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Malaysia: Publication of Financial Sector Assessment Program Documentation— Detailed Assessment of Observance of Insurance Core Principles

This Detailed Assessment of Observance of Insurance Core Principles in Malaysia was prepared by staff of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available following the FSAP discussions that ended on September 7, 2012, with the officials of Malaysia. Based on the information available at the time of these discussions, the assessment was completed in February 2013. The related ROSC was published together with the FSSA on February 28, 2013. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Malaysia or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM

MALAYSIA

INSURANCE CORE PRINCIPLES

DETAILED ASSESSMENT OF OBSERVANCE

FEBRUARY 2013

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR DEVELOPMENT VICE-PRESIDENCY
EAST ASIA AND PACIFIC REGION VICE-PRESIDENCY

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GLOSSARY

AA	Appointed Actuary
AC	Audit Committee
AML/CFT	Anti-Money Laundering and Counter Financing of Terrorism
BNM	Bank Negara Malaysia, The Central Bank of Malaysia
CA	Companies Act
CAR	Capital Adequacy Ratio
CBA	Central Bank of Malaysia Act 2009
CDD	Customer Due Diligence
CRR	Composite Risk Rating
CSA	Cooperatives Societies Act
DG	Director-General
FAFT	Financial Action Task Force
FCR	Financial Condition Report
FHC	Financial Holding Company
FICPS	Financial Institutions Corporate Profile System
FIDE	Financial Institutions Directors' Education
FIU	Financial Intelligence Unit
FSA	Financial Service Act, proposed financial services legislation
FSAP	Financial Sector Assessment Program
FSC	Financial Stability Committee
FSEC	Financial Stability Executive Committee
FSOC	Financial Sector Operations Committee
FSPSR	Financial Stability and Payment Systems Report
HHSF	Home-Host Supervisory Framework
IA	Insurance Act 1996
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
ICPs	Insurance Core Principles
IFRS	International Financial Reporting Standards
IFSA	Islamic Financial Service Act, proposed financial services legislation
IGSF	Insurance Guarantee Scheme Fund
IMF	International Monetary Fund
LFSA	Labuan Financial Services Authority
LIAM	Life Insurance Association of Malaysia
LINK	Laman Informasi Nasihat dan Khidmat
MACC	Malaysian Anti-Corruption Commission
MASB	Malaysian Accounting Standards Board
MAT	Marine, Aviation and Transit
MDIC	Malaysia Deposit Insurance Corporation
MII	Malaysian Insurance Institute
MITBA	Malaysian Insurance and Takaful Brokers Association

MOF	Minister of Finance
MoU	Memorandum of Understanding
MPC	Monetary Policy Committee
MTA	Malaysian Takaful Association
NC	Nominating Committee
NCC	National Co-ordination Committee to Counter Money Laundering
ORSU	Operational Risk Specialist Unit
PDPA	Personal Data Protection Act 2010
PDRM	Polis Diraja Malaysia / Royal Malaysian Police
PIAM	Persatuan Insurans Am Malaysia / General Insurance Association of Malaysia
PIDM	Perbadanan Insurans Deposit Malaysia / Malaysia Deposit Insurance Corporation
PIDM Act	Malaysia Deposit Insurance Corporation Act 2011
RAS	Risk Assessment Summary
RBC	Risk Based Capital
RC	Remuneration Committee
SA	Signing Actuary
SC	Securities Commission
SIU	Special Investigation Unit
STR	Suspicious Transactions Reports
SuRF	Supervisory Risk-based Framework
TA	Takaful Act 1984
TIPS	Takaful and Insurance Benefit Protection System
TOF	Takaful Operational Framework

EXECUTIVE SUMMARY

Bank Negara Malaysia (BNM) is a highly respected insurance regulator. Based upon discussions with industry and stakeholders, BNM is rated as among the best in the region. BNM staff are viewed as knowledgeable, the regulatory guidance is comprehensive, and the supervision is effective and focused on the right things. The assessor found nothing that would challenge this overall perception.

Of the twenty-six ICPs, none was rated 'not observed'. Four were rated as 'partly observed'. The proposed financial institutions legislation will address concerns with BNM's powers for group-wide supervision and will ensure that client monies with intermediaries are properly protected. The implementation of the *Internal Capital Adequacy Assessment Process* (ICAAP), and new risk governance guidance, will close current gaps in BNM's formal expectations for better insurer risk management practices. Lastly, BNM is not a home supervisor to any insurance group, and cross-border activities of Malaysian insurers are not significant, so there may not currently be a significant urgency for BMN to implement substantive measures to ensure it can be effective in cross-border coordination during a crisis.

Minor shortcomings existed to result in fifteen ICPs rated 'largely observed', these do not raise any concerns about the BNM's ability to achieve full observance. Generally, these relate to matters of formalizing expectations into current guidelines, clarifying approaches in certain areas, enhancing transparency, and expanding the tool kit. Recommendations have been provided that will address these minor shortcomings.

Seven ICPs were rated as 'observed', mostly relating to supervisory activities and practices. Given the speed of change in the financial sector, including the insurance industry, BNM should endeavor to seek continuous improvements in these areas as well. The ICPs are minimum standards, all jurisdictions should aim higher.

The assessment did not reveal any current potential sources of significant risk to Malaysian financial stability from its insurance industry. The sector continues to be relatively small and fragmented, without any major risk accumulations apparent that could impact system stability. Insurers should continue be monitored to ensure they do not introduce imprudent practices and instability within the industry, with special attention paid to those that may not have an extensive track record of conducting business in Malaysia, such as new entrants and insurers where there has been a recent change of control. Also, any substantial growth in risk accumulations in Danajamin should be very closely monitored, given the nature of its business risks and the incomplete regulatory framework that exists for financial guarantee insurance. BNM has indicated that efforts will be taken to strengthen the regulatory framework for financial guarantee insurance.

The Malaysian insurance industry is well served with BNM as its regulator. The assessor was impressed with the professionalism and dedication of BNM staff, their clear understanding of the areas in which they can improve, and their firm desire to do so.

I. ASSESSMENT OF INSURANCE CORE PRINCIPLES

A. Introduction and Scope

1. **This assessment provides an understanding of the significant regulatory and supervisory framework for the insurance sector of Malaysia.** The assessment was conducted by Mark Causevic (external expert from OSFI Canada) during April 2012. Malaysia is undertaking the Financial Sector Assessment Program (FSAP) for the first time, and it includes a formal assessment of its observance with the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS). The Malaysia market has been growing for Islamic insurance products (family takaful, general takaful, and re-takaful). The ICPs were not specifically developed with Islamic insurance products in mind. Consequently, based on the scope that was agreed upon prior to the start of the assessment work, details on the regulation, supervision and various workings of Malaysian Islamic insurance market are included in this report, but they do not form part of the ICP assessment ratings for Malaysia.

2. **The current assessment is benchmarked against the ICPs issued by the IAIS in October 2011.** The ICPs apply to all insurers whether private or government-controlled insurers. Specific principles apply to the supervision of intermediaries. The ICPs are presented according to a hierarchy of supervisory material:

a) ICP statements are the highest level and prescribe the **essential elements** that must be met in order to achieve observance;

b) Standards which are linked to specific ICP statements and set out key **high level requirements** that are fundamental to the implementation of the ICP statement; and

c) Guidance material provides detail on how to implement an ICP statement or standard.

B. Information and Methodology Used for Assessment

3. **The level of observance for each ICP reflects the assessments of its standards.** Each ICP is rated in terms of the level of observance as follows:

a) **Observed**: where all the standards are observed except for those that are considered not applicable. For a standard to be considered observed, the supervisor must have the legal authority to perform its tasks and that it exercises this authority to a satisfactory level.

b) **Largely observed**: where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.

c) **Partly observed**: where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.

d) **Not observed**: where no substantive progress toward observance has been achieved.

e) **Not Applicable**: when the standards are considered to be not applicable.

4. **The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment**. ICP assessments are, by their nature, based on the legal framework, supervisory arrangements and practices, and the stage of development of the insurance market at a point in time. Any changes to any of these aspects may lead to different assessment results. Ongoing regulatory initiatives are noted by way of additional comments e.g., proposed pending legislation. A comprehensive self-assessment and other pertinent information (reports, studies, public statements, websites, unpublished guidelines, directives etc.) provided by the authorities facilitated a meaningful assessment. The assessor also benefitted from the valuable inputs and insightful views from Malaysian insurers, industry associations and other stakeholders.

5. **The assessor is grateful to the authorities for the full cooperation, thoughtful logistical arrangements and coordination of various meetings with industry participants.** In-depth discussions with, and briefings by, officials from Bank Negara Malaysia (BNM), the central bank and regulatory authority over financial institutions, enabled and enhanced the analysis of the regulatory and supervisory regime for the insurance sector in Malaysia.

C. Overview: Institutional and Macro Prudential Setting

Market Structure and Industry Performance

6. **Malaysia's insurance sector accounts for around 6 percent of financial sector assets, equivalent to 15 percent of GDP** (Source: IMF)**.** While the market is fairly sophisticated, offering a wide range of life, non-life and takaful insurance products, there is scope for further growth and consolidation. While takaful product sales continue to grow, takaful comprises less than 15 percent of total premiums and contributions in the insurance and takaful industry. Current industry challenges that BNM has identified and is addressing include asset-liability matching in a low interest rate environment, rising claims costs and increased volatility in the global markets.

7. **Malaysia has relatively low insurance penetration and density rates.** Both rates have been steadily improving, led by the life insurance sector.

Table 1. Insurance Penetration[1] and Density Rates[2] by Type of Insurer (Malaysia 2007–2011)

	2007	2008	2009	2010	2011
Penetration rate					
Life	3.6%	3.5%	3.8%	3.9%	4.0%
Non-life	1.5%	1.5%	1.6%	1.6%	1.8%
Reinsurance	0.3%	0.3%	0.3%	0.3%	0.4%
Density (USD)					
Life	221.5	223.3	233.7	253.3	261.8
Non-life	90.4	97.7	101.8	106.9	114.3
Reinsurance	17.0	18.5	20.2	22.9	23.5

[1] Measured as total premiums as a percentage of GDP
[2] Measured as total premium per capita, expressed in US dollars
Source: Bank Negara Malaysia

8. **The insurance industry is a significant employer, but industry employment growth has been stagnant.** The table excludes agents, brokers and other intermediaries.

Table 2. Malaysian Insurance Industry – Number of Employees (2006 – 2011)

	2006	2007	2008	2009	2010	2011
Number of Employees	22,989	23,848	24,152	23,359	23,329	23,865

Source: Bank Negara Malaysia

9. **Access to the Malaysian insurance market is very restricted, BNM issues a limited number of insurer licences.** No direct conventional insurance licence has been issued since the 1970s. New reinsurance, takaful and retakaful licences have been issued from time to time since 1995 to meet specific objectives to enhance domestic reinsurance capacity and further develop the takaful industry. Seven reinsurance licences (one life reinsurance licence and six general reinsurance licences) were issued between 1995 and 2007 and twelve takaful and retakaful licences were issued between 2005 and 2010. Not included is the special license for the government backed financial guarantee insurer established in 2009 (see white box).

10. **Foreign ownership of Malaysian insurers is restricted.** The foreign equity limit for insurers is 70 percent. A foreign equity limit above 70 percent will be considered on a case-by-case basis, particularly for players that can facilitate consolidation and rationalisation of the general insurance industry. The foreign equity limit for reinsurers is 70 percent. Reinsurers are also allowed to be established as branches. The foreign equity limit for takaful operators is 70 percent. There is no foreign equity limit for retakaful operators.

11. **There is a clear trend towards consolidation of insurance industry players in the Malaysian market, led by the general insurance sector.** As the Malaysian general

insurance industry is very fragmented, BNM has encouraged consolidation and rationalisation to strengthen the overall industry.

Table 3. Number of Licensed Insurers in Malaysia – selected years

	2000	2006	2011
Insurance Companies	**53**	**42**	**36**
Life	7	8	9
General	36	26	21
Composite	10	8	6
Reinsurance Companies	**11**	**6**	**7**

Source: Bank Negara Malaysia

12. **Four out of nine life insurers are owned by the large domestic banks and domestic parties account for most of the ownership of the Malaysian general insurers.** Nevertheless, foreign-owned insurers have a major presence in Malaysia, with foreign-owned insurers ranking as or amongst the largest insurers in the life and non-life sectors. Domestic banks have major presence in the takaful market, with the dominant takaful operator being a subsidiary of a large domestic bank.

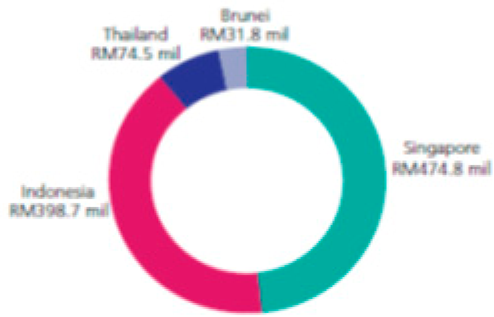
Table 4. Ownership[1] of Malaysian Insurers and Takaful Operators[2]

	Life	Non-life	Reinsurance	Composite	Takaful	Retakaful
Domestic						
Banks[3]	4	3	-	1	5	-
Non-financial entities	1	7	-	1	2	-
Public sector	-	2[4]	1	-	-	-
Insurance group	-	-	2	-	1	1
Foreign						
Banks	1	1	-	-	1	-
Insurance group	3	8	4	4	2	4

1 Based on majority (more than 50%) ownership
2 Includes reinsurers and retakaful operators
3 Includes financial holding companies with substantial banking activities
4 Includes Danajamin, the financial guarantee insurer
Source: Bank Negara Malaysia

13. **The cross-border operations of domestic insurers remained very small in terms of size and span.** In 2011, such operations involved total assets of RM979.8 million, amounting to only 0.5 percent of total insurance industry assets, spanning four countries near the Malaysian borders.

Figure 1. Insurance Sector: Asset Size of Overseas Operations



Source: Bank Negara Malaysia

14. **Agency is the primary distribution channel for both life and general business**. The agency channel generates 59 percent and 65 percent of new premiums (Life) and gross premium (General) respectively. The number of licensed agents and brokers has remained level of the past 5 years. Bancassurance has also gained prominence in the recent years because insurers can leverage on the banks' existing network and customer base. Bancatakaful is the main distribution channels in family takaful sector with 53 percent contribution generated in 2011.

Table 5. Number of Licensed Intermediaries (Agents, Brokers)

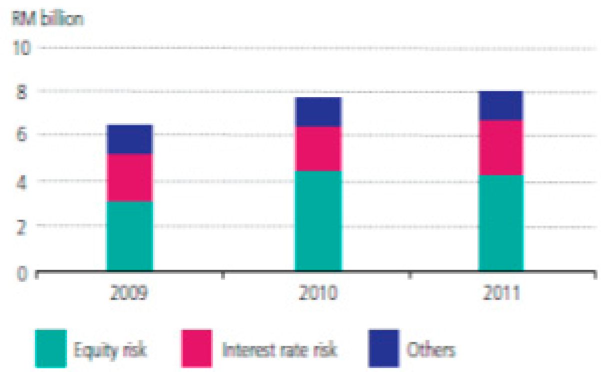
	2007	2008	2009	2010	2011
Agents	117,752	113,653	116,008	122,399	118,783
Brokers	34	34	37	37	38

Source: Bank Negara Malaysia

15. **The composition of insurance fund assets (including takaful business) remained similarly stable with private debt securities (PDS) continuing to form the majority of assets held** (2011: 37.3 percent; 2010: 38.6 percent of total assets). Market and credit risk exposures arising from holdings of PDS remained manageable with the bulk of PDS (88.1 percent) held in high-grade papers (rated 'A' and above). Insurers reduced holdings in equities during the year to 14.7 percent of assets as at end-2011 (2010: 16.5 percent of industry assets), in favour of less risky assets such as MGS and fixed deposits which accounted for 17 percent and 13.6 percent of the industry's total assets respectively (2010: 15.5 percent and 11.2 percent respectively). The rebalancing of investments maintained the market risk exposures of insurers at 12.6 percent of capital available (2010: 12.5 percent), with interest rate risk from higher investments in MGS partly offset by lower equity risk exposures. Collectively, equity and interest rate risks formed 84.6 percent of insurers' total market risk exposures.

Figure 2. Insurance Sector: Composition of Assets

Figure 3. Insurance Sector: Component of Market Risk Exposure



Source: Bank Negara Malaysia, FSPSR 2011.

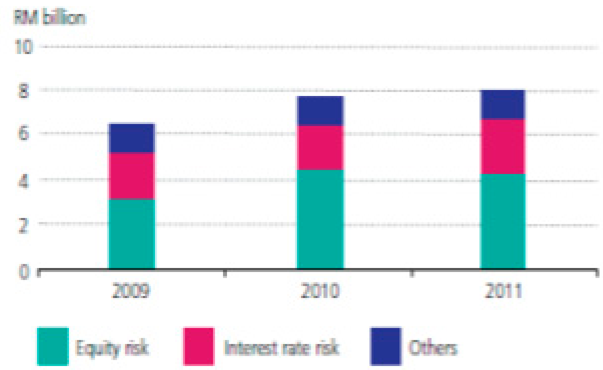
16. **A significant component of life insurance businesses are investment-linked products which account for one third of the total new life business.** Demand for Investment-linked products has been reduced significantly as a result of global market uncertainty. Moving forward, the potential of the life industry can be further harnessed through a holistic pension review that is being undertaken, which include providing tax incentives to spur the private pensions industry:

17. **Takaful has experienced a double-digit growth in past 5 years with average annual growth of 24 percent.** Family takaful has contributed considerably to the growth in contributions compared to general takaful fund, it accounts for 85 percent of total funds in 2011. Ordinary family product continue to be the key contributor to the new business, accounted for 79 percent of family takaful, while in general business it is dominated by motor takaful with gross contribution of 54 percent in 2011.

18. **Malaysia is not a country that has significant natural catastrophe risks.** While flooding events can lead to significant gross insurance losses, commercial risks tend to be the bigger source of large losses.

19. **The overall business retention level for general insurers is approximately 70 percent, but this varies widely by business class**. Use of reinsurance is more pronounced for large and specialised risks in the aviation, oil & gas and engineering classes of business, where reinsurance premium ceded amounted to 94 percent, 93 percent and 56 percent of total premiums respectively. In contrast, for motor insurance, the dominant general insurance line in Malaysia, the retention rate approaches 90 percent. Malaysian insurers reinsure a substantial part of risks underwritten in the global reinsurance market, either directly or through reinsurance placements with Malaysian branches of foreign reinsurers.

Figure 4. Insurance Sector: Retention Ratio by Major Business Classes

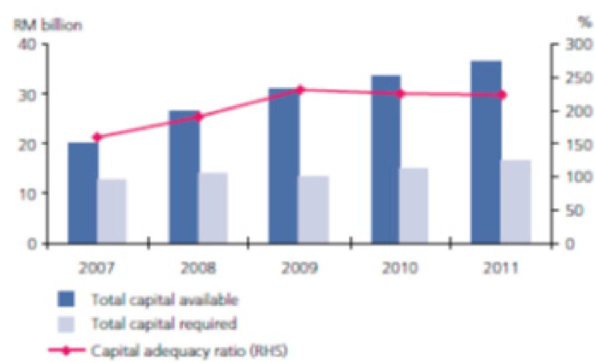


Source: Bank Negara Malaysia

20. **While Industry and premium growth dropped off in 2011, capital adequacy continued to remain strong.** Persistent low yields and investment losses have been a drag on profitability. Reinsurers recorded operating losses as claims from business interruption losses surged due to the floods in Thailand. This sharply increased the overall claims ratio for fire business (including cover for business interruptions) to 69.5 percent (2010: 36.3 percent). Underwriting losses for motor third-party bodily injury (or motor 'Act') insurance continued to pose downward pressure on profitability with the claims ratio rising to a record high of 300 percent (2010: 278.7 percent). The overall motor claims ratio (including 'comprehensive' business), however, improved to 76.8 percent (2010: 79.5 percent). Despite weaker profits, the combined capitalisation level of the general and life insurance industry remained strong with the aggregate capital adequacy ratio (CAR) at 222.5 percent (2010: 224.6 percent), well above the supervisory minimum capital requirement of 130 percent.

Figure 5. Insurance Sector: Profitability and Premium Growth

Figure 6. Insurance Sector: Capital Adequacy Ratio



Source: Bank Negara Malaysia

21. **All insurance sectors maintained strong average capital positions**. The Life sector has shown a declining trend since 2009, while the average capital ratio for the general sector has strong gains.

Table 6. Solvency Position of Insurers

	2009 (FYE)	2010 (FYE)	2011 (Q4)
Life	320.1 percent	307.8%	279.0%
Non-life	189.6%	198.4%	222.9%
Composite	239.1%	236.9%	243.1%
Reinsurance	218.9%	218.1%	220.4%

Source: Bank Negara Malaysia

Box 1. About Danajamin Nasional Berhad (Danajamin)

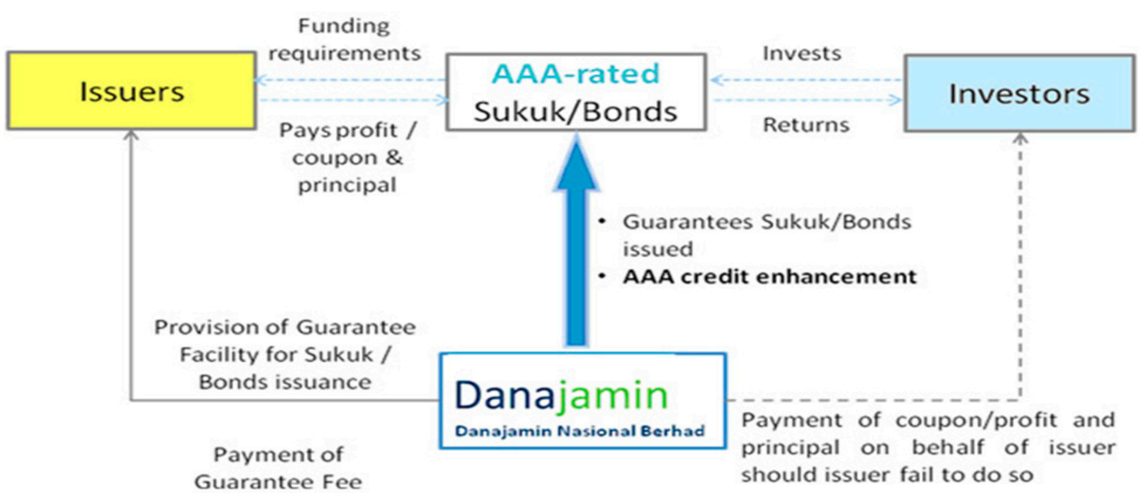
Danajamin, the country's first Financial Guarantee Insurer, was established by the Government 2009 to be a catalyst to stimulate and further develop the domestic bond and sukuk market. Danajamin is a 'AAA'-rated company, jointly owned by Minister of Finance Incorporated (50%) and Credit Guarantee Corporation Malaysia Berhad (50%). It has a paid-up capital of RM1 billion with another RM1 billion callable capital. It has the capacity to underwrite policies of up to RM15 billion based on its existing capital. Danajamin is licensed under the Insurance Act 1996, and is regulated and supervised by BNM.

