

Client Alert

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Exposure Draft Guidelines on Operating Cost Controls for Life Insurance and Family Takaful Business

Bank Negara Malaysia (i.e. the Central Bank of Malaysia) ("**BNM**") had, on 27 October 2017, issued an exposure draft of the Guidelines on Operating Cost Controls for Life Insurance and Family Takaful Business ("**Exposure Draft**") to obtain public and industry feedback on the proposed changes to the existing cost control regimes.

The Exposure Draft is therefore the next step in BNM's gradual deregulation of the operating cost control limits, aimed at providing greater flexibility for life insurers and takaful operators to manage operating expenses (to be in line with their business strategies) and encouraging greater innovation and competition.

The revised regulatory standards under the Exposure Draft are part of BNM's initiative under the Life Insurance and Family Takaful Framework issued on 23 November 2015 ("**Life Framework**") to support the long-term development of the life insurance and family takaful industry. In particular, BNM is striving to promote innovation and a more competitive market supported by higher levels of professionalism and transparency.

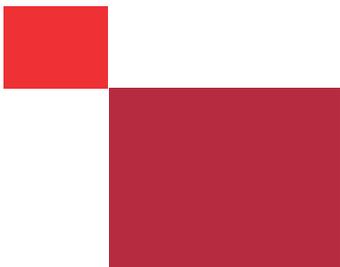
Under the current Guidelines to Control Operating Costs of Life Insurance Business and the Guidelines to Control Operating Costs of Family Takaful Business ("**Existing Guidelines**"), there are prescribed limits on agency commissions, agency-related expenses ("**ARE**"), management expenses and agency structure. The limits on management expenses had been disapplied for both life insurers and family takaful operators with effect from 1 December 2015.

While still in a draft format, some of the salient changes being proposed under the Exposure Draft are set out below.

a) **Remuneration Policy**

BNM intends to impose an obligation on the board and senior management of a life insurer / takaful operator to promote the following outcomes when setting the remuneration policy and criteria for the maintenance of contracts or promotion of an intermediary (i.e. agent, financial adviser, broker and/or bancassurance partner):

1. encourage intermediaries to consider a consumer's financial needs and circumstances, and provide proper advice and recommendations;
2. raise and maintain effective and responsive customer support services provided by intermediaries to a policyholder / participant throughout the policy / certificate term;





3. drive the continuous professional development (“CPD”) of intermediaries; and
4. assure the ethical and professional conduct of intermediaries.

b) Implementation of the BSC Framework

BNM had previously, under the Life Framework, introduced the concept of the balanced scorecard (“BSC”) to encourage intermediaries to provide consumers with quality advice and suitable recommendations based on a consumer’s financial needs and circumstances. The BSC would include non-sales key performance indicators (“KPIs”) as a basis for remunerating intermediaries. Life insurers and takaful operators were required to introduce the BSC on a pilot basis (i.e., with no impact on agents’ commission) in the second half of 2016 to allow agents to adjust to the new framework and to monitor the impact of the BSC on the industry.

The Exposure Draft seeks to formalise the BSC regime by introducing the parameters for the new framework (“BSC Framework”), which links remuneration of intermediaries to their quality of service.

The BSC Framework is intended to apply only to the sale / marketing of products which are subject to the Guidelines on Proper Advice Practices for Life Insurance / Family Takaful Business. All relevant life insurers and takaful operators will need to incorporate the BSC Framework in their remuneration policy for intermediaries by:

1. 1 January 2018 for agents (except for new agents within the first 3 years of recruitment), financial advisers and brokers; and
2. 1 January 2019 for bancassurance and bancatakaful partners (separate guidelines will be issued in this regard in 2018).

Under the Exposure Draft, the following KPIs must be incorporated into each life insurer’s / takaful operator’s BSC Framework:

1. completion rate of Customer Fact Find form;
2. persistency rate;
3. number of substantiated complaints; and
4. CPD hours.

The Exposure Draft prescribes certain weight for each of the KPIs. The performance of the agents will be measured against the KPIs based on the parameters set out in the Exposure Draft. A life insurer / takaful operator may, after 1 January 2020, set additional KPIs and adopt higher standards for measuring the performance of agents.

