Asean Insurance Pulse 2023

An annual market survey

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ASEAN Insurance Pulse 2023

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Contents

Foreword Malaysian Re

This year´s 7th edition of the ASEAN Insurance Pulse is dedicated to the topic of inflation and its impact on the ASEAN insurers. The past year will go down as the one, when inflation returned. Jumping globally to almost 9 %, it had hovered around 3 % for most of the last decade. For Southeast Asia, the situation was similar: in 2020 we stood at 2 %, two years later we crossed 6 %.

The surge in inflation did not come in isolation. Risk managers worldwide spoke about a «poly-crisis», a year, when several crises – some of them rather unexpected – submerged into one large challenge. Inflation aside, headwinds blew from the continued high toll in natural catastrophes – globally and across Asia – the sudden invasion Russia´s into Ukraine, shortages in energy and food supply – coupled with steep price rises – disruptions of supply chains.

As risk takers our industry had to digest all of the above and its consequences too – swiftly rising interest rates, volatile bond and equity markets, and the contraction of the global reinsurance markets with its tightening of risk capacity. Inflation was sometimes at the core of these developments and sometimes just a symptom. Nevertheless, it spelt trouble to the insurers worldwide as it affects both the purchasing power and the security of consumers and corporate clients as well as the financial strength and profitability of insurers.

The ASEAN region, which consists partly of emerging and partly of mature markets, is no stranger to inflation. Nevertheless, complexity, speed and the altitude to which inflation surged within just a few months, present a novelty to most of us in this industry. As Malaysian Re, we were thus interested to know how the ASEAN insurers dealt with this phenomenon, where they saw key challenges, how well they were prepared and what they heard from their policyholders in terms of their needs.

Overall – without disclosing too much of our findings – our industry fared quite well and demonstrated its resilience in the past unprecedented 18 months. Nevertheless, inflation continues to pose a threat to our insurers´ underwriting, their investment and operational results as well as to the progress in strengthening our region´s insurance penetration and to policyholders' confidence in our products.

In this regard, we once again would like to express our deepest appreciation to the industry leaders who participated in this survey and shared their invaluable input with our researchers from Faber Consulting. We are also grateful to Bank Negara Malaysia, Malaysian General Insurance Association (PIAM), ASEAN Insurance Council and respective Insurance Associations of ASEAN countries for the steadfast support of the initiative.

We hope that you will enjoy reading the Pulse and we look forward to your feedback.

Ahmad Noor Azhari Abdul Manaf
President & Chief Executive Officer,
Malaysian Reinsurance Berhad

Foreword Faber Consulting

We are pleased to present the ASEAN Insurance Pulse 2023. This year's 7th edition focuses on the impact of inflation on the ASEAN insurers and how they tackled this challenge.

At a global level, inflation, which rose in many countries as a result of supply-demand mismatches and pandemic-related policy support, appears set to remain at elevated levels for an extended period. This scenario coincides with a marked tightening of financial conditions, weighing on a wide range of emerging and developing markets.

The impact of inflation on ASEAN insurance markets was less than in mature Western markets, as inflation in Southeast Asia was on average lower than in the US or the EU. The Russia-Ukraine war, for example, had less of an impact on ASEAN markets, and labour markets were not as tight as in Europe. In some ASEAN markets, inflation increased while local currencies depreciated, leading to higher costs for imports and thus increasing insurers' claims payments.

ASEAN insurers were not equally affected by inflation. Rates varied widely, with Vietnam and Thailand at the lower end and Laos and Myanmar at the higher end. Inflation also affected insurers differently, depending on their business model: those with a high share of personal insurance were hit harder than those focusing on commercial lines or reinsurance. Nevertheless, AM Best, which we interviewed in this edition again, concludes that the ASEAN insurers fared quite well, proving their preparedness and resilience.

Malaysian Re remains the indispensable guardian and partner of this publication. Through its continued support of the ASEAN Insurance Pulse, Malaysian Re demonstrates its commitment to the ASEAN insurers and to advancing regional markets.

We would like to express our deepest gratitude to Malaysian Re for once again enabling this research project, which will in turn benefit the entire ASEAN region. Finally, we thank our interviewees, the many insurers, brokers and members of associations that have shared once again their expertise and opinion so openly with us.

We hope that you will enjoy reading the 7th edition of ASEAN Insurance Pulse and consider its findings meaningful.

Henner Alms
Partner
Faber Consulting

Andreas Bollmann
Partner
Faber Consulting

Methodology

The findings of this report are based on 24 structured interviews with executives representing regional and international (re)insurance companies, intermediaries, policy makers and trade associations. The interviews were conducted by Faber Consulting, a Zurich-based research, communication and business development consultancy, from July to August 2023. Interviewees belong to the regional network of Faber Consulting or were recommended by Malaysian Re. In addition, the General Insurance Association of Malaysia (PIAM) encouraged their members to support this research. We would like to thank the following organisations for sharing their insights with us:

- AIG, Malaysia
- Allianz Ayudhya Assurance, Thailand
- AM Best
- ASEAN Insurance Council
- Berjaya Sompo Insurance Berhad, Malaysia
- BIDV Insurance Corporation, Vietnam
- Brunei Insurance and Takaful Association (BITA)
- Campu Lonpac Insurance, Cambodia
- Gallagher Re, Malaysia
- General Insurance Association of Malaysia (PIAM)
- Great Eastern General Insurance Indonesia, Indonesia
- Great Eastern General Insurance (Malaysia) Berhad, Malaysia
- Great Eastern Life Assurance Company Limited, Singapore
- Malaysian Re, Malaysia
- MSIG Insurance (Singapore) Pte. Ltd, Singapore
- Myanma Insurance Company, Myanmar
- National Insurance Company, Brunei
- National Reinsurance Corporation of the Philippines (Nat Re), Philippines
- Philippine Insurers and Reinsurers Association (PIRA)
- Swiss Re, Malaysia
- Syarikat Takaful Brunei Darussalam, Brunei
- Tokio Marine Kiln, Singapore
- Vietnam National Reinsurance Corporation (VINARE), Vietnam
- Wahana Tata Insurance, Indonesia

Key Pulse readings

The surge in inflation coined much of 2022. Caused by rising food and energy prices, demand pend-up during COVID-19, supply-chain disruptions, and labour shortages, it resulted in a tightening of monetary policy, capital market volatility and the depreciation of currencies in emerging markets. For insurers, inflation spelt trouble at all fronts – on the underwriting as well as on the investment side, in operations and, due to higher cost of capital, substantially tighter reinsurance markets.

Naturally, the impact of inflation varied greatly. Firstly, inflation rose to different levels across the ASEAN markets, with Vietnam, Brunei, and Malaysia at the lower end with less than 5 % and Myanmar and Laos at the upper end with close to or even above 20 %. Secondly, currency depreciation had a strong impact, with mature economies like Singapore trading in line with the major global currencies, while Malaysia, Indonesia or the Philippines depreciated significantly.

Inflation also affected insurers according to their business model. Non-life insurers with a bias on personal lines, particularly motor and property business, were likely to be hit hardest as higher cost for raw materials, spare parts, repair and labour drove up claims ratios. Medical insurers had to digest rising cost due to inflation too. For ASEAN affiliates which have their assets mostly managed at group level, the impact of inflation on their investment portfolio had less of an effect than for those, which had to realise losses on their bond portfolio due to losses on the underwriting side. And finally, the cost of operations varied greatly with insurers in markets such as Singapore spending a larger share of their budget on rising salaries.

IMPACT OF INFLATION PERCEIVED DIFFERENTLY

Given these discrepancies it comes as no surprise that the ASEAN insurers assessed the importance of inflation for their operations differently. The consensus is that it is a «relevant» challenge, but part of a flurry of different headwinds which hit the markets all at the same time. Inflation did not catch insurers off guard. It had already started to rebound before the end of the pandemic and in some ASEAN markets, had been part of their reality for quite some time. In addition, insurers had risk management measures in place to stress-test the impact of inflation on their book and reserves. However, a major concern was with policyholders, namely consumers, who often underestimate the risk of underinsurance.

In many ASEAN markets inflation was lower than in Europe or the USA. But in combination with currency depreciations and – typically for emerging markets – a bias for personal lines and short-tail business, and higher cost for imported goods and spare parts, raw material, repair and labour, inflation posed a substantial risk for ASEAN insurers. They had to keep a close eye on motor claims repair cost, construction and medical claims cost – ahead of the general consumer price index, which provided them with an indication of the willingness or ability or consumers to spend on insurance.

Claims costs were the biggest concern for insurers. However, the effect of deteriorating claims ratios was dwarfed by the tightening of reinsurance markets since the year-end renewals 2022. Insurers partly interpreted the hardening as a consequence of inflation, caused by the abrupt increase in interest rates and reinsurers´ costs of capital. Insurers´ investment returns were affected by the same token – the tightening of monetary policy led to a decline in fixed income securities and thus to rising unrealised – and in unfortunate cases also some realised losses. Top-line was affected too, as higher sums-insured drive premium volume. However, clients hit hard by rising prices might reduce their insurance buying.

PERSONAL LINES MOST AFFECTED

Motor, property and medical insurance were the lines most affected. According to some ASEAN insurers, prices for motor spare parts rose due to a combination of inflation and higher import costs by as much as 30 % to 40 % in some markets. Similarly, construction costs were up by 20 % to 30 %. In medical insurance, insurers saw a continuation of the double-digit medical inflation that markets had already witnessed for some time. Due to higher import and labour costs, medical inflation accelerated further. Reserves, however, posed no major concern. The lines most affected are mainly short-term liabilities, while long-tail risks are less affected. In addition, insurers had prepared for inflationary pressure, slightly adjusted reserves, and test its adequacy on a regular basis.

In times of inflationary distress, consumers tend to regard insurance as a dispensable cost which they limit by buying less cover, cancelling insurance or resorting to self-insurance. This affects particularly the personal lines. In case of underinsurance clients might declare a reduced property value – thereby taking the risk of underinsurance. Lower insurance spending may also affect the commercial lines, as inflation plus tighter rates and commissions force policyholders to reduce coverage.

Opinions diverged regarding the relevance of underinsurance. In some cases, insureds might lack the understanding or awareness to adjust premiums to the rising value of their assets. However, at least larger corporations will increase their sum-insured to reflect the impact of inflation. Insurers made quite some efforts to assure that clients remained properly insured. For policies that do not renew and adjust automatically or include escalation or inflation clauses, insurers launched educational campaigns explaining why premiums must rise.

Insurers reacted with a mix of measures to combat the impact of inflation on their underwriting portfolio. Price increases were the most frequently mentioned feature, affecting foremost motor and property – unless tariffed. Tighter market conditions were reflected by a hardening of terms and conditions – partly due to the developments in reinsurance. Insurers demanded that clients disclose how they manage their risk and asked for an updated valuation of assets to adjust sums-insured. Furthermore, insurers pruned their portfolio and reallocated capacity, often shifting from severity to frequency risks to reduce the amount of reinsurance cover needed. The quality of the account was a dominant theme with insurers systematically screening their portfolio, increasing deductibles to force clients to better understand their own risks. Ultimately, many claimed to have shed risks that they felt was not meeting their requirements.

Market overview

INFLATION IS LIKELY TO REMAIN HIGHER FOR LONGER

Inflation refers to increases in the cost of goods and services. The underlying drivers of inflation typically fall into three broad categories: First, «demand-pull inflation» results from dynamics rooted in the demand side of the economy, while second, «cost-push inflation» gains momentum through the amplifying effect of increased input costs on the supply side of the economy. In addition, the path of inflation can be influenced by the third factor, «inflation expectations», where households' and firms' perceptions of future price developments can have a tangible impact on actual future prices.

At a global level, inflation, which was already on the rise in many countries as a result of supply-demand mismatches and pandemic-related policy support, appears set to remain at elevated levels for an extended period. This scenario coincides with a marked tightening of financial conditions, which is weighing on a wide range of emerging market and developing economies. The impact is manifesting itself in rising borrowing costs and the looming specter of capital outflows.

According to the European Economic Governance and EMU Scrutiny Unit[1], the Russia-Ukraine war has led to a further profound shift in the dynamics of energy and food prices in many countries. In particular, Russia's important role as an energy supplier has been curtailed, leading to a significant increase in energy and food valuations. Expectations of impending shortages, especially of natural gas, have pushed up energy prices. At the same time, the escalation in food prices has a dual cause: first, because of the agricultural strength of Russia and Ukraine, and second, because energy plays a central role in the production and transit of food. This twofold increase in energy and food inflation has in turn spread through the price structure, affecting the production of various goods and services, and triggering the automatic indexation of both consumer goods and wages.

FOOD AND ENERGY ARE THE MAIN DRIVERS OF GLOBAL INFLATION

Global inflation was initially on a moderating path as the pandemic took hold, and this down- and sideward trajectory continued through the early stages of the crisis. However, a significant increase in prices from the second half of 2020 onwards drove inflation steadily higher, maintaining its upward trend until the end of 2022. In particular, the average global cost of living increased more in the 18-month period from early 2021 to mid-2022 than in the cumulative five-year period preceding this phase.

