



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Financial Condition Report

Applicable to:

1. Licensed insurers
2. Licensed takaful operators
3. Professional reinsurers
4. Professional retakaful operators

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PART A OVERVIEW

1 Introduction

- 1.1 The policy objective of this policy document is to provide standards and guidance on the preparation of the Financial Condition Report (FCR), being one of the appointed actuary's duties specified in paragraph 9.1(b) of both the policy document on 'Appointed Actuary: Appointment and Duties' and the policy document on 'Appointed Actuary: Appointment and Duties (for reinsurers and retakaful operators)'. The FCR provides for the appointed actuary's overall investigation results, assessments, independent opinions and recommendations to the board on various aspects of the licensed person's financial condition, including any significant threats to the financial condition of the licensed person and potential mitigation measures for such threats.
- 1.2 This policy document sets out the following:
 - (a) the minimum areas of analyses to be considered by the appointed actuary in preparing the FCR; and
 - (b) the requirements for the FCR to be:
 - (i) presented to the board; and
 - (ii) submitted to the Bank.

2 Applicability

- 2.1 This policy document is applicable to:
 - (a) licensed insurers, whether carrying on life or general business;
 - (b) licensed takaful operators, whether carrying on family takaful business or general takaful business;
 - (c) professional reinsurers and professional retakaful operators; and
 - (d) appointed actuaries of the persons referred to in subparagraphs 2.1 (a) – (c) above.

3 Legal provisions

- 3.1 This policy document is issued pursuant to:
 - (a) sections 47, 76, 143 and 266 of the Financial Services Act 2013 (FSA); and
 - (b) sections 57, 85, 155 and 277 of the Islamic Financial Services Act 2013(IFSA).

4 Effective date

- 4.1 This policy document comes into effect—
- (a) on and from 1 January 2016, for licensed insurers carrying on life business and licensed takaful operators carrying on family takaful business in respect of their FCR prepared for financial years beginning in 2016 and thereafter;
 - (b) on and from 1 January 2017 for licensed insurers carrying on general business and licensed takaful operators carrying on general takaful business in respect of their FCR prepared for financial years beginning in 2017 and thereafter; and
 - (c) on and from 1 January 2017 for professional reinsurers and professional retakaful operators in respect of their FCR prepared for financial years beginning in 2017 and thereafter.

5 Interpretation

5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA and IFSA, as the case may be, unless otherwise defined in this document.

5.2 For the purposes of this policy document:

“S” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action;

“G” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

“board” means the board of directors of a licensed person, including a committee of the board where the responsibilities of the board set out in this policy document have been delegated to such a committee;

“foreign professional reinsurer” means a professional reinsurer established as a branch in Malaysia;

“foreign professional retakaful operator” means a professional retakaful operator established as a branch in Malaysia;

“licensed insurer” means a licensed insurer which carries on direct insurance business;

“licensed person” collectively refers to –

- (a) a licensed insurer;

- (b) a licensed takaful operator;
- (c) a professional reinsurer; and
- (d) a professional retakaful operator;

"licensed takaful operator" means a licensed takaful operator which carries on direct takaful business; and

"senior management" refers to the chief executive officer and senior officers of a licensed person.

6 Related legal instruments and policy documents

- 6.1 This policy document must be read together with other relevant legal instruments and policy documents that have been issued by the Bank, in particular -
- (a) policy document on 'Appointed Actuary: Appointment and Duties';
 - (b) policy document on 'Appointed Actuary: Appointment and Duties (for reinsurers and retakaful operators)';
 - (c) 'Risk-Based Capital Framework for Insurers';
 - (d) 'Risk-Based Capital Framework for Takaful Operators';
 - (e) policy document on 'Management of Participating Life Business';
 - (f) 'Guidelines on Takaful Operational Framework'; and
 - (g) policy document on 'Financial Reporting for Takaful Operators'.

