



**Perbadanan Insurans Deposit Malaysia**  
**Protecting Your Insurance And Deposits In Malaysia**

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**CONSULTATION PAPER ON  
DIFFERENTIAL LEVY SYSTEM FRAMEWORK  
FOR TAKAFUL OPERATORS**

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## PART 1: INTRODUCTION

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### 1.0 BACKGROUND

- 1.1 Perbadanan Insurans Deposit Malaysia (“PIDM”) implemented the Differential Levy System (“DLS”) Framework for the Takaful and Insurance Benefits Protection System (“TIPS”) in 2013. The DLS Framework was brought in to replace the flat-rate levy system that was introduced when TIPS was implemented in 2010.
- 1.2 During the implementation of the DLS Framework, takaful operators were excluded due to limited data. This was particularly so in relation to a capital adequacy measure as the Risk-Based Capital Framework for Takaful Operators (“RBCT”) was not yet effective at that time.
- 1.3 Once RBCT was put in place in 2014, PIDM commenced the development of the proposed DLS Framework for Takaful Operators (“DLST Framework” or “Framework”) for TIPS.
- 1.4 This consultation paper details the proposals for the Framework, methodology, approach, the criteria, indicators and score ranges.

### 2.0 CONSULTATION PROCESS

- 2.1 PIDM welcomes comments and feedback on any aspect of the consultation paper, including suggestions on any particular areas or alternative proposals that PIDM should consider. To facilitate PIDM’s assessment, please support each comment with clear rationale, accompanying evidence or illustrations, where appropriate.
- 2.2 Responses shall be submitted by **6 February 2015** to:

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



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(Please mark **“CP DLST”** on the top left hand corner of the envelope for written comments posted to PIDM)

Or Email: [dls@pidm.gov.my](mailto:dls@pidm.gov.my)

Enquiries: Encik Azman Mokhtar 03-21737596  
Mr Ganesh Sivarajah 03-21737572

- 2.3 All comments will be treated in strictest confidence. PIDM will collate comments on this consultation paper and publish its responses on PIDM’s website. Thereafter, PIDM will finalise the Framework and follow the relevant legislative process to implement the Framework.
- 2.4 The DLST Framework is planned to be implemented in the assessment year 2016.

## PART 2: LEGAL PROVISIONS AND SCOPE OF APPLICATION

### 3.0 LEGAL PROVISIONS TO DEVELOP AND CHARGE DIFFERENTIATED LEVIES

3.1 Pursuant to subsections 71(2) and 72(4) of the Malaysia Deposit Insurance Corporation Act 2011 (“the Act”), PIDM may make regulations in respect of the determination of first and annual premiums for member institutions, including:

- (a) the establishment of a system of classifying members in different categories; and
- (b) the criteria or factors to be taken into consideration and the procedures to be followed in determining the category in which a member is classified.

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

### 4.0 SCOPE OF APPLICATION

4.1 The proposed DLST Framework is applicable to all takaful operators that are registered under the Islamic Financial Services Act (“IFSA”) 2013 (“takaful operators”), except retakaful operators. All takaful operators conducting general takaful and/or family takaful businesses are subject to the DLST Framework.

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

**Table 1: Scope of Application**

Entity	Business	General Takaful DLST Criteria	Family Takaful DLST Criteria
Takaful Operators	Family Takaful		X
	Composite Takaful	X	X

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## PART 3: PROPOSED DIFFERENTIAL LEVY SYSTEM FRAMEWORK

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### 5.0 OVERVIEW

- 5.1 Under TIPS, which came into effect on 31 December 2010, a flat-rate levy has been applied for takaful operators, regardless of their risk profiles. With the establishment of the proposed DLST Framework, PIDM aims to promote greater fairness in the levy assessment process. In addition, the DLST Framework supports one of the objectives of PIDM, which is to provide incentives for sound risk management. The takaful operators will have to improve the overall aspects of their businesses in order to achieve the best risk category and the lowest levy rate.
- 5.2 DLST replicates the successful implementation of the DLS Framework for TIPS in 2013. The DLS Framework classifies conventional insurance members into different categories according to their respective risk profiles.

### 6.0 OBJECTIVES

- 6.1 The objectives of the DLST Framework are as follows:
- (a) to differentiate takaful operators according to their risk profiles;
  - (b) to introduce more fairness into the levy assessment process, so that takaful operators assessed to be of higher risk will pay higher levies as opposed to takaful operators classified as having lower risk exposures;
  - (c) to provide incentives for takaful operators to adopt sound risk management practices; and
  - (d) to promote stability of the financial system via the overall improvement in risk management practices of the takaful operators.
- 6.2 The general approach taken by PIDM in developing the DLST Framework is to ensure consistency, to the extent possible, with the existing DLS Framework, with adaptations to reflect the unique characteristics of takaful business.



## 7.0 GUIDING PRINCIPLES

7.1 The development of DLST Framework is guided by the following principles:

- (a) the DLST should be equitable to all takaful operators, irrespective of their size or complexity;
- (b) the DLST should provide incentives for takaful operators to move towards the best classification (lowest levy rate) by improving their risk profiles;
- (c) the DLST should take into consideration both quantitative and qualitative factors and contain forward-looking elements;
- (d) the DLST should depend on accurate, reliable and timely information;
- (e) the DLST should use data based on the approved financial reporting standards adopted by the Malaysian Accounting Standards Board;
- (f) the DLST should be objective and transparent so that takaful operators understand and are able to manage their risk profiles; and
- (g) the DLST should ensure that there is no discretion on the part of PIDM and the takaful operators to adjust scores arbitrarily.

## 8.0 GENERAL APPROACH

8.1 In developing the DLST Framework, PIDM carried out the following:

- (a) **Research and Review**  
The proposed DLST Framework has been developed following extensive research on various risk assessment methodologies performed by primary regulators and rating agencies both domestically and internationally.
- (b) **Positional and Trend Analysis**  
PIDM reviewed and tested the takaful operators' statistical data and analysed the trends.
- (c) **Discussion and Consultation**  
PIDM's development process commenced with one-on-one engagement sessions with all takaful operators for preliminary views on the proposed DLST

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Framework. Further discussions were held with Bank Negara Malaysia (“BNM”) representatives and industry experts to assess the practicability of the methodology, criteria and measures used. PIDM has taken their feedback into consideration in the development of the proposed DLST Framework.