The IMF has identified food and energy as the main catalysts for this surge in inflation. Since the beginning of 2021, the average impact attributable to food alone has exceeded the overall average inflation rate observed from 2016 to 2020. To elaborate further, the pace of food-related inflation has paralleled the erosion of global living standards in tandem with overall inflation, which includes all consumption, over the five-year period immediately preceding the pandemic. This analogous story extends to energy spending, both through direct influence and through the spillover effect of higher transport costs.

In addition, due to the pandemic, consumption had been forestalled. However, when lock-down measures were lifted, penned-up demand was met by supply-chain disruptions and dislocations as market had not opened simultaneously. Finally, in mature markets, economies have to deal with a shortage in labor – partly caused by the pandemic – but mainly due to the fact that the large baby boomer generation is heading for retirement.

1 https://www.europarl.europa.eu/RegData/etudes/IDAN/2023/741487/IPOL _ IDA(2023)741487 _ EN.pdf

FIRST SIGNS OF EASING INFLATIONARY PRESSURES IN ASIA

According to the IMF's May 2023 Regional Economic Outlook for Asia and the Pacific, there are signs that inflationary pressures are easing, both within Asia and globally. Across Asia, the inflation trajectory has already been on a moderating path since mid-2022, a trend attributed to the decline in commodity valuations and lower transportation costs. At the same time, the fundamental force driving headline inflation in Asia has shifted to rising core inflation, reflecting a broader global pattern. Specifically, core inflation in the majority of Asian economies remains above central bank benchmarks, albeit at a moderate pace relative to the global panorama.

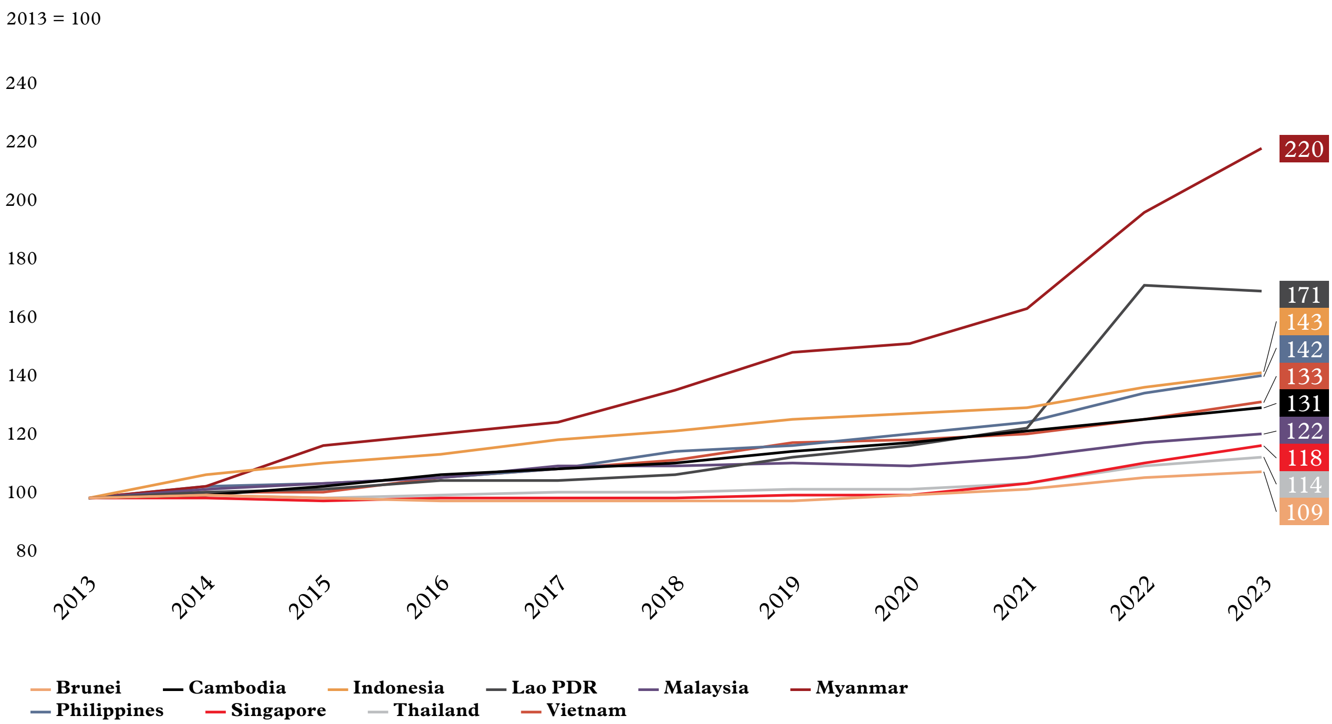
Core and headline inflation: Two different concepts

Core inflation is based the Consumer Price Index (CPI), which captures the inflationary movement of all goods and services, excluding the capricious fluctuations of food and fuel prices, excise duties, income taxes and other financial investments. This measure serves as a compass for governments to anticipate the trajectory of long-term inflation trends within an economy.

Conversely, headline inflation serves as an umbrella term that encompasses broad measures of inflation across the economic spectrum. It typically also includes commodities such as energy (including oil and gas valuations), food and beverages. The sensitivity of food and energy prices to rapid changes makes this form of inflation more volatile and easily influenced.

The acceleration in Asian core inflation gained momentum in the second half of 2022, coinciding with the gradual relaxation of COVID-19 containment measures in the region. This easing catalyzed increased mobility and stimulated domestic demand, which was particularly evident in emerging markets (excluding China).

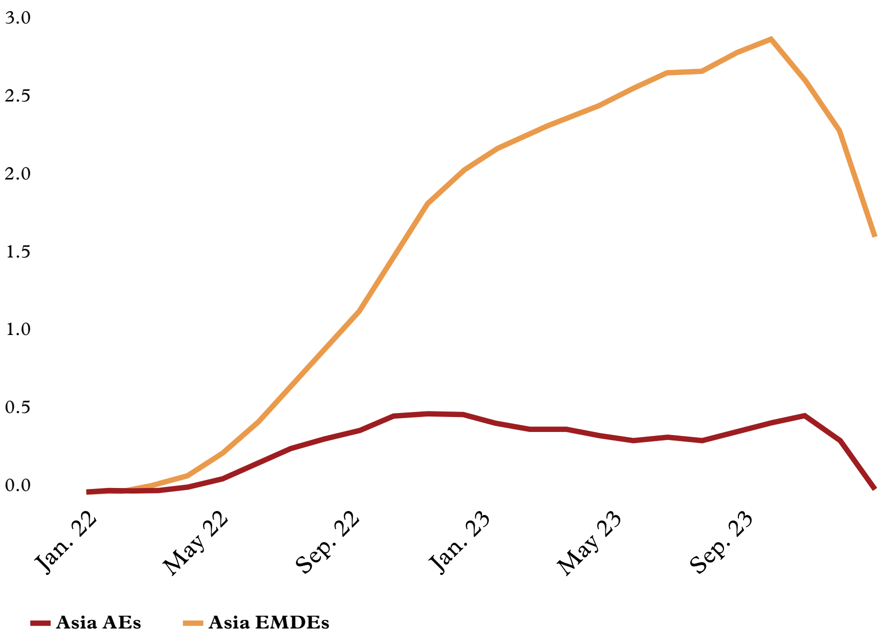
Chart 1: Inflation, indexed end of period consumer prices, 10 ASEAN countries
Source: Faber Consulting AG, based on IMF World Economic Outlook Database April 2023 data
2022: Estimates for Cambodia, Lao PDR, Malaysia and Myanmar
2023: Estimates for all countries



RISING COSTS OF IMPORTED GOODS WAS A MAJOR CONTRIBUTOR TO INCREASING INFLATION RATES IN ASIA

So-called imported inflation is a major contributor to rising inflation rates in Asia. Imported inflation refers to the increase in domestic prices of goods and services caused by the rising cost of imported products. Exchange rate movements can contribute significantly to imported inflation: If a country's domestic currency depreciates against the currencies of its trading partners, the cost of imported goods and services denominated in foreign currency will rise. This, in turn, can lead to higher prices for imported products in the domestic market. The IMF calculates that in 2023, exchange rates will contribute between two and three percentage points to headline consumer price inflation (CPI) in emerging market and developing economies (EMDEs) in Asia, much more than in advanced economies (AEs), where they amount to about 0.5 percentage points.

Chart 2: Estimated contribution of the exchange rate to headline CPI in Asia, percentage points
Source: IMF Regional Economic Outlook Asia and Pacific, May 2023



Advanced economies (AEs) include Australia, Japan, Korea and New Zealand. Emerging economies (EMDEs) include China, India, Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

The IMF suggests that central banks in Asia should focus on achieving a sustained return of inflation to target. They recommend maintaining a tight monetary stance for an extended period of time to prevent inflation expectations from dissipating. The downside of failing to keep inflation below target is likely to outweigh the benefits of maintaining loose monetary conditions. Insufficient tightening in the near term could require much stronger future monetary action to prevent high inflation from becoming entrenched, increasing the likelihood of a more severe economic contraction.

However, ASEAN central banks were under significant political pressure to tread carefully in raising rates. Monetary tightening was heavily debated, as it was feared that it would affect consumption and the ability of consumers or companies to service their debts, thus potentially stalling the economy.

In the context of Asia, several indicators point to the need to maintain tighter monetary conditions for an extended period. For example, the substantial depreciation of Asian currencies witnessed up to October 2022 could lead to significant price pressures, even with the partial reversal of exchange rates since then. If the exchange rate volatility seen in the region in 2022 persists, inflationary pressures are expected to peak in the second half of 2023. This would imply price increases of more than 2 % in Asia's emerging markets and around 0.5 % in advanced economies.

Exchange rate movements can also affect the cost of production for domestic industries. For example, if a country relies on imported raw materials or intermediate goods for production, a depreciation of the domestic currency can increase the cost of these inputs, potentially leading to higher production costs and inflationary pressures. Central banks often consider exchange rates as part of their monetary policy decisions. In some cases, central banks may intervene in the foreign exchange market to influence the value of the domestic currency.

INFLATION MOST PRONOUNCED IN NON-LIFE INSURANCE, PROPERTY AND MOTOR TO BE HIT HARDEST

Insurance markets around the world are already feeling the effects of an economic downturn combined with high inflation. First, demand for insurance naturally falls in times of slowing growth. But more importantly, insurers and reinsurers have liabilities in the form of obligations to policyholders. These liabilities arise from insurance policies issued to individuals or organisations. If inflation rises, the future cost of goods and services, such as healthcare or property replacement costs, may increase. This may result in higher claims payments for insurers, which will affect the present value of their policy liabilities. If premiums collected do not keep pace with claims inflation, insurers may find that their liabilities exceed their available assets, resulting in underfunded liabilities and potential financial distress. Thus, although inflation will also affect the asset side of insurers' balance sheets, the main impact is likely to be an increase in claims costs, which will be particularly pronounced in non-life insurance as opposed to life insurance where benefits are built in from the outset.

The property and motor vehicle sectors are expected to be most affected. In the construction sector, supply chain disruptions and labor shortages have led to an increase in repair and rebuilding costs. This has already been reflected in rising insurance claims. Similarly, the motor insurance industry is facing escalating claims costs due to component shortages that have kept new and used car prices at historically high levels.

But the impact is not limited to these lines of business, as the ripples are also being felt in personal accident, motor liability and general liability. The continuing rise in inflation is also having an impact on bodily injury claims. To counter the negative impact of rising claims costs on their bottom line, insurers need to understand the fundamentals of inflation in their respective market environments. They should therefore take strategic steps to rebalance their financial base and recalibrate their reserve management procedures.

RISING INFLATION IS TAKING ITS TOLL ON NON-LIFE INSURERS: CLAIMS PAYOUTS UP BY MORE THAN 5 %

Soaring inflation rates have already taken their toll on property and casualty (P&C) insurers, revealing a world of financial challenges, according to Swiss Re. While the lingering effects of natural catastrophe losses have also contributed to the deterioration in P&C loss ratios, the real impetus for this predicament has been the abrupt rise in economic inflation. The global reinsurer estimates that inflation, taken in isolation, has increased P&C claims payouts in five selected key global markets by a margin of 5 % to 7.5 % over the period to 2022. For 2023, Swiss Re's projections herald an additional increase of between 3.5 % and 6.5 %, a result deeply rooted in the far-reaching impact of inflation.

In the property sector, a short-term business that is highly sensitive to the effects of inflation and rising construction costs, Swiss Re estimates an increase in claims payouts of between 6 % and 13 %, demonstrating the direct sensitivity of real estate companies to the vagaries of inflation. This trend is expected to continue through 2023, with an estimated incremental increase of between 3.5 % and 10 %, highlighting the ongoing evolution of the industry.

However, there are already signs of a gradual moderation in the development of property and casualty claims. This is closely linked to inflation rates, which are already falling slightly, and could help to alleviate the recent underwriting burden. For this to happen, however, it is essential that insurers maintain their pricing discipline and avoid a softening of policy conditions. In contrast, inflation is expected to continue to rise in many other claims-related cost categories, such as labour and medical costs.

