

Governor's Statement



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The insurance industry in the global financial system continued to be presented with a highly challenging environment in 2002. Amidst this more difficult environment the Malaysian insurance industry recorded a positive performance during the year. The business growth of the insurance funds of both the life and general insurance sector has continued to expand with the total assets now accounting for almost 5% of the total assets of the financial system. In particular, the growth was supported by improved business performance in the general sector and product innovations in the life sector.

In the global insurance market, the difficult market conditions that prevailed in 2002 are expected to continue into 2003, weighed down by the weak investment climate and significant depletion of capital following the huge catastrophe and liability claims in the recent two years. The developments have, however, prompted a return to technical fundamentals with premium rates restored to more adequate levels and an increased focus on prudent underwriting and reserving policies.

Against this backdrop, policy measures for the Malaysian insurance industry in 2002 continued to focus on enhancing the capacity of insurers to strengthen the resilience not only to weather the prevailing uncertainties in the business environment, but at the same time, enhance the capacity of the industry to play its role as an important component of the financial sector. Indeed, prospects for improved performance in the industry were enhanced further with the completion of another eight mergers and acquisitions (M&As) during the year, bringing the total number of M&As completed since 1999 to 14 involving 27 insurers. Combined with the strengthened average capitalisation, an increasing number of insurers are well positioned to make significant improvements to maintain their long-term competitiveness.

Building on the strengthened foundations in place, new directions were introduced in the regulatory environment to provide insurers with greater operating flexibility to achieve efficiency gains through disintermediation and alternative distribution strategies. With continuing trends towards financial convergence, these measures aim to pave the way for the development of integrated consumer strategies and transactional capabilities across products, services and channels. As product differentiation becomes more challenging, such enhanced capabilities are essential to enable insurers to meet increased consumer demands for value-added financial solutions, higher levels of service and convenience through a more diversified distribution system. Focus was also given to benchmarking, as a potent tool for insurers to drive performance improvements and to strengthen their competitive positions. The performance results and emerging issues arising from the benchmarking programme are discussed with individual insurers. To complement the benchmarking exercise Bank Negara Malaysia has also initiated a market analysis study to develop a service quality index for the insurance industry. The index will provide an objective basis for the assessment of service levels from a consumer perspective. As a service industry, importance is placed on the ability of insurers to respond effectively to consumer expectations.

The insurance sector continued to be a key player in shaping developments towards the convergence of financial products and services. Investment-linked business, which combines insurance and investment products, saw its most significant growth in 2002 since its introduction into the market in 1998. Further progress was achieved with the finalisation of the governing regulatory framework for financial advisers who will be able to offer consumers a wide range of financial products, including but not confined to insurance, from competing financial service providers.

Towards ensuring the orderly development of the industry, the Bank has also embarked on strategies to prepare consumers for the more diversified financial landscape. A comprehensive consumer education effort is now underway. This will be supplemented by measures to enhance product transparency, promote greater accountability in sales practices and expand avenues for consumers to seek redress. In addition to enhancing consumer protection, these efforts will also promote greater market discipline through heightened consumer activism.

A significant challenge for the industry in the rapidly evolving business environment lies in providing effective strategic leadership and maintaining high professional standards. To facilitate this, the Bank has announced the establishment of the International Centre for Leadership in Finance to spearhead a coordinated approach to human resource development for senior management in the financial sector. The insurance industry will therefore be able to benefit from this effort to drive the accelerated development of intellectual capital and managerial capabilities in the financial sector. During the year, the Registered Financial Planner Programme was also launched to promote professional competence, conduct and ethics among life insurance agents in the industry. Important progress was also achieved in the area of training at the regional level with the adoption of the Memorandum of Understanding (MoU) on the establishment of the ASEAN Insurance Training and Research Institute (AITRI) by the ASEAN insurance regulators in December 2002. As the regional centre for insurance training and research in ASEAN, AITRI is positioned to contribute significantly towards the development of human resources in the region.

The year also saw further progress in the prudential supervision of the industry. Improved technological capabilities have enabled more effective surveillance of insurance licensees as a result of continuous improvements to the quality as well as timeliness of information submitted to the Bank. A more rigorous supervisory process was introduced with the implementation of the Informal Enforcement Actions Framework for insurers and takaful operators. The framework provides a structured approach towards enforcing commitments made by insurers to address findings raised by the supervisory exercises.

Going forward, the changing business models, further financial convergence, intensifying competition and changing risk profiles can be expected to test the limits of the current regulatory boundaries. The Bank will therefore continue to devote resources towards both modernising the regulatory environment and strengthening the supervisory

infrastructure. In particular, prudential standards will be regularly reviewed to take into account the changing business environment, while emphasising the essential role of sound corporate governance and risk management within an effective control framework. In this process, the international environment has prompted increased importance being accorded to consolidated supervision, fair value accounting and risk-based capital regulations worldwide on the industry. At the same time, the Bank's surveillance systems are also focused on the early identification of potential areas of weaknesses and the implementation of prompt corrective measures. This is essential to support the transition from a prescriptive to a performance-based supervisory regime as envisaged under the Financial Sector Masterplan.

While the enabling infrastructure and environment is being put in place for the development of a dynamic, sound and stable insurance industry, it has to be the result of the combined efforts of all the relevant parties involved. In this effort, responsible leadership provided by the industry itself and the positive contribution of industry players towards initiatives to elevate the industry to a higher level are vital to build on the significant progress already made.

A handwritten signature in black ink, appearing to read 'Zeti Akhtar Aziz', with a stylized, flowing script.

Zeti Akhtar Aziz
Governor

15 April 2003