Danajamin's objective is to provide financial guarantee, a credit enhancement, to bond/sukuk issuances to help viable companies raise long-term fixed rate financing from the bond/sukuk market. The bond/sukuk market is an important alternative source of financing to the banking sector.

As at December, 2011 Danajamin has provided guarantees to 16 companies for bond programmes totalling RM5.3 billion, where Danajamin exposure is 83.4% or RM4.4 billion. The companies are from various sectors including plantation, utilities, construction, property, aviation, retail and manufacturing.

How does Danajamin's financial guarantee work?

While Danajamin provides direct financial guarantee insurance to support access by corporations to the bond/sukuk market, it has also introduced co-guarantee and syndicated guarantee arrangements with commercial banks under which commercial banks guaranteed the shorter-maturity tranche, while Danajamin guaranteed the longer-maturity tranche. This has enabled commercial banks to participate in the larger bond issuances with longer-dated maturity structures. This has contributed to the lengthening of the maturity profile of bonds to a maximum of 20 years, compared to 10 years previously.



Source: Danajamin website, BNM FSPSR 2011

Institutional Framework and Arrangements

22. **Oversight of the Malaysian financial sector primarily performed by the BNM and the Securities Commission (SC)**. The BNM supervises the banking sector (conventional, Islamic, investment[1] and development banks) as well as the insurance sector (including reinsurance and takaful). It also licenses financial advisors, insurance brokers, and money brokers, as well as oversees the money and foreign exchange markets; and the payment clearing and settlement systems. The SC regulates the securities industry as well as derivatives (other than exchange rate related OTC contracts). There is a stand-alone deposit protection agency (the PIDM). The Labuan FSA covers all offshore financial activities in Labuan (banking, insurance, fund management). The LFSA is chaired by the BNM Governor and has a close working relationship with BNM. The two main pension funds are state-owned and overseen by the Ministry of Finance. The SC currently regulates the nascent private sector pension fund industry using fund management regulations; separate pension regulations are to be introduced soon.

23. **Malaysia is undertaking comprehensive changes to its legislative framework for the regulation and supervision of financial institutions.** Proposed legislation, referred to as the proposed Financial Services Act (FSA) and Islamic Financial Services Act (IFSA), aim to consolidate and rationalize existing regulatory laws to achieve a more cohesive legislative framework. A dual framework will be maintained for the conventional and Islamic financial business consistent with the dual financial system in Malaysia. Within this dual framework, the prudential and market conduct supervision of institutions and markets under the Bank's purview will be integrated under proposed new legislation which will replace the existing Banking and Financial Institutions Act 1989, Islamic Banking Act 1983, Insurance Act 1996, Takaful Act 1984, Payment Systems Act 2003 and Exchange Control Act 1953. Included in the proposed legislative changes are provisions to allow BNM to exercise oversight over financial groups that have one or more licensed institutions within the group.

Preconditions for Effective Insurance Supervision

24. **The legal framework in Malaysia is based on the common law system.** Law is enforced through a single structured judicial system consisting of superior and subordinate court whose decisions are enforceable, with avenues for appeal consistent with common law systems. In addition to the court system, alternative mechanisms for resolving disputes and debts also exist that allow judicial resources to be conserved, while expediting case disposals.

25. **Pursuant to the Companies Act 1965, companies are required to prepare their accounts based on approved accounting standards issued by the Malaysian Accounting**

[1] The SC shares responsibility for investment banks with the BNM.

Standards Board (MASB). The financial statements should show a "true and fair" view of the financial positions, financial performance and cash flow of an entity.

26. **Public interest entities are required to report their accounts using Financial Reporting Standards (FRS) set by the MASB, which is in full compliance with International Financial Reporting Standards as set by the International Accounting Standards Board (IASB).** IFRS is directly transposed into Malaysian FRS, with the text changed where absolutely necessary. Any changes made are done with the sole objective of enhancing the quality of reporting, and typically deal with only specific issues not dealt with in the IFRS by illustrating or providing additional clarifications for better understanding or making changes necessary to comply with local laws and regulations.

27. **Companies' accounts are required to be audited annually by approved auditors.** Reports and the audit procedures performed are in compliance with National Auditing Standards, which are in full compliance with the International Standards on Auditing. Membership in the Malaysian Institute of Accountants (MIA) is a pre-requisite for employment in Malaysia as a professional accountant or auditor and all members are required to comply with the MIA By-Laws on Professional Ethics.

28. **The Malaysian financial markets continue to develop.** The size of the debt securities market has grown to 104 percent of GDP in 2011. Financing through the corporate debt securities and sukuk markets increased to account for 58 percent of total outstanding corporate financing as at the end-2011. Danajamin, the country's first financial guarantee insurer, was established by the Government 2009 to be a catalyst to stimulate and further develop the domestic bond and sukuk market and help issuers obtain long-term fixed rate financing from the bond/sukuk market. The size of the equity market has also expanded, with market capitalization at RM 1.2 trillion in 2010.

29. **Malaysia has a guarantee fund for the protection of owners of insurance policies and takaful certificates.** The Government set up a Takaful and Insurance Benefits Protection System (TIPS), administered by Perbadanan Insurans Deposit Malaysia (PIDM) to protect owners of takaful certificates and insurance policies from the loss of their eligible benefits in the unlikely event of an insurer member failure. TIPS, one of the components of the Enhanced Financial Consumer Protection Package established by PIDM was brought into effect on 31 December 2010. TIPS is funded by annual premiums paid by member institutions. Part of the reserves also came from the transfer of the Insurance Guarantee Scheme Fund (IGSF), from BNM to PIDM. To be eligible for protection under TIPS, the takaful certificate or insurance policy must be issued in Malaysia by an insurer member and be denominated in Ringgit Malaysia. Based on the limits and scope of coverage, 95 percent of all Takaful certificates and insurance policy holders are protected in full.

D. Key Findings and Recommendations

Table 7. Malaysia: Summary of Compliance with the ICPs

Insurance Core Principle	Level	Comments
ICP1 - Objectives, Powers and Responsibilities of the Supervisor	LO	Existing legislation clearly defines BNM as the authority responsible for insurance supervision, and BNM's powers to administer and enforce the enabling legislation (subject to Ministerial approval in many cases) for insurance operators and intermediaries in Malaysia. Supervisory objectives could be more clearly defined.
ICP2 - Supervisor	LO	Legislation provides for BNM to be an operationally independent statutory body. It also affords BNM directors, officers, employees and others working on its behalf with appropriate legal protection, as well as requires them to protect confidential information. Internal governance practices emphasize committee decision-making, to promote soundness and consistency. BNM's operations are self-funded, with resourcing decisions fully within their control. It has a practice of overstaffing in order to address turnover issues, especially at entry-level positions. BMN offers a remuneration package that is comparable to industry, invests significantly in staff training, and requires staff to follow a substantive code of conduct to promote high ethical standards. BNM staff are highly regarded by industry stakeholders. The transparency of BNM's regulatory expectations, and the process for regularly reviewing their continued appropriateness, could be enhanced.
ICP3 - Information Exchange and Confidentiality Requirements	LO	There is an adequate legal and administrative framework in place that allows BNM to exchange information, on entities it supervises, with other supervisors and authorities subject to confidentiality, purpose and use requirements. BNM does not have explicit power to regulate and supervise authorised financial or insurance holding companies and all their related entities, and so does not have legal authority to directly obtain information from such entities. BNM's HHSF aims to address specific information sharing situations in a consistent manner. BNM has a very limited number of MOUs in place for insurance supervision purposes.
ICP4 - Licensing	LO	Only licensed entities can lawfully conduct insurance activities in Malaysia. Legislation establishes clear

Insurance Core Principle	Level	Comments
		parameters for the allowable legal forms and business activities of insurers, as well as the relevant licensing approval authorities and their applicable powers. In the absence of specific licensing criteria within legislation, BNM established specific guidelines and communiqués to articulate the licensing criteria, and information required for license application, during the limited rounds of BNM acceptance of reinsurer and (re)takaful applications since 1995. No direct conventional insurance licenses have been issued since the 1970s, The requirements and procedures for licensing are appropriately clear and adequately administered within the parameters of the insurance market for which access by new entrants is significantly restricted. In such circumstances, applications that best meet objective criteria are approved. Licensing approval criteria is not contained within existing legislation. The FSA is expected to address this.
5 - Suitability of Persons	LO	An adequate legislative and BNM administrative framework exists to ensure that Board members, senior management and key persons in control functions possess competence and integrity to fulfil their roles, both upon and subsequent to their (re)appointment. While significant owners are subject to suitability assessments upon application for approval for licensing and significant changes in their shareholdings, there are no requirements for significant owners to continually comply with suitability requirements. The FSA is expected to address this.
6 - Changes in Control and Portfolio Transfers	LO	Legislation clearly defines 'control', and approval is required for share ownership transactions well below the level of 'control'. The approval regime for changes in an insurer's ownership is two-staged. The first relates to the commencement of negotiations, where BNM's prior approval is required for any party to enter into negotiations to transfer 5% or more shares of an insurer. The second stage involves the details of the arrangement which will result in the transfer of shares in an insurer, which under legislation requires the Minister's prior approval upon BNM's recommendation. BNM effectively uses licensing and suitability of persons criteria to assess such applications, which includes financial and non-financial requirements. Under legislation, any scheme of transfer for insurance or reinsurance business has to be approved by BNM,

Insurance Core Principle	Level	Comments
		and confirmed by the court (if the transfer is in relation to business in Malaysia). Legal provisions and administrative processes exist to protect policyholders under such transactions. Legislation does not explicitly outline approval criteria for the acquisition of a significant ownership interests in insurers or for insurer portfolio transfers. The FSA is expected to address this.
7 - Corporate Governance	LO	Legislation provides broad, but limited, corporate governance requirements. BNM outlines its corporate governance expectations for insurers through various guidelines. Overall, the guidance is extensive in scope and reflects high standards. The expectations are reinforced with insurers through BNM's supervisory focus on corporate governance and its mandatory training program for financial institution directors. Certain key corporate governance guidelines from BNM are due for review. In particular, one key guideline was issued about ten years ago and contains 'best practices' which are more appropriately elevated to mandatory standards based on BNM's expectations of insurers today.
8 - Risk Management and Internal Controls	LO	BNM outlines its risk management and internal control expectations for insurers through various guidelines. Overall, while the expectations articulated within BNM's risk management and internal controls related guidelines are wide in scope, and many reflect high standards, some key regulatory guidelines are due for review. In particular, one key guideline was issued about ten years ago and contains 'best practices' which are more appropriately elevated to mandatory standards based on BNM's expectations of insurers today.
9 - Supervisory Review and Reporting	O	BNM's supervisory framework is an integrated risk-based system that uses both off-site monitoring and on-site inspections to assess the overall risk profile of the insurer - based upon insurer business activities, inherent risks, the quality of risk management activities, compliance with legislative and supervisory requirements, and financial and solvency condition. BNM collects extensive information, on both a regular and ad hoc basis, and as deemed necessary to conduct effective supervision of insurers and to evaluate the insurance market.
10 - Preventative and Corrective Measures	O	The legislative, administrative and supervisory frameworks in place promote the ability for BNM to take timely, suitable and necessary preventative and

Insurance Core Principle	Level	Comments
		corrective measures to achieve supervisory objectives. BNM's early intervention supervisory approach under SuRF, and increasing supervisory intensity and severity of measures under SIG, allow for remedial actions to be taken by insurers before problems become worse. BNM is active in communicating prudential and non-compliance issues to insurers, as well as in indicating actions and timeframes for corrective actions to be taken.
11 - Enforcement	LO	The legislation and administrative framework in place provides BNM with the ability to pursue a wide range of enforcement actions. Many examples were identified where BNM utilized a wide-range of substantive enforcement powers under legislation. To ensure consistency, BNM decisions on enforcement actions are made through internal committee, but it does not make publically available information relating to the criteria or basis for its enforcement decisions or actions. While BNM does not have the authority to invoke some substantive enforcement actions without Ministerial approval, this has not been seen as practical impediment to BNM's enforcement activities. The expansion of available enforcement tools for BNM, and greater transparency of the basis of enforcement decisions, would enhance BNM's effectiveness.
12 - Winding-up and Exit from the Market	O	There is an extensive legislative framework in place for the winding-up and exit of insurers from the market, which provides for a range of failure resolution options and appropriate priority protection for policyholders. Upon BNM's determination of insurance non-viability, PIDM is empowered to intervene and resolve troubled insurers, with the aim of minimizing costs to the financial system.
13 - Reinsurance and Other Forms of Risk Transfer	LO	BNM has a well-established legal and administrative framework with respect to the use of reinsurance, particularly for general insurers, with communicated expectations that insurers adequately control and report on their risk transfer programmes. BNM's supervisory activities reinforce good reinsurance management practices by insurers. BNM's key detailed guideline on reinsurance arrangements is due for review, and currently does not extend to life reinsurance.
14 - Valuation	O	For solvency purposes, BNM effectively uses IFRS as the valuation basis with prescribed requirements in certain areas outlined in BNM guidance. The technical provisions reflect the present value of relevant cash

Insurance Core Principle	Level	Comments
		flows, with a MOCE, and a requirement for discounting for life insurers.
15 - Investment	LO	Legislation and BNM guidelines set out prudential considerations for insurer investment management activities. In particular, BNM's RBC guideline addresses investment management expectations as well as capital changes relating to investment risks. The guidelines do not fully reflect BNM's expectations and do not address group-wide risks.
16 - Enterprise Risk Management for Solvency Purposes	PO	BNM has many guidelines that promote robust insurer enterprise risk management and governance activities appropriate to the nature, scale and complexity of insurer risks. In particular, BNM's RBC guideline requires insurers to establish links between their risk and solvency capital management activities. BNM's planned near-term changes will address gaps it has identified, particularly with respect to risk governance and ICAAP expectations.
17 - Capital Adequacy	LO	BNM has a risk-based capital (RBC) framework to adequately and explicitly capture insurer risks, on a total balance sheet basis, and provide for sufficient capital to absorb significant unforeseen losses. It provides two explicit triggers to allow for different degree of supervisory intervention. RBC is not defined in terms of level of protection provided. BNM has not developed a risk capital framework for financial guarantee insurance.
18 - Intermediaries	PO	Under legislation, BNM is empowered to license, regulate and supervise brokers and financial advisors. BMN conducts assessments of broker and financial advisor compliance requirements, using that that information as part of its process for license renewal decisions. Agents are subject to the various self-regulatory requirements set out by their industry associations. In practice, BNM works closely with those associations to ensure appropriate requirements are set out. Also, BNM does periodically do assessments of agent compliance with those requirements as part of its supervisory activities at the insurer, and takes enforcement actions as necessary. Legislation does not require the maintenance of separate fiduciary accounts for monies collected from clients, but BNM indicates that this is observed in practice by all insurance brokers and financial advisors. This gap is expected to be addressed in the new legislation. Also,

Insurance Core Principle	Level	Comments
		BNM is developing a supervisory approach more specific to the relevant considerations for intermediaries.
19 - Conduct of Business	LO	Through the issuance of various consumer protection guidelines, BNM has set many expectations for the conduct of business to ensure customers are treated fairly. BNM conducts market conduct surveillance activities to assess the adherence to its expectations. It is also involved in many consumer education initiatives. BNM's effectiveness could be enhanced with strengthened enforcement tools and the development and implementation of a supervisory framework specific to market conduct activities. Both measures are being currently undertaken.
20 - Public Disclosure	LO	BNM's public disclosure requirements leverage on requirements for all insurers to effectively report using IFRS, with some additional requirements imposed by various BNM guidelines. BNM actively promotes the public dissemination of insurer information, both through its public disclosure requirements on insurers, and through its own extensive publishing of insurer and industry data on its website. Beyond accounting requirements, BNM's additional public disclosure requirements are not extensive, and do not include certain disclosures currently viewed as useful by analysts/ market participants.
21 - Countering Fraud in Insurance	LO	Legislation has serious penalties for fraud activities. BNM has issued guidelines to industry on fraud prevention and control activities, collects insurance fraud data from insurers, conducts macro surveillance to determine insurance fraud trends, and examination activities assessing insurer anti-fraud practices, and periodically shares data and intelligence on fraud matters with police authorities. Supervisory practices could be enhanced to more specifically address insurer anti-fraud activities.
22 - Anti-Money Laundering and Combating the Financing of Terrorism	O	BNM is the designated AML/CFT competent authority in Malaysia. It has taken a number of measures to ensure insurers and intermediaries take effective measure to combat money laundering and the financing of terrorism, including the issuance of guidelines, supervisory AML/CFT reviews, and feedback sessions with industry. BNM's FIU is involved in various initiatives to identify issues and share information relating to money laundering and the financing of terrorism. BNM has signed 34 information sharing MoUs with foreign

Insurance Core Principle	Level	Comments
		authorities.
23 - Group-wide Supervision	PO	There are no significant insurance groups for which BNM is the home supervisor, For insurers belonging to a foreign financial group, under its HHSF BNM shares information with other relevant supervisors as necessary to facilitate the supervision of group-wide risks. While BNM does not have explicit authority to regulate and supervise holding companies and their related entities, as part of its supervisory approach, BNM analyzes group entities for their ability to provide capital support and for activities that may pose a risk to the financial condition of the regulated entity. The group-wide analysis feeds into the development of the supervisory strategy for the regulated entity. While BNM's indirect approach mitigates some concerns, it is not an adequate substitute for the range of additional tools available when there is clear authority for group-wide supervision.
24 - Macroprudential Surveillance and Insurance Supervision	O	BNM conducts many activities around identifying, monitoring and analyzing various market and financial developments, as well as other environmental factors, which may impact insurers and insurance markets. Such work is supported by the extensive data it collects from insurers and other sources, some of which it publicly discloses for transparency purposes and objectives. With some surveillance activities, a more structured approach would enhance BNM's effectiveness.
25 - Supervisory Cooperation and Coordination	O	The Malaysian insurance sector has few insurance groups with cross-border operations, and the Malaysian operations of foreign-owned groups are small in relation to the overall operations of these foreign groups. There are no significant insurance groups or FHCs for which BNM is home supervisor. Nevertheless, BNM has an adequate legal and administrative framework in place to allow it to effectively cooperate and coordinate with other relevant supervisors and authorities on matters relating to the entities it regulates, subject to confidentiality requirements. Many examples demonstrated BNM's openness to cooperating and coordinating with other relevant authorities
26 - Cross-border Cooperation and Coordination on Crisis Management	PO	Given the relative size and structure of the Malaysian insurance industry, BNM expects that its role in effectively managing a cross-sector crisis involving an insurer would be limited in most cases.

Insurance Core Principle	Level	Comments
		BNM has an adequate legal and administrative framework in place to allow it to effectively cooperate and coordinate with other relevant supervisors and authorities on matters relating to the entities it regulates. BMN also has demonstrated its openness to cooperating/ coordinating with other relevant supervisors and authorities. BNM could further enhance its ability to contribute to the effective resolution of an insurer cross-border crisis by increasing its expectations of insurers to maintain comprehensive contingency plans and information systems capable of generating timely and reliable ad hoc information on risk accumulation
Aggregate Level: Observed (O), largely observed (LO), partly observed (PO), not observed (NO), not applicable (N/A).		

Summary of Grading

Observed (O)	7
Largely observed (LO)	15
Partly observed (PO)	4
Not Observed (NO)	0
Total	**26**

Table 8. Malaysia: Recommendations to Improve Observance of ICPs

Insurance Core Principle	
1 - Objectives, Powers and Responsibilities of the Supervisor	To reduce the possibility of conflicting supervisory functions, legislative amendments should be made to more specifically highlight the application of BNM's principal objectives to the supervision of the insurance sector for the benefit and protection of policyholders. This is expected to be addressed in the FSA.
2 - Supervisor	As transparency promotes greater accountability, BNM should move forward with its plans to formalize a policy development framework and establish a more liberal approach towards public disclosure of its regulatory expectations. Subsequent to the assessment, BNM indicated that the policy development framework was rolled out for implementation in May 2012.
3 - Information Exchange and Confidentiality Requirements	BNM's should participate in more extensive MOU arrangements (including the IAIS MMOU) with other supervisors so as to have a stronger foundation for ensuring appropriate protection of shared information.
4 - Licensing	In order to better support the consistent administration of

Insurance Core Principle	
	licensing standards, clear and objective licensing approval criteria should be incorporated within legislation. BNM has indicated that current proposed legislation aims to do this.
5 - Suitability of Persons	Legislative amendments should be made to require significant owners to continually comply with suitability requirements, and provide substantive powers to adequately address situations where significant owners no longer meet such requirements. This is expected to be addressed in the FSA.
6 - Changes in Control and Portfolio Transfers	To ensure greater consistency of requirements and approval objectives, and reduce the potential of undue political interference in transactions requiring Ministerial approval, legislation should more explicitly define the approval criteria for acquisitions of a significant ownership interests and insurer portfolio transfers. This is expected to be addressed in the FSA.
7 - Corporate Governance	To ensure the continued appropriateness and clarity of its corporate governance expectations, BNM should look to update and consolidate its related guidelines where appropriate. . In doing so, BNM should take into consideration the recent updates made to the *Malaysian Code on Corporate* Governance, by the Securities Commission Malaysia, that are to be implemented beginning later this year by the companies listed on Bursa Malaysia.
8 - Risk Management and Internal Controls	To ensure the continued appropriateness and clarity of its risk management and internal control expectations for insurers, BNM should look to update its related guidelines where appropriate. The finalization and implementation of BNM's recent concept paper on risk management governance, which BNM indicates will occur later in 2012, should assist in addressing current BNM identified gaps.
9 - Supervisory Review and Reporting	BNM's SuRF may not be appropriate for use on certain types of supervisory reviews, such concerns are outlined within other ICP assessments.
11 - Enforcement	To enhance the structure and effectiveness of the enforcement regime, consideration should be given to: • Better aligning the need for Ministerial approval for enforcement actions within legislation with clearer objectives and purpose for such powers; • Enhancing the range and options of the enforcement tools available to BNM, and the deterrence measures within legislation; and • Making the criteria or basis for BNM's enforcement

Insurance Core Principle	
	decisions or actions more transparent. The above is expected to be addressed in the FSA.
12 - Winding-up and Exit from the Market	To ensure greater understanding and consistency in intervention and resolution practices, consideration should be given to more clearly defining 'non-viability' triggers within legislation.
13 - Reinsurance and Other Forms of Risk Transfer	To ensure the continued appropriateness and sufficient scope of its reinsurance management expectations for insurers, BNM should look to update and expand its related guidelines where appropriate.
14 - Valuation	BNM indicated that it plans to conduct more detailed assessments and benchmarking of the methods used to for MOCE determination, so as to strengthen processes, promote better comparability, and ensure regulatory objectives are being met. BNM should review the extent to which current valuation approaches for solvency purposes adequately meet regulatory objectives during 'normal' stress periods, so that temporary adjustments to valuation approaches need only be considered during truly anomalous economic conditions, such as those existing around 2008-09.
15 - Investment	BNM should review its investment related guidelines to identify and implement further enhancements, which should include expectations on insurer use of external credit ratings and investment aggregation risks on a group-wide level.
16 - Enterprise Risk Management for Solvency Purposes	BNM's planned near-term changes will address many current gaps and insurance sector inconsistencies within its enterprise risk management expectations for insurers, particularly the implementation of its new ICAAP requirements and its draft *Risk Management Guidelines – Risk Governance*.
17 - Capital Adequacy	BNM should give consideration to explicitly addressing interdependencies between and within risk categories within the RBC. Also, for greater clarity of RBC objectives, BNM should consider more explicitly defining the RBC in terms of the level of risk protection that it should afford, provided that BNM is satisfied that appropriate insurer competencies as well as market depth and liquidity exist to support such an initiative. In addition, to better promote prudent practices, BNM should establish definitive project plans for the near term development and implementation of a regulatory capital framework for financial guarantee insurance.

