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IN TWO MINDS OF REPLACING LIFE INSURANCE POLICY[1]

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SYNOPSIS

The case is about how Maju Takaful Resources (MTR), a takaful consultation firm, dealt with their agents' grievances regarding the regulation of Replacement of Policy (ROP) imposed by Bank Negara Malaysia (BNM). The regulation was imposed to curb unwarranted replacement of life insurance policy and to ensure the interest of the policyholders is continuously safeguarded. The regulation specified that agents shall not receive any commission for any policy which is construed as ROP. However, the regulation has placed MTR at a great disadvantage, since most of their clients, whom previously subscribed to conventional life insurance policy wished to switch to family takaful (a shariah-compliant version of life insurance). Unfortunately, according to ROP regulation, these cases were still considered as ROP. The case allowed students to learn the effects of ROP on different stakeholders within the insurance and takaful industries in Malaysia.

PROLOGUE

It was early March 2018. In the office, Suffian[2], the manager of Maju Takaful Resources (MTR), had just finished an intense discussion with the firm's top takaful agent, Sani. The firm is one of the many takaful and insurance consultant firms attached to Prudential Assurance Malaysia Berhad (PAMB), one of Malaysia's leading conventional insurers. The discussion was mainly focused on the firm's monthly sales report. Suffian was satisfied with the firm's performance as the report showed that MTR's sales recorded a double-digit growth. However, he was shocked to find out that the firm's persistency rate had dropped to 80 percent, below the 85 percent minimum requirement for the maintenance of contract as an agent or agency leader. Sani felt that their firm's persistency rate dropped was due to the Replacement of Policy (ROP) requirement imposed on all takaful agents. During the discussion, Sani insisted that Suffian brought up the issue of Replacement of Policy (ROP) during PAMB's regional meeting on the next day. However, Suffian was not entirely sure about it.

The regulation on ROP imposed by Bank Negara Malaysia (BNM) had become a pressing matter to MTR of late because it jeopardized both individual agent and the firm's income. In fact, one of their agents was terminated recently due to high number of ROP cases. The ROP regulation was imposed to ensure the interest of policyholders is continuously safeguarded and deterred unwarranted ROP. Since life insurance agents receive the biggest chunk of the sales commission during the first six years, there is a tendency for agents to advice their customers to replace their existing policy with new policy, thus, ensuring the continuity of their commission. Thus, BNM had specified that an agent or an agency leader shall not receive any compensation for any policy which is construed as a ROP.

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[2] The names of the protagonist (decision maker) and the company in the case are disguised for confidentiality reasons.

However, the regulation has placed takaful agents in MTR at a great disadvantage since most of their customers who previously subscribed to conventional life policy wished to replace it with a family takaful policy instead. Suffian, however was not sure whether it was the ROP regulation or something else that has brought down his agency's persistency rate. Furthermore, the ROP regulation has been enforced since 2005. He decided to call a meeting with Sani and a few of his agents later. He knew, if the situation continued, MTR might not be able to maintain its contract as a takaful consultant. In other words, MTR's agency contract will be terminated. He needed to present his case in the meeting by tomorrow morning. Suffian instructed his assistant to set up an urgent meeting to prepare for the upcoming regional meeting.

OVERVIEW OF TAKAFUL INDUSTRY IN MALAYSIA

The birth of takaful in Malaysia in 1984 was resulted from a proclamation by the National Fatwa Committee that the practice of conventional insurance contradicts the shariah principle. Conventional insurance contract was deemed non-shariah compliant due to the presence of three prohibited elements by shariah, namely *riba* (interest), *gharar* (ambiguity) and *maysir* (gambling). Given the importance of insurance for risk management, Muslim scholars called for an Islamic insurance to be introduced to fulfill the needs of Muslims. It was also intended to complement the operation of the Islamic banking systems in Malaysia.

