and small retailers. The product range for these alternative distribution channels is likely to be limited to simple pure protection products. However, simple and cheap products are likely to be more appropriate for these market segments.

> Developing alternative distribution channels (e.g. direct marketing, online) for pure protection plans.

> In addition, the study recommends that industry/MTA branches are developed which can be utilised by all takaful operators in East Malaysia such that the distribution cost can be shared between the participating MTA members. This will enable takaful players to minimise the expense level and yet continue to expand its distribution reach.

viii. **SIMPLIFYING THE SALES PROCESS:** The study recommends that the purchasing process of insurance and takaful to be simple and transparent. In particular, the insurance sector is lagging behind most industries, where information is typically available online and customers are able to compared products, prices and obtain independent opinion from various sources. Underwriting processes, such as medical assessments, can dissuade customers from completing the purchase[20]. A complicated buying process combined with a poor understanding of products can lead to the perception of insurance or takaful having poor value for model.

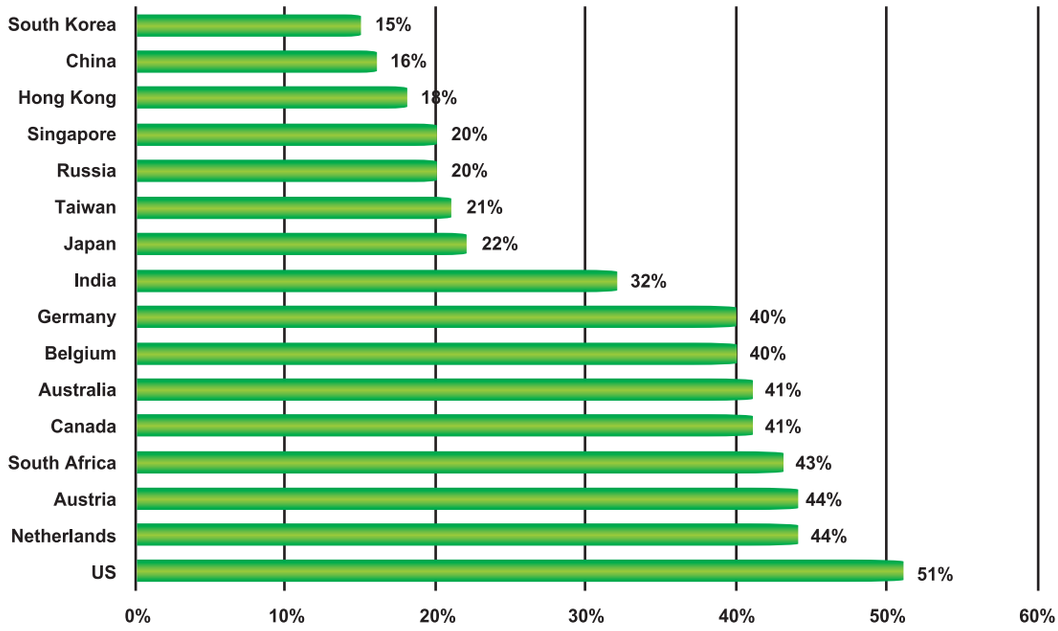
[18] Lienbenberg, A., J. Carson and R. Dumm (2012). A dynamic Analysis of the Demand for Life Insurance, Journal of Risk and Insurance. New parents are 40% more likely to initial term insurance purchase than other households and they purchase 2.3rds more cover than other households.

[19] Genworth Financial, Inc. "TheLifeJacketSM Study" 2011

[20] Sigma No.6/2013 – Life insurance: focusing on the consumer

Consumers will typical delay making unpleasant demanding decisions and the process of buying insurance presents many opportunities for buyers to procrastinate, particularly when medical underwriting is required. Consumers will also typically either fail to act or make poor decisions, when presented with too much information and too many choices[20]. A summary of the recent survey by CapGemini on the global consumer experience on purchasing insurance is summarised below. The study indicates generally a poor consumer experience overall in most markets.

Figure 7.1: Percentage consumers with positive consumer experience on insurance



Source: "Voice of the Customer Survey, World Insurance Report 2014", CapGemini

ix. **DEVELOPING A PRODUCT AGGREGATOR ON THE WEB:** Introducing an online product aggregator to compare similar products in the market (e.g. term insurance) will empower consumers to compare simple insurance products without the need to meet an agent. A 2012 Ernst & Young global survey[21] found that a growing proportion of customers prefer to make life insurance purchases independently, without an adviser or agent. In addition, consumers will typically gather information about products process and brands from online comparison websites, but will commonly make the purchase face-to-face[22] . Therefore, the distribution channel needs to be adapted to the digital age, given changes in consumer shopping behaviour.

[21] Ernst & Young, "Global Consumer Insurance survey 2012 - Americas" pg 2
[22] World Insurance Report 2013, CapGemini and Insurance Barometer Study, LIMRA 2013

x. **DEVELOPING TRUST, BRAND AWARENESS AND TRANSPARENCY:** In Asia in particular, consumers tend to place a strong importance on the insurer's financial strength and reputation when selecting the insurance product and its provider[23] . Financial-savvy and internet-savvy consumers would typically conduct research into companies and products before purchasing a life insurance product, even though the actual product purchase may be done offline. Therefore it is essential for insurance and takaful companies to develop informative online tools. Having presence on social networking sites may also further develop brand recognition amongst the younger generation. It is recommended that insurers and takaful operators improve its communication in order to improve transparency, build trust and facilitate the decision making process for consumers.

xi. **SIMPLIFYING THE PRODUCTS:** Pure protection product would be the simplest and cheapest form of coverage available to consumers and the availability of such products should be highlighted to the consumers during the sales process. However we note that most consumers, particularly the working level population, would typically prefer some returns in their insurance product as policyholders can benefit from some additional earnings in addition to the basic mortality and morbidity protection coverage. Although many sellers (e.g. agents) view that there are sufficient products in the market there is a need for more emphasis for simple products, ideally with some savings element in the market. As mentioned previously in Para 6.22, consumers typically find insurance/takaful products confusing and opaque and therefore would be put off from purchasing insurance/takaful products. It would be more beneficial for the consumers if insurance and takaful providers can provide a range of simple and innovative products that consumers can understand and appreciate, compared to having a wide range of complex products. Having a simple product, with a balance in terms of affordability and reasonable coverage, would encourage consumers' understanding and appreciation towards the need to have takaful/insurance product.

xii. **DEVELOPING PRODUCTS THAT ARE APPROPRIATE TO THE TARGET MARKET, VIA AN APPROPRIATE DISTRIBUTION CHANNEL**. This includes the following:

> For consumers with a lack of regular disposable income, a single premium protection product is likely to be more appropriate compared to a regular premium product. This market segment would typically have a lower level of disposable income, and therefore product offerings to this market should be based on simple and cheap products.

> For the younger generation, it is essential that the product developed complements their lifestyle preference for entertainment and gadgets. For example, a life insurance policy can be sold as a package together with a gym membership. There is also a need to develop a distribution strategy to take into account the digital age.

> For the mass affluent, there is an opportunity to develop products for the higher net worth individual. The strategy for this product group is likely to be different.

[23] Sigma No. 6/2013 – Life insurance: focusing on the consumer

> For banca products, insurance products that complement and are packaged or embedded with banking products are critical for successful sales. In addition, banca products need to be simple as typically banca consumers will have a limited time available to purchase products. Removing underwriting burdens from frontline sales using new solutions in processes and technology, and packaging protection products as riders to savings/investment plans can assist in higher penetration rates in the banca channel.

xiii. **DEVELOPING DIVERSIFIED DISTRIBUTION CHANNELS THAT ARE ALIGNED TO THE TARGET MARKET AND CONSUMER SEGMENT:** For example, those that are outside the urban areas are typically more receptive to telemarketing compared to those in the urban areas.

xiv. **DEVELOPING A PRODUCT ON A COST-SHARING BASIS (E.G. A NATIONAL PRODUCT AND PRODUCTS FOR THE LOW INCOME SEGMENT):**

> For the lower segment of the market where the protection gap is large, there is a need to develop a product which is affordable to consumers. Given the low average premium size, there is a need to keep costs low as well. Therefore, for such products, the study recommends that takaful companies share its resources to spread the costs amongst all the participating takaful operators. For example, the claims processes can be managed at any of the takaful company branches, without the need of a third party administrator.

