

Zamani Abdul Ghani: Changes and challenges concerning the insurance industry in Malaysia

Keynote address by Mr Zamani Abdul Ghani, Deputy Governor of the Central Bank of Malaysia, at the 23rd Pacific Insurance Conference, Kuala Lumpur, 29 October 2007.

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Let me start by joining my colleagues from the Malaysian insurance industry in extending a very warm "Selamat Datang ke Malaysia" to all the guest speakers and conference delegates from abroad. It is my earnest hope that you will not only benefit from the deliberations during the conference, but also find time in between your short stay here to discover Malaysia and experience our rich diversity in colours and culture.

I am indeed honoured to be with you this morning to officiate the opening ceremony of the 23rd Pacific Insurance Conference – the first to be held in Kuala Lumpur in the conference's 44-year history. I must congratulate LIAM for its efforts in organizing this prestigious conference involving insurance leaders from the Asia Pacific Region. The conference theme "New Solutions for Traditional Challenges: Winning Ideas from Industry Leaders" is most appropriate as the changing financial landscape poses significant challenges to the insurance industry in the Asia Pacific Region. It is indeed timely therefore that the life insurance fraternity has come together to share critical insights and perspectives of key challenges ahead and map out new strategies to capitalize on the opportunities while avoiding the pitfalls. With a gathering of more than 300 industry leaders from 25 countries, I am confident that the deliberations will generate new solutions/strategies in an industry that is undergoing rapid transformation, underpinned by globalization, broad-based financial deregulation and increasing opportunities as well as uncertainties amidst an environment of heightened volatility.

Rapid developments in technology and financial liberalization have played a catalytic role in transforming the financial services industry worldwide. Consequently, traditional business boundaries have become increasingly blurred, as demand for financial products and services become more diverse and sophisticated, transcending the traditional offering of stand-alone banking, insurance or investment products. As changes in the global financial industry continue to occur and indeed accelerate, insurance companies in the region will face mounting pressures to adapt effectively into the evolving environment by embracing innovation and becoming strategically more focused.

A key ingredient in supporting such transformation is to nurture strategic leaders who have the foresight to anticipate, influence and reshape the strategies in tune with these developments. Charting the journey forward, insurance leaders need to consider the following salient trends:

- **Firstly**, the global trend seen in several industries, including insurance, to reduce costs and increase efficiency and productivity in an increasingly competitive environment. The traditional paradigm of pricing goods and services purely on cost-plus basis should therefore be re-evaluated. Indeed the focus needs to be shifted towards providing products and services that provide superior value proposition to consumers, made possible through re-engineering of business processes and operating models that promote greater productivity and competitiveness.
- **Secondly**, the dynamics of the market place have already resulted in alternative marketing approaches to the traditional agency system, including more cost effective distribution channels like bancassurance. This concept has gained acceptance worldwide for the provision of a wide range of life and pension products via the distribution networks of banks.

- **Thirdly**, globalization of the world economy and financial markets, as well as trends towards greater financial innovation and promoting shareholder value, have contributed to a wave of mergers and acquisitions between insurers, banks and asset management companies resulting in the emergence of financial conglomerates. These integrated entities will inevitably raise the bar in the entire business value chain, including product design and pricing, streamlining of distribution channels and integrating valuable databases of customer information, thus accentuating further competitive pressures within the life insurance markets in the region.
- **Finally**, an area that will present significant opportunities as well as challenges to the insurance industry will be the evolving structure of social security systems and safety nets that will have to keep pace with demographic changes as well as the rising cost of medical care. Many nations are already finding it difficult to provide adequately for the needs of the aging population through state provided social security.

It has been reported that globally, life insurance premiums amounted to USD2,200 billion in 2006, and Asia as a region is the fastest growing life insurance market, in line with rapid economic development and growth. Financial services and economic liberalization in Asia, particularly in China, India and South-East Asia have significantly widened the market outreach for life insurance whilst unlocking considerable market potential in new growth areas. Indeed, the transformation of Asian countries into industrial and services powerhouses, with increasing share of world output, will present abundant insurance opportunities within the region as countries make huge investments in upgrading their physical, financial and human capital infrastructure.