Takaful industry experienced a slower growth than the Islamic banking sector mainly due to the skepticism regarding insurance in the Muslim world (Hashim, N.H, 2006). Nevertheless, after more than 30 years in the Malaysian financial market, takaful has emerged as a fast-growing industry within the insurance industry. It has also proven to be a viable alternative in providing insurance coverage to the Muslim community. The industry now has 11 operators, offering a wide range of products, matching those offered by conventional insurers. Although 11 takaful players were set up along similar line of objective, that was to fulfil the insurance needs among the Muslim community, there is a very distinctive difference in models adopted by these operators in their business operations.

A pioneer in Malaysia's takaful industry, Syarikat Takaful Malaysia Berhad (STMB) is the only takaful company that adopted the *Mudharabah* model and it does not employ any agents to sell and market their takaful products. STMB utilizes the direct marketing channel to market its products and rely on walk in customers[3]. The other takaful operators mostly adopted either *Wakalah* or *Wakalah Mudharabah* model (combination model), hence, utilizes the agency force to attract and service their customers. **Table 1** provided the list of takaful operators and their ownership in Malaysia.

Takaful business is divided into two broad products, namely general takaful and family takaful. General takaful is basically the equivalent to conventional general insurance, which is a short term contract of joint guarantee among the participants in relation to material losses resulting from catastrophe inflicted upon properties belonging to the participants. Examples of general takaful products include fire takaful, motor takaful and marine takaful. Family takaful on the other hand is similar to the coverage provided by the conventional life insurance. It is a long term savings and investment contract, with a fixed maturity period that provides assistance to the participants in time of need due to untimely death, and other mishaps resulting from injury or disablement. Examples of family takaful products are family takaful for education, mortgage, investment and other savings products for specific purposes.

[3] Since 2009 STMB uses the wakalah contract for its new family takaful business, hence, utilizes the agency force to sell its family takaful products.

Table 1: Takaful Operators in Malaysia

Takaful Operators	Ownership
1. Syarikat Takaful Malaysia Berhad	Local
2. Takaful Ikhlas Berhad	Local
3. Hong Leong MSIG Takaful Berhad	Local
4. Zurich Takaful Malaysia Berhad	Local
5. Etiqa Takaful Berhad	Local
6. Prudential BSN Takaful Berhad	Local
7. HSBC Amanah Takaful (Malaysia) Berhad	Local
8. AIA PUBLIC Takaful Bhd.	Foreign
9. AmMetLife Takaful Berhad	Local
10. Great Eastern Takaful Berhad	Foreign
11. Sun Life Malaysia Takaful Berhad	Local

Source: BNM, Financial Stability Report 2016.

Overall, in 2014 the market penetration rate[4] of Malaysia's insurance industry is 5.2 percent of the country's GDP. Life insurance is ahead at 3.3 percent of GDP in comparison to non-life or general insurance at 1.8 percent of GDP. Malaysia's life insurance and family takaful, accounted for the bulk or 69 percent of the RM48.8 billion total insurance industry premiums. In 2014, the conventional life business was dominated by three key players, namely: Great Eastern (25 percent market share); AIA (25 percent market share); and Prudential (18 percent market share). For family takaful, the top operators were Etiqa (39 percent market share) and Syarikat Takaful Malaysia Berhad (22 percent). For both conventional and takaful industry, the life or family takaful business segment seemed to be the industry's major force, contributing more than 75 percent of the industry's income.

In terms of market dominance, conventional insurance is still at the forefront, due to its superiority in terms of asset funds, number of players and seniority in the insurance industry (Hashim & Muda, 2004). However, according to the Bank Negara Malaysia (BNM) Governor, Datuk Muhammad Ibrahim (in his speech on August, 2016), the growth within the insurance industry has started to reach a plateau, with life insurance penetration rate remaining stagnant at 55 percent over the past three years. Takaful industry, on the other hand, although much smaller, has always recorded a double digit growth and increased penetration rate. In fact, over the last five years (2009 – 2014), the takaful business saw encouraging growth of net contribution of 12.4 percent compounded annual growth rate (CAGR)[5], which was much higher than the conventional insurance at only 7.81 percent. **Appendix 1** described the key indicators of both insurance and takaful industries.