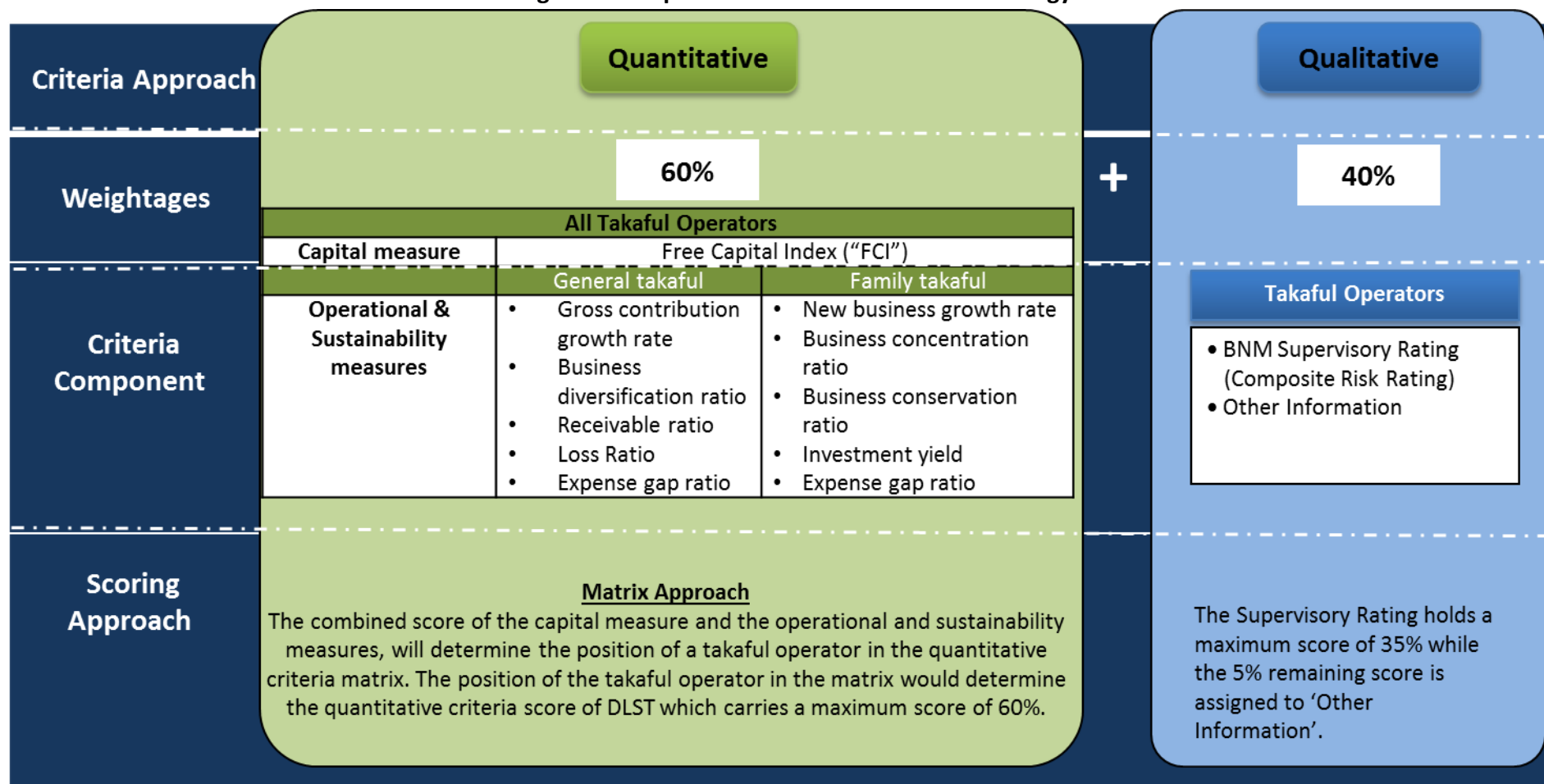
## 9.0 SALIENT FEATURES

### Methodology

- 9.1 Using a similar approach as that for the DLS Framework, PIDM will classify takaful operators into different categories based on their combined quantitative and qualitative criteria. This approach is more effective and comprehensive than a pure quantitative or qualitative criteria approach.
- 9.2 PIDM aims to ensure that the DLST Framework is objective, transparent and forward-looking in its approach. Correspondingly, a larger weightage will be assigned to the quantitative criteria, which carry a score of 60%, while the qualitative criteria will carry the remaining score of 40% out of a total score of 100%.
- 9.3 The quantitative criteria are made up of indicators representing statistical measures on capital, operational performance and business sustainability of the takaful operators. On the other hand, the qualitative criteria of the DLST Framework comprise the supervisory rating of the takaful operators and any other information that would have implications on the well-being of the takaful operators.
- 9.4 With regard to the quantitative criteria, PIDM will implement a two-dimensional approach i.e. a “matrix approach”. One of the dimensions is the capital criteria, and the other is a composition of the other quantitative measures, which are referred to as “operational” and “sustainability” measures.
- 9.5 The overview of the methodology used in the DLST Framework incorporating the approach, weightages and criteria is illustrated in Diagram 1: Proposed DLST Framework Methodology.

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**Diagram 1: Proposed DLST Framework Methodology**



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## Quantitative Criteria

- 9.6 PIDM considers the effectiveness of the relevant measures within the quantitative criteria in order to differentiate takaful operators according to the risks associated with their business portfolios and regulatory requirements (if any).
- 9.7 In coming up with the selected quantitative measures, PIDM conducted extensive analyses to ensure the suitability of the indicators. Further reviews and tests were performed on the distribution of the results of indicators to ensure its applicability in the business operating environment. Thresholds were established to categorise takaful operators into differentiated scores.
- 9.8 Furthermore, the thresholds for the indicators were chosen and tested based on the current and expected future developments in the operating environment. In setting the thresholds, PIDM considered factors such as alignment with the current regulatory and supervisory policies, fairness to all takaful operators, the average industry performance, the peer positioning of the takaful operators, as well as the industry direction going forward.

## Components of Quantitative Criteria

### Capital Measure

- 9.9 The primary component of the quantitative criteria is the capital measure. Capital provides a crucial cushion against adverse changes in the takaful operator's earnings and asset quality. Thus, a strong capital buffer is critical in ensuring that the takaful operators remain solvent as it represents the last line of defence against any expected and/or unexpected losses.
- 9.10 A well-capitalised takaful operator is in a better position to carry out its fiduciary duties to the certificate owners. These include meeting its obligations to cover the expenses of managing the takaful business and providing an interest-free loan ("qard") if there is a deficit in the takaful business.
- 9.11 The capital measure is denoted by an index formulated by the takaful operator's capital adequacy ratio ("CAR") divided by the individual target capital level ("ITCL"). This index is termed 'Free Capital Index' ("FCI"), which is a measure of capital buffer above takaful operator's ITCL. The FCI leverages on the ITCL set by the takaful operators as required under BNM's RBCT. Takaful operators will be scored based on the buffer they have against the ITCL. From PIDM's perspective, this index will be a

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good leading measure of the takaful operators' capital sufficiency and trends. It will be a trigger for any prompt corrective measures to be taken to ensure that the takaful operators' capital remains above the ITCL level. Further description of the index is in Appendix I(a).

### **Operational and Sustainability Measures**

- 9.12 This component of the quantitative criteria aims to assess the takaful operators' operational management efficiency and the sustainability of their financial performance.
- 9.13 Apart from the importance of capital buffer, equally significant is the ability of the takaful operators to ensure the operational soundness and sustainability of their business. A key objective of the operational and sustainability measures is to assess the financial performance in relation to its ability to sufficiently support the takaful business as it grows. This includes their ability to generate and sustain the income needed to meet the contractual obligations to the certificate owners or participants while maintaining sound underwriting and investment practices. Ultimately, the takaful business must generate surpluses in the long-term to be financially viable.
- 9.14 Under these measures, takaful operators with general takaful businesses will be assessed on:
- (a) the sustainability of the business underwritten measured by the extent and the stability of business growth via the gross contributions growth rate;
  - (b) the sensitivity of takaful operators to adverse experiences in their lines of businesses via the business diversification ratio;
  - (c) the efficiency of their business operations as reflected in their ability to ensure timely collection of takaful receivables; and
  - (d) the ability of the takaful operators to implement rigorous underwriting and claims costs efficiently.
- 9.15 In the case of takaful operators conducting family takaful business, the takaful operators will be assessed on:
- (a) the sufficiency of their new business growth, which is a vital component towards business sustainability;

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- (b) the extent of business concentration through an assessment of contributions composition between single and regular contributions;
- (c) the ability of takaful operators to ensure continuation of the business underwritten by measuring its business conservation ratio; and
- (d) the sustainability of earnings of the takaful operators from the perspective of investment returns, being one of the key components of the family takaful operator's performance.

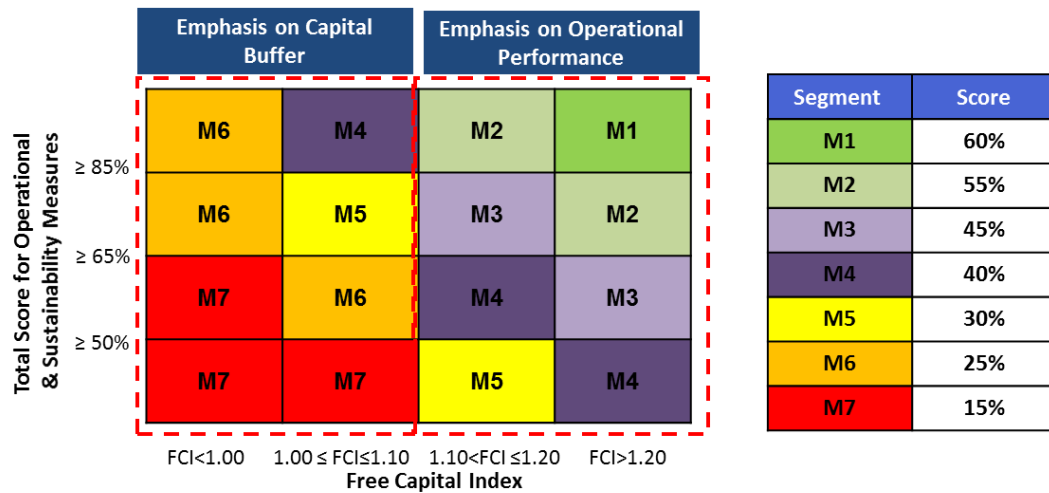
- 9.16 Family and general takaful businesses above refer to all takaful funds, i.e. the participants' risk fund, the participants' investment fund, including all the sub-funds established and maintained by the takaful operators.
- 9.17 In respect of the takaful operator, a key assessment criterion is the efficiency in managing the actual expenses incurred in operating the takaful business against the expected expenses. The takaful operator will be assessed on the income generated through wakalah fees earned by the shareholder against the operating expenses incurred in managing the takaful business.
- 9.18 Detailed descriptions of the measures for general and family takaful businesses are in Appendix I(b), Appendix I(c) and Appendix I(d), respectively.

