The Malaysian Islamic Finance Issuers and Investors Forum 2006
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Keynote Address by

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It is my great pleasure to be here today to speak at this Malaysian Islamic Finance Forum that has been the joint efforts by the key regulatory and market authorities in the financial services sector in Malaysia, that includes Bank Negara Malaysia, the Securities Commission, Labuan Offshore Financial Services Authority (LOFSA) and Bursa Malaysia. The aim of this forum is to provide a platform for industry players and regulators to interact and discuss recent developments in Islamic finance in Malaysia, the performance of the Islamic financial market, and to provide greater awareness on the innovative products and services and the opportunities for both issuers and investors.

The rapid pace of development of Islamic finance in Malaysia has taken place in an environment of strengthening economic growth that is underpinned by strong fundamentals. The growth has been achieved with relative price stability, low unemployment and a strong external balance. The level of savings remains high and external reserves are at a comfortable level at about USD80 billion. Meanwhile, GDP per capita in current prices has increased by an average of 7.1% per annum since 1991 to about USD5,000 in 2005. And if adjusted for the cost of living the purchasing power parity (PPP) adjusted GDP doubled over the period to USD10,318. The sustainability of the economic growth momentum has been derived from the diversified economic structure that has evolved, as the flexibility of the economy has yielded the continuous ability to shift to new areas of comparative advantage. It is this diversification in the economy that has also reduced vulnerability to shocks and increased resilience.

Malaysia has also taken advantage of globalisation to strengthen its economic and financial relationships with the major trading blocs in the world. This year we expect our trade value to exceed **RM1 trillion** for the first time. Foreign direct investment has been sustained, in particular, into the new areas of growth. There has also been an increase in Malaysian corporates and financial institutions venturing abroad. This has strengthened our inter-linkages in the global economy and our integration in the international financial system.

Amid the environment of favourable growth and strong fundamentals, Malaysia has taken the opportunity to further deregulate and liberalise the Malaysian financial sector, with a view to enhancing its contribution to efficiency and growth. The sector has also continued to be progressively transformed through rationalisation amongst existing financial institutions and the introduction of new institutions. These developments have contributed to the strengthening of the international dimension in the financial system. This has been particularly the case for the Islamic finance sector. In the development of the Islamic financial system, the Islamic Banking Act 1983 of Malaysia accords universal banking stature to licensed Islamic banks. The banks are permitted to conduct the full spectrum of banking business, including the more sophisticated investment banking activities such as corporate finance, private equity and wealth management. It is innovations in product development in this particular sector that has paved the way for increased opportunities in the Islamic financial system.

The Malaysian Islamic banking system saw strong performance in 2005, with higher profitability and positive trends in all key indicators. Profitability surpassed the RM1 billion mark for the first time in 2005, and assets surpassed the RM100 billion mark. The Islamic banking sector has remained well capitalised with the risk weighted capital ratio sustained above 12 percent. The most recent performance of the Malaysian Islamic financial market has been encouraging with Islamic banking assets amounting to RM117.4 billion, takaful assets of RM6.2 billion, and Islamic corporate bonds of RM125 billion, which constituted 46 percent of the total corporate bond market in Malaysia. A total of 26 new corporate sukuk issues with an aggregated value of about RM23 billion were announced in the first half of 2006. This is equivalent to 71 percent of the Malaysian domestic market's rated corporate bond issues for the same period. This increase in critical mass reflects the demand for issues, providing the supply for investors.

Let me now touch on several important aspects of the Malaysian Islamic financial markets that are important to issuers and investors. These relate to the freedom to move capital into and out of Malaysia, the availability of credible and timely market information and the capacity of the Malaysian Islamic financial market to allow for greater product diversification and risk management.

On capital mobility, Malaysia maintains a highly liberal foreign exchange administration regime. The primary focus of foreign exchange administration is to support the monitoring of flows of funds to promote financial and economic stability. As part of the continuous effort to enhance efficiency and reduce the cost of doing business, the foreign exchange administration rules have been progressively liberalised and simplified. There is free mobility of inward and outward movement of funds relating to both foreign direct investment and portfolio capital investments. Foreigners investing in Malaysia are also free to hedge with onshore banks their committed flow of funds such as the repatriation of investment proceeds, dividend and profits from Malaysia as well as the purchase of ringgit assets in Malaysia. In addition, investors are freely able to obtain ringgit and foreign currency to fund their investments in Malaysia.

