Muhammad bin Ibrahim: Takaful industry at crossroads - a critical examination

Remarks by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Takaful Annual Dinner and Awards 2018 "Takaful industry at crossroads: A critical examination", Kuala Lumpur, 23 March 2018.

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Just last year, I addressed the insurance industry. The day after, the newspaper headlines screamed “insurance models broken”. And so, I was more than a little surprised to receive an invitation to speak. I could not resist it, and so I accepted.

This evening, I promise to be no less critical of the takaful industry. But take this well, as the path to success begins with a critical examination of where we are today. We need to work as a collective. And also bear in mind that the takaful’s industry success is also our success.

Let us start by reviewing the industry’s progress. Indeed, it has come a long way since its birth over thirty years ago. Its 1% market share in 1990 is now around 15%. Net contributions have grown 9% annually since 2010. These are achievements that we all should be proud of. However, before we celebrate, let us consider three issues.

First, can the industry sustain the growth momentum as we move into the 21st century world of technology and innovation. We have set ourselves an objective but we are far away from meeting the target. The objective of 25% family takaful penetration by 2020 is admittedly, ambitious but achievable. However, at the rate it is growing, we will only reach 16% in 2020, from the 14.8% today. This would be even lower if we were to correct for double counting of policies. Clearly, the data proves that takaful is still far below its full potential, and is nowhere near where it should be.

Second, individual takaful operators have not reached optimal size. Takaful operators are dwarfed by their conventional counterparts. Without sufficient scale, takaful operators are hampered in making meaningful inroads against their larger competitors. This is not just about competition within the takaful and insurance industry, but also of technology. Technology is reshaping the landscape of finance and lowering the barriers to entry from adjacent industries. Takaful operators must shape up, or risk being marginalised, or worse, made irrelevant.

Third, the value proposition of takaful needs to be more apparent. As it currently stands, many view it as being no different from insurance. Some even view it as being unnecessary.

It is disheartening to learn that 51% of respondents to a MTA survey cited these very reasons on why they have little knowledge or interest in takaful products. The issue of misperception also remains, with many non-Muslims deeming takaful as being only for Muslims.

Opportunity to reposition takaful for the future

This is the grim reality of the state of the industry, but it need not be so. In fact, I am positive about the prospects and potential of takaful. However, to get out of this “predicament”, we need an immediate and radical change.

Takaful must shed its image as being an imitator, a follower or impersonator of conventional insurance. Takaful operators, including the financial groups to which they belong, must see beyond takaful as yet another line of insurance products. In this, we need the right leadership, shareholders included, to set the right tone from the senior leadership that takaful must offer distinctive benefits highly valued by all. Its impact must be lasting and profound. This is especially so in our system, where takaful is competing side by side with the insurance industry.

All this considered, allow me to suggest three priorities for the industry to embark on to realise the full potential of takaful:

First, fulfill the promise of takaful in helping protect people and businesses. Takaful is derived from the Arabic word “kafal”, which means ‘to help’. To my mind, this calls for the industry to reach out beyond its comfort zone of focusing on mandatory products, such as motor and fire, or those that are easy to sell, namely mortgage related products. It must make serious inroads in other areas where protection gaps exist, such as in agricultural risk, annuity and trade credit. Something that is consistent with the needs of our economy. Ultimately, the industry must be ahead of the curve to innovate and deliver solutions that are truly needed and highly valued by customers, both individuals and businesses.

In family takaful, the industry must position itself as a trusted and valued solution provider for all Malaysians. It must dispel the image of takaful as being an overly-complicated form of insurance suitable only for Muslims. Market positioning should have broad appeal. Products should be easy to understand and live up to public expectations of fair treatment, transparent and efficient service.

In operational terms, this means using plain and simple language and always seeking to do what is right for the customer, rather than only what is legally required. Over 50% of insurance and takaful complaints that we received in 2017 were of mis-selling or misrepresentation. Remember, when our staff or agents misinform or mistreat a customer, they harm the institution and industry’s reputation, undoing all the hard work that went into building the system that we have today.