#### **Quantitative Criteria Score (Matrix Approach)**

- 9.19 The quantitative criteria will be scored using a matrix approach, taking into consideration both the capital strength and the operational soundness and business sustainability of takaful operators as described above.
- 9.20 Diagrammatically, the capital measure is plotted on the horizontal axis, whilst the operational and sustainability measures will be gauged on the vertical axis. Mapping of these two (2) sets of measures would allow for the quantitative criteria score to be determined from the possible seven (7) matrix categories. The matrix as well as the relationship between capital measure and the operational and sustainability measures are depicted in Diagram 2.

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**Diagram 2: Quantitative Criteria Matrix**



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

**Table 2: Free Capital Index Score Range**

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

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

**Table 3: Operational and Sustainability Score Range**

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

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- 9.22 The FCI relates to the extent of the capital buffer maintained by the takaful operators. As shown in the matrix, takaful operators will be measured based on its FCI score where the capital buffer would determine the takaful operator's position along the horizontal axis (Please refer to description of the measures in Appendix I(a) for the FCI scores).
- 9.23 In the case of the operational and sustainability measures, these are made up of different sets of indicators for general takaful and family takaful businesses. These indicators are assigned specific weightages to the overall assessment on the operational and business sustainability of the takaful operators. The total aggregated score for these indicators is 100%. Table 4 lists the indicators and the corresponding weightages for general takaful and family takaful businesses, respectively.

**Table 4: Summary of Operational and Sustainability Measures**

General Takaful Business		Family Takaful Business	
Indicators	Weightage	Indicators	Weightage
Gross Contributions Growth Rate	25%	New Business Growth Rate	25%
Business Diversification Ratio	20%	Business Concentration Ratio	20%
Receivable Ratio	20%	Business Conservation Ratio	20%
Loss Ratio	10%	Investment Yield	10%
Expense Gap Ratio	25%	Expense Gap Ratio	25%
<i>Total</i>	<i>100%</i>		<i>100%</i>

- 9.24 Each indicator in Table 4 will be scored according to thresholds assigned (refer to description of the measures in Appendix I(b), Appendix I(c) and Appendix I(d) for the respective scores). Thus, by aggregating the results of each indicator, a takaful operator would be able to determine its operational and sustainability measures score. This score would indicate the takaful operator's position on the vertical axis.
- 9.25 Composite takaful operators would have the total score for the respective types of business proportioned to the percentage of the net contributions of general takaful and family takaful businesses for a total aggregate score of 100%. (Refer to Illustration 2 for an illustration to compute operational and sustainability measures of a composite takaful operator).



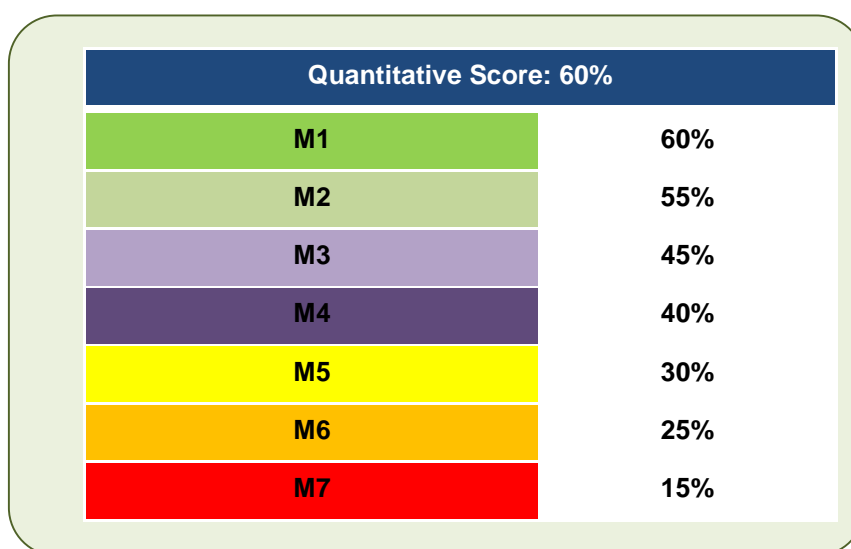
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- 9.26 A takaful operator is able to determine its position in the matrix by using the combination of FCI score and the aggregated score of the operational and sustainability measures. The matrix category would then reflect the takaful operator's total quantitative criteria score.
- 9.27 PIDM wishes to highlight that the distribution of categories within the matrix is guided by two (2) levels of importance. For the takaful operators with a FCI score of 1.10 and below, the emphasis would be on the capital buffer where scores of the operational and sustainability measures would be less significant in arriving at better matrix categories. Conversely, for takaful operators with an FCI score of above 1.10, where the capital buffer is stronger, the performance of the takaful operator's operational and sustainability measures would be of higher significance in determining better matrix categories.

### Total Quantitative Criteria Score

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

**Diagram 3: Quantitative Score**



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### Qualitative Score

- 9.29 PIDM aims for the DLST Framework to contain forward-looking elements in its criteria and this is achieved by incorporating sources of qualitative assessment. As the quantitative criteria mostly measure past financial conditions, these does not reflect the important aspects of risk management practices, governance and management quality and the supervisory ratings of the takaful operators. Hence, the quantitative measures alone are inadequate and less effective at providing leading indication of the future risk profile of the takaful operators. As a complement, the qualitative criteria are to provide important information on current and future risk profiles of the takaful operators.
- 9.30 The qualitative criteria give greater weightage to the supervisory rating, namely the Composite Risk Rating (“CRR”) assessed by BNM, due to the direct supervisory relationship between BNM and the takaful operators. The CRR would encapsulate first-hand information about the takaful operators by BNM which supervises and monitors the takaful operators’ risk profiles, operational management and their risk management control functions.
- 9.31 The remaining score within the qualitative criteria incorporates other information not considered by the quantitative and qualitative criteria as described above. This other qualitative criterion would assess the takaful operators based on their compliance with regulations, guidelines and any other regulatory requirements which may include supervisory concerns and intervention actions. This factor aims to capture any issues that may have a significant impact on the financial performance and/or reputation of the takaful operators.

#### Feedback 1: DLST Framework methodology

PIDM seeks your comments and suggestions on the following:

- (a) the proposed quantitative criteria and the score ranges;
- (b) the overall quantitative scoring criteria using the matrix approach;
- (c) the weightage assigned to each criterion and indicators; and
- (d) the proposed qualitative criteria.

Please provide supporting evidence and the rationale for your comments.

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

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### Feedback 2: Proposed treatment of composite takaful operators

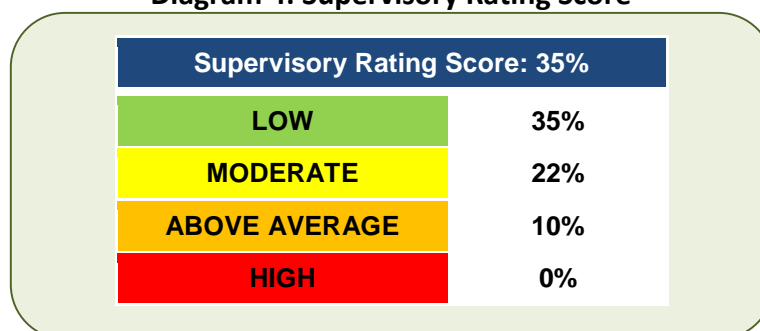
Under this consultation paper, PIDM proposes a separate assessment for general and family takaful business and the total score will be apportioned using 'net contributions' for the operational and sustainability measures scores of composite takaful operators.

