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PART I - OVERVIEW

1. INTRODUCTION

1.1 The Prudential Framework of Corporate Governance for Insurers (Framework) is developed to raise corporate governance standards in the conduct of insurance business. The Framework serves as the foundation for a responsive and responsible insurance industry in an environment of progressive liberalisation whereby market forces are expected to assume a greater role in financial and market discipline.

2. COVERAGE

2.1 The primary objectives of the Framework are to enhance the corporate accountability of insurers and promote the interest of their stakeholders, specifically those of policy owners, claimants and creditors. To this end, the Framework establishes basic principles of good corporate governance which focus on the processes and structures used to direct and manage the business and affairs of insurers. The Framework comprises six parts dealing respectively with:-

- (a) Board responsibility and oversight;
- (b) Management accountability;
- (c) Corporate independence;
- (d) Internal controls and operational risk management;
- (e) Public accountability; and
- (f) Financial reporting.

2.2 With respect to the board responsibility and oversight, the Framework has adopted, with only minor modifications, the principles enshrined in the Malaysian Code of Corporate Governance (Code) which has been endorsed by the Government. Therefore, public-listed insurers, in complying with the Code, would also comply with the principles under Part A of the Framework on board

responsibility and oversight. Part A is not applicable to insurers incorporated outside Malaysia which do not have board representation in Malaysia.

3. APPLICATION

3.1 The application of the Framework principles is achieved through prescriptive requirements and best practice standards. Prescriptive applications must be complied with by all insurers¹ (except to the extent provided for under paragraph 2.2 above in respect of insurers incorporated outside Malaysia). For completeness, the prescriptive applications include relevant regulatory requirements that are already in place under the Insurance Act and Regulations 1996 and Bank Negara Malaysia's (the Bank) guidelines.

3.2 Best practice applications are recommended, but not mandatory. Alternative applications may be adopted by insurers provided that they satisfy the requirements of the Framework principles. However, insurers are encouraged to strive towards achieving the best practice standards over time to raise their corporate governance practices to international standards.

PART II - BOARD RESPONSIBILITY AND OVERSIGHT

4. BOARD ESTABLISHMENT

Principle 1: Every insurer must be headed by an effective board charged with the responsibility of leading the insurer.

4.1 An effective board provides direction for insurers in terms of its corporate objectives and business strategies. Directors are placed in positions of trust by shareholders while the law places responsibility for managing the affairs of the insurer firmly on the board. Therefore, the board represents the interests of

shareholders as well as the general public who have dealings with the insurer, either as policy owners, claimants or creditors of the insurer. It carries the ultimate responsibility for the proper stewardship of company resources, the achievement of corporate objectives and good corporate citizenship. To be effective, the board of an insurer must be composed of a minimum number of directors that reflects the nature of its fiduciary responsibilities and the complexity and scale of its operations, and each individual director should dedicate sufficient time and commitment to the affairs of the insurer. This applies to both executive as well as non-executive directors.

Application

Prescriptive: An insurer should appoint no less than five and no more than 10 directors to its board in compliance with the Bank's Minimum Standards for Prudential Management of Insurers (BNM/RH/GL/003-1). An executive director of an insurer should also not simultaneously serve on the board of more than five companies (including the insurer) pursuant to BNM/RH/GL/003-1. In addition, a non-executive director on the board of an insurer should not simultaneously serve on the board of more than 15 companies (including the insurer) consistent with the Government's decision to restrict the number of directorships that may be held by directors (both executive and non-executive) of public-listed companies.

5. BOARD BALANCE

Principle 2: The board should include a balance of executive directors and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision making.

5.1 Executive directors add value to the decision-making process by providing a management and operational perspective to issues placed before the board. This ensures that decisions of the board can be successfully executed to achieve their

¹ With effect from 10 May 2000.

intended objectives. At the same time, the participation of non-executive directors enables a balanced and objective consideration of issues, hence facilitating optimal decision-making. Non-executive directors who are independent enhance accountability in the decision-making process by removing self-serving interests which may tend to cloud good judgment in decision-making. The need for board accountability and independence is of paramount importance in an insurance company to protect non-interested parties (specifically policy owners and claimants) against the mismanagement of funds entrusted to the insurer.

Application

Prescriptive: The number of executive directors on the board of an insurer should not exceed 40% of the members of the board as stipulated in BNM/RH/GL/003-1. Accordingly, the composition of non-executive directors on the board should not be less than 60%.

Best practice: The majority of non-executive directors on the board of an insurer should comprise independent directors² in line with international best practices.

6. BOARD APPOINTMENTS

Principle 3: There should be a formal and transparent procedure for the appointment of new directors to the board and the assessment of the effectiveness of individual directors on an ongoing basis.

6.1 A documented and transparent procedure for the appointment of new directors to the board is important to protect the integrity of the board against unjustified bias. This helps to preserve the freedom that should be accorded to board members to exercise their independent and professional judgment within the law without fear or favour. The procedure for appointments should be approved by the full board and disclosed to shareholders of the insurer. As the directors are

² As defined in BNM/RH/GL/003-1: Minimum Standards for Prudential Management of Insurers

ultimately responsible for the business and affairs of the insurer, there should also be a procedure in place for a regular assessment of their performance and an enforceable mechanism to replace ineffective directors.

6.2 The internal procedure established by an insurer for the appointment of new directors should provide sufficient checks and balances to ensure that nominations of new directors are made in the best interests of the insurer and its stakeholders before an application is made to the Bank under section 70(1) of the Insurance Act 1996 (Act). In addition, the insurer should also establish an objective and transparent mechanism for the assessment of the effectiveness of its directors on an ongoing basis.

Application

Prescriptive: The appointment of directors to the board of an insurer shall be subject to the prior approval of the Bank pursuant to section 70(1) of the Act. The board should appoint a **nominating committee** of directors in accordance with the composition and terms of reference set out in BNM/RH/GL/003-1, charged with the responsibility for proposing new nominees for appointment to the board. The actual decision as to who shall be nominated remains with the full board after considering the recommendations of the committee. The board should also implement a process, to be carried out by the nominating committee, for an annual assessment of the effectiveness of the board as a whole and its various standing committees as well as the contribution of each individual director. The committee's findings should be disclosed to the full board. The terms of appointment of directors should provide an avenue for the removal of a director who is clearly proven to be ineffective, errant or negligent in discharging his responsibilities as a member of the board.

Principle 4: Directors sitting on the board of an insurer should be persons of calibre, credibility and integrity with the necessary skills and experience to bring sound and independent judgment to bear on issues relating to the strategy, performance and resources of the insurer.

6.3. Directors provide leadership on matters of strategic importance to the future direction and viability of an insurer. They are also expected to bring sound judgment to bear on difficult issues and to make optimal decisions after having weighed the options available. To be able to do this effectively, directors must be highly competent and experienced, both generally in terms of management capabilities and also to some degree, specifically in the field of insurance. The fiduciary nature of insurance obligations further requires directors to also be persons of unquestionable integrity and credibility.

