Governor's Statement

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The Malaysian insurance industry maintained positive growth in 2005 despite more challenging investment conditions. The determinant of growth has shifted to the general insurance sector which has benefited from the significantly higher motor insurance sales, increased insured exposures and favourable pricing conditions. In the life sector, demand conditions during the year have remained positive with the improving risk awareness and increasing affluence of the population. Overall, healthy operating results continued to be achieved, underpinned by improved underwriting results and efficiency gains reaped from greater economies of scale as well as the more efficient utilisation of capital. This further strengthened the solvency position of the insurance industry. It therefore provided a conducive environment for the implementation of regulatory and supervisory initiatives to further enhance the resilience of the industry and to improve market conditions in addition to taking the development of the industry forward to new levels.

The competitive structure of the insurance industry was further enhanced during the year with the passage of legislation providing for the introduction of financial advisers and more aggressive penetration through the direct distribution channels as well as continued expansion in bancassurance which has increased opportunities for broader participation by smaller insurers in the market. A more competitive market has also emerged in the life and reinsurance sectors with the gradual unwinding of market agreements which had previously been a factor impeding competition. These developments were accompanied by improvements in innovation and a greater degree of differentiation in the market, offering consumers a wider diversity of products and services. Following the liberalisation of the foreign exchange administration rules, insurers have also begun to offer foreign-denominated education and investment-linked products. It has further contributed towards encouraging continued innovation in the market to meet the more diverse and discerning consumer expectations.

Bank Negara Malaysia has remained focused on moving towards a more proportionate and flexible approach to regulation and supervision based on sound risk assessments. The adoption of the risk-based supervisory framework approach, now well into its second year of implementation, continued to be refined to sharpen the focus on institution-specific risks in the supervisory assessment and rating process. The Bank has also issued the second concept paper on the new risk-based capital framework which will be implemented in 2008, setting out details of the basis for the future determination of solvency, as well as the supporting institutional risk management and governance framework that insurers will need to have in place. Further steps have been taken to replace rules-based prescriptions with more flexible principles-based regulations, while reinforcing the Bank's enforcement capabilities to ensure that insurance institutions deliver against a set of high-level principles of best practice. Advances made in these areas are ultimately aimed at creating a robust regulatory and supervisory regime that facilitates differentiated approaches to dealing with the distinct characteristics of different institutions, while maintaining a consistent view and treatment of risk.

These regulatory and supervisory reforms are also taking place at a time when the risk dimensions affecting insurers' operations have become more challenging. The increasing risks associated with natural disasters and global pandemics have led to considerably shorter premium cycles in the general insurance industry. At the same time, an increasing proliferation of complex, and often illiquid, financial instruments are fundamentally presenting new challenges to risk management, valuation and reporting approaches and disciplines. Greater technological capacity coupled with increasingly complex internal organisational and institutional structures have also increased vulnerabilities to operational risk and financial crime.

Against this backdrop, the focus on institutional capacity building to ensure that insurers are well-placed to cope with the challenges posed by the changing environment remained a high priority for the Bank. Emphasis continues to be given to sound corporate governance led by effective boards, promoting a strong risk management and internal control culture within insurers, and strengthening the accountability of auditors and actuaries in supporting prudent pricing and reserving practices, as well as robust reporting and valuation processes. These priorities have been firmly entrenched in the Bank's regulatory and supervisory processes - including in the appointments of directors and chief executives, the review of product submissions as well as the financial surveillance processes. In the development of technical expertise, particular focus has also been directed at strengthening the internal investment management capabilities of insurers in parallel with the environment of increasing investment flexibility – eventually culminating in the substantial removal of investment restrictions under the risk-based capital regime - being accorded for insurers to enhance investment performance and improve asset-liability structures.

The insurance industry continues to perform an increasingly important socio-economic function within the economy. Market penetration and per capita spending on insurance rose further in 2005. Of significance was the more rapid increase in the level of new insurance protection purchased during the year which reflects the more proactive efforts by Malaysians to better manage and provide for their current and future financial needs. Notably, higher levels of insurance protection were observed for medical and health and consumer credit insurance plans which, in turn, facilitate better access to healthcare and improved household debt management. To support the further expansion in medical and health insurance coverage, revised guidelines on medical and health insurance business were issued to achieve more equitable terms and conditions for consumers. Many individuals, however, still do not have adequate resources set aside to finance their retirement needs. This presents a significant challenge to Government policy, the industry and the population at large, particularly in the light of long-term demographic changes leading to an ageing population which have been confirmed by the updated mortality data published in this Report.

Initiatives in the area of market conduct were focused along three major strands - enhancing the financial capabilities of consumers to better manage the more complex financial decisions and options, improving product disclosures, and strengthening enforcement. Under the InsuranceInfo consumer education programme, efforts have been intensified to increase the programme's visibility and reach. The public response to both Bank Negara Malaysia LINK (Laman Informasi Nasihat dan Khidmat), a one-stop customers service centre at the Bank, and the Financial Mediation Bureau which are now actively operational has also been encouraging with more consumers accessing their services. To ensure the effective enforcement of proper market practices, the Bank is currently reviewing its market conduct supervisory focus and orientation to deliver a regime that will reinforce positive long-term changes in market behaviour.

On the external front, the Bank has continued to actively engage with regional and international fora to foster closer insurance cooperation among the regulators. The external relations in this context aims to facilitate the process of integrating domestic regulation and supervision with global best practice. In addition, efforts will continue to be directed to working with the international supervisory community towards promoting a more consistent global approach to insurance regulation and supervision. The Bank's efforts will therefore be to maintain a robust regulatory and supervisory system that is compatible with domestic market conditions and capabilities, while meeting the objectives of promoting regional and global market efficiency and stability.

Cooperation in the region has been focused on capacity building, with a marked increase in demand seen for training support. The Bank continued to extend its full support to the regional capacity building agenda, both on a bilateral as well as multilateral basis. To meet the increasing volume of requests for technical assistance, the Bank has developed and delivered a comprehensive training programme on insurance regulation and supervision for middle level supervisors which has attracted wide participation from regulators in the region. The programme has since been elevated to a flagship course which will be offered annually to participating countries through Malaysia's Technical Cooperation Programme. Cooperation in this area has the potential to significantly enhance the prospects for long-term regional stability and the realisation of the benefits from greater regional economic and financial integration.

Looking ahead, as more significant impending regulatory changes draw closer for implementation, and as market conditions continue to evolve to reflect broader-based competition and multi-faceted risk dimensions, the Bank will step up its vigilance of the industry's state of readiness to cope with the changing environment. An orderly transition of the market-led adjustments is vital to ensure that the adjustments does not destabilise the market or undermine public confidence. To this end, efforts will continue to be directed towards building institutional capabilities and putting in place the necessary supporting financial infrastructure to provide a firm foundation for orderly change. Initiatives in the area of financial education for consumers will be intensified to further expand the coverage as well as to promote the fair treatment of consumers. Our internal resource and system capabilities to support a more complete assessment of risks confronting the industry will also be continuosly strengthened. We will also continue to leverage on our regional and international linkages to drive positive change in areas where gaps continue to persist. The Bank remains unwavering in its commitment to these endeavours.

Zeti Akhtar Aziz
Governor

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