

Liberalization of the Malaysian Conventional Insurance and Takaful Markets

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The Liberalization Plan

A recent announcement on changes to the Malaysian financial services (including insurance) regulatory regime is a further sign of the desire to expand the domestic conventional and Takaful insurance industries and to encourage foreign investment.

The Prime Minister of Malaysia, Datuk Seri Mohd Najib bin Tun Abdul Razak, and the Malaysian insurance regulator, Bank Negara Malaysia¹ (“BNM”), announced on April 27, 2009 as part of a plan for liberalization of the Malaysian financial services sector (the “Liberalization Plan”), that up to two new family² Takaful licenses will be granted in 2009 to (local or foreign) insurers that “can offer [a] significant value proposition to Malaysia to spur the development of the Takaful industry and reinforce Malaysia’s position as an international Islamic financial hub.”³ **Applications for the new family Takaful licenses should be received by BNM by October 31, 2009.**

Furthermore, the limit on foreign equity participation in conventional Malaysian insurers and Takaful operators has been lifted from 49% to 70%. This will enable a foreign insurer with an existing minority interest in a Malaysian conventional insurer or Takaful operator to increase its existing equity interest in and gain majority control of such conventional insurer or Takaful operator. There will be more operational flexibility for locally incorporated subsidiaries of foreign insurers and Takaful operators, with the aim of strengthening the resilience and competitiveness of the Malaysian conventional insurance and Takaful industries.

The New Family Takaful Licenses

Under the Liberalization Plan, up to two new family Takaful licenses will be granted. The licensee, which can be up to 70% owned by a foreign insurer,

¹ The Malaysian Central Bank, which is also the regulator for banks and other financial institutions.

² The Takaful equivalent of life insurance.

³ As part of the Liberalization Plan, the following seven new licenses will also be granted in 2009 and 2011: (a) two new Islamic banking licenses will be offered in 2009 to foreign players to establish new Islamic banks with paid-up capital of at least US\$1 billion “to enhance global interlinkages, leverage on global developments in Islamic finance and reinforce Malaysia’s position as an international Islamic financial hub,” (b) two new commercial banking licenses will be offered in 2009 to foreign players “that will bring in specialized expertise to address gaps in the financial sector and spur the development of targeted economic sectors,” and (c) three new commercial banking licenses will be offered in 2011 to “world-class banks that can offer significant value propositions to Malaysia.”

must be locally incorporated and will be regulated by BNM.⁴ The new family Takaful operator must have minimum issued and paid-up capital of RM100 million (about US\$28.3 million).

In assessing the merits of the applications, BNM will apply the following criteria:

- The applicant must be a reputable regulated institution or a shareholder of a reputable regulated institution; and
- The applicant must demonstrate, through a comprehensive three year business plan, that the proposed new licensed institution to be established in Malaysia will have the necessary expertise and resources to be able to tap the global Islamic financial markets and contribute to reinforce Malaysia's position as an international Islamic financial hub.

The applicant will need to provide as part of its application, among other information, a list of shareholders who hold 5% or more (directly or indirectly) of the voting shares of the applicant and the Malaysian operations.

The business plan should include "*strong value propositions*" which, among other things, should cover:

- Areas of specialized expertise with details on how the products and services proposed to be offered will enhance the depth and breadth of the market;
- Commitment to develop human capital and infrastructural requirements for a robust Malaysian operation; and
- Concrete plans as to how the operations would be extended for regional and international expansion.

Duly completed applications for the new family Takaful licenses should be received by BNM by October 31, 2009. Successful applicants are expected to commence operations by no later than 12 months from the date they receive their respective approval.

Increase in Foreign Equity Limit

In order to "*further strengthen the resilience and competitiveness of the insurance and Takaful industry,*" insurance companies and Takaful operators have been given greater flexibility to form alliances with foreign partners under the Liberalization Plan. The limit on foreign equity participation in conventional insurers and Takaful operators has been lifted with immediate effect from April 27, 2009 from 49% to 70%.

⁴ The licensee will be registered under the Takaful Act 1984.

In addition, a higher foreign equity participation limit beyond 70% will be considered on a case-by-case basis for conventional insurers and Takaful operators “*who can facilitate consolidation and rationalization of the [Malaysian] insurance industry.*”

However, there are a significant set of consents / approvals that potential investors should be aware of concerning investments in Malaysian conventional insurers or Takaful operators. A foreign insurer intending to enter into negotiations for the acquisition or disposal of an aggregate interest of 5% or more of the shares of a Malaysian conventional insurer or for acquiring or disposing of “control”⁵ of a Takaful operator will require the following necessary approvals / consents (as appropriate):

- BNM consent prior to entering into any negotiations on the terms and conditions of the proposed acquisition or disposal of an aggregate interest of 5% or more of the shares of a conventional insurer or of a Takaful operator;
- Approval from the Malaysian Minister of Finance through BNM before any agreement or arrangement to acquire or dispose of such aggregate interest of 5% or more of a conventional insurer can be entered into;
- Approval from the Governor of BNM as the Director General of Takaful of any change in the “control” of a Takaful operator; and
- Approval from the Foreign Investment Committee (FIC) for any proposed acquisition of 15% or more of the voting rights of any conventional insurer or Takaful operator, or for any proposed acquisition of any interest with a value of RM10 million (about US\$2.8 million) or more in any conventional insurer or Takaful operator.

