Mohd Razif bin Abd Kadir: Unlocking opportunities

Opening address by Mr Mohd Razif bin Abd Kadir, Deputy Governor of the Central Bank of Malaysia, at the 10th ASEAN Insurance Regulators Meeting and 33rd ASEAN Insurance Council Meeting, Kuala Lumpur, 15 November 2007.

* * *

It is my great pleasure to be here today at the 10th ASEAN Insurance Regulators meeting and the 33rd ASEAN Insurance Council Meeting in Kuala Lumpur. Let me first extend a warm welcome and "Selamat Datang" to all the delegates from abroad as well as to fellow Malaysians here today. During this "˜Visit Malaysia Year" which is also the year of Malaysia's 50th Anniversary celebrations of our independence, I do hope that our foreign delegates will make time to enjoy Malaysia's diverse culture and the many unique sights, sounds and flavours.

I am indeed honoured to be officiating the opening of the 10th ASEAN Insurance Regulators Meeting and the 33rd ASEAN Insurance Council Meeting. I understand that several fruitful meetings and exchange of ideas have already taken place yesterday, and several meetings have been outlined over the next two days to discuss various matters, revolving around the theme towards moving the ASEAN insurance industry forward.

The **ASEAN region** has recorded **significant growth** with member countries growing at an average rate of 6% in 2006. ASEAN countries have grown stronger and our trade and cooperation have expanded further. Building on these existing strong linkages, ASEAN is expected to further progress in deepening and broadening its economic pie within ASEAN and in the region.

The ASEAN region as a group accounted for approximately 8.3% of Asia's total GDP in recent years and generated around 22% of Asia's total export, placing the region second behind China, Asia's largest exporter. In 2006, ASEAN foreign direct investment rose by 27% to reach USD52 billion and total exports increased by 16.5% to reach USD758.04 billion. Trade among ASEAN countries has also increased tremendously. In fact for Malaysia , our trade with the ASEAN region comprised about 25% of our total trade. As we move towards AFTA and the removal of tariffs, the economic integration between countries in the region will deepen further.

The encouraging economic growth prospects of ASEAN present **tremendous growth potential and opportunities** for the ASEAN insurance market. This increases the need to accelerate the development of insurance markets in the region to support the explosive growth in trade within ASEAN. Over time, the aim should be to achieve a better balance between reliance on foreign insurance markets and the domestic insurance markets within ASEAN to support economic activity. This will contribute towards achieving greater risk diversification, while at the same time, reaping more benefits for ASEAN economies from increasing economic integration.

ASEAN currently has a total population of 568 million, and a large proportion comprising of a young workforce in the middle income group. The changing priorities and lifestyles of this new generation, growing wealth and increasing proportion of middle income population will also support continued and further growth in demand for investment-linked and wealth management products. As a result, the **insurance** industry has, and will continue to, expand its role **beyond merely providing protection** products. Against this backdrop, prospects for increasing the insurance penetration rate in our economies are clearly positive. However, this will hinge on the ability of the industry to respond to these changing demographics and dynamics in the financial system. In 2006, the insurance premiums averaged 2.95% of GDP in South East Asia as compared with 8.8% in the U.S. or 16.5% in the U.K. Compared to the banking sector, the insurance industry remains relatively less developed and commands a significantly smaller percentage of the total financial assets of the region's financial system.

To tap these opportunities, appropriate strategies, new thinking and approaches will be required. In this regard, a significant development has been the evolution of alternative distribution mechanisms for insurance products and services in the region, notably through **bancassurance.** Indeed, bancassurance has developed in a number of ASEAN markets into a viable alternative distribution approach to the traditional agency force. Perhaps, in those markets where the insurance distribution channels through agency force have yet to be firmly established, bancassurance could provide a quantum leap to allow insurers to rapidly widen their outreach by tapping into an established banking network and client base. Worldwide, insurers have been successfully leveraging on bancassurance to gain a foothold in markets with low insurance penetration and a limited variety of distribution channels. Bancassurance can increase market penetration given the relatively higher level of public confidence in dealings with banks. For the banks and insurers, **capitalising on synergies** derived from tapping into the banks' extensive customer base to offer consumers comprehensive financial solutions while **optimising on the branch network** have proven to be highly successful strategies towards mutually improving productivity and profitability.

In Malaysia, bancassurance constitutes a significant feature of Malaysia's financial landscape, and continues to develop rapidly in terms of market reach and operational sophistication. These developments have contributed towards significantly raising the nation's insurance penetration level and enhancing the competitive structure of the insurance industry.

In addition to bancassurance, the **Internet** is emerging as a promising medium for insurers **to advertise products and service** policyholders. With the rapid technological advancements and increasing consumer demands for more efficient delivery of products and services, it offers the potential for insurers to target a wider market, improve client service and conduct business seamlessly across borders.