6.4 The fit and proper criteria prescribed under the Insurance Regulations 1996 (Regulations) generally prescribe that a director of a licensee shall have *"educational qualifications and experience which will enable him to effectively perform his duties"*. The Finance Committee's Report on Corporate Governance (FCRCG) has recommended that a formal accreditation programme be introduced for all existing and future directors of public-listed companies that would require them to undergo formal training in the areas of directors' legal rights and responsibilities, the operation of the board and the Malaysian Code on Corporate Governance. While this Framework does not propose that formal accreditation be adopted for all insurers, nevertheless, given the critical role played by directors in the governance process, there is a need to more specifically address the required level of competence of directors appointed to the board of an insurer. Directors, particularly the chairman and directors serving on standing committees established by the board, should possess the appropriate level of minimum qualifications and experience. There is also a need for insurers to more actively participate in the orientation and education of new directors since an in-depth knowledge of the company and its business are pre-requisites for effective strategic leadership by directors.

Application

Prescriptive: Candidates proposed for nomination to the board of an insurer should not be disqualified under section 70(2) of the Act and should meet the minimum qualification standards for directors specified by the Bank under

BNM/RH/GL/003-1. At least two members of the board of an insurer should be qualified or experienced in finance-related disciplines, which at a minimum should be at a university degree level, or have at a minimum of five years of working experience at the managerial level in these disciplines. The nominating committee should undertake an annual review of the required mix of skills, experience and other core competencies within the board which is necessary to enable the insurer to achieve its corporate objectives and fulfil its fiduciary responsibilities. The findings of the committee should be disclosed to the full board and shareholders. Insurers should also develop in-house orientation and education programmes for new directors to familiarise them with the industry (including relevant legal and regulatory requirements) and the company. On an ongoing basis, insurers should notify the board of all guidelines and circulars (excluding administrative circulars) issued by the Bank within one month of the date of issuance of the guideline or circular.

7. BOARD RESPONSIBILITIES

Principle 5: The board should explicitly assume specific minimum responsibilities in relation to the affairs of the insurer which facilitate the effective discharge of the board's stewardship responsibilities.

7.1 The board cannot be expected to effectively discharge its duties unless each and every individual member of the board is fully aware of his principal responsibilities. A complete understanding and appreciation by individual board members of their responsibilities is crucial to an effective decision-making process and serves as an important control mechanism to ensure that the board functions objectively, independently and effectively.

7.2 BNM/RH/GL/003-1 establishes the board's function and role by enumerating several principal responsibilities of the board. More recently, the FCRCG recommended six principal responsibilities of the board of a public-listed company. Directors on the board of insurance companies should be made fully aware of, and guided by, these responsibilities.

Application

Best practice: Under the terms of appointment, directors should *explicitly* agree to assume specific responsibilities as a member of the board. The terms of appointment should clearly spell out the responsibilities to be assumed by the directors, which should include as a minimum, the following principal responsibilities (which are in line with recommendations in the FCRCG) **in addition** to the responsibilities stipulated in BNM/RH/GL/003-1:-

- (a) reviewing and approving a strategic plan for the insurer;
- (b) overseeing the conduct of the insurer's business to ensure that the business is properly managed towards achieving the insurer's corporate objectives, and that the insurer's dealings with its policy owners, claimants and creditors are conducted in a fair and equitable manner;
- (c) identifying key business risks, determining the risk appetite of the insurer, and ensuring the implementation of appropriate systems to manage risks within established risk-tolerance limits;
- (d) approving corporate policies on critical areas of operations including underwriting, investment, reinsurance and claims management;
- (e) succession-planning, including the appointment, training, remuneration and performance review of senior management; and
- (f) ensuring the adequacy and integrity of the insurer's internal control and management information systems, including systems for monitoring compliance with applicable laws, regulations, rules, directives and guidelines.

8. BOARD REMUNERATION

Principle 6: There should be a formal and transparent procedure for developing policies on the remuneration of directors and setting the remuneration packages of individual directors. The level of remuneration should reflect the experience and level of responsibility borne by an individual

director. Remuneration packages for executive directors that link rewards to corporate or individual performance should be structured with care to avoid incentives for insider excesses.

8.1 The policy on the remuneration of directors should be developed under conditions of objectivity and full transparency in order to curb abuses. The levels of remuneration should be sufficient to attract and retain directors of calibre needed to manage the insurer successfully, but at the same time, should also be balanced against the need to ensure that insurance funds are not used to subsidise excessive remuneration packages. To encourage high performance standards, remuneration packages for executive directors that link rewards to corporate or individual performance may be justified. However, the linkages should not create incentives for irresponsible behaviour and insider excesses. For example, a remuneration package for an executive director that incorporates a direct linkage between the director's remuneration and the achievement of premium growth targets or net returns on investments may lead to overly aggressive underwriting and risk taking that will create strains either in the longer term or in other aspects of the insurer's operations. Performance should be assessed holistically in terms of the overall performance of the company, and preferably over a reasonable time frame to avoid incentives for aggressive short-term strategies that cannot be sustained over the long term. This is especially important in insurance business which operates over a long term horizon.

Application

Prescriptive: The board should appoint a **remuneration committee** in accordance with the composition and terms of reference set out in BNM/RH/GL/003-1, responsible for developing a policy on the remuneration of directors that is consistent with this principle. The remuneration policy should, as far as possible, avoid room for the exercise of sole discretion by any one individual or restricted group of individuals in fixing the remuneration package of individual directors but rather, should provide for remuneration packages to be determined based on objective

considerations of the merits and value of a director's contribution to the insurer. The policy should be documented and approved by the full board and any changes thereto should be subject to the endorsement of the full board. The specific remuneration packages of individual directors should be determined by the full board with the individuals concerned abstaining from discussions on their own remuneration. The remuneration packages of executive directors should take due consideration of the findings of the nominating committee with respect to the effectiveness and contribution of the director concerned.

9. BOARD CHAIRMANSHIP

Principle 7: There should be a clear division of responsibilities between the top management positions in an insurer which will ensure a balance of power and authority, such that no one individual has unfettered decision-making powers.

9.1 The separation of duties and responsibilities is an important aspect of governance that provides the needed check and balance to preserve integrity in the decision-making process. The absence of such a separation enables bad and irresponsible decisions to go undetected, often until it is too late when damage has already been inflicted on the company and the interests of stakeholders jeopardised.

9.2 Given the public interest considerations that factor in insurance business, it is particularly important that the roles of chief executive officer and chairman should **not** be combined. This is in view of the crucial role of the chairman in ensuring the effective functioning of the board. Among other things, the role of the chairman involves ensuring that all relevant issues are included in the agenda for board meetings and that all directors are enabled to participate fully in the board's activities. This includes making certain that directors, especially non-executive directors, receive timely and relevant information and are properly briefed on issues arising at board meetings. This role may be compromised if the chairman is also the chief executive officer or an executive director in any other capacity.

Application

Prescriptive: The chairman of the board should be a non-executive director. Accordingly, an insurer should not combine the roles of board chairman and chief executive officer.

10. BOARD MEETINGS

Principle 8: The board should meet regularly, with due notice given of issues to be discussed. The board should, prior to each meeting, be duly furnished with all relevant information and statistics necessary to enable it to properly consider issues to be discussed, and the proceedings of board meetings and decisions of the board should be recorded.

10.1 To a large extent, the effectiveness of the board can be gauged by the frequency of its meetings. Independence and accountability are lost when the board fails to convene regular meetings to deliberate issues of strategic importance to the insurer because such a situation lends itself to the free reign of executive directors in the affairs of the insurer. Circular resolutions cannot be a perfect substitute for board meetings since they do not offer the opportunity for active debate over the issues circulated and a biased presentation of the issues without an opportunity for the board members to raise immediate questions or reservations may lead to inappropriate decisions being made.

