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Market Segment Outlook: Malaysia Non-Life Insurance

> Our outlook is Stable, underpinned by underwriting discipline and the market's recovery from the economic fallout from COVID-19

AM Best is maintaining its Stable outlook on Malaysia's non-life insurance segment. Key supporting factors include the following:

- Premium growth expected to rebound, in line with GDP growth prospects
- Underwriting discipline and robust pricing expected to be maintained despite ongoing phased de-tarrification of motor and fire business
- Consolidation and regulatory push to strengthen the market

The following factors partially offset the positives:

- Rising inflation and low interest rate environment continue to pressure investment yields despite a rise in the overnight policy rate

Malaysia's non-life insurance segment has been challenged with moderate insurance growth and an uptick in pricing competition in key lines of business over the past few years. With the economy recovering from the fallout from the pandemic, non-life market growth has also rebounded. In addition, non-life companies have maintained disciplined underwriting and have transitioned well during the phased liberalisation of core business lines. However, AM Best expects non-life insurers to continue facing headwinds from a challenging investment landscape, which has resulted in a reduction in investment incomes and subjected capital and surplus to volatility from fair value losses.

Premium Growth Rebound

Over the past several years, the Malaysia non-life insurance market has exhibited a generally modest expansion, with a five-year average compound annual growth rate (CAGR) of 1.8% in terms of gross premium written (GPW) (2017-2021). Although the general insurance segment has largely remained stable, the general takaful segment has been growing rapidly at a CAGR of around 10%, increasing its contribution from 13% in 2017 to 18% of GPW in 2021. In 2021, the non-life insurance GPW rose by 4.0% to MYR21.97 billion (USD4.9 billion), 44% of which was driven by the general takaful segment. The increase was also attributed to a recovery in most lines of business, especially fire, engineering and the growing motor takaful segment.

Prospectively, key lines of business, namely motor (which accounted for 49% of total 2021 GPW) and fire insurance (20%) are expected to drive the growth of the non-life insurance segment. Following the end of movement restrictions and lock-downs, the motor insurance business is likely to expand over the near term, supported by growing new vehicle sales.

With a hardening of reinsurance rates for fire in recent periods, primary insurers have been moderately increasing the pricing for fire since late 2020. Following the December 2021 flood event in Malaysia, price increases for the fire line peaked in the fourth quarter of 2021.

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Over the near to medium term, AM Best expects the segment's growth to be supported by the country's economic recovery and increased insurance penetration. (The non-life insurance penetration rate, at approximately 1.3%, is low compared to international peers.) According to Bank Negara Malaysia (BNM), Malaysia's real GDP grew by 3.1% in 2021, rebounding from a significant contraction of -5.6% in 2020. The International Monetary Fund (IMF) expects the economy to continue to recover in 2022, with real GDP growth forecast at 5.6%, underpinned by expanding exports and improvement in domestic demand as prolonged COVID-19 related social and business restrictions were lifted in 2022.

BNM actively champions the digital transformation of the financial sector, where licensing new digital insurance and takaful operators (DITO) in 2023 is one of the key initiatives in its Financial Sector Blueprint for 2022-2026. Prospective DITOs will be granted lower minimum paid-up capital requirements and certain regulatory flexibilities. The increased adoption of digitalisation has helped to reshape insurance business models in Malaysia, improving the ease of policy subscriptions, which will help to raise insurance penetration.

Disciplined Underwriting Amid Phased De-Tariffication

BNM first implemented the gradual and phased liberalisation of Malaysia's largest non-life product lines, motor and fire insurance, in July 2016. Prior to this, these lines of business were subject to fixed regulatory tariffs. To date, there have been two phases of de-tariffication rolled out that have led to a partial liberalisation of the motor and fire business. Insurers underwriting certain motor and fire products have greater flexibility over their pricing, subject to an upper and lower threshold around the prescribed tariff rates. In the case of motor, insurers are able to set their pricing within a +/- 10% range of the tariff rates, while the range for fire is +/- 30%. A third phase of de-tariffication is also planned, and is expected to further enhance the market's liberalisation. However, this has been postponed owing to the pandemic.

Since the implementation of the phased de-tariffication, AM Best notes that Malaysia's non-life segment has seen an uptick in pricing competition, particularly for motor business. For fire insurance, insurers have shown discipline in transitioning from a tariffed market to a liberalised pricing market, and have maintained robust underwriting margins.

After several years of underwriting losses, motor business in Malaysia reached a position of profitability in 2020 and 2021. Reduced claims frequency driven by pandemic-related movement restrictions contributed to notable improvement in the motor loss ratio. However, technical performance in the fire line deteriorated in 2021 due to relatively higher claims arising from the year-end floods, which affected Kuala Lumpur and Selangor. Overall, the non-life market remained technically profitable in 2021.

Prospectively, as economic activity resumes with the easing of lock-down measures in 2022, a rise in claims frequency is likely to drive a contraction of underwriting profit. However, AM Best expects that non-life insurers in Malaysia will maintain underwriting and pricing discipline.

Market Consolidation

There are currently 22 conventional insurance companies and four takaful providers operating in Malaysia's non-life market. The top five insurers account for over 45% of the segment based on 2021 gross direct premiums, while the top ten companies make up 74% of the non-life market.