7 Policy document superseded

- 7.1 This policy document supersedes the 'Guidelines on Financial Condition Report' (BNM/RH/GL/003-17) issued on 11 August 2007.

PART B ANALYSES IN THE FCR

8 General requirements

- S 8.1 The FCR serves to provide the board with critical insights into the developments of a licensed person's risk profile and the options available to mitigate identified threats to the licensed person's financial condition. As such, an appointed actuary must provide in the FCR, the results of his overall investigations into the licensed person's financial condition in respect of the following areas:
- (a) the licensed person's current and expected future financial condition;
 - (b) significant risks and threats to the licensed person's current and expected future financial condition;
 - (c) options and recommendations proposed to the board to mitigate such risks and threats;
 - (d) actions taken by senior management in response to recommendations in previous FCRs, as well as the extent to which these actions have effectively addressed the concerns; and
 - (e) any other significant findings from the appointed actuary's investigations.
- S 8.2 In order to support the results of the overall investigations referred to in paragraph 8.1, the appointed actuary must include in the FCR his assessments and independent opinions, with recommendations where relevant, on key areas impacting the risk profile of the licensed person. These key areas must include the licensed person's:
- (a) nature of business;
 - (b) experience analysis;
 - (c) asset-liability management;
 - (d) capital adequacy and threats to its financial condition;
 - (e) reinsurance or retakaful arrangements;
 - (f) distribution of surplus;
 - (g) repayment of *qard* in respect of a takaful operator and professional retakaful operator; and
 - (h) management of estate in participating life business.
- S 8.3 The appointed actuary must include other areas not specified in paragraph 8.2 in his assessment if such areas are relevant to the licensed person's financial condition and are necessary in providing the board with a complete understanding of the licensed person's financial condition.
- S 8.4 The appointed actuary must, in the FCR, also inform the board of all factors identified in the course of performing his duty¹ that may have affected the

¹ The appointed actuary's duty in paragraph 9.1(d) of both the policy document on 'Appointed Actuary: Appointment and Duties' and 'Appointed Actuary: Appointment and Duties (for insurers and takaful operators)'.

results of his assessments, including any significant limitations or variations to the basis or assessment upon which a recommendation has been formed. These factors include:

- (a) the credibility, accuracy and completeness of data used for investigations;
- (b) limitations of information systems or any models used for investigations;
- (c) availability of resources;
- (d) any reliance placed on input from other parties; and
- (e) any actual or potential conflict of interest in the preparation of the FCR, such as where the appointed actuary holds other positions of responsibility in the licensed person,² and how the conflict has been resolved or avoided.

- S** 8.5 In relation to paragraph 8.4, where there are limitations on input provided by the various functions of the licensed person, the appointed actuary must take reasonable steps to make appropriate adjustments to the input for the purpose of his assessments in the FCR and must document the rationale of such adjustments.
- S** 8.6 Where there are operational deficiencies to the systems, procedures, and controls used for the purposes of producing input which impairs the results of his assessments in the FCR, the appointed actuary must highlight these concerns to the board.
- G** 8.7 The appointed actuary of a foreign professional reinsurer or a foreign professional retakaful operator may make use of an equivalent report prepared by the regional or head office to serve as input for the FCR for the purposes of this policy document.
- S** 8.8 Notwithstanding paragraph 8.7, the Bank may require the foreign professional reinsurer or foreign professional retakaful operator to supplement the equivalent report by relevant assessments by its appointed actuary where the Bank is of the opinion that the requirements specified in paragraphs 8, 9, 10 and 11 have not been met in the equivalent report.

² As required in paragraph 9.8 of both the policy document on Appointed Actuary: Appointment and Duties and the Policy Document on Appointed Actuary: Appointment and Duties (for insurers and *takaful operators*), the appointed actuary must have taken reasonable steps to avoid actual and potential conflicts of interest in the course of carrying out his duties.