10.2 Increasingly, pressure is being brought to bear on public-listed companies to disclose details of board meetings in their annual reports as a matter of best governance practice. Such disclosure will enable shareholders and interested members of the public, including policy owners, to evaluate the effectiveness and commitment of the board as a whole as well as their elected individual representatives on the board.

Application

Prescriptive: The board should meet not less than once in every two months and individual directors must attend at least 75% of the board meetings held in each year pursuant to Regulation 52(c) of the Regulations.

Best practice: Insurance companies should disclose in the Directors' Report, the number of board meetings held in a year and details of attendance of individual directors in respect of meetings held.

11. BOARD AUTHORITY

Principle 9: The board should establish and document a formal schedule of matters specifically reserved for its decision to ensure that the direction and control of the insurer is firmly in its hands.

11.1 As the body ultimately responsible for the affairs of the insurer, critical decision-making powers must be reserved for the board as a safeguard against the risk of misjudgment or deliberately illegal or irregular practices. Sole and unrestricted discretion accorded to the chief executive officer impairs the ability of the board to effectively govern the affairs of the insurer. It is therefore important that matters reserved for board decision be clearly established and communicated to all levels of staff in an insurance company.

Application

Best practice: The board should formally document and adopt a comprehensive and specific schedule of matters specifically reserved for its decision. The schedule should be made available to all directors on appointment and should be kept up to date. The schedule should include *at least* the following matters:-

- (a) acquisitions and disposals of assets of the insurer or of its subsidiaries that are material in nature;
- (b) related-party transactions of a material nature;

- (c) authority levels for core functions of the insurer;
- (d) corporate policies on investment (including the use of derivatives), underwriting, reinsurance, claims management and risk management; and
- (e) the outsourcing of core business functions.

PART III - MANAGEMENT ACCOUNTABILITY

12. ORGANISATIONAL STRUCTURE AND ALLOCATION OF RESPONSIBILITIES

Principle 10: There should be a documented and well-communicated organisational structure that clearly shows lines of reporting responsibility and authority. The allocation of duties and responsibilities should be documented in well-defined job descriptions. There should be no gap in reporting lines and effective management control should be maintained at all levels throughout the organisation of the insurer.

12.1 An important aspect of accountability is the existence of a proper reporting structure that provides appropriate checks and balances to ensure the integrity of operations. Further, optimum performance is only achieved when each individual employee of the insurer fully understands his job functions and responsibilities, the boundaries within which he operates and the interconnecting relationships between

the various operating units of the insurer. Ambiguity and misunderstandings in these areas, gaps in reporting structures or a lack of effective management control in the organisational set up have resulted in breaches of internal policies and procedures leading to losses for the insurer, or even non-compliances with laws and regulations which drew compounds or other forms of regulatory action to the insurer concerned. An understanding of the interdependencies between operating units in an insurer and the resultant awareness of implications of an error or misconduct on other parts

of the organisation also encourages employees to exercise due care and diligence in carrying out their duties.

Application

Best practice: Insurers should have a well-documented and updated organisational structure showing all reporting lines as well as clearly documented job descriptions for at least all management and executive employees. Authority limits and other operating boundaries for each individual officer should be clearly established either in the job description or separately in other approved documents. The organisational structure and job description and authority limits for the chief executive officer (including any changes thereto) should be approved by the board. Job descriptions and authority limits for senior management other than the chief executive officer, line management and executive employees should be approved by the chief executive officer. The organisational structure and job descriptions should be made available to staff upon their recruitment.

13. CONFLICT OF INTEREST

Principle 11: Persons empowered with decision-making authority (including directors) should exercise care to avoid situations (including remuneration policies) that may give rise to a conflict of interest. Where such conflict exists, the circumstances giving rise to the conflict should be disclosed to the appropriate level of higher management which shall exercise its discretion, taking into account the overriding interests of policy owners, claimants, creditors and the public in general, as to whether to accept the conflict (with appropriate controls) or take action to remove it.

13.1 Conflicts of interest situations call into question the ability of the person involved in the conflict to act objectively in the best interests of the insurer and its stakeholders. However, whether or not such a conflict will in fact impair the ability of the person concerned to properly discharge his duties is a matter to be judged by the

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collective management or board of the insurer, taking into consideration the responsibilities held by the person and the internal controls in place. In order for the management to exercise this judgement, disclosure of the conflict must be made.

13.2 Both the Insurance Act 1996 and the Companies Act 1965 already contain comprehensive provisions that mandate the disclosure of circumstances giving rise to a conflict of interest situation and shareholder approval for material transactions involving directors and chief executive officers³. These provisions currently apply only to directors and chief executive officers in view of their positions of special influence and the fiduciary responsibilities that they bear. However, in reality, conflicts of interest involving any person empowered with *final* decision-making authority in respect of the operations of the insurer can compromise the interests of the insurer and its stakeholders.

Application

Prescriptive: A director or chief executive officer of an insurer shall make disclosure of circumstances giving rise to conflicts of interest in compliance with sections 54 and 55 of the Act.

Best practice: All employees of an insurer who are empowered with final decision-making authority in respect of the operations of the insurer should make disclosure of any circumstance giving rise to a conflict of interest situation. Disclosure of conflicts of interest involving the chief executive officer and senior managers of the insurer should be made to the full board, while those involving line managers and executive employees should be made to the chief executive officer and at least one other senior manager.

³ Relevant sections include sections 131- 132 of the Companies Act 1965 and sections 54 - 55 of the Insurance Act 1996.

14. COMMUNICATION

Principle 12: There should be effective channels of communication in place within the insurer to ensure that all staff fully understand and adhere to policies and procedures affecting their duties and responsibilities and that relevant information (encompassing both internal financial, operational and compliance data as well as external market information) reaches the appropriate personnel. Information should be reliable, timely, accessible and provided in a consistent format that facilitates comparative analyses.

14.1 The lack of effective communication and adequate information inevitably compromises management accountability since employees cannot be held responsible for failing to implement and adhere to policies and procedures that were not communicated to them in the first place. Similarly, employees, in carrying out their duties, cannot be faulted for not taking account of relevant information that failed to reach them or that reached them too late, or for making decisions based on information that, unknown to them, was incomplete or inaccurate. Management accountability therefore requires that there be an effective path of communication to ensure that important information about the operations of the insurer is reaching the appropriate levels of personnel in a reliable, timely, accessible and consistent manner.

14.2 Insurers should establish a communication policy and procedures that support an effective flow of information and ensure that important information reaches the appropriate personnel in a timely manner. The policy should ensure that the necessary framework and structural linkages exist to enable information to flow *upward* so that the board and senior management are aware of the business risks and operational issues confronting the insurer; *downward* so that the insurer's objectives, strategies, expectations and established policies, procedures and regulatory requirements are communicated to lower management and operational personnel; and *across* the organisation so that pertinent information can be shared to enhance the overall performance of the insurer.

