Muhammad bin Ibrahim: Towards resilience - are we on the right path?

Keynote address by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Malaysian Insurance Summit (MIS) 2017 "Towards Resilience: Are We on the Right Path?", Kuala Lumpur, 30 October 2017.

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Nearly 30 years ago, the Governor of Bank Negara Malaysia highlighted several challenges facing the insurance industry in Malaysia at the “Malaysian Insurance Industry Seminar” organised by the Malaysian Insurance Institute (MII). He made four observations in his speech:

- Insurance companies accounted for only 3% of the assets of the Malaysian financial system.
- Only 1 in 10 Malaysians had a life insurance policy.
- Foreign insurers were at best, agents for their head offices. There was no urgency to develop local underwriting and management expertise.
- Due to lack of local technical expertise, the sector was significantly dependent on the international reinsurance market. This in turn curtailed the development of local expertise, perpetuating a vicious cycle.

A “Stock-take” on the Insurance and Takaful Industry’s achievements and shortcomings

In the decades since, the Bank has implemented major reforms to strengthen market participation, improve transparency and professionalism in sales practices, and encourage the development of domestic underwriting capacity to optimise retention of reinsurance and specialised risks. In 2009, foreign equity participation in the sector was liberalised further.

After almost three decades of BNM taking over the task of regulating the insurance industry, it is worth for us to do a brief stock take.

The insurance and takaful industry has grown at a healthy annual rate of 10.47% in the 20 years prior to 2016, and the sector now accounts for 6% of the Malaysian financial system assets.

The industry is on a strong financial footing, with excess capital above regulatory requirements of RM37.9 billion. Risk management and corporate governance practices have also been significantly strengthened. Insurance penetration, which is the ratio of life insurance policies and family takaful contracts to total population, increased from 25.3% in 1996 to 56% in 2016. Liberalisation in the insurance sector shareholding was also undertaken with a view to further improve the insurance sector.

Unfortunately, this is where the good news ends. Despite stronger and better managed insurers, and an increase in foreign insurers’ market share from 60% in 2009 to 76% in 2016, many of the issues raised 30 years ago remain with us today.

There are a few areas in particular that I would like to highlight:

- First, the failure to make insurance and takaful attractive enough to large segments of our population who are still devoid of any form of protection;
- Second, underinvestment in talent and the continued dependency on group resources to support core functions, and
- Third, the low commitment to domestic arrangements for reinsurance optimisation.

From the perspective of the population that remains underserved, the existing business models are essentially broken. While life insurance premiums and family takaful contributions have grown by 48% since 2010, the penetration rate has only increased by 5 percentage points. This indicates that the industry is increasingly concentrated on a narrow insurance segment. If we eliminate double-counting, only 35% of adults have some form of cover. For the rest, products are too complex and remain unaffordable. Existing distribution channels also fail to provide adequate access, especially outside urban centres. Technological advancements are not being used to the fullest.

Even for the population segments that are being served, making a purchase or a claim is a process fraught with anxiety and headache. Increasing medical insurance premiums have also placed insurers under heightened public scrutiny, with questions raised on the suitability of product designs that offer little protection against escalating costs of healthcare. Insurers' contracting arrangements with healthcare service providers have also been called into question. While insurers might not be the guilty party here, the response to the criticism has been slow and wanting. As a group, the insurance community is meek in safeguarding the sector's image and reputation.

Underinvestment in domestic talent and capacity is another key concern. Among a large number of foreign insurers, significant reliance on group level support has limited the investments in core functions needed to develop strong domestic capabilities. In addition, large amounts of payments are being made for management fees and outsourcing arrangements. Between 2014 and 2016, it is estimated that insurers in Malaysia made no less than RM1.3 billion of such payments to foreign affiliates. The repatriation of funds will be even larger if we compute the amount over a longer period. Such arrangements are extractive in nature, and will have longer term implications for the development of a strong domestic industry. We need higher reinvestment by insurers to support the protection and risk management needs of our population and businesses.

Intra-group reinsurance arrangements have also resulted in unnecessary outflows when such risks are well within the capacity of the onshore market. A handful of insurers have continued to disregard arrangements that have been put in place to optimise onshore capacity, ceding large amounts to group reinsurers. This is not an acceptable behaviour. It must change.

Going forward, we expect insurers to review these practices and fully support optimisation arrangements. In parallel, more must be done to develop domestic underwriting expertise, especially in specialist risks. More must be done to create high income jobs. More needs to be done to improve remuneration packages at entry and middle levels, to attract young talents and retain expertise. The data we collated is stark. It is a clear conclusion. The data points to a prolonged underinvestment in talent, with fewer than 1 in 10 of the industry workforce today having any form of professional qualification.

From another angle, the industry has yet to realise its potential, in part due to a lack of long-term commitment from domestic shareholders. The industry needs domestic shareholders that have a long term outlook and can support the deepening of our market. For such shareholders, the payoffs are likely to be significant given the untapped growth potential of the industry in Malaysia. However, on more than several occasions, opportunistic shareholding transactions have destabilised the market, and set back broader efforts to build a strong domestic sector. There are a number of domestic shareholders who after being given a license and the opportunity to participate in the insurance sector decided to sell off their shareholding and make quick profits. These types of shareholders are a cause of instability to the insurers' operations. These are not the kind of shareholders that would be viewed favourably for future participation in the financial industry.

The way forward: invest now to make insurance accessible to all

Given this state of affairs, I would like to pose this question, borrowing from the theme of this summit: "Are we on the right path?" I believe that the industry can be on the right path if it takes a long term view and starts taking meaningful steps to address the gaps in our market. Let me lay out some of these steps.

