

The Four Fields Factors Makes Inadequacy of Life Insurance Coverage in Malaysia

Halim Khalid ¹⁺, Haslifah Hashim ², Massita Mohamad ², Kamil Khalid ³ and Kamal Khalid ⁴

¹ MNRB Holdings Berhad

² Centre of Actuarial Science, Universiti Teknologi MARA, Malaysia

³ Universiti Malaya, Malaysia

⁴ Universiti Utara Malaysia, Malaysia

Abstract. In Malaysia, life insurance agents become the main source of knowledge to their prospects. The high dependence to this source of information sometimes may result to risk of being underinsured. The risen of the risk causes by variety of factors categorized into four fields as man, methodology, materials and tools. There are several differences to acknowledge in each field factor. The differences make the amount of suggestion contradictory each other. In result the prospects may impel into three states which are adequate, underinsure or over insure. In other to promote a good resonance to the industry in Malaysia the prospect must always be put in the state of adequacy today and later depending on their policy. Thus the first step to do this is to identify which factors that causes the problem of inadequacy of life insurance coverage in Malaysia. Then, this paper will list, review, discuss, summarize for each of the field factor.

Keywords: Malaysia, Life insurance, Adequacy, Underinsure, Over insure, Inadequacy

1. Introduction

Recently, life insurance companies growing and expanding their activities through transformation into new technology, improvements in products pricing in order to increase their competitiveness and acquire marketing advantages. The agents are trained and licensed to deliver the company mission to the prospects with ethically as regulated by authorities. They know how to suggest products that most fits with the needs of their prospects especially the amount of sum assured. However, Malaysian life insurance prospects must be educated so that they are not too dependent to this source of knowledge. Since it is possible where different agents suggest different amount of sum assured. The high dependence to this source of information sometimes may result to risk of being underinsured.

The amount of sum assured is a key idea of financially protected and peace. Life insurance agents must suggest the amount of sum assured always in adequacy so that it will promote good resonance to further industry growth and penetration. Any mistakes in determining this amount would leads to over insured and make the life insurance contract excess in value which is unnecessary. Also, it is prohibited to buy any insurance to gain profits but suggested to follow the core role of insurance to provide “replacement” as the value loss due to the risk exposes. Indeed, the miscalculating of the amount also lead to another risk which is under insured and make the life insurance contract less in value. This is the risk should any policy holder avoid especially in current economic situation.

We will discuss the factors which make inadequacy of life insurance coverage in Malaysia and summarize into the four fields of Kaoru Ishikawa fishbone diagram, (Hermens, 1997) and (Martin, 2006). As new knowledge and findings expand, hopefully the population and industry would benefit each other.

⁺ Corresponding author. Tel.: + 60196734306 / +60162117753; fax: +60355435384.
E-mail address: halimbinkhalid@gmail.com.

2. Factors of Inadequacy in Life Insurance Coverage

2.1. Methodology Factor

The roots of problem regarding life insurance inadequacy or over insure start from methodology uses in calculating the amount. Presently four popular method uses in various tools. Each of method has different in concept and inputs needed. Some may too simple, while the other may too obscure. Each method has advantage and disadvantages.

First and earliest method is the time-honored rule of thumb. The disadvantages of this method are it will always suggesting too minimum amount of protection thus later drive a policy owner to the state of being underinsure, too simple thus ignoring any important factor, not involve any professional and reliable formulation and calculation, no modeling works, obsolete and finally it should not applicable to the ages. But, until today we can see the availability of this method whether uses online or by life insurance agents in Malaysia.

Second method is capital need analysis. The disadvantages of this method are it not includes change in income and include fixed assets. When a change in income doesn't take into account, it could increase the possibility of being under insured. When includes fixed assets, it will increase possibility of being over insure (Todd, 2004). While combining the two factors could results inaccurate amount of protection. The fixed asset shouldn't consider because even a breadwinner dies today his/her fixed assets such house and land remains owned because most of mortgage loans today come with MRTA policy rider which protect their owner from related risks. Overall this method will drive into over insure, unnecessary and make the recommend protection comes with high premium.

Third method is need analysis method. The disadvantages of this method are it does not include mortality rates, not consider future career development and only depend on current financial needs. The important of mortality rate is to provide a time frame where it will maximize efficiency of formulation, calculation and model. It helps to avoid unnecessary calculations take into account. For example, if a person expected to live ten years later, why we need calculate for twenty years or if person expected to live in twenty years and why we need to calculate less than that? Otherwise it could put life insurance coverage in the stated of being under insure or over insure. By depending on current financial needs does not imply the adequacy of coverage in the future. If people have a total salary MYR 24000 yearly but in the future he/she actually has an opportunity on his/her career development to acquire promotion later increase in basic, bonuses and allowance thus result in greater yearly income such MYR 48000. Now looks what is the different if this case is really happen. The protection buys today will put the policy owner under insure by 100% in future.