> To increase the market penetration to the younger generation who are internet-savvy, there is a suggestion by one of the MTA members to develop a national pure protection takaful product to be sold via the internet. Developing an online infrastructure is likely to expensive and takaful operators may not be willing to invest for products with a low average premium. Therefore the study concurs with the suggestion, that a national protection takaful product is developed such that the distribution, infrastructure and marketing costs are shared amongst all participating MTA members. The product differentiation would be the surplus sharing percentage of each takaful operator which would be dependent on individual experience.

xv. **REWARDING CONSUMERS' LOYALTY:** Consumers typically perceive life companies are making little effort to retain them at the point of policy lapse. Insurers and takaful operators can also develop loyalty programs to encourage persistency and longer term relationships, similar to the loyalty rewards provided in many other industries (e.g. supermarkets, airlines, and credit companies).

The loyalty program can be in the form of price discounts or extra value to be rewarded (e.g. free items upon accumulation of points). This program complements the concept of takaful as a 'cooperative' entity.

xvi. **MTA AND INDUSTRY ASSISTANCE:** The study recommends that the MTA provides further assistance to the takaful players and sellers in increasing the penetration rate, such as providing assistance in highlighting the key target market and developing national products. In addition, as described in Para 7.17, the industry can work together to highlight to the consumers how much protection coverage is typically required and how much support is available from social security, existing coverage and available assets, similar to those practiced in Denmark and the US.

7.20 In addition to the above, based on the survey results, it is noted that takaful operators intend to sell pure protection riders to investment-linked plans as its strategy to minimise the protection gap. There are risks associated with this approach as where the riders are unit deducting, any downturn in investment performance of the underlying investment-linked plans may result in a policy lapsing as a result of insufficient funds.

7.21 The strategy to be developed to minimise the protection gap should be done holistically within the industry, taking into account the regulators and all the insurance and takaful providers. Silo efforts are unlikely to have a material impact in meeting the national challenge to minimise the protection gap in Malaysia. Extending SOCSO protection to the self-employed for example can help to immediately address a portion of the protection gap for the lower income self-employed segment of the population.

CONCLUSIONS

08

CONCLUSIONS

8.1 The Protection Gap is increasing in Malaysia, at approximately RM2.5 trillion as at 2012. This is equivalent to about 8.7 times the average annual income.

8.2 The largest aggregate protection gap were identified for the following market segments:

> The younger age groups (i.e. below 30 years old).

> Klang Valley followed by East Malaysia, Johor and Penang.

> Low income earners below RM1,000 per month.

> Average monthly salary of RM5,000 - RM10,000 (mass affluent).

> Self-employed individuals.

8.3 The large protection gaps for these market segments indicate that there is a big opportunity for insurers and takaful operators to offer good value insurance and takaful products in Malaysia. The proportion of protection provided by the takaful market has been increasing in the recent years.

8.4 The average gap per working person is largest for the higher income group (i.e. the mass affluent or those with earnings more than RM5,000 per month). This provides opportunities for insurers and takaful operators to develop high net worth protection products for these individuals.

8.5 For the low income earners, there is significant potential for takaful to play a fundamental role to address the needs of this market segment. We recommend companies to work together to address this need, by sharing resources to keep premium and management expenses low.

8.6 Micro-takaful may also be a solution but for this product to be viable, product needs to be priced as accurately as possible with minimum margins, and low management expenses.

8.7 SOCSO provides a significant role in addressing the protection gap for the lower income group but it is noted that the insurance/takaful industry cannot compete with the protection provided with SOCSO.

8.8 The study recommends that the following key principles and objectives are met in developing strategies to minimise the protection gap in Malaysia:

> Empowering consumers with knowledge and decision to purchase insurance.

> Developing financial incentives to encourage consumers to purchase insurance, in particular pure protection products.

> Developing appropriate products that meet the consumer needs in various market segments.

> Developing a suitable approach and channel for product distribution purposes, taking into account the characteristics of the various market segments.

> Developing partnership strategies to minimise cost while targeting a higher penetration rate.

8.9 The study recommends that the overall strategy adopted to minimise the protection gap should be considered holistically by all industry players and the regulators such that the all efforts are well-placed and coordinated to maximise its effectiveness.

APPENDICES

09

APPENDICES

Appendix A1
Key sources of data.

Appendix A2
Methodology to estimate the gap.

Appendix A3
Key findings from the Takaful Survey.

Appendix A4
Key components underlying the gap analysis

Appendix A5
Updates on product distribution guidelines in other countries.

Appendix A1

KEY SOURCES OF DATA

A1.1 The key sources of data for the purpose of the protection gap study include the following:

> Labour Force Survey Report, Malaysia 2012, Department of Statistics Malaysia.

> Salaries and Wages Survey Report, Malaysia 2012, Department of Statistics Malaysia.

> Report on Household Expenditure Survey Malaysia 2009-10, Department of Statistics Malaysia.

> Household Income and Basic Amenities Survey Report, Malaysia 2012, Department of Statistics.

> National Accounts GDP by State 2005 – 2012, Department of Statistics, Malaysia.

> Social Security Organisation Annual Report 2012.

> Debt and savings statistics from Bank Negara Malaysia.

> Insurance and takaful statistics from Bank Negara Malaysia.

> Statistics on unit trust funds in Malaysia from Securities Commission Malaysia and Federation of Investment Managers Malaysia.

> Employers Provident Fund (EPF) Annual Report 2008 – 2012.

> EPF Savings and Your Benefits, EPF website.

> The Malaysian House Price Index Report at Q3 2013, Valuation and Property Services Department.

> Marketing brochures of products offered by insurance and takaful companies in Malaysia from website of each companies.

> Sigma No4/2004 – Mortality Protection: The core of life, Swiss Re.

> Presentation on “Mortality and Morbidity Gaps, Aging Society and Implications on Product Development, July 2012”, Swiss Re.

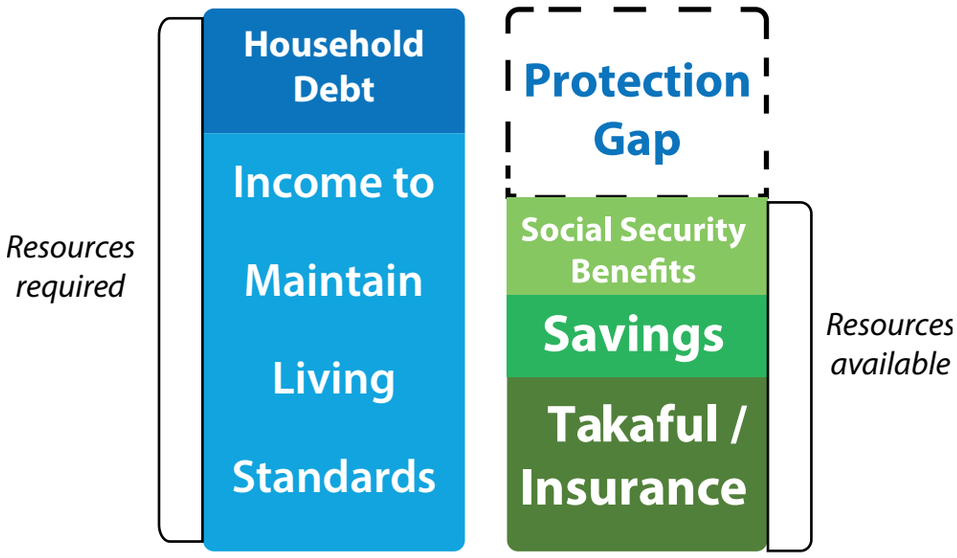
> Mortality Protection Gap: Asia- Pacific 2011, Swiss Re.

Appendix A2

METHODOLOGY TO ESTIMATE THE GAP

A2.1 This section summarises the methodology to estimate the aggregate protection gap in Malaysia. In addition, limitations and the approximations applied in estimating the gap is highlighted below.

