

Masterplan for Malaysia's Insurance Sector

Malaysia's economy is projected to expand rapidly over the next ten years. With it, the demand for insurance can be expected to grow significantly. The international experience of an 'S' curve growth in life insurance markets indicates that the life sector could grow significantly faster than the economy. A similar effect can be observed for general insurance markets. Within the next decade, a large proportion of the Malaysian population is expected to reach levels of per capita income that will create increased demand for insurance products. The ability of the domestic insurance industry to capture a share of this growth in this rapidly changing environment in which new challenges are emerging will depend on the ability of insurers to maintain their competitive positions, both within the industry and the broader financial sector.

Diagnostic of Current Situation of the Malaysian Insurance Sector

The regulation and supervision of the insurance industry was brought under Bank Negara Malaysia (BNM) in 1988. The insurance industry has made remarkable progress. A series of measures aimed at protecting public interest, promoting fairness and equity, and fostering a viable and competitive industry capable of serving the needs of a growing economy implemented over the years has substantially strengthened the industry. In particular, the coming into force of the Insurance Act 1996 significantly enhanced the regulatory regime governing the operations of the insurance industry by raising the standards of accountability of insurers as custodians of public funds, strengthening their financial positions, giving better protection to policy owners and ensuring that insurance operations are conducted with professionalism and in accordance with sound insurance principles. As a result of these measures, public confidence in the industry has improved as reflected by the significant increase in the market penetration of life insurance business from only 11.4% of the

population in 1988 to 30.8% in 1999. Insurers are also on a stronger financial footing, as evidenced by the total paid-up capital of the industry and the average capitalisation per insurer which has increased fivefold to RM4 billion and RM71.7 million respectively in 1999 (1988: RM634.9 million and RM12.4 million respectively). At the same time, total insurance fund assets and the average asset base per insurance fund increased proportionately to RM45.4 billion and RM582.1 million respectively in 1999 (1988: RM7 billion and RM93.7 million respectively).

Notwithstanding the progress made by the insurance industry, insurers face considerable challenges ahead as global trends of consolidation and specialisation are expected to create international insurers that are larger, better-skilled and more focused on core areas of competence. Apart from traditional players, insurers will also face increasingly sophisticated competition from new players such as asset managers, captive insurers, independent financial advisers and Internet players who, through disintermediating core elements of the insurance value chain, are improving product range and performance and lowering the prices paid by consumers. Given these challenges, efforts need to be directed to achieve enhanced efficiency, effectiveness and stability. Specifically, benchmarks must be set:-

- domestic players in the life and general insurance industries should improve further on economies of scale;
- greater progress should be made towards the development of skills in the areas of management, information technology and underwriting;
- greater competition should be encouraged to reduce acquisition costs, especially in the life sector, and premiums charged in the general sector;

- the penetration of alternative distribution channels such as independent financial advisers (IFAs), banks, telephone, direct mail and Internet could be further enhanced;
- the quality and productivity of the agency force should be improved; and
- the breadth and standard of insurance products and services in Malaysia should be improved to match that in more advanced markets.

Significant changes must be made to raise performance standards in the Malaysian insurance industry in tandem with advances being made globally so as to narrow the gap between Malaysian insurers and international best practices.

Overview of the Masterplan for the Insurance Sector

With this in view, BNM has developed a Masterplan for the insurance sector that is designed to implement a programme of change that will build the capabilities of domestic insurers to compete more effectively for a share of the growing insurance market, while ensuring that Malaysian consumers have access to the range of products and services to meet their needs. The primary objective of the Masterplan is to build an efficient, effective and stable insurance sector that supports both the needs of the real economy and the socio-economic objectives of the country. BNM also aspires to build a core of domestic insurers that can provide consumers with world-class products and services without compromising international commitments to the liberalisation of the insurance sector.

