

Seminar on The Implementation of International Financial Standards in Asia

Adoption of [International Association of Insurance Supervisors \(IAIS\) Insurance Core Principles](#) in Malaysia's Insurance Sector

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This presentation focuses on

- Malaysia's recent experience with the self-assessment exercise, including plans to go forward to improve the insurance regulatory and supervisory system in Malaysia;
- the benefits of the exercise and suggestions for improvement; and
- some of the issues and challenges facing the insurance industry in Malaysia in adopting the IAIS Insurance Core Principles.

Experience with the Self-assessment Exercise

Assessment Process

Malaysia completed a detailed self-assessment of observance of the IAIS Insurance Core Principles in April 2001. The self-assessment took approximately six weeks to complete and encompassed four stages of review:

- (i) **Regulatory Review** – A unit within the Insurance Regulation Department in Bank Negara Malaysia carried out an initial assessment of the regulatory framework governing the insurance industry. The focus here was on determining the adequacy of legislative powers available to the supervisory authority to carry out its supervisory functions effectively. An assessment was also made of the adequacy of existing prudential regulations based on the essential criteria set out in the Core Principles Methodology paper.
- (ii) **Operational Evaluation** – This involved looking at the processes carried out by the Bank in discharging its supervisory functions. This stage focussed on assessing the level of consistency and transparency in enforcing the regulations and included consultations with officers involved in administering the insurance legislation, examiners and financial analysts within the Bank. This completed the initial assessment.
- (iii) **Internal Peer Review** – The initial assessment was then subjected to an internal peer review carried out mainly by the Insurance Supervision Department (which is distinct from the Insurance Regulation Department that completed the initial assessment) to agree on the initial assessment. To improve the objectivity of the internal peer review, we intend to expand the peer review group to include interdisciplinary representatives for future self-assessments.

- (iv) **Management Review** – Finally, the assessment was reviewed and approved by senior management. At this juncture, deficiencies identified from the self-assessment were discussed and action plans were developed.

Overview Of Assessment Results

Based on Malaysia's self-assessment, 11 principles were observed, 4 were largely observed and 2 were materially nonobserved. With respect to the principles that were assessed to be largely observed, the following action plans have been identified to raise the degree of observance of the principles, although these were not required to be reported in the self-assessment questionnaire (action plans are required only for principles which were nonobserved or materially nonobserved):

- *Principle 1 – Organisation of an Insurance Supervisor*
To improve transparency, the Bank will develop a dedicated insurance web-site to disseminate laws, regulations and guidelines applicable to the insurance sector. The web-site will also facilitate the release of key market indicators at regular intervals.
- *Principle 8 – Capital Adequacy and Solvency*
To more accurately reflect the size, complexity and business risks of individual insurers, the Bank is studying the possibility of implementing a risk-based capital framework to determine the minimum required regulatory capital for the conduct of insurance business in Malaysia.
- *Principle 11 – Market Conduct*
To strengthen available complaints mechanisms, the Bank will consider introducing a requirement for insurers to have in place clear complaints procedures within the company to deal with public complaints under the regulations on unfair trade practices that are being developed for the insurance industry. In addition, to raise the fitness and propriety of insurance agencies that are not directly regulated by Bank Negara, the Bank is working with the insurance associations to upgrade the entry requirements and enhance continuing education programmes for insurance agents. At the same time, to ensure that insurance intermediaries exercise due diligence in seeking relevant information from their customers before giving advice, the Bank will be issuing best advice regulations that hold intermediaries liable for advice given in procuring sales. Certified independent financial advisers who can represent a broad range of competing financial service providers will also be introduced in Malaysia to provide consumers with access to professional independent advice on their financial options.

Principles that were materially nonobserved related to Cross-border Business Operations (Principle 15) and Coordination and Cooperation (Principle 16). The nonobservance was mainly due to legal constraints on the ability to share information with foreign supervisors. To mitigate the supervisory risks associated with this limitation, stringent prudential standards are imposed on the operations and insurance funds held in Malaysia of companies licensed in Malaysia. These standards are designed to ensure

that the Malaysian operations (including any foreign business supported by insurers licensed in Malaysia) remain self-sufficient and to that extent, insulated from any consequences arising from its international operations outside the country. Moreover, the operations of locally incorporated insurers are currently largely contained in Malaysia, which itself has a large untapped market. Given that the risk stemming from cross-border business operations is fairly limited at the moment, there are no immediate plans to formalise information-sharing arrangements with supervisors outside Malaysia. However, Malaysia continues to forge networking relationships with its counterparts to facilitate the exchange of information on an informal basis as and when the need arises.