Insurance Core Principle	
18 - Intermediaries	To substantively enhance the regulatory regime for insurance intermediaries, legislative changes should be made to codify requirements for the maintenance of separate fiduciary accounts for monies collected from clients and to strengthen enforcement powers. This is expected to be addressed in the FSA. Also, to ensure supervisory effectiveness, BNM should further develop a supervisory approach more specific to the relevant considerations for intermediaries.
19 - Conduct of Business	To enhance effectiveness, legislative amendments should be made to strengthen enforcement powers and enhancements made to BNM's market conduct supervisory function and practices. This is expected to be addressed in the FSA.
20 - Public Disclosure	BNM should give consideration to enhancing its public disclosure regime for insurers through additional requirements for disclosures of disaggregated information on key measures such as insurer source of earnings and capital adequacy measures and risks/risk management processes.
21 - Countering Fraud in Insurance	BNM should give consideration to reviewing the effectiveness and rigour of SuRF in adequately capturing and assessing insurer anti-fraud practices and issues.
22 - Anti-Money Laundering and Combating the Financing of Terrorism	BNM should utilize its FIU specialists on AML/CFT supervisory reviews of insurers with significant sales of products having a higher susceptibility to ML risks.
23 - Group-wide Supervision	Legislative amendments should be made to provide BNM with explicit powers to regulate and supervise holding companies and related entities. The FSA is expected to explicitly empower BNM to regulate and supervise holding companies and all its related entities
24 - Macroprudential Surveillance and Insurance Supervision	BNM utilizes macroprudential surveillance tools appropriate to the nature, scale and complexity of the insurance sector. Enhancements could be made by: • Requiring insurers to conduct periodic comprehensive industry-wide standardized scenario testing exercises, this would provide BNM with an additional tool for assessing the build-up of industry risks/ vulnerabilities; • Establishing a more structured internal processes for identifying, assessing, monitoring and reporting on emerging risks in the industry; and • Developing more robust indicators for assessing systemic risk of insurers.

Insurance Core Principle	
25 - Supervisory Cooperation and Coordination	Recommendations on related matters of group-wide supervision and information sharing considerations are addressed in assessments of other ICPs.
26 - Cross-border Cooperation and Coordination on Crisis Management	BNM should further enhance its ability to contribute to the effective resolution of an insurer cross-border crisis by increasing its expectations of insurers to maintain: • Comprehensive contingency plans; and • Information systems capable of generating timely and reliable ad hoc information on accumulation of risks.

Authorities' response to the assessment

Bank Negara Malaysia (the Bank) welcomes the assessment on Malaysia's observance of the Insurance Core Principles (ICPs). The assessment affirms the Bank's continuing efforts to maintain an effective regulatory and supervisory framework in ensuring the safety and soundness of the insurance and takaful industry in Malaysia. The assessment also makes recommendations that largely correspond with the Bank's current priorities to further strengthen the regulatory and supervisory system, and validates the various initiatives that are at advanced stages of implementation or for which definite plans have been put in place. We thank the assessors for the candid and open discussions, and the fruitful exchange of views throughout the assessment process.

A significant number of the recommendations will be addressed by the proposed financial services legislation. Amongst others, this will provide greater transparency in licensing standards and suitability requirements for shareholders. It will also further enhance powers for the Bank to take timely enforcement and corrective actions, and provide for the regulation and supervision of holding companies. Legislative changes and enhancements to the supervisory framework will also strengthen market conduct standards across the industry, including for intermediaries, and further reinforce financial integrity. The Bank's policy development framework, which was implemented in May 2012, will provide a well-defined process for the development and communication of regulatory expectations going forward. An important part of this process includes the regular review of regulatory standards issued by the Bank to clarify, update and enhance the standards as necessary to reflect the changing environment.

In line with increasing regional and international financial integration, the Bank is also committed to further strengthening its existing cooperation and exchange of information arrangements with other supervisors and authorities, including through wider participation in bilateral MOUs and by enhancing capabilities to support effective cross-border crisis management and resolution. The Bank will also continue with efforts to introduce more advanced tools for monitoring of systemic risks in the insurance sector.

II. Detailed Principle-by-principle Assessment

Table 9. Malaysia: Detailed Assessment of Observance of the ICPs

ICP 1	**Objectives, Powers and Responsibilities of the Supervisor** The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.
Description	Under the CBA (s. 5(1)), the principal objective of BNM is to promote monetary and financial stability conducive to the sustainable growth of the Malaysian economy. The CBA (s. 5(2)) specifies a number of primary functions of the BNM, including to regulate and supervise financial institutions which are subject to the laws enforced by the central bank, as well as to promote a sound, progressive and inclusive financial system. (Re)insurers and (re)takaful operators are subject to the enabling and other legislative provisions within the IA and TA respectively. BNM is clearly identified as the administrative and enforcement authority under both the IA (s.3) and TA (s.54), and so the broad objectives outlined for BNM under the CBA apply to BNM's activities under the IA and TA. However, neither the IA nor TA specifically highlight the application of BNM's principal objectives to the supervision of the insurance/takaful sector for the benefit and protection of policyholders. The IA and TA provide clarity on the range of powers afforded BNM to administer and enforce the respective legislation, including powers to: • Recommend the Minister[2] approve a license grant (IA s.13, TA s8), acquisition or disposal of an interest in shares exceeding 5% of an insurer licensee or its controller (IA s.67(3)), and a change of control of a takaful operator (TA s.34 as modified by s.54(3)); • Approve the (re)appointment of licensee insurer directors and CEOs (IA s.70), licensee external auditors (IA s. 74(1), TA s.41(3c)), and the AA role required of life insurer licensees (IA s. 83(1)); • Prescribe administrative, conduct of business and prudential standards for licenses to follow (general provisions under IA s. 201and TA s.69, IA part XII and various other specific provisions within IA and TA); • Conduct examinations and investigations of licensees (IA parts VIII and IX, TA part III); and • Take pre-emptive to corrective and resolution measures when an insurer or takaful operator is operating in an imprudent manner, has contravened the law, is defaulting or has inadequate assets to meet required solvency requirements (Parts X and XI of IA, part III of TA), with court or Ministerial approval required for a number of actions. Generally, BNM has adequate powers to conduct insurance supervision, including powers to issue and enforce rules by administrative means. Specific areas where BMN's powers may be unduly limiting are examined more fully under ICPs that address those specific areas.

[2] All references to 'the Minister' relate to the existing Minister of Finance within the Malaysian government.

Assessment	Largely Observed
Comments	Existing legislation clearly defines BNM as the authority responsible for insurance supervision, and BNM's powers to administer and enforce the enabling legislation for insurance operators and intermediaries in Malaysia. BNM has advised that recently proposed comprehensive legislative amendments will, among other things, more specifically highlight the application of BNM's principal objectives to the supervision of the insurance sector for the benefit and protection of policyholders.
ICP 2	**Supervisor** The supervisor, in the exercise of its functions and powers: • is operationally independent, accountable and transparent; • protects confidential information; • has appropriate legal protection; • has adequate resources; and • meets high professional standards.
Description	The CBA provides for BNM to be an operationally independent statutory body, establishing and outlining the composition of the BNM Board of Directors and its statutory responsibilities, which includes the general administrative oversight and approval of BNM's operating plans and budget (s.14). The central bank's operations are self-funded, supported by its reserves and profitable activities. It has autonomy in determining the use of its resources to carry out its regulatory and supervisory responsibilities. The CBA requires that the Board establish Governance, Audit and Risk committees of the Board, each with specific statutory oversight functions and responsibilities (s.21). BNM's risk management and internal audit departments act as independent internal control functions that provide necessary support, and report directly to, the Board Risk and Audit Committees respectively. Under the CBA (s. 15), the BNM Governor is appointed by the Yang di-Pertuan Agong (the King) for a 5 year term, while the Deputy Governors are appointed by the Minister for 3 year terms – all are eligible for reappointment. Under the Act, the Governor and Deputy Governors are to be persons of impeccable reputation with proven experience and recognized knowledge in monetary or financial affairs (s. 15(2)). The legislation also outlines the grounds on which the term of appointment of the Governor, Deputy Governor or any other Directors of the board may be terminated, which includes conviction of a criminal offence, bankruptcy and involvement in activities that may interfere with his/her independence (s.17). Since the establishment of BNM, no Governor, Deputy Governor or member of the Board has been removed from office. The CBA, IA and TA provide clarity on the many specific matters that BNM is to recommend or refer to the Minister or the courts for decision making (with these Acts often outlining the broad criteria to be considered for such decision-making), and the areas where these executive and judicial authorities can override BNM decisions. Within the IA and TA, such matters are generally in respect to licensing, change of control and portfolio transfers, and enforcement actions involving employment contracts, property rights and the due process of law, but such provisions are not consistent across the IA and TA. The assessor did not find any evidence that the legislative provisions that provide for Ministerial involvement in certain aspects of licensing, changes of control and portfolio

	transfer approvals, and enforcement created any undue government interference in the operational independence of BNM. However, greater clarity within legislation of transaction approval criteria, objectives and purpose of Ministerial involvement would reduce the potential for undue government interference in the future – such matters are addressed within the ICPs specifically dealing with licensing (ICP 4), changes in control and portfolio transfers (ICP 6), and enforcement (ICP 11). The CBA requires that BNM keep the Minister informed of policies relating to its principal objectives, which BNM advises it does from time to time, including through its bi-annual briefings by the Board. In situations where there are differences in opinions between BNM and the Minister on policy issues relating to BNM's statutory objectives, the CBA details out the mechanism to resolve such differences through the Cabinet as well as the Parliament (s.72) - such a situation has never arisen since BNM's establishment. BNM has established an internal empowerment framework for the delegation of authority, within defined parameters, by the Governor to BNM staff for the administration of BNM powers under the IA and TA. BNM also has in place internal committee governance arrangements and procedures that promote consistency and soundness of policymaking, supervision and resolution decisions. Various high-level internal decision-making committees have been established with various terms of reference, with many of these committees chaired directly by the Governor. Significant issues are escalated to the relevant committees for decision-making, and BNM has indicated that there is sufficient regularity and flexibility over the scheduling of these committee meetings such that timely decisions and actions can be taken on significant issues and matters arising from emergencies. BNM's accountability is further promoted through its transparency, including its: Public reporting on its roles, objectives and the performance of its insurance regulatory and supervisory functions in respect of its objectives via BNM's website, annual report and the annual FSPSR; Response to requests to provide explanation on policy issues to the Parliament (via the Public Accounts Committee of the Parliament); and Public posting of a great many, if not the large majority, of its administrative and prudential guidelines for the insurance/ takaful industry on its website, as well as the public and Industry consultations it conducts with respect to most new regulatory and supervisory initiatives. BNM does not have clear criteria in place for determining the information it wants to publicly disclose, and uses an industry portal to disseminate various regulatory expectations to insurers without making them publicly transparent. There are opportunities for BNM to further enhance its transparency with: More detailed disclosures on the performance of its duties, particularly its assessments of changes in industry and insurer risks and its issuance of fines and penalties (with measures to preserve confidentiality); and Establishing a clearer framework, with appropriate triggers, for a more consistent determination of when to review the continued adequacy of its issued guidance and the extent to which regulatory and supervisory initiatives will be subject to public consultation and disclosure processes. BNM has indicated plans to improve future practices in this area

	with the development of a formal policy development framework and a more liberal approach toward publicly disclosing its regulatory expectations. In May 2012, subsequent to the assessment, BNM advised that its policy development framework had been rolled out for implementation. The CBA also provides for: • Legal immunity for BNM directors, officers, employees, and any person lawfully acting on behalf of the BNM, in respect of any actions/omissions committed in good faith for the purpose of performing their duties (s87, indemnity provisions also under IA s.191 and TA s.55); and • The protection of confidential information by prohibiting current or past BNM directors, officers or employees, and others appointed under the Act, from disclosing information relating to business of BNM except for the purpose of performance of duties, carrying out functions or when lawfully required to do so (s.86, similar provisions under IA s.191 and TA s.59). BNM also has internal information security policies that outline expectations for the treatment of confidential information/documents. There have been no cases of breach of confidentiality rules by BNM's staff or other individual acting on behalf of BNM in the past. According to BNM, it offers a remuneration package comparable to market rates within the financial services industry, and it invests significantly in training and provides career development opportunities in order to promote the retention and development of its professional staff. BNM staff have diverse backgrounds and qualifications, and more than 90% have at least a bachelor's degree. BNM provides some opportunities for staff to attend short duration attachment programmes at financial institutions in Malaysia or overseas at other regulatory agencies to enhance their knowledge and supervisory experience. It also funds scholarship programmes for postgraduate and doctorate studies to enhance staff academic qualifications. Nevertheless, almost 40% of the supervisory and regulatory function staff have less than 5 years of experience working in BNM. To address resourcing issues caused by high turnover rates, particularly at the entry level positions, BNM overstaffs as a matter of practice. In addition, BNM advised that its senior management staff for insurance supervision has an average of 17 years of experience with the Bank. BNM is empowered to appoint any person who is not an officer of BNM to render assistance as necessary or perform any function on its behalf (IA s.3, TA s.54). In the past, BNM had used the services of risk consulting firms to advise on actuarial matters. The use of such services has been minimal in recent years with the establishment of an internal pool of qualified actuaries, encouraged by BNM through its provision of financial assistance to staff to pursue professional actuarial qualifications, and consequently reducing its reliance on external services. BNM's insurance supervision departments utilize their staff pool of qualified actuaries, professionals in short supply in Malaysia, to examine insurance risks and insurer vulnerabilities. Other internal specialist resources are also periodically utilized to examine insurer credit, market, operational and other risks. Based on discussions with a limited number of insurers and insurance industry stakeholders, BMN's insurance regulation and supervision staff are held in very high regard, viewed as being amongst the best in the region, but some also suggested that BNM could benefit from hiring more staff with direct insurance industry work experience. BNM's staff are subject to a code of conduct that sets out standards of integrity, addressing

	issues such as confidentiality, conflicts of interests and dealings with the industry. Measures to mitigate conflicts of interests are also implemented at the Board level, where BNM's directors are legally required to disclose to the Board any direct or indirect interests in dealings or businesses with BNM (CBA s.20). Directors facing a potential conflict of interest are then required to exclude themselves from any deliberations and shall be disregarded from the Board's quorum with respect to decisions on such dealings or businesses.
Assessment	Largely Observed
Comments	Legislation allows for BNM to be an operationally independent statutory body. It also affords BNM directors, officers, employees and others working on its behalf with appropriate legal protection, as well as requires them to protect confidential information. Internal governance practices emphasize committee decision-making, to promote soundness and consistency. No evidence was found of any undue political, governmental or industry interference in the operational independence of BNM in carrying out its supervisory functions. BNM's operations are self-funded, with resourcing decisions fully within their control. It has a practice of overstaffing in order to address turnover issues, especially at entry-level positions. BMN offers a renumeration package that is comparable to industry, invests significantly in staff training, and requires staff to follow a substantive code of conduct to promote high ethical standards. BNM staff are highly regarded by industry stakeholders. While the central bank is active in providing public transparency on its performance and its expectations of industry participants, more can be done to establish a clearer framework to promote consistency in guideline review practices, as well as in developing fuller internal processes and criteria for its public consultations and public disclosures of its regulatory expectations.
ICP 3	**Information Exchange and Confidentiality Requirements** The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose and use requirements.
Description	In the interest of financial stability, BNM is empowered to request any supervisory authority or Government agency in Malaysia overseeing specified institutions (financial institutions, intermediaries, related corporations, etc.) to submit to BNM any information or document relating to activities which BNM considers necessary for giving effect to the financial stability objective (CBA s.30(1)). Also, for the purposes of promoting financial stability, BNM is empowered to obtain any information/document from, or share such information or document with any other supervisor authority, if BNM considers it necessary that such information or document be obtained or shared (CBA s40(1)(a)), subject to measures and agreements to ensure appropriate confidentiality and use of such information (CBA s40(2)). BNM may share information with foreign supervisory authorities even if no formal agreement has been put in place (i.e. MoU or confidentiality agreement). For instance, BMN has strong bilateral relationships with certain outside regulatory authorities where information is exchanged upon request, subject to restrictions on usage and circulation, despite the absence of a formal agreement between BNM and other regulatory authority. Nevertheless, BMN has some information sharing MOUs in place with other regulatory authorities, and has indicated it is taking steps towards signing the IAIS multilateral MOU, which would impose confidentiality requirements on all its signatories. As BNM does not currently have explicit power to regulate and supervise authorised financial or insurance holding companies and all their related entities, BNM does not have

	legal authority to directly obtain information from such entities. BNM has indicated that proposed new legislation will provide it with the explicit power to regulate and supervise authorised financial or insurance holding companies and all their related entities, giving BMN explicit authority to obtain information from such entities for supervisory purposes. There are no significant insurance groups or FHC for which BNM is the home supervisor. BMN indicates that, out of 60 licensees operating in Malaysia, only four belong to groups which have branches, subsidiaries or sister companies operating in one or two other foreign jurisdictions, while three quarters of the insurance entities operating in Malaysia belong to either local banking groups or foreign financial groups. As BNM supervises both the banking and insurance sectors, there is an integrated approach to supervision of banks and insurers within the same financial group as well as exchange of information between the banking and insurance supervisors in BNM. BNM developed its HHSF to specifically address information sharing situations on a case-by-case. Under its HHSF, BNM evaluates the request for information from another supervisor, taking into consideration the legitimate purpose for such information, its relevance, materiality, proportionality and safeguards in place to protect the confidentiality of information shared. BNM indicated that it has, to date, not denied any request for information from another supervisor. Under HHSF, reciprocity is not one of the factors to be considered in the sharing of information with another supervisor. The framework mentions the areas for information sharing and does not place any requirement on the level, format or detailed characteristics. BNM shares confidential information on condition that it is to be kept and meant only for the specific purpose for which the information is requested and should not be divulged to a third party without BNM's prior consent. For example, for cases where information sought is with regard to information on character vetting on key appointments, the BNM has shared such information with foreign supervisory authorities subject to the condition that the information provided is for the sole purpose of assessing the individual's application to a key position. BNM has not encountered a situation where it is legally compelled to disclose confidential information it received from another supervisor
Assessment	Largely Observed
Comments	There is an adequate legal and administrative framework in place that allows BNM to exchange information, on entities it supervises, with other supervisors and authorities subject to confidentiality, purpose and use requirements. BNM does not have explicit power to regulate and supervise authorised financial or insurance holding companies and all their related entities, and so does not have legal authority to directly obtain information from such entities. Proposed new legislation is expected to provide such authority. Currently, there are no significant insurance groups for which BNM is home supervisor While BNM's HHSF aims to address specific information sharing situations in a consistent manner, participating in more extensive MOU arrangements (including the IAIS MMOU) with other supervisors would provide a stronger foundation for ensuring appropriate protection of information being shared.

ICP 4	**Licensing** A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.
Description	In Malaysia, the conduct of insurance business is prohibited unless licensed under the IA (s.9). Similarly, no company or society can carry on business as a takaful operator if it is not registered[3] under the TA (s.4). While no direct conventional insurance licenses have been issued since the 1970s, new reinsurance, takaful and retakaful licenses have been issued since 1995, largely to meet specific objectives to enhance domestic reinsurance capacity and further develop the takaful industry. Seven reinsurance licenses (one life reinsurance license and six general reinsurance licenses) were issued between 1995 and 2007, and twelve total takaful and retakaful licenses were issued between 2005 and 2010. Primary insurers and takaful operators are required to conduct their business through locally-incorporated companies[4], only professional reinsurers and retakaful operators are allowed to conduct business through a branch operation. The cross-border supply of insurance business is prohibited except for cross-border supply of insurance broking. The licensing considerations are the same for both domestic and foreign applicants. (Re)insurance and (re)takaful businesses are grouped into two classes: life (or family solidarity under the TA) and general insurance business. Insurers and takaful operators are prohibited from conducting activities beyond what they are licensed to do. There are also certain activities where BNM is of the view that further assessment on the competence of the insurer is required to underwrite such a business. The offering of certain products such as annuity certain or investment-linked insurance by insurers further requires BNM's prior written approval (IA s.7). Additionally, insurers have prohibitions and/or restrictions on issuing certain credit or financial guarantees. The IA prohibits licensed primary insurers from carrying on both life and general business in a single entity (s.12), composite insurers licensed prior to the enactment of IA have been allowed to continue to do so. There are currently six direct insurers that operate with a composite license, except one, all are predominantly life insurers. The general business carried on by these insurers is small in volume relative to the life business. Licensed reinsurers are allowed to carry on both life business and general business, currently only one reinsurer does so. In contrast, the TA (s.8(1)) allows both takaful or retakaful operators to be registered to carry on both family and general takaful business. There are currently eight direct takaful operators and three retakaful operators that conduct both family and general takaful business in one entity. BNM has not issued any composite license for takaful operators since 2007 and for retakaful operators since 2009.

[3] For clarity, BNM indicates the term 'registration' under TA should be used in the same context as the term 'licensing' in the IA. BNM has indicated that proposed legislation will use the term 'licensing' for both insurance and takaful business.

[4] While the TA allows for registration under the *Co-operative Societies Act*, rather than the *Companies Act*, no takaful operator has chosen to do so. BNM has indicated that this option will be eliminated under proposed legislation.

