Muhammad bin Ibrahim: Charting new frontiers – financial advisers the future

Keynote address by Mr Muhammad bin Ibrahim, Deputy Governor of the Central Bank of Malaysia, at the Inaugural Conference of the Association of Financial Advisers "Charting new frontiers – financial advisers the future", Kuala Lumpur, 31 October 2012.

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I would like to congratulate the Association and its members for your commitment, which has resulted in the successful formation of the AFA to champion and promote the interests of all licensed financial advisers in Malaysia. The formation of AFA is most timely, and marks a significant milestone in the progressive maturing of the financial advisory industry.

Since the introduction of FAs in 2005, we have seen commendable growth within the industry, with the number of licensed FAs rising from 2 to 17, and the number of licensed FA representatives increasing from 17 to 229 today. The formation of the AFA is timely as it provides a platform to encourage greater collaboration among FAs to instill greater professionalism among its members and I expect the AFA to play an important role in coming up with clear strategies to propel the financial advisory sector towards greater progress and growth.

Developments in the insurance and takaful sectors

There are some broad developments within the economy and the financial sector that will expand the opportunity for growth in the provision of independent financial advisory services.

First, the insurance and takaful sectors have seen positive and continuous growth over the last five years, with total insurance premiums transacted and takaful contributions recording an average annual growth of 4.9%, with annual growth peaking at 13% in 2010. In terms of insurance penetration, in 2011, 67 out of 100 Malaysians had some form of life insurance or family takaful coverage as compared to only 59 out of 100 Malaysians in 2006. This means there remains a large untapped segment of the population with no life insurance or family takaful protection that the profession can further develop.

Second, in terms of distribution channels, the agency force is still the dominant intermediation point for the insurance industry. At present, the market share of financial advisers as a delivery channel is still low and therefore, the prospect of growth is tremendous.

The prominence of the agency force as a delivery channel of choice for the distribution of life insurance business is evidenced from the more than 10% growth in the number of life insurance agents enrolled between 2006 and 2011. Consistent with the increase in the agency force, the expenditure dedicated to maintain this delivery channel also remained significant, with commissions and agency remunerations consistently accounting for more than 70% of the net investment income of the industry.

This trend reflects the attractive payouts a productive agent can potentially earn, although the industry's commission structure is bound by the limits specified in the operating costs control guideline (OCC Guideline) issued by the Bank.

Benchmarked against selected countries within the region which do not regulate commission payment, the commission rate currently earned by Malaysian agents remains relatively high compared to the benchmarked rates of between 140% to 150%, as seen in other jurisdictions. This excludes other agency-related benefits which are also allowable under the OCC guideline.

Some have argued that the current commission levels are too low as the commission structure has not been revised since the Guidelines were first introduced in 1996. However, closer scrutiny shows that agency income from commissions had increased in absolute terms in line with the increase in average premiums size. The average size of new business grew by 9% per annum over the last decade while in-force premium size recorded a compounded annual growth rate of 5%. Hence, the commission income of productive agents has in fact been growing in excess of the consumer price index and national average wage inflation.

The world is constantly changing, the transformation that is taking place in the financial sector landscape also warrants a suitable change in the regulatory framework which the industry must be prepared to embrace and adapt to, going forward. The OCC had served its objectives well to keep operating costs reasonable to ensure policyholders' interests are preserved. To enhance greater efficiency and facilitate a more competitive market environment, the Bank will accord greater operational flexibility to the industry in determining amongst others, the commission structure for its agents and other intermediaries.

Based on statistics made available to the Bank, commission and agency remuneration have consistently accounted for approximately 40% of the total net premium income of life insurers since 1997. With the proposed flexibility, individual insurers will have the ability to determine the remuneration of its intermediaries but subject to appropriate safeguards being put in place such as a more robust disclosure framework for greater transparency. These operational flexibilities will be implemented in a gradual manner, with some measures being introduced by the end of this year. This is to minimize the risk of adverse impact on the efficient delivery of insurance products and services to consumers.

With the fundamental changes taking place around us, it is timely for insurers including intermediaries, to assess how best to improve insurance penetration going forward. There are some fundamental questions that need to be asked. Would attracting a larger agency force be the most effective solution in this more liberalized environment? Or, should the focus perhaps be on expanding the diversity of the intermediaries in general, to ensure consumers have more alternatives to receive high-quality and suitable advice?

