GUIDELINES ON INVESTMENT MANAGEMENT FOR LABUAN INSURANCE AND TAKAFUL BUSINESS

1.0 Introduction

1.1 The Guidelines on Investment Management for Labuan Insurance and Takaful Business (the Guidelines) sets out Labuan FSA's expectations on the minimum standards to be adhered to by Labuan (re)insurers and (re)takaful operators (For the purpose of this Guidelines, these shall be referred to as "Labuan insurers").

1.2 The Guidelines is intended to ensure that the investment management framework and practices amongst Labuan insurers are sound and effective as follows:

(i) there is a strong and effective governance of investment activities;

(ii) an appropriate investment risk management framework is in place for identifying, monitoring, controlling and mitigating the various risks arising from investment activities; and

(iii) a sound management of assets is practised and this includes ensuring that the investment portfolio and investment risk appetite is appropriate with the profile of the insurance liabilities underwritten.

1.3 The approach for investment management adopted by each Labuan insurer may vary depending on a wide range of factors e.g. the size, level of sophistication and complexity of their investment activities. Notwithstanding this, basic principles such as accountability and responsibility of the board of directors[1] and senior management, the need for robust risk management policy and adequate monitoring and controls should be applicable to all Labuan insurers.

1.4 As regards Labuan (re)takaful operators, they are expected to observe that the objectives, management and the activities of investments are in compliance with Shariah principles at all times.

[1] For the purpose of this Guidelines, in relation to a Labuan insurer of a branch status; the Board shall refer to the parent company, regional office or head office overseeing the management of the branch Labuan insurer.

1.5 Labuan insurers must ensure that their officers or representatives that manage their investment portfolio understand and comply with the requirements of this Guidelines.

2.0 Applicability

2.1 The Guidelines is applicable to all Labuan insurers under the following categories:

(i) Labuan insurer and reinsurer licensed under Part VII of the Labuan Financial Services and Securities Act 2010 (LFSSA) including (re)insurance captives;

(ii) Labuan takaful and retakaful operator licensed under Part VII of the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA) including (re)takaful captives; and

(iii) Labuan takaful and retakaful window approved under Part VII of LIFSSA.

2.2 Unless otherwise specified, the term "insurer(s)" in the Guidelines refers collectively to all Labuan insurance licensees as provided under paragraph 2.1 above, whichever is applicable.

3.0 Legal Provision

3.1 The Guidelines is issued pursuant to Section 4A of the Labuan Financial Services Authority Act 1996 (LFSAA) for the purpose of clarifying the requirements on investment management for Labuan insurers.

3.2 Any person who fails to comply with the Guidelines is guilty of an offence punishable under Section 36B and 36G of the LFSAA.

4.0 Effective Date

4.1 This Guidelines shall come into effect on 1 January 2015 and would remain effective and applicable unless amended or revoked.

5.0 Investment Policy

5.1 Labuan insurers are required to have in place formal and written investment policies describing the overall investment policies and strategies; as well as the appropriate risk management framework to provide the oversight.

5.2 The overall investment policies and strategies should be communicated to all staff involved in investment activities, and should incorporate the following main elements:

(i) the **investment objectives**, at company and fund-specific levels;

(ii) the **risk/liability profile of the insurance fund** which includes duration and the timing of future cash outflows of the insurance contracts;

(iii) the **strategic asset allocation and its basis of determination** i.e. the consideration of long-term asset mix (across the main investment categories) in relation to the investment objectives. This includes consideration for investment diversification so that there is no excessive reliance on investment in an asset type or any target jurisdiction;

(iv) the **asset investment limits** to reflect the Labuan insurer's investment risk appetite e.g. limits on types of instruments, geographical area, markets, sectors, counterparties, investment grades and currency denomination;

(v) the **selection criteria of individual securities or other investment instruments** which supports the Labuan insurer's investment objectives and strategic asset allocation;

(vi) the **extent to which the holding of certain types of assets is restricted** or disallowed, e.g. illiquid or highly volatile assets, or where independent (i.e. external) verification of investment value is not available;

(vii) the **policy on the usage of financial derivatives and structured products** that have economic effect of derivatives:
  (a) the framework of accountability for all asset transactions and associated risks; and
  (b) the conditions under which the insurer can pledge or lend assets.

