Zeti Akhtar Aziz: Insurance and reinsurance in the aftermath of the global crisis

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the 21st Federation of Afro-Asian Insurance and Reinsurance Conference, Kuala Lumpur, 20 October 2009.

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It is my great pleasure to be here today at the 21st Federation of Afro-Asian Insurance and Reinsurance Conference in Kuala Lumpur. This Conference reinforces the cooperation between the African and Asian region in the development of the insurance industry. The theme of this year's conference, "the insurance and reinsurance environment in the aftermath of the global financial and economic crisis", is indeed highly relevant as stabilization and signs of recovery are emerging in the world economy. The crisis has tested the robustness and resilience of financial systems around the world. The far reaching implications of the financial crisis have shaken the foundations of the international financial system. The effects of the crisis on the financial systems and the re-thinking by the international community on the issues that have surfaced during the crisis will fundamentally change the future financial landscape. This Conference provides an important platform to discuss the key issues faced by the insurance and reinsurance industry, in particular, in the context of our two regions and to discuss the potential to leverage on our respective relative strengths and the opportunities that the new environment presents.

While several of the advanced economies will continue to be weighed down by weak growth as the slow process of financial resolution continues and the high unemployment delays the recovery process, emerging economies, in general, and Asia in particular, have shown a high degree of resilience. The financial intermediation in most emerging economies have remained undisrupted and have continued to support the domestic economic activity. While the emerging economies are expected to lead the recovery process, there needs to be a reassessment of the strategies for future growth. Over reliance on export orientation to the traditional markets would increase the vulnerability to external developments.

Going forward, emerging economies now need to achieve a greater balance between external-oriented development strategies and the strengthening of our domestic demand. In Asia, domestic demand in most emerging economies are well supported by the positive demographic structure, the rising income levels, and the broadening of affluence. This is reinforced by the low levels of unemployment and inflation, and the continued access to financing. This changing spending patterns in Asia have already led to the rise of a modern retail sector across our region. In addition, high savings rates exceeding 30% of Gross National Product for most countries in Asia, raises the potential for long-term sustainability of domestic consumption spending. This trend has also supported increased intra-regional trade, investment and tourism that is reinforcing the growth prospects in the region.

The evolving trends and encouraging growth prospects in our respective regions present tremendous opportunities for the insurance and reinsurance industry. Of significance is that the global insurance industry on the whole has remained resilient throughout the current financial crisis. The overall aggregate financial position of insurers in the crisis affected countries have continued to be strong, and generally not severely affected by liquidity pressures or exposures in the credit derivatives markets. Earlier losses by insurers in financial market activities had resulted in a shift to "back-to-basics" models, focusing on core underwriting business instead of heavily relying on investments as the main source of earnings. The industry had also benefited from the subsequent upturn in the pricing cycle which has fortified the capital position of insurers and provided the support to maintaining sound underwriting standards. These conditions have placed the industry on a much stronger position to withstand the challenges emanating from this global financial turmoil.

Domestic and external conditions are however expected to remain volatile for some time. Significant uncertainties will persist in the international financial markets and the broader global economic conditions. These conditions will continue to pose significant challenges to the insurance industry. In this environment, maintaining strong capital buffers and sound risk management is even more imperative to ensuring the continued resilience of the insurance industry. With the adoption of Solvency II in Europe and its influence on solvency regimes in other jurisdictions, more countries, including Malaysia, have now moved to adopt more risk-aligned capital regimes. This needs to be reinforced by substantive improvements in risk management practices, greater alignment between business strategy and risk, and greater appreciation by boards and senior management of insurers on risk issues given the growing complexity and increasing interconnectedness of financial markets and financial sector players.

The insurance industry has progressed significantly over the years and is well-positioned to supporting both the recovery process and future growth potential of the economy. As emerging economies rebalance with greater emphasis on private consumption, the social safety net will need to be strengthened, with insurance and pensions now having a greater role. An ageing population will also become an issue in the future. Globally, the number of the aged population that is aged 65 and above is expected to grow dramatically by 2050. Such rapid growth will have major economic and social consequences in many countries. Many nations are finding it increasingly difficult to provide adequately for this segment of the population through state-provided social security. Planning for retirement has therefore become essential both for individuals as well as public policy to ensure sustainable financing to meet retirement and healthcare needs in the long term. An enhanced social safety net would foster greater security in addition to reducing the need for significant precautionary savings. This would in turn promote increased consumption spending.

