# Donald Joshua Jaganathan: Nailing down the winning strategies in bancassurance

Keynote address by Mr Donald Joshua Jaganathan, Assistant Governor of the Central Bank of Malaysia, at the 15th Asia Conference on Bancassurance & Alternative Distribution Channels: "Nailing Down the Winning Strategies in Bancassurance", Kuala Lumpur, 6 May 2014.

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It gives me great pleasure to be here at the 15th Asia Conference on Bancassurance & Alternative Distribution Channels. This conference takes place at an exciting time for the insurance industry in Asia. After decades of strong growth and modernisation, Asia has achieved remarkable standards of living, with hundreds of millions lifted out of poverty and a middle-class population of over half a billion. Structural reforms following the Asian financial crisis have enabled the region to remain resilient throughout the global financial crisis of 2008/2009. Post-crisis, the vibrant economies in Asia have continued to be a pillar for global recovery, with this year's GDP for developing Asia projected by the IMF to grow 6.7%[1]. Insurance markets have also grown in tandem with the economy. Over the past decade, total premium in emerging Asia[2] increased by 10% per annum for life business and 13% per annum for non-life business on average[3] and is projected to grow 11% this year and 10%[4] in the next. The insurance industry, however, cannot be complacent and take this story for granted. Our past successes have been as much a result of foresight in pursuing new opportunities as a firm resolve in confronting new challenges. Even as insurance markets continue to mature in Asia, forces of change are already underway that will transform the landscape in which insurers operate and drive the development of new business models and delivery channels.

In the coming decade, insurance business in Asia will be profoundly shaped by social and economic transitions. I will briefly touch on five areas: (i) demographic shifts, (ii) increasing affluence, (iii) greater connectivity from new technologies, (iv) more intense competition and (v) a renewed focus on financial inclusion.

Firstly, while countries in Asia are at different stages of demographic transitions, what is unique to Asia is the speed at which populations are ageing. For example, the US took 72 years for the population over age 65 to double from 7% to 14%. Most countries in Southeast Asia are expected take 20 to 25 years, while Korea and Singapore are expected to take less than 20 years[5] Asia will have a much shorter timeframe to ensure an adequate social safety net is in place to support an aged society. Greater reliance will therefore be placed on the insurance sector to keep pace with the growing demand for old age protection and healthcare funding.

Secondly, increasing affluence and a growing middle-income population will be a key driver of demand both in terms of quantity as well as quality. With greater affluence, households will also become more empowered in expressing preferences and more discerning in making

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1 IMF- World Economic Outlook 2014 Update.

2 Emerging Asia definition: South and East Asia excluding advanced countries (Hong Kong. Singapore, South Korea, Taiwan).

3 Swiss Re- Sigma World Insurance in 2004 – 2012.

4 Swiss Re- Global Insurance Review 2013 and Outlook 2014/15.

5 Why Does Population Aging Matter So Much for Asia (Lee et al 2011), Aging, Economic Growth, and Old-Age Security in Asia (ADB 2012).

financial decisions. Insurers will need a more tailored approach in ensuring their distribution capabilities are able to effectively deal with different customer segments.

Thirdly, advancements in information and communication technology (ICT) have given rise to an era of instantaneous connectivity. According to certain estimations, Internet and smartphone penetration rates in Asia have reached 32%[6] and 43% respectively in 2013[7] Beyond offering new channels for delivery of products and services, ICT has opened up new ways of doing business. The Internet has evolved from being merely a tool for insurers to provide information on products into a competitive marketplace and platform for exchange. In more advanced economies, for example, aggregators have intensified price competition in personal lines insurance business. The advent of "big data", encompassing technologies ranging from social media to telematics, will significantly augment insurers' analytical capabilities to enable a more responsive and personalised customer experience, foster process innovation and provide strategic agility through quicker time-to-market.

Fourthly, with globalisation and progressive liberalisation of insurance markets in Asia driving increased competition, the search for growth through new customer segments and improved margins from efficient operations will continue to intensify. In certain markets, players have shifted away from expensive face-to-face channels towards offering simple products through more cost efficient direct marketing channels. Such channels have also enabled insurers to make inroads into previously uninsured segments thereby going beyond just winning market share towards expanding the insurance marketplace.