(viii) the **documents of title that provide evidence of the Labuan insurer's ownership or right** to its invested assets shall be maintained in Labuan either at its own office or is kept in the custody of any other authorised person on its behalf;

(ix) put in place **plans to mitigate adverse effects arising from deteriorating market conditions** i.e. ready plans that describe actions to be taken under a variety of adverse scenarios to address investment deteriorations. This may be undertaken via stress test simulation on investment results of different adverse market scenarios. For example, identification of liquefiable investments and how these can be disposed in a scenario of the insurer's liquidity crunch; and

(x) describe **the method and frequency for investment valuation** including those that are not regularly traded. While the board of directors of the Labuan insurer is responsible to ensure compliance with accounting standards related to asset recognition and valuation; the impact of accounting standards on investment strategy and results should be carefully considered.

5.3 Due to the different nature of the different type of (re)insurance/(re)takaful liabilities, Labuan composite insurers shall consider separate investment strategy for life/family as opposed to general insurance/takaful business in situations where both businesses are undertaken by the same entity.

5.4 In addition, due to unique fund requirements of (re)takaful business, for family takaful business, Labuan (re)takaful operators/windows may need to also consider separate investment strategies for participants' investment fund and participants' risk fund due to distinctive differences in objectives of both funds as follows:

(i) The investment strategy for participants' risk fund should take into account the ability of the fund to meet (re)takaful liability obligations; and

(ii) The investment strategy for the participants' investment fund should take into account the ability of the fund to meet future tabarru' deduction and reasonable expectation of investment return.

5.5 Where necessary, Labuan insurers shall also consider whether certain products require specific investment strategy to commensurate the uniquely different risk/liability profile as compared to other products that they underwrite.

6.0 Investment Risk Management Framework

6.1 Labuan insurers shall have an investment risk management framework that continuously assesses the appropriateness of their investment policies and ensure sound management of their investment risk exposures. This includes:

(i) instituting **control procedures** over the determination of the areas under the investment policies including their periodic review;

(ii) determining the **investment risk appetite** vis-à-vis the overall underwriting strategy adopted by the Labuan insurer;

(iii) assessing of all **risks associated with investment activities** (e.g. the market, credit, liquidity risks and duration/sensitivity mismatch risks) that may affect the sufficiency to cover the insurer's insurance liability obligations as they fall due and effects on its solvency/capital position taking into account the relevant minimum requirements of Labuan FSA;

(iv) establishing **clear governance procedures over investment decision** making process. The process and rationale for such decisions shall be adequately documented;

(v) ensuring **proper segregation of duties** to ensure sufficient check and balance is in place within the organisation. For example, investment risk management function and the investment operations function should be independent of each other;

(vi) ensuring the **assets/instruments invested are sufficiently transparent** i.e. assets'/instruments' features and associated risks are all accounted for which includes those risks relating to an instrument's underlying asset. In this regard, the Labuan insurer should limit its investments to those where the associated risks of the asset can be properly managed by the insurer i.e. where the insurer can identify, measure, monitor, control and report those risks and appropriately take them into account in its own risk and solvency assessment;

(vii) that the Labuan insurer should **understand all risks involved in a particular asset/instrument sufficiently well before an investment is undertaken**. Such an understanding is necessary in order to assess how material the risk from a proposed investment is to the insurer. Assessments of risks should take into account the maximum loss possible in a transaction, including losses that may occur in situations where assets or derivatives become liabilities for the insurer. For investment in a target jurisdiction, other considerations include its sovereign rating and the investment market conditions;

(viii) establishing **procedures for monitoring and managing the asset liability mismatches** that effectively ensure the investment activities and asset positions are appropriate in relation to the liability and risk profiles. This includes procedures to monitor and control insurance fund's exposure to fluctuations in profit rates, foreign exchange rates, market prices, risks associated with duration mismatches. For investments in a target jurisdiction which is different from where the insurance liabilities are derived from, the insurer should also consider minimising impact of currency mismatches and the target market's volatilities; and

(ix) ensuring that **the investment placement with parties connected to the insurer** (i.e. related companies within the insurer's Group) are on arms-length basis. This includes ensuring the terms and conditions are adequate to safeguard the interest of the insurer, particularly on the asset recoverability.

