18 December 2018 | Sector Update

Insurance and Takaful

***Maintain* POSITIVE**

Sustained premium growth expected in FY19

INVESTMENT HIGHLIGHTS

- **The insurance and takaful industry on a strong growth momentum**
- **Premium income is expected to continue its upward trend**
- **Proactive measures by the Government likely to boost demand**
- **Digitalization remains one of key strategies in meeting structural change**
- **We reiterate our POSITIVE stance on the sector**

Sustained industry growth rate. We expect the strong demand in the insurance industry is expected to continue into next year, as the insurance sector's contribution to GDP (in absolute terms) grew the highest amongst other services for the first three quarters in CY18. It increased by +9.8%yoy, +13.1%yoy and +13.0%yoy respectively. Given the stagnant penetration rate (circa 54-55%) of the past 5 years and huge protection gap, we view there will be an opportunity for growth in FY19 as the Malaysian government has announced multiple incentives moving forward, with the growth of takaful market as a key catalyst. We also anticipate the insurance and takaful combined assets to continue to climb higher by +6.3%yoy to RM313b, signaling continuous strength of the industry.

Premium income to move at a steady pace. According to the prevailing growth trend and favorable market environment of the industry, we expect the total net premium and contribution income to increase by around +5.1%yoy to higher level at circa RM62.2b. This is premised on the higher growth of premium in new business by life insurers and family takaful operators at +7.7%yoy in 1H18 and also a 5-year CAGR of total premium of 5.2% (2012-2017). We also opine that the further expansion in the industry to be spurred predominantly through the takaful market, as the yearly growth in contribution income has approximately doubled the premium growth in the conventional market since 4 years ago. Furthermore, we observed that the total premium growth was mostly attributable to the life segments as compared to non-life segments in the past three years, indicating possible increased take-up rate in life protection by consumers.

Evaluation of liberalization performance in the general segment. In CY19, BNM will make an official assessment of the phased liberalization since the full implementation of motor insurance de-tariffication in July 2017. Upon which, the results would determine the readiness of the industry to fully adopt a liberalized environment, particularly with fire insurance de-tariffication to be targeted next. As the motor and fire insurance form two of the largest lines of business, we see this step-by-step approach as strategic as to ensure the sustainability and competitiveness of the general and takaful insurance industry in the long run. We believe that insurers with a rigorous and robust risk-based pricing operational model will be better off in taking advantage of the opportunities presented in a more dynamic market, thus resulting in better underwriting profit. We also expect further liberalization to be beneficial to both consumers and insurers as more products may be tailored to suit both parties' needs and profile compared to the fixed price tariff, thus enhancing the efficiency of the industry as a whole.

Favorable government stimulus for the insurance market. In view of reducing national protection gap, the Government had announced several initiatives effective in CY19 to address the largely underserved market (i.e. B40 segment) as well as to incentivize consumers to adopt insurance protection. We view that the tax relief of RM3,000 for life insurance and takaful products to be an encouraging move to stimulate the take-up rate of insurance products by non-policy holders. Additionally, the removal of stamp duty on Perlindungan Tenang products for 2 years is also seen as a tactical move to address the lack of insurance protection among the B40 group, further easing the burden of purchasing the prescribed insurance products. We also opine that the provision of free insurance protection for top four critical illnesses via the national B40 Health Protection Fund to be managed by BNM is another significant step forward in reducing protection gap as well as achieving breakthrough in the penetration rate. Thus, we remain upbeat on the development of the industry on the back of the Government's incentives in CY19.

Implementation of Minimum Allocation Rate (MAR) for investment-linked (IL) products effective January 2019 marks the end of Phase 1 of the Life Insurance and Family Takaful Framework to replace the removal of maximum limits on commission and agency-related expenses (ARE). According to Table 1.0 below, insurers need to have a minimum portion of premium to be retained in the unit fund before any charges (i.e. commission and management expenses) made by the insurers. This would reduce the margin available in the earlier years to pay for front end expenses, predominantly the commission to the agency force. We opine that given the industry's reliance on agents (circa 48%), insurers would be expected to take a meticulous approach in revising the incentive structure or rationalize its distribution network in meeting the regulatory requirement. It is likely that insurers might experience slight margin compression or asset reduction in the initial stages. Recall that IL products accounted for circa 44.5% and circa 21% of new premiums/contributions in life insurance and family takaful sector respectively. Thus, we view that the impact would be greater on the life insurance companies as compared to takaful operators.

