Adnan Zaylani Mohamad Zahid: Leading in a disruptive world - revolutionising Takaful

Keynote address by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Takaful Rendezvous 2019 “Leading in a Disruptive World – Revolutionising Takaful”, Kuala Lumpur, 8 October 2019.

* * *

I am delighted to join all of you today at the 2019 Takaful Rendezvous. This is an important gathering for the finance and business community to exchange ideas on the opportunities and issues facing the global takaful industry. Our backdrop today is of an economy and environment that has seen remarkable changes and challenges that emerge in just a short period of time. While we have thought the financial crises of recent times were safely behind us, the global and domestic economy has been beset with an escalating trade war that has rippled far. This has affected the trade and investment climate worldwide and could bring about large downside risks. Malaysia’s economy will not be spared from this fallout.

At the same time, we have a growing sense of urgency to deal with environmental challenges. Globally, the focus is shifting towards climate change and sustainability. Closer to home, we have just experienced an episode of the country’s now, alarmingly, annual haze seasonality. Undoubtedly, each one of us can feel the impact and risks from environmental degradation on the quality of our daily lives. It will not be long from the time when we can clearly see its negative impact to the economy and financial stability. On a positive note, technology has transformed virtually every aspect of our lives – the way we interact with each other, consume our needs, follow the news, and navigate our movements. By 2018, more than half of the global population have become internet users. Here in Malaysia, almost 90% of Malaysians are internet users, and more than half of these users conduct banking and financial activities online. Digitisation and technology adaptation is already making significant inroads in providing new solutions going forward and has become a key strategy for us to enhance financial inclusion and also protection. While this means financial institutions now have greater avenues to reach consumers, it also entails greater exposure to emerging vulnerabilities and risks such as cyber and technology risks. This needs to be properly managed, otherwise it can potentially trigger grave systemic consequences.

In addition, there are also the gradual and structural changes that we cannot ignore. Over the last 20 years, the global population has more than doubled to reach 7.5 billion. This has posed significant challenges for policy makers and governments to appropriately allocate capital and finite resources. Every country including Malaysia is experiencing ageing population growth and will be affected by demographic changes either today or in future years. Declining share of working-age population and higher number of old-age dependents will strain the healthcare systems and place an upward pressure on costs of pension schemes. The design of financial protection has to evolve and, for many underserved segments, financial protection has become even more pressing. Islamic finance and takaful should therefore embrace its transformative role, responding to these evolving needs, rather than merely reacting to past and existing demand. It is thus imperative for takaful industry to **be agile and adapt to these changes**.

In my remarks today, I will outline three dimensions that offer significant opportunities for the transformative role of takaful:

- First, takaful can be a **key enabler for the Muslim economy**;
- Second, it can be a **solution of choice for Malaysians**; and
- Third, it can also be a **game-changer in empowering financial resilience**.

Takaful as a key enabler for the Muslim economy

For hundreds of years, merchants and traders have relied on arrangements based on mutual assistance to protect each other against the perils of sea travels, damage to property and other forms of misfortunes. Marine protection schemes, similar to the schemes offered in Edward Lloyd's coffee shop more than 330 years ago, can be traced back to the Islamic civilisation of the Ottoman Empire. One could argue that such protection arrangements were part of the ecosystem that made such empires the marine superpowers of their times. Fast forward to modern times, households and businesses continue to experience various risk events that could impact their lives, financial capabilities and assets. From nature-driven risks to man-made risks, these risks will directly impact those we protect and cover in increasingly significant ways.

The Muslim economy, in particular, is one of the fastest growing economies worldwide, driven by the exponential growth of Muslim population demanding Shariah-compliant products and services. Globally, the Muslim population itself is expected to grow twice as fast as the non-Muslim population. The global halal market is expected to reach USD9.71 trillion by 2025 – more than 20 times the size of Malaysia's economy. The global Islamic finance assets on the other hand have already surpassed USD2 trillion last year. All these present significant opportunities for the takaful industry to provide protection and risk management solutions – be it for trade or goods in transit, for protection of physical or financial assets, and for the protection of human livelihoods. Yet, the global takaful growth ranges at only around 4% last year. While the number of takaful operators has increased to 306, the global takaful industry still accounts for less than 1% of the global insurance market. This calls for serious attention and more concerted efforts by the takaful industry worldwide to ideate and introduce solutions that can support the progress of the Muslim community. Indeed, we should also recognise that this lack of protection and coverage is holding back the economic development of the Muslim community, and it is incumbent upon us to do more to improve this.