While planning for effective distribution channels may become the key differentiating factor in the growing region today, one must not overlook the implications of the changing demands of the general public. The **ageing of the population** is an issue of increasing importance in the developing world. All across Asia , the number of people aged 65 and above is expected to grow dramatically over the next 50 years. For the region as a whole, the population in this age group will increase by 314 % from 207 million in 2000 to 857 million in 2050. Many nations are finding it increasingly difficult to provide adequately for the needs of their aged through state-provided social security. Faced with such prospects, **planning for retirement** has become more important, both for individuals as well as public policy to ensure sustainable financing and management of retirement and healthcare needs in the long term.

In this context, the **development of deep financial markets** among ASEAN countries is critical. One of the significant challenges currently facing the insurance industry in this region has been the shortage of long term assets that match the duration of insurance liabilities. While the bond markets in several ASEAN economies have been extensively developed over the last decade, longer-dated papers remain scarce in most countries. This has been a key impediment to the development of private pension products needed to meet the increasing demand for channels through which the population can save for retirement. While there are significant efforts being made to further develop the longer end of the bond market, the engagement between the industry, regulators and Government needs to be maintained *and intensified* further to take this agenda forward. This is critical both for the management of risks in the industry, and to support sustainable growth in the longer term.

Another untapped segment of the market is the takaful sector in view of the fact that Muslims constitute more than 40% of the population in ASEAN, mainly in Malaysia , Indonesia and Brunei . Globally, the Muslim population accounts for about 24% of the total population. This has supported the growth of the takaful market in recent years as an alternative to conventional insurance. The global takaful market is expected to grow between 15 and 20 per cent per annum. Based on the market penetration level which is at 6.8% in Malaysia and less than 5% in many Muslim countries, this represents significant market potential for the future growth of takaful business.

The expansion of insurance markets in ASEAN will need to be reinforced by further **consumer education** to increase awareness among the public on the importance of **long-term financial planning** as well as to equip them to evaluate product features and make informed decisions. The insurers must recognise that it is an important responsibility on their part not just to ensure that adequate information is provided to the consumers, but that consumers are suitably advised in the sales process. This includes ensuring that information about insurance products is presented in a manner that is meaningful and easily understood by consumers. This distinction between quantity and quality is important. In this respect, we should learn from the unsatisfactory outcomes that have emerged in some of the more developed markets where product disclosures can run into 60-page documents, which no one can reasonably expect an average consumer to read, let alone understand. Ultimately, the purpose of disclosures must be to help consumers understand the risks associated with different product options. In this context, more information is not necessarily better. The quality of information and financial capability of consumers must be enhanced in tandem with improved disclosures. Of course, increasing product innovations also need to be **matched** by **strong risk and portfolio management capabilities** critical to ensure the long-term sustainability and viability of the products offered in the market as well as the financial soundness of insurance companies.

The operating landscape in which we operate has also changed significantly. Convergence in financial services has **blurred** the **boundaries between insurance, banking and capital market** activities. In this environment, financial sector regulation and supervision has become significantly more challenging. The increasing linkages between insurance and the banking systems as well as capital markets have increased the importance of achieving a **harmonised regulatory approach and standard** across sectors to minimise possibilities of regulatory arbitrage between different types of institutions. Under such environment, the approach towards regulatory and supervisory framework also has to evolve in tandem with the change in the environment.

Recognising these dynamic changes, Bank Negara Malaysia took efforts to strengthen our regulatory and supervisory capabilities as well as sharpen our focus. The organisational structure for the regulatory and supervisory functions within the Bank were realigned in November 2006 to move from the previous institutional based approach, to one that integrates the Bank's regulatory functions for the different financial sectors under its purview along functional lines. The new functional based, cross-sector regulatory structure allows us to modernise the regulatory framework for both the insurance and banking sectors at a more equal pace. The increased synergies created will enable the Bank to apply the best regulatory practices in both the banking sector to the insurance sectors. Under the new structure, the Bank is able to leverage on the more advanced developments in either sector to enhance the regulatory framework for both sectors, simultaneously if possible. At the same time, it allows us to develop and train our personnel to be better equipped in the constantly changing operating environment. These efforts, will promote a more consistent regulatory regime for both the banking and insurance sectors.

A positive side effect that can accrue from this move is the **enhancement of public confidence** on the insurance sector which augurs well towards increasing the level of insurance penetration. Achieving a more integrated approach to cross-sector regulation was relatively easy in Malaysia as Bank Negara is the single regulator for both the banking and insurance industries. In other countries, **greater coordination and collaboration** between separate regulatory agencies can similarly contribute towards a more consistent approach to regulation and supervision across sectors in dealing with similar risks.

