

PART I – OVERVIEW	1
1. BACKGROUND	1
2. COVERAGE	2
PART II – FINANCIAL CONDITION INVESTIGATIONS	2
3. EXECUTIVE SUMMARY REPORT	2
4. INTRODUCTION	3
5. NATURE OF BUSINESS.....	4
6. EXPERIENCE ANALYSIS.....	4
7. INVESTMENT OF INSURANCE FUNDS	6
8. SOLVENCY	7
9. DISTRIBUTION OF SURPLUS	8
10. REINSURANCE	10
11. OTHER ISSUES.....	10
12. ACTION REQUIRED.....	10
PART III – WITHDRAWAL OF GUIDELINES	11

BNM/RH/GL/003-17	Prudential Financial Policy / Insurance and Takaful Supervision Department	GUIDELINES ON FINANCIAL CONDITION REPORT	Page 1/11
------------------	--	--	-----------

PART I – OVERVIEW

1. BACKGROUND

1.1 Section 85 of the Insurance Act 1996 (Act) provides that a licensed life insurer shall have an investigation made by its Appointed Actuary into the financial condition of its business at the end of each financial year. The investigation includes the Appointed Actuary's recommendation on surplus distribution as required under section 43(2) of Act. Further, the Guidelines on the Role of the "Appointed Actuary" state that the Appointed Actuary shall report in writing to the management any event that in his opinion has a material adverse impact on the financial condition of the insurer. In this report, the Appointed Actuary is required to outline the effect that such an event may have on the assets and/or liabilities of the insurance fund and the recommended corrective measures. Arising from the above obligations, there is a need for the Appointed Actuary to report to the Board of Directors (Board) with a comprehensive Financial Condition Report (FCR) on the current financial position of the insurer and its possible future development.

1.2 The purpose of these guidelines is to set out a framework which will enable the preparation of a comprehensive FCR, taking into account all relevant financial investigations and their implications. Corporate governance would be enhanced if the Board has the appropriate information to fully understand the financial condition of the insurer.

2. COVERAGE

2.1 These guidelines provide a **minimum standard/scope** for the Appointed Actuary to ensure that the coverage of the FCR is comprehensive enough to present a consolidated position of the insurer over both the short and long term to the Board. However, the guidelines should not restrict the scope of the Appointed Actuary's investigation. The Appointed Actuary is encouraged to widen the scope of the FCR to include other issues if in his professional opinion these issues are important and relevant to the insurer, and enhances the understanding of the insurer's financial position. The Appointed Actuary may well go beyond the requirement of the Act.

2.2 The report should be expressed and presented from a layman's point of view to accord better understanding and appreciation of the issues by members of the Board who may not be conversant with actuarial and technical terms. Further, the FCR should also be regarded as an opportunity to educate members of the Board on important technical and actuarial concepts. **The Appointed Actuary is required to present the FCR to the Board annually not later than six months after the end of the financial year.**

2.3 The general format of the FCR, including the issues which the Appointed Actuary shall address is set out in the paragraphs below.

PART II – FINANCIAL CONDITION INVESTIGATIONS

3. EXECUTIVE SUMMARY REPORT

3.1 The executive summary will provide an overview of the significant areas covered by the FCR, including the significant issues that shall be addressed by the Board. The summary shall include conclusions drawn on the financial position of the insurer with appropriate recommendations.

BNM/RH/GL/003-17	Prudential Financial Policy / Insurance and Takaful Supervision Department	GUIDELINES ON FINANCIAL CONDITION REPORT	Page 3/11
------------------	--	--	-----------

3.2 The FCR shall report briefly on the actions taken by insurer arising from recommendations proposed in the previous report. The Appointed Actuary shall assess the progress made so far and provide an opinion as to his satisfaction with the progress made. The attention of the Board shall be drawn if progress on any action taken arising from the recommendations made fall significantly below the Appointed Actuary's expectation.