Strategic measures have also been taken to allow non-residents, in particular, Multinational corporations and Multilateral agencies to issue ringgit denominated bonds in Malaysia. The ringgit funds raised may be used either in Malaysia or outside Malaysia. Both the foreign issuers and investors are free to hedge their foreign exchange exposure from the issuance and interest respectively. There is no withholding tax on the profit realised from investments in these ringgit denominated bonds. The International Finance Corporation and the International Bank for Reconstruction and Development have since issued their first ever Islamic bond issuances in Malaysia. The total issuance amounted to RM1.3 billion, all of which were over subscribed. A portion of these papers was purchased by non-resident investors, indicating foreign interest in the ringgit denominated instruments.

On the availability of credible and timely information, the Malaysian regulatory framework, reinforced with the adoption of best practices, has created an environment of greater transparency and richness in financial market information. The financial regulators provide extensive information about the Malaysian economy and Malaysian financial system, including regulatory requirements. The Bank also has put in place several websites that provide market information on the issues that are available for the market participants. Finally, on the capacity for diversification and risk management in the Islamic financial system, while being relatively small compared to the conventional system, it is expected to expand as the financial system strengthens and as new products are introduced.

In the context of this financial infrastructure, the Malaysian Islamic financial

system is both robust and fast growing. The market has highly diversified players, with Islamic banks, investment banks, takaful companies, development financial institutions, savings institutions, fund management companies, stock brokers and unit trusts. The Malaysian Islamic financial market has already introduced a variety of Islamic financial hedging instruments, including the Islamic profit rate swap, Islamic cross-currency swap and Islamic forward rate agreement. The wider use of commodity murabahah transactions will also add breadth and depth to the Islamic money market as it facilitates a more efficient distribution of money-market liquidity and expands the range of instruments that market participants can actively transact in.

We are pleased to announce that Bank Negara Malaysia will soon be adding murabahah-based transactions to our already diverse range of policy instruments to manage short-term liquidity in the Malaysian Islamic inter-bank money market. The Bank Negara Malaysia's murabahah based-transactions may either utilise global or Malaysian commodities as the underlying transaction, and in the future, other Shariah-approved assets similar to the Ijarah sukuk notes. The widespread usage of this globally practised financing instrument would allow market participation by a more extensive investor base, including those from the Middle-East.

Product innovation must be a continuous and deliberate part of the process of market development. We are therefore firmly committed to developing the capabilities in Islamic finance and strengthening the global pool of talent and expertise in Islamic finance to increase the potential for this to happen. As part of the initiative to meet this objective, we have established the International Centre for Education in Islamic Finance, INCEIF, in March this year to offer professional certification programs in Islamic finance, in addition to, Masters and Doctorate programs. Bank Negara Malaysia has also recently made available a Shariah Scholarship Award and Shariah Research Grant, available to Malaysian and non-Malaysians seeking to pursue research studies in Islamic finance.

East Asian, West Asian and the Middle East Regions : Greater Inter-linkages

Islamic finance has made significant inroads in the international financial markets in that it has achieved growing global awareness. Islamic finance now has a presence in over 60 countries, with total Islamic assets under management by Islamic banks and conventional banks offering Islamic banking services reportedly exceeding USD400 billion. At present, Islamic mutual funds are estimated to be at a value of over USD300 billion, while issuance of Islamic sovereign and corporate bonds, or sukuk, have reached about USD50 billion. Islamic finance has demonstrated its viability and competitiveness in the current environment of a more liberalised and globalised financial system, with changing business and technological climates. As a form of financial intermediation it is now becoming increasingly integrated with the international financial system.

Against the backdrop of this rapid development in the international Islamic financial markets, there is potential to build greater intermediation linkages between the East Asian, the West Asian and Middle East regions to expand further the inter-regional trade and cross border investments. In an increasingly globalised financial environment, sovereigns, development institutions and corporations of capital deficit countries have the option of raising Islamic financial instruments in capital surplus countries through the Islamic financial intermediaries. Significant economic benefits will arise from the strengthening of these inter-linkages.

