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Takaful unlikely to face negative impact of MFRS

PETALING JAYA: The new Malaysian Financial Reporting Standards (MFRS) 17 will not have an impact on the fundamentals of Syarikat Takaful Malaysia Keluarga Bhd 's (STMK) business, in terms of its financial strength, ability to pay claims and dividend distribution.

This was revealed by STMK corporate finance and strategy general manager, Juliana Lo, at an expert speaker session on MFRS 17, organised by CGS-CIMB Research for institutional investors recently.

To put it into perspective, MFRS 17 is a new accounting standard for insurance and takaful contracts that will be adopted by insurance companies and takaful operators (ICTO) effective Jan 1, 2023.

Based on STMK's guidance on the MFRS 17 impact on its financial year 2023 performance, CGS-CIMB Research said the establishment of contract service margin (CSM) is expected to reduce the group's retained earnings by about 30% to 45%.

The group's takaful contract liabilities will also increase, mainly due to CSM, said the research house in its note to clients.

Upon transition, CGS-CIMB Research expects STMK's profit for the year to decline by 15% to 20%, mainly due to the recognition of new business profits in CSM and the change in the timing of earnings from investment-related activities.

However, the group's earnings are expected to normalise within five to six years, the research house noted.

"STMK projects a return on equity (ROE) of 22% to 25% upon adoption of MFRS 17. This is higher than our projected ROE of 17.3% in FY22 due to the reduction in its retained earnings by 30% to 45%," said CGS-CIMB Research.

The potential decline in STMK's retained earnings from the MFRS 17 adoption was due to the "carve-out" of some of the retained earnings into CSM, which is the future profits to be released by STMK to its profit and loss statement over the tenors of its takaful contracts.

CGS-CIMB Research, however, does not expect MFRS 17 to trigger any equity capital raising by STMK in the next two years.

"We think that the CSM will be included in its capital positions for the calculation of capital adequacy ratio under the risk-based capital framework. This is despite certain risk weights could be applied to the CSM," the research house pointed out.

STMK also does not expect the adoption of MFRS 17 to materially alter its underwriting strategies as the adoption of MFRS 17 will not change the profitability of its takaful products, said CGS-CIMB Research.

The research house had also factored in the impact of MFRS 17 in its earnings forecasts for STMK in June, leading to a cut of 29% in FY23 and FY24's net profit forecasts, together with the impact of the higher assumed tax rate.

Hence, it has retained FY22 to FY24 net profit forecasts with an "add" call on the stock at a target price of RM4 per share.

The potential re-rating catalysts to its call include strong growth in its gross earned contributions.

In addition, and despite the year-on-year decline, STMK's FY22 to FY24 ROE of about 17% is one of the highest in the financial services sector, said CGS-CIMB Research.