4. INTRODUCTION

4.1 The name of the insurer and the time period to which the investigation relates to shall be stated.

4.2 The name of the Appointed Actuary and his relationship to the insurer shall be stated clearly, i.e. whether he is an employee of the insurer or an external consultant to the insurer. The Appointed Actuary shall also state whether he is holding other positions of responsibility in the insurer, e.g. Chief Financial Officer, etc. If so, he shall disclose any possible conflict of interest in the preparation of the FCR and declare that he has acted professionally under both capacities.

4.3 The Appointed Actuary shall comment on the database and whether the accuracy of the data and its consistency with previous investigations are satisfactory. He shall also state the precautions that were taken to ensure the accuracy of the data in carrying out the investigations. Any significant restrictions to the scope of the FCR or details of a required analysis for reasons such as unavailability of data, shortcomings in computer system or unavailability of resources to carry out the analysis shall be highlighted. The Appointed Actuary shall draw attention to any such inadequacies and provide an opinion as to their importance and relevance to the insurer. In particular, if the scope of the FCR is limited by pertinent information not forthcoming from the insurer, the FCR should be qualified.

5. NATURE OF BUSINESS

5.1 The FCR shall include commentary on the business of the insurer and the environment in which it is expected to operate. The FCR shall analyse business in force and new business written with its implications on new business strain. The analysis shall be made in respect of business maintained under separate sub-funds, i.e. the participating and non-participating sub-funds etc..

5.2 The FCR shall provide a summary of new products launched and also existing products which were modified during the financial year under review. It shall also comment on any unusual features of the insurer's business in regard to business in force, current new business and development of new products, particularly on guarantees or options given under policies and their likely effects on financial standings of the insurer.

5.3 The FCR shall highlight any significant change in underwriting standards and also provide a brief description of the various distribution methods employed by the insurer.

6. EXPERIENCE ANALYSIS

6.1 The FCR shall analyse the experience and comment on any significant trends in the experience of the insurer, at least by sub-fund basis, in regard to the following areas:-

- (i) mortality;
- (ii) morbidity;
- (iii) persistency;
- (iv) investment returns;
- (v) expenses; and

BNM/RH/GL/003-17	Prudential Financial Policy / Insurance and Takaful Supervision Department	GUIDELINES ON FINANCIAL CONDITION REPORT	Page 5/11
------------------	--	--	-----------

(vi) acquisition expenses.

6.2 The FCR shall include comments on steps which are proposed to be taken by the insurer to address any areas of adverse experience, including any deterioration in experience vis-a-vis product pricing assumptions.

6.3 The Appointed Actuary is required to carry out an ageing analysis of the persistency experience of the insurer.

6.4 In the case of investment returns, the analysis shall also include a study of investment returns achieved by the respective sub-funds for the preceding four financial years on the basis of a “marked to market” rate of return.

6.5 The FCR shall study the level of any expense overruns experienced or any potential expense overruns in relation to the product pricing assumptions in the future. Recommendations as to how to manage the expense overruns, e.g. the setting up of reserves or support from shareholders, and measures to control expenses shall be highlighted for the consideration of the Board. The expense analysis shall also include comments on the marginal expense.

6.6 As regards to product viability, an analysis of actual experience against product pricing assumptions would reveal continuing viability of the business written by the insurer at current premium rates and charges. The FCR shall provide an opinion on the viability of current premium rates and charges for the non-participating business while in the case of participating business, emphasis shall be given to the ability to maintain the current bonus declaration rates.

7. INVESTMENT OF INSURANCE FUNDS

7.1 Investment performance has a significant impact on the financial condition of the insurer. The FCR shall state the policy of the management in regard to the investments of the various sub-funds maintained by the insurer. The FCR shall also delineate the different investment strategies adopted for the various sub-funds. This may include a description of how the respective sub-funds should be invested in terms of percentage holdings in equities, fixed interest securities, properties, etc..