Forth method is multiple earnings method. The advantages of this method are it not include living expenses, less accuracy and not consider stage of life in human life cycle. The human life cycle can be assumed as a plan or journey of human being today and later. The information will provide us a strong financial need along the stages especially the timing of those expenses take place and last. While ignoring the important element can increase the uncalculated significant financial needs should occur in future. Later it will provide insufficient valuation of life insurance coverage because of the unspecified and missing financial needs (Todd, 2004).

Fifth method is human life value method. The disadvantages of this method are it does not include liabilities, liquid asset and difficult to understand by most people especially not financial literacy group. Since an adequacy life insurance purchase must at least equitable to the minimum standard of living if both husband and wife survive, than any current liabilities should incorporate into formulation and calculation. Hire purchase is a popular liability in Malaysia because of the new rider of general insurance to protect vehicles beneficiary from paying outstanding loans amount if the owner dies still in the level of introduction with a slow response. The liability should be includes in the formulation so that the beneficiary further expected to hold and use the same car later in future if their breadwinner dies. The result from this calculation could make confusion even though it provide more accurate and reliable than other methods previously because of it involve a complex formulation, models and calculation and limited to professional able to understand. So, it is more helpful if the result summarize into more simple form such multiple earning forms.

2.2. Men Factor

There are two major problems of life insurance adequacy whether over insured or under insured. Prospects are the first group involve to the problems. Low financial literacy among Malaysian life insurance prospects lead to a total dependent to life insurance agents while seeking information of financial planning thus later increase the possibility of buying life insurance whether over or less sufficient. The impact of urbanization increase quality of living among Malaysian especially in urban area such Klang Valley. But in other side it also increase the living cost among citizens. For example with comparing to other country such Hong Kong, the transportation monthly budget of their citizen shift from owning and using personal vehicle to using public transportation which much more saving where they are only pay the cost of travelling without fears to buy the asset. But in developing country such Malaysia, the improvement of public transport is still in progress thus most urban citizens owning at least two cars per household. These will lead to most prospects plan their life insurance coverage, where they are likely to buy the lowest premium. Then, the investment link products will be their first choice which is more expensive than a term product thus makes their coverage insufficient. There are several industry players competing each other and these different agents suggesting different amount of sum assure (Haslifah, 2007). The variability will make most of prospect confuse and later false to decide an accurate amount of sum insure to buy.

Second group is policy owner or the insured person. Unlike to other tangible products, life insurance contracts deal with times frame and it start today until specified period of time or even for the whole life of a policy owner or insured person. Thus it needs some effort, information and awareness to maintain the status of life insurance adequacy at current economic level or stage of life cycle. Most of this groups lack of this decisive factor. They didn't update their current financial needs with the life insurance purchased. Maybe there is no special personal tool like how bank account holders maintain their accounts through personal online banking solutions. Now, the only document kept by the policy owner is the book of policy itself to remain until the contract mature without any information whether the current coverage is sufficient enough compare to current financial needs. Since it is a long way products and required effort to update the status of life insurance purchased and financial needs then today the only way out to this problems is both agent and policy owner must maintain their relationship without any possibility of getting lost contact in the future. But, it is too hard to treat people equally and predetermine situation because they own of unknown passage and remain mysterious in the future. Some may move out to other place, some may change career, change phone number or many other possibilities. So, the mutually relationship between policy owner and their agents is hard to maintain for both of them.

Third group fall into this factor are agents of life insurance. Malaysian life insurance agents play important role for their prospects and policy owner. The authorities regulated that each of the agents must satisfy certain professionalism in order to market the life insurance product ethically. In result there is hard to find any public news of agents deliver their roles unethically. But, there is still possibilities of agents provide wrong ideas and fail to suggest the adequate amount. This is because they work for commission based on reward structures. Since there are a lot of life insurance plan such endowment, whole life, term and etc, thus differ in commission. Some offer high commission, some offer less. For example the cost of investment link life insurance products are much more expensive than term life products since it differ in risk, rate of claim, effort, operation and etc. For a normal perception the agents are more preferred to sell or intend to promote the investment link product rather than term products because the different in commission will receive. The coverage period of product will become another reason to influence a bias suggestion to the policy owner. If the price is expensive then the possibilities of the prospect to buy inadequate amount of sum assured is high as him/her to fits with their monthly expenses budget.