RISK MANAGEMENT STRATEGIES CRITICAL TO MITIGATING THE IMPACT OF INFLATION ON ASSET VALUES

Inflation can also affect the investment returns of insurers and reinsurers. Insurers typically invest the premiums they collect to generate returns and meet their liabilities. However, in periods of high inflation, investment returns may not keep pace with rising expenses or claims costs. Most ASEAN insurers and reinsurers often hold a significant portion of their investment portfolios in cash and fixed-income securities such as bonds. Rising inflation can erode the purchasing power of cash and reduce the purchasing power of future interest and principal payments, leading to a decline in the real value of cash and fixed-income investments. This can lead to a decline in the market value of existing investments, which can affect the insurer's balance sheet. According to Swiss Re research[2], interest rates in Asia have not risen as fast or as much as in the West because inflation has been lower, allowing for a more gradual repricing of assets and easing concerns about asset-liability mismatches.

Some insurers and reinsurers also invest in real estate assets, such as commercial or residential property, as part of their investment portfolios. Inflation can have a direct impact on the value of these assets. In periods of high inflation, property prices may rise, increasing the value of property investments. However, inflation can also lead to rising construction costs and higher property maintenance costs, which can affect the profitability of these investments.

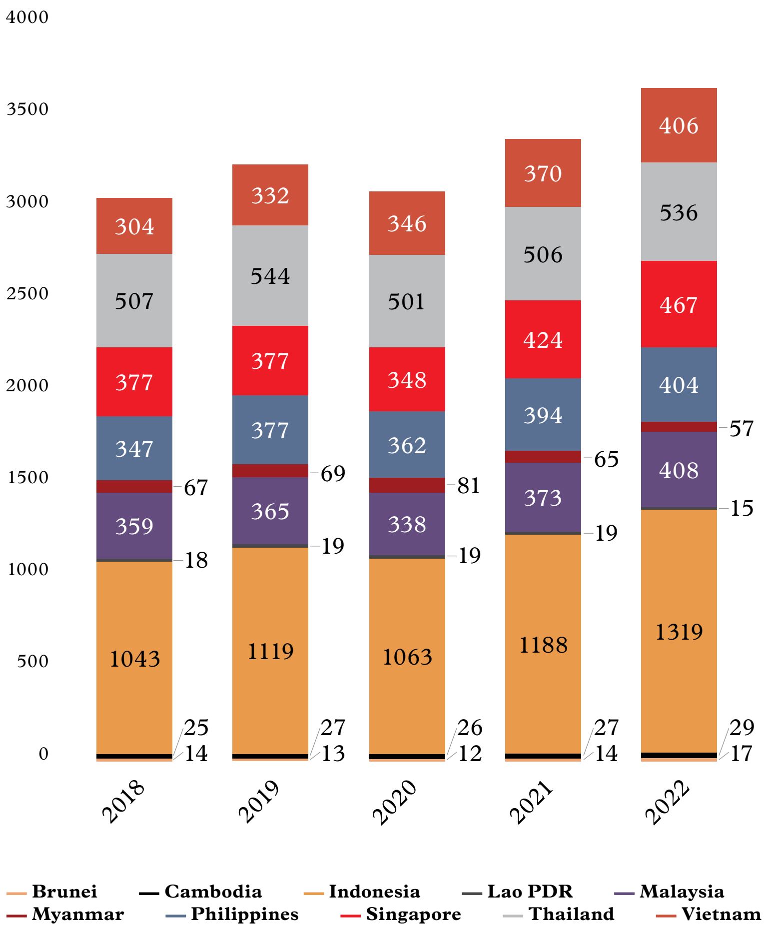
In addition, some re-/insurers may have equity investments in their portfolios. Inflation can affect the performance of these equity investments and, consequently, asset values. Inflation expectations tend to influence investor sentiment, market volatility and corporate earnings. Therefore, changes in the level of inflation can affect the profitability and valuations of companies, leading to fluctuations in equity prices. Therefore, inflation may affect the fair value of equity investments held by insurers and reinsurers.

2 Swiss Re Institute (2023), sigma No 3 / 2023: World Insurance: stirred, and not shaken

ASEAN CONTINUES TO RECOVER QUICKLY FROM THE ECONOMIC IMPACT OF COVID-19

After a pandemic-induced GDP decline in almost all ASEAN countries in 2020 – only Myanmar and Vietnam recorded GDP growth that year – the ASEAN region as a whole returned to a growth path from 2021 onwards. Only Laos and Myanmar experienced GDP declines between 2021 and 2022. According to the World Bank, economic activity in the Lao PDR has been weighed down by structural challenges, macroeconomic instability, and a deteriorating external environment. In Myanmar, the reasons are similar: household incomes remain weak, limiting the ability of domestic demand to drive growth. High prices and shortages due to import restrictions make it difficult for many businesses to obtain essential inputs, and power cuts are common.

Chart 3: GDP current prices, ASEAN member countries, 2018–2022, USD billion
Source: IMF World Economic Outlook Database, April 2023



Estimates start after 2020 (Lao PDR, Myanmar), 2021 (Brunei, Cambodia, Malaysia, and Thailand)

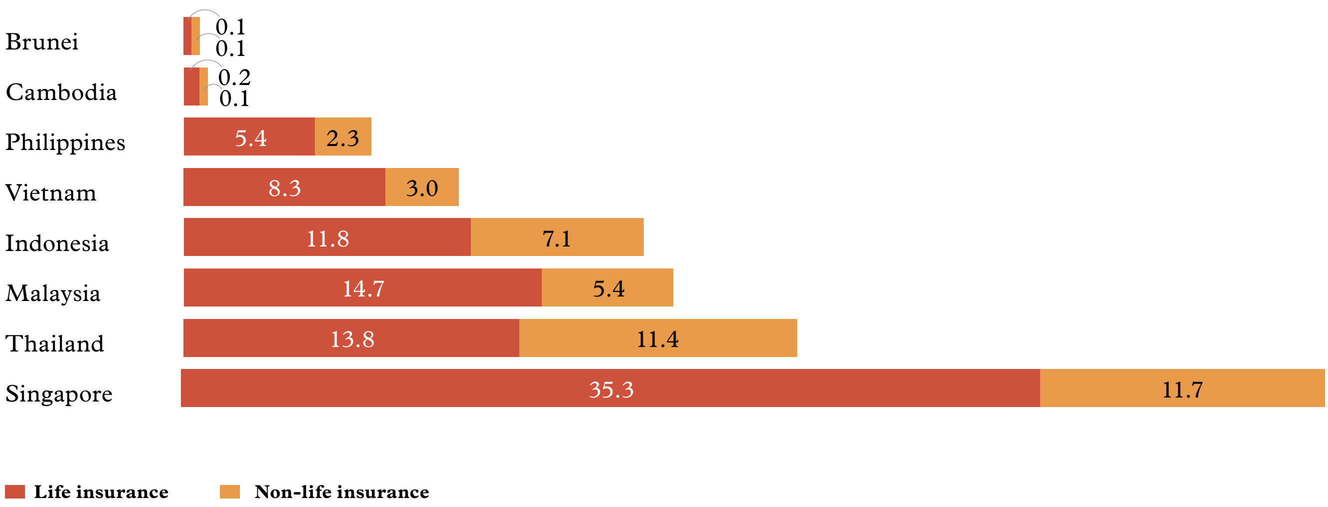
SINGAPORE IS ASEAN'S LARGEST INSURANCE MARKET, LIFE INSURANCE DOMINATES WITH A 70 % SHARE

According to Swiss Re, life insurance premiums in global emerging markets grew by 1.4 % in 2022, below the expected trend. In emerging Asia, however, real premiums grew much faster at a rate of 3.7 %, making this region the growth leader in 2022. The driving force behind this remarkable growth is the substantial 8.2 % expansion of the Indian life insurance market, which took premium volumes to an impressive USD 100 billion.

Looking ahead, global reinsurers see a positive outlook for the region's life insurance segment. A real growth rate of 3.8 % is forecast for 2023, and the optimism continues into 2024 with a projected growth rate of 4.7 %. Notably, these projections remain above the established long-term growth trend of 3.8 %, with India once again expected to lead the way in driving growth within this sector.

In 2022, real non-life insurance premiums in all global emerging markets grew by 2.8 % in 2022. In emerging Asia (excluding China), this segment grew by 6.0 % in 2022 and is forecast to grow by 6.6 % in real terms in 2023, close to the 2012–2021 average (6.3 %).

Chart 4: Selected ASEAN insurance markets, 2021*/2022 gross direct premiums, life and non-life business, USD billion
Source: Faber Consulting AG, based on Swiss Re Institute, sigma 3/2023, sigma-explorer.com for Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam.
Insurance Regulatory Authorities: Brunei (2021) and Cambodia



* Brunei

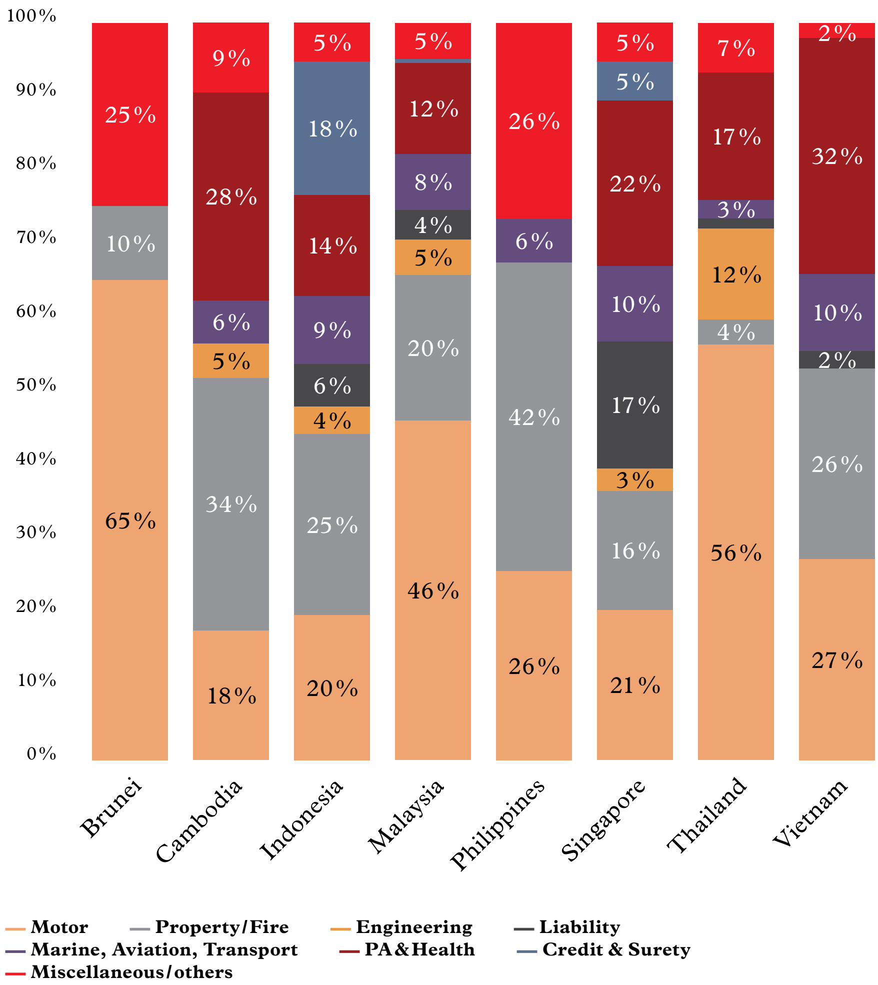
In 2022, total insurance premiums in ASEAN amounted to more than USD 130 billion – approximately USD 90 billion life and USD 41 billion non-life premiums. In all markets, the share of life premiums is higher than that of non-life premiums. In Malaysia, Singapore and Vietnam, the share of life premiums is particularly high at around 75 % of the total market, while in Thailand the shares of the two market segments are quite close at 55 % and 45 % respectively.

MOTOR INSURANCE: HIGH PREMIUM VOLUMES IN ASEAN, BUT VERY VULNERABLE PROFITABILITY

In Brunei, Malaysia and Thailand, motor is by far the most dominant non-life insurance line of business, with a share of around 50 % or sometimes higher. In the Philippines and Cambodia, property/fire has the highest share, while in Vietnam it is health/medical. The compulsory nature of certain motor and health insurance products in many insurance markets around the world means that while these two lines of business generate relatively stable premium volumes, they are also highly competitive, resulting in intense price pressure and often very low profitability. If systemic external shocks, such as an unexpected rise in inflation, are added to these low-margin segments, the combination of relatively high premium volumes and inadequate profitability, or even losses, can lead to a serious crisis for individual companies or even the market as a whole. In markets where certain insurance products are tariffed, failure to adjust tariffs to inflation, or to do so too slowly, can significantly increase the risk of underpricing.