7.2 The Appointed Actuary shall decide whether, in his judgement, the investment policy being pursued by the insurer is, or could become inappropriate having regard to the nature and term of the insurer's liabilities and policy owners' reasonable expectations. If it is considered that the investment policy is inappropriate, or potentially so, the Board shall be advised of the constraints or changes necessary in order to protect the financial standings of the insurer and policy owners' reasonable expectation. The FCR shall also comment on the performance and the appropriateness of the mix of assets by types for the various sub-funds. In particular, the Appointed Actuary shall comment on the adequacy of the investment returns to meet policy owners' reasonable expectations in relation to the illustrated bonus rates.

7.3 The Appointed Actuary shall assess and report on the financial consequences of:-

- (i) the extent to which the insurer's investment policy is not met;
- (ii) the mismatching of assets and liabilities;
- (iii) the lack of marketability of assets in circumstances when they may be called upon to meet policy proceeds; and
- (iv) any asset default risks.

7.4 As regards to the use of derivatives by the insurer, the FCR shall report any financial derivative exposures, if potentially significant. The Appointed Actuary should also take into consideration the issues highlighted by JPI/GPI 20 on Guidelines on Derivatives issued by Bank Negara Malaysia (the Bank).

8. SOLVENCY

8.1 The Statement of Solvency (Form L5) prescribed as part of the Annual Statutory Returns shall be presented to the Board.

8.2 The FCR shall provide a summary of the statutory valuation of policy liabilities, highlighting any change in valuation basis or methodology for the financial year under review and also the rationale for the change. The effect of the change in basis or methodology shall be quantified unless the Appointed Actuary is satisfied that the changes are not material.

8.3 The FCR shall comment on the level of and reasons for deficiency in the margin of solvency **during the financial year under review** and the actions taken or proposed to be taken to rectify the deficiency.

8.4 The report shall also provide a summary of the results of any resilience/stress tests conducted throughout the financial year under review as well as any action taken or proposed to be taken resulting from the studies.

8.5 If any additional valuation has been undertaken on a different methodology and/or basis to examine the adequacy of reserves, e.g. a liability valuation based on the insurer's own internal basis, the results of such a valuation shall be given together with the conclusions that can be drawn from the investigation.

BNM/RH/GL/003-17	Prudential Financial Policy / Insurance and Takaful Supervision Department	GUIDELINES ON FINANCIAL CONDITION REPORT	Page 8/11
------------------	--	--	-----------

8.6 In addition to the immediate solvency and capital adequacy of the insurer, the Appointed Actuary should also be concerned with the medium and long term solvency and capital adequacy prospect of the insurer. In accordance with BNM/RH/GL/003-18: Guidelines on Dynamic Solvency Testing (DST), the DST technique shall be utilised to assess the ability of the insurer to withstand changes in the external economic environment as well as the likely impact of such changes on the insurer. The summary of the DST results, as per the presentation format disclosed under paragraph 21 and 22 of BNM/RH/GL/003-18 shall be presented as part of the FCR. Arising from the projections, the Appointed Actuary shall provide comments, analysis and recommendation on the course(s) of action to be taken by the Board as required by paragraph 23 and 24 of BNM/RH/GL/003-18.

9. DISTRIBUTION OF SURPLUS

9.1 Section 43(2) of the Act provides that an insurer may allocate the valuation surplus at the end of a financial year by way of bonus to its participating policy owners or transfer to shareholders' fund. In order to ensure a fair and equitable distribution of surplus to all parties concerned, the Appointed Actuary shall therefore conduct an annual financial assessment on all participating plans. An asset share study as outlined in JPI: 29/2004 – Appointed Actuary's report to the Board on Recommendation for a Reduction in Bonus Rates for Participating Life Products or any other equivalent methods can be used for this purpose. The results of such study shall be presented in the FCR. In addition, the Appointed Actuary is to disclose the general bonus philosophy of the company as adopted by the Board and to comment on whether the philosophy has been practised in the past. The analysis of size of the inherited estate (if any) of the participating fund and the Appointed Actuary's recommendation on the management of the estate as well as the possible distribution of the estate beyond what is needed to maintain an effective buffer for the maintenance of the bonus rates for current policyholders is to be reported in the FCR.