Firstly, products and delivery channels need to be diversified and redesigned to be better suited to the whole population. This must entail a renewed focus on protection needs especially for first-time buyers. The Bank is partnering with the industry to roll out Perlindungan Tenang, a national branding and communication platform in the near future. Perlindungan Tenang is intended to reach 8 million working-age Malaysians and over 700,000 micro enterprises that currently need insurance and takaful protection against key risks.

Products that meet the three criteria of being: Affordable, Accessible and Easy to understand. This product will carry the Perlindungan Tenang logo and benefit from regulatory flexibilities and co-branding and promotional initiatives. The aim is to address ‘pain points’ that commonly hold consumers back from purchasing insurance and takaful products. To-date, four insurers and two takaful operators have developed products that will be introduced under this initiative and we expect many more to come on board.

Secondly, the industry needs to embrace digitalisation to revolutionise the customer experience. Many of the factors that make digitalisation possible in other sectors, such as a high mobile penetration rate of 134% and the proliferation of new technologies, are also available to the insurance and takaful sector. The banking industry has made significant strides towards enhancing the take up of financial services delivery through the use of technology. In 2016, there were 22.8 million Internet banking subscribers which represents over 70% of the total population.

The insurance and takaful sector needs to catch up. Today, online insurance distribution still accounts for less than 0.1% of business volume. A very poor achievement. With consumers already enjoying benefits of digitalisation in many other daily activities, they should expect better levels of personalisation, responsiveness and reliability from their insurance and takaful experience. This includes shorter time-to-compensate for insurance claims.

In terms of the migration to e-payments, the insurance and takaful sector is a key sector where the usage of cheques is still prevalent. In 2016, 2.3 million cheques were issued by insurance and takaful companies while 9.8 million cheques were collected by such companies from their customers.

While good progress has been made this year with the decline in cheque collection accelerating from -0.5% in 2016 to -22.1% in the first 7 months of 2017, more effective and creative measures are needed to drive cheque usage to negligible levels. To this end, Bank Negara Malaysia has recently concluded a consultation exercise with the industry on the implementation of an e-Payment Incentive Fund Framework (ePIF).

Under the framework, insurance companies shall set aside RM3 for every cheque issued and RM1 for every cheque collected to be used as incentives to encourage their customers, agents, service providers and government agencies to migrate to e-payments.

The current practice where agents collect premiums from customers in cash and make payment to insurance and takaful companies using the agencies’ own cheques or credit cards should stop. The industry should promote greater prudence and transparency in the collection of customer premiums by facilitating customers to make direct payments to the insurance and takaful companies. To this end, the industry equipping agents with mobile point-of-sale (mPOS) or mobile apps to collect payment directly from customers should be the norm.

Thirdly, the industry needs to collaborate and invest in key market infrastructure and arrangements. These should support at least four key objectives, to enhance access to insurance; increase efficiencies in claims processing; promote fair competition and provide additional choice for consumers as well as provide a strong mechanism to prevent frauds and cheats. This is important not only to deliver a superior customer experience, but also to control leakages, manage costs and ensure sustainability over a long term. It will also position the industry to compete and position itself more effectively as we move forward as the disruptive forces of competition, including from non-traditional players, continue to gain traction. It will also prevent leakages arising from abuses, misrepresentation and fraudulent claims.

In the immediate term, the industry needs to set its sights on creating a convenient and seamless first-loss-notification process that leverages on shared infrastructure. Such a process should eliminate intermediate processes that are currently adding costs and enabling abuse and fraud to take place. Certain infrastructure should not be considered as a competitive edge. We have raised this issue many times. Sharing infrastructure and information among industry players is very important, but efforts towards this have been quite disappointing.

The establishment of the ISM Fraud Intelligence System marks a significant first step in this direction. Deploying the latest data analytics and network analyses, the Fraud Intelligence System is a milestone in the industry's efforts to combat fraud, especially in the motor business.

This is a long overdue development and I note that the first phase has successfully gone live in September 2017 with four pilot insurers. Its success and benefits will very much depend on achieving the widest possible network effects. We expect all insurers to support these arrangements. Insurers who refuse to participate in this scheme will be looked upon unfavourably. We shall also take note of these recalcitrants' failure to participate for a common good.

Fourthly, insurers and takaful operators need to invest individually and collectively in creating a strong talent pipeline for the industry. We need to take stronger measures to professionalise the insurance workforce and foster the highest standards of conduct and competence. As the benefits of upskilling will accrue to the industry as a whole, talent development should also be a collective endeavour. Only through collective effort can this be achieved.

In this regard, I am pleased to announce the establishment of a Talent Development Fund, funded by the industry that will be made available to support professional training and development initiatives for the sector. This will include the introduction of appropriate professional qualifications for key strategic and operational roles in the industry.

Finally, there will be deeper engagements with shareholders, boards and management of individual insurers and takaful operators on the development agenda for the industry. We will make clear the areas of development focus in the coming years. Regular engagement with candid assessment of individual company's performance will pave the way for companies to make more significant contributions to development objectives. And we shall rigorously measure insurers' performance. Failure to register favourable achievements will have its own consequences.

Conclusion

Change is not an option. It is a constant. While global insurance growth is expected to remain healthy and will continue to be driven by emerging economies over the next few years, the quality of growth is equally important. We want growth that is sustainable and balanced where benefits are enjoyed by society at large via higher levels of meaningful protection for households and businesses. We must be responsive to the changes that are taking place in our society and economy.

We need to take urgent action or risk becoming irrelevant. The rising awareness of insurance in our population is a golden opportunity for us to make an impact and change the way insurance is perceived and experienced. The heightened consumer expectations and disruptive forces of the new economy will mean that accomplishing this will require a steadfast commitment to the values that are fundamental to the social mission of insurance. We must always act in the public interest for the long term benefit of our society.