

Muhammad bin Ibrahim: The changes in Malaysia's insurance sector

Keynote address by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the 6th Malaysian Insurance Summit, Kuala Lumpur, 18 October 2016.

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Reaching the point of inflection on the “S-curve”

Over a decade ago in the Insurance Annual Report 2000, Bank Negara Malaysia projected that Malaysia's insurance sector would expand following the trajectory of an “S-curve”. Growth in both the life and general insurance markets would significantly outpace the economy, ascending the steep slope up the “S-curve”. Since then, total assets of the insurance and takaful sector have expanded at an annual rate of 13.3%, more than tripling in value from RM52 billion in 2000 to RM181 billion in 2010. Life insurance penetration increased from 33% to 51% of the Malaysian population over the same period.

In the more recent years however, this growth has started to plateau. Life insurance penetration has remained stagnant at 55% for the past 3 years, while in the general insurance sector, domestic capacity for larger and more specialised risks appears to be reaching its limits. This in turn has contributed towards sustained reinsurance outflows which have an impact on the country's long term current account balances.

Based on our observations, the industry appears to be approaching the point of inflection in the “S-curve”. Yet we know that its growth potential remains significant, with Malaysia still a long way from being a saturated market. This suggests that the industry is ripe for transformation to a new growth trajectory. The industry in essence has not delivered the required results.

Jumping the “S-curve”: The need for positive feedback loops

Successfully jumping the cusp of the “S-curve” is the only way to realise the aspiration of a deeper and more diverse insurance market. This calls for *transformational change*, driven and reinforced by positive drivers that will revitalise the industry.

In the context of financial services today, these drivers focus on three “T”s – ***talent, technology and trust***. These three factors can be harnessed to catapult the industry onto a path of new and stronger growth, or they can precipitate its decline over time. The industry must secure the former for its future expansion or else it will continue plateauing.

Let me speak briefly on these three factors.

Firstly, we must grow the talent we need to bring our insurance and takaful sector to the next level.

As our economic structure evolves, we will need a deep pool of insurance and takaful professionals who can develop and support new solutions for managing risks.

Unfortunately, talent shortage has been a persistent issue which, if not resolved, will not only hold back the industry from gaining new ground; it could lead to a further retrenchment of business growth. The industry needs to make further efforts to attract and nurture new talents.

For example, the lack of underwriting expertise is a major reason why we have yet to stem the outflow of insurance for large and specialised risks. Over the last five years, the amount of direct and reinsurance premiums ceded overseas for the Marine, Aviation & Transit (MAT) and Energy risks amounted to over RM5 billion, with the retention ratio for these classes

remaining below 30% for the last 10 years. With our world-class oil and gas industry and one of the largest airline fleets in the region, having the requisite insurance underwriting expertise in these sectors is not only a logical business extension for the industry; it is also an important economic imperative for the country.

With more than 200 actuarial science graduates coming into the market annually, a healthy talent pipeline exists to support a whole range of functions from pricing to risk management and financial reporting. To leverage this resource, more needs to be done by the industry. In a recent survey of 20,000 graduates in Malaysia, the insurance and takaful sector lags other financial institutions in attractiveness, with only three positions among the top 100 employers in Malaysia, compared with the banking sector which has 16 names. The industry, collectively, ought to do better than this. We cannot be complacent when it comes to talent development.

The hunt for talent is a continuous affair. Therefore, a strategic focus and investments to attract, retain and develop this talent must be prioritised. This cannot be left to random and piecemeal initiatives; strong leadership at the industry level is required to drive a more organised industry effort to develop and strengthen core competencies of the industry workforce across the board.

As a way to accelerate the breadth and depth of our talent pool, the Bank would support the establishment of regional functions and centres of excellence by insurers and takaful operators in Malaysia to serve the regional and international markets. In addition to deepening the domestic insurance market, this will have positive spillovers in lifting the quality of jobs in the industry more generally and reversing the brain drain of insurance talent.

Secondly, insurers need to stay ahead of the curve in leveraging new technologies to be more accessible, more efficient and more agile.

Many forces will be driving insurers to be more innovative. The removal of tariffs and changes introduced under the LIFE Framework will drive the growth of new products and delivery channels. As social media and other forms of communication change the way insurance is accessed, traditional business models will be at risk of being “Uberised”. Even where face-to-face contact remains important, for example in the purchase of long term life insurance, the effectiveness and cost efficiency of agents will be transformed by enhancements in productivity arising from better data analytics.