	To manage potential risks that may arise from allowing composite companies, both the IA and TA require separate funds be maintained for the different classes (IA s.38, TA s.16(1)). Also, BNM indicated that proposed legislation will require 'grandfathered' composite players to segregate their businesses within a stipulated timeframe. While BNM is responsible under legislation for assessing applications for a license, the Minister is the licensing authority for insurance and reinsurance business (IA s13 (1)). The Minister may grant or refuse to grant such a license upon receiving a recommendation from BNM, after taking into consideration its conduciveness to a sound financial structure in Malaysia and the interests of the general public. Similarly, while the TA effectively accords BNM the responsibility for the registration of takaful and retakaful operators (s.8 (1)), BNM must refer an application that has met the relevant requirements to the Minister, who can direct BNM not to register the applicant (s 8(6) of TA). BNM advised that, in practice, the Minister has neither rejected an application for a license that has been recommended by BNM, nor has there been a case where the Minister over-ruled BNM's recommendation to refuse an application for a license and proceeded to grant a license. Given that legislation does not provide the specific licensing criteria, BNM issued specific guidelines and communiqués to articulate the licensing criteria and information required for an application. While the *Guidelines on Application for Carrying on Reinsurance Business in Malaysia* are only available to interested parties upon request, other specific guidelines and communiqués relating to the criteria and information required for (re)takaful registration are available on BNM's website. BNM identifies the licensing criteria as comprising two main areas, prudential considerations and the applicant's commitment and contribution to Malaysia and the overall development of the financial system. The prudential considerations assess the financial soundness and strength of the applicant, including the nature and sufficiency of the financial resources of significant shareholders, the integrity and track record of the applicant and the suitability of the Board and key persons operating the Malaysian operations. The extent to which the group and reporting structure is transparent and whether it is so complex such that it will impede effective supervision of the Malaysian entity, as well as the extent to which the applicant is supervised by their home supervisory authority (for foreign applicants). As part of BNM's prudential assessment, the applicant has to also submit a minimum 3-year detailed business plan, where an assessment is made on whether the plan is realistic and the financial ability of the applicant to meet the minimum capital or working funds at entry and on an ongoing basis. The applicant's commitment and contribution to Malaysia is also assessed based on the business plan for the Malaysian operations, with consideration to the ability of the applicant to meaningfully contribute to Malaysia's development objectives for the industry. As part of the process before the license is approved, a written confirmation is required from the applicant's home supervisory authority to confirm: • The home supervisor has no objection towards the applicant's establishment of business in Malaysia;

	• The applicant is of good financial standing and meets the prudential regulatory requirements in the home jurisdiction; and • The home supervisor practices consolidated supervision and agrees to co-operate in the supervision of the proposed insurer or takaful operator. Prior to the commencement of operations, BNM conducts a readiness review on the entity to ensure it has the necessary governance structure, policies and procedures, risk management framework, internal controls and systems in place, commensurate with the size, nature and complexity of operations. BMN indicates that the time period for the final decision on licensing/registration upon completed submission of the application is between 3 to 6 months. As a matter of practice, BNM does not inform the applicant the specific reasons for rejection in writing, but will verbally communicate the reasons for rejection upon request by the applicant. Legislation allows BNM to make a recommendation to the MOF to impose conditions on the license at the point of granting the license. The Minister is also empowered to impose additional conditions after considering the impact of the licence on the soundness of the Malaysian financial sector and the interest of the general public (IA s.16). Once a licence has been issued, the law provides for Minister to amend or impose additional licensing conditions or restrictions (IA s.23). Legislative powers to limit the scope of a license were used in 2010 with the establishment of Danajamin Nasional Berhad, the national financial guarantee insurer that is 50% owned by the Ministry of Finance and 50% owned by Credit Guarantee Corporation Malaysia Berhad, and subject to the Insurance (Financial Guarantee Insurance) Regulations (2001). Similarly, the TA empowers BNM to impose conditions of registration on the takaful operator at the point of registration or at any other time (s.8(1) and s.10(1)). An insurance or takaful license is valid for an unlimited period, unless revoked under section 30 of IA or cancelled under section 11 of TA. BNM has indicated that the licensing criteria, requirements and procedures for the application of licences for insurers and takaful operators will be provided explicitly under proposed legislation.
Assessment	Largely Observed
Comments	Only licensed entities can lawfully conduct insurance activities in Malaysia. Legislation establishes clear parameters for the allowable legal forms and business activities of insurers, as well as the relevant licensing approval authorities and their applicable powers. In the absence of specific licensing criteria within legislation, BNM established specific guidelines and communiqués to articulate the licensing criteria, and information required for license application, during the limited rounds of BNM acceptance of reinsurer and (re)takaful applications since 1995. No direct conventional insurance licenses have been issued since the 1970s, The requirements and procedures for licensing are appropriately clear and adequately

	administered within the parameters of the insurance market for which access by new entrants is significantly restricted. In such circumstances, applications that best meet objective criteria are approved, Establishing clear and objective licensing approval criteria within legislation, as BNM has indicated is being proposed in the FSA, will support the consistent administration of licensing standards upon the further opening up or future liberalization of the Malaysian insurance industry to new entrants.
ICP 5	**Suitability of Persons** The supervisor requires Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfill their respective roles.
Description	Legislation specifies that directors, CEOs and managers of insurers must fulfil fit and proper criteria (IA s.70). Managers are effectively defined in BNM guidelines as senior management and persons performing key control functions, including persons who have authority to make decisions, are responsible for the implementation of policies and strategies; and are responsible for the proper conduct of the insurer's operations (including internal audit functions, risk management and compliance functions and also the appointed or signing actuaries). While TA does not identify persons who have to meet suitability requirements, these persons are identified in BNM's guidelines, which detail the suitability requirements for the Chairman, directors, CEO, persons performing senior management functions and persons responsible for key control functions, including actuaries. As indicated by BNM, the fit and proper requirements are prescribed in specific insurance regulations and BNM guidance for insurers and takaful operators[5]. BNM places the obligation for assessing fit and proper on the insurer or takaful operator, in particular the Nominating Committee (NC) of the Board of Directors, which BMN requires be chaired by an independent director and must consist of at least five members including a minimum of four non-executive directors. BNM imposes specific responsibilities on the NC so as to promote an appropriate assessment and determination of the suitability of the key responsible persons (Board members, senior management, and key persons in control functions), at the time of appointment and on an ongoing basis, under the following areas (each with supporting BNM assessment criteria): • Probity, personal integrity and reputation • Financial integrity • Competence and capability BNM's approval is required for the (re)appointment of Board of Directors, CEOs and appointed actuaries (IA s. 70 and s.83, imposed by BNM guidelines for (re)takaful operators). For such purposes, BNM requires information detailing the person's

[5] Specifically, Part XII of the Insurance Regulations 1996 (for insurers) and specified in the Guidelines on Directorship for Takaful Operators (for takaful operators) and Guidelines on Fit and Proper for Key Responsible Persons (applicable to both insurers and takaful operators).

	qualifications, work experience, present roles in other companies and financial obligations. Specifically for actuaries, they also have to be professionally qualified and be a Fellow of a recognised professional actuarial body. BNM requires a written assessment by the NC, which explains their assessment of the person with respect to specified BNM criteria and proposed training plans aimed at addressing competency gaps. Among other things, the person also has to provide a statutory declaration confirming that he is not disqualified from holding the position under specific legislative criteria (IA s.71, TA s.31) Where the NC has assessed that a person is no longer suitable for a position, BNM expects the Board to take reasonable steps to remove the person from such position as soon as practicable, and in the interim, take necessary measures to mitigate risks associated with the person continuing to hold the position. Under these circumstances, BNM guidance specifies that the Board is required to notify BNM. Additionally, given that the term of appointment for Board members, CEOs and actuaries is for a finite period of years (up to three years for Board and CEO, and one year for actuaries), a person who no longer meets suitability requirements would not be approved by BNM for reappointment. At the point of entry, significant owners are also required to meet suitability requirements, and these are effectively applied when approval is being sought for a new license or for ownership changes, both applications utilize similar fit and proper assessment processes. Insurers are required to obtain the Minister's approval for the acquisition or disposal of an aggregate interest in shares exceeding 5% (IA s.67), while BNM approval (subject to prior Ministerial concurrence) is required for a change of 'control' for a takaful operator, 'control' is defined as possession of power to direct or cause the direction of management and policy of the takaful operator (TA s.34). Despite the legislation, BMN noted that it also administratively applies a 5% threshold for approval of share ownership changes for takaful operators, based upon an 2006 circular outlining that BMN approval is required before any party can enter into negotiations to transfer 5% or more of shares in a takaful operator. There are no requirements for significant owners to comply with suitability requirements at all times. Also, BNM does not have the power to order a divestment of shares if the significant owner no longer meets suitability requirements. However, pursuit to legislated powers (IA s.67, TA s.34), applications for approval of further significant acquisition of shares in an insurer, or changes in control in a takaful operator, can be denied for significant owners that no longer meets suitability requirements. In practice, BNM can also utilize various supervisory mechanisms restrict or minimize the operational influence of significant owners that no longer meets suitability requirements. BNM indicated that the proposed FSA will include provisions to harmonize suitability requirements for insurers and takaful operators, and will correct current legislative gaps in expectations and enforcement actions available when significant owners no longer meet specified suitability standards. More specifically, the proposed FSA will expand suitability requirements to significant owners and provide BNM more powers to enforce such requirements, including ordering a divestment if deemed necessary.
Assessment	Largely Observed
Comments	An adequate legislative and BNM administrative framework exists to ensure that Board members, senior management and key persons in control functions possess competence and integrity to fulfil their roles, both upon and subsequent to their (re)appointment.

	While significant owners are subject to suitability assessments upon application for approval for licensing and significant changes in their shareholdings, there are no requirements for significant owners to continually comply with suitability requirements, and no legal powers available to BNM to order a divestment of shares if the significant owner no longer meets such requirements. BNM has indicated that proposed legislation will aim to address current gaps.
ICP 6	**Changes in Control and Portfolio Transfers** Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.
Description	Legislation contains definitions of the term "control". The IA defines "controller" as the chief executive officer of the insurer or its holding company, or a person who, either alone or with any associate has interest in one-third or more of its voting shares or the power to appoint a majority of its directors or the power to make decisions in its business and administration (S.2). The TA defines "control" as direct or indirect possession of the power to direct the management and policy of the operator (s.34), but the definition does not include any share ownership thresholds. While the TA requires BMN approval (subject to prior Ministerial concurrence) for a change of 'control' for a takaful operator, the IA requires insurers to obtain the Minister's approval for the acquisition or disposal of an aggregate interest in shares exceeding 5% (IA s.67), a significant ownership threshold in line with the definition of "substantial" ownership in CA (s.69). Administratively, BNM also applies a 5% threshold for approval of share ownership changes for takaful operators, based upon an 2006 circular[6] outlining that BMN approval is required before any party can enter into negotiations to transfer 5% or more of shares in a takaful operator or insurer. The scope also extends to intermediate and ultimate beneficial owners and applicants who are acting individually or in concert with others, although BNM applies this administratively to takaful operators given that such provisions are not within the TA. In effect, the approval regime for changes in an insurer's or takaful operator's ownership is two-staged. The first relates to the commencement of negotiations, where BNM's prior approval is required for any party to enter into negotiations to transfer 5% or more shares of an insurer or takaful operator. The second stage involves the details of the arrangement which will result in the transfer of shares in an insurer or takaful operator, which under legislation requires the Minister's prior approval (upon BNM's recommendation) for an insurer and for transactions where there is a change of control of the takaful operator. BNM effectively uses licensing and suitability of persons criteria to assess such applications, which includes financial and non-financial requirements. Insurers and takaful operators are required by BNM to submit information on shareholders on a semi-annual basis, which is used to update BNM's database containing corporate profile information on all insurers and takaful operators (FICPS). BNM indicated that it also

[6] The circular is entitled the *Negotiations for the Acquisition and Disposal of Interest in Shares of Licensed Institutions Regulated by Bank Negara Malaysia*

	regularly engages with insurers and takaful operators on an on-going supervisory basis to to obtain information on their shareholders and direct or indirect controllers. Any scheme of transfer for insurance or reinsurance business has to be approved by BNM, and confirmed by the court (if the transfer is to a party within Malaysia) under the IA (s.128). Although TA does not explicitly require supervisory approval for transfers of takaful business, BNM expects that, in practice, takaful operators would seek BNM approval prior to submitting the schemes to the Court for confirmation - there have been no such cases for takaful operators. BMN outlines that the broad rationale of requiring supervisory approval for portfolio transfers is to provide an avenue for BNM to ensure that the transfer of portfolios does not pose undue risks to the viability, safety and soundness of the insurers or takaful operators concerned and that the interests of policyholders are protected. Provisions in IA and TA outline various safeguards for the interests of the policyholders, including requirements for the transferor to: Submit to BNM confirmation that policyholders will not be adversely affected following the transfer (IA s.129); and Notify the public of the approval and a policy owner is given an opportunity to object to the scheme. If a policy owner files an objection to the scheme, the transferor may modify the scheme with BNM's approval (IA s.132, TA s.52); and Also, an application to the Court may also be made by the policyholder at any time before confirmation of the scheme by the Court, if the policyholder feels that his or her rights are adversely affected with the transfer (IA s.133, TA s.52). Legislation does not explicitly outline approval criteria for the acquisition of a significant ownership interests in insurers or for insurer portfolio transfers. BNM has indicated that proposed legislation will provide for more stringent requirements, better clarification, and greater harmonization of existing requirements for changes in control and portfolio transfers of insurers and takaful operators.
Assessment	Largely Observed
Comments	Legislation clearly defines 'control', and approval is required for share ownership transactions well below the level of 'control'. The approval regime for changes in an insurer's ownership is two-staged. The first relates to the commencement of negotiations, where BNM's prior approval is required for any party to enter into negotiations to transfer 5% or more shares of an insurer. The second stage involves the details of the arrangement which will result in the transfer of shares in an insurer, which under legislation requires the Minister's prior approval upon BNM's recommendation. BNM effectively uses licensing and suitability of persons criteria to assess such applications, which includes financial and non-financial requirements. Under legislation, any scheme of transfer for insurance or reinsurance business has to be approved by BNM, and confirmed by the court (if the transfer is in relation to business in Malaysia). Legal provisions and administrative processes exist to protect policyholders under such transactions.

	Legislation does not explicitly outline approval criteria for the acquisition of a significant ownership interests in insurers or for insurer portfolio transfers. Such provisions would ensure greater consistency of requirements and approval objectives, as well as reduce the potential of undue political interference in transactions requiring Ministerial approval. BNM indicated this will be addressed in the proposed FSA.
ICP 7	**Corporate Governance** The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.
Description	Legislation provides broad, but limited, corporate governance requirements. For example, the CA, IA and TA, cover areas such as the appointment and disqualification of directors and employees, fiduciary duties and responsibilities of directors, Board's meetings and proceedings, related-party transactions and conflict of interest, external audit requirements and appointment of external auditors. More explicit corporate governance expectations are outlined in BNM guidelines. Corporate governance principles are enumerated in various BNM issued guidelines[7]. BNM's general expectations are outlined within *Minimum Standards on Prudential Management of Insurers* and *Prudential Framework of Corporate Governance*. These guidelines articulate BNM's expectations of Boards to provide a clear framework of objectives and policies within which senior management are to operate, covering all major and key areas of insurer operations, and to provide effective oversight of the affairs of the insurer to ensure sound management of the company. BNM's expectations include: • Specific Board committees are to be established (Audit, Risk Management, Nominating, and Renumeration Committees), with explicit mandates and responsibilities as outlined in the guidance; • The Board is to establish oversight functions i.e. internal audit, risk management, compliance and actuarial functions that are commensurate with the size and complexity of the institution; • The Board is required to monitor the performance of senior management in meeting the agreed goals and objectives, ensuring that it has the necessary information to do so; and • Clear lines of management responsibility and authority, with no gaps in effective management control, as well as management and Board accountabilities for reliable financial reporting, including required disclosures. Based on its guidance, BNM places significant expectations on insurer Board committees, including:

[7] Including within BNM's *Minimum Standards for Prudential Management of Insurers; Guidelines on Directorship for Takaful Operators; Prudential Framework of Corporate Governance; Guidelines on Audit Committees and Internal Audit Function; Guidelines on Appointment of External Auditors; Guidelines on Fit and Proper for Key Responsible Persons; Guidelines on Related Party Transactions; and Guidelines on Financial Reporting for Insurers & Takaful Operators.*

	• The Risk Management Committee is responsible to review and recommend the appropriate risk strategy and risk tolerance level for the Board's approval; • The Nominating Committee is to be responsible to establish policies and procedures on the engagement, performance review and succession of senior management of an insurer. NC is also required to be responsible for overseeing the performance evaluation of senior management and recommending to the Board for the removal of senior management if considered necessary. The Committee also serves to support BNM suitability assessments pursuant to its legislated approval powers over Board, CEO and Appointed Actuary reappointments following expiry of their set terms – as outlined in the ICP 5 assessment; • The Audit Committee and Risk Management Committee oversee internal controls and risk management areas respectively. In the event there are weaknesses or lapses in controls or risk management, the Board is required to ensure that the necessary rectification actions are followed through and promptly implemented; and • The Renumeration Committee is responsible for the development of remuneration policies for directors and senior management of insurers. BNM has issued various separate corporate governance related guidelines for takaful operators, which largely aim to provide similar governance expectations for takaful operators as exists for insurers, except for areas where there are understood business model differences, such as matters involving a takaful operator's Shariah Committee. A key feature of BNM's promotion of high standards for corporate governance is BNM's supervisory process, which places a significant focus on the corporate governance activities and oversight done by Boards. Consequently, supervisors evaluate and rate Board oversight against good (as well as expected) corporate governance practices and the demonstrated adequacy and effectiveness of its corporate governance framework. Additionally, to improve Board director competencies, BNM requires directors of financial institutions to attend its Financial Institution Director Education (FIDE) training program, developed by BNM in collaboration with industry associations. Overall, while the expectations articulated within BNM's corporate governance guidelines are extensive in scope, and reflect high standards, some key guidance is now dated[8], and the overlap of various guidelines creates the potential for insurer misunderstandings of BNM's expectations, despite the reinforcing nature of BNM's supervisory focus on corporate governance and the FIDE program. BNM has indicated that it plans to harmonize, update and codify certain aspects of its corporate governance expectations, both through the issuance of new/updated BNM guidelines and through proposed legislation.

[8] For example, BNM's *Prudential Framework of Corporate Governance* guideline was issued approximately ten years ago, and references as 'best practices' certain key considerations that BNM currently views as required practices for insurers.

Assessment	Largely Observed
Comments	Legislation provides broad, but limited, corporate governance requirements. BNM outlines its corporate governance expectations for insurers through various guidelines. Overall, the guidance is extensive in scope and reflects high standards. The expectations are reinforced with insurers through BNM's supervisory focus on corporate governance and its mandatory training program for financial institution directors. Certain key corporate governance guidelines from BNM are due for review. Consequently, to ensure the continued appropriateness and clarity of its corporate governance expectations, BNM should look to update and consolidate its related guidelines where appropriate. In doing so, BNM should take into consideration the recent updates made to the *Malaysian Code on Corporate* Governance, by the Securities Commission Malaysia, that are to be implemented beginning later this year by the companies listed on Bursa Malaysia.
ICP 8	**Risk Management and Internal Controls** The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters, and internal audit.
Description	BNM's expectations for insurer risk management and internal control systems are established within various related BNM issued guidelines[9]. BNM's general expectations are outlined within its *Prudential Framework of Corporate Governance*. It highlights expectations for insurers to have in place a sound risk management and internal control system that is capable of identifying and continually assessing all material risks that could affect their corporate objectives, performance and financial condition. Further, such systems should be designed commensurate with the nature, scale and complexity of its operations as well as keep pace with the changing business operating environment. The general guideline also articulates that insurers should have effective and independent enterprise-wide risk management and robust compliance functions, other BNM guidance highlight specific expectations for risk management, internal audit and actuarial functions. BNM has no specific guideline that details expectations for insurer compliance functions. Additionally, BNM has issued guidance on the outsourcing of insurer activities, which include requirements for outsourcing arrangements to include audit and inspection rights. The IA restricts the ability for insurers to outsource management activities (which could include risk control functions), except to the extent permitted and subject to the requirements set out by BNM (s. 30) BNM has issued various separate risk management and internal control related guidelines for takaful operators, which largely aim to provide similar expectations for takaful operators as exists for insurers, except for areas where there are understood business model

[9] Including within BNM's *Minimum Standards for Prudential Management of Insurers; Guidelines on Directorship for Takaful Operators; Prudential Framework of Corporate Governance; Guidelines on Audit Committees and Internal Audit Function; Guidelines on Internal Audit Function of Licensed Institution; Guidelines for Audit Committees and Internal Audit Department (Part A); Guidelines on Outsourcing for Insurers; Guidelines on Outsourcing for Takaful Operators; Guidelines on Takaful Operational Framework; Risk-Based Capital Framework for Insurers; and Guidelines on General Reinsurance Arrangements.*

	differences, such as matters involving a takaful operator's Shariah Committee. Expectations from BNM's guidance are further augmented by BNM's supervisory process, which places a significant emphasis on evaluating the structure, independence and demonstrated effectiveness (based on detailed criteria) of insurer enterprise-wide risk management, internal audit and compliance functions. Further supervisory work is also done on the independent risk management role of insurer actuaries, and their adherence to good practice and BNM requirements. In some areas, BNM's supervisory expectations for insurer risk control functions of insurers go much further, in terms of promoting high standards for effective and independent control functions, than BNM's own issued regulatory guidelines – an example of this is BNM's supervisory criteria and expectations for insurer compliance functions, which is not specifically covered by BNM's regulatory guidance. Overall, while the expectations articulated within BNM's risk management and internal controls related guidelines are wide in scope, and many reflect high standards, some key regulatory guidance is now dated[10], and gaps exist between the expectations that BNM's supervisory criteria imposes on insurers and the expectations (or lack thereof) within the regulatory guidelines that BMN has issued. BNM has indicated that it plans to harmonize, update and codify certain aspects of its corporate governance expectations, both through the issuance of new/updated BNM guidelines and through proposed legislation. Recently, BNM issues a concept paper: *Risk Management Guidelines – Risk Governance*, which aims to address various gaps in current regulatory guidance. BNM indicated that it will be finalized and targeted for implementation in 2012.
Assessment	Largely Observed
Comments	BNM outlines its risk management and internal control expectations for insurers through various guidelines. Overall, while the expectations articulated within BNM's risk management and internal controls related guidelines are wide in scope, and many reflect high standards, some key regulatory guidelines are due for review. Consequently, to ensure the continued appropriateness and clarity of its risk management and internal control expectations for insurers, BNM should look to update its related guidelines where appropriate. The finalization and implementation of BNM's recent concept paper on risk management governance, which BNM indicates will occur later in 2012, should assist in addressing current gaps identified by BNM.

[10] For example, BNM's *Prudential Framework of Corporate Governance* guideline was issued approximately ten years ago, and references as 'best practices' certain key considerations that BNM currently views as required practices for insurers. – such as there should be reporting to the Board on the major risks facing the insurer which are likely to affect the performance and financial condition of the insurer, and that such risks should be assessed on an integrated basis, combining exposures across business activities, group entities and regional markets.