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

### DLST Score

- 9.32 The sum of the total quantitative criteria score and the qualitative criteria score would represent the DLST score of a takaful operator.
- 9.33 The CRR component of the qualitative criteria consists of four (4) different levels of rating, namely 'low', 'moderate', 'above average' and 'high'. For the purpose of DLST Framework, these CRRs are assigned corresponding scores. Diagram 4 describes the CRR and its respective score.

**Diagram 4: Supervisory Rating Score**



- 9.34 Ultimately, with a maximum score of five percent (5%) from the 'Other Information' component of the qualitative criteria, the takaful operators would be able to determine their DLST scores.

### DLST Levy Categories

- 9.35 Takaful operators will be classified into four (4) levy categories based on their DLST scores. A system with four (4) categories is envisaged to be appropriate given the

number of takaful operators, while at the same time provide a meaningful differentiation between levy categories.

- 9.36 The key consideration in determining the appropriate number of levy categories is its effectiveness in differentiating takaful operators into appropriate risk categories in order to achieve the DLST objectives and principles. Using more categories would result in smaller levy differences between categories, thus reducing the incentive for improvements.
- 9.37 In setting the range of scores for each category, any takaful operators who achieve a DLST score of less than 50% out of 100% will be placed in the highest levy category four (4) and those with a score of 85% or better will be classified in the lowest levy category one (1). The remaining two (2) categories are proportionally set between the highest and lowest.
- 9.38 Table 5 sets out the DLST scores and levy categories:

**Table 5: DLST Scores and Levy Categories**

DLST Score	Levy Category
DLTS Score $\geq$ 85%	1
$65\% \leq$ DLST Score $<$ 85%	2
$50\% \leq$ DLST Score $<$ 65%	3
DLST Score $<$ 50%	4

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

## 10.0 NEW TAKAFUL OPERATOR

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

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10.2 The new takaful operator will not be required to submit its quantitative information to PIDM as required under paragraph 14.0 (Reporting and Submission) in the first two (2) assessment years. The new takaful operator shall start submitting the quantitative information to PIDM in the assessment years subsequent to its second assessment year.

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

## **11.0 AMALGAMATION**

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

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

11.3 For those takaful operators amalgamated on or before 31 December of the preceding assessment year, for the purpose of reporting DLST indicator components, the preceding year data should be based on the amalgamated entity, whilst the data required prior to the preceding year's data would be of the surviving/ acquiring takaful operator's data.

11.4 If an amalgamated takaful operator is formed before or on 31 December of the preceding assessment year, the takaful operator is required to submit the DLST reporting forms containing the quantitative information of the amalgamated entity to PIDM. The DLST score shall be based on the quantitative information, supervisory rating and other information of the amalgamated takaful operator as at 31 December of the preceding assessment year.

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- 11.5 If an amalgamated takaful operator is formed after 31 December of the preceding assessment year, the amalgamated takaful operator is required to submit the quantitative information of each of the amalgamating takaful operators based on information as at 31 December of the preceding assessment year. For the purpose of determining the levy category for the amalgamated takaful operator, the DLST score will be based on the result of the amalgamating takaful operator with the highest quantitative score and its corresponding qualitative score. The corresponding levy category and rate will then be applied to both amalgamating takaful operators' basis in the calculation of levy payable.

### **Feedback 3: Treatment of new takaful operators and amalgamation**

Please provide comments on the treatment of the following:

- (a) new takaful operator; and
- (b) amalgamation.

## **12.0 TRANSITION PERIOD**

- 12.1 A transition period shall be in effect for the first year of the DLST during which takaful operator will be allowed certain adjustments to their scores. This is to allow takaful operators to adapt to the DLST and provide ample time for takaful operators to improve their financial performance and operations.
- 12.2 During the transition period, PIDM proposes that the total quantitative score of each takaful operator be adjusted upwards by 10%. This adjustment shall only be applicable for the assessment year 2016.
- 12.3 For example, during the transition period, if a takaful operator has scored 40% for its quantitative criteria, its score would be increased by 4 percentage points, resulting in a total quantitative score of 44%.
- 12.4 Any adjustment shall not result in a takaful operator's total quantitative score exceeding 60%. For example, if a takaful operator has a total quantitative score of 57%, a 10% increase will result in an additional 5.7 percentage points. In this case, the adjusted score will be 60%, which is the maximum score for quantitative criteria.

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#### **Feedback 4: Transition Period and Process**

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

- (a) transition period; and
- (b) transitional process.

### **13.0 FUTURE REVISIONS**

- 13.1 PIDM accepts that there will be developments in the financial services industry that could affect the financial statements and regulatory reporting of the takaful operators. In order to accommodate any changes within the industry landscape, such as the splitting of composite licenses into separate general and family takaful licences as required by IFSA 2013, PIDM will continuously review the DLST Framework to ensure that the system is kept up to date with current developments.
- 13.2 These future revisions are meant to enable the DLST Framework to take into account the latest developments in the regulatory and supervisory regime so as to ensure consistency of approach. This will also provide PIDM with the flexibility to enhance the DLST Framework's ability to differentiate takaful operators according to their risk profiles.

## PART 4: REPORTING, SUBMISSION AND APPEAL

### 14.0 REPORTING AND SUBMISSION

#### Reporting Reference Date

##### Quantitative Criteria

- 14.1 For takaful operators with financial year ending on 31 December, the quantitative criteria shall be calculated based on audited financial year end information as at 31 December of the preceding assessment year.
- 14.2 For takaful operators whose financial year does not end on 31 December, the quantitative criteria shall be calculated based on calendar year end information as at 31 December of the preceding assessment year.

##### Qualitative Criteria

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

#### Feedback 5: Reporting reference date

PIDM seeks your comments on the following:

- (a) whether the proposed reporting reference date is appropriate; and
- (b) the calculation of quantitative information based on calendar year end information for takaful operators whose financial year end is not 31 December.



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### Submission Date

- 14.5 All takaful operators shall submit quantitative information in pre-formatted templates or forms to PIDM by 30 April of an assessment year for the purpose of levy computation. PIDM will then assign the score for the supervisory rating and other information criterion to each takaful operator.
- 14.6 The submission forms must be certified by the chief executive officer (“CEO”) jointly either with the chief financial officer (“CFO”) or the appointed actuary (“AA”) of a takaful operator to be truly and accurately reflective of the financial information of the takaful operators as at 31 December of the preceding assessment year.
- 14.7 For a takaful operator that fails to submit quantitative information by 30 April of an assessment year, PIDM will assign scores to the takaful operator according to any available information. A levy surcharge may be imposed on takaful operators that do not comply with the submission deadline.

#### Feedback 6: Submission date

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

### Information Integrity

- 14.8 Takaful operators shall be accountable to ensure that the accuracy of the information submitted for the DLST is equivalent to that of their audited and/or approved financial information.
- 14.9 PIDM will issue a separate consultation paper on the validation programme for DLST in due course.
- 14.10 PIDM may impose a levy surcharge on takaful operators that do not comply with the requirements with regard to information integrity.

#### Feedback 7: Information integrity

PIDM seeks your comments on the control mechanisms that takaful operators have put in place to ensure information accuracy and reliability.

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### Computation and Notification of Score

- 14.11 The DLST score will be a sum of scores assigned for the quantitative and the qualitative criteria.
- 14.12 PIDM will compute the DLST score for each takaful operator and notify the takaful operators of their respective scores, levy categories and applicable levy by 15 May of an assessment year. This will provide sufficient time for takaful operators to make the necessary arrangements for the payment of levies due to PIDM by 31 May of an assessment year. Please refer to Illustration 1 for an example of DLST score and levy categorisation.

### Insufficient Quantitative Information

- 14.13 For takaful operators with insufficient information to calculate certain criteria, the scores for such criteria shall be determined on a proportionate basis as stated below. Please refer to Illustration 3 for an example of DLST scoring for takaful operators with insufficient quantitative information.