In addition to the above:

- A foreign insurer who: (a) acquires more than 33% in a conventional insurer or a Takaful operator; or (b) holds more than 33% but less than 50% of the voting shares of a conventional insurer or a Takaful operator and such foreign insurer acquires or intends to acquire in any six month period more than 2% of the voting shares of such conventional insurer or Takaful operator, shall – in either case – extend a mandatory general offer for the remaining shares of the conventional insurer or Takaful operator (unless a waiver is obtained from the Malaysian Securities Commission).

⁵ The possession, directly or indirectly, of the power to direct or cause the direction of the management and policy of the Takaful operator.

- All proposed appointments of directors and the chief executive officer of a conventional insurer must first be approved by BNM.
- A Takaful operator shall give written notice to the Governor of BNM as the Director General of Takaful of the fact that any person has become or ceased to be its managing director, director, chief executive or principal officer.

Greater Operational Flexibility

To increase conventional insurance and Takaful penetration in Malaysia, locally-incorporated foreign owned insurance companies and Takaful operators may now establish branches throughout Malaysia without restriction and they may now also enter into *bancassurance / bancatakaful* arrangements with banking institutions (which they were previously restricted from doing). Furthermore, insurance companies and Takaful operators will be accorded greater flexibility to employ specialist expatriates that have the relevant expertise to contribute to the development of the conventional insurance and Takaful industries in Malaysia and promote the transfer of international best practices and skills to the local talent pool.

The Liberalization Plan in Context

Since the beginning of the Asian financial crisis in 1997, it has been Malaysian government policy not to issue any new licenses for the carrying on of conventional direct insurance business⁶ and also Takaful business. Through this policy and through introducing gradual increases⁷ between 1997 and 2004 in the minimum paid up capital requirement for direct insurers and Takaful operators, the Malaysian government and BNM sought to develop such insurers and Takaful operators into larger, stronger and more well managed players and to prepare them to compete in a more liberalized environment. This led to a wave of consolidation among direct insurers – according to BNM statistics, between 1999 and 2002, a total of 14 M&A transactions involving 27 insurers were successfully completed leading to a reduction in the number of Malaysian direct insurers from 58 to 44. Both insurers and Takaful operators were also encouraged to enter into joint-ventures with foreign insurers – this is well illustrated in the Takaful space where five out of the current total of eight Takaful operators are Malaysian / foreign joint-ventures (Aviva, Fortis, Tokio Marine, HSBC, Prudential UK and Solidarity Company BSC (of Bahrain) being the relevant foreign insurers).

With the implementation of BNM's "Financial Sector Masterplan" (the "FSMP") launched in March 2001, BNM prioritized capacity building measures for insurers to achieve greater economies of scale, develop core competencies,

⁶ BNM press announcement of September 2, 1997.

⁷ From RM35 million to RM50 million and then finally to the current RM100 million (effective June 30, 2001 for direct insurers and December 31, 2004 for Takaful operators).

expand distribution and product range as well as strengthen consumer confidence by raising standards of professionalism. Phases I and II of the FSMP have to date been focused on building the capabilities of domestic insurers, strengthening the operational, legal and regulatory infrastructure for Takaful operators, and promoting competition, consolidation and the enhanced performance of direct insurers and Takaful operators. This has led to some further consolidation and rationalization resulting in the current number of 40 direct insurers and eight Takaful operators. With the announcement of the Liberalization Plan, direct insurers and Takaful operators are entering into the final stage, Phase III, of the FSMP.

The road ahead

Phase III of the FSMP, of which the Liberalization Plan is part, involves the progressive liberalization of the conventional insurance and Takaful sectors, with the aim of enhanced efficiency and innovation in these sectors.

With the Liberalization Plan, two of the key FSMP recommendations for Phase III have been initiated – namely:

- Allowing new insurance licenses for innovative players; and
- Increasing the caps on foreign equity participation.

According to the BNM announcement of April 27, the Malaysian finance and insurance sector has expanded by 8.8% per annum between 2006 and 2008, outpacing the growth in GDP, whilst the growth of the Islamic banking and Takaful sector has averaged about 20% per annum between 2003 and 2008. After over a decade of industry consolidation, rationalization and strengthening of domestic insurers and Takaful operators, the recent announcement of the Liberalization Plan is indicative of a 'coming of age' and of a new phase in the growth of the Malaysian conventional insurance and Takaful industries; a new phase which will be marked by a limited number of new licenses in specialized lines of business for new players with innovative and strong value propositions and an increased opening up to competition from foreign insurers.

For foreign insurers with a robust business plan focused on, *inter alia*, new product offerings, technical skills and expertise to support the provision of such new products, ability to enhance insurance and Takaful penetration, and concrete plans for regional and international expansion of their Malaysian operations, there should be some opportunities for new licenses and greater opportunities for M&A within the Malaysian insurance and Takaful spaces. Indeed, as mentioned in the introduction, for foreign insurers "*who can facilitate consolidation and rationalization of the [Malaysian] insurance industry,*" a higher foreign equity participation limit beyond 70% may be available.

If you have any questions regarding this alert or on any Asia insurance related matters, please contact any of the following people in the Asia Insurance Practice Group: Paul Chen (Hong Kong) at +852 3697 7008, Heng Loong Cheong (Hong Kong) at +852 3697 7019, or Bill Marcoux (London) at +44 20 7459 5001.

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