Chart 5: Selected ASEAN non-life insurance markets, lines of business split, 2021/22*

Source: Faber Consulting AG, based on data provided by national insurance associations and regulatory authorities



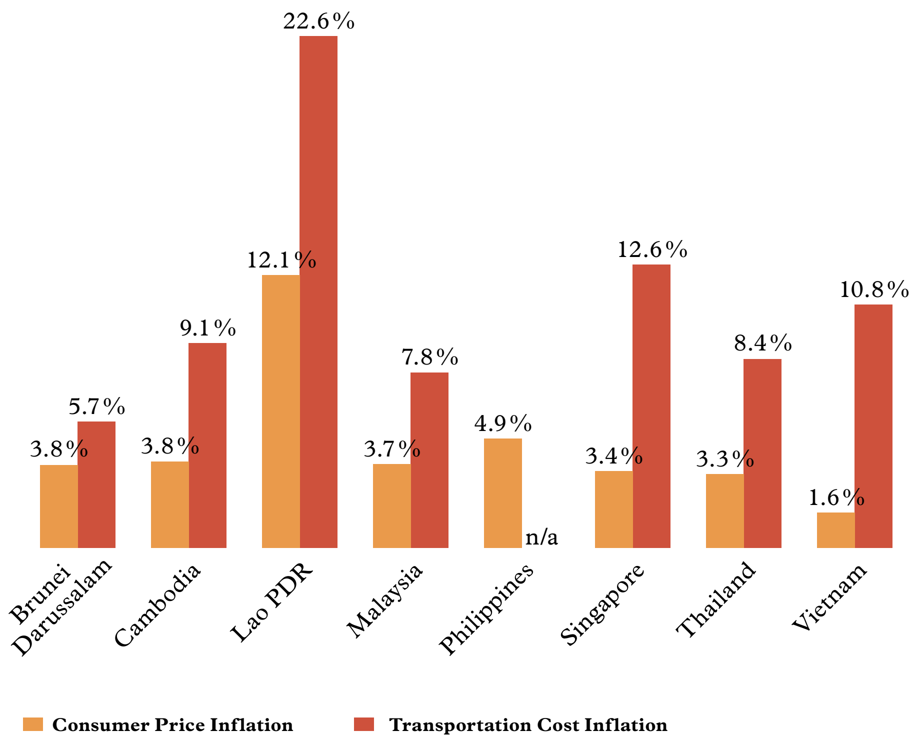
* 2021: Brunei, Philippines, Vietnam; 2022: Cambodia, Malaysia, Singapore, Thailand; Q1-2023: Indonesia

TRANSPORT PRICE INFLATION MUCH HIGHER THAN CONSUMER PRICE INFLATION IN ALL ASEAN COUNTRIES

In the context of this study, we decided to take a closer look at the relationship between inflation and its possible impact on the claims burden in motor insurance, given the high share of motor premiums in total premiums, the low resilience to external shocks combined with low profitability and the good data availability. In order to establish, on the basis of publicly available statistics, a link between macroeconomic developments, such as an increase in the inflation rate, and a potential impact on the insurance business, for example through increased claims costs in certain market segments, such as motor insurance, it is necessary to take a closer look at the composition of what is known as the Consumer Price Index (CPI).

In practice, most CPI calculations involve the calculation of weighted averages of the percentage price changes of a particular group of consumer goods, known as a «basket». These weights reflect the relative importance of the products in household consumption over a given period. In order to coordinate and harmonise the process of collecting CPI data worldwide, international organisations have agreed to designate the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) as the entities responsible for collecting and disseminating national CPI data at the international level. As part of this data collection initiative, countries are required to report both the all-items headline index and more detailed indices and associated weights for 12 sub-categories of consumer expenditure. These 12 sub-categories include «health», «communication», «education», «food and alcoholic beverages», but also «transport». According to the IMF classification, transport prices cover «transport services», the «purchase of vehicles» and the «operation of passenger transport equipment», which includes parts and accessories for passenger transport equipment, fuel and lubricants, and the repair and maintenance of passenger transport equipment. This index can therefore also give a first indication of increased costs for vehicles and their spare parts, which in turn can have an impact on the loss ratio in motor insurance.

Chart 6: Consumer Price Inflation (CPI) and Transport Cost Inflation in selected ASEAN countries, Compound Annual Growth Rates 2020–2022, in %
Source: IMF

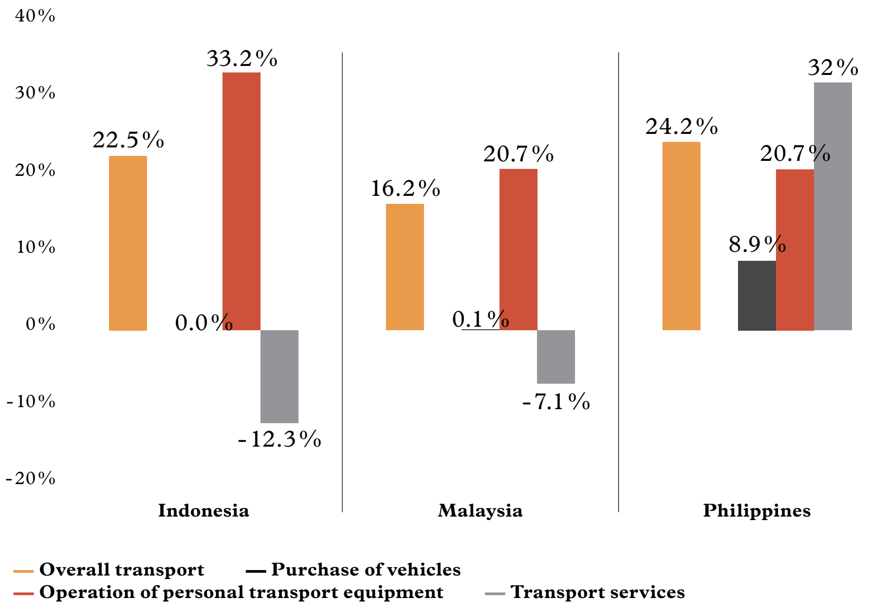


When CPI and transport prices are compared across all ASEAN countries, it is striking that transport-related prices increased significantly faster than general and broad-based consumer price inflation between 2020 and 2022. The collection and publication of more detailed data on the 12 sub-categories of the CPI is primarily the responsibility of the national statistical offices in the ASEAN countries. As a result, these data are not always uniformly available to the public, so we have taken a closer look at price developments for the underlying sub-categories of transport in Indonesia, Malaysia and the Philippines.

THE COST OF OPERATING PERSONAL TRANSPORT EQUIPMENT WAS A MAJOR DRIVER OF OVERALL TRANSPORT COST INFLATION

A closer look at the parameters influencing the overarching category of transport costs shows that in all three countries considered here as examples, the category «operation of personal transport equipment» was a major driver of the overall increase in transport costs. In Malaysia and Indonesia, the increase in transport costs can be attributed solely to cost increases in this category, while in the Philippines it was a combination of this category together with a significant cost increase in the category «passenger transport services». In Indonesia and Malaysia, prices for «purchase of vehicles» remained constant over the period, while the cost of «transport services» fell significantly in both countries.

Chart 7: Transport Price* Inflation in Indonesia, Malaysia and the Philippines, January 2020–June 2023, in %**
Source: National Statistical Offices of Indonesia, Malaysia and the Philippines

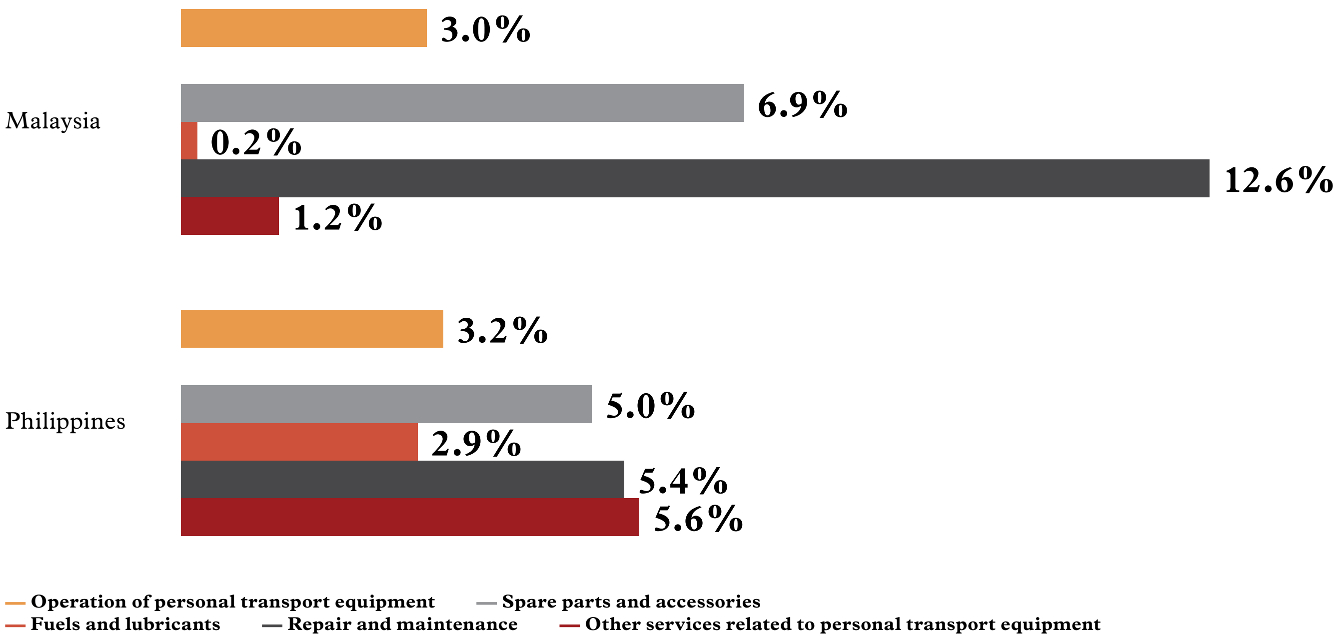


* Philippines: Transport Services of Goods only; Indonesia and Malaysia: Overall combined cost of Passenger Transport Services and Transport Services of Goods
** Indonesia: January 2020 – December 2022

THE IMPACT OF INFLATION ON MOTOR CLAIMS IN ASEAN: RISING COSTS OF SPARE PARTS, MAINTENANCE, AND REPAIR

In the international statistics, the cost of «operation of personal transport equipment» is made up of the components «spare parts and accessories», «fuels and lubricants», «repair and maintenance» and «other services in respect of personal transport equipment». The significant increase in the cost of «operating personal transport equipment» in all ASEAN countries over the period from early 2021 to mid-2022 is mainly due to a dramatic increase in the price of petrol and diesel in most of the countries. In the Philippines, for example, fuel prices more than doubled over the period. Although they have since fallen, they are still significantly higher than at the start of the period. Therefore, we have limited the time frame for a more detailed analysis of the components of the cost of «operating personal transport equipment» to the period from early 2022 to mid-2023, after the worst fuel price fluctuations have passed.

Chart 8: Operation of personal transport equipment price* inflation in Malaysia, Q1/2022 – Q2/2023 and in the Philippines, January 2022–June 2023, in %**



Looking more closely at the individual components that have driven up the cost of «operating personal transport equipment» in Malaysia and the Philippines over the past 18 months, it can be seen that in Malaysia in particular, it is almost exclusively the significant increase in the cost of spare parts and a sharp rise in repair costs that have led to the substantial increase in costs in this area. In the Philippines, too, these two components have been the main drivers of cost increases in this area since the beginning of 2021, much more so than, for example, the rise in fuel prices. The early detection of price increases in spare parts and repair costs is therefore crucial for insurance companies, as price increases in these areas – in contrast to rising fuel prices – are immediately and directly reflected in rising claims costs under motor insurance contracts.

THE IMPACT OF RISING PRICES ON CLAIMS COSTS IS UNDISPUTED, BUT DIFFICULT TO QUANTIFY

However, it is not clear whether and to what extent the higher cost of spare parts and repair services over the period also led to a rise in the motor loss ratio. For example, although the overall motor loss ratio in Malaysia increased very significantly from 55.6 % in 2021 to 65.3 % in 2022, it should be noted that the ratio was also well below the long-term average during the COVID-19 pandemic due to limited mobility. In addition, major flood events in the first quarter of 2022 also pushed up the loss ratio. Despite these uncertainties, the early identification of a significant increase in the claims inflation rate above and beyond general inflation is critical for insurers, as a quick response to these developments can at least ensure that the core function of insurance, namely the payment of insured claims, can be carried out without financial difficulty.

CLOSE MONITORING OF PRICE DEVELOPMENTS FORMS THE BASIS OF COUNTER-INFLATIONARY STRATEGIES

In the face of high rates of inflation, the main challenge for insurers is not the rapid rise in prices, but when either the speed or the magnitude of the changes in inflation rates are unexpected. Advanced data analytics can help insurers monitor claims trends and identify early signs of claims inflation. This information can serve as a basis for pricing strategies and policy adjustments. On the other hand, it is a positive development for insurance customers to have bought cover at a time when the cost was relatively lower than the rising cost of, for example, car repairs, as this increases the value of their insurance. While insurers will undoubtedly seek to restore profitability in the long term through inevitable premium increases, there remains a benefit from the policyholder's perspective: Premiums are likely to be adjusted later on due to unforeseen inflationary developments.