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

where

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

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

#### **Feedback 8: Insufficient quantitative information**

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

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### Filing Resubmission

- 14.14 In instances where takaful operators submit any amendments on quantitative information to PIDM after the submission deadline, i.e. 30 April of an assessment year, the rating of a takaful operator will be based on the information submitted by 10 May of an assessment year.
- 14.15 Takaful operators that submit amended information are expected to comply with provisions for information integrity as specified under paragraph 14.8 (Information Integrity).
- 14.16 Takaful operators that resubmit quantitative information are required to comply with the deadlines set for the appeal process as specified in paragraph 14.20.

#### Feedback 9: Filing resubmission

Please provide comments on the proposal for filing resubmission.

### Appeal Process

- 14.17 Notwithstanding paragraph 14.12, in line with PIDM's corporate principles of fairness and transparency, PIDM proposes to put in place an appeal process, providing an avenue for any takaful operator to request a review of its final score.
- 14.18 Takaful operators may request for an appeal of the scores after 31 May of an assessment year and are required to formally submit the request in writing to PIDM. The request should include reason(s) for an appeal.
- 14.19 The appeal is on the basis of errors in the quantitative information provided by a takaful operator or errors in PIDM's computations in relation to quantitative criteria, and other information criteria. Members may not appeal against the supervisory rating provided by BNM since BNM already provided a review process for their final supervisory ratings.
- 14.20 Any request for appeal will be submitted to PIDM no later than 31 August of an assessment year. PIDM will review and respond to the appeal by 30 September of an assessment year upon receiving the request in writing.



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14.21 If the appeal process results in a takaful operator having overpaid levies, PIDM will reimburse the takaful operator the overpayment if the appeal process is successful.

**Feedback 10: Appeal process**

Please provide your comments on the proposed appeal process.

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## **APPENDIX I (a): QUANTITATIVE CRITERIA – CAPITAL ASSESSMENT**

### **Free Capital Index**

#### **Rationale**

Capital is very important to a takaful operator as it serves as a cushion against any unexpected losses and must be freely available to provide qard to the takaful business. A takaful operator with a higher capital buffer is in a better position to perform its duty to provide qard in the event there is a deficit in the takaful business. Therefore, a strong capital buffer reduces the possibility of takaful operators' failure due to adverse business experience.

With the implementation of RBCT on 1 January 2014 as a regulatory capital requirement by BNM, a takaful operator's capital strength is measured by CAR. CAR is the capital level (total capital available) compared against the level of capital required (total capital required). Takaful operators are required to comply with a minimum supervisory target capital level of 130% at all times.

Notwithstanding the minimum supervisory target capital level imposed by BNM, takaful operators are also required to maintain capital that corresponds with its risks. It includes the determination of an ITCL that commensurate with a takaful operator's risk profile under the RBCT.

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

#### **Calculation**

Takaful operators will be classified into different matrix categories based on their FCI.

FCI is set based on the average of four (4) quarters of CAR within the calendar year of the preceding assessment year against its ITCL. The average of four (4) quarters of CAR is used to address any potential inconsistencies with the takaful operator's CAR.

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The formula is:

Free Capital Index (FCI) =	CAR (%)
	ITCL (%)

### Categorisation of Scores

A takaful operator's FCI score will be based on the following range of results:

**Table 6: Score Range for Free Capital Index**

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

### Feedback 11: Free Capital Index

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

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

### **Rationale**

Equally imperative is the ability of the general takaful operator to ensure the sustainability of its operations through consistent financial performance. A strong capital buffer alone will not ensure long-term sustainability. The takaful operator's capital may be depleted if is required to provide a growing amount of qard to the general takaful business, unless the operations are efficient, sustainable and performing financially. Given the nature of the general takaful business, where the takaful operator deals with various parties, operational efficiency is critical. Hence, well-managed takaful operators should be more resilient to operational risks.

Under the DLST Framework, PIDM aims to measure the level of efficiency of the takaful operators' business operations. Strong and efficient operational performance will contribute towards business sustainability where operational risks are minimised.

Sustainable and strong financial performances are also emphasised under the DLST Framework. This is assessed by reference to the takaful operator's ability to consistently generate strong level of earnings from sustainable business growth, sound underwriting practices and efficient operational management. The strong and sustainable financial performance will contribute to the general takaful business's ability to be able to be self-sufficient, hence, enhancing its financial viability and lower the probability of relying on qard. Moreover, if the general takaful business consistently performs well, it is likely to generate more wakalah fees and provide the takaful operator with the income to strengthen its capital position.

The emphasis on contribution growth reflects the importance of generating a consistently higher stream of income to support operations and develop the general takaful business. Strong growth is premised on a diversified portfolio. Diversification reduces susceptibility to adverse experience of any line of business. Together with sound underwriting and claims management practices, the general takaful business will have better claims experience and consequently, achieve maintainable earnings.

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## Criteria Measures

The following four (4) indicators are used for the operational and sustainability of general takaful operators.

### **1.0 Gross Contribution Growth Rate**

The growth of the contribution income is essential to assess the sustainability of the general takaful business as it provides a constant stream of income to support the business operations. However, the business growth should commensurate with the operational capacity, risk management and risk appetite of the takaful operator.

The gross contribution income reflects the overall business exposure of the takaful operators. Even if retakaful is used to mitigate the takaful risks, the takaful operator would have to ultimately absorb losses in the event the counterparties fail to honour its obligation. Consistent growth in gross contributions over time, conditional on appropriate risk and underwriting practices, indicates growth by the takaful operator and generation of sustainable income.

#### Calculation

The indicator denotes the difference between the gross contribution for the preceding assessment year and the gross contribution of the second year preceding the assessment year divided by the latter.

A takaful member's gross contribution growth rate will be based on a 3-year weighted average growth rate. The weightages to be applied are 50% for preceding assessment year, 30% for one year of the preceding assessment year and 20% for two years of the preceding assessment year.

The formula is:

Gross Contribution Growth Rate (%)	=	$\frac{\text{Gross Contribution (t)} - \text{Gross Contribution (t-1)}}{\text{Gross Contribution (t-1)}}$
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with

$$\text{weighted growth rate} = 50\% \text{ growth rate } (t) + 30\% \text{ growth rate } (t-1) + 20\% \text{ growth rate } (t-2)$$

where,

$t$  = preceding assessment year

$t - 1$  = one year of the preceding the assessment year; and

$t - 2$  = two years of the preceding the assessment year.

### Categorisation of Scores

A takaful operator's gross contribution growth rate score will be based on the following:

**Table 7: Score Range for Gross Contribution Growth Rate**

Gross Contribution Growth Rate	
Range of Results	Score (%)
Gross Contribution Growth Rate > 7.00%	25
5.00% < Gross Contribution Growth Rate ≤ 7.00%	16
0.00% < Gross Contribution Growth Rate ≤ 5.00%	8
Gross Contribution Growth Rate ≤ 0.00%	0

## **2.0 Business Diversification Ratio**

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

The calculation of capital charges under RBCT recognises the lower risk of having a more balanced portfolio of business by rewarding takaful operators with a diversification benefit in the calculation of capital charges. BNM's Guidelines on Valuation Basis for Liabilities of General Takaful Business allows for a reduction in

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contribution liabilities capital charges up to a maximum of 50% of total provision of risk margin for adverse deviation (“PRAD”)<sup>1</sup>.

### Calculation

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

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

*t = preceding assessment year*

### Categorisation of Scores

A takaful operator’s business diversification ratio score will be based on the following:

**Table 8: Score Range for Business Diversification Ratio**

Business Diversification Ratio	
Range of Results	Score (%)
Business Diversification Ratio > 30.00%	20
20.00% < Business Diversification Ratio ≤ 30.00%	14
15.00% ≤ Business Diversification Ratio ≤ 20.00%	7
Business Diversification Ratio < 15.00%	0

<sup>1</sup> Part II Policy Requirements Paragraph 10.6 Guidelines on Valuation Basis for Liabilities for General Takaful Business

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### 3.0 Receivable Ratio

It is essential for the takaful operator to ensure the takaful receivables are managed efficiently. The receivable ratio is useful to assess whether the business is running efficiently and serves as an early warning signal on receivable management issues and potential increase in impairment.

The receivable ratio reveals how efficient the business is in collecting its takaful receivables from its agents and retakaful over the course of a year. PIDM is of the view that receivable ratio indicates the takaful operators' sound business practices. This measure will encourage the takaful operators to improve its collection and management practices.