Finally, there is a renewed focus on financial inclusion to ensure that all segments of society benefit from economic growth. This includes ensuring that everyone is adequately protected from catastrophic events and other adverse shocks. Swiss Re has estimated the mortality protection gap in South and East Asia to be around USD32 trillion[8]. Closing these gaps would require a clear vision to which all stakeholders, from the insurance industry to the Government and financial regulators, must aspire through stronger collaboration and coordinated initiatives. In this regard the Bank aims to increase the insurance and takaful penetration rate in Malaysia, defined as number of policies per population, to 75% by 2020[9] supported by other measures to promote the long-term sustainable growth and development of the industry as outlined in the Life Insurance and Family Takaful Framework (LIFE Framework).

In the environment I have just described, insurers can no longer afford to rely solely on traditional business models and delivery channels. Instead, insurers must be aligned to the broad diversity of consumer needs and preferences, while also being flexible to adapt as these needs and preferences change over time. Such a market will see the emergence of a diversity of business models from multi-channel strategies to specialised players focused on single channels such as direct marketing, financial advisers or bancassurance. Still others will realise the fortune at the bottom of the pyramid[10] through microinsurance. Specialisation is also expected to occur along the supply chain with new players, including from non-insurance sectors such as retailers, adding greater value with innovations in areas ranging from branding and marketing to data enrichment.

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6 International Telecommunication Union- ICT Facts and Figures 2013.

7 Nielsen quoted by Media Research.

8 Swiss Re- Sigma No.6/2013 Life insurance: focusing on the consumer.

9 Based on the target set under the Economic Transformation Programme (ETP).

10 C.K. Prahalad "Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits".

**Bancassurance, financial advisers and direct channels**

While the possibilities for alternative distribution channels are extensive, I will address three areas that are already showing great promise for our markets here in Asia, namely: bancassurance, financial advisers and direct channels.

Bancassurance presents a unique proposition for insurers to widen their outreach while maintaining acquisition costs at manageable levels. By leveraging on banks' existing branch network and customer base, which are well established throughout most markets in Asia, insurers are able to scale up very quickly into geographical areas and customer segments that might not be accessible by existing channels. It is therefore not surprising that bancassurance is the fastest growing global channel for insurance. In China, bancassurance sales increased by 415% within 5 years from 2004 to 2009[11]. In Malaysia, bancassurance accounted for 36%[12] of new life insurance business premium and 39%[13] of gross contributions for Takaful business in 2013. At the current penetration level of 5% of the banking population, there remains significant room for growth. Under the LIFE Framework, the Bank has envisaged a bancassurance penetration target of 10%[14] as part of the move towards diversification of insurance distribution channels in Malaysia. Rationalization of incentive structures proposed under the framework are aimed at improving persistency through more widespread adoption of needs-based selling, product strategy reviews and quality post-sales service. These measures are also expected to shift the mix towards protection and savings products from credit-related insurance that currently dominates this channel in particular for bancatakaful[15].

Financial advisers on the other hand have the advantage of providing advice to consumers on overall financial planning by growing, managing and protecting personal wealth to meet specific financial goals. With increasing affluence, a growing segment of consumers with more complex financial needs and goals will require the sort of comprehensive service that is delivered by financial advisers. In addition, financial advisers may be perceived to be more independent than tied agents, which will be important as consumers become more discerning. As a relatively new channel in most of Asia, the primary focus is to establish public confidence through raising professional and ethical standards of financial advisers. This is a key focus under the LIFE Framework for Malaysia. In addition, the Bank will reduce paid-up capital requirements for financial advisors to encourage new entrants.

Previously consisting mainly of tele-marketing and direct mailing, direct distribution is today considered an important channel by most insurers, in view of the new possibilities enabled by the high levels of internet penetration and proliferation of mobile devices such as smartphones and tablets. Social media has become a vital platform for business to engage with consumers and build their brand as well as being a rich data source in its own right on today's fast moving consumer trends. The availability of instantaneous information has tipped the balance of power in favour of consumers. One such innovation is the aggregator, which has seen an increase in utilisation of 44% and 50% for motor and home insurance respectively in just a short period from July 2012 to April 2013[16] according to a report on the insurance market in Asia-Pacific. In Malaysia, the high levels of internet banking and mobile

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[11] 25th Pacific Insurance Conference 2011- Plenary Session 1 – Bancassurance and Its Impact on Consumers and the Insurance Industry.

[12] BNM IFAS System.

[13] BNM TOSS System.

[14] BNM Financial Sector Development Department (FSD) – Based on number of bancassurance/bancatakaful policies with regular premium/contribution to the number of savings account in Malaysia (August 2013).

[15] FSD – Annual submission by insurers to the Bank on Bancassurance data.