Benefits of the Self-assessment Exercise

The principal benefits of the self-assessment exercise include

- providing a structured methodology to assess the adequacy of a jurisdiction's regulatory and supervisory regime on an ongoing basis. In this respect, the core principles are set out in a sufficiently broad manner to accommodate changes in the market environment that would affect the assessment results. It is important that the assessment be carried out at regular intervals, and particularly when the market has undergone significant structural changes, to determine if the existing regulatory approach continues to remain effective in dealing with new risks that emerge.
- providing a uniform framework for the conduct of self assessments. In particular, the essential criteria set out under the Core Principles Methodology ensure that the key features needed in a supervisory system to effectively deal with specific supervisory concerns are considered so that a high degree of objectivity can be achieved in arriving at the overall assessment for each core principle;
- facilitating internal discussions on the regulatory framework and supervisory processes. This contributes to enhancing the understanding of the inter-dependencies between different units/groups responsible for different aspects of regulation and supervision in each jurisdiction. Such discussions can also prove useful in unveiling inconsistencies in supervisory approaches or even more importantly, drawing attention to gaps in supervision that need to be addressed.
- providing a mechanism for eliciting management's active participation in formulating concrete action plans to strengthen the regulatory and supervisory system.

Suggestions for Improvement

Following are some suggestions that may be considered to improve the self-assessment process:

- first, some guide could be developed to assist in arriving at the overall summary assessment for each principle where there is some divergence in the assessment made for individual essential criteria. For example, it is not uncommon to have a

number of essential criteria that are fully observed and a number that are largely observed for a particular principle. In these situations, a guide to the prioritisation of the criteria would be useful to help countries determine what the overall assessment should be for that principle;

- a standard template or guidelines could also be developed for completing the qualitative assessments to facilitate comparisons of assessments between jurisdictions. Without this, there may be substantial disparity between the level of detail and coverage in the qualitative assessments by different jurisdictions. Some standardisation in this area should also facilitate more effective background research by the World Bank-IMF missions prior to the FSAP;
- a number of criteria could be rationalised to minimise repetition under different principles;
- it may also be necessary to expand the rating options to accommodate the dynamism of supervision. Supervisory measures are often developed in response to changes in the marketplace. At a specific point in time, it is possible, particularly in emerging markets, for an area not to be addressed in the supervisory framework simply because the area does not pose a supervisory concern at the time. This in turn may be due to the limited nature and scope of the business in a jurisdiction where the insurance industry is still in its infant stage of development. It is not clear from the current self-assessment whether such situations can be accommodated under the 'not applicable' category; and
- as an initial step to familiarise countries with the assessment process, we would also recommend that a pool of qualified experts be created to 'walk' jurisdictions through the assessment exercise. This will facilitate the application of common evaluation standards in all jurisdictions. This can be done through attachments with specific jurisdictions, or in a training environment with case studies that simulate the detailed assessment process.

Issues and Challenges Facing the Insurance Industry in Malaysia

Some of the issues and challenges faced by the insurance industry in Malaysia in adopting the IAIS Insurance Core Principles are

- Firstly, the lack of qualified actuaries in the country has limited the use of actuaries to verify the adequacy of technical provisions and carry out financial condition assessments of general insurance companies. The shortage and consequently, high

demand for actuaries in the market have also made it difficult for the Bank to attract and retain qualified actuaries to support its supervisory functions.

- Secondly, there is a need to build up more comprehensive statistical databases of domestic market experience. This is necessary to enable acceptable market norms and benchmarks as input to the financial surveillance process. Such data is also needed to determine appropriate capital charges under the risk-based capital framework that is being developed by the Bank for the local insurance industry.
- Thirdly, there is a need to enhance the competencies of directors in Malaysia to effectively discharge their corporate governance responsibilities. Corporates, including insurers, in Malaysia currently face some difficulty in identifying a sufficient number of qualified independent directors within the country to constitute a balanced and effective board. In this regard, steps are already being taken by the Malaysian Institute of Corporate Governance to introduce training and accreditation programmes to enhance the capabilities of directors to carry out their functions. At the same time, the Bank is also looking into setting specific minimum qualification requirements for directors serving on the boards of insurance companies.
- Fourthly, trends towards consolidation and financial convergence are creating new challenges for Bank Negara Malaysia. Among other things, the supervisory approach and prudential standards set by the Bank need to be continuously adapted to take into account risks associated with the increasing interdependencies between companies under financial groups and the unbundling of traditional insurance products. In addition, with many insurers undergoing mergers and acquisitions in the domestic market, there is also a need to pay close attention to issues associated with post-merger rationalisation, particularly where they may potentially impact policyholders' interests or the future viability of the insurers concerned.
- Finally, with the rapid changes in product, business and investment structures taking place in the market, it is imperative for the Bank to have access to experts who can provide technical assistance in addressing specific supervisory concerns. In this regard, we welcome the efforts of the IAIS, which is working to establish a database of experts to provide assistance, particularly to emerging markets, in their respective fields of expertise.

Conclusion

The [IAIS Insurance Core Principles](#) and the self-assessment exercise provide a useful tool to achieve some degree of mutual regulatory recognition and standardisation. This will become increasingly important as markets become more integrated with the process of globalisation. It is important however, to understand that the true value of the self-assessment exercise will only be realised if jurisdictions commit themselves to *continually* assess their supervisory systems in the context of changing circumstances and market conditions. Indeed, the Core Principles themselves should be continually updated to accommodate such changes. Otherwise, the self-assessment exercise risks being reduced to an academic one that will fall short of its intended objective to help

individual jurisdictions maintain efficient, fair, safe and stable markets at any point in time.