#### Calculation

For the purpose of this indicator, takaful receivables include outstanding aggregate of outstanding contributions and agents' balances of more than 60 days and amount due from retakaful of more than 90 days, net of wakalah fees. The receivable ratio is calculated as takaful receivables to its gross contribution, net of wakalah fees, as at 31 December of the preceding assessment year. The formula is:

$$\text{Receivable Ratio (\%)} = \frac{\text{Takaful Receivables, net of Wakalah Fee (t)}}{\text{Gross Contribution, net of Wakalah Fee (t)}}$$

where

*t = preceding assessment year*

#### Categorisation of Scores

The takaful operator's receivable ratio score will be based on the following:

**Table 9: Score Range for Receivable Ratio**

Receivable Ratio	
Range of Results	Score (%)
Receivable ratio $\leq$ 10.00%	20
10.00% < Receivable ratio $\leq$ 15.00%	14
15.00% < Receivable ratio $\leq$ 20.00%	7
Receivable ratio > 20.00%	0

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#### Feedback 12: Receivable ratio

Please provide your comments:

- (a) To exclude wakalah fee from the gross contributions and takaful receivables
- (b) Suitable methods on excluding the wakalah fee from the gross contributions and takaful receivables.

## 4.0 Loss Ratio

A stable and positive underwriting result is vital for a takaful operator to achieve sustainability. To accomplish this, a takaful operator must implement sound underwriting practices and manage claims efficiently. It is also important for the general takaful business to be self-sufficient from a claims pay out standpoint by generating enough contributions to pay out claims incurred.

A general takaful business with a high loss ratio raises concerns about the risk management and underwriting practices of the takaful operator. A prolonged adverse claims experience may indicate the poor financial health of the general takaful business and potentially lead to a deficit in the general takaful business, requiring support from the shareholder.

### Calculation

The formula is:

$$\text{Loss Ratio (\%)} = \frac{\text{Net Claims Incurred (t)}}{\text{Net Earned Contributions net of Wakalah Fee (t)}} \times 100\%$$

where

*t = preceding assessment year*

### Categorisation of Scores

A takaful operator's loss ratio score will be based on the following:

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**Table 10: Score Range for Loss Ratio**

Loss Ratio	
Range of Results	Score (%)
Loss Ratio $\leq$ 40.00%	10
40.00% < Loss Ratio $\leq$ 50.00%	7
50.00% < Loss Ratio $\leq$ 60.00%	4
Loss Ratio > 60.00%	0

**Feedback 13: Loss Ratio**

Please provide your comments:

- (a) To exclude wakalah fee from the gross contributions in the calculation of the net earned contributions.
- (b) Suitable methods on excluding the wakalah fee from the gross contributions above.

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## **APPENDIX I(c): QUANTITATIVE CRITERIA - OPERATIONAL AND SUSTAINABILITY MEASURES FOR FAMILY TAKAFUL BUSINESS**

### **Rationale**

The DLST Framework incorporates a number of quantitative criteria that aim to assess the operational performance and sustainability of takaful operators' business operations. The operational performance of takaful operators is dependent upon their ability to effectively execute their strategies and manage their business profile. A family takaful business that is growing and achieves a maintainable financial performance is more likely to generate the wakalah fees and earnings for the takaful operator that ultimately contribute towards internal capital generation. Consequently, its operational performance will contribute to the long-term financial strength and takaful operators' abilities to meet their obligations to certificate owners.

The emphasis on the generation of new business combined with the takaful operators' ability to conserve its business will indicate the takaful operators' ability to ensure a stable stream of income to meet the liabilities of the family takaful business. Despite growth in new business, consideration will be given to the level of riskiness of the certificates underwritten, which may depend on the business composition and types of contribution payment. Therefore, emphasis is placed on the proportion of regular contributions to single contributions, with regular contributions providing a continuous income stream. Due to the long-term nature of family takaful products, takaful operators are subject to unforeseen events and market movements. Regular contributions provide regular cash flows and the duration gives flexibility to the takaful operators to respond to any unexpected developments. Comparatively, single contributions do not provide a recurring income and they lack the cash flow flexibility of regular contributions, even though the products may also be long-term. Given the long term nature of family takaful business, the ability to generate sufficient investment returns is also important to adequately support the contractual liabilities underwritten.

Strong and sustainable financial performance of the family takaful business enhances its financial viability and self-sufficiency. This lowers the probability of the need for qard from the takaful operator.

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### Criteria Measures

The following four (4) indicators are used for the “operational” and “sustainability” measures of family takaful operators:

#### **1.0 New Business Growth Rate**

For family takaful businesses, the new business contribution growth is a vital component towards business sustainability. The takaful operators’ ability to record consistent growth of new business contribution will ensure a constant stream of income to support the business operations.

The level of business growth should match the takaful operator’s risk appetite, operational capacity and risk management practices. The ability to generate new businesses eventually translates into profitability and internal capital generation.

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

#### Calculation

In the growth rate calculation, new business contributions are measured on a gross basis. PIDM is of the view that gross contributions reflect the overall takaful operators’ exposure as compared to measurements on net basis, i.e. net of reinsurance.

As for family takaful certificates, contributions are paid regularly on an annual basis and with the option to contribute in the form of quarterly, semi-annual or monthly instalments. However, some certificates are single contribution payments with a one-time payment made at the inception of the certificate.

A common industry measure for new business growth is the “annual contribution equivalent”. This aggregates the total regular new contributions with 10% of total single contributions. For single contribution, the 10% weightage applied is based on the assumption that the average certificate term is ten years.

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

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preceding the assessment year divided by total new business contributions of the second year preceding the assessment year.

A takaful operator's new business growth rate will be based on a 3-year weighted average growth rate. The weightages to be applied are 50% for the preceding assessment year, 30% for one year for the preceding assessment year and 20% for two years for the preceding assessment year.

The formula is:

<p>New Business Growth (%)</p>	<p>=</p>	$\frac{\text{New Business Contributions (t)} - \text{New Business Contributions (t-1)}}{\text{New Business Contributions (t-1)}}$
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with

$$\text{weighted growth rate} = 50\% \text{ new business growth (t)} + 30\% \text{ new business growth (t-1)} + 20\% \text{ new business growth (t-2)}$$

where

*New business contribution = 100% of total annual contribution + 10% of single contribution; and*

*t = preceding assessment year*

*t -1 = one year of the preceding the assessment year; and*

*t -2 = two years of the preceding the assessment year.*

### Categorisation of Scores

A takaful operator's New Business Growth rate score will be based on the following:

**Table 11: Score Range for New Business Growth Rate**

New Business Growth Rate	
Range of Results	Score (%)
New Business Growth Ratio > 10.00%	25
5.00% < New Business Growth Ratio ≤ 10.00%	16
0.00% < New Business Growth Ratio ≤ 5.00%	8
New Business Growth Ratio ≤ 0.00%	0



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#### **Feedback 14 : New Business Growth Rate**

PIDM seeks your comments on the above method and provide suggestion on other appropriate methods.

## **2.0 Business Concentration Ratio**

A single contribution plan involves one contribution at inception whilst regular or recurring contribution plan involves regular contributions at agreed intervals over a specified number of years. In addition, single contribution plans are normally shorter term than regular contribution plans with the exception of mortgage takaful.

Notwithstanding this, the contribution amount charged to participants is determined in advance using actuarial forecasts of a benefit pay out with an assumed profit rate, mortality and morbidity, expenses etc. Due to the long-term nature of family takaful products, takaful operators are subject to unforeseen events and market movements that impact the assumptions. Single contribution plans are more susceptible to these fluctuations. Furthermore, regular contributions lengthen the duration of cash flows and provides the takaful operator added flexibility in determining its investment strategy.

Generally, takaful operators have a higher proportion of single contributions as compared to regular contributions with credit protection type products comprising a significant proportion of single contribution business. Therefore, takaful operators may have a greater dependency on single contribution credit protection takaful business and if there is a significant slowdown in growth in this segment, this would adversely impact the revenue stream of takaful operators.

As the potential inherent risks in single contribution plans discussed above are typically higher compared to regular contribution plans, PIDM aims to promote further diversification and a more balanced portfolio that ensures the appropriate composition of single and regular contribution. This also encourages takaful operators to reduce their dependency on single contributions and move towards more sustainable and continuous future stream of income while at the same time being less susceptible to adverse impact due to external factors.