While consistency in regulatory and supervisory approaches will contribute towards overall financial stability and increased regulatory as well as business efficiency, it is important to appreciate the fundamental differences between different market players. As someone put it, notwithstanding current trends in financial conglomeration, banks will always be banks, and insurers will always be insurers. As such, the risks stemming from the liability side of an insurance company is far more significant than the asset side, while the reverse is generally true for banks. While some dimensions of this are changing, such differences must be properly catered for in the regulatory framework as well as in insurers' own internal risk management practices.

Human **intellectual capital** plays a pivotal role in driving the industry's future and competitiveness. The environment of increasing complexity in financial services that is accompanied by increasingly sophisticated consumer expectation place new demands on the skill sets and competencies of regulators and industry professionals. Adoption of the highest standards of **professionalism and integrity** is essential in generating public confidence in the insurance industry. It is therefore critical for us to continuously invest in human capital as the pace of **progression for the insurance industry** would to a large extent **depend upon the capability of those working in the industry** - their skill set, expertise and competency.

Unfortunately for all of us, similar to other emerging economies, there is a scarcity of qualified and well trained personnel to meet the growing and increasingly complex needs of the industry. Therefore human capital development should not be viewed as an expense but as an investment for the future. Without such investment, our insurance industries will not be able to quickly make the leap forward and we risk losing the opportunities to players from more sophisticated economies that are ready on the sides to take advantage of our inadequacies.

On this note, I am pleased to note that in the short span since its establishment in December 2004, the ASEAN **Insurance Training and Research Institute**, or **AITRI**, has successfully conducted technical training and seminars on insurance for over 200 insurance regulators, supervisors and practitioners to date. AITRI has also received recognition from international organisations such as the International Association of Insurance Supervisors and First Initiative for the training programmes that were conducted. Despite its limited capacity and funding, AITRI has continued to serve as the regional network centre for insurance education and research, providing opportunities for regulators to meet, learn and share experiences. I wish to urge ASEAN countries to leverage on **AITRI as the regional platform for greater interaction and collaboration** and continue to provide support to enable the institute to expand and play the role expected of it.

In addition to building capacity within our own respective economies, there is great potential for the ASEAN insurance industry to increase our competitiveness as a region in order to **retain a greater share of the insurance business** particularly in reinsurance and underwriting of large, specialised risk which traditionally flows out of the region. In order to increase our capacity and expertise to underwrite such risks, greater collaboration in the form of technical assistance and information sharing are important. Great value can be derived from the **pooling of experiences and resources** to develop our own probability models which will enable us to better price risks based on the unique characteristics of our region. Through such collaboration, the ability for the insurance industries in ASEAN to underwrite and reinsure risks to serve the needs of the ASEAN businesses and individuals can be significantly enhanced. In this regard, I would like to encourage the **industry to work together** with the **regulators** to explore ideas to build our capabilities and capacities as well as enhance our competitiveness towards developing a robust insurance industry in the region.

To further support the development of ASEAN's insurance industry, initiatives to **harmonise standards across countries** should continue to remain as an important agenda. Exchange of information on insurance development and statistics among regulators would enable members to benchmark on their current progress and leverage on each others' experiences to advance forward. A more **systematic and structured information sharing mechanism** though a regional centre can serve as a catalyst for the development of insurance and reinsurance business among ASEAN members. The mechanism could form a core infrastructure for the region to build on its insurance data, enable trend analysis and support product pricing that better reflects the region claims experience and pricing environment. These initiatives should be further supported by efforts to **mutually recognise insurance coverage across borders to facilitate trade and transfer of goods** between our countries. This is an important area that should continue to be focused on by the practitioners and authorities in our shared vision towards developing ASEAN as an integrated economic region.

Another important element is for the regional insurance industry, as institutional investors, to play an important role to help foster the **development of the regional capital and bond market** by investing in the regional securities. This should go along efforts towards diversifying the risk in the financial systems from becoming overly reliant on the banking system to fund the growing member economies.

The South East Asia region is developing at a rapid pace and changes in the global economic and financial environment are driving us to continuously adopt new strategies and approaches. To quickly respond to these demands, enhanced **regional cooperation** is the key foundation towards **achieving greater collective growth and economic prosperity**. I'm confident that the gathering of regulators and industry practitioners at this 10th ASEAN Insurance Regulators Meeting and 33 rd ASEAN Insurance Council Meeting will see further concrete steps taken towards promoting cooperation and building strong, stable and competitive insurance industries within ASEAN. I wish all of you a fruitful and stimulating meeting in the coming day.

On this note, I declare the 10th ASEAN Insurance Regulators and the 33rd ASEAN Insurance Council meeting opened.