ICP 9	**Supervisory Review and Reporting** The supervisor has an integrated, risk-based system of supervision that uses both off-site monitoring and onsite inspections to examine the business of each insurer, evaluate its condition, the quality and effectiveness of its Board and Senior Management and compliance with legislation and requirements. The supervisor obtains the necessary supervisory information to conduct effective supervision of insurers and evaluate the insurance market.
Description	BNM has put in place a financial stability framework that encompasses both micro and macro prudential supervision, specifically creating a Financial Surveillance Department with a mandate to perform integrated macro surveillance and undertake measures to preserve stability of the financial system, including crisis management and resolution measures. For micro-level supervision, BNMs' supervisory framework (SuRF) provides a risk-based systematic process for the assessment of the safety and soundness of insurers, utilizing both off-site monitoring and on-site inspections. BNM is empowered by legislation to conduct on-site inspection, without any prior notice, and gather information deemed necessary to perform its duties (IA s.99-100, TA s.33). BNM supervisors set the scope of on-site examinations based upon its risk-based supervisory strategies for that insurer, and this often includes the periodic verification of financial and other reports submitted to BNM by the insurer. BNM's outsourcing guidance requires that provisions be included within service agreements that allow BNM rights to examine books and records, as well as internal audit reports, of insurer service providers. A Relationship Manager (RM) is focal point for supervision of his/her assigned insurers, serves as BNM"s primary contact with the insurers, and is responsible for performing continuous surveillance and supervisory activities over the insurer. RMs are accountable for developing an understanding and knowledge of the insurers and making supervisory assessment as well as improvement recommendations relating to the insurers. Such assessments are based on an analysis of information from many sources, including insurer required submissions, management reports, internal and external audit reports, actuarial reports, interviews with insurer staff, and publicly available information. Information is also utilized from thematic inspections, which are carried out to identify practices of individual insurers and the industry in relation to expectations set by BNM. SuRF requires RM supervisors to develop an understanding of the business activities and operations of insurers through 'knowledge of business' (KoB) analysis, which utilizes inputs from internal specialist groups and others (such as external auditors), and feeds into the development of a supervisory strategy. Supervisors are also required to conduct detailed assessments of the risks inherent in the significant activities of insurers, quality of risk management systems employed to mitigate the risks, adequacy of capital to cushion for residual risks (including assessment of earnings performance in regard to their ability to contribute towards capital generation) as well as the institution's compliance with the applicable laws and regulations. BMN utilizes internal specialists, as necessary, to assess technical or complex insurer credit, market, operational and insurance risks. Based on the SuRF process, each insurer is assessed a 'composite risk rating' (CRR), commensurate with its determined risk profile. For insurers with 'above average' or 'high' CRRs, an intervention stage rating may also be assigned (based on BNM's *Supervisory Intervention Guide*, or SIG) which will trigger increased monitoring and intervention actions from BNM supervisors.

	BNM will issue interim supervisory letters to the Boards of insurers when material supervisory concerns are found during on-site examinations, and annual supervisory letters outlining any prudential concerns, required actions, and BNM's assessment of the insurer's financial health, including its CRR. BNM supervisors are expected to follow-up on issues and track completion of insurer required actions. SuRF involves an ongoing/ continuous supervisory assessment which combines both off-site monitoring and on-site inspection, with feedback loops to periodically update the KoB and revisit supervisory strategies, which is done at least on an annual basis, more often unforeseen events significantly alter the risk profile of an insurer BMN's SuRF and SIG is a structured system of assessing the risks of insurers, taking into account their nature, scale and complexity. In applying SuRF, large and complex insurers are subjected to more BNM scrutiny. In applying SIG, insurers with higher CRRs will be subject to higher levels of monitoring and intervention/ enforcement actions from BNM. The nature, scope, frequency and intensity of supervisory activities are commensurate with the risk profiles of insurers. Information is a key aspect of the entire supervisory assessment process. In this regard, BNM requires: • All insurers to submit various detailed financial and non-financial information, including actuarial and solvency position reports, in the form and at set intervals prescribed by BNM; • Senior officer sign-off, often from the CEO, on prescribed information submissions to BNM, and resubmission where inaccurate or incomplete information has been filed; and • Audited annual financial statements to be filed, as required by legislation (IA s.87, TA s.41(2)), as well as external auditor certified year-end risk-based capital returns. BNM outlined that it periodically reviews its reporting requirements, which in practice takes place every 2 to 3 years. BNM is not legally empowered to require holding companies or other non-BNM regulated entities within insurance groups to submit information to it. BNM indicated that proposed legislation will contain specific provisions that will explicitly empower BNM to regulate and supervise authorised financial holding companies and all their related entities, BNM will then have the power to require any group entities to provide information to it for supervisory purposes.
Assessment	Observed
Comments	BNM's supervisory framework is an integrated risk-based system that uses both off-site monitoring and on-site inspections to assess the overall risk profile of the insurer - based upon insurer business activities, inherent risks, the quality of risk management activities, compliance with legislative and supervisory requirements, and financial and solvency condition. BNM collects extensive information, on both a regular and ad hoc basis, and as deemed

	necessary to conduct effective supervision of insurers and to evaluate the insurance market. Note that group-wide supervision considerations are addressed under ICP 23. BNM's SuRF may not be appropriate for use on certain types of supervisory reviews, such matters are discussed within ICPs 18, 19, and 21.
ICP 10	**Preventive and Corrective Measures** The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.
Description	BNM has various legislative powers, including enforcement powers, and responsive administrative processes and practices, to prevent and correct unsafe and unsound business practices of licensed insurers and takaful operators (as well as those operating without a license). Under the IA, BNM can appoint an investigating officer, who would have wide-ranging investigation powers, if it believes an offence has been committed under legislation (s. 103-104). Severe penalties exist for obstruction of the investigating officer, including imprisonment (s. 104). The TA allows BNM similar investigation powers, but more specific to certain violations of the Act. For example, the IA provides for a penalty of imprisonment for ten years or ten million ringgit or both if a person carries out insurance activities without the necessary licence (IA s.9-10). The TA carries similar provisions, although much less severe (TA s.4-5), and allows BNM to investigate financial and other records (s.7). The powers which are provided under IA and TA are complemented by various prudential and operational guidelines and circulars to enable BNM to take preventive and corrective actions and impose penalty or sanction on the wrong-doings and non-compliance of the requirements set in the legislations and guidelines/circulars. The specific powers and actions available to BNM are covered in more detail within ICP 11. In practice, BNM 's supervisory processes aim at early identification of prudential concerns and legislative compliance issues, and for insurers to take preventative/corrective actions, before such matters are deemed concerning enough to require that legislative preventative/corrective enforcement tools and measures be invoked. The supervisory framework (SuRF) is designed to allow for early the identification and reporting of prudential and compliance concerns, and BNM formally communicates such concerns to insurer senior management and Boards and seeks actions to rectify the concerns, with follow-up activities as necessary. SuRF is complemented by BNM's Supervisory Intervention Guide (SIG), which identifies one of six stages ratings (stages 0 – 5) for each insurer. For insurers that fail to rectify substantive concerns, or if they maintain higher risk profiles, the application of BNM's Supervisory Intervention Guide (SIG) will result in the escalation of the supervisory intervention stage rating, with increasingly more severe and intrusive BNM interventions to be expected. BNM communicates to the insurer's senior management and Board its evaluation of the company's risk profile and the insurer's composite risk rating (CRR) under SuRF. At the time of the assessment, BNM did not communicate its SIG rating for the company. The SIG rating effectively identifies the seriousness with which BNM views the prudential issues at the insurer and the potential for it to run into viability concerns in future. Subsequent to the assessment, BNM indicated that it had implemented a new practice of disclosing SIG ratings to insurers.

	Key supervisory actions are required to be discussed at FSOC[11] to ensure proper checks and balances, and consistency in BNM's policies and actions across different segments of the financial sector. BNM advised that proposed legislation will strengthen BNM's intervention and resolution powers in respect of issuance of directions of compliance at earlier stages to licensed insurers and takaful operators, and their directors and officers, if they engage in any conduct that may adversely affect the safety and soundness of the institutions or that are detrimental to the interests of policyholders. Additionally, the new law will have more severe penalties applicable for specified contraventions.
Assessment	Observed
Comments	The legislative, administrative and supervisory frameworks in place promote the ability for BNM to take timely, suitable and necessary preventative and corrective measures to achieve supervisory objectives. BNM's early intervention supervisory approach under SuRF, and increasing supervisory intensity and severity of measures under SIG, allow for remedial actions to be taken by insurers before problems become worse. BNM is active in communicating prudential and non-compliance issues to insurers, as well as in indicating actions and timeframes for corrective actions to be taken.
ICP 11	**Enforcement** The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	As identified within ICP 10, BNM has various legislative powers, including enforcement powers, and responsive administrative processes and practices to prevent and correct unsafe and unsound business practices of licensed insurers and takaful operators (as well as those operating without a license). Legislation provides clarity on applicable sanctions and penalties, and grants powers to compound offenses (ICA s.211, TA s.61). The existing framework does not promote the introduction of civil and administrative penalties in addition to criminal penalties under the existing legislation The powers provided under IA and TA are complemented by various prudential and operational guidelines and circulars to enable BNM to take corrective action and impose penalty or sanction for wrong-doings and non-compliance of the requirements set in the legislations and guidelines/circulars. BNM 's supervisory processes aim at early identification of prudential concerns and legislative compliance issues, and for insurers to take preventative/corrective actions, before such matters are deemed concerning enough to require that legislative preventative/corrective tools and measures be invoked. In such situations, BNM would look to take enforcement actions if insurers are not responsive to correcting serious prudential or non-compliance issues.

[11] FSOC comprises of Governor, Deputy Governor of Supervision Sector and Assistant Governors of Regulations and Supervision Sectors.

	BNM has general powers to pursue enforcement of corrective action in a timely manner where problems involving insurers are identified, this includes powers to issue direction or order to insurers to take a particular action or to desist from taking particular action in relation to itself, its business, directors or employees where BNM is satisfied that the insurers are carrying on business in a manner detrimental to the interests of their policy owners / participants, creditors, or the public generally (IA s.59(2), TA s.47(1)). The IA provides for the expediency of enforcement (under 59(6) as an order under IA section 59 may be made first and the opportunity to make representation could be given immediately after the order has been made if the delay would be detrimental to the interests of the licensed insurer, its policy owners or the public generally. In addition to the general powers, the IA and TA provide BNM specific powers to address certain situations. BNM outlined that its authority to take timely preventive and corrective enforcement measures on licensed insurers and takaful operators is largely provided by the following legal provisions (although others provisions may also apply in specific situation):

	Range of Measures	IA	TA
1	Direction of compliance	S59	S47
2	Business restrictions	S6	S47
3	Removal of directors	S59	S47
4	Removal of officers	S59	
5	Appointment of advisors	S59	
6	Assumption of control	S59	
7	Capital reduction	S64	
8	BNM to specify person to be appointed as liquidator	S115	
9	BNM may present a petition to the Court for winding-up	S112	S48
10	Suspension/ revocation of license	S31	S11, 37(5), 38(5)
11	Investment restrictions	S45	S17

Many of these enforcement measures require Ministerial approval to be invoked, such as the substantive provisions under section 59 of IA and section 47 of the TA. The requirement for Ministerial or court approval largely relates to enforcement matters dealing with employment/property rights or legal due process. In some instances, legislative requirements may be inconsistent with other powers provided to BNM. For example, IA s.59(3) requires Ministerial approval for the removal of insurer Board directors, while BNM has full authority to approval or reject an application for Board director reappointments following their (maximum three year) term. Various enforcement measures also have specified legislative conditions under which those measures can be utilized, such as IA s31 which specifies the conditions which could trigger a license revocation action.

The legislative and administrative enforcement powers allow BNM to issue, directly or indirectly:

- Restrictions on business activities, including; prohibiting the insurer from issuing new policies, withholding approval for new business activities or acquisition, restricting asset transfers, restricting the ownership of subsidiaries and restricting activities of a subsidiary (where, in BNM's opinion, such activities jeopardise the financial situation of the insurer).

- Directions to reinforce financial positions, including; requiring measures that reduce or mitigate risk; requiring capital levels to be increased; restricting or suspending

	dividend or other payments to shareholders; and restricting an insurer's purchase of its own shares • Other directions, including; arranging for the transfer of obligations under the policies from a failing insurer to another insurer that accepts this transfer; revoking the licence of an insurer; barring individuals acting in responsible capacities from such roles in future; controlling owners replaced or their powers restricted, replacing directors and managers or restricting their powers; replacing external auditors. • The application of various sanctions, including; sanctions against individuals who fail to provide information to the supervisory authority in a timely fashion, withhold information from the supervisory authority, provide information that is intended to mislead the supervisory authority IA section 59(4) empowers BNM, upon Ministerial approval, to assume control of or to carry on the whole or part of the insurer's property, business and affairs or for BNM to appoint an appointed person to do so on its behalf. In this regard, upon BNM assuming control of an insurer, it would have the power to sell the insurer's business or alternatively to run off its liabilities. Under the PIDM Act 2011, BNM may give written notification to PIDM if BNM is of the opinion that an insurer/a takaful operator has ceased to be viable or is likely to become non-viable, based on the various criteria, which are covered in more detail under ICP 12. In practice, when serious matters arise where an insurer or an individual is found to have committed wrongdoing or is acting imprudently, facts of the case will be compiled and analysed and subsequently referred to BNM's Legal Department to ensure enforceability of actions, penalties and sanctions. Based on SIG and views of the BNM Legal Department, a final enforcement proposal will be presented to the FSOC, which was set up to deliberate and decide on policies concerning the financial sector. FSOC, in making its decisions, aims to ensure consistency in determining the course of action against an insurer. BNM does not make publically available information relating to the criteria or basis for its enforcement decisions or actions. BNM highlighted a number of cases where enforcement actions were taken against insurers for compliance and/or imprudent practices, including where BNM had assumed control of an insurer. The cases also highlighted that the requirements for Ministerial approval for BNM to invoke many of the serious enforcement actions available under legislation has not been seen as a practical impediment to BNM's enforcement activities. BNM indicated that proposed legislation will enhance both the penalty and intervention frameworks, including the introduction of administrative penalty and civil penalty and the widening of options for supervisory/regulatory actions to address wrongdoings and to rectify any safety and soundness concerns/issues of insurers. The objective of the proposed legislation will be to provide greater deterrence against any wrongdoings or activities which are likely to affect the safety and soundness of the insurers and to ensure that the criteria and circumstances for the enforcement of corrective and punitive actions are as clear and as transparent as possible. BNM also indicated that it will work towards making public the criteria or basis for BNM's enforcement and corrective/ intervention actions.
Assessment	Largely Observed
Comments	The legislation and administrative framework in place provides BNM with the ability to pursue a wide range of enforcement actions. Many examples were identified where BNM

	utilized a wide-range of substantive enforcement powers under legislation. To ensure consistency, BNM decisions on enforcement actions are made through internal committee, but it does not make publically available information relating to the criteria or basis for its enforcement decisions or actions. While BNM does not have the authority to invoke some substantive enforcement actions without Ministerial approval, this has not been seen by BNM as practical impediment to its enforcement activities. To enhance the structure and effectiveness of the enforcement regime, consideration should be given to: • Better aligning the need for Ministerial approval for enforcement actions within legislation with clearer objectives and purpose for such powers; • Enhancing the range and options of the enforcement tools available to BNM, and the deterrence measures within legislation; and • Making the criteria or basis for BNM's enforcement decisions or actions more transparent. BNM has indicated that new legislation will address some of these considerations by providing greater clarity and more explicit powers for more efficient and effective enforcement of corrective actions and imposition of sanctions.
ICP 12	**Winding-up and Exit from the Market** The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimizing disruption to provision of benefits to policyholders.
Description	Legislation provides for a wide range of options/ measures that can be employed to exit an insurance legal entity or a takaful operator. These measures include the power to direct an assumption of control, transfer of business, cancellation of paid-up capital which is lost or unrepresented by available assets and subsequently allotting new shares to persons other than the existing shareholders, as well as winding-up of an insurance legal entity or takaful operator. Part X of the IA defines the procedures that need to be complied with when dealing with insolvency and the winding up of insurers. The procedures include issuance of notices, matters related to the appointment of liquidator, application of insurance funds and the valuation basis for the assets and liabilities of the existing insurer in respect of winding up. CA complements IA and TA in setting out the modes and circumstances for a winding up to take place (Part X of CA) which is applicable to both insurers and takaful operators. In addition, the Companies (Winding up Rules) lays out the procedures to be adhered to when petitioning for a winding up. Under IA and TA, BNM may present a petition to the Court for the winding up of an insurer or a takaful operator when the business is being carried out in a manner detrimental to the interest of its policyholders, creditors, takaful participants, operators or the public. Other persons may also petition the court for the winding up of an insurer by the Court, but must

	also deliver that petition to BNM, and BNM is entitled to appear and be heard in all proceedings relating to the petition. In either case, upon court approval, BNM can appoint a liquidator to handle the winding up of an insurer or takaful operator. IA further provides that the petition order shall only be made once an insurer, its employee, director or person has been given a reasonable opportunity to make a representation in writing to BNM or the Minister, although there are provisions that allow for an order to be made first, and then the opportunity to make representation to immediately follow, if any delay would be detrimental to the interest of the insurer, its policyholder or the public generally. While there is a wide range of options for the exit of insurance legal entities and takaful operators from the market, BNM has not petitioned to the Court for the winding up of any troubled insurance legal entity since IA came into force in 1997, or any takaful operators under TA 1984. It is BNM's operating policy to adopt the least-cost resolution method and minimal-disruption option for the resolution of troubled insurance legal entities or takaful operators. BNM indicated that, thus far, it has been utilising the power under section 59 of IA (with Ministerial approval) to assume control and to require disposal of business to resolve the problems of the troubled insurance legal entity. Legislation gives a high legal authority to the protection of the rights and entitlements of policyholders. IA imposes a restriction on the winding up of local insurers by providing that the voluntary winding up of local insurers (whether or not its licence has been revoked), under CA or by the Court, is not allowed except after the transfer of the whole of its business to another insurer. The imposition of this restriction is to protect the interest of policyholders. IA further provides that in the winding up of an insurer, the assets of an insurance fund shall be applied to meet its liabilities to policyholders and claimants under policies of that class of insurance business and these liabilities have priority over unsecured liabilities other than preferential debts (wages etc., as specified under CA section 292(1)). The TA provides that in the event of a winding up, the assets comprised in the takaful fund shall be applicable only to meet such part of the operator's liabilities and expenses as is properly so attributable. Apart from the above legal powers, BNM also has in place a regulatory framework, which provides for the determination of the point at which it is no longer permissible for an insurer to continue its business. The implementation of the intervention and resolution powers of BNM are as set out within its SIG process, which stipulates the different levels of supervisory actions and oversight for different SIG stage ratings. Insurers that BNM assesses as 'stage 5' would not be viewed as viable. In determining whether an insurer has ceased to be viable or is likely to cease to be viable, BNM takes the following factors into consideration: • The institution is not following sound business and financial practices and further regulatory directives would not reasonably improve the institution's prospects to restore or preserve its financial soundness; • The shareholders are unlikely to restore the institution's capital to the regulatory level within a reasonable time frame and failure to do so would jeopardise the interests of the policyholders or takaful participants; • The institution is dependent to an excessive extent on loans, advances, guarantees or other financial assistance to sustain its operations; or • The institution has lost the confidence of policy holders, takaful participants and the

	public. These factors are also set out in the Strategic Alliance Agreement signed between PIDM and BNM and aim to ensure that institutions are placed into resolution in a timely manner. While clear non-viability triggers are not prescribed by legislation, in practice BNM works closely with PIDM in evaluating the condition of problem institutions and possible resolution considerations. Information sharing arrangements exist between BNM and PIDM to better facilitate a cooperative process in determining appropriate intervention and resolution strategies. The collaboration between BNM and PIDM in the consideration of intervention and resolution strategies provides check and balance and may reduce the use for regulatory forbearance in addressing problems of troubled insurers. The introduction of the revised PIDM Act (2011) widens the PIDM's mandate to intervene or resolve troubled institutions which have ceased to be viable or which BNM considers likely to become non-viable in the best interest of the policyholders and takaful participants, as well as to ensure prompt payments are made to policyholders and takaful participants to minimise disruption to the provision of benefits of policyholders. It specifies the circumstances in which PIDM can take comprehensive resolution and intervention actions against an insurer which is facing severe financial difficulties. If BNM is of the opinion that an insurer has ceased to be viable or is likely to cease to be viable, BNM may notify PIDM under section 98 of PIDM Act. Upon receiving written notification from BNM, PIDM is empowered to intervene and resolve troubled insurers by exercising various powers under section 99(1) of PIDM Act. The Act empowers PIDM with a range of tools and measures including designating a bridge institution to temporarily assume the commitments of a non-viable institution as a resolution option (section 99 of PIDM Act), as well as arranging to transfer policies/certificates from a distressed insurer/takaful operator to another insurer/ takaful operator. Such options are especially beneficial for life insurance and family takaful consumers as it secures the continuity of insurance/ takaful coverage for policyholders/ takaful participants and minimises the disruption of timely provision of benefits to policyholders/takaful participants/claimants. In terms of policyholders/claimants' compensation under PIDM Act (known as TIPS), the maximum coverage limits are estimated to provide for the protection of about 95% of policyholders/claimants in full. TIPS, which replaces the existing IGSF administered by BNM, operates as an explicit compensation scheme to protect consumers of the insurance and takaful industry in the event of a failure of an insurer or takaful operator. Under TIPS, the maximum level of protection is predetermined to provide greater certainty, assurance and full protection to the vast majority of policyholders and takaful participants in the insurance and takaful industry. The collaboration between BNM and PIDM in the implementation of intervention and resolution powers provides check and balance in the regulatory framework as well as minimises regulatory forbearance in addressing problems of troubled insurers. BNM indicated that proposed legislation will aim to better harmonize the protection available for consumers of insurance and takaful products.
Assessment	Observed
Comments	There is an extensive legislative framework in place for the winding-up and exit of insurers

	from the market, which provides for a range of failure resolution options and appropriate priority protection for policyholders. Upon BNM's determination of insurance non-viability, PIDM is empowered to intervene and resolve troubled insurers, with the aim of minimizing costs to the financial system. To ensure greater understandability and consistency in intervention and resolution practices, consideration should be given to more clearly defining 'non-viability' triggers within legislation.
ICP 13	**Reinsurance and Other Forms of Risk Transfer** The supervisor sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programmes. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.
Description	Legislation requires insurers and takaful operators to ensure that their reinsurance/ takaful arrangements are consistent with sound insurance/ takaful principles respectively (IA s.57, TA s.23). Further, the IA provides BNM with a wide range of powers to rectify reinsurance arrangements that it considers to be unsuitable, based upon specified IA criteria which includes that the reinsurance arrangements are not technically appropriate to the portfolio of the licensed insurer. Within its guidance on corporate governance[12], BNM outlines its expectations on the role and responsibilities of the Board in setting a clear framework and policies for, among others, underwriting, reinsurance and claims management. In Malaysia, the utilisation of reinsurance is significantly higher in the general insurance business, while the direct life insurers generally maintain high retention levels. BNM has specific detailed guidelines only on the use of general reinsurance[13]. BNM also has many other prudential and administrative guidelines, covering life and/or general insurance, that partially of indirectly address various reinsurance related expectations. For general insurance business, the *Guidelines on General Reinsurance Arrangements* (which BNM indicates was introduced in the 1990's) sets out standards for sound and prudent reinsurance policies and practices, including considerations for the appropriateness of retention level, the security of reinsurers,[14] the spread of reinsurers to avoid concentration of counterparties, the appropriateness of reinsurance contract terms/ wording, and specific reinsurance placements issues. It requires insurer Boards to confirm, in an annual 'written declaration' to BNM, that the reinsurance arrangements are adequate in relation to the business profile and that its reinsurers are of good security. BNM indicates that some insurers set their own reinsurance security and suitability criteria, exposure limits or

[12] Specifically, BNM's expectations are within its *Guidelines on Minimum Standards for Prudential Management of Insurers* and *Guidelines on Directorship for Takaful Operators*.