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### Calculation

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

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

*t = preceding assessment year*

### Categorisation of Scores

A takaful operator's Business Concentration Ratio score will be based on the following:

**Table 12: Score Range for Business Concentration Ratio**

Business Concentration Ratio	
Range of Results	Score (%)
Business Concentration Ratio > 150%	20
125% < Business Concentration Ratio ≤ 150%	14
100% ≤ Business Concentration Ratio ≤ 125%	7
Business Concentration Ratio < 100%	0

#### **Feedback 15 : Business Concentration Ratio**

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

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### 3.0 Business Conservation Ratio

A conservation of takaful certificates during a period is defined as the proportion of certificates remaining in force at the end of the period out of total certificates in force at the beginning of the period. In other words, it means the percentage of business conserved by takaful operators without lapsing or being terminated.

The impact of low business conservation is significant to certificate owners, the takaful operators as well as the intermediaries or agents. For certificate owners, it means forfeiting the contributions and losing the protection. In the case of intermediaries, they will lose renewal commission or intermediaries' fees whereas for the takaful operators, the cost of acquisition will not be fully recovered.

Takaful operators incur high expenses at the point of participation. Thus to cover the cost, the expense loading is spread over a number of years during the term of the certificate. Therefore, business not conserved would deprive the takaful operators of income and also may result in expenses that will not be fully recovered with the loss of future wakalah fees from the lapsed or terminated certificates. Furthermore, decreasing number of certificates remaining in force would reduce the contributions and cash flow available to the family takaful business for producing investment returns and contributing to financial performance.

Consequently, the implication would be that the takaful operators will have to increase loading in their future product pricing in order for the product to maintain financial performance. Potential participants will have to pay higher contributions due to the loading, hence making the operator's product proposition uncompetitive.

Based on the observations, PIDM is of the view that business conservation is crucial to assess the family takaful business's sustainability.

#### Calculation

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

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The formula is:

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

*t* = preceding assessment year

*t-1* = one year of the preceding the assessment year

### Categorisation of Scores

A takaful operator's business conservation score will be based on the following:

**Table 13: Score Range for Business Conservation Ratio**

Business Conservation Ratio	
Range of Results	Score
Business Conservation Ratio > 80.00%	20
76.00% < Business Conservation Ratio ≤ 80.00%	14
70.00% ≤ Business Conservation Ratio ≤ 76.00%	7
Business Conservation Ratio < 70.00%	0

### **Feedback 16 : Business conservation ratio**

PIDM seeks your comments on the above method and provide suggestion on other appropriate methods.

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#### 4.0 Investment yield

For family takaful operators, the family takaful business is expected to generate returns that are adequate and sustainable to meet future benefits pay out, given the long-term nature of its liabilities. Investment return is one of the key contributors towards family takaful operators' overall financial performance.

Inability to generate sufficient investment returns would result in the deterioration of the position of the family takaful business and may affect the family takaful business's ability to meet future obligations. The assumptions on investment return is a component within the pricing of family takaful product. This reflects the expectation that the investment will achieve a certain level of returns that is sufficient to meet these assumptions.

It is essential for the family takaful business, at minimum, to achieve the risk free rate to meet expected future benefits and be self-sufficient. If the family takaful business is consistently unable to meet the risk free rate, concerns should be raised about the investment strategy of the takaful operator. This could eventually lead to a deficit in the family takaful business. If other sources of income are insufficient, this may require support from shareholder's via qard.

In this indicator, Government Investment Issues ("GII") spot rate is used as the risk free rate, and it is the minimum level the takaful operators are expected to achieve. Comparison between the investment yield and the GII spot rate would indicate how well the investment of the family takaful operator performed against the minimum expectation, i.e. the risk free rate. In other words, the better the investment yield performed over the GII spot yield rate, the higher the score that can be obtained for this indicator.

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

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

The net unrealised capital gains or losses include the impairment losses and their write back on securities, unrealised gains and loss on securities, both as reflected in the

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revenue accounts and the “available for sale” (AFS) reserves movement during the preceding assessment year for the family takaful business.

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

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

where:

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

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

In setting the benchmark for the score range, the GII 5-year Spot Rate is used, i.e., the average MGS spot rate as at the last trading date of each quarter during the preceding assessment year. The GII spot rate refers to GII for the tenure of 5 years, as published by Bond Pricing Agency Malaysia Sdn Bhd.

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### Categorisation of Scores

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

**Table 14: Score Range for Investment Yield**

Investment Yield	
Range of Results	Score (%)
Investment yield > GII + 150bp	20
$GII + 75bp < \text{Investment Yield} \leq GII + 150bp$	14
$GII \leq \text{Investment Yield} \leq 75bp$	7
Investment yield < GII	0

#### **Feedback 17 : Investment yield**

PIDM seeks your comments on the above method and provide suggestions on other appropriate methods, if any.

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## **APPENDIX I(d): QUANTITATIVE CRITERIA - OPERATIONAL AND SUSTAINABILITY MEASURES FOR GENERAL TAKAFUL AND FAMILY TAKAFUL BUSINESSES**

### **1.0 Expense Gap Ratio**

For a takaful operator, an essential area for assessment is the efficiency in managing expenses incurred in operating the takaful business in relation to the income it earns, principally from wakalah fees.

In determining the wakalah fees and its expected management expenses, the takaful operator is expected to have applied reasonable assumptions based on past experience, relevant industry benchmarks and future expectations of costs. Therefore, the wakalah fees should adequately provide for commission expenses and management expenses expected to be incurred in servicing the takaful certificate until the end of its contract. A reasonable and appropriate margin is expected to compensate the takaful operator in return for managing the takaful business on behalf of the participants.

Consequently, if there is a gap between the wakalah fees earned by the takaful operator, compared to the operating expenses and commissions incurred in the operation of the takaful business, this may indicate the wakalah fees are not sufficient to cover the operating expenses of the takaful business. Persistent overruns would erode the capital of the takaful operator and may affect the viability of the takaful operator. This in turn may hinder the ability of the takaful operator to carry out its fiduciary duties to the certificate owners.

Therefore, PIDM aims to assess the takaful operator's efficiency in managing operating expenses by comparing the wakalah fees earned against the operating expenses and commissions incurred in managing the takaful business(es).

PIDM has also considered that for composite takaful operators, expenses for both general and family businesses may be managed on a totality basis. If the indicators were calculated separately, any allocation of expenses between family and general takaful business is potentially on a notional basis resulting in a distorted expense gap ratio.



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### Calculation

The indicator will be calculated using the takaful operator's total earned wakalah fees of the preceding assessment year and compared against the total management expenses, net commissions and changes in expense liabilities of the takaful operator of the preceding assessment year. For a composite takaful operator, this would be sourced from both the family and general takaful business.

The formula is:

$$\text{Expense Gap Ratio (\%)} = \frac{\text{Management Expenses (t) + Net Commissions (t) + Change in Expense Liabilities (t)}}{\text{Earned Wakalah Fees (t)}}$$

where

*t = preceding assessment year*

### Categorisation of Scores

A takaful operator's expense gap ratio score will be based on the following:

**Table 15: Score Range for Expense Gap Ratio**

Expense Gap Ratio	
Range of Results	Score (%)
Expense Gap Ratio ≤ 105.00%	25
105.00% < Expense Gap Ratio ≤ 115.00%	16
115.00% < Expense Gap Ratio ≤ 120.00%	8
Expense Gap Ratio > 120.00%	0

#### **Feedback 18: Expense Gap Ratio**

- Please provide your comments on the use of change in expense liabilities in the formula; and
- PIDM seeks your comments on the above method and provide suggestions on other appropriate methods, if any.

## **APPENDIX II: QUALITATIVE CRITERIA**

### **1.0 Supervisory Rating**

#### **Rationale**

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

#### **Criterion Measure**

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

#### **Categorisation of Scores**

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

**Table 16: Score Range for Supervisory Rating Criteria**

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

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## 2.0 Other Information

### Rationale

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

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

### Assessment Criteria

The takaful operators are assessed based on the following criteria:

- (a) Information received from supervisors about the takaful operator or its related companies, such as commitments, letter of undertaking ("LOU") and board resolution, letters of warning, reprimand, breach or non-compliance with PIDM guidelines or regulations, etc.;
- (b) The takaful operators' action plans to address deficiencies in performance and its performance in relation to commitments and LOU;
- (c) Rating agencies' review and ratings;
- (d) Whether the takaful operator is receiving financial assistance from PIDM or BNM; and
- (e) Other relevant information that may come to PIDM's attention.