To avoid significant losses in premium volume, insurers may decide to spread necessary premium adjustments over several years, motivated by self-interest in the face of higher cost of living, as evidenced by the rise in the CPI. Soaring bills will necessitate premium increases, further eroding policyholders' purchasing power and potentially leading households to reduce non-essential cover. However, if insurers manage the challenges effectively and limit the adverse impact on profitability, the capacity of the non-life market and the supply of insurance should remain stable.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INSURERS CAN PARTIALLY MITIGATE CLAIMS INFLATION RISK THROUGH CONTRACT DESIGN

The most common underwriting response to claims inflation is to re-price insurance risks with elevated claims costs. The need and extent to which this is done will vary depending on the underwriters' assumptions about the central bank's ability to contain inflation within a reasonable timeframe, the competitive environment in the relevant insurance markets and the degree of regulatory constraint and interference. For insurers, it is also important to engage in a dialogue with policyholders, highlighting the risks of inflation. Insurers can educate policyholders about the potential impact of inflation on their cover and the importance of regularly reviewing and adjusting their policies to ensure adequate protection. In addition to repricing, which may take some time, proactive insurance contract design offers alternative ways to mitigate inflation risk. The following measures may be considered:

1 Indexation: Insurers can tie coverage limits, deductibles, and policyholder retentions to an inflation-related index. This allows these parameters to automatically adjust for inflation, reducing the risk of coverage becoming inadequate over time.

2 Claims-made policies: The move to claims-made policies means that coverage applies only to claims reported during the policy period, regardless of when the actual loss or event occurred. This can help insurers to better control and predict their exposure to past events that may lead to claims in the future.

3 Sunset clauses: Specify a predetermined future date after which the insurer will no longer respond to losses or claims. This can limit the insurer's long-term exposure to claims and mitigate the impact of inflation on older claims.

4 Shortening the duration of liabilities: For long-tail lines of business, insurers can reduce the duration of their liability by offering policies with shorter coverage periods. This limits the time they are exposed to claims and reduces the potential for claims inflation.

5 Reinsurance and risk transfer: Insurers can use reinsurance arrangements to transfer some of the risk of claims inflation to reinsurers. Reinsurers may offer contracts that provide additional protection against inflation-related losses.

6 Periodic review and adjustments: Insurers can include provisions for periodic policy reviews and adjustments to ensure that coverage and pricing remain in line with current market conditions, including inflation rates.

7 Inflation riders: Some insurance policies may include optional riders that specifically address inflation-related risks. Policyholders can choose to add these riders to their coverage for an additional premium.

Interview with AM Best – The impact of inflation on the ASEAN insurers, 14 August 2023

Greg Carter, Managing Director, Analytics and Michael Dunckley, Associate Director, Analytics at AM Best

In early 2022 inflation surged rapidly across the globe. How much of an impact has inflation had on ASEAN insurers?

Overall, AM Best´s ratings on ASEAN insurers have been broadly stable in 2023. We have seen mostly rating affirmations with only a few up- or downgrades. Inflation was not a major driver of the rating actions we have taken. Rather, where we saw negative rating actions, the causes were largely idiosyncratic, including some consolidations and some remaining issues due to Covid-19 related losses in specific Asian markets.

In fact, the impact of inflation on ASEAN insurance markets has been less than on mature Western markets, as inflation in South-East Asia was on average lower than in the US or the EU. For instance, the Russia-Ukraine war had less of an effect on the ASEAN markets. Also, labour markets are not as tight as in Europe, which was a further driver for inflation in those markets.

In some ASEAN markets we have seen an increase in inflation while in tandem local currencies depreciated, causing higher cost for imports, thus increasing insurers´ claims payments. However, this effect may vary from country to country, depending on the type of imports and between different lines of business and insurers. While in some markets, spare parts for cars were predominately imported from Europe – potentially causing substantially higher prices if the local currency depreciated against the Euro, the effect is quite different in ASEAN countries where spare parts mainly are sourced from Japan or are manufactured within the region.

In 2022 insurers have come under pressure from rising inflation, unrealised losses on their assets as well as the hardening of reinsurance markets. Which of these factors has had the most severe effect on ASEAN insurers?

The availability of reinsurance capacity, the rise in pricing and tightening of conditions is the most pressing issue. Contrary to Europe, the ASEAN insurers were less faced with a swift hardening in the 1/1 renewals, but a gradual increase which kept progressing throughout 2023. Insurers across South-East Asia, such as in the Philippines or Indonesia, have a significant natural catastrophes exposure. To them, reinsurance is fundamental to their business model. In assuming catastrophic risk, they are heavily reliant on support from international reinsurers.

The unrealised losses that insurers incurred due to the rapid tightening of monetary policy by the major central banks in 2022 triggered predominately an accounting effect as most insurers hold their fixed income bonds until maturity. Thus, the negative effect of the interest rate increase will evaporate over time. The effect would only materialise if insurers were forced to sell those bonds to bolster their liquidity position. However, that was hardly the case in the ASEAN markets. In fact, typically most insurers in the region are sufficiently capitalised and have strong liquidity positions.

Inflation has been less of a problem for the ASEAN insurance markets than for instance in Europe. Firstly, as already pointed out, inflation rates have been lower in most ASEAN markets. Furthermore, the rise in inflation was anticipated and insurers could take management action to prepare for it and counter it both in terms of their reserves and in pricing. Furthermore, inflation is more challenging for long-tail than short-tail business, as for liabilities with a long duration, the risk to misjudge the development of inflation is far greater. However, the ASEAN markets have a bias towards short-tails business as a high penetration in long-tail lines is more characteristic of the more mature insurance markets. In less developed markets, long-tail business is generally heavily ceded, so more of the inflationary risk sits with the reinsurers.

Inflation has not affected all ASEAN markets in the same way. Some have witnessed a combination of inflation coupled with a currency depreciation, others have seen just the effects of global inflation. Can we cluster the markets?

Insurers in the more developed ASEAN markets tend to have been less impacted by inflation than the developing markets. Firstly, their currency might have come less under pressure – thus rising prices for imports will have been less of an issue. Secondly, the portfolio of insurers operating in the more mature markets will be more broadly diversified with less of a bias on short-tail products. Markets with a large share of motor business for instance have seen a larger impact from inflation as spare parts and repair increased substantially, either due to labour or higher cost of imports.

Inflation has also affected insurers´ operational costs. How have insurers dealt with this?

Inflation weighs on insurers´ cost bases and can erode profitability. However, the ASEAN markets are a very competitive landscape and many insurers have already made substantial investments to digitise their operations and improve their efficiency and cost bases. In addition, inflationary pressure from the labour markets is not quite as intense as in the western markets, partly because the ASEAN population is significantly younger.

What was the level of preparedness of insurers when inflation started to rise in 2022? Did you see distortions as insurers underestimated the pace in which inflation increased?

In general, insurers in the ASEAN region were not caught off guard by the rise in inflation. Quite the contrary – the return of inflation had long been on the radar as a risk to eventually hit markets and was expected following the reopening of economies after the COVID-19 lock-downs. Thus, insurers had been able to plan for this event and the more sophisticated players stress-tested the impact of inflation on their balance sheets.

However – albeit well managed – we do not expect inflation to disappear. It will remain a major concern of the sector as inflation can be stubborn and take unexpected turns. Insurers thus need to continuously prepare, price and even reprice for its effects, because if they don´t keep up with inflation, it can have serious implications. In general, anticipated inflation should not pose a significant risk to insurers as they are able to adjust pricing and strategy accordingly. The risk is that inflation could be sudden and un-anticipated with substantial negative impacts on performance, and potentially also on capital.

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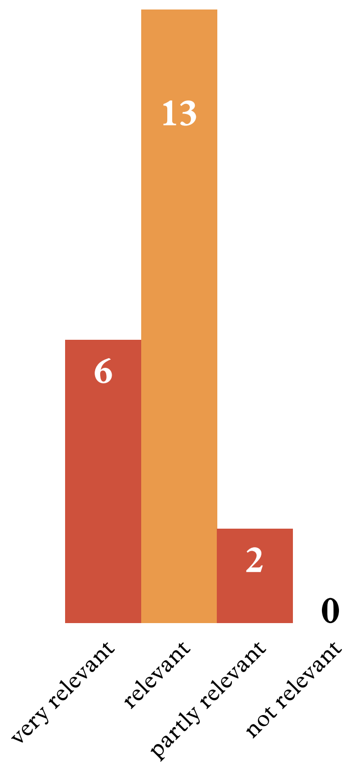
Survey results

ASSESSMENT OF INFLATION

Chart 9: Relevance and impact of inflation on insurers´ business



How relevant and impactful is the rise in inflation for your business?

Inflation did not affect all ASEAN insurers equally in the last two years. Not only did rates vary broadly with Vietnam and Thailand at the lower and Laos and Myanmar at the upper end. Inflation also impacted insurers differently according to their business model, those with a high share of personal lines were likely to be more affected than those focused on commercial lines or in reinsurance. In addition, the years 2022 – 2023 were characterised by a poly-crisis – multiple crises such as inflation, geo-political tensions, supply-chain disruptions, and high energy price fluctuations – all happening at the same time. It is thus not obvious to discern the impact of inflation from other factors which were important to the region´s insurers as well and sometimes overcast the effects from inflation, such as the tightening of the reinsurance markets, the capital market volatility or the devaluation of certain local currencies.

We had kind of anticipated the impact of inflation on claims on our books in 2022. The large losses from the Eastern Australian floods in the prior year had served as an eye-opener for the impact of inflation on claims payments, as we could see its effects on the cost for replacement materials as well as triggering a shortage in construction workers and thus causing further costs. In responding to the Malaysian floods, we thus closely engaged with clients and partners to pay claims as swiftly as possible and to avoid the long-tail impact of inflation on claims settlement.

Ahmad Noor Azhari Abdul Manaf, President & Chief Executive Officer, Malaysian Reinsurance Berhad

Insurers had been able to prepare for the onslaught of inflation. With the end of the pandemic and it´s multiple lock-down measures, economies were faced with pend up demand from stalled consumption. Often unable to spend during the pandemic years, consumers had been able to build up savings which they were now willing to release. Thus, insurers might have been caught by surprise by the speed and magnitude in which inflation rose, but that it was already in the making was far from unexpected.

According to most interviewees inflation is a relevant issue but did not manifest itself in ASEAN as dramatic as in other regions, such as Europe or the USA, where rates were higher. Insurers pointed out that while consumption and loss experiences in some sectors had already returned to pre-COVID levels as early as 2022 and prices had gone up substantially, insurers had not been able to increase rates in tandem – either because those rates are tariffed or because competition does not allow to increase rates as much as claims experience might necessitate.

It was thus predominately the personal lines insurers that emphasised the impact of higher cost of living on the lower income bracket of society. They see the effect of inflation on their claims ratio, firstly in property insurance where construction and material cost have risen substantially, in motor insurance where in combination with the depreciation of some ASEAN currencies the import costs of motor spare parts has risen largely and, thirdly, in medical and health insurance where an already quite dramatic medical inflation is feared to spin out of control.

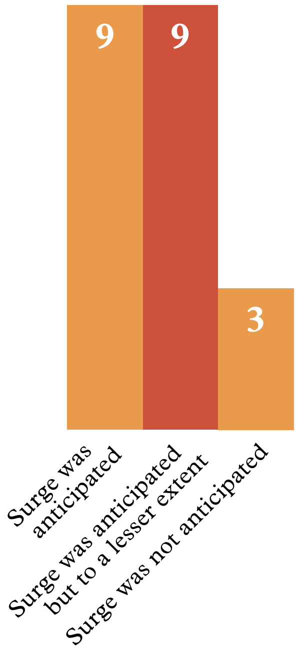
In addition, underinsurance posed a concern to insurers as policyholders do not adequately declare the rising value of their assets, possibly to avoid paying a higher premium and thus take the risk of a lower than expected insurance pay-out in case of a loss. It is thus upon the insurers to educate their customers of the potential effects of underinsurance and assure that the insured values are priced correctly.

Finally, insurers dread the impact of inflation on operations, particularly on salaries. However, labour markets are not as tight in most parts of Asia, as for instance in Europe, where the shortage in workers is seen as a driver for the rise in inflation. Besides, with the growing wealth and the rising impact of wages on the cost ratio, insurers have started to improve their efficiency and automate their processes where possible.

At Swiss Re the impact of inflation is reviewed on a quarterly basis as part of its regular process. Swiss Re could thus take the surge of inflation early into consideration in its underwriting and claims management. It was as a key topic in client conferences, and we alerted our cedants already last autumn of the risk of underinsurance, the need to adjust the sums-insured also with their policyholders and the potential raise in claims amounts.

Marcel Omar Papp, Head Retakaful, Swiss Re Asia Pte. Ltd., Malaysia Branch

Chart 10: Level of preparedness of ASEAN insurers



Did you anticipate the surge in inflation and, if so, how did you prepare?