[13] Specifically, these include the *Guidelines on General Reinsurance Arrangements and Guidelines* on the *Role of Insurers and Brokers in Reinsurance*.

[14] For overseas placements, the guideline requires insurers to place reinsurance with foreign reinsurers which have a minimum rating of 'A' by an accredited rating agency, or have a combined paid-up capital and surplus of at least US$150 million.

	concentration limits which are more stringent than BNM's requirements. As stipulated in the *Guidelines on the Role of Insurers and Brokers in Reinsurance*, BNM requires full transparency in all reinsurance coverages, and all treaty documents and facultative reinsurance policies should be received within 90 days of inception of risk. BNM subjects domestic reinsurers to the same supervisory standards as those that are applicable to direct insurers. BNM has no formal supervisory recognition arrangements relating to reinsurers. For placement of general reinsurance with foreign reinsurers (not licensed to operate in Malaysia), collateral/reserve deposit is required in order to safeguard the safety and soundness of insurers. Insurers can only recognise reinsurance credits in the unearned premium reserves to the extent of deposits retained from the reinsurers (other than for special risks). For life insurance, the recognition of reinsurance credit for cessions to foreign reinsurers is only allowed if the insurer holds an equivalent deposit from the reinsurer. For life insurance business, BNM requires the insurer's AA to assess the suitability and adequacy of the entire reinsurance programme and to formally report the assessment in the annual Financial Condition Report (FCR), which is required to be presented to the Board under *BNM's Guidelines on Financial Condition Report*. BNM's prudential requirements for retakaful arrangements are broader and not as detailed compared to the requirements relating to conventional reinsurance. BNM indicates that specific requirements relating retakaful arrangements will be enhanced and new guidelines issued, in line with the future growth of retakaful utilisation. BNM requires insurers to report their reinsurance arrangements and exposures as part of the statutory reporting requirements. BMN imposes no additional public disclosure requirements on reinsurance transactions beyond what is required under IFRS 4. BNM has no explicit approval requirements for insurer use of non-traditional risk transfer arrangements, but expects that insurers would seek their approval before entering into such transactions. To date, there has not been any reinsurance transaction involving risk transfer to the capital markets in Malaysia.
Assessment	Largely Observed
Comments	BNM has a well-established legal and administrative framework with respect to the use of reinsurance, particularly for general insurers, with communicated expectations that insurers adequately control and report on their risk transfer programmes. BNM's supervisory activities reinforce good reinsurance management practices by insurers. BNM's key detailed guideline on reinsurance arrangements is due for review, and it does not extend to life reinsurance. Consequently, to ensure the continued appropriateness and sufficient scope of its reinsurance management expectations for insurers, BNM should look to update and expand its related guidelines where appropriate.
ICP 14	**Valuation** The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.

Description	The financial reporting framework for all insurers and takaful operators in Malaysia is governed under FRA and CA, both require all reporting entities to comply with MFRSs issued by MASB (FRA s.26D, CA s.166A). Effective January 1 2012, Malaysian financial reporting standards (MFRSs) are in full compliance with IFRS as issued by IASB. Under legislation, BNM may prescribe the basis for the determination of insurance fund assets, insurance fund technical provisions and insurance fund financial liabilities of licensed insurers (IA s.44). A similar provision exists in the legislation takaful operators (TA s.41). For solvency purposes, BNM effectively uses IFRS as the valuation basis with prescribed requirements in certain areas outlined in BNM guidance. The requirements regarding the valuation of technical provision are detailed out by BNM through guidelines and the *Risk Based Capital Framework for Insurers* (RBC), *Guidelines on the Valuation Basis for General Takaful Business* and *Guidelines on the Valuation Basis for Family Takaful Business*. The technical provisions of life insurers and family takaful operators are measured using a prospective actuarial valuation based on the sum of the present value of future guaranteed benefits, and in the case of a participating life policy, appropriate level of non-guaranteed benefits. It further takes into account expected future management and distribution expenses, less the present value of future gross considerations arising from the policy discounted at the appropriate risk discount rate All options and guarantees offered under a life insurance or family takaful policy are required to be explicitly identified and quantified as part of the technical provisions. The RBC Framework for Insurers requires that stochastic methods be used for the valuation of options and guarantees unless only a small portfolio of these products are written and the guarantee features are simple and short-term in nature in which case deterministic methods may be allowed. Explicit allowance for lapses and surrenders are incorporated in the projections of future cash flows that are used to determine technical provisions. It is also a requirement that policyholders' behaviour due to specific features of the product or market condition be explicitly taken into account in determining the appropriate lapse assumption. Surrender value floors are not taken into consideration in the determination of technical provisions but are considered at the capital level. An appropriate allowance for adverse deviation (Margin over the Current Estimate or MOCE) from expected experience is required in the valuation of non-participating life policies, the technical provision backing the guaranteed benefits of participating life policies and the non-unit liabilities of investment linked policies, participant risk funds and shareholders' funds of takaful operators. The MOCE is required to explicitly provide for adverse deviation in addition to the CE such that the overall technical provision achieves a 75% confidence level. The MOCE is achieved by coherently adjusting the different valuation assumptions such that the total technical provision achieves the specified confidence level. This will lead to a reduction in the MOCE over time as uncertainty reduces and the contingent payoffs become more certain with the passage of time. Consequently, while the methods for determining MOCE are not explicitly prescribed, the identified aim is have a 75% confidence level on the overall guaranteed liabilities. The methodologies used by insurers to determine the MOCE are reviewed as part of the supervisory process.

	The prescribed risk discount rate for the technical provisions backing the guaranteed benefits of participating policies, non-participating policies, the shareholders' fund of takaful operators and the participant's risk fund of family takaful policies, is the Malaysian Government bond spot-rate curve. Under the exceptional circumstances of the recent global financial crisis, BNM had amended its existing valuation rules regarding the appropriate discount rate to use in the valuation of technical provision for life insurers in 2009. Instead of the Government spot rate curve current at the date of valuation, a weighted curve over several past periods was prescribed in order to lend stability to the valuation. However as markets stabilized, this temporary requirement was removed beginning 2011. The measurement of technical provisions for participating policies involves taking the higher of the guaranteed benefits discounted at the risk free rate, and the total benefits liabilities discounted at the fund based yield. The fund based yield is the Actuary's best estimate of the long-term investment return of the participating fund. The prescribed risk discount rate for the technical provisions backing the guaranteed benefits of participating policies, non-participating policies, the shareholders' fund of takaful operators and the participant's risk fund of family takaful policies, is the Government bond spot-rate curve. The technical provisions of general insurers consist of claims liabilities and premium liabilities. Claims liabilities can be broken down into a case-by-case reserve and reserve for claims that are incurred but not yet reported (IBNR). Case-by-case reserves are assessed per claim according to the latest information on the amount of liability to the insurer from a particular claim. IBNR reserves are determined on a portfolio basis by class of business using appropriate statistical methods with best estimate assumptions about the future development of claims. Premium liabilities are measured as the higher of unearned premium reserve and the unearned risk reserve together with a MOCE. The MOCE for general insurers are derived separately as percentages of best estimate claim liabilities and best estimate premium liabilities. As they are linked, a reduction in the best estimate liabilities as uncertainty reduces will cause a reduction in the MOCE. There is no explicit requirement for general insurers to discount their liabilities. BNM notes that companies with longer-tailed portfolios do apply discounting to their technical provisions. The companies that do not discount tend to have portfolios with shorter tails where the impact to technical provisions from discounting would be minimal. Further, the decision to discount technical provisions is required to be consistent from year to year with any departure requiring justification. While the valuation of technical provision necessarily involves a significant amount of judgement, this process is facilitated by governance over the selection of methods and assumptions by the professional actuarial bodies through the issuance of practice standards and a code of conduct. All Appointed Actuaries and Signing Actuaries are required to be Fellow members of these actuarial bodies with sufficient post qualification experience before they are allowed to assume these roles.
Assessment	Observed
Comments	For solvency purposes, BNM effectively uses IFRS as the valuation basis with prescribed requirements in certain areas outlined in BNM guidance. The technical provisions reflect the present value of relevant cash flows, with a MOCE, and a requirement for discounting for life insurers.

	BNM indicated that it plans to conduct more detailed assessments and benchmarking of the methods used to for MOCE determination, so as to strengthen processes, promote better comparability, and ensure regulatory objectives are being met. BNM should review the extent to which current valuation approaches for solvency purposes adequately meet regulatory objectives during 'normal' stress periods, so that temporary adjustments to valuation approaches need only be considered during truly anomalous economic conditions, such as those existing around 2008-09.
ICP 15	**Investment** The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.
Description	IA empowers BNM to prescribe the manner in which an insurer invests its assets (s.45), and outlines requirements relating to the safekeeping of assets (s.48), requiring insurers to ensure that documents evidencing the insurer's title to assets are held by or on behalf of the insurer and these documents are kept in Malaysia in the custody of the insurer or a banking institution or in a manner approved by BNM. BNM's *Risk Based Capital Framework for Insurers* (RBC) details BNM's expectations and capital implications for the investment activities of insurers. Specifically, RBC includes: • Expectations for insurers to have in place an overall investment strategy and risk management policy (addressing specific considerations) that is in line with the risk appetite approved and reviewed regularly by the Board; • Differentiation of the credit risk capital charge on assets based on risk and security of the counterparty, allowing for lower charges with collateralization or guarantee enhancements; • Maximum limits (as a percentage of total assets) that each of the life insurance, general insurance and shareholders' fund can hold for less secure asset classes, such as a maximum 5% exposure to non-investment grade debt securities, 5% limit for shares not listed on the Main Market of Bursa, and an absolute limit on foreign assets in jurisdictions with sovereign ratings at least equivalent to that of Malaysia (10 percent); • Specifications for general insurance funds for a minimum ratio of 10% liquid assets and a maximum of 20% invested in immovable properties; • Maximum limits for exposure to individual counterparties, with an asset concentration risk charge of 100% in excess of the limit; • Lower interest capital charges better matching of asset and liability durations. A key challenge for insurers in matching the assets and liabilities is due to insufficient long term fixed income instruments in the Malaysian market. For takaful operators, TA specifies the requirements that at least 80% of total assets in Malaysian assets, with at least 15% invested in the securities of the Federal or State Government (s.17), and requirements on the safekeeping of assets (s.20). Various guidelines address investment related activities of takaful operators, including *Guidelines on Investment Management for Takaful Operators* and *Takaful Operating Framework (TOF)*.

	BNM indicated that it is developing a risk based capital framework for takaful operators. *BNM's Guidelines on Securities Borrowing and Lending* (SBL) specify that such transactions must be collateralized and the acceptable collaterals deposited with either BNM or any authorized depository institution, specifies that the period of any SBL transaction must not be more than 1 month. The *Guidelines on Derivatives for Insurers* outlines prescriptive requirements on the permitted usage of derivatives and its conditions, to address the relatively low level of development of the overall derivatives market in Malaysia and the limited expertise within many insurers in managing derivative associated risks. It restricts the use of derivatives for hedging purposes only. The derivatives exposure of insurers in relation to their total asset is under 5% and the types of transactions prevalent are "plain vanilla" derivatives that are exchange traded and liquid. *The Guidelines on Related Party Transactions for Insurers and for Takaful Operators* outline expectations for transactions between insurers/ takaful operators and their related parties, including the requirement that the terms of the transaction must be fair and reasonable and should be made with reference to an independent valuation or arm's length commercial terms. The *Guidelines on Outsourcing for Insurers and for Takaful Operators* require insurers and takaful operators to effectively manage the risks associated with outsourcing of investment activities to related entities and fund management companies through the adoption of sound and prudent risk management practices. BNM *Guidelines on Financial Condition Report* also specifies that the Appointed Actuary (AA) of a life/family takaful business review and provide a judgement on whether the investment policy and strategy being pursued is appropriate to the nature and term of the policy liabilities and policy owner's' reasonable expectation (PRE). It requires the AA to advise the Board on the constraints or changes needed in order to protect an insurer's financial standing and PRE. This review forms part of the annual FCR that would be presented to the insurer's management and the Board. BNM indicated that it will be issuing a concept paper on managing participating business, which will detail BNM's expectations on investment management and its impact on PRE. While BNM has significant guidance for insurer investment activities, some areas not covered include: • Expectations for insurers to conduct their own due diligence to assess counterparty risk, so as not to rely solely on credit ratings issued by rating agencies; and • The applicability of requirements on a group-wide basis, to cover investment aggregation risk considerations. Investment management activities and controls are examined under BNM's supervisory process.
Assessment	Largely Observed
Comments	Legislation and BNM guidelines set out prudential considerations for insurer investment management activities. In particular, BNM's RBC guideline investment management

	expectations as well as capital changes relating to investment risks. BNM should review its investment related guidelines to identify and implement further enhancements, which should include expectations on insurer use of external credit ratings and investment aggregation risks on a group-wide level.
ICP 16	**Enterprise Risk Management for Solvency Purposes** The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.
Description	BNM has a principle-based approach to the issuance of requirements with regard to enterprise risk management for solvency purposes with the objective of allowing more flexibility for insurers to tailor risk management practices to the nature, scale and complexity of their operations. The *Prudential Framework of Corporate Governance for Insurers* sets out BNM's expectations for insurers to establish an effective risk management system that is capable of recognising and continually assessing material risks that could affect their performance and financial condition. Its guideline *Risk Based Capital Framework for Insurers* (RBC) requires insurers to maintain capital adequacy levels commensurate with their risk profiles and risk management practices at all times. RBC mandates that insurers set an Internal Target Capital Level (ITCL) above the supervisory minimum capital adequacy ratio (CAR) and put in place a capital management plan that will restore their capital levels should it fall below the ITCL due to adverse but plausible scenarios. This requirement explicitly links the risk management profile and practices of insurers with their regulatory capital level. BNM's solvency framework does not allow insurers to use internal models for purposes of minimum regulatory capital determination. Under RBC, each insurer is expected to establish effective procedure for monitoring and managing asset-liability management positions, but this would not require insurers to specify the relationship of ALM activities with product development and pricing functions as part of an overall ALM practice. In practice, ALM considerations are typically taken into account by insurers at the product development stage. BNM also requires the AA of every life insurer to annually prepare a Financial Condition Report (FCR) for the Board on the financial condition of the insurer. The *Guidelines on Financial Condition Report* provide a minimum standard for the FCR and ensures it covers the key areas of operation such as experience analysis, asset-liability management and capital. FCR is complemented by the Dynamic Solvency Test report, as required by BNM's *Guidelines on Dynamic Solvency Testing*. The guidelines require life insurers to project their solvency position forward medium term under adverse but plausible scenarios, some of which are prescribed. The projections are required to take new business into account and thus provide the means to assess the viability of the insurer's medium and longer-term business strategy. BNM's *Guidelines on Stress Testing for Insurers/Takaful Operators* requires insurers to identify potential threats due to exceptional but adverse plausible events. The guidelines require the stress tests carried out to commensurate with the nature, complexity and sophistication of the insurers' business activities. In addition, the stress testing process has to be rigorous and forward looking, take into account second round effects, and consider

	changes in correlations between risk exposures under stress situations. While BNM has many guidelines that outline its expectations on risk management practices[15], it also plans to update some, and introduce new ones, to address identified gaps. BNM plans to issue its *Risk Management Guidelines – Risk Governance* which will further clarify expectations on the roles and responsibilities of the Board and senior management relating to risk management. For example, it will make explicit BNM's expectations for insurers to set risk tolerance limits, beyond operational risk limits. The expected implementation of BNM's *Guidelines on Internal Capital Adequacy Assessment Process for Insurers* in late 2012 will require insurers to set their ITCL, prepare their capital management plan and implement processes that monitor and ensure the maintenance at all times at an appropriate level of capital commensurate with risk profile and risk management practices. The ICAAP requires insurers to factor in risks beyond those covered by RBC when setting their ITLCs. BNM also advised that it is developing RBC for takaful operators, and plans to extend the requirements of the current *Guidelines on Financial Condition Report* and *Guidelines on Dynamic Solvency Testing* to general insurers and takaful operators.
Assessment	Partly Observed
Comments	BNM has many guidelines that promote robust insurer enterprise risk management and governance activities appropriate to the nature, scale and complexity of insurer risks. In particular, BNM's RBC guideline requires insurers to establish links between their risk and solvency capital management activities. BNM's planned near-term changes will address many BNM identified gaps and insurance sector inconsistencies within its enterprise risk management expectations for insurers, particularly the implementation of its new ICAAP requirements and its draft paper *Risk Management Guidelines – Risk Governance*.
ICP 17	**Capital Adequacy** The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.
Description	In 2009, BNM implemented the *Risk Based Capital Framework for Insurers* (RBC) for all insurers as a condition of license under section 23 of IA, replacing earlier requirements under the Margin of Solvency Framework. RBC is sensitive to the key risk categories affecting the individual insurers, with flexibility for insurers to devise their investment strategies accordingly.

[15] These include the *Prudential Framework of Corporate Governance for Insurer, Guidelines on Stress Testing for Insurers/Takaful Operators, Guidelines on Financial Condition Report*, and *Guidelines on Dynamic Solvency Testing.*

	As noted in ICP 14, for solvency purposes, the financial assets and financial liabilities are valued in accordance to FRS set by MASB, which are now in full compliance with IFRS as issued by IASB, with prescribed requirements in certain areas outlined in BNM guidance. The requirements regarding the valuation of technical provision are detailed in the *Risk Based Capital Framework for Insurers* (RBC), *Guidelines on the Valuation Basis for General Takaful Business* and *Guidelines on the Valuation Basis for Family Takaful Business*. RBC was developed based on the total balance sheet approach, with recognition of the inter-relationship between insurance liabilities, financial assets and financial liabilities, regulatory capital requirements and resources available in the assessment of the capital adequacy of the insurers. The formulation of RBC was preceded by an extensive consultation process with the issuance of three consultative papers in 2004 and 2005, survey on the impact of RBC in 2005 and 2006 and feedback from the industry via focus group discussions, and parallel testing. RBC applies risk-sensitive measurement of the capital adequacy of the insurers with: • Pre-defined criteria for resources available (capital available) and a list of capital available; • Statutory capital (capital required) that is aligned to the specific risk credit, market, insurance and operational risk exposures ; and • A capital adequacy ratio (CAR), to measure the relative sufficiency of capital resources available in the insurance and shareholders' funds to support the required statutory capital for the insurer. The components of capital required aim to reflect the underlying volatilities of the exposures to assets and liabilities. BNM indicated that the risk charges to derive the capital required were developed in reference to the Malaysian market conditions based on a series of volatility studies and quantitative surveys of insurers calibrated to pre-determined confidence levels, with selected adjustments made for the purposes of consistency with benchmarked capital frameworks against other jurisdictions as well as similar requirements for the banking sector. Reinsurer counterparty risk capital charges are based on the rating of insurers. RBC recognises the effective use of credit risk mitigants to reduce the credit risk capital, which can either be in the form of eligible collateral or recognised guarantors for the debt exposures of the insurers. Operational risks are based on total assets, used as a proxy given the lack of appropriate data to objectively quantify operational risk. Liquidity risk is not a major concern for insurers, especially for life insurers, as they do not write a significant number of products that may pose material liquidity risk in cases such as mass surrenders. This risk is addressed as part of the prudential limits for general insurance funds only, as general insurance business usually involves contracts which are short term in nature. RBC addresses key risk categories and their aggregation, but does not address the interdependencies between and within risk categories explicitly. The capital requirements under RBC only consider entity-specific risks. There are currently no expectations of capital adequacy assessments for insurance groups.