A2.2 The estimated protection gap is determined based on the difference between the resources required and the resources available to meet these needs.



A2.3 The resources required comprises:

> The income required to maintain current living standards.

> Household debt – this includes mortgages, car loans, personal loans and credit card debts.

A2.4 The resources available comprises:

> Personal savings and the savings in the Employee Provident Fund ("EPF"). Only 50% of the savings is taken to be resources available to generate a supporting income.

> The insurance and takaful coverage. This includes credit-related insurance and takaful business (e.g. mortgage reducing term assurance or takaful or MRTA/ MRTT).

> The present value of social security benefits, such as those provided by the government to civil servants, SOCSO benefits and EPF benefits upon death.

Income Required To Maintain Current Living Standards

A2.5 The income required to maintain current standards of living is estimated to be around 13 times of the annual income. This is higher compared to the average multiplier applied in the protection gap study in other markets (typically 10). This is due to the demographic profile of Malaysians, which has a greater proportion of the younger working population. The multiplier is greater for the younger working population, to represent the longer outstanding working lifespan, compared to the older working population that is nearing the retirement age.

A2.6 The multiplier to the annual salary, used to estimate the income required to maintain current standards of living, is determined using the following methodology and assumptions:

> The income to be replaced is based on existing salary, which is assumed to be sufficient to meet current needs. This is subject to a minimum income as described in Para A2.7.

> Income replacement is partial at two-thirds of the current annual income. This is on the basis that on average, typically 20%-30% of the monthly income is for debt repayment and another 10% of the income is for EPF deductions. Similarly, this is subject to a minimum income as described in Para A2.7.

> Income replacement is assumed to end at retirement age, given that the financial needs at retirement are excluded from the scope of the study. Therefore, the income stream up to retirement age of 60 is projected, and is assumed to increase with a long term expected inflation rate of 3% p.a.

> The projected income stream is discounted using the long-term expected investment return of 4% p.a. to give the lump sum required at death.

> The multiplier is determined as: lump sum required / annual income.

The multiplier will vary by age bands, with a higher multiplier at younger ages trending towards zero at the retirement age.

A2.7 The methodology assumes that the current annual salary is sufficient. However, we have assumed that a minimum income of RM1,000 a month is required for survival, based on the poverty income line in Malaysia as at 2012. A minimum income of RM1,500 per month is assumed for Klang Valley and Penang.

A2.8 The methodology does not consider the number of dependents on the basis that the current annual salary is assumed to be sufficient to meet current needs. Given that the protection gap takes into account both mortality and morbidity risk, each individual will require its own protection cover, regardless whether the individual has a dependent or otherwise.

A2.9 The methodology does not take into account the potential earnings from a non-working spouse. It is assumed that the employment status of the spouse remains unchanged in the event of a death or disability of the breadwinner.

Household Debts

A2.10 Household debts such as mortgages, car loans, personal loans, credit card debts are taken into account as resources required to be fully met in the event of death or disability.

Savings Available

A2.11 Only 50% of the personal savings and the EPF savings are taken into consideration as assets currently available to meet the protection needs. It is assumed that remaining 50% of the savings are required to meet other obligations such as tertiary education needs and the retirement needs of the spouse.

A2.12 The methodology is a compromise between having all of the wealth being liquidated to meet the protection gap and retaining all the wealth as inheritance to the dependents.

Life Insurance And Takaful Protection

A2.13 We have taken into account the aggregate life insurance and takaful protection provided, based on the total sums assured of provided under the individual and group life insurance and family takaful policies.

Social Security Benefits

A2.14 We have also taken into account the social security benefits for the following market segments:

> A sum cover of RM2,500 for EPF members. EPF members represent about 6.4 million out of a total of 12.7 million working population in 2012.

> A derivative gratuity and derivative pension payable to spouse and dependents in the event of death of civil servants. There are approximately RM1.4 million civil servants in 2012.

> A pension payable upon death to spouse for SOCSO members.

Limitations

A2.15 The methodology adopted to estimate the protection gap is likely to underestimate the true protection gap, due to the following reasons:

> The calculation only takes into account the working population only. This approach understates the true protection gap as it excludes the protection needs of the non-working adults.

> The calculations are based on national averages, such as average income, average debt repayment rates, average savings rate, average insurance and takaful protection and average social security benefits expected to be received. Therefore, the methodology assumes that the surplus arising from individuals with an excess of resources available relative to the resources required will offset the protection gap of others. The true protection gap is the sum of the gaps for individuals with a protection shortfall only, without allowing for any cross subsidization. However, the cross subsidy is minimised by taking into account the different level of average income by age group and income group.

> The benefit payout from critical illness policies are assumed to be used as income protection under this methodology. However it is noted that in some cases, the critical illness protection is purchased to meet medical needs instead of income replacement needs, and therefore will understate the true protection gap.

> The methodology assumes that the current amount of income is sufficient to meet the needs of daily living, subject to a minimum income of RM1,000 a month (or RM1,500 per month in Klang Valley and Penang). In circumstances where the current income level is not sufficient, or if the minimum threshold to survive is above RM1000 a month, then the income required to maintain living standards and the corresponding estimated protection gap is understated.

A2.16 Given the availability of aggregated data only for most of the key input items, the methodology to estimate the protection gap is on a top-down approach, such that the gap is determined on an aggregate level. Given the lack of available data at a more granular level, we have applied judgment and approximation to estimate the distribution of the aggregated data for each market segment (e.g. by state, age group, income group, etc.) for the purpose of calculating the gap by key market segments.

A2.17 A summary of the judgment and approximation applied is summarised below.

A2.18 For the purpose of the study, conventional insurance industry statistics at a granular level were not provided given that the conventional insurance industry is not participating in the study. Nevertheless, the conventional insurance industry statistics on an aggregate basis are publicly available from BNM.

A2.19 Takaful statistics at a granular level provided by MTA members, which were analysed to determine the distribution by key market segments. Therefore, to estimate the distribution of conventional insurance coverage for the purposes of estimating the protection gap by market segments, the aggregate conventional insurance statistics were utilised and it was assumed that the distribution of the life insurance business by income group, age bands and regions to be similar to the takaful industry.

A2.20 Under this approach, the higher average sums covered under conventional insurance relative to the takaful business is implicitly accounted for given the higher aggregated sums assured under conventional business relative to takaful.

A2.21 The study reviewed the reasonableness of this assumption based on our knowledge of the industry and the study notes that there are no significant differences in terms of the distribution by age bands and income group between the takaful and conventional insurance industry.

A2.22 In addition, it is noted that only the aggregated debt and savings data are available from BNM. Given the lack of debt and savings data on a more granular basis (e.g. by age bands, state, income level etc.), the study have applied the following approximation to estimate the debt and savings distribution by the various market segments.

> The study assumed the debt distribution by age group to be similar to the distribution by age group of the credit-related insurance and takaful business. This is deemed to be a reasonable proxy, given that a large proportion of the household debt comprise of mortgages. Based on the data provided by MTA members and our knowledge of the industry, it is noted that the distribution by age group for credit-related insurance and takaful business is not significantly different.

> The debt distribution by state takes into account the average level of house prices in each state, such that areas with a higher cost of living and housing costs will have a higher proportion of the household debt.

> Personal savings by age bands are assumed to follow a similar distribution as observed for EPF savings.

> Notwithstanding the above, where further data is not available, the study estimated the distribution of the debt, EPF and personal savings by taking into account the distribution of the average income level for each market segment.

Appendix A3

KEY FINDINGS FROM TAKAFUL SURVEY

A3.1 This appendix summarises the results of the takaful survey, completed by the management of all eleven takaful operators in Malaysia. The takaful operators have been anonymised for confidentiality reasons.