6.2 To add clarity to their investment risk management, Labuan insurers may consider defining and measuring their investment risk exposures based on the key investment risks. Generally, Labuan insurers may adopt a basic approach which involves monitoring of absolute or relative deviations from the market/proxy/value benchmark based on their investment portfolio performance or results.

7.0 Investment Monitoring and Control

7.1 To ensure proper monitoring and control are exercised over the investment management function, Labuan insurers are required to:

(i) establish **adequate internal audit controls** to ensure that the investment activities are managed in accordance with:

(a) the Labuan insurer's approved investment policies as well as investment risk management framework; and

(b) relevant legal, accounting and any other requirements issued by Labuan FSA from time to time.

(ii) maintain **proper documentation** to facilitate the checking by internal audit that the investments have been appropriately effected according to approved policies/procedures.

In effecting the internal audit of their investment management, Labuan insurers shall be guided by the requirements of "Guidelines on Minimum Audit Standards for Internal Auditors of Labuan Insurance and Insurance-Related Companies" issued by Labuan FSA.

7.2 In view of the need for Labuan takaful operators/windows to adhere to the Shariah requirements, they would need to have in place appropriate Shariah governance to ensure that the investment portfolios are Shariah-compliant including the process required in respect of returns from tainted/non-halal income. The roles of the Labuan takaful operators' Internal Shariah Advisory Board shall be clearly spelled out to ensure the effectiveness of the Shariah governance.

7.3 Regular and timely reports of investment activity to senior management and the board of directors should be produced to disclose the insurance fund's exposure in clearly legible terms, including quantitative and qualitative information. The frequency and details of reporting should commensurate with the nature, complexity and sophistication of the investment strategy. Reports should at least include the following areas:

(i) Details and commentary on investment activity;
(ii) Details of positions by asset type;

(iii) An analysis of credit exposures by counterparty;
(iv) Details of the relative positions of assets and liabilities e.g. maturity mismatch; and
(v) Deviation from approved policies and the rationale e.g. assets holding above investment limit.

7.4 Labuan insurers should ensure that the latest investment policy and investment risk management framework are properly documented and shall be subject to the Labuan FSA's supervisory review and assessment.

8.0 Roles of Board of Directors and Senior Management

8.1 The ultimate accountability for the investment of insurance funds lies with the board of directors of the Labuan insurers. The investment policy and investment risk management framework must be ratified and approved by the board of directors. While the senior management is expected to implement the overall investment policy and investment risk management framework, the board of directors retain the ultimate accountability for the company's investment policy and procedures, regardless of the extent to which associated activities and functions are delegated or outsourced.

8.2 The board of directors may delegate the responsibility for the day-to-day implementation and monitoring to the senior management. Senior management has the responsibility in ensuring the comprehensiveness of the investment policy and investment risk management framework of the Labuan insurer. This includes the responsibility for the development of detailed operational policies and procedures and ensuring that the investment policy and investment risk management framework approved by the board of directors is being implemented and monitored effectively.

8.3 Senior management should, on annual basis, review the investment and risk management policies. In discharging this responsibility, senior management should ensure that effective channels of communication of investment policies to all relevant functions or personnel are in place and periodic review on the adequacy of resources with sufficient level of skills and competencies should be performed. On an annual basis, senior management of the Labuan insurers should provide an assurance to the board of directors that policies and procedures relating to investment and risk management policies are sufficient and effective, and no material breach of the policies occurred.

Labuan Financial Services Authority
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