Application

Best practice: Insurers should formally adopt a communication policy that is approved by the board. As a minimum, the policy should provide for:-

- (a) a regular evaluation of the organisational structure to identify communication gaps;
- (b) the documentation of important policies and procedures which should be readily accessible by the relevant personnel. Operating manuals should be developed for critical functions such as underwriting, claims, reinsurance and investment;
- (c) the implementation of structured induction programmes for new recruits involved in core functions of the insurer to familiarise them with the organisational structure of the insurer, established internal policies and procedures as well as regulatory requirements;
- (d) the necessary composition and frequency of divisional/business unit meetings to discuss issues of common concern and share important information on the latest developments affecting the insurer or industry;
- (e) a list of types of priority information (e.g. new regulatory requirements, reinsurance failures, large claims) which should be communicated immediately and the personnel to whom that information should be channelled; and
- (f) procedures for the verification of important information and their timely transmittal to the relevant personnel.

The board should adopt a formal agenda at least once a year to review the effectiveness of the insurer's communication policy.

15. GOAL-SETTING

Principle 13: There should be a formal process in place for the development of individual goals used for performance appraisals that ensures that the goals are in line with the insurer's corporate objectives and responsibilities.

15.1 Practically, an insurer's corporate objectives are ultimately broken down into individual and business unit goals that support the achievement of the company's broad objectives. It is important to ensure that these goals support and are not in conflict with the insurer's broad corporate objectives or its fiduciary responsibilities owed to policy owners and claimants.

15.2 Individual and business unit goals that are used as a basis for performance appraisals should avoid incentives for irresponsible behaviour. To this end, the goals should be realistic and objective criteria defined for measuring actual performance against the goals set. At every level, management should ensure that the individual goals are in line with the insurer's broad corporate objectives and responsibilities such that the collective goals of each separable component of the insurer contribute towards the fulfilment of those objectives and responsibilities.

Application

Best practice: Insurers should adopt a consultative approach to the development of individual goals used for staff performance appraisals with the full participation of the individuals concerned. The collective goals of each separable segment/business unit/division of the insurer should be approved by the chief executive officer in relation to the overall corporate objectives of the company as determined by the board, at the beginning of each assessment year.

PART IV - CORPORATE INDEPENDENCE

16. RELATED-PARTY TRANSACTIONS

Principle 14: Related-party transactions should be conducted on terms that are at least comparable to normal commercial terms and should not leave the insurer or its policy owners, creditors or claimants worse off under foreseeable circumstances than if the transaction had not taken place. Full disclosure of related-party transactions should be made to the board of the insurer. The prior approval of the board should be obtained for related-party transactions that are material in nature.

16.1 Under normal operating conditions, it may be assumed that an insurer has independent discretionary power over its resources and carries out its activities independently of its individual shareholders, directors or management personnel in the best interests of the company and its policy owners, creditors or claimants. Transactions are presumed to have been undertaken on an arm's length basis at normal commercial terms, that is, terms obtainable between knowledgeable, willing parties who are unaffected by a subsisting relationship between them. These assumptions may not be justified for related-party transactions. While related parties may endeavour to achieve fair value terms in their dealings, the very existence of relationship ties between the parties concerned may preclude necessary conditions for competitive free-market dealings. Under these circumstances, addressing the inherent risks posed by related-party transactions is an important element of good corporate governance.

Application

Prescriptive: An insurer shall ensure compliance with the Bank's Guidelines on Related-Party Transactions (BNM/RH/GL/003-3) in respect of all its related-party undertakings and make disclosure in its accounts of its related-party transactions in compliance with MASB 8: Related Party Disclosures.

17. GROUP STRUCTURE

Principle 15: The group structure within which an insurer operates should provide for a reasonable degree of corporate independence for the insurer from controlling shareholders and associated companies in deciding on matters affecting the company, its policy owners, claimants, creditors and minority shareholders.

17.1 Some degree of corporate independence is crucial to ensuring that an insurance company does not compromise the interests of its policy owners, claimants, creditors and minority shareholders. Corporate independence is primarily achieved through the effective functioning of an independent board. In this respect, the principles related to board responsibility and oversight should apply. However, an appropriate group structure can also help to reduce or remove the potential risk of too many overlapping interests that may exert pressure on the insurer to compromise its corporate independence. Overlapping or multi-tiered interests in the insurer may also increase the financial risks associated with multiple gearing and excessive leverage (*see principle 16 below*).

Application

Best practice: Preferably, an insurer operating within a group structure should not be subject to the influence of more than two tiers of controlling or substantial interests above it. Where such a structure cannot be achieved, disclosure should be made to the board and shareholders of the extent of overlapping interests in the insurer and any material transaction involving such interested parties either as counterparty or beneficiary, should be made subject to prior board approval.

18. MULTIPLE GEARING AND EXCESSIVE LEVERAGE

Principle 16: In assessing and monitoring the capital adequacy of an insurer operating under a corporate group /conglomerate structure, adequate

provision should be made for the effects of multiple gearing or excessive leverage arising from both upstream and downstream structural linkages. Disclosure should be made of the extent of capital that is geared or leveraged.

18.1 Multiple gearing occurs when the insurer holds capital that is issued by an intermediate holding company, which in turn holds capital issued by the ultimate parent company. In such an instance, the external capital of the ultimate parent company is said to be geared up three times, first by the parent, a second time by the intermediate holding company, and finally by the insurer. Such gearing can occur any number of times, progressively spreading the original source of capital thinner and thinner over multiple tiers of entities with implications for the amount of "free" capital backing the insurer within the group.

18.2 Capital is leveraged when a parent issues debt (or other instruments not acceptable as regulatory capital for an insurer) and downstreams that capital to the insurer in a form of capital that on the surface, qualifies as regulatory capital. This can pose a prudential risk where undue stress is placed on the insurer as a result of the obligation on the parent to service that debt.

18.3 Multiple gearing and excessive leverage can permit difficulties in one entity to be transmitted more quickly through corporate linkages to other entities within the group. Given this, an assessment of financial strength of an insurer should take into account the extent to which gearing or leverage may have compromised the capital resources available to the insurer.

Application

Prescriptive: Pursuant to section 193(1) of the Act, insurers shall disclose with the statutory annual returns submitted to the Bank, the extent of geared or leveraged capital which constitutes more than one third of the total capitalisation of the insurer under the following circumstances:-

- (a) where the capital is geared up more than twice (i.e. capital provided by the insurer's ultimate holding company is channelled through at least one intermediate holding company); and/or
- (b) where the capital is constituted from debt issued by the insurer's immediate shareholder.

PART V - INTERNAL CONTROLS AND OPERATIONAL RISK MANAGEMENT

19. RISK RECOGNITION AND ASSESSMENT

Principle 17: Every insurer should establish an effective internal control and risk management system that is capable of recognising and continually assessing material risks that could affect its performance and financial condition. The assessment should cover all risks facing the insurer on a consolidated basis (including underwriting risk, reinsurance risk, investment risk, geographical risk, operational risk and legal risk). Internal controls should be revised as necessary to effectively address any new or previously uncontrolled risks.

19.1 As insurers are in the business of risk-taking, it is imperative that they establish an internal control and risks management system that is able to detect and continually assess risks that could materially impair the insurer's ability to meet its corporate objectives and responsibilities. The risk assessment process should identify and consider both internal factors (such as the complexity of the organisation's structure, the portfolio mix, organisational changes and employee turnover) as well as external factors (such as fluctuating economic conditions, changes in the industry and technological developments) that could adversely affect the insurer's performance and financial condition. Insurers should also distinguish between those risks that are controllable from those that are not. Controllable risks should be mitigated through appropriate internal controls and the use of risk

management tools. For those risks that cannot be controlled, the insurer must decide whether to accept the risks or withdraw from, or reduce the level of, the business activity that creates exposure to the risks concerned. The responsibility for establishing an effective risk management and internal control system should rest with the board (*please refer to the application of principle 5*).

