Jessica Chew Cheng Lian: Distribution in a liberalised environment

Keynote address by Ms Jessica Chew Cheng Lian, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the General Insurance Agents Convention "Distribution in a Liberalised Environment", Kuala Lumpur, 5 August 2016.

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The profound impact of financial technology on the provision of financial services – including insurance – is set to gain more traction in Malaysia. Just last week, Bank Negara Malaysia issued a discussion paper which outlines the conditions for companies to test financial technology (also known as "fintech") innovations in a safe environment. This responds to the innovations that we have seen emerge in the financial services industry; many of them tapping into opportunities now made possible by technology to enhance the customer experience, improve risk management and lower the costs of providing financial services.

The insurance industry itself has just entered the first phase in the progressive liberalization of the motor and fire insurance tariffs which began on 1 July this year. After over 30 years during which more than 60% of the general insurance market has been regulated under tariffs, this is arguably the most significant reform of the general insurance market in decades. The implications of the reform are much wider than just an adjustment to premium levels. It will pave the way for a new wave of product innovation, significantly expanding choices for consumers. It will improve incentives for safe driving behaviours and better risk management practices by both risk owners and insurers. And it will address market distortions which have threatened access to motor insurance, particularly for higher risks.

This is also a time when businesses and households are facing rising costs and more uncertain conditions which can adversely affect discretionary spending on insurance. At the same time, the exposures of households and businesses which insurance is designed to protect, have actually increased as evidenced by more frequent and severe incidents of natural and man-made disasters.

All of these developments raise critical questions for insurance agents. One question that comes up time and again is: Will insurance agents continue to be relevant? If you are in this room today, then I assume you will agree with me that the answer is clearly 'yes'. But I believe you are also here because there is a recognition that agents will have to evolve. Even if some of you were not completely convinced of this before, that reality surely can no longer be ignored or dismissed. So the more important question then is how agents can be a meaningful part of this change in order to advance the important benefits of insurance for the economy and the wider society?

Today in Malaysia, the general insurance penetration level measured in terms of premiums as a share of GDP stands at less than 2% (1.68% as at end 2015). In comparison, premiums as a share of GDP are about 3 to 4% in more developed markets. There is reason to believe that the extent of underinsurance is widening given the growth in economic activity and higher risk exposures. As an example, during the December 2014 flooding in the east coast of Malaysia, total economic losses were RM2.6 billion while insured losses paid nationwide as at end-2015 was close to RM100 million, which is only a fraction of total economic losses.

Some of the more important reasons for underinsurance include a lack of risk awareness and the lack of affordable products particularly for low income groups. Another important reason, and one that the Bank has also observed more widely in our work on market conduct issues, is a lack of trust in insurance providers and intermediaries. For most people, any insurance that they buy, with the exception of required insurance coverage for regulatory or financing purposes, would have been on the recommendation of an agent, broker or financial adviser. Yet, the same people who have purchased insurance products on the advice of their agents or advisers rarely express confidence that they really understand what they have purchased, if it was suitable for their circumstances, or even if it was the right amount of insurance. If their experience with insurance providers or intermediaries later disappoints, particularly when they are trying to make a claim, their trust in the industry at large quickly erodes.

Ultimately, the most important measure of success for the reforms that we are now pursuing in the general insurance industry will be how far they contribute towards addressing the protection gap that exists, in turn strengthening our foundations for growth and stability. Today, I would like to talk about how agents have a key role in this process.

In a more liberalised environment, insurers will have much greater flexibility in the design and pricing of products based on their respective business and risk strategies. This should encourage pricing that is more aligned to risks (let's call this point "A"), and place greater power in the hands of consumers to manage the cost of insurance by controlling the risk factors that influence pricing (let's call this point "B"). This in turn can make insurance more affordable for more people and businesses, especially small businesses.

However, interventions by an agent are what effectively connects points "A" and "B". In a detariffed environment, the number and range of risk factors that determine insurance prices are expected to expand. Consumers will also have more choice on the scope and level of protection that they purchase. Agents, having both direct access to consumers, and intimate knowledge of an insurance provider's underwriting considerations and products, are best placed to explain the insurance options that are available to the consumer and make recommendations on how to maximize the value of a purchase.

A number of things will need to happen for agents to deliver on this expectation. First, agents will need to build their capacity to analyse consumer needs and risk profiles, and be able to match them efficiently to suitable products or combinations of products that are appropriate to the consumer. In practical terms, this has significant implications for the information systems that agencies need to develop and maintain, the training, development and recruitment programs that they have in place, and the kind of information and support that they need to secure from insurers to enable them to properly advise consumers.

The role of agents is especially important for an orderly transition to a more liberalized environment. A deeper understanding of risks developed by agents can help address information gaps in the earlier stages of transition and prevent premiums from over or under-shooting their technical levels. This in turn will reduce future volatility in premiums which is important to build confidence in the ability of insurers to meet their promises as expected. Consumers should also be informed that in the first year of transition, they can continue to maintain the same motor insurance coverage at prevailing tariff-rates. This is to provide an opportunity for the public to familiarize themselves with new product options that will become available – a process that agents will play a key role in helping with.

