

# Governor's Statement



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

The insurance industry maintained its growth momentum in 2004. Strong demand for life insurance, particularly in investment-linked insurance, sustained overall growth at double digit levels. This was despite the slower growth in the general sector following a second year of premium rate corrections after significant rate increases in 2001-2002. The combined premium income grew by 17.2%, significantly exceeding the growth in 2003. Importantly, growth in 2004 was accompanied by a further strengthening of the industry's solvency position, continued profitability and improved technical fundamentals in terms of investment structures and underwriting practices.

Domestic insurers continued to make substantive progress in performance improvements during the year. This was reflected in the new business growth rate achieved by domestic insurers and their higher combined market share in the life sector. Of greater importance were the structural improvements in the market that followed. The level of market concentration in the life sector has been progressively reduced, reflecting a significantly more competitive industry than has ever prevailed in its history. The highly successful penetration of bancassurance by domestic insurers has evolved a more diversified distribution system. Internal capacities of insurers have also been strengthened with greater investments made, notably in technology, to enhance productive capacity, encourage innovation, increase efficiency and improve service levels. These developments have significantly enhanced prospects for more balanced and sustainable growth in the industry. It has also improved solutions for consumers in terms of both access to and choices for a greater diversity of products and service providers available to choose from.

A more robust regulatory and supervisory system has also been put in place to reinforce the positive structural changes that are taking place in the industry. Bank Negara Malaysia remained vigilant to ensure that appropriate regulatory adjustments are made to keep pace with new business innovations and their associated risk management challenges, without stifling innovation or distorting market incentives. With trends towards financial convergence continuing to redefine the financial landscape, regulatory adjustments have also been made with a specific view to converge the prudential framework for the banking and insurance industries, particularly along the dimensions of capital adequacy, risk management practices and public disclosure.

During the year, a number of prudential standards were reviewed to achieve a closer alignment between risk and regulation, as well as to reflect the realities of the increasingly more complex and diverse business environment. Among them were the solvency standards and technical reserving guidelines which are being revised to achieve more dynamic evaluations of overall capital adequacy and reserving requirements. Standards relating to audit committees and the suitability of key functionaries were also strengthened. In addition, a new risk-based supervisory framework was introduced to support an increased focus on the evaluation of insurers' risk exposures and risk management systems by Bank Negara Malaysia's examination teams. These adjustments are ultimately aimed at facilitating greater operating flexibility for insurers, while strengthening the supporting institutional framework to promote disciplined internal

approaches to risk management and corporate governance. This approach provides the most effective means of preserving the integrity of insurance institutions and ensuring their long-term financial soundness in a rapidly changing environment.

Investment conditions remained challenging for the life sector, particularly in terms of meeting expectations of policy owners on non-guaranteed returns for participating life insurance policies. Notwithstanding this, improvements to the underlying investment structures of life insurers have enhanced the prospects for more stable investment results going forward. Of significance was the higher proportion of insurance funds invested in fixed income securities of investment-grade quality. The distribution of investments by maturity was also more positive in terms of achieving a better match between assets and the long term liabilities of life insurers. New initiatives in 2004 to support the development of the bond market will further contribute towards improved asset-liability structures within the industry. Specifically, the liberalisation of the domestic bond market to allow for the issuance of papers denominated in domestic currency by multi-lateral institutions as well as the Asian Bond Fund initiatives are aimed at broadening and deepening the domestic bond markets which, in turn, will improve the investment risk profiles of insurers.

The insurance industry as an agent of social inclusion continued to increase in importance within the economy. Market penetration and per capita spending on insurance rose further during the year. With the growing level of risk awareness among Malaysians and rising income levels, demand for medical and health insurance as well as life insurance plans remained strong. With the more competitive conditions prevailing, a challenge for the insurance industry has been the ability to deliver suitable products and services to consumers that effectively meet their specific protection, savings and wealth preservation objectives. Against this backdrop, additional measures were introduced by Bank Negara Malaysia to promote the fair treatment of consumers. These included measures aimed specifically at enhancing consumer benefits, improving product disclosure and strengthening internal control mechanisms within insurers to mitigate mis-selling practices. The Financial Mediation Bureau also commenced operations in January 2005, providing convenient public access to dispute resolution mechanisms for financial consumers. To support the broader economic and social agenda, the industry, in collaboration with various Government agencies and non-Government organisations, continued to explore mechanisms through which insurance services and products could be delivered viably to meet the needs of identified segments of the population and economy, including the agriculture sector and in the area of retirement savings.

The year also saw the deepening of regional ties among insurance supervisory authorities to promote sound and stable insurance systems in the ASEAN region. Cooperation through the main platform of the ASEAN Insurance Regulators forum was complemented by technical assistance, information sharing and supervisory cooperation undertaken between countries on a bilateral basis. This provided objective avenues for pragmatic support to countries with specific requests and needs, and contributed to the more

vibrant collaboration between supervisory authorities in the region. Monitoring and surveillance of regional insurance activities has also been enhanced with the sharing of financial data on insurance industries in individual jurisdictions, as well as the agreement by ASEAN regulators to conduct periodic surveys of key industry risks and trends within their respective jurisdictions.

Despite the significant challenges to the industry brought about in recent years by the changing competitive landscape, cyclical markets and financial market volatilities, the diversity and health of the insurance industry today reflects the improved financial discipline within the industry and its increased agility in adapting to the challenges faced. This has been the product of the combined effects of the policy measures and the positive industry response. Going forward, Bank Negara Malaysia will continue to provide a supportive framework for positive change in the face of new challenges emerging with the ongoing financial evolution. In doing so, Bank Negara Malaysia remains committed to move forward with further initiatives towards promoting financial stability, building institutional capacity within the industry, and ensuring the integrity of insurance operations and market practices.



Zeti Akhtar Aziz  
Governor

19 April 2005