		A	B	C	D	E	F	G	H	I	J	K	Total
Q2	**In your opinion, why are these products (listed in Q1) very popular? Please tick the relevant points.**												
a	Consumers like products with some money-back (e.g. savings element, return of premium, etc)		1	1		1	1		1				5
b	Current distribution channel likes to sell these products because of the high commission level					1			1			1	3
c	Current distribution channel likes to sell these products because these products are simple and easy to understand	1		1		1			1		1	1	6
d	There is consumer awareness on the need of these insurance products	1				1	1		1	1	1		6
e	The product is cheap						1						1
f	The product is easy to sell	1		1	1				1		1	1	6
g	Consumers receive tax relief on these products					1	1		1		1		4
h	Others:							1		1			2
Q4	**In your opinion what is the main reason that causes these products in Q3 to be less popular amongst consumers. Please tick the relevant points below:**												
a	Product is too expensive			1		1	1	1					4
b	Lack of awareness amongst consumers	1		1		1	1		1			1	6
c	Consumers do not like products with no savings element or no money back (e.g. return of premiums)			1								1	2
d	There is no or limited tax relief on these products		1									1	2
e	Current distribution channel do not like to sell the products because product is complicated/difficult to understand and explain	1			1			1	1				4
f	Current distribution channel do not like to sell the products because commission level is low			1			1	1					3
g	Others:					1			1	1			3
Q5	**In your view, what are the company's challenges in selling pure protection products :**												
a	Limited interest from consumers	1		1		1	1		1	1		1	7
b	Limited interest from agents to sell such products (if applicable)	1	1	1	1					1			5
c	Limited interest from other distribution channels (e.g. banca etc) to sell such products												0
d	Lack of expertise to develop and price products / underwrite						1						1
e	Lack of reinsurance cover												0
f	Lack of suitable matching assets												0
g	Onerous capital requirement								1				1
h	Others:							1	1			1	3

		A	B	C	D	E	F	G	H	I	J	K	Total
Q6	**In your view, why are pure protection products not popular amongst consumers? Please tick the relevant points below:**												
a	Lack of consumer awareness	1		1	1	1	1		1		1	1	8
b	Limited consumer incentive (e.g. tax relief)			1									1
c	Product is too expensive						1						1
d	Product is seen to not provide value-for-money (e.g. pure protection product does not provide money-back unlike savings products)	1	1	1	1	1	1	1	1	1	1		10
e	Others:					1							1
Q7	**Are there any plans for the company to help increase the demand of pure protection products? If yes, what are the strategies to do so? Please tick the relevant points below:**												
a	No							1					1
b	Yes. Potential strategies considered:	1	1	1	1	1	1		1	1	1	1	10
	increase consumer awareness	1	1			1	1				1	1	6
	develop cheaper products						1					1	2
	Sell protection products as riders	1			1	1	1		1		1	1	7
	Incentivise agents/distribution channel to sell protection products			1		1	1					1	4
	Develop alternative distribution channels (e.g. direct, online) to sell protection products	1		1	1	1						1	5
	Others:			1						1			2
Q8	**In your opinion, what type of protection product is lacking in the industry (i.e. protection products other than those available in the current market) given the current population and demography in Malaysia?**												
a	micro-insurance/micro-takaful				1		1	1	1	1			5
b	Affordable / cheap term only product (similar to the level seen in developed countries such as the UK / US)		1		1		1	1	1				5
c	Lifetime annuities			1			1		1	1		1	5
d	Variable annuities (VA)		1	1			1		1	1		1	6
e	Long term care		1	1	1		1	1	1	1	1	1	9
f	Income Protection Plans	1	1				1	1			1		5
g	Reverse Mortgages			1					1			1	3
h	Others:					1							1
Q10	**In your view, which market segment is currently underserved by insurance/takaful? Please tick the relevant points below:**												
a	Lower Income Group	1	1		1	1	1	1	1	1	1		9
b	Self employed (e.g. farmers, fishermen, etc)	1				1	1	1	1		1	1	7
c	Vulnerable groups (e.g. single mothers)						1	1	1		1	1	5
d	Older ages (e.g. those in post-retirement ages)			1	1		1	1	1	1	1		7
e	Foreign workers				1			1					2
f	Others:	1						1					2

		A	B	C	D	E	F	G	H	I	J	K	Total
Q6	**In your view, why are pure protection products not popular amongst consumers? Please tick the relevant points below:**												
a	Lack of consumer awareness	1		1	1	1	1		1		1	1	8
b	Limited consumer incentive (e.g. tax relief)			1									1
c	Product is too expensive						1						1
d	Product is seen to not provide value-for-money (e.g. pure protection product does not provide money-back unlike savings products)	1	1	1	1	1	1	1	1	1	1		10
e	Others:					1							1
Q7	**Are there any plans for the company to help increase the demand of pure protection products? If yes, what are the strategies to do so? Please tick the relevant points below:**												
a	No							1					1
b	Yes. Potential strategies considered:	1	1	1	1	1	1		1	1	1	1	10
	increase consumer awareness	1	1			1	1				1	1	6
	develop cheaper products						1					1	2
	Sell protection products as riders	1			1	1	1		1		1	1	7
	Incentivise agents/distribution channel to sell protection products			1		1	1					1	4
	Develop alternative distribution channels (e.g. direct, online) to sell protection products	1		1	1	1						1	5
	Others:			1						1			2
Q8	**In your opinion, what type of protection product is lacking in the industry (i.e. protection products other than those available in the current market) given the current population and demography in Malaysia?**												
a	micro-insurance/micro-takaful				1		1	1	1	1			5
b	Affordable / cheap term only product (similar to the level seen in developed countries such as the UK / US)		1		1		1	1	1				5
c	Lifetime annuities			1			1		1	1		1	5
d	Variable annuities (VA)		1	1			1		1	1		1	6
e	Long term care		1	1	1		1	1	1	1	1	1	9
f	Income Protection Plans	1	1				1	1			1		5
g	Reverse Mortgages			1					1			1	3
h	Others:					1							1
Q10	**In your view, which market segment is currently underserved by insurance/takaful? Please tick the relevant points below:**												
a	Lower Income Group	1	1		1	1	1	1	1	1	1		9
b	Self employed (e.g. farmers, fishermen, etc)	1				1	1	1	1		1	1	7
c	Vulnerable groups (e.g. single mothers)						1	1	1		1	1	5
d	Older ages (e.g. those in post-retirement ages)			1	1		1	1	1	1	1		7
e	Foreign workers				1			1					2
f	Others:	1						1					2

Appendix A4

KEY RESULTS

A4.1 This appendix summarises the key components underlying the protection gap study, specifically the resources required and the resources available to meet the protection needs against mortality and morbidity risks are shown below for each of the following:

> Historical for the past five years

> By age group

> By states in Malaysia

> By urban and rural areas

> By gender

> By marital status

A4.2 The estimated aggregate resources required and resources available to meet the protection needs against mortality and morbidity risks for the past five years are shown below.

Figure A4.1A: Historical estimated resources required for protection (RM bn)

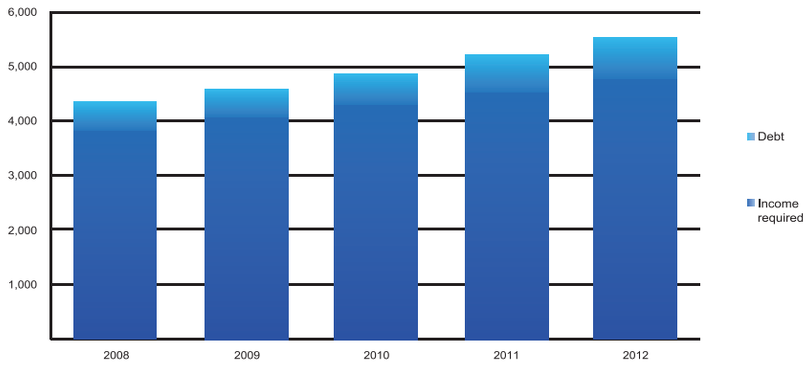
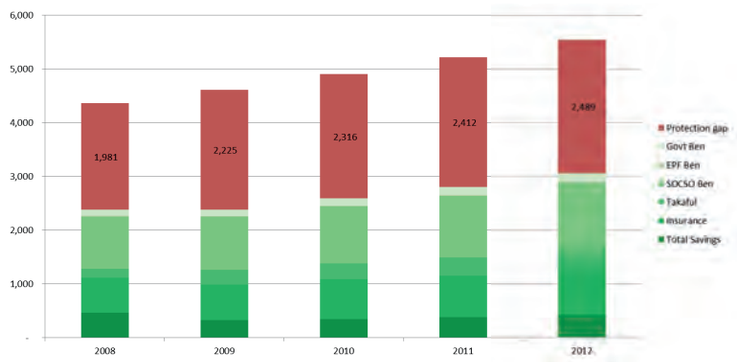


Figure A4.1B: Historical estimated resources available to meet protection needs (RM bn)



A4.3 The estimated aggregate resources required and resources available to meet the protection needs against mortality and morbidity risks by age group are shown below.

