

## **Jessica Chew Cheng Lian: Financial advisers the future – rise of the new wave**

Keynote address by Ms Jessica Chew Cheng Lian, Assistant Governor of the Central Bank of Malaysia, at the 2nd Annual Conference of the Association of Financial Advisers “Financial advisers the future – rise of the new wave”, Kuala Lumpur, 31 October 2013.

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It is my great pleasure to be here this morning at the 2nd annual conference of the Association of Financial Advisers (AFA). This year would be the eighth year that financial advisers have been a part of the financial landscape in Malaysia. As the industry looks to the future, I think it is useful to also look back to the motivations for developing financial advisers in Malaysia. Fundamentally, the objective was to improve the quality of advice on insurance solutions that was being provided to consumers. Before financial advisers, such advice was mainly only available in this country from tied agents and this system had certain limitations in terms of incentive structures and the breadth of products that the agent could draw on to advise consumers. A second objective, and perhaps one that has not been emphasized enough, is the expectation that financial advisers would be able to help individuals and households with a broader financial outlook. This means helping individuals and households understand how insurance fits within their broader financial management strategies to grow their savings, manage risk and meet specific financial goals.

### **Growth potential and opportunities**

Over the last three years, the financial advisory industry saw total premiums transacted increase by an average annual growth of 21%. While this is from a low base, the industry is on a sustained growth trajectory, which suggests that financial advisers are adding value and successfully distinguishing themselves from alternative channels for the distribution of insurance offerings. We are pleased to see a further three new financial advisers added to the industry this year. The industry has only begun to scrape the surface in harnessing the potential that exists for financial advisers to make a substantial contribution in helping Malaysian households improve their financial management and prepare for income shocks.

This potential is striking. Every year, more than two million life and family takaful policies are sold, 69% of this by tied agents. More than 40% of the Malaysian population still do not have any form of insurance, and a large proportion of those who do are likely to be significantly under-insured. This is supported by a recent study commissioned by Bank Negara Malaysia which found that 79% of more than 1,000 respondents surveyed did not have enough financial buffers to sustain living expenses beyond 3 months. Malaysian of retirement age and older are particularly vulnerable. Based on statistics from the Employees Provident Fund in 2011, more than 70 percent of contributors who were 54 years old at the time had savings of only RM50,000 or less accumulated for retirement. Only 30% of these contributors were still working. With a reported average life expectancy of 75 years, many Malaysians are clearly at risk of not being able to meet their financial needs during retirement. The low level of financial literacy among Malaysians, especially in appreciating the importance of risk diversification and reduction, and how to use financial instruments effectively to achieve this, has further compounded the problem.

Taken together, these observations underscore the tremendous opportunity that exists for financial advisers to raise the game in quality of advice, and in educating Malaysian households on the effective use of insurance and takaful as a financial management tool. Financial advisers are well-placed to provide lifelong financial planning support to Malaysian individuals and households in an environment of a growing middle class segment with higher purchasing power. To do this, gaining public trust and confidence is critical. Today, I think you will agree with me that that level of trust and confidence in insurance intermediaries at

large remains below where it could and should be. An important starting point has to be a mindset that puts a client's needs at the centre of advice and product recommendations, and which is firmly focused on helping the client to achieve his financial and life goals. This implies a view to developing lasting and durable partnerships with clients, and investments to build and maintain a high level of competence among financial adviser representatives who can tailor advice and tackle a broad range of consumer needs and profiles.

### **Importance of sound advice**

Access to sound financial advice has become even more important today as households face the challenges of managing heavier debt loads, higher costs of healthcare and education, effects of natural calamities that are occurring with greater frequency, and longer life spans. We believe that the responsibility to provide sound advice falls on all insurance intermediaries, whether you are an agent, an insurance broker, a bancassurer, or a financial adviser. This is clear in our Guidelines on Proper Advice which states among other things, that if an intermediary cannot match the needs and requirements of a customer with a life or takaful product within the intermediary's offerings, the intermediary should not recommend any product to the consumer. However, we are also mindful that sound advice can have different shades which depend on many factors, including the competence of those providing the advice, the solutions that they are permitted or equipped to advise on, and incentive effects which may, either in perception or reality, colour that advice. Financial advisers provide an alternative channel through which consumers can obtain insurance advice, taking into account individual perspectives on these factors. The fundamental principle remains the same – that whichever the channel, and acknowledging the advantages and limitations of different channels, consumers should receive advice that is in their best interests.

### **Strengthened legislative framework for consumer protection**

Before I turn to the Bank's strategies and priorities for the further development of the financial advisory industry, let me briefly touch on the new legislation for financial services that marks a key milestone in strengthening the consumer protection framework Malaysia. As you are aware, the Financial Services Act and the Islamic Financial Services Act 2013 were brought into force in June this year. Under these new laws, the Bank has been given a clear mandate to foster fair, responsible and professional business conduct among financial service providers. To this end, the Bank may specify and enforce standards on the business conduct of financial service providers to ensure that financial consumers are treated fairly. The laws also specifically prohibit financial service providers from engaging in unfair or deceptive business conduct including making false, misleading or dishonest representations, and tied selling. The laws further provide for the approval of a financial ombudsman scheme for the resolution of disputes involving financial services.

A significant amount of work is currently being undertaken by the Bank on these fronts to give full effect to the law. We are close to finalising principles for treating customers fairly and guidance on prohibited conduct which will be published for consultation and feedback from the industry and other stakeholders. We will continue to raise standards on transparency to consumers, taking into account new insights from research conducted by the Bank to better understand how consumers use information to make financial decisions. We are also considering options for putting in place an effective mechanism to handle disputes involving financial intermediaries. This mechanism does not exist today outside of the advisory and complaint services provided through Bank Negara Malaysia's LINK channel.