Takaful as a solution of choice for Malaysians

Here in Malaysia, the dual financial system which also includes conventional insurance and takaful market, is well-entrenched. The operating environment presents both opportunities and challenges for the takaful industry. Undoubtedly, it must compete and present a viable alternative to the conventional insurance. At the same time, it has a unique value proposition that can meet the Muslim demand and Shariah requirements. The sustained demand for takaful, especially among Muslims, has contributed towards the industry's steady growth – from 3% market share a decade ago to almost 18% in 2018.

The growth potential for takaful industry remains clear and promising. In 2018, almost half (45.8%) of the Malaysian population have yet to obtain protection. Based on a recent demand survey, 46% of Malaysian households and 48% of businesses responded that they are unaware about the comprehensive range of solutions that the takaful industry is able to offer. To reduce this gap, as an industry, takaful operators must collectively elevate the prominence of takaful and its capabilities to be a **solution of choice for Malaysians**. I wish to suggest three pathways for this aspiration to be realised:

- First, by offering **good value solutions** to customers;
- Second, by adopting **innovative** tools and **effective distribution strategy**;
- Third, by inculcating **sound understanding of financial protection** and **prudent financial behaviours** among Malaysians.

Allow me to elaborate on these . Firstly, the takaful industry has the advantage of a **business model that is grounded on the values of mutual assistance and solidarity**. Unlike insurance, which is premised on the buying-and-selling of risks at a premium, takaful advocates for value propositions that consumers are likely to find unique and take comfort in. Risk-sharing mechanisms in takaful, which entail greater participation of consumers in the scheme with possible rewards in the event of no claims, will appeal to many. The underlying mutuality principle allows for exploration of innovative business models that can constructively disrupt the existing risk-transfer modality. Value-adding services that complement the takaful offerings should also be optimised in designing solutions that are compatible and meaningful for consumers.

The initiative this year to expand the application of value-based intermediation (VBI) to takaful is a positive step forward for the industry to promote good value solutions. The takaful industry in Malaysia has established the Task Force under the oversight of the Malaysian Takaful Association (MTA), to spearhead this development. Intuitively, we would already expect that takaful is consistently aligned with VBI. Nonetheless, we will be looking forward to the stewardship that the takaful industry can offer in innovating impactful financial protection solutions and developing framework of business practices that are solidly grounded in fairness and incorporate sustainability principles.

Secondly, the takaful industry must **optimise the use of technology and digital infrastructures** to provide premier service quality to consumers. Globally, we do see the insurance and takaful sector as one of the sectors that can benefit the most from innovative technologies such as data analytics, robotics, artificial intelligence (AI), blockchain and cloud computing. App-based insurance platforms which leverage on AI have been established to identify interests of consumers in providing niche coverage. Parametric insurance using geospatial support and big data to validate legitimate claims by farmers have been rolled-out in many parts of the world. These are all examples of technology reinvigorating the "business-as-usual" means of providing protection.

From our own engagements with SMEs in particular, businesses often cited that complicated and lengthy procedures remain among the top reason for not purchasing takaful. This is not a new challenge and the solutions are available for takaful operators to deploy. More targeted investment into enhancing operational capabilities is paramount for takaful operators to stay competitive. Efforts should continue to be undertaken by the industry to provide seamless customer experience by digitising operational processes, expanding distribution outreach and also upskilling the intermediaries.

We also continue to be open to new proposals and would encourage players to test innovative business models and solutions in Malaysia. To date, 80 applications have been submitted under the Financial Technology Regulatory Sandbox – of which, 12 relate to insurance and takaful services. As we facilitate viability testing of these propositions, we have been gathering data and experience that will allow us to make evidence-backed regulatory adjustments, for new and incumbent market players to operate under a regulatory framework that is more risk-proportionate. This will cater for new designs of offerings and business modality, while remaining effective in promoting financial soundness and stability.

