

Assessment of Malaysia's Observance of the IAIS Insurance Core Principles

The Insurance Core Principles (ICPs), first published by the International Association of Insurance Supervisors (IAIS) in 2000, were substantially revised in 2011. The new ICPs are based on a set of high-level principle statements, supported by more specific standards and guidance which are used to assess observance of the ICPs. The new ICPs place greater emphasis on risk-based approaches to regulation and supervision, and provide for the application of the ICPs based on proportionality. Enhancements were also made, particularly in the areas of corporate governance, risk management, group-wide supervision and macroprudential surveillance, to reflect developments in insurance markets and supervision, and to incorporate recommendations of the Group of Twenty Finance Ministers and Central Bank Governors, and the Financial Stability Board (FSB). Malaysia was among the first few countries to be assessed by the International Monetary Fund (IMF) and the World Bank against the revised set of improved ICPs.

This article presents a summary of the assessment and key observations of Malaysia's observance of the ICPs. The detailed assessment is published separately on both the IMF's and the World Bank's websites.

Malaysia was assessed to have either 'observed' or 'largely observed' 22 out of the 26 ICPs (Table 1). Four ICPs relating to prudential requirements on enterprise risk management, group-wide supervision, arrangements for the legal protection of customer funds held by insurance intermediaries, and cross-border cooperation in crisis management were rated 'partly observed'. The assessment noted that the Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) will address many of the recommendations for improvements, while ongoing enhancements to existing regulatory requirements to formalise the Bank's supervisory expectations will further enhance Malaysia's level of observance. These enhancements are already well advanced. In particular, the implementation of the Internal Capital Adequacy Assessment Process and the issuance of new requirements on risk governance will strengthen enterprise risk management within insurance companies, while the new legislation affords legal protection for monies received and held in trust by intermediaries for the benefit of insurance/takaful customers.

Malaysia's level of observance of the ICPs on group-wide supervision and cross-border cooperation and crisis management largely reflect the current nature and scope of group-wide exposures and cross-border activities of insurers situated in Malaysia, and the risks that they pose to financial stability. The assessment noted that currently there are no significant domestic insurance groups and that the cross-border activities of Malaysian insurers are limited. For these reasons, the scope and intensity of the Bank's supervision on a group-wide basis as well as the focus on more formal cross-border arrangements for crisis management corresponds to the Bank's view of the relatively low risks from group exposures to insurers in Malaysia. The Bank expects to intensify measures to address group-wide and cross-border issues as and when the activities of insurers expand more significantly and have a wider cross-border presence.

The key findings from the assessment are:

- **A comprehensive legal framework is in place that clearly defines the authority and responsibility of the Bank, and the Bank is accorded with a range of powers that supports its mandate.** Legislation provides for the Bank to be an operationally-independent statutory body, with effective control of its strategic focus and resource allocation to carry out its regulatory and supervisory activities. Officers of the Bank are required to adhere to a code of conduct that promotes high ethical standards. Legal protection is provided to enable the effective performance of their duties.
- **Entry into the industry is subject to rigorous review.** New licences and significant shareholders are assessed against a broad set of financial and non-financial requirements, and a regulatory framework is in place to ensure that the directors, senior management and key persons in control functions possess the competence and integrity to carry out their roles effectively.

Table 1

Degree of Observance of the Insurance Core Principles

Insurance Core Principles	Level of Observance
1. Objectives, powers and responsibilities of the supervisor	LO
2. Supervisor	LO
3. Information exchange and confidentiality requirements	LO
4. Licensing	LO
5. Suitability of persons	LO
6. Changes in control and portfolio transfers	LO
7. Corporate governance	LO
8. Risk management and internal controls	LO
9. Supervisory review and reporting	O
10. Preventive and corrective measures	O
11. Enforcement	LO
12. Winding-up and exit from the market	O
13. Reinsurance and other forms of risk transfer	LO
14. Valuation	O
15. Investment	LO
16. Enterprise risk management for solvency purposes	PO
17. Capital adequacy	LO
18. Intermediaries	PO
19. Conduct of business	LO
20. Public disclosure	LO
21. Countering fraud in insurance	LO
22. Anti-money laundering and combating the financing of terrorism	O
23. Group-wide supervision	PO
24. Macroprudential surveillance and insurance supervision	O
25. Supervisory cooperation and coordination	O
26. Cross-border cooperation and coordination on crisis management	PO

- **Observed (O)** – All applicable standards are observed. The authority has the legal powers to carry out its duties and demonstrates the exercise of the powers to a satisfactory level.
- **Largely observed (LO)** – Only minor shortcomings are observed, which do not raise any concerns about the authority's ability to achieve full observance.
- **Partly observed (PO)** – Shortcomings are observed that are sufficient to raise doubts about the authority's ability to achieve full observance.
- **Not observed (NO)** – No substantive progress toward observance has been achieved.