On the domestic front, the Malaysian economy continued to be on a steady growth path with real GDP expanding by 5.7% in the second quarter of 2007 and an anticipated 6% for the entire year. In tandem with this growth, the insurance industry, including the takaful sector, recorded a combined premium growth of nearly 10% for both the life and general sectors to reach RM13 billion in the first half of 2007. The assets of the life and general insurance funds correspondingly registered a double-digit growth of 14% to RM116 billion as at end June, 2007, from 11% in the corresponding period in 2006. This growth momentum is expected to continue in 2008 in line with the sustained growth of the Malaysian economy.

One of the key mandates of Bank Negara Malaysia is to develop the insurance industry into a strong, dynamic and innovative component of the financial system. In this respect, industrialization and real sector growth have to be complemented by a strong and thriving services sector, especially in the area of banking and insurance. As a mobiliser of long term private savings, life insurance has a critical role in providing long term funding for the massive investment required to achieve the growth and income objectives of Vision 2020, that is, in becoming a fully developed economy.

In line with the rapid changes taking place in the business landscape of the insurance industry, the authorities have moved away from prescriptive regulation to one that allows for a more flexible operating environment. Specifically, insurers are now operating in an environment where regulations have become more principle-based. The principle-based regime places greater expectation and demands on the leadership and senior management of insurers in driving fundamental changes required within the organization in response to the changing regulatory landscape. In particular, senior management of insurers must raise the bar for the organization to achieve best-in-class practices that are aligned with the organization's strategic orientations, rather than merely complying with a minimum set of prescribed requirements. A pre-requisite for this transformation is that senior management acquires a thorough understanding of the relationship and inter-linkages between the various components of the insurance business, and to manage these dynamics in a manner that optimizes performance.

The regulatory shift also places greater prominence on creating a strong risk management culture that is fundamental to sound insurance operations. In Malaysia, the transition to a Risk Based Capital Framework and the implementation of the risk-based supervisory regime constitute important capacity building elements of this change. The transition taking place is in tandem with emerging trends taking place at the international front, as well as the core supervisory principles of the International Association of Insurance Supervisors (IAIS), which collectively, provide a road map on the future direction of insurance regulation.

Notwithstanding the move to a more principle-based regime, it is important that there remains a sufficient degree of regulatory oversight to maintain financial stability and public confidence. It is equally important for the regulations to focus on facilitating market-led adjustments that will allow the industry to evolve in response to market developments. This includes putting in place mechanisms that harness market forces and discipline, to reinforce prudential regulation whilst also promoting a more efficient and responsive financial system. As we prepare ourselves for the challenges arising from greater integration and increased competition, there will be regular review and re-assessment of the regulatory framework as we benchmark our regulations against leading business practices and international standards set by recognized bodies such as the IAIS and the International Accounting Standards Board.

Rapid developments in technology and information systems coupled with the forces of globalization have made the world increasingly borderless. While such developments are welcome as they provide a platform to hasten the pace and manner through which businesses and financial transactions can be efficiently concluded, they can also facilitate money launderers and terrorist financiers to conduct a range of illegal activities, thus destabilizing a country's financial system and damaging its image and reputation. As structured programs on Anti-Money Laundering and Counter Financing of Terrorism activities are relatively new especially among many developing member countries, it remains a challenge for the financial industry and regulators alike to formulate adequate measures and mechanisms to counter these perpetrators. In this regard, compliance with the standards set by the Financial Action Task Force on Money Laundering help deter the Asia Pacific region from being targeted as a regional centre for money laundering and terrorism financing. In this regard, I am especially pleased to share with you that Malaysia has been ranked among the top 10 countries in terms of AML/CFT compliance in the recent Mutual Evaluation Report 2007 assessment exercise.

