Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

CONSULTATION PAPER ON DIFFERENTIAL LEVY SYSTEM FRAMEWORK FOR TAKAFUL AND INSURANCE BENEFITS PROTECTION SYSTEM

ISSUE DATE : 27 APRIL 2012
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PART A: INTRODUCTION

1.0 Introduction

1.1 Perbadanan Insurans Deposit Malaysia ("PIDM") is a statutory body established under the Malaysia Deposit Insurance Corporation Act ("the Act"). PIDM's mandates as set out in the Act, are:

(a) to administer a deposit insurance system and a takaful and insurance benefits protection system;

(b) to provide insurance against the loss of part or all deposits for which a deposit-taking member is liable and provide protection against the loss of part or all of takaful or insurance benefits for which an insurer member is liable;

(c) to provide incentives for sound risk management in the financial system; and

(d) to promote or contribute to the stability of the financial system.

1.2 The Takaful and Insurance Benefits Protection System ("TIPS") is a system established to protect takaful beneficiaries and insured persons from the loss of their eligible takaful and insurance benefits in the unlikely event that an insurer member fails and is unable to honour the takaful or insurance benefits. TIPS was brought into effect on 31 December 2010.

2.0 Objective of Consultation Paper

2.1 The purpose of this Consultation Paper is to seek the views and comments on the proposed TIPS Differential Levy System ("DLS") Framework.

2.2 The Consultation Paper is divided into five (5) parts:

Part A: Introduction

Part B: Legal Provisions and Scope of Application

Part C: Proposed Differential Levy System Framework

Part D: Reporting, Submission and Appeal

Part E: Appendices

Appendix I(a) Quantitative Criteria – Capital Assessment

Appendix I(b) Quantitative Criteria – Operational and

	Sustainability Measures for General Insurance Business
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3.0 Consultation Process and Effective Date of Regulations

3.1 In line with PIDM's approaches and values, a consultation approach has been adopted in order to ensure that the DLS Framework is appropriate and effective.

3.2 PIDM welcomes written comments on any aspect of the Consultation Paper. Comments should be received by PIDM no later than **8 June 2012** and addressed to:

General Manager
Insurance, Risk Assessment and Monitoring Division
Perbadanan Insurans Deposit Malaysia
Level 12, Quill 7
No. 9, Jalan Stesen Sentral 5
Kuala Lumpur Sentral
50470 Kuala Lumpur
Malaysia

(Please mark "CP DLS" on the top left hand corner of the envelope for written comments posted to PIDM)

Enquiries: 03 2173 7436
Fax: 03 2173 7494
Email: dls@pidm.gov.my

3.3 All comments will be treated in strictest confidence. PIDM will collate comments on this Consultation Paper and publish its response on PIDM's website, by the end of **July 2012**. PIDM will issue guidelines and regulations to put the Framework into effect upon its finalisation. The public will be informed through PIDM's website once the regulations come into force.

3.4 The DLS Framework is planned to be effective in the assessment year 2013.

PART B: LEGAL PROVISIONS AND SCOPE OF APPLICATION

4.0 Legal Provisions to Develop and Charge Differentiated Premiums

4.1 Pursuant to subsections 71(2) and 72(4) of the Act, PIDM may make any regulations in respect of the determination of first premium and annual premiums for member institutions, including:

(a) the establishment of a system of classifying members in different categories; and

(b) the criteria or factors to be taken into account and the procedures to be followed in determining the category in which a member is classified.

For the purpose of this Consultation Paper, “levy” or “levies” shall have the same meanings as “premium” or “premiums” in the Act.

5.0 Scope of Application

5.1 The proposed DLS Framework is applicable to all insurance companies that are locally incorporated and licensed to carry on insurance business under section 16 of the Insurance Act 1996, except reinsurance companies and Danajamin Nasional Berhad, (“insurer members” or “members”). All insurer members conducting general insurance and/or life insurance businesses are subject to the DLS Framework.

5.2 Table 1 depicts the application of DLS Framework in respect of an entity’s business or businesses.

Table 1: Scope of Application

Entity	Business	General Insurance DLS Criteria	Life Insurance DLS Criteria
Conventional Insurer Members	General Insurance	X	
	Life Insurance		X
	Composite Insurance	X	X
Takaful Operators	General and Family Takaful	NOT APPLICABLE	

5.3 Takaful operators are excluded from this DLS Framework at this point of time due to limitation of data, particularly in relation to capital adequacy measure. PIDM plans to develop the takaful DLS Framework in line with the impending proposed Risk-Based Capital ("RBC") Framework for Takaful Operators. In the meantime, PIDM will continue to explore developing appropriate measures to be applied for takaful DLS Framework.

Issue 1: Proposed Treatment of Takaful Operators

a) PIDM seeks your comments on the exclusion of takaful operators from this DLS Framework.

b) Please provide your views and suggestions on the acceptable measures, especially on the capital adequacy indicator to be adopted on an interim basis for a DLS Framework for Takaful.

PART C: PROPOSED DIFFERENTIAL LEVY SYSTEM FRAMEWORK

6.0 Background

6.1 TIPS, which came into effect on 31 December 2010, applies a flat-rate levy for the insurer members, regardless of their risk profiles. With the establishment of the proposed DLS Framework, PIDM aims to promote greater fairness into the levy assessment process. In addition, the DLS Framework supports one of the mandates of PIDM, which is to provide incentive for sound risk management. The members will have to improve the overall aspects of their business in order to get to the best risk category and be subjected to the lowest levy rate.

6.2 In this regard, PIDM replicates the successful implementation of the Differential Premium System ("DPS") Framework of the Deposit Insurance System ("DIS") introduced in 2008. The DPS Framework classifies deposit-taking members into different categories according to their respective risk profiles.

7.0 Objectives

7.1 The objectives of the DLS Framework are as follows:

7.1.1 to differentiate insurer members according to their risk profiles;

7.1.2 to introduce more fairness into the levy assessment process where insurer members assessed to be of higher risk would pay higher levies as opposed to members classified as having lower risk exposures;

7.1.3 to provide incentives for insurer members to adopt sound risk management practices; and

7.1.4 to promote stability of the financial system via the overall improvement in risk management practices of the insurer members.

7.2 The general approach taken by PIDM in developing the DLS Framework is to ensure consistency, to the extent possible, with the existing DPS Framework.

8.0 Guiding Principles

8.1 The development of DLS Framework is guided by the following principles:

8.1.1 the DLS should be equitable for all insurer members, irrespective of their size or complexity;

8.1.2 the DLS should provide incentives for insurer members to move towards the best classification (lowest levy rate) by improving their risk profile;

8.1.3 the DLS should take into consideration both quantitative and qualitative factors and contain forward-looking elements;

8.1.4 the DLS should depend on accurate, reliable and timely information;

8.1.5 the DLS should use data based on the approved financial reporting standards adopted by the Malaysian Accounting Standards Board;

8.1.6 the DLS should be objective and transparent so that insurer members understand and are able to manage their risk profiles; and

8.1.7 the DLS should ensure that there is no discretion on the part of PIDM and the insurer members to adjust scores arbitrarily.

9.0 General Approach

9.1 In developing the DLS Framework, PIDM had carried out the following:

9.1.1 **Research and Review**

The proposed DLS Framework had been developed following extensive research on various risk assessment methodologies performed by primary regulators and rating agencies both domestically and internationally. In addition, approaches adopted by the insurance guarantee schemes of other jurisdictions were also reviewed.

9.1.2 **Positional and Trend Analysis**

PIDM had reviewed and tested the members’ statistical data and analysed the trends. PIDM had also taken into account the performance of the members during the 1997-1998 financial crisis.

9.1.3 **Discussion and Consultation**

Various discussions were held with Bank Negara Malaysia ("BNM") and industry experts to assess the applicability and operationalisation of the methodology, criteria and measures used. PIDM had taken their feedbacks into consideration in the development of the proposed DLS Framework.