The expansion of inter-linkages of intermediation and markets among these regions would lead to a more efficient allocation of capital and thus enhance the prospects for strengthening further the growth performance. It also offers enhanced opportunities for raising financing and would also facilitate greater risk diversification. In

particular, the strong growth performance in these regions create a significant potential demand for financial instruments that conform to the Islamic injunctions. These dynamic regions can therefore be expected to contribute towards accelerating the expansion of Islamic finance in the international financial system. Indeed, these trends will also contribute towards promoting a more balanced global growth.

The participation in the Islamic finance intermediation process would require the development of a comprehensive and well established Islamic financial system, a wide range of products and services; a good legal system, adequate financial infrastructure with competitive tax structures, low cost of doing business, high standards of business ethics, and conducive living conditions and cultural offerings. It would also need to be supported by adequate human talents that would drive the business and spur innovation. In addition, a strong regulatory regime in the Islamic financial system would be another pull factor. More recently, the regulatory regime in Islamic finance has been further reinforced by rapid progress on the issuance of prudential and supervisory standards by the Islamic Financial Services Board (IFSB). Fund raising, investments and risk diversification are essentially complex transactions. These transactions are highly dependent on financial markets that are well regulated and capable of evolving to meet the emerging new challenges and the changing market needs. Finally, the potential for the markets to function efficiently would be enhanced if the financial market is developed in an environment that enjoys financial stability, monetary stability and sustained economic growth.

The MIFC initiatives

To enhance the inter-linkages in the global Islamic financial markets, Malaysia is continuing its efforts to not only develop further the Islamic financial infrastructure but to also implement measures and initiatives that will strengthen our position as an international Islamic financial hub.

The Malaysian Government is therefore launching an initiative known as the Malaysia International Islamic Financial Centre or MIFC. The MIFC initiative is specifically undertaken by the collective efforts of the country's financial and market regulators, including Bank Negara Malaysia, Securities Commission, LOFSA and Bursa Malaysia, together with the participation of the industry representing the banking, takaful and capital market in Malaysia. As part of the initiatives, Islamic financial products and services that are transacted in international currencies may now be conducted **from anywhere in Malaysia**. Malaysia has the physical infrastructure, international connectivity, the communication network, cultural offerings as well as the talents which is inherently advantageous to the MIFC.

In this first phase, the MIFC initiative will introduce measures and incentives to promote the centre in the offering of Islamic financial products and services by the diversified range of financial institutions in international currencies to the international and domestic financial community. The key measures and incentives include:

i. Firstly, the Malaysian Islamic banks and takaful operators that are offering Islamic financial services in international currencies will be granted approval under the existing licence to set up **International Currency Business Units** within the institutions. These new divisions will have their own accounts separate from the ringgit transactions of the head offices, while at the same time sharing the same infrastructure with the head offices. This division may benefit from tax and other incentives that may be introduced.

   This measure will apply to the Islamic banks and takaful operators licensed under the Islamic Banking Act and Takaful Act respectively to operate in the Islamic financial system as well as to the existing financial institutions which are eligible to participate in the

Islamic financial services. This is also expected to enhance the capability of the foreign players that have identified Malaysia as their centre to serve the regional markets. International entities will also be able to participate via foreign interest of up to 49 percent in Islamic banks and takaful companies. Investment funds set up in Malaysia will be able to enjoy the Double Tax Agreements that Malaysia has entered into with over 60 treaty partner countries.

ii. Second, Bank Negara Malaysia will issue new **conditional licences under the Islamic Banking Act** to qualified foreign and Malaysian financial institutions to conduct the full range of Islamic banking business in international currencies and enjoy the same **tax incentives** as those accorded to the International Currency Business Units. The new entity will be termed **licensed International Islamic bank**.