Figure A4.2A: Estimated resources required for protection by age group in 2012

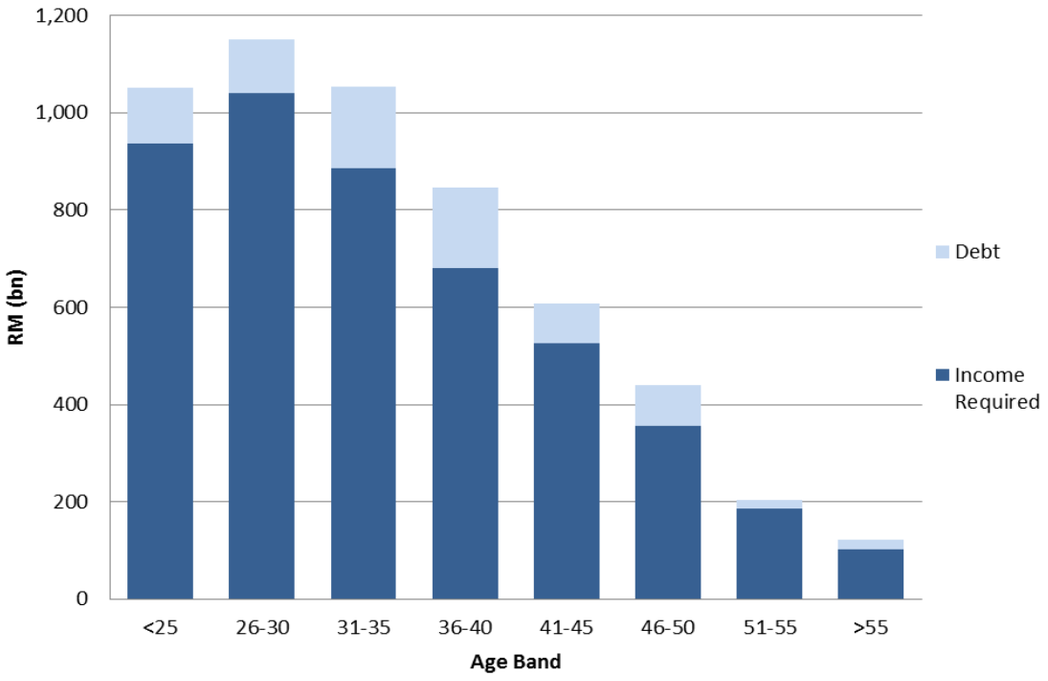
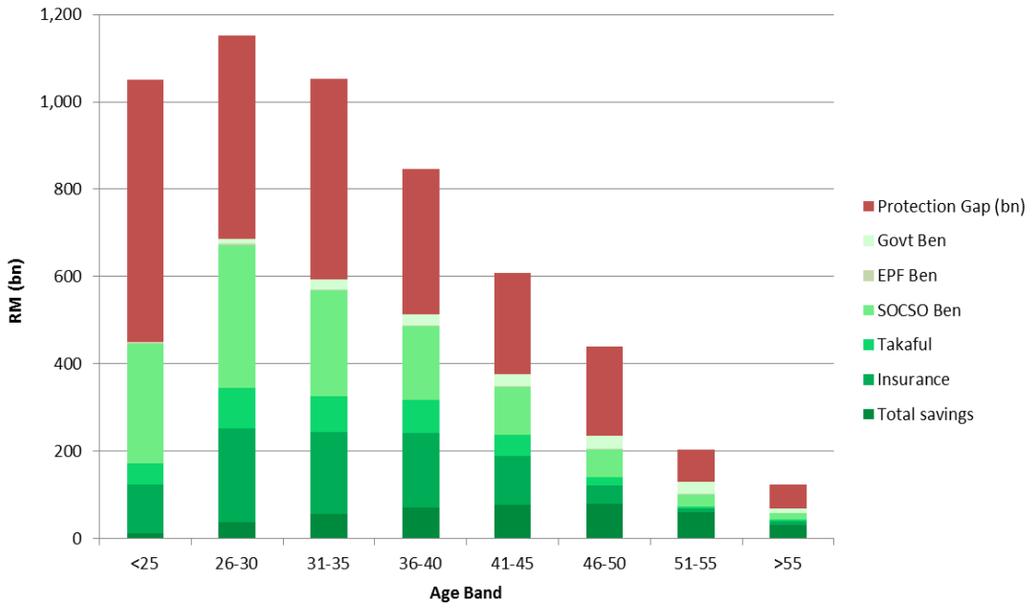


Figure A4.2B: Historical estimated resources available to meet protection needs by age group in 2012



A4.4 The estimated aggregate resources required and resources available to meet the protection needs against mortality and morbidity risks by age group are shown below.

Figure A4.3A: Estimated resources required for protection by income group in 2012

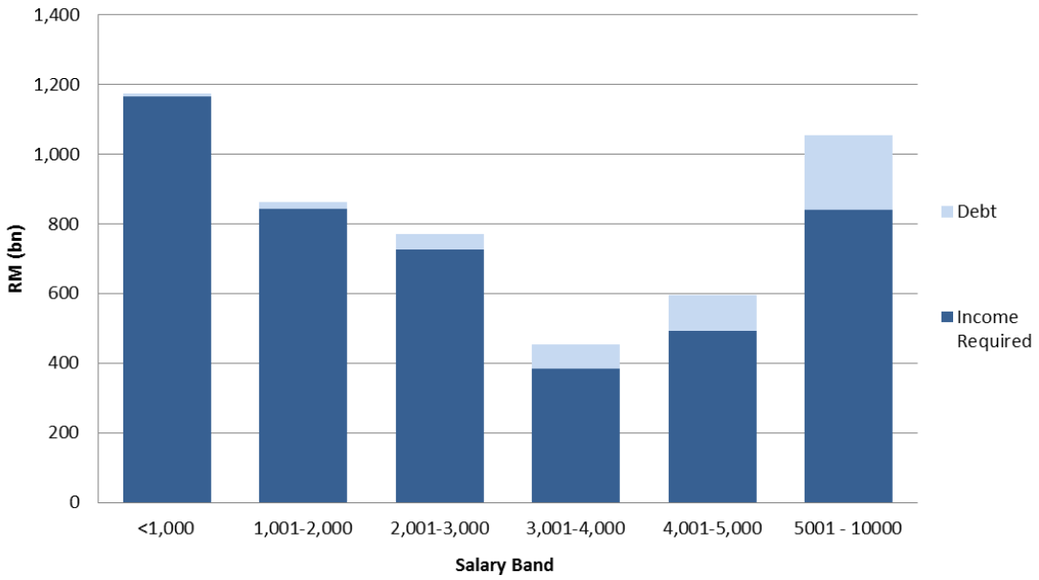
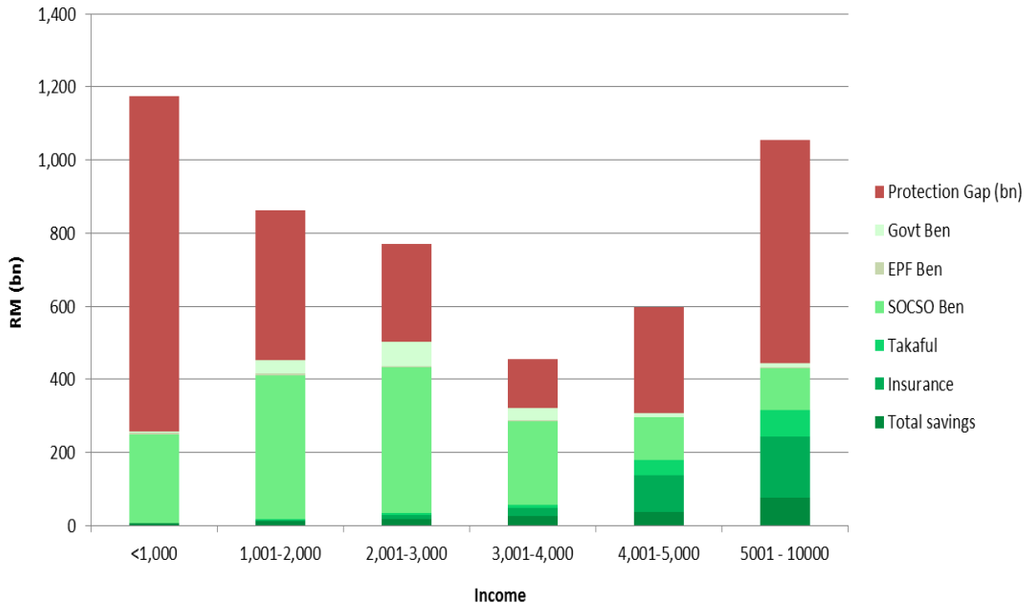