BNM/RH/GL/003-17	Prudential Financial Policy / Insurance and Takaful Supervision Department	GUIDELINES ON FINANCIAL CONDITION REPORT	Page 9/11
------------------	--	--	-----------

9.2 The FCR shall also contain a summary of the realistic gross premium valuation (GPV), including the assumptions used, as conducted by the Appointed Actuary in accordance with the regulation applicable at the time of FCR preparation. If the asset share study is conducted, then both the results of the asset share and realistic GPV for different generation of policy owners shall form the basis to determine the appropriateness of surplus distribution between shareholders and participating policy owners. If the maintenance of future bonus/dividend rate is unlikely to be sustainable in the future, a formal report on the detailed asset share study conducted as per the requirement outlined in JPI 29/2004 prepared by the Appointed Actuary and endorsed by the Board need to be submitted separately to the Bank at least three months before the implementation of the bonus revision. The Appointed Actuary shall highlight in the FCR any change in bonus/dividend declaration rates for any in force participating policy for the financial year in relation to the previous financial year.

9.3 The FCR shall also analyse surplus arising due to interest and mortality experiences, change in valuation basis, expense experience and other sources during the financial year as required under Form SV2 of the Actuarial Valuation Returns. The report shall comment on any significant variations observed as compared with previous analysis.

9.4 The Appointed Actuary shall explain the rationale for his recommendation on surplus distribution and in particular, state his opinion on:-

- (i) the equity of the surplus distribution between policy owners and shareholders and equity among different generations of participating policy owners having due regard to policy owners' reasonable expectation;
- (ii) the consistency of the bonus/dividend declaration with the surplus distribution policy of the insurer and policy owners' reasonable expectations as perceived by the Appointed Actuary; and
- (iii) the likely consequences of the surplus distribution on the insurer's current and future financial position.

10. REINSURANCE

10.1 The FCR shall provide a description of the existing reinsurance arrangements in force, including their purpose and the retention levels, and comment on the adequacy and effectiveness of the arrangements. The description shall include the identity of the reinsurer, the nature of cover and the circumstances, if any, under which the reinsurer can terminate the arrangement for in-force business or make any significant changes in reinsurance arrangements during the financial year. The description shall also include a summary of the financial results of the reinsurance arrangements for the current financial year and the four immediately preceding years. In addition, any arrangements which involve the taking of reserve credits and/or the alleviation of surplus strain through a cash infusion from the reinsurer should be described in full including the aspect of counterparty risk of the reinsurer.

10.2 The Appointed Actuary shall comment if in his judgement, any reinsurance arrangements undertaken by the insurer are, or could become inappropriate.

11. OTHER ISSUES

11.1 In his report, the Appointed Actuary may present any other issues which he considers pertinent to bring to the attention of the Board. This may include other important aspects of the business and its operating environment which may affect the financial standings of the insurer.

12. ACTION REQUIRED

12.1 The FCR shall be presented to the Board by the Appointed Actuary for each financial year. The insurer is required to forward a copy of the FCR to the Bank within two weeks following the Board meeting on the FCR. **In any case, the FCR shall**

BNM/RH/GL/003-17	Prudential Financial Policy / Insurance and Takaful Supervision Department	GUIDELINES ON FINANCIAL CONDITION REPORT	Page 11/11
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be prepared and submitted to the Bank not later than six months after the end of each financial year.

PART III – WITHDRAWAL OF GUIDELINES

With the issuance of these Guidelines, the previous guidelines as stated below is hereby withdrawn:-

Guideline/Circular	Title	Date
JPI/GPI 24	Guidelines on Financial Condition Report	2 May 2000