- **A comprehensive compendium of prudential requirements and guidance is in place, aimed at promoting safety and soundness, market discipline and integrity of the insurance industry.** This includes extensive expectations on corporate governance and effective risk management and control functions covering an insurer's significant activities. A key cornerstone of the prudential framework is the Risk-Based Capital Framework for Insurers, which captures risks on a total balance sheet approach and requires insurers to maintain sufficient capital to absorb significant unforeseen losses. Valuation and disclosure requirements are aligned with the International Financial Reporting Standards and specifically address required disclosures relevant to insurance contracts. In addition, the Bank publishes an extensive set of industry data on its website.
- **Regulatory requirements address expectations for the fair treatment of customers and are reinforced through the Bank's market conduct surveillance and a structured consumer education programme.** Insurers are required to observe standards of fair dealing in the development of new products, sales and marketing practices including proper advice and disclosures to consumers, and claims settlement. Assessments from the Bank's off-site and on-site monitoring of market conduct practices prompt supervisory actions and decisions to renew the licences of insurance intermediaries. The legislation also provides for severe penalties for insurance fraud and money laundering. The Bank also actively monitors and shares information with relevant authorities to support effective enforcement actions.
- **The supervisory regime is robust and supports effective risk assessments of insurers.** The risk-based supervisory framework enables the systematic and consistent supervision of all licensed insurers, through continuous off-site monitoring, regular on-site inspections and thematic examinations. This is well-integrated with the Bank's macrosurveillance activities and supported by a rigorous stress testing programme. Legislation enables the Bank to take appropriate preventive measures in a timely manner. Supervisory concerns are clearly communicated to insurers and corrective actions closely monitored by the Bank. The Bank also has at its disposal a broad range of tools to implement corrective and enforcement actions, and to cooperate with the Malaysia Deposit Insurance Corporation to resolve distressed insurers in a manner which safeguards the interests of policyholders and minimises costs to the financial system.
- **The Bank adopts a macrosurveillance approach that is commensurate with the nature, scale and complexity of the insurance sector.** The surveillance framework tracks key financial soundness indicators and trends within the insurance industry. Stress testing is conducted regularly, and combines both a macro (top-down) and micro (bottom-up) approach. In addition, work by the Bank is underway to develop a framework to assess the systemic importance of insurers based on guidance developed by the FSB.

Key Recommendations

The assessment noted several recommendations for further improving Malaysia's observance of the ICPs. A number of these recommendations are relevant to more developed insurance markets and are expected to gain greater significance for Malaysia as the domestic industry grows further in size and complexity. These recommendations are included in the Bank's medium- to longer-term plans.

As with the assessment on Malaysia's compliance with the Basel Core Principles for Effective Banking Supervision, similar recommendations have been made for improving transparency in licensing and suitability requirements for shareholders, and for the regulation and supervision of financial holding companies to support the supervision of insurers on a group-wide basis (refer to box article 'Assessment of Malaysia's Compliance with the Basel Core Principles for Effective Banking Supervision'). This has been addressed in the new FSA and IFSA. As also noted above, risks associated with the cross-border activities of domestic insurance groups remain low at present. In practice, informal arrangements have been established with host supervisors in jurisdictions where Malaysian insurance groups have cross-border operations. The supervisory approach also incorporates an ongoing assessment of potential risks arising from activities of related entities that may impact the

financial condition of insurers in Malaysia. The Bank remains committed to further strengthening its existing cooperation and exchange of information arrangements with other supervisors and authorities, including through wider participation in bilateral memoranda of understanding and by strengthening capabilities to support effective cross-border crisis management and resolution as appropriate to the risks posed by insurers' cross-border activities.

Recommendations were also made to review and update a number of regulatory requirements to incorporate principles of sound practice that the Bank already demands of insurers through its supervisory activities. This is being implemented under an ongoing programme to regularly review the existing requirements in line with the Bank's internal policy development framework.

Other recommendations include the following:

- **Strengthen enforcement tools and implement a supervisory framework specific to market conduct activities.** The new FSA and IFSA establish specific provisions for the Bank to issue and enforce standards of business conduct. A major development in the Bank's regulatory agenda has been the development and implementation since 2011 of a more structured and integrated framework for supervising market conduct risks. This is now fully operational, providing for more effective assessments of risks to consumers that draw on a broad range of information and more targeted supervisory activities. Provisions for administrative and civil penalties in the new FSA and IFSA will further support effective enforcement of market conduct standards by the Bank.
- **Develop a more comprehensive capital framework for financial guarantee insurance.** Danajamin Nasional Berhad, Malaysia's only financial guarantee insurer, is subject to equivalent requirements on corporate governance and risk management that apply to other financial institutions regulated by the Bank. It must also comply with prudential exposure limits on a single and aggregate basis which are commensurate with its financial capacity. Moving forward, the Bank intends to put in place a more comprehensive and risk-sensitive capital framework for financial guarantee insurance business which will better capture the risks inherent in the business, while reinforcing incentives for sound risk management. This will also lend support to the sustainable growth of Danajamin as it continues to expand its role in providing credit enhancements to more Malaysian corporations and in a wider array of economic sectors.
- **Provide for interdependencies between and within risk categories under the capital framework.** Stress testing requirements currently help to identify risk correlations and inform management decisions regarding the adequacy of financial buffers for addressing synchronous risks and spillovers from specific risk events. The Bank intends to further enhance the capital requirements in the future to account for the effects of risk correlations as more data becomes available to support such refinement to the framework.