10.0 Salient Features

10.1 Methodology

10.1.1 Using a similar approach as that for DPS Framework, PIDM will classify insurer members into different categories based on their combined quantitative and qualitative criteria. This approach is viewed to be more effective and comprehensive than a pure quantitative or qualitative criteria approach.

10.1.2 PIDM aims to ensure that the DLS Framework is objective, transparent and forward-looking in its approach. Correspondingly, a larger weightage is assigned to the quantitative criteria which carry a score of 60%, while the qualitative criteria carry the remaining score of 40% out of a total score of 100%.

10.1.3 The quantitative criteria is made up of indicators representing statistical measures on capital, operational performance and business sustainability of the insurer members. On the other hand, the qualitative criteria of the DLS Framework comprise the supervisory rating of the insurer members and any other information that would have implications on the well-being of the members.

10.1.4 With regard to the quantitative criteria, PIDM will implement a two-dimensional approach i.e. "matrix approach". One of the dimensions is the capital criteria, and the other is a composition of the other quantitative measures which is termed as operational and sustainability measures.

10.1.5 The overview of the methodology used in the DLS Framework incorporating the approach, weightages and criteria is illustrated in Diagram 1: DLS Framework Methodology.

Diagram 1: DLS Framework Methodology

Criteria Approach	**Quantitative**	+	**Qualitative**
Weightages	**60%**		**40%**
Criteria Components	(see table below)		All Insurer Members • BNM Supervisory Rating (Composite Risk Rating) • Other Information
Scoring Approach	**Matrix Approach**: The FCI together with the Operational & Sustainability measures determine the position of an insurer member in the matrix. The position of the insurer member in the matrix would determine the quantitative score of DLS Framework which carries a maximum score of 60%.		The Supervisory Rating holds a maximum score of 35%, while the remaining score of 5% is assigned to 'Other Information'

	All Insurer Members	
Capital	Free Capital Index ("FCI")	
	General Insurance Business	Life Insurance Business
Operational & Sustainability measures	• Gross Premium Growth Rate • Business Diversification Ratio • Receivable Ratio • Combined Ratio • Operating Margin Ratio	• New Business Growth Rate • Business Concentration Ratio • Business Conservation Ratio • Investment Yield • Return on Required Capital

10.2 Quantitative Criteria

10.2.1 PIDM considers the effectiveness of the relevant measures within the quantitative criteria in order to differentiate members according to the risks associated with their business portfolios and regulatory requirement.

10.2.2 In coming up with the selected quantitative measures, PIDM had conducted extensive analysis to ensure the appropriateness and suitability of the indicators. Further reviews and tests were performed on the distribution of the results of indicators to ensure applicability over the business operating environment. Encompassing the analysis conducted, thresholds were established to categorise insurer members into differentiated scores.

10.2.3 Furthermore, the thresholds of the indicators were chosen and tested based on the current and expected future development of the operating environment. In setting the thresholds, PIDM considers the alignment with the current regulatory and supervisory policies, fairness to all insurer members, the average industry performance, as well as peer positioning of the insurer members.

10.3 Components of Quantitative Criteria

Capital Measure

10.3.1 The primary component of the quantitative criteria is the capital measure. Capital provides a crucial cushion against adverse changes in the member’s earnings and asset quality. Thus, a strong capital buffer is critical in ensuring that the insurer members remain solvent as it represents the last line of defence against any expected and/or unexpected losses.

10.3.2 The capital measure is denoted by an index formulated by the insurer member’s capital adequacy ratio (“CAR”) divided by the internal target capital level (“ITCL”). This index is termed ‘Free Capital Index’ (“FCI”), which is a measure of capital buffer above the member’s ITCL. The FCI leverages on the ITCL set by the insurer members as required under BNM’s RBC Framework for Insurers. Members will be scored based on the buffer they have against the ITCL. From PIDM’s perspective, this index will be a good leading measure on members’ capital sufficiency and trends. It will be a trigger for any prompt corrective measures to be taken to ensure that the members’ capital remains above the ITCL level. Further description of the index is in Appendix I(a).

Operational and Sustainability Measures

10.3.3 This component of the quantitative criteria aims to assess the members' operational management efficiency and the sustainability of their financial performance.

10.3.4 Apart from the importance of capital buffer, equally significant is the ability of the insurer members to ensure the operational soundness and sustainability of their business. Strong capital buffer alone would not ensure long term sustainability, as it may be depleted unless it is being further supported by an efficient and sustainable business operation as well as strong financial performance.

10.3.5 Under these measures, insurer members with general insurance business will be assessed on:

(a) the sustainability of the business underwritten measured by the extent and the stability of business growth via the gross premium growth rate;

(b) the sensitivity of insurer members towards adverse experiences of their lines of businesses that they may be exposed to via the business diversification ratio;

(c) the efficiency of its business operations as reflected in its ability to ensure timely collection of insurance receivables; and

(d) the profitability of the insurer members both from the insurance business as well as from the overall profitability perspectives.

10.3.6 In the case of insurer members conducting life insurance business, the members will be assessed on:

(a) the sufficiency of their new business growth, which is a vital component towards business sustainability;

(b) the extent of business concentration through an assessment of premiums composition between single and regular premiums;

(c) the ability of insurer members to ensure continuation of the business underwritten by measuring its business conservation ratio; and

(d) profitability of the members from the perspective of investment yield, being one of the key components of the life insurer member's profitability as well as the returns generated relative to the capital employed.

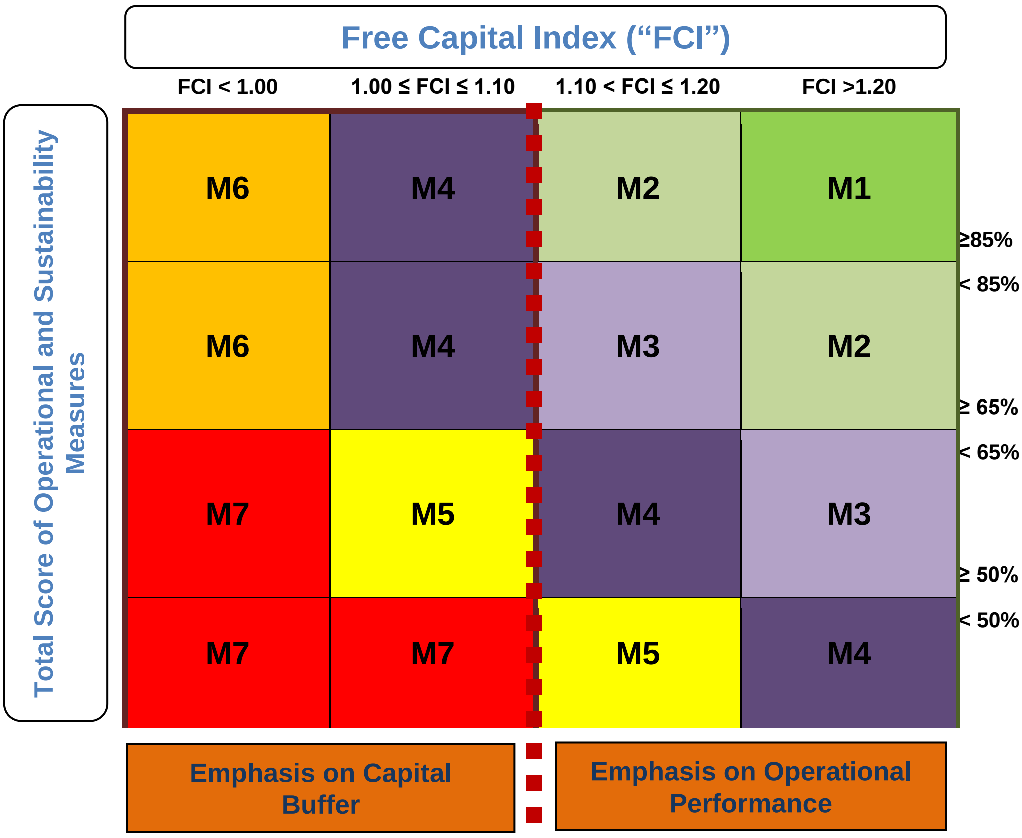
10.3.7 Detailed descriptions of the measures for general and life insurance businesses are in Appendix I(b) and Appendix I(c), respectively.