The commissions payable to intermediaries which are measured against the KPIs under the BSC Framework (i.e. “BSC Commissions”), shall be set at 25% of the total commissions payable. Such BSC Commissions



may exceed the limits on commissions prescribed by BNM (if any) provided that the excess commissions are funded from the shareholders' fund of the life insurer / takaful operator.

Note that under the Exposure Draft, where the life insurer / takaful operator remunerates its agents through a combination of fixed salary and variable commission, the aggregate amount paid must not exceed the commission limits prescribed by BNM (if any). The KPIs under the BSC Framework will therefore also be adopted in measuring the aggregate amount of salary and commissions payable to such salaried agents.

c) Removal of commission limits (pure protection products and investment linked products) and ARE (investment linked products)

Under the Exposure Draft, with effect from 1 January 2018, the commission limits prescribed under the Existing Guidelines will be dispensed with in respect of pure protection term products (i.e., TERM products structured to cover only the risk of death with or without total permanent disablement, and does not have maturity benefits) sold / marketed through intermediaries if the following conditions are fulfilled:

1. the products provide the same benefits and coverage as those available through the life insurer's / takaful operator's direct distribution channels; and
2. the life insurer / takaful operator meets all the requirements specified in the Policy Document on Direct Distribution Channels for Pure Protection Products.

The commission limits for pure protection critical illness products and pure protection medical and health products sold / marketed through intermediaries will also be removed with effect from 1 July 2018, subject to the same conditions as above.

Further, with effect from 1 January 2019, the commission and ARE limits for certain investment-linked products will also be removed.

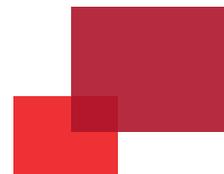
d) Adjustment of commission limits - bancassurance partners

Currently, BNM's Guidelines on Bancassurance and Guidelines on Bancatakaful prescribe certain limits on the commissions payable to bancassurance / bancatakaful partners.

Under the Exposure Draft, BNM will be introducing new limits with effect from 1 January 2019. However, at this juncture, it is unclear what the new limits will be, and we are therefore unable to determine the impact of such changes on existing bancassurance / bancatakaful arrangements.

e) Agency-related expenses

Generally, a life insurer / takaful operator may provide additional benefits in cash or kind to agents. The expenses incurred for the provision of such benefits is deemed to be ARE.



Under the Exposure Draft, the provision of such benefits to agents and the corresponding qualifying criteria must be clearly provided for and documented in the life insurer's / takaful operator's remuneration policy, with due regard to the aims and objectives of the Exposure Draft.

The Existing Guidelines currently prescribe a cap on ARE at 3% of annual premiums / contributions. The Exposure Draft adopts the same limit of 3%, save for products for which the commission limits will be removed (as discussed above).

f) Board and Senior Management oversight

BNM imposes an obligation on the board and senior management of a life insurer / takaful operator to ensure that the conduct of the life insurer / takaful operator is consistent with the objectives and requirements set out in the Exposure Draft. This includes:

1. developing and approving the remuneration policies which include parameters for the implementation of the BSC Framework;
2. ensuring adequate training and support is provided to intermediaries to understand the key outcomes and implementation of the BSC Framework;
3. ensuring that the performance of intermediaries is reviewed against the KPIs of the BSC Framework at least once a year;
4. ensuring that the maintenance of contracts or promotion of intermediaries be assessed against the performance under the BSC Framework; and
5. monitoring the effective implementation of the remuneration policies and the BSC Framework and taking timely corrective measures as required to promote the objectives of the BSC Framework.

g) Additional disclosure requirements

The Exposure Draft requires a life insurer / takaful operator to submit to BNM:

1. a report on the performance of intermediaries against the KPIs of the BSC Framework and the information on the amount of BSC Commissions payable to the intermediaries for the year, by the end of the first quarter of the following year (beginning from 2018); and
2. information relating to its compliance with the operating cost control limits for the year, in the relevant statutory returns specified for life and family takaful business, by 21 January of the following year.



Conclusion

The proposed changes under the Exposure Draft are in line with the objectives set out in the Life Framework, and signify BNM's overarching goal of deregulating the operating cost control limits with a view to granting flexibility to life insurers / takaful operators to manage and tailor their operating expenses.

However, the new regime has also introduced the BSC Framework and will require more significant oversight by the board and senior management of the life insurer / takaful operator. The board and senior management will therefore play a pivotal role going forward in creating an efficient and cost-competitive environment to grow the ecosystem.

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