As a society we need to take care of our own, specifically for the B40 group. There is a lot of work to be done. As at end-2016, insurance and takaful penetration in the B40 segment of working age stood at 30.3%, compared with the overall penetration rate of 46.8%.

The roll out of affordable, accessible and easy to understand products under Perlindungan Tenang is a start in meeting the needs of the underserved. Unfortunately, to date, only three takaful operators have developed products under this initiative. Given the importance of financial inclusion for the nation and takaful being a product with pseudo-social leanings, we should expect much more from takaful operators.

Another area that is wide open for innovation is the integration of takaful with elements of waqf, sadaqah and zakat to fund the provision of takaful coverage to the poor. I understand that a microtakaful waqf product to help out those in the low income segment was launched a few weeks back. I look forward to seeing more products such as these in the future. There is strong potential for takaful to take the lead in solving development challenges facing the world, including poverty and environmental degradation.

Takaful can also be the missing link for businesses. The potential is enormous just by looking at the list of large infrastructure projects being undertaken. In Malaysia, just to name a few, there are the two new MRT lines, the ECRL and the KL-Singapore High Speed Rail in the pipeline. Internationally, there is the Belt and Road Initiative. All these entail large protection needs.

Capturing these opportunities would require much greater capacity to underwrite large and specialised risks than currently exists in the industry today. This calls for greater retakaful capacity. Given the absence of such retakaful operators, alternative arrangements for the industry to come together to pool their capacity, expertise and business need to be seriously explored.

We already have the essential ingredients – the presence of the world’s largest global players in our takaful market, deep Shariah knowledge within our domestic takaful and retakaful companies, and an entire Islamic finance ecosystem that can be tapped into to really push the frontiers in building retakaful capacity. We just need companies that are willing to lead the way. Building this will take time, resources and a long term perspective, but this may be a small price to pay to build scale, generate critical mass and position takaful as a credible solution for large and specialised risks.

There is also a big opportunity in halal trade facilitation, especially in serving SMEs. The global halal industry is valued at around USD2 trillion. The takaful industry however, has to be more committed and visible in serving local and international halal businesses. After all, takaful has its roots in the Nusantara, when Muslim merchants who plied their trade in the Far East centuries ago were protected by early forms of takaful. This is why the takaful industry must join the banking industry in participating at the upcoming Malaysia International Halal Showcase. Participation will indicate intent, non-participation reflects poorly on the takaful industry, showing the lack of commitment or ability to spot opportunities, or maybe even both. This certainly has to be addressed if the industry is to make any meaningful progress, this sort of things matter.

Second, the takaful industry must conduct itself in a way that alleviates, not add, to the hardship of customers. I would make this same remark to insurers and takaful operators alike, but with its very essence of kafal emphasising mutual help and assistance, takaful must do more. Our expectation is for the industry to consistently deliver best-in-class and superior customer experience. It makes perfect business sense for positive customer experience to be at the heart of the industry's strategy.

This is true for any business, but even more important for a product that most people do not normally seek out to buy. McKinsey & Co. estimates that globally, insurers that consistently offer best-in-class customer experience produce up to four times more growth in new business. They are also 30% more profitable than those who do it inconsistently.

What the research underscores is the importance of being accessible, empathetic, fast and reliable. Not just when selling, but also when providing after sales service and processing claims.

In this day and age, customers can hail a taxi ride in five minutes and have their food delivered in 30 minutes. Complaints on service are responded to within the same day, if not within minutes. Quality and response to services are forever being transformed by technological advances. It is thus unacceptable that service in the takaful industry is delivered slowly.

When I was finalising my speech, I was told by my staff that the average turnaround time to process damage motor claims has increased by 10, from an already miserable record of 83 days. In the 19th century, Jules Verne wrote that anyone can travel around the world in 80 days. We can't settle an insurance claim any earlier in the 21st century. Go figure.

My own experience suggests that the turnaround time is the most important aspect of takaful operations that shapes the industry's image in the eyes of the customer. The industry has to seriously look at this. It should relentlessly pursue changes in processes, rules and parameters that are necessary to improve the experience for customers. This requires creativity and persistence.