9 Nature of business

- S** 9.1 The appointed actuary must make an assessment and provide his opinion on the impact of the current and emerging nature of the licensed person's business on its risk profile. In his assessment, the appointed actuary must consider the following:
- (a) business in force and new business volumes for each insurance or takaful fund;
 - (b) new products and revisions to existing products, including significant risks to the financial soundness of the licensed person arising from such products;
 - (c) changes to the licensed person's distribution strategy, underwriting standards and investment strategy;
 - (d) changes to the licensed person's management practices and internal policies;
 - (e) external factors, including economic, legal and regulatory, social, demographic and consumer behavioural factors;
 - (f) for takaful/retakaful business, any impact arising from the implementation of or changes made to the operational model of the takaful/retakaful business; and
 - (g) any other relevant areas relating to the nature of the licensed person's business.

10 Experience analysis

- S** 10.1 The appointed actuary must provide an experience analysis in the FCR, together with his opinion on-
- (a) the appropriateness of assumptions previously set;
 - (b) significant trends in experience over the past years, if any;
 - (c) deviations in actual experience from the previous assumptions; and
 - (d) the underlying reasons for any material deviations of actual experience from the previous assumptions.
- S** 10.2 In conducting the experience analysis for all insurance or takaful funds, the appointed actuary must take into consideration the key risk drivers of the business and ensure that the analysis is conducted at a sufficient level of granularity to allow a meaningful assessment by the appointed actuary.
- G** 10.3 For life business including life reinsurance business and family takaful business including family retakaful business, the key risk drivers may include:
- (a) mortality;
 - (b) morbidity;
 - (c) persistency;
 - (d) expenses, including commissions and bonus;

- (e) options and guarantees;
 - (f) changes in exposure and patterns or trends in claims; and
 - (g) investment returns.
- G** 10.4 For general insurance business including general reinsurance business and general takaful business including general retakaful business, the experience analysis by the appointed actuary may also include key risk drivers such as the investigation of changes in exposure and patterns or trends in claims, expenses and premiums or contributions. The analysis may be conducted based on -
 - (a) line of business (for example, motor, fire, residential or commercial risks);
 - (b) geographical location (for example, by country, state, and region);
 - (c) year of origin (for example, the underwriting year or accident year); and
 - (d) for analysis of claims, the types of claims (for example, property damage or liability claims).
- S** 10.5 In conducting the experience analysis, the appointed actuary must provide an assessment on the actual and anticipated expense overruns.
- G** 10.6 The assessment on the actual and anticipated expense overruns may be categorised by-
 - (a) the insurance or takaful fund;
 - (b) line of business;
 - (c) initial business and renewal business;
 - (d) direct and indirect expenses;
 - (e) expenses under the agency-related expenses (ARE), management expenses and claims related expenses; and
 - (f) allocated and unallocated loss adjustment expenses.
- S** 10.7 Based on the experience analysis for life business and family takaful business, the appointed actuary must provide an assessment of the surplus arising for each source of surplus in each insurance or takaful fund³ and respective shareholders' funds, to demonstrate the financial impact of the deviations between previous assumptions and actual experience.
- S** 10.8 The appointed actuary must conduct the assessment on the sources of surplus arising at a sufficient level of granularity, such that the board is provided with sufficient information and context to understand the nature of the surplus arising in each insurance or takaful fund and its constituent components. In conducting the assessment, the appointed actuary must include an opinion on-
 - (a) whether the surplus is one-off or expected to be sustained over a period of time;

³ For the purpose of this paragraph, surplus arising from each takaful fund refers to surplus arising only from the Participating Risk Funds (PRF).