Figure A4.3B: Historical estimated resources available to meet protection needs by income group in 2012



A4.5 The estimated aggregate resources required and resources available to meet the protection needs against mortality and morbidity risks by states are shown below.

Figure A4.4A: Estimated resources required for protection by states in 2012

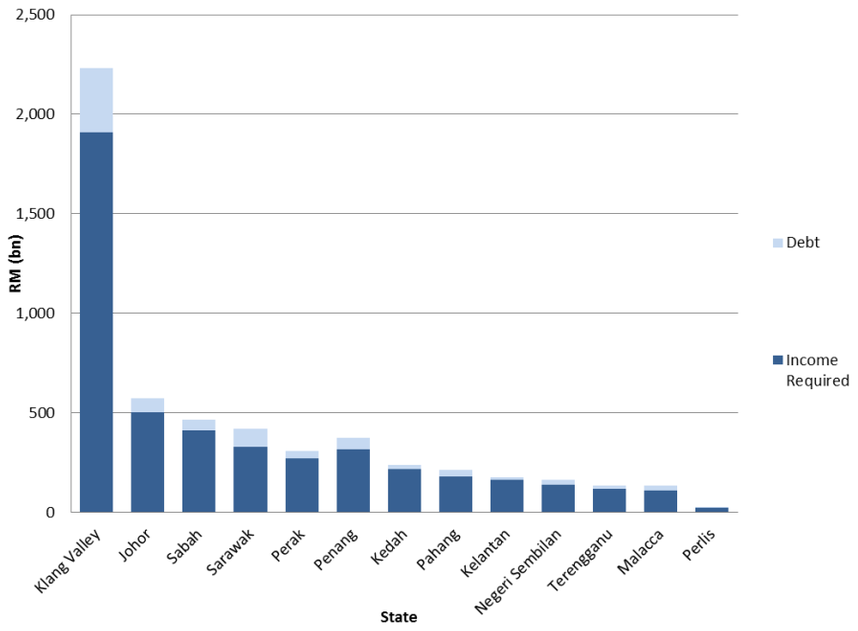
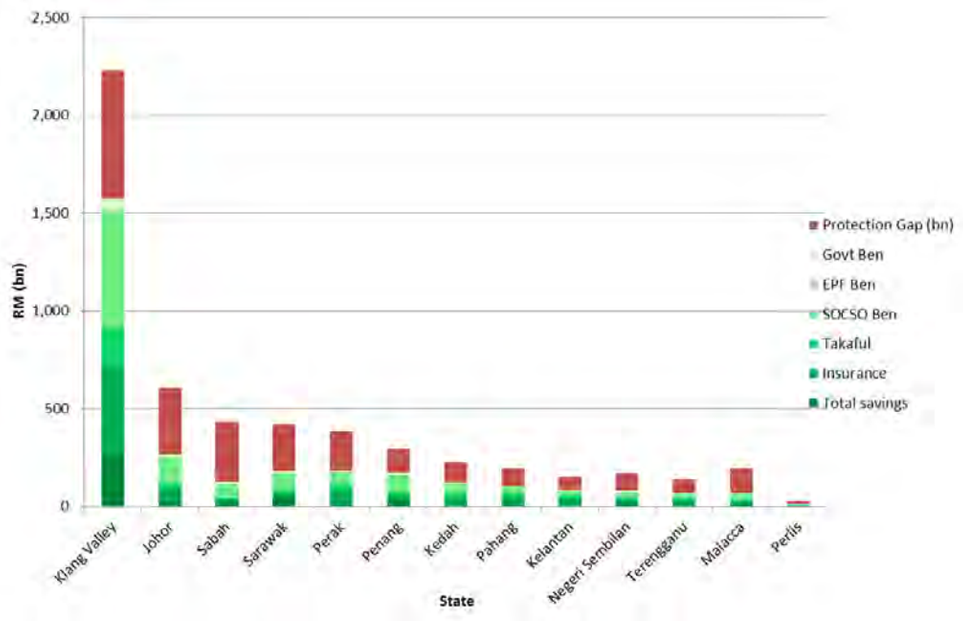


Figure A4.4B: Historical estimated resources available to meet protection needs by states in 2012



A4.6 The estimated aggregate resources required and resources available to meet the protection needs against mortality and morbidity risks for urban and rural areas are shown below.

Figure A4.5A: Estimated resources required for protection by urban and rural areas in 2012

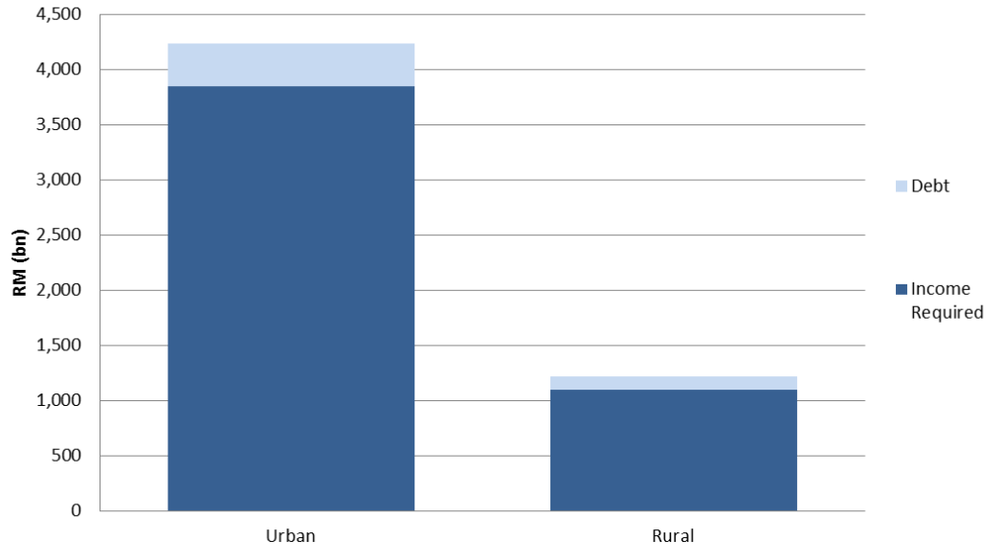
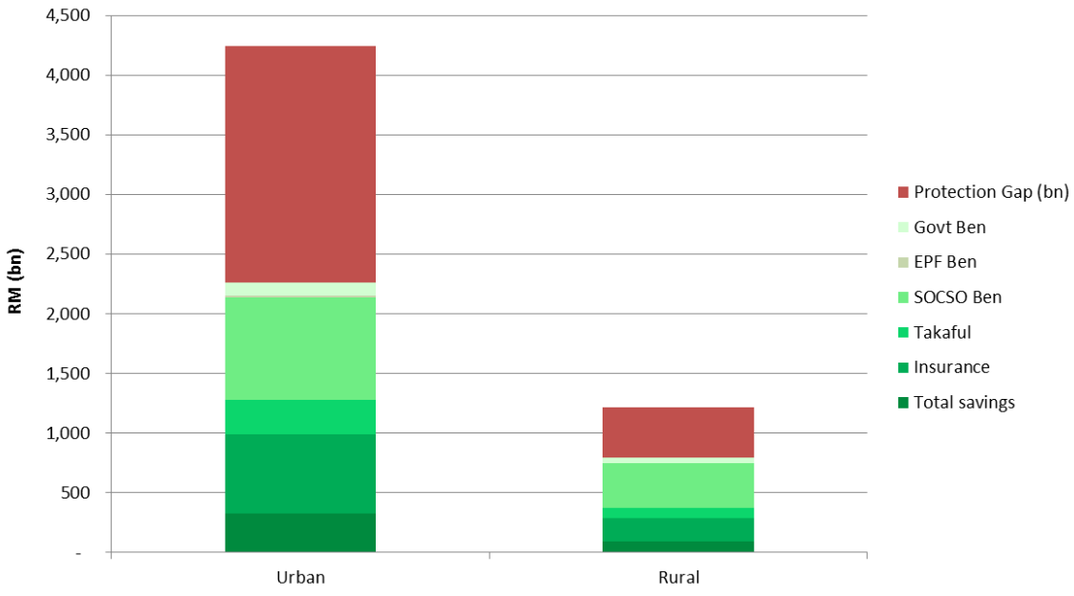