### Categorisation of Scores

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

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**Table 17: Score Range for Other Information Criteria**

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

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**ILLUSTRATION 1: DLST SCORING AND LEVY CATEGORISATION FOR FAMILY TAKAFUL INSURER MEMBER**

**Table 18: Calculation of Total DLST Score for a Sample Family Takaful Operator X**

Criteria		Maximum Score	Member Score
<b>Quantitative</b>			
1.	Capital FCI	NA	1.25
2.	Operational & Sustainability		
	(i) New Business Growth Rate	25%	25%
	(ii) Business Concentration Ratio	20%	14%
	(iii) Business Conservation Ratio	20%	14%
	(iv) Investment Yield	10%	4%
	(v) Expense Gap Ratio	25%	16%
Total Operational & Sustainability Score		100%	73%
Total Quantitative Criteria Score (placed at M2 in Table 2: Quantitative Criteria Matrix)		<b>60%</b>	<b>55%</b>
<b>Qualitative</b>			
1.	Supervisory Rating	35%	10%
2.	Other Information	5%	5%
Total Qualitative Score		<b>40%</b>	<b>15%</b>
Total DLST Score		<b>100%</b>	<b>70%</b>

Based on table above, the family takaful operator will be categorised in **Category 2**.

Note:

\* N.A. denotes not applicable.

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## **ILLUSTRATION 2: DLST SCORING AND LEVY CATEGORISATION FOR COMPOSITE TAKAFUL OPERATOR**

For a composite takaful operator, the proportion of net contributions of its respective general and family takaful businesses would determine the weightages of the other quantitative indicators beside the FCI.

Composite Takaful Operator	Net Contributions for the Period Ending 31 Dec 20XX	% of Total Net Contributions
General Takaful Business	RM750,000.00	30.00%
Family Takaful Business	RM1,750,000.00	70.00%
Total	RM2,500,000.00	100.00%

**Table 19: Calculation of Total DLST Score for a Sample Composite Takaful Operator Y**

Criteria		Maximum Score	Business Score	Net Contributions Apportionment	Member Score
<b>Quantitative</b>					
1.	Capital FCI	NA	1.25		1.25
2.	Operational & Sustainability for General Takaful Business:				
	i. Gross Contribution Growth Ratio	25%	16%		
	ii. Business Diversification Ratio	20%	14%		
	iii. Receivable Ratio	20%	14%		
	iv. Expenses Gap Ratio	25%	16%		
	v. Loss Ratio	10%	10%		
	TOTAL	100%	70%	30%	21%
3.	Operational & Sustainability for Family Takaful Business:				
	i. New Business Growth Rate	25%	25%		
	ii. Business Concentration Ratio	20%	14%		

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Criteria		Maximum Score	Business Score	Net Contributions Apportionment	Member Score
	iii. Business Conservation Ratio	20%	14%		
	iv. Investment Yield	10%	4%		
	v. Expense Gap Ratio	25%	16%		
	<b>TOTAL</b>	<b>100%</b>	<b>73%</b>	<b>70%</b>	<b>51%</b>
Total Operational & Sustainability Score		100%			72%
Total Quantitative Criteria Score (placed at M2 in Table 2: Quantitative Criteria Matrix)		<b>60%</b>			<b>55%</b>
<b>Qualitative</b>					
1.	Supervisory Rating	35%			10%
2.	Other Information	5%			5%
<b>Total Qualitative Score</b>		<b>40%</b>			<b>15%</b>
<b>Total DLST Score</b>		<b>100%</b>			<b>70%</b>

Based on table above, the DLST Scores and Levy Categories for the composite takaful operator will be categorized in **Category 2**.

Note:

\* N.A. denotes not applicable.

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### **ILLUSTRATION 3: INSUFFICIENT QUANTITATIVE INFORMATION**

If a family takaful operator does not have information for the computation of business expense gap ratio, the score for such criteria shall be calculated as follows:

**Table 20: Calculation of Total DLST Score a Sample Family Takaful Operator X – Insufficient Quantitative Information**

Criteria		Maximum Score	Member Score
<b>Quantitative</b>			
1.	Capital FCI	N/A	1.25
2.	Operational & Sustainability		
	(i) New Business Growth Rate	25%	25%
	(ii) Business Concentration Ratio	20%	14%
	(iii) Business Conservation Ratio	20%	14%
	(iv) Investment Yield	10%	4%
	(v) Expense Gap Ratio	25%	NI
Total Operational & Sustainability Score		100%	76% **
Total Quantitative Criteria Score (placed at M2 in Table 2: Quantitative Criteria Matrix)		<b>60%</b>	<b>55%</b>
<b>Qualitative</b>			
1.	Supervisory Rating	35%	10%
2.	Other Information	5%	5%
Total Qualitative Score		<b>40%</b>	<b>15%</b>
Total DLST Score		<b>100%</b>	<b>70%</b>

**Note:**

\* NI denotes no information.

\*\*Referring to paragraph 14.13 (Insufficient Quantitative Information), depicted below is the proportionate quantitative score for criteria with insufficient information (item v):

$$[57.00\% / (100.00\% - 25.00\%)] \times 25.00\% = 19\%$$

The table below shows the total operational and sustainability score for the insurer member:

Description	Member Score
Quantitative score for criteria with sufficient score	57%
Add: Proportionate quantitative score for criteria with insufficient information	19%
<b>Total Operational &amp; Sustainability Score</b>	<b>76% **</b>

Based on total DLST score, the takaful operator will be categorised in **Category 2**.



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#### **ILLUSTRATION 4: COMPUTATION ON TRANSITION PERIOD**

**Table 21: Calculation of Total DLST Score before transitional adjustment for a Sample General Takaful Operator Z**

Criteria		Maximum Score	Member Score
<b>Quantitative</b>			
1.	Capital FCI	NA	1.25
2.	Operational & Sustainability		
	(i) New Business Growth Rate	25%	25%
	(ii) Business Concentration Ratio	20%	14%
	(iii) Business Conservation Ratio	20%	14%
	(iv) Investment Yield	10%	4%
	(v) Expenses Gap Ratio	25%	16%
Total Operational & Sustainability Score		100%	73%
Total Quantitative Criteria Score (placed at M2 in Table 2: Quantitative Criteria Matrix)		<b>60%</b>	<b>55%</b>
<b>Qualitative</b>			
1.	Supervisory Rating	35%	22%
2.	Other Information	5%	5%
Total Qualitative Score		<b>40%</b>	<b>27%</b>
Total DLST Score		<b>100%</b>	<b>82%</b>

**Table 22: Calculation of Total DLST Score after transitional adjustment for a Sample General Takaful Operator Z**

Criteria		Maximum Score	Member Score
<b>Quantitative</b>			
1.	Capital FCI	N/A	1.25
2.	Operational & Sustainability		
	(i) New Business Growth Rate	25%	25%
	(ii) Business Concentration Ratio	20%	14%
	(iii) Business Conservation Ratio	20%	14%
	(iv) Investment Yield	10%	4%
	(v) Expense Gap Ratio	25%	16%
Total Operational & Sustainability Score		100%	73%
Total Quantitative Criteria Score (placed at M2 in Table 2: Quantitative Criteria Matrix)		<b>60%</b>	<b>55%</b>
Add: 10% upward adjustment to the total quantitative criteria score (55% x 10%)		N/A	<b>5.5%</b>
Total Quantitative Criteria Score		<b>60%</b>	<b>60%</b>



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Criteria		Maximum Score	Member Score
<b>Qualitative</b>			
1.	Supervisory Rating	35%	22%
2.	Other Information	5%	5%
<b>Total Qualitative Score</b>		<b>40%</b>	<b>27%</b>
<b>Total DLST Score</b>		<b>100%</b>	<b>87%</b>

The DLST score for the family takaful operator before the transitional adjustment is 82%, hence the family takaful operator should be categorised in **Category 2**.

However, during the transition period, i.e. only be applicable for assessment year 2016, the total quantitative criteria score for the family takaful operator will be adjusted upward by 10%. The DLST score after the transitional adjustment is 87%, hence the family takaful operator will be categorised in **Category 1**.