10.4 Quantitative Criteria Score (Matrix Approach)

10.4.1 The quantitative criteria will be scored using a matrix approach, taking into consideration both the capital strength and the operational soundness and business sustainability of insurer members as described above.

10.4.2 Diagrammatically, the capital measure is plotted on the horizontal axis, whilst the operational and sustainability measures will be gauged on the vertical axis. Mapping of these two (2) sets of measures would allow for the quantitative criteria score to be determined from the possible seven (7) matrix categories. The matrix as well as the relationship between capital measure and the operational and sustainability measures are depicted in Diagram 2.

Diagram 2: Quantitative Criteria Matrix



10.4.3 The FCI and the operational and sustainability measures will have four (4) differentiated thresholds. On the horizontal axis, the FCI will be scored on the following ranges:

Table 2: Free Capital Index Score Range

Free Capital Index-Range of Results
Free Capital Index > 1.20
1.10 < Free Capital Index ≤ 1.20
1.00 ≤ Free Capital Index ≤ 1.10
Free Capital Index < 1.00

While on the vertical axis, the operational and sustainability measures will be scored on the following ranges:

Table 3: Operational and Sustainability Score Range

Operational and Sustainability Measures-Range of Results
Operational and Sustainability ≥ 85%
65% ≤ Operational and Sustainability < 85%
50% ≤ Operational and Sustainability < 65%
Operational and Sustainability < 50%

10.4.4 The FCI relates to the extent of the capital buffer maintained by the insurer members. As shown in the matrix, insurer members will be measured based on its FCI score where the capital buffer would determine the member's position along the horizontal axis (Please refer to description of the measures in Appendix I(a) for the FCI scores).

10.4.5 In the case of the operational and sustainability measures, these are made up of different sets of indicators for general and life insurance businesses. These indicators are assigned specific weightages to the overall assessment on the operational and business sustainability of the insurer members. The total aggregated score for these indicators is 100%. Table 4 lists the indicators and the corresponding weightages for general and life insurance businesses, respectively.

Table 4: Summary of Operational and Sustainability Measures

General Insurance Business		Life Insurance Business	
Indicators	**Weightage**	**Indicators**	**Weightage**
Gross Premiums Growth Rate	20%	New Business Growth Rate	15%
Business Diversification Ratio	25%	Business Concentration Ratio	25%
Receivable Ratio	20%	Business Conservation Ratio	25%
Combined Ratio	20%	Investment Yield	20%
Operating Margin Ratio	15%	Return on Required Capital	15%
Total	***100%***		***100%***

10.4.6 Each indicator in Table 4 will be scored according to thresholds assigned (refer to description of the measures in Appendix I(b) and Appendix I(c) for the respective scores). Thus, by aggregating the results of each indicator, an insurer member would be able to determine its operational and sustainability measures score. This score would indicate member's position on the vertical axis.

10.4.7 Composite insurer members would have the total score for the respective types of business proportioned to the percentage of the net premiums of general and life insurance businesses for a total aggregate score of 100%. (Refer Appendix III: Illustration 2 for an illustration to compute operational and sustainability measures of a composite insurer member).

10.4.8 An insurer member is able to determine its position in the matrix by using the combination of FCI score and the aggregated score of the operational and sustainability measures. The matrix category would then reflect the member's total quantitative criteria score.

10.4.9 PIDM wishes to highlight that the distribution of categories within the matrix is guided by two (2) levels of importance. For the insurer members with a FCI score of 1.10 and below, the emphasis would be on the capital buffer where scores of the operational and sustainability measures would be less significant in arriving at better matrix categories. Conversely, for members with a FCI score of above 1.10, where the capital buffer is stronger, the performance of the member's operational and sustainability measures would be of higher significance in determining better matrix categories.

10.5 Total Quantitative Criteria Score

10.5.1 The seven (7) categories within the matrix would then be mapped to the total quantitative score as depicted in Diagram 3: Quantitative Score. The score would reflect the overall quantitative performance of the insurer members, after considering both capital measure and the operational and sustainability measures.

Diagram 3: Quantitative Score

Quantitative Score: 60%	
M1	60%
M2	55%
M3	45%
M4	40%
M5	30%
M6	25%
M7	15%

10.6 Qualitative Score

10.6.1 PIDM aims for the DLS Framework to contain forward-looking elements in its criteria and this is achieved by incorporating sources of qualitative assessment. As the quantitative criteria mostly measure past financial conditions, these does not reflect the important aspects of risk management practices, governance and management quality and the supervisory ratings of the insurer members. Hence, the quantitative measures alone are inadequate and less effective at providing leading indication of the future risk profile of the members. As a complement, the qualitative criteria is to provide important information on current and future risk profiles of the insurer members.

10.6.2 The qualitative criteria give greater weightage to the supervisory rating, namely the Composite Risk Rating ("CRR") assessed by BNM, due to the direct supervisory relationship between BNM and the insurer members. The CRR would encapsulate first hand information about the insurer members by BNM which supervises and monitors the insurer members' risk profiles, operational management and their risk management control functions.

10.6.3 The remaining score within the qualitative criteria incorporates other information not considered by the quantitative and qualitative criteria as described above. This other qualitative criterion would assess the insurer members based on their compliance with regulations, guidelines and any other regulatory requirements which may include supervisory concerns and intervention actions. This factor aims to capture any issues that may have a significant impact on the financial performance and/or reputation of the insurer members.

Issue 2: DLS Framework Methodology

PIDM seeks your comments and suggestions on the following:

(a) the proposed quantitative criteria and the score ranges;

(b) the overall quantitative scoring criteria using the matrix approach;

(c) the weightage assigned to each criterion and indicators; and

(d) the proposed qualitative criteria.

Please provide supporting evidence and the rationale for your comments.

PIDM also wishes to seek your comments and views on the quantitative measures in the appendix I(a), I(b) and I(c).

Issue 3: Proposed Treatment of Composite Insurer Members

Under this Consultation Paper, PIDM proposes a separate assessment for general and life insurance business and the total score will be apportioned using 'net premiums' for the operational and sustainability measures scores of composite insurer members.

Another approach would be to set a materiality threshold in determining the applicability of general or life quantitative criteria in deriving to a total quantitative score. For example, a composite member with life insurance net premiums proportion that is more than, say 80%, the total quantitative score would be derived from the life business criteria only.

PIDM seeks your comments on the above approaches and provide suggestion on other appropriate method, if any as well as the materiality threshold.

10.7 DLS Score

10.7.1 The sum of the total quantitative criteria score and the qualitative criteria score would represent the DLS score of an insurer member.

10.7.2 The CRR component of the qualitative criteria consists of four (4) different levels of rating, namely 'low', 'moderate', 'above average' and 'high'. For the purpose of DLS Framework, these CRRs are assigned corresponding scores. Diagram 4 describes the CRR and its respective score.

Diagram 4: Supervisory Rating Score

Supervisory Rating Score: 35%	
LOW	35%
MODERATE	22%
ABOVE AVERAGE	10%
HIGH	0%

10.7.3 Ultimately, with a maximum score of five percent (5%) from the 'Other Information' component of the qualitative criteria, the insurer members would be able to determine their DLS scores.

10.8 DLS Levy Categories

10.8.1 Insurer members will be classified into four (4) levy categories based on their DLS scores. A system with four (4) categories is envisaged to be appropriate given the number of insurer members, while at the same time provide a meaningful differentiation between levy categories.

10.8.2 The key consideration in determining the appropriate number of levy categories is its effectiveness in differentiating members into appropriate risk categories in order to achieve the DLS Framework objectives and principles. Using more categories would result in smaller levy differences between categories, thus reducing the incentive for improvements.