The ASEAN insurers were aware and had anticipated the rise in inflation. In some countries like Vietnam, the inflation in 2022 did not surpass levels seen pre-COVID. Thus, what seems like a dramatic surge in some countries felt more like a return to the «courant normal». Interviewees fared differently only in the extent to which they had expected inflation to increase and at which pace.

Most players regularly – often quarterly – stress test their portfolio and reserves against the impact of inflation under different scenarios. COVID-19 had already contributed to improved risk management measures in ASEAN. According to interviewees this is a standard procedure for most insurers, particularly if they are part of a larger group. Furthermore, reinsurers also reminded their cedants to test the impact of inflation and to take measures on rate adequacy and reserving, enhancing the resilience of their book of business.

Insurers also contacted their clients – either directly or via their network of agents and brokers – to increase their sums-insured in avoiding underin-surance. However, while that risk is widely understood among commercial clients, the number of consumers who followed the recommendation of their insurers remained low with many of them purposely taking the risk of benefiting only from a partial pay-out in case of a loss.

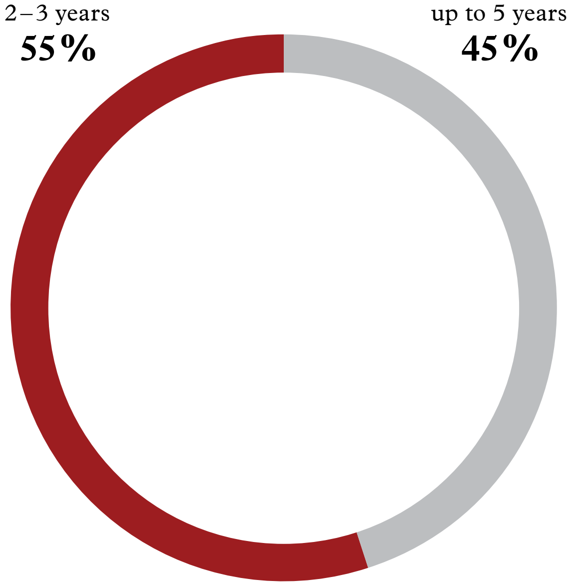
In addition to tackling the risk of underinsurance, insurers also try to adjust their pricing to the higher claims-ratio – particularly in motor insurance as spare parts and labour cost for the repair have risen beyond the inflation rate and cost in some markets over 20 % more than in 2021. However, either tariffs in motor insurance or tight competition often stood in the way of such action. Some insurers therefore decided to tighten conditions – where they could – or even reposition their portfolio – moving from fleets to personal cars and thereby reducing their reinsurance cover or systematically screening their portfolio for low performers, trying to terminate such policies.

Insurer´s experience with the impact of inflation in other regions has helped to prepare for its potential effects in ASEAN. The Australian floods from early 2021 for instance served as an eye opener for insurers in Malaysia following the massive flood losses in December of the same year. While the Australian insurers got caught by the sudden rise in inflation and had to pay higher claims as initially anticipated, insurers in Malaysia sped up the loss adjustment and claims payment process to avoid the long-tail inflationary impact on claims payments.

The experience of Covid-19 and the great floods of December 2021 have greatly elevated the awareness of Malaysians towards the need for insurance. Whilst this is positive for the industry, insurers need to remain focused on affordability for consumers, particularly the lower income group where the impact of inflation particularly on household essentials such as food forces them to make difficult decisions to prioritize food on the table over essential protection.

Antony Lee, Chairman of the board of PIAM

Chart 11: Probable length of inflation



Do you assume a rather prolonged (more than 3 years) phase of inflation, or do you expect inflation to subside again within the next three years?

A slight majority of ASEAN insurers expects that inflation will subside steadily in the next two to three years. Insurers see positive signs that it already peaked in early summer as prices for petrol and imports have started to come down. However, its further development is seen to largely depend on the monetary policy of the US Federal Reserve and the European Central Bank and the geopolitical developments.

These external drivers are also the main reasons, why the ASEAN insurers differ in their assessment of the length of inflation, with 45 % of interviewees expecting that it might take the main central banks in the mature markets longer than two to three years to reduce inflation to a level of two to three percent.

Locally, governments have taken action to curb inflation by subsidising food prices and sometimes petrol too, thereby reducing the effect of inflation on the lower income parts of society. Nevertheless, insurers still see the stress heightened inflation is causing, such as rising borrowing cost which will weigh on growth and construction activities, in particular. Furthermore, while most insurers expect inflation to flatten, a lack in foreign direct investments and the weaknesses and limited liquidity of their own currencies cause concern as this might mean that imports will remain expensive and thus claims ratio in motor insurance will stay high.

Although Thailand’s inflation rate is lower than in many other ASEAN countries, it is also very important for local insurers to not only react to inflation, but to proactively address the issue. For example, insurers could proactively offer higher limits to customers to avoid underinsurance due to inflation. Or they could adjust pricing to reflect the rising cost of claims, which is already affecting motor insurance.

Thomas Wilson, Country Manager, President & CEO, Allianz Ayudhya Assurance Pcl

Chart 12: The most relevant type of inflation that cause long-term concern

What type of inflation is most relevant to your business portfolio?

Given an insurance penetration of roughly 4 % for the ASEAN insurance markets, it comes as no surprise that the region´s insurers have a bias towards personal lines and property insurance. Motor repair cost determine very much the claims ratio for typically their largest line of business. Due to higher cost for imported spare parts and rising repair costs, the deteriorating claims ratio weighs heavily on the profitability of these insurers, particularly as their options to increase rates of motor insurance are limited.

The buyers of motor insurance will also present a good proxy for the type of consumers that many of the ASEAN insurers will target for most of their products. Their willingness or ability to spend or to cut on expenses might be a good indication of how they will behave not only in motor but across their lifestyle. In addition, the impact of inflation on motor insurance reflects not only rising replacement costs, but also the impact of social inflation, as insurers see an increasing willingness in third party liability courts to award higher compensation to victims.

The second most important index of inflation with high significance to the ASEAN insurers is the development of construction costs. Property presents the dominant line for many ASEAN insurers after or ahead of motor insurance. The prices for raw materials and labour had started to rise post-COVID, driven by high demand. The invasion of Russia into Ukraine further increased the prices for imports. In some countries, such as Malaysia, construction cost thus rose by 20 % – 30 %. For insurers which state that 80 % – 85 % of their portfolio is «property driven», an increase of that magnitude will have a substantial impact on their claims ratios.

For personal lines insurers which offer medical or health insurance products, the rising cost for medical treatments, products, pharmaceuticals and staff too has been a concern long before the COVID pandemic already. The further increase in medical inflation seen in the last 36 months is thus not an exception but the norm, according to many interviewees. While the number of claims quickly returned to pre-COVID levels after the end of the pandemic, insurers are working closely with partners such as hospitals or medical practices to contain cost, but thus far the steady rise in medical cost has proven to be rather «sticky».

The ASEAN insurers also keep a close eye on their market´s Consumer Price Index (CPI) as rising cost will affect consumers´ willingness to spend on insurance and it will provide an indication for the development of casualty lines as well, where premium volume is often tied to revenues. In addition, the CPI rate will also influence salaries of staff and therefore impact the operational cost of insurers.

We are concerned about the potential underinsurance of our customers. In order to manage the cost of insurance and thus make it easier for our customers to maintain their cover in times of rising inflation, we offer our customers an interest-free insurance premium repayment scheme through our Group's bank credit card facility. This allows customers to pay their insurance premiums in monthly instalments using the bank's credit card facilities.

Tio Soon Keong, CEO, Campu Lonpac Insurance PLC

EFFECTS OF INFLATION ON INSURERS

2022 was a difficult year for ASEAN insurers and inflation was a decisive factor. Firstly, insurers´ top-line had already come under pressure during the COVID years, when clients and consumers had tried to reduce what they felt were expendable expenses in some insurance lines. Inflation further heightened the cost pressure for some consumers and corporations. As a result, some refrained from increasing the sum-insured of their assets or simply decided to carry some risk themselves.

Inflation had the biggest effect on the bottom-line of insurers. It directly impacted the claims experience in motor, medical and property insurance – lines of business, which are tariffed in some ASEAN markets and are fiercely competitive too. Insurers thus struggled to reprice their book of business. Instead, they countered the rising claims through a more selective underwriting approach as the prices for motor spare parts increased by some 30 %–40 %, while replacement and freight costs for many of the numerous property losses from natural catastrophes in the region rose too.

Insurers are also battered with rising rates and conditions as reinsurance hardened substantially in the year-end renewals and throughout 2023. Reinsurers´ capacity was hit not only by continued large losses but also by higher cost of capital as interest rates rose. In fact, to many ASEAN insurers the tightened reinsurance markets had the most lasting and severe effect on their results. Insurers were mostly unable to pass on the higher cost to clients while – on top – reinsurers scrapped them of ceding commissions which had contributed to improve results.

Inflation also took its toll on the ASEAN insurers´ asset side. In response to the rapidly rising inflation, the central banks of the major currencies, the US Federal Reserve and the European Central Bank drastically tightened their monetary policy, toppling equity and fixed income markets. While higher interest rates will benefit investment returns in the long-term, short-term insurers had to grapple with a decline in equities as well as unrealised and some realised losses in the fixed income portfolio.

Finally, inflation also drove up the cost ratio of insurers as staff´s salaries increased and maintenance costs for operations rose. Insurers responded with intensified efforts to improve their efficiency and strengthened the automation of processes, where possible.

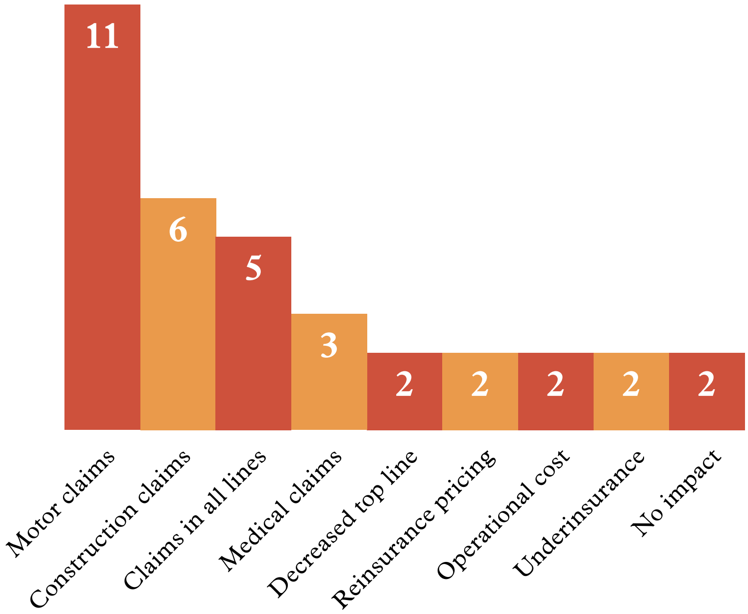
In 2023 the ASEAN insurers feared a further deterioration of their earnings – although not strong enough to affect their capital position, unless severe loss events aggravated the impact of inflation and higher cost. Insurers were helped by the continued GDP growth in the region. In addition, some of the headwinds from 2022 calmed down. Inflation seemed to have peaked by mid-year, while the reliability of supply chains recovered and energy prices relaxed somewhat. Overall, on the client side, insurers aim to work closely with their policyholders to adjust sums-insured appropriately and to also team up with partners to contain rising claims. In addition, tight reinsurance conditions force some insurers to rethink their portfolio and to position themselves in lines where they need less cover.

For the region´s reinsurers the situation was quite different. For those ASEAN reinsurers operating internationally, inflation and the depreciation of locally currencies had the opposite effect as for primary insurers. For those with a sizable international business, premium volume – most collected in US dollar – went up and therefore local currency depreciation had a positive effect on those reinsurers´ top-line. By contrast though, liabilities in foreign currencies also increased and hence, the reserving for certain lines such as motor or property underwritten in Europe or Northern America had to be increased too.

Accurate property values are critical in insurance as high inflation affects the cost of replacing damaged property and claims outcomes. To ensure that our customers are not under-insured in the event of a claim, we provide them with background information on the subject, e.g. in renewal notices, and help them to determine appropriate sums insured.

Aziz Adam Sattar, President Director, PT Great Eastern General Insurance Indonesia

Chart 13: Main impact of inflation on the liability side



Which lines of business have been / are affected the most?

The biggest impact of inflation has been felt in motor, construction and medical insurance. Other lines of business were hardly mentioned by our interviewees. In these three lines claims cost increased substantially. By early 2022, the frequency in claims in all three lines had rebounded to or even beyond pre-COVID levels. On top, inflation took its toll. In some ASEAN countries its impact was aggravated by the depreciation of the local currencies, such as the Ringgit in Malaysia. Where the currency stayed strong, such as in Singapore with the Singapore dollar, the effect was felt far less.

In motor, repair cost rose drastically, driven by increased cost for spare parts and higher labour cost. In some markets, claims ratios were also impacted in 3rd party liability by social inflation as the courts tend to award higher compensation for victims in traffic accidents. In construction, the situation followed a similar pattern with inflation driving up the cost for raw material and labour and currency depreciation worsening that effect. In addition, major ASEAN markets had experienced above average losses from natural catastrophes, further enhancing the need for repair, imports and freight cost, as machinery had to be ordered to restore manufacturing sites for instance in Malaysia, following the large flooding in December 2021.