19.2 Although formal risk assessment procedures are encouraged, it is not the intention of this Framework to mandate such a requirement. More importantly, risk management should be nurtured as an inherent part of the insurer's corporate culture. It is also possible for insurers to effectively manage risk through largely informal mechanisms. However, good corporate governance in risk management can only be effective where there is a consciousness within the senior management ranks of the critical importance of knowing and continuously monitoring the full spectrum of risks that directly affect the insurer's performance and financial condition. This can be achieved through disclosure.

Application

Best practice: Insurers should report to the board, together with the results of the stress-tests required by LIAM and PIAM, the major risks facing the insurer and which are likely to affect the performance and financial condition of the insurer and the approach taken by management in dealing with these risks. Risks should be assessed on an integrated basis, combining exposures across the business activities within the insurer, entities within the group structure, and regional markets.

20. INTERNAL AUDIT

Principle 18: There should be an effective and comprehensive internal audit of the insurer's internal control system carried out by operationally independent and competent staff. The internal audit function should report directly to the board through the Audit Committee, and its findings and recommendations should be communicated to senior management and all levels of staff

concerned. The frequency and extent of internal audit reviews should be commensurate with the nature, complexity and risk of the insurer's activities.

20.1 The internal audit function is an important part of any effective internal control and risk management system because it provides an independent assessment of the adequacy of, and compliance with, established policies and procedures. The nature of the internal audit role makes it critical that internal audit personnel are independent from the day-to-day activities of the insurer, and have unrestricted access to all activities conducted by the insurer, including the operations of its branches and subsidiaries. Direct accountability to the board facilitates the proper functioning of corporate governance by enabling the internal auditor to provide the board with information that is not biased in any way as a result of interference by the affected levels of line or senior management. The importance of the internal audit function to the corporate governance process also requires that it be staffed with competent, well-trained officers who have a clear understanding of their role and responsibilities and the risks or *potential* risks faced by the insurer.

20.2 The Audit Committee (AC) plays a crucial role in ensuring the effectiveness of the internal audit function. BNM/RH/GL/003-1 requires the board of an insurer to establish an AC and internal audit department. The Bank's Guidelines on Audit Committees and Internal Audit Departments (JPI/GPI 13) sets out in detail, requirements as to the constitution (including the size, composition and qualification of members) of the AC as well as its authority and functions which, among other things, place responsibility for the performance review and remuneration of the chief internal auditor and ensuring that the internal audit department has adequate resources, squarely on the AC. These requirements aim to secure the independence of the AC and the effectiveness of the internal audit function needed to support good corporate governance in an insurer.

Application

Prescriptive: An insurer shall ensure compliance with BNM/RH/GL/003-1 and JPI/GPI 13 with respect to the establishment, duties, responsibilities and scope of audit committees and the internal audit function. Internal audit reports should be tabled before the AC within one month of the completion of the audit. To ensure that the AC functions effectively and provides adequate support to the internal audit department, insurers are required pursuant to section 193(1) of the Act, to furnish the Bank with annual reports on the activities of the AC, the number of audit meetings held in a year and details of attendance of each individual director on the AC in respect of such meetings. The report should be submitted to Pengarah, Jabatan Penyeliaan Insurans dan Takaful not later than by 31 January of each year.

21. INTERNAL CONTROL ACTIVITIES

Principle 19: The insurer should develop an internal control culture within the organisation that integrates control activities into the daily operations of the insurer. Internal control activities should involve all levels of personnel and should cover the entire spectrum of the control process, including the establishment of control policies and procedures, the verification that the control policies and procedures are being adhered to and the regular evaluation of the effectiveness of internal controls.

21.1 Control activities are most effective when they are viewed by management and all employees as an *integral* part of the daily activities of the insurer, rather than *in addition* to them. Furthermore, controls that are an integral part of the insurer's daily activities enable quick responses to changing conditions and avoid unnecessary costs. For effective internal control, risks identified in the risk assessment process must be controlled on a timely basis. In many cases, this entails *daily* control activities. Periodic internal audits or supervisory checks, although in themselves important control activities, are not sufficient to address risks in a timely, and therefore effective, manner. It is also not sufficient for senior

management to simply establish appropriate policies and procedures for the various activities and business units of the insurer. They must regularly ensure that all parts of the organisation operate in compliance with established policies and procedures and also evaluate the policies and procedures to ensure that they remain adequate. Internal controls should be reviewed especially under changing circumstances to take account of new or changing risks.

21.2 The majority of insurers currently rely heavily on the internal audit and compliance functions as the primary control activity. There is a need for insurers to adopt a more holistic approach to internal control activities. Here, the internal audit function can play a greater role in promoting an integrated control culture within the insurer.

Application

Best practice: Apart from the requirements of JPI/GPI 13, the scope of the internal audit function should also include a specific evaluation of the adequacy and effectiveness of the following categories of control activities:-

- (a) **top level reviews** - there should be regular performance and exception reports to senior management that enable them to gauge the progress of the insurer in relation to corporate goals and the effectiveness of internal controls. This serves as an important monitoring function and questions or concerns raised by senior management in the course of reviewing such reports facilitate the timely detection of errors, fraud or control weaknesses. In its evaluation, the internal auditor should determine the quality and timeliness of information provided in management reports (*also refer to the application of principle 33*) to ensure that top level reviews are effective as a control activity, and make an assessment of the attention paid by senior management to these reports;

- (b) **functional reviews** - line management should also receive and review performance and exception reports on a regular basis. Functional reviews should be carried out more frequently than top level reviews and are usually more detailed. As in top level reviews, the internal auditor should assess the quality and timeliness of information provided and the attention given to such reports;
- (c) **physical controls** - there should be adequate physical controls in place to safeguard the insurer's tangible assets and the integrity of information. Controls include physical restrictions to access, dual custody and the encryptment of important information stored electronically;
- (d) **exposure limits** - prudent limits on risk exposures should be established. In addition to verifying the enforcement and compliance of the limits, the internal auditor should also make an assessment of the reasonableness of limits for individual activities or business lines from a risk management and control perspective, taking into account the total risk exposure of the insurer on an aggregated basis;
- (e) **approvals and authorisations** - there should be transparent and documented procedures for the approval and authorisation of transactions above certain limits to establish management accountability and ensure that the appropriate levels of management are aware of material transactions and circumstances affecting the insurer (*also refer to the application of principle 10*). The internal auditor should be alert to sweeping delegations of authority and be able to make a control judgment of the reasonableness of approval and authorisation limits in relation to

the nature, volume, frequency and materiality of the transactions involved; and

- (f) **verifications and reconciliations** - the independent verification of transaction details and periodic reconciliations represent crucial control activities. The internal auditor should ensure that sufficient checks and balances exist in the insurer's operating processes to detect activities or records that require correction and hence, preserve the integrity of transactions. Errors or problems detected through verifications and reconciliations should be brought to the attention of the appropriate levels of management.

