

Briefing Session on Insurance Capital Adequacy Framework (ICAF)

2 December 2022

Part 1: Overview of ICAF

ICAF Salient Features... *transition from “one size fits all” solvency regime to “fit for purpose” risk-sensitive capital regulation*

Solvency Margin Regime

- 1) **‘One size fits all’** approach
- 2) **Not calibrated** to major risks and **ignores investment risk and claims**
- 3) Does **not consider the nature of different line** of insurance business
- 4) Does **not provide incentives** for good risk management
- 5) **Stand-alone from supervisory intervention** approach
- 6) **Top-line driven** solvency i.e. volume driven
- 7) **Not in synch** with international standards & practices
- 8) **No semblance to Banking’s** capital requirements

Risk-based Regime

- 1) **Differentiated** by insurers’ risk profile
- 2) Caters for **all major risks including investment risk and claim liabilities**
- 3) **Considers different nature** of business line & risks
- 4) Promotes **prudent risk management**
- 5) Allows **linkage to capital targets for supervisory intervention**
- 6) More **transparent** with **granular** solvency building blocks
- 7) Benchmarked against **international standards & best practices**
- 8) **Consistent approach** between insurance & banking’s capital regulations



Framework Designing...*consistent with Malaysia's RBC regime*

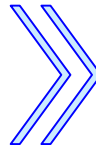
- ❑ ICAF's requirements were benchmarked with:
 - ***IAIS' Insurance Capital Standard***
 - ***Malaysia's RBC Framework*** to ensure regulatory parity with onshore capital regime.
 - ***Globally recognised insurance capital regulations of peer International Insurance Centres***

- ❑ ICAF's refinements were made based on benchmarked international insurance market through:
 - ***Engagement of professional actuary by Labuan FSA to provide ICAF's overall approach & design***
 - ***Joint collaboration with industry's actuaries & technical experts (ICAF Working Group) for market insights***
 - ***Consultations with BNM's RBC Team to ensure broad consistency with Malaysia's RBC***

Approach... *gradual roll-out to avoid 'big bang' impact*

1

Phasing-in implementation

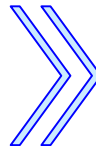


- *Reserving buffer and capital-add on margins sequentially implemented.*
- *Sectoral roll-outs (insurance followed by takaful business)**

| <u>ICAF Phase I</u> | <u>ICAF Phase II</u> |
|---|--|
| <ul style="list-style-type: none"> ▪ Consultation paper 2014 ▪ Guidelines on liability valuation: <ul style="list-style-type: none"> ⇒ 2015 - Insurance sector ⇒ 2016 - Takaful sector | <ul style="list-style-type: none"> ▪ 2017-18 - Exposure Draft issued <ul style="list-style-type: none"> ⇒ 2019-21 - 2 Quantitative Impact Studies ⇒ 2022 - Public consultation |

2

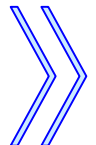
Market consultation & industry-wide simulation



To ensure practical & appropriate requirements for market adoption

3

One-year parallel run (only regulatory reporting)

