

**MARC
ANALYTICAL
INSIGHTS****THE GENERAL INSURANCE
INDUSTRY OF MALAYSIA:
PERFORMANCE AND PROSPECTS****INDUSTRY PERFORMANCE****Premium growth moderates amidst economic slowdown**

Malaysia's general insurance industry, unlike its peers in the developed world, was mostly shielded from the direct effects of the global financial crisis. However, its performance during 2009 was affected by the slowdown in the real economy and volatilities in the domestic financial market. A notable effect was the moderation of gross direct premiums growth to 5.7% in 2009 compared to a growth of 8.5% for 2008; the five-year compounded annual growth rate (CAGR) between 2004 and 2009 was 6.2%.

The motor business continued to be the key sector for the general insurance industry, contributing 45.6% of gross direct premiums, followed by fire (17.6%) and marine, aviation and transit (MAT) (10.1%). A slowdown in domestic consumer and business spending, especially for motor vehicles, and a decline in international trade transactions amidst the global economic slowdown were the main factors dragging down overall premium growth.

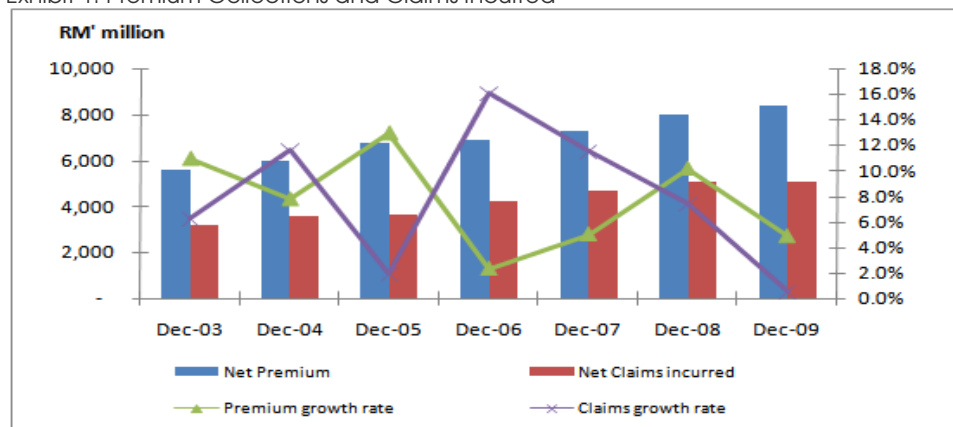
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Exhibit 1: Premium Collections and Claims Incurred



Source: General Insurance Association of Malaysia (PIAM), MARC

Nevertheless, underwriting results improved thanks to lower claims and improved efficiency

Despite the lower growth in premiums, the underwriting results of the industry improved in 2009 to record an underwriting surplus of 7.5% of earned premiums (2008: 2.2%). This was enabled by a lower claim ratio and increased insurers' efficiency, as reflected by a lower management expense ratio. The main sectors, i.e. motor, fire and MAT, showed better results, with loss ratios improving to 80.0%, 26.0% and 31.2% from 82.7%, 30.7% and 50.0% respectively a year ago.

Exhibit 2: Key Performance Indicators (%)

Breakdown	Dec-09	Dec-08	Dec-07	Dec-06	Dec-05
Net commission ratio	9.7	9.8	9.8	9.4	9.1
Claim ratio	61.5	65.5	66.6	60.9	55.9
Management expense ratio	21.3	22.5	23.8	23.4	22.9
Combined ratio	92.5	97.8	100.2	93.7	87.9
Underwriting surplus	7.5	2.2	(0.2)	6.3	12.1

Source: PIAM

Higher local retention as a result of improved underwriting capacity

The underwriting capacity of Malaysian (re)insurers has improved over time, with the retention ratio in Malaysia steadily improving to 92.1% in 2008 from 87.6% in 2004. The result is in line with Bank Negara Malaysia's (BNM) concerted efforts to maximise local retention and strengthen local (re)insurers, including the introduction of guidelines restricting outward foreign reinsurance premium deduction in the computation of unearned premium reserves (UPR) (which results in higher UPR and lower profits), compulsory cession of risk to Malaysian Reinsurance Berhad, and lower credit risk charge for amounts due from qualifying reinsurers under the Risk Based Capital (RBC) framework.

That said, the retention ratio for direct insurers alone remained in the range of 71% - 73% for the past five years, reflecting their prudent underwriting policies despite having stronger balance sheets. The motor, medical and personal accident insurance segments have high retention ratios, driven by their voluminous nature (>80%), while sums assured for other classes, especially those with large individual risks, were partially ceded to other (re)insurers.

Tariff-regulated motor insurance business remains a drag

While most classes have shown improvement in their claim experience, the long-tail motor insurance segment remains a key concern for industry players, with the combined ratio exceeding 100% for six out of the previous seven years as a result of an increase in motor theft cases and road accidents, as well as escalating court awards for motor accident fatalities and injuries.

In fact, the current tariff-rated system for the motor segment has been unchanged since 1978. Although a revision has been discussed among insurers, General Insurance Association of Malaysia (PIAM) and BNM, it has been put on hold, partly due to the surge in oil prices during the first half of 2008, followed by the economic downturn since the second half of 2008. MARC expects BNM and the industry to pursue a revision of motor premiums going forward as it remains critical for strengthening the general insurance industry and improving its competitiveness.