MAJU TAKAFUL RESOURCES (MTR)

MTR was established in 2006 by Suffian bin Ramli, then an agency leader in Prudential Assurance Malaysia Berhad (PAMB), one of Malaysia's leading insurer. In 2006, PAMB marked a significant milestone by entering Malaysia's Shariah-compliant takaful industry via a joint venture with Bank Simpanan Nasional (BSN), hence, the birth of Prudential BSN Takaful (Pru BSN), a full-fledged takaful provider. After more than 10 years in the insurance industry, Suffian decided to open his own firm, MTR, doing what he knew best, which was selling insurance and takaful products.

MTR was one of the many takaful and insurance consultants registered with PAMB and Pru BSN. Suffian was the quality leader of the agency and overseen the overall operation. MTR consisted of one administration staff and 16 agents, whom were all supervised by Suffian. All of

[4] Penetration rate is measured as the ratio of premium underwritten in particular year to the GDP.

[5] CAGR = the mean annual growth of an investment over a specified period of time longer than 1 year.
The CAGR calculation = [ending value / beginning value] $^{(1/\text{no of years})}$ - 1

the 16 agents are licensed to sell both conventional insurance and takaful products from PAMB and Pru BSN exclusively. However, Suffian would advise his agents to promote the family takaful products, as most of his customers are Muslims.

> *"It was always easier to promote family takaful products because most of our customers have always preferred to be insured with a shariah compliant policy and the awareness on the importance of having a takaful plan is better now. I've had many customers who were previously insured by conventional life insurance wished to replace them with family takaful." (Suffian)*

All of MTR's agents went through all the exams and training as per required by the Malaysian Insurance Institute (MII). To become a life insurance and/or takaful agent in Malaysia, firstly an individual must be registered with ONLY ONE insurer or takaful operator. If the agents wanted to sell both conventional and takaful products, he/she will have to pass two separate exams. Takaful agents must pass the Takaful Basic Examination (TBE) organized by the Islamic Banking and Financial Institute Malaysia (IBFIM), whereas a conventional insurance agent must pass the Pre-Contract Examination for Insurance Agents (PCE) organized by the Malaysian Insurance Institute (MII). The following is the TBE and PCE route taken by a potential agent:

i. Part A + C = Basic insurance knowledge + Family takaful / insurance
ii. Part A + C = Basic insurance knowledge + General takaful / insurance
iii. Part B = General Takaful / Insurance
iv. Part C = Family Takaful / Insurance

In order to register with the takaful operator or insurance company, an agent must pass either one of the examination route which was Part A+C or Part A+B. Then only he/she can sit for Part B or Part C and register with the takaful operator or insurance company. If the agent is transacting investment-linked life business, he/she must pass the Certificate Examination in Investment-Linked Life Insurance (CEILLI), administered by the MII.

In terms of compensation, agents generally relied on their commissions as the main source of income, although bonuses may be rewarded. Bonuses are based on the agent's yearly sales premium, with the maximum of 13 percent. Pru BSN adopts the *wakalah* operational model, where takaful participants, as a group are the principal, and the takaful company represented by the shareholders and the management as the agent. In the context of takaful operation, the policyholders as a group, appoint and authorize the takaful operator to be their agent (*wakeel*) to manage the takaful fund, for both underwriting and investment activities that has been principally contributed by the takaful participants as *tabarru'*. This service will be rewarded in terms of a fixed fee (*Wakalah* fee). The *Wakalah* fee is typically a fixed percentage of the contribution.

Agents' commission amount varies depending on the products sold, with investment-linked takaful provided the highest commission. **Table 2** indicates the agent's schedule for a typical investment-linked family takaful product.

