Position Paper

RAB response to BNM on Exposure Draft on Risk-Based Capital Framework for Insurers and Takaful Operators

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Contact person:	RAB secretariat	E-mail:	international@insuranceeurope.eu
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The Insurance Europe Reinsurance Advisory Board (RAB) welcomes the opportunity to provide comments to the Bank Negara Malaysia (BNM) Exposure Draft on Risk-Based Capital Framework for Insurers and Takaful Operators (RBC Exposure Draft).

The RAB notes that paragraphs 9.1, 15.1 and 15.3 of the RBC Exposure Draft, taken together, suggest that reinsurance/retakaful recoveries less deposits will not be recognised as Tier 1 and Tier 2 Capital if the reinsurer is not regulated by BNM or the Labuan Financial Services Authority (LFSA). **The RAB would kindly invite the BNM to reconsider these stipulations which discriminate reinsurers not regulated domestically.**

Credit for reinsurance afforded to ceding undertakings should not be restricted based solely on the geographic location of a reinsurer, but rather on **a risk-based assessment of the reinsurer's financial strength, credit ratings, business expertise and experience, as well as the robustness of the supervisory framework it is subject to**. Professionally managed and well-capitalised reinsurance companies from well-regulated regimes should be treated without discrimination.

It is imperative to recognise that the economic value of reinsurance lies in the spreading and diversification of risk rather than the generation of premiums within national borders. Through their global presence and significant risk diversification, reinsurers contribute to financial stability during a financial crisis and mitigate financial impact of major catastrophic events on primary insurers, in turn ensuring protection of policyholders.

For general insurers and takaful operators, the proposed catastrophe risk charge on flood peril would materially increase the capital requirements. Any restrictions on cross-border reinsurance would further dampen the solvency ratios of the industry, potentially leading to higher premiums or even the withdrawal of coverage, ultimately to the detriment of policyholders in flood-prone areas.

Discriminatory prudential provisions for cross-border reinsurers not regulated by domestic regulators, such as the aforementioned requirements proposed by the BNM in its RBC Exposure Draft, could fundamentally weaken the strength of the Malaysian insurance market by:

- reducing access to international reinsurance capacity and risk management expertise;
- counteracting the goal of diversification of risks and compromising financial stability in the face of major catastrophes, where losses may be concentrated with domestic insurers and reinsurers rather than globally distributed, with the potential risk of forcing state intervention in some cases; and
- creating non-alignment with global regulatory standards and best practices.

Insurance Europe's Reinsurance Advisory Board
Secretariat • rue du Champ de Mars 23, B-1050 Brussels
Tel: +32 2 894 30 00
E-mail: international@insuranceeurope.eu

A key objective of the revised RBC Framework is achieving greater alignment with global capital standards. It is therefore important that the proposal is based on global best practices, eg recognition of diversification benefits and risk mitigation, removal of disincentives to cross-border business, and recognition of robust regulatory frameworks of other jurisdictions. Professionally managed and well-capitalised (re)insurance companies that are subject to risk-based solvency requirements and reliable supervision should be able to serve insurers in Malaysia equally.

The RAB recommends the BNM to revise the relevant paragraphs to allow the inclusion of reinsurance/retakaful recoveries available capital as long as the reinsurers/retakaful operators are subject to risk-based solvency supervision and regulated by a reputable insurance regulator with whom the BNM has effective cooperation arrangements in place, eg signatories of the IAIS Multilateral Memorandum of Understanding.

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Through its member bodies, the RAB represents more than 50% of total worldwide reinsurance premium income. The RAB promotes a stable, innovative and competitive market environment. It further promotes a regulatory and trading framework that facilitates global risk transfer through reinsurance and other insurance-linked capital solutions.