Forth group goes to large organization which is the life insurance companies itself. There is no doubt about life insurance professionalism towards handling their operation and delivering the promise ethically. But there is still a gap to fulfil so that the life insurance inadequacy – adequacy problems among Malaysian policy owner solve and remain controlled over the years. The adequacy problems may be more control especially inadequacy since it totally harm the beneficiary's standard of living if the life insurance companies itself help their policy owners updating the coverage adequacy status. They can provide assistant to remind policy owner to check and update their coverage with current financial needs. And this is not happen at up to

date. The policy owner will leave alone without knowing that their coverage was adequate or not. It is good if the companies send a special letter or reminder just to inform to the policy owner to check, update and take appropriate action if there is necessary. For that the policy owner should be guided to learn how to monitor their adequacy of coverage periodically.

Fifth group goes to more large population which is government. People wish to live with good and harmony. The policy owner wish to set an amount of life insurance coverage so that their beneficiary will sustain the current standard of living in the future as anything goes wrong to the insured persons. Any declining in future standard of living would become worst and put their loves one in the place that they try to avoid today. Agents, policy owner or life insurance companies may influence several contingency to updating an adequate coverage throughout the period with variable reasons. They may subject to inconsistency factor which make them unable to promise effort to help the possibilities of the adequacy factor not occur. Now, most of Malaysian hopes that government can help them today and future. The demand of better social security increases the need of code of conduct to life insurance adequacy. But, since we are still new in the industry as compare to Great Britain and United States, the research regarding to the field is still insufficient to provide total complete plan to solve the life insurance adequacy problems that fits with local economic environment. Till now, there is no standard or reference regulated to ensure the right amount of suggestion or yearly suggested minimum life insurance coverage for specific income range or other measures.

2.3. Tools Factor

Tools are a core aspect in everything we do in life. Our tasks could be easier and less complicated by using appropriate tools to solve any tasks given. The wrong choice of tools will be unhelpful and exaggerate to us. So it is essential if we have knowledge of how to choose the right tools for our specific purpose. Otherwise it could make the tasks pensiveness from our expectation. In life insurance inadequacy problems, the wrong choice of tools become one of key factor for us to consider. According Haslifah Hashim (2007) there are a lot of tools employ by life insurance companies to assist their agents in suggesting of how much life insurance coverage to purchase. Availability and variability of online tools would give more ideas to the policy owner. But the variability of these tools would make confusion among prospect or policy owner since it's suggest different amount of sum assure. Thus, there is no perfect tools fits with the needs of Malaysian life insurance prospects.

The variability of current tools especially online tools make different amount of suggestion. Some will suggest high while some will suggest less. The question to which one is right becomes an issue and always be gives dilemma especially to non financial literacy groups in Malaysia. For example, if a user with specific economic with his financial needs uses five different online tools, the expected result will be in different amount. Since there is no standard in available tools the confusion will never ends. The wrong amount of suggestion will give a surface idea of purchasing behaviour. If a tool suggest less than other, than the prospect could encourage acquire the amount with make his/her policy in the state of inadequacy. If a tool suggest greater than other tools, the risk of buying inadequacy protection still occur where he/she could choose to buy less protection because the large amount of suggestion will further comes with high premium where outside of average budget for that person. Then purchasing behaviour will back on premium which best fits with their monthly budget. The inconsistencies of suggestion amount arrive from implementation of different concept and methodology.

Majority of available online tools originate from overseas life insurance companies or professional financial planners especially United State and United Kingdom. These tools use their local financial and social needs in structuring their model. The model for Malaysian would be different and thus the tools employs are not valid as a central reference. The reliability of the online tools might not suitable for Malaysian. For example, different in plan social security plan always give an impact to futures financial plan on each of their citizens. A citizen with live in a country that provide free medical services to all social groups might think that less needs in future medical fund. But he/she could need to locate a sum of money to other purpose that more important which his/her country's social security not provided. Even though we are human kind with always similar in life stages need especially the basic ones, our life still influence by our

unique traditional. For example the need of large sum of funds needed for funeral expenses in most English and Chinese while Malays does not. These are the key that makes the models differ and each country has their own unique financial needs preferences.

A primary role of a tool is to simplify our specific task. There is a range of different in calculating the adequacy of life insurance coverage in term of difficulties level. Most of current tools are innovated to make the difficulty level more reachable to most average people. So that it can be usable by less financial literacy group of prospect or policy owner. Some tools are too simplified while some tools are too complicated. The range of difficulties comes from the number of input need to run the calculations. Thus, most of it will make variability of amount of suggestions. But how can we prove that which one is accurate and vice versa? By eliminating some key elements in the calculation or models could risk the suggestion patterns thus result inadequacy of life insurance coverage. It is normal to afraid that the main objective of the tools will lessen by the trend of innovation towards user friendly applications through disengage of some important elements. Any innovation in developing such user friendly tools should maintain the main roles of tool in providing an accurate, desirable, and most fitted to life stages, no bias and etc.