Changes were also introduced under the new laws to deliver a more efficient regulatory regime for insurance intermediaries. Specifically, the scope of regulatory approvals required has been substantially reduced, for example the requirements to seek the Bank's prior approval for shareholding changes not amounting to control, and for the appointment of key personnel, financial adviser's representatives (FAR) and auditors. Intermediaries now only

need to notify the Bank and comply with minimum qualification and suitability standards. While we believe this will help you run your businesses more efficiently, our focus on preserving a high level of integrity, competence and professionalism among intermediaries has not changed and we will, as we have demonstrated over the course of the year through stronger enforcement actions, apply more intrusive supervision if we find that intermediaries have not discharged their responsibilities as expected.

A new category of financial adviser, that is the Islamic financial adviser, was introduced under the Islamic Financial Services Act 2003. This is also aligned to the objective of encouraging takaful agents to upgrade themselves to be Islamic financial advisers as the demand for financial advice grows. Similar to specialised takaful brokers introduced in 2005, Islamic financial advisers will be specialising in advising on family takaful and other Shariah-based products.

### **Strategic priorities to further develop the financial advisory industry**

The Bank has identified a number of strategic priorities to further develop the full potential of the financial advisory industry in delivering better outcomes to consumers and increasing the level of insurance penetration in Malaysia. I should say that we benefitted significantly from our engagements with the industry on the direction that we intend to take and the key issues that need to be addressed moving forward. Today, let me mention four key priorities.

Our first priority is to ensure that financial advisers are highly competent and professional when they provide advice. We understand from our engagements with AFA that recruiting the right talent continues to be a major challenge given that financial advisory firms are competing with larger financial institutions for a limited pool of qualified individuals. The Bank will continue to work in close collaboration with AFA to increase the talent pool. This includes reviewing on a regular basis, the programmes and qualifications that meet the minimum standards for financial advisors and working with academia, training providers and accreditation bodies to broaden the qualifications recognized without compromising on quality. There is also a need to lift the competency requirements for financial advisers. The current emphasis has been largely on ensuring that financial advisers have sound product knowledge and the core competencies to understand and analyse their client's needs. We believe there is a need for financial advisers to possess a larger body of financial and technical knowledge, that includes a deeper awareness of latest developments in the industry and opportunities available, and to be able to apply this knowledge to a client's advantage. Other core competencies that need to be given greater emphasis include effective communication and problem solving skills.

The second priority is to identify and address the barriers that are preventing qualified parties from entering the industry, and the constraints that are limiting the ability of financial advisers to recommend the best solutions to their clients. We are close to making an announcement on revised minimum entry requirements for financial advisory business. The Bank is also currently working on measures to create a more level playing field with respect to product offerings among the insurance intermediaries. The Bank and the Securities Commission will also continue to coordinate closely in facilitating the ability of financial advisers and financial planners to provide advice on a broad range of financial solutions. In this respect, further enhancements are expected to be made to regulatory processes to improve efficiency and further ease the regulatory burden on the existing players.

The third priority is to improve the alignment between the interests of consumers and financial advisers. We believe how incentives are structured have an important role in shaping the quality of advice that a consumer receives. While there are current requirements for potential conflicts to be clearly disclosed to consumers, the effect of such disclosure in alerting consumers to consider how such conflicts may affect any advice received, and to temper their decisions appropriately, may not be adequate to resolve the inherent conflicts that are created when a financial adviser is compensated by product providers. At the same

time, the vast majority of Malaysian consumers are not currently accustomed to paying directly for advice. In moving towards a better alignment of interests, there is an opportunity for fee-based business models to gain more traction, with financial advisers doing more – individually and collectively as an association – to explain how they add value through the advice that they give.

The fourth priority is to intensify our review of the quality of advice provided by financial advisers to consumers through our supervisory work programme. This will contribute towards ensuring that financial advisers stay at the “top of their game” in terms of quality of advice, and that this is sustained through effective oversight arrangements within financial advisory firms to check that the interests of clients are being well-served at all times.

At the industry level, the AFA will have a key role in elevating the stature of the industry by coordinating initiatives to create greater awareness on the role of financial advisers, educate consumers on the importance of financial advice and to promote financial advisory services. AFA can also play an important role in driving higher standards of professionalism in the industry through the development and implementation of industry codes of conduct and ethics that are focused on the interests of clients.

### **Well informed financial consumers**

The Bank is mindful that while great emphasis has been placed on the responsibility of financial service providers and intermediaries to ensure that the products recommended to consumers are appropriate to their needs, consumers are ultimately accountable for their own financial decisions. Our best efforts to improve the quality of and accessibility to financial advice would be incomplete without at the same time, equipping consumers with the knowledge, skills and tools to make informed financial decisions. These capabilities not only allow individuals to build, manage and preserve wealth, they are essential to help consumers protect themselves against poor market practices and to take appropriate actions when treated unfairly. Therefore, enhancing financial capability among Malaysians has been and will continue to be an important agenda of the Bank. Financial advisers have an important role in this effort given your unique vantage point as an objective adviser, and through the close relationships that are cultivated with your clients. We look to the industry to provide input and support to the Bank’s ongoing work to develop financial capability programmes that are tailored to the different key life stages of individuals from their days as a student, when they enter the workforce, when they start and raise a family, and in retirement.

### **Conclusion**

In closing, let me congratulate the AFA on its second annual conference and the progress that has been made in bringing the industry together under an organized platform to further advance and develop the industry. I come back to my opening comments and look forward to working with the Association to deliver the objectives that were originally set out for the industry, that is to improve the quality of advice and enhance its role in supporting the broader financial management strategies of Malaysian households and individuals to grow their savings, manage risk and meet their financial goals. Thank you.