

Jessica Chew Cheng Lian: The insurance broking sector – threshold of an exciting but challenging future?

Keynote address by Ms Jessica Chew Cheng Lian, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the 3rd Asia Insurance Brokers' Summit, Kuala Lumpur, 3 March 2015.

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It is my great pleasure to be a part of this 3rd Asia Insurance Brokers' Summit which is being held for the first time in Malaysia. I would also like to take this opportunity to congratulate MITBA as they celebrate 40 years in service of insurance and takaful brokers in Malaysia. In that time, the domestic insurance industry has seen significant change – beginning with an overhaul of the legal and regulatory framework when the industry was brought under the regulatory oversight of Bank Negara Malaysia, followed by a series of successive reforms that have served to strengthen the industry and promote its healthy development to first and foremost meet the needs of individuals and businesses. This continues to be a journey that the Bank and industry are committed to taking forward, mindful that as the Malaysian economy is progressively transformed, so too will demands of the industry evolve. Throughout this journey, associations like MITBA have played an important role in helping members adjust to the changing environment, by providing a platform to examine issues, make representations, communicate with stakeholders, and implement collective responses. It must be recognised that many individual companies would have neither the resources nor the inclination to pursue these actions on their own. Yet such actions can shape policy, be a force for change, and build reputational capital and credibility with long lasting payoffs for the industry at large.

As the broking and insurance community come together today, the questions that are being asked will almost certainly include: What lies ahead for the insurance broking industry? What are the key challenges that will face the industry? How will the landscape continue to change? Where will new opportunities lie? Where will new threats come from? And ultimately, how confident is the industry of its future?

I am sure these questions will all be addressed in some way over the course of this Summit. A sampling of what has already been said and published on this subject would indicate that insurance broking is at a crossroad of critical strategic business decisions that will have a significant impact on its future prospects. We often hear this at different periods in time, and each time there is a sense that *this* will be the defining moment for the industry. I would like to suggest however, that this sense is more palpable in the current environment for a number of reasons that I would like to explore this morning.

Let me begin with the Global Financial Crisis. While it is largely associated with a banking crisis, its implications have spread far beyond the banking sector. The insurance industry found itself in a position of having to defend its activities from being subjected to the same fate of the wide-ranging regulatory reform that has consumed the banking sector following the crisis. The loss of confidence in financial intermediaries has been particularly damaging. Consumer confidence and trust in financial intermediaries have fallen to all-time lows and continuing discoveries of misconduct have done little to restore confidence. Consumers are unfortunately prone to painting all intermediaries with the same broad brush and asking themselves how far they can trust their financial service providers.

As a result, conduct issues are coming under significant scrutiny globally, and the expectation of professional conduct is no longer taken for granted by consumers and regulators alike. This general shake-up of the industry that followed the crisis has meant that insurance brokers, swept up in the tide, must confront the very basic ethos of their business. They must make serving the real economic interests of businesses and helping individuals secure their financial futures the heart of their business. They need to be concerned about

the social and environmental impact of the business decisions that they make. And they must commit to providing a fair deal to their customers and building enduring long term relationships. The environment has become far more unforgiving of anything less.

A second reason that insurance broking is at a critical crossroad is the accelerated pace of change that is occurring in Asia and the business implications that this will have for the region. Asia is the most dynamic and fastest growing region in the world today. The region recorded economic growth of over 7 percent in the past decade, higher than global growth of 4 percent. The IMF's latest forecast projects growth for Asia at 6.4 and 6.2 percent in 2015 and 2016 respectively, in sharp contrast with anaemic growth in more advanced economies. Reflecting its growing contribution to global growth, Asia accounted for approximately 28% of the world's premiums, after Europe (35%) and North America (30%).¹ Coupled with a high population growth rate, there are projections that Asia will overtake North America as the second largest contributor to world insurance premiums in several years.

The establishment of the ASEAN Economic Community at the end of 2015 will create a single large market and production base with freer flow of goods, services, investment, skilled labour, and capital; opening up huge opportunities for business growth from a combined GDP of over USD2 trillion and population of 600 million people. Services have also become a more important component of trade across the region. This has obvious strategic implications for the insurance broking sector to capture the significant growth opportunities that will emerge. It is therefore not surprising to find that more companies already have, or are developing, ASEAN-oriented strategies to position themselves for an integrated ASEAN environment. These companies are quickly internalising new economic realities which call for a fundamental re-orientation of business and operating models. A clearly defined and well-executed strategy for capturing new growth opportunities in the region is more than likely at this critical juncture to reap significant payoffs over the next few decades.

A third reason that this period is significant for the insurance broking sector is the intensity of focus that is now being directed at the effects of climate change. Globally, catastrophes are increasing in frequency and intensity. The cost of catastrophes is estimated to have risen by USD870 billion in real terms between 1980 and 2011. In 2013 alone, global economic losses due to natural catastrophes amounted to USD131 billion. Only about a quarter of this was insured. According to a report released last week by the United Nation Economic and Social Commission for Asia and Pacific, more than half of the world's 226 natural catastrophes last year occurred in the Asia and Pacific region. Floods account for about 40% of the natural hazards affecting the region. Some 80 million people were affected by natural disasters, with economic losses tallying up to nearly USD60 billion. The region was found to be largely unprepared in its response to widespread floods and landslides. Despite the recurring nature of these events, only a fraction of properties and assets are fully protected against risks.

The question that is being asked with increasing urgency is "How can the financial sector play a more significant role in supporting disaster risk reduction strategies?" Along with this focus has been a growing call for actors in the financial sector to do more to reduce vulnerabilities to climate and disaster risks, including through better analytics, professional advice, providing or supporting effective risk mitigation solutions, and by conducting their business in a socially and environmentally responsible manner. Going forward, society will be more demanding of financial service providers, including brokers, to discharge these responsibilities with much greater diligence, and those that do not are likely to bear more severe consequences.