Let me now turn to a subject close to us here in Malaysia, that is, Islamic insurance or better known as takaful. In recent years, takaful has grown significantly as the Islamic alternative to conventional insurance and has evolved from being a domestic operations to becoming a thriving global business. The global takaful market is expected to grow between 15 and 20 per cent per annum. Nevertheless, the market penetration level remains low, notably less than 5% in many Muslim countries and 6.8% here in Malaysia, thus providing significant market potential that remains untapped.

Bank Negara Malaysia will continue to foster the continued growth of takaful business by providing a conducive business and regulatory environment. However, there is a clear need for the takaful industry to deliver innovative financial products and services, that can effectively compete with those offered by conventional insurers. While acknowledging the necessity of having different rules in certain areas to reflect the underlying fundamental differences between the two systems, a key consideration of the Bank is to maintain a level playing field. Given the functioning of Islamic finance in parallel with the conventional financial system, neutrality in treatment between takaful and conventional insurance products is considered important to ensure the sustainability of both systems in the economy. The dual system would also serve to provide a comprehensive array of financial products and services as well as intermediaries for the overall benefit of consumers.

Allow me to also share with you Malaysia's latest initiatives to strengthen its position as an international Islamic financial centre. In line with our efforts to enhance our inter-linkages with the global Islamic financial markets, the Malaysian Government has launched the Malaysia International Islamic Financial Centre or MIFC as part of the initiatives to position Malaysia to become a leading international Islamic financial centre. It is our objective to build greater intermediation linkages between East Asia, South Asia and the Middle East which will, in turn, further expand inter-regional trade and cross border investment flows. As part of these initiatives, foreign financial institutions are allowed to establish International Islamic Banks, International Takaful Operators, as well as International Currency Business Units to undertake international currency business in Islamic finance with non-residents in Malaysia or abroad through a locally incorporated entity or a branch.

The Malaysian Government has also focused its efforts towards strengthening its position as an international takaful and retakaful centre, with particular emphasis on widening and deepening the retakaful sector so as to effectively complement the growth and expansion of the takaful industry. In this regard, I wish to invite strong and qualified applicants to make Malaysia as their centre for retakaful activities. Foreign applicants with strong credentials are certainly welcome to conduct retakaful business in Malaysia.

The changing global investment climate continues to pose challenges for life insurers in respect of their life fund investment. The recent sub-prime crisis in the US has induced greater fluctuations of the yield curve as well as higher volatility in the equity markets. Given the increased proliferation of innovative products with investment guarantees, insurers' remain very vulnerable to the movements of the capital markets. As for traditional non-investment linked business, asset-liability management and duration mismatch continue to pose a challenge, and insurers must seek new long term investment avenues to minimize the risk of mismatches.

The occurrence of global warming and climate change is of particular significance to the insurance industry which, has had to bear the brunt of severe losses arising from weather-related catastrophes. Between the 1960s and 1990s the number of natural catastrophes has doubled while insured losses increased nearly seven-fold, most of them weather-related. While the property and casualty insurers have been the hardest hit, life insurers are not necessarily spared as climate change has also taken its toll on human lives via natural disasters, epidemics and the like. While the global insurance industry has displayed remarkable resilience to withstand such record losses, the future remains fraught with uncertainties and the challenge is to ensure that risk management strategies remain adequate to counter the impact of unpredictable changes in global climate patterns.

Allow me now to briefly share with you, some of the measures undertaken by Malaysia in responding to the evolving changes and challenges seen in the insurance marketplace.

Firstly, in the area of structural reform, industry consolidation remains an area of priority for Bank Negara Malaysia in its efforts to foster a more competitive and resilient industry to harness economies of scale, expand distribution capacity, enhance business volume and exploit opportunities for cost rationalization.