The situation is not much better in the family takaful business, although we are putting in place the infrastructure to tackle this problem. The Bank, the insurance and takaful industry, and the National Registration Department will roll out a new, automated mechanism this year to expedite the process for claiming death benefits. With this, the industry will be better able to help those in their hour of need.

The Bank, through the LIFE Framework and other initiatives, is determined to ensure that customers receive a fair deal. The recent implementation of the balanced scorecard will increase the professionalism of takaful intermediaries. It is now incumbent upon the industry to establish and maintain trust and goodwill with its customers. Takaful operators have started publishing and implementing new customer service charters. The industry must now walk the talk.

In the next few months, a Customer Satisfaction Index Survey will be carried out to measure actual service levels against what operators promise. The results will be made public. Customers can shop around and make better informed choices when deciding who to trust to protect them.

In this digital age, technology has changed the way we live, the way we save, and the way we bank. But it seems that little has changed in the takaful and insurance space. This perplexes me. This is quite telling from the industry's attitude towards efficiency and innovation more generally.

Mobile and internet penetration in Malaysia stand at about 132% and 81% respectively. There is potential to increase the offering of supplementary services online, such as vehicle anti-theft services and health advice, as a recent study by Bain & Company on insurance customers in 19 countries confirms. The industry can invest in its own capacity to deploy new technological solutions itself, or it can partner with others.

The point is that it has to respond proactively, or risk being disrupted by others. Just a few weeks ago, Amazon, Berkshire Hathaway and JPMorgan announced a new venture to disrupt health insurance in the U.S. This is the reality that the industry has to face.

Another issue that the industry is lagging behind is in terms of migration to e-payments. The use of cheques is still prevalent. In 2017, insurers and takaful operators issued 1.5 million cheques while 5.7 million were collected from customers. This is a huge number. Cheques are very costly, inefficient and obsolete.

If the industry does not respond to these challenges, then others will. Over the past year, the Bank has allowed financial product aggregators to offer insurance and takaful products on a non-advisory basis under the Regulatory Sandbox. These platforms allow consumers to easily compare and assess product offerings, thus increasing the visibility of insurance and takaful products and supporting our objective of digitalising insurance and takaful distribution.

The Bank is close to finalising changes to the regulatory framework that will enable online product aggregators to operate with broad access to the insurance and takaful market by the end of this year. This is a game-changing initiative that will pave the way for a more contestable insurance and takaful market going forward, ultimately improving access and choice for consumers.

For the industry, it offers the potential to open up new market segments that were previously untapped, particularly younger millennials, and lower the cost of bringing new products to the market.

Third, the takaful industry has to have the right people with the right competence. Strong leadership and quality talent are needed to steer the industry forward to reach greater heights. Let us start from the top with each company's leadership – shareholders, the board and senior management. For the industry to really break new ground, we need to consider a total re-imagination of the takaful model. It needs to break out of the shadows of insurance by evolving new business and operating models.

Concepts in takaful with rich potential, such as mutual takaful remain largely untested. The mutual model has a long history. It is also enjoying a resurgence with the rise of new online, peer-to-peer insurers in other countries. This is just one model. There might be others. Boards and senior management should lead the way in exploring these developments and charting new territory. This will require more active engagement of shareholders to develop a clear vision for the company and enlist support for bold strategies that will change the status quo for the better.

Various programmes such as FIDE and FIDE Forum already include content to help prepare directors in future proofing their institutions. The focus will be even stronger going forward. We are also pleased to announce that a specialised executive Islamic finance education programme tailored for directors of Islamic banks and takaful operators will be launched in the first half of this year.

It will equip directors with an appreciation and knowledge of Islamic finance by incorporating practical business perspectives. With this, directors are better able to contribute towards growth and innovation, beyond their roles in ensuring that their institutions operate within sound Shariah and risk management parameters.

At the level of employees, the reality is that good talent is in short supply. And so, the industry must take a longer view in its human capital strategies. It must invest to develop talent. Remuneration that is competitive is one part of the solution. Sadly, the remuneration of employees of takaful operators is not competitive. Among highly skilled employees, we estimate that those in the takaful industry earn 15% less than those in insurers. So long as this difference exists, it will not be the employer of choice for the best talent.