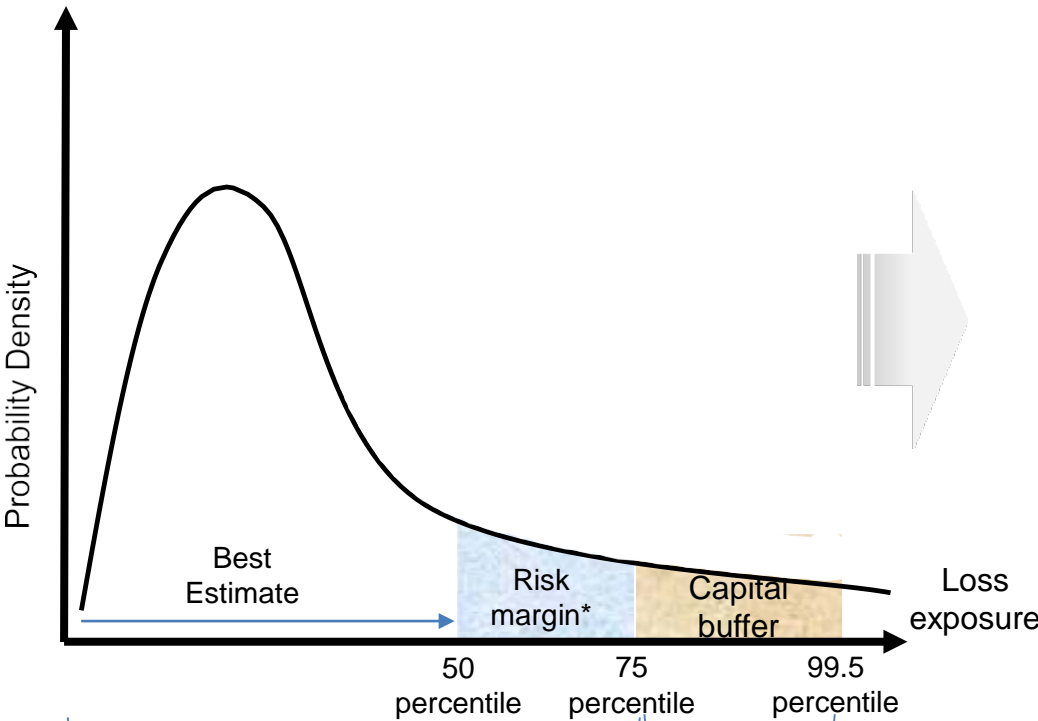


- *To provide transition time for system changes prior to full implementation*
- *To identify & address any systemic risks to the market*

**Captive insurance is excluded from ICAF due to its limited to non-commercial, group-related risks. ICAF-like requirements may be considered once the captive market has matured.*

Overall ICAF's Conceptual Design

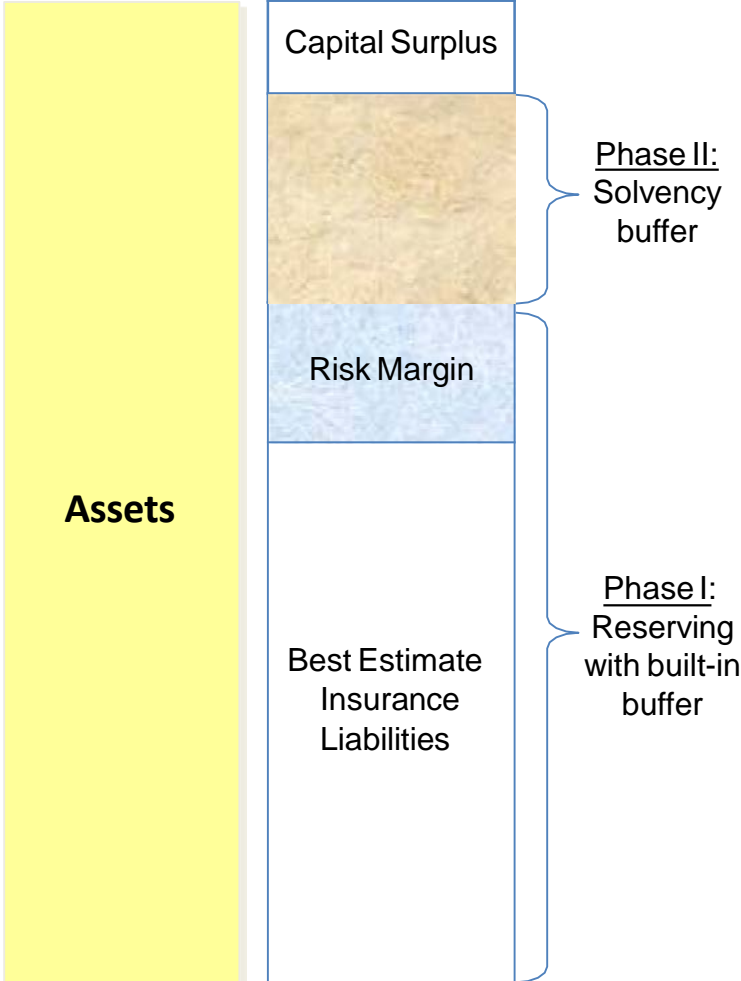
Translating RBC from risk perspective to...