10.8.3 In setting the range of scores for each category, any members who achieve a DLS score of less than 50% out of 100% will be placed in the highest levy category four (4) and those with a score of 85% or better will be classified in the lowest levy category one (1). The remaining two (2) categories are proportionally set between the highest and lowest.

10.8.4 Table 5 sets out the DLS scores and levy categories:

Table 5: DLS Scores and Levy Categories

DLS Score	Levy Category
DLS Score ≥ 85%	1
65% ≤ DLS Score < 85%	2
50% ≤ DLS Score < 65%	3
DLS Score < 50%	4

10.8.5 An annual levy will be prescribed in relation to each levy category. The applicable levy for each member is based on the levy category in which a member is categorised. The levy rate will be prescribed via regulations in due course. All insurer members shall pay their levies by 31 May of an assessment year based on the scores provided by PIDM.

11.0 New Member

11.1 In the event that a new institution becomes a member of PIDM during the year, the member shall be automatically categorised in the lowest levy category for its first two (2) assessment years on the basis that it has just started operations, hence its risk profile may not be significant.

11.2 The new insurer member will not be required to submit the quantitative information to PIDM as required under paragraph 15 (Reporting and Submission) in the first two (2) assessment years. The new member shall start submitting the quantitative information to PIDM in the assessment years subsequent to its second assessment year.

11.3 For the computation of quantitative criteria for the subsequent assessment years following the second assessment year, quantitative information for the first assessment year should not be included. The rationale is to minimise the impact of drastic fluctuations in the information as newly established members will generally experience rapid growth and start-up costs which may result in operating losses.

12.0 Amalgamation

12.1 Amalgamation is defined as the acquisition of one (1) or more members or merger of two (2) or more members. An amalgamated member means a member formed from the amalgamation of two (2) or more members, whereas an amalgamating member means a member that has undergone an amalgamation process, resulting in the formation of an amalgamated member.

12.2 The following provisions should be applied in determining the total score of an insurer member formed by an amalgamation that occurred after 31 May of the preceding assessment year and on or before 31 May of the assessment year.

12.3 For the quantitative criteria, the following score will be assigned to an amalgamated member:

(a) where an amalgamated member is formed on or before 31 December of the preceding assessment year, the scores will be based on the quantitative information of the amalgamated member as at 31 December of the preceding assessment year; or

(b) where an amalgamated member is formed after 31 December of the preceding assessment year, the highest of the sums of the scores based on information as at 31 December of the preceding assessment year assigned to each of those amalgamating members will be assigned to the amalgamated member.

12.4 For the qualitative criteria, the following score will be assigned to an amalgamated member:

(a) where an amalgamated member is formed on or before 31 December of the preceding assessment year, the scores will be based on the supervisory rating and other information of the amalgamated member as at 31 December of the preceding assessment year; or

(b) where an amalgamated member is formed after 31 December of the preceding assessment year, the supervisory rating and other information of the amalgamating member whose scores were used in scoring the amalgamated member’s quantative criteria will be applied.

Issue 4: Treatment of New Member and Amalgamation

Please provide comments on the treatment of the following:

(a) new member; and

(b) amalgamation.

13.0 Transition Period

13.1 A transition period shall be in effect for the first year of the DLS Framework during which insurer members will be allowed certain adjustments to their scores. This is to allow members to adapt to the DLS Framework and provide ample time for members to improve their financial performance and operations.

13.2 During the transition period, PIDM proposes that the total quantitative score of each insurer member be adjusted upwards by 10%. This adjustment shall only be applicable for the assessment year 2013.

13.3 For example, during the transition period, if an insurer member has scored 40% for its quantitative criteria, its score would be increased by 4 percentage points, resulting in a total quantitative score of 44%.

13.4 Any adjustment shall not result in an insurer member's total quantitative score exceeding 60%. For example, if a member has a total quantitative score of 57%, a 10% increase will result in an additional 5.7 percentage points. In this case, the adjusted score will be 60%, which is the maximum score for quantitative criteria.

Issue 5: Transition Period and Process

Based on the members' experience and system capabilities, is the one year transition period sufficient in order to adjust to the requirements of the DLS Framework? If not, please provide comments (with supporting rationale or evidence) on the:

(a) transition period; and

(b) transitional process.

14.0 Future Revisions

14.1 PIDM accepts that there will be developments in the financial services industry that could affect the financial statements and regulatory reporting of the insurer members. In order to accommodate any changes within the industry landscape, PIDM will review on an ongoing basis the DLS Framework to ensure that the system is kept up to date with current developments.

14.2 These future revisions are meant to enable the DLS Framework to take into account the latest developments in the regulatory and supervisory regime so as to ensure consistency of approach. This will also provide PIDM with the flexibility to enhance the DLS's ability to differentiate members according to their risk profiles.

PART D: REPORTING, SUBMISSION AND APPEAL

15.0 REPORTING AND SUBMISSION

15.1 Reporting Reference Date

<u>Quantitative Criteria</u>

15.1.1 For insurer members with financial year ending on 31 December, the quantitative criteria shall be calculated based on financial year end information as at 31 December of the preceding assessment year.

15.1.2 For insurer members whose financial year does not end on 31 December, the quantitative criteria shall be calculated based on calendar year end information as at 31 December of the preceding assessment year.

<u>Qualitative Criteria</u>

15.1.3 For supervisory rating criteria, the rating provided by BNM for each member as at 31 December of the preceding assessment year will be applied.

15.1.4 As for other information criteria, members will be assessed based on information received by PIDM after 31 December of the preceding assessment year up to 30 April of the current assessment year. Sources of information will include supervisory intervention action, deficiencies identified in the operations of members, reviews from rating agencies and any other information. This is to ensure that the qualitative scores assigned to members will reflect as much as possible their current conditions and risk profiles.

Issue 6: Reporting Reference Date

PIDM seeks your comments on the following:

(a) whether the proposed reporting reference date is appropriate; and

(b) the calculation of quantitative information based on calendar year end information for members whose financial year end is not 31 December.

15.2 Submission Date

15.2.1 All insurer members shall submit quantitative information in pre-formatted templates or forms to PIDM by **30 April** of an assessment year for the purpose of levy computation. PIDM will then assign the score for the supervisory rating and other information criterion to each member.

15.2.2 The submission forms must be certified by the chief executive officer ("CEO") jointly with the chief financial officer ("CFO") or the appointed actuary ("AA") of an insurer member to be truly and accurately reflective of the financial information of the members as at 31 December of the preceding assessment year.

15.2.3 For a member that fails to submit quantitative information by 30 April of an assessment year, PIDM will assign scores to the member according to information available in BNM's Insurance Companies Statistical System ("ICSS") and RBC submissions. A levy surcharge may be imposed on insurer members that do not comply with the submission deadline.

Issue 7: Submission Date

Please provide comments and suggestions on the proposed submission dates and requirements.

15.3 Information Integrity

15.3.1 Insurer members shall be accountable to ensure that the accuracy of the information submitted for the DLS Framework is equivalent to that of their audited and/or approved financial information. To ensure accuracy, the information submitted for DLS Framework must be validated by an insurer member's external auditor and certified by the CEO jointly with the CFO or the AA. PIDM will be issuing the consultation paper on the regulation on the external auditor validation programme in due course.

15.3.2 PIDM may impose a levy surcharge on members that do not comply with the requirements with regard to information integrity.

Issue 8: Information Integrity

PIDM seeks your comments on the following:

(a) the control mechanisms that members have put in place to ensure information accuracy and reliability; and

(b) engaging the external auditor to validate information submitted for the DLS Framework;

15.4 Computation and Notification of Score

15.4.1 The DLS score will be a sum of scores assigned for the quantitative and the qualitative criteria.

15.4.2 PIDM will compute the DLS score for each member and notify the members of their respective scores, levy categories and applicable levy by 15 May of an assessment year. This will provide sufficient time for members to make the necessary arrangements for the payment of levies due to PIDM by 31 May of an assessment year. Please refer to Appendix III: Illustration 1 for an example of DLS score and levy categorisation.