The Masterplan sets out to achieve these objectives by:-

- **firstly**, improving the performance of domestic players through building capabilities and promoting industry

consolidation and the adoption of best practices;

- **secondly**, gradually liberalising the industry in order to stimulate innovation and ensure that consumers have access to world-class products and services. The insurance industry will be progressively liberalised to new domestic and/or foreign players who can offer innovative products and services to Malaysian consumers. Equally, new entrants unencumbered by legacy assets may more rapidly transform the provision of products and services in the industry, thereby, accelerating the development of the Malaysian insurance market; and
- **thirdly**, managing the transition in order to minimise any instability in the industry while ensuring that the needs of Malaysian consumers are met. The transition towards realising the objectives set for the insurance industry will be carefully managed, building the necessary foundations for the successful implementation of the Masterplan. While the Masterplan takes a market-driven approach, emphasis will be given to capability building, performance improvement and industry consolidation.

Specific Recommendations

Recommendations under the Masterplan to **enhance the capabilities and competitiveness of domestic insurers** include:-

- encouraging the use of alternative distribution channels including the Internet and bancassurance to improve efficiency and productivity;
- relaxing restrictions on outsourcing and the employment of expatriates to enable domestic insurers to capture the scale, skill and technology available both domestically and internationally;
- promoting the management of pension funds by insurers to increase

the market share of the domestic life insurers;

- relaxing restrictions on the opening of branches to achieve higher market penetration;
- allowing insurers to distribute personal financial service products other than insurance in keeping with the emergence of one-stop financial service providers;
- allowing qualified players to sell takaful products to promote the development of the takaful sector to complement conventional insurance;
- relaxing restrictions on operating expenses to allow insurers greater flexibility to attract and retain talent, and invest in research and development; and
- in the medium to long term, gradually deregulating the pricing of tariff-rated general insurance products to encourage the development of more sophisticated underwriting skills and pricing techniques in the domestic market. More competitive pricing will also serve as a strong incentive for consolidation, specialisation and the development of more cost-efficient distribution channels.

To **promote consolidation and the adoption of best practices**, the Masterplan includes the implementation of the following measures:-

- progressively increasing the statutory minimum paid-up capital for direct insurers;
- strengthening 'fit and proper' regulations, specifically in relation to requirements with respect to the minimum qualification or experience as well as the introduction of performance incentives and evaluation processes for directors and senior management executives of insurers;
- upgrading the agency force by raising the standards of qualifying examinations

and introducing additional qualification requirements as part of continuing education programmes for agents;

- introducing certified IFAs who can represent a broad range of financial service providers to provide independent advice on financial options, including but not confined to insurance, that will most effectively meet the needs of individual consumers;
- introducing 'best-advice' regulations which hold intermediaries, including tied agents, company representatives, brokers, IFAs and financial planners, liable for their advice on sales of life and general insurance products; and
- strengthening regulations on unfair trade practices to ensure fair competition and market conduct.

The above measures aim to establish the foundations of stronger consumer protection, higher professionalism and enhanced competitive capabilities that are necessary to support the industry in an open market environment. With these in place, in the next phase of development, further liberalisation will be introduced to **stimulate innovation by incumbent insurers and provide Malaysian consumers with access to world-class products and services**. These include:-

- allowing a limited number of new insurance licences in specialised lines of business for innovative players;
- allowing financial and non-financial institutions to acquire interests in direct insurers;
- offering additional new licences to foreign entrants for the conduct of professional reinsurance business; and
- relaxing the foreign equity limit for new entrants into the market.

End-game

With a combination of measures to build domestic capabilities and promote consolidation, innovation and the adoption of best practices implemented through a carefully managed transition plan, BNM is confident that the Masterplan will accelerate the evolution of the domestic insurance industry towards achieving

international performance standards within the next decade. Ultimately, the change envisaged under the Masterplan is expected to result in a more efficient, effective and stable insurance industry, with benefits in the form of more sophisticated products at competitive prices flowing both to Malaysian consumers as well as the economy at large. This, in essence, is the end-game of the Masterplan.