The situation in medical insurance is different. While the number of claims rebounded quickly to its pre-COVID level too, the line had been faced with a double-digit claims inflation even prior to the pandemic. The economic inflation which kicked in by 2022, only worsened the situation, but did not alter it at all. The main parameters for a constant rise in medical expenses remain unchanged: improved but also more expensive technology, rising as well as changing demand, aging population and changing lifestyle driving an increase in critical illnesses, altogether more expensive treatments as also the cost for nursing and medical staff exploded. While none of these factors were new, inflation drove up the cost for imports and personnel.

In battering these inflated loss ratios, insurers responded by either increasing rates – where regulation and competition allowed – enforced a more selective underwriting to get out of loss making and low performing accounts, or shifted capacity into segments which were less exposed to rate increases – for instance moving from fleets and personal motor, which requires less reinsurance. Often enough though, insurers admitted that the rising costs were hurting their profitability, which in some cases they deemed bearable as margins were sufficient.

Vietnam's current inflation rate is below the average for the past 15 years, so it poses few problems for consumers and businesses. More important is the economic recovery following the COVID-19 crisis, which we believe is well underway.

Tran Trung Tinh, Chief Underwriting Officer, BIDV Insurance Corporation (BIC)

When we noticed an increase in our motor claims ratio in the spring of 2023, a portfolio analysis immediately showed that the cause was the increased cost of imported spare parts for a limited range of models. We responded by adjusting our prices for insuring certain car models to reflect these increased costs.

Klaus Tomalla, General Manager, National Insurance Company Berhad

Impact of inflation on the asset side

Similarly to the underwriting side, the ASEAN insurers´ assets were affected quite differently too, according to the insurer´s home country or its business model. Many local insurers are part of a global group and assets are typically managed centrally. Thus, the global effects of last year´s decline in bond and stock markets did not necessarily leave its mark on local subsidiaries or branches as it had centrally. Furthermore, the insurers typically pursue an asset-liability matching. Since many of the ASEAN insurers focus on personal lines and short-tail risks, their assets will follow similar durations, providing them with certain flexibility in times when fixed income securities take a dive.

Nevertheless, the year 2022 was challenging on the investment side for the ASEAN insurers too. Many explained that they had to digest a double blow as both underwriting results and investments were faced with fierce headwinds. In addition, 2022 was one of the rare occasions where both equity and bond markets plunged. However, equities mostly recovered throughout the year while falling bonds caused unrealised losses on insurers´ balance sheets. Throughout the year, they might have dampened insurers´ solvency ratios, but since most ASEAN insurers will hold their fixed income securities to maturity, that effect evaporates as the securities near maturity. Thus, most ASEAN insurers were able to outsit the impact of 2022 on their fixed income book, unless they experienced a large loss and were forced to liquidise assets and thereby to realise some of those losses.

Most ASEAN insurers were looking forward to 2023 as equity markets continued to improve while rising interest rates translated into higher spreads for fixed income bonds. Overall, the ASEAN insurers were thus looking forward to much improved investment results in 2023 which would alleviate them of some of the challenges experienced on the underwriting side.

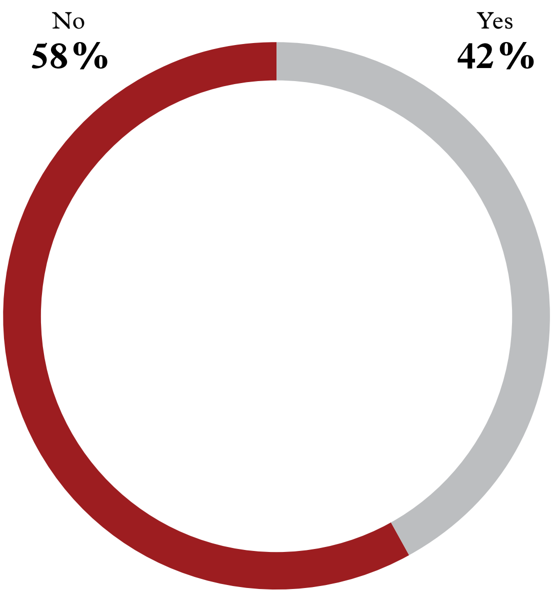
We are concerned about rising inflation rates. In order to avoid our customers being underinsured, we proactively address this issue when renewing policies with our customers to ensure they are adequately insured.

Dr. Sandar Oo, Managing Director, Myanma Insurance

In Malaysia the surge in inflation compounded the impact from the heavy flood losses, which the country had experienced in late December 2021. The flooding had damaged many factories and facilities - often of Japanese ownership - for which the companies had to seek replacements in their home country. Due to the supply chain disruptions, higher freight cost and raw material prices, replacements were far more costly than anticipated and underinsurance proved to be a serious issue.

Faris Davidson, Managing Director, Gallagher Re

Chart 14: Impact of inflation on claims reserves



Are you concerned about the impact of inflation on claims reserves?

To a majority of ASEAN insurers, the impact of inflation on reserves does not pose a major concern. Firstly, predominately claims in motor and construction are affected by rising inflation. Although these are the major lines of business for most ASEAN insurers, they do not account for an equally large proportion of their reserves. Since these are short-tail lines, their impact on reserves is limited. The long-tail lines, by contrast, are less exposed to the impact of inflation. Furthermore, insurers have prepared for inflationary pressure, slightly adjusted their reserves, where necessary, and tested its adequacy on a regular basis. In addition, they work diligently to manage their claims, collaborating with partners to maintain control and to keep the time to settle claims as short as possible. Finally, high inflation rates are rare and in fact, most insurers are convinced that inflation already peaked. They state that the current single digit ratios are well within the realms of their control.

Nevertheless, the reserves of ASEAN insurers are not immune to inflationary pressures. However, the main concern is social inflation. In light of rising court awards in 3rd party liability suits, Bank Negara in Malaysia for instance demands that insurers retain 100 % of reserves for a six-year period following an accident, to assure that claimants get paid in full. As a result, some insurers adjusted their reserves. Furthermore, insurers highlighted the importance of credit control related to clients in inflation. One insurer explained that they offer a premium discount to clients for swift premium payments.

Again, for the region's reinsurers operating internationally, reserves had to reflect the heightened liabilities in US dollar terms versus the depreciated local currency and hence had to be increased.

In combination with the hard market, inflation has increased the cost of insurance. As a result we have seen a slight uptake in self-insurance - in particular in lines where the coverage is not compulsory. However, in light of the high loss experiences in recent years, clients see the need for insurance and understand that as inflation increases their sums-insured have to reflect that trend.

Pavlos Spyropoulos, Regional Managing Director Asia, Tokio Marine Kiln Singapore

EFFECTS OF INFLATION ON CUSTOMERS

Chart 15: Impact of inflation on the purchasing decisions of insurance customers

Has inflation an impact on insurance purchasing – yes/no?

As inflation bites into the financial resources of consumers, in particular those at the lower end of the income pyramid, insurers observe that more essential expenses take priority and consumers limit their insurance spending, buy less cover, cancel insurance and resort to self-insurance. This affects particularly the personal lines – provided consumers have the choice and the cover is not compulsory. Thus, where insurance is voluntary, insurers pointed out that their sales job has become more difficult. Consumers who feel that inflation bites into their wallet, declare a reduced property value, defer payments and prolong or try to avoid adjusting their sum-insured to the increased value of their property – thereby consciously taking the risk of underinsurance on their own account. This presents a real issue as the cover should not just reflect the inflationary effect, but also the changes in the risk profile as recent events have demonstrated the rising impact from climate change on South-East Asia´s weather.

Although inflation in the Philippines is a challenge for the insurance industry in itself, other developments, such as the hardening of global reinsurance markets, make it a real problem.

Michael F. Rellosa, Executive Director, Pira Inc., Philippine Insurers and Reinsurers Association

According to the ASEAN insurers, lower insurance spending affected not just non-life, but also life products – namely life savings products – that consumers felt were dispensable in times of tighter budgets. Insurers mentioned that they saw them suffer substantially. By a similar token, insurers also observed that demand decreased for personal accident products.

Reduced insurance spending might foremost be a phenomenon in the personal lines. However, it also affects the commercial lines, where clients also increased their self-insurance as inflation plus higher rates and tighter commissions forced some policyholders to reduce their coverage. In fact, some insurers perceived the market hardening as the main driver for a certain reluctance among clients to increase their sums-insured.

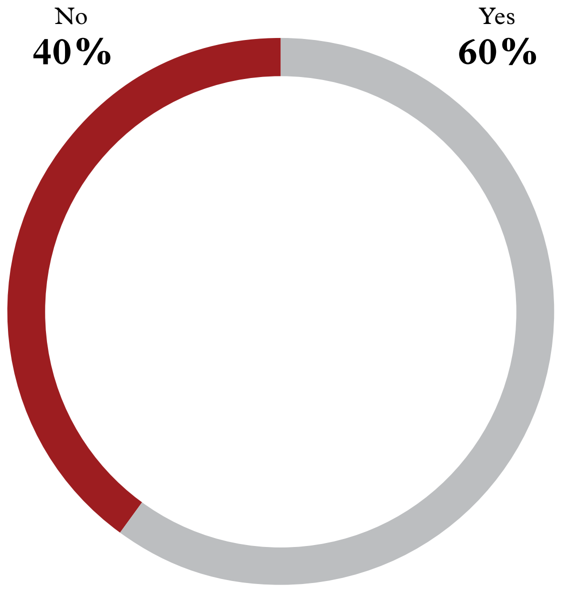
By contrast, there are also voices which see less of an impact from inflation. Firstly, as already stated, the impact of inflation varies – with countries such as Singapore seeing less of an effect. In others, where inflation is more pronounced, the bearing on personal lines may still vary. Where motor insurance is compulsory, it might be tariffed, offering no flexibility to insurers to raise prices. Also in property, insurers stressed that clients have not much of a choice. But where insurance is discretionary, self-insurance might increase. In fact, some insurers see the largest effect on medical insurance with consumers cutting protection – which in the case of medical inflation might be welcome.

However, insurers also pointed out positive signs in clients´ purchasing behaviour. Both the COVID pandemic and also the heightened natural catastrophes in recent years have raised the awareness for the benefits of insurance. Thus, both among consumers and commercial clients, insurers perceived a determination to maintain or even expand coverage despite higher rates. In addition, life insurers already noticed an increased interest in investment linked life products as a way to benefit from rising interest rates.

When post-COVID inflation started to surge, Singapore’s monetary authority acted swiftly and tightened its monetary policy. As a result, the Singapore dollar stayed strong and as insurers we only experience a moderate inflation in motor spare parts, some medical inflation due to shortages in supply and substantial price hikes of 20% - 30% in construction due to labour shortages and higher cost for building material.

Jimmy Tong, Managing Director General & Group Insurance, The Great Eastern Life Assurance Co Ltd

Chart 16: Insurers´ measures to avoid clients´ underinsurance



Is underinsurance an issue for clients?

Opinions diverged regarding the relevance of underinsurance. Some insurers stressed that mainly small to mid-size clients and consumers might lack the understanding or awareness to adjust premiums to the rising value of their assets in times of inflation. For large corporations or foreign owned entities, it might go without saying that they increase their sum-insured to reflect the impact of inflation and enjoy an unchanged insurance cover.

However, those insurers who are focused on personal lines or the SME segment, made quite some efforts to assure that clients remained properly insured. For policies that do not renew and adjust automatically or include so-called escalation clauses, insurers launched educational campaigns explaining that in combination with rising exposures – for instance due to climate change – premiums should rise at least 5% annually and proactively offered adjusted covers. They collaborated closely with agents, brokers or instructed their own sales force to reach out to customers, raise awareness and explained to customers the impact of underinsurance in case of a loss and the need to increase premiums to close that gap. Also, in motor, the depreciation of the value of cars might present an issue too.

In some markets, property policies include an inflation charge. Also, where the underlying asset is financed by a loan, banks will insist on a proper valuation and corresponding adjustments. In some markets, insurers required an update on the valuation of assets at renewal. However, in some markets, few clients followed suit and rather preferred to accept the risk of underinsurance.

In fact, policyholders have three options to select from: either follow suit and pay the higher premium, increase their retention or run the risk. Therefore, agents or brokers need to inform the clients to adjust their values at risk because otherwise it might turn out to be a «painful process», as one insurer explained, as the customer will only realise its underinsurance in case of a loss.

Higher inflation rates have a significant impact on both our underwriting and investment portfolios. While we periodically rebalance our investments to reflect expected market movements, especially those related to inflation, on the underwriting side we are particularly concerned about the increase in reconstruction or replacement costs and medical claims costs. Medical inflation rates are often rising much faster than consumer prices, not only in the Philippines but also in most other countries.