Table 2: Agents' Commission Schedule for Investment-Linked Takaful

Year	1st	2nd	3rd	4th	5th	6th
Rate (from premium paid)	20 + 5 %	20%	13.5%	18.5%	15%	15%

> *"Agents will get more commission with a longer term product because the income goes through all the six years. However, it is not easy to find a 'quality customer' who could sustain the premium for six years. Most customers will only pay premium up to three years only".*
> *(Suffian)*

AGENT'S MAINTENANCE OF CONTRACT

All insurance and takaful agents that are registered with PAMB must fulfil the minimum requirement for the maintenance of contract as an agent or agency leader. If these requirements were not met, the agent will be terminated. There are three requirements, as the followings:

1. **Total Production Credit (TPC)**
   Individual agents are required to achieve the minimum of RM15, 000 production credit per year. This is equivalent to selling (closing of sales) takaful or insurance policies to a minimum 12 customers yearly. However, for an agency leader, the minimum total production credit per year is RM250, 000.
2. **Continuing Professional Development Training (CPD)**
   All agents including agency leader must undergo 30 hours of professional training in a year.
3. **Persistency Rate**
   Persistency rate refers to the volume of business (paying customer) that an agent is able to retain for a minimum of 12 months. It implies the percentage of existing policies remaining in force without lapsing (non-payment) or being replaced by other policies of other insurer or takaful. Agents registered under PAMB must retain at least 85 percent persistency rate during the first year.

> *"Most of my agents do not have any problems meeting the production credit and CPD training to maintain their contract. However, to maintain the persistency rate is not so easy. This is because, when faced with financial difficulty, the first option among the customers is to let go (lapse or surrender) their policy. Sometimes, within the 3rd year, half of the customers lapsed their payment)". (Suffian)*

REPLACEMENT OF POLICY OR CERTIFICATE (ROP or ROC)

According to BNM (JPI:2/2005) the purchase of a life insurance policy or a takaful certificate is construed as a replacement of policy, if within 12 months before or after a new policy is enforced, an existing life insurance policy has been[6]:-

a. Lapsed, surrendered, partially surrendered or forfeited;
b. Changed or modified into paid-up insurance policy, continued as extended term insurance or under another form of non-forfeiture benefits, dividend accumulations, dividend cash values or other cash values; or
c. Changed or modified so as to affect a reduction in the amount of premiums paid arising from the reduction of sums insured and/or rider or removal of rider

ROP and ROC shall apply to all life insurance policies and family takaful certificates with cash value features only. Cash value policies are a type of life or family takaful policy that pays out upon the policyholder's death, and also accumulates cash value during the policyholder's lifetime. The cash value of these policies is equal the total amount of premiums paid minus the cost of insurance and other charges assessed by the insurer. Cash value balances can also fluctuate based on the underlying investment in which the balance is allocated. The objective of the guidelines on ROP and ROC are as follows[7]:

a. to develop a common understanding and establish a set of decisive procedures amongst member companies
b. to ensure the interest of policyholder is continuously safeguarded
c. to deter unwarranted ROC or ROP that may tarnish the reputation and best practices of insurers and takaful operators

[6] Definition of ROP in BNM (JPI:2/2005) also applied for Replacement of takaful certificates (ROC). In this case, ROP and ROC is treated interchangeably. Technically, ROP refers to the conventional insurance sector and ROC refers to takaful operators.

[7] Refer Guidelines on Replacement of Family Takaful Certificates (ROC) – Inter Takaful Operator Procedures.

d. to maintain the trust that participants place on takaful operators and insurers, knowing that they will conduct their business ethically and with integrity
e. to reduce the incident of the ROP and ROC