2.4. Material Factor

In other domain, material may reflect to things use in the process. For example in food processing, material means of raw resources such sugar, corn, meat, etc. Here we will equate material as any factor that influences the change in person's economic preferences. The economic preferences further will describes the change in financial needs for today and later. One factor is persuading to another. Thus it shows a kind of unique relationship pattern. We will discuss some of factor and their relationships with the impact of life insurance underinsure or over insure.

First factor is change in economic rates. There are a lot of economic rate which result from growth in Malaysian factor market such base lending rate, inflation rate, investment rates, foreign exchange rate etc. The changes in inflation rate make increase or decrease in value of money. For example, if the inflation rate increases, the value of money will decrease. If the inflation rate decreases, the value of money will increase. The value of money implies purchasing power. While change in value of money further influence the adequacy state of life insurance purchased whether under insure or over insure. If the value of money remains the same it will give a good sign of the coverage purchased meet the policy owner's expectation in assumption other factor was not involves. The impact of inflation to the adequacy state of a policy may increase by time. It seems less implication for a short period rather than long period of policy. The longer of a policy contract increases the risks of being under insure because in average, the inflation rate will keep increase over the years. It's good to have over insured policy today than to be under insured later. But not suggested to have too over insured over the years. An efficient coverage is always in state of adequate today and later.

Second factor is change in future life style. Life style is very close to the urbanization development as discuss early. Urbanization will charge to increase in living expenses and budget preferences. Life style is close related to not only need basic thing such shelter, food/water and cloths, but also wants. Then the mean quality of living comes into each of urban citizen in order to satisfy their wants. Increase in quality of living also increase in standard of living. For example, a hand phone is not a necessary thing than fixed line for back ten years before. But today a hand phone becomes one of must buy things in current life style. More, the life style standard could be differentiating by models and price. If one's life style standard is high, he/she might thing to buy/change his/her hand phone to the latest model at high price and vice versa. According to (Kotlikoff, 1985), the future adequacy of life insurance purchased should be equate to the standard of living of beneficiary could have today. By adopting their suggestion, if a person could have latest models at high price of a hand phone today, then he/she must also have that opportunity later if his/her breadwinner dies today. The lack of knowledge to consider change in life style in suggesting the amount of life insurance coverage could make the policy inadequacy to sustain the current standard of living.

Third factor is change in career development. In career development there is several things influence the adequacy state of life insurance policy which are basic salary, bonuses and job promotion pattern. Salary is the popular source income in most Malaysian households. It provides a stream of income until retirement age.

From that salary, bread winners control their household budget to acquire needs while satisfying their wants. In between, they attempt to obtain some advantages through investment in various financial derivatives, business venture and etc. Change in basic salary could give implication in life insurance adequacy. There is no possibility of being decrease in basic salary despite the fact that have a high possibility increase in basic salary throughout the years until retirement age if a person works on the same sector and employer in Malaysia. The issue of being underinsures increase if no salary increments put into consideration in determining the amount of coverage should a person purchase. More, instead of salary alone is not enough without considering bonus. In Malaysia, bonuses are given whether public or private sectors at the end of their financial year depend on productivity of the organization. Lack information on bonus rates for the sector further increase possibility of being underinsure. Other things must put into account is job promotion pattern. There is a high probability of being promotes along with productive years of a worker. For example in army, a private today have a possibility to promote to sergeant later in future. Thus any promotion would incur raise in basic salary. It is important if we have to identify the promotion patterns for both public and private factor in Malaysia in order to provide complete sufficient life insurance coverage.

3. References

- [1] Haslifah, H. An Analysis of the Quality of Online Calculators in Calculating. Life Insurance Recommendations. *Asia-Pacific Journal of Risk and Insurance*. 2007.
- [2] Hermens, Michael. A New Use for Ishikawa Diagrams. *Quality Progress, Milwaukee*. 1997, **30** (6).
- [3] Kotlikoff, A.J. Life Insurance of Elderly: Its Adequacy and Determinants. *NBER Working Paper Series, Working Paper No.1737*. 1985.
- [4] Martin, J. Fishy Story. *Jurnal Pendidikan Tahun 2006, Jilid 1*. 2006.
- [5] Todd, J.D. Integrative Life Insurance Needs Analysis. *Journal of Financial Service Professional*. 2004, **58** (2).