Phase I: Reserving
 ⇒ To cater for known risk exposures i.e. policy obligation

Phase II: Risk-based capital
 ⇒ To cater for unknown risk factors e.g. economic downturn, market crash, etc.

...to capital buffers in the balance sheet



Part 2: ICAF Requirements

Applicability

ICAF Phase I (Liabilities Valuation)

Labuan general (re)insurer

Labuan life (re)insurer

Labuan general (re)takaful operator

Labuan family (re)takaful operator

ICAF Phase II (Capital Buffer)

Labuan general (re)insurer

Labuan life (re)insurer



| ICAF Applicability | | |
|--------------------|--------------------|--|
| | Malaysian Business | Non-Malaysian Business |
| Subsidiary | ✓ | ✓ |
| Branch | ✓ | <ul style="list-style-type: none"> ▪ <i>May be exempted subject to LFSA's approval</i> ▪ <i>To maintain minimum Working Fund</i> |

* RBC for Takaful Sector will be developed after ICAF's implementation e.g. 2024

ICAF is not applicable to captives

Applicability... *criteria for exemption consideration (only for non-Msian business) for branch (re)insurers*

1

Explicit undertaking from the branch's head office to satisfy the non-Malaysian business liabilities in the event that the branch is unable to fulfil its obligations

- Can be in the form of a guarantee letter/letter of undertaking/financial outlay/other types of commitment
- The guarantee letter provided by head office during licensing would generally sufficient to satisfy this condition.
- Additional confirmation from head office may be required if the guarantee letter is deemed to be insufficient.

2

Strong Group's financial position

- Good financial strength rating e.g. minimum A-.
- Supported by the latest audited financial statement of the Group.

3

The branch is subjected to consolidated supervision by home supervisor.

4

The home supervisor is willing to cooperate with Labuan FSA in the supervision of Labuan insurer.

- Labuan insurer is advised to provide the contact details of its home supervisor (e.g. email add. & tel no.) to Labuan FSA. Labuan FSA will liaise with the home supervisor to seek confirmation on the 3rd & 4th conditions.
- Regulators that have signed the bilateral Memorandum of Understanding (MoU) with Labuan FSA or multilateral MoU (MMoU) in which Labuan FSA is a signatory, would be considered to meet the 4th condition.
- The list of MoUs signed between Labuan FSA and other regulators is available on Labuan FSA website <https://www.labuanfsa.gov.my/about-labuan-fsa/the-regulator/memoranda-of-understanding>.

Overview of ICAF... *key components of the capital metrics*

Current Requirement: Margin of Solvency (MOS)

| Type of Licence | <i>To maintain the higher of :</i> | |
|------------------|------------------------------------|---|
| Labuan insurer | RM 7.5 million | <u>GENERAL</u> : 20 % of net premium income of the preceding year |
| Labuan reinsurer | RM 10.0 million | <u>LIFE</u> : 3% of the actuarial valuation of life insurance liabilities |



Proposed Requirement: ICAF

Similar to Basel capital adequacy
i.e. Tier 1 & 2 capital

$$\text{Capital Adequacy Ratio (CAR)} = \frac{\text{Total Capital Available (TCA)}}{\text{Total Capital Required (TCR)}} \times 100\%$$

Encapsulates all key risk charges

Overview of ICAF...*key requirements of ICAF (cont.)*

01

Capital Resources

Capital components:

- *Tier 1 Capital*
- *Tier 2 Capital*
- *Deductions*

02

Capital Required

Capital charges for all material risks:

- *General insurance business*
- *Life insurance business*

03

Capital Control Levels

Solvency building blocks:

- *Supervisory capital level*
- *Internal target capital level*

04

Reporting Requirement

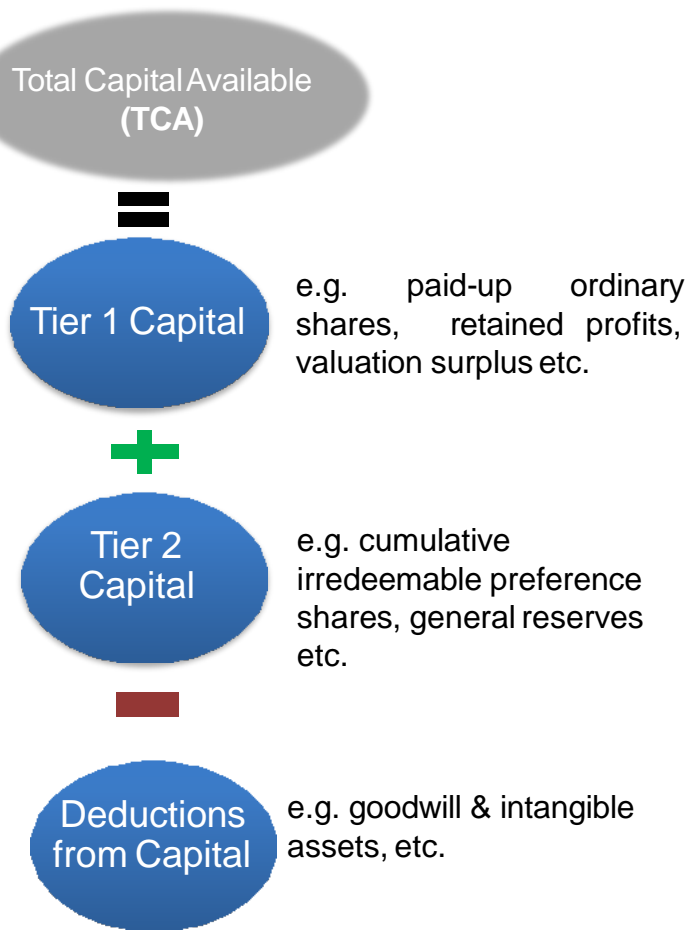
Reporting of Capital Adequacy position:

- *Quarterly submission for supervisory monitoring*

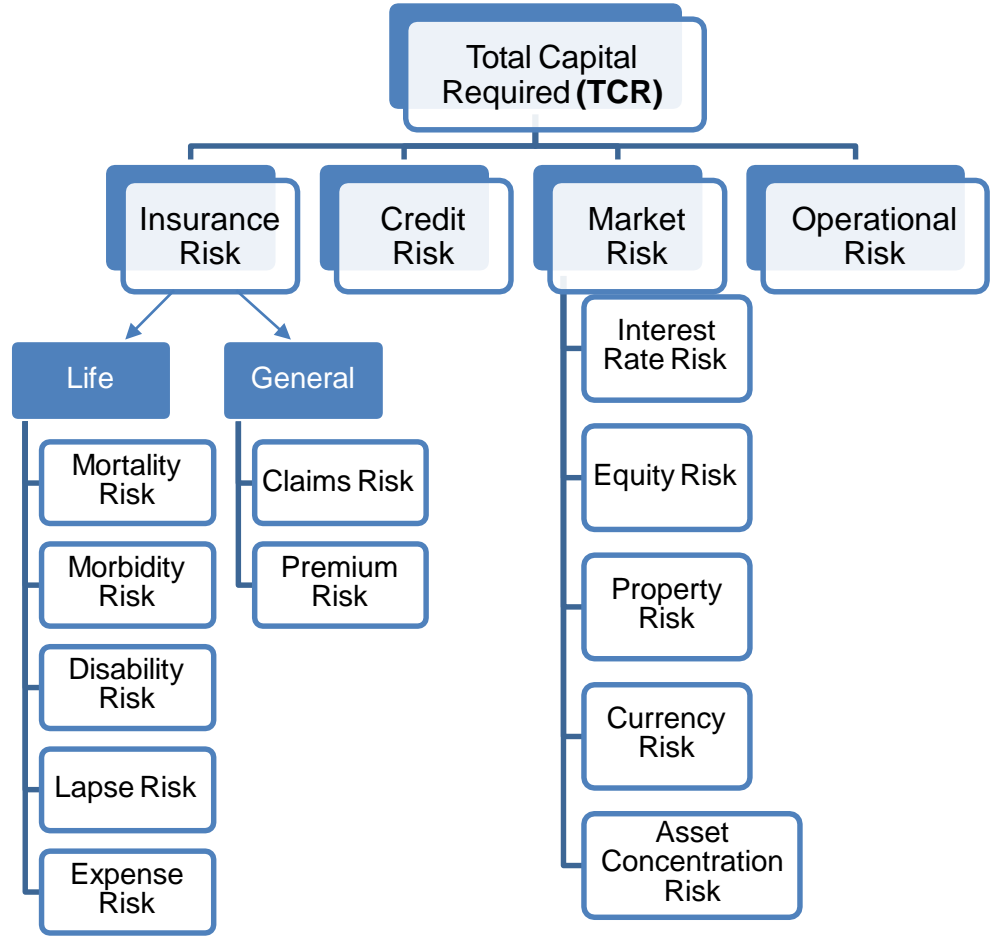


Overview of ICAF... *capital resources and risk charges elements* (cont.)

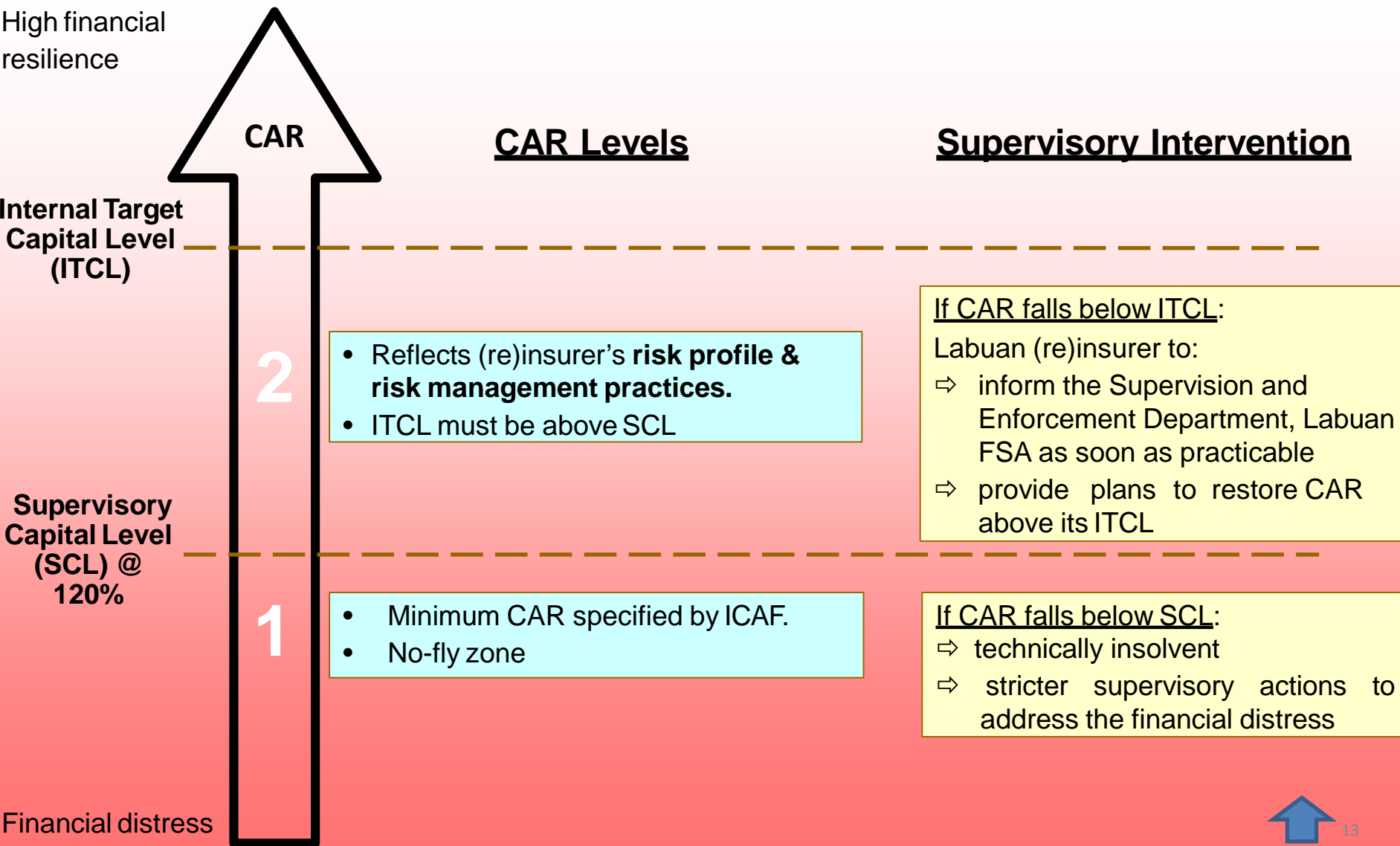
High quality capital resources akin to Basel's requirement for banking sector...