The business that the licensed International Islamic bank would be allowed to undertake includes the wide-ranging business of Islamic commercial banking, Islamic investment banking and Islamic leasing in international currency.

iii. Third, Bank Negara Malaysia will also issue new **conditional registrations under the Takaful Act** to qualified foreign and Malaysian insurance companies to conduct the full range of takaful business in international currencies. Similar **tax treatment** will be accorded to these entities as that for the banks. The new entity will be termed **International Takaful Operator.**

iv. Fourth, the Labuan offshore Islamic banks and the Islamic divisions of the offshore banks as well as offshore takaful operators will be given greater flexibility in their business operations by allowing the **opening of operational offices anywhere in Malaysia** with no limitation on staffing, to conduct non-ringgit business while maintaining their presence in Labuan. This measure would be accorded to the six existing offshore Islamic banks and Islamic investment banks operating in offshore centre Labuan to participate in the MIFC.

v. Fifth, incentives will be given **to attract the best foreign talents and market players to the MIFC** to spur innovation and offering of attractive Islamic financial instruments. This is to further strengthen the large pool of highly trained workforce with vast experience in Islamic finance already in Malaysia. Further incentives will also be introduced to spearhead the aspiration of developing Malaysia as a **centre of education excellence in Islamic finance** to complement the MIFC.

vi. Sixth, in the pursuit of this national agenda, an **MIFC Executive Committee** comprising heads of relevant Ministries, agencies and industry representatives has been set up as a single coordinating committee to efficiently and effectively act collectively in the implementation of the recommendations. The Committee is entrusted to provide direction as well as review existing policies for the comprehensive and coordinated promotion of MIFC, and to align the role and responsibilities of the respective parts of Government and the industry to the development of MIFC. The secretariat is Bank Negara Malaysia, which will act on behalf of this committee as a **one-stop body** to fulfil this task.

We believe that these measures and initiatives will serve as a catalyst in our efforts for Malaysia to become a centre of origination, issuance and trading of Islamic capital

market and treasury instruments, Islamic fund and wealth management, international currency Islamic financial services, and takaful and retakaful business. It is also aimed at positioning Malaysia as the gateway for tapping investment opportunities in this rapidly growing region.

In this environment, financial players, particularly with investment banking and fund management expertise, would need to sharpen their strategies and intensify their efforts in structuring cutting-edge Islamic investment instruments and in attracting new funds. Investors, especially those from the Middle East have shown strong interest to invest in Malaysian assets and to become partners with our local business corporates. There are therefore significant opportunities to strengthen trade and investment ties with the Middle East region. In respect of acceptable Shariah interpretation and practices, the MIFC will adopt a policy of mutual recognition and accommodate the various juristic reasoning based on contemporary analysis and logical inference so long as it is approved by recognised Shariah advisers. Harmonisation and knowledge sharing in Shariah is expected to be further enhanced with the on-going Shariah dialogues for the regional and international Shariah communities that are held annually in Malaysia.

The gathering of so many practitioners here for these two days to discuss the wide ranging matters that concern issuers and investors will contribute to developing our collective understanding of these issues and expand the boundaries of our knowledge. In closing, I wish to say that the motivation for advancing our mission to position Malaysia to become increasingly more integrated with the international financial system is to contribute towards facilitating greater cross border flows in terms of increased intra-regional trade and investment transactions. With the strengthening of intra-regional trade and investment flows, the greater regional economic and financial inter-linkages would contribute towards raising the prospects for more balanced global growth and greater shared prosperity.

The 2006 Dialogue Session with Insurers and Takaful Operators 22 August 2006, Kuala Lumpur

"Strategic Positioning in a Changing Environment"

Keynote Address by

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In a rapidly changing environment, rethinking the future and strategic repositioning needs to be a high priority agenda. Strategic positioning is not only necessary to deal with the new emerging challenges but more importantly, it needs to be part of the process that will shape the future.

The changes taking place are on several fronts.

- Nations are becoming increasingly inter-linked and integrated in a more globalised environment.
- The Malaysian economy continues to experience significant structural shifts into new areas of growth and comparative advantage.
- Consumers are becoming increasingly discerning in terms of the range and quality of financial products and services.
- The financial system is transitioning into a more competitive environment as institutional arrangements become increasingly more deregulated and liberalised.
- Technological advancement has enabled greater innovation in the development of financial products and services, operational processes and delivery channels.
- The regulatory and supervisory approaches to maintaining financial stability are becoming more principle and risk-based.

With these changes intensifying, it is timely to reflect on the emerging issues for the insurance and takaful industry.