15.5 Insufficient Quantitative Information

15.5.1 For members with insufficient information to calculate certain criteria, the scores for such criteria shall be determined on a proportionate basis as stated below. Please refer to Appendix III: Illustration 2 for an example of DLS scoring for members with insufficient quantitative information.

$$[A \div (100 - B)] \times B$$

where

A is the sum of the scores assigned to a member for each quantitative criterion where the quantitative information is available.

B is the sum of maximum scores for criteria where information is not available for computation.

Issue 9: Insufficient Quantitative Information

Please comment on the proposed method for scoring criteria where certain information is unavailable. Please provide suggestions.

15.6 Filing Resubmission

15.6.1 In instances where members submit any amendments on quantitative information to PIDM after the submission deadline, i.e. 30 April of an assessment year, the rating of an insurer member will be based on the information submitted by 15 May of an assessment year.

15.6.2 Insurer members that submit amended information are expected to comply with provisions for information integrity as specified under paragraph 15.3 (Information Integrity).

15.6.3 Insurer members that resubmit quantitative information are required to comply with the deadlines set for the appeal process as specified in paragraph 15.7.5.

Issue 10: Filing Resubmission

Please provide comments on the proposal for filing resubmission.

15.7 Appeal Process

15.7.1 Notwithstanding paragraph 15.4.2, in line with PIDM's corporate principles of fairness and transparency, PIDM proposes to put in place an appeal process, providing an avenue for any member to request a review of its final score.

15.7.2 Insurer members may request for an appeal of the scores **after 31 May** of an assessment year and are required to formally submit the request in writing to PIDM. The request should include reason(s) for an appeal.

15.7.3 The appeal is on the basis of errors in the quantitative information provided by a member or errors in PIDM's computations in relation to quantitative criteria, and other information criteria. The supervisory rating provided by BNM shall not be applicable for appeal since BNM already provides a review process prior to assigning the members their final supervisory ratings.

15.7.4 Any request for appeal shall be submitted to PIDM **no later than 31 August** of an assessment year. PIDM will review and respond to the appeal by **30 September** of an assessment year upon receiving the request in writing.

15.7.5 If the appeal process results in a member having overpaid levies, PIDM will reimburse the member the overpayment once the appeal process is successful.

Issue 11: Appeal Process

Please provide your comments on the proposed appeal process.

PART E: APPENDICES

APPENDIX I(a): QUANTITATIVE CRITERIA – CAPITAL ASSESSMENT

1.0 Free Capital Index

Rationale

Capital is very important to an insurer member as it serves as a cushion against any unexpected losses. Capital should be permanent and freely available to absorb losses. A strong capital buffer reduces the risk of insurer members' failure due to the risk inherent in their business.

The RBC Framework for the insurance industry was implemented on 1 January 2009 as a regulatory capital requirement by BNM. CAR is the measure of the insurer member's capital level (total capital available) to the level of capital required (total capital required). Insurer members are required to comply with a minimum supervisory target capital level of 130% at all times.

Notwithstanding the minimum supervisory target capital level imposed by BNM, insurers are also required to maintain capital that corresponds with its risks. It includes the determination of an ITCL that commensurates with an insurer's risk profile under the Guidelines on Internal Capital Adequacy Assessment Process (ICAAP) issued on 28 February 2012.

PIDM proposes a score range that reflects the insurer members' reasonable capital buffer above their ITCL where a higher capital buffer would reduce the risk of insurer members' failure.

Calculation

Insurer members would be classified into different matrix categories based on their FCI.

FCI is set based on the average of four (4) quarters of CAR within the calendar year of the preceding assessment year against its ITCL. The average of four (4) quarters of CAR is used to address any potential inconsistency of the insurer member's CAR. The formula is:

$$\textbf{Free Capital Index (FCI)} = \frac{\textbf{CAR (\%)}}{\textbf{ITCL (\%)}}$$

Categorisation of Scores

A member's FCI score would be based on the following range of results:

Table 6: Score Range for Free Capital Index

Free Capital Index
Range of Results
Free Capital Index > 1.20
1.10 < Free Capital Index ≤ 1.20
1.00 ≤ Free Capital Index ≤ 1.10
Free Capital Index < 1.00

Issue 12: Free Capital Index

Please provide your comments on the use of average of four (4) quarters of CAR within the calendar year of the preceding assessment.

APPENDIX I(b): QUANTITATIVE CRITERIA - OPERATIONAL AND SUSTAINABILITY MEASURES FOR GENERAL INSURANCE BUSINESS

Rationale

Apart from the importance of capital buffer described in Appendix I(a), equally imperative is the ability of the general insurer member to ensure the sustainability of its operations in order to obtain a consistent stream of profitability. A strong capital buffer alone will not ensure long-term sustainability; it may be depleted unless it is being further supported by efficient and sustainable operations and financial performance. Given the nature of the general insurance business, where the insurer member deals with various parties, operational efficiency is critical. Hence, well-managed insurer members should be more resilient to operational risks.

Under the DLS Framework, PIDM aims to measure the level of efficiency of the insurer member's business operation. A strong and efficient operational performance will contribute towards business sustainability where operational risks are minimised.

Sustainable and strong financial performance is also emphasised under the DLS Framework. This is assessed on the member's ability to consistently generate strong level of earnings from both underwriting and investment operations. The strong and sustainable earnings performance would contribute to the member's ability to generate capital internally, hence further enhance its financial viability and have a lower probability of requiring additional capital.

In addition, consistent premium generation as well as portfolio diversification are also factors considered. The premium growth reflects the member's ability to generate a stable stream of income whilst well diversified portfolio reduces the member's vulnerabilities towards adverse experience of any of its line of business.

Criteria Measures

The following five (5) indicators are used for the operational and sustainability of general insurer members.

1.0 Gross Premium Growth Rate

Premium growth is one of the important factors considered to assess the sustainability of the insurance business. As the main source of income, growth in premiums will provide a constant stream of income to support business operations and enhance its market share. Furthermore, the growth is crucial as it ultimately increases the shareholders' value. The level of business growth, nonetheless, should match the members' operational capacity, risk management capability and risk appetite.

Given the nature of general insurance business, reinsurance is used to mitigate the insurance risks. However, it is generally accepted that the insurer member would have to ultimately absorb the losses in the event the counterparties failed to honour its obligation. Therefore, gross premiums are selected as they reflect the overall business exposure of the insurer members. Gross premiums will indicate the true value of the business underwritten.

Calculation

The indicator denotes the difference between the gross premiums for the preceding assessment year and the gross premium of the second year preceding the assessment year divided by the latter. The formula is:

$$\textbf{Gross Premium Growth (\%)} = \frac{\textbf{Gross Premiums (t)} - \textbf{Gross Premiums (t-1)}}{\textbf{Gross Premiums (t-1)}}$$

Where,
t = preceding assessment year
t -1 = second year preceding the assessment year

Categorisation of Scores

A member’s gross premium growth rate score will be based on the following:

Table 7: Score Range for Gross Premium Growth Rate

Gross Premium Growth Rate	
Range of Results	**Score (%)**
Gross Premium Growth Rate > 13.00%	20
7.00% < Gross Premium Growth Rate ≤ 13.00%	14
0.00% < Gross Premium Growth Rate ≤ 7.00%	7
Gross Premium Growth Rate ≤ 0.00%	0

Issue 13: Gross Premium Growth Rate

PIDM is considering three-year weighted average gross premium growth rate with weightages as follows:

- 50% for the preceding assessment year;
- 30% for the second year preceding the assessment year; and
- 20% weight for the third year preceding the assessment year.

This is to emphasise on the sustainability of growth over a period.

PIDM seeks your comments on the above method and your suggestions on other appropriate method.

2.0 Business Diversification Ratio

The general insurance business consists of numerous lines of business such as motor insurance, fire insurance, personal accident insurance, marine and cargo insurance, etc. In this regard, each line of business is exposed to different risk factors where the impact and sensitivity of the risk factors on each line of business varies. Insurer members usually mitigate the impact with a portfolio diversification as it reduces the susceptibility to adverse business experience.