Whatever the response to these questions, what is obvious is that investing in human capital is an important common denominator, not only to enhance the existing level of expertise of intermediaries but also to attract the right people to ensure a continuous supply of talents into the profession.

It is from this perspective that an incentive package is being considered by the Bank to subsidize the costs related to minimum professional qualifications for FAs. We hope that it will entice more agents to consider upgrading themselves to become successful FAs.

Growing demand for independent financial advisory services

As our economy continues its track towards high income nation status, and as our society becomes more affluent and discerning, we envisage an increasing demand and preference for high-quality, independent and personalized advisory services among financially-savvy consumers.

Apart from rising levels of disposable income and financial sophistication, Malaysians are expected to live longer now than ever before. It is projected that by 2040, 17% of the Malaysian population will live beyond the age of 60 years old compared to about only 8% of the total population in 2010. This creates the need for more effective long-term financial planning on the part of consumers to ensure they have sufficient funds to see them through their golden years. In this respect, as part of the Government's initiative to encourage savings among Malaysians to better prepare for their retirement, the Government had announced a tax relief of RM3,000 for individuals who have bought an annuity plan for the next 10 years commencing in 2012.

An increased competition within the financial sector and evolving demographic structures has also led to the introduction of new and more complex financial products offered by financial service providers. While financial consumers now have a greater array of choice, the challenge is in choosing the most appropriate financial product commensurate to their needs. Lessons learned from other markets showed that high-profile cases of mis-selling of investment-linked and pension products extols the importance of ensuring consumers are properly adviced on the key features, terms, conditions and suitability of a financial product before they enter into any financial contract.

Assisting consumers to make wise financial choices

As FAs, you have the responsibility to educate consumers on the importance of financial planning, such as saving for the first home or a child's future education, or buying insurance protection to safeguard against unexpected losses. FAs can assist consumers in better understanding their current and future financial needs and circumstances. FAs can provide independent and impartial advice which is tailored to the consumers risk appetite and financial needs.

Apart from educating their clients on what they should be investing in, FAs also play an important role in educating their clients on what they should *not* be investing in. As you are the industry's front-liners and are actively meeting with potential customers on a daily basis, FAs can be relied on as a key source of information to prevent consumers from falling prey to financial scams.

Broad strategies for effective provision of wealth management

In recognition of the need to further enhance the regulatory framework supporting the development of the financial advisory sector, the Bank has recommended for further streamlining of the current dual licensing regime for FAs and financial planners (FPs) in the Financial Sector Blueprint 2011–2020. A Joint Working Group with the Securities Commission has been formed to assess the existing legislations and regulatory regime across both jurisdictions, with the aim of further reducing duplications and related costs of compliance for the benefit of industry participants.

Some of the measures that have already been introduced include the harmonization of limits on foreign shareholding and streamlining of professional qualifications and requirements on continuing professional development. The Bank will be engaging with the AFA at a later stage as part of the consultative process towards further enhancing the regulatory regime for FAs and FPs.

In line with our objective of promoting fair and responsible conduct by financial service providers, the Bank has recently reissued the Guidelines on Proper Advice Practices for Life Insurance and Family Takaful Business. The Guidelines which was previously applicable to the sales force and agents of insurers and takaful operators has now been extended to include all insurance and takaful intermediaries, including financial advisers. The Guidelines outline the minimum standards for proper advice and ethical selling practices of life insurance and family takaful products by insurance and takaful intermediaries, with the aim of ensuring consumers are provided with suitable advice to support informed decision-making.

With these Guidelines in-force, the Board of Directors of respective FAs are now required to establish the necessary processes to ensure proper monitoring of the quality of the advisory process conducted by FA representatives, and we expect FAs to deal firmly and expediently in the event of non-compliance which results in mis-selling or the provision of inappropriate advice.

I am greatly encouraged to see the continuing growth of the FA industry and today's event marks a significant milestone for the industry as a whole. The theme of this Conference, "Charting New Frontiers – Financial Advisers the Future" is well-timed and reflective of the changes we are now experiencing as our nation progresses towards a high-income economy. Once again, I would like to congratulate AFA on its official launch and look forward to meaningful contributions from the Association in driving the financial advisory sector forward. On this note, I wish you all a successful and productive Conference.