Second, agents need to be able to provide higher and more unique value in their services, and they need to be able to do this in a highly flexible way. Going forward, insurers are expected to leverage more extensively on direct channels to distribute their products and communicate with customers. With digitisation and other new technologies, not just in insurance but across all other financial and non-financial services, the costs of distribution and managing customer relationships can be greatly reduced with expanded reach. Digitisation is also expected to give rise to new entrants into the insurance value-chain such as product aggregators, which will allow consumers to easily compare product features, providers, coverage and price. These developments will drive the increasing adoption of multi-channel distribution strategies.

The implications for agents will be a greater need to specialise and to be able to do so while seamlessly integrating with different and more diverse contact points with consumers. This will require innovative business models as parts of the distribution chain become commoditised. For example, agents may specialise in more complex product offerings, provide more tailored advice, improve the customer experience by deploying new technologies and reaching out to untapped consumer segments. As greater efficiencies drive down costs, fees and commissions will increasingly be tied to the breadth and depth of services provided by agents. This in turn will contribute towards lifting productivity and the value of jobs in the industry, including that of the agency force.

Third, insurance agents will need to embrace a broader role in the education of consumers. Over the years, Bank Negara Malaysia working together with the insurance associations has invested significantly in informing the public about insurance through our financial literacy initiatives. We have come a long way in this process. Today, schoolchildren as young as 10 years of age will already be introduced to insurance through subjects taught in the formal school curriculum. By 2021, we expect to complete the process of integrating financial education content in the formal school curriculum at all levels of primary and secondary education.

We have also continued to expand the ways in which we reach consumers, through different mediums and leveraging in particular on social media. We have adopted a life cycle approach to guide education initiatives, so that education content is more targeted and delivered when consumers are most responsive to receiving information. And we continue to adapt our education content so that it remains relevant and current to the issues and experiences that consumers face.

In parallel with these efforts, agents will have a more important role going forward. With greater proliferation of online avenues for consumers to obtain information, contacts between agents and consumers are likely to be more targeted and specific in nature. Consumer needs and appetite for advice will also be greater in a more diverse insurance landscape. This opens up an enormous opportunity to tap into the potential for the more than 100,000-strong life and general insurance agency force to play a much more active role in educating consumers on the importance of insurance protection, on how to evaluate their insurance needs, and on making informed choices about the insurance options available.

It is often joked that an insurance agent can persuade you to buy almost anything. Imagine what we could achieve by more effectively mobilizing such a powerful persuasive force to communicate essential and life-changing messages on the importance of insurance. The ability of agents to distinguish this role from the sales process is also important. This should be further developed by the representative bodies of agents as part of a professional commitment of all agents to promote sound financial and risk management.

Finally, agents need to engender the type of trust that is built on a solid track record of quality professional service that places the long term interests of consumers front and centre. With more than 39,000 general insurance agents registered with PIAM, agents continue to have the widest outreach of any distribution channel, accounting for over 63% of general insurance revenues. With such reach, agents wield significant influence over how people perceive and experience insurance. This in turn affects not only decisions to purchase insurance; it can also affect the value that is derived from insurance coverage.

For these reasons, Bank Negara Malaysia places significant importance on the responsibilities that insurers and agents have to treat customers fairly. Our supervisory reviews show that while most agents are honest and professional, there continue to be agents who have knowingly mis-sold products. We have and will continue to take firm actions against such agents and the insurers which failed to implement adequate controls to prevent these incidents. The Bank is also developing standards on the fair treatment of consumers to set out our expectations on fair dealings. This includes an expectation that consumers are provided with products that perform as insurers and agents have led them to expect, and services associated with the product meet acceptable standards and are consistent with specific representations made when the product was sold. We will hold insurers accountable for ensuring that agents comply with these standards, and we will expect agents to align the way that they engage with consumers to meet these expectations. For many agents who have placed the consumer at the heart of their business, this will not have a material effect on their conduct or business. But for agents that have largely thrived on just closing sales, this will provide an important catalyst for transforming agents into trusted and dependable advisers.

Conclusion

Over the next 5 to 10 years, the insurance industry will undergo its most significant transformation, possibly since the early 1990s when the insurance regulatory system in Malaysia was overhauled. During this period, the insurance landscape is expected to change in ways that will have a direct and profound impact on the experience that consumers and businesses have with insurance. As major intermediaries between insurance providers and consumers of insurance products and services, how insurance agents think about their business and interact with their customers can make an important difference in helping millions of individuals, families and businesses across the country who remain ill-prepared for losses arising from unforeseen events. Addressing this protection gap is ultimately the goal that we must all aspire to, to promote a resilient economy and the well-being of our society.