Figure A4.5B: Historical estimated resources available to meet protection needs by urban and rural areas in 2012



A4.7 The estimated aggregate resources required and resources available to meet the protection needs against mortality and morbidity risks by gender are shown below.

Figure A4.6A: Estimated resources required for protection by gender in 2012

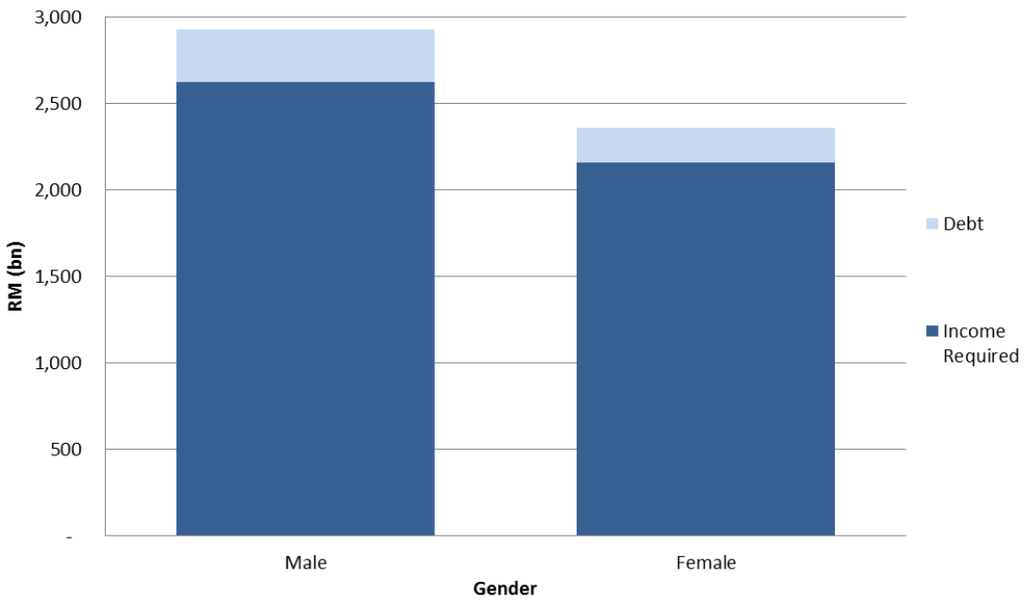
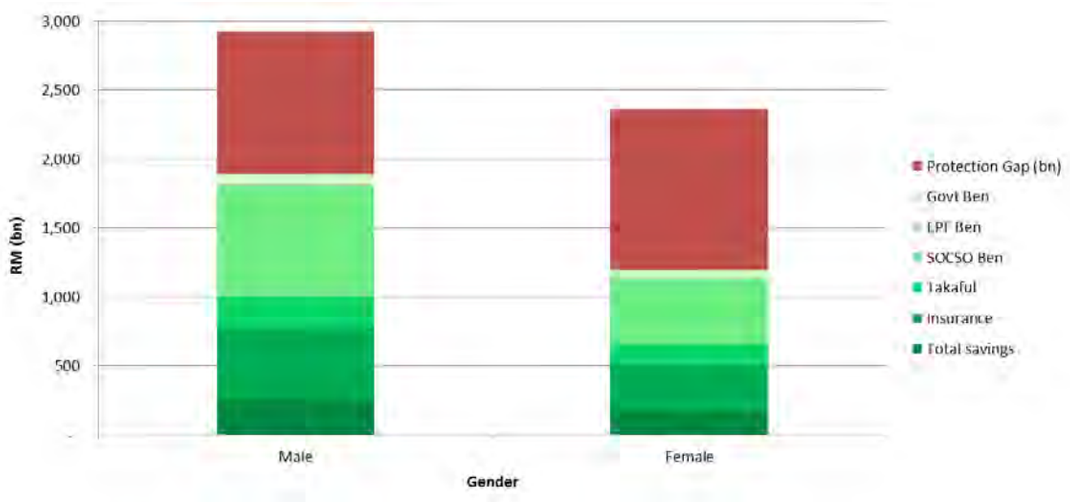


Figure A4.6B: Historical estimated resources available to meet protection needs by gender in 2012



A4.8 The estimated aggregate resources required and resources available to meet the protection needs against mortality and morbidity risks by marital status are shown below.

Figure A4.7A: Estimated resources required for protection by marital status in 2012

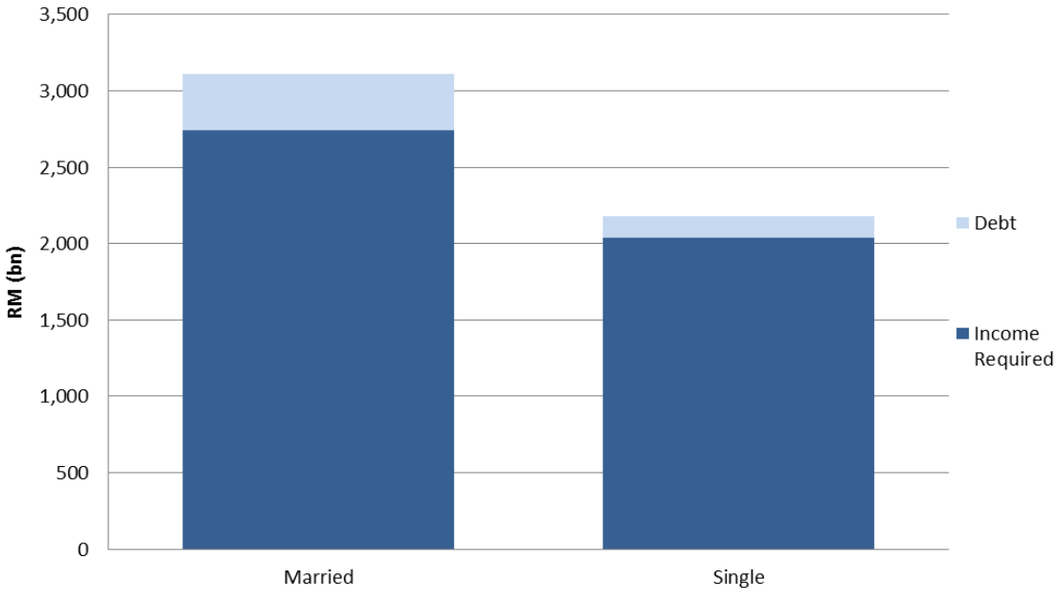
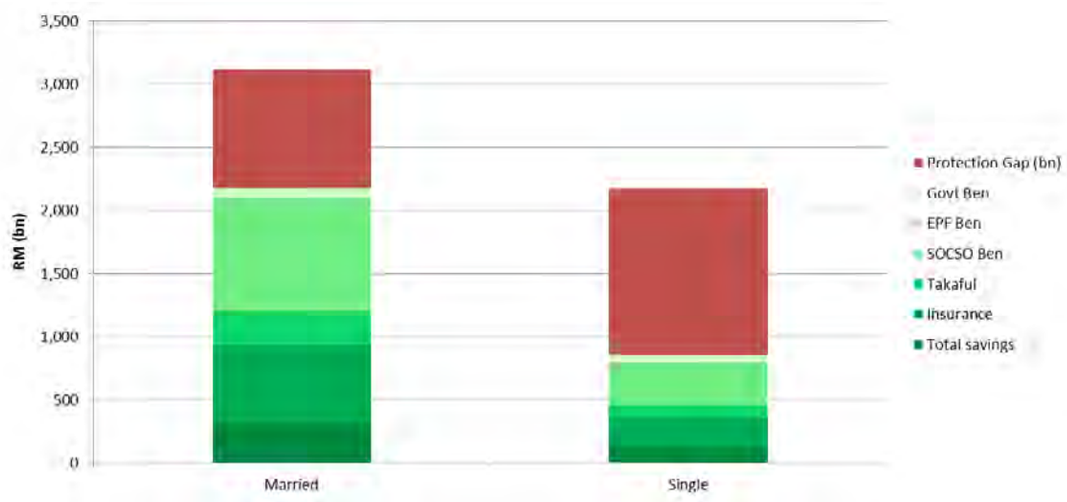