AM Best notes that there is currently a trend of consolidation, which appears to be driven by larger international players seizing market opportunities. Given the country's low insurance penetration rate as compared to its more mature peers in Asia, international insurers seeking geographical diversification see potential in expanding to Malaysia. This is evident from two acquisition announcements made in 2021. The first transaction involves Affin Bank's sale of its general and life insurance to Generali group, which would place Generali Malaysia among the top three non-life insurers in the market. Similarly, Liberty Insurance's acquisition of AmGeneral Insurance would not only create one of the largest general insurers, but also one of the top motor insurers in Malaysia.

AM Best is of the view that the market consolidation trend is likely to continue as these merged entities will benefit from economies of scale, and be able to achieve greater synergy through digitalisation efforts that can lead to long-term cost efficiencies. Consolidation in the market is also likely to reduce pricing competition with large international groups, and introduce global best practices to local operations.

International groups have not been deterred by BNM's foreign ownership regulations introduced in 2018, which require foreign insurers to either reduce their stakes to a maximum of 70% in their local ventures, or contribute to a charitable fund by the end of 2023. Foreign insurers that do not comply with the ownership limit by the deadline will have to pay into a national health insurance programme known as B40 Health Protection Fund, that provides coverage for critical illnesses. AM Best is of the view that foreign insurers are likely to contribute to the fund instead of reducing their ownership stakes, as Malaysia continues to be a good source of diversification for them, given the market's technical profitability and growth potential.

Regulatory Developments

In December 2021, BNM published an exposure draft, "Climate Risk Management and Scenario Analysis", which sets out the proposed requirements and guidance on managing climate risk for financial institutions (which includes insurers and takaful operators). The proposed specific requirements and expectations (which took effect from 1 June 2022) are to ensure that financial institutions strengthen the management of financial risks stemming from climate change to enhance the resilience of the financial sector against climate-related risks and to facilitate an orderly transition to a low-carbon economy. The requirements around governance, strategy, risk appetite and risk management are to be met by 31 December 2023, while requirements for scenario analysis, metrics, targets and disclosures are to be met by 31 December 2024.

AM Best is of the view that the potential requirements and guidance will drive insurers to tap deeper into the issue on climate risk and consequently manage their climate risk exposures more efficiently. A greater focus on the management of climate risk is expected to benefit the insurance industry over the longer term.

In early 2022, BNM released its financial sector blue print for 2022-2026, which outlined several areas where the insurance and takaful industry would be instrumental. Key targets of the plan include achieving an insurance/takaful penetration rate of 4.8%-5.0%, and doubling the number of individuals subscribed to microinsurance/microtakaful. The plans aims for greater usage of insurance and takaful to support financing to firms, especially in high risk industries.

Investment Headwinds Persist Amid Economic Recovery

Most non-life insurers have recorded a decline in investment income due to the unfavourable investment climate in recent periods. Not only has the low interest rate environment hurt operating profits, but interest rate and equity market volatility have resulted in notable fair value movements, which negatively impacted reported capital and surplus. Consequently, the overall capital and surplus reported for the non-life insurance segment declined by 4.5% in 2021, largely due to fair value losses.

Prospectively, AM Best expects non-life insurers' investment results to improve over the near term, given BNM's stance of raising interest rates to curb inflation. Like its global peers, Malaysia is facing headwinds such as headline inflation that has risen from around 2% to 3% in 2022. In May and July 2022, BNM consecutively raised its key overnight policy rate by 25 basis points to 2.25%, having maintained it at a record low of 1.75% since July 2020. This was in view of the pandemic's impact on the economy, which has eased amid the sustained reopening of the global economy and an improvement in labour market conditions.

The country's main stock market index, FTSE Bursa Malaysia KLCI, has rebounded close to pre-pandemic levels in the first half of 2022. Any direct impact from the Ukraine-Russia conflict on Malaysia's capital market remains manageable given its minimal exposure to both countries.

However, further capital market volatility remains a risk over the near term and is likely to be subject to the ongoing global development and management of the pandemic and deteriorating supply chain issues. In response to these market conditions, AM Best expects non-life insurers to continue monitoring their underlying risk exposure to various investment classes, as well as actively adjust and refine their portfolio allocation as part of their risk management. This is following AM Best's observation that some non-life insurers have decided to shift part of their asset allocations from cash and deposits to other instruments including exchange traded funds and unit trusts in an attempt to enhance yields during the pandemic and low interest rate environment. In addition, any further increase in interest rates is expected to drive fair value losses on fixed income portfolios.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies. Best's ratings take into account the manner in which companies manage these factors and trends.

A Best's Market Segment Outlook, like a Best's Credit Rating Outlook for a company, can be Positive, Negative, or Stable.

Best's Market Segment Outlook

Positive	A Positive market segment outlook indicates that AM Best expects market trends to have a positive influence on companies operating in the market over the next 12 months. However, a Positive outlook for a particular market segment does not mean that the outlook for all the companies operating in that market segment will be Positive.
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Stable	A Stable market segment outlook indicates that AM Best expects market trends to have a neutral influence on companies operating in that market segment over the next 12 months.

We update our market segment outlooks annually, but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.

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BEST'S MARKET SEGMENT REPORT

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