All material risks to be considered for capital requirement computation...

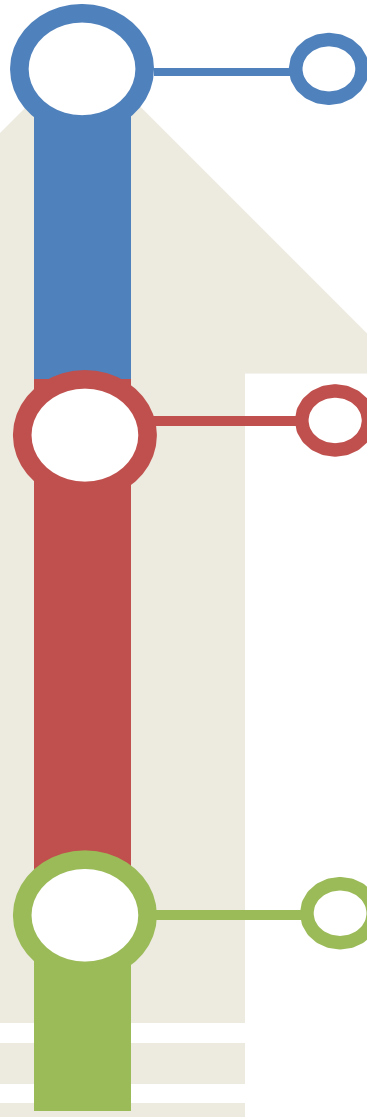


Overview of ICAF... *solvency building blocks for pre-emptive supervisory approach (cont.)*



Part 3: Implementation of ICAF

Overall Implementation Timeline



ICAF's Full implementation: 1 Jan 2024

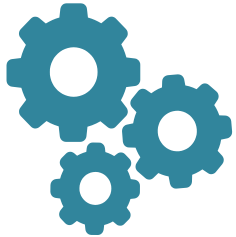
- The MOS requirements will be replaced by ICAF for (re)insurance sector.

Parallel Run Reporting: 1 Jan – 31 Dec 2023

- ICAF reporting to be made on quarterly basis for monitoring purpose
- MOS requirements specified under *Clarification Note for Directive on Minimum Capital Requirement by Labuan Licensed Entities* issued on 13 October 2015 remain enforceable

ICAF's Issuance to Industry: 24 Aug 2022

Operational Arrangement for Parallel Run Reporting



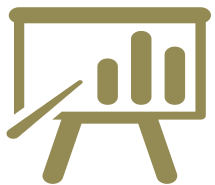
Preparatory Arrangements

- Labuan (re)insurers are expected to undertake **early preparation** to comply with ICAF:
 - **Get familiarised** with ICAF requirements
 - **Allocate resources** e.g. technical know-how on ICAF requirements
 - Be **equipped with IT infrastructures** to support ICAF including requisite databases or systems.