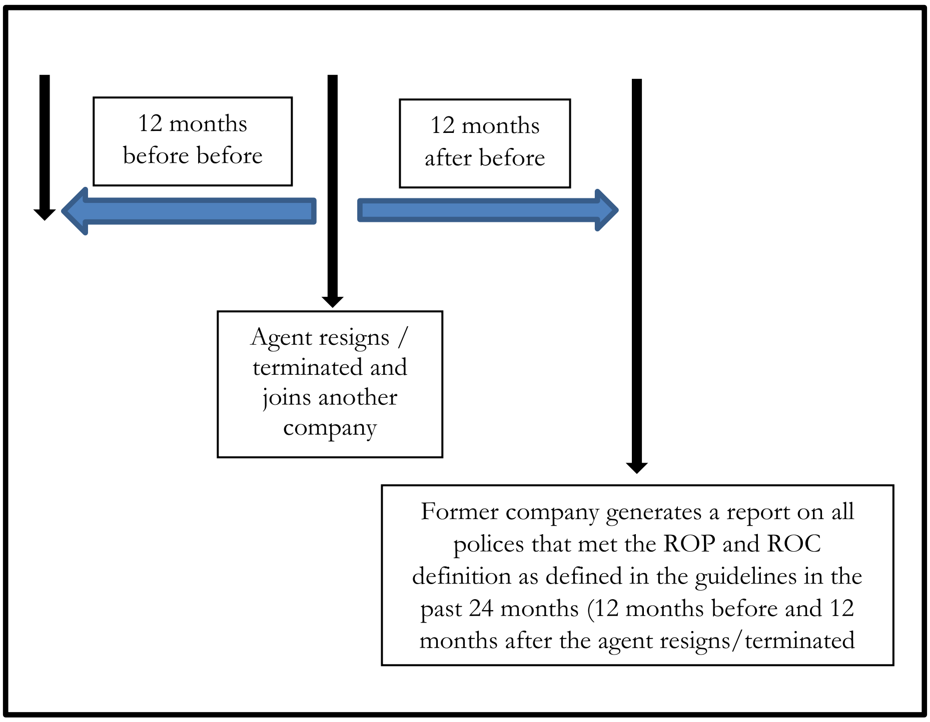

Figure 1: Illustration of ROP and ROC

For further understanding of the concept of ROP or ROC, consider the following scenarios:-

Scenario 1 (ROP or ROC by different agents)
a. New policy taken with Company A: 1st February 2017
b. Existing cover lapsed with Company B: 1st January 2018 (event date)
Date of ROP or ROC is 1st January 2018

Scenario 2 (ROP or ROC arising from movements of agents)
a. Existing cover lapsed with insurer B: 1st February 2017 (event date)
b. Agent moved to different insurer (Company A): 1st June 2017
c. New policy taken with Insurer A: 1st January 2018
Date of ROP or ROC is 1st January 2018

Scenario 3 (ROP or ROC arising from replacing a conventional life insurance policy with family takaful by the same agent)
a. New takaful certificate taken with takaful operator A: 1 February 2018
b. Existing cover lapsed with insurer A: 1st January 2018
Date of ROC is 1st January 2018

HOW ROP AFFECTS POLICYHOLDERS AND AGENTS

To present the issue of ROP in the meeting without looking overly biased towards the agents, Suffian decided to list down the effects of ROP on the two parties involved, namely the policyholders and the agents. He asked Sani to join him to brainstorm the issue. Sani suggested to call another two agents, Haris and Azman, to join them.

Suffian : We need to discuss on the effects of ROP on our customers and ourselves. I don't want to look biased in the meeting when I present our case.

Sani : I agree, but I can't help being biased, because to me, the most affected party would be us! Our income is affected, because we don't get any commission when a policy is considered as ROP. If the number of ROP is high, we cannot maintain the 85 percent persistency rate. To make matters worse, our contract can be terminated!

Suffian : I know, high ROP cases might jeopardize the firm's maintenance of contract too. If your persistency rate is not fulfilled, the firm will suffer. But please, help me with this first. I promise once we've laid everything in order, we will have more points to justify our argument.

Sani : Ok Suffian. But just bear in mind, most of our ROP cases are because of the customers' own wishes. They wanted to replace their conventional policy with a takaful certificate. They no longer wanted to be insured with something not shariah-compliant. How can we say no to that? I don't feel right objecting to such request.