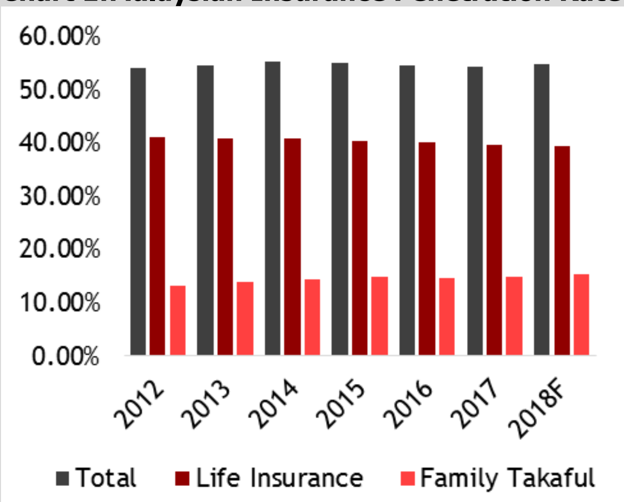
Digitalization remains an important driver in the industry. In the face of ongoing deregulation and pricing pressure, we view that insurers with a key focus on digital technology in its business model may provide further impetus to ensure profitability moving forward. The domestic claims environment has been favourable but management expense has been on the rise in recent years partly due to meeting the structural demand of the industry (e.g. online distribution and mobile first approach). We believe that this trend will continue in CY19. However, we view this as only transitional, whereby the decline in average industry underwriting profitability is to achieve greater cost savings in the long run. Hence, we believe that the industry will maintain a positive and relatively healthy average underwriting margin due to prudent underwriting. Additionally, we view the development of micro insurance may continue to be harnessed by digital technology in CY19 through means of online channels as well.

Maintain positive on the sector. With multiple initiatives underway to spur the demand for insurance protection in CY19, we maintain an optimistic outlook on the insurance/ takaful industry. We see the ongoing digital transformation will enable the sector to reap the benefits of liberalization as well as tapping into the underserved market on a wider scale. This is in line with the target of insuring the majority of the population (i.e. 75% by 2020). At this juncture, we believe the growth of the industry to continue led by the higher take-up rate of takaful products due to wider awareness and favorable demographic pattern in the domestic market. As such, our top pick remains to be **Syarikat Takaful (STMB)** with a **TP of RM4.49**. Recall earlier this year, STMB has launched its online portal (i.e. Click for Cover) as part of its digitalization efforts and sustained double-digit growth in contributions for preceding quarters which are expected to be continued in FY19.

Table 1.0: Minimum allocation rate for IL products' term greater than 20 years

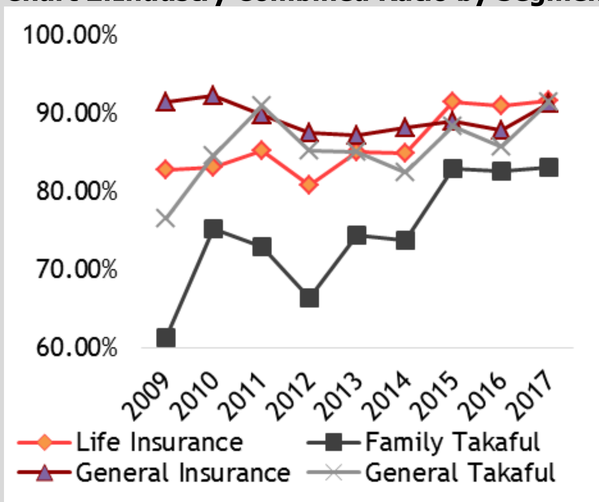
Policy/Certificate Year	MAR
	Annual Premium/Contribution
1-3	60%
4-6	80%
7-10	95%
11 onwards	100%