It is my pleasure to welcome you to this year's dialogue session between Bank Negara Malaysia and the insurance and takaful industries to discuss the challenges and opportunities the changing environment presents. A year ago, the focus of the discussions was on the strategic issues facing the industry as we transitioned towards a more competitive market environment. The emphasis was on the expectations on the industry to deliver a fair proposition to consumers, its relevance in the changing environment and its readiness in terms of capacity, and to support and sustain a successful strategy for growth. While the theme for this dialogue is to focus on how the industry should position itself to meet the new challenges, it will specifically address the transition towards a risk-based and a more self-regulated market conduct regime, and the development of a dual financial system for the insurance and takaful industry.

This year, the dialogue has been jointly organised by the industry with the Bank. The industry's active involvement will be important in making this important event a success. This dialogue will provide an opportunity for deliberations on the strategic issues confronting the industry in the changing environment from the different perspectives between the industry and Bank Negara Malaysia. At this juncture, let me take this opportunity to share with you some of the recent economic and financial developments and the major policy initiatives by Bank Negara Malaysia.

The global economic performance for 2006 has so far been favourable with a more balanced growth among the major economies, including in Japan and Europe. The world economy is however, facing an extended period of high energy prices and its consequent effects on inflation. Following these developments, interest rates have been raised in most economies. While risks are now emerging for a slower growth in a number of the major economies, growth in the Asian economies have continued to remain robust and resilient. This trend has not only increased Asia's relative significance in the world economy but it has also contributed to a more balanced global growth.

The Malaysian economy has benefited from this favourable external environment. Growth has been supported by both the strengthening exports performance that has been reinforced by strong domestic demand. Domestic demand also continues to be driven by the private sector as private consumption and investment have been an important source of growth. The continued expansion in private investment is particularly important in ensuring the long-term sustainability of the growth.

The focus of the monetary policy in this environment continues to be towards achieving macroeconomic stability. More recently, the higher energy costs have resulted in an increase in consumer prices. In this environment, interest rates have been raised three times. In May this year, a pause in this increase was announced. With limited evidence of demand induced inflation, the assessment is for inflation to moderate in the second half of this year. In addition, the extent to which the external environment will be affected by the higher energy prices and rising interest rates, and its implications on our domestic economy, will be important considerations in the future direction of interest rates. The risk to higher inflation and to the growth prospects will be carefully balanced. Monetary policy will continue to promote sustainable growth in an environment of price stability.

Since the dialogue a year ago, the financial landscape continues to be transformed. The domestic financial industry has seen further rationalisation and consolidation in the banking groups in retail banking and investment banking. While the rationalisation in the retail banking industry would benefit from the economies of scale, reduce duplication of resources and promote cost efficiency, the new investment bank framework is expected to bring about the emergence of more effective, efficient and resilient capital market intermediaries. It will essentially result in the consolidation of 32 entities into 16 investment banks by the end of this year. Another significant development in 2005 was the establishment of the Malaysian Deposit Insurance Corporation which will further strengthen the domestic financial infrastructure by providing an explicit guarantee of deposits, while simultaneously reinforcing incentives for the improvement of risk management practices by banking institutions. To promote greater financial inclusion in our financial system, development financial institutions have also been strengthened to ensure that they are more focused and complementary in their objectives and business strategies. A major initiative during the year was to promote increased access to financing to the new areas of growth as well as to small and medium scale enterprises, including for micro enterprises. This aims to enhance the potential and capacity of domestic indigenous enterprises to grow and thus enhance their contribution to the economy.

In the area of Islamic banking and finance, policy initiatives have been implemented to position Malaysia to become a leading international Islamic financial centre. Earlier this month, the Malaysian Government had launched the Malaysia International Islamic Financial Centre or MIFC initiative. This initiative is aimed at building greater intermediation linkages between the East Asian, the West Asian and Middle East regions which will in turn, further expand inter-regional trade and cross border investment flows. This would also contribute towards a

more efficient allocation of capital and thus enhance the prospects for mutually reinforcing intra-regional growth. In addition, the enhanced opportunities for raising financing offers would also facilitate greater risk diversification. To achieve this goal, efforts and resources are being directed towards achieving two broad objectives:

- First, to become an international leader in the origination, issuance as well as trading of Islamic capital market and treasury instruments, fund and wealth management services, offshore Islamic financial services, and takaful and retakaful.