Nonetheless, what we have seen thus far can only be characterised as digitisation of existing delivery channels and services. Going beyond this, we have yet to see true disruptions. For takaful operators, staying competitive in a digital world will require far more than just direct sales channel or automated processes. It requires a rethinking of the fundamentals and principles of takaful, for which digital technology can be a catalyst. Takaful operators must rethink their sources of revenue, operational efficiency and talent strategy to reap the opportunities of digital disruptions. It is also important to rethink the business model and the role that takaful operators can play in a digital ecosystem that has transcended geographical boundaries. Digital disruptors such as virtual or peer-to-peer takaful provider that is tech-enabled might be able to overcome many pain points experienced by the industry in more efficient ways. The buzz right now in the financial industry is around digital banks. Nonetheless, this can swiftly turn to digital insurers or takaful operators. Such development could be the next phase that could further enhance the quality and pricing of services delivered, while also penetrating new areas for the industry to achieve our protection goals. This development could provide the impetus for exponential growth in insurance and takaful penetration in the country.

Thirdly, the industry must take greater responsibility **to educate consumers and inculcate understanding about the importance of financial protection**. Almost half of respondents in the 2018 Financial Capability and Inclusion Demand Side Survey cited lack of product understanding to be the key reason for not purchasing life insurance and family takaful. While there are attempts to publicise takaful offerings, these efforts remain fragmented and lack of focus on advocating greater appreciation and understanding about the value of protection. Households and businesses remain unaware and uninformed in making decisions relating to financial protection. Recognising this persistent challenge, the Bank and the Securities Commission recently spearheaded the establishment of the Financial Education Network and the launch of the National Strategy for Financial Literacy to increase the impact of financial education initiatives and to elevate financial literacy among Malaysians. Efforts to improve financial literacy will also require industry associations to drive the development of best practices for industry-wide adoption. In this regard, the Malaysian Takaful Association should be consistently proactive and agile in responding to emerging opportunities and resolving impeding industry issues.

Takaful industry as a game-changer in empowering financial resilience

As Malaysia advances towards the shared prosperity vision, it is crucial to ensure balanced and inclusive growth. The takaful industry has a critical role in enhancing the socio-economic well-being of Malaysians. This vision cannot be achieved without addressing the specific needs of the lower income group. According to a study by Khazanah Research Institute, people in the lower income category now have lesser residual income. The cost of living burden is the heaviest for lower income households, who spend 94.8% of their income on basic expenditure. Not much is left for savings or for financial protection in the event of misfortune. Overcoming the issue of affordability requires long-term and broader measures to grow people's income. In the interim, we can think of social finance as a vehicle to bridge this gap. The integration of social finance instrument in takaful solutions in a more structured and scalable manner can have transformative impact in making financial protection more affordable for society. Waqf, sadaqah and zakat are examples of social finance instruments which can be embedded in the design structure of takaful products. Mainstreaming the integration of social finance can unlock commercially viable financial protection to be extended to those who are most vulnerable in our society. This is definitely a unique value-added feature that can drive innovation in the area of inclusive protection.

In designing solutions to cater for the lower income segment, the takaful industry can capitalise and leverage on the principles of Perlindungan Tenang initiative, which promote protection solutions that are affordable, accessible, easy to understand, easy to buy and claim, as well as offering good protection value. Admittedly, the uptake by the industry to date has not been satisfactory. Many players cited business viability and distribution model to be among the critical challenges in advancing this initiative beyond corporate social responsibility. This is something that takaful operators, as an industry, would need to overcome. We will need to apply unconventional thinking and take bold steps to create an ecosystem that is more enabling for microtakaful solutions to be implemented in a sustainable manner. On the Bank's part, we have initiated a review of the relevant regulatory framework to spur the development of inclusive protection. A consultative paper will be issued by end of the year for industry to give its feedback.

Conclusion

As the takaful industry matures, all stakeholders will continue to set higher expectations. Consumers today expect seamless experience and quality service in every aspect of the business operation. Shareholders, of course, expect financial entities to offer sustainable returns on investments while exploring innovative business opportunities. Regulators expect financial institutions to adopt business strategies and operational models that are sustainable and value-adding to the economy and society.

The window of opportunity for takaful to deliver meaningful propositions for all its stakeholders is wide open. The takaful industry must step up with strong stewardship towards meeting these expectations. I believe the discussion at this conference today can help us better navigate the path towards purposeful transformation of the takaful industry. I look forward to engaging dialogues ahead and productive sessions with all of you. Thank you.