[16] EY- 2014 EY Asia-Pacific Insurance Outlook.

banking penetration of 52.2% and 12.7% respectively[17] augurs well for direct insurance models. In fact, in the general insurance and takaful sector, direct channels already have achieved significant market shares of 10% and 14% respectively[18]. For the life insurance and family takaful sector, the LIFE Framework envisions greater adoption of direct channels such as internet platform and walk-ins for pure protection products.

## Safeguarding consumer interests

The global financial crisis has shown that rapid financial sector innovation without due regard to business conduct can result in large-scale losses to consumers and cause widespread disruption to financial institutions and markets. As a result, there has been a renewed focus on consumer protection and market conduct, with new institutional arrangements for conduct regulation being established in some jurisdictions and strengthened enforcement frameworks in others. Of importance in a conduct regulation framework is an emphasis on financial institutions' having effective oversight arrangements to ensure that business is conducted in a responsible manner.

With the Financial Services Act 2013 and Islamic Financial Services Act 2013, which came into force in June 2013, the Bank has a clear mandate to foster fair, responsible and professional business conduct among all financial service providers. The new legislation also strengthens the protection of policyholders against disproportionate actions by providers to void contracts in cases where misrepresentation by consumer was unintentional. In this regard, greater responsibility will be placed on insurers to pose specific questions for consumer insurance contracts, to obtain information for underwriting purposes. Against this backdrop, the Bank has recently issued a Concept Paper on Prohibited Business Conduct outlining practices that are assessed as providing misleading or deceptive information, exerting undue pressure when marketing products and collusive business practices that may result in unfavourable outcomes to consumers. The Bank is also developing standards of fair and responsible business conduct that will require the board and senior management to ensure high standards of fair dealing and professional conduct. While regulations governing business conduct is applicable to all areas of an insurer's business, new distribution channels will likely require a heightened vigilance in view of the potential for new types and sources of risks.

In addition to strengthening business conduct practices, securing public confidence in a market with diverse distribution channels will also require building the financial capability of consumers. While this applies to all consumer segments, particular emphasis will need to be placed on empowering lower income households and other groups that are currently uninsured so that they are able to make informed decisions on the products and services they need. Financial education initiatives must aim to increase consumer understanding of insurance, including how to navigate in an environment with multiple delivery channels and how to seek avenues for redress where products and services fall short of expectations.

## Governance and risk management

Insurers pursuing new distribution strategies will need appropriate governance and risk management to ensure that emerging sources of financial and operational risks are well contained. Insurers' strategic planning process must take into account their competitive positioning, the target risk / reward trade-off and financial capacity to absorb losses. Prior to introducing a new distribution channel, insurers must ensure they have the capacity, including the appropriate expertise and resources, to adequately manage and control the

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[17] BNM Payment Systems Policy Department.

[18] BNM IFAS and TOSS System.

risks associated with that channel and possible spillovers onto existing business. Policies and procedures for managing and mitigating new types of risks will need to be developed and implemented across the whole value chain, including product development, authorisation, pricing, marketing, sales, post-sales servicing and portfolio management. These will need to be designed to ensure that the insurer continues to operate within its pre-determined risk appetite and limits.

Success in the new insurance distribution landscape will require strong internal communication flows to ensure that the governance and risk management across all distribution channels are fully integrated with the insurers' operations and control functions. New policies and procedures must be communicated in a timely manner to all relevant parts and levels of the organisation and periodically reviewed in the light of changing circumstances. In addition, more complex IT infrastructures that are central to many of the new channels will require commensurate attention to IT-related risks, which include strategic, compliance and business continuity risks.

## Conclusion

The Austrian economist Joseph Schumpeter described "creative destruction" as "process … that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one"[19]. As Asia transforms and replaces old social and economic structures with new ones, so must the insurance industry revolutionise its business models and paradigms. The challenges for insurers are significant, yet great rewards await those who seize the opportunities presented by the new environment. In so doing, not only will the industry benefit from growth but the public, who are the ultimate stakeholders, will continue to enjoy rising standards of living and protection from adversity. With many in Asia still not adequately insured, the imperative is clear – insurers must rise to the challenge and chart new pathways towards success.

With that, I congratulate Asia Insurance Review for organising this most timely and relevant Asia Conference on Bancassurance & Alternative Distribution Channels. To all the speakers and participants, I wish you all a productive conference and thank you for your kind attention.

[19] Capitalism, Socialism, and Democracy (1942) by Joseph Schumpeter.