

Response to feedback received

Internal Capital Adequacy Assessment Process for Takaful Operators

Introduction

The Bank has finalised the issuance of the policy document on Internal Capital Adequacy Assessment Process (ICAAP) for Takaful Operators.

As part of the consultation process, the Bank received written responses from a range of respondents, including takaful operators (TOs), industry association and other regulatory authority.

The Bank appreciates the feedback and suggestions received during the consultation process. Key comments received and the Bank's responses are provided in the following sections. Other comments and suggestions for clarification have been incorporated in the final policy document where appropriate.

Bank Negara Malaysia

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1. Risk appetite/ tolerance of participants

As the TO's risk appetite/ risk tolerance could be materially different from participants, some respondents suggested for participants' risk appetite or risk tolerance to be considered in the approval of TO's risk appetite/ risk tolerance by the Board.

- 1.1 The policy document acknowledges the significance and materiality of participants' risk appetite/ risk tolerance. Hence, the final policy document has been drafted such that participants' risk appetite/ risk tolerance present and are embedded in the takaful funds in the form of inherent risk.
- 1.2 The policy document clarifies that participants' risk appetite must be taken into consideration by the Board during approval of a licensed person risk appetite/ risk tolerance and capital management framework.

2. Definition of the term “operational activities” for takaful operations

Some respondents requested for clarity on the term “operational activities” when setting up Individual Target Capital Level (ITCL) as the term is relatively broad to be considered for quantification & projection purposes.

- 2.1 The final policy document does not explicitly explain on the term “operational activities”. However, TOs are required to refer to other relevant policy documents issued by the Bank in understanding the term. Some of the guidance are provided under item 2.2 to 2.6 below for references.
- 2.2 The Risk-Based Capital Framework for Takaful Operators (RBCT) provides the formula to compute the Operational Risk Capital Charges (ORCC) which aims to mitigate the risk of losses arising from inadequate or failed internal processes, people and systems, in managing the takaful operations. The ORCC also includes the risk of losses arising from non-compliance to Shariah and failure by TOs in executing their fiduciary duties.
- 2.3 Takaful Operational Framework (TOF) outlines the parameters to govern operational processes of takaful operators and defining in detail where necessary, the various rules and requirements for takaful operators without limiting or specifying particular contracts to apply to the takaful operators.
- 2.4 Concept Paper on Operational Risk Management elaborates the Bank's key expectations of a financial institution operational risk management framework & practices and principles underpinning sound operational risk management. The concept paper, together with Operational Risk Reporting Requirement – Operational Risk Integrated Online Network (ORION) further guides TOs in identifying and assessing the appropriate operational risks affecting its business.
- 2.5 Guidelines on Outsourcing for Takaful Operators sets out minimum expectations of the Bank to takaful operators that outsource, or plan to outsource, any of its business activities, functions or processes (collectively referred to as activities).
- 2.6 In essence, the above relevant policy documents should assist TOs in determining the appropriate definition of “operational activities”.

3. Maintenance of capital level above the ITCL

Some respondents requested for clarity on the requirements to maintain capital levels above ITCL, subject to a minimum of three years based on projection period to conduct capital planning processes.

- 3.1 The policy document clarifies that TOs are required to operate and maintain capital levels above the ITCL at all times.
- 3.2 ITCL which is set through an iterative process of stress tests based on a projection period of one year will need to be reviewed annually. Meanwhile, the Capital Management Plan (CMP) spans over a projection period of at least three years and will need to be reviewed at least on annual basis.
- 3.3 Despite of any changes found in the review of ITCL, CMP or ICAAP, TOs are required to ensure their capital levels are maintained and operated at level above the ITCL at all times.

4. Computation and reporting of ITCL at a more granular level

Some respondents requested for clarity on the granularity of computation and reporting of ITCL required by the Bank in the case ITCL is not satisfied/ adequate. For example, whether TOs are required to compute ITCL at sub-fund level within the same Participants' Risk Fund.

- 4.1 Paragraph 15.2 of the policy document is not intended to be definitive into what would be required of the TOs to report ITCL granularly. The Bank will make assessment as to what type of granular information that is considered necessary to understand better the setting of ITCL by the TOs.