This is further reflected in the RBC Framework where diversification forms an integral part whereby members with more balanced portfolio would be rewarded with diversification benefit in the calculation of capital charges. The RBC Framework allows for a reduction in premium liabilities capital charges up to a maximum of 50% of total provision of risk margin for adverse deviation (“PRAD”)[1].

Calculation

Business diversification ratio is calculated based on the difference between total premium liabilities PRAD and total premium liabilities fund PRAD to total premium liabilities PRAD as at 31 December of the preceding assessment year.

[1] Appendix VI Valuation Basis for General Insurance Liabilities of BNM Guidelines on Risk-Based Capital Framework for Insurers

The formula is:

$$\text{Business Diversification Ratio (\%)} = \frac{\text{PRAD} - \text{Fund PRAD}}{\text{PRAD}}$$

Categorisation of Scores

A member's business diversification ratio score would be based on the following:

Table 8: Score Range for Business Diversification Ratio

Business Diversification Ratio	
Range of Results	**Score (%)**
Business Diversification Ratio > 30.00%	25
20.00% < Business Diversification Ratio ≤ 30.00%	16
15.00% ≤ Business Diversification Ratio ≤ 20.00%	8
Business Diversification Ratio < 15.00%	0

3.0 Receivable Ratio

It is fundamental for the insurer members to ensure efficient collection of insurance receivables. The emphasis of one's receivable is important as it may provide an early warning signal of potential problems with receivable management and rising bad debts risk.

Furthermore, this will also reflect a member's operational efficiency with the ability to collect insurance receivables within a timely and reasonable period in order to meet its obligation. PIDM is of the view that receivable ratio indicates members' sound business practices. This measure will encourage insurer members to improve its collection and management practices.

Calculation

For the purpose of this indicator, insurance receivables include outstanding premiums, agents balances and amount due from reinsurers. Receivable ratio is calculated as a member's insurance receivables to its gross premium income as at 31 December of the preceding assessment year. The formula is:

$$\text{Receivable Ratio (\%)} = \frac{\text{Insurance Receivables}}{\text{Gross Premiums}}$$

Categorisation of Scores

An insurer member's receivable ratio score will be based on the following:

Table 9: Score Range for Receivable Ratio

Receivable Ratio	
Range of Results	**Score (%)**
Receivable ratio < 5.00%	20
5.00% ≤ Receivable ratio ≤ 10.00%	14
10.00% < Receivable ratio ≤ 15.00%	7
Receivable ratio > 15.00%	0

4.0 Combined Ratio

Underwriting performance is an essential indication of business conduct as well as risk appetite of the insurer members. It is contributed by the core components of insurance business activities such as premiums earned, claims payout, management expenses as well as acquisition costs incurred.

PIDM is of the view that good and stable underwriting performance is vital to ensure insurer members' business sustainability. Good underwriting performance has a strong correlation with the overall profitability of the insurer member.

The combined ratio is used as a comprehensive measure that reflects the performance and profitability of the insurer members' business activities. It measures the extent of insurance cost and expenditure that arise from insurance underwriting activities relative to the premiums generated.

Calculation

Combined ratio is calculated as **an aggregate of** three (3) ratios:

(a) net claims incurred divided by earned premium income;

(b) management expenses divided by gross premiums; and

(c) gross direct commission divided by gross premiums,

as at 31 December of the preceding assessment year.

The formula is:

$$\textbf{Combined Ratio (\%)} = \frac{\textbf{Net Claims Incurred}}{\textbf{Earned Premium Income}} + \frac{\textbf{Management Expenses}}{\textbf{Gross Premiums}} + \frac{\textbf{Gross Direct Commission}}{\textbf{Gross Premiums}}$$

Categorisation of Scores

A member's combined ratio score will be based on the following:

Table 10: Score Range for Combined ratio

Combined Ratio	
Range of Results	**Score (%)**
Combined Ratio < 80.00%	20
80.00% ≤ Combined Ratio ≤ 90.00%	14
90.00% < Combined Ratio ≤ 100.00%	7
Combined Ratio > 100.00%	0

5.0 Operating Margin Ratio

The other main source of earnings for insurer members is its investment returns. The investment returns can further enhance the overall performance and capital generating capability of the insurer members as well as improve members' performance sustainability. For this purpose, operating margin ratio is selected as it measures the overall profitability of the general insurer members.

Calculation

The operating margin ratio measures the operating profits generated relative to the premiums earned. It basically reflects the unit of profit generated for every unit of premium earned. The ratio is measured by dividing the operating profit with earned premium income as at 31 December of the preceding assessment year. The formula is:

$$\textbf{Operating Margin Ratio (\%)} = \frac{\textbf{Operating Profit}}{\textbf{Earned Premium Income}}$$

For the purpose of this measure, the operating profit includes movements in available for sale ("AFS") reserves during the preceding assessment year for the insurance fund.

Categorisation of Scores

A member's operating margin ratio score will be based on the following:

Table 11: Score Range for Operating Margin Ratio

Operating Margin Ratio	
Range of Results	**Score (%)**
Operating Margin Ratio > 23.00%	15
15.00% < Operating Margin Ratio ≤ 23.00%	10
7.00% ≤ Operating Margin Ratio ≤ 15.00%	5
Operating Margin Ratio < 7.00%	0

APPENDIX I(c): QUANTITATIVE CRITERIA - OPERATIONAL AND SUSTAINABILITY MEASURES FOR LIFE INSURANCE BUSINESS

Rationale

The DLS Framework incorporates a number of quantitative criteria that aim to assess the operational performance and sustainability of members' business operation. The operational performance of insurer members is dependent upon their ability to effectively execute their strategies and manage their business profile that ultimately contribute towards members' internal capital generation. Consequently, operational performance will contribute to the long-term financial strength and members' ability to meet their obligations to policyholders.

Generation of new business combined with members' ability to conserve its business will indicate members' capability to ensure a stable stream of income in meeting the expenses and liabilities of the life insurance business. Despite growth in new business generated, consideration needs to be made on the level of riskiness of the policies underwritten where business composition may be one of the contributing factors.

Given the long term nature of life insurance, investment productivity is also important to adequately support the contractual liabilities underwritten. In this regards, investment performance is crucial for the viability of the life business. In addition, the effectiveness of the capital utilisation is ascertained by measuring the extent of the overall profitability as compared to the capital employed.

Criteria Measures

The following five (5) indicators are used to assess the life insurance business' operational and sustainability:

1.0 New Business Growth Rate

For life insurance business, new premiums growth is a vital component towards business sustainability. The members' ability to record consistent growth of new business premium will ensure a constant stream of income to support the business operations.

Nevertheless, the level of business growth should match the members' risk appetite, operational capacity and risk management practices. New business generation capability eventually translates into profitability and internal capital generation.

In developing the threshold, PIDM considers the growth rate that is consistent with market average, without emphasis of excessive growth. Excessive growth would lead to potential complications for the member during the adverse economic conditions.

Calculation

In the growth rate calculation, new business premiums are measured at a gross basis. PIDM is of the view that gross premiums reflect the overall members' exposure as compared to measuring on net basis, i.e. net of reinsurance.

As for life insurance policies, premiums are paid regularly on an annual basis and with the option to pay in the form of quarterly, semi-annually or monthly instalments. However, some policies are paid up front at the inception of the policy, i.e. in single premium. Annual premium equivalent is commonly used as an industry measure where it aggregates total regular new premiums with 10% of total single premium. For single premium, the 10% weightage applied is based on the assumption that the average policy term is ten years.

New business growth rate is derived using total new business premiums for the preceding assessment year minus total new business premiums of the second year preceding the assessment year divided total new business premiums of the second year preceding the assessment year.