The other part of the solution is in building skills and competencies. The industry needs to take this seriously if it wants to break new ground in realising the potential of takaful. Takaful operators must set a clear vision and culture of continuous learning and development.

Programmes such as the Chartered Professional in Islamic Finance, Certified Shariah Advisor and Certified Shariah Practitioner play an important role in elevating the technical and ethical standards of the takaful workforce. The industry needs to get behind these standards and invest in upskilling employees across all levels, starting with those in key senior roles. This can take the form of sponsorships for professional qualifications, alignment of incentive systems and development pathways for staff.

Agents are also an important component of the takaful eco system. Many of the imperatives that I mentioned earlier are also applicable to them. In particular, professionalising the agency force is a priority. The life insurance industry association is already taking steps to require agents to be accredited by the Financial Accreditation Agency. I hope to see MTA doing the same, and being proactive in providing the support and resources for its implementation.

Moving forward, Bank Negara Malaysia, will further lay the groundwork to strengthen the industry. This includes creating an environment that fosters innovation, facilitated by the revised Takaful Operational Framework which will be published for consultation before the middle of the year. The revised framework will bring greater clarity on the use of multiple Shariah standards in the models and structures of takaful. We will also strengthen the governance of takaful operators, including how takaful funds are managed, to further safeguard the interests of takaful participants. An exposure draft will be published before the middle of the year, and the industry and public are welcomed to provide feedback.

Conclusion

Before I end, let me briefly touch on the developments with regards to the Malaysian economy. The domestic economy grew strongly, by 5.9% in 2017, supported by the global growth upswing and robust domestic demand. Domestic demand remained central to Malaysia’s growth, grounded on healthy income and labour market conditions.

This is not the fruition of just one year’s effort. It is a reflection of the successful structural changes undertaken over the last two decades. Malaysia’s shift towards a domestic demand-driven economy and continuous economic diversification have placed us in a very good position to adapt to and leverage on the changes in the global economy.

Another transformation that has taken place in the past two years is the increased sophistication of the onshore financial and foreign exchange market. The introduction of the Financial Markets Committee (FMC) measures has put in place the foundation for a healthier and more vibrant financial and foreign exchange market.

As a result of the strong economic performance in 2017 and the improved sentiments following these measures, the ringgit has strengthened by 14.6% in 2017 and 2018 thus far. The ringgit has also been of the most stable currency in the region. As our economic outlook remains strong, the ringgit will continue to reflect this strength.

For Bank Negara, we have always indicated that market forces will determine the value of the ringgit. There has never been a target level for the ringgit exchange rate. With the economy and financial markets constantly evolving, fixation on a particular level of ringgit exchange rate is counterproductive, if not detrimental to the economy.

What matters for Bank Negara and all of us here is to ensure that any adjustments taking place is done in a gradual and orderly manner, without causing undue disruptions to businesses and households. The foreign exchange market can sometimes be very fickle. Therefore, we should always remain on our guard, as the global economic and financial conditions may change rapidly following many developments such as normalisation of interest rates, geopolitical risks and the tendency to adopt policies that might curtail open trade.

The ringgit’s recent appreciation and stability is not something that we should take for granted. What we have learnt in recent years is to never downplay the unexpected. The rapid decline in global oil prices, drastic disruptive policy shifts in major economies, and the more recent increase in trade tensions are prime examples of tail-risk events that will continue to affect our economy and the ringgit.

Similar to the Malaysian economy, while we have witnessed progress and growth of the Malaysian takaful industry, moving to the next level requires us to move away from status quo and to do things differently.

Therefore I urge the industry to not waste any more time in thinking anew and strengthening its capacity to play a much more meaningful role in supporting sustainable and inclusive economic growth. Let us all be committed to realise the values that are fundamental to the benevolent mission of takaful.

I would like to take this opportunity to congratulate tonight’s award winners. I am confident that such recognition will motivate you and all parties to continue to contribute and strengthen the growth of the takaful industry.

Thank you and enjoy the rest of the evening.