- Second, to position Malaysia as a centre of excellence for Islamic banking and finance education, training, consultancy and research. This will not only provide an extensive pool of highly trained and capable expertise to spearhead future development, but will also promote greater innovation in Islamic financial products and services.

Given the functioning of Islamic finance in parallel with the conventional financial system in our financial environment, neutrality in treatment between Islamic and conventional finance products is important to ensure its viability and sustainability. This competitive environment would in fact encourage greater innovation to take place, thereby supporting the development of the Islamic financial services industry. With the much strengthened and more robust Islamic financial infrastructure that is now firmly in place, the Islamic financial services industry is well positioned to tap new growth opportunities to realize its full potential. This will inevitably increase the breadth and depth of the Islamic financial markets and, more importantly, strengthen Malaysia's position as an attractive and dynamic international Islamic financial centre.

The Bank's regulatory orientation in this changing environment continues to evolve towards a more robust and flexible regime to effectively maintain financial stability. The regulation of the financial services industry in the changing environment will continue to focus on safeguarding the financial system against systemic risk, ensuring the reasonable protection of consumers in financial service dealings and enhancing the efficiency of the financial system. In addition, the regulatory function will also continue to facilitate the achievement of the socio-economic objectives, including increasing the insurance penetration, promoting adequate provision for retirement needs and supporting the growth of target sectors.

While these objectives will provide the basis and direction for regulation, it is recognised that the environment in which financial institutions operate has changed significantly. Accordingly, the regulatory practices have undergone significant change in recent years to ensure that they continue to be aligned with the underlying rationale for regulation. More specifically, the Bank's approach to regulation is increasingly characterised by:

- a heightened focus on, and alignment with, risk;

- anticipatory, rather than reactive interventions;

- greater use of incentives to achieve desired institutional behaviours and outcomes; and

- convergence with international best practices.

Efforts have also been directed at achieving regulation that is more proportionate in relation to its costs and benefits. This has resulted in an expanded regulatory toolkit that is now beyond prescriptive rules, but leveraged more extensively on inherent checks and balances within the system, and on the greater use of incentives to achieve desired institutional behaviours and outcomes. In addition, there has been an increased focus on market conduct and harnessing more

active consumerism to reinforce prudential regulation and supervision.

To further reinforce these changes, the Bank has undertaken a holistic review of the regulatory and supervisory structures within the Bank. The internal organisational changes that are being made will result in a complete transition from the current approach to regulation on a sectoral basis, to one that will integrate the Bank's regulation of different financial institutions under its purview along functional lines. In effect, the existing regulatory departments will be transformed into new departments with respective responsibilities for financial sector development, prudential policy, consumer protection and market conduct, and financial surveillance across both the banking and insurance sectors. The supervisory functions will similarly be integrated for financial service groups that include both banks and insurance companies under their umbrella.

We believe this organisational change will deliver a more comprehensive overview and cohesive approach to the development of the financial system, while facilitating a clear distinction between the objectives of prudential regulation and financial stability, and the broader developmental objectives. It will also sharpen the regulatory focus on the management of risk in the financial system in a manner that will more effectively address the basic components of credit, market, operational and insurance risks. For the regulated institutions, this new structure is also intended to promote greater efficiency and competition in the financial system by:-

- minimising regulatory overlaps and duplication within the system;
- preserving regulatory neutrality in the management of similar risks between different financial service providers; and
- ensuring more efficient use of regulatory resources.

The Bank will be communicating the details of the new structure to the licensees in November and December this year. A smooth transition will be ensured to maintain continuity in the major ongoing regulatory initiatives currently being undertaken by the Bank, and clear arrangements will be made for dealings between licensees and the Central Bank during the transition.

Under the new regulatory landscape, the relationship between the Bank and the regulated entities, and thus, the supervisory expectations, will change, as the prudential framework evolves towards a predominantly principle-based and risk-based regulatory approach. There will be a greater emphasis on corporate governance, integrity and transparency as the foundations for industry players so as to maintain investor confidence and public trust. Under this environment, it is also envisaged that insurers, individually or collectively, will play a bigger role in developing market conduct standards, fostering fair market practices and improving financial literacy among consumers. Moving forward, as market discipline improves, and insurers and takaful operators are better positioned to implement self-regulation, further deregulation can be expected. A differentiated regulatory approach will increasingly be adopted, where companies that exhibit strong corporate governance and risk management practices will be given greater regulatory flexibility.