The formula is:

$$\textbf{New Business Growth (\%)} = \frac{\textbf{New Business Premiums (t)} - \textbf{New Business Premiums (t-1)}}{\textbf{New Business Premiums (t-1)}}$$

where
t = preceding assessment year
t-1 = second year preceding the assessment year

Categorisation of Scores

An insurer member's New Business Growth rate score will be based on the following:

Table 12: Score Range for New Business Growth Rate

New Business Growth Rate	
Range of Results	**Score (%)**
New Business Growth Ratio > 11.00%	15
4.00% < New Business Growth Ratio ≤ 11.00%	10
0.00% < New Business Growth Ratio ≤ 4.00%	5
New Business Growth Ratio ≤ 0.00%	0

Issue 14: New Business Growth Rate

PIDM is considering three-year weighted average new business growth rate with weightages as follows:

- 50% for the preceding assessment year;
- 30% for the second year preceding the assessment year; and
- 20% weight for the third year preceding the assessment year.

This is to emphasise on the sustainability of growth over a period.

PIDM seeks your comments on the above method and your suggestions on other appropriate method.

2.0 Business Concentration Ratio

It is important to note the distinct nature of premium payment obligations for life insurance products. A single premium payment product involves the payment of one premium at inception whilst regular or recurring premium product involves regular premium payments at agreed intervals over a specified number of years. In addition, single premium products are normally of shorter term than regular premium products with the exception to mortgage insurance.

Notwithstanding this, premium amount charged to policyholders is determined in advance using actuarial forecasts of benefits payout with assumed interest rate, mortality and morbidity, expenses, etc. Due to the long-term nature of life insurance products, insurer members are subject to unforeseen events and market movement that impact the assumptions. Comparing single premium and regular premium products, single premium products are more susceptible to these fluctuations. Since the term is shorter than that of the regular premium's, it allows less flexibility for insurer members to make corrections.

Moreover, single premium products are usually embedded with guarantee element such as capital guarantee at maturity. The explicit guarantee require insurer members to maintain higher reserves, thus higher capital charges.

With the inherent risks in single premium products which are higher compared to regular premium products, PIDM aims to promote a balanced portfolio that ensures appropriate composition of single and regular premium products for continuous future stream of income.

Calculation

Business Concentration Ratio is calculated as the proportion of new business written for regular premium against single premium as at 31 December of the preceding assessment year. The formula is:

$$\text{Business Concentration Ratio (\%)} = \frac{\text{Regular New Business Premium (t)}}{\text{Single New Business Premium (t)}}$$

where
t = preceding assessment year

Categorisation of Scores

An insurer member's Business Concentration Ratio score will be based on the following:

Table 13: Score Range for Business Concentration Ratio

Business Concentration Ratio	
Range of Results	**Score (%)**
Business Concentration Ratio > 2.00	25
1.50 < Business Concentration Ratio ≤ 2.00	16
1.00 ≤ Business Concentration Ratio ≤ 1.50	8
Business Concentration Ratio < 1.00	0

3.0 Business Conservation Ratio

Renewal of life insurance policies during a period is defined as the proportion of policies remaining in force at the end of the period out of total policies in force at the beginning of the period. In other words, it means the percentage of business conserved by insurer members without lapsing or being terminated.

The financial impact of low business conservation is significant to policyholders, insurer members as well as the intermediaries or agents. For policyholders, it means forfeiting the paid premium and losing the insurance protection. In the case of intermediaries, they will lose renewal commission or intermediaries' fee whereas for insurer members', the cost of acquisition will not be fully recovered.

Members incur high expenses at the point of sale thus to cover the cost, the expense loading is spread over a number of years during the term of the policy. Therefore, business not conserved would mean losses to the members. Furthermore, decreasing number of policies remained in force, reduces the profits, hence increases the cost of capital.

Consequently, the implication would be that the insurer members will have to increase loading in their future product pricing to remain profitable. New policyholders will have to pay higher premium due to the loading, hence making members' product proposition weak and not competitive.

Based on these observations, PIDM is of the view that business conservation is crucial to assess insurer members' sustainability.

Calculation

Business Conservation Ratio is a ratio of renewal premiums of the preceding assessment year to the aggregate of new business regular premiums of the second year preceding the assessment year and renewal premiums of the second year preceding the assessment year. The formula is:

$$\text{Business Conservation Ratio (\%)} = \frac{\text{Renewal Premiums (t)}}{\text{Renewal Premiums (t-1)} + \text{New Business Regular Premiums (t-1)}}$$

where

t = preceding assessment year
t-1 = second year preceding the assessment year

Categorisation of Scores

An insurer member's business conservation score will be based on the following:

Table 14: Score Range for Business Conservation Ratio

Business Conservation Ratio	
Range of Results	**Score (%)**
Business Conservation Ratio > 95.00%	25
90.00% < Business Conservation Ratio ≤ 95.00%	16
80.00% ≤ Business Conservation Ratio ≤ 90.00%	8
Business Conservation Ratio < 80.00%	0

4.0 Investment Yield

For life insurer members, the insurance funds are expected to generate returns that are adequate and sustainable in order to meet future benefits payout, given the long-term nature of its liabilities. Among the various components of life insurance surplus, investment returns is one of the key contributors towards life insurer members' overall financial performance. The investment yield is selected mainly due to its objectivity as compared to other components of life insurance surplus.

Inability to generate sufficient investment returns would result in depletion of the insurance fund and may affect the member's ability to meet future obligations which includes meeting the policyholders' reasonable expectation. In fact, investment returns assumption is a component within the pricing of life insurance product. This reflects the expectation on investment to achieve a certain level of returns that sufficient to meet these assumptions.

In addition, PIDM recognises that the investment returns would be affected by the market condition, hence the ratio would reflect such market movement. PIDM is of the view that such volatility is inherent, nevertheless good investment strategy would allow members to minimise the impact.

Similarly to the other indicators, the score range for investment yield is set at the industry average as not to promote aggressive risk-taking by the members in order to achieve high investment returns.

Calculation

For the purpose of this indicator, the net investment income would be as reflected in the revenue accounts of the life insurance funds. For net capital gains or losses, it includes both the net realised and unrealised capital gains.

The net realised capital gains or losses consist of the profit and loss on disposal of securities, as reflected in the revenue accounts.

The net unrealised capital gains or losses include the impairment losses and their writeback on securities, unrealised gains and loss on securities, both as reflected in the revenue accounts and AFS reserves movement during the preceding assessment year for the life insurance fund.

As the ratio aims to measure the overall investment performance, the investment yield is calculated as total investment income, including the net realised and net unrealised capital gain during the preceding assessment year divided by the average assets of the insurance funds for the preceding assessment year. The formula is:

$$\textbf{Investment Yield (\%)} = \frac{\textbf{2 x [Net Investment Income (I) + Net Capital Gains or Losses (C)]}}{\textbf{Total Assets (t) + Total Assets (t-1) – (I+C)}}$$

where:

(t) denotes the total assets of insurance funds as at 31 December of the preceding assessment year, whilst (t -1) denotes the total assets of insurance funds as at 31 December of second year preceding the assessment year.

For the purpose of calculating AFS reserves movement, the amount would be the difference between AFS reserves as at 31 December of the preceding assessment year and the AFS reserves as at 31 December of the second year preceding the assessment year.

Categorisation of Scores

A member's investment yield score will be based on the following:

Table 15: Score Range for Investment Yield

Investment Yield	
Range of Results	**Score (%)**
Investment Yield > 5.25%	20
4.25% < Investment Yield ≤ 5.25%	14
3.00% ≤ Investment Yield ≤ 4.25%	7
Investment Yield < 3.00%	0

5.0 Return on Required Capital

This ratio is another profitability-related indicator where it measures the extent of profitability relative to the capital employed.

The cornerstone of this measure is that the insurer member is envisaged to generate strong and sustainable returns on the capital employed.

Profit before tax is selected as a comprehensive indication of profitability for a particular insurer member whilst the total capital available at ITCL is applied as the level of capital employed.

As ITCL reflects a level of which the capital assigned would commensurate with the insurer member's risk profiles, PIDM is of the view that such capital level would be the appropriate means of the required capital for the purpose of calculating this measure.

In summary, the indicator aims to assess the sufficiency of earnings generated by the insurer members out of the capital that is required to be put aside.