- (b) the magnitude and timing of the cashflows expected to emerge in the future; and
 - (c) the impact of the surplus referred to in subparagraphs 10.8(a) and 10.8(b) to the licensed person's capital position.
- S** 10.9 For a licensed insurer and licensed takaful operator, the appointed actuary must also include an opinion on product pricing in the FCR as required in paragraph 9.9 of the policy document on 'Appointed Actuary: Appointment and Duties.'
- S** 10.10 For investment-linked insurance and takaful business, the appointed actuary's opinion on the licensed insurer and licensed takaful operator's product pricing must address the long-term sustainability of the policy owner or participant unit account to meet future costs of insurance or tabarru charges and other relevant charges of fees imposed.
- G** 10.11 In his opinion on product pricing referred to in paragraph 10.10, the appointed actuary may consider the following factors that could lead to non-sustainability of unit accounts resulting in possible early termination of investment-linked insurance policies and takaful certificates ahead of the maturity date:
 - (a) inappropriate pricing for additional benefits such as not charging additional premiums when it is necessary;
 - (b) prolonged poor investment performance of the unit fund;
 - (c) significant partial withdrawals and premium holidays;
 - (d) for takaful certificates, deviations between the actual surplus sharing and the expected surplus sharing during the pricing stage;
 - (e) revisions to the cost of insurance or tabarru charges due to poor claims experience, as well as any revisions to other fees and charges imposed by the licensed insurer and licensed takaful operator from time to time, without a corresponding increase in premium or contribution amounts.

11 Asset-liability management

- S** 11.1 In the FCR, the appointed actuary must provide his assessment and opinion on the appropriateness of the licensed person's overall investment policy and asset-liability management policy, taking into account the liability profile and risk appetite of the licensed person.
- S** 11.2 For purposes of paragraph 11.1, the appointed actuary's assessment must take into consideration the following areas:
 - (a) the strategic asset allocation and tactical asset allocation of each fund, including specific investment strategies for any products with unique features;
 - (b) the characteristics of the licensed person's liability cashflows, including the nature, term, currency, amount and timing of such cashflows;

- (c) any options and guarantees in the licensed person's product features;
- (d) for participating life business, the manner in which policyholders' reasonable expectations (PRE) are managed and impact of the PRE on bonus revisions;
- (e) the effectiveness of specific risk mitigation measures taken by the licensed person (for example, hedging or reinsurance arrangements);
- (f) key risks arising from any mismatches between the licensed person's investment strategy and the characteristics of its liability cashflows; and
- (g) the availability and adequacy of surplus capital in the respective insurance or takaful funds to withstand such mismatched risks.

12 Capital adequacy and threats to financial condition

- S** 12.1 The appointed actuary must provide in the FCR, an opinion on the capital adequacy ratio (CAR) of the licensed person by considering the movements in the CAR over the financial year and the results of the multi-period stress test⁴ on the CAR.
- S** 12.2 The purpose of multi-period stress test is to demonstrate the significant threats to the financial condition of the licensed person and the potential impact of the proposed mitigation measures. The scenarios developed for the multi-period stress test and mitigation plans by the appointed actuary must correspond to the licensed person's business profile and business plans over the projection period.
- S** 12.3 The appointed actuary must use the multi-period stress test as a tool to demonstrate the financial impact of significant threats identified on the licensed person's financial condition. Where financial impact cannot be easily quantified, the appointed actuary must use his judgement to determine whether the financial impact of such threats is best demonstrated through the multi-period stress test or through alternative approaches.
- S** 12.4 The results of the multi-period stress test must be appended with the FCR to support the appointed actuary's opinion on the adequacy of the licensed person's capital position over the projection period of the multi-period stress test, and any recommendations for senior management's action.

⁴ The multi-period stress test must be conducted in accordance with the requirements in the policy document on Stress Testing for Insurers and Takaful Operators, which will be issued in the future.

13 Reinsurance/retakaful arrangements

- S 13.1 The appointed actuary must carry out an assessment and provide his opinion in the FCR on the overall suitability of the licensed person's reinsurance or retakaful arrangements in relation to its liabilities.
- S 13.2 In undertaking the assessment of reinsurance or retakaful arrangements under paragraph 13.1, the appointed actuary must consider the following areas:
- (a) the appropriateness of the reinsurance or retakaful arrangements with respect to the relevant product lines;
 - (b) the financial position of the reinsurer or retakaful operator;
 - (c) the appropriateness of the level of retention of risks;
 - (d) an assessment of the credit risk and any concentration risks arising from the reinsurance or retakaful arrangements, especially where such arrangements are made with related companies; and
 - (e) the prospects for claim recovery under a reinsurance or retakaful contract, taking into account legal opinions provided, if any.