	Two sets of solvency control levels are established under RBC as triggers for supervisory intervention: • Supervisory Target Capital Level (STCL) – based on the average industry risk level for each business activity mitigated with standard risk management practices, insurers are required to maintain a CAR at 130%, also known as the STCL over a period of 1 year. Breaches of the STCL will be subject to the most severe supervisory actions. The level is set to allow pre-emptive supervisory actions in view of the potential for a quick deterioration in the financial position of insurers under adverse conditions and the significant amount of time required for these insurers to undertake the necessary restructuring or remedial measures; and • Individual Target Capital Level (ITCL) – above the STCL to reflect their specific risk profiles, and capturing risks that are not addressed adequately or not at all under RBC, as well as the adequacy of the qualitative factors such as their governance and risk management practices. In setting the ITCL, insurers are required to take into account plausible adverse scenarios over a one-year time horizon such that the ITCL does not fall below the STCL in the event that such scenarios occur. Breaches of ITCL may result in supervisory actions such as restrictions on the payment of dividends, interest or redemption of capital instruments to prevent further depletion of the capital of the insurers with financial difficulties. The RBC solvency control levels have not been defined in terms of level of protection measures (such as a VAR or tail-VAR measures), but BNM highlighted that a prudent approach was adopted in deriving the risk charges for the STCL. In addition, BNM views that an adequate level of risk protection is determined at the level of the individual insurer by requiring the insurer's CAR to exceed its ITCL at all times, as described above. The adequacy of risk protection level is afforded by an appropriate selection of plausible adverse scenarios, for which guidance is provided under the Stress Testing Guidelines. BNM views that such a scenario-based approach provides a more meaningful basis for determining capital adequacy levels and potentially avoids spurious accuracy, in particular where markets are incomplete or data is inadequate for accurate calibration of the tails of distributions and as such, supervisors place significant weight on the selected scenarios in their review of the capital adequacy submissions. There is no explicit minimum bound for STCL which would trigger 'non-viability' determination, such a determination would be based on supervisory judgement. Also, BNM does not have triggers for supervisory intervention in the context of group-wide capital adequacy assessments. Other more tailored approaches such as partial or full internal models are not permitted for STCL determination, as BNM recognises the current constraints in terms of resources and expertise in the industry. BNM has also provided explicit clarification that the determination of ITCL under the ICAAP (to be implemented in late 2012) should not be based on the outputs of internal models unless the internal models outputs are expressed as plausible adverse scenarios consistent with the expectations of stress tests under ICAAP. All planned issuance of capital instruments by insurers under RBC are subject to prior approval by BNM. The capital available is defined based on a tiering approach and maintained as core Tier 1 and supplementary Tier 2 capital instruments. The suitable forms of capital available under RBC are governed by the underlying principles of its degree of permanence and the extent to which it is free and clear from any encumbrances. BNM

	requires Tier 1 capital to exceed Tier 2 capital to ensure sufficient high quality capital is available and readily realisable when required. Furthermore, instruments that are viewed not fully realisable on a going-concern or gone concern basis are deducted from the aggregate of Tier 1 and Tier 2 capital. There are additional allowances to recognise other capital resources available to provide cushion against losses in the insurance funds such as the valuation surplus maintained in the insurance fund and 50% of discretionary future bonuses payable for participating business in the insurance funds. The computation of CAR for RBC requires adjustments to recognise non-fungibility of valuation surplus between the participating life insurance business and their insurance business or the shareholders' fund. While the assessments on capital available under RBC do not apply to insurance groups and insurance legal entities that are members of groups, the capital deductions under RBC address the intra-group exposures partially, in terms of the deduction from the investment in subsidiaries. The issues of fungibility and transferability are addressed partially for cross-jurisdictional entities through the IA requirements for separation of insurance funds for Malaysian policies and foreign policies (with allowance for small portfolios of foreign policies). This is further reinforced by the requirements for each insurance fund to have assets equivalent to or higher than the liabilities of the insurance fund. BNM indicated that future enhancements to RBC may include: • Internal models and partial internal models as tailored approaches in the future, taking into consideration both the capacity and capability of the industry in this regard as well as the depth and liquidity in the market, thereby enabling the adoption of more statistically driven quantification methodologies; and • Adjustments to regulatory capital requirements due to diversification effects, to fully address the effect of interdependencies between and within the risk categories. During the recent global financial crisis, BNM introduced temporary counter-cyclical measures to dampen the effects of the sudden movements in interest rates, out of line with historical norms, to reduce the pro-cyclicality of capital adequacy requirements – further discussion of the temporary measures taken by BNM during the financial crisis are included within ICP 14. Takaful operators are currently subject to a solvency regime that requires surplus of assets over liabilities of not less than RM5 million for each family and general takaful business and minimum paid-up capital of RM100 million. BNM is in the process of implementing a risk-based capital framework for the takaful sector (RBCT), introducing a concept paper on RBCT in April 2011. RBCT aims to provide for capital adequacy requirements which cater for takaful specificities, with approaches and principles similar to RBC. BNM is also in the process of developing a regulatory capital framework for financial guarantee issuance, a need resulting from the establishment of Danajamin Nasional Berhad (Danajamin) in 2009, Malaysia's first Financial Guarantee Insurance Company, jointly owned by the Ministry of Finance and the Guarantee Corporation Malaysia Berhad crown-corporation. BNM indicated that it planned to develop a regulatory capital framework for financial guarantee insurance within the next few years.

Assessment	Largely Observed
Comments	BNM has a risk-based capital (RBC) framework to adequately and explicitly capture insurer risks, on a total balance sheet basis, and provide for sufficient capital to absorb significant unforeseen losses. It provides two explicit triggers to allow for different degree of supervisory intervention. RBC does not apply to insurer groups, ICP 23 covers group–wide supervision. BNM should give consideration to explicitly addressing interdependencies between and within risk categories within the RBC. Also, for greater clarity of RBC objectives, BNM should consider more explicitly defining the RBC in terms of the level of risk protection that it should afford, provided that BNM is satisfied that appropriate insurer competencies as well as market depth and liquidity exist to support such an initiative. In addition, to better promote prudent practices, BNM should establish definitive project plans for the near term development and implementation of a regulatory capital framework for financial guarantee insurance.
ICP 18	**Intermediaries** The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.
Description	BNM advised that the insurance intermediation market in Malaysia is dominated by the agency force, with insurance and takaful agents accounting for more than 60% of total premiums transacted in 2010, while the insurance brokers and financial advisers accounted for about 11% and less than 1% respectively of total premiums transacted in 2010. The distribution of insurance products through Bancassurance arrangements is significant in Malaysia. Insurance and takaful agents are not directly regulated by BNM, they are subject to the self-regulatory requirements of the industry associations. As principals, insurers are required to oversee the conduct of their agents. BNM's expectations for the business conduct of agents are indirectly administered through its supervision of insurers. Life insurers, general insurers and takaful operators are required, under inter-company agreements to only deal with agents who are registered with the respective mandatory associations[16], which are the: • *Life Insurance Association of Malaysia* (LIAM) for life insurance agents; • *Persatuan Insurans Am Malaysia* (PIAM) for general insurance agents; and • *Malaysian Takaful Association* (MTA) for takaful agents. Under inter-company agreements, members are prohibited from dealing with unregistered agents and appropriate actions, including imposition of fines, can be taken against any member in breach of the agreement.

[16] Section 22 of IA and section 4 of TA imposes a mandatory requirement for licensees to become a member of an association of life insurers (life insurance business), general insurers (general insurance business), takaful operators (takaful business) and insurance brokers (insurance broking business). BNM approves the constituent documents of these associations.

	The associations have established rules for the registration and regulation of the insurance agents to ensure professionalism and good business conduct. In practice, BNM works closely with the associations to issue rules to regulate the conduct of the agents. In the case of corporate agents of life insurers, the requirement to register with LIAM is also applicable to individual staff engaged by the corporate agents to sell life insurance. Apart from agents, several insurers and takaful operators also enter into bancassurance arrangements with banking institutions by leveraging on the latter's distribution channels to market insurance/ takaful products. Staff of banking institutions involved in the marketing of life insurance products are required to register with LIAM and comply with the rules applicable to life insurance agents. Similar requirements are also imposed by MTA for staff of banking institutions marketing takaful products. Staff of banking institutions marketing general insurance products are exempted from registration with PIAM. However, as required in the inter-company agreement, a PIAM member is to ensure that its bancassurance partner submits an undertaking to PIAM that the banking institution and its staff selling general insurance products will comply with the rules and regulations applicable to general insurance agents and are subject to applicable procedures and penalties in the event of any breach of the regulations. In this regard, PIAM has the ability to impose penalties, such as requiring corrective actions, prohibition from selling as well as imposing fines, against the banking institution and its staff concerned. The respective associations issue guidelines on training and testing requirements, which insurance and takaful agents are required to pass before they are allowed to market insurance/ takaful products. Insurance agents selling investment-linked products must also pass additional training course before they can sell such products. Agents are also subject to compulsory continuing professional development requirements of their associations. Insurance and takaful agents are required to comply with the code of conduct set by their respective associations. LIAM, PIAM and MTA maintain a repository of information on agents whose services were terminated due to disciplinary reasons such as breach of code of ethics, misconduct, criminal breach of trust and violating associations' rules. BNM advised that efforts are currently underway towards introducing a common platform to facilitate sharing of information between LIAM, PIAM and MTA on errant agents who have been deregistered due to disciplinary cases to prevent the migration of unprofessional agents between insurance and takaful industries. The legal framework requires that Insurance/ takaful brokers and financial advisers be licensed and regulated by BNM (IA s.9(1), TA s.37(1)). For financial advisers, apart from licensing at the entity level, the individual representatives of financial advisers must also be approved by BNM. The licensing criteria for insurance/takaful brokers and financial advisers include minimum paid-up capital and shareholders' fund requirements, as well as minimum professional indemnity insurance cover. Compliance with these requirements is assessed by BNM prior to the issuance of a new license as well as during the processing of licence renewal of these licensed intermediaries, which occurs every one to two years. BMN conducts periodic on-site examinations of intermediaries, based on information submitted by the intermediary, findings from prior on-site examinations, and received complaints or tip-offs on misconduct. The results of BNM's supervisory activities to monitor intermediaries' compliance to standards of conduct, including off-site and on-site

	assessments and mystery shopping, feed in BNM's review and decisions on the renewal of broker/ financial advisor licenses. The licensing review includes compliance to licensing criteria and conditions, extending to assessments on number of qualified staff and suitability[17] of Directors and CEOs. BNM may issue a shorter period of license for less serious breaches to any licensing criteria and conditions. In addition, insurance and takaful brokers must also comply with the Code of Ethics and Conduct issued by the Malaysian Insurance and Takaful Brokers Association (MITBA), the mandatory association for insurance and takaful brokers that sets standards of professional conduct for all members and their employees. BNM advised that MITBA is in the process of enhancing its compulsory training requirements. BNM also indicated that it is in the process of strengthening its surveillance of insurance brokers and financial advisers, including a review of the criteria and assessment process for the renewal of licences and the conduct of thematic reviews of insurance broking and advisory practices. IA and TA empower BNM to sanction any insurance broker, takaful broker and financial adviser (including their representatives) for any contravention of IA and TA. Sanctions provided under IA and TA include, among others, imposing a fine, imprisonment, revocation or non-renewal of licence and the removal of directors and senior management. The legislations also empower BNM to deal with any intermediaries operating without a licence. IA and TA currently prohibit insurers/ takaful operators not licensed under the legislation from offering insurance/ takaful products in the domestic market. Therefore, the issue of foreign insurers selling products on a cross-border basis does not arise[18]. Various BNM Guidelines supplement legislation provisions relating to the market conduct and other activities of insurance intermediaries. For example BNM's *Guidelines on Product Transparency and Disclosure* require, among other things, insurance intermediaries to disclose to customers the amount of commissions received on investment-linked, general, and medical and health insurance policies, before a customer decides to buy a particular insurance policy. There are no requirements imposed on intermediaries to disclose other terms of business to customers relating to cancellation rights, notification of complaints, client money arrangements, and confidentiality of information provided. BNM has issued requirements for insurance and takaful brokers to execute letters of undertaking with insurers/ takaful operators as evidence of their acceptance and acknowledgement to remit any premiums collected from clients to the insurers/ takaful operators within 15 days of receipt, or upon the expiry of the 60-day premium warranty period, whichever is earlier. MITBA's Code of Ethics and Conduct requires insurance and takaful brokers to maintain separate bank accounts for premiums collected from clients which are pending remittance to insurers/ takaful operators, as well as claim monies

[17] *IA* and *Insurance Regulations* require insurance brokers and financial advisers to appoint directors and CEOs who are "fit and proper". Although TA does not expressly provide for "fit and proper" criteria for takaful brokers, such assessment are done by BNM as administrative practice.

[18] Pending Regulations will provide exemptions, under certain conditions, to supervised insurance brokers in ASEAN countries and the Labuan International Business and Financial Centre to provide cross-border insurance broking services on international Marine, Aviation And Transit (MAT) insurance directly to MAT risk owners in Malaysia. Such brokers would be required to obtain the prior approval of BNM to conduct such business.

	received on behalf of the clients. BNM indicated that this is observed in practice by all insurance and takaful brokers, and checks on compliance to market conduct requirements are conducted by BNM at the point of license renewal to ensure that all insurance and takaful brokers have fulfilled this requirement. However, there is no legislated requirement for insurance brokers, takaful brokers and financial advisers to maintain separate fiduciary accounts for monies collected from clients. Actions against agents for any breach of their agency agreements or code issued by the associations are expected to be taken by the principal insurers/ takaful operators. Also, there are provisions in IA and TA that empower BNM to take corrective actions against agents for any contravention of IA/ TA. For example, section 150(4) of IA empowers BNM to impose a fine against insurance agents who make misleading statements, fraudulently conceal a material fact or use sales brochures or sales illustrations not authorised by the licensed insurer, a similar provision also exists in section 28 of TA. In practice, BNM has required insurers/ takaful operators to take remedial and corrective actions for misrepresentation and mis-selling by their intermediaries. These include requiring insurers/ takaful operators to withdraw misleading promotional materials, provide restitution to affected policy/ certificate owners, clawing back of commission payments to intermediaries involved and the suspension/termination and/or retraining of the intermediaries involved. BNM does not have a supervisory process specific to the examination of intermediaries, but indicated that a modified version of its SuRF is being developed and piloted for such reviews. As it has a small number of staff specifically conducting intermediary reviews, a thematic approach is often used. Also, the focus is on the brokers and financial advisors, given BNM license renewal responsibilites, as agents fall under the self-regulatory regime of the industry associations, BNM's involvement in looking at agent conduct and compliance issues is typically in response to identified concerns. BNM has indicated that proposed legislation will strengthen BNM's enforcement powers against improper business conduct by intermediaries, and include specific provisions on the proper handling of clients' moneys. It will prescribe the functions and duties of the Board of Directors. BMN also indicated that it plans to introduce guidance to require intermediaries to disclose the terms of business to their customers as part of regulatory expectations on the provision of proper advice by intermediaries. Also BNM plans to implementation a significantly strengthened market conduct supervisory framework to support a more rigorous market conduct assessments of intermediaries.
Assessment	Partly Observed
Comments	Under legislation, BNM is empowered to license, regulate and supervise brokers and financial advisors. BMN conducts assessments of broker and financial advisor compliance requirements, using that that information as part of its process for license renewal decisions. Agents are subject to the various self-regulatory requirements set out by their industry associations. In practice, BNM works closely with those associations to ensure appropriate requirements are set out. Also, BNM does periodically do assessments of agent compliance with those requirements as part of its supervisory activities at the insurer, and takes enforcement actions as necessary. To substantively enhance the regulatory regime for insurance intermediaries, legislative

	changes should be made to codify requirements for the maintenance of separate fiduciary accounts for monies collected from clients and to strengthen enforcement powers. Also, to ensure supervisory effectiveness, BNM should further develop a supervisory approach more specific to the relevant considerations for intermediaries.
ICP 19	**Conduct of Business** The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.
Description	Legislation and various BNM guidelines impose specific requirements and expectations on insurers and intermediaries to protect consumer interests. Various BNM guidelines highlight expectations for insurers and intermediaries to act with due skill, care and diligence in their dealings with consumers, these include guidelines issued on introduction of new products, product transparency and disclosure, proper advice practices, complaints management and claims settlement. Various guidelines also impose expectations, both explicit and implicit, for insurers and intermediaries to establish and implement policies and procedures relating to the fair treatment of customers. For example, under the *Guidelines on Introduction of New Products for Insurance Companies and Takaful Operators*, the Board is required to approve policies and procedures that specify the appropriate parameters and guidance for the fair treatment of consumers to avoid mis-selling, and inherently unfair terms and conditions to consumers and business practices that restrict the freedom of choice to consumers. The guideline also requires insurers to submit relevant information to BNM, including product brochures, Product Disclosure Sheet and other marketing materials on new products to be offered in the market. Insurers may proceed to offer a new product to customers upon complete submission of the information stipulated under the 'launch-and file' system. The 'launch-and file' system does not apply to the following products: • Insurance and takaful products that are being introduced in the Malaysian market for the first time; • Annuity certain and life/family annuity products; • General and family takaful products that involve new Shariah contract(s), changes in the Shariah contract for existing products or creation of new sub-funds for existing products; and • Investment-linked products invested in financial derivatives for purposes other than hedging of existing exposures. Insurers are not to offer these products until the expiry of 30 days from the date of receipt by BNM of the complete submission of information stipulated in the guidelines, this allows BNM an opportunity to review the risks inherent in these products to the insurer and consumer and to satisfy itself that the risks have been adequately considered and managed by the insurer. The review also assesses the adequacy and accuracy of representations made to consumers on the product features and risks in line with BMN's *Guidelines on Product Transparency and Disclosure*. This guideline outlines various considerations and disclosure requirements at the point-of-sale, including a requirement to provide a Product Disclosure Sheet, the need for documents to be written in 'plain language', and disclosure requirements around fees, risks, claims procedures, and other important details.

	Legislation prohibits insurers from making misleading, false or deceptive statements or fraudulently concealing a material fact to induce a person to enter into or offer to enter into a contract of insurance/ takaful with them (IA s.150(4), TA s.28). BNM's *Guidelines on Unfair Practices* further detail prohibitions on insurers from making misrepresentations and carrying out false advertising of insurance policies/ takaful plans for the purpose of inducing or tending to induce the purchase of any plan or avoiding claims. Additionally, the *Guidelines on Proper Advice Practices* set minimum standards for proper advice and a structured process aimed at ensuring that the sale of life insurance and family takaful products is needs-based. BMN has also issued some guidance relating to the managing potential conflicts of interest when customers review advice. Specifically, BNM's *Circulars on Replacement of Life Policies and of Family Takaful Certificates* require insurers and takaful operators to implement specific measures to detect and prevent the unwarranted replacement of life insurance policies/family takaful certificates by agents. BMN also advised that it plans to extend requirements to disclose commissions to include ordinary life insurance and family takaful. Additionally, there are some expectations and requirements in place that promote the handling of claims by insurers in a fair and timely manner. BNM's *Guidelines on Claims Settlement Practices* requires general insurers and takaful operators to ensure prompt and fair settlement of claims, stipulating specific procedures and timelines for the processing and settlement of claims. For life insurers, the IA outlines that, where a claim or a part of the claim made under a life/personal accident policy upon the death of the policy owner is not paid by the insurer within 60 days of receipt of intimation of the claim, the insurer is required to pay a minimum compound of 4% per annum on the amount until the date of payment (IA s.161(1)). Under the *Guidelines on Complaints Handling* insurers are expected to establish systems, structures and procedures for handling complaints with processes that are clear and straightforward, easily understood and readily accessible by customers. Each insurer should have a dedicated unit to handle public complaints within their respective institutions. The functions of the unit include establishing effective and fair policies and procedures for complaints resolution, consistent with the minimum procedures specified by BNM and taking appropriate actions to resolve issues raised by the complainants within a specified period of time. Insurers are also required to provide information in their policy and claims documents about available avenues for recourse by members of the public against unfair practices by any insurer. Also, new legislation is now in place to protect personal data. The broad-based law, with disclosure and consent among its principles, provides increased protection of personal information of consumers and will be applicable to insurers and intermediaries. Additionally, LIAM has recently established an industry framework that sets minimum standards for treating customers fairly in the provision of life insurance services. The framework covers standards for the whole spectrum of the provision of life insurance, starting from designing of product, marketing and selling, after sales servicing and complaint handling. As part of the market conduct supervisory process, BNM supervisors engage with insurers in ensuring that proper policies on fair treatment of consumers are established by the insurers. Training materials of the insurers for their staff, particularly the sales personnel and agents

	are also reviewed by BNM supervisors to ascertain that the staff and agents concerned are adequately trained on the established policies and procedures, as well as the features and risks of insurance/ takaful products marketed to consumers. Where there are concerns with insurer practices, BNM discusses them with the relevant insurer. BNM indicated examples where they had issued directives to an insurer to amend or provide clarification on the product details. While BNM has enforcement tools available to it under legislation, they are not viewed as being extensive, and do not include the ability to impose civil as well as administrative penalties. BNM indicated that proposed legislation will provide it with these additional enforcement tools. BNM has a small number of staff doing market conduct reviews, and its processes and approach for conducting market conduct reviews are not as well defined as those used for its prudential supervision of insurers. BNM indicated that its market conduct supervisory function will be further strengthened to reinforce the implementation of fair treatment policies among insurers and their intermediaries. BNM also indicated that it is enhancing its current market conduct supervisory framework to support a more robust risk-based approach to supervision of the industry in the area of market conduct, given the large number of institutions that are subject to conduct supervision by BNM. Under this revised approach, greater emphasis will be placed on transparency as well as further strengthening the governance, culture and internal controls of the insurers with respect to market conduct. BNM actively promotes consumer understanding of insurance contracts under its consumer education programme for the insurance and takaful industries. *insuranceinfo,* a joint-effort Consumer Education Programme (CEP) between BNM and the insurance and takaful industries, provides educational information to enable consumers to make well-informed decisions when purchasing insurance or takaful products and to have a better understanding of their rights and responsibilities. BNM also participates in various other consumer information disclosure initiatives and maintains a dedicated customer service centre, LINK, also serves to address consumers enquiries on a wide range of issues relating to the conduct of insurance/ takaful business.
Assessment	Largely Observed
Comments	Through the issuance of various consumer protection guidelines, BNM has set many expectations for the conduct of business to ensure customers are treated fairly. BNM conducts market conduct surveillance activities to assess the adherence to its expectations. It is also involved in many consumer education initiatives. To enhance effectiveness, legislative amendments should be made to strengthen enforcement powers and enhancements made to BNM's market conduct supervisory function and practices.
ICP 20	**Public Disclosure** The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.
Description	BNM does not place significant emphasis on market discipline, through public disclosures,

	as a line of defense. In Malaysia, the level of insurance penetration is relatively low and the insurers are not active issuers of capital market instruments, which would subject them to the additional requirements of the Securities Commission and scrutiny from market analysts. The financial reporting framework for all insurers and takaful operators in Malaysia is governed under FRA and CA, both require all reporting entities to comply with MFRSs issued by MASB (FRA s.26D, CA s.166A). Effective 1 January 2012, financial reporting standards (MFRSs) in Malaysia are in full compliance with IFRS issued by IASB. Additionally, the IA requires that all insurers: • To apply the reporting basis used in the preparation of the statutory reporting (submitted to BNM based on prescribed format) for general purpose financial statements (IA s.87(2))[19]; • Ensure that the disclosures in their financial statements are made in accordance with BNM guidelines (IA s.90), which includes BNM's *Guidelines on Financial Reporting for Insurers*[20]; and • Excluding reinsurers, publish their annual financial statements within 14 days after the tabling of the financial statements at their annual general meeting, in at least two local daily newspapers and to exhibit them at each of their branches/offices in Malaysia (IA s.95). Takaful operators are expected to follow BNM's *Guidelines on Financial Reporting for Takaful Operators*. BNM publishes statistical and financial reports for both individual insurers, consolidated insurance industry and consolidated takaful industry on its website. BNM also requires insurers and takaful operators to publish their interim unaudited financial reports prepared on a half-yearly basis on their websites within 8 weeks of interim reporting period. BNM places reliance on the external auditors to ensure compliance with the requirements of both MFRSs and BNM guidelines in relation to financial reporting. External auditors are required to perform the financial audit in accordance with the *Malaysian Approved Standards on Auditing*, which are compliant with *International Standards of Auditing* as of 2010. BNM leverages IFRS required disclosures, complementing those substantive disclosures with additional disclosure expectations from its various issued Guidelines. Considerations include: • In the absence of a comprehensive IFRS for insurance contracts, IFRS 4 allows the use of previous local practices that meet specified parameters. Insurers which determine the value of the technical provisions in accordance with the BNM's *Risk-*

[19] BNM indicates current statutory reporting requirements do not override generally accepted accounting principles (GAAP).