Calculation

The indicator is calculated as profit before tax as per the income statement divided by the total capital available at ITCL as at 31 December of the preceding assessment year.

$$\textbf{Return on Required Capital (\%)} = \frac{\textbf{Profit Before Tax}}{\textbf{Total Capital Available @ ITCL}}$$

Categorisation of Scores

The member's return on required capital ratio score will be based on the following:

Table 16: Score Range for Return on Required Capital Ratio

Return on Required Capital Ratio	
Range of Results	**Score (%)**
Return on Required Capital Ratio > 5.00%	15
3.00% < Return on Required Capital Ratio ≤ 5.00%	10
0.00% < Return on Required Capital Ratio ≤ 3.00%	5
Return on Required Capital Ratio ≤ 0.00%	0

APPENDIX II: QUALITATIVE CRITERIA

1.0 SUPERVISORY RATING

Rationale

To complement the quantitative criteria, the DLS Framework also incorporates qualitative assessment of current and future risk profiles of the insurer members. One of the components is the supervisory rating, namely the CRR, assessed by BNM. The CRR would capture first hand information about the insurer members by BNM which supervises and monitors insurer member's risk profiles, operational management and its risk management control functions. In addition, it reflects the important aspects of risk management practices, governance and management quality and the supervisory ratings of the insurer members. PIDM is of the view that supervisors are in a position to have first hand information about the members, monitor them closely, and understand their operations and risk profiles comprehensively.

Criterion Measure

The criterion used is based on the supervisory ratings provided by BNM. PIDM will use the ratings provided by BNM for assessment period up to 31 December of the preceding assessment year to determine scores for levy purposes for an assessment year.

Categorisation of Scores

A member would be assigned scores as presented in the table below:

Table 17: Score Range for Supervisory Rating Criteria

Supervisory Rating	
Range of Results	Score (%)
Supervisory Rating of **LOW** or equivalent	35
Supervisory Rating of **MODERATE** or equivalent	22
Supervisory Rating of **ABOVE AVERAGE** or equivalent	10
Supervisory Rating of **HIGH** or equivalent	0

2.0 OTHER INFORMATION

Rationale

This criterion is to complement the supervisory rating. The score for this criterion shall be assigned by PIDM based on information that has come to its attention about the safety, soundness, financial condition and viability of each member.

On assessing a member based on this criterion, PIDM places emphasis on the significance and severity of the situations revealed by the information or enforcement action, i.e. whether it represents a threat to or materially affect the safety, soundness, or viability of a member.

Assessment Criteria

The members are assessed based on the following criteria:

(a) Information received from supervisors about a member or its related companies, such as commitments, letter of undertaking ("LOU") and board resolution, letters of warning, reprimand, etc;

(b) Members' action plan to address deficiencies in performance and members' performance in relation to commitments and LOU;

(c) Rating agencies' review and ratings;

(d) Whether the member is receiving financial assistance from PIDM or BNM; and

(e) Other relevant information that may come to PIDM's attention.

Categorisation of Scores

The scores would be determined as set out in the table below:

Table 18: Score Range for Other Information Criteria

Other Information Criteria	
Assessment Criteria	**Score (%)**
As at 30 April of the assessment year, no information has come to PIDM's attention about circumstances that represent a threat to or materially affect the safety, soundness, financial condition or viability of the institution.	5
As at 30 April of the assessment year, information has come to PIDM's attention about circumstances that represent a threat to or may materially affect the safety, soundness, financial condition or viability of the institution.	3
As at 30 April of the assessment year, information has come to PIDM's attention about circumstances that materially affect the safety, soundness, financial condition or viability of the institution.	0

APPENDIX III: ILLUSTRATION

ILLUSTRATION 1: DLS SCORING AND PREMIUM CATEGORISATION FOR LIFE INSURER MEMBER

Table 19: Calculation of Total DLS Score for a Sample Life Insurer Member X

Criteria		Maximum Score	Member Score
Quantitative			
1.	Capital FCI	NA	1.30
2.	Operational & Sustainability i. Ratio ii. Ratio iii. Ratio iv. Ratio v. Ratio	 15% 25% 25% 20% 15%	 10% 16% 25% 14% 10%
Total Operational & Sustainability Score		100%	75%
Matrix Score (placed at M2 in Diagram 2: Quantitative Criteria Matrix)		**60%**	**55%**
Qualitative			
1.	Supervisory Rating	35%	10%
2.	Other Information	5%	5%
Total Qualitative Score		**40%**	**15%**
Total DLS Score		**100%**	**70%**

Based on Table 5: DLS Scores and Levy Categories, Life insurer member X will be categorised in **Category 2**.

Note:
* NA denotes not applicable.

ILLUSTRATION 2: DLS SCORING AND PREMIUM CATEGORISATION FOR COMPOSITE INSURER MEMBER

For a composite insurer member, the proportion of net premiums of its respective general and life insurance businesses would determine the weightages of the other quantitative indicators beside the FCI.

Composite Insurer Members	Net Premiums for the Period Ending 31 Dec 20XX	% of Total Net Premiums
General Insurance Business	RM750,000	30%
Life Insurance Business	RM1,750,000	70%
Total	RM2,500,000	100%

Table 20: Calculation of Total DLS Score for a Sample Composite Insurer Member Y

Criteria		Maximum Score	Business Score	Net Premiums Apportionment	Member Score
Quantitative					
1.	Capital FCI	NA	1.30		1.30
2.	Operational & Sustainability for General Insurance Business: i. Ratio ii. Ratio iii. Ratio iv. Ratio v. Ratio	(as indicated in Table 4) 20% 25% 20% 20% 15%	14% 16% 14% 14% 10%		
	TOTAL	100%	68%	30%	20%
3.	Operational & Sustainability for Life Insurance Business: i. Ratio ii. Ratio iii. Ratio iv. Ratio v. Ratio	(as indicated in Table 4) 15% 25% 25% 20% 15%	10% 16% 25% 14% 10%		
	TOTAL	100%	75%	70%	53%

Criteria		Maximum Score	Business Score	Net Premiums Apportionment	Member Score
Total Operational & Sustainability Score		100%			73%
Matrix Score (placed at M2 in Diagram 2: Quantitative Criteria Matrix)		**60%**			**55%**
Qualitative					
1.	Supervisory Rating	35%			10%
2.	Other Information	5%			5%
Total Qualitative Score		**40%**			**15%**
Total DLS Score		**100%**			**70%**

Based on Table 5: DLS Scores and Levy Categories, Life insurer member Y will be categorized in **Category 2**.

Note:
* N.A. denotes not applicable.

ILLUSTRATION 3: INSUFFICIENT QUANTITATIVE INFORMATION

If a member does not have information for the computation of business diversification ratio and receivable ratio, the scores for such criteria shall be calculated as follows:

Table 21: Calculation of Total Quantitative Score a Sample General Insurer Member Z – Insufficient Quantitative Information

Criteria		Maximum Score	Member Score
Quantitative			
1.	Capital FCI	N/A	1.21
2.	Operational & Sustainability i. Ratio ii. Ratio iii. Ratio iv. Ratio v. Ratio	 20% 25% 20% 20% 15%	 14% NI NI 14% 10%
Total Operational & Sustainability Score		100%	28%**
Matrix Score (placed at M4 in Diagram 2: Quantitative Criteria Matrix)		**60%**	**40%**
Qualitative			
1.	Supervisory Rating	35%	10%
2.	Other Information	5%	5%
Total Qualitative Score		**40%**	**15%**
Total DLS Score		**100%**	**55%**

**Referring to paragraph 15.5.1 (Insufficient Quantitative Information), depicted below is the proportionate quantitative score for criteria with insufficient information (item ii and iii):

[34% / (100% - 45%)] * 45% = 28%

Based on Table 5: DLS Scores and Levy Categories, General insurer member Z will be categorised in **Category 3**.

Note:
* NI denotes no information.

Perbadanan Insurans Deposit Malaysia
27 April 2012