The internal auditor's evaluation of these control activities should be reported to the board and senior management of the insurer.

Principle 20: Internal control deficiencies or breaches, whether identified by business units, internal audit, the Bank examiners or other control personnel (e.g. compliance officers), should be reported in a timely manner to the appropriate management level and addressed promptly.

21.3 Timeliness in reporting and acting on internal control deficiencies (risks that are not effectively controlled) or breaches is critical to mitigate any exposure to the insurer, and by extension, its policy owners. In order to ensure that all internal control deficiencies are addressed in a timely manner, senior management should establish a system to track internal control weaknesses and actions taken to rectify them. Procedures should exist for the prompt reporting of internal control deficiencies or breaches to the appropriate management level and prompt follow-up or corrective action. Serious deficiencies and breaches should be reported to senior management and the board.

Application

Best practice: Periodic (preferably monthly or more frequently as necessary) reports on control issues identified by whatever means should be submitted to the board and senior management of the insurer. Material breaches or deficiencies should be reported to the board and senior management as soon as they are identified. The board and senior management should, in addition to ensuring that corrective action is taken, also examine potential trends indicated by control issues and institute *preventive* actions against more significant control deficiencies that are likely to arise in future.

22. SEGREGATION OF DUTIES

Principle 21: There should be an appropriate segregation of duties such that staff are not assigned potentially conflicting responsibilities. Areas of potential conflicts which are not addressed, either completely or partially, by a segregation of duties, should be compensated by other forms of mitigating controls against misconduct and subject to careful, independent monitoring.

22.1 Assigning potentially conflicting responsibilities to one individual (for example, claims processing and payments) provides the opportunity for that individual person to misappropriate corporate assets by manipulating records for personal gain, or conceal losses. Areas of potential conflict should be identified, minimised and subject to independent monitoring. As far as possible, conflicting duties within the insurer should be separated between different individuals or business units. Where this is not practicable, there should be other mitigating controls to address potential conflicts, and a system for independent and vigilant monitoring must be firmly established and implemented. To the extent practicable, job rotation may also be justified for certain critical activities to ensure that individuals are not in a position to conceal their activities for any extended period of time.

22.2 While the appropriate segregation of duties should be a matter for the insurer's management to decide, good governance practice dictates that a minimum degree of separation be observed in certain critical activities of the insurer.

Application

Best practice: Insurers should observe minimum lines of separation to address potentially conflicting responsibilities in critical areas of operations. The segregation of duties should at least cover the separation between:-

- (a) approval of the disbursement of funds and the actual disbursement;
- (b) operational and internal audit/compliance functions;
- (c) the execution and recording of investment transactions;
- (d) the execution and custody of title documents; and
- (e) underwriting and credit control.

23. INFORMATION SYSTEMS

Principle 22: There should be reliable information systems in place that cover all significant activities of the insurer. These systems, including those that hold and use data in electronic form, must be secure, maintained independently and supported by adequate contingency arrangements. Information systems should also provide for the independent verification of data produced.

23.1 Management decision-making and the effective conduct of key business activities could be adversely affected by lost, unreliable or misleading information. Therefore, it is imperative that insurers establish well-designed and controlled management information systems that cover the full range of the insurer's major activities. The system may be designed around electronic or non-electronic forms of data, but insurers should be particularly alert to the specific structural and internal control requirements needed to protect the integrity of electronic information. It is

also important to ensure the existence of an adequate audit trail of financial information processed through electronic systems.

23.2 Controls over electronic information systems should include both general and application controls. General controls are controls over computer systems (e.g. mainframes, client servers and end-user workstations) that ensure their continued and proper operation. They also include back-up and recovery procedures, software development and acquisition policies, maintenance procedures, and access security controls. Application controls are programmed controls within software applications and other manual procedures that control the processing of transactions and business activities (e.g. logic checks of transactions processed).

23.3 Electronically stored or transmitted information, while increasing efficiency, also tends to increase the risk of business disruptions. In the current technology-driven business environment and the resultant technological interdependencies between insurers and their business partners, business resumption and contingency plans play a critical role in protecting an insurer against the risk of extended business disruptions caused by factors beyond its control. Business resumption and contingency plans should, preferably using independent facilities, provide for the recovery of critical systems.

Application

Prescriptive: Insurers shall ensure compliance with the Bank's Guidelines on EDP Security Controls (JPI/GPI 7) with respect to the minimum security controls for their EDP systems. Pursuant to JPI/GPI 13, the internal auditor shall ensure that the insurer establishes an information systems security policy to protect the confidentiality, integrity and availability of the insurer's computerised data.

Best practice: Insurers should maintain and regularly review business resumption and contingency plans on an *ongoing* basis to ensure that they can continue to

operate “mission-critical” functions in the event of a management information system failure. The plans should be structured along the Year 2000 Business Resumption and Contingency Guideline (JPI: 33/1998) and the Guidelines on Minimum Service Levels for Y2K Contingency Planning for the Insurance and Takaful Industries (JPI/GPI 21) issued by the Bank. Business resumption plans should also be periodically tested to ensure their functionality in the event of an unexpected disaster.

24. OPERATIONAL RISK LIMITS

Principle 23: Insurers should establish operational risk limits within the risk tolerance boundaries determined by the board for all core activities of the insurer, including underwriting, reinsurance and investment.

24.1 Operational risk limits serve as important internal controls to contain an insurer's exposure to business or market risks, abuses, professional misjudgment or fraudulent activities. The board is ultimately responsible for determining the risk appetite of the insurer (*please refer to the application of principle 5*). Within the risk tolerance boundaries established by the board, the board and senior management should determine operational risk-taking limits for the insurer's core activities, specifically, underwriting, reinsurance and investment.

24.2 The regulatory framework already provides for the application of operational risk limits in the areas of investment and reinsurance. In addition, insurers should establish their own operational risk limits for underwriting to manage risks associated with accumulation (the concentration of risks accepted), inadequate monitoring of large individual risks, premium defaults, oversights in securing the necessary reinsurance arrangements for large risks not covered under automatic reinsurance treaties and the collapse or withdrawal of reinsurers.

Application

Prescriptive: Insurers shall ensure compliance with the specification of admitted assets pursuant to section 46(2) of the Act, counterparty exposure limits stipulated in the Bank's Guidelines on Derivatives (JPI/GPI 20) and reinsurance exposure limits stipulated in the Bank's Guidelines on General Reinsurance Arrangements (JPI/GPI 22).

Best practice: To limit the extent of exposure to large individual losses, insurers should establish single risk acceptance limits (which may vary for different lines of business) that are commensurate with its financial capacity, risk appetite and technical capabilities.

25. NEW PRODUCTS

Principle 24: There should be an established and formal procedure for new product approvals (both insurance products introduced for sale as well as financial options used in investment and reinsurance) and product reviews from the business, risk management and internal control perspectives. Internal controls should be regularly evaluated and assessed against changes in the insurer's risk profile resulting from a change in products sold or used by the insurer in its activities.

25.1 The introduction of new insurance and financial products, either for sale by the insurer, or for use in its investment and reinsurance activities, is essentially a strategic issue. As such, its implications for the insurer can be enormous from the business as well as risk management and internal control perspectives. Therefore, it is imperative that new products (including derivatives and alternative risk transfer arrangements) be carefully considered by the appropriate management levels before they are approved for sale or use in the insurer's business activities.