[20] BNM guidelines specify minimum disclosure requirements as well as certain accounting treatments required for prudential reasons, such as presenting insurance liabilities life participating contracts as liabilities within financial statements

	Based Capital Framework for Insurers are deemed to comply with the liability adequacy test under IFRS 4[21]. • Insurers are required to disclose their total capital available, in components similar to regulatory capital requirements. BNM has no specific requirement for insurers and takaful operators to disclose their capital adequacy measure and key risks which influence the capital calculation and insurer's risk tolerance policy. BNM advised that additional public disclosure requirements are currently being considered in relation to risk and capital adequacy considerations, some will be required upon insurer implementation of BNM's *Guidelines on Internal Capital Adequacy Assessment Process (ICAAP) for Insurers* later in 2012.
Assessment	Largely Observed
Comments	BNM's public disclosure requirements leverage on requirements for all insurers to effectively report using IFRS, with some additional requirements imposed by various BNM guidelines. BNM actively promotes the public dissemination of insurer information, both through its public disclosure requirements on insurers, and through its own extensive publishing of insurer and industry data on its website. BNM could enhance its public disclosure regime for insurers through additional requirements for disclosures of disaggregated information on key measures such as insurer source of earnings and capital adequacy measures and risks/risk management processes.
ICP 21	**Countering Fraud in Insurance** The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.
Description	Fraud is a punishable offence under the Malaysian Penal Code, with imprisonment for a term which may extend to seven years, or with a fine, or with both (s.418). Abetments and criminal conspiracy are also offences punishable under the Malaysian Penal Code. Insurance fraud is not specifically segmented under legislation. The IA requires the external auditor of an insurer to immediately report to BNM on any offence involving fraud or dishonesty under any written law committed by the insurer or its employees that the auditor discovers in the course of his/her duties It also imposes a statutory duty on the external auditor to immediately report to BNM any contravention of IA committed by the insurer or its employees or any serious irregularities in the insurer's operations (s.82). BNM issued two key guidelines[22] to the general insurance industry which outline specific measures and practices for insurers to take to prevent, detect and control insurance fraud. Insurance Industry associations have taken a proactive role in combating fraud. Various industry-wide anti-fraud measures and initiatives have been implemented such as the

[21] BNM requires the valuation of technical provisions to be certified by the appointed (life) or signing (general insurers) actuary.

[22] Specifically, Guidelines to Combat Motor Insurance Fraud and Guidelines on Claims Settlement Practices.

implementation of the standardized motor spare parts system (MRC), industry code of ethics and conduct as well as the establishment of a mechanism for sharing of information on fraud cases among industry players.

BNM's Operational risk Specialist Unit (ORSU) conducts macro surveillance on fraud and will alert BNM supervisors should there be any industry-wide concerns, emerging fraud trends or new fraud modus operandi in the insurance sector. ORSU produces regular fraud analysis reports for BNM supervisors, which contains statistical data on fraud cases, trends and emerging concerns. ORSU provides BNM supervisors with advisory assistance such as comments and recommendations on best practices relating to operational risk mitigation, which includes the assessment of an insurer's vulnerability to fraud. BNM supervisors will in turn alert the financial institutions and intermediaries if there is a trend that affects the whole industry. BNM promotes specific training programmes and knowledge sharing on fraud among its supervisory staff.

The primary sources of macro surveillance data are BMN's internal systems. Legislation empowers BNM to require insurers to submit information on cases of fraud (IA s.193(1), TA s.57(1)). BNM's 'eFIDS' facilitates fraud information gathering and sharing through the on-line reporting of fraud cases by insurers and intermediaries to BNM as and when they are detected. The eFIDS contains information such as the nature and status of the fraud, financial impact to the reporting institution, categories of fraud, description of modus operandi, features of fraud, profile of parties suspected/involved/ defrauded and actions taken by the reporting institution.

BNM supervisors will assess, review and monitor the reported fraud cases and the corresponding follow up actions taken by the insurer to remedy and strengthen its control features to prevent the recurrence of similar fraud or material irregularities. Insurers are required to report to the police where fraud is suspected to have been or is being committed.

Under SuRF, BNM supervisors assess the insurer's control system against fraud as part of the overall operational risk management assessment. The supervisory process includes reviewing and evaluating insurer's fraud detection and prevention controls over underwriting, policy issuance, appointment of adjusters and claim procedures by individual lines of business. BNM supervisors also monitor and follow up with an insurer on the modus operandi, circumstances and remedial actions taken by its management for fraud reported to BNM through the eFIDS.

As SuRF was not designed specifically for insurance anti-fraud assessments, its effectiveness and rigour in adequately capturing and assessing such issues should be examined by BNM.

BNM supervisors may conduct investigations and will cooperate with the police to assist insurers in addressing fraud. BNM supervisors are also empowered to communicate as appropriate with enforcement authorities and other supervisors including those outside Malaysia under legislation.

BNM through its Special Investigations Unit (SIU) maintains a close working relationship with other law enforcement agencies in Malaysia, including Polis Diraja Malaysia (PDRM), the Royal Malaysian Police, that enforces penal code offences, including financial crimes. Periodic bilateral and ad-hoc meetings are held between BNM and PDRM to share information in areas of common interest such as emerging trends in insurance fraud.

	BNM advised that it will soon be formalizing an MoU with PDRM to establish a formal framework of cooperation between PDRM and BNM, to collaborate in combating financial crimes which includes sharing of information on insurance fraud, enforcing various legislations which address fraud, capacity building in the areas of investigation and security and conducting public awareness programs in the areas of financial crimes.
Assessment	Largely Observed
Comments	Legislation has serious penalties for fraud activities. BNM has issued guidelines to industry on fraud prevention and control activities, collects insurance fraud data from insurers, conducts macro surveillance to determine insurance fraud trends, conducts examination activities assessing insurer anti-fraud practices, and periodically shares data and intelligence on fraud matters with police authorities. BNM should give consideration to reviewing the effectiveness and rigour of SuRF in adequately capturing and assessing insurer anti-fraud practices and issues.
ICP 22	**Anti-Money Laundering and Combating the Financing of Terrorism** The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, and the supervisor takes effective measures to combat money laundering financing of terrorism.
Description	Since the Asia Pacific Group on Money Laundering (APG) Mutual Evaluation Report on Malaysia in 2007, serious steps have been taken to address the APG recommendations, BNM indicated that Malaysia's AML/CFT regime has been formulated and implemented consistent with FATF standards. BNM established a financial Investigations Unit (FIU) to carry out its mandated role as the competent authority to administer and enforce the AMLATFA. The legislation provides BNM with a broad range of enforcement and sanction powers for contraventions, including significant monetary penalties, criminal sanctions, and license revocation in severe cases. Persons carrying on insurance business, insurance broking business, adjusting business, financial advisory business and takaful business are designated as reporting institutions under AMLATFA. BNM has issued comprehensive AML/CFT guidelines to the insurance and takaful industries, requiring them to effectively detect and deter money laundering and combat financing of terrorism activities. Requirements are outlined within the Standard Guidelines on AML/CFT (AML GP1) and the AML/CFT Sectoral Guidelines 2 for Insurance and Takaful Industries [AML GP1(2)]. These includes the implementation of a risk-based compliance framework, application of customer due diligence (CDD) measures, requirements for a database of 'red flags' and ongoing compliance programme for the insurance and takaful agents. Both the AML GP1 and AML GP1(2) were issued in November 2006 and subsequently amended in February 2009. In 2010, the AML/CFT expertise of BNM's FIU was leveraged to develop a risk-based AML/CFT Supervisory Framework for the review of ML/TF risks in the financial institutions (AML Manual). The framework provides guidance in understanding the inherent risks of ML/TF, including product features that make insurers susceptible to ML risks as well as the roles of operational management and risk management control functions in combating ML/TF. In addition, BNM has also put in place a comprehensive supervisory checklist which

	is meant to assist supervisors in assessing the ML/TF risks. The checklist outlines each step and review that needs to be carried out by supervisors in assessing the quality of risk management in financial institutions in relation to ML/TF risk. The AML Manual was seen as necessary to effectively address the AML/CFT issues from a risk based perspective and to ensure the scope and coverage of assessments are adequate such that AML/CFT risks are adequately addressed. Supervisors are provided basic training on AML/CFT upon joining BNM, and may attend more advanced training to enhance their skills. For insurance supervisors, the specific AML/CFT manual assists them in carrying out the AML/CFT assessment of the individual insurers' susceptibility to AML/CFT risk. For Malaysia, BNM assesses the insurance sector as having low ML/TF risk. In 2010, BNM supervisors analysed AML/CFT considerations on all insurers and takaful operators. In 2011, additional follow-up reviews were done. While BNM's FIU staff provided expert guidance to insurance supervisors in conducting their AML/CFT assessment activities, they did not participate directly in conducting them. From BNM's AML/CFT assessment work, no issues were identified as being serious enough to warrant any sanctions to be imposed on the insurers. There have been no ML/FT prosecutions, convictions or civil forfeitures relating to the insurance sector. In 2010 and 2011, BNM conducted feedback sessions with insurers and intermediaries on issues such as the quality of suspicious transaction reports (STRs) submitted and the typologies and emerging trends of ML/TF risk. BNM indicated that the sessions and feedback have led to the insurers submitting better quality STRs. BNM's FIU is undertaking the country's National Risk Assessment (NRA). The NRA was initiated with the aim to assess ML/TF risk at the national level which will enable the authorities, including supervisory & regulatory authorities to better understand the scale, sources, trend and methods of money laundering and identify the vulnerabilities in the AML/CFT system and controls. In carrying out the NRA, a task force has been set up which consists of law enforcement agencies (LEAs) and supervisory & regulatory authorities. Also, the National Coordination Committee (NCC) was established in 2000 to enhance cooperation among the 15 Ministries and government agencies[23] involved in the fight against ML/TF. As the NCC Secretariat, BNM regularly updates the NCC members on the experiences of other countries in combating ML/TF, reviews existing investigative processes and develops the national AML/ CFT strategy. To facilitate the greater sharing of intelligence relating to ML/TF matters, BNM has signed 34 memoranda of understanding (MoUs) with foreign authorities.
Assessment	Observed

[23] These include Ministry of Finance, Attorney-General's Chambers, Ministry of Foreign Affairs, Securities Commission, Companies Commission of Malaysia, Malaysian Anti-Corruption Commission, Royal Malaysian Police, Registrar of Societies, Ministry of Home Affairs, Inland Revenue Board, Immigration Department, Royal Malaysian Customs, Ministry of Domestic Trade, Cooperatives and Consumerism, Labuan Financial Services Authority and Bank Negara Malaysia.

Comments	BNM is the designated AML/CFT competent authority in Malaysia. It has taken a number of measures to ensure insurers and intermediaries take effective measure to combat money laundering and the financing of terrorism, including the issuance of guidelines, supervisory AML/CFT reviews, and feedback sessions with industry. BNM's FIU is involved in various initiatives to identify issues and share information relating to money laundering and the financing of terrorism. BNM has signed 34 information sharing MoUs with foreign authorities. While BNM assesses the insurance sector in Malaysia as having low ML/TF risk, in order to ensure effective supervision, BNM should utilize FIU specialists on AML/CFT supervisory reviews of insurers with significant sales of products having a higher susceptibility to ML risks.
ICP 23	**Group-wide Supervision** The supervisor supervises insurers on a legal entity and group-wide basis.
Description	There are no significant insurance groups for which BNM is the home supervisor. Out of 60 insurers operating in Malaysia, only four belong to groups which have branches, subsidiaries or sister companies operating in one or two other foreign jurisdictions, and those foreign operations are not significant for the group. Three quarters of the insurers operating in Malaysia belong to either local banking groups or foreign financial groups. For insurers that are part of a Malaysian financial conglomerate with a banking institution at the holding level, BNM supervisors are able to obtain any supervisory information it requires from the bank or any of its related corporations. For insurers belonging to a foreign financial group, Supervisory activities are primarily focused on the insurers which are licensed and regulated by BNM, and the sharing of information with other relevant supervisors to facilitate supervision of group-wide risks is done as necessary. BNM has informal arrangements with host supervisors in jurisdictions where Malaysian insurance groups have cross-border operations to exchange information. BNM established its HHSF to facilitate the exchange and sharing of information between supervisors, by detailing out the procedures for engagements with other supervisory authorities and the governance of information to be shared. For insurers belonging to a non-regulated group with a local FHC, BNM supervisors look to determine the extent to which supervisory monitoring should apply to capture all material entities within the group. The intensity and scope of supervision will be expanded for groups with problematic institutions. BNM supervisors will assess the structure and business activities of the group, as well as the financial conditions of material entities, the shareholding structure, as well as governance and oversight structures. One of the primary aims is to assess whether the owners are in a position to provide capital support and value-add to the regulated entity when required, and that other group activities do not pose a risk to the financial condition of the regulated entity. As BNM's supervisory framework (SuRF) is not specifically designed for group-wide supervision, the monitoring and analysis done on non-regulated group entities becomes part of background assessment used to determine the supervision strategy of regulated entity. In situations where material risks exist, and BNM lacks the legal authority to supervise or take action, BNM's approach is to employ alternative or indirect approaches to achieve its supervisory objectives. For example, BNM may enhance the ring-fencing measures around the insurer, by restricting the payment of dividends and restricting related party transactions.

	While BMN does not have the clear authority to require non-regulated group changes to facilitate transparency, as part of its approval process for licensing, and for changes in significant shareholders, BNM looks at insurance group structures to ensure they are sufficiently transparent to facilitate supervision of group-wide risks. For local groups, BNM has powers to extend an examination to, and obtain information from, other parties with dealings with the regulated insurer (IA s.101). BNM also has agreements with other domestic regulatory bodies to share information. BMN advised that proposed legislation will explicitly empower BNM to regulate and supervise holding companies and all its related entities
Assessment	Partially Observed
Comments	There are no significant insurance groups for which BNM is the home supervisor, For insurers belonging to a foreign financial group, under its HHSF BNM shares information with other relevant supervisors as necessary to facilitate the supervision of group-wide risks. While BNM does not have explicit authority to regulate and supervise holding companies and their related entities, as part of its supervisory approach, BNM analyzes group entities for their ability to provide capital support and for activities that may pose a risk to the financial condition of the regulated entity. The group-wide analysis feeds into the development of the supervisory strategy for the regulated entity. Legislative amendments should be made to provide BNM with explicit powers to regulate and supervise holding companies and related entities. BNM indicated that proposed legislation will provide such powers.
ICP 24	**Macroprudential Surveillance and Insurance Supervision** The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilize information from, and insights gained by, other national authorities.
Description	BNM regularly conducts internal stress testing on insurers to assess the potential impact of certain events, trends or shocks on their profitability and capital position. Shock parameters are simulated on credit, market and insurance risks under macroeconomic scenarios of adverse and extreme economic growth, and financial market movements. The results of the BNM stress tests are compared with regular stress tests conducted by the insurers, and serves as a basis for assessing the level of rigour of the insurers stress tests, as well as contributing to the supervisory analysis of insurer business strategies, capital planning and risk appetite. The internal BNM stress testing done on insurers is based on the aggregated data received from insurers, and so is only a rough approximation of the more refined results that insurers might be able to provide based on testing the more detailed underlying data. BNM has not required insurers to conduct periodic comprehensive industry-wide standardized scenario testing exercises. For supervisory analysis purposes, BNM obtains a considerable amount of quantitative and qualitative information from insurers, both at periodic intervals and on an ad hoc basis. Supervisors also make use of results obtained from horizontal review of insurers, as well as publicly available information.

	BNM also publishes, on an annual basis, the detailed balance sheet information and financial data and performance of individual insurers and the industry on its website. The annual statistics cover data on life, general, takaful, reinsurance, loss adjusting and insurance broking businesses. BNM also has on its website general information on industry structure, such as number of licensees, branch network and number of employees. BNM tracks key financial soundness indicators for the insurance sector. It also identifies and tracks various underlying trends within the insurance industry, and reports on such trends within its annual *Financial Stability and Payment Systems Report* (FSPSR). BNM also communicates its analyses on the financial performance and capital adequacy of insurers in the Quarterly Bulletin. While BNM conducts analysis on various risks and underlying trends, it does not have clear structured internal process for identifying, assessing, monitoring and reporting on emerging risks within the insurance industry. Also, BNM does not have an established process for, and has not conducted a comprehensive structured assessment of, the systemic importance of insurers. Based largely on certain size and inter-connectedness measures, but also taking into account the role of the insurer in specific market/business segment and the availability of ready substitutes, BNM assesses the systemic importance of insurers in Malaysia as being low. For example, BNM identifies the life and family takaful business as being fragmented with, using the Herfindahl- Hirshman Index (HHI)[24], a concentration index of 0.1092, and the general sector as being even more fragmented with a concentration index of 0.0005. The life and general insurers (including takaful operators) accounted for only 6% of the financial system assets as at end-2011. Domestic insurers do not have significant international operations (only 0.5% of insurance industry's assets). BNM did analyse the importance of niche insurers to key segments of the economy within its high-level assessment. BNM indicated that work is underway to enhance its assessments of the relative importance of insurers, based on a more robust set of indicators.
Assessment	Observed
Comments	BNM conducts many activities around identifying, monitoring and analyzing various market and financial developments, as well as other environmental factors, which may impact insurers and insurance markets. Such work is supported by the extensive data it collects from insurers and other sources, some of which it publicly discloses for transparency purposes and objectives. BNM utilizes macroprudential surveillance tools appropriate to the nature, scale and complexity of the insurance sector. Enhancements could be made by: • Requiring insurers to conduct periodic comprehensive industry-wide standardized scenario testing exercises, this would provide BNM with an additional tool for assessing the build-up of industry risks/ vulnerabilities;

[24] The Herfindahl- Hirshman Index (HHI) uses ranges between 0–1, where 0 denotes highly fragmented and 1 highly concentrated.

	• Establishing clear and structured internal processes for identifying, assessing, monitoring and reporting on emerging risks in the industry; and • Developing more robust indicators for assessing systemic risk of insurers.
ICP 25	**Supervisory Cooperation and Coordination** The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.
Description	The Malaysian insurance sector is largely dominated by foreign players which have established locally-incorporated subsidiaries. BNM indicated that, out of 60 licensees operating in Malaysia, only four belong to groups which have branches, subsidiaries or sister companies operating in one or two other foreign jurisdictions, while three quarters of the insurance entities operating in Malaysia belong to either local banking groups or foreign financial groups. BNM indicated that most, if not all, of the foreign operations also form and constitute an insignificant part of the insurance groups. Also, BNM does not have explicit power to regulate and supervise authorised financial or insurance holding companies, BNM has advised that proposed legislation is expected to address this. As such, the determination of the group-wide supervisor has been straight forward. BNM has not organised any supervisory college meetings to date as there are no significant insurance groups or FHCs for which BNM is the home supervisor. Insurers are generally supervised by BNM on the basis where the primary focus of supervisory activities is on insurers licensed and regulated by BNM, with information sharing between BNM supervisors and other supervisors to facilitate supervision of group-wide risks. As identified under ICP 3, BNM has the legal power to share relevant supervisory information with foreign supervisors. Also, BNM indicated that it generally does not place any restrictions on home-country supervisors with respect to their supervisory responsibilities on the Malaysian subsidiaries/ branches of foreign (re)insurers. BNM noted many examples of their cooperation and coordination of supervisory activities with host supervisors, including participation in supervisory colleges and facilitation of cross-border supervisory activities BNM has entered into MOUs with some other domestic regulators, but to date has entered into very few formal arrangements with foreign supervisors, and is not yet a signatory to the IAIS MMOU. In the absence of a formal arrangement, BNM supervisors are guided by its HHSF which sets out the procedures for engagement and information sharing with the home and host supervisors. BNM established the HHSF to formalize and promote consistency of practices for cross-border supervisory engagement and cooperation with other supervisors. The HHSF provides guidance to BNM supervisors in relation to information exchange, the mode and frequency of engagements as well as governance structure.
Assessment	Observed
Comments	The Malaysian insurance sector has few insurance groups with cross-border operations, and the Malaysian operations of foreign-owned groups are small in relation to the overall

	operations of these foreign groups. There are no significant insurance groups or FHCs for which BNM is the home supervisor. Nevertheless, BNM has an adequate legal and administrative framework in place to allow it to effectively cooperate and coordinate with other relevant supervisors and authorities on matters relating to the entities it regulates, subject to confidentiality requirements. Through many examples, BNM has also demonstrated its openness to cooperating and coordinating with other relevant supervisors and authorities. ICP 23 addresses BNM's legal limitations with respect to group-wide supervision, while ICP 3 provides recommendations with respect to increasing the utilization of MOUs with other supervisors to provide a stronger foundation for ensuring appropriate protection of information being shared.
ICP 26	**Cross-border Cooperation and Coordination on Crisis Management** The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.
Description	Only four insurers operating in Malaysia belong to groups which have branches, subsidiaries or sister companies operating in one or two other foreign jurisdictions. The size of these foreign operations is very small, in terms of gross premiums it comprises less than 8% of the total insurers' gross premiums underwritten in Malaysia during 2011. BNM currently has no internationally-coordinated crisis management plans in place. As noted in ICP 3, BNM has wide-ranging legislative powers to deal with insurers in crisis within its jurisdiction, given its role as the financial stability authority. For the purposes of promoting financial stability, BNM has legal authority to obtain any information or document from, or share such information, with any supervisory authority, if BNM considers it necessary that such information or document be obtained or shared (CBA s.40(1)). In the absence of signed MOUs with other supervisor and authorities, which BNM has few in place for insurance supervision, BNM's HHSF provides guidance to BNM supervisors in relation to information exchange, mode and frequency of engagements as well as governance structure, cross-border supervisory engagement and cooperation with other supervisors. There are a number of examples where BNM supervisors have engaged in cross-border cooperation and coordination activities, including during the 2008 financial crisis where it assisted in the facilitation of a cross-border resolution involving a distressed insurer. While BNM has issued guidance to the industry on its expectations for insurers have reliable data systems, and more specific guidance on business continuity management, it has no requirements for insurers to maintain comprehensive contingency plans on either a going or gone concern basis. BNM has advised that new guidance, currently being developed, will address some of these current gaps in the formalized regulatory expectations for insurers. BNM has also not extensively tested the capacity of insurer systems to generate, on a timely and reliable basis, specific ad hoc information requests such as the accumulation of risk in terms of exposure to a catastrophic event, particularly indirect exposures. Consequently, BNM is unsure of the extent to which the insurers it supervises could provide timely and reliable ad hoc information on risk exposures during a financial crisis.

Assessment	Partially Observed
Comments	Given the relative size and structure of the Malaysian insurance industry, BNM expects that its role in effectively managing a cross-sector crisis involving an insurer would be limited in most cases. BNM has an adequate legal and administrative framework in place to allow it to effectively cooperate and coordinate with other relevant supervisors and authorities on matters relating to the entities it regulates. It has also demonstrated its openness to cooperating/ coordinating with other relevant supervisors and authorities. BNM could further enhance its ability to contribute to the effective resolution of an insurer cross-border crisis by increasing its expectations of insurers to maintain comprehensive contingency plans and information systems capable of generating timely and reliable ad hoc information on accumulation of risks.