The fourth reason that insurance broking is finding itself at a critical crossroad is a more obvious one – the technology revolution. This phenomenon is hardly new and we continue to experience new technological revolutions at an unrelenting pace. The challenge is in

¹ Swiss Re, Sigma No. 3/2014: "World Insurance in 2013".

understanding and anticipating how evolutions such as aggregator capabilities, internet-based insurance, and big data are impacting insurance broking business models.

So far, brokers appear to be taking some comfort in views expressed that technology is having the biggest impact on the more commoditised market for personal insurance lines, while brokers will continue to retain their share in the corporate insurance placements. While this may be a legitimate view, technology will nevertheless have an important impact on the kind of services that brokers are offering their corporate clients and what clients are prepared to pay for such services. In many emerging markets, the technology revolution is starting to gain more traction in the delivery of financial services, including insurance, following greater stability in internet connections, advancements in security and payments infrastructure and strengthened data protection frameworks in these markets. Correspondingly, brokers need to strategically review the strength of their value propositions in this changing environment and actively seek to lift their own services by leveraging on technology.

These four reasons are just a few that should prompt the insurance broking community to re-evaluate their business and operating strategies going forward. All of them – the fallout from the global financial crisis, Asia's growth trajectory, the focus on climate risk, and more entrenched technological revolution in the delivery of financial services – are converging to re-define expectations, possibilities and risks in the insurance broking sector in a profound way that will determine if a firm will thrive or be marginalised in the coming decade.

Going forward, brokers will be expected to play a far more significant role in delivering innovation and choice by developing deep knowledge of the industries that their clients operate in, and working with insurance providers to bring new products into the market that are meeting the changing needs of businesses. Brokers will be called on to provide expertise and advice in managing a more complex set of risks that will include environmental, geopolitical, supply chain and cyber risks in a more interconnected global and regional economy. In other words, the traditional information function of brokers will expand significantly.

An area that will grow in importance for brokers is the SME sector. SMEs are a significant part of economies in Asia, driving growth and employment. In Malaysia, SMEs account for about one-third of Malaysia's GDP and 59% of employment. Within five years, the contribution of SMEs to GDP is targeted to increase to 41%. Their importance to the economy however, remains disconnected with the extent to which these businesses are effectively managing their risks through insurance solutions. A significant majority of small businesses continue to be either not insured, or have inadequate insurance to secure the prospects of survival following business disruptions due to a natural disaster or other event.

Among the most important reasons for this are cost and products offered by insurance providers that fail to reflect the specific risks that SMEs face. This is more acute for businesses at the lower end of the spectrum that operate with tight margins, have limited resources dedicated to formal risk management programs and are more vulnerable to business disruptions. There is substantial scope in the region for brokers to better understand the risk profiles of SMEs – specifically how they are affected by loss events and what it would take for them to recover – and to work with insurance providers to lower the costs of insurance through innovative solutions and better data.

A key focus of Bank Negara Malaysia in the coming years will be to provide an enabling environment for insurance brokers in Malaysia to develop the technical, financial and operational capacity that will enable them to effectively support businesses in both mainstream and niche areas under the new economic landscape. In this connection, the Bank will be introducing new measures to foster greater competition, and expand opportunities for brokers to forge strategic partnerships for long term growth. This will include specific measures with respect to foreign participation in the insurance and takaful broking industry in line with the recommendation of the Bank's Financial Sector Blueprint 2011 – 2020. The Bank expects to make further announcements on this in due course.

The evolution of insurance broking also raises important questions for managing conflicts of interest. Insurance brokers are often well placed to offer a broad range of services that may go beyond advising on and securing insurance solutions. These include an expanded role in risk consulting and management, the administration of employee benefit schemes, and claims handling services provided for a fee. The diversification into a broader range of activities however increases the potential for conflicts to arise between the interests of clients in a traditional broking context, and that of the broker which may seek to protect relationships with insurers that it has dealings with in a different context. Brokers engaged in risk consulting activities may also have strong incentives to increase commission revenue by inappropriately influencing clients to purchase more insurance than they need or which do little to provide meaningful protection.

In Malaysia, these issues are coming into greater focus with growing demand for value-added services that brokers can provide. We do not believe that disclosures alone are sufficient to mitigate the risk of conflicts. We have presently required brokers to limit the revenue earned from these activities to 20% of total revenue in the previous financial year. We are also insisting on strengthened procedures and controls within brokers to manage conflicts. And we are asking brokers that engage in additional activities to demonstrate to us that their core broking responsibilities have not been compromised – including in terms of the adequacy of competent resources performing core broking functions, the quality of infrastructure supporting core broking activities and the outcomes produced for broking clients.

This is also a time for the industry to come together collectively to raise the bar on standards of professional ethics and conduct that must be demonstrated towards clients. Such a code needs to clearly address new business realities and changing expectations of the industry. And it should have credibility by ensuring swift and effective mechanisms for addressing complaints on breaches and the ability of the profession to act against errant members. In Malaysia, avenues for customers to address disputes with insurance brokers are being enhanced with establishment of a Financial Ombudsman Scheme that will include insurance and takaful brokers as members of the Scheme in the later part of this year.

In closing, the insurance broking sector finds itself today at the threshold of an exciting, but also challenging, new era in which solutions of the past are unlikely to be adequate for the demands of the future. The stakes are higher, and the time is ripe for insurance broking in this region to do its part to contribute to sustainable growth.

Thank you very much and I wish you all very constructive and enlightening discussions ahead.