December 17, 2014

Malaysia: Concept paper on management of participating life policy business

With the aim of promoting effective governance and the fair management of participating life policy business, on 7 November 2014 Bank Negara Malaysia (BNM) issued a concept paper on the 'Management of Participating Life Policy Business' for public consultation. This paper has been drafted to provide greater clarity on BNM's expectations regarding the management of participating business, setting out roles and responsibilities of various key stakeholders (the board, senior management and appointed actuary) as well as the key requirements in important areas such as bonus revisions, transparency and disclosure. The proposed new requirements include the implementation and establishment of a 'management of participating life business policy' (MPB policy). This e-Alert provides a summary of the key points proposed in the concept paper.

1. Governance and oversight

Board: The board is to be responsible for reviewing and approving the MPB policy, approving annual bonus rates and providing oversight on the implementation of the MPB policy. The board will also be required to obtain an annual independent review to validate that actual practices are in line with the MPB policy and that policyholders' interests are being properly protected.

Senior management: Senior management will be responsible for implementing and developing the MPB policy, ensuring that the MPB policy is clearly documented and advising the board on any developments in respect of the management of participating business, including changes to the MPB policy.

Appointed Actuary: The Appointed Actuary will be responsible for conducting an annual bonus study, making bonus recommendations to the board, taking into account policy owners' reasonable expectations (PRE) and assessing the application and use of any surplus assets beyond those explicitly backing policyholder liabilities (the estate).

2. MPB policy requirements

The MPB policy will set out the principles and practices adopted by the insurer for determining participating policy benefits, the management of PRE, the bonus supportability study, the allocation of expenses, investment and risk management practices, the treatment of the estate and the impact of new business on the participating fund.

Benefit payout: The principles and practices underlying policy benefits need to be documented in the MPB policy, covering the categorisation of policy cohorts, the methodology and assumptions adopted in calculating asset shares, the approach to smoothing, the approach used to determine bonus levels, and the approach and basis used for making transfers to shareholders. Consistent with current regulations, policy benefits will need to be referenced to asset shares for policies sold after 1 July 2005 and will have to be at least 100% of asset shares for death and maturity benefits, at least 90% of asset shares for surrenders in the early policy years and at least 100% of asset shares upon surrender from the 15th policy year onwards. Whilst policies sold prior to 1 July 2005 are exempted from these requirements, BNM has imposed a new regulatory requirement requiring the distribution of full asset shares at maturity cohort level for these policies.

PRE: The MPB policy will need to take into consideration PRE related issues, in particular avoiding any situations that may give rise to undue PRE through the active management of bonus rates and effective communication with policyholders.

Bonus supportability study: The bonus supportability study will need to be carried out by the Appointed Actuary and is required to include a comparison between asset shares and gross premium valuation (GPV) reserves, by cohort. The study must be carried out separately for various types of bonuses and include comparisons to GPV reserves with and without terminal bonuses. It must also include sensitivity and stress testing to assess potential future events that could lead to bonus adjustments. In making the final bonus recommendation the Appointed Actuary will need to take into account PRE. Should PRE effectively dictate a minimum level of bonus that the company could declare in reality, such a minimum should be treated as guaranteed and reserved accordingly. Consistent with current regulatory requirements, the report underlying this study will need to be appended to the Financial Condition Report (FCR) with sufficient information provided to enable validation by an independent actuary.

Allocation of expenses: The MPB policy will need to include an overall policy on the allocation of expenses to the participating fund.

Investment and risk management: Investment and risk management practices must be carried out in accordance with the investment and risk management policy as set out in the risk-based capital (RBC) framework and the Policy Document on Risk Governance. The investment strategy will also need to be in line with any communication to policyholders.

Treatment of estate: The MPB policy will include principles and practices around estate management. The estate must not be used in a manner that would create unfair competitive advantage or lead to adverse effects on the interest of existing participating fund policyholders. The Appointed Actuary will include his or her opinion on the use of the estate in the FCR report.

Treatment of new business: The MPB policy will contain principles and practices relating to new business, including specific trigger points and thresholds that will result in the participating fund being closed to new business and conditions for pricing new contracts in order to avoid any material adverse effect on the interest of existing policyholders.

3. Specific requirements on bonus revisions

Any revisions to bonuses will need to be formally proposed by senior management, approved by the board and lodged with BNM one month before the planned implementation date. Any communications to stakeholders in respect of the bonus revisions must be made in line with the Product Transparency and Disclosure guidelines as set out in the concept paper.

4. Transparency and disclosure requirements

A sales illustration will need to be presented to prospective policyholders. This illustration, together with all marketing materials, must comply with the requirements as set out in the Code of Good Practice for life insurance business and the Policy Document on Product Transparency and Disclosure. The insurer must also provide participating policyholders with an annual bonus statement.

Observations/Implications

With this concept paper, BNM is looking to further strengthen the governance around the management of participating business in Malaysia. It aims to consolidate various existing regulatory directives and to clarify the roles of different stakeholders, as well as introduce some new requirements. The paper covers the most important aspects of the management of participating business, from determining bonus scales and management of the estate to governing the transparency and disclosure requirements. The requirement for companies to document their policies for various areas of participation fund management is similar to the requirements in the United Kingdom to maintain a Principles and Practices of Financial Management document (PPFM). A notable difference in the UK, however, is that PPFMs are made publically available.

While many of the areas should already be covered within the day-to-day management of participating business, the documentation and implementation of the MPB policy could prove challenging for the industry given tight resource constraints and may be seen as somewhat onerous. However, it will play an important role in shaping consistent standards across the industry for the way that companies determine bonuses and manage the overall financial condition of their participating funds. The independent review requirement will also provide an extra layer of governance, highlighting the importance that BNM is placing on this process.

Given the history of participating business regulation in Malaysia, with various regulatory initiatives having been introduced historically, we think it is sensible to consolidate all prior requirements into one overall framework. Malaysia appears to be leading the way in terms of strengthening governance requirements for par business, and it will be interesting to see if regulators in other markets follow suit. How companies react to the new requirements and whether some find the requirements to be too onerous will also be interesting to follow. Situations where companies stop writing new participating business may become more common, and maybe in time we will see the transfer of closed blocks of business to ‘industry consolidators’ who are more willing to take on the management of these more complex blocks of business.

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