14 Distribution of surplus

- S 14.1 For licensed insurers carrying on participating life business and licensed takaful operators including professional retakaful operators, the appointed actuary must include in the FCR his recommendations to the Board on the distribution of surplus as specified in the policy document on 'Appointed Actuary: Appointment and Duties' and the policy document on 'Appointed Actuary: Appointment and Duties (for reinsurers and retakaful operators)', as applicable.
- S 14.2 For the licensed insurers referred to in paragraph 14.1, the appointed actuary must append the results from the annual bonus recommendation report as required in the policy document on 'Management of Participating Life Business.'
- S 14.3 For the licensed takaful operators including professional retakaful operators, the appointed actuary's recommendation on the distribution of surplus from the Participants' Risk Fund (PRF) must include -
- (a) the rationale for the amount recommended for distribution as required in the 'Guidelines on Takaful Operational Framework'⁵;
 - (b) the impact of the distribution on the financial position of the takaful funds;
 - (c) the methods used in determining the distribution (for example, whether differentiated by product lines or cohorts of participants); and
 - (d) the amount of surplus retained in the PRF and the factors considered in determining the amount.

⁵ Paragraphs 10.23 and 12.8 of the Guidelines on Takaful Operational Framework.

15 Repayment of *qard*

- S 15.1 For licensed takaful operators including professional retakaful operators, the appointed actuary must carry out an assessment and provide an opinion in the FCR on -
- (a) the repayment of *qard* to the licensed takaful operator and professional retakaful operator in the case of *qard* that has been provided to rectify a previous deficit in the PRF; or
 - (b) the possibility of the PRF requiring *qard* in the future, taking into account the results of the multi period stress test, irrespective of whether *qard* has already been provided to rectify a previous deficit.
- S 15.2 The appointed actuary's opinion in paragraph 15.1 must include an elaboration on -
- (a) the causes of the deficit in the PRF or sub-funds;
 - (b) the impact of the *qard* given and repayment of the *qard* on the financial position of the licensed takaful operator including professional retakaful operator or PRF; and
 - (c) the ability of the PRF to repay *qard* to the licensed takaful operator including professional retakaful operator where there is *qard* outstanding in the PRF, including circumstances in which *qard* is deemed irrecoverable⁶.

16 Management of estate in participating life business

- S 16.1 For licensed insurers carrying on participating life business, the appointed actuary must provide an opinion in the FCR on the overall suitability of the use of estates, taking into account the requirements in the policy document on 'Management of Participating Life Business'.

⁶ The assessment should take into account requirements in the Guidelines on Takaful Operational Framework and Financial Reporting for Takaful Operators.

PART C REPORTING

17 Reporting to the board

- S** 17.1 The FCR must be presented by the appointed actuary to the board at least annually to support the licensed person's business planning process.
- S** 17.2 The appointed actuary must ensure that the information used in the FCR for the purpose in paragraph 17.1 is up-to-date. In particular, the reference date for the information used must be from the immediate quarter preceding the submission of the FCR to the board.
- G** 17.3 Given the technical content of the FCR, it is recommended that the appointed actuary takes steps to validate that the deliberations on the FCR by the board are clearly and adequately reflected in the record of the discussions, consistent with his own records, to facilitate any follow up actions required.

18 Reporting to the Bank

- S** 18.1 The FCR must be submitted by the licensed person to the Bank annually and no later than 14 days after its presentation to the board.
- S** 18.2 Any documentation or information supporting the FCR but which is not included as part of the FCR must be made available by the licensed person to the Bank for inspection upon request.