Application

Prescriptive: All new life insurance products shall be certified by the insurer's appointed actuary and lodged with the Bank pursuant to section 142 of the Act. Insurers shall also ensure compliance with JPI/GPI 20 with respect to procedures for the approval of new derivative products. The prior approval of the Bank must be obtained for any financial reinsurance arrangement.

Best practice: Insurers should establish documented procedures for the approval of new insurance and financial products, whether for sale or for use in the insurer's business activities. Only senior management and the board, as appropriate, should be authorised to approve new products. To ensure transparency and accountability, deliberations of the board or senior management on new products and product reviews should be duly recorded.

PART VI - PUBLIC ACCOUNTABILITY

26. UNFAIR PRACTICES

Principle 25: No insurer should, under any circumstance, engage in any unfair or deceptive acts or practices that prejudice the rights of policy owners and claimants or that jeopardise the stability of the market.

26.1 As custodians of public funds, it is incumbent upon insurers to ensure that their dealings with the public are always conducted fairly, honestly and professionally. This cannot be compromised in any way as officers of insurers owe a public duty of trust to the policy owners and claimants with whom they deal. This duty requires that officers of insurers take particular care to avoid conflicts of interest (*see principle 11*) or actions that constitute unfair or deceptive practices to the detriment of the insurer's policy owners and claimants.

Application

Prescriptive: Insurers shall strictly comply with the provisions relating to policies under Parts XII and XV of the Act. In addition, insurers are prohibited from engaging in any unfair or deceptive acts or conduct that constitute unfair trade practices, including but not confined to:-

- (a) misrepresentations through false, deceptive or misleading statements - this includes misrepresentations as to the terms and benefits of insurance policies (including dividends and distributable surpluses), the financial condition of the insurer and information about competitors for the purpose of inducing a policy owner to lapse, forfeit or surrender his policy;
- (b) entering into any agreement to commit any act of boycott, coercion or intimidation resulting in a market monopoly of insurance business;
- (c) making or permitting any unfair discrimination that is not properly justified, between individuals of the same class and equal life expectations, in the rates charged for life insurance policies or life annuities, in the dividends or other benefits payable thereon, or in any other policy term and or condition; and
- (d) knowingly committing or performing as a general business practice, unfair claims settlement practices as defined in the Bank's Guidelines on Claims Settlement Practices (BNM/RH/GL/003-9).

Principle 26: There should be alternative avenues, apart from the legal system, for recourse by members of the public against unfair practices committed or alleged to have been committed by an insurer. Information about the availability of such recourse and procedures for lodging complaints and grievances should be established and widely disseminated to the public.

26.2 The legal system is the obvious and established avenue for members of the public to resolve their disputes with insurers. However, while serving its purpose,

it presents difficulties for the individual policy owner, claimant or beneficiary seeking redress because of the cost and time involved in taking legal action. Hence, the availability of alternative and independent means outside the legal system for members of the public to seek redress against unfair practices by insurers serves as an important restraint on insurers against engaging in unfair practices.

26.3 The Financial Mediation Bureau (FMB) and the Bank's Customer Services Bureau (CSB) provide alternative avenues for members of the public to seek redress against unfair market practices. However, for these avenues to effectively serve their purpose in promoting public accountability, public awareness of their role and functions must be heightened.

Application

Prescriptive: Insurers shall include in **any insurance policy issued or delivered to a new policy owner**, a written disclosure alerting the policy owner to the existence of the FMB and the CSB, their roles in investigating complaints into unfair market practices by insurers, their contact details and procedures for lodging complaints with the FMB or CSB. In addition, the notice required to be provided to claimants under BNM/RH/GL/003-9 with respect to the avenue for appeal to the FMB against the rejection of any element of a claim shall also include a notice to the same effect for appeals to the CSB.

Best practice: Insurers should also provide additional notice on the avenues of appeal to the FMB or CSB in information brochures or in notices displayed prominently at its offices.

PART VII - FINANCIAL REPORTING

27. PROPER RECORDS

Principle 27: Insurers should maintain records necessary to explain their financial transactions and which would enable the preparation of financial statements and the audit and examination of those financial statements.

27.1 The financial transactions of an insurer must be fully supported by documents showing the details of the transactions and the proper authorisation of the transactions. Proper financial records are essential to the preparation of accurate financial statements and the audit process. They also represent an important safeguard against the misappropriation of insurance funds. Proper records enable supervisors and persons responsible for the proper management of the insurer (including internal auditors) to verify that the assets of the insurer are applied only to meet liabilities and expenses that are properly attributable to the insurance fund.

27.2 While insurers generally have satisfactory record-keeping systems in place, the existence of long outstanding unreconciled items (between the insurer's own financial records and those provided by third parties), if material, can compromise the integrity of an insurer's financial statements. Timely reconciliations represent an important aspect of good financial governance and should form an integral part of an insurer's record-keeping systems and procedures as they provide a means of **independently** checking the integrity of the insurer's own financial records. Unreconciled items can be indicative of problems with the integrity of financial data, which, if left unattended to, can lead to longer-term financial problems for the insurer.

Application

Prescriptive: Officers of insurers shall observe their statutory duty of care and diligence pursuant to section 98 of the Act in maintaining proper accounting records and shall take adequate measures to ensure the timely reconciliations of outstanding balances. In this regard, insurers are required to observe the following⁴:-

- (a) cease the practice of offsetting debit and credit balances except where permitted under accounting standards issued by the Malaysian Accounting Standards Board, in particular FRS 101: Presentation of Financial Statements and FRS 132: Financial Instruments: Disclosure and Presentation;
- (b) review/establish procedures to ensure that all source documents necessary to support transactions with third parties are complete and accurately transmitted to the finance/accounts functions for recording purposes;
- (c) establish procedures to request for, and follow up on, statements from insurers/reinsurers and intermediaries to facilitate the timely reconciliation of outstanding balances;
- (d) establish procedures to ensure that reconciliations of third-party statements with the insurer's own records are performed within 30 days from the receipt of third-party statements and any unreconciled items are resolved in a timely manner; and
- (e) ensure that payments received from insurers and intermediaries are properly identified and matched with individual policies/treaties to which the payments relate.

⁴

With effect from 17 October 2001.

In addition, disclosure should be made of the amount and nature of unreconciled items in an insurer's balance sheet which constitute more than 2% of the category of assets (at gross carrying amounts before provisions) or liabilities to which the unreconciled items relate. For this purpose, unreconciled items refer to amounts in respect of which differences arise between the insurer's records and statements provided by third parties. The disclosure should be made in the notes to the accounts in respect of both the insurer's published annual accounts as well as statutory annual returns submitted to the Bank.

28. ANNUAL ACCOUNTS

Principle 28: Annual accounts which are lodged with regulatory authorities and made available for consumption by members of the public, must be audited by a registered company auditor independent of the insurer and must be accompanied by a directors' report about the operations of the insurer and a director's declaration as to whether the accounts have been prepared in accordance with approved accounting standards, present a true and fair view of the insurer's financial position and whether the insurer is solvent.

28.1 The annual accounts of an insurer is the most widely relied upon source of information used by external parties to gauge the state of affairs of the insurer. It is therefore imperative that information provided in the annual accounts is reliable. The external auditor provides an independent certification that the financial statements have been prepared in accordance with approved accounting and disclosure standards and present a true and fair view of the financial state of affairs of the insurer.