Engagement with Labuan FSA

- Labuan (re)insurers to formulate capital management plan vis-a-vis the risk management policy
- May liaise with LFSA (Prudential & Supervision) for further guidance on ICAF



Reporting Arrangement

- Manual ICAF submission to Statistics Unit of Labuan FSA through email at iru@labuanfsa.gov.my.
- ICAF will be incorporated into the Statistical Management System as future enhancement and Labuan FSA will advise on this when the system is ready.

Guidance on Internal Target Capital Level (ITCL)



ITCL is set at a level that better reflects (re)insurer's risk profile & risk management practices...

Labuan (re)insurer

- Labuan insurer to **develop its ITCL using** assumptions & projections e.g. risks exposure and capital management plan.
- The assessment of ITCL should include **stress and scenario tests**.
- **Board oversight & internal process** to ensure the maintenance of appropriate ITCL

Dialogue

Labuan FSA's Supervisor

- Labuan FSA can **impose higher ITCL** if:
 - the ITCL does not commensurate with (re)insurer's business activities, risk exposures & risk management practices based on its supervisory assessment
 - The (re)insurer has supervisory issues merited for higher capital

Part 4: FAQs

Questions

Q1: Are there any changes to ICAF & regulatory reporting forms in view of IFRS 17?

Q2: What is Labuan FSA expectation for non-compliance with ICAF during parallel run period ?

Q3: Does the minimum CAR need to be maintained at both company & fund level under ICAF?

Q4: Would Labuan FSA consider further extension to comply with ICAF beyond 2024?

Q5: Would ICAF be applicable for (re)insurers that are dormant, on run-off or in the process of surrendering their licences?

Q1: Are there any changes to ICAF & regulatory reporting forms in view of IFRS 17?

- The existing policy requirements and regulatory reporting remain status quo.
- Relevant changes can still be considered during parallel run in 2023 if there is a merit to do so.
- LFSA may engage LIIA to assess on the impact of IFRS 17.

Financial Reporting – *for preparation of true & fair financial statement*

- A Labuan insurer that adopts IFRS (MFRS) would need to comply with the new IFRS/MFRS 17 - Insurance Contract requirements for the preparation and presentation of its financial statement effective from 1 January 2023.

Regulatory Reporting – *for collating information to support supervisory assessment*

- Labuan FSA plans to assess the impact of IFRS 17 to the existing policy requirements e.g. insurance valuation once the new accounting standard comes into effect in 2023.
- Labuan FSA plans to have a joint working group with LIIA for the assessment.



Q2: What is Labuan FSA expectation for non-compliance with ICAF during parallel run period ?

- During parallel run, ICAF requirements are intended for reporting purpose only while compliance to MOS is still enforced.
- Labuan (re)insurers are expected to undertake the necessary effort to comply with ICAF by 1 Jan 2024.
- Labuan FSA will have a close engagement with individual insurers that require facilitation for ICAF compliance.



Q3: Does the minimum CAR need to be maintained at both company & fund level under ICAF?

- In terms of regulatory requirement, a Labuan insurer is only required to maintain the minimum CAR at company level.
- The same is also expected for the maintenance of ITCL



Q4: Would Labuan FSA consider further extension to comply with ICAF beyond 2024?

- In terms of policy stance, all Labuan (re)insurers are required to comply with ICAF effective 1 Jan 2024.
- During the trial run in 2023, Labuan FSA will engage directly with the individual (re)insurers to facilitate compliance and resolve any implementation issues.



Q5: Would ICAF be applicable for (re)insurers that are dormant, on run-off or in the process of surrendering their licences?

- In principle, ICAF is applicable to all Labuan (re)insurers regardless of the status e.g. dormant/run-off as long as they hold the licence to operate in Labuan IBFC.
- Given that ICAF is risk-based in nature, a dormant, run-off (re)insurers would still be able to determine and report their CAR position as required under ICAF.
- During the supervisory dialogue session on ITCL, Labuan FSA will engage with insurers to discuss on their specific circumstances that are relevant for ICAF.

THANK YOU

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Disclaimer

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