Secondly, the shift towards principle-based regulations and the implementation of a risk-based capital and supervisory framework in Malaysia provides a greater degree of flexibility for insurers to exploit business opportunities arising from the changing financial environment, whilst not losing sight of the inherent risks. Moving forward, Bank Negara Malaysia will adopt an increasingly differentiated regulatory approach where insurers that exhibit strong corporate governance and risk management practices will be given greater regulatory flexibility.

Thirdly, the advent of bancassurance and bancatakaful has seen more players packaging life insurance and family takaful with innovative investment options that incorporate banking and investment product features. Bancassurance and bancatakaful provide immense potential for further market penetration given the relatively higher level of public confidence in financial

dealings with banks and the significant spin-offs that can be reaped through data mining arrangements with banks. Although bancassurance has become firmly entrenched in Malaysia (accounting for 45% of new business premiums in 2007), it also continues to develop rapidly in terms of market reach and operational sophistication.

Fourthly, with the rapid technological advancements and increasing consumer demands for more efficient delivery of products and services, the Malaysian insurance industry has continued to transition towards information technology-driven solutions, as well as, leveraging on more efficient payment and settlement systems such as e-payments. This has significantly enhanced the delivery of personalized and customized insurance solutions, made possible through the utilization of new delivery channels, including those that are internet-based. In the area of general insurance for instance, the successful implementation of e-cover notes for motor insurance policies led to vast improvements in service efficiency, better enforcement of cash-before-cover regulations as well as reduction in premium collection fraud.

In the area of capacity building, human capital development is key to the future development and growth of the financial sector. As competition intensifies, the role of human capital in defining the areas of comparative advantage will become more prominent. Recognizing these trends, Bank Negara Malaysia launched the International Center for Leadership in Finance (ICLIF) in 2003 to accelerate the development of top management talent for the corporate and financial sector within the Asian region. At the management trainee level, the Bank has initiated the Financial Sector Talent Enrichment Programme or in short FSTEP, a joint collaborative effort undertaken with the industry and training institutes aimed at boosting the supply of well-trained and competent personnel for the financial services industry. This is complemented by the International Centre for Education in Islamic Finance (INCEIF) which was established for the purpose of meeting the increased demands of Islamic finance professionals as well as conducting research and consultancy in Islamic finance. I would very much like to encourage you to take the opportunity of participating in some of these programs.

Finally, no less important an area for consideration in re-engineering financial sector development, is consumer education and protection. Today, we experience growing consumerism as well as changing consumer preferences and expectations in tandem with increased education levels and growing personal wealth. These and other developments collectively reinforce the need for greater financial literacy to ensure the efficient functioning of the financial system.

An important aspect of Bank Negara Malaysia's regulatory strategy and approach therefore, has been to ensure that the continued growth of the financial sector is underpinned by fair market practices and conduct. In this regard, initiatives undertaken by Bank Negara Malaysia in the insurance sector have been primarily directed towards enhancing product transparency and disclosure, improving sales practices, raising the bar of professionalism for insurers and intermediaries, as well as strengthening the consumer protection framework.

Apart from promoting sound and fair market practices, considerable efforts have also been made to develop the necessary infrastructure to facilitate consumers in obtaining redress, information and advice on matters relating to financial services. These include the implementation of the Consumer Education Programme and the establishment of a dedicated customer service centre (Bank Negara Malaysia LINK) and contact centre (BNM TELELINK) to improve access to information on financial products and services by members of the public.

As we advance forward, changes in the global economy and international financial landscape will continue to be dynamic and the level of complexity and sophistication in the financial markets will further intensify. Achieving success in an environment fraught with greater uncertainty and more intense competition, will ultimately hinge on the ability of the industry players to continuously innovate and deliver enhanced value propositions to customers.

On that note, ladies and gentlemen, I hope that the 23rd PIC will not only be a platform for industry leaders to share and explore ideas for the benefit of the life insurance industry, but more importantly, to be followed up with affirmative actions on the part of the delegates involved. Sir Winston Churchill once said, "*There are plenty of good ideas if only they can be backed with the power of action*". With that, I wish you a fruitful Conference.

Thank you.