Application

Prescriptive: Insurers shall comply with sections 74(1) and 87(1) of the Act with respect to the appointment of an external auditor and the annual audit of financial statements and attendant reports submitted to the Bank respectively.

Principle 29: The legislative framework applicable to financial reporting should provide for supervisory authorities responsible for the oversight of insurers and the protection of policy owners, to prevent annual accounts which are not prepared in accordance with accounting standards or duly audited in accordance with sound auditing principles, or which are in any other way misrepresentative or misleading, from being made available to the public until the accounts have been modified to present a true and fair view of the insurer's financial condition.

28.2 This principle prevents annual accounts that are in any way misrepresentative or misleading, and which were not duly corrected through the audit process, from being released to shareholders and the general public. Given the fiduciary nature of insurance business and the potential public implications of misleading information being released, it is important that insurance supervisors be legally empowered to prevent misrepresentative annual accounts from being released where it is in the interests of the public to do so.

Application

Prescriptive: Insurers shall comply with any directive issued by the Bank pursuant to section 92(5) of the Act.

29. PUBLIC DISCLOSURE

Principle 30: Key financial information about an insurer should be made readily and easily accessible to the public (including the shareholders, policy owners, creditors or claimants of an insurer) in a timely and cost efficient manner.

29.1 Financial information about an insurer is only useful if it is communicated to end-users promptly and accurately, and can be retrieved at reasonable or marginal costs. Important financial information about an insurer should be easily

accessible by its policy owners, creditors, shareholders and interested members of the general public. To ensure this, it is important that channels selected for the dissemination of financial information enable the information to be retrieved in a reliable, timely and cost-efficient manner.

Application

Prescriptive: Insurers shall comply with section 95(1) of the Act with respect to the publication of annual accounts.

30. STATUTORY REPORTING

Principle 31: Insurers should be required by law to submit annual financial statements, duly audited, to the supervisory authority responsible for the financial surveillance of the insurer. Interim financial statements should also be submitted to the supervisory authority at regular intervals *within* the insurer's financial year. The statements should be of sufficient detail to enable the prompt detection of financial distress and provide a sound basis for projections to be made about the future operations and long-term viability of the insurer.

30.1 To facilitate the effective financial surveillance of insurers, the supervisory authority must be furnished with adequate financial information that will enable supervisors to promptly detect and monitor any adverse trends in the financial condition of the insurer, and take the necessary pre-emptive action to prevent insolvencies. Typically, information required by supervisors will need to be more comprehensive in detail and reporting intervals more frequent than that applied for general purpose annual accounts.

Application

Prescriptive: Insurers shall comply with sections 87(1) and 89(1) in respect of the submission of annual and quarterly returns to the Bank, and section 193 in respect of other statistical returns specified by the Bank.

Principle 32: Insurers should exercise due care and diligence in ensuring the accuracy of information submitted to supervisory authorities.

30.2 Section 205 of the Act makes it an offence for any person, with intent to deceive, to make a false entry, omit to make any entry or alter, abstract, conceal or destroy any entry in respect of documents relating to an insurer. However, more often than not, misleading information is provided as a result of negligence or irresponsibility on the part of officers concerned, and not with deliberate intent to deceive. Nevertheless, the implications of materially misleading information, whether furnished intentionally or not, can be equally damaging for the insurer and its stakeholders. To ensure that the financial surveillance function of the Bank serves its intended purpose in protecting the viability of insurers and by extension, the interests of policy owners and claimants, it is crucial that officers of insurers exercise due care and diligence to ensure that any information furnished to the Bank is not false or misleading in any material particular.

Application

Prescriptive: Any person who signs any document lodged with the Bank, or furnishes the Bank with any information under or for the purpose of the Act by any other means, shall exercise due care to secure that the document or information is both complete and not false or misleading in any material particular.

31. MANAGEMENT REPORTING

Principle 33: The board and senior management should receive regular reports of such nature, frequency and detail that provide a sound basis for decision-making and enable them to effectively monitor on an ongoing basis, the financial performance and condition of the insurer in relation to its corporate objectives and responsibilities.

31.1 Financial reports form the primary basis for decisions and strategies taken by the board and senior management (hereafter collectively referred to as "management") in respect of an insurer's corporate objectives and day-to-day operations. Effective management reporting is integral to good corporate governance because it ensures, by keeping them well-informed, that management always has a good handle on the affairs of the insurer. It is therefore crucial that pertinent information about the insurer's activities, of both a quantitative and qualitative nature, are supplied to management on a timely basis.

31.2 Management reporting generally serves two basic purposes – (i) for keeping management informed of the general state of affairs of the insurer and (ii) for decision-making. General purpose management reports should cover all the key aspects of the insurer's operations and should contain sufficient detail so as to provide the management with a sound basis for assessing the insurer's financial performance and condition at any point in time, for identifying real and potential problems facing the insurer and for formulating appropriate policies and strategies to achieve the insurer's corporate objectives and fulfil its fiduciary responsibilities. Special purpose management reports prepared for decision-making should contain only *relevant data* (so as not to cloud the issue under consideration) and should include *relative data* (to enable management to appreciate the degree of materiality of the issue) and *comparative data* - alternative scenarios, competitors or other business segments within the insurer (to provide a proper perspective of the issue).

31.3 Most insurers prepare monthly reports to senior management on the performance and financial condition of the insurer. As a general rule, this is sufficient to ensure that management is kept abreast of the business and affairs of the insurer. More frequent reports may be necessary for certain activities of the insurer which are subject to a higher degree of operational and/or market risks, or under certain market conditions of volatility which render the affairs of the insurer less predictable. Insurers should also endeavour to report to the board on their core activities at least at quarterly intervals.

Application

Best practice: Insurers should prepare and submit **general purpose reports** on the financial condition and performance of the insurer and attendant matters, to the board and chief executive officer *at least* on a quarterly basis. The reports should cover all key operations of the insurer and should at least include an analysis of premium growth, forfeiture experience, underwriting performance, investment results, claims management and credit control. Related-party transactions, the sale or acquisition of assets of material value and large risks assumed or claims notified/incurred together with an assessment of their financial impact should be highlighted for management attention. **Special purpose reports** prepared for decision-making should fulfil the critical qualitative characteristics of comprehensiveness, relevance, timeliness, reliability, comparability and materiality.

PART VIII - DISCLOSURE

32. IMPLEMENTATION AND ENFORCEMENT⁵

32.1 Insurers are required to make a general disclosure of their corporate governance practices, briefly describing the manner in which the Framework principles have been applied. The disclosure should be made in the Directors'

⁵ With effect from 10 May 2000.

Report accompanying the insurer's annual accounts and statutory annual returns to the Bank, and should be reported under the heading "Corporate Governance" after the item "Issue of Shares". Any departure from the Framework principles and the circumstances justifying such departure should be specifically explained.

PART IX - WITHDRAWAL OF GUIDELINES/CIRCULARS

33. With the issuance of these consolidated guidelines, the following guidelines and circulars are hereby withdrawn:-

Guideline/ Circular	Title	Date of Issuance
JPI/GPI 25	Prudential Framework of Corporate Governance for Insurers	10 May 2000
JPI: 11/2001	Reconciliation of Outstanding Balances	17 October 2001