Chart 1:Malaysian Insurance Penetration Rate



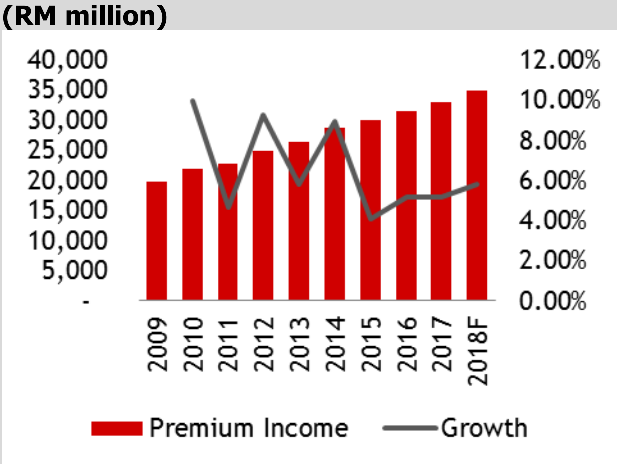
Source: BNM, MIDFR

Chart 2:Industry Combined Ratio by Segment



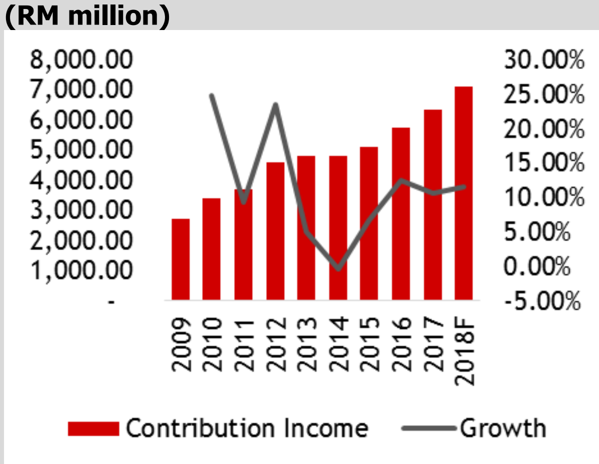
Source: BNM, MIDFR

Chart 3: Life Insurance Premium Income (RM million)



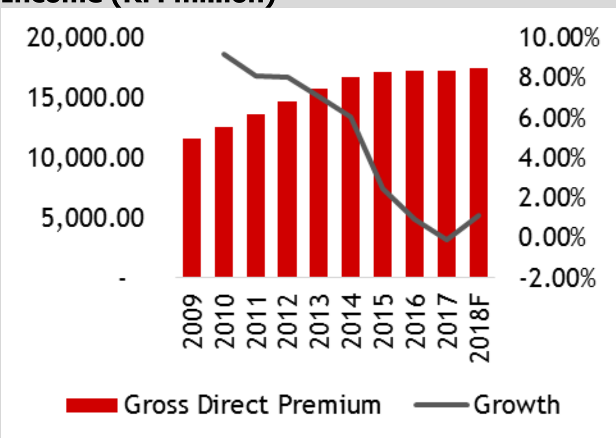
Source: BNM, MIDFR

Chart 4: Family Takaful Contribution Income (RM million)



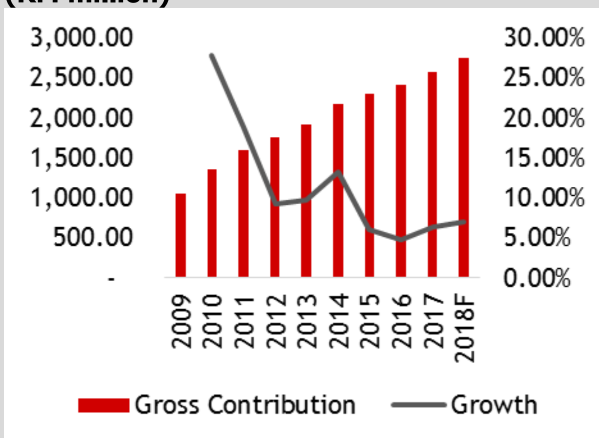
Source: BNM, MIDFR

Chart 5: General Insurance Gross Premium Income (RM million)



Source: BNM, MIDFR

Chart 6: General Takaful Contribution Income (RM million)



Source: BNM, MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.