Allan Santos, President, CEO, National Reinsurance Corporation of the Philippines

The most immediate effect of inflation is the increase in claims in the two classes, motor and construction. However, the most substantial effect that we see, caused by inflation and the rise of interest rates, is in the hardening of reinsurance pricing. This year's renewals created volatility in our books and a decrease in underwriting results by more than 20%. As a result we consider to segmentize our book differently, writing more SMEs risk of which we are able to retain a larger portion.

Kok Kheng Ng, CEO, Great Eastern General Insurance (Malaysia) Berhad

Chart 17: Efforts of insurers to buffer the effects of inflation and higher rates for clients

Have insurers taken measures to buffer the effects of inflation and higher rates?

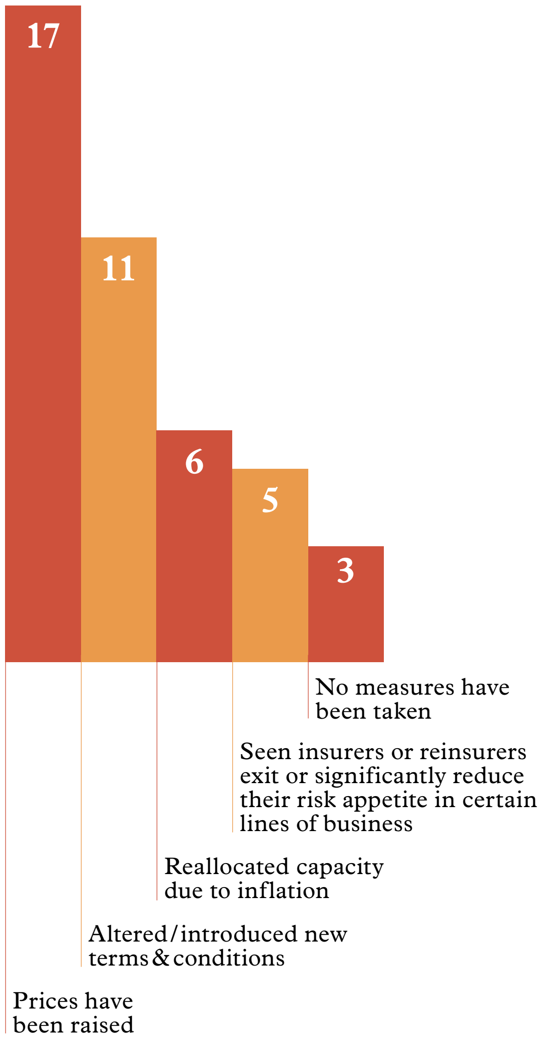
Insurers understood that rising insurance prices – possibly due to a combination of inflation, higher exposures and tighter reinsurance markets – may have posed an addition strain on the budgets of their clients. They explain that firstly they tried to communicate as early as possible the rising prices and that they took measures to cushion the impact of higher rates on their clients by consulting with them and brokers to restructure programs and coverage terms and conditions to make rate increases more palatable.

For consumers, some insurers worked with affiliated banks to provide interest free loans for clients to pay their premiums, if necessary, in twelve-month instalments. They also provided assistance in properly valuing property and in providing pricing guidelines. Nevertheless, many insurers pointed out that their flexibility in aiding their clients is very limited as products might be highly standardized. Problems might occur as in some countries motor vehicles are insured on an «actual cost basis» and not on a «replacement value basis». As a result, a policyholder may only receive the depreciated value of his or her vehicle in case of an accident, leaving the policyholder with a gap to cover when replacing that vehicle. Some insurers actually considered to develop top-up products to cover that gap.

> The rise in inflation had an impact on insurers in 2022, as claims costs increased, particularly in motor and property. It was not as pronounced at the time, as it was somewhat offset by available stock, despite supply chain disruptions. As supplies dwindled, we had anticipated a rise in claims costs and prepared by diligently managing our costs through collaboration with our vendor partners, improving our operational efficiency and continuing to drive digitalisation. In addition, we partnered with our intermediaries to raise awareness and educate our clients on the need to increase the sums-insured due to the same inflationary pressures.
>
> **Mack Eng, Executive VP for business development and digitalisation, MSIG Asia**

MEASURES OF INSURERS

Chart 18: Measures to protect the underwriting portfolio against the impact of inflation



Which measures did you take to protect your underwriting portfolio against the impact of inflation?

Insurers in the ASEAN region had to batter with at least three market forces since 2022: (1) inflation, (2) a changing risk landscape and, as of Dec 2022, (3) the tightening of reinsurance markets. It is the combination of these phenomena which led to a hardening of insurance markets as well.

Thus, insurers often stressed that yes, they raised prices or tightened conditions, but not only due to inflation, but because rates in reinsurance went up too. The ASEAN insurers perceived this as the outflow of a global trend, which led to a hardening of reinsurance rates by 20 % - 25 % and even more for non-proportional treaty.

Insurers reacted with a mixture of measures which they altogether labelled as a conservative approach to underwriting, where the quality of the portfolio played an enhanced role. Price increases were the most frequently mentioned feature, affecting foremost motor and property – unless tariffed – both for personal and corporate clients. They were more common in motor than fire, where margins were more comfortable, but also affected specialty lines, such as political risk, where rates were adjusted due to a rise in social unrest – partly caused by inflation too.

Tighter market conditions were reflected in a hardening of terms and conditions as well – partly due to a similar development in reinsurance – where conditions tightened due to the hardening of the retro market, the rise in natural catastrophes, the Russian / Ukrainian war or in response to COVID-19. Insurers demanded that clients disclose more transparently how they manage their risk. Furthermore, they asked for an updated valuation of assets to adjust sums-insured. In addition, to manage the claims inflation, they introduced a claims cooperation clause to take influence on the repair, replacement or rebuilding of property.

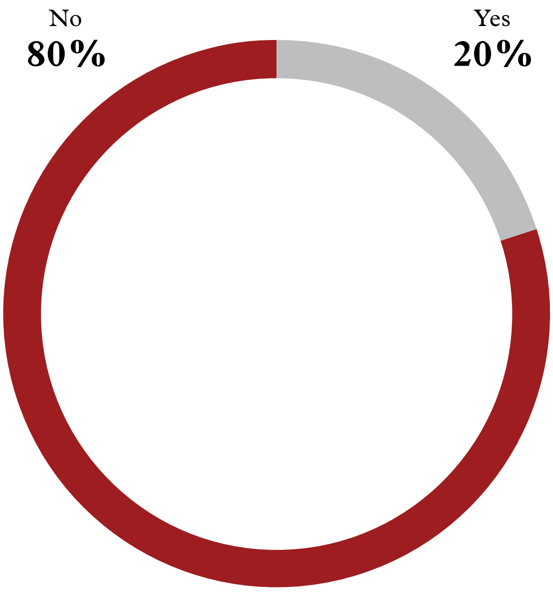
In response to inflation and tighter reinsurance conditions, the ASEAN insurers frequently adjusted their portfolio and reallocated capacity – often within the same line. Some insurers for instance moved from residential to commercial property because the felt pricing was more flexible or tried to allocate capacity to smaller risks – such as to SMEs or personal lines – again, to reduce a reliance on reinsurance protection. The quality of the account was a dominant theme with insurers systematically screening their portfolio, increasing deductibles to force clients to better understand their risks. Ultimately, many claimed to have shed risks that they felt was not meeting their requirements.

Few insurers decided to exit certain lines, although the picture was far from consistent, and motives might have been rather idiosyncratic. The consensus was to decrease reinsurance buying by reducing exposures to natural catastrophe as well as single large risks. One interesting feature were the takaful insurers, which said that they saw no need for adjustments as reserving was sufficient and reinsurance audit showed no need to act.

As a Takaful Operator in Brunei, the protection of the participants is our priority, as it is aligned with the regulator's overall objective. Thanks to our high level of reserve funds, we are better able to absorb the impact of inflation without an immediate increase in takaful premiums for our customers.

Sharildin bin Pehin Dato Jaya, Managing Director and CEO, Syarikat Takaful Brunei Darussalam

Chart 19: Product innovations in response to inflation



Have you seen product innovations in response to inflation?

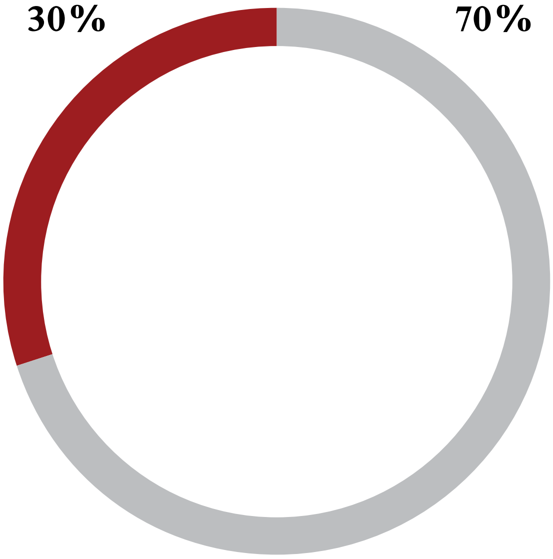
Product innovations in response to inflation have been rare and predominately refer to simplifications or top-up products, trying to capitalise on underinsurance risks or responding to rising prices with simpler and cheaper products. Thus, most insurers just stated that at most they had seen some adjustments in terms and conditions or simplifications like digital lisenses – probably still also a consequence from lock-down times.

Top-ups to existing policies were seen in motor, where insureds could add a cover to avoid the underinsurance in case their vehicle was insured on a cost value basis and they wanted to make sure they would be able to replace with the same vehicle at current prices. Also, insurtechs were trying to push into the market with simplified or «light» insurance products that could be sold at cheaper rates than existing solutions.

So far, the macroeconomic situation in Vietnam has remained stable and inflation has been kept under control. However, the Vietnamese insurance market is not immune to global developments, as international reinsurers, for example, have significantly increased prices in recent renewals, partly due to inflationary pressures.

Vietnam National Reinsurance Corporation (VINARE)

Chart 20: Changes to the asset portfolio in response to inflation



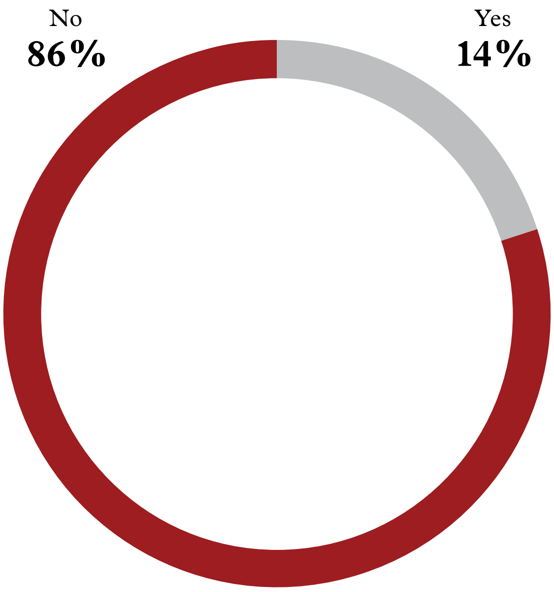
Have you made changes to the composition of your asset portfolio?

The majority of ASEAN insurers adapted the composition of their asset portfolio to the changes triggered by higher interest rates. Since the region's insurers tend to have a bias towards personal lines in the property & casualty segment, their assets are of short duration. Obviously, these insurers have shifted into bonds paying a higher coupon, once the previous bonds mature. They remained underweight in equities, but lessened the duration of their fixed income portfolio while interest rates are increasing, moving into bonds with higher spreads and longer duration. Also, government bonds, which previously had only paid very low coupons, have found more buyers.

Those who stated that they left their portfolio unchanged were predominately insurers, where the asset allocation is done at group level or who are invested mainly in government bonds, as that is the preferred asset allocation by the regulator too.

> Although we are currently seeing higher sums insured, higher premiums and, in some lines such as motor, higher claims payments due to higher inflation, the development in Indonesia is overshadowed by the significant hardening of global reinsurance markets.
>
> **Christian W. Wanandi, President Director, PT Asuransi Wahana Tata and Secetary General of the ASEAN Insurance Council**

Chart 21: Regulators´ reaction to the increase in inflation



Did regulators react to the increase in inflation?

Mostly, the ASEAN regulators have not directly reacted to the increase in inflation by asking insurers for more reporting or disclosure. This might be due to the resilience of the ASEAN insurers, which demonstrated that they had been prepared for the rise in inflation and their reserves remained solid.

The focus of the ASEAN regulators was felt to be more with the policyholders, which in times of tighter budgets bought less insurance. Since the ASEAN regulators are keen in reducing the protection gap in their markets, rather than seeing it widen, pressure increased on insurers to try and provide more affordable cover to those with low income. However, this has been an ongoing task, which will have gained more momentum with the steady rise in natural and weather-related catastrophes. Insurance is still seen as the fairer and more targeted protection for the vulnerable population than the government measures introduced after catastrophic events, which are indiscriminate in the way how they provide relief to the population.

Rising inflation has also led to an increase in interest rates. These changes are anticipated to potentially yield positive impacts on investment returns over the long term as insurers are expected to gradually adjust their management of funds to capture higher yields.

Brunei Insurance and Takaful Association (BITA)

MALAYSIAN RE