The Bank will continue to pursue the innovation agenda. Technology advancement is here to stay. Revolution in business brought about by technological advancements will change the way we live and do business. As a catalyst for such innovations, I am pleased to announce that following a public consultation process, the Bank has today issued details of the Financial Technology Regulatory Sandbox. Effective immediately, financial institutions and fintech companies will now be able to pilot innovations in a controlled, live-test environment with appropriate flexibilities accorded. This will include flexibilities under existing regulatory requirements that apply to outsourcing arrangements and access to customer information, subject to compensating safeguards.

The experience from the sandbox will provide input into formulating more proportionate regulations that will spur the orderly growth of new innovations in the financial industry, including insurance. We see significant potential for positive disruptions to transform the business of insurance and takaful in Malaysia – from the way insurance is consumed, to opportunities for addressing leakages to drive insurance costs lower.

Indeed, the greatest gains from technological innovations may well be reaped in the more mundane aspects of running a business efficiently. Today, money is still being left on the table from inefficiencies and leakages in the insurance system. From inefficient manual

processes to the slow take-up of electronic payments, there are large gaps in the supply chain that unduly increase the cost of insurance and limit efforts to combat insurance fraud.

The insurance industry needs to accelerate its pace in terms of its technological adoption or else events will dictate the shape of the industry's future.

I urge the industry to come together and focus on the long term benefits, and give its full support to initiatives such as ISM's Fraud Intelligence System, and collaborate on other innovations such as the electronic reporting of motor accidents to bring the cost of insurance closer to its "true cost". Such collective effort is critical to make insurance and takaful accessible to many, and to promote its sustainability over the long term. Individual insurers should also adopt the longer term view and invest in innovation. Much more can still be done by insurers that are part of global insurance groups to bring new technologies, product designs and process improvements into the Malaysian market. The undue focus on short term profitability driven at the group level have often come at the expense of certain market segments being underserved and customers being denied best value for money. Foreign insurers need to contribute more to justify their presence in the Malaysian market.

Thirdly, insurers and takaful operators need to cultivate and continuously affirm society's trust in the industry.

Insurance and takaful products have become more complex with the result that most consumers do not fully understand what they have purchased. A larger number of players chasing the same pool of customers, result in intense competition that gives rise to poor sales practices. Pressure to improve underwriting results by controlling claims costs can also have unintended effects on the consumer experience.

Cumulatively, these factors can undermine consumer confidence and trust in the industry, with important implications for business growth and persistency.

Globally, financial institutions need to get serious about addressing the trust deficit in the financial industry. The hallmark of an industry that engenders trust often goes back to the basics of serving its core purpose, and doing it well. This begins with product innovations that should be aimed at increasing the level of public engagement and interest. The industry must abandon the mindset that "insurance is sold not bought", and design products that people actually need and want to buy. Such products must also be able to afford protection to the underserved segments of society through affordable and simple product solutions. Such products will be easier to sell, lowering distribution costs and contributing to even lower prices in a virtuous circle that delivers benefits to all parties.

The industry also needs to explore new cost-efficient delivery channels. The industry has not done well in this respect. As a catalyst, beginning next year, insurers will be required to offer pure protection products through a direct channel without commissions. The high internet and mobile phone penetration in Malaysia suggests that internet or mobile insurance makes good sense. Other untapped channels include banking agents, retail chains, employers and cooperatives. We expect the industry to fully adopt these channels to diversify delivery of services.

New products and delivery channels that enhance outreach ultimately contribute towards expansion of a larger industry, and pool of customers for *all* participants in the insurance sector as a whole. In other words, it is not a zero sum game. Everybody will gain. Insurance agents and financial advisers will continue to provide a valuable service as households and businesses move up the income ladder and require more personalised advice on product options. It is important that this evolution is accompanied by a strong focus on raising standards of professional competence. Increasing the proportion of full time agents from the current 40% in the life sector and 30% in the general sector will be a vital component of this agenda. Equally important is ensuring that remuneration structures are aligned with the

interests of consumers. The implementation of the balanced scorecard is an important step in this direction and should not be further delayed or diluted.

There is no question that the potential for growth in the insurance and takaful industry is significant, with estimates placing the life and medical insurance protection gap alone in Malaysia at between RM550,000 and RM723,000 per household. Closing this protection gap is ultimately the moral responsibility of the industry. Microinsurance and microtakaful should be further developed to improve access to the underserved segment of society.

Charles Handy who conceived the concept of the “S-curve”, has this to say, “It is one of the paradoxes of success that the things and the ways which got you where you are, are seldom those that keep you there”. A reminder that is worth heeding.