Commensurate with the diversity and complexity of products and services, the continuous upgrading of risk management practices, with improvements in governance standards and enhancements of information management systems will be critical. With the impending implementation of the risk-based capital framework, the responsibility for the implementation of sound risk management and market conduct governance, as well as assessment of risks and management of the financial condition of an insurer, will rest increasingly with the Board of Directors and Senior Management of the insurers.

Integral to the increased flexibility provided under the new regulatory landscape is the highest standards of integrity and ethics in the industry. Indeed, the very foundation of insurance is one that is based on a relationship of trust and integrity. Reputation and trust are indeed the valued assets of the insurance and takaful industries' business. Any lapses in market conduct will have widespread implications on the business and on the industry. Ensuring fair and equitable dealings with customers should also be a priority. In this environment where the industry originates more and more innovative and complex financial solutions, insurers and takaful operators therefore have a responsibility to ensure that:-

- consumers receive sufficient information to be able to make informed decisions;

- that they understand the key features of a policy, including any significant exclusions, before any purchase;

- that the recommended policies are suitable for their demands and needs; and

- that their claims are dealt with promptly and fairly.

The new environment of increased market discipline now places even greater emphasis on stronger corporate governance, integrity and transparency. High standards of integrity should also define the management of the institution's human and physical resources. In this respect, there can be no substitute for the commitment of an institution's leadership to uphold the highest standards of integrity in dealing with its human capital and corporate resources that are managed on behalf of shareholders and policyholders.

Achieving success in an environment of greater competition will hinge on the ability of the domestic industry to innovate and provide enhanced value propositions for consumers. This underscores the importance of capacity building by industry players in research and development, and re-engineering of business processes in search of operational excellence and enhanced customer service delivery. A strong culture of excellence is therefore vital: one that is embedded into all levels of the organisation; one that fosters and rewards innovation and service quality.

Increasingly, highly-skilled individuals will be needed to be able to deliver high value-added products and services, adopt advanced business practices, and have the necessary competencies to build consumer confidence and trust. It is, therefore, crucial for the industry to continuously invest in human intellectual capital to create the pool of talent, skills and expertise that will drive the performance of the industry. To meet this demand, specialised training organisations have been established. They include the International Centre for Leadership in Finance (ICLIF), which is now in its 3rd year of operation, and the recently-launched International Centre for Education in Islamic Finance (INCEIF). The programmes carried out by the Malaysian Insurance Institute (MII) have also been reviewed to meet the evolving demands of the financial sector.

As we move towards the final phase of the Financial Sector Master Plan and into a more competitive landscape, we require robust financial institutions that are resilient, effective and well positioned to serve the nation. In particular, to achieve a financial sector that will effectively facilitate and support sustainable economic growth and transformation. To complement the ongoing efforts to build the capacity of domestic insurers, the Bank will continue to leverage on strategic initiatives to achieve the desired financial landscape which will also be better able to contribute to the socio-economic objectives of the country, as well as to be better to withstand competitive pressures in the provision of insurance products and services.

Consolidation and fostering strategic alliances will have the potential to strengthen the position of the industry to compete more effectively as the market becomes increasingly deregulated and liberalised. In particular, in fostering strategic alliances within the industry, the foreign shareholding limit for new entries in direct insurers has been increased from 30% to 49% to harness the potential for financially strong and internationally known foreign players. This would contribute towards enhancing the development of domestic capabilities, particularly in the areas of technical expertise, innovation and improved operating processes. This will provide an additional avenue for potential foreign partners to participate more substantively in the domestic industry through a strategic equity interest in existing licensed insurers.

As part of efforts to promote good risk management practices in the financial system, the Bank will also consider introducing differentiated premium contributions to the insurance guarantee scheme fund, based on the risk profile of individual insurers. This is similar to that being adopted for the deposit insurance system in the banking sector. This will provide an incentive for insurers to strengthen their risk management practices in order to benefit from lower contributions to the insurance compensation scheme.

It is hoped that discussions at this dialogue will contribute towards providing greater clarity in the thinking on the future direction of corporate strategies as well as the regulatory responses to ensure the sound development of the insurance and takaful industry.