Governor's Statement

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The insurance industry continued to expand in 2003 with the strengthening of the domestic economy and the recovery of the global insurance market after a challenging year faced in 2002. Against a backdrop of reduced global insurance capacity, insurance markets in both the industrialised and emerging markets benefited from a more positive investment environment, while the non-life sector benefited from the higher premium rates sustained in 2003. In Malaysia, the stronger domestic demand, spurred by increased private sector activity, provided an impetus for the growth of financial services, including insurance. The insurance industry, which has an important role in facilitating economic risk transfers and mobilising long term funds for economic development, expanded further by 11.7% and 15.3% in terms of aggregate premium income and insurance fund assets respectively. The combined premium income of the industry as a percentage of Nominal Gross National Product increased to 5.1% in 2003.

The first phase of our Financial Sector Masterplan (2001-2003) has focused on evolving a more diversified financial structure with stronger and more competitive financial institutions. Positive results in the insurance sector have contributed to a higher market penetration rate of 36.7%, reflecting a wider insurance coverage of the Malaysian population. Opportunities in new growth areas for domestic life insurers have enhanced their competitive positions. Of particular significance has been the encouraging progress made by domestic insurers in increasing their market shares by leveraging on bancassurance as an alternative distribution channel. Domestic life insurers have also significantly increased their share of investment-linked insurance business.

The role of the insurance sector as an alternative source of financing to the banking system has also become more significant with the increased capacity of insurance institutions to support the development of a robust private bond market. Investments of the insurance industry in private debt securities constituted 25.3% of the overall composition of insurance fund assets as at end of 2003, increasing from only 18.4% in 2000. During the year, a more flexible investment framework was introduced to further enhance the ability of insurers to invest in private debt securities as part of their asset-liability management strategies. In addition to broadening the institutional investor base for such papers, the revised framework is aimed at enabling insurers to achieve more stable investment yields and reduce risks associated with maturity mismatches, particularly in the life insurance sector.

Following the consolidation of the insurance sector which saw the successful completion of 15 mergers and acquisitions involving a total of 28 insurers since 1999, the resilience of the industry has strengthened. Overall profitability, productivity and efficiency levels improved in both the life and general sectors. The more competitive environment has also driven greater product innovation, resulting in a wider range of products available to consumers, ranging from the basic risk protection products to the more sophisticated financial planning solutions designed for retirement and asset accumulation. Further improvements are expected within a more flexible regulatory environment which will present opportunities for insurers to become more competitive through rationalisation of operations, continuous innovation and development of internal capabilities. In this process, the ongoing consolidation of the insurance sector will remain relevant in creating a core of strong insurers that will be able to fulfil a leading role in supporting a vibrant and progressive insurance industry.

Policy initiatives during the year continued to be directed at strengthening the foundations for an efficient, effective and stable insurance industry. In the area of corporate governance, the focus has been on further strengthening the governance structure within insurance institutions, promoting market discipline and an environment in which those responsible for the stewardship of insurers will provide effective leadership and accountability in the more challenging environment. To this end, the effectiveness and accountability of the board of directors of insurers to their policy owners and other stakeholders have been further enhanced with improved disclosure on the remuneration of directors and chief executive officers as well as the establishment of expanded board committees by all insurers. In addition, the independence of the board has been strengthened to provide an effective check and balance in the board's oversight function.

The consumer protection infrastructure is being strengthened to ensure fair market practices, while promoting greater consumer activism. The terms of reference of the existing insurance mediation bureau will be expanded to enable the bureau to resolve a wider spectrum of insurance disputes. Further progress would be achieved with the forthcoming establishment of a single new financial mediation bureau which will integrate the insurance and banking mediation bureaus to improve public access and delivery of complaints and dispute handling services to financial consumers in a more efficient manner. Equally important is to achieve the desired outcome of high standards of market conduct founded on principles of integrity, sound ethics and professionalism. In this context, the regulatory framework governing insurance market practices was further strengthened. Measures were taken to enhance claims settlement practices in general insurance business, standards of product disclosure and transparency as well as professional standards of insurance intermediaries. To equip consumers faced with increasingly complex choices and options in the more diversified financial landscape, the Bank launched an extensive consumer education programme for the insurance and takaful sectors in August 2003.

The surveillance capabilities of the Bank have been strengthened. More frequent reporting requirements have been introduced to facilitate the effective and timely financial surveillance by the Bank. This is supported by ongoing enhancements to the legal framework as well as the Bank's internal supervisory systems to enable the early identification of emerging risks and the institution of prompt corrective measures. Substantive progress was achieved during the year in the development of a more robust risk-based solvency framework that will enable insurers to operate at more efficient capital levels, while ensuring that capital remains adequate to support the actual risk profile of individual institutions. These initiatives constitute an important element of the Bank's overall strategy to achieve financial development with stability.

The Bank remains committed to insurance cooperation initiatives at both the regional and international levels. During the year, the Bank continued to extend technical assistance to regulatory authorities in the region, participated actively in the development of international insurance standards through the consultative process and engaged in active exchange of information between regulators in the region. With greater international integration, such cooperation will become increasingly critical in efforts to promote greater stability in insurance markets.

Progress in the further development of the financial system as an important enabler of economic growth also will depend on the efforts of financial institutions to build competitive advantage and their ability to adapt to changing conditions. The insurance industry can expect increased demands to support the efficient and effective transfer of risk. It is therefore essential that insurers develop the necessary capacity to meet these demands. Dynamic management within domestic insurers to drive performance improvements will be critical to achieve the desired results. The ongoing benchmarking initiative remains an important tool to drive performance improvements towards achieving more efficient operating levels, greater innovation and higher service standards.

As the insurance industry prepares to enter into a new era of competition with the progressive removal of competitive barriers, the Bank will continue to drive the development of the industry within a framework that is focused on consumer protection, sound risk management and ongoing institutional and capacity building. The blueprint for this development has been outlined in the recommendations under the Financial Sector Masterplan. While significant progress has been achieved, much remains to be done. This needs to be achieved in an environment of financial stability. The challenge continues to be to achieve a dynamic and high performing industry that is able to contribute to sustainable growth in a rapidly changing environment.

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Governor

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