Prospects for higher insurance penetration rate in the region continue to remain positive. In 2008, insurance premiums accounted for 5.95% of Gross Domestic Product (GDP) in Asia and 3.57% of GDP in Africa compared to 7.29% in America and 7.46% in Europe. The changing priorities of the growing population in the region, largely comprising of a young workforce in the middle income group, have also enhanced the demand for investment-linked and wealth management products. These opportunities require strategies to increase the accessibility of insurance products. Worldwide, insurers have successfully leveraged on bancassurance and internet channels to enhance insurance penetration. In Malaysia, insurers can now freely enter into bancassurance arrangements with banking institutions and extend their branch network based on the liberalisation measures announced in April this year.

In the more recent period, the role of insurance becomes increasingly more important, with the increasing frequency of catastrophies that have been associated with global climate change and pandemics. According to a recent study, economic losses caused by natural and man-made catastrophes around the world in 2008 amounted to USD269 billion. Asia accounted for the top five worst catastrophes in terms of fatalities in 2008. The recent natural disasters in Southeast Asia and the Pacific Islands have also resulted in major destructions. Public-private partnership between Government and the insurance industry in providing appropriate insurance schemes and developing risk mitigating mechanisms are needed to cope with these losses. Greater collaborative efforts among industry players in the region in the form of technical assistance and pooling of resources will increase capacity and expertise to underwrite such risks. Through such collaboration, the ability for the insurance industry to underwrite and reinsure risks based on the requirements of the region can be significantly enhanced.

The growth of the takaful sector has also been commendable over these recent few years. Between 2004 and 2007, the average annual growth rate of the global takaful industry is estimated at 25%, compared to 10.3% for conventional insurance. With the proliferation of players and products, and the rapid pace of development of the sukuk market, Malaysia's takaful sector experienced an average annual growth of 20% from 2003 to 2008. Today, the takaful industry accounts for 11.5% of the overall insurance premiums. Takaful companies in Malaysia have also ventured into international markets to expand their business. This positive outlook is expected to continue with the impending entry of new takaful players as well as from the increased participation of international industry players in the takaful market. Of importance is that the industry is well supported by a robust legal and regulatory framework that upholds Shariah principles.

In the aftermath of the global financial crisis there has also been a rethinking of the regulatory structure of the financial system. The crisis has exposed serious shortcomings in the supervisory architecture. Increased consideration is being given to a more integrated approach to the prudential regulation of the insurance industry together with the other segments of the financial sector. With the growing significance of the insurance industry, this would result in more consistent prudential standards for regulation. In addition, there has been an ongoing convergence in the financial sector as traditional boundaries continue to be eroded by changes in institutional structures, shifting legal barriers and product innovations. The proliferation of conglomerate arrangements have also increased the need for more consistent regulatory approaches across industry boundaries to reduce the prospect of regulatory arbitrage and inefficiencies.

France and Germany have recently made announcements on the consideration to place the supervisory responsibility of the insurance sector with the Central Bank. This has however, drawn some resistance from insurers on grounds that" the concentration of responsibilities would create new conflicts of interest for the financial sector". Bank Negara Malaysia has been the supervisory authority of the banking industry since its establishment in 1959 and for the insurance industry since 1988. This integrated approach within the Central Bank has enabled us to form a more complete assessment of the risks to financial stability while ensuring consistency in the treatment of risks across the different industries to avert risks to the overall financial stability.

The rapid pace of changes in the global economic and financial environment requires industry players to continually upgrade their expertise. Cooperation in this area between industry players can contribute towards bringing the insurance industry to the next frontier. Since its establishment in 1964, the Federation of Afro-Asian Insurers and Reinsurers has fostered a strong cooperation among insurance industry players in Africa and Asia. Such expertise may indeed be tapped through such regional platforms, bringing with it mutual benefit to the insurance industry in both markets.