Suffian : I understand. Furthermore, most of our ROP cases were policies between PAMB and Pru BSN. It's not actually switching to a different company. It's between a subsidiary and the parent company. But we still need to justify everything. Just try to have more empathy and put ourselves in their shoes for once. Shall we start?

Haris : I don't think ROP is the main problem because the regulation on ROP was around since 2005, but the ROP cases were low then. However, during the last two years, our ROP cases increased substantially. Maybe the issue is in-house or maybe we overlook the fact that there is a stiff competition between conventional and takaful products. Just like what Sani said, our ROP cases were mostly to replace conventional policies with takaful certificates.

Suffian : The firm's monthly sales is doing well. In fact, based on the latest report by BNM, as of the end of 2016, Pru BSN was the number one takaful provider with 33.1 percent of market share. AIA was at number two, with 15 percent market share, followed by Etiqa. These figures showed that takaful business is doing very well indeed. And yet our persistency rate dropped. We need to do something to ensure that our paying customers do not lapse their policy!

Azman : I have asked a few of my friends form Etiqa takaful, Zurich takaful and Hong Leong takaful. As far as I know, Zurich has the same ROP regulation as ours. Etiqa, obviously doesn't face the same problem because the company is a full-fledged takaful operator. They don't have any problem of replacing conventional policies with takaful certificates. Only a handful of ROC (replacement of takaful certificate) cases existed. Interestingly, Hong Leong has a different ROP regulation. If a request of replacing a conventional policy with a takaful certificate occurs, the company will contact the customers themselves and ask whether it was really their decision to change. That is, the replacement is on voluntary basis. In addition to that, there is a release form for the customer to sign. If it is proven that the ROP is voluntary, the agents commission will not be affected at all.

EFFECTS OF ROP ON POLICYHOLDERS

The decision to replace one's policy might be of the policyholders themselves or was recommended by the insurance agent. When it was recommended by an agent, it might be a good idea for the policyholder and their family, or it might be a good idea for the agent! No matter how the decision came around, a careful analysis is required. The following are the advantages and disadvantages of ROP to policyholders.

The advantages of ROP to policyholders are possible higher death benefit, a lower premium and a change of policy types. These will be a suitable protection with cost-effective benefits. On the other hand, the disadvantages of ROP would be costly, loss of features and lower cash value. In short, it would be more costly to the policyholders to replace a policy.

EFFECTS OF ROP ON AGENTS

According to BNM rule on ROP, (JPI:2/2005), in instances where an agent or agency leader has been or is involved in the ROP or policies from one company to another, the insurer shall be required to undertake the following actions:

1. **Cease payment of all commissions**, including overriding commissions and bonuses on all policies replaced and re-booked in the new company and if any payment has been made, the new company shall claw back all payments made.
2. The insurer or takaful operator may also exercise one or more of the following disciplinary actions:
   a. **Deferment** of promotion for one year, together with a warning letter after five instances of ROP.
   b. **Demotion** and a warning letter after 10 instances of ROP.
   c. **Termination** (after 15 instances of ROP).

   Sani thought the regulations were not favoring the agents.

"I don't see any advantage of the ROP regulation towards the agent. It's all about punishing the agent. I can understand if it is an unwarranted ROP, but the regulation did not provide any provision in the case of replacing a conventional life with a family takaful. If I am the customer, rather than paying for two policies for 12 months, I would just lapse or surrender the existing policy. The customer will not want to spend more just to help the agent to get his commissions".

EPILOGUE

Suffian recalled that if ROP cases happened during the first 12 months, it will directly affect the agent's and his firm's persistency rate due to policy lapse and policy being replaced. The agents and even his firm will no longer be able to retain the 85 percent rate, which is mandatory to maintain an agent or agency contract. If the maintenance of contract is not fulfilled, automatically they can be terminated! It is up to him to find the middle way to solve the agents' grievances and secure the future of his firm. Suffian started to have cold sweat.

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