Figure A4.7B: Historical estimated resources available to meet protection needs by marital status in 2012



Appendix A5
RECENT NEW GUIDELINES

A5.1 **This appendix summarises the following recent new guidelines:**

> Financial Advisory Industry Review (FAIR)

> Risk Distribution Review (RDR) in the UK

> New proposed bancassurance guidelines in China

A5.2 **Financial Advisory Industry Review (FAIR)**

The Financial Advisory Industry Review (FAIR) aims to enhance the standards and professionalism of the FA industry and improve efficiency in the distribution of life insurance and investment products in Singapore. FAIR aims to do so by:

> raising the competence of FA representatives;

> raising the quality of FA firms;

> making financial advising a dedicated service;

> lowering distribution costs; and

> promoting a culture of fair dealing.

After gathering feedback from the public, the Monetary Authority of Singapore (MAS) accepted 19 of the panel's 28 recommendations, eight were modified and one was dropped. The recommendations are expected to be implemented in 2015.

Below are some of the accepted recommendations:

> Launch of free website (web aggregator) to compare life insurance and endowment products between insurance providers

> Insurance companies have to make basic life insurance products available directly (direct channels) to consumers instead of only through agents

> Balanced scorecard remuneration framework with non-sales KPIs for financial advisers (FA).

> FA firms will have to set up independent sales audit departments to sample 5 per cent of the transactions of each sales representative every quarter with reports given to MAS.

> Educational requirements for financial advisors to be raised

> Increased capital requirements for financial advisory firms

> Minimum working and managerial experience of Chief Executive Officers of Licensed FA firms (LFAs) to 10 years and five years respectively.

> Require LFAs to employ at least three resident, full-time and experienced professionals

> First year commissions are capped at 55%. The remaining 45% of commissions will be paid out over the next five years or the remaining premium payment years, whichever is shorter.

> Disclosure of Trailer Fees for Collective Investment Schemes and Disclosure of Total Expense Ratios of Participating Funds

When FAIR was launched, there was much apprehension in the industry, particularly about the possible removal of commissions and moving to a fee-based model similar to the UK. However, this did not come to pass and the commission-based model remains. As such, the agency remuneration will remain largely unchanged even with the 55% cap in place as current first year commissions are 49-55% of total commissions.

It is expected that the recommendations would have a larger impact on the financial advisory firms, due to the higher capital requirements and other requirements as mentioned above. This will increase the compliance burden and costs of their business and as such, the smaller and less competitive FA firms may have to rethink their business strategies.

For the man on the street, the web aggregator will be a useful tool to compare the available basic insurance products. Consumers will also gain from the direct insurance distribution model as these channels are expected to have lower distribution costs and commissions. In addition, enhanced disclosure would also help the consumer better understand the insurance products they are buying.

As for insurers, disclosure of the expense ratios may not be favourable to those who have smaller participating funds or which have not achieved economies of scale. Consumers may then look for alternative participating structures with lower expenses, such as unitised with profit products.

A5.3 **Retail Distribution Review (RDR)**

The objective of RDR, which was introduced on 1 January 2013, is to:

> raise professional standards in the industry

> introduce greater clarity between the different types of service available; and

> make the cost of advice very clear

The recommended changes include a ban on insurers' influence on distributor remuneration, whereby commissions are replaced with advisor fees. The advisors have to agree on the fees or charges with customers and the charges must be related to the services provided and not products sold. Ongoing charges are only applicable where ongoing services are provided and customers are able to discontinue advice charges at any time. Trail commissions for products sold pre-RDR were also banned.

Other changes include clearer disclosure of advisor status and remuneration, higher conduct standards for independent financial advisors and minimum qualification standards and continuing professional development for all advisors.

As the recommendations have only been in place for a year, the impact of the RDR is yet to be determined. However, based on research by Cass Business School and BNY Mellon, the following are the views of industry practitioners on the impact of RDR.

> Slightly more than half of the survey respondents suggested that the mass market for financial advice would be 'less attractive' to advisers in the RDR world, while a quarter said that it would make the mass market 'very unattractive'

> One of the expected consequences of RDR will be a reduction in the number of mass market IFAs, which may create a "guidance gap" where consumers may find themselves without independent financial advice.

> Direct sales forces may make a comeback as the disappearance of the commission-based model created a clear distinction between advice on the one hand and product providers on the other. Direct sales are clearly just products and consumers do not need to pay for advice.

> RDR will be an advantage to more process-focussed firms of financial advisers. This is because they are expected to focus on higher value clients that may have become advice orphans or that that may have been traditionally serviced by wealth management companies as these clients are more accustomed to fee-based advice. On the other hand, this would mean that firms of small advisers, the 'cottage industry' component of the financial advice industry, will shrink.

> Three quarters of respondents to the survey stated that they would be using a mix of fee types, utilising an annual charge as a percentage of assets, a fixed fee and/or a fee based upon an hourly rate. Almost 80% of survey respondents believe that a majority of their clients (more than 75%) would be willing to pay a fee-based charge. Also, a similar percentage of respondents remain confident that the fee-based charging will become more accepted by clients over time.

> RDR is also likely to have the greatest impact on smaller IFAs, who would not have had the necessary infrastructure to support the requirements. They are also more likely to be affected by consequences of the elimination of trail commissions. As such, it is expected that there would be a larger number of advisory businesses ready to sell at low prices i.e. below what the businesses are actually worth.

> On a related note, it is likely that it will take time for advisory businesses to build up a track record of transparent charging. Interviewees have suggested that mergers and acquisitions activity may become subdued after an initial wave of distressed sales. A second wave of activity will come in late 2014 as the new regulations become embedded and advisers would have a better understanding of what it will take to run a successful advisory business in the post-RDR environment.

A5.4 New bancassurance rule in China

In late 2013, the China Banking Regulatory Commission (CRBC) issued a draft proposal for the sale of insurance policies by banks and postal agencies, placing the focus on protection products. The key observations from the new draft guidelines are summarised below:

> At least 20 percent of the total premiums received by banks and postal agencies must be from protection-type insurance products. This will be a challenge for most banca channels as currently protection-type premiums represent less than 10 percent of total bancassurance sales. The main products sold through this channel currently are high-returns wealth management products.

> Banca and postal agencies are advised to consider the 13-month persistency ratio of the insurer's bancassurance products, its operating structure and the functions of its various products.

> insurance company will now be allowed to have representatives to be stationed at banks and postal agencies to help with customer enquiries (previously this was prohibited). However clear identification is required to show consumers that these representatives are not the employees of the bank or the post office.

> Banks and postal agencies are required to carry out Know-Your-Customer assessments during the sales process and to avoid excessive financial commissions, sellers are required to match customers' incomes to the value of insurance products to be sold.

The new regulations are expected to apply in early 2014.