Currently, BNM is in the midst of consulting various parties to ensure that its proposed plan is fair and does not burden any specific group or individual. Among the suggested proposals under discussion at this stage is the setting up of a new company to underwrite third party bodily injury insurance and capping the existing unlimited third party bodily injury liability under the Road Transport Act to a specified sum. However, as it has been in the past, the political sensitivities of such a move remain an important obstacle that needs to be overcome.

Macro interest rates to continue to impact investment income

Meanwhile, investment income, which is another important source of income for insurers, was also affected by the economic slowdown and the resulting decline in financial asset prices. Although historically the exposure of Malaysian insurers to equities and foreign assets has been low, the downward revision of BNM's policy rate to 2.0% in January 2009 did have an adverse impact on their investment income given their large holdings of liquid and short-term deposits to meet their short-duration liabilities. Although the overnight policy rate has increased to 2.75% in July 2010, MARC expects investment income to remain constrained.

Exhibit 3: Asset Composition of General Insurance Funds (%)

Breakdown	Dec-09	Dec-08	Dec-07	Dec-06	Dec-05
Investment in corporate securities	30	30	32	32	35
Investment in government securities	19	18	18	17	15
Cash and deposits	31	35	31	32	31
Other assets	20	17	19	19	19
Total	100	100	100	100	100

Source: BNM

DEVELOPMENTS IN THE GENERAL INSURANCE SECTOR

Introduction of risk-based capital requirements will strengthen the industry over the long term, but will pose short-term challenges

In terms of regulatory development, the most significant change was the implementation of the RBC framework in 2009 in line with evolving global best practices in insurance regulation. The implementation of the RBC framework is expected to strengthen the standards of prudential regulation in the insurance industry and to align individual insurers' solvency and capital position according to their respective individual risk profiles. This will also enable the deployment of more transparent risk-adjusted capital and valuation requirements within the industry and through it promote the rationalisation of underwriting businesses as well as augment risk management standards.

Under the RBC framework, all insurers and reinsurers are required to maintain a capital adequacy ratio (CAR) above the pre-determined internal CAR. The internal CAR is decided by both the regulated insurance company and the BNM, and must not be less than the regulatory CAR of 130%, which is the absolute minimum imposed by the regulator. The implementation of the RBC framework is likely to increase insurers' capital requirements, thus to an extent exerting pressure on their return on equity. From a credit standpoint, the introduction of the RBC framework gives creditors a greater equity buffer and provides them with the added comfort of a more responsive regulatory framework. As for insurer financial strength ratings, MARC would consider the insurer's compliance with minimum and internal CAR ratios as an important rating consideration.

Liberalisation of the sector to increase competitive pressure

In April 2009, the government announced a liberalisation plan for Malaysia's insurance sector, including the increase of the foreign equity participation threshold in insurance companies to 70% and allowing foreign incorporated insurance companies and takaful operators to establish branches nationwide without restrictions. Currently, including composite insurers, there are 32 licensed general insurers, eight takaful operators and six general reinsurers in Malaysia. The liberalisation of the sector is expected to intensify competition in an already fragmented industry, where the top seven general insurers accounted for 48% of conventional direct premiums collected during 2009. In this context, MARC views that further consolidation in the insurance industry is unavoidable, given the visible benefits of economies of scale in underwriting, capital management, investment portfolio diversification and operations. As such, MARC expects the smaller and less profitable players to be acquisition targets, especially for interested foreign insurers given the relaxation of foreign equity participation.

In fact, the industry saw few consolidations in recent years, including the acquisitions of PanGlobal Insurance Berhad by Tokio Marine Insurans Malaysia Berhad in 2009 and the acquisition of Malaysian Assurance Alliance Berhad's general insurance business by AMG Insurance Berhad in 2010. The most recent one is the strategic merger between the general insurance arm of Hong Leong Assurance Berhad with MSIG Insurance (Malaysia) Berhad (MSIG) which was announced in June 2010. After this merger, MSIG is expected to become the second largest general insurer in Malaysia.

INDUSTRY PROSPECTS

Premium growth hinges on economic recovery

MARC expects insurers' revenue to experience higher growth going into the second half of 2010 and 2011 in line with the recovery of the Malaysian economy and the improvements in trade and business sentiments. Lower motor vehicles sales, which was approximately 2% lower in 2009 than in 2008, affected premiums underwritten during the year. However, the Malaysian Automotive Association has estimated a 2.4% increase in total industry volume for 2010, which is likely to provide some growth impetus to the lagging motor insurance segment, albeit softened to an extent by the rise in lending rates following the recent increases in the overnight policy rate. Furthermore, the growth prospects of the segments is likely to be moderated by the larger market share of lower-value Perodua and Proton cars, which currently command more than 55% of the automotive market and in MARC's view is likely to increase due to consumer cost preferences and the possible reduction of fuel subsidies. Premium growth aside, the actual underwriting results of the motor segment is likely to remain weak due to higher claim experience and the regulated low tariff structure. Any positive revision to the motor tariff-rated premium structure or revamp to the motor insurance regime is expected to contribute positively to the insurers' bottom lines.

The medical and personal accident insurance segment, which has a relatively lower correlation with the performance of the economy, is expected to register notable growth, despite stiff competition from the life insurance companies. The expansion is mainly spurred by increasing consumer awareness and need for protection arising from concerns over escalating medical and healthcare expenses.

While investment income is expected to remain constrained under the current interest rate environment, MARC believes that premium growth will pick up into the second half of 2010 considering the recent signs of economic recovery. This will set the stage for improved underwriting performance for the general insurance sector as a whole.

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